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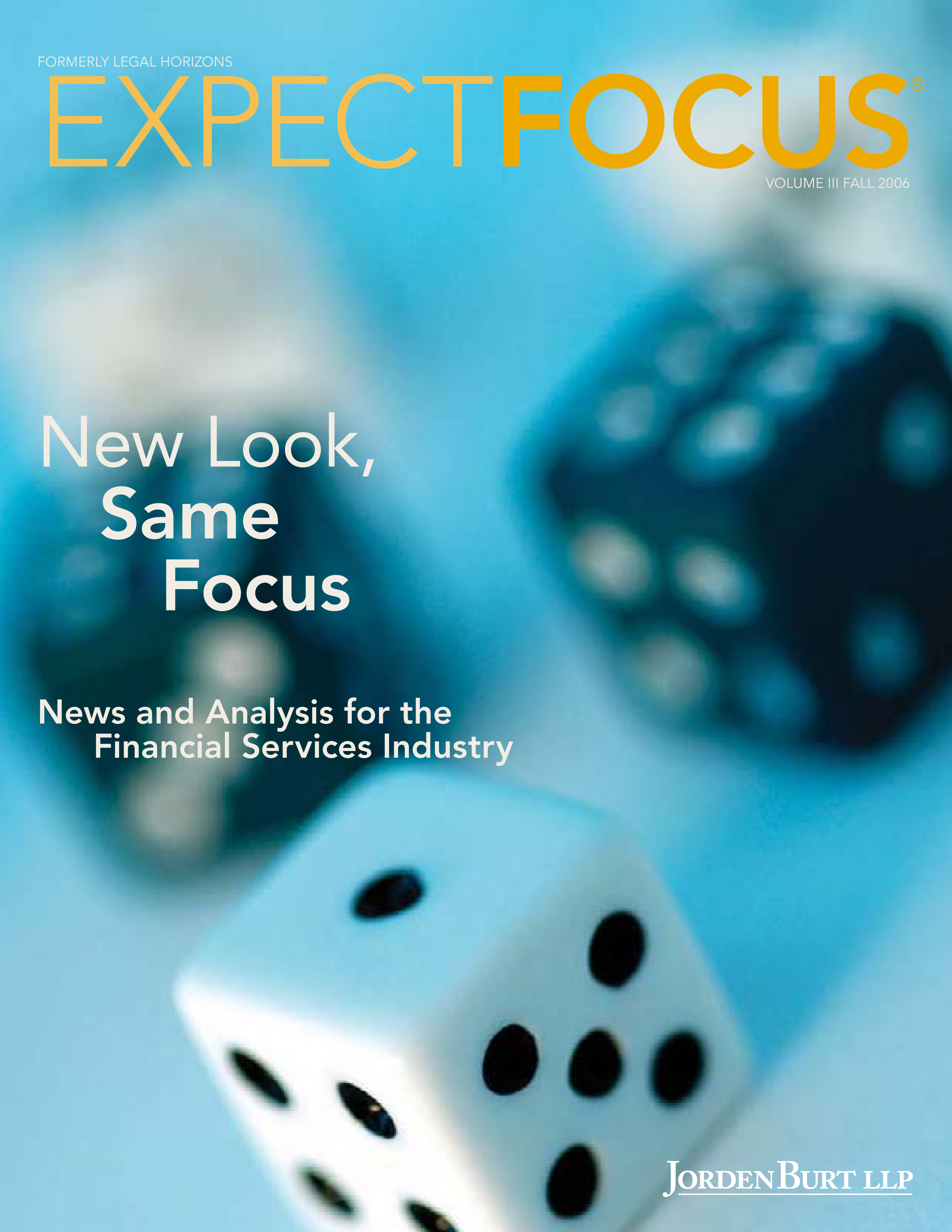
VOLUME III FALL 2006



New Look, Same Focus

News and Analysis for the Financial Services Industry

JordenBurt LLP

EXPECTFOCUS® Volume III Fall 2006

EXPECTFOCUS® is a quarterly review of developments in the insurance and financial services industry, provided on a complimentary basis to clients and friends of Jorden Burt LLP.

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INTHESPOTLIGHT

Ninth Circuit Adopts New Standard of Review in Conflict of Interest Benefits Cases

Abatie v. Alta Health & Life Insurance

BY WALLY PFLEPSEN & STEVE GOLDBERG

On August 15, 2006, the Ninth Circuit Court of Appeals issued an en banc opinion in *Abatie v. Alta Health & Life Insurance*. The decision establishes a new standard in that circuit for reviewing a plan administrator's decision to deny ERISA benefits when the administrator operates under an apparent conflict of interest or where the process is irregular. Under the new standard, where there is an apparent conflict, courts in the Ninth Circuit should now apply an abuse of discretion review, "tempered by skepticism commensurate with the plan administrator's conflict of interest."

This decision places the circuit in the mainstream of the tests followed by most other circuits, and, indeed, is somewhat more defendant friendly. Jorden Burt briefed and argued this issue on behalf of the appellee insurer before the Ninth Circuit, and successfully resisted appellant's arguments for the adoption of a far stricter standard.

REFOCUS *10 years ago in our publication*

SEC to Scrutinize Soft Dollar Practices

(December 1996)

"'If they're not on your doorstep now, they will be soon.' That's the message delivered by the SEC in connection with recently announced plans to conduct a series of 'soft dollar' inspections." The article proceeds to discuss remarks delivered by SEC Chairman Levitt at a Securities Industry Association conference, noting that SEC staff "is planning to conduct a series of examination of investment advisers, their institutional clients, and the broker-dealers with whom they have soft-dollar arrangements."

*Soft Dollar Practices are still a hot topic in the industry—**see page 18* *for "New SEC Position on Soft Dollar Arrangements."*

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SPECIALFOCUS

Annuity Roundup

Bonus Annuity Litigation Watch

BY SHAUNDA PATTERSON-STRACHAN

Since the summer of 2005, the insurance industry has seen several putative class action lawsuits filed by the same law firm in multiple federal district courts. Each action alleges that the defendant insurance companies and selling banks, acting as their agents, sold fixed annuities by promising they would be credited with a "permanent" bonus interest rate, when in fact the annuities supposedly were designed to allow the insurers to "recapture" the bonus by declaring lower renewal rates in subsequent years, rendering the interest "bonus" illusory and negating any real benefit to the plaintiffs.

Bonus annuity actions have been filed against five carriers in recent months. A defendant insurer's motion for summary judgment is pending in one action. The other four actions remain pending.

The complaints filed on this issue largely have involved circumstances where the annuities were marketed and distributed through banks. Whether these cases shift focus to additional litigation involving different bonus insurance products and distribution systems remains to be seen.

Annuities: Suitability for All

BY ANN BLACK

Suitability for all is inevitable and producers and insurers will need to implement compliance and review procedures in response to the various suitability requirements. Nearly half of the states have adopted suitability standards that are based on the NAIC's Suitability in Annuity Transaction Model Regulation or some other separate suitability standard. Several states are still considering adopting suitability standards. NASD is pushing ahead with proposed Rule 2821.

In developing the procedures, producers and insurers will be faced with the competing push to expedite annuity transactions and the time required for individualized review of annuity purchases. They will also confront the fact that most individual producers sell a variety of insurers' products and they must know the material features of each of these products to make recommendations and to appropriately respond to customers' questions.

This means that there will be a need for greater coordination between producers and insurers, and their contracts will need to specifically allocate the responsibilities among the producers and insurers. Producers will likely be responsible for the review of the suitability determination. But will the producers be entitled to rely on the insurers' wholesalers and internal sales desks for the training of the individual producers, and if so, what steps will insurers take to ensure that the indvidual producers understand the features of the insurers' products?

Variable Annuity Class Action Dismissed

BY APRIL GASSLER

A New York state trial court recently dismissed a putative class action in which plaintiffs alleged the insurer breached its variable annuity contracts by failing to pay the minimum guaranteed interest rate on funds invested in the Separate Account investment options under the contracts. In *Webster v. New York Life Insurance & Annuity Co.*, plaintiffs argued that because a policy data page listed the minimum guaranteed interest rate without specifying the specific contractual investment alternatives to which it was applicable, the minimum guaranteed interest rate applied to all allocation alternatives, including investments in the Separate Account.

Following an unsuccessful SLUSA removal, the state court granted the insurer's motion to dismiss, holding that based on the plain language of the contract, the minimum guaranteed interest rate did not apply to investments in the Separate Account. The court cited policy provisions stating that values based on the performance of the Separate Account are variable and are not guaranteed and noted that there was no mention of interest crediting in sections discussing valuation of the Separate Account, in contrast to the discussion of interest crediting in valuation of the Fixed Account. Plaintiffs' efforts to avoid SLUSA preemption left the court with a simple question of contract interpretation. Jorden Burt was co-counsel for the prevailing insurer.

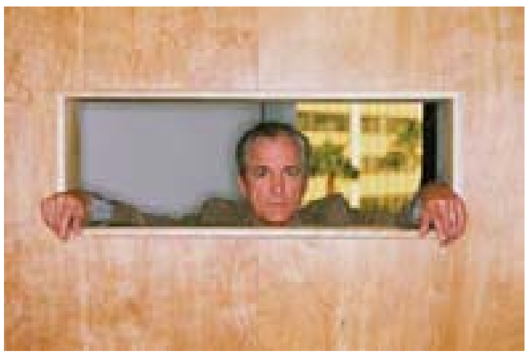
Spotlight on Sales to Seniors

California Annuity Litigation Survives Motion to Dismiss

BY KRISTEN TREMBLE

A California federal district court denied, in all but one respect, a motion to dismiss an action alleging misrepresentations and omissions in connection with the marketing and sale of deferred annuities to senior citizens through brokers and individual marketing organizations.

In *Migliaccio v. Midland National*, the court dismissed plaintiffs' Unfair Competition Law ("UCL") claim, finding that the plaintiffs could not rely on violations of the California Consumer Remedies Act ("CLRA") to state a violation of the UCL. The court, consistent with the reasoning articulated in *Bacon ex. rel. Moroney v. AIG*, held that insurance is not a "good" or "service" under the CLRA, and thus the statute does not reach the sale of insurance or annuities. In denying the remainder of defendants' motion to dismiss, the court rejected defendants' arguments that plaintiffs failed to state a claim on the various grounds of primary jurisdiction, failure to plead fraud with particularity, and lack of fiduciary duty.



Can a keen understanding of investment terminology be a trap?

Can Knowledge Be a Dangerous Thing?

BY ERIC PINCISS

A July 17, 2006 "Senior Summit" roundtable hosted by the SEC coincided with the release of an NASD-sponsored Investor Fraud Study that made a number of notable findings, including that seniors with a better understanding of investment terminology may be at a higher risk of succumbing to fraud than seniors without such knowledge. The Summit also coincided with the announcement that the SEC is currently engaging in widespread "sweep" examinations to detect violations in sales to seniors, and has brought multiple enforcement actions in this area.

NASD's Mary Schapiro stated that in combating fraud against seniors, NASD is focusing on the accuracy and suitability of senior seminar materials. Schapiro stated that an integral part of any effective suitability analysis is competency and the age of the individual investor, and that "good firms" have compliance systems that test the suitability of transactions against the age of the investor.

Court Rejects Certification of Deferred Annuity Class

BY LYNN HAWKINS

Relying on the holdings in *Parkhill v. Minnesota Mutual Life Ins. Co.* and *In Re LifeUSA Holding, Inc.*,* on July 14, 2006, a federal district court in Hawaii denied certification of a class consisting of Hawaii citizens who purchased deferred annuity products after the age of 65. In *Yokoyama v. Midland Life Insurance Company*, plaintiffs alleged that the defendant had a "practice of targeting senior citizens in Hawaii to sell wholly inappropriate financial products—'deferred annuities'—without regard for the complete unsuitability of such products to people of advanced age."

The court denied class certification, concluding that individual rather than common issues predominated over plaintiffs' claims. The court relied on the fact that plaintiffs did not argue that deferred annuities are universally unsuitable for seniors, but rather that they are unsuitable for ***most*** seniors and Midland should have taken steps to ensure that senior customers did not purchase an investment that was not appropriate for them. As a result, the court agreed with Midland that disposition of the claims of the proposed class would require a fact-specific individualized analysis as to each plaintiff, and that such inquiries would be unmanageable in a single case.

The court granted the plaintiffs permission to file an amended complaint and a renewed motion for class certification based on the claim (articulated for the first time in plaintiffs' class certification reply brief) that Midland's deferred annuities are inherently deceptive products, unsuitable for any investor.

* Jorden Burt was lead counsel in the earlier decisions in the U.S. Court of Appeals on which *Yokoyama* was based.

News from the 109th Congress

BY MARION TURNER

Pension Reform Adopted; Makes Changes To COLI

After a long and often contentious debate, Congress recently adopted pension reform legislation (H.R. 4) that will force companies to not only fully fund their pension plans, but also participate in maintaining the solvency of the Pension Benefit Guaranty Corporation (PBGC).

Companies must now pay full share

Among many provisions in this comprehensive act are those that make changes to Corporate Owned Life Insurance (COLI). Those changes are namely that tax-advantaged COLI policies can cover only directors and highly compensated employees; that such employees must be notified and provide written consent; and that companies are to file yearly returns detailing their COLI use. Highly compensated employees are defined as more than 5% owners, directors and anyone else in the top 35% of employees ranked by pay. The COLI provision applies only to contracts issued after the statute's enactment.

Optional Federal Charter Debate Continues

While debate continues on Capitol Hill with regard to legislation (S. 2509) to create an optional federal charter for property and casualty and life insurance companies, it remains highly doubtful that any legislation will become law this year. Ongoing hearings in the Senate Banking Committee have highlighted both the need for reform, as well as deep divisions between insurers and the NAIC over the issue.

What Could Be Realized: Accounting for COLI and BOLI Contracts

BY ANN BLACK

FASB Emerging Issues Task Force issued a draft abstract for EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4." Technical Bulletin No. 85-4 requires that the amount that could be realized under the insurance contract should be reported as an asset. The Task Force recognized that the amount that could be realized (that is, converted into cash) is dependent on how the contract is assumed to be hypothetically settled and, if surrendered, whether the insurance policies are surrendered at the individual or group level. This has led to a variety of methods of determining the amount that could be realized.

Based on the draft abstract, a policyholder should consider any additional amounts included in the contractual terms of the policy in determining the amount that could be realized under the insurance contract, except to the extent that the amounts are at the discretion of the insurance company. If there is any contractual provision limiting the amount realized, the limit should be considered in determining the value of the contract. In additional, in its September 6th Meeting, the Task Force decided that if there is any contractual limit on the ability to surrender, the cash surrender value would not need to be discounted. Disclosure of the limit, however, would be required.

The draft abstract also makes clear that a policyholder should determine the amount that could be realized under a multiple life insurance contract by assuming that the surrender will be on of an individual-life by individual-life basis. Thus, for example, if a waiver of surrender charges only applies if the insurance coverage on all lives is surrendered at once, because that waiver would not apply if there are surrenders of individual coverages, the contract should be reported at the cash value, less surrender charges. This position is similar to that taken in OCC 2004-56.

If the EITF is adopted, policyholders would be required to implement changes in the accounting for COLI and BOLI contracts for fiscal years beginning after December 15, 2006.

Eyes on 2003 Rule Amendments After Certification Reversal

BY BEN SEESSEL

Added to Rule 23 in December 2003, Rule 23(c)(1)(B) requires that "an order certifying a class must define the class and the class claims, issues, or defenses." In a June 30, 2006, opinion vacating class certification, the Third Circuit (which is the first Court of Appeals to address the new rule) held that Rule 23(c)(1)(B) places a strict new requirement on district judges.

In *Wachtel v. Guardian Life Ins. Co.*, the Third Circuit found that Rule 23(c)(1)(B) requires that an order certifying a class contain not only a "precise statement of the parameters defining the class," but "a readily discernible, clear, and complete list of the claims, issues or defenses to be treated on a class basis." The court opined that a "particular format" was not required, but suggested that "a concise paragraph" would suffice if it "fully listed the claims, issues or defenses to be treated on a class basis."

The court based its decision on its reading of the plain text of Rule 23(c)(1)(B), as well as parallel provisions of revised Rule 23. The Third Circuit also pointed to the Advisory Committee Notes, which explain the "critical need to determine how a case will be tried" such that "an increasing number of courts" require "a trial plan" prior to certification.

Juvenile Smoking

Lighting Up a New Genre of Litigation

BY PHIL STANO

The latest category of class litigation—"juvenile smoking claims"—has already resulted in at least six class action lawsuits. Plaintiffs assert that insurers commit fraud and breach of contract when they issue life insurance policies on the lives of juveniles and "deceptively" price the coverage using smoker rates, although the insureds were nonsmoking children at the time the policies were issued. The breach of contract allegations are based on the negative answers given by the applicant to smoker-related questions in the application. Plaintiffs assert these application answers constitute binding insurance contract provisions, erroneously alleging that a smoker rate is charged to juveniles, despite the nonexistence of distinct smoker/nonsmoker actuarial data at most juvenile ages. Insurers typically charge a blended or composite rate for insureds who have not reached the age of majority.

What, me smoke?

Jorden Burt has defended three of the juvenile smoker cases filed to date. Other insurers may well confront juvenile smoker litigation in the coming months, when class certification and dispositive motion decisions are expected in pending cases.

Term Life (with Side Fund) Alleged by SEC to be a Security

BY ANN FURMAN

The SEC's case seemed to have all the elements of intrigue—thousands of American military personnel putting their lives at risk for our country, investing their life savings through an alleged deceptive sales pitch that promised to make one a millionaire and a life insurance policy and side fund that promised wealth but produced little or nothing. So what's missing? For the SEC's case, one thing: a security.

In a settlement announced on August 3, 2006, American-Amicable Life Insurance Company of Texas agreed to settle an SEC enforcement action by paying $10 million to approximately 57,000 military personnel who purchased a term life insurance policy and guaranteed interest paying side fund sold as an investment known as "Horizon Life."

Interestingly, the SEC's complaint against American-Amicable skirts the issue of whether the term insurance policy and side fund is a security. Indeed, term life insurance policies traditionally are not securities as the insurer retains the investment risk.

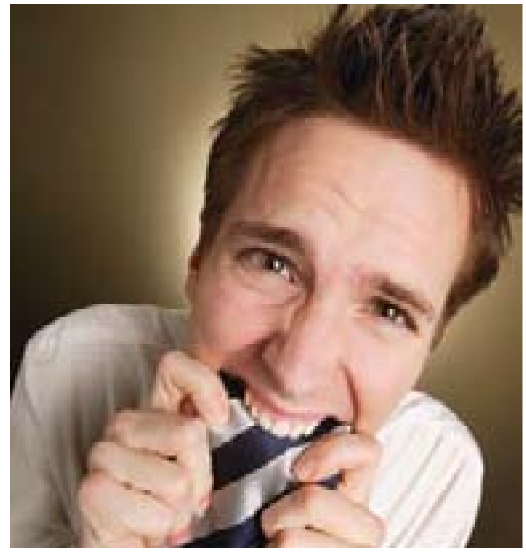
Instead, the complaint alleges that the insurer's salespersons were referred to as "financial advisers" and "financial coaches" and marketed "Horizon Life" as an investment. After describing the alleged deceptive marketing tactics, the complaint concludes in the claim for relief under Securities Act Section 17(a) that the insurer engaged in "the offer or sale of a security."

The case signifies that the SEC will not be timid in pursuing cases involving a non-security insurance policy that is marketed as an investment. Did anyone say "indexed annuity?"

Insurer Ordered to Produce Other Claims and Litigation Files

BY CHRIS BARNES

Can insurers be compelled to produce other claims and litigation files arising from similar policy language in discovery in insurance coverage or bad faith cases? In *J.C. Associates v. Fidelity & Guaranty Insurance Co.*, the Federal District Court in the District of Columbia answered the question in the affirmative and ordered the protocol to be used by the insurer to search for the electronic documents. *J.C. Associates* involved an insurer's denial of a claim based on the absolute pollution exclusion.



You want what?

The central issue was whether a plaintiff is entitled to discovery regarding "other claims and litigation related to the policy language upon which the defendant relies for its denial of coverage." The court quickly dismissed the relevancy issue, stating: "the information plaintiff seeks is entirely relevant. For example, information as to how defendant interpreted the absolute pollution exclusion would qualify as an admission under Rule 801 of the Federal Rules of Evidence and relevant to the claim presented by plaintiff if that interpretation is different from the interpretation that the defendant is asserting in this case."

The court then turned its focus to the issue of burdensomeness on the insurer to have to review the other claims and litigation files. The insurer searched its 1.4 million active and inactive electronic claim and litigation files using internal codes. It identified 454 potentially relevant files. The court ordered the insurer to randomly select and scan 25 of the 454 files and then conduct an electronic search of the 25 files using search terms selected by the court. The court ordered the insurer to produce the responsive, non-privileged documents and submit the documents claimed to be privileged, along with a privilege log, to the court for *in camera* review. The court reserved ruling on whether it would order additional searches of the "other claims" files.

Additional Insured Chants D-Fence

BY CHRIS BARNES

In *BP A.C. Corp. v. One Beacon Ins. Group*, the New York Appellate Division, in a 2-1 decision, concluded that a subcontractor who was named as an additional insured under a CGL policy endorsement was entitled to a defense prior to the resolution of the underlying personal injury action.

The issue before the court was whether an additional insured is entitled to a defense in an action in which it is uncertain whether any eventual judgment against plaintiff will be within the scope of the coverage. In answering the question in the affirmative, the court held that in the absence of unambiguous contractual language to the contrary, an additional insured enjoys the same protection as the named insured. The additional insured endorsement to the CGL policy provided coverage for "any person or organization for whom you are performing operations when you and such person or organization have agreed in writing in a contract or agreement that such person or organization be added as an additional insured on your policy."

Decision might expand insurers' defensive responsibilities

One Beacon argued that the liberal principles governing the activation of the duty to defend apply only to named insureds, not to parties covered pursuant to additional insured endorsements. One Beacon further argued that its duty to defend under an additional insured endorsement would only be triggered when a court has made findings of fact giving rise to such coverage under the terms of the endorsement. In rejecting these arguments, the court stated the fact that the primary insured may ultimately be exonerated of responsibility for the personal injuries is immaterial to the issue of the duty to defend while the issue of liability remains unresolved.

To Certify or Not to Certify

BY AMOR ROSARIO

In *Macomber v. Travelers Property and Casualty Corp.*, the Connecticut Supreme Court defined the trial court's burden on evaluating the appropriateness of class certification. *Macomber* involved a purported class action consisting of automobile accident victims that settled claims with Travelers' insureds through structured settlements. On appeal, the defendants argued that the trial court improperly certified the class because it failed to undertake the necessary analysis to establish that common issues of law and fact predominated. Although the court emphasized that "close calls" would be resolved in favor of certification, the court held that the trial court's deference to the plaintiff was improper.

The trial court reviewed only 30 claim files to determine whether common issues predominated. The court noted that there was no way of establishing that the 30 claim files reviewed were materially representative of the thousands of potential class members. In any event, the court held that "the presence and predominance of [common representations] simply cannot be properly gauged on the basis of thirty files out of thousands." Moreover, the court noted that if the claim files did not contain information as to the representations that were made, the plaintiff would be required to establish them through oral testimony from the class members, claims adjusters or other insurance agents.

The trial court also assumed that Connecticut law would apply, but chose not to undertake an analysis of Connecticut choice of law provisions. Given the potential national scope of the class, and the fact that any representations to class members necessarily were made to them in their home state, the court held that "it was incumbent on the trial court, before certifying the class, … to determine whether the various differing state laws as to such representations shared a commonality that predominated over any differences in such laws, and it was incumbent on the plaintiff to present the data from which the trial court could engage in that analysis."

Ultimately, the court did not hold that class certification was improper; rather the court remanded for further analysis and proof, stating that it was "disinclined to preclude the plaintiff from an opportunity to establish the requisite predominance of common factual issues on the basis of an adequate record."

Negligent Attorneys Not Liable for Lost Punitive Damages

BY JAKE HATHORN

In a 4-3 decision, the Illinois Supreme Court has held that lost punitive damages are not recoverable in a subsequent action for legal malpractice. In *Tri-G, Inc. v. Burke, Bosselman & Weaver* (June 22, 2006), following a trial on the merits of Tri-G's legal malpractice claim against Burke, the jury returned a substantial verdict for Tri-G, finding that but for Burke's negligence, Tri-G would have recovered compensatory and punitive damages in an earlier action.

Negligent attorneys: Not so knee-deep after all

In reversing the jury's punitive damages award, the Illinois Supreme Court concluded that allowing such a recovery would serve neither punitive nor deterrent purposes since the negligent attorney was not the party responsible for the intentional and malicious acts that gave rise to the punitive damages in the first place. Such awards are also arbitrary since they consider neither the gravity of the attorney's misconduct nor the attorney's financial wherewithal. Since punitive damages are a jury's inherently subjective expression of moral condemnation, it is also too difficult for a jury assessing damages in a legal malpractice action to retroactively imagine with any legal certainty how its hypothetical counterpart in the underlying case would have decided the punitive damages issue. Finally, exposing attorneys to such liability might compel professional liability insurers to raise premiums, exclude coverage, and/or withdraw from certain jurisdictions, resulting in an increased financial burden on lawyers and clients alike.

The dissent argued that punitive damages lost in an underlying action become compensatory damages for purposes of the subsequent malpractice action. Accordingly, if the jury in a malpractice case determines that the client would have recovered punitive damages but for the attorney's negligence, then award of those damages is the only way to make the injured client whole. Such a result also deters attorneys from exercising anything less than reasonable care on behalf of their clients when punitive damages are at stake.

D.C. Circuit Affirms Dismissal of Putative Class Counterclaims Against Lloyd's

BY STEVEN JORDEN

In *Society of Lloyd's v. Siemon-Netto* (Aug. 8, 2006), the United States Court of Appeals for the District of Columbia Circuit affirmed the dismissal of putative class counterclaims brought by individual underwriters ("Names") in the London reinsurance market against Lloyd's and the entry of judgment in favor of Lloyd's on its suit to enforce English judgments against the Names for nonpayment of reinsurance premiums. The defendant Names had asserted counterclaims in the district court against Lloyd's for fraud, negligent misrepresentation, consumer fraud, and breach of fiduciary duty. They had also sought to avoid recognition of the English judgments on public policy grounds.

The D.C. Circuit affirmed the district court's dismissal of the counterclaims on the ground that the Names as a condition of their membership in Lloyd's signed an agreement providing that the English courts would have exclusive jurisdiction over any dispute "arising out of or relating to" the Name's "membership of, and/or underwriting of insurance business at, Lloyd's." The Court of Appeals rejected the Names' efforts to plead their way around the forum selection clause by characterizing the suit as one relating to the Lloyd's American Trust Fund, rather than their membership in Lloyd's. The court also rejected the Names' defenses to the English judgments, agreeing with the district court that the recognition of defenses were not legally cognizable and, in part, violated the Act-of-State doctrine.

Jorden Burt represented Lloyd's in the district court and on appeal.

U.S. District Court: Facultative Reinsurer Not Required to "Follow the Fortunes"

BY ANTHONY CICCHETTI

In *Suter v. General Accident Insurance Company of America* (July 14, 2006), the United States District Court for the District of New Jersey held that a facultative reinsurer was not obligated to "follow the fortunes" of the cedent because of the cedent's gross negligence and bad faith in claims administration and payment. The court found that the cedent failed to conduct reasonable and businesslike investigation of claims and paid claims that were outside the timeframe of the primary insurance. As a result, the reinsurer met the burden of proof required to defeat the presumptive application of the "follow the fortunes" doctrine. The court's 67-page opinion, available at Jorden Burt's reinsurance blog—*ReinsuranceFocus.com*—highlights the fact-specific nature of "follow the fortunes" disputes.

H.R. 5637: Changes to Reinsurance Regulation?

BY MARION TURNER

Legislation was recently reported by the House Financial Services Committee (H.R. 5637) that addresses two categories of insurance—surplus lines and reinsurance—that are frequently sold across state lines.

The bill, introduced by Rep. Ginny Brown-Waite (R-FL), would establish national standards for how states can collect and allocate premium taxes for these surplus lines, which are routinely sold to a small minority of customers. The bill also alters the rules for reinsurance, prohibiting states other than the home state of the reinsurer from imposing financial solvency requirements. Finally, the bill prohibits states other than the home state of the company that is purchasing reinsurance from imposing requirements on the reinsurance contract.

The bill is currently pending on the House floor, and has widespread support from both the industry and the state regulators, who see the legislation as an alternative to more controversial legislation creating an optional federal charter.

Announcing

Jorden Burt Launches *ReinsuranceFocus.com*

BY ROLLIE GOSS

Jorden Burt recently launched an Internet blog—***Reinsurance Focus*** (www.reinsurancefocus.com). *Reinsurance Focus* provides a broad range of information concerning reinsurance, including brief summaries of recent court opinions, copies of those opinions for later reading, special focus entries concerning topics of particular interest to those working in the reinsurance area, and information about reinsurance legislation, trade associations, educational programs, and scholarly articles about reinsurance. Due to the importance of arbitration in reinsurance dispute resolution, *Reinsurance Focus* also provides summaries of selected court opinions in non-insurance cases that involve important aspects of the arbitration process.

Jorden Burt's Reinsurance Industry Group updates *Reinsurance Focus* several times each week. These updates include the full copy of court opinions discussed in the reinsurance pages of this newsletter. We invite our readers to make regular visits to *Reinsurance Focus* and to provide us with their comments as to how it can provide additional information of interest.

A Ride in a Sidecar

BY BOB SHAPIRO

An emerging investment vehicle, called a "sidecar," is gaining popularity among investors looking to participate in the reinsurance markets on a limited basis. The sidecar is set up by a reinsurance company to function as a retrocessionaire in a sense, and is funded by outside investors, primarily hedge or private equity funds, which agree to commit their funds for a limited period of time, typically two or three years. The reinsurer usually establishes the sidecar offshore to take advantage of relatively prompt regulatory approval processes and certain tax advantages.

The sidecar provides the reinsurer with more capacity to assume risk from primary insurers without the need to access the capital markets. The sidecar's financial strength and ability to pay reinsured claims are not an issue because the sidecar's obligations to the reinsurer are fully secured through letters of credit or trusteed assets. In addition, whereas reinsurers intend to operate over the long term, assuming risk from various insurers, a sidecar is typically in existence for a 1 or 2 year operating cycle and assumes risk only from the reinsurer that established it.

The sidecar relies on the established reinsurer's market position and underwriting capabilities. As a result, a potential related pitfall for investors is poor underwriting by the reinsurer, which could attempt to use the sidecar to pass on its worst risks. Sidecar investors may consequently seek to encourage sound underwriting by requiring the reinsurer to invest its own capital in the sidecar, retain a part of the business written, or a combination of both.

In recognition of the increasing popularity in the use of sidecars, A.M. Best Company, the insurance rating service, has begun looking more closely at sidecars in analyzing their creditworthiness and their impact on the sponsoring reinsurer. Until recently, Best focused its analyses on the integrity of the transactions to which a sidecar was to be involved and how rigorous the analysis and modeling of the sponsor's experts were in determining whether the sidecar would have any positive or negative effect on the financial strength ratings of the sponsoring reinsurer. In June, however, Best stated that it will now publish issuer credit ratings and/or debt ratings, where appropriate, on all sidecars and their corresponding debt, if any.

Sidecars aren't so scary

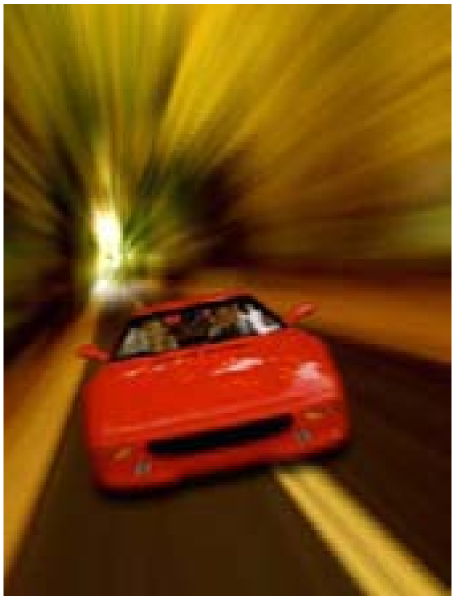
SPECIAL**FOCUS**

Intellectual Property & Technology

Contracting Objectives for Straight-Through Processing

BY DIANE DUHAIME & JO CICCHETTI

Many companies are implementing system platforms to provide straight-through processing (i.e., paper-free processing) (STP) of life and annuity business. Importantly, the contract with the technology vendors who provide the systems solutions for electronic processing must accurately and concretely reflect the expectations of your company and the vendor. The vendor contract should be carefully crafted to address, among other things, a full description of the systems' functional specifications, acceptance testing provisions, warranties concerning non-infringement of intellectual property rights and other matters, appropriate allocation of responsibility for various types of potential errors and losses, systems and other security measures to prevent unauthorized access to data, procedures to follow in the event of unauthorized access, and a governance framework by which contract performance will be measured throughout the contract term. Also, the proposed electronic process and form language for obtaining the customer's e-signature should be analyzed to ensure compliance with applicable laws, such as the Electronic Signatures in Global and National Commerce Act, commonly known as "E-Sign."



Full speed ahead

A comprehensive approach to the STP project would ideally include input from your company's technical/operational, financial, legal and business groups, and the development of contract specifications before vendor selection. In this manner, your company will retain negotiation leverage and the resulting contract will fairly and reasonably set forth the expectations of your company and the vendor(s).

Insurance Regulation

Audit Letter Responses Requested

BY STEVE KASS

Recently, insurance regulators have been requiring insurance companies to produce copies of their lawyers' audit letter responses as part of the regulators' financial examinations. This emerging trend raises some potentially thorny issues, including potential privilege waiver issues, as audit letter responses are prepared within the context of a carefully crafted ABA/AICPA "Treaty" that contemplates a limited audience for these letters. Accordingly, any insurance company or other entity receiving such a request should carefully consider the ramifications of compliance (or alternatives to full compliance) before making any such letters available to regulators, particularly when controlling state law affords public access under "Freedom of Information Act" laws.

National Trial Practice

Massachusetts Jury Finds for Jorden Burt Client

BY JEFF WILLIAMS & CHRIS BARNES

Members of the Jorden Burt National Trial Practice Team recently defended a major life insurance company in a one-week jury trial in Massachusetts state court. Seeking more than $3 million in actual and enhanced damages, the trustee of a life insurance trust brought suit alleging 13 different counts, including fraud and misrepresentation, in connection with the sale of a $12 million life insurance policy to the trust. Among other things, the plaintiff argued that the trust was misled into believing the policy was guaranteed to remain in force until age 99 without payment of additional premiums. The plaintiff also argued "suitability," asserting that the policy was an unsuitable investment for the trust and that the defendants failed to comply with applicable life insurance replacement regulations in Massachusetts. The trial team convinced the Suffolk County (Boston) jury to return a complete defense verdict in favor of the insurer on all of plaintiff's common law claims. The trial judge later ruled for the defendants on plaintiff's sole remaining claim for unfair and deceptive practices under the Massachusetts Consumer Protection Act.

AT PRESS TIME

At the NAIC Fall National Meeting. Changes to the Viatical Settlements Model Act to curtail IOLI were at the forefront of the Life and Annuity Committee's agenda, with a goal of adopting a revised Model Act in December.… The Class Action Insurance Litigation (C) Working Group will consider a proposal by Commissioner Morrison (Montana) to have NAIC legal staff review and make recommendations to the court regarding all insurance class action settlements subject to the Class Action Fairness Act.

Round One to the Insurers. A Southern District of Mississippi judge ruled in August that Nationwide's policies, which cover damage caused by wind but not water, do not cover damage from flood waters or storm surges caused by Hurricane Katrina.… Also in the Southern District of Mississippi, class action certification was recently denied to State Farm and Allstate policyholders whose homes were damaged by Hurricane Katrina.

Mark your Calendars

Jim Jorden to Speak at LOMA-LIMRA Conference: Jim Jorden will be a featured speaker at the **LOMA-LIMRA Meeting Series: Compliance & Market Conduct Exchange, November 12-14, 2006** in Orlando, FL. His session is titled "Compliance: Operational Risk Crosscurrents From the Perspective of Litigation, Regulatory & Reputational Issues—A View From the Front Lines." For more information on the conference visit www.loma.org.

XBRL: The Train Has Left the Station

BY CHIP LUNDE

Under the direction of Chairman Cox, the SEC continues to push for the adoption of XBRL technology as part of its initiative to improve disclosure to investors. XBRL is a computer language that allows data tags to be embedded in financial data. The data tags can then be used by investors and analysts to analyze company filings and compare information across companies and financial products.

Since becoming head of the SEC, Chairman Cox has repeatedly expressed his belief in and commitment to XBRL technology. In May 2006, he stated, "Interactive data is a marriage made in heaven for investing and high tech."

In April 2005, the SEC began a voluntary pilot program for issuers to file financial reports using XBRL. After a tepid initial response, the SEC encouraged participation in the program by guaranteeing registrants who file in XBRL expedited review of their securities registrations. Currently there are over two dozen companies (including GE, Pepsi, Microsoft and Old Mutual) voluntarily filing financial information in XBRL.

The SEC is currently hosting a series of roundtables throughout 2006 designed to gather information on the pilot program and speed implementation of XBRL tools. Most recently, on August 14, 2006, the SEC issued an RFP for private companies to develop web-based software that will let investors and analysts manipulate and analyze XBRL data contained in mutual fund and corporate filings.

Chairman Cox has particularly noted the potential benefits of XBRL for mutual fund investors. In March 2006, he stated, "Almost immediately, I expect to see interactive data play a leading role in helping consumers analyze and compare mutual funds." With statements like this, the potential use of XBRL for analyzing and comparing variable life and annuity products is not likely lost on Chairman Cox. Industry observers predict the SEC will eventually make XBRL mandatory.

SEC Won't Appeal Decision to Vacate Hedge Fund Rules

BY KAREN BENSON

Approximately six weeks after the D.C. Circuit Court of Appeals vacated the SEC's hedge fund adviser registration rules in *Phillip Goldstein, et al. v. SEC*, SEC Chairman Cox announced on August 7, 2006 that the agency would not seek a rehearing or appeal of the appellate court's decision. In striking down the SEC's hedge fund rulemaking, the court found that, among other things, the registration rule was "arbitrary" and "conflict[ed] with purposes underlying" the Investment Advisers Act of 1940. In reaching its decision, the court examined the legislative history of the Advisers Act and the SEC's prior interpretation of the safe harbor exemption from adviser registration. Because the appellate court's decision was unanimous and based on multiple grounds, the SEC concluded further appeal would be futile. The SEC stated that it would instead be working aggressively on new rules and staff guidance to address the legal fallout from the court's decision. Among the new rule proposals will be an anti-fraud rule under the Advisers Act that will make hedge fund advisers accountable for fraud against individual hedge fund investors. The SEC staff also is considering whether to increase the minimum asset and income requirements for hedge fund investors and is expected to issue guidance addressing the grandfathering, transition and other miscellaneous relief necessitated by the SEC's rulemaking being vacated. The SEC expects the staff's guidance will help eliminate disincentives for voluntary registration, and enable hedge fund advisers who are currently registered to remain registered.

SEC Adopts New Rules and Disclosure Requirements for Fund of Funds Investments

BY ERIC PINCISS

On June 20, 2006, the SEC adopted three new rules and amendments to several forms under the Investment Company Act of 1940 (the "1940 Act") that address fund of funds arrangements. The new rules codify several exemptions from the 1940 Act that the SEC has issued over the years, while the forms are intended to provide greater transparency of investor expenses in these arrangements.

Rule 12d1-1: Permits a fund to engage in "cash sweep arrangements," under which a fund may purchase shares of affiliated or unaffiliated, registered or unregistered money market funds in excess of the 1940 Act's Section 12(d)(1) limitations. An acquired money market fund cannot charge an acquiring fund a sales load, distribution fee, or service fee without a waiver by the acquired money market fund's investment adviser to offset the cost of the loads or distribution fees. The rule also provides exemptions from Section 17(a) of the 1940 Act and Rule 17d-1 thereunder, which otherwise would restrict a fund's ability to enter into transactions and joint arrangements with affiliates.

Rule 12d1-2: Permits greater flexibility to fund of funds arrangements that invest exclusively or primarily in funds in the same fund group in reliance on Section 12(d)(1)(G). In particular, the rule allows an affiliated fund of funds (i) to acquire shares of funds that are not part of the same group of investment companies, subject to the limits in Section 12(d)(1)(A) or Section 12(d)(1)(F); (ii) to invest directly in stocks, bonds, and other types of securities (i.e., securities not issued by a fund); and (iii) to invest in affiliated or unaffiliated money market funds in reliance on Rule 12d1-1.

Rule 12d1-3: Rule 12d1-3 allows greater flexibility for a fund that invests small amounts in many unaffiliated funds to structure the sales load it charges without complying with the sales load limitation in Section 12(d)(1)(F), which caps an acquiring fund's sales load at 1.5%. Under the new rule, an acquiring fund (and its affiliates) may purchase up to 3% of an acquired fund as long as the acquiring fund does not charge a sales load exceeding the limits on sales loads established by NASD Sales Charge Rule 2830(d)(3).

Form Amendments: Forms N-1A, N-2, N-3, N-4, and N-6 were amended to require a registered fund that invests any of its assets in another fund, including an unregistered fund such as a hedge fund, to disclose in its fee table the cumulative amount of expenses charged by the fund and any fund in which it invests.

New Rules 12d1-1, 12d1-2, and 12d1-3 became effective on July 31, 2006. All new registration statements on the indicated forms, and all post-effective amendments that are annual updates to effective registration statements on any of those forms filed on or after January 2, 2007, must include the disclosure required by the form amendments.

Congratulations

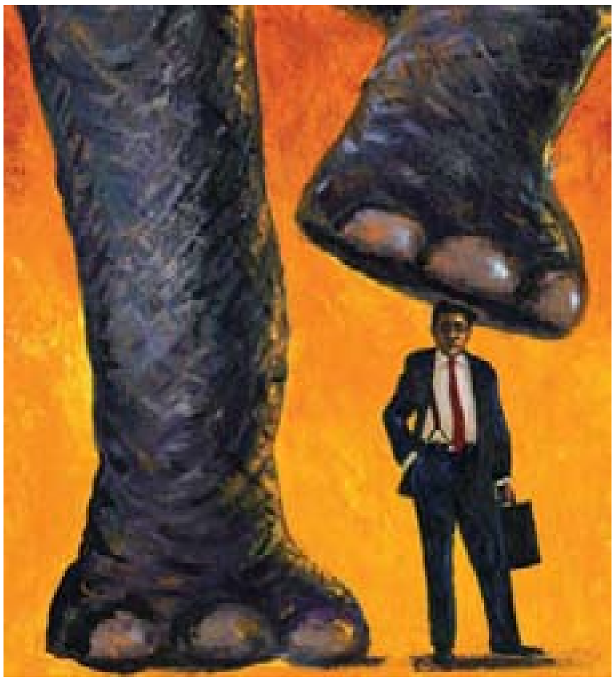
Shaunda Patterson-Strachan is the 2006 Chair of the Life Insurance Law Committee of the Tort Trial and Insurance Practice Section (TIPS) of the American Bar Association. Her term officially began at the ABA annual meeting in August.

Elizabeth Bohn has been elected a member of The Fellows of the American Bar Foundation. Established in 1952, the mission of the Foundation is to advance justice through research on law, legal institutions, and legal processes.

SEC Brings Its First Compliance Program Enforcement Action

BY ED ZAHAREWICZ & SARAH JARVIS

On June 6, 2006, the SEC brought its first enforcement action under Investment Advisers Act Rule 206(4)-7 against CapitalWorks Investment Partners, LLC and one of its principals, Mark Correnti. Rule 206(4)-7 requires registered investment advisers to adopt and implement policies and procedures designed to prevent violations of federal securities laws, to annually review those policies and procedures, and to designate a Chief Compliance Officer to be responsible for administering the policies and procedures.



According to the SEC, Correnti served as both Director of Client Services and head of compliance at CapitalWorks. The SEC found that between August 2002 and December 2004, under Correnti's supervision, 12 requests for proposals were sent out to clients that falsely answered questions relating to a 2002 SEC examination which cited CapitalWorks for several deficiencies. The SEC further found that notwithstanding being again notified by the SEC inspection staff of these deficiencies, Correnti allegedly approved another false RFP dated after October 5, 2004, Rule 206(4)-7's compliance date.

> … some believe it was overkill on the part of the SEC to have brought an action under Rule 206(4)-7 …

The SEC found that despite its knowledge of the concerns raised by the staff, "CapitalWorks failed to adopt any written procedures that would have addressed the types of issues that arose regarding the responses until April 2005," and had thus violated Sections 206(2) and 206(4) of the Investment Advisors Act and Rule 206(4)-7 thereunder. CapitalWorks and Correnti, who was found to have willfully aided and abetted and caused the violations, submitted settlement offers to the SEC without admitting or denying the findings. The SEC accepted and ordered, among other things, that CapitalWorks and Correnti pay a $65,000 fine.

While some believe it was overkill on the part of the SEC to have brought an action under Rule 206(4)-7 when the conduct was plainly in violation of the Adviser Act's general anti-fraud provisions, others see it simply as a forceful reminder from the SEC that advisers need to take seriously their compliance responsibilities under Rule 206(4)-7. In either case, the CapitalWorks action serves to illustrate that: (i) advisers have a responsibility to ensure that their client communications, including responses to RFPs, are accurate and not misleading; (ii) where there is any doubt, advisers should review their existing compliance policies and procedures to ensure that they adequately cover all relevant client communications; (iii) compliance programs should address issues cited in past SEC deficiency letters; and importantly, (iv) when the SEC says there is a problem within the firm, corrective action should be taken right away.

Mark your Calendars

The 24th annual ALI-ABA Conference, **"Life Insurance Company Products: Current Securities, Tax, ERISA, and State Regulatory and Compliance Issues,"** will be held **November 16-17, 2006** in Washington, DC. Jorden Burt partner Joan Boros co-chairs the program; the faculty includes Richard Choi and Gary Cohen. For more information visit www.ali-aba.org.

SEC Extends No-Action Relief for Customer Identification Rule

BY KAREN BENSON

On July 11, 2006, the SEC Division of Market Regulation issued a letter to the Securities Industry Association extending no-action relief that was originally granted in February 2004 (and previously extended in February 2005) in connection with customer identification programs ("CIP"). Without the further extension, the no-action relief was scheduled to terminate on July 12, 2006 because the U.S. Treasury Department's Financial Crimes Enforcement Network has not yet adopted a rule requiring advisers to have an anti-money laundering program ("AML Program").

The no-action relief provided in these letters permits a broker-dealer to rely on an investment adviser, prior to such adviser being subject to an AML Program rule, to perform some or all of its CIP obligations with respect to shared customers, provided certain other reliance conditions in the broker-dealer CIP rule are met. With the extension, the no-action relief will continue until January 12, 2008, unless an AML Program rule for advisers becomes effective before that time.

Adviser CIPs still OK

Proposal to Reduce or Eliminate Funds Transfer Reporting Threshold

BY KAREN BENSON

The Financial Crimes Enforcement Network and the Federal Reserve Board recently published an advance notice of proposed rulemaking seeking information on the effect of reducing or eliminating the dollar threshold in the recordkeeping rules for transfers and transmittal of funds. The rules currently require banks and broker-dealers, among others, to maintain records of certain information regarding transfers and transmittals of funds in amounts of $3,000 or more. The proposal sought comments from interested persons and organizations regarding the benefits and burdens of lowering the threshold and the impact on funds transfer and transmittal practices. Recognizing that expanded requirements under the Bank Secrecy Act, coupled with technology advances, may have reduced the burden to entities covered by the requirements, regulators are now considering a threshold no higher than $1,000, as recommended by the FATF, an inter-governmental body developing and promoting policies to combat money laundering. The comment period has now closed and FinCEN has received 20 comment letters, some of which call for the proposed rule to be reconsidered or rejected.

NASD Annuity Roundtable: The Storm Before the Calm

BY ANN FURMAN

Several months have passed since the May 5, 2006 NASD Annuity Roundtable and inquiring minds want to know: what has happened since? Not much. The regulatory silence is notable.

As part of an effort to "harmonize regulation" of insurance products, former NASD Chairman Robert Glauber announced at the conclusion of the Roundtable an intent to establish working groups to address: suitability, disclosure, advertisements, training, and state insurance department resources. To date, no working groups have been created.

An indexed annuity regulation steering committee (comprised of NASD staff, Minnesota and Iowa insurance department staff and NAIC "A" Committee Chair) intends to meet in late September to discuss next steps. An upcoming gubernatorial race in Minnesota may be a contributing factor to the lack of deliberate speed; a new governor (and new Minnesota commissioner) could change the steering committee's composition and focus.

In the meantime, the NASD staff has publicly voiced its support for adoption in all states of NAIC's *Suitability in Annuity Transactions Model Regulation*, which now applies to annuity consumers of all ages.

For its part, the SEC also has been silent. Will it issue written guidance? Will it take enforcement action? Stay tuned.

SEC Pulls Rug

Withdraws No-Action Letters for Insurance Products

BY TOM LAUERMAN

The SEC staff recently stated that commissions on the sale of insurance securities products may be paid to an insurance agency that is not a registered broker-dealer only where both: (1) a state's law requires the commissions to be paid to an insurance agency licensed in that state, and (2) a legal impediment prevents the recipient of the commissions from being, at the same time, a licensed insurance agency and a registered broker-dealer.

The staff stated this position in a letter (the "Withdrawal Letter") that withdrew two no-action letters that the staff had issued in this area.

Many insurers sell variable annuities, variable life insurance policies, and other insurance products that involve securities ("Securities Products") pursuant to what are commonly referred to as "networking" arrangements. Under these arrangements, commissions on Securities Products are paid to insurance agencies that are not registered as broker-dealers, subject to certain conditions. The conditions include that salespersons be registered representatives of a broker-dealer firm that assumes securities law compliance responsibilities for the Securities Product.

The SEC staff had issued a number of no-action letters covering networking arrangements over the years, but the Withdrawal Letter withdrew only two of those letters. Nevertheless, shortly after the Withdrawal Letter, the SEC staff also sent letters to some persons whose no-action letters were not withdrawn, calling their attention to the above-described position set out in the Withdrawal Letter.

Historically, some industry participants may not have understood that the staff applied this position to all networking arrangements involving the payment of Securities Product commissions to insurance agencies that are not registered broker-dealers. In any event the recent letters indicate that such networking arrangements may now be receiving increased SEC staff scrutiny.

Insurers selling securities may face heightened SEC scrutiny

New SEC Position on Soft Dollar Arrangements

BY ERIC PINCISS

In a July 18, 2006 final Interpretive Release (the "2006 Release") the SEC prescribed a *three-step analysis* for determining whether soft dollar arrangements fall within the Securities Exchange Act Section 28(e) safe harbor for certain research and brokerage services. The new analysis makes some significant departures from prior interpretations (although the SEC had already previewed most of the changes in a 2005 proposing release).

For example, the 2006 Release takes the position that "inherently tangible" items that do not themselves have any "intellectual content" will never be eligible as "research" covered by the safe harbor. This *excludes* from the safe harbor such items as:

- Computer hardware and peripherals, even when used to receive or manipulate market research data that is itself within the safe harbor
- Meals, transportation, and lodging, even when necessary in connection with attendance at meetings, conferences, or seminars that are themselves within the safe harbor
- "Mass-marketed" publications

The 2006 Release also discusses a wide range of research products and services that *are* potentially covered by the safe harbor, such as certain "market research," "data services," and "proxy services."

The effective date of the 2006 Release was July 24, 2006. However, market participants have the option of continuing to rely on previous SEC interpretations until January 24, 2007, when compliance with the 2006 Release will be mandatory. A more detailed discussion of the 2006 Release can be found on Jorden Burt's website at http://www.jordenusa.com/industry-profile-6.html.

Summary Arbitration Awards Remain Controversial

BY TOM LAUERMAN

Courts and the NASD continue to consider under what circumstances an NASD arbitration panel should be permitted to grant a summary dismissal motion: *i.e.*, a motion to dismiss an arbitration claim prior to a hearing on the merits of the claim.

A recent federal district court case, for example, involved an NASD arbitration panel's summary dismissal of claims by certain investors against RBC Dain Rauscher, Inc. There, in addition to submitting various written briefs to the panel, the parties had orally argued the motion to dismiss in a telephonic "pre-hearing conference." The court declined to vacate the dismissal award, holding that the NASD Code of Arbitration Procedures ("NASD Code") does not expressly prohibit summary dismissal, that the parties actually participated in a hearing before a decision was rendered, and that questions of summary dismissal, including when and how it should be rendered, are generally for the panel to decide.

Against a background of such court decisions, the NASD is proposing to amend the NASD Code to provide that summary dismissals of arbitration proceedings are discouraged and may only be granted in extraordinary circumstances. This change is part of the NASD's proposal to significantly revise and reorganize the NASD Code into two codes (the "New Codes")—one for "customer" disputes and one for "industry" disputes.

Until recently, the proposed New Codes contained explanatory language that amplified on what would be deemed to be "extraordinary circumstances" such that a summary dismissal motion might be granted. This explanatory language, however, drew a substantial amount of negative reaction in the SEC's public comment process on the New Codes. As a result, the NASD recently withdrew the explanatory language from the proposed New Codes, pending further consideration.

The proposed express recognition of summary dismissal authority will be helpful to member firms who have faced reluctant arbitrators. However, even when the New Codes go into effect, substantial disagreement probably will remain about the circumstances under which NASD arbitration panels may grant summary motions to dismiss.

Should NASD panels be authorized to dispose of arbitration claims?

Key SLUSA Developments

BY ROLLIE GOSS & DAWN WILLIAMS

Supremes Settle Split. In *Kircher v. Putnam Funds Trust*, the United States Supreme Court recently resolved a circuit court split by holding that a federal district court's order to remand a case that was originally removed under the provisions of SLUSA is ***not*** reviewable on appeal.

Plaintiffs brought solely state law claims in state court, but defendants had removed the cases to federal district court as being precluded under SLUSA. The district court, however, found there was no such preclusion and remanded the cases, opining that the court lacked subject matter jurisdiction. The Supreme Court held that the remand order was subject to the appeal prohibition contained in 28 U.S.C. §1447(d). The Court rejected an exception that the Seventh Circuit had read into that section for appeals of district court non-jurisdication findings based on the absence of SLUSA preclusion.

The Court further held that both state and federal courts have the authority to decide whether claims are precluded by SLUSA. The Court suggested that, upon remand, the state court might apply the holding of *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit* and dismiss the claims as precluded.

Substance over Style. In another recent SLUSA case, *In re Mutual Funds Investment Litigation*, a district court held that claims based on allegedly improper pricing of variable annuities were, in substance, misrepresentation claims and thus precluded by SLUSA. The plaintiffs initially had made misrepresentation claims, but amended their complaint to allege only negligence, in an attempt to avoid SLUSA. The court was not persuaded, emphasizing that the issue of SLUSA preclusion hinges on the content of the allegations—not on the label affixed to the cause of action.

First Circuit Says No to Class Action Waivers in Arbitration Clauses

BY SHEILA CARPENTER & JOANNA HALL

On April 20, 2006, the First Circuit in *Kristian v. Comcast* struck down a provision barring class actions in an arbitration clause. The plaintiffs, Boston area subscribers of Comcast, brought state and federal actions alleging antitrust violations. Comcast moved to compel arbitration and plaintiffs resisted such arbitration on grounds that the arbitration provision's class action waiver denied them their statutory rights. The First Circuit agreed with plaintiffs and held that the class action ban was invalid because it conflicted with Rule 23 of the Federal Rules of Civil Procedure.

This decision departs from decisions in the Third, Fourth, Seventh and Eleventh Circuits which have all upheld the use of an arbitration clause barring a class action. The First Circuit addressed this divergence by examining *Johnson v. West Suburban Bank*, a Third Circuit case which held that claims under the Truth in Lending Act were subject to arbitration even though the arbitration clause precluded class actions. *Johnson* provided three grounds for its decision: (1) class actions do not necessarily give plaintiffs better incentives to bring private enforcement actions; (2) plaintiffs are able to find representation without the class action mechanism because of the availability of attorney's fees and costs; and (3) even if plaintiffs are discouraged, their claims can be enforced in an administrative context.

The First Circuit distinguished its decision from *Johnson* by noting that the claims brought under the Truth in Lending Act can be readily advanced on an individual basis, whereas antitrust claims cannot. Antitrust claims involve complex issues and are expensive to litigate. Since each plaintiff stood to gain only a small amount of money, the Court reasoned that precluding a class action would effectively deny plaintiffs their substantive rights.

Arbitration may not be a cure-all

Contract-Based Consumer Class Action Decertified in Florida

BY JASON KAIRALLA

Florida's Second District Court of Appeals recently decertified a class of 65,000 consumers who had sued their termite extermination company under various theories, including breach of contract and alleged violations of Florida's Deceptive and Unfair Trade Practices Act. The plaintiffs in *Rollins, Inc. v. Butland* (June 30, 2006), alleged fourteen distinct deceptive acts or practices, and the appellate court found that adjudication of the defendant's alleged conduct, along with issues of causation and damages, would require multiple factual determinations that would be unique to each class member. Questions relating to each individual's claims would *predominate* over any questions common to the class rendering the class to be *unmanageable*.

Likewise, the court explained that to maintain a breach of contract action in Florida, each claimant must prove performance of its obligations under the contract or a legal excuse for nonperformance. Because the contracts at issue placed various duties on the customer, each class member would be required at trial to prove his or her performance of these obligations. As with the unfair trade practices claim, individual issues would *predominate* over common issues rendering certification inappropriate. The appeals court criticized the lower court for creating classwide issues by accepting "pattern and practice" evidence, explaining that such a procedure leaves the defendant unable to defend against individual claims where there may be no liability and amounts to a violation of defendant's **due process** rights.

The court also rejected certification under Florida's equivalent of Federal Rule 23(b)(2), finding that under the allegations of the case "the injunctive relief requested would be little more than an overture to the damages opera."

Fourth Circuit: Nonsignatory May Compel Arbitration

BY ANDRES CHAGUI

In *American Bankers Insurance Group, Inc. v. Long* (July 14, 2006), plaintiffs purchased a $75,000 promissory note from Thaxton Life Partners ("TLP"), who sold automobile insurance policies underwritten by American Bankers. The promissory note was attached to, and incorporated by, a Subscription Agreement ("the Agreement") containing an arbitration clause. Plaintiffs and TLP were signatories to the Agreement, but American Bankers was not. After TLP filed for bankruptcy, plaintiffs sued American Bankers alleging individual and class causes of action for American Bankers' alleged participation in a "fraudulent promissory-note scheme."

In seeking to compel arbitration of the complaint, American Bankers argued that, even though it was not a signatory to the Agreement, it was entitled to enforce the arbitration clause because all of plaintiffs' individual causes of action relied on the terms of the promissory note. Plaintiffs, on the other hand, argued that their complaint did not allege that American Bankers breached any duties created by the promissory note, but rather was based on theories of liability *other than* the breach of the note.

The Fourth Circuit agreed with American Bankers, finding that equitable estoppel makes arbitration appropriate where '"in substance [the signatory's underlying] complaint [is] based on the [nonsignatory's] alleged breach of the obligations and duties assigned to it in the agreement."' The court found that plaintiffs' claims relied on the terms of the promissory note because, without the note, plaintiffs would have no basis for recovery against American Bankers. The court emphasized that it would be "unfair for a party to rely on a contract when it works to its advantage, and repudiate it when it works to its disadvantage." Accordingly, the Fourth Circuit concluded that arbitration was appropriate in this case and reversed the District Court's denial of American Bankers' motion to compel arbitration. Jorden Burt LLP represented American Bankers in this case.

Florida Supreme Court Reverses $145 Billion Award

BY FARROKH JHABVALA

On July 6, 2006, the Florida Supreme Court issued its decision in *Engle v. Liggett Group, Inc.*, the so-called Florida smokers' class action suit. The court affirmed the intermediate appellate court's reversal of the $145 billion class-wide punitive damages award, and ordered the class to be decertified going forward because issues such as causation and apportionment of fault among the defendants are "highly individualized and do not lend themselves to class action treatment."

The trial court had erred by allowing the jury to determine the punitive damages award for the class as a whole before determining the total compensatory damages for the class. Thus, the court explained, "the punitive damages award violated due process because there is no way to evaluate the reasonableness of the punitive damages award without the amount of compensatory damages having been fixed." The court also found the punitive damages award to be "clearly excessive because it would bankrupt some of the defendants."

The 4 to 2 decision (Justice Cantero recusing) also approved a multi-phase trial plan for the case, and ruled that liability findings made in the Phase I trial would be res judicata for the individual trials that would be needed to establish the claims of some 700,000 class members who were given a year to file their individual actions. The court cautioned against taking the decision as a general approval of phased trials in class actions, explaining that its approval of a phased trial plan stemmed from the "unique" procedural posture of the case which was "unlikely to be repeated."

Up in smoke

Congratulations

Jim Jorden, Jeff Crockett, Rick Ovelmen, Richard Sharpstein, Richard Simring and Irma Solares were selected as 2006 "Florida Super Lawyers." Crockett, Ovelmen and Simring also were recognized as "Florida's Legal Elite" for 2006.

CAFA Update

BY RICHARD SAHUC

The Eleventh Circuit recently reversed remand of a class action based upon CAFA's local controversy exception. *Evans v. Walter Industries, Inc.* (May 22, 2006), the first reported appellate court decision to address CAFA's local controversy exception, was filed as a class action in Alabama state court and alleged that class members were injured by waste substances released by manufacturing facilities over an 85-year period. Following removal under CAFA, the plaintiffs moved for remand based upon CAFA's local controversy exception to removal, arguing that the case qualified as a local controversy because more than two-thirds of the putative class were Alabama citizens and at least one defendant was an Alabama citizen and a significant defendant as defined by CAFA.

The plaintiffs' sole support for their claims were affidavits from two of their attorneys. One affidavit opined that two-thirds of the class were Alabama citizens based only upon the attorney's analysis of 10,000 potential plaintiffs. The second affidavit, in support of the significant defendant claim, did not provide "any enlightenment at all" in the Court's opinion. Accordingly, the Court held that the plaintiffs failed to carry their burden of proof on the local controversy exception issue. Unfortunately, since the plaintiffs provided such woefully inadequate evidence, the case provides little insight into how courts will interpret the local controversy exception to federal jurisdiction under CAFA.

In other CAFA news, the Fifth Circuit reversed remand and held that a new suit was commenced for purposes of CAFA when the complaint was amended to add a new defendant subsequent to the enactment of CAFA. Citing the unanimous holding of other circuits, the Fifth Circuit held in *Braud v. Transport Service Co. of Illinois* (April 6, 2006) that state law determines when a lawsuit is commenced for purposes of CAFA. Because the newly named defendant in *Braud* was an additional defendant, rather than a misnamed defendant, the Court found that the action was commenced post-CAFA as to the new defendant under Louisiana law. Thus, the new defendant's removal under CAFA was deemed proper.

Class Certification Reversed: Insufficient Choice Of Law Analysis

BY BRETT WILLIAMS

In *All American Life & Casualty Ins. Co. v. Vandeventer*, (Mar. 23, 2006), a Texas appellate court reversed the trial court's class certification order, holding that a "rigorous analysis of the choice of law issue is required" to make the predominance determination. The dispute in this case arose out of insurance policies issued by All American Life & Casualty Insurance Company, which were sold to, and later cancelled by, another insurer. The trial court had certified a breach-of-contract class against All American that included approximately five hundred class members residing in thirty-six states. On appeal, All American argued that the trial court failed to perform the requisite rigorous analysis and erred by determining that the requirements of numerosity, predominance, and superiority had been satisfied.

Weighing choice of law issues

Heeding the instructions of the Texas Supreme Court in *Compaq Computer Corp. v. Lapray* (May 7, 2004), the intermediate appellate court noted that resolution of choice-of-law issues is necessary for a proper analysis of the predominance issue. The appellate court also observed that the predominance of questions of law or fact common to the class over questions affecting individual members "is one of the most stringent prerequisites to class certification." It added that although the laws of the relevant states might be the same regarding the claims at issue, the plaintiffs had the burden to establish the uniformity, or at least demonstrate "that any differences in the laws fall into manageable categories." It concluded that "an extensive, state-by-state choice of law analysis" must be conducted before the trial court can appropriately make a predominance determination for class certification purposes.

NEWS & NOTES

Jorden Burt Client Successes

Dismissal Obtained in Putative Juvenile Smoker Class Action: On September 12, 2006, in the U. S. District Court for the Northern District of Illinois, Eastern Division, Jorden Burt obtained the dismissal of a putative nationwide juvenile smoker class action against our insurance company client. Plaintiffs, in these cases, allege breach of contract and fraud when they purchase life insurance on their juvenile children and are charged a "smoker" premium rate, even though the applicant answers "no" to the application question about whether they smoke. In many instances, the juvenile insureds are just a few years old. In this case, the plaintiff ageed to a voluntary dismissal when Jorden Burt confronted him with a release obtained in a prior "vanishing premium" class action settlement.

Partial Summary Judgment Granted in Missouri Action: A U. S. District Court Judge granted Jorden Burt's motion for partial summary judgment on behalf of a life insurance company in an individual action involving variable and fixed life insurance policies, finding that the insured's contracts and accompanying materials triggered the statute of limitations.

Seven Year Lawsuit Ends in Jorden Burt Victory: A panel from the AAA International Dispute Resolution Center determined that a former Managing General Agent who claimed millions in damages as a result of the termination of his MGA contract was owed no further duties or responsibilities after his termination without cause by his employer.

Redskins Safety Sean Taylor Reaches Plea Agreement: In a highly-publicized case, attorneys from the Jorden Burt Criminal Defense Practice Team achieved a plea deal on behalf of Washington Redskins player Sean Taylor, dismissing all felony charges against him.

Speeches and Publications

Phil Stano was a panelist at the National Association of Insurance Commissioners' CLE seminar on September 8, 2006, in St. Louis, MO, at the session entitled "Clubhouse Confidential: Confidentiality and Attorney Client Privilege."

Ann Black spoke at the ACLI Compliance Section Annual Meeting, July 12-14, 2006, in Charlotte, NC, participating in the panel entitled "Update on Evolving Litigation Issues Confronting Life Insurers: A Look Over the Shoulder as a Precursor of Things to Come."

Rick Ovelmen participated in the Media and Communications Committee annual panel discussion, "The First Amendment and the United States Supreme Court," held June 23, 2006, in Boca Raton, FL.

Jeff Crockett was a speaker at the Florida Bar Employment Seminar, September 8-9, 2006 in Plantation, FL, where he discussed "New Developments in Florida Statutory Offers of Settlements."

In the News

"Managed Care Litigation" a Highly Recommended Resource. *Managed Care Litigation*, published in 2005 by BNA Books, received enthusiastic reviews in the June 2006 issue of *Legal Information ALERT*. The reviewer noted that the handbook is "truly admirable in that it covers the multi-faceted world of [managed care organization] liability in a single, readable volume." Jorden Burt attorneys Wally Pflepsen and Glenn Merten co-authored the chapter on "Managed Care Class Actions."

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