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EXPECT FOCUS®

VOLUME II SPRING 2007

Does Anyone Still Need This?

Technology in the Financial Services Industry

JORDEN BURT LLP

EXPECTFOCUS® Volume II Spring 2007

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INTHESPOTLIGHT

Revenue Sharing Class Actions: From 401(k) to 457 Plans

BY MARKHAM LEVENTHAL & BRETT WILLIAMS

The insurance and financial services class action bar has expanded its target of putative class actions against insurers based on "revenue sharing" from the 401(k) market to the 457 market. These cases define revenue sharing broadly to include any compensation paid by mutual funds or their affiliates to insurers or their affiliated broker-dealers, including but not limited to 12b-1 fees, service, administration, and subtransfer agent fees.

Earlier revenue sharing class actions involving 401(k) plans argued that insurers, by exercising discretion over the selection of mutual funds offered to the plan, became "fiduciaries" under ERISA, and breached their fiduciary duties by accepting revenue sharing payments from mutual funds. (See *Expect Focus*, Vol. 1, Winter 2007, p.2). While 457 plans, unlike 401(k) plans, are not subject to the requirements of ERISA, plaintiffs in recently filed putative class actions involving 457 plans have substituted common law theories of liability for ERISA-based theories applicable to the 401(k) market.

Plaintiffs in these 457 plan cases argue that the insurer acts as an agent or trustee with respect to the plan and therefore becomes a "fiduciary" under the common law. Based on this purported fiduciary relationship, the plaintiffs contend that the receipt of revenue sharing payments from mutual funds is an unauthorized transaction which constitutes a breach of fiduciary duty. These cases have been filed notwithstanding that the revenue sharing payments have long been disclosed both by insurers providing group variable annuity contracts, and by the mutual funds themselves. Plaintiffs essentially contend that disclosure is irrelevant. These cases are still in their infancy and serious questions remain regarding the merits of the claims.

REFOCUS *10 years ago in our publication*

NAIC Draft White Paper: Marketing Insurance Over the Internet (Winter 1997)

"Recognizing the increased use of electronic commerce and the unique concerns surrounding electronic commerce, the NAIC has been studying the marketing and regulation of insurance through the Internet. On October 3, 1997, the Internet Marketing Issues Working Group of the Market Conduct and Consumer Affairs Committee issued a draft white paper, *The Marketing of Insurance Over the Internet*." The White Paper discusses the concerns surrounding insurance sales over the Internet, along with related regulatory issues and recommendations of the group. One of the key issues covered is electronic signatures, and whether or not they are secure.

The validity of electronic signatures are still in dispute in some areas. *Read "May Life Insurers Accept Web-Based Beneficiary Changes?" on page 7 of this issue.*

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Policies Confiscated by Castro Government Not Suitable for Class Action

BY LYNN HAWKINS

Castro keeping Cubans' life insurance

A Texas district court, in denying a plaintiff's motion for class certification, explained, "A litigant who seeks certification of a worldwide class involving different events occurring over decades faces numerous, onerous hurdles." In *Schydlower v. Pan American Life Insurance Company*, the plaintiff, an American citizen and beneficiary of a life insurance policy, brought a putative class action against Pan American, the issuing insurer. The policy was purchased by the plaintiff's father, a Cuban national, in Cuba in the late 1940s or early 1950s. In the summer of 1959, Fidel Castro's government began seizing money and private property, and the plaintiff's father contracted with Pan American to leave the value of the mature policy in Pan American's possession provided that the policy's proceeds could be withdrawn at any date. In 1961, the plaintiff left Cuba for the United States, but his father remained in Cuba.

Since 1961, the plaintiff, first acting as his father's agent and then as the beneficiary of the policy after his father's death in 1966, sought to redeem the proceeds of the policy from Pan American in the United States. Pan American repeatedly told the plaintiff that the Cuban government had seized Pan American's Cuban assets, including the reserve existing on his father's policy, and by Cuban law had substituted itself for the insurer. Accordingly, plaintiff was advised to direct all further inquiries to the Cuban government, which in 1966 had called in all such policies for final settlement.

> … the Cuban government in 1966 called in all policies for final settlement.

In November 2004, the plaintiff filed a putative class action against Pan American, seeking certification under Rule 23(b)(2) of a declaratory judgment class for persons entitled to receive benefits under life insurance policies and related contracts issued by Pan American. He also sought certification of a subclass for policyholders to whom Pan American allegedly made misrepresentations regarding the effects of the Cuban government's actions on the policies or contracts. Because the proposed class included individuals with substantively different polices and vastly different facts and circumstances, the plaintiff was unable to satisfy Rule 23(a)(2) or (a)(3) or any of the Rule 23(b) requirements and the court denied certification. The plaintiff also failed to satisfy the amount in controversy required for diversity jurisdiction. Jorden Burt was co-counsel for the insurer.

Suitability Issues on State Agendas

BY ANN BLACK

Suitability and replacement issues continue to be a focus of state legislative and regulatory activity. In California, under AB 1271, if a replacement is involved, the agent must complete and sign a contract comparison summary that provides information about the replaced and proposed contracts. In addition, the contract comparison summary would also disclose "the specific elements of the proposed coverage that will provide a substantial financial benefit over the coverage that is being replaced." AB 1271 appears to be legislating some of the California Department of Insurance's views on best practices discussed in its white paper, "A Suitable Match: Best Practices for Annuity Sales."

In Texas, a proposed bill would regulate the activities of insurers and agents with respect to the replacement of existing life insurance and annuities. Finally, in March, Massachusetts Secretary of State Galvin brought charges against agents who allegedly committed sales practice abuses in transactions involving replacements of existing insurance contracts or other investments with insurance products. The complaint also alleges that the insurance products sold were unsuitable. Approximately ten states have pending proposed legislation or rules to adopt a suitability requirement or to make their existing suitability requirements applicable to all annuity transactions.

Courts Address Legal Validity of Rico Claims In California Deferred Annuity Cases

BY JOANNA HALL

United States District Courts in California continue to address the application of the Racketeering Influenced and Corrupt Organizations Act in actions challenging the marketing and sale of deferred annuities.

In spite of some judicial pruning, a number of RICO cases remain

On February 12, 2007, the Northern District Court of California granted in part and denied in part Conseco's motion to dismiss in *In re Conseco Insurance Co. Annuity Marketing & Sales Practice Litig.*, involving allegations of agent misrepresentations and challenges to the suitability of deferred annuities sold to persons 65 years or older. The court dismissed the majority of state claims on statute of limitations grounds. The court also dismissed the RICO section 1962(a) and (c) claims, holding that a corporation and its sales agents engaged in the ordinary course of the corporation's business was not an "enterprise" under the RICO statute. The court did not dismiss the RICO section 1962(b) and (d) claims because, the court stated, Conseco failed to present any argument for dismissal.

The Southern District of California also recently denied defendants' motion to dismiss the RICO claims in *In re National Western Life Insurance Deferred Annuities Litigation*, another putative class action challenging the marketing and sale of deferred annuities to seniors. The court refused to dismiss plaintiffs' RICO section 1962(b), (c) and (d) claims, rejecting National Western's challenges to the legal validity of plaintiffs' RICO enterprise of insurer and sales agents and unspecified others involved in the sale of annuities. The court, however, dismissed the section 1962(a) claim because plaintiffs did not allege injury from the investment of proceeds obtained from racketeering. The court also rejected an argument that the McCarran-Ferguson Act barred the claims, finding that California did not have a state policy against allowing private suits against insurers for conduct prohibited under the California Insurance Code. In doing so, the court distinguished several prior state court decisions holding that no private right of action exists to enforce provisions of the California Insurance Code, and refused to follow a California state appellate court's decision that the McCarran-Ferguson Act barred claims under RICO challenging the marketing of insurance products.

Issuers and distributors of annuity products will continue to monitor the developments in these cases and the decisions of courts in other circuits addressing similar RICO and McCarran-Ferguson Act issues.

Slow Start for Optional Federal Charter Legislation

BY MARION TURNER

Efforts to legislate an Optional Federal Charter for insurance companies have been slow to resume in the new congressional session following a flurry of activity in the 109th Congress. Over three months into the 110th, legislation has yet to be introduced in either the House or Senate. Furthermore, there have been no hearings in either body on an issue that remains a top priority for many of the largest insurance trade groups like ACLI and AIA.

Instead, efforts to extend, and perhaps make permanent, the Terrorism Risk Insurance Act (TRIA) have taken center stage this spring, along with other Democratic priorities such as subprime lending. TRIA extension represents a more pressing priority with its expiration at year's end and remains highly controversial on both Capitol Hill and within the Treasury.

Patience required

Rep. Ed Royce (R-CA), who authored House legislation last year (H.R. 6225), plans to re-introduce his bill in the coming months. The re-introduction of Senate legislation (S. 2509), jointly sponsored by Senators John Sununu (R-NH) and Tim Johnson (D-SD), remains on hold while Sen. Johnson recovers from an illness.

New "Bonus Annuity" Class Action Filed

BY ANNE BECK

On February 1, 2007, yet another "bonus annuity" class action was filed, this time against AIG and First SunAmerica Life Insurance Company in the Southern District of New York. In *Phillips v. American International Group*, the latest of several such "bonus annuity" class actions brought by the same Alabama firm (see *Expect Focus* Vol. III, Fall 2006 and Vol. I, Winter 2007), plaintiff seeks to recover millions of dollars in charges that defendants allegedly fraudulently concealed from purchasers.

Plaintiff owned two bonus annuity contracts with defendants, each of which promised a bonus rate of interest payable during the first year. The complaint alleges that the defendants recaptured the entire promised bonus rates because of the actuarial design, pricing and structure of the bonus annuity contracts, and as a result, "the interest paid to Plaintiff and other class members was substantially less than represented in the Bonus Annuity Contract." Plaintiff claims that defendants intentionally designed the contracts to contain undisclosed penalties and costs that would "recoup and recapture" the entire bonus credited to purchasers, thereby precluding purchasers from "permanently realizing" the benefit of the promised bonus.

Plaintiff contends that this alleged misconduct constitutes fraudulent and negligent misrepresentation, an argument previously rejected by the Northern District of Alabama in *Sayer v. Lincoln Nat'l Life Ins. Co.* (see *Expect Focus* Vol. I, Winter 2007). The complaint also contains causes of action for breach of contract, civil conspiracy, unjust enrichment, violation of New York's business and insurance law, and for breach of fiduciary duty based on defendants' "superior knowledge of the structure and pricing" of the contracts and "the trust and confidence" placed in defendants by the class.

Electronic Processing of Annuity Sales

Close to Becoming a Reality

BY ANN FURMAN

What five years ago seemed unachievable may soon become a reality. Comprehensive standards and regulatory support are advancing the ultimate goal of the "Straight Through Processing" (STP) initiative: entirely electronic processing of annuity transactions.

In February, NAVA, the association for insured retirement solutions, released a set of 24 voluntary standards for simplifying and improving the electronic annuity purchasing process for consumers, insurers, distributors and regulators. The standards include suitability procedures, electronic forms, privacy, and records management, among others.

Here is the annuity you ordered

As NAVA working groups finalized the standards, industry representatives met with several state insurance regulators to garner regulatory support for STP. As a result of these meetings, state insurance departments may soon issue bulletins announcing support of STP standards and processing. Several state insurance departments already have determined that no new NAIC model law or regulation is needed to implement the STP standards. Rather, those regulators have informally indicated that STP standards and processes comply with the electronic signature, record retention and delivery requirements as well as the requirements regarding replacement of life insurance and annuities found in state insurance statutes and regulations. *The standards are available on the NAVA website, www.navanet.org.*

Mark your Calendars

ALI-ABA Insurance Industry and Financial Services Litigation Conference. Jim Jorden, conference co-founder, will chair the 12th Annual Advanced ALI-ABA Conference on Insurance Industry and Financial Services Litigation, May 10-11, 2007 in Chicago. Washington partners **Wally Pflepsen** and **Rollie Goss** are also speaking at the conference.

May Life Insurers Accept Web-Based Beneficiary Changes?

BY DIANE DUHAIME

As insurance companies implement Straight Through Processing (i.e., paper-free processing) systems for their life and annuity businesses, customers are expressing the desire to conduct changes of beneficiary via the web, rather than via traditional paper means.

Everyone wants less paperwork

Generally, electronic signatures are governed by two statutes: the Electronic Signatures in Global and National Commerce Act (E-Sign), and each state's version of the Uniform Electronic Transactions Act (UETA). UETA was developed by the National Conference of Commissioners on Uniform State Laws and is only effective in a particular state when adopted by that state. Many states have adopted some form of UETA, and a few states have their own form of electronic signature and record laws (e.g., New York and Illinois).

E-Sign expressly provides that it applies to the business of insurance and generally provides that signatures may not be denied legal effect, validity, or enforceability solely because they are in electronic form. E-Sign does not require the use of any particular format or technology for electronic signatures, so the contractholder's electronic signature in the form of a unique user ID and password submitted on the insurer's web-based change of beneficiary form would be an acceptable format under E-Sign. Unfortunately, the legal inquiry does not stop with the format of the electronic signature. With regard to individual consumer contractholders, the insurer must also meet the consumer consent, disclosure and record retention requirements of E-Sign. The insurer's counsel should conduct a legal analysis of the proposed electronic change of beneficiary process and associated forms to ensure compliance with E-Sign. If inappropriate language is contained in the consent form, such consent may be held invalid, thereby voiding the change of beneficiary form that was electronically signed and submitted to the insurer. Other items an insurer must consider in implementing a web-based change of beneficiary process include whether the language in the policy prescribes a specific method by which the contractholder may change a beneficiary. For example, some states' laws require strict compliance with the method stated in the insurance contract while others require only substantial compliance.

Big Fine for Lax Supervision of Small Branch Offices

BY TOM LAUERMAN

NASD has come down hard on a broker-dealer's procedures for supervising a large number of "producing" registered principals who sold variable insurance products and mutual funds out of small, geographically dispersed offices. These producers also served as the branch managers of their respective offices, and NASD concluded that they were often, in effect, acting (improperly) as the primary supervisors of their own activities.

The broker-dealer, Raymond James Financial Services, Inc., had assigned supervisory authority for the producing principal/managers (who numbered more than 1000) to three sales managers and also relied on an electronic transaction surveillance system maintained by the broker-dealer's compliance department, as well as certain "exception reports." Nevertheless, NASD found that, in practice, the producing principal/managers themselves performed important daily supervisory functions, such as approving new accounts with their customers, approving transactions by their customers, and reviewing their own correspondence. Nor, according to NASD, did the broker-dealer have adequate procedures for detecting unsuitable recommendations that the producing principal/managers might make.

Accordingly, NASD imposed a $2.75 million fine on the broker-dealer. This action by NASD underscores the need for robust supervision of producers and branch offices, even where their small size or geographic dispersion makes such supervision challenging.

Requirements Unclear in Excess Coverage Investigations

BY JAKE HATHORN

On December 19, 2006, a New York appellate court ruled in *Shaya B. Pacific, LLC v. Wilson, Elser, Moskowitz, Edelman & Dicker, LLP* that the law firm retained by a primary carrier may have a duty to ascertain whether the insured it was hired to represent has excess liability insurance coverage.

Retained to defend the primary carrier's insured, Shaya B. Pacific (Shaya), against a $52.5 million personal injury claim, the law firm made no attempt to identify any potential excess coverage beyond Shaya's $1 million primary policy limit until after Shaya was found liable. The excess carrier declined the law firm's tender on behalf of Shaya and disclaimed coverage based on, among other things, late notice.

Don't overlook excess liability coverage!

The trial court's dismissal of Shaya's malpractice claim was reversed on appeal, based primarily on the appellate court's reasoning that there are no special pleading requirements for a legal malpractice claim under New York law. As such, the insured did not bear the initial burden of pleading sufficient facts to establish that the scope of the law firm's representation included a duty to investigate excess coverage. Rather, it was the law firm, as the moving party on a motion to dismiss, that was required to provide documentary evidence conclusively establishing that the scope of its representation did not include the duty to investigate excess coverage.

Since the law firm failed to meet its burden on the motion to dismiss, the court could not conclude, as a matter of law, that the law firm did not have a duty to investigate the existence of additional coverage for its client, the insured.

The $20 Million Dollar Question

Are Agents At-Will Employees?

BY AMOR ROSARIO

The Missouri Court of Appeals recently reversed a $20 million jury award to five former State Farm Insurance agents who claimed they were improperly discharged. The agents had permitted their names to be used in a letter sent to the Texas insurance commissioner that alleged overcharges, sales discrimination and fraud by State Farm. The company terminated the agents after discovering their involvement. Pursuant to the agent's agreement, the agents sought and obtained internal termination reviews, which upheld the terminations. The agents then sued, alleging breach of contract, breach of the duty of good faith and fair dealing, and tortious interference with business expectations. The jury found in favor of plaintiffs and awarded compensatory and punitive damages. State Farm appealed.

On appeal, plaintiffs argued that the agreement's termination clause, stating that either party had "the right to terminate this agreement by written notice delivered to the other," was ambiguous and that the termination review process implied a good cause requirement. The appellate court held that the employment-at-will doctrine applied because the agreement had no fixed duration and did not contain provisions relating to reasons for termination. Following federal precedent, the court held that the termination review process suggested "State Farm's desire to prevent arbitrary terminations without limiting its legal entitlement" to terminate by written notice. Finally, the court held that there could be no claim for tortious interference because the policies were contracts between State Farm and the insured, and the plaintiffs had no separate relationship with the insured.

Supreme Court to Define "Willful" FCRA Violation

BY ELIZABETH BOHN

Last year, in class actions against automobile and home insurers, the Ninth Circuit held that the Fair Credit Reporting Act (FCRA) requires insurers to send consumers the FCRA mandated "notice of adverse action" whenever premium rates charged were increased or set higher than they otherwise would be because of poor credit reports.

In its decision, the court also adopted the Third Circuit's definition of "willfully," as used in the FCRA in determining the state of mind needed to establish a right to punitive damages, concluding that a company is liable for a "willful" violation of FCRA if it acts in reckless disregard as to whether its policies violated the law.

Is something more than reckless disregard required?

The Supreme Court granted certiorari review of the Ninth Circuit's decision in *Edo v. Geico,* and heard oral argument in January. The insurers argue that the Ninth Circuit's construction of "willfully" impermissibly permits a finding of willfulness to be based on nothing more than negligence, gross negligence, or a good faith but incorrect interpretation of the law. The insurers further argue that the court improperly expanded the adverse action notification requirement of the FCRA to include where the consumer's credit information had either no impact, or a favorable impact on the rates and terms of the insurance.

There is currently a split among the circuits as to the mens rea required for a willful violation of the FCRA. In the Ninth and Third Circuits, a company may have been deemed to have acted recklessly, and therefore, willfully under the FCRA, if the company relied, even in good faith, on an interpretation of the FCRA which a court later finds untenable. The insurers argue that the Court should adopt the more stringent standard of other circuits, which allow a finding of willfulness only when "the defendant knew his conduct was unlawful."

Expect a decision on this important issue this spring.

Insurer Not Required to Accept Electronic Signatures

BY DIANE DUHAIME

Recently, a New York court determined that New York's Electronics Signatures and Records Act (ESRA) and the federal Electronic Signatures in Global and National Commerce Act (E-Sign) do not require an insurance company to accept an electronic signature submitted on a no-fault insurance claim form and, consequently, the insurer's request for additional verification of the claim under New York's No-Fault Insurance Law was proper. In *DWP Pain Free Med. P.C. v. Progressive Northeastern Ins. Co.*, the defendant insurer received from the plaintiff's medical provider both a claim form and assignment of benefits form with electronic signatures of the patient/assignor. In addition, both forms stated that the signature of the provider/assignee was "on file." The insurer responded by mailing a request for additional verification which stated, inter alia, electronic signatures are not acceptable and only original signatures will be accepted. The plaintiff argued that ESRA and E-Sign required the insurer to accept electronic signatures because these laws give electronic signatures the same validity and effect as handwritten ones. Basing its decision on the October 25, 2006 opinion of the General Counsel's Office of the New York State Insurance Department, the court rejected the plaintiff's argument and reasoned that an insurer may choose to accept an electronic signature, but neither ESRA nor E-Sign obligate an insurer to do so.

Insurers may require actual human signatures

Actuaries Publish P&C Risk Transfer Guidance

BY ANTHONY CICCHETTI

The American Academy of Actuaries, through its committee on Property and Liability Financial Reporting, has updated its Reinsurance Attestation Supplement 20-1: Risk Transfer Testing Practice Note. The Practice Note is intended to serve as advisory and non-binding guidance to property/casualty actuaries for risk transfer testing in connection with Annual Statement reinsurance attestation by CEOs and CFOs.

Charting a well reasoned course

The principal changes in this update include enhanced guidance for determination of when risk transfer is reasonably self-evident, with specific discussion of this concept under Statement of Statutory Accounting Principles (SSAP) No. 62. In this regard, the Practice Note discusses characteristics common to transactions in which risk transfer is reasonably self-evident, and applies these characteristics to identify categories of contracts where risk transfer is typically reasonably self-evident. These contracts include:

- Single year property catastrophe and casualty clash contracts that have little or no risk-limiting features, and
- Most facultative and treaty per risk excess of loss arrangements that call for premium well below the present value of the aggregate limit of coverage and do not involve sub-limits, experience accounts, or other risk-limiting contingent features.

The Practice Note also provides sample checklists used by some companies to document their processes for determining contracts wherein risk transfer is reasonably self evident. The Practice Note is available at the Academy's web site (*www.actuary.org*) or can be accessed through Jorden Burt's reinsurance blog at *www.reinsurancefocus.com*.

Treaty Tips: Silence Is Not Always Golden

BY ANTHONY CICCHETTI

Underscoring the importance of spelling out all essential terms, an arbitrator has rejected a reinsurer's attempt to have a limitation of coverage read into the reinsurance agreement. The Southern District of New York confirmed the arbitrator's award in *Employers' Surplus Lines Insurance Co. v. Global Reinsurance Corp.* (Jan. 11, 2007).

Gerling Global had issued a certificate of facultative reinsurance to Employers reinsuring, on a following form basis, an excess umbrella policy that provided for per-occurrence and aggregate loss coverage. Gerling refused to pay its pro rata share of certain indemnity and defense costs, arguing that a non-concurrency existed between the certificate and the underlying policy with regard to the aggregate coverage. According to Gerling, the absence of the word "aggregate" in certain sections of the certificate precluded consideration of aggregate limits of liability; therefore, its reinsurance limits applied strictly on a per-occurrence basis. The arbitrator concluded that although the presumption of concurrency "can be overridden by clear language of limitation, …silence, as an expression of limitation, strains credulity and is insufficient to preclude aggregate liability." The arbitrator emphasized that the reinsurer could have taken any of several measures to effect the limitation argued, such as including the phrase "Nil Aggregate" in the certificate or adding an endorsement.

Reinsurer Must Put Up or Shut Up

BY ANTHONY CICCHETTI

A Connecticut District Court has enforced against a reinsurer a Connecticut statute requiring unauthorized insurers to post collateral before filing any pleadings in court actions brought against them. In *Security Ins. Co. of Hartford v. Universal Reinsurance Co.*, the defendant reinsurer argued that the collateral requirement did not apply to it because it was a reinsurer and because the reinsurance agreement at issue concerned policies issued outside Connecticut. The court rejected these arguments, concluding that the statute did not provide an exception for reinsurance contracts. Furthermore, the action involved a reinsurance contract covering the ceding company in Connecticut. The court gave the defendant 15 days to post the required collateral, failing which its answer would be stricken.

UK Court Rules Against Intermediaries

BY ROLLIE GOSS

The UK Queen's Bench Division of the Commercial Court has denied applications to vacate judgments against certain reinsurance intermediaries awarding damages for fraud and conspiracy totaling approximately £17,000,000. In *R & V Versicherung v. Risk Insurance and Reinsurance Solutions*, the reinsured had originally brought an action against the intermediaries in connection with two binders involving short tail property and contingency risks and personal accident risks. The prior judgments rescinded the binders and awarded damages, finding that the intermediaries fraudulently abused the binders by placing risks that were not authorized, and by signing an addendum to the binders, without authority. The unauthorized actions had produced for the intermediaries an extra 40% commission on the first 12 months gross premium. A copy of the opinion is available at *www.reinsurancefocus.com*.

Arbitration Not Over Until the AAA Sings

BY LYNN HAWKINS

In *Appel Corp. v. Katz*, an important decision for the American Arbitration Association (AAA), the Second Circuit recently affirmed a district court's decision to defer to the AAA's interpretation of its rules regarding finality of awards. In the underlying arbitration, a three-member panel issued two contrary awards three days apart. A dispute arose as to which award was final. The AAA concluded that the first award was not final due to ongoing discussions among the panel members. The Second Circuit agreed with the district court's analysis regarding finality, stating that this "is a concept that [the AAA] has the authority to define differently in different circumstances." The court also rejected arguments that the arbitrators were *functus officio* when they issued the second award and that the second award was in manifest disregard of the law. Copies of the opinions are available at *www.reinsurancefocus.com*.

Reinsurance Securitization Report

BY ROLLIE GOSS

Reinsurance intermediary Guy Carpenter & Company, along with MMC Securities, recently published a report titled *The Catastrophe Bond Market at Year-End 2006: Ripples into Waves*, which provides a description of market dynamics, and of the substantial increase in cat bond transactions in 2006. The report also provides information about sidecar and extreme mortality transactions. This report is very readable, yet detailed enough to be of interest to professionals in this area. It is available on the March 26 posting at *www.reinsurancefocus.com*, Jorden Burt's reinsurance blog.

National Trial

Supreme Court Reverses $79.5 Million Punitive Damages Award

BY JULIANNA THOMAS MCCABE

Don't celebrate just yet!

In *Williams v. Philip Morris USA*, the United States Supreme Court reversed an Oregon jury's award of $79.5 million of punitive damages to the estate of a smoker whose widow alleged he was deceived by cigarette manufacturer Philip Morris. In a 5-4 decision described by experts as minimalist, Justice Breyer wrote that a jury's award of damages based "in part upon its desire to punish the defendant for harming persons who are not before the court," would "amount to a taking of 'property' from the defendant without due process." The Court opined that state courts must provide guidance to juries to avoid the "risk of unfairness" that may arise from a jury's confusion between (1) properly considering harm to non-parties to "determine reprehensibility;" and (2) improperly punishing "for harm caused strangers." The Court's four dissenters, Justices Stevens, Ginsburg, Scalia and Thomas, believe this distinction is confusing and difficult if not impossible to apply. By focusing on the narrow issue of possible jury confusion, the majority failed to resolve whether a 97:1 ratio of punitive to compensatory damages was excessive. Chief Justice John Roberts and Justice Samuel Alito voted with the majority in their first punitive damages case, but it remains to be seen whether the Court has the votes to further restrict ratios in a case in which excessiveness is the central issue.

E-Discovery

A Three Step Plan For e-Discovery Preparation

BY ROLLIE GOSS

The discovery of electronic data under the amended Federal Rules of Civil Procedure is not mysterious or particularly problematic. It is, however, different than the discovery of paper documents, and there are three steps that companies can take to help manage this e-discovery. First, implement "legal hold" procedures. Since electronic data can be destroyed much more quickly than paper documents, companies must implement legal hold procedures quickly and effectively. Update existing procedures and consider appointing an experienced person from the IT department as a discovery liaison to in-house counsel to assist in such efforts. Second, draft a capabilities description. It is not possible to implement effective legal holds and respond to e-discovery requests if one does not properly understand how a company creates, maintains, uses and archives data. A comprehensive description of a company's computer systems and capabilities, including the formats in which the company can readily, and cost effectively, produce data from its various systems, will be useful in every legal proceeding involving production of electronic data. The company should have appropriate IT personnel participate in the preparation of such a description that can be used, consistently, in all legal disputes, and to update that description as needed. Finally, resolve e-discovery scope early. Instruct outside counsel in each dispute to press for early agreement, approved by the court, with respect to the scope of data preservation and the format of data production.

WASHINGTON MONITOR—An inside look at key regulatory agencies

SEC Chairman Trying to Avoid Controversy?

BY GARY COHEN

What direction will SEC Chairman Christopher Cox take in managing the Securities and Exchange Commission? And what difference will it make to investment companies that the agency regulates?

Chairman Cox has been in office for a year and a half. That's long enough to learn his way around and begin putting his stamp on things. But he has not asserted himself at the commission level regarding investment company matters–at least not to the extent that his predecessor William Donaldson did. Chairman Donaldson, for example, forced the commission to vote on controversial fund governance issues. Donaldson, a Republican, then voted with the two Democratic commissioners, much to the chagrin of the two other Republican Commissioners. This led to much rancor among the Commissioners. It also led to lawsuits that the U.S. Chamber of Commerce won against proposed SEC fund governance rule.

Chairman Cox seems to be trying to avoid sharp controversy among the five commissioners. He came to the SEC from Congress, an institution that emphasizes behind-the-scene negotiation of opposing views. He probably also wants to avoid the opprobrium of the commissioners' being reversed by a court.

All this has led some to deem Chairman Cox to be a "consensus Chairman" who strikes a different balance between competing interests than his predecessor. Detractors say that this image arguably was recently underscored by Cox's acceptance of an invitation to speak at a meeting of the U.S. Chamber of Commerce, the plaintiff in victorious lawsuits against the SEC. But Chairman Cox vigorously disputes this perception.

Still an unknown quantity

In an April speech to the Mutual Funds Directors Forum, Chairman Cox announced that the commission intended "to re-propose and then finalize our mutual fund governance rule" this year. He explained that the commission was studying public comments on the economic studies done in connection with the rule as originally proposed. He did not indicate in what form the commission would re-propose the rule. But the announcement can be read to indicate that Chairman Cox will be following in former Chairman Donaldson's footsteps regarding investment companies–at least regarding the fund governance rule.

At the moment, Chairman Cox has not clearly demonstrated his management philosophy or the direction he intends to take in chairing the commission regarding investment companies. Whether he will favor consensus over division, or education over enforcement, is anybody's guess. Meanwhile, investment companies that the SEC regulates are left to reach business decisions with this analytical factor left uncertain.

SEC Proposes XBRL for Mutual Fund Risk/Return Summaries

BY CHIP LUNDE

Data tagging sheds new light on risks

On February 6, 2007, the SEC proposed rule amendments to expand its voluntary interactive data reporting program to include the risk/return summary portion of mutual fund prospectuses. Under the current program, mutual funds may submit XBRL exhibits only with respect to certain financial information appearing in semi-annual certified shareholder reports on Form N-CSR or in quarterly reports of portfolio holdings on Form N-Q. The new rules would allow mutual funds to submit exhibits containing tagged risk/return summaries using the data tag taxonomy developed by the ICI.

As proposed, any tagged risk/return summary submitted under the program must be filed as an exhibit to a currently effective registration statement. Participation in the program would not create a continuing obligation to submit tagged data for subsequent filings.

In the release, the SEC stated that the extension of the XBRL program to the risk/return summary is intended to help the SEC "evaluate the usefulness of data tagging" and is expected to provide "valuable insights" into the potential for tagging information that is largely narrative in format. According to the SEC, "[t]agging of key mutual fund information could help to streamline the delivery of mutual fund information and provide investors, analysts, and others with improved tools to compare funds based upon, among other things, costs, investment objectives, strategies and risks."

To address liability concerns related to the voluntary submissions, the SEC emphasized that voluntary filings under the program are considered "furnished" rather than "filed," and investors should continue to rely on the official version of a filing, not the XBRL exhibits. Program participants would continue to be required to file their complete official registration statements in HTML or ASCII format.

In the proposing release, the SEC requested comments on a number of issues, including the adequacy of the safeguards against additional liability for information submitted in XBRL format, and the adequacy of the taxonomy developed by the ICI.

Congratulations

Boros Elected to Retirement Association Board. On January 25, 2007, **Joan Boros** was elected to the Board of Directors of RIIA, the Retirement Income Industry Association. The RIIA's mission is to assist the financial services industry's development of the products, processes and services Americans need to solve their retirement income challenge.

Boros Interviewed on Fortune Magazine Radio Show. Joan Boros' interview, "The Changing Landscape of Retirement Investing," was broadcast in April on the Fortune Magazine Radio Show, as part of the "America's Premier Lawyers" segment on both American Airlines and Northwest Airlines US and international flights. Joan also appeared in the April issue of Fortune magazine's America's Premier Lawyers' "Tune In" section.

SEC Provides Guidance on Hedge Clauses

BY ELINA TODOROVA

In a recent no-action letter, the SEC staff affirmed that the use of a hedge clause with a gross negligence standard, accompanied by non-waiver disclosure, would not per se violate the anti-fraud provisions of the Investment Advisers Act of 1940. Rather, the staff believes that "whether an investment adviser that uses hedge clauses in investment advisory agreements that purport to limit that adviser's liability to acts of gross negligence or willful malfeasance violates … the Advisers Act would depend on all of the surrounding facts and circumstances."

Permissibility of hedge clauses depends, in part, on investor sophistication

The staff stated that in making this determination, it "would consider the form and content of the particular hedge clause (e.g., its accuracy), any oral or written communications between the investment adviser and the client about the hedge clause, and the particular circumstances of the client." When a hedge clause is in an investment advisory agreement with a client "who is unsophisticated in the law," the staff stated that is would consider, among other factors, "whether: (i) the hedge clause was written in plain English; (ii) the hedge clause was individually highlighted and explained during an in-person meeting with the client; and (iii) enhanced disclosure was provided to explain the instances in which such client may still have a right of action." In addition, the staff "would consider the presence and sophistication of any intermediary assisting a client in his dealings with the investment adviser and the nature and extent of the intermediary's assistance to the client."

The staff expressed its views in a February 12 letter to Heitman Capital Management, LLC to correct a common misperception, based in part on past deficiency letter comments from the staff, that hedge clauses are per se fraudulent.

Revenue Sharing Action Survives NSMIA

BY KAREN BENSON

On January 26, 2007, a California Court of Appeal overturned the dismissal of an enforcement action brought by the California attorney general against a fund family's investment adviser and wholesale broker-dealer for allegedly failing to adequately disclose revenue sharing payments made to unaffiliated broker-dealers to sell defendants' mutual funds.

At issue in the case, *Capital Research Mgmt. & Co. v. Brown*, was whether the savings clause in the National Securities Markets Improvement Act of 1996 (NSMIA) was sufficiently broad to permit the California attorney general to pursue his action. NSMIA prohibits the states from limiting or imposing any conditions upon the use of "any offering document that is prepared by or on behalf of" the issuer of a covered security, but the savings clause permits certain state officers to "bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions." The lower court determined that the attorney general's enforcement action was impliedly preempted by NSMIA because, at least indirectly, it seeks relief that would impose conditions on the adviser's and broker-dealer's use of their funds' offering documents.

In reversing the lower court's decision, the court focused on the plain language of the savings clause and its legislative history. The court found that NSMIA's savings clause was intended to preserve the "states' anti-fraud authority to control the conduct of brokers and dealers, notwithstanding that the exercise of such controls might prospectively influence the disclosures made by a covered security." The court also found no ambiguity in the savings clause, interpreting it to mean that while the attorney general could not sue a mutual fund to force it to change its disclosure documents, it could sue an investment adviser and broker-dealer to force them to disclose their revenue sharing agreements.

Financial Planners Prevail in Vacating Contentious Rule

BY ANN FURMAN

To characterize Rule 202(a)(11)-1 under the Advisers Act as contentious may be a bit of an understatement. Since adoption of the rule governing availability of the Advisers Act exclusion of certain broker-dealer activities from regulation under the Advisers Act (the exclusion), the SEC has been in the position of defending its rule, broker-dealers have been adjusting business practices to comply with the rule, and the Financial Planners Association (FPA) had gone to court to challenge the rule.

Will the striking down of Rule 202(a)(11)-1 mean peace in the valley?

The FPA prevailed on March 30, 2007, when the U.S. Court of Appeals for the D.C. Circuit issued an opinion striking down Rule 202(a)(11)-1. The court held that the SEC overstepped the bounds of its authority where Congress had already legislated and vacated the entire rule.

The ruling may raise significant issues for firms that have been relying on the exclusion. For example, the rule had addressed the extent to which the exclusion is available where the broker-dealer engages in "financial planning" activities. That is, in providing financial planning-type services, whether registered representatives are providing advice that is "solely incidental" to their conduct in selling securities products. The rule provided that financial planning is not solely incidental, and that therefore the exclusion does not apply.

The rule also had resolved difficult interpretive questions about whether the exclusion was unavailable where a broker-dealer receives asset-based compensation from a brokerage customer or discounts its brokerage commission rates to customers to whom the broker-dealer does not provide investment advice. Now, firms relying on the rule will again be faced with the question of deciding, as an interpretive matter, whether their business practices fall within the exclusion. As of this writing, however, it is unclear how the court's action in striking down the rule will affect this analysis.

Janus Excessive Fee Case Survives

BY JOEL SMITH

On December 15, 2006, the U.S. District Court for the District of Colorado denied defendant Janus Capital Management LLC's motion to dismiss claims that Janus charged excessive mutual fund investment fees in breach of its fiduciary duty under Section 36(b) of the Investment Company Act of 1940.

The court analyzed the allegations in the case of *Sims v. Janus Capital Management* under the so-called Gartenberg test—whether the investment advisor charged "a fee that is so disproportionately large that it bears no reasonable relationship to services rendered and could not have been a product of arms-length bargaining." In applying the applicable factors under the test, the court found that the following allegations were sufficient to state a claim under Section 36(b): (1) that Janus charged lower fees to other clients for identical services; (2) that although its costs of services decreased and it enjoyed economies of scale as fund assets grew, Janus failed to share those economies through lower fees; (3) an absence of fee breakpoint levels in the advisory fees for the funds, in contrast to fees for services to third parties; and (4) that Janus resold investment services conducted for multiple clients without charging less.

Janus argued, among other things, that the allegations did not necessarily support an inference of disproportionality "because economies of scale can be shared with funds by means of a flat fee schedule." The court, however, finding itself bound on a motion to dismiss to draw all permissible inferences in favor of plaintiffs, concluded, "Since it is possible to infer from these facts that the growth in Funds assets has not been matched by a proportional, as opposed to marginal, decrease in fees and that the lack of breakpoints in fee structures demonstrates that savings from economies of scale are not being passed on to the Funds, I must do so."

Life Settlement Concerns For Seniors

BY TOM LAUERMAN & PATRICK LAVELLE

Life settlements continue to generate a wide variety of issues and concerns especially for senior citizens. A life settlement basically involves an investor's purchase of a life insurance policy, or the right to receive the policy's death benefit, from the policy's original owner. Typically, the insured person under the policy has a remaining life expectancy of no more than ten years.

Seniors faced with difficult, complex issues

Thus, life settlements commonly involve senior citizens and may involve variable life policies that are securities. This led the NASD to publish an investor alert to seniors in February 2007. The investor alert contains a lengthy discussion of the often difficult and complex issues that a senior citizen should consider before deciding whether to enter into a proposed life settlement transaction. The NASD also offers advice to seniors about how to investigate the character and qualifications of the party proposing a life settlement and how to seek the most favorable terms for such a transaction.

Many of these issues were also addressed in a notice to members that the NASD issued in 2006. The notice to members, however, primarily discussed the obligations of broker-dealers and their registered representatives when recommending or otherwise facilitating a life settlement with respect to a variable policy. Again, because of the difficulty and complexity of the issues involved, the notice to members is lengthy and requires careful study. Insurers generally do not favor life settlements. In some cases, however, broker-dealers or registered representatives may feel they have a responsibility to recommend a life settlement as being in a customer's best interest.

The ongoing activities and actions of other regulators, the courts and state legislatures also continue to shift the legal environment within which life settlements occur. Continued serious attention will be required, therefore, on the part of individuals and firms that recommend or facilitate life settlement transactions or are considering doing so.

NASD Eyes Roving Reps

BY JIM SCONZO

In our fluid economy, it is common for registered representatives with an existing customer base to move from one firm to another. In most cases, the registered representative will try to bring to the new firm customer assets, including mutual funds and variable insurance products. Although such movement presents many opportunities, a recent NASD notice to members contains an extensive discussion of the obligation on the new firm to closely supervise the activities of the new representative.

For example, in some cases the new firm may be prohibited from selling or even servicing the investments or receiving trail commissions from the distributor. In those cases, the inclination might be to replace those investments with investments that provide income to the new firm. But before that can happen, the new firm must first assess the suitability of the transaction to determine that it is in the best interest of the customer.

NASD members should have in place policies, including supervisory procedures, to help guide the smooth hiring of new registered representatives. Those policies should include special procedures for evaluating investment recommendations made to the new representative's existing customers.

Now Playing at an NASD Arbitration Near You

BY ROBIN SANDERS

In order to make the NASD's Code of Arbitration Procedure more useful and understandable, the SEC recently approved certain significant Code revisions. With the most recent changes, the Code, as we have known it, no longer exists. Instead, the Code is now in three distinct parts: The Customer Code, the Industry Code and the Mediation Code. Although the Customer Code is now separate, its provisions, by and large, incorporate the substance of those found in the old Code. However, there are some new noteworthy provisions.

For example, the Customer Code now incorporates many historic arbitration practices that were not formerly part of the Code. These include:

- New uniform procedures regarding the filing of motions,
- The codification of an arbitrator's power to issue sanctions for failing to comply with Code provisions or panel orders, and
- Specific procedures for initial pre-hearing conferences.

Flowers? You promised me the revised NASD Customer Code!

Also, the new Customer Code establishes rules regarding pleading amendments and arbitrator selection procedures. The changes to the arbitrator selection procedures provide that proposed arbitrators are selected on a random, rather than a rotating, basis and that panel chairs are chosen from a chair-qualified arbitrator list. Also, each party is now limited to four arbitrator strikes.

Finally, the Customer Code now incorporates many provisions that have historically been part of the NASD Discovery Guide, specifically discourages depositions, and authorizes a wide-range of sanctions for discovery violations.

The new Customer Code will generally apply to arbitrations filed on or after April 16, 2007; however, ongoing arbitrations may be affected by the new provisions governing arbitrator lists (if the NASD has not already generated an arbitrator list or has to generate a new arbitrator list during the arbitration).

The Care and Feeding of Automated Supervisory Systems

BY MARILYN SPONZO

The NASD is warning broker-dealers that automated supervisory systems require oversight and maintenance. An automated system does not alter a firm's responsibility to comply with applicable requirements; that is, use of an automated system is not a safe harbor that ensures compliance. To protect firms and their supervisors, NASD has offered the following guidance to principals:

- Approve the criteria that the automated supervisory system uses,
- Audit and update the automated supervisory system as necessary,
- Review exception reports created by the automated supervisory system, and
- Provide training on correct input procedures, as well as utilization and analysis of exception reports.

Firms should remember that, as with so many aspects of technology, an automated supervisory system is only as good as the persons who use it.

Congratulations!

Benson Receives AML Certification. Miami associate **Karen Benson** has passed the Certification Examination for the Association of Certified Anti-Money Laundering Specialists (ACAMS). The CAMS (Certified Anti-Money Laundering Specialist) designation is awarded to professionals who successfully complete a rigorous examination demonstrating their aptitude and expertise in anti-money laundering detection and enforcement.

Soft Dollar Research Providers Avoid Broker-Dealer Registration

BY PATRICK LAVELLE

The SEC staff recently issued a letter assuring Goldman, Sachs & Co. that the staff would not recommend enforcement action against research providers who receive compensation from a pool of brokerage commissions without registering as broker-dealers. Goldman Sachs, a registered broker-dealer, has established a program under which money managers who execute client portfolio transactions through Goldman Sachs may direct Goldman Sachs to record brokerage commissions on such transactions in a separate pool. Periodically, upon instructions from money managers, Goldman Sachs will pay specified dollar amounts from the pool to the research providers for providing the money managers with research services that are eligible for the safe harbor under Section 28(e). Use of such a commission pool to pay for research services was facilitated by interpretations that the SEC published in a major release last year.

Could a dip in the pool bring unforseen consequences?

It has been unclear, however, whether by receiving compensation from the commission pool research providers could be participating in transaction-based compensation in a way that would require them to register as broker-dealers. The SEC staff's favorable response to Goldman Sachs was subject to several conditions, including:

- Research providers must not perform any other functions that are characteristic of broker-dealer activity.
- Research providers' compensation must not be conditioned on the execution of any particular transaction or transactions.
- In making its good faith determination of the value of the research services (as required by Section 28(e)), the money managers must act independently and without involvement of Goldman Sachs.

AML Regulators Address Insurance Products Sold On Bank Premisess

BY KAREN BENSON

The Financial Crimes Enforcement Network, together with five other federal regulators, recently issued guidance on the obligation of banks to identify and verify the identity of individuals that purchase insurance products on their premises. The guidance indicates that the sale of insurance products on bank premises does not create a "formal banking relationship" for purposes of the customer identification program (CIP) rule for banks if certain conditions are met. These conditions are that the insurance company is not a subsidiary or an affiliate of the bank, the bank's only role is to effect the sales transaction, no account agreements are executed with the bank, and all future transactions relating to the insurance product are handled directly between the purchaser and insurer. Nevertheless, the guidance encouraged banks to perform some level of due diligence on purchasers of insurance products.

While insurers are not currently subject to a CIP rule, those that sell their products at banks should consider what effect this guidance will have on their ability to "know your customer." One potential effect of the guidance is that insurers may need to focus more of their anti-money laundering resources on issues at the time of sale.

Number Four and Counting

BY MARILYN SPONZO

In the fourth amendment to its proposed variable annuity suitability rule, the NASD has tightened the timing requirement for principal review, and relaxed the suitability review requirement. A principal must review and approve a variable annuity application prior to transmission to the issuer, but no later than seven days after the customer signs the application. With respect to suitability, a broker-dealer must now reasonably believe (rather than determine) that the purchase is suitable.

Class Settlements Closely Scrutinized

BY TODD FULLER

Courts are increasingly placing class settlements under a microscope. In *Masters v. Wilhelmina Model Agency, Inc.* (2d Cir. Jan. 4, 2007), the parties settled an antitrust class action and established a settlement fund for pro rata distribution to class members. The district court approved the proposed settlement, awarded fees to plaintiffs' counsel, and decided that excess settlement funds would be distributed to cy pres charities without considering whether those funds could be allocated to the class members as treble damages.

On appeal, plaintiffs challenged the district court's cy pres decision and the calculation of the fee award as a percentage of the total funds claimed by class members rather than on the total amount of the settlement fund. Although the Second Circuit did not consider the district court's cy pres decision to be an abuse of discretion, it still instructed the lower court to consider whether the excess settlement funds could be allocated to class members as treble damages before applying the cy pres doctrine. With regard to the attorney-fee calculation, the court noted a split of authority, but decided the better view was to allocate fees by percentage "on the basis of the total funds made available, whether claimed or not."

Settlements are due for a check-up

In *In re Nortel Networks Corp. Securities Litigation*, the court reduced Milberg Weiss' award for fees and costs from a requested $101 million to approximately $37.7 million for its role as lead counsel in the shareholder litigation against Nortel. The court applied the percentage method for awarding fees, but was also guided by traditional criteria such as the time expended and the magnitude and complexities of the litigation. The award represented 3% of the gross cash settlement fund and the gross settlement shares.

Class Action Prohibition Deemed Unconscionable

BY EDDIE KIRTLEY

Wireless customers no longer in left field

The "unconscionability" of class action prohibitions in arbitration clauses has spread to Washington state. In *Riensche v. Cingular Wireless LLC*, a U.S. District Court ruled that an arbitration clause in a cell phone company's terms of service was unconscionable, and therefore unenforceable, because it prohibited the consumers from pursuing class actions. The court explained that the class action prohibition was substantively unconscionable because it "effectively prevents consumers from seeking redress whenever the monetary value of the claim is so small that it is not worth the time or money to pursue in small claims court or arbitration, while allowing Cingular to allegedly 'cheat large numbers of consumers out of individually small sums of money.'" The court assigned no weight to the fact that the restriction applied to both parties, stating that "there is no circumstance under which Cingular would bring a class action against consumers." The court found the class action bar was not severable because "[t]he arbitration agreement provides that if the class action prohibition 'is found to be unenforceable, then the entirety of this arbitration clause shall be null and void.'" The federal court ruled on the issue even through "[t]he question whether Cingular's class-arbitration waiver is unconscionable, and therefore unenforceable, under Washington law is currently pending before the Washington Supreme Court."

TILA Rescission Classes Barred

BY FARROKH JHABVALA

In cases of first impression in California and Massachusetts, the courts held that, as a matter of law, class actions are not available for rescission claims under the Truth in Lending Act. Based on the specific terms of the statute and its legislative history, the decisions in *McKenna v. First Horizon Home Loan Corp.* in the First Circuit and in *Laliberte v. Pac. Mercantile Bank* in a California appellate court, rendered within days of each other, ruled that Congress intended rescission to be a "purely personal remedy," which is inconsistent with the class action mechanism. Both courts also found that Congress intended to protect lenders from potentially devastating claims for minor or technical violations of the statute and, accordingly, limited class claims for statutory damages to $500,000 or one percent of the creditor's net worth. For rescission claims asserted on a classwide basis, however, the potential recovery could be "catastrophic" for the lender. It strained credulity, the First Circuit observed, to maintain that "Congress would limit liability to $500,000 with respect to one remedy while allowing the sky to be the limit with respect to another remedy for the same violation."

Congress Moves to Stop Tax Patents, Curtail Overseas Havens

BY MARION TURNER

The Stop Tax Haven Abuse Act (S. 681), a recently filed bipartisan Senate bill, would impose strict penalties for the use of overseas tax havens, in addition to prohibiting the Patent and Trademark Office from issuing patents on inventions designed to avoid tax liability.

The bill targets the use of offshore tax havens and "secrecy jurisdictions" used to shelter income from U.S. taxes, by enacting numerous new disclosure rules, increased authority for IRS officials, and more severe penalties.

One major difference between S. 681 and similar bills from previous years is the inclusion of language to stop the patenting of tax strategies, a practice that has raised concern from both the tax community and Treasury officials. The anti-patent language would become effective on the date of enactment and would apply to any patent that has not been granted prior to enactment.

The bill has been referred to the Senate Finance Committee.

CAFA Plaintiffs Come Out Smelling Like Roses

BY MICHAEL SHUE

In *Gladstone Florist, LLC v. TTP, Inc.*, the U.S. District Court remanded a suit for tortious interference on the ground that the removing defendant had not proven federal jurisdiction by establishing the CAFA requirement of at least 100 class members. The decisive issue in the case was whether, under CAFA, the removing defendant had the burden of proving the existence of federal jurisdiction or whether the plaintiff instead had the burden of proving the nonexistence of federal jurisdiction. "With no binding authority–beyond the statute itself," the court held that the burden of proof under CAFA falls on removing defendants, who must demonstrate by a preponderance of evidence that the case belongs in federal court. The court found that the defendant failed to meet this burden because it did not establish the required number of at least 100 class members. The decision is consistent with the circuit courts, including the Second, Third, Seventh, Ninth, and Eleventh Circuits, all of which have found that nothing in CAFA indicates an intention to shift the longstanding burden of proof from the removing parties who are the proponents of federal jurisdiction.

Arbitration Alive in California

Court Upholds Class Action Waiver

BY LARA GRILLO

In *Konig v. U-Haul Co. of California*, a California appellate court upheld an employment contract provision waiving the plaintiff's right to bring a class action lawsuit against his employer. The class action waiver was part of an arbitration agreement which required employees to arbitrate any dispute against their employer, and to forego any right to bring claims on a representative class member basis or as a private attorney general. The court found that although the waiver was procedurally unconscionable as a condition precedent to employment, it was not substantively unconscionable. The court applied the standard articulated in *Discover Bank v. Superior Court* (see *Legal Horizons* 2005, Vol. III, p.20), which places the burden on the plaintiff to show that the action involves a "predictably small" amount of damages per class member. The plaintiff in *Konig* presented no evidence that potential damages to class members were "predictably small," and thus failed to meet his burden of showing substantive unconscionability. The case is currently pending review of a related matter before the California Supreme Court.

Supreme Court Rules On Attorneys' Fees In Bankruptcy

BY ELIZABETH BOHN

The Supreme Court recently ruled in a unanimous decision in *Travelers Casualty & Surety v. Pacific Gas & Electric Company* that an insurer who issued a surety bond assuring payment of workers compensation benefits of the bankrupt company could file a claim for its attorneys' fees incurred in negotiating language in the bankruptcy plan to protect itself from the debtor's default. The insurer filed a claim for post-petition attorneys fees based on the indemnity contract between the insurer and the debtor. The debtor objected, and the bankruptcy court and Ninth Circuit disallowed the claim. The Supreme Court held that federal bankruptcy law does not disallow contract-based claims for attorneys' fees incurred in litigating bankruptcy issues. In so holding, the Court rejected the Ninth Circuit's Fobian rule, which the Court noted had no support in the Bankruptcy Code.

Congratulations!

Jorden Burt Elects Three New Partners. Jorden Burt LLP is pleased to announce that **Enrique D. Arana**, **Marvin C. "Chip" Lunde, III** and **Shaunda Patterson-Strachan** have been elected partners of the firm. The partnership became effective January 1, 2007.

Enrique D. Arana (Miami office), focuses his practice on major litigation involving insurance companies and other financial institutions, commercial contract disputes, constitutional, land-use, local government, media and intellectual property law. He received his B.A. from the University of Illinois, cum laude, and his J.D. from Harvard Law School, cum laude.

Chip Lunde (Washington, DC office), focuses his practice on investment company and investment adviser regulation, including variable insurance products, retail mutual funds and advisory services. Mr. Lunde received his B.A. from the University of North Carolina at Chapel Hill (with honors) and his J.D. from the University of Texas School of Law.

Shaunda Patterson-Strachan (Washington, DC office), focuses her practice on representing insurance and financial services companies in class action and other high-impact litigation, ERISA litigation, and general commercial litigation, at both the trial and appellate court levels, throughout the United States. She received her B.A. from Hampton University (with honors) and her J.D. from The George Washington University Law School.

NEWS & NOTES

Jorden Burt Client Successes

Georgia Federal Court Decertifies West Virginia Class Action. Three years after a West Virginia state court certified a class of consumers in a "packing" case, Jorden Burt had the class decertified by the Bankruptcy Court in the Southern District of Georgia. The plaintiff in *Dunlap v. Friedman's Jewelers et al.* alleged that, along with their jewelry purchases, he and all class members were sold credit insurance products without their knowledge or consent. When the co-defendant to Jorden Burt's client filed a Chapter 11 petition in the Bankruptcy Court in Savannah, Georgia, Jorden Burt's team removed the entire case to the Southern District of West Virginia, and then had the case transferred to the Southern District of Georgia, which referred it to the Bankruptcy Court. That court granted Jorden Burt's motion to decertify the class on March 16, 2007.

Voluntary Dismissal in Assurant Health Case. On February 15, 2007, plaintiff CP Motion, a medical services provider, dismissed with prejudice its case against Assurant Health. CP Motion claimed that it was owed the benefits payable under a health insurance policy administered by Assurant Health. After some negotiation, Jorden Burt persuaded CP Motion to dismiss the lawsuit without paying damages.

Publications

The third edition of the *Handbook on ERISA Litigation*, written by **Jim Jorden**, **Wally Pflepsen** and **Steve Goldberg**, was recently released. The handbook details every major claim area under ERISA, along with providing guides, checklists and forms to help attorneys prepare pleadings and briefs quickly and efficiently.

Gary Cohen wrote "Fund Director Approval of Advisory Contracts: Shareholder Report Disclosure" in the January 2007 issue of *The Investment Lawyer.* For the February 2007 issue, he authored "Indexed Investment Products: Are They Securities?"

Jim Sconzo and **Jonathan Sterling** wrote "Financial Services Sector Targeted in Litigation" for the January 2007 issue of the *Connecticut Law Tribune.*

Speeches

Richard Choi spoke on "Mutual Fund and Variable Annuity Suitability from the Issuer's Perspective" at the Securities Industry & Financial Markets Association Compliance & Legal Division's 38th Annual Seminar, March 27, 2007 in Phoenix, AZ. He also presented the Annuity Review at the Association of Life Insurance Counsel Annual Meeting in San Diego, CA on May 7, 2007.

Gary Cohen moderated a panel, "Hot Topics in Insurance Products," at the PLI Investment Management Institute, April 12-13 in New York City. He also gave a regulatory update at the National Association of Fixed Annuities Annual Meeting, April 25-27, 2007 in Scottsdale, AZ.

Elizabeth Bohn led two panel discussions for the Loan Workout and Bankruptcy Subcommittee of the ABA Commercial Financial Services Committee on March 15 and 17, 2007 in Washington, D.C.. The first panel discussed "Recent Trends and Decisions to Get Ready for the Next Big Wave." She was also a panelist on "Issues and Developments in the Sale of Distressed Debt."

Mark your Calendars

Cohen, Duhaime, Furman and Choi to Speak at NAVA Conferences. At the NAVA OpsTech Conference, June 3-6, 2007, in Baltimore, MD, **Gary Cohen** will be a panelist on the topic "XBRL Taxonomy in Annuities - To Be or Not to Be?" At the same conference, **Diane Duhaime** will be a moderator and panelist on the topic "STP and Compliance with E-Signature, Record, and Contract Laws."

At NAVA's Compliance and Regulatory Affairs Conference, June 24-26, 2007, in Washington, DC, **Ann Furman** will be speaking on suitability issues. **Richard Choi** will be presenting on revenue sharing.

JORDEN BURT LLP

JORDEN BURT LLP is the premiere national legal boutique providing litigation and counseling services to the financial services industry. The Firm's practice is organized into six industry groups:

- Life & Health Insurance
- Property & Casualty
- Reinsurance
- Mutual Funds & Investment Advisers
- Securities
- Banking & Consumer Finance

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