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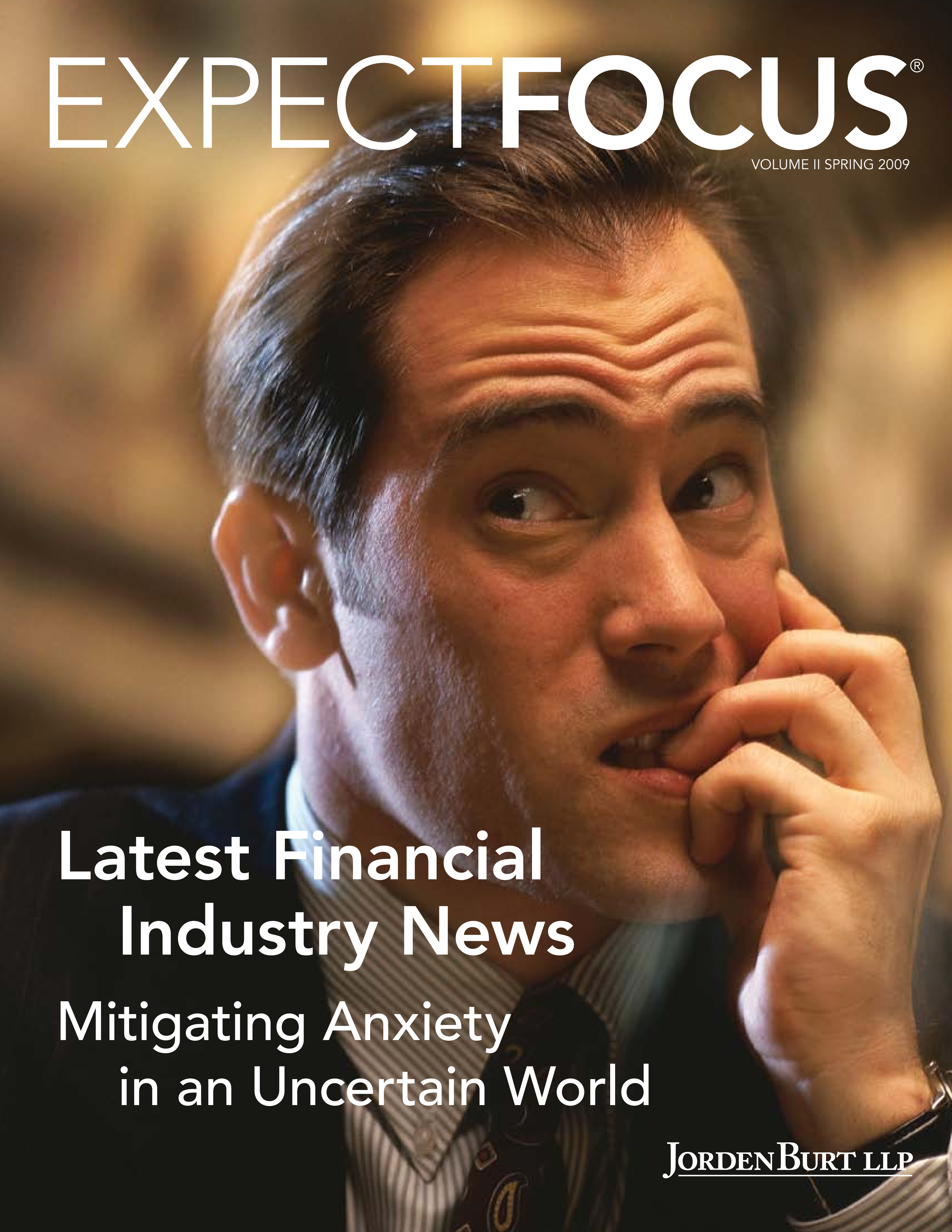

Latest Financial Industry News

Mitigating Anxiety in an Uncertain World

JORDEN BURT LLP

EXPECT**FOCUS™**® Vol. II Spring 2009

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INTHE**SPOTLIGHT**

TARP Funds Extended To Insurers

BY ERIC COMBS

The U.S. Department of the Treasury recently expanded its Troubled Asset Relief Program (TARP) to the life insurance industry. Pursuant to new guidelines released by the Treasury Department on April 7, 2009, insurers that own federally chartered banks may participate in the TARP's Capital Purchase Program (CPP). Many insurers owned banks or savings and loans before the Treasury announcement, and some insurers that didn't own banks or thrifts recently purchased such institutions so that they could qualify. The deadline to apply under the new guidelines was May 7, 2009. On May 14, 2009, the Treasury Department announced that six insurers had been approved for capital infusions.

Uncle Sam getting down to business with insurers

The new Treasury guidelines take the form of term sheets for new qualifying financial institutions applying to the CPP. The new term sheets establish specific eligibility and program guidelines for (a) publicly-traded subsidiary holding companies seeking to participate in CPP by issuing preferred stock, (b) privately-held subsidiary holding companies seeking to participate by issuing preferred stock, and (c) top-tier mutual holding companies that do not have subsidiary holding companies seeking to participate by issuing debt. Depending on its holding company structure, the terms for an insurer participating in the CPP are substantially similar to the original TARP CPP terms offered to publicly-traded, privately-held, or subchapter S institutions. Included in such terms are requirements for certain levels of stock dividend and debt interest payments, immediately exercisable warrants for new issues of stock or debt, and mandates for compliance with Congress's strict executive compensation rules.

Mark your Calendars

The **ALI-ABA Conference on Insurance and Financial Services Industry Litigation** will take place July 9-10, 2009 in Boston, MA at the Langham Hotel. Managing Partner **James F. Jorden** is the planning chair for this conference. Partners **Wally Pflepsen**, **Gary Cohen** and **Stephen Jorden** will serve as faculty. Mr. Cohen is moderating a panel on "The Litigation Impact of Rule 151A Adoption and the Continuing Regulatory Battles over Suitability Standards between 'Securities' Regulation and 'Insurance' Regulation." Mr. Pflepsen will be speaking on a panel on "Retirement Plan, ERISA, and Related Litigation Developments", and Mr. Jorden will be presenting on a panel on "The Developing Law of Standards for Class Certification."

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NEWS & NOTES

No Certification for Annuity Purchasers In Interest Crediting Action

BY DAWN WILLIAMS

The District of Minnesota recently declined to grant class certification to a putative class of fixed deferred annuity owners who alleged that Reliastar Life Insurance Company wrongfully set higher interest rates on "new money" than on "old money," even though the rates for all policies were at or higher than the contractual guarantees. The plaintiffs claimed that the practice breached the duty of good faith implied in the contract provision "interest greater than the guaranteed rate may be credited in a way set by our Board of Directors" and that alleged misrepresentations or omissions concerning the interest crediting violated various consumer protection statutes.

The court found that individual class members' expectations regarding interest crediting would predominate over common issues because a class member could not recover on their contract claims if their expectations were consistent with the company's interest crediting mechanism. Because "class members could have obtained information about interest crediting through point-of-sale interactions or publicly available materials," the court anticipated that at least some purchasers' expectations were consistent with the company's crediting methodology.

The court also refused to certify the consumer protection act claims because those claims centered on alleged misrepresentations and nondisclosures, and, as in *In re St. Jude*, evidence of reliance by individual class members would be relevant to proving causation. The court further held that the statute of limitations defense would require individual proof, as the accrual of the claims depends on when each individual knew of the company's interest crediting practices.

Key Developments in "Revenue Sharing" Litigation

BY BEN SEESSEL

Staying busy with revenue sharing cases

The Department of Labor, AARP, and a group of law professors have filed amicus briefs in support of plaintiffs' petition for rehearing and rehearing en banc in *Hecker v. Deere*, which remains pending in the Seventh Circuit. In *Hecker*, a three-judge panel affirmed the district court's dismissal of plaintiffs' 401(k) plan participants' breach of ERISA fiduciary duty claims, holding that "revenue sharing" fees are not plan assets and need not be disclosed where the total fees charged by a mutual fund are disclosed. Defendants include plan sponsor Deere, plan recordkeeper Fidelity Trust, and Fidelity Research, the investment advisor to the Fidelity funds offered in the plan.

Many of the cases brought by plan participants against plan sponsors have been stayed pending resolution of the *Hecker* case. United Technologies, however, was recently granted summary judgment in the District of Connecticut; the court stated in dicta that the recordkeeper (Fidelity) was not an ERISA fiduciary. That dismissal has been appealed to the Second Circuit. The dismissal in *Braden v. Wal-Mart* likewise remains on appeal in the Eighth Circuit.

On the class certification front, a hearing was held in late February in *Haddock v. Nationwide* on plaintiffs' motion for class certification, suggesting a decision may be forthcoming. In addition, in *Ruppert v. Principal Life*, the court granted plaintiff leave to file, and plaintiff recently filed, supplemental class certification motion pertaining to Principal's alleged breaches of fiduciary duty relating to its proprietary "Foundation Option" funds. The court had previously denied plaintiff's motion for class certification, holding that Principal's fiduciary status "would have to be determined on a plan-by-plan basis." In support of its decision, the court cited Principal's admission that it had acted as an ERISA fiduciary with respect to the selection, monitoring, and retention of investment managers for its Foundation Option funds.

Rule 151A Litigation On Way To Court Decision

BY GARY COHEN

Oral argument was held on May 8, 2009, before the D.C. Court of Appeals in the litigation involving Rule 151A, which would regulate registration under the Securities Act of 1933 for the offering of certain types of fixed index annuities.

Waiting on the court's decision

Two sets of plaintiffs urged the court to vacate Rule 151A: a coalition of life insurance companies and distribution firms (Coalition), and the National Association of Insurance Commissioners and the National Conference of Insurance Legislators. The SEC defended the Rule.

The oral arguments, as well as the briefs filed by the parties and friends of the court, set out a number of legal and policy arguments. These arguments relate, among other things, to the application of U.S. Supreme Court precedents regarding the scope, allocation and assumption of "investment risk." Some observers, however, predict that the decision will turn principally on the SEC's authority to adopt Rule 151A, rather than the application of substantive precedents.

There's no word when the court might announce its decision. The Coalition had originally asked for an expedited briefing schedule, given the work required to comply with the Rule if it survives, which would include registering, with the SEC, index annuities as securities and distribution firms as broker-dealers. The court granted a briefing schedule that was more expedited than the one requested, suggesting the Court might decide the case sooner rather than later. Although the court has not acted on the Coalition's request that the court extend the Rule's compliance date, the losing party at the Court of Appeals level may well petition the U.S. Supreme Court to review the case, and Supreme Court review probably would extend the compliance date for the Rule.

Jorden Burt filed an amicus curiae brief on behalf of an index annuity insurer in support of plaintiffs. Jorden Burt also authored the comment letter previously filed by the National Association for Fixed Annuities opposing the SEC's proposal to adopt Rule 151A.

FL Proposes Rule to Adopt Annuity Suitability Forms

BY ANN BLACK

On May 22, 2009, a notice of proposed rulemaking to adopt new Rule 69B-162.011 was published. This proposed Rule implements the suitability and replacement forms referenced in Florida Statutes Section 627.4554. For any recommendation of an annuity to a senior, Section 627.4554 requires that there must be an objectively reasonable basis for believing that the recommendation is suitable based on specific information that the agent (or the insurer if no agent is involved) must make reasonable efforts to obtain from the senior consumer on a form adopted by the Department of Financial Services. Section 627.4554 also requires that senior consumers be provided with specific information comparing the annuities involved in a replacement or exchange transaction on a form adopted by the Department. Other than the use of the Department adopted forms, insurers, as well as agents, must have begun complying with Section 627.4554 beginning on January 1, 2009.

The new Rule adopts the Annuity Suitability and Disclosure and Comparison forms previously proposed by the Department in January 2009. The new Rule also:

- Exempts annuity sales that are subject to FINRA's suitability rules from the requirement of using the Annuity Suitability form.
- Permits insurers to adapt the Annuity Suitability form or the Disclosure and Comparison form for their own use upon written approval from the Department.
- Specifies the conditions under which the Department would approve insurer adapted forms.

The Department has no intent to hold further hearings on the proposed Rule unless a request for a hearing is made in writing on or before June 12, 2009. If requested, the hearing will be held on June 16, 2009, at 9:30 a.m. If not, the Department has informally advised us that it expects the Rule will be adopted in mid-June, and take effect in mid-August.

Louisiana District Court Dismisses "Juvenile Smoker" Claims

BY MICHAEL KENTOFF

Expect Focus has previously reported on a number of federal court decisions rejecting plaintiffs' theory that in checking the "no" box beside a smoking question in a life insurance application, they reasonably expected that the insured would be provided a non-smoker premium rating as opposed to a less favorable "standard" rating (see *Expect Focus, Vol. I Winter 2009; Vol. IV, Fall 2008*). On April 9, 2009, Judge Madeleine M. Landrieu of the Civil District Court of the Parish of Orleans in Louisiana issued an order dismissing identical claims and agreeing with those decisions that merely answering a tobacco question in the negative on a life insurance application "does not create an obligation for the Defendants to provide such rates."

Slow and steady won the case

In *Finnan v. Pan American AssuranceCompany*, the court discarded plaintiffs' common law claims (breach of contract and negligent misrepresentation) because "[n]o evidence was presented to suggest that the insurer charged a rate distinguishing juvenile smokers from juvenile non-smokers or that there was any such thing as a 'non-smoker' discount for juveniles." Due to the removal of the judge initially assigned to the case and the chaos created in New Orleans by Hurricane Katrina, the case took a lengthy, circuitous path; during the delay caused by these events, federal court cases rejecting these claims were decided. Following closely Pan-American's briefing, Judge Landrieu cited the strong federal court precedent and concurred with the "central holding" of these prior decisions while also dismissing two statutory causes of action as inapplicable to plaintiffs' factual assertions.

California Consumer Class Action Update

BY BRIAN PERRYMAN

Three cases—one not yet decided—are expected to significantly impact California consumer class actions involving insurers and others in the financial services industry.

Consumer class actions will be packaged differently in CA

In one decision generally favorable to the industry, the California Supreme Court decided that life insurance is not a "service" subject to the California Consumer Legal Remedies Act's remedial provisions. Although the parties had framed the issue in *Fairbanks v. Superior Court* as whether insurance in general is a "service," the court narrowed the issue to focus on life insurance. Observing that the Act applies only to consumer "goods" and "services," the court found that the statute's plain language compelled the conclusion that an "insurer's contractual obligation to pay money under a life insurance policy is not work or labor, nor is it related to the sale or repair of any tangible chattel."

More recently, however, in a 4-3 opinion, the California Supreme Court decided *In re Tobacco II Cases*, addressing two questions. First, the court considered in a class action under the California Unfair Competition Law, who must comply with the requirements that a "person" has "suffered injury in fact" and "lost money or property as a result of" alleged unfair competition. The court held that these requirements apply only to class representatives, not unnamed class members. The court also addressed what is required to show causation ("as a result of") for purposes of establishing UCL standing, and concluded that UCL plaintiffs are not required to allege that misrepresentations were the sole, or even decisive, cause of an injury, and that plaintiffs need not plead with specificity that they relied on misrepresentations. These conclusions provoked a strong dissent that the majority had esssentially determined "that normal class action rules do not apply to UCL private representative actions."

The Ninth Circuit Court of Appeals, too, is expected to deliver its en banc decision in *Dukes v. Wal-Mart, Inc.*, which may fundamentally alter that court's treatment of federal class actions certified for declaratory and injunctive relief. The case involves the largest civil rights class action ever certified in the United States.

Rescission Due to Insured's Misrepresentations Upheld by Eleventh Circuit

BY JOHN PITBLADO

In *American General Life Ins. Co. v. Schoenthal Family*, LLC, the U.S. Court of Appeals for the Eleventh Circuit affirmed summary judgment in favor of the plaintiff life insurer. The case arose after the death of the insured in 2005, when the plaintiff insurer conducted a contestable claim investigation of the $7,000,000 life policy it issued less than two years earlier. The investigation revealed that the insured materially misrepresented his net worth as $10,700,000, with annual income of $150,000, when in fact his net worth was approximately $160,000, and his annual income $7,200. The company concluded that, had the insured been truthful, it would have declined to issue a policy in the amount requested. It then denied the beneficiaries' claim, and filed an action in federal district court, naming the beneficiaries as defendants and seeking rescission of the policy based on the insured's misrepresentations.

Both parties submitted expert testimony to the district court, and American General moved for summary judgment based on the undisputed facts. The district court admitted American General's expert testimony, excluded the beneficiaries' expert testimony, and granted summary judgment to American General. The beneficiaries appealed, claiming that their expert's testimony was improperly excluded, the plaintiff's expert testimony was improperly admitted, and summary judgment should have been denied because factual disputes remained pertaining to the materiality of the misrepresentations.

The Eleventh Circuit affirmed in all respects. It held that the decisions to admit and exclude the respective experts' testimony were not an abuse of discretion, because American General's expert was amply qualified to testify as to industry standards, and because the beneficiaries' expert's testimony, even if admitted, was equivocal and did not directly refute plaintiff's expert's testimony. The court held that summary judgment was properly granted on the rescission claim because (1) the undisputed expert testimony supported the company's decision; and (2) the decision was proper according to widely recognized industry guidelines, which the beneficiaries themselves had described as a model of reasonable insurance practices.

"Bonus Annuity" Claims Again Rejected

BY SHAUNDA PATTERSON-STRACHAN & LYNDA CHANG

The latest in a string of insurer victories in "bonus annuity" suits came via a May 6, 2009 ruling by the U.S. District Court for the Western District of Tennessee. Like the plaintiffs in similar suits, the plaintiff in *Cirzoveto v. AIG Annuity Ins. Co.* alleged that the insurer designed the fixed annuity at issue to allow it to recoup a first-year interest bonus by subsequently crediting lower renewal rates.

Upon consideration of AIG's summary judgment motion, the court rejected each of the plaintiff's claims. Among other things, the court found there could be no contractual breach because the plaintiff's annuity was credited first-year and renewal interest rates consistent with those promised in the contract.

Rejecting the misrepresentation claims, the court observed that AIG had disclosed in multiple documents that the bonus interest rate would be in effect only for the first year. Largely adopting the first substantive opinion in this genre of litigation, *Sayer v. Lincoln National Life Ins. Co.*, issued by an Alabama federal court and affirmed by the Eleventh Circuit (see *Expect Focus Vol. 1, Winter 2007*), the court held that there could be no reasonable reliance on oral representations contrary to the terms of a written contract where the plaintiff had the opportunity to read that contract. The Court also relied on *Sayer* and Tennessee authorities to hold that AIG had no duty to disclose its internal ratemaking and pricing procedures.

This latest ruling on the merits, coupled with the class certification denial by a federal court in Pennsylvania (see S*mith v. John Hancock Life Ins. Co.* discussed in *Expect Focus Vol. IV, Fall 2008)*, reflect insurers' continued success in repelling this particular bonus theory.

Self-Defense is an "Accident"?

BY JOHN PITBLADO

The Connecticut Supreme Court recently held in *Vermont Mut. Ins. Co. v. Walukiewicz*, that the term "accident" as used in a liability policy can reasonably be interpreted to include bodily injury caused by acts of self-defense.

In an underlying negligence action, Kevin Brown alleged that Joseph Walukiewicz caused him bodily injury during an altercation between the two men at the residence of Mr. Brown's estranged wife. Evidence presented to the jury showed that Walukiewicz forcibly caused Brown to fall down some porch steps and sustained significant injuries to his leg.

Mr. Walukiewicz submitted a claim under his Vermont Mutual homeowner's insurance policy, which provides coverage for suits against the insured alleging "bodily injury… caused by an…accident," but excludes from coverage "bodily injury … which is expected or intended by the insured." In the ensuing declaratory judgment action to determine coverage, Vermont Mutual obtained summary judgment.


Self-defense injuries ruled accident

On appeal, the Connecticut Supreme Court reversed. Noting a split of authority, the Connecticut court joined those other states that utilize a subjective test in analyzing whether injury caused by self-defense may be accidental. The court reasoned that, while the Walukiewicz's physical acts in defending himself could narrowly be interpreted as intentional, the same acts could also reasonably be interpreted as "instinctive or reactive" and, accordingly, unintentional, depending on the his state of mind. Because the court found both interpretations reasonable, it construed the ambiguity in the term "accident" in favor of the insured. The court also held that the "intended or expected" exclusion was inapplicable, because the language of the exclusion indicated a subjective standard, and was only applicable to bodily injury expected or intended "by the insured."

Being Wrong Doesn't Mean Bad Faith

BY JAMES GOODFELLOW

The Fifth Circuit Court of Appeals recently held in *Kodrin v. State Farm Fire and Casualty Company* that where a legitimate dispute exists between insurer and insured as to the nature of loss claimed under a homeowner's insurance policy, denial of coverage alone is not evidence of bad faith by the insurer.


Denial of coverage doesn't lock up bad faith claim

Following destruction of their home by Hurricane Katrina, the Kodrins submitted a claim for coverage under their homeowner's policy for loss caused by wind damage. Asked by State Farm to explain why their house was destroyed while others in their neighborhood remained relatively intact, the Kodrins speculated that their damage was caused by a tornado prior to the arrival of the storm surge. State Farm denied the claim.

The Kodrins sued State Farm, alleging that the insurer's denial of claims and failure to make payment were both acts of bad faith under Louisiana law. The jury delivered a verdict for the insured.

On appeal to the Fifth Circuit, the court agreed with State Farm that there was insufficient evidence to support the finding of bad faith. Notwithstanding this conclusion, however, the court held that there was sufficient evidence to support the jury's finding that wind damage, if not the tornado posited by the Kodrins, was the cause of the loss. As such, State Farm was required to pay the combined coverage limits set forth in the homeowner's policy.

Texas Requires Prejudice

BY JACOB HATHORN

When an insured notifies its insurer of a claim within the policy term or other reporting period specified by a claims-made policy, the insured's failure to provide notice "as soon as practicable" will not defeat coverage under Texas law in the absence of prejudice to the insurer.

Timing matters as soon as practicable

In *Prodigy Commc'ns Corp. v. Agricultural Excess & Surplus Ins. Co.*, Prodigy was insured under a claims-made D&O liability policy issued by AESIC. Under the express terms of the Policy, Prodigy was required, as a condition precedent to coverage, to give AESIC written notice of a claim as soon as practicable, but in no event later than 90 days after the Policy's extended reporting deadline of May 31, 2003.

Prodigy first notified AESIC of its claim in June 2003, when it was on the verge of settling a lawsuit after more than a year of litigation. Citing Prodigy's failure to tender notice "as soon as practicable," AESIC denied coverage. Prodigy sued AESIC, seeking a declaratory judgment that it was entitled to coverage. Both the trial and intermediate appellate courts sided with the insurer.

The Supreme Court of Texas reversed, citing its opinion in a 2008 case that, absent a showing of prejudice to the insurer, an insured's alleged failure to comply with an "as soon as practicable notice" provision does not defeat coverage. But that case involved an occurrence-based policy that did not expressly designate "as soon as practicable notice" as a condition precedent to coverage. The court deemed these distinguishing facts inconsequential, and concluded that Prodigy's obligation to provide "notice as soon as practicable" was not a material part of the bargained-for exchange between AESIC and Prodigy. Even if Prodigy had failed to provide notice as soon as practicable, it still provided notice within 90 days of the Policy's extended reporting deadline. As such, the insurer could not deny coverage without showing that it suffered actual prejudice. Because AESIC admitted it suffered no such prejudice, the court held that the insurer wrongfully denied coverage for Prodigy's alleged failure to give notice "as soon as practicable."

Time-out in Louisana

BY DAN CRISP

The Supreme Court of Louisiana recently denied a writ application to review an appellate court decision that allowed an insured to pursue her claim against Louisiana Citizens Property Insurance Corporation despite filing her complaint six months after the state legislature's deadline to file Hurricane Katrina-related claims.

In *Pitts v. Louisiana Citizens Prop. Ins. Corp.*, the insured alleged that the insurer inadequately compensated her for damages sustained from Hurricane Katrina.

Pitts had alleged that prior to filing her complaint in state court, several pending class action lawsuits had represented her interests against the insurer. It was only after one court denied class certification due to a lack of demonstrated commonality, and another court restricted the class definition to exclude plaintiffs like her whose claims were insufficiently paid, however, that Pitts filed her individual suit. The trial court dismissed Pitts's lawsuit with prejudice as being time-barred.

The appellate court reversed and remanded for further proceedings, noting that a class action filing suspends the deadline for claims and that notice ends the suspension. Thus, Pitts's suit could proceed against her insurer.

As to the putative class members who, unlike Pitts, were not excluded from the narrowed class definition, the appellate court went on to state that the deadline was interrupted and did not begin to run anew until notice was given. Accordingly, the legislature's deadline to file hurricane-related claims has been extended.

Reinsurers Prevail In Securities Fraud Class Actions

BY ROLLIE GOSS

Two reinsurance companies have prevailed on motions to dismiss in shareholder securities law putative class actions involving restatements of loss levels from cat events. In these cases, the courts essentially acknowledged the practical difficulties of precisely forecasting ultimate cat loss levels.

In *In re PXRE Group, Ltd., Securities Litigation*, PXRE prevailed in a suit alleging a scheme to understate losses after it restated several times the amount of losses arising out of a series of hurricanes that devastated the Gulf Coast in 2005. The court granted PXRE's motion to dismiss, finding that plaintiffs "failed to plead that defendants were reckless in not knowing about the flaws in PXRE's calculation of its loss estimates."

In *Zirkin v. Quanta Capital Holdings Ltd.*, Quanta issued several estimated loss projections relating to Hurricanes Katrina and Rita that ranged from $42 to $68.5 million, resulting in multiple rating downgrades, and forcing Quanta to cease writing new insurance and reinsurance business and to sell its remaining insurance and reinsurance portfolios.

Reinsurers loving results of two securities fraud class actions

Noting the conjectural nature of insurance reserves established for losses that have been incurred but not yet reported, the court ruled that the complaint did not put forth sufficient factual allegations such that it could plausibly find that the loss estimate included in the offering documents was a material untruth at the time it was made, especially since the adjusted estimate was based on a single business interruption claim. The court also held that the complaint did not meet applicable heightened pleading requirements, and that some of the claims failed because the $68.5 million preliminary loss estimate was protected by the "bespeaks caution" doctrine.

Congratulations!

Jorden Burt LLP is pleased to announce that **Michael Kentoff** and **Julianna Thomas McCabe** have been elected partners of the firm.

Michael Kentoff (Washington, DC office) focuses his practice on securities, consumer fraud, and product liability litigation, litigation relating to sales practices and the administration of insurance and investment products, litigation concerning the design and pricing of insurance products, and NASD broker-dealer arbitrations. He serves as Vice Chair of the Intellectual Property and Technology Practice Team. Mr. Kentoff received his B.A. from American University and his J.D. from American University, Washington College of Law.

Julianna Thomas McCabe (Miami office) focuses her practice on the representation of the financial services industry in complex federal and state litigation, including class action defense, consumer fraud, ERISA litigation, securities litigation, commercial litigation, and contractual disputes. Ms. McCabe has successfully represented the Firm's clients at arbitration before the NASD, and she has extensive experience litigating the enforceability of contractual arbitration clauses under the Federal Arbitration Act. She serves as Vice Chair of the Insurance Regulatory Practice Team. Ms. McCabe received her B.A. from the University of Akron, *magna cum laude*, her M.A. from the University of Connecticut, and her J.D. from Boston University, *magna cum laude*.

NAIC Exposes Three Proposals On The Reinsurance Front

BY ANTHONY CICCHETTI

The NAIC continues to be active in the reinsurance arena, and recently exposed for comment the following items.

NAIC continues to build on framework

Regulatory Modernization—Proposed Federal Enabling Legislation: Moving forward efforts to implement the Reinsurance Regulatory Modernization Framework, the NAIC's Reinsurance Task Force in late March exposed draft federal legislation titled the "Reinsurance Regulatory Modernization Act of 2009." Among other things, the Act creates the Reinsurance Supervision Review Board, a nonprofit corporation owned by or affiliated with the NAIC with authority to take actions required for implementation of the Framework.

Proposed Amendment to Credit for Reinsurance Model Law: Responding to concerns that assuming insurers in run-off are unduly burdened by the current $20 million minimum trusteed surplus requirement for multiple-beneficiary trusts, the Reinsurance Task Force exposed a proposed amendment to Section 2(D)(3) of the Credit for Reinsurance Model Law. The proposed amendment authorizes the commissioner with principal regulatory oversight of the trust, after an appropriate risk assessment, to allow exceptions to the $20 million trusteed surplus requirements for assuming insurers that have permanently discontinued underwriting new business secured by the trust for at least three years. In no event, however, would the trusteed surplus be allowed to fall below 50% of the assuming insurer's liabilities attributable to reinsurance ceded by U.S. ceding insurers.

Reinsurance Collateral Requirements: In light of the recent upheaval in the financial markets, the Reinsurance Task Force exposed a guidance memorandum on the application of authority granted to commissioners under the Credit for Reinsurance Model Law and Credit for Reinsurance Model Regulation to accept "any other form of security acceptable to the commissioner," and to determine that a financial institution meets the criteria for a "qualified U.S. financial institution." Among other things, the guidance memorandum cautions commissioners to exercise their authority concerning other forms of security "on a case-by-case basis only after careful and thorough evaluation of all information relevant to each situation." In addition, the guidance underscores that the permitted security should be held in the United States for the sole benefit of the ceding insurer and subject to the exclusive control of the ceding insurer or, in the case of a trust, in a qualified U.S. financial institution. The Task Force has stated that it will consider the development of a communication mechanism among NAIC members relating to situations where "other forms" of security have been accepted.

Jorden Burt has reported on the details of the Reinsurance Regulatory Modernization Framework in previous editions of *Expect Focus.* In addition, you can access more information concerning the workings of the Framework, as well as the proposed Reinsurance Regulatory Modernization Act of 2009 and the other items recently exposed by the NAIC, at www.ReinsuranceFocus.com.

Announcing

"Re-Better!"—Jorden Burt's award winning blog covering reinsurance and arbitration developments has a new look and new features. Visit www.ReinsuranceFocus.com to see the easier to navigate version, with interesting additions like our new "Treaty Tips" section and expanded "Special Focus" features.

NOTE**WORTHY**

Scribner, Hall & Thompson, LLP

Protected Cell (Series LLC) Arrangements Should Consider Segregation of Corporate Earnings and Liquidation Rights

BY LYNLEE C. BAKER

Recently, Treasury and the Internal Revenue Service (IRS) provided guidance and requested comments on the circumstances under which a protected cell of a protected cell company (or a "Series" of a "Series LLC") would be treated as a separate insurance company for Federal income tax purposes, and some of the consequences of such treatment. The IRS also requested comments on the treatment of a Series in a non-insurance context. A Series LLC is a legal entity comprised of subparts called Series, where the assets of each Series are segregated from the creditors of the Series LLC and the creditors of each other.

The ABA Section of Taxation responded to the request for comments with a letter detailing its recommendation for the treatment of a Series in the non-insurance context (2009 TNT 2-56.). Interestingly, while both the IRS guidance and the ABA recommendation proposed separate entity treatment of each Series, neither addressed whether there must be segregation of the traditional corporate equity ownership rights, e.g., earnings and liquidation rights, in one Series from another. Without such segregation, if a Series is treated as a corporation for federal income tax purposes (and required to file a tax return), how does one determine who is the owner of the equity interest of each Series and whether the equity interest is common or preferred stock? Further, can the separate taxable entity Series be part of a consolidated return?

The IRS finessed these potential equity ownership issues in Rev. Rul. 2008-8, 2008-5 I.R.B. 340, by factually establishing that all of the income, expense, assets, liabilities and capital of each of the cells was separately accounted for and, upon liquidation, become the property of the participant, who was the sole shareholder with respect to each cell. Representations to a similar effect were relied upon in PLR 200803004 (Oct. 15, 2007). Treasury and the IRS may continue to rely on such representations, even though it might be more helpful to provide Series LLC guidance that addresses segregation vs. non-segregation of the traditional equity ownership rights (e.g., earnings and liquidation rights) in one Series from another, in both the insurance and non-insurance context. Regardless, it would be prudent for Series LLC arrangements in the insurance context to consider segregation vs. non-segregation of the earnings and liquidation rights of each Series (and the Series LLC), if the relevant statute does not otherwise so provide, when tax treatment of a Series as a corporation for Federal income tax purposes is contemplated.

New calculations for protected cell?

Financial Fraud & Investigation Task Force

SIGTARP Does Not Just Spell Relief

BY RICHARD SHARPSTEIN & ARI GERSTIN

In response to the global financial crisis, Congress enacted late last year the Emergency Economic Stabilization Act of 2008 (EESA). In section 121 of the EESA, Congress created the Office of the Special Inspector General For The Troubled Asset Relief Program (SIGTARP). SIGTARP has the responsibility, among other things, to conduct, supervise and coordinate audits and investigations of the purchase, management and sale of assets under the Troubled Asset Relief Program (TARP). TARP was created and authorized the Department of Treasury to spend up to $700 billion to purchase "troubled assets."

In March 2009, Congress passed SIGTARP, which amended EESA and expanded the powers of SIGTARP to include, among other things, undertaking law enforcement functions, without first obtaining Attorney General approval. Just how far SIGTARP can go, and how long its reach can only be tested by time. Similar to the Patriot Act, this act was hastily prepared legislation in extreme reaction to the most severe economic crisis in the United States and worldwide since the Great Depression.

SIGTARP promises "robust criminal and civil enforcement against those who would waste, steal or abuse TARP funds." To that end, SIGTARP's Investigative Division "will pursue any wrong doers focusing on the recipients of TARP funds," including "the institutions that receive TARP investments; the vendors hired to administer TARP activities; those who intentionally misrepresent in the TARP application processes and in their financial reporting Treasury, [who] may be in violation of criminal statutes, including securities fraud, wire fraud, mail fraud and false statements." To date, over 200 "tips" have been reported to a fraud hotline established by SIGTARP, resulting in the initiation of nearly 20 criminal investigations.

The complexities of these "economic stimulus" efforts and the unprecedented vastness of these programs weave a web of unexplored legal authority. The powers created in SIGTARP combined with the public demand for swift results creates a situation demanding that all financial services companies stay vigilant as to their direct or indirect participation in this program and receipt of any TARP-related funds or participation in TALF.

Congress Provides Law Enforcement With More Tools To Prosecute Fraud

BY RICHARD SHARPSTEIN & RAMIRO ARECES

With the stated goal of "[improving] enforcement of mortgage fraud, securities fraud, financial institution fraud and other frauds related to federal assistance and relief programs," both the House and Senate have passed the Fraud Enforcement and Recovery Act of 2009. (FERA). This landmark piece of legislation, among other things, redefines and broadens terms under the False Claims Act (FCA), lessens the government's burden in establishing fraud under the FCA, and provides additional funds for the investigation and prosecution of fraud in the financial sector.

FERA will also establish a ten-member "Financial Markets Inquiry Commission" that will examine the causes of the current financial crisis. The commission will have the authority to issue subpoenas and hold hearings on issues such as the role of fraud and abuse in the financial sector, tax treatment for financial products, and corporate governance and executive compensation.

FERA was introduced, and co-sponsored, by Senators Patrick Leahy (D-VT) and Chuck Grassly (R-IA). The bill was passed by the Senate on April 28, 2009 and by the House on May 6, 2009. Sen. Leahy believes this bill will ensure accountability for fraudulent acts, and serve as an investment for the American taxpayer who recovers $32 for every dollar spent on criminal fraud litigation.

Subprime Crisis Exposes Advisers & Directors to Lawsuits

BY ANN FURMAN

One consequence of the subprime mortgage crisis has been an increase in putative class action lawsuits against fund advisers and directors by investors claiming that their funds were over-exposed to risky mortgage-backed securities.

The lawsuits allege inaccurate and misleading disclosure regarding these securities, the purchase of which purportedly violated:

- The funds' fundamental policy to track a benchmark index;
- The 25% industry concentration requirement; and
- Section 13(a) of the Investment Company Act of 1940 (1940 Act), which prohibits a fund from deviating, without shareholder approval, from the fundamental policies stated in its registration statement.

What has securities practitioners scratching their heads is a recent U.S. district court holding in *Northstar Financial Advisors, Inc. v Schwab Investments, et al.*, that there is an implied private right of action under Section 13(a) of the 1940 Act. Section 13(a) contains no express language conferring any right to bring an action.

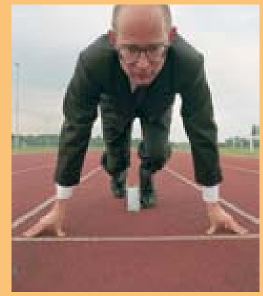
The *Northstar* court, however, found an implied private right of action under Section 13(a) by examining Section 13(c), which was added in 2007 as part of the Sudan Accountability and Divestment Act to restrict the rights of "persons" to bring actions against a fund or adviser for divesting from securities issued by persons that conduct or have direct investments in business operations in Sudan.

The *Northstar* court reasoned that Section 13(c) expressly limited the types of actions that a "person" could file under Section 13 and "[i]f there were no private right of action under Section 13(a), there would be no need to restrict the actions that could be filed under Section 13… The fact that Congress only limited certain types of actions suggests that Congress intended that there be a private right of action under Section 13(a)."

Significantly for fund directors, at least one of these putative class actions, *Smith v. Oppenheimerfunds, Inc.*, et al., named fund directors as defendants because the directors were authorized to sign the allegedly inaccurate and misleading registration statements.

Racing Toward Money Market Fund Resiliency

BY TOM LAUERMAN



After September 18, 2009, money market funds will need to stand on their own two feet once again. That date marks the expiration of the Treasury Department's temporary program for guaranteeing certain investments in money market funds that participate in the program, and there is no indication that the program will be further extended.

The Treasury program has helped to reduce the threat of disorderly and massive redemptions such as those that seriously threatened the viability of money market funds last autumn.

Widespread agreement now exists that money market funds should take other steps to enhance their "resiliency" and thus promote investor confidence going forward. Treasury Secretary Geithner, for example, has recently given Congressional testimony to that effect.

Also, a Money Market Fund Working Group of the Investment Company Institute has issued a detailed report that makes numerous recommendations, most of which contemplate new SEC rule making. Pending SEC action, the ICI is encouraging money market funds to voluntarily implement as many of the report's recommendations as possible by September 18, 2009. And many funds are in the process or have already done so.

While substantive and significant, the recommendations of the ICI working group for the most part represent merely an expansion and elaboration of regulatory principles and concepts that already apply. Thus, these recommendations would not significantly change the nature of money market funds.

Enhancing money market fund resilience is also a top priority item for the SEC, although it is not clear whether the SEC will be able to take action by September 18. Informal statements by SEC staff members suggest, however, that the SEC may propose some reforms that could go well beyond those contained in the ICI working group report.

Adviser Sanctioned for Proxy Voting Rule Violations

BY KAREN BENSON

Sanctions for adviser no small change

The SEC recently settled its first enforcement action to be brought under Rule 206(4)-6 of the Investment Advisers Act of 1940—the so-called proxy voting rule. Among other things, the rule requires registered investment advisers that exercise proxy voting authority over client securities to adopt written proxy voting policies and describe them to clients, including procedures to address material conflicts of interest that may arise between the adviser and its clients. In an administrative proceeding, the SEC alleged that a Florida-based investment adviser willfully violated the rule, and that its former chief operating officer willfully aided and abetted and caused those violations.

The SEC found that, in determining how to vote client securities, the adviser selected a third-party proxy voting service's guidelines that followed AFL-CIO proxy voting recommendations, and that the adviser chose to follow those guidelines at a time when it was participating in an annual AFL-CIO-sponsored survey that ranked advisers based on their adherence to the AFL-CIO recommendations on certain votes. The adviser, according to the SEC, believed that following the guidelines would improve its ranking in the survey and that the improved score would be helpful in maintaining existing and attracting new clients. The SEC determined that, contrary to the proxy voting rule, the adviser's written policies and procedures did not address material potential conflicts that may have arisen between the adviser's interests and those of its clients who were not pro-AFL-CIO, and further that the adviser did not sufficiently describe to clients its proxy voting policies and procedures.

As to the COO, the SEC determined that he had participated in drafting the proxy voting polices and procedures while aware of this potential conflict of interest. The SEC found that, despite the COO's knowledge, the adviser told its clients in a cover letter signed by the COO that it did not expect any conflicts to arise in the proxy voting process.

Without admitting or denying the SEC's findings, the adviser and its former COO agreed to pay fines of $300,000 and $50,000, respectively, and to cease and desist from committing or causing any violations and any future violations of the proxy voting rule.

Supreme Court Declines To Review Investment Adviser Standing Case

BY STEPHANIE FICHERA

Expect Focus, Vol. I, Winter 2009 reported on the decision of the Second Circuit Court of Appeals in *W.R. Huff Asset Management Co. v. Deloitte & Touche LLP,* holding that an investment adviser lacked constitutional standing to sue on behalf of its clients. On April 20, 2009, the U.S. Supreme Court declined to review the Second Circuit's decision. In *W.R. Huff*, an investment adviser brought suit against firms that provided underwriting, auditing, and legal services to a bankrupt corporation in which its clients had invested. The adviser argued that its standing to sue stemmed from its power to make investment decisions for its clients and from a power-of-attorney in which its clients authorized the lawsuit. The Supreme Court denied certiorari despite the adviser's claim that a majority of district courts supported standing under such circumstances.

Adviser Sanctioned for Not Providing Fund Board Adequate Information in 15(c) Process

BY ED ZAHAREWICZ

The SEC recently sanctioned, apparently for the first time, a mutual fund adviser for failing to provide a fund's board of trustees, in violation of Section 15(c) of the Investment Company Act of 1940 and Section 206(2) of the Investment Advisers Act of 1940, information reasonably necessary to evaluate a fund-related guarantee in connection with a series of investment advisory contract renewals. The adviser was also sanctioned for filing with the SEC, in violation of Section 34(b) of the Investment Company Act, prospectuses, annual reports and registration statements in which the adviser allegedly misrepresented that there was no charge to the fund and its shareholders for the guarantee. The case may signal a more aggressive stance by the SEC in its examination of information that advisers provide to fund boards to justify their management fees.

The case involved the renewal of three investment advisory contacts, which were approved by the fund's board and its disinterested members over a period of two and a half years. For each contract renewal process, commonly known as the "15(c) process," the SEC found that the adviser urged the fund's board to consider the guarantee feature in evaluating the proposed management fees, which were among the highest of the fund's peer-group of mutual funds. While the adviser was claiming that the guarantee should be considered to justify its management fees, the adviser was also allegedly filing with the SEC prospectuses, annual reports, and registration statements in which it represented that there was no charge to the fund or its shareholders for the guarantee.

To settle the case, the adviser, without admitting or denying the SEC's findings, agreed to pay a disgorgement of $3,950,075, prejudgment interest of $1,350,709, and a civil penalty of $800,000. The SEC's order and related findings *In the Matter of New York Life Investment Management LLC*, SEC Administrative Proceeding (File No. 3-13487), can be found on the SEC website.

SEC Ups Custodial Safeguards

BY SARAH JARVIS

In view of the Madoff scandal, the SEC's Office of Compliance Inspection and Examinations announced that they will be looking more closely at the custody and safekeeping of client assets. In addition, the SEC on May 14, 2009, unanimously voted to propose rulemaking designed to provide additional safeguards under the Investment Advisers Act of 1940 when an adviser has custody funds or securities.

The OCIE recently announced that as part of their examinations of registered advisers and broker-dealers, they will be seeking confirmation of accounts not only from independent custodians "up the chain," but also from advisory clients "down the chain." According to OCIE Associate Director Gene Gohlke, the SEC may send advisory clients a letter asking them to confirm their account balances as of a certain date and that transactions were authorized by them. The SEC's intent to contact clients directly has worried some advisers, who fear that their clients will assume the adviser is being investigated by the SEC. To ease those fears, the SEC promised that it would release to the public the form of letter it intends to send to advisory clients, as well as a model letter which advisers can use to notify clients that the SEC may be contacting them to verify account holdings and transaction information. The model letter and form are now available on the SEC's website.

In addition, the SEC is proposing amendments to the custody rule under the Advisers Act and related forms that, among other things, would:

- require advisers that have custody of client funds or securities to undergo an annual surprise examination by an independent public accountant;
- where client accounts are not maintained by an independent qualified custodian (i.e., a custodian other than the adviser or a related person), require the adviser or related person to obtain a written report from an independent public accountant that includes an opinion regarding the qualified custodian's controls relating to custody of client assets; and
- provide the SEC with better information about the custodial practices of registered advisers.

The comment period for the proposed rulemaking ends on July 28, 2009.

Whistleblowers Turn Regulators' Heads

BY KAREN BENSON

Learning a lesson from recent securities scandals, FINRA has established a new Office of the Whistleblower to expedite senior FINRA staff review of high-risk tips and to ensure a rapid response for tips believed to have merit. This whistleblower initiative enhances, rather than replaces, FINRA's existing processes for handling routine regulatory tips and customer complaints.

New options to get heard

Through the Office of the Whistleblower, individuals with evidence of, or material information about, potentially illegal or unethical activity can contact FINRA's senior staff by telephone (1-866-96-FINRA) or by email (whistleblower@finra.org). Any whistleblower tips that fall outside FINRA's jurisdictional reach will be referred to the appropriate regulatory or law enforcement agencies.

Meanwhile, the SEC also is taking steps to improve the efficiency, effectiveness, and overall management of how the agency addresses whistleblower tips, complaints, and referrals, and how its staff uses the information received to protect investors. The SEC has retained a federally-funded research and development center to review the agency's internal procedures for evaluating whistleblower tips, complaints, and referrals.

Also, although in the early stages, there has been active discussion within the SEC about whether to broaden the whistleblower statutes so as to allow (among other things) monetary reward for tips. SEC Chair Schapiro has cited the Internal Revenue Service's whistleblower scheme as a potential model. According to Schapiro, the SEC receives between 750,000 and one million tips per year, and encouraging whistleblowers to come forward would assist the under-staffed agency with its enforcement efforts.

As these securities regulators move aggressively to improve the use of whistleblower tips and complaints, securities firms could well become subject to greater regulatory scrutiny and increased enforcement action.

Scrutiny of Madoff Feeders Has Wide Implications

BY LIAM BURKE

Recent scrutiny of Madoff "feeder" funds is raising the due diligence and disclosure sensitivities of investment funds that place money with other investment managers, even where the ultimate investment manager has no connection to Madoff.

Much of this scrutiny has come from state and federal authorities. For example, the largest feeder fund to Madoff, Fairfield Greenwich Group, has been sued by Massachusetts regulators. The complaint alleges that Fairfield Greenwich Group failed to perform the level of due diligence that it promised to its customers, while ignoring red flags and collecting large fees. In another recent suit, the New York Attorney General filed a civil fraud action against J. Ezra Merkin in connection with investments his Ariel Fund made with Madoff. Like the Massachusetts suit, New York's suit alleges that Merkin failed to disclose that investors' money was going to Madoff and ignored irregularities and other red flags concerning Madoff's investments. Additionally, the SEC and at least one U.S. Attorney are reportedly investigating Madoff feeder funds to determine whether the funds told investors that their money was invested with Madoff and whether the feeders disclosed to investors that they were receiving fees from Madoff for doing business with him.

In addition to such governmental actions, numerous private lawsuits have been instituted against funds and advisers that fed their customers' assets to Madoff. These lawsuits make numerous allegations that are similar to the authorities' concerns outlined above.

Both governmental and private actions concerning the Madoff feeders will doubtless continue to proliferate. Moreover, many of the principles on which such actions are based will doubtless also apply to funds and advisers who feed their customers' assets to other, non-Madoff, investment managers. It may be only a question of time, therefore, until the authorities and private litigants turn their sights to the due diligence and disclosure practices of such non-Madoff feeders.

SEC Filing Fee Relief for Certain Annuity Contracts

BY PETER PANARITES

The SEC staff has issued a no-action letter allowing retroactive payment of filing fees in connection with variable annuities funding certain tax-qualified pension or profit-sharing plans or governmental plans. The letter covers cases where the variable annuity is registered under the Securities Act of 1933, but the insurance company separate account supporting the variable annuity has not been registered under the Investment Company Act of 1940, in reliance on the registration exclusion Section 3(c)(11) thereof.

Until now, 1933 Act filing fees in connection with this type of variable annuity have had to be paid in advance, based on estimates of the dollar amount of variable annuity sales. Thus, careful monitoring has been necessary to assure that sales do not exceed the specified amount registered. By contrast, in connection with variable annuities supported by separate accounts that are registered under the 1940 Act, the 1933 Act filing fees are paid pursuant to 1940 Act Rule 24f-2, once a year on an after-the-sale basis. Thus, the worry of "over sales" is eliminated. Rule 24f-2 also permits redemptions to be "netted" against sales during a given year, thus reducing fees due.

Under the no-action letter, dated February 26, 2009, 1933 Act filing fees in connection with the types of variable annuities covered by the letter can be paid in reliance on Rule 24f-2 substantially as if the separate account involved was 1940 Act registered. Moreover, we have informally confirmed with the SEC staff that, where the facts are the same in all material respects, other insurance company issuers also may rely on the February no-action letter.

This no-action letter raises the question whether the staff might also agree to similar retroactive filing fee payment procedures for other types of insurance products registered under the 1933 Act, but not the 1940 Act, such as market value adjustment contracts, so-called "synthetic" annuities and fixed indexed annuities.

Mark your Calendars

The 2009 NAVA Operations & Technology Conference will be held June 28 through July 1, 2009 in Boston, MA. **Michael Kentoff**, who serves on the planning committee for this conference, will be moderating a panel on "Defending the Castle: Why You Must Know How to Authenticate E-Documents." **Gary Cohen** will be discussing Indexed Annuities on a separate panel.

Will One Size Fit All?

BY TOM LAUERMAN

In recent congressional testimony, the president of the Securities Industry and Financial Markets Association (SIFMA) recommended the formulation of a "universal standard of care" that would express fundamental principles of fair dealing that individual investors can expect from all of their financial services providers. The same standard would apply regardless of whether the service provider is, for example, a financial planner, investment adviser, securities broker-dealer, bank, or insurance agency.

This is one of many recent proposals to reconcile or harmonize the currently disparate duties that different types of financial service providers owe to their customers. Investment advisers, for example, generally owe a fiduciary duty to their customers, whereas securities broker-dealers generally are subject only to lesser duties of fair dealing.

SIFMA's proposed universal standard presumably would be lower than the standard currently applicable to providers who are fiduciaries, which would cause controversy. Continued applicability of fiduciary duties for at least some providers is favored by, among others, the Financial Planning Association, the North American Securities Administrators Association, the President of the Investment Company Institute, the Investment Adviser Association, and the Consumer Federation of America.

Because of the recent tenure of SEC Chair Schapiro and Commissioner Walter as senior FINRA officers, some supposed they would be sympathetic to FINRA's proposal. However, both Schapiro and Walter, as well as Commissioner Aguilar, have made recent statements recognizing the merits of fiduciary duties with respect to at least some types of financial services.

While there is broad agreement that providers of comparable financial services should be subject to comparable duties to their customers, there seems much less agreement on whether a single standard in this regard should apply for all types of financial services or whether any such standard should be a fiduciary standard.

"Manifest Disregard of Law" Perhaps Not Fatal to Arbitration Awards

BY LYNDA CHANG

An arbitrator's "manifest disregard of the law" is no longer a ground for vacating an arbitration award, according to the Fifth Circuit. In other circuits, however, this ground for vacatur may have some continuing vitality.

In the Fifth Circuit, manifest disregard has been a difficult standard to satisfy, as it has required a readily-perceived error by an arbitrator who appreciated, but ignored, the existence of a clearly governing principle. Nevertheless, like most circuits, the Fifth Circuit had come to recognize manifest disregard as a nonstatutory basis for vacatur.

The Fifth Circuit recently changed all of this in *Citigroup Global Markets Inc. v. Bacon*, an appeal of a lower court's vacatur of a FINRA securities arbitration award. The court concluded that it was bound to follow a 2008 Supreme Court holding to the effect that the four statutory grounds set forth in Section 10 of the Federal Arbitration Act are the exclusive grounds for vacatur.

Award would still stand in Fifth Circuit

Does the Supreme Court's holding reduce the likelihood in all circuits that broker-dealers will prevail on their motions to vacate? Perhaps not. Manifest disregard persists as a relevant concept in at least three circuits that have since considered this issue.

The Sixth Circuit, for example, has construed the Supreme Court's holding only to invalidate any agreement by the parties to expand the statutory grounds for review. The Sixth Circuit does not otherwise foreclose a court's review of an arbitrator's manifest disregard of the law. Moreover, the Ninth and Second Circuits have concluded that, despite the Supreme Court's holding, manifest disregard of the law remains a relevant consideration in applying one of the statutory grounds. To date, only the Fifth Circuit has definitively held that such manifest disregard is no longer a "useful" concept in actions to vacate arbitration awards.

Denial of Class Certification Does Not Divest Court of CAFA Jurisdiction

BY TODD FULLER

The District Court for the Western District of Louisiana ruled recently that federal courts retain jurisdiction under CAFA even after class action status has been denied. In *Kitts v. Citgo Petroleum Corp.*, plaintiffs commenced a class action in Louisiana state court alleging that they suffered health problems after a nearby Citgo facility allegedly released dangerous chemicals during a 2006 oil spill. Citgo removed the action to federal court pursuant to CAFA. Following nearly eighteen months of litigation in federal court, and less than a week before trial, the plaintiffs sought to remand the action arguing that the district court's denial of their class certification motion stripped the court of jurisdiction. The court, however, disagreed. Although the court recognized that some district courts have held that remand is warranted when post-removal activities affect the original basis for removal, the court found more "compelling the reasoning of those cases finding jurisdiction continues to exist even after denial of the class action." The court found "[p]articularly appropriate" the conclusion reached by the Southern District of Florida in the similarly postured *Colomar v. Mercy Hospital, Inc.* case, which held that developments subsequent to removal do not affect the courts' jurisdiction, if jurisdiction was proper at the time of removal. Relying on the *Colomar* decision the court noted that, since plaintiffs conceded that this matter was properly removed under CAFA, "plaintiffs' current efforts to unravel jurisdiction 'equates to a forum shopping which the traditional rules of removal and remand are designed to preclude.'"

No "forum shopping"

Class Certification Denied In Option ARM Loans Case

BY MICHAEL SHUE

In *Jordan v. Paul Financial LLC*, the District Court for the Northern District of California denied class certification for all classes of payment-option adjustable-rate mortgage (option ARM) purchasers sought in the action. Option ARM loans, which the plaintiff claimed were "deceptively designed," typically have an adjustable interest rate and allow the borrower to make one of several payment amounts each month. Specifically, Plaintiff alleged that he was promised a low, fixed rate but was later charged a much higher rate and was misled about the potential for negative amortization created by some of the payment options. Plaintiff sought to represent three classes: a nationwide class in connection with claims brought under the Truth in Lending Act (TILA) and two classes based on claims under California law. The Court denied certification of the nationwide TILA class because plaintiff's TILA claim was barred by the statute of limitations. The court denied certification of the California classes because plaintiff could not satisfy the "traceability" requirement for standing, finding that "members of the putative class own loans that are held and serviced by entities other than the companies that hold and service plaintiff's loan." The court also addressed whether plaintiff satisfied the typicality requirement of Rule 23(a)(3), concluding that plaintiff's claims were not suitable for class certification because of unique circumstances in his case, including specific available defenses and contract terms. The *Jordan* opinion is the first to rule on class certification among the over 40 option ARM class actions currently pending nationwide.

Mortgage related class action denied

"Local Controversy" Exception To CAFA Jurisdiction Clarified

BY FARROKH JHABVALA

In *Kaufman v. Allstate New Jersey Insurance Co.*, the Third Circuit tackled several issues of first impression regarding CAFA's "local controversy" exception. Nine plaintiffs sued six insurance companies in New Jersey state court alleging that the defendants did not pay "diminished value" claims, suffered because an automobile loses value if it is damaged in an accident even though it may be completely repaired. The plaintiffs sought a New Jersey-only class. The plaintiffs subsequently dismissed three New Jersey insurers, leaving Allstate New Jersey as the only in-state defendant. After the case was removed the plaintiffs sought a remand under CAFA's local controversy exception. The district court granted remand. The Third Circuit granted the defendants' petition for review, ultimately vacating in part and remanding to the district court for further consideration.

"Local controversy" clarified

Although federal diversity jurisdiction is generally determined on the facts prevailing at the time a suit is filed, the Third Circuit concluded that the local controversy exception requires consideration of only those defendants who are in the action at the time of removal. The court joined four other circuits in holding that once CAFA jurisdiction is established, it is plaintiffs' burden to demonstrate that the local controversy exception applies. The case concerned two provisions of the local controversy exception to CAFA jurisdiction: that the action include at least one local defendant "whose alleged conduct forms a significant basis for the claims asserted by the proposed plaintiff class," and that "principal injuries resulting from the alleged conduct or any related conduct of each defendant were incurred in the State in which the action was originally filed." On these issues of first impression, the Third Circuit ruled that the "significant basis" provision requires at least one local defendant whose alleged conduct forms a significant basis for all the claims asserted in the action, but does not require that every member of the proposed plaintiff class have a claim against the local defendant. The "principal injuries" requirement is satisfied either when principal injuries resulting from the alleged conduct of each defendant are incurred in the state in which the action was filed, or when principal injuries resulting from any related conduct of each defendant are incurred in that state.

Class Action Arbitration Waiver Unenforcable Under NJ Law

BY ELIZABETH BOHN

The Third Circuit recently refused to uphold a class action arbitration waiver in a credit card agreement as void against public policy under New Jersey law. In *Homa v. American Express Company*, class plaintiffs sued in New Jersey District Court claiming that Amex had misrepresented terms of a rewards program in violation of New Jersey law. The cardholder agreement provided for arbitration of all claims on an individual basis, and that it was governed by Utah law. Utah law expressly allows class-arbitration waivers. However, such waivers violate New Jersey state public policy. Amex attempted to invoke the class action arbitration waiver, arguing that Utah law should apply. But applying New Jersey state choice of laws rules, which prohibit enforcement of contractual choices which violate state public policy, the court found that the class action waiver provision could not be enforced under New Jersey public policy.

In applying a state choice of law analysis, the decision closed the door on a potential Federal Arbitration Act (FAA) argument that the FAA preempts state law on class action waivers in the Third Circuit. The Ninth Circuit has already reached the same conclusion. Thus, arbitration clauses may not prevent class exposure in key consumer states, even where the agreements expressly provide that they are to be construed under the law of a state which permits such class action waivers.

Courts Split on FACTA Truncation Requirements For Internet Receipts

BY ELIZABETH BOHN

The FACTA states that "no merchant shall print more than the last 5 digits of the card number or the expiration date upon any receipt provided to the cardholder." In *Vasquez-Torres v. Stubhub*, Inc. the District Court for the Central District of California held that these requirements apply to receipts viewed or printed from one's home computer in connection with an internet sale. In the court's opinion, the display of information on the plaintiff's computer screen satisfied a definition of "print" from Webster's Dictionary: "to make an impression upon." But in *Smith v. Zazzle* and *Smith v. Underarmour*, the Southern District of Florida reached the opposite conclusion, finding the FACTA truncation requirements inapplicable to internet receipts. The Florida district court granted the internet retailers' motions to dismiss in both cases, holding that the statutory term "print" as used in FACTA meant the imprinting of something on paper or other tangible surface. Accordingly, in this court's view, the internet receipt that was automatically displayed on a computer screen was not subject to FACTA's truncation requirement. The *Zazzle* court explained that FACTA uses the phrases "point of the sale" and "any cash register or other machine or device" to describe the type of printing that is prohibited, thereby evincing an intent that the term "print" refer to the merchant's imprinting of information on a paper receipt from a device such as a "cash register" at the point of the sale. *Zazzle* and *Underarmour* followed recent similar rulings in the Southern District of Florida in *Grabein v. Jupiterimages Corp.* and *Haslam v. Federated Dep't Stores, Inc.*

Opposite decisions on FACTA

Arbitration Roundup

BY LANDON CLAYMAN

The U.S. Supreme Court issued several decisions construing the Federal Arbitration Act. In *Vaden v. Discover Bank*, a credit card issuer filed suit in state court against a cardholder to collect on past-due charges, and the cardholder responded with a class action counterclaim, alleging that Discover Bank's demands violated state credit laws. Discover Bank then filed a petition in federal district court under §4 of the FAA to compel arbitration of the state court counterclaim pursuant to the card agreement's arbitration provision. Discover Bank argued federal question jurisdiction was present because the counterclaim was preempted by federal banking laws.

The Court held the federal district court should determine federal question jurisdiction by "looking through" the §4 petition to ascertain whether "the controversy between the parties" arises under federal law. However, the Court also held that federal question jurisdiction in such a case could not be premised on a counterclaim, even if it were completely preempted by federal law. Accordingly, the federal courts lacked jurisdiction to entertain the §4 petition.

In *Arthur Andersen LLP v. Carlisle*, plaintiffs brought suit in federal district court concerning an unsuccessful tax shelter arrangement. Various defendants moved pursuant to §3 of the FAA to stay the action, contending principles of equitable estoppel required plaintiffs to arbitrate even though the moving defendants were not signatories of the relevant arbitration agreement. The trial court denied the stay, and the Sixth Circuit dismissed the interlocutory appeal brought under §16(a)(1)(A) of the FAA.

The Supreme Court reversed, rejecting the reasoning that §3 affords a stay only to signatories of an arbitration agreement, and that therefore the §16(a)(1)(A) requirement that the appeal be from the denial of a stay "under section 3" would deprive non-signatories of an appeal. The Court disapproved this "conflating" of the appellate jurisdictional question with the merits of the appeal, and held that by its terms §16(a)(1)(A) allowed an appeal of the denial of a §3 stay regardless of the underlying merits. The Court further held that §3 stays are not limited to "disputes between parties to a written arbitration agreement[,]" but also are available when an arbitration provision "is made enforceable against (or for the benefit of) a third party under state contract law." Thus, §§ 3 and 16(a)(1)(A) of the FAA do not discriminate between signatories and non-signatories of arbitration agreements.

NEWS & NOTES

Speeches and Publications

Joan Boros wrote "Index Life's Status More Uncertain than Ever" in the March 2, 2009, issue of *National Underwriter: Life & Health.*

Gary Cohen spoke at PLI's Investment Management Institute, April 2-3, 2009 in New York City. He addressed hot topics in insurance products regulated by the SEC.

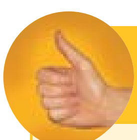
Steve Kass spoke at the Understanding Insurance Law 2009 PLI Conference. His presentation, "Life Insurance Fundamentals and Emerging Issues," was held April 7, 2009 in New York City.

Elizabeth Bohn presented "Loan Workouts and Bankruptcy" at the Spring meeting for the ABA Business Law Section on April 17, 2009, in Vancouver, BC.

Diane Duhaime moderated a program called "LinkedIn®, Facebook® and Twitter Understanding Online Social Networking for Lawyers." The program was part of the Hartford County Bar Association CLE Program in Hartford, CT.

Gary Cohen spoke at the NAFA Annuity Summit and Annual Meeting on May 7, 2009. Mr. Cohen gave a luncheon address on *"The Political Mind is a Terrible Thing to Waste – The Ins and Outs of the 151A Rule-making Process."*

Joan Boros wrote "The SEC and Innovation in Annuities: What Is Needed" in the June 1, 2009 issue of *National Underwriter: Life & Health.*



Congratulations!

Shaunda Patterson-Strachan was elected to the eight-member Executive Committee of the ABA Judicial Division's Lawyers Conference in March 2009. The Conference provides a forum for private practitioners to work directly with members of the judiciary on a variety of issues, including efforts to improve the administration of justice, the courts, and the judicial process, and to advance confidence in the judiciary. Ms. Patterson-Strachan's term runs through 2011.

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