EXPECTFOCUS®

VOLUME II 2010

Set Another Plate

More Regulators on the Way

JORDEN BURT LLP

EXPECT**FOCUS**® Vol. II 2010

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

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Moira Demyan
mfd@jordenusa.com

www.expectfocus.com

INTHE**SPOTLIGHT**

Supreme Court Torpedoes Class Arbitration Under Silent Clause

BY FARROKH JHABVALA

In a 5-3 decision, the U.S. Supreme Court struck a major blow against class action arbitrations where the arbitration clause is "silent" as to whether the parties intended to allow class arbitration. In *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, the Supreme Court reversed the Second Circuit Court of Appeals and held that "a party may not be compelled under the Federal Arbitration Act to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so." [Emphasis in the original.] Because the parties in the case stipulated that the arbitration provision was silent, and they had reached "no agreement" on that issue, the Court concluded, "it follows that the parties cannot be compelled to submit their dispute to class arbitration." The decision does not firmly shut the door on all class arbitrations under "silent" clauses, but it sets a very high bar for parties seeking class arbitrations under such clauses.

Arbitration matter of consent, not silence

The decision is based on the long-standing FAA law that "arbitration is a matter of consent, not coercion," that "private agreements to arbitrate are enforced according to their terms," and that arbitrators draw their powers from the parties' agreement and must "give effect to the contractual rights and expectations of the parties." In particular, the Court explained that parties "may specify *with whom* they choose to arbitrate their disputes." [Emphasis in original.] The Court concluded from these fundamental principles that the arbitration panel failed to follow the relevant law, "imposed its own policy choice" upon the parties, and "imposed class arbitration even though the parties concurred that they had reached 'no agreement' on the issue." Thus, the "panel's conclusion [was] fundamentally at war with the foundational FAA principle that arbitration is a matter of consent", and the panel "exceeded its powers." In support of its decision, the Court analyzed the benefits of bilateral arbitration – lower costs, greater efficiency and speed, the ability to choose expert arbitrators, and confidentiality – which would be lost in a class arbitration, and concluded that class arbitration "changes the nature of arbitration to such a degree that it cannot be presumed the parties consented to it by simply agreeing to submit their disputes to an arbitrator."

The decision also states that *Green Tree Financial Corp. v. Bazzle*, which has been used to justify class arbitrations under silent clauses, "did not establish the rule to be applied in deciding whether class arbitration is permitted." Plainly, that rule has now been established by *Stolt-Nielsen*.

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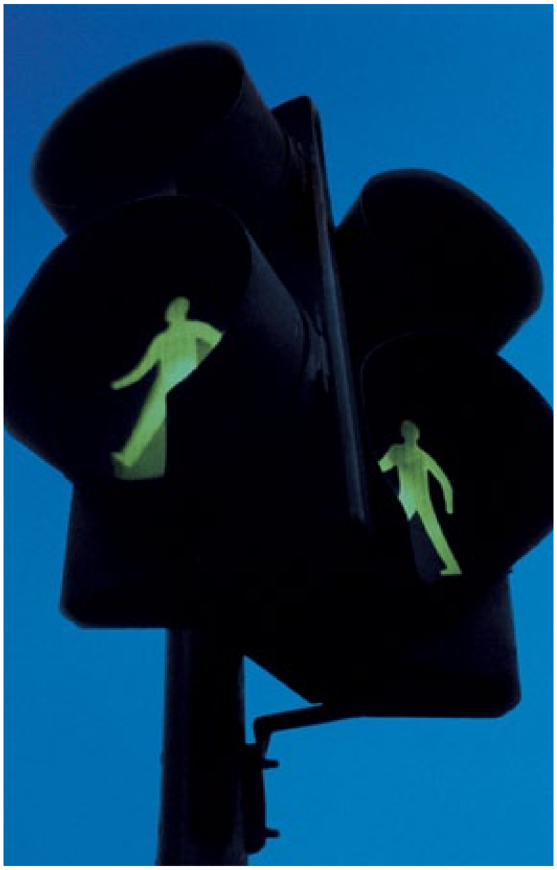
Supreme Court Reaffirms Rule 23 Dominance

BY JASON MORRIS



Supreme court ruling may send mixed signals to lower courts

In a modern sequel to the famous *Erie R.R. Co. v. Tompkins* decision, the Supreme Court, in a splintered March 23, 2010 opinion, held that Federal Rule 23 controls when a class action lawsuit may be pursued in federal court. Given the different rationales espoused by the concurring justices, however, the states might sidestep this result by adopting subtle language in future legislation.

Writing for the 5-4 majority in *Shady Grove Orthopedic v. Allstate Ins. Co.,* Justice Scalia rejected the Second Circuit's view that Rule 23 and a New York law banning certain class action claims seeking statutory penalties could live harmoniously. Scalia, calling Rule 23 "a one-size-fits-all formula for deciding the class-action question," reasoned that the Court "cannot contort its text, even to avert a collision with state law that might render it invalid." Scalia found that Rule 23 was valid under the Rules Enabling Act, as "it is not the substantive or procedural nature or purpose of the affected state law that matters, but the substantive or procedural nature of the Federal Rule."

Justice Stevens concurred that the federal and state rules were conflicting and that Rule 23 was valid under the Rules Enabling Act, but he did so by different reasoning, arguing that the Rules Enabling Act requires courts to focus on both the state law affected and the federal rule. In short, the federal rule applies so long as it does not displace a state law that defines substantive rights.

Stevens' rationale is controlling, under *Marks v. United States*, because his rationale was the narrowest ground for concurrence in the judgment. However, given the fractured nature of the opinion, the lower courts are likely to struggle with this issue.

California Supreme Court to Rule on the Extent Unfair Competition Laws Apply to Insurance Companies

BY BRIAN PERRYMAN

On February 10, 2010, the California Supreme Court granted review in the appeal of *Zhang v. Superior Court*. The lower appellate court held that alleged fraudulent conduct by an insurer which would violate California's Unfair Insurance Practices Act (UIPA) can give rise to a private civil action under California's Unfair Competition Law. Earlier, in *Moradi-Shalal v. Fireman's Fund Insurance Companies*, the California Supreme Court held that UIPA does not afford private litigants a right of action. In 2004, another intermediate appellate court extended this ruling to also bar any derivative liability under the Unfair Competition Law. The questions now certified for review by the high court are: "(1) Can an insured bring a cause of action against its insurer under the unfair competition law (Bus. & Prof. Code, § 17200) based on allegations that the insurer misrepresents and falsely advertises that it will promptly and properly pay covered claims when it has no intention of doing so? (2) Does *Moradi-Shalal v. Fireman's Fund Ins. Companies* (1988) 46 Cal.3d 287 bar such an action?" No argument date has been set.

Broker Protocol Sees Membership Growth

BY MICHAEL PETRIE

As a result of an increasingly competitive business environment, financial advisors appear to be moving from one firm to another with more frequency. Better compensation, increased freedom, more competitive transaction costs and the ability to better serve clients are routinely cited as reasons. Litigation against departing financial advisors and their new firms was frequently associated with such moves, as brokerage firms sought to prevent financial advisors from walking off with lucrative business. Because of fiduciary and contractual commitments advisors owed to their former firms, such lawsuits often involved charges of breach of fiduciary duty, breach of non-compete and non-solicitation agreements, unfair competition, theft of confidential trade secrets and the like.

In 2004, to stem expensive litigation, three large wirehouses created what has become known as the "Broker Protocol," which sets forth specific procedures and restrictions that advisors must abide by when transferring from one signatory firm to another. So long as the terms of the Broker Protocol are followed, the signatory firms agree there will be no litigation. Signatory firms agree to follow certain practices for recruiting advisors, departing advisors are permitted to take certain information about their clients, and advisors are allowed to solicit their former clients after their departure. Although adoption was initially slow, since November 2009, the number of signatory firms has surged from around 380 to over 450, suggesting that firms may be coming to grips with the reality that advisors moving from one firm to another is just business as usual. However, we continue to see instances in which the Broker Protocol is not adhered to.

Florida Legislature Passes "Safeguard Our Seniors Act"

BY STEVEN KASS

On April 30, 2010, the Florida Legislature passed the "Safeguard Our Seniors Act," which modifies a number of provisions of Florida insurance law relating to the sale of annuity products and, to a lesser extent, life insurance to persons aged 65 and over. The Act has since been signed into law by Florida's Governor, and its effective date will be January 1, 2011.

Leading up to this Legislative action, Florida's Department of Financial Services had been holding workshops and seminars to draw seniors' and legislators' attention to the need for "tougher senior investor fraud laws." The Act will affect insurers' sales of annuities to seniors by: (i) limiting surrender charges to 10% and the surrender charge period to 10 years (subject to certain exemptions, including sales to accredited investors); and (ii) lengthening free look periods to 21 days. The Act also requires insurers selling annuities, whether to seniors or non-seniors: (i) to provide a policy cover sheet, which will be part of the policy form and thus required to be filed for approval, informing the purchaser about the free look period, and providing contact information for the insurer, producer, and the Department together with any other information the Department may require by rule; and (ii) to deliver "Buyer's Guides" at or prior to policy delivery in the form required by the NAIC Annuity Disclosure Model Regulation until the Department promulgates its own Buyer's Guide (or for variable annuities, a policy summary until the NAIC or the Department promulgates a Buyer's Guide). The Act will impact producers by, among other things, providing for enhanced penalties for wrongful conduct, empowering the Department to require producers to make restitution, and enhancing the Department's license suspension and revocation powers.

Various provisions of the Act will impose administrative burdens on insurers and necessitate action before the law takes effect, such as the filing for approval of the cover sheet forms and modifications of policy administration systems to accommodate printing of the producer's contact information on each contract's cover sheet. Likewise, if contract forms do not currently comply with the Act's free look and/or surrender charge percentage and period requirements, insurers will need to file for approval new forms as well as decide whether those new forms will apply to all sales or only senior sales. Having different forms and/or contract terms, depending on whether the purchaser is a senior, may also give rise to practical administrative difficulties.

Supreme Court Rejects "Prevailing Party" Standard for ERISA Fee Awards

BY ROBIN SANDERS

On May 24, 2010, the U.S. Supreme Court issued its decision in *Hardt v. Reliance Standard Life Insurance Company*, which interpreted the parameters of ERISA's discretionary fee-shifting provision, 29 U.S.C. § 1132(g)(1). In a unanimous decision (Justice Stevens concurring), the Court held that ERISA § 502(g)(1) permits lower courts the discretionary authority to award attorney's fees to either party, so long as the party has "achieved 'some success on the merits.'" [Quoting *Ruckelshaus v. Sierra Club*, 463 U.S. 680, 694 (1983)]. The Court reached this decision by interpreting § 502(g)(1)'s "plain and unambiguous statutory language," concluding that § 502(g)(1) does not limit the award of statutory attorney's fees to prevailing parties, but instead, gives courts "'discretion' to award attorney's fees 'to either party.'" [Emphasis in original]. The Court commented that, based on the language contained in ERISA's other fee-shifting provision (§ 502(g)(2)(D)), which permits the recovery of attorney's fees for "plaintiffs who obtain 'a judgment in favor of the plan,'" Congress clearly intended to give either party the ability to recover attorney's fees pursuant to § 502(g)(1).

After concluding that either party may recover fees pursuant to § 502(g)(1), the Court then addressed the standard under which such fees may be recovered. Based on its prior precedent in *Ruckelshaus*, the Court held that, although a party need not be a "prevailing party" in the traditional sense of the phrase, a party must have had "some degree of success on the merits." To satisfy the "some degree of success on the merits" standard, a claimant must have achieved more than "'trivial success on the merits' or 'a purely procedural victor[y].'" [Quoting *Ruckelshaus*, alterations in original]. A district court may exercise its discretion to award attorney's fees when it "can fairly call the outcome of the litigation some success on the merits ... ." Because the outcome of the action was largely dependent on the specific facts of the *Hardt* case, the "some degree of success on the merits" standard enunciated by the Court will no doubt continue to be litigated and clarified through future decisions in the lower courts.

Scribner, Hall & Thompson, LLP

What Is an Annuity?

BY SUSAN J. HOTINE & JANEL C. FRANK

Last year, the IRS issued three rulings (PLRs 200949007 (Jul. 30, 2009), 200949036 (Jul. 30, 2009) and 201001016 (Sep. 14, 2009) that address whether contracts for stand-alone withdrawal benefits, referred to as "contingent annuity contracts," will be treated as annuity contracts under I.R.C. § 72. In each ruling, an individual ("owner") will purchase a certificate of a group contract, which qualifies as an annuity under state law. The certificates will be sold to the owner in conjunction with opening an investment account with a financial institution ("sponsor"). Investments for the account are prescribed by the insurance company and are limited to publicly-traded securities. The owner is permitted to withdraw a specified annual amount from his account and will receive that amount as periodic payments for life if/when the account is reduced to zero for any reason (other than the withdrawal of amounts in excess of the permitted annual withdrawal amount). The certificate has no cash surrender value.

Because "annuity" and "amounts received as an annuity" have not been defined, the IRS considered other sources to determine whether the certificates in these rulings would be considered annuities under I.R.C. § 72(a). Significantly, however, the IRS did not seem to consider I.R.C. § 72(s), which prohibits treatment as an annuity unless the contract provides certain death-of-the-owner distribution rules. Since its adoption, practitioners have questioned whether specific contract language is required under I.R.C. § 72(s) and whether death-of-the-owner distribution rules have any application to contracts with no cash value. One might conclude, by lack of its being mentioned, that I.R.C § 72(s) is not relevant for the contracts in these rulings, perhaps because they have no cash value. We understand, however, that the IRS did require the I.R.C. § 72(s) language in at least one of the group contracts, even though there is no mention of this fact in any of these rulings.

Regulators Contemplate Preventing Stranger Originated Annuity Transactions

BY SCOTT SHINE

Insurance regulators are concerned about harm to consumers that arises in stranger originated annuities transactions (STATs). On May 20, 2010, the NAIC held a public hearing as it deliberated whether current laws and regulations need to be revised or new laws and regulations need to be developed to prohibit these types of transactions.

In a STAT, a third party investor initiates the purchase of an annuity for investment purposes. The investor finds a terminally ill individual on whom the investor purchases a variable annuity that offers guaranteed minimum death benefits (GMDBs). Through the GMDBs the investor receives at the death of the annuitant, at a minimum, a full return of the purchase price. Thus, an investor can reap the potential gains of an up-market with essentially no risk of loss in the event of a down-market.

At the May 20 hearing, the Committee received testimony from regulators, industry leaders and victims of STATs. The presenters discussed how insurers could prevent STATs. Some of the actions that have been proposed include:

- Inquiring about the health of the annuitant and about the relationship between the annuitant and the owner during the application process;
- Adding attestation clauses to the application regarding the purpose of the annuity purchase; and
- Adjusting agent commissions for policies annuitized within the first year of the contract.

The presenters also discussed the extent to which state insurable interest statutes could be applied to prohibit STATs and that STATs run afoul of the public policy that prohibits wagering on the death of a person. Many of the presenters believed that the various insurance and securities regulations are sufficient to protect consumers. Another point of discussion was how anti-rebating laws could be applied to STATs. ACLI offered that it is working with its members to assess the prevalence of these transactions.

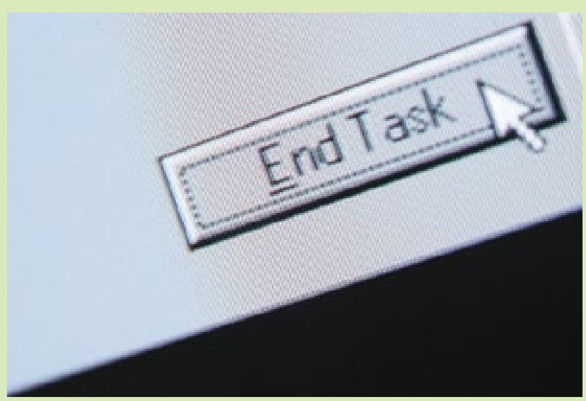
Any action taken would be complementary to standards for GMDBs for individual deferred annuities adopted on February 22, 2010 by the Interstate Insurance Product Regulation Commission. These standards permit the GMDB form to include provisions for termination of the GMDB feature upon assignment or a change in ownership where the new owner or assignee is not essentially the same person as the prior owner.

The End for Embattled Rule 151A?

BY GARY COHEN & KRISTIN SHEPARD

At press time, the House and Senate Committees charged with finalizing the pending financial reform legislation have approved an amendment that, in effect, overrules SEC Rule 151A. The financial reform legislation is now headed to the full House and Senate for a vote; if approved by both houses, it could be on the President's desk for signature before the 4th of July recess.

In addition to this legislative attack, Rule 151A has been under legal attack in the U.S. Court of Appeals for the District of Columbia Circuit, which previously held that the SEC arbitrarily and capriciously failed to analyze the impact of the Rule on efficiency, competition and capital formation. The court invited briefing on the proper remedy for the SEC's failure to conduct the required analysis, with the insurance industry petitioners arguing that the Rule should be vacated. The SEC had told the court that it expected its staff to complete the analysis and bring a recommendation to the Commission "in the Spring of 2010" and asked that the Rule be stayed in the interim. However, the SEC, on June 18, 2010, filed a "Status Report" in the litigation, which, instead of containing an update on the promised analysis and recommendation, referred the court to the pending anti-151A legislation in Congress.



End of the road for Rule 151A

Fraud Not Necessary For Policy Rescission

BY JONATHAN STERLING

In *National Bank of Andover v. Kansas Bankers Sur. Co., et al,* the Kansas Supreme Court rejected the argument that rescission of an insurance policy is only proper where the insured knowingly or fraudulently includes incorrect information on an insurance application.

In 2002, the National Bank of Andover (Bank) submitted to Kansas Bankers Surety Company (KBS) a financial institution crime bond renewal application form. The application contained representations that the Bank had in place certain internal controls. The Bank agreed that any misrepresentation, omission, concealment or incorrect statement of a material fact in the application would be grounds for rescission of the policy.

Shortly after the renewal application was submitted, the Bank learned that its accounting clerk had cashed checks for three customers despite knowing the customers had insufficient funds in their accounts to cover the checks. The clerk's actions resulted in a loss to the Bank of approximately $900,000. The Bank submitted a proof of loss statement to KBS seeking to recoup this amount.

KBS investigated the claim and found that the Bank had provided false answers to the internal control questions on the application. KBS commenced a declaratory action to rescind the policy, and a separate action was commenced by the Bank claiming that KBS breached the parties' contract. In the trial of the consolidated action, the Bank argued that only a fraudulent, and not simply a negligent misrepresentation was a proper basis for the rescission of the policy. The trial court instructed the jury that it must find a fraudulent misrepresentation by the Bank on the application for the rescission to have been proper. The Kansas Supreme Court reversed the jury's verdict in the Bank's favor, holding that KBS could have properly rescinded the policy for less serious than fraudulent misconduct. The court found that the policy provision allowing for rescission of a contract between two sophisticated commercial entities, did not contravene public policy and was not illegal.

Policy rescission not due to rubber checks

Bad Faith Claim Survives Summary Judgment Despite No Duty to Defend or Indemnify

BY JIM GOODFELLOW

In *North Seattle Community College Foundation (the Foundation) v. Great American E & S Insurance Co. (Great American)*, the U.S. District Court for the Western District of Washington concluded that even though Great American had no duty to defend or indemnify its insured, whether it acted in bad faith nevertheless raised genuine issues of material fact that precluded summary judgment.

The Foundation, which operated a credit counseling service, was sued in Georgia for allegedly violating the cap on fees imposed by Georgia's Debt Adjusting Act. The Foundation had a professional liability policy issued by Great American that excluded coverage for statutory penalties incurred and disgorgement of monies improperly collected.

When the Foundation notified Great American of the lawsuit, Great American declined to provide coverage, but allegedly did not communicate a definitive coverage position, merely stating that it had serious questions about coverage. The Foundation ultimately settled the underlying suit.

Great American later sued the Foundation in Georgia, seeking declaratory judgment regarding coverage. The Foundation successfully had the suit transferred to Washington, where it had initiated its own suit for breach of contract and bad faith. Both parties moved for summary judgment. While the court concluded that Great American had no obligation to defend or indemnify the Foundation because of the policy exclusion, it found that there was a genuine issue of material fact as to whether Great American acted in bad faith in failing to communicate a definitive coverage position, and then suing the insured without warning. The court stated that straightforward communication with the Foundation, rather than equivocation, could have benefitted the Foundation during underlying settlement negotiations. The court further found that Great American's decision to sue in Georgia caused the Foundation to incur unnecessary expenses associated with transfer of the action to Washington.

First Chinese Drywall Rulings Noxious for Insurers

BY LIAM BURKE & DAN CRISP

The first substantive rulings in the ubiquitous Chinese-made drywall litigation indicate a growing headache for property insurers. In the Eastern District of Louisiana – where federal cases involving Chinese-made drywall have been consolidated – the court awarded seven Virginia families a total of $2.6 million in damages against a Chinese drywall manufacturer. The award was based on, among other things, the cost of repair, damages for lost use and enjoyment of the home, and alternate living expenses that the families will incur while their homes are being repaired. Significantly, the court held that the seven homes at issue represented a cross section of all homes affected by Chinese-made drywall. The thorough 108-page opinion is likely to provide plaintiffs with a roadmap for future lawsuits. A second decision (by the same judge) followed suit, reaching similar conclusions and awarding plaintiffs $164,049.64, plus attorneys' fees and costs.

Meanwhile, a Louisiana state court judge granted the plaintiff homeowners' motion to strike three policy exclusions that were asserted as affirmative defenses to coverage by the defendant insurer. Addressing each exclusion in turn, the court first ruled that the "Pollution or Contamination" exclusion did not apply, as the damage did not affect the "environment" and the various gases released by the drywall did not qualify as a "pollutant." Next, the court found the "Gradual or Sudden Loss" exclusion inapplicable, reasoning that the plaintiffs' losses related to drywall "off-gassing," not gradual deterioration. The court also addressed the "Faulty, Inadequate or Defective Planning" exclusion, finding the exclusion inapplicable because the defect does not render the drywall incapable of performing its purpose.

These decisions signal a potentially long and expensive road for property insurers, as more than 3,700 claims reportedly have been asserted across 37 states relating to the use of Chinese-made drywall.

Consumer Product Safety Commission Recommends Removal of All Chinese Drywall

BY LIAM BURKE

The U.S. Consumer Product Safety Commission (CPSC) and the Department of Housing and Urban Development (HUD) recently recommended that consumers whose homes were built using certain Chinese-made drywall have their homes gutted as a safety precaution. This recommendation coincides with a recent court decision in which the court found that the scientific, economic, and practical concerns involved dictated that affected homeowners remove all the drywall in their homes. Additionally, due to the corrosive effect the Chinese drywall has on wire, smoke detectors, and other home safety equipment, it also was recommended that homeowners inspect and/or replace these items.

The problematic drywall emits hydrogen sulfide at rates reported to be 100 times greater than normal drywall. Hydrogen sulfide causes corrosion of metals, foul smells, and is an irritant to humans. Homeowners have even reported jewelry corrosion. It is believed that more than 20,000 homes nationwide may have been built using Chinese drywall, as a result of supply shortages arising from massive rebuilding after Hurricanes Katrina and Rita and the housing boom in the mid-2000's.

The CPSC and HUD's announcement is further bad news for property insurers already beleaguered by the mass of litigation that has arisen from the problematic drywall.

A fresh coat of paint won't help this drywall

State Legislative Update: Reinsurance and Captives

BY KAREN BENSON

Reinsurance: ***Maryland HB 305.*** In April 2010, Maryland's Governor signed into law legislation that (effective June 1, 2010) amends the State's domestic reinsurance law requirements by: (1) specifying an assessment fee payable by certain domestic reinsurers to the Maryland Insurance Commissioner; (2) exempting domestic reinsurers from a requirement to have an office in the State; (3) requiring domestic reinsurers to keep specified assets in the State; and (4) authorizing domestic reinsurers to keep their general ledger account records outside the State under specified circumstances. ***Kansas HB 2500.*** This amendment to the Kansas Municipal Group-Funded Pool Act allows municipal insurance pool applicants to submit a confirmation that reinsurance approved by the Insurance Commission is in effect or will be effective at the time the pool assumes risk. The legislation takes effect upon its publication in the Kansas Statute Book.

Captive Insurers: ***Delaware HB 314.*** This bill proposes to amend Delaware's captive insurance company laws by adding two new forms of captive insurance companies – "agency captive insurance companies" and "branch captive insurance companies" – to those that can currently be licensed in Delaware. In an "agency captive" structure, the insurance risk on policies is reinsured to the agency captive, thereby allowing the agents or brokers that placed the policies to share in the profits or losses attributable to these policies. "Branch captive" insurance companies are divisions of offshore captives that establish a business unit onshore. The legislation was passed by the Delaware House in March 2010 and by the Delaware Senate in April 2010, subject to an amendment introduced by the Senate, which requires the Insurance Commissioner to make a finding that a "branch captive" insurer is financially stable in order to exempt the insurer from the minimum capital and surplus requirements and reserve requirements of the State insurance law.

N.Y. Clears Up Some Contract "Un-Certainty"

BY STEVEN KASS

In its 2008 Circular Letter No. 20, the New York Insurance Department addressed "contract certainty" – the requirement that parties to reinsurance contracts and P&C insurance policies reach final and complete agreement on all contract terms by contract inception, and then execute the contract itself at or "promptly" after inception. The Department has now issued Supplement No. 1 to the Circular Letter to provide further guidance on the issue.

Global standards ok if not inconsistent with NY law

Supplement No. 1 explains that "promptly" is generally interpreted to mean within 30 business days. It goes on to remind parties that "any principles and practices established to ensure contract certainty must comply with all existing statutory or regulatory provisions concerning the content, timing, or delivery of insurance policies." The Supplement also addresses compliance, stating that the Department will focus resources on policies where, because of the unique nature or size of the risk, issues regarding contract certainty are most apt to surface, including those issued to (1) large commercial insureds, written on a standard or manuscript basis, (2) policyholders in the special risk and excess lines markets, and (3) other insurers via reinsurance.

The Supplement explains that policy documentation for purposes of contract certainty should contain all agreed terms of the contract, and may include an insurance policy, binder, schedule of cover, signed contract wording, or a complete slip; for reinsurance, documentation can be evidenced by a binder, cover note, or similar document, provided it reflects all agreed terms and conditions. The Supplement also recognizes the global nature of the insurance industry, stating that contract certainty principles and standards established in the United Kingdom and Bermuda will guide the Department to the extent they are not inconsistent with New York law.

The Department also announced that in the latter half of 2010 it may issue letters of inquiry to licensees aimed at gathering information regarding practices implemented to assure that contract certainty is routinely achieved.

Challenging an Arbitrator Appointment
Actual Bias vs. Potential Future Bias

BY JOHN PITBLADO

In two recent Illinois federal district court cases, Trustmark Insurance Company challenged , with mixed success, the impartiality of a counterparty's selected arbitrator for reinsurance proceedings. In the first case, involving an arbitration between Trustmark and John Hancock Life, Trustmark brought suit to enjoin from service on the arbitration panel the same arbitrator John Hancock had selected in a previously concluded arbitration between the parties. Trustmark asserted that John Hancock's arbitrator breached a confidentiality agreement by discussing the earlier arbitration with the other arbitrators selected in the subsequent proceeding. The court agreed with Trustmark and enjoined the arbitration from proceeding with John Hancock's selected arbitrator.

Calling out arbitrator's bias gets mixed results

In the second case, Trustmark made a similar argument against Clarendon National Insurance Company, with which Trustmark also commenced a second arbitration. Here, however, there was no showing that Clarendon's selected arbitrator breached a confidentiality agreement relating to the previous arbitration. Trustmark argued instead that it would be impossible for Clarendon's arbitrator not to breach the previous confidentiality agreement at some point by discussing the first arbitration case with the other arbitrators. The court in this instance rejected Trustmark's argument, finding that a potential future breach of the confidentiality agreement was not sufficient grounds for a preliminary injunction barring the arbitration from proceeding.

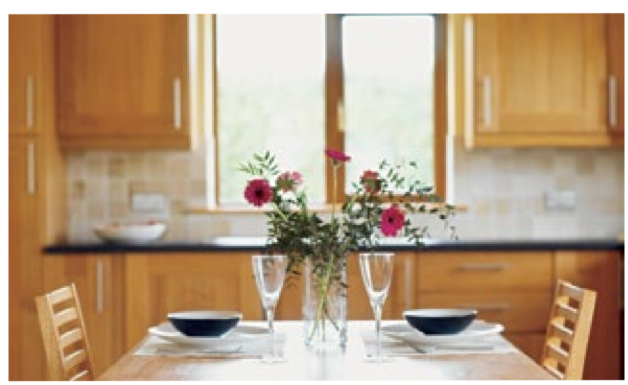
Both decisions have been appealed to the Seventh Circuit.

Reinsurance Litigants Denied In Bids For Home Cooking

BY ANTHONY CICCHETTI

In a dispute concerning payment obligations under a "builders risk" reinsurance slip, the U.S. District Court for the Western District of Missouri held in *Continental Casualty Co. v. AXA Global Risks (UK) Ltd.* that related cases filed therein and in London should both proceed. The reinsurers were first in initiating a declaratory judgment action in the Commercial Court of London. The cedent responded five weeks later with the U.S. federal court action. Arguing that the reinsurers were seeking to avoid the application of Missouri law and to secure instead potentially more favorable English law, the cedent sought a preliminary injunction preventing the London action. (Apparently, the slip did not definitively address choice of law or venue.) The reinsurers, in turn, argued for a dismissal or stay of the U.S. suit based upon the first-filed London action.

The court applied what it explained to be the "conservative" view adopted by the Eighth Circuit, which accords greater weight to considerations of international comity when a foreign anti-suit injunction is at issue. The court concluded that both actions should proceed because the case before it, based upon contract law issues, "simply [did] not rise to the level of a 'vital American interest' sufficient to outweigh concerns of international comity." Addressing the reinsurers' claim that the later U.S. action should be dismissed or stayed, the court reasoned that "[w]hen related cases are before two different sovereigns, the appropriate procedure is to permit both jurisdictions to proceed, with any decision of one becoming res judicata on the other." Thus, the court placed a premium on prosecuting an action to a speedy and favorable conclusion.



For these litigants, no home-cooked meal

IP & Technology

Electronically-Filed Insurance Application Raises Host of Issues

BY LYNDA CHANG & DIANE DUHAIME

In *Prudential Insurance Company of America v. Dukoff*, the U.S. District Court for the Eastern District of New York denied both a plaintiff insurer's and a defendant beneficiary's cross motions for summary judgment. In doing so, the court affirmed the importance of implementing clear electronic transaction procedures.

Prudential initiated the action to void a life insurance policy issued on the life of the wife of the defendant and beneficiary on the basis of alleged misrepresentations in the application. In response to Prudential's complaint, defendant Dukoff and his wife's estate filed a counterclaim for the full value of the policy, disputing the charge that it had been procured via fraud. In resolving the parties' cross motions, the district court considered numerous issues traditionally associated with life insurance claims, including those related to the applicability of a two-year incontestability period. The court was also called upon to consider a host of issues stemming directly from the fact that the application was submitted electronically via what the court called "a standard internet click-through process."

The defendants argued that a box that was checked at the end of the electronic application process did not constitute a valid electronic signature under New York's Electronic Signatures and Records Act (ESRA), and thus, Prudential was barred from challenging statements in the application to invalidate the contract. While the court was unaware of any other court that had addressed the validity of electronic signatures for insurance documents under ESRA, in deference to holdings in advisory opinions by the New York Insurance Department, the court held that Prudential could challenge the statements if Prudential could reasonably identify the person who made them. The court then held that there was a triable issue of fact as to whether the final page of the application, which included personal information inputted by the applicant, sufficiently identified the person who signed the application.

The electronically filed application also raised evidentiary issues with regard to who actually submitted the application and when. According to the court, a computer printout produced by the plaintiff insurer shows the application was submitted on a date suggesting that Mrs. Dukoff did not submit the application. The court concluded, however, that the plaintiff insurer did not offer sufficient evidence to establish that this printout accurately reflects the date of submission.

In conducting business electronically, insurers should anticipate the need to produce evidence that proves a given person signed a given electronic document on a given date (and perhaps even at a given time of day). In this regard, insurers may take such steps as including authentication procedures to verify the identity of the signatory, and maintaining evidence of not only the particular electronic document that was signed electronically, but also the electronic process that was followed in obtaining the electronic signature on the electronic document.

RAFSA Includes Measures For Reinsurance Reform

BY ROLLIE GOSS

On March 22, 2010, the Senate Committee on Banking, Housing and Urban Affairs (the Senate Committee) approved on a party-line vote the Restoring American Financial Stability Act of 2009 (RAFSA). RAFSA would make a wide variety of far-reaching and comprehensive regulatory reforms that are in many respects similar to those included in H.R. 4173, which was passed in the House of Representatives on December 11, 2009. The Senate Committee considered only relatively limited changes, which were contained in a "manager's amendment" that was also approved by party-line vote. It will be up to the full Senate to consider the many additional amendments that are expected to be put forward.

Building plans for Office of National Insurance potentially in the works

Three portions of RAFSA may be of interest to those in the reinsurance industry. First, RAFSA contains a version of reinsurance-specific proposed legislation that has been introduced in Congress as separate bills since at least 2006. This proposed legislation, known as the Nonadmitted and Reinsurance Reform Act, is also included in similar form in H.R. 4173. This portion of RAFSA would:

- regulate premium taxes for nonadmitted insurance;
- provide that the placement of nonadmitted insurance shall be subject to regulation solely by the insured's home state;
- limit the ability of a state to establish eligibility requirements for U.S.-domiciled nonadmitted insurers that vary from the Non-Admitted Insurance Model Act;
- require a GAO study of the nonadmitted insurance market;
- regulate the extent to which a state may not recognize credit for reinsurance for an insurer's ceded risk;
- partially pre-empt the extraterritorial application of the law of a state to a ceding insurer not domiciled in that state; and
- provide that in most circumstances a state that is the domicile of a reinsurer shall be solely responsible for regulating its financial solvency.

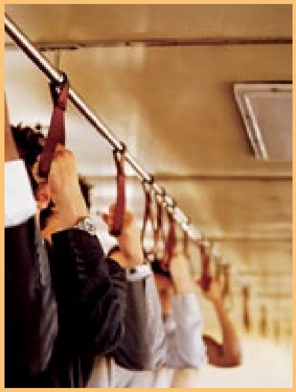
Second, RAFSA would establish an Office of National Insurance, which, similar to the House bill, would be largely information-gathering, policy-planning, and advisory in nature, except that it would play a lead role in international policy development.

RAFSA also contains provisions for imposing system risk regulation upon certain companies or activities, or liquidating companies that become a threat to the economy. Although it is possible that such provisions might be applied to companies in the reinsurance industry, such companies are not among those that prompted these provisions.

Mutual Funds Regulated as BSA Financial Institutions

BY KAREN BENSON

FinCEN issued a final rule that defines mutual funds as "financial institutions" under rules implementing the Bank Secrecy Act (BSA). As such, mutual funds will be subject to rules under the BSA on (i) the filing currency transaction reports (CTRs) and (ii) the creation, retention and transmittal of records or information on transmittal of funds and other specified transactions (the Recordkeeping and Travel Rule).



Mutual funds on board as BSA institutions

The final rule replaces a mutual fund's requirement to file an IRS/FinCEN Form 8300 with a requirement to file a CTR on FinCEN Form 104. Both forms document a transaction in currency over $10,000, but differ in technical respects regarding the definition of "currency" and the treatment of multiple transactions.

Mutual funds must also comply with the Recordkeeping and Travel Rule, subject to certain exceptions. The Recordkeeping and Travel Rule requires that a financial institution obtain and retain certain information relating to transmittal of funds of $3,000 or more, and that this information be passed along to other financial institutions in the payment chain. The amount and type of information a financial institution must obtain, retain, and/or transmit depends upon its role in the funds transfer process. Additionally, mutual funds must comply with the recordkeeping requirements relating to extensions of credit and cross-border transfers of currency, monetary instruments, checks, investment securities, and credit.

Finally, the rule harmonizes the definition of mutual fund in the AML program rule with definitions found in the other BSA rules as well as amends the rule to clarify the delegation of authority to examine institutions for BSA compliance to the SEC and not the IRS.

The CTR filing requirement becomes effective May 14, 2010. Mutual funds must comply with the Recordkeeping and Travel Rule and related recordkeeping requirements by January 10, 2011.

SEC Staff to Review Derivatives Use by Funds and ETFs

BY RICHARD CHOI

In late March, the SEC staff announced that it was reviewing the use of derivatives by mutual funds, exchange-traded funds (ETFs), and other investment companies to determine whether additional protections are necessary under the Investment Company Act of 1940 (Act).

Pending its review, the staff stated that it would defer action on new and pending exemptive requests under the Act to operate ETFs that intend to make significant use of derivatives. The deferral will affect certain actively-managed and leveraged ETFs that "particularly rely on swaps and other derivative instruments to achieve their investment objectives," but does not affect any existing ETFs or other types of fund applications. Among other things, the staff will be evaluating whether:

- current market practices involving derivatives are consistent with the leverage, concentration, and diversification provisions of the Act,
- funds that rely substantially upon derivatives, particularly those that seek to provide leveraged returns, maintain and implement adequate risk management and other procedures in light of the nature and volume of the fund's derivatives transactions,
- fund boards of directors are providing appropriate oversight of the use of derivatives by funds,
- existing rules sufficiently address matters such as the proper procedure for a fund's pricing and liquidity determinations regarding its derivatives holdings,
- existing prospectus disclosures adequately address the particular risks created by derivatives, and
- funds' derivative activities should be subject to special reporting requirements.

The SEC staff also will seek to determine whether any changes in SEC rules or guidance may be warranted. In a recent speech, SEC Director Buddy Donohue explained that the SEC staff's goal regarding derivatives is not simply to react to recent market events, but, rather, to develop an appropriate regulatory framework for the proper use of derivatives by funds.

Investors Permitted to Sue Adviser for Transfer Agent Fee Kickbacks

BY STEPHANIE FICHERA

The Second Circuit Court of Appeals recently reversed a district court's dismissal of claims that an investment adviser committed securities fraud and breached its fiduciary duties by failing to disclose kickbacks received in connection with a transfer agent services contract. In *Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Management LLC*, investors sued Citigroup Asset Management (CAM), a provider of investment advisory and management services to Citigroup-sponsored mutual funds, alleging that CAM concealed from the funds' shareholders and boards of directors that it renegotiated a contract for transfer agent services in a manner that resulted in the funds being charged more in transfer agent fees and a substantial portion of those fees being pocketed by CAM.

The court ruled that CAM's misrepresentations were material, explaining that "the facts that shareholders were being grossly overcharged for transfer agent services and that CAM was reaping the benefits were ones that would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." CAM, the court concluded, was obligated to negotiate the best possible arrangement for the funds and to make clear to their boards and shareholders that it was benefitting from the agreement.

The court also found that the investors adequately alleged a causal connection between the material misrepresentation and their loss. The defendants contended that investors could not establish a diminution in the funds' values because the SEC had ordered defendants to disgorge transfer agent profits to the funds following an SEC investigation prior to the filing of civil suits by investors. The court rejected the defendants' argument because it was premature to conclude that investors were fully compensated by SEC-ordered restitution. Moreover, the court stated that CAM's misrepresentations resulted in the improper deduction of monies from the funds, which negatively and predictably impacted fund returns.

Privately Held Fidelity Entities Cannot Avoid Sarbanes-Oxley Whistleblower Suits

BY MICHAEL VALERIO

In a March 30, 2010 opinion addressing two separate cases brought against Fidelity, the United States District Court in Massachusetts denied Fidelity's motions to dismiss employment retaliation claims under Section 806 of the Sarbanes-Oxley Act (SOX). The court rejected Fidelity's argument that the SOX claims should be dismissed because the whistleblower plaintiffs were not employees of publicly held investment companies covered under SOX (i.e., the Fidelity mutual funds) but, rather, were employees of privately held Fidelity entities (i.e., Fidelity Brokerage Services and Fidelity Management & Research). The court's holding breaks with prior Department of Labor administrative decisions – as well as the rulings of other federal district courts – which concluded that the SOX whistleblower provision does not cover employees of non-public affiliates or agents of public companies.

The Massachusetts court acknowledged that "the statutory text is far from pellucid" regarding whose employees are covered. The court ultimately concluded, however, that Section 806 protects employees of "contractors, subcontractors, or agents" of public companies, provided those employees establish the "protected activity" and retaliation prongs of the statute. In turn, the court found that the non-public Fidelity affiliates that employed the plaintiffs fell within this ambit in light of their operational relationships with the publicly held Fidelity investment companies.

In the end, the court appeared to be guided primarily by its view of the broader preventative, punitive, and remedial purposes of SOX. The court observed: "If Section 806 only protected employees of public companies, then any reporting of fraud involving a mutual fund's shareholders would go unprotected, for the very simple reason that no 'employee' exists for this particular type of public company." If the court's interpretation stands and is adopted elsewhere, it could have significant implications for privately held mutual fund complexes in the SOX arena.

Court of Appeals Rejects SEC's Expansive Interpretation of Rule 10b-5

BY SCOTT SHINE

In *SEC v. Tambone*, the U.S. Court of Appeals for the First Circuit recently dismissed fraud charges brought by the SEC against two senior executives of a broker-dealer.

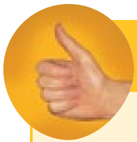
The SEC alleged that the executives violated Rule 10b-5 under the Exchange Act by using mutual fund prospectuses containing prohibitions against market timing while simultaneously allowing preferred customers to engage in the activity. Rule 10b-5 deems it unlawful to make any untrue statement of material fact in connection with the purchase or sale of a security.

The opinion focused on what it means to "make a statement." The SEC argued that the executives "made" misrepresentations by using the prospectuses to sell the funds and by implying to investors that they had a reasonable basis for believing that key representations were truthful and complete. The court rejected the SEC's "expansive interpretation" as inconsistent with the definition of the word "make."

The court ultimately concluded that a person does not "make" a statement when he merely "uses" a statement created entirely by another. As support, the court noted that the drafter's of 10b-5 faithfully tracked the language in Section 17(a) of the Exchange Act but eschewed the more expansive word "use" in 17(a) in favor of the word "make," suggesting a deliberate legislative and regulatory intent to confine the liability under Rule 10b-5 to actions that fall only within the use of the narrower word "make."

SEC interpretation too expansive?

While the court did allow the SEC to proceed with its claims under Section 17(a) and for aiding and abetting primary violations under Section 10(b), the court also based its decision on the concern that ruling in favor of the SEC's expansive interpretation of 10b-5 would have blurred the line between primary and secondary liability, thus opening the flood gates to private shareholder litigation.



Congratulations!

Karen Benson, Associate in the Miami office, was named Co-Chair of the Executive Board of the South Florida Chapter of ACAMS. The Association of Certified Anti-Money Laundering Specialists (ACAMS) is an international membership organization dedicated to enhancing the knowledge and skills of AML professionals from a wide range of industries. It serves in excess of 10,000 members in more than 140 countries. Ms. Benson has previously served as Secretary and Co-Secretary of the Executive Board of the South Florida Chapter.

Variable Annuity Summary Prospectus Gains Momentum

BY RICHARD CHOI

SEC Chairman Mary Schapiro and SEC Director of Investment Management Buddy Donohue recently heralded the development of a variable annuity (VA) summary prospectus. The VA summary prospectus initiative represents a golden opportunity for the VA industry not only to develop concise consumer-friendly offering documents, but also to save millions of dollars annually in printing and delivery costs.

In furtherance of those goals, the Insured Retirement Institute (IRI) submitted a rulemaking petition to the SEC proposing the adoption of a VA summary prospectus in 2008. The SEC deferred consideration of the IRI rulemaking petition while it gained experience with the mutual fund summary prospectus, which it adopted in early 2009.

Late last year, at the invitation of the SEC staff, members of an IRI working group met with the SEC staff to discuss the IRI's rulemaking petition. The SEC staff provided detailed comments on the model VA summary prospectus template that was included in the rulemaking petition. In April 2010, after months of work, the IRI working group submitted three sample VA summary prospectus templates to the SEC staff, based on actual products, ranging from the simple to the more complex. Also, under the IRI proposal's "layered" disclosure approach, full statutory prospectuses and periodic reports could be delivered online.

The IRI anticipates engaging in further dialogue with the SEC staff with a view to bringing the VA summary prospectus initiative to fruition.

Financial Institutions to Unmask Some Account Beneficial Owners

BY KAREN BENSON

The states generally do not collect much information about beneficial owners of legal entities created under state law. Accordingly, FinCEN, acting jointly with the SEC and other regulators, has issued recent guidance imposing new regulatory expectations on broker-dealers, mutual funds and other financial institutions.

True identities to be revealed

The guidance specifically calls for such institutions to implement, as part of their anti-money laundering compliance programs, procedures "that are reasonably designed to identify and verify the identity of beneficial owners of an account, as appropriate, based on the institution's evaluation of risk pertaining to an account." These procedures should be developed to identify customers who pose heightened money laundering or terrorist financing risks, such as certain trusts, corporate entities, shell companies, and PICs.

For such accounts, the guidance instructs financial institutions to perform "enhanced due diligence" that is reasonably designed to enable compliance with AML requirements. Depending on the risk level, this may include not only ferreting out beneficial owners, but also taking steps to reasonably understand the sources and uses of funds in the account and the relationship between the customer and the beneficial owner.

The guidance also instructs financial institutions to use the information they obtain under these new procedures for monitoring purposes and to determine whether the actual sources of funds and uses of the account are as expected.

In important respects, the guidance seems to go beyond the pre-existing requirements for customer identification programs, even though the guidance purports that it "does not alter or supersede previously issued regulations, rulings or guidance related to customer identification program … requirements." Indeed, some have criticized the regulators for issuing this guidance informally, rather than pursuant to a rule-making procedure.

Industry Eyes New SEC Enforcement Units

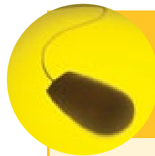
BY MICHAEL VALERIO

SEC enforcement units to keep investments safer

The SEC recently created five "national specialized units" dedicated to enforcement efforts in "particular highly specialized and complex areas of securities law," as well as a new Office of Market Intelligence to oversee the analysis of tips and other information provided to the agency by external sources. The SEC touted these initiatives as part of the Enforcement Division's "most significant reorganization since its establishment in 1972." These actions followed on the heels of a substantial year-over-year uptick in both the number of new investigations opened and the amount of fines imposed in 2009.

The five new specialized units are: Asset Management (focusing on investment companies, advisers, hedge funds, and private equity); Market Abuse (large-scale market abuses and complex manipulation schemes); Structured and New Products (complex derivatives and financial products, including credit default swaps and CDOs); Foreign Corrupt Practices; and Municipal Securities and Public Pensions. The proclaimed emphasis for the new units will not only be on maximizing the division's knowledge base in these areas, but also on increasing the speed with which the agency moves "message" cases from investigation to prosecution. In this regard, the SEC's recent fraud case against Goldman Sachs relating to synthetic CDOs was filed and announced by, among others, the chief of the Structured and New Products unit.

It is not yet clear exactly how broadly the new units will construe their mandates or how prolific they will be. Nevertheless, broker-dealers and investment advisers clearly could come within the crosshairs of one or more of the units in the context of particular investigations. In any event, it is important to keep in mind that the new units are intended to supplement – rather than supplant – the existing enforcement structure and staff.



Intellectual Property & Technology Update

Google's "AdWords" Service Clears Big Hurdle in European Court

BY JOHN PITBLADO

Google's AdWords service has come under fire in litigation around the world. Typically, the suits are brought by companies who find their competitors have purchased keywords for use in Google's search algorithm, which results in competitors' ads appearing when those trademarks are searched in Google's search engine. If a recent ruling in the European Court of Justice is an indication, service providers like Google may face less litigation over keyword advertising, while litigation between competitors over unauthorized trademark usage in internet advertising may very well increase.

Luxury fashion brand company Louis Vuitton Malletier brought suit against Google in France, alleging that Google's AdWords service allowed counterfeiters and other competitors to purchase from Google certain of Vuitton's trademarks as search terms that trigger the placement of those competitors' ads alongside search results.

Google's appeal of a ruling against it to France's highest court, resulted in that court referring questions to the European Court of Justice. In March, 2010, the ECJ ruled for Google, finding that "Google has not infringed trademark law by allowing advertisers to purchase keywords corresponding to their competitors' trade marks." The ECJ warned, however, that a trademark owner may invoke its rights against advertisers who arrange for a service provider like Google to place ads in a manner which create customer confusion as to the origin of the products covered by the ads.

According to the ECJ ruling, service providers that are not considered "neutral" with regard to their role in keyword advertising, may be held to have violated the trademark laws. If a trademark owner believes the keyword advertising is posted by a counterfeiter, the trademark owner may still request that the service provider remove the trademark from the posted ad. The ECJ ruling seems to suggest that even a "neutral" service provider may be deemed to have violated the trademark laws if, after being notified, it does not remove the trademark from a posted ad that makes unlawful use of another's trademark.

SEC Settlement Dynamics May Change

BY LIAM BURKE

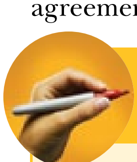
The SEC's Enforcement Director, Robert Khuzami, recently stated that the SEC may begin to make public more details about the facts underlying settlements that the SEC announces. Typically, the SEC has not revealed the underlying facts that have resulted in an investigation, charge, or sanction, if the accused agrees to a settlement. Rather, such details remain confidential and the accused neither admits nor denies wrongdoing.

Could disclosures trash settlements?

Any change in these longstanding practices could dramatically increase the number of securities class action lawsuits, as private plaintiffs are provided better "roadmaps" for their claims. Participants in settlement negotiations with the SEC also would be concerned about potential reputational damage (both to the company and to the individuals involved) that would result from any increased disclosure of relevant facts.

In many cases, the possibility of such increased disclosure would doubtless make an accused company significantly less willing to settle with the SEC. Even if the SEC is willing to negotiate with the company over the wording of any factual disclosures, such negotiations would tend to prolong settlement timetables.

On the other hand, the threat of publicizing underlying factual details could strengthen the SEC's bargaining position in settlement negotiations. Such increased disclosure could also facilitate court approval of settlements. Recently, in two closely-watched cases that have become an embarrassment for the SEC, courts have refused to approve settlement agreements and were critical of the SEC's lack of transparency, among other things.



Mark your Calendars

ALI-ABA Conference on Insurance and Financial Services Litigation

The 15th Annual ALI-ABA Conference on Insurance and Financial Services Litigation will be held July 15-16, 2010 in Chicago, IL. In addition to Jorden Burt partners **Jim Jorden** and **Wally Pflepsen**, who serve as planning chairs, and partners **Rollie Goss** and **Markham Leventhal**, the faculty includes industry, defense, plaintiff, SEC, FINRA, DOL and state insurance department lawyers and a U.S. District Court Judge. Topics will include:

- Updates on settlements and trials of individual and class action cases involving life insurance, annuities, mutual funds and ERISA plans.
- A panel of litigation experts and federal and state regulators will explore recent regulatory activities, their impact on insurance and securities products – including potential new SEC regulation of fixed annuities as securities, and recent attacks on 12b-1 plans – and what they may portend for litigation in the insurance and mutual fund industries.
- Update on retirement plan litigation, including "revenue sharing" and "stock drop" class actions, and the latest developments in major legal and strategic issues involving ERISA litigation.
- A panel of class action litigation experts, moderated by the Honorable Wayne R. Andersen, of the U.S. District Court, Northern District of Illinois, will analyze the latest developments in class action battles, including expert witness uses, choice of forum, evolving evidentiary standards, and settlement procedures.

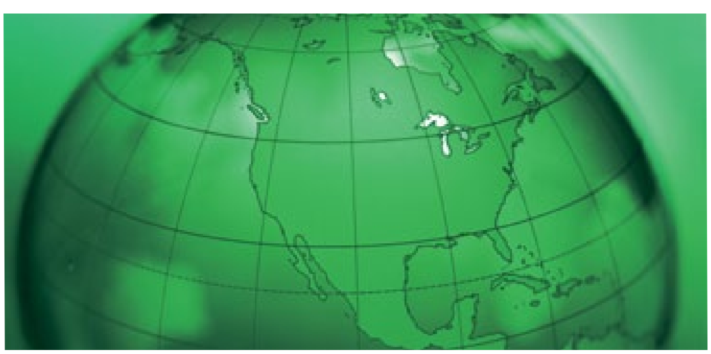
For more information and registration, visit *www.ali-aba.org*.

Supreme Court Adopts "Nerve Center" Test For Corporations' Citizenship

BY FARROKH JHABVALA

In *Hertz Corp. v. Friend*, the Supreme Court resolved a split between the Circuits on the issue of a corporation's citizenship for purposes of the federal diversity statute, 28 U.S.C. § 1332(c)(1), which states that for the purposes of the diversity and removal statutes "a corporation shall be deemed to be a citizen of any State by which it has been incorporated and of the State where it has its principal place of business …." *Hertz* discusses the history and development of a corporation's citizenship from the earliest days of the republic to 1958, when Congress enacted the present wording of § 1332(c)(1). The decision also discusses the difficulties encountered with the phrase "principal place of business," and the growing welter of tests that resulted in "different circuits (and sometimes different courts within a single circuit) … [applying] these highly general multifactor tests in different ways."

In seeking to reimpose fidelity to the statute's language, and to provide administrative simplicity and clarity to a jurisdictional statute, *Hertz* concludes that "'principal place of business' is best read as referring to the place where a corporation's officers direct, control, and coordinate the corporation's activities," the location the courts of appeal call the corporation's "nerve center." The decision explains that a corporation's "nerve center" is "usually its main headquarters, [and] is a single place." The decision concedes that "there may be no perfect test that satisfies all administrative and purposive criteria," and that under the "nerve center" test "there will be hard cases," anticipating that creative lawyering and business exigencies will pose challenges to its new definition of a corporation's principal place of business.



A company is where its nerve center is

Variations in Unjust Enrichment Laws Bar Class Certification

BY CLIFTON GRUHN

In *Tyler v. Alltel Corp.*, the District Court for the Eastern District of Arkansas denied certification of a multistate class action asserting claims for unjust enrichment, because resolution of the case would necessitate analysis of 25 states' unjust enrichment laws. The plaintiff sought to certify a Rule 23(b)(3) class of Alltel wireless customers who were charged an early contract termination fee, as well as a 23(b)(2) class of customers who would be subject to the fee. The court noted that when a putative class consists of persons from numerous states pursuing common law claims, a court "must conduct a choice of law analysis before considering the requirements of Rule 23."

Static-free message from court

The court's analysis led it to conclude that Arkansas' unjust enrichment laws differed in material respects from the other states' laws and that Arkansas law would not apply to all the putative class members' claims. The court would have to apply the laws of the class members' home states or the law of the state where the members signed their wireless phone contracts to each class member's claim. Thus, application of the varied unjust enrichment laws to the putative class members' claims precluded class certification under Rule 23(b)(3) due to the lack of commonality and predominance. The court also concluded that, although commonality and predominance are not factors under Rule 23(b)(2), the plaintiff was required to show class cohesion for a (b)(2) certification, and that the requisite cohesion could not be demonstrated where the laws applicable to the class members' claims were "notably different."

Single Bite at the Class Action Certification Apple

BY SCOTT BYERS

In *In re Baycol Products Litigation*, the Eighth Circuit affirmed the lower court's decision enjoining state court plaintiffs from attempting to certify a class after a multidistrict court denied class certification on the same issues in a separate case. In the original case, plaintiff initiated a proposed class action in state court, which was removed to federal court and subsequently transferred to a multidistrict court, seeking refunds for economic loss caused by Baycol, a prescription medication, in violation of the West Virginia Consumer Credit and Protection Act. Other individuals attempted to represent a similar class with similar allegations in West Virginia state court. After denying a nationwide class, the MDL district court denied certification of the original plaintiff's West Virginia class determining that individual issues of fact did not predominate. After the deadline to appeal passed, plaintiffs in the other action moved for certification of a class in state court. The district court granted defendant's motion to enjoin such plaintiffs from relitigating the previous decision in state court. The plaintiffs appealed the injunction.

Plaintiffs can't try class certification again

The Eighth Circuit determined that if collateral estoppel would bar the plaintiffs from seeking certification of an economic class in state court then the injunction was proper. Following West Virginia's collateral estoppel requirements, the court determined that the analysis under Federal Rule 23 was the same as that under West Virginia's Rule 23. Further, it found that there was a final adjudication on the merits, that the state court plaintiffs were in privity with the party to the prior action, and that they had a full and fair opportunity to litigate the issue in the prior action. Finally, the court stated that there was no due process violation because the plaintiffs could still bring individual claims in state court.

Defenses, State-Law Variations Defeat Class Certification

BY KIM FREEDMAN

In *Sacred Heart Health Systems, Inc. v. Humana Military Healthcare Services, Inc.*, the Eleventh Circuit held that the district court abused its discretion in certifying a class under Federal Rule 23(b)(3). Several hospitals filed a class action alleging that Humana systematically underpaid them for medical services rendered to veterans under a federal program, thereby breaching their individual network provider agreements. The lower court certified a class of approximately 260 hospitals in six states. The Eleventh Circuit granted review under Rule 23(f) and reversed the class certification order because the prerequisites of Rule 23(b)(3) had not been met. The court based its decision on three primary reasons.

First, the court held that wide variations in the material contract terms "overwhelmed" questions of law or fact common to the class and were "fatal" to class certification. Second, the court recognized that Humana's defenses of waiver and ratification, and the considerable variation in state law under which extrinsic evidence relating to these defenses would have to be analyzed, required a "serious analysis of the variations in applicable state law" and a "rigorous analysis" by the district court. Because the plaintiffs failed to provide the necessary analysis of such variations, the district court abused its discretion by granting certification. Finally, the court noted that the lack of predominance belied a finding that a class action was superior to other methods of fairly and efficiently adjudicating the controversy.

Eleventh Circuit Clarifies Removal Procedure:
Defendants Now Permitted to Provide Jurisdictional Facts

BY FARROKH JHABVALA

In *Pretka v. Kolter City Plaza II, Inc.*, the Eleventh Circuit Court of Appeals rectified a disturbing uncertainty introduced into the law of removals by *Lowery v. Alabama Power Co. Pretka* effectively restores the ability of state court defendants in the 11th Circuit region to remove cases from state court within 30 days of service of the complaint based on information that the defendants may possess but which was not included in the complaint or otherwise provided by the plaintiff. Both *Pretka* and *Lowery* concern CAFA removals, but set forth propositions applicable to non-CAFA cases as well.

The removal statute, 28 U.S.C. § 1446(b), addresses removals in two situations. The statute's first paragraph permits removals within 30 days of the service of the "initial pleading setting forth the claim for relief," and the statute's second paragraph concerns the removal of cases when "the case stated by the initial pleading is not removable." Second-paragraph removals are triggered by "receipt by the defendant . . . of an amended pleading, motion, order or other paper from which it may first be ascertained that the case is one which is or has become removable . . . ." *Lowery* was a second-paragraph case, but it included dicta that many district courts in the Circuit interpreted to severely limit first-paragraph removals to cases in which the removal was based on evidence the defendant had received from the plaintiff. Subsequent to *Lowery*, a first-paragraph removal in many district courts within the 11th Circuit became virtually impossible. As noted by *Pretka*, *Lowery* presented "plaintiffs with a trick by which they could make federal jurisdiction disappear. A diverse plaintiff could defeat federal jurisdiction simply by drafting his pleadings in a way that did not specify an approximate value of the claims and thereafter provide the defendant with no details on the value of the claim. That would subject the defendant's right to remove to the caprice of the plaintiff . . . ."

Pretka contains a tour de force of removal law marshaled to refute *Lowery's* dicta. It concludes that to compel a defendant "to tarry in state court when he has evidence establishing his right to be in federal court, and to force state courts to waste their resources on cases that will eventually be decided in federal court, cannot be what Congress had in mind when it enacted § 1446." Thus, if the dicta in *Lowery* became law, "it would undermine the statutory scheme, which was designed to encourage expeditious removals from state to federal court." *Pretka* holds that in first-paragraph cases, "the evidence the defendant may use to establish jurisdictional facts is not limited to that which it received from the plaintiff or the court," and properly includes affidavits as to an estimate of the amount in controversy based on defendant's records. The decision also holds that evidence submitted after removal should be considered to establish the facts present at the time of removal. The *Pretka* opinion restores the conformity of 11th Circuit removal law with the law of other federal circuits.

Third Circuit Latest to Require Detrimental Reliance Under TILA

BY MICHAEL SHUE

The Third Circuit recently joined a growing consensus of Circuit Courts holding that detrimental reliance must be shown to recover actual damages for Truth in Lending Act (TILA) violations. In *Vallies v. Sky Bank*, a borrower brought a putative class action on behalf of consumers who obtained motor vehicle loans from the defendant lender, claiming that the lender violated TILA's disclosure requirements. The district court granted the lender's motion for summary judgment, holding that the plaintiff could not recover actual damages because he failed to plead and could not prove detrimental reliance. The Third Circuit affirmed, holding that TILA's "plain meaning ... requires causation to recover actual damages. In the context of TILA disclosure violations, a creditor's failure to properly disclose must cause actual damages; that is, without detrimental reliance on faulty disclosures (or no disclosure), there is no loss (or actual damage)." While *Vallies* was a case of first impression in the Third Circuit, the opinion follows every Circuit Court that has considered this issue, including the First, Fifth, Sixth, Eighth, Ninth, and Eleventh Circuits.

NEWS & NOTES

Publications

Joan Boros, of Counsel in the Washington, DC office, published "An Income Planning Challenge" in *National Underwriter, Life and Health,* June 7, 2010.

Rollie Goss, Partner in the Washington, DC office, wrote "RICO Claims Would 'Impair' Ohio Regulatory Scheme" in *Insurance Litigation Reporter,* Vol. 32, No. 7, May 10, 2010.

Two Jorden Burt attorneys were published in the May 10, 2010 issue of *Harris Martin's Reinsurance Reporter.* Connecticut Associate **John Pitblado** wrote "Pre-Award Challenge to a Party-Selected Arbitrator" and Washington, DC Partner **Rollie Goss** wrote "An Overview of *Stolt-Nielsen SA v. AnimalFeeds International Corp.*" Mr. Goss also wrote "*Powershare Inc. v.Syntel Inc.: An In-Depth Analysis*" for the April 2010 issue of the Reinsurance Reporter. Mr. Pitblado published "*The Latest in Insurance-Linked Securities*" in the March 2010 issue.

Speeches

Two Jorden Burt attorneys presented at the IRI 2010 Government, Regulatory & Compliance conference, April 28-30 in Washington, DC. Managing Partner **Jim Jorden** spoke on "Annuity Litigation Update." Washington Partner **Richard Choi**, who serves on the Planning Committee for the conference, presented "Variable Annuity Summary Prospectus Initiative" and participated in a general session panel on "SEC Regulation and Rulemaking."

Rollie Goss, Partner in the Washington, DC office, presented at the American Conference Institute's 6th Annual Advanced Forum on Reinsurance Agreements: Comprehensive Strategies for Creating Profitable and Secure Business Arrangements in a Changing Regulatory Environment. On April 28, 2010, in New York, NY, Mr. Goss spoke on a panel discussing "Anticipating Reinsurance Disputes: How to Use an Arbitration Clause to Facilitate Resolutions."

Mark Your Calendars

Steven Kass, Partner in the Miami office, will present on "Unclaimed Property Audits" at the American Counsel of Life Insurers 2010 Compliance and Legal Sections Annual Meeting. The conference will be held July 13-15, 2010 in Ft. Lauderdale, FL.

Washington Partner, **Richard Choi** will present at the Financial Research Associates' 6th Marketing & Advertising Compliance Forum for Investment Advisers, September 16-17, 2010 in New York, NY.

JORDEN BURT LLP

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For more information, visit our website at www.jordenburt.com.

SOUTHEAST
Suite 500
777 Brickell Avenue
Miami, FL 33131–2803
305.371.2600
Fax: 305.372.9928

WASHINGTON, D.C.
Suite 400 East
1025 Thomas Jefferson St., N.W.
Washington, D.C. 20007–5208
202.965.8100
Fax: 202.965.8104

NORTHEAST
Suite 301
175 Powder Forest Drive
Simsbury, CT 06089–9658
860.392.5000
Fax: 860.392.5058