EXPECTFOCUS®

VOLUME III SUMMER 2007

Industry News that's **Good For You**

McCarran-Ferguson Changes?
Bonus Annuity Cases
12b-1 Fees
Arbitration Update

JORDEN BURT LLP

EXPECTFOCUS® Vol. III Summer 2007

INTHESPOTLIGHT

SEC States Views on Fee-Based Brokerage Accounts

BY TOM LAUERMAN

Broker-dealers who offer customers fee-based brokerage accounts waited with bated breath to learn if these accounts would be subject to regulation under the Investment Advisers Act. The wait now seems to be over; the SEC affirmed regulation in a May 17, 2007 filing with the D.C. Circuit Court of Appeals.

Broker-dealers not rewarded for their patience

With a fee-based brokerage account, the broker-dealer provides investment advice to the customer and executes the customer's securities transactions for a single fee that is based on the amount of assets in the customer's account. Until the SEC adopted Rule 202(a)(11)-1 under the Investment Advisers Act in 2005, there had been substantial doubt as to whether these accounts were subject to investment adviser regulation. The Rule resolved the question by providing, in effect, that fee-based brokerage accounts would not be subject to investment adviser regulation, so long as certain conditions were met (and the SEC staff had observed a "no-action" position on this point during a period of several years while the Rule was pending prior to its adoption).

When the D.C. Circuit vacated the Rule on March 30, 2007 (see *Expect Focus*, Vol. II, Spring 2007), the interpretive uncertainty returned. Would the SEC staff revert to its no-action position? If not, would the SEC or its staff provide any interpretive guidance, or would broker-dealers be left entirely to their own devices in light of the D.C. Circuit's decision? In its May 17, 2007 filing, the SEC made clear its view that at least a great preponderance of the estimated $300 billion in fee-based brokerage accounts is subject to investment adviser regulation. It remains unclear whether there may be (or may be created) any unusual types of such accounts that do no not require investment adviser registration.

In its filing, the SEC also moved for a stay, subsequently granted by the court, that would preserve the Rule until October 1, 2007. This will provide broker-dealers with some time to take steps in response to the court's vacating of the Rule. The SEC indicated that such steps might include (1) commencing to operate the fee-based brokerage accounts in compliance with all of the registration and other applicable requirements of the Investment Advisers Act, (2) taking all steps necessary to convert from fee-based brokerage accounts to commission-based brokerage accounts, (3) developing new types of brokerage accounts to which fee-based brokerage accounts could be converted, and (4) obtaining consents, elections, or authorizations from customers in connection with such changes.

CONTENTS

INTHESPOTLIGHT

LIFE&HEALTHINDUSTRY

PROPERTY&CASUALTYINDUSTRY

REINSURANCEINDUSTRY

MUTUALFUNDS&INVESTMENT ADVISERSINDUSTRY

SECURITIESINDUSTRY

BANKING&CONSUMER FINANCEINDUSTRY

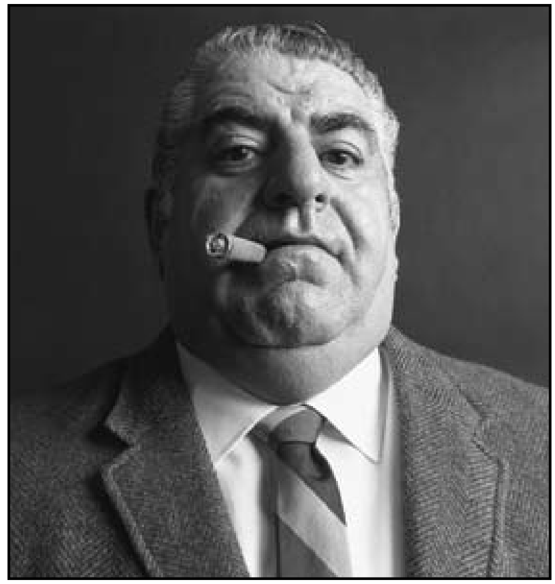
NEWS & NOTES

NOTEWORTHY

Third Circuit Revives RICO Claim

BY GLENN MERTEN

Insurer efforts to preclude civil RICO claims in New Jersey on the basis that such claims interfere with state regulation of insurers in contravention of the McCarran-Ferguson Act were recently dealt a setback by the Third Circuit Court of Appeals. In *Weiss v. First Unum Life Ins. Co.*, plaintiff sued after his disability benefits were terminated, alleging a "pattern of fraudulent activity by First Unum aimed at depriving its insureds with large disability payouts of their contractual benefits." After a series of procedural maneuvers unrelated to the ultimate determination of the issue, the U.S. District Court for the District of New Jersey dismissed the complaint on the grounds that allowing federal RICO claims would impair New Jersey's regulatory scheme for insurance, embodied in New Jersey's Insurance Trade Practices Act (ITPA).



RICO claims may be brought against insurers in New Jersey

Applying the factors set forth by the U.S. Supreme Court in *Humana Inc. v. Forsyth*, the Third Circuit reversed and revived the federal RICO claims. Although the lower court found it significant that New Jersey's ITPA did not provide a statutory private right of action, the Third Circuit held that the absence of a statutory private right of action was "an obstacle to Weiss's claim, but by no means a dispositive one." Rather, the court found that the balance of the other *Humana* factors compelled the conclusion (albeit a close one) that "RICO does not and will not impair New Jersey's state insurance scheme." The Third Circuit found it particularly significant that the "ITPA explicitly notes that its penalties are not intended to be exclusive." The court also held that unlike *Doe v. Norwest Bank Minn., N.A.*, in which the Eighth Circuit Court of Appeals held that permitting RICO claims would impair Minnesota's insurance regulatory scheme, New Jersey had not indicated any "stated fear of 'extraordinary' remedies, or declaration that the insurance market or economic policy … would be adversely affected" by permitting RICO claims.

Annuity Sales Practices Lawsuits Consolidated

BY KRISTIN SHEPARD

Fighting for certification

The Judicial Panel on Multidistrict Litigation (MDL Panel) recently issued an order consolidating two putative class actions involving the deferred annuity sales practices of Midland National Life Insurance Company. In its May 2, 2007 order, the MDL Panel transferred *Bendzak v. Midland National Life Ins. Co.*, a putative nationwide class action which had been pending in the U.S. District Court for the Southern District of Iowa, to the U.S. District Court for the Central District of California (Judge Snyder) for pretrial consolidation with *Migliaccio v. Midland National Life Ins. Co.*, another putative nationwide class action on which we have previously reported (see *Expect Focus*, Vol. III, Fall 2006).

Plaintiff Bendzak also remains a plaintiff in a separate annuity sales practices putative class action against American Equity Investment Life Insurance Company–which was originally transferred from the U.S. District Court for the Central District of California (Judge Snyder), and which remains pending in the Southern District of Iowa. It is not yet clear whether plaintiffs' counsel will now request that the Midland case be sent back to Judge Snyder and consolidated with the *In re American Equity* proceeding.

Minnesota AG Strikes Again

BY JASON GOULD

In Minnesota, 2007 appears to be shaping up as the Year of the AG Lawsuit, as Minnesota Attorney General Lori Swanson has filed suit against yet another insurance carrier over allegedly unsuitable sales of deferred annuities to Minnesota senior citizens. The latest lawsuit, filed in Hennepin County District Court on April 26, 2007 against American Equity Investment Life Insurance Company, alleges violations of Minnesota's suitability statute and state laws against fraud, false advertising and deceptive trade practices in connection with the sale of deferred annuities to Minnesotans over the age of 75 at the time of purchase. Swanson claims that "the maturity date of the annuities in some cases was longer than the life expectancy of the senior citizen," and that the 25% surrender penalty in the early years of certain annuities was "particularly outrageous." Swanson said she was particularly concerned that it was "not uncommon for the insurance company to tie up over 50% of the senior citizen's net worth," which the senior needed for retirement income.

The action echoes allegations made in previous lawsuits brought earlier this year by Attorney General Swanson against insurance carriers and marketing organizations over similar alleged practices. It seeks restitution, injunctive relief and the imposition of civil penalties.

Not just the land of 10,000 lakes

News From The 110th Congress

BY MARION TURNER

Congress Debating McCarran-Ferguson Changes

Stemming from perceived abuses in the aftermath of Hurricanes Katrina and Rita, Congress took a hard look at insurance industry practices and potential reforms. As a result, legislation has been introduced in both the House and Senate that would repeal an antitrust exemption for the industry that has been in place for over 60 years.

A new remedy for insurance abuses

The Insurance Industry Competition Act of 2007 (H.R. 1081/S. 618), would amend the 1945 McCarran-Ferguson Act to make the Federal Trade Commission Act, as it relates to areas other than unfair methods of competition, applicable to the business of insurance. The bills, sponsored by Rep. Peter DeFazio (D-OR) and Sen. Patrick Leahy (D-VT), have received significant attention on and off Capitol Hill.

Sen. Trent Lott (R-MI), whose Gulfport home was destroyed by Katrina and whose initial claim was denied by State Farm, has declared a "vendetta" against an industry he says has been doing "bad things." State Farm eventually settled with Lott, but not before he did extensive research on the 1945 act, which he claims was intended to be temporary.

Optional Federal Charter Bill Reintroduced

After its release was delayed due to the illness of initial sponsor Sen. Tim Johnson (D-SD), legislation to create an optional federal charter for property and casualty and life insurance companies was introduced on May 24, 2007.

The National Insurance Act of 2007 represents the culmination of a multi-year campaign by the financial services sector to allow the insurance industry to function in a manner similar to banks, which can operate either under supervision of states or the federal Office of the Comptroller of the Currency. The bill would establish an independent federal insurance commissioner within the Treasury Department and a consumer protection division under its control.

Another Bonus Annuity Case, Another Dismissal

New Jersey Court Rejects Claims in Nationwide Class Action

BY BRETT WILLIAMS & SHAUNDA PATTERSON-STRACHAN

A New Jersey federal district court has become the latest to dismiss a putative nationwide class action involving the sale of bonus annuity products. In *Delaney v. American Express Co.*, the plaintiffs brought suit against American Express Company and American Enterprise Life Insurance Company (AEL) on behalf of individuals who purchased fixed-rate annuities providing for a first-year 1% bonus rate of interest and, subject to a 3% guaranteed minimum rate, annual renewal rates to be determined by AEL.

It's in the contract

Essentially, plaintiffs contended that the defendants fraudulently coerced them into buying the annuities through the promise of the first-year 1% interest rate bonus, which the defendants allegedly recaptured by undisclosed fees, expenses, and charges. Plaintiffs' complaint alleged claims for fraudulent misrepresentation and omission, breach of contract, negligent and wanton hiring, training, and/or supervising of agents, violations of consumer fraud statutes, and civil conspiracy.

In its May 11, 2007 decision granting defendants' motions to dismiss the complaint with prejudice, the court concluded that the terms disclosed in the annuity contract and disclosure documents precluded any finding that the defendants had participated in a deceptive scheme to recoup the interest bonus provided in the first year. The court found that the material terms of the annuities could not have been misrepresented or omitted by the defendants as a matter of law, as plaintiffs could not have reasonably relied on alleged oral statements or omissions by the sales agents that contradicted the annuity documents. As to the contract claim, the court reasoned that the complaint did not allege any failure by the defendants to satisfy their obligations under the annuity contracts, and that dissatisfaction with the terms of a contract or a product was not a basis for an actionable claim for relief.

IRS Addresses COLI Owned By Life Insurance Companies

BY STEVE KRAUS

In a private letter ruling (PLR) that is not yet officially released, the IRS held that in computing its taxable income, a life insurance company must reduce the closing balance of its reserves under IRC § 807(a)(2)(B) and 807(b)(1)(B) by the amount of the policyholder share of the increase in the cash value of policies it owns, without taking into account the exceptions to the interest disallowance rules. The May 3, 2007 PLR notes that this result is similar to the treatment of tax-exempt interest received by a life insurance company.

The PLR considered whether the IRC references to policies "to which section 264(f) applies" include the exception in IRC §264(f)(4)(A) for policies covering individuals who are officers, directors or employees of the insurance company. The narrow (and taxpayer-favorable) reading of the word "applies" sought by the company that requested the PLR would have included only those policies as to which section 264(f)(1) actually operates to disallow interest deductions. The broader (and taxpayer-adverse) reading of the word "applies" adopted by the PLR includes all policies that are described in section 264(f), even policies to which the interest disallowance provisions of section 264(f)(1) do not apply.

COI Suit vs. AIG is DOA

BY DAWN WILLIAMS

The First Circuit recently affirmed a Massachusetts district court's grant of summary judgment for the defendant insurer in a cost of insurance (COI) case. The flexible premium adjustable life policy at issue in *Brooks v. AIG SunAmerica Life Assurance Co.* provided that any change in the COI rate would be in accordance with procedures or standards on file with the Department of Insurance. The policy, issued by Mutual Benefit Life, was eventually assigned to AIG SunAmerica. Whereas Mutual Benefit Life had only ever increased the COI rate by 11%, AIG's increases were double that – nearly 22%.

The policy beneficiaries claimed that AIG's COI increases breached the contract and constituted unfair trade practices because they were inconsistent with procedures on file with the department. The court first considered the actuarial memorandum and noted that it addressed only the calculation of the maximum COI rate but not the actual COI rate applied to the insured. The court also considered the assignment agreement, which provided that the COI "scale" could not be changed for a set period of time. Defendants claimed that "scale" and "rate" were not equivalent, and although the court seemed willing to find that an issue of material fact existed, it affirmed the grant of summary judgment because plaintiffs had adduced no evidence that the two were the same. Finally, the court ruled that plaintiffs' argument based on a Massachusetts insurance regulation was raised too late in the litigation.

As to the unfair trade practices allegations, the court held that a mere breach of contract, absent egregious behavior, does not constitute an unfair trade practice, and noted that plaintiffs in any event had failed to allege either a breach of contract or the violation of any statute or regulation. Interestingly, though, the court speculated that had plaintiffs pursued a different theory and pled that the rate increases were circumstantial evidence that AIG had inflated the rates for improper purposes, perhaps by considering factors other than those permitted by the contract, this "might have been a different case."

Thorn and *Hunter* Decisions Fine in South Carolina

BY MICHAEL KENTOFF

For the third time in less than three years, Judge Cameron McGowan Currie of the U.S. District Court for the District of South Carolina has denied class certification on the basis that individualized issues overwhelmed class-wide proof.

As in *Thorn* v. *Jefferson-Pilot Life* (in which Jorden Burt was co-counsel for Jefferson-Pilot), and *Hunter v. American General Life and Accident* (see *Expect Focus*, Vol. I, Winter 2007), plaintiffs in the *In re American General Life and Accident Insurance Company Industrial Life Insurance Litigation* proceeding sought certification of a class of individuals who owned industrial life insurance policies allegedly issued on a racially discriminatory basis. In a March 9, 2007 hearing on plaintiffs' motion, Judge Currie cited concerns over plaintiffs' satisfaction of Federal Rule 23 commonality, typicality, and adequacy of class representation requirements "primarily due to differences between the proof which might apply to individual class members as to the statute of limitations and as to the entitlement to the requested form of relief, in this case an injunction requiring policy reformation." She held that while plaintiffs' pursuit of injunctive relief and certification under Federal Rule 23(b)(2) did not technically implicate a predominance requirement, the need to determine, on an individual basis, who was entitled to such "injunctive" relief echoed the predominance requirement of Federal Rule 23(b)(3) and served a like function. Judge Currie's class certification denials in *Hunter* and *Thorn* were upheld by the Fourth Circuit.

South Carolina: warm weather, lovely beaches, wise class certification denials …

GEICO Adjusters Say "Show Me the Money"

BY JON STERLING

Former Auto Damage Field Adjusters, on behalf of themselves and others similarly situated, filed three separate lawsuits against GEICO in New Jersey state court in May 2007. The suits, which were removed to federal district court, allege that the adjusters were paid only for forty hours per week, though they actually worked almost twice that many hours and never received overtime pay. The adjusters claim that the amount of work they were required to do could not be completed in a forty-hour week, and that GEICO knew this. The complaints allege violations of the federal Fair Labor Standards Act (FLSA) and state wage and hour law. GEICO denies any wrongdoing.

A barrage of suits

The key issue in the case is whether the adjusters qualified for an exemption from overtime payment requirements. Notably, in October 2006, the Ninth Circuit Court of Appeals found that auto adjusters for Farmers Insurance Exchange did qualify for such an exemption under the FLSA. However, the FLSA's regulations are clear that it is the actual duties of the employee, rather than simply the employee's job title, that will determine whether an exemption applies. The amount of discretion afforded to GEICO adjusters will likely be determinative.

This is just the latest in a barrage of overtime suits targeting the financial services industry. In recent months, lawsuits naming several firms have been brought by various classes of employees, including loan officers, IT technicians and brokers, all asserting that they were misclassified as being exempt from overtime payment requirements.

Oh, THAT Malpractice Claim

BY JAKE HATHORN

On the heels of three court decisions finding that a law firm had failed to file suit on behalf of its client within the applicable statute of limitations period, the law firm could not plausibly claim–as it attempted to do on an application for professional liability insurance–that it had no reasonable basis to anticipate a professional liability claim against it.

In *Liberty Surplus Insurance Corporation, Inc. v. Nowell Amoroso, et al.*, after a trial court and two appellate division decisions held that the statute of limitations had been missed, Nowell Amoroso Klein Bierman, P.A. (Nowell Amoroso) submitted an application to Liberty Surplus Insurance Corporation (Liberty) for a "claims made and reported" professional liability policy. The policy application included a subjective question asking whether "any lawyer to be insured under this policy [has] knowledge of any circumstance, act, error or omission that could result in a professional liability claim," to which Nowell Amoroso answered "No." Liberty issued the policy. Upon learning the facts underlying the legal malpractice suit that was subsequently filed against Nowell Amoroso, however, Liberty disclaimed coverage.

In a coverage dispute such as the one that ensued, an insured's knowledge at the time of application would ordinarily be a subjective question of fact for the jury. Presented with the facts above, however, the Supreme Court of New Jersey agreed with its lower court that there could be but one unavoidable resolution to the factual dispute over Nowell Amoroso's knowledge of any potential malpractice claim at the time the law firm submitted the policy application. Under these circumstances, the court concluded that the insured's subjective state of mind at the time of application could be determined as a matter of law.

States Pass Statutory Bad Faith Causes of Action

BY BEN SEESSEL

Certain state legislatures recently introduced measures that would create statutory remedies for alleged "bad faith" claims settlement practices. The statutes can be loosely grouped into two categories – those that would allow statutory first party actions and those that would create first and third party claims. Industry advocates argue that such laws, if enacted, will dramatically raise the cost of insurance, clog the courts with litigation and increase the number of frivolous claims.

In the face of these industry concerns, the state of Washington recently passed the Insurance Fair Conduct Act, a law creating a statutory cause of action for any first party insured against an insurer for claims which are unreasonably denied or delayed. The statute permits the court to award treble damages and attorneys' fees, including expert witness fees, to successful claimants. It was signed into law on May 15, 2007 and will take effect this summer.

Call a plumber for the clogged courts

In Oregon, the state legislature introduced a bill in March 2007 that would create a direct cause of action for both first and third party plaintiffs against insurers who allegedly engage in unfair claims settlement practices. Similar legislation was defeated in May 2007 in Minnesota's Senate after earlier passage in the House. In Maine, a comparable bill was introduced in the House but was abandoned.

Katrina Policyholders Hope for Settlement

BY ELEANOR MICHAEL

Katrina plaintiffs and an insurance company have found a creative way to seek to resolve their dispute, despite a court's reluctance to allow them to do so. In *Woullard v. State Farm Fire and Cas. Co.*, after Judge L.T. Senter, Jr. twice expressed reservations about the fairness and practicality of a settlement proposal, the parties decided to pursue settlement through the Mississippi Department of Insurance (DOI).

In the court proceeding, plaintiffs' attorneys withdrew the motion for class certification and for preliminary approval of the proposed settlement. The parties subsequently informed the court that the named plaintiffs' individual claims had been settled. Thereafter, the court granted State Farm's motion to dismiss the action because the plaintiffs were no longer eligible to represent the putative class of State Farm policyholders.

It now appears that the proposed settlement rejected by the court will instead be implemented, at least in part, through the DOI. The court, however, pointed out that the dismissal of the action should not be construed as an endorsement of any settlement through the DOI.

Despite the court's apparent reservation about the policyholders' plan to pursue settlement through a non-judicial avenue, the court stated that it is still prepared to approve a general settlement or settlement of any particular class or sub-class of claims provided the settlements are just and reasonable. State Farm previously indicated that it would discuss a settlement plan with any group of policyholder representatives handling the cases in litigation.

Supreme Court Rules Reckless = Willful

BY ELIZABETH BOHN

The U.S. Supreme Court recently found in *SAFECO v. Burr and GEICO v. Edo* that an insurer who used credit scores to set rates did not violate the Fair Credit Reporting Act (FCRA) in failing to send a notice of adverse action (NAA) to a consumer where the initial rate offered would have been the same without taking into account his credit score.

Although the decision has been lauded as a win for insurers, it was not entirely favorable: the Court also held that a willful violation of the law (permitting punitive damages) takes into account a "reckless" standard as well as a knowing one. The Court found that a second insurer was not "reckless" for failing to give the consumer a required NAA under the mistaken belief that notice was not required for initial applicants. The Court held that reckless means an action "entailing an unjustifiably high risk of harm that is either known or so obvious that it should be known."

States Keeping an Eye on Reinsurance

BY JOEL SMITH

This year has seen a variety of state legislative and regulatory activity affecting reinsurance, with captive insurance company matters assuming an increasingly prominent profile:

- District of Columbia Bill B16-0897, effective March 14, 2007, authorizes special purpose financial captive insurance companies.
- Montana Senate Bill No. 161, signed into law in May, reduces capital requirements for protected cell captives and for captives that reinsure admitted insurers.
- Arizona House Bill 2294, signed into law in April, lowers the capital requirements for Arizona-domiciled protected cell captive insurers and makes a number of changes to simplify their regulation.
- Missouri House Bill HB 238, introduced in January and currently pending, permits the creation of captive insurers and special purpose life reinsurers.
- Vermont regulation C-2006-02, effective April 1, 2007, changes the reporting requirements for Vermont-domiciled captives that reinsure life insurance policies.
- New Hampshire regulation part 601, adopted in February, renews in full the state's rules regarding credit for reinsurance.

- Connecticut Senate Bill SB 65, introduced in January and currently pending, requires the state insurance commissioner to study the feasibility of creating an optional state catastrophe fund.
- New York Bill A4011, introduced in January and currently pending, authorizes a $10 million allocation for creation of a state catastrophe fund.
- South Dakota Senate Bill SB 129, currently pending, establishes a health reinsurance pool to spread the costs of high-risk citizens.
- Arkansas Senate Bill SB 769, currently pending, creates the Small Employer Health Reinsurance Program to provide certain levels of reinsurance for small employer health insurance claims.

Announcing!

Four summer associates are participating in the 2007 summer program at Jorden Burt.

In the Washington office, **John Kimble** finished his second year at the University of Virginia School of Law. He received his B.A. and M.A. in Philosophy from the University of Mississippi.

John Black, also in the Washington office, completed his second year at the University of Florida, Levin College of Law. He graduated from Cornell University with a B.A. in Government and History.

In the Miami office, **Jonathan Hart** finished his second year at the University of Miami School of Law. He graduated from the University of Wisconsin with a B.A. in Political Science.

Rachel Smith, in the Miami office, completed her second year at the University of Florida, Levin College of Law. She received a B.A. in Legal Studies and Political Science from the University of Massachusetts-Amherst.

Treaty Tips: Choice of Law and Unanticipated Coverage Gaps

BY ROLLIE GOSS

As demonstrated in a recent U.K. court opinion, coverage gaps can arise when a reinsurance program is maintained across national boundaries and the insurance and reinsurance agreements are governed by different laws. The April 25, 2007 case decision of the Queen's Bench Commercial Court in *Wasa International Insurance Co. v. Lexington Insurance Co.* involved reinsurance placed in the London market covering environmental risks written by the ceding company in the United States. The ceding company reached a settlement with its U.S. insured using a "pro rata by exposure" trigger that resulted in payment of losses occurring both before and after the policy period. The resulting reinsurance dispute was litigated in a U.K. court. Despite a follow the settlements clause, the court concluded that the reinsurers were not obligated under English law, which governed the reinsurance agreement, to indemnify the ceding company for losses covered by the settlement that occurred outside the time period of the coverage of the reinsurance agreement.

UK and US laws–ships passing in the night

Reinsurer? Yes; Fiduciary? No

BY ANTHONY CICCHETTI

Applying Connecticut law, a Missouri federal court has held that a reinsured cannot properly assert a claim for breach of fiduciary duty against its reinsurer. In *Employers Reinsurance Corp. v. Massachusetts Mutual Life Insurance Co.* (April 2, 2007), the reinsured entity brought various counterclaims, including a breach of fiduciary duty claim, based on the reinsurer's alleged failure to make reinsurance payments under their contract. In dismissing the fiduciary duty claim, the court cited several Connecticut cases for the proposition that "there is no fiduciary relationship between an individual policy holder and a sophisticated insurance company." Although the court recognized that Connecticut had not addressed the fiduciary relationship question specifically in the reinsurance context, it concluded that the cited cases established that Connecticut courts "are not likely to imply one in a reinsurance relationship between two sophisticated insurance companies."

Three New Run-Off Reports

BY ROLLIE GOSS

Recent publications have addressed strategy, management and risk issues related to run-off operations. Lloyd's issued a report addressing the FSA's minimum capital requirements as they relate to Lloyd's syndicates that are in run-off. Although one might wonder how Lloyd's capital requirements would be of interest, this 65-page report, plus appendices, contains fairly detailed operational strategies that are intended to assist syndicates in maintaining sufficient capital levels. It is organized by areas of risk faced by run-off syndicates, including insurance risk, credit risk, operational risk, market risk, group risk and liquidity risk, as well as diversification suggestions. These types of risks are not unique to Lloyd's syndicates. PriceWaterhouseCoopers has published reports concerning run-off operations in the U.S. and Europe. Both reports are based upon surveys of reinsurance companies, and provide information as to strategies and operations of the survey participants. The U.S. report covers run-off management and strategy, claims management, and reinsurance collections. The European report is more general, covering the regulatory climate, the challenges of run-off operations, and the use of portfolio transfers with respect to discontinued operations. All three of these reports are available at *www.reinsurancefocus.com*, Jorden Burt's reinsurance blog.

National Trial

To Waive or Not to Waive? That is the Question

BY RICHARD SHARPSTEIN & ARI GERSTIN

Corporations involved in federal investigations are asking themselves whether or not to "cooperate" by waiving crucial legal privileges. The Department of Justice (DOJ) has recently replaced the controversial Thompson Memorandum, which instructed prosecutors to consider whether a corporation waived its attorney-client and work-product privileges in determining whether a corporation has "cooperated" during an investigation.

The new McNulty Memorandum directs prosecutors to submit requests for coerced corporate waiver of the attorney-client privilege to designated officials at DOJ for their approval. According to DOJ, this additional layer of scrutiny will help eliminate improper requests for waivers by lower level prosecutors and ensure that waiver requests will only be made in legitimate situations. This rationalization has yet to be tested. Requests for privilege waivers should be carefully considered in consultation with counsel experienced in white-collar defense because blanket waivers can have significant ramifications for executives and other employees who may someday become involved in the investigation.

In another burgeoning controversy, the DOJ Inspector General recently exposed the FBI's mishandling and abuse of National Security Letters (NSLs), an investigative tool under the PATRIOT Act, to obtain financial information without a formal subpoena, warrant, or grand jury process. Apparently, the FBI has no mechanism for maintaining and/or indexing these letters and therefore there is no accountability for requests made by individual agents. NSLs always instruct institutions not to inform their clients/customers of these requests under penalty of law. Financial institutions can be exposed to potential liability for releasing private financial data and information, only later to discover that an NSL was inaccurate, fraudulent, or issued without authority. At least one class action has been filed against a large financial institution on this issue.

Pro Bono Spotlight

Pro Bono Program Celebrates One Year Anniversary

BY SHEILA CARPENTER

Jorden Burt attorneys have always served the disadvantaged by providing pro bono services. In February 2006, managing partner Jim Jorden announced a special program to encourage all attorneys to donate time each year to the underprivileged, to civil rights causes and to nonprofit organizations without the resources to hire counsel. In 2006, the program had a successful launch under the dedicated supervision of Sheila Carpenter, partner in the DC office. Ms. Carpenter is responsible for coordinating the efforts of the firm in all pro bono matters on a full-time basis.

The first year of the pro bono program included many highlights. Jason Kairalla in the Miami office received the John Edward Smith Child Advocacy Award from Lawyers for Children America for his outstanding and tireless work on behalf of children. Attorneys in the DC office worked on adoptions with the Children's Law Center, defended battered women and handled Social Security appeals for the elderly and disabled. Connecticut office attorneys assisted Volunteer Lawyers for the Arts on a copyright case.

WASHINGTON MONITOR—An inside look at key regulatory agencies

SEC, ICI, ACLI, NAVA and XBRL

BY GARY COHEN

In the alphabet soup of Washington, our favorite players are trying to pull off a fascinating trade-off. It all has to do with the electronic delivery of prospectuses.

The SEC has embraced the concept of "access equals delivery"—the idea that an issuer's legal obligation to deliver a prospectus is satisfied if the issuer provides offerees with electronic access to the prospectus.

The SEC implemented "access equals delivery" for non-investment companies a few years ago. But the SEC stopped short of doing so for investment companies. The SEC said, at the time, that it would get to investment companies.

Moving beyond the postal service?

The SEC, true to historical form, didn't specify separate accounts. However, separate accounts are, of course, investment companies and are arguably in the SEC's contemplation.

SEC Chairman Christopher Cox has taken the "access equals delivery" concept one step further. He not only wants disclosure delivered electronically, he wants the disclosure to be electronically tagged so it can be—as he puts it—"sliced and diced." He passionately believes that XBRL will enable investors, analysts, the press and even regulators to maneuver disclosure electronically to fit their varying needs.

The ICI originally gave a cold shoulder to XBRL. However, the ICI realized that it didn't make sense to stonewall Chairman Cox's pet project at the same time the ICI was seeking SEC approval of "access equals delivery." So, the ICI reversed itself and actually paid PriceWaterhouse to develop an XBRL taxonomy for mutual funds.

The SEC hasn't said much about XBRL for variable insurance products. However, ACLI and NAVA have quietly joined forces on a project that could end up being related.

ACLI and NAVA vociferously opposed the SEC's "point of sale disclosure" proposals. They prefer a so-called "profile plus" prospectus that could be delivered electronically and linked to more detailed disclosure. Although ACLI and NAVA haven't actively embraced XBRL, they may have embarked on a path that, like the ICI, will lead them there.

The ICI is using its support of XBRL to extract SEC approval of electronic delivery of investment company disclosure. The ACLI and NAVA are seeking SEC approval of electronic delivery of variable product disclosure, but through point-of-sale disclosure rather than XBRL.

12b-1 Fees: SEC Ready for Change, Directors Seek Guidance

SEC Chairman Pondering 12b-1 Fees

BY SARAH JARVIS

Reviewing 12b-1 fees is on the top of the SEC's agenda, announced Chairman Christopher Cox at the April 13, 2007 address to the Mutual Fund Directors Forum. Chairman Cox stated that "with today's uses of 12b-1 fees barely recognizable in the light of the rule's original purpose, it is high time for a thorough re-evaluation."

The future of 12b-1 fees

When 12b-1 fees were adopted in 1980, the purpose of the regulation was to allow mutual funds to use fund assets to market to new customers and pay for distribution costs. Because the mutual fund industry was in a time of net redemptions, the idea was that bringing in new customers would benefit all parties by growing the funds and thus spreading costs over more investors and ensuring the health of the industry. Chairman Cox noted that the need for such help has passed and that the use of 12b-1 fees has drastically changed.

After referring to current 12b-1 fees as "sales loads in drag," Chairman Cox pointed out that the majority of the $11 billion in 12b-1 fees last year were used to compensate brokers. Another way that 12b-1 fees are being used is to pay for administrative costs for existing fund shareholders. Cox stated that both of these purposes are far from the original intent of the fees and that "[i]t is worth revisiting the original intent of Rule 12b-1, and considering its meaning in light of today's market realities and current practice."

The SEC held a round-table discussion of these 12b-1 issues on June 19, 2007, where industry participants defended the current uses of 12b-1 fees.

Mutual Funds Directors Forum Issues 12b-1 Report

BY CHIP LUNDE

The Mutual Fund Directors Forum recently published a report providing guidance for mutual fund directors in fulfilling their obligations under rule 12b-1. The report criticizes the SEC for providing directors with "little formal guidance" regarding the rule and for not updating its guidance to reflect current conditions and uses of 12b-1 fees.

The report states that the rule was originally intended to allow mutual funds to pay for distribution, but today 12b-1 fees are used primarily to compensate brokers for accounting and shareholder services, or as an alternative to front-end loads. The report also notes that in the current competitive landscape, where funds are distributed though unaffiliated intermediaries, the fees for using those channels are "largely nonnegotiable."

The report acknowledges that Chairman Christopher Cox and Division Director Andrew Donohue have announced that the SEC will reexamine rule 12b-1 in 2007, but states fund directors cannot wait for amendments to the rule or new guidance from the SEC.

Among other things, the report advises directors to understand how the fund's 12b-1 plan fits into its overall distribution plan, and to seek relevant information from management including a breakdown of how 12b-1 fees are being used. The report recommends directors consider how the plan will potentially benefit shareholders, and whether the fees are reasonable in relation to the services provided. The report also states directors should be allowed to consider the competitive landscape, and the need of the fund to penetrate a particular distribution channel, as well as the ability of shareholders to select which class of shares they purchase.

The Forum is a non-profit organization of independent investment company directors.

Forum's guidance easing the confusion

Registered Principal Proposal

BY JOEL SMITH

One review is enough

As part of a broader initiative to reduce the regulatory burden on broker-dealers, the NASD Board of Govenors approved a proposed exception to NASD Rule 2210 (Communications with the Public) on April 26, 2007.

Rule 2210 currently requires a registered principal of an NASD member firm to give written approval of all broker-dealer sales material prior to its use. Under the proposed amendment—recommended by the NASD Small Firm Rules Impact Task Force—prior review would not be necessary if a broker-dealer is using a distributor's sales material that is already on file with the NASD. According to the NASD, the proposed amendment will eliminate dual review by registered principals, saving retail firms numerous hours spent reviewing sales materials previously approved by a registered principal at the product distributor level.

For mutual funds, because it will no longer be required that principals at both mutual fund firms and broker-dealers sign off on advertising, the amendment should eliminate the occurrence of registered principals at broker-dealers contacting fund firms to have the advertising materials modified when the broker-dealer has a more conservative interpretation of regulations. The proposal still has to be approved by the SEC and go through the standard rulemaking process.

Industry Critical of SEC's Rulemaking Proposals

BY KAREN BENSON

The SEC's proposed antifraud and accredited investor rulemaking has drawn strong criticism from the industry, generating over 600 comment letters. The rules, proposed in December 2006, would establish a new antifraud provision under the Advisers Act and a heightened accredited investor standard under Regulation D of the Securities Act.

A main concern reported by commenters relates to the breadth of the antifraud rule. The Investment Company Institute, for example, questioned whether the rule was consistent with the SEC's rulemaking authority under Advisers Act Rule 206(4) and whether it was necessary for registered advisers, who are already subject to various fraud standards under the federal securities laws. Other industry groups voiced related concerns, including the rule's failure to define any type of prohibited practice and its lack of a scienter requirement.

Commenters also raised concerns about the accredited investor standard, including that the increased threshold amount for investing in 3(c)(1) funds may be too high and it may create confusion given the various investor standards already in place. Commenters like the Investment Adviser Association (IAA) also requested the SEC to reconsider certain requirements, including indexing the proposed standard for inflation and treating joint investments differently from the treatment received under Investment Company Act Rule 2a51-1 for 3(c)(7) funds. Among other things, the IAA and other commenters requested the SEC to consider treating knowledgeable employees as accredited investors and confirm that investors affected by the proposed standard would be grandfathered with respect to their existing investments in 3(c)(1) funds.

Industry needs a louder voice

Streamlined Mutual Fund Prospectus

Protections for Issuer and Investor?

BY PETER PANARITES

A prospectus even I can understand!

One stated purpose of the Securities Act of 1933 is to provide "full and fair disclosure of the character of securities sold" in interstate commerce and to "prevent frauds" in their sale. Whether the two-page streamlined prospectus for mutual funds currently in the works at the SEC's Division of Investment Management will meet the Act's objectives is being questioned by the private securities bar. Some lawyers are not sure that the SEC even has the authority to allow extensive "additional information" to be made available separately, as proposed, from a two-page prospectus.

Nonetheless, the division is seriously addressing a very real issue: has the information contained in mutual fund and variable insurance product prospectuses become so complex and voluminous as to discourage reading by investors.

The SEC can be expected to move cautiously. Its "profile prospectus" adopted in 1998, although a model for the proposed short-form prospectus, "has not been fully successful," Division Director Andrew Donohue has said.

The division is working with the Department of Labor to provide mutual fund investors, including those participating in 401(k) plans subject to ERISA, concise, easier to understand disclosure documents. Whether there will be a short-form prospectus any time soon that can be used to get essential mutual fund information to plan participants remains to be seen. Director Donohue has said that he expects to have a recommendation regarding a short-form streamlined prospectus to the SEC's commissioners by the end of 2007.

Searching for a Theory Amenable to Class Certification

BY ED ZAHAREWICZ

In a revenue sharing lawsuit targeting Well Fargo, a federal court has ruled that plaintiff's claims under Section 10(b) of the Securities Exchange Act may proceed rather than be dismissed. The ruling in the case of *Siemers v. Wells Fargo & Co. et al.*, in the U.S. District Court for the Northern District of California, may raise concerns for the fund industry because it is contrary to the decisions of most other courts that have dealt with similar claims. It also shows how sympathetic some courts can be to allegations of wrongdoing concerning revenue sharing arrangements.

Perceived "secret compensation" hurt defendant

The action began, as many before it, with an emphasis on brokers allegedly steering clients into mutual funds without disclosing that they were receiving "secret compensation" for making their recommendations. Whether a recommendation was made (and relied on), however, would vary from individual investor to individual investor. Recognizing this, plaintiff was allowed to amend his complaint no less than three times "in search of a theory amendable to class certification." The action's focus then shifted to the funds' disclosures.

According to the court, "a Section 10 challenge to revenue sharing must allege, among other things, (i) that the sponsors had an undisclosed and continuing practice of misappropriating money out of the common fund in material amounts, and/or (ii) that the size and scope of the revenue sharing, even if within limits, had grown so large as to generate a conflict of interest at the adviser level requiring disclosure." The court eventually found that plaintiff had successfully pleaded "both hazards" with respect to the Well Fargo fund sponsors.

NASD/NYSE Combination Continues to Percolate

BY TOM LAUERMAN

How long will the honeymoon last?

While the combination of NASD and NYSE broker-dealer regulatory functions is pending SEC approval, it seems that the NASD has become more sensitive to the need to tailor its rules to fit different types of broker-dealers. In a recent speech, NASD Vice Chairman Doug Shulman stressed that the new sole regulator, the Securities Industries Regulatory Association, will have and vigorously pursue real opportunities for such tailoring. Shulman said that the NASD is committed to making more distinctions based on firm size, business focus and business model.

In a similar vein, the Small Firm Rules Impact Task Force that the NASD created last September recently had two proposals adopted by the NASD's Board of Governors. These proposals would make modest, but welcome, reductions in compliance burdens in the areas of (1) keeping the NASD apprised of a broker-dealer's contact persons with whom the NASD may deal and (2) eliminating duplicative principal approvals of certain sales materials. Chairman Mary Schapiro has advised that the Small Firm Rules Impact Task Force will be making additional recommendations in the coming months.

Some small and specialty broker-dealers, however, remain concerned about how long the honeymoon will last after the NASD/NYSE nuptials. In that regard, the NASD recently retained William Alsover as a consultant with the NASD's member relations department, reportedly to improve the NASD's relationship with small firms and to better communicate the NASD's policies to those firms. Mr. Alsover had been the small firm representative on the NASD's Board of Governors. Although he has now resigned that position, some small broker-dealers thought that he did not adequately take account of their concerns and interests. Some are also concerned whether Mr. Alsover's new position signals that the NASD's approach to small and specialty broker-dealers will emphasize public relations more than substance.

Risky Mortgage Fallout Impacts Securities Industry

BY PAUL FISCHER

With all the current publicity about the bursting of the real estate market bubble, and the consequences on home owners holding the "creative" and risky refinancing mortgages that were popular at the height of the market, it is not surprising that securities regulators and broker-dealer customers have turned their attention to past sales of securities financed by refinanced home mortgage proceeds.

All bets are off with creative financing

In December 2004, NASD issued Notice to Members 04-89 in which it alerted members to concerns when recommending or facilitating investments of liquefied home equity—proceeds from refinancing. Now two years later in a changed real estate market, we are aware that securities regulators currently are looking into the suitability of securities transactions conducted since December 2004 where the securities customer also was the recipient of home refinancing proceeds within a close proximity in time. Regulators are inquiring into the terms of the mortgage transaction, the terms of the securities transaction and the link, if any, between the two. We are also aware that customers allegedly saddled with onerous mortgages, the proceeds of which were used to invest, are looking to rescind securities transactions that may not be liquid, in order to carry or buy out mortgages which threaten foreclosure.

Broker-dealers may be called upon to verify and justify the suitability of securities transactions where they knew, or a regulator or customer thinks they "should have known," that a mortgage transaction provided the source of funds. Although fewer consumers are refinancing or attracted to innovative mortgages these days, given the continuing low interest rate environment, securities brokers may want to remind personnel of the importance of conducting and fully documenting securities suitability determinations where a mortgage loan may lurk in the background.

NASD, SEC in Conflict Over Roving Reps

BY JIM SCONZO

The NASD has warned that when hiring a registered representative from another firm, a member should ensure that each of the rep's customer accounts is handled in a way that serves each customer's best interest. Such oversight may be hampered, however, by the SEC's privacy rule.

Regulators pulling in opposite directions

The SEC's rule precludes a broker-dealer from disclosing non-public information about customers, including the types and amounts of the customer's investments and transactions, as well as certain non-financial information, such as unlisted telephone numbers. Although some of this information is necessary to the new employer's NASD-mandated review of the handling of customer accounts, the SEC staff has recently stated that the information cannot be shared with a rep's new employer without advance authorization by the customer. This could give the new employer less time to conduct its review and might unnecessarily delay its acceptance of the customer's account.

Few customers will have previously given such authorization in a manner that is effective under the SEC privacy rule; and obtaining such authorizations may prove time-consuming, particularly where the number of customers is large or the old employer does not fully cooperate to facilitate such authorizations. Moreover, the SEC staff has stated that a rep who is no longer associated with the old employer may no longer use non-public customer information for any purpose (including, perhaps, soliciting authorizations).

Practically speaking, most customers will be more concerned about receiving uninterrupted service and attention to their financial needs than about what non-public information is given to the rep's new firm. The NASD reports that account transfers generally take six to ten days and are already a subject of considerable customer complaint. Under the SEC staff's interpretations, the process would be further complicated, delayed and frustrating, or worse, to customers. Hopefully, the regulators will soon provide further guidance on this thorny problem.

Broker-Dealer Regulators Provide AML Assistance

BY KAREN BENSON

Broker-dealers are facing increased pressures as anti-money laundering (AML) compliance enters a more mature phase. In response, the SEC and NASD have developed resources to assist broker-dealers and their registered representatives with compliance issues. The AML source tool, published by the SEC on April 16, 2007, contains key AML laws, rules and related guidance, including web links. In addition, the NASD recently hosted a webcast to raise broker-dealer awareness of identification and reporting suspicious activity. The webcast also presented numerous common money laundering red flags that may arise before or after account opening.

The NASD webcast included the following warning signs:

- The customer or person publicly associated with the customer has a questionable background or is the subject of news reports that suggest possible criminal activity;
- The customer account doesn't make business sense or is inconsistent with stated business purpose or investment objective; and
- The customer account shows unexplained high level of deposit and withdrawal activity with low level of securities transactions.

Know the real customer

Soft Dollar Arrangements for Third Party Research

BY PATRICK LAVELLE

Money managers are taking advantage of additional leeway granted by the SEC to purchase third party securities research with brokerage commissions (soft dollars) paid by the money managers' clients.

If such research is not "provided by" the broker-dealer to whom the commissions are paid, the "safe harbor" relief afforded by Section 28(e) under the Securities Exchange Act is not available, which would preclude the use of soft dollars in most cases. Historically, this "provided by" requirement imposed significant practical limitations on the dealings between a money manager and a third party research preparer. For example, if the money manager were deemed to have incurred an obligation to pay the research preparer for the research in question, that research would not be considered to be provided by the broker-dealer. Under the SEC's most recent positions, such limits are now almost gone, however, and the SEC staff has recently issued no-action letters that describe the types of arrangements that broker-dealers are setting up as a result. Such letters have been issued to Goldman Sachs & Co. (see *Expect Focus*, Vol. II, Spring 2007) and more recently to Capital Institutional Services, Inc.

Under these arrangements, the money manager and broker-dealer can agree as to how much of the commissions paid to the broker-dealer will be available to pay for research, and the money manager is generally free to direct the broker-dealer as to how much of such available amounts are to be paid to each research preparer. Under the SEC's new position, regardless of the nature and extent of the dealings between the money manager and a third-party research preparer, research generally will be deemed to be provided by the broker so long as several simple conditions prescribed by the SEC are met. These conditions, moreover, can be easily satisfied in most cases.

E-Signature

Can You Ensure the Admissibility of Electronic Signatures?

BY DIANE DUHAIME & MARIA MIRAN

Use of electronic signatures and records in life insurance and annuity transactions is growing among carriers and distributors alike. Companies must comply with the Federal Electronic Signatures in Global and National Commerce Act (E-Sign) and all applicable state laws and regulations, including the various forms of the Uniform Electronic Transactions Act (UETA) adopted by the states. Companies also will want to take necessary steps to ensure that electronic signatures and records can be authenticated in order to be admissible as evidence in legal proceedings.

Will a signature provided via a mouse click after the person uses unique and confidential credentials be sufficient to attribute that signature to the identified signatory? Some consider this e-signature method as only moderately secure, especially if the issued credentials are based on non-secret, personal information available to others. Other methods generally considered more secure include biometric handwriting (which captures the unique speed, pressure and other physical motion elements of a person's signature) and public key infrastructure or PKI. PKI, through the use of proprietary software, is reportedly able to accept almost any kind of electronic signature input, including a mouse click, fingerprint, voice response over the phone, or digitized biometric captured signatures. A company might implement several electronic signature methods, using more secure methods for transactions that involve higher dollar amounts and/or a higher level of forgery risk.

Whose signature is it?

The issues of authentication and admissibility of electronic signatures and records are emerging ones and necessarily involve the issues of document integrity and non-repudiation. Until court decisions provide the necessary clarifications, administrative rulings and the like, companies will continue to experience a tension between the use of electronic signatures and records, and compliance with applicable state and federal laws.

Unsolicited Faxes Generate Class Action

BY TODD FULLER

Illustrating the danger of sending unsolicited advertisements by fax, the U.S. District Court for Washington state certified a class and a subclass in *Kavu, Inc. v. Omnipak, Corp.* Plaintiff filed suit in Washington state court alleging violations of the federal Telephone Consumer Protection Act (TCPA), Washington's Unsolicited Facsimile Act (WUTA) and the Washington Consumer Protection Act (CPA) due to a single unsolicited fax advertisement sent by the defendant to about 3,000 businesses. The TCPA and WUTA provide for a $500 penalty for sending an unsolicited fax, and the TCPA provides for trebling the penalty if the sender willfully or knowingly violated the act. The CPA provides for attorney's fees and a trebling of actual damages up to $10,000. Plaintiff claimed it suffered damages due to loss of paper and toner, the temporary loss of use of its fax machine, the potential loss of business while its fax machine was receiving the unsolicited material, and a violation of its right to privacy. Plaintiff sought a multistate class for violation of the TCPA and a Washington state subclass for the state law claims. The defendant removed the case to federal court under CAFA and opposed class certification. In certifying the class and subclass, the court presented the defendant with the specter of statutory penalties of between $1.5 million and $4.5 million.

More than just a waste of paper

No One-Way Intervention in California

BY JASON KAIRALLA

The disapproval of one-way intervention was reaffirmed by the California Supreme Court in the April 16, 2007 decision in *Fireside Bank v. Superior Court*. One-way intervention occurs when a court rules on the merits in favor of the class prior to resolving class certification issues and notifying the class. The practice is disfavored because it allows absent class members to know the outcome of the litigation prior to deciding whether to join the class, thereby allowing them to benefit from favorable outcomes without the risk of being bound by unfavorable decisions. In *Fireside Bank*, the trial court granted plaintiff judgment on the pleadings for alleged violation of certain state consumer finance laws and simultaneously certified a class of 3,000 individuals. The court of appeals affirmed, finding that support for the rule against one-way intervention was "tenuous at best" and that the trial court retained broad discretion to rule on the merits prior to deciding class issues. The California Supreme Court reversed. It traced the thirty-year history of the rule against one-way intervention in the state and explained that the entry of judgment prior to notice to class members constituted an abuse of discretion and was fundamentally unfair to Fireside because it virtually eliminated any incentive for class members to opt out. Surprisingly, despite its concerns, the court left the class certification in place and vacated the judgment on the pleadings.

Mark your Calendars

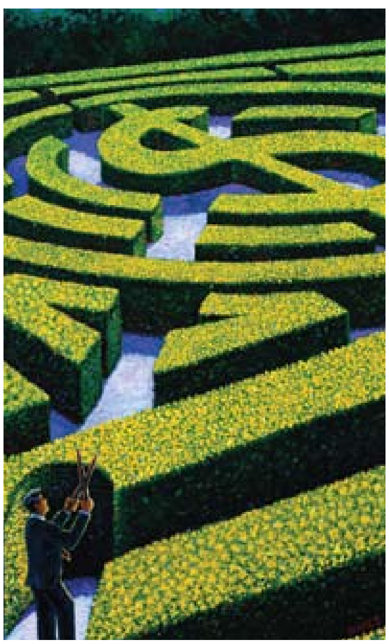
Ann Young Black and **Jason Gould** will be presenting on "What Not to Do When Developing Your Sales Programs: Recent Trends in Litigation and Compliance" at the American Bankers Insurance Association Annual Conference, September 16-18, 2007 in Washington, DC. More information is available at *www.aba.com/abia*.

Eleventh Circuit Tightens Removals

BY FARROKH JHABVALA

The Eleventh Circuit's April 11, 2007 opinion in *Lowery v. Alabama Power Co.* appears to have significantly tightened the standards for removals by barring post-removal discovery as an aid in establishing federal jurisdiction. "If the jurisdictional amount is either stated clearly on the face of the documents before the court, or readily deducible from them, then the court has jurisdiction. If not, the court must remand." Henceforth, barring narrow exceptions (such as where a contract in question provides the measure of plaintiff's damages), courts in the Eleventh Circuit must consider only the document received by the removing defendant that suggests there is federal jurisdiction, and "determine[] whether that document and the notice of removal [along with accompanying documents] unambiguously establish federal jurisdiction."

The opinion also handed down the following CAFA-related clarifications: First, a later-added defendant can remove the entire action even though the removing defendant was added after CAFA's effective date to an action that was filed against other defendants prior to that date. Second, parsing the "opaque, baroque maze" of CAFA's mass action provisions, the decision establishes as a matter of first impression that at least four requirements must be satisfied for an action to be removable as a CAFA mass action: (1) the amount in controversy aggregates $5 million, (2) minimal diversity exists, (3) the action has at least 100 plaintiffs, and (4) the plaintiffs' claims involve common questions of law or fact. The *Lowery* court expressly did not decide whether the mass action provisions also require that the removing defendant prove that at least one plaintiff has a claim in excess of $75,000. And, third, the Eleventh Circuit joined the Second, Third, Seventh and Ninth Circuits in holding that the burden of proving federal jurisdiction lies on the removing defendant, and that burden is evaluated by the preponderance standard.



Don't get lost in the maze of CAFA provisions

Damages and Choice of Law Issues Sink Class Action

BY ARI GERSTIN

The nationwide class action brought by annuity purchasers for breach of contract and breach of fiduciary duty was torpedoed by the Wisconsin Court of Appeals in *Noonan v. Northwestern Mutual Life Insurance Company*, November 16, 2006. The lower court had found that damages and choice of law issues rendered the case unmanageable because plaintiffs, who resided in all fifty states, had obtained their annuities under disparate scenarios. On appeal, plaintiffs challenged the lower court's reliance on choice of law issues as weighing against certification, arguing that Wisconsin law mandated application of Wisconsin law to all claims in the case because the defendant was a Wisconsin company, had its home office in Wisconsin, and managed its annuities from Wisconsin. The Court of Appeals disagreed because the annuities were negotiated and purchased in the various states in which the putative class members resided. Consequently, the different factual scenarios for each putative class member would need to be considered, rendering the determination of choice of law unmanageable.

No smooth sailing for this class action

The court also noted several other obstacles to class treatment, such as the issue of whether the defendant owed each plaintiff a fiduciary duty, would vary depending on the state law at issue. Likewise, the widely differing rules for the interpretation of contracts, including treatment of word-of-mouth evidence, would render the breach of contract claim unmanageable. Finally, an "unmanageable amount of evidence" of agent/purchaser interactions would be necessary to determine damages. These obstacles, along with the potential application of various statutes of limitation, provided ample support for the lower court's denial of certification.

Updates from the World of Arbitration

BY LANDON CLAYMAN

Federal Jurisdiction to Compel Arbitration of State Law Claims

The Eleventh Circuit's decision in *Community State Bank v. Strong* takes an expansive view of federal courts' subject matter jurisdiction to order arbitration of state law claims. The underlying suit was a Georgia state court action in which plaintiffs asserted that certain "payday" loans violated an assortment of state laws but expressly disavowed any federal claims. Though no federal claims were alleged, diversity jurisdiction was lacking, and the Federal Arbitration Act does not by itself confer federal subject matter jurisdiction, the state court defendants nevertheless filed an independent action in federal court seeking to compel arbitration.

The Eleventh Circuit held that a federal court may "look through" the arbitration request at the underlying dispute to ascertain whether a federal question is presented. Because the allegations of the state court complaint "could" form the basis of a federal RICO claim, and because the arbitration being sought would necessarily adjudicate whether the "payday" loans were lawful under a federal statute, the court of appeals held there existed federal subject matter jurisdiction to enforce the agreement to arbitrate. At least four circuits have adopted a contrary approach, suggesting this issue may be ripe for Supreme Court review.

Who Decides if Litigation Conduct Waives the Right to Arbitrate

In *Ehleiter v. Grapetree Stores, Inc.*, the Third Circuit held that courts are authorized to determine in the first instance whether litigation-related conduct has waived the contractual right to arbitrate. Rejecting arguments that the Supreme Court's opinions in *Howsam* and *Bazzle* directed that, if the arbitration agreement was silent on the matter, the issue should be resolved by arbitrators. The court affirmed a ruling that defendant had waived arbitration by engaging in litigation activity for over four years.

Another way to resolve disputes?

May Nonsignatories Enforce Arbitration Agreements?

The Fifth Circuit in *Ford Motor Co. v. Ables* reaffirmed its strong commitment to allowing nonsignatories to compel arbitration under principles of equitable estoppel. The dispute concerned automobile purchases involving retail installment contracts containing a broad arbitration provision. The auto manufacturer defendant was not a signatory to the contracts, but filed suit in federal court anyway seeking to compel arbitration.

The Fifth Circuit held that the legal doctrine of equitable estoppel allows a nonsignatory to compel arbitration in two different circumstances: (1) when the signatory must rely on the terms of an agreement containing an arbitration provision in making its claims against the nonsignatory; or (2) when the signatory alleges "substantially interdependent and concerted misconduct" by both the nonsignatory and one or more other signatories.

On the Web

IRS Clarifies Rules For Tax-Free Exchanges of Insurance Policies

BY STEVE KRAUS

Section 1035 of the Internal Revenue Code provides that the exchange of an annuity contract for another annuity contract is not taxable. But Section 1035 does not provide for the tax-free reinvestment of cash received. To read how the IRS clarified this issue, visit *www.expectfocus.com*.

NEWS & NOTES

Jorden Burt Client Successes

Sweetwater Ordered to Pay Attorneys' Fees for Successful Defense. Sweetwater, FL has been ordered to pay the two attorneys who successfully defended two police officers last year. The officers were accused of beating a teenage suspect. This is the first test of the 2004 state amendment requiring local governments to pay for the defense of officers wrongly accused of crimes while on duty. Jorden Burt represented one of the officers in this case.

Publications

Joan Boros authored "Developing the New Products Needed for Baby Boomers" in the April 30, 2007 issue of *National Underwriter: Life and Health.*

Jim Jorden wrote "Significant Developments Involving Insurance and Financial Service Class Actions and Major Trial Themes" for *Insurance Law 2007: Top Lawyers on Trends and Key Strategies for the Upcoming Year,* published by Aspatore Thought Leadership.

Jim Sconzo was one of four lawyers featured in *GC New England* for its Roundtable on Employment Law, published in July 2007.

Speeches

Ann Furman, Richard Choi and **Steve Goldberg** were on the faculty of the NAVA Compliance and Regulatory Affairs Conference, June 24-26, 2007 in Washington, DC. Ann Furman, who sits on the planning committee of the conference, moderated a panel on suitability issues. Mr. Choi moderated a panel on revenue sharing and Mr. Goldberg participated in that panel as well.

Bruce Leshine spoke at the Healthcare Financial Management Association's (HFMA) Annual National Institute, June 24-27 in San Diego, CA. His presentation was on "Making a Business Case for IT Outsourcing."

Jim Sconzo was a panelist at the "Annual Labor and Employment Law Review" at the Connecticut Bar Association Annual Meeting, June 18, 2007 in Hartford, CT.

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

Jim Jorden, conference founder and planning chair, led the 12th Annual ALI-ABA Conference on Insurance Industry and Financial Services Litigation, May 10-11, 2007 in Chicago, IL. **Wally Pflepsen** and **Rollie Goss** also spoke at the conference.

Jim Sconzo, Jon Sterling and **Michael Petrie** hosted a seminar on the Family and Medical Leave Act, May 8, 2007 in Hartford-Cromwell, CT. The master class was an Advanced Interactive Workshop for Connecticut Employers sponsored by M. Lee Smith Publishers.

Sponsorships

Jorden Burt sponsored the American Counsel of Life Insurers Compliance and Legal Sections Meeting, July 12, 2007 in Fort Lauderdale, FL.

Jorden Burt is a sponsor of the American Bankers Insurance Association Annual Conference, September 16-18, 2007 in Washington, DC.

Congratulations!

Ann Young Black was elected to a three-year term on the Board of Directors of the National Association for Fixed Annuities (NAFA). The election was held on April 25, 2007, at NAFA's annual meeting.

JORDEN BURT LLP

JORDEN BURT LLP is the premiere national legal boutique providing litigation and counseling services to the financial services industry. The firm serves clients in six key industries:

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

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 201
175 Powder Forest Drive
Simsbury, CT 06089–9658
860.392.5000
Fax: 860.392.5058