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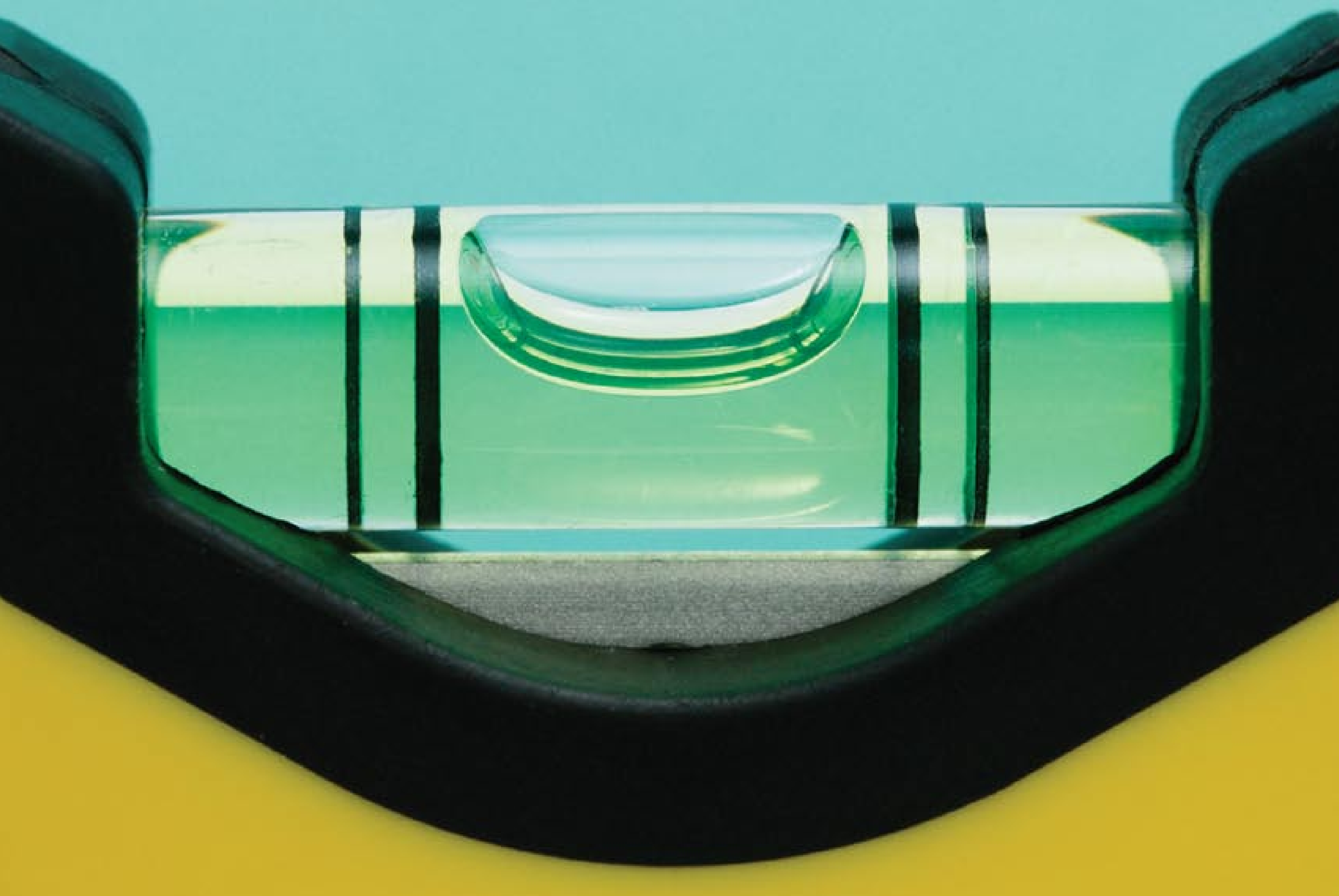
VOLUME III SUMMER 2008

Industry News in a Shaky Environment



JordenBurt LLP

EXPECT**FOCUS**® Vol. III Summer 2008

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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INTHESPOTLIGHT

Proposed Rule 151A Proposes Sweeping Change

BY GARY COHEN, CHIP LUNDE & RICHARD CHOI

After a three-year collaboration with the North American Securities Administrators Association, on June 25, 2008, the SEC proposed a new Rule 151A that would require registration under the Securities Act of 1933 for the offering of certain types of fixed index annuities.

Proposed Rule 151A would set out a new definition of "annuity contract" under the exclusion in Securities Act Section 3(a)(8). If adopted, it would prospectively define certain fixed index annuities as not being an "annuity contract" or "optional annuity contract," even though regulated as annuities under state insurance law if the amounts payable by the insurer under the contract are: (i) calculated in whole or in part by reference to the performance of a security, including a group or index of securities; and (ii) more likely than not to exceed the amounts guaranteed under the contract. Proposed Rule 151A would apply prospectively, and not to fixed index annuities issued before the effective date of a final rule if adopted.

The SEC received hundreds of comment letters by the September 10 deadline, which was not extended despite countless requests. Most commenters, including NAFA and NAIC, oppose Proposed Rule 151A. Others, including NASAA and the Investment Company Institute, support the rule. Some insurers, including AXA Equitable and The Hartford, expressed support for further regulation of index annuities, but expressed concern about the rule's breadth. In opposition to the proposed rule, NAFA argued that the SEC did not provide sufficient evidence of selling abuses or lack of enforcement to justify the proposal. NAFA argued that fixed index annuities are not securities under three different Supreme Court standards: (a) *VALIC* and *United Benefit*, because the owner does not assume substantial investment risk where the insurer guarantees principal, a minimum interest rate and credited interest; (b) *Howey*, because any risks assumed by the owner relate to fluctuations of an external index and, not the managerial efforts of others; and (c) *Weaver*, because the owner is protected by state insurance regulation. The NAFA letter detailed existing regulation of fixed index annuities under state insurance law.

The NAIC, also in opposition, emphasized that state insurance laws regulate not only insurance company solvency, but also advertising, replacement sales, producer licensing, and continuing education. The NAIC also highlighted a new model regulation to address certain sales practices, disclosure and suitability requirements.

NASAA argued that fixed index annuities are securities under the tests referred to above. Stay tuned.

CONTENTS

IN THE SPOTLIGHT

LIFE & HEALTH INDUSTRY

PROPERTY & CASUALTY INDUSTRY

REINSURANCE INDUSTRY

NOTEWORTHY SPECIAL

MUTUAL FUNDS & INVESTMENT ADVISERS INDUSTRY

SECURITIES INDUSTRY

CONSUMER FINANCE & BANKING INDUSTRY

Certification of Immediate Annuity Class Denied

BY TODD WILLIS

Individualized issues precluded class certification

The U.S. District Court for the Western District of Washington recently denied a motion to certify a nationwide class of immediate annuity purchasers who were 85 years old or older at the time of purchase. In the *Estate of Felts v. Genworth Life Ins. Co.*, the estate claimed that Genworth misrepresented the inherent risks in the purchase of its life-only single premium immediate annuities (LOSPIAs), misrepresented or failed to disclose material facts regarding the annuities, and failed to properly access the LOSPIA as suitable for Mr. Felts.

The district court held that the estate satisfied neither the predominance nor the superiority requirements under Rule 23(b)(3). Despite the estate's laundry list of "deceptive sales and marketing practices," ranging from failure to disclose the actuarial tables used by Genworth to misrepresenting the non-refund nature of the LOSPIAs, the court found that individualized issues predominated, noting that "hundreds of large financial institutions, insurance brokerages, and independent agents … market Genworth LOSPIAs in hundreds of different ways." In addition, the laws of as many as 50 different states could apply since the estate alleged no federal claims, but instead sought relief under contract-based claims, a negligence claim and state consumer protection and criminal profiteering acts. The district court also decided that individual claims were superior to class treatment because hundreds of purchasers across the nation purchased LOSPIAs from different sales people using different practices. The court stated that each individual should be able to challenge the specific practices that induced him or her to purchase the annuity and the purportedly deceptive written or oral representations made to the individual.

Class Actions Seek Health Coverage for Mental Illnesses

BY ROBIN SANDERS

In both the ERISA context and otherwise, health and disability insurance carriers continue to see claims seeking to expand the level of coverage offered under policies for illnesses most commonly considered mental illnesses. One of the more common bases for these claims is that the illnesses at issue may be biologically based. While these types of claims are not new, the types of illnesses for which such expanded coverage is sought continue to evolve. For instance, one carrier recently settled a class action where the insureds sought expanded coverage for eating disorders. Additionally, plaintiffs' counsel continue to bring individual and class actions alleging that bipolar disorder is not a mental illness for purposes of policy limitations. As medical research continues into the origins of various mental illnesses, it may be expected that these types of claims, and types of illnesses at issue, will only continue to increase.

Will health and disability coverage expand to include mental illness?

Senate Seeks Additional Protection for Senior Investors

BY ANN FURMAN

Federal and state regulators have had their say and now Congress may be stepping in to adopt measures aimed at eliminating investment fraud against seniors. Senators Robert Casey [D-PA] and Herb Kohl [D-WI] introduced legislation in the U.S. Senate on June 27, 2008 that would enhance penalties for federal securities law violations involving conduct that targets senior investors.

In particular, the Senior Investor Protections Enhancement Act of 2008 (S.3219) would add a $50,000 civil fine for each federal securities law violation that is "primarily directed toward, targets, or is committed against" a senior. The bill defines "senior" as an individual 62 years old or older. This is the age at which most retirement savings become available for use and investment.

If enacted, S.3219 may enhance the likelihood of private and/or SEC litigation under the federal securities laws. As introduced, S.3219 creates a "special rule for seniors" in the civil action, willful violation and other violation sections of four federal securities laws. The bill also requires the Federal Sentencing Commission to review and amend the federal sentencing guidelines and policy statements to ensure that securities law violations involving conduct against seniors are appropriately punished. The legislation follows hearings held by the U.S. Senate Special Committee on Aging in September 2007 to examine some of the questionable practices used by "senior financial investment specialists" to gain access to retirement savings of senior citizens.

Earlier this year, Senator Kohl also introduced the Senior Investor Protection Act of 2008 (S.2794), which seeks to protect older Americans from fraudulent marketing practices, with the goal of increasing retirement security. S.2794 directs the U.S. Attorney General to establish a program of grants to states to investigate and prosecute fraudulent marketing practices, or develop educational materials and training aimed at reducing fraudulent marketing of financial products toward seniors.

S.3219 was referred to the Senate Committee on Banking, Housing and Urban Affairs. S.2794 was referred to the Senate Judiciary Committee. At this time, there are no companion bills pending in the House of Representatives.

NAIC National Meeting Update

BY STEVEN KASS

The NAIC held its Summer National Meeting in June, and there have been numerous follow-up Committee and Working Group conference calls in advance of the September 21-24, 2008 Fall National Meeting. Important outcomes and developments include:

- Senior Designations. At the Summer Meeting, the Life Insurance and Annuities (A) Committee unveiled a new model regulation, based on the NASAA model rule, restricting the use of "senior designations" in life insurance and annuity sales. This model regulation was refined in subsequent conference calls, and we expect the NAIC will formally adopted it at the Fall Meeting.
- Annuity Suitability and Disclosure. Under the A Committee's auspices, the Suitability of Annuity Sales Working Group and a new Annuity Disclosure Working Group have each held a series of conference calls after the Summer Meeting. On the suitability side, the Wisconsin Insurance Department has developed draft "Annuity Supervision, Monitoring and Training Guidelines," and these Guidelines are on the Suitability Working Group's Fall Meeting discussion agenda. The Disclosure Working Group is considering changes to the Annuity Disclosure Model Regulation, primarily related to the point-of-sale Buyer's Guide, and discussions are continuing.
- Producer Licensing. In an ongoing effort to promote more uniform practice by the states, the Producer Licensing (D) Working Group continues to evaluate the findings and issues contained in the NAIC's February 2008 Producer Licensing Assessment Report. The Working Group is assisting states to achieve more uniform licensing practices. An updated version of the NAIC State Licensing Handbook has been drafted and is expected to be adopted by the end of 2008.
- Travel Underwriting. At the Summer Meeting, the NAIC plenary formally approved the proposed amendment to the Unfair Trade Practices Model Act prohibiting life insurance underwriting on the basis of past or future travel, subject to limited exceptions.
- Excess Policy Loans. Prior to the Summer Meeting, the A Committee asked its Life and Health Actuarial Task Force to review the financial and actuarial implications of an emerging practice by insurers of making policy loans in excess of a policy's cash surrender value. (For further information on this topic, see the Loan Settlement article on page 18.) LHATF briefly discussed this matter at the Summer Meeting, but it is not on LHATF's Fall Meeting agenda, pending further A Committee guidance.

Insurer Prevails in ERISA Class Action

BY EVAN TAYLOR

On June 3, 2008, the U.S. District Court for the Central District of California granted defendants' motion for summary judgment in *Knapp v. Unum Life Insurance Company, et al.*, disposing of plaintiff's class claims for benefits due and a clarification of rights under an ERISA plan pursuant to 29 U.S.C. § 1132(a)(1)(B), breach of fiduciary duty pursuant to 29 U.S.C. § 1132(a)(3), and her accompanying request for injunctive relief.

Having suffered an on-the-job injury, plaintiff was receiving long-term disability benefits under her employer's employee benefits plan. She filed suit when Unum, the underwriter of the group policy, serving as plan administrator, began to offset her plan payments by the amounts of the workers' compensation she received.

The "Summary Plan Description" provided, "[i]f you are eligible for group disability benefits from other sources, such as Workers' Compensation, … your … LTD benefit will be adjusted so that your total monthly income from all sources does not exceed the percentage of pay option you elected." Nonetheless, plaintiff argued that the reduction in plan payments was improper because the term "income," as used in plan documents, referred only to payments made for the purpose of wage replacement and, under California law, wage replacement is not the purpose of workers' compensation permanent disability benefits.

The court found Unum's interpretation of the plan's offset provisions and resulting reduction of benefits reasonable and within its broad discretion. According to the opinion, plaintiff failed to set forth any evidence that Unum's practice in calculating disability benefits under the plan differed from its interpretation of the plan's offset provisions. The court also held that the Policy and Summary Plan Description, when read together, adequately informed plaintiff of the practice of offsetting disability benefits, thus foreclosing any argument that plaintiff did not receive adequate notice or rational explanation for the reduction in benefits or that the reduction was contrary to plaintiff's reasonable expectations.

Focus on Tax Cases

Kentucky Premium Tax Cases

BY FRANK BURT & FARROKH JHABVALA

Kentucky has long permitted local governments to impose premium taxes on a range of insurance risks located within the local government's geographical boundaries. Hundreds of Kentucky local governments have enacted premium taxes with varying rates that insurers must collect from insureds and remit to the appropriate local government. The practical difficulties encountered by insurers in complying with what is by any measure a very complicated set of overlapping requirements have resulted in regulatory examinations that are now being used by the plaintiffs' bar to bring class actions on behalf of both local government entities and individual policyholders.

A new Kentucky statute granting underwriters immunity if they follow certain procedures became effective in July 2008, prompting the filing of numerous class actions against life and property casualty underwriters in Kentucky federal district court. The actions brought by local governments allege that insurers improperly allocated the premium taxes between various local governments or that they underpaid the taxes. The actions on behalf of insureds allege they were charged a premium tax when none was owed (because their property or other risk was not located within the territory of a local government that had levied a premium tax), or that they were charged a tax at a higher rate than that levied by the local jurisdiction within whose geographical boundaries the insurance risk was located.


Underwriters granted immunity from premium tax hurdles

In sum, the governmental class actions claim that the insurers failed to pay the premium taxes that were owed to the local governments. The insureds' class actions claim that the insurers overcharged the insureds by collecting taxes when none was owed because the insureds reside or own real or personal property in areas that have not enacted a local government premium tax, or by collecting taxes at a tax rate higher than that enacted by the relevant local government.

Annuity Issues in 2008
Putative Class Narrowed

BY TODD FULLER

In *Studley v. American Investors Life Insurance Company*, plaintiffs brought a putative class action on behalf of individuals named as beneficiaries of deferred annuities purchased by seniors who have since passed away. The gist of plaintiffs' complaint was that American Investors knew that the annuities purchased by seniors would be used as wealth transfer vehicles and thus the imposition of certain conditions on receiving the death benefits was intended to target and damage the beneficiaries.

No injury: You can't lose what you never had

American Investors moved to dismiss arguing, among other things, that the beneficiary class lacked standing under Article III or RICO and otherwise failed to state a claim. The court agreed, adopting nearly all of the arguments advanced in the motion to dismiss.

The court found as a threshold matter that the beneficiary class claims failed because plaintiffs were unable to demonstrate that they suffered an injury in fact, as required by Article III. The court noted that the "fundamental logical flaw" in plaintiffs' damages theory was that, unlike the actual purchasers of the annuities, plaintiffs had no interest in the money prior to becoming beneficiaries of those annuities.

The court also found that plaintiffs failed to plead any loss or injury to property as required for RICO standing. Their complaint made no specific allegations that the senior annuity purchaser was misled or received anything other than was expressly bargained for. Consistent with its Article III analysis, the court noted that plaintiffs could not show that they suffered a concrete financial loss because they were no worse off than they were before the senior purchased the annuity and named them as beneficiaries.

The court also rejected plaintiffs' negligence claims, which they contended encompassed a duty to ensure suitability of the annuities purchased, because, among other things, plaintiffs failed to identify any relevant duty that the insurer owed to them as beneficiaries of the annuities. Finally, the court noted that plaintiffs' claims for unjust enrichment failed because they could not identify, as beneficiaries, any benefit that they had conferred upon the insurer. Plaintiffs have appealed the dismissal ruling. Jorden Burt acted as counsel in this case.

Mark your Calendars

The ALI-ABA Conference on Life Insurance Products will be held November 13-14, 2008 in Washington DC. **Richard Choi** is a planning chair of this conference, and **Joan Boros** and **Gary Cohen** will be presenting. For more information, please visit www.ali-aba.org.

Alternative Loss Computation Upheld

BY JOHN PITBLADO

Court remands case for recalculation of loss

In *Landry v. Louisiana Citizens Prop. Ins. Co.* (Citizens), the Louisiana Supreme Court recently upheld the applicability of a provision in Louisiana's Valued Policy Law statute which excepts insurers from the obligation to pay insureds the full value of the policy without deduction or offset in cases of total loss, where the parties have validly agreed to an alternative loss computation at the time of contracting.

Mark and Barbara Landry lost their home to Hurricane Rita. Their homeowners' policy with Citizens covered loss caused by wind and rain, but excluded damage caused by floodwaters. The parties disputed the extent to which the loss was caused by covered perils. The Landrys filed suit, asserting entitlement to the full insured value of the home under the statute. Citing the policy's floodwaters exclusion, Citizens argues that reimbursement for the loss should be computed in such a way as to include only loss caused by any covered peril, as set forth in the terms of the policy and as additionally incorporated by a signed supplement to the application.

The Louisiana Supreme Court held that the alternative loss computation provisions contained in both the policy and the signed application supplement unambiguously satisfied the requirements of the statute's exception, and therefore examined the policy's alternative loss computation provisions. Finding that those provisions did not require Citizens to pay the full face value of the policy, the court remanded the case back to the trial court for a determination of loss.

No "Home Cooking" in Hurricane Class Action

BY BEN SEESSEL

The State of Louisiana sponsors the "Road Home Program," whereby it advances substantial sums to its citizens whose homes were damaged or destroyed by Hurricanes Katrina and Rita. Under the program, Louisiana forwards up to $150,000 to homeowners in exchange for an assignment of claims against the homeowner's insurer. The attorney general of Louisiana filed a putative class action in state court on behalf of the state and these homeowners against over 200 insurers that allegedly failed to honor their contracts to which the State is partial assignee under the Road Home Program. The attorney general and other putative class plaintiffs asserted claims for breach of contract, breach of the covenant of good faith and fair dealing, and breach of fiduciary duty.

Several defendant insurers removed the case to federal court under CAFA. Louisiana moved to remand, arguing that CAFA does not apply to states and, furthermore, removal to federal court offended its sovereign immunity. The district court, Judge Stanwood Duval, Jr., denied the state's motion to remand. The Fifth Circuit affirmed.

The Fifth Circuit first held that CAFA applies to states, even though states are not "persons." Further, while avoiding a decision on whether sovereign immunity would bar removal if Louisiana brought the case on its own, the court held that Louisiana waived any sovereign immunity it may have had by joining itself with a putative class of its citizens. The court reasoned that Louisiana, while frustrated with Congress's decision to give the defendant insurers access to federal court, could not "pull its citizens under its claimed umbrella" of immunity. Allowing it to do so, the court continued, would countermand the very basis for diversity jurisdiction – to avoid what is "known then and now to the trial bar as 'home cooking.'"

Excess Policy Not Triggered By Settlement Below The Primary Limit

BY JACOB HATHORN

A California appellate court recently declined an invitation to broadly declare that when an insured settles with its primary insurer for an amount below the primary policy limit and absorbs the resulting gap between the settlement amount and the primary policy limit, primary coverage should be deemed exhausted and excess coverage triggered in *Qualcomm, Inc. v. Certain Underwriters at Lloyd's, London*.

Starting in 1999, Qualcomm became a defendant in individual and class actions brought by its current and former employees. Qualcomm tendered the claims to its director and officer liability insurers. It held a $20 million primary D&O insurance policy through National Union Fire Insurance Company, and a $20 million excess policy through Certain Underwriters at Lloyd's. Once it settled certain of the underlying suits, Qualcomm looked to these and other insurers to reimburse defense and settlement expenses.

Qualcomm's primary carrier, National, agreed to reimburse a portion of the expenses in the non-class action cases in exchange for Qualcomm's agreement to release National from all future obligations under the primary policy, and accordingly paid $16 million under the primary policy.

Unable to reach a similar agreement with Underwriters, Qualcomm sued its excess carrier for recovery of more than $9 million in unreimbursed expenses. Underwriters defended by citing the following exhaustion clause in the excess policy: "Underwriters shall be liable *only* after the insurers under each of the Underlying policies *have paid or have been held liable to pay* the full amount of the Underlying Limit of Liability." Concluding that the foregoing exhaustion clause was unambiguous and that National had neither paid nor been held legally obligated to pay the full $20 million limit of liability under the primary policy prior to obtaining its release, the court agreed with Underwriters that excess coverage was never triggered.

Florida Passes "Homeowner's Bill of Rights Act"

BY JOHN PITBLADO

On May 28, 2008, Florida Governor Charlie Crist signed an omnibus property insurance reform bill titled the "Homeowner's Bill of Rights Act." Effective July 1, 2008, the Act addresses a number of Florida's increasing property insurance problems with the following revisions and additions to Florida's insurance statutes:

- An extension of the hold on residential property insurance rates until January 1, 2010, by which time proposed increases must be filed and approved by the Office of Insurance Regulation (OIR) as actuarially sound.
- An increase of the cap from $1,000,000 to $2,000,000 on residential properties eligible for property insurance through the Citizens Property Insurance Corporation (CPIC), Florida's insurer of last resort.
- An extension until December 31, 2009 of the requirement that all proposed property insurance rate increases be filed and approved prior to use. An exception is provided where the OIR fails to act on the filing within 90 days, in which case the insurer may use the proposed rate filed prior to approval.
- Repeal of provisions allowing arbitration panels to resolve rate disputes between insurers and the OIR; expedited hearings on rate filings requiring a hearing within 30 days after an insurer's request, and an order by the administrative judge within 30 days of the hearing.
- A requirement that any insurer seeking to non-renew more than 10,000 policies within a twelve month period must notify the OIR at least 90 days prior to the issuance of non-renewal notices.
- Increased fines for violation of certain state unfair competition, unfair or deceptive acts or practices relating to insurance, and unfair claims handling practices laws, including fines up to as much as $200,000 for certain violations (from a previous maximum of $100,000).
- Authorizing the OIR to require an insurer to file its claims handling practices and procedures as a public record based on findings of a market conduct examination.
- New requirements for underwriting methods pertaining to hurricane prediction models.
- The creation of a Task Force to develop a report setting forth proposed changes needed to return CPIC to its former role as a state-created, noncompetitive market mechanism providing property insurance coverage to risks that are otherwise uninsurable in the private insurance market, which report must be submitted by January 31, 2009.

Regulatory Update:
Posting Security Becomes More Than A "Collateral" Issue

BY ANTHONY CICCHETTI & PATRICK LAVELLE

Reinsurance Collateral Proposals Evolve. The NAIC continues to develop its Reinsurance Regulatory Modernization Framework proposal, which aims to eliminate the dichotomy between U.S. and non-U.S. reinsurers as the controlling factor in determining collateral requirements for business ceded by U.S. insurers. The latest NAIC proposal contemplates the establishment in the NAIC of a Reinsurance Supervision Review Department that would, among other things, establish uniform standards for the single-state regulation of "national" (U.S.-domiciled) reinsurers and "port of entry" (non-U.S.) reinsurers. The NAIC proposal calls for each such reinsurer to be assigned one of five specified ratings – from "Secure-1" to "Vulnerable-5" – based upon the reinsurer's financial strength ratings from rating agencies and other factors. The rating assigned by the reinsurer's U.S. supervising jurisdiction would determine the amount of reinsurance collateral required on a sliding scale, with no collateral being required for reinsurers rated "Secure-1" to 100% collateral being required for a "Vulnerable-5" rating.

Single state regulator would have a lot of tracks to cover

New York and Florida have developed their own proposals relating to reinsurance collateral requirements and related matters, with Florida's proposal being limited to property and casualty insurance given the state's paramount concern with increasing reinsurance capacity in the property insurance market. These proposals are similar to that of the NAIC in that they base collateral requirements on a reinsurer's agency ratings, although each state introduces its own variations and requirements.

Jorden Burt has been monitoring developments in this area. For a more detailed summary of the NAIC, New York, and Florida proposals, please see the article posted on our reinsurance blog at *http://www.reinsurancefocus.com/*.

State Regulation of Captives. Regulators continue to refine state captive regulations in an effort to capture a larger segment of the U.S. alternative insurance market. Delaware has proposed amended regulations that would overhaul the financial and reporting requirements of state-domiciled captive insurers. Regulators in South Carolina recently issued a bulletin addressing requirements for managers of captive insurers, and legislators proposed a bill relating to the capitalization and free surplus requirements of captive insurers.

Announcing

Jorden Burt is pleased to welcome eight new associates: Daniel Crisp and James Goodfellow in the Connecticut office; in the Washington office, John Black, John Kimble and Aileen Warren; and in the Miami office, Ramiro Areces, Stephanie Fichera, and Jonathan Hart.

Underlying Insured Lacks Standing to Sue Reinsurer

BY BOB SHAPIRO

School's out for this case

A U.S. District Court in Louisiana has ruled that absent a clear intent by the parties to a reinsurance contract to confer an advantage on a third party, that party has no standing to bring suit against the reinsurer. At issue in *LaSalle Parish School Board v. Allianz Global Risks U.S. Ins. Co.* was whether the underlying insured, LaSalle Parish School Board, could sue for recovery of a claim against the reinsurer, Allianz, under an insurance policy issued by Property Casualty Alliance of Louisiana (PCAL) to LaSalle. The insurance policy was reinsured by Allianz pursuant to a reinsurance agreement between PCAL and Allianz. Following the destruction of a high school insured by PCAL, PCAL paid the amount it owed under the insurance policy. LaSalle then sued Allianz claiming that Allianz should pay "the remainder of the monies owed under the terms and conditions of the policies."

In granting Allianz's motion to dismiss, the court noted that LaSalle had no standing to sue Allianz since they were not a party to the contract. The court further noted that nothing in the reinsurance agreement suggested that the parties, PCAL and Allianz, intended to grant any advantage to any party other than those named in the agreement, and the reinsurance contract did not contain a cut-through indicating the reinsurer intended to assume for itself any of the policy obligations of the ceding insurer.

Mediation in Eleventh Circuit Is Not Arbitration

BY LYNN HAWKINS

The Eleventh Circuit has held that for the purposes of the Federal Arbitration Act (FAA), mediation is not arbitration. Specifically, in *Advanced Bodycare Solutions, LLC v. Thione International, Inc.*, the court held that a party cannot use § 3 of the FAA to enforce a contract clause requiring an aggrieved party, prior to filing a lawsuit, to institute mediation or non-binding arbitration. The court noted that while the FAA does not define "arbitration," classic arbitration is characterized by submitting a dispute to a third party for a binding decision. Furthermore, the court said, the "FAA clearly presumes that arbitration will result in an 'award' declaring the rights and duties of the parties." Thus, a dispute resolution procedure that does not result in an award is not arbitration "within the scope of the FAA."

Mediation is not arbitration

While some in the ADR circuit may believe this decision represents a clear understanding of the differences between arbitration and mediation, others may feel the court unnecessarily denigrated the mediation process by implying that it is little more than a speed bump on the way to the courthouse.

Conditional Exemption from Reporting Requirements in Proposed Rule 12h-7

BY RICHARD CHOI

Proposed Rule 12h-7 would provide insurers with a conditional exemption from the periodic reporting requirements of the Exchange Act with respect to its securities that are registered under the Securities Act and that are either subject to state insurance regulation of the insurer's domiciliary state or are guarantees of securities subject to such regulation. The proposed exemption would cover existing types of insurance contracts, including fixed index annuities, contracts with market value adjustment features, contracts that provide certain guarantees in connection with assets held in the investor's mutual fund, brokerage, or investment advisory accounts, as well as other contracts that are developed in the future that are registered under the Securities Act. The proposed exemption would not apply, however, to other types of securities, such as common stock, that constitute an equity interest in the insurer.

Reliance on proposed Rule 12h-7 would be subject to compliance with the following conditions: the insurer must be a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any state; the insurer must file an annual statement of its financial condition with, and the insurer must be supervised and its financial condition periodically examined by, the insurance regulator of the insurer's domiciliary state; the securities with respect to which the exemption is claimed may not be listed, traded, or quoted on any exchange, alternative trading system, inter-dealer quotation system, electronic communications network, or any other similar system, network, or publication for trading or quoting; and the insurer must take steps "reasonably designed" to ensure that a trading market for the securities does not develop.

The SEC based the proposed exemption on two factors, including (1) the nature and extent of the activities of insurance company issuers, and their income and assets, and, in particular, the regulation of these activities and assets under state insurance law; and (2) the absence of trading interest in the securities.

Industry Comment Letters

Proposed Rule 12h-7 generally has been viewed as a positive development. Supporters of the proposed exemption include not only members of the insurance industry, but also the ICI. There appears to be little disagreement with the SEC's view that, in light of state insurance regulation, the imposition of Exchange Act reporting as a general matter may be unnecessary and may result in duplication of state insurance regulation that is burdensome. Notably, in addition to relieving insurers of duplicative regulation, Proposed Rule 12h-7 would exclude insurers eligible to rely on it from the requirements of the Sarbanes-Oxley Act of 2002 to the extent they would be subject to it by reason of the registration of the subject annuities.

A bright idea from the SEC

Short but Powerful:
New Privacy Law Requires Compliance by October 1, 2008

BY DIANE DUHAIME & BRUCE LESHINE

Following a series of data security breaches involving the loss of record amounts of personal information, including one bank's reported loss of up to 10 unencrypted tapes containing names and Social Security numbers, the Connecticut legislature passed Connecticut Public Act No. 08-167 (House Bill No. 5658). Effective on October 1, 2008, the law requires any individual or business having possession of "Personal Information" of another person to (a) safeguard such data, computer files and documents containing the information from misuse by third parties, and (b) destroy, erase or make unreadable such data, computer files and documents prior to its disposal. Insurers and other financial services firms must comply if they have customers or do business in Connecticut; being physically located in Connecticut is not a prerequisite for compliance.

Under the new law, "Personal Information" means information capable of being associated with a particular individual through one or more identifiers, including, but not limited to, a Social Security number, a driver's license number, a state identification card number, an account number, a credit or debit card number, a passport number, an alien registration number or a health insurance identification number, but does not include publicly available information that is lawfully made available to the general public from federal, state or local government records or widely distributed media.

Additionally, the law requires entities which collect Social Security numbers in the course of business to create and publish or publicly display a privacy protection policy which: (1) protects the confidentiality of Social Security numbers, (2) prohibits the unlawful disclosure of Social Security numbers, and (3) limits access to Social Security numbers.

There is no private cause of action for violations of the law. Only the Connecticut Department of Consumer Protection and some other state agencies have the right to enforce the statute which provides for civil penalties of $500 per violation, up to $500,000 for any single event. The new law does not, however, impose these penalties unless the violations were intentional.

Actions Required by October 1, 2008:

- Review current privacy policies to confirm compliance with the statute
- If not in compliance, develop a privacy protection policy that complies with the statute
- Publish or publicly display such privacy protection policy
- Implement the privacy protection policy, including a policy for safeguarding and destroying Personal Information as described in the statute
- As part of implementing the privacy protection policy, encrypt Personal Information and limit access to Personal Information as appropriate
- Confirm that the privacy protection policy conforms with all other federal and state privacy laws, rules and regulations that are applicable to your business

Seventh Circuit 'Disapproves' *Gartenberg* Standard

BY ED ZAHAREWICZ

On May 19, 2008, the U.S. Court of Appeals for the Seventh Circuit, in the case of *Jones v. Harris Associates*, affirmed a district court decision granting summary judgment in favor of a mutual fund adviser in an excessive fee case brought by three individual shareholders. In his opinion, Chief Judge Easterbrook, a nationally respected jurist known for his use of economic analysis of law, expressly "disapproved" the approach taken by the Second Circuit in *Gartenberg v. Merrill Lynch Asset Mgmt.*, which for more than 25 years has been the touchstone for nearly all judicial decisions involving allegations of excessive fees:

> Having had another chance to study this question, we now disapprove the Gartenberg approach. A fiduciary duty differs from rate regulation. A fiduciary must make full disclosure and play no tricks but is not subject to a cap on compensation. The trustees (and in the end investors, who vote with their feet and their dollars), rather than a judge or jury, determine how much advisory services are worth.

Under the Harris approach, it is clear that absent some deceit on the part of the fund adviser in the negotiation or disclosure of its fees, courts should not be involved in a judicial review of the "reasonableness" of those fees, as they are under the Gartenberg approach.

Just how much of an impact the decision will have, however, remains to be seen. Harris is binding only on courts within the Seventh Circuit while Gartenberg appears to remain the standard in many other jurisdictions. The clear conflict between the two approaches leaves open the possibility that the U.S. Supreme Court may eventually step in to decide what the standard should be.

SEC Proposes Mandatory XBRL Filings for Mutual Funds

BY ED ZAHAREWICZ

On June 10, 2008, the SEC proposed rules that would require mutual funds to provide the risk/return summary section of their prospectuses to the SEC in interactive data format using XBRL — eXtensible Business Reporting Language. The interactive data would be provided as an exhibit to registration statements filed on Form N-1A, beginning with initial registration statements and annual updates that become effective after December 31, 2009.

Mutual funds also would be required to post the same risk/return summary information on their Web sites on the date the interactive date is submitted to the SEC or is required to be submitted, whichever is earlier. Other notable elements of the proposal include:

Risk/return summaries may become interactive

- Viewable interactive data as displayed through software available on the SEC's Web site, and to the extent identical in all material respects to the corresponding portion of the traditional format filing, would be subject to all the same liability provisions of the federal securities laws as the corresponding data in the traditional format filing.
- Each interactive data submission would be required to be filed as a post-effective amendment under Rule 485(b) under the Securities Act and would be required to be filed after effectiveness of the related filing, but no later than 15 business days after the effective date of the related filing.
- If a mutual fund does not submit or post interactive data as required, the fund's ability to file post-effective amendments under Rule 485(b) would be automatically suspended until the fund submits and posts the interactive data as required.

If the proposed rules are adopted, the SEC anticipates that the current voluntary filer program would be modified to exclude participation by mutual funds with respect to risk/return summary information but continue to permit mutual funds to participate with respect to financial statement information.

Court: SEC Lacks Authority to Seek Monetary Penalties

BY KAREN BENSON

In the case of *SEC v. Steven M. Bolla, et al.*, the U.S. District Court for the District of Columbia recently held that the SEC is not authorized to seek monetary penalties against aiders and abettors of violations of the Investment Advisers Act in an action brought in federal court. The case centered on Section 209(e) of the Advisers Act, which provides that the SEC "may bring an action in a United States district court to seek … a civil penalty to be paid by the person who committed such violation." The court read this language as authorizing monetary penalties against primary violators, but not aiders and abettors.

According to the court, this interpretation is supported by the fact that Congress gave the SEC the explicit authority to seek penalties against aiders and abettors under other securities laws, such as Section 203(i) of the Advisers Act, which expressly authorizes the SEC to seek monetary penalties from aiders and abettors in administrative proceedings. The court stated that it also could not overlook the views of the U.S. Supreme Court, which has stated that "Congress knew how to impose aiding and abetting liability when it chose to do so. If … Congress intended to impose aiding and abetting liability, we presume it would have used the words 'aid' and 'abet' in the statutory text." In addition, the court noted that the SEC could not point to any precedent actually analyzing the availability of monetary penalties against aiders and abettors in judicial proceedings.

SEC can't seek monetary penalties

Notwithstanding the court's holding, the SEC still has authority to pursue monetary penalties against aiders and abettors of Advisers Act violations through administrative proceedings. The SEC also has authority to pursue injunctive relief against aiders and abettors of Advisers Act violations through judicial proceedings.

Supreme Court Preserves Municipal Bond Market

BY STEVE KRAUS

Like most other states, Kentucky exempts interest on bonds issued by in-state entities from state income taxes, while subjecting interest on bonds from other states to the Kentucky state income tax. Petitioners, Kentucky residents who paid state income tax on interest from out-of-state municipal bonds, challenged Kentucky's tax scheme as impermissibly discriminating against interstate commerce. The trial court upheld Kentucky's tax scheme, but was overturned on appeal by the Kentucky Court of Appeals.

Interstate commerce not affected by KY tax law

In reversing the decision of the Kentucky Court of Appeals, the U.S. Supreme Court, in *Department of Revenue of Kentucky v. Davis*, held that "Kentucky's tax exemption favors a traditional government function without any differential treatment favoring local entities over substantially similar out-of-state interests. This type of law does 'not discriminate against interstate commerce' for purposes of the dormant Commerce Clause."

An adverse decision from the Supreme Court would have caused major disruptions in the municipal bond markets. The ruling thus comes as welcome news for municipal bond funds, but especially for single-state funds, which focus on a particular state's municipal bonds to drive fund sales.

MFDF to SEC: Clarify Directors' Authority to Delegate

BY PATRICK LAVELLE

The Mutual Fund Directors Forum recently sent a letter to the Director of the Division of Investment Management recommending that the SEC and its staff give fund directors clear authority to delegate routine board functions. The letter contends that uncertainty regarding the SEC's and staff's views of delegation "may limit the ability and willingness of boards to take steps that they otherwise believe would benefit their funds and shareholders." The MFDF believes that having the SEC and staff clarify their view would "provide directors with more leeway to delegate oversight activities to appropriate persons" and thus enable them to use their time as productively as possible.

SEC clarification may help to delegate oversight

The letter suggests that the following points should guide directors in analyzing the extent to which delegation is appropriate:

- Require registered investment companies, advisers, and broker-dealers subject to the safeguards rule to develop, implement, and maintain a comprehensive "information security program," including "written policies and procedures that provide administrative, technical, and physical safeguards for protecting personal information, and for responding to unauthorized access to or use of personal information."
- Directors should be more reluctant to delegate "core" responsibilities, such as approval of investment advisory contracts.
- Responsibilities that are delegated should be given to persons who are sufficiently independent, free of conflicts, and will be both responsible only to the board and report to the board regularly.
- When delegating activities, boards should determine that they are sufficiently familiar with the delegated activity and that the delegation would not jeopardize shareholder interests.

The letter cites numerous specific board obligations in which the level of detail involved, it is argued, risks distracting directors from their central responsibility of ensuring that funds are managed in the best interest of shareholders. The MFDF believes that clarification of the SEC's and staff's views on delegation would address the potential detrimental effects of the level oversight required by these obligations without the need for regulatory change.

California Still Hedge Fund Friendly

BY SARAH JARVIS

California's Department of Corporations has decided not to proceed with a proposal that would have required hedge fund managers to register with the state. In September 2007, the department proposed to revoke an exemption from licensing for investment advisers with fewer than 15 clients and more than $25 million in assets under management that are not voluntarily registered with the SEC. Revocation of the exemption would have subjected most hedge fund managers to state oversight that, in certain circumstances, would have included capital requirements and providing financial statements to the state.

The proposal was met with strong opposition from California's hedge fund industry, one of the largest outside of New York and Connecticut, including warnings from some in the industry that the many hedge funds could move to another state to avoid registration. In a May 1, 2008 statement, the California Commissioner stated that the department was "withdrawing the regulations due to an ongoing parallel process at the federal level which may pre-empt or obviate the need for state action at this time."

Achieving "Look-Through" Treatment for Variable Product Hedge Funds

BY STEPHEN KRAUS

By amendment to long-standing regulations, the Treasury Department has revoked "look-through" treatment under IRC Section 817(h) for investment funds operated as nonregistered partnerships that are not "insurance dedicated." Consequently, in order for a variable insurance product supported by a nonregistered partnership to have its intended tax deferral attributes, it is now generally necessary for all owners of beneficial interests in the partnership to be either insurance company separate accounts or other entities specified in the regulations (including insurance company general accounts, fund managers, and certain qualified pension or retirement plans).

This change is particularly relevant for hedge funds that support variable insurance products, because most such hedge funds are operated in the form of nonregistered partnerships.

The regulations also provide that, if an insurance company general account or a fund manager owns a beneficial interest in an insurance dedicated partnership, Section 817(h) look-through treatment will be available only if the return on such interests is computed in the same manner as the return on an interest held by an insurance company separate account. Thus, the manner in which the general account's or the fund manager's return is computed must be carefully scrutinized to ensure compliance with this requirement. Also, even if none of the interests in the partnership is held by an insurance company general account or by a fund manager, there is a risk that the partnership may still fail to qualify for "look-through" treatment if the partnership credits different returns with respect to different separate account investors. This potential problem arises because the language of the regulations could be read to assume that there will be only one rate of return for any partnership that will qualify for Section 817(h) look-through treatment.

SEC Explains Proposed Summary Prospectuses for Underlying Funds

BY GARY COHEN

Expect Focus previously raised some questions about how the SEC's summary fund prospectus proposal would apply to "underlying" funds that support variable insurance products (see *Expect Focus*, Vol. I, Winter 2008).

At the PLI Investment Management Institute in April 2008, panelist William "Bill" Kotapish, head of the SEC's Office of Insurance Products, was asked some of these questions. We understood Mr. Kotapish to say:

- Insurers would be deemed to be financial intermediaries that could deliver summary prospectuses of underlying funds.
- Underlying funds, not insurers, would decide whether or not to deliver summary prospectuses. (Some believe that the SEC's proposal does not answer certain concerns about liability, particularly regarding incorporation by reference. Consequently, some underlying funds may choose not to deliver summary prospectuses.)
- If an underlying fund chooses to use summary prospectuses, an insurer could deliver full length prospectuses to some (such as new offerees) and summary prospectuses to others (such as existing contract owners).
- Where several insurers participate in an underlying fund, some insurers could deliver summary prospectuses, notwithstanding that other insurers deliver full-length prospectuses.
- Insurers could maintain, on their websites, the documents and links required of funds as a condition for using summary prospectuses.
- Insurers would not be required to maintain, on their websites, information about revenue sharing payments and conflicts of interest.
- The fact that the SEC's proposing release did not state that the SEC would take up disclosure reform for variable insurance products and separate accounts does not mean that the SEC will not do so.
- The SEC staff has reviewed summary variable insurance product prospectus templates developed by the ACLI and NAVA and considers them to be "a moving target."

FINRA Proposes New Amendments to Rule 2821

BY CHIP LUNDE

On May 21, 2008, FINRA filed with the SEC a proposal to amend its suitability rule covering the sale of variable annuities.

The proposal would limit the scope of Rule 2821 to recommended purchases and exchanges of deferred variable annuities and recommended initial sub-account allocations, rather than to all purchases and exchanges. Also, broker-dealers whose principals disapprove applications will no longer have the option of informing the customer of the reason for disapproval, and authorizing the transaction if the customer affirms his or her desire to proceed.

The proposal would require registered representatives to promptly transmit completed and correct applications to a broker-dealer's office of supervisory jurisdiction (OSJ). In addition, the proposal would require principals to review and approve or reject applications within seven business days of the broker-dealer's receipt of the application at an OSJ.

The proposed amendments include a "*Supplementary Material*" section that provides interpretive guidance, including as follows:

- Broker-dealers may forward checks made payable to an issuing life insurance company or, if the broker-dealer is fully subject to Rule 15c3-3 under the Securities Exchange Act, transfer funds to the insurance company prior to principal approval, provided the customer is informed of the proposed transfer(s), and the insurance company, pursuant to a written contract with the broker-dealer, agrees to: (a) segregate the broker-dealer's customers' funds in certain qualifying bank accounts that protect the funds from the rights of creditors, and hold only cash or certain other instruments; (b) not issue the variable annuity prior to principal approval; and (c) promptly return the funds to a customer upon the customer's request or broker-dealer's rejection of the application; and
- Prior to principal approval, broker-dealers may share the information required for principal review with the insurance company, provided that the insurance company agrees not to issue the contract prior to principal approval.

New Loan Settlement Products Emerging

BY TOM LAUERMAN & STEVEN KASS

New products are coming on the scene that may give life settlements of insurance policies a run for their money. "Life settlements" basically involve an investor's purchase of a life insurance policy, or the right to receive the policy's death benefit, from the policy's original owner. Typically, the insured person under the policy has a remaining life expectancy of no more than ten years. Life settlements present a number of thorny issues and have been the subject of extensive regulatory and legislative consideration over the past few years (see *Expect Focus*, Vol. I, Winter 2008 and Vol. II., Spring 2007).

Are new loan settlements a remedy?

Now, some companies are beginning to offer so-called "loan settlements" as an alternative that can achieve benefits similar to life settlements, but with certain potential advantages. With a loan settlement, the policy owner receives a loan from the company offering the settlement, and the owner's obligation to repay the loan and interest thereon is secured by the death benefit under the life insurance policy. The policy's beneficiary, however, also retains the potential to receive a portion of the death benefit. The life insurance policy's owner prior to the settlement remains the owner of the policy and may terminate the arrangement at any time by repaying the loan and interest.

Such loan settlement arrangements bear some similarity to traditional loans under life insurance policies, except that the companies offering the settlement will lend in excess of a policy's cash value. State insurance regulators have had mixed reactions to recent loan settlement product filings, and the NAIC is currently examining the regulatory implications of these products. (Please see the NAIC meeting article on page 5 for more detail).

SEC Targets Lawyers

BY PETER PANARITES

The 2002 Sarbanes-Oxley Act and SEC activism have resulted in more frequent actions against lawyers for securities law violations.

Historically, the SEC tended to limit administrative proceedings and court cases against lawyers to those involving such matters as fraud or insider trading by the lawyer or aiding and abetting of a client's securities law violations. Thus, the SEC rarely proceeded against lawyers solely for making erroneous legal judgments, even if the judgments may have been negligent or inadvertently contributed to a client's securities law violation.

Increasingly, the SEC has become more aggressive in proceeding against lawyers—whether employed by companies or in private practice.

The role of lawyers as "gatekeepers" has been underscored by the SEC's "up the ladder" reporting requirement, adopted as part of the implementation of Sarbanes-Oxley. This requires corporate lawyers to report specified types of legal violations (or potential violations) to senior corporate management under certain circumstances; and the SEC has actively proceeded against lawyers for failures to report as required.

Even apart from Sarbanes-Oxley, the SEC has more often been proceeding against lawyers for making erroneous legal judgments. This has included cases involving little or no indication of intentional, willful or grossly negligent conduct by the lawyers.

Finally, proceedings against lawyers on more traditional grounds have also continued at a brisk pace. This has included, for example, a spate of recent actions based on lawyers' alleged direct involvement in the backdating of stock options and insider trading.

The SEC probably will continue to ratchet up the pressure on securities lawyers. The extent to which this is wise public policy is, and will continue to be, a matter of much serious debate.

Plan Sponsors Choosing CITs Over Mutual Funds

BY PATRICK LAVELLE & SCOTT SHINE

Collective investment trusts are emerging as a cost-effective alternative to mutual funds for defined-contribution plan assets. While they have been available for years, collective investment trusts, or CITs, are experiencing a resurgence as plan sponsors have become disenchanted with high mutual fund fees and concerned over fee litigation.

Similar to mutual funds, CITs pool investors' assets into a single portfolio and invest in a range of securities including stocks and bonds. However, unlike mutual funds, CITs are offered only through qualified retirement plans and are not registered with the SEC. Instead, they are subject to Department of Labor and bank rules and regulations.

The exempt status of CITs from SEC registration creates attractive benefits for plan sponsors. Typically, CITs have substantially lower fees than mutual funds, because they do not have to comply with SEC regulations or market to retail customers. CITs also permit plan sponsors to negotiate their management fees. Together, these cost advantages translate into lower fees paid by plan participants and result in higher investment returns.

Additionally, CITs have flexibility to invest in hedge funds, exchange traded funds, mutual funds and other alternative investment vehicles.

CITs becoming more popular

However, CITs do have substantial differences compared to mutual funds. For example, product disclosure is often less extensive and performance and holding information is less accessible. Moreover, CITs cannot be rolled over into an individual retirement account when the participant leaves the qualified retirement plan.

Nevertheless, CITs are becoming a popular alternative to mutual funds for plan sponsors seeking lower costs and greater investment flexibility.

Congress Revises FACTA To Quell Abusive Class Actions

BY FARROKH JHABVALA

When Congress enacted the Fair and Accurate Credit Transactions Act in 2003 to protect individuals' identities, it little expected that it would spawn a spate of abusive class actions. Under FACTA (15 U.S.C. § 1681c(g)), "no person that accepts credit cards or debit cards for the transaction of business shall print more than the last 5 digits of the card number or the expiration date upon any receipt provided to the cardholder at the point of sale or transaction." The law came into effect on December 4, 2004 or December 4, 2006 depending on whether the machine that electronically printed the receipts was first placed in use before or after January 1, 2005. Willful noncompliance was punishable by the award of actual damages sustained by the consumer, or statutory damages of between $100 and $1,000 for each noncompliant transaction. Many businesses properly truncated the card numbers but failed to block out expiry dates. As a result, hundreds of class actions were filed even though, as Congress subsequently noted, none of the lawsuits alleged harm to any consumer's identity. These suits were quintessentially extortionist, instantly confronting defendants with catastrophic statutory damages. Recognizing that these class actions served no purpose other than to generate attorney's fees, courts generally refused to certify the cases, primarily on the ground that class treatment was not a superior method of adjudicating these disputes. Belatedly acknowledging that the "continued appealing and filing of these lawsuits represents a significant burden on the hundreds of companies that have been sued and could well raise prices to consumers without corresponding consumer protection benefit," Congress retroactively amended the statute's civil liability provision (15 U.S.C. § 1681n) on June 3, 2008 to state that it shall not be a willful noncompliance of FACTA if a receipt issued prior to that date shows the card's expiration date but complies with all other truncation requirements. The amendment applies to all truncation actions except those that have become final.

Credit card class actions declined

First Circuit Mandates "Searching Inquiry" For Some Class Actions

BY JASON KAIRALLA

The First Circuit Court of Appeals recently reversed three orders certifying nationwide injunction classes in antitrust cases against American Honda, General Motors Corp., and Ford Motor Company. See *In re New Motor Vehicles Canadian Export Antitrust Litigation*. The plaintiffs alleged that the automobile manufacturers conspired to block lower-priced imports from Canada, and thereby maintained higher prices in the United States. The court found that the plaintiffs lacked standing to represent injunction classes because injunctions are "forward-looking" and the market condition that led to the alleged price disparity (the exchange rate differential between the U.S. and Canadian dollars) no longer existed. Accordingly, the court found that the alleged threat that might have necessitated an injunction was not "real and immediate." With regard to the state-law damages claims in the cases, the panel vacated certification and remanded for the lower court to apply a newly-announced standard requiring a more "searching inquiry" for certification under Rule 23. Rather than ruling, as some circuits have, that a rigorous inquiry is always required as to Rule 23 criteria, the court limited its pronouncement to situations where "a Rule 23 requirement relies on a novel or complex theory as to injury." In such a case, district courts in the First Circuit "must engage in a searching inquiry into the viability of that theory and the existence of the facts necessary for the theory to succeed."

Heart Valve Class Decertified Again

BY MICHAEL WOLGIN

The Eighth Circuit recently struck down for a second time the district court's certification of nationwide classes of patients implanted with an allegedly defective heart valve in *In re St. Jude Medical, Inc.* In the first case, the district court had certified two classes, a "medical monitoring class," which sought injunctive relief under Rule 23(b)(2), and a "consumer protection class" seeking damages under Rule 23(b)(3). At that time, the district court had concluded without conducting a conflict-of-laws analysis that plaintiffs across the country could avail of the Minnesota consumer protection statutes because they granted standing to "any person." The Eighth Circuit had reversed the medical monitoring class because it lacked the required "cohesion" of a proper 23(b)(2) class, given that each plaintiff's need for medical monitoring was highly "individualized." The court had reversed the consumer protection class because the district court failed to conduct a choice-of-law analysis, as required by the Due Process and Full Faith and Credit clauses of the U.S. Constitution.

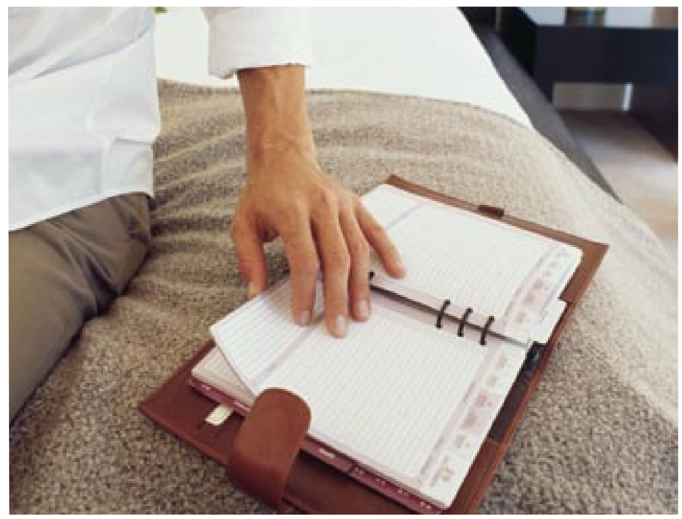
The plaintiffs then dropped the 23(b)(2) class in favor of a single consumer protection 23(b)(3) nationwide class that sought both damages and medical monitoring. The district court conducted a choice-of-law analysis, determined that Minnesota law would apply, and certified the proposed class. On appeal, the Eighth Circuit found that the "predominance" requirement of Rule 23(b)(3) was not satisfied. The court held that the class had to be decertified because the defendant had the right to submit individualized rebuttal evidence with respect to whether each class member relied upon the alleged misrepresentation, and the cause of damages suffered by each class member, which individualized evidence made certification inappropriate under Rule 23(b)(3). The court also held as it did in its first decision, that the remedy of medical monitoring "present[s] too many individual factual and legal issues," which defeat predominance under 23(b)(3).

Too many individual issues for class action

Third Circuit Follows the Crowd On Rule 23(f) Appeals

BY MICHAEL SHUE

In *Gutierrez v. Johnson & Johnson*, the Third Circuit joined a growing consensus of Circuit Courts holding that Rule 23(f)'s ten-day time limit for interlocutory appeals of class certification orders is "strict and mandatory." The District Court for New Jersey had denied plaintiffs' motion for class certification. A month later, plaintiffs requested leave to file a reconsideration motion. After the district court denied the reconsideration motion, plaintiffs filed their Rule 23(f) motion for review in the Third Circuit



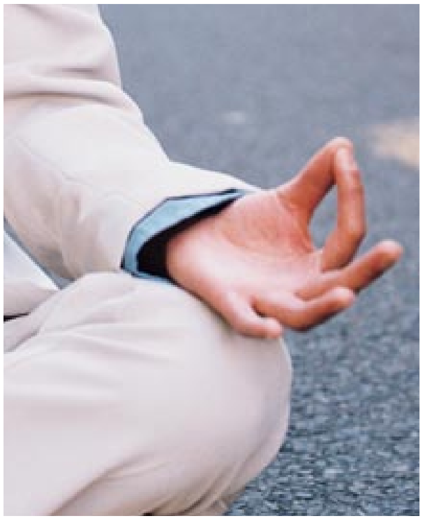
Mark the calendar - 10 days means 10 days

within ten business days. The Third Circuit rejected plaintiffs' argument that their interlocutory appeal was timely filed, holding that it was the district court's denial of the motion for class certification – not the motion for reconsideration – that started the running of the ten-day period. "The fact that the District Court extended the time for Petitioners to file their Motion to Reconsider beyond the time limit within which to file a timely Rule 23(f) petition does not change our determination that Petitioners' petition was untimely." While the Third Circuit did note that a motion for reconsideration filed in district court within ten days of the ruling will toll the Rule 23(f) time limit, the court held that plaintiffs' motion for reconsideration was not "timely and proper." The Third Circuit's opinion is consistent with previous decisions in the Fifth, Seventh, Tenth and Eleventh Circuits which have also rejected attempts at circumventing Rule 23(f)'s ten-day deadline.

Seventh Circuit Tackles Poorly-Drafted CAFA Provision

BY FARROKH JHABVALA

With tongue firmly planted in cheek, Judge Easterbrook parsed the poorly-drafted CAFA provision in 28 U.S.C. § 1453(c)(1) in *Spivey v. Vertrue, Inc.* The statute is an exception to the general rule of non-reviewability of remand orders stated in § 1447(d), and provides that the federal courts of appeals "may accept" appeals from district court orders granting or denying remand "if application is made to the court of appeals not less than 7 days after entry of the order." The case noted that the "garble[d]" language has spawned a number of cases and law review articles, but Congress has not yet corrected the text. The Seventh Circuit rejected the approach taken by five other circuits, which have read "less" to mean "more," because "[t]urning 'less' into 'more' would be a feat more closely associated with the mutating commandments on the barn's wall in *Animal Farm* than with sincere interpretation." While agreeing with the other circuits that, notwithstanding the statute's text, petitions seeking review of remand decisions are timely even when filed within seven days after the entry of the district court's order, the Seventh Circuit departed from the other circuits for petitions filed more than seven days after the district court order, regarding such petitions as timely under the statute. The Seventh Circuit borrowed from Appellate Rule 4(a) and set the time limit for filing 1453(c)(1) petitions at 30 days.


Less equals more? Not this court's mantra

Arbitration Roundup

BY LANDON CLAYMAN

During the first three months of 2008, the U.S. Supreme Court issued two decisions concerning the Federal Arbitration Act. On February 20, 2008 in *Preston v. Ferrer*, the Court held that the FAA supersedes state statutory provisions that refer disputes regarding the validity of contracts containing arbitration clauses initially to an administrative agency. In *Preston*, television's "Judge Alex" Ferrer sought to invalidate, under the California Talent Agencies Act, an entertainment management agreement containing an arbitration clause. The CTAA vests primary jurisdiction over talent agency disputes with the state labor commissioner, and creates procedural prerequisites to the enforcement of an arbitration agreement. The California courts ruled that the dispute should go initially before the labor commissioner, and enjoined Judge Alex's adversary from proceeding with arbitration. The Supreme Court reversed, holding that the FAA preempted the California statute's procedural prescriptions. Following its decision in *Buckeye Check Cashing, Inc. v. Conklin* (2006), the Court also held that questions concerning the validity of a contract in its entirety must be resolved in the first instance by the arbitrator, not the administrative agency.

In *Hall Street Associates, L.L.C. v. Mattel, Inc.* on March 25, 2008, the Court ruled that if judicial review of an arbitration award is sought under the FAA, the parties may not contractually expand the grounds listed in the FAA for confirming, vacating, or modifying an arbitration award. In the Court's view, exclusivity of the statutory grounds for review is needed to maintain arbitration's "essential virtue of resolving disputes straightaway." However, the Court noted that its ruling is limited to judicial review sought pursuant to the FAA, and stated that it was deciding nothing about "other possible avenues" for judicial enforcement of arbitration awards, such as state statutes or common law.

NEWS & NOTES

Speeches

Rollie Goss spoke at the American Conference Institute's Reinsurance Claims and Arbitration conference in New York, NY on September 23, 2008.

Robin Sanders was a panelist in a webinar on the "Conflicts of Interest in the Aftermath of *MetLife v. Glenn*," held on July 23, 2008.

Diane Duhaime moderated an International Trademark Association Roundtable on *E-Discovery in Trademark Disputes* at our Simsbury office, on July 23, 2008.

Ann Black presented a Litigation Update at the ACLI Conference in Toronto, Canada on July 10, 2008.

On June 19, 2008, **Richard Ovelmen** participated in an annual seminar regarding recent First Amendment decisions of the United States Supreme Court at the Florida Bar Convention.

Five Jorden Burt attorneys participated in the NAVA's 2008 Compliance & Regulatory Affairs Conference in Washington, DC, June 1-3, 2008. **Chip Lunde** participated on a panel on Suitability. **Ann Furman** and **Richard Choi** co-moderated a panel on Senior Investors. **Glenn Merten** moderated and **Enrique Arana** participated in a panel on Litigation Trends.

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