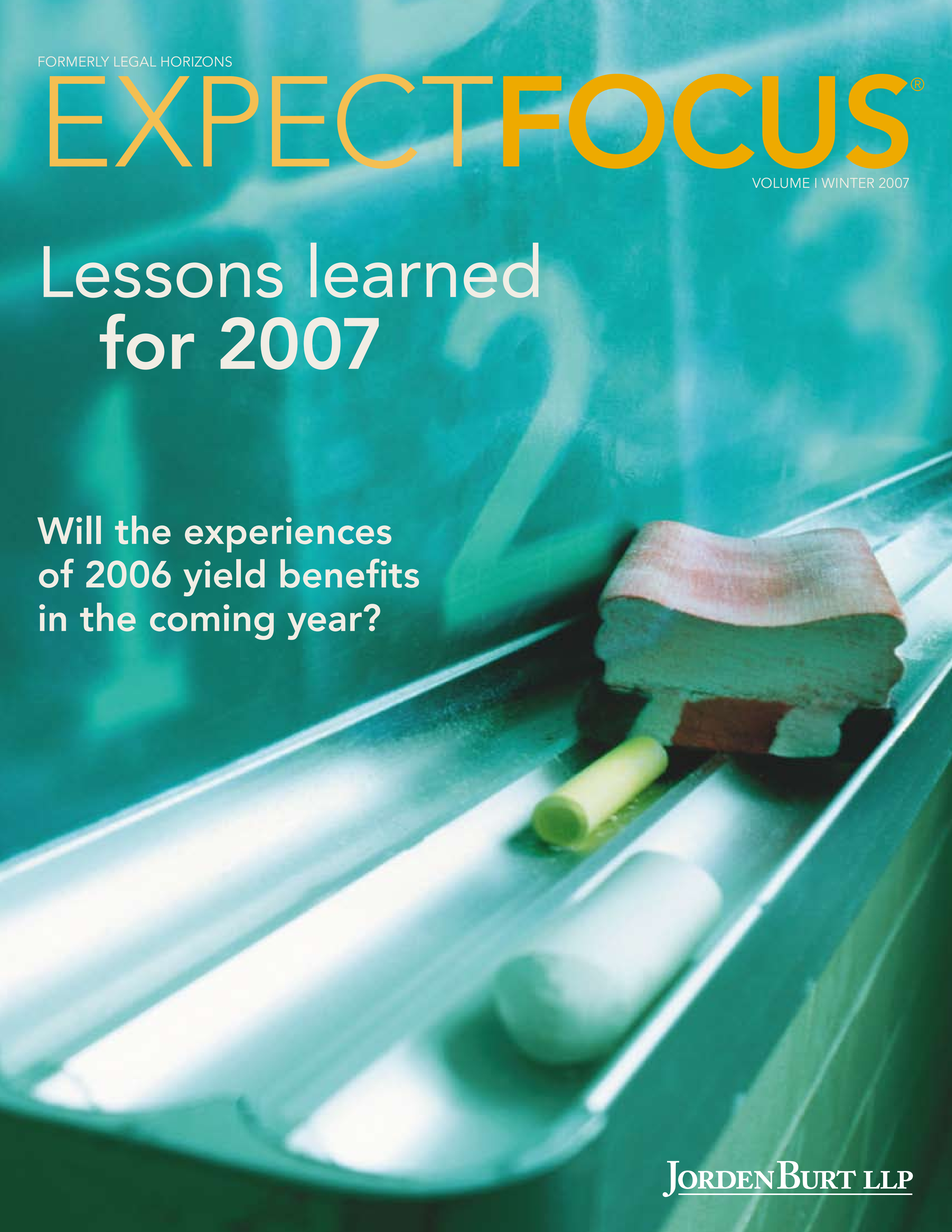

FORMERLY LEGAL HORIZONS

EXPECTFOCUS®

VOLUME I WINTER 2007

Lessons learned for 2007

Will the experiences of 2006 yield benefits in the coming year?

JORDEN BURT LLP

EXPECT**FOCUS**® Volume I Winter 2007

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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INTHE**SPOTLIGHT**

Revenue Sharing: A New Wave of Class Action Litigation in 401(k) Industry

BY STEVE GOLDBERG

Revenue Sharing, a common practice among life insurers and mutual funds that participate in the 401(k) market, is quickly emerging as one of the hot new targets of the insurance and financial services class action bar. The practice involves the payment by mutual funds or their affiliated investment advisers of fees to insurers who choose such funds as part of a package of investment vehicles and administrative services offered to sponsors of 401(k) plans.

In a number of recent putative nationwide class actions (where the class generally is defined to include all of the plans to which an insurer has sold products involving its receipts of "revenue sharing" fees), the defendant insurers' receipt of such fees are alleged to violate ERISA's prohibited transaction provisions (usually ERISA Section 406(b)(3), commonly known as the "anti-kickback" rule) as well as ERISA's general fiduciary requirements. Additionally, some of those suits also allege ERISA or other violations for the insurer's purported non-disclosure (or inadequate disclosure) to plan sponsors and participants of its receipt and the amount of revenue sharing fees. While primarily confined to 401(k) plans, a recent case has been filed against Nationwide Life Insurance Company in connection with its receipt and retention of revenue sharing fees for Section 457 plans.

For several years, most insurers have relied on the Department of Labor Advisory Opinion 97-16(A), which expressed DOL's opinion that an insurer's receipt of these kind of fees from mutual funds would not constitute a prohibited transaction if the insurer provided advance notice to a plan before any mutual fund was replaced, and gave the plan the opportunity to object to the replacement by cashing out of the fund (AO 97-16(A)). A recent decision by the United States District Court for the District of Connecticut, *Haddock v. Nationwide Financial Services, Inc.*, 419 F. Supp.2d 156 (D. Ct. 2006), has called into question reliance on the latter Advisory Opinion.

We believe that there are several reasonable grounds on which these cases can be defended on the merits as well as several grounds upon which class certification can be defeated. We also believe that future liability exposure can be substantially reduced by a number of steps including adequate disclosure to and authorization by plan sponsors of an insurer's receipt and retention of such fees.

RE**FOCUS** *10 years ago in our publication*

States Approve Lawyers' Use of E-Mail to Communicate With Clients (Autumn 1997)

"E-Mail and Internet supporters take note: Several state ethics committees have recently determined that communications between lawyers and their clients through unencrypted electronic mail…[is] ethical." The article proceeds to discuss privacy and confidentiality issues surrounding e-mail, and cautions that "in instances involving communications of very sensitive information…encryption might be prudent.

As is all too often the case, new technology processes can open the door for fraud and misuse. *See page 22 to read "Pharming: Are You Protected?"*

CONTENTS

Court Dismisses Nationwide LTC Class Action

BY APRIL GASSLER

Is there a break in the pattern?

On December 12, 2006, the United States District Court for the Eastern District of Pennsylvania granted the defendant insurer's motion to dismiss with prejudice a putative nationwide class action regarding "guaranteed renewable" Long-Term Care insurance. The plaintiff in *Alvarez v. Insurance Company of North America* had filed suit after the insurer raised premiums on his group policy for the first and only time in the sixteen years since the policy had been issued. The plaintiff alleged that prior to his purchase, the insurer knew but failed to disclose that the coverage was "underpriced" and that the insurer planned to increase premiums in the future.

The plaintiff had initially filed his complaint in District of Columbia federal court asserting claims for fraud, constructive fraud, violation of the D.C. Consumer Procedures and Protection Act ("CPPA"), breach of the implied covenant of good faith and fair dealing and punitive damages. Defendants successfully sought transfer of the case to the Eastern District of Pennsylvania. On November 21, 2006, the court determined that D.C. law governed plaintiff's claims and dismissed the cause of action for breach of the implied covenant of good faith and fair dealing, holding that the claim was not cognizable where the insurer's conduct was expressly permitted under the terms of the contract. The court also dismissed the claim for punitive damages, holding it was not an independent cause of action under D.C. law. After requesting supplemental briefing by the parties, the court dismissed plaintiff's remaining claims ***with prejudice***, holding that under D.C. law, the insurer was under no duty to disclose the information allegedly omitted and therefore plaintiff could not state a claim for fraud, constructive fraud or violation of the CPPA.

… Dismissal of this case is a welcome departure from the prevailing trend in "guaranteed renewable" Long-Term Care litigation…

Dismissal of this case is a welcome departure from the prevailing trend in "guaranteed renewable" Long-Term Care litigation where plaintiffs have avoided summary judgment and, in some instances, achieved certification of statewide or nationwide classes. Jorden Burt was counsel for the prevailing insurer.

A "Thorn" in Plaintiffs' Side

BY MICHAEL KENTOFF

The February 2006 decision in *Thorn v. Jefferson-Pilot Life*, in which the U.S. Court of Appeals for the Fourth Circuit upheld a lower court's denial of class certification of industrial life insurance policyholders, continues to benefit insurers, as evidenced by the Fourth Circuit's November 13, 2006 decision in *Hunter v. American General Life and Accident*. Plaintiffs in *Hunter* represented a proposed class of individuals who owned industrial life insurance policies allegedly issued on a racially discriminatory basis.

American General opposed the certification of the proposed class on the same grounds successfully asserted by Jorden Burt on behalf of Jefferson-Pilot in *Thorn*– namely, that its statute-of-limitations defense was an inherently individualized inquiry and, as such, demonstrated that individual issues predominated over common ones. The *Hunter* court found, without oral argument, the "facts [in *Thorn*] materially indistinguishable from those presented here" and upheld the district court's denial of class certification where "the defendant's statute-of-limitations defense could not…be resolved on a class-wide basis."

Summary Judgment Granted to Insurer in "Bonus Annuity" Case

BY EVAN TAYLOR

On October 12, 2006, the U.S. District Court for the Northern District of Alabama dismissed the last of the original group of "bonus annuity" actions that had recently been filed (see Expect Focus Vol. III, Fall 2006). In a complete defense victory, the court in *Sayer v. Lincoln National Life Insurance Co.* granted Lincoln National's motion for summary judgment and rejected all of plaintiff's claims, which included allegations of breach of contract, breach of fiduciary duty, and fraud in connection with a Lincoln National "bonus annuity" product purchased by plaintiff.

Customers got what they bargained for

Central to the claims asserted against Lincoln National was plaintiff's contention that the annuity product at issue was priced so as to allow it to recoup its costs, including a 1% bonus rate added to the first-year rate of return. The court found this allegation regarding Lincoln National's internal pricing structure to be merely an expression of dissatisfaction with the product purchased and therefore irrelevant, and held that there could be no breach of contract where plaintiff had received all that she was entitled to under the actual terms of the annuity contract.

The district court further held that a claim for breach of fiduciary duty could not be sustained where plaintiff was an adult, capable of handling her own affairs, who had decided to purchase a bonus annuity following an arm's length negotiation. The fact that plaintiff had a longstanding investment relationship with Lincoln National's agents and may have taken their investment advice did not alter the court's determination.

Finally, the court dismissed plaintiff's fraud based claims, noting that the only representation Lincoln National had made to plaintiff was that it would credit plaintiff's annuity account with a 5.95% first-year interest rate (incorporating a 1.0% bonus rate), and an interest rate equal to or greater than 3.0% thereafter. Because plaintiff had admittedly received the interest rates promised, and Lincoln National had no duty to disclose its internal pricing or profit practices (i.e., its yield spread and how the costs of the bonus rate were covered), liability for fraudulent misrepresentation or concealment could not be established.

Demutualization Suit Dismissed Under SLUSA

BY ERIC COMBS

On October 20, 2006, the Eighth Circuit affirmed an Iowa federal district court's dismissal of a state law class action suit pursuant to the Securities Litigation Uniform Standards Act ("SLUSA"). The plaintiff in *Sofonia v. Principal Life Insurance Co.*, a policyholder who was part of a settlement class in a previous deceptive sales practices action against Principal Life, claimed that Principal Life had made false statements in its marketing materials to induce him and other putative class members to approve a demutualization plan. According to plaintiff, these misrepresentations enabled Principal Life to shift the costs of the prior class settlement back to those same class members by giving them fewer shares of common stock in the demutualization than they would have otherwise received.

Swept away by SLUSA

The court held that plaintiff's claims were preempted by the application of SLUSA, which was designed to prevent state law class actions based upon alleged misrepresentations or omissions of a material fact "in connection with the purchase or sale of a covered security." In "flexibly" construing SLUSA's language, the Court determined that the common stock received by the policyholders in exchange for their membership interests was a "covered security," and that the exchange of non-liquid, non-property membership interests into tangible, transferable, value-certain shares of common stock constituted a "purchase" under the statute. Further, the court found that plaintiff's purported claims sufficiently alleged misrepresentations "in connection with" the purchase of covered securities because plaintiff alleged that the exchange transaction was the means by which Principal Life recaptured the costs of the earlier settlement. Finally, the McCarran-Ferguson Act did not prevent application of SLUSA in this case, since plaintiff's claims did not implicate a state statute enacted specifically to regulate the business of insurance, and applying SLUSA would not interfere with Iowa's regulation of insurance company demutualizations.

Insurer Stamps Out Juvenile Smoker Class Action

BY GLENN MERTEN

Juvenile smoker litigation continues to be a hot topic for class action plaintiffs' counsel, although it has not yet resulted in either substantial settlements or ultimate litigation successes.

Insurers not obligated to charge "non-smoking rates" to juveniles

In *Thompson v. American General Life and Accident Ins. Co.*, the U.S. District Court for the Middle District of Tennessee granted American General's motion for summary judgment on the plaintiff's breach of contract claim, holding that despite the presence of a question in the policy application regarding the smoker status of the juvenile insured, the policy clearly and unambiguously provided that premium rates were based on the insured's age and sex. The fact that the juvenile insured did not use tobacco did not obligate American General to charge "nonsmoking rates," especially when the company did not offer smoker-distinct pricing for insureds under age 20. Notwithstanding the plaintiff's assumptions to the contrary, the court found that the clear and unambiguous policy terms of the policy controlled the rate determination. In the face of such explicit policy terms, any expectation the plaintiff had of securing non-smoker rates was not reasonable as a matter of law, and did not fall within the purview of the reasonable expectations doctrine.

In another recent decision of note, the U.S. District Court for the Western District of Pennsylvania granted in part and denied in part State Farm's motion to dismiss in *Alleman v. State Farm Life Ins. Co.* The court dismissed the plaintiff's claim for breach of fiduciary duty, holding that Pennsylvania typically does not recognize a fiduciary relationship between an insurer and an insured. However, the court allowed the plaintiff to proceed with her breach of contract claim, supplying no basis for its decision other than noting that "[p]laintiff has stated facts sufficient to maintain a claim for breach of contract." Such a decision is commonplace in juvenile smoker litigation, although many courts, such as the court in *Thompson*, eventually grant summary judgment as to breach of contract claims on a more developed record.

110th Congress—Democrats Outline Financial Services Agenda

BY MARION TURNER

Representative Barney Frank (D-Mass.), the incoming chairman of the House Financial Services Committee, intends to hold hearings on hedge funds, stock options, and issues surrounding the Sarbanes-Oxley Act during the 2007 Congressional Session.

With regard to Sarbanes-Oxley, Frank has indicated he will focus on lessening the burden of the law on companies but not exempting them from it. One example he's considering: reducing the amount of information that corporate executives would have to certify.

On hedge funds, the incoming Chairman believes there is some concern about what happens when public pension funds invest in hedge funds. Frank has sponsored previous legislation that reversed a federal appeals court decision striking down the SEC's rule requiring the registration of hedge fund advisers, but he will not reintroduce it in the coming session. The SEC, meanwhile, may address issues relating to hedge fund regulation on its own.

Executive compensation will also be a focus of the Committee next year, with the Chairman pledging to reintroduce legislation to deal with so called "golden parachute" packages. The *Protection Against Executive Compensation Abuse Act* (H.R. 4291), originally introduced in November 2005, would require greater disclosure of executive compensation by companies, and require shareholder votes on executive compensation plans.

Democrats to focus on hedge funds

Who Moved Our Policies?

Bankruptcy Sales of Life Insurance Policies

BY ELIZABETH BOHN

Life insurance policies often are sold by their original owners. Such sales are fueled in part by increased interest in purchasing policies insuring the lives of strangers as investment vehicles. When policies are sold, insurers may assume that the new owner will be subject to the terms of the policy and the insurer's regular policy administration guidelines and procedures. However, when policies are sold in a bankruptcy case to investors, policy administration procedures may be affected or even changed by the bankruptcy court before the company realizes what has occurred.

A bankruptcy trustee or debtor can obtain bankruptcy court approval to sell policies which are part of the debtor's property, "free and clear of liens and other interests." In connection with sales of policies in bankruptcy, especially block sales of investor-owned policies, the trustee may submit an order to the court governing administration of the policy after the sale. The trustee and its counsel are likely to be unfamiliar with the terms of the policies, much less the insurer's practices and procedures, especially where multiple policies and/or insurers are involved.

Life insurers could be in for a confusing ride

A policy administration order which does not take into account the company's practices and procedures may give new owners rights to further assign or transfer the policies, or otherwise alter rights under the policy without reference to normal company procedures, creating problems for the insurer. An insurance company should be notified of a proposed bankruptcy sale of its policies. The deadline for objecting to the sale and entry of proposed orders will be short. Therefore, prompt, careful review of notices relating to policy sales in bankruptcy should be undertaken so that objections may be filed on a timely basis to any proposed policy administration order which may conflict with company procedures.

First Circuit: Rescission Decision Affirmed With Precision

BY JASON GOULD

The U.S. Court of Appeals for the First Circuit recently held that a life insurance applicant's intentional misrepresentation allowed the insurer to rescind the policy without demonstrating an actual increased risk of loss, and recover the commission it had paid to the sales agent. In *Indianapolis Life Ins. Co. v. Herman*, the First Circuit affirmed a Massachusetts district court's previous judgment for the insurer, holding that because the applicant's misrepresentation had been made "with the actual intent to deceive, Indianapolis Life was not required to show that the misrepresentation increased its risk of loss."

Mark your Calendars

Jorden Burt managing partner **Jim Jorden** is one of the featured speakers at the **Defense Research Institute's Life, Health, Disability and ERISA Claims seminar**, which will be held March 28-30, 2007 in Chicago, IL. For details visit www.dri.org.

Round Two To The Insureds

Who Pays for Water Damages?

BY AMOR ROSARIO

An Eastern District of Louisiana judge recently denied insurer's motions to dismiss litigation involving property damage caused by the levee breaches following Hurricane Katrina's landfall. In contrast to the recent Southern District of Mississippi decision, at issue in Louisiana was not whether the policies exclude water damage caused by storm surges, but rather whether the flood exclusions exclude water damage caused by levee breaches and floodwall collapses. The November 27, 2006 ruling held that the flood exclusions were ambiguous because the policies failed to define the term "flood"; therefore, the exclusions must be interpreted against the insurer and in favor of coverage.

On January 11, 2007, U.S. District Judge Senter, Jr. of the Southern District of Mississippi granted a directed verdict against State Farm in the first Katrina suit to proceed to trial. Judge Senter, Jr. had previously ruled that State Farm's policy clearly excluded damage from storm surges but had found the policy's "anti-concurrent clause" ambiguous because it purported to deny coverage when wind acts in any sequence with an excluded event, such as storm surges, to cause damage. The issue at trial was whether the damage to plaintiffs' home, which was reduced to a slab, was only caused by storm surges. Judge Senter, Jr. ruled that State Farm could not prove that storm surges were responsible for all of the damage to plaintiffs' home and ordered State Farm to pay over $220,000 in compensatory damages. The jury awarded $2.5 million in punitive damages.

Just two days prior to the verdict, it had been reported that State Farm was in negotiations with the Mississippi Attorney General's office and policyholders' lawyers to settle over 600 lawsuits relating to Hurricane Katrina. The tentative settleent agreement would have required State Farm to pay $80 million, with payments to policyholders ranging from $2,000 to $2 million. The effect of the verdict on the settlement negotiations remains to be seen.

Notice-Prejudice Rule Does Not Apply to Claims-Made Policies

BY CHRIS BARNES

Tick-tock: coverage attaches only when claim is reported

In *Salt Lake Toyota Dealers Association v. St. Paul Mercury Insurance Company*, the federal district court in Utah, applying Colorado law, granted the insurer summary judgment, holding that the notice-prejudice rule does not apply to claims-made policies and, thus, the insurer did not need to show prejudice as a result of the untimely notice. In *Salt Lake Toyota*, the insured reported a claim under its Non-Profit Corporation and Directors, Officers and Corporate Indemnification Policy more than nine months after the expiration of the Policy. In rejecting the notice-prejudice rule, the court reasoned that "[a]pplication of the notice-prejudice rule would have the effect of extending the coverage, thus depriving parties of what they had bargained for and re-writing the contract."

Insurer Unable to Escape Bad Faith Liability

BY IRMA SOLARES

In a matter of first impression, the Florida Supreme Court in *Macola v. Government Employees Insurance Co.*, held that an insurer cannot avoid a third-party common law bad faith action by tendering the policy limits to its insured after suit has been filed against the insured.

On a certified question from the U.S. Court of Appeals for the Eleventh Circuit, the Florida Supreme Court was asked to decide whether an insurer's "cure" of a statutory Civil Remedy Notice filed by its insured after a lawsuit has been initiated against the insured but before entry of an excess judgment precludes a third-party common law bad faith cause of action.

A bad taste is not so easily remedied

The court answered the question in the negative, noting that "the distinction between first-party and third-party bad faith causes of action is critical." The court explained that Section 624.155, Florida Statutes, created a statutory cause of action for first-party bad faith claims and codified prior decisions authorizing third parties to bring a bad faith action under the common law. The language of Section 624.155(8) expressly provides, however, that it was not intended to preempt or limit any remedy or cause of action that existed at common law prior to enactment of the statute. Thus, unlike a first-party bad faith claim which must be brought pursuant to the statute, a third-party bad faith action can be pursued under both the common law and the statute.

The Florida Supreme Court has previously held that an insurer's tender of the policy limits within the sixty-day cure period provided for in the statute bars a *first-party* statutory bad faith action. The court noted, however, that "the essence of a *third-party* bad faith cause of action is to remedy a situation in which an insured is exposed to an excess judgment because of the insurer's failure to properly or promptly defend the claim." The court reasoned that tendering the policy limits to the insured after the time to settle has expired and while the underlying tort action is still pending does not eliminate the tort action or the insured's exposure to an excess verdict. Precluding a third-party bad faith claim on these facts would place the insured "in a worse position than he or she would have been in had the Legislature not enacted Section 624.155."

Jury Awards $2.8 Million in Trade Insurance Dispute

BY CHRIS BARNES

Jorden Burt won a $2.8 million jury verdict following a one-week trial in Florida state court in a commercial dispute arising from the purchase of trade credit insurance by Computek Enterprises USA, Inc., a Miami exporter of computer equipment. Computek retained Aon Trade Credit Inc. as a broker to obtain trade credit insurance for it, so that its accounts receivable could be paid by the insurer in the event of protracted default or bankruptcy by its customers. Aon, in violation of Florida law, obtained the insurance through an unauthorized foreign insurer. By statute, a broker who places or assists an unauthorized insurer to do business in the state of Florida without the required regulatory approvals must pay any denied claim which should have been covered by the insurer under the contract of insurance. Jorden Burt prevailed on summary judgment on liability, and before the jury on the damage issues.

Insurance brokers should look before they leap

Accounting for Reinsurance–Now You "C" It, Now You Don't

BY STEVE KASS

In the wake of the finite reinsurance inquiries and other matters affecting financial statement presentation of reinsurance transactions, there has been a flurry of activity on several fronts. The NAIC, the SEC, the FASB, trade organizations, and, of course, state regulators have all taken action relating to reinsurance accounting practices.

Most recently, California updated its reinsurance regulations, which took effect January 1, 2007 and will apply to all insurers licensed in California. These regulations "are intended to elicit from insurers a true exhibit of their financial condition and to safeguard the solvency of licensees." Although primarily directed at cedents who seek reserve credit, the regulations extend more broadly and have implications for assuming reinsurers and intermediaries as well as for reinsurance collateralization arrangements.

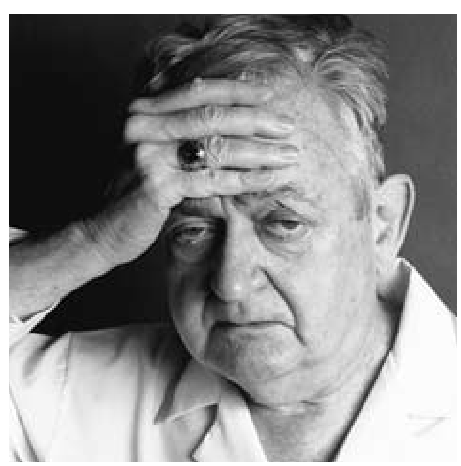
The regulation updates the reinsurance accounting requirements embodied in Appendix A-791 of the NAIC Accounting Practices and Procedures Manual (e.g., they mandate that all reinsurance agreements contain an express "entire agreement" clause and require the filing of such agreements and data detailing the financial impact of the transaction with the Department) as well as Appendix A-785's collateralization requirements (e.g., they require trust agreements to provide that a trustee's failure to draw down on a letter of credit constitutes negligence and/or willful misconduct). Perhaps most controversial is the regulation's extraterritorial reach over insurers domesticated in other states. After much give and take in the drafting, the regulations created a category of "volume insurers," who are regulated just like domestics, with the Commissioner also retaining enhanced authority over other non-domestics.

Colorado has also adopted new reinsurance regulations, effective January 1, 2007, and Connecticut recently proposed amendments to its regulations. This has caused one Firm pundit to remark: "Watch out for those "C" states … maybe Delaware will be next."

Court Steps in to Appoint Replacement Umpires

BY ROLLIE GOSS

In *AIG Global Trade and Political Risk Ins. Co. v. Odyssey America Reinsurance Corporation*, two arbitrations involving affiliates of AIG and Odyssey, umpires were determined by lot after the party-appointed arbitrators could not agree on umpire selection. In each case, an individual proposed by AIG was selected as umpire. After both umpires resigned in the face of allegations of partiality, the parties could not agree on replacements. AIG contended that because it had already "won" the umpire appointment process, the replacements had to come from its list of names. Odyssey maintained that all of AIG's proposed umpires were partial, and that impartial umpires should be selected.



Two years to find an arbitrator?

Finding that the reinsurance agreements did not provide a procedure for the appointment of replacements, and pointedly noting that the parties had been fighting over arbitrators for nearly two years, the court ruled that it would appoint the umpires after giving each party an opportunity to suggest names and object to suggestions made by the other party. In just over three weeks, the court appointed umpires who were not mentioned in either party's briefing.

Staying Focused on Reinsurance

BY ROLLIE GOSS

At press time, Jorden Burt's reinsurance blog, Reinsurance Focus, had more than 200 substantive entries. Postings since our previous newsletter have included:

- regulatory developments such as major revisions to reinsurance regulations in California and Colorado, as well as the credit for reinsurance proposals under consideration by the NAIC;
- opinions regarding reinsurance claims;
- court decisions regarding reinsurance intermediaries, liquidators and run-off administrators;
- UK court opinions regarding avoidance, arbitration procedure and reinsurance claims;
- actions by the SEC and state regulators against current and former reinsurance executives; and
- a continuing stream of opinions protecting the authority of arbitrators and their awards.

Visit the blog at www.reinsurancefocus.com, and send us your comments and suggestions for additional content.

An easier way to stay informed

Credit for Reinsurance Debate Continues

BY ANTHONY CICCHETTI

Debate over the credit for reinsurance rules—in particular, the 100% collateralization requirement for alien reinsurers—continues as proposals take shape. On December 11, 2006, the NAIC's Reinsurance Task Force adopted a ratings-based proposal that would apply to all companies that assume reinsurance liabilities, regardless of their domicile or status as insurers or reinsurers in the United States. Under this proposal, the amount of collateral required for the cedent to receive credit would depend on the reinsurer's individual rating, which would be assigned by a Reinsurance Evaluation Office taking into account the reinsurer's financial strength and operating integrity. Jorden Burt's reinsurance blog—www.reinsurancefocus.com—is tracking developments on this issue.

Reinsurance Does Not Save Voidable Preference

BY ANTHONY CICCHETTI

The Utah Supreme Court has affirmed a liquidator's recovery, as a voidable preference, of $3.5 million in commercial liability insurance proceeds paid by an insurer that was later placed in liquidation. In *Wilcox v. Anchor Wate Co.*, the insured argued that underlying reinsurance and related communications between the insurer and its reinsurers had effectively earmarked those funds for the insured's benefit and kept them from becoming a part of the insurer's estate. The court rejected this argument, emphasizing that the reinsurance arrangement did not give the insured any legal right to make a direct claim against the reinsurers for the reinsurance payments. Therefore, the reinsurance proceeds were properly deemed a part of the liquidated insurer's estate and subject to recovery in accordance with the liquidation statute.

NOTEWORTHY

Intellectual Property & Technology

Financial Services Institutions Are Wise To Pay Close Attention to Their Telecom Arrangements

BY BRUCE LESHINE

Sometime in 2007, the "new" AT&T—product of the merger of SBC Communications and the former AT&T Corp.—will acquire BellSouth, resulting in AT&T and Verizon collectively controlling 75% of the long-distance voice, data and wireless telecommunications market in the United States. Of even greater consequence, however, is that each of these entities will have unprecedented (since 1982) market power in their respective regions regarding local exchange services and the economic feasibility of customers' use of the other's inter-exchange services. AT&T and Verizon will have "divvied up" the country. There will be little incentive for the two to compete against one another in the other's "backyard." In the place of 1974's regulated monopoly is an unregulated duopoly.

In the absence of traditional market forces bringing AT&T and Verizon to the negotiating table, insurance and other financial services industry companies must become smarter in the evaluation and purchase of their telecommunications products and services. This includes improved technical and financial analysis, the development and management of more sophisticated competitive procurement processes and the audit and review of their existing contracts and agreements for service performance, technical and price benchmarking and vendors' compliance with all terms and conditions. A comprehensive approach to the project would ideally include input from your company's technical/operational, financial, legal and business groups, and the development of contract specifications before vendor selection. In this manner, your company will retain negotiation leverage and the resulting contract will fairly and reasonably set forth the expectations of your company and the vendor(s).

Pro Bono

Equal Rights Center Files Fifth National Discrimination Lawsuit

The Equal Rights Center, represented by the Washington Lawyers' Committee for Civil Rights and Urban Affairs and Jorden Burt LLP, has filed a federal lawsuit against Post Properties, Inc., a developer of apartment complexes and condominiums, alleging discrimination against persons with disabilities.

The lawsuit is the fifth in a series of complaints filed by the Equal Rights Center against national residential apartment and condominium developers alleging the developers failed to include in their residential buildings the basic features of accessibility required by federal civil rights laws. The complaint alleges that Post Properties has engaged in continuous and systematic violations of the Fair Housing Act and the Americans with Disabilities Act in the design and construction of more than 60 apartment complexes in 7 states, including more than 20,000 individual apartment units. Such violations discriminate against persons with disabilities, as charged in the complaint.

Post Properties, a publicly-traded real estate investment trust, headquartered in Atlanta, GA, is recognized in the multifamily housing industry as one of the 50 largest owners of multifamily housing units in the United States, claiming to own over 22,000 apartment units. Jorden Burt attorneys Sheila Carpenter and Richard Choi, with assistance from Eric Combs and Evan Taylor, are representing the Equal Rights Center as part of the firm's Pro Bono legal program.

Labor & Employment

$52 Million Overtime Pay Verdict Reversed

BY IRMA SOLARES

In an important victory for financial service industry employers, the U.S. Court of Appeals for the Ninth Circuit overturned a verdict which awarded $52.5 million to former and current claims adjusters employed by Farmers Insurance Exchange.

Proper classification can prevent headaches

More than 1,100 claims adjusters handling automobile damage claims, non-automobile property damage claims, and personal injury claims elected to opt-in to a collective action certified under the Fair Labor Standards Act (FLSA). The adjusters claimed that Farmers' improperly classified them as exempt from the overtime pay provisions of the FLSA. Farmers argued that the adjusters qualified for the "administrative" employee exemption.

The trial court held that some adjusters were exempt, but made exceptions finding that all automobile damage adjusters and those adjusters who handle smaller non-automobile claims not exceeding $3,000, were non-exempt. The Ninth Circuit rejected the trial court's reasoning and held that the adjusters all satisfied the criteria in § 541.203, irrespective of the dollar amount of claims authority which they were assigned or whether the automobile adjusters utilized a computer program to facilitate their review of the claims.

AT PRESS TIME

NASD Members Approve NYSE Merger

BY TOM LAUERMAN

On January 19, 2007, NASD member firms voted to approve the proposed merger of the regulatory functions of the NYSE and the NASD. Each NASD member firm will receive a one-time payment of $35,000 in connection with the merger, and it is hoped that the merger will reduce future regulatory costs.

Nevertheless, many smaller NASD member firms actively opposed the merger. Historically, such firms' voice at the NASD has been protected to some extent by the NASD's "one firm, one vote" policy, which the merger will change. The merger will result in three of the NASD's 23 member Board of Governors being associated with (and elected by) firms having no more than 150 registered persons. Even so, some opponents fear that the combined regulatory body will not give sufficient consideration to legitimate concerns that smaller firms may have.

Similar questions face firms that distribute insurance securities (such as variable annuities and variable life insurance). Such securities involve unique considerations that weigh against uncritical application of the same regulatory requirements as apply to the distribution of non-insurance securities. It has always been a challenge to communicate this effectively to the NASD. Some fear that the challenge will be even greater after the planned merger.

Manager-Less Management Companies

BY JOAN BOROS

More red tape for fund boards

The increasing popularity of "fund of funds" structures used to answer a variety of investment needs of the investing public has indeed resulted in expected and unexpected structures. From the investor's point of view, a fund of funds provides an automatically rebalanced asset allocation program. From fund management's point of view, consolidating complementary investment strategies in one investment vehicle reduces administrative burdens and the costs of asset allocation programs. One interesting variation is a fund of funds that is registered as a management investment company but has no manager, which is surprisingly permissible under the Investment Company Act of 1940. The investment allocation to selected funds is fixed for all time in the array of carefully selected time-tested funds. The non-discretionary rebalancing is performed by an administrator. Were the selected funds to deviate materially from their historical performance, the board of directors of the fund of funds could step in and alter the array. In fact, this may be a new and heavy governance burden for boards. When viewed with regard to what value a registered investment adviser as manager would bring, it seems reasonable to reduce costs by eliminating an adviser with no advisory functions.

SEC Proposes New Adviser Antifraud and Accredited Investor Rules

BY EDMUND ZAHAREWICZ

In a December 27, 2006 release, the SEC is proposing a new rule that would prohibit advisers to investment companies, and companies excluded from the definition of investment company by Sections 3(c)(1) or (7) of the Investment Company Act, from defrauding investors or prospective investors in their funds. The rule would apply to all investment advisers, including advisers that are not registered or required to be registered under the Investment Advisers Act. The proposed rulemaking is intended to clarify the SEC's ability to bring enforcement actions under the Advisers Act against advisers to hedge funds and other pooled investment vehicles in light of a recent court decision that created uncertainties regarding the obligations of such advisers under existing antifraud provisions of the Advisers Act.

You make me feel like an accredited natural person

The SEC also is proposing new rules that would define a new category of accredited investor called "accredited natural person." The rules would apply to offers and sales of securities issued by certain privately offered investment vehicles in reliance on Section 3(c)(1) of the Investment Company Act to accredited investors under Regulation D or Section 4(6) of the Securities Act. The rulemaking is designed to help ensure that individuals who invest in these types of funds are capable of evaluating and bearing the risks of their investments. The term "accredited natural person" would include any natural person who meets the current definition of accredited investor and who owns not less that $25 million in investments, as defined in the proposed rules. Interested persons have until March 9 to comment on the rule proposals.

Goldstein to SEC: Form 13F is Unconstitutional

BY ERIC PINCISS

Fresh off his surprising victory against the SEC in the D.C. Circuit Court of Appeals, which struck down the SEC's fledgling hedge fund adviser registration rule, hedge fund manager Philip Goldstein filed with the SEC on October 24, 2006, an application for exemptive relief from Form 13F reporting requirements. Some believe the application may be an attempt to lay the foundation for another court challenge, but this time, to a longstanding SEC regulation. Under Section 13(f)(1) of the Securities Exchange Act and Rule 13f-1 thereunder, institutional advisers with equity securities holdings of more than $100 million are generally required to file quarterly reports on Form 13F with the SEC detailing their equity securities holdings.

In the application, Goldstein argues that requiring an adviser to publicly disclose its investment holdings is analogous to requiring an operating company to disclose its trade secrets, thus constituting an unconstitutional government taking in violation of the Fifth Amendment. He also claims that Form 13F filings do not serve the purposes for which Section 13(f) was adopted by Congress in 1975, as reflected in the legislative history. Skeptics doubt Goldstein will succeed, but then again many also doubted his chances of success in his last go-around with the SEC.

Are adviser investment holdings trade secrets?

Identity Theft A Top SEC Concern

BY JOEL SMITH

Identity theft prevention is receiving increased regulatory scrutiny as identity thieves become more cunning. Regulation S-P requires written procedures reasonably designed to prevent "any anticipated threats or hazards to the security or integrity of customer records and information" and "unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any consumer." SEC inspection officials have advised that they will be looking for registrants to have robust controls to comply with Regulation S-P and to prevent common types of identity theft such as:

- the "family fraud," where a relative gains access to, and loots, an account;
- the "account takeover," where a stranger gains access to and loots an account;
- the "trading account takeover," where the perpetrator removes no assets, but actively trades, usually as part of a "pump-and-dump" scheme; or
- "alias fraud," where the perpetrator opens an account in another person's name, usually for money laundering purposes.

SEC Amends Rule 22c-2 Shareholder Information Requirements

BY KAREN BENSON

In September 2006, the SEC finalized amendments to Rule 22c-2 under the Investment Company Act and extended two deadlines: first, the deadline for funds and intermediaries to enter into shareholder information-sharing agreements to April 16, 2007; and second, the date by which funds must be able to request and promptly receive information under such agreements to October 16, 2007. The amendments limit the types of intermediaries with which funds must enter into information-sharing agreements, clarify the effect of a fund's failure to enter into an information agreement with an intermediary, address provisions that must be included in the information agreement, and address potential privacy law and disclosure issues that information agreements may raise. The National Association for Variable Annuities and the Investment Company Institute are expected to make available to members a model shareholder information-sharing agreement for variable insurance products and underlying funds.

SEC Snags BISYS in Rebate Scandal, More Fallout Expected

BY ELINA TODOROVA

In an enforcement action against mutual fund administrator BISYS Fund Services, Inc., the SEC alleged that BISYS, along with 27 mutual fund advisers, improperly used fund assets for marketing and other expenses incurred by the advisers.

According to the SEC, BISYS entered into undisclosed side agreements obligating BISYS to rebate a portion of its administrative fee to the funds' advisers so that the advisers would continue to recommend BISYS as an administrator of the funds. Over a five year period, BISYS is alleged to have allocated over $230 million of its administrative fees to the fund advisers or to third parties named in the side agreements. The fund advisers allegedly used the side agreements to pay out of the funds' assets the marketing expenses they incurred in advertising the mutual funds. In several instances, the side agreements also allegedly enabled the advisers to use fund assets to pay expenses unrelated to marketing, including check fraud losses, settlement disputes and seed capital for new funds, expenses which normally are payable out of the advisers' own assets.

Still ironing out investigation details

BISYS reached a settlement with the SEC in September by agreeing to pay disgorgement of $9.7 million, prejudgment interest of $1.7 million, and a $10 million civil penalty. BISYS also agreed to cease and desist from committing or causing any future violations under the federal securities laws and agreed to retain an independent consultant to conduct an extensive review of BISYS' current policies and procedures. The SEC's investigation continues and further SEC enforcement action would not come as a surprise.

Disaster Recovery Sites Raise Regulatory Issues

BY PATRICK LAVELLE

In the wake of disasters such as the September 11 attacks and Hurricanes Rita and Katrina, securities regulators have taken serious interest in making sure that companies have in place adequate and effective business continuity plans. While the SEC has taken a flexible approach—one followed by the NASD that allows investment companies and advisers to develop plans "best suited" to their particular businesses, it nevertheless has espoused several important points of guidance.

First, registrants should build their backup facilities "as far from primary sites as necessary to avoid being subject to the same set of risks as the primary location." Second, registrant backup facilities should have alternative telecommunication services to communicate with customers, employees and regulators. Third, backup facilities should possess the capability to expediently clear and settle customer purchase and redemption transactions.

In implementing these guidelines, registrants will face a host of regulatory issues. For example, recovery site employees must be adequately trained and properly licensed to conduct securities related activities. These issues are part of a growing list of regulatory and practical concerns that the SEC and NASD are only now beginning to address in the context of disaster recovery plans.

Disaster preparedness: a hotbed of new issues?

SEC May Clarify Status of Indexed Products

BY GARY COHEN

The SEC staff has announced that it is "currently taking a close look at equity index annuities and their status under the federal securities laws." At a recent ALI-ABA Conference referred to below, Division Director Buddy Donohue explained that some have questioned "whether the products have fallen through a regulatory crack" and "cross the line into the realm of securities."

The staff reviewed indexed products in 1997 and again late in 2005. In 1997, the staff announced that it "will do its part in clarifying the regulatory status of these products." However, in the following nine years, neither the SEC nor its staff has done so. Jorden Burt partner Joan Boros, who has been involved with this issue since the outset, has noted that, until recently, the products and markets had hardly "ripened" enough to have been the basis for meaningful clarification.

The SEC has only stated the truism that "[d]epending on the mix of features, an equity-indexed annuity may or may not be a security." The SEC may now be prepared to go further and draw some lines.

The NASD has issued directives to its members that have disrupted the marketing of indexed products. This has led insurance companies and their distributors to seek what the SEC staff calls "more certainty regarding the regulatory environment."

More detail is set out in the author's paper entitled "Fixed Indexed Insurance Products: Perspective on Their Status as Insurance or Securities Under the Federal Securities Laws," presented at the 2006 ALI-ABA Conference on Life Insurance Company Products.

Cool Reception for Discovery Arbitrators

BY PAUL FISCHER & ROBIN SANDERS

To curb arbitration discovery abuses and conflicting discovery rulings, the NASD, in August 2005, launched a pilot discovery arbitrator program. Under the pilot program, parties to an arbitration can agree to use a discovery arbitrator to resolve discovery-related disputes. The discovery arbitrator is a public arbitrator, not also part of the three-member panel chosen to resolve the merits of the dispute.

A lot of time on their hands

Based on a recent NASD publication, the program has been utilized only 38 times (22 of which were a group of related arbitrations). Although the NASD had hoped for greater participation, the reaction from those who have used the program has been positive.

Why is the discovery arbitrator program being so little used? The discovery arbitrator program makes it harder for both litigants and members of the merits panel to become familiar with one another. It also can delay the merits panel's exposure to the issues in the arbitration. By declining to participate in the discovery arbitrator program, arbitration litigants may have an earlier opportunity to "size up" the panel and to begin the process of advocacy leading to a favorable award. Additionally, some rulings on discovery matters may directly affect merits-based issues. Without the merits panel hearing these matters, some remedies (such as a discovery sanction of dismissal on the merits) may be unavailable.

NASD Tweaks Proposed Variable Annuity Suitability Rule (Again)

BY MARILYN SPONZO

Formidable proposed NASD Conduct Rule 2821 has undergone additional revisions in response to industry comments. Significant changes in the most recent amendment (filed November 15) include:

I've had a makeover!

- **Timing of principal approval.** A principal would have to approve a transaction within 2 business days after transmital to the insurance company, or 5 business days if additional contact with the customer or registered representative is necessary. This change coordinates principal review with the "2 day/5 day" processing requirement under the SEC's rules.

- **Authorization of non-recommended transactions.** There would be a safe harbor for a principal to approve a transaction the principal believes is unsuitable. In such a case, the principal must independently determine that: 1) the transaction was not recommended; 2) the customer has been informed why the principal believes the transaction is unsuitable; and 3) the customer affirms transaction.

- **Surveillance of registered representative exchange rates.** A broker-dealer could review representatives' rates of effecting VA exchanges periodically through exception reporting (rather than each time a principal reviews a transaction).

Insurance companies and broker-dealers should not underestimate the profound infrastructure changes that Rule 2821 may require, including: 1) creation of analytical tools to determine and document suitability; 2) use of additional disclosure documents at point of sale; 3) implementation of automated surveillance tools to detect sales practice improprieties, especially relating to exchanges; and 4) enhanced training programs for registered representatives who sell, principals who approve, and supervisors who monitor, VA sales.

Revolving Door Turbulence

Financial Firms Feud Over Departing Employees

BY JIM SCONZO

Broker-dealers regularly grow by acquiring registered representatives (and the reps' clients) from other firms. It is now common that the former firm, in an effort to maintain its clients and protect its confidential business information, commences litigation against the departing rep and the new firm.

The former firm will likely assert its rights under non-compete and confidentiality agreements that are now customary. Non-contractual theories are also likely to be asserted, including that the rep is violating duties of loyalty or misappropriating the former firm's property, trade secrets and other confidential business information. All of this is well illustrated by a recent lawsuit filed by Robert W. Baird & Co. against three former employees who left to start their own rival firm (see Jorden Burt client email alert of November 21, 2006 at www.jordenburt.com/news).

In this increasingly turbulent environment, broker-dealers are finding that careful planning and attention to detail can greatly reduce the potential legal fallout that can accompany reps coming from other firms.

Variable Products Escape Ban on Payment Plans

BY GARY COHEN

Congress has amended the Investment Company Act to ban registered investment companies from issuing or selling periodic payment plans—except variable insurance contracts.

The amendment came in under the radar. It was part of the Military Personnel Financial Services Protection Act. That Act protects members of the U.S. Armed Forces from unscrupulous practices in the sale of financial products. However, the ban on periodic payment plans applies to sales to anyone—whether on or off military bases.

The SEC, in its effort to fit a square peg in a round hole, has always treated variable insurance contracts as periodic payment plans. So, a ban on periodic payment plans could ban variable insurance contracts.

But the ban is subject to an exclusion for any registered separate account funding variable insurance contracts, the sponsoring life insurance company and principal underwriter.

Beware of Shell Company Money Laundering Risks

BY KAREN BENSON

The U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) recently warned all Bank Secrecy Act regulated financial institutions, such as broker-dealers and mutual funds, to review their anti-money laundering programs to ensure that money laundering risks associated with shell companies are being assessed and appropriately managed. FinCEN distributed this warning as a written advisory along with a 26-page report, entitled "The Role of Domestic Shell Companies in Financial Crime and Money Laundering: Limited Liability Companies." There have also been other recent governmental reports concerning lack of transparency in corporate ownership information.

FinCEN's advisory and report acknowledge that most shell companies are formed for legitimate reasons, and FinCEN does not intend to discourage shell company relationships. However, FinCEN identifies numerous ways in which lack of transparency in the structure, ownership, and activities of shell companies have made them common tools for money laundering and other financial crimes. FinCEN expects financial institutions to asses the risks involved in each shell company relationship and take measures to manage those risks in accordance with their anti-money laundering obligations, including filing suspicious activity reports where appropriate. It is clear from FinCEN's advisory and report that, in many cases, meeting these obligations will be a very complex undertaking that requires financial institutions to commit significant resources.

"Networking" Arrangements in Jeopardy?

BY TOM LAUERMAN

Distributors of variable annuities (and other insurance product securities) are considering whether they will need to modify what are commonly referred to as "Networking" arrangements.

Under these arrangements, sales commissions for insurance product securities can be paid to an insurance agency that is not registered with the SEC as a broker-dealer. Networking arrangements have been permitted under SEC staff no-action letters.

Recent SEC staff statements have raised a serious question whether the staff's previously-issued no-action letters can continue to be relied upon in many cases. If not, distributors of insurance product securities may find it necessary to modify their arrangements so that no commissions on such products are paid to any entity that is not registered with the SEC as a broker-dealer. For a variety of reasons, this could be extremely costly and cumbersome.

There do not appear to have been abuses or compliance problems that would justify a requirement for major changes in the current arrangements. Accordingly, industry groups are pursuing a dialogue with the SEC staff to resolve any regulatory concerns of the staff, within the general framework of current networking arrangements. In the meantime, the SEC staff so far has not taken action against firms who continue to operate networking arrangements in reliance on the staff's previous no-action positions.

Regulators Pursue 529 Plan Sales Practices

BY MICHAEL VALERIO

Both SEC and NASD enforcement staff have lately been on the trail of broker-dealers selling Section 529 College Savings Plans. While prior regulatory scrutiny had focused on the sale of out-of-state plans to clients who do not obtain the state tax benefits that would be available from an in-state plan, the latest actions also focus on alleged failures to consider the impact of differing unit class fee structures.

In a recent consent order, the SEC found that 1st Global Capital Corp. recommended and sold to numerous customers classes of 529 Plan units without reasonable grounds for believing that the recommended unit class (as opposed to another unit class) was suitable, based upon plan fee structures and customer needs, including, in particular, the plan beneficiary's age. In addition to certain compliance undertakings, the order requires 1st Global to pay a $100,000 fine.

Similarly, the NASD has recently settled a series of actions against broker-dealers, with even stiffer fines and client restitution, for failing to implement adequate systems and procedures for supervising sales of 529 Plans. Among other things, the NASD has cited firms for not providing specific criteria or guidance to their registered representatives when making 529 Plan recommendations, for not establishing criteria for supervisors responsible for reviewing 529 Plan recommendations, and for not establishing effective procedures for documenting suitability determinations.

Class Action Prohibitions In Arbitration Clauses Given Close Scrutiny

BY LANDON CLAYMAN

Two state supreme courts recently answered one of the hottest questions in arbitration law: whether a class action waiver in the arbitration clause of a consumer contract is enforceable? In two decisions issued on the same day in August 2006, *Muhammad v. County Bank of Rehoboth Beach, Delaware* and *Delta Funding Corp. v. Harris*, the New Jersey Supreme Court found the class action bar valid in one instance, but invalid in the other. In *Muhammad*, which involved a class action lawsuit against the lender and the servicer of payday loans, the court applied state law for determining unconscionability of contracts of adhesion, and decided that the class arbitration waiver in the agreement was unenforceable. Concluding that the plaintiff's damages probably were less than $600, the court stated that the class arbitration bar rendered individual enforcement of the plaintiff's rights, and the rights of her "fellow consumers," difficult if not impossible by reducing the possibility of attracting competent counsel to pursue the claims. The court also found that the public interest in preserving the consumers' ability effectively to pursue their rights under New Jersey's consumer protection laws overrode the defendant's right to enforce the class treatment bar in the arbitration agreement, and it severed the class arbitration prohibition from the arbitration agreement.

In contrast, in *Delta Funding Corp.* the New Jersey Supreme Court did not invalidate the class arbitration waiver in an action involving a sub-prime mortgage loan. Reiterating that under New Jersey law class arbitration waivers are not unconscionable per se, the court noted that the plaintiff sought more than $100,000 in damages, and that the statutes under which she sought relief provided for attorney's fees and costs for prevailing plaintiffs. The court concluded that the plaintiff's claim was not the type of low-value suit that would not be litigated absent the availability of a class proceeding, and that the plaintiff had adequate incentive to bring her claim as an individual action. Based on these factors, the court found that the class arbitration waiver was enforceable.

The Illinois Supreme Court addressed the same issue in *Kinkel v. Cingular Wireless LLC* (October 5, 2006), finding that a prohibition of class arbitration in a cellular telephone service agreement was unconscionable. The court emphasized that the enforceability of a class action waiver must be determined on a case-by-case basis. Observing that the plaintiff's actual damages were $150, the court found the waiver of class actions to be unconscionable because it was contained in a contract of adhesion that did not inform the plaintiff of the costs to her of the arbitration, and did not provide a cost-effective mechanism for individual customers to obtain a remedy for the injury alleged. The court also found the class action waiver was severable from the remainder of the agreement.

Both the Illinois and New Jersey Supreme Courts emphasized that the Federal Arbitration Act did not preempt their consideration of the validity of the class arbitration waivers under state law principles regarding contracts and unconscionability. Until the United States Supreme Court addresses this important issue, entities whose consumer contracts contain class action prohibitions should carefully monitor the decisions of the different state courts and consider appropriate modifications to the arbitration clauses in their agreements.

Rule 68 Offer Doesn't Derail Class Action

BY TODD FULLER

In *Morgan v. Account Collection Technology, Inc.* (S.D.N.Y. 2006), plaintiff filed a class action complaint against Account Collection Technology and the Law Offices of Daniel J. Ciment alleging violations of the Fair Debt Collection Practices Act ("FDCPA"). Prior to plaintiff moving for class certification, Ciment made a Rule 68 offer of judgment for $1,001.00, plus reasonable attorneys' fees and costs. This offer represented the maximum statutory damages available to an individual plaintiff under the FDCPA. After receiving no response from plaintiff, Ciment moved to dismiss contending that, under traditional mootness theories, the offer for complete relief destroyed plaintiff's personal stake in the case and mooted the action.

Although the court agreed that the offer represented full relief for an individual plaintiff under the FDCPA, the court explained that there was a split in the district courts as to whether a Rule 68 offer for full relief made prior to the filing of a motion for class certification mooted the action. After thorough discussion, the district court embraced the majority view that such an offer does not moot the action unless the plaintiff unduly delayed pursuing certification.

On the facts of this case, the court determined that plaintiff was not dilatory in pursuing class certification because, although plaintiff had time to move for certification, she had expressed legitimate concerns about the timing of discovery relevant to the potential certification motion. The court explained that plaintiff's claims should not be mooted by an offer of judgment submitted before plaintiff has had a reasonable opportunity to compile a record necessary to support class certification. However, the court advised plaintiff that, in light of her non-committal attitude toward filing a certification motion, she would only be given one month to pursue class certification or else face dismissal.

Timing is everything

Collection, Unfair Practices Claims Arbitrable in Florida

BY LARA GRILLO

In a case of first impression, *Reeves v. Ace Cash Express, Inc.* (Sept. 29, 2006), a Florida appellate court ruled that arbitration of claims under the Florida Consumer Collection Practices Act (FCCPA) would not violate public policy. The same court previously considered a similar issue in *Orkin Exterminating Co. v. Petsch* (Feb. 6, 2004), and held that public policy did not preclude arbitration of claims under Florida's Deceptive and Unfair Trade Practices Act. In *Reeves*, the court noted that nothing in the FCCPA evinced legislative intent to preclude arbitration of FCCPA claims. The court rejected plaintiff's argument that the arbitration agreement violated public policy because it prohibited class actions, adding that the agreement included a severability clause and the bar on class actions could be severed.

Tell everyone: Artibration OK under the FCCPA

Pharming: Are Your Customers Protected?

BY DIANE DUHAIME & JAKE HATHORN

Pharming occurs when a legitimate user who enters the URL for a web site is brought to a fraudulent web site that looks identical to the one that the user expects to see. This fake web site is called a spoof web site. The pharming victim proceeds to enter his or her login, account and other personal information at the spoof web site while the pharmer captures this information on its own server for its own financial gain.

Pharming poses a threat of financial loss and identity theft to the online consumer, adversely affecting online consumer confidence as well as the companies that offer Internet-based financial services. For these reasons, many financial institutions have strengthened their online authentication processes to include more than just a user name and password. One institution requires online customers to select an image from a library of hundreds of photos, ranging from appliances to animals to nature scenes. On subsequent logins, the system informs the customer to proceed only if the image displayed is the one originally selected. Additional layers of authentication assure online customers attempting to access their accounts that they have reached the actual web site of their financial institution.

Companies can mitigate pharming risks by implementing multi-factor authentication processes and monitoring and reporting systems that detect and report illicit activities. For some helpful risk mitigation guidelines, a paper entitled "Authentication in an Internet Banking Environment" (available at http://www.ffiec.gov/pdf/authentication_guidance.pdf) details the new standard that is now followed by federal bank auditors.

Court Approves Pleading Around CAFA

BY JASON KAIRALLA

Plaintiff gambled and won

New Jersey's federal district court recently remanded a consumer fraud class action, *Morgan v. Gay* (Aug. 7, 2006), because the complaint expressly limited monetary relief to less than CAFA's $5 million amount-in-controversy threshold. Originally, this action was filed in federal court on behalf of a nationwide class with representatives from eight states including New Jersey. The plaintiffs voluntarily dismissed the case after the defendants successfully transferred venue to the District of Utah, their home court. The case was refiled as a statewide class action brought by one New Jersey plaintiff for violation of New Jersey's consumer fraud act. For the sole purpose of avoiding federal jurisdiction under CAFA, the complaint expressly provided that the "monetary relief for the class as a whole" would not exceed $5 million.

Despite recognizing the active effort to plead around CAFA, the court found that the plaintiff's conduct, in dismissing the prior federal lawsuit and expressly limiting monetary relief, was not improper. The court held that it was the defendant's burden to establish amount in controversy, and they could not meet this burden in the face of "concrete evidence" that the most the plaintiff could obtain in judgment was $5 million, including attorney's fees.

NEWS & NOTES

Jorden Burt Client Successes

Swift Resolution to Redomestication Transactions: Jorden Burt attorneys represented Templeton Funds Annuity Company (TFAC), a subsidiary of Franklin Resources, Inc., in obtaining necessary regulatory approvals to redomesticate their life and annuity insurance company from Florida to the State of Minnesota. The application for redomestication was filed with the Minnesota Department of Commerce on September 22, 2006, and approved on December 15, 2006. Although the Minnesota statute allows for a much longer review process, Jorden Burt attorneys were able to obtain approval in less than 90 days.

South Florida Agency Ordered to Obtain Federal Clean Water Act Permit: Jorden Burt trial lawyers assisted the Miccosukee Tribe of Indians of Florida in achieving a significant victory in an environmental case under the Clean Water Act. In the case of *Friends of the Everglades v. South Florida Water Management District*, after a six week trial, the U.S. District Court ordered the Defendant South Florida Water Management District to obtain a federal Clean Water Act permit for discharging polluted canal water into Lake Okeechobee.

Appellate Court Rules for Jorden Burt Client: In a dispute over arbitration of claims for fraudulent billing, breach of contract, and libel, the Florida Third District Court of Appeal adopted Jorden Burt's arguments and ordered that the entire dispute be resolved in court because the opposing party, by initiating and pursuing a court case, had waived the right to arbitrate any aspect of the dispute.

Speeches

Rick Ovelmen served as Panel Moderator at the Practising Law Institute's *Communications Law Conference*, November 9-10, 2006 in New York City, NY. His session examined the topic of access in the legal profession.

Richard Simring and **Bob Shapiro** lectured at the Marcus Evans *Reinsurance Regulation, Arbitration and Litigation Seminar*, October 17-18, 2006 in Miami, FL. Mr. Simring discussed "Post Award Procedures and Collection Issues," and Mr. Shapiro provided a "Critical Update on the Use of Captives for Insurance and Reinsurance."

Joan Boros co-chaired the Practising Law Institute *Understanding the Securities Products of Insurance Companies*, held January 8-9, 2007 in New York, NY.

Ms. Boros also spoke at the *2006 Society of Actuaries Annual Meeting and Exhibit* in Chicago, IL, October 15-18, 2006 on "Indexed Products: Distribution and Suitability."

Publications

Joan Boros authored "How Variable Products are Responding to Retirement Uncertainties" in the September 4, 2006 issue of *National Underwriter/Life & Health*.

Mike Valerio is the author of "Putnam Fiduciary Trust Company: A Seaboard Report For Regulated Entities," which appeared in the *Investment Lawyer*, June 2006.

Jorden Burt Sponsors 33rd Annual ABA TIPS Symposium

Jorden Burt was a sponsor of the 33rd annual "**Midwinter Symposium on Insurance, Employment and Benefits**," of the American Bar Association's Tort Trial & Insurance Section, which was held January 11-14, 2007 in Laguna Beach, CA. **Irma Solares** participated on the panel "Litigation Trends in Class Actions," while **Shaunda Patterson-Strachan**, 2007 Chair of the Section's Life Insurance Law Committee, moderated "When Can We Shred This? Ethics and Issues in Document Retention and Destruction."

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