INSURANCE AND REINSURANCE REVIEW

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A Shift in the Balance of Power: An Analysis of the UK Takeover Code Changes Six Months On

By Damian Connolly, Andrew Overend and Theo Godfrey (London)

Recent changes to the UK Takeover Code (the Code) have markedly shifted the balance of power from bidders to target boards in any takeover subject to the Code. As a result, bidders will need to carefully consider their deal strategy from day one.

The changes follow the UK Takeover Panel's (the Panel) review of the Code in the wake of the hostile takeover of Cadbury by Kraft in 2010. In that takeover there were allegations that the drawn-out bid process had a destabilizing effect on Cadbury and there was criticism regarding the fact that Kraft did not deliver on its stated belief that a UK manufacturing plant would not be closed.

The changes to the Code came into force on 19 September 2011 and include a new *"put up or shut up deadline"*, a ban on *"offer-related arrangements"*, such as break fees, and increased disclosure requirements. Broadly, the Code applies to all offers for companies which have their registered offices in the UK and have securities admitted to trading on a regulated market in the UK (which includes the LSE's main market and AIM).

"PUT UP OR SHUT UP" DEADLINE

Any potential bidder identified as such in an announcement will, unless the Panel has consented to an extension, now have 28 days to either (i) announce a firm intention to make an offer (known as a *"Rule 2.7 Announcement"*) or (ii) announce that it will not make an offer. This is often referred to as a *"put up or shut up"* or "PUSU" deadline.

The Code stipulates that the Panel will *"normally consent to an extension"* of a PUSU deadline if requested to do so by the target board and after taking into account all relevant factors including the status of negotiations between the target and the potential bidder. The support of the target board for any proposed extension may be influential in whether the Panel grants consent.

Bidders should therefore be extremely careful to try and avoid

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information leaks during the negotiation process with any target that might require the target board to announce a potential approach and trigger the start of the 28 day PUSU period. If an extension is not granted (which may be considered likely if the target board does not support the deal and therefore does not support such an extension request) and, as a result, the bidder is forced to announce that it will not make an offer, then the bidder will usually be prohibited from making an offer for a minimum period of 6 months.

BAN ON OFFER-RELATED ARRANGEMENTS

A general ban on bidder deal protection measures and inducement fees has been introduced under the Code changes, which extends to any *"offer related arrangement"* between any target and the bidder in connection with an offer. The Code defines *"offer-related arrangements"* very broadly and this term will catch implementation agreements (which were the standard con-tractual protection sought by bidders seeking to ensure 'deal-certainty' pre-Code changes), exclusivity agreements and, in particular, break fee agreements.

Any potential bidder considering a takeover will need to be aware that it no longer has any contractual recourse (under an implementation agreement) if the target breaches any deal conditions set out in an offer document. Furthermore, bidders should be aware that the Panel will only consider allowing a bidder to walk away from a deal after publication of an offer document by the target if there has been a material breach of any deal condition by the target. The question of what constitutes a *"material"* breach is entirely in the discretion of the Panel but indications from the Panel are that the threshold is likely to be very high. For example, in 2001 the Panel refused to allow WPP to invoke a material adverse change condition in relation to its offer for Tempus, which WPP claimed had been triggered as a result of the economic effects of the terrorist attacks in the United States on 11 September of that year.

REQUIREMENT TO PUBLISH ANY DOCUMENTS RELATING TO FINANCING OF THE OFFER AND MATERIAL CONTRACTS DESCRIBED IN THE OFFER DOCUMENT

The new Code stipulates that, except with the consent of the Panel, documents relating to the financing of the offer need to be published on the target's website from the date of the Rule 2.7 Announcement. Our experience suggests that this will not extend to requiring publication of details of the general financing arrangements of the bidder group, but any bidder should be mindful given the broad wording of the Code provisions.

In addition, except with the consent of the Panel, any *"material contract"* entered into by an offeror in connection with the offer that is described in an offer document under Rule 24.3(a) of the Code also needs to be published on the target's website. Given that this Rule includes a requirement to include a *"summary of the principal contents of each material contract"*, discussions with the Panel will be required to confirm the extent to which material contracts or a summary of their terms are required to be disclosed. Again, the Panel has wide discretion on these matters to determine what is appropriate in its view.

REQUIREMENT TO STATE INTENTIONS REGARDING TARGET EMPLOYEES

The new Code requires bidders to make a negative statement in any offer document if they do not plan to make any changes in relation to the continued employment of the target employees and management. If a bidder makes a statement in an offer document relating to any course of action that it intends to take (or not take) after completion of a takeover, it will be regarded as having committed to it for a minimum period of 12 months from completion. If the Panel thereafter receives a complaint from an interested party that any such statement has been breached, the bidder may be subject to disciplinary sanctions under the terms of the Code (including a public statement of censure by the Panel and referral to the UK Financial Services Authority, which may take its own disciplinary action, including levying a fine). Bidders will need to carefully consider and negotiate with the Panel (if deemed appropriate) to ensure that any statement accurately reflects their intentions.

Overall, it is clear that target boards have greater power in a bid situation following implementation of the new Code changes. Bidders will need to approach their deal strategy with care and potentially protracted negotiations with the Panel may be required for cautious bidders who wish to abide by the new Code changes whilst keeping information they consider to be confidential out of the public domain.

From a different perspective, however, it is clear that for many small to mid-cap listed companies (particularly on AIM, where many companies have experienced share liquidity issues and near stagnation in the aftermath of the credit crunch), the new Code perhaps represents an opportunity to consider takeover approaches, which may give them the opportunity to flourish either as part of a larger listed buyer group or by returning the company to the private company arena.

Edwards Wildman advised AmWINS Group Inc. on the acquisition by way of scheme of arrangement of THB Group plc, an insurance broker that (prior to de-listing following completion) was listed on AIM. The acquisition completed on 25 January 2011 and was the first Code-governed takeover in the insurance sector following the changes to the Code.

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Online Behavioral Advertising/Tracking Litigation: A Rising Risk Facing Insurers and Insureds

By Dominique R. Shelton (Los Angeles), Laurie A. Kamaiko (New York) and Mark E.Schreiber (Boston)

2012 began with over 100 pending consumer class actions alleging various companies' improper tracking of customer and other users' behavior online and via mobile devices. Some 60 class actions were filed in December 2011 alone against the mobile industry for tracking user behavior for internal analytics and measurement purposes, and other industries are likely to be targeted as well. Plaintiffs' attorneys have vowed to institute more claims of these sorts in the months to come.

Insurers face potential exposure both as insurers of other companies that track consumer activities for targeted advertising and other purposes, and as users of tracking of online consumer activities themselves. In light of these activities and exposures, a careful understanding and nuanced appreciation of these developing issues is essential for insurers.

THE EXPLODING BEHAVIORAL ADVERTISING MARKET

Targeted advertising has become global and ubiquitous. Online Behavioral Advert-ising (OBA) is the term now used to describe the process of company tracking of consumers' online activities to target them for advertising directed at their specific interests. Digital advertising is currently an $80.2 billion industry,[1] with online ad spending now exceeding that of print advertising. This has generated increasingly scrutiny of the appropriateness of use of OBA, and the level of notice afforded to and consent required of consumers. Other uses of tracking of customer online behavior have also been attacked.

Significant privacy concerns have been raised by regulators, legislators, and in a rash of class actions filed against compa-nies in a wide range of industries, about user tracking on a variety of mobile devices. Targeted industries include telecommuni-cations and media companies, internet providers, wireless phone manufacturers and device makers, and software develop-ment companies.

Given the importance of digital advertising revenue to digital business models, we expect that the issue of tracking and privacy will continue to grow in 2012, with resultant increase in regulatory scrutiny and litigation.

IMPACT ON INSURERS

Insurers may be called upon to address these issues as their insureds tender claims for defense and indemnity. As with many of the claims arising from use of new technologies, such claims can present an unexpected exposure, the challenge of addressing requests for coverage under policies not intended to cover such risks and, in a more positive aspect, an opportunity to develop new products that specifically address these exposures.

As insurers increasingly avail themselves of new technologies and platforms to market their products and connect to their insureds and agents, they too are potentially subject to similar regulatory and legal proceedings as other industries now face. Companies in the insurance industry are or soon will be employing technologies and platforms to engage with or track their insureds, market their products, assess underwriting exposures and identify issues that present significant exposure to both them and their customers. Many are developing technologies that will allow them to combine data from a variety of sources to develop risk profiles for casualty, property and personal line exposures. There is now the potential ability for companies to determine the number of claims filed involving a particular property and the claims filed by or against individuals owning those properties, and to gather information from publicly available sources (including social networks where companies and individuals often have a presence) to be able to develop a risk profile on a potential insured or claimant. Insurers are also using smart phone apps to provide insurance quotes and take down information.

These new practices bring with them new exposures, and companies utilizing online behavioral advertising and other tracking of user behavior should be aware of those exposures and consider protective measures, including updating and redrafting their web privacy policies to take into account their new activities and the developing regulatory and legal landscape.

WEB AND OTHER PLATFORM EXAMPLES

Last year, one credit card brand published patents in which they described advertising databases that could combine consumer purchasing history with other online social networking preferences to be able to develop an advertising profile that could be targeted to particular consumers. Companies in a wide range of businesses operate websites and smart phone applications that contain tracking technology that can identify the websites' users visit, their specific geographic locations and the pages that they "Like" through Facebook. This tracking has had the benefit of permitting website operators to serve targeted ads which have click through rates that are twice as effective as regular banner ads that users have come to ignore. In addition, tracking for internal analytic purposes has allowed companies to create infrastructure based upon user location, and create new products tailored to users' interests.

The wide-spread usage of such OBA and tracking has captured the attention of class-action attorneys, who seek the potential financial benefits of asserting violations of various federal and state statutes directed at limiting collection

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and dissemination of information about individuals and often requiring specific disclosures with statutory penalties and fines for violations, as well as at times alleging common law claims.

THE FEDERAL AND LITIGATION LANDSCAPE

Federal regulators have already taken action based on existing federal statutes, as well as proposed amendments to expand existing legislation to encompass OBA within their scope.

The FTC Recommendations and Enforcement Orders

The Federal Trade Commission (FTC) defines OBA as a process of "tracking consumers' activities online to target advertising."[2] It often, but not always, includes a review of the searches consumers have conducted, the Web pages visited, the purchases made, and the content viewed – in order to deliver advertising tailored to an individual consumer's interests. In its December 2010 report titled "Protecting Consumer Privacy in an Era of Rapid Change. A Proposed Framework for Business and Policy Makers," the FTC proposed a "Do Not Track" option to prevent targeted advertising without consumer consent. The final guidance is expected shortly.

On September 15, 2011, the FTC also recommended amendments to the Children's Online Privacy Protection Act (COPPA)[3] which would expand the definition of "personal information" to include OBA information. Final comments were due the end of December 2011, with the amendments still to be finalized. Privacy public interest advocates and industry groups provided comments.

Meanwhile, in 2011, the FTC announced four enforcement consent orders against companies for delivering OBA without consumer consent. For each of these actions, the FTC alleged "deceptive" acts in violation of the FTC Act, Section 5 (codified at 15 U.S.C. § 45(a)), and imposed on-going reporting requirements for 20 years.[4]

The Electronic Communications Privacy Act[5]

The Electronic Communications Privacy Act (ECPA) is being argued by plaintiffs to prevent or restrict access and tracking of user behavior without user consent. Sections within the ECPA have become the basis of claims asserted in many of the pending class actions.

The Federal Wiretap Act[6] is part of the ECPA. To prevail on a claim under the Wiretap Act, plaintiffs must prove that the defendants (1) intentionally (2) intercepted or endeavored to intercept (3) the contents (4) of an electronic communication (5) using a device.[7] It provides for statutory damages of $10,000 per violation or $100 per day.[8]

The Stored Electronic Communications Act (SCA)[9] is also part of the ECPA. The SCA prohibits "(1) intentionally access[ing] without authorization a facility through which an electronic communication service is provided; or (2) intentionally exceed[ing] an authorization to access that facility; and thereby obtain[ing], alter[ing], or prevent[ing] authorized access to a wire or electronic communication while it is in electronic storage in such system."[10]

Some courts have shown a willingness to infer consent if a consumer has reviewed a privacy policy that discloses tracking.[11]

The Consumer Fraud and Abuse Act [12]

The Computer Fraud and Abuse Act (CFAA), plaintiffs allege, makes it unlawful to track user browsing behavior if this causes $5,000 in economic loss. Where economic harm is not specified, Courts have been willing to dismiss CFAA complaints.[13]

State Law Claims

Plaintiffs in the pending class actions have alleged a wide variety of state law claims, relying heavily on state consumer protection statutes as well as state common law claims. These can impact the class certification issues, as states vary as to whether their consumer protection acts apply to out of state consumers, and can give rise to state law variations among multi-state classes that potentially can be raised as a defense to prevent class certification.

State regulators are also expanding the application of existing state statutes to the new practices. On February 23, 2012, the California Attorney General announced that mobile apps made available to California consumers must include privacy notices in compliance with the California Online Privacy Protection Act.[14]

Class Action Litigation

The class action bar has filed more than 115 putative class action lawsuits since January 2011, alleging violations of the ECPA, the Federal Wiretap Act, the SCA, the CFAA, and state statutes and common law. Many include allegations of a broad range of violations of other state statutes in addition to ECPA and CFAA, ranging from state wiretap laws to computer crime laws to state consumer protection statutes, as well as common law causes of action for trespass, misrepresentation, unjust enrichment, and violations of rights to privacy, among others. Damages are already a major issue, with defendants challenging plaintiffs' standing to pursue the class action claims based on lack of economic harm as required by statutes such as CFAA, and plaintiffs seeking statutory damages as allowed by certain of the statutes allegedly violated. For example, the Federal Wiretap Act,[15] which is often cited in these actions, provides for statutory damages of $10,000 per violation or $100 per day. The recent claims against the mobile industry for tracking allege monitoring software was installed on 151,000,000 phones, resulting in a floor of alleged damages of $1.5 billion.

Next Generation Litigation

While the first wave of class actions, filed in 2010, focused on cable companies providing Internet services, in recent months targets of putative class action complaints have included companies ranging from online retailers to financial institutions. Allegations range from assertions of improper use of "spyware, "persistent tracking cookies" and other applications to track consumer behavior, to assertions of failure to provide requisite disclosures and obtain requisite consents, as well as a broad range of statutory and common law violations.[16]

These class actions are still in the early stages, with issues such as class certification, standing and viability of certain causes of action and alleged damages still to be fully litigated. Some early decisions indicated that plaintiffs may face difficulties pursuing ECPA, CFAA and common law privacy claims in many of the suits, and courts at least initially showed a willingness to infer consent to receive behaviorally targeted advertising if a consumer reviewed privacy disclosures provided by companies. However, these early rulings relate to only a few of the class actions pending, and in many instances portions of the actions have survived and are still pending, or the claims were allowed to be amended.

Proposed "Do Not Track" Legislation

On March 16, 2011, the Obama administration called for a universal privacy bill, and specifically supported the FTC's "Do Not Track" proposals. Legislators have responded with privacy bills that address tracking.[17]

In addition, on January 30, 2012, in response to the filing of numerous recent class actions against the mobile industry for tracking for non-OBA analytic purposes, Representative Ed Markey (D. Mass.) announced his intent to introduce the "Mobile Device Privacy Act" that would require companies to disclose to consumers the capability of software to monitor mobile telephone usage and require the mobile phone users' express consent before tracking their usage, whether or not such tracking was for advertising purposes.[18] Thus the act of tracking user behavior online or via mobile devices is being scrutinized if not challenged on privacy grounds apart from the concerns raised about OBA. On February 23, 2012, President Obama released the Administration's long awaited privacy framework.[19] The Framework proposes national legislation focused on required disclosures for OBA.

State legislatures are not far behind. California, which is typically at the forefront of privacy legislation, has proposed a "Do Not Track" bill that contains a private right of action and statutory penalties.[20]

OBA IS A GLOBAL ISSUE

OBA issues are being grappled with by regulators in other countries as well, including those in the European Union, and Canada.

The European Union, which generally has a greater degree of consumer privacy protection than the U.S., has also been addressing the issues presented by OBA. Effective May 25, 2011, countries in the EU were required to implement regulations to obtain explicit consent before companies collect OBA information. On December 13, 2011, the UK's Information Commissioner's Office advised that opt-in consent will be necessary to collect OBA.[21] On February 27, 2012, Europe's largest mobile operators and a U.K.-based industry group (GSMA) unveiled voluntary app privacy guidelines.

Canada's Office of the Privacy Commission (OPC) issued its guidance on OBA and tracking in December 2011. It takes the position that OBA "generally" constitutes personal information,[22] and disclosures "cannot be buried in a privacy policy." If declining cookies "renders a service unusable, then organizations should not be employing that type of technology." It also states that OBA should not be collected from children, reflecting the concern of those in the U.S. pressing for an expansion of the Children's Online Privacy Protection Act restrictions to include OBA.[23]

CONCLUSION

Any company that advertises online or through mobile phone applications, has a website, or otherwise collects, uses or stores consumer data is potentially exposed to OBA and other types of "Do Not Track" claims. Insurance companies face exposures from OBA and tracking claims both from practices of their insureds and their own. Insurers as well as their insureds may be engaged in marketing their products online and through smart phone apps, and in tracking customer data for their own internal analytic purposes. Companies in the insurance industry use sophisticated databases to track claims history and merging data into databases to create underwriting profiles. Many of these activities likely entail or in the future will include some component of tracking technology. Thus, it is important for companies in the insurance industry, as well as those in other industries, to be aware of the developing regulatory and legal landscape governing tracking of customer and other users' behavior on line and via mobile devices.

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1. www.emarketer.com (June 2011). Digital spending is expected to exceed $94 billion in 2012. Id.
2. FTC Staff, FTC Staff Report: Self-Regulatory Principles for Online Behavioral Advertising (Feb. 2009), at p. 2 http://www.ftc.gov/os/2009/02/P0085400behavadreport.pdf.
3. Children's Online Privacy Protection Rule 16 C.F.R. § 312 (located at http://www.ftc.gov/os/2011/09/110915coppa.pdf). Comments were originally due on November 28, 2011 but the comment period was extended to Friday December 23, 2011 https://ftcpublic.commentworks.com/ftc/2011copparulereview/. Also, on November 8, 2011, the FTC issued its new guidance on November 8th regarding consumers and cookies. See http://onguardonline.gov/articles/0042-cookies-leaving-trail-web.
4. *In the Matter of Chitika, Inc.*, the FTC pursued Chitika for having an "opt out" for behavioral advertising that expired after ten (10) days – alleging this was a "deceptive" practice because the opt out was not meaningful. Chitika now has a 20 year reporting requirement to the FTC. In August 2011, the FTC pursued its first mobile app complaint, resulting in a consent decree against a mobile advertiser that served targeted ads to children under the age of 13 in violation of COPAA. United States of America, *Plaintiff v. W3 Innovations*, LLC, also d/b/a Broken Thumbs Apps http://www.ftc.gov/opa/2011/08/w3mobileapps.shtm. Most recently, on November 8, 2011, the FTC entered into issued a consent order against a digital third party advertiser Scanscout, for its alleged due of flash cookies to target advertising. And, on November 29, 2011, the FTC released its consent agreement with Facebook for alleged deceptive practices pertaining to tracking.
5. 18 U.S.C. § 2510.
6. 18 U.S.C. §2511.
7. 18 U.S.C. § 2511(3)(a).
8. Id. at §2520.
9. 18 U.S.C. § 2701.
10. Id. at § 2701(a).
11. See e.g., *Mortensen v. Bresnan Communications LLC*, 1:10-cv-00013 (D. Montana) (December 2010 Order, Dkt. 30 at p. 12, dismissing plaintiffs' class action allegations based upon the federal ECPA on grounds that Bresnan's privacy disclosures disclosed its collection and tracking of user "browsing behavior" and concluding that by using "... Bresnan's Internet Service, ...[plaintiffs] gave or acquiesced their consent to such interception."); and In re Facebook Privacy Litigation (N. D. Cal.) (where on May 12, 2011, Judge Ware dismissed the plaintiffs' ECPA claims with leave to amend); and In re Facebook Privacy Litigation (N.D. Cal. November 22, 2011) (where J. Ware dismissed the plaintiffs' claims with prejudice on the ground, among other things, that no harm had been shown).
12. 18 U.S.C. § 1030.
13. See e.g., *In LaCourt v. Specific Media, Inc.* 2011 WL 1661532 (C.D. Cal. Apr. 28, 2011), the court held plaintiffs failed to allege economic harm as required by the CFAA. Similarly, in *Bose v. Interclick; McDonald's USA, LLC; McDonald's Corporation; CBS Corporation; Mazda Motor of America, Inc. and Microsoft Corporation*, Case No. 1:10-cv-9183 (S.D.N.Y. August 2011), the court dismissed with prejudice the plaintiff's claims of alleged violations of the CFAA for failure to allege harm. See Order, Dkt. 36 dated August 17, 2011). See also, *In Re iPhone App. Litigation 11-MD-02250-LHK*, Order Granting Defendants' Motions to Dismiss for Lack of Article III Standing With Leave to Amend, Dkt. 8 (N.D. Cal. September 20, 2011).
14. CA Bus. and Prof. Code Sec. 22575.
15. 18 U.S.C. § 2520.
16. See footnotes 11 and 12 above.
17. H.R. Bill Nos. 611, 653 and 654, recommend "do not track" without consumer consent (introduced by Representatives Jackie Speier and Bobby Rush In February 2011). Also, Senators Kerry and McCain introduced similar legislation on the Senate side. See Commercial Privacy Bill of Rights Act (introduced March 2011) at http://kerry.senate.gov/imo/media/doc/Commercial%20Privacy%20Bill%20of%20Rights%20Text.pdf. Senator Rockefeller introduced the Do-Not-Track Online Act of 2011 (which would create a "universal legal obligation" for companies to honor users' opt-out requests on the Internet and mobile devices).
18. Rep. Markey's proposed draft "Mobile Device Privacy Act" (released for discussion purposes only) is located online at http://markey.house.gov/sites/markey.house.gov/files/documents/Mobile%20Device%20Privacy%20Act%20--%20Rep.%20Markey%201-30-12_0.pdf.
19. The Consumer Data Privacy in a Networked World: A Framework for Protecting Privacy and promoting Innovation in the Global Digital Economy.
20. In California, a "do not track" bill is pending. The bill was introduced by state Senator Alan Lowenthal introduced (SB 761), in April 2011. It would require the state attorney general to issue regulations that would require Web companies to notify state residents about online data collection and allow them to opt out. In addition, the California bill contains a private right of action and $1,000 statutory violation per violation.
21. Must Try Harder on Cookie Compliance Says ICO http://www.ico.gov.uk/news/latest_news/2011/must-try-harder-on-cookies-compliance-says-ico-13122011.aspx.
22. Guidelines located at http://www.priv.gc.ca/information/guide/2011/gl_ba_1112_e.pdf.
23. See footnote 3, above.

INSURE. REINSURE. EDWARDS WILDMAN REALLY SURE.

Black Horse brings some good news for lenders and insurers in the field of PPI

By Sam Tacey and Ed Norman (London)

The various problems surrounding the sale of payment protection insurance (PPI) have been a major issue for the banking and insurance industries in recent years, as exemplified by the case of *R (on the application of British Bankers Association) v Financial Services Authority* [2011] EWHC 999 (Admin), in which it was held that a policy statement issued by the FSA concerning the assessment and redress of PPI complaints was lawful. In the most recent decision in this area, *Harrison & ANOR v Black Horse* [2011] EWCA Civ 1128, the Court of Appeal held that a lender's failure to disclose to borrowers that it received commission for selling them PPI did not amount to unfairness. It is worth noting that some of the issues raised in *British Bankers* and *Harrison* have now been addressed in part, since as of April 2011 the sale of PPI has been prohibited at the point of sale of credit.

THE FACTS

In the case of *Harrison*, Mr and Mrs Harrison (the Harrisons), the appellant borrowers, sought to recover the cost of a PPI policy, which they had been sold by the respondent lender Black Horse (BH) (part of the Lloyds TSB Group), at the same time as they had obtained a loan from BH.

In July 2006, the Harrisons took out a loan from BH for £60,000 together with a PPI policy at a cost of £10,200. The PPI was sold by BH to the Harrisons as agent for the insurer, Lloyds TSB General Insurance Limited (Lloyds Insurance). As was typical in this sort of transaction, the PPI policy in this case was provided by an associated company within the same group of companies as the lender.

BH earned commission from Lloyds Insurance on the sale of the PPI in the sum of £8,887.49. This represented 87% of the premium paid by the Harrisons. BH disclosed neither the fact nor the amount of this commission to the Harrisons.

CASE HISTORY AND RELEVANT STATUTORY PROVISIONS

The Harrisons brought their action under ss.140A and B of the Consumer Credit Act 1974 (the Act), which gives the court wide-ranging powers (to, for example, require a lender to repay to a borrower all or part of the cost of the PPI) in circumstances where the relationship between a lender and a borrower has been determined to be unfair to the borrower.

The trial at first instance took place at Worcester County Court, where the Harrisons' claim was dismissed. Their appeal before Judge Waksman in the Mercantile Court at Manchester was also dismissed. The Harrisons therefore appealed to the Court of Appeal, challenging the lower courts' conclusions in relation to BH's compliance with the Insurance Conduct of Business Rules (ICOB). These rules regulate activities carried out in relation to non-investment insurance contracts. They were created by the FSA with the overall aim of ensuring fair treatment of customers, and cover such concerns as the suitability of advice given to customers, the disclosure of appropriate information and the fair handling of claims. A number of these issues were considered to be relevant to potential unfairness under the Act.

For the purposes of the ICOB rules in force at the time, BH was an insurance intermediary. Under ICOB Rule 4.3.6(2), when assessing the suitability of a non-investment insurance contract, an insurance intermediary was obliged to take into account the cost of the contract, where this was relevant to the customer's demands and needs. Furthermore, in circumstances where ICOB Rule 4.3.6(2) applied, under ICOB Rule 4.3.7(1), an insurance intermediary was also under an obligation to compare the contract with others that cover a similar range of demands and needs on which they can provide advice or information.

DECISION AND REASONING

The court looked at various factors when considering the issue of unfairness under the Consumer Credit Act 1974. These included the size of the commission and the disclosure requirements set out in ICOB.

The Harrisons argued that, in the absence of an explanation, the commission charged by BH was so egregious that it gave rise to a conflict of interest which it was the lender's duty to disclose. Lord Justice Tomlinson, delivering the judgment of the Court of Appeal, acknowledged that the commission was on *"any view quite startling"*. However, he cautioned that the undisclosed commission could not be unfair merely because of its size. This was so because of the particular facts of the case. He held that there was no likelihood of any material conflict of interest because any commission was not paid or attributed in whole or in part to the actual salesperson involved in the sale, nor was the extent of the commission known to her. Finally, the *"scripted"* approach the salesperson had to follow when speaking to customers meant that there was little or no prospect of her attempting to mislead the Harrisons.

Turning to the issue of non-disclosure of the commission, the court commented upon the noticeable absence from the ICOB rules of any requirement for the disclosure of commission. Tomlinson LJ clearly considered this to be a crucial factor, stating that *"the touchstone must in my view be the standard imposed by the regulatory authorities pursuant to their statutory duties"*. Tomlinson LJ further stated that it would be *"an anomalous result if a lender was obliged to disclose receipt of a commission in order to escape a finding of unfairness under s.140A of the Act but yet not obliged to disclose it pursuant to the statutorily imposed regulatory framework under which it operates"*.

In addition, the court considered the relevance of cost and whether or not there was an obligation on BH to conduct a comparative exercise. Tomlinson LJ commented that he was at first inclined to think that cost must be relevant to every customer's demands and needs. However, having considered the wording of ICOB Rule 4.3.6(2), which presupposes that the cost of the contract will not always be relevant to a customer's demands and needs, he held that the provision ought to be construed as meaning that cost need only be taken into account *"where the customer has indicated that this is a relevant concern"*. Since on the facts of this case, it had not been shown that cost was a relevant factor for the Harrisons or that it was a matter of real concern to them, the court considered that there had been no breach of ICOB Rule 4.3.6(2).

Since the court held that ICOB Rule 4.3.6(2) had not been engaged, it wasn't necessary for the court to consider the position under ICOB Rule 4.3.7(1). However, Tomlinson LJ nevertheless stated that even if ICOB Rule 4.3.6(2) had been engaged, BH would not have been under an obligation to conduct a comparative exercise since BH only offered one product and so there was no other product on which it could provide advice or information.

Ultimately, the court held in favour of BH in relation to all of the above issues, and as a result the Harrisons' appeal was dismissed.

COMMENTARY AND SIGNIFICANCE OF THE CASE

The decision in *Harrison* confirms that provided a lender's internal procedures comply with the requirements of ICOB, the mere payment of an undisclosed commission will not render the relationship between lender and borrower unfair, even if (as in this case), that commission is very large relative to the PPI premium.

In view of the wide-ranging nature of complaints concerning the mis-selling of PPI, it is important to emphasise that the subject matter of this case was very narrow. It focussed on a single aspect of a PPI transaction, namely the failure by the lender to disclose to the borrower that it would receive from the insurer a handsome commission upon the sale of the PPI.

However, that does not mean that the judgment is not significant. Firstly it provides certainty for lenders and insurers that claims against them of this type should fail, provided that they have complied with the relevant ICOB provisions. In addition, as was commented on by the Court of Appeal, the judgment ought to provide useful guidance in the many other cases which were stayed pending the decision.

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Nick Pearson Elected President of Insurance Federation of New York

Nick Pearson, a partner in the Insurance and Reinsurance Department of the firm's New York office, has been elected president of the Insurance Federation of New York, Inc. (IFNY). A director of the IFNY for 10 years, Nick served as president-elect in 2011 and began his term on December 15, 2011.

IFNY membership includes leaders from all segments of the New York insurance industry. Since 1913, it has served as a forum for the entire industry for the consideration of issues of mutual concern. Its membership includes life and P&C insurers, agents, brokers, law firms, and consultants. IFNY is a not-for-profit corporation and does not engage in lobbying. Its board includes four former New York Superintendents of Insurance.

Nick has represented U.S. and foreign insurers, reinsurers and producers since 1977. He has broad insurance regulatory, transactional and arbitration experience. He has lectured on insurance and reinsurance in the United States, England and Bermuda, and he has contributed to legal treatises. His articles have frequently appeared in leading international insurance publications.

Nick has been recognized in The International Who's Who of Insurance and Reinsurance Lawyers, Chambers USA: America's Leading Lawyers for Business, Euromoney's Guide to the World's Leading Insurance and Reinsurance Lawyers, and Woodward/White's The Best Lawyers in America. He has been named as one of the "New York Area's Best Lawyers" by New York Magazine. He holds the "AV" attorney rating from Martindale-Hubbell, signifying achievement at the highest level for legal ability and ethical standards.

Nick is a member of the Insurance Law Committee of the Association of the Bar of the City of New York, a director of the US Chapter of the International Association of Insurance Law, and as pro bono counsel to the Business Council for the United Nations. He is a member of the New York City Bar Association, the Federation of Regulatory Counsel and the International Association of Insurance Receivers.

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INSURE. REINSURE. REALLY SURE.

Insuring Against Cyber Risks: Congress and President Obama Weigh In

By Mark R. Heilbrun (Washington DC), E. Paul Kanefsky (New York) and Isaac Brown, Public Policy Advisor (Washington DC)

The world insurance and reinsurance industries have a significant role to play in the future of U.S. cybersecurity policy. As Congress and the Obama administration engage in debate during the next several months over these policies, the property and casualty insurance industry should be considering a number of possible changes to business lines addressing cybersecurity that may be considered by Congress and the administration over the coming months.

BACKGROUND

Cyber insurance is a product used to protect businesses from Internet-based risks, and risks of this nature are typically excluded from traditional commercial general liability policies. Coverage provided by cyber insurance policies may include: first-party coverage against losses such as data destruction, extortion, theft, hacking, and denial of service attacks; liability coverage indemnifying companies for losses to others caused, for example, by errors and omissions, failure to safeguard data, or defamation; and other benefits including regular security audits, post-incident public relations and investigative expenses, and criminal reward funds.

Cyber insurance encourages the adoption of best practices. Insurers will require a level of security as a precondition of coverage, and companies adopting better security practices often receive lower insurance rates. However, the market for cyber insurance is adversely affected by a number of problems. Major cyber attacks represent an uncertain risk of very large losses and as such are very difficult for insurers to plan for. Because computer systems are interdependent, they tend to be especially vulnerable to correlated losses of this nature. Insurers are also hampered by a lack of actuarial data with which to calculate premiums.

LEGISLATIVE INITIATIVES

The federal government may soon act to shore up domestic and international cybersecurity. For example, the federal government may exert its leverage in the marketplace by requiring government contractors and subcontractors to carry cyber insurance. Also, owners of covered critical infrastructure ("CCI") may need a certain level of cyber insurance in the future to sustain the CCI designation, albeit with the U.S. government as reinsurer. Further down the line, companies carrying cyber insurance to meet federal contracting requirements would be able to point to their insured status when bidding on private contracts. Precedent for requiring cyber insurance may be found in the Federal Acquisition Regulations, which require government contractors "to provide insurance for certain types of risks." The principal advantage of this approach is that it would directly increase the adoption of cyber insurance, and thereby improve cybersecurity, while imposing an additional regulatory burden that is relatively minimal. However, any such requirement might be viewed as an unfunded government mandate.

In addition, the federal government may enact pending legislation that provides safe harbors or other limitations on cybersecurity liability, contingent on reasonable efforts to conform to best practices. Liability, for example, would be capped at the amount of insurance purchased, and there would be requirements to purchase adequate amounts of insurance. Precedent for such action may be found in the Support Anti-Terrorism by Fostering Effective Technologies Act of 2002, which provides limitations on liability and damages for claims against sellers of such technologies arising out of the use of the technologies, contingent on having liability insurance.

Further, the federal government may establish an antitrust exemption to allow insurers to pool data on vulnerabilities and attacks. This would allow insurers and risk managers to create better actuarial models for cyber risks, reducing insurance premiums and making cyber insurance more attractive to companies. Precedent for this approach may be found in the Year 2000 Information and Readiness Disclosure Act of 1998, which provided a limited exemption from federal antitrust law, and the Freedom of Information Act for the sharing of vulnerability information related to the Year 2000 bug.

Finally, as alluded to above, the federal government may increase the supply of cyber insurance by providing reinsurance to cyber insurance companies. Precedent for this action may be found in the Terrorism Risk Insurance Act of 2002, which for a limited period provides compensation for insurers who suffer sufficiently large losses resulting from designated acts of terrorism, subject to recoupment through risk-spreading premiums on other insurance products.

RECENT DEVELOPMENTS

On Tuesday, February 14, Senators Lieberman (I-CT), Collins (R-ME), Feinstein (D-CA) and Rockefeller (D-WV) introduced the Cyber Security Act of 2012, a comprehensive cybersecurity bill. The legislation would create a mechanism for information-sharing among private entities and the government. It would also require new regulations for companies whose work is so significant to the nation's security that, should an attack take place, it would cause mass death or catastrophic damage to our economy and security. Senate Majority Leader Harry Reid (D-NV) has already announced he will use his authority to bring the bill to the floor quickly, and we expect a vote soon.

The House is also developing legislation, and a bill has passed in the House Intelligence Committee that also provides a system for private entities to share information. We also expect legislation from members of the Energy and Commerce Committee, whose members, in a hearing held on Wednesday, February 8, expressed bipartisan support for legislation addressing cyber threats. The members agreed on several points not included in either the Senate bill or the bill passed by the House Intelligence Committee. Those provisions include a national standard for data breach notification and the need to regulate Internet Service Providers. Significantly, the members also raised the point that the government should give consideration to implementing reinsurance programs to help underwrite the development of cyber security insurance programs. They also acknowledged that, over time, the government reinsurance programs could be phased out as insurance markets gained experience with cyber security coverage. Meanwhile, government sponsored reinsurance would be a means to help protect insurers and their CCI-owner insureds to protect themselves from potentially enormous liability.

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Industry Presence

ARTICLES:

- On January 6, 2012, Bloomberg Law Reports published an article by **Nick Pearson**, **Jeff Etherington** and **Amber Mills** (New York) entitled "Dodd-Frank: The Road Ahead". The article centers on recent developments in the federal regulation of insurance.
- **Soceth Sor** (Hartford) co-authored two articles in January:
  - "March 1 Deadline for Companies and Vendors with Massachusetts Personal Information," Edwards Wildman Palmer LLP Client Advisory, January 2012; and
  - "Regulatory: Follow the Leader When it Comes to Preventing Data Breaches," *InsideCounsel*, January 18, 2012.

  Soceth's expertise in the area of privacy has also been recognized by *Computerworld*, where she was quoted in the January 25, 2012 article, "Final phase of Mass. Data Protection Law Kicks in March 1."
- **Jon Yorke**, **Damian Connolly** and **Mark Everiss** (London) were interviewed for the February edition of *Lawyers Magazine's Legal Focus on Insurance and Reinsurance,* in which they discussed aspects of insolvency and restructuring in the insurance industry.
- **Chris Tauro** and **Kip Adams** (Boston) co-authored "Protect High-Level Corporate Officials from Unnecessary Depositions: Use of the Apex Doctrine," published in the February 2012 issue of *"For the Defense"* (Defence Research Institute).
- **Elizabeth Duffy** and **Kathleen Carr** (Boston) and **David Sigmon** (New York) published an article in *CLM Management Magazine* entitled, "A Small Technical Failure: Liability and Coverage Aspects Related to the Wreck of the Costa Concordia," which covered the insurance implications of the January 2012 Italian cruise ship disaster.
- **Laurie Kamaiko** (New York), **Ted Augustinos** (Hartford) and **Richard Graham** (London) were interviewed for the March issue of *Lawyers Magazine's Legal Focus on Insurance and Reinsurance*, in which they discussed US, UK and EU privacy and data breach issues.
- An article on recent developments in the Dodd-Frank Act and the Federal Insurance Office, authored by **John Street** (Chicago), appears in the March issue of the *ABA's Tort Trial & Insurance (TIPS) Practice Law Journal.* John's article is a major feature of the ABA TIPS Insurance Regulation Committee's annual article in the TIPS Practice Law Journal on recent developments in insurance regulation.
- **Chris Finney**, **Mark Everiss** and **Stephen Ixer** (London) have written an article entitled, "Guidance on sex in insurance: the UK and the European Commission issue their views on Test-Achats" which will be published in the March edition of the *BILA Journal."*

CONFERENCES:

- On January 24, **Nick Pearson** (New York) and **Jon Yorke** (London) served as speakers at the HB Litigation Conference in New York, which addressed the subject of developments in solvent schemes. Nick's topic was the "Great Debate - The Future of Solvent Schemes and Other Finality Options," while Jon discussed "UK Solvent Schemes and the UK run off market."
- **Ted Augustinos** (Hartford), **Richard Graham** (London), and **Vince Vitkowsky** (New York) presented an LMA Masterclass in London on January 31 entitled "Cyber Risks - What Are They and Who Is Affected?"
- **Jonathan Toren** (Boston) spoke at the New England Corporate Counsel Association on February 1, on "How to Get a Great Deal on D&O and E&O Insurance."
- On February 7, **Mark Peters** (New York) spoke on "Developments in US Insolvency" at a seminar sponsored by the the International Association of Insurance Receivers in London.
- **Michael Griffin** (Hartford), attended the annual meeting of the Professional Insurance Marketing Association (PIMA) in Palm Coast, FL (2/9-12). Michael has been appointed to the Legislative and Regulatory Committee of PIMA and was a featured speaker at this year's annual conference.
- **Vince Vitkowsky** (New York) will be moderating and presenting on a panel addressing Private Civil Litigation Under the Antiterrorism Act during the Seventh Annual ABA Homeland Security Institute in Washington, DC on March 22-23.

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FSA Winds Up Firms Offering Unauthorised Satellite Television Warranties

By Rhys Davies (London)

The Court of Appeal has upheld a decision of the High Court to wind up three firms that had been held to be offering extended warranties (which amounted to contracts of insurance) without the requisite FSA authorisation.

THE BACKGROUND

In November 2010 the Financial Services Authority (FSA) obtained a High Court ruling appointing provisional liquidators to three firms that the FSA considered to be engaged in insurance activities, a regulated activity under the Financial Services and Markets Act 2000 (FSMA), without FSA authorisation. Provisional liquidators were appointed to prevent further warranties being sold and to safeguard the position of creditors.

The firms, Digital Satellite Warranty Cover Limited, Satellite Services (a partnership) and Nationwide Digital Satellite Warranty Services Limited (collectively the Firms) offered Sky satellite customers a form of extended warranty to cover satellite equipment. The warranty plan offered by each of the Firms was in a similar, but not identical, form. The High Court, having reviewed marketing materials, a telephone script used by salespersons, transcripts of telephone calls between salespersons acting for the Firms and customers, and the written conditions on which customers contracted with the Firms, found that none of the material in question suggested that the Firms were under any obligation other than to repair equipment, or where repair was impractical, to replace the equipment covered. There was no obligation to pay money in respect of repair or replacement costs incurred by a customer or in place of fulfilment of the repair or replacement obligation.

ARE EXTENDED WARRANTIES CONTRACTS OF INSURANCE?

Council Directive 73/239/EEC (the Directive) and Council Directive 84/621/EEC (the Amending Directive) (the Directives) do not effect a total harmonisation of the regulation of direct insurance (other than life assurance) but the Directives do effect a measure of co-ordination across the European Community requiring Member States to regulate business which falls within the scope of the Directives. One of the aims of the Directives is consumer protection. In the UK, the Financial Services and Markets Act 2000 (Regulated Activities) Order (SI 2001/3544) (the RAO) gives effect to the Directives.

Section 19 of FSMA contains the widely known general prohibition that *"no person may carry on a regulated activity in the United Kingdom, or purport to do so, unless he is an authorised person or an exempt person"*. Section 22 of FSMA states that *"an activity is a regulated activity for the purposes of [FSMA] if it is an activity of a specified kind which is carried on by way of business and relates to an investment of a specified kind ..."*.

Central to both the decisions of the High Court and of the Court of Appeal was whether the Firms had been carrying out and effecting insurance business in breach of the general prohibition found in section 19 of FSMA.

First Instance Decision

Neither the Directives nor FSMA contain definitions of *"insurance"* or *"a contract of insurance"*. The RAO does, in Article 3, contain a definition of a contract of insurance namely that a *"contract of insurance"* includes a *"contract of general insurance"* or a *"contract of long-term insurance"*. A contract of general insurance (relevant in this instance) is a contract falling within Part 1 of Schedule 1 of the RAO. Examples of such contracts include class 4 which is a *"Contract of insurance against loss of or damage to railway rolling stock."* The judge at first instance held that the RAO provided only a circular definition of *"contracts of insurance"* and therefore the court had to look to the common law for a definition.

The judge referred to the widely acknowledged starting point of the judgment of Mr Justice Channell in *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658 at [664]:

"A contract of insurance, then, must be a contract for the payment of a sum of money, or for some corresponding benefit ... to become due on the happening of an event, which event must have some amount of uncertainty about it ..."

The judge held that a contract of insurance does not therefore have to provide for the payment of a sum of money; it could for example be the provision of services paid for by the insurer.

Reviewing the classes of insurance in Schedule 1 of the RAO the judge held that the contracts entered into by the Firms fell within class 16(b) namely a contract of insurance for the *"risks of loss to the persons insured attributable to their incurring unforeseen expense"*. His reasoning was that there was no material distinction when considering whether a contract fell within class 16(b) between a contract providing for repair and replacement (as the extended warranties clearly did) and one which provides indemnity for the costs incurred by the insured in repairing or replacing faulty equipment. The judge held in each case that *"the risk covered is essentially the same"* i.e. against faulty equipment.

The Firms were therefore in breach of the general prohibition under section 19 of FSMA and the judge made the winding-up orders.

Court of Appeal Decision

Two of the firms appealed against the order of the first instance judge. The sole issue for the Court of Appeal was whether the business of the firms comprised the making of contracts of general insurance within the meaning of Article 3(1) of the RAO. The appellant firms accepted that if the first instance judge was correct that the warranties were ones of general insurance within class 16, then there could be no answer to the FSA's petition for winding-up orders.

Delivering the leading judgment of the Court of Appeal, Lord Justice Patten held that the first instance judge's reasoning on the construction of the warranties was correct and he was therefore right to hold that the warranties fell within paragraph (b) of class 16. Although the warranty provided for repair and replacement, the risk was essentially a financial one as, without the cover, the insured would be *"exposed to the cost of remedying the defect [and] this risk of financial loss was the basis of the promotional material for the warranty scheme."*

As a result, the appeal was dismissed and there was no defence to the winding-up orders. The Court of Appeal has refused the firms permission to appeal to the Supreme Court. However the firms have applied direct to the Supreme Court for permission to appeal. A decision on whether the Supreme Court will allow an appeal is expected in March or April 2012.

COMMENT

The FSA has, as part of its statutory objective of consumer protection, publicised this action. In a press release following the decision of the Court of Appeal, the FSA commented that it was aware of other firms offering similar warranties without the requisite FSA authorisation. The FSA identified warranties covering other household goods such as *'white goods'* and warranties covering electrical, plumbing and boiler problems which may in fact be contracts of insurance.

The Court of Appeal judgment is reported as Re Digital Satellite Warranty Cover Ltd [2011] EWCA Civ 1413.

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NEW IRD PARTNERS

Over the past six months, the IRD has grown with the addition of five partners, each bringing additional depth to the already strong bench of the department. They not only bring their considerable skill sets, but establish the department's reach into Los Angeles and Chicago.

On October 1st, 2011, as part of the merger of Edwards Angell Palmer & Dodge and Wildman Harrold Allen & Dixon, the IRD welcomed two legacy Wildman partners to the IRD's Coverage and Claims Practice Group in Chicago:

Tom Bush has extensive experience in complex litigation, antitrust and insurance matters. In particular, Tom has been actively involved in the representation of significant Japanese and other companies and clients in the global insurance and reinsurance industry and is currently representing the interests of Japanese-based insurers on issues and arbitrations related to large scale events in the United States.

John Street has over 20 years of experience in counseling and representing insurance industry clients. He has extensive experience with premium and claims handling disputes arising under large commercial insurance programs. He has represented carriers in numerous antitrust and other class action litigation throughout the United States, both in personal and commercial lines matters. John represents and counsels carriers on regulatory matters, primarily when regulatory issues are litigated. John also has experience with coverage issues. In addition, John has significant experience in general commercial litigation and in counseling trade associations with respect to antitrust and other matters.

In November 2011 the IRD welcomed **Jon Yorke** as a member of the Regulatory & Transactional Practice Group in London. Jon is experienced in both contentious and non-contentious insurance insolvency, run-off and restructuring matters. He deals with formal insolvency proceedings in the Companies Court such as petitions for the appointment of administrators, winding up petitions and applications for direction. He also has a substantial practice in drafting and implementing both solvent and insolvent schemes of arrangement for insurance companies. Finally, Jon has considerable experience in foreign and cross border cases, acting for accounting firms, UK clearing banks and foreign banks.

In January 2012, the IRD welcomed **Barry Weissman** as a member of the Regulatory & Transactional Practice Group, resident in our Los Angeles office. Barry's practice encompasses regulatory and transactional services, and reinsurance disputes and litigation in state and federal courts on behalf of insurance and reinsurance companies. He has represented American, European and Asian clients in a variety of complex reinsurance, commercial and litigation matters, many of which have involved cross border issues such as mergers and acquisitions, dispute resolution and insurance regulatory matters. Barry has also been involved in matters in jurisdictions outside of the United States, including the United Kingdom, Japan and Korea.

In February 2012, the IRD also welcomed **Chris Finney** as a member of the Regulatory & Transactional Practice Group in London. Chris advises life and general insurers, reinsurers and captives on a wide range of financial services regulatory issues. Chris has a particular interest and expertise in Solvency II. He first developed this interest when he was working in the General Counsel's Division at the Financial Services Authority on the development and UK implementation of the new regime. At the FSA, Chris specialized in the regulation of insurers, reinsurers, captives and brokers. His experience also includes four years' acting for insurers and their insureds defending professional negligence claims.

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INSURE. REINSURE. EDWARDS WILDMAN REALLY SURE.

Medical Loss Ratio Requirements Force Reduction in Commissions Paid to Insurance Agents and Brokers

By Alfred J. Kritzman (Hartford)

Lawmakers and insurance industry leaders are expressing concern over the Medical Loss Ratio (MLR) requirements under the Patient Protection and Affordable Care Act of 2010 (PPACA). Under the MLR requirements, individual and small group plans must spend no less than 80% of their premiums on medical care provided to subscribers and quality improvement activities. For large-group plans, the ratio is 85%. The remaining 20% (or 15% for large-group plans) is classified as administrative expenses and profits. Insurers began reporting their MLRs to the Center for Consumer Information and Insurance Oversight (CCIIO) on January 1, 2011, the office within the Department of Health and Human Services (HHS) charged with implementing, monitoring compliance with, and enforcing the rules regarding the MLR requirements.

MLR requirements are nothing new, in concept. Many states have long established their own MLR requirements, with some exceeding those required by PPACA. Because each state defines medical care differently, with differing levels of competition (i.e., number of insurers) and geographical mixes (e.g., urban vs. rural), the state-determined MLR rates differ widely (e.g., North Dakota at 55% vs. New Jersey at 80%). Under PPACA, if a state has an MLR requirement higher than required by PPACA, the higher MLR requirement prevails.

REBATING

Insurers with individual and small-group plans whose MLRs fall below the 80% threshold (or 85% for large-group plans) must rebate the difference to their customers beginning in the 2012 plan year. These rebates are to be paid to the employer, employee or other entity that paid the premiums. Insurers with fewer than 1,000 insureds are exempt from the MLR rebate requirement. PPACA's drafters included the minimum MLR requirements as a way to drive down health care costs while improving insurer transparency and accountability.

PRODUCER COMMISSIONS AS ADMINISTRATIVE COSTS UNDER PPACA

Under PPACA and its regulations, commissions paid to insurance producers (both agents and brokers) are considered administrative expenses. Insurance agents and brokers, many of whom are small business owners serving other small businesses, contend that classifying commissions as administrative expenses will cause insurance companies to either (1) reduce the commissions they pay to agents and brokers, or (2) increase the premiums they charge to policyholders. The Government Accountability Office supported this position in a report issued in July 2011, wherein it stated that almost all insurers it interviewed were reducing brokers' commissions and making adjustments to premiums in response to PPACA's MLR requirements in an effort to decrease their company's MLRs.[1]

Opponents of PPACA's MLR requirements argue that insurers' actions will result in consolidation in the industry and reduced levels of customer service. They contend lower commissions will force small producers either to close their doors or sell themselves to larger competitors that can remain profitable with lower commission rates. With fewer small producers in the marketplace, customers will have less of a choice in which producer to use. On the other hand, consumer advocates believe the opposite will occur, as enforcement of MLR requirements will ensure customers receive the highest value for their premium dollars.

The House Subcommittee on Investigations, Oversight and Regulations (the Subcommittee) held a hearing on December 15, 2011 titled, "Medical Loss Ratios: Increasing Health Care Value or Just Eliminating Jobs?" where witnesses testified how the MLR requirements will affect healthcare insurance agents and brokers. The Subcommittee is part of the House Small Business Committee. The hearing demonstrated the differing views on PPACA's MLR requirements and whether sacrificing producer compensation, and ultimately the services producers provide, is an acceptable tradeoff for lower healthcare costs.

At the hearing, Representative Mike Coffman (R-CO), Chairman of the Subcommittee, stated, "We want quality health care and affordable insurance premiums," but that "[t]he MLR is an incentive for insurers to increase, not reduce, premiums, because they will need to improve their medical ratio and forgo administrative tools that can ultimately save money." Representative Coffman contended this will deter small insurers from entering the market, force established insurers to exit the market, reduce compensation paid to insurance agents and brokers, and ultimately result in job losses. Further, to keep administrative costs low, Representative Coffman stated that insurers are likely to be dissuaded from "making investments in anti-fraud, anti-waste, customer service, and transparency tools because they are considered administrative."

Representative Kurt Schrader (D-OR), the only Democrat on the Subcommittee, stated that while he was not sure the MLR is a bad piece of legislation, he was concerned about the effect it may have on agents and brokers.

Mitchell West, an independent health insurance broker from Colorado, testified on behalf of the National Association of Health Underwriters. According to Mr. West, the MLR requirements have resulted in a 50% decrease in commissions paid to insurance producers by the largest health insurance carriers. Mr. West commented that many producers have already left the business as a result, although the need for them now is greater because of the many complexities of purchasing health insurance. According to Mr. West, "the current situation is not sustainable in the long run."

Other witnesses who gave testimony to the Subcommittee include Ms. Grace-Marie Turner of the Galen Institute and Professor Timothy Jost of the Washington and Lee University School of Law. Ms. Turner was particularly critical of how the MLR requirements will discourage low-cost, high-deductible plans where the insured pays a larger portion of their medical expenses. Under such a plan, only the insurer's payments for medical care count towards the MLR ratio. This, in turn, will make the MLR for high-deductible plans seem lower than they actually are. Conversely, Professor Jost supported the MLR requirements by claiming that had they been in place in 2010, about $450 million in rebates would have been paid to nearly 16% of small businesses and 23% of all employees.

PLEAS FOR STATE-SPECIFIC ADJUSTMENTS TO PPACA'S MLR REQUIREMENTS

PPACA allows the Secretary of HHS to adjust the minimum MLR in a state if it is determined the MLR may destabilize the individual health insurance market. There is no authority for the Secretary to grant adjustments for the small and large group markets. States may apply to the CCIIO for an adjustment to their individual market MLR for a limited time subject to a period of public comment. To qualify, a state must demonstrate that requiring insurers to meet the individual market MLR of 80% would result in fewer consumer choices and higher premiums. Currently, of the 17 states that applied for such temporary adjustments, the CCIIO granted only six on either a partial or conditional basis and denied nine. Of the nine that were denied, three filed for reconsiderations, all of which were also denied. The applications for the remaining two states are pending a determination.

LEGISLATIVE ACTION

Section 1001(5) of PPACA added the MLR requirements to Section 2718 of the Public Health Service Act (PHSA) (42 U.S.C. 300gg-18), which was further amended by Section 10101(f) of PPACA. On March 17, 2011, Representative Mike Rogers (R-MI) introduced H.R. 1206, titled the "Access to Professional Insurance Advisors Act of 2011." The bill, which has 149 co-sponsors, would amend Section 2718 of the PHSA to exclude compensation paid to licensed insurance producers from administrative expenses when calculating the MLR of a health insurance plan. Also, on June 3, 2011, Representative Tom Price (R-GA) introduced H.R. 2077, titled the "MLR Repeal Act of 2011." This bill, which has 27 co-sponsors, would repeal Section 2718 of the PHSA. Both bills were referred to the House Energy and Commerce Subcommittee on Health but, as of this time, no action has been scheduled.

Because many health insurers drastically reduced producer commissions in order to meet the minimum MLR requirements, the National Association of Insurance Commissioners (NAIC) pleaded with Congress and HHS in an open letter dated November 22, 2011 to take action to use their respective authorities to preserve consumer access to insurance agents and brokers by adjusting the MLR component of PPACA.[2] The letter did not specifically support either H.R. 1206 or 2077, nor did it come with unanimous support of the NAIC membership. Rather the letter urges the exploration of possible options for providing relief to agents and brokers such as: "(1) approving state MLR adjustment requests; (2) placing an immediate hold on implementation and enforcement of the MLR requirements relative to agent and broker compensation; and (3) considering the NAIC's finding that a significant portion of insurance producer activities are dedicated to consumer advocacy and service and therefore classifying an appropriate portion of producer compensation as a health care quality expense for purposes of Section 2718 of the PHSA."

GOING FORWARD

Given that three states have had their reconsiderations for MLR adjustments denied after the NAIC issued its open letter, it appears HHS is unlikely to reconsider its present position and will continue to include 100% of agent and broker compensation in administrative expenses in the MLR calculations. However, if enough members of Congress believe the MLR requirements are harming small businesses such as agents and brokers, momentum may build in the legislative branch to pass a bill similar to H.R. 1206 rather than a wholesale repeal of the MLR requirements as proposed by H.R. 2077.

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1. 715 F. Supp. 2d 699 (E.D. Vir. June 3, 2010).
2. 759 F.Supp. 2d 822 (E.D. La. 2010).

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Restraining Litigation in Support of Arbitration

By David Kendall and Ajita Shah (London)

Anti-suit injunctions are orders made by English courts to restrain the pursuit of court proceedings abroad. Two recent cases in the Commercial Court and the Court of Appeal have re-examined the basis of a court's power to grant these injunctions, and the grounds on which it does so.

Anti-suit injunctions are often sought where court proceedings have been commenced abroad by one party in breach of an arbitration agreement or clause stating disputes are to be resolved by arbitration in England, or where foreign proceedings are commenced which are considered to be vexatious or oppressive. Both scenarios are represented in the two cases examined below. As with all injunctions, an anti-suit injunction is an equitable remedy, to be granted at the court's discretion. Since the enactment of the Senior Courts Act 1981 (SCA 1981), this equitable remedy has been granted under statutory powers.

ABSENCE OF ARBITRAL PROCEEDINGS

In *AES Ust-Kamenogorsk Hydropower Plant LLP v Ust-Kamenogorsk Hydropower Plant JSC* [2011] EWCA Civ 647, Lord Justice Rix examined the relationship between the two statutory provisions under which a court can grant anti-suit injunctions. S.37 SCA 1981 gives the court a general power to grant interim or final injunctions wherever it sees fit. S.44 Arbitration Act 1996 (AA 1996) gives the court the power to grant interim injunctions *"for the purposes of and in relation to arbitral proceedings"*. Clearly the powers granted under s.37 SCA 1981 are wider than those under s. 44 AA 1996. However, there has been a recent trend for courts to exercise powers under the SCA 1981 to grant interim injunctive relief, only to the extent that it would be appropriate to act under s.44 AA 1996 as well.

In the instant case, the Defendant (who had begun court proceedings in Kazakhstan despite an English arbitration clause) challenged the English Commercial Court's jurisdiction to grant an anti-suit injunction sought by the Claimant. By the time of the hearing, the Kazakhstan proceedings had been withdrawn, but the Claimant wished to maintain the injunction that had already been granted, to restrict further breaches of the arbitration agreement. As the Claimant did not intend to commence arbitral proceedings in England, the court considered whether it had the jurisdiction to grant an anti-suit injunction where no proceedings were in prospect or in motion.

The comments of the judge, Rix LJ, in a previous case (*OT Africa Line Ltd v Magic Sportswear Corporation* [2005] EWCA Civ 710) that *"an injunction must be necessary to protect the applicant's legitimate interest in English proceedings"* was raised in the present case by the Defendant, in an attempt to prove that the absence of existing *"English proceedings"* precluded the court from granting an anti-suit injunction. However it was deemed that the English arbitration clause itself *"plainly represent[ed] a 'legitimate interest in English proceedings' "*.

It was accepted that where there was no arbitration in being and none realistically in prospect, the court's power to grant an interim injunction under s.44 AA 1996 did not apply. The Defendant argued that the court's lack of jurisdiction under s.44 AA 1996 meant that the court lacked any power to intervene, as it submitted that the AA 1996 occupied *"the whole ground relating to the granting of relief in the form of anti-suit injunctions"*. Rix LJ disagreed, saying that he found in the present case *"no jurisdictional or principled lack of powers in these courts to [grant the anti-suit injunction]."* He agreed with previous case-law that the wider powers afforded by s.37 SCA 1981 should not be used to circumvent the restrictions posed by the narrower limits of s.44 AA 1996, where s.44 was applicable.

VEXATIOUS OR OPPRESSIVE PROCEEDINGS

In the case of *BNP Paribas SA v (1) Open Joint Stock Co Russian Machines (2) Joint Stock Asset Management Co Ingosstrakh-Investments* [2011] EWHC 308, the Claimant bank commenced arbitral proceedings to enforce a loan guarantee provided by the first Defendant on behalf of its subsidiary. The first and second Defendants were related companies. The second Defendant began proceedings in Russia against the Claimant and first Defendant, seeking invalidation of the guarantee by arguing that it had never been properly authorised. In the present hearing, the court was required to decide whether the incorrect service (due to an innocent error) of anti-suit proceedings on the first and second Defendants in England and Russia respectively, by the Claimant, could retrospectively be validated, or whether permission for service out of the jurisdiction could be granted now. The second Defendant challenged the court's jurisdiction to grant permission to serve proceedings out of the jurisdiction or retrospectively validate incorrect service, by challenging each of the requirements necessary to grant such permission:

- the availability of a jurisdictional gateway (civil procedure rules under which the court may give permission to serve an arbitration claim out of the jurisdiction);
- whether there was a serious issue to be tried between the parties; and
- whether the English court was the proper place for the claim to be tried.

Having held that the Claimant's action against the Defendants passed through one or more of the jurisdictional gateways, Mr Justice Blair turned to the question of whether there was a serious issue to be tried between the parties. In this case, this turned on whether either Defendant had breached or continued to breach the terms of the Arbitration Agreement between the Claimant and the first Defendant, or whether either had acted or continued to act vexatiously, oppressively or unconscionably (as noted above, these are the instances in which an anti-suit injunction is usually sought) so that the ends of justice required that the Claimant be granted the relief it sought.

The Claimant submitted that it was to be inferred that behind the scenes the Defendants were colluding to bring the proceedings in Russia with the purpose of impeding the London arbitration. Examining evidence from the record that the first Defendant had supported the second Defendant's case in the Russian proceedings, and noting that *"unconscionable"* behaviour could not be exhaustively defined, Blair J said that it was arguably unconscionable for companies under the same ownership and control, to work together to the extent of one bringing court proceedings with a view to impeding the outcome of an arbitration to which the other was a party. He drew the inference that this had been the purpose for which the Russian proceedings had been brought, and thus was satisfied that a sufficiently arguable case of vexatious and oppressive proceedings had been established.

Having no doubt that England was the proper place to determine the claims, Blair J held that the court had jurisdiction to decide on the issue, and 'deemed' that the methods of service used by the Claimant on the first and second Defendant constituted good service and were valid.

COMMENT

Both cases are valuable additions to the body of case law on anti-suit injunctions. The first makes clear that the absence of arbitral proceedings precludes a court from granting injunctive relief under s.44 AA 1996 but not under s.37 SCA 1981. The second gives a useful example of the vexatious or oppressive proceedings which are commonly cited as a ground for granting an anti-suit injunction, although in this case they were used to justify the court's interference in Russian proceedings by permitting the service of anti-suit proceedings on the two Defendants. It is notable that a third party (the second Defendant) was also served with the proceedings.

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Alan Levin, Bob Shuftan and Laurence Harris

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