

FOCUS ON THE INSURANCE INDUSTRY IS NOW LEGAL NEWS: INSURANCE... A CUTTING-EDGE APPROACH TO DELIVERING THE SAME INSURANCE THOUGHT LEADERSHIP YOU'VE COME TO EXPECT FROM FOLEY.

Legal News is part of our ongoing commitment to providing up-to-the minute information about pressing concerns or industry issues affecting our clients and colleagues.

In this issue:

The New Federal Lobbying Law: Surely They Didn't Mean Our Company

Amended Life Settlements Model Act Unanimously Adopted by NCOIL

Finite Reinsurance Under a Microscope: *United States v. Ferguson*

Supreme Court Considers Varying Review Standards for Arbitration Awards

The New Federal Lobbying Law: Surely They Didn't Mean Our Company



By Clea Mitchell

On September 14, 2007, President Bush signed into law "The Honest Leadership and Open Government Act of 2007" (HLOGA) significantly expanding the scope and reach of the federal lobbying registration and disclosure laws *and* extending the coverage of the U.S. House and Senate ethics rules to lobbyists, lobbying firms, registered foreign agents, *and* the companies, clients, associations, and entities that employ or retain them.

For the first time, not only are lobbyists and lobbying firms subject to regulation, registration, disclosure, and filings, but now the clients and employers of lobbyists and lobbying firms also are swept into the provisions of federal law and subject to the penalties for non-compliance.

Who Is Impacted?

- Any company that employs a federal lobbyist, regardless of where that individual or company is located

Example: XYZ Insurance Company in West Memphis, Tennessee employs a director of government relations who works in the corporate headquarters in Tennessee and handles all state and federal lobbying responsibilities of the company. The new provisions of the law require the company to file more frequently and report more information. Additionally, both the company and the employee-lobbyist must now have a brand new semi-annual filing (described more fully below), which requires more recordkeeping and new compliance systems to properly capture and report the information.

- Any entity that retains a lobbying firm or lobbyist on a contractual basis, even if the lobbyist is not an employee of the company

Example: ABC Insurance Company in Atlanta, Georgia has no employees who are registered federal lobbyists. However, the company retains a lobbying firm in Washington, D.C. that monitors federal legislation and handles any lobbying responsibilities for the company in the nation's capital. Under the new law, the company is subject to the provisions of the gift and travel rules related to congressional staff, employees, and members.

- A company that retains or employs a registered foreign agent is subject to the same provisions of law governing lobbyists and lobbying firms

What Is the Impact of the New Law?

- Any company that employs a registered federal lobbyist or registered foreign agent is now subject to new filing, disclosure, and reporting provisions. The filings are required of both the company itself and by each individual employee who is registered as a lobbyist or foreign agent.
- The changes in the law for those entities that employ a registered federal lobbyist are:
 - The triggers for employees' registration as lobbyists under the Lobbying Disclosure Act of 1995 (LDA) have been amended and reduced to quarterly expenditures of \$10,000 by the company, rather than semi-annual expenditures of \$20,000 for lobbying activities under the prior law. There are other factors required to trigger registration; those factors were not changed under the new law.
 - The former semi-annual reporting under the LDA had been increased to quarterly reports, due 20 days after the reporting period ends, rather than 45 days after the semi-annual reporting period ends.
 - New disclosures of prior employment of employees registered as lobbyists are required, as are additional reporting and disclosure of memberships in associations and coalitions.
 - A new semi-annual report is required to be filed by the employer and by the lobbyist/employee of the company, disclosing (1) the existence of any federal political action committee (PAC) established by the company or the lobbyist; (2) contributions from the company PAC or the employee to any federal candidate or officeholder, federal leadership PACs, or national party committees of \$200 or more; and (3) any contributions from the company or the individual lobbyist to any events honoring federal officeholders or officials, entities established or designated by federal officeholders or officials, presidential library funds and inaugural committees, or other recipients described in the new law.
 - A representation *under penalty of perjury* that the filer (including the company and the individual employee(s) registered as lobbyist(s)) is familiar with the ethics rules of the U.S. House and Senate and that neither the company *nor* the lobbyist has given any gift to any member, officer, or employee of Congress in violation of the gift rules of the House or Senate.

Example: XYZ Insurance Company in West Memphis, Tennessee, because it employs its own federal lobbyist, must make new filings regarding its federal lobbying activities quarterly instead of semi-annually. *Plus*, the individual employee and the company must now separately file a report twice per year that attests under penalty of

perjury that neither the company nor the lobbyist/employee has violated the congressional gift rules.

- Any company that retains or employs a registered federal lobbyist is subject to new restrictions on gifts to members and employees of Congress, regardless of whether the gift is given by a lobbyist

Example: ABC Insurance Company in Atlanta, Georgia has no employees who are registered as lobbyists, but does *retain* a lobbying firm in Washington, D.C. to monitor legislation and assist the company's chief executive officer (CEO) in getting meetings with key members and staff in Congress on issues of importance to the company. The company and all its employees are now subject to the congressional gifts and travel rules. The CEO takes the local congressman to dinner during the CEO's annual trip to Washington, D.C. *It is now illegal for the company to reimburse the CEO for the costs of the dinner, and the cost of the dinner cannot exceed \$49.99 (drinks included).* The extent and reach of the congressional gift and travel rules are extensive ... and any entity that employs or retains a federal lobbyist is now subject to the prohibitions of the rules.

What Are the Penalties for Violation of the Law?

HLOGA carries stiff civil *and criminal* penalties for its violation, and it authorizes random audits of all filings required under HLOGA:

- Civil penalties up to \$200,000 for failure to comply with the disclosure and reporting provisions of the act
- Criminal penalties up to five years in federal prison for "knowingly and corruptly" failing to properly report and disclose gifts that violate the House and Senate ethics rules
- The U.S. Government Accountability Office (GAO) is directed to conduct random audits of all filings under the LDA and is authorized to request documentation from filers to substantiate the reports filed
- HLOGA has added to the federal criminal code a blanket prohibition against violation of the House and Senate ethics rules by any individual or entity, with violators subject to prosecution by the United States Department of Justice

HLOGA makes it imperative that any entity that employs or retains a federal lobbyist, lobbying firm, or registered foreign agent take the following steps:

- Become familiar with the provisions of HLOGA and ascertain its impact on the company
- Conduct an internal compliance assessment and identify needed changes
- Establish a compliance and reporting system to ensure proper recordkeeping and reporting of pertinent information required by the law
- Get professional help



Amended Life Settlements Model Act Unanimously Adopted by NCOIL

By Jennifer K. Schroeder and Kenyatta Bolden

After 16 months of debate, the National Conference of

Insurance Legislators (NCOIL) has adopted an amended Life Settlements Model Act (Model Act). The Model Act was unanimously adopted during NCOIL's Annual Meeting in November. First adopted in November 2000 and last updated in July 2004, the Model Act "is a targeted attempt to prohibit controversial stranger-originated life insurance (STOLI) transactions while encouraging legitimate life settlements."¹ Although the Model Act and the amended Viatical Settlements Model Act adopted earlier this year by the National Association of Insurance Commissioners (NAIC) have similar objectives, there are several substantive differences between the two model acts.

Among the notable differences, NCOIL has adopted a "first-of-its-kind definition of STOLI,"² which is defined as "a practice or plan to initiate a life insurance policy for the benefit of a third-party investor who, at the time of policy origination, has no insurable interest in the insured."³ The definition goes on to say that "STOLI practices include but are not limited to cases in which life insurance is purchased with resources or guarantees from or through a person, or entity, who, at the time of policy inception, could not lawfully initiate the policy himself or itself, and where, at the time of inception, there is an arrangement or agreement, whether verbal or written, to directly or indirectly transfer the ownership of the policy and/or the policy benefits to a third party."⁴

Another distinguishing point between the two models is the length of time a policyholder is prohibited from settling a policy. The NCOIL Model Act has a two-year moratorium on settlement, which parallels the contestability period traditionally used in life insurance contracts, whereas the NAIC model has a five-year moratorium with certain exceptions for life-changing events.

Recognizing that some commentators have criticized the five-year ban in the NAIC model as addressing STOLI at the back-end, North Dakota State Representative George Keiser, NCOIL's Life Settlements Subcommittee chairman, said, "STOLI occurs at the front-end of a life insurance sale. By defining STOLI, and strengthening reporting requirements and penalties for participating in STOLI, the NCOIL model gets at the heart of what needs to change."⁵ Despite the amendments to the Model Act, "[NCOIL] attempted to protect all of the legitimate applications of financing, trusts, and the structural options that exist in packaging products sold, both from the life settlements perspective, and from the life insurance industry," said Mr. Keiser.⁶

The Model Act also includes: (1) a recommendation that states amend their insurable interest laws, if necessary, to prevent the use of trusts to benefit

investors without insurable interest; (2) an annual statement requirement for contracts settled within five years of policy issuance; and (3) a penalties section addressing fraudulent life settlement acts.

¹ See Press Release, NCOIL, NCOIL Closes In On Illegal STOLI, Unanimously Adopts Amended Model Act (Nov. 20, 2007), <http://www.ncoil.org/HomePage/2007/LifeSettlementsPR.pdf> (last visited Dec. 14, 2007).

² *Id.*

³ Life Settlements Model Act, Section 2(Y) (Nat'l Conference of Ins. Legislators 2007).

⁴ *Id.*

⁵ See note 1, *supra*.

⁶ NCOIL Strikes Agreement on Bill Banning STOLI, A.M. Best Newswire (Nov. 16, 2007).



Finite Reinsurance Under a Microscope: *United States v. Ferguson*

By William J. Katt, Jr.

Finite reinsurance will be a hot topic over the next few months as the criminal trial of former General

Reinsurance Co. (Gen Re) CEO Ronald Ferguson and his four co-defendants commences in January in federal court in Hartford, Connecticut.

Mr. Ferguson stands accused with Christopher Garand, a former vice president of Gen Re's finite reinsurance operation, Robert Graham, Gen Re's former assistant general counsel, Christopher Milton, a former vice president of Reinsurance for American International Group (AIG), and Elizabeth Monrad, former chief financial officer of Gen Re, as a result of a finite reinsurance transaction that the United States alleges was fraudulent.

Finite reinsurance is a type of reinsurance that transfers only a finite amount of risk, limited through accounting or financial methods. This type of reinsurance appeared in the 1990s as a way for buyers of reinsurance to acquire some risk protection in times of limited capacity in the reinsurance market. By transferring less risk, insurers have been able to acquire limited reinsurance coverage on potential claims at a lower cost than they could through traditional reinsurance. In recent years, however, some finite reinsurance transactions have been challenged on the ground that they transfer no risk at all.

Finite transactions have been negotiated in several kinds of reinsurance, including loss portfolio transfer, where an insurer passes to the reinsurer some responsibility for a bundle of insurance claims. The indictment against Mr. Ferguson and his co-defendants contains allegations about this type of agreement. The indictment alleges that the transaction in question was a sham, was fraudulent, and violated the federal securities laws.

According to the indictment, the reinsurance agreement provided that AIG was to reinsure a bundle of Gen Re policies under two contracts with a total liability limit of \$600 million extending over a two-year period, at a total premium of \$500 million, for a net exposure of \$100 million. AIG allegedly was to receive \$10 million of the premiums as a loss portfolio transfer fee, while Gen Re could withhold the remaining

\$490 million in an experience account. The indictment alleges that the agreement also contained a commutation provision by which Gen Re could unilaterally terminate the contract at any time and keep any remaining withheld portion of the premiums.

These terms purported to transfer a finite risk from Gen Re to AIG. AIG ultimately appeared to assume a limited risk of \$100 million in exchange for \$10 million in cash premiums.

According to the indictment, however, the parties also reached a secret side agreement. Under the alleged terms of this agreement, (1) the parties agreed that AIG assumed no real exposure by the transaction — i.e., there was no chance that AIG would ever have to take a loss on its contractual \$100 million exposure; (2) AIG agreed to repay to Gen Re the \$10 million loss portfolio transfer fee it had advanced as part of the public contract; and (3) AIG agreed to pay to Gen Re a \$5 million service fee for its participation in the transaction.

According to the indictment, AIG benefited from the transaction because, on the basis of the total premium owed by Gen Re under the terms of the reinsurance contracts, it increased the loss reserves on its balance sheet by \$250 million in the fourth quarter of 2000 and by another \$250 million in the first quarter of 2001, enhancing its apparent financial health. Because of the alleged side agreement, however, prosecutors claim that Gen Re essentially lent the purported premium amounts to AIG, amounts that could not properly be booked by AIG as loss reserves.

The *Ferguson* trial will be the most prominent example to date of the skeptical eye government regulators at the federal and state levels have cast toward some kinds of finite reinsurance transactions in the last few years. If convicted, Messrs. Ferguson, Graham, Milton, and Ms. Monrad each will face up to 230 years in prison and \$46 million in fines and Mr. Garand will face 160 years in prison and \$29.5 million in fines.



Supreme Court Considers Varying Review Standards for Arbitration Awards

By Brett H. Ludwig and Linda M. Annoye

On November 7, 2007, the United States Supreme Court heard oral arguments in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, Case No 06-989, an arbitration case that could have significant implications for any insurer or reinsurer that uses arbitration provisions in its contracts. Typically, insurers that arbitrate are bound by the arbitrators' decision,

with only very limited rights to appeal a decision they think is wrong. The Supreme Court's decision in *Hall Street* may change that.

Hall Street involved an environmental clean-up dispute, a portion of which the parties agreed to arbitrate. As part of their arbitration agreement, the parties agreed to broaden substantially the rights they would ordinarily have to appeal from the arbitrator's decision. They agreed that the district court could review the arbitration award for compliance with the evidence and for errors of law, both of which are beyond the limited review courts ordinarily undertake with respect to arbitration rulings.

The arbitrator ultimately issued a decision in Mattel's favor and Mattel sought to confirm the award in court under the Federal Arbitration Act (FAA). *Hall Street* responded by filing a motion to vacate, modify, or correct the award, invoking the enlarged grounds for review provided in the parties' arbitration agreement. The district court agreed and, applying the broader review standard, vacated the award for legal error. On remand, the arbitrator amended his decision (based on the district court's ruling) and entered a decision in favor of Hall Street. The district court confirmed the revised award in part and modified it in part, again applying the broader review standard agreed to by the parties.

Then, in the first of two rounds of appeals from the district court, the United States Court of Appeals for the Ninth Circuit reversed the district court's judgment. The Ninth Circuit concluded that Sections 10 and 11 of the FAA provide the exclusive grounds for review of an arbitration award and remanded the case to the district court with instructions to confirm the arbitrator's initial award in favor of Mattel unless the district court determined that the award should be vacated, modified, or corrected on the grounds allowable under the FAA.

On remand, the district court again held that the arbitrator's award should be vacated, this time purporting to apply the FAA review standard and concluding that the arbitrator's award was based upon an "implausible" interpretation of the contract. This led to a second appeal and reversal, with the Ninth Circuit holding that "implausibility" is not a valid ground for avoiding an arbitration award under the FAA.

The case has now been brought to the U.S. Supreme Court, where oral argument has been heard. The Supreme Court's decision, which can be expected within the next several months, will decide whether parties may extend the limited scope of review of arbitration awards provided for in the FAA. *Hall Street* has implications for insurers that have arbitration provisions in agency agreements or reinsurance contracts. If the Supreme Court opens the door for parties to contract for broader standards of review from arbitration awards, every insurer with arbitration clauses in its contracts should consider whether to seek a change in the standard of review to be applied by the courts in their review of arbitration awards.

ABOUT FOLEY

Foley & Lardner LLP continually evolves to meet the changing legal needs of our clients. Our team-based approach, proprietary client service technology, and practice depth enhance client relationships while seeing clients through their most complex legal challenges. The BTI Consulting Group (Wellesley, Massachusetts) recently recognized Foley as one of the top four law firms shaping the U.S. legal market, while *CIO* magazine has named Foley to its CIO 100 list six times for our client-focused technology. Whether in the United States or around the world, count on Foley for high-caliber business and legal insight.

Learn more at Foley.com

Foley & Lardner LLP Legal News is intended to provide information (not advice) about important new legislation or legal developments. The great number of legal developments does not permit the issuing of an update for each one, nor does it allow the issuing of a follow-up on all subsequent developments.

If you do not want to receive further issues of Legal News, please e-mail info@foley.com or contact Marketing at Foley & Lardner LLP, 321 N. Clark Street, Suite 2800, Chicago, IL 60610 or 312.832.4500.

To subscribe to Legal News: Insurance, please send an e-mail to Foley&LardnerInsuranceIndustryGroup@foley.com or visit us on the Web at Foley.com/insurance.

ANNOUNCEMENTS

Successes

The article, "The Death, by Taxes, of the Pure Captive," authored by Foley Partner **Kevin G. Fitzgerald**, appeared in Mealey's™ *Litigation Report: Reinsurance* on December 7, 2007, Volume 18, Issue #15.

The following Foley Insurance Industry Team attorneys were named or selected to the *Wisconsin Super Lawyers* list as published by *Law & Politics* and *Wisconsin Magazine*: **Gordon (Chip) Davenport, III, Lisa S. Neubauer, Anne E. Ross, and Michael B. Van Sicklen.**

The following Foley Insurance Industry Team attorneys were named or selected to the *Wisconsin Rising Stars* list as published by *Law & Politics* and *Wisconsin Magazine*: **Paul S. Hunter, Ethan D. Lenz, Brett H. Ludwig, and Bartholomew F. Reuter.**

The following Foley Insurance Industry Team attorneys were named to the list of *The Best Lawyers in America*: **Patrick D. Daugherty, Kevin G. Fitzgerald, John N. Gavin, Thomas J. Maida, Lisa S. Neubauer, Leigh C. Riley, Anne E. Ross, Michael B. Van Sicklen, and Peter N. Wang.**

Upcoming Events

Foley Partners **Ethan D. Lenz** and **Brian S. Kaas** will present at the Mealey's™ Teleconference: Insurance Coverage for Product Recalls on Thursday, February 7, 2008.

Recent Events

The 2007 Blue Cross Blue Shield National Tax Conference was held on December 5 – 7, 2007 at the Westin La Cantera Resort in San Antonio, Texas. Foley attorneys participated in the following panels: Partner **Richard Bromley** discussed insurance tax reserves and Partner **Kevin G. Fitzgerald** discussed state and local tax and a Blue Card Update.

Foley Partners **Thomas R. Hrdlick** and **Brett H. Ludwig** presented at the Mealey's™ Teleconference: Overview of Managing General Agents and Program Writing Business, along with colleagues from Smart Business Advisory & Consulting, on Wednesday, December 5, 2007.

On November 14, 2007, Foley Partner **Richard Bromley** presented and chaired a panel on "Federal Perspective on Insurance Regulation." Of Counsel, **Philip G. Kiko** also presented on the panel.

On November 8, 2007, Partner **George H. Keller** presented at the Mealey's™ Construction Defects SuperConference in Las Vegas on the panel regarding "Additional Insured Issues — Coverage for Contractual Risk Transfer."

Partner **Richard Bromley** chaired a panel on "State Tax Issues for Insurers," at the 32nd Annual Insurance Tax Conference in Chicago on November 1 – 2, 2007. Partner **Brian S. Kaas** spoke on recent legislative developments impacting the reinsurance industry.

Foley's Reinsurance Practice attorneys hosted clients, colleagues, and friends in New York on October 31, 2007 at "Foley's ARIAS Conference Kick-off Dinner."

On October 18, 2007, **Leonard Schulte** presented on Florida property insurance issues at "Florida's Coastal Insurance and Property Tax Crisis," a day-long seminar for South Florida journalists sponsored by the Foundation for American Communications in association with the Society of Professional Journalists and the South-Florida *Sun-Sentinel*.

■ LEGEND

Agency/Distribution = AD

Financial Products/Variable Insurance = FP

Insolvency/Guaranty Fund = IG

Intellectual Property = IP

Litigation = LT

M&A/Transactional = MA

Public Affairs = PA

Regulatory = RG

Reinsurance/Commutation/Runoff = RE

Risk Management/Captives = RM

Tax = TX

Annoye, Linda M.

Associate, RE
414.319.7301
lannoey@foley.com

Aprahamian, Michael J.

Partner, LT
414.297.5516
maprahamian@foley.com

Bolden, Kenyatta

Associate, MA/RG
414.297.5541
kbolden@foley.com

Branch, Joseph C.

Partner, MA/RG/RE
414.297.5837
jbranch@foley.com

Bromley, Richard

Partner, IG/TX
312.832.4517
rbromley@foley.com

Chester, Maksim

Associate, RE
414.297.5573
mchester@foley.com

Daugherty, Patrick D.

Partner
313.234.7103
pdaugherty@foley.com

Davenport III, Gordon

Partner, AD/LT
608.258.4208
gdavenport@foley.com

Fitzgerald, Kevin G.

Partner, AD/MA/RG/RE/RM
414.297.5841
kfitzgerald@foley.com

Gavin, John N.

Partner, IG/MA/RG/RE/RM
312.832.4544
jgavin@foley.com

Gustafson, Christine A.

Special Counsel, RM/TX
312.832.4529
cgustafson@foley.com

Hakim, Anat

Partner, IP
202.295.4046
ahakim@foley.com

Harrell, Michael P.

Public Affairs Director, PA
850.513.3379
mharrell@foley.com

Herbert, W. Carlisle

Partner, IG/LT/RE
312.832.4551
wherbert@foley.com

Hosay, Robert H.

Special Counsel, PA
850.513.3382
rhosay@foley.com

Hrdlick, Thomas R.

Partner, IG/MA/RG/RE
414.297.5812
thrdlick@foley.com

Hunter, Paul S.

Senior Counsel, IP
608.258.4292
phunter@foley.com

Kaas, Brian S.

Partner, MA/RG/RE/RM
414.297.5847
bkaas@foley.com

Kanwit, Glen H.

Partner, RE
312.832.4380
gkanwit@foley.com

Keller, George

Partner, LT
415.438.6415
gkeller@foley.com

Kuhlmann, Patrick M.

Associate, RE
414.297.5614
pkuhlmann@foley.com

Lenz, Ethan D.

Partner, AD/MA/RG/RE
414.297.5835
elenz@foley.com

Leventhal, Robert C.

Partner, RE
310.975.7734
rleventhal@foley.com

Ludwig, Brett H.

Partner, RE
414.297.5524
bludwig@foley.com

Luetzgen, David G.

Partner, IP
414.297.5769
dluetzgen@foley.com

Maassen, Eric L.

Partner, LT/RE
414.297.5585
emaassen@foley.com

Mahe, Henry E.

Strategic Counselor, PA
202.295.4106
emahe@foley.com

Maida, Thomas J.

Partner, MA/PA/RG/RE
850.513.3377
tmaida@foley.com

Martire, Mary Kay

Partner, IG/LT
312.832.4560
mmartire@foley.com

Monsees, Paul R.

Partner, RE
202.672.5342
pmonsees@foley.com

Moser, Gregory V.

Partner, RM
619.685.6426
gmoser@foley.com

Neal, Austin B.

Partner, MA/RG
850.513.3363
aneal@foley.com

Neubauer, Lisa S.

Partner, LT
414.297.5507
lneubauer@foley.com

Oberdeck, Andrew A.

Associate, AD/MA/RG/RE
414.297.5598
aoberdeck@foley.com

Ossyra, James D.

Partner, LT/RE
312.832.4565
jossyra@foley.com

Patel, Jamshed J.

Partner, RM/TX
414.297.5742
jpatel@foley.com

Pontrelli, Michael R.

Partner, LT/RE
617.342.4074
mpontrelli@foley.com

Reuter, Bartholomew F.

Senior Counsel, LT/RE
414.297.5826
breuter@foley.com

Ridley, Eileen R.

Partner, IP/LT/RE/RM
415.438.6469
eridley@foley.com

Riley, Leigh C.

Partner, RG
414.297.5846
lriley@foley.com

Ross, Anne E.

Partner, MA/RG
608.258.4218
aross@foley.com

Schroeder, Jennifer K.

Associate, AD/MA/RG/RE/RM
414.297.5647
jkschroeder@foley.com

Schulte, Leonard

Public Affairs Advisor, PA
850.513.3380
lschulte@foley.com

Strickland, Nate Wesley

Senior Counsel, MA/RG
850.513.3369
nstrickland@foley.com

Thomas, Benjamin S.

Associate
414.319.7329
bthomas@foley.com

Van Sicken, Michael B.

Partner, RE
608.258.4206
mvansicklen@foley.com

Varon, Jay N.

Partner
202.672.5380
jvaron@foley.com

Wang, Peter N.

Partner, LT
212.682.7474
pwang@foley.com

Zinkgraf, Gary M.

Partner, RE
202.672.5303
gzinkgraf@foley.com