

BRIEFING

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New Jersey Court Dismisses ERISA Class Action Under *Iqbal* Standard

McDonough v. Horizon Blue Cross Blue Shield of New Jersey, Inc., Civil Action No. 2: 09-cv-00571 (October 7, 2009)

A putative ERISA class action filed against Horizon Blue Cross Blue Shield of New Jersey (“Horizon”) claiming that Horizon violated ERISA in processing and paying out-of-network (“ONET”) claims was recently dismissed by the United States District Court for the District of New Jersey. Judge Stanley R. Chesler, citing the heightened pleading standards set forth in *Ashcroft v. Iqbal*, 129 S.Ct. 1937, (2009) and *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, (2007), held that the complaint’s dearth of factual substance and heavy reliance on legal conclusions could not support an action against Horizon and dismissed the case without prejudice.

McDonough, an insured under an employer group Horizon policy, sought unpaid benefits and other legal and equitable relief under ERISA. McDonough sought to represent a nationwide class consisting of “all members of any health plan administered by Horizon or as to which Horizon is a claims fiduciary, who received medical or hospital services from an out-of-network provider and for whom Horizon made out-of-network determinations (including but not limited to reductions based on usual and customary rate ‘UCR’) in an amount less than the billed charge for that procedure.”

McDonough claimed that her health plan required Horizon to calculate the payment of ONET claims based on the UCR for a similar service in the geographical area. That policy allowed Horizon to determine a UCR based on its profiles of usual and customary payments or profiles compiled by a third-party vendor. McDonough alleged that the UCRs relied upon by Horizon were generated by flawed databases, resulting in underpayment of ONET claims. The complaint further alleged that Horizon breached its obligations under the health plan and ERISA by relying on flawed databases that did not satisfy the contractual definition of UCR, that it underpaid ONET claims, and that it failed to disclose to insureds how the ONET reimbursements were calculated.

The District Court analyzed McDonough’s claims under *Iqbal* and *Twombly*. Finding that the Supreme Court’s recent re-interpretation of the standards on motions to dismiss requires that a court must be able to draw a reasonable inference that the defendant is liable for the misconduct alleged based on the factual content as pled. The *McDonough* court was not persuaded that a complaint with such a “dearth of factual substance” met the *Iqbal* standard. The court stated that “[w]hile the complaint need not demonstrate that a defendant is *probably* liable for the wrongdoing to meet the pleading standard of Federal Rule of Civil Procedure 8(a), allegations that give rise to the mere *possibility* of unlawful conduct will not do.”

Even assuming the truth of the factual allegations for purposes of the motion, it was not clear to the court that McDonough was entitled to relief under any of the proposed legal theories. The court reiterated that legal conclusions are not entitled to an assumption of truth and a complaint cannot overcome a Rule 12(b)(6) challenge without “enough facts to raise a reasonable expectation that discovery will reveal evidence of the necessary element.” In addition, there was no allegation that Horizon was under any contractual, statutory or regulatory obligation to disclose the methodology used to determine UCRs. Finally, the court said, the claim that Horizon failed to supply accurate Summary Plan Descriptions in violation of ERISA is the kind of “unadorned, the defendant-unlawfully-harmed-me accusation that does not pass muster under Rule 8(a).”

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Inter-related Wrongful Acts Clause Releases Subsequent D&O Carrier from Liability

G-I Holdings, Inc., et al v. Hartford Fire Insurance Company, 2009 WL 3416166 (C.A.3 (N.J.)) (October 26, 2009)

In *G-I Holdings*, the U.S. Court of Appeals for the Third Circuit affirmed the district court’s finding that three fraudulent conveyance claims brought against G-I Holdings Inc. (G-I) over a period of years – and across separate D&O policies – related back to the first year of coverage provided by an insolvent insurer, Reliance Insurance Company (Reliance).

In February 2000, G-I purchased an insurance policy from Reliance that covered liability arising out of claims made by third parties against G-I’s directors and officers from July 1, 1999 to July 1, 2002. The policy’s “inter-related wrongful acts” clause provided that the date of filing of all suits arising from the same wrongful act would be on the date of the first suit. In 2000, Reliance was in financial difficulty and its credit rating fell below an acceptable level. In the event, the G-I policy was amended. Reliance retained coverage from inception to July 15, 2000; Hartford Fire Insurance Company (Hartford) issued G-I an identical policy for the remaining two years of coverage. Hartford also entered into a claims management agreement with Reliance and provided reinsurance for certain segments of Reliance’s business. In October 2001, a Pennsylvania state court ordered the liquidation of Reliance.

Three separate fraudulent conveyance claims were made against G-I after it filed for Chapter 11 bankruptcy: (1) January 3, 2000; (2) September 19, 2000; and (3) September 17, 2001. The claims related to the distribution of stock to certain of its officers.

In 2006, G-I and Hartford filed cross motions for summary judgment. G-I argued that Hartford must cover some or all of the fraudulent conveyance actions because (1) the inter-related wrongful acts clause did not apply, and therefore the two later-filed actions fell within Hartford’s coverage; (2) Hartford and Reliance provided coverage for a single policy period; and (3) the claims administration and reinsurance agreements brought Hartford so close to Reliance as to make it directly liable for the claims. The court quickly dismissed the latter two claims. The plain language of the policy and separate payment of premium, the court concluded, could only lead a sophisticated party to understand that there was separate coverage provided by Reliance and Hartford.

Moreover, Hartford’s duties as claims manager and reinsurer did not in any way make them directly liable for claims made during the first year of coverage.

G-I acknowledged the court’s reading of the plain language of the inter-related wrongful acts clause, but argued that the purpose of such a clause was to “ensure that risks arising out of the same wrongful act are subject to one policy and therefore one liability limit” and to “prevent changes in policy language from one policy period to another from creating disparate coverage determinations for the same wrongful act.” The court was unconvinced. A wrongful act provision “not only allows insurers to cabin related wrongful acts to a single policy period,” it also “allows an insured to obtain coverage under a new policy, despite facing additional liability exposure from its past acts, by reserving the argument that any future claims arising out of the interconnected wrongful acts of a previously submitted claims will be covered by the former policy.”

Third Circuit Reaffirms That Arbitration Clause, Incorporated-by-Reference, is Binding

Century Indemnity Company v. Certain Underwriters at Lloyd’s, London, 2009 WL 3297322 (C.A.3 (Pa.)) (October 15, 2009)

The U.S. Court of Appeals for the Third Circuit (Third Circuit) heard appeals by Century Indemnity Company (Century) of two orders issued by the U.S. District Court for the Eastern District of Pennsylvania (District Court): the first order compelled Century to arbitrate with its retrocessionaire, Certain Underwriters at Lloyd’s, London (Lloyds); the second order denied Century’s motion to vacate an arbitration award in Lloyds’ favor. The Third Circuit affirmed the District Court’s orders.

Lloyds, in three agreements, provided retrocessional coverage to Century, which in turn provided excess of loss coverage to Argonaut Insurance Company (Argonaut). Argonaut litigated with its insured over certain coverage and incurred declaratory judgment (DJ) expenses. Argonaut sought reimbursement from Century for these DJ expenses. Century paid Argonaut approximately \$2.2M and then turned to Lloyds for reimbursement. Lloyds refused payment, contending that Century had no obligation to pay Argonaut for its DJ expenses. Century filed suit in the Philadelphia Court of Common Pleas. Lloyds both removed to federal court and moved to compel arbitration, arguing that, although the retrocessional agreements did not contain arbitration

A Mixed Jury Verdict in Allianz' Sale of Indexed Annuities

Linda L. Mooney, et al. v. Allianz Life Insurance Company of North America, Case No. 06-cv-00545

On October 12, 2009, a Minnesota federal jury ruled that Allianz Life Insurance Company of North America (Allianz) used deceptive practices in its sale of certain indexed annuities that are linked to stock market performance. However, the jury awarded no damages to the estimated 340,000 people nationwide who purchased the annuities during the class period.

The verdict brings to an end a prolonged legal battle between Allianz and policyholders who claimed the company enticed them into purchasing annuities with "up-front" or "immediate" bonuses that never materialized. The case cast a pall of uncertainty over the multi-billion dollar annuity industry for years. Annuity issuers were forced to defend their reputations as an onslaught of plaintiffs' attorneys and state regulators accused them of glossing over the complex nature of the products and failing to properly disclose the contracts' benefits and restrictions.

Commentators have suggested that defense attorneys for Allianz were successful in the damages portion of the trial due to the ailing stock market since 2007. Indexed annuities allow contract holders limited participation in the stock market but also provide guarantees that lock in performance gains or otherwise provide a minimum return. Plaintiffs' investment returns were impressive in comparison with the average market return during the class period. These annuity guarantees are how the products are sold, and the jury was able to see they performed as promised.

As defined benefits give way to cash balance retirement plans, annuities will become a regular form of securing income after retirement. Annuity issuers need to pay close attention to suitability requirements for the sale of these products. Plain language disclosures of a product's benefits and costs will enable an issuer to convince future juries that contract holders received exactly what the issuer sold. Allianz had the advantage of its products' benefits working exactly as promised just as the case came to trial. The SEC continues to press to bring these products under its purview, a move that would undoubtedly adversely affect sales and increase costs. The best antidote to keeping the SEC at bay is for issuers to monitor its brokers and enforce its own compliance guidelines.

provisions, they incorporated-by-reference the arbitration clauses contained in Century's reinsurance agreements with Argonaut. The District Court agreed and Century was compelled to arbitrate. The arbitration panel found that the retrocessional agreements did not provide coverage for DJ expenses. In so holding, the panel excluded evidence of industry custom and practice, finding the agreements unambiguous and that their meaning could be discerned without looking beyond their terms. The District Court confirmed the panel's award and Century appealed both District Court orders.

The Third Circuit stated that to compel a party to arbitrate a court must first determine that (1) there is an agreement to arbitrate and (2) the dispute at issue falls within the scope of that agreement. It also acknowledged "the strong federal policy in favor of arbitration that manifests itself in a presumption favoring arbitration." The parties, however, disagreed as to whether this presumption applied both threshold determinations. The District Court, following Third Circuit precedent, concluded that "when determining both the existence and the scope of an arbitration agreement, there is a presumption in favor of arbitrability." The Third Circuit disagreed. "We determine whether a party has [agreed to arbitrate] by ordinary state-law principles that govern the formation of contracts, not by applying a presumption in favor of arbitration." Nevertheless, the Third Circuit held that the District Court properly found that there was an agreement between Century and Lloyds to arbitrate and that their dispute fell within the scope of the arbitration clause.

Having determined that the District Court properly compelled arbitration, it then considered the second question raised by Century on appeal: whether the District Court properly affirmed the panel's award in light of Century's allegation that the panel erred in refusing to hear extrinsic evidence regarding custom and practice of the reinsurance industry. The court noted that "in making evidentiary determinations, an arbitrator need not follow all the niceties observed by the federal courts." The panel concluded that the retrocession and reinsurance agreements were unambiguous and therefore witness testimony regarding prior claims or payments by Lloyds would be of little or no probative value. Considering the panel's wide latitude in making evidentiary determinations the court found there was no statutory basis to vacate the award.

Third Circuit Resuscitates Countrywide Reinsurance Kickback Case

Alston v. Countrywide Financial Corp., 2009 WL 3448264 (3d Cir. 2009) (October 28, 2009)

The United States Court of Appeals for the Third Circuit confronted the issue of whether consumer plaintiffs alleging a violation of section 8 of the Real Estate Settlement Procedures Act of 1974 (“RESPA”) need show a monetary injury “in the form of an overcharge” to have standing to bring a private right of action. The Third Circuit concluded that plaintiffs need not suffer an overcharge because the plain language of RESPA does not impose such a requirement. Plaintiffs need only allege that a defendant received a kickback or offered a sham service, under RESPA sections 8(a) and 8(b), to have Article III standing to sue.

Alston involved class plaintiffs who obtained home mortgages from defendant Countrywide Home Loans (“Countrywide”) with down payments of less than 20%. Countrywide’s policy required such mortgagees to purchase private mortgage insurance (“PMI”). Plaintiffs allege that, in purchasing PMI, Countrywide extracted kickbacks from the private mortgage insurers for referring business their way.

Plaintiffs’ PMI insurers reinsured their risk with defendant Balboa Reinsurance Co. (“Balboa”), a Countrywide affiliate. Plaintiffs maintain that Balboa was paid over \$892 million but paid no claims during the period of coverage. Plaintiffs alleged that the Balboa reinsurance was illusory and the premium thinly veiled kickback for Countrywide referrals. These “kick-backs,” plaintiffs contended, resulted in overcharges for PMI insurance. Moreover, they maintained that even if they were not overcharged, they were “nonetheless entitled to kick-back free [real estate] settlements” and the statutory damages set forth under section 8(d)(2) of RESPA. Countrywide moved to dismiss plaintiffs’ RESPA claims for lack of standing, arguing that PMI rates were *per se* reasonable because they had been approved by the Pennsylvania Insurance Department. Because the rates were *per se* reasonable, the plaintiffs could not have been “overcharged” and in the absence of an overcharge lacked standing to proceed under RESPA. The District Court agreed with Countrywide’s reasoning and dismissed the action.

Plaintiffs appealed, contending that “Congress bestowed upon the consumer the right to a real estate settlement free from unlawful kickbacks and unearned fees, and Countrywide’s invasion of that statutory right, *even*

without an overcharge, was an injury-in-fact for the purposes of Article III standing.” The Third Circuit agreed, reversing the District Court, and holding that plaintiffs had standing to sue under RESPA. *Alston* stands as a potentially significant development for class action suits brought under RESPA. In the wake of *Alston*, mortgage providers can anticipate new section 8(d)(2) claims.

New Jersey Court Dismisses ERISA Class Action Under *Iqbal* Standard

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McDonough is an important example of how the new pleadings standards espoused in *Iqbal* and *Twombly* are being followed by the federal courts on motions to dismiss, making it easier to attack poorly pled complaints, and dismiss frivolous actions prior to the commencement of costly discovery.

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Philadelphia

Joseph M. Donley
Insurance & Reinsurance Practice Group Leader
 Christopher M. Brubaker
 William E. Cox
 Christopher J. Day
 Aditi J. Oakley
 Robert W. Tomilson

For more information

For more information, please contact Joseph M. Donley at jdonley@thorpreed.com, or call 215.640.8500.

To subscribe to *Insurance & Reinsurance Briefing*, please contact Cynthia Tonet-Stewart at 412.394.7786 or cstewart@thorpreed.com.

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Philadelphia

One Commerce Square
 2005 Market Street, Suite 1000
 Philadelphia, PA 19103
P 215.640.8500
F 215.640.8501

Pittsburgh

One Oxford Centre
 301 Grant Street, 14th Floor
 Pittsburgh, PA 15219
P 412.394.7711
F 412.394.2555

Princeton

Princeton Pike Corporate Center
 933 Lenox Drive, Suite 200
 Lawrenceville, NJ 08648
P 609.844.7595
F 609.895.2666

Wheeling

1233 Main Street, Suite 4000
 Wheeling, WV 26003
P 304.233.5599
F 304.233.5656