BURR & FORMAN LLP

TIPS bulletin

News & Resources on Business Torts, Insurance and Products Liability

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MEDICARE PART D LITIGATION

Jason A. Walters

The scene is not difficult to imagine: A courtroom in a rural southern county. An elderly lady who says she was tricked into buying the wrong prescription drug plan. A jury of locals, many of sympathize with the insured. A plaintiffs' attorney with a reputation for large verdicts, who tells the jury it's time to send a message.

The complexity of the new Medicare Part D prescription drug coverage and the frustration many Medicare recipients have experienced with it have been highly publicized. Due to the widespread confusion and uncertainty surrounding this new federal program, prescription drug plans will likely be the focus of a significant amount of litigation over the next few years.

Medicare prescription drug coverage was passed by Congress under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA). The MMA sets forth mandatory guidelines for coverage disputes and grievances. It also grants the Centers for Medicare and Medicaid Services (CMS) the right to sanction plan sponsors for engaging in certain conduct, such as denying or discouraging the enrollment of unhealthy individuals or furnishing false or misleading information relating to the Part D program. The sanctions vary between \$10,000 and \$100,000, and can go even higher in certain instances. Perhaps more importantly, the plan sponsor "may also be subject to other applicable remedies available under the law." It thus appears that even if a plan sponsor is sanctioned for fraudulent conduct by CMS, the company may nevertheless be subject to civil liability under applicable state and federal law.

How this litigation will develop remains to be seen. We believe it is likely, however, that the first wave of lawsuits will involve fraudulent sales practices. Plaintiffs in such cases would allege that an agent (or possibly even a doctor or pharmacist) either fraudulently misrepresented the benefits of a particular plan or sold the individual a different plan than was requested (e.g., a

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CLASS ACTION FAIRNESS ACT CASE ALLOWS REMOVAL OF NEW CLAIMS IN PRE-ACT LITIGATION

Christian W. Hancock

Earlier this year, the Seventh Circuit Court of Appeals allowed a defendant to remove a case to federal court under the Class Action Fairness Act ("CAFA"), because the class definition had been altered to include new claims against the defendant. Knudsen v. Liberty Mut. Ins. Co., 435 F.3d 755 (7th Cir. 2006). The Knudsen opinion illuminates an avenue for removing cases filed before CAFA's February 18, 2005 effective date if new claims are later asserted.

At its inception, Knudsen involved a state-court class action against defen-

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Medicare Part D Litigation

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Medicare Advantage plan instead of a stand-alone plan). In passing the MMA, Congress recognized the potential for fraud and specifically prohibited certain marketing practices, such as representing that a plan is endorsed by Medicare, providing cash in exchange for enrollment, and selling plans door-to-door. As previously mentioned, the MMA also prohibits furnishing false or misleading information in connection with the Part D program. Even aside from regulatory violations, just one fraudulent sale in a dangerous jurisdiction could expose a plan sponsor to significant liability. In the case of a rogue agent, who unscrupulously signs up dozens of individuals, the stakes could be even higher.

In future years, as the general public becomes more familiar with Medicare prescription drug coverage, it is likely that the litigation will begin to focus on other issues. Future plaintiffs may allege that a plan sponsor increased monthly premiums or removed drugs from a plan formulary in order to encourage disenrollment. Others may assert that a sponsor engaged in discriminatory activity by focusing on higher income areas, which is also prohibited by the MMA. What other shapes Part D litigation ultimately may take is anybody's guess. Regardless of the factual allegations, plan sponsors can be certain that the lawsuits will include allegations of fraud and requests for punitive damages.

> Any entity that offers advice to Medicare recipients in connection with choosing a Part D benefit plan is opening itself up to potential liability.

In addition to plan sponsors, it is also prudent for employers, pharmacists and physicians to be cognizant of their potential exposure. Any entity that offers advice to Medicare recipients in connection with choosing a Part D benefit plan is opening itself up to potential liability. As doctors and pharmacists have already experienced in pharmaceutical litigation, plaintiffs' attorneys will go to great lengths to find an in-state entity to name as a defendant in an effort to avoid federal jurisdiction. While the desire to assist seniors through the confusing process of obtaining prescription drug coverage is understandable, if not admirable, those offering such advice should do so cautiously and only after ensuring the accuracy of their information. When in doubt, perhaps the safest way to help is to simply refer recipients to the Medicare hotline (1-800-MEDICARE) or to the Medicare website at www.medicare.gov.

While it is difficult to predict exactly when Medicare Part D cases will be filed, we believe that plaintiffs' attorneys will likely begin to solicit beneficiaries in the second and third quarters of this year. The insurance litigation section of Burr & Forman LLP plans to monitor the evolution of Part D litigation very closely in the coming months and years in an effort to keep our clients and other plan sponsors abreast of new developments and informed of ways to protect themselves against potential liability.

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EXPANDING YOUR BUSINESS? CONSIDER THE LEGAL CLIMATE

Edward D. Cotter

If fortunate, a business will face the decision of where to expand its opera-

tions. When considering such a step, a company often examines the local government, work force, infrastructure, and population movements of the region. But businesses often fail to consider a region's legal environment.

The American Tort Reform Association updates annually its list of "Judicial Hellholes." Topping the latest list of "Judicial Hellholes" are: Rio Grande Valley and Gulf Coast, Texas; Cook County, Illinois; the State of West Virginia; Madison County, Illinois; St. Clair County, Illinois; and South Florida. The American Tort Reform Association's "Watch List" includes: the State of California; Philadelphia, Pennsylvania; New Orleans, Louisiana; and Eastern Alabama.

Many business owners may think to themselves, *"no worries, we will never do anything to get us on the wrong end of a large jury verdict."* One insurance company likely thought the same thing prior to a Williamson County, Illinois jury handing down a $1.19 billion dollar verdict against it for allegedly using inferior crash parts to repair insured vehicles. A pharmaceutical company no doubt was in shock when it was hit with a $1.01 billion dollar verdict in Beaumont, Texas for marketing a drug that it allegedly knew had serious side effects. Even the tobacco industry--a constant target of lawsuits--had to be stunned when a $10.1 billion dollar verdict was handed down against one of its own by a Madison County, Illinois jury for purportedly duping smokers into believing a light cigarette was safer than those of full strength. And a large automobile manufacturer assuredly was floored when a Los Angeles jury awarded $4.9 billion dollars in damages to six passengers who were seriously injured as a result of their car being rear-ended by another car traveling seventy miles per hour.

Granted, many large verdicts are overturned, reduced, or settled during the appeals process for a lesser amount. However, the hassle and mammoth amount of legal fees spent to have a large verdict overturned or reduced is a serious matter. Therefore, prior to expanding your business, discuss the legal climate of the region your company is considering with an attorney who is knowledgeable on the subject. Doing so could literally save *millions*.

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Paul is the head of Burr & Forman's TIPS practice group. He practices in the firm's Litigation section and has a full-spectrum insurance litigation practice. Paul handles agent lawsuits, contract disputes, and matters involving bad faith and fraud in the life, health, and disability areas of insurance litigation, as well as regulatory matters. He also has expertise in defending class action lawsuits against insurance companies in state and federal courts nationwide. Paul was recently voted by his peers as one of the Birmingham Bar's best insurance lawyers. He belongs to the TIPS and Litigation sections of the American Bar Association and is a member of the Alabama State Bar, the Tennessee State Bar, the Texas State Bar and the Birmingham Bar Association. Paul is also an affiliated member of the America's Health Insurance Plans ("AHIP") and the American Council of Life Insurers.

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CONTRACTUALLY EXPANDING AN ARBITRATOR'S JURISDICTION

William J. Long, IV

A new trend is emerging in which federal courts are delegating greater jurisdictional authority to arbitrators. Generally, a federal court follows a two-step process before compelling arbitration: (1) The court determines whether the parties agreed to arbitrate the dispute; and (2) the court then considers whether any federal statute or policy rendered the claims nonarbitrable. The application of the first step is rather straightforward, but the second step requires each court to assess the merits of any direct attack on the arbitration agreement. Under Prima Paint's severability doctrine, a federal court is required to rule, before compelling arbitration, on any attacks that go to the arbitration agreement itself, but abstain from any attacks that go to the contract as a whole. Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967). A recent Eleventh Circuit Court of Appeals' decision, however, may severely restrict a federal court's assessment ability under Prima Paint.

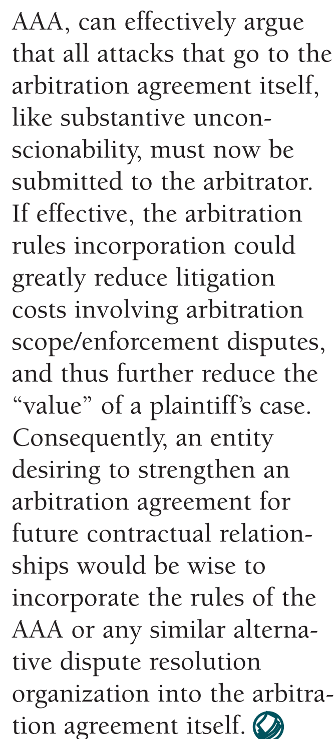
A recent Eleventh Circuit Court of Appeals' decision may severely restrict a federal court's assessment ability under Prima Paint.

In Terminix International Co., LP, v. Palmer Ranch Ltd. Partnership, the Eleventh Circuit overturned a district court's decision to deny a motion to compel arbitration based on the inclusion remedial restrictions [i.e. lack of punitive/treble damages or injunctive relief] without severability clauses within the arbitration agreement. 432 F. 3d 1327 (11th Cir. 2005). Terminix specifically holds that by "incorporating the [American Arbitration Association] Rules…into [an] agreement, the parties clearly and unmistakably [agree] that the arbitrator should decide whether the arbitration clause is valid." Id. at 1332. Initially, this statement may appear somewhat redundant as federal courts have long held that parties could agree to allow an arbitrator to decide the issue of arbitrability. See Scott v. Prudential Secs., Inc., 141 F.3d 1007, 1011 (11th Cir. 1998). Moreover, under the First Options doctrine, where there is clear and unmistakable evidence that the parties agreed to arbitrate the issue of arbitrability, a federal court should allow the arbitrator to determine his or her own jurisdiction and defer to such a determination. First Options, Inc. v. Kaplan, 514 U.S. 938, 943 (1995). The Eleventh Circuit's emphasis, however, on the arbitration agreement's incorporation of the American Arbitration Association's ("AAA") Rules, appears to expand the First Options role of the arbitrator in deciding his own jurisdiction.

Under the AAA's Rule 7, which is entitled "Jurisdiction", an "arbitrator shall have the power to rule on his or her own jurisdiction, including any objects with respect to the existence, scope or validity of the arbitration agreement." Taking into account the wide scope of Rule 7, Terminix held that the AAA's "'provisions clearly and unmistakably allow the arbitrator to determine her own jurisdiction when…there exists a prima facie agreement to arbitrate whose continued existence and validity is being questioned.'" 432 F.3d at 1332; See also Citifinancial, Inc. v. Newton, 359 F. Supp. 2d 545, 549-552 (S.D. Miss. 2005). Thus, the Eleventh Circuit concluded that it normally "would decide the [remedial restrictions] questions only because they go to the validity of the arbitration clause itself," but in this case no such ruling was necessary because "the parties have contracted around the default rule, and it is, therefore, unnecessary for us to reach these issues." 432 F. 3d at 1333. The Eleventh Circuit thus declined to address the arbitration

agreement attacks because the parties contractually agreed to submit the disputes to the arbitrator. In effect, Terminix arguably expands the First Options doctrine, so that parties can now contract, through the incorporation of select arbitration rules, to grant the arbitrator complete jurisdiction to decide all challenges to the arbitration agreement once the federal court determines that said agreement actually exists.

Practically, the expansion of the First Options doctrine is by no means settled law. However, by specifically incorporating the rules of the AAA, which grant almost unlimited jurisdictional discretion to the arbitrator, the draftsman will strengthen his client's ability to compel arbitration. Arguably this interpretation goes a long way to eliminating any but the most cursory judicial review. Once the court determines that the "making" of the arbitration agreement is not in issue, all other potential issues relating to the enforceability of the arbitration agreement go immediately to the arbitrator without all of the fine analysis that is sometimes found in decisions invoking Prima Paint. As a practical matter, the arbitrator, who has been hired to hear your case, is less likely to conclude that arbitration is unenforceable; they are comfortable with the concept of arbitration and the fairness of the process. Moreover, their completion of their assignment is dependent upon a finding that the arbitration should proceed, so there is an inherent bias in favor of such a finding. Therefore, a party moving to compel arbitration, under the rules like those mandated by the



AAA, can effectively argue that all attacks that go to the arbitration agreement itself, like substantive unconscionability, must now be submitted to the arbitrator. If effective, the arbitration rules incorporation could greatly reduce litigation costs involving arbitration scope/enforcement disputes, and thus further reduce the "value" of a plaintiff's case. Consequently, an entity desiring to strengthen an arbitration agreement for future contractual relationships would be wise to incorporate the rules of the AAA or any similar alternative dispute resolution organization into the arbitration agreement itself.

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Class Action Fairness Act Case

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dant Liberty Mutual Insurance Company where plaintiffs alleged that the company systematically underpaid automobile and worker's compensation insurance claims. The defendant originally removed the case in 2005, but the court "held that the initial removal was unavailing, because the suit had been 'commenced' in state court before February 18, 2005, the new Act's effective date." Id. at 755. After the denial of the first removal attempt, the plaintiffs sought "much more relief" against the defendant and asked, among other things, that the state court "hold Liberty Mutual responsible for all policies issued by any subsidiary or affiliate, about 35 firms in all." Id. at 756. Plaintiffs also "proposed that they be certified to represent a nationwide class, and that the court disregard any difference in insurance and workers' compensation laws across the 50 states." Id.

> [T]he Seventh Circuit found that the plaintiffs' class definition had been amended to "initiate new claims" that did not relate back to the original complaint under Illinois law.

Despite admonitions from the Supreme Court of Illinois and the Seventh Circuit Court of Appeals "describing the grave problems with class actions for damages under multiple states' laws", the state court approved the plaintiffs' proposal with minimal changes on September 29, 2005. Id. The following class was certified:

"All insureds of Liberty Mutual Insurance Company, its affiliates and subsidiaries (collectively 'Liberty Mutual'), their third party beneficiaries and their assignees who submitted medical bills covered by a Liberty Mutual insurance policy, and whose claims were paid for less than the medical charge, based upon the application of a medical cost and utilization database."

Id. at 756-57.

The order certifying this class was entered well after the CAFA's effective date, and Liberty Mutual immedi-

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Class Action Fairness Act Case

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ately filed its second notice of removal. On appeal after the district court's remand of the proceeding, the Seventh Circuit noted that a "second removal is proper when based on a new development." Knudsen, 435 F.3d at 757. (citing 28 U.S.C. § 1446(b) ¶ 2).[1] The second removal was possible because the Seventh Circuit found that the plaintiffs' class definition had been amended to "initiate new claims" that did not relate back to the original complaint under Illinois law. Id. The court found that the original pleading did not furnish the defendant with notice of the events that underlie the new contentions against it:

What causes the class definition of September 2005 to initiate new claims is the fact that Liberty Mutual does not adjust all demands for payment of all of its affiliates' policies. For example, Liberty Northwest Corporation, one of Liberty Mutual's affiliates, has adjusted claims against its own policies since 1996 using its own cost-and-utilization software. The complaint initially filed in this case could not have notified Liberty Mutual that plaintiffs contested any decision made by Liberty Northwest-nor did the complaint allege that Liberty Mutual and Liberty Northwest are alter egos.

• • •

Employers Insurance of Wausau provides an even better example. Liberty Mutual acquired Wausau in 1998, so it is part of "Liberty Mutual" under the class definition. Wausau has employed a "medical cost and utilization database" since 1985. It adjusts its own claims, however-obviously so before the acquisition. Yet the class includes all insureds (and their assignees) whose claims were adjusted by Wausau using its own data and methods back to 1985, when Wausau's cost-and-utilization database was inaugurated.…The complaint that Knudsen filed in March 2000 did not even hint that Liberty Mutual might be accountable for underpayments on the Wausau policies, claims against which had been adjusted as long as 15 years earlier under a distinct system. Any effort to recover on account of these policies is a distinct claim for relief ("cause of action" in the state's parlance).

Id. at 757-58. In sum, the Seventh Circuit explained that, "as we intimated in Knudsen[2] I and Schorsch[3], and now hold, **a novel claim tacked on to an existing case commences new litigation for purposes of the Class Action Fairness Act.**" Id. at 758 (emphasis added).

The removal to federal court was crucial to Liberty Mutual because the state court had entered a default against the company for its alleged failure to alert the plaintiffs during discovery to the need to substitute a subsidiary, Liberty Fire Insurance Company, as a defendant (even though only Liberty Fire's name was on the policies at issue). The Seventh Circuit found that,

The conduct of the plaintiffs and the state judge in this litigation, turning an arguable error in discovery into a sprawling proceeding in which Liberty Mutual will be required to pay on account of other insurers' decisions taken long ago under different rules for calculating proper payment, and without any opportunity to defend itself on the merits or even insist that the policies' actual terms be honored, illustrates why Congress enacted the Class Action Fairness Act."

Id.

The Seventh Circuit concluded by noting that CAFA "provides for federal resolution of the plaintiffs' claims, so the district court need not (and should not) give any weight to the state judge's order of default and the scope of class certification. These and all other questions are open to independent resolution in the federal forum." Id.

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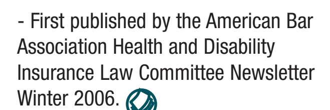

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[1] "If the case stated by the initial pleading is not removable, a notice of removal may be filed within thirty days after receipt by the defendant … of a copy of an amended pleading, motion, order or other paper from which it may first be ascertained that the case is one which is or has become removable".

[2] Knudsen v. Liberty Mut. Ins. Co., 405 F. Supp. 2d 916 (N.D. Ill. 2005).

[3] Schorsch v. Hewlett-Packard Co., 417 F.3d 748 (7th Cir. 2005).

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