



# GOLDBERG SEGALLA<sup>LLP</sup>

## Reinsurance Review

An international reinsurance law publication

January 2010 • Vol. 2, No. 1

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Goldberg Segalla's *Reinsurance Review* provides timely summaries of and access to the latest reinsurance law developments worldwide, and is published monthly. Cases are organized by court and date. In addition, we provide the latest information regarding news in the insurance and reinsurance industries. Your interest in our publication is appreciated and we welcome your feedback. Please feel free to share this publication with your colleagues. If others in your organization are interested in receiving the publication, or if you do not wish to receive future issues, please contact [Jeffrey L. Kingsley](#).

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## **UNITED STATES CIRCUIT COURT DECISIONS**

### **TENTH CIRCUIT**

#### **SHELL OIL COMPANY V. CO2 COMMITTEE (CIVIL ACTION NO. 08-2281 DECEMBER 21, 2009)**

#### ***Tenth Circuit Reverses District Court and Orders The Issue Of Res Judicata To Be Determined By New Arbitration Panel***

The parties entered into an agreement involving a structured payment plan resulting from several class action settlements. The agreement contained an arbitration provision that stated “any and all disputes” were to be resolved by an arbitration panel that consisted of two party appointed arbitrators and one neutral arbitrator.

In 2006, the defendant originally brought an arbitration alleging that plaintiffs’ accounting practices violated the agreement. A year later in 2007, the defendant filed a second arbitration complaint which contained allegations that again questioned the plaintiffs’ accounting practices. Shortly after the filing of the second arbitration complaint, the plaintiffs filed a suit in district court requesting that the second complaint be barred by res judicata and asked for an injunction preventing a second arbitration. The defendant moved to dismiss the district court action citing that the issue of res judicata falls within the scope of the arbitration panel’s authority. The court agreed and ordered the parties to “proceed with arbitration in accordance with their arbitration agreement.” After the district court’s ruling, the defendant did not permit the issue of res judicata and re-filed the second arbitration complaint.

The plaintiffs again turned to the district court to determine if the original panel had the authority to decide the issue of res judicata or if a newly constituted arbitration panel should hear the issue. The district court ruled in favor of the plaintiffs relying on financial considerations of the parties and ordered the original arbitration panel to determine this issue. The defendant appealed.

In reviewing the district court’s decision, the Tenth Circuit turned to the Federal Arbitration Act (FAA) regarding the scope of a court to appoint an arbitrator. According to Section 5, a court may designate arbitrators: “(1) if the arbitration agreement does not provide a method of selecting arbitrators; (2) if the arbitration agreement provides a method of selecting arbitrators but any party to the agreement failed to follow that method; or (3) if there is a ‘lapse in the

naming of an arbitrator or arbitrators.” The Tenth Circuit then examined the arbitration agreement and found that each time a party files an agreement complaint, a new three person arbitration panel will be formed. As a result, the Tenth Circuit reversed the district court’s ruling by stating that to allow the original arbitration panel to decide this issue “effectively designated the arbitrators for that issue in direct contravention of the panel selection provision” of the agreement.

**IMPACT (ARBITRATION):** In this interesting case, we have two general principles that courts refer to when analyzing an arbitration agreement. First, one of the fundamental purposes of arbitration is to expedite a decision regarding a dispute in a cost effective manner. Second, the court is obligated to defer to the terms and conditions of the arbitration provision and if the terms and conditions are clear, enforce them. Typically these two principles are not in conflict but, as this case demonstrates, there are unusual circumstances that could arise putting these principles at odds. Again, this is an issue of contract drafting and given the detailed language requiring that a new arbitration panel be constituted each time an arbitration complaint was filed, the court enforced the parties’ agreed-to terms even though the decision would add additional expenses onto the parties.

For a copy of this decision, click here: <http://tinyurl.com/ReinsuranceReview-January-10>

## **SECOND CIRCUIT**

**CHAD CONDRA V. PXRE GROUP LTD ET AL**  
(CIVIL ACTION NO. 09-1370 DECEMBER 21, 2009)

### ***Second Circuit Upholds Dismissal Of Claims Against Reinsurer Regarding Securities Fraud Action Resulting From Hurricane Katrina***

Plaintiffs filed this class action against the reinsurer alleging claims under section 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5. The genesis of the complaint centers around statements made by officer’s of the reinsurer concerning the possible losses that its company endured as a result of Hurricane Katrina. Specifically, plaintiffs allege that the reinsurer manifestly underestimated the impact Hurricane Katrina would have on its business. As a result of Hurricane Katrina, the reinsurer become insolvent and operated in run-off causing the plaintiffs to lose their investments into the company. The District Court granted the reinsurer’s motion to dismiss on the basis that plaintiffs failed to establish that the reinsurer and/or its officers intended to deceive actual and possible investors.

On appeal, plaintiffs argued that the district court failed to appreciate the “strong inference of scienter” in order for their complaint to survive a motion to dismiss. Furthermore, plaintiff argued that the district court failed to take into consideration the level of misrepresentations made by the reinsurer’s officers shortly after Hurricane Katrina. The Second Circuit analyzed the standard in which to plead scienter under the Private Securities Litigation Reform Act of 1995. The Second Circuit concluded that in order to survive a motion to dismiss, a plaintiff must allege “with particularly ‘facts giving rise to a strong inference that the defendant acted with the

required state of mind” to deceive and/or defraud. The Second Circuit, in analyzing the complaint, found that the plaintiffs failed to lay out the necessary facts that survive a motion to dismiss.

**IMPACT (REINSURANCE):** Practitioners who represent reinsurers in runoff must be cognizant of this case in counseling clients on the importance to minimize, if not reduce, liability exposure as the company winds down. Here, the courts found that the class action failed to demonstrate the necessary facts to survive a motion to dismiss but with the Private Securities Reform Act of 1995, reinsurers and their counsel, must be cognizant that there are certain causes of action available to investors to potentially recoup capital investment.

For a copy of this decision, click here: <http://tinyurl.com/ReinsuranceReview-January-10>

## **UNITED STATES DISTRICT COURT DECISIONS**

### **SOUTHERN DISTRICT OF CALIFORNIA**

#### **SUN LIFE ASSURANCE COMPANY OF CANADA V. LIBERTY MUTUAL INSURANCE CO. ET AL**

(CIVIL ACTION NO. 09-CV-2133 DECEMBER, 2009)

#### ***District Court Grants Respondents’ Motion Compelling Arbitration Of Parties’ Rights Under Reinsurance Contracts, Staying Pending Litigation Affirming A Prior Award***

This action arises from a dispute between the parties over their obligations under two reinsurance contracts. The petitioner, Sun Life, sought confirmation of a prior arbitration award. whereas Liberty maintained that Sun Life improperly sought substantive rulings regarding the rights and liabilities of the parties that the arbitration panel did not address. Thus, Liberty filed a motion to compel further arbitration and a stay of the litigation arguing that the determination of the substantive issues is subject to the parties’ arbitration agreements.

In granting the respondents’ motion to compel further arbitration and whether Sun Life owed any interest on the prior award, the court noted that, under the Federal Arbitration Act (FAA), arbitration agreements should be rigorously enforced. The court further noted that while the arbitration agreements between the parties are undoubtedly broad (covering any dispute “arising with respect” to the reinsurance contracts), any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. Moreover, the court found that, while Sun Life sought to avoid this dispute by confirming the arbitration award and “terminating the relationship between the parties,” under these circumstances, it would not be proper for the court to terminate the relationship of the parties, because it was expressly defined by the reinsurance contracts that contain the arbitration agreements.

Specifically, the court concluded that because it would have to interpret the reinsurance contracts to decide whether Sun Life owes interest and whether the relationship should be terminated, the issues must be decided via arbitration. The court also discounted Sun Life's argument that the reinsurance contracts were affirmatively terminated when Sun Life paid the commutation amount and therefore, there were no operative contracts requiring arbitration. The court, in citing Ninth Circuit precedent, concluded that whether a contract is terminated and whether its arbitration clause still applies is a question for the arbitrator, as it requires interpretation of the contract itself. Applying this rationale, the court granted respondents' motion compelling arbitration.

**IMPACT (ARBITRATION):** Again, courts have shown great deference in allowing arbitrators to handle issues which fall within the scope of the arbitration agreement. Here, the court ordered the arbitration panel to make a legal decision as to whether the contract is still valid and enforceable and, by extension, the enforceability of the arbitration provision. This case again demonstrates the expanded scope of an arbitration panel's authority in resolving matters and practitioners need to be cognizant of this recent trend when drafting these provisions.

For a copy of this decision, click here: <http://tinyurl.com/ReinsuranceReview-January-10>

## **EASTERN DISTRICT OF MISSOURI**

### **DATACOR, INC. V. HERITAGE WARRANTY INSURANCE RISK RETENTION GRUP**

(CIVIL ACTION NO. 09-CV-1123 DECEMBER 16, 2009)

#### ***Nebraska Statute Inverse Pre-Empts Federal Arbitration Act***

The plaintiff purchased a contractual liability policy from the defendant. The parties also entered into an agreement which required the defendant to reimburse the plaintiff for monies expended for warranty claims. The agreement contained an arbitration provision, and a choice of law provision. The choice of law provision designated Nebraska as the applicable state law.

A dispute arose between the parties, and the plaintiff filed suit. The defendant sought to compel arbitration based upon the Federal Arbitration Act (FAA). The plaintiff claimed that the McCarran-Ferguson Act, 15 U.S.C. §§ 1101 et seq., which prevents the inadvertent federal pre-emption of state insurance statutes, trumped the FAA. More specifically, the plaintiff claimed that the FAA could not override the Nebraska Uniform Arbitration Act, which exempts "any agreement concerning or relating to an insurance policy" from the rule that a written agreement to arbitrate "is valid, enforceable, and irrevocable." See Neb. Rev. Stat. § 25-2602.01(f)(4).

The Eastern District agreed holding that the FAA was reverse pre-empted by the Nebraska statute, and that defendant could not compel arbitration.

**IMPACT (ARBITRATION):** As discussed in previous editions of the *Reinsurance Review*, the way the McCarran-Ferguson Act was drafted allows states to apply their laws regarding arbitration and preempt the federal statute. Initially, many states statute concerning arbitration exempted insurance policies. Over the past few years, however, several states revised their respective arbitration statutes to allow for insurance policy disputes to be arbitrated. Nebraska, however, has not revised its Arbitration Act and, as a result, precluded the enforcement of the arbitration provision due to its language. From a practitioner's perspective, one must be cognizant of which states continue to have this exemption and plan accordingly with appropriate legal strategy.

For a copy of this decision, click here: <http://tinyurl.com/ReinsuranceReview-January-10>

## **UNITED STATES STATE COURT DECISIONS**

### **NEW YORK**

#### **A-B UNITED STATES FIDELITY & GURANTY CO. V. EXCESS CASUALTY REINSURANCE ASSOCIATION ET AL** (NEW YORK APPELLATE DIVISION, FIRST DEPARTMENT, DECEMBER 8, 2009)

#### ***Court Clarifies Ruling and Determined that Reinsured Cannot Advance Advice of Counsel Defense***

The issue before the Appellate Division was whether its prior order in this action, where it ruled that the reinsured waived its attorney-client privilege, would be expanded beyond communications between its in-house attorney and its officer. This action involved the scope and enforceability of a reinsurance contract issued from 1956 to 1962. The reinsured, among numerous other parties, was sued by several plaintiffs for asbestos-related personal injuries. In an effort to resolve these actions, the reinsured and other parties agreed to settle for \$975 million dollars. According to the settlement agreement, although there was a twelve year period of coverage, all of the claimants were placed under the policy between 1959 and 1960.

After its payment, the reinsured requested that the reinsurer compensate it in the amount of \$400 million dollars. The reinsurer, in turn, requested information regarding the other parties and financial information. When the reinsured failed to receive payment, it brought a declaratory judgment action. The reinsurer again served discovery demands pertaining to the financial health of the other parties along with financial information and information involving the settlement agreement. The reinsured, in turn, argued that information pertaining to the settlement agreement was protected under the attorney-client privilege. The reinsurers argued that the reinsured waived its right to assert a privilege given that those documents were disclosed in the underlying action. The trial court ordered that the reinsured produce the documents stating that the reinsurer needed that information and that the reinsured had placed the privileged matter

“at issue” in this action. With respect to the waiver concern, the court found that the reinsured waived the attorney-client privilege as it related to communications with an officer and its in-house counsel. The reinsurer argued that the waiver extended broadly into areas that are subject to this litigation. During discussions in the earlier action, the reinsured stated that it would not advance an “advice of counsel” defense.

In this action, the New York Appellate Court ruled that there is no need for clarification or an expanded view of the waiver argument given that the reinsured voluntarily relinquished its rights to assert an “advice of counsel” argument. The court concluded that the reinsured is precluded from raising this defense given its prior waiver.

**IMPACT (REINSURANCE):** One must be cognizant of the documents disclosed during an underlying action as this may make it difficult to assert defenses in a potential reinsurance dispute. In other words, one representing a cedent must be aware of the consequences of its action not only in the underlying action but also its potential impact on a reinsurance reimbursement action. In this action, given that the information was circulated in the underlying action, the reinsurer correctly asserted that the reinsured waived its right to rely on the attorney-client privilege.

For a copy of this decision, click here: <http://tinyurl.com/ReinsuranceReview-January-10>

## **TEXAS**

### **AMERICAN NATIONAL INSURANCE CO. V. TEXAS DEPARTMENT OF INSURANCE**

(TEXAS COURT OF APPEALS DECEMBER 16, 2009)

#### ***Self-Funded Plans Are Classified As Reinsurance Under Texas Law***

This dispute involves the appeal of insurers against a ruling by the Texas Department of Insurance finding that stop-loss insurance policies sold to self-funded employee benefit plans are characterized as direct insurance instead of reinsurance.

The insurers asserted that the self-funded plans are insurers as defined by the insurance code and thus qualify, under the contextual definition of former article 3.10(a), to buy reinsurance like any other insurer allowing the insurers to classify the insurance they sold to the plans as reinsurance. Under Texas law, insurance carriers are obligated “to pay fees on the sale of health insurance, seek approval from the insurance department for their policy contracts and report the sale of direct insurance differently in their financial and regulatory filings.” In this action, the insurance carriers issued stop-loss coverage to “employee welfare benefit plans” as defined under the Employee Retirement Income Security Act (“ERISA”) as well as “governmental plans” which are typically exempt from many provisions within ERISA.

Applying both state law and ERISA principles, the Court of Appeals held that by selling the stop-loss policies at issue in this case to self-funded benefit plans and reporting their sale to the

Texas Department of Insurance as a sale of assumed reinsurance, the insurers did not violate the insurance code, and therefore the stop loss policies are classified as reinsurance under Texas Law.

**IMPACT (REINSURANCE):** This decision appears to establish that, in the context of ERISA, stop loss policies over “self-insurance plans” are viewed as reinsurance. Arguably, this decision’s impact may be limited to the Texas cases as the court relied on state law in rendering its decision. It will be interesting to see what, if any, impact this decision will have on other jurisdictions.

For a copy of this decision, click here: <http://tinyurl.com/ReinsuranceReview-January-10>

## **OTHER NEWS AND NOTES**

### **NEW ARBITRATION PROGRAM AIMED AT EXPEDITING CONSTRUCTION DEFECT CLAIMS**

The Construction Defects Claims Manager Association (CDCMA) and Arbitration Forum, Inc. (AF) announced that they are exploring a new arbitration program to resolve inter-insurer disputes over construction defect claims. According to the proposed program, representatives from both insurers will be allowed to attend the initial hearing in order to have confidence that the arbitrators have a good appreciation of the issues at hand. Moreover, the proposed program will require extensive training for certified arbitrator in this field.

For more information click here: <http://tinyurl.com/RR-January-10-Article-1>

### **TWO AIG EXECUTIVES RESIGNED JANUARY 1, 2010**

It has been announced last week, that two of AIG top executives announced their resignation. Anastasia Kelly, the company’s Vice Chairman for Legal, Human Resources, Corporate Affairs and Corporate Communications, resigned her position effective December 30, 2009. Also, AIG’s Chief Compliance and Regulatory Officer has also resigned effectively immediately. In the company’s statement, AIG suggested that part of the reason for the resignations centered on the reduction of the officers’ compensation that was mandated by United States Treasury Department.

For more information click here: <http://tinyurl.com/RR-January-10-Article-2>

## **REINSURANCE RATES APPEAR TO HAVE SOFTEN**

January 1, 2010 renewals revealed a significant decrease in prices. According to several analysts, the price drop was from negative 5 percent to negative 15 percent. The cause of the price decline appears to be strong reinsurance underwriting profits together with a recovery in the global investment markets.

For more information click here: <http://tinyurl.com/RR-January-10-Article-3>

## **ANALYSTS PREDICT A FINANCIAL ADJUSTMENT FOR PARTNER RE AFTER ITS BUYOUT OF PARIS RE**

Analysts at JP Morgan conclude that the 1.7 billion buyout of Paris Re might not help Partner Re operating return. As such, it predicts that Partner Re's operating return of equity will remain at 13 percent.

For more information click here: <http://tinyurl.com/RR-January-10-Article-4>

## **VENEZUELA IMPOSES "SPECIAL CONTRIBUTION" TAX ON INSURERS**

Beginning January 1, 2010, Venezuela will tax insurers approximately .30 percent of the total net premiums it secures during the fiscal year. It is described as a "special contribution" tax by the government. Additionally, the government will begin taking steps toward greater control over La Previsora, an insurance carrier principally involved with banks seized over the past few months.

For more information, click here: <http://tinyurl.com/RR-January-10-Article-5>

## **ARCH UNVEILS ITS OPERATION IN AUSTRALIA**

On December 22, 2009, Arch Underwriting at Lloyd's announced its expansion into the Australian market with Arch Underwriting at Lloyd's (Australia). Arch Underwriting at Lloyd's (Australia) will be part of its comprehensive underwriting program. This new branch will be given the "green light" to enter into contracts starting in 2012.

For more information click here: <http://tinyurl.com/RR-January-10-Article-6>

## **CBO ANNOUNCES GREATER TORT REFORM SAVINGS**

The Congressional Budget Office announced that it has recalculated the amount of savings in medical liability insurance due to the tort reform package. Due to a recent study, the agency indicated if the tort reform package was instituted, it would save approximately \$4 billion beginning in 2010.

For more information click here: <http://tinyurl.com/RR-January-10-Article-7>

## **ARMOUR REINSURANCE GROUP LTD APPROVES PURCHASE OF PMA CAPITAL CORP.**

PMA Capital Group announced that it has sold its PMA Capital Insurance Co. unit to Armour Reinsurance Group Ltd. This unit, which has been in runoff since 2003, may be required to pay 46 million dollars in claims concerning certain workers compensation and excess line liability over the next few years.

For more information click here: <http://tinyurl.com/RR-January-10-Article-8>

## **SENTATE BANKING, FINANCE AND URBAN AFFAIRS ANNOUNCE PROGRESS ON FINANCIAL SERVICES PACKAGE**

On December 28, 2009, members of the Senate Banking, Housing and Urban Affairs Committee announced that they hope to resolve any remaining issue regarding financial services reform legislation this month. The existing financial service package includes insurers in a systemic risk oversight system that would require most financial institutions with more than 50 billion dollars in assets to help fund an authority dedicated to win down troubled financial institutions.

For more information click here: <http://tinyurl.com/RR-January-10-Article-9>

## **COMMITTEE OF EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS SUPERVISORS WARMS TO SOVLENCY II**

Earlier this month, the insurance industry was provided its last chance to respond to the Solvency II implementation. Earlier discussions with the Committee of European Insurance and Occupational Pensions Supervisors resulted in heated discussions and a clear stance of disapproval of its implementation. In a conciliatory manner, however, the industry's tough stance has changed somewhat and appears open to the implementation.

For more information click here <http://tinyurl.com/RR-January-10-Article-10>

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