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ERISA's Preemption of Discretionary Clause Bans: A Lost Clause?

By Ian S. Linker

Under ERISA, when a benefit plan grants discretionary authority to a fiduciary, courts review the fiduciary's benefit determinations under the highly deferential abuse of discretion standard of review. But when a plan does not contain such a discretionary clause, courts review benefit determinations under the far more rigorous de novo standard. Many states have attempted to ban these clauses through state insurance law to eliminate the deferential standard. This article focuses on the important effect of these states' efforts.

While successfully litigating whether ERISA preempts the discretionary clause bans enacted by roughly half of the states seems a lost cause, given how many courts have held that it doesn't, the issue is nevertheless ripe for Supreme Court review. The courts considering the issue have almost unanimously held that the bans are saved from preemption. To get there, however, courts have misapplied the bans' language and ignored the critical importance of deferential review.

Under ERISA, a plan sponsor, typically the employer, is charged with executing a written instrument containing the terms and conditions of its employee benefit plans. 29 U.S.C. § 1102. Sometimes when an insurance policy funds a benefit plan, the insurer will write the document and the sponsor will adopt it as its plan. And other times the plan sponsor, not the insurer, will write the document. But either way, the sponsor is the plan master.

When an ERISA plan grants discretionary authority, courts review the ensuing benefit determinations for an abuse of discretion. *Firestone v. Bruch*, 489 U.S. 101 (1989). This deferential standard of review is critical to preserve the balance "between ensuring fair and prompt enforcement of rights under a plan and the encouragement of the creation of such

plans." *Conkright v. Frommert*, 559 U.S. 506 (2010). Indeed, *Conkright* recognized that employers are not required to offer benefits to their employees. Instead, ERISA "induc[es] employers to offer benefits by assuring a predictable set of liabilities, under uniform standards of primary conduct and a uniform regime of ultimate remedial orders and awards when a violation has occurred." *Rush Prudential HMO, Inc. v. Moran*, 536 U.S. 355, 379 (2002). Further, Congress sought "to create a system that is [not] so complex that administrative costs, or litigation expenses, unduly discourage employers from offering [ERISA] plans in the first place." *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996). *Conkright* recognized that the abuse of discretion standard facilitates these goals.

Nevertheless, roughly half of the states through their insurance codes have attempted to prevent plan sponsors from granting discretionary authority over their benefit plans and to eliminate the deferential standard of review by banning the use of these discretionary clauses in insurance policies.

The bans take many forms, but generally they state, "No policy, contract, certificate, endorsement, rider application or agreement may contain a provision purporting to reserve discretion to the carrier to interpret the terms of the contract."

Typically, ERISA preempts state laws that relate to an ERISA plan. 29 U.S.C. § 1144(a). A state law is saved from preemption, however, if it regulates insurance, 29 U.S.C. § 1144(b)(2)(A), i.e., if the law is specifically directed at the insurance industry and substantially affects the risk-pooling arrangement. *See Ky. Ass'n of Health Plans v. Miller*, 538 U.S. 329 (2003).

There is no dispute that the bans relate to ERISA plans. But three circuit courts of appeals and several district courts have held that the discretionary clause bans are saved from ERISA preemption. These courts have stated that the bans preclude a plan sponsor from granting discretionary authority, even though the express language of the bans is limited to insurance contracts and other insurance documents—presumably, to avoid preemption. But the courts shouldn't be able to have it both ways. How can the bans be specifically directed at the insurance industry when in application their primary target is a plan sponsor? The courts have described this insurance-policy-plan-document distinction as "hyper-technical" and "artificial." They've said that if this was a valid distinction, the states would be "powerless" to regulate insurance in ERISA plans because sponsors would simply place substantive provisions in the plan and argue that state law can't touch them because they're outside the insurance contract. *See, e.g., Fontaine v. Metropolitan Life Ins. Co.,* 800 F.3d 883, 888 (7th Cir. 2015)

The courts are wrong. Their hyperbole ignores how insurance works and superficially disposes of the argument in response that substantive insurance regulations and discretionary clause bans are simply different. Indeed, there can be no dispute that the former, much as the notice-prejudice law at issue in *UNUM Life Ins. Co. v. Ward,* 526 U.S. 358 (1999), is a true insurance regulation specifically directed at the insurance industry, and the latter, directly targeting plan sponsors, is not a true insurance regulation, since discretionary clauses typically are not included in insurance policies. Thus, as applied, the bans are not specifically directed at the insurance industry, despite their language.

And this is not the same situation as in *Miller,* 538 U.S. at 335–36, even though the courts have said that it is. There, Kentucky's "any-willing-provider" law, while expressly targeting HMOs, had a mere incidental effect on medical providers. The discretionary clause bans, however, while expressly worded to apply to insurance contracts, have been targeted directly at plan sponsors of insured benefit plans. This has more than an incidental effect on plan sponsors; it is a frontal attack by the states on the largely federal abuse of discretion standard of review and on sponsors' statutory authority to establish and maintain benefit plans under ERISA.

The courts holding that the discretionary clause bans are saved from preemption have, frankly, gotten it wrong. They've misinterpreted the bans and the law on ERISA preemption to assist the states enacting the bans to eliminate the abuse of discretion standard. Deferential review, however, is critical to meeting the goals of ERISA. And the Supreme Court should intervene to restore the balance that the standard creates.

***Ian S. Linker**, a partner in Rivkin Radler LLP's Uniondale, New York, office, has nearly 20 years of civil litigation experience. Before joining the firm's Insurance Coverage Practice Group, he worked for 12 years as in-house counsel for MetLife's litigation department, where he managed ERISA litigation matters, counseled clients, and trained and supervised attorneys handling ERISA litigation. Mr. Linker also led MetLife's appellate practice group. He is admitted to practice in U.S. District Courts for the Southern and the Eastern Districts of New York, and the U.S. Courts of Appeals for the First, Second, Third, Fourth, Fifth, Seventh, Eighth, and Ninth Circuits. Mr. Linker is a member of the DRI Life, Health and Disability/ERISA Committee.*

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