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IN THIS ISSUE

This article highlights some of the questions and areas of concern that practitioners should be alerted to when facing a dispute where a state has taken some action that arguably bans the application of the clause. The article encourages the plan and their counsel to pay close attention to issues such as where in the plan the discretionary language is found, the date that the state's discretionary clause ban went into effect, the jurisdiction where a policy is issued and delivered, and the type of policy to which the ban may apply because any one of those factors can be determinative as to the standard of review that will be used by a reviewing court.

Discretionary Clause Bans: Fifteen Years Later the Battles Wage On

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The origin of the ban on discretionary clauses in health and disability insurance policies is now approaching fifteen years. First appearing in 2002 at the NAIC as a Model Law on health insurance policies, it was later expanded in 2004 to include disability insurance. *NAIC Model Law No. 42, adopted 2002, amended 2004 to extend scope to include disability insurance*. Shortly after the Model Law's adoption, the states began to enact various forms of bans either by statute, regulation or some other administrative action. As of this writing, 25 states now prohibit discretionary clauses in health and disability insurance policies.

The movement to ban discretionary clauses came about more than ten years after the Supreme Court's decision in Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101 (1989). In that case, the Supreme Court decided that the default standard of review in ERISA plan disputes was *de novo* unless the terms of the plan provided discretionary authority to the claim administrator or fiduciary to render benefit determinations. After Firestone, insurers in the employee benefit marketplace raced to insert discretionary clause language in their policies. Courts interpreting those clauses, more frequently than not, applied the favorable arbitrary and capricious standard of review. The standard was viewed by many regulators and claimant advocates as being decidedly anti-consumer and thus efforts were undertaken to moderate the impact of discretionary clause in ERISA litigation. The most successful strategy to date has been the nationwide effort to get state law makers and regulators to prohibit insurers from inserting discretionary clauses in policy provisions. When the bans first went into effect claim administrators argued that these state law enactments were preempted by ERISA. But, each of the Circuit Courts ruling on the issue has found that no such preemption exists. Fontaine v. Metro. Life Ins. Co., 800 F.3d 883 (7th Cir. 2015); Standard Ins. Co. v. Morrison, 584 F.3d 837 (9th Cir. 2009); Am. Council of Life Insurers v. Ross, 558 F.3d 600 (6th Cir 2009). Nevertheless, there are still some preemption battles being waged and won. Troiano v. Aetna Life Insurance Company, No. 14-496-ML, 2015 WL 5775160 (D.R.I. Sept. 30, 2015), *aff'd on other grounds*, 844 F.3d 36 (1st Cir. 2016).

The purpose of this article is not to further the debate whether bans on discretionary clauses should be preempted, but instead to review decisions that have addressed the various bans and the efforts by plan administrators and claim fiduciaries to push back on their impact. In reviewing the cases discussed herein, it was remarkable to see just how many different avenues of approach have been taken to counter the effect of the discretionary clause bans.

Where is the discretionary language found?

Some insurers have complied with the statutory bans on the clause by taking the language out of their insurance policies but leaving it in accompanying Summary Plan Descriptions or types of ERISA pages that are not among the forms required to be filed with state insurance departments. In Littleton v. Liberty Life Assurance Company of Boston, No. 6:15-187-KKC, 2016 WL 3093887 (E.D. Ky. June 1, 2016), the District Court reviewed the applicability of the Texas

ban found in Tex. Ins. Code § 1701.062 Section 1701.002, which prohibits insurers from using a discretionary clause in "(1) a policy, contract or certificate of: (A) accident or health insurance, including group accident or health insurance…." In Littleton, the discretionary clause language was not in the policy but instead in separate Plan documents and delivered to the participant by their employer. The insurer successfully argued and the Court ultimately held that the statutory prohibition only applied to documents "issued or delivered by an insurer". Id. at *3. As a result, the Court ruled, irrespective of the statutory ban, that the arbitrary and capricious standard of review would be applied to the dispute. *See also,* Rose v. Liberty Life Assurance Company of Boston, No. 3-15-cv-28-DJH-CHL, 2016 WL 1178801 (W.D. Kentucky Mar. 23, 2016). Several Michigan District Courts have made similar findings. Markey-Shanks v. Metro. Life Ins. Co., No. 1:12 –CV-342, 2013 WL 3818838 (W.D. Mich. July 23, 2013) and Hess v. Metro. Life Ins. Co., 91 F.Supp.3d 895 (E.D. Mich. 2015).

Unlike Kentucky and Michigan courts, several District Courts in Illinois have enforced that state's regulatory ban on discretionary clauses even though the language was found outside of the actual policy. The Illinois ban applies to language found in a "… policy, contract, certificate, endorsement, rider, application or agreement offered in this State…". 50 Ill. Adm. Code tit. § 2001.3. In Novak v. Life Insurance Company of North America, 956 F. Supp.2d 900, 906 (N.D. Ill., 2013), the Court found that Section 2001.3 barred the grant of discretion found in a Plan Document but not the policy. And, in Borich v. Life Ins. Co. of N. Am., No. 12 C 734, 2013 WL 1788478 at *2 (N.D. Ill. Apr. 25, 2013) the Court held that, "[discretionary language] is not rendered ineffective merely because it appears in plan documents other than the policy." Similar holdings are found in Difatta v. Baxter Int'l, Inc., No. 12 C 5023, 2013 WL 157952, at *3 (N.D. Ill. Jan. 15, 2013) and Ehas v. Life Ins. Co. of N. Am., No 12 C 3537, 2012 WL 5989215, at *5-7 (N.D. Ill. Nov. 29, 2012).

Like the courts in Illinois, California courts have also been reluctant to permit discretionary clauses in non-policy documents. In Gallegos v. the Prudential Insurance Company of America, No. 16-cv-02168-BLF, 2017 WL 35517 (N.D. Cal. Jan. 3, 2017), the discretionary clause language was found in the Summary Plan Description. Since the discretionary language resided in a document outside of the policy, the insurer argued that the California ban on discretionary clauses found in California Ins. Code § 10110.6 should not apply. The Court disagreed and in reviewing a string of California decisions addressing §10110.6 stated that "…whether section 10110.6 voids discretionary clauses did not hinge on whether the discretionary language resided in a document outside of the policy. There is no reason why the result here should differ when a state law is directed toward a discretionary clause contained in the agreement or another document relating to the administration of an insurance policy." Id. at *4. *See also*, Nagy v. Grp Long Term Disability Plan for Employees of Oracle Am., Inc., 183 F.Supp. 3d 1015 (N.D. Cal. 2016). The bottom line is that the application of discretionary clause bans to non-policy

documents are treated differently depending on the jurisdiction and the court.

In what jurisdiction was the policy issued and delivered and does the policy have a governing law provision?

Since half of the states still do not have discretionary clause bans in place, the state where the policy is issued and delivered could make a difference as to whether a ban applies to the coverage in question. In Tikkanen v. Liberty Life Insurance Co., 31 F.Supp.3d 913 (E.D. Mich. 2014) the Court was presented with a claim under a group disability insurance policy issued and delivered to Home Depot in Atlanta, Georgia. The plaintiff lived and worked for the company in Michigan. The Michigan Administrative Code section 500.2202(c) states that "[o]n or after [July 1, 2007] a discretionary clause issued or delivered to any person in this state in a policy contact, rider, endorsement, certificate or similar contract document is void and of no effect". The plaintiff could not present actual evidence of any document that was issued or delivered to him in Michigan. Because of the lack of actual proof, the Court refused to make any assumptions that the plaintiff received a document evidencing his coverage. As a result, the Court did not enforce the Michigan regulatory ban to the coverage and applied the abuse of discretion standard of review in analyzing the claim. Tikkanen at *922. Presumably the outcome would have been different if the plaintiff produced a certificate issued and delivered in Michigan.

An almost identical result was reached in Mellian v. Hartford Life and Accident Insurance Co., 161 F.Supp.3d 545 (E.D. Mich. 2016). In Mellian, the group policy was issued and delivered to an employer in Illinois. Like the facts in Tikkanen, the plaintiff could not produce any evidence of a certificate being issued or delivered in Michigan. Consequently, the Court applied the abuse of discretion standard finding that the Michigan regulatory ban did not apply.

Many group policies have choice of law provisions. Those provisions can be used to challenge a state law ban on the discretionary clause in the claimant's state of residence if the state where the policy was issued does not have such a ban in place. In Rice v. Sun Life & Health Insurance Co., No. 1:12-cv-1362, 2014 WL 24046 (W.D. Mich. Jan 2, 2014), the policy was issued and delivered to the plaintiff's employer in Rhode Island in 2009 and the claim was denied in 2012. The policy had a provision stating that it would be governed under the laws of Rhode Island, which at the time did not have a discretionary clause ban. (Rhode Island later promulgated a discretionary clause ban in 2013. *See* RI ST § 27-4-28.) Since the plaintiff worked and lived in Michigan, he argued that Michigan's ban on discretionary clauses should apply. The Court rejected the argument, found that the Rhode Island governing law clause would take precedence and applied the abuse of discretion standard to the dispute. Rice at *5. The Court in Rice cited three earlier Michigan decisions with similar findings; Williams v, Target Corp, No. 12-cv-11775, 2013 WL 5372877 (E.D Mich. Sept. 25, 2013), Foorman v. Liberty Life Assurance Co. of Boston, No. 1:12- CV-927, 2013 WL 1874738 (W.D. Mich. May 3, 2013) and Grimmett v.

Anthem Ins. Cos., Inc., No. 2:11-cv-12623 (E.D Mich. Sept. 27, 2012).

Is it possible to draft around the ban?

Some insurers have attempted to draft around statutes and regulations that purport to ban discretionary clauses. An example of that strategy is found in Weisner v. Liberty Life Assurance company of Boston, 192 F.Supp.3d 601 (D. Md. 2016). The plaintiff in Weisner argued that the court should apply a *de novo* review of his disability claim dispute because of the Maryland ban on discretionary clauses found in Md. Code Ann., Ins. § 12-211 which provides as follows:

> A disability insurance policy may not be sold, delivered, or issued for delivery in the State by a[n insurer] if the policy contains a clause that purports to reserve sole discretion to the [insurer] to interpret the terms of the policy or to provide standards of interpretation or review that are inconsistent with the laws of the State.

Liberty Life, in an effort to maintain a level of discretion but not "sole discretion" and avoid the strictures of a *de novo* review, drafted policy language which provided that, the company "shall possess discretion to reasonably construe the terms of this policy and to reasonably determine eligibility hereunder." Further, the policy stated that Liberty Life's decisions "may be subject to judicial review." Despite the careful drafting, the Court found that the language still provided a *de facto* level of sole discretion to Liberty Life and reasoned that the statute was more than a drafting guide and that insurers could not achieve a deferential review by shrewd wordsmithing. Reflecting on the history of the discretionary clause and purpose behind the statutory bans, the Court stated, "And then these insurer-administrators could carry on in precisely the same vein as they have done since Firestone, making virtually autonomous decisions subject only to deferential review. The Court will not bless an interpretation of section 12-211 that guts the statute of its meaning." Id. at *612. The end result was a *de novo* review.

There is great concern among plan administrators and fiduciaries that conceding to a *de novo* review standard will bring about the opening of the administrative record to new evidence by way of traditional discovery. However, the Court in Weisner did no such thing. While the court did deny both parties summary judgment motions, it decided to conduct a trial based exclusively on the administrative record.

Does the statutory ban apply to the policy in question?

Since many of the statutory bans have only recently been enacted, there are often questions about whether the ban applies to the particular policy in question. Most of the prohibitions enacted to date apply only to those policies issued or delivered after their effective date. In Stone v. Unum Life Insurance Company of America, No. 15-CV-0630-CVE-PJC 2017 WL 57831 (N.D, Okla. Jan. 5, 2017), the Court had to determine whether a post claim discretionary clause ban in Texas applied to the underlying dispute.

The plaintiff in Stone, who was an Oklahoma resident, first became covered under a group long-term disability policy issued to his employer in Texas on January 1, 2000. The policy was subsequently amended on January 1, 2002. The claim was first filed in December 2002 and the plaintiff remained disabled through the date of denial and the decision on appeal which was rendered on October 2, 2015. The Texas policy covering the group under which the insured made his claim was terminated in 2007. The Texas ban on discretionary clause first became law in December, 2010. Tex. Admin. Code § 3.1203. The law states that the discretionary clause ban applies to "forms offered, issued, renewed, or delivered on or after June 1, 2011." Id. at § 3.1202. The law also applies to policies that do not contain a renewal date on the occurrence "of any rate increase applicable to the form or any change, modification, or amendment of the occurring on or after June 1, 2011." Id. at § 3.1201(d). The plaintiff introduced evidence that Unum amended the policy form with the Texas Insurance Department in 2014 and as a result the discretionary ban should now apply. While reluctant to review information outside of the administrative record, the Court made an exception for the limited purpose of deciding what standard of review should apply. Since the contract was terminated four years before the discretionary ban went into effect, the Court rejected the plaintiff's arguments and found that the ban did not apply to the dispute in question. The subsequent amendments filed by Unum with the Texas Insurance Department on a similar policy form had no effect.

A more traditional analysis of when a discretionary clause ban should apply is discussed in Fowkes v. Metropolitan Life Insurance Company, No. 2:15-cv-00546-KJM-CKD 2017 WL 363155 (E.D. Cal. Jan. 24, 2017). In Fowkes, the Court had to determine whether the California ban on discretionary clauses found in Cal. Ins. Code § 10110.6 and which became effective on January 1, 2012 applied to the dispute. The ban applied to "… a policy, contract, certificate, or agreement offered, issued delivered, or renewed" after its effective date. The certificate of coverage in this case was issued by MetLife on January 1, 2011. The insured first became disabled on March 12, 2013 and the claim was ultimately denied in October, 2014. The Court held that the same policy was in effect from January, 2011 to October, 2014. Observing that the term "renewed" under Code § 10110.6, is defined as "continued in force on or after the policy's anniversary date," the Court reasoned that the policy had been renewed beyond its anniversary date and held that the discretionary clause ban applied and with it the *de novo* standard of review. Id. at *11.

When performing its review of the claim denial under the *de novo* standard, the Court held that the consideration of evidence outside the administrative record was not warranted. Carefully reviewing Ninth Circuit precedent, the Court reasoned that only under exceptional circumstances will additional evidence be considered during a *de novo* review and since those exceptional circumstances were not present in Fowkes, no new evidence would be admitted. Then, analyzing the claim pursuant to a *de novo* review it upheld MetLife's decision. Id. at

*15. The takeaway is that a properly investigated and documented claim can withstand a court's scrutiny even under a less deferential standard of review. As a result of discretionary clause bans, more and more courts will be deciding cases using a *de novo* review and, as the Fowkes matter gives testament, those well-handled claim denials can and will be upheld.

A very interesting twist as to whether the California statute banning discretionary clauses applied to a claim dispute arose in Montoya v. Reliance Standard Life Insurance Company, No. 14-cv-02740-WHO 2016 WL 5394024 (N.D. Cal. Sept. 27, 2016). In that case, the plaintiff pled in his complaint that Reliance had abused its discretion in denying benefits. Thereafter, plaintiff sought discovery to uncover whether Reliance suffered from bias or a structural conflict in making its decision. Interpreting the plaintiff's pleadings and his discovery tactics, Reliance argued that he had conceded that the abuse of discretion standard applied and that plaintiff's conduct established the "law of the case" on the issue. Part of Reliance's reasoning was based on the fact that discovery was sought and permitted on the conflict/bias issue and there would be no reason to conduct such inquiry if the statutory ban already applied thereby mandating a *de novo* review. The Court disagreed with the "law of the case" argument and enforced the California statutory ban thus warranting the *de novo* standard. Id. at *8. Reliance may have been able to avoid the conflict discovery by conceding the statutory ban applied, but that would have also meant giving in to a *de novo* review in the first instance. The Court ultimately found in favor of plaintiff using the *de novo* standard but in so ruling stated that Reliance's decision was unreasonable. Id. at *13. Since there was a finding of "unreasonableness", arguably Reliance may have lost even under the abuse of discretion standard.

The type of coverage matters.

The language in the statutory and regulatory bans typically applies to a specific policy type such as "health" or "disability" insurance. The issue in Petit v. Metropolitan Life Insurance Company, 160 F.Supp.3d 1238 (D. Oregon 2016) was whether the discretionary clause ban in Washington insurance regulations, Wash. Admin Code 284-44-015, which applies to "every health care service contractor" or Wash. Admin. Code 284-96-012, which applies to "disability" insurance, impacted the standard of review under an ERISA governed group life and accidental death and dismemberment policy ("AD&D"). Both parties brought motions for Partial Summary Judgment on the appropriate standard of review. The plaintiff argued that the policy should be interpreted under the laws governing disability insurance and therefore the discretionary clause ban should apply. MetLife argued that the policy should be interpreted under the laws governing life insurance and since there was no ban on using discretionary clause language in life insurance contracts the discretionary language in the policy should be enforced.

The Court first had to determine whether the policy should be regarded as a life or a disability policy. Using Washington state court precedent, the challenge was "to determine the nature of the insurance by the

dominant purpose of the policy as reflected by the risk or contingency insured against." Gomez v. Life Insurance Company of North America, 84 Wash. App. 562, 928 P.2d 1153 (Wash.Ct.App. 1997). Applying the analysis in Gomez, the Court found that the dominant purpose of the policy was to provide life insurance with additional coverage provided in the case of an accident. Since the ban under Washington law did not govern life insurance, it was not applied to the AD&D coverage and the abuse of discretion standard was used to review the claim denial. Petit at *1250.

Consequently, counsel should look carefully at laws purporting to ban discretionary clauses to determine whether they apply to the specific type of coverage being litigated.

Conclusion

For fifteen years ERISA claim administrators have been litigating the impact of discretionary clause bans. At first glance, it would appear as though the application of a statutory or regulatory prohibition on the use of discretionary clauses would be simple and straightforward. But, like many issues in the field of insurance and ERISA a closer analysis reveals a number of issues that can arise when faced with an argument that a discretionary clause should be stricken from an ERISA governed claim dispute. This article highlights some of the questions and areas of concern that practitioners should be alerted to when facing a discretionary clause ban. There is an impressive array of creativity used by the lawyers who litigated the cases referenced in this article—well done! By paying close attention to issues such as the whereabouts of discretionary language, the date that discretionary clause ban went into effect, the state where a policy is issued and delivered, and the type of policy to which the ban may apply can be determinative as to the standard of review that will be used by a reviewing court.

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