

Why Discretionary Clauses Must Be Prohibited

Testimony before the National Association of Insurance Commissioners (NAIC) at their meeting in Anaheim, California on the topic of disability insurance and ERISA on December 8, 2003.

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Historical Background

The ERISA¹ law was enacted in 1974 by Congress to

protect . . . participants in employee benefit plans and their beneficiaries, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information with respect thereto, by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal Courts.²

Despite that lofty goal, discretionary clauses in insurance policies present the most formidable obstacles faced by claimants seeking benefits due under employee benefit plans funded by insurance.

Historically, courts have questioned the wisdom of allowing discretionary clauses, which have the legal effect of triggering an arbitrary and capricious standard of judicial review when such claims reach the court. For example, Judge Richard Posner, an influential jurist and legal scholar, wrote in *Van Boxel v. The Journal Company Employees' Pension Trust*,³ “[benefits] are too important these days for most employees to want to place them at the mercy of a biased tribunal subject only to a narrow form of ‘arbitrary and capricious’ review, relying on the company’s interest in its reputation to prevent it from acting on its bias.”

¹ Employee Retirement Income Security Act of 1974, 29 U.S.C. §1001 *et seq.* (2003)

² 29 U.S.C. §1001(b)(2003).

³ 836 F.2d 1048 (7th Cir. 1987)

Yet another reason for not granting discretion to insurers administering benefit plans was given in *Luby v. Teamsters Health, Welfare and Pension Trust Funds*,⁴ where the court explained:

Plan administrators are not government agencies who are frequently granted deferential review because of their acknowledged expertise. Administrators may be laypersons appointed under the plan, sometimes without any legal, accounting or other training preparing them for their responsible position, often without any expertise in or understanding of the complex problems arising under ERISA, and, as this case demonstrates, little knowledge of the rules of evidence or legal procedures to assist them in factfinding.⁵

Despite those warnings, when the issue reached the Supreme Court in *Firestone Tire & Rubber Co. v. Bruch*,⁶ the Court gave *carte blanche* to insurers to include discretionary clauses in their insurance policies, apparently without any consideration of the resulting consequences. Recognizing the effect of the Supreme Court's ruling, Judge Posner, in *Herzberger v. Standard Insur.Co.*⁷ wrote, "The very existence of "rights" under [employee benefit] plans depends on the degree of discretion lodged in the administrator. The broader that discretion, the less solid an entitlement the employee has..."⁸

Judge Posner was right, because the practical effect of allowing discretionary clauses in insurance policies is contrary to every principle of insurance law and civil procedure developed over the past 100 years.

The Practical Effect of Discretionary Clauses

⁴ 944 F.2d 1176 (3d Cir. 1991).

⁵ 944 F.2d at 1183

⁶ 489 U.S. 101 (1989)

⁷ 205 F.3d 327 (7th Cir. 2000)

⁸ 205 F.3d at 331.

As noted above, the effect of discretionary clauses has been to transform the judicial paradigm of decisionmaking. It is not enough for a claimant to show an insurer's decision was wrong or contrary to the terms of the insurance contract. Instead, the claimant must prove the decision is "unreasonable, and not merely incorrect."⁹ Illustrations of how this works can be found in representative recent court decisions. For example, in *Glista v. Unum Life Insur.Co. of America*,¹⁰ a federal court upheld an insurer's denial of benefits claimed by an individual suffering from a fatal neurological disorder based on an application of a pre-existing condition exclusion. Although the insurer's claim manual mandated a policy interpretation favoring the claimant, the insurer argued it was within its discretion to interpret its policy differently and in a manner that excluded coverage. Agreeing with that argument, the court held, "In sum, by creating a training or a reference manual, Unum did not relinquish its discretion to interpret the terms of its own insurance policy."¹¹ *Graham v. L&B Realty Advisors, Inc.*,¹² is another recent decision finding that despite "clear evidence to the contrary" of the insurer's determination, the court's hands were tied by the arbitrary and capricious standard of review. The court concluded:

The Court is concerned by this result. If the Court were finding the facts based on the administrative record, it would find Graham is disabled. Likewise, if the Court could decide the standard of review to use when a carrier's decision is based on the opinions of a captive professional, the Court might extend less deference to such decisions. However, under the statutory framework of ERISA as applied in this Circuit, the Court must hold that substantial evidence supports UNUM's decision. Accordingly, UNUM's motion for summary judgment is granted.

⁹ 205 F.3d at 329

¹⁰ 2003 U.S. Dist. LEXIS 17457 (D. Mass. 9/30/03)

¹¹ 2003 U.S. Dist. LEXIS 17457 *23 - *24.

¹² 2003 U.S. Dist. LEXIS 17272 (N.D. Tex. 9/30/03)

Perhaps the most shocking case, though, is *Brigham v. Sun Life of Canada*.¹³ In that ruling, an insurer's decision to deny disability benefits to a paraplegic was upheld with the court making the following pronouncement:

The question we face in this appeal is "not which side we believe is right, but whether [the insurer] had substantial evidentiary grounds for a reasonable decision in its favor." ... Beyond this, it seems counterintuitive that a paraplegic suffering serious muscle strain and pain, severely limited in his bodily functions, would not be deemed totally disabled. Moreover, it seems clear that Sun Life has taken a minimalist view of the record. But it is equally true that the hurdle plaintiff had to surmount, establishing his inability to perform any occupation for which he could be trained, was a high one. As to that issue, we have to agree with the district court that the undisputed facts of record do not permit us to find that Sun Life acted in an arbitrary or capricious manner in terminating appellant Brigham's benefits."

These cases illustrate the almost impossible burden faced by claimants left at the mercy of insurers who are able to utilize discretionary clauses as a shield against payment of meritorious claims. Particularly due to the Supreme Court's rejection, in *Black & Decker Disability Plan v. Nord*,¹⁴ of a rule giving deference in disability claim adjudications to opinions from treating doctors, insurers are empowered to utilize in-house doctors, rather than independent medical examinations, as a means of denying claims,¹⁵ a strategy that the *Graham* ruling shows is sufficient to survive judicial review.

Discretionary clauses also trigger other adverse harms to claimants. For example, in *Pearlman v. Swiss Bank Corp.*,¹⁶ the court ruled, "Deferential review of an

¹³ 317 F.3d 72 (1st Cir. 1/28/03)

¹⁴ 123 S.Ct. 1965; 155 L. Ed. 2d 1034 (2003)

¹⁵ A physician formerly employed by the UnumProvident Corporation characterized his company's use of physicians in this manner as a "means to an end... The end was denial." Deposition of Patrick Fergal McSharry, *Chapman v. Unum* (Cal., Marin.Cty. Super.Ct.), September 4-6, 2002 at 163-169; reported on *Dateline NBC* October 13, 2002.

¹⁶ 195 F.3d 975 (7th Cir. 1999)

administrative decision means review on the administrative record.”¹⁷ Thus, claimants are barred from introducing any new evidence in court proceedings. The court reviews only the claim record created by the insurer, even if relevant and material evidence could not have been secured earlier.

Finally, discretionary clauses overturn a well-accepted principle of insurance law known as *contra proferentem*, which requires courts, when faced with differing policy interpretations, to adopt the interpretation favoring coverage in order to protect consumers against ambiguities. Although some courts find the principle applicable in ERISA cases, other courts, such as *Kimber v. Thiokol Corp.*,¹⁸ have found *contra proferentem* inconsistent with a grant of discretion to interpret policy language. The *Glista* ruling also illustrates this abrogation of *contra proferentem* in a manner that allowed an insurer to defeat a benefit claim, despite the court’s concession that a different reading of the policy was plausible.

Accordingly, discretionary clauses have tremendous legal significance unavailable in any other insurance context. Such clauses are the vehicle by which ERISA is transformed from an employee’s sword into a near impenetrable shield. That, plus the fact that the ERISA law precludes the recovery of damages, discourages deserving claimants from pursuing meritorious claims. State Insurance Commissioners have the authority to prohibit discretionary clauses since the ERISA law has been found to exempt state insurance regulation from federal preemption. Without discretionary clauses, claimants can receive judicial review of their cases that gives equal consideration to the

¹⁷ 195 F.3d at 981-82.

¹⁸ 196 F.3d 1092 (10th Cir. 1999)

evidence presented by both sides. Therefore, as a matter of consumer protection and simple justice, discretionary clauses must be prohibited.