Epstein Becker Green | ERIC

BENEFITS LITIGATION UPDATE

A Quarterly Publication From Epstein Becker Green & The ERISA Industry Committee

September 2012 Issue 2

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- IMPORTANT ISSUES IN PENDING CASES -

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A Short Message from ERIC President Scott Macey:

Last April, ERIC and Epstein Becker Green ("EBG") distributed the initial issue of our joint Benefits Litigation Update. This is our second issue and we intend to continue to distribute future Updates on a periodic basis. What we are also doing with this and future Updates is to follow the distribution with a FocusOn call in which counsel from EBG will briefly summarize key points from each of the cases discussed in the Update and discuss questions from the audience. ERIC members and EBG clients receiving this Update have also been sent an invitation to register for that call which is scheduled for September 13 at 2 pm (EDT). (If you have not received an invitation to the call, please let us at ERIC know by emailing acooper@eric.org) Once you have had an opportunity to review this Update, we urge you to send questions to us that you would like addressed in the FocusOn call. (Please send those questions to me at smacey@eric.org) Of course, you will also have the opportunity to ask questions on the call itself.

We have all become aware over the years of the risks and importance of ERISA litigation. The Update is a response to that and is intended for benefit professionals in general not just lawyers. The Update will alert you to a number of key cases, analyze both the facts and decisions in those cases, and (with respect to the featured cases reviewed) suggest some steps that plan sponsors and fiduciaries can take to mitigate some of the risks of costly litigation. The associated FocusOn call will give readers the opportunity to hear more about cases discussed in the Update and dialogue with experienced counsel from EBG on those cases.

ERIC and EBG want to make the Benefits Litigation Update and the associated FocusOn call as informative and helpful to you as we can. Accordingly, we welcome your suggestions for our future Updates and calls as well as your requests for cases that you would like to see reviewed. In any case, we always welcome your comments and suggestions on this and other matters.

FEATURED ARTICLES

Practical Guidance for Employer Plan Sponsors from the *Tussey v. ABB, Inc.*, Decision

By: Daly D.E. Temchine and Kenneth J. Kelly

I. INTRODUCTION

In the first edition of this newsletter published in April, we noted the decision in a class action brought on behalf of 401(k) plan participants, *Tussey v. ABB, Inc.*, No. 2:06-CV-04305-NKL, 2012 WL 113291 (W.D. Mo. March 31, 2012). We remarked that the decision could be used as a vehicle for a refresher course about fundamental principles under the Employee Retirement Income Security Act ("ERISA") that govern the administration of ERISA benefit plans by their employer sponsors. The court found the employer defendant in *Tussey* had failed to adhere to basic plan fiduciary administration principles that resulted in $37,000,000 in damages. We decided to follow up with an analysis of *Tussey* that would be useful to ERIC's members as they review their ERISA plan administrative structures for compliance with those principles and take appropriate actions to avoid a similar fate.

II. SUMMARY OF KEY FACTS

In *Tussey*, the employer, ABB, Inc. ("ABB"), appointed committees consisting of senior officers who controlled all aspects of the administration of two defined contribution plans (collectively, "Plan"), as the designated Plan Administrator with oversight of all employee benefit programs as well as the selection and monitoring of the performance of the Plan's investment options offered to Plan participants. ABB's status as Plan Administrator, a fiduciary position by statutory definition, and the fact that its officers exercised direct control of the Plan, was the basis for the Court's determination that the company was the key plan fiduciary. Consequently, it was exposed to liability for any violation of ERISA arising out of the administration of its Plan. In any case, although it is possible for a plan sponsor to avoid significant aspects of direct fiduciary responsibility for plan operations through appropriate delegations and allocations of such responsibilities, it would be difficult for an employer sponsor to avoid all fiduciary responsibility for an ERISA plan. To maximize insulation from fiduciary liability exposure, a sponsor would have to: (a) contract with an entity to serve explicitly as the statutory Plan Administrator and, (b) also not retain any authority respecting their plan that is exercised by their directors, officers, employees and committees whose membership they control. Even in that circumstance, the selection of the Plan Administrator itself would be a fiduciary decision subject to ERISA.

The following summarizes the primary problems (but by no means all of the problems) that the court found with the administration of the ABB Plan in its 81-page analysis. The opinion painstakingly dissects virtually all of the decisions and practices of the various plan fiduciaries involved in the harsh light of hindsight.

Disclosures: ABB retained the services of a record-keeper (referred to as "RK") to provide bookkeeping and educational services to both the Plan and the participants. The Plan did not directly pay RK for these services. Rather, as is not uncommon, RK was compensated for the record-keeping services to the Plan through a "revenue sharing" arrangement with the investment companies whose products were offered as investment options to Plan participants. Simply put, RK received a split of the fees those investment vehicles received from Plan participants who invested in their offerings. One of these investment companies was a corporate affiliate of RK (referred to as "RKFund"). While revenue sharing is an appropriate and acceptable practice, the court noted that the disclosures to Plan participants concerning the arrangement were "opaque," and this was pertinent because, in effect, the participants' contributions that went to RKFund were paying RK for its services to them. Because the Plan contributions were Plan assets, ABB was subject to fiduciary duties regarding the propriety of such payments. The key concerns here were the amount and the disclosure of such expenses.

Failure to Monitor and Excess Fees: ABB never kept track of the revenue-sharing compensation that RK received from the investment companies for its Plan record-keeping services, nor did it compare RK's fees with market rates for similar services. Notably, in 2005, a consultant reported to ABB that RK's compensation for its services to the Plan was well above market rates. The consultant further noted that the Plan had failed to leverage its asset size—$1.4 billion—to negotiate more favorable rates.

Nevertheless, ABB failed to act on that advice. Its assumption seems to have been that, because the Plan itself did not make direct payments to RK, RK was not receiving Plan assets subject to ERISA's requirements. The court made it clear that if a plan fiduciary is going to use revenue sharing as a means of compensating plan service providers, it must engage in a multi-faceted "deliberative process" to determine why that choice is in the plan's and its participants' best interests. In short, among other things, it must determine that the amount of the fees is appropriate.

Self Dealing and Conflict of Interest: The fact that the revenue-sharing payments were not competitive was only one of ABB's problems. ABB also received corporate record-keeping services from RK, but RK was not paid anything by ABB for these services that were not related to or for the benefit of the Plan. RK was compensated for these services solely from the revenue-sharing payments that were derived from Plan assets. ABB's status as the employer sponsor of the Plan and a Plan fiduciary made it a party-in-interest ("p.i.i.") to the Plan. The use of plan assets to benefit a p.i.i. is prohibited by ERISA. The court referred to this arrangement as the Plan subsidizing RK's services to ABB. Any arrangement involving either multiple plans or a plan and other services to the company sponsor should be scrutinized closely and include clear lines of demarcation so that plan assets cannot be used for non-plan purposes.

Failure to Follow Plan Documents: ABB's administrators also failed to follow the directions of the Plan's governing documents that require the Plan's fiduciaries to pursue rebates for the benefit of the Plan. The court found that, as the consultant had pointed out, the Plan's fiduciaries could have obtained record-keeping services for the Plan for substantially less than the compensation that was received by RK by using the size of the Plan's assets to negotiate with service providers for lower rates.

Inadequate/Erroneous Monitoring: The court also focused on the plan's "Investment Policy Statement" ("IPS") that mandates a specific process for the evaluation of the performance of a fund that was offered as an investment option to Plan participants before that fund could be removed as an investment option. In 2000, ABB "delisted" a Vanguard fund on the ground that it had "deteriorating performance" as compared to two funds offered by RKFund, but it did not follow the procedure mandated by the IPS. The court found that, if an investigation had been conducted in compliance with the IPS criteria, it would have revealed that the Vanguard fund had not been performing poorly. To the contrary, its performance was significantly better than that of the RKFund's investment options that ABB selected as replacements. The court also found that the investigation conducted in connection with the selection of the replacement investment options was imprudent because the number of investment vehicles that were investigated was too small to adequately inform ABB about the range of options available in the marketplace. Simply put, ABB failed to obtain sufficient information about the investment options available on the market to prudently select replacement options.

ABB Liability: Because ABB was found to have committed these fiduciary breaches, it was held liable to the Plan for the difference in value between the delisted Vanguard fund and the RKFund that was its replacement, i.e., essentially a highly troubling form of "lost profit" calculation in the amount of $21.8 million. (It did not help ABB that the investment options it selected were offered by an affiliate of a Plan p.i.i. that was a receiving a de facto subsidy from Plan assets for services unrelated to the Plan's needs that only benefitted ABB.)

The IPS also clearly required that, when a fund selected as an investment option for Plan participants offered different share classes, the Plan's fiduciaries must select the class of shares with the lowest administrative expenses. The RKFund options selected by ABB had different share classes with varying expense levels, but ABB did not select the share class with the lowest administrative expenses. Moreover, the higher administrative fee level benefitted a Plan p.i.i., RK, because RK had a sharing agreement with the RKFund pursuant to which RK shared in the administrative fees that the RKFund received from Plan participants who invested in its funds. The higher the RKFund's administrative fees were, the greater the compensation to RK. The court held that this resulted in further breaches of fiduciary duty by ABB: (i) the duty to follow the terms of Plan documents, and (ii) the duty to avoid using Plan assets in "prohibited transactions," as defined under ERISA.

The core lesson of this case, briefly stated, is that if an employer is going to undertake plan administration and/or investment responsibilities, it must appoint knowledgeable individuals to handle the fiduciary responsibilities and ensure that they devote sufficient time and effort and have the resources to perform those duties properly.

III. TAKEAWAYS

Tussey provides a base for the identification of a series of questions that employers can use as a guide to review the administrative practices of their ERISA employee benefit plans, and to determine the actions that they can take to minimize their risk of exposure to liability for fiduciary breaches and prohibited transactions under ERISA. These questions are as follows:

❒ Has the employer taken on responsibilities and authority with respect to the administrative and substantive management of its benefit plans?

> NOTE: An employer can limit its responsibility for the administration of an ERISA benefit plan. Responsibilities can be delegated to others who are prudently selected by the employer. If so, what are the responsibilities that the employer has retained or assumed? When those responsibilities have been identified, it would be helpful to the employer to consult with ERISA counsel to identify those that may qualify as fiduciary responsibilities as contrasted to settlor responsibilities as a plan sponsor.
>
> It is not the case, however, that the prudent selection of a fiduciary by an employer ends the employer's responsibilities as a fiduciary. Judicial precedents and DOL criteria establish that employers have an obligation to keep reasonable track of the selected fiduciary's performance, and to step in and take proper action if that performance is not up to contract standards or otherwise defective. One way to view this obligation is to appreciate that a key fiduciary standard under ERISA is whether the conduct under examination comports with what a "prudent and knowledgeable businessman" would do in a like circumstance. Such a businessman would pay attention to whether the performance of a vendor of services to the business enterprise satisfied contractual obligations and otherwise complied with applicable industry standards. The employer's supervision of the appointed fiduciary should not be any different.

❒ What tangible benefits, if any, does the employer achieve by taking on fiduciary responsibilities and possessing or exercising such authority?

❒ In connection with the preceding question, do any of those benefits derive from the application of plan assets in a manner that may be perceived as benefitting the employer, its affiliates, officers, directors, or certain shareholders, thus giving rise to potential prohibited transactions?

❒ If the answer to the question in the second bullet above is "none," the proper question for an employer to ask may be, "Why take on this authority and exposure to the risks and liabilities of ERISA fiduciary status?" Even if it only has limited fiduciary responsibilities, the employer also should ask the following relevant questions:

- ○ Have we identified, collected, and organized in a controlled manner all plan documents, and are they compliant with current laws?

- Do we know which individuals are responsible for each activity that must be undertaken to deliver promised benefits in a manner that conforms to the requirements of (i) plan documents, (ii) applicable statutes and regulations, and (iii) applicable judicial precedents? Have we identified all assets that may reasonably be deemed to be plan assets?
- Do we know who the individuals are who have the responsibility for the control and application of plan assets?
- What are our mechanisms and safeguards for assuring that plan assets are applied only to proper purposes and not, by intention or inadvertence, to prohibited uses?
- Who is responsible for an integrated broad spectrum oversight of all of the activities involving plans and plan assets (e.g. senior officer of the company, committee of executives, board or board committee, etc.)?
- Do those persons have the means to identify activities and conduct that cut across multiple areas of oversight and responsibility that may create exposures and potential liabilities because of how they affect multiple areas?
- Are plan administrative, claim and investment decisions well-documented?

The evaluation of the information gathered and the assessment of the actions that may be required based on that information can present complex legal issues. Consultation with your ERISA counsel would be prudent.

IV. CONCLUSION

The responses you receive for each of the preceding inquiries can serve as a guide to action. Every question for which a clear, complete and appropriate answer is not available may identify an area of potential exposure to liability that should be addressed by appropriate inquiry and remedial action. One critical and perhaps overarching recommendation for plan fiduciaries in this regard is to be proactive in the performance of their obligations.

As noted earlier, employers that offer retirement and other benefit plans, whether or not they undertake broad fiduciary duties as did ABB, would be wise to make periodic comparisons of a diverse selection of service providers as appropriate in view of the size of the plan, the number of participants, the requirements of plan documents, and the exercise of reasonable business judgment. Decisions as to what is offered to participants and the cost for each component of service that are based on weighing multiple potentially applicable factors will tend to insulate employers from liability for breach of fiduciary duty claims (in the absence of p.i.i. self-dealing issues) on the ground that the employer reasonably exercised its discretion.

Judicial decisions in the employee benefit plan areas concerning the selection of vendors of services, covered benefits, and investment options will give some form of deference to a disinterested fiduciary's judgment calls, provided there is some rational basis for the fiduciary's selection among competing potential plan providers and with regard to other discretionary decisions. Note, however, that when courts perceive that there may be a conflict of interests that could affect the employer's judgment, the degree of deference provided may be reduced, and some courts would shift the burden of proof to the employer to show that its interest did not affect its judgment. In *Tussey*, for example, the circumstance that ABB was receiving services for free from RK, alone, might have caused the Court not to give any deference at all to ABB's selection of RK as a Plan service provider."

As a practical matter, in the 401(k) plan context (as in *Tussey*), a service provider comparison would include identifying qualified service providers evaluating and ranking their plan administration capabilities, fiduciary services, and investment menu platform, and whether a provider is limited to offering TPA services, revenue requirements (pricing), fee transparency and cost structures (including revenue sharing). It is unlikely that one candidate would be at the top of each category, thus allowing for the plan sponsor's judgment to play a significant role in the selection process. In addition, the evaluation should include whether the provider's website is "user friendly" in allowing plan participants to obtain investment disclosures, allocate assets among investment options, and determine account status.

Why It May Be Important to Your Administration of Pension Plans for the Supreme Court to Decide If Section 3 of the Defense of Marriage Act Is Enforceable

By: Daly D.E. Temchine and Kenneth J. Kelly

Backgound: The U.S. Court of Appeals for the First Circuit recently ruled that Section 3 of the Defense of Marriage Act ("DOMA")[1] is unconstitutional (*Massachusetts v. U.S. Dep't of Health & Human Servs*., No. 10-2204 (1st Cir. May 31, 2012). This provision defines "marriage" for purposes of federal laws as follows: "The word 'marriage' means only a legal union between one man and one woman as husband and wife, and the word 'spouse' refers only to a person of the opposite sex who is a husband or a wife."[2] This means that federal laws do not recognize marriages of same sex spouses even if valid under a state's law. This definition impacts more than 1,000 federal laws.

The U.S. Department of Justice previously announced that it would not defend this law in the courts and a group formed by members of the U.S. House of Representatives, known as the "Bipartisan Legal Advisory Group" ("BLAG") stepped in to take that role. BLAG filed a Petition for a Writ of Certiorari to the Supreme Court seeking review and reversal of the decision. The Solicitor General filed a Cross-Petition in the case and also filed a Petition for Cert. in *Golinski v. OPM*, a case involving the same issue pending before the Ninth Circuit, before that Circuit had ruled. The lower court in *Golinski* had ruled that DOMA was unconstitutional. The Solicitor urged the Supreme Court to grant certiorari and the odds are very good that the Court will grant certiorari in one or both cases.

We provide you with an early "heads up" about these cases because a Supreme Court decision is likely to have significant and broad implications. Plan sponsors with employees in same-gender spousal relationships will likely feel an impact. Below are a few illustrative examples of potential effects any Supreme Court decision in these or other future cases may have on the administration of employer-sponsored benefit plans.

As a preliminary matter, we address the question of how employers are affected when an employee who is party to a same sex marriage conducted in a state where such marriages are recognized is relocated to a state in which the law does not recognize same sex marriage. DOMA expressly permits each state to decide whether it will recognize same sex marriages lawfully performed in other states. Currently, therefore, it seems that the appropriate response is that employers must deal with the employee and the spouse on the basis of the legal status of same sex marriage in the jurisdiction in which the employee currently is employed. (We note that the question concerning <u>where</u> an employee is employed can be complicated, as are issues relating to employment in one state and residency in another, and is beyond the scope of this article.)

1 Defense of Marriage Act, 1 U.S.C. § 7 (2006).
2 *Id.*

Possible Impact of DOMA Invalidation:

A. Interplay With Social Security Benefits

DOMA denies federal benefits that would otherwise accompany a marriage between individuals of the same sex, even if those individuals are married and residing in states that recognize such marriages. For example, same-sex couples may not collect Social Security survivor benefits if one spouse predeceases the other. Also, since certain pension plan formulas include a Social Security offset or are otherwise coordinated or integrated with Social Security benefits, a ruling that DOMA is unconstitutional could affect these pension plan designs. With DOMA out of the picture, those plans can treat same sex spouses in legally recognized marital relationships in the same manner as opposite gender spouses as both sets of spouses would be eligible to receive the Social Security benefits barred to same sex spouses under DOMA.

B. Retirement Benefits

1. Certain pension plans provide survivor benefits for a surviving spouse (qualified joint and survivor annuities). DOMA prevents same-gender spouses from receiving the protections regarding qualified joint and survivor annuities in ERISA pension plans (although a plan could provide a non-qualified survivor annuity).
2. Hardship distributions from 401(k) plans are permitted if events of financial hardship affect the participant or the participant's spouse. DOMA excludes same-gender spouses from this protection because they cannot be recognized as a "spouse."
3. In sum, a decision affirming the ruling of the First Circuit will change (and, in some respects, simplify) the administration of providing benefits or other protections (e.g. spousal consent requirements) to same-gender spouses.

C. Health and Welfare Benefits

1. Many employers have extended medical coverage to same-sex spouses. But, under DOMA, the employer premium contributions made to a group health plan benefiting both a same-sex spouse and the dependent children of that spouse are not excludable from the employee's federal income tax because the beneficiary is not recognized as a "spouse." Presumably, if the employee legally adopts those children, DOMA is irrelevant regarding coverage of the children. Similarly, the employee may not make a pre-tax contribution under the employer's Section 125 cafeteria plan for the premium the employee contributes for coverage for his or her same-sex spouse. This bar is equally applicable to HSAs, HRAs and FSAs which cannot be tax advantaged with respect to contributions applicable to health care expenditures for a same sex spouse.
2. DOMA has led many employers to develop and administer ERISA welfare benefit programs on the premise that they are not required to offer spousal rights benefits to same-sex spouses, even if a marital relationship is recognized under applicable state law (ERISA, as well as DOMA, preempts state laws for these purposes). If DOMA is found to be unconstitutional, the law will revert to pre-DOMA status and state law will control spousal status and coverage issues, at least in connection with insured plans and, perhaps, with respect to self-funded plans. For example, if an employer offers a health benefit that covers spouses, a state law that recognizes same sex spousal relationships

likely would be interpreted to require employers to provide coverage to all lawful spouses without regard to whether they are of the same gender as the employee.

3. The nullification of DOMA might also have other consequences.
   For example:

- An employer with employees in states that explicitly recognize same sex marriages, as well as states that explicitly prohibit the recognition of such marriages (particularly employers who fund benefits through insurance), could have practical difficulties treating same sex couples and their children uniformly in both sets of states.
- Self-funded employer plans might have an easier time creating plans that are not affected by state laws concerning same sex spousal relationships because ERISA's preemption provisions might shield them against the interference with their benefit plan designs such laws may cause. This is because the only state laws that are permitted to affect the coverage and administration of ERISA plans are laws that "regulate the business of insurance." As self-funded plans do not involve insurance, they would not be subject to any state law that would prohibit insurance policies from treating same sex relationships as if they were lawful marital relationships.

NOTE: The Supreme Court could rule that all discrimination against same sex marital relationships is unconstitutional in the same manner as discrimination on the basis of race is proscribed. In that event, all plans, whether self-insured or insured would have to treat same sex marital relationships in the same manner as they treat opposite sex marital relationships. We believe, however, that the Supreme Court will address this issue carefully and in incremental steps, and is likely to limit its ruling to whether DOMA itself is constitutional, not whether any form of discrimination regarding same sex marriages is prohibited.

Many states, however, have been targeting self-funded plans to bring them under state control by such means as, for example, asserting regulatory control because the states argue that the stop-loss arrangements self-funded plans have created are deemed to convert such plans to insured plan status. (See, *Modeling and Analysis of Stop- Loss Insurance for Use in NAIC Model Act*, Milliman, May 24, 2012, documenting effort of state insurance commissioners to regulate self-funded plans; California S.B. 2114, approved by the Assembly on 8/20/12, (regulating stop-loss insurance required to be purchased by self-funded plans)). State corporate and individual income tax laws also could play an influential role with respect to coverage of same sex spouses and the children of such relationships much in the same manner as federal law does under DOMA. For example, state corporate income tax laws might not allow employers to deduct premium contributions made for coverage of an employee's same sex spouse and for the children of a same sex spouse.

- Various enrollment provisions under the Health Insurance Portability and Accountability Act of 1996 ("HIPAA") pertaining to married couples are not available to participants in same-sex marriages because of DOMA. Currently, employers that desire to treat all marital relationships similarly must negotiate or develop complex arrangements that generally are a higher cost undertaking. If the Supreme Court finds that DOMA is not constitutional, this complexity may be avoided in states that recognize same-sex marital relationships. In the absence of DOMA, as previously explained in "2", self-funded plans could treat same sex marital relationships equally with opposite sex relationships even in states with laws that same sex relationships are not marital relationships.[3]

D. FMLA & COBRA Benefits

Under DOMA, private employers are not required to provide benefits under the Family and Medical Leave Act ("FMLA") and the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA") to spouses in same-sex marriages. This would change if the Supreme Court were to sustain the ruling that DOMA is unconstitutional. Because DOMA prohibits the recognition of same sex relationships as marital relationships for federal law purposes, an employee is not entitled to take time off to care for a same sex partner, even if they are lawfully married under applicable state law, because the partner does not qualify as a spouse under FMLA. The same would be true of that spouse's children. With respect to COBRA, since a same sex spouse is not entitled to be covered under an insured benefit plan that includes spousal coverage, that spouse would not be entitled to a COBRA notice when that coverage terminates.

E. Benefits in States Recognizing Same-Sex Marriages

If DOMA is found unconstitutional, the greatest impact on employers will be in states that recognize same-sex marriages. The reason, as noted earlier, is that the federal laws that govern benefit plans, such as ERISA, HIPAA, and COBRA, as well as the Internal Revenue Code, no longer will treat same-sex relationships in those states as other than ordinary marital relationships. At present, this involves relatively few states. Whether more states will recognize same-sex marriages is uncertain, but this possibility cannot be discounted. Thus, if DOMA is invalidated, significant issues (discussed above) arise as to the treatment of same sex marriages under both insured and self-insured plans (see below).

F. What If The Court Sustains The Decisions That Invalidate Section 3?

The ruling that DOMA is unconstitutional will not of itself require that employers provide coverage to same gender spouses of employees. Employers whose plans do not offer spousal coverage will not be required to do so. Employers who do provide spousal coverage through insurance in states that recognize same sex marriages likely will not be able to purchase coverage that excludes same gender spouses. And employers with plans that cover domestic partners that includes same sex marriages may have to revise the tax treatment of those who are lawfully married under a state's laws. The projection is more difficult with respect to self-funded employers located in such states. In those states, employees who are lawfully married to same sex spouses arguably could raise state law claims that an employer's failure to provide coverage to their spouse constitutes unlawful discrimination. Depending upon the provisions of the state law and the grounds of the Supreme Court's ruling, among other factors, such a claim might be sustained.

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3 **A QUICK NOTE ON PREEMPTION**: The reason for the distinction between self-funded and insured plans is that the states have the ability to regulate the content of insured benefit plans because of the so-called ERISA "Insurance Savings Clause." In ERISA, Congress did not take away the states' historical authority to regulate the business of insurance. ERISA's key preemption provision, however, otherwise prohibits the states from attempting to regulate self-funded plans. Indeed, ERISA has a specific provision called the "Deemer Clause" that expressly prohibits the states from treating self-funded plans as a form of insurance.

In states that enact laws that expressly rule that same sex marriages are not cognizable as marital relationships, the impact of the Court's ruling may depend upon whether the Court rules that the states are free to decide for themselves whether to recognize same gender marriages, and that the holding is applicable only to the federal government. In this circumstance, employers located in those jurisdictions likely would be able to offer insured spousal coverage only to opposite gender marital relationships. Employers who sponsor self-funded plans would be indirectly affected; of course, by state corporate income tax provisions that preclude the taking of deductions for contributions made on behalf same sex spouses or their children. If, however, the Court's ruling rests on the finding that the refusal to treat same sex marriages as lawful is an unconstitutional discrimination, challenges to such states' laws can be expected.

We will keep you apprised as this issue moves through the courts.

ABOUT THE AUTHORS

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IMPORTANT ISSUES IN PENDING CASES

Subrogation: *U.S. Airways, Inc. v. James E. McCutchen* (3rd Cir. November 16, 2011)

I. The Facts

This decision could be significant because, if the ruling of the Third Circuit Court of Appeals is upheld and adopted by the Supreme Court, the ability of ERISA plans to enforce subrogation rights might be severely impaired. This result would depend on the extent to which the defenses available to plan participants with respect to subrogation claims are expanded.

The essential facts are straightforward. McCutchen was an employee of U.S. Airways and a participant in its self-funded health and welfare benefit plan (the "Plan"). He was severely injured in a non-work related accident. The Plan paid $66,866.00 for the medical services McCutchen required.

McCutchen filed a lawsuit against the individual who caused the accident and settlements in the aggregate amount of $110,000.00 were reached. McCutchen's lawyers received 40% of that amount ($41,500.00) ,which they placed in a trust account. McCutchen received $66,000.00.

The Plan documents include a comprehensive and very specific subrogation clause squarely applicable to the circumstances, and U.S. Airways made a demand for reimbursement of the medical costs it paid. McCutchen refused and U.S. Airways filed suit seeking equitable relief under Section 502(a)(3) of ERISA. It sought to recoup the $41,500.00 placed in trust by the attorneys, and $25,366.00 personally from McCutchen.

The District Court entered a judgment in favor of U.S. Airways and required McCutchen to transfer the $41,500.00 in the trust account and to pay an additional $25,366.00 personally. This award left McCutchen with $40,634.00 from the settlement and indebted to his lawyers in the amount of $41,500.00. McCutchen and his lawyers appealed.

II. The Third Circuit's Decision

The Third Circuit vacated the judgment and remanded the case to the District Court. The Third Circuit rejected its own precedents on subrogation on the ground that they had been superseded by subsequent Supreme Court decisions. The McCutchen court acknowledged that the Supreme Court decisions do not address the issue presented by the case (i.e. whether equitable defenses apply that limit either the right to or the amount of the plan's recovery), and had left that issue as an "open question." It decided to answer this "open question," and accepted McCutchen's argument that the term "appropriate," which modifies "equitable relief" in §502(a)(3) makes equitable principles and defenses applicable to a claim brought under that section. Critically, it accepted the argument that the equitable doctrine of "unjust enrichment" is available as a defense to an insured in a subrogation action by a plan.

III. Takeaways

- The implications of *McCutchen* if its holding were to be upheld could be grave and could seriously limit the utility of subrogation clauses, or they might be mild;
- At one extreme, the argument could be made to and accepted by the courts that any carrier which is compensated for and profits from taking risk is unjustly enriched when it can recoup from its insured the costs it incurs by reason of performing the contractual obligations for which it has been compensated;
- Although the preceding argument might not be applicable to self-funded plans, McCutchen confirms that self-funded plans would be equally affected as the U.S. Airways' plan was self-funded;
- Under an alternative construction, for which there is case law that suggests that this interpretation might prevail, unjust enrichment may be defined as a carrier, plan or plan sponsor taking a share of a settlement or judgment without bearing a commensurate share of the fees and costs incurred to obtain that settlement or judgment;
- Indeed, in many subrogation matters in which we have represented plans, we have avoided protracted and costly litigation through such cost sharing arrangements with the participant;
- Many subrogation agreements allow a plan to bring its own separate action against the individual or entity responsible for causing the injuries that required the medical services that were covered by the plan. The advantage of such provisions is that they do not involve a claim by the plan against its member for reimbursement;
    - The disadvantages are that: (i) the plan incurs external and internal costs for the conduct of its litigation, (ii) has to coordinate its strategy with the insured's counsel in order to avoid the presentation of conflicting theories of liability, and (iii) it can be more difficult to negotiate individual settlements with a defendant faced with multiple plaintiffs and multiple liabilities.
- It also is our experience that courts are more receptive to subrogation claims from carriers, plans or sponsors when it is clear from the outset that they are willing to bear a proportionate share of the fees and costs of pursuing claims against the third party that caused the injury resulting in the health care costs.

In sum, although the *McCutchen* decision has a potential to generate seriously adverse effects, it is too soon to say that these effects will be unavoidable and could not be mediated by cost sharing arrangements. However, one very disturbing aspect of the Third Circuit decision is that it sets a precedent that clear and specific plan provisions regarding subrogation rights can be judicially nullified. ERIC is filing *amicus* brief before the Supreme Court in the U.S. Airways case.

Forum Selection Clauses: *Mozingo v. Trend Personnel Serv.,* Dkt. No. 11-3282 (10th Cir.)

- Federal District Court in Kansas dismissed claim for insurance death benefits based on forum selection clause (which required suit to be brought in Texas) set forth in agreement that conferred the benefit.
- The United States Department of Labor ("DOL") submitted *amicus* brief contending that forum selection clauses in ERISA plans are invalid because they allegedly conflict with ERISA's Section 502(e)(2), which allows plan participants to sue "where the plan is administered, where the breach took place or where the defendant resides or may be found."
- While the application of ERISA to the actual substantive benefit in this case is at issue, if ERISA applies, the Tenth Circuit's determination of the enforceability of forum selection clauses will be the first federal appellate court ruling on the issue and may influence the direction of the law in this area.

Judicial Deference: *Frommert v. Conkright,* Dkt. No. 12-67 (2d Cir.)

- On remand from the United States Supreme Court's 2010 decision in this case, which directed that judicial deference in ERISA cases should not be diminished simply because an administrator erred in one determination in an earlier stage of a benefit claim proceeding, the Federal District Court in the Western District of New York endorsed the administrator's construction of certain plan provisions, and the participants appealed.
- DOL submitted *amicus* brief arguing for the application of a "reasonable expectation of participants" standard to an administrator's interpretation of plan provisions.
- Various industry groups, including ERIC, submitted an *amicus* brief supporting broader deference for administrator, without a "reasonable expectations" limitation.
- The Second Circuit's determination in this appeal should further clarify the scope of deference due to administrators in the wake of the Supreme Court's three key decisions since 2008 on benefit claims, *Glenn, Conkright*, and *Amara*.

Please send questions, comments, and related requests to Scott J. Macey or Joan Disler.