Supreme Court Decision on Conflict of Interest

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This discussion is intended to briefly summarize certain recent legal developments in employee benefits, but is not intended to be legal advice and must not be relied upon as such. All readers are urged to raise any concerns they may have based on matters discussed in this column with experienced benefits legal counsel.

In another major decision impacting employee benefit plans, the United States Supreme Court rendered a decision on June 19, 2008, that will significantly affect the administration of employee benefit plan claims decisions for plans subject to the Employee Retirement Income Security Act of 1974 (ERISA).

The case of *Metropolitan Life Insurance Co. v. Glenn* concerned the following facts. Sears, Roebuck & Company maintained a long-term disability plan for employees. This plan was insured and administered by Metropolitan Life Insurance Company (MetLife). In 2000, a Sears employee was diagnosed with severe dilated cardiomyopathy. The employee was granted long-term disability benefits for an initial two-year period under the terms of the plan, which provided that for the first two years an employee was considered "disabled" if unable to perform duties of the employee's own job. The Sears plan also required that an employee apply for Social Security disability benefits. Such benefits, if granted, were offset against the plan benefits. The employee was granted Social Security disability benefits. The Social Security Administration concluded her disability prevented her for performing any job.

In 2003, MetLife told the employee that after the initial two-year period of benefits the definition of disability changed, and she would be required to show she was unable to perform any work for which she was reasonably qualified. MetLife determined the employee could perform sedentary work even though the employee's treating physician expressed the opinion she should not return to work. The employee then filed suit. The District Court found in favor of MetLife; but the Sixth Circuit Court of Appeals reversed, saying MetLife had a conflict of interest that made its decision-making unreasonable.

The Supreme Court accepted the case because there was a conflict among the various Circuit Courts of Appeal as to what importance a court needed to give to an apparent conflict of interest on the part of the claims decision maker. An earlier Supreme Court decision, *Firestone Tire & Rubber Co. v. Bruch*, had said if the administrator of an employee benefit plan is operating under a conflict of interest, the reviewing court has to weigh this as a factor. But the Firestone decision did not say how it should be weighed.

In this new decision, the Court said clearly when an employer both funds a plan and evaluates claims there is an inherent conflict of interest. It stated:

> *The employer's fiduciary interest may counsel in favor of granting a borderline claim while its immediate financial interest counsels to the contrary. Thus, the employer has an "interest . . . conflicting with that of the beneficiaries," the type of conflict that judges must take into account when they review the discretionary acts of a trustee of a common-law trust.*

The question that remained was whether there was still a conflict when the employer funds the plan but hires an outside entity such as MetLife to handle claims determinations. While MetLife argued that there was not a conflict because it had a marketplace interest in providing accurate claims processing, the Court concluded that a marketplace interest is not sufficient:

> *We nonetheless continue to believe that for ERISA purposes a conflict exists. For one thing, the employer's own conflict may extend to its selection of an insurance company to administer its plan. An employer choosing an administrator in effect buys insurance for others and consequently (when compared to the marketplace customer who buys for himself) may be more interested in an insurance company with low rates than in one with accurate claims processing.*
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> *For another, ERISA imposes higher-than-marketplace quality standards on insurers. It sets forth a special standard of care upon a plan administrator, namely, that the administrator "discharge [its] duties" in respect to discretionary claims processing "solely in the interests of the participants and beneficiaries" of the plan. . . .*
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> *Finally, a legal rule that treats insurance company administrators and employers alike in respect to the*

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existence of a conflict can nonetheless take account of the circumstances to which MetLife points so far as it treats those, or similar, circumstances as diminishing the significance or severity of the conflict in individual cases.

After determining that both plan sponsors and third-party entities hired by the plan sponsor can have a conflict of interest, the Court focused on how a reviewing court would take this conflict into account in determining whether a claims denial was proper or not. First of all, the Court made it clear that it was still proper for a court to defer to the judgment of the claims administrator (provided the plan document granted that discretion) as long as the decision was not arbitrary and capricious. Second, it said that a conflict of interest was only one of many factors the reviewing court should consider. The Court did indicate there were some actions an employer could take to make the conflict a less important factor as follows:

The conflict of interest at issue here, for example, should prove more important (perhaps of great importance) where circumstances suggest a higher likelihood that it affected the benefits decision, including, but not limited to, cases where an insurance company administrator has a history of biased claims administration. . . . It should prove less important (perhaps to the vanishing point) where the administrator has taken active steps to reduce potential bias and to promote accuracy, for example, by walling off claims administrators from those interested in firm finances, or by imposing management checks that penalize inaccurate decision-making irrespective of whom the inaccuracy benefits.

The Supreme Court cited with approval the approach taken by the underlying Circuit Court of Appeals in this case. The Court of Appeals was quite disturbed by the fact that MetLife required that the employee seek Social Security disability benefits which require that an individual be unable to undertake any work, offset those benefits against the benefits otherwise payable under the long-term disability plan, yet disregarded Social Security's determination of lifetime disability when it came time to determine whether long-term disability benefits continued after two years under the Sears plan. Furthermore, MetLife failed to provide independent medical experts with all the documentation. These facts together with a conflict of interest led the Court of Appeals to set aside MetLife's claim denial, and the Supreme Court approved this analysis taken by the Court of Appeals and its decision.

In light of this decision, what steps can a medical practice that is the sponsor of an ERISA benefit plan take to ensure the most deference possible will be given to its claims determinations? First, it is important, if possible, for the individual who makes the claims determinations not to be involved in the employer's finances. Second, all claims decisions should be carefully thought out and documented so, for example, the employer does not have to defend the seeming inconsistencies involved in this case. Third, as noted by the Court itself, if an employer uses an outside third-party administrator for claims administration, the employer should research the administrator's reputation for claims paying and make sure that there is nothing in the third-party administrator contract that would indicate a financial incentive exists for denying claims.

PROPOSED DEPARTMENT OF LABOR REGULATIONS WILL SIGNIFICANTLY IMPACT ADMINISTRATION OF 401(K) PLANS

In general, this column does not focus on proposed legislation or proposed regulations as many changes may occur between the date of proposal and final adoption. An exception is being made in the case of proposed regulations issued by the Department of Labor (DOL) concerning required disclosure of fees and expenses under defined contribution plans that permit participants to direct investment of their accounts. In today's marketplace, this means almost all 401(k) plans and a good portion of profit sharing plans as well.

While the regulations were proposed on July 23, 2008, they have an effective date of January 1, 2009. Therefore, although these regulations are only proposed, given these time constraints it is believed the final regulations will follow for the most part the same principles established in these proposed regulations. Because employers that sponsor covered plans will have to not only provide the disclosure of plan expenses to participants but set up mechanisms to obtain relevant data from plan investments and service providers under the plan, it is important to understand now just what major changes in plan administration are required.

While in recent years the DOL has encouraged more detailed fee disclosure so that both plan sponsors and participants can determine how much fees and expenses reduce their investment return, it is believed the release of the proposed regulations at this time is designed to perhaps eliminate the need for legislature proposals now circulating in Congress that would impose even more far-reaching disclosure duties.

The information that must be disclosed falls into two categories: (1) plan information; and (2) investment information. Plan information includes items such as all the investment choices, how investment instructions are given, plan administrative expenses (legal, accounting, recordkeeping), and any expenses that are charged individually to a participant's account such as loans, qualified domestic relations orders, and investment advice. The plan must provide a quarterly statement of all

administrative and individual fees *actually charged* to a given participant's account.

Turning to investment fees, an employer will need to provide in a comparative format, such as a chart, 1-, 5-, and 10-year rates of return; broad-based benchmarks; shareholder fees (i.e., loads, sales charges, redemption fees, surrender charges, exchange fees, account fees. and purchase fees); and operating expenses expressed as a percentage. Fixed rate of return investments would need to disclose all fees relating to the purchase, transfer, or withdrawal from the investment.

These proposed regulations are but a part of a new overall fee disclosure project developed by the DOL to force greater disclosure of hidden fees from plan investments and service providers and to provide for the communication of this information to plan participants in a meaningful way. Other aspects of this project previously published are changes to the annual reporting form (Form 5500) requiring reporting of fees and proposed regulations setting forth what information must be disclosed in contracts between plan service providers and plan fiduciaries. There is no question the disclosure of this fee and expense information will benefit plan sponsors and participants alike, but the transition to this new environment will be challenging as new methods of capturing and reporting these data are developed. ■