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Commentary

Ban Discretionary Clauses in ERISA Matters

Current system precludes meaningful judicial review of claim denials

By Michael E. Quiat

State insurance departments across the country are outlawing the use of discretionary clauses in group health and long-term disability contracts governed by ERISA. However, New Jersey, historically a leader in consumer rights laws, has not acted.

On Sept. 13, 2004, the National Association of Insurance Commissioners adopted the "Discretionary Clause Prohibition Act." Its purpose is to assure that group health and disability benefits are contractually guaranteed, and not subject to an arbitrary determination by claims administrators inherently conflicted by their dual role as claims reviewers and benefit payors. Many states — including California, Illinois, Indiana, Hawaii, Montana, Oregon, Utah and Minnesota — have followed the national association's lead.

Discretionary clauses give plan fiduciaries (in most cases the carrier that issued the policy and must pay out approved benefits) the right to construe plan terms and determine eligibility.

The Supreme Court has said that because of this grant of discretion, such determinations, otherwise subject to de novo review in federal court, are subject

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only to a review for being arbitrary and capricious.

This standard prohibits courts from exercising their own judgment and precludes any meaningful judicial review of claim denials. The result is that employee benefit rights frequently end up being subject to a conflicted plan administrator's decision, with highly limited redress in the courts.

Problems with ERISA and its devastating impact on employee welfare benefits have been well documented. *The Wall Street Journal* reported on Aug. 6 in an article, "The ERISA Trap," that ERISA's reach is now pervasive in the employee health and disability benefits arena.

And because state and federal employees are exempt from ERISA, they might not recognize the seriousness of the problem.

Originally designed to protect workers' rights, ERISA has achieved the opposite result and is now the darling of the health and disability insurance industry, shielding it from such fundamental rights as trial by jury or judge, discovery, right of confrontation and extra-contractual damages. In a famous and comprehensive concurring opinion in *DeFelice v. Aetna U.S. Healthcare*, 346 F.3d 442 (2003), Third Circuit Judge Edward Becker described the "rising judicial chorus" urging Congress and the Supreme Court to address the "unjust ... ERISA regime." He characterized ERISA as a "virtually

impenetrable shield that insulates plan sponsors from any meaningful liability" for wrongful acts committed against plan beneficiaries.

Because ERISA pre-empts state law across the board, attempts by various states to negate its more objectionable provisions have been largely ineffective. However, the pre-emption doctrine does not extend to matters relating to the "regulation" of insurance — a matter reserved to the states.

As a result, state insurance departments across the country are acting to eliminate the discretionary language that gives plan administrators nearly unbridled authority to determine an individual's entitlement to health and disability benefits. Though such action is only the first step in blunting ERISA's exceedingly sharp edges, it will make health and disability carriers more accountable and allow for more effective judicial review of claims determinations.

It is clear that New Jersey possesses the legal authority to act in this arena as other states have done. Aside from being contrary to the most fundamental notions of fairness embedded in our jurisprudence, these clauses are contrary to long-established state law and public policy designed to protect New Jersey consumers. But such statutes cannot be enforced because they are pre-empted by federal law.

The upshot is that tens of thousands of New Jerseyans who believe they have security in their company's long-term disability and health plans are potential-

ly in for a very rude awakening. Among the many problems with these discretionary clauses, perhaps the most vexing is that they allow third-party administrators to determine whether a beneficiary gets any of his or her benefits. Absent action by Congress, which appears

unlikely, states have little control over most of ERISA's inequities. But outlawing discretionary clauses is an area where New Jersey can and must act.

The fact that this matter has not been addressed and corrected in New Jersey is inexplicable. People's lives are

being turned upside down by this problem and yet the state has still not acted. There is no excuse for further delay. I call upon Acting Gov. Richard Codey to enhance his positive legacy by directing the Department of Banking and Insurance to take action on this issue. ■