TEXAS MEDICAL ASSOCIATION

Physicians Caring for Texans

December 21, 2009

The Honorable Michael Geeslin
Commissioner of Insurance
Texas Department of Insurance
333 Guadalupe, MC 113-1C
Austin, TX 78701

Re: Discretionary Clauses in Insurance Contracts—Supplemental Filing

Dear Commissioner Geeslin:

Thank you for this opportunity to submit supplementary comments on the important issue of the Office of Public Insurance Council's Petition for Rulemaking Regarding Discretionary Clauses. The Texas Medical Association (TMA) respectfully requests that this comment letter be considered in addition to our previously submitted letter, dated December 1, 2009.

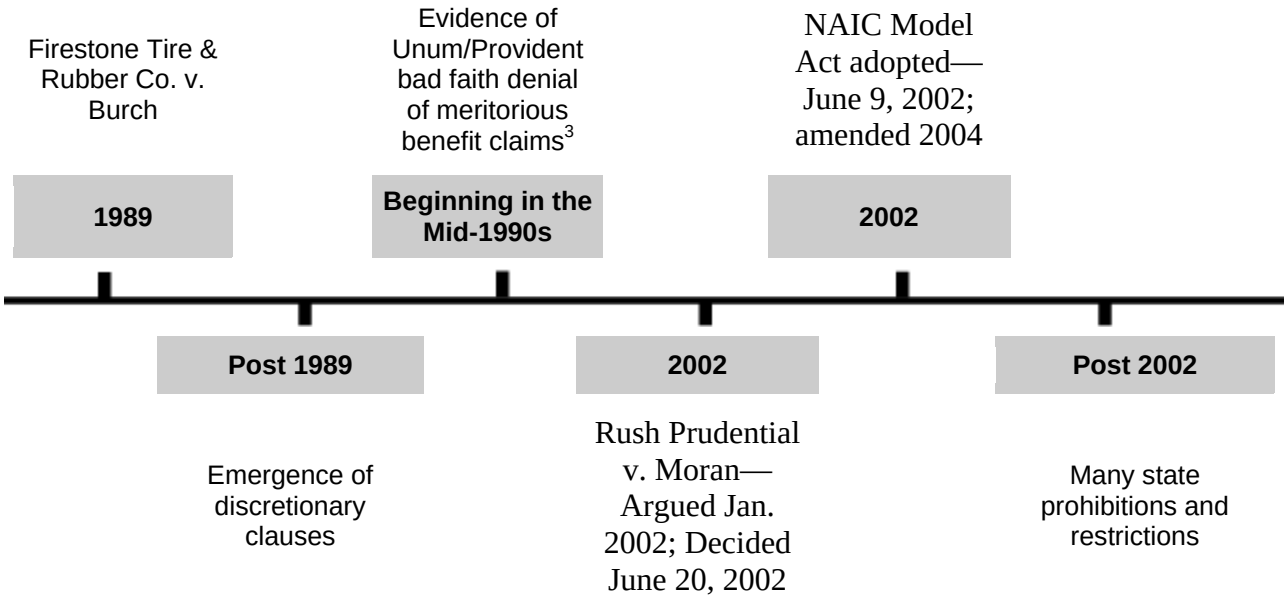
TMA is a private, voluntary, nonprofit association of Texas physicians and medical students. TMA was founded in 1853, to serve the people of Texas in matters of medical care, prevention and cure of disease, and improvement of public health. Today, its maxim continues in the same direction: "Physicians Caring for Texans." Its almost 45,000 members practice in all fields of medical specialization. The Association offers the following comments to the above-referenced petition and proposed rules.

Specifically, TMA would like to use this opportunity to address many of the issues posited by the Commissioner at the December 9, 2009 hearing on discretionary clauses.

Historical Background of ERISA and Discretionary Clauses

First, the Commissioner specifically requested information regarding the historical background of discretionary clauses and the sequence of events occurring from the U.S. Supreme Court decision of *Firestone Tire & Rubber Co. v. Bruch*[1] to the present. By reviewing the timeline included on the next page, one may better understand both the need for a prohibition on discretionary clauses at the state level and the permissibility of such a prohibition under the Employee Retirement Income Security Act of 1974 (ERISA).[2]

[1] 489 U.S. 101, 115 (1989).
[2] 29 U.S.C. §1011, *et seq.*



As the timeline above indicates, the genesis of discretionary clauses in insurance policies followed the U.S. Supreme Court case of *Firestone Tire.* In *Firestone,* the Supreme Court was presented with an opportunity "to resolve conflicts among the Court of Appeals as to the appropriate standard of review in actions under §1132(a)(1)(B)" of ERISA.[4] Importantly, the U.S. Supreme Court noted in *Firestone* that "ERISA [itself] does not set out the appropriate standard of review for actions under §1132(a)(1)(B) challenging benefit eligibility determinations."[5]

Without a mandate regarding the standard of review imposed by ERISA and prior to *Firestone,* many federal courts of appeal began applying the arbitrary and capricious standard as the default standard of review for denial of benefits under ERISA, which was an importation of the law from the Labor Management Relations Act of 1947.[6] In *Firestone,* the U.S. Supreme Court expressly rejected this standard as the default standard, instead applying principles from trust law and stating that "the trust law de novo standard of review is consistent with the judicial interpretation of employee benefit plans prior to the enactment of ERISA."[7] Further, the Supreme Court acknowledged that "ERISA was enacted 'to promote the interests of employees and their beneficiaries in employee benefit plans'"[8] and "adopting Firestone's reading of ERISA [i.e., a reading that all benefit determinations under ERISA be subject to arbitrary and capricious review] would require us to impose a standard of review that would afford ***less*** protection to employees and their beneficiaries than they enjoyed before ERISA was enacted."[9]

Taking the aforementioned factors into consideration, the U.S. Supreme Court held that the default standard of review for claims denial cases under ERISA was the de novo standard "unless the

[3] John H. Langbein, *Trust Law as Regulatory Law: The Unum/Provident Scandal and Judicial Review of Benefit Denials Under ERISA*, 101 Nw. U. L. Rev. 1315 (Spring 2007).
[4] *Firestone*, *supra* note 1 at 108.
[5] *Id*. at 109.
[6] *Id*.
[7] *Id.* at 112.
[8] *Id*. at 113 (citing *Shaw v. Delta Airlines, Inc*., 463 U.S. 85, 90, 103 S. Ct. 2890, 2896, 77 L.Ed. 2d 490 (1983)).
[9] *Id*. at 113-114 (emphasis added).

benefit plan gives the administrator or fiduciary discretionary authority to determine eligibility for benefits or to construe the terms of the plan."[10] This holding simultaneously expressed a preference for the de novo standard of review as a protection to employees and their beneficiaries and opened the door to the inclusion of discretionary clauses in insurance policies.

As one would expect, insurance companies soon began to take advantage of the highly-deferential standard of review available through the use of discretionary clauses related to ERISA plans and introduced these clauses into their insurance policies.

Following *Firestone*, a highly-publicized scandal involving Unum Provident Corporation, the nation's largest insurance company that specialized in disability, brought to light the negative implications of *Firestone*'s holding with many allegations of bad faith denials of meritorious benefit claims emerging.[11] The Unum/Provident Scandal was publicized in 2002 through lawsuits and television news programs such as "60 Minutes" and "Dateline."[12] Shocking allegations of the pressure imposed on claims processors to deny legitimate claims were made.[13]

As Yale Law Professor John Langbein stated in a 2007 law review article:

> As regards Unum's ERISA-governed policies, Unum's program of bad faith benefit denials was all but invited by an ill-considered passage in an opinion of the United States Supreme Court, Firestone Tire & Rubber Co v. Bruch, which allows ERISA plan sponsors to impose self-serving terms that severely restrict the ability of a reviewing court to correct a wrongful benefit denial.[14]

Further elaborating on the abuses uncovered in the lawsuits against Unum, Langbein writes:

> In the course of discovery proceedings …, there came to light a remarkable internal memorandum written in 1995 by a Unum executive. In it, he exults the 'enormous' advantages that ERISA, as interpreted by the courts, bestowed upon Unum in cases in which an insured sought judicial review of a benefit denial. '[S]tate law is preempted by federal law, there are no jury trials, there are no compensatory or punitive damages, relief is usually limited to the amount of the benefit in question, and claims administrators may receive a deferential standard of review.' The memorandum recounts that another Unum executive 'identified 12 claim situations where we settled for $7.8 million in the aggregate. If these 12 cases had been covered by ERISA, our liability would have been between zero and $0.5 million.' We see in this document Unum's keen understanding of how the deferential standard of review under Bruch interacts with aspects of ERISA remedy law to facilitate aggressive claim denial practices.[15]

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[10] *Id*. at 115.
[11] Langbein, *supra* note 3 at 1315-1316.
[12] *Id.* at 1318-1319(citing Dateline: Benefit of the Doubt (NBC television broadcast, Oct. 13, 2002) and 60 Minutes: Did Insurer Cheat Disabled Clients? (CBS television broadcast, Nov. 17, 2002)
[13] *Id.* at 1318-1321.
[14] *Id.* at 1316 (citation omitted).
[15] *Id*. at 1321 (citations omitted).

As a result of the ensuing litigation, many federal courts have remarked upon what they deemed the questionable claims denial procedures of Unum.[16] One court even stated that they "bordered on outright fraud."[17]

With the highly-publicized scandal regarding Unum in 2002, the insurance commissioners of many states began to take notice of the use of discretionary clauses and to take action to ban such clauses. In 2002, the National Association of Insurance Commissioners (NAIC) considered and adopted the Discretionary Clauses Model Act, which prohibited the use of discretionary clauses in health insurance policies.[18] The rationale for the adoption of this Model Act and its 2004 extension to disability insurance policies was based upon: (1) the belief "that discretionary clauses were inconsistent with basic insurance consumer rights,"[19] (2) the desire to "assure that the reasonable expectations of the claimant would be protected under an objective, contract-based standard for claims,"[20] (3) the need to avoid a conflict of interest when a carrier has the discretionary authority to determine the insured's benefits,[21] and (4) a recognition of "the long-standing principle that any ambiguities in an insurance policy must be interpreted in favor of the insured person."[22]

Further pursuing the alleged abuses by Unum, the NAIC and its members conducted a multi-state market conduct examination in 2003, which examined Unum claims practices.[23] Notably, Texas participated in this examination.[24] The Unum Multistate Examination Report ultimately led to a settlement of over $120 million and a $15 million fine against Unum.[25] Additionally, the state of California entered into a separate settlement agreement with Unum and imposed another $8 million civil penalty.[26] As part of the California settlement agreement, Unum agreed to discontinue use of discretionary clauses in any California contract sold after a specified date.[27]

At the same time that the NAIC was considering the passage of its Discretionary Clauses Model Act in 2002, the U.S. Supreme Court was also considering the case of *Rush Prudential HMO, Inc. v. Moran*, which specifically addressed the standard of review for benefit denials.[28] In this case, the Court considered whether Illinois' independent review statute was preempted by ERISA. The

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[16] *Id*. at 1320.
[17] *Id*. at 1320 (citing *Watson v. UnumProvident Corp*., 185 F. Supp. 2d, 579, 585 (D. Md. 2002).
[18] 1 Proc. Of the Nat'l Ass'n Of Ins. Comm'rs 4, 12-13 (2002).
[19] Brief for National Association of Insurance Commissioners as Amicus Curiae in Support of Respondent in the case of Metropolitan Life Insurance Co. v. Glenn, No. 06-923 in the Supreme Court of the United States –on writ of certiorari to the United States Court of Appeals for the Sixth Circuit, Amicus Brief, Filed Mar. 31, 2008, at 9 (citing 4 Proc. Of the Nat'l Ass'n of Ins. Comm'rs 4, 12-13 (2003)[hereinafter "NAIC amicus brief"].
[20] NAIC amicus brief, *supra* note 19 at 9 (citing Prohibition on the Use of Discretionary Clauses Model Act, Technical Amendment and Project History. 2 Proc. Of the Nat'l ass'n of Ins. Comm'rs 10, 17 (2002)).
[21] NAIC Discretionary Clauses Model Act, Section 2, Purpose and Intent; *see also* Brief for National Association of Insurance Commissioners, *supra* note 19 at 11.
[22] NAIC amicus brief, *supra* note 19 at 10.
[23] Nat'l Ass'n of Ins. Comm'rs, Report of the Targeted Multistate Market Conduct Examination**,** *available* at http://www.maine.gov/pfr/insurance/unum/Unum_Multistate_ExamReport.htm ; *see also* NAIC amicus brief, *supra* note 19 at 15.
[24] *Id*.
[25] *See* NAIC amicus brief, *supra* note 19 at 15 (citing Joint Press Release , Multi-State Settlement Addresses Concerns Regarding Unum-Provident Claims Handling (Nov. 18, 2004); *available at* http://www.state.tn.us/commerce/pdf/press/prsRls111804.pdf.
[26] *See* NAIC amicus brief, *supra* note 19 at 16 (citing California Settlement Agreement, File No. DISP05045984, available at http://www.secinfo.com/d14D5a.z5UXK.d.htm#1stPage).
[27] California Settlement Agreement, File No. DISP05045984, *available at* http://www.secinfo.com/d14D5a.z5UXK.d.htm#1stPage).
[28] *Rush*, 536 U.S. 355 (2002).

Court held that the statute regulated insurance in accordance with ERISA's savings clause and that it did not conflict with ERISA's exclusive remedies.[29] Thus, it was not preempted by ERISA.[30] Importantly, the Court rejected Rush's argument that the statute was at odds with ERISA's system of uniform enforcement and a deferential standard of review for benefit denials.[31] The Court stated the following:

> Not only is there no ERISA provision directly providing a lenient standard for judicial review of benefit denials, but there is no requirement necessarily entailing such an effect even indirectly…. Nothing in ERISA, however, requires that these kinds of decisions be so 'discretionary' in the first place; whether they are is simply a matter of plan design or the drafting of an HMO contract. In this respect, then, [Illinois' independent review statute] §4-10 prohibits designing an insurance contract so as to accord unfettered discretion to the insurer to interpret the contract's terms. As such, it does not implicate ERISA's enforcement scheme at all, and is no different from the types of substantive state regulation of insurance contracts we have in the past permitted to survive preemption, such as mandated-benefit statutes and statutes prohibiting the denial of claims solely on the ground of untimeliness.[32]

Encouraged by the strong language and favorable holding of *Rush*, a flurry of state activity prohibiting discretionary clauses soon followed. As of 2008, the NAIC reported that at least 12 states had measures (adopted in varying forms, including bulletins, regulations, and statutes) restricting or prohibiting the use of discretionary clauses in some shape or form.[33]

As expected, some state prohibitions on discretionary clauses were soon challenged by insurance companies and their trade associations. In 2009, two U.S. Court of Appeals Circuit Court cases were decided, thereby removing any lingering doubt as to the propriety of state regulation of this area. On March 28, 2009, the U.S. Court of Appeals, Sixth Circuit held that a rule adopted by the Michigan Office of Financial and Insurance Services, which prohibited insurers from issuing, advertising, or delivering to any person in Michigan, a policy containing a discretionary clause, was not preempted by ERISA.[34] The Court held that (1) the rule fell within ERISA's savings clause for state laws that regulate insurance and substantially affect the risk pooling arrangement, and (2) it did not "create, duplicate, supplant, or supplement any of the causes of action that may be alleged under ERISA."[35]

Similarly, on October 27, 2009, the U.S. Court of Appeals, Ninth Circuit, held that the practice of the Montana Commissioner of Insurance disapproving insurance policy forms containing discretionary clauses was not preempted by ERISA.[36] Once again, this Court held that the practice (based upon a Montana statute that required the commissioner to disapprove any form containing ambiguous or misleading clauses that deceptively affect the risk assumed in the general coverage of

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[29] *Id*. at 384-388.
[30] *Id*.
[31] *Id*.
[32] *Id*. at 385-386 (citations omitted).
[33] *See Standard Insurance Co. v. Morrison*, 584 F.3d 837, 841 (9th Cir. 2009).
[34] *American Council of Life Insurers v. Ross*, 558 F.3d 600 (6th Cir. 2009).
[35] *Id*. at 607.
[36] *Standard Insurance Co. v. Morrison*, *supra* note 33.

the contract) fell under ERISA's savings clause, because it regulated insurance companies[37] and substantially affected the risk pooling arrangement.[38] The Court specifically noted that "the Commissioner's practice is directed at the elimination of insurer advantage, a goal which the Supreme Court has identified as central to any reasonable understanding of the savings clause."[39] Additionally, "it creates no new substantive right, offers no additional remedy not contemplated by ERISA's remedial scheme, and institutes no decisionmakers or procedures foreign to ERISA."[40]

The Sixth and Ninth Circuit Court opinions and the timeline discussed above, therefore, lead us to the present time and the issue of OPIC's petition which is before you. In analyzing the petition, we may now state that the proposed rule is supported by:

- the state's authority and responsibility to regulate insurance under the McCarran-Ferguson Act;[41]
- the Commissioner's authority under Texas Insurance Code Section 1701.060;
- Texas' longstanding common law regarding contra proferentum (i.e., the interpretation of contracts against the drafter);[42]
- the U.S. Supreme Court's preference for a de novo standard as expressed in *Firestone*;[43]
- the U.S. Supreme Court's analysis in *Rush Prudential*;[44]
- the protective intent of ERISA;[45]
- the NAIC's Model Act and its intent to prevent conflicts of interests;[46]
- the goal of the savings clause of ERISA[47] and
- the holdings of two U.S. circuit courts on this precise issue.[48]

As stated previously, the interpretation of insurance policies is approached by Texas courts utilizing contract law theories. TMA respectfully suggests that you and your department not be distracted by carriers' arguments regarding ERISA. The U.S. Supreme Court's interpretation of the ERISA relationship as one between a trustee and beneficiary is not the law for insurance contracts and is not the law that provides you with the authority to regulate the business of insurance in Texas. Texas law regulating insurance (e.g., Texas Insurance Code Section 1701.060) provides the Commissioner with the authority to prohibit discretionary clauses. As the U.S. Supreme Court itself stated in *Rush* with regard to Illinois' independent review statute:

> … this effect of eliminating an insurer's autonomy to guarantee terms congenial to its own interests is the stuff of garden variety insurance regulation through the

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[37] *Id*. at 842. Specifically, the court stated "it is well-established that a law which regulates what terms insurance companies can place in their policies regulates insurance companies." (citing *See, e.g., Kentucky Ass'n*, 538 U.S. at 337, 123 S. Ct. 1471).
[38] *Id*. at 844-845.
[39] *Id*. at 849.
[40] *Id*.
[41] McCarran-Ferguson Act of 1945, 15 U.S.C. §1011, et. seq.
[42] *See, e.g., Balandran v. Safeco Ins. Co. of America*, 972 S.W.2d 738 (Tex., 1998), citing, *National Union Fire Ins. Co. v. Hudson Enegery Co.*, 811 S.W. 2d 552, 555 (Tex. 1991).
[43] Firestone, *supra* note 1 at 115.
[44] *See generally*, Rush, *supra* note 28.
[45] *Firestone*, *supra* note 1 at113 (citing *Shaw v. Delta Airlines, Inc*., 463 U.S. 85, 90, 103 S. Ct. 2890, 2896, 77 L.Ed. 2d 490 (1983)).
[46] NAIC Discretionary Clauses Model Act, Section 2, Purpose and Intent; *see also* Brief for National Association of Insurance Commissioners, *supra* note 19 at 11.
[47] *Standard Insurance Co. v. Morrison*, 584 F.3d at 849.
[48] American Council of Life Insurers v. Ross, *supra* note 34 and Standard Insurance Co. v. Morrison, *supra* note 33.

> imposition of standard policy terms. …It is therefore hard to imagine a reservation of state power to regulate insurance that would not be meant to cover restrictions of the insurer's advantage in this kind of way.[49]

With the recognition of all of the foregoing indicating that a prohibition on discretionary clauses is both necessary and proper through state regulation, it is incumbent upon Texas to take the necessary steps to protect its patients. At a time when criticism regarding the state of health care coverage has reached a fever pitch and captured the national spotlight, it is imperative that Texas demonstrate its commitment to protecting the rights of its patients to full review of their benefit denials. Certainly we can all agree that the citizens of this state are equally deserving of the same level of protection as that which is provided to citizens in states that have prohibited the use of discretionary clauses. Thus, TMA respectfully requests that the Commissioner grant the Public Insurance Counsel's petition and prohibit discretionary clauses through its rulemaking authority under Texas Insurance Code Section 1701.060 and as an unfair and deceptive trade practice.

Once again, TMA thanks you for the opportunity to provide these supplementary comments. If you should have any questions or need any additional information, please do not hesitate to contact me or the following staff of the Texas Medical Association: Donald P. "Rocky" Wilcox, JD, TMA Vice President and General Counsel; Lee A. Spangler, JD, TMA Vice President, Division of Medical Economics; or Kelly Walla, JD, LLM, TMA Associate General Counsel at TMA's main number 512-370-1300.

Sincerely,

William H. Fleming III, MD
President

Cc: The Honorable Rick Perry
Governor of Texas

Deeia Beck, Public Counsel
Office of Public Insurance Counsel

[49] Rush, *supra* note 28 at 387.