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CLIENT ALERT

Supreme Court Narrows ERISA Preemption Protection For Insured Employee Benefit Plans

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Boxing judges might call the Supreme Court's latest pronouncement on ERISA preemption a split decision. In *UNUM Life Insurance Co. of America v. Ward,* 1999 U.S. LEXIS 2839(April 20, 1999), the Court resolved two preemption issues presented in that case. The Court gave one to each side and sent the case back to the lower courts. *Ward* thus disappointed those who (perhaps wistfully) hoped for additional clarification regarding the scope of ERISA preemption of benefits claims litigation involving insured plans. On balance, the Court's decision could turn out to be a significant cutback in the scope of ERISA preemption that may result in more litigation over claims disputes. The Court's decision may also have an impact on the various "patients rights" proposals now pending in Congress.

Ward arose over a dispute over an application for benefits under a group long-term disability plan maintained by Ward's employer. The claim was submitted to UNUM which denied it as untimely. Ward then filed suit under Section 502(a) of ERISA, 29 U.S.C. § 1132(a), which authorizes beneficiaries of an ERISA plan to sue to recover benefits due under the terms of the plan. The district court granted summary judgment to UNUM on timeliness grounds. The Ninth Circuit reversed, concluding that Ward's claim might not be untimely under the 'notice-prejudice' rule applied in California. California courts hold that a claim under an insurance policy cannot be rejected by the carrier as untimely merely because it may not have been received by the carrier within the time limit set by the insurance contract. California courts, instead, require the insurance company to show actual prejudice from the late-filed claim. Rejecting the carrier's argument, the Ninth Circuit concluded that the notice-prejudice rule was saved from ERISA preemption as a law that "regulates insurance," within the meaning of the "savings clause" of Section 514(b)(2)(A) of ERISA. Alternatively, the appellate court reasoned that because Ward's employer had timely notice of the claim under the terms of the policy, his claim should be deemed timely under California case law holding that an employer that administers an insured group health plan should be deemed the agent of the insurance company. The court concluded that this "general principle of agency law" should not be subject to ERISA preemption because it did not "relate to" employee benefit plans within the meaning of the general preemption provision of Section 514(a) of ERISA. Because the appellate court determined that there were factual issues both as to the prejudice issue and the role of Ward's employer in administration of the plan, the court concluded it was inappropriate to grant UNUM summary judgment.

In a unanimous opinion, the Court adopted half of the Ninth Circuit's reasoning. The Court concluded that ERISA does not preempt the California notice-prejudice rule, agreeing with the Ninth Circuit that this rule was covered by the savings clause. The Court then held that the California agency rule was subject to ERISA preemption, because application of that rule "related to" employee benefit plans.

The Court's treatment of the notice-prejudice rule followed the preemption analysis articulated in its 1985 decision in *Metropolitan Life Ins. Co. v. Massachusetts.* First, the Court concluded that, as a matter of common sense, the Ninth Circuit was correct in concluding that the California rule was directed specifically at the insurance industry and applicable only to insurance contracts. The Court here distinguished *Pilot Life v. Dedeaux¸* concluding that the California notice-prejudice rule, unlike the

Mississippi law of bad faith held preempted in *Pilot Life*, "is distinctive most notably because it is a rule firmly applied to insurance contracts, not a general principle guiding a court's discretion in a range of matters."

The Court then determined that the notice-prejudice rule fit within the "business of insurance" as that term is used in the McCarran-Ferguson Act. Here the Court explicitly rejected UNUM's argument that the California rule must satisfy each of the three McCarran-Ferguson Act factors articulated in *Metropolitan Life*. Describing these factors as "guideposts, not essential elements," the Court concluded that the notice-prejudice rule served an integral part of the policy relationship between the insurer and the insured, and that the rule was limited to entities within the insurance industry. The Court also rejected UNUM's argument that application of the notice-prejudice rule would conflict with substantive provisions of ERISA.

The Court's discussion of the agency point was comparatively brief. Stating that the Ninth Circuit was "mistaken," the Court held that the California agency rule would have "a marked effect on plan administration" and was thus "related to" an employee benefit plan within the meaning of the preemption provision of Section 514(a) of ERISA.

The Court's decision may be most noteworthy in the context of the Clinton Administration's view of ERISA preemption. As we noted in a past issue of our *Update* publication, the government filed an *amicus curiae* brief in *Ward* agreeing with the plaintiff's view of the notice-prejudice rule. In a press release, Labor Secretary Alexis Herman called the *Ward* ruling "an important step forward in the effort to protect patients' rights." Both the Court's opinion and Herman's press statement acknowledge the Administration's change in position regarding the scope of ERISA preemption in claims dispute litigation, notably the government's effort to modify its earlier understanding of the Court's landmark decision in *Pilot Life*. Herman has now announced the Administration's intention to have *Pilot Life* reversed or severely limited, so that ERISA is not read "to restrict the states' ability to provide insurance remedies for employees or their dependents who have been denied benefits by their employers' health plan plans." For those who may be unfamiliar with "BeltwaySpeak," Herman's advocacy of "insurance remedies" includes changing the law to permit compensatory and punitive damages in benefits claims litigation, remedies currently available in state court tort lawsuits typically tried before juries.

By our count, *UNUM v. Ward* is the Court's seventeenth decision on various aspects of ERISA preemption since 1981. Like its forbearers, *Ward* is unlikely to resolve the debate over the proper scope of Section 514 of ERISA. The Court's analysis of the notice-prejudice rule is a much more flexible application of the rule articled in *Metropolitan Life*. To that extent, *Ward* is likely to make it easier for plaintiffs to argue that a wide range of state law concepts should be applicable in benefit claims cases brought under Section 502 of ERISA. On the other hand, employers, managed care companies and insurers who value ERISA preemption as a bar against malpractice and other tort claims can take some comfort from the standard articulated by Justice Ginsburg with respect to the agency issue. Whether Congress will help clarify these issues in the context of the upcoming political debate over proposals to "reform" managed care and enhance "patients rights" remains to be seen.

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