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August 31, 2006

Alfred W. Redmer, Jr.
Insurance Commissioner, State of Maryland
Maryland Insurance Administration
525 St. Paul Place
Baltimore, MD 21202-2272

Re: Discretionary Clauses in Disability and Health Insurance Policies

Dear Commissioner Redmer:

Request for Declaratory Ruling Regarding Discretionary Clauses

I am requesting that the Commissioner immediately take steps to protect the insurance consumers in Maryland from the insurance industry's unfair grant of discretionary authority to itself with respect to disability income and health insurance benefit claims by taking the following action:

- Issue a declaratory ruling pursuant to Stat. §§ 12-205, 12-206, 15-201, *et seq*. that discretionary authority clauses in disability and health policies issued by insurance companies doing business in this jurisdiction are in violation of the insurance code.
- Revoke or withdraw any prior approval of forms with discretionary authority clauses.
- Adopt the NAIC Discretionary Clause Model Act 42 effective immediately, as commissioners in several other states have already done.

The NAIC adopted the Discretionary Clause Prohibition Act on September 13, 2004. This Act states the following:

> The purpose of this act is to assure that health insurance benefits and disability income protection coverage are contractually guaranteed, and to avoid the conflict of interest that occurs when the carrier responsible for providing benefits has discretionary authority to decide what benefits are due.

The Act also states:

> No policy, contract, certificate or agreement offered or issued in this state providing for disability income protection coverage may contain a provision purporting to reserve discretion to the insurer to interpret the terms of the contract, or to provide standards of interpretation or review that are inconsistent with the laws of this state."

Many states have already adopted the NAIC Discretionary Clauses Model Act by statue, including Maine, Oregon, and Minnesota. Discretionary clauses have been found to be in

violation of the state insurance laws in the states of California, Utah, Montana, Hawaii, Indiana, and Illinois with other states considering taking similar action.

California
On 2/26/04, the General Counsel for the Californian Insurance Commissioner issued a legal opinion finding discretionary clauses to violate the rights of policyholders and rendering the insurance contract "fraudulent or unsound insurance" in violation of California's Insurance Laws.

The California Department of Insurance then issued a notice to withdraw approval and order for information, withdrawing approval of disability policy forms containing discretionary clauses.

Hawaii
On 3/8/05, the Hawaii Senate passed S.B.140 prohibiting the use of discretionary clauses in insurance contracts.

Illinois
On 7/15/05, 29 Illinois Register 10172 prohibiting discretionary clauses in disability policies as well as summary plan descriptions.

Indiana
On 5/8/01, the Indiana Insurance Commissioner, issued Insurance Bulletin 103 prohibiting the use of full and final discretionary clauses in group health insurance.

Montana
On 5/8/03, Montana issued Rules I and II prohibiting discretionary clauses in insurance policy forms.

Oregon
ORS 742.005(2) and (3), NAIC Discretionary Clause Model stating that plans including discretionary clauses do not give a company full and final discretion in interpreting its insurance contract. It goes on to state that discretionary clauses are considered inequitable, deceptive, and misleading to consumers.

Utah
On July 29, 2002, the Utah Insurance Commissioner issued Bulletin 2002-7 which prohibits discretionary clauses. Discretionary clauses were described as inequitable, misleading, deceptive, obscure, unfair, not in the public interest, otherwise contrary to law, and encourage misrepresentation and violate a statute.

Grounds for Adoption of the Model Act with Declaration of All Discretionary Clauses Void

<u>Insured are unfairly deprived of entitlement to benefits set forth in policy language.</u>

The Insurance Commissioner is charged with the duty to protect consumers by voiding any clauses which unjustly or unfairly deprive insureds of the protection of the covenant of good

faith and fair dealing. Under the guise of "discretion" to interpret and apply the policy; in opposition to the doctrines of reasonable expectations and *contra proferentum*- insurance companies have unfairly construed the language of the policy to deny legitimate claims.

The language of the discretionary clauses makes eligibility for benefits contingent on the insurer's discretion, rendering the policy ambiguous at best and illusory at worst. When making a decision whether to pay the premium for coverage, the consumer insured is presented with a policy which *seems* to set out clear requirements to qualify for benefits. But the policyholder cannot rely on the benefits provided in the general coverage section, as eligibility for benefits and *interpretation* of those policy terms is subject to the insurer's whim. Worse, the insurer's interpretation is typically influenced and/or conflicted by self interest – i.e. payment of the claim increases costs and reduces profits. This conflicted analysis is made worse for consumers because the carrier's grant of discretion to itself triggers a court review far more favorable to carriers. With the grant of discretion to itself, the carrier's denial decision becomes subject to review under the arbitrary and capricious doctrine, which is far more burdensome for consumers than the standard de novo review. See *Firestone Tire & Rubber Co. v. Bruch*, 489 US 101 (1989). In other words, the consumer is led to believe he is purchasing a policy with seemingly clear language when he is actually receiving a policy subject to unexpected interpretation rendering the coverage illusory.

Discretionary clauses are deceptive and misleading since they give the insurer unfettered control over benefit decisions. Generally, polices with such a clause would be subject to the policy of *contra proferentum*, and such insurance contracts would be found to be an improper contract of adhesion.

As the party administrating the plan, the insurer has a fiduciary duty to the beneficiary. This duty is breached by insertion of a discretionary clause into its policies so as to permit the insurer to interpret language to its own interest rather than being bound to the best interests of the insured. This results in a conflict of interest that is all too often present in relationships between the insurer and its insured.

<u>Discretionary Clauses Injure the Consumer.</u>

Insurers argue that the grant of discretion has no impact on the decision making process as it only effects that standard governing judicial review. The fallacy of this argument has been addressed in *Johnson v. Allsteel*, 259 F.3d 885. 8^{88} Cir. 2001) in which it was ruled that discretionary clauses significantly increase the risk of denial as:

> [t]he administrator has an incentive to avoid intense scrutiny by the courts (such processes can be costly and time consuming) and is therefore more likely to choose an interpretation that will be favored by the reviewing court.

This decision went to hold that if an administrator knows that his decision will be subject to *de novo* review he will be more likely to adopt a more reasonable interpretation than if he believes he will be reviewed under that highly deferential standard of arbitrary and capricious

review. This was further emphasized in the finding that: "[t]he very existence of 'rights' under such plans depends on the degree of discretion lodged in the administrator." *Id*.

The language at issue in these policies purports to confer "discretionary authority" to determine eligibility for benefits under the policy and to "construe the terms of policy." This language should be found to be in violation of this jurisdiction's insurance law in the following ways:

- Discretionary authority clauses purport to give an insurer unfettered discretion to determine benefit eligibility and/or interpret policy terms and conditions.
- Discretionary clauses cause the policies to be ambiguous, misleading, unjust, unfair, inequitable, and to serve to reduce the risk purported to be assumed in the general coverage of the policy relied upon at the time of purchase.
- Discretionary clauses significantly limit the ability of policyholders to collect benefits otherwise payable under the policies and thus the benefits provided are unreasonable in relation to the premium charged.
- Discretionary clauses are deceptive as they give the impression to a policyholder that the insurer's decision or interpretation is final and binding when it is for courts applying the rule of law and accepted rules of construction to make such final decisions and interpretations.
- Discretionary clauses make coverage illusory as they make the eligibility of the policyholder uncertain due to dependence on unlimited discretion of the insurer rather than on the actual written terms of the policy as applied to the pertinent claim facts.

Insurers frequently work under a conflict of interest and are often predisposed towards denying benefits. This fact has been the cause of voluminous litigation in this area. As such, states bear the responsibility to regulate insurance companies so as to balance the conflict of interest and prevent insurers from not honoring valid claims made rather than the current system which allows for uncertain claims adjudication and frequent claim denials.

<u>The Seemingly Harmless Appearance of Discretionary Clauses Hides Their Injurious Use by Insurers.</u>

Although discretionary clauses may seem harmless on their face, they serve as an instrument to insulate insurers from liability, allowing them to deny valid claims. The Supreme Court held that the denial of benefits under an ERISA plan is generally reviewed under the plenary or *de novo* standard of review. *Firestone Tire and Rubber Co. v. Bruch*, 489 U.S. 101, 115 (1989). Under this standard, the courts decide on the basis of all the evidence whether or not the claimant is entitled to benefits.

Then, the Court went on to say that if a plan explicitly provides for discretionary authority to determine eligibility that the standard for review becomes elevated to the highly deferential arbitrary and capricious (also termed abuse of discretion) standard. *Id*. Under this deferential standard, the court is not free to substitute its own judgment for that of the plan administrator's and is only entitled to reverse if found to be unreasonable only if the decision is not a product of a deliberate, principled reasoning process. *Bernstein v. Capital Care, Inc.*, 70

F.3d 783, 788 (4th Cir. 1995). This review is made even more stringent by the holding that a discretionary decision will not be disturbed except to prevent an abuse of discretion **even if the court itself would have reached a different conclusion**. *Booth v. Wal-Mart Stores, Inc. Assocs. Health & Welfare Plan*, 201 F.3d 335, 341 (4th Cir. 2000)(emphasis added).

Even the litigation process is limited under the arbitrary and capricious standard of review as the court's review is restricted to the claims record consisting of materials before the plan administrator at the time he made the determination. This insulates the insurer to an even greater extent as financial motives for denying the claim cannot be discovered as part of the litigation process. This is particularly disturbing where insurers act in the dual capacity as administrators where an unavoidable conflict of interest is apparent. Even with this very common and transparent conflict, the evidence of the conflict is only weighed as a "factor" in the review analysis. *Smith v. Continental Cas. Co.*, 369 F.2d 412, 417 (4th Cir. 2004). In the end, the insured has no recourse in litigation to discover the facts for the claim denial so as to present the underlying rationale for the denial of the claim including all economic considerations. This places the insured at an enormous disadvantage in proving the conflict of interest as the facts to prove such a case cannot be obtained in most circumstances. Therefore, fair judicial review of the claim is defeated via the discretionary authority clause.

This firm has handled and is currently handling claims for insured who suffer from a myriad of serious illnesses and injuries for which insurers have denied claims based on discretionary authority to review and deny claims. Examples include:

- A bank manager who suffers from Major Depressive Disorder, Recurrent, Severe with Psychotic Features
- A travel representative who was disabled from Multiple Sclerosis
- An audit director who suffers from Systemic Lupus Erythematosus who is further prevented from working due to regular IV infusion treatment
- A newspaper editor who is disabled from Chronic Fatigue Syndrome

The extensive litigation in these matters, usually ending in payment to the claimant, could be avoided if the discretionary clause was not permitted. The enormous expense to the consumer to litigate these cases is very advantageous to wealthy insurers who can afford to perpetuate these cases to see if claimants can withstand litigation with its concordant voluntary impoverishment. It is very difficult for claimants to hire attorneys when they are being denied benefits by the same entities who hire large law firms to litigate against them.

<u>Insurance Regulations Are Not Preempted under ERISA.</u>

Although a plan is governed by ERISA, each state remains empowered to determine what language may appear in a policy issued, including a policy insurance benefits provided by a plan. *FMC Corp. v. Holliday*, 498 U.S. 52, 64 (1990)

The ERISA savings clause, § 514(b)(2)(A) stipulates that insurance regulations and law are not preempted. *Unum v. Ward*, 526 U.S. 375 - 7 (1999); *Kentucky Assn of Health Plan, Inc. v. Miller* 538 U.S. 329 (2003). Further, ERISA does not require discretionary clauses in policies.

Rush Prudential HMO, Inc. v. Moran, 536 U.S. 355 (2002).

Insurers Routinely Claim That Discretionary Clauses Do Not Harm the Consumer.

Insurers argue that the grant of discretion has no impact on the decision making process as it only effects the standard governing judicial review. The Seventh Circuit of Appeals recognized the fallacy of this argument in *Johnson v. Allsteel*, 259 F.3d 885 (7th Cir. 2001). The court concluded that a discretionary clause significantly increases the risk of denial as "[t]he administrator has an incentive to avoid intense scrutiny by the courts (such processes can be costly and time consuming) and is therefore more likely to choose an interpretation that will be favored by the reviewing court." Thus, if an administrator knows that his decision will be subject to *de novo* review he will be far more likely to adopt a reasonable interpretation than if he believes he will be reviewed under the highly deferential arbitrary and capricious standard." *Id*. at 889. To put it bluntly, "[t]he very existence of 'rights' under such plans depends on the degree of discretion lodged in the administrator." *Id*. at 888.

It is widely recognized that insurers frequently work under a conflict of interest and are often predisposed towards denying benefits. As such, the state has the responsibility to regulate insurance companies in such a way that balances the conflict of interest and provides insurers with an incentive to honor valid claims when they become due. The state must work to protect its citizens be ensuring that insurers are not able to escape liability for denying benefits when they become due.

Discretionary Clauses Unfairly Tilt the Balance to the Insurers and Hurt the Consumer.

With the balance of power already leaning towards the insurance industry which is much better funded than impoverished consumers who have been denied benefits, the discretionary clause invoked standard of review makes it nearly impossible for the consumers to get the benefits to which they are entitled. The bargaining position is so inequitable that many consumers are forced to decide between settling for far less than the amount to which they would otherwise be legally entitled or face a court which has a limited power to review the denial of benefits. This is an unjust situation that needs to be remedied.

For the reasons stated, I request that this State adopt the Model Act and declare that discretionary clauses are contrary to state law and be prohibited. I further request that any forms containing such clauses be disapproved and that prior approval of any forms containing such clauses be withdrawn or revoked.

I welcome any opportunity to address these issues with the Insurance Commission.

Respectfully,

Elliott Andalman

ATTACHED EXHIBITS

Exhibit A: California Department of Insurance Notice to Withdraw Approval (2/27/04)

Exhibit B: Legal opinion issued by the General Counsel for the California Insurance Commissioner finding discretionary clauses violative of California insurance laws

Exhibit C: Memorandum 2004-13(H) issued by Hawaii's Insurance Commissioner (12/8/04)

Exhibit D: 29 Illinois Register 10172 (7/15/02)

Exhibit E: Indiana Insurance Bulletin (5/8/01) prohibiting discretionary clauses in group health policies

Exhibit F: Montana Notices and Bulletins (3/17/03) referencing the adoption by the State Auditor of rules pertaining to the disapproval of discretionary clauses in insurance policy forms (5/8/03)

Exhibit G: Oregon Discretionary Clause Model Act, Oregon Revised Statute 742.005, as stated in the Standard Provisions for Group Health Benefit Plans issued by Oregon Insurance Division

Exhibit H: Bulletin 2002-7- Discretionary Clauses Prohibited - Issued by Utah Insurance Commissioner (7/29/02)

Exhibit I: Article by Mark DeBofsky, Chicago attorney and Adjunct Professor of Law at the John Marshall Law School, entitled "Why Discretionary Clauses Must Be Prohibited"

Exhibit J: Letter to commissioners of NAIC by Mila Kofman, Assistand Professor, Health Policy Institute, Georgetown University (8/9/04) to adopt the model act prohibiting discretionary clauses with respect to disability insurance

Exhibit K: Letter to commissioners of NAIC to adopt the model act prohibiting discretionary clauses with respect to disability insurance signed by 19 non-profit public advocacy groups (6/10/04)

Exhibit L: NAIC Prohibition on the Use of Discretionary Clauses Model Act (9/3/04)

Reply via email at eandalman@a-f.net

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