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EMPLOYER RECORD-KEEPER MISTAKES AND INSURER LIABILITY

Round Table Discussion

March 28, 2023

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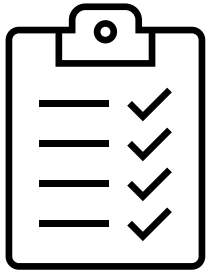
Issues Addressed:



- Intersection of employer/record-keeper and insurer
- Examples of record-keeper mistakes
- When can the insurer be liable
- Avoiding liability
- Other ways to address liability
- Business Considerations

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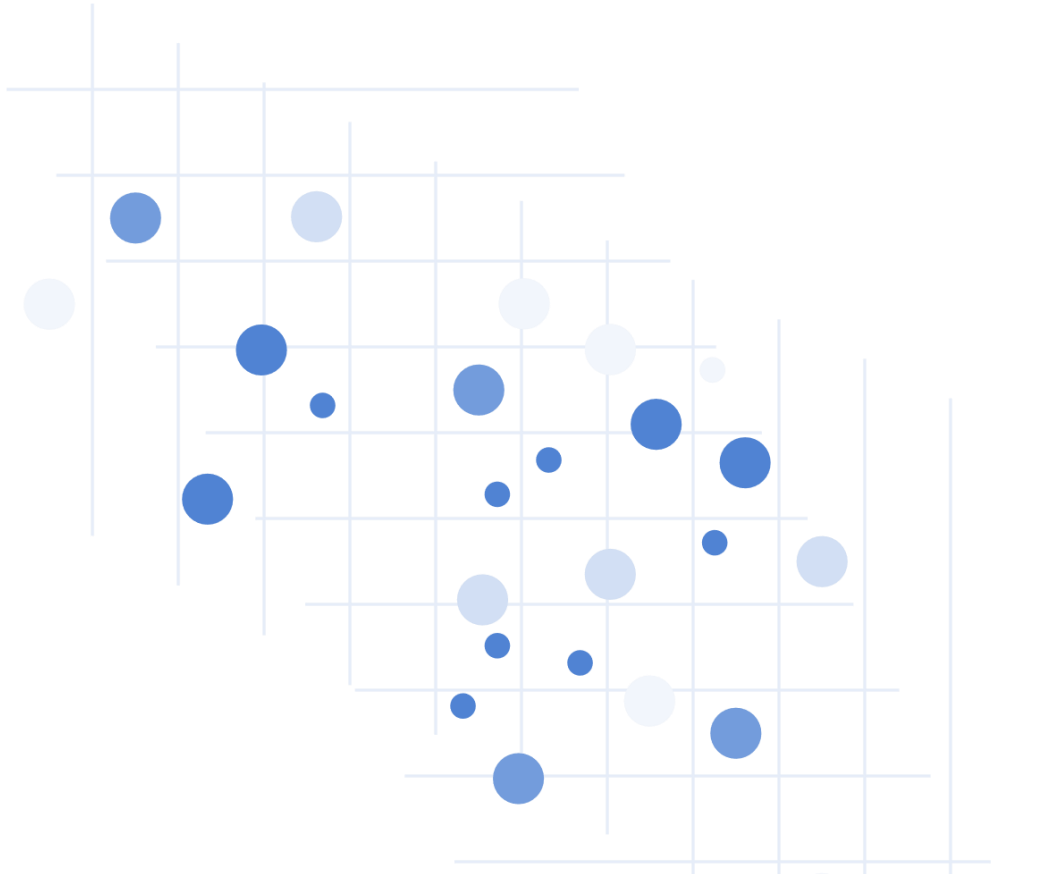
Scenario Giving Rise to Issue

- Insurance company issues group policy to employer/professional trade group or association
  - ERISA and non-ERISA
- Rather than using the Insurance Company for Record-Keeping, the Contract-Holder/Employer either maintains records in-house or contracts with TPA for record-keeping
  - Cost or Volume Concerns
  - Small and Large Employers
- Insurance company always obligated to pay any benefits due under contract

Examples of Record-Keeper Mistakes

- Failure to record beneficiary designation
- Recording improper designation (i.e., from an agent via POA, unsigned or incomplete form…)
- Failure to enroll, collect or allocate payment resulting in lapse in coverage
- Lack of notice of portability or conversion



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Results of These Record-Keeping Mistakes

- Interpleader whenever possible
  - Or even quasi-interpleader
- Extra-contractual liability
- Allocating liability

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Insurer Liability for Employer Contract Holder/Recorder-Keeper Error

- ERISA vs. non-ERISA
- Split by state – minority vs. majority view
- Effect of disclaimer or Master Contract language
- Indemnification
- Business Considerations for Allocating Liability

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Agency

- Agency is created by mutual consent.
- Does not need to be by express agreement. It may be implied by the conduct of the parties.
- Determination of an agency relationship may be a question of either fact or law.

ERISA vs. Non-ERISA

Unum Life Insurance Co. of America v. Ward, 526 U.S. 358, 378, 119 S. Ct. 1380, 1391-92, 143 L.Ed.2d 462, 478-79 (1999), *reversing*, 135 F. 2d 1276 (9th Cir. 1998): the U.S. Supreme Court held that ERISA preempts state agency law on the issue of whether the employer acts as the agent of the employee or the insurer.

The Court's decision in Unum v. Ward essentially does away with agency theory but there could liability and other issues to consider as a result of ERISA's provision to preserve "any law of any State which regulates insurance" under 29 USC §1144(b)(2).

In Ward, the Supreme Court held that California's common law rule that the employer acts as agent for the insurer was not a "law . . . which regulates insurance." Therefore, the Court found California's agency law preempted. The Court held that the other issue identified by the Ninth Circuit – California's requirement that an insurer show prejudice for late notice to be a defense – was a "law . . . which regulates insurance." The Supreme Court held that California law on this issue not preempted by ERISA. Unum Life Ins. Co. of America v. Ward, *supra*, 526 U.S. at 375, 119 S. Ct. at 1390, 143 L.Ed 2d at 477.

Unum v. Ward Take-Away

- Did not address federal common law on agency re Boseman v. Connecticut General Life. Ins. Co., 301 U.S. 196, S.Ct. 686 (1937).
- Inference is that the Supreme Court found that ERISA totally preempts state and federal common law on agency. Therefore, traditional agency law is totally displaced and plays no part in allocating rights and liabilities among employees, employer, and insurer for purposes of an ERISA group plan.
- No fact-sensitive inquiry.

However….

State Statutes Regulating Insurance Are Not Preempted By ERISA.
See 29 U.S.C. §1144(b)(2)(A) - ERISA "Savings" Clause.

What does this mean? If not preempted by ERISA, State law (*e.g.* Notice of Conversion Statute) applies as to whether the Insurer can be held liable, even when an ERISA Group Plan is involved. This was the case in Unum (California) and in Northeastern Hospital (Pennsylvania).

Yet…

Even if the Insurer can be found liable under State law, some State statutes allow Insurers to avoid liability by delegating obligations to the Employer.

Example:

Pennsylvania Conversion Notice Provision provides:

A group contract issued by an insurer may contain a provision to the effect that notice of such conversion privilege and its duration shall be given by the contract holder to each certificate holder upon termination of his group coverage. 40 P.S. §756.2(d)(19).

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Delegating Duty and Avoiding Liability When Employer Fails to Give Notice:

"Moreover, the [Conversion Notice] provision indicates that the insurer can even protect itself against such liability by drafting the group policy so that the group policyholder [Employer] has the sole obligation to notify the individual insured."

See Northeastern Hosp. v. John Macko & Virginia Macko & Pilgrim Life Ins. Co.,1988 WL 679871 (Pa. Com. Pl. Oct. 17, 1988).

Non-ERISA:
Minority vs. Majority View States

Minority View: Employer acts as the agent of the insurer for purposes of group insurance.

Majority View: Employer acts as agent for the employee and not the insurer for purposes of group life insurance.

Minority View: Employer acts as the agent of the insurer
Alabama
California
Colorado
Georgia
Iowa
Louisiana
Massachusetts
Montana
Nebraska
Oklahoma
Texas
Virginia

Majority View: Employer acts as the agent for the employee
Arkansas
Connecticut
Florida
Illinois*
Indiana
Kansas
Kentucky
Massachusetts
Mississippi
New Hampshire
New Jersey*
New York
North Carolina
Pennsylvania
Tennessee

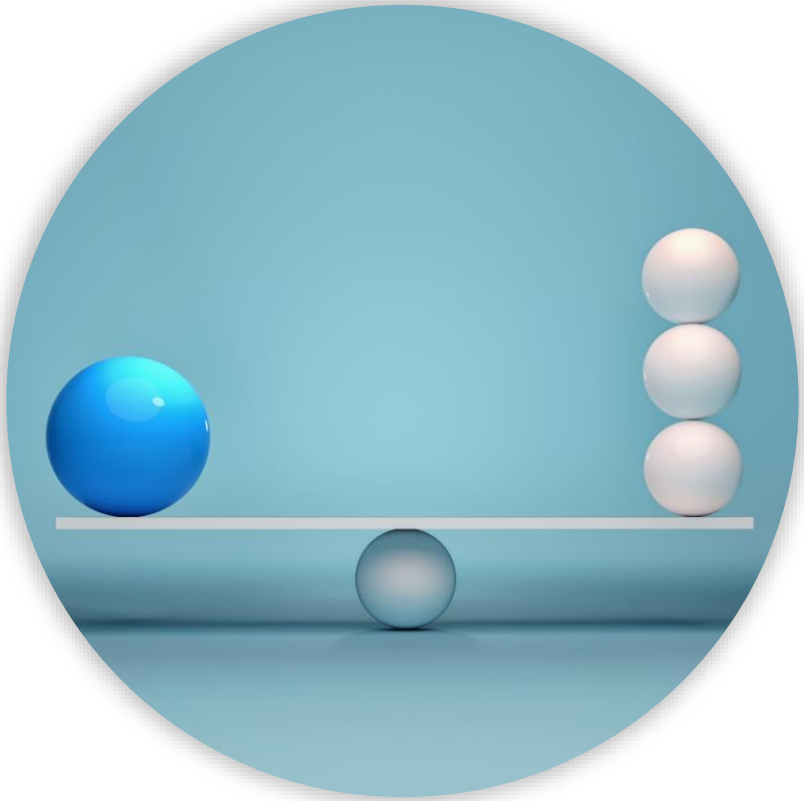
Direct Comparison of Competing Views

Situation:

Employer continued to deduct premium contributions from the employee's wages for several months after the group policy terminated due to the employer's failure to timely pay premiums to the insurer. Notice given to the employer but the insured had no notice of the employer's default or termination of the group plan at the time of the insured's death. Employee dies, beneficiary is denied benefits and then sues.

Same basic situation, two outcomes:

- Majority View – Beneficiary was not entitled to benefits because the employer was not the insurer's agent and, therefore, the premium payments to the employer were not considered payment to the insurer to keep the coverage in force. *Boger v. Prudential Ins. Co. of America*, 259 N.C. 125, 130. 130 S.E.2d 64 (1963).
- Minority View – Beneficiary was entitled to benefits and insurer liable because the *insurer* was under a duty to inform the employee about the termination. *New York Life Ins.. Co. v. Love*, 163 Colo. 7, 428 P.2d 364 (1967).



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Majority View Explained

- The general rule in the group insurance context has been that various actions taken by an employer in procuring and administering a group policy of insurance are done on behalf of the employer and its participating employees
- Thus, the employer is not an agent of the insurer even where they perform administrative tasks in connection with the Group Policy
- Practically speaking, works the same way as group policies governed by ERISA

Majority View – Examples No Liability

- Employee tendered premium payment to insurer who refused to accept it. Held: this was not a tender to the insurance company. Rivers v. State Capital Life Ins. Co., 245 N.C. 461, 96 S.E.2d 431 (1957): Though recognizing "diversity of opinion" among jurisdictions, the Court declared that "it is definitely held [in North Carolina] that the employer in a group insurance policy is not ordinarily the agent of the insurance company.
- An employer is not the agent of the insurance company in order to revive a terminated group policy. Wyatt v. Security Ben. Life Ins. Co., 178 Kan. 91, 283 P.2d 243 (1955).
- Insurer was not liable where it relied on information provided by employer and employer's records had omitted an employee's name as a covered individual. Hanna v. Mt. Vernon Life Ins Co. of N.Y., 260 F.2d 244 (8th Cir. 1958).
- Insurer not liable to beneficiary after relying on information from the trustees of a group fund to cancel policy. Schwartz v. Mutual Ben. Life Ins. Co., 28 Misc.2d 367, 212 N.Y.S.2d 359 (Sup. 1961), aff'd 14 A.D.2d 754 (1st Dept. 1961).

Minority View Explained

In contrast to the Majority view, a significant minority of jurisdictions characterize the employer as an agent of the insurer. Or, at a minimum, Minority view jurisdictions are willing to deem the employer an agent of the insurer depending on the factual circumstances in which the specific issue(s) in the case arises. For example, where certain administrative tasks are expressly delegated to employer, the Courts will find agency for those specific delegated functions.

Kirkpatrick v. Bos. Mut. Life Ins. Co., 393 Mass. 640, 644–46, 473 N.E.2d 173, 176–77 (1985): Rejecting the "older 'conventional' rule" that reasoned "that an employer serves its own interests and those of its employees—rather than the adverse interests of the insurer—when it assumes administrative responsibilities. And then noting: "With the tremendous expansion of the group insurance market, a growing minority of courts have come to realize that the insurer is equally benefitted by employer-administered plans. It cannot be said that the employer acts entirely for its own benefit or for the benefit of its employees in undertaking administrative functions. While a reduced premium may result if the employer relieves the insurer of these tasks, and this, of course, is advantageous to both the employer and the employees, **the insurer also enjoys significant advantages from the arrangement**. The reduction in the premium which results from employer-administration permits the insurer to realize a larger volume of sales, and at the same time the insurer's own administrative costs are markedly reduced." (internal quotations omitted.)

Thus, by the employer taking on these functions that would ordinarily have been performed by the insurer, a benefit is conferred upon the insurer.

…Continued

Kirkpatrick v. Bos. Mut. Life Ins. Co., 393 Mass. 640, 644–46, 473 N.E.2d 173, 176–77 (1985):

"Inferring the existence of an agency, a number of courts have held insurers responsible for administrative errors committed by employers (or other group policyholders) who act on their behalf." Citing:

John Hancock Mut. Life Ins. Co. v. Dorman, 108 F.2d 220, 222–223 (9th Cir.1939)
Clauson v. Prudential Ins. Co., 195 F.Supp. 72, 80 (D.Mass.), aff'd on other grounds, 296 F.2d 76, 79 (1st Cir.1961) (applying Delaware law)
Blue Cross-Blue Shield v. Thornton, 56 Ala.App. 678, 684, 325 So.2d 187 (1975)
Metropolitan Life Ins. Co. v. State Bd. of Equalization, 32 Cal.3d 649, 659, 186 Cal.Rptr. 578, 652 P.2d 426 (1982)
Woodard v. Prudential Ins. Co., 350 So.2d 948, 952 (La.App.1977)
Norby v. Bankers Life Co. of Des Moines, Iowa, 304 Minn. 464, 465, 231 N.W.2d 665, 667 (1975)
Hirsch v. Travelers Ins. Co., 153 N.J.Super. 545, 553, 380 A.2d 715 (1977);
Baum v. Massachusetts Mut. Life Ins. Co., 357 P.2d 960, 964 (Okla.1960);
Paulson v. Western Life Ins. Co., 292 Or. 38, 636 P.2d 935, 941 (1981).

Examples of Minority View Cases

California State law follows the minority rule that employers generally act as agent for the insurer. See Elfstrom v. New York Ins. Co., 67 Cal. 2d 503, 432 P. 2d 731, 63 Cal. Rptr. 35 (1967).

While some later courts and commentators have viewed Elfstrom as applying a bright-line rule that the employer acts as agent for the insurer for all purposes, the Ninth Circuit did not. Rather, after finding state agency law was not preempted by ERISA, the Ninth Circuit concluded that Elfstrom requires a case-by-case review of the facts to determine whether, under California's common law of agency, the employer acted as agent for the insurer. Accordingly, the Ninth Circuit reversed and remanded to the district court for further fact-findings on whether the employer was agent of the insurer, and, if not, whether the insurer suffered prejudice from the late notice. Ward v. Management Analysis Co. Emp. Disability Benefit Plan, 135 F.3d 1276, 1289 (9th Cir. 1998).

Minority View- Examples of Agent Liability

- Cason v. Aetna Life Ins. Co., 91 Ga.App. 323, 85 S.E.2d 568 (1954): Knowledge of employer that employee was not working and, therefore, not eligible for coverage was imputed to insurer. By accepting premiums for an increased amount of insurance with that knowledge imputed to it, the insurer was estopped from denying coverage based on ineligibility for the increased coverage.
- Baum v. Massachusetts Mut. Life Ins. Co., 1960 OK 225, 357 P.2d 960, 964: "In the instant case, employer procured the group policy, accepted applications for insurance thereunder, determined whether an applicant was eligible for insurance and paid the premiums owing under the policy. In performing these functions employer acted as the agent of insurer, and since it so acted, insurer is charged with knowledge possessed by employer while so acting."
- Paulson v. W. Life Ins. Co., 292 Or. 38, 48, 636 P.2d 935, 941 (1981). The Court held that: (1) if an employer is charged with performance of functions incident to administration or sales of insurance which are commonly performed by insurer, it is proper to say that employer is insurer's agent for those purposes.

Explaining the Case by Case/Question of Fact View

Ultimately, the Kirkpatrick Court held that it was a question for fact for the jury to decide whether there was an agency:

"Whether or not the employer acts as the insurer's agent is a factual question to be resolved on a case by case basis. Among the criteria to consider are (1) whether the task is expressly delegated to the employer by the insurer; (2) whether the employer's performance is subject to the insurer's supervision and control; (3) whether there is any evidence of collusion between employer and employee to defraud the insurer.

Blue Cross-Blue Shield of Alabama v. Thornton, 56 Ala. App. 678, 683, 325 So. 2d 187, 191 (Civ. App. 1975): "The existence of agency should be determined by an examination of the facts of each case."

Case-specific Analysis, Liability Found

Employer found to be agent of insurer in connection with the following administrative duties under the group policy:

Accepting applications from employees:	Kentucky Home Mut. Life Ins. Co. V. Marshall, 291 Ky. 120, 163 S.W.2d 45 (1942).
Determining employee eligibility:	Baum v. Massachusetts Mut. Life Ins. Co., 1960 OK 255, 357 P.2d 960 (Okla. 1960).
Receiving notices:	Patterson v. John Hancock Mut. Life. Ins. Co., 27 Ill.App.2d 135, 169 N.E.2d 183 (2nd Dist. 1960).
Enrolling an ineligible person where they should not have:	Elfstrom v. New York Life Ins. Co., 67 Cal.2d 503, 63 Cal. Rptr. 35 (1967).
Collecting premiums:	Somog v. West Virginia & Kentucky Ins. Agency, 110 W. Va. 205, 157 S.E. 400 (1931).

Case by Case/Question of Fact View

It's important to keep in mind that even in jurisdictions where Courts have found the employer to be the agent of the insurer for certain administrative functions, it does not mean the employer is the agent of the insurer generally, even where the employer may be deemed the agent for several functions. It is a fact-specific inquiry for purposes of liability.

Majority View Flip-Side: No Agency = Insurer Liability?

- While the Majority View rule generally benefits the insurer, it can sometimes work the other way. Court found Employer not the agent of the insurer which resulted in liability to insurer.
  - For example, an insured requested that the employer cancel his insurance but the employer did not relay the request to the insurer prior to the employee's death. The Court held there was no effective notice to the insurer since the employer/policyholder was not its agent. As a result, the insurer was liable for payment under the policy. Eason v. Aetna Life Ins. Co., 212 Cal. App. 2d 607 (disapproved of by Elfstrom and does not reflect the current view in California).
  - Similar result reached where employee had notified the employer of facts which would have reduced the amount of coverage but the information was not passed on to the insurer. Insurer held liable for the higher amount. Whitfield v. Metropolitan Life Ins. Co., 262 F.Supp. 977 (W.D. ARk 1967).

Disclaimers – Do They Work

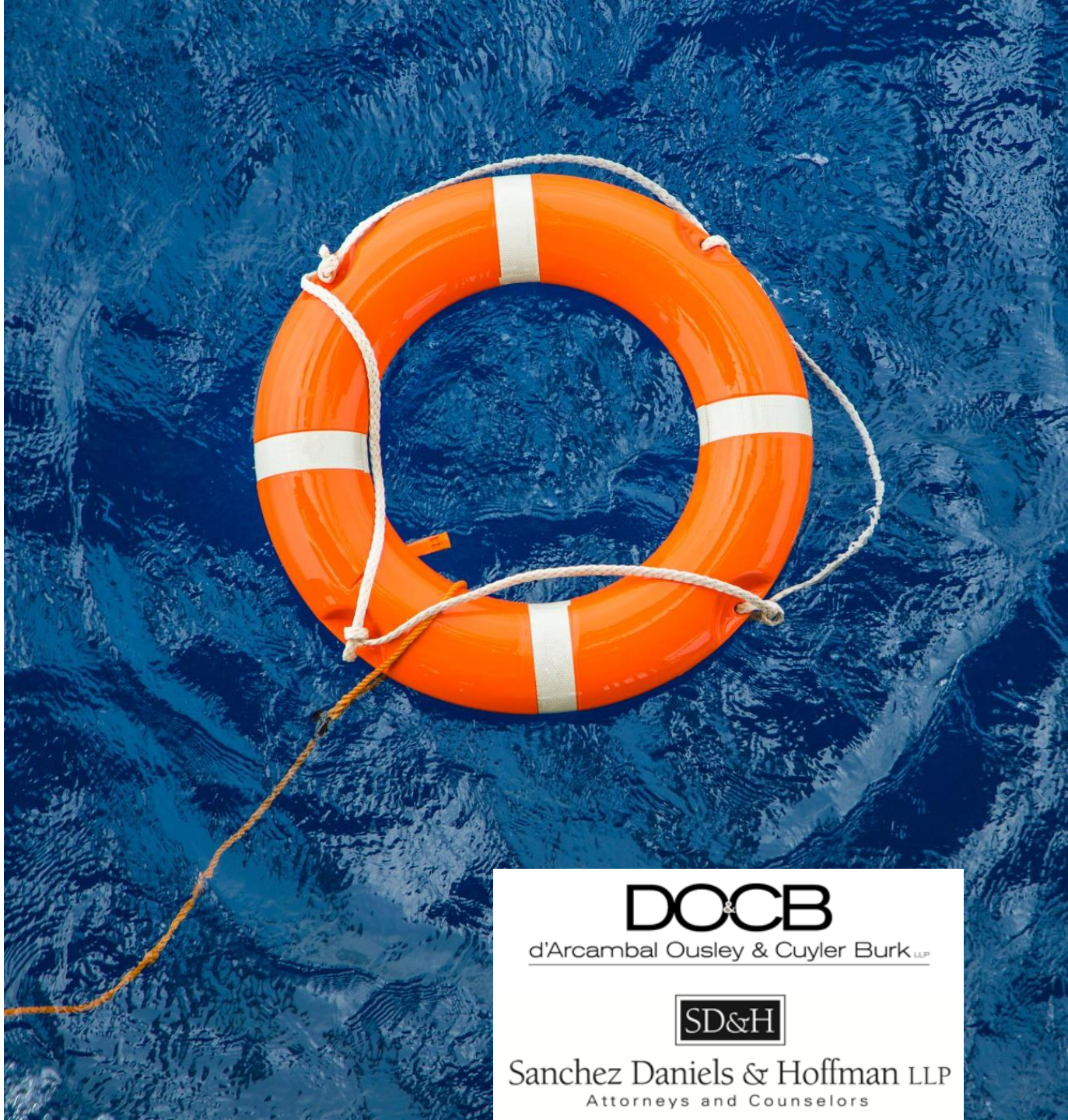
Effect of Disclaimer language in group/master contract between insurer and employer:

Under well-established principals of agency law, a statement by the agent and principal as to the absence of an agency relationship or limitations placed upon the agency relationship cannot bind third parties. 2A Corpus Juris Secundum, Agency § 7 (1972)

Example: Hirsch v. Travelers Ins. Co., 153 N.J. Super 545, 553 (App. Div. 1977): New Jersey cases holding that insurers are responsible for administrative errors committed by employers (or other group policyholders) who act on their behalf. Court noted that Master Policy attempted to disclaim that Employer was agent of Insurer, however, the disclaimer was not controlling, and therefore, Insurer cannot be discarged from liability via interpleader.

What Else Can the Insurer Do To Avoid Liability?

- Choice of Law Within Contract – opting for majority view states
- Other contractual safeguards: Indemnification from "agent"



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Group Plan Indemnification:

The EMPLOYER must furnish to COMPANY data as may be required by COMPANY. Such data may include, without limitation, a list of Covered Persons who are to be covered under the Policy, completed applications of the Insureds, ... It is the EMPLOYER's obligation to notify COMPANY no later than thirty-one (31) days after the effective date of any change in a Covered Person's status under the Policy. All such notifications by the EMPLOYER to COMPANY must be furnished in a format approved by COMPANY and must include all information reasonably required by COMPANY to effect such changes. It is further understood and agreed that the EMPLOYER is liable for any substantive errors made by the EMPLOYER in keeping or reporting data which may materially affect an individual's coverage under the policy and for any benefits paid for a terminated Covered Person if the EMPLOYER had not timely notified COMPANY of such Covered Person's termination.

The EMPLOYER hereby agrees to indemnify and hold harmless COMPANY and its employees and agents for any loss, damage, expense (including, but not limited to, reasonable attorneys' fees and costs) or liability that may arise from or in connection with untimely and/or inaccurate data provided by the EMPLOYER to COMPANY or data furnished by the EMPLOYER to COMPANY in a format not approved by COMPANY.

Indemnification Case Scenario:

Case Facts: Employer wrongfully instructed Insurer to terminate Employee's Coverage under Group Plan.

Employer Errors:

1) Untimely Notice to Employee for Election of Conversion Coverage
2) Miscalculating Deadline for Payment of Premium < Statutory Period

Result: EMPLOYEE v. INSURER

AVOIDING LIABILITY WITH INDEMNIFICATION CLAUSE:

1) Tender of Defense Letter to Employer
2) Third-Party Complaint v. Employer
3) Motion for Summary Judgment
4) Settlement

Liability Avoided – Does it Even Matter?

Relationship Issues between insurer and employer even where no agency invoked

Business Considerations

Cost of Doing Business, Very Large Contracts

If Liability Cannot Be Avoided:

Case Strategy When There Could be Liability (or business considerations)

- Choice of Law Within Litigation – arguing for majority view states
- Shoe-horning as interpleader anyway where there are record-keeping errors, whether agency liability or not
- Sharing Liability
- Settling favorably with release to employer as well to avoid second lawsuit

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