

Seven “Deadly Sins” To Avoid When Negotiating Self-Funded Benefits Plans

By Rhonda D. Orin and Daniel J. Healy

Every year, an increasing number of employers decide to self-fund the medical benefits they provide to their employees. They are drawn to readily apparent advantages, such as up-front cost-savings, tax benefits and avoidance of state laws. Yet many employers may not fully understand the small print behind their self-funded benefits plans. In particular, they may not appreciate important nuances that can impact the three principal documents of self-funding: third-party administrator (TPA) agreements, stop-loss insurance policies and summary plan descriptions.

Understanding these contracts, and how they interact with insurance regulations, state laws and the Employees’ Retirement Income Security Act of 1974 (ERISA) can save employers significant headaches and expense. Whether starting up a self-funded plan, or renewing an existing one, employers should keep the following considerations in mind:

1. *Don’t Assume Responsibility for Making Final Determinations*

TPA contracts often attempt to provide that employers, rather than TPAs, are responsible for the ultimate determinations of medical claims. Such provisions, however, may benefit TPAs more than employers. It is not essential for

employers to agree to such provisions. Employers should not do so unless they affirmatively want this responsibility.

In considering this issue, employers should recognize that they may find it difficult to make final claims determinations. Unless the employers happen to be in the business of health insurance, they may lack the qualifications and experience necessary to evaluate issues like medical necessity and “usual and customary” rates. They may even be precluded by law from accessing certain necessary information.

TPAs, in contrast, are fully qualified to make final claims determinations and should be held accountable for doing so.

2. *Avoid TPA Contracts That Minimize the TPAs’ Fiduciary Duties*

TPA contracts often attempt to minimize the fiduciary obligations of TPAs. Employers are well served by contract language that has the opposite effect. One example is contract language that affirmatively identifies TPAs as agents, as most states place high legal burdens on agents to act in the interests of their principals. Even without using the word “agent,” there are many other ways in which contracts can impose comparable legal burdens upon TPAs.

Employers rely heavily upon TPAs for expertise and valuable advice. They should ensure that their contracts require their TPAs to act in the employers’ best interests, rather than looking out for number one.

3. *Avoid TPA Contracts Without Indemnification Provisions*

Indemnification provisions are important to TPA agreements because TPAs frequently act on behalf of employers. Thus, employers can end up with up-front liability for TPA mistakes. In such situations, indem-

A Note from the Editor

As editor of Anderson Kill’s Self-Funding Advisor, I am pleased to introduce you to the first issue of our newsletter. This quarterly publication is dedicated to exploring the pros and cons of self-funding, with a focus on the practical needs of employers. We would welcome your feedback about the articles in this issue or topics that you would like us to address in the future. Please feel free to contact me or anyone on our Editorial Board.

—Rhonda D. Orin

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nification provisions are a way for employers to make themselves whole. The mere existence of indemnification provisions can have a valuable deterrent effect on TPAs and prevent mistakes from happening.

At the negotiating table, employers should request indemnification provisions that are triggered by negligent conduct and/or lack of ordinary care and reasonable diligence by TPAs. At the very least, indemnification provisions should be triggered by acts of gross negligence and fraud. No matter the trigger, all TPA contracts should provide for some form of indemnification.

4. Avoid TPA Contracts Without Run-Out Services

Run-out services are important to TPA contracts because, with medical benefits, there inevitably will be some claims in the pipeline at the end of a contract period. Just because one TPA contract ends on December 31 and the next one starts on January 1 does not mean that the plan will have seamless TPA services. Run-out services fill the gap.

Different TPAs have different requirements for obtaining run-out services. Employers should understand what actions trigger their TPAs' run-out obligations and should take all actions that are required.

5. Avoid Gaps in Stop-Loss Insurance Coverage

Stop-loss insurance policies are another of the three basic agreements of self-funding. These policies cover medical claims exceeding a particular threshold amount in a given policy period.

In stop-loss policies, coverage typically is based on when claims were incurred and paid. The policy terms can vary widely, with run-in periods at one end of the spectrum and run-out periods at the other.

Stop-loss coverage for run-out claims can be important when employers decide to change TPAs and stop-loss insurance companies. To smooth future transitions, employers would be well advised to request that their stop-loss policies set forth, from the outset, the terms and conditions for such coverage at termination.

6. Avoid Agreements To "Laser" Employees From Coverage

Employers and traditional health insurers typically are barred from terminating an individual's health coverage on grounds that the individual is ill. Stop-loss policies, however, regularly attempt to exclude indi-

viduals on such grounds. This tactic, called "lasering," can leave employers liable for those individuals' medical benefits, without stop-loss coverage.

The concept of lasering undermines the principle behind stop-loss coverage. If stop-loss insurers laser all likely exposures, then premiums may never lead to actual coverage. For this reason, among others, some states are starting to ban the practice altogether. In addition, employers can combat the practice by rejecting stop-loss proposals that contain lasers.

7. Avoid Surprises, When it Comes to Applicable State Laws

Many employers generally understand that self-funded plans are governed exclusively by ERISA and state laws are preempted. Preemption has considerable value to employers, particularly because it avoids state-mandated coverage.

Many employers do not know, however, that stop-loss policies are covered by state insurance laws. Stop-loss coverage constitutes "insurance," which traditionally has been reserved to the states. State regulation of stop-loss insurance policies has positive and negative effects for self-funded employers. For example, some states deem stop-loss policies to be subject to state mandates in certain circumstances. Other states, however, require stop-loss policy applications to offer run-out coverage and, when it is not offered, provide it statutorily.

Conclusion

While self-funding will never be risk-free, informed employers have many tools for protecting themselves. A good starting point is to understand the "deadly sins" of contract negotiation and ensure that the final plan documents serve their interests, not just the interests of others. ▲



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Employer Prevails Against TPA; Wins Attorney Fees

By Dona S. Kahn

In 2005, Anderson Kill successfully defended an employer that had been sued by its former third-party administrator (“TPA”) and its stop-loss insurer. Following a jury trial, the TPA lost a breach of contract claim that it had asserted against the employer; the employer prevailed on a counterclaim against the TPA; and the court ordered the TPA to pay the employer’s legal fees.

That case arose out of the TPA’s payment, during a run-out period, of approximately \$750,000 in bills for a deceased participant. The TPA had demanded reimbursement from the employer, but the employer did not have stop-loss coverage for the run-out period, so the reimbursement of that run-out payment would not be covered by insurance.

The employer refused to reimburse the TPA because the employer believed that the bill should have been paid before the termination, when it would have been 100% covered. The employer so believed because: (a) the services had been rendered many months before the termination; (b) the TPA had pre-certified the services, so it knew about them from the beginning; yet (c) the TPA had not identified this participant to the employer as a large claimant when the employer requested such information, prior to termination.

Notably, the stop-loss insurance company was a corporate affiliate of the TPA, so the timing of the TPA’s payment happened to save the TPA’s corporate affiliate the entirety of the claim.

After eye-opening discovery, the jury heard the following at trial:

- In response to the employer’s pre-termination request for large claimant information, the TPA had generated a computerized report that correctly identified the deceased participant as the largest claimant of the year. An employee at the TPA “shredded” that report, then manually generated a substitute that omitted the participant’s name. The TPA gave only the incorrect report to the employer.
- The TPA billed the employer for the cost of generating the incorrect report.
- The TPA received bills for the participant

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SPOTLIGHT

Tax Consequences— Self-Funding vs. Captive Insurance

By Phillip England

Obtaining tax advantages are, in most instances, not the primary reason to engage in a self-funding program involving employee benefits, although avoiding the incurrence of certain taxes (such as taxes on premiums paid to a third-party insurer) is a benefit of a self-funded or self-insurance program.

Self-funding is the opposite of commercial insurance for tax purposes and hence the provisions of the Tax Code that can facilitate a commercial insurance arrangement with concomitant tax benefits to the insured do not apply.

To the extent self-funding is viewed as a reserve for future liabilities of the entity engaging in such a program, a reserve is not tax deductible (unlike 3rd party premiums) under the premise that, in the absence of an insurance structure, with premiums paid for the issuance of an insurance contract and deductible loss reserves available to an insurer (such as a captive), only currently incurred and fixed obligations can generally be deducted for tax purposes.

Some commercial insurance arrangements, such as retrospectively rated insurance arrangements, are like self-insurance arrangements. Most insurance arrangements, however, differ from self-funding in substantial ways, including tax consequences.

As noted above, while certain tax costs are avoided with a self-funded program, the advantages of tax deductions for premiums paid to a commercial (or captive) insurer are lost, along with tax deductible loss reserves, except for plans that choose instead to self-insure through a captive which would qualify as an insurance company for purposes of the Internal Revenue Code. It could also be noted that a well set up captive, in addition to certain tax advantages, can avoid the unpredictable ramifications that can exist with self-funding. ▲

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months before the termination date, but held them without payment. The TPA then paid a consolidated re-bill after termination. Because the payment was not made until after the termination date, the coverage obligations of the TPA's stop-loss counterpart went from 100% to zero.

- When the employer asked the TPA when the bills were received, the TPA only identified

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the date when it received the consolidated re-bill. It never disclosed the dates it received the original bills.

Thus, not only did the TPA provide incorrect documentation to the employer, it based a lawsuit against the employer on that incorrect documentation.

During pre-trial proceedings, and in the course of discovery, the TPA repeatedly took the position that most plans, presented with such documentation, would have immediately reimbursed the TPA the requested sum. If that is true — and it probably is — then all employers should carefully review what their TPAs tell them. ▲



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More than half of the businesses in America now self-fund their employee benefits plans, rather than purchasing traditional insurance policies. This percentage is likely to increase, due to the up-front cost-savings that can be achieved by self-funding and the opportunity for certain legal protections. Yet self-funding is complicated and its advantages are accompanied by a wide variety of disadvantages. This quarterly publication is dedicated to exploring all aspects of self-funding, with a focus on the practical needs of employers.

If you require more information, legal advice or an opinion with respect to a specific situation, please contact our Editorial Board.

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