Anderson Kill & Olick, P.C.
SELF-FUNDING ADVISOR
Volume 3 Number 2 www.andersonkill.com Autumn 2008

Metropolitan Life v. Glenn:
An Appropriate Standard or "Gobbledygook"?

By Rhonda D. Orin

This past June, the U.S. Supreme Court issued the latest of many decisions about conflicts of interest under the Employee Retirement Income Security Act ("ERISA").

In *Metropolitan Life v. Glenn*, 554 U.S. ___ (2008), a divided Court decided that a plan administrator has a conflict of interest when it decides whether to grant or deny claims that the plan will be required to pay. The Court found the conflict to be clear since "[t]he employer's fiduciary interest may counsel in favor of granting a borderline claim while its immediate financial interest counsels to the contrary."

The Court found that when an employer has a conflict, that fact may carry great weight in reversing a coverage denial. In *Glenn*, for example, the Court found that plan administrator Met Life acted under a conflict of interest when it denied disability benefits to an employee of Sears, Roebuck & Company. Based largely on that conflict, the Court upheld a lower court's decision to reverse the denial.

This decision is of immediate importance to all companies that provide health, life and disability benefits to their employees, whether self-funded or fully insured. Among its various implications, it highlights the need for companies, or their third-party administrators ("TPAs"), to support coverage denials with solid and objective documentation. In short, if you're going to deny a claim, be right—and be able to prove it.

A Note from the Editor

This summer was a banner time in the world of self-funding. Not only did the U.S. Supreme Court hand down an extremely important decision in *Metropolitan Life Insurance Co. v. Glenn*, President Bush signed into law the Genetic Information Nondiscrimination Act. In this issue, we bring you up to speed on these two developments and discuss the various ways in which they are relevant to you.

—*Rhonda D. Orin*

In the wake of *Glenn*, courts are likely to conduct detailed, fact-specific reviews of challenges to coverage denials. Not much, if anything, may be beyond the scope of discovery, including the role of the employer in the denial, the role of the TPA, the interaction between the employer and the TPA, the facts supporting the denial, the facts opposing it, and so on.

If you're going to deny a claim, be right—and be able to prove it.

Also fair game, as shown in the decision, will be whether "the administrator has taken active steps to reduce potential bias and to promote accuracy, for example, by walling off claims administrators from those interested in firm finances, or by imposing management checks that penalize inaccurate decisionmaking irrespective of whom the inaccuracy benefits."

Perhaps the most significant part of *Glenn* is the Court's determination of the weight that such conflicts should be given by reviewing courts. A five-Justice majority adopted an entirely flexible standard. In short, they held that courts should weigh all factors relevant to claims determinations and are free to decide—if they deem it appropriate under the facts—that evidence of a conflict warrants more weight than any of the others.

The Court was firm in its refusal to establish a single test for determining the weight that such conflicts deserve:

> Benefits decisions arise in too many contexts, concern too many circumstances, and can relate in too many different ways to conflicts—which themselves vary in kind and in degree of seriousness—for us to come up with a one-size-fits-all procedural system that is likely to promote fair and accurate review.

"An Appropriate Standard or 'Gobbledygook'?" continued p2

"An Appropriate Standard or 'Gobbledygook'?" continued from p1

In *Glenn*, the Court found that Met Life had a conflict and that the conflict so clearly influenced Met Life's decision to deny coverage that the Sixth Circuit was correct in reversing the coverage denial. Reminiscent of the "I know it when I see it" approach once taken toward the definition of pornography, the Court stressed a particular action taken by Met Life as a basis for reversing that denial:

> In particular, the court found questionable the fact that MetLife had encouraged Glenn to argue to the Social Security Administration that she could do no work, received the bulk of the benefits of her success in doing so. . . and then ignored the agency's finding in concluding that Glenn could in fact do sedentary work.

Justice Antonin Scalia, joined by Justice Clarence Thomas, objected violently to the flexible standard adopted by the majority. In unforgiving terms, he decried it as "gobbledegook," as "painfully opaque," and as "absurd."

Justice Scalia deemed the concept of a conflict of interest to be irrelevant to whether the coverage denial was appropriate. He then found the Court's elucidation of a flexible standard for evaluating the denial to be incomprehensible, uncertain and ultimately useless:

> In the final analysis, the Court seems to advance a gestalt reasonableness standard (a "combination-of-factors method of review," the opinion calls it, ante, at 11), by which a reviewing court, mindful of being deferential, should nonetheless consider all the circumstances, weigh them as it thinks best, then define whether a fiduciary's discretionary decision should be overturned. Notwithstanding the Court's assurances to the contrary, ante, at 9, that is nothing but *de novo* review in sheep's clothing.

The factual circumstances of *Glenn* may lead some to argue that the decision has a narrow scope. Among other things, *Glenn* was rendered in the context of disability insurance, not a self-funded health plan. In addition, the plan administrator was a third-party insurance company, Met Life, not the employer itself.

Yet there is good reason to believe that the Court did not intend the decision to be narrowly construed. For example, the Court expressly considered—and rejected—the idea that "a professional insurance company" should be subject to a different standard of decision-making than the employer itself. The Court offered several reasons for rejecting this idea, including that "the employer's own conflict may extend to its selection of an insurance company to administer its plan;" i.e., the employer "may be more interested in an insurance company with low rates than in one with accurate claims processing."

There is much more that will be said about *Met Life v. Glenn* in the days and years ahead. For now, what is important for self-funded employers is to be aware of this decision and to follow the case law as it develops. In short, every employer should do everything possible to make sure that the next big case is about some other company's decisions—not about their own.

Rhonda D. Orin is the managing partner in Anderson Kill's Washington, D.C. office. Ms. Orin has recovered millions of dollars for self-funded plans from third-party administrators, stop-loss insurers and others, and also has extensive experience in representing policyholders against insurance companies in traditional coverage disputes.
(202) 416-6549
rorin@andersonkill.com

The IRS Clarifies Rent-a-Captive Tax Treatment

By Phillip England

Captive insurance companies have long offered attractive tax advantages — particularly so-called "rent-a-captives," known officially as segregated cell captives. Ambiguity in IRS rules, however, has led many cautious tax advisers to steer clients away from rent-a-captives. This year there's good news: the IRS effectively ended the ambiguity on one particularly sticky tax question pertaining to rent-a-captives. Revenue Ruling 2008-8 holds that if a rent-a-captive satisfies the tax requirements of an insurance company, it will be treated as a standalone insurance company despite its lack of separate legal status.

In a typical rent-a-captive structure, a sponsor forms a segregated account company (SAC) consisting of segregated cells and effectively leases each cell to a user to conduct insurance business within. The sponsor provides captive management services to the cell for a fee. Under applicable law, the cell has license to write related-party insurance risk or to reinsure unrelated risk. The SAC typically owns the cell's common voting stock, while the cell's user owns preferred stock. Preferred stock dividends track the cell's net income. Each cell's assets and liabilities are thus insulated from other cells and the sponsor.

The tax treatment of cells had been ambiguous because cells merely had partial characteristics of corporate personhood. A cell executes contracts for its own account, has limited liability and has independent governance if the tenant tells the sponsor how to vote. Cells are not separate legal entities, however. They cannot exist independently of their sponsor. Some tax advisers feared that the IRS could contradict whatever interpretation the client chose, whether it involved saying the "insurance company" at hand was the SAC or the cell or both.

Rev. Rul. 2008-8 ends this uncertainty by making the pivotal issue whether the cell's activity is self-insurance or real insurance. If self-insurance, then the user cannot deduct premiums paid to the cell nor defer recognition of income via preferred stock dividends. If real insurance, then the user is essentially the owner of a standalone captive insurance company.

By ending that core ambiguity, Rev. Rul. 2008-8 give the green light to creative planning alternatives that are already popular. The rent-a-captive industry is growing quickly thanks to the lower administrative costs of "renting" a captive. The SAC, not the cells, incurs incorporation costs and audit fees (unless auditing at the cell level is desired). The low cost structure may make it cost-effective to set up multiple commonly-managed rent-a-captives, each of which-with careful planning-may qualify for a small insurance company tax exemption in situations where the cells' owners or users are business associates or family members.

The ruling also effectively overturns the commonly held view that captive insurance tax elections (such as the section 953(d) "domestic" election) must be made by the SAC sponsor. Per IRS Notice 2008-19, such tax elections should be made at the cell level, provided that the cell meets the tax definitional requirements of "insurance."

Some captive advisers have celebrated Rev. Rul. 2008-8 as a bold, new interpretation from the IRS. But the interpretation is neither new nor bold. The

"The IRS Clarifies Rent-a-Captive Tax Treatment" continued p4

SPOTLIGHT

The Genetic Information Nondiscrimination Act:

A New Challenge for Self-Funded Employers

By Rhonda D. Orin

President Bush signed into law the Genetic Information Nondiscrimination Act ("GINA"), HR. 493, on May 21, 2008. The act is designed to do what it says: prevent discrimination against employees and prospective employees on grounds of genetic information.

From the employment perspective, the act makes it unlawful for employers with 15 or more employees to base employment-related decisions on genetic information or to seek out genetic information about employees or prospective employees.

From the insurance perspective, the act makes it unlawful to alter premiums or contributions based on genetic information, to use genetic information for underwriting or enrollment purposes, or to compel genetic testing from plan participants or their families.

The act is particularly complicated for self-funded employers since they essentially fall into both categories—first as employers and second as "insurers."

But the new regulations are perilous for all employers because there are many ways in which they can inadvertently become aware of genetic information and thereby become at risk for GINA violations. For example, there is a constant flow of information in the daily lives of most offices about medical affairs of employees and their families. When employees miss work for doctor's appointments, when they take sick days, when they chat at the water cooler, when they take leave under the Family and Medical Leave Act ("FMLA")—all are situations that can inadvertently convey information to employers about their employees' genetic background and heritage.

Notably, the definition of genetic information in GINA is very broad:

> IN GENERAL—The term "genetic information" means, with respect to any individual, information about —
>
> (i) such individual's genetic tests,
>
> (ii) the genetic tests of family members of such individual, and

"A New Challenge for Self-Funded Employers" continued p4

"A New Challenge for Self-Funded Employers" continued from p3

(iii) the manifestation of a disease or disorder in family members of such individual.

There is a grace period before these provisions take effect: 18 months after the date of enactment for the employment-related provisions and one year after the date of enactment for the insurance-specific ones. Self-funded employers would be wise to use that time to ensure that they and/or their third-party administrators put procedures into place to comply with the act's requirements.

Not only would such procedures provide protection from exposure to claims of GINA violations, it would also guard against claims for violations of Sarbanes-Oxley.

Among other things, these procedures should ensure that, as required by GINA, any genetic information that is necessarily obtained by employers is kept on separate forms, in separate medical files, and is treated as confidential medical records.

For most self-funded employers, the procedures also should require that third-party administrators, or TPAs, certify that they are aware of GINA and accept full responsibility for complying with its provisions. For the rare employer that is self-administered in addition to being self-funded, the establishment of GINA may warrant an even more sweeping set of protections.

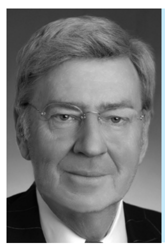
For the self-funded employer, the challenges presented by GINA are not exactly new. Prudent self-funded employers have long appreciated the tension between choosing to provide health plans to their employees, while needing to protect themselves, as employers, from knowing too much about their employees' health needs.

GINA just raises the stakes a little higher. It offers one more reason for employers to appreciate that health care can be a minefield when mishandled, and to treat health-related information about their employees with the tremendous sensitivity that it deserves.

"The IRS Clarifies Rent-a-Captive Tax Treatment" continued from p3

better argument is that Rev. Rul. 2008-8 now formalizes the proper interpretation that always existed.

This is not to say that Rev. Rul. 2008-8 has cleared up all ambiguities in the tax treatment of rent-a-captive. It is important for many corporate taxpayers to include a captive's insurance accounting methods in the parent company's consolidated return. Rent-a-captive cells remain an exception in corporate America insofar as it remains unclear whether a cell can be consolidated. A parent (and/or affiliates) must own 80% of a captive's stock by vote and value in order to consolidate it. Although a cell's preferred stockholder may be able to tell the sponsor how to vote, the sponsor retains voting control formally. Lingering ambiguities such as this reveal that Rev. Rul. 2008-8 is just a first step in guidance for this area.



Phillip England is a shareholder at Anderson Kill in the firm's tax practice. Mr. England has extensive experience in complex tax issues including captive insurance matters.
(212) 278-1483
pengland@andersonkill.com

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 the editor, Rhonda D. Orin, at (202) 416-6549 or rorin@andersonkill.com

The firm has offices in New York, Washington, D.C., Philadelphia, Newark and Greenwich.