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ERISA Litigation

The ERISA Uncertainty Principle: *Edmonson v. Lincoln National Life Insurance Company* and ERISA's Unanswered Questions

Craig C. Martin and Amanda S. Amert

The Employee Retirement Income Security Act of 1974 turns 40 this year. It could reasonably be expected, after thousands of court decisions, to have progressed from hotly contested upstart into a stolid statute yielding pleasantly predictable results. Instead, as the Supreme Court petition for a writ of certiorari recently filed in *Edmonson v. Lincoln National Life Insurance Company* demonstrates, ERISA at 40 is showing the kind of identity crisis that might signal an impending mid-life crisis. The petition underscores the substantial uncertainty that continues to surround the statute despite the significant judicial interpretation the federal courts have applied to its provisions over the last 40 years.

The *Edmonson* petition presents the following question: "Is an insurer that uses a retained asset account bound by fiduciary obligations under ERISA when the ERISA plan gives the insurer discretion to set the interest rate and other key terms?"[1] This raises two fundamental questions about the extent of ERISA's reach. First, who is subject to ERISA's fiduciary obligations? And, second, when are benefits due under an ERISA plan no longer plan assets subject to the statute?

The *Edmonson* petition arises from a Third Circuit decision that itself attempted to reconcile two conflicting decisions from the First and Second Circuits, *Mogel v. UNUM Life Insurance Co.*,[2] and *Faber v. Metropolitan Life Insurance Co.*[3] All three decisions concern what has been an increasingly litigated practice in the life insurance industry—the

Craig C. Martin, a partner in Jenner & Block LLP's Chicago office, is co-chair of the firm's National Litigation Department and long-time member of the firm's governing committee. Amanda S. Amert, who also is a partner in the firm's Chicago office, is chair of the firm's ERISA Litigation Practice. The authors can be reached via email at *cmartin@jenner.com* and *aamert@jenner.com,* respectively.

use of what are called "retained asset accounts" for the payment of life insurance benefits under employer-sponsored life insurance plans.

Structurally, retained asset accounts are relatively straightforward. Upon the death of an insured, rather than issuing a check for the amount of the death benefit, the life insurance company creates an account in the name of the beneficiary in the amount of the life insurance benefit, and provides the beneficiary with check-like "drafts" that allow her to draw on that account over time, until the full amount of the benefit has been paid out. Unlike a bank account, however, the retained asset account is unfunded until it is drawn upon, and the life insurance funds are kept in the insurer's general accounts. As the Third Circuit made clear, the fundamental purpose of a retained asset account is to allow the insurer a longer period of time to hold and invest funds in its general account before paying them out as policy proceeds:

> When distributing benefits using retained asset accounts, an insurance company does not deposit any funds into the account. Rather, it merely credits the account with the benefits, and when a beneficiary writes a check on the account, the insurance company transfers funds into the account to cover the check. Until that time, the insurance company retains the money owed to the beneficiary ... and can invest the retained assets for its own profit.[4]

In *Edmonson*, the plaintiff was due a death benefit of $10,000. She was provided with a retained asset account, withdrew the full amount after three months, and later received an additional $52.33 interest payment. She filed suit in the United States District Court for the Eastern District of Pennsylvania, alleging that the insurer's use of the retained asset account violated its fiduciary duties under ERISA, and seeking, among other things, disgorgement of the insurer's profits from the investment of the funds. The district court held that the insurer's challenged actions were not subject to ERISA's fiduciary duties because they did not involve the administration or management of the plan, and did not involve exercising authority or control over plan assets, and accordingly, granted summary judgment to the insurer.[5]

On appeal, the Third Circuit discussed at length both *Faber*, in which the Second Circuit concluded that the use of a retained asset account did not violate ERISA when the insurance policy provided for it, and *Mogel*, which concluded that the use of a retained asset account did violate ERISA when the insurance policy required a lump sum payment. Noting that the plan and policy language before it was silent as to the method of benefits payment, leaving the choice up to the insurer, the court concluded the insurer's decision was an exercise of discretion subject to ERISA's fiduciary obligations—a point apparently conceded by the insurer at oral argument.[6] Thus, the Third Circuit rejected the district court's conclusion that the insurer was not acting as an ERISA fiduciary

when it selected a retained asset account as the method of payment of benefits.

Nevertheless, the court concluded that there was no breach of that duty. It divided the insurer's choice of method of payment from its investment of the retained funds. First, the court held that the decision to use a retained asset account did not violate the insurer's fiduciary obligations, in part because the plaintiff could have prevented the insurer from investing the retained assets for its own profit by immediately withdrawing them, and because it concluded that ERISA did not mandate any specific form of payment where a plan is silent on that point. The court distinguished Edmonson's plan from the plan in *Mogel*, which specifically called for the insurance proceeds to be paid out in one lump sum.[7]

Second, it concluded that the insurer "fulfilled its obligation to pay [plaintiff] when it established" the retained asset account, and that therefore, the retained funds were not plan assets and the insurer's investment of them for its own profit was not subject to ERISA's fiduciary standards.[8] In so holding, the court rejected the plaintiff's heavy reliance on the Supreme Court's holding in *Varity Corp. v. Howe* that ERISA fiduciary duties are intended to "'constrain the exercise of discretionary powers which are controlled by no other specific duty imposed by the trust instrument or the legal regime,'" concluding that "*Varity Corp.* does not suggest that [the insurer's] fiduciary duty to administer the plan continued after it satisfied its contractual duty to pay" benefits, by establishing the retained asset account.[9]

This holding tracked Second Circuit's holding in *Faber*. In that case, the court, invoking an amicus brief submitted by the Department of Labor, concluded that once an insurer creates a retained asset account and "provides a checkbook, the beneficiary has effectively received a distribution of all the benefits that the Plan promised, and ERISA no longer governs the relationship" between the insurer and the life insurance beneficiary.[10] The Third Circuit did not directly address the significance of the difference between the *Faber* plan language, which explicitly contemplated the payment of the policy proceeds through a retained asset account, and the *Edmonson* plan language, which did not. Presumably, the court did not find that distinction significant.

The fact that 40 years after ERISA was enacted, courts continue to wrestle with issues as fundamental as when an insurance provider who issues a policy under an ERISA plan is an ERISA fiduciary, or when money that will be used to pay plan benefits is a plan asset, is striking. Retained asset accounts may be a relatively new innovation, but the basic plan-insurer-beneficiary relationship has been in place from the outset. Indeed, in her petition, Edmonson seizes on the everyday nature of the relationship to explain why the court should hear her case.

Edmonson argues that the confusion among the courts "cries out" for the Supreme Court's intervention, and that the status quo is "intolerable" for both insurers, who need clear guidance in order to structure their policies,[11] and for beneficiaries, who, it asserts, "cannot possibly know

their rights and obligations" given the current state of the law.[12] She also argues that the lack of clarity is problematic for plan sponsors, who may be subject to class action litigation based on their duties to select and monitor insurers if plaintiffs cannot be certain they can obtain relief from insurers directly.[13]

Whether the Supreme Court will take up the issue of retained asset accounts remains to be seen. Either way, the Third Circuit's fine parsing of the underlying issues highlights the many gaps courts, plan sponsors, and plan service providers confront as ERISA enters its 40th year.

Notes

1. Petition for a Writ of Certiorari, Edmonson v. Lincoln National Life Insurance Co., No. 13-934, at 1 (U.S. Feb. 3, 2014).

2. 547 F.3d 23 (1st Cir. 2008).

3. 648 F.3d 98 (2d Cir. 2011).

4. 725 F.3d 406, 411-12 (3d Cir. 2013).

5. *Id.* at 411-13.

6. *Id.* at 421-22.

7. *Id.* at 423-24.

8. *Id.* at 429.

9. *Id.* at 426 (quoting Varity Corp. v. Howe, 516 U.S. 489, 504 (1996)).

10. *Faber*, 648 F.3d at 102 (internal quotations omitted).

11. The argument that the status quo is "intolerable" for insurers would seem to be undermined, however, by Edmonson's assertion that insurers' use of retained asset accounts is increasing. *See* Petition for a Writ of Certiorari, *Edmonson*, at 2-7 (No. 13-934).

12. *Id.* at 22-23.

13. *Id.* at 22.

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