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SPECIAL ADVERTISING SECTION

OUTSIDE PERSPECTIVES

INSURANCE

Self-Administration of Insurance Policies

Are You Qualified To Do It and, If You Err, Who Pays?

Just in case corporate law departments don't have enough to think about, here's one more thought for the new year—do corporations that self-administer their health, life and disability insurance plans do their jobs correctly, and does anyone fully appreciate the exposure if they don't?



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These questions are important because self-

administration can be like anesthesiology: 99 percent boredom and 1 percent sheer terror. Much of the job involves fairly routine record-keeping, not likely to be of interest to anyone outside of the Human Resources department. But, when something goes awry, the consequences can be great, triggering legal liability, employee relations issues, financial exposure and considerable legal complexities.

One self-administered hospital system learned this lesson the hard way with regard to its life insurance plan. There, a benefits administrator advised an employee that he was entitled to purchase an increase in benefits without providing additional documentation, such as evidence of insurability. The company deducted a premium for the increased benefit

from the employee's salary for several months. Then, suddenly, the employee died. When his widow filed a life insurance claim, the life insurer denied coverage for the increased benefit. The reason was that evidence of insurability had been required after all. The coverage was not in place because evidence of insurability had not been obtained.

It turned out that the mistake arose because of an ambiguity in the wording of the evidence of insurability requirement in the summary plan description, known as the SPD. The SPD had been written by the life insurer, so the ambiguity was technically the life insurer's fault. Regardless, it was the employer who put its name on the SPD, provided the SPD to the employee, told the employee the coverage was in place, and deducted premiums for it from the employee's paychecks. Thus, it was the employer who ended up paying to the widow — out of corporate coffers — a sum equal to the denied life insurance benefit.

Every homeowner knows that there's no such thing as just one mouse. The same axiom applies to mistakes in self-administration of insurance policies. Once a mistake has been discovered involving a single employee, a prudent employer should at least consider the possibility that there may be others in the same situation.

The following, accordingly, is a list of some issues that corporate counsel

should consider when first alerted to a seemingly isolated mistake down in HR:

Internal Controls

Is the corporate law department sufficiently involved in the systems used by HR and benefits personnel to identify and enforce the requirements of a self-administered insurance policy? Especially since the passage of the Sarbanes-Oxley Act of 2002, 15 U.S.C. §7201, et seq., it has become increasingly risky for a corporation to have skimpy review and oversight in this arena. To have adequate controls, the corporate law department should have a clear understanding of the differing legal obligations and exposures involved in being: (a) self-administered, (b) self-funded, (c) self-insured through a captive insurance company, or (d) whatever combination of these approaches has been selected by that corporation. Appropriate controls may involve periodic reviews of the various HR forms, revising as necessary to achieve accuracy, consistency, lack of ambiguity and conformity with the underlying plan documents and insurance policies. Other controls may involve conducting spot-checks of randomly selected employees, to verify that the sums being deducted from their paychecks are in accord with the benefits they have selected and that are in place. Still other controls may involve review of the personnel in

the HR department, including hiring practices, training, and frequency of turnover.

Potential Financial Exposure

Once a mistake is recognized for a single employee, all efforts should be made to locate others in the same situation, and to put a dollar sign on the benefits at risk. Although tedious, this task must be undertaken promptly, as it will enable corporate counsel to assess the severity of a situation and the resources that should be devoted toward finding a solution. It also will enable public companies, in conjunction with their lawyers and accountants, to assess the need, if any, for disclosures of potential exposure in upcoming public filings.

Potential Legal Exposure

Conducting an immediate search for others in the same situation, as described above, has legal benefits in addition to financial ones. Specifically, if a second mistake is made, after a corporation has arguably been placed "on notice" of the problem, the corporation's legal exposure may be higher than it was for the first mistake. But it would be a valid defense for a corporation to show that it took steps immediately to avoid other mistakes and that, although those steps may have failed to prevent the second mistake, they may have succeeded in preventing a third one.

Labor Relations

At all levels of a corporation — from top executives to mailroom personnel — employees can be extremely touchy about the possibility of errors in their benefits. Life, health and disability insurance can have enormous consequences on an

individual level. Thus, rumors and unrest, along with a decrease in productivity, can spread quickly at the mere thought of problems. Unfortunately, this sensitivity was heightened by the collapse of Enron Corporation and the substantial amount of publicity accorded to employees who witnessed their 401k funds fall victim to abject corporate mismanagement (Alan Sloan, "Enron Day Provides Little to Celebrate," *Washington Post*, Oct. 15, 2002, at E1.). In recognition of this environment, corporate counsel would be well-advised to move HR problems to the front burner as soon as they are identified, and to resolve them as quickly and quietly as possible.

Legal Complexities

Problems that arise in connection with benefits can be exceedingly complex as a legal matter. These complexities arise from the juxtaposition of ERISA (Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001, et seq.); the Sarbanes-Oxley Act, as mentioned above; HIPAA (Health Insurance Portability and Accountability Act of 1996), Pub. L. No. 104-191, 110 Stat. 1936 (1996); IRS codes and regulations (Internal Revenue Code, 26 U.S.C. §§ 401, et seq.); state insurance laws; and state unfair trade practices acts, among other things. To cite but one example, if an employee sues an employer for the wrongful denial of a health benefit, that suit ordinarily would arise under ERISA, which would preempt both state law and the jurisdiction of state courts. If the same employer sues its stop-loss insurance company for wrongful denial of a claim, that suit ordinarily would arise under state common law for breach of contract,

and the state courts would have jurisdiction. Thus, whenever corporate counsel are presented with a potential problem in HR, they should carefully consider which procedural and substantive laws would be applicable to all possible issues.

Self-administration of insurance plans offers many benefits to corporations, particularly in terms of the bottom line. Corporate counsel should remember, though, that self-administration is not for the faint of heart. When problems arise, as they inevitably will, quick thinking by corporate counsel can prevent this cost-saving measure from turning into a financial sieve.

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