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Insurance

$13M Fiduciary Breach Award Axed, Closes Retained Asset Accounts Circuit Split

BY MATTHEW LOUGHRAN

Unum Life Insurance Co. of America's use of retained asset accounts to pay death benefits and establishment of interest rates payable on those accounts don't violate fiduciary duties under federal benefits law if the use of the accounts as a payment method is permitted by plan documents, the U.S. Court of Appeals for the First Circuit ruled (*Merrimon v. Unum Life Ins. Co. of Am.*, 2014 BL 184781, 1st Cir., No. 13-2128, 7/2/14).

In approving the use of the accounts as a payment method for death benefits, the appellate court limited its earlier holding in *Mogel v. UNUM Life Ins. Co. of Am.* (547 F.3d 23 (1st Cir. 2008)) to instances in which plan documents required a different method of paying benefits.

The court decision comes just over a month after the U.S. Supreme Court denied certiorari to an appeal from the U.S. Court of Appeals for the Third Circuit, which had approved of the same practice.

The decision also closes a circuit split between the First Circuit and the Second and Third circuits. The Second and Third circuits had previously endorsed the use of the accounts.

In his July 2 opinion, Judge Bruce M. Selya cited both the Second Circuit opinion in *Faber v. Metro. Life Ins. Co.* (648 F.3d 98 (2d Cir. 2011)) and the Third Circuit opinion in *Edmonson v. Lincoln Nat'l Life Ins. Co.* (725 F.3d 406 (3d Cir. 2013) in reversing in part a decision by the U.S. District Court for the District of Maine that had found that the insurer's establishment of interest rates payable to the accounts violated fiduciary duties under Section 404(a) of the Employee Retirement Income Security Act.

The appellate court upheld the portion of the district court opinion that ruled that the retained assets weren't plan assets and thus their continued presence in the insurer's general account wasn't prohibited self-dealing under Section 406(b).

Reaction to Decision Mixed. "This decision is an important one for the life insurance industry and is consistent with rulings from other jurisdictions," Gavin G. McCarthy, a partner at Pierce Atwood LLP in Portland, Maine, and counsel for Unum, told Bloomberg BNA on July 3. "It affirms a common and convenient delivery of life benefits to survivors through the use of secure accounts, and we're pleased with the result," he said.

"The judges took a serious and scholarly approach to the case and came out with a decision that certainly favors the position of the insurance company," John C. Bell, a partner at Bell & Brigham in Augusta, Ga., and counsel to the beneficiaries, told Bloomberg BNA on July 3. "But I continue to fail to understand how you can be in a fiduciary relationship and send what amounts to an IOU to the beneficiaries while retaining and investing their funds for your own benefit," he said.

Jeremy P. Blumenfeld, a partner at Morgan Lewis & Bockius LLP in Philadelphia who represented the Defense Research Institute as an *amicus curiae* in the case, had a different view.

"We believe on the whole that the First Circuit's decision was correct. It was a well-reasoned opinion that considered the Department of Labor's views, as well as those of the other courts of appeals—Second and Third circuits—to have addressed the issue," he told Bloomberg BNA on July 3.

"Clearly, the First Circuit believed that Unum's handling of these retained asset accounts was lawful and consistent with the relevant plan terms," he said.

"The First Circuit also made it possible for insurers and plan sponsors to continue to offer life insurance benefits through retained asset accounts, which is good for all concerned," he said. "It gives participants and beneficiaries one more option for managing the proceeds of any life insurance benefits they receive, and if they would rather invest the money elsewhere, they have the right to withdraw their money from the retained asset account at any time and do whatever they want with it."

Retained Asset Accounts. Retained asset accounts (RAAs) typically come in the form of checkbooks that earn limited interest and can be used to withdraw funds, with the issuing insurer retaining control of the benefits—and often investing those benefits for profit—until they are drawn on by the beneficiary.

In the instant case, Unum used the accounts as a payment method for life insurance death benefits to beneficiaries of the life insurance policies.

According to the court, Unum established accounts at State Street Bank for the beneficiaries and credited to each beneficiary's account the full amount of benefits owed.

Unum retained the funds to back the accounts in its general account and paid the beneficiaries 1 percent interest on the funds while they remained in the insurer's control.

The beneficiaries brought suit in federal district court, asserting that the insurer had breached its fidu-

ciary duties by retaining the funds behind the accounts in its own general account and engaging in prohibited self-dealing by earning more interest on those funds than it paid to the beneficiaries.

The district court agreed in part, finding in a 2012 decision that Unum breached its duty under Section 404(a) to manage the RAAs solely in the interest of the beneficiaries by setting the comparatively low interest rate on the money held in the account.

However, the court also found that the insurer hadn't engaged in prohibited self-dealing in violation of Section 406(b) through its use of the accounts as a payment method for death benefits since the retained funds weren't defined as plan assets under the statute.

As a remedy for the interest rate violation, the district court averaged money market account returns over the same time frame and awarded the difference between that and the 1 percent that the beneficiaries had received, arriving at more than $13 million payable to the beneficiaries.

Both parties appealed to the First Circuit, which upheld the court's determination that the use of the accounts didn't violate Section 406(b) but reversed the district court's finding that the insurer's establishment of an interest rate payable to the accounts violated Section 404(a).

As a result of the appellate court's decision, the $13 million class award was also vacated and the case was remanded to the district court to enter judgment in favor of the insurer.

Circuit Split Closed. The First Circuit previously addressed this practice in 2008 in *Mogel*, holding that Unum had breached its fiduciary duties by using RAAs when the policy documents in that case called for lumpsum payouts to beneficiaries.

Three years later, in 2011, the Second Circuit decided in *Faber* that the use of RAAs didn't violate fiduciary duties under ERISA when the plan documents specifically provided for them.

In deciding that case, the Second Circuit sought guidance from the Department of Labor, which provided an amicus brief in which it said that an insurer's fiduciary duties under ERISA are discharged by providing a beneficiary complete access to the RAA as required by policy documents and not retaining any plan assets by holding and managing the funds that back the RAA.

In August 2013, the Third Circuit joined the fray in *Edmonson*, siding with the Second Circuit and finding that an insurer didn't violate its fiduciary duties when using RAAs to pay death benefits when the underlying policy documents were silent on the manner of payment for benefits.

The U.S. Supreme Court in May denied certiorari in *Edmonson*, refusing to settle the emerging circuit split on the use of RAAs.

On Aug. 9, 2013, two days after the Third Circuit decision was announced, the U.S. District Court for the District of Massachusetts, which sits within the First Circuit's jurisdiction, agreed with the reasoning of the Third Circuit and granted summary judgment to an insurer, finding that it didn't violate fiduciary duties under ERISA by selecting RAAs as a payment method for death benefits (*Vander Luitgaren v. Sun Life Assurance Co. of Canada*2013 BL 217740 (D. Mass. 8/9/13)).

Pending RAA Cases. At least two cases are pending on this issue that could be greatly affected by the First Circuit decision.

The *Vander Luitgaren* case was argued before the same panel of judges in the First Circuit on the same day.

The key difference between the two cases is that the plan documents in the instant case directly provided that benefits would be paid by way of a RAA unless the beneficiary selected a different settlement method, while the plan documents in *Vander Luitgaren* allowed for, but didn't require the use of, RAAs.

Additionally, in April a life insurance beneficiary filed putative a class action against Metropolitan Life Insurance Co. alleging similar violations through use of RAAs in the U.S. District Court for the Northern District of Georgia, a federal court that sits within the jurisdiction of the U.S. Court of Appeals for the Eleventh Circuit, which has yet to rule on the subject (*Owens v. Metro Life Ins. Co.*, N.D. Ga., No. 2:14-cv-00074-RWS*complaint filed* 4/17/14).

Circuit Judge Juan R. Torruella and District Judge Steven J. McAuliffe of the U.S. District Court for the District of New Hampshire, sitting by designation, joined the opinion of the court.

The beneficiaries were represented by Bell and Leroy W. Brigham of Bell & Brigham in Augusta, Ga.; Stuart T. Rossman and Arielle Cohen of the National Consumer Law Center in Boston; M. Scott Barrett of Barrett Wylie LLC in Bloomington, Ind.; Andrea E. Bopp Stark of the Molleur Law Office in Biddeford, Maine; Jeffrey G. Casurella of Atlanta; and Fred Schultz of Greene & Schultz in Bloomington, Ind.

Unum was represented by McCarthy, Donald R. Frederico, Catherine R. Conners, Byrne J. Decker and Katherine S. Kayatta of Pierce Atwood LLP in Boston and Portland, Maine.

Amicus curiae Defense Research Institute was represented by Blumenfeld of Morgan Lewis & Bockius LLP in Philadelphia and J. Michael Weston of Lederer Weston Craig in Cedar Rapids, Iowa.

Amicus curiae American Council of Life Insurers was represented by James F. Jorden, Waldemar J. Pflepsen, John Pitblado, Ben V. Seesell and Michael A. Valerio of Carlton Fields Jorden Burt in Washington and Simsbury, Conn., and Lisa Tate of the American Council of Life Insurers in Washington.

To contact the reporter on this story: Matthew Loughran in Washington at mloughran@bna.com

To contact the editor responsible for this story: Jo-el J. Meyer at jmeyer@bna.com

Text of the opinion is at http://www.bloomberglaw.com/public/document/DENISE_MERRIMON_and_BOBBY_S_MOWERY_Plaintiffs_Appellees_v_UNUM_LI.

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