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Volume 21  
Number 4 *Symposium: The Role and Function  
of the United States Solicitor General*

Article 16

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6-1-1988

## Blind Faith Conquers Bad Faith: Only Congress Can Save Us after Pilot Life Insurance Co. v. Dedeaux

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### Recommended Citation

Robert L. Aldisert, *Blind Faith Conquers Bad Faith: Only Congress Can Save Us after Pilot Life Insurance Co. v. Dedeaux*, 21 Loy. L.A. L. Rev. 1343 (1988).

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**BLIND FAITH CONQUERS BAD FAITH: ONLY  
CONGRESS CAN SAVE US AFTER *PILOT LIFE*  
*INSURANCE CO. V. DEDEAUX***

**I. INTRODUCTION**

Over the resistance of insurance companies, a growing majority of jurisdictions recognize a tort cause of action against insurers for bad faith refusal to pay benefits to their insureds.<sup>1</sup> Recognition of the tort of bad faith has developed from courts appreciating that the insurance policy is not an ordinary commercial contract and that the insurer-insured relationship is a special one.<sup>2</sup> Specifically, courts regard the insurance contract as one of adhesion, with the insurer enjoying vastly superior bargaining power.<sup>3</sup> In addition, courts have viewed the insurance industry as imbued with the public interest,<sup>4</sup> and have viewed insurers as

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1. See *Gulf Atl. Life Ins. Co. v. Barnes*, 405 So. 2d 916 (Ala. 1981); *United Services Auto Ass'n v. Werley*, 526 P.2d 28 (Alaska 1974); *Sparks v. Republic Nat'l Life Ins. Co.*, 132 Ariz. 529, 647 P.2d 1127, cert. denied, 459 U.S. 1070 (1982); *Aetna Casualty and Sur. Co. v. Broadway Arms Corp.*, 281 Ark. 128, 664 S.W.2d 463 (1984); *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973); *Travelers Ins. Co. v. Savio*, 706 P.2d 1258 (Colo. 1985); *Grand Sheet Metal Prod. Co. v. Protection Mut. Ins. Co.*, 34 Conn. Supp. 46, 375 A.2d 428 (Conn. Super. Ct. 1977); *White v. Unigard Mut. Ins. Co.*, 112 Idaho 94, 730 P.2d 1014 (1986); *Sexton v. Meridian Mut. Ins. Co.*, 166 Ind. App. 529, 337 N.E.2d 527 (1975); *Rodgers v. Pennsylvania Life Ins. Co.*, 539 F. Supp. 879 (S.D. Iowa 1982) (applying Iowa law); *Gibson v. National Ben Franklin Ins. Co.*, 387 A.2d 220 (Me. 1978); *Blue Cross & Blue Shield v. Campbell*, 466 So. 2d 833 (Miss. 1984); *St. Paul Fire & Marine Ins. Co. v. Cumiskey*, 204 Mont. 350, 665 P.2d 223 (1983); *United States Fidelity & Guar. Co. v. Peterson*, 91 Nev. 617, 540 P.2d 1070 (1974); *Payne v. North Carolina Farm Bureau Mut. Ins. Co.*, 67 N.C. App. 692, 313 S.E.2d 912 (1984); *Corwin Chrysler-Plymouth v. Westchester Fire Ins. Co.*, 279 N.W.2d 638 (N.D. 1979); *Hoskins v. Aetna Life Ins. Co.*, 6 Ohio St. 3d 272, 452 N.E.2d 1315 (1983); *Christian v. American Home Assurance Co.*, 577 P.2d 899 (Okla. 1977); *Bibeault v. Hanover Ins. Co.*, 417 A.2d 313 (R.I. 1980); *Nichols v. State Farm Mut. Auto Ins. Co.*, 279 S.C. 336, 306 S.E.2d 616 (1983); *Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987); *Anderson v. Continental Ins. Co.*, 85 Wis. 2d 675, 271 N.W.2d 368 (1978).

2. See, e.g., *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 819, 598 P.2d 452, 456, 157 Cal. Rptr. 482, 486 (1979), cert. denied, 445 U.S. 912 (1980) (not typical commercial contract because insureds do not seek commercial advantage).

3. See, e.g., *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 280, 419 P.2d 168, 179, 54 Cal. Rptr. 104, 115 (1966) ("consumer does not occupy a sufficiently strong economic position to bargain with such institutions [insurance companies] as to specific clauses of their contracts of performance . . .").

4. See, e.g., *Egan*, 24 Cal. 3d at 820, 598 P.2d at 457, 157 Cal. Rptr. at 487 (insurers are purveyors of vital quasi-public service).

standing in fiduciary relationships with their insureds.<sup>5</sup> Thus, contract remedies—suing for policy proceeds due—have been found utterly inadequate in protecting insureds.<sup>6</sup>

Unlike mere contract remedies, the tort of bad faith refusal to pay policy benefits can expose the insurance company to liability which far exceeds any benefits due the insured. Insureds have recovered extracontractual damages for medical and legal expenses, loss of income and emotional distress<sup>7</sup> as well as large punitive awards.<sup>8</sup> The tort of bad faith<sup>9</sup>

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5. See, e.g., *id.*, at 818-19, 598 P.2d at 456, 157 Cal. Rptr. at 486 (in handling claim insurer must give as much consideration to insured's interest as to insurer's).

6. For a discussion of the historical development of the tort of bad faith, see W. SHERNOFF, S. GAGE & H. LEVINE, *INSURANCE BAD FAITH LITIGATION* §§ 1.02-1.08 (1987) [hereinafter SHERNOFF].

7. See, e.g., *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 433-34, 426 P.2d 173, 179, 58 Cal. Rptr. 13, 19 (1967) (court affirmed emotional distress award against insurer who refused to reasonably settle claim against insured).

8. See, e.g., *Egan*, 24 Cal. 3d at 819-23, 598 P.2d at 457-59, 157 Cal. Rptr. at 487-90 (punitive damages permitted where insurer intentionally failed to reasonably investigate insured's disability claim before denying benefits).

9. Bad faith is based on a variety of legal theories. Courts in the leading jurisdiction, California, bases the cause of action on tortious breach of the covenant of good faith and fair dealing. See, e.g., *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973) (fire insurance). The covenant is implied-in-law into every contract. *Id.* at 573, 510 P.2d at 1036, 108 Cal. Rptr. at 484. The covenant requires that each party do nothing which will injure the right of the other to receive the benefits of the agreement. *Id.*

The California courts have concluded that the breach of the covenant of good faith and fair dealing is a tort in the insurance context because of the special nature of the relationship between the insurer and insured. In particular, the insured does not seek commercial advantage by purchasing the policy, rather, the insured seeks protection from calamity. *Egan*, 24 Cal. 3d at 819, 598 P.2d at 456, 157 Cal. Rptr. at 486. In short, the purchase of insurance provides peace of mind. *Id.*

Thus, in the third party insurance situation, where a claimant files a claim against the liability policy of the insured, the insurer has the duty to accept reasonable settlement offers. *Gruenberg*, 9 Cal. 3d at 573, 510 P.2d at 1037, 108 Cal. Rptr. at 485. If the insurer does not accept the reasonable settlement offer, the insurer is liable for the entire amount of any judgment against the insured, even if the judgment exceeds the policy limits. *Id.* at 573, 510 P.2d 1036-37, 108 Cal. Rptr. at 484-85.

In the first party situation, the insurer contracts to pay benefits directly to the insured. Types of policies include health, fire, disability, life and others. The covenant of good faith and fair dealing is manifested in the insurer's implied promise not to unreasonably and without cause withhold policy benefits from its insured. *Id.* at 573-74, 510 P.2d at 1037, 108 Cal. Rptr. at 485. The duty to accept reasonable settlements in the third party situation and the duty not to unreasonably withhold payments to the insured in the first party situation are two different aspects of the same duty: the duty of good faith and fair dealing. *Id.* at 573, 510 P.2d 1037, 108 Cal. Rptr. at 485. In *Gruenberg*, the California Supreme Court summarized the duty:

[The] responsibility is not the requirement mandated by the terms of the policy itself—to defend, settle, or pay. It is the obligation, deemed to be imposed by the law, under which the insurer must act fairly and in good faith in discharging its contractual responsibilities. Where in so doing, it fails to deal *fairly and in good faith* with its insured by refusing, without proper cause, to compensate its insured for a loss

therefore serves to equalize the insurer-insured relationship, to deter insurance companies from acting in bad faith and to assure that the insured gets the benefits for which he or she bargained.<sup>10</sup>

Enter the Supreme Court of the United States. The Court recently dealt insurance companies a royal flush in the high stakes game of bad faith litigation. In *Pilot Life Insurance Co. v. Dedeaux*,<sup>11</sup> the Court held that the civil enforcement remedies contained in the Employee Retirement Income Security Act of 1974 (ERISA)<sup>12</sup> preempted state common-law bad faith causes of action.<sup>13</sup>

ERISA, a startlingly sweeping and complex federal statute,<sup>14</sup> gov-

covered by the policy, such conduct may give rise to a cause of action in tort for breach of an implied covenant of good faith and fair dealing.

*Id.* at 573-74, 510 P.2d at 1037, 108 Cal. Rptr. at 485 (emphasis in original).

In addition, the California Supreme Court has held that in order not to breach the covenant, the insurer "must give at least as much consideration to the [insured's] interest as it does to its own." *Egan*, 24 Cal. 3d at 818-19, 598 P.2d at 456, 157 Cal. Rptr. at 486.

As a tort, the breach of the covenant of good faith and fair dealing (bad faith) exposes the insurer to liability for all damages suffered by the insured, whether or not anticipated at the time the contract was formed. *Gruenberg*, 9 Cal. 3d at 579, 510 P.2d at 1041, 108 Cal. Rptr. at 489. Thus, breaching insurers are liable for all costs incurred by insureds proximately caused by the breach including medical bills, attorney fees, loss of income and mental suffering. *See id.* at 580, 510 P.2d at 1041-42, 108 Cal. Rptr. at 489-90.

If the insurer's bad faith is especially egregious, the insurer may be held liable for punitive damages. *Egan*, 24 Cal. 3d at 819-23, 598 P.2d at 457-59, 157 Cal. Rptr. at 487-90. For example, in one California case the insurer refused to pay ongoing disability benefits because it believed, based on scant investigation, that the insured suffered from a "sickness" rather than an "injury." *Id.* at 821-22, 598 P.2d at 458, 157 Cal. Rptr. 484. The plaintiff had suffered a bona fide injury. *Id.* The supreme court held that punitive damages were appropriate. *Id.* at 823, 598 P.2d at 459, 157 Cal. Rptr. at 489.

Most of the majority of jurisdictions that recognize the tort of bad faith share California's theoretical basis for bad faith—tortious breach of the covenant of good faith and fair dealing. *See SHERNOFF, supra* note 6 § 1.07[2]. Other theories include fraud, intentional infliction of emotional distress and tortious interference with property interest. *See generally id.* § 1.06 (discussion of evolution of bad faith). *See infra* note 290 for a discussion of Mississippi's theory of bad faith, "tortious breach of contract." *See infra* note 426 for further discussion of standards of bad faith liability.

10. *See generally* SHERNOFF, *supra* note 6 §§ 1.02-1.08 (detailed discussion of evolution of bad faith cause of action).

11. 107 S. Ct. 1549 (1987).

12. 29 U.S.C. §§ 1000-1145 (1982 & Supp. III 1985); *id.* §§ 1201-1242; I.R.C. §§ 401-415 (1982 & Supp. III 1985).

13. *Pilot Life*, 107 S. Ct. at 1558.

14. This Note principally concerns ERISA's remedy section, 29 U.S.C. § 1132 (1982) and the preemption section, *id.* § 1144. All section references are to Title 29 of the United States Code unless otherwise indicated.

The Departments of Labor and the Treasury, the Pension Benefit Guarantee Corporation and the Internal Revenue Service administer ERISA.

For general, scholarly commentaries regarding ERISA, see S. GOLDBERG, PENSION PLANS UNDER ERISA (1976); D. LOGUE, LEGISLATIVE INFLUENCE ON CORPORATE PEN-

erns all aspects of employer or union provided employee benefit plans, including the insured "welfare benefit" plan.<sup>15</sup> This type of plan provides employees health, disability, life or other insurance through the purchase of group insurance policies. As of March 1984, employers or unions provided over 134 million American workers or their beneficiaries with health insurance.<sup>16</sup> ERISA therefore potentially reaches into most American households.

Since the Supreme Court held that ERISA preempts common-law bad faith actions, the statute's enforcement provisions are of paramount significance to persons with employer<sup>17</sup> or union<sup>18</sup> provided health, disability or other insurance. These provisions allow an aggrieved ERISA plan participant<sup>19</sup> or beneficiary<sup>20</sup> to obtain policy benefits, to enforce rights under his or her plan or to clarify rights to future benefits under

SION PLANS (1979); D. MCGILL, *FUNDAMENTALS OF PRIVATE PENSIONS* (4th ed. 1979); FASSER, *The New Pension Law*, 28 N.Y.U. CONF. ON LAB. 59 (1975); *Litigation Under ERISA*, 71 CORNELL L. REV. 949 (1986) (symposium); *The Employee Retirement Income Security Act of 1974*, 19 U. MICH. J.L. REF. 1 (1985) (symposium); *The Employee Retirement Income Security Act of 1974: Labor Law Considerations*, 17 WM. & MARY L. REV. 205 (1975) (symposium).

For the legislative history of ERISA, see SUBCOMM. ON LABOR OF THE SENATE COMM. ON LABOR AND PUBLIC WELFARE, 94TH CONG., 2D SESS., *LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974* (Comm. Print 1976) [hereinafter COMMITTEE PRINT].

15. See *infra* text accompanying notes 40-52 for a discussion of ERISA plans.

16. U.S. CENSUS BUREAU, 1986 STATISTICAL ABSTRACT 89 (1987).

17. Section 1002(5) provides: "The term 'employer' means any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan; and includes a group or association of employers acting for an employer in such capacity." 29 U.S.C. § 1002(5) (1982).

18. Section 1002(4) provides:

The term "employee organization" means any labor union or any organization of any kind, or any agency or employee representation committee, association, group, or plan, in which employees participate and which exists for the purpose, in whole or in part, of dealing with employers concerning an employee benefit plan, or other matters incidental to employment relationships; or any employees' beneficiary association organized for the purpose in whole or in part, of establishing an employee benefit plan.

*Id.* § 1002(4).

19. Under ERISA, "participant" means:

any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit.

*Id.* § 1002(7).

20. "Beneficiary" means: "a person designated by a participant, or by the terms of an employee benefit plan, who is or may become entitled to a benefit thereunder." *Id.* § 1002(8). In this Note, use of the term "participant" includes "beneficiary" unless otherwise indicated.

the plan.<sup>21</sup> At its discretion, a court may also award a prevailing plaintiff reasonable attorney fees.<sup>22</sup> Most importantly, recent Supreme Court decisions have effectively foreclosed welfare benefit plan participants and beneficiaries from recovering extracontractual compensatory or punitive damages under ERISA.<sup>23</sup>

Now liable merely for benefits due a plaintiff and perhaps attorney fees, employee group insurers may delay with impunity the processing and payment of claims.<sup>24</sup> Further, without threat of tort liability, insurance companies stand to lose nothing by withholding payments and, at minimum, gain use of funds rightfully due the insured.<sup>25</sup> In effect, the Court has removed serious incentive from employee group insurers to deal fairly and promptly with their insureds. Moreover, because the ruling affects only ERISA plans and participants, the Court has created an anomalous distinction: persons covered by individual health, disability or other policies may proceed on bad faith causes of action while their neighbors covered by employer or union provided group insurance must sue under ERISA for mere benefits due.

This Note examines the Court's reasoning in *Pilot Life* against the backdrop of relevant ERISA provisions and case law. The Note argues that the decision was poorly reasoned and failed to consider all relevant congressional concerns. The Note also discusses the volatile question of whether statutory bad faith actions survive the decision.<sup>26</sup> The Note concludes by proposing that Congress amend ERISA to explicitly confer upon insured welfare benefit plan participants and beneficiaries the right to sue their group insurers under applicable state law.

## II. BACKGROUND

Employee welfare<sup>27</sup> and pension<sup>28</sup> benefit<sup>29</sup> plans proliferated in the

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21. *Id.* § 1132(a)(1)(B).

22. *Id.* § 1132(g)(1).

23. See *infra* notes 69-70 and accompanying text for a discussion of extracontractual damages under ERISA.

24. *Nichols v. State Farm Mut. Auto Ins. Co.*, 279 S.C. 336, 340, 306 S.E.2d 616, 619 (1983).

25. *Id.*

26. Statutory bad faith actions are based not in common law but in provisions of state insurance codes. See *infra* text accompanying notes 312-39 for a discussion of these causes of action.

27. See *infra* text accompanying notes 44-46 for an explanation of "employee welfare benefit plan."

28. See *infra* note 41 for the definition of "employee pension benefit plan."

29. See *infra* note 42 for the definition of "employee benefit plan."

1960s and early 1970s.<sup>30</sup> Congress determined, however, that these plans frequently became instruments of abuse and mismanagement at the expense of workers.<sup>31</sup> By enacting ERISA,<sup>32</sup> Congress sought to protect employee rights under benefit plans through uniform and rigorous federal regulation.<sup>33</sup>

To effectuate this purpose, Congress wrote into ERISA a powerful preemption section.<sup>34</sup> ERISA supersedes, with enumerated exceptions,<sup>35</sup> all state laws relating to employee benefit plans.<sup>36</sup> State laws that regulate insurance constitute one of these exceptions.<sup>37</sup> This insurance law exception lies at the heart of the dispute in *Pilot Life Insurance Co. v.*

30. For example, Congress found that in 1973 30,000,000 Americans were participating in pension plans. H.R. 462, 93d Cong., 1st Sess. § 2 (1973), reprinted in COMMITTEE PRINT, *supra* note 14 at 67-68.

31. In ERISA's declaration of public policy, Congress clearly revealed its intention to eradicate employee benefit plan abuse:

[D]espite the enormous growth in [employee benefit] plans many employees with long years of employment are losing anticipated retirement benefits owing to the lack of vesting provisions in such plans; that owing to the inadequacy of current minimum standards, the soundness and stability of plans with respect to adequate funds to pay promised benefits may be endangered; that owing to the termination of plans before requisite funds have been accumulated, employees and their beneficiaries have been deprived of anticipated benefits; and that it is therefore desirable in the interests of employees and their beneficiaries, for the protection of the revenue of the United States, and to provide for the free flow of commerce, that minimum standards be provided assuring the equitable character of such plans and their financial soundness.

29 U.S.C. § 1001(a) (1982).

32. Congress passed ERISA in August 1974 and, appropriately, President Ford signed the statute into law on the following Labor Day. COMMITTEE PRINT, *supra* note 14, at 5321.

33. Plan administrators are required to furnish plan participants with summary plan descriptions. 29 U.S.C. § 1021 (1982). Further, plan administrators must file with the Secretary of Labor a summary plan description, annual reports, modifications and plan termination reports. *Id.* See *supra* note 19 for the definition of "plan participant"; and see *infra* note 58 for the definition of plan administrator.

Willful failure to comply with reporting requirements may result in criminal prosecution under § 1131. See *infra* note 66 for a description of § 1131.

34. ERISA's framers viewed federal preemption of the field as the cure for ills caused by inconsistent and conflicting state regulation. For example, Senator Williams, a principal Senate sponsor of ERISA, stated:

Consistent with this principle [of sweeping federal preemption of the field], State professional associations acting under the guise of state-enforced professional regulation, should not be able to prevent unions and employers from maintaining the types of employee benefit programs which Congress has authorized . . . .

120 CONG. REC. 29,993 (1974) (remarks of Senator Williams). See *infra* notes 82-87 and accompanying text for a discussion of the legislative history of ERISA's preemption clause.

35. ERISA exempts from preemption state laws regulating insurance, securities and banking. 29 U.S.C. § 1144(b)(2)(A) (1982).

36. *Id.* § 1144(a).

37. *Id.* § 1144(b)(2)(A).

*Dedeaux*.<sup>38</sup> The Court there considered whether Mississippi's common law of bad faith regulated insurance within the meaning of ERISA, and as such was exempted from preemption.<sup>39</sup>

Part A of this section explains what constitutes an ERISA plan, the scope of ERISA coverage and the civil enforcement remedies available under the statute. Part B discusses ERISA's preemption provisions and their legislative history. Finally, Part C analyzes Supreme Court ERISA preemption doctrine prior to *Pilot Life*.

### A. ERISA Plans, Scope of ERISA Coverage and Remedies

#### 1. What constitutes an ERISA plan

ERISA protects two types of employee benefit plans: "welfare benefit"<sup>40</sup> and "pension benefit"<sup>41</sup> plans.<sup>42</sup> The *Pilot Life* decision and this Note address welfare benefit plans.<sup>43</sup> Welfare benefit plans provide "through the purchase of insurance or otherwise . . . [benefits for] medical, surgical, or hospital care or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs."<sup>44</sup> Welfare benefit plans may provide benefits to participants and beneficiaries directly, without purchasing insurance policies—"uninsured plans"<sup>45</sup>—or they may provide benefits through purchased group insurance policies—"insured plans."<sup>46</sup>

Terminology aside, an employee benefit plan exists if from the surrounding circumstances a reasonable person could ascertain intended statutory benefits,<sup>47</sup> beneficiaries, a source of financing and procedures for receiving benefits.<sup>48</sup> In particular, to be an employee welfare benefit plan (1) the intended benefits must include health, accident, death, disability or other benefits enumerated in section 1002(1); (2) the intended

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38. 107 S. Ct. 1549 (1987). See *infra* text accompanying notes 180-311 for a detailed discussion and analysis of *Pilot Life*.

39. *Pilot Life*, 107 S. Ct. at 1550-51.

40. 29 U.S.C. § 1002(1) (1982).

41. *Id.* § 1002(2).

42. Employee "benefit plans" include both welfare benefit and pension benefit plans. *Id.* § 1002(3). "Benefit plan" may refer to either a welfare benefit or pension benefit plan. *Id.*

43. Pension benefit plans are those established to provide employees with retirement or deferred income. 29 U.S.C. § 1002(2)(A).

44. *Id.* § 1002(1).

45. *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 732 (1985). For example, a company or union that sets aside its own funds for the purpose of paying health benefits to its employees or members creates an uninsured plan.

46. *Id.*

47. See *supra* text accompanying note 44 for a list of these benefits.

48. *Donovan v. Dillingham*, 688 F.2d 1367, 1373 (11th Cir. 1982).



beneficiaries must include employees, union members, former employees or their beneficiaries; and (3) the employer or employee organization, not individual employees, must establish and maintain the plan.<sup>49</sup> Although ERISA requires that plans be in writing,<sup>50</sup> the plan need not be in writing to be considered in force and governed by the statute.<sup>51</sup> No single act necessarily establishes a plan.<sup>52</sup>

## 2. Scope of ERISA coverage

ERISA covers virtually all private employee benefit plans.<sup>53</sup> Coverage includes benefit plans established by (1) employers engaged in commerce or in any industry or activity affecting commerce; or (2) employee organizations representing employees engaged in commerce or in any industry or activity affecting commerce.<sup>54</sup>

Significantly, ERISA does not regulate the substantive content of welfare benefit plans;<sup>55</sup> that is, the statute does not dictate what benefits and services a plan must contain. However, ERISA does impose standards of fiduciary responsibility<sup>56</sup> upon plan fiduciaries<sup>57</sup> and administra-

49. *Id.*

50. See 29 U.S.C. § 1102(a)(1) (1982).

51. *Donovan*, 688 F.2d at 1372. The *Donovan* court noted that although ERISA's fiduciary and reporting provisions require administrators and fiduciaries to file with the Department of Labor a written instrument establishing the plan, filing is not a prerequisite to coverage under the Act. *Id.* The court reasoned that because the policy of ERISA is to protect the security of workers and their beneficiaries, it would be incongruous to allow persons establishing or maintaining informal plans to circumvent the statute's requirements merely because a plan administrator or fiduciary had failed to satisfy reporting or filing requirements. *Id.*

52. *Id.* at 1373.

53. Several statutory exceptions to ERISA coverage exist. Congress exempted from ERISA coverage plans maintained solely to comply with workers' compensation, unemployment compensation or disability insurance laws. 29 U.S.C. § 1003(b)(3) (1982). Also, ERISA does not cover "governmental" plans. *Id.* § 1003(b)(1). A governmental plan is one established by federal, state or local government for its employees. *Id.* § 1002(32). Further, ERISA does not cover "church" plans. *Id.* § 1003(b)(2). A church plan is one established by a church or religious organization for its employees, or by an association of churches or religious organizations that is exempt from taxes under § 501 of the Internal Revenue Code of 1954 (I.R.C. § 501 (1982)). *Id.* § 1002(33).

54. *Id.* § 1003(a).

55. *Metropolitan Life*, 471 U.S. at 732.

56. Section 1104(a)(1), setting out ERISA's standard of fiduciary responsibility, provides in pertinent part:

[A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

(A) for the exclusive purpose of:

- (i) providing benefits to participants and their beneficiaries; and
- (ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims . . .

tors,<sup>58</sup> which are directed toward plan participants and to the plan itself.<sup>59</sup> ERISA also requires plan administrators to report to the Labor Department,<sup>60</sup> and to disclose plan terms to participants.<sup>61</sup>

In contrast to ERISA, state insurance laws govern the substantive content of insured welfare benefit plans.<sup>62</sup> For example, a state law requiring all group health insurance policies to include mental health benefits substantively regulates welfare benefit plans.<sup>63</sup> Thus, ERISA and state insurance laws regulate insured welfare benefit plans simultaneously—ERISA creates fiduciary, reporting and disclosure standards while state insurance laws<sup>64</sup> govern plan content.<sup>65</sup>

29 U.S.C. § 1104(a)(1) (1982).

57. Section 1102(a) provides:

(1) Every employee benefit plan shall be established and maintained pursuant to a written instrument. Such instrument shall provide for one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation and administration of the plan.

(2) For purposes of this subchapter, the term "named fiduciary" means a fiduciary who is named in the plan instrument, or who, pursuant to a procedure specified in the plan, is identified as a fiduciary (A) by a person who is employer or employee organization with respect to the plan or (B) by such an employer and such an employee organization acting jointly.

29 U.S.C. § 1102(a) (1982). See *infra* note 58 for the definitions of plan administrators and sponsors. See *supra* note 56 for ERISA's standard of fiduciary responsibility.

58. Section 1002(16)(A) provides:

The term "administrator" means—

(i) the person specifically so designated by the terms of the instrument under which the plan is operated; (ii) if an administrator is not so designated, the plan sponsor; or (iii) in the case of a plan for which an administrator is not designated and a plan sponsor cannot be identified, such other person as the Secretary [of Labor] may by regulation prescribe.

29 U.S.C. § 1002(16)(A) (1982).

"Plan sponsor" means:

(i) the employer in the case of an employee benefit plan established or maintained by a single employer, (ii) the employee organization in the case of a plan established or maintained by an employee organization, or (iii) in the case of a plan established or maintained by two or more employers or jointly by one or more employers and one or more employee organizations, the association, committee, joint board of trustees, or other similar group of representatives of the parties who establish or maintain the plan.

*Id.* § 1002(16)(B).

Thus, the written instrument establishing the plan designates the administrator. If the instrument does not, then generally the employer or the union sponsoring the plan is considered the administrator.

59. See *id.* § 1104(a)(1)(A). See *supra* note 56 for the relevant text of this section.

60. 29 U.S.C. § 1021(b) (1982).

61. *Id.* § 1021(a).

62. See, e.g., *Metropolitan Life*, 471 U.S. at 739 (state law requiring inclusion of mental health benefits in all health insurance policies regulated terms of employee benefit plans).

63. See, e.g., *id.* See *infra* text accompanying notes 131-79 for a discussion of *Metropolitan Life*.

64. The core dispute in *Pilot Life* was whether a Mississippi state law regulated insurance

### 3. Enforcement and remedies under ERISA

Six avenues of civil enforcement are available under ERISA.<sup>66</sup> Of significance to insured welfare benefit plan participants is section 1132(a)(1)(B). This provision allows aggrieved participants to sue for benefits due under a plan.<sup>67</sup> Another subsection permits participants and beneficiaries to obtain injunctive or "other appropriate equitable relief."<sup>68</sup>

In addition to benefits due, one circuit of the United States Court of Appeals has held that punitive damages were available under ERISA in "appropriate cases."<sup>69</sup> However, more recent Supreme Court decisions

within the meaning of ERISA. See *infra* text accompanying notes 180-311 for a detailed discussion of *Pilot Life*.

65. *Metropolitan Life*, 471 U.S. at 732. Unlike welfare benefit plans, ERISA subjects pension benefit plans to exhaustive and rigorous substantive regulation. Substantive provisions regulate pension benefit plans in terms of participation, vesting and funding. See 29 U.S.C. §§ 1051-1086 (1982 & Supp. III 1985).

66. 29 U.S.C. § 1132 (1982). Under § 1132(a)(1)(B), a plan participant may sue to recover benefits due, to enforce rights under the terms of the plan or to clarify rights to future benefits under the terms of the plan. *Id.* § 1132 (a)(1)(B). Under § 1132(a)(1)(A), a plan participant or beneficiary may bring a civil action to compel a plan administrator to disclose certain information about the plan. *Id.* § 1132(a)(1)(A).

Section 1132 provides five other means of enforcement. Actions may be brought: (1) by the Secretary of Labor, a plan participant or beneficiary or a plan fiduciary against a plan fiduciary for breach of fiduciary duty to the plan, *see id.* § 1132(a)(2); (2) by a participant, beneficiary or plan fiduciary for injunctive or other equitable relief to redress violations of ERISA or terms of a plan, *see id.* § 1132(a)(3); (3) by the Secretary of Labor, plan participant or beneficiary to obtain from the plan administrator information contained in reports to the Internal Revenue Service, *see id.* § 1132(a)(4); (4) by the Secretary of Labor to enjoin any proscribed activity under ERISA, *see id.* § 1132(a)(5); and (5) by the Secretary of Labor to collect any civil penalties, *see id.* § 1132(a)(6).

Criminal sanctions are available against plan administrators who willfully violate reporting requirements. Willful reporting violations may result in prison terms of up to one year and fines of up to \$5,000, or if the violator is not an individual, such as a corporation, of fines up to \$100,000. *See id.* § 1131.

Concerning jurisdiction, federal courts exercise exclusive power to hear ERISA cases except for actions brought under § 1132(a)(1)(B). *Id.* § 1132(e)(1). This exception is quite significant because it is the avenue under which participants must sue to recover benefits due. Under § 1132(a)(1)(B), the participant may also bring the action in state courts of competent jurisdiction. *Id.* § 1132(e)(1). However, if a participant brings an action in state court based upon state law, the defendant may remove the action to federal court upon pleading as a defense that ERISA preempts the state causes of action. *Metropolitan Life Ins. Co. v. Taylor*, 107 S. Ct. 1542, 1548 (1987) (companion case to *Pilot Life Ins. Co. v. Dedeaux*, 107 S. Ct. 1549 (1987)).

67. *See supra* note 66 for a discussion of § 1132(a)(1)(B) and other ERISA enforcement provisions.

68. *See* 29 U.S.C. § 1132(a)(3) (1982).

69. *See Kuntz v. Reese*, 760 F.2d 926, 938 (9th Cir. 1985) (punitive damages available in appropriate cases to participants under § 1109(a) which provides cause of action against plan fiduciary who breaches fiduciary duty owed to plan), *vacated*, 785 F.2d 1410 (9th Cir. 1986);

have virtually foreclosed participants from recovering such damages under the statute.<sup>70</sup>

In contrast, the majority of states permit insureds to sue their insurers in tort for bad faith mishandling of claims.<sup>71</sup> This distinction is important because under tort theories insureds may recover substantial extracontractual awards.<sup>72</sup> Thus, the decision in *Pilot Life*, where the Court held that ERISA preempts common-law bad faith actions, significantly and negatively affects rights of insured welfare benefit plan participants and beneficiaries.

## *B. ERISA's Preemption Provisions: the Preemption, Saving and Deemer Clauses and Their Legislative History*

### 1. Plain language

On its face, ERISA's preemption section presents a three-step analy-

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Russell v. Massachusetts Mut. Life Ins. Co., 722 F.2d 482, 490-92 (9th Cir. 1983) (same), *rev'd*, 473 U.S. 134 (1985).

70. See *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134 (1985); *Pilot Life Ins. Co. v. Dedeaux*, 107 S. Ct. 1549, 1555-58 (1987). In *Russell*, the Court held that § 1109(a), which establishes liability for breach of fiduciary duty, does not entitle a participant to recover extracontractual damages against the fiduciary for the fiduciary's mishandling of a claim. *Id.* at 148. The Court expressly reserved the question whether and to what extent extracontractual damages were available under "catchall" § 1132(a)(3). *Id.* at 139 n.5. Section 1132(a)(3) authorizes a participant to bring an action to "enjoin any act or practice which violates any provision of [ERISA] or the terms of the plan," 29 U.S.C. § 1132(a)(3), or "to obtain other appropriate equitable relief." *Id.* In addition, the Court stated that the "carefully integrated" civil enforcement provisions of ERISA show that Congress did not intend to authorize remedies other than those expressed in the statute, and that the Court accordingly should not "tamper" with expressed remedies. *Russell*, 473 U.S. at 146-47.

Concurring in the Court's judgment, Justice Brennan, joined by Justices White, Marshall and Blackmun, criticized as overbroad the majority's dictum which stated that extracontractual damages were not available to participants and beneficiaries under any ERISA provision. *Id.* at 150-51 (Brennan, J., concurring in judgment). Justice Brennan reasoned that Congress intended to allow courts under § 1132(a)(3) to decree appropriate equitable remedies based on federal and state trust and pension law. *Id.* at 154-58 (Brennan, J., concurring in judgment). Justice Brennan concluded that if trust law allowed extracontractual recovery and did not conflict with ERISA, then extracontractual liability could be appropriate. *Id.* at 157-58 (Brennan, J., concurring in judgment).

Notwithstanding Justice Brennan's objection, subsequent lower courts have held that punitive damages are not recoverable under ERISA, even on a trust theory. See, e.g., *Sommers Drug Stores v. Corrigan Enters., Inc.*, 793 F.2d 1456, 1462-65 (5th Cir. 1986) (catchall § 1132(a)(2)'s term "other appropriate equitable relief" does not import punitive damages because under general trust theory punitive damages are not available for breach of fiduciary duty), *cert. denied*, 107 S. Ct. 884 (1987); *cert. denied*, 107 S. Ct. 1298 (1987).

71. See *supra* note 1 and accompanying text.

72. See *supra* notes 7-8 and accompanying text.

sis to determine whether the statute preempts a state law.<sup>73</sup> First, the "preemption clause"<sup>74</sup> provides that ERISA preempts any state law relating to an employee benefit plan.<sup>75</sup> Second, the "saving clause"<sup>76</sup> exempts ("saves") from preemption state laws that relate to employee benefit plans but also regulate insurance, banking or securities.<sup>77</sup> Third, the "deemer clause"<sup>78</sup> bars states from deeming employee benefit plans to be insurance companies for the purpose of laws purporting to regulate insurance.<sup>79</sup> Thus, ERISA recognizes a distinction between insured and uninsured welfare benefit plans. On one hand, ERISA allows states to partially regulate insured welfare benefit plans because the saving clause saves state insurance laws from preemption. On the other hand, states are barred from regulating uninsured plans because state insurance laws cannot deem a plan to be an insurance company for purposes of regulating the plan.<sup>80</sup>

To determine whether ERISA preempts a state law,<sup>81</sup> courts must

73. Section 1144 contains ERISA's preemption provisions. The section provides in pertinent part:

(a) [(preemption clause)] Except as provided in subsection (b) of this section [the saving clause], the provisions of this subchapter and subchapter III of this chapter shall supersede any and all state laws insofar as they may now or hereafter relate to any employee benefit plan . . . .

(b)(2)(A) [(saving clause)] Except as provided in subparagraph (B) [the deemer clause], nothing in this subchapter shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities.

(B) [(deemer clause)] Neither an employee benefit plan nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer . . . for purposes of any law of any State purporting to regulate insurance companies, [or] insurance contracts . . . .

29 U.S.C. § 1144 (1982). "[T]his subchapter" referred to in subsection (a) (preemption clause) refers to Subchapter I, entitled "PROTECTION OF EMPLOYEE BENEFIT RIGHTS." Subchapter I is located at 29 U.S.C. §§ 1001-1145 (1982 & Supp. III 1985). Subchapter I includes all sections of ERISA relevant to this Note.

74. *Id.* § 1144(a) (preemption clause). See *infra* note 73 for the pertinent text of the preemption, saving and deemer clauses.

75. 29 U.S.C. § 1144(a).

76. *Id.* § 1144(b)(2)(A).

77. *Id.*

78. *Id.* § 1144(b)(2)(B).

79. *Id.* Under § 1132(d), a plan is a legal entity capable of suing and being sued. *Id.* § 1132(d).

80. See *supra* notes 45-46 and accompanying text for an explanation of insured and uninsured plans.

81. ERISA's preemption section also touches upon federal law. The statute provides that ERISA shall not impair or supersede any other federal statute. 29 U.S.C. § 1144(d) (1982). This aspect of ERISA preemption doctrine creates a quandary when the *other* federal statute contains a saving clause. That is, the other statute provides that *it* shall not impair state laws regulating a certain subject. In such a situation, ERISA arguably cannot operate to impair the federal law which leaves regulation of a subject to the states. As a result, ERISA should not preempt state law saved by the other federal statute. For an example of this "double saving

therefore test the law against all three clauses.

## 2. Legislative history of ERISA's preemption provisions

ERISA's preemption clause<sup>82</sup> contains sweeping language. The clause provides that ERISA preempts "any and all state laws insofar as they now or hereafter relate to any employee benefit plan."<sup>83</sup> The legislative history confirms that ERISA's principal framers intended the words to be interpreted broadly. Senator Harrison Williams, ERISA's Senate co-sponsor,<sup>84</sup> stated:

It should be stressed that with the narrow exceptions specified in the bill, the substantive and enforcement provisions of the conference substitute<sup>[85]</sup> are intended to preempt the field for Federal regulations, thus eliminating the threat of conflicting or inconsistent State and local regulation of employee benefit plans. This principle is intended to apply in its broadest sense to all actions of State or local governments, or any instrumentality thereof, which have the force or effect of law.<sup>86</sup>

Representative Dent, the House sponsor, stated:

I wish to make note of what is to many the crowning achievement of this legislation, the reservation to Federal authority the sole power to regulate the field of employee benefit plans. With the preemption of the field, we round out the protection afforded participants by eliminating the threat of conflicting and

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clause" theory involving ERISA and Title VII of the Civil Rights Act of 1964, 42 U.S.C. §§ 2000-2000h-6 (1982), see *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 100-06 (1983) (ERISA preempted New York discrimination law purportedly saved by Title VII saving clause).

82. 29 U.S.C. § 1144(a).

83. *Id.* See *supra* note 73 for the pertinent text of the preemption clause.

84. *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 156 (1985) (Brennan, J., concurring in judgment). Senator Javits of New York was the other Senate co-sponsor. *Id.*

85. ERISA's conference committee substituted the much broader language quoted in the text for that contained in the bill which became ERISA. *Shaw*, 463 U.S. at 98-99. The bill that passed the House provided that ERISA supersedes state laws " 'relat[ing] to the reporting and disclosure responsibilities, and fiduciary responsibilities, of persons acting on behalf of any employee benefit plan.' " *Id.* at 98 n.18 (quoting SUBCOMM. ON LABOR OF THE SENATE COMM. ON LABOR AND PUBLIC WELFARE, 94TH CONG., 2D SESS., LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 at 4057-58 (Comm. Print 1976)). The Senate version provided that ERISA preempted state laws " 'relat[ing] to the subject matters regulated by [the] Act.' " *Id.* (quoting SUBCOMM. ON LABOR OF THE SENATE COMM. ON LABOR AND PUBLIC WELFARE, 94TH CONG., 2D SESS., LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 at 3820 (Comm. Print 1976)).

Thus, by substituting much broader language in the preemption clause, the Conference Committee manifested Congress' intent that the clause's scope be sweeping.

86. 120 CONG. REC. 29,933 (1974) (remarks of Senator Williams).

inconsistent State and local regulation.<sup>87</sup>

The language and legislative history of ERISA suggest that the preemption clause has extremely broad effect.

While the legislative history of the preemption clause is enlightening, the record reveals virtually no mention of the saving or deemer clauses.<sup>88</sup> The Conference Committee report merely stated: "the preemption provisions of [subchapter I] are not to exempt any person from any State law that regulates insurance . . . ."<sup>89</sup> Thus, Congress left the courts the task of developing the relationship among the three provisions.

### C. *The Supreme Court and ERISA Preemption Doctrine Prior to Pilot Life*

#### 1. Preemption clause: The meaning of "relate to"

The Supreme Court has developed the parameters of the preemption

87. 120 CONG. REC. 29,197 (1974) (remarks of Representative Dent). For a discussion of ERISA's legislative history in general and of its preemption provisions in particular, see Gregory, *The Scope of ERISA Preemption of State Law: A Study in Effective Federalism*, 48 U. PITT. L. REV. 427, 437-58 (1987). See also *Shaw*, 463 U.S. at 98-100 (Supreme Court's analysis of legislative history of preemption section).

88. The Conference Committee report merely stated: "The preemption provisions of [subchapter I] are not to exempt any person from any State law that regulates insurance . . . ." H.R. CONF. REP. NO. 1280, 93D CONG., 2D SESS. 383, reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 5162.

However, the history does indicate that Congress failed to consider the conflict generated by juxtaposing the preemption and saving clauses. In *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724 (1985), the Supreme Court reported comprehensively on the history of the saving clause. The Court found:

The Conference Committee that was convened to work out differences between the Senate and House versions of ERISA broadened the general pre-emption provision from one that pre-empted state laws only insofar as they regulated the same areas explicitly regulated by ERISA, to one that pre-empts all state laws unless otherwise saved. The change gave the insurance saving clause a much more significant role, as a provision that saved an entire body of law from the sweeping general pre-emption clause. There were no comments on the floor . . . specifically concerning the insurance saving clause, and hardly any concerning the exceptions to the pre-emption clause in general.

*The change in the pre-emption provision was not disclosed until the Report was filed with Congress 10 days before final action was taken on ERISA.* The House conferees filed their Report . . . on August 12 [1974] while the Senate conferees filed their report . . . the following day. . . . ERISA was passed by the House on August 20, 1974, and by the Senate on August 22.

*Id.* at 745 n.23 (emphasis added) (citations omitted). The Court concluded that little indicated that Congress appreciated the "prominence" it was giving the saving clause. *Id.* at 745.

See *infra* text accompanying notes 131-79 for a discussion of the ramifications of the language and juxtaposition of the preemption and saving clauses.

89. H.R. CONF. REP. NO. 1280, 93d Cong., 2d Sess. 383, reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 5162.

clause<sup>90</sup> over the course of two cases: *Alessi v. Raybestos-Manhattan, Inc.*<sup>91</sup> and *Shaw v. Delta Air Lines, Inc.*<sup>92</sup> Subsequent cases, including *Pilot Life Insurance Co. v. Dedeaux*,<sup>93</sup> have reaffirmed *Alessi* and *Shaw* with respect to the scope of the preemption clause.<sup>94</sup>

*a. Alessi v. Raybestos-Manhattan, Inc.: ERISA and directly conflicting state laws*

In *Alessi v. Raybestos-Manhattan, Inc.*,<sup>95</sup> the plaintiffs were a class of retired workers who participated in pension benefit plans.<sup>96</sup> The defendants, who maintained the pension plans, had been the plaintiffs' employers.<sup>97</sup> Under the plans, pension payments to retirees were offset by amounts the retirees received from workers' compensation—the "integration" method for calculating pension benefits.<sup>98</sup> However, New Jersey, the jurisdiction in which this case arose, amended its workers' compensation law to prohibit such offsets.<sup>99</sup> Completing the picture, ERISA permitted the offsets.<sup>100</sup>

The retirees claimed that the employers were operating the plan in violation of New Jersey law.<sup>101</sup> They further contended that ERISA did not preempt the New Jersey law because the law was a workers' compensation law rather than a pension law.<sup>102</sup> Therefore, the argument went, the New Jersey law did not "relate to" an employee benefit plan within the meaning of the preemption clause.<sup>103</sup>

The Supreme Court rejected the retirees' argument as elevating form over substance.<sup>104</sup> Justice Marshall stated for the Court:

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90. 29 U.S.C. § 1144(a) (1982).

91. 451 U.S. 504 (1981).

92. 463 U.S. 85 (1983).

93. 107 S. Ct. 1549 (1987).

94. See *id.* at 1553 (1987); *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 737 (1985).

95. 451 U.S. 504.

96. *Id.* at 508.

97. *Id.* at 507.

98. *Id.* The integration method of calculating pension benefits determines benefit levels by combining pension funds with other streams of income available to the participant, such as social security. *Id.* at 514.

99. *Id.* at 508. The amendment stated "[t]he right of compensation granted by this chapter may be set off against disability pension benefits or payments but shall not be set off against employees' retirement pension benefits or payments." *Id.* (quoting N.J. STAT. ANN. § 34:15-29 (West Supp. 1981)).

100. *Alessi*, 451 U.S. at 517-21.

101. *Id.* at 508.

102. *Id.* at 524-25.

103. *Id.*

104. *Id.* at 525.



It is of no moment that New Jersey intrudes indirectly, through a workers' compensation law, rather than directly, through a statute called "pension regulation." ERISA makes clear that even indirect state action bearing on private pensions may encroach upon the area of exclusive federal concern. . . . ERISA's authors clearly meant to preclude the States from avoiding through form the substance of the pre-emption [clause].<sup>105</sup>

Significantly, the Court reserved defining the outer limits of the phrase "relate to."<sup>106</sup> Since the New Jersey law directly conflicted with ERISA, the Justices found it unnecessary to "determine the outer bounds of ERISA's pre-emptive language."<sup>107</sup> The Court accordingly held that the preemption clause encompassed the New Jersey law and therefore pre-empted it.<sup>108</sup>

Two ramifications of the *Alessi* decision are noteworthy. First, a state cannot avoid the preemption clause by couching a law in terms other than those of an "employee benefit" law. Second, the New Jersey law directly conflicted with ERISA. Thus, after *Alessi*, defenders of state laws *not* in direct conflict with substantive provisions of ERISA could still argue that the preemption clause did not affect such laws.<sup>109</sup>

*b. Shaw v. Delta Air Lines, Inc.: the outer boundary of "relate to"*

The Court next addressed the scope of the preemption clause in *Shaw v. Delta Air Lines, Inc.*<sup>110</sup> In *Shaw*, the Justices faced the issue they had reserved in *Alessi*<sup>111</sup>—the outer boundary of the preemption clause phrase "relate to."

In *Shaw*, the Justices examined New York's Human Rights Law<sup>112</sup>

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.* at 525-26. Because this case did not involve a state insurance, banking or securities law, the Court did not consider the operation of the saving clause.

109. The Court reserved the question by stating, "[w]e need not determine the outer bounds of ERISA's pre-emptive language to find this New Jersey provision an impermissible intrusion on the federal regulatory scheme." *Id.* at 525.

110. 463 U.S. 85 (1983).

111. See *supra* note 109.

112. N.Y. EXEC. LAW § 296.1 (McKinney 1982 & Supp. 1983). Section 296.1 provides:

1. It shall be an unlawful discriminatory practice:

(a) For an employer or licensing agency, because of the age, race, creed, color, national origin, sex, or disability, or marital status of any individual, to refuse to hire or employ or to bar or to discharge from employment such individual or to discriminate against such individual in compensation or in terms, conditions or privileges of employment. *Id.* (as quoted in *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 88 (1983)).

against ERISA's preemption clause.<sup>113</sup> The New York law prohibited employers from discriminating against employees based on age, race, creed, color, national origin, sex, disability or marital status.<sup>114</sup> In addition, the New York Court of Appeals had previously held that employers engaged in sex discrimination within the meaning of the law when they treated pregnancy differently from other nonoccupational disabilities in the context of employee benefit plans.<sup>115</sup>

The unanimous Supreme Court held that a state law related to an ERISA plan if the law merely had a "connection with or reference to such a plan."<sup>116</sup> The Court rejected a narrower *Alessi* construction which maintained that the preemption clause encompassed only state laws in direct conflict with ERISA provisions.<sup>117</sup> The Justices reasoned that as a general rule federal law preempts state law if Congress intended preemption.<sup>118</sup> The preemption clause language,<sup>119</sup> the structure of the section in which the clause is located,<sup>120</sup> and that section's legislative history<sup>121</sup> clearly indicated to the Court that Congress intended to give broadest meaning to the phrase "relate to."<sup>122</sup>

Turning to the Human Rights Law, the Court noted that the law as construed by the New York Court of Appeals prohibited employers from discriminating within employee benefit plans on the basis of pregnancy.<sup>123</sup> Given the broad meaning of "relate to," the law certainly related to employee benefit plans within the meaning of the preemption clause.<sup>124</sup> Thus, the preemption clause encompassed the Human Rights Law.<sup>125</sup>

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113. *Shaw*, 463 U.S. at 92-100.

114. See *supra* note 112 for the pertinent text.

115. *Shaw*, 463 U.S. at 88 (citing *Brooklyn Union Gas Co. v. New York State Human Rights Appeal Bd.*, 41 N.Y.2d 84, 359 N.E.2d 393, 390 N.Y.S.2d 884 (1976)).

116. *Id.* at 96-97.

117. *Id.* at 96 n.15.

118. *Id.* at 95. *Accord Metropolitan Life*, 471 U.S. at 738. See *infra* notes 131-79 and accompanying text for further discussion of *Metropolitan Life*.

119. See *supra* note 73 for the text of § 1144(a).

120. The Court found that Congress manifested its intent to give broad meaning to "relate to" by placing the sweepingly worded preemption clause, § 1144(a), before the narrow exception of § 1144(b), which exempts state criminal laws from preemption. *Shaw*, 463 U.S. at 98. In so structuring the clauses, Congress manifested its intention to lend the words "relate to" their natural, "plain language" broadness. *Id.* at 97.

121. *Id.* at 98-99. The Court cited the remarks of ERISA sponsors Representative Dent and Senator Williams, which are set forth *supra* text accompanying notes 85-87.

122. *Shaw*, 463 U.S. at 96-100.

123. *Id.* at 88.

124. *Id.* at 96-97.

125. The Court also determined that a second law, New York's Disability Benefits Law, N.Y. WORK. COMP. LAW §§ 200-242 (McKinney 1965 & Supp. 1983), related to employee

The *Shaw* decision represented a significant broadening of the preemption clause's scope. Not only did ERISA preempt state laws directly conflicting with it, but the statute also preempted state laws merely exerting some effect, however indirect, on employee benefit plans. As in *Alessi*, however, the Court did not have occasion to interpret the interrelationship between the preemption clause and the insurance saving clause.<sup>126</sup>

## 2. *Metropolitan Life Insurance Co. v. Massachusetts* and the saving clause: the meaning of "regulate insurance"

In *Alessi* and *Shaw*, the Supreme Court definitively described the boundaries of the preemption clause. The saving clause,<sup>127</sup> however, has eluded precise demarcation. Upon plain reading, its language appears clear.<sup>128</sup> It provides that notwithstanding the preemption clause, ERISA does not preempt state laws that regulate insurance.<sup>129</sup> Difficulty arises, however, in determining precisely what laws "regulate insurance."<sup>130</sup>

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benefit plans. *Shaw*, 463 U.S. at 95-100. Regardless of whether an employer provided a benefit plan, the law required employers to provide the same level of disability benefits for pregnancy as they must for other disabilities. *Id.* at 90. The Court determined that since the law required employers to provide benefits, the law related to employee benefit plans and the preemption clause therefore encompassed it. *Id.* at 97 & n.17.

126. The Court did, however, address a saving clause theory unrelated to the insurance saving clause. The Court rejected as simplistic what one commentator has called the "double saving clause" theory. See Gregory, *supra* note 87, at 462. The argument ran as follows. ERISA may not impair the operation of any federal law. See 29 U.S.C. § 1144(d) (1982) ("[n]othing in this subchapter shall be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States . . . or any rule or regulation issued under any such law."). Title VII of the Civil Rights Act of 1964, 42 U.S.C. §§ 2000 to 2000h-6 (1982), which prohibited employment discrimination against employees based on race, religion, color, sex and national origin, also had a saving clause. This clause provided that the Civil Rights Act may not impair the operation of state discrimination laws unless the laws directly conflicted with Title VII. *Id.* § 2000h-4. Thus, the Title VII saving clause and the ERISA saving clause operated together to save from ERISA preemption all state discrimination laws not conflicting with Title VII. *Shaw*, 463 U.S. at 100-01.

The Court rejected the theory on the basis that Title VII was not impaired by ERISA preempting the New York laws. *Id.* at 102-03. The Court found Title VII "neutral" on the subject of employment practices it does not prohibit. *Id.* at 103. Thus, the Court "fail[ed] to see how . . . [Title VII] would be impaired by pre-emption of a state law prohibiting conduct that . . . [Title VII] permitted." *Id.* at 103-04.

See Gregory, *supra* note 87, at 462-67 for a detailed discussion of the double saving clause theory and its ramifications upon federalism.

127. 29 U.S.C. § 1144(b)(2)(A) (1982).

128. See *id.*

129. *Id.* The saving clause also exempts from preemption state banking and securities laws. *Id.* See *supra* note 73 for the text of the saving clause.

130. In addition to the definitional problem, the preemption and saving clauses read together create a conceptual inconsistency. The preemption clause provides that ERISA

In *Metropolitan Life Insurance Co. v. Massachusetts*,<sup>131</sup> the Supreme Court offered guidance to courts in determining whether a state law regulated insurance within the meaning of the saving clause. In a unanimous opinion written by Justice Blackmun, the Court held that a Massachusetts law requiring that all general health insurance policies contain certain minimum benefits for mental health care<sup>132</sup> regulated in-

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preempts any state law that relates to an employee benefit plan. 29 U.S.C. § 1144(a) (1982). Yet the saving clause exempts from preemption any state law that regulates insurance. *Id.* § 1144(b)(2)(A). Since insured welfare benefit plans provide benefits through purchase of group insurance policies, the saving clause seems to give back to the states much of which the preemption clause takes away—the power to regulate employee welfare benefit plans. See *supra* text accompanying notes 45-46 for an explanation of insured and uninsured welfare benefit plans. See also *Metropolitan Life*, 471 U.S. at 740 (“the saving clause appears broadly to preserve the States’ lawmaking power over [employee benefit plans]”). See *infra* notes 131-79 and accompanying text for a discussion of *Metropolitan Life*.

Congress’ motivation in exempting state insurance laws from preemption adds perspective to this collision between the preemption and saving clauses. Until 1944, insurance contracts, even between residents of different states, were considered local business and as such not subject to Congress’ commerce power. *Paul v. Virginia*, 75 U.S. (8 Wall.) 168, 183 (1868). Thus, only the states regulated the insurance business. In *United States v. South-Eastern Underwriters Ass’n*, 322 U.S. 533 (1944), however, the Supreme Court held that insurance contracts, while not in themselves interstate commerce, were part of interstate commerce. As such, insurance was subject to Congress’ commerce power.

In response to *South-Eastern Underwriters*, Congress in 1945 passed the McCarran-Ferguson Act (Act). E. BARRETT & W. COHEN, *CONSTITUTIONAL LAW* 211 n.a (1985). The Act, codified at 15 U.S.C. §§ 1011-1015 (1982 & Supp. IV 1986), explicitly conferred upon the states the power to regulate the insurance business. *Id.* § 1012(a). The Act provides in pertinent part:

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance . . . .”

*Id.* § 1012. Congress’ purpose was to ensure that the states retain the ability to tax and regulate the industry. *Metropolitan Life*, 471 U.S. at 744 n.21. In particular, Congress intended that cooperative ratemaking efforts among insurance companies be exempt from federal anti-trust laws. *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982) (citing *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 221 (1979)). Congress recognized that insurance company intra-industry rate cooperation was necessary to underwrite risks in an informed and responsible way. *Id.* Congress manifested this recognition in the McCarran-Ferguson Act by exempting the insurance industry from federal regulation—including the anti-trust laws. *Id.*

In the spirit of the McCarran-Ferguson Act, Congress exempted from ERISA preemption state laws that regulate insurance. *Metropolitan Life*, 471 U.S. at 744 n.21.

131. 471 U.S. 724.

132. MASS. GEN. LAWS ANN. ch. 175, § 47B (West Supp. 1985). Section 47B provides in pertinent part:

Any blanket or general policy of insurance . . . or any policy of accident and sickness insurance . . . or any employees’ health and welfare fund which provides hospital expense and surgical expense benefits . . . shall, provide benefits for expense of resi-

insurance within the meaning of the saving clause.<sup>133</sup> As a result, this "mandated benefits"<sup>134</sup> law was saved from preemption.<sup>135</sup>

In determining that the Massachusetts law regulated insurance, the Court subjected the law to two inquiries: (1) whether from a common sense point of view the mandated benefits law regulated insurance,<sup>136</sup> and (2) whether applying factors gleaned from cases interpreting the McCarran-Ferguson Act<sup>137</sup> phrase "business of insurance" indicated the law regulated insurance.<sup>138</sup>

First, the Court determined that from a common sense point of view the Massachusetts statute regulated insurance.<sup>139</sup> Since mandated benefits laws regulated the terms of insurance policies, such laws, "[t]o state the obvious,"<sup>140</sup> regulated insurance.<sup>141</sup>

Second, the Court turned to cases interpreting the McCarran-Ferguson Act phrase "business of insurance" to determine whether the Massachusetts law "regulated insurance" within the meaning of ERISA's saving clause. The McCarran-Ferguson Act<sup>142</sup> had empowered the states to regulate and tax the insurance business.<sup>143</sup> Particularly, Congress had exempted insurance companies from the federal antitrust

dents of the commonwealth covered under any such policy or plan, arising from mental or nervous conditions as described in the standard nomenclature of the American Psychiatric Association . . . .

*Id.* (as quoted in *Metropolitan Life v. Massachusetts*, 471 U.S. 424, 730 n.11 (1985)).

133. *Metropolitan Life*, 471 U.S. at 738-47.

134. The insurance industry and the courts refer to laws that require certain benefits to be included within an insurance policy as "mandated benefits" laws. *See, e.g., id.* at 728.

135. *Id.* at 758.

136. *Id.* at 740-41.

137. 15 U.S.C. §§ 1011-1015 (1982 & Supp. IV 1986). *See supra* note 130 for the pertinent text and a discussion of the Act.

138. *Metropolitan Life*, 471 U.S. at 742-44.

139. *Id.* at 740-41.

140. *Id.* at 740.

141. *Id.* The Justices found support for their common sense conclusion in the overall structure of ERISA's preemption provisions. *Id.* The saving clause does not identify characteristics of laws that regulate insurance. *See* 29 U.S.C. § 1144(b)(2)(A). Justice Blackmun determined, however, that by expressly including in the *deemer* clause laws regulating the terms of insurance contracts, Congress manifested its intention to include such laws within the scope of the saving clause as well. *Metropolitan Life*, 471 U.S. at 741-42; *see* 29 U.S.C. § 1144(b)(2)(B) (1982) (*deemer* clause) (employee benefit plan shall not be deemed to be insurance company for purposes of state laws "purporting to regulate insurance companies [or] insurance contracts"). The Court stated: "[u]nless Congress intended to include laws regulating insurance contracts within the scope of the insurance saving clause, it would have been unnecessary for the *deemer* clause explicitly to exempt such laws from the saving clause when they are applied directly to benefit plans." *Metropolitan Life*, 471 U.S. at 741. *See supra* note 73 for the text of the *deemer* clause.

142. 15 U.S.C. §§ 1011-1015. *See supra* note 135 for the text of the Act.

143. 15 U.S.C. § 1012 (1982).

laws.<sup>144</sup> Thus, whether a particular industry practice was part of the "business of insurance" became critical in determining whether that practice was subject to either federal antitrust regulation or state insurance laws.

In the cases construing the McCarran-Ferguson term "business of insurance,"<sup>145</sup> the Court had developed three factors to determine whether an industry practice was part of the "business of insurance."<sup>146</sup> The factors included (1) whether the insurance practice transferred or spread policyholder risk;<sup>147</sup> (2) whether the practice was an integral part of the insurer-insured relationship; and (3) whether the practice was limited to entities within the insurance business.<sup>148</sup> No one factor was in itself dispositive.<sup>149</sup> However, if applying the three factors together indicated that a practice regulated insurance, then the practice was subject to state rather than federal regulation.<sup>150</sup> The *Metropolitan Life* Court thought the issues subsumed in these factors equally relevant in determining whether a state law regulated insurance within the meaning of ERISA's saving clause.<sup>151</sup>

*a. policyholder risk*

First, the Court considered whether the Massachusetts law transferred policyholder risk.<sup>152</sup> This factor was pertinent in determining whether a practice was part of the McCarran-Ferguson "business of insurance" because Congress had determined that underwriting and transferring risk comprised the very essence of the insurance business.<sup>153</sup> The Court analogized insurance industry practices to state insurance laws.<sup>154</sup> The Justices reasoned that if the law transferred policyholder risk, then the law likely regulated insurance within the meaning of ERISA's saving

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144. *See id.* § 1013(b).

145. The Court cited *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982) and *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979).

146. *See, e.g., Pireno*, 458 U.S. at 126-34 (considering whether insurance company practice where committee comprised of chiropractors that determined whether individual treatments rendered by chiropractors were "unreasonable" constituted "business of insurance" practice).

147. *See infra* text accompanying notes 152-62 for a discussion of the spreading or transferring of policyholder risk.

148. *Metropolitan Life*, 471 U.S. at 743.

149. *Pireno*, 458 U.S. at 129.

150. The McCarran-Ferguson Act largely exempted insurance from federal regulation. *See* 15 U.S.C. § 1012(a); *see supra* note 130 for the text of the Act.

151. *Metropolitan Life*, 471 U.S. at 742-43.

152. *Id.*

153. *Pireno*, 458 U.S. at 127-28.

154. *Metropolitan Life*, 471 U.S. at 743.

clause.<sup>155</sup>

In determining whether the law transferred risk, the *Metropolitan Life* Court impliedly relied on general concepts of insurance and risk.<sup>156</sup> In general, insurance is an arrangement for transferring and distributing risk.<sup>157</sup> An insurance industry practice or insurance law spreads or transfers policyholder risk where the practice or law affects or manipulates risk allocation in a particular insurance market.<sup>158</sup> For example, a law or practice effects a transfer of risk when it forces good-risk persons, those not likely to place a claim for a certain benefit, to pay increased premiums for that potential benefit. As a result, bad-risk individuals can buy insurance policies for which they otherwise might not have qualified or for which they might have been forced to pay a much higher premium than good-risk individuals.

Applying these principles to the Massachusetts law, the Court found that the Massachusetts legislature had forced good-risk individuals to become part of the risk pool by requiring all health insurance policies to include mental health benefits.<sup>159</sup> By paying increased health insurance premiums resulting from the addition of mental health benefits to their policies, these good-risk individuals shouldered more of the burden of mental health insurance than they would have absent the law.<sup>160</sup> Conversely, bad-risk individuals—in this situation, those prone to need mental health care—were able to obtain insurance for mental illness.<sup>161</sup> Thus, the Massachusetts mandated benefits law effected a transfer or spreading of policyholder risk.<sup>162</sup>

### b. insurer-insured relationship

Second, the *Metropolitan Life* Court considered whether the man-

155. *Id.*

156. The Court derived the McCarran-Ferguson factors from *Pireno*. *Id.* (citing *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 126 (1982)). In *Pireno*, the Court in turn relied upon *Royal Drug*. *Pireno*, 458 U.S. at 127. Both the *Pireno* and *Royal Drug* Courts looked to the general insurance authorities 1 G. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 1:3 (2d ed. 1959); R. KEETON, *INSURANCE LAW* § 1.2(a) (1971); and 1 G. RICHARDS, *THE LAW OF INSURANCE* § 2 (5th ed. 1952). See *Pireno*, 458 U.S. at 127; *Royal Drug*, 440 U.S. at 211.

157. *Pireno*, 458 U.S. at 127 n.7 (quoting *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 211 (1979) (in turn citing 1 G. RICHARDS, *THE LAW OF INSURANCE* § 2 (5th ed. 1952))).

158. For a discussion of basic elements of risk and insurance, see generally E. VAUGHAN & C. ELLIOT, *FUNDAMENTALS OF RISK AND INSURANCE* 2-30 (2d ed. 1978); M. GREENE, *RISK AND INSURANCE* 1-19 (3d ed. 1973).

159. *Metropolitan Life*, 471 U.S. at 731.

160. *Id.*

161. *Id.*

162. *Id.*

dated benefits law affected an integral part of the insurer-insured relationship.<sup>163</sup> The McCarran-Ferguson cases had demonstrated that a law or practice affecting that relationship concerned “the type of policy which could be issued, its reliability, interpretation and enforcement— . . . the core of the ‘business of insurance.’ ”<sup>164</sup> The *Metropolitan Life* Court in turn found the question illuminating in analyzing whether the Massachusetts law regulated insurance within the meaning of the saving clause.<sup>165</sup>

Applying this factor, the Court determined that the law necessarily affected the “type of policy which could be issued” by limiting the type of coverage that could be transacted.<sup>166</sup> The mandated benefits law therefore affected an integral part of the insurer-insured relationship.<sup>167</sup>

*c. limited to entities within the insurance industry*

Finally, the Court turned to whether the mandated benefits law was limited to entities within the insurance industry.<sup>168</sup> The Court in the McCarran-Ferguson cases had distilled this factor from Congress’ intention that cooperative ratemaking efforts among insurance companies be exempt from federal antitrust laws.<sup>169</sup> Specifically, Congress had recognized that insurance company intra-industry rate cooperation was necessary to underwrite risks in an “informed and responsible way.”<sup>170</sup> Congress had manifested this concern in the McCarran-Ferguson Act by exempting the insurance industry from federal regulation—including the antitrust laws.<sup>171</sup>

At the same time, however, Congress did not intend to extend this exemption to entities outside the insurance industry.<sup>172</sup> Accordingly, the Court reasoned in the cases that if a practice was limited to the insurance industry, then exempting it from federal antitrust laws would not exempt

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163. *Id.* at 743.

164. *Pireno*, 458 U.S. at 128 (quoting *Securities & Exch. Comm’n v. National Sec., Inc.*, 393 U.S. 453, 460 (1969)).

165. *Metropolitan Life*, 471 U.S. at 743.

166. *Id.*

167. *Id.*

168. *Id.*

169. *Pireno*, 458 U.S. at 129 (citing *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 221 (1979)). See *supra* note 130 for the text and a discussion of the McCarran-Ferguson Act.

170. *Pireno*, 458 U.S. at 129 (quoting *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 221 (1979)).

171. *Id.*

172. *Id.*



a noninsurance industry practice.<sup>173</sup> Thus, a practice affected the “business of insurance” only when it concerned entities solely within the insurance business.

The *Metropolitan Life* Court adopted this third factor as indicative of whether a law regulated insurance within the meaning of ERISA’s saving clause. If the law affected only entities within the insurance industry, then it was likely the law regulated insurance.<sup>174</sup> Applying this factor, the Court noted that the mandated benefits law imposed requirements only on insurers.<sup>175</sup> Further, the Massachusetts legislature had intended the law to affect only the insurer-insured relationship.<sup>176</sup> Thus, the Court concluded that the law was limited to entities within the insurance industry.<sup>177</sup>

In sum, the Massachusetts mandated benefits law met all three McCarran-Ferguson factors. Moreover, the law in common sense regulated insurance. The Court accordingly held that the law regulated insurance within the meaning of the saving clause and was saved from ERISA preemption.<sup>178</sup>

The saving clause emerges muted gray in light of the Court’s analysis in *Metropolitan Life*. To determine whether a law falls within the saving clause, a court must subjectively determine whether the law in common sense regulates insurance. Then the court must weigh the law against the three McCarran-Ferguson factors, none of which is dispositive. In contrast, the preemption clause looms in sharp relief: a court need only ask if the state law affects, even indirectly, an employee benefit plan. As Justice Blackmun dryly remarked, “[the preemption and saving clauses], while clear enough on their faces, perhaps are not a model of legislative drafting . . . .”<sup>179</sup>

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173. *Id.*

174. *Metropolitan Life*, 471 U.S. at 743.

175. *Id.*

176. *Id.*

177. *Id.*

178. The Court also found nothing in ERISA’s legislative history indicating that Congress intended to place a narrower meaning on the phrase “regulate insurance.” *Id.* at 745-46.

179. *Id.* at 739. *Metropolitan Life* also illuminates the interaction between the saving and deemer clauses. Congress attempted to preserve state regulation of insurance by writing the saving clause into ERISA’s preemption provisions. *Id.* at 744 n.21. At the same time, by inserting the deemer clause after the saving clause Congress assured that states could not regulate *uninsured* welfare benefit plans. See 29 U.S.C. § 1144(b)(2)(B); see *supra* text accompanying notes 48-49 for an explanation of insured and uninsured plans.

In *Metropolitan Life*, a Massachusetts mandated benefits law required that all group health insurance policies and all employee welfare benefit plans include benefits for mental health treatment. The Supreme Court held that ERISA’s saving clause saved the law from preemption with respect to insured welfare benefit plans. 471 U.S. at 747. However, the Court

III. *PILOT LIFE INSURANCE CO. V. DEDEAUX*

The Supreme Court was next called upon to decide whether a law was saved from ERISA preemption in *Pilot Life Insurance Co. v. Dedeaux*.<sup>180</sup> In this case, the state law in question, Mississippi's common law of bad faith, presented an even more difficult subject for analysis than the mandated benefits law in *Metropolitan Life Insurance Co. v. Massachusetts*.<sup>181</sup>

A. *The Facts*

The dispute in *Pilot Life* arose in 1975 after the plaintiff, Everate Dedeaux (Dedeaux), suffered a work related back injury.<sup>182</sup> Following the incident, Dedeaux applied to defendant, Pilot Life Insurance Company (Pilot Life), for long term disability benefits through his employee benefit plan.<sup>183</sup> Dedeaux's employer, Entex, Inc., had established this insured welfare benefit plan<sup>184</sup> by purchasing a group disability insurance policy from Pilot Life.<sup>185</sup> Under the plan, Pilot Life decided whether claimants were to receive benefits.<sup>186</sup> After paying benefits to Dedeaux for two years, Pilot Life terminated the payments.<sup>187</sup> During the following three years, Pilot Life reinstated and terminated Dedeaux's benefits several times.<sup>188</sup>

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held that the law was not saved from preemption when applied to uninsured benefit plans. *Id.* at 735 n.14. The Court realized that its decision resulted in a distinction between insured and uninsured plans—the former were open to state regulation and the latter were not. *Id.* at 747. The Court went on, however, to declare that it was merely giving life to a distinction created by Congress in the deemer clause. *Id.*

180. 107 S. Ct. 1549 (1987).

181. 471 U.S. 724 (1985). See *supra* text accompanying notes 131-79 for a discussion of *Metropolitan Life*.

182. *Pilot Life Ins. Co. v. Dedeaux*, 107 S. Ct. 1549, 1551 (1987).

183. *Id.*

184. See *supra* text accompanying notes 45-46 for an explanation of insured and uninsured plans.

185. *Pilot Life*, 107 S. Ct. at 1551.

186. *Id.*

187. *Id.*

188. *Id.* Pilot Life contended that it originally terminated payments because "independent" medical reports indicated Dedeaux was able to perform light or sedentary work. Brief for Petitioner at 3, *Pilot Life Ins. Co. v. Dedeaux*, 107 S. Ct. 1549 (1987) (No. 85-1043). Under the terms of the plan, Pilot Life was entitled to stop payments if the employee was able to "engage in any gainful employment." *Id.* at 2 n.1, 3. After Dedeaux filed suit in the district court, Pilot Life reinstated payments retroactively based upon a "new independent medical examination." *Id.* at 3 n.3. Pilot Life then received information that Dedeaux had allegedly engaged in carpentry work, shrimping, moving furniture and installing a fence and carpet. *Id.* It then filed a counterclaim against Dedeaux for "judgment and recovery of all disability benefits improperly received." *Id.*

In 1980, the frustrated Dedeaux filed a diversity action against Pilot Life in the United States District Court for the Southern District of Mississippi.<sup>189</sup> In his complaint, Dedeaux pleaded three Mississippi common-law causes of action: tortious breach of contract (bad faith<sup>190</sup>), breach of fiduciary duty and fraud in the inducement to contract.<sup>191</sup> Dedeaux sought damages for Pilot Life's failure to pay policy benefits, \$250,000 in general damages for emotional distress and \$500,000 in punitive damages.<sup>192</sup> Although ERISA remedies were clearly available to Dedeaux,<sup>193</sup> he declined to claim relief under the statute.<sup>194</sup> The district court granted Pilot Life's motion for summary judgment,<sup>195</sup> holding that ERISA preempted Dedeaux's Mississippi common-law causes of action.<sup>196</sup>

The United States Court of Appeals for the Fifth Circuit reversed,<sup>197</sup> holding that the common-law causes of action coexisted with

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189. *Pilot Life*, 107 S. Ct. at 1551.

190. See *supra* note 9 for a discussion of the theory underlying bad faith.

191. *Pilot Life*, 107 S. Ct. at 1551.

192. *Id.*

193. See *supra* note 66 for a discussion of ERISA remedies.

194. *Pilot Life*, 107 S. Ct. at 1551. As the Fifth Circuit later noted, Dedeaux's choice of remedies was "obvious." *Dedeaux v. Pilot Life Ins. Co.*, 770 F.2d 1311, 1313 n.3 (5th Cir. 1985), *rev'd*, 107 S. Ct. 1549 (1987). Construing ERISA, the Supreme Court has held that a plaintiff may not recover more than benefits due. *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 145-48 (1985) (*dicta*). Under the Mississippi common-law causes of action, however, plaintiffs may recover extracontractual damages. *Dedeaux*, 770 F.2d at 1313 n.3. Given the choice, then, plaintiffs like Dedeaux would certainly proceed under state causes of action. See *supra* note 69 for a discussion of ERISA remedies.

195. *Pilot Life*, 107 S. Ct. at 1551.

196. *Id.*

197. Judge Williams, writing for a unanimous three judge panel of the court of appeals, held that Mississippi's common-law causes of action regulated insurance within the meaning of the saving clause and were thus saved from preemption. *Dedeaux*, 770 F.2d at 1316. The court reasoned that federal statutes are not presumed to preempt state laws, especially where the state laws involve traditional areas of state regulation such as insurance. *Id.* at 1315-16. Pilot Life, however, argued that ERISA specifically proscribed mishandling of claims and granted a right of action to aggrieved participants. *Id.* at 1314. Therefore, the argument went, Congress could not have intended to allow states to enact laws forbidding the same conduct. *Id.*

Relying on *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724 (1985), the court of appeals rejected Pilot Life's argument. Judge Williams stated that nothing in the legislative history supported Pilot Life's position. *Dedeaux*, 770 F.2d at 1316. Moreover, the court held that if a state law regulated insurance and thus fell within the saving clause the preemption analysis ended there—with no preemption. *Id.* In conclusion, the court held that state remedies such as Mississippi's common law of bad faith, provided causes of action "in place of, in addition to, or coequal with any cause of action available under ERISA." *Id.* at 1317. The Court stated that it was aware that its decision would open the door to inconsistent state remedies, but that it was for Congress to correct the problem. *Id.*

For a discussion of *Metropolitan Life*, see *supra* text accompanying notes 131-79. For a

ERISA remedies.<sup>198</sup> The Supreme Court of the United States then granted certiorari<sup>199</sup> and reversed the court of appeals, reinstating the district court's summary judgment in favor of Pilot Life.<sup>200</sup>

In reversing, the Supreme Court held that the remedial provisions of ERISA preempted the Mississippi common-law bad faith cause of action.<sup>201</sup> The Court reasoned that (1) the bad faith action did not regulate insurance and was thus not saved from preemption;<sup>202</sup> and that (2) Congress intended ERISA's civil enforcement provisions<sup>203</sup> to be the sole remedies available to aggrieved employee benefit plan participants and beneficiaries.<sup>204</sup>

### B. *The Reasoning of the Court*

In its analysis, the Supreme Court examined the scope of ERISA preemption,<sup>205</sup> interpreted the ERISA clauses that relate to the statute's effect on state law<sup>206</sup> and ascertained whether Congress intended ERISA's civil enforcement provisions to be the sole remedies available to plan participants and beneficiaries.<sup>207</sup>

Writing for a unanimous Court, Justice O'Connor began by construing ERISA provisions relating to the statute's effect on state law. The Court found: (1) the preemption clause encompassed state laws that relate to an employee benefit plan; (2) the saving clause saved from preemption any state law that regulated insurance; and (3) the deemer clause prevented any state law that purported to regulate insurance from deeming an employee benefit plan an insurance company.<sup>208</sup>

The Court stated that congressional intent governed the nature and

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detailed discussion of the Supreme Court's analysis in *Pilot Life*, see *infra* text accompanying notes 205-64.

198. *Dedeaux*, 770 F.2d at 1317.

199. *Pilot Life Ins. Co. v. Dedeaux*, 106 S. Ct. 3293 (1986).

200. *Pilot Life*, 107 S. Ct. at 1551.

201. *Id.* at 1558. In the district court, *Dedeaux* asserted three causes of action: tortious breach of contract (bad faith), breach of fiduciary duty and fraud in the inducement to contract. *Id.* at 1551. In the Supreme Court, however, *Dedeaux* claimed only that tortious breach of contract was protected from preemption. *Id.* at 1553.

202. *Id.* at 1553-55.

203. See *supra* note 66 for a discussion of ERISA's civil enforcement provisions.

204. *Pilot Life*, 107 S. Ct. at 1555-58.

205. *Pilot Life Ins. Co. v. Dedeaux*, 107 S. Ct. 1549, 1551-52 (1987).

206. *Pilot Life*, 107 S. Ct. at 1553-55.

207. *Id.* at 1555-58.

208. *Id.* at 1551-52. See *supra* note 73 for the pertinent text of § 1144, containing ERISA's preemption provisions. See *supra* text accompanying notes 73-89 for a background discussion of the provisions.

scope of a federal law's preemptive effect upon state law.<sup>209</sup> Gathering support from legislative history and past case law, the Justices determined that Congress intended ERISA to have a sweeping preemptive effect on state law.<sup>210</sup>

### 1. Preemption clause

With ERISA's broad preemptive powers in mind, the Court held that Dedeaux's common-law tortious breach of contract<sup>211</sup> (bad faith) cause of action related to an employee benefit plan within the meaning of the preemption clause.<sup>212</sup> Relying on *Shaw v. Delta Air Lines, Inc.*,<sup>213</sup> and *Metropolitan Life Insurance Co. v. Massachusetts*,<sup>214</sup> the *Pilot Life* Court stated that to relate to an employee benefit plan, a state law need not be specifically designed to affect such plans.<sup>215</sup> It must simply have a connection with or reference to a plan.<sup>216</sup> Applying this principle, the Court determined that the bad faith cause of action related to an employee benefit plan because Dedeaux had based the cause of action upon alleged improper handling of a claim for benefits under an employee benefit plan.<sup>217</sup> The Court therefore held that the preemption clause encompassed the bad faith cause of action.<sup>218</sup>

### 2. Saving clause

The Court next moved to the heart of the analysis:<sup>219</sup> whether the bad faith cause of action regulated insurance within the meaning of the saving clause and was thus exempted from preemption.<sup>220</sup> In its inquiry, the Court fashioned key elements of its saving clause analysis in *Metropolitan Life* into a two-prong test.<sup>221</sup> The prongs included (1) whether a common sense reading of the saving clause indicated a state law "regu-

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209. *Pilot Life*, 107 S. Ct. at 1552.

210. *Id.*

211. See *supra* note 201.

212. *Pilot Life*, 107 S. Ct. at 1553.

213. 463 U.S. 85 (1983). See *supra* text accompanying notes 110-26 for a discussion of the *Shaw* Court's analysis of the scope of the preemption clause.

214. 471 U.S. 724 (1985).

215. *Pilot Life*, 107 S. Ct. at 1553.

216. *Id.*

217. *Id.*

218. *Id.*

219. Neither Dedeaux, *Pilot Life* nor the Court disputed that the bad faith cause of action related to an employee benefit plan within the meaning of the preemption clause. *Id.* Thus, this case turned on whether the saving clause saved the bad faith cause of action from preemption.

220. *Id.* at 1553-55.

221. See *supra* text accompanying notes 131-79 for a discussion of *Metropolitan Life*.

lated insurance" within the meaning of that phrase,<sup>222</sup> and (2) whether applying the three McCarran-Ferguson Act<sup>223</sup> factors which define the phrase "business of insurance" indicated that the law regulated insurance.<sup>224</sup>

*a. common sense*

The Court first considered whether a common sense reading of ERISA's saving clause language indicated that the bad faith cause of action regulated insurance.<sup>225</sup> The Court posited, without explaining, that common sense dictated that a law must be "specifically directed" toward the insurance industry to regulate insurance within the meaning of the saving clause.<sup>226</sup> Justice O'Connor conceded that the Mississippi Supreme Court had "identified" its bad faith law with the insurance industry.<sup>227</sup> However, she found the Mississippi bad faith law firmly rooted in the state's general tort and contract law.<sup>228</sup> Thus, the Court concluded that Mississippi's bad faith law was not specifically directed toward the insurance industry. Accordingly, the law failed to "regulate insurance" under a common sense reading of the phrase.<sup>229</sup>

*b. McCarran-Ferguson factors*

In the second prong of the saving clause analysis, the Court employed the three-factor McCarran-Ferguson "test."<sup>230</sup> As in *Metropolitan Life*, the Court applied the factors to determine whether the state law at issue fell under the heading "business of insurance" within the meaning of that phrase in the McCarran-Ferguson Act.<sup>231</sup> The factors included: (1) whether the law transferred or spread policyholder risk;<sup>232</sup> (2) whether the law affected an "integral part of the policy relationship" between the insurer and the insured;<sup>233</sup> and (3) whether the law was di-

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222. *Pilot Life*, 107 S. Ct. at 1554.

223. 15 U.S.C. §§ 1011-1015 (1982 & Supp. IV 1986).

224. *Pilot Life*, 107 S. Ct. at 1554-55.

225. *Id.* at 1554.

226. *Id.* See *supra* note 73 for the text of the saving clause.

227. *Pilot Life*, 107 S. Ct. at 1554.

228. *Id.*

229. *Id.*

230. The three factors are instructive rather than dispositive; no factor is necessarily determinative in itself. *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982).

231. *Pilot Life*, 107 S. Ct. at 1554-55. See *supra* note 130 for the pertinent text and discussion of the McCarran-Ferguson Act.

232. *Pilot Life*, 107 S. Ct. at 1553. See *supra* text accompanying notes 152-62 for a discussion of this concept.

233. *Pilot Life*, 107 S. Ct. at 1553.

rected only to entities within the industry.<sup>234</sup>

First, the Court summarily concluded that Mississippi's common law of bad faith did not effect a spreading of policyholder risk.<sup>235</sup> Second, since an insurer may incur liability for punitive damages by breaching policy terms, the Court determined that the bad faith cause of action affected the policy relationship between the insurer and insured.<sup>236</sup> Justice O'Connor, however, found this effect "attenuated at best."<sup>237</sup> She distinguished Mississippi's bad faith cause of action from the Massachusetts mandated benefits law at issue in *Metropolitan Life*.<sup>238</sup> There, the mandated benefits law had defined terms of insurance contracts by limiting the types of insurance coverage that could be transacted.<sup>239</sup> Hence, the Court had held that the Massachusetts law affected an integral part of the insurer-insured relationship.<sup>240</sup>

In contrast, the Mississippi bad faith law under consideration in *Pilot Life* allowed insureds to recover punitive damages for certain breaches by insurers regardless of the substantive terms of the policy.<sup>241</sup> Justice O'Connor concluded that Mississippi's bad faith law was no more "integral" to the insurer-insured relationship than general contract law was integral to a contract.<sup>242</sup>

Third, although associated with the insurance industry, Mississippi's common law of bad faith had evolved from general principles of the state's tort and contract law available in any breach of contract case.<sup>243</sup> The Court therefore found that the bad faith cause of action was directed at entities other than those in the insurance industry.<sup>244</sup>

In sum, the Court determined that under a common sense reading of the saving clause, Mississippi's bad faith law did not regulate insurance.<sup>245</sup> Further, the bad faith law met at most one of the McCarran-Ferguson factors.<sup>246</sup> Thus, analyzing Mississippi's law against the saving clause did not show that the law regulated insurance within the meaning

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234. *Id.* at 1553-54.

235. *Id.* at 1554.

236. *Id.* at 1555.

237. *Id.*

238. *Id.*

239. *Metropolitan Life*, 471 U.S. at 743.

240. *Id.*

241. *Pilot Life*, 107 S. Ct. at 1555.

242. *Id.*

243. *Id.*

244. *Id.*

245. *Id.* at 1554.

246. *Id.* at 1554-55.

of the saving clause.<sup>247</sup>

### 3. Exclusive remedies

The Court chose not to rest its holding upon the saving clause analysis. “[W]e are obliged in interpreting the saving clause to consider not only the factors by which we were guided in *Metropolitan Life*, but also the role of the saving clause in ERISA as a whole.”<sup>248</sup> The inquiry therefore addressed whether Congress intended the civil enforcement remedies of ERISA to be the exclusive recourse for ERISA plan participants and beneficiaries who assert that a claim had been mishandled.<sup>249</sup>

To determine whether Congress intended ERISA’s remedies to be exclusive, the Court examined: (1) the structure and detail employed by Congress in crafting the remedies;<sup>250</sup> (2) Congress’ balancing of policy in structuring the remedies;<sup>251</sup> and (3) the preemptive force of the statute after which the remedies were modeled.<sup>252</sup>

Discussing statutory structure, the Court noted that where a comprehensive remedial scheme exists within a statute, courts should presume that Congress deliberately omitted remedies not expressed in the statute.<sup>253</sup> The Court recited in detail ERISA’s complex remedy provisions<sup>254</sup> and found them quite comprehensive.<sup>255</sup> Quoting from a similar analysis of ERISA’s remedy provisions in *Massachusetts Mutual Life Insurance Co. v. Russell*,<sup>256</sup> Justice O’Connor concluded that the six “carefully integrated” civil enforcement provisions provided “strong evidence that Congress did *not* intend to authorize other remedies that it simply forgot to incorporate expressly.”<sup>257</sup>

247. *Id.*

248. *Id.* at 1555.

249. *Id.* at 1555-58.

250. *Id.* at 1555-56.

251. *Id.* at 1556-57.

252. *Id.* at 1557-58.

253. *Id.* at 1556. For this proposition, the Court relied on *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134 (1985). The *Russell* Court had in turn relied upon *Middlesex County Sewerage Auth. v. National Sea Clammers Ass’n*, 453 U.S. 1, 14-15 (1981); *Texas Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 639-40 (1981); *California v. Sierra Club*, 451 U.S. 287, 295 n.6 (1981); *National R.R. Passenger Corp. v. National Ass’n of R.R. Passengers*, 414 U.S. 453, 458 (1974); *Nashville Milk Co. v. Carnation Co.*, 355 U.S. 373, 375-76 (1958); *Switchmen v. National Mediation Bd.*, 320 U.S. 297, 301 (1943); *Botany Worsted Mills v. United States*, 278 U.S. 282, 289 (1929). *Russell*, 473 U.S. at 147 n.15. See *supra* note 70 for a discussion of *Russell*.

254. See *supra* note 66 for the text of the provisions.

255. *Pilot Life*, 107 S. Ct. at 1556.

256. 473 U.S. 134 (1985). See *supra* note 70 for a discussion of *Russell*.

257. *Pilot Life*, 107 S. Ct. at 1556 (quoting *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 146 (1985)) (emphasis in original).



In further support of its finding that Congress intended ERISA's remedies to be exclusive, the Court explained that Congress had engaged in a delicate balancing.<sup>258</sup> The statute's framers had weighed plan participants' and beneficiaries' need for prompt and fair claims settlements against the public interest in encouraging the formation of employee welfare benefit plans.<sup>259</sup> The Court determined that Congress' policy choices would be "completely undermined" if participants and beneficiaries were permitted to pursue remedies under state law that Congress had rejected in ERISA.<sup>260</sup>

Finally, the Court found in the legislative history that Congress modeled the "preemptive force" of ERISA after section 301 of the Labor-Management Relations Act of 1947 (LMRA).<sup>261</sup> Justice O'Connor stated that section 301 had a preemptive force so powerful that it displaced entirely any state law cause of action that required a court to interpret a labor contract.<sup>262</sup> In determining that Congress modeled ERISA's preemptive force after section 301 of the LMRA, the Court found additional support for concluding that Congress intended ERISA's remedies to be exclusive.<sup>263</sup>

The Court ended its analysis by summarizing its holding. Justice O'Connor stated that the common sense understanding of the saving clause, the McCarran-Ferguson factors defining the business of insurance and, most importantly, Congress' intention that ERISA's remedies be exclusive clearly demonstrated that ERISA preempted Dedeaux's Mississippi common-law bad faith cause of action.<sup>264</sup>

#### IV. ANALYSIS

In *Pilot Life Insurance Co. v. Dedeaux*,<sup>265</sup> the Court divided its opinion into two major discussions: (1) whether the Mississippi common law of bad faith regulated insurance within the meaning of ERISA's saving clause; and (2) whether Congress intended ERISA remedies<sup>266</sup> to be exclusive. Both analyses were considerably flawed.

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258. *Id.*

259. *Id.*

260. *Id.*

261. *Id.* at 1557. LMRA § 301 is codified at 29 U.S.C. § 185 (1982).

262. *Pilot Life*, 107 S. Ct. at 1557.

263. *Id.* at 1557-58.

264. *Id.* at 1558.

265. 107 S. Ct. 1549 (1987).

266. 29 U.S.C. § 1132 (1982). See *supra* note 66 for the pertinent text of this section.

### A. Saving Clause

In applying ERISA's saving clause<sup>267</sup> against Mississippi's bad faith law, the *Pilot Life* Court constructed a two-tiered analysis based on its reasoning in *Metropolitan Life Insurance Co. v. Massachusetts*.<sup>268</sup> Justice O'Connor, writing for a unanimous Court, reasoned fallaciously on both levels.

#### 1. Common sense

The Court first applied a common sense reading to the saving clause.<sup>269</sup> The Court's reasoning contains cracks in logic. The Justices' analysis may be reduced to a syllogism: major premise—a law does not regulate insurance unless it is specifically directed toward the insurance industry; minor premise—Mississippi's bad faith law is not directed specifically toward the insurance industry; conclusion—Mississippi's bad faith law does not regulate insurance.<sup>270</sup> The Court's major and minor premises were both flawed.

Regarding the major premise, the Court posited, without explanation, that common sense dictates that to regulate insurance a law must be specifically directed toward the insurance industry.<sup>271</sup> This premise is patently erroneous. A law need not be specifically directed at an industry to regulate it. For instance, contract law is not specifically directed toward any particular industry. Yet, contract law permeates significant aspects of all industries, guiding and shaping the conduct of all participants. Thus, it can only be said that contract law regulates any particular industry.

Similarly, bad faith law regulates the insurance industry. Insureds suing insurance companies for bad faith may recover substantial extracontractual awards. As a result, insurers are forced to be quite cir-

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267. 29 U.S.C. § 1144(b)(2)(A) (1982).

268. 471 U.S. 724 (1985).

269. *Pilot Life Ins. Co. v. Dedeaux*, 107 S. Ct. 1549, 1554 (1987).

270. *Id.*

271. *Id.* The following comprised the Court's common sense "reasoning":

Certainly a common-sense understanding of the phrase "regulates insurance" does not support the argument that the Mississippi law of bad faith falls under the saving clause. A common-sense view of the word "regulates" would lead to the conclusion that in order to regulate insurance, a law must not just have an impact on the insurance industry, but be specifically directed toward that industry. Even though the Mississippi Supreme Court has identified its law of bad faith with the insurance industry, the roots of this law are firmly planted in the general principles of Mississippi tort and contract law. Any breach of contract, and not merely breach of an insurance contract, may lead to liability for punitive damages under Mississippi law.

*Id.*

cumspect in denying benefits.<sup>272</sup> Bad faith law therefore regulates insurer behavior even if not specifically directed toward the insurance industry.

Furthermore, a plain reading of the word "regulate" does not support the Court's proposition. Commonly cited legal and general dictionaries do not include "specifically directed" in their definitions of "regulate."<sup>273</sup> For example, the current edition of Black's Law Dictionary defines "regulate" to mean, among other things, "[to] fix, establish, or control; . . . to subject to governing principles or laws."<sup>274</sup>

Applying the tenor of this definition to the bad faith context demonstrates that bad faith law regulates the insurance industry. The specter of bad faith liability can only be viewed as "controlling" insurance company behavior. Hence, plain reading supports the conclusion that bad faith law regulates the insurance industry without being specifically directed toward it.

Even assuming for sake of argument that the Court's major premise is valid, the syllogism still fails. The Court's minor premise—that Mississippi's common law of bad faith is not specifically directed toward the insurance industry—is inaccurate. The Mississippi Supreme Court has clearly directed the state's bad faith law specifically toward the insurance industry.<sup>275</sup> Under ERISA, state "laws" include decisional law.<sup>276</sup> Thus, Mississippi's bad faith law regulates insurance even under Justice O'Connor's own common sense model.

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272. See *supra* text accompanying notes 7-10.

273. See BLACK'S LAW DICTIONARY 1156 (5th ed. 1979); THE RANDOM HOUSE DICTIONARY OF THE ENGLISH LANGUAGE 1209 (unabr. ed. 1983).

274. BLACK'S LAW DICTIONARY 1156.

275. "We have come to term an insurance carrier which refuses to pay a claim when there is no reasonably arguable basis to deny it as acting in 'bad faith,' and a lawsuit based upon such an arbitrary refusal as a 'bad faith' cause of action." *Blue Cross & Blue Shield, Inc. v. Campbell*, 466 So. 2d 833, 842 (Miss. 1984) (quoted in *Pilot Life Ins. Co. v. Dedeaux*, 107 S. Ct. 1549, 1554 (1987)). See also *Employers Mut. Casualty Co. v. Tompkins*, 490 So. 2d 897 (Miss. 1986) (uninsured motorist policy); *State Farm Fire & Casualty Co. v. Simpson*, 477 So. 2d 242 (Miss. 1985) (fire insurance); *Gulf Guarantee Life Ins. Co. v. Kelley*, 389 So. 2d 920 (Miss. 1980) (credit life policy); *Travelers Indem. Co. v. Wetherbee*, 368 So. 2d 829 (Miss. 1979) (fire insurer); *Standard Life Ins. Co. v. Veal*, 354 So. 2d 239 (Miss. 1977) (life insurance policy); *Progressive Casualty Ins. Co. v. Keys*, 317 So. 2d 396 (Miss. 1975) (automobile insurance).

276. 29 U.S.C. § 1144(c)(1) (1982). Indeed, the Court in *Pilot Life* stated that decisional law fell under the saving clause. 107 S. Ct. at 1553 n.1.

## 2. McCarran-Ferguson factors

### a. policyholder risk

In applying the three McCarran-Ferguson factors<sup>277</sup> to the Mississippi bad faith law, the Court's reasoning remained superficial. First, Justice O'Connor concluded, again without analysis, that the state's bad faith law effected no shift or spreading of policyholder risk.<sup>278</sup> The Justice should not have paid such short shrift to this factor.

An insurance industry practice or state insurance law spreads or transfers policyholder risk when the practice or law manipulates the allocation of risk in an insurance market.<sup>279</sup> For example, the mandated mental health benefits law in *Metropolitan Life* shifted policyholder risk.<sup>280</sup> The Massachusetts law required all general health insurance policies to contain mental health benefits.<sup>281</sup> In passing the law, the state legislature intended to spread the burden of the risk of mental health insurance to the population at large, thereby making it available and affordable to citizens who required such benefits.<sup>282</sup>

Bad faith law also spreads the burden of policyholder risk. Extracontractual awards by definition require insurance companies to pay insureds more than the benefits for which the parties contracted. Insurers shift the burden of risk of these extracontractual awards to all of its insureds through higher premiums.<sup>283</sup> Thus, bad faith law spreads and transfers the burden of risk to and among its insureds. True, the mandated benefits law in *Metropolitan Life* directly caused the shift while bad faith law did so indirectly through market forces. The "spreading" result, however, occurs in both instances.

### b. insurer-insured relationship

Justice O'Connor conceded in her analysis of the second McCarran-Ferguson factor that Mississippi bad faith law affected the insurer-insured relationship but characterized the effect as "attenuated at best."<sup>284</sup>

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277. The three factors include: (1) whether the state law transfers or spreads policyholder risk; (2) whether the state law affects an integral part of the insurer-insured relationship; and (3) whether the state law is limited to entities within the insurance industry. *Pilot Life*, 107 S. Ct. at 1553-54.

278. *Id.* at 1554. See *supra* text accompanying notes 152-62 for a discussion of this concept.

279. See *supra* notes 152-62 and accompanying text.

280. *Metropolitan Life*, 471 U.S. at 731, 743. See *supra* notes 131-79 and accompanying text for a discussion of *Metropolitan Life*.

281. *Metropolitan Life*, 471 U.S. at 730 n.11.

282. *Id.* at 731.

283. See *supra* text accompanying notes 152-62.

284. *Pilot Life*, 107 S. Ct. at 1555.

In contrast to the Massachusetts mandated benefits law in *Metropolitan Life*, the Justice found Mississippi's bad faith law no more "integral" to the relationship between the insurer and insured than general contract law was integral to a contract.<sup>285</sup>

Here again, the Court's logic was flawed. Justice O'Connor concluded that bad faith law did not affect an integral facet of the insurer-insured relationship because Mississippi plaintiffs could invoke the law to obtain extracontractual damages for tortious breaches of *noninsurance* contracts.<sup>286</sup> The Court proceeded on the implicit assumption that an attribute of a relationship can be integral only if that attribute is unique to that particular relationship. This assumption was unwarranted. No reasonable person would enter into an insurance contract if claims legitimately made upon it were unenforceable. Thus, enforcement of claims can only be thought of as a key area of the insurer-insured relationship. Moreover, in a prior case construing the McCarran-Ferguson Act term "business of insurance," the Court had characterized enforcing claims as central to the insurer-insured relationship.<sup>287</sup> The Justices therefore reasoned superficially and ignored precedent by deeming "attenuated" the impact of bad faith law on the insurer-insured relationship.

The Court properly applied the third McCarran-Ferguson factor to Mississippi's bad faith law. This factor inquires whether the law is limited to entities within the insurance industry.<sup>288</sup> As Mississippi's bad faith law applies to breaches of contracts other than insurance,<sup>289</sup> it is indisputable that the law is not limited to entities within the insurance

285. *Id.*

286. *Id.*

287. In *Securities and Exch. Comm'n v. National Sec., Inc.*, 393 U.S. 453 (1969), the Court stated:

[In passing the McCarran-Ferguson Act], Congress was concerned with the type of state regulation that centers around the contract of insurance . . . . The relationship between the insurer and insured, the type of policy which could be issued, its reliability, its interpretation, and enforcement—these were the core of the 'business of insurance.' . . . [T]he focus [of the statutory term 'business of insurance'] was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this relationship, directly or indirectly, are laws regulating the 'business of insurance.'

*Id.* at 460 (emphasis added).

288. *Pilot Life*, 107 S. Ct. at 1553-54.

289. See *D.L. Fair Lumber Co. v. Weems*, 196 Miss. 201, 16 So. 2d 770 (1944) (breach of contract accompanied by intentional destruction of plaintiff's fence); *American Ry. Express Co. v. Bailey*, 142 Miss. 622, 631, 107 So. 761, 763 (1926) (punitive damages available where breach "attended by some intentional wrong, insult, abuse, or gross negligence which amounts to an independent tort"); *Hood v. Moffett*, 109 Miss. 757, 767, 69 So. 664, 666 (1915) (physician liable for breach of contract for failing to attend to woman at her approaching *accouchement*).

industry.<sup>290</sup>

Specific failings in logic aside, the Court lost sight of its reason for applying the McCarran-Ferguson factors. The purpose of the three-factor analysis is to determine whether a state law regulates the "business of insurance" consistently with Congress' notion of that phrase in the McCarran-Ferguson Act.<sup>291</sup> If so, then the law regulates insurance for purposes of ERISA's saving clause.<sup>292</sup> In enacting McCarran-Ferguson, Congress intended to reserve the insurer-insured policy relationship for state regulation.<sup>293</sup> Particularly, the states were to regulate policy terms, reliability, interpretation and *enforcement*.<sup>294</sup> In *Pilot Life*, the Court never acknowledged Congress' concern that the states retain control over enforcement of insurance contracts. Thus, even assuming that common-

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290. Mississippi cases demonstrate that the state's bad faith law is a subset of "tortious breach of contract." In the insurance and noninsurance context alike, cases uniformly hold that to recover punitive damages, the breach of contract must be "attended by intentional wrong, insult, abuse or such gross negligence as to consist of an independent tort." See, e.g., *Progressive Casualty Ins. Co. v. Keys*, 317 So. 2d 396, 398 (Miss. 1975).

*D. L. Fair Lumber Co. v. Weems*, 196 Miss. 201, 16 So. 2d 770 (1944), presents an example of "tortious breach of contract" in the non-insurance context. A landowner sold timber rights to a lumber company while simultaneously leasing the land as a pasture to a tenant farmer. *Id.* at 216, 16 So. 2d at 771. The lumber company then proceeded to clear portions of the parcel. *Id.* In the process of clearing, a cutter continually allowed trees to fall on a fence built by the tenant farmer, thereby permitting his cattle to escape. *Id.* at 217, 16 So. 2d at 771. The Mississippi Supreme Court held that independent of the lumber company's lease/contract with the landowner, the lumber company owed a duty to the landowner and his tenant to use reasonable care not to injure or destroy improvements on the land. *Id.* at 220-21, 16 So. 2d at 773. The lumber company argued, however, that punitive damages were not recoverable because the relationship was merely contractual. *Id.* at 221, 16 So. 2d at 773. The court rejected this argument. Since the lumber company had knowingly allowed falling trees to destroy the fence, its conduct amounted to gross negligence or willful wrong, justifying an award of punitive damages to the tenant. *Id.* at 221-22, 16 So. 2d at 773.

In the insurance context, if an insurer has an "arguable reason" for denying a claim, Mississippi courts will not hold the insurer liable beyond contract damages. *Standard Life Ins. Co. v. Veal*, 354 So. 2d 239, 248 (Miss. 1977). An insurer's conduct, however, rises to the level of gross negligence or willfulness when it lacks an "arguable reason" for denying or delaying a claim. *Id.* Thus, an insurer commits the independent tort of bad faith when it lacks an arguable reason for denying a claim, and may be held liable for punitive damages. *Id.*

Under Mississippi law, therefore, bad faith in the insurance context is a subset of tortious breach of contract. See *supra* note 9 for a discussion of other theoretical bases for bad faith recovery. See generally SHERNOFF, *supra* note 6 §§ 1.01-1.08 (discussion of development of bad faith theory).

291. *Pilot Life*, 107 S. Ct. at 1553; *Metropolitan Life*, 471 U.S. at 743; *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982).

292. *Pilot Life*, 107 S. Ct. at 1554; *Metropolitan Life*, 471 U.S. at 743.

293. See *supra* notes 287 and 130 for further explanation of Congress' concerns in enacting the McCarran-Ferguson Act.

294. *National Securities*, 393 U.S. at 460. See *supra* note 287 for the relevant quotation from *National Securities*.

law bad faith causes of action do not technically spread policyholder risk or affect an integral part of the insurer-insured relationship, bad faith actions do regulate insurance consistently with Congress' notion of the "business of insurance" in the McCarran-Ferguson Act.

In sum, the Court applied ERISA's saving clause to Mississippi's bad faith law in a slipshod manner. Its premise—that common sense dictates that a law be specifically directed toward the insurance industry to regulate insurance—is not supportable. Further, the Court blindly applied the McCarran-Ferguson Act factors without regard to the Act's purposes. As the Court did not rest its decision upon the saving clause analysis, perhaps the Justices recognized the inherent weaknesses of their reasoning.

### B. Exclusive Remedies

The Court's flawed saving clause analysis was not dispositive in *Pilot Life*.<sup>295</sup> The Court characterized as most important to its decision Congress' intention that ERISA's civil enforcement remedies be exclusive.<sup>296</sup> The Court's determination of Congress' intent was correct.

In ascertaining Congress' intent with respect to ERISA remedies, the Court relied on dicta from its decision in *Massachusetts Mutual Life Insurance Co. v. Russell*.<sup>297</sup> In *Russell*, the Court discussed whether punitive damages were available directly under ERISA.<sup>298</sup> The *Russell* Court cited a plethora of cases supporting the proposition that where Congress enacts an interlocking, interrelated and interdependent remedial scheme as part of a comprehensive statute, courts should presume that Congress deliberately omitted remedies not expressed.<sup>299</sup> The *Russell* Court viewed ERISA's "carefully-integrated" civil enforcement provisions as a sterling example of such a remedial scheme.<sup>300</sup> Since the provisions did not expressly provide for punitive damages, the *Russell* Court determined that Congress in all likelihood did not intend that punitive damages be recoverable under the statute.<sup>301</sup>

The *Pilot Life* Court's reliance on *Russell* was well taken. In *Rus-*

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295. *Pilot Life Ins. Co. v. Dedeaux*, 107 S. Ct. 1549 (1987).

296. *Id.* at 1558.

297. 473 U.S. 134 (1985).

298. *Id.* at 147. The *Russell* Court specifically held that § 1109(a), which establishes liability for breach of fiduciary duty, does not entitle a participant to recover extracontractual damages against the fiduciary for the fiduciary's mishandling of a claim. *Id.* See *supra* note 70 for a discussion of *Russell*.

299. *Id.* at 147. See *supra* note 253 for a list of these cases.

300. *Russell*, 473 U.S. at 147.

301. *Id.* at 146-47.

*sell*, the Court had discussed whether punitive damages were available through express ERISA remedies.<sup>302</sup> In *Pilot Life*, the question was whether aggrieved ERISA plan participants could invoke a cause of action derived from state law—a source other than ERISA. For practical purposes these questions are indistinguishable: the end relief sought by plaintiffs is the “remedy” desired. If Congress intended that no extracontractual damages would be available under ERISA, it would make little sense to circumvent that intention through legalistic gymnastics.<sup>303</sup>

Although correct in discerning Congress’ intention that ERISA’s remedies be exclusive, the *Pilot Life* Court failed to reconcile that particular intention with another, competing congressional purpose: ERISA must not interfere with the long-established federal policy that the states regulate insurance. This congressional intention emerges when ERISA is read together with the McCarran-Ferguson Act.<sup>304</sup> The McCarran-Ferguson Act granted states the power to regulate and tax the insurance industry.<sup>305</sup> ERISA’s preemption provisions provide that nothing in ERISA shall “alter, amend, modify, invalidate, impair or supersede any law of the United States.”<sup>306</sup> Because the McCarran-Ferguson Act is a statute of the United States, ERISA cannot supersede it. Thus, assuming a state law such as Mississippi’s law of bad faith regulates insurance within the meaning of the McCarran-Ferguson Act,<sup>307</sup> ERISA does not preempt the law.<sup>308</sup>

302. *Id.* at 145-48.

303. The year of ERISA’s enactment, 1974, and the circumstances surrounding its passage support the conclusion that Congress never considered whether to include bad faith recovery as an ERISA remedy. Congress debated and negotiated bills that contributed to the formation of ERISA in 1973-74. The main thrust of the various bills was pension benefit rather than welfare benefit reform. *See, e.g.*, H.R. 462, 93d Cong., 1st Sess. § 2 (1973), reprinted in COMMITTEE PRINT, *supra* note 14, at 67-69 (findings and declaration of policy directed virtually exclusively toward pension plans); S. 4, 93d Cong., 1st Sess. § 2 (1973), reprinted in COMMITTEE PRINT, *supra* note 14, at 94-97 (same); S. 1179, 93d Cong., 1st Sess. § 101 (1973), reprinted in COMMITTEE PRINT, *supra* note 14, at 230-32 (directed solely at pension plans); *see also* 29 U.S.C. § 1001 (1982) (ERISA’s policy section).

Moreover, no state court allowed extracontractual recovery against an insurer for breach of the covenant of good faith and fair dealing in the first party situation until 1973. *See Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973) (first court allowing extracontractual recovery against insurer for breach of covenant of good faith and fair dealing).

Thus, in all likelihood ERISA’s framers never considered whether participants would be able to recover extracontractual damages against welfare plan insurers.

304. 15 U.S.C. §§ 1011-1015 (1982 & Supp. IV 1986).

305. *Id.* § 1012(b). *See supra* note 130 for the pertinent text and a discussion of the Act.

306. 29 U.S.C. § 1144(d) (1982).

307. *See supra* text accompanying notes 267-94 for an argument that Mississippi’s law regulates insurance.

308. *See Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 744 n.21 (1985) (Court



This approach is consistent with *Metropolitan Life*. In that case, the Court stated: "[t]he presumption is against pre-emption, and we are not inclined to read limitations into federal statutes in order to enlarge their pre-emptive scope."<sup>309</sup> Therefore, even if Congress' intention that ERISA remedies be exclusive and its intention that ERISA not preempt the McCarran-Ferguson Act are given equal weight, the general presumption against preemption should tip the scale toward saving bad faith causes of action from preemption.

Moreover, the *Pilot Life* Court gutted the saving clause of meaning. By elevating above other congressional purposes Congress' intention that ERISA remedies be exclusive, the Court implied that *even if* a law regulates insurance within the meaning of the saving clause ERISA nonetheless preempts it.<sup>310</sup> The Court therefore implied a willingness to ignore the saving clause if an insurance law affected remedies. Alternatively, the Justices could have held that ERISA preempted state laws relating to ERISA remedies *except* where those laws regulated insurance. By so holding, the Court would have reconciled the competing congressional purposes rather than merely have chosen between them. The states would have retained control over enforcement of insurance policies while ERISA remedies would have remained exclusive in all other contexts. In effect, the Court would have preserved the significance and purpose of the saving clause.<sup>311</sup>

To summarize, the Court reasoned superficially at best in its saving clause analysis. Further, although the Court correctly discerned Congress' intention that ERISA remedies be exclusive, the Justices failed to reconcile this with Congress' other intention that ERISA not preempt the McCarran-Ferguson Act. The Court did not isolate any one factor as dispositive to its holding that ERISA preempted state common-law bad

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cites § 1144(d) for proposition that ERISA did not impair operation of McCarran-Ferguson Act). See also *infra* text accompanying notes 391-97 for a discussion of *Goodrich v. General Tel. Co.*, 195 Cal. App. 3d 675, 241 Cal. Rptr. 640, *review granted*, 746 P.2d 871, 242 Cal. Rptr. 732 (1987), where the court took the position taken in the text accompanying this note.

309. *Metropolitan Life*, 471 U.S. at 741. In addition, the *Metropolitan Life* Court stated: "[w]e also must presume that Congress did not intend to pre-empt areas of traditional state regulation." *Id.* at 740.

310. *Pilot Life*, 107 S. Ct. at 1555, 1558. Indeed, a subsequent court in *Roberson v. Equitable Life Assurance Soc'y of the United States*, 661 F. Supp. 416 (C.D. Cal. 1987), read *Pilot Life* to mean just that. See *infra* text accompanying notes 340-72 for a discussion of *Roberson*.

311. Ironically, Justice Blackmun stated for the Court in *Metropolitan Life*: "While Congress occasionally decides to return to the States what it has previously taken away, it does not normally do both at the same time." 471 U.S. at 740 (discussing role of saving clause read together with preemption clause). The reverse rings equally true. If Congress were to take back insurance regulation from the states, it would not take it back couched in language importing that the states may continue to regulate insurance exclusively.

faith causes of action. The Court did, however, deem most important Congress' intention that ERISA remedies be exclusive. As discussed in the following section, the Court's lack of clarity has spawned widely divergent lower court decisions on questions closely related to the preemption issue in *Pilot Life*.

## V. IMPACT OF *PILOT LIFE*: ARE STATUTORY BAD FAITH ACTIONS PREEMPTED?

The *Pilot Life* Court clearly established that ERISA preempts common-law bad faith causes of action.<sup>312</sup> The unanimous Justices, however, did not indicate whether ERISA preempts statutory causes of actions derived from state insurance codes. This section therefore analyzes post-*Pilot Life* cases addressing this issue.

### A. Background

Based on the Model Unfair Insurance Practices Act<sup>313</sup> (Model Act) drafted by the National Association of Insurance Commissioners

312. *Pilot Life Ins. Co. v. Dedeaux*, 107 S. Ct. 1549, 1558 (1987).

313. AN ACT RELATING TO UNFAIR METHODS OF COMPETITION AND UNFAIR AND DECEPTIVE ACTS AND PRACTICES IN THE BUSINESS OF INSURANCE, 1 N.A.I.C. PROC. 493-501 (1972) [hereinafter cited as MODEL UNFAIR INS. PRACT. ACT]. To promote uniform insurance regulation among the states, the National Association of Insurance Commissioners (NAIC) adopted the Model Act in 1942. See generally SHERNOFF, *supra* note 6 at § 6.03 (history of Model Act). The NAIC amended the act in 1960 and 1972. The 1972 version contains penalties for unfair or deceptive practices. Section 4(9) proscribes the following unfair claims practices:

- (a) misrepresenting pertinent facts or insurance policy provisions relating to coverages at issue;
- (b) failing to acknowledge and act reasonably promptly on communications with respect to claims arising under insurance policies;
- (c) failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;
- (d) refusing to pay claims without conducting a reasonable investigation based upon all available information;
- (e) failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed;
- (f) not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear;
- (g) compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds;
- (h) attempting to settle a claim for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application;
- (i) attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of the insured;
- (j) making claims payments to insureds or beneficiaries not accompanied by a statement setting forth the coverage under which the payments are being made;
- (k) making known to insureds or claimants a policy of appealing from arbitration

(NAIC), the majority of states have enacted insurance "unfair practices" statutes. Most states have adopted the Model Act's unfair claims settlement provisions.<sup>314</sup> These provisions empower the state's insurance commissioner to investigate alleged unfair or deceptive acts by insurers and to determine whether an insurer has committed such an act.<sup>315</sup> Further, if the commissioner finds that an insurer has violated the act, the commissioner may issue a cease and desist order or assess a civil penalty.<sup>316</sup> Although only Florida expressly grants a private right of action under its act,<sup>317</sup> courts in several states have implied private tort causes of action under their respective statutes.<sup>318</sup> Among these states is the influential

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awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration;

(l) delaying the investigation or payment of claims by requiring an insured, claimant, or the physician of either to submit a preliminary claim report and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information;

(m) failing to promptly settle claims, where liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy;

(n) failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement.

MODEL UNFAIR INS. PRACT. ACT, *supra*, § 4(9) (emphasis omitted).

314. See ALA. CODE § 27-12-24 (1977); ALASKA STAT. § 21.36.125 (1984); ARIZ. REV. STAT. ANN. § 20-461 (Supp. 1987); ARK. STAT. ANN. § 23-66-206 (1987); CAL. INS. CODE § 790.03(h) (West Supp. 1988); COLO. REV. STAT. § 10-3-1104(h) (1974 & Supp. 1986); CONN. GEN. STAT. § 38-61(6) (1987); DEL. CODE ANN. tit. 18, § 2304(16) (1975); FLA. STAT. § 626.9541(1)(i) (1984); HAWAII REV. STAT. § 431-647 (1976); IDAHO CODE § 41-1329 (1977 & Supp. 1987); IND. CODE. § 27-4-1-4.5 (Supp. 1987); IOWA CODE § 507B.4(9) (1988); KAN. STAT. ANN. § 40-2404(9) (1986); MASS. GEN. LAWS ANN. ch. 176D, § 3(9) (West 1987); MICH. COMP. LAWS ANN. § 500.26 (West 1983); MINN. STAT. § 72A. 1 (Supp. 1988); MO. REV. STAT. § 375.936(10) (1986); MONT. CODE ANN. § 33-18-201 (1985); NEB. REV. STAT. § 44-1525(9) (1984); NEV. REV. STAT. § 686A.310 (1986 & Supp. 1987); N.H. REV. STAT. ANN. § 417:4 (1983); N.J. REV. STAT. ANN. § 17:29B-4(9) (1985); N.M. STAT. ANN. § 59a-16-20 (1987); N.Y. INS. LAW § 2601 (McKinney 1985); N.C. GEN. STAT. § 58-54.4(11) (1982 & Supp. 1987); N.D. CENT. CODE § 26.1-04-03(9) (Supp. 1987); OR. REV. STAT. § 746.230 (1983); PA. STAT. ANN. tit. 40, § 1171.5(a)(10) (Purdon Supp. 1986); TENN. CODE ANN. § 56-8-104(8) (1980 & Supp. 1987); TEX. INS. CODE ANN. § 21.21-2 (Vernon 1981); VT. STAT. ANN. tit. 8, § 4724(9) (1984); VA. CODE ANN. § 38.2-510 (1986); W. VA. CODE § 33-11-4(9) (1988).

315. MODEL UNFAIR INS. PRACT. ACT, *supra* note 326, § 6.

316. *Id.* § 7.

317. See FLA. STAT. §§ 624.155(1)(a), 626.9541(1)(i) (1984).

318. See *Sparks v. Republic Nat. Life Ins. Co.*, 132 Ariz. 529, 540-41, 647 P.2d 1127, 1138-39 (1982) (implied cause of action under ARIZ. REV. STAT. § 20-443(1)), *cert. denied*, 450 U.S. 1070 (1982)); *Royal Globe Ins. Co. v. Superior Court*, 23 Cal. 3d 880, 884-90, 592 P.2d 329, 332-35, 153 Cal. Rptr. 842, 845-48 (1979) (implied cause of action under CAL. INS. CODE § 790.03(h)); *Klaudt v. Flink*, 202 Mont. 247, 251, 658 P.2d 1065, 1067 (1983) (third party claimants may bring civil action under MONT. CODE ANN. § 33-18-201); *Farmer's Union Cent. Exch. v. Reliance Ins.*, 626 F. Supp. 583, 590 (D.N.D. 1985) (North Dakota law; cause

and populous jurisdiction of California.<sup>319</sup> Currently at issue in California is whether the *Pilot Life*<sup>320</sup> holding extends to these statutory causes of action.

Since *Pilot Life*, two courts have squarely addressed whether ERISA preempts California's version of the Model Act's unfair claims practices provisions—California Insurance Code section 790.03(h).<sup>321</sup> The courts reached diametrically opposite results. In *Roberson v. Equitable Life Assurance Society of the United States*,<sup>322</sup> the United States District Court for the Central District of California<sup>323</sup> held that ERISA preempted the California statute.<sup>324</sup> However, in *Goodrich v. General Telephone Co.*,<sup>325</sup> a three judge panel of the California Court of Appeal held that ERISA did not preempt section 790.03(h).<sup>326</sup>

### B. Section 790.03

California has adopted much of the NAIC's Model Act.<sup>327</sup> Section 790.03 prohibits insurers from committing certain "unfair and deceptive acts or practices in the business of insurance."<sup>328</sup> Subsection (h) is substantially similar to the unfair claims practices provisions of the Model Act.<sup>329</sup> Under subsection (h), unfair practices include failing to respond promptly to claims by insureds,<sup>330</sup> failing to adopt and implement rea-

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of action under N.D. CENT. CODE § 26.1-04-02)); *Jenkins v. J.C. Penney Casualty Ins. Co.*, 280 S.E.2d 252, 258 (W. Va. 1981) (implied cause of action under W. VA. CODE § 33-11-(9)).

319. See *supra* note 318.

320. *Pilot Life Ins. Co. v. Dedeaux*, 107 S. Ct. 1549 (1987).

321. CAL. INS. CODE § 790.03(h) (West Supp. 1988). See *infra* notes 327-39 and accompanying text for a more detailed discussion of § 790.03(h).

322. 661 F. Supp. 416 (C.D. Cal. 1987).

323. Judge Pamela Rymer presided.

324. *Roberson*, 661 F. Supp. at 424.

325. 195 Cal. App. 3d 675, 241 Cal. Rptr. 640, *review granted*, 746 P.2d 871, 242 Cal. Rptr. 732 (1987). When the California Supreme Court grants review of a case, litigants and California courts may no longer cite lower court opinions concerning that case unless the supreme court specifically orders the opinion "published." CAL. R. CT. 976(d), 977(a). The supreme court has not specifically ordered published the *Goodrich* opinion by the California Court of Appeal. Thus, although currently available in the above cited advance sheets, *Goodrich* is not officially "published." Nevertheless, the arguments and conclusions reached by the court of appeal in *Goodrich* are highly relevant to this discussion and are therefore analyzed.

326. *Id.* at 683-90, 241 Cal. Rptr. 644-49.

327. See CAL. INS. CODE §§ 790-790.10 (West 1972 & Supp. 1988). See *supra* notes 313-20 and accompanying text for a discussion of the Model Act.

328. CAL. INS. CODE § 790.03 (West Supp. 1988). All section references in the text will hereafter be to the California Insurance Code unless otherwise indicated.

329. *Id.* § 790.03(h). Subdivisions (1)-(5), (7), (8), (10)-(13) are essentially identical to comparable subdivisions of the Model Act. See *id.*; see *supra* note 313 for the pertinent text of the Model Act.

330. CAL. INS. CODE § 790.03(h)(2) (West Supp. 1988).

sonable standards for prompt investigations of claims,<sup>331</sup> failing to affirm or deny coverage within a reasonable time after the insured submits proof of loss requirements<sup>332</sup> and where liability is reasonably clear failing to attempt in good faith to reach prompt and fair settlements of claims.<sup>333</sup>

Section 790.03(h) may be enforced by the California Commissioner of Insurance. The Commissioner is empowered to investigate and determine whether an insurer has violated the section.<sup>334</sup> If the Commissioner determines that an insurer has violated a specific provision of the section, he or she may issue a cease and desist order.<sup>335</sup> If the insurer has engaged in an unfair or deceptive act not specifically provided for under the section, the Commissioner may seek injunctive relief.<sup>336</sup>

In addition to the Commissioner's power to enforce section 790.03(h), the California courts have declared that insureds and third party claimants may sue under 790.03(h).<sup>337</sup> Moreover, insureds and third party claimants may recover extracontractual damages under section 790.03(h).<sup>338</sup> Thus, if courts were to hold that ERISA does not preempt section 790.03(h), welfare benefit plan participants<sup>339</sup> residing in California would be able to recover extracontractually while, anomalously, those living in common-law jurisdictions could not.

### C. Roberson: Pilot Life Taken to Its Logical Conclusion

The facts of *Roberson*<sup>340</sup> largely echo those of *Pilot Life*. The plaintiff, however, based his claim not only on common-law causes of action,

331. *Id.* § 790.03(h)(3).

332. *Id.* § 790.03(h)(4).

333. *Id.* § 790.03(h)(5).

334. *Id.* § 790.04.

335. *Id.* § 790.05.

336. *Id.* § 790.06.

337. See *Royal Globe Ins. Co. v. Superior Court*, 23 Cal. 3d 880, 884-90, 592 P.2d 329, 332-35, 153 Cal. Rptr. 842, 845-48 (1979) (holding insureds and third party claimants have private right of action under § 790.03(h)).

338. See *id.* at 884, 592 P.2d at 332, 153 Cal. Rptr. at 845 (complaint under § 790.03(h) claiming damages for physical and emotional distress and punitive damages stated cause of action).

339. See *supra* notes 40-52 and accompanying text for an explanation of ERISA plans.

340. *Roberson v. Equitable Life Assurance Soc'y of the United States*, 661 F. Supp. 416 (C.D. Cal. 1987). The plaintiff employee contracted a serious illness and then through his employee benefit plan filed a claim for group health insurance benefits. *Id.* at 418. After paying benefits for a while, the defendant plan insurer discontinued payments. *Id.* The plaintiff contended that he was entitled to additional benefits. *Id.* The insurer denied this was so. *Id.* The plaintiff brought suit for additional benefits under the group policy. *Id.* He also claimed extracontractual damages for emotional distress as well as punitive damages for the defendant's mishandling of his claim. *Id.*

but also claimed breach of statutory duty under section 790.03(h).<sup>341</sup> The defendant insurer moved for summary judgment, contending that in light of *Pilot Life* ERISA preempted the statutory cause of action as well as those based in common law.<sup>342</sup> The *Roberson* court held that ERISA preempted section 790.03(h) to the extent the section affected employee benefit plans.<sup>343</sup>

In reaching her decision, Judge Rymer relied on *Pilot Life* and its framework of analysis. First, she applied the two-tiered saving clause analysis to section 790.03(h) and, second, considered the section in light of Congress' intention that ERISA's remedies be exclusive.

### 1. Saving clause

Following the *Pilot Life* Court's lead, Judge Rymer broke the saving clause analysis into two parts: (1) whether common sense dictated that section 790.03(h) regulated insurance,<sup>344</sup> and (2) whether applying the three factors<sup>345</sup> indicated that section 790.03(h) regulated the "business of insurance" within Congress' meaning of that phrase in the McCarran-Ferguson Act.<sup>346</sup>

#### a. common sense

First, the court garnered from *Pilot Life* that to "regulate insurance" in the common sense of the phrase, a state law must be "specifically directed" toward the insurance industry.<sup>347</sup> Not surprisingly, Judge Rymer determined section 790.03(h) was specifically directed toward the industry and therefore common sense indicated section 790.03(h) regulated insurance.<sup>348</sup> Indeed, Judge Rymer stated that it "strain[ed] logic" to argue otherwise.<sup>349</sup>

#### b. McCarran-Ferguson factors

The *Roberson* court thought it "unlikely" that section 790.03(h) met

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341. *Id.*

342. *Id.* at 418. ERISA's preemption provisions are codified at 29 U.S.C. § 1144 (1982).

343. *Id.* at 424.

344. *Id.* at 422.

345. The three factors include: (1) whether the state law effects a transfer or spreading of policyholder risk; (2) whether the state law affects an integral part of the insurer-insured relationship; and (3) whether the state law is limited to entities within the insurance industry. *Id.* at 420 (citing *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 743 (1985)).

346. *Id.* at 422-23.

347. *Id.* at 422.

348. *Id.*

349. *Id.*

two of the three McCarran-Ferguson factors.<sup>350</sup> First, the section seemed not to effect a transferring or spreading of policyholder risk.<sup>351</sup> Judge Rymer contrasted section 790.03(h) with the mandated mental health benefits law of *Metropolitan Life Insurance Co. v. Massachusetts*.<sup>352</sup> In *Metropolitan Life*, the Massachusetts law had regulated the substantive terms of insurance policies.<sup>353</sup> Section 790.03(h), however, primarily regulated enforcement—a “procedural” aspect of settling claims.<sup>354</sup> As a result of this substantive/procedural distinction, the court concluded that section 790.03(h) did not appear to shift policyholder risk.<sup>355</sup>

Second, although finding it “difficult to resolve,” the court determined that section 790.03(h) did not affect an integral part of the insurer-insured relationship.<sup>356</sup> Judge Rymer thought the analysis difficult because section 790.03(h) affected that relationship unlike the laws at issue in either *Metropolitan Life* or *Pilot Life*.<sup>357</sup> On one hand, Judge Rymer viewed section 790.03(h) as affecting the relationship less than *Metropolitan Life*’s mandated benefits law, which defined the terms of insurance contracts.<sup>358</sup> On the other hand, section 790.03(h) exerted more effect than Mississippi’s common law of bad faith in *Pilot Life* which “merely” provided punitive damages for breach of existing terms.<sup>359</sup>

In resolving its difficulty, the court tapped into congressional policy behind the McCarran-Ferguson Act. Judge Rymer stated, “[s]ection 790.03(h) does not regulate the terms of the contract itself and hence does not regulate the ‘business of insurance’ as that term is defined under the McCarran-Ferguson Act.”<sup>360</sup> From this proposition the court concluded that “section 790.03(h) is not ‘integral’ to the insurer-insured rela-

350. *Id.*

351. *Id.* See *supra* text accompanying notes 152-62 for a discussion of this concept.

352. *Roberson*, 661 F. Supp. at 422 (relying on *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724 (1985)).

353. See *supra* notes 131-79 for a discussion of *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724 (1985).

354. *Roberson*, 661 F. Supp. at 422.

355. *Id.*

356. *Id.*

357. *Id.*

358. *Id.*

359. *Id.* To illustrate her point, Judge Rymer noted that although § 790.03(h) was itself derived from general tort and contract law an insured may sue under the section for specific, enumerated bad faith or deceptive practices. *Id.* Thus, the section is “arguably more definitive” about what constitutes bad faith in the insurance context than Mississippi’s common law. *Id.*

360. *Id.*

tionship.”<sup>361</sup> Judge Rymer supported her conclusion by noting that in enacting the McCarran-Ferguson Act, Congress was concerned with state laws that “[center] around the contract of insurance.”<sup>362</sup>

Concerning the third McCarran-Ferguson factor, the court and the insurance company defendant conceded that section 790.03(h) was limited to entities within the insurance industry.<sup>363</sup> As a result, section 790.03(h) met one of the McCarran-Ferguson factors.<sup>364</sup>

In summary, under the *Pilot Life* saving clause analysis, the *Roberson* court found that section 790.03(h) regulated insurance within the common sense meaning of the phrase and was limited to entities within the insurance business. However, the section did not effect a spreading or transferring of policyholder risk nor did it affect an integral part of the insurer-insured relationship.

## 2. Exclusive remedies: The bottom line

The court did not rest its holding on its exhaustive saving clause analysis. Judge Rymer read the *Pilot Life* Court’s determination that Congress intended ERISA remedies to be exclusive as *dispositive*.<sup>365</sup> The judge stated, “even assuming that section 790.03(h) regulates insurance and is therefore within the scope of the saving clause, it must be preempted for infringing on the same exclusive civil remedy provisions that were dispositive in *Pilot Life*.”<sup>366</sup> Thus, the court held that ERISA preempted section 790.03(h) solely because Congress intended ERISA remedies to be exclusive.

## 3. Analysis of *Roberson*

By finding dispositive Congress’ intention that ERISA remedies be exclusive, the *Roberson* court expressly held what the *Pilot Life* Court implied: ERISA preempts even state laws within the saving clause if the state laws concern remedies available to employee benefit plan participants. This application of Congress’ intent was wrong for the same reasons it was theoretically wrong in *Pilot Life*.<sup>367</sup>

First, by relying on only this congressional intention, the *Roberson* court eviscerated all meaning from the saving clause. The court held

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361. *Id.*

362. *Id.* (citing *Powell v. Chesapeake & Potomac Tel. Co.*, 780 F.2d 419, 423 (4th Cir. 1985)).

363. *Id.*

364. *Id.*

365. *Id.* at 424.

366. *Id.*

367. See *supra* text accompanying notes 304-11.



that ERISA preempts even laws encompassed by the saving clause if those laws concern remedies.<sup>368</sup> Thus, the court rendered the saving clause—an integral component of ERISA’s preemption provisions—superfluous in the context of remedies.<sup>369</sup>

Second, by focusing solely on Congress’ intention that ERISA remedies be exclusive, the court ignored Congress’ specific intention that ERISA not preempt the McCarran-Ferguson Act.<sup>370</sup> Like the *Pilot Life* Court,<sup>371</sup> Judge Rymer failed to reconcile these competing congressional purposes. Instead, she chose between them, undermining Congress’ wish that ERISA not preempt state laws such as section 790.03(h) that control enforcement of insurance policies.<sup>372</sup>

#### D. Goodrich: *Pilot Life as Precedent for Saving from Preemption*

The facts in *Goodrich* nearly duplicated those of *Pilot Life* and *Rob-*

368. *Roberson*, 661 F. Supp. at 424. Although the *Roberson* court rendered the saving clause analysis academic, several aspects of its discussion warrant mentioning. First, § 790.03(h) undeniably meets the *Pilot Life* common sense “test.” The *Pilot Life* Court held that to regulate insurance in the common sense of the phrase, a state law must be specifically directed toward the insurance business. *Pilot Life Ins. Co. v. Dedeaux*, 107 S. Ct. 1549, 1554 (1987). Section 790.03(h) is specifically directed toward the insurance industry because it is found in the California Insurance Code. Therefore, the *Roberson* court could not rationally deny that § 790.03(h) regulated insurance in the *Pilot Life* common sense meaning of the term.

Concerning the McCarran-Ferguson factors, the *Roberson* court held that § 790.03(h) did not effect a spreading or transferring of policyholder risk because the law did not dictate policy terms. *Roberson*, 661 F. Supp. at 422. See *supra* notes 284-87 and accompanying text for an analysis of this rationale arguing that it is erroneous.

Finally, the court found that § 790.03(h) did not affect an integral part of the insurer-insured relationship. *Roberson*, 661 F. Supp. at 422. The court reasoned that § 790.03(h) did not regulate the “business of insurance” within the meaning of that phrase as used in the McCarran-Ferguson Act. *Id.* As a result, the section could not affect an integral part of the insurer-insured relationship. *Id.*

The court placed the proverbial cart before the horse. The purpose of applying the McCarran-Ferguson factors is to discern whether a state law regulates insurance within the meaning of the McCarran-Ferguson Act. *Id.* at 420. Judge Rymer, however, stated that since the law did not regulate insurance within the meaning of the McCarran-Ferguson Act, the law did not affect an integral part of the insurer-insured relationship. Thus, the judge used the conclusion of the analysis to prove one of the factors leading to that conclusion.

369. See *supra* notes 304-11 and accompanying text for a more detailed exposition of this argument.

370. See *supra* note 130 for the pertinent text of the McCarran-Ferguson Act. See *supra* note 287 for a quotation from a prior Supreme Court analysis determining that Congress was quite concerned with enforcement of insurance policies when it passed the McCarran-Ferguson Act.

371. See *supra* text accompanying notes 304-11.

372. See *supra* text accompanying notes 304-11 for a more detailed exposition of this argument; and see *infra* notes 387-402 and accompanying text for a discussion of a California court’s adoption of it.

erson.<sup>373</sup> Nevertheless, Justice Johnson, writing for a unanimous California Court of Appeal panel,<sup>374</sup> held that ERISA did not preempt section 790.03(h).<sup>375</sup>

The *Goodrich* court, like the *Roberson* court, relied on *Pilot Life* for its decision. First, it applied to section 790.03(h) the two-tiered saving clause analysis consisting of the common sense test and the McCarran-Ferguson factors. Second, the court discussed section 790.03(h) in light of Congress' intention that ERISA remedies be exclusive.

### 1. Saving clause

The *Goodrich* court agreed with the *Roberson* court that section 790.03(h) in common sense regulated insurance.<sup>376</sup> The Justices reasoned that it would strain common sense to hold otherwise because section 790.03(h) was located in California's Insurance Code.<sup>377</sup>

The *Goodrich* court also agreed with Judge Rymer on two other issues. First, section 790.03(h) was limited to entities within the insurance industry, thus meeting the third McCarran-Ferguson factor.<sup>378</sup> Second, the *Goodrich* court concurred, without explanation, that section 790.03(h) did not affect policyholder risk.<sup>379</sup> Thus, the *Goodrich* and *Roberson* courts were in accord on the common sense test and two of the three McCarran-Ferguson factors.

In analyzing whether section 790.03(h) affected an integral part of the insurer-insured relationship, however, the two courts parted company. The *Goodrich* court found that section 790.03(h) defined that relationship "by specifically regulating the obligations of an insurance company to its policyholders."<sup>380</sup> By prescribing and proscribing significant aspects of insurer conduct, the section affected an integral part of the insurer-insured relationship.<sup>381</sup> Moreover, the court pointed out that

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373. *Goodrich v. General Tel. Co.*, 195 Cal. App. 3d 675, 678, 241 Cal. Rptr. 640, 641, review granted, 746 P.2d 871, 242 Cal. Rptr. 732 (1987). Plaintiff employee Goodrich brought suit in California state court against his employer, General Telephone of California, and Traveler's Insurance Company. *Id.* Goodrich claimed damages resulting from delays in processing his claim for disability benefits under a group policy issued by Traveler's to employees of General Telephone. *Id.*

374. Lillie, P.J., and Thompson, J. comprised the remainder of the panel. *Id.* at 691, 241 Cal. Rptr. at 650.

375. *Id.* at 683, 241 Cal. Rptr. at 644.

376. *Id.* at 683-84, 241 Cal. Rptr. at 645.

377. *Id.* at 684, 241 Cal. Rptr. at 645.

378. *Id.*

379. *Id.*

380. *Id.*

381. *Id.*

insurance policies are governed by the law in force at the time the contract was entered into.<sup>382</sup> These laws are then “‘read into each policy issued thereunder, and become a part of the contract with full binding effect upon each party.’”<sup>383</sup> In other words, insurance laws become implied terms of policies, thereby substantively regulating their terms. Thus, the panel held that section 790.03(h) affected an integral part of the insurer-insured relationship.<sup>384</sup>

In summary, the *Goodrich* court held that section 790.03(h) met the common sense test and two of the three McCarran-Ferguson factors.<sup>385</sup> The court accordingly held that section 790.03(h) fell within the saving clause.<sup>386</sup>

## 2. Exclusivity

The *Goodrich* court conceded that Congress intended ERISA remedies to be the sole recourse to aggrieved employee benefit plan participants.<sup>387</sup> However, the court found in ERISA another congressional purpose inconsistent with exclusivity.<sup>388</sup> The panel determined that in enacting ERISA Congress recognized and perpetuated its longstanding policy of deference to state regulation of insurance which was originally demonstrated in the McCarran-Ferguson Act.<sup>389</sup>

Congress demonstrated this policy through two ERISA provisions. First, the saving clause exempted from preemption state laws that regulated insurance.<sup>390</sup> Second, section 1144(d), also located in ERISA’s preemption section, prevented ERISA from “‘impair[ing] or supersed[ing] any law of the United States.’”<sup>391</sup> The court concluded that since the McCarran-Ferguson Act was a statute of the United States, ERISA could not be invoked to impair its operation.<sup>392</sup> Since section 790.03(h) regulated insurance with the meaning of the saving clause, and since

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382. *Id.* at 688, 241 Cal. Rptr. at 647.

383. *Id.* (quoting *Interinsurance Exch. v. Ohio Casualty Ins. Co.*, 58 Cal. 2d 142, 373 P.2d 640, 23 Cal. Rptr. 592 (1962)).

384. *Id.* at 684, 688, 241 Cal. Rptr. at 645, 647-48.

385. The court drew further support for its holding from two federal district court cases decided before *Pilot Life*. Both courts held that § 790.03(h) regulated insurance within the meaning of the saving clause and was thus saved from preemption. *Id.* at 686, 241 Cal. Rptr. at 646 (citing *Presti v. Connecticut Gen. Life Ins. Co.*, 605 F. Supp. 163, 165 (N.D. Cal. 1985); *Eversole v. Metropolitan Life Ins. Co.*, 500 F. Supp. 1162, 1163 (C.D. Cal. 1980)).

386. *Goodrich*, 195 Cal. App. 3d at 684, 241 Cal. Rptr. at 645.

387. *Id.* at 686, 241 Cal. Rptr. at 647.

388. *Id.* at 687, 241 Cal. Rptr. at 647.

389. *Id.*

390. *Id.*

391. *Id.* (quoting 29 U.S.C. § 1144(d) (1982)).

392. *Id.*

Congress intended that ERISA not preempt the McCarran-Ferguson Act, ERISA did not preempt section 790.03(h).<sup>393</sup>

In addition, the *Goodrich* court distinguished *Pilot Life* on the issue of exclusivity. The *Pilot Life* Court had concluded that Mississippi's common law of bad faith did *not* regulate insurance within the meaning of ERISA's saving clause.<sup>394</sup> In contrast, the justices in *Goodrich* held that section 790.03(h) *did* regulate insurance.<sup>395</sup> Thus, the *Goodrich* court determined that *Pilot Life* did not control a case where a state law actually regulated insurance.<sup>396</sup> Specifically, the court of appeal reasoned that even if Congress' intention that ERISA remedies be exclusive *had been* dispositive in *Pilot Life*, that decision was irrelevant to a case where the remedy considered was an *insurance* law—a law specifically saved from preemption by the saving clause.<sup>397</sup>

### 3. Criticism of *Roberson*

In *Goodrich*, the court of appeal criticized the *Roberson* court on two counts. First, the justices thought the *Roberson* court acted illogically in holding that section 790.03(h) was not saved from preemption even though it fell within the saving clause.<sup>398</sup> Further, the *Goodrich* court found the *Roberson* holding in direct conflict with the language of the saving clause.<sup>399</sup> The *Goodrich* court noted that the saving clause provided that “‘*nothing in this subchapter shall be construed to exempt or relieve any person from any law of any State which regulates insurance.*’”<sup>400</sup> Since ERISA's remedy provisions are located in the subchapter to which the court referred,<sup>401</sup> the *Goodrich* court found that Congress had specifically prohibited construing ERISA to preempt state insurance laws—even in the context of remedies.<sup>402</sup>

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393. *Id.* The court recognized that upholding a cause of action under § 790.03(h) was inconsistent with Congress' intention that ERISA remedies be exclusive. *Id.* at 686, 241 Cal. Rptr. at 647. However, the court stated, “[t]his inconsistency is not of our making. Rather it is the inevitable result of inherently inconsistent goals expressed in the ERISA preemption provisions.” *Id.* at 687, 241 Cal. Rptr. at 647.

394. *Pilot Life Ins. Co. v. Dedeaux*, 107 S. Ct. 1549, 1554-55 (1987).

395. *Goodrich*, 195 Cal. App. 3d at 684, 241 Cal. Rptr. at 645.

396. *Id.* at 688, 241 Cal. Rptr. at 648.

397. *Id.*

398. *Id.* Justice Johnson stated, “[w]e have great difficulty with the concept § 790.03(h) can be both within and without the scope of the preemption clause.” *Id.*

399. *Id.*

400. *Id.* (emphasis in original).

401. Subchapter I is entitled “PROTECTION OF EMPLOYEE BENEFIT RIGHTS,” and encompasses 29 U.S.C. §§ 1001-1145 (1982 & Supp. III 1985). Subchapter I contains all ERISA provisions relevant to this Note.

402. *Goodrich*, 195 Cal. App. 3d 688, 241 Cal. Rptr. at 648.

In short, the *Goodrich* court found that section 790.03(h) fell within the saving clause, and as such was saved from preemption. The court diminished in importance Congress' intention that ERISA remedies be exclusive by pointing out that this intention must be reconciled with another congressional concern—that the states retain control over insurance matters.

#### 4. Analysis

The *Goodrich* rationale differed from *Roberson* in one essential respect: the *Roberson* court considered dispositive the *Pilot Life* Court's determination that Congress intended ERISA's remedies to be exclusive; the *Goodrich* court did not. Examination of *Pilot Life*'s language indicates both interpretations are plausible. The *Pilot Life* Court summarized its reasoning:

[c]onsidering the common-sense understanding of the saving clause, the McCarran-Ferguson Act factors defining the business of insurance, and, *most importantly, the clear expression of congressional intent that ERISA's civil enforcement scheme be exclusive*, we conclude that . . . [the] state law suit asserting improper processing of a claim for benefits under an ERISA-regulated plan is not saved by [the saving clause], and therefore is pre-empted . . . .<sup>403</sup>

Thus, although the Court did not expressly characterize Congress' intent regarding remedies as dispositive, the Court did elevate the factor above the others.

The *Goodrich* court viewed the Supreme Court's vagueness as an opportunity to factor in another congressional intention not analyzed by the Court in *Pilot Life*—that ERISA not preempt the McCarran-Ferguson Act policy that the states regulate enforcement of insurance contracts.<sup>404</sup> The *Goodrich* court then reconciled these competing policies by concluding that ERISA's remedies were exclusive—*except* where employee benefit plan participants may invoke state laws regulating insurance.<sup>405</sup>

#### 5. Which is correct: *Roberson* or *Goodrich*?

Notwithstanding the *Goodrich* court's plausible arguments, *Roberson* is consistent with *Pilot Life* while *Goodrich* is not. The *Pilot Life*

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403. *Pilot Life*, 107 S. Ct. at 1558 (emphasis added).

404. *Goodrich*, 195 Cal. App. 3d at 686-87, 688, 241 Cal. Rptr. at 647, 648.

405. *Id.* at 688, 241 Cal. Rptr. at 648.

Court concluded that Mississippi's common law of bad faith did not regulate insurance.<sup>406</sup> The Court, however, did not rest its holding on that determination.<sup>407</sup> It proceeded to characterize as most important to its decision Congress' intention that ERISA's remedies be exclusive.<sup>408</sup> By doing so, the Court strongly implied that this intention was dispositive. The *Roberson* court merely expressed this implication.

The *Goodrich* court, on the other hand, considered another congressional intention not analyzed by the *Pilot Life* Court—that ERISA not preempt the McCarran-Ferguson Act. As the Supreme Court also analyzed the saving clause against the backdrop of the McCarran-Ferguson Act, it must be presumed that the Court intentionally refused to reconcile the two congressional purposes. *Roberson* therefore appears more in tandem with *Pilot Life* than *Goodrich*.

To criticize *Roberson*, then, is to criticize *Pilot Life*. Even so, the *Goodrich* approach appears better reasoned than that of *Roberson/Pilot Life*. The *Goodrich* approach provides that employee benefit plan participants may utilize only ERISA remedies unless state insurance law is implicated. This is consistent with the language of the saving clause.<sup>409</sup> In contrast, under the *Roberson/Pilot Life* theory, the saving clause is meaningless when remedies are involved.<sup>410</sup>

Moreover, while the *Roberson/Pilot Life* approach ignores all congressional policies save one the *Goodrich* approach balances competing federal concerns with fidelity to both. On one hand, it recognizes that Congress intended ERISA remedies to be exclusive. On the other hand, the *Goodrich* approach incorporates Congress' intention that ERISA not preempt the McCarran-Ferguson Act and its longstanding policy that the states regulate insurance law.<sup>411</sup> Thus, the *Goodrich* theory absorbs both policies while the *Roberson/Pilot Life* theory ignores the McCarran-Ferguson policy.

In practical terms, *Goodrich* would leave exclusively for ERISA remedies actions concerning pension benefit plans and uninsured welfare benefit plans.<sup>412</sup> At the same time, either state or ERISA remedies would cover insured welfare benefit plans. This distinction between in-

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406. *Pilot Life*, 107 S. Ct. at 1554-55.

407. *Id.* at 1555.

408. *Id.* at 1558.

409. 29 U.S.C. § 1144(b)(2)(A) (1982). See *supra* note 73 for the text of the saving clause.

410. See *supra* notes 310-11 for further discussion of this theory.

411. See *supra* notes 304-11 and accompanying text for a more detailed exposition of the premises underlying this argument.

412. See *supra* text accompanying notes 45-46 for an explanation of insured and uninsured plans.

sured and uninsured welfare benefit plans is consistent with prior Supreme Court interpretation of ERISA. In *Metropolitan Life Insurance Co. v. Massachusetts*,<sup>413</sup> decided before *Pilot Life*, the Court held that ERISA did not preempt a Massachusetts mandated benefits law as applied to insured plans, but did preempt the law when applied to uninsured plans.<sup>414</sup> The Court stated:

[w]e are aware that our decision results in a distinction between insured and uninsured plans, leaving the former open to indirect [state] regulation while the latter are not. By so doing we merely give life to a distinction created by Congress in the "deemer clause," a distinction Congress is aware of and one it has chosen not to alter.<sup>415</sup>

Thus, the *Goodrich* approach is consistent with Supreme Court saving clause doctrine prior to *Pilot Life*.

Whether ERISA preempts section 790.03(h) and similar statutes depends upon whether the circuits,<sup>416</sup> and perhaps eventually the Supreme Court, adopt the *Goodrich* or *Roberson* approach. Since *Roberson* more closely resembled *Pilot Life* than did *Goodrich*, it is unlikely that courts will find the *Goodrich* reasoning persuasive. Absent congressional action, it will eventually be settled law that ERISA preempts statutory bad faith causes of action.

## VI. CONGRESSIONAL ALTERNATIVES

The Supreme Court has spoken; the ramifications will be enormous. As of March 1984 the *majority* of Americans, 134,000,000 strong, were covered by employer or union provided health insurance.<sup>417</sup> Their recourse governed solely by ERISA, welfare plan participants may now recover only policy benefits and possibly attorney fees—even in the face of gross mishandling of claims.

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413. 471 U.S. 724 (1985).

414. *Id.* at 735 n.14, 747.

415. *Id.* at 747.

416. As this Note nears publication, the Court of Appeals for the Ninth Circuit is considering the appeal of *Kanne v. Connecticut Gen. Life Ins. Co.*, 607 F. Supp. 899 (C.D. Cal. 1985), *aff'd in part and rev'd in part*, *Kanne v. Connecticut Gen. Life Ins. Co.*, 819 F.2d 204 (9th Cir. 1986), *op. withdrawn*, *Kanne v. Connecticut Gen. Life Ins. Co.*, 823 F.2d 284 (9th Cir. 1987). In *Kanne*, the district court held that ERISA preempted neither common law claims nor § 790.03(h). *Id.* at 904-06. On appeal and after resubmission in light of *Pilot Life*, the court of appeals held that ERISA preempted the common-law causes of action. *Kanne v. Connecticut Gen. Life Ins. Co.*, 819 F.2d 204, 205-06 (9th Cir. 1987).

The court has heard separate argument on whether ERISA preempts § 790.03(h). Its decision is expected in mid-1988.

417. *See supra* note 16.

Since the Court in *Pilot Life Insurance Co. v. Dedeaux*<sup>418</sup> was unanimous, it is extremely unlikely that the Justices will soon, if ever, reconsider ERISA preemption of common-law bad faith causes of action. Thus, Congress alone can effect a change in the law.

Congress has three alternatives: (1) do nothing; (2) amend ERISA to prescribe a uniform federal standard of bad faith liability, permitting insured welfare benefit plan participants to sue group insurers directly under the statute; or (3) amend ERISA to explicitly permit participants<sup>419</sup> to sue group insurers under state bad faith causes of action.

#### A. *No Action*

For Congress to do nothing is unacceptable. The insurer-insured relationship is a special one, characterized by vastly unequal bargaining power and imbued with the public interest.<sup>420</sup> The specter of bad faith recovery equalizes this disparate relationship by deterring insurance companies from exploiting insureds when they are most financially vulnerable.<sup>421</sup> If Congress fails to act insurers will remain free to deny or delay the processing of claims with impunity. Furthermore, inaction would perpetuate an anomalous distinction: insureds covered by individual policies could sue insurers for bad faith under state law in jurisdictions recognizing the tort, but insureds participating in group plans in those same jurisdictions could sue only under ERISA merely for policy proceeds. Congress must act.

#### B. *Amend ERISA to Prescribe a Uniform Federal Standard of Bad Faith Liability*

Congress could create a uniform federal standard of bad faith liability. It could amend ERISA's civil enforcement provisions<sup>422</sup> to permit insured welfare benefit plan participants to sue group insurers for bad faith directly under the statute. This alternative has several advantages. First, Congress would perpetuate its original ERISA policy to federalize the regulation of employee benefit plans.<sup>423</sup> At the same time, plan insurers would be encouraged to deal fairly with plan participants because insurers would be exposed to extracontractual liability for bad faith mis-

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418. 107 S. Ct. 1549 (1987).

419. Use of "participant" in this section means "insured welfare benefit plan participant or beneficiary." See *supra* notes 19-20 for ERISA's definitions of these terms.

420. See *supra* notes 3-5 and accompanying text for a discussion of these aspects of the insurer-insured relationship.

421. See *supra* notes 7-10 and accompanying text.

422. 29 U.S.C. § 1132 (1982).

423. See *id.* § 1001, ERISA's declaration of policy. See *supra* note 31 for an excerpt.



handling of claims. Thus, Congress would equalize the relationship between insured welfare benefit plan participants and group insurers in the same manner the majority of states have balanced the individual insured-insurer relationship.<sup>424</sup> In addition, group insurers would enjoy the advantage of having to reckon with only one standard of liability. One standard could result in a streamlining of claims procedures and therefore a reduction in costs to insurers doing business in more than one state.

Creating a federal bad faith cause of action, however, has significant drawbacks. First, Congress would undermine the long established federal policy of preserving state regulation of insurance.<sup>425</sup> A federal standard would allow bad faith recovery, albeit under federal law, in states that have not yet recognized the tort. Second, in states that recognize the tort, insurance companies would have to conform with potentially differing standards of conduct. Depending on the components of the federal standard and eventual court interpretations, the standard might evolve to be more or less exacting than the state's.<sup>426</sup> In short, a federal tort of bad faith would greatly benefit insureds, but it would place inconsistent burdens on insurance companies and disturb the balance of federalism.

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424. See *supra* note 1.

425. See *supra* note 130 for the pertinent text and a discussion of the McCarran-Ferguson Act, 29 U.S.C. §§ 1011-1015 (1982 & Supp. IV 1986), which conferred upon the states the power to regulate the insurance business.

426. Standards of liability vary widely among the states. California's standard is quite liberal. An insured may recover compensatory damages beyond the policy limits if the insurer unreasonably and without cause withholds policy benefits. *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 575, 510 P.2d 1032, 1038, 108 Cal. Rptr. 480, 486 (1973). An insurer acts unreasonably, for example, when it fails to adequately investigate an insured's claim before denying benefits. *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 819, 598 P.2d 452, 457, 157 Cal. Rptr. 482, 487 (1979), *cert. denied*, 445 U.S. 912 (1980).

At the other extreme, Arkansas allows extracontractual recovery only if the insurance company commits affirmative misconduct characterized by dishonesty, malice or oppression. *Aetna Casualty & Sur. Co. v. Broadway Arms Corp.*, 281 Ark. 128, 133, 664 S.W.2d 463, 465 (1984). Malice is characterized by ill will, hatred or spirit of revenge. *Id.* at 133-34, 664 S.W.2d at 465. Negligence or bad judgment on the insurer's part are not sufficient for extracontractual recovery. *Id.* at 133, 664 S.W.2d at 465. Interestingly, dishonesty, malice or oppression will allow a California plaintiff to recover not only extracontractual compensatory damages but punitive damages as well. *Egan*, 24 Cal. 3d at 819-23, 598 P.2d at 457-59, 157 Cal. Rptr. at 487-90. Thus, for an insurer to incur bad faith liability in Arkansas, its conduct must rise to a level that would justify punitive damages in California. For a survey of the various bad faith standards, see generally Goldberg, *Standards of Liability for Bad Faith Refusal to Pay Benefits in First Party Insurance*, DEF. COUNS. J., April, 1987, at 169.

*C. Congress Must Amend ERISA to Permit Insured Welfare Benefit Plan Participants to Sue for Bad Faith Under State Law*

One alternative remains. One that would avoid the problems inherent in enacting a federal bad faith cause of action and yet still provide insureds with the leverage they need against insurance companies. One that would keep ERISA's civil enforcement remedies exclusive—except where the dispute involves an insured welfare benefit plan. Congress must amend ERISA to permit insured welfare benefit plan participants to sue either under the statute for benefits due *or* under applicable state bad faith law.

Such an amendment would serve two seemingly conflicting federal policies. First, it would preserve state regulation of insurance. Congress would therefore remain true to its intentions embodied in the McCarran-Ferguson Act<sup>427</sup> and ERISA's saving clause.<sup>428</sup> Second, in passing ERISA, Congress was largely concerned with federal regulation of private pension plans, not welfare benefit plans.<sup>429</sup> Thus, allowing insured *welfare* benefit plan participants to sue under state law would not significantly undermine its original ERISA intention that federal law exclusively govern employee pension benefit plans. Congress would remain true to both of these policies by explicitly granting participants the right to sue under state law.

Furthermore, by permitting participants to sue under state law, Congress would foster federalism. That is, Congress would not be inserting bad faith law into states where the tort is not yet recognized. Similarly, a co-existing and possibly conflicting standard of bad faith would not be created in states which do recognize the tort.

Finally, insurance companies are already geared toward state regulation. Permitting insured welfare benefit plan participants to sue under state law would not significantly affect insurance company administration of group policies.

In sum, Congress should amend ERISA to give insured welfare benefit plan participants the choice to sue either under ERISA for benefits due or under state causes of action for bad faith.<sup>430</sup> Such an amendment

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427. 29 U.S.C. §§ 1011-1015 (1982 & Supp. IV 1986). See *supra* note 130 for a general discussion of the McCarran-Ferguson Act.

428. *Id.* § 1144(b)(2)(A). See *supra* note 73 for the text of ERISA's preemption provisions. See *supra* text accompanying notes 73-88 for a general discussion of the preemption provisions.

429. See 29 U.S.C. § 1001 (1982) (congressional findings and declaration of policy).

430. By adopting the following language, Congress could amend ERISA to offer insured welfare benefit plan participants the choice of suing under the statute for policy benefits or suing under available state remedies:

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would preserve the rights of plan participants as insureds under state law, eliminate the anomalous distinction between group and individual insureds and foster federalism.

## VII. CONCLUSION

In *Pilot Life Insurance Co. v. Dedeaux*,<sup>431</sup> the Supreme Court of the United States held that ERISA's civil enforcement provisions preempted state common-law based bad faith causes of action in disputes involving employee welfare benefit plans. Since ERISA's remedy provisions do not provide for extracontractual damages, the Court has stripped insured welfare benefit plan participants and beneficiaries of their hard won bad faith rights against insurers.

Moreover, the Court blindly deferred to Congress' intention that ERISA remedies be exclusive without factoring in Congress' other long-established intention that the states regulate the enforcement of insurance contracts. Thus, the Court has upset the balance of federalism struck by Congress in the McCarran-Ferguson Act<sup>432</sup> and ERISA's saving clause.<sup>433</sup>

The Court's decision was unanimous; it is unlikely that the Justices will soon, if ever, reconsider their decision. As a result, only Congress can reestablish bad faith rights to plan participants and restore the equilibrium between the states and the federal government.

Therefore, Congress must amend ERISA to explicitly permit in-

(a) Persons empowered to bring a civil action

A civil action may be brought—

(1) by a participant or beneficiary— . . .

(B) to recover benefits due to him [or her] under the terms of his [or her] plan, to enforce his [or her] rights under the terms of the plan, or to clarify his [or her] rights to future benefits under the terms of the plan; . . .

(b) *In the case of an employee welfare benefit plan established or maintained through the purchase of one or more insurance policies, nothing in this section shall be construed to preclude a participant or beneficiary from bringing an action under applicable State law. . . .*

(f) [formerly (e)] Jurisdiction

(1) Except for actions under subsection (a)(1)(B) of this section, the district court of the United States shall have exclusive jurisdiction of civil actions . . . . State courts of competent jurisdiction and district courts of the United States shall have concurrent jurisdiction of actions under subsection (a)(1)(B) of this section.

29 U.S.C. § 1132 (proposed amendment) (language of proposed amendment in italics). Subsections (a), (b), and (f) (formerly (e)) taken together would allow competent state courts to hear both ERISA and state claims. Federal courts could also hear the state claims along with the ERISA claim under the doctrine of pendent jurisdiction. See generally *United Mine Workers v. Gibbs*, 383 U.S. 715 (1966) for a discussion of the doctrine of pendent jurisdiction.

431. 107 S. Ct. 1549 (1987).

432. 15 U.S.C. §§ 1011-1015 (1982 & Supp. IV 1986).

433. 29 U.S.C. § 1144(b)(2)(A) (1982).

sured welfare benefit plan participants and beneficiaries to sue either under ERISA for benefits due or under applicable state bad faith law. By so amending ERISA, Congress would guarantee that group insureds could exercise their state law based bad faith rights and restore the balance of federalism. At the same time, Congress would not significantly erode its intention that ERISA remedies be exclusive because insured welfare benefit plans constitute only a sidelight to the main thrust of ERISA regulation—pension plans.

In the wake of *Pilot Life*, ERISA welfare benefit plan participants—including the reader, odds are—will languish at the mercy of their group insurer's good graces. An unacceptable situation, Congress must rectify what sloppy legislative drafting and the Supreme Court have wrought.

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\* Thanks to J. Russell Stedman, associate, Barger & Wolen, for introducing the writer to the general issues addressed and to Professor Terrence D. Collingsworth for his comments. Very special thanks to Susan Strong Aldisert for her extraordinary patience throughout the writing and production of this Note.

