Under ERISA, Communications with In-House Counsel Before a Final Claims Decision are Not Privileged and are Subject to Discovery to Show a Conflict of Interest

Are insureds entitled to communications between an insurance company's in-house counsel and the claims handlers that might otherwise be protected by the attorney-client privilege? Following a new ruling by the Ninth Circuit Court of Appeals, if the claimant is insured under an ERISA plan, the answer might be "yes."

For decades, courts, including the Ninth Circuit, have recognized a "fiduciary exception" to the attorney-client privilege in the context of ERISA. Courts have required production of legal advice given to plan fiduciaries when they are acting as fiduciaries for the benefit of the beneficiaries. This "fiduciary exception" has however been subject to exceptions.

In *Stephan v. Unum Life Insurance Company of America*, __ F.3d __, 2012 U.S. App. LEXIS 19139, 2012 WL 3983767 (9th Cir. September 12, 2012), for the Ninth Circuit for the first time addressed whether the fiduciary exception applies to insurance companies in the ERISA context. The Court ruled that, in an ERISA case, a claimant is entitled to conduct discovery regarding communications between claims handlers and in-house counsel in an attempt to determine whether the insurer's decision was improperly influenced by a conflict of interest. Following the Third Circuit's ruling in *Wachtel v. Health Net, Inc.*, 482 F.3d 225 (3d Cir. 2007), the court held that the ERISA "fiduciary exception" to the attorney-client privilege did not apply to communications made while the claim is still being evaluated.

Unlike most cases involving long-term disability insurance, the dispute in *Stephan* was not over whether the claimant was entitled to benefits, but rather the amount of those benefits. Following a bicycling accident that left him quadriplegic, Unum calculated Stephan's earnings using only his monthly salary, but not his annual bonus. Given that Stephan's bonus was 1 ½ times his salary, Unum's interpretation of the Plan terms to exclude to bonus resulted in a substantial cost savings for the insurer. Stephan, with the full support of his employer, who provided evidence that the bonus was not a discretionary addition to his income, but rather the "main portion" of his compensation, sued Unum to have the bonus included as part of his monthly earnings.

On cross motions for summary judgment, the District Court applied the abuse of discretion standard of review and held that Unum's interpretation of the Plan was not an abuse of discretion. The District Court also denied Stephan's motion to compel discovery of a series of internal memoranda created by Unum's in-house counsel regarding Stephan's claim. Stephan appealed both rulings.

As to the issue of the proper standard of review, the Ninth Circuit ruled that District Court's decision to apply the abuse of discretion standard of review was proper, rejecting the plaintiff's arguments that an agreement between Unum and the California Department of Insurance prohibits the discretionary authority provision, as well as the argument that the discretionary provision is contrary to California state law and public policy and is therefore void. However, the Ninth Circuit criticized the District Court's failure to consider evidence showing that Unum's decision might have been improperly influenced by a conflict of interest.

> The district court held that "Unum's conflict of interest did not weigh heavily upon its decision-making process in this case and therefore does not tip the scale towards a

> finding of an abuse of discretion." In reaching this conclusion, the district court erred by failing to apply traditional principles of summary judgment; denying Stephan's motion to compel discovery of certain internal memoranda between Unum's claim analyst and its in-house counsel; and ignoring evidence that Unum has a history of biased decision making that indicates that its conflict of interest in this case ought to be given more weight."

Similarly, the Ninth Circuit criticized the District Court's refusal to compel the production of certain documents that Stephan sought in an effort to demonstrate that Unum's decision was influenced by its conflict of interest. Specifically, "Stephan sought to discover a series of internal memoranda created between December 2007 and February 2008 by Unum's in-house counsel, at the request of Unum's claims analyst." Acknowledging that ordinarily such documents would fall under the attorney-client privilege, Stephan argued that because Unum is a fiduciary of the ERISA Plan, the fiduciary exception to the privilege permits his discovery of the documents."

The Ninth Circuit agreed with the District Court's finding that the fiduciary exception applies to wholly insured ERISA plans, but disagreed with the District Court's application of the doctrine. The District Court refused to compel the production of the documents because "the interests of plaintiff and defendant had sufficiently diverged at the time the disputed memoranda were created." However, after reviewing the documents, the Ninth Circuit ruled that they merely "offer[ed] advice solely on how the Plan ought to be interpreted," and did not address any potential civil or criminal liability Unum might face. The Ninth Circuit further noted that the documents "were prepared to advise Unum claims analysts about how best to interpret the Plan, and were communicated to the analysts *before any final determination* on Stephan's claim had been made." (Emphasis added.) In discussing the issue, the Ninth Circuit rejected the conclusion of *Wachtel*, expressing its view that the justifications for the fiduciary exception did not support excluding insurers from the fiduciary exception:

> ERISA has broad disclosure requirements: It requires that "every employee benefit plan . . . afford a reasonable opportunity to any participant whose claim for benefits has been denied for a full and fair review by the appropriate named fiduciary of the decision denying the claim." 29 U.S.C. § 1133. Because "[t]he opportunity to review . . . pertinent documents is critical to a full and fair review," Ellis v. Metropolitan Life Insurance Co., 126 F.3d 228, 237 (4th Cir. 1997), the regulations implementing this provision require that upon request, a claimant be provided all "information relevant to the claimant's claim for benefits," 29 C.F.R. § 2560.503-1(h)(2)(ii). Neither the statute nor the regulations provide any reason why the disclosure of information is any less important where an insurer, rather than a trustee or other ERISA fiduciary, is the decisionmaker.

Similarly, the obligation that an ERISA fiduciary act in the interest of the plan beneficiary does not differ depending on whether that fiduciary is a trustee or an insurer. There is therefore no principled basis for excluding insurers from the fiduciary exception. Accordingly, because the advice was given before the interests of Unum and the claimant became adverse, the Court ruled that the fiduciary exception to the attorney-client privilege applied.

Finally, while the Ninth Circuit remanded the ruling on the underlying claim decision to the District Court, the Court of Appeals offered a detailed analysis of the Plan language and controlling case law suggesting that there is ample evidence that Unum's decision was likely tainted by a conflict of interest and the decision to exclude Stephan's bonus from the calculations of the LTD benefits was improper and should be overturned.

This plaintiff-participant friendly decision has some very beneficial statements and holdings and should be referred to by attorneys for plan participants/beneficiaries.