

Spring 1991

## ERISA Preemption: As the Federal Courts Identify the Outer Boundaries of ERISA's Preemption Clause, What are the Implication for South Carolina State Actions?

Caroline W. Cleveland

Follow this and additional works at: <https://scholarcommons.sc.edu/sclr>



Part of the [Law Commons](#)

---

### Recommended Citation

Caroline W. Cleveland, ERISA Preemption: As the Federal Courts Identify the Outer Boundaries of ERISA's Preemption Clause, What are the Implication for South Carolina State Actions?, 42 S. C. L. Rev. 743 (1991).

This Note is brought to you by the Law Reviews and Journals at Scholar Commons. It has been accepted for inclusion in South Carolina Law Review by an authorized editor of Scholar Commons. For more information, please contact [digres@mailbox.sc.edu](mailto:digres@mailbox.sc.edu).

**ERISA PREEMPTION: AS THE FEDERAL  
COURTS IDENTIFY THE OUTER  
BOUNDARIES OF ERISA’S  
PREEMPTION CLAUSE, WHAT ARE THE  
IMPLICATIONS FOR SOUTH CAROLINA  
STATE ACTIONS?**

I.	INTRODUCTION .....	744
II.	THE ACT .....	745
	A. <i>Affected Plans</i> .....	745
	B. <i>Standing to Litigate and ERISA Remedies</i> .....	746
	C. <i>Preemption of State Law</i> .....	748
	1. <i>The Preemption Clause</i> .....	748
	2. <i>The Saving Clause</i> .....	749
	3. <i>The Deemer Clause</i> .....	749
	4. <i>Interaction of the Preemption, Saving and         Deemer Clauses</i> .....	750
III.	CASE LAW .....	751
	A. <i>Pre-Pilot Life Interpretations</i> .....	751
	1. <i>State Laws That Relate to an Employee Benefit         Plan: The Meaning of “Relate To”</i> .....	751
	a. <i>Alessi v. Raybestos-Manhattan, Inc.</i> .....	751
	b. <i>Shaw v. Delta Airlines, Inc.</i> .....	752
	2. <i>The Meaning of “Regulate Insurance”</i> .....	753
	a. <i>Metropolitan Life Insurance Co. v.             Massachusetts</i> .....	753
	B. <i>Pilot Life Insurance Co. v. Dedeaux</i> .....	755
	C. <i>Implications</i> .....	757
IV.	IMPACT ON SOUTH CAROLINA AND FOURTH CIRCUIT LAW ...	757
	A. <i>Common-Law Actions</i> .....	757
	1. <i>Bad Faith Refusal to Pay</i> .....	757
	2. <i>Alternative Plaintiffs</i> .....	761
	a. <i>The Issue</i> .....	761
	b. <i>Analysis</i> .....	763
	i. <i>The Parameters of “Relate To”</i> ..	763
	ii. <i>A Remedies Approach</i> .....	766
	iii. <i>Congressional Intent</i> .....	769
	iv. <i>South Carolina and the Fourth                 Circuit</i> .....	770
	B. <i>Statutory Provisions</i> .....	773

1. <i>Continuation of Coverage</i> .....	773
2. <i>Trade Practices</i> .....	777
3. <i>Exempted Statutes</i> .....	779
V. CONCLUSION .....	779

## I. INTRODUCTION\*

In December 1963 Studebaker Corporation announced the closing of its South Bend, Indiana automotive manufacturing plant and the termination of the plant's pension benefit plan. Because of contractual termination priorities, only 3,600 retirees and employees who had reached the retirement age of sixty received their full benefits. Four thousand other employees aged forty through fifty-nine, who had at least ten years of service, received only fifteen percent of the actuarial value of their accrued pension benefits. The remaining 2,900 unfortunate workers, who were either under the age of forty or had completed less than ten years of service with Studebaker, received nothing.<sup>1</sup>

The benefits plan had been seriously underfunded, leaving thousands of workers, many middle-aged and unable to find other employment, to face a forced retirement without the benefits they had been promised.

Over the next decade Congress waded through hearings, studies, and voluminous proposed legislation in an effort to alleviate the Draconian effect of failed or abused employee pension and benefit plans. In 1971 the Senate Labor Subcommittee heard the testimony of a succession of workers in their late forties and fifties who told of losing their pension rights because of layoffs, plant shut-downs, transfers, and business closings. One witness had worked for one company for thirty-two years and was laid off three years before he became eligible for his pension.<sup>2</sup> After countless "horror stories" and on the crest of a wave of public and media demand for congressional action, Congress enacted the Employee Retirement Income Security Act of 1974 (ERISA or the Act). Congressional intent to alleviate employee benefit plan abuse through federal regulation is clear from the Act's declaration of public policy:

[D]espite the enormous growth in [employee benefit] plans many em-

---

\* Thanks to Elizabeth A. Carpentier, Sinkler & Boyd, P.A., Columbia, South Carolina, for her time and patience in introducing the author to the Act and underlying concepts.

Special thanks to David C. Cleveland and to the legal staff of Farm Credit Bank of Columbia for their support of this project.

1. J. LANGBERN & B. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 53-58 (1990).

2. See *id.* at 65.

employees with long years of employment are losing anticipated retirement benefits owing to the lack of [sufficient vesting, funding, and termination provisions] . . . . [I]t is therefore desirable . . . that minimum standards be provided assuring the equitable character of such plans and their financial soundness.<sup>3</sup>

One feature of ERISA that makes the Act so sweeping is a broadly-construed preemption clause, which enables ERISA to preempt state actions that involve ERISA-governed plans.<sup>4</sup> There are, of course, exceptions to preemption. Because of the ramifications of preemption, prolific litigation has arisen concerning the interpretation and application of those exceptions. One of the more widely litigated exceptions is one in which actions based on state laws that regulate insurance are saved from preemption.<sup>5</sup> These cases deal primarily with criteria for determining when state laws “regulate insurance” for the purposes of the Act. The most recent opinions address the preemption of state bad-faith actions and issues surrounding fiduciary aspects of the Act.

This Note examines recent case law, statutory provisions, and legislative history with regard to saving state insurance regulation laws from preemption, and then applies the relevant analyses and tests to South Carolina law. The Note begins with an overview of ERISA and an examination of the interaction between the preemption, saving, and deeming clauses. It then explores the reasoning and analysis of the judiciary that interprets and applies this legislation. Finally, by applying the determining factors to South Carolina law, this Note will attempt to determine which state actions, if any, would be saved from preemption.

## II. THE ACT

### A. *Affected Plans*

ERISA regulates two categories of employee benefit plans: pension plans and employee welfare benefit plans.<sup>6</sup> This Note focuses on welfare benefit plans because they are more frequently the subject of litigation. Although the Act uses the terms “benefit plan” and “employee

---

3. 29 U.S.C. § 1001(a)(1988).

4. *Id.* § 1144(a).

5. *Id.* § 1144(b)(2)(A).

6. Pension plans are those established to provide employees with retirement or deferred income. *Id.* § 1002(2)(A). Welfare benefit plans provide medical, accident, disability, death or unemployment, vacation, or training benefits. *Id.* § 1002(1).

benefit plan” to refer to both pension and welfare benefit plans,<sup>7</sup> these terms generally will refer only to welfare benefit plans in this Note.

Under 29 U.S.C. § 1002,<sup>8</sup> a regulated plan is one that is established and maintained by an employer to provide welfare or pension benefits to employees.<sup>9</sup> ERISA does not regulate governmental plans,<sup>10</sup> church plans,<sup>11</sup> or plans established solely for the purpose of complying with workers’ compensation, unemployment, or disability insurance laws.<sup>12</sup> Aside from small group plans (fewer than 20 employees), which are exempt from COBRA<sup>13</sup> requirements, all plans other than those cited are subject to ERISA regulation.

Unlike its treatment of pension plans, ERISA does not address the substantive terms of welfare plans.<sup>14</sup> ERISA confines its regulation of welfare plans to procedural and administrative aspects and establishes certain fiduciary duties. The substantive content of some welfare benefit plans may be influenced by state law.<sup>15</sup> ERISA also contains tax provisions which are designed, in part, to create incentives for providing and participating in benefit plans. This Note will focus on the Act’s labor provisions and will not address the tax issues.

### *B. Standing to Litigate and ERISA Remedies*

A participant<sup>16</sup> or beneficiary<sup>17</sup> can sue under ERISA: (1) to com-

7. *Id.* § 1002(3).

8. (1988). An “employer” is any person acting directly as an employer or indirectly in the interest of an employer, in relation to an employee benefit plan; this includes a group or association of employers acting for an employer in such a capacity. *Id.* § 1002(5).

9. “[E]mployee” means any individual employed by an employer.” *Id.* § 1002(6).

10. *Id.* § 1003(b)(1). A governmental plan is one established by federal, state, or local government for its employees. *Id.* § 1002(32).

11. *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 exempt from taxes under the Internal Revenue Code, 26 U.S.C. § 501 (1988). 29 U.S.C. § 1002(33) (1988).

12. 29 U.S.C. § 1003(b)(3) (1988).

13. Consolidated Omnibus Budget Reconciliation Act, parts of which are codified in ERISA at 29 U.S.C. §§ 1161-1168 (1988).

14. *Metropolitan Life Ins. v. Massachusetts*, 471 U.S. 724, 732 (1985).

15. *Id.* at 729-33.

16. ERISA defines participant as:

[A]ny 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.

29 U.S.C. § 1002(7) (1988).

17. 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.* §

pel a plan administrator to make certain disclosures,<sup>18</sup> to recover benefits, enforce rights under the plan, or clarify future rights;<sup>19</sup> (2) to obtain appropriate relief for breach of fiduciary duty;<sup>20</sup> (3) to enjoin any practice that is contrary to the Act or the terms of the plan, to obtain relief from such contradictory practices or to enforce any provisions of the Act or the plan;<sup>21</sup> and (4) to enforce disclosure to the beneficiary of reports made to the Internal Revenue Service.<sup>22</sup> The Secretary of Labor has standing in actions described in (2) and (4) above. In addition to these possible actions, the Secretary of Labor may sue to enjoin any violation of ERISA<sup>23</sup> or to collect civil penalties.<sup>24</sup> A fiduciary of a plan has standing to bring an action under section 1132(a)(3) to enjoin any act that violates ERISA, to obtain appropriate relief from the violation, or to enforce any provision of the Act or the plan.

ERISA remedies differ from those allowed by South Carolina law. Under the Act, a court can award either party attorneys' fees with no statutory cap on the amount.<sup>25</sup> Under South Carolina law, only the insured can get attorneys' fees and a cap on fees exists.<sup>26</sup> Another distinction is that courts generally will limit claims for benefits under ERISA to the terms of the plan.<sup>27</sup> This contrasts with South Carolina laws that allow extracontractual and punitive damages upon a showing of certain elements, such as bad faith.<sup>28</sup> The general rule under the Act is that punitive damages are not recoverable.<sup>29</sup> This latter difference arguably provides less incentive for violators to comply with the Act and is a factor in pro-saving arguments.

---

1002(8). For the purposes of this Note, "participant" and "beneficiary" are used interchangeably.

18. *Id.* § 1132(a)(1)(A).

19. *Id.* § 1132(a)(1)(B).

20. *Id.* § 1132(a)(2).

21. *Id.* § 1132(a)(3).

22. *Id.* § 1132(a)(4).

23. *Id.* § 1132(a)(5).

24. *Id.* § 1132(a)(6).

25. *Id.* § 1132(g).

26. S.C. CODE ANN. § 38-59-40 (Law. Co-op. Supp. 1990).

27. Section 1132 specifically permits a participant or beneficiary to recover benefits due under the terms of a plan and permits participants, beneficiaries, or fiduciaries to enjoin ERISA violations and obtain appropriate equitable relief.

28. *See, e.g.,* *Robertson v. State Farm Mut. Auto Ins. Co.*, 464 F. Supp. 876, 883 (D.S.C. 1979).

29. *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134 (1985).

### C. Preemption of State Law

#### 1. The Preemption Clause

When Congress drafted ERISA, it intended to eliminate the abuse and failure of benefit plans by imposing a uniform standard to which all plans must conform.<sup>30</sup> To ensure this uniformity, Congress deemed it necessary to limit regulation of such plans to federal law.<sup>31</sup> To achieve this, the drafters incorporated a preemption clause, 29 U.S.C. § 1144.<sup>32</sup> This powerful clause was modeled after section 301 of the Labor Management Relations Act of 1947 (LMRA).<sup>33</sup>

Section 1144 provides that “[e]xcept as provided in subsection (b)<sup>34</sup> of this section, 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 . . . not exempt under section 1003(b) . . . .”<sup>35</sup>

Courts have liberally interpreted this clause to give it wide-reaching effect. The term “state laws” should be construed broadly to include statutes, case law, rules, regulations, and other state actions.<sup>36</sup> Furthermore, the term “state” includes a state, its political subdivisions, and all agencies or instrumentalities of either.<sup>37</sup> The United States Supreme Court has interpreted the words “relating to” to include laws whose only effect on ERISA-governed plans is indirect or consequential.<sup>38</sup> This provision has swept away conflicting state actions. Representative Dent, a drafter of ERISA, referred to this as “the

30. Congress clearly revealed its intention to eliminate employee benefit abuse in ERISA’s declaration of public policy. *See* 29 U.S.C. § 1001(a) (1988).

31. “It should be stressed that with the narrow exceptions specified in the bill, the substantive and enforcement provisions . . . 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.” H.R. 2, 93d Cong., 2d Sess., 120 CONG. REC. 29,933 (1974) (statement of Senator Williams).

32. (1988).

33. Labor Management Relations Act of 1947, Pub. L. No. 80-101, § 301, 61 Stat. 136 (1947), *amended by* the Labor-Management Reporting and Disclosure Act of 1959, Pub. L. No. 86-257, 73 Stat. 519 (1959) (codified as amended at 29 U.S.C. §§ 141-197 (1988)).

34. 29 U.S.C. § 1144(b) (1988). *See infra* text accompanying notes 40-44.

35. 29 U.S.C. § 1144(a) (1988). Section 1003(b), cited in the text, exempts governmental and church plans, which are maintained to comply with workers’ compensation or unemployment compensation laws, maintained outside of the United States for non-resident aliens, and are excess benefit plans.

36. *See, e.g., id.* § 1144(c)(1).

37. *Id.* § 1144(c)(2).

38. *See Shaw v. Delta Air Lines*, 463 U.S. 85, 97-98 (1983).

crowning achievement of this legislation . . . .”<sup>39</sup>

## 2. *The Saving Clause*

The drafters tempered this preemption power by enacting a “saving clause.” It precludes ERISA preemption of certain state and federal laws. This clause provides that the preemption clause shall not apply to:

- (1) causes of action arising before January 1, 1975,<sup>40</sup>
- (2) any law of any state which regulates insurance, banking or securities,<sup>41</sup>
- (3) any generally applicable criminal law of a state,<sup>42</sup>
- (4) specified aspects of the Hawaii Prepaid Health Care Act,<sup>43</sup> and
- (5) any state law mandating that employee benefit plans not include certain provisions, to the extent that such state law is mandatory in order for the state to comply with title XIX of the Social Security Act.<sup>44</sup>

In contrast to the preemption clause, which has been construed liberally, courts have very narrowly and strictly applied the saving clause.<sup>45</sup>

Most litigation that involves the saving clause centers around the exception for state laws that regulates insurance. Although the language seems simple, the resulting litigation and judicial interpretation of the clause have been complex.

## 3. *The Deemer Clause*

To modify the insurance exception of the saving clause, Congress incorporated a “deemer clause.” This clause provides that:

Neither an employee benefit plan . . . nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for purposes of any law of any State purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies.<sup>46</sup>

---

39. H.R. 2, 93d Cong., 2d Sess., 120 CONG. REC. 29,179 (1974) (statement of Representative Dent).

40. 29 U.S.C. § 1144(b)(1) (1988).

41. *Id.* § 1144(b)(2).

42. *Id.* § 1144(b)(4).

43. *Id.* § 1144(b)(5).

44. *Id.* § 1144(b)(8).

45. *See Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 745-46 (1985).

46. 29 U.S.C. § 1144(b)(2)(B) (1988).



ERISA treats insured<sup>47</sup> and uninsured<sup>48</sup> plans very differently because of this clause and these differences will be discussed in the next section of this Note.

#### 4. *Interaction of the Preemption, Saving, and Deemer Clauses*

Courts apply a three-part test in which all three parts must be satisfied to determine whether ERISA preempts a state action. The court determines (1) whether the state action “relates to” an employee benefit plan, (2) whether the state law regulates insurance,<sup>49</sup> and (3) whether the deemer clause should be given effect. The deemer clause deems that employee benefit plans are not insurers or insurance companies for the purposes of ERISA. Therefore, the court must determine whether the state law legitimately regulates the business of insurance or only regulates an employee benefit plan.<sup>50</sup>

The Act distinguishes between insured and uninsured plans. Because the state may regulate the independent insurer, the state may regulate some aspects of an insured plan. This is significant because participants in insured plans may have state remedies that are not available to participants in self-insured plans.<sup>51</sup> The application of this three-part test is complex because its application hinges on the meaning of language such as “relate to” and “regulate insurance.”

---

47. An insured plan provides benefits through the purchase of an insurance policy. *Metropolitan Life*, 471 U.S. at 732.

48. An uninsured or self-insured plan is one that insures or funds itself. *Id.*

49. The Act also saves state laws as discussed *supra* in text accompanying notes 40-44. This Note focuses only on state laws that regulate insurance.

50. *Metropolitan Life*, 471 U.S. at 741.

51. *Id.* at 747. The Court stated that the distinction made between insured and uninsured plans was created by Congress in the deemer clause. In *FMC Corp. v. Holliday*, 111 S. Ct. 403 (1990), the Court clarified that this distinction extends to all state insurance regulations and not only to those that are specifically designed to affect employee benefit plans.

### III. CASE LAW

#### A. *Pre- Pilot Life Interpretations*

##### 1. *State Laws That Relate to an Employee Benefit Plan: The Meaning of "Relate To"*

###### a. *Alessi v. Raybestos-Manhattan, Inc.*<sup>52</sup>

*Alessi* provides the best starting place for an investigation of the meaning of "relate to" for several reasons. First, *Alessi* was the Supreme Court's first analysis of ERISA's preemption clause, and its holding laid the groundwork for following cases. Second, the facts in *Alessi* make it a simple case in that the law in question directly conflicted with ERISA provisions, making it easy for the Court to apply preemption. Finally, the Court's unanimous decision to affirm the Third Circuit makes interpretation and application easier.<sup>53</sup>

When Congress enacted ERISA, it was common for employers to offset benefits due under employee plans by other payments such as social security benefits and railroad retirement benefits. Although the Act placed limits on such offsets, it did not prohibit them. By maintaining the "integration method"<sup>54</sup> of calculating pension benefits, Congress allowed plans to limit the total maintenance funds received by an individual to reduce plan costs.<sup>55</sup> *Alessi* arose against this backdrop.

The plaintiffs in *Alessi* were retiree-participants in pension benefit plans.<sup>56</sup> The plans provided that pensions paid to retirees were to be offset by funds received from workers' compensation claims via the integration method.<sup>57</sup> This litigation originated in New Jersey, however, where state workers' compensation statutes expressly prohibited any offsets for payments received pursuant to the statute.<sup>58</sup> The plaintiffs contended that (1) the plans' offsetting practices violated state law,<sup>59</sup> and (2) because the state law was one that regulated workers' compensation rather than employee benefit plans, it did not "relate to" the

---

52. 451 U.S. 504 (1981).

53. J. LANGBERN & B. WOLK, *supra* note 1, at 373.

54. Integration is a "calculation practice under which benefit levels are determined by combining pension funds with other income streams available to the retired employees . . . ." *Id.* at 370.

55. *Id.*

56. 451 U.S. at 508.

57. *Id.* at 514.

58. *Id.* at 508.

59. *Id.*

plan for purposes of preemption.<sup>60</sup> The plaintiffs also argued that the offset constituted a forfeiture that contravened the Act's nonforfeiture provisions.<sup>61</sup>

The Court rejected the plaintiff's argument, stating that "[i]t 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."<sup>62</sup>

The *Alessi* Court spoke only about situations in which the state law directly contradicted ERISA provisions.<sup>63</sup> As a result, the argument remained that if the state law at issue did not contradict the terms of the Act, it fell outside the realm of preemption. The Court did not define the outer boundary of "relate to" until *Shaw v. Delta Airlines, Inc.*<sup>64</sup>

b. *Shaw v. Delta Airlines, Inc.*

In *Shaw* several airlines and other employers sued for a declaratory judgment that ERISA preempted New York's Human Rights Law, which prohibited employers from discriminating on the basis of age, race, creed, color, national origin, sex, disability, or marital status.<sup>65</sup> A New York case had held that a private employer's employee benefit plan which treated pregnancy differently from other nonoccupational disabilities was discriminatory for the purposes of the New York statute.<sup>66</sup> The employers in that action argued unsuccessfully that the case related to employee benefit plans and that the state law pertaining to employee benefit plans, the Disability Benefits Law, therefore, preempted New York's Human Rights Law.<sup>67</sup>

The *Shaw* Court held that a law "'relates to' an employee benefit plan, in the normal sense of the phrase, if it has a connection with or reference to such a plan."<sup>68</sup> Justice Blackmun delivered the Court's

---

60. *Id.* at 524-25.

61. *Id.* at 508. The district court judges concluded that the offsets based on workers' compensation awards would be forfeitures that were forbidden under § 1053 of the Act. J. LANGBERN & B. WOLK, *supra* note 1, at 370.

62. *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504, 525 (1981).

63. Note, *Blind Faith Conquers Bad Faith: Only Congress Can Save Us After Pilot Life Insurance Co. v. Dedeaux*, 21 Loy. L.A.L. Rev. 1343, 1358 (1988).

64. 463 U.S. 85 (1983).

65. N.Y. EXEC. LAW § 296.1 (McKinney 1982).

66. *Shaw*, 463 U.S. at 88.

67. *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).

68. 463 U.S. at 96-97.

opinion. He pointed to a dictionary definition of “relate”<sup>69</sup> and to legislative history as indicating Congressional intent to preempt state laws such as the one in question. The opinion noted: “The bill that became ERISA originally contained a limited pre-emption clause, applicable only to state laws relating to the specific subjects covered by ERISA.”<sup>70</sup> It further noted that because Congress rejected those provisions in favor of the present preemption provisions, the Court believed that Congress intended a broad preemptive scope.

After *Shaw*, state law was preempted if it merely had an indirect effect on employee benefit plans. Although the Court addressed and rejected a saving clause theory in *Shaw*,<sup>71</sup> it did not interpret the insurance saving clause.

## 2. The Meaning of “Regulate Insurance”

### a. Metropolitan Life Insurance Co. v. Massachusetts<sup>72</sup>

Although the Court defined the meaning of “relate to” in *Shaw*, it did not define the meaning of the saving clause as it related to state insurance regulation. The language of the clause states that state laws which regulate insurance are saved from preemption.<sup>73</sup> This becomes complicated when one attempts to determine exactly which laws regulate insurance. In *Metropolitan Life* the Court established tests for making this determination.

In *Metropolitan Life* the appellant insurance company contended that ERISA preempted a Massachusetts statute which required certain minimum mental health care benefits to be provided under any general insurance policy, accident or sickness policy, or employee health-care plan that covered hospital and surgical expenses.<sup>74</sup> Clearly, the statute was a state law that related to employee benefit plans. The question remained whether ERISA’s “regulate insurance” clause saved it from preemption.

The Court used a two-part test to determine that the Massachusetts mental health law was one that regulated insurance within the meaning of ERISA’s saving clause. Step One consisted of a “common sense” approach: because mandated benefit laws regulated the terms of

69. *Id.* at 97 n.16. See BLACK’S LAW DICTIONARY 1158 (5th ed. 1979).

70. *Id.* at 98.

71. Note, *supra* note 63, at 1360 n.126.

72. 471 U.S. 724 (1985).

73. 29 U.S.C. § 1144(b)(2)(A) (1988) (“nothing in this subchapter shall be construed to exempt or relieve any person from any law of any state which regulates insurance . . .”).

74. 471 U.S. at 727.

insurance policies, these laws obviously regulated insurance.<sup>75</sup> Step Two integrated factors from case law that interpreted the McCarran-Ferguson Act,<sup>76</sup> which explicitly conferred upon states the power to regulate insurance. This step itself was a three-part test. To determine whether a practice involved the “business of insurance,” the Court had to determine that (1) the practice or law transferred or spread policyholder risk, (2) the practice or law affected an integral part of the insurer-insured relationship, and (3) the practice or law was limited to entities within the insurance business.<sup>77</sup> The Court adopted this test from the earlier McCarran-Ferguson cases, which held that when those three factors indicated that a practice regulated insurance, the practice was subject to state rather than federal regulation.<sup>78</sup> The Supreme Court, by analogy, believed these factors indicated whether a law or practice constituted insurance regulation for the purposes of ERISA’s saving clause.

The first factor considers the transfer of risk. An insurance law or practice generally transfers policyholder risk if it manipulates or reallocates risk so that low-risk beneficiaries, by paying increased premiums for the coverage, carry part of the potential risk for high-risk beneficiaries. By mandating that all health insurance policies provide minimum mental health benefits, the Massachusetts law forced the low-risk participants to become a part of the risk pool, thereby spreading the risk over a higher number of participants.<sup>79</sup>

The second factor considers whether the law or practice is an integral part of the insurer-insured relationship. Interpreting and applying the McCarran-Ferguson Act in *Union Labor Life Insurance Co. v. Pireno*,<sup>80</sup> the Court established that a law or practice which affects the insurer-insured relationship is one that, among other things, regulates the type of policy that could be issued.<sup>81</sup> Thus, the *Metropolitan Life* Court reasoned that by determining the type of insurance policy that could be provided, the Massachusetts statute touched an integral part of the insurer-insured relationship.<sup>82</sup>

The third factor considers whether the law or practice applies only to entities within the insurance industry. The *Metropolitan Life* Court reasoned that because the benefits granted to insurance entities by the McCarran-Ferguson Act did not extend to entities outside of the insur-

---

75. *Id.* at 740.

76. 15 U.S.C. §§ 1011-1015 (1988).

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

78. *Id.* at 743.

79. *Id.*

80. 458 U.S. 119 (1982).

81. Note, *supra* note 63, at 1364 n.156.

82. *Id.*

ance industry, a law or practice did not regulate insurance under the McCarran-Ferguson Act if it extended to entities not solely within the insurance business. Consequently, the Court determined that a law must regulate only entities within the insurance business to be saved from ERISA preemption. The Court also decided that the Massachusetts legislature had intended the mandated benefit law to impose requirements only on insurers. Therefore, it satisfied the test for the final McCarran-Ferguson Act factor.<sup>83</sup>

Although the Court found that the Massachusetts law was saved from preemption, its two-step test is not a model of clarity for future application. Not only is "common sense" an imprecise term, but the Court did not deem any of the three factors in step two as dispositive in this decision. The *Metropolitan Life* decision was an easy one because the statute in question met all three factors. The Court declined to comment, however, on whether a law regulates insurance if it satisfies only one or two of the factors.

#### B. Pilot Life Insurance Co. v. Dedeaux<sup>84</sup>

Although *Metropolitan Life* laid the groundwork to define the insurance saving clause, the Court did not explore the limits of the saving clause until 1987. In *Pilot Life* the Court addressed the impact of the saving clause on those state actions that, despite having a profound regulatory effect on insurance, were derived from general common-law principles.

Everate Dedeaux, the plaintiff in *Pilot Life*, was employed by Entex, Inc. Entex provided employee benefits through a group insurance policy purchased from Pilot Life. Dedeaux suffered a back injury while at work; he claimed and received long-term disability benefits. Pilot Life paid the claims for two years. Over the next three years, Pilot Life alternately terminated and reinstated the payments because of several disputes about the nature and extent of Dedeaux's disability. Finally, Pilot Life stopped making payments on the claim.<sup>85</sup>

Dedeaux filed a diversity action seeking damages for failure to provide benefits, infliction of emotional distress, incidental damages, and punitive damages. Dedeaux sued under the Mississippi common-law theories of tortious breach of contract (bad faith), breach of fiduciary duty, and fraud. He did not claim relief under the Act.<sup>86</sup>

Pilot Life moved for summary judgment, which was granted by

---

83. *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 743-44 (1985).

84. 481 U.S. 41 (1987).

85. *Id.* at 43.

86. See Note, *supra* note 63, at 1368 & n.194.

the district court on the ground that ERISA preempted the action. The United States Court of Appeals reversed, holding that the McCarran-Ferguson factors, as set forth in the *Metropolitan Life* test, saved the action from preemption, and that common-law remedies applied simultaneously with federal ERISA remedies.<sup>87</sup> The Supreme Court granted certiorari, applied the *Metropolitan Life* test, and reversed the court of appeals. The Supreme Court held (1) that the common-law actions did not satisfy the *Metropolitan Life* test and thus was not saved from preemption,<sup>88</sup> and (2) that the civil remedies provided under ERISA were meant to be the sole remedies available to an employee to the exclusion of any state common-law remedies.<sup>89</sup>

After establishing that the bad faith cause of action did “relate to” an employee benefit plan as designated by *Shaw v. Delta Airlines, Inc.*,<sup>90</sup> the Court approached the heart of the *Pilot Life* dispute: the scope of the insurance saving clause. To avoid preemption, the law had to “regulate insurance” as determined by the two-part test established in *Metropolitan Life*.

The Court concluded that although the Mississippi common-law bad faith action had been strongly identified with the insurance industry, it had developed from general tort and contract law. “Common sense” would dictate that a law did not regulate insurance within the meaning of the Act if it was not directed specifically at insurance.<sup>91</sup>

As for the McCarran-Ferguson factors, the facts in *Pilot Life* failed to meet all three parts of the test. First, unlike the mandated benefits law in *Metropolitan Life*, the Court determined that the common-law tort of bad faith did not effect a transfer or spreading of policyholder risk.<sup>92</sup> Second, the Court examined the effect of the state action on the insurer-insured relationship. Although the insurer incurred liability under the tort by breaching the policy terms,<sup>93</sup> the Court stated that this effect was “attenuated at best.”<sup>94</sup> Thus, the tort failed to affect an *integral* part of the relationship. Finally, the Court determined that because the bad faith action had evolved from tort and contract law, it was directed at entities outside the insurance business.<sup>95</sup>

Significantly, the Court did not base its holding solely on the *Met-*

---

87. *Pilot Life*, 481 U.S. at 44.

88. *Id.* at 47-51.

89. *Id.* at 52-56.

90. 463 U.S. 85 (1983).

91. *Pilot Life*, 481 U.S. at 50.

92. *Id.*

93. *Id.* at 51.

94. *Id.*

95. *Id.*

*ropolitan Life* test, but further determined that Congress had intended the remedies provided by ERISA to be the sole remedies available—to the exclusion of any existing common-law remedies: “The deliberate care with which ERISA’s civil enforcement remedies were drafted and the balancing of policies embodied in its choice of remedies argue strongly for the conclusion that ERISA’s civil enforcement remedies were intended to be exclusive.”<sup>96</sup> This is significant because it provides a type of preemption separate from section 1144 preemption. While section 1144 preemption focuses on the nature of the state law, under section 1132 preemption, a state law is preempted regardless of its nature, as long as the Act provides a remedy.

The Court concluded that common sense and the McCarran-Ferguson test coupled with Congressional intent to create exclusive remedies demonstrated that ERISA preempted the common-law tort of bad faith.<sup>97</sup>

### C. Implications

If the Supreme Court’s opinion in *Pilot Life* mandates ERISA preemption of common-law bad faith actions brought by an insured against an insurer under an employee benefit plan, to what other causes of action does that decision apply? Can a beneficiary still enforce statutory bad faith actions? Can other plaintiffs (such as providers, employers, and insurers) bring common-law actions based on outside contracts that bear some relationship to an ERISA-governed plan? In examining *Pilot Life*’s effect on various other state actions, the second part of this Note will focus on the application of ERISA’s statutory provisions and case law to South Carolina insurance law, with related comments on federal statutory and common law.

## IV. IMPACT ON SOUTH CAROLINA AND FOURTH CIRCUIT LAW

### A. Common-Law Actions

#### 1. Bad Faith Refusal to Pay

Because an insured generally possesses no bargaining power or means of protection from an insurer’s unreasonable refusal of payment, South Carolina recognizes a common-law bad faith action if an insurer refuses to pay first-party claims.<sup>98</sup> This tort action was adopted first by

---

96. *Id.* at 54.

97. *Id.* at 57.

98. See *Nichols v. State Farm Mut. Auto. Ins. Co.*, 279 S.C. 336, 306 S.E.2d 616



the United States District Court for the District of South Carolina in *Robertson v. State Farm Mutual Automobile Insurance Co.*<sup>99</sup> Pursuant to the Erie doctrine,<sup>100</sup> the *Robertson* court held that South Carolina would recognize this action and that an insured could waive the contract action and sue in tort.<sup>101</sup>

The district court's identification of the bad faith action has since been adopted by the South Carolina Supreme Court.<sup>102</sup> Also, in *Washington v. Group Hospitalization, Inc.*<sup>103</sup> the United States District Court for the District of Columbia adopted the rule established in *Robertson*.<sup>104</sup> *Washington* was a pre-*Pilot Life* action by an insured against a group insurer for bad faith refusal to pay medical benefits.

To prevail under South Carolina tort law and recover consequential damages, the plaintiff-insured must demonstrate bad faith or unreasonable action by the insurer.<sup>105</sup> Actual damages are not limited by the contract. If the plaintiff can show that the insurer's actions were "willful" or in "reckless disregard," the plaintiff-insured can also recover punitive damages.<sup>106</sup> However, the South Carolina common-law tort of bad faith falls squarely within the bounds of the *Pilot Life* holding. Plaintiffs who want to bring such an action against ERISA-governed plans can recover only the actual amount of the benefits withheld by the insurer<sup>107</sup> and can do so only under ERISA's provisions.

Given that South Carolina's common-law bad faith actions by insureds against insurers are preempted under *Pilot Life*, what are the implications for statutory bad faith actions? The South Carolina Code outlines those insurer practices that constitute improper claim practices.<sup>108</sup> South Carolina Code section 38-59-30 provides that if after due

---

(1983).

99. 464 F. Supp. 876 (D.S.C. 1979).

100. *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938).

101. 464 F. Supp. at 883.

102. *See, e.g., Nichols v. State Farm Mut. Auto. Ins. Co.*, 279 S.C. 336, 306 S.E.2d 616 (1983) (breach of the implied covenant of good faith by an insurer's refusal to settle renders the insurer liable in tort).

103. 585 F. Supp. 517 (D.D.C. 1984).

104. *Id.* at 521.

105. *Nichols*, 279 S.C. at 340, 306 S.E.2d at 619.

106. *Id.* The United States Supreme Court recently held that the common-law method for assessing punitive damages is not *per se* unconstitutional and that an award of punitive damages does not violate a defendant's due process rights even though the punitive damages award may be much greater than the compensatory damages award. *Pacific Mut. Life Ins. Co. v. Haslip*, 111 S. Ct. 1032 (1991).

107. 29 U.S.C. § 1132 (1988) (allows attorneys' fees under certain circumstances).

108. S.C. CODE ANN. § 38-59-20 (Law. Co-op. 1989) provides that the specified practices constitute improper claim practices if done by "an insurer doing accident and health insurance, property insurance, casualty insurance, surety insurance, marine insur-

notice and a hearing the Commissioner of Insurance determines that an insurer has engaged in bad faith practices as set forth in section 38-59-20, he shall issue a cease and desist order and may impose penalties pursuant to section 38-2-10.<sup>109</sup> Section 38-59-40 allows a court to award a policyholder all reasonable attorneys' fees from the insurer, plan, or corporation. "Reasonable attorneys' fees" must be determined by the trial judge, based upon a finding that the refusal to pay the claim was made in bad faith.<sup>110</sup>

Because these statutes do not provide a statutory private right of action, the insured must bring a common-law action to enforce the statutory duty. However, any common-law action is clearly preempted under *Pilot Life*. The question remains whether an insurer can invoke ERISA preemption as a defense to the statutory penalties. The United States District Court for the District of South Carolina addressed these issues in *Kriegal v. Equitable Life Assurance Society*.<sup>111</sup> The plaintiff Lucille Kriegal brought an action for common-law bad faith and a claim for attorneys' fees as provided for under South Carolina Code section 38-59-40 against Equitable Life for long-term disability benefits under an employee benefit plan.<sup>112</sup>

The *Kriegal* court held that the common-law action did not pass *Pilot Life*'s McCarran-Ferguson test, primarily because it did not meet the first step which requires a spreading or transferring of policyholder risk. The court found this portion of the three-part test to be indispensable.<sup>113</sup> The *Kriegal* court did not address the possibility of preemption as a defense to the statutory remedies although it held that South Carolina Code section 38-59-40 provides a remedy in addition to ERISA's remedies provided in section 1132.<sup>114</sup>

The *Kriegal* court's holding that South Carolina Code section 38-

---

ance or title insurance business," and if committed without just cause and if performed with sufficient frequency to constitute a general business practice.

109. These penalties are:

(1) If violator is an insurer or Health Maintenance Organization: fine of not more than \$15,000 or suspension of license or both. If violation is willful, fine may go up to \$30,000 or suspension of license or both.

(2) If violator is a person, other than an insurer or HMO: fine of not more than \$2,000 or \$5,000 if violation is willful, or suspension of license or both.

S.C. CODE ANN. § 38-2-10 (Law. Co-op. 1989).

110. See *id.* § 38-59-40(1) (Law. Co-op. Supp. 1990).

111. No. 88-2137-3 (D.S.C. 1989) (LEXIS, Genfed library, Dist. file, 1989 U.S. Dist. LEXIS 1905).

112. *Id.* at \*1.

113. *Id.* at \*9 (citing *Gordon v. United States Dep't of Treasury*, 668 F. Supp. 483, 489-90 (D. Md. 1987), *aff'd*, 846 F.2d 272 (4th Cir.), *cert. denied*, 488 U.S. 954 (1988)).

114. *Id.* at \*13. The second *Pilot Life* test established the § 1132 preemption. See *supra* text accompanying note 96.

59-40 falls within the preemption clause is consistent with the decisions of other district courts ruling on the preemption of statutory bad faith actions. Of particular note is a line of cases stemming from a 1987 California case, *Roberson v. Equitable Life Assurance Society*.<sup>115</sup> The *Roberson* facts are similar to those found in *Pilot Life*, the most significant difference being that in *Roberson* the plaintiff based his claim not only on common-law causes of action, but also on a violation of California Insurance Code section 790.03(h),<sup>116</sup> which imposes on the insurers a statutory duty to deal in good faith. Previous California case law already had established a private right of action under the statute.<sup>117</sup>

To reach its decision in *Roberson*, the court applied the *Pilot Life* test. Because California Insurance Code section 790.03(h) was "specifically directed" toward the insurance industry, the court found that it satisfied the "common sense" test of *Pilot Life* as well as the third factor of the McCarran-Ferguson test; the court stated that it would strain logic to argue otherwise.<sup>118</sup> The court found it "unlikely," however, that section 790.03(h) met the first and second McCarran-Ferguson factors based on findings that (1) it did not effectuate a spreading of policyholder risk, and (2) the California statute did not regulate the terms of the contract itself and thus was not integral to the insurer-insured relationship.<sup>119</sup> Furthermore, the *Roberson* court found the exclusive remedies theory to be dispositive: because section 790.03(h) afforded remedies beyond those in ERISA, it was preempted by the Act.<sup>120</sup>

*Goodrich v. General Telephone Co.*<sup>121</sup> conflicts with *Roberson* in its interpretation of ERISA preemption of California Insurance Code section 790.03(h). The *Goodrich* court agreed with the decision in *Roberson* to the extent that section 790.03(h) satisfied the common-sense test and the third McCarran-Ferguson factor. The *Goodrich* court also found that section 709.03(h) did not effect a spreading of policyholder risk. Contrary to *Roberson*, however, the court in *Goodrich* found that by regulating significant aspects of insurer conduct, the statute affected an integral part of the insurer-insured relationship.<sup>122</sup> Further-

115. 661 F. Supp. 416 (C.D. Cal. 1987).

116. *Id.* at 418.

117. See Note, *supra* note 63, at 1386 n.337. Florida expressly grants a private right of action under its statute. FLA. STAT. ANN. §§ 624.155(1)(a), 626.9541(1)(i) (West 1984 & Supp. 1989).

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

119. *Id.*

120. *Id.* at 424.

121. 241 Cal. Rptr. 640 (Ct. App.), *vacated*, 242 Cal. Rptr. 732, 746 P.2d 871 (1987). (The case also originally appeared at 208 Cal. App. 3d 505, but has been deleted).

122. 241 Cal. Rptr. at 644-45.

more, the court reasoned that insurance laws are “read into” insurance contracts and become part of the terms.<sup>123</sup>

Most significantly, the *Goodrich* court recognized that along with exclusivity, Congress manifested another purpose in ERISA: deference to state authority to regulate insurance. The court reasoned that even though Congress intended ERISA remedies to be exclusive, that intent was irrelevant in those cases in which the law being considered was an insurance law that was expressly saved by the saving clause.<sup>124</sup>

Although the *Goodrich* court employed the more sound and logical reasoning<sup>125</sup> because it considered all goals expressed by Congress and gave real meaning to both the preemption and the saving clauses, that decision was subsequently vacated. The *Roberson* decision, more directly in line with *Pilot Life*, appears to have become settled law. *Roberson* has been followed by other federal courts.<sup>126</sup>

When *Kriegal v. Equitable Life Assurance Society* is taken in conjunction with concurring decisions from other districts as discussed above, the provisions of section 38-59-40 of the South Carolina Code<sup>127</sup> are preempted despite the legislature’s apparent attempt to overcome that outcome by the addition of subsection (4) in the 1989 amendments. Subsection (4) provides that “[t]his section applies to cases filed or removed to federal court and cases appealed in the federal court system.”<sup>128</sup>

## 2. Alternative Plaintiffs

### a. The Issue

The broad construction of ERISA’s preemptive scope has had a profound effect on the litigation of employee benefit plans. The United States District Court for the Northern District of Alabama held that “[t]he ERISA quicksand is fast swallowing up everything that steps in it or near it. This morass serves as the stage for a theater of the absurd.”<sup>129</sup> How far does this preemptive power extend? *Pilot Life* mandates the preemption of common-law actions along with statutory bad

---

123. *Id.* at 647-48 (citing *Interinsurance Exch. of the Auto. Club v. Ohio Casualty Ins. Co.*, 58 Cal. 2d 142, 148, 373 P.2d 640, 643, 23 Cal. Rptr. 592, 595 (1962)).

124. *Id.* at 647.

125. *But see* Chittenden, *ERISA Preemption: The Demise of Bad Faith Actions in Group Insurance Cases*, 12 S. ILL. U.L.J. 517, 527 (1988).

126. *See, e.g.*, *Buehler Ltd. v. Home Life Ins. Co.*, 722 F. Supp. 1554, 1561-62 (N.D. Ill. 1989); *Taylor v. Blue Cross & Blue Shield*, 684 F. Supp. 1352, 1357 (E.D. La. 1988).

127. S.C. CODE ANN. § 38-59-40 (Law. Co-op. Supp. 1990).

128. *Id.*

129. *Jordan v. Reliable Life Ins. Co.*, 694 F. Supp. 822, 827 (N.D. Ala. 1988).

faith actions that are brought by a party to the employee benefit plan against a fiduciary. An issue remains about what effect *Pilot Life* has on South Carolina common-law actions against nonfiduciaries that have some connection to the plan, but arise out of conduct or contracts that are outside of the plan. Does ERISA preemption encompass everything that it touches, however remotely? Such an unlimited boundary would result in the legal absurdities to which the Alabama court referred. Therefore, the preemptive clause must have some limits although the outer boundary remains unsettled.

Consider the following hypothetical situation: Employer *A* hires employee *B*. *A* provides benefits to *B* through a self-insured benefit plan which is administered by insurance company *C*. *C* does not underwrite any of the insurance and *C* does not have any discretion over how the benefits are paid. *C* merely pays *B*'s claims according to the terms of *A*'s plan. Doctor *D* provides medical services to many individuals, including *B*, who assigns the rights to his benefits to *D*. *D* then processes claims through *C*. Consequently, *C* enters into a contract with *D* to install a computer terminal in *D*'s office so that he can enter claims directly into *C*'s mainframe according to *C*'s instructions. This arrangement increases efficiency because the workload associated with making an individual claim is reduced. *D* has no discretion over payment of claims and does not participate in the actual satisfaction of the claims. He merely enters the factual information necessary to apply for benefits under the plan according to his contract with *C* and benefit assignments from *B*. *B* visits *D* to receive medical treatment for a condition covered under the plan. In addition to the covered treatments, *D* administers an experimental treatment. Experimental treatment is not covered under the plan. *D* deliberately enters an incorrect code into the computer, however, which indicates that all of the treatment was covered. The system accepts the information and *C* pays the claim. Subsequently the fraud is discovered. *C* brings an action against *D* in a South Carolina state court charging fraud, breach of contract terms, and bad faith. *C* seeks to recover not only the funds disbursed but contractual and punitive damages as well. *D* seeks to remove the case to federal court claiming ERISA preemption in an attempt to limit damages to the actual amount of the benefits. The question presented is whether such claims lie outside the scope of the preemption clause. The courts have taken several approaches to determine the application of the preemption clause in similar situations. These approaches include: (1) qualifying the parameters of "relate to," (2) categorizing cases according to the remedies available, and (3) examining congressional intent.

## b. Analysis

### i. The Parameters of "Relate To"

In *Shaw v. Delta Air Lines*<sup>130</sup> the Court interpreted the preemption clause very broadly and stated that a law "relates to" an employee benefit plan, in the normal sense of the phrase, if it has a connection with or reference to such a plan."<sup>131</sup> Subsequent case law has qualified that statement by asserting that the preemptive scope of ERISA, while broad, is neither all-encompassing nor unlimited.<sup>132</sup>

In *Rebaldo v. Cuomo*<sup>133</sup> the trustees of an ERISA plan challenged a section of New York's Public Health Law that prohibited hospitals from establishing inpatient charges for self-insured employee plans other than those charges authorized by statute. The plaintiffs argued that the state statute precluded the plans from negotiating discount rates.<sup>134</sup> They also argued that because this increased the plan's cost of business, the state law related to the plan and was preempted by ERISA.<sup>135</sup> The court stated that this argument proved to be "altogether too much"<sup>136</sup> and reasoned that such an argument does not withstand scrutiny: "So too, for example, do State laws and municipal ordinances regulating zoning, health, and safety increase the operational costs of ERISA trusts, but no one could seriously argue that they are preempted."<sup>137</sup>

The *Rebaldo* court found that whether a state action is preempted depends upon the nature of its relationship with an ERISA plan. The court cited the Supreme Court's note in *Shaw* that "[s]ome state actions may affect employee benefit plans in too tenuous, remote, or peripheral a manner to warrant a finding that the law 'relates to' the plan."<sup>138</sup> The court concluded that this "follows as a matter of common sense from the fact that ERISA plan members and managers are bound to engage in myriad transactions which Congress never considered when it drafted [the ERISA preemption provisions]."<sup>139</sup> The court

130. 463 U.S. 85 (1983).

131. *Id.* at 96-97.

132. See *infra* text accompanying notes 133-54.

133. 749 F.2d 133 (1984), *cert. denied*, 472 U.S. 1008 (1985).

134. *Id.* at 134.

135. *Id.* at 138.

136. *Id.*

137. *Id.* (quoting *Lane v. Goren*, 743 F.2d 1337, 1340 (9th Cir. 1984)). See also *American Progressive Life & Health Ins. Co. v. Corcoran*, 715 F.2d 784, 787 (2d Cir. 1983) (regulation establishing maximum commissions for life insurance salesmen fell within saving clause).

138. *Rebaldo*, 749 F.2d at 138 (quoting *Shaw*, 463 U.S. at 100 n.21).

139. *Id.*

further stated that a state law which “incidentally touches pension plans through its effect on individuals”<sup>140</sup> is not preempted, nor does “the mere fact that the statute has some economic impact on the plan”<sup>141</sup> require preemption.

These ideas are echoed in *Quigley v. Unum Life Insurance Co.*,<sup>142</sup> a decision in which the court characterized the state contract action at issue as being so tenuously related to a plan as to avoid preemption.<sup>143</sup> The *Quigley* court cited, as did the *Rebaldo* court, the Supreme Court’s proposition in *Shaw* that some state actions are simply too remote to be related to an employee benefit plan.<sup>144</sup>

Courts have also attempted to limit the scope of “relate to” by distinguishing the conduct or events from which the cause of action arises from the type of damages sought. In many of the cases that find preemption of a state action, the action arose from an alleged wrongful termination or denial of benefits.

In *Boren v. N.L. Industries*<sup>145</sup> an employee who had been placed on his employer’s long-term disability program sought to recover under state law theories when his disability benefits were terminated. Because Boren’s benefits had originally been paid as a result of a settlement agreement rather than under the terms of the plan, Boren argued that the court should “carve a narrow exception to that all-encompassing entity known as ERISA.”<sup>146</sup> The court refused to do so, stating that the plaintiff was actually “relying on state law to advance his complaint that his benefits under the plan were terminated. As such, the law relates to the plan.”<sup>147</sup> In other words, his action actually arose out of a denial of benefits.

In *Scott v. Gulf Oil Corp.*<sup>148</sup> the court held that the plaintiff’s claims were preempted to the extent that they arose out of denial of benefits under a plan.<sup>149</sup> Because the claims did not involve benefits denied under a benefit plan the plaintiff’s additional claims for other damages arising from the same tortious conduct were not pre-

140. *Id.*

141. *Id.* at 139.

142. 688 F. Supp. 80 (D. Mass. 1988), *aff’d*, 887 F.2d 258 (1989).

143. *Id.* at 82. *See also* *Sommers Drug Stores Co. Employee Profit Sharing Trust v. Corrigan Enters.*, 793 F.2d 1456, 1465-70 (5th Cir. 1986) (state common law of corporate fiduciary duty benefits plan in too tenuous a manner to warrant a finding that it relates to the plan); *Lane v. Goren*, 743 F.2d 1337, 1340 (9th Cir. 1984) (state employment discrimination laws not related to benefits plan and will not be preempted by ERISA).

144. *Quigley*, 688 F. Supp. at 82 (quoting *Shaw*, 463 U.S. at 100 n.21).

145. 889 F.2d 1463 (5th Cir. 1989), *cert. denied*, 110 S. Ct. 3283 (1990).

146. *Id.* at 1466.

147. *Id.*

148. 754 F.2d 1499 (9th Cir. 1985).

149. *Id.* at 1505.

empted.<sup>150</sup> The court distinguished between the claims based on whether the claim was made to recover benefits under the plan. The claim for damages other than benefits was not preempted despite its relationship to the plan.

Other courts have also attempted to more clearly define the boundary of "relate to." Some have linked that decision to a determination of whether adjudication of the state action would require that the court interpret or examine the plan or its terms.<sup>151</sup>

These judicial limitations indicate that the hypothetical action by *C* against *D* would not relate to the plan for the purposes of preemption. Although there would be some economic effect on the plan because the plan would recover the disbursed funds, economic impact alone is not enough to warrant preemption. *C*'s claim does not derive from a wrongful denial of benefits and does not allege any violation of terms of the plan. It alleges only violation of the computer agreement. Adjudication of the claim will not require any interpretation or examination of the plan because the terms of the plan are not in dispute.

Perhaps the most persuasive argument in favor of preemption is that some of the damages sought by *C* are benefits that were paid pursuant to a plan. The Supreme Court addressed this argument in *Fort Halifax Packing Co. v. Coyne*.<sup>152</sup> The Court held that "ERISA's preemption provision does not refer to state laws relating to 'employee benefits' but to state laws relating to 'employee benefit plans'. . . ."<sup>153</sup> In reaching this conclusion, the Court made the following observation: "The words 'benefit' and 'plan' are used separately throughout ERISA, and nowhere in the statute are they treated as the equivalent of one another. Given the basic difference between a 'benefit' and a 'plan,' Congress's choice of language is significant in its pre-emption of only the latter."<sup>154</sup>

Thus, in the hypothetical case, preemption would not serve any congressional purpose. Adjudication of the state law claim would merely decide the fate of benefits already disbursed and would not affect the substantive terms or operation of the plan itself.

---

150. *Id.* at 1506.

151. See *Kentucky Laborers Dist. Council Health & Welfare Fund v. Hope*, 861 F.2d 1003, 1005 (6th Cir. 1988); *Whitworth Bros. Storage Co. v. Central States, Southeast & Southwest Areas Pension Fund*, 794 F.2d 221, 234 (6th Cir.), *cert. denied*, 479 U.S. 1007 (1986).

152. 482 U.S. 1 (1987).

153. *Id.* at 7 (emphasis in original).

154. *Id.* at 8.



## ii. A Remedies Approach

In addition to limiting the scope of “relate to,” some courts have limited the scope of preemption according to the availability of a remedy under ERISA. Section 1132 provides that actions may be brought by a plan participant or beneficiary, the Secretary of Labor, or a plan fiduciary. Because *C* is not a plan participant,<sup>155</sup> beneficiary, or the Secretary of Labor, he must qualify as a fiduciary in order to bring an action under ERISA. He must also show that *D* is a fiduciary to bring a civil suit against *D* to redress violations of ERISA or terms of a plan.<sup>156</sup>

Other than a “named fiduciary,”<sup>157</sup> a person generally becomes a fiduciary to a plan only by performing fiduciary functions. Section 1002(21)(a) provides that a person is a fiduciary to a plan to the extent he performs any of three functions: (1) exercising discretionary authority or control over plan management or any authority or control over management or disposition of plan assets, (2) providing investment advice for a fee or other compensation with respect to plan assets or having authority to do so, or (3) exercising discretionary authority or responsibility over plan administration.<sup>158</sup> The Supreme Court cited this definition in *Firestone Tire & Rubber Co. v. Bruch*.<sup>159</sup>

The key word in the definition of an ERISA fiduciary is “discretionary.” The courts have attempted to define fiduciary more clearly by defining what conduct constitutes discretionary authority. Many courts indicate that plan administrators comparable to *C* are not fiduciaries. The Eleventh Circuit Court of Appeals has held that “[An administrator] performing only claim-processing, investigatory, and recordkeeping duties . . . is not a fiduciary . . . .”<sup>160</sup> The Ninth Circuit has held that “[A company which] performs only administrative functions, processing claims within a framework of policies, rules, and procedures established by others [does not exercise fiduciary responsibilities].”<sup>161</sup> A federal district court in Missouri held that an “[administrator’s] payment of health care claims pursuant to the provisions of the Plan . . . does not clothe [the administrator] with discretionary authority over management of plan assets or over the administration of the plan to such an extent that [the administrator’s] role was

155. See *supra* note 16 for definition of participant.

156. See 29 U.S.C. § 1132 (1988).

157. A named fiduciary is “a fiduciary who is named in the plan instrument, or who, pursuant to . . . the plan, is identified as a fiduciary . . . .” *Id.* § 1102(a)(2).

158. *Id.* § 1002(21)(a).

159. 489 U.S. 101, 113 (1989).

160. *Howard v. Parisian, Inc.*, 807 F.2d 1560, 1564 (11th Cir. 1987).

161. *Gelardi v. Pertec Computer Corp.*, 761 F.2d 1323, 1325 (9th Cir. 1985).

that of a fiduciary.”<sup>162</sup> Finally, a Federal District Court in Colorado held that the “ability to make policy decisions outside of a pre-existing or separate framework of policies, practices and procedures” determines ERISA fiduciary status.<sup>163</sup>

In *Baker v. Big Star Division of the Grand Union Co.*<sup>164</sup> the Eleventh Circuit Court of Appeals addressed this issue. *Baker* involved an ERISA action brought against both the Grand Union Company, an employer with a self-insured welfare benefits plan, and Connecticut General, the insurance company that administered the plan. The question was whether Connecticut General, as an administrator, was a fiduciary subject to ERISA jurisdiction. Grand Union argued that “since Connecticut General has the power to make initial eligibility determinations ‘in accordance with the terms and conditions of the Plan,’ Connecticut General’s role [was] ‘inherently discretionary.’”<sup>165</sup> The court rejected this argument and ruled that “Grand Union did no more than ‘rent’ the claims processing department of Connecticut General to review claims and determine the amount payable ‘in accordance with the terms and conditions of the Plan.’”<sup>166</sup>

These cases indicate that *C* is not a fiduciary under ERISA. Other cases find that a state law has been preempted, however, regardless of the interpretation of the term “fiduciary.” In *Howard v. Parisian, Inc.*<sup>167</sup> the Eleventh Circuit held that ERISA preempted a state law claim against a nonfiduciary administrator of a self-funded benefit plan. The court reasoned that “[a]llowing plan beneficiaries to assert state law claims against non-fiduciary plan administrators for the wrongful termination of benefits would upset the uniform regulation of plan benefits intended by Congress.”<sup>168</sup> The *Howard* court cited the Fifth Circuit decision in *Light v. Blue Cross & Blue Shield*,<sup>169</sup> which also held that ERISA preempts claims that allege wrongful denial of benefits against nonfiduciary administrators.<sup>170</sup> The hypothetical case posed above can be distinguished because *C*’s action does not arise out of a denial of benefits. This distinction is consistent with case law holding that ERISA preempts actions arising out of a denial of bene-

---

162. *Degeare v. Alpha Portland Indus., Inc.*, 652 F. Supp. 946, 962 (E.D. Mo. 1986), *aff’d*, 837 F.2d 812 (8th Cir. 1988).

163. *Munoz v. Prudential Ins. Co.*, 633 F. Supp. 564, 568 (D. Colo. 1986).

164. 893 F.2d 288 (11th Cir. 1989).

165. *Id.* at 291.

166. *Id.* at 290.

167. 807 F.2d 1560 (11th Cir. 1987).

168. *Id.* at 1565.

169. 790 F.2d 1247 (5th Cir. 1986).

170. *Id.* at 1249.

fits.<sup>171</sup> Furthermore, the facts of *Howard* and *Light* required the court to interpret the plan while the hypothetical case would not.<sup>172</sup>

Other arguments support excluding actions against nonfiduciaries from the scope of preemption. Although ERISA expressly regulates fiduciary behavior, it does not purport to regulate nonfiduciary behavior. In *Southern California Meat Cutters Union & Pension Trust Fund v. Investors Research Co.*<sup>173</sup> the Federal District Court for the Central District of California held that a nonfiduciary who acts in concert with an admitted ERISA fiduciary is outside the reach of ERISA preemption, and is subject to the state rules that regulate the behavior of fiduciaries not governed by ERISA.<sup>174</sup> The court referred to the reasoning in *Munoz v. Prudential Insurance Co.*,<sup>175</sup> in which the court stated:

I do not find it to be Congress' intent to pre-empt state common law liabilities where there is no federal regulation to fill the void. In this vein, the state common law invoked by plaintiff does not denigrate the objectives of ERISA because regulation of non-fiduciary conduct is not an ERISA objective.<sup>176</sup>

Another problem that arises when nonfiduciaries are held subject to ERISA provisions is the lack of an express standard of care. A federal court in Alabama addressed this issue in *Jordan v. Reliable Life Insurance Co.*<sup>177</sup> The court reviewed other cases and then stated:

[T]hese courts [that have deemed nonfiduciary behavior subject to ERISA] have also presumed that the regulation for nonfiduciary misconduct would be the same as that for fiduciary misconduct. . . . Furthermore, this court can find no indication that Congress intended to regulate only certain nonfiduciary behavior while not expressly providing a remedy for any nonfiduciary misconduct.<sup>178</sup>

To bring an action under ERISA, a party must be able to qualify under the civil action provisions of 29 U.S.C. § 1132. If *C* does not qualify as a fiduciary, he would have no remedy under ERISA. Therefore, because the Act does not provide regulation or remedy for the conduct of nonfiduciaries, state actions that arise out of that conduct should not be preempted. This theory is consistent with comparisons that note a parallel between ERISA's preemption clause and section

171. See *supra* text accompanying notes 145-50.

172. See *supra* note 151 and accompanying text.

173. 687 F. Supp. 506 (C.D. Cal. 1988).

174. *Id.* at 509-10.

175. 633 F. Supp. 564 (D. Colo. 1986).

176. *Id.* at 571.

177. 694 F. Supp. 822 (N.D. Ala. 1988).

178. *Id.* at 829-30 (citing *Investors Research*, 687 F. Supp. at 509-10).

301 of the LMRA.<sup>179</sup> The Supreme Court's section 301 preemption doctrine preempts state law actions by unionized employees whose actions are regulated by the LMRA. However, this doctrine does not allow preemption of state remedies for nonunion employees whose actions are not regulated by the Act.<sup>180</sup> This theory garners further support from the premise that under section 301, "state claims *not* requiring interpretation of the collective bargaining agreement are not preempted."<sup>181</sup>

Based on the Act's definition of a fiduciary, its lack of nonfiduciary regulations or remedies, and lack of federal law concerning the comparable provision of LMRA section 301, ERISA's preemptive clause should not preclude an action like the one posed in the hypothetical.

### iii. Congressional Intent

One additional element to consider is Congressional intent. The Supreme Court in *Fort Halifax Packing Co. v. Coyne*<sup>182</sup> noted that "in any preemption analysis, 'the purpose of Congress is the ultimate touchstone.'"<sup>183</sup> As applied to the hypothetical case posed above, this analysis requires examination of Congressional intent regarding the Act in general as well as the preemption clause specifically. The *Fort Halifax* Court recognized Congressional intent to provide for disclosures and safeguards concerning employee benefit plans.<sup>184</sup> Congress intended to prevent abuses of responsibility by requiring disclosures and setting fiduciary standards.<sup>185</sup> To further this purpose, the drafters included a strong preemption clause to eliminate conflicting and inconsistent state and local regulations.<sup>186</sup> As the Court noted in *Shaw v. Delta Air Lines*,<sup>187</sup> ERISA preemption was designed so that employers would not have to administer their plans differently in different states.<sup>188</sup> In the hypothetical, C's action does not interfere with congressional purposes. As the District Court stated in *Quigley v. Unum Life Insurance Co.*:<sup>189</sup> "Litigation of these issues will not, in effect, result in state regulation of the pension plans contrary to the purposes of

179. See *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 54-56 (1987).

180. D. Nolan, *Federal Preemption of State Law Claims*, IV-7 (unpublished outline by Dennis R. Nolan, Webster Professor of Labor Law, University of South Carolina).

181. *Id.* at IV-5 (emphasis added).

182. 482 U.S. 1 (1987).

183. *Id.* at 8 (quoting *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 747 (1985)).

184. *Id.* at 15.

185. *Id.*

186. *Id.* at 9.

187. 463 U.S. 85 (1983).

188. *Id.* at 105.

189. 688 F. Supp. 80 (D. Mass. 1988), *aff'd*, 887 F.2d 258 (1st Cir. 1989).

ERISA.”<sup>190</sup> State regulation of the contract between *C* and *D* will neither alter the requirements of parties to the plan nor force a different administration in different states.

Preemption of the hypothetical case would be inconsistent with case and statutory law concerning the meaning of “relate to,” the remedies and regulations found in the Act, and congressional intent. The more consistent and better-reasoned outcome is to allow the action to be adjudicated under state law.

#### *iv. South Carolina and the Fourth Circuit*

Although an analysis of the foregoing decisions indicates that the courts in those circuits would not find the hypothetical state action preempted, it is not clear what the law is in South Carolina and the Fourth Circuit. Several decisions have dealt with issues touched on by the hypothetical case. These opinions shed some light on how a South Carolina or Fourth Circuit court might rule in such a situation.

In *Baker Hospital v. Isaac*<sup>191</sup> a hospital provided care to a beneficiary of an ERISA-governed plan after both the hospital and an official representative of the plan assured the beneficiary that he was covered. The plan later refused to pay the claim and the hospital sued the beneficiary, the insurer, and the employer. The claims were state common-law claims for breach of contract, promissory estoppel, negligence, and misrepresentation.<sup>192</sup> Although ERISA does not provide any remedy for a provider, the South Carolina Supreme Court nevertheless held that ERISA preempted the state law actions.<sup>193</sup> The court based this finding on the *Pilot Life* rule that common-law actions that relate to employee benefit plans are preempted.<sup>194</sup>

On its face, this seems to indicate that a South Carolina court would deem the common-law actions in the hypothetical to be preempted despite the lack of an express remedy under ERISA. However, *Baker* is distinguishable from the hypothetical. The *Baker* court, although it did not explain its reasoning in great detail, did reveal that its decision followed the Michigan Court of Appeals holding in *Providence Hospital v. National Labor Union Health & Welfare Fund*.<sup>195</sup> The plaintiff-provider in *Providence Hospital* was acting as an assignee of plan participants. ERISA provides a remedy for plan partici-

---

190. *Id.* at 83.

191. 301 S.C. 248, 391 S.E.2d 549 (1990).

192. *Id.* at 249, 391 S.E.2d at 550.

193. *Id.* at 250-51, 391 S.E.2d at 550-51.

194. *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 45 (1987).

195. 162 Mich. App. 191, 412 N.W.2d 690 (1987).

pants. Specifically, 29 U.S.C. § 1132(a)(1)(B) permits plan participants to sue for benefits due under the plan. The *Providence Hospital* court found that the plaintiff's claim could be based upon the civil enforcement provisions of ERISA,<sup>196</sup> and therefore determined that the beneficiary's remedy was available under ERISA. Assuming that the South Carolina court intended to adopt this reasoning, the hypothetical case could be distinguished because *C* is not asserting any right protected under ERISA.

Although ERISA's preemptive scope has been broadly construed, Fourth Circuit decisions indicate that it is not without limitation. In *Pizlo v. Bethlehem Steel Corp.*<sup>197</sup> the court marked the outer boundary of preemption. State actions do not relate to the plan for purposes of preemption, even though damages might be measured in part by plan benefits lost, if (1) the claims do not subject the employer to conflicting obligations or variable standards of recovery; (2) the claims would not determine the payment of any benefits; (3) the claims would not directly affect administration of benefits under the plan; or (4) the plan itself would not be liable and its administrators would not be burdened in any way by a damage award.<sup>198</sup> Using this standard, the Fourth Circuit found that state action for wrongful termination was not preempted.<sup>199</sup> The first requirement is consistent with Congressional intent.<sup>200</sup> *C*'s hypothetical action will not interfere with Congressional intent to provide uniform obligations and standards for benefit plans. The other three requirements follow the "relate to" limitations adopted by other circuits.<sup>201</sup> Again, *C*'s hypothetical action seems to lie outside this boundary.

In a later Fourth Circuit decision, *U.S. Steel Mining Co. v. District 17, UMW*<sup>202</sup> the court held that the "other appropriate equitable relief" provision of 29 U.S.C. § 502(a)(3) did not create a federal common-law action for a plan seeking to recover damages that stem from some source outside the benefits contract.<sup>203</sup> This interpretation supports the contention that the hypothetical case, which arises out of a contractual relationship outside of the benefits contract, would not be preempted.

---

196. *Id.* at 196, 412 N.W.2d at 692.

197. 884 F.2d 116 (4th Cir. 1989).

198. *Id.* at 120-21.

199. *Cf. Ingersoll-Rand Co. v. McClendon*, 111 S. Ct. 478 (1990) (state action for wrongful termination "relates to" a plan for preemption purposes if the main question is the employer's alleged desire to avoid contributing to or paying benefits).

200. *See supra* text accompanying notes 182-90.

201. *See supra* text accompanying notes 130-54.

202. 897 F.2d 149 (4th Cir. 1990).

203. *Id.* at 152-53.

In contrast to *U.S. Steel*, the Fourth Circuit later found that under the facts of *Provident Life & Accident Insurance Co. v. Wal-ler*<sup>204</sup> a federal common-law action of unjust enrichment was available to a plan seeking to recover benefits.<sup>205</sup> An insurance company, acting as an administrator, brought a common-law action of unjust enrichment against a plan beneficiary. The beneficiary had been injured in an accident caused by a third party. The plan advanced medical expenses with the stipulation that the advance be subrogated to any amounts recovered from the third party. When the beneficiary recovered from the third party, she refused to refund the plan, claiming that the terms violated a Virginia antisubrogation statute. She also claimed that ERISA did not provide a federal cause of action for plan administrators and, therefore, the federal court did not have jurisdiction under ERISA.<sup>206</sup>

The court conceded it did not have federal jurisdiction under 29 U.S.C. section 1132(a)(1)(B). Nevertheless, it claimed jurisdiction under the federal question provision and addressed the plaintiff's claims.<sup>207</sup> Jurisdiction was based on the facts that "demonstrate[d] the existence of a substantial federal question."<sup>208</sup> The court also stated that the state antisubrogation action was preempted in favor of a federal common-law remedy because such a remedy would support the clear intent of the plan documents. The hypothetical case posed above, however, is distinguishable. The *Provident Life* court decided to invoke this federal common-law jurisdiction to protect issues of "central concern" to the Act.<sup>209</sup> Furthermore, the court in *Provident Life* interpreted the subrogation terms of the plan. In contrast, the outside contracts at issue in the hypothetical case are not of central concern to the Act, and C's claims do not require the court to interpret plan terms.

One commentator has suggested the following reconciliation of *U.S. Steel* and *Provident Life*:

If an injury or claim arises out of some source external to the employee benefit plan itself, then the remedies are found in state law and the proper forum is the state court. By contrast, if the injury or claim determines the relationship between the plan and a participant or beneficiary and derives from the language and intent of the plan, then a remedy will be created under federal common law. That rem-

---

204. 906 F.2d 985 (4th Cir.), cert. denied, 111 S. Ct. 512 (1990).

205. *Id.* at 993-94.

206. *Id.* at 986-87.

207. *Id.* at 987-88.

208. *Id.* at 988.

209. *Id.* at 991 (interpreting *Franchise Tax Bd. v. Construction Laborers Vacation Trust*, 463 U.S. 1 (1983) and *Shaw v. Delta Airlines*, 463 U.S. 85 (1983)).

edy will then become the plaintiff's exclusive remedy.<sup>210</sup>

This reconciliation would support the contention that the hypothetical action, which arises out of a contract outside the benefits plan, would not be preempted.

### B. Statutory Provisions

Having examined the preemption of state common-law actions, this Note now examines the effect of *Pilot Life* on some specific South Carolina statutory provisions.

#### 1. Continuation of Coverage

The South Carolina Code provides that any employee or member insured under a group policy for a minimum of six months is entitled to a continuation of coverage if his coverage under the plan has been terminated for any reason other than nonpayment of the required contribution.<sup>211</sup> This extended coverage continues for the fractional policy month that remains at termination plus six additional policy months.<sup>212</sup>

Although the statute expressly excludes employees or members who qualify for longer coverage under federal law, the scope of the South Carolina statute is broader than the continuation provisions of ERISA. For example, ERISA's continuation of coverage provisions do not apply to employers with fewer than twenty employees.<sup>213</sup> These small groups would be covered by South Carolina Code section 38-71-770. Thus, if South Carolina Code section 38-71-770 provides remedies beyond those provided by ERISA, does the Act preempt the Code? To answer this, ERISA's continuing coverage provisions must be examined.

The Consolidated Omnibus Budget Reconciliation Act (COBRA)<sup>214</sup> contains the continuation provisions that apply to ERISA-governed plans. COBRA provides, in pertinent part, as follows:

---

210. V. Vroegop, *New Thoughts on the Scope of ERISA* (Sept. 26, 1990) (unpublished commentary by Virginia Vroegop, Esquire, Sinkler & Boyd, P.A., Columbia, S.C.).

211. S.C. CODE ANN. § 38-71-770 (Law. Co-op. Supp. 1990).

212. *Id.* Section 38-71-770 as amended increased the period of time that an employee or member may continue coverage under the group policy following termination. The mandatory conversion privilege previously contained in the statute has been eliminated. See S.C. DEP'T OF INS., BULLETIN No. 11-90.

213. 29 U.S.C. § 1161(b) (1988).

214. Consolidated Omnibus Budget Reconciliation Act of 1985, Pub. L. No. 99-272, 100 Stat. 82 (codified at 29 U.S.C. §§ 1161-1168 (1988)).



A. A *qualified beneficiary* covered under an employer's group health plan who has a *qualifying event* may elect to continue that health coverage for up to 18 or 36 months.

1. Qualified beneficiaries are employees and their spouses and dependents, if covered under the employer's plan.

2. A qualifying event is any of the following, if it causes the individual to lose coverage under the employer's plan:

(a) the employee's termination of employment (including retirement), except for gross misconduct, or reduction in hours;

(b) the employee's becoming entitled to Medicare;

(c) the death of the employee;

(d) the divorce or legal separation of the employee and spouse; and

(e) a dependent losing dependency status (e.g., by marrying or reaching the age of majority).

B. If the qualifying event is termination of employment or reduction in hours, COBRA eligibility may last for up to 18 months; for any of the other events, the maximum period of eligibility is 36 months. If there is a termination of service or reduction in hours, followed by one of the other events, maximum eligibility is extended to 36 months from the date of the original event, for qualified beneficiaries other than the employee.

C. The qualified beneficiary can be required to pay for the coverage. The rate cannot exceed 102% of the cost to the plan of providing the benefit.

D. COBRA eligibility can terminate before the maximum 18- or 36-month period if:

1. the individual becomes covered under another employer's group health plan, as an employee or the spouse or dependent of an employee;

2. the individual becomes entitled to Medicare;

3. the employer terminates all of its group health plans, or

4. the individual fails to pay the COBRA premium when due.

For this purpose the plan must offer a grace period that is the longest of:

(a) 30 days, or

(b) the grace period allowed for active employees, or

(c) the grace period allowed the employer under an insurance or similar contract.<sup>215</sup>

To illustrate the conflict between the COBRA provisions and South Carolina Code section 38-71-770, consider the following hypo-

---

215. Mazo, *Continuation of Health Coverage Provisions of COBRA*, ERISA BASICS: A TWO-PART PRIMER ON ERISA ISSUES, Part I (1988); An ABA Satellite Seminar Telecast (ABA 1988) (summarizing COBRA provisions).

thetical situation. Suppose that A, a South Carolina employer, provides a welfare benefits plan for its nineteen employees. This plan is established and maintained by A for the exclusive benefit of A's employees and otherwise qualifies as an ERISA-governed plan. Suppose further that employee B's coverage is now terminated for a reason other than nonpayment of premiums. Assume that B's coverage has been in effect for the last eight months. Because COBRA expressly excludes plans maintained by an employer with fewer than twenty employees,<sup>216</sup> B has no protection under COBRA. B is covered, however, under section 38-71-770. The question is: Whether B can claim the six-month continued coverage under the plan pursuant to the South Carolina statute, or whether the ERISA remedies preempt the statute.<sup>217</sup> The answer is controlled by the interaction between the preemption, saving, and deemer clauses.

A persuasive argument to save this statutory claim is its obvious and direct connection to the regulation of insurance. Because it is a part of the South Carolina Insurance Code and applies to entities acting as insurers, it seems that the statute is specifically directed toward the insurance industry. Therefore, section 38-71-770 should satisfy the common-sense test of *Pilot Life Insurance Co. v. Dedeaux*.<sup>218</sup> The Supreme Court has also stated, however, that the statute must pass muster under the McCarran-Ferguson test.<sup>219</sup>

The *Pilot Life* Court recognized three McCarran-Ferguson factors that determine whether an industry practice is part of the business of insurance: These are (1) whether the practice transfers or spreads policyholder risk, (2) whether the practice is an integral part of the insurer-insured relationship, and (3) whether the practice is limited to entities within the insurance business.<sup>220</sup>

South Carolina Code section 38-71-770 appears to satisfy the first element. Often the employee or member has been terminated because the employer has changed policies and the new policy or carrier will not accept a high-risk member. Because the statute forces the insurer to accept the high-risk member, the insurer will probably cover its losses by increasing premiums for low-risk members. Hence, the statute has transferred or spread policyholder risk.<sup>221</sup>

The second factor is whether the law affects an integral part of the insurer-insured relationship. The McCarran-Ferguson cases demon-

216. 29 U.S.C. § 1161(b) (1988).

217. See *supra* text accompanying notes 96-97.

218. 481 U.S. 41, 48 (1987).

219. *Id.* at 48-49.

220. *Id.*

221. See *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724 (1985)(quoting *Group Life Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 215-16 (1979)).

strate that a law or practice which affects this relationship is one that addresses “the type of policy which could be issued, its reliability, interpretation and enforcement . . . the core of the ‘business of insurance.’”<sup>222</sup> The *Pilot Life* Court stated that because the insurer incurred liability related to the policy terms under state law, there was at least an attenuated effect on the insurer-insured relationship. Although South Carolina Code section 38-71-770 does not regulate the kind of policy that can be issued, or its interpretation or enforcement, it does arguably affect the policy’s reliability because under the statute it is virtually impossible to terminate the contract without significant warning.

The third factor is unquestionably met. South Carolina Code section 38-71-770 is part of South Carolina’s insurance code and applies only to insurers.

Although the Court has not expressly stipulated which or how many of the McCarran-Ferguson factors must be met for a state law to qualify under the saving clause, case law indicates that in the United States District Court for the District of South Carolina the first factor is critical.<sup>223</sup> Because South Carolina Code section 38-71-770 appears to meet the first and third factors, and arguably meets the second, it also seems to meet the saving clause tests of *Pilot Life*. However, the *Pilot Life* Court did not base its decision entirely on the mechanics of the saving clause. The Court stated that state law is preempted if it contravenes the Congressional purpose in drafting the Act.<sup>224</sup> Therefore, ERISA would preempt section 38-71-770 if the state continuation provisions contradicted ERISA’s Congressional purpose. Perhaps the most persuasive argument against preemption on the basis of Congressional intent is that Congress drafted ERISA in part to protect employee plans and their beneficiaries from arbitrary action and abuse by those who control the plan. Because section 38-71-770 purports to provide a safeguard against a specific abuse, it is consistent with Congressional intent.

Having examined section 38-71-770 in light of the preemption and saving clauses, it is necessary to consider the effects of the deemer clause. The saving clause saves those state laws that regulate insurance. For the purposes of the saving clause, the deemer clause specifies that an employee benefit plan cannot be deemed to be an insurer. Therefore, the possibility of preemption in the hypothetical case may depend on whether the plan is self-insured. If A provides benefits to B

---

222. *Union Labor Life Ins. Co. v. Pierno*, 458 U.S. 119 (1982).

223. *See, e.g., Kriegal v. Equitable Life Assurance Soc’y*, No. 88-2137-3 (D.S.C. 1989) (LEXIS, Genfed library, Dist. file, 1989 U.S. Dist. LEXIS 1905, \*8).

224. *Pilot Life*, 481 U.S. at 52-57.

via an insurance policy purchased from an insurer, the insurer will be regulated by the state insurance law. However, because a self-insured plan cannot be deemed an insurer, and the law "regulates insurance" as long as it affects only insurers, then the same situation would have the opposite outcome if A self-insured its benefit plan. The end result is that employees covered under a self-insured plan would not have access to the protection of section 38-71-770 afforded to their counterparts whose benefits were provided under a policy purchased from an insurer. This result, though seemingly harsh, is consistent with congressional intent in drafting the Act.<sup>225</sup> It is also consistent with the Supreme Court's ruling in *FMC v. Holliday*<sup>226</sup> that self-funded ERISA plans are beyond the reach of even those state laws that regulate insurance and are saved from preemption.

## 2. Trade Practices

The South Carolina Code also regulates trade practices in the insurance business by determining what practices constitute unfair methods of competition, or unfair or deceptive acts and practices.<sup>227</sup> Although the statute does not authorize a private cause of action, ERISA preemption could become an issue if an insurer invoked preemption as a defense to penalties sought pursuant to the statute.

As an aid in examining the issues, consider the following South Carolina Code section. Section 38-57-60 provides that: "No person may make a false, misleading, fraudulent, or incomplete representation or comparison of insurance policies or insurers for the purpose of inducing or intending to induce any person to lapse, forfeit, surrender, terminate, retain or convert an insurance policy or to take out a policy in another insurer."<sup>228</sup>

The United States District Court for the Northern District of Alabama discussed a similar statute in *Butler v. Fringe Benefits Plan, Inc.*<sup>229</sup>

---

225. See *supra* note 51 and accompanying text.

226. 111 S. Ct. 403 (1990).

227. S.C. CODE ANN. §§ 38-57-10 to -320 (Law. Co-op. 1976).

228. *Id.* § 38-57-60.

229. 701 F. Supp. 804 (N.D. Ala. 1988). The Alabama statute entitled "Twisting" stated:

No person shall make or issue, or cause to be made or issued, any written or oral statement misrepresenting or making misleading incomplete comparisons as to the terms, conditions or benefits contained in any policy for the purpose of inducing, or attempting or tending to induce, the policyholder to lapse, forfeit, surrender, retain, exchange or convert any insurance policy.

ALA. CODE § 27-12-16 (1977).

To determine whether the Alabama statute was saved from preemption, the *Butler* court compared the approaches of the Eleventh Circuit holding in *Anschultz v. Connecticut General Life Insurance Co.*<sup>230</sup> and the United States District Court for the Northern District of California in *Graves v. Blue Cross*.<sup>231</sup> Application of the *Anschultz* reasoning would have resulted in preemption rather than saving because “Alabama Code § 27-12-6 would not meet the criteria for an exception from ERISA preemption, especially since [section 27-12-6] does not purport to transfer or spread policyholder risk.”<sup>232</sup> The *Butler* court declined to adopt the reasoning of *Anschultz*; rather, it favored the *Graves* court’s reasoning that “a California statute that prohibits certain insurance practices because they are ‘unfair’ and ‘deceptive’ is a law ‘regulating insurance’ and, therefore, is *not* preempted by ERISA.”<sup>233</sup> The *Butler* court rendered this finding moot by holding that an action under section 27-12-16 did not “relate to” a plan for preemption purposes.<sup>234</sup> The court cited the Supreme Court’s reasoning in *Fort Halifax Packing Co. v. Coyne*<sup>235</sup> that some claims are so remotely, indirectly, or peripherally related to a plan that they do not constitute an ERISA claim.<sup>236</sup>

Also, a South Carolina or Fourth Circuit court might look to the *Pizlo v. Bethlehem Steel Corp.*<sup>237</sup> tests combined with the “central concerns” considerations outlined in *Provident Life & Accident Insurance Co. v. Waller*<sup>238</sup> to determine whether the statute fell outside the boundary of the “relate to” language of the Act.<sup>239</sup>

If the court found that the law related to the plan for preemption purposes, it would turn to the saving clause to determine whether the law should be saved from preemption. Unlike the *Butler* court, the Fourth Circuit probably would reject the *Graves* court’s reasoning in favor of the *Anschultz* rule. In *Kriegal v. Equitable Life Assurance Society*<sup>240</sup> the United States District Court for the District of South Carolina cited *Anschultz* to hold that a law which failed to meet the McCarran-Ferguson factors could not be saved as one that regulates

---

230. 850 F.2d 1467 (11th Cir. 1988).

231. 688 F. Supp. 1405 (N.D. Cal. 1988).

232. *Butler*, 701 F. Supp. at 806-07.

233. *Id.* at 807 (emphasis in original).

234. *Id.*

235. 482 U.S. 1 (1987).

236. *Butler*, 701 F. Supp. at 807.

237. 884 F.2d 116 (4th Cir. 1989).

238. 906 F.2d 985 (4th Cir. 1990).

239. See *supra* text accompanying notes 196-208.

240. No. 88-2137-3 (D.S.C. 1989) (LEXIS, Genfed library, Dist. file, 1989 U.S. Dist. LEXIS 1905).

### 3. Exempted Statutes

Although the Act stipulates that ERISA supersedes “any and all State laws insofar as they may now or hereafter relate to any employee benefit plan,”<sup>242</sup> certain state laws, other than those that “regulate insurance, banking or securities”<sup>243</sup> are also saved. The saving clause also saves state criminal laws,<sup>244</sup> the Hawaii Prepaid Health Care Act,<sup>245</sup> qualified domestic relations orders,<sup>246</sup> and state laws necessary to comply with Title XIX of the Social Security Act.<sup>247</sup>

Section 1144(d) also stipulates that “[n]othing in this title 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.”<sup>248</sup> This last provision would be especially persuasive against preemption of charges under RICO,<sup>249</sup> which was already in effect when Congress enacted ERISA and was not expressly preempted. More complicated issues arise, however, when an action involves a federal law written since ERISA’s drafting that contains clauses which contradict ERISA’s preemption clause.

## V. CONCLUSION

From the early Supreme Court decisions of *Alessi v. Raybestos-Manhattan, Inc.*<sup>250</sup> and *Shaw v. Delta Airlines*,<sup>251</sup> which broadly construed the preemption clause, through *Metropolitan Life Insurance v. Massachusetts*,<sup>252</sup> which narrowly defined the saving clause, the preemptive powers of ERISA have evolved into one of the most powerful federal preemption clauses ever drafted. The recent trend is to limit the boundaries of the preemption clause and to recognize the existence of actions that should rightfully be outside its scope. In response to the growing need for some sort of limitation, more recent federal decisions

---

241. *Id.* at \*10.

242. 29 U.S.C. § 1144(a) (1988).

243. *Id.* § 1144(b)(2)(A).

244. *Id.* § 1144(b)(4).

245. *Id.* § 1144(b)(5); HAW. REV. STAT. §§ 393-1 to -51 (1974).

246. 29 U.S.C. § 1144(b)(7) (1988).

247. *Id.* § 1144(b)(8).

248. *Id.* § 1144(d).

249. 18 U.S.C. §§ 1961-1968 (1984).

250. 451 U.S. 504 (1981).

251. 463 U.S. 85 (1983).

252. 471 U.S. 724 (1985).

have attempted to harness the preemption clause by more narrowly defining "relate to"<sup>253</sup> or by excluding from preemption those actions that have no remedy under the Act or that arise out of sources outside the benefits contract.<sup>254</sup> More frequently, courts are using such language as "broad, but not all-encompassing."<sup>255</sup>

This limitation must be balanced, however, against Congressional intent to reserve the area of employee benefits for federal regulation. An underlying objective of the Act is to protect plans from the complexities of conflicting state regulations.<sup>256</sup> By doing so, Congress hoped to stabilize plan obligations and thus encourage employers to establish and maintain benefit plans.<sup>257</sup>

This Note suggests that adjudication of South Carolina actions such as in the hypothetical example would not disturb this balance. Such an action arises from a contract or obligation apart from the plan itself. Although the results of the action may have an incidental economic impact on the plan, adjudication would not affect the terms or administration of the plan, nor would it subject the plan itself to any conflicting state obligations. Adjudication of these state claims would merely allow the state to retain jurisdiction over those disputes that fall outside ERISA's jurisdiction under sections 1144 and 1132.<sup>258</sup>

A federal court may still retain jurisdiction over actions that involve issues of central concern to the Act even though they arise out of a contract or obligation apart from the benefits plan. In *Provident Life and Accident Insurance Co. v. Waller*<sup>259</sup> the court held that federal question jurisdiction exists when "the issue in dispute is of 'central

253. See *supra* text accompanying notes 130-54.

254. See *supra* text accompanying notes 201-09.

255. *Scott v. Gulf Oil Corp.*, 754 F.2d 1499, 1504 (9th Cir. 1985); *Lane v. Goren*, 743 F.2d 1337, 1339 (9th Cir. 1984); *Rebaldo v. Cuomo*, 749 F.2d 133 (2d Cir. 1984). See also *Quigley v. UNUM Life Ins. Co.*, 688 F. Supp. 80, 82 (D. Mass. 1988) ("Despite the expansive interpretation accorded the ERISA preemption provision, the scope of 29 U.S.C. § 1144 is not entirely unlimited.").

256. H.R. 2, 93d Cong., 2d Sess., 120 CONG. REC. 29,933 (1974) (Senator Williams remarked: "[ERISA's provisions] 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." *Id.*).

257. Congress also provided protection to participants and their beneficiaries by requiring certain disclosures and enacting federal minimal standards concerning funding, vesting, and termination. See 29 U.S.C. § 1001 (1988).

258. The Act provides that ERISA preempts all state laws which relate to a plan except for those that fall within the saving clause of § 1144(b). Section 1132 contains the civil remedies provisions of ERISA. *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41 (1987) held that the existence of a remedy under the Act confers federal jurisdiction and preempts state action. *Id.* at 52.

259. 906 F.2d 985 (4th Cir. 1990).

concern' to the federal statute."<sup>260</sup> Thus in those cases, the federal courts are empowered to develop a federal common law to further the purposes of ERISA.

This power is not without limitation. In *U.S. Steel Mining Co. v. District 17, UMW*<sup>261</sup> the court recognized that "[t]hough courts have the power to create federal common law . . . [the courts] are constrained to fashion only those remedies that are appropriate and necessary to effectuate the purposes of ERISA."<sup>262</sup> The court also stated that "Congress did not intend that federal courts should develop common law to decide these issues that bear at best a most attenuated relation to the purposes of ERISA."<sup>263</sup>

South Carolina actions such as the one in the hypothetical bear such an attenuated relation to the plan itself that it should not bring about federal question jurisdiction or "relate to" the plan for the purposes of section 1144. Further, section 1132 of the Act provides no remedy for such an action. Therefore, the proper forum for deciding these questions should be the state rather than the federal courts.

*Caroline Wrenn Cleveland*

---

260. *Id.* at 990; see also *Franchise Tax Bd. v. Construction Laborers Vacation Trust*, 463 U.S. 1 (1983).

261. 897 F.2d 149 (4th Cir. 1990).

262. *Id.* at 153.

263. *Id.*



