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ERISA Litigation

Although found nowhere in the statutory text of ERISA, during the 40 years of the law, the federal courts have established a firm pillar that is a staple of ERISA litigation: the exhaustion of administrative remedies. This report by Bloomberg BNA's Matthew Loughran examines the origins of the exhaustion of remedies requirement, how the requirement has evolved and issues still remaining to be decided by the courts.

The Exhaustion of Administrative Remedies: A Nonstatutory Pillar of ERISA Litigation

As we look back at 40 years of ERISA litigation, it's interesting to note that one pillar of that litigation, the exhaustion of administrative remedies, is never actually mentioned anywhere in the statutory text but is instead a judicially created requirement based on the law's purpose and legislative history.

Under Section 503 of the Employee Retirement Income Security Act as enacted in 1974, employee benefit plans must both provide written notice for a claim denial and ''a reasonable opportunity to any participant whose claim for benefits has been denied for a full and fair review by the appropriate named fiduciary of the decision denying the claim.''

In the intervening 40 years, the federal courts have developed the requirement in most cases brought under the statute that a participant or beneficiary under a plan exhaust the administrative remedies established to fulfill the requirements of Section 503 before bringing a case in federal district court.

Development of Exhaustion Requirement

In 1978, in one of the first cases to address the exhaustion requirement, Judge Franklin T. Dupree Jr. of the U.S. District Court for the Eastern District of North Carolina identified the link between ERISA and the Labor Management Relations Act as the basis for the requirement (*Taylor v. Bakery & Confectionary Industry Int'l Welfare Fund*, 455 F. Supp. 816 (E.D.N.C. 1978)).

In that opinion, the judge identified a sentence in the House conference report accompanying ERISA that said that civil actions under the law ''are to be regarded as arising under the laws of the United States in similar fashion to those brought under Section 301 of the Labor-Management Relations Act of 1947'' as reasoning for importing the requirement to exhaust administrative remedies into ERISA litigation.

Two years after the opinion in *Taylor*, in 1980, Senior District Judge William C. Hanson from the U.S. District Court for the Southern District of Iowa, who was sitting by designation on a panel of the U.S. Court of Appeals for the Ninth Circuit, agreed with Dupree in ruling that exhaustion of administrative remedies was required for all claims under ERISA (*Amato v. Bernard*, 618 F.2d 559, 2 EBC 2536 (9th Cir. 1980)).

Since then, every federal appellate circuit has adopted the requirement that administrative remedies be exhausted prior to bringing a claim for benefits under ERISA Section 502, while there is still some question as to whether the requirement is a hard and fast rule in all cases, including claims for fiduciary breach.

Natural Outgrowth or Roadblock?

According to some practitioners, the requirement is a natural outgrowth of the statutory language.

''There is a long-standing concept in favor of private dispute resolution in labor law,'' said Mark Casciari, a

 ISSN

partner at Seyfarth Shaw LLP in Chicago. ''Under collective bargaining agreements, you had to follow all of the procedures, the grievance process and arbitration. It fostered information gathering and relieved the pressure on the courts to decide every issue under an agreement.''

Casciari added, ''It also helped to resolve conflicts early and locally. That was the theory behind the exhaustion requirement in the labor law context and, since ERISA was based in part on labor law principles, it was adopted into ERISA litigation and it made eminent sense in ERISA litigation.''

''If you look at the early cases, everyone—the parties, the courts—implicitly conceded or easily recognized an exhaustion requirement,'' he said, citing as an example *Firestone Tire & Rubber v. Bruch*, 489 U.S. 101, 10 EBC 1873 (U.S. 1989).

Meanwhile, William T. Payne, a partner at Feinstein Doyle Payne & Kravec LLC in Pittsburgh, sees it more as a roadblock to proper adjudication of employee benefit cases.

''You have this idea that the plans have the right to require you to do anything that they want,'' he said. ''I mean, Section 503 sets forth only a specific procedure, why do you need to shoehorn an additional mandatory exhaustion requirement into it?''

Payne added, ''I think that you have a lot of judges that don't like the cases and want to throw as many roadblocks up as possible to stop the cases from coming to them.''

Pros and Cons of Exhaustion

Predictably, practitioners disagree about the benefits or harms caused by the exhaustion requirement in ERISA litigation.

''It has been a net benefit,'' said Patrick W. Begos, a founding member of Begos, Brown & Green LLP in Southport, Conn. ''Exhaustion advances the goal of minimizing the load on the federal court system, and it provides a full and complete administrative record for the court's review.''

Debra A. Davis, vice president for benefits at the ERISA Industry Committee in Washington, agreed.

''Exhaustion has been a really efficient and consistent nonadversarial method of deciding employee benefit claims,'' she said. ''It acts as a way of avoiding costly litigation for both the participant and the plan.''

According to Casciari, the requirement has also led to greater benefits for plan participants.

''You have to remember that ERISA is a voluntary statute,'' he said. ''Outside of the Affordable Care Act's employer mandate, which hasn't really gone into effect yet, there is no requirement that an employer establish an ERISA-governed benefit plan. So exhaustion has actually helped in that sense because it has limited the amount of money that plan sponsors have to spend on federal litigation, giving the plan sponsors more money to spend on benefits.''

Casciari further warned, ''If it gets too expensive to provide these benefits because more denials become federal cases, then you may see employers deciding either to cut back on benefits or just not offer benefit plans at all.''

Payne disagreed, and said he thinks that the efficiency argument is overblown.

''I don't really buy it,'' he said. ''That's just speculation. I don't think that they can prove that the process makes it more cost effective even if it is not mandatory.''

Payne added, ''Exhaustion as an efficiency argument cuts both ways. If you have to go through the process, it just results in additional delay, actually making plans expend time and resources going through the process just to affirm the initial denial.''

D. Brian Hufford, a partner at Zuckerman Spaeder LLP in New York, agreed with Payne.

''To some degree, it has become a huge weapon for the defense in employee benefits cases,'' he said. ''More often than not, it is an elevation of form over substance.''

''All it really means is an extra burden on participants,'' Hufford said. ''For example, an insurance company can easily deny claims even knowing that they are wrong to do so, but realizing that the vast majority of people won't appeal.''

According to Clarissa A. Kang, a director at Trucker Huss in San Francisco, ''exhaustion is definitely part of the defense toolbox.'' However, she said, ''it allows the administrator to have the first attempt at interpreting the plan terms.''

Davis agreed, saying that ''one of the advantages of this process is that it gives the fiduciary an opportunity to fix any mistakes in the operation of the plan and potentially avoid years of litigation.''

Nancy G. Ross, a partner at McDermott Will & Emery LLP in Chicago, agreed that this initial plan administrator review was a benefit for ERISA plan litigation.

''If you don't have the plan administrator deciding the claim on the basis of the plan terms,'' she said, ''the potential result is having a court essentially drafting a different plan than the one that the sponsor intended.''

But Hufford warned that even multiple layers of review don't guarantee a different result in these cases.

''Exhaustion is mainly a weapon used by the insurance companies who know that they can block any claim, and at worst, all they will have to do is pay the benefit and maybe the attorneys' fees,'' he said.

Completion of Administrative Record

Most defense experts also identified the advantage of having a complete administrative record for the court as a reason that exhaustion has been a positive for ERISA litigation. As Kang said, ''exhaustion may take more time, but it is more useful than simply going to court first because you get a fully developed administrative record that the court can use to review the claim denial.''

  ISSN

Begos agreed, noting that counsel is frequently involved at the early stages of review.

''In many cases, the participant will hire counsel for the administrative appeal,'' he said. ''Many of them tend to do a very good job of getting into the record the evidence they think they need to support the participant's claim for benefits.''

''It results in the fiduciary doing at least one more review than it would have done than if exhaustion was not required,'' Begos said. ''The appellate reviews will typically address any arguments raised by the claimant in his appeal, and also address any new evidence submitted. The result is a much more full and complete record.''

But Payne sounded a cautionary note to that argument.

''The administrative record is just another trap for the unwary,'' he said. ''Just a way to say, 'Hey, that doctor's opinion is not in the administrative record. It should be excluded.' There are so many pitfalls. For example, long-term disability cases shouldn't be difficult to handle, but they've thrown up so many roadblocks with these procedures.''

Exceptions to Requirement

The federal appeals courts have recognized exceptions to the requirement of exhaustion, both in instances in which such exhaustion would be futile and in certain types of claims under ERISA.

As an example, the U.S. Court of Appeals for the District of Columbia Circuit recently joined the Third, Fourth, Fifth, Ninth and Tenth circuits in finding exhaustion isn't required for enforcement of statutory rights for breach of fiduciary duty rather than contractual rights to benefits under the terms of an ERISA-governed plan (*Stephens v. PBGC*, 2014 BL 175728, 58 EBC 1716 (D.C. Cir. 2014)) (122 PBD, 6/25/14; 41 BPR 1365, 7/1/14).

On the other side of the split, the Seventh and Eleventh circuits have ruled that exhaustion should be required in all cases under ERISA, regardless of whether they originate as claims for benefits or fiduciary breach claims (*Kross v. W. Electric Co., Inc.*, 701 F.2d 1238, 4 EBC 1265 (7th Cir. 1983); *Mason v. Cont'l Grp., Inc.*, 763 F.2d 1219, 6 EBC 1933 (11th Cir. 1985)).

According to Payne, this tension has existed since early on in the development of the exhaustion requirement.

''I worked with this issue for a long time back in the 1980s,'' he said. ''We found that courts weren't requiring exhaustion in cases of statutory rights. It seemed bizarre that a court would require it in statutory cases.''

Defense practitioners agreed to a certain extent that exhaustion shouldn't be required in all ERISA cases.

''You really have to look at it on a case-by-case basis,'' Begos said. ''It's going to depend on what it looks like the dispute is about, whether the claim is for a violation of fiduciary duties or just a claim for benefits.''

Ross agreed, saying that ''the court should look at the nature of the claim presented to determine whether it is based on claims for benefits or based on a fiduciary breach claim.''

''For example,'' she said, ''in a stock-drop case, I can see the logic of not requiring exhaustion when the issue is whether a fiduciary breached its duties, as that could be perceived as a conflict of interest unless an independent fiduciary was called upon to review the claim.''

However, Begos warned, ''You have to look at what the participant is really arguing. You may see plaintiffs try to bring claims for benefits but mask them as claims of statutory violations to try to get around the exhaustion requirement.''

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