

LEWIS, FEINBERG, LEE, RENAKER & JACKSON, P.C.
ATTORNEYS AT LAW
1330 BROADWAY, SUITE 1800
OAKLAND, CALIFORNIA 94612-2519

PHONE: (510) 839-6824 • FAX: (510) 839-7839
SENDER'S E-MAIL: JKEENLEY@LEWISFEINBERG.COM

January 8, 2009

By Electronic Mail (HomN@insurance.ca.gov)

Nancy Hom, Senior Staff Counsel
California Department of Insurance
45 Fremont St., 24th Floor,
San Francisco CA, 94105
Homn@insurance.ca.gov

**RE: Comments on Proposed Repeal of Disability Income Insurance Benefit
Reduction Regulations Article 2.2 REG-2008-00033**

Dear Ms. Hom:

① Thank you for the opportunity to comment on the Insurance Commissioner's proposed revisions to the California Code of Regulations. Lewis, Feinberg, Lee, Renaker & Jackson, P.C. is a national law practice that represents plaintiffs in ERISA employee benefit and pension, civil rights, and wage-and-hour litigation. Over the past 25 years the firm's work on behalf of employees has resulted in several landmark cases that changed the employee benefit and employment practices of major companies, restored lost benefits and wages to hundreds of thousands of employees, and established important legal precedents on behalf of employees, disabled employees, and retirees.

We write to express our strong opposition to the Commissioner's proposed repeal of regulations prohibiting benefit reductions based on involuntary retirement and worker's compensation payments. The Commissioner's stated rationale – that the regulations are unnecessary because the subject matter is covered by “existing state and federal statutory and common law” and thus any problematic offset clauses can be dealt with through individual enforcement actions – lacks legal merit and is poor public policy.

② **I. The Subject Regulations Provide Important Protections to California Workers.**

The regulations¹ that the Commissioner now proposes to repeal protect California

¹ The subject regulations are California Code of Regulations sections 2232.45.1 (Authority and Purpose), 2232.45.2 (Benefit Reductions Shall Not Be Based on Involuntary Retirement), 2232.45.3 (Benefit Reductions Shall Not Be Based on Estimated Worker's Compensation Temporary Disability Benefits Not Actually Received by the Insured), 2232.45.4

Exhibit B

workers from unfair offset clauses in disability insurance policies. Specifically, the regulations target the practices of forcing employees to involuntarily commence their retirement benefits because of estimated offsets from their disability benefits, forcing employees to file worker's compensation claims because of estimated offsets for temporary worker's compensation benefits, and reducing disability benefits on the basis of permanent disability worker's compensation benefits. These practices are unfair to California workers and are bad for the California economy because they offload the risk of disability onto the retirement and worker's compensation systems. This results in diminished retirement income for workers, and contributes to a significantly overburdened worker's compensation system.

Our written comments submitted in support of the Commissioner's initial effort to enact the subject regulations describe in detail the numerous harms suffered by California workers because of unfair offset provisions in group disability policies, and the numerous benefits that will inure to California workers if the regulations are kept in place. Accordingly, these comments are attached hereto as Exhibits A and B, and are incorporated to our comments on the proposed repeal of the subject regulations by this reference.

3

II. The Subject Regulations are not Duplicative of Federal and State Statutory and Common Law.

As justification for the proposal to repeal the subject regulations the Commissioner cites existing federal and state statutory and common law as a source of legal authority that will enable the Commissioner to accomplish the same underlying policy through individual enforcement actions. This argument mistakes the current state of the law on offsets from disability insurance policies.

As an initial matter, we are not aware of any specific statutory provisions under federal or state law that speak to the issue of disability insurance offsets. The Notice of Proposed Action and Notice of Public Hearing (the "Notice") cites California Insurance Code sections 790.02, 790.03, and 790.10, but these statutory provisions do not deal directly with unfair offset provisions in disability insurance policies. What these provisions do accomplish is to grant the Commissioner the power to issue regulations, such as the subject regulations, prohibiting specific unfair practices. The Notice does not contain citations to any federal statutes. We are confident that none exist on the subject of disability insurance offsets. In fact, the leading federal law on employee benefits, the Employee Retirement Income Security Act ("ERISA") was purposefully designed to place no substantive mandates on employers to provide employee benefits of any kind. *See, e.g.*, ERISA § 2(a)-(c), 29 U.S.C. § 1001(a)-(c) ("Findings and Declaration of Policy"); *Lockheed Corp. v. Spink*, 517 U.S. 882, 887 (1996). Accordingly, it does not regulate

(Benefit Reductions Shall Not Be Based on Worker's Compensation Permanent Disability), and 2232.45.5 (Benefit Reductions Based on Earnings Received for Work Performed While Disabled).

the practice of taking offsets from group disability insurance benefits.

There is a limited body of case law regarding offsets from group disability insurance policies, but it only covers a small portion of the practices addressed by the subject regulations. For example, in *Kalvinskas v. California Institute of Technology*, 96 F.3d 1305 (9th Cir. 1996), the Ninth Circuit Court of Appeals held that it is a violation of the Age Discrimination in Employment Act for a long-term disability plan to take an offset of estimated (but not received) retirement benefits which would require a reasonable person to involuntarily take retirement benefits that he would not otherwise have to take. *Id.* at 1307-08. However, as we noted in our initial comments in support of the subject regulations, this holding was *expressly* limited to situations where the estimated offset eliminated the disability benefit *in its entirety*. *Id.* Thus, the existing case law on this subject fails to protect a large number of California workers who would be subject to estimated offsets that did not reduce the disability benefit in its entirety. The subject regulations ameliorate this problem by making it clear to both insurers and insureds that the practice of taking estimated retirement offsets is not permitted in California.

In regards to permanent worker's compensation benefits, we are aware of only one case addressing the issue in California: *Alloway v. Reliastar Life. Ins. Co.*, Order Denying Defendants' Motion for Summary Judgment, Case No. CV-06-4719 (CAS) (April 28, 2008) (attached here to as Exhibit C). In *Alloway*, as discussed in detail in our comments in support of the regulations (see Exh. B), the court denied the defendant insurer's motion for summary judgment that it was entitled as a matter of law to deduct permanent disability worker's compensation benefits under a policy term that allowed reductions based on "other income" including "Worker's Compensation" benefits. *Id.* This result was only possible because the policy did not specify that other income included permanent disability benefits, and because there was unique evidence that the defendant insurer was only adopting that position as a convenient litigation position, but that it was not its general practice. *Id.* The upshot of *Alloway* is clear: under ERISA, if a group disability policy explicitly stated that permanent disability benefits would be reduced, the courts would have no choice but to enforce the policy term as written. Accordingly, this case underscores the need for the Department of Insurance to regulate this unfair practice directly.²

As evidenced by the lack of specific statutes and the limited case law, the core problem with the Commissioner's proposal to accomplish the purpose of the subject regulations through individual enforcement actions is that there is not a clear body of law for the Commissioner to draw on in conducting such actions. This is not to say that the Commissioner has no power to

² Policies that purport to deduct permanent disability benefits are unfair and deceptive because the permanent disability benefit under the worker's compensation system does not insure the employee for the same risk that group disability benefits do: loss of income. Rather, it is a benefit that compensates the employee for the residual effects of a workplace injury, e.g., pain and suffering. For a detailed discussion, see Exhibit A.

Nancy Hom, Senior Staff Counsel
California Department of Insurance
January 8, 2009
Page 4

ban the practices addressed by the subject regulations; he clearly does under the broad authority accorded to him to regulate unfair insurance practices in California Insurance Code section 790, *et. seq.* However, we believe that any enforcement actions will be considerably more likely to succeed if the Commissioner maintains the regulations as they are because the regulations themselves can be relied on as a source of authority. In fact, by repealing the regulations, the Commissioner will only hinder future enforcement efforts, as this sends a message that the Department of Insurance is uncertain about its ability to regulate these practices.

4

III. Individual Enforcement Actions are not Preferred to Broad Regulation.

Another problem with the Commissioner's proposal to repeal the subject regulations is that individual enforcement actions are a poor tool for accomplishing the underlying policy goals of the subject regulations. For one thing, individual enforcement actions are resource-intensive and their outcomes are uncertain, especially, as noted, if there are no regulations to back the enforcement up. Also, in our experience, many if not most California workers are completely unaware of the Commissioner's power to police individual insurance policies, and are even more uninformed of the underlying rules. Thus, it is unlikely that individual workers will bring unfair offset provisions to the Commissioner's attention. This problem will only be magnified by the lack of regulations on the subject because there will be no clear source of authority for insureds to rely on when presenting unfair policies to the Commissioner.

The subject regulations are also valuable in their own right in a system grounded on the rule of law. The regulations make clear what offset practices are prohibited in California group disability insurance policies, and this clarity allows both insurers and insureds to understand their rights and obligations. Repealing the regulations is a step backwards: the law on this subject will be rendered more confusing and unclear than it was to begin with.

IV. Conclusion

We strongly oppose the Commissioner's proposal to repeal the subject regulations because the regulations are a vital and necessary protections for California workers and they promote consistency and clarity in the law governing group disability insurance policies in California.

Thank you for your consideration of these comments. Please do not hesitate to contact me with any additional questions or concerns.

Nancy Hom, Senior Staff Counsel
California Department of Insurance
January 8, 2009
Page 5

Sincerely,

LEWIS, FEINBERG, LEE,
RENAKER & JACKSON, P.C.

By

James P. Keenley

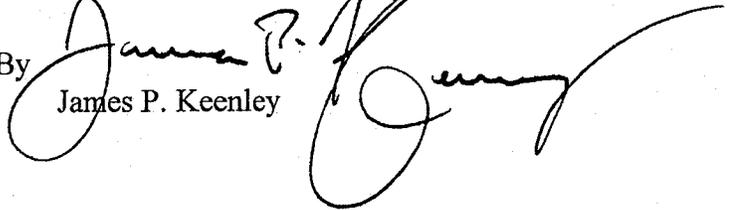
A handwritten signature in black ink, appearing to read "James P. Keenley", written over the typed name. The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Exhibit A

LEWIS, FEINBERG, LEE, RENAHER & JACKSON, P.C.
ATTORNEYS AT LAW
1330 BROADWAY, SUITE 1800
OAKLAND, CALIFORNIA 94612-2519

PHONE: (510) 839-6824 • FAX: (510) 839-7839
SENDER'S E-MAIL: JKEENLEY@LEWISFEINBERG.COM

April 23, 2008

By Electronic Mail & Facsimile (415) 904-5729

Nancy Hom, Senior Staff Counsel
California Department of Insurance
45 Fremont St., 24th Floor,
San Francisco CA, 94105
Homn@insurance.ca.gov

**RE: Comments on Proposed Revisions to California Code of Regulations §§
2232.45.2, 2232.45.3, 2232.45.4**

Dear Ms. Hom:

Thank you for the opportunity to comment on the Insurance Commissioner's proposed revisions to the California Code of Regulations. Lewis, Feinberg, Lee, Renaker & Jackson, P.C. is a national law practice that represents plaintiffs in employment litigation, including litigation under the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 *et. seq.* ("ERISA"). Over the past 25 years the firm's work on behalf of employees has resulted in several landmark cases that changed the employee benefit and employment practices of major companies, restored lost benefits and wages to hundreds of thousands of employees, and established important legal precedents on behalf of employees, disabled employees, and retirees. We write to express our strong support for the Commissioner's proposed regulations prohibiting benefit reductions based on involuntary retirement and worker's compensation payments. These regulations are consistent with existing law, and further the policies expressed in the California Insurance Code and ERISA by ensuring that disability insurance *and* retirement benefits are not inappropriately reduced.

1. Comments to Section 2232.45.2: Benefit Reductions Shall Not Be Based on Involuntary Retirement.

The proposed regulation at section 2232.45.2 would prohibit group disability income insurance policies (that are subject to approval under the California Insurance Code) from containing any terms that permit the disability insurer to estimate the retirement benefits a disabled beneficiary would receive if the insured retired and to accordingly deduct that amount from the beneficiary's disability benefit regardless of whether the beneficiary actually elects to receive her retirement benefits. The practice of taking estimated retirement offsets is, in essence, a way for group long-term disability ("LTD") insurers to force disabled employees to take retirement benefits that will reduce the insurer's liability and also reduce the employee's retirement income. The proposed regulation is consistent with existing federal and state law that

prohibits employee benefit plans from requiring or permitting the involuntary retirement of an individual on the basis of that person's age, and it is necessary because it closes and clarifies gaps in the current law on estimated retirement offsets.

A. Federal Policy Provides Strong Protections for Retirement Benefits.

To protect the health, safety, security, and simple peace-of-mind of older Americans federal law has long provided strong protections and incentives for retirement savings and benefits that are designed to ensure that those benefits will be available when they are needed: when people are too old to generate income from work. For example, retirement plans that meet qualification requirements under ERISA and the Internal Revenue Code receive favorable tax treatment such that contributions are tax-deductible or tax-deferred and plan investment earnings are not taxable to the plan, the employer, or the employee until distribution. *See, e.g.*, Internal Revenue Code ("IRC") § 401. To ensure that this favorable tax treatment achieves its intended results, some benefits under pension plans carry tax penalties if the benefits are distributed prior to retirement age. IRC § 72. One important requirement for tax qualification is that a plan prohibit assignment or alienation of benefits. ERISA § 206(d)(1), 29 U.S.C. § 1056(d)(1). So powerful is the anti-alienation rule that benefits under qualified pension plans cannot be reached by creditors in bankruptcy, *Patterson v. Shumate*, 504 U.S. 753 (1992), and a specific Congressional enactment, the Retirement Equity Act, was required before state courts were allowed to divide pension assets on divorce, *see* ERISA § 206(d)(3), 29 U.S.C. § 1056(d)(3). Disability policy provisions for estimating offsets of retirement benefits effectively cause an alienation of such benefits in favor of the insurer, in contravention of the public policy underlying the anti-alienation provision, and undermine the policy of encouraging deferral of income to retirement through favorable tax treatment.

The strong federal policy of protecting retirement benefits for use during retirement counsels in favor of not allowing LTD insurers to take a bite out of those benefits by forcing beneficiaries to diminish their retirement assets as a source of disability insurance. This is precisely the effect of estimated offset provisions in LTD policies. Because the estimated offset puts the beneficiary in the untenable position of either drawing on their retirement assets or suffering a substantial income reduction based on a retirement benefit they do not receive, such practices should not be allowed in LTD insurance policies in California.

In contrast to the function of retirement benefits in providing income after an employee's working life is over, the purpose of long-term disability insurance is to replace income when the employee's working life ends prematurely (or is temporarily interrupted) due to illness or injury. Estimated offsets of retirement benefits conflate these two functions, and undermine both, by forcing employees to shift income from the retirement period into a period of pre-retirement disability.

B. Estimated Retirement Income Offsets Harm Individual Retirement Plan Beneficiaries and the Retirement System as A Whole.

i. Defined Benefit and Defined Contribution Plans.

There are two major categories of retirement benefit plans that estimated retirement benefit offsets will impact: defined benefit plans and defined contribution plans. A defined benefit plan is one in which the employee, upon retirement, is entitled to a fixed periodic payment, usually monthly, that is calculated using a formula that ordinarily takes into account years of service, age, and compensation. Defined benefit plans are often referred to as "traditional pension plans." A defined contribution or "individual account" plan is one in which the employee, upon retirement, is entitled to the balance of assets allocated to her account, which reflects employer contributions, employee contributions, and investment earnings or losses. *See* ERISA § 3(34), (35), 29 U.S.C. § 1002(34), (35); *Nachman Corp. v. Pension Ben. Guar. Corp.*, 446 U.S. 359, 364 (1980).

ii. The Effect of Estimated Offsets on Benefits Under Defined Benefit Plans.

Estimated LTD offsets of early retirement benefits under defined benefit plans force disabled employees to either accept significantly reduced income while they are disabled and below normal retirement age (by not taking early retirement and absorbing the entire cost of the offset), or significantly reduced income after they reach normal retirement age (when they typically will no longer be eligible for LTD benefits and will also have a reduced annuity). Since it is generally financially disadvantageous to take early retirement benefits, and because reduced early retirement benefits will harm California's oldest citizens the most, LTD insurers should not be permitted to use estimated offsets to put disabled employees in the untenable position of choosing between impoverishment now or (unless they "win the bet" by dying young) impoverishment later.

Defined benefit plans must prescribe a "normal retirement age," which cannot be later than age 65, at which employee-participants become eligible to receive their normal retirement benefits. ERISA §§ 3(22), (24), 206(a), 29 U.S.C. §§ 1002(22), (24), 1056(a). Many defined benefit plans also permit employees who meet certain age and/or service requirements to receive an "early retirement benefit," that is, a benefit commencing before normal retirement age. However, such benefits typically are the actuarial equivalent of the normal retirement benefit; that is, because they are expected to be paid out over a longer period, the monthly benefit amount is reduced. (An early retirement benefit that is greater than the actuarial equivalent of the normal retirement benefit increases the employer's benefit cost.) Such a reduction typically is on the order of .5% per month before normal retirement age that the employee receives the benefit. This "age reduction" is a permanent reduction; the benefit does not increase upon the attainment of normal retirement age.

Therefore, employees who take early retirement because of an estimated offset of benefits under a long-term disability policy will suffer a permanent reduction in the benefits accumulated

for retirement. Again, the estimated offset has the effect of shifting income from the retirement period into the pre-retirement disability period. Thus, the disabled employee suffers a one-two punch to her retirement security: (1) the disability itself causes a loss of additional pension benefits that would have accrued had she been able to continue to work; and (2) the LTD offset causes a reduction of the pension benefits that have accrued due to early retirement.

Nor should estimated LTD offsets be permitted for employees who are eligible to receive normal retirement benefits under defined benefit plans. As an initial matter, group LTD plans that allow for disability benefits after a disabled employee reaches retirement age are, in our experience, extremely rare. Thus, this situation is not likely to arise very often. But, when it does, LTD insurers who chose to issue policies that insure disabilities after normal retirement age should not be permitted to shift the risk of those disabilities onto disabled beneficiaries' retirement assets. There are many reasons why it would not be in a disabled beneficiaries' interest to take an unreduced defined benefit pension after normal retirement age. For example, the disabled employee may hope to recover and return to work, and that might not be possible if the beneficiary commences receiving his pension, as was the case in *Kalvinskas v. California Institute of Technology*, 96 F.3d 1305, 1308-09 (9th Cir. 1996). Also, a beneficiary who purchases LTD insurance covering post-retirement age disabilities might desire to avoid pay status on their defined benefit pension because they are continuing to accrue benefits under the pension.

iii. The Effect of Estimated Offsets on Benefits Under Defined Contribution Plans.

Estimated retirement offsets have a potentially devastating effect on participants in defined contribution plans and should not be allowed. The principal concern with defined contribution plans is that estimated retirement offsets could plausibly be used to compel premature distribution of defined contribution assets – with steep taxes and penalties to the employee. There are several different types of defined contribution or individual account plans, the most popular is commonly known as a 401(k) plan. Under 401(k) plans, early distributions are subject to immediate excise taxation plus a 10% penalty. Moreover, the assets lose their ability to grow tax-free until retirement. The entire point of these rules is to ensure that 401(k) assets are used for retirement and not as income during a participant's working years. Estimated LTD offsets that could plausibly force a premature distribution of 401(k) assets should not be allowed under any circumstances as they would undermine the 401(k) system as a whole.

Estimated offsets should also not be allowed where a 401(k) participant would not face any premature distribution penalties (either because they are of age or qualify for an exception from the penalties). The core problem is that the defined contribution plan system only works if participant assets are kept in their accounts long enough to accrue substantial capital gains. Forcing distribution of these assets to insure workplace disabilities interrupts this system and prevents future capital gains on the assets. Another troubling issue is the difficulty of assessing a 401(k) participant's "income" from the account. Unlike defined benefit plans, defined

contribution plans do not mandate a particular monthly benefit amount; instead the benefit typically is a single-sum distribution of the account balance. Once they reach retirement age, 401(k) participants are generally free to draw on their assets as they see fit. Thus, an LTD insurer is in no position to estimate the monthly income that a 401(k) participant should receive, and any offsets based on such estimates are bound to be flawed.

As with defined benefit plans, early distribution of defined contribution plan assets shifts income from the retirement period to a pre-retirement disability period, when the employee had planned to be working and accruing retirement benefits. Forcing the employee to use retirement benefits during pre-retirement disability defeats the purpose of long-term disability insurance and dramatically escalates the risk that the employee will have inadequate support in retirement.

iv. LTD Offsets Based on Retirement Income Are Generally Inappropriate.

More fundamentally, we believe that the Commissioner should reconsider the policy of allowing LTD insurers to issue policies that permit offsets of any retirement assets at all. Pension plans and LTD insurance are cut from different cloth. Pension benefits are a form of deferred compensation and collective savings, accrued over a lifetime of hard work, that are meant to support workers in their later years (hopefully, in a manner that is comfortable and that rewards one's lifetime of toil). LTD insurance covers the risk of catastrophic income loss as a result of sickness or injury during an employee's working years. LTD insurance policies that allow for retirement asset offsets are essentially shifting the risk of workplace disability onto retirement systems that were not designed to bear that risk. This is a deceptive practice that disguises the true cost of pre-retirement disability. We realize, assuming that existing LTD insurance policies providing for retirement income offsets are actuarially correct, that disallowing retirement-based offsets will result in increased LTD premiums. However, we believe that the benefits flowing to individuals and the retirement system as a whole outweigh this cost. Further, there is intrinsic social and economic value in ensuring that the costs of insuring pre-retirement disability are clear, accurate, and channeled through appropriate legal and economic institutions.

C. Benefit Reductions Based on Estimated Retirement Offsets Violate Federal Law.

The federal Age Discrimination in Employment Act (ADEA) expressly prohibits requiring a retirement plan beneficiary to involuntarily take retirement benefits because of the participant's age. 29 U.S.C. § 623(f)(2). In *Kalvinskas*, the Ninth Circuit Court of Appeals held that it is a violation of this provision for a long-term disability plan to take an offset of estimated (but not received) retirement benefits which would require a reasonable person to involuntarily take retirement benefits that he would not otherwise have to take. *Id.* at 1307-08.

The proposed regulation at section 2232.45.2 is an important clarification of *Kalvinskas*. The *Kalvinskas* court explicitly noted that its holding was limited to situations where the

estimated offset nullifies the entire LTD benefit. *Id.* But, even where estimated retirement offsets do not offset the entire LTD benefit insureds can be put in the difficult position of sacrificing a substantial proportion of their monthly income now (by not electing retirement benefits), or sacrificing a substantial portion of their monthly income in retirement. Further, some employees (as was the case in *Kalvinskas*) may hope to recover from their disabilities and return to work despite their eligibility for unreduced retirement benefits. Forcing involuntary retirement by means of an estimated offset can deprive these employees of this option. *Id.* Thus, the justifications for not allowing estimated offsets that nullify the entire LTD benefit are equally valid where the offsets only partially reduce the LTD benefit, and the proposed regulation properly recognizes this fact.

2. Section 2232.45.4. Benefit Reductions Shall Not Be Based on Workers' Compensation Permanent Disability.

The proposed regulation at Section 2232.45.4 would prohibit provisions in California group LTD policies that allow the insurer to take an offset for permanent disability payments under a worker's compensation settlement or judgment. We strongly support this regulation because it is consistent with California law, under which permanent disability payments are meant to compensate injured employees for their diminished capacity to compete in the labor market, not to replace income lost as a result of disability. *See Russell v. Bankers Life Co.*, 46 Cal. App. 3d 405, 415-16 (Ct. App. 1975); *see also* 8 Cal. Code Reg. § 10151.

Under the worker's compensation system, the loss compensated by permanent disability payments is different from that of temporary disability payments, which are specifically intended to replace lost wages as a result of a workplace injury – just like LTD insurance. Permanent disability benefits are based on a permanent disability rating, which is a numeric figure that expresses the permanent effects of an injury on the capacity of an employee to compete in the labor market and factors in the age of the employee and the nature of the injury. *See* Schedule for Rating Permanent Disabilities, incorporated by reference at 8 Cal. Code Reg. § 10151, *available at* <http://www.dir.ca.gov/dwc/PDR.pdf>. Unlike temporary disability payments (which cover lost wages), permanent disability payments deal with the residual effects of an injury (for example, pain and suffering) and are a replacement for tort damages. Disallowing LTD insurers from offsetting permanent disability benefits is necessary to protect employees who suffer workplace injuries from indirect reductions in their compensation for those injuries. Further, banning the practice of offsetting permanent disability protects the integrity of California's worker's compensation system as a whole because it ensures that permanent disability payments will fully compensate the targeted loss.

In their July 10, 2007, comments to this proposed regulation, the Association of California Health Insurance Companies and the American Council of Life Insurers argue that the proposed regulation is inappropriate because permanent disability benefits cover the same risk as LTD insurance and because the regulation will result in excess litigation and windfalls to disabled employees because worker's compensation settlements will be structured to avoid

categorizing payments as temporary disability. As discussed above, the first point lacks merit. LTD insurance covers the risk of income loss as a result of sickness or injury. Permanent disability covers the long-term residual effects of a workplace injury. The second point proves too much. Employees already have an incentive to structure worker's compensation settlements so as to categorize the payments as being for losses other than temporary or permanent disability (e.g., medical costs, attorney's fees, vocational rehabilitation, and the like) because many LTD policies purport to give the insurer the right to offset both categories of disability payment. Under the proposed regulation, workers' compensation settlements would actually become more clear, and the risk of an inappropriate windfall would be reduced, because employees will feel free to use the permanent disability rating system for its intended purpose without fear of harming their interests under an LTD policy.

3. Section 2232.45.3. Benefit Reductions Shall No Be Based on Estimated Workers' Compensation Temporary Disability Benefits Not Actually Received by the Insured.

The proposed regulation at section 2232.45.3 would prevent California LTD insurance policies from containing provisions that allow the insurer to offset LTD payments by estimating the amount of temporary disability benefits an employee might receive if she pursued workers' compensation benefits. This regulation is necessary to protect injured workers and the workers' compensation system. As with estimated early retirement offsets, estimated temporary disability offsets put a disabled beneficiary in the untenable position of either accepting a severe reduction in her monthly income, or filing a worker's compensation claim for temporary disability benefits. This creates a perverse incentive encouraging disabled employees to file questionable workers' compensation claims (which may take years to resolve) in an already over-burdened workers' compensation system. There is a parallel problem plaguing the Social Security Disability Insurance system, which is overburdened by applications from individuals who do not meet the SSDI standard of disability, but are nonetheless pushed to apply for SSDI benefits by LTD insurers in search of offsets. This practice is currently the subject of several *qui tam* lawsuits. See Walsh, *Insurers Faulted as Overloading Social Security*, N.Y. TIMES (April 1, 2008) (attached as Exhibit A).

4. Comments to sections 2232.45.5 and 2536.2.

We strongly support the proposed regulations at sections 2232.45.5 and 2536.2, which would regulate LTD advertising practices and the practice of taking offsets for income generated by work performed while a beneficiary is disabled. These regulations will clarify existing legal requirements, prevent deceptive marketing practices, and protect employees from unreasonable actions by LTD insurers.

5. Additional Comments on LTD Offsets for Dependent Social Security Disability Benefits.

Nancy Hom, Senior Staff Counsel
California Department of Insurance
April 23, 2008
Page 8

LTD insurance policies commonly take an offset for Dependent Social Security Disability benefits. We encourage the Commissioner to propose regulations banning this practice in California. Dependent SSDI benefits do not cover the same risk insured by LTD policies. Dependent SSDI benefits are the legal property of the dependent child, not the disabled caregiver; indeed, the disabled caregiver is legally required to spend the dependent's benefit on the dependent's needs. It is a benefit program created by the federal government to ensure that the special needs of dependents of disabled persons are provided for by a separate and distinct benefit (e.g., special transportation costs). In contrast, we are not aware of any LTD insurance policies that provide an additional benefit for disabled employees with children. Therefore, it is inappropriate for LTD insurers to attempt to offset a disabled person's benefit by the amount of his dependent's disability benefits. *See generally, Carstens v. U.S. Shoe Corporation's Long-Term Benefits Disability Plan*, 520 F. Supp. 2d 1165 (N.D. Cal. 2007).

Thank you for your consideration of these comments. Please do not hesitate to contact me with any additional questions or concerns.

Sincerely,

LEWIS, FEINBERG, LEE,
RENAKER & JACKSON, P.C.

By

James P. Keenley

Exhibit B

LEWIS, FEINBERG, LEE, RENAHER & JACKSON, P.C.
ATTORNEYS AT LAW
1330 BROADWAY, SUITE 1800
OAKLAND, CALIFORNIA 94612-2519

PHONE: (510) 839-6824 • FAX: (510) 839-7839
SENDER'S E-MAIL: JKEENLEY@LEWISFEINBERG.COM

May 2, 2008

By Electronic Mail & Facsimile (415) 904-5729

Nancy Horn, Senior Staff Counsel
California Department of Insurance
45 Fremont St., 24th Floor,
San Francisco CA, 94105
Hornn@insurance.ca.gov

RE: Additional Comments on Proposed Revisions to California Code of Regulations § 2232.45.4

Dear Ms. Horn:

Thank you for the opportunity to comment on the Insurance Commissioner's proposed revisions to the California Code of Regulations. Lewis, Feinberg, Lee, Renaker & Jackson, P.C. submits these comments to supplement our prior comments of April 23, 2008, with recent legal authority supporting the Insurance Commissioner's proposed regulations prohibiting long-term disability ("LTD") insurance policies in California from containing provisions that allow the insurer to offset Permanent Disability payments under California's workers' compensation laws.

In *Alloway v. Reliastar Life. Ins. Co.*, Order Denying Defendants' Motion for Summary Judgment, Case No. CV-06-4719 (CAS) (April 28, 2008) (attached hereto as Exhibit A), Judge Snyder of the Central District of California recently held that Permanent Disability benefits under California's workers' compensation system could not be offset under a policy term allowing the insurer to offset "other income" from the beneficiary's disability payment. *Id.* at 6-17. The basis and scope of the *Alloway* decision underscores the pressing need for regulations clarifying that California law does not permit LTD insurance policies that purport to offset Permanent Disability workers' compensation benefits.

In *Alloway* the court's precise holding was to deny the defendant-insurer's motion for summary judgment that it did not abuse its discretion under the Employee Retirement Income Security Act, 29 U.S.C. § 1001 *et. seq.* Under ERISA, if an employee benefit plan grants discretion to the plan administrator to interpret the terms of the plan, the administrator's interpretations of the plan are reviewed under an abuse of discretion standard when challenged in federal court. See generally *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 111-115 (1989). Where an administrator both administers the plan and pays benefits under the plan,

Nancy Hom, Senior Staff Counsel
California Department of Insurance
May 2, 2008
Page 2

courts factor the conflict of interest into the standard of review. *Id.*¹ In *Alloway* the court held that there were triable issues of fact as to whether the defendant-insurer's discretionary interpretation of the term "other income" to include Permanent Disability benefits was influenced by its conflict of interest and therefore rejected the defendant's motion for summary judgment. *Alloway* at 13. Uncontradicted evidence in the case showed that the defendant-insurer's practice for taking actual workers' compensation offsets was not consistent with its interpretation of the "other income" term, and therefore the court did not defer to the defendant's interpretation of that term as a matter of law. *Id.*

Though we believe the result in *Alloway* is correct as a matter of ERISA law, it underscores the need for California to directly regulate the practice of issuing LTD insurance policies that allow insurers to offset Permanent Disability benefits. The policy in *Alloway* did not specifically include Permanent Disability payments in its definition of "other income," instead the policy just stated that "Workers' Compensation" benefits were included. *Alloway* at 6-7. The ambiguity of the term, combined with the defendant-insurer's structural conflict of interest and evidence that the insurer's practice was to only deduct "wage replacement" workers' compensation benefits, enabled the court to avoid deferring to the defendant-insurer's interpretation of the "other income" term. It is clear that if the term was not ambiguous, that is, if the policy was written to explicitly include Permanent Disability benefits in the definition of other income, the *Alloway* court would have had no choice under ERISA but to enforce the policy as written. Moreover, even under the ambiguous term, the result in *Alloway* might still have resulted in deferring to the defendant-insurer's interpretation of the "other income" term if it was not for unique and uncontradicted evidence suggesting that the desired interpretation was merely a convenient litigation position that did not reflect the actual practices of the insurer. Nor is it clear that the defendant-insurer's interpretation will ultimately fail when the issues are put to a trial.

Thus, the underlying lesson of *Alloway* is that the protections ERISA affords to LTD beneficiaries are thin. The Insurance Commissioner's proposed regulations barring Permanent Disability offsets will address this problem by providing needed protections for California employees and the California workers' compensation system. As we discussed in our previous comments of April 23, 2008, Permanent Disability does not protect employees from the same risk as LTD insurance. Permanent Disability is compensation for the employee's reduced ability to compete over the course of their entire career as a result of an on-the-job injury; essentially, it compensates injured employees for the residual harms of a workplace injury that previously were

¹ How exactly a conflict of interest alters the discretionary standard of review is unsettled and currently under Supreme Court review in *Metlife v. Glenn*, No. 06-923, Order Granting Petition for Writ of Certiorari (January 18, 2008) (Question presented: "If an administrator that both determines and pays claims under an ERISA plan is deemed to be operating under a conflict of interest, how should that conflict be taken into account on judicial review of a discretionary benefit determination?").

Nancy Horn, Senior Staff Counsel
California Department of Insurance
May 2, 2008
Page 3

remediable in tort. Permanent Disability is not wage-replacement for the direct economic loss that results from a disabling injury: income lost as a result of being unable to work, which is instead covered by the Temporary Disability workers' compensation benefit. LTD insurance, like Temporary Disability, replaces lost income as a result of disability, it does not insure against the many other long-term residual harms caused by a workplace injury. Allowing LTD insurance policies to offset Permanent Disability would frustrate the California workers' compensation system by shifting the risk of income loss onto a benefit system that was never intended to insure this risk.

Thank you for your consideration of these comments. Please do not hesitate to contact me with any additional questions or concerns.

Sincerely,

LEWIS, FEINBERG, LEE,
RENAKER & JACKSON, P.C.

By

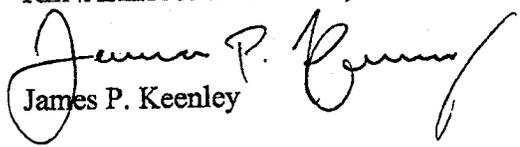

James P. Keenley

Exhibit C

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No. CV 06-4719 CAS (FMOx) Date April 28, 2008

Title DALLAS ALLOWAY v. RELIASTAR LIFE INS. CO.; ET AL.

Present: The Honorable CHRISTINA A. SNYDER

CATHERINE JEANG

LAURA ELIAS

N/A

Deputy Clerk

Court Reporter / Recorder

Tape No.

Attorneys Present for Plaintiffs:

Attorneys Present for Defendants:

Robert Gianelli
Jully Pae

Margaret Levy
Carlos Needham

Proceedings: DEFENDANT RELIASTAR LIFE INSURANCE CO.'S MOTION FOR SUMMARY JUDGMENT UNDER RULE 56 (filed 02/27/08)

I. INTRODUCTION

On July 28, 2006, on behalf of himself and all others similarly situated, plaintiff filed suit against defendants ReliaStar Life Insurance Company ("ReliaStar") and Farmer Brothers Company Long Term Disability Plan ("the Farmer Brothers Plan"). Plaintiff filed a first amended complaint ("FAC") on September 20, 2006. On December 28, 2006, the Court granted in part and denied in part defendants' motion to dismiss the FAC. Plaintiff filed the second amended complaint ("SAC") on March 15, 2007. On April 19, 2007, the parties stipulated to dismiss the Farmer Brothers Plan without prejudice. On May 21, 2007, the Court granted in part and denied in part ReliaStar's motion to dismiss the SAC.

Plaintiff alleges that ReliaStar has "improperly reduced the disability income benefits of Plaintiff and other employees/participants by offsetting from those benefits any workers' compensation disability benefits received by the employees/participants, contrary to the terms of the plans." SAC ¶ 1. Plaintiff purports to represent a class consisting of

[a]ll California residents who have been or are participants under ERISA plans funded by group disability income policies issued by Reliastar to plans established by California employers.

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No. CV 06-4719 CAS (FMOx) Date April 28, 2008

Title DALLAS ALLOWAY v. RELIASTAR LIFE INS. CO.; ET AL.

SAC ¶ 11. Additionally, plaintiff purports to represent a subclass consisting of

[a]ll California residents (1) who have been or are participants under ERISA plans funded by group disability income policies issued by Reliastar to plans established by California employers and (2) who have had their benefits under those plans reduced by amounts received for workers' compensation permanent disability benefits.

Id.

Plaintiff alleges a claim, on behalf of the subclass, for recovery of plan benefits pursuant to the Employee Retirement Income Security Act, 29 U.S.C. § 1132(a)(1)(B) ("ERISA"). Plaintiff also alleges a claim, on behalf of the class, for breach of fiduciary duties owed under 29 U.S.C. § 1132(a)(3) and § 1109(a). In its May 21, 2007 Order granting in part and denying in part defendants' motion to dismiss, the Court dismissed plaintiff's claim under § 1132(a)(3) to the extent that plaintiff seeks to enjoin defendant from offsetting any workers' compensation disability benefits as income. The Court permitted plaintiff to proceed under § 1132(a)(3) to the extent that plaintiff seeks to require defendant to determine the character of workers' compensation permanent disability benefits before offsetting them as income.

ReliaStar filed the instant motion for summary judgment on February 27, 2008. Plaintiff filed an opposition thereto on March 17, 2008. ReliaStar filed a reply on March 31, 2008. A hearing was held on April 28, 2008. After carefully considering the arguments set forth by the parties, the Court finds and concludes as follows.

II. FACTUAL BACKGROUND

Plaintiff is a former employee of Farmer Brothers Company. SAC ¶ 7. He became totally disabled under the terms of the plan after suffering injuries to his back. Id. Plaintiff receives long term disability benefits under a group disability policy, Group Policy No. GH-26460-1 ("the Policy"), issued by ReliaStar. Id. ¶¶ 5-7. Plaintiff also receives workers' compensation permanent disability benefits. Id. ¶ 8.

The Policy provides that the "monthly income benefit" is calculated as the "lesser

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No. CV 06-4719 CAS (FMOx) Date April 28, 2008

Title DALLAS ALLOWAY v. RELIASTAR LIFE INS. CO.; ET AL.

of 60% of your Basic Monthly Earnings or \$5,000, minus Other Income.” Declaration of Nancy Collins-Jabas (“Jabas Decl.”) ¶ 2, Ex. A at 38. “Other Income” is defined as

income you and your dependents are eligible to receive because of one of the following:

- your age
- the same or related disability for which you are eligible to receive benefits under the Group Policy.

Other Income is subtracted from the benefit you would otherwise receive, as shown on the Schedule of benefits. . . .

Id. at 42.

The Policy further defines “Other Income” as follows:

Other Income includes, but is not limited to, the following:

- Federal Social Security benefits.
- State Disability benefits.
- Railroad Retirement Act benefits.
- Other government disability or retirement income.
- *Worker’s Compensation benefits.*

[etc.] . . .

Id. (emphasis supplied)

Additionally, the Policy provides that

Other income includes only the following retirement benefits:

- Early retirement benefits you are receiving that are voluntarily selected.

. . .

ReliaStar considers retirement benefits received before age 62, or if later, before normal retirement age, to be voluntarily selected until you provide written proof satisfactory to

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No. CV 06-4719 CAS (FMOx) Date April 28, 2008

Title DALLAS ALLOWAY v. RELIASTAR LIFE INS. CO.; ET AL.

ReliaStar Life that you did not elect to receive benefits voluntarily.

Id.

Regardless of the amount of benefits that are offset as "Other Income," the Policy provides that a participant is entitled to a "minimum monthly income benefit," which is the greater of \$100 or 10% of the participant's gross monthly income benefit. Id. at 38.

The Policy provides that "ReliaStar has final discretionary authority to determine all questions of eligibility and status and to interpret and construe the terms of this policy(ies) of insurance." Id. at 57.

III. LEGAL STANDARD

Summary judgment is appropriate where "there is no genuine issue as to any material fact" and "the movant is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). The moving party has the initial burden of identifying relevant portions of the record that demonstrate the absence of a fact or facts necessary for one or more essential elements of each cause of action upon which the moving party seeks judgment. See Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986).

If the moving party has sustained its burden, the nonmoving party must then identify specific facts, drawn from materials on file, that demonstrate that there is a dispute as to material facts on the elements that the moving party has contested. See Fed. R. Civ. P. 56(c). The nonmoving party must not simply rely on the pleadings and must do more than make "conclusory allegations [in] an affidavit." Lujan v. National Wildlife Fed'n, 497 U.S. 871, 888 (1990). See also Celotex Corp., 477 U.S. at 324. Summary judgment must be granted for the moving party if the nonmoving party "fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." Id. at 322. See also Abromson v. American Pacific Corp., 114 F.3d 898, 902 (9th Cir. 1997).

In light of the facts presented by the nonmoving party, along with any undisputed facts, the Court must decide whether the moving party is entitled to judgment as a matter of law. See T.W. Elec. Serv., Inc. v. Pacific Elec. Contractors Ass'n, 809 F.2d 626, 631

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No. CV 06-4719 CAS (FMOx) Date April 28, 2008

Title DALLAS ALLOWAY v. RELIASTAR LIFE INS. CO.; ET AL.

& n.3 (9th Cir. 1987). When deciding a motion for summary judgment, "the inferences to be drawn from the underlying facts . . . must be viewed in the light most favorable to the party opposing the motion." Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587 (1986) (citation omitted); Valley Nat'l Bank of Ariz. v. A.E. Rouse & Co., 121 F.3d 1332, 1335 (9th Cir. 1997). Summary judgment for the moving party is proper when a rational trier of fact would not be able to find for the nonmoving party on the claims at issue. See Matsushita, 475 U.S. at 587.

IV. DISCUSSION

Central to the dispute in this case is the following question: when calculating plaintiff's disability payments, which other benefits received by plaintiff may ReliaStar offset under the terms of the Policy? The answer to this question depends on what constitutes "Other Income" within the meaning of the Policy, and, in particular, the extent to which plaintiff's workers' compensation disability benefits are comprised of "Other Income."

Plaintiff argues that "Other Income" refers only to payments made to him as wage replacement. Thus, plaintiff contends that ReliaStar improperly offset his workers' compensation permanent disability benefits, which, plaintiff argues, are not paid for lost wages under California law. See Livitsanos v. Super. Ct., 2 Cal. 4th 744, 753 (1992) (noting that "temporary disability" workers' compensation benefits "are a substitute for lost wages during a period of temporary incapacity from working," while "permanent disability" workers' compensation benefits "are provided for permanent bodily impairment, to indemnify for impaired future earning capacity or decreased ability to compete in an open labor market."). Plaintiff points to the deposition of one of ReliaStar's claim managers, Sandra Sykloski, which contains the following exchange:

- Q: Now, over the last approximately five years, when it is learned that a claimant has received Workers' Compensation benefits, has Reliastar offset all the benefits received by the plaintiff?
- A: Yes, if they are for wage loss.

Declaration of Robert S. Gianelli ("Gianelli Declaration") ¶ 2, Ex. 1 at 4, 14. On the basis of this testimony, plaintiff argues that it is ReliaStar's practice to offset only for