

and is free to sell and administer policies for other insurers, the TPA does not owe the health insurer a general fiduciary duty not to “roll” the insurer’s less risky policies over to another insurer, even though doing so left riskiest, least profitable policies with the original insurer.

Summary of Decision

The ultimate issue in this case concerns whether third-party administrators have broad fiduciary duties to the insurers for whom they adjust claims (and perhaps do other things as well). Defendant National Plan Administrators, Inc. (NPA) contracted with plaintiff National Health Insurance Company, Inc. (National Health) for NPA to perform third-party administration duties for cancer insurance policies issued by National Health. Many of these policies were sold by co-defendant CRS Marketing Agency, Inc. (CRS), which owned NPA. The dispute between National Health and NPA/CRS Marketing arose when National Health decided to leave the cancer policy business. National Health informed NPA that it would sell its entire book of cancer insurance to another insurer that would terminate National Health’s contract with NPA unless NPA could find another buyer within 90 days. Rather than find another buyer, NPA “rolled” National Health’s policies over to another insurer, Hartford Insurance Company. When a policy is “rolled” or “transferred” from one insurer to another, the policy originally written by one insurer is ended and then rewritten by another insurer. This process can result in less-desirable insureds, for example, those with pending claims, remaining with the original carrier while other insureds move on to a new carrier. Often, the insureds which are transferred have lower foreseeable risk. National Health claimed that NPA/CRS Marketing owed it a general fiduciary duty and breached that duty when it rolled National Union’s policies to Hartford, leaving National Union with a much riskier book of cancer insurance business.

Background Facts: CRS began marketing individual insurance policies to school district employees in the late 1970s. Over time, CRS developed its own policy forms and pricing structures. CRS marketed insurance through agents and earned “override commissions” on the sales. CRS also developed expertise in helping school districts administer

November 17, 2007

Fiduciary Duty/ Third Party Administrators

Third-Party Administrators Do Not Owe Insurers General Fiduciary Duties

Agreement between Health Insurer and Third Party Administrator Precluded General Fiduciary Duties

National Plan Administrators, Inc. v. National Health Insurance Company, ___ S.W.3d ___, 2007 WL 2811130 (Tex., Sept. 28, 2007)

Case at a Glance

The nature and purpose of a third party administrator’s (TPA) relationship with an insurer determines the scope of the duties the TPA owes the insurer. Nothing in the Texas Insurance Code or the common law precludes a TPA and an insurer from contractually defining their relationship in a manner that precludes imposition of fiduciary duties. If the contract between a TPA and a health insurer recognizes that the TPA is an independent contractor

insurance and other benefit plans by means of what it called a "common-remitter" program, which it offered through NPA. The common-remitter program allowed NPA to offer multiple products to an employer and allowed the employer to offer insurance products and fringe benefits to employees with minimal administrative difficulties.

In 1995, CRS and National Health began discussing the possibility of National Health underwriting CRS cancer policies. During those discussions, National Health's chief executive told CRS that he did not want then-existing policies, underwritten by American Heritage Insurance Company, "rolled" to National Health. This, of course, is what NPA/CRS would later do to National Health, triggering the present lawsuit.

Later in 1995, National Health and CRS entered into a contract entitled "Administrative, Compensation and Receipt Claim Service Agreement" (the Agreement). Lead-up negotiations were conducted at arms-length, and each side received advice from counsel. The Agreement provided that CRS-developed insurance products would be marketed exclusively through NPA. The Agreement also stated that NPA "shall act as an independent contractor in the performance of responsibilities formed under this Agreement, and that [NPA's] services are not exclusive to National Health and that [NPA] will provide services to third parties." The rolling practice was not addressed in the Agreement.

After the Agreement was formed, CRS began marketing cancer insurance policies underwritten by National Health. NPA began administering those policies. Two years later, in 1997, NPA also began administering cancer insurance policies for another insurer, Hartford Life Insurance Company (Hartford). Those policies were developed by CRS and were similar to the National Health policies that CRS marketed. They were not, however, sold to the school districts. In May 1999, NPA and Hartford began discussing rolling to Hartford the cancer insurance policies NPA administered for National Health and American Heritage. These discussions proceeded without National Health knowing about them.

National Health was having its own discussions about the future of its cancer insurance business around the time NPA and Hartford were discussing a possible rollover. In July 1999, National Health informed NPA of its decision to stop underwriting

CRS-developed cancer policies. National Health also announced that it found a buyer to purchase this book of business but this buyer would administer its own claims instead of using NPA. National Health gave NPA 90 days to find a different buyer for the National Health book of business that would continue to use NPA as a TPA. NPA asked Hartford to buy National Health's entire book of cancer insurance policies business. To assist Hartford in evaluating the offer, NPA sent Hartford what National Health asserted was confidential information about National Health's policyholders and premiums. Hartford declined to purchase the entire book. It agreed, however, to offer replacement policies to many of those whom National Health insured. It would not require evidence of insurability for these transferees, if they were actively at work.

During the fall of 1999, Hartford policies replaced most of the National Health policies. At that time, the number of National Health policies that NPA administered dropped from about 7,000 to around 500. Most insureds actively at work transferred to Hartford. Most of those who were not switched did not work.

Procedural History. National Health sued. The defendants were NPA, CRS, and Hartford. (Nothing further will be said about Hartford. It won at trial, and National Health did not appeal.) National Health's claims against NPA and CRS included breach of contract, breach of fiduciary duties, fraud, fraudulent inducement, "unfair deceptive acts or practices" as specified under the Texas Deceptive Trade Practices Act, misappropriation of trade secrets, and negligent misrepresentations.

Trial. The trial of the case, so far as NPA and CRS were concerned, focused on fiduciary duties. The trial court held, as a matter of law, that NPA owed National Health a fiduciary duty, and submitted the question of breach to the jury. The court instructed the jury that in order to prove that it complied with its fiduciary duty to National Health, NPA must prove five separate and distinct propositions. Here they are:

- a. The transaction(s) in question were fair and equitable to [National Health];
- b. NPA made reasonable use of the confidence that [National Health] placed in NPA;

c. NPA acted in the utmost good faith and exercised to the utmost scrupulous honesty toward [National Health];

d. NPA placed the interests of [National Health] before its own, did not use the advantage of its position to gain any benefit for itself at the expense of [National Health], and did not place itself in any position where its self-interest might conflict with its obligations as a fiduciary; and

e. NPA fully and fairly disclosed all important information to [National Health] concerning NPA's role as third-party administrator for [National Health].

The jury found NPA had breached its fiduciary duty, and therefore awarded actual damages of \$744,937; it further found malice; and awarded punitive damages of \$100,000. In addition, it found that NPA and CRS were a single-business entity, making them jointly and severally liable for both actual and punitive damages.

NPA had objected to the question just discussed being sent to the jury. One of the grounds was that the question and its instructions inquired about breach of a *general fiduciary duty*, when NPA owed no such duty to National Health, even though it may have owed a few distinct, specific, and separate fiduciary duties. The legal issues underlying this objection are the central issue treated by the Texas Supreme Court and its opinion.

Court of Appeals's Opinion. NPA and CRS appealed, but the Texas Court of Appeals affirmed. It held that NPA generally owed a fiduciary duty to National Health, "given the structure of the statutes regulating agents in the insurance industry generally, the scope of the statute regulating third-party administrators in particular, and the details of the written agreement between National Health and National Plan Administrators[.]" It also affirmed the trial court's judgment for piercing the corporate veil between NPA and CRS on the basis of the "single-business enterprise theory" deployed in the trial court.

The Texas Supreme Court granted NPA's and CRS's petition for review. The supreme court held that NPA did not owe National Health a general fiduciary

duty. It therefore reversed judgment of the court of appeals and rendered judgment that National Health take nothing.

Texas Supreme Court's Opinion. NPA argued that it did not have a *general fiduciary duty* to National Health resulting from either the Insurance Code—whether its specific provisions or its general structure are considered—or under the Agreement. NPA argued that it owed National Health several distinct fiduciary duties but did not owe it a *general* fiduciary duty. It argued that the closest fiduciary duty it did owe was "in regard to holding premiums it collected," and National Health did not claim a violation of that duty. At bottom, one of the most important features of this argument is that fiduciary duties are logically distinct; one fiduciary duty does not necessarily entail another; and the existence of important fiduciary duties does not entail the existence of a general—across the board—fiduciary duty.

The supreme court's opinion agreeing with NPA's argument is divided into three substantive parts, each building on the previous part. The first part examines the scope of fiduciary duties in general, and concludes that parties to an agency relationship are free to agree to alter the duties an agent owes its principal, unless a statute prevents them from doing so. The second part examines whether the Texas Insurance Code imposes a general fiduciary duty on agents that cannot be modified by agreement, and concludes that it does not. The third analyzes whether the Agreement between National Health and NPA modified the scope of NPA's fiduciary duty, and concludes that it did.

Fiduciary Duties, In General. The supreme court first noted that whether or not a fiduciary duty exists is a matter of law, and therefore something to be decided by a judge. As a general rule, the court acknowledged that the existence of an agency relationship imposes some fiduciary duties at least upon the agent. Nevertheless, courts must take all aspects of a relationship into consideration when they determine "the nature of [the] fiduciary duties flowing between the parties." Justice Johnson, who wrote the court's unanimous opinion, stated that the court adheres to the principles set forth in RESTATEMENT (SECOND) OF AGENCY in its § 387 (1958), which provides: "Unless otherwise agreed, an agent is subject to a duty to its principal to act solely for the benefit of the principal in all matters connected with

his agency.” Significantly, however, Justice Johnson restated the Restatement’s language in a manner that clarifies its applicability to insurance agency relationships and arguably establishes new law. “Unless otherwise provided by statute or law,” Justice Johnson wrote, “duties owed by an agent to his or her principal may be altered by agreement. Accordingly, factors which must be taken into consideration when determining the scope of an agent’s fiduciary duty to his or her principal include not only the nature and purpose of their relationship, but agreements between the agent and principal.” [Obviously, this point applies to agents other than TPAs, e.g., insurance brokers and insurance agents. There is more of this to come.]

Texas Insurance Code. The court reviewed several fiduciary duties imposed by the Legislature through the various codes, including the Insurance Code, to determine whether they prevent a TPA from modifying the duties it owes to the insurer. Unquestionably, observed the supreme court, “the Insurance Code in effect when this case was filed and appealed imposed certain specific fiduciary duties owed by various agents to insurance companies.” [Interestingly, the Supreme Court only discusses the former statute which has now been repealed. It does not mention the fact that the new statute has been designed only to reorganize the old statute, and not to change it. Then again, a few people have noticed that the new statute does change some things here and there.] The Insurance Code establishes, for example, that “funds held by managing general agents on behalf of an insurance company are held in a fiduciary capacity[.]” It also establishes that “third-party administrator[s] must hold premiums and other funds collected on behalf of an insurance company in a fiduciary capacity[.]” However, nowhere does the Code impose a general fiduciary duty on all agents. While the article of the Insurance Code then in effect defining “agents” expressly withholds authority from an agent to alter the terms of an insurance policy, “it does not otherwise specify duties of the agents.” In some cases, the Code specifically provides that an agent’s duties are not fiduciary in nature. For example, a specialty license holder that collects premiums for an insurer need not be treated as a fiduciary, at least under some circumstances, for money it has received. This stands in sharp contrast to managing general agents discussed by the court of appeals. Thus, the

supreme court determined, “[e]ven if we assume that the sections of the Code applying to agents generally also apply to third-party administrators, the Legislature clearly and specifically address certain fiduciary duties in the Code, yet it did not impose a general fiduciary duty on agents in general or on third-party administrators.” Since there are specific fiduciary duties specified and a general fiduciary duty is not expressly specified, it is reasonable, in the supreme court’s view, to infer that the Legislature did not impose a general fiduciary duty on third-party administrators, especially “when the administrators are statutorily required to have a written contract with the party they serve as administrator.” In this regard, the court added: “The Legislature could have rationally presumed that parties to a written agreement, especially parties in a commercial setting bargaining their own self-interest, would set out their respective duties, obligations, and expectation in the agreement[,] as did NPA and National Health.”

Common Law. Nor does the common law establish that third-party administrators have a general fiduciary duty. In fact, the common law stands for quite the opposite proposition. This can be seen in both § 376 of the RESTATEMENT (SECOND) OF AGENCY (1958) and § 8.06 of the RESTATEMENT (THIRD) OF AGENCY (2006). Each of these sections make it perfectly clear that fiduciary duties amongst commercial entities are to be established by contract. The same proposition is to be found in previous cases decided by the Texas Supreme Court. In this context, it is important to remember that, as a general point, contractual obligations do not necessarily give rise to fiduciary duties. In fact, they usually do no such thing, and when they do, the duty usually is quite specific. It should also be remembered that “fiduciary duties are equitable in nature and generally not subject to hard and fast rules.” *Tex. Bank & Trust Co. v. Moore*, 595 S.W2d 502, 508 (Tex. 1980). If fiduciary duties are not subject to hard and fast rules, it is unlikely that they are established by statute.

The Contract. The NPA-National Health contract imposed several obligations on NPA. It “was to solicit potential insurance, receive and process applications, maintain accounting, administrative, and statistical records, and process and pay eligible claims.” Thus, NPA controlled large amounts of information regarding National Health’s cancer policy book of business and exercised control over the substantial

value of the business.” This last fact, together NPA’s assumption of certain uncontested, specific fiduciary duties, such as the duty to act in National Health’s interest when processing and paying claims, was the foundation for the decision in the court of appeals to impose a general fiduciary duty. The supreme court does not dispute these facts, but flatly rejects the court of appeals’ finding that they formed the basis of a general fiduciary duty.

Significantly, under the explicit terms of the Agreement, NPA was to act as an independent contractor in the performance of its responsibilities, and the parties agreed that NPA’s service obligations to National Health were not intended to be exclusive. In fact, the contract explicitly stated that NPA “will provide services to third parties.” Nothing in the contract barred NPA from marketing policies underwritten by other insurers in direct competition with National Health, or from “rolling” NPA’s policies to another insurer. To the contrary, National Health’s own witnesses acknowledged that they were not concerned with such activities by NPA so long as NPA produced certain premium levels for National Health. National Health entered into a negotiated, arms-length relationship with NPA knowing that NPA had developed relationships and contracts with school districts and employers and other insurers through a common-remitter program. Indeed, NPA’s relationships and marketing program were the primary attractions for National Health to enter its agreement with NPA. Thus, the nature of the contractually-defined relationship between NPA and National Health was completely inconsistent with imposition of general fiduciary duties. If NPA owed National Health general fiduciary duties, it could not submit policy applications to insurers other than National Health without first submitting them to National Health.

Jury Question. Since, as a matter of law, NPA did not owe National Health a general fiduciary duty, the jury question should not have been submitted. This was true even though the question did not actually use the phrase “general fiduciary duty.” Its very structure, organization, and use of the term “and” between lettered entries in the explanatory part to the jury regarding the question proved this. For this reason, the Texas Supreme Court declined to review whether the jury question was proper in substance, assuming that it could have been given at all.

Comment

This is an opinion of historic significance. If nothing else, it establishes that the existence of fiduciary duties running from agents to principals must be based upon explicit agreements, implied agreements, behavioral history, and so forth. In effect, the opinion is that there is no such thing as a *general fiduciary duty*, at least with respect to both TPAs and insurance intermediaries (i.e., agents and brokers). It does the former directly and the latter inferentially. The precise holding in this case, of course, pertains only to TPAs. It is perfectly obvious from the language of the opinion, however, that it will be extended to agents and brokers. It does not, of course, imply that agents and brokers can have no duties other than obtaining requested policies or immediately disclosing to customers that such policies cannot be obtained. Of course, there may be duties over and above these two, and those duties may be fiduciary duties. Whether the duties exist and whether they’re fiduciary duties will depend upon a variety of factors, including express contracts, implied contracts, the history of services provided, statutes, and so forth.

Perhaps, the Texas Supreme Court is also suggesting that in interpreting statutes, general structures do not imply additional rules. Rules are to be found in the express language of a statute, when there are no linguistic or grammatical errors. They are not to be found hidden in abstractions like structure.

A really interesting question about this case is whether it could have been won by National Health if it had deployed a different strategy or if it had submitted a different jury issue. The answer may well be negative. At least five separate jury issues should have been submitted. These would correspond to the five lettered instructional parts of the fiduciary duty question that was asked. The first question might go like this:

The court has found that NPA had a fiduciary duty to National Health to make sure that any transactions in which it was involved and which affected the interests of National Health must be fair and equitable from the point of view of National Health. Did NPA comply with this requirement?

Answer: Yes No

Without definitions of "fair" and "equitable" I don't see how this question could be asked.

There is another question which, if answered Yes, would certainly have led to reversal. Here it is:

The court has found that NPA owed a duty of utmost good faith and a duty of utmost scrupulous honesty to National Health. Do you find from a preponderance of the evidence that NPA violated either or both of these two duties?

Answer: Yes No

This question, like the previous question would be extremely difficult to deal with without a definition of the phrase "utmost good faith." Nevertheless, if this question were answered Yes and if that answer played any role in the entry of a judgment in the trial court, the Supreme Court would be certain to reverse that judgment. This observation proves that this case could not be won. Granted, the behavior of NPA didn't look right. Still, the contract language was what mattered. // Quinn