From the Bench

Virginia Federal Court Relies on Virginia Economic Loss Rule to Limit Claims by Group Against Broker and TPA

Phoenix Packaging Operations LLC, et al. v. M&O Agencies, Inc., et al., No. 7:15cv569, in the United States District Court for the Western District of Virginia, June 3, 2016

Written by Tom Croft

Unwinding this one in a readily understandable way is no small task. But, once the issues are identified, it is, at bottom, a relatively straightforward decision involving the duties of a broker and a TPA to their client and the damages recoverable for the alleged breach of such duties.

The Alleged "Facts"

I put the word "facts" in quotes, because this case came to the Court on motions to dismiss – meaning that all the Court had were the allegations set forth in the Group's Complaint and the arguments contained in the briefing by all sides on the pending motions. No depositions, affidavits, or other conventional means of "proof" were involved, such as in a summary judgment proceeding. Rather, the questions presented to the Court

revolved around the sufficiency of the Group's allegations in their Complaint under applicable Virginia law.

The standard in the federal courts for assessing the sufficiency of the allegations for motion to dismiss purposes has evolved considerably over the past several years. Currently, a complaint must "state a claim for relief that is plausible on its face... [and] must present sufficient nonconclusory factual allegations to support a reasonable inference that the plaintiff is entitled to relief and the defendant is liable for the unlawful act or omission alleged. Determining whether a complaint states a plausible claim for relief is a context-specific task that requires the reviewing court to draw on its judicial experience and common sense." [Citations and internal quotations omitted]. Against this legal backdrop, the Court first recounted the allegations of the Group's Complaint.

The Group ("Phoenix") operates a commercial food packaging plant in Virginia. On July 26, 2013, Phoenix hired Defendant M&O Agencies, Inc. ("Mahoney") to serve as Phoenix's exclusive broker of record. This was reflected in an "Agent/Broker Record of Change" signed and dated the same day. Phoenix alleged that its agreement with Mahoney required Mahoney to advise it concerning insurance matters, procure health insurance for its employees and to provide ongoing consultation work related to the foregoing. In late 2013, Mahoney advised Phoenix to self-insure and to procure stop-loss insurance. It also allegedly advised Phoenix to retain the services of a TPA, Tall Tree Administrators, LLC ("Tall Tree"), to administer the trust from which employee benefit claims were to be paid and to procure stop-loss coverage from Gerber Life Insurance Company ("Gerber").

Approximately a year later, it is alleged that Mahoney represented that the self-insurance arrangements were succeeding and that discussions with Gerber for a renewal of the stop-loss contract for the coverage year beginning October 1, 2014 were going well. At this point, the allegations become somewhat muddled, so I will simply quote from the Court's opinion:

"On August 12, 2014, Mahoney informed Phoenix of Gerber's renewal proposal for the 2014-15 coverage year. Phoenix approved the renewal proposal on the same day. On September 8, 2014, Mahoney advised Phoenix that Tall Tree required an additional $135,462 to satisfy employee claims as the Trust lacked sufficient funds. On September 9, 2014, Mahoney advised Phoenix that it need not pay outstanding health insurance claims. Tall Tree similarly advised Phoenix on September 10, 2014, explaining that Gerber would pay all claims accruing on after May 1, 2014 pursuant to the aggregate stop-loss provision for coverage year 2014-15. On September 12, 2014, Tall Tree advised Phoenix not to pay the outstanding claims or seek reimbursement until October, as doing so earlier would jeopardize the renewal process with Gerber.

On October 13, 2014, Mahoney informed Phoenix that negotiations with Gerber to set rates for the policy period beginning on October 1, 2014 were ongoing. Mahoney also informed Phoenix that Gerber conditioned renewal of the stop-loss coverage on Phoenix providing onsite medical staff. On October 22, 2014, Mahoney informed Phoenix that Gerber had not agreed to a renewal for the 2014-15 coverage year, but that an amended policy was forthcoming. On October 24, 2014, Mahoney advised Phoenix that Gerber refused to renew stop-loss coverage unless Phoenix paid all outstanding claims from the 2013-14 coverage year.

Though Phoenix incurred out of pocket expenses related to outstanding claims near the end of the 2013-14 coverage year, Phoenix received no reimbursement under the stop-loss contract with Gerber.

On November 3, 2014, Phoenix terminated its relationship with Mahoney and hired a new health insurance broker. Phoenix learned that Mahoney had instructed both Gerber and Tall Tree not to engage in direct communication with Phoenix. On December 19, 2014, Phoenix procured stop-loss coverage from Gerber for the 2014-15 coverage year.

Gerber conditioned the renewed policy on Phoenix paying approximately $1,200,000 in unpaid claims. Additionally, the renewed insurance policy contained a $1,300,000 exclusion for claims arising during the 2014-2015 coverage year for a specific employee. In this lawsuit, Phoenix seeks recovery of its actual loss of $2,500,000 plus $1,000,000 in punitive damages." [internal citations omitted].

We cannot tell from the Court's opinion what the $1,300,000 dispute was about, but it sounds like (and this is merely my speculation) a disclosure/laser problem. Nor can we tell what the specifics of the alleged $1,200,000 in "unpaid claims" concerned, though one could infer, based on the quote from the Court above, that these were allegedly not timely paid under the terms of the earlier stop-loss contract, allegedly due to advice Phoenix received from Mahoney and Tall Tree.

The Court's Analysis of Phoenix's Claims and its Application of the Economic Loss Rule

The first important conclusion the Court reached was that Phoenix's claims in the first two Counts of its

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Complaint arose out of the agreement dated July 26, 2013, between Phoenix and Mahoney whereby Mahoney became Phoenix's agent of record. The Court concluded that regardless of the precise terms of this agreement, Mahoney's alleged failure to procure stop-loss insurance for Phoenix for the 2014-2015 year, "such failure may constitute a breach of the obligations implicit in the agency relationship... ." The second Count of Phoenix's Complaint alleged "professional negligence" – essentially malpractice – on the part of Mahoney. Because Virginia law, as interpreted by this Court, characterizes such a claim as a breach of contract (and not a tort), the Court found that Counts I and II of Phoenix's Complaint were essentially redundant and "merged" them for purposes of its analysis. Since both Counts were, according to the Court, simply breach of contract claims, only contractual damages were recoverable. This is the application of the "economic loss rule." No punitive damages, such as may be available in an appropriate tort-based action, were recoverable. The Court likewise concluded that Phoenix's remaining claims simply arose out of the agency relationship and were barred by the economic loss rule as well.

As for the claims against the TPA, Tall Tree, the Court concluded that all of Phoenix's claims occurred during the existence of the written contract between Tall Tree and Phoenix and were, essentially, complaints about Tall Tree's performance under that agreement. As such, they were barred by the Virginia economic loss rule. The Court left intact Phoenix's claim against its TPA for breach of contract, but, as it did with the claim against Mahoney, limited Phoenix's potential recovery to contractual damages only.

Postscript: After receiving the guidance from the District Court described above on June 3, 2016, the parties agreed to a settlement of the matter, as reported by the Court in a document filed on June 22, 2016. The terms of the settlement were not disclosed in the Court's report.

This case illustrates the potential value of motion practice in the resolution of stop-loss (and, of course other) disputes. I am firmly convinced that the Court's opinion and its description of the effect of the Virginia economic loss rule led to the early settlement of this matter. ■

Tom Croft is a magna cum laude graduate of Duke University (1976) and an honors graduate of Duke University School of Law (1979), where he earned membership in the Order of the Coif, reserved for graduates in the top 10% of their class. He returned to Duke Law in 1980 as Lecturer and Assistant Dean (1980-1982) and as Senior Lecturer and Associate Dean for Administration (1982-1984). He also taught at the University of Arkansas-Little Rock law school, where he was an Associate Professor of Law (1990-91), earning teacher of the year honors.
Tom currently consults extensively on medical stop-loss claims and related issues, as well as with respect to HMO Excess Reinsurance, Medical Excess of Loss Reinsurance and Provider Excess Loss Insurance. He maintains an extensive website analyzing more than one hundred cases and containing more than fifty articles published in the Self-Insurer Magazine over many years. See www.stoplosslaw.com. He regularly represents and negotiates on behalf of stop-loss carriers, MGUs, Brokers, TPAs and Employer Groups informally, as well as in litigated and arbitrated proceedings and has mediated as an advocate in many stop-loss related mediations. Tom can be reached at tac@xsloss.com.