RISK MANAGEMENT RESOURCES

ARTICLES

ERISA Subrogation Claim Update

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ERISA Subrogation Claim Update

Lawyers continue to be plagued by ERISA subrogation claims. In a recent case out of the United States Court of Appeals for the Sixth Circuit, *The Longaberger Company v. Kolt*, 586 F.3d 459 (2009), an ERISA Plan brought an action against the Plan beneficiary and his lawyer to recover the Plan's payment. The District Court granted summary judgment in favor of the Plan and the Sixth Circuit Court of Appeals affirmed. In essence, the lawyer was required to disgorge his fee that had been collected and spent prior to the filing of the lawsuit by the Plan.

Longaberger was followed by *The Boeing Company v. Thurmon et al.*, 2009 WL 4782085 (E.D. Mo. 2009), in which the District Court denied the Plan beneficiary's and her lawyer's motion to dismiss for failure to state a claim.

These cases may spell trouble for the lawyer who has taken comfort in the belief that an ERISA Plan has no viable claim against the lawyer because there is no "identifiable fund" upon which the Plan can seek to impose a constructive trust.

Longaberger also underscores the need for the lawyer to scrutinize the plan documents, since the Plan's rights and hence the outcome of any claim for reimbursement, will be dependent upon the language of the Plan documents.

For a fuller treatment of this issue, please read Jay Trehy's Opinion Letter dated June 4, 2008, and his update of January 26, 2010, addressing the *Longaberger* and *The Boeing Company* cases.

TO: Lawyers Mutual Insureds

FROM: Jay Trehy

DATE: January 26, 2010

Attached is an opinion letter on ERISA Subrogation that I was retained to develop for LMLNC. The letter is already dated. This brief introduction should be read again after one finishes the letter.

Few matters have changed so drastically and quickly as ERISA subrogation in the past decade. The trend continues with the Sixth Circuit's November 16, 2009, game-changing decision in *The Longaberger Co. v. Kolt*, 586 F.3d 459 (6th Cir.). We now have a two-pronged test for subrogation language, as reflected in *Longaberger* and now "named" in *The Boeing Co. v. Thurmon*, 2009 U.S. Dist. LEXIS 113693 (E.D.Mo. December 7, 2009) as: the "Particular Fund Requirement" and the "Particular Share Requirement."[1]

[1] Note how these tests were applied in *Popowski*, discussed in the opinion letter, to determine whether the reimbursement provisions would be enforceable in a court of equity.

Longaberger—if followed by the Fourth Circuit and not reversed—brings us full circle from *Knudson*, by eliminating as a practical matter the distinction between legal and equitable claims for reimbursement. *Longaberger* involved a self-funded plan's law suit to obtain from a claimant's attorney the fees that the attorney had collected and spent prior to the filing of the suit. Slip Op. p. 6. The Sixth Circuit merely noted that *Sereboff's* "equitable lien by agreement" required neither tracing nor maintenance of a fund "in order for equity to allow repayment." Slip Op. p. 8.

For self-funded plans, the plan documents must be scrutinized to determine if "the agreement specifically identify a particular fund—distinct from the defendant's general assets—and a particular share of that fund to which the plan was entitled." Slip Op. p. 9. *Boeing* relied upon *Longaberger* to uphold a reimbursement law suit. In *Boeing*, Magistrate Judge David D. Noce reviewed earlier decisions that examined plan language for the Particular Fund Requirement:

> Whether the plan targets a particular fund or only general assets depends on the specific language of the plan at issue. In some instances, courts have found the plan language specified a particular fund. In *Sereboff*, the plan claimed a right to "all recoveries from a third party (whether by lawsuit, settlement, or otherwise)." In [*Longaberger*], the plan claimed the right to recover "upon the proceeds of any recovery by you or your Dependent(s) from such [third] party. . . ." In *Popowski*, one of the plans claimed the right to "recovery made from the third party or insurer."
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> In *Tague*, the plan claimed the right to "subrogation and reimbursement from any other source." In *Taylor*, the plan claimed the right to "first reimbursement from any recovery a covered Member receives, even if the covered Member has not been made whole." In *Salazar*, the plan claimed the right to recover "any funds recovered from another party, by or on behalf of the estate of any covered person." In each of these cases, the courts found the language of the plan identified a particular fund, having stated from where the funds would be recovered.
>
> In other instances, courts have found the plan language did not specify a particular fund. In *Popowski*, one of the plans claimed the right to reimbursement "in full, and in first priority, for any medical expenses paid by the Plan relating to the injury or illness." In *Bentley*, the plan mandated that the beneficiary "promptly reimburse the Plan when the recovery is received until the Plan has been fully reimbursed for benefits it paid for or provided." In each of these cases, the courts found the language of the plan failed to specify that reimbursement was limited to a particular fund.

Boeing, Slip Op. p. 8-9 (citations omitted).

Magistrate Judge Noce then turned to the Particular Share Requirement, stressing that the plan provisions must "identify a particular share of the fund to which the fiduciary is entitled." An action to enforce such provisions still sound in equity, rather than in law.

According to this analysis, the plan in *Knudson* would have been successful — and the reimbursement remedy sought would have been an equitable rather than a legal — if the language found in the reimbursement provisions of the plan met both the Particular Fund and the Particular Share Requirements.

The federal common law under ERISA is constantly shifting. When faced with a new ERISA reimbursement question, my advice is to "Shepardize" the *Sereboff*, *Popowski*, and *Longaberger* cases in order to find the latest changes.

June 4, 2008

RE: ERISA Reimbursement Claims

Sereboff v. Mid-Atlantic Medical Services, Inc.[2] resolved a conflict between federal circuits and showed the way for ERISA plans to pursue reimbursement claims under 29 USC § 1132(a)(3).[3] Nevertheless, the federal courts remain inconsistent in their interpretation of ERISA law.[4] Many of the decisions are unpublished, district court decisions that are not binding on other district courts. They have no actual precedential value, and can only be cited as persuasive authority. Federal courts have exclusive jurisdiction for reimbursement claims brought by plans,[5] and an emerging trend for a crowded federal system is to side, whenever possible, with plans, perhaps in the hopes that such reimbursement actions will go away as claimants and their attorneys are forced to cooperate with ERISA plans.

The bottom line is that North Carolina attorneys who ignore claims for reimbursement by ERISA self-funded plans do so at their own risk and at the risk of their clients. No one can predict what the courts will do in every scenario and so the safest course appears to be to approach such plans *before* filing a lawsuit and as an

[2] 547 U.S. 356, 126 S. Ct. 1869, 164 L. Ed. 2d 612 (2006).
[3] "Persons empowered to bring a civil action. A civil action may be brought--(3) by a . . . fiduciary (A) to enjoin any act or practice which violates any provision of this title or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this title or the terms of the plan."
[4] Contrast *Cossey v. Associates' Health and Welfare Plan*, 2008 U.S. Dist. LEXIS 7185 (E.D.Ark. 2008)(attorney could be required to sign reimbursement agreement before plan pays benefits because he would not thereby become a plan fiduciary) with *Trustees Of The Teamsters Local Union No. 443 Health Services And Insurance Plan v. Papero*, 485 F.Supp.2d 67 (D.Conn. 2007)(Claimant's attorney may be a plan fiduciary because he exercises controls over plan assets.)
[5] 29 USC § 1132(e)(1).

integral part of the decision whether to take a case. If one cannot work out a suitable arrangement with the plan, one may very well decide to decline representation. Determining the status of a potential client's health plan should be done in the initial interview or immediately thereafter. The attorney needs to have a frank discussion with the potential client regarding the law of reimbursement under ERISA.

Moreover, it is advisable to include in retainer contracts language that protects the attorney, allowing an out if a suitable agreement cannot be negotiated with the ERISA plan. If it is too late for negotiation, and the client insists on disbursement without reimbursement to a plan, the attorney should obtain written confirmation that the client has been advised and understands that a lawsuit by the plan may be, and in many cases will be, forthcoming.

A number of important points can be found by looking at the latest federal decisions, especially those in the aftermath of *Sereboff*.

1. ERISA preemption has been called "super-preemption." For example, ERISA preempts North Carolina's limit on repayment of medical expenses in wrongful death actions.[6] ERISA even preempts medical lien statutes, so that a plan will be reimbursed even if it means a health care provider's bills go unpaid.[7] If a North Carolina plan is "self-funded," its provisions regarding reimbursement will be honored.[8] A plan is self-funded if, by its terms, it is ultimately responsible for payment of medical expenses, even when the plan uses a "stop-loss" policy to pay all but the smallest self-retention. If a plan is *fully* funded by an insurance policy, then North Carolina's anti-subrogation regulation, 11 N.C.A.C. 12.0319, will apply to thwart the reimbursement claim.[9] One needs to check the Form 5500 that plans must file with the Department of Labor to determine the manner of funding. In many cases, these forms can be found at www.freeERISA.com. Sometimes, one must resort to getting a copy of the Form 5500 from the plan administrator, thereby guaranteeing the plan's notice of the third-party liability claim.

2. The attorney must obtain from the plan administrator a copy of the plan documents, including the Summary Plan Description ("SPD"), since the SPD is considered part of the plan documents.[10] Normally, if there is an ambiguity between the SPD and the other plan documents, the SPD prevails because that is the document that has to be given to employees.[11] Plan provisions change as plans are renewed and as plan administrators find more and more ways to protect the plans at the cost of participants and beneficiaries. For example, most plans today give plan administrators discretion to interpret plan provisions,

[6] *McInnis v. Provident Life & Accident Ins. Co.*, 21 F.3d 586 (4th Cir. 1994).
[7] *Mutual of Omaha Ins. Co. v. Arachikavitz*, 2007 U.S. Dist. LEXIS 71172 (D.Nev. 2007).
[8] It should be noted that ERISA disability plans also may attempt to seek reimbursement, but such plans are rarely self-funded.
[9] *See Smith v. Life Ins. Co. of North America*, 466 F.Supp.2d 1275 (N.D. Ga. 2006)(applying Georgia's anti-subrogation statute to plans fully funded by insurance policies).
[10] *Administrative Committee of the Wal-Mart Stores, Inc. Associates' Health and Welfare Plan, v. Gamboa*, 479 F.3d 538, 543-45 (8th Cir. 2007); *Administrative Comm. For the Wal-Mart Stores, Inc. Associates' Health and Welfare Plan v. Salazar*, 2007 U.S. Dist. LEXIS 61273 (D.Ariz. 2007).
[11] *Salazar*, 2007 U.S. Dist. LEXIS 61273; 29 U.S.C. § 1022(a)(1).

and their interpretations will not be disturbed as long as they are reasonable.[12] One needs to review the plan documents as they existed at the time the benefits are paid, but be aware that many plans allow for amendment at any time, without the consent of participants and beneficiaries.[13]

3. If the plan's reimbursement provisions are proper in content, they will be honored by a federal court. If the plan provisions state a priority of payment, the provisions will be followed. If the provisions fail to state a priority of payment—a circumstance that has become increasingly rare—then the courts will resort to the Make Whole Doctrine, at least in the Fourth Circuit,[14] as a gap-filler. If the plan provisions decline to pay fees or expenses except in the plan administrator's discretion, those plan provisions will be followed.[15] If the plan provisions calls for reimbursement from a settlement or through a judgment, the provisions will be honored even if the settling parties attempt to designate the recovery as being for something other than reimbursement of medical expenses.[16] The courts will enforce reimbursement provisions that specifically identify a particular fund—the settlement or judgment recovery, as distinct from the participants' general assets—to which the plan is entitled. The plan provisions must recite that reimbursement comes from a third-party recovery, and reimbursement provisions that failed to so recite will not be enforced.[17] In addition, the plan must also identify the portion of the recovery that is due the plan, and a reimbursement claim fails if it does not.[18]

4. Strict traceability is not required for ERISA reimbursement claims. Unlike equitable liens for restitution which are limited to the res itself, traceability is not required for "equitable liens by agreement or assign

[12] *Id.* ("Where the plan administrator offers a reasonable interpretation of the plan and that decision was made in good faith, it should be upheld.")
[13] *Id.*
[14] *See Sealy, Inc. v. Nationwide Mut. Ins. Co.*, 286 F. Supp. 2d 625 (M.D.N.C. 2003). The First Circuit rejected this gap-filling approach in *Harris v. Harvard Pilgrim Healthcare, Inc.*, 208 F.3d 274 (1st Cir. 2003).
[15] *Brown v. Associates Health and Welfare Plan*, 2007 U.S. Dist. LEXIS 60307 (W.D.Ark. 2007) ("Plaintiffs had a pre-existing contractual obligation to the Plan to reimburse it for the full amount of any benefits paid on their behalf without a reduction for attorney's fees. That obligation precludes Plaintiffs from entering into an agreement with their lawyer to pay him from a fund they were not entitled to.").
[16] *Administrative Comm. of the Wal-Mart Stores, Inc. Associates' Health and Welfare Plan v. Shank*, 500 F.3d 834, 839 (8th Cir. 2007), *cert. denied*, ___ U.S. ___, 170 L. Ed. 2d 386, 2008 U.S. LEXIS 2615 (2008)(rejecting argument successfully made for Medicaid reimbursement in *Arkansas Department of Health & Human Services v. Ahlborn*, 547 U.S. 268, 126 S. Ct. 1752, 164 L. Ed. 2d 459 (2006) that part of settlement was for items other than medical benefits).
[17] *Popowski v. Parrott*, 461 F.3d 1367 (11th Cir. 2006) offers an interesting contrast of reimbursement provisions. One plan had valid provisions because it recited the reimbursement was to come from a recovery from a third party or insurer. The other plan's claim for reimbursement was dismissed because its reimbursement provision failed to state the reimbursement was from a particular fund. It said, "If . . . the Covered Person receives a settlement, judgment, or other payment relating to the accidental injury or illness from another . . . paid by, or on behalf of, the person or entity who allegedly caused the injury or illness, the Covered Person agrees to reimburse the Plan in full, and in first priority, for any medical expenses paid by the Plan relating to the injury or illness." *But see*, *Providence Health System-Washington v. Bush*, 2006 U.S. Dist. LEXIS 81912 (W.D. Wash 2006), in which a similar plan reimbursement provision was honored, although the Court resorted to the Make Whole Doctrine because the plan was silent on priority of payment.
[18] *Fleetwood Enterp., Inc. v. Taylor*, 2007 U.S. Dist. LEXIS 74802 (W.D.Ky. 2007).

ment."[19] Although the employee may not have made an "agreement" with the plan for reimbursement, the employer did. That means the plans can go after commingled funds, settlement trusts, special needs trusts, conservatorships, and even annuity payments.[20] Even when a guardianship proceeding in state court established a special needs trust with spendthrift protection, a federal court ordered reimbursement.[21] It may be possible to spend the money, but there's no guarantee that the plan will be unable to reach the property that is purchased.[22] As long as the plan sues the proper person with the money or assets from a third-party recovery, it does not matter that the person was neither a participant nor a beneficiary with the plan. A fiduciary's reimbursement claim can proceed as long as it seeks to recover funds that (1) are specifically identifiable, (2) "belong in good conscience to the Plan," and (3) are within the possession and control of the defendant.[23]

5. A reimbursement claim will be permitted to go forward so long as an action is filed while the funds or assets from the funds are in the possession of a defendant.[24] In one case, the attorney transferred his fees from his IOLTA account to his operating account, and the court ordered him to replace the money into the IOLTA account and then awarded it to the plan.[25]

6. A plan can bring an action for reimbursement in the district court where the plan is administered, even if the participant or beneficiary lacks minimum contacts with that state in which the district is found.[26]

7. With the exception of the gap-filling use of the Make Whole Doctrine, equitable defenses have thus far proved unsuccessful and the courts have declined to create federal common law that conflicts with plan terms.[27] "Unclean hands" by the plan administrator requires bad faith or bad intent,[28] or willful or fraudulent behavior, and not merely negligence.[29] This author could find no decision in which a plan was denied reimbursement for unclean hands.

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[19] *Sereboff*, 547 U.S. at 364-65, 126 S. Ct. at 1875, 164 L. Ed. 2d at 621.
[20] *Administrative Comm. of the Wal-Mart Stores, Inc. Associates' Health and Welfare Plan v. Horton*, 513 F.3d 1223 (11th Cir. 2008) (conservatorship); *Popowski*, 461 F.3d at 1370; *Shank*, 500 F.3d 834 (8th Cir. Mo. 2007)(settlement trust and special needs trust); *Mutual of Omaha Ins. Co. v. Arachikavitz*, 2007 U.S. Dist. LEXIS 71172 (D.Nev. 2007)(special needs trust); *Ralcorp Holdings, Inc. v. Fricke*, 290 F. Supp. 2d 759 (W.D.Ky. 2003)(annuity payments).
[21] *Bush*, 2006 U.S. Dist. LEXIS 81912.
[22] It may be possible, however, to use the recovery as a down payment on a home, or to pay off a mortgage debt. Any reimbursement claim would then be a suit for money damages.
[23] *Bombardier Aerospace Employee Welfare Benefits Plan v. Ferrer, Poirot & Wansbrough*, 354 F.3d 348, 356 (5th Cir. 2003); *Beveridge v. Benefit Recovery, Inc.*, 2006 U.S. Dist. LEXIS 50942 (D.Az. July 21, 2006).
[24] *Popowski*, 461 F.3d at 1373.
[25] *Brown*, 2007 U.S. Dist. LEXIS 60307.
[26] *United Health Group Inc. v. Mesa*, 2007 U.S. Dist. LEXIS 71692 (D. Minn. 2007); 29 U.S.C. § 1132(e)(2).
[27] *Shank*, 500 F.3d at 838-840.
[28] *Salazar*, 2007 U.S. Dist. LEXIS 61273.
[29] *Chitkin v. Lincoln National Ins. Co.*, 879 F. Supp. 841, 854 (S.D.Calif. 1995).

8. If plan documents require the signing of a reimbursement contract, a plan can withhold payment of benefits until the contract is signed.[30] On the other hand, if plan documents do not call for the execution of a reimbursement provision, the plan administrator cannot require it.[31]

9. A plan may bring a reimbursement claim even if the participant or beneficiary has settled the case before the plan sends out notice of its reimbursement claim.[32] As stated in *Sereboff*, "a contract to convey a specific object even before it is acquired will make the contractor a trustee as soon as he gets title to the thing."[33]

10. A lawyer *may* have an ethical duty to protect a self-funded plan's reimbursement interest. RPC Rule 1.15-1 states:

    (d) "Entrusted property" denotes trust funds, fiduciary funds and other property belonging to someone other than the lawyer which is in the lawyers possession or control in connection with the performance of legal services or professional fiduciary services.

    RPC Rule 1.15-2 states:

    (a) Entrusted Property. All entrusted property shall be identified, held, and maintained separate from the property of the lawyer, and shall be deposited, disbursed, and distributed only in accordance with this Rule 1.15.

    (b) Deposit of Trust Funds. All trust funds received by or placed under the control of a lawyer shall be promptly deposited in either a general trust account or a dedicated trust account of the lawyer.

    Finally, RPC Rule 1-15 Comment [14] states:

    > Third parties may have lawful claims against specific funds or other property in the lawyer's custody, such as a client's creditor who has a lien on funds recovered in a personal injury action. A lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client. In such cases, when the third-party claim is not frivolous under applicable law, the lawyer must refuse to surrender the property to the client until the claim is resolved. A lawyer should not unilaterally assume to arbitrate a dispute between the client and the third party, but, when there are substantial grounds for dispute as to the person entitled to receive the funds, the lawyer may file an action to have a court resolve the dispute.

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[30] *Cossey*, 2008 U.S. Dist. LEXIS 7185.
[31] *Burgett v. Meba Medical and Benefits Plan*, 2007 U.S. Dist. LEXIS 70934 (E.D. Texas 2007).
[32] *Brown*, 2007 U.S. Dist. LEXIS 60307 (settlement date is not relevant because participant "had prior notice they would be required to reimburse the Plan if they recovered funds from a third party as reimbursement for injuries for which the Plan paid out benefits").
[33] *Sereboff*, 547 U.S. at 363, 126 S. Ct. at 1877, 164 L. Ed. 2d at 612 (quoting *Barnes v. Alexander*, 232 U.S. 117, 121, 34 S. Ct. 276, 58 L. Ed. 530 (1914)).

Again, my advice is to handle these ERISA reimbursement issues up front while one still has some negotiating leverage with the ERISA, self-funded plan. When the money is in hand, it may well be too late to negotiate a deal, and the client and attorney may be at the mercy of the plan language.

One commentator who works for a Rhode Island firm that regularly represents ERISA plans has opined:

> Consider the lienholder after *Knudson* and *Sereboff*. What then can be done to protect a lien for employee benefits properly paid and recoverable? The lesson of *Knudson* and *Sereboff* may be to sue early and often. As soon as the lienholder knows that a plan participant or beneficiary who has been paid benefits is prosecuting claims against a tortfeasor, the lienholder may be best served by suing the participant or beneficiary and their lawyer to enjoin the disbursement of settlement funds. This may be necessary to preserve the res and, consequently, the lienholder's rights under ERISA. The frequency of this practice is increasing.[34]

I anticipate a growth in the cottage industry of lawyers representing ERISA plan for reimbursement claims. Until federal legislation is enacted to protect plan participants and beneficiaries, the litigation world will be tilted wrongly in the favor of self-funded plans. Employees will learn, usually too late, that private employers have signed away the civil justice rights of plan participants and beneficiaries.

Please let me know if you have any further questions regarding this area of law.
With best regards, I remain

Sincerely yours,

Jay Trehy

[34] Brooks Magratten, "Lienholder Rights Under ERISA Or Why You Might Not Pay Blue Cross," 55 RI Bar Jnl. 15, March/April, 2007.