



THE HEALTH LAWYER

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THE SUPREME COURT REVISITS THIRD-PARTY REIMBURSEMENT CLAIMS UNDER ERISA: *SEREBOFF V. MID-ATLANTIC MEDICAL SERVICES, INC.*

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Introduction

The Employee Retirement Income Security Act of 1974 ("ERISA") authorizes an action by an individual plan participant or beneficiary or a plan fiduciary to (1) enjoin an act or practice that violates Title I of ERISA or the terms of a plan; or (2) obtain other appropriate equitable relief to redress such a violation or to enforce Title I or the terms of a plan.¹ The Supreme Court has referred to this section of ERISA as the "catch-all" provision, as distinguished from provisions allowing benefit claims under Section 1132(a)(1)(B) and fiduciary claims on behalf of a plan under Section 1132(a)(2).²

Many health plans (whether insured or not) and a significant percentage of disability plans include provisions that allow the plan or its fiduciary to seek reimbursement from the plan participant or beneficiary³ for medical costs paid by the plan where the participant or beneficiary obtains a recovery from a third-party tortfeasor allegedly

responsible for the injuries which triggered the need for medical care. Plan fiduciaries have sought to enforce these "reimbursement" provisions, also known as "subrogation" provisions, by actions for equitable relief under Section 1132(a)(3) of ERISA. Until the Supreme Court decided the case of *Great-West Life & Annuity Insurance Co. v. Knudson*, 534 U.S. 204 (2002), suits to enforce such plan terms were generally successful in most federal circuits, with the notable exception of the Ninth Circuit.⁴ Such subrogation provisions can be important in holding down plan costs and insurance premiums, since, if they can be enforced, they may result in substantial net reductions in the amounts paid out in benefit claims.

On May 15, 2006, in *Sereboff v. Mid-Atlantic Medical Services, Inc.*, 126 S.Ct. 1869 (2006), in an opinion written by new Chief Justice John Roberts, a unanimous Supreme Court held that enforcement of such a subrogation clause on behalf of a health plan was permissible under ERISA, on grounds that the remedy sought by the plan fiduciary constituted "equitable relief" under Section 11032(a)(3).⁵ *Sereboff* constitutes a significant victory for medical

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benefit plans and the medical and disability insurance industry by providing a blueprint for plans, insurers and plan fiduciaries to recoup overpayments by use of subrogation clauses in benefit plans. To understand Justice Roberts's reasoning in *Sereboff*, however, it is useful to review the development of case law leading up to it, and particularly the Supreme Court's earlier opinion in *Great-West Life & Annuity Insurance Co. v. Knudson*.

Antecedents to *Sereboff*

The *Great-West* Decision

In *Great-West Life & Annuity Insurance Co. v. Knudson*, 534 U.S. 204 (2002), a health insurer, Great-West, had sought to recover from a plan beneficiary, Janette Knudson, over \$400,000 in benefits paid by an employer-sponsored medical plan insured by Great-West and as to which Great-West was the claim review fiduciary. The benefit plan contained a term that entitled the plan to a first lien upon any recovery from a third party, and made the participant "personally liable" up to the amount of the first lien. The benefits were paid to Ms. Knudson's medical providers to cover medical expenses for treating her injuries from a car accident. Ms. Knudson thereafter settled a tort claim arising from that accident for \$650,000. The settlement funds were allocated as follows: (1) approximately \$375,000 for attorneys fees and costs; (2) \$5,000 to reimburse Medi-Cal; (3) approximately \$14,000 to reimburse Great-West for its first lien; and (4) the remainder of approximately \$250,000 to a "special needs trust" for the benefit of Ms. Knudson.

After attempting to intervene in the state lawsuit leading to the settlement, Great-West filed an ERISA action in United States district court, seeking declaratory and injunctive relief under 29 U.S.C. § 1132(a)(3). The federal district court denied the temporary restraining order requested by Great West, which ruling Great-West did not appeal. After

the state court approved the settlement and the money was disbursed, the federal district court granted summary judgment to Ms. Knudson. It held that the language of the plan limited its right of reimbursement to the amount *received* by Ms. Knudson from third parties for past medical treatment, an amount that the state court determined was \$13,828.70.

The Ninth Circuit affirmed on different grounds. Citing *FMC Medical Plan v. Owens*, 122 F.3d 1258 (9th Cir. 1997), the Ninth Circuit held that judicially decreed reimbursement for payments made to a beneficiary of an insurance plan by a third party is not equitable relief and is therefore not authorized by 29 U.S.C. Section 1132(a)(3).⁶

The Supreme Court granted certiorari. Justice Scalia, writing the opinion for the 5-4 majority, reasoned that the basis for the repayment claim was legal and not equitable, and was therefore beyond the scope of ERISA's permissible equitable remedies. The Court held that Great-West sought the imposition of personal liability on Ms. Knudson for a contractual obligation to pay money, which constituted legal relief and not equitable relief.

Citing the Court's earlier opinion in *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993), Justice Scalia opined that under Section 1132(a)(3), the term "equitable relief" refers to those categories of relief that were typically available in equity.⁷ The Court rejected Great-West's argument that it was entitled to relief under that section because it sought to enjoin an act or practice — Ms. Knudson's failure to reimburse the plan — which violated the terms of the plan, reasoning that an injunction to compel the payment of money past due under a contract, or specific performance of a past due monetary obligation, was not typically available in equity.

The Court likewise rejected Great-West's argument that its suit was authorized because it sought restitution,

noting that restitution is a legal remedy in a case at law, and an equitable remedy when ordered in an equity case. For restitution to lie in equity, the action generally must seek not to impose personal liability on the defendant, but to restore to the plaintiff specific and identifiable funds in the defendant's possession. Because the funds to which Great-West claimed entitlement were not in Ms. Knudson's possession, but instead in the possession of the special needs trust, the claim was a contract claim and not an equitable one.⁸

Finally, the Court in *Great-West* rejected the argument of the U.S. Department of Labor (which had intervened as *amicus curiae*) that the common law of trusts provided the plan with equitable remedies that allowed the plan fiduciary to bring the action under Section 1132(a)(3).

Nonetheless, Justice Scalia's majority opinion did not foreclose all potential routes to enforcement of plan subrogation clauses. The majority opinion suggested that equitable restitution might be available where the plan beneficiary had actual possession of the funds, on which a constructive trust or equitable lien could be imposed. This, Justice Scalia suggested, was a possibility because at common law a plaintiff "could seek restitution in equity, ordinarily in the form of a constructive trust or an equitable lien, where money or property identified as belonging in good conscience to the plaintiff could clearly be traced to particular funds or property in the defendant's possession."⁹ Alternatively, the majority opinion suggested that the equitable remedy of an accounting might be available against a plan beneficiary, even where the particular res cannot be traced.¹⁰

Plan Reimbursement Claims in the Interval Between *Great-West* and *Sereboff*

After *Great-West*, courts were divided in considering whether a plan

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reimbursement claim sought “appropriate equitable relief.” In the Ninth Circuit and Sixth Circuit primarily, the courts looked to “the substance of the remedy”, and held that reimbursement claims were legal and not equitable in nature, and therefore not available under ERISA, even if the defendant had possession of the funds.¹¹

In other circuits, the courts focused on the identity of the person who had possession of the funds recovered from the third-party tortfeasor. If the plan beneficiary, or his agent, had actual or constructive possession of the funds, the courts generally allowed the remedy of a constructive trust to proceed under Section 1132(a)(3). For example, in *Administrative Committee of the Wal-Mart Associates Health and Welfare Plan v. Willard*, 393 F.3d 1119 (10th Cir. 2004), the Court held that a constructive trust remedy was available under Section 1132(a)(3) where the settlement funds were in the district court’s registry, determining that, although the plan beneficiary had never had actual possession of the funds, he had exercised control over the funds by agreeing to their deposit in the court registry and in any event had “constructive possession” of those funds.¹²

In cases where the funds were set aside in the plan beneficiary’s personal injury attorney’s trust account, several courts have held that a constructive trust is available over them, as they constitute an identifiable *res* in the possession of the beneficiary’s agent.¹³

Sereboff and Its Rationale

As set forth above, in *Sereboff* The Supreme Court ruled that enforcement of a subrogation clause in an health plan was permissible under ERISA on the grounds that the remedy sought by the plan fiduciary constituted “equitable relief” under Section 11032(a)(3), where the funds were in the possession of the

plan participant. In contrast to *Great-West*, the Court noted, the health plan in *Sereboff* sought “specifically identifiable” funds that were “within the possession and control of” the plan beneficiary.¹⁴ The Court’s opinion emphasizes that, in addition to seeking an equitable remedy, a plaintiff under Section 1132(a)(3) must also “establish that the basis for its claim is equitable.” The Court drew a distinction between two forms of equitable lien: (1) equitable liens *as a matter of restitution* and (2) equitable liens *by agreement or assignment*. An equitable lien as a matter of restitution requires that the plaintiff trace the funds at issue to the fund against which the lien is asserted. An equitable lien by agreement or assignment does not require tracing of specific funds, but nonetheless is an equitable remedy.

The Court held that the benefit plan in *Sereboff* asserted an equitable lien by agreement or assignment, and hence the plan was not required to trace the specific funds at issue. Instead, the only requirement of such a claim is that the lien be asserted against the fund identified by the agreement or contract. (In *Sereboff*, the plan language specified the lien target as: “[a]ll recoveries from a third party.”) On this basis, the Court rejected the *Sereboffs*’ contention that, in order for the claim to be equitable under Section 1132(a)(3), the plan was required to show that the fund against which the lien was asserted contained the actual health plan benefits originally paid by the plan. (This probably would have been an impossibility, given the likelihood that the benefits were paid directly to the plan participant’s medical providers.) The Court also stated that the “fund over which a lien is asserted need not be in existence when the contract containing the lien provision is executed.”¹⁵

The *Sereboff* opinion does not discuss whether subrogation claims can be made by an ERISA plan fiduciary

under relevant state law, an issue that the *Great-West* opinion mentioned in passing. Likewise, the Court declined to address the meaning of the term “appropriate” in Section 1132(a)(3) as modifying “equitable relief.” The *Sereboffs* argued that the plan’s assertion of a lien over the entire amount of the third party recovery was unfair and inequitable, and violated well-accepted principles such as the “make whole” doctrine, which would require the plan to compromise its claim at the level at which the plan participant compromised its claim, and as well to grant credit for attorneys fees incurred in prosecuting the third-party claim. The Supreme Court noted that the *Sereboffs* did not raise this issue below, and it declined to determine it in the first instance.¹⁶

Practical Implications of *Sereboff*

It is important to note that *Sereboff* does not reject the holding of *Great-West*, and that, presumably, if the recovered funds had been deposited into an account or fund over which the plan beneficiary had no control, the result might well have been the same as in *Great-West*. Nevertheless, *Sereboff* is a unanimous opinion, and is frankly much clearer and easier to apply than *Great-West*. As a practical matter, *Sereboff* counsels that, in order to enforce reimbursement rights under a plan (at least in federal court), the responsible plan fiduciary should act *quickly* to enforce an equitable lien by assignment or agreement, which has been created by plan terms, once a plan beneficiary obtains a judgment or settlement from a third party tortfeasor. This would necessarily require close monitoring of the personal injury litigation, and action at the time of settlement, before the recovery is dissipated or placed beyond the possession, actual or constructive, of the beneficiary.



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Endnotes

- ¹ 29 U.S.C., Section 1132(a)(3)
- ² *Varity Corp. v. Howe*, 516 U.S. 489, 510 (1996)
- ³ This article uses the term “beneficiary” to include any who are entitled to benefits from or otherwise participate in an ERISA plan, whether formally termed a “beneficiary,” “participant,” “member,” “enrollee,” or other.
- ⁴ See, e.g., *FMC Medical Plan v. Owens*, 122 F.3d 1258 (9th Cir. 1997)
- ⁵ *Sereboff v. Mid-Atlantic Medical Services, Inc.*, 126 S.Ct. 1869, 1878 (2006)
- ⁶ *Great West Life & Annuity Insurance Company v. Knudson*, 2000 U.S. App. LEXIS 10203 (2000).
- ⁷ *Knudson*, 534 U.S. 204, 209
- ⁸ *Knudson*, 534 U.S. 204, 214
- ⁹ *Id.*
- ¹⁰ *Id.*, at n. 2
- ¹¹ See, e.g., *Weststaff (USA) Inc. v. Arce*, 298 F.3d 1164 (9th Cir. 2002); *Great-West Life & Annuity Ins. Co. v. Berlin*, 45 Fed.Appx. 750 at *1 (9th Cir. 2002) (The fact that the funds sought by the plan fiduciary had been placed in a trust account and were specifically identifiable did not transform the action into one for equitable relief); *Qualchoice, Inc. v. Rowland*, 367 F.3d 638, 646 (6th Cir. 2004) (Plan fiduciary’s action to enforce a plan-reimbursement provision was a legal action, regardless of whether the plan participant or beneficiary recovered from another entity and possessed that recovery in an identifiable fund.)
- ¹² See, also, *Administrative Committee of Wal-Mart Stores, Inc. Associates Health & Welfare Plan v. Varco*, 338 F.3d 680 (7th Cir. 2003)
- ¹³ See, e.g., *Primax Recoveries, Inc. v. Lee*, 260 F.Supp.2d 43 (D.D.C. 2003); *Bombardier Aerospace Employee Welfare Benefits Plan v. Ferrer, Poirot & Wansbrough*, 354 F.3d 348 (5th Cir. 2003)(plan participant had “constructive possession” of settlement funds in his attorney’s account.)
- ¹⁴ The facts in *Sereboff* were more typical than those in *Great West*. The Sereboffs were involved in an automobile accident in California and suffered injuries. Pursuant to the provisions of the ERISA medical plan sponsored by Ms. Sereboff’s employer, the plan paid the couple’s medical expenses. The Sereboffs filed a tort action in state court against several third parties, seeking compensatory damages for injuries suffered as a result of the accident. Soon after the suit was commenced, the plan administrator sent the Sereboffs’ attorney a letter asserting a lien on the anticipated proceeds from the suit for the medical expenses the plan paid on the Sereboffs’ behalf. On several occasions over the next 2 1/2 years, the plan administrator sent similar correspondence to the attorney and to the Sereboffs, repeating its claim to a lien on a portion of the Sereboffs’ recovery, and detailing the medical expenses as they accrued and were paid by the plan. The Sereboffs’ tort suit eventually settled for \$750,000. Neither the Sereboffs nor their attorney sent any money to the plan in satisfaction of its claimed lien which, after the plan completed its payments on the Sereboffs’ behalf, totaled \$ 74,869.37. The plan then filed suit in federal court, seeking restitution under ERISA.
- ¹⁵ *Sereboff*, 126 S.Ct. 1869, 1876.
- ¹⁶ *Id.*, at 1876-1877