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Supreme Court Limits ERISA Plans' Reimbursement Rights

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In *Montanile v. National Elevator Industry Health Benefit Plan* (January 20, 2016), the U.S. Supreme Court dealt a blow to ERISA plans that seek to recover health benefits paid to participants who sustain injuries caused by third parties.

The fact pattern in *Montanile* was unremarkable and frequently recurring: an ERISA plan participant received health coverage for injuries sustained in a car accident, received a recovery in an underlying action relating to the accident, and the plan then requested reimbursement based on plan terms requiring Montanile to repay the plan out of the settlement he received. After unsuccessfully attempting to resolve his reimbursement obligations with the plan, Montanile's counsel dispersed the settlement monies to Montanile, who quickly spent the settlement (or, at least portions of it).

The plan brought an action under ERISA Section 502(a)(3), which provides in part that an ERISA plan fiduciary may obtain "appropriate equitable relief" to enforce ERISA plan terms. These three words have received perhaps more attention from the Supreme Court than any other provision of ERISA over the past 30 years, with the Court continually refining its interpretation of the phrase in cases involving ERISA plans as both plaintiffs and defendants. In erecting a framework to analyze claims arising under Section 502(a)(3), the Supreme Court has repeatedly referred back to olden times when the legal system was divided into two different sets of courts with different remedial powers: courts in law and equity. Though such courts merged long before the passage of ERISA, the Supreme Court interpreted "appropriate equitable relief" to mean the categories of relief "typically available in equity." *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 256 (1993). This test in turn required an examination of old legal treatises explaining the various forms of equitable relief available in "the days of the divided bench." Therefore, the outcomes under Section 502(a)(3) depended on whether the Supreme Court could find an analogue in the basis for relief and type of remedy sought in a Section 502(a)(3) action.

Remarkably, in just 15 short years prior to *Montanile*, the Court has had three separate occasions to analyze the phrase "appropriate equitable relief" as it applied to ERISA plan reimbursement cases. The first was *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204 (2002). In *Knudson*, the Supreme Court, in a 5-4 decision, rejected an

ERISA plan's attempt to enforce plan reimbursement terms in a situation where the injured plan participants did not actually receive the underlying tort recovery – instead, that recovery had been placed in a special needs trust and was also in the custody of counsel, neither of whom were named by the ERISA plan in its lawsuit. The Court rejected the plan's claim as not “typically available in equity” because it sought “legal restitution” rather than “equitable restitution.” The difference turned on the fact that equitable restitution required a plaintiff to obtain relief over a particular fund in the possession of defendant, rather than a general money judgment for the same amount against the individual's general assets. That decision drew a sharp dissent from Justice Ginsberg, who criticized the majority's seemingly archaic and formalistic analysis, believing that Congress did not use the word “equitable” with the notion of reintroducing those antiquated legal doctrines.

ERISA plans fared better in *Sereboff v. Mid-Atlantic Medical Services*, 547 U.S. 356 (2006). *Sereboff* presented a similar third-party reimbursement scenario, only this time the defendant had possession of the settlement fund from which the plan sought reimbursement. The Court thus distinguished *Knudson*, and analogized the plan's claim to an “equitable lien by agreement,” a category of relief “typically available in equity.” An “equitable lien by agreement” is an agreement by one party to convey a specific fund or property to another before that fund or property exists. Most ERISA plan reimbursement clauses, if drafted properly, constitute an “equitable lien by agreement.” Such liens are valid if they identify a particular fund over which the plan has rights, specify the portion of the fund to which the plan is entitled, and are enforced as against a fund in the defendant's possession or control. Notably in *Sereboff*, the Supreme Court rejected the Sereboffs' assertion that “strict tracing” principles – the plaintiff's ability to “trac[e] the asset into its products or substitutes,” or “trace his money or property to some particular funds or assets,” were relevant in cases involving equitable liens by agreement. Said another way, in equitable restitution cases, it was often the case that the plaintiff had to identify a specific piece of property or asset it possessed and that defendant wrongfully took, and would be required to “trace” that asset from when plaintiff possessed it to the time defendant wrongfully took possession. This was called “strict tracing” the asset into defendant's hands. The Court flatly found that such requirements did not apply in situations involving equitable liens by agreement like those contained in ERISA plans. Lower courts' interpretation of that part of *Sereboff* ultimately led to the dispute in *Montanile*.

Conspicuously left open in *Sereboff*, however, was the question of whether enforcement of such ERISA plan clauses, though arising properly in equity, was nevertheless “appropriate” within the meaning of the phrase “appropriate equitable relief” in Section 502(a)(3).

The Court took up that question in *U.S. Airways v. McCutchen*, 133 S. Ct. 1537 (2013).¹The core question in *McCutchen* was whether the word “appropriate” in the phrase “appropriate equitable relief” allowed courts to disregard ERISA plan terms and fashion “appropriate relief” on a case-by-case basis, ostensibly on the basis of various equitable doctrines, depending on the fairness of the particular situation in which the plan sought reimbursement. The Court agreed with the plan that such doctrines could not be used to override clear plan language, and thus solidified *Sereboff* and ERISA plans' reimbursement rights.

Montanile presented a situation not found in the prior Supreme Court reimbursement cases, but one that is not uncommon: a plan member who spends a tort recovery before the plan is able to protect its reimbursement rights. A circuit split developed on whether plans could pursue an “equitable lien by agreement” under Section 502(a)(3), even though the plan participant spent the recovery. Six circuits (including the Eleventh Circuit in *Montanile*) held that the plans could pursue such claims under Section 502(a)(3) notwithstanding a participant's act of ignoring the lien and spending the money. Many of these courts relied on *Sereboff*'s “strict tracing” language to support the conclusion that dissipation did not affect the plans' right to relief. Two circuits held that such action by ERISA plan beneficiaries stripped the claim of its equitable nature, and converted it to a legal claim – a mere money judgment against a defendant's general assets.

The Supreme Court in *Montanile* agreed with the minority view and, much as it had in *Knudson*, employed technical rules of equity to find against the plan. The Court found that relief “typically available in equity” meant that a remedy could be enforced only against an intact fund or traceable proceeds (e.g. a car or house) emanating from that fund or, perhaps, “comingled funds.” As the Court noted, “A defendant's expenditure of the entire identifiable fund on nontraceable items (like food or travel)

¹ The author was co-counsel for the ERISA plan in *McCutchen*.

destroys an equitable lien.” The Court once again examined old equity treatises and doctrines and focused on the fact that equitable remedies were often directed at a particular thing, as opposed to taking the form of a general monetary recovery from a defendant’s assets. And the Court noted “the plaintiff could not attach defendant’s general assets instead because those assets were not part of the specific thing to which the lien attached.”

The Court appeared to cast aside the issue of whether the dissipation of the tort recovery was “wrongful” conduct by the ERISA plan member. Instead, the Court found such conduct—wrongful or not—did not change the analysis and conclusion that relief in such a situation was not “typically available in equity.” Justice Ginsburg, the lone dissenting member, noted the patent unfairness of rewarding a plan member’s flagrant breach of plan terms, and wondered rhetorically “What brings the Court to that bizarre conclusion?”

The Court considered and rejected the plan’s argument that similar forms of relief existed in equity over dissipated assets, finding that those forms of relief were not “typical” in equity and were simply a product of the equity courts’ ancillary ability to provide legal relief.

The court also rejected the plan’s argument that *Sereboff*’s “strict tracing” language meant the plan could recover regardless of dissipation, noting instead that nothing in *Sereboff* altered the requirement that “the plaintiff must still identify a specific fund in the defendant’s possession to enforce the lien.”

Lastly, and perhaps in the opinion’s weakest moment, the Court cast aside the plan’s policy arguments, which focused on ERISA plan solvency and the creation of perverse incentives whereby ERISA plan participants can simply defeat equitable liens by breaching the very plan language under which they accepted the benefits coverage. The Court casually suggested that it would normally be quite easy for the plan to prevent dissipation of settlement funds, and that the decision will not pose much hardship or additional costs on plans. This section of the opinion (which Justice Alito notably refused to join) is startlingly naïve. While it is true that ERISA plans are at times aware of recoveries or potential recoveries before or shortly after they occur, often they are not. Often ERISA plans are met with resistance at every turn and do not even learn about settlements or recoveries until long after they occur, despite diligent pursuit of information regarding them. In short, encouraging ERISA plan participants to dissipate recoveries on non-traceable items creates poor incentives and invariably will raise litigation costs. The Court weakly supported its conclusion in this regard by noting that the plan had 14 days’ notice that the participant’s lawyer might disperse the funds to the participant but did not object, and then waited six months to actually bring suit. Seemingly, though, under the Court’s analysis it would have made no difference if the plan participant’s lawyer gave 48 hours’ notice and the plan sued much sooner.

Takeaways

The result in *Montanile* was not entirely surprising, given that the Court in *Knudson* had laid the groundwork for such a result. It remains to be seen whether personal injury lawyers and their clients will seize on *Montanile* and attempt to frustrate plan reimbursement claims by hiding the ball on settlement and quickly spending the funds in such a way as to avoid plans’ claims. It similarly remains to be seen whether ERISA plans will continue to provide coverage at all in third-party liability situations, given that plans are not required under ERISA to extend such coverage in the first place. Moreover, even under the majority opinion, it appears plans have avenues of relief in the event settlement funds are spent on “traceable” items. However, these avenues will undoubtedly result in more litigation costs and perhaps invasive discovery into ERISA plan members’ finances. A further result is likely to be greater (and more prompt) activity by ERISA plans in securing injunctive relief to preserve settlement funds intact and prohibit plaintiffs from benefitting from their own breach of plan terms. This may, in turn, make settlement of such claims more difficult. In short, while the result in *Montanile* is a blow to ERISA plans, it may have negative consequences for both plans and participants alike.