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**SEREBOFF: ERISA SUBROGATION
REGAINS LIFE AFTER GREAT-WEST**

The Supreme Court's unanimous May 15, 2006 decision in *Sereboff v. Mid Atlantic Medical Services, Inc.*, clarifies the subrogation and reimbursement landscape for ERISA benefit plans that has been in flux for the four years since *Great-West Life & Annuity Insurance Co. v. Knudson*, 534 U.S. 204 (2002). In *Sereboff*, the Supreme Court renewed the life of plan subrogation and recoupment provisions by sustaining a plan's right to subrogation as equitable relief under § 502(a)(3) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), codified at 29 U.S.C. § 1132(a)(3), at least where there is an identifiable, traceable res that the plan seeks to recover.

In light of *Sereboff*, plans seeking to enforce subrogation provisions in plan documents are likely to intervene in underlying tort actions brought by plan participants that are pending in federal court or file injunctive actions in federal court under ERISA § 502(a)(3) to preserve their rights to recovery. Plans that, in light of *Knudson*, have deleted subrogation and recoupment provisions are likely to amend their documents to include such provisions again. Plans are further likely to include provisions that any tort recovery by a plan participant is to be held in trust for the repayment of benefits provided by the plan.

The Uncertainty Created by Knudson

As articulated by Justice Scalia on behalf of a five-justice majority, the issue facing the Supreme Court in *Knudson* was whether ERISA authorizes an insurance company to enforce a plan's subrogation provision where the insurance company had paid health benefits to a participant injured in an automobile accident but such funds were no longer separately identifiable nor clearly in the possession or control of the participant. The *Knudson* decision made clear that a characteristic of equitable restitution is that it seeks to impose a constructive trust or lien on "particular funds or property in the defendant's possession." Characterizing the relief sought where there were no identifiable funds or property as "in essence" a claim "to impose personal liability . . . for a contractual obligation to pay money," Justice Scalia on behalf of the *Knudson* majority held that the requested relief was not equitable in nature. Simply put, ERISA § 502(a)(3) does not extend to fiduciaries the remedy that ERISA § 502(a)(2) extends to "a participant or beneficiary" to file a federal civil action "to enforce his rights under the terms of the plan," unless the relief sought is equitable in nature.

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The facts in *Great-West* are relevant to an understanding of the Supreme Court’s holding. Respondent Jannette Knudson was rendered quadriplegic by a June 1992 accident involving a car manufactured by Hyundai Motor Company. A health plan provided by her husband’s employer, Earth Systems, Inc. (the “Plan”) covered \$411,157.11 of Jannette’s medical expenses. The Plan contained the following reimbursement provision that is similar to the reimbursement provision in *Sereboff*:

[The Plan shall have] the right to recover from the [beneficiary] any payment for benefits [paid by the Plan to which the beneficiary is entitled to recover from a third person]. [Specifically, the Plan has] a first lien upon any recovery, whether by settlement, judgment or otherwise [that the beneficiary receives from a third party, not to exceed] the amounts of benefits paid [by the Plan or] the amount received by the [beneficiary] for such medical treatment. . . .”

In 1993 the Knudsons filed an action in California state court against Hyundai and other tortfeasors. The parties negotiated a \$650,000.00 settlement that allocated \$256,745.30 to a special needs trust, \$373,426.00 to attorney fees and costs, \$5,000.00 to reimburse the California Medicaid Program, and, \$13,828.70 to reimburse Great-West’s subrogation claim under the Plan.

On the eve of the state court hearing to approve the settlement, Great-West intervened and purported to remove the state-court action to the Central District of California. Upon concluding that Great-West was not a proper defendant, the district court remanded the case to the state court, which then approved the settlement. The state court’s order directed the defendant tortfeasors to pay the settlement amount allocated to the special needs trust directly to the trust, with the remaining amounts paid to Jannette’s attorney, who tendered checks to Medi-Cal and Great-West.

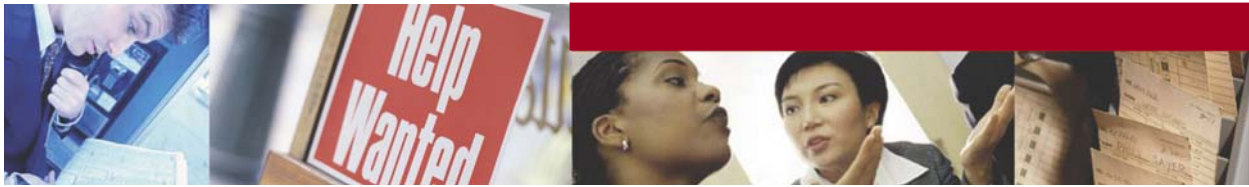
Great-West never cashed its check for \$13,828.70. Instead, at the time it sought to remove the pending state-court action, Great-West filed a separate action in the Central District of California seeking injunctive and declaratory relief under ERISA § 502(a)(3), *codified at* 29 U.S.C. § 1132(a)(3). Through this action, Great-West sought to enforce the Plan’s subrogation provisions and require the Knudsons to pay the Plan \$411,157.11 of any proceeds recovered from third parties.

Great-West subsequently added Earth Systems and the Plan as parties, seeking a temporary restraining order to stay the state-court proceedings. Upon denial of the temporary restraining order, which Great-West did not appeal, the state court approved the settlement and the money was disbursed. Great-West did not add to the district court action as parties the tortfeasors who paid the settlement, the special needs trust or Respondents’ attorneys who received the settlement proceeds. Following distribution of the settlement proceeds to the special needs trust and the attorneys, the district court granted summary judgment to the Knudsons,

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holding that the Plan's language limited Great-West's right of reimbursement to \$13,828.70. The Ninth Circuit affirmed on a separate ground, *viz.*, "that judicially decreed reimbursement [subrogation] for payments made to a beneficiary of an insurance plan by a third party is not equitable relief and is therefore not authorized by §502(a)(3)."

In affirming the Ninth Circuit, the five-justice *Great-West* majority adhered to its decision in *Mertens v. Hewitt Associates*, 508 U.S. 248, 257-58 (1993), and held that "appropriate equitable relief" under ERISA §502(a)(3), does not include claims for "money damages" that are "the classic form of *legal relief*." *Quoting Mertens*, 508 U.S. at 255; italics in original. Justice Scalia also reasoned that Great-West's subrogation claim could not be characterized as a fiduciary's action "to enjoin a[n] act or practice which violates. . . the terms of the plan," because an injunction to compel the payment of money is not typically available in equity. As a result, the *Great-West* majority established the principle that unless the remedy is "typically available in equity" it is not permissible under ERISA § 502(a)(3), *codified at* 29 U.S.C. § 1132(a)(3).

Knudson's Progeny

Within months of *Knudson*, the Fourth Circuit held that *Great-West* does not totally bar a plan's right to subrogation:

The Court indicated that if the plan administrator had been seeking an equitable lien on particular property in the hands of the plan beneficiaries, such a suit would sound in equity and would be authorized by § 502(a)(3). *Id.* 122 S. Ct. at 714-15. *Knudson* therefore does not affect the conclusion of the bankruptcy and district courts that Wal-Mart has an enforceable equitable lien on Carpenter's settlement proceeds.

In re Carpenter, 2002 U.S. App. LEXIS 10615, at [*10]-[*11] (4th Cir. June 3, 2002) (unpublished). Other courts, such as the Sixth Circuit in *Qualchoice, Inc. v. Rowland*, 367 F.3d 638 (6th Cir. 2004), held that no right exists for subrogation even as to an identifiable *res*.

The Sereboff Holding

To resolve the split in the circuits, the Supreme Court granted certiorari in *Sereboff*. The Supreme Court held that where there were "specifically identifiable' funds" that were "within the possession and control of the Sereboffs," a constructive trust or equitable lien, each of which the Court held to be a traditional equitable remedy, could be imposed in favor of the plan. As a result, *Sereboff* stands for the proposition that ERISA § 502(a)(3) authorizes a plan to enforce its subrogation and recoupment provisions as to identifiable funds in the possession of a participant.





Likely Effect of Sereboff

Sereboff, which was narrowly drafted by Chief Justice Roberts to address the equitable nature of a specific restitutionary remedy, is likely to impact only a plan's ability to recover those benefits reimbursed by a tortfeasor, as well as recoupment of overpayments and erroneous payments that can be traced as specific funds in the participant's possession. *Sereboff* has no concurrence, such as Justice Ginsburg's concurrence in *Aetna Health Inc. v. Davila*, 542 U.S. 200 (2004), which can be cited as supporting reconsideration of the fundamental *Knudson* principle that ERISA § 502(a)(3) allows traditional equitable remedies.

Finally, *Sereboff* does not authorize plans to enforce subrogation provisions where assets are neither in the participant's possession nor specifically identifiable because intermixed with general assets. Plans must proactively seek to recover assets. Because ERISA § 502(a)(3) is enforceable only in federal court, a plan must intervene in underlying tort actions pending in federal court or file an injunctive action in federal court to enforce the plan's rights to restitution.

If you have questions about the impact of *Sereboff* or how your plan should respond to this case, please contact any of the following Thompson Hine attorneys:

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