NINTH CIRCUIT HOLDS ERISA DOES NOT PREEMPT STATE-COURT SUITS SEEKING REIMBURSEMENT FROM PLAN PARTICIPANTS

By Harvey L. Rochman and Joanna S. McCallum

The Ninth Circuit Court of Appeals surprised many when it ruled last month that employer-provided health plans can sue in state court to enforce provisions requiring participants to reimburse the plans for medical costs paid by third parties. Despite contrary state and district court rulings, the bold decision in Providence Health Plan v. McDowell holds that such state-court breach of contract actions are not preempted by ERISA. If the decision survives likely petitions for rehearing and certiorari, it will point the way for plans operating within the Ninth Circuit to enforce standard reimbursement provisions and ease a conflict between ERISA’s preemption provisions and its limited remedies that threatened to prevent efficient enforcement of health plans’ economically important reimbursement rights.

Most health plan agreements provide a right of reimbursement, triggered when a participant recovers damages from a third party that include payments for medical expenses. McDowell involved ERISA plan participants injured in an automobile accident. Providence Health Plan, the McDowells’ employer-provided insurer, paid for their care. Their plan stated that they would reimburse Providence up to the amount of benefits provided, less proportionate attorneys’ fees, if they recovered from a third party. The McDowells also signed agreements directing their attorney to reimburse Providence if they recovered from a third party. Later, the McDowells settled their personal injury lawsuit. When the McDowells refused to reimburse the plan, Providence sued in Oregon state court alleging that the McDowells breached the plan reimbursement agreement and the separate promise to direct their lawyers to reimburse the plan.

ERISA, however, has posed significant hurdles in both state and federal courts for employer-provided health plans seeking to enforce similar rights. On one hand, state court remedies appeared to be unavailable. Although outside of
the ERISA context, reimbursement rights are routinely enforced under the laws of most states, state courts have held that breach of contract actions by health plans seeking reimbursement are preempted by ERISA because they involve enforcement of plan provisions. See Liberty Northwest Insurance Corporation v. Kemp, 192 Or. App. 181 (2004); Jefferson-Pilot Life Insurance Company v. Kraftka, 50 Cal. App. 4th 190 (1996). On the other hand, in Great-West Life & Annuity Insurance Company v. Knudson, 534 U.S. 204 (2002), the Supreme Court severely limited the ability of employer-provided health plans to obtain reimbursement, holding that plans could not sue under ERISA to enforce reimbursement agreements or for restitution of benefits paid. Thus, it appeared that ERISA plans were stuck in a Catch-22, with no viable state or federal mechanism to enforce reimbursement provisions.

In Great-West, the Supreme Court indicated that an employer-provided health plan might be able to enforce reimbursement provisions under ERISA through the equitable remedy of a constructive trust on the funds paid by a third party for medical costs, but the remedy would be available only if the participant had custody of the funds. Although other cases have recognized the constructive trust theory, the costs of the procedure (including seeking to enjoin disbursement pending the litigation) may be unreasonable compared to the amount at stake. See e.g., Administrative Committee of Wal-Mart Stores, Inc. Associs. Health & Welfare Plan v. Varco, 338 F.3d 680 (7th Cir. 2003). In McDowell, for example, Providence sought only $21,727.55, an amount easily swamped by the legal costs of elaborate enforcement procedures.

Providence’s efforts to obtain reimbursement illustrate the ERISA Catch-22. The McDowells removed Providence’s breach of contract case to federal court. That court dismissed the case on grounds of ERISA preemption, because Providence sought to enforce a provision of the McDowells’ ERISA plan. Providence sued again, in federal court, seeking specific performance of the reimbursement agreement. The court dismissed this action as well, finding that Providence was in fact seeking damages, a legal remedy not available under ERISA. That decision was fully consistent with Great-West and several recent
Ninth Circuit decisions, which held that health plans seek legal remedies when they attempt to enforce third-party reimbursement provisions against participants, and that such legal remedies are not available under ERISA, which provides only equitable relief. Together the rulings foreclosed relief for Providence.

In McDowell, the Ninth Circuit resolved the enforcement problems by holding that the most efficient solution – a state court breach of contract action – was not preempted by ERISA. As the court noted, the possibility of state-law enforcement was expressly left open by Great-West, in which the Supreme Court expressed “no opinion” whether “a direct action by petitioners against respondents asserting state-law claims such as breach of contract would have been pre-empted by ERISA.” Following that suggestion, the Ninth Circuit rejected the district court’s determination that the contract action was preempted. While the Ninth Circuit’s short analysis of the preemption issue may draw criticism, it follows the current trend of preemption analysis established by the Supreme Court’s watershed decision in New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Company, 514 U.S. 646 (1995), which began to limit the scope of ERISA preemption.

In Travelers, the Court rejected “uncritical literalism” in applying ERISA’s broad preemption provision, which covers state laws that “relate to” an employee benefit plan and has been interpreted as encompassing any state law with “a connection with or reference to” an ERISA plan. The Court criticized the “connection with” test, looking instead to the “objectives” of ERISA preemption – creation of a uniform body of benefits law – as “a guide to the scope of the state law that Congress understood would survive” preemption.

In McDowell, the Ninth Circuit summarized Travelers as a direction to read the preemption standard “practically, with an eye toward the action’s actual relationship to the subject plan.” The court said that a state law claim has a “reference to” an ERISA plan if it “is premised on the existence of an ERISA plan” and “the plan is essential to the claim’s survival.” Similarly, a claim has a
“connection with” an ERISA plan if the action has a “genuine impact” on a relationship governed by ERISA.

Although in a concrete sense the ERISA plan was “essential” to Providence’s contract claim because it contained the reimbursement provision, the court suggested focusing on that fact put form over substance, contrary to Travelers’ teachings. The court noted that adjudication of Providence’s claim did not require interpretation of the plan or dictate distribution of plan benefits. “Providence has already paid ERISA benefits on behalf of the McDowells, and they are not disputing the correctness of the benefits paid.” Providence simply sought to enforce contractual reimbursement from settlement proceeds, after the matters with which ERISA is concerned were concluded.

McDowell thus follows a path suggested by Great-West and takes a further step in the direction established by Travelers. The question raised by McDowell is whether the relatively new practical focus on preemption’s “objectives” can overcome the fact that state contract actions do, at least technically, seek to enforce plan provisions. If state courts follow its analysis of federal law, McDowell may clear the way for efficient plan enforcement of participants’ reimbursement obligations in the Ninth Circuit and help relieve economic pressures on ERISA plans.

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