FEATURE ARTICLE
August / September 2006

Supreme Court Approves Enforcement of Reimbursement Provisions in ERISA Plans

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On May 15, 2006, the United States Supreme Court decided *Sereboff v. Mid-Atlantic Medical Services, Inc*. (2006) 547 U.S. ___, 126 S. Ct. 1869, 164 L. Ed.2d 612, authorizing ERISA plans to enforce reimbursement provisions in their plan documents against plan members for health care expenses recovered in personal injury cases. The High Court distinguished its 2002 decision in *Great West Life & Annuity Ins. Co. v. Knudson* (2006) 534 U.S. 204, which had denied reimbursement to a plan, on the basis that the plan in *Knudson* had failed to sue the person or entity (a Special Needs Trust) which was holding the personal injury recovery.

Facts in *Sereboff v. Mid-Atlantic*

Mr. and Mrs. Sereboff were insured by a group benefit plan subject to ERISA when they were injured in a car accident in California. The plan, administered by Mid-Atlantic, paid about $75,000 in medical expenses on behalf of the Sereboffs. The plan contained an "Acts of Third Parties" provision which entitled the plan to be reimbursed from any recovery from a third-party action without regard to whether the beneficiaries recovered their full damages claimed. The plan also included a common fund provision allowing a deduction for "reasonable attorney's fees and court costs" from the recovery due the plan. [Author's note: It is necessary to read the Fourth Circuit's decision in *Sereboff* at 407 F.3d 212 to gain a full understanding of the facts, including the existence of the common fund provision in the plan.]

The Sereboffs filed a personal injury action in California which was eventually settled for $750,000. Mid-Atlantic had sent several letters to the Sereboffs and their attorneys asserting a lien against the anticipated proceeds from the action. The attorneys responded to Mid-Atlantic by indicating that such liens were not recognized by the Ninth Circuit. Upon settlement of the case, the

Sereboffs' attorneys disbursed to their clients without honoring the claim of lien or reserving any funds in trust. The Sereboffs in turn placed the recovery in their investment accounts.

As a consequence, Mid-Atlantic filed suit in the District Court of Maryland where the plan was apparently administered. It should be noted that 29 U.S.C. §1132(e) grants jurisdiction to federal district courts anywhere the plan is administered. There is no reference in the cases to any motion attacking jurisdiction or moving to change venue. Mid-Atlantic sought a TRO and preliminary injunction to prevent the Sereboffs from disposing of the settlement funds until the lawsuit was resolved. As a result, the Sereboffs formally stipulated to preserve the $75,000 in dispute until the case was finally resolved.

Mid-Atlantic sued for constructive trust and enforcement of an equitable lien among other theories. Mid-Atlantic filed a motion for summary judgment and the Sereboffs filed a motion to dismiss. The motion to dismiss was denied and the summary judgment was granted. The court then reduced the judgment by the prorated amounts of the Sereboffs' fees and costs in recovering the $75,000. Mid-Atlantic then moved for attorney's fees under ERISA and the court awarded it $19,000 in fees.

The Sereboffs appealed the reimbursement award and the attorney's fee award. Mid-Atlantic cross-appealed the ruling allowing the common fund reduction. The Fourth Circuit affirmed the district court's decision allowing reimbursement as a proper equitable remedy and the common fund reduction per the terms of the contract. It then vacated and remanded the attorney's fee award against the Sereboffs because the court had not properly considered all of the relevant factors. The Sereboffs petitioned the United States Supreme Court for *certiorari* based upon the split of opinion in the federal circuit courts over the enforceability of reimbursement provisions as proper equitable relief authorized by ERISA.[i] The Supreme Court granted *certiorari* to resolve the split in authority.

Supreme Court's Holding

The Supreme Court framed the issue presented in its simplest form: "The only question is whether the relief Mid-Atlantic requested from the District Court was 'equitable' under §502(a)(3)." *Sereboff v. Mid-Atlantic, supra,* 164 L.Ed.2d at 619. The High Court noted that ERISA allows a plan only to sue for equitable relief. The Court relied upon *Barnes v. Alexander* (1914) 232 U.S. 117 (1914) (on appeal from the Supreme Court of the *Territory* of Arizona), as authority for the proposition that Mid-Atlantic could impose a constructive trust or equitable lien on the proceeds of a third-party lawsuit as soon as the proceeds reached the Sereboffs' hands. The Court cited Justice Holmes' opinion in *Barnes, supra,* for "'the familiar rule of equity that a contract to convey a specific object even before it is acquired will make the contractor a trustee as soon as he gets a title to the thing.'" *Sereboff v. Mid-Atlantic, supra,* 164 L.Ed.2d at 620, quoting from *Barnes v. Alexander, supra,* 232 U.S. at 121.

The Court distinguished its holding in *Knudson, supra,* by emphasizing that the plan in *Knudson* had sued the plan beneficiaries rather than the Special Needs Trust which had actual possession of the settlement funds. Consequently, the *Knudson* decision held that an action for restitution against the plan beneficiaries was really nothing more than an action at law for damages. As such, it did not constitute appropriate equitable relief available to a plan under ERISA. However, the *Sereboff* Court backed away from the detailed dicta in *Knudson* of what would be required to

constitute appropriate equitable relief in the form of a constructive trust or equitable lien. The Court also rejected the strict tracing and ownership interest suggested in the *Knudson* dicta.[ii]

The High Court then rejected the Sereboffs' claim that the "make whole" rule should apply to the plan's claim, which was essentially for equitable subrogation. The Court held that such a doctrine would not apply, reasoning:

> **But Mid-Atlantic's claim is not considered equitable because it is a subrogation claim. As explained, Mid-Atlantic's action to enforce the "Acts of Third Parties" provision qualifies as an equitable remedy because it is indistinguishable from an action to enforce an equitable lien established by agreement, of the sort epitomized by our decision in *Barnes*. See, 4 Palmer, Law of Restitution §23.18(d), at 470 (A subrogation lien "is not an express lien based on agreement, but instead is an equitable lien impressed on moneys on the ground that they ought to go to the insurer"). Mid-Atlantic need not characterize its claim as a freestanding action for equitable subrogation. Accordingly, the parcel of equitable defenses the Sereboffs claim accompany any such action are beside the point.**

Sereboff v. Mid-Atlantic, supra, 164 L.Ed.2d at 623-624.

The Sereboffs attempted to argue that the equitable relief sought by Mid-Atlantic was not "appropriate equitable relief" under 29 U.S.C. §1132(a)(3) because "it contravened principles like the make-whole doctrine." *Id.* at 624. The Supreme Court refused to decide this issue because the argument was not made as a distinct assertion in the lower courts, noting, "We decline to consider it for the first time here." *Id.* at 624, fn. 2.

Based primarily on the *Barnes* case, the Supreme Court held that Mid-Atlantic's action sought equitable relief under 29 U.S.C. §502(a)(3) of ERISA and affirmed the Fourth Circuit's decision in relevant part.

ANALYSIS AND IMPLICATIONS OF *SEREBOFF*

It is quite likely that the *Sereboff* decision will permit enforcement of ERISA reimbursement/subrogation cases when a self-insured plan, with a provision waiving the make-whole doctrine, sues the person holding the settlement funds for constructive trust or equitable lien.

There are a number of pertinent issues not decided by the High Court in *Sereboff*. For example, when the plan does not include a waiver of the make-whole doctrine, it appears likely that this equitable defense would survive. Moreover, when there is an *insured* plan, the provisions of California Civil Code §3040 would presumably apply to limit the recovery, due to the "saving clause" in ERISA's preemption provision, 29 U.S.C. §1144, providing that, "nothing in this title shall be construed to exempt or relieve any person from any law of any State which regulates insurance . . . ."

The *Sereboff* decision does not stand for the proposition that the common fund doctrine applies to ERISA reimbursement actions because the plan provision in *Sereboff* contained a common fund reduction.[iii] Therefore, the application of the common fund doctrine remains an open question, as does the effect of plan provisions waiving common fund. However, in *Empire Healthchoice*

Assurance, Inc. v. McVeigh, No. 05—200 (U.S.S.C. June 15, 2006), the Supreme Court in *dicta* suggested possible support for the common fund doctrine in a FEHBA reimbursement action.[iv]

The issue of whether an action in equity to enforce subrogation without regard to the make-whole doctrine constitutes "appropriate equitable relief" is also undecided by *Sereboff* as is expressly noted in footnote 2 in the opinion.

Factually and procedurally, *Sereboff* was a poor case to reach the Supreme Court for a number of reasons. First, because there was a $75,000 lien and a $750,000 recovery, no obvious issue of under-compensation of the victims was presented. Second, the plan provision in question waived the make-whole doctrine. Third, the case was allowed to proceed in the ERISA- friendly Fourth Circuit instead of the Ninth Circuit, where such actions have been uniformly dismissed. There is nothing in the record suggesting that any motion to quash summons or to change venue from the Fourth Circuit was made. 29 U.S.C. §1132(e) provides that an ERISA action can be filed wherever a plan is administered and also provides for nationwide service of process. In order to protect a California plan member from being forced to defend in a distant forum, it is important in cases like *Sereboff* to move to quash summons on the basis of the minimum contacts rule and, in the alternative, to move to change venue based upon *forum non conveniens*.

Had the case been transferred back to the Ninth Circuit as a more convenient forum, it likely would have been dismissed based on the authority of *Carpenters H&W Trust v. Vonderharr* (9th Cir. 2004) 384 F.3d 667. In *Vonderharr*, the Ninth Circuit held, under the Supreme Court dicta in *Knudson, supra*, that no action for constructive trust or equitable lien would lie against ERISA participants who had merely submitted their claims for ERISA health benefits and then stood on their rights under ERISA. The *Vonderharr* decision expressly held that such an action required fraud or wrongful conduct to proceed. This likely would have forced the Supreme Court to address the necessary elements for a constructive trust cause of action. Traditionally, fraud, mistake or "other wrongful conduct" has been necessary in order to impose a constructive trust. See, *e.g.*, California Civil Code §2224.

It is unclear from the *Sereboff* decision whether the Supreme Court intended to modify the elements of a constructive trust cause of action in ERISA cases. It is clear that the Solicitor General was urging the Court to approve constructive trust actions whenever the ERISA plan had located the holder of the funds and sued that person or entity. The Solicitor General filed such a brief, at the Court's request, in *Vonderharr, supra*, and advised the Court to grant *certiorari* in *Sereboff* because *Vonderharr* had been settled. The adoption of such a rule of "automatic constructive trust" would constitute a major change in the law. There is no discussion in either the Fourth Circuit or Supreme Court opinions of the elements necessary for a constructive trust. Consequently, it may be worth arguing that the necessary factual basis for a constructive trust or equitable lien action has been resolved in the victims' favor by the Ninth Circuit and was not addressed by the Supreme Court.

Another argument that might prove useful arises in cases in which significant under-compensation exists due to policy limits or other constraints. If the policy limits in *Sereboff* had been $50,000, one wonders whether the Supreme Court's opinion might have been considerably different. In such a case, the victim's attorney could argue convincingly that $50,000 in medical expenses had not been recovered. Rather, equity would seem to dictate that some apportionment should be made

based upon the relative size of the claims for loss of earnings and other damages. Otherwise, the ERISA plan would be allowed to recover its medical expenses paid primarily from the victim's award for loss of earnings, general damages, etc. Support for an argument about the recovery about various damages claims can be found in the language of *Sereboff* itself, quoting *Barnes, supra,* for "'the familiar rule of equity that a contract to convey a specific object even before it is acquired will make the contractor a **trustee as soon as he gets a title to the thing**.'" *Sereboff v. Mid-Atlantic, supra,* 164 L.Ed.2d at 620, 623, quoting from *Barnes v. Alexandra, supra,* 232 U.S. at 121 (emphasis added). Note that this quote from *Barnes* is considered so controlling that it is twice quoted fully in the *Sereboff* opinion. One could certainly argue in the $50,000 hypothetical that since the victim would recover less than 5% of his total damages, he must have recovered less than 5% of his medical damages. As such, can it seriously be argued in equity that the "title to the thing" that he obtained was solely medical damages?

By way of analogy, this argument finds support in two other recent Supreme Court cases. In *Arkansas Dept. of Health & Human Services v. Ahlborn* (2006) 126 S. Ct. 1752, 164 L.Ed. 2d 459, decided 5/1/06, the High Court held that a state Medicaid agency (like Medi-Cal) would be limited in its statutory entitlement to reimbursement from a recipient's personal injury case when the recovery was limited by virtue of the recipient's own comparative negligence. Because the recipient was 5/6 at fault, the Court limited DHHS to 1/6 of its statutory lien, as being the only amount of DHHS-paid medical bills that the recipient had actually recovered.[v]

Likewise, in *Fitch v. Select Products* (2005) 36 Cal.4th 812, the California Supreme Court held that Medi-Cal was not entitled under the Medicaid statutes to recover its medical expenses paid to a recipient from his heirs' wrongful death action. The California Supreme Court's reasoning was that such medical expenses were only recoverable in a survival action and therefore, as a matter of law, had not been recovered in the wrongful death action. Thus, whenever one can show convincingly that the full medical damages were not recovered in the victim's injury case, one should make this argument.

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[i] The Sixth and Ninth Circuit Courts of Appeal have refused to recognize an ERISA plan's cause for reimbursement, holding it is a legal remedy not allowed under ERISA. However, the Fourth, Fifth, Seventh and Tenth Circuit Courts have allowed ERISA plans to seek recovery from specifically identifiable tort-recovery proceeds within the possession and control of the plan participant or beneficiary, holding that such actions are equitable in nature.

[ii] For an analysis of the Supreme Court's decision in *Great West v. Knudson* (2002) 534 U.S. 204, see the author's article in ***Trial Bar News***, Vol. 28, Issue 8, August/September 2005 at page 9. In *Knudson, supra,* the Supreme Court affirmed the established position of the Ninth Circuit precluding enforcement of reimbursement/subrogation provisions in ERISA plans under the facts of that case. The Supreme Court held that this type of restitution was legal in nature, rather than equitable, because it sought to impose personal liability on the beneficiary who was not in possession of the funds. The Court in dicta described in detail what would be necessary to constitute a constructive trust or equitable lien that would constitute "appropriate equitable relief" under ERISA.

[iii] The plan in *Sereboff* had appealed the District Court's allowance of the common fund reduction, arguing that the Sereboffs' refusal to cooperate voided the effect of the provision. This argument was rejected by the Fourth Circuit and apparently not subject to the petitions for *certiorari* to the Supreme Court.

[iv] The "Indeed it may" dicta at least shows some support from on high for common fund. This case was a FEHBA case for reimbursement in federal court that was dismissed for lack of federal jurisdiction.

[v] It is very interesting to note that *Sereboff* and *Ahlborn* are both unanimous decisions.