TORT LAW

***Sereboff* Revisited—Using the Title Argument to Minimize Liability for Medical Provider Liens**

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On May 15, 2006, the United States Supreme Court decided *Sereboff v. Mid Atlantic Services, Inc*. (2006) 126 S. Ct. 1869, 164 L. Ed.2d 612, authorizing ERISA plans to enforce reimbursement provisions against plan members for health care expenses recovered in personal injury cases. The Court distinguished its 2002 decision in *Great West Life & Annuity Co. v. Knudson* (2002) 534 U.S. 204, denying reimbursement to a plan, on the basis that the plan in *Knudson* had failed to sue the person or entity (a Special Needs Trust) holding the personal injury recovery. In the two plus years since *Sereboff* was decided, experience has revealed that the import of the decision is not as harsh for ERISA plan members as initially expected.

Facts in *Sereboff*

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 entitling the plan to be reimbursed from any recovery from the third party action without regard to whether the beneficiaries recovered their full damages. The plan also included a common fund provision allowing a deduction for "reasonable attorneys fees and court costs" from the recovery due the plan.[i]

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 Sereboff's 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.[ii] Mid Atlantic sued for constructive trust and enforcement of an equitable lien, among other theories. After losing in the trial court and the Fourth Circuit, the Sereboffs petitioned the Supreme Court for certiorari based upon the split in the federal circuits over the enforceability of reimbursement provisions as proper equitable relief authorized by ERISA. The Supreme Court granted certiorari to resolve the split in authority.

SUPREME COURT 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 Court relied upon *Barnes v. Alexander* (1914) 232 U.S. 117 (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 the lawsuit as soon as the proceeds reached the Sereboffs' hands. The *Sereboff* 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, supra*, 164 L.Ed. 2d at 620, quoting from *Barnes v. Alexander, supra,* 232 U.S. at 121.

The *Sereboff* Court distinguished its holding in *Knudson, supra*, from four years earlier by emphasizing that the plan in *Knudson* had sued the plan beneficiaries rather than the Special Needs Trust that was in possession of the actual settlement funds. Consequently, *Knudson* 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 constructive trust or equitable lien. The Court rejected the strict tracing and ownership interest suggested in the *Knudson* dicta.

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." *Sereboff, supra*, 164 L.Ed. 2d at 624. The 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 upon the *Barnes* case, the *Sereboff* Court held that Mid Atlantic's action sought equitable relief under Section 502(a)(3) of ERISA and affirmed the Fourth Circuit's decision in relevant part.

Impact of *Sereboff*

Sereboff clearly allows enforcement of ERISA reimbursement/subrogation cases when a self-funded plan, with a provision waiving the make-whole doctrine, sues the person holding the settlement funds for constructive trust or equitable lien.

Erisa Defenses Surviving *Sereboff*

However, there are a number of pertinent issues not decided by *Sereboff*. When there is no waiver of the make-whole doctrine, it appears likely that this equitable defense survives. In *Providence Health Plan v. Bush* (D.C. WA 2006) 461 F.Supp.2d 1226, the court held that the make whole doctrine applied as a complete defense to an ERISA plan's reimbursement suit post-*Sereboff*. Moreover, when there is an *insured* plan, the provisions of California Civil Code §3040 applies 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..." *Sereboff* does not stand for the proposition that the common fund doctrine applies because the plan provision therein contained a common fund reduction.[iii] The application of common fund remains an open question, as does the effect of plan provisions waiving

provisions waiving common fund. 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 virtue of footnote 2 in the opinion.

Likewise, there was no discussion by the Court of the legal requirements to establish a constructive trust. Traditionally, fraud, mistake or "other wrongful conduct" has been necessary in order to impose a constructive trust. See, *e.g.*, California Civil Code §2224. In *Carpenters H&W Trust v. Vonderharr* (9th Cir. 2004) 384 F.3d 667, cert. denied (2005) 126 S. Ct. 729, the Ninth Circuit held 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. *Vonderharr* expressly held that such an action required **fraud or wrongful conduct** to proceed. Since the *Sereboff* Court did not discuss this issue, one can argue that the *Vonderharr* ruling and its predecessor cases are still binding *stare decisis* on all district courts within the Ninth Circuit. The Ninth Circuit has not revisited this issue post-*Sereboff*.

***Sereboff* Title Argument**

The most significant pro-consumer argument to emerge from *Sereboff* is the apparent requirement that the constructive trust available to the ERISA plan be limited to those medical expenses paid by the ERISA plan that were actually recovered in plaintiff's injury action. Support for this argument 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. Alexander, supra,* 232 U.S. at 121 (emphasis added). Note that this quote from *Barnes* was considered so controlling that it was quoted two and one-half times in the *Sereboff* opinion. This "title" argument is identical to the more familiar equitable apportionment argument, but without the burdensome requirement imposed by California law of proving both procedural and substantive unconscionability. *See, Samura v. Kaiser* (1993) 17 Cal.Aoo.4th 1284.

By way of example, if a hypothetical plaintiff suffered a $2 million injury with $300,000 paid by his ERISA plan, but his recovery was limited to a $100,000 policy, one can clearly see that he did not recover title to $300,000 in medical bills or even $100,000. Rather, since this exemplar plaintiff recovered only 5% of his total damages, it is both reasonable and equitable to assume that he only recovered 5% of his medical expenses, or $15,000. Expressed as a mathematic formula, the calculation is: Total Recovery/Total Value of Injury X ERISA lien, or $100,000/$2 million X $300,000 = $15,000. Consequently, the plan should be limited to a constructive trust of only that $15,000 of the $100,000 to which plaintiff recovered title. This amount should be further reduced by virtue of the common fund doctrine.

This title argument finds support from two other recent Supreme Court cases. In *Arkansas Dept. of Health & Human Services v. Ahlborn* (2006)126 S. Ct. 1752, the 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 reduced 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.[iv] The *Ahlborn* Court emphasized that the Medicaid statute operated to assign rights only to recover medical expenses—not other damages recovered by plaintiff:

> **Again, the statute does not sanction an assignment of rights to payment for anything other than medical expenses--not lost wages, not pain and suffering, not an inheritance**.

Id. at 1761. The *Ahlborn* Court then held that since the tortfeasors had only paid one-sixth of the recipient's total damages, the state Medicaid program's recovery was limited to one-sixth of the amount it had expended on her medical bills, reasoning:

> **Here, the tortfeasor has accepted liability for only one-sixth of the recipient's overall damages, and ADHS has stipulated that only $35,581.47 of that sum represents compensation for medical expenses. Under the circumstances, the relevant "liability" extends no further than that amount.**

Arkansas v. Ahlborn, supra, 126 S. Ct. at 1761, n.9. 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 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.

The Sereboff title argument is useful only when it is needed most, *i.e.*, with a severely under-compensated plaintiff and an ERISA reimbursement provision that effectively waives the make whole rule. Many of these plan provisions purport to waive not only the make whole rule, but also the common fund doctrine. In such cases, self-funded ERISA plans can and do claim that they are entitled to 100% reimbursement, even if it leaves the seriously injured plaintiff with nothing whatsoever. The recent notorious Wal-Mart case is a prime example. *See, Administrative Committee of the Wal-Mart Stores, Inc. V. James A. Shank, Trustee* (2007) United States Court of Appeals for the Eighth Circuit, No. 06-3531.

CONCLUSION

The clear benefit of the *Sereboff* title argument is that it relies upon the law of equity and the language from the Supreme Court's own holding in order to provide significant lien relief to clients who are severely under-compensated due to artificial constraints on their recoveries. This benefits those clients who need it the most.

Reductions ranging from 79%-95% of what the ERISA plan would have been entitled to under a straight contractual interpretation of its reimbursement provision and/or Civil Code §3040 have been achieved. The plans agreeing to these reductions have included self-funded plans, insured plans and Kaiser. This frequently results in more than doubling the plaintiff's net recovery. While the *Sereboff* title argument has not yet been tested in court, it is quite possible that ERISA plans will be reluctant to jeopardize the *Sereboff* ruling which at least gives them Supreme Court sanction for their claims. In the equitable landscape of ERISA, plans must be careful to avoid overreaching and suffering erosion of the rights that they gained with the *Sereboff* decision.

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[i] 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.

[ii] 29 U.S.C. 1132(e) grants jurisdiction to federal district courts anywhere the plan is administered.
[iii] The plan in *Sereboff* had appealed the district court's allowance of the common fund reduction, arguing that the Sereboff's 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] It is very interesting to note that *Sereboff* and *Ahlborn* are both unanimous decisions.