TIC International Corporation
Benefit Administrators and Consultants

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CLIENT BULLETIN

U.S. Supreme Court Limits Reach of a Plan's Subrogation Clause Under ERISA Where The Participant Spends the $$

In the recent case of *Montanile v. Board Of Trustees Of The National Elevator Industry Health Benefit Plan, 136 S. Ct. 651 (2016),* the U.S. Supreme Court addressed the limits of subrogation clauses found in employee benefit plans regulated by the *Employee Retirement Income Security Act of 1974 (ERISA). ERISA*-governed health plans, including multiemployer health plans, often contain "subrogation clauses" requiring a plan participant to reimburse the plan for medical expenses if the participant later recovers money from a third party for his injuries.

In the instant case, the plan participant (Montanile) was seriously injured by a drunk driver, and his *ERISA* governed coverage under the National Elevator Industry Health Benefit Plan ("Plan") paid more than $120,000 for his medical expenses. Montanile later sued the drunk driver, obtaining a $500,000 settlement. Montanile then paid his attorneys' fees of $200,000 and repaid his attorneys about $60,000 that they had advanced him, leaving about $240,000 of the settlement to be distributed to Montanile. His attorneys held most of that sum in a client trust account. This included enough money to satisfy Montanile's obligations to the Plan.

The terms of the Plan allow it to demand reimbursement when a participant recovers money from a third party for medical expenses. The Plan states: "*Amounts that have been recovered by a [participant] from another party are assets of the Plan ... and are not distributable to any person or entity without the Plan's written release of its subrogation interest*."

The Plan also provides that "*any amounts*" that a participant "*recover[s] from another party by award, judgment, settlement or otherwise ... will promptly be applied first to reimburse the Plan in full for benefits advanced by the Plan ... and without reduction for attorneys' fees, costs, expenses or damages claimed by the covered person*." Participants must notify the Plan and obtain its consent before settling claims.

In addition to these Plan provisions, Montanile signed a reimbursement agreement reaffirming his obligation to reimburse the Plan from any recovery he obtained "*as a result of any legal action or settlement or otherwise*."

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After Montanile's settlement, the Board of Trustees of the Plan sought reimbursement from Montanile on behalf of the Plan. Montanile's attorney argued that the Plan was not entitled to any recovery. The parties attempted but failed to reach an agreement about reimbursement. After discussions broke down, Montanile's attorney informed the Board that he would distribute the remaining settlement funds to Montanile unless the Board objected within 14 days. The Board did not respond within that time, so Montanile's attorney gave Montanile the remainder of the funds.

Six months after negotiations ended, the Board sought reimbursement from the settlement under the Plan's subrogation clause and sued Montanile in District Court under ERISA section 502(a)(3), which authorizes plan fiduciaries to file suit "*to obtain ... appropriate equitable relief ... to enforce ... the terms of the plan*.". The Board sought an "equitable lien" on any settlement funds or property in Montanile's possession and an order enjoining Montanile from dissipating any such funds. Montanile argued that because he had *already spent* almost all of the settlement, no identifiable fund existed against which to enforce the lien. The District Court rejected Montanile's argument, and the Eleventh Circuit affirmed, holding that even if Montanile had completely dissipated the fund, the Plan was entitled to reimbursement from Montanile's general assets.

The Supreme Court Reverses the Lower Courts

The Supreme Court granted certiorari to resolve a conflict among the Courts of Appeals over whether an *ERISA* fiduciary can enforce an equitable lien against a defendant's *general assets* under these circumstances when the defendant spent the settlement prior to repaying the plan. The Court noted its prior cases did not address whether a plan is still seeking an equitable remedy when the defendant, who once possessed the settlement fund, has dissipated it all, and the plan then seeks to recover out of the defendant's general assets. For those interested in the Court's evolution of its treatment of subrogation clauses and *ERISA*, the case contains a discussion of all the intricacies of equitable remedies, equitable liens, etc., found in earlier cases.

To resolve this issue, the Court turned to standard equity treatises. Those treatises made clear that a plaintiff could ordinarily enforce an equitable lien only against *specifically identified funds* that remain in the defendant's possession or against *traceable items* that the defendant purchased with the funds (*e.g.,* identifiable property like a car). *A defendant's expenditure of the entire identifiable fund on nontraceable items (like food or travel) destroys an equitable lien.* The plaintiff then may have a personal claim against the defendant's general assets—but recovering out of those assets is a *legal* remedy, not an equitable one.

The Court held (8-1) that when an *ERISA*-plan participant wholly dissipates a third-party settlement on nontraceable items, the plan fiduciary may not bring suit under *ERISA* Section 502(a)(3) to attach the participant's separate assets because the suit is not one for "appropriate equitable relief" but in such a scenario the relief sought is legal. Undissipated assets that could be traced would apparently still be subject to a claim for "equitable relief." In this case, it was unclear whether the participant had dissipated all of his settlement in this manner so the Court remanded the case back to the District Court for further proceedings.

In response to the Plan's arguments that the Court's interpretation would cause troubles for health plans with subrogation language, the Court stated:

> More than a decade has passed since we decided *Great-West*, and plans have developed safeguards against participants' and beneficiaries' efforts to evade reimbursement obligations. Plans that cover medical expenses know how much medical care that participants and beneficiaries require, and have the incentive to investigate and track expensive claims. Plan provisions—like the ones here—obligate participants and beneficiaries to notify the plan of legal process against third parties and to give the plan a right of subrogation.
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> The Board protests that tracking and participating in legal proceedings is hard and costly, and that settlements are often shrouded in secrecy. The facts of this case undercut that argument. The Board had sufficient notice of Montanile's settlement to have taken various steps to preserve those funds. Most notably, when negotiations broke down and Montanile's lawyer expressed his intent to disburse the remaining settlement funds to Montanile unless the plan objected within 14 days, the Board could have—but did not—object. Moreover, the Board could have filed suit immediately, rather than waiting half a year.

The Ginsburg Dissent

Justice Ginsburg's dissent was classic, a portion of which is excerpted below:

> Montanile received a $500,000 settlement out of which he had pledged to reimburse his health benefit plan for expenditures on his behalf of at least $121,044.02. He can escape that reimbursement obligation, the Court decides, by spending the settlement funds rapidly on nontraceable items. What brings the Court to that bizarre conclusion? I would therefore affirm the judgment of the Court of Appeals for the Eleventh Circuit.

Conclusion

After *Montanile*, health plans will need to be diligent in enforcing their subrogation agreements as on one level the case encourages participants who receive an injury settlement to spend the monies to avoid an *ERISA* action against them. However, even if the individual spent all the monies quickly, the plan would still have the right to pursue a legal action against the individual. That seems like a hollow right if the individual lacks sufficient assets to pay any judgment the plan might obtain. Further, there is always the possibility the individual could seek bankruptcy court protection in the event the plan wins at trial and is awarded a monetary judgment.

There are several advantages for a plan to bring an action to enforce its subrogation rules under *ERISA* rather than under state law. First, suing for equitable relief under *ERISA* allows the plan to file in federal district court instead of state court where it would probably need to file in bringing a strictly legal action under state contract law. This provides access to a federal judiciary usually more familiar with *ERISA* than state court judges. In addition, there is a body of established caselaw and federal common law applicable to an *ERISA* action.

Finally, another distinct advantage to a plan in bringing an action under *ERISA* for equitable relief is that it allows for the fund to seek attorney's fees if it prevails.

Otherwise, attorney's fees are not generally awarded in non-*ERISA* legal actions barring some agreement or statute to the contrary.

It would seem that a plan could include in its subrogation language (and in any subrogation agreement the participant signs) a provision for attorney's fees in the event a lawsuit is brought by the plan to enforce the subrogation clause, whether legal or equitable in nature, and whether or not the participant has possession of the settlement funds. Courts have upheld plan requirements that state a participant who incurs medical expenses under the plan for which a third-party may be liable to the participant must sign a reimbursement/subrogation agreement. See, *Peterson v. Hotel Employees and Restaurant Employees,* 288 F.Supp.2d 1145 (D.Nev.2003).

In going a little further, the plan could require the participant's attorney sign the plan's subrogation agreement. One court approvingly called such an idea "novel." In that case, the plan's subrogation provision required both the injured plan participant/beneficiary and his attorney sign a Subrogation Agreement that read:

> "[Y]ou are required to reimburse the Fund in full from any recovery you or your eligible dependent may receive, no matter how it is characterized.... The Fund requires that you and/or your eligible dependent (if applicable) and **your** or your dependent's **attorney** fill out, sign, and return to the Fund office a subrogation agreement that includes a questionnaire about the accident. Your claim will not be deemed complete and will be pended for payment until your fully executed subrogation agreement is received by the Fund office. If it is not completed in a timely fashion [within 180 days after the accident], your claim will be denied. Furthermore, the Subrogation Agreement requires that the Fund receive first priority for reimbursement, 'before all others'."

Kress v. Food Employers Labor Relations Ass'n, 285 F.Supp.2d 678 (D.Md.2003)
Affirmed 391 F.3d 563 (4th Cir.2004)

It may even be possible to add language to the plan and subrogation agreement that requires the injured party (participant/beneficiary) and the attorney to sign an agreement that makes the unpaid monies subject to subrogation to the plan into "plan assets" and the injured party and the personal injury attorney into "fiduciaries" (much like unpaid employer contributions can become plan assets depending on the language of the collective bargaining agreement). In such a case, it seems the plan could bring an action under ERISA Section 502(a)(2)[1] for breach of fiduciary duty against the injured party and the attorney. The remedy for a fiduciary breach under ERISA Section 409[2] states the fiduciary *"shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate."*

[1] *ERISA* Section 502(a)(2) is codified in the United States Code (USC) at 29 USC 1132(a)(2).
[2] *ERISA* Section 409 is codified in the United States Code (USC) at 29 USC 1109.

In any event, Fund Counsel may wish to determine if any changes should be made to the Plan language and language of the plan's subrogation agreement. The Trustees may wish to review the administrative practices used to track possible subrogation claims. Plans may want to verify with participants early on if any claims are subject to the plan's subrogation provisions, closely monitor such claims and be vigilant[3] in protecting its subrogation rights by diligent action by the trustees and fund counsel.

Potential Effect to Pension Plans

Other commenters have noted that *Montanile's* tracing requirement may impact recovery of overpayments of disability or pension benefits under *ERISA* Section 502(a)(3). Pension plans generally have recoupment language allowing recovery of overpayment of benefits from individual recipients. This new "tracing" requirement applicable to equitable actions under *ERISA* Section 502(a)(3) may limit pension plans recoupment efforts when there is no distinct fund of money representing the overpayments. Overpayments in monthly pension benefits would probably be dissipated by daily living costs making pension overpayment recovery under *ERISA* Section 502(a)(3) doubtful under *Montanile*.

After *Montanile*, the old adage "*He who hesitates is lost*" takes on new vitality when it comes to enforcing a plan's subrogation provisions.

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[3] One commenter stated: "*The details in this case are particularly informative from that perspective. Frankly, this case never should have made it into court. The plan sponsor really dropped the ball and did not proactively pursue this money apparently until well after it was spent. What is worse is that the sponsor was warned well in advance by the participant's attorney that the assets in question were going to be distributed unless the plan took action. The plan didn't even respond here for some six months. It's a critical error and a critical contributing factor to this decision." (emphasis added)*