Do Plan Subrogation Provisions Survive the Supreme Court’s Decision in Great-West?

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Overview

In Great-West & Annuity Insurance Co. v. Knudson, [122 S. Ct. 708 (2002)] the U.S. Supreme Court held that ERISA does not authorize certain lawsuits to enforce a plan’s subrogation provision where the plan or its assignee seeks to impose personal liability on a participant or beneficiary for a contractual obligation to pay money. This article reviews that decision and suggests steps plan sponsors may consider in response to Great-West.

In a Nutshell

Great-West was seeking to enforce the plan’s subrogation provision under ERISA’s civil enforcement provisions. The crux of the dispute in Great-West was whether the remedy sought against the participants was for equitable restitution and therefore allowed under ERISA Section 502(a)(3), or whether the remedy was for legal damages, in which case the remedy would be unavailable under ERISA Section 502(a)(3). ERISA Section 502(a)(3) allows participants, beneficiaries, and fiduciaries to stop an act or practice that violates ERISA or to obtain other appropriate equitable relief to redress a violation of ERISA.

The Supreme Court concluded that because the participants were no longer in possession of the funds at the time Great-West brought the action, the basis of the lawsuit was for breach of contract and the remedy sought was for legal, not equitable, relief. The Court therefore concluded that such relief was unavailable.

Subrogation provisions, like the one at issue in Great-West, are common in many health plans. Subrogation provisions or plan reimbursement provisions allow a plan to recover medical expenses the plan has paid on behalf of a participant for injuries caused by someone else, as in the case of a participant who gets into a car accident and recovers money (from a third party) for injuries that were (caused by that third party). Under these types of provisions, the plan or its assignee generally retains the right to sue the third party directly. More typically, however, the participant will initiate an action against the third party, and the plan will later assert a right to any proceeds recovered in the course of the litigation. This usually leads to a dispute between the participant and the plan over who has the right to the proceeds.

Although the Supreme Court decided that Great-West did not have a remedy under ERISA, (in this case) it alluded to alternative avenues that plans could pursue to enforce subrogation provisions.
The Facts and Procedural History

In 1992, Janet Knudson was in a car accident and rendered a quadriplegic. She was covered under her then-husband’s medical plan, which was maintained by his employer, Earth Systems, Inc. (the plan). The plan paid $411,157 for Janet’s medical claims. Its subrogation provision provided that the plan would be entitled to recover any payment for benefits that a participant or beneficiary recovered from a third party. The subrogation provision also gave the plan a priority lien on recovered assets in an amount not to exceed the plan’s medical payments. The subrogation provision also stated that if the participant or beneficiary failed to reimburse the plan, the plan would hold the participant or beneficiary personally liable for the amount of the lien.

In 1993, Janet Knudson sued the maker of the car she was driving at the time of the accident and others in state court. When the case was ultimately settled for $650,000, a notice was sent to Great-West. The settlement agreement allocated $257,000 to a special needs trust to pay for Janet’s future medical needs, $374,000 to pay attorneys’ fees and costs, $5,000 to reimburse California Medicaid, and $14,000 to reimburse Great-West for Janet’s past medical expenses.

Great-West attempted a number of procedural maneuvers to stop the settlement from being approved by the state court but was unsuccessful. Great-West therefore sued the Knudsons in federal court under ERISA Section 502(a)(3) to enforce the plan’s subrogation provision and compel the Knudsons to reimburse the plan the full $411,157 it had paid to cover Janet’s medical expenses. The district court and the Ninth Circuit both ruled in favor of the Knudsons and Great-West appealed to the Supreme Court.

The Supreme Court’s Ruling

The Supreme Court held that Great West was seeking money damages from the Knudsons because they failed to comply with the plan’s subrogation provision. The Court held that Great-West, in essence, was suing the Knudsons for breach of contract and seeking to make them personally liable for the medical expenses the plan had paid on Janet’s behalf. This, the Court said, was the quintessential form of a legal remedy and legal remedies, under the facts here, are not allowed under ERISA. The Court rejected GreatWest’s arguments that it was seeking an injunction to stop an “act or practice” that violated the plan or, in the alternative, seeking monetary restitution from the Knudsons, both equitable remedies allowed under ERISA’s civil enforcement provisions.

The Court acknowledged that courts of equity frequently awarded monetary restitution, but stated that restitution was also a remedy awarded by courts of law. The Court said that historically a court of equity could impose a constructive trust or equitable lien on a person in possession of property or funds that in good conscience belonged to another. In such instances, a court of equity could then order a defendant to transfer title, in the case of a constructive trust, or grant a security interest, in the case of an equitable lien, to the plaintiff. When the defendant was not in possession of the assets or property, the case was typically brought in a court of law seeking damages against the defendant. Here, the Court said, the Knudsons were not in possession of the funds, since some of the funds were in the special
needs trust and some had been paid to the attorney. Great-West, it concluded, was therefore seeking to hold the Knudsons personally liable for a contractual obligation to pay money. This, the court said, was not equitable restitution, and therefore not a remedy allowed under ERISA Section 502(a)(3).

The Court, *in dicta*, stated that it was not saying that there was no way for Great-West to obtain the relief that it was seeking. For example, the Court suggested that Great-West might have been able to get reimbursed if it had intervened in the state-court tort action, or directly sued the Knudsons in state court for breach of contract. It also mused about whether Great-West might have been able to maintain an action under ERISA if it had asserted equitable relief against the trustee for the special needs trust and the Knudsons attorneys. In essence, the Court was inviting other types of actions to enforce subrogation provisions. The Court, however, did not comment on whether the alternatives would be successful or whether breach of contract actions against participants in state court would be preempted by ERISA.

**Analysis**

This case settles a split in the circuits concerning whether subrogation provisions are enforceable under ERISA when the relief seeks monetary restitution. The Supreme Court appears to answer that question in the negative, at least when the participant or beneficiary is no longer in possession of the funds or proceeds.

Subsequent to *Great-West*, courts have ruled that when the participant is in possession of the proceeds recovered from a third party, the action may proceed under ERISA for imposition of a constructive trust where the funds at issue are identifiable and traceable. [See *Administrative Comm. Of Wal-Mart Stores, Inc. Asoc. Health & Welfare Plan v. Varco*, 2001 WL 47159 (N.D. Ill Jan. 14, 2002); *Bauer v. Camrud, Maddock, Olson & Larson, Ltd.*, 2002 U.S. Dist. LEXIS 7246 (D.N.D. Apr. 22, 2002); *Mills Companies Employee Welfare Benefit Trust*, Case No. 02-C-032-S (WD. Wis. May 14, 2002); *Great-West Life & Annuity Ins. Co. v. Randall Brown*, No. 7:01-CV 40 (MD Ga. Mar. 26, 2002)] Courts are also allowing actions to proceed if the remedy sought is the enforcement of an equitable lien. [See *Wal-Mart Stores Inc. v. Carpenter (In re Carpenter)*, 4th Cit. No. 00-2348, unpublished 6/3/02, (plan’s action seeking to enforce an equitable lien against a bankrupt participant under a subrogation agreement was authorized under ERISA § 502 (a)(3)] If the participants are no longer in possession of the proceeds, like the Knudsons, courts have not allowed the action to proceed under ERISA. [See *Bauhaus USA, Inc. v. Copeland*, 2002 U.S. App. LEXIS 9559 (5th Cit. May 21, 2002)]

The *Great-West* decision will affect how subrogation rights are enforced by ERISA plans. Plans, in subrogation cases, commonly play a passive role in pursuing any recovery against a third party. Typically, the plan lets the participant obtain a recovery and then seeks repayment from the participant under the plan’s subrogation provision. After *Great-West*, plans should be more aggressive and actively involved in the participant’s litigation in order to recover funds. This will require better monitoring of participant suits and an ability to move promptly. Resort to state courts for the kind of relief the
Supreme Court denied Great West, (i.e., for legal rather than equitable relief) might allow the prior minimum-effort approach to continue. However, there are still issues regarding whether such state court actions are preempted by ERISA, and a number of states have laws and courts that are not friendly to subrogation claims.

**Conclusion**

The Supreme Court’s ruling in Great-West raises serious questions for all plans with subrogation provisions. A review of subrogation provisions and their enforcement procedures to ensure conformity to the Court’s recent ruling is advisable.

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