Supreme Court Sends ERISA Plans Racing to the Courthouse for Subrogation Recoveries

The Supreme Court of the United States recently handed down a decision that opens the door for participants in ERISA-covered benefits plans to stop a lawsuit against them in its tracks by doing something that most people love to do — spending money. In Montanile v. Board of Trustees of the National Elevator Industry Health Benefit Plan, the Court held that fiduciaries of an employee benefit plan governed by ERISA cannot exercise subrogation rights to recover settlement funds from a plan participant who has already spent the money on “nontraceable assets,” such as food, services, or travel.

The Montanile case presented a familiar fact pattern: A plan participant was injured by a third party (in this case, a drunk driver), and the plan paid for his initial medical care. The participant then sued the third party, resulting in a settlement. The plan’s board of trustees then sought to recover from the participant the amount the plan had initially paid.

Underlying the quest for recovery was the plan’s subrogation clause, which provided that “[a]mounts 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 further provided that “any amounts” a participant “recovery[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.”

It is well-settled that ERISA allows plan fiduciaries to obtain only equitable relief to enforce the terms of the plan. Therefore, to recover money in cases such as this, plan fiduciaries will typically ask a court to enforce an equitable lien against the funds the participant received, which are held separate and apart from the participant’s general assets. Here, because the participant had already taken possession of the funds, the board of trustees also sought an injunction to prevent him from spending the money. The U.S. District Court for the Southern District of Florida entered judgment in the board of trustee’s favor, ordering the participant to reimburse the plan, and the Court of Appeals for the Eleventh Circuit affirmed.

These decisions were in error, the Supreme Court held, to the extent that the participant had already spent the money on nontraceable assets. The rub is that when the funds are “dissipated” in a nontraceable way, there is no separate, identifiable fund against which an equitable lien can be enforced, and a plan is left to recover the money from the participant’s general assets. In other words, the only way the plan can be made whole is to collect money from the participant himself. This is a legal remedy which flies in the face of ERISA’s clear admonition that plans are limited to equitable relief, the Supreme Court reasoned.
This is true, the Court continued, even though the basis of the claim was equitable: “The Board [of Trustees] had an equitable lien by agreement that attached to Montanile’s settlement fund when he obtained title to that fund. And the nature of the Board’s underlying remedy would have been equitable had it immediately sued to enforce the lien against the settlement fund then in Montanile’s possession” (emphasis in original). However, the board of trustees waited too long, and by the time the lawsuit was filed, the settlement fund was gone — and so was the opportunity for a remedy in equity.

Lessons Learned

This case reinforces the idea that a subrogation clause is not enough to ensure that a plan will be able to recoup its payout from a plan participant in the event of a third-party settlement or other recovery. And if you think that having a plan participant sign a reimbursement agreement upon receipt of funds is enough to get the plan over the hump, think again. That’s exactly what the trustees did in Montanile, to no avail.

So what are plan fiduciaries to do?

First, make sure the plan requires participants to agree that they will convey the proceeds of any third-party settlement (or other recovery) back to the plan to the extent that the plan has paid out. But be aware that such a clause, or any other payback agreement, will not in and of itself transform a claim for repayment into a permissible request for equitable relief under ERISA or allow fiduciaries to bring the claim as a contract action.

Second, plans wishing to take a particularly pro-active approach may establish a litigation monitor for participants who receive payments from the plan. If a participant files a lawsuit which may result in recovery from a third party that would trigger the plan’s subrogation rights, then the plan may seek to intervene in that lawsuit to impose an equitable lien on any payments that would otherwise go to the participant.

Third, consider requiring plan participants to provide an accounting when they use payments received from a third party to purchase traceable assets. This will make it easier to identify specific property over which the plan seeks to exercise dominion, which the Supreme Court reminds us is key in these cases, noting: “[A]n equitable lien is simply a right of a special nature over [a] thing … so that the very thing itself may be proceeded against in an equitable action.”

Fourth, consider modifying the plan to create a clearly worded procedure that identifies the obligation to repay any overpayment and provides an expedited arbitration process under which the plan may be able to seek recovery at lower cost (and with a higher probability of success) as compared to litigation.

Fifth, if a plan participant’s attorney gives notice that absent objection, funds received from a third party (through settlement or otherwise) being held in a client trust account will be released to the participant, object. The board of trustees in Montanile failed to do so, and the Supreme Court made note of it.

When all else fails, and a plan participant refuses to repay amounts owed to the plan, be prepared to file a lawsuit fast. Remember: That individual now has more incentive than ever go on a spending spree, and once the money lands in his or her hands, the plan’s chances of recovery are likely to drop precipitously.
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