

H.R. ALERT*

J U N E 2 0 0 2

Guidance on Enforcement of Reimbursement and Subrogation Claims in Louisiana

On January 8, 2002, the United States Supreme Court issued a five-to-four decision in *Great-West Life & Annuity Ins. Co. v. Knudson*, 122 S.Ct. 708 (2002). The majority of the divided court held that an action brought by a group medical plan and its reinsurer against a participant to enforce the reimbursement provisions of the plan is not an action for equitable relief within the meaning of ERISA¹ Section 502(a)(3), but instead is a contractual obligation to pay money (*i.e.*, a legal action). As a result, the plan's (and reinsurer's) rights to reimbursement were strictly limited.

On May 21, 2002, the Fifth Circuit Court of Appeals issued its first holding after *Great-West*. In *Bauhaus USA, Inc. v. Copeland*, the court held that *Great-West* precluded an action for subrogation and/or reimbursement under facts similar to those presented in *Great-West*. On June 21, 2002, the Fifth Circuit denied the plan's petition for rehearing.

Impact of Great-West and Bauhaus

a. Holding of Great-West:

In *Great-West*, the plaintiff and his spouse were covered under a group medical plan maintained by her employer. The plan was a self-insured group medical plan, Great-West Life & Annuity Insurance Company was the third-party administrator and the reinsurer. As a result of a car accident, the plan paid medical benefits in excess of \$400,000. The Knudsons filed suit against the automobile manufacturer in state court; the case was settled, and the California Superior Court approved an allocation of only \$13,828 to Great-West for past medical claims. The remainder of the settlement was paid by the automobile manufacturer for attorneys' fees and deposited in a "special needs trust," which is a form of structured settlement arrangement available in California.

Great-West was not a party to the Knudson's state court action. Great-West did not cash its settlement check, but instead filed suit in federal court against the Knudsons seeking recovery of the additional medical benefits under ERISA Section 502(a)(3).

The Supreme Court affirmed the dismissal of the lawsuit, holding that the Knudsons were not proper parties to the lawsuit because they were not in possession of the amounts recovered in the state court action. As a result, the plan was not seeking "equitable relief" as required under ERISA Section 502(a)(3), but instead was seeking "legal relief," by attempting to enforce express plan terms against the Knudsons.

It is important to note that both the majority decision and the dissent indicate that a cause of action may be available in federal court under a plan's subrogation or reimbursement provisions, provided the relief sought can be characterized as equitable restitution.

b. The Holding of Bauhaus:

The minor dependent of an employee of Bauhaus was injured in an automobile accident. Although the plan terms did not provide coverage for injuries caused by a third-party, the plan paid medical claims of approximately \$46,000 on behalf of the minor. The plan further provided that if the plan elected to advance benefit payments, the plan was to be reimbursed from any recovery.

The minor settled her claims against the tortfeasor for \$750,000. A portion of the settlement was deposited into the registry of the Mississippi state court for the purpose of paying minor's obligations arising from the accident, including the plan's claims. The plan filed suits in both federal and state court, seeking to enforce its right of reimbursement under the plan terms. The legal basis for both suits was that the plan's right of reimbursement arose under an ERISA plan and that ERISA should preempt any state law requiring state court approval of the disbursement of the settlement proceeds.

The Fifth Circuit did not address the preemption argument, but instead strictly applied the holding of *Great-West*, dismissing the action because the plan was not seeking to enforce a contract right, and not equitable relief as required under ERISA.

* H.R. ALERT is intended to provide late-breaking news in the employment arena.

c. Subsequent Cases Since January 8th on Subrogation:

Since January 8th, there have been a number of cases in other jurisdictions that apply the holding of *Great-West*, finding that a proper subrogation or reimbursement claim survives. These cases generally illustrate how the “constructive trust” remedy may be used to pursue a subrogation or reimbursement action to establish an equitable claim.

A constructive trust exists under federal common law when money or other property identified as belonging in good conscience to the plaintiff (in this case, the plan) can clearly be traced to particular funds or property in the defendants’ possession. The cases suggest that when the plan files suit against the party who is actually holding the settlement funds (usually before disbursement for other

purposes), a “trust” may attach to the funds over which a federal court can assert jurisdiction under ERISA.

¹ All references are to the Employee Retirement Income Security Act of 1974, as amended (“ERISA”).

Employer Tip

In light of the recent pronouncements by the Supreme Court in *Great-West*, certain practical approaches are recommended and should be considered:

1. The time of filing a claim for reimbursement and subrogation is now critical; care must be taken to ensure that funds constituting a constructive trust can be identified with some certainty;
2. The designation of defendants is also critical; the named parties must be in physical possession of (or entitled to) the property constituting the constructive trust; and
3. Consider modifying plan language and ancillary plan documents to designate the participant (or other parties) as constructive trustees and identifying recovered amounts as being held in constructive trust for the benefit of the plan.

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Inquiries concerning topics addressed in the H.R. ALERT may be directed to Nan Alessandra, Jane Armstrong, or Susan Desmond. Your comments, questions, and suggestions are encouraged.

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