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OVERPAYMENTS IN LONG TERM DISABILITY CASES CAUSED BY THE RECEIPT OF SOCIAL SECURITY BENEFITS — WHAT MAKES A GOOD CASE WORTH FIGHTING OVER?

BY: R. CHANDLER WILSON

I. Introduction

Many people who become disabled file claims for both social security benefits and for benefits under long term disability policies ("LTD") provided by their employers. Most LTD policies are written so that the insurance company gets to take advantage of the favorable social security decision, reducing the LTD benefits paid by offsetting the social security benefits paid.

Frequently, people are paid their full LTD benefits for a while before they win their social security disability case. When they win their social security cases, and get back pay, the insurance companies claim less LTD should have been paid, so the insurance companies attempt to recover the disabled person's social security back benefits.

While insurance companies may have policy provisions that allow them to attempt to recover overpayments of LTD benefits, the insurance company cannot recover in every case. And, because the insurance company can often take the money out of future benefits, a fight over whether the insurance company can get the back pay might not get the person any more money in the end. This article explores the case law to help determine which those claims are worth fighting.

II. ERISA plan's rights of recovery and subrogation

A. ERISA subrogation law Post-*Knudson*

The Supreme Court addressed what remedies were available to an ERISA plan administrator in *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 122 S.Ct. 708, 151 L Ed 2d 635 (2002), a case that, for a while, changed the landscape of the ability of an ERISA LTD plan to seek and pursue claims for the recovery of money properly paid in the first instance from an ERISA beneficiary. Great West paid over $411,000 to medical providers treating injuries sustained by Janette Knudson. Ms. Knudson also sued Hyundai on a products liability theory for her injuries. Ms. Knudson settled with Hyundai for $650,000, allocating as part of the judicially supervised settlement a little more than $13,800 to repay Great West for its plan created lien on her personal injury claims. Great West sued for recovery of the entire amount of its lien, refusing to negotiate the check payable to it pursuant to the terms of the judicially supervised settlement. The Supreme Court held *inter alia* that ERISA did not permit Great West to pursue a legal remedy to enforce the terms of the plan. *Great-West Life*, 534 U.S. at 220-221 *citing* 29 U.S.C. § 1132(a)(3) (ERISA § 502(a)(3)). The Court's rationale rested on the form of restitution sought by Great West, a money judgment from undifferentiated assets of Ms. Knudson. Because that action is classified as "legal" rather than "equitable" the limited grant of authority given to plans and their fiduciaries by 29 U.S.C. § 1132(a)(3) deprived Great West of a cognizable theory of equitable relief under ERISA. The majority opinion written by Justice Scalia clearly states the law:

> We have observed repeatedly that ERISA is a "'comprehensive and reticulated statute,' the product of a decade of congressional study of the Nation's private employee benefit system." *Mertens v. Hewitt Associates,* 508 U.S. 248, 251 (1993) (*quoting Nachman Corp. v. Pension Benefit Guaranty Corporation,* 446 U.S. 359, 361 (1980)). We have therefore been especially "reluctant to tamper with [the] enforcement scheme" embodied in the statute by extending remedies not specifically authorized by its text. *Massachusetts Mut. Life Ins. Co. v. Russell,* 473 U.S. 134, 147 (1985). Indeed, we have noted that ERISA's "carefully crafted and detailed enforcement scheme provides `strong evidence that Congress did *not* intend to authorize other remedies that it simply forgot to incorporate expressly.'" *Mertens, supra,* at 254 (*quoting Russell, supra,* at 146-147).

In sum, *Knudson* stands for the following proposition: If an insurance company or other ERISA Plan Administrator provides benefits under a plan that is preempted by ERISA, and the administrator is seeking to recover from a beneficiary of the plan, the only cause of action available to the administrator is one found in ERISA. Under ERISA, the only cause of action available to the administrator is ERISA § 502(a)(3), which limits remedies to "equitable" remedies. The Supreme Court held that "equitable remedies" were the narrow set of remedies available in a court sitting in equity prior to the merger of equity and law courts. Thus, if an administrator is seeking to enforce the term of an insurance policy or similar document, the administrator is really seeking to enforce a contract, which is a cause of action at law, and not available under ERISA. However, the Court reserved the question whether or when equitable remedies are available to administrator.

B. *Sereboff* changes the law in favor of insurance companies

In the subsequent ERISA case of *Sereboff v. Mid Atlantic Medical Services, Inc.*, 547 U.S. 356 (2006), the pendulum swung almost all the way back to the insurance companies. The Sereboffs were involved in an automobile accident in California and suffered injuries; Mid Atlantic provided medical benefits to the Sereboffs totaling $74,869.37. Sereboffs filed a lawsuit against the tortfeasors. Mid Atlantic notified Sereboffs' attorney of its asserted lien on the anticipated proceeds from the suit over the two and a half years the case was pending; however after the case settled for $750,000 neither the Sereboffs or their attorney sent any money to Mid Atlantic.

Mid Atlantic filed a claim as an ERISA fiduciary under ERISA § 502(a)(3) to enforce the terms of the Plan, which gave Mid Atlantic a subrogation right. The Supreme Court distinguished *Great West v. Knudson* on the grounds that, in *Knudson*, the recovery in the underlying tort case was placed directly in a special needs trust, and was never in the hands of the Knudsons. Then, despite the clear language in Knudson that only equitable causes of action can provide an equitable remedy, the Court in *Sereboff* held that the character of the underlying cause of action does not "prove relief is not equitable; that would make § 502(a)(3)(B)(ii) an empty promise." *Sereboff*, 126 S.Ct. at 1874.

The Court relied on a 90 year old case, *Barnes v. Alexander,* 232 U.S. 117, 34 S.Ct. 276, 58 L.Ed. 530 (1914), for the proposition that equity provides for a rule "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." *Id.,* at 121, 34 S.Ct. 276. The Court then explained that, the Court's previous analysis in *Knudson* that equity only provided for certain remedies where the specific assets could be traced to specific funds did not provide a complete list of all available equitable remedies. The Court explained that:

> *Knudson* simply described in general terms the conditions under which a fiduciary might recover when it was seeking equitable restitution under a provision like that at issue in this case. There was no need in *Knudson* to catalog all the circumstances in which equitable liens were available in equity; Great-West claimed a right to recover in restitution, and the

> Court concluded only that equitable restitution was unavailable because the funds sought were not in Knudson's possession.

Sereboff at 1876. Thus, while *Sereboff* did not explicitly overrule *Knudson*, it effectively overruled most of *Knudson*, in that a plan administrator or ERISA fiduciary can recover money from a beneficiary to enforce the terms of the plan even without specifically being able to trace identifiable funds into the beneficiaries possession. Thus, the only part of *Knudson* that remained was that if the funds are not paid directly to the plaintiff, but are placed in a trust, then either a plan cannot recover, or would need to at least establish a constructive trust over the funds.

Lastly, the Court added insult to injury, by rejecting Sereboff's argument that any equitable claim by the ERISA fiduciary would be subject to equitable defenses. The Supreme Court explained that the fiduciaries claim was not truly an equitable claim, but rather was an ERISA claim to recover under the terms of the plan; therefore, "the parcel of equitable defenses the Sereboffs claim accompany any such action are beside the point." *Sereboff*, at 1877. Then, in footnote 2, the Court left the door open to arguments that, a recovery by a plan fiduciary that does not take into account equitable defenses, such as the made-whole doctrine, may not be an "appropriate" equitable remedy under ERISA § 502(a)(3), but, because that issue was not raised below, the Supreme Court declined to consider it for the first time. Therefore, the Supreme Court has left open the question whether equitable defenses, such as the made-whole doctrine, that was the rule in the Sixth Circuit prior to *Knudson*, are still available after *Sereboff*.

The main takeaway of *Sereboff* is that the Plan could recover to "enforce the terms of the plan" and that the relief sought was equitable. Thus, if an ERISA plan allows a recovery from a beneficiary, the likely outcome in most cases will be that the recovery will be allowed. However, ERISA does not provide for general equitable relief to enforce a subrogation claim as a general rule. ERISA's limited remedies only allow a plan to recover under the terms of ERISA or the terms of the plan. ERISA § 502(a)(3), 29 U.S.C. § 1132(a)(3).

C. *Montanile* swings the pendulum back in favor of claimants

Recently, in 2016, SCOTUS again addressed the remedies available to a plan fiduciary under ERISA in *Montanile v. Bd. of Trustees of Nat. Elevator Indus. Health Benefit Plan*, 136 S. Ct. 651, 193 L. Ed. 2d 556 (2016). The Court held that when an ERISA plan participant obtains funds from a third party that are subject to a reimbursement or subrogation claim, but spends the whole amount on "nontraceable items (for instance, on services or consumable items like food)," the plan fiduciary cannot maintain a suit under ERISA § 502(a)(3) to obtain a judgement to recover from the participant's other assets. *Id*. at 655. Specifically, "when a participant dissipates the whole settlement on nontraceable items, the fiduciary cannot bring a suit to attach the participant's general assets under [ERISA] § 502(a)(3) because the suit is not one for 'appropriate equitable relief.'" *Id.*

Montanile was severely injured by a drunk driver that ran a stop sign and the plan paid over $121,000 for Montanile's health care. Montanile ultimately settled his claim for $500,000. The plan had very strong language that gave it a first right of recovery without reduction for other damages, attorney's fees, etc.. The plan also required its written permission before any settlement funds could be distributed, and also required plan participants to notify the plan and obtain the plan's consent before settling any claim. Montanile also 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.' " *Id.* at 656.

The Court's opinion does not explain at what point the plan and Montanile's attorney began to communicate, but Montanile's attorney did originally keep Montanile's proceeds (more than enough to cover the subrogation claim) in his trust account while he negotiated with the plan. Montanile's attorney argued with the plan administrator that it was not entitled to any recovery, but attempted to settle the matter. After settlement discussions broke down, Montanile's attorney wrote to the plan administrator that he would distribute the remaining settlement funds to Montanile unless the Board objected within 14 days. The plan administrator did not respond within that time, and the attorney released the funds to Montanile. Six months after the settlement negotiations ended, the plan administrator sued Montanile under ERISA § 502(a)(3), 29 U.S.C. § 1132(a)(3). *Id.*

The Court explained that this case was another in the line of cases including *Mertens v. Hewitt Associates,* 508 U.S. 248 (1993), *Great–West Life & Annuity Ins. Co. v. Knudson,* 534 U.S. 204 (2002), and *Sereboff v. Mid Atlantic Medical Services, Inc.,* 547 U.S. 356 (2006) examining what is an "appropriate equitable remedy" available for an ERISA fiduciary under ERISA § 502(a)(3). In those cases, the Court had held that "equitable" was a limit on all remedies, and that word matters, and meant that it limited remedies to those available to courts of equity in equity cases. The Court emphasized that equitable remedies were not all the remedies that an equity court might grant, because in many cases, equity courts could provide legal remedies, but instead, "the term "equitable relief" in § 502(a)(3) is limited to 'those categories of relief that were *typically* available in equity' during the days of the divided bench (meaning, the period before 1938 when courts of law and equity were separate)." *Id*. at 657, citing *Mertens,* 508 U.S. at 256. The Court explained that "whether the remedy a plaintiff seeks "is legal or equitable depends on [(1)] the basis for [the plaintiff's] claim and [(2)] the nature of the underlying remedies sought." *Id.* citing *Sereboff,* 547 U.S. at 363. Also, to determine what is a "purely equitable remedy" the Court will rely on "standard treatises on equity, which establish the 'basic contours' of what equitable relief was typically available in premerger equity courts." *Id.,* citing *Knudson,* 534 U.S. at 217.

The Court noted further, as previously set out in *Sereboff,* the equitable cause of action that would be available to a plan in this situation was an equitable lien by agreement, and had the plan sued Montanile while the funds were still in his possession, the plan would have had an equitable remedy. The Court again examined equitable treatises and determined that an equitable lien could not be enforced,

> if the defendant once possessed a separate, identifiable fund to which the lien attached, but then dissipated it all. The plaintiff could not attach the defendant's general assets instead because those assets were not part of the specific thing to which the lien attached. This rule applied to equitable liens by agreement as well as other types of equitable liens.

Montanile, at 659. Therefore, because Montanile had spent the money, the plan could not recover.

The Court rejected several arguments by the plan administrator that some rules of equity would have allowed the recovery here, generally because those rules required exceptions that were not met here. The Court also rejected the general arguments that this outcome was inconsistent with ERISA's purposes and that tracking and participating in legal proceedings would be costly. The Supreme Court addressed the first point by explaining that the plain language of a statute cannot be overcome by a statute's general purpose. In response to the argument that plans would incur additional costs tracking litigation and settlements, the Court rejected this as inconsistent with the facts of this case. Here, the plan administrator had notice of the settlement in time that the plan could have taken steps to protect its lien while Montinale still had the funds; the plan "could have—but did not—object [within the 14 days notice the attorney gave] . Moreover, the Board could have filed suit immediately, rather than waiting half a year." *Id*. at 662.

Lastly, the Court remanded the case to the district court because the record was not clear whether Montanile in fact dissipated every penny of the settlement funds, or whether he still maintained some of the funds, because the plan could recover those funds that were not dissapated. *Id.* at *9.

III. Summary of the Case Law

As the title of this article explains, the remedies available to ERISA fiduciaries, and the obligations of ERISA participants and beneficiaries, have swung back and forth like a pendulum over the last 13 years. Beginning with *Great–West Life & Annuity Ins. Co. v. Knudson, supra*, in 2002, plans went from having no right to recover, to later cases where they could easily recover, to this case where plans face another significant hurdle.

Specifically, in *Knudson,* the Court set out two important rules. First, the Court held that an ERISA plan administrator's subrogation or reimbursement claim under the terms of an ERISA plan was essentially a cause of action to enforce a contract, which would be a legal cause of action, for which only a legal, not equitable, remedy would be available. Under that part of *Knudson*, ERISA plans essentially had no way to ever enforce a reimbursement clause in an ERISA plan. The second part of *Knudson* held that, even if a cause of action were available, equity would only allow a party to recover specifically identifiable funds, and not obtain a general judgment.

But, shortly after that, in 2006, the Court went the other way in *Sereboff v. Mid Atlantic Medical Services, Inc., supra.* Without specifically overruling *Knudson*, the Court in *Sereboff* made it very clear that ERISA § 502(a)(3) would be a nullity if no remedy were available. The court went all the way back to a 1914 case on "equitable liens by agreement" to allow the ERISA fiduciary to recover. But the court went further to say that strict tracing was not necessarily required, so long as the ERISA fiduciary properly seeks a remedy typically available in equity. Some lower courts essentially held this to be a "magic language" test; so long as the plan alleges it is seeking specifically identifiable funds, and the language of the plan allows for the recovery from specific funds, the fact that specific funds might not be identifiable was not a bar to ERISA fiduciaries and plans recovering, because “strict tracing” was not required. Thus, with carefully drafted plans and well-drafted pleadings, ERISA plans could recover subrogation or reimbursement claims with regularity. Also, in *Sereboff,* the plan participant argued that if equitable remedies were all that were available, then equitable defenses should be available too. The court refused to answer that question because it was not raised sooner, and allowed the ERISA plan to recover.

Now, in *Montanile* the pendulum has swung back the other way. *Montanile* clarifies that tracing is important, and not only must a plan have proper language, but the plan must also be able to specifically identify funds in the plan participant’s possession. It is significant that the Court said that the plan could have recovered had it acted quickly enough, but failed to act when it has the chance. Now, if a plan has notice of a settlement or funds in the participant’s possession, and fails to act before the funds are dissipated, the plan may have no recovery.

Most people receiving LTD benefits are living off those benefits month-to-month, and usually have dissipated those benefits by living off of them. When the disabled person is eventually awarded social security disability benefits, and the LTD fiduciary seeks to recover what it has paid, the LTD fiduciary usually cannot seek the specifically identifiable funds it paid, because those are gone. The social security benefits will be in the hands of the beneficiary, but there are several problems collecting those benefits. First, those are not the same dollars the LTD fiduciary paid, so the LTD fiduciary cannot claim it is seeking the same LTD dollars back. Second, if the plan allows the LTD fiduciary to recover the actual social security benefits, that is money that is sent directly to the beneficiary, and can be easily and quickly dissipated before the LTD fiduciary has time to take legal action to obtain the funds. Third, if the dollars the disabled beneficiary has are social security benefits, a provision in the Social Security Act, 42 U.S.C. § 407 provides for very broad protections against anyone getting a lien, judgement, etc. or otherwise taking someone’s social security benefits. The bottom line is that *Montanile* makes it much more difficult for LTD fiduciaries to recover social security overpayments when the disabled beneficiary is awarded social security benefits.

IV. The Take-Away

The takeaway is that if an insurance company seeks to recover an overpayment for a claimant due to the receipt of social security disability benefits, it may be worth fighting over if those benefits have since dissipated and the insurance company failed to act in a timely manner.

However, in the situation where an individual is still receiving benefits from their insurance company, the insurance company can simply withhold benefits until the overpayment is satisfied. Unfortunately, in such situations, there is likely nothing that can be done.

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