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ERISA & DISABILITY BENEFITS NEWSLETTER

VOLUME 8, ISSUE 1, JANUARY 2016

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Eric Buchanan & Associates, PLLC is a full-service disability benefits, employee benefits, and insurance law firm. The attorneys at our firm have helped thousands of disabled people who have been denied social security disability benefits, ERISA LTD benefits, health insurance, life insurance and other ERISA employee benefits, as well as private disability and health insurance benefits. Eric Buchanan and R. Scott Wilson are certified as Social Security Disability Specialists by the National Board of Social Security Disability Advocacy. For more information, visit our website at www.buchanandisability.com.

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IN *MONTANILE*, THE ERISA SUBROGATION PENDULUM SWINGS BACK IN FAVOR OF A PLAN PARTICIPANT

BY ERIC L. BUCHANAN

This week the U.S. Supreme Court again addressed the remedies available to a plan fiduciary under ERISA in *Montanile v. Board of Trustees of the National Elevator Industry Health Benefit Plan*, _ U.S. _, 2016 WL 228344, (U.S. Jan 20, 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[1], 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 *2. 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 who ran a stop sign and the ERISA 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 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* *3.

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 the word "equitable" matters, meaning 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 4, 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 explained that, 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 *7. 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 *9.

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 dissipated. *Id.* at *9.

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.

Then, more recently, in *US Airways, Inc. v. McCutchen,* 569 U.S. __, 133 S.Ct. 1537, (2013), the pendulum swung even more in favor of ERISA plans and

ERISA fiduciaries. The Court in *McCutchen,* addressed the question it refused to answer in *Sereboff,* whether ERISA participants and beneficiaries could use the parcel of equitable defenses when an ERISA plan seeks an equitable remedy. The Court in *McCutchen* held that equitable defenses could not be used to overcome the plain language of an ERISA plan; so again, ERISA plans had the upper hand and could continue to recover so long as the plan was carefully drafted. However, the Court did throw one bone to plan participants, by also holding that principles of equity could be used appropriately to fill in gaps in an ERISA plan where the plan language did not address an issue.

Now, in *Montanile* the pendulum has swung back the other way, at least a little. This case clarifies that tracing is important: not only must a plan have proper language, and the cause of action a plan brings must be the right cause of action in equity - not just "magic language" - but rather 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.

One of the questions plaintiff's attorneys should ask now is whether they can rely on this case to simply distribute funds to a client as quickly as possible and advise the client to go spend the money as soon as possible. I believe the short answer is, "no." In this case the court faulted the plan administrator for sitting on its hands when the attorney gave the plan 14 days' notice before distributing the funds, and then the plan waited six months before bringing suit, which gave Montanile, the plan participant, six months to spend the money, probably on past due bills, living expenses, etc.

The Court rejected several arguments made by the plan fiduciaries that other equitable remedies might be available, but I submit that if a plan participant or his or her attorney fails to notify the plan, communicate with the plan, and give the plan sufficient notice before the funds are distributed, that a court is more likely to find that the plan would have an equitable remedy in those circumstances. My advice is that the best practice is still to communicate with the plan early, try to work something out early, and to communicate with the plan throughout the case. If, after regular communications, the plan and the participant cannot reach an agreement, then the attorney can give 14 days' notice that the funds are being distributed. But, if that becomes a regular practice for plaintiff's attorneys, I believe plans are going to be much more likely to file suit early.

Another important point from *Montanile* is that the record was not fully fleshed out below as to how much of the proceeds had been dissipated, and the Supreme Court held that those funds that were not dissipated could still be recovered. If a plaintiff's attorney gives notice to the plan, and the plan still does not take action, so that the funds can be released to the client, it would be important to tell the client to keep records of how the money is spent, and be prepared to prove that the funds are gone. And, if an issue like this is litigated, the attorney for the plan participant should document and make a record for the court that the funds have been dissipated.

One last point about this case is the impact it will have on ERISA long-term disability ("LTD") claims, and the overpayments that ERISA LTD plans and fiduciaries seek to recover. Most ERISA LTD plans provide that a disabled beneficiary receives a monthly benefit, such as 60% of the person's pre-disability earnings. However, most plans also allow the LTD benefits to be reduced by other benefits, such as social security disability benefits. In many cases, a disabled person may be paid the full LTD benefits for many months, typically 24 to 36 months, before winning their social security benefits. At that point, the ERISA LTD plan typically asks the person to pay back the amount of LTD benefits that were overpaid. So, for example, if a person is receiving $1,500 a month for 24 months, and then is found disabled for the same time period by the Social Security Administration, and receives, say, $1,000 per month in social security benefits, then the LTD plan will say, "we should have only been paying $500 per month" and the disabled person is asked to pay back $24,000 in back pay.[2]

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* will make it much more difficult for LTD fiduciaries to recover social security overpayments when the disabled beneficiary is awarded social security benefits.

One other question neither *Montanile* nor any of the other Supreme Court ERISA cases has addressed is whether an ERISA fiduciary can use "self-help" to recover overpayments and reimbursements out of future benefits.

For example, if a person refuses to pay back health insurance benefits because the money is dissipated, can the ERISA plan refuse to pay for future health claims, and instead apply the dollars due for those claims toward the previous debt? Or, in the case of LTD benefits, if the disabled beneficiary does not pay the social security benefits over to the LTD fiduciary, can the LTD plan or insurance company refuse to pay future benefits due and apply those dollars toward the alleged debt?

This case clarifies the ERISA subrogation/ reimbursement landscape, by settling the question whether it really matters that a plan beneficiary must have funds in his or her possession before an ERISA fiduciary can get an equitable remedy to collect those funds. However, this case also creates more work and confusion about what the best practices will be going forward, both for ERISA fiduciaries and for plaintiff's attorneys.

End Notes

[1] Technically, the right of subrogation is the right to step into another party's shoes. In the case of an ERISA plan, a right of subrogation would give the plan the right to step into the shoes of the injured plan participant and become a co-plaintiff in the underlying lawsuit. A "reimbursement" claim is one by the ERISA plan to recover directly from the injured plan participant after that person recovers from a third party. However, courts use the terms "subrogation" and "reimbursement" interchangeably in most cases. In this case, the actual claim by the ERISA plan was for reimbursement for the medical benefits it previously paid.

[2] Fortunately for most disabled beneficiaries, if the person hires a social security attorney, and pays 25% of the back pay to the attorney, almost all insurance companies do not ask the person to pay back the amount that was paid to the attorney. So, if the person paid the social security attorney a $6,000 fee, most LTD insurance companies would ask for $18,000 back.

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