Ethics of ERISA Subrogation and Reimbursement:

What ethics rules apply when a health insurance company wants part (or all) of your client's recovery, and when courts have held attorneys directly responsible to pay back the money, even from their fee.

By: Hudson T. Ellis
ellish@buchanandisability.com

The favorable verdict is in, the check is in-hand, and you want to move on to the next case, but a letter from your client's insurance company is sitting on your desk claiming an ERISA subrogation right to the money that just landed in your trust account. This paper explores what ethical obligations you have as a Tennessee attorney toward your client and the ERISA Plan as well as the dangers where you fail to deal with the ERISA claim appropriately.

Groundwork:

Tennessee's Rules of Professional Conduct ("RPC") 1.15(d) and (e) provide our starting point, as they are the ethical foundation for dealing with this situation. They read:

> (d) Upon receiving funds or other property in which a client or third person has an interest, a lawyer shall promptly notify the client or third person. Except as stated in this Rule or otherwise permitted by law or by agreement with the client, a lawyer shall promptly deliver to the client or third person any funds or other property that the client or third person is entitled to receive and, upon request by the client or third person, shall promptly render a full accounting regarding such funds or other property.
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> (e) When in the course of representation a lawyer is in possession of property or funds in which two or more persons (one of whom may be the lawyer) claim interests, the property shall be kept separate by the lawyer until the dispute is resolved. The lawyer shall promptly distribute all portions of the property or funds as to which the interests are not in dispute.

Comments to both of these rules provide even further direction and are as follows:

> Comment 11: Third parties, such as a client's creditors, may have just claims against funds or other property in a lawyer's custody. A lawyer may have a duty under applicable law to protect such third-party claims against wrongful interference by the client and accordingly may refuse to surrender the funds or other property to the client. However, a lawyer should not unilaterally assume to resolve a dispute between the client and the third party.
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> Comment 12: When two or more persons (one of whom may be the lawyer) have substantial grounds for dispute as to the person entitled to the funds or other property held by the lawyer, the lawyer, with due regard to his or her confidentiality obligations under RPC 1.6, may file an action to have a court resolve the dispute, including an interpleader action.

In 2010, the Board of Professional Responsibility provided even more detailed guidance in an excellent ethics opinion that reviews in detail the rule, synthesizes ethics opinions on the same issue from numerous other jurisdictions, and provides substantial guidance for Tennessee attorneys on this issue ("Ethics Opinion"). (a copy of Ethics Opinion attached).

General Ethical Obligations of Tennessee Attorneys

Based on these sources, Tennessee attorneys have several ethical obligations when notified of a third party's interest in our client's money.[1]

As an initial matter, the duty to investigate the existence of third party claims in the absence of notice is not directly addressed in the rule, the comments, or the Ethics Opinion. That said, the Ethics Opinion cites to numerous other States' ethics opinions which conclude that actual knowledge of the third party claim is required to trigger an attorney's ethical obligations. While the implication is there

[1] As noted in preamble to the RPC, a violation of the ethical guidelines in the RPC does not necessarily support civil liability,

> Violation of a Rule should not itself give rise to a cause of action against a lawyer nor should it create any presumption in such a case that a legal duty has been breached. […] They are not designed to be a basis for civil liability. […] Nevertheless, in some circumstances, a lawyer's violation of a Rule may be relevant in determining whether there was also a breach of the applicable standard of conduct.

Preamble, at ¶ 21. The Ethics Opinion explains that civil liability is determined through substantive law, which will be addressed separately below.

that the duty is not triggered absent actual knowledge, performing a baseline investigation using common sense and readily available information will help neutralize any claims of willful ignorance.[2]

Once made aware of a claim, the next step is to find out whether it is a "just claim" that imposes a "duty under applicable law" to protect. The Ethics Opinion, while recognizing that whether a claim is a colorable interest is determined by substantive law, provides a list of five categories of claims that qualify as a protectable "just claim" as guidance:

1. An attachment or garnishment arising out of a valid judgment lien relating to disposition of the funds;[3]
2. A valid and perfected statutory,[4] contractual, or judgment lien against the property;
3. A letter of protection or similar obligation specifically entered into to aid in obtaining the funds;
4. A written assignment or authorization signed by the client, counsel, or other individual with authority conveying interest in the funds to a third person or entity; and
5. A court order relating to the funds in the attorney's possession.

In contrast to these categories that prompt ethical duties, the Ethics Opinion lists several claims that specifically fail to do so, including: The mere assertion of a claim by a third party; general debts of the client; unpaid medical bills sent to the attorney from a medical provider; or a letter from a medical provider demanding payment for bills.

Where there is a claim that arguably meets one of the five categories above, the disputed portion of the funds should be held in trust and the client and third party should be promptly notified. Where you determine the claim is actually valid, and the client does not dispute that the third party is owed, the third party should be paid without delay.

However, if the client disputes the claim, RPC 1.15(d) specifically requires you to refuse to pay your client, even if he insists. Where there is a valid dispute, you have a duty to maintain the contested portion of the funds in trust until the dispute is resolved. While the rule does not limit the available avenues to reach an agreement as to the disputed funds, it suggests that a possible solution is to interplead the disputed property and ask the Court to decide how it is

[2] Where you know the client was treated at a hospital, a call to the Circuit Court in your client's County of residence will uncover any perfected hospital liens (see Tenn. Code Ann. §29-22-101 and 102); and if you have seen insurance paperwork such as Explanations of Benefits or seen medical documents referring to health insurance payments, a call and a follow-up letter to the health insurer should be sufficient.

[3] The Ethics Opinion makes clear that the mere fact a judgment lien exists is insufficient to trigger a duty; the third party must use the judgment lien to attach or garnish the client's property in the lawyer's possession (hence "relating to").

[4] Hospital liens (TCA §29-22-101 et seq.), Worker's Compensation liens (TCA § 50-6-112(c)), payments made under the Medical Assistance Act (TCA § 71-5-101 et seq.)

divided. Whatever you do, do not unilaterally decide how to divide the disputed funds without the agreement of both parties.

Civil Liability of a Tennessee Attorney for Impairing an ERISA Subrogation Interest

In 2001, the Middle District Court of Tennessee was faced with the question of whether an attorney could be personally liable for failing to preserve a ERISA subrogation claim. *Greenwood Mills v. Burris*, 130 F. Supp. 2d 949, 960 (M.D. Tenn. 2001). In deciding what law to apply to the situation, the Court held that, if the matter is "traditionally of state concern," the state law could provide a guide, as long as it was consistent with the policies underlying the federal statute. *Greenwood Mills v. Burris*, 130 F. Supp. 2d 949, 960 (M.D. Tenn. 2001). Since regulating the professional conduct of lawyers is generally governed by state law, the court looked at Tennessee's rule on the subject and determined that it was consistent with ERISA's goals and policies and adopted it.

The *Greenwood* Court looked at *Aetna Cas. & Sur. Co. v. Gilreath*, a Tennessee's Supreme Court ruling in which Tennessee's highest court established the scope of liability for attorneys. 625 S.W.2d 269 (Tenn. 1981). The *Gilreath* court held that,

> a lawyer will be held civilly liable to a non-client where he knowingly participates in the extinguishment of a subrogation interest of a non-client third party and delivers to his client funds that he knows belong to the third party and knows or should know, that he has thereby placed the funds beyond the reach of the third party.

Id., at 274. The Middle District imported this reasoning and held that "[a] lawyer who is fully aware of his client's obligation under an ERISA plan to honor the subrogation interest of his employer may be held liable under § 1132(a)(3)." *Greenwood*, 130 F.Supp. 2d, at 960.

The attorney in *Greenwood* was informed by the ERISA administrator of the subrogation interest before he settled the case for $50,000. Despite his knowledge of the ERISA claim, the attorney disbursed the settlement funds to the client after deducting his fee. Thereafter, the client lied to the insurance company about several things, including denying that the case had settled; even worse, the attorney wrote a letter to the client telling him to inform the insurance company that he had settled the case for $25,000,[5] but that such amount did not make him whole and the insurance company was not entitled to any subrogation interest.[6] The Middle District ultimately found the client and attorney jointly and severally liable for the subrogation claim.

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[5] The Court does explain whether the misstatement of the amount of the settlement was by mistake, or intentional.

[6] The enforceability of Tennessee's "made whole" doctrine is beyond the scope of this paper. However, in brief: The *Greenwood* Court found that, while the made whole doctrine is alive and well in the Sixth Circuit and would be applicable to the facts of the case, the rule is based on equitable principles and, in view of the concealment of the defendants, it would be inequitable to allow them to benefit from their fraud. *Id*., at 955. Presumably, the Sixth

More recently, the Sixth Circuit reaffirmed that an attorney could be individually liable for failing to protect an ERISA subrogation/reimbursement claim in *Longaberger Company v. Kolt.* 586 F.3d 459, (6th Cir. 2009). In *Longaberger*, Kolt represented his clients in an auto accident case, and obtained a $135,000 settlement in August of 2004. *Id.*, at 462. After settling, Kolt notified the ERISA plan of the settlement and offered to amicably resolve the subrogation. *Id*. The opinion does not say whether the plan responded, or if any further communication took place, but in December 2004 Kolt disbursed $86,082.18 to his client and $45,000 in attorney's fees to himself.

Based on these facts, and after a finding that the ERISA plan language was sufficient to create a valid claim,[7] the Court of Appeals held that, under *Sereboff*, even though the funds had been distributed, the plan could still recover. *Id.*, at 6. Kolt also argued that his statutorily granted attorney's lien attached prior to the ERISA plan's and had priority under state law. The Court disagreed, finding that any such state law was not a law regulating insurance, and thus was preempted by ERISA. The attorney was again found to be civilly liable for his failure to protect the ERISA subrogation interest.

Conclusion

Because ERISA subrogation or reimbursement claims preempt many defenses and can eliminate the made whole doctrine simply by carefully drafting plan language, they can easily result in a substantially reduced—or even eliminated—recovery for you and your client. Regardless of the inherent headache attached to dealing with an ERISA claim, the last thing you should do is ignore the ERISA subrogation letter sitting on your desk, as disbursing funds would not only be an ethical violations, but could lead to civil liability.

Instead, the best practice is to deal with ERISA claims as early as possible. If you wait until a claim has been settled or verdict rendered, the insurer has little to no incentive to reduce its subrogation claim, unless you, by the good fortune, discover that the ERISA plan is poorly drafted and contains exploitable loopholes. However, if you approach the insurer early in the process, you can often negotiate a favorably reduced subrogation, with or without the help of drafting errors in the plan. If nothing else, where the ERISA fiduciary refuses to play ball and the un-subrogated claim would not be worth your time, walk away; you will avoid wasting your time, and the insurer may learn a lesson.

Circuit's acceptance of the made whole doctrine remains intact, though it has not been revisited in a published decision since the landmark Supreme Court decision in *Sereboff v. Mid Atl. Med. Servs*., 547 U.S. 356, 126 S. Ct. 1869, 164 L. Ed. 2d 612 (2006). That said, the doctrine can be abrogated where the ERISA plan contains "clear and specific language rejecting the make-whole rule […]." *Copeland Oaks v. Haupt*, 209 F.3d 811, 813 (6th Cir. 2000).

[7] The intricate law that establishes whether an ERISA plan contains sufficient language to create a valid and enforceable subrogation or right of recovery is likewise beyond the scope of this paper.