

Subrogation Rights: Equitable Claims, Constructive Trusts, and Control over Funds

A plan sponsor's right to enforce its health plan's subrogation provision has long been the subject of numerous court cases. In each case, the outcome ultimately hinged upon an evaluation of not only the subrogation language, but also upon which specific type of remedy was being sought. This is because ERISA recognizes only certain types of remedies. Consequently, the precise variety of remedy pursued will make a critical difference as to whether any recovery is permitted. As will be further emphasized in this *Alert*, subrogation recoveries rely, in large measure, upon a detailed fact analysis, plan language, the legal substance of the claim and the source of the recovery. Additionally, this *Alert* will consider a recent Supreme Court decision that provides an opportunity to further explore the equitable remedies that are available under ERISA.

One very recent court case, *Buchanan v. Aetna Life Insurance Company*, 2006 U.S. App. LEXIS 11046 (2006), centered on which type of recovery a plan sponsor would be entitled to receive under ERISA, and while this contested issue was not a subrogation claim, the analysis is similar to what courts consider when deciding a subrogation case. A review of *Buchanan* provides an excellent starting point for a discussion of ERISA claims.

The court's decision in *Buchanan* turned on whether the remedy was a remedy "at law" or a remedy "in equity." Consequently, the case has generated numerous questions about the terms "remedy at law" and "remedy in equity."

Charles Buchanan was first employed by Progressive Casualty Insurance Company in September 1996 as a computer programmer. As an employee of Progressive, Buchanan was covered under the company's disability benefits plan (administered by Aetna). The disability benefits in which Buchanan was enrolled would provide him with disability income for 24 months, and after that point, benefits would continue only if he was "not able, solely because of disease or injury, to work at any reasonable occupation." The plan also provided that an eligible person would receive a monthly benefit equal to a certain percentage of his/her salary, but that that benefit would be reduced by the amount of any other income — such as Social Security Disability Insurance.

Buchanan left work in the summer of 1997 because of a disability, and he began receiving disability benefits in October 1997. However, three months later (January 1998), he also began receiving Social Security Disability. He continued receiving both his employer's disability benefits and Social Security benefits for 23 months, at which point Aetna discovered the error and adjusted his monthly benefit to recoup a portion of the \$15,120 that Aetna had overpaid to Buchanan.

Legal action ensued when Buchanan did not repay the remaining balance due on the overpayment, and ultimately the Court of Appeals heard the case. The court case was intriguing in that the facts were not in dispute. Both parties recognized that Buchanan received an overpayment of benefits, but Buchanan's simple defense to Aetna's demand for repayment was that ERISA does not provide Aetna with a legal reimbursement remedy. Ultimately, the court agreed with Buchanan on that point, and Aetna was not able to recover the remaining owed balance.

Background

In the early days of American legal history, judges had two primary avenues to remedy disputes — they were referred to as *equity* or *legal*. Just as these two theories of law are different, so are the types of awards available under each theory.

- **Law:** These remedies generally relate to technical remedies such as contractual damages or reimbursement of an amount of money. Such remedies are available because the rules of law exist to provide those remedies.
- **Equity:** Generally, such remedies consist of injunctive relief, a constructive trust, or an equitable lien. These remedies evolved outside of the technical rules to give courts an additional basis to come up with a "fair" or equitable result.

The federal judiciary virtually eliminated this antiquated system of distinguishing between appropriate remedies, when the courts adopted the *Rules of Federal Procedure*. (Something which occurred long before ERISA was created.) For better or for worse, however, the body of ERISA law preserved this “law versus equity” distinction, and modern courts have consequently felt compelled to revisit concepts of law and equity when deciding a person’s rights under ERISA.

Example A:

John and Mary are injured in a car accident. They are covered under a group health plan through John’s employer. John’s health insurance includes a “reimbursement” provision that requires the injured parties to reimburse the plan out of funds collected from the at-fault party. When John and Mary do not reimburse the plan, the plan initiates legal action against John and Mary, seeking reimbursement under the terms of the plan. Courts have found that the plan’s claim would be a claim “at law,” in other words, a claim based upon a contract, and would therefore not be recoverable as an equitable remedy.

Example B:

Howard is injured in a car accident. He is covered under a group health plan through his employer. Howard’s health insurance includes a “subrogation” provision that allows the plan to become an active participant in legal action against the at-fault party. Accordingly, the plan pays Howard’s medical expenses and contacts Howard’s attorney, asserting a “lien” against any recovery that Howard receives. Howard’s attorney is then put on notice that the plan is asserting its rights under equity. When Howard refuses to reimburse the plan out of the settlement that he receives, the plan takes legal action to enforce its equitable lien. The plan’s action would be a claim “in equity” and would likely be recoverable as a remedy under ERISA.

Constructive Trusts

One issue that has prompted numerous questions — particularly as related to subrogation — concerns the technical concept of the “constructive” trust. Constructive trusts arise by operation of law in order to protect or place a claim on money or goods that have been obtained by fraud, duress, or other questionable means. Someone holding money or goods under a constructive trust will be held to an equitable duty to convey the money or goods on to another person. Although plan sponsors may pursue a variety of different “equitable” remedies, this

article specifically examines the “constructive trust” remedy under equity.

In general, a constructive trust requires the following key elements:

- *Possession* of identifiable property; and
- *Control* over that property.

Fundamentally, whether a constructive trust does or does not exist requires an ownership determination. The court will therefore carefully scrutinize the facts to establish who is holding the property. Additionally, although one person may hold or obtain property, a court may find that the individual has a duty to transfer that property to another person based on the recognition that continued ownership of the property in question would be unjust under the particular circumstances. (For example, allowing someone to keep the property might result in that person’s unjust enrichment.)

As a result, a person with property that a court deems to be held inside a “constructive trust” is legally considered to only have temporary custody of the property, and he or she is legally regarded as holding the property “in trust” for the rightful owner.

Great-West v. Knudson

The “constructive trust” issue was heavily debated in the Supreme Court’s 2002 decision in *Great-West v. Knudson*. In *Knudson*, an accident resulted in serious injuries that left one person in need of permanent nursing home care. The injured parties sued the entity at fault and obtained a settlement which was placed directly into a trust account (over which the Knudsons did *not* have control or possession) to pay for future nursing home bills. When the employee’s plan later sought to recover medical expenses that it had paid, the court considered whether the group health plan’s claim was truly an “equity” claim (based upon the constructive trust doctrine).

The court ultimately found that, because the Knudsons did not have actual possession of the settlement funds, there could be no constructive trust action against them. Consequently, the group health plan’s litigation effort to recover the settlement funds was deemed to be of a contractual nature — thereby converting the judicial review from an equity analysis to a review of the matter “at-law.” As stated above, the “at-law” analysis is appropriate because, without the existence of a constructive trust, the group health plan would merely be seeking reimbursement under its contract. Unfortunately for the group health plan in

Knudson, although actions “at-law” would ordinarily authorize cash reimbursement, they are not permitted under ERISA. The fact that the Knudsons were not found to be in possession of the settlement funds turned out to be a fortuitous key factor enabling the Knudsons to keep the money — despite the group health plan’s subrogation attempt.

It should be noted that although some legal observers proclaimed this case as a repudiation of subrogation, it actually was not. Numerous subsequent cases demonstrate that the courts generally remain comfortable with subrogation — as long as applicable rules are satisfied.

More Case Law

The issue of determining whether a party has “possession” of funds resurfaced in *Sereboff v. Mid Atlantic Medical Services, Inc.*, 126 S. Ct. 1869 (May 15, 2006). (Note: Determining “possession” is critical because answering that question will push a court towards either the “equitable” or “at-law” resolution.)

In *Sereboff*, a husband and wife were injured in an automobile accident. The Sereboffs’ group health plan paid the couple’s medical expenses, and the couple also received an award for damages against the at-fault party — thereby allowing the couple to effectively realize a double recovery. When Mid Atlantic filed suit to recover the medical expenses that it had paid, the Sereboffs agreed to take the amount that Mid Atlantic claimed and put that money in a special investment account until the case was resolved.

The court ultimately found that Mid Atlantic was seeking an equitable remedy against the Sereboffs and that Mid Atlantic sought “identifiable” funds that were within the possession and control of the Sereboffs. (The court said that the funds were sufficiently identifiable because the funds were separate from the Sereboffs’ general assets.) Consequently, Mid Atlantic was allowed to collect the money at issue under the theory that the Sereboffs were, as a matter of law, “holding” the money — in a constructive trust — for the rightful owner (Mid Atlantic).

When analyzing rulings from a growing number of subrogation cases, it appears that if the money that is being sought is mixed together with a person’s general assets, then the money would not be considered sufficiently “identifiable,” and could not therefore be reached through the subrogation process — even if the settlement or award could be traced to the person’s general assets. Also, applicable case law suggests that money held in trust, and under the control of someone other than the injured party, cannot be reached because, even though it may be identifiable, it is not directly under the control of the injured party. Consequently, under current case law, the Sereboffs would likely have been able to keep the disputed funds (or at least prevail against a subrogation claim) *if* the funds had been combined with the Sereboffs’ general assets and bank accounts, or if the funds were considered to be under someone else’s control.

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