Beware the ERISA health plan lien

You’ve negotiated a good settlement for your client. But now the client’s health plan wants to be reimbursed for the medical benefits it paid. Can the plan’s lien be defeated—or negotiated down?

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Once largely ignored, ERISA liens have become formidable obstacles to settlement and client satisfaction. Plaintiff attorneys cannot afford to overlook their impact. They can lay claim to most or even all of the proceeds from settlement of, for example, a personal injury case involving an auto accident where the plaintiff received benefits from an ERISA health plan.

To make matters worse, many states’ ethical opinions and rules of professional conduct can now be read to impose a duty to hold disputed funds (such as lien amounts) in the attorney’s trust account and even to notify the ERISA lien holder of settlement. These developments present an alarming challenge to the traditional view that an attorney owes no duties to the lien holder. The presence and size of a potential ERISA lien must now be considered when determining whether to even take a case.

What caused this change? In 2006, the Supreme Court’s decision in Sereboff v. Mid Atlantic Medical Services, Inc., gave ERISA liens some very large teeth by holding that ERISA plans can enforce complete reimbursement of their liens. The case originated in California, where Marlene Sereboff and her husband, Joel, received health insurance under her employer-sponsored plan. Mid Atlantic Services administered the plan, which was covered by ERISA.

The Sereboffs were injured in a car accident, and the plan paid about $75,000 of the couple’s medical expenses. They sued several third parties, seeking damages for their injuries. Shortly thereafter, Mid Atlantic notified the Sereboffs that it was asserting a lien on any recovery they received. The Sereboffs settled the lawsuit for $750,000 but did not pay anything to Mid Atlantic.

Mid Atlantic sued to enforce the lien under §502(a) (3) of ERISA, claiming that it was entitled to reimbursement as a matter of equity. That section of the statute permits a lawsuit to enjoin any act or practice that violates the terms of a plan, or to obtain “other appropriate equitable relief” to enforce the terms of
the plan. The trial court found in the company’s favor and the Sereboffs appealed, arguing that Mid Atlantic’s claim was actually for breach of contract, not equitable relief—the only type of relief granted under §502(a)(3). The Fourth Circuit affirmed, ruling that Mid Atlantic’s suit was one seeking equitable relief, and a unanimous Supreme Court agreed.

Sereboff has emboldened ERISA plan administrators everywhere and led to sobering interpretations by federal courts. In light of the decision, courts have ruled that ERISA liens can trump a catastrophically injured plaintiff’s need for lifetime care, consume a special-needs trust, and lay claim to an entire settlement—including attorney fees. One recent decision that looked like a solid win for plaintiff counsel—holding that an ERISA lien cannot be recovered from a minor’s special-needs trust—depended more on procedural technicalities than substantive ERISA law and should not be given widespread reliance.

ERISA subrogation has thus become a minefield for plaintiff attorneys. If a valid lien is not adequately satisfied, you risk a lawsuit against your client or yourself. Although a plaintiff attorney is generally not considered a plan fiduciary, you may still be sued by a plan administrator. You may also be liable for the amount of your attorney fees if your client has signed a reimbursement agreement, even though you yourself were not a party to it. Moreover, if you counsel or assist your client in subverting a valid ERISA claim through deceit or dishonesty, you can also be liable to the plan.

Thus, even though an attorney is not a party to the ERISA plan, he or she may still be held liable in a number of ways. Conversely, if you mistakenly pay an invalid lien, you have committed malpractice against your client. If you disburse the settlement before the lien is resolved, you risk ethical sanctions as well.

Throughout, you must advise and counsel your client that the lien might consume a large portion (and possibly all) of any potential settlement. These dangers are not what the average plaintiff attorney bargains for when taking a case, and it is crucial that ERISA liens be dealt with properly.

Getting started
The first thing you will probably want to know is whether you owe any obligation to ERISA lien holders. Must you notify ERISA plans of third-party claims? Can you simply disburse the settlement funds to clients and leave them to work out liens on their own? The answers to these questions are changing in light of the Sereboff decision and developing state ethical rules. These sources indicate an emerging duty to ERISA lien holders. State ethics opinions are imposing a duty to hold disputed funds (here, the lien amount) in the attorney’s trust account until the lien is resolved.

Therefore, the release of settlement proceeds to your client in the face of a potential ERISA lien could give rise to two separate complaints against you: an ethical complaint based on an alleged violation of a state’s rules of professional conduct, and another complaint seeking the remedies prescribed by 29 U.S.C. §1132(a)(3). You should be aware of these possibilities and act accordingly.

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Ascertaining enforceability
There are two basic types of ERISA health plans: insured and self-funded. An insured plan is a health plan where the employer has purchased a group insurance policy for its employees from a health insurance carrier. A self-funded ERISA plan is one in which the employer completely funds the plan and pays for employee health care with its own assets. These two types of plans and their liens are treated differently under ERISA, due to somewhat confusing rules as to when that federal body of law preempts state insurance law and when it works in tandem with state law.

The general rule is that ERISA preempts state law in the governance of em-
Employee health plans. However, the exception is found in ERISA’s “saving clause,” under which state laws regulating insurance are saved from the sweep of federal preemption. This clause greatly narrows the scope of ERISA preemption where health insurance carriers are concerned.

The saving clause provides that health insurance carriers—and the group health insurance policies they sell to employers—are subject to state law. Thus, claims based on an employee health plan purchased through a health insurance carrier are governed by both state law and ERISA. However, the “deemer clause,” which immediately follows the saving clause, provides that a self-funded employee benefit plan is not to be considered (or “deemed”) an insurance company. Application of this somewhat circular statutory language creates the result that self-funded ERISA plans are not subject to state law but health insurance carriers and insured ERISA plans are. Because of this distinction, determining whether an ERISA plan is self-funded or insured is of great importance.

Self-funded ERISA plans are exempt from state law regulation. Because self-funded plans are not connected to an insurance company, they benefit from ERISA preemption. As the Supreme Court said in FMC Corp. v. Holliday, “State laws that directly regulate insurance . . . do not reach self-funded employee benefit plans because the plans may not be deemed to be insurance companies, other insurers, or engaged in the business of insurance for purposes of such state laws.”

Insured ERISA plans are subject to state law regulation. When an insured plan asserts a lien against a personal injury settlement, it is the insurer—not the plan—that is attempting to recoup its expenses. Holliday: “An insurance company that insures a plan remains an insurer for purposes of state laws purporting to regulate insurance after application of the deemer clause.”

Of course, the insurance company is not relieved from state insurance regulation. This was confirmed in Holliday, where the Supreme Court interpreted the deemer clause to mean that “if a plan is insured, a state may regulate it indirectly through regulation of its insurer and its insurer’s insurance contracts; if the plan is uninsured, the state may not regulate it.”

Given the distinction between insured and self-funded plans, the question arises of how to treat a plan that is self-funded but has also purchased excess or “stop-loss” insurance to cover large, unexpected claims. Does the purchase of this type of insurance make an otherwise self-funded plan “insured” for the purposes of ERISA preemption? In a word, no. The U.S. Department of Labor (DOL) has taken the position that merely obtaining a stop-loss insurance policy will not cause a plan to lose its self-funded status for ERISA preemption purposes. Although the Supreme Court has not addressed the issue, the DOL’s view appears to be uniformly adopted throughout the federal circuits, meaning that the terms of ERISA and the provisions of the plan will still preempt state law despite the presence of stop-loss insurance.

Determining whether the ERISA plan is insured or self-funded will tell you what rules you’re playing by: federal law exclusively or state law as well. This is crucial to evaluating the strength of a lien. State insurance statutes and common law will often offer equitable defenses against the lien that are not available under the purely federal law of ERISA. Thus, it is critical to determine whether the ERISA plan is insured and to be familiar with state subrogation law.

The SPD is required to disclose the funding arrangement of the plan. However, not all plan administrators comply with this rule. Some fail to disclose at all, while others—innocently or otherwise—have been known to claim self-funded status when their plans are, in fact, insured. The SPD should not be relied on as the final word on this crucial matter.

Another resource to check is the plan’s Form 5500, which must be filed each year with the DOL and must declare the appropriate funding status. Many (but not all) of these documents may be found online at the site www.freeerisa.com by searching the Form 5500 filings by employer name. If the Form 5500 cannot be located in this way, it can always be requested from the plan administrator un-

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The reason for this lies in the type of lien-related relief allowed by ERISA. The statute provides that a plan may seek only “equitable relief” to enforce its terms. The equitability of the relief sought stands as the basis for the Court’s decision in Sereboff and the previously controlling decision of Great-West Life & Annuity Insurance Co. v. Knudson. In both cases, the Court attempted to decipher what Congress meant by “equitable relief.”

In Great-West, the ERISA lien was held unenforceable because the third-party recovery provision of the plan at issue did not specify a particular fund from which to recover the lien. Rather, it sought legal restitution from the client’s general assets. The Court held that such relief was “legal” rather than “equitable,” and not permissible under ERISA.

Echoing the ruling in Great-West, the Sereboff Court found that one feature of equitable restitution is the imposition of a “constructive trust” on “particular funds or property in the [client’s] possession.” However, Sereboff was distinguished from Great-West in two ways. First, the settlement funds had been set aside pending the resolution of the case and were still in the Sereboffs’ possession and control. Second, the Court found that the plan language justified equitable restitution for two reasons: The plan specifically identified the settlement proceeds—apart from the Sereboffs’ general assets—as being subject to its lien; and the plan limited its right of recovery to only the amount it had paid for injury-related care, as opposed to the settlement as a whole.

By identifying a specific fund from which it would claim reimbursement (the settlement), and limiting that reimbursement to the amount to which it was equitably entitled (the amount it had paid for injury-related care), the plan had created a “constructive trust” on that portion of the settlement. In essence, the Sereboff Court concluded that that portion of the settlement rightfully belonged to the plan, and its recovery was therefore equitable.

When analyzing the language of an ERISA plan that is asserting a lien against a client, examine the third-party recovery provision closely. If the language does not identify a specific fund to which it is entitled—namely, the settlement proceeds—or does not limit the plan’s recovery to the amount it has paid for injury-related care and is thus rightfully entitled to, then under Sereboff the lien is unenforceable.

The make-whole doctrine. This doctrine is, by and large, a common law rule that limits an insurer’s right of subrogation. The Fourth Circuit has explained it this way:

Generally, under the doctrine, an insurer is entitled to subrogation of an insured’s recovery against a third party only to the extent that the combination of the proceeds the insurer has already paid to the insured and the insured’s recovery from the third party exceed the insured’s actual damages. In other words, the insured must be made whole before the insurer can exercise his right of subrogation.

There currently exists a circuit split as to whether the make-whole doctrine should be applied as the default rule in ERISA subrogation. The Fourth Circuit recently rejected the doctrine as the default rule, reasoning that “such a rule would frustrate the purposes of ERISA by requiring plan drafters to inject legalese into plans rather than use clear, ordinary language explaining the plan’s provisions.” Other circuits taking a similar position include the First, Third, and Eighth.

However, some circuits do apply the make-whole doctrine to ERISA liens. The Ninth Circuit clearly adopted the doctrine as the default rule, stating that “in the absence of a clear contract provision to the contrary, an insured must be made whole before an insurer can enforce its right to subrogation.” Other federal courts of appeals using the doctrine as the default rule include the
Sereboff's decision has also made ERISA liens substantially more difficult. With a strong knowledge of the law and a calculated approach, many ERISA liens can be resolved beneficially; others, however, may prove to be legally unassailable.

Nonetheless, all ERISA liens must be treated with respect, and they may require nearly as much attention as the underlying liability claim if you want to protect yourself against legal and ethical liability. Failing to give these liens adequate consideration could be entitlement to most or even all of its claims for reimbursement regardless of the results such a rule could produce, or that the plan will pay reasonable fees and expenses providing some support and incentive to the plan’s beneficiaries to move forward with their claims, to which the plan will be partially subrogated.

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quate attention may expose you to such liability and could have serious ramifications for your client.

Notes
2. ABA Model R.1.15 (D) (2002); see also Iowa R. Prof. Conduct 32:1.15 (2005).
3. 120 S. Ct. 1869 (2006).
7. See Brown, 2007 WL 2350523.
8. Mills v. London Green Township, 2007 WL 2985365 (E.D. Pa. July 19, 2007). The court was asked to approve the personal injury settlement of a minor where the net proceeds were to be placed into a special-needs trust but were also subject to an outstanding ERISA lien. The court found the lien unenforceable because the ERISA plan sought to recover the lien from the minor’s parents, while the settlement proceeds would directly pass into the trust. However, in the opinion of these authors, if the plan had simply waited until the funds were placed in the trust, and then filed an action against it, the lien would likely have been recoverable as allowed by numerous other courts. Several other procedural technicalities, rather than substantive law, also informed the Mills court’s decision. Thus, an attorney relying on this case alone as a defense to an ERISA lien was not “in and of itself” a basis for civil liability—though it may be a contributing factor.
11. ERISA is, as the Supreme Court describes it, an “enormously complex and detailed” statute. E.g. Hughes Aircraft Co. v.Jacobson, 525 U.S. 432, 447 (1999). An article of this length cannot provide all the background necessary to properly evaluate the merits of an ERISA plan’s asserted lien; it can only provide a primer to assist a plaintiff attorney in identifying the issues and possible pitfalls that may be involved. More research, and possibly even consultation with an ERISA lawyer, may be needed.
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14. See e.g. Va. Legal Ethics Op. 1747 (2000). Read narrowly, this opinion interprets Rule 1.15 of Virginia’s Rules of Professional Conduct as placing a legal obligation on an attorney to not deliver disputed settlement funds to a client when a third party has a valid statutory lien, contract, or court order that grants an interest in the funds.
15. However, the opinion invites broader interpretation of the rule to include agreements or laws (such as ERISA) creating a legal obligation to deliver those funds to another.
16. See e.g. United States v. Broadway Co., 534 U.S. 204 (2002). The settlement funds in Great-West had been placed in a special-needs trust before the lien was asserted and were no longer in the beneficiary’s control. Id. at 207-08.
18. Id.
19. 29 U.S.C. §1002. The information that must be contained in the SPD is set forth in the rule of equity 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.
22. 120 S. Ct. 1869 (2006).
28. Id. (internal quotations omitted).
29. Id. at 64.
32. 29 U.S.C. §1022(b).
36. Sereboff, 126 S. Ct. at 1875.
37. 29 U.S.C. §1132(a) (3).
38. 534 U.S. 204 (2002).
39. The settlement funds in Great-West had been placed in a special-needs trust before the lien was asserted and were no longer in the beneficiary’s control. Id. at 207-08.
40. Sereboff, 126 S. Ct. at 1874 (emphasis added).
41. Id. at 1872.
42. Id. at 1875.
43. The Sereboff Court invoked “the familiar rule of equity 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.
45. Id. at *3.
47. Barnes v. Ind. Auto Dealers Benefit Plan, 64 F.3d 1389, 1395 (9th Cir. 1995).
48. Copeland Oaks, 209 F.3d at 813; Cutting v. Jerome Foods, Inc., 993 F.2d 1299, 1297-98 (7th Cir. 1993); Cagel v. Bruner, 112 F.3d 1510, 1511 (11th Cir. 1997).
50. Copeland Oaks, 209 F.3d at 813.
52. Gaffney v. Riverboat Servs. of Indiana, Inc., 451 F.3d 424, 466-67 (7th Cir. 2006).
53. Kress v. Food Employers Labor Relations Assn., 291 F.3d 563, 569 (4th Cir. 2004); Harris, 208 F.3d at 279; Walter v. Wal-Mart Stores, Inc., 159 F.3d 938, 940 (5th Cir. 1998); Ryan v. Federal Express Corp., 78 F.3d 123, 127 (3d Cir. 1996).
54. Walter, 120 F.3d at 141. The court went on to decide that the plan’s subrogation recovery should be reduced by a reasonable amount of attorney fees.

Keep your client informed to encourage realistic expectations. If an ERISA lien is large enough to lay claim to most of the settlement, this will affect your client’s incentive to pursue the case.