ERISA Restitution Claims:
A Primer on Post-*Knudson* Litigation Strategy

By Patrick R. Nichols

While health insurance can provide a tremendous boon to the injured client, when settlement of an underlying third-party tort action occurs, some health plans, particularly those established under ERISA, can assert claims for repayment that may consume much of the recovery. The United States Supreme Court's recent decision in *Great-West Life v. Knudson*[1] has fundamentally altered the "balance of power" among the parties. Understanding *Knudson* and its ramifications is essential to proper advice and representation of clients when such claims are involved.

In employer-funded and properly prepared ERISA health plans, provision is made for repayment of any expenses or health benefits provided by the plan when a third-party recovery is sought. Typically, these provisions require "first dollar" repayment. No provision is made to adjust the claim based on the adequacy of recovery or cost incurred as attorney's fees or litigation expenses. This discourages some third-party claims from being filed and presents a variety of other problems.

The precedent upon which *Knudson* was based must be understood to properly advise clients about possible future decisions.

Knudson held that the term "appropriate equitable relief" used in the statute authorizing civil actions to redress violations by the plan precluded litigation for specific performance of reimbursement provisions of that plan, or actions to compel restitution of the plan for benefits paid. The Court relied on prior decisions refusing to allow actions for money damages under the "appropriate equitable relief" provision and narrowly construing, if not rewriting, the phrase. The decision places in doubt the ability of plan trustees and fiduciaries to enforce plan provisions post-settlement.

Knudson was an action by the plan managers, Great-West, to recover medical benefits paid. The defendant, Jeanette Knudson, was injured in an auto accident. On behalf of her husband's employer, over $400,000 in medical expenses were paid. The plan contained reimbursement provisions which allowed recovery from a beneficiary of any payment for benefits made by the plan which were recovered from a third party.

Knudson filed a state court action to recover from the manufacturer of her car, and eventually negotiated a settlement. Most of the settlement was allocated to a trust for her medical care. The parties set aside $13,828.70 to satisfy Great-West's reimbursement claim of $411,000. This amount was agreed to represent the portion of the settlement attributable to past medical expenses. The state court approved the settlement and ordered the state court defendants to pay the amount due the trust directly and to forward the remainder to Knudson's attorney. The attorney tendered checks to Great-West and other creditors.

However, Great-West refused to cash the checks and filed a federal action under §503(a)(3) of ERISA. Their action sought to enforce the plan's reimbursement provision by requiring repayment of the medical expenses in full. On different grounds, the relief was denied by both the district court and the Ninth Circuit. On appeal, a sharply divided United States Supreme Court affirmed.

To summarize the opinion of Justice Scalia[2]: The *Knudson* court held that Great-West was seeking legal relief, i.e. personal liability for a contractual obligation to pay money, and therefore ERISA did not authorize the action. The provision of that statute[3] known as §502(a)(3) had previously been construed by the Court to prohibit recovery of money damages.

Section 502(a)(3) provides that a civil action may be filed "to enjoin any act or practice which violates...the terms of the Plan or...to obtain other appropriate equitable relief...." This finding was based on previous decisions, notably *Mertens v. Hewitt*.[4] In what many consider very strained construction, *Mertens* restricted the operative phrase "appropriate equitable relief" to exclude actions for monetary damages. The Court held that the action against Knudson was purely and simply an effort to compel the payment of money past due under a contract which, like their claim for specific per-

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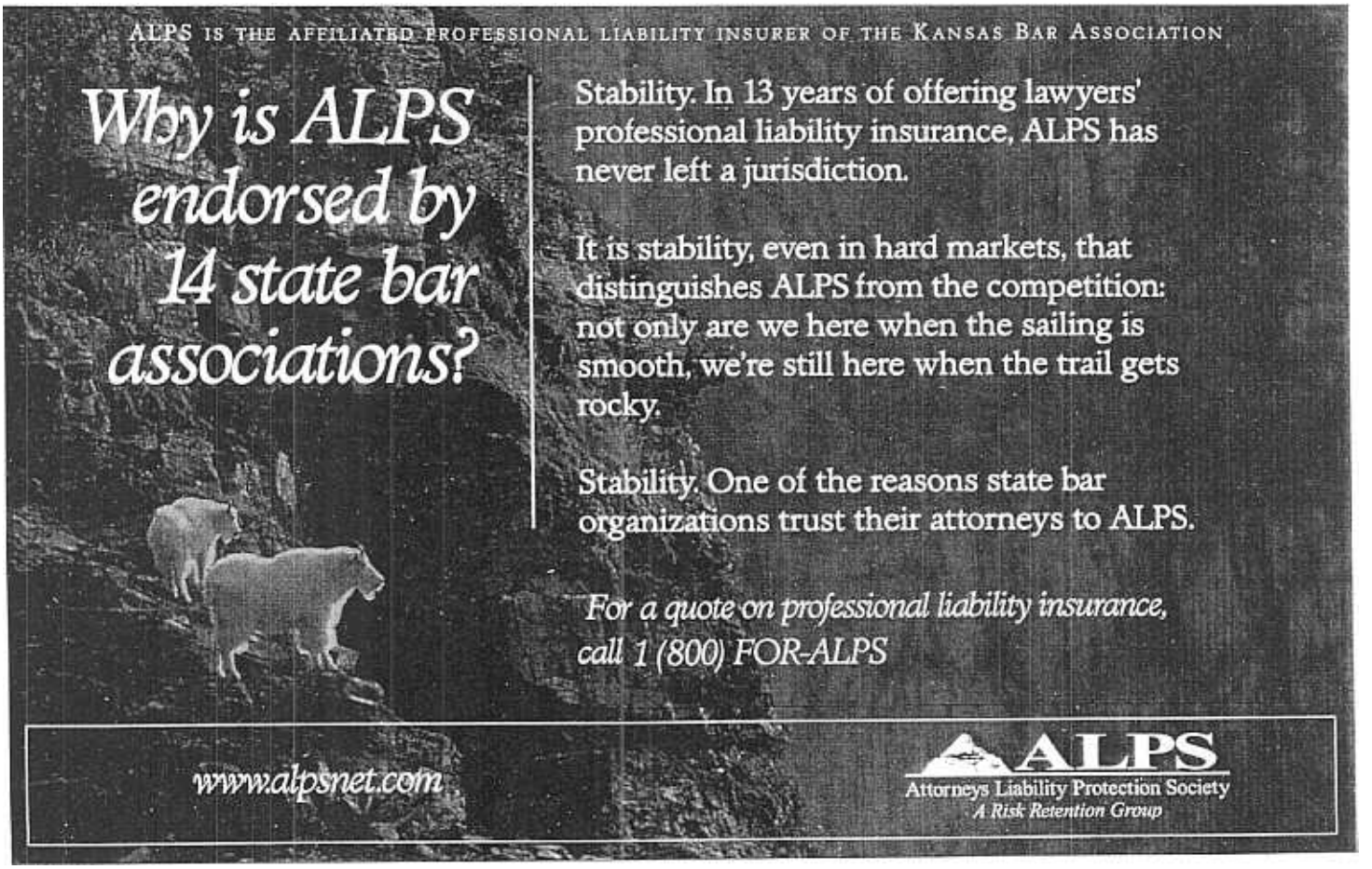
formance, was not "typically available" in equity. The petitioner's argument that restitution was a proper form of equitable relief and therefore would justify the suit was also rejected. The majority opinion held that restitution was a legal remedy when ordered in a case at law and an equitable remedy when ordered in an equity case. Therefore, its legal or equitable status depended on the basis of the plaintiff's claim and the underlying remedies which were sought. Since Great-West's claim was not in essence one for return of funds held, but rather a claim for entitlement under contract to reimbursement, the relief was not equitable but legal.

The dissenting justices argued that the majority continued to misconstrue the intent of Congress in its restriction on remedies under ERISA. Justice Stevens noted, "It is fanciful to assume that in 1974, Congress intended to revive the obsolete distinctions between law and equity as a basis for defining remedies available in federal court...."[5]

Justice Ginsburg wrote criticizing the Court's reliance here and in *Mertens* on the "antiquarian" inquiry concerning remedies which were "typically available" in equity. Moreover, she notes, "Restitution was within the recognized power and within the highest traditions of a court of equity."[6] Noting further that monetary damages in general and punitive damages in particular were ordered in equitable actions (the so-called "clean-up doctrine"), she and the justices agreeing with her urged here, as they did in *Mertens*, that the statutory language authorizing "appropriate equitable relief" should include such recoveries. Any other construction "yields results that are demonstrably at odds with Congress' goal in enacting ERISA. Because in my view, Congress cannot plausibly be said to have 'carefully crafted' such confusion, I dissent."[7]

The precedent upon which *Knudson* was based must be understood to properly advise clients about possible future decisions. In *Mertens*, and its predecessor, *Russell*,[8] the strained construction of the "appropriate equitable relief" language of §502(a)(3) was initially crafted. In those cases, this construction served to deny plaintiffs their right to money damages against plan fiduciaries or trustees for wrongful denial of claims. As such, these cases were decidedly anti-plaintiff and pro-business. The logical underpinnings of these cases in turn compelled the result in *Knudson*.

In *Russell*, the plaintiff sued for compensatory and punitive damages where short-term disability benefits had been discontinued by the plan administrator. The benefits were later restored and a retroactive payment of benefits was made. Russell claimed that this incorrect interpretation by the plan administrator forced her disabled husband to cash out retirement savings and aggravated her psychological condition. The Ninth Circuit concluded she had a valid cause of action under §502(a)(3) based on an alleged violation of the fiduciary's good-faith obligation to process claims in a fair and diligent manner. The Supreme Court reversed on limited grounds, holding that no portion of ERISA pro-



vided recovery of extra contractual (i.e. monetary) damages.[9]

Some years later, the Court revisited the remedies question in *Mertens*. Plaintiffs there sought recovery of monetary relief under §502(a)(3) against a fiduciary who knowingly participated in a breach of trust. The action was brought by a class of former employee participants in a retirement plan against the plan's actuary. They claimed the actuary caused losses by allowing the employer to select the plan's actuarial assumptions and by failing to disclose a variety of issues including funding shortfalls.

Laying the groundwork for *Knudson*, Justice Scalia's opinion in *Mertens* engaged in an extensive analysis, much of it convoluted and strained, to conclude that the right of action under §502(a)(3) for "other equitable relief" really meant those forms of "relief that were *typically* available in equity (such as injunction, mandamus and restitution, but not compensatory damages)."[10] Although plaintiffs characterized their claim as equitable because they sought "make-whole relief" traditionally available in equity under the common law of trusts, this request was denied.

The Court's opinion turns on a highly debatable proposition: "appropriate equitable relief" in the form of restitution and make-whole damages (classic trust remedies) were not damages which were traditionally "equitable." The majority opinion notes that money damages had been available in certain equitable actions against the trustee and against third parties. Their opinion in *Mertens*, and thus the underpinning in *Knudson*, turns on the opinion of five justices that,

> ...[I]n the context of the present statute, we think there can be no doubt. Since *all* relief available for breach of trust could be obtained from a court of equity, limiting the sort of relief obtainable under §502(a)(3) to 'equitable relief' in the sense of 'whatever relief a common-law court of equity could provide in such a case' would limit the relief *not at all*.[11]

The dissent notes that such actions for equitable relief have always included money damages as an appropriate remedy. The dissenters state,

> Construing the statute [to allow relief] also avoids the anomaly of interpreting ERISA so as to leave those Congress set out to protect —the participants in ERISA-governed plans under beneficiaries— with less protection than they enjoyed before ERISA was enacted.[12]

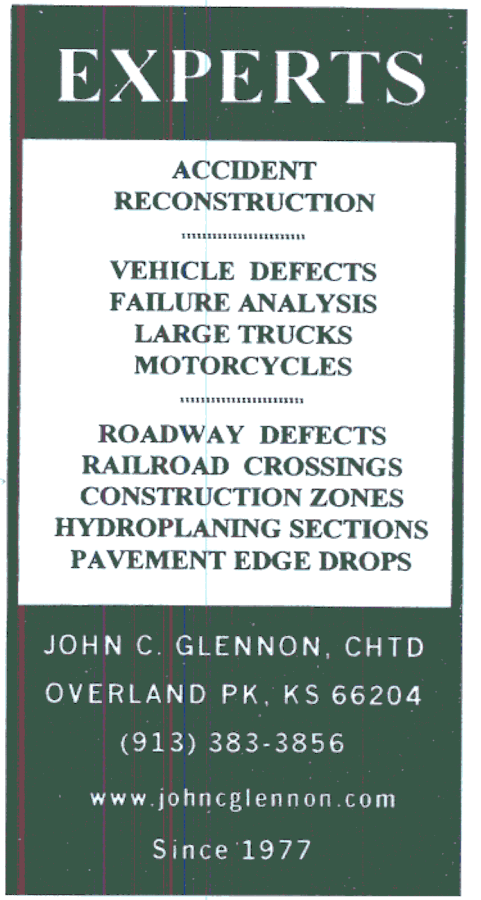
The Court in *Mertens* set the tone for the outcome in *Knudson*. In order to narrowly construe the remedial phrase "appropriate equitable relief," the Court held that the phrase encompassed only "those categories of relief that were *typically available* in the broad run of equity cases without regard to the particular equitable remedies available in trust cases." Justice White's dissent notes:

> It seems to me a treacherous leap to draw from these sections a Congressional intent to foreclose compensatory monetary awards under §502(a)(3) notwithstanding that such awards had always been considered 'appropriate equitable relief' for breach of trust at common law.[13]

Knudson addresses a variety of other potential theories of recovery and appears to exclude them from "appropriate equitable relief." State law breach-of-contract claims are probably preempted by ERISA. Claims for a "constructive trust" are likewise questionable. Intervention in state court actions is a possibility, but in the absence of a viable remedy there will be no legal basis upon which to seek such standing. Virtually every type of relief which could be sought by the ERISA plan against the beneficiaries appears foreclosed by *Knudson* or the general principles of ERISA cases.

However, it is important not to overstate the impact of *Knudson*. First, the funds in *Knudson* were not in the plaintiff's possession but in the possession of a Special Needs Trust, not a party to the action. Second, the litigation was post-settlement. Third, Great-West sought a temporary restraining order in federal court to prevent the dispersal of the state court proceeds. This was denied and Great-West did not appeal. Finally, the settlement was structured, pursuant to court approval, to provide that past medical treatment was only $13,828.70. The plan language provides that the right of reimbursement is only on the amount *received by respondents for past medical treatment*.

In questioning the reliability of a post-*Knudson* analysis, one must always be mindful of the premise that the law is whatever the Supreme Court decrees it to be. Should the Court find itself motivated to reverse a decidedly anti-business holding, they are free to do so and likewise turn a "blind eye" to the intellectual inconsistency of such an outcome. More than that, however, they could use the factual points in the preceding paragraph to draw distinctions between a newer case and *Knudson*. If, for instance, the funds are in the hands of the plaintiff, the plaintiff's attorney or still held prior to settlement, a later case might find that these distinctions were crucial to the outcome and dictate a different result. Finally, changes in the make up of the Court could shift the majority to an arguably more rational



analysis allowing both recovery of restitution for payments and monetary damages against fiduciaries.

It can be forcibly argued that following *Knudson* ERISA insurers maintain virtually no right to reimbursement or restitution. The sweeping language contained in the opinion is such that any such claim for money appears to be barred. Since money damages have been held in *Mertens* and *Knudson* not to be a form of "typically available equitable relief," it seems difficult to argue that any effort to intervene, assert a claim, or maintain an allegation of a constructive trust would find merit using a strict *Knudson* analysis.

ERISA managers have taken the position that *Knudson* does not create any significant change in the law. A memo prepared by Rawlings Company, LLC, makes three basic points.

First, they claim *Knudson* does not deal with subrogation or alter the right to pursue subrogation. In this regard they are attempting to draw a distinction between subrogation and reimbursement, an apparently spurious distinction under *Knudson*'s overall holding—a distinction without a difference.

Second, they urge their employees to pursue "equitable restitution" as an alternative vehicle for reimbursement. However, *Knudson* specifically states that equitable restitution is excluded by the provisions of §502(a)(3).

Finally, they urge state law remedies as an alternative for recovery. However, state laws frequently contain no provision for subrogation. Additionally, any contract claims based on an ERISA plan would arguably be preempted by the latter statute.

Rawlings and other plan administrators are also attempting to craft some type of legal theory which would require that the member's legal representative to cooperate by providing information upon request under threat of a claim of tortious interference with contractual relations. A variety of responses could be crafted to such a contention. The threat of tortious action could justify the beneficiary's counsel to take the position that he or she will engage in no contact whatsoever, like the plan representative, so that no inadvertent impropriety could occur. Furthermore, failing to provide information upon request may very well not rise to the intentional interference with the contractual relationship that the tort would generally require.

The ultimate litigation strategy for resolving ERISA claims should be made after a full disclosure to the client of the risks and benefits of each potential course. On the one hand, refusing to honor the lien based on a *Knudson* analysis would leave the plaintiff whole and would place the burden for litigation on the plan and its fiduciary, as well as provide an opportunity for the development of additional case law favorable to the plaintiff's position. However, ongoing litigation over an ERISA lien would be funded either by the plaintiff on an hourly basis or subsidized by plaintiff's counsel as part of the overall representation in the tort action. This element of the relationship must be clearly understood for the plaintiff to make an intelligent decision.

On the other hand, a negotiated settlement provides the benefits of certainty and finality while reducing the plaintiff's gross recovery. Finally, the risk that a subsequent change in the law either overtly by the Supreme Court or more gradually through interpretations of *Knudson* by the various lower federal courts could embroil the parties in litigation with an uncertain outcome years ahead.

This body of law is growing and changing on a daily basis. To intelligently analyze a given situation requires a familiarity with a body of case law which is unfamiliar to most plaintiffs' attorneys. The Law of Trusts, ERISA, and Preemption must be carefully studied in order to properly advise the client regarding given fact circumstances. In addition, additional decisions are being made by lower federal courts on a weekly basis construing, analyzing and distinguishing *Knudson*. A careful review of these decisions is also in order prior to any decision on appropriate litigation strategy. ❖

Endnotes

[1] *Great-West Life & Annuity Ins. Co., et al., v. Janette Knudson and Eric Knudson*, 534 U.S. 204, 122 S. Ct. 708, 151 L. Ed. 2d 635 (2002).

[2] Scalia was joined in his opinion by Lindquist, C.J., O'Connor, Kennedy and Thomas, J.J. Stevens, J. filed a dissenting opinion as did Ginsberg, J. in which Stevens, Souter and Brier joined.

[3] 29 U.S.C.A. §1132(a)(3) (1974).

[4] *William J. Mertens, et. al. v. Hewitt Associates*, 508 U.S. 248, 256, 113 S. Ct. 2063, 124 L. Ed. 2d 161 (1993).

[5] 534 U.S. 204, 122 S.Ct. 708, 719.

[6] At 723.

[7] At 726.

[8] *Massachusetts Mutual Life Ins. Co. v. Russell*, 473 U.S. 134, 105 S.†Ct. 3085, 87 L. Ed. 2d 96 (1985).

[9] *See* concurring opinions which argue that the court does *not* reach the §502(a)(3) issue.

[10] 508 U.S. 248 at 256, 113 S. Ct. 2063 at 2069.

[11] At 257.

[12] 508 U.S. 248 at 267, 113 S. Ct. 2063 at 2074.

[13] At 269.