

Sereboff v. Mid Atlantic Medical Services, Inc.
The Supreme Court Throws Insurers a Lifeline.

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I. Introduction.

Janette Knudson and Marlene Sereboff were both hurt in car accidents.² Both had medical insurance policies through their employers and both their policies had nearly identical “third party provisions”.³ The provisions said that if they recovered money because they were injured by someone else’s “act or omission” they must pay back any medical expenses their policies paid. Still, in 2002, in *Great West v. Knudson*, the Supreme Court let Knudson off the hook without repaying.⁴ For four years, personal injury lawyers debated the Court’s arcane reasoning in the case and wondered whether medical reimbursements would continue to cut into tort recoveries at all. Then this year, in *Sereboff v. Mid Atlantic Medical Services, Inc.* the Supreme Court said Marlene Sereboff had to repay her insurer.⁵ Now all bets are off. *Sereboff* ingeniously undid *Knudson* without appearing to contradict it and left few if any cases where personal injury lawyers can remove medical reimbursements from their claim resolution calculus.

The *Great West* Ruling.

Employer-provided medical insurance is covered by ERISA, Section 502(a) which limits to a specific list who can sue and for what.⁶ Section 502 says nothing about medical insurers suing plan participants to recoup expenses under contractual third party provisions. Insurers, however, have long claimed they could sue under Section 502 (a)'s "catch all" provision, Section 502(a)(3), which allows plan administrators and others to sue for "appropriate equitable relief" enforcing plan provisions. *Great West v. Knudson* tested that claim with disastrous results for insurers.

Following up on its decision in *Mertens v. Hewitt* where the Court held that "appropriate equitable relief" was confined to the kinds of relief "typically" awarded in the courts of equity, in *Great West* the Supreme Court said that courts of equity didn't typically award money damages for breach of contract and thus modern courts can't award money damages to insurers claiming breach of third party provisions.⁷ While the insurers argued that what they were after was a kind of restitution, the Supreme Court held that the restitution "typically" awarded in the courts of equity didn't involve contract claims and required plaintiffs to identify a specific object or fund of money in the defendants' possession that rightfully

belonged to them, i.e. —“There’s my cow, make them give it back.” Regrettably, Great West couldn’t identify a specific fund; it simply wanted to be reimbursed out of Knudson’s general assets.⁸ Case closed. No relief.

Sereboff

The Supreme Court spoke in *Great West* and Mid Atlantic Medical Services listened. When Sereboff resolved her personal injury case, her lawyer had already received several lien letters from Mid Atlantic, and, once the case resolved, the company promptly sought a preliminary injunction and temporary restraining order forcing Sereboff to set aside the disputed portion of the proceeds.⁹ Ultimately, she agreed to do so while Mid Atlantic’s rights were settled in court.

The Supreme Court heartily approved this approach.¹⁰ After all, Mid Atlantic had found a specific fund against which it had a good claim. Yet a question remained: Wasn’t the claim a contract claim -- a classic legal claim -- that wasn’t “typical” in the courts of equity and hadn’t the *Great West* Court suggested that the claim’s contractual status had just as much to do with the Court’s decision as Great West’s failure to identify a specific fund it could tap? In answer, Chief Justice Roberts, writing for a unanimous Court, waxed inventive. According to Roberts, what matters is not that the obligation to repay was created by contract, but that the basis of the claim is

equitable.¹¹ With perhaps a wry smile, he found the basis equitable because it was much like a 1914 lawyers' personal injury referral fee case, *Barnes v. Alexander*.¹² In *Barnes*, the Court enforced a fee sharing agreement under the theory that it created an equitable lien by agreement where the moment the lawyer who accepted the case got his one-third fee. Under the referral agreement, he became trustee of a third of that fee for the benefit of the lawyer who sent him the case.¹³ Thus, Chief Justice Roberts observed that *Barnes* enforced "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."¹⁴ Like the lawyer who got the referral, Roberts reasoned *Sereboff* held the medical expense amount in trust for Mid Atlantic the moment the money passed into her hands. To the Court, enforcing an equitable lien by agreement is plainly an equitable action, so any doubt about insurers' right to that portion of third party recoveries that reimburses them for their medical expenses is gone.¹⁵ This is not to say, of course, that all the related questions discussed since *Great West* are gone too.

What to do when the Lien Letter Arrives.

Many questions are left about what lawyers have to do when a third party provision may affect the resolution of a tort settlement. Here are three

important ones: (1) what if the insured has dissipated the settlement proceeds? (2) what if the money is in a lawyer's trust account and not with the insured? (3) what if no lien letter arrives?

(1) What if the Insured Dissipated the Settlement Proceeds?

Where insureds have spent money recovered from a third party or mingled with other funds, insurers may still have a hard time recovering because of the lack of a specific fund to lien. This generally means that insurers who snooze lose.¹⁶

There are exceptions. Courts, like the Northern District of Illinois in *Lumenite v. Jarvis* have held that a single bank account with commingled funds is still an identifiable fund that can be liened.¹⁷ Although the argument becomes increasingly strained, other courts, like the Seventh Circuit in *Admin Comm Wal-Mart v. Varco*, have held that insurers can also lien tangible property that tort recoveries used to purchase like cars or homes.¹⁸ As the Northern District of Illinois held in *Leipzig v. AIG* where the proceeds have been spent on ordinary living expenses or such intangibles as educational expenses, (a "host of ordinary expenditures") insurers are not likely to recover.¹⁹ There are no rulings by the Second Circuit or the District of Connecticut on these questions, however, the District of Connecticut has ruled on questions about funds in a lawyer's trust account.

(2) What if the Money is in a Lawyer's Trust Account?

The first thing to remember is that the insured must repay the insurer, so, whatever happens to the money next, lawyers holding tort claim proceeds should tell their clients about this obligation. The insurer can also lien the trust account. It is a specific fund containing the money the insurer has a right to receive. As the District of Connecticut held as recently as 2005 in *Scholastic Corp. v. Kassem*, “[t]hese identifiable funds [held in the Casper & de Tolledo's client trust account] can be traced directly to Ms. Kassem's settlement of her state-court tort action, and, to date, the funds have not been dispersed to her or otherwise dissipated.... [t]he funds in question are in the constructive, if not actual, possession and control of Defendants.”²⁰

Lawyers should also be wary of clients who instruct them to turn the proceeds over without paying off the insurer's lien. While lawyers' natural inclinations might be to follow their clients' instructions after advising them of the risks, this situation is tricky. Some courts, including, the Fifth Circuit in *Bombardier Aerospace Employee Welfare Benefits Plan v. Ferrer, Poirot & Wansbrough*, have held that attorneys may be liable to insurers for failing to pay off the liens.²¹ Taking it one step further the Middle District of Tennessee in *Greenwood Mills v. Burris*, held the appropriate remedy against an attorney for failing to pay off subrogation liens was disgorgement

of fees.²² Other courts, including the District of Maryland in *Mid Atl. Med. Servs., Inc. v. Do*, have rejected liability because attorneys aren't parties to the repayment agreement or the lawsuit that yielded the recovery.²³ Unfortunately, the matter is made even more complicated for lawyers in Connecticut; they should consider carefully whether an insurer might grieve them.²⁴ Rule 1.15 "Safekeeping Property" under The Connecticut Rules of Professional Conduct suggests lawyers have a duty to safeguard the part of the property in the trust accounts that legally belongs to the insurer:

(b) 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 property.

Arguably, after notifying insurers that they hold funds in which they have an interest, lawyers may "by agreement" with their clients distribute the money to the clients but not the insurers. This, however, doesn't change the lawyers' potential exposure to suit from the insurers. The safe thing to do is for lawyers to persuade clients of their legal obligations to insurers and avoid complications. Then, if notifying insurers isn't enough in every case to trigger suits freezing the money in the account, lawyers caught between

their duties to their clients and their status as potential defendants in insurers' lawsuits can always interplead the disputed amount into court and pay the money as the interpleader judgment directs.²⁵

Unfortunately, *Sereboff* is not good news for personal injury lawyers, but its consequences are real nonetheless.

(3) What if the Lien Letter Never Arrives?

Remember, the lien letter doesn't create the lien; the insured's agreement to repay creates the lien. So, even if the lien letter never arrives, the lien still exists and, in Connecticut, the Rules of Professional Conduct say lawyers must tell insurers when the money reaches their accounts. Once money arrives in the lawyers' trust account, it's under the control of the insureds and the insureds become trustees for the benefit of their insurers. Regardless of its popularity, the genius of *Sereboff* is that it leaves little wiggle room. Whether lawyers have a duty to investigate for liens, however, is unclear, but where lawyers know that there is a reasonable likelihood that a lien will be claimed, the lawyers' duty to their clients, probably includes, at a minimum, advising them on the subject.

Conclusion.

Sereboff closed the door fairly hard on ERISA plan insureds trying to avoid repaying medical expenses. The Court made the obligation to repay

clear. While it didn't address all of the implications for lawyers handling personal injury suits, unless the money was dissipated, insurers will likely recover. Lawyers playing it safe should try to persuade their clients to repay; they take risks in following clients' instructions to ignore the obligation.

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² *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 207 (2002);
Sereboff v. Mid Atl. Med. Servs., 126 S. Ct. 1869 (2006).

³ This article doesn't address the case where a policy isn't subject to ERISA. Where it isn't Conn. Gen. Stat. § 52-225c governs.

⁴ 534 U.S. at 221.

⁵ 126 S. Ct. at 1878.

⁶ 29 U.S.C. § 1132(a).

⁷ 534 U.S. at 210-211

⁸ 534 U.S. at 214

⁹ 126 S. Ct. 1872-73

¹⁰ 126 S. Ct. 1878

¹¹ 126 S. Ct. 1877.

¹² *Barnes v. Alexander*, 232 U.S. 117 (1914).

¹³ 232 U.S. 121.

¹⁴ 126 S. Ct. 1869.

¹⁵ 126 S. Ct. 1876

¹⁶ As this article demonstrates, most tort proceeds won't even get distributed before the lien issue must be addressed, but the rules about dissipated funds will apply sometimes

and certainly will apply where the money was distributed before the Supreme Court decided *Sereboff*.

¹⁷ 252 F. Supp. 2d 700, 704 (D. Ill. 2003)

¹⁸ 338 F.3d 680, 687 (7th Cir. 2003)

¹⁹ 257 F. Supp. 2d 1152, 1153 (N.D.Ill. 2003)

²⁰ 389 F. Supp. 2d 402, 414-15. (Conn. 2005); See also, *Bombardier Aero. Empl. Welfare Benefits Plan v. Ferrer, Poirot & Wansbrough, P.C.*, 354 F.3d 348, 358 (5th Cir. 2003); *Wellmark, Inc. v. Deguara*, 257 F. Supp. 2d 1209, 1216 (D. Iowa 2003)

²¹ 354 F.3d 348, 353-54 (5th Cir. 2003); See also; *Great-West Life & Annuity Ins. Co. v. Smith*, 180 F. Supp. 2d 1311, 1313 (M.D. Fla. 2002); *Aetna Cas. & Sur. Co. v. Gilreath*, 625 S.W.2d 269, 274 (Tenn. 1981); *Motors Ins. Corp. v. Blakemore*, 584 S.W.2d 204, 207 (Tenn.Ct.App. 1978); *Harris Trust and Savings Bank v. Salomon Smith Barney Inc.*, 530 U.S. 238, 120 S. Ct. 2180, 147 L. Ed. 2d 187 (2000).

²² 130 F. Supp. 2d 949, 960-961, 963 (D. Tenn. 2001).

²³ 294 F. Supp. 2d 695 (D. Md. 2003); See also, *Maryland Elec. Indus. Health Fund v. Levitt*, 155 F. Supp. 2d 482, 484 (D. Md. 2001).

²⁴ Which is not to say sue them since the Rules of Professional Conduct don't by themselves create causes of action. - Connecticut Rules of Professional Conduct Section 18 of Preamble, Scope and Terminology.

²⁵ See *Conn. Practice Book* §§23-43,44.