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Note

Adding Insult to Injury: ERISA, *Knudson*, and the Error of the Possession Theory

David D. Leishman*

Until relatively recently, insurers did not demand that injured policyholders repay the medical expenses they received from their insurance plans.¹ Today, however, insurers commonly do make such a demand, usually supported by language in the policy requiring reimbursement.² A majority of states, by statute or common law, prevent insurers from enforcing such clauses.³ If the insurance plan falls under the aegis of the Employee Retirement Income Security Act of 1974 (ERISA),⁴ however, the plan⁵ will often recover because ERISA preempts state law that would prevent reimbursement.⁶ The distinction

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1. See *infra* notes 13–14 and accompanying text.

2. See *infra* notes 15–16 and accompanying text.

3. See *infra* notes 17–19 and accompanying text.

4. 29 U.S.C. § 1002(1) (2000). Under ERISA, an “employee benefit plan” is:

any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that such plan, fund, or program was established or is maintained for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, . . . medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment

Id.

5. Reimbursement actions may be brought by both an ERISA plan (the entity that administers the payment of medical benefits), see, e.g., *Mid Atlantic Medical Services, Inc. v. Sereboff*, 303 F. Supp. 2d 691, 695 (D. Md. 2004), or its insurer (which agrees to pay some or all of the medical expenses on behalf of the plan), see, e.g., *Great-West Life & Annuity Insurance Co. v. Knudson*, 534 U.S. 204 (2002). The distinction is beyond the scope of, and largely immaterial to, this Note.

6. See *infra* Part I.B.

is significant: almost all health insurance but Medicare is provided through employer plans and thus subject to ERISA.⁷

In *Great-West Life & Annuity Insurance Co. v. Knudson*, the Supreme Court limited actions by ERISA plans to those typically available at equity, and held that an insurer cannot obtain reimbursement when the policyholder does not possess an identifiable fund of money directly traceable to the third-party recovery.⁸ Since *Knudson*, most federal courts have adopted an erroneous doctrine known as “the possession theory,” which observes the obvious corollary to *Knudson*’s holding: an ERISA plan *can* obtain reimbursement when the policyholder *does* possess an identifiable, traceable fund.⁹ The Sixth and Ninth Circuits, however, have declined to follow the possession theory and generally refuse to allow reimbursement actions by ERISA insurers against policyholders.¹⁰

This Note sketches the traditional state law presumption against subrogation or reimbursement by an insurer in personal injury cases. It then describes how ERISA trumps these state laws, and how *Knudson* has led most federal courts to allow plans to pursue causes of action “traditionally available at equity” against policyholders. This Note argues that reimbursement under the possession theory does not meet the requirements set forth in *Knudson*, and concludes that there is no currently viable cause of action for an ERISA plan seeking reimbursement from a policyholder. It also describes the reasoning of the two circuits that refuse to follow the possession theory and concludes that their analyses are incomplete.

I. DEVELOPMENT OF CURRENT FEDERAL COMMON LAW CONCERNING REIMBURSEMENT ACTIONS BY ERISA PLANS

A. SUBROGATION OF PERSONAL INJURY CLAIMS HAS BEEN HISTORICALLY DISFAVORED

Subrogation is a principle whereby an insurer who has indemnified a policyholder may assume legal standing in place of

7. Lorraine Schmall & Brenda Stephens, *ERISA Preemption: A Move Towards Defederalizing Claims for Patients’ Rights*, 42 BRANDEIS L.J. 529, 538 (2004).

8. 534 U.S. 204 (2002).

9. See *infra* Part I.C.2.

10. See *infra* Part IV.

the policyholder to sue a third-party tortfeasor on the policyholder's claim for compensation.¹¹ Closely related to, but distinct from, subrogation is reimbursement, in which the insurer asserts a contractual right to repayment from the policyholder should she later recover from a third party.¹²

Courts historically did not allow subrogation of personal injury claims¹³ due to the common law prohibitions against assignment of personal injury claims and against splitting personal injury causes of action.¹⁴ In the 1960s, however, insurers found that couching subrogation clauses in language of "reimbursement" avoided the rule against subrogation while achieving the same result.¹⁵ Thus, the concept of subrogation and/or reimbursement of personal injury claims "is of relatively recent origin, having only been developed in the last thirty to forty years."¹⁶

A minority of states have flatly rejected, either by court decision or statute, the extension of subrogation actions into the realm of personal injury claims.¹⁷ More commonly, state "make-whole" doctrines reduce an insurer's ability to recover from a

11. BLACK'S LAW DICTIONARY 1467 (8th ed. 2004); Roger M. Baron, *Subrogation: A Pandora's Box Awaiting Closure*, 41 S.D. L. REV. 237, 238 (1996).

12. See Michelle J. d'Arcambal, *The Assault on Subrogation*, in ALI-ABA CONFERENCE ON LIFE INSURANCE LITIGATION 461, 463 (ALI-ABA eds. 1997) (defining subrogation and reimbursement).

13. See Baron, *supra* note 11, at 239-40 (noting that "subrogation had been disallowed by virtually all courts until recently").

14. ROBERT E. KEETON, BASIC TEXT ON INSURANCE LAW 152-53 (1971).

15. *Id.* As insurers sought ways around the common law prohibition of subrogation of personal injury claims, they discovered that courts were often more amenable to language of "reimbursement" than of "subrogation." Roger M. Baron, *Public Policy Considerations Warranting Denial of Reimbursement to ERISA Plans: It's Time to Recognize the Elephant in the Courtroom*, 55 MERCER L. REV. 595, 603 (2004). For a case illustrating the erosion of the distinction between subrogation and reimbursement, see *Lee v. State Farm Mutual Automobile Insurance Co.*, 129 Cal. Rptr. 271 (Cal. Ct. App. 1976). The policy language exalted form over substance by requiring "reimbursement," but also required the policyholder, upon the insurer's request, to sue a third party to facilitate the insurer's reimbursement right. *Id.* at 274. In this manner, "the disingenuous draftsmen of insurance policies move[d] into the gaps created by decisional erosion The cumulative effect of the policy provisions is to create the economic reality of subrogation to the personal injury claim without its language." *Id.* at 278 (Freidman, J., concurring).

16. Baron, *supra* note 15, at 602-03.

17. Roger M. Baron, *Subrogation on Medical Expense Claims: The "Double Recovery" Myth and the Feasibility of State Anti-Subrogation Laws*, 96 DICK. L. REV. 581, 584-85 (1992) (noting that Missouri, Arizona, Connecticut, Nevada, Montana, Pennsylvania, and Oklahoma adopt this minority view).

policyholder by requiring that the policyholder first be fully compensated for any uninsured loss.¹⁸ Twenty-five jurisdictions have adopted the make-whole doctrine.¹⁹ The majority of states, therefore, at least agree that an insurer is not entitled to share in a policyholder's recovery from a tortfeasor until the policyholder has been fully compensated for her loss.

B. ERISA PREEMPTS STATE LAWS PROHIBITING SUBROGATION AND REIMBURSEMENT

Congress drafted ERISA in response to the failure of a number of employer-sponsored benefit plans. It was intended to guarantee the solvency of such plans, thus guaranteeing benefits to workers.²⁰ During drafting, ERISA came to encompass not only pension plans, but also medical and other employee benefit plans.²¹ Congress, unfortunately, "gave very little explicit consideration to the implications of this expansion."²²

To protect workers by guaranteeing the solvency of their benefit plans, and to encourage employers to offer benefit plans to their employees, Congress created nationwide standards for the administration of benefit plans, hoping to reduce the ad-

18. Greta E. Cowart, *Subrogation After Great-West Life & Annuity Ins. Co. v. Knudson*, in PENSION, PROFIT-SHARING, WELFARE, AND OTHER COMPENSATION PLANS 661, 670 (ALI-ABA eds. 2002).

19. Elaine M. Rinaldi, *Apportionment of Recovery Between Insured and Insurer in a Subrogation Case*, 29 TORT & INS. L.J. 803, 807 (1994) (reporting that Alabama, Arkansas, Colorado, Connecticut, Florida, Illinois, Indiana, Iowa, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Montana, New Jersey, North Carolina, Rhode Island, Tennessee, Texas, Utah, Vermont, Washington, West Virginia, and Wisconsin have adopted the doctrine).

20. Russell Korobkin, *The Failed Jurisprudence of Managed Care, and How To Fix It: Reinterpreting ERISA Preemption*, 51 UCLA L. REV. 457, 464 (2003) (citing H.R. REP. NO. 93-533, at 1 (1973), reprinted in 1974 U.S.C.C.A.N. 4639, 4639) ("The primary purpose of the statute was to regulate private-sector pension plans at the federal level and thus guarantee the solvency and integrity of such plans for the benefit of employees."). See generally James A. Wooten, *"The Most Glorious Story of Failure in the Business": The Studebaker-Packard Corporation and the Origins of ERISA*, 49 BUFF. L. REV. 683 (2001) (describing how the 1963 shutdown of the Studebaker plant in South Bend, Indiana and its ensuing failure to meet pension obligations to its employees was a catalyzing event in the drafting of ERISA).

21. Korobkin, *supra* note 20, at 465 ("In the drafting process, however, the scope of ERISA was expanded to provide federal oversight of all employer-sponsored fringe benefit plans, including plans that provide for the medical care of employees.").

22. *Id.*

ministrative cost of compliance with various state regulations.²³ To further this standardization, Congress endowed ERISA with "the most comprehensive and pervasive preemption of the present era."²⁴ The precise machinations of ERISA preemption continue to perplex federal courts, including the Supreme Court;²⁵ nonetheless, certain general principles are clear.

ERISA preemption is governed by three clauses: the preemption clause,²⁶ the saving clause,²⁷ and the deemer clause.²⁸

23. N.Y. Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 646 (1995). Congress implemented nationwide standardization as a means, not an end; Congress was ultimately driven by "the absolute need that safeguards for plan participants be sufficiently adequate and effective to prevent the numerous inequities to workers under plans which have resulted in tragic hardship to so many." H.R. REP. NO. 93-533, at 9 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4647.

24. *Bauhaus USA, Inc. v. Copeland*, 292 F.3d 439, 445 (5th Cir. 2002) (Wiener, J., dissenting).

25. See *DiFelice v. Aetna U.S. Healthcare*, 346 F.3d 442, 454 (3rd Cir. 2003) (Becker, J., concurring) (resolving ERISA preemption claims in the healthcare context is like a "descent into a Serbonian bog wherein judges are forced to don logical blinders and split the linguistic atom to decide even the most routine cases"); *Dishman v. UNUM Life Ins. Co. of Am.*, 269 F.3d 974, 980 (9th Cir. 2001) (noting that defining a rule for preemption "has bedeviled the Supreme Court"); *Carpenters Local Union No. 26 v. U.S. Fid. & Guar. Co.*, 215 F.3d 136, 139 (1st Cir. 2000) (noting that the Supreme Court has "been at least mildly schizophrenic in mapping" the contours of ERISA preemption); *Travelers Ins. Co. v. Cuomo*, 14 F.3d 708, 717 (2d Cir. 1993) ("With understated irony, the Supreme Court has described the ERISA section at issue here as 'not a model of legislative drafting.' In truth, it is a veritable Sargasso Sea of obfuscation."); *Atlantis Health Plan v. Local 713, I.B.O.T.U.*, 258 F. Supp. 2d 284, 289 (S.D.N.Y. 2003) ("Deciphering the mysteries surrounding the circumstances under which ERISA works to supersede a conflicting state statute or common law claim has become a task demanding nothing less than oracular power."); *Florence Nightingale Nursing Serv., Inc. v. Blue Cross & Blue Shield of Ala.*, 832 F. Supp. 1456, 1457 (N.D. Ala. 1993) ("A hyperbolic wag is reputed to have said that E.R.I.S.A. stands for 'Everything Ridiculous Invented Since Adam.' This court does not take so dim a view of [ERISA]. Instead, this court is willing to believe that ERISA has lurking somewhere within it a redeeming feature."), *aff'd*, 41 F.3d 1476 (11th Cir. 1995).

26. 29 U.S.C. § 1144(a) (2000) ("Except as provided in [the saving clause], the provisions of this subchapter . . . shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan [covered by ERISA].").

27. *Id.* § 1144(b)(2)(A) ("Except as provided in [the deemer clause], nothing in this subchapter shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities.").

28. *Id.* § 1144(b)(2)(B) (providing that certain employee benefit plans may not be "deemed to be an insurance company" within the meaning of the saving clause). For purposes of this Note, a cursory sketch of ERISA preemption will suffice; the reader should be aware that this sketch is a gross oversimplification of this tortuous body of law.

Generally speaking, the preemption clause provides broad prima facie preemption of any state law relating to an ERISA plan.²⁹ The saving clause “saves” from preemption state regulations directed at insurance, banking, and securities, thus preventing ERISA from swallowing those areas of state law in their entirety.³⁰ Finally, the deemer clause provides that self-insured ERISA plans (those that pay claims themselves rather than contracting with an insurer to do so) shall not be “deemed” insurers under state law, thus preventing states from passing insurance legislation narrowly aimed at ERISA plans and making an end-run around ERISA preemption.³¹

ERISA’s preemption clause provides that the Act’s provisions “supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan” covered by ERISA.³² The Supreme Court has given the “relate to” phrase its “broad common-sense meaning.”³³ A state law relates to an employee benefit plan, “in the normal sense of the phrase, if it has a connection with or reference to such a plan.”³⁴ The Supreme Court has recognized that “ERISA’s nearly limitless ‘relates to’ language offers no meaningful guidelines to reviewing judges,”³⁵ and that courts “‘simply must go beyond the unhelpful text and the frustrating difficulty of defining its key term, and look instead to the objectives of the ERISA statute as

29. See *infra* notes 32–36 and accompanying text.

30. JAMES F. JORDAN ET AL., HANDBOOK ON ERISA LITIGATION § 2.04 (2d ed. 2004).

31. *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 45 (1987).

32. 29 U.S.C. § 1144(a).

33. *Pilot Life*, 481 U.S. at 47.

34. *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 96–97 (1983). For purposes of ERISA preemption, “state law” includes both statutory and common law. 29 U.S.C. § 1144(c)(1); *Pilot Life*, 481 U.S. at 48 (1987). A state law that expressly refers to an ERISA plan will unquestionably “relate to” an employee benefit plan for purposes of the preemption clause. *District of Columbia v. Greater Wash. Bd. of Trade*, 506 U.S. 125, 137 (1992) (“State laws that directly regulate ERISA plans, or that make it necessary for plan administrators to operate such plans differently, ‘relate to’ such plans in the sense intended by Congress.”). However, “the preemption clause is not limited to state laws specifically designed to affect employee benefit plans.” *Pilot Life*, 481 U.S. at 47–48.

35. *Gerosa v. Savasta & Co.*, 329 F.3d 317, 323 (2d Cir. 2003) (citing *Rush Prudential HMO, Inc. v. Moran*, 536 U.S. 355, 365–66 (2002), *cert. denied*, 540 U.S. 967 (2003), and *cert. denied*, 540 U.S. 1074 (2003); *N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 655–56 (1995)).

a guide to the scope of the state law that Congress understood would survive.”³⁶

C. CURRENT FEDERAL COMMON LAW ALLOWS ERISA PLANS TO PURSUE REIMBURSEMENT

ERISA's text is silent on subrogation and reimbursement,³⁷ so federal common law determines the application of state anti-subrogation laws and make-whole doctrines to actions by ERISA plans. The Supreme Court's decision in *FMC Corp. v. Holliday*³⁸ forms the current framework for ERISA preemption of state antisubrogation statutes. In that case, the defendant policyholder argued that Pennsylvania's antisubrogation statute precluded an ERISA plan's demand for reimbursement.³⁹ The Court found that the antisubrogation law “related to” an employee benefit plan and was *prima facie* preempted,⁴⁰ but that the saving clause “return[ed] the matter of subrogation to state law” since the law was directed at insurance.⁴¹ The state antisubrogation law did not reach the ERISA plan in question, however, because as a self-funded plan it could not be “deemed” an insurance company for purposes of the law.⁴² *FMC Corp.* means that state antisubrogation statutes are preempted as applied to self-funded ERISA plans but not as to insured ERISA plans.⁴³

State make-whole doctrines fare even worse under ERISA. The doctrine provides the “default understanding” of an ERISA

36. *Gerosa*, 329 F.3d at 323 (quoting *N.Y. State Conference of Blue Cross & Blue Shield Plans*, 514 U.S. at 656).

37. “ERISA says nothing about subrogation provisions. ERISA neither requires a welfare plan to contain a subrogation clause nor does it bar such clauses or otherwise regulate their content.” *Member Servs. Life Ins. Co. v. Am. Nat'l Bank & Trust Co. of Sapulpa*, 130 F.3d 950, 958 (10th Cir. 1997) (quoting *Ryan v. Fed. Express Corp.*, 78 F.3d 123, 127 (3d Cir. 1996)); *see also* Baron, *supra* note 15, at 617 (noting that “nothing in the ERISA scheme endorses reimbursement or suggests that reimbursement is permitted under ERISA”). ERISA's silence may result from the fact that “reimbursement,” a recent development in insurance law, was not prevalent at the time of ERISA's drafting and that “the idea of reimbursement had yet to be presented or approved by the courts.” *Id.* at 618.

38. 498 U.S. 52 (1990).

39. *Id.* at 55.

40. *See id.* at 58–60.

41. *Id.* at 60–61.

42. *See id.* at 61–62.

43. *See* Baron, *supra* note 17, at 586.

plan.⁴⁴ However, the ERISA plan may overcome the doctrine simply by clearly indicating an intent to do so in the plan language.⁴⁵ State make-whole doctrines provide no meaningful protection to ERISA policyholders since even a boilerplate subrogation clause in the plan language negates the doctrine.⁴⁶

1. *Great-West Life & Annuity Insurance Co. v. Knudson*
Precludes Actions "At Law" by ERISA Plans

While the state antisubrogation laws that exist may be preempted, and any reasonably careful insurer can avoid state make-whole doctrines, ERISA plans cannot obtain reimbursement at will from their policyholders. The Supreme Court's decision in *Great-West Life & Annuity Insurance Co. v. Knudson*⁴⁷ revived the archaic distinction between actions "at law" and those "at equity" in holding that, under ERISA, plans could obtain reimbursement only through actions "typically available at equity."⁴⁸ To understand why, it is necessary to sketch ERISA's remedial provisions.

ERISA provides that a plan fiduciary may bring a civil action for an injunction against a plan violation or "to obtain other appropriate equitable relief to redress such violations."⁴⁹ In *Mertens v. Hewitt Associates*,⁵⁰ plan participants sought damages from, inter alia, an actuarial firm whose work allegedly led to the insolvency of a benefit pension plan sponsor. Justice Scalia, in a five-to-four decision, held that money dam-

44. See *Sanders v. Scheideler*, 816 F. Supp. 1338, 1347 (W.D. Wis. 1993) (observing that "[a]doption of the make whole doctrine as a default priority rule appears consistent with the congressional mandate to fashion federal common law to facilitate the ERISA scheme"), *aff'd*, 25 F.3d 1053 (7th Cir. 1994).

45. See *Cagle v. Bruner*, 112 F.3d 1510, 1521 (11th Cir. 1997) ("[T]he make whole doctrine applies to limit a plan's subrogation rights where an insured has not received compensation for his total loss and the plan does not explicitly preclude operation of the doctrine." (emphasis added)).

46. *In re Paris*, 44 F. Supp. 2d 747, 748 (D. Md. 1999), *aff'd*, 211 F.3d 1265 (4th Cir. 2000).

47. 534 U.S. 204 (2002).

48. See *infra* notes 55-57 and accompanying text (emphasis omitted).

49. 29 U.S.C. § 1132(a)(3)(B) (2000) (internal numbering omitted). Section 1132(a)(3) provides an ERISA plan's only means of civil enforcement; ERISA's other remedies are restricted to plan participants or beneficiaries. See *id.* § 1132(a).

50. 508 U.S. 248 (1993).

ages are a "classic form of *legal* relief" and therefore not authorized by ERISA's "equitable relief" provision.⁵¹

The legal/equitable distinction resurfaced in *Knudson*. Great-West, the insurer of an ERISA plan, paid approximately \$350,000 to Janet Knudson for medical expenses stemming from a car accident in which she was rendered a quadriplegic.⁵² Knudson subsequently settled a tort suit against the car manufacturer and other alleged tortfeasors for \$650,000.⁵³ Great-West sued for specific performance of the plan's reimbursement provision, which gave Great-West "'the right to recover from the [beneficiary] any payment for benefits' paid by the Plan that the beneficiary is entitled to recover from a third party."⁵⁴

In another five-to-four decision penned by Justice Scalia, the Court held that because ERISA is a "comprehensive and reticulated statute," the judiciary may not extend remedies beyond those specifically authorized in its text.⁵⁵ Following *Mertens*, Scalia wrote that "equitable relief" refers to "'those categories of relief that were *typically* available in equity."⁵⁶ By asking for performance of the reimbursement provision, Great-West sought to impose a contractual obligation on Knudson, and a contractual obligation is a classic form of *legal* relief.⁵⁷ Therefore, ERISA did not allow Great-West the relief it sought.⁵⁸

Scalia spurned Great-West's attempts to shoehorn its action into one of the equitable categories authorized by ERISA.⁵⁹ Great-West argued that it sought restitution, which, as an equitable form of relief, was authorized by ERISA.⁶⁰ Indeed, in *Mertens*, Scalia himself had identified restitution as a form of relief typically available at equity.⁶¹ Scalia rejected this argument, but had to backtrack on his *Mertens* opinion to do so: "restitution is a legal remedy when ordered in a case at law . . . and an equitable remedy when ordered in an equity case,' and

51. *Id.* at 255.

52. *Knudson*, 534 U.S. at 207.

53. *Id.*

54. *Id.* (citing Joint Appendix at 58(a), *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204 (2002) (No. 99-1786)).

55. *Id.* at 209 (quoting *Mertens*, 508 U.S. at 251).

56. *Id.* at 210 (quoting *Mertens*, 508 U.S. at 256).

57. *Id.* at 214.

58. *Id.* at 218.

59. *Id.* at 212-16.

60. *Id.* at 212.

61. *Id.* at 215 (citing *Mertens*, 508 U.S. at 256).

whether it is legal or equitable depends on 'the basis for [the plaintiffs] claim' and the nature of the underlying remedies sought."⁶² Because Great-West's action was not for *particular* funds, but rather for *any* funds, Scalia concluded that the claim was legal, not equitable, and subject to dismissal.⁶³

Great-West's action was not authorized by ERISA, according to Scalia, because "the funds to which [Great-West] claim[ed] an entitlement . . . [were] not in [Knudson's] possession."⁶⁴ In contrast, Scalia wrote, "a plaintiff could seek restitution *in equity*, ordinarily in the form of a constructive trust or an equitable lien, where money or property identified as belonging in good conscience to the plaintiff could clearly be traced to particular funds or property in the defendant's possession."⁶⁵ The obvious import of Scalia's opinion was that an ERISA insurer who properly pleaded for imposition of a constructive trust or equitable lien upon funds identifiable and in the defendant's possession *would* be allowed to proceed with its cause of action.⁶⁶

2. Reimbursement Under the Possession Theory

Virtually every federal court since *Knudson* has adhered to the "possession theory," which holds that "where funds in the actual or constructive possession of a plan beneficiary are traceable to money or property identified as belonging in good conscience to" the ERISA plan, the plan may seek a constructive trust or equitable lien as "other equitable relief" available under ERISA.⁶⁷ Under this theory, an ERISA insurer may impose a constructive trust or equitable lien upon "funds that are specifically identifiable, that belong in good conscience to the

62. *Id.* at 213 (quoting *Reich v. Cont'l Cas. Co.*, 33 F.3d 754, 756 (7th Cir. 1994)).

63. *Id.* at 214, 221. Justice Scalia also rejected Great-West's claim that it sought "to enjoin a[n] act or practice" contrary to the policy; the Court held that "an injunction to compel the payment of money past due under a contract . . . was not typically available in equity." *Id.* at 210-11 (internal citation omitted).

64. *See id.* at 214.

65. *Id.* at 213.

66. The Court expressed "no opinion as to whether petitioners could have intervened in the state-court tort action brought by respondents," or "whether a direct action by petitioners against respondents asserting state-law claims such as breach of contract would have been pre-empted by ERISA." *Id.* at 220.

67. *See Mid Atlantic Med. Servs., Inc. v. Sereboff*, 303 F. Supp. 2d 691, 695 (D. Md. 2004); *see also B.P. Amoco Corp. v. Connell*, 320 F. Supp. 2d 1368, 1371 (M.D. Ga. 2004) (noting the "possession theory" label for this approach).

Plan, and that are within the possession and control of the defendant ERISA beneficiary.”⁶⁸

The Fifth Circuit decision in *Bombardier Aerospace Employee Welfare Benefits Plan v. Ferrer, Poirot and Wansbrough*⁶⁹ illustrates the application of the possession theory. An ERISA plan sought funds that, like those in *Knudson*, came from a specifically identifiable fund of money traceable to a third-party settlement.⁷⁰ Moreover, as in *Knudson*, the plan’s terms contained an express, unambiguous reimbursement provision establishing the plan’s claim to the funds.⁷¹ In contrast to *Knudson*, however, the *Bombardier* policyholder had control of the funds in question.⁷² Thus, the Fifth Circuit held, the plan could assert a constructive trust upon the funds under *Knudson*’s reasoning.⁷³

The U.S. District Court for the Eastern District of Wisconsin, in *Forsling v. J.J. Keller & Associates, Inc.*,⁷⁴ also attempted to follow *Knudson* by adopting the possession theory. The *Forsling* court delineated a four-part test for a truly equitable action:

First, a defendant must be in possession of disputed funds. . . . Second, the funds must not have been dissipated. . . . Third, the party seeking equitable relief must not be attempting to impose personal liability on the opposing party. . . . Finally, the money at issue must be identifiable and must belong in good conscience to the party seeking relief.⁷⁵

The court noted that:

Knudson, by its own language, did not bar plan administrators from bringing an action to obtain reimbursement for benefits they paid. Instead the court expressly embraced the use of constructive trusts and other forms of equitable relief directed toward the funds from which reimbursement was sought while still in the possession of the defendant, as opposed to an action at law for damages against the injured party.⁷⁶

68. *Bombardier Aerospace Employee Welfare Benefits Plan v. Ferrer, Poirot & Wansbrough*, 354 F.3d 348, 355–56 (5th Cir. 2003) (internal numbering omitted), *cert. denied*, 124 S. Ct. 2412 (2004).

69. *Id.*

70. *Id.* at 356.

71. *Id.*

72. *Id.*

73. *See id.* at 358.

74. 241 F. Supp. 2d 915, 918 (E.D. Wis. 2003).

75. *Id.* (internal citations omitted).

76. *Id.* at 919.

"Possession" under the possession theory is construed broadly. Thus, funds in the ERISA beneficiary's bank account have been held the proper subject of equitable relief,⁷⁷ but so have funds deposited in a registry of the court,⁷⁸ as well as funds held by the defendant's attorney,⁷⁹ held in trust for the defendant,⁸⁰ held by the third-party tortfeasor's attorney,⁸¹ and held by the tortfeasor's insurer.⁸²

Courts in the Fourth,⁸³ Fifth,⁸⁴ Seventh,⁸⁵ Eighth,⁸⁶

77. See *Mid Atlantic Med. Servs. v. Sereboff*, 303 F. Supp. 2d 691, 696 (defendants held money in an investment account).

78. See, e.g., *Admin. Comm. of the Wal-Mart Assocs. Health & Welfare Plan v. Willard*, 302 F. Supp. 2d 1267, 1271 (D. Kan. 2004) (tortfeasor deposited funds with court as part of settlement agreement), *aff'd*, No. 04-3081, 2004 WL 2988571, at *5-6 (10th Cir. Dec. 28, 2004); *Sealy, Inc. v. Nationwide Mut. Ins. Co.*, 286 F. Supp. 2d 625, 628 (M.D. N.C. 2003) (funds deposited in a registry of the court by interpleading insurer). But see *Bauhaus USA, Inc. v. Copeland*, 292 F.3d 439, 445 (5th Cir. 2002) (holding that although funds were on deposit in a registry of court, the facts were "indistinguishable in principle from *Great-West*").

79. See, e.g., *Wal-Mart Stores, Inc. Assocs. Health & Welfare Plan v. Wells*, 213 F.3d 398, 401 (7th Cir. 2000) ("[T]he lawyer's interception of the entire amount en route from the insurer to the plan is clearly wrongful."); *IBEW-NECA S.W. Health & Benefit Fund v. Douthitt*, 211 F. Supp. 2d 812, 816 (N.D. Tex. 2002) (holding that funds held by the defendant's attorney are "presently within [the defendant's] possession and control"), *aff'd*, Int'l Bd. of Elec. Workers v. Douthitt, 98 Fed. Appx. 306 (5th Cir. 2004).

80. See, e.g., *Great-West Life & Annuity Ins. Co. v. Brown*, 192 F. Supp. 2d 1376 (M.D. Ga. 2002) (funds in trust account); *Corporate Benefit Servs. of Am., Inc. v. Sempf*, No. 03-C-0048-C, 2003 WL 21704145, at *4-5 (W.D. Wis. May 9, 2003) (funds in revocable living trust); *B.P. Amoco Corp. v. Connell*, 320 F. Supp. 2d 1368, 1372 (M.D. Ga. 2004) (special needs trust). Note that the *Knudson* funds were also in a special needs trust. *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 207 (2002). However, *Knudson* did not decide whether Great-West could have obtained equitable relief against the trustee since Great-West did not appeal the district court's denial of its motion to amend its complaint to add the trustee as a defendant. *Id.* at 220.

81. See *Primax Recoveries, Inc. v. Young*, 83 Fed. Appx. 523, 525 (4th Cir. 2003).

82. See *Forsling v. J.J. Keller & Assocs., Inc.*, 241 F. Supp. 2d 915, 919 (E.D. Wis. 2003).

83. See, e.g., *Primax Recoveries*, 83 Fed. Appx. at 525 ("Because Primax seeks a constructive trust on identifiable funds that they claim belong in good conscience to them, and those funds are in Young's possession, we find Primax properly proceeded under ERISA.").

84. *E.g. Bombardier Aerospace Employee Welfare Benefits Plan v. Ferrer, Poirot & Wansbrough*, 354 F.3d 348, 356 (5th Cir. 2003).

85. See, e.g., *Forsling*, 241 F. Supp. 2d at 919.

86. See, e.g., *Allison v. Wellmark, Inc.*, No. C00-3015-MWB, 2002 WL 31818946, at *9 (N.D. Iowa Oct. 15, 2002) (holding that "equity requires the imposition of a constructive trust on the insurance proceeds at issue").

Tenth,⁸⁷ Eleventh,⁸⁸ and D.C.⁸⁹ Circuits have adopted the possession theory. In so doing, these courts believe they are giving proper weight to Justice Scalia's distinction between legal and equitable restitution in *Knudson*.⁹⁰ Courts in the First, Second, and Third Circuits have yet to take a position on the possession theory.⁹¹

II. PUBLIC POLICY SUPPORTS ABOLISHING REIMBURSEMENT ACTIONS BY INSURERS

Before examining the failings of the possession theory, it is helpful to understand why courts should want to prevent insurers' reimbursement actions. If the plan language calls for reimbursement, why not allow it? Technical deficiencies in the possession theory aside, there are strong policy reasons to oppose insurers' attempts to recover money from their injured policyholders.

A. INSURERS' FLAWED ARGUMENTS FOR REIMBURSEMENT

Insurers frequently justify subrogation actions by proclaiming that the injured policyholder should not receive a

87. See, e.g., *Admin. Comm. of the Wal-Mart Assocs. Health & Welfare Plan v. Willard*, 302 F. Supp. 2d 1267, 1275 (D. Kan. 2004) (holding that fiduciary's suit to obtain declaratory relief with regard to proceeds in the custody of the court is equitable in nature), *aff'd*, No. 04-3081, 2004 WL 2988571, at *5-6 (10th Cir. Dec. 28, 2004).

88. See, e.g., *B.P. Amoco Corp. v. Connell*, 320 F. Supp. 2d 1368, 1372 (M.D. Ga. 2004) ("[T]he most important consideration is that the settlement proceeds are still intact, and thus constitute an identifiable *res* that can be restored to its rightful recipient.").

89. See, e.g., *Primax Recoveries, Inc. v. Lee*, 260 F. Supp. 2d 43 (D.D.C. 2003).

90. See, e.g., *Forsling*, 241 F. Supp. 2d at 918 ("I therefore conclude that the plain language of *Knudson* authorizes Keller's third-party action as an equitable action for a constructive trust over the funds possessed by defendant Shelby Mutual.")

91. See *Radford Trust v. First Unum Life Ins. Co. of Am.*, 321 F. Supp. 2d 226, 254 n.23 (D. Mass. 2004) (noting that "[t]he First Circuit has taken note of *Knudson*, but has not determined what effect the case has on prior case law governing the availability of particular kinds of relief under Section 1132(a)(3)(B)"). The Third Circuit has not explicitly adopted the possession theory, although its opinion in *Skretvedt v. E.I. DuPont de Nemours* applied an analysis similar to the possession theory in holding that an ERISA policyholder was entitled to an award of prejudgment interest from an ERISA plan. 372 F.3d 193, 214 (3rd Cir. 2004) (noting that the policyholder "has sufficiently identified specific funds traceable to the defendant ERISA plans that belong in good conscience to him").

windfall by virtue of being injured. Without reimbursement, the argument goes, the policyholder will receive a "double recovery": once from the insurer, and again from the tortfeasor.⁹² This argument fails in several ways. First, in almost every case the policyholder will *never* be made whole. "The sad fact in the vast majority of these critical injury cases is that the insured is left not only seriously impaired for life, but, if reimbursement is permitted, the insured is also left financially destitute."⁹³ Historically, the policy against double recovery by a policyholder arose in the context of property insurance, where the value of damage may be ascertained with reasonable accuracy and there is little danger that the property owner will wind up undercompensated.⁹⁴ In personal injury cases, it is much more likely that the injured policyholder will not receive adequate compensation.⁹⁵ In *In re Paris*,⁹⁶ for example, a twenty-four-year-old man was permanently brain damaged when injured in a motorcycle accident. After recovering a \$100,000 settlement, he sought a declaratory judgment that a state make-whole doctrine precluded subrogation by his ERISA plan.⁹⁷ The U.S. District Court for the District of Maryland needed only two pages to conclude that the make-whole doctrine did not apply and to award summary judgment for the plan,⁹⁸ even though the \$100,000 settlement was insufficient to satisfy the subrogation claim.⁹⁹ The court also declined to reduce the subrogation award to compensate Paris for his attorney's fees.¹⁰⁰ Paris's mother was thus left to pay years of medical expenses for her twenty-four-year-old, brain-damaged son, as well as pay her own attorney's fees and the remainder of the subrogation judgment without the benefit of any of the third-party settlement.

92. See Rinaldi, *supra* note 19, at 803.

93. Baron, *supra* note 15, at 597. For example, insurers contended in *Knudson* that the quadriplegic defendant was receiving a "windfall . . . [which] must inexorably come out of the pockets of the rest." Brief of Amici Curiae the American Associations of Health Plans et al. at 16, *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204 (2002) (No. 99-1786). It is unlikely that Ms. Knudson believed the loss of the use of her limbs led to a "windfall."

94. Baron, *supra* note 15, at 624.

95. *Id.* at 625-26.

96. 44 F. Supp. 2d 747, 748 (D. Md. 1999), *aff'd*, 211 F.3d 1265 (4th Cir. 2000).

97. *Id.*

98. *Id.* at 748-49.

99. *Id.* at 748.

100. *Id.* at 749.

Second, after reimbursement the *insurer* has received a double recovery: once from the policyholder's faithful (but now wasted) premium payments and again from the reimbursement.¹⁰¹ Even granting the unlikely proposition that the injured party has recovered "double," there is no obvious reason why public policy would favor a transfer of the double recovery to the insurer rather than to the injured policyholder, who exhibited the foresight and prudence to acquire insurance in the first place.

Third, insurers contend that subrogation forces the tortfeasor to bear the burden of reimbursing the insurer for the loss caused by the tortfeasor's own acts or omissions.¹⁰² This straw man argument "proves" only what was never in dispute: that a tortfeasor ought to be liable for his wrong. Under the collateral-source rule, it is generally presumed that "a plaintiff who has been compensated in whole or in part for his damages by a source independent of the tortfeasor is nevertheless entitled to a full recovery against the tortfeasor."¹⁰³ But simply asserting that the tortfeasor ought to pay does not decide whether the injured policyholder or the ERISA plan should benefit from that payment.

A fourth argument is that without subrogation insurers would need to make up the difference by charging more to society as a whole.¹⁰⁴ This argument would be sensible if insurers actually did calculate future subrogation recoveries into current premium payments, but they do not. "[I]nsurers consistently fail to introduce the factor of such recoveries into rate-determining formulae, but rather apply such recoveries to increasing dividends to shareholders."¹⁰⁵ Indeed, "the conjectural

101. David M. Kono, Note, *Unraveling the Lining of ERISA Health Insurer Pockets—A Vote for National Federal Common Law Adoption of the Make Whole Doctrine*, 2000 BYU L. REV. 427, 446.

102. Rinaldi, *supra* note 19, at 803.

103. See *Potvin v. Seven Elms, Inc.*, 628 A.2d 115, 116 (Me. 1993).

104. *Cunningham v. Metro Life Ins. Co.*, 360 N.W.2d 33, 37 (Wis. 1985) ("Other proponents of the subrogation doctrine assert that it returns the excess, duplicative proceeds to the insurer who can then recycle them in the form of lower insurance premiums."); *Silinsky v. State-Wide Ins. Co.*, 289 N.Y.S. 2d 541, 549 (N.Y. App. Div. 1968) (noting that subrogation *hopefully* lowers premium rates).

105. JOHN F. DOBBYN, *INSURANCE LAW IN A NUTSHELL* 284 (3d ed. 1996); see also Baron, *supra* note 17, at 582. But see F. Joseph Du Bray, *A Response to the Anti-Subrogation Argument: What Really Emerged from Pandora's Box*, 41 S.D. L. REV. 264, 273-74 (1996) (contending that "subrogation operates to reduce the actual past cost total used in the calculation of probable future in-

and remote nature of subrogation militates against including it as a factor in premium rate setting.”¹⁰⁶

B. ERISA PREEMPTION OF STATE ANTISUBROGATION LAWS AND MAKE-WHOLE DOCTRINES UNDERMINES ERISA’S PRIMARY PURPOSE

Generally, congressional intent to preempt state law must be “clear and manifest.”¹⁰⁷ Courts should not interpret federal statutes to preempt state law in traditional areas of state governance unless the federal government unambiguously requires such a construction.¹⁰⁸ Since there is no express intent in ERISA’s text to preempt state antisubrogation laws and make-whole doctrines, courts should not read it to do so.¹⁰⁹

Moreover, preemption actively thwarts ERISA’s stated purpose. Recall that ERISA’s implementation of nationwide standards for employee benefit plans was a means to ERISA’s ultimate purpose of protecting employees.¹¹⁰ When the judiciary adopts the lowest common denominator of employee protection, as is the case with across-the-board preemption of state antisubrogation and common law make-whole doctrines, it undermines the very concerns that inspired ERISA’s drafting in

surable risk or loss on which future premiums will be based”).

106. Baron, *supra* note 17, at 582.

107. N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 655 (1995) (quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)).

108. *Id.* at 654–55; FMC Corp. v. Holliday, 498 U.S. 52, 67 (1990) (Stevens, J., dissenting) (“When there is ambiguity in a statutory provision preempting state law, we should apply a strong presumption against the invalidation of well-settled, generally applicable state rules.”).

109. Others have argued that ERISA’s current preemptive scope is broader than Congress intended. See Brief of Amicus Curiae United States at 22–23, UNUM Life Ins. Co. of Am. v. Ward, 526 U.S. 358 (1999) (No. 97-1868) (“Congress has saved state substantive law, and it is not clear why Congress would have wanted to foreclose all access to state-created remedies or sanctions to enforce that substantive law, especially where the causes of action provided under Section 502 itself are not suited to that purpose.” (internal citation omitted)); Elaine Gareri Kenney, *For the Sake of Your Health: ERISA’s Preemption Provisions, HMO Accountability, and Consumer Access to State Law Remedies*, 38 U.S.F. L. REV. 361, 367 (2004) (arguing that the Supreme Court’s decision in *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41 (1987), needlessly expanded ERISA preemption).

110. H.R. REP. NO. 93-533, at 8–9 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4647 (noting that Congress was ultimately driven by “the absolute need that safeguards for plan participants be sufficiently adequate and effective to prevent the numerous inequities to workers under plans which have resulted in tragic hardship to so many”); see *supra* notes 20–25 and accompanying text.

the first place. In *Knudson*, for instance, had Great-West properly named Janette Knudson's special needs trustee as a defendant and pleaded a constructive trust, under the possession theory Great-West would have recovered and left the policyholder destitute as well as quadriplegic. Such an outcome would not square well with ERISA's stated goal of preventing inequities and hardships to workers. "[T]he inescapable conclusion is that the spirit and purpose of ERISA provide greater support for prohibition of reimbursement than for its authorization."¹¹¹

Some scholars urge the Supreme Court to implement a federal common law make-whole doctrine in the ERISA regime.¹¹² The Supreme Court's ERISA jurisprudence does not preclude this: *Knudson* did not address the fact that Knudson was not made whole by her settlement recovery or whether that fact made any difference to the subrogation analysis, and therefore does not preclude a court from applying the make-whole doctrine to funds within the beneficiary's possession.¹¹³ Furthermore, the necessity of interstitial federal common law in ERISA's regulatory scheme is well-recognized.¹¹⁴ For now, however, federal common law holds that the make-whole doctrine is overcome by an express provision in the language of the insurance policy.¹¹⁵

III. REIMBURSEMENT UNDER THE POSSESSION THEORY IS NOT RELIEF "TYPICALLY AVAILABLE AT EQUITY," AS REQUIRED BY *KNUDSON*

ERISA preemption of state antisubrogation and make-whole doctrines is a boon to insurers,¹¹⁶ who can now bring

111. Baron, *supra* note 15, at 619; see also Korobkin, *supra* note 20, at 483–84 (arguing that the broad ERISA preemption doctrine "created a body of law that did not effectuate ERISA's underlying purposes").

112. See, e.g., Baron, *supra* note 15, at 626–27; Kono, *supra* note 101, at 449–50.

113. Cowart, *supra* note 18, at 670.

114. See *Jamail, Inc. v. Carpenters Dist. Council*, 954 F.2d 299, 303 (5th Cir. 1992) ("[T]he inevitable incompleteness presented by all legislation means that interstitial federal lawmaking is a basic responsibility of the federal courts."); *Cooperative Benefit Admin., Inc. v. Ogden*, 367 F.3d 323, 329 (5th Cir. 2004) (recognizing that federal common law is appropriate to fill "minor gaps" in ERISA's text).

115. See *supra* notes 44–46 and accompanying text.

116. This is generally true whether the action is brought by the ERISA plan or its insurer, since the plan, upon obtaining reimbursement, will be required in turn to reimburse the insurer. In *Knudson*, for example, the plan

against their own policyholders reimbursement actions that historically were barred. The Supreme Court's *Knudson* decision limited, but did not eliminate, the relief that insurers could pursue. Properly understood, however, *Knudson* leaves an ERISA insurer without any viable cause of action for reimbursement against its policyholder, because the policyholder possesses no funds traceable to the insurer upon which the court may impose a constructive trust or equitable lien. This result is consistent with ERISA's goal of protecting employees, prevents a double recovery by the insurer, affords the policyholder the rightful benefits of her own foresight, and may result in slightly lower dividends for insurers' shareholders but will not directly result in higher insurance premiums.

A. REQUIREMENTS FOR A CONSTRUCTIVE TRUST OR EQUITABLE LIEN

"Restitution," as Justice Scalia intimated in *Knudson*, can mean many different things.¹¹⁷ Among the restitutionary remedies available at equity were the constructive trust and the equitable lien,¹¹⁸ and Scalia named these as the options available to insurers seeking reimbursement within ERISA's statutory framework.¹¹⁹

A court will impose a constructive trust where one party has acquired property that does not in good conscience belong to her, and to which another party is entitled.¹²⁰ A constructive trust, unlike a remedy at law, requires that the disputed property be in the possession of the defendant.¹²¹ If a constructive trust is to be imposed on money, it must be an identifiable fund traceable to the plaintiff.¹²² The court then labels the defendant

contributed \$75,000 to Janette Knudson's \$411,157 worth of medical bills, while the plan's insurer paid the rest. If the plan had been permitted to recover, the recovery would have been apportioned accordingly, with over eighty percent of the recovery going to the insurer. Baron, *supra* note 15, at 620.

117. See *supra* notes 64–66 and accompanying text; 1 DAN B. DOBBS, DOBBS LAW OF REMEDIES § 1.1, at 6 (2d ed. 1993) ("So restitution today is a general term for diverse kinds of recoveries aimed at preventing unjust enrichment of the defendant and measured by the defendant's gains, but it has many specific forms, each of which must be addressed separately.").

118. See 1 DOBBS, *supra* note 117, § 4.3(1), at 587.

119. See *supra* note 65 and accompanying text.

120. 4 JOHN NORTON POMEROY, A TREATISE ON EQUITY JURISPRUDENCE § 1048, at 104 (1941).

121. 1 DOBBS, *supra* note 117, § 4.3(2), at 591.

122. *Id.* at 590.

(in a reimbursement action, the policyholder) a constructive trustee and orders that title be transferred to the plaintiff (the ERISA plan or insurer) as the constructive beneficiary.¹²³ For example, if I fraudulently acquire title to Blackacre from you, an equity court would declare that I hold Blackacre in constructive trust for you and order me to convey title to you.¹²⁴

The equitable lien may arise in two situations. Generally, an equitable lien may operate as a limited form of constructive trust, giving the plaintiff a security interest in certain property to prevent unjust enrichment.¹²⁵ This type of equitable lien differs from a constructive trust in that the lien may be foreclosed by forcing the sale of the property in question to pay the plaintiff, but the plaintiff may not obtain title to the res in question.¹²⁶ For instance, if I build an addition on my house with money I embezzled from you, you may impose an equitable lien upon the house and lot for the amount embezzled, but you may not impose a constructive trust to acquire title to my house, since you would then be unjustly enriched.¹²⁷

An equitable lien may also arise by express or implied-in-fact agreement between the parties that a certain fund or piece of property will stand as security for a debt.¹²⁸ If the pledge failed to satisfy some requirement for enforcement at law, it might be recognized and enforced by a court of equity and thus become "equitable."¹²⁹

Both the constructive trust and the equitable lien require particular assets that can be identified as belonging in good conscience to the plaintiff, and that can be traced to the plaintiff in some way.¹³⁰ "[T]he trust or lien is invoked only when there is a specific res—either the funds taken from the plaintiff or property the wrongdoer has exchanged for those funds."¹³¹

123. *Id.* § 4.3(1), at 587.

124. *See id.* § 4.3(2), at 591.

125. *Id.* § 4.3(3), at 601.

126. *Id.* at 603.

127. *Id.* at 602.

128. *Id.* at 601–02.

129. *Id.* at 601.

130. *Id.* at 603; *see also In re Fin. Federated Title & Trust, Inc.*, 347 F.3d 880, 891 (11th Cir. 2003) ("[I]t is the burden of the party seeking to impress a constructive trust to trace the property to specific funds before it can prevail."); RESTATEMENT OF RESTITUTION § 161 cmt. e (1937) ("Where . . . the property subject to the equitable lien can no longer be traced, the equitable lien cannot be enforced.")

131. 2 DOBBS, *supra* note 117, § 6.1(2), at 7–8.

The underlying "idea is that the plaintiff's property has been found in the hands of the defendant and must be restored to the plaintiff, . . . even if the property has undergone a change in form."¹³² Thus where I receive some of your money by mistake and use it to purchase a cow, you may recover the cow, or force its sale to recover the funds. However, where you can show only that I received your money but cannot demonstrate that these specific funds are still in my possession, you have established a debt claim that may be pursued at law, but not an equity claim for a constructive trust or equitable lien.¹³³ "It is hornbook law that before a constructive trust may be imposed, a claimant to a wrongdoer's property must trace his own property into a product in the hands of the wrongdoer."¹³⁴

Two additional features of constructive trusts as typically granted by courts of equity are noteworthy. First, courts of equity balanced ethical and economic considerations when granting remedies such as a constructive trust; if the balance of the hardships did not favor granting the remedy, the court would not grant it.¹³⁵ Second, "restitution is measured by the defendant's gains, not by the plaintiff's losses."¹³⁶

B. THE ERISA PLAN CANNOT ASSERT A CONSTRUCTIVE TRUST OR EQUITABLE LIEN UPON FUNDS THAT ARE NOT TRACEABLE TO THE PLAN

The possession theory ignores an essential requirement of the constructive trust or equitable lien: the res sought must be traceable *to the plaintiff*.¹³⁷ In a reimbursement action, however, the only money traceable to the plaintiff is that which has already been dissipated to pay for the policyholder's medical expenses. The third-party recovery, upon which the insurer seeks the trust or lien, is not traceable to the insurer; the in-

132. *Id.* § 6.1(3), at 11.

133. *Id.* at 12.

134. *United States v. Benitez*, 779 F.2d 135, 140 (2d Cir. 1985).

135. 1 DOBBS, *supra* note 117, § 2.4(1), at 90–91. As Dobbs explains:

When equitable relief is sought, courts claim the power to deny that relief as a matter of discretion. . . . Discretion to deny or to limit equitable relief is normally invoked by considering an equitable defense which permits wide latitude in decision-making, or by "balancing" equities, hardships, and the interests of the public and of third persons.

Id. Thus, "[e]ven when an equitable defense does not bar the claim, the total balance of equities and hardships might do so." *Id.* at 91.

136. *Id.* § 1.1, at 5.

137. *See supra* Part III.A.

suror's only claimed right to that fund is the contract right embodied in the ERISA plan, and this relief is absolutely foreclosed after *Knudson*.

A plaintiff can impress a constructive trust upon a res different from that which the defendant wrongfully appropriated in only one situation: where the defendant disposes of the wrongfully acquired property, a constructive trust may be impressed upon the proceeds of the sale.¹³⁸ This avenue will afford no relief to an ERISA insurer, however, because the policyholder has used the funds she received under the terms of her health plan for exactly its stated purpose: payment of medical expenses. She has "wrongfully disposed of" nothing, and "where the disposition made of property is not wrongful, no constructive trust arises."¹³⁹ And, at any rate, no one has ever suggested that insurers ought to be able to collect the hospital beds, prostheses, and other accoutrements purchased with the insurer's money, or force their sale to satisfy the insurer's reimbursement claim.

Consider again a classic illustration of a constructive trust: I fraudulently obtain title to Blackacre from you. An equity court might find that I hold Blackacre constructively in trust for you. If I have sold the property, you will be entitled to the price I received, or to whatever property I purchased with the money.¹⁴⁰ But if I have sold Blackacre and no longer possess the money or any substituted asset, there is nothing upon which to impose a constructive trust; you are a creditor with an action at law against me, but no action in equity. If I have recently received a sum of money from the sale of some other property, you cannot impose a constructive trust or equitable lien upon this money because it is not traceable to you. You are analogous to the insurer in a reimbursement action, whose property has been dissipated and is no longer traceable in any form to the policyholder's possession.

Faced with the inapplicability of a constructive trust to its reimbursement action, the plan may turn to an equitable lien. The plan cannot assert the more general variety of equitable lien (that imposed by the court to prevent unjust enrichment)¹⁴¹ upon the policyholder's third-party recovery, however, for the

138. 90 C.J.S. *Trusts* § 194 (2002).

139. *Id.*

140. See 1 DOBBS, *supra* note 117, § 4.3(2), at 591.

141. See *supra* notes 125–29 and accompanying text.

same reason that it cannot impose a constructive trust. *Both* remedies require identifiable, traceable assets in the possession of the defendant but belonging in good conscience to the plaintiff.¹⁴²

C. THE ERISA PLAN CANNOT ASSERT A CONSTRUCTIVE TRUST OR EQUITABLE LIEN UPON A FUND THAT HAS NOT BEEN APPROPRIATED TO THE PLAN

The plan might then urge imposition of an equitable lien by express or implied-in-fact agreement, in which "a borrower agrees that a certain fund or piece of property will stand as security for his debt."¹⁴³ This argument is troubling at the outset because an equitable lien by express or implied agreement presupposes a debt, duty, or obligation owed by the policyholder to the plan.¹⁴⁴ After collecting the policyholder's premiums, the plan is asserting that the policyholder must make a further pledge to receive the benefits for which she contracted. But the medical benefits paid by the ERISA plan do not create a debt in the policyholder; they are not loaned to the policyholder contingent upon repayment. The plan is obliged to pay the benefits regardless of whether the policyholder has any prospect for a third-party recovery.

More importantly, as a technical matter, an equitable lien by express agreement upon the third-party recovery fails because creation of an equitable lien by agreement requires that "the property or fund sought to be charged be distinctly appropriated to, or as security for, the payment of the debt or other liability in question."¹⁴⁵ An equitable lien requires "more than a mere expectation, or even an agreement, that a debt will be paid out of a particular fund,"¹⁴⁶ and "more than a mere promise by a debtor to pay a debt out of a particular fund due him, as soon as he receives it."¹⁴⁷ In a reimbursement action, at the

142. "[T]he trust or lien is invoked only when there is a specific res—either the funds taken from the plaintiff or property the wrongdoer has exchanged for those funds." 2 DOBBS, *supra* note 117, § 6.1(2), at 7–8; see *supra* notes 130–34 and accompanying text.

143. 1 DOBBS, *supra* note 117, § 4.3(3), at 601.

144. See 51 AM. JUR. 2D *Liens* § 24 (1970); *Id.* § 13 (2000) ("Because a lien is a right to encumber property until a debt is paid, it presupposes the existence of a debt. . . . In other words, without a debt, there can be no lien.").

145. *Id.* § 29 (1970). "The promisor must place the fund beyond his control and grant to the promisee a complete and present right therein . . ." *Id.*

146. *Id.*

147. *Id.*

time the policyholder agrees to the plan terms or accepts medical benefits from the plan, she possesses no third-party recovery which she can appropriate to the plan; the most she can offer to the plan is her promise to repay if and when she later obtains recovery. Such a promise might support a contract claim, but cannot support an equitable lien by express agreement.

D. THE ERISA PLAN SHOULD NOT BE PERMITTED TO AVOID ERISA'S EQUITABLE RELIEF REQUIREMENT BY ASSERTING AN IMPLIED-IN-FACT EQUITABLE LIEN

Lacking necessary elements of a constructive trust, an equitable lien to prevent unjust enrichment, and an equitable lien by express agreement, the ERISA plan is left to hang its hat on an equitable lien by implied-in-fact agreement. This option looks better for the plan, since an equitable lien "may exist without agreement . . . between the parties to the transaction and without title or possession in the lienholder."¹⁴⁸ Once a court has wandered this far into the mists of equitable actions, it will discern few principles to guide its decision; as Justice Holmes noted, "the phrase 'equitable lien' may not carry the reasoning further or do much more than express the opinion of the court that the facts give a priority to the party said to have it"¹⁴⁹ The only boundaries on the court's discretion to find an implied-in-fact equitable lien appear to be "general considerations of right and justice."¹⁵⁰

Recall, though, that the essence of the implied-in-fact equitable lien is that the parties intended to create a lien but the agreement was somehow incapable of enforcement in a court of law.¹⁵¹ An equity court would intervene to create the lien and give effect to the contractual intentions of the parties, in effect providing legal relief when a court of law was prevented from doing so by some technical defect. In an ERISA reimbursement action, however, the plan and the participant have usually entered into an express, written agreement that includes a reimbursement clause, enforceable on its face. The issue with the

148. *Id.* § 30; *Warren Tool Co. v. Stephenson*, 161 N.W.2d 133, 140 (Mich. Ct. App. 1968) ("It is now well settled that non-existence of the fund at the time of the agreement does not prevent establishment of an equitable lien on the fund").

149. *Sexton v. Kessler & Co.*, 225 U.S. 90, 98-99 (1912).

150. 51 AM. JUR. 2D, *supra* note 144, § 30 (1970).

151. 1 DOBBS, *supra* note 117, § 4.3(3), at 601.

reimbursement provision is not that it is somehow legally deficient, but that ERISA does not afford the insurer the legal cause of action necessary to enforce the agreement. To allow an ERISA plan to give effect to the legal remedy contemplated by the reimbursement clause simply by clothing it in equitable garb would be to eviscerate *Knudson's* legal/equitable distinction and leave no discernible limit on the relief available to ERISA plans. Since "[e]quitable' relief must mean *something* less than *all* relief,"¹⁵² courts should not allow plans to cloak contract claims in equitable terms solely for the purpose of avoiding *Knudson's* bar on legal relief.

Justice Ginsburg, dissenting in *Knudson*, raised a similar prospect of relief for ERISA plans: allow the plan to enforce an injunction (an equitable remedy explicitly permitted by ERISA)¹⁵³ against a failure to pay a simple indebtedness.¹⁵⁴ Scalia's majority opinion rejected this approach as "render[ing] the statute's limitation of relief . . . utterly pointless."¹⁵⁵ The same logic precludes allowing the plan to enforce an equitable lien by implied-in-fact agreement: by allowing an end-run around ERISA's preclusion of legal relief, such an approach would render meaningless ERISA's civil remedies limitations.

To prevent the implied-in-fact equitable lien from swallowing *Knudson's* legal/equitable distinction whole, courts should not allow ERISA plans to pursue this cause of action against policyholders. There are two further reasons courts should hesitate to grant reimbursement to an ERISA plan on an equitable relief theory: equitable remedies are properly measured by the defendant's gain, not the plaintiff's loss, and courts of equity retained discretion to balance the equities and hardships of each case before granting relief.

E. RECOVERY IN EQUITABLE RESTITUTION IS MEASURED BY THE DEFENDANT'S GAIN, NOT THE PLAINTIFF'S LOSS

The heart of equitable restitution is the defendant's gain, not the plaintiff's loss.¹⁵⁶ But in most personal injury reimbursement cases, the injured defendant has received little or no

152. *Mertens v. Hewitt Assoc.*, 508 U.S. 248, 258 n.8 (1993).

153. 29 U.S.C. § 1132(a)(3)(A) (2000).

154. *Great-West Life v. Knudson*, 534 U.S. 204, 216 (2002).

155. *Id.*

156. *See supra* note 136 and accompanying text.

"gain."¹⁵⁷ A case for equitable restitution might be made in those cases where, after accounting for the defendant's medical expenses, suffering, lost wages, and attorney's fees, she still comes out ahead. But even in such a scenario, the amount of the constructive trust would never be the full amount paid out by the insurer, because the policyholder has necessarily incurred costs beyond just her medical expenses (including pain and suffering and attorney fees). Courts that apply the possession theory, however, invariably and erroneously measure the insurer's relief by the amount paid out by the plan (the insurer's purported "loss"), not the defendant's net "gain" after the third-party recovery.

F. COURTS OF EQUITY RETAINED DISCRETION TO BALANCE THE EQUITIES AND HARDSHIPS OF EACH CASE BEFORE GRANTING RELIEF

Courts of equity retained the prerogative to balance the equities and hardships of each case before awarding relief.¹⁵⁸ Courts considering ERISA reimbursement actions, however, seem generally disinclined to consider the potential hardships awaiting the policyholder if reimbursement is awarded.¹⁵⁹ Were federal courts to exercise this prerogative, ERISA insurers would seldom obtain relief, at least not for the full amount they request. In a reimbursement action, the defendant policyholder has not only been injured, sometimes catastrophically, but rarely receives full compensation for her medical expenses, to say nothing of pain and suffering and lost present and future wages. After losing the case, she is left in debt to her attorney with reduced or no income and no remaining insurance benefits. The insurer, meanwhile, receives a windfall that results not in lower premiums for all, but in higher dividends for the

157. Consider *In re Paris*, 44 F. Supp. 2d 747 (D. Md. 1999), *aff'd*, 211 F.3d 1265 (4th Cir. 2000), in which a twenty-four-year-old, brain-damaged tort victim was ordered to reimburse his ERISA plan the full value of his \$100,000 third-party settlement, leaving his family with nothing to pay his future medical expenses and past attorney's fees. See also *supra* Part III.A (debunking insurers' argument that, without reimbursement, injured policyholders receive a double recovery).

158. See *supra* note 135 and accompanying text.

159. See, e.g., *In re Paris*, 44 F. Supp. 2d at 748 (noting that an ERISA plan's motion for summary judgment entitling it to the entire value of a brain-damaged policyholder's third-party settlement "raises *only* a legal issue" (emphasis added)).

insurer's shareholders.¹⁶⁰ Courts of equity would be extremely unlikely to award such relief in light of a balancing analysis.

IV. THE SIXTH AND NINTH CIRCUITS' APPROACH TO THE POSSESSION THEORY

The two circuits that refuse to recognize insurers' causes of action for reimbursement, unfortunately, do so with less than compelling reasoning: the Ninth Circuit misrepresents *Knudson*¹⁶¹ and the nature of constructive trusts, while the Sixth Circuit simply announces by fiat that reimbursement actions are, by nature, legal.

A. THE NINTH CIRCUIT'S APPROACH TO DENYING REIMBURSEMENT IGNORES THE CLEAR IMPORT OF *KNUDSON* AND MISSTATES THE LAW OF CONSTRUCTIVE TRUSTS

The Ninth Circuit, ever the black sheep of the federal judiciary,¹⁶² took a stand on behalf of employees (and in furtherance of ERISA's stated purpose) in *Westaff (USA) Inc. v. Arce*.¹⁶³ Betty Arce was injured in an automobile accident.¹⁶⁴ The plan administrator paid medical expenses on her behalf, before Arce received a \$15,000 settlement from the third party.¹⁶⁵ The plan contained a standard reimbursement clause, providing that the plan "had subrogation and reimbursement rights in any monies received by a covered person from a third party tortfeasor."¹⁶⁶ The check was made out to Arce and Westaff as copayees.¹⁶⁷ Arce forwarded the check to Westaff for signature, promising to deposit the funds into escrow until the rightful recipient could be determined.¹⁶⁸ Westaff obligingly signed the check and sought a declaratory judgment against

160. See *supra* notes 104–06 and accompanying text.

161. 534 U.S. 204 (2002); see *supra* Part I.C.1.

162. "[I]t is commonly accepted that the Ninth Circuit is the most watched, and most criticized, of all the lower federal courts in the country." Vikram David Amar, *Lower Court Obedience & the Ninth Circuit*, 7 GREEN BAG 2D 315, 315 (2004) (internal quotations omitted).

163. 298 F.3d 1164, 1167 (9th Cir. 2002).

164. *Id.* at 1166.

165. *Id.*

166. *Id.*

167. *Id.*

168. *Id.*

Arce that it was entitled to reimbursement of the \$15,000 it had paid for her medical expenses.¹⁶⁹

Westaff argued that the relief it sought was equitable because the money it sought was held in escrow.¹⁷⁰ The Ninth Circuit had little patience for this argument. Noting that it looked "to the substance of the remedy sought rather than the label placed on that remedy,"¹⁷¹ the court easily concluded that "Westaff is seeking to enforce a contractual obligation for the payment of money, a classic action at law and not an equitable claim."¹⁷² According to the court, Westaff's action differed from that in *Knudson* "only in that the money at issue . . . has been placed in an escrow account and remains specifically identifiable."¹⁷³ The existence of an identifiable fund of money, clearly traceable to the policyholder's third-party recovery, was a distinction without a difference in the *Westaff* court's opinion. But this is the very difference on which *Knudson*'s holding turned: "for restitution to lie in equity, the action generally must seek . . . to restore to the plaintiff particular funds or property in the defendant's possession."¹⁷⁴ *Knudson*'s only stated reason for not allowing reimbursement was the lack of an identifiable, traceable fund of money; *Westaff* casually dismisses the existence of such a fund as immaterial.

Amazingly, the court asserted that *Knudson* had actually affirmed this approach.¹⁷⁵ Later Ninth Circuit opinions stubbornly insist that *Knudson* supports the circuit's categorical refusal to allow reimbursement actions, contrary to Justice Scalia's invitation to seek remedies typically available at equity.¹⁷⁶

169. *Id.*

170. *Id.*

171. *Id.* (quoting *Watkins v. Westinghouse Hanford Co.*, 12 F.3d 1517, 1528 n.5 (9th Cir. 1993) (internal quotations and alterations omitted)).

172. *Id.*

173. *Id.* at 1166 (emphasis added).

174. *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 214 (2002).

175. *Westaff*, 298 F.3d at 1166.

176. "Against the weight of authority . . . the Ninth Circuit seems to have ignored the Supreme Court's *dicta*, as it continues to declare, even after *Knudson*, and seemingly without qualification, that reimbursement claims by ERISA fiduciaries are legal claims for compensatory damages seeking to impose personal liability." *Mid Atl. Med. Servs., Inc., v. Sereboff*, 303 F. Supp. 2d 691, 695 (D. Md. 2004).

The Ninth Circuit has also articulated that an action for constructive trust requires an "ill-gotten" gain and a breach of fiduciary duty on the part of the defendant.¹⁷⁷ This is incorrect; a constructive trust redresses unjust enrichment, not wrongdoing, and is therefore not limited to cases involving misconduct.¹⁷⁸ While the Ninth Circuit's refusal to allow subrogation actions by ERISA insurers is laudable, its reasoning is not. A better approach is needed.

B. THE SIXTH CIRCUIT'S APPROACH IN *QUALCHOICE* IS SOUND, BUT REQUIRES MORE EXPLANATION

In *Qualchoice, Inc. v. Rowland*, the Sixth Circuit precluded equitable relief under the possession theory.¹⁷⁹ The court affirmed the dismissal of the ERISA plan's claim, even though the plan sought equitable restitution and the defendant possessed an identifiable fund of money.¹⁸⁰ In its first post-*Knudson* look at the issue, the court considered but rejected the possession theory.¹⁸¹ The court reasoned that *Knudson* had left open the question of whether an ERISA insurer could recover a specifically identifiable fund of money, and that the *Knudson* majority repeatedly emphasized that "a breach of contract claim seeking money damages is a legal action."¹⁸² Even though *Qualchoice* sought a constructive trust upon an identified set of funds, the court found the spirit, if not the letter, of the request to be *legal*.¹⁸³ The court explained that "[t]he problem of formal title was irrelevant in cases where the plaintiff sought intangibles, such as money; therefore, all plaintiffs could bring such actions in the courts of law."¹⁸⁴ While equity courts historically may have imposed a constructive trust on a particular bank account, reasoned the court, the fact that an ERISA beneficiary deposited funds into a bank account did not change the nature of the insurer's action, which was for breach of contract, not for a property right in any particular fund.¹⁸⁵

177. *FMC Med. Plan v. Owens*, 122 F.3d 1258, 1261 (9th Cir. 1997).

178. 1 DOBBS, *supra* note 117, § 4.3(2), at 597.

179. 367 F.3d 638 (6th Cir. 2004).

180. *Id.* at 650.

181. *See id.* at 645–46.

182. *Id.* at 646.

183. *See id.* at 649.

184. *Id.*

185. *Id.*

While the *Qualchoice* result aligns with public policy and a proper understanding of ERISA, its reasoning is deficient. The court pointed out that "[e]quitable restitution developed to fill the void left" when legal restitution, which required proof of formal title to property, was unavailable to the plaintiff.¹⁸⁶ From there, the court reasoned that where the property in question allowed no formal title, as in the case of money, "all plaintiffs could bring such actions in the courts of law."¹⁸⁷ While this may be true, the availability of an action at law does not rule out a corresponding action "typically available at equity" as invited by *Knudson*. Indeed, courts of equity regularly awarded constructive trusts over funds of money.¹⁸⁸ The fact that courts of law could award monetary relief is irrelevant, because *Knudson* did not require that the insurer's action be one that was typically available *only* at equity.

The Sixth Circuit's second rationale for denying relief in *Qualchoice* was that "the source of the claim asserted . . . is a contract to pay money" and that equitable remedies were not typically used in such an action.¹⁸⁹ The court was right, but made no effort to explain *why* the action sounded in contract, not in equity. The court also did not explain where it thought the six other federal circuits, which apply the possession theory and presumably would have granted the relief requested by *Qualchoice*, went wrong.

CONCLUSION

After *Knudson*, most federal courts follow the possession theory and allow ERISA plans to enforce reimbursement clauses against their policyholders using the equitable mechanisms of constructive trusts and equitable liens. These courts erroneously believe they are following *Knudson's* mandate to allow relief "typically available at equity." In fact, reimbursement actions fail to satisfy the essential elements of either a

186. *Id.*

187. *Id.*

188. 1 DOBBS, *supra* note 117, § 4.3(2), at 591. If, as seems to be the case, the court is asserting that funds of money were never the proper subject of a constructive trust, the court is mistaken. "The constructive trust is only used when the defendant has a legally recognized right in a particular asset. . . . It may even be a fund of money like a bank account." *Id.* "The principle [of constructive trust] is one of universal application; it extends alike to real and to personal property, to things in action, and funds of money." POMEROY, *supra* note 120, § 1044, at 96.

189. *Qualchoice*, 367 F.3d at 649.

constructive trust or an equitable lien. In allowing such relief, federal courts ignore public policy concerns, thwart ERISA's stated purpose, and misunderstand the nature of the equitable remedies they purport to grant.

In the final analysis, the *Qualchoice* court was right: shorn of creative lawyering and games with pleading, an ERISA plan's action for reimbursement is ultimately one for contractual relief. The plan cannot assert a constructive trust or ordinary equitable lien upon funds that were never in its possession. The plan cannot assert an equitable lien by express agreement upon funds that have never been appropriated to it. The only cause of action mentioned in *Knudson* for which the plan can satisfy each required element is an equitable lien by implied-in-fact agreement, but this is simply a contract claim in equitable disguise. Furthermore, it is unlikely that a court of equity considering any of these forms of relief would award them after considering the true measure of the defendant's gain, and balancing the equities and hardships in the case.

Courts following the possession theory point to *Knudson*'s unanswered question: "may an insurer assert a constructive trust or equitable lien upon an identifiable set of funds in the possession of the defendant policyholder?" And, they answer "yes." But the courts are wrong—the answer is "no," in terms of both policy and substantive law. By correcting their answer, federal courts would give effect to ERISA's ultimate goal of protecting workers, and prevent further insult to injury.
