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Where Do the ERISA Dollars Go?

ERISA REIMBURSEMENT PROCEEDS: WHERE DOES THE MONEY GO?

By Roger M. Baron and Delia M. Druley

A possible . . . reason [to allow subrogation], that of ultimately reducing insurance rates by virtue of subrogated recoveries by insurers, has simply not come to pass. Insurers consistently fail to introduce the factor of such recoveries into rate-determining formulae, but rather apply such recoveries to increasing dividends to shareholders.- John F. Dobbyn, Insurance Law in a Nutshell 284 (3d ed. West 1996).

In a recent decision, the Supreme Court recognized that insurance companies have a conflict of interest in administering ERISA plans. *Metropolitan Life Ins. Co. v. Glenn,* 128 S. Ct. 2343, 2345. (2008). "Often the entity that administers the plan, such as an employer or an insurance company, both determines whether an employee is eligible for benefits and pays benefits out of its own pocket. We here decide that this dual role creates a conflict of interest[.]" *Id.* This conflict of interest becomes particularly stark when considering subrogation or reimbursement. While insurers often argue that the decision to pursue subrogation is motivated by a desire to lower premiums, the proceeds of these recoveries do not flow to the benefit of insureds. Rather, the money recovered increases the insurer's bottom line, payouts to shareholders, and executive compensation, intensifying the "conflict of interest" the Court observed in *Glenn.*

The Double Recovery Myth

The most common justification utilized by insurers and ERISA plans for pursuing subrogation against beneficiaries is that it is done for the benefit of the other insureds. "Insurers have claimed that [subrogation clauses] are justified, arguing that the insured should not be permitted to receive benefits from the insurer and be paid by a third party for the same loss, as the beneficiary would receive an unjustified windfall."[1] Legal authorities have critiqued this double recovery argument, pointing out that the premiums paid by the insured were in exchange for indemnification.[2] A similar criticism of the windfall argument is that it is *the insurer*, not the insured, who receives a windfall through subrogation, because the insurer is able to recoup its costs through reimbursement, despite the fact the insurer had been paid a premium for coverage.[3] This observation is not new. Over forty years ago, Professor Edwin Patterson wrote "Subrogation is a windfall to the insurer. It plays no part in rate schedules . . ."[4] As has previously been explained:

> In paying the loss, the insurer simply pays an anticipated loss on a risk that has been actuarially distributed over a pool of similarly-situated individuals. The initial setting of the insurance premium for the transfer of the risk from the insured to the insurer encompasses the insured's pro-rata share of total estimated losses for the pool, as well as the insured's pro-rata share of the insurer's profit to be realized from the insurance undertaking.[5]

Subrogation recoveries are not included in this calculus. Insurance premiums are calculated based upon losses actually incurred and adjusted to allow the company to turn a profit.[6] Subrogation recoveries are not included in the factors that influence premium calculation.

Rates

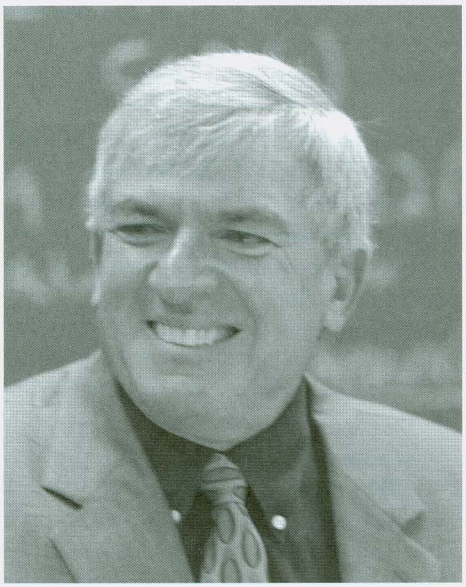
The speculative and remote nature of a successful subrogation claim also weighs against its inclusion as a factor in rate setting.[7] In terms of analyzing risk, it's important to remember that the medical bills in catastrophic cases have to be paid, regardless of the cause of the injury. The insurer must pay, regardless of whether the insured is sick, struck by lightning, injured in a one car accident where the insured was at fault and there is no possibility of recovery, or if this person was struck by an uninsured tortfeasor. The possibility of a subrogated recovery exists only in those instances where injuries were inflicted by a tortfeasor and there is a successful settlement or recovery in court. Furthermore, due to the often-protracted nature of litigation and settlement negotiations, the determination of whether there is a chance for subrogation occurs long after the event and long after the bills have been paid. "The delay in this whole process militates against the inclusion of subrogated recoveries in the setting of rates. It's just not done."[8]

Various courts have recognized that subrogation does not lead to lower premiums. *See Cooper v. Argonaut Ins. Co.,* 556 P.2d 525, 527 (Alaska 1976); *Allstate Ins. Co. v. Druke*, 576 P.2d 489, 492 (Ariz. 1978) (en banc); *Travelers Indem. Co. v. Chumbley*, 394 S.W.2d 418, 425 (Mo. Ct. App. 1965); *DeCespedes v. Prudence Mut. Cas. Co.,* 193 So.2d 224, 227-28 (Fla. Dist. Ct. App. 1966); *Rimes v. State Farm Mut. Auto. Ins. Co.,* 316 N.W.2d 348, 355 (Wis. 1982). Thus, there is judicial skepticism regarding insurers' purposed justification that the allowance of subrogation creates a benefit for all insureds. Furthermore, a review of many ERISA reimbursement cases demonstrates that the insured is often left in a devastated situation, lacking full compensation for losses and certainly not attaining a windfall at the expense of the insurer.[9]

ERISA Beneficiaries

ERISA plans continue to assert the double-recovery argument, sometimes arguing the language of the statute, requiring an ERISA fiduciary to "discharge [their] duties solely in the interest of the [plan] beneficiaries" *requires* a plan to pursue subrogation for the benefit of the other beneficiaries.[10] While this ignores the harm to the individual injured beneficiary, some plans go so far as to argue that the individual beneficiary's interest is not cognizable

under the statute. There is some support for the position that ERISA's protections extend primarily to insureds as a class. In *Massachusetts Mutual Life Insurance Co. v. Russell*, the U.S. Supreme Court observed, "A fair contextual reading of the statute makes it abundantly clear that its draftsmen were primarily concerned with the possible misuses of plan assets, and with remedies that would protect the entire plan, rather than with the rights of an individual beneficiary." 473 U.S. 124, 142 (1985). But even if this were so, the decision to pursue subrogation at the expense of a particular beneficiary does not create a benefit for the plan participants as a group because subrogation recoveries do not lower insurance premiums. Rather, the subrogation inures to the benefit of the insuring entity.[11] Furthermore, following the Court's decisions in *Varity Corp. v. Howe*, 516 U.S. 489 (1996) and *LaRue v. DeWolff, Boberg & Assoc. Inc.*, 552 U.S. 248 (2008), it is clear that ERISA's fiduciary protections extend to individuals, as well as the class of plan beneficiaries. Accordingly, the pursuit of subrogation against individual beneficiaries may be tantamount to a breach of an ERISA plan's statutory obligation to act "solely for the benefit of plan participants."[12]



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Insurers' Utilization of Recoveries

While there is a "lack of comprehensive data" on subrogation recoveries, many legal scholars theorize that the proceeds of subrogation recoveries are applied to the bottom line of insurers.[13] "Insurers consistently . . . apply such [subrogation] recoveries to increasing dividends to shareholders."[14] One scholar flatly asserts, "Subrogation recoveries are used to increase executive compensation or shareholder dividends, not to decrease premiums."[15] Another theory is that subrogation recoveries are treated like unutilized reserves.

> When an insurance company is faced with a large claim, the first thing the company does is create a reserve on its books. This looks like a loss on the books. If the insurer is not required to pay the claim, the "book loss" is now available as revenue or profit for the insurance company. It is an unutilized reserve which is available for other purposes. After discussing this with insurance regulators and insurance executives, I learned that the treatment of subrogated recoveries is similar. If the insurer has an opportunity to pursue subrogation against a beneficiary and is successful, it recovers the money paid on a risk which has already been accounted for. And, these "book losses" become revenue for the insurer and are treated however the management deems they should be treated.[16]

The general consensus among legal scholars is that this revenue does not flow

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to the benefit of consumers by reducing insurance rates, but rather increases executive compensation and shareholder payouts. The wisdom of continuing such a policy has been questioned; "It is highly debatable that public policy would favor placing an additional windfall into the pockets of an insurance company rather than into the hands of an injured individual."[17]

A review of the available numbers reveals the injustice of a policy that allows insurance companies to apply the proceeds of injured beneficiaries' tort recoveries towards executive compensation and shareholder dividends. According to Forbes Magazine, in 2009, the CEO of MetLife earned nearly $11 million, the Hartford Financial CEO earned almost $10 million, and the CEO of AFLAC earned nearly $7 million.[18] These numbers do not include the compensation these executives earned from the shares of the company they own, which is substantial in some cases. The MetLife CEO owns approximately $31 million in shares of MetLife; the Hartford Financial CEO owns approximately $78 million in shares of Hartford Financial; the AFLAC CEO owns $127 million in AFLAC shares.[19] While their executives earn millions annually, insurers continue to argue that subrogation is necessary to prevent injured beneficiaries from recovering twice, despite the injustice caused in many cases.[20]

Conclusions

The original and basic intent of Congress in enacting ERISA was to protect workers from pension plan abuses.[21] Allowing ERISA reimbursement claims today is arguably a current example of such abuse. Permitting insurers to pursue subrogation against injured beneficiaries is unjustified. The major argument in favor of allowing ERISA reimbursement claims — that permitting subrogation lowers insurance premiums — is false. Subrogation recoveries are not factored into rates. While there is little concrete data on what insurance companies actually do with the proceeds of subrogation recoveries, it is clear that the money does not flow to the benefit of the other insureds or beneficiaries.

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[1] Andrew H. Koslow, "*Appropriate Equitable Relief" in Wal-Mart v. Shank: Justice for Whom?*, 12 QUINNIPIAC HEALTH L. J. 277, 280 (2008).

[2] *Lee v. State Farm Mut. Auto. Ins. Co.*, 129 Cal. Rptr. 271, 278 (Cal Ct. App. 1976) (Friedman, J., concurring).

[3] *See* 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, 623 (2004).

[4] EDWIN E. PATTERSON, ESSENTIALS OF INSURANCE LAW 151 (2d ed. 1957).

[5] Roger M. Baron, *Subrogation on Medical Expense Claims: The " Double Recovery" Myth and the Feasibility of Anti-Subrogation Statutes*, 96 DICK. L. REV. 581, 582 (1992).

[6] *See* Keith E. Edeus, Jr., Comment, *Subrogation of Personal Injury Claims: Toward Ending an Inequitable Practice*, 17 N. ILL. U. L. REV. 509, 514 (1997). *See also* Johnny C. Parker, *The Made Whole Doctrine: Unraveling the Enigma Wrapped in the Mystery of Insurance Subrogation*, 70 MO. L.REV. 723, 737 (2005) (collecting cases recognizing that the insurer receives a windfall if all owed both subrogation and retention of the premiums paid by the insured).

[7] Roger M. Baron, *Subrogation: A Pandora's Box Awaiting Closure*, 41 SD L. REV. 237, 244 (1996).

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[8] Roger Baron, Defeating ERISA Reimbursement Claims, Presentation to Minnesota Association for Justice (Sept. 25, 2009).

[9] *Id.*

[10] 29 U.S.C. § 1104 (2006).

[11] In addition to financially benefitting the insurer, a portion of the subrogation recovery will likely go to a collection firm. ERISA reimbursement claims have created a billion dollar industry. Brief filed on behalf of The American Associations of Health Plans, The American Benefits Council, The Blue Cross Blue Shield Association, The Chamber of Commerce of the United States, and The Health Insurance Association of America. Brief of Amici Curiae the American Associations of Health Plans et al., at 10, Knudson, 534 U.S. 204 (2002) (No. 99-1786). "As the efforts to seek subrogation and reimbursement for medical expense claims has grown, so too has the development of private collection firms, which seek recovery of these dollars through assignments from the ERISA plan and their insurers. " Baron, *Public Policy Considerations*, *supra* note 3, at 620.

[12] Delia Druley, South Dakota State Medical Holding Company v. Hofer: *A Deferential Standard of Review Permits ERISA Administrators to Contravene Their Fiduciary Obligations,* 54 S.D. L. Rev. 266, 292 (2009).

[13] Holly Ludwig, *Restoring Sanity to Subrogation After Sereboff*, 9 Nev. L. J. 431, 450 (2009) (discussing the absence of data).

[14] Kristin L. Huffaker, Note, *Where the Windfall Falls Short: "Appropriate Equitable Relief" After* Sereboff v. Mid Atlantic Medical Services, Inc., 61 Okla. L. Rev. 233, 248-49 (2008).

[15] Scott M. Aronson, *ERISA's Equitable Illusion: The Unjust Justice of Section 502(a)(3),* 9 Emp. Rights & Emp. Policy J. 247, 289 (2005).

[16] Baron, Defeating an ERISA Reimbursement Claim, *supra* note 8. (portions of original words spoken have been rearranged, edited and enhanced for clarity in written format).

[17] David M. Kono, Comment, *Unraveling the Lining of ERISA Health Insurer Pockets: A Vote for National Federal Common Law Adoption of the Make Whole Doctrine,* 2000 B.Y.U. L. Rev. 427, 446 (2000).

[18] Special Report: CEO Compensation, Forbes Magazine, April 22, 2009, available at http://www.forbes.com/lists/2009/12/best-boss-09_CEO-Compensation-Insurance_9Rank.html.

[19] *Id.*

[20] *See, e.g., Administrative Committee of Wal-Mart, Inc. v. Shank,* 500 F.3d 834, cert. denied, 128 S.Ct. 1651 (8th Cir. 2007) (subrogation allowed against Walmart employee rendered permanently disabled in car accident); *In Re Paris,* 44 F.Supp. 2d 747 (1999) (subrogation allowed where defendant suffered permanent brain damage as a result of a motorcycle accident and defendant qualified as disabled, destitute adult); *Cagle v. Bruner*, 112 F.3d 1510 (11th Cir. 1997) (court permitted subrogation where insurer refused to pay medical bills until insured signed form acknowledging insurer's right to pursue subrogation and insured had suffered serious injuries in car accident requiring four month hospitalstay and four months of outpatient treatment); *Sunbeam-Oster Co. Group Benefits Plan v. Whitehurst*, 102 F.3d 1368 (5th Cir. 1996) (subrogation of $500,000 settlement allowed though insured had suffered over $2 million in damages).

[21] *See* James A. Wooten, The Employee Retirement Income Security Act of 1974- A Political History (University of California Press, 2005) (stating that ERISA was enacted to ensure the "equitable character" of employee benefit plans and to protect workers). *See also* Alison S. Rozbruch, Comment, *Resolving the Conflict Between Two Visions for a Standard of Review in ERISA Benefit Denial Claims*, 9 J.L. & Pol'y 507, 513 (2001) (stating "[J]udicial interpretation has made employee benefits less secure by creating a body of common law that controverts ERISA's initial policy objectives."); Nola A. Kohler, Note, *An Overview of the Inconsistency Among the Circuits Concerning the Conflict of Interest Analysis Applied in an ERISA Action with an emphasis on the Eighth Circuit's Adoption of the Sliding Scale Analysis in Woo v. Deluxe Corporation*, 75 N.D. L. Rev. 815, 821 (1999) ("Congress expected that courts would interpret the prudent man rule and other fiduciary standards while remaining cognizant of the purposes of ERISA.") (citing H.R. 93-533, reprinted in 1974 U.S.C.C.A.N. 4639, 4650).