SUBROGATING FULLY-INSURED
ERISA AND NON-ERISA
EMPLOYEE WELFARE
BENEFIT PLANS

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Today, a growing number of health plans fall outside the scope of ERISA, or alternatively, fall within the scope of ERISA, but are fully-insured, or unfunded. A great deal of confusion surrounds such fully-insured plans, and whether these plans enjoy the benefit of ERISA preemption. As we know, ERISA preemption is a formidable tool for avoiding the devastating effects of equitable subrogation defenses such as the Made Whole Doctrine or the Common Fund Doctrine. Like many other aspects of the law, however, whether the fully-insured plan enjoys the benefits of ERISA preemption depends on the state in which you are subrogating and the laws of that particular state. The non-ERISA plan is never entitled to ERISA preemption, however, creative arguments may exist that will assist in negotiating settlements in the face of state law that purports to limit or eliminate your subrogation recovery. Knowing how to effectively subrogate private plans or plans which are exempt from ERISA is vital to maximizing your subrogation recovery.

When we analyze health plans, we typically think of the Plan in terms of whether it falls within the scope of ERISA or whether it falls outside the scope of ERISA. Therefore, it is important to understand the Act itself. The term “ERISA” is an acronym for “Employee Retirement Income Security Act.” It is a federal law passed by Congress in 1974 that sought to protect employee benefit Plan participants by establishing minimum standards for administering Plans, disclosing financial and other information and processing claims. ERISA was designed to standardize the regulation of employee benefit Plans by preempting the field for federal regulation, thus eliminating the threat of conflicting or inconsistent state and local regulation.” Put another way, by enacting ERISA, Congress was attempting to protect employees from unfair employee benefit Plan practices while federally protecting them from inappropriate remedies.

Specifically, ERISA applies to any employee benefit Plan established or maintained by any employer or employee organization engaged in commerce or in any industry or activity affecting commerce. As we will see, it is just as important to understand which Plans are or are not governed by ERISA, as it is to understand exactly what ERISA says.

Two types of ERISA plans exist, the “self-funded” or “self-insured” plan and the “fully-insured” or “unfunded” plan. If a plan is self-funded, the employer pays the benefits directly through its general assets or through a trust fund established for that purpose. If a Plan is “fully-insured,” on the other hand, the employer does not pay the benefits, but rather, the employer purchases an insurance policy via the Plan, and an insurance company pays the losses. Finally, those plans that fall completely outside the scope of ERISA, or are otherwise excluded from ERISA coverage are considered non-ERISA Plans.

The type of Plan you are subrogating has a dramatic impact on your subrogation potential and recovery. Generally, a self-funded ERISA Plan always receives the benefits of ERISA preemption, the fully-funded ERISA Plan sometimes receives the benefits of ERISA preemption, and the non-ERISA Plan never receives the benefits of ERISA preemption. Because the fully-funded ERISA Plan falls somewhere between the across the board preemption of the self-funded ERISA Plan, and the non-ERISA Plan that is routinely subject to state law, some common misconceptions exist regarding fully-funded ERISA Plans. Often, plaintiffs’ attorneys believe that fully-funded ERISA Plans never enjoy the benefit of ERISA preemption. Others believe that because your Plan is ERISA covered, that it is entitled to across the board preemption. While neither of these misconceptions are true, they can clearly work either to your advantage or disadvantage.

SUBROGATING THE FULLY-FUNDED ERISA PLAN

We now know that if your ERISA Plan is fully-funded, your Plan’s language can, in certain circumstances, trump state law and allow preemption of that law. Preemption is the key to why ERISA subrogation is different and more powerful than ordinary insurance subrogation and much more effective. The benefit of preemption, is that it “trumps” state law and ensures state doctrines do not apply to reduce or eliminate an ERISA Plan’s interest. It is possible to successfully argue, depending on the state in which you are subrogating, that a fully-insured ERISA Plan trumps the made whole doctrine, common fund doctrine, anti-subrogation laws, collateral source laws and other state laws.

To determine whether a fully-funded ERISA Plan can trump or preempt a certain state law, we must look to the three main clauses of ERISA to determine if we have the ability to preempt state law, if the state can regulate our plan, and finally, if the state law is “saved” from preemption.

ERISA’s Preemption Clause indicates that all state law is preempted insofar as it “relates to employee benefit Plans.” The United States Supreme Court has held that a state law “relates to” an employee benefit Plan if it has a “connection with or reference to such a Plan.”

ERISA’s Savings Clause “saves” from preemption those state laws which “regulate insurance.” Or, in other words, if a state law “regulates insurance,” the Plan will not preempt that state law. It is important to remember that a fully-funded ERISA Plan does not want a state law to be “saved” from preemption, because if it is “saved,” the state law will apply to reduce or eliminate the Plan’s subrogation interest.

Finally, ERISA’s Deemer Clause prevents states from “opting out” of Federal preemption of employee benefit law by “deeming” self-funded Plans to be subject to the state law for purposes of the Savings Clause. The Deemer Clause, therefore, creates a distinction between self-funded and fully-insured ERISA Plans and establishes that States cannot “deem” a self-funded ERISA Plan an insurance company and thus, regulate it.

Now that we know that the Savings Clause “saves” from preemption those state laws which “regulate insurance,” how do we know which laws “regulate insurance” In Pilot Life Ins. Co. v. Dedeaux, the U.S. Supreme Court adopted a two-prong test to determine whether a state law “regulates insurance,” and is therefore saved from ERISA preemption. The first-prong of the test is to take a “common sense view” of the language of the saving clause itself. The second-prong makes use of case law interpreting the phrase “business of insurance” under the McCarran-Ferguson Act, 15 U.S.C. § 1011, et seq., in interpret-
ing the saving clause. Three criteria have been used to determine whether a practice falls under the "business of insurance":

(1) whether the practice has the effect of transferring or spreading a policy holder's risk;

(2) whether the practice is an integral part of the policy relationship between the insurer and the insured; and,

(3) whether the practice is limited to entities within the insurance industry.

In order for a state law to be deemed a "law which regulates insurance," and for it to be saved from preemption under ERISA, that law must be specifically directed toward entities engaged in insurance and it must substantially affect the risk pooling arrangement between an insurer and its insured. In particular, ERISA's saving clause does not require that state law regulate "insurance companies" or even "the business of insurance," in order to save state law from preemption. It needs only to be a "law ... which regulates insurance." (Id.)

In practical terms, whether a state law "regulates insurance" varies from law to law and state to state. The following are some examples of decisions with respect to whether a particular state law "regulates insurance." In FMC Corporation v. Holliday, a Pennsylvania anti-subrogation statute was held to regulate insurance. The court determined that a law that merely impacts the insurance industry will not be saved, but a law that is "aimed at" the insurance industry will be.

The 11th Circuit has interpreted FMC Corporation to stand for the proposition that subrogation laws are a "regulation of insurance." In Wisconsin, the made whole doctrine has been held to "regulate insurance." On the other hand, the 8th Circuit has held that common law rules with regard to subrogation were not the type of state insurance regulations intended to survive the broad scope of ERISA preemption, and were not saved as "regulating insurance." A Federal Court within the 6th Circuit has held that Tennessee's common law of subrogation, including its made whole doctrine, was preempted by ERISA because this common law was not limit-ed to the insurance industry, and was a law of general application. Therefore, it did not regulate insurance. That same Federal Court within the 6th Circuit has held that Tennessee's common law "common fund doctrine," however, did regulate insurance and was saved from preemption.

The Supreme Court of Alabama has held that the right of subrogation exists only after the insured has been "made whole." However, this law of subrogation was held by a federal court within the 11th Circuit not to "regulate insurance," because it did not solely apply to entities within the insurance industry. The Louisiana Supreme Court has held that Louisiana's law on subrogation does not transfer or spread a policyholder's risk, even though they can be an integral part of the policy relationship between the insurer and the insured. However, because subrogation law is not limited to entities within the insurance industry, these state laws do not "regulate insurance," and are not safe from ERISA preemption.

New Jersey's collateral source rule contains anti-subrogation provisions which the 3rd Circuit recently held were "not specifically directed toward the insurance industry," and therefore, was not saved from preemption by the savings clause of ERISA. In addition, the 4th Circuit has held that the subrogation provision of Maryland's HMO Act was saved from preemption as a legitimate state regulation of insurance. A federal court in Arkansas cited the 8th Circuit Baxter decision and held that Arkansas' made whole rule did not regulate the insurance industry directly. Indiana's common fund doctrine was held to "regulate insurance" and was saved from preemption. On the other hand, Indiana's lien reduction statute was held not to be saved from preemption because it did not "refer to" ERISA Plans.

The 6th Circuit has held that a Michigan statute requiring a no-fault insurer to place primary responsibility for medical expenses on health Plans was a statute "regulating insurance," because the statute had the effect of directly regulating the ERISA Plan. Illinois courts have developed a rule prohibiting subrogation of a minor's tort settlement to reimburse the party who paid the child's medical expenses.

This anti-subrogation law was held to "regulate insurance" and was saved from preemption, because the rule was directed toward the insurance industry.

Clearly, knowing what state laws you can argue apply, and the ability to successfully subrogate your fully-insured ERISA Plan will vary dramatically from state to state.

It is important to remember, however, that ERISA itself is silent with respect to subrogation and reimbursement. Amazingly, it says nothing about a Plan's right to recover benefit payments once they are made. Therefore, subrogation and reimbursement rights of an ERISA Plan will be determined largely by the Plan language itself. Good Plan language should, at a minimum, include language regarding the right to subrogation, reimbursement and first recovery, a lien on the proceeds of any reimbursement, the Insured's cooperation, and eliminating the effect of the made whole, contributory negligence or comparative fault doctrines, lien reduction statutes, or common fund doctrine. If your fully-insured Plan does not have good language, or any language at all, you may still have a right to subro-gate, assuming the state you are in recognizes the doctrine of equitable subrogation; however, you will undoubtedly be subject to all equitable defenses, including the made whole and common fund doctrine.

**Subrogating Non-ERISA Health Plans**

Certain Plans fall completely outside the scope of ERISA, or are otherwise excluded from ERISA, and, thus, do not enjoy the benefits of ERISA preemption. As such, these Plans are routinely subject to state law, including the made whole doctrine, common fund doctrine and anti-subrogation statutes. Likewise, fully-insured ERISA Plans that do not enjoy the benefit of ERISA Preemption (because the state law is determined to regulate insurance) must deal with the reality of the various state laws limiting subrogation recoveries. As is true with respect to subrogating all health plans, good Plan language is key to maximizing your recovery and preserving all potential arguments to maximize your subrogation recovery. Although non-ERISA Plans and fully-insured ERISA Plans do not enjoy the benefit of ERISA...
preemption and thus, are routinely subject to state laws, it is important to remember that the Plan is considered a contract and, under the right circumstances, you may argue that the language of your Plan controls rather than the equitable principles or doctrines you are attempting to overcome.

ENDNOTES

7 Kentucky Ass'n of Health Plans, Inc. v. Miller, 123 S. Ct. 1471 (2003).
9 Id.
10 O'Neal v. Kemmmner, 958 F.2d 1044 (11th Cir. 1992).
12 Baxter by Baxter v. Lynn, 886 F.2d 182 (8th Cir. 1989).
15 Blue Cross and Blue Shield of Ala. v. Sanders, 974 et seq. 1416 (M.D. Ala. 1997).
19 Levine v. United Healthcare, 402 F.3d 156 (3rd Cir. 2005).
22 I.C. § 34-4-41.
24 I.C. § 34-4-33-12 (predecessor to § 34-51-2-19, known as the Indiana Lien Reduction Statute).
25 Hoover, supra.