

CONFUSION ABOUNDS SUBROGATION/ REIMBURSEMENT IN HEALTH INSURANCE POLICIES AND PLANS

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Nothing concerning insurance is simple, especially when it comes to determining when, where and how subrogation/reimbursement applies in health insurance. An insurer's subrogation/reimbursement remedies were once roughly divided between whether ERISA applied or not. In most instances group health insurance fell within the purview of ERISA, and claims for subrogation/reimbursement had to be made under ERISA. Individual health insurance is rarely governed by ERISA; instead, it is governed by individual state laws and/or state court holdings.

Times have changed. The previous distinctions governing subrogation/reimbursement have disappeared. This is especially true in states governed by the Ninth Circuit Court of Appeals (hereinafter "9th Circuit"), where after *Providence Health Plan v. McDowell*² subrogation/reimbursement is not preempted by ERISA.

How does the lack of preemption effect subrogation/reimbursement in ERISA plans? State laws and state court determinations apply to subrogation/reimbursement. The more difficult question is whether state courts will look to past precedent concerning subrogation/reimbursement or develop new standards. Due to the breadth and depth of case law, treatises, and law review articles regarding the scope of ERISA preemption, and even who is covered by ERISA, those issues will not be covered in depth in this article. This article focuses on Nevada's and the other 9th Circuit states' enforcement of subrogation/reimbursement provisions.

This, of course, begs the question - is subrogation/reimbursement of health insurance claims possible? The answer to this question is fairly simple, although it comes across as flippant: it depends. As set forth below, there are a number of variables determining whether subrogation/reimbursement is allowed in a health insurance claim.

Subrogation/Reimbursement Basics

Subrogation and reimbursement are possible policy provisions where the insurer can seek repayment of some or all of the claims paid. Subrogation is the substitution of one party for another party in the assertion of rights against a third party. Reimbursement is a repayment when the insured has received funds from another responsible party. Many health plans use these terms interchangeably, as will this article. However, these seemingly interchangeable terms may significantly impact the plan's ability to recover, or the insured's ability to retain the damages recovered against the tortfeasor. A right of subrogation may arise by contract ("conventional subrogation"), by application of equitable principles of law ("legal subrogation"), or by application of a statute ("statutory subrogation").³ Subrogation is based on the premise the tortfeasor should compensate the insurer for payments the insurer made to the insured.⁴

Subrogation/Reimbursement In Nevada For Individual Health Policies Prior To McDowell

States in the 9th Circuit, after *McDowell*, must face the issue of how to interpret subrogation/reimbursement provisions. Will Courts apply the non-ERISA case law predicated upon state law principles? To understand where things are going, we have to understand when, where and how the various state courts have grappled with subrogation/reimbursement.

Prior to *McDowell*, ERISA governed health plans and policies could only recover benefits paid to a beneficiary from a third party tortfeasor in equity. That recovery was unrestricted by state law and state court prohibitions and/or limitations on the enforcement of subrogation/reimbursement provisions. Although ERISA limits the remedies to equity, it was initially believed subrogation/reimbursement was permitted. ERISA allowed health plans and insurers to avoid state laws, and court decisions that prohibit subrogation/reimbursement, with the trump card of ERISA "preemption."

In Nevada the enforceability of subrogation/reimbursement provisions is determined by whether the insured has first been "made whole."⁵ The "made whole" or "make whole" doctrine was adopted in Nevada through a body of case decisions. In *Sullivan v. Dairyland Ins. Co.*, the Nevada Supreme Court provided that insureds should

reasonably expect to be covered by the insurance they purchase.⁶ In *Maxwell v. Allstate Ins. Co.*, the Nevada Supreme Court determined subrogation violates Nevada's public policy.⁷ The Court provided: "we conclude that it violates public policy to allow an insurer to collect a premium for certain coverage and then allow the insurer to subrogate its interest and deny the insured his benefit."⁸ The Court set out five distinct public policy rationales for preclusion of subrogation: (1) Insurer receives a windfall when it collects premiums and then denies coverage; (2) Subrogation plays no part in rate schedules; (3) Insured incurs all the costs and effort in collection, while insurer receives 100% of its payments without effort or cost; (4) Insureds rarely receives adequate compensation; and (5) The tortfeasor's insurer deliberately anticipates insured's own insurance coverage.⁹

After *Maxwell*, group health insurers lobbied to permit subrogation in group health insurance. In 1994 the group health insurers succeeded. The Nevada Insurance Commissioner promulgated NAC 689B.180, which provides, in pertinent part:

Except as otherwise provided by specific federal or state statute or regulation, an insurer may include in a policy of group health insurance issued pursuant to chapter 689B of NRS a provision for subrogation regarding the right of an insured to recover, ... from a third person for the cost of medical benefits reimbursed by the insurer to the insured because of injuries incurred by the insured as a result of the actions of the third person. (emphasis added).

The Commissioner's enabling authority for the adoption of NAC 689B.180 was NRS 689B.034, which still reads, in pertinent part:

Every policy of group health insurance must contain a provision which reduces the insurer's liability because of benefits under other valid group coverage. To the extent authorized by the Commissioner, such a provision may include subrogation. (emphasis added).

NAC 689B.180 has never been tested as permitting subrogation/reimbursement in Nevada courts. The statutory authority for the regulation, NRS 689B.034, only authorizes the commissioner to permit subrogation when there are two group health policies - "coordination of benefits." The regulation is also contrary to the holding in *Maxwell* and its progeny.

The United States District Court applied *Maxwell* to health insurance policies in *Schulenberg v. Rawlings Co., LLC*.¹⁰ The Court found that *Maxwell* was the weight of authority against subrogation/reimbursement, providing, "[t]he Nevada Supreme Court has held that subrogation/reimbursement clauses for medical payments paid under an insured's policy is void as violative of public policy."

In *Ellison v. Cal. State Auto. Ass'n.*, the Nevada Supreme Court permitted subrogation/reimbursement, but only after first determining the insured was "made whole." The Court held the policy terms control once the insured has been made whole: "In *Maxwell*, we prohibited an insurer from subrogating medical payments of its insured as a matter of public policy. There, we were concerned about the injured party receiving something less than a full recovery. Inasmuch as Ellison received a full and total recovery, *Maxwell* and its public policy concerns are inapplicable."¹¹ Nevada clearly distinguishes between set-offs and double recoveries, allowing the first but prohibiting the latter. The offset limitations are inapplicable when the damages exceed the coverage limits.¹² Double recoveries are not recognized under Nevada law.¹³

In *Canfora v. Coast Hotels and Casinos, Inc.* the Nevada Supreme Court explicitly adopted the "make-whole" doctrine, stating "[t]he make-whole doctrine 'is a general equitable principle of insurance law' that prevents an insurance company from enforcing its subrogation rights before the insured has been fully reimbursed for their losses."¹⁴ The Supreme Court's October 20, 2005, decision further provided, "[t]he make-whole doctrine limits 'a plan's subrogation rights where an insured has not received compensation for his total loss,' *i.e.*, has not been made whole."¹⁵ Accordingly, in Nevada subrogation/reimbursement provisions are only applicable when the insured collects an amount from the tortfeasor over the total amount of the loss.¹⁶

In sum, Nevada has a clear precedent limiting when, where and how subrogation/reimbursement allows for recovery of benefits. Subrogation/reimbursement is limited to where there is a third party recovery from the tortfeasor and where there was not a policy or plan governed by ERISA. No Nevada laws or regulations specifically permit subrogation/reimbursement in individual health insurance policies. Arguably group health insurance remains the only area where subrogation/reimbursement may be possible. Nevada statutes do not permit subrogation/reimbursement for individual health insurance policies. If a Nevada court permits subrogation/reimbursement it is clear that it would only be after the insured has been “made whole.”

The Made Whole Doctrine

The made whole doctrine holds that the insured must be made whole (i.e. their damages must be totally paid for) before the insurer may subrogate. Under the made whole or make whole doctrine, “an insured who has settled with a third-party tortfeasor is liable to the insurer-subrogee only for the excess received over the total amount of his loss.”¹⁷

In addition to Nevada, at least twenty-eight (28) other jurisdictions have adopted the “made whole” doctrine: Alabama, Arkansas, California, Connecticut, District of Columbia, Florida, Georgia¹⁸, Indiana¹⁹, Iowa, Kentucky, Louisiana, Michigan, Minnesota²⁰, Mississippi, Montana, Nebraska, New Hampshire, New Jersey, New York, Ohio, Oklahoma, Pennsylvania, Tennessee, Texas, Utah, Washington, West Virginia, and Wisconsin.

The made whole doctrine applies to instances where the insured has recovered from the third party and the insurer attempts to exercise its subrogation right by way of reimbursement against the insured’s recovery.²¹ The doctrine acknowledges the realistic nature of tort recoveries. The made whole doctrine appropriately places the burden on the subrogated insurer to establish that the insured has been fully compensated prior to the allowance of subrogation rights. Where either the insurer or the insured must to some extent go unpaid, the loss should be borne by the insurer for that is a risk the insured has paid it to assume.²² The Supreme Court of Wisconsin observed that “subrogated insurers are not entitled to reimbursement from their insured when the insured has recovered the full amount of her insurers’ payments but has not recovered all of the damages to which she is entitled.”²³ Subrogation must not injure the insured. If the insured has only been paid part of the damages suffered, the insurer should not be allowed subrogate to the detriment of the insured.²⁴ An insurer can recover only the excess collected from the wrongdoer after the insured is fully compensated for his loss, including the costs and expenses of collection.²⁵

Several states entirely prohibit subrogation/reimbursement. A clear line of cases from states in the Ninth Circuit deny subrogation completely whenever it appears the insurer is seeking to be subrogated against its own insured.²⁶

Limited to Equitable Remedies Under ERISA

The civil enforcement section of ERISA clearly states a plan/fiduciary is only allowed to obtain equitable relief.²⁷ Therefore, it is very important whether the court perceives subrogation as an equitable remedy or a remedy at law. In looking at the type of claim, courts look to the substance of the remedy sought, and not to the title of the remedy.²⁸ Money damages are, of course, the classic form of legal relief.²⁹

The question left unanswered after *Great-West Ins. Co. v. Knudson* was whether subrogation is an equitable remedy, and thus allowed under ERISA. The 9th Circuit answered this question in *McDowell*.

Subrogation/Reimbursement After McDowell

McDowell held there was no right to subrogation under ERISA; therefore, the Plan only had a state law claim for breach of contract.³⁰ The 9th Circuit concluded there is no right to subrogation/reimbursement under ERISA, because enforcement of a contractual obligation for repayment is not equitable relief. The Court determined reimbursement claims are state law claims for contract damages, and therefore not preempted by ERISA.

McDowell relied upon *Great-West*, wherein the Supreme Court found ERISA does “not authorize a fiduciary to enforce a reimbursement provision ...”³¹ *Great-West* was consistent with previous 9th Circuit cases.³² “[I]n light

of our precedent and the Supreme Court's recent direction in *Great West*, . . . we agree with those states that have found no ERISA preemption."³³

McDowell rejected the insurer's attempt to cloak subrogation in equitable terms. The Court classified the plan's argument for "specific performance" as "lawyerly inventiveness" that was nothing more than an attempt to "disguise its claim in equitable clothes."³⁴ In *Westaff (USA)*³⁵ NRS §687B.110

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2. *Providence Health Plan v. McDowell*, 385 F.3d 1168 (9th Cir.2004), *cert. denied*, --- U.S. ----, 125 S.Ct. 1726, and *cert. denied*, --- U.S. ----, 125 S.Ct. 1735 (2005).

3. *York v. Sevier County Ambulance Auth.*, 8 S.W.3d 616 (Tenn. 1999).

4. *Id.*

5. *Canfora v. Coast Hotels and Casinos, Inc.*, 121 Nev. Adv. 76, --- P.3d ----, 2005 WL 2665801 (Oct. 20, 2005), <http://leg.state.nv.us/scd/121NevAdvOpNo76.pdf> (referring to the doctrine as the "make whole" doctrine).

6. *Sullivan v. Dairyland Ins. Co.*, 98 Nev. 364, 366, 649 P.2d 1357, 1359 (1982).

7. *Maxwell v. Allstate Ins. Co.*, 102 Nev. 502, 728 P.2d 814 (1986).

8. *Id.* at 506; 728 P.2d at 815.

9. *Id.*

10. *Schulenberg v. Rawlings Co., LLC*, 2003 WL 22129230 (D.Nev.,2003).

11. *Ellison v. Cal. State Auto. Ass'n.*, 106 Nev. 601, 603, 797 P.2d 975, 977 (1990)

12. *Sullivan v. Dairyland Ins. Co.*, 98 Nev. 364, 366, 649 P.2d 1357, 1359 (1982).

13. *Ellison*, 106 Nev. at 603; 797 P.2d at 977.

14. *Canfora v. Coast Hotels and Casinos, Inc.*, 121 Nev. Adv. 76, at pg. 9-10 (Citing *Barnes v. Independent Auto. Dealers of California*, 64 F.3d 1389, 1394 (9th Cir.1995).

15. *Id.* at 9 (Citing *Cagle v. Bruner*, 112 F.3d 1510, 1520-21 (11th Cir.1997)).

16. *Id.* (citing *Guy v. Southeastern Iron Workers' Welfare Fund*, 877 F.2d 37, 39 (11th Cir.1989).

17. *Guy*, 877 F.2d at 39; 16 *Couch on Insurance* §§ 61:64 (2d ed. 1983).

18. Ga. Code § 33-24-56.1

19. I.C. 34-51-2-19.

20. M.S.A. 62A.095; Bulletin 92-1.

21. *Davis v. Nepco Employees Mutual Benefit Assn.*, 51 F.3d 752, 754 (7th Cir. 1995); *Mahler v. Szucs*, 957 P.2d 632, 642 (Wa. 1995).

22. *Powell v. Blue Cross & Blue Shield*, 581 So. 2d 772, 777 (Ala. 1990); *Continental W. Ins. v. Swartzendruber*, 570 N.W.2d 708, 713 (Neb. 1997).

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23. *Sorge v. National Car Rental Sys., Inc.*, 182 Wis. 2d 52, 512 N.W.2d 505, 507 (Wis. 1994).
 24. *Durham Life Ins. Co. v. Lee*, 625 So. 2d 706 (La.App. 1993).
 25. *Ortiz v. Great Southern Fire & Cas. Ins. Co.*, 597 S.W.2d 342, 343 (Tex. 1980).
 26. *Piano v. Hunter*, 840 P.2d 1037 (Ariz. 1992); *Allstate Ins. Co. v. Reitler*, 628 P.2d 667 (Mt. 1978).
 27. 29 USC §1132 (a)(3).
 28. *Great-West Ins. Co. v. Knudson*, 534 U.S. 204, 122 S.Ct. 708 (2002).
 29. *Mertens v. Hewitt Associates*, 508 U.S. 248, 255, 113 S.Ct. 2063 (1993).
 30. *McDowell*, supra.
 31. *Id.* at 1173.
 32. *Cement Masons Health & Welfare Trust Fund for N.Cal v. Stone*, 197 F. 3d 1003, 1007 (9th Cir. 1999); *FMC Medical Plans v. Owens*, 122 F.3d 1258, 1262 (9th Cir. 1997).
 33. *McDowell*, at 1173 (emphasis added).
 34. *Id.* at 1173-1174.
 35. *Westaff (USA) Inc. v. Arce*, 298 F.3d 1164, 1165 (9th Cir. 2002).