RECOUPMENT OF PENSION OVERPAYMENTS: EQUITABLE LIENS AND MEANINGFUL REFORM AFTER *MONTANILE*

By Jeanne Medeiros and Maria O'Brien Hylton***

I. INTRODUCTION

Beginning in 1961, Brendan Jones[1] worked as a machine operator at Obelisk Manufacturing ("Obelisk") in Connecticut. Jones joined Obelisk as an 18 year-old right out of high school and worked there continuously until the plant closed in 1995 when he was almost 52 years old. When he reached the age of 55, Jones applied for and began receiving his pension in the amount of $123.79 per month from the Obelisk plan. In July 2010, 12 years into retirement, he received a notice from the plan informing him that it had made an error in calculating his monthly benefit. The correct amount, he was told, was $82.53 per month—a reduction of $41.26 or 33%. Then, in September of 2013 Jones received another notice from the plan that informed him, "When an overpayment is discovered, the Plan is required to take steps to correct the mistake and make the plan whole. To correct the overpayment of your benefits, further periodic payments to you will be reduced. . ."[2] At that point his benefit was further reduced to $24.78 per month.

The Obelisk Plan acknowledged that it paid him an incorrect benefit amount for approximately 12 years and that, as a result of this error, Jones owed the plan a total of $8257.65.[3] The plan's solution to this self-created problem was to reduce Jones' payments by 70%.[4] It is undisputed that Jones was unaware of the overpayment error.[5] The Plan also admits that Jones provided accurate information about his personal and employment history—[6]in

* Director, The Pension Action Center, University of Massachusetts Boston.
** Professor of Law, Boston University. The authors wish to thank Jordan Shelton and Philip Mackson for excellent research assistance and Michael Lauretano for tech help.

1. The names of all plan participants and of the plan sponsor are fictitious and have been changed in order to honor a confidentiality agreement entered into between the sponsor and The Pension Action Center in Boston, MA. Original documents are on file with the authors.
2. Letter from Jeanne M. Medeiros, Esq., to Plan Administrator (Jan. 12, 2015) (on file with authors).
3. Letter from Plan Administrator to Jones, (July 23, 2010) (on file with authors).
4. Letter from Plan Administrator to Jones, (Sep. 3, 2013) (on file with authors).
5. Letter from Plan Administrator to Jones' Attorney (April 6, 2015) (on file with authors).
6. *Id.*

other words, the plan does not allege that Jones engaged in any fraud or deception. The error was entirely the fault of the plan.

Jones was one of dozens of retired Obelisk Manufacturing participants who were overpaid as a result of plan error.[7] Some of the other retirees were overpaid for as much as eighteen years.[8] Like Jones, none of the other retirees did anything to cause or encourage the overpayment, yet all were the targets of a recoupment action and faced dramatic reductions in their monthly benefit amounts.[9]

Fortunately, these retirees secured legal representation through the New England Pension Assistance Project at the Pension Action Center in Boston. The Project provides fee pension counseling and advocacy to New Englanders through a grant from the U.S. Administration for Community Living/ Administration on Aging.[10] Ultimately, their benefits were restored to the correct levels set by the plan formula, and the plan stopped its recoupment efforts against them.[11]

Unfortunately, recoupment actions like the ones Jones and his fellow retirees faced are not uncommon. Although exact figures are hard to come by,[12] and the exact cause of the phenomenon in unknown, an increase in recoupment actions could be traceable to the economic downturn of 2008.[13] Recoupment actions in cases like Jones'—where there is no evidence of retiree wrongdoing—are not only legal and increasingly common, but are also, arguably, encouraged by an ERISA regulatory regime that has failed to place

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7. Confidential case files of the Pension Action Center (on file with authors).

8. *Id.*

9. Letter from Jeanne M. Medeiros, Esq., to Plan Administrator (June 24, 2015) (on file with authors).

> The twelve named retirees were completely unaware that their benefit payments may have been incorrectly calculated . . . . [T]he different methodologies outlined in the plan document were not described in the Summary Plan Description given to participants. The only methodology outlined in the SPD is consistent with their original benefit amounts. They did nothing to cause any alleged overpayment of benefits. In all of their contacts with the plan, they gave accurate and complete information about their personal and employment histories. They relied on the plan administrator's expertise to properly calculate and pay the correct benefit amount. In fact, the plan does not allege that the overpayment occurred due to any fault on the part of any of these retirees. The alleged overpayment was, in fact, due completely to the plan's own calculation methodology.

Id. at 2.

10. Pension Action Center, *Who We Can Help*, UNIV. OF MASS. BOSTON, https://www.umb.edu/pensionaction/who (last visited Feb. 2, 2017).

11. Confidential Settlement Agreement (on file with authors).

12. "There aren't any statistics regarding pension overpayments, but senior advocates say they have seen a spike of 'recoupment' cases, which are now one of the most common pension problems some advocacy groups are handling. Mr. Freeborn ['a lawyer with the Western States Pension Assistance Project, a Sacramento, Calif., group that is partly funded by the U.S. Administration on Aging'] now spends almost one-third of his working time handling recoupment cases; a few years ago, the staff rarely saw such cases." Ellen E. Schultz, *'Overpaid' Pensions Being Seized*, WALL ST. J., Aug. 13, 2010.

13. *Id.*

responsibility for the errors where it properly belongs, namely with the plan fiduciary or other entity that made the miscalculation.

This paper reviews the current state of recoupment actions for ERISA[14] plans and argues that a few simple reforms are needed in order to protect the typical target of these actions—elderly retirees who are often living on a fixed income and who do not enjoy the option of reattaching to the labor force to compensate for a dramatic reduction in lifestyle that follows from a successful recoupment. Retirees are uniquely vulnerable to the mistakes and subsequent corrections that plans seek to impose given their advanced age and limited opportunities to earn additional income.[15] When plans are solely responsible for overpayments, they need to look elsewhere to make the plan whole following the discovery of their error.

This paper argues that federal law does not in fact require a plan to engage in aggressive recoupment efforts, and that equitable principles bar recovery under circumstances in which the retiree would experience hardship. In addition, in cases where the plan's own gross negligence is responsible for the overpayment, we argue that the plan fiduciary has breached its duty of prudence to retirees. This fiduciary breach cannot be rectified by placing the entire burden of compensating the plan directly on the shoulders of those who are victims of the fiduciary's gross negligence.

Finally, this paper reviews the Supreme Court's recent decision in *Montanile v. Board of Trustees of the National Elevator Industry Health Plan*, which affirmed that an equitable lien by agreement can only be enforced

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14. Sections of ERISA that are relevant for this paper are as follows:
"Every employee benefit plan shall be established and maintained pursuant to a written instrument. Such instrument shall provide for one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation and administration of the plan." 29 U.S.C. § 1102(a)(1) (2012).
"Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary." 29 U.S.C. § 1109(a) (2012).

15. *See* Jennifer Anders-Gable, *Provisions for the Recoupment of Pension Plan Overpayments*, LOS ANGELES LAWYER, Nov. 2015, at 11.

> A plan's calculation error, whether administrative or otherwise, and failure to timely discover the error, coupled with reliance on a promised monthly benefit, may demand an exception to repayment suggestions found in the plan or elsewhere. In order to protect the income security of older vulnerable retirees and incentivize fiduciaries to do a better job administering their plan, more plans should heed recent IRS guidance and waive overpayments, particularly when the action is against an elderly individual who is unable to work and relies on his or her pension for life's necessities. . . . Some retirees will seek public benefits to replace suspended pensions or may face foreclosure when their monthly income is no longer sufficient to cover mortgage payments. . . . While a plan is permitted to correct future payments, it sometimes may be imprudent to recoup from an unknowing overpaid retiree who was unable to prevent the error and is unable to adjust his or her circumstances to make the plan whole.

Id. at 13.

against a specific, identifiable fund in the possession of a defendant and not against his general assets.[16] *Montanile* concludes that tracing of assets is required in order to enforce an equitable lien;[17] for defendants who receive lump sum payouts, this suggests that where overpayment dollars have already been spent on, for example, basic living expenses, no recoupment will be possible.

II. THE RECOUPMENT PHENOMENON

The Employee Retirement Income Security Act (ERISA) sets standards for the operation of retirement plans sponsored by private companies.[18] This paper reviews the current state of the law with respect to recoupment actions undertaken by these plans, and proposes prudent solutions to resolving the conflicting forces involved in these situations.

As a preliminary matter, we note that ERISA only governs retirement plans sponsored by private companies.[19] It does not control state and local governmental plans, most church plans, nor plans sponsored by the federal government for its employees.[20]

Many pension plans were adversely affected by the economic downturn that began in the last decade.[21] At about the same time, Congress enacted the Pension Protection Act of 2006, which imposed greater financial monitoring and disclosure regarding the sufficiency of plan assets and the funded status of ERISA-governed plans.[22] As a result, plans may be auditing their funds and their payments to retirees more closely.[23] It is likely that this is one of the reasons underlying the apparent uptick in overpayment recoupment actions.[24]

To understand recoupment efforts, it is important to keep in mind that two

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16. "We hold that, when a participant dissipates the whole settlement on nontraceable items, the fiduciary cannot bring a suit to attach the participant's general assets under § 502(a)(3) because the suit is not one for 'appropriate equitable relief.' In this case, it is unclear whether the participant dissipated all of his settlement in this manner, so we remand for further proceedings." Montanile v. Bd. Of Trs. of the Nat'l Elevator Indus. Health Benefit Plan, 136 S. Ct. 651, 655 (2016).

17. *Id.* at 654. ("The Board's arguments in favor of the enforcement of an equitable lien against Montanile's general assets are unsuccessful. Sereboff does not contain an exception to the general asset-tracing requirement for equitable liens by agreement.").

18. 29 U.S.C. § 1001(a)–(b).

19. 29 U.S.C. § 1003(a)–(b).

20. *Id.*

21. *See* JUAN YERMO & CLARA SEVERINSON, THE IMPACT OF THE FINANCIAL CRISIS ON DEFINED BENEFIT PLANS AND THE NEED FOR COUNTER-CYCLICAL FUNDING REGULATIONS, OECD Working Papers on Finance, Insurance and Private Pensions, No. 3 (2010), http://www.oecd.org/finance/private-pensions/45694491.pdf. *See also* Paul M. Secunda, *The Forgotten Employee Benefit Crisis: Multiemployer Benefit Plans on the Brink*, 21 CORNELL J.L. & PUB. POL'Y 77, 78 (2011).

22. *See generally* Daniel B. Klaff, *The Pension Protection Act of 2006: Reforming the Defined Benefit Pension System*, 44 HARV. J. ON LEGIS. 553 (2007).

23. *See* Jennifer Anders-Gable, *supra* note 15 at 11.

24. *See* Medeiros, *supra* note 9.

forces are at play: first, ERISA-regulated pension plans must conform to IRS guidelines in order to maintain their tax-qualified status.[25] The statute does not require plans to recover overpayments from participants and beneficiaries; on the contrary, plans are free to recover from the plan sponsor (employer) or other parties.[26] However, plans frequently assert that they are legally obligated to recover from participants and often seek to collect interest on the unpaid balance on the theory that the overpayment was a "loan".[27]

It is worth noting that overpayments are not limited to private, ERISA-regulated plans. Overpayments have also occurred in both the Social Security and public pension contexts.[28] The approach taken when an overpayment is discovered in these other situations is strikingly different from that described in the Obelisk Manufacturing case. With respect to public plans, both CalPERS and CalSTRS in California have statutes of limitations that forbid long reachbacks of the sort applied to Jones and his fellow retirees.[29] For federal

25. "Pension plans often cite their tax-qualified status as the reason why they must recoup from the recipient. Often, a plan asserts that it is required to recover overpaid funds and therefore a retiree's pension must be stopped until the funds are recouped. In some cases, the plan claims it is obligated to demand a six-figure, plus interest, lump sum return of the overpayment." Anders-Gable, *supra* note 15, at 11.

26. "The IRS recently revised its regulations . . . to clarify its position in recoupment matters. IRS Revenue Procedure 2015-27 states that 'depending on the facts and circumstances, correcting an Overpayment . . . may not need to include requesting that an Overpayment be returned to the plan by plan participants and beneficiaries.' . . . The IRS now explicitly states that 'an employer or another person' can repay the plan, with appropriate interest, 'in lieu of seeking recoupment from plan participants ad beneficiaries.'" *Id.* at 11.

27. *See* Samantha Valerius, *Safeguarding a Portion of the Retirement Nest Egg: ERISA and the Need for Regulations in Restricting Companies' Ability to Recoup Overpayment of Pension Funds Made to Struggling Retirees*, 33 HAMLINE J. PUB. L. & POL'Y 423, 433 (2012) ("In addition to asserting that retirees have received unearned money, some companies maintain that these overpayments are interest-free loans. However, the PBGC has countered this phrase with the term 'unsolicited loans,' which seems to be the more appropriate verbiage for these overpayments, as the retiree is forced to pay back a loan that he never wanted and, in fact, never knew that he had. Furthermore, companies have posited that if the situation were reversed (if the company had made underpayments to retirees), the retiree would most likely be requesting the additional payments due to him even if the retiree had made the mistake in the first place."); *see also* Appellees' Brief at 40, *Burns v. Corning Inc.*, 178 F.3d 1278 (3d Cir. 1999) (No. 98-3527) ("It is undeniable that the Committee's liberal recoupment determination has assured that Remington will transition to the *status quo ante* without any significant hardship. As of the time of trial, Remington had owned the mobile home for five years and she had not repaid the Plan one dollar of the more than $10,000 in overpayments she received between 1993 and 1995. She has no obligation to begin repayments until she retires in 2000, and then she will have more than 18 years to fully repay the Plan. . . . Her enjoyment of an interest-free and principal-free loan can hardly be characterized as a detriment. The withdrawal of the 401(k) funds also benefited Remington, because she used the funds to extinguish unrelated debt that she had incurred at very high interest rates.").

28. Irrespective of the type of plan, overpayments can result from data entry errors, confusion about plan terms, and confusion about the interplay between collective bargaining agreements and plan terms and errors in employment history. Plan terminations and the merger or sale of a plan sponsor have also been identified as sources of overpayment errors. *See* Valerius, *supra* note 27, at 429–33.

29. *See* CAL. GOV'T. CODE § 20164 (West 2016) (discussing the statute of limitations for CalPERS: "For the purposes of payments into or out of the retirement fund for adjustment of

government employees, the Office of Personnel Management (OPM) "has guidelines in place that deal with how quickly and aggressively the Federal Employees Retirement System and the Social Security Administration can reduce benefits or recoup overpayments when equitable remedies and hardships come into play."[30]

Likewise, Social Security "has a similar no-fault equity and good conscience requirement," under 42 U.S.C. § 404(b).[31] That section states that the Commissioner of the Social Security Administration ("SSA") "shall specifically take into account any physical, mental, educational, or linguistic limitation such individual may have (including any facility with the English language)."[32] ERISA, though, as many have[33] noted, contains no such explicit limitations on recoupment. Unsurprisingly, some private plans have taken full advantage of this regulatory vacuum.[34] Many private plans take the view that

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errors or omissions, whether pursuant to Section 20160, 20163, or 20532, or otherwise, the period of limitation of actions shall be three years, and shall be applied as follows: (1) In cases where this system makes an erroneous payment to a member or beneficiary, this system's right to collect shall expire three years from the date of payment. (2) In cases where this system owes money to a member or beneficiary, the period of limitations shall not apply."); *see also* 1988 STATE LEGISLATION, http://www.calstrs.com/post/1988-state-legislation (last visited July 26, 2016) (SB-2682, CalSTRS, has a "statute of limitations of 3 years for adjustments of errors or omissions. . .").

30. Sean Forbes, *Fiduciary Responsibility: As Pension Recoupment Grows, Advocates For Pensioners Offer Advice to Agencies*, Pens. & Ben. Rep. (BNA) (42 *BPR* 882) at *2 (May 19, 2015). For examples, "Under 5 U.S.C. § 8470, recovery of overpayments may not be made when in the judgment of the OPM, 'the individual is without fault and recovery would be against equity and good conscience.'" *Id.* Additionally, "Under FERS regulations, 'against equity and good conscience' includes financial hardship. The FERS regulations define financial hardship as applying when the benefits recipient 'needs substantially all of his or her current income and liquid assets to meet current ordinary and necessary living expenses and liabilities.'" *Id.*

31. *Id.*

32. *Id.* at 2.

33. *See* Valerius, *supra* note 27, at 438–39 ("There is also no limitation for how far back companies can go to seek overpayments. Retiree Charlie Craven was required to return overpayments that spanned eighteen years. . . . Without any limitations on . . . how far back the company can seek to recoup overpayments, the retiree could face paying back the overpayments for the rest of his life."); Letter from Ellen A. Bruce, Senior Fellow, Gerontology Institute, to Internal Revenue Service (July 16, 2015) (on file with authors) at 3 ("At this point there is no limit on how far back a plan can go in calculating an overpayment. If, for instance, there was a benefit calculation mistake that occurred 25 years ago, a plan can recalculate the benefit and seek to recoup from the participant 25 years of the overpayment."); Memorandum from Ellen A. Bruce, Director Pension Action Center, to Phyllis Borzi, Assistant Secretary of Labor (Nov. 19, 2013) (on file with authors), at 4 ("There should be some time limit to how long a plan can look back for recoupment. The three year limitation used by the PBGC seems a reasonable time for recouping overpayments that retirees did not cause.").

34. *See* Forbes, *supra* note 30. For example, in the Sheet Metal Workers Local 73 Pension Plan case, plan trustees engaged in what has been described as among the most aggressive recoupment efforts in modern times. The Hillside Illinois plan was audited in May 2010 and the audit found both overpayments and underpayments dating back to 1974. In 2014 the plan filed a proposal with the IRS' Voluntary Correction Program "to pursue recoupments, with some going back 34 years, and for amounts in the tens of thousands, or even hundreds of thousands, of dollars. The plan trustees went after nearly 600 plan participants, and informed recipients who weren't expected to live long enough to pay by installments that they would have to pay

because they are obligated to ensure that the plan is compensated for an overpayment, and because ERISA does not prohibit recovery from a plan participant, this is the best option.[35] The appeal of this approach to plan administrators who can quickly adjust future payouts to current retirees requires no further comment.

The second force that tugs on plans that have uncovered an overpayment seems to be a genuine sense on the part of plan fiduciaries that a retiree who has been overpaid has been unjustly enriched at the expense of the plan. There is, of course, a sense in which any over payment results in an "unjust" (and legally unwarranted) payment to the recipient. In the private pension context of defined benefit plans,[36] however, where all participants and beneficiaries are profoundly dependent upon both good plan administration as well as investment results that are consistent with actuarial expectations, it is not hard to understand why an overpayment to some may be viewed as a direct harm to others. The collective defined benefit pot, when badly managed, does at least in theory, result in direct losses to other participants.[37] In other words, an un-

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immediately with a lump sum . . . ." *Id.* (quoting Karen Ferguson, Director of the Pension Rights Center in D.C.).

35. ERISA was therefore enacted to ensure that retirees were protected and to guarantee that companies were dealing with pension funds in a reliable manner. . . . Above all, the Act was to "protect the interests of participants and their beneficiaries." . . . The Act states that a company, acting as a fiduciary, "shall discharge [its] duties with respect to a [pension] plan solely in the interest of the participants and beneficiaries and . . . with the care, skill, prudence, and diligence under the circumstances." That is, companies must act in the interest of all plan participants, not individual retirees. With respect to pension overpayments, this means the company needs to return the overpaid money to the pension plan in order to act in the best interest of all plan participants. . . . The Act does not expressly state which of these three should be required to return the overpayments, but most companies read the Act as requiring them to recoup the overpayment from the retiree. Valerius, *supra* note 27, at 426–27.

36. ZVI BODIE ET AL., PENSIONS IN THE U.S. ECONOMY 139 (1988).

> Although employer pension programs vary in design, they are usually classified into two broad types: defined contribution and defined benefit. These two categories are distinguished in the law under ERISA. Under a defined contribution (DC) plan each employee has an account into which the employer and, if it is a contributory plan, the employee make regular contributions. Benefit levels depend on the total contributions and investment earnings of the accumulation in the account. Often the employee has some choice regarding the type of assets in which the accumulation is invested and can easily find out what its value is at any time. Defined contribution plans are, in effect, tax-deferred savings accounts in trust for the employees, and they are by definition fully funded. They are therefore not of much concern to government regulators and are not covered by Pension Benefit Guarantee Corporation (PBGC) insurance. In a defined benefit (DB) plan the employee's pension benefit entitlement is determined by a formula which takes into account years of service for the employer and, in most cases, wages or salary. Many defined benefit formulas also take into account the Social Security benefits to which an employee is entitled. These are the so-called integrated plans.

Id. at 139.

37. *See Comparison of Traditional Defined Benefit with Traditional Defined Contribution Plans*, CUCFA (last visited July 25, 2016), http://cucfa.org/news/pension_table.html. In DC plans, "[e]mployees absorb investment risk in exchange for potential investment rewards," while DB plans make the "[e]mployer absorb investment risk in exchange for investment control." *Id.*

recovered overpayment to you may lead to a reduction in funds available to pay me. Of course, the plan remains liable to pay me the full benefit I am entitled to under the plan. Therefore, it has a strong incentive to recover any overpaid benefits in the easiest and most efficient way possible—by reducing the ongoing monthly benefit of the retiree who was incorrectly overpaid. It comes as no surprise then that practitioners report soaring numbers of recoupment actions following the economic collapse of 2008.[38]

However, as discussed in Section III,[39] American courts have typically required more than a mere assertion of an overpayment in order to permit recovery on a theory of unjust enrichment.

III. PHILLIPS, MONTANILE, AND LUMP SUMS

It will come as no surprise that in cases in which the fiduciary duty of care and prudence is negatively implicated by a plan error (as opposed to fraud on the part of a plan participant for example), the federal courts have for some time linked the fiduciary breach to the sought-after remedy of recoupment.[40] The problem of overpayments is not new and the targets of recoupment actions have long sought to place blame with the plan fiduciary as part of an effort to resist repayment.[41]

A. Phillips Decision

For example, in *Phillips v. Maritime Ass'n ILA Local Pension Plan*,[42] the federal district court for the Eastern District of Texas rejected an attempt by a

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While DC plans may be safer for all parties, DB plans provide a risk-reward for both parties. *See, id.*

38. Schultz, *supra* note 12.

39. *See* discussion *infra* Section III.

40. *See* Jennifer Anders-Gable, *supra* note 15, at 11–12 (citing Phillips v. Maritime Ass'n ILA Pension Plan,194 F. Supp. 2d 549 (E.D. Tex. 2001)).

41. *See, e.g.*, Jennifer Anders-Gable, *supra* note 15, at 11. S*ee also Phillips*, 194 F. Supp. 2d at 552 ("This case involves the question of an ERISA plan's ability to recoup benefit overpayments by drastically reducing monthly payments, when the overpayments were the result of a breach of fiduciary duty.").

42. Phillips v. Maritime Ass'n ILA Pension Plan, 194 F. Supp. 2d 549 (E.D. Tex. 2001).

> [T]he fiduciary should exert at least that duty of care that a reasonably prudent person would exert in his own affairs under like circumstances. In short, the fiduciary must exercise his position of trust so as, at the very minimum, not to harm the beneficiary as a result of his failure to exercise reasonable care. The prudent person standard imposed by ERISA provides that the fiduciary shall discharge her duties "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in like capacity and *familiar with such matters* would use in the conduct of an enterprise of a like character and with like aims" 29 U.S.C. § 1104(a)(1). Hunt violated the prudent person standard imposed by Section 1104(a)(1) of ERISA. By: [sic] (1) failing to seek and follow the advice of Plan counsel that every DRO should be submitted to an actuary; (2) failing to submit the DROs to the Plan actuary; (3) failing to submit the QDROs to an actuary; and (4) representing to Plaintiffs that the stated amounts would be the amounts they received.

Id. at 555–56 (emphasis in original) (citations omitted).

plan to recover overpayments by reducing promised future benefits to a group of former wives of plan participants who had obtained otherwise valid QDROs.[43] The ex-wives argued that the overpayments were unfair and unauthorized given that the plan administrator violated the prudent person standard by failing to submit the QDROs to the plan actuary before qualifying them.[44] The court agreed with the ex-wives and noted that the plan as administrated violated the prudent person standard by failing to submit the QDROs to the actuary even though counsel for the plan had advised that this step be taken.[45]

In language that is easily applicable to the Obelisk retirees, the court noted: "[t]hese older women depended on the dollar amounts not only stated in the QDROs . . . but actually distributed to them for years, when planning the rest of their lives. They neither knew nor had reason to know that the monthly benefits were incorrect. [They] suffered and continue to suffer as a result of [the] recoupment efforts."[46] In rejecting the plan's effort to recover under a

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43. *See id.*

> Congress created the QDRO structure when it amended ERISA with the Retirement Equity Act ("REA") of 1984. The REA enhanced ERISA's protection of divorced spouses and their interest in retirement funds earned during marriage; *see also Boggs*, 520 U.S. at 848, 117 S. Ct. at 1763. "The QDRO provisions protect those persons who, often as a result of divorce, might not receive the benefits they otherwise would have had available during their retirement as a means of income." *Id.* at 854, 117 S. Ct. at 1767. Thus, the REA amendments require each pension plan to provide for "the payment of benefits in accordance with the applicable requirements of any qualified domestic relations order." 29 U.S.C. § 1056(d)(3)(A) (2012). Furthermore, "[e]ach plan shall establish reasonable procedures to determine the qualified status of domestic relations orders and to administer distributions under such qualified orders." 29 U.S.C. § 1056(d)(3)(G)(ii) (2012).

Phillips, 194 F. Supp. 2d at 554–55.

44. *Phillips*, 194 F. Supp. 2d at 555–56. For guidance on how plans should create procedures, see *DOL Provides Guidance on Qualified Domestic Relations Orders*, PENSION ANALYST (Prudential Retirement, Sept. 1997).

> Every plan is required to establish written procedures. Plan procedures should be established to ensure that QDRO determinations are made in a timely, efficient and cost-effective manner. When a DRO is received, the plan administrator must promptly notify the affected participant and each alternate payee named in the order to acknowledge receipt. In addition, the plan administrator must provide a copy of the plan's procedures. A plan's QDRO procedures must:
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> - Be in writing;
> - Be reasonable;
> - Provide that each person specified in a DRO will be notified of the plan's procedures for making a QDRO determination; and
> - Permit an alternate payee to designate a representative for receipt of copies of notices and plan information that are sent to the alternate payee with respect to a DRO.
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> The DOL has indicated that QDRO procedures are not reasonable if they hamper the determination of a QDRO or the distribution of payments under the QDRO. For example, a procedure that requires a participant or alternate payee to pay a fee or charges a participant's account to qualify the DRO is not reasonable.

Id. at 3.

45. *Phillips*, 194 F. Supp. 2d at 556.

46. *Id.*

theory of restitution, the court highlighted that the core problem—a long period of reliance on an overly generous pension payment—was the direct result of the fiduciary breach of a duty owed to participants and their beneficiaries.[47] But for this breach, the ex-wives would have received a correct payout initially and not come to rely on a larger amount.[48] The court declined to allow recoupment of the overpayment (although it did approve of a lower, corrected payout going forward) because of the plan's own culpability in creating the conditions that later gave rise to the need for an adjustment.[49]

B. Post-Phillips

In spite of the early and clear signal in *Phillips* that culpability was a necessary and critical part of the analysis in recoupment cases, plans continued to reduce benefits not just to their proper level after uncovering the error, but further, in order to recoup overpayments. In *Kapp v. Sedgwick*[50] and *Weiner v. Elizabeth Board of Educ.*,[51] the courts again grappled with plan assertions that the overpayments constituted unjust enrichment for which the only fair remedy was repayment. *Kapp* involved an employee who was forced to leave work due to a disability.[52] He received short term and then long-term disability benefits as well as Social Security Disability benefits (SSDI).[53] During this time his former employer was merged and acquired in a series of corporate transactions.[54]

Kapp repeatedly disclosed to the plan administrator his SSDI benefit over many years.[55] The plan administrator repeatedly reaffirmed that his disability payment was correct.[56] Finally in 2010 the administrator discovered that

47. *Id.*

48. *Id.* at 557 ("The court does not believe it would be equitable for the Plaintiffs to bear the weight of an error that Hunt could have prevented by upholding her duty as plan administrator and allowing an actuary to check the QDROs.").

49. The *Phillips* court noted that the plan might yet be able to recover the overpayments from trustees or others who might subsequently be found liable for the oversight. *Id.* at 557. Recovery from the beneficiaries, however, was prohibited on the ground that "the balance of equities weighs in favor of disallowing [it]. . . ." *Id.*

50. Kapp v. Sedgwick CMS, 2013 U.S. Dist. LEXIS 219, at *2 (S.D. Ohio Jan. 2, 2013) ("[T]he Court further holds that, due, in part, to the facts that Plaintiff relied on the correctness of the monthly amounts for a period of over eight years and repeatedly disclosed information that revealed the plan administrator's mistake of overpaying, Defendants are equitably barred from recovering the mistaken overpayments made up to the date hereof.").

51. Weiner v. Elizabeth Bd. of Educ., 2013 N.J. Super. Unpub. LEXIS 1729, at *5 (N.J. Super. Ct. Feb. 26, 2013). The New Jersey court noted that the standard for evaluating a claim of unjust enrichment in the state was that "[i]t is a general rule that a payment of money under a mistake of fact may be recovered, provided that such recovery will not prejudice the payee. This rule is grounded upon considerations of equity and fair dealing. It is considered unjust enrichment to permit a recipient to retain money paid because of a mistake, unless the circumstances are such that it would be inequitable to require its return." *Id.* (citations omitted).

52. *Kapp,* 2013 U.S. Dis. LEXIS 219, at *2.

53. *Id.* at *2–*4,

54. *Id.* at *3.

55. *Id.* at *4.

56. *Id.* at *5.

Kapp's SSDI benefit had never been deducted as required from his plan benefit amount.[57] Kapp was offered three choices: (1) he could repay the $162,308.21 overage in full; (2) he could be subject to a period of benefit withholding to effect repayment; or (3) he could be subject to a reduction of $500 per month until the overage was repaid.[58] Kapp elected option three and sued.[59]

Noting that this area of law is governed by trust law and not contract law, the *Kapp* court pointed to the long period of reliance on the plan's calculations and the repeated disclosure to the plan by Kapp of his SSDI award and rejected the plan's claim for recoupment.[60] As in *Phillips* more than a decade earlier, the court found that the equities favored Kapp and barred recovery of the overpayment.[61] Kapp, however, was not entitled to the incorrect higher benefit amount going forward.[62]

C. Montanile and Recoupment of lump sums

Recently, the U.S. Supreme Court issued a decision in the *Montanile* case[63] which, like *Phillips* and *Kapp*, casts serious doubt on the sorts of plan tactics seen in cases where recoupment of a lump sum payout is sought. Beginning with *Great-West Life & Annuity Ins. Co. v. Knudson,*[64] which limited relief in a plan reimbursement case to "equitable relief" only and excluded money damages or damages typically available in a court of law, and *Sereboff v. Mid Atlantic Medical Services Inc.,*[65] which essentially sanctioned

57. *Id.* at *6.

58. *Kapp,* 2013 U.S. Dis. LEXIS 219, at *6.

59. *Id.* at *1.

60. *Id.* at *11–15.

61. *Id.* at *13–15; *see Phillips*, 194 F. Supp. 2d at 556.

62. In *Kapp* the court identified six factors to be used in determining whether equitable principles bar recovery in an ERISA mistaken overpayments situation: 1. The amount of time which has passed since the overpayment was made; 2. The effect that recoupment would have on that income; 3. The nature of the mistake made by the administrator; 4. The amount of the overpayment; 5. The beneficiary's total income; and 6. The beneficiary's use of the money at issue. *Kapp*, 2013 U.S. Dis. LEXIS 219 at *10.

63. Montanile v. Bd. of Trs. of the Nat'l Elevator Indus. Health Ben. Plan, 136 S. Ct. 651, 653 (2016) (holding, "[w]hen an ERISA-plan participant wholly dissipates a third-party settlement on nontraceable items, the plan fiduciary may not bring suit under §502(a)(3) to attach the participant's separate assets.").

64. Great-West Life & Annuity Ins. Co. v. Knudson, 534 U.S. 204, 220–21 (2002). For a critique of the majority's opinion in *Great-West*, *see* Justice Ginsburg's dissent in which she describes the revival of the law/equity distinction in connection with ERISA remedies as "fanciful" and "antiquarian" and unnecessary. "The rarefied rules underlying this rigid and time-bound conception of the term "equity" were hardly at the fingertips of those who enacted [the remedial provisions of ERISA]. By 1974, when ERISA became law, the "days of the divided bench" were a fading memory, for that era had ended nearly 40 years earlier with the advent of the Federal Rules of Civil Procedure.... It is thus fanciful to attribute to members of the 93rd Congress familiarity with those "needless and obsolete distinctions [cites omitted] much less a deliberate "choice" to resurrect and import them wholesale into the modern regulatory scheme laid out in ERISA.") *Id.* at 225.

65. *See generally* Sereboff v. Mid. Atl. Med. Servs, 547 U.S. 356 (2006). The Sereboffs were injured in a car accident and their medical expenses were covered by Marlene Sereboff's

recovery from insureds by insurer who had paid medical bills so long as the settlement fund was distinct and identifiable, the Supreme Court has worked to develop a set of coherent rules with respect to equitable liens consistent with the remedies available in courts of equity (and not courts of law). Prior to *Montanile* in which the Court resolved this issue, plans with pension recoupment claims assumed the equitable lien was the amount of the overpayment, which in some cases might be specific and distinct enough to permit repayment.[66] However, in the typical recoupment scenario it was still often the case that specificity was lacking when the funds routinely became part of a retiree's monthly assets and were spent on groceries, rent, and other necessary expenses. Under these circumstances, an equitable lien cannot be enforced against a retiree who has been overpaid.

In its recent *Montanile* decision, the Court reaffirmed that an equitable lien may only be enforced against a specific, identifiable fund that is in the defendant's possession.[67] The facts are pretty straightforward: Robert Montanile was injured in a car accident.[68] The plan covered about $120,000 in medical expenses for Mr. Montanile, who filed a tort claim against the drunk driver who hit him.[69] Montanile recovered $500,000, about half of which was set aside for attorneys' fees.[70] The plan demanded reimbursement from the settlement, and $120,000 was set aside while Montanile's lawyer negotiated with the plan.[71] Negotiations stalled and the lawyer notified the plan that he would release the funds to Montanile within two weeks.[72] The funds were released and six months later, the plan sued.[73]

The Supreme Court overturned the Eleventh Circuit, which like a majority of circuit courts,[74] had concluded that Montanile needed to turn the funds over

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employer-sponsored health plan. *Id.* The Sereboffs obtained a $750,000 tort settlement and the plan sought reimbursement of $75000. *Id.* The demand for reimbursement was based on plan document language ("Acts of Thirds Parties") in which beneficiaries promised to reimburse the plan for all third party recoveries. *Id.* The Court said the plan was entitled to reimbursement as "appropriate equitable relief." *Id.* The Acts of Third Parties language in the contract created an equitable lien on the tort settlement obtained by the Sereboffs. *Id.* It was critical that there was an identifiable, specific fund separate from the Sereboffs general assets out of which the plan could be reimbursed. *Id.*

66. *Montanile*, 136 S. Ct. at 656.

67. *Id.*

68. *Id.* at 655–56.

69. *Id.* at 653.

70. *Id.* at 656.

71. *Id.*

72. *Montanile*, 136 S. Ct. at 656.

73. *Id.* at 656.

74. In its *Montanile* decision, "the Eleventh Circuit relied on its recent holding in *AirTran Airways, Inc. v. Elem*, in which it ruled that for the purpose of equitable lien rights under ERISA, settlement funds were 'specifically identifiable' even after they are no longer in the possession of the plaintiff-plan member; a plan member's dissipation of the funds thus could not destroy the lien that attached before the dissipation. The Eleventh Circuit's ruling reinforced its holding in *Elem* and falls in line with the opinions of six other circuit courts. Two circuits, however, currently take the opposite view, finding that ERISA does not provide for recovery of a plan's equitable lien against dissipated settlement proceeds and at the time of an ERISA action a 'strict

to the plan because dissipation was irrelevant.[75] Citing "standard equity treatises,"[76] the Court readily reaffirmed the longstanding requirement that specific funds remain in the defendant's hands or at least be traceable to items that were purchased with those funds—identifiable property like real estate or a vehicle.[77] Expenditure of the funds on non-traceable items such as groceries or travel destroys an equitable lien.[78] If the equitable lien is destroyed, the plan may still have a personal claim against the defendant's general assets but recovering from those assets is a legal remedy rather than an equitable one.[79]

D. Post-Montanile

A critical part of the analysis in these recoupment cases, then, is the location of the funds from the lump sum payout, and if they are no longer in the possession of the participant, are they traceable? In many of the recoupment cases involving large, one-time payouts, one would expect that the funds will be long gone and untraceable by the time the plan discovers its errors. Funds expended each month on rent, food, and prescription drugs, which are typically significant expenses for low- and moderate-income retirees, are not recoverable with an equitable lien.

It is important to note that the plan bears the burden of proving that the participant or beneficiary still has the funds.[80] Should a plan decide to pursue

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tracing' of the funds from settlement to the plan member's (or his/her attorney) actual or constructive possession is required." Nicholas W. D'Aquila et al., *U.S. Supreme Court Grants Cert in* Montanile v. National Elevator - *Will the Court 'trace' its Roots Back to Sereboff?*, 11 ABA HEALTH ESOURCE 11 (July 2015). "The First, Second, Third, Sixth, Seventh, and Eleventh Circuits have issued opinions allowing a plan to enforce an equitable lien against dissipated settlement proceeds under ERISA. The Ninth and Eighth Circuits have held that plans are not entitled to such a remedy." *Id.* at note 5. *Compare* Cent. States, Se. & Sw. Areas Health & Welfare Fund v. Lewis, 745 F.3d 283, 285 (7th Cir. 2014), *and* AirTranAirways, Inc. v. Elem, 767 F.3d 1192, 1198–99 (11th Cir. 2014), *and* Thurber v. Aetna Life Ins. Co., 712 F.3d 654, 664 (2d Cir. 2013), *and* Funk v. CIGNA Grp. Ins., 648 F.3d 182, 194 (3d Cir. 2011); Cusson v. Liberty Life Assurance Co. of Boston, 592 F.3d 215, 231 (1st Cir. 2010), *and* Longaberger Co. v. Kolt, 586 F.3d 459, 466–67 (6th Cir. 2009), *with* Treasurer, Trs. of Drury Indus., Inc. Health Care Plan & Trust v. Goding, 692 F.3d 888, 897 (8th Cir. 2012), *and* Bilyeu v. Morgan Stanley Long Term Disability Plan, 683 F.3d 1083, 1095 (9th Cir. 2012).

75. *Montanile*, 136 S. Ct. at 656.

76. *Id.* at 658 ("those treatises make clear that a plaintiff could ordinarily enforce an equitable lien only against specifically identified funds that remain in the defendant's possession or against traceable items that the defendant purchased with the funds (*e.g.*, identifiable property like a car). A defendant's expenditure of the entire identifiable fund on nontraceable items (like food or travel) destroys an equitable lien. The plaintiff then may have a personal claim against the defendant's general assets—but recovering out of those assets is a *legal* remedy, not an equitable one.").

77. *Id.* at 654.

78. *Id.*

79. *Id.* at 658.

80. RESTATEMENT (FIRST) OF RESTITUTION § 215 cmt. b (AM. LAW INST. 1937) ("A person whose property is wrongfully taken by another is not entitled to priority over other creditors unless he proves that the wrongdoer not only once had the property or its proceeds, but still has the property or its proceeds or property in which the claimant's property or its proceeds have been mingled indistinguishably.").

recoupment after *Montanile*, the plan will need to follow basic tracing rules.[81] In the case of low- and moderate-income retirees, we would expect that comingling and dissipation of the funds will be very common. In the case of higher income retirees, it will likely be easier to identify specific assets—autos, stocks, or real estate—against which an equitable lien may be enforced. It is important to note that the Court pointed out that an asset would first need to be seized and sold to satisfy the lien.[82] An equitable lien must be distinguished from a constructive trust: the asset itself cannot be turned over to the plan pursuant to a lien[83] in the way it could be turned over to a trust.[84]

IV. REFORMS AND INSURANCE COVERAGE FOR NEGLIGENCE TRIGGERING RECOUPMENT ACTIONS

In addition to the improved legal environment for lump sum retirees facing a recoupment action after *Montanile,* there appears to be growing consensus that some combination of legislative and administrative reforms are needed in order to avoid overly aggressive recoupment efforts against retirees who are both without fault and without the resources to adjust to dramatic drops in their monthly retirement income.[85] This paper reviews some of the

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81. *Montanile*, 136 S. Ct. at 654.

82. *Montanile*, 136 S. Ct. at 661 ("To the extent that courts endorsed any version of the swollen assets theory, they adopted a more limited rule: that commingling a specifically identified fund—to which a lien attached—with a different fund of the Defendant's did not destroy the lien. Instead, that commingling allowed the plaintiff to recover the amount of the lien from the entire pot of money. (citations omitted) Thus, even under the version of the swollen assets doctrine adopted by some courts, recovery out of Montanile's general assets — in the absence of commingling — would not have been 'typically available' relief.").

83. *Id.* at 659–60 ("The question we faced in *Sereboff* was whether plaintiffs seeking an equitable lien by agreement must "identify an asset they originally possessed, which was improperly acquired and converted into property the defendant held." We observed that such a requirement, although characteristic of restitutionary relief, does not 'appl[y] to equitable liens by agreement or assignment.' That is because the basic premise of an equitable lien by agreement is that, rather than physically taking the plaintiff's property, the defendant constructively possesses a fund to which the plaintiff is entitled. But the plaintiff must still identify a specific fund in the defendant's possession to enforce the lien.").

84. "A constructive trust is a relationship with respect to property subjecting the person by whom the title to the property is held to an equitable duty to convey it to another on the ground that his acquisition or retention of the property is wrongful and that he would be unjustly enriched if he were permitted to retain the property." RESTATEMENT (SECOND) OF TRUSTS, § 1(e) (AM. LAW INST. 1959). "An equitable lien can be established and enforced only if there is some property which is subject to the lien. Where property is subject to an equitable lien and the owner of the property disposes of it and acquires other property in exchange, he holds the property so acquired subject to the lien… So also, where the property which is subject to the lien is mingled with other property in one indistinguishable mass, the lien can be enforced against the mingled mass Where, however, the property subject to the equitable lien can no longer be traced, the equitable lien cannot be enforced (citations omitted)." RESTATEMENT (FIRST) OF RESTITUTION, § 161(e) (AM. LAW INST. 1937). "The distinction between the remedy of imposing an equitable lien and that of imposing a constructive trust is brought out in the numerous cases involving following money into its product." *See id.* (Reporter's Notes citing Scott, *The Right to Follow Money Wrongfully Mingled with Other Money*, 27 HARV. L. REV. 125 (1913)).

85. *See* discussion *infra* Section IV.A–C.

commonly offered proposals for reform and also suggests that a fairly simple solution would be the addition of insurance to cover plans in the event that they uncover their own negligently caused error. Many retirees, like Jones, who do not receive lump sum payouts would benefit from one or more of these proposals.

A. Adopt a Statute of Limitations on Recoupment Actions and Limit Reductions to 10% of Benefit Amount

It appears that the most commonly proposed solution[86] to the recoupment problem described here is the formal adoption by plans of maximum three-year statutes of limitations that would limit plans' ability to collect overpayments. The notion is fairly simple: a three-year limit would cap the total overpayment amount and keep it from becoming a figure that unduly burdens a retiree.[87] With a limited amount at issue, the likelihood that a low- or moderate-income retiree would be able to agree to a reasonable repayment plan increases. A three-year look back limit combined with a rule limiting the maximum reduction in ongoing benefit payments to 10%[88] would further protect the

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86. *See* Valerius, *supra* note 27.

> An additional reform can either establish a statute of limitations for recoupment actions or can limit how far back overpayments can be recouped. Senator Harkin's bill prohibited recoupment if the company failed to commence the action within 3-years of the initial overpayment. The statute of limitations would ensure retirees would only have to pay back a maximum of three years worth of overpayments. Similarly, ERISA could require that companies only recoup overpayments that were made over a limited number of years. For example, if the retiree was overpaid for ten years, the company would only be able to recoup two, three, or five years of overpayments. While both of these resolutions would help limit the amount that retirees would be expected to pay back and thus relieve the financial burden of having to pay back many years of overpayments, the second solution, limiting how far back overpayments can be recouped, would better benefit both parties. Establishing a statute of limitations on companies would likely mean that companies would not be able to acquire any overpayments since some companies do not recognize the overpayment error until years after the initial mistake had been made.

Id. at 448; *see also* Memorandum from Ellen A. Bruce to Phyllis Borzi, *supra* note 33, at 3.

87. Valerius, *supra* note 27, at 448.

88. *See id. at* 447–48.

> The PBGC has proposed . . . monthly limitations on recoupment. The PBGC once proposed that recoupment of overpayments should be decided by: Computing the ratio of the net overpayments to be recouped to the total value of the participant's benefit...The percentage reduction [would be] computed by dividing the total overpayment subject to recoupment by the present value of the...benefits and multiplying by 100 percent...Because recoupment under [this] proposed method is spread over the entire term of the benefit payments to the participant or beneficiary, the monthly reduction in benefits [would] generally be less than...a flat 10 percent reduction. Limiting a company's recoupment practices, by either requiring it to utilize a methodical calculation like the one proposed by the PBGC or by establishing that monthly reductions cannot exceed 10 percent of the retiree's monthly pension payment, would free resources in order to fight the recoupment action and also ease the retiree's

ability of retirees to maintain their standard of living while also improving the likelihood of repayment.

For example, if X was overpaid $5000 per year by her plan for 10 years, say from 2005 to 2015, the plan would be limited under the rules we envision, to a maximum recovery of $15,000 instead of $50,000. The likelihood that a reasonable repayment plan could be formulated is greatly enhanced when the overpayment period is capped.

Currently, there is *no* statute of limitations applicable to recoupment actions which exposes participants (who are often elderly and of very limited means) to astronomical repayment amounts. We propose the adoption of a three year limit which will promote basic fairness and encourage plans to be much more proactive about monitoring, discovering and promptly addressing their own accounting errors.

Of course, a three-year statute of limitations would prevent plans from full recovery in cases where the overpayment took place over many years. However, the statute, like its corollary in criminal statutes,[89] is designed to promote overall fairness. Properly designed, it should promote fiduciary responsibility, and regular audits, and enhanced oversight, while also protecting participants from sudden, devastating payment demands.

B. Amend Regulations to Require Explicit Consideration of Participant's Ability to Repay

A plan participant's ability to repay an erroneous overpayment will turn on two issues: first, the dollar amount of the overage amortized over some reasonable period as a percentage of the retiree's income in retirement; and second, the added burden imposed by interest charges when a plan deems the overpayment to have been an interest-free loan. Frankly, it is hard to see how a rational actor would have agreed to the "loan" terms the plan typically proposes. The repayment amount (the "loan principal") is often so large that repayment at a reasonable rate requires a dramatic reduction in lifestyle.[90]

Few rational consumers would agree to such terms. When interest is

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financial burden of paying back the recoupment.

Id. at 447–48 (citing Benefit Reductions in Terminated Single-Employer Pension Plans and Recoupment of Benefit Overpayments, 48 Fed. Reg. 50111-01, 50116 (proposed Oct. 31, 1983) (to be codified at 29 C.F.R. pt. 2623)).

89. *See* Rinat Kitai-Sagero, *Between Due Process and Forgiveness: Revisiting Criminal Statutes of Limitations*, 61 DRAKE L. REV. 423, 424 (2013) ("Most countries adopt statutes of limitations barring prosecution after a certain period of time from the occurrence of the crime. The United States Supreme Court praised such statutes: [']Statutes of limitation are vital to the welfare of society and are favored in the law. They are found and approved in the all systems of enlightened jurisprudence. They promote repose by giving security and stability to human affairs. An important public policy lies at their foundation. They stimulate to activity and punish negligence.['] Customary conceptions view statutes of limitations as providing fairness to the defendant and as being productive for society.").

90. *See* discussion *supra* Section I.

added to the "loan" the burden becomes even greater as the likelihood of voluntarily having consented to such an arrangement, which of course includes "calling in" the "loan" at a future, undetermined date drops to miniscule and undetectable levels. The years of overpayment are not, as some plans assert[91], the equivalent of an interest-free loan. On the contrary, the overpayment in these cases is almost always the direct result of plan error that the retiree had no reasonable way of detecting. This "solution" permits the plan to solve the problem it created on the back of retirees living on a fixed income.

We suggest the adoption of formal hardship guidelines, which would provide a measure of protection to participants. Specifically in cases where the plan is solely at fault and repayment would cause significant hardship, we support guidelines that, consistent with the result in *Phillips*, for example, bar repayment and only permit a reduction in benefits to the correct amount going forward.[92]

Consider two examples. First, suppose participant Y lives solely on a pension of $24,000 per year. Through no fault of his, an overpayment of $700 per year for 12 years (or $8400) is discovered. Initially, a demand for full repayment of $8400 from an annual income of $24,000 would leave Y with $15,600 to live on. This amounts to a 35% drop in income and, in most parts of the country this reduction puts Y well below the poverty level.[93] For this fact situation, we propose guidelines that would forego any repayment, especially if the plan is fully funded.

Second, if Z, like Y owes $8400 under identical conditions except that Z's income is $48,000 instead of $24,000 and Z has other significant assets, guidelines that would permit a reasonable repayment schedule in order to recoup no more than three years' worth of overpayments would avoid pushing Z into poverty.

The guidelines we envision would take, at a minimum, income, assets (both liquid and illiquid) and disability status into account. In every innocent participant recoupment case, fairness demands that the plan look to the fiduciary or any other responsible entity *before* attempting to recover from the participant. Even in cases of significant wealth, where the repayment would not affect the participant in a meaningful way, fairness demands that the party which made the initial error take responsibility for the chain of events it

91. *See e.g.*, Forbes, *supra* note 30 at 1–3 (discussing the Triangle Wire overpayment response: "Triangle Wire retirees were informed that future pension payments were being reduced based on a recalculation of the correct benefit, but then also were told that they had to reimburse the plan, with interest, for the overpayments.... [Triangle Wire's] plan was an ''ungenerous plan,'' but... after the benefit amounts were recalculated, retirees were told their benefits were being reduced to the correct amount, then reduced another 25 percent, and finally that they were being charged 7.5 percent interest. Some retirees saw their benefits reduced by as much as 80 percent").

92. *See supra* text accompanying notes 33–44.

93. *See generally* U.S. Dep't of Health & Human Serv., *U.S. Federal Poverty Guidelines Used to Determine Financial Eligibility for Certain Federal Programs* (Jan. 26, 2017), https://aspe.hhs.
gov/poverty-guidelines (assuming Y is in a household of two).

erroneously set in motion.

The plan, in cases like this, should be encouraged to look to the fiduciary or other entity that is responsible for the error for compensation.[94] In cases where the plan is fully funded, the plan could almost certainly absorb the typical loss. Where the plan is underfunded, it is in the best interest of all parties to have a reliable source to turn to for indemnification following an act of negligence.

C. Insurance

Finally, we argue, there is a real sense that the basic issue raised by recoupment cases can be resolved with the fairly simple solution of insurance coverage. The core of the recoupment story is invariably an act of simple or gross negligence which is not discovered for some period of time and which results in financial harm to the plan. Liability insurance is the well-accepted method for risk transfer in cases of negligence that causes harm and this paper argues that it offers the best possible solution to the problems described in this paper.

To understand how this might work, we reimagine the facts in Brendan Jones' case: years after discovering that it had overpaid Jones, the Obelisk Plan would notify both its liability carrier and Jones of its error and file a claim with its insurer to recover some part of the loss covered by the policy.[95] In order to push back against moral hazard[96], one would expect an insurer to cover a portion, but not all, of an overpayment. Following an investigation which

94. "Where the participant did nothing to cause the overpayment, the plan should look at the equities before seeking repayment from the participant. Several options should be examined first including the plan absorbing the loss, the plan sponsor covering the loss, and fiduciary insurance covering the loss. We note that the participant is usually the party with the lease ability to cover the loss. Requiring the participant to pay for the mistakes of others is inequitable. In cases where the plan is fully funded and the participant was not at fault, the plan should be required only to correct the benefit going forward and not recoup the overpayment from the participant. Where the plan is not fully funded, the plan should look first to fiduciary insurance if there was a fiduciary breach and then to the plan sponsor for payment." Letter from Ellen A. Bruce to Internal Revenue Service, *supra* note 33, at 2.

95. *See supra* text accompanying notes 2–11.

96. *See* Mark Thoma, *Explainer: What is "moral hazard"?*, CBS MONEY WATCH (Nov. 22, 2013), http://www.cbsnews.com/news/explainer-moral-hazard/.

> Moral hazard is a term describing how behavior changes when people are insured against losses. If, for example, your car is fully insured against any and all damage and there is no deductible, then you would have no incentive to avoid minor accidents, like scratches or backing into poles, beyond the inconvenience of getting the car fixed. You would be much more likely to take risks that could lead to minor car damage knowing that any damage is fully covered.... Whenever people are protected from the downside of their choices, they will tend to take on additional risk, sometimes excessively so. If taking on extra risk has the potential to impose costs on other people, or puts other people at risk in some way, such as in a financial system breakdown, then some mechanism is needed to temper the risk-taking and protect innocent bystanders from the consequences of morally hazardous behavior.

Id.

confirmed Jones' complete lack of culpability, the carrier would pay the claim subject to policy terms; the insured plan may be required to cover a portion (10 or 20% for example) of the loss to insure its continued efforts at loss prevention. Jones' future payments would be reduced to the correct amount and he would essentially be an implied co-insured[97] on the plan's policy, which would protect him from any future attempts at subrogation.[98]

The plan and its carrier would enjoy the option to pursue claims against any and all parties it believed were responsible for the overpayment to Jones. Additionally, the plan would have to pay appropriate premiums to the carrier to pick up and manage this risk. The beauty of the insurance mechanism in cases like Jones' is that both the insurer and the plan would be incentivized to engage in regular audits and other reviews designed to limit years-long overpayments.[99] Errors should be caught quickly and if they are not, the plan would face losing its coverage. Loss of coverage would presumably negatively implicate a fiduciary's duty of prudence giving rise to possible claims for fiduciary breach by participants and beneficiaries.

Had the Obelisk Plan had insurance coverage it could turn to when it discovered its many years of mistaken overpayments, Jones and his fellow retirees would not have faced economic catastrophe as the plan scrambled to retrieve the cash it wrongly paid out. Indeed, it seems reasonable to assume

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97. The implied co-insured rule finds its roots in Landlord-Tenant Law, but could equally be inserted in other insurance contexts. *See* Kevin J. Price, *When is a Tenant an Implied Co-Insured?*, CUMMINS & WHITE LLP, http://www.cumminsandwhite.com/2012/09/when-is-a-tenant-an-implied-co-insured/ ("The innocent co-insured rule derives from the Oklahoma case of *Sutton v. Jondahl*, a case arising from a fire caused by 10 year old John Jondahl and his chemistry set. The logic behind the "Sutton Rule" goes like this: The fact that there is a landlord and tenant implies that the tenant's rent payments are paying the premiums on the property insurance policy.").

98. "The *Sutton* court opined that it would be unfair to allow an insurer to subrogate against the tenant who was paying for the policy that gives rise to the subrogation action. That tenant, so said the court, should be considered an insured such that the insurer would not be permitted to subrogate against him. Thus, implied co-insured." *Id.*

99. *See* Joanne Linnerooth-Bayer & M.J. Mace, *Insurance-Related Actions and Risk Assessment in the Context of the UNFCC*, UNFCC (May 2003) (discussing insurance loss prevention schemes in the context of natural disasters).

> Risk estimation is an important part of managing natural disaster risks, and involves three types of activities: (1) the reduction of the risks by preventing losses and preparing for crises before disasters; (2) emergency response during the disaster; and (3) providing relief and reconstruction after disasters. Because of the concern in many developing countries that far more resources are spent on post-disaster activities at the expense of proactive preventive measures, the concept of integrated disaster risk management has become increasingly popular. This concept calls for a holistic approach to disaster management activities, across different functions, across different hazards, and taking into account the social, psychological and consequences of disasters. An important extension of this concept has become known as financial risk management, which examines the ways in which insurance and other financial instruments can be put into place to assure that countries and citizens can quickly and effectively recover from disasters, and to link these instruments with preventive measures.

Id. at 9.

that an insurer standing behind the Obelisk Plan's poor financial practices would have discovered the errors earlier, which would have reduced both the losses to the plan and the shock to Jones and his former coworkers.

V. CONCLUSION

The recoupment crisis appears to be a direct result of several factors: (1) plan error compounded over time; (2) complicated calculations that are affected by external factors like sales, mergers, and workers compensation payments; and (3) increased pressure on plans to aggressively pursue payment given the losses suffered in the most recent economic downturn. The upshot of the recoupment actions we describe in this paper is surprise followed by a profound threat to the livelihood of retirees who were in no way responsible for the initial error and who had no way to discover that they were being overpaid. The current legal regime provides insufficient protections to plan participants, although the Supreme Court's recent ruling in *Montanile* casts serious doubt over the ability of plans to pursue repayment of lump sum payments using the equitable lien device. Of all of the proposals for improving protections for people like Brendan Jones, we are most optimistic about simply requiring that plans purchase insurance to protect against the possibility of overpayment, thereby shielding participants from harsh recoupment actions and ensuring that funds will nonetheless be available to plans that seek to recover from their own mistakes.