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Remedies

High Court Allows Common-Fund Doctrine To Fill 'Gap' in ERISA Plan's Language

By Jacklyn Wille

The terms of an Employee Retirement Income Security Act plan cannot be overridden by equitable principles in a plan's action for reimbursement under ERISA's equitable remedies provision, the U.S. Supreme Court ruled April 16 in a 5-4 split decision (*US Airways Inc. v. McCutchen,* U.S., No. 11-1285, 4/16/13).

However, the majority found that, while equitable principles cannot trump a plan's clear reimbursement provision, they may aid in properly construing ambiguous or absent plan terms. Because the plan in question was silent as to the allocation of attorneys' fees following a participant's third-party recovery, the court used the common-fund doctrine to fill that gap.

BNA Snapshot

US Airways Inc. v. McCutchen, U.S., No. 11-1285, 4/16/13

Key Holding: Equitable defenses cannot override clear plan terms in a plan's action for reimbursement under ERISA Section 502(a)(3), but application of the common-fund doctrine is appropriate when the plan is silent as to the allocation of attorneys' fees.

Key Takeaway: Divided Supreme Court allows a health plan participant to use the common-fund doctrine as a defense to his health plan's action for reimbursement out of the participant's personal injury settlement.

In an opinion by Justice Elena Kagan, the high court vacated and remanded a decision by the U.S. Court of Appeals for the Third Circuit declining to enforce a health plan provision requiring participants to reimburse the plan for amounts received in third-party recoveries against a participant who was not made whole by a personal injury settlement. Justices Anthony M. Kennedy, Ruth Bader Ginsberg, Stephen G. Breyer, and Sonia M. Sotomayor joined the opinion.

In a short dissenting opinion, Justice Antonin Scalia disagreed with the majority's use of the common-fund doctrine, finding that this issue was not properly before the court. Chief Justice John G. Roberts Jr. and Justices Clarence Thomas and Samuel A. Alito Jr. joined the dissent.

The Third Circuit's 2011 decision created a split among the circuits, with the Fifth, Seventh, Eighth, and Eleventh circuits enforcing plan language to allow full reimbursement and precluding a participant's reliance on equitable defenses. The Third and Ninth circuits have permitted the use of equitable defenses in a plan's action for reimbursement.

Circuit Split on Appropriate Equitable Relief

The justices were asked to shed light on the meaning of "appropriate equitable relief" under ERISA Section 502(a)(3). This section allows participants, beneficiaries, and fiduciaries of ERISA-governed plans to bring actions for appropriate equitable relief to redress ERISA violations or enforce the terms of a plan.

In 2011, the Third Circuit narrowed the definition of appropriate equitable relief under ERISA to exclude US Airways' action for reimbursement against McCutchen and his attorney for benefits paid to McCutchen before he received a partial settlement from the third-party tortfeasor responsible for his injuries (222 PBD, 11/17/11; 38 BPR 2143, 11/22/11; 52 EBC 2143). The Third Circuit found that reimbursement would not be appropriate equitable relief in this instance, because recovery would exhaust McCutchen's entire settlement.

The Third Circuit's decision created a split among the circuits on the issue of appropriate equitable relief. The Third and Ninth circuits have expressed the view that courts granting appropriate equitable relief under ERISA may consider traditional equitable defenses notwithstanding express plan terms disclaiming their applications. Taking the contrary view, the Fifth, Seventh, Eighth, and Eleventh circuits have enforced express plan

language to allow full plan reimbursement and preclude a participant's reliance on equitable defenses.

Before deciding *McCutchen*, the Supreme Court weighed in on the issue of appropriate equitable relief under ERISA Section 502(a)(3) twice in the past several years. In a 5-4 decision in *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 27 EBC 1065 (2002), the high court held that Section 502(a)(3) is limited to lawsuits in which a party seeks equitable relief and does not extend to actions to enforce contractual obligations to pay money (6 PBD, 1/9/02; 29 BPR 217, 1/15/02). In 2006, the court unanimously ruled in *Sereboff v. Mid Atlantic Medical Services Inc.*, 547 U.S. 356, 37 EBC 1929 (2006), that a health plan administrator's action to enforce a subrogation agreement against a plan participant who recovered a third-party tort settlement qualified as equitable relief under ERISA (94 PBD, 5/16/06;33 BPR 1297, 5/23/06).

Evolution of the Case

After James E. McCutchen sustained severe injuries in a car accident that left him functionally disabled, his employer, US Airways, paid nearly $67,000 toward his medical expenses. McCutchen later received $110,000 for his injuries from third-party insurance companies, but he retained less than $66,000 after paying attorneys' fees and expenses.

US Airways demanded reimbursement for the entire $67,000 it had paid for McCutchen's medical bills and filed a lawsuit in the U.S. District Court for the Western District of Pennsylvania against both McCutchen and his attorney when McCutchen did not pay. McCutchen's lawyer then placed the attorneys' fees, totaling $41,500, in a trust account.

The district court granted summary judgment to US Airways for the entire amount in the trust account and more than $25,000 from McCutchen personally, holding that plan terms required reimbursement from "any monies recovered."

On appeal, McCutchen argued that it would be inequitable to reimburse US Airways in full when he had not been fully reimbursed for all his medical expenses. The Third Circuit agreed and reversed, ruling that "Congress purposefully limited the relief available to fiduciaries under [ERISA] Section 502(a)(3) to appropriate equitable relief." The appellate court found that it would be inequitable for US Airways to be fully reimbursed when McCutchen received less than full payment for his medical expenses.

The Supreme Court granted US Airways' petition for review in June 2012. The justices heard oral arguments in the case in November 2012 (227 PBD, 11/28/12; 39 BPR 2305, 12/4/12).

Where Plan Terms Are Clear, No Equitable Defenses

The Supreme Court first considered the Third Circuit's use of the equitable principle of unjust enrichment to prohibit an ERISA plan from obtaining full reimbursement from a participant who was not made whole by his third-party settlement. According to the majority, McCutchen presented a "more refined version" of this position, arguing that "an insurer in US Airways' position could recoup no more than an insured's 'double recovery'—the amount the insured has received from a third party to compensate for the same loss the insurance covered."

However, the majority concluded that "*Sereboff*'s logic dooms McCutchen's effort." As in *Sereboff*, US Airways "is seeking to enforce the modern-day equivalent of an 'equitable lien by agreement,'" which, the majority explained, "both arises from and serves to carry out a contract's provision." Enforcing such a lien "means holding the parties to their mutual promises," the majority said.

To that end, the majority found that it must "declin[e] to apply rules—even if they would be 'equitable' in a contract's absence—at odds with the parties' expressed commitments." Because the plan's reimbursement provision was clear, the majority concluded that "McCutchen therefore cannot rely on theories of unjust enrichment to defeat US Airways' appeal to the plan's clear terms." In situations in which plan terms are clear, equitable principles are "'beside the point' when parties demand what they bargained for in a valid agreement," the majority wrote, quoting *Sereboff*.

In so ruling, the majority rejected the position advanced by the U.S. solicitor general in an amicus brief. The solicitor argued that the terms of the plan "do not control" with respect to costs incurred by a plan beneficiary in bringing a third-party tort action, because equity courts have "inherent authority" to apportion litigation costs in accordance with the common fund doctrine. Dismissing this notion, the majority wrote that "if the

agreement governs, the agreement governs." Again emphasizing the written contract between the parties, the majority explained that "[t]he agreement itself becomes the measure of the parties' equities; so if a contract abrogates the common-fund doctrine, the insurer is not unjustly enriched by claiming the benefit of its bargain."

When Plan Is Silent, Common-Fund Doctrine Applies

Although the majority concluded that McCutchen could not rely on equitable defenses to trump the plan's clear reimbursement provision, it noted that the plan was "silent" with respect to the allocation of attorneys' fees. Given this silence, the majority said it was appropriate to consider the common-fund doctrine, which is "designed to prevent freeloading" by allowing a litigant who recovers a "common fund" for the benefit of others to recoup reasonable attorneys' fees from the fund as a whole. Calling the doctrine "the appropriate default," the majority concluded that, if US Airways "wished to depart from the well-established common-fund rule, it had to draft its contract to say so—and here it did not."

According to the majority, this result comported with "[o]rdinary principles of contract interpretation," which direct courts to look to both plan terms and "other manifestations of the parties' intent" in interpreting ERISA plans. "The words of a plan may speak clearly, but they may also leave gaps," the majority wrote, adding that "background legal rules" such as the common-fund doctrine should be used in interpreting these contractual gaps.

In contrast with the clear plan language establishing US Airways' right to reimbursement, the majority found that the absence of plan language addressing attorneys' fees "leaves space for the common-fund rule to operate." The majority noted that the plan's reimbursement provision "*might* operate on every dollar received from a third party, even those covering the beneficiary's litigation costs…[b]ut alternatively, that formula could apply to only the true recovery, after the costs of obtaining it are deducted." The distinction between these two alternatives was emphasized by Justice Stephen G. Breyer during oral arguments (227 PBD, 11/28/12; 39 BPR 2305, 12/4/12).

Finding that the plan terms "fail[ed] to select between these two alternatives," the majority concluded that the common fund doctrine "provides the best indication of the parties' intent." Noting that "almost every state court that has confronted the issue" has applied the common-fund doctrine, the majority reasoned that a party "would not typically expect or intend a plan saying nothing about attorney's fees to abrogate so strong and uniform a background rule."

This conclusion was reinforced by the rationale behind the common-fund doctrine, the majority explained. "Third-party recoveries do not often come free," the majority wrote. "To get one, an insured must incur lawyer's fees and expenses. Without cost sharing, the insurer free rides on its beneficiary's efforts—taking the fruits while contributing nothing to the labor."

McCutchen's case presented an especially compelling argument for application of the common-fund doctrine, the majority found, explaining that McCutchen spent $44,000 to obtain a total recovery of $110,000, leaving him a "real recovery" of $66,000. Because US Airways sought reimbursement totaling $66,866, allowing full recovery would, the majority said, "put McCutchen $866 in the hole; in effect, he would pay for the privilege of serving as US Airways' collection agent." The majority reasoned that, if this situation were allowed, "[w]hen the next McCutchen comes along, he is not likely to relieve US Airways of the costs of recovery."

Dissent Would Not Apply Common-Fund Doctrine

Justice Scalia authored a brief dissenting opinion in which he objected to the majority's application of the common-fund doctrine. He disputed the majority's characterization of the plan terms as being silent on the issue of attorneys' fees.

According to Scalia, the court "granted certiorari on a question that presumed the contract's terms were unambiguous—namely, 'where the plan's terms give it an absolute right to reimbursement.'" Scalia contended that "all parties," including McCutchen, agreed that the US Airways plan required beneficiaries to reimburse the plan "out of any monies the beneficiary recovers from a third-party, *without any contribution to attorney's fees and expenses*." Given this, Scalia found that the court "has no business deploying against petitioner an argument that was neither preserved…nor fairly included within the question presented."

Scalia wrote that he agreed with the portion of the majority's opinion concluding that equity cannot override clear plan terms and that he would reverse the judgment of the Third Circuit.

Attorney Reaction Mixed

ERISA practitioners expressed mixed views on how the court's opinion would affect sponsors and beneficiaries of health insurance plans in the future.

"The Supreme Court ruling will likely be viewed favorably by plan sponsors, as it will allow them to anticipate with more certainty the impact of the plan terms they draft," Myron D. Rumeld, co-chair of Proskauer Rose's employee benefits practice center in New York, told BNA April 16. "Although in this particular instance the court limited the plan's reimbursement right because of a perceived ambiguity in the plan's terms relating to attorney's fees, the court unanimously ruled that a clearly drafted reimbursement clause will trump all equitable defenses," he said.

"Thus, if properly drafted, a reimbursement clause will allow a plan to recover the full amount of the medical costs it paid, without qualification," said Rumeld, who noted that the decision was "less clear, however, on the role of equity and equitable defenses in other types of suits brought under ERISA."

Tybe A. Brett, of counsel to Stember Feinstein Doyle Payne & Kravec in Pittsburgh, cautioned that the court's opinion only applies to "so-called self-funded health plans," as insured plans are governed by state law and in some cases prohibited from seeking reimbursement from third-party recoveries. To that end, Brett told BNA April 16 that she suspects that "we'll see a greater effort to discover the role of insurance in so-called self-funded plans."

"The bigger issue is that self-funded health plans ought to be cautious in drafting reimbursement provisions in plans too broadly, because they'll be shooting themselves in the foot if they put a broad reimbursement provision in their plans and properly disclose it to employees," Brett said, pointing to the portion of the majority's opinion wherein Justice Kagan opined that requiring full reimbursement would be akin to making McCutchen "pay for the privilege of serving as US Airways' collection agent."

"No participant will seek a modest recovery at all under such circumstances," Brett said.

J. Timothy McDonald, a partner in Thompson Hine's Atlanta office, praised the decision for bringing "welcome clarity to a previously jumbled area of the law."

"The court unanimously held that a benefit plan is to be governed by its terms, and those terms cannot be overridden by vague notions of what someone else thinks is better," McDonald told BNA April 16.

Greta E. Cowart, a partner in Haynes & Boone's Dallas office, said that the court's decision created new challenges in drafting health plans.

The decision "should make the plan sponsors and drafters carefully consider not only what the plan says, but also what the plan does not say and how that might be construed under [ERISA Section] 502(a)(3)," Cowart told BNA April 16. "Now the plan must not only say what you mean it to say, but you also have to make sure you did not leave any holes or openings which might be construed as gaps which a court can fill."

In a statement released April 16, the ERISA Industry Committee (ERIC) applauded the court's decision.

"ERIC welcomes the ruling by the U.S. Supreme Court reversing the Third Circuit's earlier decision. The high court appears to have agreed with the basic analysis and argument put forward by ERIC and other trade associations that equitable rules cannot override the clear terms of a plan," said ERIC President & CEO Scott Macey.

"Had the Third Circuit ruling been allowed to stand, you would have seen an influx of litigation from participants using equitable defense claims to rewrite the clear terms of a plan, and thus undermine the principles of ERISA," Macey added.

US Airways was represented by Neal K. Katyal of Hogan Lovells, Washington. McCutchen was represented by Matthew W.H. Wessler of Public Justice, Washington.

For More Information

The full text of the opinion is at http://op.bna.com/pen.nsf/r?Open=jwie-96tk5t.

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