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Supreme Court Upholds Plan's Reimbursement Provision But Uses Common Fund Doctrine To Allocate Attorney's Fees Where Plan Is Silent On Such

In *Benefit News Briefs 2012-42*, we reported on a Third Circuit reimbursement decision that had the potential to drastically change reimbursement rules for *ERISA*-governed health plans if an "unjust enrichment" defense was allowed to offset any monies owed the Plan by an amount equal to the injured person's attorney's fees and expenses. See, *U.S. Airways v. McCutchen,* 663 F.3d 671 (3rd Cir 2011). In the end, the U.S. Supreme Court rejected McCutchen's "equitable defenses" argument and upheld the Plan's right of reimbursement pursuant to the terms of the Plan's reimbursement provisions, calling such provision an "*equitable lien by agreement.*"

But, since the Plan's reimbursement provision was *silent* on the allocation of attorney's fees, the Supreme Court used the "common-fund" doctrine as the appropriate default rule to fill that gap and apportioned the attorney's fees and expenses between US Airways and McCutcheon. The Court noted that without the rule, the Plan can free ride on McCutcheon's efforts, and he may be made worse off for having pursued a third party recovery. The Court continued that:

> "A contract should not be read to produce these strange results *unless it specifically provides as much*." (emphasis added)

Thus, if the Plan had repudiated the common fund doctrine in its reimbursement clause that language would control and the common fund doctrine would be inapplicable. Under the "common fund" rule, "a litigant or a lawyer who recovers a common fund for the benefit of persons other than himself or his client is entitled to a reasonable attorney's fee from the fund as a whole."

The Supreme Court opinion is available by "*clicking here*." Let's take a look at the case and some of its history.

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In short, the health benefit plan established by US Airways paid $66,866 in medical expenses for injuries suffered by McCutchen, a US Airways employee, in a car accident caused by a third party. McCutchen retained attorneys, in exchange for a 40% contingency fee, to seek recovery of all his accident-related damages, *estimated to exceed $1 million*. (Given the medical bills were much less than that amount it appears likely the rest of McCutcheon's damages were related to damages for loss of future earnings or pain and suffering or some permanent impairment.)

The health plan entitled US Airways to obtain reimbursement from McCutchen if he later recovered money from the third party responsible for the expenses paid by the Plan as a result of the third parties fault. McCutchen's attorneys sued the driver responsible for the crash, but settled for only $10,000 because she had limited insurance coverage and the accident had killed or seriously injured three other people. His attorneys also secured a payment from McCutchen's own automobile insurer of $100,000, the maximum amount available under his policy.

McCutchen received $66,000 after deducting the lawyers' 40% contingency fee. US Airways demanded reimbursement of the full $66,866 it had paid. This would mean McCutchen was not only not "made-whole" (in light of his accident-related damages *estimated to exceed $1 million*) but for all his efforts he would end up with nothing and still owe the Plan $866. As the Supreme Court said:

> That would put McCutchen $866 in the hole; in effect, he would pay for the privilege of serving as US Airways' collection agent.

When McCutchen did not comply with the Plan's reimbursement request, US Airways filed suit under Section 502(a)(3) of the *Employee Retirement Income Security Act of 1974 (ERISA)*,which authorizes health-plan administrators to bring a civil action "*to obtain . . . appropriate equitable relief . . . to enforce . . . the terms of the plan*."

McCutchen raised two defenses to US Airways' request for an equitable lien on the $66,866 it demanded: that, absent over-recovery on his part, US Airways' right to reimbursement did not kick in; and that US Airways had to contribute its fair share to the costs he incurred to get his recovery, so any reimbursement had to be reduced by 40%, to cover the contingency fee. Rejecting both arguments, the District Court granted summary judgment to US Airways.

The Third Circuit vacated the District Court's opinion, reasoning that traditional "equitable doctrines and defenses" applied to Section 502(a)(3) suits. It held that the principle of unjust enrichment overrode US Airways' reimbursement clause because the clause would leave McCutchen with less than full payment for his medical bills and would give US Airways a windfall.

The Supreme Court reversed the Third Circuit and held that in a Section 502(a)(3) action based on an equitable lien by agreement the Plan's terms govern. Neither general unjust enrichment principles nor specific doctrines reflecting those

principles (such as the double-recovery or common-fund rules invoked by McCutchen) can override the applicable contract.

But, as noted earlier, the Supreme Court said while McCutchen's equitable rules argument cannot trump a reimbursement provision, they may aid in properly construing it.

> Yet McCutchen's arguments are not all for naught. If the equitable rules he describes cannot trump a reimbursement provision, they still might aid in properly construing it. And for US Airways' plan, the common-fund doctrine (though not the double-recovery rule) serves that function. The plan is silent on the allocation of attorney's fees, and in those circumstances, the common-fund doctrine provides the appropriate default. In other words, 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.
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> [T]he plan provision here leaves space for the common-fund rule to operate. That equitable doctrine, as earlier noted, addresses not how to allocate a third-party recovery, but instead how to pay for the costs of obtaining it. And the contract, for its part, says nothing specific about that issue. The District Court below thus erred when it found that the plan clearly repudiated the common-fund rule. To be sure, the plan's allocation formula—first claim on the recovery goes to US Airways—*might* operate on every dollar received from a third party, even those covering the beneficiary's litigation costs. But alternatively, that formula could apply to only the true recovery, after the costs of obtaining it are deducted. See *Dawson, Lawyers and Involuntary Clients: Attorney Fees From Funds*, 87 Harv. L. Rev. 1597, 1606–1607 (1974) *("[T]he claim for legal services is a first charge on the fund and must be satisfied before any distribution occurs"*). The plan's terms fail to select between these two alternatives: whether the recovery to which US Airways has first claim is every cent the third party paid or, instead, the money the beneficiary took away.
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> Given that contractual gap, the common-fund doctrine provides the best indication of the parties' intent. No one can doubt that the common-fund rule would govern here in the absence of a contrary agreement. This Court has "recognized consistently" that someone "who recovers a common fund for the benefit of persons other than himself" is due "a reasonable attorney's fee from the fund as whole." We have understood that rule as "reflect[ing] the traditional practice in 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. And that means a court should be loath to read such a plan in that way.
> (some citations omitted)

Almost as a word of warning to plans whose reimbursement language would allow the plan to seek reimbursement without paying any of the costs of recovery, the Court adapted a comment by Judge Easterbrook of the Seventh Circuit in a 1997 case:

> "[I]f . . . injured persons could not charge legal costs against recoveries, people like [McCutchen] would in the future have every reason" to make different judgments about bringing suit, "throwing on plans the burden and expense of collection".

Participants whose damages would leave them with little or nothing after attorney's fees would have no incentive to go through the "*sturm and drang*" of protracted litigation. Many states, such as Indiana, provide for an allocation of costs and attorney's fee between an insured party and its insurance company. Such rules do not apply to self-funded *ERISA* plans due to *ERISA* preemption.

Some multiemployer self-funded *ERISA*-governed health care plans allow for an allocation of attorney's fees in cases such as McCutcheon's, or at least preserve the option for the plan to do so. At any rate, this case serves as a reminder for Trustees, Fund Counsel and plan administrators to review their plan's subrogation and reimbursement provisions. In the course of such review, it would be prudent to make sure the plan provisions on subrogation and reimbursement are also explained in the plan's Summary Plan Description.

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