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Supreme Court Declares That Plan Terms Trump Equity (McCutchen v. U.S. Airways)

BY THE GLOBAL COMPENSATION, BENEFITS, AND ERISA PRACTICE

I. Introduction

Most health plans provide for a right of reimbursement, requiring a participant to reimburse amounts the plan paid, typically for injury-related medical expenses, out of the participant's recovery from a third party.

ERISA limits health plan enforcement of contractual reimbursement rights to equitable remedies. In *U.S. Airways v. McCutchen*, the Supreme Court found that in applying such remedies, courts may not apply equitable defenses, such as unjust enrichment, to override clear plan terms, but courts may apply equitable defenses that the plan does not clearly override.

McCutchen is a win for plan sponsors, but the Supreme Court assigned plan sponsors homework: ensure that plan recovery rights are clearly stated and that equitable defenses are clearly disclaimed. There is a broader message for plan sponsors: ERISA plan documents govern in all respects, from determining eligibility and benefits, to the terms for resolving litigation when participants and employers disagree. In the latter respect, *McCutchen* may provide a solid basis for limiting litigation cost through plan provisions that trump common law or equitable principles.

II. Reimbursement Before *McCutchen*

ERISA Section 502(a)(3) allows a plan fiduciary "to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of . . . the terms of the plan." The Supreme Court held in *Sereboff v. Mid Atlantic Medical Services, Inc.*, 547 U.S. 356 (2006), that plan administrators can sue participants under Section 502(a)(3) to enforce plan reimbursement rights by seeking "specifically identifiable funds" within the participants' control, because that is 'equitable relief' under § 502(a)(3). *Id.* at 369, 362-63 (noting that claim was based on the equitable principle that a contract to convey property not yet acquired creates a lien on the property, once the contracting party obtains it). The Court held that Mid Atlantic's reimbursement claim was "the modern-day equivalent of an action in equity to enforce . . . a contract based lien" or "an equitable lien agreement." *Id.* at 364-65.

III. *McCutchen* and the Circuit Split

James McCutchen is a former U.S. Airways employee who was covered by U.S. Airways self-insured group health plan (the "Plan") at the time he suffered severe injuries in an automobile accident. The

Plan paid $66,866 of McCutchen's medical expenses. McCutchen had a clear obligation under the Plan to reimburse it for any third party recoveries:

> If the Plan pays benefits for any claim you incur as the result of negligence, willful misconduct, or other actions of a third party, the Plan will be subrogated to all your rights of recovery. You will be required to reimburse the Plan for amounts paid for claims out of any monies recovered from a third party.

McCutchen recovered $110,000 from the driver who caused the accident (and the insurance company), but paid 40% to his attorneys, for a net recovery of $66,000. After McCutchen refused to pay the Plan back, it sued to recover the full $66,866. McCutchen argued that the Plan's recovery should be limited, because when fashioning "appropriate equitable relief," courts must consider traditional equitable defenses, such as unjust enrichment.

The district court granted summary judgment to the Plan, and McCutchen appealed. The Third Circuit vacated and remanded, holding that "Congress intended to limit the equitable relief available under § 502(a)(3) through the application of equitable defenses" – a nod to the old maxim that one who seeks equity must do equity – and that under the principle of unjust enrichment, full reimbursement to the Plan would be "inappropriate and inequitable." 663 F.3d 671, 673 (3d Cir. 2011).

The Third Circuit's holding marked a stark departure from the position previously taken by all other circuit courts that had considered the issue – that clear plan provisions requiring full reimbursement trump traditional equitable principles. (The Ninth Circuit, in *CGI Technologies and Solutions, Inc. v. Rose*, 683 F.3d 1113, 1123 (9th Cir. 2012), adopted the Third Circuit's position; the Supreme Court just vacated and remanded *CGI* in light of *McCutchen*.[1])

The Plan appealed.

IV. *McCutchen*'s Holding

The Supreme Court found that *Sereboff*'s logic regarding equitable liens "doom[ed] McCutchen's effort" to apply equitable defenses to limit the Plan's recovery. It held that enforcing the Plan's equitable lien against McCutchen "means holding the parties to their mutual promises" and "declining to apply rules -- even if they would be 'equitable' in a contract's absence -- at odds with the parties' expressed commitments." *Id.* at *6. The Court concluded that in a reimbursement action under ERISA Section 502(a)(3), unjust enrichment doctrines cannot trump the plan terms or the parties' agreement.

However, the Court also left the door open for plaintiffs' attorneys by holding that when a plan is silent or ambiguous as to whether equitable defenses are available, equitable principles could apply to help interpret the plan or to fill in gaps. Because the Plan did not specifically require reimbursement without reduction for attorney's fees, the Court looked to the common-fund doctrine,[2] explaining: "[I]f U.S. 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." *Id.* at *8.

V. McCutchen Shuts the Door on Expansion of *Amara*

In *Amara*, the Supreme Court had held that where a participant can show actual harm, certain equitable remedies (i.e., reformation, estoppel, and surcharge) may be available under Section 502(a)(3)'s "other appropriate equitable relief" provisions. In its decision here, the Third Circuit took an expansive view of *Amara*, finding not only that a plan is subject to modification based on equitable

principles, but also that such "equitable principles can apply even where no one has committed a wrong." *Id*. at 679. The Third Circuit went too far, and *Amara* cannot be read so broadly. When "no one has committed a wrong," *McCutchen* leaves no question that clear Plan language controls and equitable principles cannot apply. Moreover, *McCutchen* suggests that plan sponsors could consider including plan language disclaiming remedies like reformation, estoppel, and surcharge, even where the participant has experienced actual harm – though it remains to be seen whether courts would honor such disclaimers.

VI. Recommendations

The Supreme Court has clarified that ERISA plans can enforce reimbursement rights without fear that their recoveries will be reduced by application of "equitable" doctrines. But, in order to do so, plans must be drafted clearly. We recommend that

- Plan sponsors who have eschewed reimbursement provisions because of concerns over equitable defenses should reconsider implementing them.

- Plans that include reimbursement provisions should clearly trump all equitable defenses (except to the extent the plan sponsor wishes to honor them, e.g., to limit recovery to the participant's recovery net of reasonable attorney's fees and other recovery expenses). Summary plan descriptions should mirror this.

For a complimentary copy of model language, please contact any of the Paul Hastings attorneys identified below.

When it comes to reviewing an ERISA plan's claims procedures and dispute resolution provisions, there are several other tune-ups that a plan sponsor might wish to employ.

- *Internal Statutes of Limitation* – There is significant ERISA case law supporting the right of a plan to require that participants assert claims within a reasonable period that the plan designates. Designating a limitations period that is shorter than the otherwise applicable statute of limitations enables a plan to more promptly and efficiently identify and resolve claims. It also prevents late-arising claims, which sometimes occur long after the plan ceases to have relevant records.

- *State Law* – Under ERISA, the statute of limitations for a claim depends on the most relevant state law limitations period. In a recent New York case,[3] a non-qualified plan designated Delaware law, which the court enforced because the employer was headquartered in Delaware. As a result, the applicable statute of limitations was not six years (as would have applied under New York law), but one or three years (depending on the applicable Delaware law). Precision in plan documents enables sponsors to position for certainty and the most desirable law and limitations periods that are reasonably available.

- *Forum Selection and Arbitration?* Plan sponsors may want to streamline ERISA litigation through designating an exclusive forum where all plan-related claims must be heard and resolved. Likewise, an ERISA plan may provide for mandatory arbitration. Decisions about alternatives such as these should be made in the context of determining an overall ERISA plan litigation strategy.

- *Equitable Remedies* - Plan sponsors may wish to consider other provisions that might be viewed as aggressive by some, such as those disclaiming participants' right to utilize equitable doctrines that would increase the Plan's obligations.

McCutchen is a win – but it is only the beginning, not the end, of the next stage of the developing jurisprudence around reimbursement, specifically, and equitable relief under ERISA generally.

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[1] --- S.Ct. ----, 2013 WL 1704705 (Mem) (April 22, 2013).

[2] Under the common fund doctrine, one who recovers a common fund for the benefit of others is entitled to fees from the entire fund.

[3] *Barton v. Martha Stewart Living Omnimedia, Inc.*, 2012 WL 4068576, at *4-5 (S.D.N.Y. September 17, 2012).