

Equity Returns to ERISA – *U.S. Airways v. McCutchen*

By Donald M. de Camara

On November 16, 2011, the federal Third Circuit Court of Appeals in a unanimous published decision held that equitable defenses applied to ERISA subrogation provisions. (See *U.S. Airways v. McCutchen*, et al., No. 10-3836 (3d Cir.)) This is the very first opinion anywhere in the country allowing equitable defenses to such claims since the U.S. Supreme Court approved enforcement of subrogation provisions on an equitable lien or constructive trust basis in *Sereboff v. Mid-Atlantic Medical Services, Inc.*, 547 U.S. 356 (2006). This groundbreaking case should prove very useful to plaintiffs and their attorneys in negotiating subrogation liens with ERISA plans.

Some historical perspective may be helpful in understanding the significance of the *U.S. Airways* case. When Congress passed ERISA, it limited ERISA plans' actions against plan members to equitable relief. (See 29 USC § 1132(a)(3).) Consequently, plans cannot sue members for breach of contract to enforce their contractual subrogation and reimbursement provisions.¹ This led several circuits, including the Ninth Circuit, to rule that contractual subrogation provisions were not enforceable under ERISA's equitable relief requirement absent a showing of

fraud or wrongful conduct. In fact, the Ninth Circuit established this prohibition through eight published cases between 1994–2004, culminating in *Carpenters Health v. Vonderharr* (9th Cir. 2004), cert denied 126 S.Ct. 729 (2005). After *Sereboff*, *supra*, was decided in 2006, ERISA subrogation provisions have been found generally enforceable as long as the plan sued the person or entity holding identifiable funds from the settlement on a constructive trust or equitable lien theory. In the wake of *Sereboff*, self-funded² ERISA plans consistently began drafting their subrogation provisions to strip all equitable defenses, such as make-whole, common fund and equitable apportionment, from the plan provisions.

Courts have had great difficulty interpreting ERISA on any kind of consistent basis. However, the law has gradually evolved through Supreme Court opinions to limit plans' enforcement of subrogation provisions to the "appropriate equitable relief" specified in 29 USC § 1132(a)(3). (See *Great West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204 (2002).) In *Sereboff*, *supra*, the Sereboffs attempted to argue that the plan's waiver of the make whole rule violated this appropriate equitable relief requirement. However, their counsel had not raised the issue in the lower courts and the Supreme Court therefore refused to decide the issue of exactly what constitutes appropriate equitable relief under the statute. (*Sereboff*, *supra*, fn2.) Following *Sereboff*, courts generally have interpreted the "appropriate" in the limitation "appropriate equitable relief" to mean "typical" rather than "suitable" or "fitting." As a result, so long as the plans sued for a constructive trust or equitable lien, which the Supreme Court had

seemingly approved in *Sereboff*, the lower courts would find this relief was "typical" and therefore "appropriate." This led to a series of cases in which federal appellate courts sanctioned enforcement of subrogation provisions resulting in grievously injured victims losing their full net recovery

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to the plans' subrogation claims. Perhaps the most notorious of these was *Wal-Mart v. Shank*, 500 F.3d 834 (8th Cir. 2007), in which Wal-Mart sued its own brain damaged and crippled employee and obtained a judgment for her entire net recovery.³ Most plaintiffs' attorneys have experienced similar claims from self-funded ERISA plans and were likely surprised when their research revealed that there was no case authority since *Sereboff* allowing the assertion of equitable defenses to such claims. Now, for the first time, there is.

Facts in *U.S. Airways v. McCutchen*

James McCutchen had his health coverage through the U.S. Airways self-funded ERISA plan when he was "grievously injured" in an automobile accident. He survived the accident only after emergency surgery and ultimately underwent a complete hip replacement. He was rendered functionally disabled as a result of his injuries. Because there were multiple victims in the accident, Mr. McCutchen recovered



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only \$10,000 from the tortfeasor, plus an additional \$100,000 from his own underinsured motorist coverage. These were all of the available policy limits. U.S. Airways' health benefit plan had paid \$66,866 to Mr. McCutchen's medical providers and demanded reimbursement of this amount. U.S. Airways sued Mr. McCutchen for this full amount, which was slightly more than his entire net recovery. The district court rejected McCutchen's equitable arguments and granted summary judgment in favor of the plan. Mr. McCutchen then appealed to the Third Circuit.

Holding in U.S. Airways v. McCutchen

The Third Circuit began its discussion by finding that:

Congress intended to limit the equitable relief available under §502(a) (3) through the application of equitable defenses and principles that were typically available in equity. (Id. at 11, emphasis supplied.)

The court next held that equitable defenses such as unjust enrichment would apply to negate reimbursement provisions that would unjustly enrich the plan, citing Palmer, *Law of Restitution*, as follows:

“The principle of unjust enrichment... should serve to limit the effectiveness of contract provisions which in terms provide for reimbursement out of the insured's tort recovery without regard to whether or the extent to which, that recovery includes medical expense.” (Id. at 12, emphasis supplied.)

The court then rejected opinions from other circuits reaching the opposite conclusion, such as *Shank* and *Varco*, holding:

We disagree with those circuits that have held that it would be pioneering federal common law to apply equitable limitations on an equitable claim. Congress purposefully limited the relief available to fiduciaries under §502(a) (3) to “appropriate equitable relief.” (Id. at 15.)

The US Airways court then specifically held that ERISA reimbursement provisions were subject to modification as equity required:

Moreover, as the Supreme Court recently demonstrated in *CIGNA*, the importance of the written benefit plan is not inviolable, but is subject – based

upon equitable doctrines and principles – to modification and, indeed, even equitable reformation under §502(a) (3). (Id. at 16, emphasis supplied.)

The court then held that contractual language was not “sacrosanct” when applying principles of equity. (Id. at 16.) Finally, the court, noting that “Equity abhors a windfall,” concluded:

Applying the traditional equitable principle of unjust enrichment, we

conclude that the judgment requiring McCutchen to provide full reimbursement to *US Airways* constitutes inappropriate and inequitable relief. (Id. at 17, emphasis supplied.)

The court then reversed the district court's granting summary judgment to the plan to enforce its provision and remanded it to the lower court to make factual findings to ascertain “appropriate equitable relief.” (Id. at 17.)




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Discussion

It is impossible to determine from the opinion whether the U.S. Airways subrogation provision at issue purported to waive all equitable defenses. In fact, under the portion of the provision quoted in the opinion (*id.* at 5), the language would likely be considered inadequate under the law of the Ninth Circuit to even waive the make whole rule. (See *Barnes v. Independent Auto Dtrs. Assn. of CA H&B Plan*, 64 F.3d 1389, 1395 (9th Cir. 1995); *Providence Health Plan v. Bush*, 461 F.Supp.2d 1226 (DC WA 2006). However, it clearly appears from the court's opinion that the quoted language was sufficient to support a full recovery to the Plan under previous Third Circuit authority. (*Id.* at 13.)

In the Ninth Circuit, under the authority of *Barnes*, *supra*, any failure to waive the make-whole rule would result in a complete defense for any plan member who was not fully compensated by the recovery in the personal injury case. However, self-funded ERISA plans typically purport to waive both the make-whole rule and the common fund rule. Moreover, it is becoming increasingly common for such plans to waive equitable apportionment, reduction for plaintiff's comparative fault and to provide that the plan is entitled to everything even if the plaintiff recovers nothing. The *U.S. Airways* case will be especially helpful in dealing with such provisions. The quoted passage from *Palmer*, *supra*, (*id.* at 12) in the court's opinion is especially helpful in calling for a determination of *whether, and to what extent, plaintiff's recovery included medical expenses*. Where the plaintiff is

substantially under-compensated, this would appear to require an equitable apportionment approach, similar to the *Sereboff* title argument.

Thus, the current practice of self-funded ERISA plans of stripping all equitable defenses from their subrogation provisions would appear to also violate this underlying principle of equity.

This case can be used to support the application of any equitable defense to the plan's equitable claim for reimbursement, including unjust enrichment, equitable apportionment, unconscionability, equity abhors a forfeiture or a windfall, and estoppel. Moreover, it is a well known principle of equitable jurisprudence that "He who seeks equity must do equity." A court will not grant equitable relief to a plaintiff unless the plaintiff acknowledges or makes provision for the equitable claims of the adverse party arising out of the same subject matter. (See generally *Dool v First Nat. Bank* (1929) 207 Cal.347, 351; *District Bond Co. v. Pollack* (1942) 19 Cal.2d 304, 307.) In *Oregon & California Railroad Co. v. U.S.*, 28 U.S. 393, 420 (1915), the Supreme Court noted: "And it is a general principle that a court of equity is reluctant to (some authorities say never will) lend its aid to enforce a forfeiture." *Pomeroy on Equity Jurisprudence*, § 385 describes this principle "as

the foundation of all equity" and defines its effect as follows:

The meaning is, that whatever be the nature of the controversy between two definite parties, and whatever be the nature of the remedy demanded, the court will not confer its equitable relief upon the party seeking its interposition and aid, *unless he has acknowledged and conceded, or will admit and provide for, all the equitable rights, claims, and demands justly belonging to the adversary party*, and growing out of or necessarily involved in the subject-matter of the controversy. (Emphasis supplied.)

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By affirming for the first time that equitable defenses can be raised against ERISA subrogation provisions, *U.S. Airways v. McCutchen* provides a powerful weapon in the plaintiff attorney's arsenal to minimize subrogation or reimbursement claims against his or her clients. ■

¹ Most courts have interpreted subrogation and reimbursement provisions to create identical substantive rights and therefore use the two terms interchangeably – as will this article. (See e.g. *Reynolds Metals v. Ellis*, 202 F.3d 1246 (9th Cir. 2000).)

² Unlike insured ERISA plans, which are subject to state insurance law protections (like Civil Code § 3040) under the insurance "saving" clause in ERISA's preemption section, 29 USC § 1144, members of self-funded ERISA plans have no such protection.

³ Which Wal-Mart then waived due to the public outcry after the press reported this result.

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