PART FIVE:
ERISA PREEMPTION
AND THE COMMON
FUND DOCTRINE

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As discussed in previous installments of this series, preemption is the key to why ERISA subrogation is different and more powerful than non-ERISA health insurance subrogation—and much more effective. It is because of the preemption provisions of ERISA that you have such tremendous leverage when attempting to subrogate in a third party case which may have been pending for years. Preemption is also the reason why you are able to recover the lion’s share or all of your subrogated interest—free of attorneys’ fees in many cases—and not withstanding the fact that the beneficiary may not have been fully compensated in his settlement or recovery in the third party case for all of his injuries.

The heart of the ERISA statute is a complicated preemption section designed to preempt all state law, even consistent state law, which “relates” to an employee benefit Plan as defined under § 1003(a). The preemptive sweep of § 1144 has been called “deliberately expansive” by the United States Supreme Court. As a result of ERISA preemption, states cannot regulate employee benefit Plans, though they can regulate insurance companies. So if a Plan is self-funded (the employer self-insures the Plan), then the states cannot touch it by legislation or common law. However, if it is a fully-insured Plan (the Plan merely purchases an insurance policy covering the employees), then the Plan can be indirectly regulated by the states as long as the state law in question is one that applies specifically to the business of insurance and as long as it is not simply a regulation specifically applying to employee benefit Plans. More specifically, the state can regulate this insurance policy purchased by an unfunded Plan, but it may not regulate the Plan. As further explained by the United States Supreme Court in the case of FMC Corporation v. Holliday, 498 U.S. 52, 111 S. Ct. 403 (1990).

The Common Fund Doctrine - Generally

The Common Fund Doctrine is a so-called equitable doctrine that allows a plaintiff’s attorney, who has done most of the work in creating a recovery from which a subrogee (subrogated carrier) is reimbursed, to recover attorneys’ fees and costs from the subrogee’s recovery. The doctrine runs contrary to the recognized American Rule that a party in a civil action is not entitled to attorney fees absent a specific contractual obligation or a controlling statutory provision. Nevertheless, plaintiffs’ attorneys routinely rely on the common fund doctrine to reduce health care and ERISA benefit plans subrogation and reimbursement claims for costs and fees incurred in making the recovery. The common fund doctrine is argued to be “fair,” but when combined with other “equitable doctrines” like the made-whole rule, the effect can be devastating to subrogation recoveries.

A Brief History and Origin of the Common Fund Doctrine

A discussion of the doctrine’s effect is incomplete without a review of its origins. The common fund doctrine, occasionally called the attorney’s fund doctrine, has been a part of the common law for more than 100 years. The principle was first introduced in the Supreme Court’s 1881 case, Trustees v. Greenough, 105 U.S. 527. In Greenough, the state of Florida conveyed to trustees more than ten million acres of land as security for a bond issued by the Florida Railroad Company. In the meantime, the trustees had wasted the fund through fraudulent conveyances and failed to secure funds for the repayment of principal and interest on the bonds. The plaintiff, Mr. Vose, held bonds of the railroad company and brought suit to set aside the fraudulent transfers and restore the assets to the fund. Vose actively pursued the litigation for more than 11 years at his own expense until he was able to set aside the fraudulent con-
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veyances and restore the assets to the benefit of all bondholders. Vose then presented the Trustees with a claim for reimburse-
ment of his attorneys' fees. The Supreme Court held that Vose was entitled to reimbursement of his attorneys' fees from the
passive bondholders because they had received a benefit from
the litigation for which they must contribute their fair share.

The common fund doctrine has evolved over the years and it
has been expanded to create an independent claim by the attor-
ney's against passive beneficiaries. Courts have explained that
both claims exist because they act to prevent unjust enrichment
of the passive beneficiaries. Today, this doctrine is a staple in
most every state and federal court and must be actively combat-
ed by subrogation counsel.

In order for the doctrine to apply, there must be a common
fund out of which the fee is claimed and passive beneficiaries
seeking a portion of the fund. The doctrine's most routine
application involves a personal injury action where a fund exists
to satisfy not only the injured plaintiff, but numerous subroga-
tion interests, including ERISA Plans. If an ERISA Plan is enti-
tled to subrogation out of the funds obtained in the tort recov-
er, will the common fund doctrine apply such that the Plan's
recovery is reduced so that the Plan bears its share of attorney's
toes and costs? Because the ERISA statute is silent about attor-
nies' fees and costs, their recovery by plaintiff's counsel will
depend on the language of the particular Plan involved. Where
a Plan is silent about costs and fees incurred by the beneficiary
in generating a recovery, some courts have reduced the Plan's
reimbursement by one-third or some other amount. Other
courts have held that a Plan need not contain express language
about fees and costs. Generally, if the Plan claims entitlement to
full reimbursement, it need not pay anything toward expenses.
However, there are exceptions and it is best to craft strong Plan
language dispelling the common fund doctrine.

Subrogation Rights "Out of Any Monies Recovered" or as to
"All Rights of Recovery"

Where the Plan language claims subrogation against "all rights
of recovery" and reimbursement "out of any monies recovered"
from the third party, full reimbursement has been allowed by
the 3rd Circuit without reduction for attorney's fees. Bollman
Hat Co. v. Root, 112 F.3d 113 (3rd Cir.), cert. denied, 522 U.S.
952 (1997).

Likewise, where the Plan claims repayment of the lesser amount
recovered or the amount of benefits that had been paid by the
Plan, the common fund doctrine was held inapplicable by the
4th Circuit. United McGill Corp. v. Stinnett, 154 F.3d 168 (4th
Cir. 1998).

"Full Reimbursement" Language

In one 3rd Circuit case where the Plan language simply stated
that the Plan was entitled to "full reimbursement," the court
held that the Plan did not have to bear its proportionate share
of fees and expenses, even though the district court had found
the Plan unjustly enriched and ordered it to pay its share of
F.3d 123 (3rd Cir. 1996). The appellate court reversed the trial
court saying that because ERISA is silent on the issue, the terms
of the Plan control. The terms of the Plan provided that:
The Plan shall have the right to recover, against any source which makes payments or to be reimbursed by the covered participant who receives such benefits, 100% of the amount of covered benefits paid . . . if the 100% provided above exceeds the amount recovered by the covered participant, less legal and attorney’s fees incurred by the covered participant in obtaining such a recovery . . . the covered participant shall reimburse the Plan the entire amount of such net recovery.

Therefore, if an ERISA Plan provides for full reimbursement, but is silent with regard to attorneys’ fees, the Plan will probably not be responsible for paying attorneys’ fees under the common fund doctrine.

The 5th Circuit has held that where the Plan clearly spells out that it is entitled to “full reimbursement,” its language is unambiguous and the common fund doctrine is not applicable. *Walker v. Wal-Mart Stores, Inc.*, 159 F.3d 938 (5th Cir. 1998).

**Plan Language Clearly Exempts Common Fund Doctrine**

In the 3rd and 6th Circuits, the Plan subrogation recovery will not be reduced if the Plan expressly precludes such a reduction, or the language expressly negates the common fund doctrine. *Ryan By Kapra-Ryan v. Fed. Express Corp.*, 78 F.3d 123 (3rd Cir. 1996); *Healthcoast Controls v. Isbell*, 139 F.3d 1070 (6th Cir. 1997); *Fairfield Mfg. Co., Inc. v. Hartmann*, 132 F. Supp. 2d 1142 (N.D. Ind. 2001).

**Absence of Language Exempting Common Fund Doctrine**

Other courts have held that where there is an absence of language expressly exempting the Plan from paying attorney’s fee and/or costs, some reduction for fees and costs has been allowed. In *Blackburn*, the 7th Circuit noted that the common fund doctrine predates ERISA and most of its applications have nothing to do with employer-sponsored healthcare Plans. *Blackburn v. Sunstrand Corp.*, 115 F.3d 493 (7th Cir. 1997). The court rejected the argument that the common fund doctrine is a state law that is “related” to ERISA Plans because it can reduce Plan revenues, observing that the doctrine may actually increase Plan revenues in the long run. The court stated that Plans could in many cases incur even greater fees and costs if they had to hire their own lawyers and file their own lawsuits.

In another case, the 7th Circuit has found that where a Plan was silent regarding apportionment of attorney’s fees, it refused to award 100 percent reimbursement to the Wal-Mart Associates Health and Welfare Plan. The court rejected the Wal-Mart Plan’s argument that the court should defer to the Wal-Mart’s Administrative Committee’s interpretation of the Plan. *Wal-Mart Stores, Inc. Associates’ Health and Welfare Plan v. Wells*, 213 F.3d 398 (7th Cir. 2000) (the court noted the possibility that an injured ERISA Plan participant could be worse off by virtue of having exercised his or her right to bring a lawsuit against a third party, and also noted that the Plan itself might be worse off in the long run as it would have to incur attorney’s fees in order to enforce its right of subrogation). It is now clear that in the 7th Circuit, if an ERISA Plan specifically and expressly required beneficiaries to pay their own attorney’s fees, then the Plan will not be responsible for a proportionate share of the plaintiff’s attorney’s and/or costs. *Admin. Comm. of the Wal-Mart Stores, Inc. Associates’ Health and Welfare Plan v. Varco*, 338 F.3d 680 (7th Cir. 2003), cert. denied, 124 S. Ct. 2904
(June 28, 2004). This effectively throws a wrench in the plans of many plaintiffs' attorneys who have cited the Blackburn case for the proposition that all Plans are responsible for a proportionate share of attorney's fees, regardless of whether the Plan prohibits it or not.

Illinois state courts have been battling with their own federal courts over the common fund issue. In Scholten, an Illinois Supreme Court held that the common fund doctrine was not to be preempts because its relationship to ERISA Plans is too remote. Scholten v. Schneider, 671 N.E.2d 657 (Ill. 1996). In an Illinois Federal District Court decision, the beneficiaries attempted to recover common fund doctrine attorneys' fees out of an ERISA Plan that had made a subrogation recovery. Great-West Life & Annuity Ins. Co. v. Moore, 133 F. Supp. 677 (N.D. Ill. 2001). The Plan provided:

Great-West's first lien rights will not be reduced due to the covered person's own negligence; or due to the covered persons not being made whole; or due to attorneys' fees and costs.

The court ruled that ERISA preempted the common fund doctrine. The Illinois Supreme Court has also held in another case that, despite an ERISA Plan's contractual language requiring 100 percent reimbursement, the common fund doctrine requires the Plan to bear its proportionate share of the participant's attorney's fee. Bishop v. Burgard, 764 N.E.2d 24 (Ill. 2002). However, the 7th Circuit criticized the Bishop opinion, and while admitting that only the United States Supreme Court of the legislature can overrule a state supreme court (a federal district or appellate court cannot), a strange quirk of jurisdiction required the 7th Circuit to decide on its own and not defer it to a state court determination of federal law unless that determination is "correct." Admin. Comm. of the Wal-Mart Stores, Inc. Associates' Health and Welfare Plan v. Varco, 338 F.3d 680 (7th Cir. 2003), cert. denied, 124 S. Ct. 2904 (June 28, 2004). Therefore, the 7th Circuit has criticized Bishop and presumably Scholten as being implicitly incorrect.

The 7th and 8th Circuits have focused on the absence of the attorney's fee provision in the Plan. Where a Plan has no provision and does not give the administrator discretion to interpret Plan language, the 8th Circuit construed the subrogation provision to allow for payment of fees by the Plan. Wal-Mart Stores, Inc. Assoc. Health and Welfare Plan v. Wells, 213 F.3d 398 (7th Cir. 2000); Waller v. Hormel Foods Corp., 120 F.3d 138 (8th Cir. 1997).

Common Fund Doctrine Under Federal Common Law

Despite the existence of Plan language negating the common fund doctrine, many plaintiffs will argue that federal common law should be used to avoid the full reimbursement language in the Plan subrogation clause and reduce the Plan's recovery by its pro rata share of attorney's fees under the doctrine of unjust enrichment or the common fund doctrine. However, federal common law is only appropriate to fill gaps left by ERISA's express provisions. Landro v. Glendenning Motorways, Inc., 625 F.2d 1344 (8th Cir. 1980). A primary purpose of ERISA is to ensure the integrity and primacy of the written plans. Duggan v. Hobbs, 99 F.3d 703 (9th Cir. 1996); Van Orman v. American Ins. Co., 680 F.2d 301 (3rd Cir. 1982). Courts may not apply common law principles to alter the express terms of written benefit plans. Hollman Hat Co. v. Root, 112 F.3d 113

The federal courts are divided over the creation of the federal common law of unjust enrichment in ERISA cases. In Cummings, the court held that courts should only invoke federal common law of unjust enrichment in “limited circumstances.” Cummings v. Briggs & Stratton Retirement Plan, 797 F.2d 383 (7th Cir.), cert. denied, 479 U.S. 1008 (1986). In Van Orman v. American Insurance Company, the 3rd Circuit held that no federal common law cause of action under the doctrine of unjust enrichment applies when “such a right would override a contractual provision.” 680 F.2d 301 (3rd Cir. 1982). The 2nd Circuit has also held that no ERISA common law of unjust enrichment existed in “circumstances of this case.” Amato v. Western Union Int’l, 773 F.2d 1402 (2nd Cir. 1985), cert. dismissed, 474 U.S. 1113 (1986).

A Delaware federal court included within the grant of authority to create federal common law, the power, in appropriate circumstances, to order restitution to prevent unjust enrichment. Airco Indus. Gases v. Teamsters Health & Welfare Pension Fund, 618 F. Supp. 943 (D. Del. 1985). Finally, a Louisiana court stated that the creation of a federal common law of unjust enrichment would be inconsistent with ERISA’s terms and policies. Morales v. Pan American Life Ins. Co., 718 F. Supp. 1297 (E.D. La. 1989), aff’d, 914 F.2d 83 (5th Cir. 1990). Therefore, it is clear that unjust enrichment should seldom be used where it will negate an express provision of an ERISA Plan.

Some courts have applied the common fund doctrine under federal common law to deduct attorney’s fees from subrogation recoveries due to an ERISA Plan. McIntosh v. Pac. Holding Co., 928 F. Supp. 1464 (D. Neb. 1996), rev’d, 120 F.3d 911 (8th Cir. 1997). In Stillmunkes, the 8th Circuit ruled, without discussion, that the common fund doctrine could not be used to reduce an ERISA Plan's subrogation claim by its share of the attorney’s fees. Stillmunkes v. Hy-Vee Emp. Benefit Plan & Trust, 127 F.3d 767 (8th Cir. 1997). It appears that when the application of the common fund doctrine would undermine the express terms of the Plan that requires full reimbursement for medical benefits, it is not applicable. The court further found no cases where unjust enrichment or the common fund doctrine has been applied to defeat full reimbursement language in a subrogation clause in an ERISA Plan.

Conclusion

As you see, the common fund doctrine provides ERISA Plans with a constant battle with plaintiff’s attorneys and plenty of ammunition with which to argue over a share of their fees. The key to avoiding the effect of the common fund doctrine is good plan language that explicitly negates its application. Without good plan language, even the most creative subrogation counsel will have difficulty convincing the court that the common fund doctrine should not apply. However, these days the plaintiffs’ bar is attempting to erode your subrogation rights at every turn. In some cases, judges have begun to apply the common fund doctrine to the benefit of plaintiffs’ attorneys despite good Plan language to the contrary. We can expect the same sort of trend to occur within ERISA subrogation unless we zealously and aggressively take a stand to prevent it.