No. 14-168

In the Supreme Court of the United States

BLUE CROSS BLUE SHIELD OF MICHIGAN,
Petitioner,

v.

HI-LEX CONTROLS INC., HI-LEX AMERICA, INC., AND HI-LEX CORPORATION HEALTH AND WELFARE BENEFIT PLAN,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the court of appeals erred by holding that a third party administrator of an ERISA welfare benefits plan acts as an ERISA fiduciary when it unilaterally determines the amount of its administrative compensation and takes it from the plan's assets.

2. Whether the court of appeals erred by holding that an ERISA fiduciary, who has engaged in self-dealing in violation of Section 406(b)(1) of ERISA, is not entitled to assert a "reasonable compensation" defense under Section 408(c)(2).

PARTIES TO THE PROCEEDING

The caption of the case contains the names of all the parties to the proceeding.

CORPORATE DISCLOSURE STATEMENT

Hi-Lex Controls Inc. is 100% owned by Hi-Lex Corporation, a corporation organized under the laws of Japan.

Hi-Lex America, Inc. is 100% owned by Hi-Lex Corporation, a corporation organized under the laws of Japan.

Hi-Lex Corporation Health & Welfare Benefit Plan is an ERISA employee welfare benefit plan. Thus, it has no parent or publicly held company owning 10% or more of the corporation's stock.

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BRIEF IN OPPOSITION

Hi-Lex Controls Inc., Hi-Lex America, Inc., and Hi-Lex Corporation Health & Welfare Benefits Plan ("Plaintiffs") respectfully submit this brief in opposition to the petition for a writ of certiorari filed by Blue Cross Blue Shield of Michigan ("BCBSM").

OPINIONS AND ORDERS BELOW

The court of appeals' opinion is reported at 751 F.3d 740. Pet. App. 1a. The district court's findings of fact and conclusions of law are unreported, but are found on WestLaw at 2013 WL 2285452. Pet. App. 33a. The district court's order striking Defendant's expert witness as to its claimed "reasonable compensation" defense is unreported, and is not publicly available because it was filed under seal. Pet. App. 103a. The district court's summary judgment order is unreported, but is found on WestLaw at 2012 WL 3887438. Pet. App. 109a.

JURISDICTION

The court of appeals entered its judgment and opinion on May 14, 2014. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 3 of ERISA, titled "Definitions," states in relevant part:

> (21)(A) Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan to the extent
> (i) he exercises any discretionary authority or discretionary control respecting management of

> such plan or exercises any authority or control respecting management or disposition of its assets, . . . or
> (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

29 U.S.C. § 1002(21)(A) (Pet. App. 135a).

Section 406(a) of ERISA, titled "Prohibited Transactions," states in relevant part:

> **(a) Transactions between plan and party in interest**
> Except as provided in section 1108 of this title:
> (1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—
> (A) sale or exchange, or leasing, of any property between the plan and a party in interest;
> (B) lending of money or other extension of credit between the plan and a party in interest;
> (C) furnishing of goods, services, or facilities between the plan and a party in interest;
> (D) transfer to, or use by or for the benefit of a party in interest, of any assets of the plan; or
> (E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 1107(a) of this title.
> (2) No fiduciary who has authority or discretion to control or manage the assets of a plan shall permit the plan to hold any employer security or

> employer real property if he knows or should know that holding such security or real property violates section 1107(a) of this title.

29 U.S.C. § 1106(a) (Pet. App. 159a).

Section 406(b) of ERISA, titled "Prohibited Transactions," states in relevant part:

> **(b) Transactions between plan and fiduciary**
> A fiduciary with respect to a plan shall not—
> (1) deal with the assets of the plan in his own interest or for his own account, . . .

29 U.S.C. § 1106(b) (Pet. App. 159a).

Section 408 of ERISA, titled "Exemptions From Prohibited Transactions," states in relevant part:

> **(b) Enumeration of transactions exempted from section 1106 prohibitions**
> The prohibitions provided in section 1106 of this title shall not apply to any of the following transactions: . . .
> (2) Contracting or making reasonable arrangements with a party in interest for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor.
> * * *
> **(c) Fiduciary benefits and compensation not prohibited by section 1106**
> Nothing in section 1106 of this title shall be construed to prohibit any fiduciary from— . . .

> (2) receiving any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan; except that no person so serving who already receives full time pay from an employer or an association of employers, whose employees are participants in the plan, or from an employee organization whose members are participants in such plan shall receive compensation from such plan, except for reimbursement of expenses properly and actually incurred;

29 U.S.C. § 1108(b)(2), (c)(2) (Pet. App. 160a).

STATEMENT OF THE CASE

I. Preliminary Statement

This is an ERISA case, not a contract case. This case involves a fraudulent scheme by which BCBSM skimmed millions of dollars from funds entrusted to it by self-insured customers—funds to pay employee healthcare claims (the "Disputed Fees"). BCBSM secretly decided how much in Disputed Fees it would keep, and then lied to its customers (including Plaintiffs) in report after report about what it did. As the district court and court of appeals concluded, BCBSM's fraud violated the Employee Retirement Income Security Act ("ERISA").

Following a three-week trial with 21 witnesses and nearly 300 exhibits, the district court issued a thorough, 63-page, 272-paragraph Corrected Findings of Fact and Conclusions of Law. Pet. App. 33a. The district court confirmed its summary judgment rulings:

BCBSM was acting as Plaintiffs' ERISA fiduciary with respect to the Disputed Fees scheme; and BCBSM engaged in unlawful self-dealing under ERISA § 406(b) by unilaterally determining its own compensation. The district court also held BCBSM liable under ERISA § 404(a) for breaching its fiduciary duties by misrepresenting and omitting the Disputed Fees to Plaintiffs. The district court rejected BCBSM's defenses, finding that BCBSM fraudulently concealed its misconduct. It awarded Plaintiffs $6 million dollars, reflecting 100% of the Disputed Fees plus prejudgment interest.[1]

The court of appeals unanimously affirmed the district court's judgment in a published opinion. It agreed that BCBSM was acting as Plaintiffs' fiduciary when it unilaterally determined the amount of Disputed Fees and secretly took them from Plaintiffs' plan assets. It also agreed that BCBSM had violated ERISA, explaining that BCBSM's liability for self-dealing and breaching fiduciary duties with respect to the Disputed Fees was already established in an earlier, published decision. The court confirmed that BCBSM did not have a statute-of-limitations defense based on its fraud or concealment. Finally, the court of appeals affirmed a pre-trial ruling that BCBSM is not entitled to present a "reasonable compensation" defense under ERISA § 408 to Plaintiffs' § 406(b) claim.

The court of appeals and the district court applied well-established legal principles to the facts as found by the district court, following a three-week trial. The

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[1] The district court reserved the issue of attorneys' fees until the conclusion of this petition.

legal principles employed by the court of appeals are consistent with the decisions of this Court, the decisions of other courts of appeals, the decisions of district courts, and the federal regulations promulgated by the Department of Labor, which filed an amicus brief below. BCBSM's claimed "departure" by the court of appeals in this case is fictional.

II. Proceedings Below

A. Factual Summary

1. The parties' relationship

Since 1991, BCBSM has administered Plaintiffs' ERISA welfare benefit plan. The terms under which BCBSM served as Plaintiffs' third party administrator are set forth in Administrative Service Contracts ("ASC's"). Pet. App. 2a. "The parties renewed those terms each year . . . by executing a 'Schedule A' document." *See id.*

"Under the ASCs, BCBSM agreed to process healthcare claims for [Plaintiffs'] employees and grant those employees access to BCBSM's provider networks." *See id.* "In exchange for its services, BCBSM received compensation in the form of an 'administrative fee'—an amount set forth in the Schedule A on a per employee, per month basis." *See id*.

BCBSM administered the healthcare claims for Plaintiffs' ERISA plan from the plan's assets. Pet. App. 40a. Plaintiffs deposited these funds with BCBSM in advance of incurring healthcare claims by wiring funds to a BCBSM account. *Id.*

2. Before 1993: BCBSM under pressure to increase revenue; customers balk when BCBSM implements new fees

In 1987 and 1988, BCBSM was in poor financial shape. *Id.* at 41a. To regain financial stability, BCBSM started charging its self-funded ASC customers various fees. *Id.* The customer response to the new fees was resoundingly negative. *Id.* BCBSM received "tremendous complaints from customers," in part because "[t]he billing of these amounts to customers was an add-on to the bill, highlighted for all to see." *Id.*

The charges were so unpopular that, in 1989 alone, BCBSM lost 225,000 members. *Id.* at 42a. Many other customers refused to pay them. *Id.* Internal memoranda showed that the fees made it a "challenge to maintain customer relationships." *Id.* By disclosing the fees, BCBSM was "its own worst enemy." *Id.*

3. 1993-94: BCBSM's plan to hide fees

In 1993, BCBSM executives proposed a solution: replacing the disclosed fees with a hidden fee buried in marked-up hospital claims (the Disputed Fees). *Id.* at 2a-3a, 42a. The scheme worked as follows: regardless what BCBSM was required to pay a hospital, it reported a larger charge that was passed on to the customer. BCBSM kept the additional amount as hidden administrative compensation:

Actual Claim Paid to Hospital:	$6,000
Disputed Fees Kept by BCBSM:	$810
Hospital Claim Reported to Plaintiffs:	$6,810

This solution had advantages for BCBSM, including that the Fees (per a BCBSM executive summary) "will be inherent in the system and no longer visible to the customer." *Id.* at 42a-43a. BCBSM's senior management approved this proposal. *Id.* at 43a.

"This new system was termed 'Retention Reallocation.'" *Id.* at 3a. "[BCBSM] would retain additional revenue by adding certain mark-ups to hospital claims paid by its ASC clients." *Id.* at 2a-3a. "[R]egardless of the amount BCBSM was required to pay a hospital for a given service, it reported a higher amount that was then paid by the self-insured client." *Id.* at 3a. "The difference between the amount billed to the client and the amount paid to the hospital was retained by BCBSM." *Id.*

The Disputed Fees were determined unilaterally by BCBSM; cost accountants and actuaries decided what expenses BCBSM wanted to recoup through the Disputed Fees and then decided how much hospital claims had to be marked up to reach that goal. *Id.* at 45a-46a. Plaintiffs had no input in the process. *Id.* at 42a.

4. 1994-Present: BCBSM employs a bevy of artifices to hide the fees

BCBSM went to great lengths to keep the Disputed Fees invisible to the customer. *Id.* at 47a. The court of appeals aptly described this fraud:

> "BCBSM committed fraud by knowingly misrepresenting and omitting information about the [Disputed] Fees in contract documents. Specifically, the ASC, the Schedule As, the monthly claims reports, and the quarterly and

> annual settlements all misled Hi-Lex into believing that the disclosed administrative fees and charges were the only form of compensation that BCBSM retained for itself."

Id. at 14a. Additionally, "the Form 5500 certification sheets that BCBSM provided to Hi-Lex every year concealed the additional administrative compensation that was being taken in the form of Disputed Fees." *Id.* at 15a.

a. Form 5500 Worksheets. Each year, BCBSM provided customers (including Plaintiffs) with information for the preparation of their Form 5500 Schedule A, which is filed with the U.S. Department of Labor. *Id.* at 52a. The Department of Labor, Internal Revenue Service, and Pension Benefit Guaranty Corporation developed Form 5500's to satisfy annual reporting requirements under ERISA and the IRS Code. *Id.*

BCBSM's Form 5500 worksheets were fraudulent, because they falsely "indicated that BCBSM was not retaining any administrative compensation beyond that clearly delineated in the ASC and Schedule A's." *Id.* at 13a. Specifically, "[i]n the certifications provided by BCBSM to help prepare DOL 5500s, the Disputed Fees were included on the line for 'Claims Paid.' The 'Administration' section that should have included all administrative fees listed only those fees disclosed by BCBSM. Lines for 'Other Expenses' and 'Risk and Contingency' were either marked zero or not applicable each year." *Id.* at 13a, n.11. BCBSM also reported on each worksheet the "Total Retention," which did not

include the Disputed Fees kept by BCBSM as additional administrative compensation. *Id.* at 52a-53a.

A reader reviewing the Form 5500 certifications could not determine whether any Disputed Fees were charged or in what amount. *Id.* at 53a. As a result, Plaintiffs were misled into believing that BCBSM retained far less administrative compensation than it, in fact, actually retained. *Id.*

b. Monthly Claims Reports. Each month, BCBSM gave Hi-Lex detailed claims reports for every claim incurred. *Id.* at 47a. The monthly claims data did not mention Disputed Fees; in fact, BCBSM hid the Disputed Fees within the claims numbers provided to Plaintiffs. *Id.* Using the example above, BCBSM would report a claims cost of $6,810 to Plaintiffs instead of the actual claims cost of $6,000. The extra $810 kept by BCBSM was not revealed anywhere in the report.

c. Quarterly Settlements. BCBSM sent Plaintiffs quarterly reports containing details about the plan's performance. *Id.* These reports contained false and misleading statements in that the amounts for hospital claims were inflated by the Disputed Fees charged, while the hospital discounts were reduced by the same amount. *Id.* at 47a-48a. Plaintiffs could not determine from these reports whether any Disputed Fees were charged, much less their amount.

d. Annual Settlements. After the close of each plan year, BCBSM sent Plaintiffs an annual settlement statement. *Id.* at 50a. This report included a section titled "Administrative Fee Settlement"; however,

BCBSM did not include the Disputed Fees in that section. *Id.* at 51a. Additionally, the annual settlements included a section that purported to show the "Actual Claims Paid by BCBSM." *Id.* at 50a-51a. Despite the use of the terms "actual" and "paid," the actual claims amount was increased to include the Disputed Fees kept by BCBSM. *Id.*

5. 2003: BCBSM refused to answer questions that would disclose the Disputed Fees, then falsely denied their existence in an RFP

In 2003, Plaintiffs sought a formal quote from BCBSM and its competitors. *Id.* at 61a-62a. The Request for Proposal ("RFP") specifically asked BCBSM to identify any "Network Access / Management Fees" or "Other Fees." *Id.*

BCBSM responded to the RFP by denying that there were any such fees, saying they were "N/A" (not applicable). *Id.* at 62a. This answer was false. *Id.* The Disputed Fees included a "Network Access" component. *Id.* at 44a. And the remaining components of the Disputed Fees were "Other Fees." *Id.* At trial, BCBSM account manager Deborah Dickson admitted that the "N/A" response was "the wrong answer." *Id.* at 62a.

This misrepresentation created the illusion that BCBSM was more cost competitive than BCBSM's competitors. *Id.* Had BCBSM disclosed its Disputed Fees, Plaintiffs would have seen that BCBSM was the most expensive option. *Id*. at 63a-64a.

6. 2003-2007: BCBSM internally debates whether to disclose the Disputed Fees to customers and then decides not to

"Starting around 2003, a few BCBSM executives raised concerns about the lack of disclosure surrounding Disputed Fees." *Id.* at 64a. This "led to an internal debate about what to do." *Id.* Some "favored disclosing the amount of [Disputed] Fees, but Mr. [John Paul] Austin and the new business sales staff did not want to do so because the Administrative Fees would be too high and BCBSM could not compete." *Id.* at 64a-65a.

"BCBSM senior underwriter, Ken Krisan, was in charge of the strategy for 'disclosing' the Disputed Fees without customers noticing." *Id.* at 65a-66a. As the district court found in Hi-Lex, "Mr. Krisan's emails confirm that actual disclosure of the [Disputed] Fees was not BCBSM's intent:"

- "I think there is a need [to] ***downplay*** this [Disputed Fees] with respect to the outside world … [corporate communications] may be helpful in developing some internal training materials or job aids that puts the proper 'spin' on what we want to say."
- "We want to keep this a little on the ***understated*** side so we don't want to include this in any mass communications. ***In many cases this is not going to [be] good news.***"
- "[B]ecause we want to ***downplay*** the release of this information, it was decided that Agents and

Customers should not receive any written materials."

- "The [Disputed] Fee portion of the discussion is intended to be ***downplayed*** to the customer. … There is no plan to provide anything to customers or agents on this topic."

- "We want to stay away from identifying what is in the fee."

Id. (emphasis in original).

7. 2007: Internal Documents Confirm that BCBSM Knows that its Customers Don't Know About the Fees

In 2007, "BCBSM undertook an investigation to determine which customers would be surprised to learn that they had paid the Disputed Fees the year before." *Id.* at 66a. "The investigations resulted in detailed spreadsheets that identified whether BCBSM's customers, or their brokers, knew about the Disputed Fees." *Id.* at 67a. Each indicates that Plaintiffs did not know about the Disputed Fees. *Id.* In fact, the spreadsheets revealed that "a substantial majority—83%—did not know the Disputed Fees were being charged." *Id.* at 17a.

As the district court found, "[t]he results of BCBSM's formal investigation were consistent with anecdotal accounts from BCBSM employees:"

- "[N]ot all ASC groups are aware of BCBSM's Retention Reallocation Policy."

- "I know many of the smaller [groups] aren't aware [of disputed fees]."
- "I agree that there is overwhelming confusion on [disputed] fees internally (and externally)."
- "[I]t is not certain [some accounts] were aware of the [disputed] fees when entering into the arrangement."

Id. at 67a.

B. District Court Decision

Plaintiffs filed their Complaint over the Disputed Fees in this case on June 13, 2011. Plaintiffs alleged violations of ERISA § 404(a) (breach of fiduciary duty) and ERISA § 406(b) (self-dealing).[2] BCBSM raised two primary defenses: ERISA § 408 (the "reasonable compensation" defense) and ERISA § 413 (statute of limitations).

Early in the case, Plaintiffs moved to strike an expert witness who was expected to testify as to BCBSM's reasonable compensation defense under ERISA § 408. *Id.* at 103a. The district court granted the motion in December 2011, stating that it was "persuaded by the majority of jurisdictions which hold that §§ [4]08(b)(2) and (c)(2) do not apply to claims arising under § [4]04(a) or § [4]06(b)." *Id.* at 107a. It confirmed that "§ [4]08 does not provide a safe harbor to fiduciaries who self-deal." *Id.* (citing *Patelco Credit Union v. Sahni*, 262 F.3d 897, 911 (9th Cir. 2001)).

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[2] Plaintiffs also alleged violations of Michigan law, but the district court dismissed those claims as preempted under ERISA. Pet. App. 129a. The claims were not before the court of appeals.

Thereafter, in July and August 2012, the parties filed cross-motions for summary judgment. In a September 2012 order, the district court held that BCBSM was Plaintiffs' ERISA fiduciary with respect to the Disputed Fees and that the Fees were collected from ERISA plan assets. Pet. App. 118a-128a. The district court granted summary judgment for Plaintiffs as to their claim under ERISA § 406(b), concluding that BCBSM's unilateral determination of the Disputed Fees constituted per-se unlawful self-dealing. *Id.* at 130a-132a. The district court held that there remained issues of fact concerning BCBSM's liability under ERISA § 404(a) and BCBSM's statute-of-limitations defense under ERISA § 413. *Id.* at 132a-134a.

In April and May 2013, the district court held a nine-day bench trial over the course of three weeks. *Id.* at 39a. The parties presented testimony from 21 witnesses and offered over 300 exhibits. On May 23, 2013, the district court issued its Corrected Findings of Fact and Conclusions of Law. *Id.* at 33a. After reiterating its earlier holdings from the summary judgment order, the district court held that BCBSM was liable for breaching its fiduciary duties under ERISA § 404(a). *Id.* at 82a-84a. It also held that Plaintiffs' claims were timely because BCBSM had engaged in "fraud or concealment" under ERISA § 413, and Plaintiffs had filed their lawsuit within six years of the time that they knew or should have known of the misconduct. *Id.* at 85a-97a.

The district court awarded damages under ERISA § 409 to reflect 100% of the Disputed Fees plus pre-judgment interest. *Id.* at 99a-102a. The Court also

indicated that it would entertain a petition for attorneys' fees. *Id.* at 102a. BCBSM appealed.

C. Court of Appeals Decision in Pipefitters

Not one month after the district court entered the judgment in this case, on June 28, 2013, a panel of the U.S. Court of Appeals for the Sixth Circuit heard oral argument in the *Pipefitters* case. *Pipefitters Local 636 Ins. Fund v. Blue Cross & Blue Shield of Mich.*, 722 F.3d 861 (6th Cir. 2013). *Pipefitters* involved the same claims and applicable law (ERISA § 404(a) and § 406(b)), the same defendant (BCBSM), the same contract language and reporting documents, and one of the same fees at issue here (the "OTG fee"). *Pipefitters*, 722 F.3d at 864-65.

The *Pipefitters* panel and counsel discussed this case at oral argument. Pet. App. 6a, n.1. In a unanimous, published opinion, the court of appeals affirmed BCBSM's fiduciary status and ERISA liability. *Pipefitters*, 722 F.3d at 869. It held that BCBSM (1) was an ERISA fiduciary with regard to the OTG fees, *id.* at 865-67; (2) engaged in per se illegal self-dealing by unilaterally determining the amount of the OTG fees and collecting them from Pipefitters' plan assets, *id.* at 867-68; and (3) violated its fiduciary duties with regard to the OTG subsidy, *id.* at 868-89.

D. Court of Appeals Decision in Hi-Lex

On May 14, 2014, the Sixth Circuit issued its opinion and judgment in this case, rejecting each and every one of BCBSM's claims of appeal.

First, citing *Pipefitters*, the Court held that BCBSM was Plaintiffs' ERISA fiduciary because "the Disputed

Fees were discretionarily imposed" by BCBSM. Pet. App. 6a. It rejected BCBSM's argument that the Disputed Fees "were part of the standard pricing arrangement for the company's entire ASC line of business." *Id.* And it agreed that the funds which paid the Disputed Fees were ERISA plan assets. *Id.* at 6a-11a.

Second, the court agreed that Plaintiffs' claims were timely. *Id*. at 11a-17a. The case involved the exception to the six-year ERISA statute of limitations because BCBSM engaged in "fraud or concealment." *Id.* at 13a-14a. "BCBSM committed fraud by knowingly misrepresenting and omitting information about the Disputed Fees in contract documents." *Id.* at 14a. "BCBSM also engaged in a course of conduct designed to conceal evidence of [its] alleged wrong-doing[:]

> After rumors emerged that BCBSM had "hidden fees" in the early 2000s, representatives from BCBSM told various insurance brokers that customers got 100% of the hospital discounts and that "Blue Cross does not hold anything back." . . . Finally, the Form 5500 certification sheets that BCBSM provided to Hi-Lex every year concealed the additional administrative compensation that was being taken in the form of the Disputed Fees.

Id. at 14a-15a. The court rejected BCBSM's argument that its customers should have discovered the Disputed Fees based on language in the contracts. *Id.* at 12a-13a. The court described the cited language as "opaque and misleading." *Id.* at 12a. Any alleged disclosure was negated by BCBSM's subsequent misleading reports:

> Furthermore, even to the extent that the contract documents provide some hint about additional fees, those documents describe only what *might* happen in the future. Every year, however, Hi-Lex received DOL 5500 certification sheets from BCBSM which purported to show the administrative compensation that BCBSM was *actually* receiving. The 5500 Forms, though, indicated that BCBSM was not retaining any administrative compensation beyond that clearly delineated in the ASC and Schedule As.

Id. at 13a. (emphasis in original). And the record showed that a "hypothetically diligent" plaintiff under similar circumstances would not have discovered the Fees. *Id.* at 16a-17a. Thus, the ERISA claims were timely.

Third, the Sixth Circuit summarily affirmed BCBSM's liability for self-dealing (Count II) and breach of its fiduciary duties (Count I) based on its 2013 decision in *Pipefitters*. *Id.* at 17a-19a.

REASONS FOR DENYING THE PETITION

I. The ERISA Fiduciary Ruling Does Not Merit Certiorari.

A. Petitioner is collaterally estopped from relitigating the issue.

The issue before the court of appeals was whether the district court erred in holding that BCBSM was acting as an ERISA fiduciary when it unilaterally determined the amount of Disputed Fees and took them for itself. Pet. App. 5a.

This is the second time the court of appeals decided this issue in an identical context, as BCBSM had litigated the same issue, involving the same contracts, in the same forum just a year prior in *Pipefitters*. Applying ERISA § 3(21)(A), the Sixth Circuit held that "BCBSM functioned as an ERISA fiduciary with respect to hidden OTG fees that it unilaterally added to hospital claims subsequently paid by the Pipefitters Fund." *Id.* (citing *Pipefitters*, 722 F.3d at 866-87). BCBSM had an opportunity to seek certiorari in *Pipefitters*, but did not do so.

Collateral estoppel applies where a party has had a full opportunity to litigate an issue. *See, e.g.*, *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 330-31 (1979); *Smith v. S.E.C.*, 129 F.3d 356, 362 (6th Cir. 1997) (en banc). That doctrine applies to questions of law. *See, e.g., Montana v. U.S.*, 440 U.S. 147 (1979); *Burlington N. R. Co. v. Hyundai Merch. Marine Co.*, 63 F.3d 1227 (3rd Cir. 1995). BCBSM's failure to seek certiorari in *Pipefitters* means that it is collaterally estopped from relitigating whether it was acting as an ERISA fiduciary here.

B. There is no circuit split on the issue of BCBSM's fiduciary status.

In analyzing the fiduciary issue, the court of appeals applied the rule of law announced in an earlier published decision of the Sixth Circuit (and which originated in the Second and Seventh Circuits):

> [W]here parties enter into a contract term at arm's length and where the term confers on one party the unilateral right to retain funds as compensation for services rendered with respect

> to an ERISA plan, that party's adherence to the term does not give rise to ERISA fiduciary status *unless the term authorizes the party to exercise discretion with respect to that right*.

Seaway Food Town v. Med. Mut. of Ohio, 347 F.3d 610, 619 (6th Cir. 2003) (citing *Ed Miniat, Inc. v. Globe Life Ins. Grp., Inc.*, 805 F.2d 732, 737 (7th Cir. 1986); *Schulist v. Blue Cross of Iowa*, 717 F.2d 1127, 1131-32 (7th Cir. 1983); and *F.H. Krear & Co. v. Nineteen Named Trs.*, 810 F.2d 1250, 1259 (2d Cir. 1987)) (emphasis added).

There can be no dispute that the rule applied in this case (and in *Seaway*, *Ed Miniat*, *Schulist*, and *Krear*) represents the correct rule of law under ERISA § 3(21)(A). It acknowledges that one does not become a fiduciary merely by virtue of its arms-length contract with an ERISA plan; but when one retains "discretion" to determine its own compensation from an ERISA plan, it falls squarely within the definition of a "fiduciary" under ERISA.

BCBSM cites no decision in conflict with this rule. In fact, the decisions cited in BCBSM's petition (Pet. 18) *follow* the rule of law announced in *Seaway*, *Ed Miniat*, *Schulist*, and *Krear*. *See, e.g.*, *Renfro v. Unisys Corp.*, 671 F.3d 314, 324 (3d Cir. 2011) (following *Krear*, 810 F.2d at 1259); *Hecker v. Deere & Co.*, 556 F.3d 575, 583 (7th Cir. 2009) (following *Schulist*, 717 F.2d 1127); *Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 302 F.3d 18, 31 (2d Cir. 2002) (following *Krear*, 810 F.2d at 1259). Those decisions applied the same rule of law to situations where the contracts did not give the defendants discretion over their compensation.

Even the decision given the most attention by BCBSM, *Chicago District Council of Carpenters Welfare Fund v. Caremark, Inc.*, 474 F.3d 463 (7th Cir. 2007), follows the same rule of law. *Id.* at 473 (following *Schulist*, 717 F.2d at 1131-32). In *Caremark*, the court recognized that the defendant could not "increase the prices 'unilaterally'" because "any changes [had to] be made in a writing signed by both parties." *Id.* Thus, the contract "gave Caremark the right to renegotiate prices during the contract term but not the right to change the prices unilaterally." *Id.*[3]

In sum, BCBSM is incorrect when it claims that this case (and by implication, *Seaway*) created a circuit split with *Renfro*, *Hecker*, *Harris Trust*, and *Caremark*.

BCBSM's quarrel is not with the rule of law, but its application in this case. But a "misapplication of a properly stated rule of law" is not a proper basis for granting a certiorari petition. R. 10. The petition should be denied.

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[3] The compensation scheme in *Caremark* differed significantly from this case. The *Caremark* plaintiffs "negotiated to pay Caremark fixed prices for the drugs," leaving Caremark "free to negotiate" a lesser acquisition price and "pocket the difference." *Caremark*, 474 F.3d at 473. Plaintiffs and BCBSM negotiated no such "fixed prices" for medical services; but rather, Plaintiffs would reimburse BCBSM for the actual cost of employee medical claims as they were incurred. Pet. App. 38a. For its services, Plaintiffs paid BCBSM an agreed-upon, disclosed, administrative service fee paid on a per employee, per month basis. *Id.* at 40a.

C. There is no circuit split on the issue of ERISA plan assets.

BCBSM also takes issue with the court of appeals' conclusion that the Disputed Fees were "plan assets" under ERISA. Pet. 22-24. But BCBSM's real dispute is not with the announced rule of law concerning ERISA plan assets (which is beyond reproach), but with the court's application of that rule to the facts in this case. *See* R. 10.

In analyzing the "plan assets" issue, the court of appeals applied the universally accepted test from Department of Labor AO 92-24A: "the assets of an employee benefit plan generally are to be identified on the basis of ordinary notions of property rights." Pet. App. 7a. This same legal standard, based on "ordinary notions of property rights," is the announced rule of law in the very cases that BCBSM alleges form a circuit split. *Tussey v. ABB, Inc.*, 746 F.3d 327, 339 (8th Cir. 2014); *Faber v. Metro. Life Ins. Co.*, 648 F.3d 98, 105 (2d Cir. 2011).[4]

Finally, none of the decisions cited by BCBSM involve an analogous factual situation. Plaintiffs (and hundreds of other self-insured customers) deposited millions of dollars with BCBSM for the purpose of paying employee healthcare claims. The plan documents, the parties' conduct, and common sense show that BCBSM accepted the funds, intending to use

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[4] The court of appeals in *Caremark* did not cite or apply any law in reaching its conclusion that the funds at issue were not ERISA plan assets. Yet, the court's brief footnote on the subject shows that its holding was in accord with ordinary notions of property rights. *Caremark*, 474 F.3d at 476 n.6.

them "to pay the health expenses and administrative costs of enrollees in the Hi–Lex Health Plan." Pet. App. 10a. The petition should be denied.

II. The ERISA § 408(c)(2) Defense Ruling Does Not Merit Certiorari.

A. Reversal would have no impact on the outcome of this case.

BCBSM asks this Court to grant certiorari to decide whether the defenses enumerated in ERISA § 408—specifically, § 408(c)(2)—apply to ERISA § 406(b). The court of appeals, nearly all of the federal courts that have addressed the issue, and the Department of Labor have concluded that the § 408 defenses apply to § 406(a) only, and not § 406(b). The Court, however, need not analyze this issue, because even a reversal on this point would have no impact on the judgment in this case.

The district court held, after a bench trial, that BCBSM violated two separate provisions of ERISA: Section 406(b) and Section 404(a). Pet. App. 82a-85a. The court of appeals affirmed BCBSM's liability under both sections. *Id.* at 17a-19a. BCBSM makes no argument in its petition (and made no argument to the court of appeals) that § 408(c)(2) provides a "reasonable compensation" defense to § 404(a).

Even assuming, *arguendo*, that the Court grants certiorari and reverses the decision as to § 406(b), the result in this case would not change. BCBSM would still be liable for the entire amount of damages awarded, because there is no reasonable compensation defense to its ERISA § 404(a) liability. Because this issue would not change the outcome, even if favorably

decided in favor of BCBSM, the petition should be denied.

B. The Eighth Circuit's decision is an outlier.

The Eighth Circuit's decision in *Harley*, which is contrary to every other court to ever address the issue, and which is contrary to Department of Labor regulations, is an outlier. The Third, Sixth, and Ninth Circuits, together with district courts from the Second, Seventh, Tenth, and Eleventh Circuits have held that the § 408(c)(2) reasonable compensation defense applies to § 406(a), but not to § 406(b).[5] The Department of Labor regulations are in accord. *See* 29 C.F.R. § 2550.408b-2(a), -.408c-2(a). Only the Eighth Circuit and its district courts have found that the § 408 defenses apply to § 406(b). *Harley v. Minn. Mining & Mfg. Co.*, 284 F.3d 901, 908-09 (8th Cir. 2002).

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[5] *See, e.g.*, *Hi-Lex*, 751 F.3d at 750-51; *Nat'l Sec. Sys., Inc. v. Iola*, 700 F.3d 65, 93-95 (3d Cir. 2012); *Patelco Credit Union v. Sahni*, 262 F.3d 897, 910-11 (9th Cir. 2001); *Tibble v. Edison Int'l*, 639 F. Supp. 2d 1074, 1105 n.14 (C.D. Cal. 2009); *Kanawi v. Bechtel Corp.*, 590 F. Supp. 2d 1213, 1223 (N.D. Cal. 2008); *Chao v. Linder*, 421 F. Supp. 2d 1129, 1135-36 (N.D. Ill. 2006); *LaScala v. Scrufari*, 96 F. Supp. 2d 233, 238 (W.D.N.Y. 2000); *Daniels v. Nat'l Emp. Benefits Servs., Inc.*, 858 F. Supp. 684, 693 (N.D. Ohio 1994); *Whitfield v. Tomasso*, 682 F. Supp. 1287, 1304 (E.D.N.Y. 1988); *Donovan v. Daugherty*, 550 F. Supp. 390, 404 n.3 (S.D. Ala. 1982); *Gilliam v. Edwards*, 492 F. Supp. 1255, 1262 (D.N.J. 1980); *Marshall v. Kelly*, 465 F. Supp. 341, 353 (W.D. Okla. 1978); *Haddock v. Nationwide Fin. Servs.*, 262 F.R.D. 97, 129-30 (D. Conn. Nov. 6, 2009), *rev'd on other grounds*, No. 10-4237-cv, 2012 WL 360633 (2d Cir. 2012); *Chao v. Graf*, No. CV-N-01-0698, 2002 WL 1611122, at *9-10 (D. Nev. 2002).

Since the Eighth Circuit came up with its isolated interpretation, not a single court has adopted it. Every court to address the issue since then—and also before then—has found that § 408(c)(2)'s reasonable compensation defense does not apply to § 406(b). *See, e.g.*, *Nat'l Sec. Sys.*, 700 F.3d at 93-96.

Furthermore, the Department of Labor has given all the guidance that is needed for courts that have not resolved this question. This Court's precedent is well settled that when a statutory provision is ambiguous, courts should defer to an agency's reasonable construction of the provision. *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984). As pointed out by BCBSM in its Petition, the Department of Labor's regulation states that § 408(c)(2) does "not [ ] provid[e] 'an independently operative reasonable-compensation exception' to § [4]06(b)'s prohibition on transactions between a plan and a fiduciary." Pet. 26 (citing *Nat'l Sec. Sys.*, 700 F.3d at 96); *see also* 29 C.F.R. § 2550.408c-2(a). "[L]egislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *Chevron*, 467 U.S. at 844. BCBSM's Petition does not argue that the Department of Labor's regulations are "arbitrary, capricious, or manifestly contrary" to ERISA. As such, the Department's regulations should be given controlling weight; no further guidance is needed from this Court to tell lower courts that *Chevron* deference should be given to an agency's regulations.

III. This is a "One-Off" Fraud Case, Not an Issue of National Concern.

BCBSM's fraudulent Disputed Fees scheme—while pervasive within Michigan—was unique in the United States. Plaintiffs are aware of no other ERISA fiduciary that has engaged in such brazen self-dealing—unilaterally determining and capturing hidden administrative compensation through secret mark-ups of employee healthcare claims. This is not an issue of national concern that requires this Court's attention.

For nearly 20 years, BCBSM stole millions of dollars from funds deposited for the payment of employee healthcare claims. It misrepresented the Disputed Fees in countless reports to customers and, worse yet, flatly lied about the existence and amount of Fees when asked directly about them.

The evidence of BCBSM's fraud was staggering. An internal memorandum from 1994 shows the plan to hide the Disputed Fees from customers, making them "no longer visible to the customer." Pet. App. 43a. Testimony and internal e-mails showed that BCBSM exercised "complete discretion" by unilaterally deciding the amount of the fees, which were not reported to customers. *Id.* at 45a-46a.

BCBSM issued hundreds of false reports to Plaintiffs that hid the Disputed Fees. *Id.* at 47a-54a. These reports (issued monthly, quarterly, and annually) would falsely understate the amount of compensation kept by BCBSM and overstate the amount that was purportedly paid in claims to healthcare providers. *Id.* at 13a, 47a-54a.

Worse yet, testimony and documents showed that Plaintiffs falsely denied the existence of the Disputed Fees when asked by Plaintiffs and other customers. *Id.* at 55a-64a. Specifically, in a 2003 request for proposal, Plaintiffs asked BCBSM if it charged any "network access/management fees" (which the Disputed Fees were). *Id.* at 62a. BCBSM falsely responded that such fees were "N/A" and that there were no other fees. *Id.*

Internal memoranda and testimony from former employees showed that BCBSM debated disclosure of the Disputed Fees from 2003 to 2007 and ultimately decided to continue hiding the fees. *Id.* at 64a-66a. In a series of e-mails, BCBSM management stressed that the Fees needed to be "downplayed" to customers because "[i]n many cases this is not going to [be] good news" for customers. *Id.*

BCBSM went so far as to conduct internal audits in 2006 and 2007 to determine which customers would be surprised to learn of the Disputed Fees. The audit showed that Plaintiffs did not know about the Fees and globally, a "substantial majority—83%—did not know the Disputed Fees were being charged." *Id*. at 17a.

The court of appeals agreed with the district court's findings of fraud:

> BCBSM committed fraud by knowingly misrepresenting and omitting information about the Disputed Fees in contract documents. Specifically, the ASC, the Schedule As, the monthly claims reports, and the quarterly and annual settlements all misled Hi–Lex into believing that the disclosed administrative fees

and charges were the only form of compensation that BCBSM retained for itself.

BCBSM's fraudulent scheme was widespread, affecting many victims in Michigan, yet it also was *unique*. Plaintiffs are unaware of any other third party administrator that has perpetrated a similar fraud on its customers. Surely it is not standard practice in the healthcare industry for a third party administrator to steal plan assets, to determine its own compensation, or to lie to its own customers. The unique nature of the fraud perpetrated by BCBSM in this case is yet another reason to deny certiorari.

The egregious fiduciary misconduct in this case underscores the need for ERISA protections. As the Court has recognized, "the crucible of congressional concern was misuse and mismanagement of plan assets by plan administrators and . . . ERISA was designed to prevent these abuses in the future." *Mass. Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 140 n.8 (1985).

CONCLUSION

Blue Cross Blue Shield of Michigan's petition for a writ of certiorari should be denied.

Respectfully submitted,

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