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

REPLY IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
REPLY IN SUPPORT OF PETITION	1
I. THIS COURT'S REVIEW IS NEEDED TO CLARIFY THE STATUS OF SERVICE PROVIDERS TO ERISA PLANS	3
II. THIS COURT'S REVIEW IS NEEDED TO CLARIFY THE MEANING OF § 1108(c)	7
III. THIS COURT'S REVIEW IS NEEDED *IN THIS CASE*	10
CONCLUSION	12

TABLE OF AUTHORITIES

CASES Page

Calhoun Cnty. v. *Blue Cross Blue Shield Mich.*, 824 N.W.2d 202 (Mich. Ct. App.), *leave to appeal denied*, 823 N.W.2d 603 (Mich. 2012) 1, 2, 3, 5
Chi. Dist. Council of Carpenters Welfare Fund v. *Caremark, Inc.*, 474 F.3d 463 (7th Cir. 2007) 5
Exxon Mobil Corp. v. *Saudi Basic Indus. Corp.*, 544 U.S. 280 (2005) 7
Harley v. *Minn. Mining & Mfg. Co.*, 284 F.3d 901 (8th Cir. 2002) 9
Harris Trust & Sav. Bank v. *John Hancock Mut. Life Ins. Co.*, 302 F.3d 18 (2d Cir. 2002) 4
Lowen v. *Tower Asset Mgmt., Inc.*, 829 F.2d 1209 (2d Cir. 1987) 8
McKithen v. *Brown*, 481 F.3d 89 (2d Cir. 2007) 7
Nat'l Sec. Sys., Inc. v. *Iola*, 700 F.3d 65 (3d Cir. 2012), *cert. denied sub nom. Barrett* v. *Universal Mailing Serv., Inc.*, 133 S. Ct. 1812 (2013) 9
Pipefitters Local 636 Ins. Fund v. *Blue Cross & Blue Shield of Mich.*, 722 F.3d 861 (6th Cir. 2013) 7
Santomenno v. *John Hancock Life Ins. Co. (U.S.A.)*, __ F.3d __, 2014 WL 4783665 (3d Cir. Sept. 26, 2014) 6

STATUTE AND REGULATION

29 U.S.C. § 1108 9
42 Fed. Reg. 32389 (June 24, 1977) 9

TABLE OF AUTHORITIES—continued

OTHER AUTHORTY Page

18 *Moore's Federal Practice* (3d ed. 2014) 7

REPLY IN SUPPORT OF PETITION

According to the Michigan Court of Appeals, the contract between Hi-Lex and BCBSM expressly gave BCBSM the right to collect network access fees as compensation for its services to the Plan. *Calhoun Cnty.* v. *Blue Cross Blue Shield Mich.*, 824 N.W.2d 202, 210-12 (Mich. Ct. App.), *leave to appeal denied*, 823 N.W.2d 603 (Mich. 2012). As Hi-Lex acknowledges, under the rule applied by the Second and Seventh Circuits, a service provider's exercise of a contract right to collect compensation does not give rise to ERISA fiduciary status. BIO 19-20. Had those circuits' rule applied here, Hi-Lex's claims would have failed.

The Sixth Circuit instead held that BCBSM *did* act as a fiduciary when it collected compensation for services to the Plan. And it interpreted ERISA to preclude BCBSM's defense that the fees it received were no more than reasonable compensation for its services—recognizing that its ruling deepened a circuit split.

Hi-Lex cannot explain the Sixth Circuit's disregard for Michigan contract law. So Hi-Lex ignores it—not even citing *Calhoun County*. Likewise, Hi-Lex cannot reconcile the Sixth Circuit's fiduciary analysis with the decisions of the Second, Seventh, and other Circuits. So it asserts, incorrectly, that the Sixth Circuit actually followed their rule. And Hi-Lex cannot dispute the circuit split on the reasonable compensation defense. So it argues erroneously that the Eighth Circuit is the only court on the other side.

Hi-Lex's principal tactic, however, is to try to distract the Court with irrelevant facts. Indeed, nearly

sixty percent of the Brief in Opposition, 16 of 28 pages, is devoted to that.

The petition presents two questions: (1) Whether the lower courts erred in holding that BCBSM was an ERISA fiduciary under 29 U.S.C. § 1002(21)(A), and (2) whether the lower courts erred in holding that 29 U.S.C. § 1108(c) does not allow a reasonable compensation defense to alleged violations of § 1106(b). Pet. i. The first question was decided below on summary judgment and the second in a pre-trial ruling. Both are legal questions that turn on interpretation of federal statutes and a written contract—not disputed facts. The facts Hi-Lex cites were relevant only to issues—the duty of loyalty and statute of limitations—not before this Court. See Pet. App. 132a-133a.

It is not entirely surprising that Hi-Lex focuses on irrelevant facts, because the district court's findings make BCBSM look bad. BCBSM vigorously disputed the facts at trial, and believes the findings were erroneous—particularly in view of the Michigan Court of Appeals' ruling that the supposedly concealed fees were "expressly provided for" in the contract and "unequivocally agreed to." *Calhoun Cnty.*, 824 N.W.2d at 210-11. Moreover, Hi-Lex's rhetoric regarding supposedly "staggering" evidence of a "brazen" "fraudulent … scheme," BIO 26, is wildly overblown: Hi-Lex always knew the total that it paid for BCBSM's administration and payment of Plan participants' health care claims; Hi-Lex claimed only that it was unaware which buckets its payments went into; and Hi-Lex continues to contract with BCBSM to this day, with full awareness of all fees. Pet. 28-29. But more importantly for present purposes, BCBSM does not challenge any factual findings, they are not before this Court, and they have no bearing on the issues that are.

A decision from this Court on those issues is urgently needed. Several dozen cases will be directly affected by the Court's action. But that is not all. As confirmed by *amici curiae*, three national associations whose members provide services to ERISA plans, the effects of the Sixth Circuit's decision will be felt throughout the industry—causing uncertainty and risk that will lead to increased prices for ERISA plan participants. Br. of Blue Cross Blue Shield Ass'n, *et al.* as *Amici Curiae* 14-15. The petition should be granted.

I. THIS COURT'S REVIEW IS NEEDED TO CLARIFY THE STATUS OF SERVICE PROVIDERS TO ERISA PLANS.

Hi-Lex is right that BCBSM has no "quarrel" with the "rule of law" that "'[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.'" BIO 19-21 (quoting *Seaway Food Town* v. *Med. Mut. of Ohio*, 347 F.3d 610, 619 (6th Cir. 2003)). Nor does BCBSM quarrel with the courts—including the Second and Seventh Circuits—that follow that rule. See *id.* at 19-20. The problem is that the Sixth Circuit did not follow that rule—but eviscerated it.

According to the Michigan Court of Appeals, the Administrative Services Contract "expressly provided for the collection of" the disputed fees, and further provided that the fees would be "reflected in the hospital claims cost contained in 'Amounts Billed'" and were "readily ascertainable" by applying "objective" factors. *Calhoun Cnty.*, 824 N.W.2d at 210-12. Thus, the contract expressly granted BCBSM the right to

retain funds in an ascertainable, objectively determined amount as compensation for its services.

Application of the "rule of law" Hi-Lex cites therefore should have been straightforward: BCBSM adhered to the express contract term that gave it the right to collect fees. That, according to the Second, Seventh, and Eighth Circuits, does not give rise to fiduciary status.

The Sixth Circuit adopted a very different rule. It held that adherence to a contract term that provides for a right to compensation imposes fiduciary status under ERISA *if that right could be waived*. Pet. App. 5a-6a (holding that uniform fees were "discretionarily imposed" upon Hi-Lex because BCBSM had "waived" them for others). Thus, under the Sixth Circuit's rule, exercise of a *waivable* right to compensation gives rise to fiduciary status. But, *any* contract right is waivable. So, according to the Sixth Circuit's reasoning, exercise of *any* contract right to compensation gives rise to fiduciary duty. The Sixth Circuit's decision thus directly conflicts with decisions of multiple other circuits.

For example, in *Harris Trust & Savings Bank* v. *John Hancock Mutual Life Insurance Co.*, the Second Circuit rejected an ERISA claim where a third-party administrator unilaterally retained an "agreed on" fee—without regard to whether the fee could have been waived. 302 F.3d 18 (2d Cir. 2002). See also Pet. 18-19. Similarly, in *Chicago District Council of Carpenters Welfare Fund* v. *Caremark, Inc.* ("*Carpenters*"), Caremark administered pharmacy claims for Carpenters, and obtained rebates and discounts from pharmaceutical providers for products purchased for Carpenters' participants—yet passed only a portion of those rebates and discounts on to Carpenters. The Seventh Circuit held that this did not create fiduciary

status because "Caremark was not obliged to pass along all of the savings" under the contract—again without regard to whether Caremark could have waived its right to retain the discounts. 474 F.3d 463, 474-75 (7th Cir. 2007).

Hi-Lex attempts to distinguish *Carpenters* by arguing that Caremark did not have "the right to change the prices" Carpenters paid "unilaterally." BIO 21. Nor did BCBSM. The Michigan Court of Appeals confirmed that the disputed fees were definite in amount and determined using objective factors. *Calhoun Cnty.*, 824 N.W.2d at 212. The Sixth Circuit did not disagree; it held instead that BCBSM was a fiduciary because it had *waived* fees for other customers—not because it had discretion to set them unilaterally. Pet. App. 5a-6a.

The Sixth Circuit's decision on plan assets is equally at odds with other circuits. In the Second, Seventh, and Eighth Circuits, funds that an ERISA plan has remitted to a service provider to satisfy an invoice are not "assets" of the plan. See Pet. 22-23. Instead, the money is payment for a contract right. While the plan gains a right to performance, it has no property interest in the money. This is true even if the contract requires the service provider to pay others who provide services to the plan. Thus, in *Carpenters*, Caremark received money from Carpenters, and was contractually required to pay for drugs purchased by plan participants. However, the money in Caremark's possession was *Caremark's* property—even though some of it would ultimately be used to pay participants' claims. Caremark had a "contractual duty" to Carpenters, but "was controlling its own assets." 474 F.3d at 476 n.6.

The Sixth Circuit did not apply this rule. Instead, it held that the money Hi-Lex remitted to BCBSM

constituted plan assets because "the funds [Hi-Lex] sent to BCBSM were … spent covering the health expenses and administrative costs of plan beneficiaries," and because enrollees made "initial benefit claims to BCBSM, which has both the funds and the discretion to pay the claims." Pet. App. 8a-9a.[1] But under *Carpenters* and other decisions, the mere fact that BCBSM had a contractual duty to administer and pay Plan participants' claims does not transform BCBSM's assets into Plan assets.

Hi-Lex argues that "none of the decisions cited by BCBSM involve an analogous factual situation." BIO 22. According to Hi-Lex, "[t]he plan documents, the parties' conduct, and common sense show that BCBSM accepted the funds, intending to use them 'to pay the health expenses and administrative costs of enrollees in the Hi-Lex Health Plan.'" *Id.* at 22-23 (quoting Pet. App. 10a). In fact, the contract and Plan documents make explicit that the funds BCBSM "accepted" were *not* assets of the Plan. The contract was between BCBSM and Hi-Lex Corporation—not the Plan. Pet. 15. The Plan documents specified that Hi-Lex's payments came from "'the general assets of

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[1] Only the Ninth Circuit has similarly held that a service provider's ability to make initial claim determinations creates fiduciary status. Pet. 22 (citing *IT Corp.* v. *Gen. Am. Life Ins. Co.*, 107 F.3d 1415, 1420-21 (9th Cir. 1997)). Other circuits have repeatedly rejected this approach, including most recently the Third Circuit, which held just last week that a service provider did not assume fiduciary status by making initial changes to investment options available to plan participants, even though the changes altered the service provider's fees. *Santomenno* v. *John Hancock Life Ins. Co. (U.S.A.)*, __ F.3d __, 2014 WL 4783665, at *7-8 (3d Cir. Sept. 26, 2014) (noting that "ultimate authority still resided with the trustees, who had the choice whether to accept or reject John Hancock's changes").

the Company'"—not from a "'special fund or trust.'" *Id.* Hi-Lex, like the Sixth Circuit, ignores these facts.

The Sixth Circuit's approach will convert virtually every service provider into an ERISA fiduciary. Unlike nearly every other circuit, an express contract—even one held to be definite and enforceable under state law—offers no protection in the Sixth Circuit.[2]

II. THIS COURT'S REVIEW IS NEEDED TO CLARIFY THE MEANING OF § 1108(c).

The Sixth Circuit acknowledged the disagreement among the circuits on the interpretation of § 1108(c). Pet. App. 18a (recognizing conflict with *Harley* v. *Minn. Mining & Mfg. Co.*, 284 F.3d 901, 908-09 (8th Cir. 2002)). Hi-Lex seeks to minimize the split by arguing that the Eighth Circuit is an "outlier," that agency regulations resolve any "ambiguity," and that reversing the Sixth Circuit on this point would have no effect in this case. Hi-Lex is wrong in all respects.

First, the Eighth Circuit is not the only court of appeals to read § 1108(c) according to its terms. As dis-

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[2] Hi-Lex erroneously argues that BCBSM is collaterally estopped by the decision in *Pipefitters Local 636 Insurance Fund* v. *Blue Cross & Blue Shield of Michigan*, 722 F.3d 861 (6th Cir. 2013). BIO 18-19. Hi-Lex did not raise issue preclusion below, so it is forfeited. *See Exxon Mobil Corp.* v. *Saudi Basic Indus. Corp.*, 544 U.S. 280, 293 (2005); *McKithen* v. *Brown*, 481 F.3d 89, 104-05 (2d Cir. 2007). In any event, the issues are not the same. Pipefitters and Hi-Lex had separate contracts with BCBSM (albeit with overlapping terms), which is determinative for issue preclusion. *See* 18 *Moore's Federal Practice* § 132.02[2][a] (3d ed. 2014) ("issue preclusion does not carry the interpretation of one written agreement over to another, even when the terms are much the same"). To the extent *Pipefitters* is relevant here, it demonstrates that the Sixth Circuit will not correct its misreading of ERISA without this Court's intervention.

cussed in the petition, Pet. 25, the Second Circuit has also concluded that § 1108(c)(2) exempts from § 1106(b)'s prohibitions a fiduciary's receipt of reasonable compensation for "services rendered to a plan and paid for by a plan." *Lowen* v. *Tower Asset Mgmt., Inc.*, 829 F.2d 1209, 1216 & n.4 (2d Cir. 1987). As the Second Circuit explained:

> By its express language, [§ 1108(c)(2)] permits "compensation from such plan" only for the performance of services "with the plan."
>
> … [T]he Conference Report on ERISA provides that: "[ERISA] specifically allows *the plan* to pay a fiduciary or other party-in-interest reasonable compensation (or reimbursement of expenses) for services rendered to *the plan* if the services are reasonable and necessary." This language indicates that the services exempted under [§ 1108(c)(2)] are services rendered to a plan and paid for by a plan for the performance of plan duties….

Id. (second alteration in original) (citation omitted) (quoting H.R. No. 93-1280 (1974) (Conf. Rep.), *reprinted in* 1974 U.S. Code Cong. & Admin. News 5038, 5092).

Hi-Lex does not attempt to reconcile *Lowen* with the Sixth Circuit's decision. Ignoring *Lowen*, Hi-Lex simply asserts that "[e]very court to address the issue" other than the Eighth Circuit has concluded that § 1108(c)(2)'s "reasonable compensation defense does not apply to" § 1106(b). BIO 25. Hi-Lex is wrong. The split has only deepened since *Lowen* was decided. See Pet. 24-26.

Second, the Department of Labor's regulation does not "give[] all the guidance that is needed." BIO 25. Indeed, the regulation was promulgated in 1977, and

failed to prevent the current circuit split. See 42 Fed. Reg. 32389, 32393 (June 24, 1977). Moreover, the circuit courts cannot even agree concerning the proper treatment of the regulation. According to the Third Circuit, the regulation "'clarif[ies] what constitutes reasonable compensation for such services,'" and "is a reasonable construction of the statute insofar as it relates to the § [1106(b)] prohibited transactions." *Nat'l Sec. Sys., Inc.* v. *Iola*, 700 F.3d 65, 96 (3d Cir. 2012) (alteration in original), *cert. denied sub nom. Barrett* v. *Universal Mailing Serv., Inc.*, 133 S. Ct. 1812 (2013). The Eighth Circuit, by contrast, found the regulation "ambiguous" and specifically rejected the argument Hi-Lex advances because it requires a "reading of the ambiguous regulation [that] conflicts with an unambiguous statute." *Harley*, 284 F.3d at 909.

The Eighth Circuit's reading of the "unambiguous" text is correct. Pet. 24-28. Section 1108(c) is titled "Fiduciary benefits and compensation *not prohibited by section 1106*" and states that "*[n]othing in section 1106* of this title shall be construed to prohibit any fiduciary from … receiving any reasonable compensation for services rendered … in the performance of his duties with the plan." 29 U.S.C. § 1108(c) (emphases added). This text cannot mean anything other than that payment to fiduciaries of "reasonable compensation for services rendered" is "not prohibited by section 1106." The Sixth Circuit's interpretation cannot be reconciled with the text.

Finally, Hi-Lex incorrectly argues that if the Sixth Circuit's decision as to reasonable compensation were reversed, "BCBSM would still be liable for the entire amount of damages awarded" because of the finding of liability under § 1104. BIO 23. Neither lower court addressed what remedy would apply to the

§ 1104 violation alone, and neither suggested that it was unnecessary to decide the reasonable compensation question because the remedy would be the same regardless. The Sixth Circuit plainly did not view its interpretation of § 1108(c)(2) as mere *dicta*, but took a decisive position contrary to another circuit's. Moreover, the district court—the only lower court that discussed § 1104 in any detail—understood the § 1104 violation to be limited to disclosure issues, Pet. App. 84a, which would presumably call for a lesser remedy than disgorgement of all disputed fees. No matter what remedies might ultimately be appropriate, this Court's review is needed to resolve the circuit split, and to correct the Sixth Circuit's erroneous reading of the statute.

III. THIS COURT'S REVIEW IS NEEDED *IN THIS CASE.*

The Court's review of the stark conflict among the circuits on both questions presented here is needed urgently. Dozens of pending cases will turn directly on the Court's resolution of *this petition*. Pet. 29-30. For that reason alone, any delay for further "percolation" would allow the Sixth Circuit's erroneous decision to have huge, immediate, and disastrous effect.

Moreover, the effect of that decision will extend well beyond cases already pending. *All* ERISA service providers will be forced to grapple with the Sixth Circuit's new federal rule of contract interpretation—and the costs will ultimately flow to plan participants. As *amici* note, "[t]he ability affordably to outsource the countless ministerial functions required in the administration of large, often multi-state, plans is of enormous importance to the smooth functioning of ERISA plans nationally," yet the uncertainty caused by the decision below "will likely result in higher administrative costs (or reduced services) to self-insured

employers, as third-party administrators and other service providers are forced to adjust their business model." Br. of *Amici Curiae* Ass'ns 14-15. This will redound "to the ultimate detriment of ERISA plan beneficiaries." *Id.* at 15.

Hi-Lex argues that the facts of this case are "unique." BIO 28. As discussed above, the facts Hi-Lex recounts have no bearing on the issues before this Court. As for the questions that *are* presented, there is nothing unique in Hi-Lex's agreeing to contract terms that provide BCBSM a right to compensation for its services. To the contrary, service providers across the nation routinely enter into such contracts, and they do so with the "explicit understanding," and for the purpose of ensuring, that "they are not plan fiduciaries and will not be handing plan assets." Br. of *Amici Curiae* Ass'ns 14. The Sixth Circuit's decision casts a pall on all of those agreements.

CONCLUSION

The petition for a writ for certiorari should be granted.

Respectfully submitted,

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