Creditors Are Not Freeloaders:

The Common Fund Doctrine Does Not Apply to Hospital Lienholders

The Illinois Supreme Court's *Wendling* decision holds that hospital lienholders are creditors, not third-party beneficiaries of the plaintiff's lawsuit, and thus not required to pay attorney fees under the common fund doctrine.

By Robert D. Kreisman

In *Wendling v Southern Illinois Hospital Services*,[1] the Illinois Supreme Court held that hospital lienholders are not required to contribute to the plaintiffs" attorney fees under the common fund doctrine. In so doing, the high court definitively ruled that health care lienholders are creditors and thus not third-party beneficiaries of the plaintiff's recovery for common-fund purposes.

Among other things, the *Wendling* court observed that 1) the Health Care Services Lien Act[2] gives health care providers who administered services to an injured plaintiff "a lien upon all claims and causes of action of the injured person for the amount of the health care professional's or health care provider's reasonable charges,"[3] and 2) the common fund doctrine has never been applied to a creditor-debtor relationship, such as a hospital and its patient – which is to say that a creditor is not a third party for whom recovery was only possible because of the attorneys' efforts.

While *Wendling* is the most direct and recent statement of this principle, the decision lines up with established Illinois law. This article reviews *Wendling*, the rationale behind it, and the precedent upon which it was based.

The common fund doctrine

First, some background: the common fund doctrine is an exception to the general rule that each party in litigation is responsible for paying its own attorney fees and costs. Under the doctrine, if a common fund created through the efforts of attorneys representing litigants ends up benefiting a third party, then the attorney who created the fund can recover reasonable attorney fees and costs from those additional parties as payment for the benefit they received.[4]

The common fund doctrine was es-

1. 242 Ill 2d 261, 950 NE2d 646 (2011).
2. 770 ILCS 23/1 et seq.
3. *Wendling* at 263, 950 NE2d at 647, quoting Health Care Services Lien Act at 23/10(a).
4. *Morris B. Chapman & Associates, Ltd v Kitzman.* 193 Ill 2d 560, 572, 739 NE2d 1263, 1271-72 (2000).

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tablished to prevent the unjust enrichment of third parties. Essentially, it prevents third parties from freeloading on the efforts of lawyers and their clients.[5] The doctrine itself comes from an equitable concept that the attorney whose efforts led to the recovery in the personal injury action should, in good conscience, be granted fees out of the whole fund.[6]

The *Wendling* cases

The facts. The plaintiffs, Sherry Wendling and Nancy Howell, were injured in separate automobile accidents. Each filed a lawsuit against a different tortfeasor. Both plaintiffs received medical care at and hospital lien notices from hospitals owned by Southern Illinois Hospital Services pursuant to the Health Care Services Lien Act ("Act").

The Act states that the total amount of all health care liens may not exceed 40 percent of the judgment or settlement. If, however, the 40 percent limit leaves health care providers less than fully compensated, they may pursue alternate means to recover the full amount of their lien.

For example, if the settlement amount is $50,000 but the hospital's reasonable charges to the injured plaintiff were $30,000, the limit of the hospital lien is $20,000, or 40 percent of the $50,000 settlement. However, the hospital could still seek the unpaid $10,000 balance from the plaintiff in a separate claim or lawsuit. Incidentally, the Attorneys Lien Act[7] limits the amount of attorney fees to 30 percent, or $15,000 in this example.

Following the settlement of each case in *Wendling*, the plaintiffs' attorneys filed petitions to adjudicate the liens. If the amount set aside to pay those health care liens were classified as part of the common fund, then the hospital might have been required to contribute to attorney fees. Note that doing so would not have enriched the plaintiffs' lawyers, whose attorney fee contract was limited to a percentage of the recovery, but would have increased the take-home amount for their clients. In other words, if the hospital were required to pay part of the $15,000 attorney fees, the client would pay less and retain a larger amount of the settlement.

Trial and appellate court holdings. The trial court agreed with the plaintiffs, holding that the hospital's recovery for its lien should be reduced by one third, with that amount going to attorney fees and costs. The court reasoned that the hospitals directly benefited from the lawyers' work.

The hospitals appealed first to the Illinois Appellate Court. The fifth district affirmed the trial court's reasoning that hospital liens were part of the common fund, and as such, that the hospital was responsible for paying a pro rata portion of the attorney fees.[8]

In so doing, the appellate court distinguished the 1979 case *Maynard v Parker*.[9] The supreme court in *Maynard* held that the common fund doctrine's purpose is to make matters equitable for all parties involved. This is based on the premise that it is unfair for one party to benefit from a lawsuit if it is not also responsible for contributing to the cost of the litigation. Therefore, the common fund doctrine does not apply except when there is unjust enrichment.

While the fifth district acknowledged that the facts in *Wendling* were like those in *Maynard*, it opined that *Maynard* was superseded by the 2002 case *Bishop v Burgard*,[10] where the Illinois Supreme Court laid the foundation for extending the common fund doctrine to debtor-creditor relationships.[11]

Supreme court ruling. The Illinois Supreme Court in *Wendling* plainly rejected this explanation, stating that the "appellate court's interpretation of *Bishop* is incorrect."[12] The court further stated that Illinois had never applied the common fund doctrine to debtor-creditor relationships.

The supreme court in *Wendling* reviewed the *Maynard* decision and its parallel facts. In both *Wendling* and *Maynard*, the plaintiffs settled their personal injury cases and filed subsequent petitions to adjudicate the health care liens. In each case, the trial court ordered the hospitals to pay or have their liens reduced by one-third to pay the plaintiffs' attorneys.

The appellate court in *Maynard* reversed, holding that the hospital did not have to pay a portion of the plaintiff's attorney fees. The supreme court in *Maynard* affirmed, distinguishing the hospital's lien from cases where beneficiaries of the common fund would not have recovered had no fund been created in the first instance.

The supreme court reasoned that the hospital's lien was distinguishable on several fronts: 1) the lien was limited by the Health Care Services Act to 40 percent of the plaintiff's recovery, 2) a creditor-debtor relationship was established between the hospital and patient, and 3) the hospital was not dependent on the plaintiff's recovery to collect payment.

In the *Wendling* appeal to the supreme court, the plaintiffs argued for overturning *Maynard*. The supreme court refused, holding that plaintiffs "presented no compelling reason to depart from our long-standing precedent, which until the appellate court's decision in the instant case, has been consistently followed by Illinois courts."[13]

Since a creditor does not rely on the creation of a common fund to recover from the debtor plaintiff, it is not unjustly enriched by the plaintiff's recovery.

The lienholder-plaintiff relationship

The supreme court has now made clear that the nature of a lienholder's relationship to the plaintiff is the key factor to consider when evaluating whether the common fund doctrine applies. In *Bishop*, the plaintiff was injured in an automobile crash. Her medical bills were paid by her employer's ERISA plan, which in turn issued a lien for the medical expenses it had paid.

When *Bishop* settled, the plaintiff's attorney sought payment of his fees from the plan under the common fund doctrine. The Illinois Supreme Court found that the doctrine did apply because the

5. *Howell v Dunaway (v Wendling)*, 398 Ill App 3d 1078, 1080, 924 NE2d 1190, 1192-93 (5th D 2010).
6. *Bishop v Burgard*, 198 Ill 2d 495, 506, 764 NE2d 24, 32 (2002).
7. 770 ILCS 5/1 et seq.
8. *Howell (v Wendling)* at 1080, 924 NE2d at 1192.
9. 75 Ill 2d 73, 387 NE2d 298 (1979).
10. *Bishop* at 509, 764 NE2d at 33.
11. *Howell (v Wendling)* at 1082, 924 NE2d at 1194.
12. *Wendling* at 268, 950 NE2d at 650.
13. Id at 265, 950 NE2d at 649.

plan would have had no funds to recover if not for the efforts of the plaintiff's attorney.

But unlike the ERISA plan in *Bishop*, which could recover only from the proceeds of the lawsuit, the hospital lienholders in *Wendling* had other ways to collect from patients. Hospitals can employ collection agencies or hire their own attorneys to pursue payment. If they cannot recover the full amount of their liens through a civil lawsuit because of the 40 percent cap, they may "'pursue collection, through all available means, of its reasonable charges.'"[14]

Because of its creditor-debtor relationship with the patient, the hospital in *Wendling* was entitled to payment of its liens regardless of the outcome of the lawsuit.

This distinction in the relationship between the lienholder and the litigant is determinative. Because of the creditor-debtor relationship that existed between the hospital and the patient/injured plaintiff in *Wendling*, the hospital was entitled to payment of its liens, regardless of the outcome or whether a lawsuit was even filed.

The *Maynard* precedent

The *Wendling* supreme court decision followed the precedent established in *Maynard* that the common fund doctrine does not apply to lienholding hospitals. In *Maynard*, the court held that "a debtor [is] obligated to pay for the services rendered…out of any resources which might become available."[15] Since a creditor does not rely on the creation of a common fund to recover from the debtor plaintiff, it is not unjustly enriched by the plaintiff's recovery.

The court also reasoned that the common fund doctrine had no place in the health care lien setting because the act limits the health care provider to 40 percent of the settlement or recovery and thereby keeps the hospital from being unjustly enriched. In addition, the hospital lienholder has no standing in the underlying case; that is, it has no way to bring its own action against the wrongdoer. Compare that to the subrogee who has a contractual right to pursue a claim against the plaintiff to recover its outlay.

Therefore, while hospitals and health care professionals and providers can recover liens by means of a settlement or judgment, they are not obligated to contribute to a plaintiff's attorney fees under the common fund doctrine. They have not reaped the benefits of another's work, and thus have not been unjustly enriched.

The *Wendling* decision was not revolutionary. The supreme court's interpretation has been adopted and upheld in numerous other states. For example, a Colorado court held that "the hospital's right of collection on its lien flows from the personal injury litigation, but its cause of action does not. The defendants' cause of action or right to payment arose from the provision of medical care to [plaintiff] for which he agreed to pay, regardless of the outcome of the personal injury action."[16]

When does the common fund doctrine apply?

Wendling confirms that the common fund doctrine does not apply to hospital lienholders. It does, however, apply in health insurance subrogation matters, class actions, and wrongful death cases involving an intervenor.

Wrongful death. For example, in the wrongful death case of *Chapman & Associates, Ltd v Kitzman*,[17] the decedent's estate changed attorneys shortly before the case was settled. Since the original plaintiff's attorney had created the settlement fund, he was able to recover his fees under the common fund doctrine.

In *Wendling*, however, the hospital was the injured plaintiff's creditor, making the plaintiff its debtor. The debtor owed the hospital for its medical services irrespective of the lawsuit. Therefore, there was no unjust enrichment as a result of the attorney's efforts since the plaintiff's obligation to pay her creditor was not altered by the lawsuit. In *Chapman*, on the other hand, there would be no settlement fund without the original attorney's efforts, and therefore the substitute attorney would be unjustly enriched by the original attorney's services.

Insurance subrogation. The common fund doctrine also applies in lawsuits involving insurance subrogees. Again, while the insurance subrogee can bring its own cause of action against the party defendant, a hospital lienholder cannot.

Suppose an insured delivery truck driver injured the plaintiff in a crash. A settlement was subsequently reached for $30,000. The injured plaintiff's health insurance has paid $10,000, representing all of his medical bills. The attorney's fee contract with the plaintiff is for one-third of the recovery.

The health insurance company wants to recover back some or all of its outlay of $10,000 for the medical bills. A common fund was created by the efforts of the lawyer and the plaintiff. In this example, the common fund doctrine would apply and the plaintiff's attorney would be entitled to a fee and a portion of costs on the health insurer's subrogation claim.

The legal precedent for this has been established in *Taylor v American Family Ins Group*.[18] The *Taylor* decision stands for the proposition that a plaintiff's attorney is entitled to one-third of the total amount of the health insurer's subrogation claim. *Taylor* benefited the plaintiffs, increasing the amount of their bottom line recovery by holding other parties responsible for paying a portion of the attorney fees rather than placing the burden solely on them.[19]

To recover under the common fund doctrine, a third party is required to send notice of its interest in the form of a lien or subrogation claim. However, these liens are not limited to private entities, such as insurance companies and in class actions. Public entities, such as the Illinois Department of Public Aid, can submit public aid liens on the recovery of the plaintiff's personal injury settlement or judgment where they have paid for some or all of the medical treatment. If the lawsuit or claim then results in a recovery for the plaintiff, and in turn the public aid department, the department would be responsible for contributing to attorney fees to reimburse the attorney's

14. Id at 270, 950 NE2d at 651, quoting Health Care Services Lien Act, 770 ILCS 23/45.
15. *Maynard* at 75, 387 NE2d at 300.
16. *Trevino v HHL Financial Services, Inc,* 945 P2d 1345, 1349 (Colo 1997).
17. 193 Ill 2d 560, 739 NE2d 1263 (2000).
18. 311 Ill App 3d 1034, 725 NE2d 816 (5th D 2000).
19. Id at 1039, 725 NE2d at 820.

efforts in setting up the common fund.[20]

An affirmation of existing law

Wendling has ruled out health care liens as part of the common fund analysis. The supreme court's decision lines up consistently with established Illinois law.

Those who have assumed that the settlement or recovery of a plaintiff's personal injury case creates a common fund subject to attorney fees to all third parties holding liens and seeking reimbursement must rethink that assumption. Only where the court finds that the third party has been unjustly enriched by the plaintiff's attorney's work will the common fund doctrine apply. ■

20. See *Scholtens v Schneider,* 173 Ill 2d 375, 385, 671 NE2d 657, 662 (1996), quoting *Boeing Co v Van Gemert*, 444 US 472, 478 (1980).