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THE EROSION OF ERISA SUBROGATION RIGHTS

By: Gary L. Wickert

Those of us who recall the early days of ERISA and health insurance subrogation may recall the overall confusion and chaos which surrounded all ERISA litigation, including subrogation. Over time, ERISA and health insurance subrogation rights were gradually strengthened, as were its preemption provisions. Virtually every state bowed to the preemptive language of ERISA group benefit Plans. The logic behind this was that different state laws would provide different results, and uniformity of results was desired. Over the last several years, however, the once impenetrable subrogation rights which fell under the ERISA umbrella have been victimized by a process of court-sponsored erosion. Federal trial and appellate courts have taken chinks out of the ERISA subrogation armor to the point where it is now incumbent upon subrogation professionals to recognize ERISA vis-a-vis the various venues they are being handled in.

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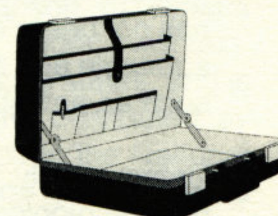
BRIEFCASE NOTES-
NEW CASE LAW



Assignment of Subrogation Interest Negated

Reed v. Bradley, 2000
WL 1030327 (Wis. App. July 27, 2000).

In this interesting subrogation case, Scott and Julie Reed were injured in an automobile accident when they were struck by another vehicle. Scott and Julie Reed's auto insurance carrier, State Farm, paid their medical in the amount of $2,978.00. The Reeds filed suit against the other driver, who was insured by American Family Insurance Company. Liability was clear, but American Family was able to

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A look at the gradual erosion of ERISA subrogation must start with the basic premise that when medical expenses have been paid by an employer's group medical benefits Plan, the rights of the Plan are governed by the Employee Retirement Income Security Act of 1974 (ERISA). This act generally preempts state law from applying when that state law is "related" to ERISA Plans. The effect of ERISA preemption is that the provisions of the Plan are allowed to control, rather than provisions of state law.

For subrogation purposes, this ERISA preemption has historically protected subrogors from the harsh effects of several state subrogation defenses used prolifically by plaintiffs' attorneys and others attempting to circumvent your subrogation rights. These include the *Common Fund Doctrine* which usually entitles a plaintiff's attorney to a portion of fees or costs out of the subrogated recovery, the Made Whole Doctrine, which prevents a subrogor from recovering a subrogated amount where the insured has not been *"made whole"*, as well as other equitable and statutory subrogation-busters such as anti-subrogation statutes.

Unfortunately, recent court decisions have begun chipping away at ERISA subrogation rights. In the area of the *Made Whole Doctrine*, some courts have held that the Plan language must now expressly claim recovery priority in order to be entitled to first dollar recovery. These decisions look at the language of the Plan to determine if the Plan specifies whether the Made Whole rule applies, whether there is a pro rata sharing of proceeds or whether the Plan gets paid "off the top." If the Plan does not *clearly* specify an allocation scheme, recent court decisions have held that the *Made Whole Doctrine* may apply. This is true in such venues as the 9th and 11th Circuits, and Ohio, Arkansas and Oklahoma, where state courts have decided cases accordingly. On the other hand, many courts have resisted applying the *Made Whole Doctrine* to ERISA subrogation cases. These courts, which include the 5th Circuit and the State of Texas, view the *Made Whole Doctrine* as preempted, either because it is a state law rule, or because the Plan does not specify a priority for allegation of the proceeds.

ERISA requires a disclosure document to make a Plan available and comprehensible to covered persons. Known as the Summary Plan Description (SPD), if this document contains a subrogation right that differs from the Plan language, the SPD may be held to be controlling. This is another area where courts have attempted to continually chip away at ERISA subrogation rights.

Where the Plan is silent about costs and attorneys' fees, some courts have held that the Plan is responsible for paying a portion of the plaintiffs' attorneys' fees and costs. Other courts have held that a Plan need not contain express language about such matters and need not pay costs and fees. Again, venue matters. In the 3rd Circuit, the *Common Fund Doctrine* does not apply if the Plan claims subrogation rights against "all rights of recovery" or reimbursement out of "any monies paid". In addition, the 3rd Circuit disallows application of the *Common Fund Doctrine* whenever there is "full reimbursement" language in the Plan. The 4th Circuit disallows application of the *Common Fund Doctrine* whenever the Plan calls for repayment of "the lesser of the total recovery or the amount paid by the Plan."

On the other hand, the 6th and 8th Circuits allow the application of the *Common Fund Doctrine* and charge the Plan for costs and attorneys' fees where the Plan does not address it and the Plan administrator has no

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discretion to interpret the Plan language. These same decisions mention that the *Common Fund Doctrine* will not apply if the Plan language clearly prohibits its application.

On the far end of the spectrum, the 7th Circuit seems destined to apply the *Common Fund Doctrine* under almost any circumstances, unless the Plan specifically and categorically rejects the application of the *Common Fund Doctrine*. The cases in the 7th Circuit seem to apply the logic that the *Common Fund Doctrine* is not "related to" the Plan, and therefore should not be preempted.

Further erosion of the ERISA subrogation rights occurs with regard to the issue of how an ERISA Plan goes about recovering its lien. Some cases in the 11th Circuit hold that the ERISA statute does not provide a cause of action for a Plan to sue an employee to recover its subrogated interest. Courts in Kentucky and Louisiana have held that a Plan cannot sue in state court because of federal preemption. The 9th Circuit and the State of North Carolina both seem to protect a plaintiff's attorney from having to pay back a portion of the Plan where he settles without repayment of the lien, despite the fact that he knew about the ERISA Plan subrogation rights. The 6th Circuit has held that a Plan cannot make a third-party insurance carrier pay your subrogated interest directly where the carrier has already paid the covered employee in settlement, even though the third-party carrier knew about the Plan's claim.

While the volume of law applicable to these issues is far more extensive than can be covered in this newsletter article, it is important to remember that ERISA is not the bastion of subrogation safety it once was. Health insurance carriers and subrogation personnel must now zealously act timely and effectively to protect subrogation rights in the face of weak Plan language or creative arguments from plaintiffs' attorneys. The best advice continues to be getting significant subrogation matters into the hands of subrogation counsel as soon as is practicable and continually improving and strengthening your Plans' subrogation-related language. Should you have any questions regarding ERISA health insurance subrogation or the application of ERISA law to your company's subrogation programs, please do not hesitate to contact Gary Wickert at gwickert@mohr-anderson.com.

SUBROGATION SEMINAR MATERIALS NOW AVAILABLE

Mohr & Anderson, S.C. is pleased to announce that it has the following subrogation seminar resource materials available for clients:

Advanced Concepts in Workers' Compensation Subrogation. This is a detailed summary of issues and law dealing with subrogating workers' compensation third party claims in fifty states. It includes a cross-section and comparison of various issues as dealt with under workers' compensation laws of various states, and is the same material recently distributed by Gary Wickert at his speech at the National Association of Subrogation Professionals (NASP) Convention in Orlando.

Subrogating Health Insurance and ERISA-Qualified Medical Benefit Plans. This is an exhaustive look at the complex issues confronting health insurers subrogating both self-funded ERISA Plans and insured health Plans (non-ERISA qualifying) in fifty states. It includes a survey of laws from all circuits.

These bound publications are available free of charge to subrogation clients of Mohr & Anderson, S.C. Please contact Jamie

(Subrogation Seminar Material Available - Continued from Page 3)

Breen at (800) 637-9176 if you would like a copy of one or both of these resource materials, or if you have an interest in a presentation of a subrogation seminar.

NEW MEXICO FIRE SUBROGATION

We have begun subrogating property damage claims resulting from the Los Alamos fire catastrophe in New Mexico. Working with local counsel in Houston, Texas and Albuquerque, New Mexico, we would be delighted to assist you in promptly recovering any property damage losses you have paid on this year. Time is of the essence. If you should have any questions regarding subrogating the New Mexico fires, please do not hesitate to call Gary Wickert at (800) 637-9176 or e-mail him at gwickert@mohr-anderson.com.

SUBROGATING DEFECTIVE FIRESTONE TIRES

On August 8, 2000, Bridgestone Corporation recalled 6.5 million Firestone brand tires, the second largest tire recall in U.S. history. They did this in response to complaints that the tires may be linked to fatal crashes involving sport utility vehicles. This recall came amidst intense pressure from major tire retailers, safety advocates and government regulators to pull the tires after receiving reports that the tires may be linked to as many as 46 deaths and hundreds of accidents. It is also costing the insurance industry untold millions of dollars in property damage, damage which might easily go unsubrogated. Subrogation personnel should be reminded to dig deeper in any single car rollovers, automobile accidents, or other incidents which may involve a defective tire, in order to determine the brand and Department of Transportation Code on the tires. If possible, any potential defective tire should be immediately marked, confiscated and\or purchased, and kept for safekeeping pending subrogation efforts.

In order to determine if the tire involved in your claim is related to the Firestone Tire recall, either look yourself or have your insured look on the inside wall of the tire where you will find a serial number. If that serial number starts with the letters VD, it was built at the Decatur, Illinois plant and is subject to recall. To be absolutely certain you are dealing with defective Firestone tires, go to the website http://www.nhtsa.dot.gov/cars/rules/manufacturer. Once there, all you will have to enter is the first two digits in the Department of Transportation ID Box and click the search button. Scroll down until you come to the "Tires" area and it will tell you where your tires were manufactured. Any tires manufactured in Decatur, Illinois are the ones that need replacing. Specific questions can be addressed to the Firestone Customer Service Center at (800) 465-1904.

Product liability subrogation efforts in these cases, which might otherwise be quite expensive, may become less expensive and easier to subrogate because of the volume of claims which will be made against Firestone\Bridgestone. Having handled many defective tire losses in the past, I am confident that Ford Motor Company may be involved because of recommendations they made for keeping tires under inflated on sports utility vehicles. Under-inflated operation of any tire generates excessive heat on either side of the crown of the tread, which can result in failure and separation of

(Subrogating Defective Firestone Tires - Continued from Page 4)

the tread and belts. In addition, the majority of the accidents are occurring in the southern states of Arizona, California, Florida and Texas, which suggests that there might be a direct correlation between heat and tire performance.

Ford has replaced Firestone tires for free on vehicles sold in Venezuela, Ecuador, Thailand, Malaysia, Columbia and Saudi Arabia, after tires failed in those countries. Though not accepting blame, Ford said last week that it swapped tires "as a customer satisfaction issue". Nonetheless, Ford knew that the tires were faulty when they began replacing them in South American countries as long as six years ago, but the companies never alerted U.S. consumers to the dangers.

The recall covers size P235/75R15 in all of the ATXII and some Wilderness AT tires that are currently in use on some of the nation's most popular SUVs. These tires have been the original equipment used on Ford, General Motors, Toyota, and Nissan for several years. However, 60% - 70% of the recalled tires are on the Ford Explorer and its twin Mercury Mountaineer models.

Potential subrogation exists in not only property claims, but also liability, workers' compensation, personal injury protection\med pay subrogation, and health insurance subrogation. Too often, we see a singe car accident or a roll over and assume that it is simply driver inattention or operator error. The Firestone recall provides ample opportunities for subrogation if the appropriate investigation and defective product acquisition is followed through with promptly in claims. Ultimately, it will be up to the front line claims handler to recognize this potential and take the action necessary. If you have any questions regarding subrogating against Firestone or Ford for these incidents, please contact Gary Wickert at 800-637-9176 or at gwickert@mohr-anderson.com.

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negotiate a settlement with regard to State Farm's subrogation interest. American Family agreed to pay 75% of State Farm's $2,978.00 medical subrogation interest, or $2,246.00, in exchange for an assignment from State Farm of its complete subrogation interest.

The case went to trial on stipulated liability and medical, and the jury reached a verdict of $22,978.00 which included the $2,978.00 stipulated in medicals. The Reeds agreed that American Family should get credit for $2,246.00 it paid to State Farm, but argued they should be entitled to the $731.00 difference between the amount that American Family paid for the subrogation assignment and the total amount of the medical. American Family argued that the $731.00 would amount to a double recovery to the plaintiffs because State Farm's subrogation interest in the amount of the full medicals paid had been discharged.

American Family also argued that allowing the Reeds to recover the $731.00 difference would run counter to the established public policy favoring settlements. In short, American Family argues they would not have settled with State Farm if they had known they had been responsible for the entire amount. The trial court found in the Reeds favor and American Family appealed.

The Reeds argued that the collateral source rule–a rule which provides that "a plaintiff is entitled to recover the reasonable and customary charges for past medical expenses without regard to the payment of those expenses or the amount of such payment by a third-party", was applicable in this case. They argue that the recovery of medical costs has a pineal effect on a tortfeasor who should not receive the advantage "gratuities from third-parties".

The Court of Appeals agreed with the trial court. It noted that a plaintiff who has been injured by another person's tortuous conduct

(Briefcase Notes - Continued from Page 5)

is entitled to recover the reasonable value of his or her medical costs which were caused by the injury. A plaintiff is entitled to the value of those medical costs, not the actual charges. The Court of Appeals felt that State Farm's agreement to settle its limited subrogation claim for less than its face value was analogous to the situation where a health care provider sets an injured plaintiff's broken bone for less than the reasonable cost. By applying the Collateral Source Rule, the Court of Appeals awarded the $731.00 difference to Scott and Julie Reed, requiring American Family to pay the entire $2,978.00 in medical expenses, despite the assignment of State Farm's subrogation interest.

The Court of Appeals felt that requiring payment of the $731.00 to Scott and Julie Reed did not run counter to the established public policy favoring settlements. Their logic was that the case would have to be tried anyway. This appears to be questionable logic, and a questionable decision. In addition, this decision detrimentally affects the ability of a third-party carrier to contract with a subrogated automobile carrier who has paid medical, for an assignment of that carrier's subrogated interest.

Despite the Court of Appeal's logic, Scott and Julie Reed would not have been entitled to recover the $2,978.00 anyway. The right to recover that subrogated amount belonged to State Farm. In our opinion, the right of State Farm to contract for an assignment of its cause of action and subrogated interest to another carrier, for a fraction of the value of that interest has been thwarted. In the most logical analysis, Scott and Julie Reed did receive a double recovery. This is because State Farm and American Family exchanged valuable consideration for the assignment of the subrogated interest (American Family received a discount on the amount it would have to pay–or should have, and State Farm relieved themselves of the potential downside of trial, having to wait for trial, etc.).

Historically, subrogors have enjoyed an unfettered right to assign subrogation interests as a tool for effecting a subrogation recovery independent of their insureds. This applies to workers' compensation, property, automobile, and all lines of insurance. Offering to assign a subrogation interest for payment of a fraction or some percentage of a subrogated amount has remained a valuable tool of subrogors who want to avoid the time, expense and uncertainty necessarily attendant with a trial.

In addition, carriers have avoided the harsh application of the *Common Fund Doctrine,* by such means, whereby the plaintiff's attorney was able to make a claim for a percentage of a subrogated amount as a fee or costs. In reality, Scott and Julie Reed received the benefit of State Farm paying $2,978.00 in medical benefits, but were only required to pay back $2,246.00 of those benefits. This thwarts both the letter and the intent of subrogation law in Wisconsin and in many other states.

WORKERS' COMPENSATION SUBROGATION IN AUTOMOBILE NO-FAULT STATES

Workers' compensation subrogation has long held a favored status in most states. With the legislative intent of reducing the burden of insurance on the public and preventing the double recovery for the worker's compensation claimant, worker's compensation subrogation provisions and cases interpreting them has been favored by appellate courts throughout our nation. Only recently have workers' compensation subrogation rights been under attack and their most favored status been threatened

(W.C. Subrogation in Automobile No-Fault States Continued from Page 8)

by extensions of equitable defenses, lien reduction statutes, and most recently, no-fault legislation involving automobile accidents.

Using the State of Colorado as an example, §8-41-203 of the Colorado Workers' Compensation Act is on its face, no different from any other workers' compensation subrogation provision contained in any other state's workers' compensation laws. It provides the workers' compensation carrier subrogation rights against the third party causing the injury, in addition to statutory credit for any amounts which the injured worker receives from the third party.

However, Colorado §10-4-713, known as the Colorado Auto Reparations Act (No-Fault Act), governs the rights and liabilities for personal injuries resulting from automobile accidents. Owners of motor vehicles are required to maintain minimum first party personal injury protection (PIP) insurance coverage, which provides PIP benefits for medical expenses, occupational rehabilitation, lost wages, and death. In the event of an accident, the no-fault insurer pays these first party PIP benefits directly to its insured covered by the policy, regardless of fault. Section 10-4-713 is known as the PIP benefits exclusion, and it destroys subrogation rights by prohibiting persons *eligible* for PIP benefits as well as the no-fault insurer from recovering those PIP benefits from the party responsible for the accident.

If the injured worker brings a third party action against the tortfeasor, the first party PIP benefits paid are excluded from any recovery obtained in that tort action. In a series of Court of Appeals and Supreme Court decisions, the subrogation rights of the worker's compensation carrier were discussed in relation to the no-fault act. The worker's compensation carrier's subrogation rights under §8-41-203 in Colorado are eliminated, to the extent that the worker's compensation benefits do not exceed in amount or duration, the minimum benefits required under Colorado law. These minimum benefits vary, such as medical expenses. For example, minimum medical benefits under the no-fault act are $50,000 for medical benefits paid within a 5-year period of time. Lost wages minimum benefits are a sliding scale, not exceeding $400 per week for a period of 52 weeks.

As a plaintiffs' lawyers for the insurance industry, our views on no-fault may be somewhat different from that of most of your defense or subrogation counsel. No-fault legislation in states like Colorado and Michigan have been enacted as a direct result of a legislative concern with what was perceived to be excessively high costs of the traditional tort liability system.

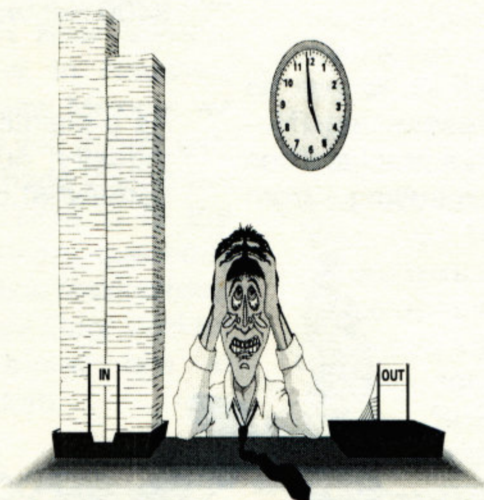
The Association of Trial Lawyers of America has a completely different set of statistics and resulting conclusions as does the Defense Research Institute and other defense bar organizations, and most legislators have enacted no-fault legislation looking at the latter of these two bodies of statistical data.

The downside of no-fault legislation is that it no longer puts the responsibility for an accident and resulting injuries and damages on the party responsible for the accident. Innocent and careful drivers

(W.C. Subrogation in Automobile No-Fault States Continued from Page 7)

with excellent driving records and their insurers now bear the burden of losses under the no-fault system. According to studies published by the National Association of Insurance Commissioners, no-fault states, which were supposed to have their automobile liability premiums reduced as a result of this "innovative" legislation, now have the highest average automobile liability premiums.

In 1995, six of the top ten states with the most expensive insurance had the no-fault systems. According to the same study, no-fault liability premiums rose nearly 25% faster than premiums without no-fault legislation. Of the 15 states with the greatest increases in the nation in auto liability premiums between 1989 and 1995, nine of those states have some sort of no-fault, either mandatory or mixed.



"Will you tell me again what the advantages are of a no-fault system?"

NAIC data demonstrates that repealing no-fault results in substantial rate reductions. Since 1976, no state has adopted a no-fault system. However, since 1989, Connecticut, Georgia, New Jersey and Pennsylvania have repealed their mandatory no-fault laws. Since 1995, ten states had mandatory no-fault laws. Those states include Colorado, Florida, Hawaii, Kansas, Massachusetts, Michigan, New York, North Dakota and Utah. Arkansas, Delaware, Kentucky, Maryland, Oregon, South Carolina, South Dakota, Texas, Virginia and the District of Columbia have mixed or hybrid no-fault systems. In addition, New Jersey and Pennsylvania have optional no-fault systems.

In mixed or hybrid no-fault systems, tort suits and compensation are not restricted. A few states, Pennsylvania, New Jersey and Kentucky, personally provide motorists with so called "choice" plans, for the kind of coverage they may purchase, although each state plan is different and none resemble current federal legislative "choice" proposals.

Initially, no-fault was viewed as a form of universal healthcare. People injured in auto accidents would receive medical care and wage loss, regardless of fault. Insurance benefits for non-economic damages, -"pain and suffering"- was to be limited, in minor accidents only to reduce the associated legal expenses. However, the public's main concern was not for universal health care, but for reducing costs of automobile insurance. No-fault appears to have failed as a means of lowering automobile insurance premiums.

The National Association of Insurance Commissioners recently published a document entitled *State Average Expenditures & Premiums for Personal Automobile Insurance in 1995*, published in January 1997. This is the most recent data available in the effect of no-fault insurance on premiums. The result is a consistent finding that no-fault states have the highest automobile premiums.

Under the no-fault system, both the innocent victim and the person who caused the accident are paid, regardless of who is at fault. Paying both parties is

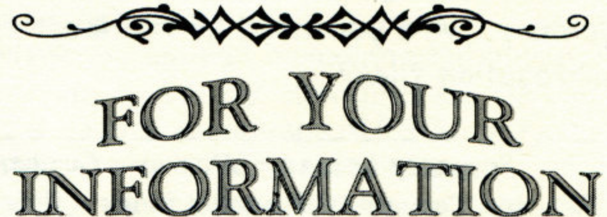
(W.C. Subrogation in Automobile No-Fault States Continued from Page 8)

vastly more expensive than under "tort" systems, in which the liability policy of the at fault driver covers the innocent driver only. There are also more claims, because insurance companies are required to provide the no-fault benefits to whomever requests them, without meeting the safeguards and requirements of the legal system. Additionally, individuals who are not covered by other forms of healthcare, or are hurt at work but want greater benefits than workers' compensation provides, file claims under the no-fault system for injuries or illnesses not caused by the operation of a motor vehicle.

Even more, no-fault insurance does not significantly reduce litigation costs. Litigation of a property damage, which constitutes a large portion of tort claims resulting from automobile accidents, continues through the no-fault system. In addition, suits by motorists against their own insurance company for failure to pay benefits, have skyrocketed in many states such as Michigan. An analysis published in the Insurance Council Journal, a publication for insurance defense attorneys, concluded in July of 1986 that "whatever the advantages of no-fault, a reduction in court cases and court costs would not appear to be one of them".

Workers' compensation insurance subrogation rights must be protected. A system which awards both the innocent victim and at fault party with compensation allow abrogating the innocent worker's compensation insurance companies insurance subrogation rights not only dysfunctional, but contrary to every state's legislative intent with regard to enacting workers' compensation subrogation. As in the example of Colorado, workers' compensation subrogation rights are simply gone, unless and until the benefits it pays exceed the minimum no-fault limits. I believe this effect is not what the legislature intended when enacting the worker's compensation subrogation legislation.

When subrogating for worker's compensation benefits which are paid in conjunction with work-related automobile accidents, be mindful of states which contain no-fault legislation. Coordination of benefits between workers' compensation benefits and no-fault benefits are tricky and often confusing. This leads to obfuscated opinions and resulting laws. If you have any questions regarding the effect of no-fault insurance in a particular state on your subrogation rights, please contact Gary Wickert.



FOR YOUR INFORMATION

SEMINARS

Mohr & Anderson, S.C. offers a variety of subrogation and insurance related seminars. To schedule a seminar or request a presentation on a particular topic or topics, please contact Gary Wickert or Doug Lehrer, or fax your request to (262) 673-3766.

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