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MONTHLY ELECTRONIC SUBROGATION NEWSLETTER JULY 2008

TO CLIENTS AND FRIENDS OF MATTHIESEN, WICKERT & LEHRER, S.C.:

This monthly electronic subrogation newsletter is a service provided exclusively to clients and friends of Matthiesen, Wickert & Lehrer, S.C. The vagaries and complexity of nationwide subrogation have, for many lawyers and insurance professionals, made keeping current with changing subrogation law in all fifty states an arduous and laborious task. It is the goal of Matthiesen, Wickert & Lehrer, S.C. and this electronic subrogation newsletter, to assist in the dissemination of new developments in subrogation law and the continuing education of recovery professionals. If anyone has co-workers or associates who wish to be placed on or removed from our e-mail mailing list, please provide their e-mail addresses to Rose Thomson at rthomson@mwl-law.com. We appreciate your friendship and your business.

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HOLDING THIRD PARTIES LIABLE FOR COMP LIENS IN TEXAS

Texas Mutual Ins. Co. v. Ledbetter Already Being Misinterpreted by Defendants

In our April newsletter, we reported on the favorable Texas Supreme Court decision of *Texas Mutual Ins. Co. v. Ledbetter*, 2008 WL 918575 (Tex. 2008), which reinforced a compensation carrier's "first money" right of recovery in Texas, and held that any attempt to gerrymander a third-party settlement to avoid repayment of a lien would result in liability of the worker, his attorney, and the third-party, to the subrogated carrier for its reimbursement rights pursuant to Texas Labor Code Chapter 417. Tortfeasors and their liability carriers are already spinning this decision into something it isn't, claiming that they cannot be held directly liable for conversion of a carrier's first money right of recovery when they settle with a worker and his attorney without first repaying the carrier's lien. Their argument focuses on language in the *Ledbetter* decision which reads:

> *"When an injured worker settles a case without reimbursing a compensation carrier, everyone involved is liable to the carrier for conversion - the plaintiffs, plaintiffs' attorney, and defendants. As between those parties, we have held that generally those who received the funds unlawfully (the plaintiffs and their attorney) should disgorge them rather than making the tortfeasors pay twice."*

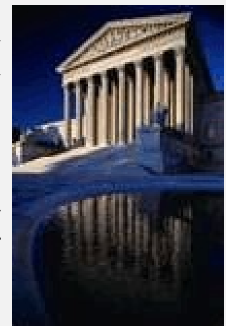
Defendants and their liability carriers are claiming they cannot be held liable for such acts of conversion because the above language implies that the plaintiff and his attorney should be the ones paying. In a classic example of making a silk purse out of a sow's ear, they are attempting to spin the case to their benefit. They are wrong, and this article should be cited to them to convince them that they still face financial risk in Texas if they don't honor compensation liens.

Texas State Capitol
Austin, Texas

In Texas, a workers' compensation carrier's subrogation rights are so strong that public policy even dictates that compromising such rights will support an action for conversion against the injured employee and his attorney. *Employers Casualty Co. v. Haneger*, 852 S.W.2d 655 (Tex. Civ. App. - Dallas 1993, *writ denied*) (conversion is a tort for the wrongful taking of property of another); *Home Indemnity v. Pate*, 866 S.W.2d 277 (Tex. Civ. App. - Houston 1993). Texas is one of a few states that elevates the wrongful taking of a carrier's subrogation interest to the level of conversion. Where the carrier has a lien in excess of $20,000, the entire $20,000 third-party recovery belongs to the workers' compensation carrier. *Granite State Ins. v. Firebaugh*, 558 S.W.2d 550 (Tex. Civ. App. - Eastland 1977, *writ ref'd n.r.e.*). Any settlement funds acquired in a third-party action settlement constitutes "first money" belonging exclusively to the workers' compensation carrier. If the third-party pays the settlement funds to the plaintiff, the third-party tortfeasor is jointly and severally liable with the worker for the smaller of the settlement amount or the entire subrogation amount. *Houston Lighting & Power Co. v. Allen & Coon Constr. Co.*, 634 S.W.2d 875 (Tex. Civ. App. - Beaumont 1982); *Texas Mutual Ins. Co. v. Ledbetter*, 2008 WL 918575 (Tex. 2008).

The very settlement check with which the third-party pays its policy limits belongs to the workers' compensation carrier and is subject to an action for conversion by both the worker and worker's attorney if they take those funds without reimbursing the carrier what is owed on its subrogation interest. *Prewitt & Sampson v. City of Dallas*, 713 S.W.2d 720 (Tex. Civ. App. - Dallas 1986, *writ ref'd n.r.e.)*. The *Ledbetter* decision does nothing to change prior Texas law on the subject. In fact, the *Ledbetter* opinion itself cites the well-established *Capitol Aggregates, Inc. v. Great American Ins. Co.*, 408 S.W.2d 922 (Tex. 1966) case in making the confusing statement above.

In *Capitol Aggregates*, the carrier had paid $12,146.65 in benefits and filed a subrogation suit against the tortfeasor. Prior to trial, the defendant settled with the plaintiff individually for $3,500, and didn't reimburse the carrier. The subrogation suit went to trial and the jury found $6,547.25 in damages. The Supreme Court held that the defendant was obligated to pay the compensation carrier the $6,547.25 in damages awarded by the jury, even though it had settled with the worker and obtained a release. Additionally, the worker was required to reimburse the compensation carrier the $3,500 he received in settlement. Later case law confirmed that the worker's attorney is also liable to the carrier for conversion of settlement funds when the attorney is aware that his client had received workers' compensation benefits. *Prewitt & Sampson v. City of Dallas*, 713 S.W.2d 720 (Tex. Civ. App. - Dallas 1986, *writ ref'd n.r.e.*). Texas courts have declared that the plaintiff's attorney has at least constructive notice of the compensation carrier's subrogation rights, when he accepts the settlement check and refuses to relinquish it to the compensation carrier. *Id*.



Texas Supreme Court Building
Austin, Texas

The *Capitol Aggregates* decision said that because the defendant was obligated to pay the damages found by the jury ($6,547.25), it was not obligated to pay the carrier the additional $3,500 it had paid in settlement to the worker, and that only the worker and his attorney were liable for the additional $3,500. Where the tortfeasor isn't held responsible for making good on a judgment in a subrogation suit such as this, it won't be paying twice as it might have had to do in *Capitol Aggregates*. It will only be made to pay once. In addition, the *Ledbetter* court said that:

> *"…generally those who received the funds unlawfully (the plaintiffs and their attorney) should disgorge them rather than making the tortfeasors pay twice."*

Clearly, there is an exception to this "general" rule, when the funds can no longer be disgorged – such as when the attorney and worker no longer have the settlement funds. The tortfeasor and its carrier should have to prove that the settlement funds can be "disgorged" before claiming they are off the hook under *Ledbetter*.

Now that this case is on the books, along with the confusing sentence referenced above, we can expect enterprising defendants, liability carriers, and attorneys, to argue that they are not responsible for intentionally settling around a workers' compensation lien in Texas, and that only the worker and his/her attorney should be on the hook for repayment. This is a misinterpretation of Texas law and of the *Ledbetter* decision. To be safe, get subrogation counsel involved early in Texas third-party actions where you have a subrogation interest.

Visit www.mwl-law.com (Newsletter link) for copies of all past MWL newsletters and published articles.

MWL PIG ROAST INVITATION

On August 23, Matthiesen, Wickert & Lehrer will be hosting its 5th Annual Pig Roast for clients and friends of the firm. If you receive this newsletter, you are cordially invited to attend the annual event. A printable copy of the invitation is attached to this e-mail. This year's catered pig roast is being held at the home of Gary and Lisa Wickert in Cedarburg, Wisconsin (about 20 miles north of Milwaukee, Wisconsin, off of Interstate 43). While our insurance litigation practice is national and our clients and local counsel are found all throughout North America and abroad, the pig roast invitation extends to anybody receiving this newsletter who is able to make it to the festivities. This event is sure to provide a great time for the whole family and kids are urged to bring their sporting equipment, baseball gloves, and even fishing poles! Check out the attached invitation and respond to Rose Thomson with your RSVP at rthomson@mwl-law.com or by calling (262) 673-7850. There will be door prizes, games, and even a bouncy house for the kids! Don't miss it!

WORKERS' COMPENSATION SUBROGATION

SELF-INSURED RETENTION IS NOT "INSURANCE" FOR PURPOSES OF MADE WHOLE DOCTRINE

***Bordeaux, Inc. v. American Safety Ins. Co.*, 2008 WL 2636817 (Wash. App. 2008).**

The Washington Court of Appeals has decided an issue which needs addressing in many other states. The issue is whether an insured which has paid a significant Self-Insured Retention (SIR) under a CGL policy has the right to be made whole before its insurer may be reimbursed from a third-party recovery. In Washington, at least, the answer is now "yes".

Bordeaux, Inc. and Cameray, Inc. built some condominiums and were later sued by Bordeaux Condominium Association for construction defects. The defects were covered under two different CGL policies of insurance with American Safety and Zurich, both of which required a $100,000 SIR. American Safety and Zurich agreed to settle the construction defect claims for $630,000, and the contractors responsible for the defects were sued by the insureds. The recovery in this third-party suit against the contractors was claimed by the insurance companies under the subrogation clauses in their CGL policies. However, the insureds claimed the recovery because they would not be made whole until they recovered their $100,000 SIR.

The gist of the insurance companies' arguments was that the SIR constituted primary insurance and the claims they paid constituted excess insurance, and therefore, they were entitled to first money from the subrogation recovery. The Washington Court of Appeals disagreed, saying:

> *First, the term "insurer" is defined under the Washington Insurance Code as "every person engaged in the business of making contracts for insurance. Persons and entities that are so engaged are subject to regulation by the Washington State Insurance Commissioner. Neither Bordeaux nor Cameray operated as insurers under Washington law…*
>
> *Second, Washington courts have rejected the argument that self-insurance constitutes "insurance". [They have] explained the distinction between self-insurance and primary insurance as follows: "[Self-insurance] is analogous to the more common types of direct insurance such as automobile collision coverage or major medical coverage, wherein there is usually a stated deductible amount, the effect of which is, in simplest terms, to make the insured "self-insured["] for any loss up to the amount of the deductible. No one has yet to suggest in such instances that the insured, being self-insured up to the amount of the deductible, is an "insurer" who has merely "reinsured" the risk above a certain limit."*

Temple of Justice
Supreme Court Building
Olympia, Washington

Washington, therefore, has answered the question regarding the subrogation/reimbursement rights of an insurance company under a policy of insurance containing a self-insured retention – at least under the clauses in these particular policies. Self-insured retention continues to mystify some subrogation professionals – partly because the insured appears to be taking on the role of co-insurer, and partly because its right of reimbursement in a subrogation context has not been addressed in a large number of states. We can now scratch Washington off of that list.

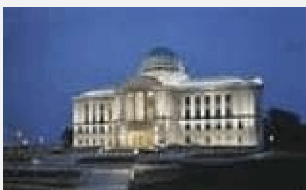
ERISA SUBROGATION

IOWA SUPREME COURT REFUSES TO PREEMPT STATE LAW UNDER ERISA

***Magellan Health Services, Inc. v. Highmark Life Ins. Co.*, 749 N.W.2d 705 (Iowa 2008)**

ERISA's preemption rights continue to be slowly eroded by state appellate courts which feel infringed upon by the expansive preemption scheme of ERISA. Last year, the Mississippi Supreme Court held that ERISA does not preempt the right of a state court with regard to assigning a minor's rights to insurance proceeds, pursuant to the Mississippi State Constitution, which provides that the state will have the right to govern a minor's business. In *Re Guardianship of Holmes*, 965 So.2d 662 (Miss. 2007). This year it is Iowa's turn to take a swing at ERISA preemption with the sledgehammer.

On May 30, 2008, the Iowa Supreme Court was asked to assess which of two health insurance policies would be primary under Iowa law and ERISA. In *Magellan Health Services, Inc. v. Wellmark Life Ins. Co.*, 749 N.W.2d 705 (Iowa 2008), a young boy (John Doe) developed leukemia. John was a dependent under his father's Magellan 90/160 ERISA-covered health plan. In order to be certain his health care was taken care of, John's mother, Jane Doe, obtained an individual insurance policy for John from Wellmark. The Wellmark policy was issued pursuant to Iowa Code Chapter 513C, which requires health insurers operating in Iowa to provide a basic or standard level of health insurance coverage to an Iowa resident regardless of the person's health status or preexisting condition (the sort of thing that doesn't get much press from the socialized medicine



Supreme Court Building
Des Moines, Iowa

crowd). In July 1999, the Iowa Insurance Commissioner promulgated regulations mandating that policies issued pursuant to Iowa Code § 513C.9 “shall not duplicate benefits paid under any other health insurance coverage.” I.A.C. § 191-75.7(513C). As a result of this mandatory regulation, many Iowa plans obtained through § 513C were amended to state that “[b]enefits covered ... will not duplicate benefits covered under any other health insurance coverage.” Such a limitation is commonly referred to as “always secondary” language.

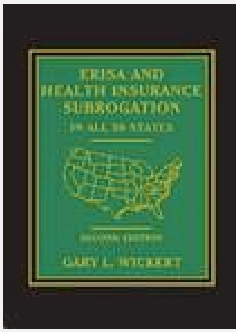
The father’s Magellan policy contained a Coordination of Benefits clause which made the Wellmark policy primary and therefore responsible for John Doe’s health care. However, under Coordination of Benefits rules, the “always secondary” language of the Wellmark policy would have trumped this clause and made Magellan responsible for the boy’s extensive medical needs. Magellan sued Wellmark, asking the court to declare that ERISA preempted the Iowa Code section and administrative regulation, and made the Magellan’s Coordination of Benefits clause determinative of the plans’ respective obligations. Its position was that Iowa Code Chapter 513C impermissibly overrides benefit provisions in self-funded ERISA plans and should be preempted.

ERISA’s preemption clause provides that all state law is preempted insofar as it “relates to” ERISA plans. In order for a state law to “relate to” an ERISA plan, it must have a sufficient “connection with” the plan. The “connection with” test of ERISA preemption requires the court to look at both “‘the objectives of the ERISA statute as a guide to the scope of the state law that Congress understood would survive’ ... as well as the nature of the effect of the state law on ERISA Plans.”

The court in *Magellan Health Services* said that Iowa Code Chapter 513C and the accompanying “always secondary” regulation do not make “reference to” ERISA plans and are not targeted directly and exclusively toward ERISA plans. As a result, the only question regarding the application of the preemption clause in ERISA is whether the “always secondary” regulation is sufficiently “connected with” ERISA to trigger preemption. To accomplish this, courts should look to “the objectives” of ERISA as well as the “nature of the effect of the state law” on ERISA plans in determining whether state law is preempted. This formulation hardly provides clear guidance, and leaves many state appellate courts free to take chinks out of ERISA’s preemption armor. This is precisely what the Iowa Supreme Court did. It determined that the objective of the “always secondary” provision in Iowa Code Chapter 513C as implemented by Iowa Administrative Code Rule 191-75.7(4) is “to promote the availability of health insurance coverage to individuals regardless of their health status or claims experience.” It determined that the policy of Chapter 513C did not undercut ERISA objectives, but rather, promoted the availability of health insurance coverage to persons who might not otherwise obtain it is within the scope of police powers traditionally left to state regulation.

The Iowa Supreme Court protected its own turf and weakened ERISA preemption in Iowa by holding that Chapter 513C did not clearly touch on the objectives of ERISA that Congress must have understood this type of law that would not survive ERISA. The court held that this administrative code rule was therefore not within the scope of ERISA’s preemption clause, 29 U.S.C. § 1144(a), the savings and deemer clauses, 29 U.S.C. §§ 1144(b)(2)(A), (B), and the Magellan 90/60 Policy provided primary coverage in this case.

This decision is yet another in a long line of cases that comprise the legal “end around” attack on ERISA preemption rights. ERISA was designed to standardize the regulation of employee benefit plans by “preempting the field for federal regulation, thus eliminating the threat of conflicting or inconsistent state and local regulation.” Put another way, by enacting ERISA, Congress was attempting to protect employees from unfair employee benefit Plan practices while federally protecting them from inappropriate remedies and inconsistent results. The goals of ERISA won’t be effective for long if states continue to undermine ERISA’s right of preemption.



ERISA and Health Insurance Subrogation in All 50 States

For a complete treatment of Coordination of Benefits rules and ERISA preemption, please see Chapters 5 and 10 in our book, *ERISA and Health Insurance Subrogation In All 50 States*. Ordering information can be found at www.mwl-law.com or by clicking the below button, which will take you to our publisher's website.

For questions about health insurance subrogation or inquiries about MWL handing your health insurance subrogation needs, contact Gary Wickert (gwickert@mwl-law.com) or Ryan Woody (rwoody@mwl-law.com).

DID YOU KNOW....

In Iowa, subrogating workers' compensation carriers must be careful to avoid a rather significant land mine. Due to some peculiar language in Section 85.35 of the Iowa Statutes, settlement of an underlying workers' compensation claim can bar a carrier's statutory right to indemnification or subrogation under Section 85.22. Special effort needs to be taken to avoid the unwitting waiver of a significant right of recovery in such circumstances. Whenever a carrier is involved in a contested hearing for workers' compensation in Iowa, Section 85.35 compels the carrier to be vigilant about a possible waiver of its subrogation rights.

This electronic newsletter is intended for the clients and friends of Matthiesen, Wickert & Lehrer, S.C. It is designed to keep our clients generally informed about developments in the law relating to this firm's areas of practice and should not be construed as legal advice concerning any factual situation. Representation of insurance companies and/or individuals by Matthiesen, Wickert & Lehrer, S.C. is based only on specific facts disclosed within the attorney/client relationship. This electronic newsletter is not to be used in lieu thereof in any way.