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MONTHLY ELECTRONIC SUBROGATION NEWSLETTER AUGUST 2007

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 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.

INSURANCE SUBROGATION

TRIAL LAWYERS UPSET AT TEXAS SUPREME COURT DECISION IN *FORTIS*

Houston Chronicle Reports on Anger and Depression Among Trial Lawyers in Texas

As we reported to you in our July 2, 2007 Special Health Insurance Subrogation Alert (a copy is attached at the end of this article), the Texas Supreme Court recently handed down perhaps the most significant subrogation victory since *Sereboff*. Although relating to a health insurance case, the decision will have widespread positive ramifications for all lines of subrogation. In a case in which Matthiesen, Wickert & Lehrer filed an amicus brief on behalf of the National Association of Subrogation Professionals ("NASP"), the court held that the made whole doctrine will not apply and prevent an insurer from subrogation, if the plan or policy language excludes application of the doctrine. The best measure of the significance of a decision to the insurance industry is usually the reaction of the plaintiff's trial lawyers. Click on the button below this paragraph to view a *Houston Chronicle* article detailing the anger and despair being expressed by the Texas Trial Lawyers and the plaintiff's bar throughout the country at the decision - a sure sign that it will be a powerful tool for subrogation professionals everywhere. This article can also be found on our website at www.mwl-law.com on our Insurance News/Developments page.

Houston Chronicle Article - July 13, 2007
Court Ruling Dismays Plaintiff Lawyers

As reported in our July Newsletter, Matthiesen, Wickert & Lehrer has been asked to draft and submit an amicus curiae brief in a significant made whole case being appealed in the State of Wisconsin. In *Muller v. Society Insurance Company*, 730 N.W.2d 668 (Wis. App. 2007), the issue

on appeal is whether a subrogated carrier can independently settle with a third party without interference by the made whole doctrine, when there are sufficient third party limits to satisfy both the subrogation interest and the insured's losses. We will keep you advised as to the progress in that case, and will continue to chip away at obstacles and impediments to subrogation across the country - one state at a time!

Click the below button to view our July 2, 2007 Special Health Insurance Subrogation Alert regarding the Texas Supreme Court handing a significant victory to subrogation over the made -whole doctrine in its decision of *Fortis Benefits v. Vanessa Cantu and Ford Motor Company, 05-0791, In The Supreme Court of Texas*.

MWL's July 2, 2007
Special Health Insurance Subrogation Alert

WORKERS' COMPENSATION SUBROGATION

THERE'S A NEW SHERIFF IN TOWN

Kansas Court of Appeals' Decision Makes Life Difficult for Plaintiff's Attorneys

Whenever there is doubt and confusion regarding the actual application and function of a workers' compensation subrogation statute, the stage is set for trial lawyers to rig settlements and otherwise try to avoid repayment of workers' compensation liens. For years, this has been the case with Kansas workers' compensation subrogation. However, more recent case law has finally begun to shed the light on how the Kansas workers' compensation subrogation statute works, and the penalties for trial lawyers who skew settlement documents so as to avoid payment of compensation liens can be severe. The Kansas Court of Appeals decision in *Richard v. Liberty Mutual* has laid down the law on efforts to circumvent and avoid repayment of carriers' workers' compensation liens. *Richard v. Liberty Mutual Ins. Co.,* 2007 WL 1747886 (Kan. App. 2007).

In Kansas, the carrier's subrogation right to the employee's recovery against a negligent third party is limited to the extent of the compensation and medical paid by the employer in workers' compensation benefits. Section 44-504 provides, in part, as follows:

> *"In the event of recovery from such other person by the injured worker or the dependents or the personal representatives of a deceased worker by judgment, settlement or otherwise, the employer shall be subrogated to the extent of the compensation and medical provided by the employer to the date of such recovery and shall have a lien therefore against the entire amount of such recovery, excluding any recovery, or portion thereof, determined by a court to be loss of consortium or loss of services to a spouse."*

Section 44-504(b) further provides:

> *"Whenever any judgment in any such action, settlement or recovery otherwise, is recovered by the injured worker or the worker's dependents or personal representative prior to the completion of compensation or medical aid payments, the amount of such judgment, settlement or recovery otherwise actually paid and recovered which is in excess of the amount of compensation and medical aid paid to the date of the recovery of such judgment, settlement or recovery otherwise shall be credited against future payments of the compensation or medical aid."*

The Kansas Court of Appeals in *McGranaham v. McGough*, 802 P.2d 593 (Kan. App. 1990), *aff'd in part, rev'd in part*, 820 P.2d 403 (Kan. 1991), had previously held that all elements of personal injury damages, including medical expenses, lost wages, disability compensation, pain and suffering, and loss of services, are subject to workers' compensation carrier's rights of subrogation. After the carrier in *McGranaham* paid $12,616.29 in compensation benefits to the employee, the employee settled his third party action for $10,000. The plaintiff tried to gerrymander the settlement so as to avoid payment of the workers' compensation lien. The stipulated settlement provided that $6,000 was for pain and suffering, $3,000 for his wife's loss of consortium, and $1,000 was for future medical expenses, and nothing was allocated to past medical expenses or lost wages. The court held that the carrier was subrogated to the $7,000, including the $6,000 in pain and suffering, because pain and suffering is an integral part of the calculation of disability. However, they found that the loss of consortium claim was not duplicative of payments made by the employer, and thus, not subject to subrogation. Despite this ruling, the central holding of the *McGranaham* decision was that subrogation was not allowed where the third party does not duplicate the compensation in medical benefits paid by the workers' compensation carrier. *McGranaham*, supra. Since then, the brand new Court of Appeals' decision in *Richard v. Liberty Mutual Ins. Co.,* 2007 WL 1747886 (Kan. App. 2007) has confirmed that § 44-504(b) grants employers subrogation liens on tort recoveries by injured workers only to the extent that a worker's recovery duplicates compensation and medical expenses paid by the employer under the Workers' Compensation Act. *Id*.

In recent years, courts have also differentiated between the carrier's rights of subrogation and reimbursement. In *Wishon v. Cossman,* 991 P.2d 415 (Kan. 1999), the court noted that in 1993, the legislature made sweeping changes to § 44-504(b). In place of the statutory language that was at issue in *McGranaham* stating that the employer "*shall have a lien therefore against such recovery*", the amended § 44-504(b) says that the employer:

> *"…shall have a lien therefore against the entire amount of the recovery excluding any recovery, or portion thereof, determined by a court to be loss of consortium or loss of services to a spouse. The employer shall receive notice of the action, have a right to intervene and may participate in the action. The district court shall determine the extent of participation of the intervenor, including the apportionment of costs and fees."*

In its 1993 amendment, the legislature essentially codified *McGranham*. Although the lien is to be against the "entire amount" of the recovery, excluding any recovery for loss of consortium or loss of services to a spouse, the carrier is only subrogated to a third party recovery which duplicates the workers' compensation benefits paid. At the time of *McGranaham*, the statute granted a lien "against such recovery". The current version of the statute grants a statutory lien "against the entire amount of such recovery". *Id*. In *Wishon*, the court indicated that this was a distinction

without a difference. It noted that § 44-504(b) had a two-fold intent: (1) to preserve injured worker's claims against third party tortfeasors; and (2) to prevent double recoveries by the injured workers. *Lemery v. Buffalo Airways, Inc.*, 789 P.2d 1176 (Kan. App. 2007).

The court in *Wishon* clarified that § 44-504(b) grants carriers subrogation liens on tort recoveries by injured workers only to the extent that a worker's recovery duplicates compensation and medical benefits paid by the employer under the Workers' Compensation Act. Despite a workers' compensation lien in excess of $55,000, the court allowed recovery of only $16,890.98, which was the amount it paid in medical benefits. This was because the plaintiff did not offer any evidence or attempt to recover lost wages from the tortfeasor in the underlying third party action. The court indicated that the legislature provides a means to prevent circumvention of the statutory lien by mandating notice, authorizing intervention, and providing for district court supervision. If the carrier is apprehensive about the strength of its lien, the court in *Wishon* suggests that it intervenes to protect its lien. *Wishon*, 991 P.2d at 420.

McGranahan dealt only with the nature of damages claimed but not the amount of damages. It did not shed light on the ultimate question of whether there are duplicative recoveries when the nature of the damages in the worker's compensation case and the tort settlement are the same, but the amount of the tort settlement does not fully compensate the claimants for their loss. This question was addressed by the Kansas Court of Appeals in *Jerby v. Truck Ins. Exch.,* 2006 WL 1932716 (Kan. App. 2006). In *Jerby,* Alan Jerby died in a collision with a tortfeasor who had only $100,000 in third party liability limits. Despite suffering a loss of more than $350,000 in lost wages, Jerby's family settled for the $100,000 limits, and then sued the workers' compensation carrier for a declaratory judgment that the carrier should not be entitled to a future credit because the third party settlement did not exceed the $350,000 lost wage damages. The trial court concluded that the American Family settlement was not duplicative of the worker's compensation benefits paid by Truck Ins. Exchange because the settlement did not exceed the amount of Jerby's actual lost wages. *Id*. The Court of Appeals opined that if widow and the children did not release the tortfeasor and preserve their claims against him, then the rule in *Kroeker* applies. *State Farm Mutual Ins. Co. v. Kroeker*, 676 P.2d 66 (Kan. 1984). In that case the settlement proceeds are not duplicative of the workers' compensation benefits received *if* the widow's share which relates to damages compensable under our workers' compensation law exceeded the amount of the carrier's lien at the time. On the other hand, if the widow and the children settled their entire claim against the third party and released him, then the workers' compensation carrier is entitled to reimbursement to the extent of any duplicative benefits. The Kansas Court of Appeals reversed, holding that the trial court must hold an evidentiary hearing to apportion the settlement proceeds between the widow and children in order to determine what portion was available for the lien.

In *Kroeker*, the issue was the insurer's right to PIP reimbursement when its insured made a partial settlement of claims against tortfeasor's estate but reserved the right to proceed against the estate for the balance of the claim. *Id*. The Supreme Court distinguished these facts from those in *Russell v. Mackey,* 592 P.2d 902 (Kan. 1979). It held that when there is a partial settlement of a claim and the settlement exceeds the PIP benefits paid, the proceeds of the partial settlement are not duplicative of the PIP benefits paid. However, "if the injured insured settles his total claim with the tortfeasor and releases the tortfeasor from all further liability, the recovery is duplicative as a matter of law, and the PIP carrier has a lien and is entitled to reimbursement for the total amount of PIP benefits paid out of the recovery made by the insured, subject to the two statutory exceptions provided for in sections (d) and (e) of K.S.A. § 40-3113(a)." *Kroeker*, supra.

Plaintiffs' counsel may try to gerrymander settlements and releases in such a way as to disguise third party settlements as compensation for items of damage not duplicative of the workers' compensation lien. Obviously, they do this to avoid repayment of the lien. However, courts have held that such efforts must be supported by the evidence, or the attorney making such a claim in an effort to avoid the lien may be subject to sanctions. *Richard v. Liberty Mutual Ins. Co.*, 2007 WL 1747886 (Kan. App. 2007). A statement that an award is not duplicative must be supported by substantial competent evidence. *Id*. If there is "substantial competent evidence" that a plaintiff's attorney had no basis to support his claim that the settlement is not duplicative, the court is justified in awarding sanctions against him. *Id*. This can include the carrier's attorney's fees incurred in defending the spurious "non-duplicative" gerrymandering argument asserted by the plaintiff. *Id*.

Damages recovered in a third party action for loss of services and loss of consortium are not subject to the workers' compensation carrier's lien because they are not compensable under the Workers' Compensation Act. K.S.A. § 44-504(b) (as reflected by 1992 amendment to this statute). A workers' compensation carrier is entitled to reimbursement to the extent of duplicative benefits resulting from a settlement by a workers' surviving spouse with a third party, provided the spouse and children enter into a full and final settlement of all claims against the third party and release him or her. *Jerby,* supra. However, a carrier is not entitled to reimbursement from a settlement between a third party and a worker's surviving spouse and children, if they entered into a partial settlement with the third party and reserved the right to preserve their claims against the third party for the balance of their loss, and if the spouse's share of the settlement regarding damages compensable under the workers' compensation law exceeded the workers' compensation lien at the time. *Id*.

What happens if the workers' attorney tries to gerrymander a settlement, but fails? Will he still be entitled to an attorney's fee out of your lien – even though he just tried to rake you over the coals? The answer in Kansas, finally, is no. The new *Richard* decision also emphasizes that Kansas law allows for recovery of attorney's fees by the workers' attorney, and provides for apportionment of costs and fees.

Section 44-504(b) provides:

> *"...the district court shall determine the extent of participation of the intervenor, including the apportionment of costs and fees..."*

Section 44-504(c) provides:

> *"...the court shall fix the attorneys' fees which shall be paid proportionately by the employer and the employee in the amounts determined by the court."*

Section 44-504(g) provides:

> *"...the court shall fix the attorney fees which shall be paid proportionately by the workers' compensation fund, insurer or qualified group-funded workers' compensation pool and the worker or such worker's dependents or personal representatives in the amounts determined by the court based upon the amounts to be received from any recovery pursuant to an action brought under this section."*

These sections refer to attorneys' fees for the recovery of the carrier's lien from the third party. The apportioning of attorneys' fees applies to both actions brought by the employee and the employer. Where an attorney for the employee brings an action and recovers the carrier's lien, the employee's attorney is entitled to an attorney's fee fixed by the court. *Nordstrom v. City of Topeka*, 613 P.2d 1371 (Kan. 1980). It's an abuse of discretion to enter an order dividing payment of attorneys' fees proportionally between the worker and the employer in an action by the worker against a third party tortfeasor for damages when the recovery also included the employer's subrogation lien recovery. *Anderson v. National Carriers, Inc.*, 717 P.2d 1068 (Kan. App. 1986), *aff'd*, 727 P.2d 899 (Kan. 1986). The proportion of attorneys' fees to be paid by the carrier shall be calculated based on the carrier's total potential liability and not on past benefits actually paid by the carrier. *Lemry v. Buffalo Airways, Inc.*, 789 P.2d 1176 (Kan. App. 1990), *rev. denied*.

Attorneys' fees are not allowed for the workers' compensation carrier's counsel from the third party recovery, but are allowed for the worker's attorney. However, the degree of participation by the carrier's counsel is taken into consideration in determining the percentage of fees to be paid to the worker's attorney. *Leroy v. City of Coffeyville*, 671 F. Supp. 23 (D. Kan. 1987).

The attorney's fees mandated in §§ 44-504(b), (c) and (g) are designed to compensate a plaintiff's lawyer who recovers an award which is subrogated to the employer's insurer. *Richard*, supra. By awarding these attorneys' fees, the court prevents a "chilling effect" upon suits against third party tortfeasors. *Anderson*, supra. If an injured employee must bear all costs of a suit against the third party tortfeasor, the employee may choose to wait and let the employer bring the suit. This forces the employee to choose between the quicker and possibly lesser recovery of workers' compensation and a delayed but possibly larger recovery against the tortfeasor. *Nordstrom*, supra. Allowing attorney's fees eliminates this choice and allows an employee to bring a suit quickly and without extra cost. If the insurer is not subrogated, the plaintiff's attorney is not entitled to attorneys' fees. *Deffenbaugh Indus., Inc. v. Wilcox*, 11 P.3d 98 (2000), *rev. denied*, 270 Kan. 897 (Kan. 2001). The statute rewards an attorney who does work, even inadvertently, for the insurer.

However, it should be remembered that the one-third fee to the plaintiff's attorney is not automatic. If the one-third fee is excessive due to the ease of obtaining the settlement or the amount of services provided, then the court should award a lesser fee. *Richard*, supra. Also, where the plaintiff's attorney attempts to gerrymander the settlement or hide a settlement from the carrier so as to defeat the lien, no attorney's fee should be awarded. *Id*. The trial court should use the reasonableness standard in awarding attorney's fees. When considering the reasonableness of attorney's fees, the trial court should consider "the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly." *Id*.; K.R.P.C. § 1.5(a). The trial court has wide discretion in awarding attorney's fees; however, the amount of the fees must be supported by substantial competent evidence. Without evidence of additional time and labor spent on a relatively simple case, the trial court may abuse its discretion in awarding over attorney's fees to the plaintiff's attorney. *Richard*, supra. A hearing to determine the proper amount of fees for the plaintiff's attorney according to the amount of time, difficulty, skill, and labor he or she expends in obtaining this award is appropriate. *Id*.

Avoiding repayment of workers' compensation liens just got tougher in Kansas. Understanding the new *Richard v. Liberty Mutual Ins. Co.* decision will go a long way toward helping your company lay down the law with plaintiffs' lawyers who don't seem to have any respect for the law.

NEW YORK APPELLATE COURT NARROWS CARRIER'S LIABILITY FOR FEES AND COSTS

Burns v. Varriale, 820 N.Y.S.2d 655 (N.Y.A.D. 2006).

Workers' compensation subrogation in New York has always been accompanied by the obligation of a workers' compensation carrier to equitably share in litigation costs and attorney's fees incurred by the worker. *Kelley v. State Ins. Fund*, 568 N.Y.S.2d 850 (N.Y.A.D. 1983). While the determination of what constitutes an "equitable apportionment" of litigation costs has been left to the court's discretion, the courts have stated that the benefit a carrier derives from a plaintiff's attorney's actions includes not only the recovery of its lien, but the value of the estimated future compensation payments that it is relieved of making due to its statutory future credit. *Donaldson v. Ryder Truck Rental & Leasing*, 737 N.Y.S.2d 793 (N.Y. Sup. 2001). The allocation formula used to determine the proportionate share of attorney's fees and costs for which a carrier is responsible for contributing has been allowed to take into consideration the full benefit a carrier receives from an employee's third party recovery, including the value of estimated future compensation payments it is relieved from making. These calculations involving future benefits must reduce future payments to "present value". *Wood v. Firestone Tire & Rubber Co.*, 123 Misc.2d 812 (Sup. Ct. 1984). Under New York law, this is known as the "*Kelley* formula", and an example of this formula in action is as follows:

	$4,000,000.00	Gross Settlement
Less	$ 100,000.00	Cost of Litigation
	$3,900,000.00	
Less	$1,300,000.00	1/3 Attorney's Fee
	$2,600,000.00	Net Recovery

$1,400,000.00/$4,000,000.00 = 35% Fees and Costs/Total Recovery

	$ 100,000.00	Carrier's Past Lien
Plus	$ 300,000.00	Carrier's Present Value Future Benefits Owed
	$ 400,000.00	Total Benefit to Carrier

$ 400,000.00 X 35% = $140,000.00 (Carrier's Pro Rata Share)

As you can see from the above example, the carrier recovers $100,000.00 for its past lien, but owes $140,000.00 as its pro rata share of costs and attorney's fees based on a calculation using not only the past benefits paid but also the future benefits to be paid. This means the carrier has to contribute $40,000.00 in "fresh money" to the plaintiff as a result of the *Kelley* formula.

A recent New York appellate decision has given a subrogating carrier in New York some relief from the obligation to include all future benefit payments into the *Kelley* calculation. In *Burns v. Varriale*, 820 N.Y.S.2d 655 (N.Y.A.D. 2006), the New York Supreme Court Appellate Division held that an award for death benefits, permanent, total disability or scheduled loss of use, should be included in the *Kelley* calculation, because these payments do not fluctuate and the duration of the benefits are predictable. However, when a claimant has a permanent, partial disability, the

court in *Burns* has held that because neither the duration nor the amount of such an award is readily predictable because the award may not continue for the rest of the claimant's life, such an award cannot be included in calculating the *Kelley* formula. While a finding of permanent, partial disability gives rise to an inference that reduction in wages is related to the disability, the initial burden remains on the claimant to demonstrate that "reducing earning capacity is not due to age, general economic conditions or other factors unrelated to the disability". In other words, there is no inference of a permanent and total loss of wages upon a finding of permanent, partial disability, as opposed to a permanent, total disability. Because a worker's actual future earnings and continued attachment of the label market constitutes unknown variables that cannot be reliably predicted, the value of workers' compensation benefits to be awarded to a worker with a non-scheduled permanent, partial disability is too speculative for a carrier to be made liable for an equitable share of attorney's fees incurred by the worker in connection with the third party action.

The net result of this favorable decision is that in permanent, partial disability cases, where the third party action is settled, the *Kelley* formula should not include these speculative future benefit payments. This means fewer opportunities for plaintiff's counsel to reduce or eliminate the workers' compensation carriers' liens or possibly require the carrier to even kick in fresh money. This translates into larger recoveries for workers' compensation carriers.

Conversely, *Burns* does allow the worker to apply to the Workers' Compensation Board, requesting that the carrier continue future benefit payments notwithstanding the third party settlement, if the claimant remains disabled on a causally related basis. The work benefits may then be continued in the same proportionate percentage as the *Kelley* formula. This would usually be about one-third of the permanent rate, since the legal fees and disbursements will generally approximate that percentage of the gross third party recovery. The *Burns* case makes it the claimant's obligation to move the Board to direct continued payments in such cases so carriers may not have to make such payments where a claimant neglects to enforce his or her rights.
