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SUBROGATING FOR MORE THAN YOUR LIEN?

By Douglas W. Lehrer

Imagine subrogating for damages an insurance carrier didn't pay for. What's more, imagine subrogating for *and actually recovering* more than the amount of the claim you paid. Amazingly, both scenarios are now possible for subrogating worker's compensation carriers in Wisconsin.

The Wisconsin Supreme Court recently held in Threshermens Mutual Insurance Company v. Page, 217 Wis. 2d. 451 (1998) that a worker's compensation insurer may seek recovery of an injured employee's claims even if the employee declines to participate in a third-party action. In Threshermens, the Court held that the Wisconsin Worker's Compensation Act allows an insurer who filed an action against a third-party defendant to assert the same claims against the third-party as those that would be available to the injured employee, including claims of pain and suffering and future medical expenses. This article will summarize the effects of this holding on an insurer's subrogation rights as well as discuss the increased chances that a worker's compensation carrier may now recover damages in excess of benefits paid.

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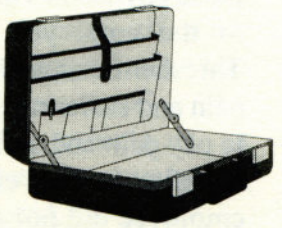

WI Supreme Court Expands UM Coverage

Hull v. State Farm Mutual Insurance Company, 222 Wis. 2d. 627 (Dec. 15, 1998).

On December 15, 1998, the Wisconsin Supreme Court held that uninsured motorists' coverage applies to a vehicle which is uninsured, even if the driver of that vehicle is insured. This decision overrules a 1985 Court of Appeals decision which had held to the contrary.

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Threshermens, arises out of an incident whereby an employee was injured when she fell in a parking lot owned by her employer while in the course of her employment. Threshermens Mutual Insurance Company was the employer's worker's compensation carrier and, pursuant to the Worker's Compensation Act, made certain payments to the employee to compensate her for the injuries she sustained in the fall. Subsequently, Threshermens filed a subrogation action, pursuant to §102.29(1), Wis. Stats., against the parties responsible for maintaining the parking lot alleging that their negligence caused the employee's injuries resulting in worker's compensation benefits being paid. Pursuant to Wisconsin Statute, Threshermens notified the employee of the pending lawsuit and allowed her the opportunity to join in the prosecution of the claim. The employee, however, declined to actively participate in the lawsuit and was subsequently joined as an involuntary plaintiff in Threshermen's action.

During the course of litigation, a dispute arose regarding which damages Threshermens would be entitled to recover at the time of trial. Specifically, Threshermens intended to present evidence and request recovery of damages representing the employee's pain and suffering claim as well as future medical expenses claim. The defendants, on the other hand, attempted to limit the action to only those payments Threshermens had previously made to the employee. The defendants argued that Threshermens was not entitled to assert a claim for pain and suffering: (1) because it was not obligated to pay pain and suffering as worker's compensation benefits to the employee; and (2) because the employee did not file her own independent action. In addition, the defendants argued that Threshermens could not assert a claim for future medical expenses because such a claim would be "too speculative".

On appeal, the court addressed the issue as to whether a worker's compensation carrier is entitled to recover damages representing an injured worker's claim of pain and suffering as well as a claim for future medical expenses under the Workers' Compensation Act. In determining whether an insurer may properly recover for such claims, the court first looked to the clear and unambiguous language of §102.29(1), Wis. Stats., which provides in pertinent part as follows:

> *The employer or compensation insurer who shall have paid or is obligated to pay a lawful claim under this chapter shall have the same right [as the employee] to make claim or maintain an action in tort against any other party for such injury or death. However, [the employer or compensation insurer, or the employee make a claim] shall give to the other reasonable notice and opportunity to join in the making of such claim or the instituting of an action and to be represented by counsel . . . If notice is given as provided in this subsection, the liability of the tortfeasor shall be determined as to all parties having a right to make claim, and irrespective of whether or not all parties join in prosecuting such claim.*

After reviewing the above language, the court noted that §102.29(1), Wis. Stats., allows either the injured employee or the insurer to commence an action against a third-party tortfeasor and further grants each the "same rights" to make a claim or maintain an action. The court further noted that the statute specifically provides that as long as proper notice is given, "the liability of the tortfeasor shall be determined as to all parties having a right to make a claim, and irrespective of whether or not all parties join in prosecuting such claim". Since it was undisputed that pain and suffering damages fell within the category of claims to which §102.29(1) applies, Threshermens was entitled to present the employee's claim for pain and suffering to the jury

even though Threshermens was never required to pay benefits for pain and suffering.

In regards to Threshermen's claim for future medical expenses, the court noted that the third-party liability statute specifically allows a worker's compensation carrier to recover "all payments made by it, or which it may be obligated to make in the future." Although the court acknowledged that there may be some inexactitude in awarding damages for future medical expenses, if competent medical evidence is presented to demonstrate that the employee will incur future medical expenses, Threshermens must be allowed to recover these damages. As such, the court held that denying Threshermens the opportunity to present the claim for future medical expenses violated the clear language of the statute.

Conclusion

The holdings of the court in the Threshermens case greatly enhance an insurer's subrogation rights to recover against a third-party tortfeasor. If an injured employee declines to actively participate in a third-party action filed under Wisconsin Statute §102.29(1), an insurer is now entitled to recover as damages monies above and beyond those actually paid to the injured employee. Specifically, the Wisconsin Supreme Court has held that damages such as an employee's pain and suffering and future medical expenses may be included in those an insurer is entitled to recover against a third-party defendant, even if the insurer did not pay those damages to the employee. Based upon this ruling, the chances that a worker's compensation insurer will recover not only the total dollar amount paid in benefits to an injured employee, but an amount greater than that actually paid are greatly increased. These are exciting, new reasons to act promptly and aggressively when subrogating, and place Wisconsin on a growing list of states which zealously protect and enforce subrogation rights. For specific questions about subrogating workers' compensation claims, please call Gary Wickert or Doug Lehrer.

A pickup truck driven by a Badger State employee, while the vehicle was consigned to Badger State, ran into an auction ring, killing Betty Hull's husband. The owner of the pickup truck did not have insurance, but the driver was covered by Badger State's policy. Instead of making a claim against Badger State and its insurer, Mrs. Hull opted to proceed against her own two State Farm UM policies. Obviously, State Farm maintained that the vehicle which struck Mr. Hull was not "uninsured", because it was covered by the Badger State policy. State Farm relied heavily on the 1985 Court of Appeals decision in Hemerly v. American Family Mutual Insurance Company, 127 Wis. 2d. 304, 379 N.W. 2d. 860 (Ct. App. 1985), which held that such a vehicle was not "uninsured". The Supreme Court, however, ruled that §632.32(4), which governs the provisions of motor vehicle insurance policies, requires an insurer to provide UM coverage whenever the owner **or** the operator of a motor vehicle is allegedly negligent and is not covered by liability insurance. Because the owner of the motor vehicle was alleged to be negligent, and was not insured, §632.32(4), and the policy language of Mrs. Hull's State Farm policies, required that State Farm provide UM coverage to Mrs. Hull. The Trial Court upheld State Farm's Motion for Declaratory Judgment that the truck was not "uninsured", and the Court of Appeals affirmed, stating that there would be UM coverage "only when no coverage exists under any scenario". The Supreme Court decided that a vehicle is an "uninsured motor vehicle" when its ownership, maintenance, **or** its use is uninsured.

The Supreme Court's decision appears to open the door to allow UM coverage when only one of several tortfeasors is not insured. This decision also presents interesting subrogation opportunities for subrogating carriers, while providing headaches and possibly limitless UM coverage for liability carriers. When subrogating against a tortfeasor with no insurance or minimum limits, and when faced with

(Briefcase Notes - Continued)

possible "made whole arguments", subrogation investigation should include issues of coverage of both the owner and the operator of the vehicle.

In a recent letter to many of you we boasted about one of our partners, indicating that Arnie Anderson is a partner and *current* President of the CTCW, as well as a professor at Marquette Law School. Actually, Arnie is a *former* President of the CTCW and a *former* Adjunct Professor at Marquette Law School. He is of counsel to Mohr & Anderson, S.C., practicing insurance litigation out of our Madison, Wisconsin office. We apologize for this inadvertent mistake.

Court of Appeals Issues Two Important Insurance Coverage Decisions

By James W. Mohr, Jr.

The Wisconsin Court of Appeals recently released two significant decisions affecting insurance coverage in construction defect cases.

The first, and more significant decision, Kalchthaler v. Keller Construction Company, discussed the products-completed operations hazard (PCOH) and the exception to the "property damage to work" exclusion for work performed by a subcontractor. The Court held, for the first time in Wisconsin, that under certain circumstances the CGL policy may become virtually a performance bond.

Keller was the insured and acted as general contractor for the construction of an apartment complex for the elderly. All the work was contracted out to subcontractors. After the completion, the building leaked and caused substantial water damage to the interior. Keller's insurer (Aetna) for some reason stipulated that at least 50 percent of the responsibility for the damage could be allocated to Keller based on negligence of its subcontractors and Keller's negligent supervision of the subcontractors. This stipulation may have become virtually a performance bond.

The Court began its opinion by addressing Aetna's contention that faulty workmanship is not an "accident" and, therefore, not an "occurrence". The court rejected this and adopted the "unfortunate event" definition of an accident, citing Webster's Third New International Dictionary:

> *"An accident is an 'event or change occurring without intent or volition through carelessness, unawareness, ignorance, or a combination of causes and producing an unfortunate result.'"*

Under this definition, when the windows leaked, it was an accident.

Having passed this hurdle, the Court then confronted the familiar exclusion which denies coverage to property which must be "restored, repaired or replaced because 'your work' was incorrectly performed on it." Although the Court acknowledged this language would exclude coverage, it held that the completed apartment building unquestionably fell with the PCOH and, therefore, coverage was restored under the exception to the exclusion. Aetna made the interesting argument that the windows

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were defective when they were installed and, therefore, the damage did not occur **after** the work had been completed but rather **during** the work. The Court rejected this argument as "strained".

It then addressed Aetna's second exclusion–the standard CGL provision which excludes property damage to "your work". However, most post-1986 CGL policies, such as Aetna's, contain an exception to this exclusion if the damaged work "was performed on your behalf by a subcontractor".

The Court noted that most pre-1986 cases upholding the work exclusion were probably now irrelevant. It then made the following chilling observation that on construction projects such as this, where most or all of the work is performed by subcontractors, there is insurance coverage for virtually everything:

> *"For some reason, the industry chose to add the new exception to the business risk exclusion in 1986 . . . We realize that under our holding a general contractor who contracts out all the work to subcontractors, remaining on the job in merely supervisory capacity, can ensure complete coverage for faulty workmanship. However, it is not our holding that creates this result: it is the addition of the new language in the policy. We have not made the policy closer to a performance bond for general contractors, the insurance industry has."*

This is a significant decision on insurance coverage. These two common exclusions, upon which coverage and the duty to defend were often precluded, may now be lost, creating on the one hand, traps and pitfalls for the CGL carrier, and on the other hand, new and interesting subrogation possibilities for commercial property carriers. The court did not address the "impaired property" exclusion and insurers faced with this fact situation should concentrate their efforts on attempting to exclude coverage under that language, if available.

The second decision (released the same day) is Jacob v. Russo Builders. This clarified the types of damage which will and will not be covered in a construction defect case.

In that action, Limbach Construction Company was the mason subcontractor who performed defective masonry work on the plaintiff's residence. The jury found the subcontractor causally negligent and awarded almost $200,000 in damages, including $110,000 for repairing the insured's brickwork; $9,800 in interior damage to the home; $5,000 to rip out and restore the landscaping in order to replace the bricks; expert witness fees of $5,000; relocation expenses of $3,000; refinancing costs of $8,000; and loss of use and enjoyment of $50,000.

All parties agreed at the outset–and the Court of Appeals joined in stating–that the CGL policy did not provide coverage for the cost of repairing or replacing the insured's defective work. The issue was which of the other damages were covered.

The Court rejected the insurer's argument that any coverage for the insured's defective work would turn the insurance policy into a "performance bond," and noted that there were damages to things other than the insured's work which is normally covered under the CGL policy. It agreed, however, that any damages incurred soley to repair the insured's defective work would not be covered. This meant that ripping out and restoring the landscaping, driveway, sidewalk and patio would not be covered under the policy because they were not injured or destroyed by the insured's defective work but were only destroyed later when the insured's defective work was repaired. Other damages which were directly caused by the insured's defective work **were** covered. These included relocation costs, temporary

repairs, repairs to the interior of the residence, and loss of use and enjoyment of the residence.

The court could not decide, however, on an area of damages which it called a "gray" area and therefore remanded these damages for further consideration by the trial court. These included financing costs and expert fees to determine the cause of the damage. Presumably, on remand, the focus will be whether the insured's faulty work actually caused these damages, or whether they were incurred solely to repair or restore the insured's defective work.

In rendering this opinion, the Court expanded those categories of damages which creative plaintiff's lawyers may now seek in construction defect cases. These two decisions together, unless reversed by the Supreme Court, will increase the potential exposure of CGL carriers who insure those general contractors who subcontract all or a significant portion of their work, while at the same time creating subrogation "deep pockets" for commercial property carriers.

Copies of these decisions, or questions pertaining to insurance coverage issues in general may be requested from or referred to Jim Mohr at Mohr & Anderson, S.C.

A Liability Carriers' Duty to Defend Upon Payment of Policy Limits

By Douglas W. Lehrer

When a liability insurer in Wisconsin is confronted with a situation where a demand is made for settlement with only the insurer for policy limits, reasonable efforts must first be made to settle the claim against the insured, prior to acceptance of the offer. If, however, such efforts do not result in a release of the insurer and the insured, the insurer may, under certain circumstances, pay its policy limits, thereby relieving the insurer from any further duty to defend its insured. This article outlines the appropriate notice requirements and policy language which must be included in the insurance policy to effectively terminate an insurance company's duty to defend upon payment or tender of policy limits.

In Wisconsin the pivotal case addressing the issue of an insurer's duty to defend upon tendering of policy limits is Gross v. Lloyds of London, 121 Wis. 2d. 78, 358 N.W. 2d. 266 (1984). In Gross, the plaintiff sustained a serious injury when an unoccupied Piper aircraft rolled into a tent she was occupying while at the Experimental Aircraft Association's annual fly-in in Oshkosh, Wisconsin. Imperial Casualty and Indemnity Company, the insurer of the aircraft's owner, investigated the accident and concluded that the plaintiff's damages were greatly in excess of the policy limits of $100,000. Imperial forwarded a check for $100,000 along with a Partial Release and Indemnification Agreement to Gross's attorney in an attempt to settle the claim which would have released both Imperial and its insured from any liability resulting from the accident. The plaintiff, however, rejected the payment of the policy limits and refused to execute the Release. Subsequently, Gross commenced an action seeking damages greatly in excess of Imperial's policy limits. Thereafter, Imperial filed a motion requesting permission to pay its policy limits into court and seeking to be relieved from any further obligation to defend its insured under the terms of the insurance policy. The policy provision relied upon by Imperial in bringing the motion provided, in part: "But the company shall not be obligated to pay any claim of judgment or to defend any suit after the applicable limit of the company's liability has been exhausted by payment of judgments or settlements or after such limits of the company's liability has been tendered for settlement." Complicating the case was the fact that the insured was issued only a binder prior to the accident and did not receive the policy that contained the exclusionary language until after the accident. The Wisconsin Supreme Court pointed out the difficulty in applying the policy language as follows:

> *Because the binder was silent concerning Imperial's obligation to defend, the reasonable expectation of an insured would be that the standard industry practice would apply. Because the "tendered for settlement" language was substantially changed from past industrial practice and because Frantz (insured) had received no notice at the time of the accident that Imperial could terminate its defense efforts upon tender of the policy limits, we hold that Imperial's tendering of the policy limits into court does not relieve its duty to defend Frantz in the lawsuit.*

Although the Court in Gross held that the insured was not properly notified of the above "tender for settlement" policy language, the Court went on to discuss how such policy language could effectuate a limitation on an insurer's duty to defend:

> *In order for an insurer to be relieved of its duty to defend upon tender of the policy limits, the "tendered for settlements" language must be highlighted in the policy and binder by means of conspicuous print, such as bold italicized, or colored type, which gives clear notice to the insured that the insurer may be relieved of its duty to defend by tendering the policy limits for settlement . . . Insureds will thus be put on notice that they are buying a policy of indemnity and a defense only up to the point where the insurer tenders the policy limits for settlement and that the insurer's duty to defend ceases once such a tender has been made. Once insureds have been given notice by the insurer of a limited duty to defend, they may choose to afford themselves greater protection in the defense of claims by increasing the amount of their policy limits or seek a policy which provides for unlimited defense. Insurers may terminate their duty to defend their insureds by tendering the policy limits, but they may do so only if the insureds receive adequate notice as outlined in this opinion.*

The Wisconsin Court of Appeals further discussed the issue of whether the insurer has a duty to defend upon exhaustion of its policy limits in Novak v. American Family Mutual Insurance Company, 183 Wis. 2d. 133, 515 N.W. 2d. 504 (1994). In Novak, the issue was whether the trial court correctly granted summary judgment in favor of American Family on the basis that American Family had no duty to defend upon exhaustion of its policy limits by payment of a settlement. Novak appealed a final order in which the trial court granted American Family's Motion for Summary Judgment and dismissed Novak's Amended Complaint which alleged that American Family had breached its duty to defend. In Novak, the policy language stated in bold as follows:

> ***However, we will not defend any suit after our limit of liability has been offered or paid.***

Despite this policy language, Novak argued that American Family's duty was fulfilled only upon payment of policy limits incidental to an agreement or judgment which meets his approval or which finally settles a pending claim against him. Furthermore, Novak contended that American Family breached its duty to defend when it paid its policy limits and refused to defend him on the excess. In rejecting these arguments, the court held that "[t]he duty to defend is a creature of contract."

(A Liability Carriers' Duty to Defend Upon Payment of Policy Limits - Continued)

As such, the Court held that, "[n]o Wisconsin Statute prescribes a duty to defend or restricts its contractual limitation." The Court then went on to apply the standards which were outlined in Gross and held that, "[t]he challenged language in American Family's policy had complied with the requirements that such language be highlighted." Since the insured had been put on notice that they were buying a policy of indemnity that defends only up to a point where the insurer tenders the policy limits for settlement, this limitation on the duty to defend was held to be enforceable and, "not contrary to public policy." As such, the Court held that an insurer may properly terminate its duty to defend by the tendering of their policy limits if the insured is notified of that result.

Although the courts, in Gross and Novak have outlined the proper notice requirements and policy language necessary to allow an insurer to "pay and walk," an insurance company must keep in mind that their duty to defend remains in effect until the court declares that the insurer may tender their policy limits and withdraw. An insurer desiring to litigate the "tendered for settlement" provision, therefore, must first retain separate counsel to defend the insured on the merits of the case up until the point that the court declares that the insurer has no further obligation to defend its insured.

Furthermore, even if the language in the subject policy of insurance is sufficient to allow an insurer to tender its policy limits and withdraw, a court may deny an insurance company's request to pay and withdraw if to do so would be prejudicial to their insured. This situation would most likely arise if the request to pay and withdraw is so close to the trial date that the withdrawal of representation would prevent the insured from effectively preparing for trial. To avoid these results, an insurer may wish to obtain a stay of the trial court proceedings to first litigate the validity of "pay and walk" provision. In this event, it is critical that an insurance company who seeks the right to tender its policy limits and withdraw from further involvement in defending the insured proceed with litigating that issue at the earliest stage possible to prevent any prejudice to the insured.

Conclusion

Recent case law has allowed insurance companies to exhaust their duty to defend upon payment or tender of policy limits under certain circumstances. Before attempting to "pay and walk," however, the insured must be certain that the proper notification and policy language are contained in the policy of insurance. Only then, and with the proper approval of the court, can an insurer properly tender its policy limits and effectively withdraw from any further involvement in defending the insured.

FOR YOUR INFORMATION

WELCOME TO THE FIRM PATRICK J. ANDERSON

An insurance litigator with eight years of litigation experience, recently joined Mohr & Anderson. Pat was formally a trial lawyer with Brennen, Steil, Basting & MacDougal in Janesville, Wisconsin and Davis & Kuelthau in Milwaukee, Wisconsin.

A former member of the Board of Directors for the Rock County Bar Association, Pat is a frequent speaker on insurance issues and was an assistant editor for selected chapters in *Wisconsin Legal Forms.*

We welcome Pat and his extensive trial experience to Mohr & Anderson. Pat will be handling insurance defense and subrogation matters at Mohr & Anderson.