MONTANA SELF INSURERS' ASSOCIATION

MEMORANDUM

TO: Economic Affairs Interim Committee, HJR 25

FROM: Bob Worthington, Montana Self-Insurers Association

DATE: January 13, 2014

RE: Workers' Compensation Subrogation Issues

The Montana Workers Compensation Act (Act) provides that when an employee is injured or killed while performing their duties of employment as a result of the act or omission of another person or entity, in addition to receiving workers compensation benefits, the injured employee has a right to prosecute any cause of action for damages against such third party. MCA § 39-71-412 (2013). The Act also provides that the workers compensation insurer is entitled to subrogation from any claim, judgment or recovery for all compensation benefits paid or to be paid arising out of such third party actions. MCA § 39-71-414 (2013). However, as a practical matter; the workers compensation insurer or self insured employer very rarely recovers anything from the third party action as established case law provides that the insurer has no subrogation interest until the Claimant has been "made whole" for "claimants entire loss" *Zacher*

v American Ins. Co., 243 Mont. 226, 794 P2d 335 (1990). As the term "made whole" has come to be defined by case law, it is virtually impossible to calculate and has the practical effect of denying all workers' compensation insurers, self insurers and employers any subrogation rights. As a result, the employer and the workers compensation insurer bear the full financial burden of an injury caused by a negligent third party. The Montana Self Insurers' Association believes that current law should be amended so as to allow the workers compensation insurer or, in the case of self insurers the employer, to recover a fair portion of the benefits it has paid from the negligent third party responsible for the accident and resulting injury.

I. What is Subrogation.

Subrogation is a device of equity which is designed to compel the ultimate payment of a debt by the one who in justice, equity and good conscience should pay it. Generally speaking, an insurer who has indemnified the insured is subrogated to any rights the insured may have against the third party who is responsible for the loss. The theory behind this principle is that absent repayment of the insurer, the claimant would be unjustly enriched by virtue of recovery from both the insurer and the wrongdoer or, in absence of such double recovery by the claimant, the third party would go free despite his legal obligation in connection with the loss. See *Skauge v. Unigard Insurance Group*, 172 Mont. 521, 565 P.2d 628, 630 (1977) and applied to workers compensation claims in *Hall v. State Fund*, 219 Mont. 180, 708 P.2d 234 (1985).

As an example relevant to workers compensation, assume an employee is injured in an auto accident while in the course of and scope of employment and through no fault of their own. The employer's workers compensation insurer pays all medical bills arising out of the accident. The auto insurer for the responsible party has an obligation under Montana law to make these same payments if liability is reasonably clear. Common sense dictates that the employer's workers compensation carrier should be able to subrogate to recover such medical benefits it has paid to the injured worker from the insurer of the responsible third party. However, as a result of the "made whole" doctrine, such a recovery seldom occurs.

II. What is the "Made Whole" Doctrine?

Established case law provides that an Insurer has no subrogation interest in proceeds from a third party action until the claimant has been "made whole" for his/her "entire loss." *Zacher v. American Ins. Co*., 243 Mont. 226, 794 P.2d 335 (1990) and *Francetich v. State Compensation Mutual Ins. Fund*, 252 Mont. 215, 827 P.2d 1279 (1992).

> In determining whether a claimant has been made whole, the amounts received and to be received under the workers' compensation claim shall be added to the amounts otherwise received or to be received from third party claims, and also added to the costs of recovery, including attorney fees; and <u>when that total equals claimant's entire loss, then the insurer</u>

> shall be entitled to subrogation from all amounts received by the claimant in excess of his entire loss, pursuant to Sec. 39-71-414, MCA (1983).

Zacher, 243 Mont. at 231, 794 P.2d at 338 (emphasis added).

III. Where does the "Made Whole" doctrine originate?

Initially, the concept that a claimant must be "made whole" before a workers' compensation insurer's entitlement to subrogation is triggered originated in the Montana Constitution.

> Article II, Section 16, of the Montana Constitution, as amended in 1972, provides:
>
> Court of justice shall be open to every person, and speedy remedy afforded for every injury of person, property, or character. No person shall be deprived of this full legal redress for injury incurred in employment for which another person may be liable except as to fellow employees and his immediate employer who hired him if such immediate employer provides coverage under the Workmen's Compensation Laws of this state. Right and justice shall be administered without sale, denial, or delay [Emphasis added.]

The emphasized portion of Article II, Section 16, was added by amendment during the Constitutional Convention of 1972.

"The second sentence is mandatory, prohibitive, and self executing and it prohibits depriving an employee of his full legal redress, recoverable under general tort law, against third-parties." *Francetich*, 252 Mont. at 224.

However, in *Zacher* and also in *State Compensation Insurance Fund v. McMillan*, 306 Mont. 155, 31 P.3d 347 (2001), the Supreme Court clarified that the "made whole" limitation on an insurer's right of subrogation is one of equity, not of constitutional principle.

> This theory is not dependent upon a right of recovery of full legal redress under the Montana Constitution. It is based upon an equitable balancing of the rights of the insurer as compared to the claimant. . . . [T]he basic conclusion is that when the amount recovered by a claimant is less than the claimant's total loss, with a result that either the claimant or the insurer must to some extent go unpaid, then it is equitable that the loss be born [sic] by the insurer which had been paid an insurance premium for the assumption of its liability. . . . The key aspect is that the insurer has been paid for the assumption of the liability for the claim, and that where the

> claimant has not been made whole, equity concludes that it is the insurer which should stand the loss, rather than the claimant. . . .

Zacher, 243 Mont. at 230, 794 P.2d at 338.

IV. What is a "Claimant's entire loss" and how does it effectively curb a worker compensation insurer's ability to subrogate?

Based on current case law, the "entire loss" must be calculated without regard to comparative fault. For example, if the injured worker is contributorily negligent, his third party recovery may be reduced by a percentage of his/her negligence, but the entire loss is calculated without regard to such negligence. The calculation of the "entire loss" also includes but is not limited to:

1) wage loss
2) loss of earning capacity
3) loss of fringe benefits, pensions, etc.
4) pain and suffering and related damages
5) medical costs, past and future

In addition, other factors have to be considered in determining the entire loss, including:

1) attorneys' fees and costs incurred in pursuing the third party recovery
2) policy limits that may have impacted the amount of the settlement

3) whether the desire to end litigation may have resulted in a smaller recovery not reflecting the entire loss.

Going back to the example in ¶ I above, if due to any of the foregoing factors or combination of factors, the claimant has not been "made whole," the workers compensation insurer will not be able to recover any portion of the medical benefits it has paid. This is true even if the auto insurer has included in its payments to the claimant, reimbursement for medical bills that have already been paid by the workers compensation insurer.

V. Current Statute

Mont. Code Ann. § 39-71-414 states:

(1) If an action is prosecuted as provided for in 39-71-412 or 39-71-413 and except as otherwise provided in this section, the insurer is entitled to subrogation for all compensation and benefits paid or to be paid under the Workers' Compensation Act. The insurer's right of subrogation is a first lien on the claim, judgment, or recovery.

(2)(a) If the injured employee intends to institute the third-party action, the employee shall give the insurer reasonable notice of the intention to institute the action.

(b) The injured employee may request that the insurer pay a proportionate share of the reasonable cost of the action, including attorney fees.

(c) The insurer may elect not to participate in the cost of the action. If this election is made, the insurer waives 50% of its subrogation rights granted by this section.

(d) If the injured employee or the employee's personal representative institutes the action, the employee is entitled to at least one-third of the amount recovered by judgment or settlement less a proportionate share of reasonable costs, including attorney fees, if the amount of recovery is insufficient to provide the employee with that amount after payment of subrogation.

(3) If an injured employee refuses or fails to institute the third-party action within 1 year from the date of injury, the insurer may institute the action in the name of the employee and for the employee's benefit or that of the employee's personal representative. If the insurer institutes the action, it shall pay to the employee any amount received by judgment or settlement that is in excess of the amounts paid or to be paid under the Workers' Compensation Act after the insurer's reasonable costs, including attorney fees for prosecuting the action, have been deducted from the recovery

(4) An insurer may enter into compromise agreements in settlement of subrogation rights.

(5) Regardless of whether the amount of compensation and other benefits payable under the Workers' Compensation Act have been fully determined, the insurer and the claimant's heirs or personal representative may stipulate the proportion of the third-party settlement to be allocated under subrogation. Upon review and approval by the department, the agreement constitutes a compromise settlement of the issue of subrogation. A dispute between the insurer and claimant concerning subrogation is a dispute subject to the mediation requirements of 39-71-2401.

(6)(a) The insurer is entitled to full subrogation rights under this section, unless the claimant is able to demonstrate damages in excess of the workers' compensation benefits and the third-party recovery combined. If the insurer is entitled to subrogation under this section, the insurer may subrogate against the entire settlement or award of a third-party claim brought by the claimant or the claimant's personal representative without regard to the nature of the damages.

(b) If a survival action does not exist and the parties reach a settlement of a wrongful death claim without apportionment of damages by a court or jury, the

insurer may subrogate against the entire settlement amount, without regard to the parties' apportionment of the damages, unless the insurer is a party to the settlement agreement.

(7) Regardless of whether the amount of compensation and other benefits payable have been fully determined, the insurer and the claimant may stipulate the proportion of the third-party settlement to be allocated under subrogation. Upon review and approval by the department, the agreement constitutes a compromise settlement of the issue of subrogation. A dispute between the insurer and claimant concerning subrogation is a dispute subject to the mediation requirements of 39-71-2401.

VI. What is the practical impact of the current statute and case law?

Workers Compensation Insurers including self-insurers absorb the entire cost of a claim caused by the negligence of another. While the statute suggests that it is the Claimant's burden to prove that he has not been "made whole," in reality it remains the insurer's obligation to establish that the claimant has been "made whole" for the "entire loss." This is an almost impossible burden to meet. As referenced above in ¶ IV, it would be a very rare case where the claimant and attorney would not be able to successfully argue that as a result of comparative fault, pain and suffering or even the desire to end litigation, the settlement or judgment did not

compensate the claimant for their "entire loss" and as such has not been "made whole." Further, few insurers are willing to spend large sums of money and resources pursuing a subrogation interest when the likelihood of recovery is minimal and the litigation costs often exceed the value of the subrogation interest. As a result, the workers' compensation insurer pays medical bills and other benefits, and the employer suffers a negative impact on its Modification Factor with a resulting increase in premiums, even though the accident/injury was the result of the negligence of a third party. In the case of self insured employers, the employer is required to pay medical bills and other benefits to the injured employee with no way to recover even a portion of those payments from the third party responsible for the accident.

VII. Do other states allow for subrogation without "made whole" limits?

Yes. Other states address subrogation issues in a number of different ways including requiring the consent of insurer before any settlement. Other states use statutory formulas to divide up the proceeds from a third party settlement. Others allow the worker compensation insurer to prosecute the case against the third party wrongdoer directly. Examples from several states are attached hereto. Unfortunately, as Montana law on subrogation has developed over the years, it is not felt that the options or formulas adopted from other states would survive judicial scrutiny.

VIII. Is there a Legislative solution that will help eliminate the current inequities and also survive judicial scrutiny?

We believe that there may be a legislative solution that will address some of the current inequities which may also survive judicial scrutiny. While not a workers' compensation case, in *Swanson v. Hartford Insurance Company*, 309 Mont. 269, 46 P.3d 584 (2002), the court considered whether revised language to MCA § 33-23-203 added in 1997 and which allowed for "reasonable subrogation" eliminated the "made whole" limitation. (MCA § 33-23-203 addresses "Limitation of liability under motor vehicle liability policy.")In deciding that it did not, the court agreed with Swanson's arguments that the legislature could have easily amended the statute to exclude some portion of the "made whole" doctrine if it chose to do so.

It seems likely that any solution that restricts a claimant's ability to retain 100% of workers' compensation wage loss benefits will be viewed as unfair and as such is more susceptible to judicial challenge. However, medical benefits may provide a different opportunity which allows for the injured worker to be fully compensated for all medical expenses while at the same time allowing the workers' compensation insurer to recover from the wrongdoer. Recently there have been several cases in which the Montana Supreme Court has not allowed double recovery of medical bills. See for example *Conway v. Benefis Health Systems, Inc.*, 369 Mont. 309, 297 P.3d 1200 (2013) (insured patient was not entitled to excess medical expense

payments made by automobile insurer for injuries patient sustained in automobile accident; medical payments coverage was for the payment of medical expenses only). However, in *Diaz v. State of Montana,* 2013 MT 331, decided on November 6, 2013 by the Supreme Court, the State Health Plan was required to pay the amount of their medical expenses even if those expenses had already been paid by a third party.

Subrogation Options for Consideration

"A Bill Clarifying a Workers Compensation Insurer's

Subrogation Interest in Third-Party Claims"

Whereas, subrogation is a device of equity which is designed to compel the ultimate payment of a debt by the one who in justice, equity and good conscience should pay it.

Whereas, in *Zacher v. American Ins. Co.*, 243 Mont. 226, 794 P.2d 335 (1990) and *Francetich v. State Compensation Mutual Ins. Fund,* 225 Mont. 215, 827 P.2d 1279 (1992), the Montana Supreme Court held that a workers compensation insurer or self-insurer has no subrogation interest in proceeds from a third-party action allowed for pursuant to MCA § 39-71-412 and MCA § 39-71-413 until the claimant has been "made whole" for his/her entire loss.

Whereas, later decisions of the Montana Supreme Court and the Montana Workers' Compensation Court have determined that the made whole calculation must be made without

regard to the negligence of the claimant and other factors that may have impacted the third-party action including policy limits and the claimant's desire to end the litigation.

Whereas, the "made whole" analysis includes wage loss, loss of earning capacity, loss of fringe benefits, pensions, pain and suffering, and related damages as well as past and future medical costs, workers compensation insurers and self-insurers are unable to exercise a subrogation interest in the proceeds of the third-party action.

Whereas, in *Zacher v. American Ins. Co.*, 243 Mont. 226, 794 P.2d 335 (1990) and *State Compensation Insurance Fund v. McMillan*, 306 Mont. 155, 31 P.3d 347 (2001), the Montana Supreme Court held that the "made whole doctrine" is not dependent upon a right of recovery of full legal redress under the Montana Constitution, Article II, Section 16; and

Whereas, in *Swanson v. Hartford Insurance Co.*, 309 Mont. 269, 46 P.3d 584 (2002), the Montana Supreme Court recognized the "made whole doctrine" is an equitable theory and that the Legislature had the authority to enact statutes limiting the "made whole doctrine."

Whereas, in *Ridley v. Guaranty Nat. Ins. Co.*, 286 Mont. 325, 951 P.2d 937 (1997), the Montana Supreme Court held that under the Unfair Trade Practices Act, an insurer has a duty to cover medical expenses for an injured third-party where liability is reasonably clear.

Option 1

MCA § 39-71-414 (2013) is amended as follows:

(6)(a) The insurer is entitled to full subrogation rights under this section for all medical benefits paid regardless of whether the claimant is able to demonstrate damages in excess of the workers' compensation and third-party recovery combined. For all other benefits . . .

Option 2

In the event of a compensable workers compensation claim arising out of an accident caused by a third party for which there is insurance, payments for medical care and treatment arising out of the accident must be made in the following order of priority:

(a) To the extent of the third party's policy's coverage limits for medical pay, bodily injury, sickness, death or disease

(b) By the workers compensation insurer for the employer.

This order of priority shall control regardless of whether the claimant is able to demonstrate damages in excess of the workers' compensation benefits and the third-party recovery combined.

Covered medical expenses must be paid according to the terms of the applicable policy or in accordance with any written agreement or contract existing between the provider and the insurer or a person contractually engaged by the insurer to perform services.