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MEMORANDUM

TO: Economic Affairs Interim Committee, HJR 25

FROM: Bob Worthington, Montana Self-Insurers Association

DATE: October 9, 2013

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 a person or entity. 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 very rarely recovers anything from the third party action as case law from the Montana Supreme Court 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 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 (MSIA) believes that current law should be amended so as to allow the self-insured employer or workers compensation insurer to recover a fair portion of the benefits it is required to pay the injured worker from the wrongdoer responsible for the accident and resulting injury. At the same time the MSIA recognizes the importance of preserving the injured workers right to "full legal redress" as provided for by Article II, Section 16, of the Montana constitution. The MSIA believes that both interests can be reconciled and intends to provide this Committee with various options for its consideration at the Jan. 21, 2014 meeting.

Background Information and Examples

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 when that total equals claimant's entire loss, then the insurer 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.)

Based on current precedent, the "entire loss" must be calculated without regard to comparative fault. For example, if the injured worker is contributory 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 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) the desire to end litigation may result in a smaller recovery not reflecting the entire loss.

The practical impact of the "made whole" doctrine is that Workers Compensation Insurers and Self-Insurers absorb the entire cost of claim caused by negligence of another. While the current statute, MCA § 39-71-414(6), suggests that it is 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". Taking into account the many factors that go into a "made whole" analysis and considering the fees and costs that would be incurred should an insurer really fight to secure its subrogation interest, this is an almost impossible burden for the insurer to meet. As a result, the employer suffers a negative impact on its Mod Factor with a resulting increase in premiums, even though the accident/injury was the result of the negligence of a third party. Of course, for the employer who self insures, the impact is even greater as benefits are paid directly by the employer to the injured employee.

The inequities that exist in the current system are perhaps best understood by example:

> Example (1). Employee A is driving in the course and scope of his employment for Business A. While sitting at a stop sign, Employee A is rear-ended by a truck owned by Business B. Employee A is off work for 2 months. During this period, Employee A receives temporary total disability benefits totaling $5,000.00 and $10,000.00 in medical bills are paid by the workers compensation insurer for Business A. Employee A sues Business B. Business B's motor vehicle liability policy has limits of $1,000,000.00. The liability case is settled for $75,000.00 based in part on the auto insurer's recognition that it is obligated by Montana law to

> reimburse Employee A for medical bills as well as any wage loss irrespective of the payment made by the workers compensation insurer. In these circumstances, the MSIA believes the workers compensation insurer should be able to recover the $15,000.00 it paid in benefits to Employee A. However, Employee A may contend that he has not been "made whole," as he only settled the case for $75,000.00 because he was tired of litigation. Further, he may claim that he still has pain from his injuries, has altered his lifestyle, and will sometime in the future not be able to maintain his employment.
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> Example (2). Same accident as above, but with serious injuries resulting in medical benefits of $250,000.00 and $100,000.00 in wage loss benefits. Case settles for $1,000,000.00 policy limits as the auto insurer for Employer B recognizes its obligation to pay all medical bills and wage loss arising out of the accident. Nevertheless, Employee A refuses to agree to subrogation, claiming that he has not been "made whole," as he had to pay his attorney 33% of the settlement, was forced to settle for policy limits, and expects a continuing disability.

The end result in each of these scenarios is that the employer/workers compensation insurer pays wage loss benefits and 100% of the medical bills arising out of the accident solely caused by the negligence of another. This is true even where the injured employee was paid for that same loss as part of the third party liability claim.

It is the Montana Self Insurers Association's position that in these and similar circumstances, the employer/workers compensation insurer should be able to recover those benefits it has paid arising from the negligence of a third party. At the same time, the injured employee will still receive all those benefits provided for by the Montana Workers Compensation Act and any additional damages recovered from the third party claim.

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