Workers' Comp subrogation: Don't allow your client to be extorted

If you "settle around" the employer, you may find yourself at odds with the subrogation attorney

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If an injured party is in the course and scope of her employment when injured, her employer must provide Workers' Compensation benefits. The employer enjoys the right to recoup Workers' Compensation benefits paid when the injured worker recovers from a third-party defendant. The employer can assert a lien or intervene in the third party matter to protect its right of recovery. If employer fault may be an issue, the employer will likely intervene. The employer will intervene to try to obtain a settlement of its lien and protect its right to assert a "Credit" in the workers' compensation matter.

Most of the time, the plaintiff's attorney and the Workers' Compensation subrogation attorney are on the same side, working towards the same goal – finding liability against the third-party defendant and obtaining some form of recovery against the third-party defendant. Usually, the plaintiff's attorney and the subrogation attorney work together, forming an alliance to benefit both sides.

However, when there is employer fault, a natural dispute arises over what, if anything, the Workers' Compensation subrogation attorney should get for the lien. If there is employer fault, plaintiff's counsel should seek to resolve the matter fully, getting the employer to reduce its lien or make other concessions. If the employee is dissatisfied with the employer's willingness to compromise, the employee may "settle around the employer." The employer's right of recovery, if any, can then be adjudicated in the Trial Court or the Workers' Compensation Appeals Board at the election of the workers' compensation insurance company.

Some subrogation attorneys believe they have an absolute right to recovery of the Workers' Compensation lien regardless of the issue of employer fault, and feel that they have no risk or downside when they attempt to "hold up" a settlement and extort money from the plaintiff's settlement as satisfaction of their lien.

The subrogation attorney will likely send a letter stating, "Plaintiff is not authorized to settle the claim with the responsible parties without her/his express consent pursuant to Labor Code section 3869." The subrogation attorney will also likely cite *Draper v. Aceto*, (2001) 26 Cal.4th 1086, claiming it establishes the employer's right to attorney's fees based upon the actual benefit conferred upon plaintiff from settlement. Such a claim is an incomplete representation of the law and intended to falsely claim that plaintiff's attorney has no alternative to satisfaction of the subrogation attorney's lien if the plaintiff wants to settle their claim against the third-party defendant.

This article provides guidance on now to prevent a Workers' Compensation subrogation attorney from extorting an improper recovery on their lien; a lien that may have little if no value depending upon the extent of employer fault.

The third-party claim

Upon filing a complaint on behalf of a client that has received Workers' Compensation benefits, serve a copy of the complaint upon the employer by personal service or certified mail and file a proof of service in the civil matter. (Lab. Code, § 3708.5.) Upon receipt of the answer(s), review it for assertions of affirmative defenses alleging employer fault or negligence of third parties. Good practice dictates this be served upon the employer as well. Failure to provide the statutory notice exposes plaintiff and his counsel to suit by the employer to recover benefits paid. (*Board of Administration v. Glover* (1983) 34 Cal.2d 906.)

Establishing employer fault

During discovery, plaintiff should consider marshaling evidence of employer fault. The timing of this pursuit should be calculated. The employer may be an ally in establishing third-party fault. Conducting aggressive discovery of employer fault may impair this alliance. So, this decision will be made on a case-by-case basis as to timing and extent of discovery of employer fault.

In addition to the obvious issue of co-worker fault, employers can have fault imposed upon them by statute. California Code of Regulations, title 8, Section 3203 imposes the obligation upon employers to establish a workplace injury and illness prevention program ("IIPP"). Employers must establish and maintain an IIPP.[1] Employers must perform periodic inspections to identify unsafe work conditions; provide training and instruction to their employees; and maintain records of same for at least one year. Violations of these regulations constitute negligence per se. (*Board of Administration v. Glover,* 935-936.) They may be asserted against the defendant as well as the employer to establish a standard of care.

"Settling around the employer"

At mediation, anticipate that the defendant's attorney may not be familiar with the intricacies of settling around the employer. Naturally, the third party will be concerned about its potential liability to the employer after settlement with plaintiff. To address these legitimate concerns, plaintiff's counsel should do the following:

- Agree to defend, indemnify and hold harmless the third party against the employer on its Complaint in Intervention;
- Establish a separate account for maintenance of settlement proceeds sufficient to protect the employer's claimed lien rights in the event no employer fault is subsequently established;
- Agree to represent the third party at trial on the issue of employer fault;
- Have third party waive conflict of interest related to allowing plaintiff's counsel to represent them related to employer fault issue;
- Obtain an assignment of third party's costs incurred in defense of suit;
- Serve a Notice of Third Party Settlement upon the employer. Attach a copy of the operative Complaint and Answer alleging employer fault;
- Serve discovery, including pointed Requests for Admission ("RFAs") upon the employer related to employer fault; and
- Serve separate Offers to Compromise on behalf of plaintiff and the third party upon the employer.

Agreement to defend, indemnify and hold defendant harmless as well as establishment of a separate account with sufficient funds to satisfy employer's recovery in the event no employer fault is established will allay defendant's concerns and facilitate resolution. Agreement to represent defendant at trial eliminates their future costs and allows them to get back to what they do, defend cases. Obtaining a conflict waiver allows plaintiff's counsel to sue the third party in the future without facing a disqualification motion. The assignment of rights of the third party costs provides leverage against the employer through subsequent Offer to Compromise. The Offer to Compromise also applies pressure through the 30-day statutory deadline. The employer cannot genuinely claim a need for more time, as in most cases, substantial discovery will have been completed. The RFAs likewise apply leverage against the employer exposing them to sanctions if you subsequently establish these facts.

Settlement of the third-party matter

Plaintiff must provide notice of the settlement to his employer. Labor Code section 3860(a) provides no release or settlement under this chapter is valid without notice to the employer. Typically, the employer will be an active participant in mediation or settlement discussions where they have intervened. Regardless, good practice again dictates formal compliance through mailing a copy of the Release to the employer citing the Code section in the cover letter.

If you are going to "settle around the employer," the release should include the following language:

- Plaintiff will defend, indemnify and hold harmless [third party] from the suit brought by employer and intervenor _____, Case No. _____ in the _____ County Superior Court, which suit has been consolidated with the claims of Plaintiff;
- Plaintiffs' counsel shall substitute into the action brought by plaintiff/employer-intervenor and represent [third-party defendant] in that action for all purposes;
- [Third-party defendant] will assign its recoverable costs in the case brought by _____ to the Plaintiff herein; and,
- [Third-party defendant] will waive any conflict of interest in this action or that may in the future arise from [Plaintiff's counsel's firm] representing [third-party defendant] in this action.

Upon receipt of the Release, the subrogation attorney should realize they now have not just a potential up-side recovery on their lien, but a financial down side as well. What they thought was their strength now may also be their weakness. Contrary to the subrogation attorney's earlier assertions, you can point out where employer fault is established, the employer's attorney's fees are deducted from the amount the employer recovers, if any, not on top of the recovery. (*Summers v. Newman,* (1999) 20 Cal.4th 1021.) Now, the other shoe drops.

Further if the subrogation attorney does not prevail, the subrogation attorney may have exposed its client to financial exposure for case costs and other statutory costs of litigation that may come into play.

Using a Qualified Settlement Fund

When a subrogation attorney and the employer are looking to get an unfair advantage in negotiations, they will often try to cut the plaintiff off financially to put economic pressure on the plaintiff. The subrogation attorney may threaten to have the employer assert a "Credit" in the Workers' Compensation matter and cut off all disability payments and medical coverage so that the injured worker has no money to pay their daily living expenses nor pay for medical treatment.

While this seems like a despicable tactic, it is one you must be prepared for when you settle around the Subrogation attorney's/employer lien. Once an employer learns plaintiff has settled with a third party, it will request written confirmation of the net amount the plaintiff will recover and then seek to terminate provision of Workers' Compensation benefits: future permanent disability and medical care costs related to the industrial injury. In order to preserve your client's access to these benefits, the plaintiff must not receive the settlement money for a "net recovery" until the issue of employer fault has been resolved.

Plaintiff's counsel can use a Qualified Settlement Fund ("QSF") to protect the settlement amount, while resolving liens and the issue of employer fault. Because the QSF expressly prevents plaintiff from being in receipt of the funds (and one cannot establish plaintiff's net

recovery until the liens and employer fault is resolved), this procedure should prohibit an employer from establishing plaintiff's receipt of settlement monies in order to terminate WC benefits. Some employers and their subrogation attorneys however, will still try.

Pursuant to Treasury Regulation section 1.468B-1(c)(1), a QSF "is established pursuant to an order of, or is approved by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) . . . and is subject to the continuing jurisdiction of that governmental authority." Therefore, a court order is required to establish the QSF. The petition should indicate the QSF shall be construed so as to prevent petitioner from being in constructive receipt, as determined under federal income tax principles, of any amounts held by the QSF prior to the time the petitioner and the QSF Administrator enter into a QSF Agreement. The petition should also indicate the QSF will allow petitioner to engage in additional financial and legal planning in a tax efficient manner.

In your petition, explain to the court why a QSF is necessary. It will allow plaintiff to make financial planning decisions free from pressures of litigation. The QSF will also protect the employer's interests by setting aside sufficient monies to cover its lien interest even
if no employer fault is established. Establishment of a QSF should prevent the employer from terminating benefits, as plaintiff is not in "constructive possession" of the settlement funds.

Trial on the issue of employer fault

After settlement with the third party, the civil case will proceed to trial. This creates the unusual situation where you may appear at trial and announce "ready" on behalf of both the plaintiff and defendant. Then you present a case establishing employer fault. Frequently, the intervenor will be ill-prepared to rebut your arguments or establish liability of the third-party defendant. On the right facts, you may establish sufficient employer fault to allow for substantial future Workers' Compensation benefits. More likely, this will result in further settlement negotiations, with the employer either "walking away" or making significant concessions.

Conclusion

Where employer fault exists, provide statutory notice to the employer to avoid a malpractice claim; give early consideration to marshaling necessary evidence to establish such fault; likewise consider the impact of discovery on the relationship with the employer's attorney who otherwise may be an ally against the third-party defendant; take an aggressive stance with the subrogation attorney regarding ability to recover on his client's lien rights; if necessary "settle around the employer;" and establish a QSF to prevent the employer from terminating plaintiff's benefits. Prevent the subrogation attorney from extorting an improper resolution of the employer's subrogation rights by forcefully asserting the options outlined herein. You and your clients deserve it.

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Endnote

[1] IIPP can also be fruitful sources for evidence against third parties related to premises liability claims, products liability claims and violations of workplace instruction.