MATTHIESEN, WICKERT & LEHRER, S.C.

A FULL SERVICE INSURANCE LAW FIRM

1111 E. Sumner Street, P.O. Box 270670, Hartford, WI 53027-0670

(800) 637-9176   (262) 673-7850   Fax (262) 673-3766

http://www.mwl-law.com

MONTHLY ELECTRONIC SUBROGATION NEWSLETTER   AUGUST 2006

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.

HEALTH CARE SUBROGATION

Wisconsin Supreme Court Hostile Toward Health Care Subrogation

By Ryan L. Woody

In an opinion filed on June 1, 2006, the Wisconsin Supreme Court again showed its hostility toward subrogated health carriers. In Drinkwater v. American Family Mutual Ins. Co., 2006 WI 56, 714 N.W.2d 568, the Court struck down a provision of an Iowa health plan that contained a choice-of-law provision applying the laws of Iowa. Iowa does not apply the made whole rule as its default, but instead allows health insurers to recover medical payments from insureds regardless of whether they have been made whole.

Drinkwater was an Iowa employee and a participant in an Iowa-sponsored health plan when he was injured in a Wisconsin accident. Drinkwater also happened to be a Wisconsin resident and therefore filed his tort action in Wisconsin. The health plan paid his medical bills and contained a subrogation clause which required reimbursement under the circumstances. The circuit court applied Wisconsin's made whole rule despite the Iowa choice-of-law provision. The health plan appealed.

In applying Wisconsin's choice-of-law analysis, the Court declared that the law of the forum state should apply unless it is clear that the out-of-state contacts are of greater significance. Id. at 575-76. Despite the fact that the health plan was issued in Iowa, by an Iowa employer to an Iowa-based employee, the Court held that Wisconsin's interest is greater than Iowa's interest. This case stands then for the proposition that "Wisconsin law will trump Illinois or Iowa subrogation law on a Wisconsin injury to a Wisconsin resident when the case is tried in a Wisconsin court." Id. at 581 (Prosser, dissenting).

This decision casts doubt on the rights of all out-of-state health plans to enforce their subrogation provisions free of Wisconsin's made whole rule. As such, all non-ERISA plans joined as a party in a Wisconsin suit will likely stare into the teeth of the made whole rule. It should be noted that this case did not deal with a self-funded ERISA plan, which is entitled to preempt state subrogation law, including Wisconsin's made whole rule.

FIDELITY AND BOND SUBROGATION

SQUEEZING THE TURNIP:
Fidelity and Surety Bond Subrogation

By Gary L. Wickert

Every day, millions of dollars in claims are paid on surety and fidelity bond payments. Despite this, subrogation in this area remains mired in obscurity and confusion, and claims handlers rarely consider the positive effects that aggressive subrogation recognition and investigation can have on an insurer's bottom line. This article will serve as a tutorial on fidelity and surety bond subrogation and suggest ways to improve recoveries upon such payment of claims.

A fidelity bond is a debt obligation serving to protect an employer from loss in the event that an employee causes damages through dishonest or negligent actions. These bonds are traditionally issued by insurance companies, although the terms and conditions of claim payments under fidelity bonds can differ greatly from traditional insurance.

A surety bond is a bond issued by an entity on behalf of a second party, guaranteeing that the second party will fulfill an obligation or series of obligations to a third party. In the event that the obligations are not met, the third party will recover its losses through a claim on the bond. Surety bonds are usually issued in construction settings or in situations in which payment of certain monies, such as taxes due to a governmental entity, are to be guaranteed by the entity issuing the bond.

In truth, bonds come in many shapes and sizes. The following are a number of different types of bonding instruments:

Advance Payment Bond: A bond that guarantees repayment by the principal of monies advanced in connection with a construction or supply bond or other type of contract.

Bid Bond: A bond given by a bidder on a contract that guarantees that the bidder, if selected, will enter into the contract and furnish the prescribed performance bond.

Blue Sky Bond: A bond required of securities dealers to prohibit the sale of worthless securities.

Concessionaire Bond: A bond required by principals operating a business venture on publicly owned or controlled property.

Court Bonds: All bonds and undertakings required of participants in a lawsuit permitting them to pursue certain remedies in the courts.

Depository Bond: A bond that guarantees that the principal (a bank) will be able to repay amounts deposited by the obligee.

Fidelity Bond: A form of "honesty insurance" which protects an employer from the dishonest acts of its bonded employees. Although called a “bond,” a fidelity bond is really an insurance policy and not a three party agreement like a surety bond.

Game of Chance Bond: A bond required by New York and Florida which guarantees that an entity sponsoring a contest will award the related cash/prizes to the legitimate contest winner.

Indemnity Agreement: An agreement required by the surety stating that, should a loss occur under a bond, the principal will hold the surety harmless from any loss or expense it may sustain as a result of the loss.

Labor and Material Bond: A bond given by a contractor to guarantee payment for labor and material used in the work, which he or she is obligated to perform under the contract.

License and Permit Bond: A bond required to ensure the licensee will conform to the laws or ordinances related to the business in which they are engaged.

Lost Instrument Bond: A bond that guarantees against damages sustained by reissuing a lost instrument or security.

Maintenance Bond: A bond that guarantees against defective workmanship or materials.

Mechanics Lien — Bond to Discharge: A lien against real estate may be filed for an amount claimed to be due for labor or materials furnished for the construction of a building or other improvement upon property. Pending final determination of the owner's liability, the owner may discharge the lien by giving this bond conditioned for the payment of any amount that may be found due to the claimant with interest and costs.

Obligee: The obligee is the entity (person, firm, corporation, government) protected by the surety bond against loss. The surety bond “runs to” the obligee and the obligee has the ability to set the language of the surety bond.

Performance Bond: A three party agreement, which guarantees faithful performance of the terms of a written contract. (Performance Bonds frequently incorporate labor and material and maintenance liability.)

Public Official Bond: A bond that guarantees the faithful performance of a wide variety of public officials. (Notary bonds, for example.)

Principal: The principal is the entity obligated, with the surety, to the obligee.

Probate Bond: A bond that guarantees honest accounting and faithful performance of duties by administrators, trustees, guardians, executors, and other fiduciaries.

<u>Reclamation Bond</u>: A bond that guarantees that the principal will reclaim land disturbed by mining operations.

<u>Street Opening/Encroachment Bond</u>: A bond required of a principal that has a permit to cut into a public sidewalk or road. The bond guarantees that the principal will comply with the conditions of the permit.

<u>Subcontract Bond</u>: A bond required by a general contractor of a subcontractor, guaranteeing that the subcontractor will faithfully perform the subcontract in accordance with its terms and will pay for labor and materials incurred in the prosecution of the subcontracted work.

<u>Subdivision/Site Bond</u>: Many municipalities require by ordinance that a developer who undertakes to develop a housing or industrial subdivision shall give a bond with surety to guarantee that, within a specified time, improvements on the property, such as streets, sidewalks, curbs, gutters, and sewers will be constructed.

<u>Supply Bond</u>: A bond that guarantees faithful performance of a contract to furnish supplies or materials.

<u>Surety</u>: The surety is the entity obligated, with the principal, to the obligee. In the event of a default on the part of the principal, the surety is required to perform the terms of the contract between the principal and obligee.

<u>Tax Bond</u>: A bond that guarantees the principal will pay taxes (fuel, sales tax, etc.).

<u>Utility Bond</u>: A bond that guarantees the principal will pay utility bills as they come due.

A claim payment under any of these instruments carries with it the possibility that some third person might be responsible or liable for the resulting claim payment under the bond, presenting subrogation opportunities for the principal or insurance company underwriting the bond. There are three parties to any sort of a bond. The **principal** or **obligor** is the party that undertakes the obligation and who is primarily bound by the bond. The **surety** or insurance company guarantees that the obligation will be performed. The **obligee** is the party who receives the benefit of the bond and is protected from loss. Subrogating bonds require creative recognition of third parties and third party liability, and a commitment to cost-effectively, yet thoroughly, squeeze every recovery dollar out of those third parties. So let's look at how bond subrogation takes place.

The subrogation rights of a surety can arise from pure common law – equitable subrogation – without any specific bond language or assignments. More commonly, however, the bond itself contains language granting subrogation rights, such as:

> *In the event of any payment under this endorsement the Company shall be subrogated to all the Insured's rights of recovery therefore against any person or organization and the Insured shall execute and deliver instruments and papers and do whatsoever else is necessary to secure such rights. The Insured shall do nothing after loss to prejudice such rights.*

Such contractual subrogation rights such as these may or may not trump equitable defense to subrogation such as the made whole doctrine, which requires that the insured be made whole for all damages before the surety can subrogate, or the common fund doctrine, which requires that any attorney who creates a fund from which a subrogation recovery is obtained, is entitled to receive a reasonable fee from that recovery.

It is well-established that any surety who discharges a principal's obligation is subrogated to the rights of the obligee against the principal. United States v. Munsey Trust Co., 332 U.S. 234 (1947). A tax bond issued to benefit an obligee, such as the State of Texas for payment of sales taxes by a principal, is a typical bond you might see. Some years ago, Gary Wickert represented Hartford Casualty Insurance Company as surety on a tax bond issued to the State of Texas and insuring the payment of sales taxes by Herbert W. Fields, the owner of a Texas business. After filing suit against Fields for recovery of a bond payment made when Fields failed to make his required sales tax payments to the State, Fields filed for bankruptcy, and tried to discharge the tax debt. Hartford argued that the tax debt couldn't be discharged in bankruptcy, while Fields argued that Hartford had no standing to claim an exemption from discharge – only the State could. The United States Bankruptcy Court held for Hartford, and the matter was appealed to the United States District Court for the Southern District of Texas, and later appealed to the Fifth Circuit Court of Appeals. Ultimately, the court confirmed that Hartford stepped into the shoes of the State of Texas and assumed whatever rights and remedies they had – even the right to claim an exception to discharge of the debt in bankruptcy. Hartford Casualty Ins. Co. v. Fields, 926 F.2d 501 (5th Cir. 1991). The United States Supreme Court even asked for briefs on the subject and ultimately denied writ, confirming the power of a subrogating bond issuer.

With fidelity bonds, a surety pays a claim when the dishonesty or theft of an employee costs the obligee company, for whom the bond is issued, money. Where an employee embezzles money from an obligee company (employer), the surety clearly has a subrogation action it can pursue against the dishonest employee. The problem here is that the employee rarely has any assets to satisfy a subrogation judgment against him or her, and is most often judgment proof. Rather than throwing good money after bad by pursuing a paper judgment against the employee, a prudent claims handler will conduct a detailed investigation into the loss which covers such things as:

- all accounting and banking records of the insured;
- a detailed synopsis of how the thefts took place;
- recorded statements of fellow employees and principals of the insured;
- copies of bank statements and cancelled checks;
- procedures for fraud prevention and audits of the insured; and
- copies of internal accounting procedures and protocols.

In nearly two-thirds of fidelity bond subrogation cases, the insured's bank account or checks were instrumental in facilitating the thefts. The dishonest employee will issue checks to himself and forge the maker's signature, issue checks to fictitious vendors, endorse the fictitious vendor's name on the checks and then deposit them in his or her own bank account, or some derivation thereof. The Uniform Commercial Code provides a number of protections to an account holder, including holding drawing and collecting banks liable for instruments, including checks, paid on forged makers' signatures or forged endorsements. Banking rules and regulations require an insured to review its monthly bank statement thoroughly and note any discrepancies. The problem is that, quite often, the dishonest employee is the one who receives and reviews the statements.

All of this is governed by the Uniform Commercial Code (U.C.C.), a uniform law governing commercial transactions. Uniform Commercial Code § 1-101, *et seq*. The U.C.C. has been adopted by all states except Louisiana.

Although the law is complicated in this area, banks assume certain liabilities simply by being in the banking business, and banking customers assume certain responsibilities. Under the U.C.C. and subject to certain responsibilities of the bank customer to review its statement and discover and report unauthorized signatures, banks warrant that checks will not be paid on forged endorsements or forged makers' signatures. The type of warranty given depends on what role the bank plays – drawer bank, collecting bank, etc. The important thing for subrogation professionals to keep in mind is that the liability of a bank can be sharply limited or eliminated altogether based on the time that passes between the date the bank customer (insured) gets its bank statement, and the date that it discovers the theft or embezzlement. Accordingly, the following should be done in addition to a zealous subrogation investigation:

- Notify the bank or banks involved immediately of the problem, specifying in detail the checks involved, the suspected forgeries, and all relevant information; and

- Get subrogation counsel involved as soon as possible. Not only are there strict statutes of limitation with regard to filing suit against banks under the U.C.C., but there may be additional third parties out there to be pursued.

Subrogation claims against banks may provide the only avenue of recovery when dishonest employees embezzle funds with the use of checking accounts. Time is of the essence, so don't wait for a significant dollar employee dishonesty fidelity bond claim to resolve itself before engaging subrogation counsel or referring it to your subrogation department. Due to the way that the U.C.C. operates, with each day that passes, more and more checks become "stale" for purposes of subrogation. Squeezing blood from a turnip can be lucrative, provided everyone in the claim chain understands that time is of the essence.

WORKERS' COMPENSATION

WORKERS' COMPENSATION SUBROGATION: Which Payments Can Be Recovered?

By Gary L. Wickert

In many respects it is as daunting and elusive as the search for the Holy Grail. All fifty states allow for recovery of workers' compensation benefits paid to or on behalf of a claimant injured in the course of his or her employment. Not a single one, however, enunciates precisely which payments or costs paid by a compensation carrier constitute "compensation" and can be recovered. The result is an ongoing debate and argument with claimants' attorneys over what can and can't be included in a carrier's lien for recovery purposes.

In addition to medical expenses, death benefits, funeral costs and/or indemnity benefits for lost wages and loss of earning capacity resulting from a compensable injury, workers' compensation insurance carriers also expend considerable dollars for case management costs, medical bill audit fees, rehabilitation benefits, nurse caseworker fees, and the like. Subrogation professionals and trial lawyers are not the only ones confused. Trial judges, too, scratch their heads and stare blankly into the courtroom when asked whether a carrier can include such payments in their subrogation liens. As is often the case when there is no answer in law – a good argument can often carry the day.

Judges like things that fit neatly into legal categories and definitions. When subrogating for more than basic medical and indemnity benefits, look first to the underlying workers' compensation subrogation statute. In Texas for example, the statute reads as follows:

> *"…the net amount recovered by a claimant in a third-party action shall be used to reimburse the carrier for benefits, including medical benefits that have been paid for the compensable injury."* V.T.C.A. Labor Code § 417.002.

Therefore, the question becomes whether or not such things as case management costs and medical bill audit fees are considered benefits or medical benefits which have been paid "for the compensable injury". "Case management" is a collaborative process of a medical assessment, planning, facilitation and advocacy for options and services to meet an injured worker's health needs through communication and available resources in order to promote quality and cost-effective recoveries and outcomes. Fee audits ensure compliance with state fee guidelines, prevent fraud, and keep liens to an absolute minimum. These efforts hold down costs of workers' compensation for employers and ensure that the smallest lien possible is taken from an injured worker's third party recovery. Refusing to reimburse costs such as these is not only illogical, it's foolish. But logic doesn't always win the day, so let's look at the law.

The Texas Department of Insurance – Workers' Compensation Division actually requires these services and expenses. Therefore, the carrier should be able to recover them. The Texas Administrative Code provides as follows:

> *"(a) The ground rules and the medical service standards and limitations as established by the Fee Guidelines shall be used to properly calculate the payments due to the healthcare providers."* Tex. Admin. Code Tit. 28, § 134.1.

The Texas Supreme Court has also indirectly weighed in on the issue. It has confirmed that § 417.002(a) requires that a carrier be reimbursed out of any third-party recovery for all benefits paid for an injury. Texas Workers' Comp. Ins. Fund v. Serrano, 962 S.W.2d 536 (Tex. 1998). It says that the statute does not limit reimbursement to only those benefits that are reasonable and necessary. Because the injured worker receives the benefit of all amounts paid, the carrier is entitled to reimbursement without proving that the amounts paid to or for the worker were reasonable and necessary medical expenses. The assumption is that if it was paid, it should be reimbursed. The Court essentially gave broad definitions to the terms "medical benefit" and "healthcare". The Serrano court allowed reimbursement for costs and payments introduced in that case which indicated on their face that they were paid in accordance with Commission guidelines.

Each state should be evaluated and argued differently, because each state's statute is different. In California, for example, the applicable statute reads as follows:

“Any employer who pays, or becomes obligated to pay compensation, or who pays, or becomes obligated to pay salary in lieu of compensation, or who pays or becomes obligated to pay an amount to the Department of Industrial Relations pursuant to Section 4706.5, may likewise make a claim or bring an action against the third person. In the latter event, the employer may recover in the same suit, in addition to the total amount of compensation, damages for which he or she was liable including all salary, wage, pension, or other emolument paid to the employee or to his or her dependents.” Ann. Cal. Labor Code § 3852.

The workers’ compensation carrier is entitled to recover in the same third party lawsuit with the employee, the total amount of its expenditures for “compensation” and any other special damages, such as salary, wage, pension or other emolument paid to the employee. Ann. Cal. Labor Code § 3856(c). California law then defines “compensation” as:

“…compensation under this division and includes every benefit or payment conferred by this division [Division IV] upon an injured employee, or in the event of his or her death, upon his or her dependents, without regard to negligence.” Ann. Cal. Labor Code § 3207.

“Compensation” therefore, includes medical and hospital expenses (Ann. Cal. Labor Code §§ 4600-4608), medical-legal expenses (Ann. Cal. Labor Code §§ 4620-4628), vocational rehabilitation expenses (Ann. Cal. Labor Code §§ 4635-4647), disability indemnity payments (Ann. Cal. Labor Code §§ 4650-4663), death benefits (Ann. Cal. Labor Code §§ 4700-4709), and interest (Ann. Cal. Labor Code § 5800). Most penalties are arguably recoverable as mandated by Division IV, and even the cost of utilization review should now arguably be recoverable as the use of such process is now mandated by California law. Ann. Cal. Labor Code § 4610. However, the cost of utilization review may not be a “benefit” or “payment conferred on an injured employee”. Aside from the logical arguments above, California law apparently does not directly support recovery of these items. But it does require mitigation of damages, and one Court of Appeals decision does allow a plaintiff to recover the cost of mitigation efforts as a recoverable item of damages. Kleinclause v. Marin Realty Co., 94 Cal.App.2d 773 (1949).

Another interesting and cogent argument is an analogy to the right to a future credit. When a recovery by a claimant is made, the carrier is given a credit toward future “benefit” payments. A close look at this law reveals that “medical-legal” costs should be costs against which a carrier can press a credit, implying that they constitute “compensation” under California law and should be recoverable by a workers’ compensation carrier. Adams v. Workers’ Comp. Appeals Board, 18 Cal.3d 226 (1976).

Arguments in each state should be fashioned from the only tools available – statutory language and common sense. In North Carolina, for example, the workers’ compensation statute provides for reimbursement to the carrier of “all benefits by way of compensation or medical compensation expense paid or to be paid”. N.C.G.S.A. § 97-10.2. Further legal archaeology reveals the definition of compensation as follows:

“The term ‘compensation’ means the money allowance payable to an employee or to his dependents as provided for in this Article, and includes funeral benefits provided therein.” N.C.G.S.A. § 97-2.

North Carolina case law reveals no further clarification on exactly what "medical compensation expenses" refer to, but the door seems open wide enough to include some of the case management costs referenced above, yet not quite wide enough to include interest. Buckner v. City of Asheville, 438 S.E.2d 467 (N.C. App. 1994). In North Carolina, however, there is also the possible appeal to the Industrial Commission to have something declared as a "benefit" recoverable in subrogation. Before the Commission can declare that a carrier is entitled to a particular expense, it must make a factual determination that the services were rehabilitative in nature and reasonably "required to effect a cure or give relief" to the claimant. Walker v. Penn Nat'l Security Ins. Co., 608 S.E.2d 107 (N.C. App. 2005). This state has a higher burden to meet in order to recover something as a "benefit" in subrogation.

Illinois has totally ignored the cost savings to the claimant of such case management fees and expenditures. It has declared such items unrecoverable because such medical rehabilitative services provided by the claims coordinator at the insurance company's direction were presumably provided for the benefit of the carrier and were not reimbursable necessary medical or rehabilitative services. Cole v. Byrd, 656 N.E.2d 1068 (Ill. 1995). The particular expense at issue was the medical rehabilitation coordinator services of a licensed professional nurse provided by Professional Rehabilitation Management (PRM).

When attempting to recover for costs or expenses beyond the basic indemnity and medical benefit payments, a subrogation professional's first strategy should be to look at the law of the particular state involved, to determine exactly what the subrogation statute allows the carrier to recover. For example, if it allows for recovery of "benefits" or "compensation" paid, then the definitions of those terms in other areas of the workers' compensation law should be determined, and an argument fashioned that those definitions include case management type fees and expenses. If that proves to be a dead end, a logical argument should be made that by discouraging the spending of such amounts, the subrogation lien will actually increase, and the recovery of the injured worker will decrease. Such expenditures actually assist in holding down the cost of workers' compensation insurance premiums, and every incentive to hold down liens and reduce fraud will make workers' compensation systems more cost-effective and affordable for businesses. As a last resort, simply include these reasonable costs in the lien totals provided to plaintiffs' lawyers, putting the burden on them to affirmatively challenge such expenses. While it is perhaps a stretch to include attorney's fees and other overhead charges in the lien total, it is reasonable to expect reimbursement of expenses and costs which actually benefit the claimant by keeping the benefits total to its absolute minimum. If the totals are not questioned, there is no foul. If they are, remember the words of Mark Twain, "Whatever you say, say it with conviction."

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