HANDLING SUBROGATION AND LIEN ISSUES IN SETTLING CLAIMS

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Subrogation

- There are two types of subrogation:
  - Contractual
  - Equitable

Subrogation

- Contractual (or conventional) subrogation is created by an agreement or contract that grants the right to pursue reimbursement from a third party in exchange for payment of a loss.

Subrogation

- The doctrine of equitable subrogation allows a party who would otherwise lack standing to step into the shoes of and pursue the claims belonging to the party with standing.
- The doctrine of equitable subrogation applies "in every instance in which one person, not acting voluntarily, has paid a debt for which another was primarily liable and which in equity should have been paid by the latter."
- *Frymire Engineering Co., Inc. v. Jomar International, Ltd.*, 259 S.W.3d 140 (Tex. 2008).

Liens

- A lien is a legal right or interest that one has in the property of another. Black's Law Dictionary (8th Edition).
- Generally, a lien is created by one of two things. The first is by statute; the second is by contract.

WORKER'S COMPENSATION SUBROGATION

- TX Labor Code Section 417.001 provides:
  - (a) An employee or legal beneficiary may seek damages from a third party who is or becomes liable to pay damages for an injury or death that is compensable under this subtitle and may also pursue a claim for workers' compensation benefits under this sub-title.

WORKER'S COMPENSATION

- Section 417.002 provides:
  - (a) The net amount recovered by a claimant in a third-party action shall be used to reimburse the insurance carrier for benefits, including medical benefits, that have been paid for the compensable injury.

WORKER'S COMPENSATION

- *Liberty Mutual v. Kinser*, 82 S.W.3d 71 (Tex.App.—San Antonio 2002, pet. withdrawn)
  - Although the term "third party" when read in isolation is not limited to tortfeasors, the term "third party" must be read in context. Section 417.001(a) modifies or limits the "third party" to a "third party who is or becomes liable to pay damages." Therefore, a carrier is only entitled to subrogation against damages paid to an injured employee by a third party who is or becomes liable to pay damages.

WORKER'S COMPENSATION

- *Liberty Mutual v. Kinser*, 82 S.W.3d 71 (Tex.App.—San Antonio 2002, pet. withdrawn)
  - Kinser contends that the subrogation provision is not applicable because State Farm was liable for contractual benefits not damages. The Houston [1st] court dismissed this argument by stating that a UIM carrier is statutorily obligated to provide for the payment of sums the insured is legally entitled to recover as damages.

WORKER'S COMPENSATION

- *Liberty Mutual v. Kinser*, 82 S.W.3d 71 (Tex.App.—San Antonio 2002, pet. withdrawn)
  - We agree with Kinser that the term "damages" as used in section 417.001(a) does not include UIM benefits but is limited to damages recovered from a third party who is liable to the injured employee because the third party breached a contract or committed a tortious act against the injured employee. Therefore, we hold that Liberty Mutual does not have a subrogation right to benefits paid to Kinser by State Farm under Kinser's UIM coverage—a holding that is consistent with the view of a majority of other jurisdictions.

WORKER'S COMPENSATION

- *Resolution Oversight Corp v Garza*, 2009 WL 1981424 (Tex App- Austin 2009)
  - This question is not one of first impression. Several of our sister courts have been presented with the question of whether the subrogation rights established by section 417.001 extend to UIM benefits. These cases fall into two categories: (1) those involving employer-purchased policies; and (2) those involving employee-purchased policies.
  - In each case involving employer-purchased policies, the courts have held that the workers' compensation carrier has a subrogation interest in the UIM benefits.

WORKER'S COMPENSATION

- *Resolution Oversight Corp v Garza*, 2009 WL 1981424 (Tex App- Austin 2009)
  - The courts found the factual distinction between these cases and those involving employee-purchased policies significant for two reasons.
  - First, as the Court noted in *Casualty Reciprocal Exchange v. Demock, 130 S.W.3d 74 (Tex. App.-El Paso 2002)*, when employee-purchased plans are involved, the courts must reconcile competing public policies:
    - The Legislature declared it to be the public policy of this state to make uninsured motorist coverage a part of every liability insurance policy issued, with certain limited exceptions....

WORKER'S COMPENSATION

- *Resolution Oversight Corp v Garza*, 2009 WL 1981424 (Tex App- Austin 2009)

  - Second, to allow subrogation rights against employee-purchased UIM policies would result in the injured employee subsidizing the workers' compensation carrier, a result which the courts found untenable. See *Kinser*, 82 S.W.3d at 79; *Gomez*, 141 S.W.3d at 772.

HOSPITAL LIENS

- TX Property Code Section 55.002(a)
- When a person is hospitalized for personal injuries, "the hospital has a lien on a cause of action or claim of an individual who receives hospital services for injuries caused by an accident that is attributed to the negligence of another person. For the lien to attach, the individual must be admitted to a hospital not later than 72 hours after the accident."

HOSPITAL LIENS

- The legislature, however, has specifically exempted from the statutory lien "the proceeds of an insurance policy in favor of the injured individual or the injured individual's beneficiary or legal representative, except public liability insurance carried by the insured that protects the insured against loss caused by an accident or collision.." *See* Sec. 55.003(b)(2).

HOSPITAL LIENS

- *Members Mut. Ins. Co. v. Hermann Hosp.*, 664 S.W.2d 325 (Tex. 1984).
  - In contrast to liability insurance, uninsured motorists coverage protects insureds against negligent, financially irresponsible motorists. *Francis v. International Service Insurance Co.*, 546 S.W.2d 57, 61 (Tex.1976); *Employers Casualty Co. v. Sloan,* 565 S.W.2d 580, 583 (Tex.Civ.App. - 328* Austin 1978, writ ref'd n.r.e.). Here, the uninsured motorists coverage did not protect the insured from liability for damages caused to others, thus it does not fit within the definition of liability insurance or public liability insurance. We therefore hold that the proceeds of uninsured motorists coverage are not subject to a hospital lien under art. 5506a.

MEDICARE/MEDICAID LIENS

- 42 USC 1395y(b)(2) states:
  - (2) Medicare secondary payer
  - (A) In general
  - Payment under this subchapter may not be made, except as provided in subparagraph (B), with respect to any item or service to the extent that—

    * * *
  - (ii) payment has been made or can reasonably be expected to be made under a workmen's compensation law or plan of the United States or a State or under an *automobile or liability insurance policy or plan (including a self-insured plan) or under no fault insurance*.

MEDICARE/MEDICAID LIENS

- *Texas Farmers Ins. Co. v. Fruge*, 13 S.W.3d 509 (Tex.App.-Beaumont 2000)
  - Medicare is a secondary payer for services covered under no-fault insurance. 42 U.S.C. § 1395y(2)(A)(B)(ii); 42 C.F.R. § 411.50(c). And "no-fault insurance" includes "personal injury protection" coverage. 42 C.F.R. § 411.50(b). This is an instance where federal law preempts state law. *See U.S. v. Geier, 816 F.Supp. 1332, 1337 (W.D.Wis.1993).* State law can be preempted by federal rules as well as federal statutes. *See Hillsborough County v. Automated Med. Lab., Inc.,* 471 U.S. 707, 713, 105 S.Ct. 2371, 85 L.Ed.2d 714, 721 (1985).

MEDICARE/MEDICAID LIENS

- *Lewis v. Allstate Ins. Co.*, 2006 WL 665790 (Tex.App.-Beaumont 2006)
  - The court held that Allstate was required to name Medicare as a co-payee for the amount of the Medicare payments.

- *Texas Farmers Ins. Co. v. Fruge*

  Farmers breached policy by including Medicare on the settlement check for $1,600 where lien was only for $150

CHILD SUPPORT LIENS

TX Family Code § 157.319. Effect of Lien Notice

(a) if a person having actual notice of the lien possesses nonexempt personal property of the obligor that may be subject to the lien, the property may not be paid over, released, sold, transferred, encumbered, or conveyed unless:

(1) a release of lien signed by the claimant is delivered to the person in possession; or

(2) a court, after notice to the claimant and hearing, has ordered the release of the lien because arrearages do not exist.

(b) A person having notice of a child support lien who violates this section may be joined as a party to a foreclosure action under this chapter and is subject to the penalties provided by this subchapter.

(c) This section does not affect the validity or priority of a lien of a health care provider, a lien for attorney's fees, or a lien of a holder of a security interest. This section does not affect the assignment of rights or subrogation of a claim under Title XIX of the federal Social Security Act (42 U.S.C. Section 1396 et seq.), as amended.

CHILD SUPPORT LIENS

§ 157.324. Liability for Failure to Comply with Order or Lien

A person who knowingly disposes of property subject to a child support lien or who, after a foreclosure hearing, fails to surrender on demand nonexempt personal property as directed by a court under this subchapter is liable to the claimant in an amount equal to the value of the property disposed of or not surrendered, not to exceed the amount of the child support arrearages for which the lien or foreclosure judgment was issued.

MADE WHOLE DOCTRINE

- The Made Whole Doctrine is an equitable defense that requires the insured must be made whole for all of its damages before an insurer or third party can recoup its expenses through subrogation.

Ortiz v. Great Southern Fire and Cas. Ins. Co. 597 S.W. 2d. 342, 343 (Tex. 1980)

- The Texas Supreme Court held "[a]n insurer is not entitled to subrogation if the insured's loss is in excess of the amounts recovered from the insurer and the third party causing the loss."
- The idea behind the made-whole doctrine is that "when either the insurer or the insured must to some extent go unpaid, the loss should be borne by the insurer for that is a risk the insured has paid it to assume." *Ortiz,* supra, 597 S.W.2d at 344.

Generally, with the Whole Made Doctrine, there are five possible outcomes:

1. The insurer is the sole owner of the claim against the third party and is entitled to the full amount recovered.

2. The insurer is to be reimbursed first out of the recovery from the third party and the insured is entitled to any remaining balance.

3. The insured is the sole owner of the claim against the third party and is entitled to the full amount recovered, whether or not the total received from the third party and insurer exceeds his loss.

Five Possible Outcomes

- 4. The insured is to be reimbursed first, for the loss not covered by insurance, and the insurer is entitled to any remaining balance.
- 5. The recovery from the third person is to be prorated between the insurer and insured in accordance with the percentage of the original loss the insurer paid the insured under the policy.

Those are the possible outcomes but what is this doctrine really about?

What has happened since *Ortiz?*

- First in *Veazey v. Allstate Texas Lloyds,* 2007 WL 29239 (N.D. Tex. 2007), a U.S. District Court found that there were limitations to the whole made doctrine.
- In *Veazey,* George Veazey's Lexus caught fire in his garage due to a manufacturer's defect, resulting in a total loss of his house and contents, and requiring significant living expenses.

Veazey v. Allstate Texas Lloyds

- Although Allstate paid Veazey a little more than $1.3 million under its homeowner's policy, (policy limits) Veazey claimed damages of $9 million and sued Toyota.
- Allstate intervened into Veazey's lawsuit and settled directly with Toyota for $900,000, assigning its entire $1,375,523 subrogation interest to Toyota.

Veazey v. Allstate Texas Lloyds

- Veazy then settled its claim against Toyota for an undisclosed amount, and immediately filed suit against Allstate, claiming that he was not made whole for all of his damages, and therefore Allstate should not be able to subrogate.
- Veazy argued that because he recovered more than the $1,375,523 paid by Allstate, but less than the $9 million in damages he sustained, he was not made whole and Allstate should not be allowed to keep the $900,000 Toyota paid it in settlement. He asked for reimbursement of the $900,000.

Veazey v. Allstate Texas Lloyds

- The federal court disagreed, granting Allstate's summary judgment, holding that the made whole doctrine did not apply.
- Because the insured brought the suit to recover from the insurance company, the insured had the burden of proof of showing that the third party settlement included some of his uninsured losses – a burden he failed to meet.

Fortis Benefits v. Cantu, 234 S.W. 3d 642 (Tex. 2007)

- After *Veazey*, the Texas Supreme Court in *Fortis Benefits v. Cantu*, 234 S.W. 3d 642 (Tex. 2007) ruled that the Made Whole Doctrine does not apply to contractual subrogation claims.

- The Court found the Made Whole Doctrine can be overcome by a boiler-plate provision in an insurance contract that purports to entitle the insurer to subrogation out of the first monies received by the insured.

Fortis Benefits v. Cantu, 234 S.W. 3d 642 (Tex. 2007)

- Fortis, as health insurer, for Ms. Cantu had paid $247,534.14 in medical benefits after she was injured in a car wreck. Ms. Cantu then filed suit against the adverse driver, the driver's employer, the vehicle seller and manufacturer.
- Ms. Cantu later recovered $1.44 million in a settlement with those defendants.
- Fortis then sought reimbursement for its lien out of those proceeds in accordance with the subrogation and reimbursement language in its policy.

Fortis Benefits v. Cantu, 234 S.W. 3d 642 (Tex. 2007)

- Cantu argued, however, that she was not made whole by the settlement and that Fortis was entitled to nothing. The trial court and a divided appellate court agreed and awarded Fortis nothing.
- The case was appealed to the Texas Supreme Court to decide whether the made whole doctrine could override the Fortis policy language.

Fortis Benefits v. Cantu, 234 S.W. 3d 642 (Tex. 2007)

- The court ruled that *"[w]here a valid contract prescribes particular remedies or imposes particular obligations, equity generally must yield unless the contract violates positive law or offends public policy."*
- The court went on to hold that *"contract-based subrogation rights should be governed by the parties' express agreement and not invalidated by equitable considerations that might control by default in the absence of an agreement."*

The Texas Legislature's Response

- Not long after *Fortis Benefits*, the Texas Legislature passed a law which made several changes to **health insurance subrogation,** which was touted as a *"legislative compromise"* between the *Fortis Benefits* case and the Made Whole Doctrine.

The Legislative Compromise

- Before we get into specifics on Chapter 140 a couple of reminders:
  - The statute is expressly not applicable to workers' compensation, Medicare, Medicaid, state child health plans, and ERISA plans. It is not clear but arguably Chapter 140 would also not apply to property damage claims.
  - The statute *applies " to a contractual right of subrogation in a cause of action that accrues on or after"* January 1, 2014.

Chapter 140 of the Texas Civil Practice and Remedies Code

- (a) If an injured, covered individual is entitled by law to seek a recovery from the third-party tortfeasor for benefits paid or provided by a subrogee as described by Section 140.004, then all payors are entitled to recover as provided by Subsection (b) or (c).
- (b) This subsection applies when a covered individual is not represented by an attorney in obtaining a recovery. All payors' share under Subsection (a) of a covered individual's recovery is an amount that is equal to the lesser of:

Chapter 140 of the Texas Civil Practice and Remedies Code

- (1) One-half (1/2) of the covered individual's gross recovery; or
- (2) The total cost of benefits paid, provided, or assumed by the payor as a direct result of the tortious conduct of the third party.

Chapter 140 of the Texas Civil Practice and Remedies Code

- (c) This subsection applies when a covered individual is represented by an attorney in obtaining a recovery. All payors' share under Subsection (a) of a covered individual's recovery is an amount that is equal to the **lesser** of:

Chapter 140 of the Texas Civil Practice and Remedies Code

- (1) One-half (1/2) of the covered individual's gross recovery less attorney's fees and procurement costs as provided by Section 140.007; or

- (2) The total cost of benefits paid, provided, or assumed by the payor as a direct result of the tortious conduct of the third party less attorney's fees and procurement costs as provided by Section 140.007.

Chapter 140 of the Texas Civil Practice and Remedies Code

- (d) The common law doctrine that requires an injured party to be made whole before a subrogee makes a recovery does not apply to the recovery of a payor under this section.
- In other words, the Made Whole Doctrine does not apply.

Attorney's Fees under Chapter 140

- If the carrier is not *"actively represented"* by counsel, the carrier must pay a fee to the injured party's attorney as set out in a fee agreement with the injured party's counsel.

- If no fee agreement, then the carrier must still pay *"a reasonable fee … not to exceed one-third of the payor's recovery."*

Attorney's Fees Under Chapter 140

- The statute seems to encourage a fee agreement between the carrier and the injury party's attorney.
- Absent an agreement, the statute only requires that the court award *"a reasonable fee,"* but in no event one that exceeds one-third of the recovery.
- In other words, the statute sets an upper limit on the fee to be paid, but no minimum. The reasonable fee could be one-third or something much less.

Attorney's Fees Under Chapter 140

- If the carrier is "*actively represented*" by counsel, then the fee payable out of the carrier's recovery is to be apportioned between the carrier's and injured party's counsel.
- The court is to consider "*the benefit accruing to the payor as a result of each attorney's service.*"