

IN THE WORKERS' COMPENSATION COURT OF THE STATE OF MONTANA

1998 MT WCC 52

WCC No. 9710-7854

JACK J. O'BRIEN,

Petitioner,

vs.

STATE COMPENSATION INSURANCE FUND,

Respondent/Insurer for

PINE HILLS SCHOOL,

Employer.

**ORDER IMPOSING SANCTIONS AND
CERTIFICATION OF JUDGMENT AS FINAL**

Summary: After claimant received a settlement in a medical malpractice action brought following an industrial injury, State Fund claimed a subrogation interest in the settlement. Claimant disagreed and filed a petition in this Court. State Fund responded to the petition, claiming the subrogation interest. Eleven days later, State Fund capitulated and eventually moved for summary judgment on the basis of its agreement that it did not have a subrogation interest. Claimant persisted in seeking sanctions, arguing the insurer's position had been without basis in law or fact.

Held: Sanctions ordered pursuant to section 39-71-2914, MCA (1991), but ordered against State Fund, not in-house counsel representing the insurer. While it may have been reasonable to assert an equitable interest in a medical malpractice recovery under the circumstances alleged by the insurer, the insurer asserted that interest without consideration of whether claimant had been made whole for his entire loss, a position without basis under statutes and Supreme Court precedent. Sanctions consist of reasonable attorneys fees and costs, along with a penalty consisting of ten percent per annum interest on the amount of the settlement State Fund argued it would take in settlement of its subrogation claim.

Topics:

Sanctions. Sanctions ordered pursuant to section 39-71-2914, MCA (1991), but ordered against State Fund, not in-house counsel representing the insurer. While it may have been reasonable for the insurer to assert an equitable subrogation interest in a medical malpractice recovery under the circumstances alleged by the insurer, the insurer asserted that interest without consideration of whether claimant had been made whole for his entire loss, a position without basis under statutes and Supreme Court precedent. Sanctions consist of reasonable attorneys fees and costs, along with a penalty consisting of ten percent per annum interest on the amount of the medical malpractice recovery State Fund argued it would take in settlement of its subrogation claim.

Subrogation. While it may have been reasonable for the insurer to assert an equitable subrogation interest in a medical malpractice recovery under the circumstances alleged by the insurer, the insurer asserted that interest without consideration of whether claimant had been made whole for his entire loss, a position without basis under statutes and Supreme Court precedent. Sanctions ordered pursuant to section 39-71-2914, MCA (1991), but ordered against State Fund, not in-house counsel representing the insurer. Sanctions consist of reasonable attorneys fees and costs, along with a penalty consisting of ten percent per annum interest on the amount of the medical malpractice recovery State Fund argued it would take in settlement of its subrogation claim.

¶1 Petitioner's request for sanctions was heard on May 11, 1998, in Helena. Mr. Gene R. Jarussi represented the petitioner. Mr. Charles G. Adams appeared for the respondent, State Compensation Insurance Fund (State Fund).

¶2 The request for sanctions arises out of the State Fund's assertion of a subrogation interest in a \$325,000 medical malpractice settlement received by the petitioner. Petitioner notified the State Fund of the settlement on July 21, 1997. (petitioner's brief in response to state fund's motion for summary judgment, Attached Document No. 39.) On August 6, 1997, the State Fund's claims adjuster notified claimant's attorney that it had an "equitable right of subrogation" in the settlement:

Please be advised that I met with Jim McCluskey, Vice President of Claims, this morning regarding your request that the State Fund waive all subrogation rights on this settlement. We understand that you do not think that the State Fund has a subrogation interest in a medical malpractice case. The State Fund however, believes it has an equitable right of subrogation, potentially for the full amount of disability caused by the alleged malpractice. Even so however, the State Fund would be willing to compromise it's [sic] full entitlement in order to resolve this issue.

The total settlement amount is \$325,000.00, with your fees and costs totaling \$126,460.07, leaving a net amount of \$198,539.93. **As a compromise**, The State

Fund makes the offer of accepting one half of that net amount or \$99,269.97 in settlement of its [sic] subrogation entitlement. We would not ask for subrogation on any of Mr. O'Brien's future medical or indemnity costs. [Emphasis added.]

(*Id.* at Attached Document No. 42.)

¶13 Petitioner's attorney held back the \$99,269.97 and on October 26, 1997, petitioned this Court for a determination that the State Fund has no subrogation interest in the settlement. On November 21, 1997, the State Fund filed its response, alleging therein:

The State Fund is entitled to subrogation interest in the proceeds of the Claimant's third-party action against St. Vincent's Hospital and General Electric Medical Services.

(Response to Petition for Hearing at 1.)

¶14 Eleven days later the State Fund capitulated. On December 2, 1997, it notified petitioner's attorney that it was waiving all claims of "equitable subrogation." (Brief in Support of Motion for Summary Judgment at 1.) In its brief, the State Fund stated specifically that it agreed to the relief requested by petitioner, which, as set out in the brief, included a request "[t]hat a ruling be made that the Defendant does not have a subrogation right in the third-party settlement." (*Id.* at 2.) Thus, the brief conceded that the State Fund also has no statutory subrogation right in the settlement. Based on its waiver, the State Fund then moved for a summary dismissal of the petition. (*Id.* at 4; Motion for Summary Judgment.)

¶15 Petitioner countered with a request for a penalty and for sanctions. (Petitioner's Brief in Response to State Fund's Motion for Summary Judgment.)

¶16 On February 10, 1998, I entered an order granting partial summary judgment, 1998 MTWCC 6, holding that the State Fund's waiver is binding and that the petition is therefore moot. However, I found that petitioner had made a *prima facie* case for sanctions:

In urging this Court to allow him to prosecute his request for sanctions, claimant cites testimony of James McCluskey (McCluskey), a vice president of the State Fund, as evidence of the unreasonableness of the State Fund's subrogation position. According to petitioner's brief at pages 3 and 4, McCluskey testified at a deposition that:

(1) the subrogation statute (§39-71-414, MCA) does not apply; (McCluskey depo [sic], pgs. 28, 29)

(2) because the subrogation statute does not apply the concept of "made whole" is irrelevant; (McCluskey depo [sic], pg. 28)

(3) that in third party cases arising out of professional health care malpractice that the State Fund has an "equitable" subrogation lien which allows it to take all of a third party settlement, less fees; (McCluskey depo [sic], pgs. 29, 34).

(4) The State Fund had no legal authority of any nature (no statute, no supreme court decision, no state district court decision, or any federal statute) to support the contention that the State Fund was entitled to an equitable subrogation lien. (McCluskey depo [sic], pgs. 30, 31, 32).

(Petitioner's Brief at 3-4.) In its reply brief the State Fund cites a single case from Pennsylvania as supporting its subrogation theory, but it does not indicate how the case fits in with Montana's statutes governing subrogation or the constitutional provision governing full redress. Its response is inadequate for the Court to resolve the sanction request.

The factual information set out above, along with the abrupt waiver of the alleged subrogation interest, raise a *prima facie* issue as to whether the State Fund's assertion of a subrogation interest was well founded and made in good faith. Without further briefing concerning the legal basis upon which the State Fund asserted the interest, it is premature to either dismiss or grant the claimant's request for sanctions.

(*Id.* at p. 4-5.) I ordered further briefing and a hearing regarding the requested sanctions. As already mentioned, a hearing on the matter was held.

Applicable Law

¶7 Petitioner's motion for sanctions is governed by section 39-71-2914, MCA (1991), which provides:

Signing of petitions, pleadings, motions, and other papers -- requirements -- sanctions. (1) Every petition, pleading, motion, or other paper of a party appearing before the workers' compensation court and represented by an attorney must be signed by at least one attorney of record in his individual name. The signer's address also must be stated.

(2) A party who is not represented by an attorney shall sign his petition, pleading, motion, or other paper and state his address.

(3) The signature of an attorney or party constitutes a certificate by him that:

(a) he has read the petition, pleading, motion, or other paper;

(b) to the best of his knowledge, information, and belief formed after reasonable inquiry, it is well grounded in fact;

(c) it is warranted by existing law or by a good faith argument for the extension, modification, or reversal of existing law; and

(d) it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

(4) If a petition, pleading, motion, or other paper is signed in violation of this section, the court, upon motion or upon its own initiative, shall impose an appropriate sanction upon the person who signed it, a represented party, or both. The sanction may include an order to pay to the other party or parties the amount of the reasonable expense incurred because of the filing of the petition, pleading, motion, or other paper, including reasonable attorney fees.

The rule is the Workers' Compensation Court's complement to Rule 11 of the Montana Rules of Civil Procedure.

¶18 The question presented by the petitioner's motion is whether the assertion of a subrogation interest in the State Fund's reply to the petition was "well grounded in fact" or "warranted by existing law or by a good faith argument for the extension, modification, or reversal of existing law." § 39-71-2914(3)(b) and (c), MCA.

Discussion

¶19 The right of subrogation in workers' compensation cases is governed by statute. Section 39-71-414, MCA (1991), provides:

Subrogation. (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, he 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 attorneys' 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 attorneys' 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 which is in excess of the amounts paid or to be paid under the Workers' Compensation Act after the insurer's reasonable costs, including attorneys' 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 and may not be reopened by the department.

In arguing the matter to the Court, the State Fund *weakly* contended that section 39-71-414, MCA, is sufficiently broad to encompass subrogation for medical malpractice in the treatment of a workers' compensation injury. It did not identify any specific language in sections 39-71-414, 412 or 413, MCA, as supporting its position.

¶10 On its face, section 39-71-414, MCA (1991), does not extend to malpractice actions arising out of the treatment of workers' compensation injuries. Section 39-71-412, MCA, which is referenced in section 39-71-414, MCA, refers only to third-party actions arising of the industrial accident. Section 39-71-412, MCA (1991), provides:

Liability of third party other than employer or fellow employee -- additional cause of action. The right to compensation and medical benefits as provided by this chapter is not affected by the fact that the injury, occupational disease, or death is caused by the negligence of a third party other than the employer or the servants or employees of the employer. Whenever such event occurs to an employee while performing the duties of his employment and such event is caused by the act or omission of some persons or corporations other than his employer or the servants or employees of his employer, the employee or in case of his death his heirs or personal representative shall, in addition to the right to receive compensation under this chapter, have a right to prosecute any cause of action he may have for damages against such persons or corporations.

Section 39-71-413, MCA, also does not extend to subsequent medical malpractice. As does section 39-71-412, MCA, it addresses third-party liability with respect to the industrial injury itself. Section 39-71-413, MCA (1991), provides:

Liability of fellow employee for intentional and malicious acts or omissions -- additional cause of action. If an employee receives an injury while performing the duties of his employment and the injury or injuries so received by the employee are caused by the intentional and malicious act or omission of a servant or employee of his employer, then the employee or in case of his death his heirs or personal representatives shall, in addition to the right to receive compensation under the Workers' Compensation Act, have a right to prosecute any cause of action he may have for damages against the servants or employees of his employer causing the injury.

¶11 The State Fund, however, did not rest its assertion of subrogation solely on section 39-71-414, MCA. Rather, it urged that it arguably has an extra-statutory right to "equitable subrogation."

¶12 Equitable subrogation is recognized in Montana, at least in non-workers' compensation insurance cases. In *Skauge v. Mountain States Telephone and Telegraph Co.*, 172 Mont. 521, 565 P.2d 628 (1977), the Court held that a property insurer which had paid its insured for a fire loss was entitled to subrogation with respect to the insured's third-party action for damages suffered in the fire. Its holding was based on the equitable principles:

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. . . .

Id., 172 Mont. at 524, 565 P.2d at 630. The Court noted that a failure to recognize a right of equitable subrogation of a property insurer would lead to either unjust enrichment of the insured or allowing the tortfeasor go free.

¶13 Medical malpractice in treating workers' compensation injuries may prolong the period of disability and increase the cost of medical care, thus enhancing the workers' compensation insurer's liability to a claimant. Equitable subrogation principles, if applicable, would entitle the insurer to subrogation with respect to the enhanced payments.

¶14 Arguably, section 39-71-414, MCA, provides the sole and exclusive subrogation remedy in workers' compensation claims, thereby precluding equitable subrogation. "It is a rule of statutory construction that the express mention of one matter excludes other similar matters not mentioned." *Helena Val. Irr. Dist. v. State Highway Commission*, 150 Mont. 192, 198, 433 P.2d 791, 794 (1967). However, I need not make any final determination as to statutory exclusivity since it is sufficient that the matter is at least reasonably debatable.

¶15 But whether subrogation is statutory or equitable, it is beyond any reasonable dispute or debate that the claimant must receive full redress for his injuries before a workers' compensation insurer is entitled to even one dollar (\$1) of repayment. The Supreme Court has repeatedly held that an insurer is "not entitled to invade a claimant's paid third party claim via subrogation until the claimant had been made whole." *Ness v. Anaconda Minerals Co.*, 279 Mont. 472, 478, 929 P.2d 205, 210 (1996) (citing several prior cases). In *Skaug* the Court applied the same principle in a non-workers compensation case based on equitable considerations, holding,

[W]e adopt the view that when the insured has sustained a loss in excess of the reimbursement by the insurer, the insured is entitled to be made whole for his entire loss and any costs of recovery, including attorney's fees, before the insurer can assert its right of legal subrogation against the insured or the tort-feasor.

172 Mont at 528, 565 P.2d at 632.

¶16 At the hearing concerning sanctions, the State Fund's attorney conceded that the petitioner must be made whole before any subrogation attaches to his medical malpractice proceeds. Thus, the focus of the hearing shifted to the underlying facts for an assertion that petitioner had been made whole. That inquiry proceeded pursuant to section 39-71-2914(3)(b), MCA, which requires that the State Fund's assertion of a subrogation in its response be "well grounded in fact." At the close of the hearing, I found that the State Fund's assertion of subrogation was not well grounded in fact.

¶17 Petitioner's attorney provided the State Fund with a copy of his analysis of damages. The analysis is in the form of a settlement brochure used in the malpractice action and is found at pages 51 to 59 of the documents attached to petitioner's brief in response to state fund's motion for summary judgment.

¶18 The economic analysis lists medical bills "to date" of \$236,986.30." Based on an analysis by Joseph Kasperic (an economist), it lists petitioner's lost earning capacity at between \$316,536.00 to \$429,869.00. After factoring in pain and suffering and other damages, the analysis sets out a range of damages between \$901,482.30 and \$1,014,815.00. The settlement, as previously mentioned, was for \$325,00, which netted claimant approximately \$200,000 after payment of attorney fees and costs.

¶19 During the hearing I asked Mr. Adams whether the State Fund had undertaken its own economic analysis of petitioner's damages. He replied that it had not. The only explanation he could offer in support of a contention that claimant had recovered the full amount of his losses was that claimant had recently undergone surgery and his condition might improve, therefore reducing his prospective wage-loss.

¶20 During a December 23, 1997 deposition of James McCluskey, claims vice-president of the State Fund, petitioner's attorney asked Mr. McCluskey what had changed on

"December 5, 1997" [actually December 2, 1997], to cause the State Fund to waive its subrogation interest. Mr. McCluskey answered:

The only information I have is that we felt that we were not going to be able to argue the equitable right of malpractice based on the position that you had taken and the strategy you had taken, and we felt that we were not going to be able to argue that on this case. Therefore, the made-whole argument which was your main issue, was going to be the issue in court, and when we reviewed that we said, well, under that circumstance, we don't think that we can successfully argue made-whole, that we are going to settle and give up our lien, and that is what the difference was. If there was any chance that I thought that we could have argued the malpractice equitable right, we would be in court, and we would be up in the supreme court if we lost there.

(McCluskey Dep. at 50.) During the hearing, I asked Mr. Adams what changed between November 21, 1997, the date on which he filed his response to the petition, and December 2, 1995, the date of the waiver. He replied that on December 2, 1995, he had authority to waive subrogation. By implication, on November 21, 1997, he did not.

¶21 The State Fund's initial notion that it was entitled to subrogation even if petitioner was not made whole by the malpractice settlement is **not** "warranted by existing law or by a good faith argument for the extension, modification, or reversal of existing law." Insofar as it was claiming a subrogation interest based on petitioner having fully recovered his damages through malpractice settlement, its position was not "well grounded in fact." A "hope" that petitioner might get sufficiently better to decrease his prospective wage loss hardly constitutes a factual basis for determining his total damages.

¶22 In asserting the subrogation interest in Court, it appears that the State Fund's attorney may well have been caught between his own independent judgment and the direction of his employer. That does not excuse him since an attorney's signature on pleadings constitutes his or her certification under section 39-71-2914, MCA. However, it does affect my decision as to whom shall pay the sanctions I am imposing. Section 39-71-2914(4), MCA, permits the Court to impose sanctions on either or both the attorney and the party. In this case I find it more appropriate to impose the sanctions on the party, the State Fund, rather than Mr. Adams personally.

¶23 Finding good cause, IT IS HEREBY ORDERED that

1. The State Compensation Insurance Fund shall pay petitioner's reasonable attorney fees and costs incurred by him in connection with the filing and prosecution of this petition and that it further pay claimant an amount equal to ten percent (10%) per annum interest on \$99,269.97 for the period of August 6, 1997, through December 2, 1997. The State Fund shall pay the interest within 20 days of

this order. It shall pay the attorney fees and costs within 20 days after the Court determines the amount of those fees and costs.

2. Within 20 days of this order, the petitioner shall file a verified memorandum itemizing his attorney fees and costs. The State Fund shall have 10 days in which to object to specific items.

3. This Order is certified as final for purposes of appeal pursuant to ARM 24.5.348.

4. Any party to this dispute may have 20 days in which to request a rehearing from this Order.

DATED in Helena, Montana, this 16th day of June, 1998.

(SEAL)

\s\ Mike McCarter

JUDGE

c: Mr. Gene R. Jarussi

Mr. Charles G. Adams

Date Submitted: May 11, 1998