Workers' Compensation Claims and Subrogation

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An injured worker has the right to file a workers' compensation claim against his or her employer pursuant to the Illinois Workers' Compensation Act (Act) if the injury occurred in the scope and course of the employment. But what if the work injury occurred due to the actions of a third party? In such a case, the employee may also be able to file a civil lawsuit to recover damages and the employer or insurance carrier may have the right to recover expenses related to the workers' compensation claim if there was an at-fault third party, otherwise known as a subrogation interest.

I. Exclusive Remedy Provisions of the Illinois Workers' Compensation Act

In exchange for a system of no-fault liability upon the employer, the employee is subject to limits on recovery for work injuries and diseases as set forth in the Illinois Workers' Compensation Act. Section 5(a) of the Act, in pertinent part, states there is:

> No common law or statutory right to recover damages from the employer, ... other than the compensation herein provided, … .

820 ILCS 305/5(a). Section 11 provides that:

> The compensation herein provided, …, shall be the measure of the responsibility of any employer engaged in any of the enterprises or businesses enumerated in Section 3 of this Act, or of any employer who is not engaged in any such enterprises or businesses, but who has elected to provide and pay compensation for accidental injuries sustained by any employee arising out of and in the course of the employment according to the provisions of this Act, and whose election to continue under this Act, has not been nullified by any action of his employees as provided for in this Act.

820 ILCS 305/11.

These two provisions, read together, are known as the exclusive remedy provisions.

In addition to the limitations on actions against an employer for work related injuries, the Illinois Supreme Court has held that an employee cannot sue his coworker for injuries sustained as a result of their negligence. *Ramsey v. Morrison*, 175 Ill. 2d 218 (1997); *Vance v. Wentling*, 249 Ill. App. 3d 867 (2d Dist. 1993). The principle behind the Act's exclusive remedy is that in return for the employer's absolute liability for work injuries, the employee gives up all other rights of action stemming from the accident.

While the Act is intended to limit the employee's actions against the employer, the employee is not bound by the same limitations against other third parties who may be liable for his or her injuries.

II. Third Party Liability Under the Act

Although an employee cannot sue his employer or coworkers, section 5(b) of the Act provides for third party litigation where the work injury or death "was caused under circumstances creating a legal liability for damages on the part of some person other than his employer." 820 ILCS 305/5(b). Section 5(b) also creates a right of reimbursement for the employer for the compensation it paid to the employee if the work injury is found to be caused by the actions of a third party. *Id.*

The employer's right to reimbursement is statutory and the Illinois Supreme Court has protected employers rights by holding that an employer does not have to specifically reserve this right in the terms of a settlement contract or by notice to a third party. *See Gallagher v. Lenart*, 226 Ill. 2d 208 (2007). Further, in order for an employer to have waived its section 5(b) rights, the waiver must be explicit in reference to section 5(b) and contain unmistakable settlement language to that effect. *Gallagher*, 226 Ill. 2d at 224.

A. Is There a Liable Third Party?

A thorough and early investigation into the alleged work accident is critical, not only to assert any defenses to the workers' compensation claim, but also to determine if there is a subrogation opportunity due to a liable third party.

The most common scenarios in which someone other than the employer may be legally responsible for the employee's injuries include construction related accidents, injuries on another's premises, motor vehicle accidents, or accidents resulting from a defective product or machinery. In such a case, the employer should be on the lookout for the potential to recoup some of the monies paid to the claimant as workers' compensation benefits.

B. How Much Can the Employer Recover?

Whether to pursue reimbursement for costs associated with a workers' compensation claim is one in which many factors must be weighed by the employer and insurer. While the employer is entitled to the entire proceeds of a third-party action if necessary to be reimbursed for the benefits it paid related to the workers' compensation claim, there are exceptions to the reimbursement rights and the employer must also take into account fees and expenses it must pay as a *pro rata* share of the costs connected with pursuing the third-party claim.

Portions of the third-party recovery that are not directly related to the employee's work injuries (such as loss of consortium, legal malpractice awards and interest) are not recoverable, but in general, the Illinois Supreme Court has stated that if an employer has made workers' compensation payments, the reimbursement requirement exists regardless of the amount the employee actually receives. *See Borden v. Servicemaster Mgmt. Servs.*, 278 Ill. App. 3d 924 (1st Dist. 1996).

The reimbursable costs to the employer include past benefits paid and future benefits that have not been made in a lump sum settlement. These costs include permanent partial disability (PPD), permanent total disability (PTD), death benefits or wage differential, all medical bills under section 8(a) of the Act, and temporary total disability (TTD). Amounts which are not reimbursable to the employer, but may be a substantial portion of costs incurred with defense of the workers compensation claim, include expert/IME fees, costs associated with using a nurse case manager, third party vendor costs, and attorney's fees.

Once the reimbursable expenses and fees are determined, the analysis regarding whether to pursue a workers' compensation lien is still not finished. Out of any reimbursement received by the employer pursuant to section 5(b), the employer must still pay a *pro rata* share of all costs and reasonably necessary expenses in connection with the third-party action and attorney fees of 25 percent of the gross amount of reimbursement. 820 ILCS 305/5(b).

Section 5(b) states that, in the absence of other agreements, the employer shall pay the third-party attorney 25 percent of the gross amount reimbursed. *Id*. While the employer is not required to pay more than the statutory 25 percent attorney fees, in the same right, the employer is not entitled to a reduction of the 25 percent fee. *Evans v. Doherty Construction, Inc*., 382 Ill. App. 3d 115 (1st Dist. 2008). If the amount of compensation paid by the employer is more than the employee's third-party recovery, the employer is entitled to the entire recovery, less fees and costs. *In re Estate of Dierkes*, 191 Ill. 2d 326 (2000). Attorney fees for civil actions are usually more than 25 percent of the recovery, but the Supreme Court in *Dierkes* found that if the 25 percent fee does not satisfy the contracted amount owed the

attorney, the employee may have to personally pay his attorney the additional fees but the employer does not have to pay more than 25 percent. *In Re Estate of Dierkes,* 191 Ill. 2d at 335.

In addition to the statutory attorney fees, section 5(b) also requires the employer to pay its *pro rata* share of all costs and reasonable expenses in connection with the third-party claim. The amount of the *pro rata* share of costs and expenses in addition to attorney's fees may make it unattractive for the employer to pursue its rights under section 5(b). There are varying formulas to calculate the employer's share of the expenses, but generally expenses are calculated by dividing the workers' compensation lien by the third-party recovery and multiplying by the expenses to come up with the employer's share. In cases where an employee will receive future workers' compensation benefits after completing the third party action, the courts have not come up with a clear formula for calculating reimbursement, but have suggested suspending future benefits or escrow of third party recovery. If there are any future expenses to take into account, the calculation must include 25 percent attorney's fees for any future medical bills, wage loss, long term care and other compensation and benefits where a credit is taken against the third party recovery. *See Vandygriff v. Commonwealth Edison Co*., 68 Ill. App. 3d 396 (1st Dist. 1979); *Shelby v. Sun Express, Inc*., 107 Ill. App. 3d 362 (1st Dist. 1982).

III. What if the Employer Shares Fault in the Injury?

As discussed, there may be strategic reasons for the employer not to seek reimbursement of its workers' compensation lien. The most compelling reason is to avoid liability for contribution in the third party claim if the employer may be found to be partially responsible for an employee's injuries. The Illinois Supreme Court has held that an employer's liability to a third party defendant for contribution is limited to the amount of liability for workers' compensation benefits paid to the employee. *Kotecki v. Cyclops Welding Corp.,* 146 Ill. 2d 155 (1991). Generally, an employer can get rid of liability for its *pro rata* share of attorney's fees and costs in the third-party suit by waiving its section 5(b) lien rights. This course may be useful if the employer is assigned, or is anticipated to be assigned, a portion of fault in the third-party claim. If the employer waives its lien, it is not receiving the benefits of reimbursement and therefore is not required to share in the fees and costs associated with the third-party lawsuit. *Corley v. James McHugh Construction Co.*, 266 Ill. App. 3d 618 (1st Dist. 1994). However, if an employer has waived the protection afforded by the Illinois Supreme Court in the *Kotecki* case, it may not be able to avoid contribution liability so easily. If an employer is found to have waived its *Kotecki* protections, its contribution liability may be unlimited and it will not be able to avoid contribution responsibility by waiving its workers compensation lien.

IV. How Might *Kotecki* Affect a Workers' Compensation Claim?

A typical subrogation scenario arises with construction work. For example, an employee of a contractor, Will Worker, files a workers' compensation claim against his employer ABC Contracting and also files a civil lawsuit against the property owner LMN Property where he was working for damages arising from an injury. The property owner then claims that ABC Contracting played a contributing role in the accident and brings the employer into the civil lawsuit as a third-party defendant. The Illinois Supreme Court held in *Kotecki v. Cyclops Welding* that the employer's maximum liability in the third party suit for contribution is limited to an amount no greater than its liability to its employee under the Workers' Compensation Act. *Kotecki*, 146 Ill. 2d at 166.

Under the Illinois Workers' Compensation Act, the employee is prevented from suing his employer and is limited to the benefits available under the Act. However, the employee is permitted to sue other parties that may have caused or contributed to his injuries. In our hypothetical, Will Worker receives $40,000 from employer ABC Contracting in a lump sum settlement under the Act. In the civil lawsuit against LMN Property, Will Worker is awarded a $500,000 verdict with the court finding that ABC Contracting and LMN Property were equally at fault for the injuries to Will Worker. If not for the *Kotecki* cap on contribution, ABC Contracting would have to pay $250,000 of the $500,000 judgment. However, because of *Kotecki*, ABC Contracting's exposure is limited to the amount paid in workers' compensation benefits; in this case, $40,000, plus the employer's share of legal fees under Section 5 of the Act.

But what if ABC Contracting had waived its *Kotecki* protection in its contract with LMN Property? The presence of "*Kotecki* waivers" have become common in construction contracts as a means to reduce the amount of the general contractor or property owner's liability for injuries but the waivers also increase the potential for employer liability for damages. In order for an employer to waive its *Kotecki* protection, contractual language must be explicit in waiving protections under the Act or affirmation that an employer will assume entire liability for its own negligence for damages sustained by employee. *Corley v. James McHugh Construction Co.*, 266 Ill. App. 3d 618 (1st Dist. 1994).

If in our example, ABC Contracting had agreed to waive its rights to limitation of loss under the Illinois Worker's' Compensation Act or agreed to assume the entire liability for its own negligence in a contract for services with LMN Property, ABC Contracting would be liable for the portion of the judgment attributed to its negligence, $250,000 in our case, less a set-off for the $40,000 paid under the Workers' Compensation settlement. By waiving its protections under the Act, ABC Contracting incurred an additional liability of $210,000 for the injuries Will Worker sustained. For these reasons, it is especially important for the employer to understand the potential consequences of any waiver of its limitations on liabilities.

V. Protecting the Employer's Interests in Third Party Actions

Section 5(b) states that the employee must formally notify his employer of a third party suit and after being notified, the employer may join in the civil action. 820 ILCS 305/5(b). The employer may protect its lien either through filing a petition to intervene or serving a lien letter to the third party and employee. By filing notice of the lien, the employer is ensuring protection of its lien and ability to take part in the civil claim and discovery proceeding and guarantees records and witnesses are not produced without notice to the employer.

Whether an employer chooses to take advantage of its lien rights under section 5(b) of the Act is something that should be analyzed given the facts of the underlying workers compensation claim and likely recovery from the third-party action.

A. When Can the Employer File a Lawsuit Against a Third Party?

The employee has the right to file a civil claim against a liable third party for damages until the statute of limitations has been met, which is usually two years from the injury. Section 5(b) allows an employer to sue the third-party directly to enforce its statutory lien under the Act for benefits that have been paid related to the accident if the worker does not. The employer's right to file suit is very limited in time and only exists for the three months leading up to the statute of limitations expiration and then, only if the employee does not file his own lawsuit. 820 ILCS 305/5(b).

At times, a workers' compensation claim may be pending at the same time as a tort claim for the same injury. The court has held that the employer or employee should not be prevented from filing a simultaneous civil claim in order to toll the statute of limitation while waiting for a determination on the compensability of the workers' compensation claim. *Cashmore v. Builders Square, Inc.,* 211 Ill. App. 3d 13 (2d Dist. 1991). When there has been substantial workers' compensation benefits paid or are anticipated to be paid and where there are sufficient assets or insurance coverage to satisfy the costs associated with the workers' compensation claim, it may be prudent for an employer or an insurer in the underlying workers' compensation claim to file suit against a negligent third party directly in order to attempt to reduce the overall cost of the workers' compensation claim.

VI. Settlement Strategies

When the employer holds a lien against the third-party lawsuit, the parties cannot enter into a release or settlement of the claim for damages without the written consent of the employer unless the employer has been fully indemnified or protected by court order. 820 ILCS 320/5(b). The lien right is intended to prevent double recovery for the same injury and allows the employer the full reimbursement allowed.

There are a number of potential recovery scenarios available to the employer depending on the status of the workers' compensation and third party claims that provide defendant employers leverage in negotiating section 5(b) liens. If the workers' compensation claim is concluded before the tort claim, it is easy to determine the actual liability of the employer under the Workers' Compensation Act and the amount of reimbursement owed to the employer for benefits paid. When no compensation claim is brought or when the workers' compensation claim is not completed before the third-party lawsuit, the amount of the employer's contribution and reimbursement is more difficult to determine.

In some instances, it may be practical for an employer to waive its section 5(b) rights to reimbursement or compromise its workers' compensation lien in some way. If the employer decides to waive its workers' compensation lien, the waiver must be explicit and reference section 5(b) specifically. Generally, an employer can get rid of liability for its *pro rata* share of attorney's fees and costs in the third-party suit by waiving its section 5(b) lien rights and this course may be useful if the employer is assigned a portion of fault in the third-party claim. If the employer waives its lien, it is not receiving the benefits of reimbursement and therefore is not required to share in the fees and costs associated with the third-party lawsuit. *Corley v. James McHugh Construction Co.*, 266 Ill. App. 3d 618 (1st Dist. 1994).

The employer may also choose to compromise its lien in order to leverage a reduction in future benefit payments or obtain a dismissal from the third-party suit. This may the best option when the potential recovery on the third-party claim could be less than the Workers' Compensation lien, or there is questionable liability for the injury.

By determining the likelihood of a third-party suit and the chances of recovery on any third-party claim, the employer and insurer can make decisions in their overall best interest. Pursuing a feasible third party claim may not make financial sense when any number of circumstances exists, *i.e.*, the third party is uninsured/underinsured or bankrupt, the venue is not plaintiff-friendly, or the facts do not bode well for establishing liability of the third party.

When a third-party is potentially at-fault in causing an employee's otherwise work-related injury, section 5(b) gives the employee, and in his absence, the employer, the right to bring a civil lawsuit. In the event the employee is able to recover damages from the third party, section 5(b) allows the employer to be reimbursed for the benefits it paid, or that it will have to pay, under the Workers' Compensation Act and the courts have consistently protected the employer's right to repayment. It is important for the employer and insurer to conduct a thorough and early investigation of any potential third-party claims and communicate with their attorney as soon as possible in order to develop the best strategy for defense of the workers' compensation claim.

The decision of whether to pursue a third-party claim or negotiate the employer's section 5(b) lien should be based on careful consideration of the specific facts in the claims and our Heyl Royster Workers' Compensation attorneys are ready to discuss potential third-party issues that may affect your workers' compensation claims.

If you have a workers' compensation claim with the potential for third-party liability, we urge you to contact our workers' compensation attorneys at Heyl Royster to discuss how a third party claim may affect your workers' compensation file.