

GO AHEAD AND NAIG!

THE EMPLOYER'S OPTIONS WHEN FACED WITH A POTENTIAL SETTLEMENT BY THE EMPLOYEE

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For the past several years, attorneys representing employees in work-related liability actions have used the threat of a *Naig* settlement to force employers into compromising their workers' compensation subrogation claims. This threat often occurs just prior to trial, when the employer has already

expended considerable amounts of time and money pursuing subrogation from the third-party tortfeasor. Employers and their attorneys should not feel constrained by such tactics. Rather, the subrogation claim has tremendous value as an independent vehicle to recover money, particularly after a *Naig* settlement by the employee. In many cases, with proper investigation and an aggressive approach, the employer's attorney can use a *Naig* settlement to greatly increase the employer's third-party recovery. The subrogation interest can also be utilized to partially or totally eliminate the employee's workers' compensation claim, or effectuate a separate settlement with the third-party tortfeasor, even where a significant contribution claim may be brought against the employer.

THE SUBROGATION CLAIM

The recovery of workers' compensation benefits by employers is authorized by the third-party liability section of the Minnesota Workers' Compensation Act. See Minn. Stat. § 176.061 (1994). This section provides an employer with subrogation and indemnity rights against an at fault third-party for workers' compensation benefits paid or payable to or on behalf of the employee. Minn. Stat. § 176.061, subd. 3, 5(a), 7, 10 (1994); see *United Steelworkers v. Quadna Mountain*, 418 N.W.2d 723, 725 (Minn. 1988); *Todalen v. U.S. Chemical Co.*, 424 N.W.2d 73, 81 (Minn. Ct. App. 1988), *pet. for rev. denied Tyroll v. Private Label Chemicals, Inc.* (Minn. Jun. 29, 1988), *overruled on other grounds* 505 N.W.2d 54 (Minn. 1993); see also *Thibault v. Bostrum*, 134 N.W.2d 308, 311 (Minn. 1965) (legislative intent of Workers' Compensation Act has always been to

give employer who meets obligations under act recourse through subrogation). The employer's subrogation claim is a function of common law damages for past and future wage loss, loss of earning capacity, medical expenses, retraining expenses, and similar items of damage. *Tyroll v. Private Label Chemicals, Inc.*, 505 N.W.2d 54, 60, 61 n. 8 (Minn. 1993); see *Dockendorf v. Lakie*, 86 N.W.2d 728, 731 (Minn. 1957).

Although the statute refers to the "employer's" subrogation and indemnity claim, the workers' compensation carrier also holds the claim. *M.W. Ettinger Transfer v. Schaper Mfg.*, 482 N.W.2d 796, 798 (Minn. Ct. App. 1992), *aff'd as modified* 494 N.W.2d 29 (Minn. 1992), *reh'g denied* (Minn. Mar. 4, 1993); accord *Folstad v. Eder*, 467 N.W.2d 608, 611 (Minn. 1991) (terms "workers' compensation carrier" and "employer" are merely shorthand references for the dual persona of employer-insurer which holds the subrogation and indemnity claim); *Liberty Mut. Ins. Co. v. Nutting Truck & Caster Co.*, 203 N.W.2d 542, 544 (Minn. 1973). The right to maintain the subrogation action is premised on the compensation carrier's obligation to pay workers' compensation benefits to the employee under the Part One portion of a typical workers' compensation policy. See, e.g., *United Steelworkers*, 418 N.W.2d at 725-26 (subrogation founded on either a "payment or obligation to pay"); *Wandersee v. Brellethin Chevrolet Co.*, 102 N.W.2d 514, 517 (Minn. 1960); *City of Red Wing v. Eichinger*, 203 N.W. 622, 623 (Minn. 1925). Thus, once the employee initiates workers' compensation proceedings, the "automatic effect" is that the employer is subrogated to the rights of the employee against the third-party tortfeasor. *United Steelworkers*, 418 N.W.2d at 725; accord *Liberty Mutual*, 203 N.W.2d at 544; see *Stephenson v. Martin*, 259 N.W.2d 467, 469 (Minn. 1977) (compensation carrier's initial denial of workers' compensation liability no basis for rejecting right of subrogation); *Metropolitan Milk Co. v. Minneapolis St. Ry. Co.*, 183 N.W. 830, 831 (Minn. 1921) (employer can pursue third-party recovery before it pays amount due employee under compensation award); see also *McDonough v. Muska Elec. Co.*, 486 N.W.2d 768, 771 (Minn. 1992) (subrogation rights exist prior to commencement of employee's compensation claim); *Allstate v. Eagle-Picher Industries, Inc.*, 410 N.W.2d 324, 327 (Minn. 1987) (employer's right of indemnity accrues on date of employee's injury).

The decision of whether to pursue the subrogation claim involves an evaluation from a fault perspective. In

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situations where the investigation reveals the third-party tortfeasor is more at fault than the employee, the subrogation claim is usually asserted, provided the claim is large enough. This is because the employee's fault alone will be compared with the third-party tortfeasor's at trial. *Todalén*, 424 N.W.2d at 82 (employer's fault not aggregated with employee's in subrogation action); *accord Froyland v. Leef Bros., Inc.*, 197 N.W.2d 656, 659 (Minn. 1972); *see Cambern v. Sioux Tools, Inc.*, 323 N.W.2d 795, 798 (Minn. 1985) (employer's fault not aggregated with third-party tortfeasor's); *Hafner v. Iverson*, 343 N.W.2d 634, 638 (Minn. 1984). *But see Kempa v. E.W. Coons*, 370 N.W.2d 414, 419 (Minn. 1985) (aggregating fault of employer and employee), *appeal after remand* 391 N.W.2d 14 (Minn. Ct. App. 1986).

Once the decision has been made to pursue subrogation, the employer has many options available to recover the compensation payments from the third-party tortfeasor. It can take an aggressive approach by intervening in the employee's action, or by commencing a separate lawsuit in its own name or in the name of the employee. Minn. Stat. § 176.061, subd. 5(a), 7 (1994); *see Norman v. Refsland*, 383 N.W.2d 673, 678 (Minn. 1986) (employer may intervene as of right to protect subrogation interest); Minn. R. Civ. P. 24.01 (1995). The employer will then become a party to the action and will have a right to any third-party recovery. *See Schweich v. Ziegler, Inc.*, 463 N.W.2d 722, 735 (Minn. 1990) (employer becomes a party to the lawsuit through intervention); *Wandersee*, 102 N.W.2d at 518-21; *Dockendorf*, 86 N.W.2d at 731 (permitting employer's post trial intervention to establish right to share in third-party recovery). In certain specialized situations, the employer may elect to "associate" with the employee's counsel for discovery and/or trial purposes through a Notice of Association. A Notice of Association does not confer party status on the employer. *Bess v. Lagerquist, Inc.*, (Minn. Ct. App. Aug. 30, 1994) (unpublished) 1994 WL468097; *see Froyland*, 197 N.W.2d at 659 (employer may agree to be bound by employee's tort action and need not be a party to recover subrogation); Minn. Stat. § 176.061 5(a), 7 (1994).

When pursuing a potential subrogation recovery, the most important principle is action. Waiting for the employee's attorney to protect the subrogation interest is counterproductive. Once the subrogation claim is asserted in the employee's case, the employee's recovery will be reduced pursuant to a statutory allocation formula. *See* Minn. Stat. § 176.061, subd. 6 (1994); *Hodder v. Goodyear Tire*

and Rubber Co., 426 N.W.2d 826, 839 (Minn. 1988), *cert. denied*, 492 U.S. 926 (1989); *Kordosky v. Conway Fire & Safety, Inc.*, 304 N.W.2d 616, 619-21 (Minn. 1981). The employee's attorney might therefore elect to abandon the employer and the subdivision 6 formula in order to maximize the employee's recovery. *Folstad*, 467 N.W.2d at 613 (employee's counsel's first obligation is to employee); *see Tyroll*, 505 N.W.2d at 58, 61; *Haase v. Haase*, 369 N.W.2d 311, 315 (Minn. Ct. App. 1985), *see also Kaiser v. Northern States Power*, 353 N.W.2d 899, 903 (Minn. 1984) (employee's interests adverse to employer's under statutory scheme). Consequently, the competing interests of the employer and employee will usually necessitate that separate counsel be retained to represent the subrogation interest. *See Quarberg v. Laundry Store Sales, Inc.*, 130 N.W.2d 340, 342 n.1 (Minn. 1964) (warning against same attorney representing both employer and employee). This enables the employer to become aggressively involved in formalized discovery and settlement discussions. It also positions the employer to strive for the highest possible jury verdict and thereby maximize the subrogation recovery.

THE EMPLOYER'S INCREASED PREMIUM CLAIM

Section 176.061 also gives the employer an independent claim against the third-party tortfeasor for increased workers' compensation premiums, either because of retroactive assessments or because of a change affecting future rates. *See* Minn. Stat. § 176.061, subd. 5(b) (1994). This claim belongs solely to the employer and not the compensation carrier. *Id.* Because the employer's increased premium claim arises out of the same occurrence as the right of subrogation — i.e., the employee's injury — it is often brought concomitant with the subrogation claim. If this claim is not included in the subrogation action, it is possible a court may deem it to have been merged into the litigation and barred from being brought in any subsequent lawsuit. *See Hauser v. Mealey*, 263 N.W.2d 803, 806 (Minn. 1988); *Kaiser*, 353 N.W.2d at 902.

The nature of the employee's injury and the amount of compensation benefits paid generally determines whether the employer has an increased premium claim. The attorney representing the subrogation interest will usually notify the employer of its potential claim for increased premiums. There is probably no conflict of interest for the same attorney to represent the employer for both claims if the attorney enters into a separate fee arrangement with the employer to prosecute the increased premium claim. The employer and its compensation carrier should be able

to resolve any additional conflicts that may arise. The technical aspects of the increased premium claim and the absence of appellate authority on this part of the statute may necessitate the use of an outside expert to analyze the claim and ultimately testify on the increased premium and how it is calculated. Any damages recovered for increased premiums are "for the benefit of the employer" and thus are not subject to the allocation formula under subdivision 6 of section 176.061. Minn. Stat. § 176.061, subd. 5(b) (1994).

THE EMPLOYEE'S CLAIM AND NAIG SETTLEMENTS

Section 176.061 also gives an injured employee a statutory right to pursue a claim for damages against a third-party tortfeasor. Minn. Stat. § 176.061, subd. 5(a) (1994); see *Kaiser*, 353 N.W.2d at 903. When the employee commences suit against the third-party tortfeasor after receiving workers' compensation benefits, "he is suing not only on his own behalf but also on behalf of the subrogated employer and its workmen's compensation carrier." *Liberty Mutual*, 203 N.W.2d at 544; accord *Keenan v. Hydra Mac, Inc.*, 434 N.W.2d 463, 466 (Minn. 1989); *Kaiser*, 353 N.W.2d at 903. Due to the involvement of the subrogation interest, the employee's claim consists of two categories of common law damages: those "recoverable" and "nonrecoverable" under the Workers' Compensation Act. See *Tyroll*, 505 N.W.2d at 59; *Folstad*, 467 N.W.2d at 611; *Kempa*, 370 N.W.2d at 414; *Kaiser*, 353 N.W.2d at 903. Nonrecoverable damages include such items as pain and suffering, general disability, emotional distress, embarrassment, disfigurement, loss of consortium and mental anguish. See *Tyroll*, 505 N.W.2d at 59; *Kaiser*, 353 N.W.2d at 903. Recoverable damages are simply those damages to which a subrogation interest attaches; i.e., damages paid and payable by workers' compensation. See *Tyroll*, 505 N.W.2d at 59; *Folstad*, 467 N.W.2d at 612.

The employee is entitled to independently settle the nonrecoverable damages with the third-party tortfeasor. The vehicle commonly used to effectuate this separate agreement is a *Naig* settlement, from the Supreme Court's decision in *Naig v. Bloomington Sanitation*, 258 N.W.2d 891 (Minn. 1977). In *Naig*, an employee sustained work-related personal injuries and commenced a tort action against the third-party tortfeasor. Prior to trial, the employee, with notice to the employer, settled his claim with the third-party, specifically excluding any amounts to which a subrogation interest attached. *Id.* at 892-93. The Supreme Court approved the settlement, holding the employee

could settle with the third-party for an amount representing the employee's damages "not recoverable" under the Workers' Compensation Act. *Id.* at 894; see *Folstad*, 467 N.W.2d at 612 (Naig settlement separates employee's tort action into claims for recoverable and nonrecoverable damages).

GO AHEAD AND NAIG

In many cases, the best course of action for the employer is to encourage the employee to reach a *Naig* settlement and eliminate the employee's nonrecoverable damages. Settlements of this type do not affect the employer's "statutory subrogation action against the third-party tortfeasor." *Naig*, 258 N.W.2d at 894 (quoting *Nutting*, 203 N.W.2d at 545); accord *Sargent v. Johnson*, 323 N.W.2d 767, 770 (Minn. 1982); *Ruddy v. Ford Motor Co.*, 399 N.W.2d 634, 637 (Minn. Ct. App. 1987) (*Naig* "settlements do not preclude an employer from exercising its subrogation rights.").

A recent Supreme Court decision provides the employer with an opportunity to make a complete recovery on its subrogation claim after a *Naig* settlement by the employee. In *Tyroll*, *supra*, the Supreme Court set forth a procedure for litigating the employer's subrogation claim after a *Naig* settlement has been reached. The court held that after a *Naig* settlement, the employer must prove the nature and extent of the employee's personal injury damages at trial. *Tyroll*, 505 N.W.2d at 59 (citing *M.W. Ettinger*, 494 N.W.2d at 34); see *Easterlin v. State of Minnesota*, 330 N.W.2d 704, 708 (Minn. 1983). However, the trial court must first hold a pretrial hearing to determine the amount of workers' compensation benefits paid and payable, and must presume the compensation payments by the employer were "reasonable and proper expenditures under the Workers' Compensation Act." *Tyroll*, 505 N.W.2d at 61. Although the court left open exactly how this pretrial hearing is to be conducted, the burden falls upon the third-party tortfeasor to present evidence which rebuts the presumption of reasonableness. *Id.*; see *Wilken v. International Harvester Co.*, 363 N.W.2d 763, 767-68 (Minn. 1985) (suggesting trial court can determine compensation amounts through affidavits, depositions and exhibits submitted). As a practical matter, the parties can usually avoid the pretrial *Tyroll* hearing by stipulating to the amount and reasonableness of the compensation payments. See *Tyroll*, 505 N.W.2d at 61.

After the amount of the compensation benefits "paid and payable" is determined by the court, a common law

personal injury case is tried to the jury, which determines the common law damages by category. *Id.* If the jury verdict exceeds the amount of compensation paid and payable as determined by the trial court, the employer recovers the entire amount of the benefits. If the common law damages are less than the amount determined by the court, the employer receives the lesser amount. *Id.*

Tyroll thus gives the employer an excellent opportunity to obtain a recovery on its entire subrogation interest, particularly in a case of favorable liability. Indeed, the holding specifically allows the employer to collect, as part of its subrogation recovery, the present value of future compensation payments as determined by the trial court. *Id.* (post-*Naig* subrogation claim includes compensation payments to date and the present value of future benefit payments); see *Wilken*, 363 N.W.2d at 767-68; cf. *Hagen v. Venum*, 366 N.W.2d 280, 286 (Minn. 1985) (total proceeds of structured settlement discounted to present value for formula allocation). In other words, the employer is entitled to collect the present value of the workers' compensation payments it *might* be required to pay to the employee in the future. If the future payments never come due, the employer still retains the money awarded for future payments. Thus, in certain cases, the employee's *Naig* settlement can actually result in a windfall to the employer.

Tyroll is not completely favorable to employers, however. The decision holds that after a *Naig* settlement the employer has the burden of proving the employee's common law damages before a jury as a prerequisite to recovering on its subrogation claim. *Tyroll*, 505 N.W.2d at 61. Because of this burden of proof, employers have found it more expensive to pursue subrogation after a *Naig* settlement, particularly in the area of medical experts. *Tyroll* has also required employers to obtain greater cooperation from employees to testify at trial concerning their common law damages. The holding might even apply in wrongful death cases, forcing employers to subpoena the employee's heirs and next of kin to testify about the employee's damages when they may be reluctant to become involved in the subrogation action.

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Another important benefit employers receive from a *Naig* settlement is the elimination the employee's right to any share of the subrogation recovery. In a pre-*Naig* settlement scenario, the statutory formula set forth in section 176.061 provides a mechanism for dividing the

proceeds of a third-party recovery between the employer and the employee. See Minn. Stat. § 176.061, subd. 6 (1994). Specifically, the formula provides the "costs of collection" must first be deducted from the party's total recovery. *Id.* Employees' attorneys generally seek to have the court equate "costs of collection" with their own fees and expenses, thereby obtaining a share from the employer for their collection of the employee's recovery. *But see Dockendorf*, 86 N.W.2d at 737 (The determination of what constitutes reasonable collection costs rests with the trial court and not with the employee's attorney.) Once the costs of collection are deducted, the formula allows the employee to then deduct one-third of the employer's net subrogation recovery. Minn. Stat. 176.061, subd. 6(b) (1994); *Sargent*, 323 N.W.2d at 769.

Where there has been a *Naig* settlement, however, the employer is able to pursue the entire amount of its compensation benefits paid and payable without being constrained by the subdivision 6 formula. *Tyroll*, 505 N.W.2d at 58, 61; see *Ruddy*, 399 N.W.2d at 637; *Haase*, 369 N.W.2d at 315 (*Naig* settlement supersedes scheme for allocation of the third-party recovery established in subdivision 6); *Naig*, 258 N.W.2d at 894. Accordingly, the employee's attorney, having obtained a *Naig* settlement for the employee, cannot force the employer to pay a share of the employee's attorneys fees from its subrogation recovery. *Folstad*, 467 N.W.2d at 612; see *Haase*, 369 N.W.2d at 315. In addition, "the employee waives her right to the 'one-third' outright share she would otherwise receive under the formula." *Naig*, 258 N.W.2d at 894; see *Folstad*, 467 N.W.2d at 612.

A *Naig* settlement also eliminates any potential contribution claim by the third-party tortfeasor against the employer. *Tyroll*, 505 N.W.2d at 61 ("[T]he employer, even if at fault, is not liable to contribute to the sum the tortfeasor paid the employee to settle the 'nonrecoverable' damages under the *Naig* release.") (citing *Kempa*, 370 N.W.2d at 419). In certain circumstances, this fact alone may be a compelling reason to encourage the employee to enter into a *Naig* settlement with the third-party tortfeasor. Further, after a *Naig* settlement, the employer controls the prosecution of the tort action, including the attorneys fees and expenses its pays to obtain the subrogation recovery. In many cases, the benefit the employer will realize after a *Naig* settlement can literally be measured in thousands of dollars.

