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SUPREME COURT UPHOLDS EMPLOYER'S RIGHT OF SUBROGATION - AN EMPLOYER'S LIEN NOT WAIVED BY SETTLEMENT CONTRACT TERMS

In previous newsletters, your Editor has commented on the contradictory decisions by several appellate courts which addressed the contention that settlement contract terms deprived the employers of the subrogation rights for compensation payments. The two most significant cases were *Borrowman v. Prastein*, where the court held that the employer had waived its lien, and *Gallagher v. Lenart*, where the court said the lien had not been waived. Your editor noted that the final decision would eventually be made by the supreme court, and now it has. The Supreme Court has affirmed the *Gallagher* case and held that the subrogation lien had not been waived.

In the *Gallagher* case, the plaintiff, James Gallagher, an employee of Rail Terminal Services, was struck by a truck driven by an employee of Pacella Trucking Express. Rail Terminal paid TTD and medical expenses in the sum of \$78,295.72. Thereafter, Rail Terminal and Gallagher settled the workers' compensation claim for \$150,000, with the terms making no reference to the pending civil claim.

The parties executed two documents as part of the settlement, that being a

settlement contract and a resignation agreement. The settlement contract provided in relevant parts:

Respondent denies these injuries are compensable and this settlement is made to settle those issues as a purchase of peace against any and all claims of temporary total compensation, permanent partial disability and medical, surgical or hospital expenses, past, present or future.

The second document which was entitled “Resignation Agreement” was contingent upon the workers’ compensation settlement contract approval by the Industrial Commission. It further acknowledged that, as part of the settlement, Gallagher would voluntarily resign from his position with Rail Terminal. It also provided that the Resignation Agreement was contingent upon the settlement of the workers’ compensation claim.

On September 16, 2005, Gallagher settled his civil case against Pacella, for a total of \$350,000, with \$125,000 to James Gallagher for his personal injury claim and \$225,000 to Michelle Gallagher for her loss of consortium claim. Understandably, Rail Terminal alleged that Gallagher had allocated the larger amount to the consortium claim to further circumvent Rail Terminal’s workers’ compensation lien. During the trial court hearing, Rail Terminal produced testimony that Rail Terminal never agreed or intended to waive its workers’ compensation lien and that it was not customary to waive an employer’s right to recover its lien as part of negotiations for settlement of a workers’ compensation claim and if such a waiver was contemplated, it would be clearly included in the terms of the

contract. The trial court found for the plaintiff. The appellate court disagreed and, in its finding for the employer against Gallagher, conducted an excellent review of the law favoring the employer’s right to recover.

SUPREME COURT DECISION

The issue the Supreme Court considered was whether, based on the language of the settlement contract and the resignation agreement, Rail Terminal waived its workers’ compensation lien. The court held that it had not, stating:

Turning to the settlement contract, plaintiffs argue that the following language constitutes a waiver of Rail Terminal’s section 5(b) workers’ compensation lien:

Respondent [Rail Terminal] to pay the petitioner [Gallagher] \$150,000 in full and final settlement of all claims under the Workers’ Compensation Act for injuries allegedly incurred on or about August 10, 2001 and any and all results, developments or sequale [sic], past, present or future resulting from this accident. (Emphasis added.)

Plaintiffs emphasize that the settlement contract disposes of “all claims” without restriction, in that it constitutes a “full and final settlement.” Furthermore, according to plaintiffs, Rail Terminal’s lien is a “claim under the Workers’ Compensation Act.” and it resulted from Gallagher’s “accident.”

The court stated:

We further hold that, even if the language of the settlement contract did constitute a general release, it would not be sufficiently explicit to waive Rail Terminal's workers' compensation lien. Considering the integral role the workers' compensation lien plays in the workers' compensation scheme, we do not believe general language is sufficient to effect such a waiver. On the contrary, the waiver of a workers' compensation lien must be explicitly stated. Accord 367 Ill.App.3d at 302-02 (concluding "waiver of a workers' compensation lien must be more explicitly and affirmatively stated in a settlement agreement and cannot simply be implied by a lack of any reference to that lien"). Here, the language of the settlement contract contains no mention of Rail Terminal's workers' compensation lien and therefore is not sufficiently explicit to waive the lien.

The court then reviewed the resignation agreement to determine whether or not the following paragraph effectuated a waiver of Rail Terminal's workers' compensation lien:

This Agreement does not constitute an admission by Employer of any liability or wrongdoing but it is intended to resolve in good faith any existing or potential disputes or claims arising out of Employee's relationship and separation with employer. (Emphasis added.)

On the basis of the above, the court concluded:

As discussed, the settlement

contract, by its own terms, waives only Gallagher's claims against Rail Terminal, and neither the settlement contract nor the resignation agreement explicitly refers to Rail Terminal's workers' compensation lien, as would be required to waive the lien.

Finally, the court addressed the question of the plaintiff's contention that Rail Terminal was in effect receiving a double recovery, stating:

Plaintiffs first contend that they settled their personal injury action for less than they otherwise would have in reliance on Rail Terminal's waiver of its lien, so a finding that Rail Terminal waived its lien will not result in a double recovery for Gallagher. This argument rests on a factual assertion regarding plaintiffs' basis for settling the personal injury action that is not borne out by the record. Plaintiffs' second argument regarding double recovery is that finding, as we have, that Rail Terminal did not waive its lien will result in a double recovery for Rail Terminal by allowing it both to recover its workers' compensation payments and retain the benefit of Gallagher's resignation. ... In reality, plaintiffs are merely asking us to conduct a generalized inquiry into the fairness of Gallagher's bargain with Rail Terminal, which we decline to do. Courts generally will not inquire into the adequacy of consideration for a contract. Moreover, Gallagher specifically acknowledged in the resignation agreement that a \$1 payment and the approval of the settlement

contract, which unambiguously did not waive Rail Terminal's workers' compensation lien, would constitute sufficient consideration for his resignation

EDITOR'S NOTE: Since the impact of the *Borrowman* case, the terms of settlement contracts, when prepared by respondents, have generally included a provision that the subrogation claim is not being waived. The *Borrowman* case has now been reversed and the *Gallagher* case is the law. Even in the absence of any reference to the waiver, the *Gallagher* decision protected the employer's subrogation lien. The Supreme Court went even further in noting that the resignation agreement had no effect on the subrogation claim.

**EMPLOYEE'S RELEASE OF
NEGLIGENT DRIVER DID NOT
PREVENT EMPLOYER'S WORKERS'
COMPENSATION CARRIER FROM
MAKING SUBROGATION
RECOVERY**

On December 5, 2003, Eric Matthews, employed by Caliber Auto Transport, was operating the company van in the course of his employment when the van was struck by Jose Carrizalez. Matthews recovered workers' compensation benefits from Caliber's carrier, Chubb Group. Chubb paid Matthews compensation benefits of \$3,072.94. Without filing suit, Matthews entered into a settlement agreement and executed a general release of liability of his claim against Carrizalez and his insurer, State Farm. Under the terms of this agreement, which was entered into on February 23, 2004, Matthews was paid \$3,600 in exchange for releasing the defendant of further liability.

On July 29, 2005, less than 24 months from the accident date, Chubb sued Carrizalez to recover money that State Farm paid to Matthews. The defendant argued that the release was binding because State Farm had no knowledge of any lien or claim by Chubb at the time the settlement was made.

The appellate court reversed the trial court pointing out that Section 5(b) of the Workers' Compensation Act is intended to provide protection to employers that are compelled to pay compensation to employees injured by third party tortfeasors.

The court acknowledged that the plaintiff's lien never came into effect because Matthews had never actually filed a suit on which a claim for lien could be made. The appellate court noted that as permitted by Section 5, Chubb had the right to file its suit because the release was invalid.

The defendant's argument as to when the lien came into effect misses the point. The plaintiff here does not seek to enforce a "lien," but relies instead on its statutory right to hold the release between the employee, Matthews, and the defendant tortfeasor, invalid as against the plaintiff because the employer did not give its written consent and was not fully indemnified or fully protected by court order.

Section 5 specifically authorizes the employer provided if the employee has not already filed an action, to institute a suit no earlier than 21 months and no later than 24

months after the accident. In this case, the employer met this burden. The release signed by Matthews would not bar the action brought by Chubb as the employer's subrogee's action. With reference to the defendant's claim that it had no knowledge of the existence of Matthews workers' compensation recovery, the court stated:

Even if a defense of lack of notice were available to the defendant, we would reject its application here.

Constructive notice need not be founded exclusively on notice, constructive or actual, arising from the circumstances that created a legal liability for damages on the part of the tortfeasor. Constructive notice of an employer's interest may also arise "from a presumption of awareness of the statute's protective provisions."

In summary, the court provided the following conclusion:

As provided by section 5(b), without the employer's consent or without an order of court protecting the employer, the release signed by Matthews is not valid against the employer. If the employer was required to provide notice of its interest to the tortfeasor, at a minimum, the defendant had such constructive notice prior to the execution of the release.

EDITOR'S NOTE: As noted by attorney Tim McMahon of our office: this is an important case as we sometimes come across the plaintiff who settled his case and releases the tortfeasor without notifying the comp

carrier ... so long as the statute is not gone on the underlying cause of action, the employer/comp carrier may sue the defendant irrespective of the defendant's knowledge, actual or constructive, of the workers' compensation lien. Absent an order of court protecting the lien or the employer/carrier's approval of the settlement, the subrogation claim survives.

LOANING EMPLOYER DENIED REIMBURSEMENT FROM BORROWING EMPLOYER BECAUSE OF AN "AGREEMENT TO THE CONTRARY"

Customarily, the respective liabilities of loaning and borrowing employers are determined by agreement. Most loaning employers are day labor services. Even in the absence of an agreement, most borrowing employers tend to expect that the labor services provide workers' compensation benefits. On rare cases, the loaning employer, after paying the benefits, will seek to impose the liability on a borrowing employer, often to the borrower's great surprise. Such a situation arose in the recent case of *Surestaff, Inc. v. Azteca Foods, Inc.*

At the time of Rodrigo Mina's hand injury, he was employed by Surestaff, a temporary employment agency, which provided labor to Azteca Foods, Inc. pursuant to an oral agreement. Under Section 1(a)(4) of the Workers' Compensation Act, Surestaff was the "loaning employer" and Azteca was the "borrowing employer." Surestaff paid the benefits and later filed suit, seeking reimbursement from Azteca. Azteca responded by raising an affirmative defense contending that there existed an "agreement

to the contrary” which had been entered into by the parties in that “Surestaff orally agreed to be responsible for the workers’ compensation coverage for the temporary workers it provided.” Section 1(a)(4) of the Act provides, in relevant part:

*Where an employer operating under and subject to the provisions of this Act loans an employee to another such employer and such loaned employee sustains a compensable accidental injury in the employment of such borrowing employer and where such borrowing employer does not provide or pay the benefits or payments due such injured employee, such loaning employer is liable to provide or pay all benefits or payments due such injured employee under this Act and as to such employee the liability of such loaning and borrowing employers is joint and several, provided that such loaning employer is in the absence of agreement to the contrary entitled to receive from such borrowing employer full reimbursement for all sums paid or incurred pursuant to this paragraph together with reasonable attorneys’ fees and expenses***. (Emphasis added)*

The sole issue at trial was whether Azteca could establish the existence of an “agreement to the contrary” by which Surestaff’s right to reimbursement had been waived. The jury instruction provided in relevant part:

In this case the defendant has asserted the affirmative defense that Surestaff and Azteca Foods, Inc. made an agreement that Surestaff would pay workers’

compensation benefits to injured workers entitled to benefits that were loaned by Surestaff, Inc. to Azteca Foods, Inc. The defendant has the burden of proving this affirmative defense.

The jury returned a verdict in favor of Azteca and found by special interrogatory that the parties had agreed Surestaff would provide workers’ compensation benefits for its loaned employees injured at Azteca’s job sites.

On appeal, Surestaff argued that the trial court should have instructed the jury that in order to avoid liability, Azteca had to prove:

Surestaff, in contracting with the defendant, had made an agreement to the contrary, agreeing to waive its right to reimbursement from Azteca for any workers compensation benefits paid out by Surestaff.

In affirming the jury decision, the court stated:

We find no basis to conclude that the parties were required to refer to the Act or any specific language contained therein in order for the jury to find there was an agreement to the contrary. The case law and a plain reading of the statute support the trial court’s conclusion that if there was an oral agreement whereby Surestaff agreed to pay the workers’ compensation benefits for its loaned employees, then there was an “agreement to the contrary,” which waived its right to reimbursement as a matter of law. A specific reference in the parties’ agreement to the Act or the

phrase “waiver of the right to reimbursement” would be ideal for determining intent, but it is not required in order for a trier of fact to determine whether there was an agreement to the contrary.

EDITOR’S NOTE: As noted, the court did not require any specific language as to the waiver. The oral statement by Surestaff that it had insurance was considered to be “an agreement to the contrary.” Despite this finding, your Editor would recommend that any borrowing employer obtain a written commitment from the loaning employer that the loaning employer would carry workers’ compensation on all “loaned employees” protecting the borrowing employer, as well as the loaning employer.

**LOANING AND BORROWING
EMPLOYERS BOTH IMMUNIZED
FROM A COMMON LAW LIABILITY
CLAIM BECAUSE OF EXCLUSIVITY
PROVISIONS OF SECTION 5**

In *Behrens v. California Cartage Company, Inc. and Staffing Resources, Inc.*, the court addressed the issue of the possible liability of loaning and borrowing employers and concluded there existed a complete absence of common law liability for all possible defendants.

On November 17, 2004, the claimant, Marshall Behrens, an experienced truck driver, was employed by People Link Staffing Solutions, a temporary employment agency, and had been sent to work at a freight distribution facility of California Cartage Company. Cynthia Smith was employed by another temporary employment agency, Staffers Resources, and was working in the dispatcher’s office of California Cartage, at which time Smith requested Behrens to relocate a shipping

container. Because Smith misinformed Behrens about the weight of the container, Behrens sustained back injuries which resulted in surgical intervention and resulted in a permanent injury. Behrens filed a compensation claim only as to his temporary employment agency, People Link Staffing Solutions, and received workers’ compensation benefits. Behrens also filed a common law suit against California Cartage and Staffing Resources, Smith’s temporary employment agency. California Cartage argued that as the borrowing employer, it had the direction and control of Behrens and as such could not be liable for a common law action.

The other defendant, Staffing Resources, who had sent Smith to the California Cartage Company facility, was also not liable because when it sent Smith to California Cartage Company, it ceased to have any direction and control of Smith, who then came under the direction and control of California Cartage. Clearly, both Behrens and Smith were acting under the direction and control of California Cartage Company and were therefore fellow employees. As such, Behrens could not sue Smith because of the exclusivity provision of Section 5.

EDITOR’S NOTE: In retrospect, one wonders why this case was ever filed. Two of the possible defendants were temporary employment agencies who would not normally be liable for injuries occurring after the employee was working at the business of the borrowing employer. Certainly, Behrens and Smith were referred by two temporary employment agencies but since they were loaned to the same employer, they clearly became employees of that borrowing employer.

FRANK J. WIEDNER
Editor