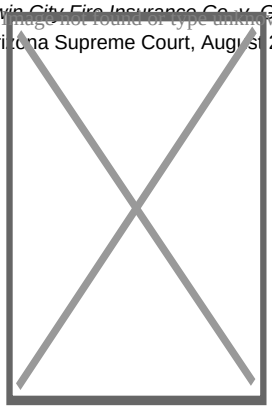
ARIZONA SUPREME COURT HOLDS “EQUITABLE APPORTIONMENT” IS INAPPLICABLE TO SETTLEMENT OF EMPLOYEE’S THIRD-PARTY TORT CLAIMS

August 8, 2018 | Law Alerts, News

Twin City Fire Insurance Co. v. Graciela Leija
Arizona Supreme Court, August 2, 2018



Written by: Lori Voepel

Last week, the Arizona Supreme Court held that when an employee settles all of his or her third-party tort claims, and a workers’ compensation carrier asserts its statutory lien against those settlement proceeds to receive reimbursement for benefits it paid to the employee, the employee is not entitled to a post-settlement trial to determine the percentage of employer fault to reduce or extinguish the carrier’s lien. It reversed the Arizona Court of Appeals’ Opinion, which had extended the rule of “equitable apportionment” under *Aitken v. Indus. Comm’n*, 183 Ariz. 387 (1995), to such settlements, even though the rule had previously been limited to third-party tort actions tried to verdict and resulting in a damage award and apportionment of fault to parties and non-party employers. In the latter situation, *Aitken* requires that a carrier’s lien be reduced by the same percentage of employer fault allocated by the jury, to avoid a situation where the employee is forced “to endure the combined effect of first having his or her award reduced by reason of the employer’s fault, and thereafter having to satisfy a lien against this diminished recovery in favor of the employer and its carrier to the full extent of compensation benefits provided.” *Aitken*, 183 Ariz. at 392.

After her husband died in a work-related accident, Mrs. Leija and her children applied for and received workers’ compensation benefits and sued numerous third-party tortfeasors under A.R.S. § 23-1023(A), alleging those third parties negligently contributed to her husband’s death. During settlement negotiations, Twin City asserted its right under § 23-1023(D) to seek full reimbursement against the settlement proceeds for the amount of worker’s compensation benefits it had paid and would pay in the future. Twin City offered, however, to reduce its lien by five percent if the Leijas settled all their third-party claims. The Leijas rejected the offer, arguing that under the rationale of *Aitken*, Twin City was required to significantly reduce its lien based on some unknown percentage of *alleged* comparative fault of Mr. Leija’s employer and co-worker in causing the accident. Twin City took the position that it is not required to equitably apportion its lien under *Aitken* where the employee’s damages and percentage of employer fault are not “fixed by verdict in the third-party action.” The Leijas ultimately settled with all third-party defendants for $1.6 million, after which Twin City filed an action to enforce its lien against the recovery. The Leijas filed a counterclaim, arguing that Twin City breached its duty of good faith and fair dealing by refusing to reduce its lien to account for the employer’s alleged comparative fault, and requesting the superior court to set a trial under *Aitken*, solely to establish the employer’s proportionate fault and the resulting amount of Twin City’s lien. The superior court rejected both arguments and entered summary judgment for Twin City.

On appeal, the Arizona Court of Appeals reversed, holding that “when a worker settles a claim against a third party for less than the limits of the third party’s insurance, the worker may obtain a judicial determination of whether the carrier’s lien should be reduced to account for the employer’s comparative fault.” *Twin City v. Leija*, 243 Ariz. 175, 177 (App. 2017). The court reasoned that the fact that the Leijas settled their third-party claims rather than trying them to a verdict does not preclude equitable apportionment under *Aitken*. The court upheld, however, the superior court’s ruling in Twin City’s favor on the bad faith claim.

The Supreme Court granted review and reversed, agreeing with Twin City that a settlement between an employee and third-party defendant does not necessitate a determination of liability and damages, including the apportionment of fault among parties and non-parties. The Supreme Court explained that there are “good reasons to limit application of the equitable apportionment rule to only those cases that are tried to verdict.” *Leija*, ¶ 22. For one, the inequity recognized in *Aitken* will exist in every case that is tried to verdict; but an inequity will not exist in every case where a claimant settles with a third-party

defendant. The Court found it is "purely speculative" to assume that merely because a third-party claim settles for less than policy limits, the employee's recovery was reduced by the non-party employer's alleged fault. *Id.* Moreover, the Supreme Court agreed that many factors may influence an employee's decision to settle with a third-party defendant and the settlement amount, including difficulties in proving fault or causation, and avoiding the risk of having a jury apportion a substantial amount of fault to the employee or his employer, and thereby reducing the employee's total award. The Supreme Court also noted that a carrier could be similarly concerned with the risk that a jury would apportion substantial fault to the employee and/or employer, which would also reduce the value of the carrier's lien. This alignment of risks encourages the carrier to reduce its lien so the employee will be incentivized to settle.

Finally, the Supreme Court agreed with Twin City that the post-settlement trial created by the Court of Appeals would itself create "perverse incentives and inequities" because the employee in a third-party action "has every incentive to maximize the percentage of fault allocated to the third-party defendant" whereas the employee would then later "be incentivized to take the diametrically opposite position by maximizing the fault attributable to the employer (and therefore minimizing the fault accruing to the settling third-party defendant) solely to reduce or extinguish the insurance carrier's lien on the settlement proceeds." *Leija*, ¶ 26. On balance, the Supreme Court observed that although a carrier's refusal to reduce its lien may be inequitable in some circumstances, "it is difficult to understand how the possible gamesmanship created by a post-settlement trial process is more equitable than permitting an insurance carrier to exercise its statutorily authorized lien on a claimant's settlement proceeds to the extent of compensation benefits paid" when "there may be no inequity at all." *Id.,* ¶ 27.

The Court added that even in a settlement context, the workers' compensation carrier has an obligation to act in good faith by giving equal consideration to the employee's interests, especially where evidence of employer fault is "clear, undisputed, and substantial." *Id.*, ¶ 28. The Court also reaffirmed, however, that because a carrier's statutory lien has strong protection under the law, the carrier " may reasonably protect its right to recover the lien amount" and is "not required to completely disregard its own interests." *Id.,* ¶ 29.

Justice Bolick wrote a Concurring Opinion stating his belief that *Aitken* should have been overruled as having violated the separation of powers doctrine under the Arizona Constitution. According to Justice Bolick, "the legislature, not the courts, should resolve the policy conundrum that was before us in *Aitken* and has reappeared repeatedly in different permutations since then." *Leija*, P. 52.

CLICK HERE TO READ THE FULL OPINION