Settlement of Third Party Liability in Workman's Compensation

Robert A. Kantor

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Similar workman's compensation acts have been enacted in all states, the District of Columbia and in United States territories.[1] However, the statutes differ in defining the effect of injury caused by third party tortfeasors[2] on the employer's compensation obligation. Most states provide that the employer must pay the compensation even when the liability for the workman's injury lies with a third party,[3] although several have included provisions allowing the workman to elect whether to receive compensation under the statute or to proceed against the actual tortfeasor.[4] Once compensation has been paid, most states give the employer subrogation rights against the third party, either independently or jointly with the injured workman.[5]

The Texas statute[6] allows the workman to elect whom to go against first. If he chooses to proceed against the third party, he has no further recourse under the statute. If he receives compensation from his employer he may still proceed in a suit against the third party;[7] but, his employer is subrogated to allow recoupment of the compensation amount before the workman can retain any money paid by the actual tortfeasor. Once the employee has collected compensation under the statute, his rights are limited to funds paid by a third party in excess of the original compensation amount.

The Texas statute poses a problem as to the effect of a settlement between the workman and the third party after the former has received compensation from his employer. This Note is concerned with such settlements and the rights of the three parties, the workman, the employer and the third party tortfeasor.

Statutory Development. The 1913 Texas Workman's Compensation Act, and most other state workman's compensation acts, were passed in order that "the burden of industrial accidents should fall on the employer, because he is in a better position, by means of prices and insurance, to shift it to the public."[8] The original Texas statute provided that the employer

[1] For a history and the specific provisions of these laws see 1 A. LARSON, WORKMAN'S COMPENSATION LAW ch. 2 (1952 and Supp. 1967); S. RIESENFELD & R. MAXWELL, MODERN SOCIAL LEGISLATION 127-36 (1950); 3 W. SCHNEIDER, WORKMAN'S COMPENSATION TEXT (Penna. ed. 1943 and Supp. 1957).

[2] For a comprehensive discussion of what persons are "third parties," see Durant, *Third Person Liability*, 9 UTAH L. REV. 939 (1965).

[3] For a compendium of statutes see McCoid, *The Third Person in the Compensation Picture: A Study of the Liabilities and Rights of Non-Employers*, 37 TEXAS L. REV. 389, 393 & n.12 (1959).

[4] *See* ARIZ. REV. STAT. ANN. § 23-1023 (1956); COLO. REV. STAT. ANN. § 81-13-8 (1963); MASS. ANN. LAWS ch. 152, § 15 (1949); MINN. STAT. ANN. § 176.061 subd. 3 (1953); OKLA. STAT. ANN. tit. 85, § 44 (1951); WASH. REV. CODE § 51.24.010 (Supp. 1961). Arizona, Colorado, Oklahoma and Washington provide that the employer is liable for a deficiency when the amount of the judgment against the third party is less than the compensation would have been.

[5] McCoid, *supra* note 3, at 394; Steffen, *The Employer's "Indemnity" Action*, 25 U. CHI. L. REV. 465, 466-74, 475 & n.81 (1958).

[6] TEX. REV. CIV. STAT. ANN. art. 8307, § 6a (1948).

[7] Independent E. Torpedo Co. v. Harrington, 128 Tex. 17, 95 S.W.2d 377 (1936); Jackson v. Hanover Ins. Co., 389 S.W.2d 328 (Tex. Civ. App. 1965).

[8] W. PROSSER, TORTS § 79 (3d ed. 1964).

or his compensation carrier would pay for an employee's injuries, even when caused by a third party, but did not provide any means for the carrier to reimburse itself by becoming subrogated to the employee's rights against the actual tortfeasor.[9] Moreover, there was nothing to prevent the injured workman from receiving compensation both from his employer and from the tortfeasor. If the action against the tortfeasor were settled by the workman, the carrier could recoup only from him with the result that it would often be denied any recovery.[10] Thus, it was necessary to amend the Workman's Compensation Act so that any money paid by the tortfeasor would first be applied to repayment of the compensation. To accomplish this, to inhibit the overcompensation of the employee, and to reduce the cost of the insurance to the employer,[11] section 6a was added in 1917. The text of this section reads as follows:

> Where the injury for which the compensation is payable under this law was caused under circumstances creating a legal liability in some person other than the subscriber to pay damages . . . [and] [i]f compensation be claimed under this law by the injured employee or his beneficiaries, then the association[12] shall be subrogated to the rights of the injured employee . . . [to] enforce . . . the liability of said other person, and in case the association recovers a sum greater than that paid . . . to the employee or his legal beneficiaries, together with a reasonable cost of enforcing such liability . . . then out of the sum so recovered the association shall reimburse itself and pay said cost and the excess so recovered shall be paid to the injured employee or his beneficiaries.[13]

Section 6a indicates clearly that even after compensation is paid, the workman owns the cause of action against the third party, subject only to the subrogation rights of the employer.[14] But the ability of the employee to enter a settlement with the actual tortfeasor and the effect of such a settlement on the rights and liabilities of the three parties are not included in the terms of the statute. One solution to this problem is the prevention of further recovery by the injured workman once compensation is paid.[15] Texas and the majority of states allow the workman to participate in any recovery from the third party in excess of the compensation paid by the carrier.

Judicial Development. In Texas the employee's ability to settle his rights to the excess prior to the actual determination of the recovery amount has been judicially developed. Beginning with *Traders & General Insurance Co. v. West Texas Utilities Co.*,[16] the rule has been clearly established

[9] *See* Consolidated Underwriters v. Kirby Lumber Co., 267 S.W. 703 (Tex. Civ. App. 1924).

[10] Fort Worth Lloyds v. Haygood, 151 Tex. 149, 155, 246 S.W.2d 865, 868 (1952). There is "but one cause of action against the third party tort-feasor" and because of the settlement the carrier is denied any recovery.

[11] Consolidated Underwriters v. Kirby Lumber Co., 267 S.W. 703, 706 (Tex. Civ. App. 1924).

[12] As used in section 6a, "association" includes private workman's compensation carriers. TEX. REV. CIV. STAT. ANN. art. 8309, § 1 (1948).

[13] TEX. REV. CIV. STAT. ANN. art. 8307, § 6a (1948).

[14] Hayhurst v. Henry, 102 F. Supp. 306 (N.D. Tex. 1951); Traders & Gen. Ins. Co. v. West Texas Util. Co., 140 Tex. 57, 165 S.W. 703 (1942).

[15] WASH. REV. CODE § 51.24.010 (1961). *See also* McCoid, *supra* note 3, at 395 n.14.

[16] 165 S.W.2d 713 (Tex. Civ. App. 1942).

that the workman is entitled only to moneys in "excess of the amount of compensation paid him by the association together with reasonable costs of enforcing same."[17] This same theory was clarified in *Fort Worth Lloyds v. Haygood*.[18] *Fort Worth Lloyds* applied section 6a to a settlement with the workman which was in excess of the compensation amount, holding that when the tortfeasor paid money to the workman both became jointly and severably liable to the carrier for the settlement amount.[19] The carrier was thus assured of a responsible party against whom it could assert its claim. Thus, in effect, the carrier is able to recoup the total compensation paid before the injured party can retain any funds given him in settlement of his individual claims. Unlike normal insurance subrogation practices, the employee's settlement with the actual tortfeasor is not independent of the carrier's rights.

A different aspect of the problem was settled in *Pan American Insurance Co. v. Hi-Plains Haulers*,[20] where the Texas Supreme Court decided the effect of a settlement between an injured workman and a third party tortfeasor which was less than the compensation paid the employee by the insurance carrier. That case held that the compensation carrier could have collected the settlement amount from the employee without releasing the third party from further liability.[21] But, the settlement did not subject the third party to liability to the carrier for both the amount of the settlement and a tort damage verdict. Rather, against the third party the carrier might recover either the amount of the damages assessed or the amount of the settlement; but not both.

The employer's choice in *Hi-Plains* arose solely because the amount of the judgment was less than either the amount of the settlement or the compensation. In a more recent supreme court decision, *Capitol Aggregates v. Great American Insurance Co.*,[22] the court seems to have completed the final development of third party liability settlements.

Capitol Aggregates. The facts in *Capitol Aggregates v. Great American Insurance Co.* were similar to those in *Hi-Plains*. After paying compensation to the workman, the insurance carrier brought suit with the workman against the third party. Immediately before trial, without the knowledge or consent of the carrier, a settlement was made by the tortfeasor with the workman for an amount less than the compensation. As part of the settlement agreement, the tortfeasor was to indemnify the employee[23] in case

[17] *Id.* at 715.

[18] 151 Tex. 149, 156, 246 S.W.2d 865, 869 (1952). "We believe the fundamental principle underlying [prior cases] is that where compensation has been paid to an injured workman, or his representatives, and they later file suit against a third party tort-feasor, the first money paid or recovered by the employee, or his representative, belongs to the carrier paying the compensation, and until it has been paid in full, the employee or his representatives have no rights to any funds."

[19] Fort Worth Lloyds v. Haygood, 151 Tex. 149, 157, 246 S.W.2d 865, 869-70 (1952).

[20] 162 Tex. 1, 350 S.W.2d 644 (1961).

[21] While not clearly stated in the opinion, later clarification by the court indicates that reference to collecting the settlement amount means from the workman. Great Am. Ins. Co. v. Capitol Aggregates, 408 S.W.2d 922, 924 (Tex. 1966).

[22] 408 S.W.2d 922 (Tex. 1966).

[23] 319 S.W.2d 419, 420 (Tex. Civ. App.), *aff'd*, 408 S.W.2d 922 (Tex. 1966).

the carrier took the settlement amount from him under the doctrine of *Fort Worth Lloyds*. Thereafter, the carrier proceeded to trial and received a jury verdict in excess of the settlement amount but less than the compensation amount. The trial court entered a judgment against the tortfeasor in the amount of the jury verdict and against the workman in the amount of the settlement. The workman was given a judgment of the settlement amount against the tortfeasor based on the indemnity contract.[24]

Reaffirming the rule that when a third party tortfeasor pays a judgment or settlement, the compensation carrier must receive everything up to the compensation amount before the workman is entitled to participate in the recovery, the supreme court distinguished this case from its ruling in *Hi-Plains*.[25] The court pointed out that in *Hi-Plains* both the jury verdict and the settlement amount were sought from the actual tortfeasor.[26] A carrier's recovery is not limited to the first money paid to the employee. Rather, it could collect the amount of the settlement from the workman, if less than the compensation amount, and this would end the joint and several liability for the settlement. But, since it would not be fully reimbursed, the carrier could proceed against the tortfeasor. If it had collected the settlement from the workman, recovery in the suit would be limited to the compensation amount less what had already been received.

In *Capitol Aggregates*, the tortfeasor was required to pay the workman because of the independent indemnity contract. The carrier had no claim to the indemnity funds even though it had not been fully reimbursed.[27] With the carrier having received the settlement amount from the workman, the tortfeasor was liable to the carrier only for the jury verdict.

Conclusion. The tortfeasor's liability before settlement is the amount of the jury verdict.[28] Although in both *Capitol Aggregates* and *Hi-Plains* the verdict was less than the compensation paid by the association, it could have been far in excess of that amount. By virtue of the settlement agreement with the injured employee, the third party is successfully able to put a ceiling on its liability exposure. A settlement for more than the compensation amount ends the entire claim, the compensation amount going to the carrier and the excess to the workman. After a settlement of less than the compensation amount, the third party's liability is no more than the amount of compensation plus the settlement. If, for instance,

[24] Although Great American was not fully reimbursed for the compensation amount, the workman was able to retain this money because the court felt that the indemnity contract was separate and independent of the carrier's subrogation rights.

[25] 408 S.W.2d 922 (Tex. 1966).

[26] In a concurring opinion Justice Smith stated that the court should not have distinguished this case from *Hi-Plains* on the basis of the parties but should have overruled *Hi-Plains* to clearly establish that the compensation carrier is entitled to all money paid by a tortfeasor up to the compensation amount. This would, in effect, give the carrier subrogation rights to the indemnity funds which would create a double liability in the tortfeasor and completely extinguish any rights of the workman. 408 S.W.2d 922, 925 (Tex. 1966) (concurring opinion).

[27] Capitol Aggregates v. Great Am. Ins. Co., 396 S.W.2d 419, 421 (Tex. Civ. App. 1965), *aff'd*, 408 S.W.2d 419 (Tex. 1966).

[28] Pan Am. Ins. Co. v. Hi-Plains Haulers, 163 Tex. 1, 6, 350 S.W.2d 644, 647 (1961).

the settlement were $2,000, the compensation amount $5,000, and the jury verdict $25,000, the tortfeasor would pay only $7,000 plus costs of the litigation.

When a workman is injured during his employment "under circumstances creating a legal liability in some person other than"[29] his employer, the employee can sue the third party directly. If he chooses to receive compensation under the Texas Workman's Compensation Act he does not give up all rights against the third party. However, the carrier must be subrogated in such a way as to allow it to recover all money paid by the actual tortfeasor, up to the amount of compensation, before the employee can claim any funds.[30] The court decisions in these cases achieve a most favorable result from which several rules can be determined. If the amount of the settlement given to the employee is less than the compensation paid, the carrier has a secured right to the settlement amount from the employee even though they may proceed to trial against the third party. If the judgment is less than the settlement amount, the carrier may elect to receive the settlement amount in lieu of judgment from the tortfeasor. If the judgment is more than the settlement amount, the carrier will receive the judgment from the tortfeasor. If this judgment is less than the compensation, the carrier can exercise its right to the settlement from the workman under section 6a. If the tortfeasor has indemnified the workman, the workman will be able to recover according to his indemnity contract. The presence of a settlement agreement should no longer create a problem, but rather is a situation to which certain determinative rules can be applied.

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[29] TEX. REV. CIV. STAT. ANN. art. 8307, § 6a (1948).

[30] For a discussion of the elimination of employer's participation in third party actions by subrogation see McCoid, *supra* note 3, at 450.