**SETTLING THIRD-PARTY CLAIMS WITHOUT CARRIER APPROVAL**

*Is it Time to Modify the Hornback Forfeiture Rule?*

When Eric Bohn settled his personal injury claim against the homeowner through whose roof he had fallen during a construction project, it likely never occurred to him that he needed the Industrial Commission’s approval. After all, its No Insurance Section (Bohn’s employer had been uninsured for workers’ compensation at the time of his accident) had denied his workers’ compensation claim. What difference was it to the Industrial Commission whether he settled with the third party?

A lot, as it turned out. An appellate court eventually found Bohn’s compensation claim to be compensable. But, when the No Insurance Section learned of the third-party settlement, it moved for a declaration that he had forever forfeited his right to compensation because he had neglected to secure its written approval. An administrative law judge sided with the Section, as did the court of appeals in a published opinion.¹

*by R. Todd Lundmark, Toby Zimbalist and Robert E. Wisniewski*
In Hornback v. Industrial Commission, an opinion issued by the Arizona Supreme Court 30 years ago, the court held that forfeiture is the sanction to be imposed when an employee settles a third-party claim without the written approval of the party liable to pay compensation benefits (the “carrier”). For the attorney of an employee who loses his benefits under such circumstances, the repercussions are potentially severe: a claim for legal malpractice, an ethics complaint, perhaps even civil liability for conversion. As many practitioners have learned through bitter experience, third-party claims arising from industrial injuries can be a trap for the unwary.

Is it time to eliminate or modify the Hornback forfeiture rule? The Arizona Supreme Court may soon provide an answer. It has granted Bohn’s petition for review, the third forfeiture case it has decided to review in the last five years. (Neither of the other two cases resulted in decisions.) For the reasons that follow, we believe it would be unwise for the court to overrule Hornback in its entirety, but an appropriate modification of the forfeiture rule may spare Bohn and other similarly situated employees from losing their benefits through simple ignorance of the law.

The Necessity of Approval

In Arizona, as elsewhere, the rules governing third-party practice derive from a blend of statutory and case law. A compensation carrier’s interest in a third-party claim is never to be taken lightly, but the carrier’s ability to participate in it turns out to be surprisingly limited.

As amended in 1968, A.R.S. § 23-1023(C) permits an employee injured in a work-connected accident to collect compensation benefits from his employer’s carrier and damages from any third party whose fault may have contributed to the accident. To prevent a double recovery by the employee, however, the statute gives the carrier a “lien on the amount actually collectable” from the third party. This gives the carrier a considerable stake in the outcome of the claim: in addition to being reimbursed for the compensation of benefits it has already paid, the carrier is given a credit against future benefits to the extent of the employee’s net recovery.

It would be a mistake, however, to exaggerate a carrier’s role in the processing of a third-party claim. The lien rights conferred by A.R.S. § 23-1023(C) are treated as subrogation rights, but the carrier, in fact, has no independent right of subrogation once the employee initiates a lawsuit. For all practical purposes, the carrier must await the outcome of the third-party litigation to determine whether and to what extent its lien will be satisfied. The settlement of the third-party claim, moreover, utterly extinguishes the carrier’s subrogation rights, forever fixing the amount of the recovery from the third party.

Instead, the statute provides the carrier with a decidedly more modest role: the right to be advised of, and to approve in writing, the third-party settlement before it becomes a fait accompli: “Compromise of any claim by the employee...at an amount less than the compensation provided for shall be made only with written approval of the...person liable to pay the claim.” The manifest purpose of this section, the court declared in Hornback, “is to prevent an employee from accepting too small a settlement and prejudicing the subrogation rights” of the carrier. In a subsequent case construing the statute as amended in 1968, the court of appeals, likewise, stated that the statute is intended “to protect the insurance carrier by precluding a settlement in an amount less than the carrier’s liability resulting in a deficiency claim against the carrier.” The United States Supreme Court itself has declared that the purpose of a similar provision in the Longshore Act is “to protect an employer against his employee accepting too little for his cause of action against a third party.”

The approval requirement is hardly onerous. In our experience, approval can often be secured in a single telephone call. We also agree with the majority in Bohn: “[O]ur experience is that carriers rather freely approve third-party settlements.” What should be the remedy, then, when an employee fails to afford the carrier this minimal opportunity to participate in the processing of a third-party claim?

Forfeiture as a Sanction

A.R.S. § 23-1023(C) does not specify a penalty for an employee’s failure to secure the carrier’s approval of a third-party settlement. As the dissent noted in Bohn, the forfeiture rule is a “judicial device.” This, however, does not make the rule either inherently wrong or peculiar to Arizona.

In defining the sanction of forfeiture, the Hornback court acted within its legitimate authority to give effect to the apparent legislative intent behind A.R.S. § 23-1023(C). It is incumbent upon a reviewing court to give meaning to each statutory “word, phrase, clause, and sentence...so that no part will be void, inert, redundant or trivial.” Although the Supreme Court itself has not revisited the forfeiture rule since Hornback, the court of appeals has applied the rule consistently in a variety of contexts. In 30 years, the Legislature itself has done nothing to overturn Hornback, a silence that “bespeaks legislative contentment.”

Arizona is not alone in defining forfeiture as the sanction for an employee’s noncompliance with the approval requirement. To the contrary, Hornback merely enunciates the “commonest” rule. According to the leading American workers’ compensation scholar, “if an employee settles a third-party claim without the employer’s consent, the employee forfeits any right to future compensation.” Indeed, of the 23 other states that impose the sanction of forfeiture, Arizona is not alone in doing so without express statutory authority.
Nor is forfeiture a sanction unique to third-party practice. Forfeiture is a remedy that the courts have read repeatedly into the Workers’ Compensation Act, even where the Legislature did not expressly provide for it. For example, an employee has been held to have forfeited his or her right to medical coverage by changing doctors without the written authorization of his self-insuring employer. Similarly, an employee has been held to have forfeited his right to workers’ compensation benefits when he was so inebriated at the time of the accident to have effectively abandoned employment.

The forfeiture rule is based on the prejudice the carrier is presumed to suffer when its subrogation rights are destroyed. The presumption has been made both when the governing statute expressly provides for forfeiture and when it does not. Thus, the Court of Appeals for the Fourth Circuit and the District of Columbia Court of Appeals have held that the Longshore Act “conclusively presum[es] prejudice to the claimant’s employer, without requiring proof of actual prejudice.” The courts reasoned that the presumption of prejudice “is only proper, because when a claimant makes a settlement of an unliquidated claim, without the employer’s consent, he has undertaken to fix the amount of recovery in an action which would have inured to the employer’s benefit.” The New York court, similarly, has held that “compromise without the consent of the carrier relieves the carrier and employer of responsibility for the award even though there is no prejudice to the carrier arising from the compromise.”

The Hornback rule has fostered compliance with A.R.S. § 23-1023(C) since 1970. Its invocation may seem harsh in some cases, but this is insufficient to establish its invalidity. Any dismissal of a claim or cause of action on technical or procedural grounds is unfortunate for the loser, yet no one questions the continuing validity of limitations statutes, discovery deadlines, and like requirements. Can an employee’s failure to comply with the approval requirement nevertheless be handled in some other way without eviscerating the requirement itself?

Alternatives to Forfeiture

The carrier’s interest in an employee’s third-party claim is substantial, but its right to participate in it is exceedingly limited. It can merely approve or disapprove the settlement. When an employee cuts off this admitted limited right, forfeiture probably remains the best remedy. But Bohn’s case and cases like his may call for a limited exception.

The alternatives to forfeiture are either illusory or unworkable. Instead of losing his benefits completely, should the employee be forced to give the carrier a credit against its future compensation liability in a sum equal to his net third-party recovery? This, it turns out, is already provided for elsewhere in A.R.S. § 23-1023(C). (“The insurance carrier or other person liable to pay the claim should contribute only the deficiency between the amount actually collected and the compensation and medical, surgical and hospital benefits provided or estimated by the provisions of this chapter for such case.”) If giving the carrier a credit were the only remedy, then the legislature’s mandate that the third-party claim be settled “only with written approval” of the carrier would be effectively void.

Similarly unworkable would be a requirement that the employee reimburse the carrier in a sum equal to the carrier’s lien. By the time the carrier learned of the settlement, its proceeds would likely have been spent by the employee. A lawsuit by the carrier against the employee for reimbursement would in most cases be an exercise in futility.

The least acceptable alternative would require either party to prove or disprove that the carrier was prejudiced by the settlement it had no opportunity to approve. The party in possession of the information needed to address the issue and establish the value of the third-party claim—the employee himself—would have little motivation to cooperate in such an exchange. In addition, the exchange would likely take place after critical evidence has been lost or become unavailable. The employee’s third-party attorney, his most likely ally in such a contest, could not participate without violating the privilege between himself and his client. A full-blown tort trial within the industrial setting would be expensive to both sides and require the third party to participate in a hearing similar to the trial he paid to avoid.

Bohn’s own case suggests another possible alternative. When a carrier denies an employee’s workers’ compensation claim, should the denial be treated as a waiver of its right to approve a third-party settlement? Although this might discourage ill-considered denials and save hard cases like Bohn’s, it is problematic on several levels. The statute itself does not condition the approval requirement on the carrier’s actual payment of benefits. An employee’s inchoate right to compensation benefits gives the carrier the same interest in the outcome of the third-party litigation as it does when a compensation claim has been accepted and benefits paid. Several courts that have considered this issue—including the United States Supreme Court in a Longshore case—have enforced the approval requirement whether or not compensation benefits have been awarded.

In the end, perhaps a reasonable solution to this dilemma is to determine whether the employee had actual notice of the carrier’s lien rights before he settled the third-party claim. If he did not, then he ought to be entitled to back the presumption of the unapproved settlement prejudiced the carrier. Conversely, when the employee had notice of the approval requirement—and an attorney’s presumed knowledge of the statutory approval requirement should be imputed to the client—then it should be conclusively presumed
that the settlement was inimical to the carrier's interests. The conclusive nature of the presumption is warranted because no public policy is advanced when an employee is permitted knowingly and with impunity to disregard the interests of the compensation carrier.

The burden this imposes upon carriers is insubstantial. Whether or not the claim has been denied, they can place employees on notice of section 1023(C)'s approval requirement either informally with a simple letter or somewhat more formally with a notice of claim status. In either case, the notice should advise the employee of the necessity that any third-party settlement receive the carrier's written approval before it is finalized. It should also expressly warn the employee that his benefits will be lost if the claim is settled without the carrier's approval. If benefits have already been paid, then the amount of the lien should be disclosed. Indeed, many carriers are already sending such notices to employees.

This modification of the forfeiture rule leaves unaddressed those rare cases in which an employee settles a third-party claim while unrepresented by counsel and before filing his claim for workers' compensation benefits. It is unlikely that a carrier will alert the employee of the approval requirement before he has actually made a claim for compensation benefits; indeed, the carrier may not even know that he has been injured in an industrial accident. In such cases, the employee should be permitted to rebut the presumption that the unapproved settlement prejudiced the carrier, because justice is not well served when an employee loses his right to workers' compensation coverage innocently and as a result of his simple ignorance of the law.

**Conclusion**

As long as the Legislature requires carriers' approval of third-party settlements, the Hornback forfeiture rule remains sound. No equally effective, alternative remedy is available
for an employee’s knowing violation of section 1023(C)’s approval requirement. A limited exception to the Hornback rule—allowing the unrepresented employee to rebut the presumption of prejudice when he has reached a third-party settlement in ignorance of the carrier’s right to approve it—would spare the truly innocent while ensuring continued compliance with the statute.

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ENDNOTES:


7. If the employee fails to pursue the third-party claim in the first year following the industrial accident, then the cause of action is assigned by operation of law to the carrier. See A.R.S. § 23-1023(B).

8. Theoretically, intervention in the third-party action is another means by which the carrier can ensure its subrogation rights. See 82 Am. Jur. 2d Workers’ Compensation §106, at 106 (1992). In practice, however, intervention has many pitfalls. First, it is costly. See Great American Insurance Co. v. Spoden, 316 N.W.2d 740, 742 (Minn. 1982) (statutory subrogation provisions can make costly intervention actions unnecessary). Second, if the case proceeds to trial both the employee and insurer may be prejudiced by the jury’s belief that the employee has already been compensated for his injuries. See Annotation, Prejudicial Effect of Bringing to Jury’s Attention Fact That Plain-Jane's Claim was Being Contested When the Third-Party Action was Settled; Grinnell, supra note 12 (forfeiture rule applied even though the employee repaid the carrier).


15. Id., at 28. (Fidell, J., dissenting).


18. See, e.g., M. acuino, supra note 1 (applying forfeiture rule even though the compensation claim was being contested when the third-party claim settled); Grinnell, supra note 12 (forfeiture rule applied even though the employee repaid the carrier).


20. Larson, § 74.17(a), at 14-428.

21. Id.


26. Id.

