

## PRACTICAL CONSIDERATIONS OF SETTLEMENT



ATLANTA | MONTGOMERY

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In a lawsuit the first to speak seems right,  
until someone comes forward and cross-examines.  
Casting the lot settles disputes  
and keeps strong opponents apart.  
Proverbs 18:17-18

### **I. Introduction**

When I began practicing law in 1990, the process of settling a case was fairly straightforward. The concept of mediation was essentially unheard of. The settlement process typically involved writing demand letters and receiving a response. After negotiating in writing, by telephone or in person, the parties, if possible, reached a case value. In a matter of days, a release and a check would be received. The client would then sign the release and disbursement schedule and receive his or her check.

Those days are long gone. Today, the settlement process is more akin to a second round of litigation. While this paper is not meant to be a detailed expose', it will attempt to address some of the more common issues you will see in the settlement process.

## II. Whether to take and/or settle the case

Every case has three primary aspects: Liability; damages; and recoverability. In some instances you may interview a client and find that there is liability and damages. But what about recoverability? Recoverability is typically based upon available insurance coverage. So the question is not alone, “Is there insurance coverage”, but “Is there enough insurance coverage.” Pursuing a case may not make a great deal of sense in every instance.

For example, assume your client was involved in a car wreck and suffered serious injuries. You learn that your client’s medical expenses are close to \$70,000. The tortfeasor has a \$25,000/\$50,000 policy. Your client’s vehicle has the same uninsured/underinsured motorist coverage. There are no other coverages and no stacking of coverages is possible.

Who gets the \$50,000 of insurance coverage? How is it shared among those who will no doubt be seeking to be paid? Do you settle the case and then attempt to negotiate a settlement with healthcare providers, insurance subrogors, or others who claim they are entitled to be paid? Are those who hold liens or claims in the settlement proceeds willing to reasonably negotiate? These are all questions a practicing attorney must ask himself/herself before filing and pursuing the case.

While our client’s best interest should always be at the forefront, even if you do settle the case, you may find that you put in more lawyer hours to possibly earn a fee than the fee is worth. It simply is not good practice to settle a case and tell your client that it is their problem to resolve these issues. And in some instances, you may have an affirmative duty to deal with subrogation interests and liens. We will address some of these concerns below.

### III. Settling your case

The vast majority of cases that survive dispositive motions settle short of litigation. Many cases are settled either in mediation or between lawyers, or between a lawyer and an insurance adjuster.

Settling cases in mediation has become an artform. Good mediators typically have the parties sign a mini-agreement, setting forth the amount of the settlement, when the funds will be exchanged, whether any portion of the settlement will be confidential, and who and how will subrogation issues be handled. In today's world it is a mistake to leave a mediation without these issues resolved. Otherwise, you may have an agreement about the money, but it may take you months to get the funds exchanged and the settlement agreement executed. With a signed mini-agreement, filing and having a motion to enforce settlement agreement granted is made much easier. A mediation settlement should, at a minimum, address the following matters: (1) the amount of settlement; (2) when the funds will be received; (3) who pays the costs of mediation; (4) how subrogation issues will be handled; and (5) whether the settlement is a full or pro tanto (limited) release. It might also be appropriate to provide punitive terms in a mediation settlement agreement, such as additional funds or attorneys fees and costs will be payable by any party who fails to abide by the agreement.

Generally, the mediator cannot be a witness about what the terms of the settlement are or were. The mediator traditionally must keep the settlement process confidential except to notify the Court that the parties have reached an agreement to settle. *See* Rule 11, Ala. Civ. Court Mediation Rules. But a written agreement may be admissible to prove the terms of settlement.

On occasion, settlements fall apart. On very rare occasions, one party will fail to abide by the terms of the settlement. They may even claim that there is no settlement. A mediation settlement agreement, thus, is essential. In lieu of settlement, it is essential to confirm the

settlement terms in writing and invite the opposing side to disagree within a period of time or to confirm the terms in writing. *See Mays v. Julian LeCraw & Co.*, 807 So.2d 551, 551 (Ala.Civ.App. 2001) (“The law in Alabama is clear in that agreements made in settlement ... are as binding on parties thereto as any other contract. A settlement agreement once entered into cannot be repudiated by either party and will be summarily enforced.”). While a written memorial of the agreement is always preferable, the agreement may be enforceable even if a verbal settlement in some cases. *See Tidwell v. Tidwell*, 505 So.2d 1236, 1237 (Ala.Civ.App. 1987); *Porter v. Porter*, 441 So.2d 921 (Ala.Civ.App. 1983). It is important to remember that an attorney can bind the client by statements made “on the record.” *See Cincinnati Ins. Co. v. Barber Insul., Inc.*, 946 So.2d 441 (Ala.Civ.App. 2006); *BFI Waste Services, LLC v. Circle J. Roll-Offs, Inc.*, 942 So.2d 1058 (Ala.Civ.App. 2005); *McIver v. Bondy’s Ford, Inc.*, 916 So.2d 616 (Ala.Civ.App. 2005).

The most common post-mediation issue that arises seems to be the claim that the defendant or its insurance carrier cannot pay limits until subrogation issues are resolved. These types of issues have begun to cause countless headaches for attorneys on both sides of the bar. Having a written agreement, again, will help to compel payment of settlement funds in a timely manner.

#### **IV. Settlement of claims of minors and incompetents**

If the settlement involves the claims of minors, do not forget that a trial court must approve the settlement. This is true even if the case is settled before suit is filed. Where a lawsuit has not been filed, the defendant/liability carrier’s attorney will typically prepare the paperwork and file it with the court for approval of the settlement. The parties should request a pro ami hearing and the appointment of a guardian ad litem.

Holding the hearing and having the guardian ad litem appointed, however, is only part of the equation. The next question is what happens to the funds. In large settlements, the best course

of action is to arrange for a structured settlement or a special needs trust may be established. It may be appropriate to have a payout for adults, but for minors the funds can typically be invested and held until the trial court enters the final order to release the funds. Another approach is to contact the clerk and discuss paying the funds into the clerk's interest-bearing account. This approach works best for modest-sized settlements. Finally, if a guardianship/conservatorship has been established, the funds may be payable to the guardian/conservator. In such cases, the guardian/conservator is restricted to the types of investments he or she may make, and routine accountings must be done through the probate court.

In the rarest of situations, the funds may be paid over to a parent or non-court appointed guardian. This should only be done with the approval of the court and only in cases with small settlements.

I encourage you to become familiar with the Uniform Transfers to Minors Act, the Facility of Payment Act, and other laws associated with settling claims for and on behalf of minors. *See* Ala. Code §§ 26-2A-6 et seq. and 35-5A-1 et seq. (1975). For further guidance, *see Abernathy v. Colbert County Hosp. Bd.*, 388 Sol.2d 1207 (Ala. 1980).

## **V. Subrogation and Liens**

Perhaps, the most difficult issue facing attorneys today on both sides of the bar has to do with how to resolve subrogation claims and liens of government and private benefit providers.

Before we get to the specifics of each area of subrogation, you need to understand that wrongful death proceeds pass outside of the Estate and are not subject to the claims of creditors, including subrogation claims and liens. Ala. Code § 6-5-410(c) (1975). This has been the rule in Alabama for a long time. *See Board of Trustees of Univ. of Ala. v. Harrell*, 188 So.2d 555 (Ala. Civ. App. 1965). For a good overview of Alabama's wrongful death law, I encourage you to look

at *Ex parte Rodgers*, 141 So.3d 1038 (Ala. 2013), which is the opinion that holds that even the Administrator cannot be paid a fee out of wrongful death proceeds.

This principle even applies to Medicare's claim for reimbursement. Medicare has a rule (§ 50.5.4.1, Contractor MSP Recovery Rules), which provides: "NOTE: If a wrongful death statute does not permit recovering medical damages, Medicare has no claim to the wrongful death payments." This rule has been upheld by the courts. *See Bradley v. Sebelius*, 621 F.3d 1330 (11<sup>th</sup> Cir. 2010); *Benavides v. U.S.*, 497 F.3d 526 (5<sup>th</sup> Cir. 2007); *Burford v. U.S.*, 642 F.Supp. 635 (N.D. Ala. 1986).

#### **A. Health Insurance subrogation**

There was a time when we all thought that the common fund doctrine would apply to resolving health insurance subrogation issues. *See Powell v. Blue Cross and Blue Shield of Alabama*, 581 So.2d 772 (Ala. 1990) (addressing the "made whole" rule and the common fund doctrine). *See also International Underwriters/Brokers, Inc. v. Liao*, 548 So.2d 163 (Ala. 1989); *Ex parte State Farm Fire & Cas. Co.*, 764 So.2d 543 (Ala. 2000). That is no longer the case. Now, we must determine whether a health insurance policy falls under ERISA.

ERISA, the Employee Retirement Income Security Act, 29 U.S.C. §§ 1000-1461 (1990), is a preemptive statute. 29 U.S.C. § 1144(a). What that means for us is that in many instances we must look to ERISA to negotiate our clients' medical liens instead of the state common law. While determining when ERISA may apply is beyond the scope of this article, it bears noting that the United States Supreme Court has determined that there is a distinction between self-funded and insured employee benefit plants. *FMC Corp. v. Holliday*, 498 U.S. 52, 61 (1990). For the ERISA preemption to apply, the plan must be self-funded and paid by the employer. Employee benefit plans, on the other hand, are subject to indirect state insurance regulation. *FMC Corp v. Holliday*, supra.; *Metropolitan Life Ins. v. Massachusetts*, 471 U.S. 724, 105 S.Ct. 2380, 85 L.Ed. 2d (1985).

There has been some confusion about the extent of the distinction between these two plans and whether state or federal law applies. *See Blue Cross & Blue Shield of Ala. v. Fondren*, 966 F. Supp. 1093, 1095 (M.D. Ala. 1997). The “make whole” or “made whole” doctrine may still apply to employer-employee based plans, but that is not the case if the plan language allows the carrier the “first reimbursement out of any coverage”. *Cagle v. Bruner*, 112 F.3d 1510 (11<sup>th</sup> Cir. 1997). For further guidance on this complicated matter, *see Mertens v. Hewitt Assoc.*, 508 U.S. 248, 256 (1993); *Great West Life & Ann. Ins. Co. v. Knudson*, 534 U.S. 204 (2002); *Sereboff v. Mid-Atlantic Med. Svcs., Inc.*, 126 S.Ct. 1869 (2006); *Popowski v. Parrott/BCBS of South Carolina*, 461 F.3d 1367 (11<sup>th</sup> Cir. 2006); *Wal-Mart Stores, Inc. v. Horton*, 513 F.3d 1223 (11<sup>th</sup> Cir. 2008); *Zurich Am. Ins. Co. v. Flaherty*, 408 Fed. Appx. 312 (11<sup>th</sup> Cir. 2011).

It has been my experience that most health insurance providers will work with you on negotiating the amount of a subrogation interest. Blue Cross Blue Shield of Alabama has begun sending letters, requiring a designation by plaintiff’s counsel as to whether he will agree to reimburse BCBS after deducting a pro rata share of expenses and a 25 percent reduction for attorneys’ fees. There are some occasions where agreeing to this early may be the most expeditious approach to resolving the subrogation issue, especially in cases where recovery will be modest. On larger settlements, it may be to your client’s benefit to disagree with the proposal by BCBS and fight BCBS for a greater reduction.

With regard to ERISA plans, you should always ask for the Master Plan Document. Insurers will send you the plan summary, but traditionally this has not been enough to satisfy the full reimbursement entitlement. *Cigna Corp. v. Amara*, 11 S.Ct. 1866 (2011). Keep in mind also that a plan administrator has 30 days to turn over all documents, or the statute allows for penalties of \$110 per day.

In any health insurance subrogation dispute, it is important to get a copy of the actual policy of insurance. Unless the law overrides a policy provision, the policy language will guide how subrogation should be handled. *See McIntosh v. Pacific Holding Co.*, 992 F.2d 882 (8<sup>th</sup> Cir. 1993), cert. denied, 510 U.S. 965 (1993); *Walker v. Wal-Mart Stores, Inc.*, 159 F.3d 938 (5<sup>th</sup> Cir. 1998). The policy defines the contract terms between the parties. Parties can vary the terms of their agreement from existing law in most instances, so you need to know where your client stands under the contract. *See, e.g., Liao*, 548 So.2d at 165-66; *Wolfe v. Alfa*, 880 So.2d 1163 (Ala.Civ.App. 2003).

Many insurance policies have done away with the “made whole” doctrine, but the “common fund doctrine” in policies not covered by ERISA is still available, meaning the amount owed can be reduced by a pro rata share of attorney fees and costs even if the plaintiff is not completely compensated for his or her injuries. *See GEICO v. Capulli*, 859 So.2d 1116 (Ala.Civ.App. 2001); *Wolfe v. Alfa*, supra; *Mitchell v. State Farm Mut. Auto Ins. Co.*, 118 So.3d 693 (Ala.Civ.App. 2011), *aff’d*, 118 So.3d 693 (Ala. 2012). *But see CNA Ins. Cos. v. Johnson Galleries of Opelika, Inc.*, 639 So.2d 1355, 1359 (Ala. 1994), finding that common fund does not apply if relationship is adversarial or if recovery on behalf of insurance carrier is merely incidental. The best course of action where the subrogation interest is negotiated after settlement is to ask the carrier for a copy of the policy and to agree to negotiate the subrogation interest in good faith.

The question has long been what is the responsibility of the attorney to pay the subrogation claims. Most settlement agreements now require the plaintiff to address and resolve subrogation issues and/or to hold-harmless the liability carrier and defendant. Aside from this, the attorney may still have a legal obligation to do so, especially where the subrogation claim arises out of an ERISA policy. *See Primax Recoveries v. Sevilla*, 324 F.3d 544 (7<sup>th</sup> Cir. 2003); *Chapman v. Klemick*, 3 F.3d 1508 (11<sup>th</sup> Cir. 1993) (attorney not a “fiduciary”); *Useden v. Acker*, 947 F.2d 1563

(11<sup>th</sup> Cir. 1991), cert denied, 508 U.S. 959 (1993); *Great West v. Bullock*, 202 F.Supp.2d 461 (2002).

### **B. Medicare and Medicaid subrogation claims**

One of the greatest impediments to prompt resolutions of settlements is having to deal with Medicare and Medicaid subrogation claims. *See Zinman v. Shalala*, 835 F.Supp. 1163, 1171 (N.D. Cal. 1993), *aff'd*, 67 F.3d 841 (9<sup>th</sup> Cir. 1995) (where the court told Medicare to stop using the term “lien”). If you have a client who is Medicare or Medicaid eligible, it is imperative that you go on the offensive and request a conditional payment letter. This can be done online. The entity with which you deal is the Centers for Medicare and Medicaid Services (“CMS”). The reason that you should do this is that Medicare’s interest applies even if they did not provide notice or even after funds are disbursed. 42 C.F.R. § 411.24(g) and (i). Also, most insurance defense counsel will not settle a case, and certainly will not pay you settlement proceeds, without knowing the amount of the subrogation interest and knowing that it will be satisfied out of the settlement proceeds. Medicare will issue a Conditional Payment Letter. That letter will set forth the benefits paid on behalf of your client and will usually include a reimbursement amount that Medicare is requesting. After you have a settlement amount, you can then request Medicare to send you a Final Payment Letter. You will have to provide proof of the settlement (usually a copy of the signed release) and a breakdown of the expenses incurred by you in obtaining the recovery. If you dispute the final amount sought by Medicare, a review and appeal process is in place.

Medicare’s right to subrogation exists under federal law. 42 U.S.C. § 1395y(b)(2) (1993). Medicare can also avoid paying for medical expenses under the Medicare Secondary Payer program where payment “has been made or can reasonably be expected to be made ... under an automobile or liability insurance policy or plan.” 42 U.S.C. § 1395 (1993). Traditionally, you will find that Medicare will make a conditional payment to the healthcare provider, even when it

is known there may be third-party recovery, where prompt payment (within 120 days) is not expected. If Medicare asks for an update on when it is expected that the case will be resolved, and you can honestly and ethically respond accordingly, it may be in your client's best interest to note that settlement or recovery is not expected for more than 120 days. When a conditional payment is made by Medicare, reimbursement is typically associated with a pro rata reduction based upon attorney's fees and expenses. *Id.*; 42 CFR § 411.37. This right to reimbursement preempts all state laws. *Kimberly-Clark Corp. v. Golden*, 486 So.2d 435, 438 (Ala.Civ.App. 1986).

Medicaid has a similar statutory right to reimbursement under Alabama law. Ala. Code § 22-6-6(a) (1975). Equitable principles can be applied to determine whether Medicaid has a right to reimbursement and, if so, how much they are entitled to. *Smith v. Alabama Medicaid Agency*, 461 So.2d 817, 819-20 (Ala.Civ.App. 1984). A list of benefits paid, and the amount of any claimed subrogation interest can be obtained from Medicaid by completing the appropriate forms. You can write, call or contact Medicaid online for guidance. It should be noted that Medicaid regulations require that Medicaid be notified of the litigation and be timely notified of the settlement. *See Alabama Adm'v Code*, Medicaid Agency, Chapter 560-X-20. Medicaid benefits are also subject to the Medicare Secondary Payer Act, and Medicaid can deny payment where the injuries caused were the result of an insured tortfeasor. This issue will be addressed in more detail under the Medical Liens part below.

Medicare has a right to file an action to recoup its subrogation interest if the funds are not paid. In some instances, lawyers have been sued along with their clients for not satisfying outstanding subrogation interests. 42 U.S.C. § 1395y(b)(2)(B)(ii) and (3). *See also 42 CFR § 411.24*. Medicaid will reduce the amount owed typically by 15 percent, although a common fund argument may be successfully made under the right circumstances. *See Smith*, supra. Medicaid may also negotiate even more in substantial hardship cases.

If you are facing a Medicaid reimbursement issue, you should also pay special attention to *Allhorn v. Arkansas Dept. of Health*, 547 U.S. 268 (2006). In this case, Medicaid's recovery was limited to the amount recovered compared to the true value of the case. In this case, it was stipulated that the value of the case was \$3,000,000, but the plaintiff only recovered \$525,000, so Medicaid's recovery was limited to about 1/6<sup>th</sup> of what was paid. Some movement has been made to change the *Allhorn* decision in favor of Medicaid, no doubt because of funding issues with State Medicaid programs.

There are some who would tell you not to seek subrogation information from Medicare or Medicaid in a wrongful death case, because Medicare/Medicaid do not have an interest in settlement benefits. However, this issue is not as simple as it might sound. For example, at times, you settle cases short of litigation. You may find yourself in a position of convincing CMS that your case does not involve a personal injury component. If you file a personal injury lawsuit and your client dies, the question becomes whether you can convert your case to a wrongful death action and drop your personal injury action. In those instances, convincing CMS that the settlement was for wrongful death may be a challenge as well.

Recently, I filed a personal injury action. The client died. A settlement was reached, and it took months to get the funds in and disbursed. The Medicare lien had to be negotiated and resolved. The insurance carrier refused to pay us the Medicare portion, so I had to send them the final lien letter after I negotiated the lien down.

Even where your case is a straight wrongful death case, issues can arise. About four years ago, I settled a wrongful death case. I disbursed the funds and about 3 months later, my client received a lien letter from CMS for \$27,000. After calming my client down, I had to deal with the lien issue. It went to the point of the reconsideration phase.

Because of this, I now ask for a list of benefits paid, which prompts a conditional payment letter, even in wrongful death cases. I would rather deal with the issue before disbursement than deal with it after my client has received and spent the funds.

### **C. Government liens and Tricare liens**

One of the things you need to keep in mind is how you handle government liens. The two I encounter the most are claims of federal hospitals and Tricare liens.

Under Tricare, if your client is military and receives benefits through Tricare, you should write the local Office of the Staff Judge Advocate. You typically will deal with a paralegal there, though you might be able to deal with a JAG officer. Most of the time, Tricare will reduce their lien by an appropriate amount. Tricare's right to recovery is found under the Federal Medical Care Recovery Act, 42 U.S.C. § 2651. Tricare may not be entitled to recovery from uninsured motorist benefits. *See GEICO v. Andujar*, 773 F.Supp. 282 (D. Kan. 1991).

The VA may send you a request asking you to guarantee payment of their bill, but I have not been able to find any authority that requires you, as the attorney, to do so. Typically, if I get these guarantee of payment letters, I send a follow up letter notifying the healthcare provider that I understand there is an outstanding balance and I will notify my client of their claim to an interest in any settlement proceeds.

### **D. Medical liens**

In Alabama, the only healthcare provider that can file and perfect a lien is a hospital. Ala. Code § 35-11-370 (1975). That is not true in other states, such as Georgia where multiple healthcare providers can perfect a lien. Where there is a perfected lien, you cannot ignore it. If your client has not received a notice of a lien, it is good practice to check the probate court in the county where the hospital is located to see if a lien was filed. Negotiating the lien and obtaining a release is critical.

It is important to verify that the lien has been perfected. Merely filing the lien by a hospital does not mean that it has a perfected lien. The statute sets forth what must be done to perfect that lien. The primary thing that must be done is that the lien must be filed with the probate court within 10 days of the patient's discharge from the hospital. *See Johnson v. Health Care Auth. Of City of Huntsville*, 660 So.2d 1017 (Ala.Civ.App. 1995) (patient did not enter hospital within 7 days and lien not filed within 10 days); *Ex parte University of So. Alabama*, 761 So.2d 240 (Ala. 1999) (patient must enter hospital within 7 days of accident); *Ex parte Infinity S. Ins. Co. Inc.*, 737 So.2d 463 (Ala. 1999) (applying the 10-day filing/perfection rule).

In some instances, the hospital's recourse is against the patient, but in other instances the hospital may sue the tortfeasor or look to the tortfeasor to pay some or all of the hospital lien. *Infinity*, *supra*.

You will find that more and more hospitals are foregoing submitting the outstanding bill to a health insurance carrier or Medicare/Medicaid. Instead, more of these facilities are foregoing the guarantee of insurance and are taking their risks of collecting from a tortfeasor's insurance company. *See Roberts v. University of Ala. Hosp.*, 27 So.3d 512 (Ala.Civ.App. 2008) (hospital chose to forego Medicare and seek full collection from "settlement proceeds"); Ala. Admin Code Chaps. 560-X-20-.01 and .02 (seemingly mandating recovery from other sources in advance of Medicaid by a "provider"); Ala. Admin. Code Chap. 560-X-1-.07(3) (provider must notify patient before services rendered of its election to seek recovery from third-party resources rather than Medicaid). If you write the hospitals and tell them to submit the outstanding bill to health insurance or Medicare/Medicaid, they may likely tell you that those coverages are secondary to liability insurance. The reason is simple – the hospital can seek to recover 100 percent from your client (or from liability proceeds) as opposed to the grossly reduced amount of coverage provided by health insurance and Medicare/Medicaid. Ala. Code § 35-11-370 and -371 (1975). The

hospital's right to be paid is not treated in the same fashion as traditional subrogation, namely, that it is not required to offset its bill or reduce the amount. *Guin v. Carraway Methodist Med. Ctr.*, 583 So.2d 1317 (Ala. 1991). However, the hospital cannot impair your settlement. If it does so, it may lose its lien. Ala. Code § 35-11-372.

Other authority you need to review on this issue includes: *Board of Trustees of Univ. of Ala. ex rel Univ. of Ala. Hosp. v. American Res. Ins. Co.*, 5 So.3d 521 (Ala. 2008), *modified on denial of reh'g* (Sept. 19, 2008); *University of So. Ala. Hosps. v. Blackmon*, 42 So.3d 1258 (Ala.Civ.App. 2009); *Progressive Specialty Ins. Co. v. University of Alabama Hosp.*, 953 So.2d 413 (Ala.Civ.App. 2006); *Alfa Mut. Ins. Co. v. University of So. Ala.*, No. 2140366, 2015 WL 4389308 (Ala.Civ.App. July 17, 2015).

Let me offer you some free advice here – NEVER sign a guarantee of payment with a healthcare provider. I know at times some attorneys will do this so their client can get treatment. In all my years of practice, I probably have only done this a couple of times. It should be a very rare instance where you do so. Once you sign that guarantee, you lose much of your bargaining power with the healthcare provider after a recovery has been made for your client.

#### **E. Worker's Compensation subrogation**

In some cases, you will have a third-party workplace case, where your client has received benefits in the form of compensation (indemnification) and medical bills. The worker's compensation carrier has a statutory right to subrogation. Negotiating the third-party claim must take into consideration the amount of the lien and the willingness of the comp carrier to negotiate or waive the lien.

Entitlement to subrogation for a comp lienholder is found at Alabama Code § 25-5-11(a) (1975). This statutory provision permits a comp carrier to proceed against a third-party to recover benefits paid by it, and this provision has been interpreted by our Supreme Court to allow a right

to subrogation. *Northeast Utilities, Inc. v. Pittman Trucking Co.*, 595 So.2d 1351, 1354 (Ala. 1992). Coincidentally, this right to subrogation may also apply to death proceeds paid to a dependent under the Act as well, where benefits are later recovered for wrongful death. *Id.* at 1354. It does not, however, apply to recovery from an uninsured/underinsured motorist carrier. *State Farm Mut. Auto. Ins. Co. v. Cahoon*, 287 Ala. App. 462, 252 So.2d 619 (1971); *River Gas Corp. v. Sutton*, 701 So.2d 35 (Ala.Civ.App. 1997); *Bunkley v. Bunkley A/C, Inc.*, 688 So.2d 827 (Ala.Civ.App. 1996).

There are many approaches to addressing these issues. In the few worker's compensation cases I have handled in my career, I have almost never recommended my clients to close meds. I have had one occasion where closing meds was in my client's best interest in order to obtain a waiver of subrogation, but in that event my client had other available insurance coverage that would cover his medical expenses into the future. The client can choose to do so, but it will not be with my advice. I do, however, encourage clients on large settlements to consider giving up PTD benefits. If a client is receiving weekly benefits, he or she can place a large portion of the settlement proceeds in an annuity and the payout will be far more than the compensation benefits in most instances. Comp carriers like this approach because it allows them to hedge their bets about whether a client will need future medical care and, if so, how much. And in the future, the comp carrier will almost certainly approach the client or you about settling the future medical issue.

To determine how much an employer or its comp carrier may be entitled to from third-party recoveries, you will need to do a *Fitch* analysis. See *Fitch v. Insurance Co. of NA*, 408 So.2d 1017 (Ala.Civ.App. 1981). I would also direct you to the following authority: *Ex parte Miller & Miller Constr. Co., Inc. v. Madewell*, 736 So.2d 1104 (Ala. 1999); *Ex parte BE&K Constr. Co.*, 728 So.2d 621 (Ala. 1998); *Maryland Casualty Co. v. Tiffin*, 537 So.2d 469 (Ala. 1988).

## **VI. Medicare set asides (MSAs)**

If you have a client who is Medicare eligible or who is approaching Medicare eligibility, you must consider (1) whether an MSA is required and (2) whether an MSA is in the client's best interest. Some defendants will push for MSAs.

It was thought that MSAs would be required in liability cases this year by CMS, but to date that has not become final. Voluntary MSAs are still allowed (and some cases might be beneficial). CMS will review your MSA and give you input on whether the amount is appropriate. My suggestion is that you do not attempt to tackle this issue on your own. If you have a settlement sufficiently large enough to consider an MSA, I encourage you to hire an entity that specializes in this issue.

Oftentimes, liability carriers will do their own MSA calculations. I have asked for a copy of their calculations, so I can review their position and then have my own expert to review the suggested numbers. Having a plan from someone who knows what they are doing puts you in a much better position when it comes time to value your case and determine how best to handle the settlement proceeds.

Even if you do not set up an MSA, it is important for you to explain to your client that the settlement may affect his or her entitlement to Medicare benefits. Because of the settlement, Medicare may become a secondary payer. In fact, this is what the Medicare Secondary Payer Act is intended to address.

In the worker's comp setting, an MSA may be required and even beneficial. MSAs are common in the worker's comp arena. Most lawyers are not qualified to tackle the MSA issue, and hiring a specialist to assist with this issue is very much the preferred approach. CMS has an MSA review process in place. I do not do worker's comp law except in conjunction with third-party claims, so I must admit I am not familiar with this process. I do understand that the review process

is optional, but if you set up the MSA without the rubber stamp of CMS, they may subsequently disagree with your assessment which can affect your client's ability to have Medicare cover his or her medical bills in the future. To hopefully avoid such a situation, I encourage you to speak to someone who is familiar with the process, if you get to this point.

In the liability arena (and perhaps the worker's comp as well), you may need to consider breaking down how much of your settlement is for future medical expenses. By doing so, you may eliminate the need for an MSA or greatly reduce the amount that might need to be placed in an MSA account.

## **VII. Confidentiality**

Frequently, defendant's counsel or the insurance carrier insists on confidentiality provisions. Our firm rarely agrees to full confidentiality. We will and have agreed to confidentiality of the amount only, since this may benefit our clients. But we do not agree that the terms of the settlement are confidential, except in the rarest of incidents.

Confidentiality agreements can result in making your settlement taxable. *See Amos v. Com'r* (U.S. Tax Court, Dec. 1, 2003). This case is often referred to as the "Dennis Rodman" case. Dennis Rodman, a former NBA player with the Chicago Bulls, while chasing a rebound went flying into a group of photographers and injured Amos. Amos sued Rodman, and the case was settled for \$200,000. The tax court concluded that \$80,000 of the settlement was not exempted from taxation. The settlement was confidential, but at the end of the day the entire agreement was set forth in this tax court opinion. The tax court noted the long-standing rule that damages "on account of personal injuries or sickness" were not subject to being included in gross income. Amos claimed his injuries were physical, and Dennis Rodman even provided an affidavit in favor of

Amos that the settlement was for physical injuries. Despite this, the tax court found that \$120,000 was paid for physical injuries and \$80,000 for nonphysical injuries.

Some have read this opinion to indicate they believe the \$80,000 was in exchange for confidentiality, which you can see ended up being meaningless in this case. There are those who believe you should attribute some consideration for the confidentiality provision, say \$1,000. The opinion does not specifically reach this conclusion, but it has certainly raised some concerns about what should be included in our settlement agreements.

Noteworthy, some courts have also seen this issue of confidentiality as an ethical issue, i.e., whether it is unethical to require an attorney to not discuss a case or post information about it in exchange for agreeing to settle. *See Jacob v. Duane Reade, Inc.*, 2017 U.S. Dist. LEXIS 71663 (S.D.N.Y.). New York has an ethical rule that, in fact, seemingly precludes gag orders over the terms of settlement. While Rule 5.6 of the NY Rules of Ethics seems to be broader than that, it has at least been interpreted to mean that confidentiality agreements that silence an attorney from talking about the case are unethical. A Chicago Bar ethics ruling indicates that Illinois's version of this rule does allow for the amount to be kept confidential, but not the terms of the agreement. Chicago Bar Assoc. Informal Ethics Op. 2012-10.

NHTSA has also noted that confidentiality might be precluded where the confidentiality agreement silences the reports of matters of public concern. *See Fed. Reg. 81 FR 13026* (March 24, 2016). The CPSC has noted that “all parties seek to include a provision in any private protective order or settlement agreement that -- despite whatever restrictions on confidentiality are imposed, and whether entered into by consent or judicial fiat – specifically allows for disclosure of relevant [consumer product] safety information to [the CPSC[] and other applicable authorities.” 81 FR 232 (Dec. 2, 2016).

Whether complete gag orders over a settlement are ethical or even legal, good practice demands that you not agree to such. In my career, I can only recall one situation where I have agreed to anything close to this, and I was compelled to do so by my client. In that instance, the full confidentiality provision had limited value, since the lawsuit was filed, and that information remains public.

I like the language used by a New York trial judge, Judge James Hudson, in *Guardino v. Graco Children's Products, Inc.*, 2015 NY Slip Op. 25392 (NY Sup. Ct. Nov. 24, 2015).: “Applying the forgoing principles [of public interest in product liability cases] to the instant case the Court finds that there is a strong public interest in a lawsuit involving the death of a child allegedly caused by a defective baby stroller. The parties interest in keeping the details of their settlement confidential do not constitute good cause to the extent that it outweighs this public interest. Therefore, under the circumstances presented, the motion must be denied.”

### **VIII. Indemnification**

We are seeing more settlement agreements that include indemnification provisions. The provisions essentially state that the client must pay back some of the settlement if a subrogor or lienholder seeks to collect from the defendant or its insurance carrier. At one point, defense attorneys and their carriers were insisting that the plaintiff law firm join in this indemnification provision. However, it is abundantly clear that an attorney is ethically precluded from agreeing to indemnify against future potential claims.

Moreover, the courts have determined that the indemnity language, like all other terms, must be clearly set forth and that the agreement will be enforced as written. *See J.E. Black Diamond Coal Min. Co. v. USC Corp.*, 581 So.2d 839 (Ala. 1991); *Walter L. Couse & Co. v. Hardy Corp.*, 290 Ala. 134, 274 So.2d 322 (1973). While these cases address more disputes

between parties, they may apply equally to indemnity (or indemnification) provisions in settlement parties where the injured person is represented by counsel.

## **IX. Other considerations**

### **A. Bankruptcy**

Generally, if your client files for bankruptcy or is in bankruptcy, the Trustee in bankruptcy becomes the client, provided the Trustee agrees to retain you. But what if your client is the personal representative of an Estate? I recently had this happen in a case I settled for a sizeable sum. I convinced the Trustee in bankruptcy that they had no authority over my handling of the case because the client was not the individual but was the Estate, of which the individual was in bankruptcy. When it came time to disburse the settlement funds, I was able to pay the funds to six of the seven heirs, but not to the one who was in bankruptcy. Instead, I had the Trustee in bankruptcy give me a figure that was owed, and she gave me approval to pay that sum into her office and then disburse the balance to the client.

### **B. Special Needs Trusts**

There may be occasions where Special Needs Trusts are in your client's best interest. In fact, it may be that an SNT is a necessity. For more information about the need for a SNT, I would encourage you to speak to someone who handles these issues. A good resource is the Alabama Family Trust ([www.alabamafamilytrust.com](http://www.alabamafamilytrust.com)). The Family Trust website has forms that are downloadable.

### **C. Shifting settlement funds to collateral claims**

It may be beneficial to your client to take a portion of a settlement and shift it away from the primary plaintiff and have as large of a portion as may be reasonable paid on a collateral claim, such as loss of consortium. Funds paid in this fashion are not subject to many of the liens and

interests set forth above. Time precludes extensive discussion of this, but courts have concluded that a lienholder may not seek and recover from that portion of a settlement paid in a derivative claim or not paid as compensation for the injured party's injuries and damages.

#### **D. Wrongful Death Settlements**

One beauty of Alabama's wrongful death law is that wrongful death settlements are not subject to the claims of creditors. One significant issue you must consider in a wrongful death case is how will the proceeds be disbursed. In order to bring a wrongful death action in Alabama, you must have the appropriate person appointed as the personal representative of the Estate. Not so long ago, some probate courts were requiring that wrongful death settlements be approved by that court, even though wrongful death proceeds pass outside of the estate. The Alabama Supreme Court made clear that a probate court has no jurisdiction over wrongful death settlements. *See Ex parte Taylor*, 93 So.3d 118, 119 (Ala. 2012).

The disbursement of wrongful death proceeds is done pursuant to Alabama's intestate succession statute. The most common statute you will reference for this purpose is Code of Alabama § 43-8-41 (1975). I encourage you to explain to your client (the personal representative) how the wrongful death proceeds will be distributed. It amazes me how often we find that family members are upset that somebody else in the family will share a portion of the recovery. If you handle this issue early on, you are much more likely to avoid a disappointed client.

Generally, the personal representative is the one who signs the settlement documents and your disbursement schedule. Where I have multiple heirs, I like to have them all sign off that they agree to the disbursement. The personal representative makes the decision about whether to settle, but the family members likely need to understand the breakdown of the disbursement, so that there will be no questions in the future. I am certain there are some out there who disagree with this and

may handle disbursements differently, and I certainly agree there may be exceptions, but this approach has guided me well over the years.

**E. Can you take a fee?**

Even if you have a contract with your client, there may be occasions when you cannot take a fee. There is some authority that indicates, for example, that you cannot take a fee from a worker's compensation settlement and take a fee from the third-party claim if it settles.

You may also find yourself fighting for your fee against those who claim their right to be paid takes priority, such as hospitals who have a perfected lien. If, for example, you take the position that a subrogor is not entitled to anything, and the subrogor eventually prevails, the full settlement (including your fee portion) may be considered for purposes of reimbursing the subrogor. If the subrogor or lienholder refuses to allow you to act on their behalf, you may still not be entitled to a fee, with the entire sum being included in the subrogation reimbursement calculation. *See CNA Ins. Cos. v. Johnson Galleries*, 639 So.2d 1335 (Ala. 1994).

**F. Co-representation and/or nonpursuit of benefits**

One approach that some have taken is to notify the subrogor or lien holder early on of your representation of the insured or patient. If you are notified by the health insurance company or the health care provider of a lien or subrogation claim, you can then offer to represent that entity for a fee (usually a fee consistent with your fee with the client, plus a pro-rata portion of the expenses). The responses you get may be one of agreement (to pay your fee and expenses); a refusal to agree and taking the position that no fee is owed; or to hire their own counsel (which I have yet to see happen). Most likely, the subrogor/lienholder will simply agree to your request.

Another approach some are taking is to notify healthcare providers that medical expenses are not being sought and to inform the healthcare provider that if they wish to collect their subrogation interest they must intervene and hire their own attorney. This might work if you go

to trial and do not seek medical expenses, but you run a great risk with this approach if you settle the case. You could conceivably put in the settlement agreement that the settlement does not represent compensation for medical expenses, but it would surprise me if a liability carrier would agree to this. Their concern most assuredly will be that the carrier will get sued for paying over benefits that the healthcare provider considers primary coverage.

Also, you may need to resolve whether representing the interests of the subrogor/lienholder might create a conflict of interest between you and your client. It is best, if this occurs, to have your client to sign a waiver, consenting to your representation of the subrogor/lienholder. In most instances, this will be beneficial to your client, since you can get an agreement on the front end to offset the lien or claim for reimbursement.

#### **G. Taxation of Settlement and other Tax Issues**

Our firm has the common policy that we do not give tax advice. We encourage our clients to seek tax advice. Despite this, it has long been the understanding that personal injury and wrongful death recoveries are not taxable, though any portion that might be attributable to lost income might be. Also, while it is not abundantly clear, it is has long been understood that punitive damages and interest on judgments may be taxable as “other income”. *See Commissioner v. Schleier*, 515 U.S. 323 (1995)(holding that two independent requirements must be met for a recovery to be excluded from income under IRC § 104(a)(2); namely, recovery must be “based upon tort or tort type rights” and must be “on account of personal injuries or sickness”); Rev. Rul. 85-97, 1985-2 C.B. 50 (noting all pecuniary damages in a personal injury action, including lost wages are excludable); Section 1605 of the Small Business Job Protection Act of 1996(excludes all damages “on account of personal physical injuries or physical sickness”, except punitive damages). Derivative damages, such as loss of consortium damages, have also long been thought excludable as income. *See Lukhard v. Reed*, 481 U.S. 368, 390, 107 S.Ct. 1807 (1987).

In *George v. Commissioner* (T.C. Memo 2016-156, Aug. 22, 2016), the U.S. Tax Court ruled that a taxpayer must include proceeds from an employment discrimination case as “gross income.” The court noted that he could deduct attorney fees “above the line” as permitted by IRC § 62(a)(20), but the net proceeds are still taxable income.

In the past few years, the IRS has released a one-page form that set forth what damages are taxable. This one-page flyer (2014 version) is attached to this paper for your review, though it appears to have been modified.

Recently, Forbes magazine reported that the newest amendments to the Tax cuts pushed by the Trump administration may change the rules somewhat. See R.W. Wood, *Trump Tax Law Hurts Personal Injury Suit Settlements* (Aug. 6, 2018). According to the article, compensatory damages related to physical injury remain non-taxable. Damages for mental or emotional injury in the absence of physical injury, however, now may be taxable. *But see Blackwood v. Commissioner* (T.X. Memo 2012-190, July 11, 2012)(holding that damages recovered for emotional distress from a wrongful termination lawsuit were not excluded from income under IRC § 104(a)(2)). The author concedes there remains some confusion exactly what the new tax code changes may encompass, so it behooves us to continue to encourage our clients to seek tax advice on the taxability of their settlement recoveries.

Another confusion that is likely to arise is how are Alabama wrongful death settlements to be handled. Again, it has long been understood that wrongful death settlements are not taxable. But if the intent of the amended code is to include all punitive awards, will Alabama be excepted from this because of our unique wrongful death statute?

In personal injury cases, it likely would be beneficial to state in the settlement agreement that the settlement represents compensatory damages only, and it may be beneficial to note that it is agreed that the plaintiff suffered a physical injury.

We also need to keep in mind that we have an obligation with regard to distributing settlement funds to our clients where a tax lien exists. If the attorney has notice of a tax lien, he or she can be held liable for distributing the funds. *See* 32 U.S.C. § 3713. The good news as attorneys is that our fee does take priority over the tax lien, *see* IRC § 6323(b)(8). This rule probably does not protect your fee where you pay the settlement proceeds to the client where a tax lien exists.

#### **H. Pro tanto settlements and disbursements**

On occasion, you will “pro tanto” one defendant out of the case. It is essential that you have the appropriate language in your settlement agreement and in your joint stipulation of dismissal, reserving all other claims. There may also be special language you need to include, such as where you may be releasing a servant, but you intend to proceed forward against the master. There is some case law out there on this issue.

Also, you may have to deal with liens on pro tanto settlements. I recently paid a small amount of a lien to a hospital, so my client could receive something out of a pro tanto settlement, and I agreed to work with the hospital to negotiate the balance of the lien if we recovered from other tortfeasors. The hospital was more than accommodating, and the result was favorable to my client in a limited-recovery case.

#### **I. The effect on disability benefits**

If your client is disabled or may be entitled to Social Security benefits or some other disability benefit in the future, then you need to be aware that a settlement compensating them for that disability could affect entitlement to other benefits. While the calculation can be complicated, your client needs to understand that their Social Security benefits will be offset in some part by the settlement, which means they may not get SS benefits until a later date or that they may get a

greatly reduced benefit. In some instances, your client may have already been declared disabled and be receiving benefits. In this instance, they need to understand that their benefits may be cut once the settlement is reported to SSA.

It is for this reason, in large settlements, I always encourage my clients to consider setting up a structured settlement, which pays them monthly benefits over long periods of time. Some insist on getting the money instead, but it is not a bad idea to have them sign something indicating they understand the consequences and want the money in a lump sum instead.

#### **J. Lawsuit loans**

One thing I loathe are the companies that contact our clients and offer them an advance on their litigation. I have received these forms from clients and asked me to sign them, so they can get some money, but I have never agreed to do so. I have handled one case where another lawyer signed one, and the interest rate was over 200 percent. After threatening to sue the company at the conclusion of the case, they ultimately agreed to take far less than what they claimed they were owed. I strongly discourage you from signing these. Explain to your clients that it is like title loans or payday advance loans – you never pay back the loan and that the interest rates are outrageous.

I will also tell you that there are some ethical concerns about whether a loan company can purchase an interest in a lawsuit. I would encourage you to seek an ethics opinion before signing one of these loans. Frankly, we are seeing fewer of these, most likely because the companies are learning that they may run over clients, but they cannot run over lawyers.

#### **K. Uninsured Motorist Claims**

Uninsured or underinsured motorist claims have their own set of rules. When you settle with a tortfeasor's carrier, you must notify the UM carrier, obtain their acquiescence, and obtain a waiver of subrogation. *See Lambert v. State Farm Mut. Auto. Ins. Co.*, 576 So.2d 160 (Ala. 1991).

The UM carrier is entitled to a reasonable notice (typically 30 days) to evaluate the liability claim and the potential for recovery in excess of liability insurance proceeds. *Brantley v. State Farm Mut. Auto. Ins. Co.*, 586 So.2d 184 (Ala.1991). Rarely will the UM carrier front the settlement proceeds to protect its subrogation rights.

## **X. Conclusion**

Settlements are loaded with landmines. In order to best navigate the dangers which accompany settlement, you must learn as much as you can about the various issues. Hopefully, this paper will serve as a starting point with some minimal research and thoughts on the various topics. If I can answer any questions for you, feel free to call or email me. I will do my best to guide you in the right direction.

## SETTLEMENTS – TAXABILITY

The Internal Revenue Service recognizes that receiving a settlement award (amount) from a personal injury suit may create new tax issues for some individuals. The following information is provided to assist recipients of cash settlements.

The type of settlement you receive is determined by your Final Settlement Agreement.

**Physical injuries or physical sickness** settlements are generally non-taxable.

- If you receive a settlement for physical injuries or physical sickness and did not take an itemized deduction for medical expenses related to this injury in prior years, the full amount is non-taxable and generally does not need to be reported on your income tax return.

### BUT

- If you receive a settlement for physical injuries or physical sickness and did deduct medical expenses related to the injury, the *tax benefit* amount is taxable and should be reported as “Other Income” on line 21 of Form 1040.

**Interest, punitive damages, emotional distress or mental anguish, and employment discrimination or injury to reputation** settlements are generally taxable.

- **Interest:** Amounts on any settlement are taxable as “Interest Income” and should be reported on line 8a of Form 1040.
- **Punitive Damages:** Amounts are taxable and should be reported as “Other Income” on line 21 of Form 1040. It does not matter if punitive damages are related to a physical injury or physical sickness.
- **Emotional distress or mental anguish:** Amounts are taxable to the extent that it exceeds medical costs, not previously deducted, for treatment of emotional distress or mental anguish. A statement showing the entire settlement amount less related medical cost should be attached to the return. The net taxable amount should be reported as “Other Income” on line 21 of Form 1040.
- **Employment discrimination or injury to reputation:** Amounts are taxable and should be reported as “Other Income” on line 21 of Form 1040.

**Loss-of use or loss-in-value of property** settlements may be taxable if the settlement exceeds your basis in the property.

- Property settlements that are less than the adjusted basis of your property are not taxable and generally do not need to be reported on your tax return.
- When property settlements exceed your adjusted basis in the property, the gain is treated as a *gain on a capital asset*. Gains on personal capital assets are reported on Form 1040’s Schedule D, Capital Gains and Losses. Gains on business capital assets are reported on Form 4797, Sale of Business Property.

Some settlement recipients may need to make estimated tax payments if they expect their tax to be \$1,000 or more after subtracting credits & withholding. Information on estimated taxes can be found in IRS Publication 505, Tax Withholding and Estimated Tax, and in Form 1040-ES, Estimated Tax for Individuals.

**For additional help contact the IRS at 1-800-829-1040.**

All of the forms and publications referenced in this publication are available from the IRS at [www.irs.gov](http://www.irs.gov), or paper copies can be ordered by calling 1-800-829-3676 (1-800-TAX-FORM).



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