Carrier's Release from Future Liability Effected by Employee's Third Party Recovery Held Not a Benefit for Consideration in Apportioning Litigation Expenses

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Carrier's release from future liability effected by employee's third party recovery held not a benefit for consideration in apportioning litigation expenses

Section 29(1) of the Worker's Compensation Law (WCL) provides that an employee injured in the course of his employment through the fault of one other than his employer or fellow employee may pursue a third party action for damages without compromising his statutory entitlement to compensation. In order to ensure the continued viability of the compensation system, however, the compensation carrier is afforded a lien upon the proceeds of any recovery to the extent of the benefits previously paid to the employee. Where the carrier seeks to satisfy such lien out of the proceeds of a judgment or settlement procured through the efforts of the attorney, it is submitted that the vagueness of these rules detract from their value as purported standards to be followed by the advertising attorney. It should be noted that proposed rule 9.3 permits solicitation on a limited basis. It provides, in part, that "a lawyer may initiate contact with a prospective client . . . [b]y a letter concerning a specific event or transaction if the letter is followed up only upon positive response by the addressee . . . ." ABA MODEL RULES OF PROFESSIONAL CONDUCT § 9.3 (1980). This provision apparently would sanction the type of letter sent by the defendants in Koffier.


of the injured employee, a 1975 amendment to the statute requires that the expenses incurred in the prosecution of the action, including attorneys' fees, be "equitably apportioned" between the employee and the carrier. Recently, however, in Castleberry v. Hudson Valley

**Notes and Citations:**

987 Ch. 190, § 29(1), [1975] N.Y. Laws 293-94 (McKinney) added to the statute the following:

Should the employee or his dependents secure a recovery from such other, whether by judgment, settlement or otherwise, such employee or dependents may apply on notice to such lienor to the court in which the third party action was instituted . . . for an order apportioning the reasonable and necessary expenditures, including attorneys' fees, incurred in effecting such recovery. Such expenditures shall be equitably apportioned by the court between the employee or his dependents and the lienor.


The 1975 Amendment was designed to eliminate two basic inequities which existed in the WCL. See Memorandum of the Law Revision Commission Relating to the Apportionment of Attorneys' Fees in Third-Party Actions Under the Workmen's Compensation Law §§ 29 and 227, [1975] N.Y. Law Rev. Comm'n Rep., reprinted in [1975] N.Y. Laws 1551, 1552 (McKinney) [hereinafter cited as 1975 Memorandum]. First, compensation liens were being fully satisfied without the carrier sharing the costs of the recovery. Id. at 1552. Second, where the third party recoveries were modest in amount, employees were left with little, if any of the proceeds after the attorney's lien and the compensation lien were paid. Id.

The amendment of section 29(1) of the WCL brought New York in line with an increasing number of states favoring apportionment of legal expenses incurred in a third party suit between the employee and the employer's compensation carrier. Id. at 1553; 2A A. Larson, Workmen's Compensation Law § 74.32 (1976 & Supp. 1979); Atleson, Workmen's Compensation: Third Party Actions and the Apportionment of Attorney's Fees, 19 Buffalo L. Rev. 515, 539 (1970).

By wording the statute to provide for "equitable" apportionment, the legislature avoided the adoption of a fixed formula to be applied in each case, opting instead for a more flexible scheme to be utilized by the trial court which is entertaining the third-party action. See 1975 Memorandum, supra, note 287, at 1553. Indeed, in Becker v. Huss Co., 43 N.Y.2d 527, 373 N.E.2d 1205, 402 N.Y.S.2d 980 (1978), it was noted that since the statute was designed to allow trial court discretion, it would be the rare case where the trial court's determination would be subject to review on appeal. Id. at 544, 373 N.E.2d at 1211, 402 N.Y.S.2d at 986. The Becker Court enumerated several factors to be weighed in determining the carrier's equitable share of the expenses, including the reasonableness of the lawyer's retainer, whether the retainer was influenced by the knowledge that the carrier would be shouldering part of the costs, the overall difficulty or ease of the case, and any other equitable circumstances. Id. at 543, 373 N.E.2d at 1211, 402 N.Y.S. 2d at 986.

Two formulas for computing the carrier's share of the attorneys' fees have evolved in the lower courts. Under one approach, the carrier's proportionate share is equal to the
Asphalt Corp., the Appellate Division, Second Department, had occasion to construe the apportionment provision, holding that the carrier's release from future liability effected by the recovery in the third party action is not a benefit upon which the apportionment of attorneys' fees may be based.

Plaintiff Castleberry had been injured in the course of his employment and was receiving weekly payments from his employer's compensation carrier. Subsequently, he brought a third-party action against the defendant for his injuries, which was ultimately settled for $75,000 without the carrier's consent or a judicial compromise order. Pursuant to the apportionment of costs provision of section 29(1), the plaintiff thereupon petitioned the Supreme Court, Orange County to extinguish the full amount of the carrier's lien. The plaintiff argued that since all of the recovery inured to the carrier's benefit by discharging its liability for future payments, the carriers should absorb the entire $25,000 in legal fees incurred in settling the third party suit. The lower court, agreeing with the plaintiff's contention, granted the motion, but limited the carrier's equitable share of the expenses to the amount of its lien.

If Castleberry's condition remained the same, the compensation payments would continue indefinitely. If his life expectancy, the recovery from the carrier would, therefore, have totalled over $100,000.

Since the carrier's lien will apply "to [the] extent such recovery shall be deemed for the benefit of such . . . carrier," N.Y. WORK. COMP. LAW § 29(1) (McKinney Supp. 1979-1980), the court viewed the release of "estimated future compensation" as constituting a benefit to the carrier. Since the carrier was required to make an additional disbursement, the language of the statute apparently does not rule out such a result.
A divided appellate division reversed, stating that it was error to compromise completely the statutory lien of the carrier "under the guise of an apportionment of attorneys' fees." Writing for the majority, Justice Margett stated that by sanctioning such an apportionment, the lower court had circumvented not only the objectives of the compensation scheme in general by ignoring the "inviolable" nature of the carrier's lien, but had contravened the legislative intent underlying the 1975 amendment as well. Conceding that the amendment was intended to assess proportionately the costs of procuring a judgment among the parties benefitting therefrom, the Castleberry majority found no evidence that the legislature contemplated the imposition of all costs on the lienor, where, in the third party action, the plaintiff recovered "less than 'the sum of the lien plus the estimated liability of the carrier extinguished by the recovery.' " Indeed, the court noted, nullifying a carrier's lien in such circumstances would afford the injured employee the "double satisfaction" of both statutory and common law recovery, a result which the existence of the lien was intended to obviate. Hence, the court concluded, a proper application of the equitable apportionment provision required that the injured employee bear "that proportion of the attorneys' fees which his 'share' of the recovery (i.e., the total settlement less the compensa-

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296 70 App. Div. 2d at 230, 420 N.Y.S.2d at 913. Justices Cohalan and Martuscello joined Justice Margett in the majority. Concurring only in the reversal, Justice Shapiro dissented in a separate opinion.

297 Id. at 230-31, 420 N.Y.S.2d at 913; see Granger v. Urda, 44 N.Y.2d 91, 96, 375 N.E.2d 380, 381, 404 N.Y.S.2d 319, 320 (1978). Noting the broad reach of the statute, the Court of Appeals in Granger found that the lien attaches "whenever a recovery is obtained in tort for the same injury that was a predicate for the payment of compensation benefits." Id. at 97, 375 N.E.2d at 381, 404 N.Y.S.2d at 321 (quoting Petterson v. Daystrom Corp., 17 N.Y.2d 32, 39, 215 N.E.2d 329, 332, 268 N.Y.S.2d 1, 5 (1966)).

298 70 App. Div. 2d at 230, 420 N.Y.S.2d at 913. See note 300 infra. See generally id. at 234, 420 N.Y.S.2d at 915 (citing 1975 Memorandum, supra note 287, at 1552-53). Justice Margett observed that the 1975 amendment sought to charge the carrier with a proportionate share of the litigation expenses and prevent recoveries from being fully exhausted by the lien and the attorneys' fees. Id. at 235, 420 N.Y.S.2d at 916.

299 Id. at 235, 420 N.Y.S.2d at 916; see 1975 Memorandum, supra note 287 at 1552.

300 70 App. Div. 2d at 235, 420 N.Y.S.2d at 916. The Castleberry court asserted that it was "nothing short of incredible" to apply the 1975 amendment as a legislative "emasculating" of the carrier's lien. Id. at 232, 420 N.Y.S.2d at 914. The court reasoned that the carrier's future liability was too indefinite to be viewed as an amount benefitting the carrier, since a compensation award is subject to modification based on changed conditions. Id. at 235 & n.2, 420 N.Y.S.2d at 916 & n.2.

301 Id. at 236, 420 N.Y.S.2d at 917. See note 286, supra.
tion lien, if any) bears to the total recovery.\textsuperscript{302}

In a lengthy dissent, Justice Shapiro endorsed the conclusion reached by special term that the carrier's release from future liability is a benefit against which a proportionate share of the expenses should be assessed.\textsuperscript{303} Maintaining that the recovery in the third-party suit takes the place of compensation benefits, the dissent contended that legal expenses should not be assessed against the plaintiff where the amount of the recovery does not exceed the carrier's lien plus its future liability, since to do so would "dilute" the recovery guaranteed by the WCL.\textsuperscript{304} Justice Shapiro concurred in the reversal, however, because the lower court's apportionment of the attorneys' fees was not based on the present value of the carrier's discharge from future obligations.\textsuperscript{305}

It is submitted that the Castleberry court's refusal to extinguish the carrier's lien to the extent of his liability for deficiency payments overemphasizes the importance of the lien in maintaining the viability of the compensation scheme. Assuming compliance with the statutory notice requirements,\textsuperscript{306} when the third

\textsuperscript{302} 70 App. Div. 2d at 238, 420 N.Y.S.2d at 918. As the attorneys' fees in the settlement were one-third of the recovery, the court allocated $6801 of the fees to the carrier, which was equivalent to one third of the amount of its lien. Id. at 238-39, 420 N.Y.S.2d at 918.

\textsuperscript{303} Id. at 239, 420 N.Y.S.2d at 918-19 (Shapiro, J., dissenting).

\textsuperscript{304} Id. at 247, 420 N.Y.S.2d at 923 (Shapiro, J., dissenting). The dissent noted that if the employee chose only to receive his compensation benefits, he would not have been required to pay any attorneys' fees in order to receive them. Id. (Shapiro, J., dissenting). Since a third party recovery effectively replaces compensation payments, Justice Shapiro reasoned that if the recovery was less than the amount already paid by the carrier plus its future liability, allowing further reduction of the proceeds through payments of litigation expenses would undercut the employee's statutorily guaranteed compensation. Id. at 247, 420 N.Y.S.2d at 923-24 (Shapiro, J., dissenting). Indeed, the dissent pointed out, most other states faced with the same issue have held that the release from future liability is a benefit which must be considered in apportioning attorneys' fees. Id. at 248-50, 420 N.Y.S.2d at 924-25 (Shapiro, J., dissenting).

\textsuperscript{305} Id. at 250-51, 420 N.Y.S.2d at 926 (Shapiro, J., dissenting). Justice Shapiro pointed out that by failing to reduce the carrier's future obligation to present value, Special Term overstated the amount of the benefit inuring to the insurer, and as a result, incorrectly apportioned the costs of attorneys' fees. Id. (Shapiro, J., dissenting). For a discussion of the concept of present value, see K. Boudreaux & H. Long, The Basic Theory of Corporate Finance, 18-18 (1977); H. Oleck, Damages to Persons and Property, § 95 (1961).

\textsuperscript{306} Id. at 237, 420 N.Y.S.2d at 917. Section 29(5) of the WCL provides that where the proposed settlement of the third-party action is less than the amount of the carrier's lien, the employee must either obtain written approval from the carrier or a judicial compromise order. N.Y. Work. Comp. Law § 29 (5) (McKinney Supp. 1979-1980). Failure to comply with these requirements automatically discharge any remaining future liability of the carrier. See Kusiak v. Commercial Union Assurance Co., 49 App. Div. 2d 122, 124, 373 N.Y.S.2d 714, 716 (4th Dep't 1975); O'Brien v. Lodl, 246 N.Y. 46, 51, 157 N.E. 925, 926 (1927). The purpose of
party recovery is less than the carrier's future liability plus its lien, the apportionment provision does not affect the amount of the benefits ultimately to be paid to the employee. 307 In such a case, the carrier remains liable for deficiency payments to the extent that its future obligation under the compensation claim exceeds the employee's net recovery from the third party action. 308 Hence, where the third party recovery does not discharge the carrier's future obligation, an apportionment of costs such as that granted by special term affects the timing but not the amount of the carrier's aggregate liability. 309 Such a result cannot logically be viewed as imperiling the integrity of the compensation scheme. 310

By incorrectly assessing the implications of imposing most, if not all, of the litigation expenses upon the carrier in a Castleberry situation, it is suggested that the majority reached a result inconsistent with the policy of encouraging employees to pursue their claims against third party tortfeasors. 311 Since the potential for an requiring either carrier approval or judicial consent is to prevent the "imprudent settlement" of third party claims which may adversely affect the carrier's rights. See Meachem v. New York Cent. R.R., 8 N.Y.2d 293, 297, 169 N.E.2d 913, 916, 206 N.Y.S.2d 569, 573 (1960); Kusiak v. Commercial Union Assurance Co., 49 App. Div. 2d 122, 124, 373 N.Y.S.2d 714, 716 (4th Dep't 1975); Clark v. Oakes & Burger Co., 16 App. Div. 2d 490, 491-92, 229 N.Y.S.2d 513, 515 (3d Dep't 1962).

307 Id. at 238, 420 N.Y.S.2d at 917-18. Where a recovery in a third party action is less than the future obligation of the compensation carrier, the carrier must pay the employee any deficiency. N.Y. WORK. COMP. LAW § 29(4) (McKinney Supp. 1979-1980). The carrier in effect shoulders the total costs of attorneys' fees in such a case, since what he does not pay in the apportionment of attorneys' fees will ultimately be made up in deficiency payments. See id.; Curtin v. City of New York, 287 N.Y. 338, 341-44, 39 N.E.2d 903, 904-06 (1942); Kussack v. Ring Constr. Corp., 1 App. Div. 2d 634, 635, 153 N.Y.S.2d 646, 647 (3d Dep't 1956), aff'd, 4 N.Y.2d 1011, 177 N.Y.S.2d 522 (1958).


309 See note 307 supra.

310 The Castleberry court's conclusion, however, appears to be correct where the employee settles without complying with the statutory notice requirements. In such a case, the aggregate liability of the carrier would not be the same under either apportionment, since the employee is not entitled to recoup his legal expenses in the form of increased deficiency payments.

311 Viewed in conjunction with the statutory lien afforded the carrier, see N.Y. WORK. COMP. LAW § 29(1) (McKinney Supp. 1979-1980), the purpose of encouraging an injured employee to pursue his common-law remedy against a third party tortfeasor is to keep the costs of coverage within practical limits, thus insuring the continued viability of the compensation system. See Granger v. Urda, 44 N.Y.2d 91, 97, 375 N.E.2d 380, 382, 404 N.Y.S.2d 319, 321 (1978); Becker v. Huss Co., 43 N.Y.2d 527, 537-38, 373 N.E.2d 1205, 1207, 402 N.Y.S.2d 980, 982-83 (1978); Curtin v. City of New York, 287 N.Y. 338, 342-43, 39 N.E.2d 903, 905 (1942). An additional, more fundamental consideration, is to assure the protection
earlier realization of his benefits operates as an inducement to the employee to seek such a recovery,\(^1\) an incentive enhanced by the recent amendment to Section 29(1).\(^2\) It appears incongruous to reject an apportionment which depletes the employee’s share of the judgment but then allows him to recoup the costs assessed against him in the form of periodic future payments from the carrier.\(^3\) It is submitted, therefore, that where the third party recovery does not exceed the sum of the lien and the carrier’s future obligation, the objectives of the WCL could best be met if future courts, in equitably apportioning the litigation expenses, strive to maximize the residuum of the judgment.

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**Developments in New York Law**

*Court of Appeals prohibits insurer’s indemnification of municipal employee for punitive damages arising out of federal civil rights action as contrary to public policy*

Under a policy of liability insurance, an insurer is obligated to indemnify its insured for an award of compensatory damages rendered in a suit within the purview of the policy’s provisions.\(^4\)