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MEMORANDUM OF LAW

DATE: November 19, 1998

TO: Valerie VanDeweghe, Flexible Benefits Program Administrator, Risk Management

FROM: City Attorney

SUBJECT: Duty to Pay Insurance Benefits

QUESTION PRESENTED

May a health care insurance provider withhold the payment of benefits to an insured individual while the insured's workers' compensation claim is pending?

SHORT ANSWER

No. Insurers must take all reasonable steps to protect the insured from liability to third parties such as hospitals or medical providers. Health care insurance providers are given statutory authority to file a lien for reimbursement against pending workers' compensation claims to protect their right to be reimbursed, if workers' compensation benefits are subsequently awarded.

BACKGROUND

The Firefighters Relief Association [FRA] is a health care provider offering coverage for inpatient and outpatient medical services to members of San Diego Firefighters Union, Local 145. When a firefighter injured himself and needed surgery he filed a claim for payment of his medical expenses with the FRA, and concurrently filed a workers' compensation claim based on his injury. Although there is a presumption that this type of injury is work related, the presumption has been challenged by the City in this case. The validity of the firefighter's workers' compensation claim is unresolved.

The FRA refused to pay the firefighter's medical expenses, citing a provision in its plan that excludes work-related injuries from coverage. Consequently, the firefighter was without health care coverage pending resolution of his workers' compensation claim. Because the firefighter required immediate surgery, Risk Management and the FRA negotiated an agreement in which the FRA agreed to pay the hospital costs in return for a lien protecting its right to reimbursement from any future workers' compensation award. To forestall future disagreements with health insurance providers regarding payment for essential medical procedures, you have asked whether health insurance providers may legally withhold payment of benefits to their insureds while workers' compensation claims are pending.

ANALYSIS

In general, an insurer cannot withhold payment to an insured because he or she has a pending workers' compensation claim. *Silberg v. California Life Ins. Co.*, 11 Cal. 3d 452, 460 (1974). The insurer must act in good faith and weigh the interests of the insured against its own interests in determining the validity of a claim. *Id.* The covenant of good faith and fair dealing implied in the insurance contract requires the insurer to accept a reasonable settlement to protect its insured from liability to third parties. *Id.* Whether a settlement is reasonable can only be determined on a case-by-case basis. Two California Supreme Court cases illustrate how the court has balanced the competing interests of the insurer and the insured.

I. The *Silberg* Case

The case of *Silberg v. California Life Ins.Co.*, 11 Cal. 3d 452, is factually similar to the situation between the City and the FRA. In *Silberg*, the court found that the insurer breached its duty of good faith and fair dealing by refusing to pay the insured's claim pending resolution of his workers' compensation claim. The court based its decision on two findings: (1) that there was an ambiguity in the contract language; and (2) that the insurer had an adequate method of recouping the benefits it paid out if the insured later received benefits from his workers' compensation claim.

In *Silberg*, the plaintiff owned and operated a dry-cleaning business. His landlord owned the laundromat next door. Silberg performed incidental laundromat services for his landlord in exchange for a reduction in his rent. Silberg was seriously injured while investigating smoke coming from his landlord's laundromat. Silberg was not an employee in the usual sense of the word, nevertheless, he filed a workers' compensation claim because his injuries occurred while he was performing services for another. Silberg also sought payment of his medical bills pursuant to the terms of his insurance policy, pending a determination of his employment status for purposes of his workers' compensation claim.

The insurance company refused to pay the claim, citing an exclusionary clause in its policy. The clause permitted nonpayment or, alternatively, reduction in payment of the amount paid by the workers' compensation award less the medical expenses, up to the amount covered by the policy, if the insured qualified for workers' compensation. However, another provision of the policy assured "all benefits payable in full regardless of any other insurance you may have." *Id.* at 719. These conflicting provisions led the court to conclude the policy was ambiguous.

Conflicting testimony at trial highlighted the ambiguity. Witnesses for the insurer testified the insurance industry usually delayed or denied payment of a claim until a determination of workers' compensation coverage was complete. Witnesses for the plaintiff, however, testified that many times the medical provider would enter into an informal agreement with the workers' compensation carrier and pay the claim pending resolution of the workers' compensation issue. If the injury was found to be work related, the insurer would be reimbursed. Plaintiff's witnesses also testified that insurance companies usually pay claims if workers' compensation denies liability and the insured has suffered severe injuries. *Id.*

Based on this evidence, the court concluded that it could not find there is a customary insurance industry practice to resolve claims when a workers' compensation claim is pending. *Id.* at 717. However, the absence of a customary industry practice did not absolve the industry of liability in such cases. The court said the insurer owes a duty to the insured to act in good faith in resolving the validity of a claim. *Id.* at 716. The insurer must, therefore, take affirmative steps to resolve the issue of liability. *Id.*

In reaching its decision the court discounted the effect of the exclusion clause in the insurance policy, because the language of the exclusion clause must be read in conjunction with the assurance clause. *Id.* at 719. The insurer could not, therefore, rely on the exclusion clause to support its failure to pay the insured's hospital costs. *Id.*

Finally, the court noted that the insurer had an adequate method to recoup monies it paid out if the insured were to subsequently receive a workers' compensation award. The court said:

> There is no question that if defendant had paid the hospital charges and it was ultimately determined workmen's compensation covered the injury, defendant could have asserted a lien in the workmen's compensation proceeding to recover the payments it had made and it would have been entitled to payment from the proceeds of the award. (Lab. Code 4903(b)).

Id. at 717.

Thus, the court determined that the insurer should have paid the claim and filed a lien for reimbursement from any subsequent workers' compensation award.

II. The *Rangel* Case

The California Supreme Court reached a different conclusion under the facts of *Rangel v. Interinsurance Exchange of the Automobile Club of Southern California*, 4 Cal. 4th 1, 14 (1992). In *Rangel*, the court held the Exchange was not obligated to pay uninsured motorist benefits during the pendency of the plaintiff's workers' compensation claim. Once again, the court looked at two issues: (1) the arbitration provision in the insurance policy, and (2) the unavailability of a method to ensure that the Automobile Club could recoup payments if the workers' compensation claim was resolved in the plaintiff's favor.

Rangel was injured in a hit and run accident by an uninsured motorist. The liability of the uninsured motorist was uncontested. The sole question was whether Rangel was injured during the course and scope of her employment. If she was, the costs would be covered by workers' compensation. If she was not within the course and scope of her employment when the accident occurred, the costs would be borne by her uninsured motorist coverage.

Rangel's uninsured motorist policy from the Automobile Club included the language of California Insurance Code section 11580.2(f), which provides for arbitration of claims when there is disagreement about whether the insured is entitled to damages or about the amount owed for damages. The statute also provides that if a workers' compensation claim is pending, the claim must be settled before the case proceeds to arbitration.

The California Supreme Court reasoned that the analysis in *Silberg* did not apply to the facts of *Rangel*. Unlike in *Silberg*, in *Rangel*, the insurance policy contained the unambiguous language of California Insurance Code section 11580.2(f) calling for a delay of arbitration in the event of a dispute over benefits owed under the policy. Withholding payment was thus legal and justified under the terms of the insurance contract.

Additionally, while the insurer in *Silberg* could obtain a lien against the workers' compensation award,[1] the insurer in *Rangel* did not have that option. The Court in *Rangel* noted, "there can be no lien against a workers' compensation award for any kind of debt except as the

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[1]California Labor Code section 49903(b).

Labor Code specifically provides." *Rangel*, 4 Cal. 4th 15. Liens against future workers' compensation benefits by health care providers are statutorily permissible, however, liens against future workers' compensation benefits by uninsured motorist providers are not. *Id.* Absent the right of the insurer to assert a lien against the workers' compensation claim, a claimant could receive and keep benefits from both the uninsured motorist policy and workers' compensation claim. The uninsured motorist carrier would have no ability to recoup payments it made prior to resolution of the workers' compensation claim. This outcome would run counter to the legislative goal in enacting Insurance Code section 11580.2(f) of avoiding double recovery by the insured. *Rangel*, 4 Cal. 4th 17.

III. The FRA Provisions

Neither *Silberg* nor *Rangel* precisely address the issue presented by the FRA. However, the weighing process used in the two cases leads to the conclusion that health care providers are generally required to pay medical benefits while a workers' compensation claim is pending. The common holding of the two cases is that, absent some countervailing statutory or contractual requirement, whether there is a method available to insure reimbursement from workers' compensation awards is the controlling factor in determining whether an insurer must pay benefits pending resolution of a workers' compensation claim. Where that method exists, the benefits must be paid.

California law specifically allows medical insurers to assert a lien against any monies received as a result of "[t]he reasonable expense incurred by or on behalf of the injured employee . . . to the extent the employee is entitled to reimbursement under Section 4621, [of] medical-legal expenses as provided by Article 2.5 (commencing with Section 4620) of Chapter 2 of Part 2." Cal. Lab. Code § 4903(b). The ready availability of this method to recoup overpayments compels an insurer to cover medical expenses, to protect its insured from liability to third parties.

CONCLUSION

A health care insurance provider cannot deny a claim simply because the insured has concurrently filed a workers' compensation claim. Where, as in the case of the FRA, there is a readily available means to recoup benefits paid out if those benefits are subsequently paid by workers' compensation benefits, the insurer must not withhold benefits to its insured.

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