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Subrogation Is Like Picking A Puppy – The Best Claims Don't Always Jump on You and Lick Your Face

Subrogation potential is not always the eager puppy of the litter who runs to you and jumps into your arms, covering you with an excess of salivary interest. Sometimes, the best subrogation claims are like the runt who hangs back, feigning indifference and sniffing a flower as competing files clamor for your attention. In this session, the panelists will discuss hard to identify subrogation claims that are often ignored until too late. Examples include contribution actions against other insurers, equitable subrogation, contractual claims and claims where third party insurance coverage and/or fault are not readily apparent.

I. General Subrogation Background

Subrogation Types

1. **Conventional or Contractual Subrogation**: Based on the contract between the parties, such as subrogation language contained in an insurance policy;

2. **Equitable or Legal Subrogation**: A product of equity, and is not dependent on any contract, assignment, or privity. It arises by operation of law out of "fairness," where one person has been compelled to pay a debt which should have been paid by another. It requires no policy language or subrogation contract – it's automatic. However, it's also subject to certain equitable defenses, such as the Made Whole Doctrine, Common Fund Doctrine, etc.; and

3. **Statutory Subrogation**: These are statutory subrogation and/or reimbursement rights established and granted by state or federal statutes. These include workers' compensation, hospital liens, Medicare, Medicaid, and the Federal Employees' Health Benefit Act, etc.

Subrogation involves putting a third person who has paid a debt (insurance company or subrogate) in the place of the creditor to whom it has been paid (insured or subrogor), so that it can seek to recover the debt (traditionally an insurance claim payment) from the debtor (third-party tortfeasor) who was responsible for causing the loss. The subrogate steps into the shoes of the subrogor and enforces all rights and claims the subrogor may have against the debtor. The subrogation claim is also subject to any defenses the debtor may have had against the subrogor.

Contribution, on the other hand, is an insurer's right to be reimbursed partially or fully, after paying more than its share of a loss. Understanding the distinction between subrogation and contribution requires a healthy supply of duct tape. The difference is not merely a technical nuance. There is an important practical difference as well. For example, a waiver of subrogation can effectively prevent an insurer from seeking contribution. This seemingly confuses the notion that subrogation rights are a derivation of the insurer's rights. The industry's conflation of contribution and subrogation also plays a significant role in the context of determining the order of coverage between primary and excess carriers. In fact, courts have said that, *"It is difficult to think of two legal concepts that have caused more confusion and headache for both courts and litigants than have contribution and subrogation." Fireman's Fund Ins. Co. v. Maryland Cas. Co.*, 65 Cal. App.4th 1279, 1291 (Cal. App. 1998).

To make matters even more confusing, subrogation also plays a role when multiple insurance policies cover the same loss, and one co-insurer seeks to make the other pay some or all the loss.

Contribution applies when two insurers share the same level of coverage (*e.g.*, primary, umbrella, excess) for the same insured and they both apply to the same loss. Under such circumstances, principles of contribution will likely apply. If contribution applies, then:

1. The trend is to prorate the loss between carriers – this sometimes provides more recovery than a straight contractual claim;

2. The courts are skeptical of "other insurance" clauses that try to convert the primary to an excess policy – it is less likely to be enforced; and

3. The damages recoverable are the amount that the paying carrier "overpaid."

Subrogation applies when there is any disparity in the level of risk or the insured. Under such circumstances, the paying carrier stands in the shoes of its insured for whom it paid the loss and pursues co-insurers by way of subrogation. If subrogation applies:

1. The paying carrier "stands in the shoes" of its insured on whose behalf it paid the loss; and

2. The defending carrier may assert all claims against the carrier that it could against the insured.

II. Equitable Subrogation

In the context of multiple insurers covering the same loss, equitable subrogation may be available to shift the loss from one insurer who was secondarily liable to another primarily-liable insurer. The purpose of equitable subrogation is to prevent an economic windfall to a primarily-liable insurer who accepted premiums from an insured, but ultimately failed to pay a righteous claim under its policy.

As a practical example, imagine a business owns a restaurant that is consumed by an accidental fire. Prior to the fire, there were two insurance policies providing coverage for the loss. One policy provides that it is to be primary in the event of a loss; however, despite the terms of its policy, the primary insurer fails to pay the claim. The second policy provides coverage only after all other policy limits are exhausted. The excess insurer, therefore, pays on the claim since no payment was ever made by the primary insurer. Now, the excess insurer has paid the entire loss while the primary insurer sits on its hands. This simply is unfair, as it would reward the primary insurer for not paying a valid claim. Equitable subrogation fills this void by permitting the excess insurer to recoup some, if not all, of its payments.

In the example above, equitable contribution may not be available. While the two insurers cover the same insured and insurable interest, they do not provide coverage for the same risk. The secondary insurer's policy *only* provides coverage for damage *in excess* of the primary insurer's limits.

Contrast the example above with the following. A general contractor has his own general liability insurance. The general contractor utilizes a subcontractor for a project, and the subcontractor agreement requires that the general contractor be named as an additional insured under the subcontractor's policy. Both policies contain mutually repugnant "other insurance" clauses providing coverage only after all other polices are exhausted. After a viable claim arises from a defect in the project, the general contractor's policy pays the claim in its entirety. The general contractor's insurer may have a claim for equitable contribution against the subcontractor's insurer because the subcontractor policy covers the same insured, same risk, and same insurable interest.

Simply stated, equitable subrogation focuses on the loss suffered by the insured. On the other hand, equitable contribution focuses on the risks insured against and permits an insurer to request contribution for a portion of the claim often on a pro-rata basis. Equitable contribution typically requires that two insurers have an identical insured, identical insurable interest, and identical risk. In *Home Ins. Co. v. Cincinnati Ins. Co*., 213 Ill. 2d 307, 323, 821 N.E.2d 269, 280 (2004), the Supreme Court of Illinois highlighted these differences and stated "[t]he doctrine of equitable contribution is not applicable to primary/excess insurer issues." In so holding, the Court correctly stated that the terms contribution, indemnification, and subrogation are often used interchangeably; however, each of them is distinct. To have a viable claim of equitable contribution, the Court stated that concurrent policies must insure: (a) the same entities; (b) the same interests; and (c) the same risks.

Conversely, the Court noted that the requirements for a viable equitable subrogation are separate and distinct, and require:

1. The defendant carrier must be primarily liable to the insured for a loss under a policy of insurance;

2. The plaintiff carrier must be secondarily liable to the insured for the same loss under its policy; and

3. The plaintiff carrier must have discharged its liability to the insured and at the same time extinguished the liability of the defendant carrier.

Understanding the role and application of equitable subrogation and equitable contribution is important, as failure to assert the proper rights early may be fatal. For example, in *Privilege Underwriters Reciprocal Exch. v. The Hanover Ins. Group*., 16-CV-61742, 2018 WL 477277, at *7 (S.D. Fla. Jan. 19, 2018), the court held that the plaintiff-insurer waived its claim for equitable subrogation before litigation ever began. The court noted that under Florida law, "an insurer is deemed to be a 'volunteer' when settling a claim on behalf of an insured, unless the insurer reserves its right to deny liability and to seek reimbursement from other insurers." Consequently, when an insurer acts as a volunteer, it waives any claims for equitable subrogation against other insurers.

III. Contractual Subrogation

In contractual subrogation, the parties agree to establish, waive, or otherwise limit subrogation rights. This manipulation of the legal right of subrogation is at the heart of risk transfer. Because subrogation arises automatically by law upon payment by the subrogate, subrogation can only truly be "modified or waived" by contract. An assignment of a cause of action from the subrogor/insured to the subrogate/insurer is not necessary for subrogation rights to exist. A well-respected treatise on insurance law puts it like this:

> *Subrogation is the substitution of another person in the place of the creditor, so that the person substituted will succeed to the rights of the creditor in relation to the debt or claim, and is an act of the law growing out of the relation of the parties to the original contract of insurance, and the natural justice or equities arising from the fact that the insurer has paid the insured, rather than a right depending upon the contract*. *On the other hand, an assignment of a right or claim is the act of the parties to the assignment, dependent upon actual intention, and necessarily contemplating the continued existence of the debt or claim, the whole of which is assigned*.[1]

[1] *16 Couch on Insurance 2d,* Subrogation § 61.92.

Subrogation presupposes an actual payment in satisfaction of a debt or claim to which the party paying is subrogated, although the remedy is kept alive in equity for the benefit of the payor, while the assignment necessarily contemplates continued existence of the debt or claim assigned. Contractual subrogation is, as its name implies, something which arises from the terms of a contract, health Plan, insurance policy, or other agreement. While subrogation may be established through the terms of a contract or insurance policy (ergo, "contractual" subrogation), in many instances it isn't subrogation at all, but simply a right of reimbursement or recovery granted by the terms of the document itself.[2] Historically, subrogation is not an express lien based on agreement, but instead is an equitable lien impressed on monies on the ground that they should go to the insurer.[3] This draws a sharp distinction between the Equitable doctrine of subrogation (equitable subrogation), and the legal remedy of breach of contract for an agreement which provides a right of reimbursement or recovery pursuant to its terms (sometimes referred to as contractual subrogation). As you will see later, this distinction becomes important when attorneys attempt to throw equitable defenses such as the Made Whole or Common Fund Doctrines in your subrogation path. Some courts and legal scholars have alluded to the fact that legal subrogation (equitable) is grounded in equity, while conventional (contractual) subrogation is grounded in contract.[4]

IV. Other Diamonds in the Rough

1. Finding a subrogation target when no insurance coverage exists for the at fault party: Example: At fault roofer believed they had insurance coverage when using subcontractors. However, the at fault roofer learned from their insurance broker that they failed to check a box when filling out their insurance application. In this instance, we were able to place pressure upon the broker for the at fault roofer, who ultimately paid the claim through their E&O insurer);

2. Finding a subrogation target even if a builder's risk policy is involved: Example: Never assume that just because a builder's risk policy is involved, a claim against a subcontractor is barred (Most builder's risk policies provide that each and every subcontractor of every tier are additional insureds under the builder's risk policy, *to the extent required by contract*. Most folks assume that the contracts will require that the subcontractors be named as additional insureds; however, that is not always the case. So, it's important to read the entire contract (and all related contract documents, schedules, etc.) to determine whether the subcontractor is in fact an additional insured;

3. Finding a subrogation target even when the insured caused the loss: Example involving fire spread: Insured was welding and caused a fire in a warehouse. Subsequently, it was discovered that the sprinkler system for the warehouse did not activate properly. Had the

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[2] *Sereboff v. Mid Atlantic Medical Services, Inc.*, 126 S.Ct. 1869 (2006).
[3] *Id.*
[4] *American Nat'l Bank & Trust Co*. v. *Weyerhaeuser Co.*, 692 F.2d 455 (7th Cir. 1982).

sprinkler system activated properly, the fire would have likely been contained and not destroyed the entire warehouse.