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MONTHLY ELECTRONIC SUBROGATION NEWSLETTER JULY 2006

TO CLIENTS AND FRIENDS OF MATTHIESEN, WICKERT & LEHRER, S.C.:

This monthly electronic subrogation newsletter is a service provided exclusively to clients and friends of Matthiesen, Wickert & Lehrer, S.C. The vagaries and complexity of nationwide subrogation have, for many lawyers and insurance professionals, made keeping current with changing subrogation law in all fifty states an arduous and laborious task. It is the goal of Matthiesen, Wickert & Lehrer, S.C. and this electronic subrogation newsletter, to assist in the dissemination of new developments in subrogation law and the continuing education of recovery professionals. If anyone has co-workers or associates who wish to be placed on our e-mail mailing list, please provide their e-mail addresses to Rose Thomson at rthomson@mwl-law.com. We appreciate your friendship and your business.

MADE WHOLE DOCTRINE

CONTRACTING AWAY MADE WHOLE

Does the Made Whole Doctrine Apply If Your Policy/Plan Says It Doesn't?

Article I, Section 10 of the U.S. Constitution couldn't be any clearer:

> *"No State shall … pass … any law impairing the Obligation of Contracts …"*

But that doesn't seem to matter to a handful of state legislatures and judges who feel that the United States Constitution should be ignored because we're only dealing with subrogation rights. Insurance policies and health plans whose terms clearly constitute a contract between an insurer and an insured, and indicate that the insurer will have subrogation and reimbursement rights even when the insured has not been made whole in a third party recovery, seem to have been marginalized and discounted for a variety of ill-founded reasons in a small number of states, despite the overwhelming support for subrogation in the majority of other states.

The **Ohio** Supreme Court has recently held:

> *"We hold that a provider of health insurance and an insured who has been injured by an act of a third party may agree prior to payment of medical benefits that the insured will reimburse the insurer for any amounts later recovered from that third party, third party's insurer, or any other person through settlement or satisfaction of judgment upon any claims arising from the third party's act. A clear and unambiguous agreement so providing is not unenforceable as against public policy, irrespective of whether the settlement or judgment provides full compensation for the insured's total damages. We have long held that principles of equitable subrogation,*

> *including the made-whole doctrine, do not override clear and unambiguous contractual provisions. Our holding therefore does not constitute a change in our precedent but rather a reaffirmance of it."* Northern Buckeye Educational Counsel Group Health Benefits Plan v. Lawson, 814 N.E.2d 1210, 1215 (Ohio 2004).

In Ex Parte State Farm Fire & Casualty Co. v. Hannig, 764 So.2d 543, 545 (Ala. 2000), the **Alabama** Supreme Court reaffirmed that *"the normal equitable rules of subrogation could be modified by contract ...."* Likewise, the **Alabama** Court of Appeals clearly delineated the inapplicability of the equitable made whole doctrine when a contract of insurance provided for subrogation:

> *"Unlike the rule when subrogation is claimed on an equity basis, where ... the terms of the insured's insurance policy ... [are] clear and unambiguous in requiring the insured to hold in trust for the insurer proceeds of any recovery obtained by the insured against the third-party wrongdoer and to reimburse the insurer to the extent of its payment to the insured, the contract language giving the insurer a right of subrogation has to be enforced even though the insured's loss, including his or her costs of collection, exceed the combined benefits of his or her tort award and insurance benefit."* Wolfe v. Alfa Mutual Ins. Co., 880 So.2d 1163 (Ala. Civ. App. 2003).

Similarly, the **Minnesota** Supreme Court has held:

> *"Conventional subrogation is contractual—it is a product of an agreement between the insured and the insurer. (citation omitted) Parties may grant greater subrogation rights under contract than would have been recognized in equity."* Medica, Inc. v. Atlantic Mutual Ins. Co., 566 N.W.2d 74, 77 (Minn. 1997).

The **District of Columbia** Court of Appeals has held:

> *"We agree with the **Arizona** Supreme Court and are persuaded to follow the line of cases holding that the superior equities doctrine, although applicable to equitable subrogation claims, has no application in cases of conventional subrogation and assignment. Conventional subrogation and assignment are based on contractual agreements between parties and do not derive their validity from principles of equity."* Nat'l Union Fire Ins. Co. of Pittsburgh, P.A. v. Riggs Nat'l Bank of Washington, D.C., 646 A.2d 966, 971 (D.C. 1994).

In State Farm Fire & Cas. Co. v. Pacific Rent-all, Inc., 978 P.2d 753, 767 fn. 9 (Haw. 1999), the **Hawaii** Supreme Court observed: *"Regarding conventional or contractual subrogation, 4 R. Long, The Law of Liability Insurance, § 23.03[1][a], at 23.18.l-18.2, and § 23.03[4], at 23-27 also states: 'The right to conventional subrogation, as opposed to legal subrogation, does not depend upon principles of equity. When subrogation claimed by an insurer is based on contract, the subrogation provisions of the policy constitute the sole measure of its rights.'"*

The **Illinois** Court of Appeals made short work of the notion that subrogation clauses should be enforced only when the insured's loss has been fully compensated, because the insurer has been paid for the risk it assumed. It went on to say:

> *"The parties here were free to negotiate the terms of the contract of insurance, including the subrogation provision with its consequent effect on premiums, and the*

> *amount of liability coverage. They declined to upset the settled expectations of the parties as reflected in the policy of insurance by overlaying inapplicable equitable principles which contravene the contract terms and forge new agreement between the parties."* Capitol Indemnity Corp. v. Strikezone, 646 N.E.2d 310 (Ill. App. 1995).

The legal treatises and case decisions in a majority of other states continually adhere to the principle that the made whole doctrine can and should be eliminated by contractual subrogation provisions. They correctly point out that as an equitable doctrine, made whole is a gap filler only to be used in the absence of a valid contract right. The scholars in the area of insurance law all agree that the made whole doctrine was to be used only in the absence of contractual language. See *16 Couch on Insurance 3d* §233:134 pgs. 223-147, 148; *22 Holmes' Appleman on Insurance 2d* §141.2[B][1] pg. 426 (copyrighted 2003); *3 Appleman Insurance Law and Practice* §1675 pg. 497 (copyrighted 1967).

The made whole rule is defined as follows:

> *"It is widely held that in the absence of contrary statutory law or valid contractual obligation to the contrary, the general rule under the doctrine of equitable subrogation is that whether an insured is entitled to receive recovery for the same loss from more than one source, e.g., the insurer and the tortfeasor, it is only after the insured has been fully compensated for all the loss that the insurer acquires a right to subrogation." 16 Couch on Insurance 3d* § 233:134, pgs. 233-147, 148 (*emphasis added*).

As stated, the made whole rule is the general rule to be used only when there is no contractual obligation between the parties. In fact, Couch states that *"where the right of an insurer to subrogation is expressly provided for in the policy, its rights must be measured by, and depend solely on, the terms of such provisions."* See Id. §222:23 pgs. 222-51. A contractual obligation overrides the general rule and controls the obligation of the parties. Thus, the made whole rule of equity by its very creation was limited to situations where no contractual rights exist.

History shows that equity is completely independent of any contractual relationship or terms between the parties. By blurring this distinction, the courts below have hampered the ability of parties to contract in accordance with their intent and desires, and violated the U.S. Constitution in the process. It is important to also note that a growing majority of states which have sounded off on this issue recognize that the made whole rule can be overridden by contract terms in a policy and allow contract terms to override application of the equitable doctrine. **Alabama:** Ex Parte State Farm Fire & Casualty Co. v. Hannig, 764 So.2d 543, 546 (Ala. 2000); Wolfe v. Alfa Mutual Ins. Co., 880 So.2d 1163 (Ala. Civ. App. 2003); **California:** Samura v. Kaiser Foundations Health Plan, 17 Cal. App.4th 1284, 1292-1295 (Cal. App. 1993); Travelers Indemnity Co. v. Ingebretsen, 38 Cal. App.3d 458, 465-66 (Cal. Ct. App. 1974); **Connecticut:** The Automobile Ins. Co. of Hartford v. Conlon, 216 A.2d 828, 829 (Conn. 1966); **District of Columbia:** District 1-Pacific Coast Distributors v. Travelers, 782 A.2d 269 (D.C. 2001); **Florida:** Florida Farm Bureau, Inc. Co. v. Martin, 377 So.2d 827, 830 (Fla. App. 1979); Blue Cross and Blue Shield of Fla. v. Matthews, 498 So.2d 421, 422 (Fla. 1986); **Georgia:** Duncan v. Integon General Ins. Co., 482 S.E.2d 325, 326 (Ga. 1997); **Illinois:** Hardware Dealers Mutual Fire Ins. Co. v. Ross, 262 N.E.2d 618 (Ill. 1970); **Indiana:** Erie Ins. Co. v. George, 681 N.E.2d 183, 188 (Ind. 1997); **Iowa:** Ludwig v. Farm Bureau Mutual Ins. Co., 393 N.W.2d 143 (Iowa 1986); **Kansas:** Unified School District No. 259 v. Sloan, 871 P.2d 861, 865 (Kan. 1994); **Kentucky:** Wine v. Globe American Casualty Co., 917 S.W.2d 558 (Ky. 1996); **Maryland:** Stancil v. Erie Ins. Co., 740 A.2d 46, 49-50 (Md. Ct.

of Special App. 1999); **Massachusetts:** Morin v. Massachusetts Blue Cross, Inc., 3411 N.E.2d 914, 916 (Mass. 1974); **Minnesota:** Westendorf v. Stasson, 330 N.W.2d 699, 703 (Minn. 1983); Medica, Inc. v. Atlantic Mutual Ins. Co., 566 N.W.2d 74, 77 (Minn. 1997); Hershey v. Physicians Health Plan of Minn., Inc., 498 N.W.2d 519 (Minn. App. 1993); **Nebraska:** Ploen v. Union Ins. Co., 573 N.W.2d 436, 443 (Neb. 1998); **New Jersey:** Providence Washington Ins. Co. v. Hogges, 171 A.2d 120, 124 (N.J. 1961); Culver v. Ins. Co. of North America, 559 A.2d 400 (N.J. 1989); **Oklahoma:** Williams & Miller Gin Co. v. Baker Cotton Oil Co., 235 P. 185, 187 (Okla. 1925); **South Dakota:** Julson v. Federated Mutual Ins. Co., 562 N.W.2d 117, 121 (S.D. 1997); **Utah:** Hill v. State Farm Mutual Auto Ins. Co., 765 P.2d 864, 866 (Utah 1988); Birch v. Fire Ins. Exchange, 2005 WL 2298130 (Utah App. 2005); **Virginia:** Geraldine Simmons Collins v. Blue Cross & Blue Shield of Virginia, 193 S.E.2d 782, 784-785 (Va. 1973); **Washington:** Thiringer v. American Motorist Co., 588 P.2d 191, 194 (Wash. 1978); and **West Virginia:** Kanawha Valley Radiologists, Inc. v. One Valley Bank, 557 S.E.2d 277 (W.Va. 2001). These jurisdictions favor the right of a carrier to contract around the made whole rule as it fosters the ability of insurance companies, employer-sponsored health plans and other administrators to craft plans ensuring their fiscal solvency. Moreover, it places the burden of full insurance on an insured who is in a better position to insure himself fully for any loss he might sustain.

Joining this majority view, a few states have limited the contractual rights of parties only when the contract would violate or interfere with mandated coverage under state statute. **Colorado:** Marquez v. Prudential Property Casualty Ins. Co., 620 P.2d 29, 32 (Colo. 1980); Kral v. American Hardware Mutual Ins., 784 P.2d 759 (Colo. 1989); **Maine:** Wescott v. Allstate Ins. Co., 397 A.2d 156, 164-165 (Me. 1979); and **Rhode Island:** Lombardi v. Merchant Mutual Ins. Co., 429 A.2d 1290, 1293 (R.I. 1981) allow limited subrogation rights only when the legislature's intent would be thwarted by enforcing the terms as written. These jurisdictions have employed the made whole doctrine only where legislatively mandated coverage would be reduced by subrogation rights such as uninsured motorist, Personal Injury Protection (PIP) and no-fault coverage. But even in these states, contractual rights generally are voided only when necessary to ensure the intent of a state legislature under mandated coverage. Such is not the case here.

A small minority of states prohibit parties from contracting away made whole. The states of **Arkansas:** Franklin v. Healthsource of Arkansas, 942 S.W.2d 837 (Ark. 1997); **Mississippi:** Hare v. State of Mississippi, 733 So.2d 277 (Miss. 1999); **Montana:** Swanson v. Hartford Ins. Co., 46 P.3d 584 (Mont. 2002); **Tennessee:** York v. Sevier County Ambulance Authority, 8 S.W.3d 616 (Tenn. 1999); and **Wisconsin:** Petta v. ABC Ins. Co., 692 N.W.2d 639 (Wis. 2005) (oral argument by Gary L. Wickert) graft made whole onto all subrogation rights arising either in equity or contract. These courts view subrogation as purely equitable in origin and thus will not apply it until a double recovery can be shown. This minority view fails to address that equity itself envisioned that a rule such as the made whole doctrine would be overridden by a contractual provision. As the treatises have noted, the made whole doctrine was to be used only in the absence of contractual rights. See *Couch* § 233:134, pgs. 233-147, 148. Made whole was not created to supplant the rights of parties to bargain or contract. This equitable principle was never intended to prohibit an insurer and insured from agreeing to different terms. Made whole, which is an equitable defense to a subrogation right which arises purely in equity (non-contract right), was never meant to apply to a contractual provision in a policy of insurance or benefit plan booklet. Equity does not support the minority view of supplanting the agreement made by the parties with something different and unintended by the parties to the contract.

Also, the minority view fails to account for the ability of the parties to insure their own risks. A health plan or property insurer cannot and should not be penalized for the insured's failure to adequately insure their person or property. An individual can insure his person, automobiles and property as he possesses an insurable interest. In contrast, the health plan of an employer cannot purchase uninsured motorist coverage, property damage coverage, or automobile medical payments coverage for the injured party who is enrolled in their plan. The minority view would essentially create a situation where a health insurer becomes responsible for paying for pain, suffering, uninsured motorist and disability benefits. In fact, the minority approach would threaten the solvency of health plans whose ratings, premiums and decisions take into account the subrogation ability of the plan or insurer.

As subrogation professionals, we are the sentinels of subrogation rights across the country - the last line of defense. We have a duty to continually be mindful and aware of opportunities to press and safeguard our constitutional right to contract for insurance free from the anti-subrogation prejudices of legislators and judges. The important and historical role subrogation plays in our insurance industry and in the American economy will be more widely recognized only if we stand up and say something when others try to take them away.

PROPERTY

SUBROGATION INVOLVING THE *FIREFIGHTER'S RULE* OR *RESCUE DOCTRINE*

Subrogation professionals will necessarily, from time to time, deal with subrogation situations involving damage to property or equipment used by firefighters, policemen, or other emergency personnel, or even personal injuries suffered by any of these professionals. A legal doctrine known as the "*rescue doctrine*", applied by many states, says that if a rescuer of a person hurt or put in peril due to the negligence or intentional wrongdoing of another (the tortfeasor) is injured in the process of the rescue, the original wrongdoer is responsible for damages for the rescuer's injury. In general, there is no duty to come to the aid or rescue of a stranger unless, the rescuer negligently created the situation which put the stranger in peril and necessitated the rescue. The essential elements of the rescue doctrine are:

(1) The defendant engaged in negligent conduct;

(2) Such conduct threatened real and imminent serious harm to the person or property of another;

(3) The plaintiff attempted to rescue the endangered person or property;

(4) In attempting such rescue, the plaintiff suffered injury, damage, loss or harm; and

(5) The defendant's negligence was a cause of the rescue attempt and of the injuries or damage sustained by plaintiff in the course of such rescue attempt.

A related doctrine is known as the "*firefighter's rule*", and applies most commonly to fire fighters. Developed at a time when the English common law classified the duties of landowners or occupiers according to the status of the persons entering the premises: i.e., trespassers, licensees or invitees. It is essentially a rule of premises liability. At first, firemen who entered the premises

in the discharge of their duties were designated "licensees" to whom landowners or occupiers owed no greater duty than to warn of known concealed dangers and to refrain from inflicting willful or intentional injury. Kithcart v. Feldman, 215 P. 419 (Okla. 1923). Later courts, recognizing the harshness of this classification, reclassified firemen as "invitees" to whom landowners or occupiers owed a duty of ordinary care to keep the premises safe. Clinkscales v. Mundkoski, 79 P.2d 562 (Okla. 1938).

Beginning around 1960, states began to diverge on the handling of what was then becoming known as the "*firefighter's rule*". States such as **Illinois**, rejecting the common law classifications as applied to firemen, held that landowners or occupiers owed a duty of reasonable care to maintain their property so as to prevent injury to firemen "rightfully on the premises, fighting the fire at a place where they might reasonably be expected to be. Thereafter, some states began to impose a duty of reasonable care on landowners or occupiers to prevent injury to firemen which might result from a cause independent of the fire, but no duty to prevent injury resulting from the fire itself. Other states adhered to the invitee rule, stating that there is no absolute duty on the owner of a premises to give warning of any particular peril, the necessity therefore depends upon the age, intelligence, and information of those to whom the warning might be due, and the obligation disappears entirely where it is shown that the injured person did in fact fully appreciate the peril. So, with regard to perils which are obvious to the injured person, there may be no obligation to give any sort of warning. Rogers v. Cato Oil & Grease Co., 396 P.2d 1000 (Okla. 1964). Obviously, this boils down to one big fact question in many subrogation cases.

Subrogation professionals should be aware of both the existence of and distinction between these two related rules of law. There are many permutations of these rules, such as Restatement Second of Torts § 388, which outlines the requirements for imposing liability on one who supplies a chattel or equipment which is known to be dangerous for its intended use. No duty can exist under § 388, however, unless the defendant actually supplies a chattel to the defendant for use. Subrogation successes are frequently hidden under the rock, rather than laying prominently on it. The key to improving recoveries in any subrogation program is diligent and thorough investigation, and and understanding of the applicable avenues for recovery. The *rescue doctrine* and *firefighter's rule* should be two arrows in the quiver of any subrogation professional.
