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MARCH 13, 2009

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 or removed from 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.

****** SUBROGATION ALERT BULLETIN******

INSURANCE SUBROGATION

MORE CONFUSION ON DEDUCTIBLE REIMBURSEMENTS:

PENNSYLVANIA FEDERAL COURT DISMISSES CLASS ACTION DEDUCTIBLE REIMBURSEMENT SUIT

***Harnick, et. al. v. State Farm Mut. Auto. Ins. Co.*, 2009 WL 579378 (E.D. Pa. 2009)**

There appears to be no limits to the extent that the plaintiffs' bar will twist and contort the equitable made whole doctrine in an effort to defeat subrogation rights. The plaintiffs' firm of Feldman, Shepherd, Wohlgelernter, Tanner & Weinstock & Dodig in Philadelphia filed a class action suit against State Farm Mutual Automobile Insurance Company claiming that State Farm's practice of prorating the repayment of the plaintiffs' deductible following State Farm's successful subrogation claim against a third party was improper under Pennsylvania law and was a violation of the made whole doctrine. The federal court dismissed the suit in its entirety on March 5, holding that the made whole doctrine wasn't applicable to deductible reimbursement in Pennsylvania.

The facts relating to the named plaintiffs' case involve State Farm's subrogation claim against a third party, with whom the plaintiffs' were involved in a car accident. On November 22, 2007, the plaintiffs' vehicle was damaged in an accident with another driver. The plaintiffs' vehicle was insured under a policy issued by State Farm. This policy contained collision damage coverage with a deductible of $500. The defendants paid to the plaintiffs the agreed value of the loss incurred in the accident, reduced by the plaintiffs' $500 deductible. Naturally, State Farm then pursued a subrogation claim against the tortfeasor responsible for the accident. In pursuing that subrogation claim, State Farm and the tortfeasor's insurance carrier determined that the driver of each vehicle shared fault for the accident in equal proportion. State Farm recovered an amount in excess of $500 through its subrogation claim. State Farm then reimbursed the plaintiffs $250, or 50% of their $500 deductible, as a prorated share of the plaintiffs' deductible.

The class action complaint alleged that State Farm has a uniform practice of repaying a prorated amount of their insureds' deductibles after recovering amounts in excess of those deductibles in the defendant's subrogation claims. The plaintiffs alleged that this practice violated their right under Pennsylvania law to be "made whole". The plaintiffs also claimed that this right was incorporated into their insurance contract and that the proration of their deductible by the defendant constituted a breach of contract. The complaint also included claims for bad faith, conversion and unjust enrichment under Pennsylvania law, as well as a claim for injunctive relief.

State Farm filed a motion to dismiss each of those claims. It argued that the plaintiffs' allegations failed to state a valid claim because State Farm's proration of the plaintiffs' deductibles was proper under Pennsylvania state insurance regulations. State Farm pointed to Pennsylvania Insurance Code Regulation § 146.8 ("Standards for prompt, fair and equitable settlements applicable to automobile insurance"), which states:

> *(c): Insurers shall, upon the request of the claimant, include the first-party claimant's deductible, if any, in subrogation demands. Subrogation recoveries shall be shared on a proportionate basis with the first-party claimant, unless the deductible amount has been otherwise recovered. A deduction for expenses cannot be made from the deductible recovery unless an outside attorney is retained to collect the recovery. The deduction may then be for only a pro rata share of the allocated loss adjustment expense.* 31 Pa. Code § 146.8(c).

The plaintiffs argued that this regulation allowed for the recovery of a deductible via an insurer's subrogation claim to be shared on a prorated basis. The federal court agreed with State Farm and on March 5, 2009 dismissed the suit. The court pointed out that this regulation grants State Farm – and all insurers - the right to prorate the deductible precisely as they did in this case. This regulation is contained on MWL's Deductible Reimbursement Chart, which outlines the deductible reimbursement laws/regulations for all 50 states and can be found at http://www.mwl-law.com/CM/Resources/50-State-Deductible-Chart-(00024058).pdf.

The very fact that such a spurious class action suit would be filed against the insurance industry reflects a very base misunderstanding of the made whole doctrine pervasive throughout the legal community.

Deductible Reimbursement and the Made Whole Doctrine

In the world of subrogation, the issue of how much of an insured's deductible must be reimbursed to the insured after a carrier makes a successful subrogation recovery, remains a perplexing and confusing issue for subrogation professionals. It rivals ERISA preemption in health insurance subrogation and the no-fault laws of certain states as being the most confusing and least understood area of subrogation. Even experienced subrogation professionals and lawyers simply get it wrong when it comes to understanding and employing the law surrounding the obligation of a subrogated carrier to reimburse an insured a deductible.

Subrogation professionals often assume that if a state employs or recognizes the "made whole doctrine", the insured must be totally reimbursed for its out-of-pocket deductible and any uninsured losses, before a carrier can subrogate. Unfortunately, this over simplistic view and application of the made whole doctrine is not only erroneous, but also results in reduced subrogation recoveries for carriers across the country. Surprisingly, the obligation of an insurer to reimburse some or all of its insured's deductible has very little to do with the made whole doctrine in most states.

The made whole doctrine generally provides that under the common law subrogation principle of equity, an insured is entitled to be "made whole" before a subrogated insurer can participate in a recovery from a tortfeasor. *Insurance Company of North America v. Lexow*, 602 So.2d 528 (Fla. 1992). Insureds may argue that the made whole doctrine prevents an insurer from subrogating or recovering anything on its subrogated interest whenever the insured has not been fully reimbursed for its deductible. Unfortunately, although understood in this fashion by many, this view is not entirely accurate. Although the specific law involved varies from state to state, the majority rule is that the made whole doctrine does not give an insured an affirmative right or cause of action against its insurer to be “made whole”, beyond the payment of the insurance policy proceeds involved. *Schonau v. Geico General Ins. Co.*, 903 So.2d 285 (Fla. App. 2005). Rather, the made whole doctrine is traditionally applicable only as a defense by insureds to protect the insured’s direct recovery from a tortfeasor, where the insured also lays claim to a limited amount of third-party proceeds based on subrogation. *Florida Farm Bureau Ins. Co. v. Martin*, 377 So.2d 827 (Fla. 1979).

Decisions from across the country applying the made whole doctrine essentially hold that where an insurer and insured simultaneously attempt to recover all of their damages from a tortfeasor who cannot (because of insolvency, limited insurance coverage, or other reasons) pay the full value of damages, the insured has priority of recovery over the insurer’s subrogation interest. This is far different from an insured claiming – as the plaintiffs did in the Pennsylvania class action suit - it is entitled to 100% of its deductible before an insurer can subrogate on its own. Even the leading case in the country on the made whole doctrine involved a dispute over limited third-party insurance proceeds between an insured and its insurer. *Garrity v. Rural Mutual Ins. Co.*, 253 N.W.2d 512 (Wis. 1977). An insured always has the right to pursue a tortfeasor independently for its deductible, and that right alone is sufficient to allow the subrogee insurance company to keep its settlement, even if the insured is not made whole. *Paulson v. Allstate Ins. Co.*, 665 N.W.2d 744 (Wis. 2003). Even one of the leading treatises on insurance, in its very first statement on the made whole rule, raises the threshold issue of insufficient funds:

> *“In many instances, the insurer and insured both have rights of recovery against the third party primarily liable for the loss, if the amount recoverable from the third party is insufficient to completely satisfy the claims of both.” Couch on Insurance, § 223.133, at 223-145 (3d Ed. 2000).*

The Utah Court of Appeals recently decided a case in which an insurer reimbursed an insured its deductible, but not before reducing the deductible based on depreciation of property damage caused by a fire. *Birch v. Fire Ins. Exchange*, 2005 WL 2298130 (Utah App. Sept. 22, 2005). In that case, fire damaged the insured’s property, and their insurance policy provided for full replacement costs, subject to a $500 deductible. The carrier subrogated against the tortfeasor, but was able to recover only the depreciated value of the property. It then reimbursed its insured their deductible, but first reduced it based on the depreciation of the property. The insured argued that the made whole rule should focus not on what he might legally have recovered from the tortfeasor, but rather on the total damages or loss he sustained. The court disagreed, and held that the reduction of the deductible was allowed because the maximum recoverable in the tort action was less than the replacement value insurance payment made by the insurer.

The Florida Court of Appeals also astutely recognizes that a blanket application of the erroneous notion that an insured must recover its deductible first before a carrier will be allowed to recover dollar one of any subrogation interest, will guarantee that insurance companies will simply readjust their premiums to pass on the added cost to consumers. *Monte de Oca v. State Farm*, 2004 WL 2955008 (Fla. App. 2004). It held that a 50% reimbursement of a deductible, where the plaintiff was 50% at fault, was perfectly equitable. What’s more, a third-party tortfeasor lacks any standing to complain that an insurance company cannot subrogate until its insured has been totally reimbursed its deductible or otherwise “made whole”. *Nationwide Property &*

Casualty Ins. Co. v. DPF Architects, 792 So.2d 369 (Ala. 2000). Unless the insureds have intervened into the action to claim a right of recovery which would otherwise be prohibited due to lack of third-party proceeds or insurance coverage, a carrier is allowed to subrogate, notwithstanding the fact that the insured has not been made whole by complete reimbursement of its deductible. The only party withstanding to object to the insurer's lack of reimbursement of 100% of a deductible is the insured - and even then, it should only be able to complain when the insured is making an affirmative claim and third-party proceeds are insufficient to satisfy both the insured's uninsured loss and the carrier's subrogation interest. *Economy Fire & Casualty Co. v. Goar*, 564 So.2d 867 (Ala. 1990).

Looking at the MWL deductible reimbursement chart, it should be clear then, that the so-called "dollar-one states" are a misnomer, and the label has little applicability to whether and to what extent a deductible must be reimbursed to an insured. The term simply refers to whether or not a state recognizes and applies the made whole doctrine as described above. But if the made whole doctrine doesn't give the insurance industry guidance as to when and under what circumstances a deductible must be reimbursed, in whole or in part, what does? The answer, where it has been declared, is usually derived from the specific insurance regulations and administrative codes of each particular state.

Twenty-two states contain regulations or administrative codes which specifically and, in detail, govern when and under what circumstances an insured's deductible should be reimbursed by a subrogating insurer. For example, in Texas, the Texas Insurance Code § 542.204 specifically requires an insurer to "take action" to recover a deductible within one year from the date a claim is paid or ninety days before the statute of limitations runs - whichever is sooner. If it does not, the law requires an insurer to pay a deductible back to its insured. However, this burden does not apply if an insured is notified that no subrogation will be pursued and the insured is authorized to proceed on his own to recover any losses it deems it has suffered. However, this code section applies only to private passenger automobile policies. No other applicable statute, administrative code provision or case law gives us guidance for matters involving fire and casualty, property, or health insurance subrogation. However, the Texas Department of Insurance indicates that the reimbursement of the insurance deductible in a third-party claim is usually dictated by the level of recovery - usually a pro-rata reimbursement based on the percentage of recovery. However, the Department warns that a carrier must be consistent on its deductible reimbursement policy.

California law requires that every insurer that makes a subrogation demand must include in every such demand the insured's deductible. 10 Cal. A.D.C. § 2695.7. Insurers must share subrogation recoveries on a pro-rata basis in order to reimburse a pro-rata share of their insureds' deductibles. A pro-rata share of legal expenses and fees may be deducted on a pro-rata basis, if actually incurred. Iowa law requires that an insurer shall, upon the insured's request, include the insured's deductible in any subrogation demand. Iowa A.D.C. 191-15.43 (507B). Any subrogation recoveries will be shared on a pro-rata basis with the insured unless the deductible amount has otherwise been recovered. New York law requires an insurer which has made a physical damage third-party subrogation recovery to mail or hand deliver to the insured a pro-rata share of the insured's deductible, within thirty days after such recovery. N.Y. Ins. Reg. 64, § 216.7(g)(1). Wyoming, on the other hand, has enacted a specific statute which requires that an insurer reimburse its insured their deductible, in full, before any part of the recovery is applied to any other use. Wyo. Stat. § 26-13-113. If the deductible exceeds the insurer's recovery, the entire recovery must be paid to the insured.

And so it goes that twenty-two states have enacted insurance regulations or statutes specifically governing the duties of a subrogated carrier in subrogation settings. Of the other twenty-eight states, twenty-one have no applicable statute, provision, or case law. In light of the fact that most of the states which have enacted regulations appear to apply a pro-rata reimbursement philosophy, an advisable policy with regard to reimbursement of deductibles in states which have not made any pronouncement, is to follow the pro-rata reimbursement formula. Obviously, plaintiffs' firms like the one in Pennsylvania will continue to lob made whole grenades at insurers in the form of class action suits, so every insurer will have to make its own policy decision – based on customer relations or the law – as to how it will proceed with deductible reimbursements.

Seven states have specific case law which governs procedure in these situations. North Carolina requires an insurer to pay the deductible first out of any subrogation recovery absent some alternate agreement. *St. Paul Fire & Marine v. Rhodes*, 198 S.E.2d 482 (N.C. 1973). The South Dakota Supreme Court has held that an insured can collect even if its insured has not been made whole by reimbursement of a deductible. *Julson v. Federated Mut. Ins. Co.*, 562 N.W.2d 117 (S.D. 1997). Washington follows the blanket rule that an insured must be made whole before an insurer can collect any excess, and the Department of Insurance advises that it relies on this case law to establish that a deductible must be reimbursed in full before a carrier can collect. *Theringer v. American Motors Ins.*, 855 P.2d 191 (Wash. 1978). Alabama has left the entire issue to be governed by the terms of the insurance policy. *Ex Parte State Farm & Cas. Co.*, 764 So.2d 543 (Ala. 2000).

It is possible that the twenty-one undecided states may fall in line at some point on either side of the fence - either requiring a deductible to be reimbursed in full before any subrogation recovery can be had or allowing a carrier to subrogate either without regard to reimbursement of the deductible or after reimbursement of a pro-rata share of the deductible.

It's time to set the record straight with regard to deductible reimbursements. Please do not hesitate to contact us with any questions regarding the summary chart of the deductible reimbursement laws of all fifty states, which can be found at the website of Matthiesen, Wickert & Lehrer, S.C., at www.mwl-law.com.