SelfFunding MAGAZINE.com

THE SOCIETAL BENEFITS OF SUBROGATION

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Aug 6, 2010

Origins of Subrogation

Subrogation is one of the oldest legal concepts in jurisprudence, having had its roots in Roman law. Under the reign of Emperor Hadrian (A.D. 177–A.D. 138), Roman law began to shape the building blocks of subrogation. The relation of suretyship could be created by stipulation. Suretyship was an accessory contract, and the surety was known as the fidei-jussor. Sureties had the beneficium divisionis, and enjoyed the beneficium ordinis, invented by Justinian, and the beneficium cedendarum actionum, or subrogation to the right of action of the creditor against the principal debtor, or pro rata against the co-sureties. It came to America through civil law, and it was from the civil law that the Courts of Chancery (equity) derived both the term and the doctrine of subrogation. As a result, subrogation is one of the oldest concepts known to the Anglo-American common law. It seems to have been formally established in common law in the Magna Carta. The right of subrogation was established in Article 9 of the Magna Carta, which provides:

“Neither We nor Our bailiffs shall seize any land or rent for any debt so long as the debtor's chattels are sufficient to discharge the same; nor shall the debtor’s sureties be distrained so long as the debtor is able to pay the debt. If the debtor fails to pay, not having the means to pay, then the sureties shall answer the debt, and, if they desire, they shall hold the debtor’s lands and rents until they have received satisfaction of the debt which they have paid for him, unless the debtor can show that he has discharged his obligation to them.”[1]

Thus, subrogation under common law has its foundation in the law of suretyship – a formal engagement where one party pledges or undertakes to become legally liable for a debt or performance of a service in the event of a default or failure to perform. The doctrine is, that a surety paying the debt for which he is bound, is not only entitled to all rights and remedies of the creditor against the principal for the whole amount, but against the other sureties for their proportional part. This is clearly the rule where the principal obligation is the payment of money or performance of a civil duty. In old England, the sureties of a debtor to the king (as for duties, taxes, excise, etc.) have always, since the Magna Carta at least, had the right, upon paying the debt, to have the benefit of prerogative process, such as extent, or other crown process adapted to the case, to aid them in coercing payment from the principal, and compelling contribution from co-sureties.[2] Today, the once strictly and sparingly applied doctrine of subrogation has been liberalized and favored under the laws of most states.

Today, subrogation is defined as the substitution of one person in the place of another with reference to a lawful claim or right. Although subrogation is usually recognized in insurance settings, the right of subrogation can arise in many other contexts wherein one party pays a debt lawfully owed by another, including mortgage and real estate settings, suretyships, and other areas. The party whose debt has been paid (usually an insured), is known as the "subrogor", while the party who has paid the debt (usually the insurance company), is known as the "subrogee". The subrogee steps into the shoes of the subrogee and acquires all legal rights the subrogee has with regard to the subject of the claim. Subrogation has wide-reaching ramifications and benefits to society, the American economy, and the system of civil jurisprudence.

Modern subrogation arises in one of three ways. The first is known as contractual subrogation (also referred to as "conventional subrogation"). This type of subrogation is based on the contract between the parties, such as subrogation language contained in an insurance policy. The term "conventional" is defined as growing out of or established by convention; that is, an agreement or mutual engagement between two or more persons or entities.

The second type of subrogation is known as equitable subrogation (also referred to as "legal subrogation"). Legal subrogation is 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. Legal subrogation is the doing of complete and perfect justice between the parties by securing the ultimate discharge of a debt by the person whom in good conscience and equity should pay it. Usually, when the term "subrogation" is used without any qualification, legal subrogation is meant.

ELEMENTS OF SUBROGATION

(1) Subrogee has paid obligation of the subrogor.
(2) The subrogee did not "volunteer" to pay the debt of the subrogor.
(3) The subrogee is secondarily, not primarily, liable for the obligation.
(4) The subrogor will not suffer injustice if subrogation is allowed (Doctrine of Equity).

The third type of subrogation is statutory subrogation. A right of subrogation and/or reimbursement can also be set forth in statutory law, giving an insurance carrier a right to recover certain benefits. It includes workers' compensation, hospital lien laws, Medicare, and many other areas.

Purposes of Subrogation

One of the chief purposes of subrogation is to place the loss ultimately on the wrongdoer or tortfeasor who caused the loss in the first place. Courts have stressed that one goal of subrogation is to place the burden for a loss on the party ultimately liable or responsible for it and by whom it should have been discharged, and to relieve entirely the insurer or surety who indemnified the loss and who in equity was not primarily liable for the loss. An additional purpose which underlies the doctrine of subrogation is that it prevents the policyholder from receiving more than he or she bargained for from the contract of insurance. In essence, this prevents a "double recovery" by the insured. Commentators in the field have suggested that if the insurer has only contracted to indemnify the insured for losses incurred, denying the insurer subrogation rights in effect rewrites the policy and allows the insured to retain benefits not contracted for. Another key function of the subrogation doctrine is that it returns the excess, duplicative proceeds to the insurer who can then recycle them in the form of lower insurance premiums. In short, subrogation is a key mechanism by which insurance premiums are kept in check and held to a minimum.

Subrogation Helps Lower Insurance Premiums

Judges and legal scholars agree that subrogation recoveries are an important component in calculating the cost of premiums. One legal scholar at the University of Chicago explained how subrogation impacts insurance premiums. "An insurance company sets its rates based on historical net costs. Thus, if the insurer had one hundred policyholders in the experience period, and experienced a total of $20,000 in claim costs, it will set its actuarial premiums at $200 per policy holder. If, on the other hand, the insurance company experienced $20,000 in claim costs and received $5,000 in subrogation, it will set its actuarial premiums at $150 per policy holder." Similarly, another writer explained how subrogation recoveries figure into an insurer's premium calculations:

Revenue gained by the insurer, whether through subrogation collection or otherwise, is applied toward responding to the actual risk that is required to be paid by the insurer under the terms of the contract or policy…As a source of revenue, subrogation operates to reduce the actual past cost total used in the calculation of probable future insurable risk or loss on which future premiums will be based.

Courts throughout the country agree that subrogation assists society by lowering insurance costs and preventing double recoveries. As a recent example, the 8th Circuit Court of Appeals, considering a Missouri case, held that by denying health plans the right of subrogation, the cost of insurance for all plan members increases. That court acknowledged that although the individual beneficiary who was injured in the accident would benefit by denying the health plan the right to subrogation, "...all other plan members would bear the cost in the form of higher premiums." In addition, courts have recognized that subrogation and reimbursement is especially vital to the financial stability of small group and self-funded plans.

For example, the Wisconsin Supreme Court commented on the different insurance choices available to consumers in that state, writing:

Insurance companies writing medical and hospital expense coverage and medical payment coverage have made increased use of provisions in their policies which are aimed at avoiding duplication in coverage. These companies have written policies, with an appropriately reduced premium, which contain a subrogation provision. This contractual provision specifies that the insurance company has subrogation rights for any recovery from a third-party or his insurer made by its insured who is injured by the negligence of a third-party and who incurs expenses which are paid by his own insurance company.

Accordingly, by allowing subrogation clauses in insurance contracts, consumers will receive bother greater choice and reduced premiums. Insurance is a plan of risk management or risk sharing. F. Joseph DuBray points out in an excellent article on the benefits of subrogation that for a certain price or "premium", a person or entity is offered an opportunity to share the costs of a defined possible economic loss or risk. This risk sharing is normally done by an insurance company or health Plan, although persons may choose to self-insure or spread the effects of a risk through group Plans. Since the risk or loss covered by the insurance is in the future, the exact risk or loss is not known when the insurance contractor or policy is issued. All who are sharing the risk – insurer and insured – view the risk as the probable amount of loss, and the amount of coverage and the premium for the insurance actually purchased are calculated on this unknown.

Correct measurement and assessment of the loss potential is the very foundation of any system of insurance. This assessment is accomplished only through the careful analysis or prior experience with loss, costs of administration of the insurance, the application of probability, or the mathematics of chance, as well as the likelihood that any loss will be recouped through the vehicle of subrogation. The insured decides, before he pays the premium, how much of the potential loss he wishes to bear, when he decides on the limits of coverage desired and whether he wishes to purchase a contract of insurance that provides for subrogation. Any negative financial implications of subrogation for the insured can be avoided by specifically requesting a policy without a subrogation or reimbursement clause. If subrogation recovery were not available for insurance companies – as is increasingly becoming the case in some states – the actual cost of insuring the past known risk would increases accordingly and the projected future costs would likewise have to be adjusted upward in the form of increased premiums. Subrogation costs not realized, or eliminated due to the erroneous application of equitable doctrines such as made whole or common fund, are reflected in and spread over future premiums among the issuing insurer and all of the insureds purchasing the same insurance. As a result, all who shared the risk during the time the claim was paid, and all who share the future risk, subsidize the reduction or elimination of subrogation recoveries or the payment to an insured that did not honor his or her subrogation agreement.

Subrogation Reduces the Number of Lawsuits

Allowing insurers a right of subrogation will not increase the amount of lawsuits. In fact, it will have the opposite effect of reducing lawsuits. For example, without subrogation many plaintiffs are free to bring a lawsuit without concern for whether he or she must repay their subrogated carrier. If plaintiffs were forced to repay their health insurers after a third-party recovery, many doubtful or borderline cases would not be brought. In fact, many lawyers would advise their clients that because the insurance company has the right to recover all of the benefits paid to the individual, filing suit does not make economic sense. The burden would fall to the carrier to enforce its subrogation rights, which are more easily settled because such subrogation rights seek to recover only the most basic economic damages – medical expenses and lost wages – which the liability carrier can easily agree to.

Consider a scenario where a plaintiff slips and falls at a local store and is partially at fault. His health insurer pays $5,000 in medical bills necessitated by the fall. If the plaintiff believes that he can only recover $5,000 from the store owner, due in part to his own fault, and must also repay his health insurer, he may decide not to bring the case at all. Justice Antonin Scalia recently commented on this scenario during oral arguments of a health subrogation case that was before the United States Supreme Court. In that case, the Supreme Court was faced with a question of whether or not to allow reimbursement to ERISA covered health insurers. In response to Justice Anthony Kennedy's question about whether subrogation should be allowed in cases where the final settlement was less than the amount paid by the health insurer, Justice Scalia replied, "Presumably such a weak claim would not be brought because there's nothing at the end of it." Conversely, the absence of subrogation encourages the hypothetical plaintiff above to bring his lawsuit every time. Subrogation has the effect of reducing lawsuits, especially the small suits which are filed in greater number.

The Importance of Subrogation

Subrogation along all lines of insurance serves the vital function of helping to keep premiums low for billions of insureds worldwide, and should be protected at all costs. As an example, subrogation keeps workers' compensation premiums low for American employers. The complicated calculation of workers' compensation premiums necessarily involves the concept known as the Experience Modification Factor. The Experience Modification Factor (also known as an Experience Modification Rating, EMR, Experience Modifier, or just the Mod) is an adjustment that is made to the Workers' Compensation insurance premium of American employers.

This means that the calculation of insurance premiums for an employer takes into consideration a number of factors, including prior years' payroll, loss history, and subrogation recoveries. One common misconception is that these factors are calculated by the state. In most states, this is not true.

Experience mods are usually calculated by rating bureaus (or as they are now designated, Advisory Organizations). Many states use the National Council on Compensation Insurance, Inc. (NCCI) for this work, but other states have their own rating bureau. California, for example, uses the Workers' Compensation Insurance Rating Bureau (WCIRB), which is a rating bureau independent of NCCI. NCCI is a private corporation, created and funded by member insurance companies. It is approved by the states, but it is not connected with government in any way. California, Delaware, Indiana, Massachusetts, Michigan, Minnesota, New Jersey, New York, North Carolina, Pennsylvania, Texas, and Wisconsin have their own separate rating bureaus. Some of these other rating bureaus are run by their state governments.

As with most rating bureaus, the WCIRB is permitted to revise an experience modification under a limited number of circumstances. The WCIRB also contains specific instructions for calculating the effect of subrogation recoveries on experience mods which reduce premiums. Once such circumstance is when the insurer reports a successful subrogation effort. The WCIRB also contains specific instructions for calculating the effect of subrogation recoveries on experience mods which reduce premiums. Other states follow similar scenarios and have similar rules. Insurance executives extol the virtues of subrogation and its effect on American insurance premiums. "Subrogation is a critical tool to control costs for workers' comp policyholders," Bob McNeil, manager of subrogation and recovery at Liberty Mutual in Boston stated in a March, 2006 interview with Risk & Insurance. "Using subrogation, we can make a significant bottom-line contribution to our customers' workers' comp costs, reducing their paid losses, maintaining their experience modification rating, and ultimately mitigating or eliminating future exposures." McNeil continued, "Subrogation provides one of the few opportunities an insured has to actually get money back from their insurer. For example, if a case is valued at $500,000, and $200,000 has been paid by the insurer in workers' comp benefits, we can go after the responsible third-party to recover those payments. In addition, we can negotiate a future credit of $300,000 to the customer into the settlement so the employer is not responsible for those remaining costs."

John Marr, senior vice president of claims at Maine Employer's Mutual Insurance Co., based in Portland, Maine, stated in the same article, "Subrogation has been around since the first workers' comp policy was written. Unfortunately, many insurance carriers haven't followed up on subrogation opportunities as closely as they should." Facilitating subrogation serves to encourage, rather than discourage, carriers from pursuing a legal option available to them which serves to benefit their insureds and hold down both the cost of insurance and the devastating effect which unfortunate accidents can have on the cost of doing business – especially accidents for which a company was not at fault.

In 2005, the Workers' Compensation Subcommittee of the American Academy of Actuaries reported to the U.S. Senate Judiciary Committee on the dangers and economic harm associated with efforts to limit subrogation rights in the workers' compensation arena, acknowledging that insurance premiums for employers are generally determined in the process of underwriting taking into consideration and counting on the fact that subrogation rights will apply. The role subrogation plays in holding down workers' compensation premiums is even much more pronounced than in some lines of insurance because when the employee makes a successful third-party recovery, the workers' compensation carrier not only has a right to recover past benefits it has paid, but in most states, it has the right to take a credit in the amount of the worker's net recovery toward any future benefit payments it might owe. This combination of subrogation and future credit plays a large role in erasing negative loss histories, positively affecting risk modifiers, and helping to hold down insurance premiums for one of the key operating costs for American businesses large and small – workers' compensation insurance. The subcommittee reported that elimination of subrogation in the field of workers' compensation for just the limited area of asbestos claims would result in "tens of billions of dollars" in additional costs to the workers' compensation system. When you consider that asbestos claims constitute less than 1% of workers' compensation claims in the United States, simple math demonstrates rather cogently how significant subrogation is in holding down costs for American employers.

Often overlooked by those who wish to limit or destroy workers' compensation subrogation rights is the fact that, in some states, a workers ' compensation carrier's rights of reimbursement are not technically subrogation rights. In Wisconsin, for example, a carrier's rights of reimbursement under § 102.29 are actually not even subrogation rights. A careful reading of this statute reveals that the rights granted by this statute are distinct from subrogation. Section 102.29 provides for a direct cause of action by an employer against a third-party. This is not the same as merely "stepping into the shoes" of an insured, as is the case with subrogation. Nowhere in the text of § 102.29 is the word "subrogation" even mentioned. That is because this statute is a legislative mandate for courts to apportion third-party recoveries using the formula set forth therein. This right of reimbursement is part of the compromise that was struck with employers who were legislatively made responsible for the injuries of employees which occur through no fault of the employers. In many cases it should not be treated as simple subrogation, nor overcome based on some of the traditional arguments against subrogation.

Anti-Subrogation Arguments

Many judges, attorneys, and lay persons, including jurors sitting on subrogation cases, do not understand subrogation. They cannot understand or comprehend why a wealthy insurance company, having accepted "confiscatory" premiums from an insured and thereafter paid a loss suffered by the insured, should be able to recover the losses it has paid from a culpable third-party, sometimes to the detriment of the insured. They rationalize that paying the loss is simply what the insurance company contracted to do in exchange for the insurance premiums it received. Trial lawyers around the country have undertaken an anti-subrogation jihad, attacking subrogation as "harsh" and "unfair", erroneously applying equitable defenses to contractual subrogation. Several states have enacted anti-subrogation statutes, with the logic that if anybody should suffer it should be the large insurance company or wealthy health Plan which has accepted premiums for years without paying a claim. However, the notion that a successful subrogating insurance company is granted a "windfall" is simply not true.

Because any risk insured against is in the future and the actual risk is unknown, the actual costs of administering the risk are likewise unknown, and the premium paid toward these uncertain events represents a payment to address probable, not actual, expense amounts. In his law review article, A Response To The Anti-Subrogation Argument: What Really Emerged From Pandora's Box, Joseph DuBray points out that because of these "unknowns", there is no known "margin" between the risks or losses that have been insured against and the premiums that have been collected to address the actual costs of paying the loss to come. Because there is no known "margin", there are no "windfalls" in the calculations, as has been suggested by opponents of subrogation.

DuBray points out that revenue gained by the insurer, whether through subrogation collection, premium collection, or otherwise, is applied toward responding to the actual risk that is required to be paid by the insurer under the terms of the contract or policy. Only experience will reveal whether the premiums collected, subrogation recovered, and revenue from other sources, will prove sufficient to cover the actual risks and expenses. DuBray notes that "as a source of revenue, subrogation operates to reduce the actual past cost total used in the calculation of probable future insurance risk or loss on which future premiums will be based." Therefore, subrogation does figure into the insurance experience calculation as "revenue", not a "windfall", as suggested by anti-subrogation proponents. Independent recognition of subrogation as an appropriate and generally accepted source of revenue for an insurance carrier is even codified in the insurance laws and regulations of some states.

The biggest assault on traditional subrogation has come in the form of the "made whole doctrine." Its premise is that subrogation should be permitted only after an insured has been fully compensated or "made whole" for all damages, whether covered by insurance or not. The illusion of "justice" in this doctrine comes at the expense of the right of parties to freely contract for the terms and benefits or their bargain. As pointed out by the U.S. Supreme Court recently in Sereboff v. Mid Atlantic Medical Services, Inc., merely because an insurance company is subrogating does not mean that subrogation is equitable. A subrogation claim is not considered equitable simply because it is subrogation. As the court pointed out, "a subrogation lien 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." It went on to say that the equitable defense of "made whole" is not available when a party is subrogating based on subrogation or reimbursement rights set forth in a contract.

Furthermore, the entire made whole argument flies in the face of existing subrogation law. For example, in many states, if an insured recovers from a collateral source, the liability of the insurer under a contract of indemnity is reduced to the extent of such collateral recovery. Also, if an insured impairs an insurer's subrogation rights, the insured may be barred from recovery under the insurance contract for the loss sustained. These results are incongruous with the argument that an insured should be able to disregard an insurer's subrogation rights because the insured was not made whole. As is noted by one court, "It is a fact of life that there are many occasions where the injuries and damages exceed the coverage afforded by insurance. That does not make the insurers automatic insurers of that excess."

Standing Up For Subrogation

All insurance professionals should stand up in defense of subrogation whenever possible, not only because it is our bread and butter or because it can result in the reimbursement of millions of claims dollars annually, but because it is as old as the law itself, and serves a valuable societal purpose which transcends auto accidents and slip and fall injury claims. An interesting defense of subrogation was undertaken earlier this year in the form of a virtual debate on a national radio program broadcast on nearly 425 radio stations. Gary Wickert appeared on the national radio program, Radio Health Journal, hosted by Reed Pence. The program focused on the battle lines being drawn by trial lawyers and subrogating insurance companies. Appearing opposite Gary was noted anti-subrogation law professor Roger Baron. Baron, who has been engaged by Democrat Senators Toricelli and Daschle to draft legislation which would bring the subrogation-killing made-whole doctrine into the ERISA subrogation arena, is the author of a highly publicized law review article entitled, "Eight Ways to Defeat or Minimize ERISA Reimbursement Claims". The debate can be listened to at www.mwl-law.com. Professor Baron's positions are typical of the attacks being made on subrogation, specifically by those who are funded by or comprise trial lawyers' organizations such as the American Association for Justice (AAJ). To borrow a phrase, eternal vigilance is the price of maintaining our rights of subrogation.

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Gary Wickert is an insurance trial lawyer and is regarded as one of the world's leading experts on insurance subrogation. He is the author of several subrogation books and legal treatises and is a national and international speaker and lecturer on subrogation and motivational topics. Gary is also a published commercial fiction author and a politician in Wisconsin. After 15 years as the youngest managing partner in the history of the 30-lawyer Houston law firm of Hughes, Watters & Askanase, L.L.P., Gary returned to his native Wisconsin in 1998 and co-founded the subrogation firm of Matthiesen, Wickert & Lehrer, S.C. He oversees a National Recovery Program which includes a network of nearly 300 contracted subrogation law firms in all 50 states, Mexico, Canada and the United Kingdom and boasts recoveries of more than $500 million in recoveries and credits for more than 250 insurance companies. Licensed in both Texas and Wisconsin, Gary is double board-certified in both personal injury law and civil trial law by the Texas Board of Legal Specialization. He is also certified as a Civil Trial Advocate by the National Board of Trial Advocacy, for whom he has both written and graded product liability questions contained on the NBTA national certification exam taken by trial lawyers around the country. For more than 25 years, Gary has served as an expert witness and insurance consultant on subrogation and insurance related issues and has been consulted by insurance carriers, lawyers, and legislative bodies from several states. He is a licensed arbitrator and has attended more than 750 mediations in more than 30 different states. He is one of only a few lawyers to have ever appeared before the United States Supreme Court on a subrogation issue, and was named as one of Law & Politics and Milwaukee Super Lawyers' magazine's Super Lawyers from 2005 to 2010.