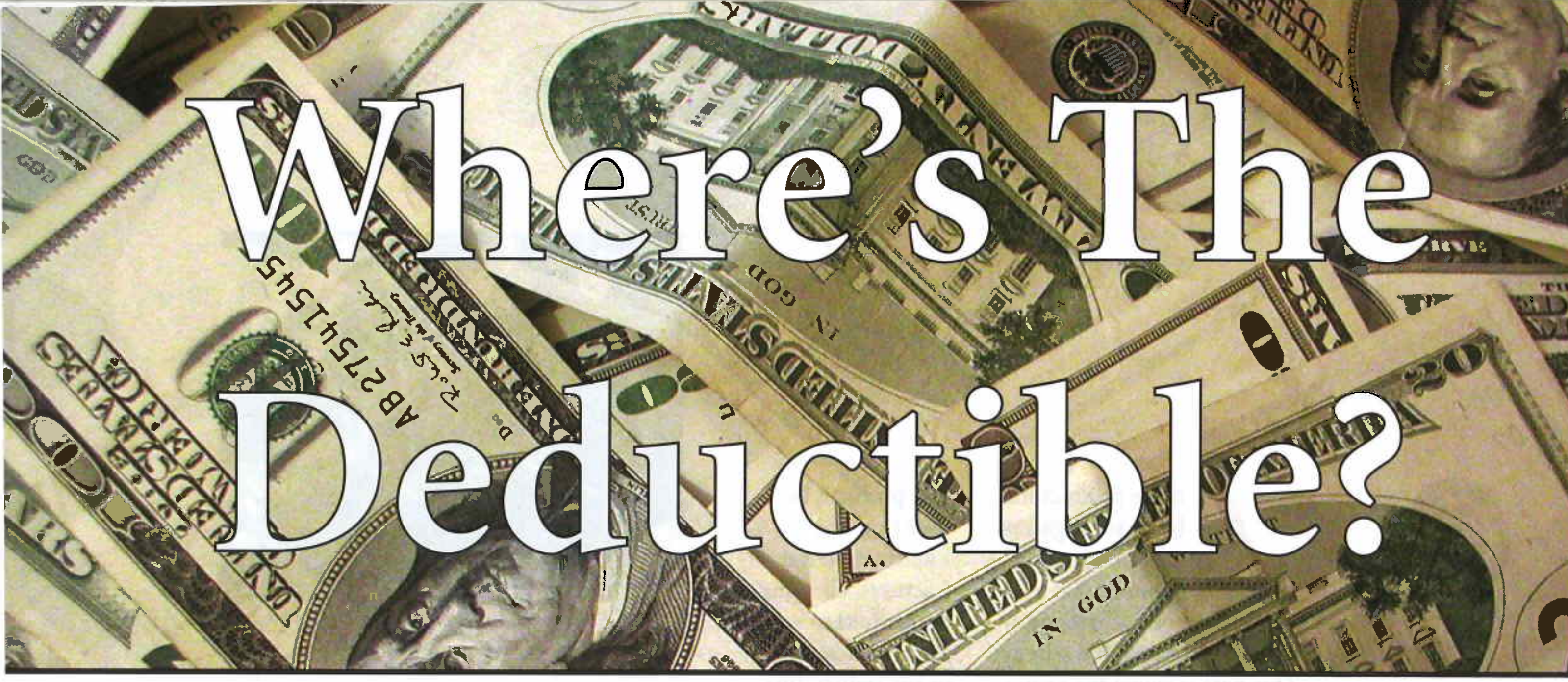

Where's The Deductible?

A Survey Of Laws Regarding Reimbursement Of An Insured's Deductible In All 50 States

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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 get it wrong when it comes to understanding and employing the law surrounding the obligation of a subrogated carrier to reimburse an insured's deductible. This article strives to shed some light on this confusing and often misinterpreted area of subrogation law.

Subrogation professionals often assume that if a state employs or recognizes the "made whole doctrine," then the insured must be totally reimbursed for its out-of-pocket deductible and any uninsured losses before a carrier can subrogate. Unfortunately, this overly-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.[1] 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 observed and recognized by a large number of subrogation professionals throughout our industry, this view is incorrect.

Although the specific law involved may change from state to state, the general consensus 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.[2] Rather, the made whole doctrine may be used only as a defense by an insured to protect his or her direct recovery from a tortfeasor, where the insured also lays claim to a limited amount of third party proceeds based on subrogation.[3] 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 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.[4] 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.[5] 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."[6]

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.[7] 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 the insured's 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 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.[8] 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."[9] 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 withstanding party 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.[10]

It should be clear then, that the so-called "dollar-one states" are a misnomer and have little application 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.

There are 22 states that 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 out, whichever is sooner. If it does not, the law requires an insurer to pay a deductible back to its insured. But, this burden does not apply if an insured is notified that no subrogation will be pursued; then 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. 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. Still, 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.[11] 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.[12] 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 that 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 30 days after such recovery.[13] Wyoming, on the other hand, has enacted a specific statute that requires that an insurer reimburse its insured's deductible, in full, before any part of the recovery is applied to any other use. If the deductible exceeds the recovery made by the insurer, the entire recovery must be paid to the insured.

And so it goes that 22 states have enacted insurance regulations or statutes specifically governing the duties of a subrogated carrier in subrogation settings. Of the other 28 states, 21 have no applicable statute, provision or case law. In light of the fact that most of the states that 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.

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.[15] The South Dakota Supreme Court has held that an insurer can collect even if its insured has not been made whole by reimbursement of a deductible.[16] 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.[17] Alabama has left the entire issue to be governed by the terms of the insurance policy.[18]

It is possible that the 21 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. A summary chart of the deductible reimbursement laws of all fifty states can be found at the website of Matthiesen, Wickert & Lehrer, S.C., at www.mwl-law.com.

ENDNOTES

1 *Insurance Company of North America v. Lexow,* 602 So.2d 528 (Fla. 1992).

2 *Schonau v. Geico General Ins. Co.,* 903 So.2d 285 (Fla. App. 2005).

3 *Florida Farm Bureau Ins. Co. v. Martin,* 377 So.2d 827 (Fla. 1979).

4 *Garrity v. Rural Mutual Ins. Co.,* 253 N.W.2d 512 (Wis. 1977).

5 *Paulson v. Allstate Ins. Co.,* 665 N.W.2d 744 (Wis. 2003).

6 Couch on Insurance, § 223.133, at 223-145 (3d Ed. 2000).

7 *Birch v. Fire Ins. Exchange,* 2005 WL 2298130 (Utah App. Sept. 22, 2005).

8 *Monte de Oca v. State Farm,* 2004 WL 2955008 (Fla. App. 2004).

9 *Nationwide Property and Casualty Ins. Co. v. DPF Architects,* 792 So.2d 369 (Ala. 2000).

10 *Economy Fire & Casualty Co. v. Goar,* 564 So.2d 867 (Ala. 1990).

11 10 CA A.D.C. § 2695.7.

12 Iowa A.D.C. 191-15.43 (507B).

13 N.Y. Ins. Reg. 64, § 216.7(g)(1).

14 Wy. Stat. § 26-13-113.

15 *St. Paul Fire & Marine v. Rhodes,* 198 S.E.2d 482 (N.C. 1973).

16 *Julson v. Federated Mutual Ins. Co.,* 562 N.W.2d 117 (S.D. 1997).

17 *Theringer v. American Motors Ins.,* 855 P.2d 191 (Wash. 1978).

18 Ex Parte State Farm & Casualty Co., 764 So.2d 543 (Ala. 2000).