MATTHIESEN, WICKERT & LEHRER, S.C.
ATTORNEYS AT LAW

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 Jamie Breen at jbreen@mwl-law.com. We appreciate your friendship and your business.*

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HEALTH INSURANCE SUBROGATION

FRUSTRATED TRIAL LAWYERS THREATEN "MADE WHOLE" CLASS ACTION SUITS

By Timothy L. Pagel

This month celebrated the Discovery Channel's *Shark Week* – a week-long series of television programs featuring hungry sharks feeding in a target-rich environment. How appropriate a month for an article on the new frenzy being exhibited by trial lawyers sensing blood in the water after last year's horrible anti-subrogation decision by the Arkansas Supreme Court in *Riley v. State Farm*, 2011 Ark. 256, 2011 WL 2410521. Insurance companies' subrogation departments rarely face the threat of class action lawsuits, but the *Riley* decision is quickly changing all of that.

While Arkansas has historically interpreted the Made Whole Doctrine rather broadly, following something called the "*Franklin Formula,"* the 2011 decision of *Riley v. State Farm* took it one step further and announced new legal standards regarding when an insurance company's right of subrogation is enforceable. In *Riley*, the Arkansas Supreme Court announced that no subrogation rights arise until there is a determination by a court (or through an agreement) that the injured party has been made whole. *Id.* Prior to the *Riley* decision, it was unclear whether the insured had the burden of proving made whole, or whether the insurer seeking subrogation had the burden of proof. *Eastwood v. S. Farm Bureau Cas. Ins. Co.*, 2012 WL 2952172 (W.D. Ark. 2012).

In *Riley*, State Farm had paid its insured $5,000 in medical benefits due to a car accident with a GEICO insured. Prior to making benefit payments, State Farm sent GEICO a letter notifying them of their right to

subrogation. Riley later settled her claim with GEICO for $11,500, which issued one check payable to Riley and her attorney for $6,500, and a second check payable to Riley, her attorney and State Farm for $5,000. Riley sent a letter to State Farm asserting that she had not been "made whole" by the settlement. State Farm responded that the $11,500 settlement from GEICO was sufficient "to fully compensate Ms. Riley for her injuries" (*Id*. at ✶1) and agreed to reduce its recovery to $3,000 (so as to reimburse for recovery expenses and fees). Riley, nonetheless, filed a declaratory judgment action and complaint against State Farm alleging that the notice letter to GEICO violated the rules and that the subrogation recovery was premature without a court's determination that Riley had been "made whole." The trial court dismissed this count ruling that State Farm had a valid but unenforceable subrogation lien under Arkansas law. The insured appealed.

The Arkansas Supreme Court reversed and held that unless an agreement has been reached between an insured and its carrier, the "subrogation lien cannot arise, or attach, until the insured has received the settlement proceeds or damage award and until there is a judicial determination that the insured has been made whole." *Id*. at ✶16. The Court was clear in stating that the legal determination of made whole "must occur before the insurance company is entitled to recover in subrogation." *Id*. at ✶12. It added that there are only two ways to determine whether an insured has been made whole:

(1) by agreement or settlement between the insurer and insured; or
(2) by a judicial determination.

In most states, the Made Whole Doctrine provides, subject to exceptions, that subrogated parties cannot recover from a negligent tortfeasor until the plaintiff is made whole. Recently, in the wake of *Riley* and other decisions, the Doctrine has been the subject of much litigation, threats of bad faith, and class action sword-rattling by trial lawyers frustrated with tort reform and the injustices they feel are attendant to any and all subrogation efforts. This is a complete reversal to the long-held understanding that it is plaintiff's burden to prove he or she was not made whole before being allowed by a court to reduce a lien.

Elsewhere, the plaintiffs' bar has taken note of *Riley* and decisions like it, and we have begun to see plaintiff's attorneys asserting that subrogated carriers have no rights until a made whole determination has been made. Our clients have been served with letters instructing them as follows:

(1) They must stop any subrogation action or efforts;
(2) They must avoid contacting the tortfeasor's liability carrier directly;
(3) They must stop pursuing recovery of liens directly from the third-party carrier;
(4) They are barred from recovery unless the insured is made whole.

Even scarier is the fact that most of these notice letters contained the not-so-veiled threats that undertaking any of the above actions by an insurance company may violate the duty of good faith and fair dealing that you owe to your insured.

The law in the vast majority of states clearly favors subrogation and holds that it is the insured's burden to show he or she has not been made whole prior to decreasing or eliminating the subrogation interest. Additionally, many states recognize that the Made Whole Doctrine is an equitable defense to subrogation and is not applicable when there is either contractual policy subrogation or reimbursement language in play or where the doctrine itself has been negated by the very terms of the insurance policy. However, this will not stop the plaintiffs' bar from attempting to assert carriers have no rights until a court determines the plaintiff is made whole, and we have even encountered lawyers arguing that it is bad faith for the insurer to assert and place parties on notice of their subrogation interest.

Unfortunately, Arkansas now presents a subrogation environment where extra steps must be taken before subrogation is possible. However, the spurious and unfounded arguments we are now seeing in the other states must be addressed aggressively by our industry, lest long-understood subrogation

concepts be turned on their heads. The time to make the arguments is early on in the case instead of getting subrogation counsel involved shortly before a trial court hearing or on appeal. The time to stop further expansion of the doctrine is now, when most states still recognize it is plaintiff's burden to prove he or she has not been made whole, acknowledging the right of the subrogated party.

In another Arkansas class action suit pending at the time of this publication, a plaintiff has sought a declaratory judgment that, under Arkansas law and the applicable insurance policy language, United Services Auto Association (USAA) had a duty to make a determination that their insureds had been "fully compensated" and "made whole" for their damages *before* asserting and collecting on their claims for subrogation. *Price v. United Services Auto. Ass'n*, 2011 WL 7414924 (W.D. Ark. 2011), report and recommendation adopted in part, rejected in part sub nom., *Price v. USAA Cas. Ins. Co.,* 2012 WL 590781 (W.D. Ark. 2012).

Class action threats relating to the reimbursement of deductibles and the Made Whole Doctrine have been around for a few years – a separate, but equally destructive phenomenon. But this new rash of fabricated bad faith threats represents a new offensive launched by trial lawyers struggling to slice an ever-shrinking pie.

Matthiesen, Wickert & Lehrer, S.C. has been engaged to draft a series of letters laying out the favorable subrogation law and countering actual threats of bad faith which have been made to some of our clients. If you receive one of these unfounded anti-subrogation demands/threats from trial lawyers as a result of legitimate subrogation efforts anywhere within North America, contact Tim Pagel at **tpagel@mwl-law.com**.

AUTOMOBILE INSURANCE SUBROGATION

MED PAY SUBROGATION IN NORTH CAROLINA: *CLEAR AS MUD*

By Gary L. Wickert

There continues to be some confusion and questions regarding Medical Payment (Med Pay) subrogation in North Carolina. Trial lawyers and many insurance practitioners say it is not allowed. North Carolina case law indicates to the contrary. The truth lies somewhere in the middle.

Med Pay subrogation is not actively pursued in North Carolina, although the reasons for this are not entirely clear. Under North Carolina's Administrative Code, an insurance company may not issue a contract of insurance that contains a subrogation clause providing for reimbursement of medical, surgical, hospital or funeral expenses. *In Re: Declaratory Ruling by North Carolina Comm'r of Ins. Re 11,* 517 S.E.2d 134 (N.C. App. 1999). Such contractual subrogation is prohibited by § 12.0319 of the North Carolina Administrative Code, which reads as follows:

> *Life or accident and health insurance forms shall not contain a provision allowing subrogation of benefits.* 11 N.C.A.C. § 12.0319 (1978).

This anti-subrogation regulation only applies to subrogation as it appears in insurance policies, *i.e.,* contractual subrogation provisions in auto policies. The North Carolina Court of Appeals has concluded that the Insurance Commissioner did not exceed his statutory authority granted by the General Assembly when promulgating the rule prohibiting subrogation provisions in life or accident and health insurance contracts. *In Re: Declaratory Ruling by North Carolina Comm'r of Ins. Re 11,* supra*;* 11 N.C.A.C. § 12.0319, supra. Even though § 12.0319 expressly prohibits contractual subrogation clauses in policies, the Court of Appeals has held that the General Assembly did not

intend to restrict equitable subrogation rights. *North Carolina Ins. Guar. Ass'n v. Century Indem. Co.,* 444 S.E.2d 464 (N.C. App. 1994). It could be argued, therefore, that even when there is no express subrogation agreement in an insurance contract, equitable subrogation rights may arise by operation of law. *Smith v. Pate,* 97 S.E.2d 457 (N.C. 1957).

Some case law decided prior to § 12.0319 appears to support equitable subrogation of Med Pay benefits. Two decisions in particular indicate that an auto insurance carrier paying Med Pay benefits may subrogate through or seek reimbursement from an insured, although the insured has legal title to the one, indivisible cause of action against the tortfeasor. *Carver v. Mills,* 207 S.E.2d 394 (N.C. App. 1974); *Milwaukee Ins. Co. v. McLean Trucking Co.*, 125 S.E.2d 25 (N.C. 1962). One case, decided after § 12.0319, indicates that a Med Pay carrier is subrogated to an insured's rights to recover medical expenses resulting from injuries inflicted by a tortfeasor when the insurer has paid such medical expenses pursuant to a Med Pay provision in an insurance policy. *Moore v. Beacon Ins. Co.*, 284 S.E.2d 136 (N.C. App. 1981).

If the insurer has made payments to the insured for the loss covered by the policy and the insured thereafter recovers for such loss from a tortfeasor, the insurer can also seek reimbursement from the insured the amount it had paid the insured, on the theory that the insured would otherwise be unjustly enriched by having been paid twice for the same loss, *i.e.*, equitable subrogation. *North Carolina Farm Bur. Mut. Ins. Co. v. Greer*, 282 S.E.2d 553 (N.C. App. 1981); *U.S. Fidelity & Guar. Co. v. Reagan*, 122 S.E.2d 774 (N.C. 1961); *Fidelity Ins. Co. v. Atlantic Coast Line Railroad Co.*, 80 S.E. 1069 (N.C. 1914).

These cases state that it is "well-settled" in North Carolina that an insurer is subrogated to its insured's rights to recover medical expenses resulting from injuries inflicted by a tortfeasor when the insurer has paid such medical expenses pursuant to a Med Pay provision in an automobile insurance policy. *Moore v. Beacon Ins. Co.,* supra. (equitable subrogation); *Milwaukee Ins. Co. v. McLean Trucking Co.,* supra. Furthermore, the Court in *In Re: Declaratory Ruling by North Carolina Comm'r of Ins. Re 11* held that "The question of whether equitable subrogation rights might also arise in the context of life or accident and health insurance coverage is not before us and, therefore, we do not address that question." However, they added that § 12.0319 does not negate an equitable cause of action.

On the other hand, confusing the issue somewhat are a few cases which have indicated that equitable subrogation rights are considered an impermissible assignment of either a personal injury cause of action or the proceeds of such a cause of action. *Southern Railway Co. v. O'Boyle Tank Lines,* 318 S.E.2d 872 (N.C. App. 1987); *North Carolina Baptist Hosp., Inc. v. Mitchell,* 362 S.E.2d 841 (N.C. App. 1987).

The prevailing notion in North Carolina seems to be that because there are no subrogation provisions in Med Pay policies, direct contractual subrogation of Med Pay benefits is not allowed. The result might be different if an out-of-state policy with contractual subrogation language is involved. Some appellate clarification on a carrier's equitable rights of recovery is needed. The reality is that most Med Pay coverage is between $2,000 and $10,000 and no insurer has yet invested the time and money to push the issue to the appellate level. However, a good and valid argument can be made for equitable subrogation of Med Pay benefits under the unjust enrichment theory. Any such equitable subrogation rights would be subject to the equitable Made Whole Doctrine and Common Fund Doctrine.

If you should have any questions regarding this article or subrogation in general, please do not hesitate to contact Gary Wickert at **gwickert@mwl-law.com**.

HCSLA AMENDMENT CODIFIES ILLINOIS MADE WHOLE AND COMMON FUND DOCTRINES

By April K. Toy

A recent amendment to the Illinois Health Care Services Lien Act will negatively impact subrogation and other reimbursement recoveries for benefits paid in personal injury or death claims. Public Act 097-1042 creates a new section of the Illinois Compiled Statutes, 770 I.L.C.S. § 23/50, and makes two significant changes to Illinois law. First, it codifies the Made Whole Doctrine in subrogation actions and other rights of reimbursement actions by proportionately reducing such claims by the plaintiff's own comparative fault or by proportionately reducing such claims by the amount in which a claim is deemed to be uncollectible due to limited liability insurance. Second, it codifies the Common Fund Doctrine by requiring subrogation claimants and other right of reimbursement claimants to "bear a pro rata share of the personal injury or death estate claimant's attorney's fees and litigation expenses." These changes will take effect January 1, 2013.

Interestingly, while this new section appears in the Health Care Services Lien Act, it does not apply to the Act itself. As introduced, the section would have applied to both healthcare lien holders and subrogation and reimbursement claims alike, but it was later amended to exempt healthcare lien holders, workers' compensation, uninsured motorist and underinsured motorists' claims.

Prior case law indicated that the Made Whole Doctrine could be overridden by clear policy language. Moreover, to sustain a claim under the Common Fund Doctrine in Illinois – which was originally based on the equitable concept that an attorney who performs services in creating a fund should in equity and good conscience be allowed compensation out of the whole fund from those who seek to benefit from it - a plaintiff's attorney was required to show that (1) the fund was created as the result of the legal services performed by the attorney, (2) the subrogee did not participate in the creation of the fund, and (3) the subrogee benefitted or would have benefitted from the fund. Going forward, even the most carefully drafted policy language will be unable to protect against the application of the Made Whole Doctrine. Furthermore, the Common Fund Doctrine will now be applied without regard to equity and regardless of whether the claimant with subrogation rights or claimant with another right of reimbursement was benefitted by the plaintiff's attorney in any way.

Practically speaking, subrogated parties and parties with other reimbursement rights will likely experience drastically reduced recoveries in personal injury and death actions in Illinois, which was previously considered to be a good subrogation state. For example, imagine that a subrogated party holds a $10,000 Med Pay lien in an automobile accident where the insured is found to be 20% contributorily negligent. The application of the Made Whole Doctrine would first reduce the lien to $8,000. Then the application of the Common Fund Doctrine would further reduce the lien to $5,600 (assuming a 1/3 contingency fee to plaintiff's counsel). Additionally, a pro rata reduction of expenses could easily reduce the lien to $5,000. Thus, the subrogated or other reimbursement right party would only recover 50% of its total lien.

Matthiesen, Wickert & Lehrer, S.C. represents the subrogation and reimbursement rights of insurers in all 50 states. This new Illinois amendment will be "automatic" only in the small number of cases where a jury verdict is returned or when the claim is brought before the court and a decision is rendered regarding (1) the value of the claim as a whole and (2) the limitations of the claim by comparative fault or limited liability insurance. The vast majority of cases, however, will require competent and aggressive subrogation counsel to negotiate the best possible recovery given the new legal obstacles.

If you need help in protecting your subrogation interest or other right to reimbursement anywhere within the U.S., please contact April Toy at **aprilltoy@mwl-law.com** or Gary Wickert at **gwickert@mwl-law.com**.

UPCOMING EVENTS

October 17, 2012 – Peter Silver will be presenting a live webinar on *"Secrets To Effectively Defending Wisconsin Workers' Compensation Claims*" from 10:00 - 11:00 a.m. (CST). This webinar is approved for 1.0 Texas CE credits and is free to clients and friends of MWL. A registration link will soon be on our website homepage, but you can click on the "Register Now" button to the right to register.

November 11-14, 2012 – MWL will be exhibiting at *NASP's 2012 Annual Conference, "Cirque du Subro",* in Las Vegas, Nevada. Please stop by Exhibit Booth 103 if you plan on attending this conference and introduce yourself. Timothy Pagel, with MWL, and Heath Sherman, with Leahy, Eisenberg & Fraenkel, Ltd., will be presenting a session on *Workers' Compensation and Employer Contribution*. Ryan Woody will also be presenting a session at this conference. For more information on this conference, please go to **www.subrogation.org**.

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