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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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**SUBROGATION**

# IT IS TIME TO RAISE PREMIUMS IN ANTI-SUBROGATION STATES

**By Gary L. Wickert**

For most people, the first and perhaps only exposure to the legal concept of subrogation occurs when they are involved in an auto accident, receive payments from their own insurance company, and later learn that their insurance company is pursuing the at-fault party to recover those payments. The first reaction many have is one of disbelief, because accepting the risk of loss is precisely why the insurance company charges high insurance premiums. Our industry must do a better job of promoting, explaining, and protecting its valuable rights of subrogation. This includes making insurance more expensive in states which have ignorantly made subrogation difficult or even impossible to accomplish.

## Purposes 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. Subrogation serves many purposes. 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. *Fireman's Fund Ins. Co. v. Maryland Cas. Co.*, 65 Cal. App.4th 1279, 1296, 77 Cal. Rptr.2d 296 (1998). An additional purpose which underlies the Doctrine of Subrogation is that it prevents the policyholder from receiving more than they 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. Kimball & Davis, The Extension of Insurance Subrogation, 60 Mich. L. Rev. 841-842 (1962).

Another key benefit of subrogation is that it returns the excess, duplicative proceeds to the insurer who can then recycle them in the form of lower insurance premiums. Fleming, John G., The Collateral Source Rule and Loss Allocation in Tort Law, 54 Cal. L. Rev. 1478, 1481-1484 (1966). In short, subrogation is a key mechanism by which insurance premiums are kept in check and held to a minimum. Subrogation along all lines of insurance serves the vital function of actually returning funds to the respective insurance companies or health Plans when the cause of the underlying loss lies elsewhere with a responsible party.

## Successful Subrogation Lowers Premiums

Generally Accepted Accounting Principles (GAAP) requires that loss reserves be stated net of anticipated salvage and subrogation recoveries. Subrogation recoveries reduce a carrier's net paid and incurred loss amount in a particular claim. When the insurance company evaluates claim data to determine reserves, the evaluation is then completed net of subrogation recoveries. Therefore, the estimated ultimate loss amounts are net of anticipated subrogation. Subrogation, therefore, plays a large role in erasing negative loss histories, positively affecting risk modifiers and experience ratings, and helps to hold down premiums for American businesses and employers.

Judges and legal scholars agree that subrogation recoveries are an important component in calculating the cost of premiums. One such scholar writing in the University of Chicago Law Review explains 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 policyholder. 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 policyholder.*" Jeffrey A. Greenblatt, Insurance and Subrogation: Where the Pie Isn't Big Enough, Who Eats Last?, 64 U. Chi. L. Rev. 1337 (1997).

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.* F. Joseph Du Bray, A Response to the Anti-Subrogation Argument: What really emerged from Pandora's Box, 41 S.D. L. Rev. 264 (1996).

Courts throughout the country agree that subrogation assists society by lowering insurance costs and preventing double recoveries. For 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. *Admin. Committee of Wal-Mart Stores, Inc. v. Shank*, 500 F.3d 834 (8th Cir. 2007). 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." Id.* at 4, citing *Harris v. Harvard Pilgrim Health Care, Inc.*, 208 F.3d 274, 280-81 (1st Cir. 2000). In addition, courts have

recognized that subrogation and reimbursement is vital to the financial stability of small group and self-funded Plans. *Bill Gray Enter., Inc. v. Gourley*, 248 F.3d 206, 214 (3rd Cir. 2001); *Admin. Committee of Wal-Mart Associates Health & Welfare Plan v. Willard*, 302 F.Supp.2d 1267 (D. Kan. 2004).

In Wisconsin, the 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. Associated Hospital Serv., Inc. v. Milwaukee Auto. Mut. Ins. Co.,* 147 N.W.2d 225, 33 Wis.2d 170 (Wis. 1967).

Accordingly, by allowing and giving full effect to subrogation clauses in insurance contracts, consumers receive both a greater choice and reduced premiums. Insurance is a plan of risk management or risk sharing, and subrogation plays a key role in risk management. Lynch, Margaret E., The Business of Insurance*,* at 7 (Trade Paper, 5th ed. rev. 1993).


F. Joseph DuBray points out in his 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. DuBray, Joseph F, A Response To The Anti-Subrogation Argument: What Really Emerged From Pandora's Box, *supra*. This risk sharing is normally done by an insurance company or health Plan. 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. *Id*. 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. *Id.* at 273. Subrogation costs not realized, or eliminated due to the erroneous application of equitable doctrines such as Made Whole Doctrine or Common Fund Doctrine, 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. *Id*. Despite protestations by trial lawyers and those in their pockets, one fact is undeniable. Subrogation helps keep premiums lower for all Americans and should, therefore, be preserved, protected, and fostered at all costs.

## Subrogation Under Attack

Sadly, despite its many benefits, subrogation has been under attack by uninformed judges and lawmakers – on both sides of the aisle - across the country. Collision subrogation in Montana has become much more difficult following some tortured decisions regarding the Made Whole Doctrine. The Montana Supreme Court has held that an insurer is precluded from bringing a subrogation action when

the insured has independently negotiated a settlement agreement with a tortfeasor for less than the insured's total loss. *Swanson v. Hartford Ins. Co. of Midwest,* 46 P.3d 584 (Mont. 2002). In *Swanson*, the Court ruled that the subrogated insurer had no subrogation rights, even though the third-party liability insurance limits exceeded the amount of the settlement reached between the insured and the third party. Unfortunately, this ruling allows an insured to negotiate a settlement with a tortfeasor without regard to the carrier's subrogation rights. By agreeing to settle for an amount less than the total amount of damages sustained by the insured, the tortfeasor insulates itself from further subrogation liability. *Id*.

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 Mut. Ins. Co,* 2011 WL 2410521 (Ark. 2011) 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.


States such as Pennsylvania and New York continually propose legislative bills banning subrogation outright. The State of Georgia has codified the Made Whole Doctrine in workers' compensation subrogation and does not allow any subrogation if benefits are paid under the laws of another state. Class action suits have been filed against carriers who attempt to subrogate without judicial determinations that their insured has been made whole or do not reimburse full deductibles to their insureds. Collateral Source Rules – meant to prevent a plaintiff from recovering double damages in some situations – have been turned into tools of the anti-subrogation crowd. Case decisions and legislative bills which bastardize the Made Whole Doctrine or demonize subrogation fail to take into account the major role subrogation plays in insurance underwriting.

It is time to fight back. There has been a long-standing and institutional disconnect between underwriting and subrogation in our industry. Protecting the right of subrogation and its many benefits actually protects our insureds and our customers. Subrogation should not be a surprise to anybody. It is there – in black and white – in every policy written. It is time to protect subrogation and raise premiums in jurisdictions where subrogation ignorance and trial lawyers have raised the cost of doing business in that state.

If you should have any questions regarding subrogation, please contact Gary Wickert at **gwickert@mwl-law.com**.

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**PROPERTY SUBROGATION**

## IMPLIED CO-INSURED ANTI-SUBROGATION RULE EXPANDS IN NEBRASKA

### ***Buckeye State Mut. Ins. Co. v. Humlicek,* 284 Neb. 463 (2012)**

A new Nebraska Supreme Court decision has added a new dimension to the ongoing saga of landlord/tenant subrogation cases. Across the country, the ability of a landlord's property insurer to subrogate against a tenant for property damage caused by the negligence of the tenant depends on which state the loss occurs in and the nature and language of the lease involved. There are generally three different approaches:

(1) A minority of courts hold that, absent a clear contractual expression to the contrary, the insurance carrier will be permitted to sue a tenant in subrogation.

(2) Seeking to avoid a *Per Se* Rule in states, the applicability of the Doctrine of Subrogation must be assessed on a case-by-case basis and governed by the intent and reasonable expectations of the parties under the terms of the lease and the facts of case.

(3) Known as the "*Sutton Rule"*, some states hold that, absent a clearly expressed agreement to the contrary, the tenant is presumed to be a co-insured on the landlord's insurance policy and, therefore, the landlord's insurance carrier has no right of subrogation against the negligent tenant.

The rule of subrogation known as the *"Sutton Rule*" states that a tenant and landlord are automatically considered "co-insureds" under a fire insurance policy as a matter of law and, therefore, the insurer of the landlord who pays for the fire damage caused by the negligence of a tenant may not sue the tenant in subrogation because it would be tantamount to suing its own insured. The "*Sutton Rule*" is derived from an Oklahoma Court of Appeals decision styled *Sutton v. Jondahl*, 532 P.2d 478 (Okla. App. 1975) and is the benchmark against which the landlord/tenant subrogation laws of most states is measured. It is the modern rule and the rule more and more states are moving toward.


Since 2004, Nebraska has followed the rule that, absent an express agreement to the contrary in a lease, a tenant and their landlord are implied co-insureds under the landlord's fire insurance policy, and the landlord's liability insurer is precluded from bringing a subrogation action against the negligent tenant. *Tri-Par Investments, L.L.C. v. Sousa*, 680 N.W.2d 190 (Neb. 2004). However, that case dealt with attempted subrogation recovery of damages to the house the tenant lived in. In *Humlicek,* the subrogated carrier for the landlord was attempting to recover for damage to a duplex in which the tenant lived and leased only half of the building, although the entire building was damaged. The owners of the duplex insured a building through two concurrently issued, identical policies - one for each unit. A fire damaged the entire structure and the insurer paid the owner's claims under both policies. The insurer then brought this action to determine its subrogation rights against the tenant of one of the duplex units, who was allegedly negligent in starting the fire. The insurer concedes that pursuant to *Sousa,* the tenant was an implied co-insured under the policy covering the unit he lived in. Therefore, the insurer sought to recoup payments made for the damage only to the unit the tenant did not live in.

The Nebraska state court granted partial summary judgment for the tenant and the landlord filed an appeal, which the Court of Appeals dismissed. After the District Court entered an order of final judgment, the landlord again appealed. The Supreme Court dismissed the appeal. On remand, the state court granted the landlord's motion to withdraw non-subrogated claims and entered judgment for the tenant. The landlord appealed once again. This time, the Supreme Court ruled that the insurer could not bring the subrogation claim against the tenant and that the tenant and landlord are implied co-insureds under the landlord's fire insurance policy, precluding the insurer from bringing the subrogation action against the negligent tenant. The insurer conceded that pursuant to *Sousa*, the tenant was an implied co-insured under the policy covering the unit he lived in. However, the insurer clarified that it was seeking to recoup only payments made for the damage to the unit the tenant did not live in.


The Supreme Court didn't buy the distinction. It held that, absent an express subrogation agreement to the contrary, a tenant is conclusively presumed to be an implied co-insured of the landlord's insurance policy - period. This case represents an effort to make a distinction to the dubious Implied Co-Insured Doctrine, which is handled differently from state to state. The distinction between commercial versus residential property has been made in a few states, but this represents relatively new ground in the war against this Anti-Subrogation Rule. It didn't succeed in Nebraska, although it might in other states.

If we can be of any help in subrogating your property damage losses caused by negligent tenants, please contact Gary Wickert at **gwickert@mwl-law.com**. You can also see our chart detailing the law in all 50 states regarding landlord/tenant subrogation and the *Sutton Rule*, by clicking **HERE**.

# WORKERS' COMPENSATION SUBROGATION AGAINST POLITICAL SUBDIVISIONS GIVEN LAST RITES IN PENNSYLVANIA

***Frazier v. W.C.A.B. (Bayada Nurses, Inc.),* 2012 WL 4465855 (Pa. Sept. 28, 2012)**

The states which seem most inimical toward subrogation rights always seem to be struggling with themselves, contorting legislation and case decisions in an inexplicable effort to destroy one of the most effective means society has for holding down insurance premiums – subrogation. Pennsylvania is the poster child for this sort of legal behavior. A recent Pennsylvania Supreme Court case ended a see-saw legal battle over whether a workers' compensation carrier has any rights of subrogation or reimbursement when the injured employee makes a third-party recovery. It didn't end well for subrogation.

In *Frazier v. W.C.A.B. (Bayada Nurses, Inc.)*, Lillian Frazier broke her ankle when a SEPTA-operated bus on which she was a passenger was involved in an accident. She received workers' compensation benefits and filed suit against SEPTA. Her carrier gave notice of its intent to seek reimbursement of the $47,351.93 in benefits it had paid, pursuant to 77 P.S. § 671. Frazier settled her third-party action for $75,000, and SEPTA agreed to "defend, indemnify and hold Claimant harmless" for the workers' compensation lien. Frazier contested the carrier's right to reimbursement, citing a portion of Act 44, § 23, which provides:

> *The Commonwealth, its political subdivisions, their officials and employees acting within the scope of their duties shall enjoy and benefit from sovereign and official immunity from claims of subrogation or reimbursement from a claimant's tort recovery with respect to workers' compensation benefits.*


Frazier filed a claim petition with the Workers' Compensation Appeal Board (W.C.A.B.) claiming that Act 44 § 23 prohibited the carrier from any reimbursement whatsoever. The carrier argued that this statute merely prevented it from filing a third-party subrogation action against a political subdivision, but didn't prevent them from seeking reimbursement directly from Frazier. The Workers' Compensation Judge (WCJ) agreed with Frazier and the carrier appealed to the W.C.A.B., which reversed, holding that § 23 only prevented direct subrogation actions against political subdivisions, not reimbursement rights. Frazier appealed to the Commonwealth Court, which affirmed the right of reimbursement. *Frazier v. W.C.A.B.,* 2009 WL 8658374 (Pa. Cmwlth. 2009). The Commonwealth Court relied on the 2009 decision of *Fox v. W.C.A.B. (PECO Energy Co.*), 969 A.2d 11 (Pa. Cmwlth. 2009), which involved a release of the City of Philadelphia which contained indemnity language similar to that in *Frazier*. Frazier appealed to the Pennsylvania Supreme Court.

On appeal, the Supreme Court focused on the language of § 23 which says that the government shall "benefit from sovereign and official immunity from claims of subrogation or reimbursement from a claimant's tort recovery." The Court held that this language is rendered meaningless if a subrogated carrier could merely sit and wait to be reimbursed and the political subdivision had to include in a settlement agreement amounts equal to the subrogation lien. If reimbursement concerns actions between employees and employers, the Court queried what was the legislature's intent in including the reimbursement clause in Act 44 § 23? The answer, in their view, was demonstrated in situations such as that presented in *Frazier*, where the Commonwealth structures a settlement that does not include workers' compensation benefits within the agreement, and agrees to defend and hold harmless the claimant for any claims of subrogation or reimbursement. In those circumstances, the carrier cannot seek subrogation or reimbursement of its workers' compensation benefit payments.

The Supreme Court dealt with two competing interests: (1) the right of subrogation and reimbursement in workers' compensation under 77 P.S. § 671; and (2) the constitutionally provided immunity of the

sovereign and its subdivisions, as applied to workers' compensation subrogation under Act 44 § 23. It determined that § 23 relegated the right of subrogation and reimbursement to the sovereign's immunity through a narrowly tailored exception to a general rule and reversed the Commonwealth Court.

It remains to be seen whether a right of reimbursement still exists under circumstances where the political subdivision does not indemnify the claimant for workers' compensation liens. If a third-party case is settled without such indemnity and without regard for the carrier's lien, an argument might be crafted that the right of reimbursement still exists. However, I wouldn't hold my breath for too long waiting for those situations because, once again, subrogation always seems to come up with the short end of the stick.

If you should have any questions regarding this article or subrogation in general, please contact Gary Wickert at **gwickert@mwl-law.com**.

## MWL NEWS

### MATTHIESEN, WICKERT & LERHER, S.C. WELCOMES ATTORNEY MATTHEW T. FRICKER TO THE FIRM

Matthiesen, Wickert & Lehrer, S.C. (MWL) is pleased to welcome a new attorney to our insurance litigation staff. Matthew T. Fricker recently joined our firm as a civil litigator and trial attorney with 21 years of extensive experience representing insurance carriers in claims involving personal injury, products liability, automobile, premises liability, medical malpractice, property damage, construction defects, workers' compensation defense, insurance coverage, and subrogation. Matt received his J.D. from Notre Dame Law School in 1991. Prior to joining MWL, Matt was a Litigation Partner at Gonzalez, Saggio & Harlan in Milwaukee, Wisconsin. Matt has also served as Senior Litigation Counsel for CNA Insurance Company and as Staff Attorney for Zurich North American Insurance Company. Matt has already begun handling workers' compensation defense, insurance defense, and subrogation files for our clients so if you have an opportunity to work with Matt, please introduce yourself and welcome him to the fold. We are pleased to have Matt on board and we look forward to Matt's contribution in representing the firm's many insurance clients throughout Wisconsin and all of North America. Matthew Fricker can be reached at **mfricker@mwl-law.com**.

## UPCOMING EVENTS

**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* on November 12. Ryan Woody, with MWL, will be participating in a panel discussion on *Strategic Considerations and Practical Concerns Prior to Filing Reimbursement Actions* on November 13. For more information on this conference, please go to **www.subrogation.org**.

Information regarding our next live webinar will be in our November Subrogation Newsletter!