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New Mexico Supreme Court Holds Assignment of Subrogation Interest Ineffective

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Urban legends and old wives' tales are everywhere. If you eat within an hour of swimming, you will get cramps. Chocolate causes acne. Carrots improve your vision. You can catch a cold by standing outside in the cold. You can ruin your eyesight by sitting too close to the television. Toads cause warts. Cracking your knuckles can cause arthritis. The list is endless. However, they all have one thing in common – they are false. It is unthinkable that such legends and tall tales might affect the outcome of Supreme Court decisions or find their way into legal precedent – but one has.

The contract clause, found in Article I, § 10 of the U.S. Constitution, prohibits the states from impairing the obligations of contracts, and the freedom to contract is an enforceable constitutional right under the due process clause of the 14th Amendment. *Frisbie v. United States*, 157 U.S. 160 (1895). But, that didn't stop the New Mexico Supreme Court from

believing in its own specious urban legend – that all subrogation is equitable.

In *Sunnyland Farms, Inc. v. Central New Mexico Electrical Co-op., Inc.*, 2013 WL 1683658 (N.M. 2013), a fire destroyed a hydroponic tomato facility belonging to a new business, Sunnyland Farms, Inc. (Sunnyland). The day before the fire, Sunnyland’s electricity had been mistakenly shut off by its local utility, the Central New Mexico Electrical Cooperative (CNMEC), for nonpayment. Sunnyland’s water pumps were powered by electricity, and, without power, Sunnyland’s facility had no water. Sunnyland sued CNMEC, alleging both that CNMEC had wrongfully suspended service, and if its electrical service had been in place, firefighters and Sunnyland employees would have been able to stop the fire from consuming the facility. Sunnyland Farms was insured by West American Insurance Company (West American), which paid it approximately \$3.2 million. West American and its parent company, Ohio Casualty Insurance Company, were originally co-plaintiffs along with Sunnyland, but CNMEC settled with them prior to the start of trial. Under the terms of the settlement, CNMEC paid West American \$1.3 million and acquired its subrogation lien against Sunnyland. After CNMEC was found liable, it moved to offset the damages against it based on its purchase of West American’s subrogation interest. The trial court granted the motion and offset CNMEC’s liability by the full subrogation lien of just over \$3.2 million. The Court of Appeals upheld this setoff, but the New Mexico Supreme Court reversed it and held that because “subrogation is an equitable remedy” CNMEC was entitled to no setoff. The Supreme Court held that because subrogation is *equitable*, the trial court abused its discretion by exercising its equitable powers to award CNMEC the setoff.

In making this questionable ruling, the Supreme Court failed to recognize that there are three varieties of subrogation – equitable, contractual and statutory. They represent three *separate and distinct rights* that, while related, are independent of each other. The notion that all subrogation is equitable is about as outdated as the white-powered wigs worn by the 17th Century English jurists who fashioned equitable law. U.S. law generally adheres to the maxim that equity follows the law, which requires equitable doctrines to conform to contractual and statutory mandates, not the other

way around. Where a valid contract prescribes particular remedies or imposes particular obligations, equity generally must yield unless the contract violates positive law or offends public policy. This legal/equitable distinction is behind the ongoing debate over whether the equitable defense to subrogation known as the Made Whole Doctrine is inapplicable when the parties' agreed contract (or insurance policy) provides a clear and specific right of subrogation. *Fortis Benefits v. Cantu*, 234 S.W.3d 642 (Tex. 2007).

The Supreme Court's decision in *Sunnyland* doesn't specifically mention whether the subrogation rights in that case flow from a specific subrogation clause, but it is hard to imagine they do not. Instead, the Supreme Court based its decision on an application of equity to the New Mexico Collateral Source Rule, a general law of damages which provides that the tortfeasor/defendant may not obtain a reduction or offset of damages for which they are liable, in an amount equal to the amount of any insurance benefits or collateral source payments received by the plaintiff, where such insurance was not procured by the defendant. *Martinez v. Knowlton*, 536 P.2d 1098 (N.M. 1975); *Selgado v. Commercial Warehouse Co.*, 526 P.2d 430 (N.M. App. 1974); *Trujillo v. Chavez*, 417 P.2d 893 (N.M. 1966); *Jojola v. Baldrige Lumber Co.*, 635 P.2d 316 (N.M. App. 1981). The classic statement of the Collateral Source Rule is that compensation received from a collateral source does not operate to reduce damages recoverable from a wrongdoer. In other words, if a plaintiff is compensated for his or her injuries by any source unaffiliated with the defendant, the defendant must *still* pay damages, even if this means that the plaintiff recovers twice. *Sunnyland Farms, Inc. v. Cent. New Mexico Elec. Co-op., Inc.*, 2013 WL 1683658 (N.M. 2013).

The Collateral Source Rule is designed to prevent a tortfeasor from benefitting from insurance which the plaintiff procured. *Yardman v. San Juan Downs, Inc.*, 906 P.2d 742 (N.M. App. 1995). The Collateral Source Rule is an exception to the rule against double recovery. *McConal Aviation, Inc. v. Commercial Aviation Ins. Co.*, 799 P.2d 133 (N.M. 1990). There are several justifications for the Collateral Source Rule. If the plaintiff can recover his full damages from the defendant, the plaintiff has the means to reimburse the collateral source. This allows the ultimate burden of compensating the plaintiff to fall on the tortfeasor, rather than on a

blameless insurer or collateral source. If the third party or collateral source does *not* seek compensation, its contribution could benefit either the defendant, by reducing the damages that the defendant must pay, or the plaintiff, by allowing the plaintiff to recover twice. In New Mexico, the Collateral Source Rule dictates that the contribution of a collateral source must operate to benefit the plaintiff rather than the defendant.

The question in the minds of the New Mexico Supreme Court justices was whether, after a subrogated insurer settles with a tortfeasor and assigns the tortfeasor its subrogation interest, the collateral source remains “collateral” to the tortfeasor. In other words, after settling with the subrogated carrier and receiving the subrogation interest by transfer, can the tortfeasor equitably assert the subrogation rights it received? Because New Mexico holds that subrogation, whether created by contract or by operation of law, is an equitable remedy, the Supreme Court in *Sunnyland Farms* held that a tortfeasor which acquires the subrogation right cannot assert the right of subrogation it acquires.

Not only did this decision mean that CNMEC purchased nothing for the \$1.3 million it paid to West American and that all future such settlements are discouraged in New Mexico, but it perpetuates a long-standing old wives’ tale that all subrogation is equitable. After all, if you cross your eyes, they could stay that way.

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