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Made-Whole Interpretations Leave Insurers Feeling Empty

There is a growing trend among state courts to interpret the made-whole doctrine in ways that have the potential to make it difficult for insurers to effectively exercise their subrogation rights. In recent years, state courts' decisions have increasingly created hurdles for insurers before they are able to actively pursue recovery for payments made to their insured. These requirements could have a potentially chilling effect on the field of insurance subrogation.

The most recent state to join this trend is Arkansas. In 2011, the Supreme Court of Arkansas decided Riley v. State Farm Mutual Automobile Insurance Company 2011 Ark. 256 (2011). In its decision, the court held that before an insurer could initiate an action for subrogation, the insured must be "made whole." While the made-whole doctrine is not a novel concept in the insurance arena, this court took a very novel and narrow approach as to when an insured has been made whole.

The court ruled that there are only two ways to determine whether an insured has been made whole: 1) by a declaration in agreement between the insurer and insured that the latter had been made whole; or 2) by a judicial determination.

One of these two events must occur before a subrogation lien can even arise, and premature pursuit of a subrogation action before either one of these events occurs is automatic grounds for dismissal for failure to state a claim, and the possible award of fees and costs in favor of the defendant.

Ruling Concerns

What is troubling about this ruling is that in cases in which insureds refuse to admit they have been fully compensated for an injury, the insurer is forced to have the issue fully litigated before it is able to commence a recovery action. In effect, this opens the door for those insureds to become unjustly enriched by way of double recovery if the insureds receive payment from both the liable tortfeasor and their insurer who determines that it is not worthwhile to pursue litigation to obtain a judicial determination before pursuing a recovery action. The ruling has the potential to create the very outcomes that the laws of subrogation were first created to prevent.

In addition, while the Riley case involved a medical payment benefit (hence the word

"lien" in this case), it would be easy for courts to apply this case across all lines of recovery within the insurance industry. As all claims professionals know, the analysis of when an insured has been "made whole" in a property claim is different from that analysis in a medical claim, workers' compensation claim, liability/indemnity claim and auto claim.

Using a typical property claim as an example, if the property carrier has paid 100 percent of the money it owes to its insured under its policy, what valid reason is there for not allowing the carrier to pursue its rights of recovery? Likewise, if an insured is asking for damages that are not provable or not recoverable, why should a valid subrogation claim ever stand behind that claim in pursuit of a tortfeasor?

Burden of Proof

It is troubling to survey cases in every state that have discussed the made-whole doctrine to see how seldom the courts "drill down" to the core concepts of what "made whole" means within each genre of recovery across the insurance landscape.

The court's ruling in Riley also left unanswered the question of who has the burden of proving an insured has been made whole. While the circuit court ruled that it would be left to the insured to prove that she had not been fully compensated for her injury, the Supreme Court of Arkansas did not address the issue.

The issue of who has the burden of proving whether the insured has been made whole is unclear in other states as well. For example, in a recent Montana state court case involving an insured's action to prevent the insurance company from enforcing its subrogation rights, the court noted that "it appeared" the burden fell on the insurer to prove that the insured had been made whole, but did not address the issue any further. Poppleton v. United Services Automobile Association, 2011 Mont. Dist. LEXIS 52 (18th Dist. 2011). Determining which party carries the burden of establishing whether an insured has been made whole may have a large impact on whether an insurer decides to pursue litigation for a judicial determination.

Other state courts have applied a similarly strict definition of when an insured has been made whole. For example, Montana courts have ruled 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. The reasoning behind the ruling is the same as is applied in Arkansas – the insured was never made whole.

Montana Ruling

Instructive of the position of Montana courts on this issue is the Supreme Court of Montana's decision in Swanson v. Hartford Insurance Company of the Midwest, 2002 Mt. 81 (2002). The court ruled that the insurer had no subrogation rights even after noting that the tortfeasor's "limits of liability exceeded the amount of the settlement reached between the [insured] and the [tortfeasor]." This ruling effectively allows an insured to negotiate a settlement with

a third party without giving any consideration to its insurer's rights to subrogation. By agreeing to settle a claim for less than the total amount of the damages sustained by the insured, the tortfeasor effectively insulates itself from further liability in a subrogation action. This ruling leaves insurers without any recourse to recover payments made and, again, allows for the possibility that the insured will receive double payment. As is evident from this situation, the subrogating carrier, having fulfilled each and every obligation it has to its insured, may still be powerless to seek recovery even when there is no true public policy argument against recovery (one could see a valid public policy argument against recovery where a tortfeasor has very low liability policy limits and where the insured's uninsured losses exceed those limits).

The National Association of Subrogation Professionals (NASP) is aware of these and other threats to an insurer's right to pursue subrogation. To this end, NASP's Amicus Committee has developed and implemented the Subrogation Rapid Response Team (SRRT) to respond to proposed legislation and recent decisional law that has the potential to negatively affect subrogation rights. For information, visit www.subrogation.org. CJ

About John Schleiter and Hobart (Hobie) Hind

Schleiter is an attorney and partner in the Chicago office of Grotefeld, Hoffmann, Schleiter, Gordon & Ochoa LLP. Hind is an attorney and partner in the Tampa office of Butler Pappas. Both work extensively on property subrogation matters, are members of the National Association of Subrogation Professionals board of directors.