

Consequences Of A Separate Subrogated Carrier Suit

Law360, New York (July 6, 2011) -- Two recent decisions under California law involving subrogation recoveries explain the consequences to all involved parties where an insurer pursues a subrogation recovery without the insured. Recently, the California Court of Appeals confirmed that the proceeds of the plaintiffs' property insurance is not a collateral source where the insurer has asserted its subrogation rights.

The court in *Garbell v. Conejo Hardwoods Inc.* 193 Cal. App. 4th 1563, 122 Cal. Rptr. 3d. 856 (2nd App. Dist. April 5, 2011) held that where the subrogated insurer separately sues, the third-party tortfeasor can settle the claim and is protected against making a double payment in the insured's suit.

Along with the 2010 decision of the Ninth Circuit Court of Appeals in *Chandler v. State Farm Ins. Co.*, 598 F.3d 1115 (9th Cir. 2010) concerning the "made whole" doctrine, the decisions clarify California law concerning the effect on the insurer, the insured and the tortfeasor responsible for the injury, where the a separate subrogation action is pursued against a third-party tortfeasor.

In *Chandler*, the Ninth Circuit predicted California courts would allow a subrogated insurer to separately pursue a claim and recoup its payment from a third-party tortfeasor without first making the insured whole. The insured was paid by his insurer State Farm, for rental car expenses necessitated by an accident with the tortfeasor. The insured did not pursue his claim for his deductible against the third-party tortfeasor. State Farm paid the full amount due under the policy to the insured and pursued a claim against the tortfeasor which did not include the insured's deductible.

The third-party insurer settled with State Farm for a portion of the subrogated amount. The insured subsequently demanded reimbursement from the third-party insurer for his deductible but the claim was rejected on the basis the claim asserted by State Farm was settled. The insured then demanded State Farm reimburse him for his deductible citing the "made whole" doctrine.

The court determined State Farm was not required to make the insured whole before pursuing a subrogation claim. The court noted the right of subrogation is “a means of balancing the equities” between the insurer, the insured, and the third-party tortfeasor. “An insured who has suffered an injury has a legal right to be made whole; the made whole rule is the legal doctrine that prevents insurers from interfering with that right.” Where the insured does not seek recovery from the tortfeasor, however, the insurer is allowed to pursue its subrogation rights because the insured may nevertheless be made whole if he sues the tortfeasor separately.

The court noted the issue was one of first impression in California but cited a New York case addressing the exact issue, *Winkelman v. Excelsior Ins. Co.*, 85 N.Y.2d 577, 650 N.E.2d 841 (N.Y. 1995).

In *Winkelman*, as noted with approval in *Chandler*, the New York court allowed the subrogated carrier to pursue a claim separate from the insured without making the insured whole because the “insurer’s obligation runs to its insured, and then only to the extent of the policy limits.

The *Chandler* court also emphasized that if the insurer is required to delay the subrogation claim, the delay may result in the action being time-barred. Moreover, if State Farm was required to reimburse the insured for his deductible, it would have ultimately paid its insured more than the policy required.

As a result of the decision in *Chandler*, subrogated insurers are able to separately pursue claims against third-party tortfeasor where the insured chooses not to pursue the uninsured claim or delays and files a claim separately. If the insurer obtains a recovery, it is not required to make the insured whole with the proceeds of any settlement or award obtained from the tortfeasor.

The decision in *Garbell v. Conejo Hardwoods Inc.* allows the third-party tortfeasor to deduct from a damage award to the insured the amount of the payment the insured received from the subrogated insurer. The Garbells’ personal property was destroyed as the result of a fire at their home they alleged was caused by a flooring contractor. Their insurer, Fire Insurance Exchange (“FIE”), paid the policy limit of \$424,050 and then filed a subrogation claim against the contractor which did not include the Garbells’ uninsured loss of \$452,356. FIE settled the claim for an undisclosed amount.

The Garbells filed a separate lawsuit against the contractor which proceeded to trial. The jury ultimately returned a verdict allocating 55 percent fault to the contractor and 45 percent to the Garbells and finding the damages to be \$822,483. The trial court reduced the award by 45 percent then subtracted the \$424,050 received from the insurer, leaving the Garbells with a recovery of \$28,315.

On appeal, the Garbells argued the contractor should not benefit with a credit of the amount received from the insurer because “they had the foresight to obtain insurance.” The appeals court, however, characterized the argument as “a thinly veiled collateral source rule argument.” The collateral source rule precludes a deduction from a damage award for recoveries the injured party receives from sources “wholly independent of the tortfeasor.”

The court noted that the rule, however, does not require that the tortfeasor pay both the injured party and the collateral source. Where the insurer asserts its subrogation rights, therefore, the insurance proceeds paid to the insured is no longer a collateral source and the collateral source rule does not apply. The amount of the payment, not the amount paid by the tortfeasor to the insurer to settle the claim, is deducted from the jury award.

The two cases confirm subrogated insurers are able to pursue claims against the party responsible for the loss without waiting for the insured to join or pursue a claim for its uninsured interest. The insurer is not required to make the insured whole with a recovery separately obtained and the tortfeasor is not required to pay both the subrogated carrier and the insured in separate actions. The third-party tortfeasor actually benefits from the separate action since the amount deducted from the insured's award is the amount it received from the subrogated carrier, not the amount paid by the tortfeasor to settle the insurer's claim.

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