RISK MANAGEMENT

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Policyholder Considerations for Insurance Company Subrogation

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Subrogation claims are a regular part of the insurance claim settlement process. Subrogation–the right of an insurance company to recover its claim payment when the wrongdoing of another party caused the loss indemnified–finds its roots in well-established principles of equity. Indeed, subrogation often touted as a means of accurately placing liability at the feet of the tortfeasor. Subrogation also allows insurance companies to offset their claims payment liabilities and, as a result, ultimately reduce the insurance premiums they charge. Viewed in a vacuum, subrogation appears to be a win for all parties.

Unfortunately, subrogation can be an unwelcome obstacle for policyholders and insurance companies alike. Somewhere along the way, subrogation seems to have lost much of its equitable underpinning. Today, subrogation often creates conflict, additional transactional costs and unnecessary hurdles during the claims process. Indeed, most property and casualty and health insurance companies have dedicated subrogation claim units focused on subrogation recoveries and third-party litigation.

The following are key issues with subrogation that may hinder a policyholder's recovery, as well as steps policyholders can take to improve the claims process when subrogation may be involved:

Common Issues with Payout Terms

Subrogation frequently arises with insurance claims involving bodily injuries and property damage. Many subrogation claims arise under CGL and first-party property insurance products, including those that provide time element coverage. Subrogation claims (and disputes) also increasingly arise in the context of other insurance products, including cyber insurance and commercial crime insurance policies/financial institution bonds.

One key issue with subrogation arises when the policyholder gets less from an insurance payout than the total loss suffered. Some subrogation provisions in insurance policies provide a clear roadmap for the formula and sequence of recoveries when the policyholder's loss exceeds the amount of the insurance company's claim payments. Other clauses are not as clear and do not always provide express protection for policyholders when subrogation efforts are undertaken before the policyholder is fully recompensed for its loss amount. One such problematic clause reads as follows:

In the event of any payment under this Policy, the Insurer shall be subrogated to all of the potential

or actual rights of recovery of the Insured against parties that are not an Insured under this Policy. The Insured shall execute all papers required and will do everything necessary to secure such rights, including but not limited to the execution of such documents as are necessary to enable the Insurer to effectively bring suit in their name and will provide all other assistance and cooperation which the Insurer may reasonably require.

Language like this can lead to a dispute over the priority of recoveries in subrogation. Can the insurance company lay claim to recoveries from a third party where the policyholder has not been fully reimbursed for its loss?

In one recent case involving a cyber insurance claim, National Union Fire Insurance Co. v. RealPage Inc., a hacker stole $10 million from an account that included rent payments and transaction fees from RealPage's landlord-clients. The insurance company (AIG) only paid approximately $1 million, in keeping with the insurance policy terms, but law enforcement efforts were able to recover $2 million of the remaining stolen funds. Rather than allowing those sums to flow to the policyholder, AIG instead attempted to claim $1 million of those funds to offset its claim payment, even though the policyholder's loss was well above what AIG had covered.

The trial court refused to find that the policy's subrogation recoveries language allowed AIG a hand in uncovered losses, even though the insurance policy had a broadly worded subrogation clause that AIG argued entitled it to any recoveries, even where just a fraction of the loss was covered by the insurer. Instead, the court found that the policy's phrase "'any recoveries' means amounts received in restoration of a loss that results from an occurrence covered by the policy." The court ultimately ruled that construing the phrase "any recoveries" to include money recovered from the cybercriminal that were not within the insurance coverage scope paid by the insurer would be improper.

The Made-Whole Doctrine

The "made-whole" doctrine is a principle affirming that the insurance company does not get to subrogate and recover money it has paid for the insurance claim until the policyholder is made whole for its loss. It may also affect the timing of recoveries in subrogation. Adhered to in varying degrees by courts in many states, the doctrine is a protection for policyholders and limits the amount of money an insurance company can keep for itself after a recovery in subrogation.

For example, New York courts have held that a policyholder may seek disgorgement of its insurance company's recovery in subrogation if that policyholder has not been made whole and the tortfeasor lacks the funds to pay the policyholder the amount owed. In Ehrlich v. American International Group Inc., the court held that AIG could not retain a portion of the recovery on the basis that insurers should not benefit from subrogation until the insured has been "made whole" for their losses.

As the court explained, "if a policyholder suffers $200 of losses, only $100 of which are insured, and the [insurance] carrier pays out the policy limit of $100 and then recovers $100 from the tortfeasor, that subrogation recovery can be disgorged by the policyholder if the tortfeasor lacks the funds to

compensate the policyholder for its $100 of uninsured losses."

Third-Party Involvement

Another complication arising from subrogation is the ability, or lack thereof, to settle with one or more parties to a calamitous event. Subrogation claims can arise when numerous third parties and their respective insurance companies are potentially liable. If the policyholder seeks claim payments from those other culpable parties, those entities and individuals likely will seek releases in exchange for their settlement payments.

However, many subrogation clauses state that the policyholder shall do nothing to "impair" insurance company rights of subrogation. As such, these clauses can hinder settlement efforts and place the policyholder in the position of forced and prolonged litigation with third parties rather than receiving prompt settlement payments that bring the policyholder closer to recouping its losses from all viable sources.

Additional Litigation and Indemnity Claims

Insurance company subrogation may also lead to additional litigation and indemnity claims for policyholders. For example, if the tortfeasor that caused the covered loss has a contract with the policyholder, that contract may call for the policyholder to indemnify the tortfeasor—even for the tortfeasor's own negligence. Setting aside whether such broad-form indemnity clauses are even permissible in the given jurisdiction, robust litigation could ensue where an insurance company pursuing subrogation against the policyholder causes the tortfeasor to claim indemnity rights against the policyholder for the subrogating insurance company's litigation.

In this case, is the policyholder now back to presenting another claim to its insurance company or companies? Does it incur new deductibles? Will the tortfeasor's indemnity claim be accepted for coverage by the insurance company in the first place? Simply put, subrogation litigation can beget more litigation and insurance claims. Additionally, even without contractual indemnity provisions, a party sued in subrogation simply may try to bring the policyholder into the insurance company's subrogation action for contribution claims or claims based upon comparative negligence theories.

Steps Policyholders Can Take to Protect Themselves

If an organization is faced with a subrogation situation, it can take the following steps to boost the odds of a favorable outcome:

- Know the law of your preferred forum to determine whether the made-whole doctrine protects policyholders against aggressive moves by a subrogating insurance company.
- Review insurance policy provisions for subrogation and transfers/assignments of rights and assess whether they are sufficiently clear and whether they explicitly override the made-whole doctrine.

- Document the full extent of uncovered losses and track what categories of claim payments the insurance company is covering and those that they are rejecting.
- Be very careful in accepting a claim payment. Look for releases or waivers before you sign any agreement or subrogation receipt.
- Consider waiver of subrogation clauses at the point of insurance policy purchase and renewals. It may be worth the additional premium to preclude subrogation suits.
- Consider joint prosecution agreements or agreements to jointly subrogate alongside your insurance company. Make sure the agreements are reasonable and accomplish your claim goals to be made whole. Otherwise, you are merely swapping one set of contractual problems for another.

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