Volume 29, Number 12
Cases Decided through July 15, 2007 Recent Developments of National Significance

INSURANCE LITIGATION Reporter™

CONTENTS

(Continued on Inside Page)

THOMSON
WEST

INSURANCE SURBROGATION: NEXT PAGE

that the follow-the-fortunes doctrine requires that courts turn a blind eye to such manifest manipulation of the allocation process in total disregard of the reinsured's obligation to act in good faith."

Comment

While courts are generally prone to enforce a follow-the-fortunes provision to prevent a reinsurer from re-litigating coverage issues, they do refuse to enforce such provisions if there is clear evidence that the reinsured had acted unreasonably or in bad faith in paying claims on the underlying coverage, and typically evaluate the applicability of the doctrine based upon the manner in which claims were investigated and paid on the underlying coverage. The focus of the inquiry here, however, was upon the inconsistent positions taken by the reinsured with its insured and its reinsurers on the loss allocation issue. The appellate panel clearly was troubled by the undeniable fact that American Home had used two inherently inconsistent allocation methodologies for the self-serving purpose of minimizing its liability to its insured on the one hand, and maximizing its reinsurance recovery on the other. Describing American Home's conduct as a "manifest manipulation" of the process, the appellate court refused to use the follow-the-fortunes doctrine to condone and reward American Home for such conduct. // Goss

Subrogation

Texas Supreme Court Refuses to Apply "Made Whole Doctrine" to Contractual Subrogation Claims

Valid Statutory and Regulatory Subrogation Rules Trump Contractual Subrogation, and Contractual Trumps Equitable Subrogation

Fortis Benefits v. Cantu, ____ S.W.3d ____, 2007 WL 1861000 (Tex. June 29, 2007)

Case at a Glance

The three varieties of subrogation—equitable, contractual, and statutory—represent three separate and distinct rights that, while related, are independent of each other. Contractual subrogation rights derive from the parties' agreement, and the parties are free to contract out of the equitable principle that the insured must be made whole before the insurer may enforce its subrogation rights.

Summary of Decision

Facts. Vanessa Cantu suffered serious injuries in a car wreck. Fortis Benefits, her health insurer, paid \$247,534.14 in medical expenses she incurred as a result of the accident. When she later sued the driver of the vehicle in which she was riding, his employer, the vehicle seller, and Ford, the vehicle's manufacturer, Fortis intervened, asserting a subrogation right under its policy. After settling her liability claims for \$1.445 million, Cantu and Fortis disputed what portion of the settlement proceeds, if any, should go to Fortis. At the time of the settlement, Cantu's past medical expenses totaled \$378,544, and two "life care plans" estimated her future medical expenses at between \$1.7 million and \$5.3 million. On this basis, Cantu argued that her total damages resulting from the car wreck exceeded by a considerable degree what Fortis had paid. She argued that she had a right to be made whole before the insurer could recover anything. This is the doctrine that subrogors must be "made whole" before subrogees are entitled to recovery.

Procedure. The trial court granted summary judgment to Cantu on Fortis's subrogation claim. Fortis appealed. A divided court of appeals affirmed. *Fortis Benefits v. Cantu*, 170 S.W.3d 755 (Tex. App.—Waco, 2005). The Texas Supreme Court unanimously reversed the decisions of the lower court with respect to the "Made Whole Doctrine." (There was another irrelevant component regarding Ford Motor Company. Nothing need be said abut this aspect of the case. It is nothing but a straightforward, simple application of the court's new doctrine.)

Reasoning. The lower courts had sided with Cantu based on the Texas Supreme Court's previous decision in *Ortiz v. Great Southern Fire & Casualty Insurance Company*, 597 S.W.2d 342 (Tex. 1980). In *Ortiz*, this court had held that "an insurer is not entitled to subrogation if the insured's loss is in excess of the amount recovered from the insurer and the third party causing the loss." The reasoning of the court then was that subrogation was designed to prevent an insured from obtaining a double recovery—one from the insurer, and then one from the injury-causing third party. The logic of the Texas Supreme Court in *Ortiz* was: "'When either the insurer of the insured must to some extent go unpaid, the loss should be born by the insurer for that is a risk the insured has paid it to assume.'"

In the *Cantu* decision, the Texas high court identified three forms of subrogation: equitable, contractual, and statutory. These three forms result from the three ways the rights of a subrogee can be created. Justice Willett, writing for the court, says that the rule in *Ortiz* would govern, if present case were a case of equitable subrogation. It is not. It is a case of contractual subrogation. Fortis is asserting its subrogation rights pursuant to clauses in its insurance contract with Cantu. One of them was entitled "Subrogation Right." It stated that Fortis "will be subrogated to *all* rights of recovery of a Covered Person may have against any personal organization. This included, but was not limited to, rights an insured might have against a third-party, rights against liability coverage, and rights against UM/UIM recoveries. These rights extended to the proceeds of any settlement or judgment[.]" This section of the policy goes on to say that if the insurer is precluded from exercising its subrogation rights, it "may exercise [its] right of reimbursement." The policy's "Right of Reimbursement" clause states that if the insured pays benefits and if the insured recovers in any way against someone who injured him, the insurer has the right to recover the amount of the benefits paid from the insured who makes the recovery. This right includes recoveries against the liability coverage of third parties.

Justice Willett explained the "Made Whole Doctrine" set forth and defended in *Ortiz* does not extend from equitable subrogation to contractual subrogation. In *Fortis* the Texas Supreme Court rejected the idea that "equitable and contractual subrogation rest upon common principles[.]" The reason was quite simple. "[C]ontract rights generally arise from contract language; they do not derive their validity from principles of equity[.]" They derive their validity "directly from the parties' agreement." Insurance policies are contracts. As a result, they declare "the parties' rights and obligations, which are not generally supplanted by court-fashion equitable rules that might apply, as a default gap-filler, in the absence of a valid contract."

The most intriguing point Justice Willett makes is somewhat different. He observes that if equity were the origin of all subrogation rights, "then an contract subrogation agreement would be superficial and serve only to acknowledge this pre-existing right[.]" The court expressly rejected this position. Besides, even if it were true that all rights of subrogation results from equity, if an insurance contract contains a right of reimbursement clause like the Fortis contract, the insurer's rights to obtain the amount it paid would be established by contract. Thus, contract would again trump equities of the subrogation. "Contractual subrogation clauses expressing the parties' intent of reimbursement should be controlled by agreed contract terms rather than external rules imposed by courts."

Even the United States Supreme Court has endorsed this view in the context of ERISA litigation. *Sereboff v. Mid Atlantic Medical Services, Inc.*, __ U.S__, 126 S.Ct. 1869 (2006). In *Sereboff*, the high court "refused to apply the 'made whole' doctrine, deeming that the [insureds'] equitable defenses 'beside the point' because Mid Atlantic's subrogation claims arose by written agreement." Cantu argued that the decision in *Sereboff* was irrelevant to her case, because the other case was decided under ERISA.

Justice Willett, however, found this a poor argument since the argument of the U.S. Supreme Court hinged on contract jurisprudence, not upon ERISA statutes.

According to the Texas Supreme Court, litigants, insureds, and lawyers, must recognize that the three varieties of subrogation, "while related, are independent of each other." At the same time, they must recognize that "[i]ndependent . . . does not mean co-equal." Observers should remember that courts adhere to the maxim *Equity Follows the Law.* This rule "requires equitable doctrines to conform to contractual and statutory mandates, not the other way around." In addition, the Texas Supreme Court, and therefore the remainder of the Texas judiciary, embraces the idea that there is "'a strong public policy in favor of preserving the freedom of contract.'" *Lawrence v. CDB Service, Inc.*, 44 S.W.3d 544, 553 (Tex. 2001) (citing *Wood Motor Co. v. Nebel*, 238 S.W.2d 181, 185 (Tex. 1951). The idea of freedom of contract entails that "a court should not by judicial fiat insert non-existent language into statutes or into parties' agreed-to contracts, or delete existent language from them either. Our duty is to construe the contract as it is, and holding that equitable considerations trump contrary contract terms would render contractual subrogation a nullity." Consequently, the parties to an insurance policy are "free to negate the 'made whole' doctrine contractually, and to do so before an event occurs that triggers medical benefits under the policy.

The Texas Supreme Court had previously recognized the importance of reimbursement in contracts of insurance. This is something that "insurers are well equipped to evaluate and [which they may use to] reduce risk[.]" *Texas Ass'n of Counties, County Government Risk Management Pool v. Matagorda County,* 52 S.W.3d 128, 136 (2000). The Texas Supreme Court noted in *Matadorda County* that "the presence or absence of a reimbursement clause in the insurance contract could affect the premium charged," and for this reason such clauses must be regarded as significant. They certainly "cannot be deemed illusory."

The court rejected Cantu's contention that contractual subrogation clauses or reimbursement clauses in insurance contracts violate Texas public policy. The court stressed that public policy is to be found in state statute and in the administrative rules formulated by those branches of government that have regulatory responsibilities. The court found no statutes and no rules formulated by the Texas Department of Insurance which support the idea that the "Made Whole Doctrine" applies to insurance across the board. If the contract language to be found in insurance policies is to be abrogated, the court reasoned, it is far more appropriate that the Department of Insurance do it than that the court do it. *Members Mutual Insurance Company v. Cutaia,* , 476 S.W.2d 278, 281 (Tex. 1972).

Thus, as a general point, the Texas Supreme Court agreed with other courts that "contract-based subrogation rights should be governed by the parties' express agreement and not invalidated by equitable considerations that might control by default in the absence of an agreement." The court rejected the view that if insurance policies are contracts of adhesion where there is little negotiating room, then they must be automatically subject to equitable principals. First, "adhesion contracts are not automatically unconscionable or void." *In re Oakwood Mobil Homes, Inc.*, 97 S.W.2d 571, 574 (Tex. 1999). "Nor is it per se unconscionable that an insurer would seek to reduce its risk and boost its solvency by including a subrogation and/or reimbursement clause." When these general principles are applied to the Fortis-Cantu insurance contract, clearly "Fortis retained an unfettered right to recover what it paid, subject to the amount of the insured's recovery."

Comment

This decision in this case is revolutionary. Most subrogation cases involve insurance companies recovering in legal actions using the names of their insureds. Frequently the suits are tort suits, and the insurers think of themselves as paradigmatic "Good Samaritans" that should be compensated for their helpfulness by those who caused the injuries of their insureds. So far so good. Indeed, the Good Samaritan Analogy is frequently used in law school teaching and insurance CLEs.

But what if the Good Samaritan Insurance Company (GSIC) has not compensated the insured for the entirety of his injuries? This is not to say that GSIC has dodged payments it should have made under the policy. Suppose it simply ran through coverage limits. Who should be compensated first: the injured or the bill-paying insurer? There is a good argument that the first monies recovered from the legally responsible party should go to the injured insured. First, he sustained the injury for which he has not yet been fully compensated. Second, insurance companies are in the business of paying injured people for their injuries or paying others for the treatment and care of injured people. A social justification of insurance is to help the wounded, the injured, and the damaged. Why should the interests of the insurer take precedence over that of the un-fully-compensated injured?

From the point of view of social utility, welfare, and community, it should not. Indeed, for more than a few years, this is exactly how it has worked. The partly uncompensated insured came first, up the extent of his injuries. (Of course, although this prose is written in the masculine, it applied to women as well as men, and more significantly, it applied to constructed entities as well as people.) It did not matter much what the policy of insurance said about subrogation. What mattered was tradition and social justice vis a vis injury-compensation.

That tradition has now been destroyed in Texas. If a contract of insurance clearly states that the insurer comes first with respect to recoveries, then it does! If the contract is clear, the traditional "Made Whole Doctrine," which favors injured insureds, is dead and gone.

In the abstract, of course, this jurisprudence and political philosophy are themselves old and honorable. First, freedom of contract is one of the foundations both of capitalism and of our democratic society. Second, a contract-party's taking responsibility for the wording of a contract affecting him by creating rights and obligations is a cornerstone of our society's conception of the dignity of man.

The trouble with this idea is that it is ideology, not sound jurisprudence. As an empirical matter, it is at least unrealistic and probably naïve. People usually don't actually read their insurance policies. Almost nobody reads all parts of every one. Even fewer if they read anything, they read the binder or the dec page. Even if they do read them, many people do not understand them. This is especially true of the "back" pages of the policy where the subrogation clauses be to be found. The point is stunningly true of health insurance policies, where insureds—particularly those who are members of groups—never see the actual policy.

But wait! There is hope, even in the decision under discussion. The court implies, virtually says, and unmistakably hints that its ruling can be altered or abridged—in effect, struck down—by either the legislature or (more likely) the Texas Department of Insurance. After all, statutory-and/or-regulatory subrogation rules trump both contract-based and equity-based subrogation. (Regulatory work is probably to be preferred here. The Insurance Department is "in session" all the time, while the legislature regularly meets only once every two years; it is then very busy; it gets little done; and it is heavily and intensely lobbied. Also, in truth, most delegates of whatever sort know next to nothing about insurance. In contrast, the Texas Department of Insurance specifies for many insurance contracts of this sort what must and must not be contained therein.)

Now for some discussion of the court's legal reasoning. First, one argument depends of the use of the proposition *Equity Follows the Law.* It is true, of course, that this sentence is one of the traditional maxims of equity. It is not true that this maxim is universal and absolute. Traditionally, equity could be used to correct, adjust, or get rid of common law that was worthless, injurious, unclear, and so forth. It didn't and doesn't always and under all circumstances subordinate itself to the common law. This observation is true of all the maxims of equity. Legal evolution and progress may depend upon the tentativeness of this maxim. (Consider the following judicial evaluatory remark made thirty years ago. "It is bromidic to say that equity follows the law. But if there be any chemistry left in this maxim[,] then. . . ." *Medical Branch at Galveston v. United States,* 557 F.2d 438, 451 (5^{th} Cir. 1977)(Goldberg, J.) See Darien Shanske, *Four Theses: Preliminary to an Appeal to Equity,* 57 STANFORD L. REV. 2053 (2005), for a historical-jurisprudential-philosophical-scholarly discussion with lots of footnotes. Here is the opening sentence: "Clarity on the meaning of equity is a precondition for an appeal to equity—or at least it ought to be.")

The established common law the Texas Supreme Court relies upon is this: *Every party to every contract has read the entire contract, understood every word of it which is understandable, exercised choice about what will be contained therein, and is therefore bound by the terms of that contract, so long* *as it is otherwise valid.* It is true, of course, that many courts rely on a principle like this one, while avoiding actually asserting it in the absolute and universal form used here. It is also true that many trial courts try to avoid forcing the use of this principle when a lengthy form contract drafted by one of the parties only is at stake, and it is further true that such courts are often assisted obliquely by appellate courts at various levels. Given the behavioral flexibility of the common law, when it comes to the realities of the legal world, it was not jurisprudentially necessary to wipe out the power of equitable tradition when it came to ignoring the literal meaning of at least some subrogation clauses in contracts of insurance. The tendency in common law is at least a century old in the English-speaking world, and it would have constituted a very small exception to the general principle of contract law used by the court and stated above.

Second, in a footnote the court asserts that the kind of exception set forth in the previous paragraphs may be utilized only if the provision in the contract is "unconscionable." It gives no binding precedent and no argument. It is certain that the language of the provision is not on its face outrageously immoral; on the other hand, it flies in the face of pretty much (although not exclusively) established norms and rules of the established legal world. Perhaps it is something like "unconscionable" for an insurer to insert the kind of strict language Fortis used without warning the insureds of what it takes the meaning of the subrogation clause to be.

Third, the court argues that if its view were not accepted then the subrogation provisions contained in insurance policies would be unnecessary and redundant. Personally, I have often wondered why they are there. They are completely unnecessary, from the point of view of the formerly established norms and customs. They have been useful a number of times to me, however, when representing an insurer in a subrogation squabble with a business insured, when it thinks it should get all the money out of the subro-suit—"After all," says the risk manager, "you are using our corporate name and the damage was done to us." My client and I would then rely on the explicit subro-clause in the policy, and work out a agreement. (Admittedly, I sometimes felt that we were counting on the lack of knowledge in the risk management department and in the office of the general counsel. "Shouldn't we educate them?" I asked myself. Then again, I would say to myself, "It is usually better for the insured for us to control this type of litigation and for everyone involved to believe that we had a right to various forms of cooperation—people, documents, and so forth.")

So what might happen next? Seven points can be made quickly and easily. First, the Fortis subro-clause together with its adjacent reimbursement clause are clearer and tougher, from the point of view of the insured, than subrogation clauses usually are. Hence, it likely that there will be a good deal of litigation interpreting "weaker," vaguer, or less clear clauses than that of Fortis. Second, there will attempts by insurers to get the Department of Insurance to approve its clause for them and for various forms many use.

Third, the Texas Department of Insurance will consider what to do, independent of any such applications. In fact, it is very likely that discussions have already begun. There will be a substantial amount of controversy within the Department as to whether to prohibit subro-clauses of the type resembling that used by Fortis, insofar as it can under state law. My bet is that it will do exactly that. After all one of its primary functions is to protect the insurance consumer. Is there any chance the legislature will try to "over rule" the Department? Obviously, it can. Statutory subrogation trumps regulatory subro. At least one bill will likely be introduced into the legislature. It will probably not pass. If the rule in *Fortis Benefits* becomes law across the board for all Texas insurance policies, will that affect the price of insurance? Is should—a few cents here and a nickel or two there—but noticeable change is unlikely.

Fourth, some insurers will make policies available which clearly adopt the "Make Whole Doctrine"? The answer is almost certainly affirmative. The immediately related question is this: "Will this increase the price of the policies?" "Will the Texas Department of Insurance let this happen?" The answer to both these questions is "Yes." Now, the next question is, "By how much?" There will be interesting discussions of this, and the answer is too unknowable to justify any speculation now.

Fifth, will at least some insurer make endorsements available for purchase that strike "Fortis Clauses" and substitute "Traditional Subro Clauses"? The answer is again yes. And insurance intermediaries should emphasize them for customers.

Sixth, assuming that such endorsements become available and assuming that "Fortis Clauses" are not outlawed by the Department might it require that insurance intermediaries present them to every purchaser of insurance, explain them, and require purchaser who do not get them to sign something—rather like UM/UIM coverage. This could happen, but I bet it will not. It's too complicated.

Seventh, and last, will the spread of "Fortis Clauses," if it happens, encourage insurance purchaser to buy policies with larger limits, so that they are likely to have sufficient coverage? The answer should be "Yes," if economic rationality claims are really true and the prices of policies are carefully and reasonably administered. Still, it won't happen, and it would be interesting to explore why not. // Quinn

Mississippi Supreme Court Rejects Tortuous Interference Claims against Insurer Based on Insurer's Assertion of Equitable Subrogation Claim

Plaintiff Suffered No Damages

McCord v. Healthcare Recoveries, Inc., __ So.2d __, 2007 WL 1366266 (Miss. May 10, 2007)

Case at a Glance

In *McCord v. Healthcare Recoveries, Inc.* (HRI), the Mississippi Supreme Court examines whether an insurer and contractor engaged in tortuous intereference by asserting an alleged contractual right to subrogation and whether the defendants' claim of equitable subrogation constituted tortuous interference under Mississippi law. Courtney Jo Ashmore McCord filed suit against HRI claiming that HRI tortiously interfered with the attempted disbursement of settlement proceeds to her arising out of an accident in which she was injured and also alleging that HRI had no valid subrogation rights to McCord's settlement proceeds. The lower court denied McCord's claims and held that the actions of HRI were not improper and that McCord failed to prove that she suffered harm or injury in the ultimate settlement of the case by HRI's activities during the negotiation process. The Mississippi Supreme Court agreed, holding that the lower court judge did not err in holding that HRI did not tortiously interfere with McCord's settlement by incorrectly asserting contractual subrogation because McCord suffered no damages. The Supreme Court further ruled that HRI's belief that it had a valid claim of equitable subrogation was plausible. Seeing no abuse of discretion on the part of the lower court, its judgment was affirmed.

Summary of Decision

In July of 1995, Courtney Jo Ashmore (Courtney) was injured when her all-terrain vehicle struck a wire cable which had been strung across the road by an adjacent landowner. Courtney suffered severe injuries and incurred substantial medical bills. A minor at the time of the accident, Courtney was covered under her step-father's health plan provided by his employer. The insurer paid benefits to Courtney's family under this health plan and ultimately assigned the claim to HRI, a recovery service which identifies potential subrogation claims for the insurer.

Courtney's mother hired an attorney to represent her minor child in a personal injury claims against the landowner that strung the wire cable across the road. In March of 2006, Courtney's lawyer wrote a letter to the health insurer requesting copies of her medical records and requesting that HRI "let him know the amount of its subrogation lien." HRI responded with a letter stating that the health plan had subrogation recovery rights pursuant to its contract with the insurer and that it had the right to be reimbursed by Courtney in the event that any compensation is received by her. HRI continued to represent to Courtney's attorney that it had a contractual right to subrogation for the benefits paid under the health plan and asserted a $26,222.79 subrogation lien. Finally, in December of 1996, Courtney's lawyer was informed that the plan covering Courtney's accident did not contain an express subrogation clause. HRI, however, advised the attorney that it was relying upon the doctrine of equitable subrogation recognized under Mississippi law.

In due course, an apparent settlement was reached on Courtney's personal injury claim. A guardian ad litem was appointed for Courtney and a hearing date set for approval of the settlement. The lower court ordered the sum of $26, 222.79, representing the amount of medical expenses, to be