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Subrogation

UNDER SOUTH DAKOTA LAW, AN INJURED INSURED IS NOT ALWAYS ENTITLED TO FULL COMPENSATION FOR INJURY BEFORE AN INSURER THAT HAS PAID SOME COMPENSATION IS ENTITLED TO RECOVERY THROUGH **SUBROGATION**

*The "Made Whole Doctrine" Does Not Necessarily Apply to **Subrogation** Based Upon Contract Terms, as Opposed to Equity*

Met Life Auto and Home Ins. Co. v. Lester, 719 N.W.2d 385 (S.D. 2006)

Quinn

Case at a Glance

A homeowners policy provision stating that, if the insurer paid for damage or injury, the insured's right to recover from others who caused the damage or injury belonged to insurer up to the amount paid created a right to **subrogation** and entitled homeowners insurer to recover amount paid for damage to a wall, regardless of whether the insured has been made whole. Under South Dakota law, the "Made Whole Doctrine" favoring insureds in **subrogation** matters does not automatically apply to **subrogation** based upon contract language.

Summary of Decision

Facts. On April 20, 2004, Weter backed his car into a brick wall owned by Lester. USAA Casualty Insurance Company insured Weter, while Met Life insured Lester.

Lester sought compensation from USAA. He also filed a claim with Met Life. A Met Life adjuster valued the claim at \$3,685.18. Lester had a \$1,000 deductible, and so Met Life issued him a check for \$2,685.18. Met Life sent a "First Notice of Claim" to USAA requesting the amount it paid. This lawsuit is about that 2,600+ dollars and nothing much else, except the jurisprudence of insurer **subrogation**. (One suspects the latter is what's really important.)

Lester estimated his damages as more than Met Life paid. He filed a small claim against Weter. USAA defended Weter, and the case was removed to circuit court. There was a settlement conference. USAA agreed to settle for \$9,000. It was concerned about the "Notice" from Met Life, so it paid \$6,314.82 to Lester, and put \$2,685.18 into the possession of the court clerk. The circuit court approved the settlement arrangement, Met Life sought distribution to it of the money in possession of the court clerk.

The established law of **subrogation** in South Dakota is that the terms of a relevant contract would control at least who would participate in a legal recovery and in what percentages. Under established South Dakota law, the policyholder is not automatically entitled to full compensation before his insurer has a right to recovery based upon **subrogation**. When **subrogation** is based upon contract, who has what rights will depend upon the wording of the contract. South Dakota law does not subscribe to the view that an insured must be made whole before the insurer may recover based upon **subrogation**. As between the insured and the insurer, who has what right depends upon the wording of the contract, at least under South Dakota law. *Westfield Ins. Co. v. Rowe*, 631 N.W.2d 175 (S.D. 2001) and *Julson v. Federated Mut. Ins. Co.*, 562 N.W.2d 117 (S.D. 1997).

The Circuit Judge who decided the underlying case read the insurance contract in such a way that it did not negate or override the "Made Whole Doctrine." Consequently, the Circuit Judge ordered the money to be disbursed to Lester. Met Life appealed. [Why? one might ask. For the money? Doubtful.]

Appellate Issues. There were two issues. One pertained to jurisdiction, and the other pertained to the correct interpretation of the **subrogation** language of the Met Life policy. It was obvious that the South Dakota courts had both subject matter jurisdiction over the issue and personal jurisdiction over Met Life. The Supreme Court said little about the issue, since the answer was so obvious, and nothing further needs to be said here.

The issue regarding **subrogation** is quite different. The doctrine of **subrogation** under South Dakota law has two different foundations: one is equity, and the other is contract. This proposition is pretty much true all over the country. In insurance matters, rights of **subrogation** are at least principally contractual, at least in South Dakota, since **subrogation** explicitly comes up in insurance policies as a matter of routine. Equitable versus contractual **subrogation** rights are elsewhere not usually sharply divided. In practice, they are treated as overlapping, even if they are conceptually distinguishable and in prose actually separated, though usually in passing.

Generally speaking, insurance policies do not say anything about an insured having any right to be made whole, before the insurer is compensated for sums it has paid the insured. Consequently, whether the "Made Whole Doctrine" applies under any given circumstances depends upon how the policy language is thought about and interpreted. This is a legal matter, of course, not a factual matter. This proposition is true even though common law contained the "Made Whole Doctrine" clearly and straightforwardly.

In the *Westfield* case, the South Dakota Supreme Court came to this decision on the basis of the following language: "If we [the insurer] make a payment under this policy and [t]he person to or for whom payment was made has a right to recover damages from another, we shall be subrogated to that right[, and if t]he person to or for whom payment is made recovers damages from another, that person shall (1) hold in trust the proceedings of the recovery, and (2) reimburse us to the extent of our payment." Significantly, there is no language in that clause which overtly and explicitly endorses the "Made Whole Doctrine."

The language in the Met Life policy involved here was similar. It read as follows: "You must do everything you can to preserve your rights of recovery. When we have paid you for your damage or injury, your right to recover from others who caused the damage or injury will belong to us up to the point we have paid you for the damage or injury[.]" This language is somewhat similar to the just quoted language from *Westfield*, but in some ways it is different. There is no reference to any trusteeship, for example. The entry-level Circuit Court ruled that this language embraces the "Made Whole Doctrine," but the Supreme Court rejected this view and reversed.

The interpretation of contract language by a court is subject to *de novo* review by appellate courts. "Although the language in Met Life's policy is less legalistic than that in *Westfield*, it clearly and unequivocally creates a right to **subrogation**. As in *Westfield*, Lester can 'point to no language in the policy or statutory authority which restricts this right of **subrogation** to instances where the insured has been made whole.' The language of Lester's insurance policy clearly establishes contractual **subrogation** and controls the nature and terms of that **subrogation**."

Neither party before the court asked that its rulings in *Julson* and *Westfield* be reversed. [This fact alone, of course, could determine the result. Why didn't Lester ask exactly for this?] Moreover, *Westfield* is supported by public policy arguments. If this rule is to be changed, it should be done by the legislature, and the legislature has not done anything to suggest that the *Julson-Westfield* Rule rejecting the "Made Whole Doctrine" be done away with.

The judge who wrote the opinion was a Circuit Judge substituting in for a Supreme Court Justice, who was disqualified. Three Justices concurred in the opinion. One Justice dissented on the issues pertaining to **subrogation**. The "score," then, was 4-1.

Dissenting Opinion. As a matter of legal tradition, **subrogation** has its origin in equity. Because of this historical origin, "**subrogation** is subject to the principles of equity." These principles include the "Made Whole Doctrine." South Dakota's departure from this principle of equity is extremely rare and should be chucked. The dissenting Justice observed that the case before the court "presents a situation ripe for the application of the 'made whole' rule. The contract provision at issue here merely restates the equitable principle of **subrogation**[.]" The policy itself is completely silent about who should recover first—the insured or the insurer. "Because the contract provision does not unambiguously abrogate the [made whole] doctrine, the generally accepted, based-in-equity 'made whole' doctrine should apply. The 'made whole' doctrine is based on the theory that 'where the sum recovered by the insured from the tortfeasor is less than the total loss and thus, either the insured or the insurer must to some extent go unpaid, the loss should be borne by the insurer for that is a risk the insured has paid it to assume.' This logic is especially relevant here, in light of [South

Dakota's] well-settled rule of liberal construction in favor of the insured. Because the contract is silent regarding the 'made whole' doctrine, we should construe it in favor of Lester [, the insured]. The majority's decision does the opposite."

Comment

As the dissenting judge points out, South Dakota law with regard to the "Made Whole Doctrine" is in a tiny minority. Interestingly, the dissenting judge cites cases from Nebraska, Montana, and New York favoring the "Made Whole Doctrine." These are all highest court cases. Many other states fall into the majority. Texas has been like this for many years. *Ortiz v. Grt. So. Fire and Casualty Ins. Co.*, 597 S.W.2d 342, 343-44 (Tex. 1980). See *State Farm Mut. Auto. Ins. Co. v. Perkins*, 2006 WL 1914627, ___ S.W.3d ___ (Tex. App.- Eastland, July 13, 2006).

It is amazing the number of adjusters who are unaware of the prevalence and strength of the Made Whole Doctrine. Perhaps not as amazing, but certainly more widespread, are the number of lawyers who do not know anything about it.

Here is a malpractice rule for lawyers handling cases where **subrogation** is an issue. When the insurer and the insured are plaintiffs on the same side, insist upon a written agreement between the insurer and the insured regarding the "Made Whole Doctrine." If the insurer refused to enter into it, and the lawyer is representing the insured, consider bringing a declaratory relief action against the insurer early on. Discuss the options carefully with the client. Never simply agree, without such a discussion, to share recovery with the insurer in any way.

Occasionally, the insured may wish to give the insurer some sort of priority, or some sort of equal distribution. For example, if that is what it takes to get the insurer to pay most-or a substantial fraction-of the expenses of subsequent litigation, then this allocation may need to be done. However, the law needs to be carefully researched in advance.

In conceptual reality, the same is true in the case under discussion. The truth is that *Julson* could be interpreted to say that an insured is entitled to the Made Whole Doctrine if he proves that a payment to the insurer that covered him would leave him less than whole. The *Westfield* case simply says that **subrogation** rights "may arise independent of the common law 'made whole' doctrine." Notice the word *may*. Furthermore, the key policy-contract language in this insurance contract in this case, unlike the language quoted in *Westfield*, does not say how much the insurer gets or the order of distribution, and it does not impose a trust on the recovery.

In conclusion, it is worth noting that the majority cites an excellent "Student Article" discussing *Westfield*. It is a good place to learn a lot. See Eric Pickar, *Westfield Insurance Company, Inc. v. Rowe: The South Dakota Supreme Court Rejects the Common Law "Made Whole" Doctrine on a Property Insurance Claim*, 47 S.D.L.Rev. 316 (2002).

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