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**Insurance—Subrogation—A Subrogation Clause in a Health Insurance Policy Is Enforceable Even Though the Insured Has Not Been Made Whole. *Higginbotham v. Ark. Blue Cross & Blue Shield*, 312 Ark. 199 (1993).**

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INSURANCE-SUBROGATION-A SUBROGATION CLAUSE IN A HEALTH INSURANCE POLICY IS ENFORCEABLE EVEN THOUGH THE INSURED HAS NOT BEEN MADE WHOLE. *Higginbotham v. Arkansas Blue Cross & Blue Shield*, 312 Ark. 199 (1993).

## I. INTRODUCTION

The Arkansas Supreme Court held, in *Higginbotham v. Arkansas Blue Cross & Blue Shield*,<sup>1</sup> that a subrogation clause in a group health insurance policy entitled the insurer to subrogation despite the fact that the insured had not been “made whole” for his loss.<sup>2</sup> This decision departs from the court’s earlier view established in 1914 in *Cowling v. Britt*<sup>3</sup> and reiterated in 1980 in *Cooper Tire & Rubber Co. v. Northwestern National Casualty Co.*,<sup>4</sup> that subrogation is an equitable doctrine and that equitable principles generally govern its application. In *Higginbotham*, the court ignored the equitable doctrines that normally apply to subrogation cases and enforced a contract provision that provided for subrogation even before the insured had been made whole.<sup>5</sup> Although this approach departs from the traditional view of subrogation taken in Arkansas, it conforms to the more restrictive view of subrogation taken by the court in a line of cases interpreting medical insurance contracts and subrogation rights.<sup>6</sup> When it adopted this position, the Arkansas Supreme Court placed Arkansas in the ranks of the substantial minority<sup>7</sup> of jurisdiction that hold that the right to contract is superior to the equitable doctrines that traditionally govern subrogation.<sup>8</sup>

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1. 312 Ark. 199, 849 S.W.2d 464 (1993).

2. *Id.*

3. 114 Ark. 175, 183, 169 S.W. 783, 785 (1914).

4. 268 Ark. 334, 335, 595 S.W.2d 938, 939 (1980).

5. *Higginbotham*, 312 Ark. at 203, 849 S.W.2d at 466.

6. See *American Pioneer Life Ins. Co. v. Rogers*, 296 Ark. 254, 753 S.W.2d 530 (1988)(denying subrogation to health insurance carriers because the policy did not contain a subrogation clause); *Cooper Tire & Rubber Co. v. Northwestern Nat. Cas. Co.*, 268 Ark. 334, 595 S.W.2d 938 (1980)(holding that the insurer was not entitled to subrogation because the ambiguous language of the subrogation clause in the insurance policy required that it be construed in favor of the insured); *Shiple v. Northwestern Mut. Ins. Co.*, 244 Ark. 1159, 428 S.W.2d 268 (1968)(holding that subrogation clauses in health insurance policies are valid and enforceable); *Storey v. Arkansas Blue Cross & Blue Shield, Inc.*, 17 Ark. App. 112, 704 S.W.2d 176 (1986)(applying contract law principles to subrogation clauses in health insurance contracts).

7. Dino A. Ross, *Subrogation and the Right to First Priority in Settlement Proceeds*, 22 COLO. LAW. 71, 72 (1993).

8. *Higginbotham*, 312 Ark. at 203, 849 S.W.2d at 466.

In its broadest context, subrogation refers to the equitable right of a third party to exercise all the rights available to a particular creditor, to whom the third party has made payment on behalf of a debtor, against the debtor.<sup>9</sup> Clauses permitting subrogation commonly appear in insurance and construction contracts, and subrogation also appears in suretyship and negotiable instrument law.<sup>10</sup>

In the context of insurance law, subrogation allows an insurance company to pursue recovery from a third party who is or may be liable to the insured for the damages paid by the insurer.<sup>11</sup> Arkansas courts have recognized two basic doctrines of subrogation with respect to insurance law: conventional subrogation and subrogation by operation of law, also known as legal subrogation.<sup>12</sup>

Under the doctrine of conventional subrogation, an insurer's subrogation right arises from an express clause in the insurance policy or settlement agreement.<sup>13</sup> In contrast, the doctrine of legal subrogation is based solely on equitable principles due to the absence of any contractual provision, and it arises when an insurer, pursuant to an insurance contract, pays a claim owed by a third party.<sup>14</sup> The distinction between conventional and legal subrogation usually has no practical significance since the facts giving rise to legal subrogation are typically the same facts that entitle a person to claim the benefits of a contract clause providing for subrogation.<sup>15</sup> However, in some situations, such as the one that arose in *Higginbotham*, the distinction defines the rights of the parties.

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9. BLACK'S LAW DICTIONARY 1427 (6th ed. 1990). For example, when an automobile insurance company pays for the damage to an automobile caused by the negligence of another, the insurance company is entitled to collect the amount of its payment from the at-fault party or his insurance company.

10. *Id.*

11. GEORGE J. COUCH, COUCH ON INSURANCE § 61:1 (2d ed. 1983).

12. See *Rogers*, 296 Ark. 254, 753 S.W.2d 530 (1988); *Cooper Tire & Rubber*, 268 Ark. 334, 595 S.W.2d 938 (1980); *Shipley*, 244 Ark. 1159, 428 S.W.2d 268 (1968); *Baker v. Leigh*, 238 Ark. 918, 385 S.W.2d 790 (1965); *Federal Land Bank v. Richland Farming Co.*, 180 Ark. 442, 21 S.W.2d 954 (1929); *Southern Cotton Oil Co. v. Napoleon Hill Cotton Co.*, 108 Ark. 555, 158 S.W. 1082 (1913); *Storey*, 17 Ark. App. 112, 704 S.W.2d 176 (1986).

13. ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW § 3.10(a) (student ed. 1988). See also *Rogers*, 296 Ark. at 259, 753 S.W.2d at 533; *Cooper Tire & Rubber*, 268 Ark. at 335, 595 S.W.2d at 939; *Shipley*, 244 Ark. at 1162, 428 S.W.2d at 270; *Storey*, 17 Ark. App. at 113-14, 704 S.W.2d at 177.

14. COUCH, *supra* note 11, § 61:2; see also *Baker*, 238 Ark. at 923-24, 385 S.W.2d at 794 (quoting *Southern Cotton Oil Co.*, 108 Ark. 555, 158 S.W. 1082 (1913)); *Richland Farming Co.*, 180 Ark. at 445, 21 S.W.2d at 955; *Southern Cotton Oil Co.*, 108 Ark. at 558, 158 S.W. at 1083-84.

15. COUCH, *supra* note 11, § 61:2.

## II. FACTS

Scott Higginbotham (hereinafter "Higginbotham") sustained serious injuries in an automobile accident that resulted in multiple fractures of the left elbow, a fracture of the right pelvis, and a transverse fracture of the fifth lumbar vertebra.<sup>16</sup> Arkansas Blue Cross & Blue Shield (hereinafter "Blue Cross") paid his medical bills, totaling \$11,482.08, pursuant to his father's health insurance policy.<sup>17</sup> The policy contained a subrogation clause that entitled Blue Cross to repayment of the amount paid by it for medical bills in the event of recovery by the insured from a third party who caused the injury.<sup>18</sup> Higginbotham accepted a settlement offer from the tortfeasor's insurer, State Farm Mutual Insurance Company (hereinafter "State Farm"), for the tortfeasor's policy limit of \$25,000.00.<sup>19</sup> As part of the settlement, Higginbotham executed a release that relieved both State Farm and its insured from any further liability.<sup>20</sup>

Blue Cross demanded that Higginbotham repay the \$11,482.00 it had expended on his behalf, citing the insurance policy's subrogation clause as the basis for its claim.<sup>21</sup> Higginbotham refused and asserted that Blue Cross was not entitled to subrogation because the \$25,000.00 he received was not a sufficient sum to fully compensate his loss.<sup>22</sup>

Blue Cross filed suit to recover the \$11,482.00, and both parties filed summary judgment motions.<sup>23</sup> In support of his motion for summary judgment, Higginbotham included affidavits from trial lawyers estimating that his damages exceeded \$50,000.00.<sup>24</sup> Blue Cross argued that the affidavits raised disputed fact questions that would render summary disposition improper, but it asserted that the court

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16. Abstract and Brief for Appellant at 15, *Higginbotham v. Arkansas Blue Cross & Blue Shield*, 312 Ark. 199, 849 S.W.2d 464 (1993).

17. *Higginbotham*, 312 Ark. at 200, 849 S.W.2d at 465.

18. *Id.* The full text of the clause is as follows:

In the event any benefits or services of any kind are furnished to you or payment made or credit extended to or on behalf of any covered person for a physical condition or injury caused by a third party or for which a third party may be liable, the Plan shall be subrogated and shall succeed to such covered person's rights of recovery against any such third party to the full extent of the value of any such benefits or services furnished or payments made or credits extended.

*Id.*

19. *Id.* It is unknown whether the settlement agreement specified what the payment was for. *Id.* at 204, 849 S.W.2d at 467 (Brown, J., concurring).

20. *Id.* at 200, 849 S.W.2d at 465.

21. *Id.*

22. *Id.* at 200-01, 849 S.W.2d at 465.

23. *Id.* at 201, 849 S.W.2d at 465.

24. *Id.*

could grant its motion for summary judgment without using the affidavits by holding that Blue Cross was entitled to subrogation regardless of whether Higginbotham had been made whole.<sup>25</sup>

The trial court held that, although the \$25,000.00 did not fully compensate Higginbotham for his injuries, Blue Cross was entitled to subrogation under the terms of its contract.<sup>26</sup> The Arkansas Court of Appeals certified the case,<sup>27</sup> and the Arkansas Supreme Court accepted the case for review and affirmed the trial court's decision.<sup>28</sup>

### III. HISTORICAL DEVELOPMENT

#### A. The Development of Insurance Subrogation

The doctrine of subrogation evolved from general principles of equity.<sup>29</sup> Courts of equity developed subrogation to prevent the insured from recovering twice for the same injury<sup>30</sup> and to reimburse a surety<sup>31</sup> for the payments it made.<sup>32</sup> At its inception, the granting of a right to subrogation rested upon the principles of natural justice, not contract law.<sup>33</sup> Whether the doctrine of subrogation would be applied in a particular case was decided according to principles of equity, good conscience, and public policy.<sup>34</sup> Subrogation was not considered an absolute right, nor was it dependent upon a contract.<sup>35</sup> Instead, it was purely equitable in nature and would not be enforced when to do so would produce inequitable results.<sup>36</sup>

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25. *Id.*

26. *Id.*

27. *Id.* at 200, 849 S.W.2d at 465. The Arkansas Supreme Court's jurisdiction attached pursuant to the rule of Arkansas Supreme Court Procedure providing for the certification of a case from the Court of Appeals to the Supreme Court. The rule states that "[t]he Court of Appeals may certify any case appealed to the Supreme Court, if the Court of Appeals finds that the appealed case: . . . (b) involves an issue of significant public interest or a legal principle of major importance." R. SUP. CT. & CT. APP. OF THE STATE OF ARK. 1-2(d).

28. *Higginbotham*, 312 Ark. at 204, 849 S.W.2d at 467.

29. COUCH, *supra* note 11, § 61:20.

30. If the insured were allowed to recover from both the insurer and a third party, such as a tort-feasor, then this double recovery would occur. Subrogation prevents this.

31. A surety is one who is primarily liable for the debt or obligation of another. BLACK'S LAW DICTIONARY 1441 (6th ed. 1990).

32. COUCH, *supra* note 11, §§ 61:18, 61:20; *see also Shipley*, 244 Ark. at 1162, 428 S.W.2d at 270.

33. COUCH, *supra* note 11, § 61:20.

34. COUCH, *supra* note 11, § 61:20.

35. COUCH, *supra* note 11, § 61:20.

36. COUCH, *supra* note 11, § 61:20; *see also* 11 JOHN A. APPLEMAN & JEAN APPLEMAN, INSURANCE LAW & PRACTICE § 6502 (1981).

The historical application of these equitable principles to medical and health insurance contracts that did not contain express subrogation clauses generally resulted in a denial of subrogation rights.<sup>37</sup> Even the subrogation clauses contained in standard automobile insurance policies did not apply to medical payments coverage until 1958.<sup>38</sup> It was not until approximately ten years ago that standard health insurance policies began to include subrogation clauses.<sup>39</sup>

The question of whether subrogation clauses in medical and health insurance contracts will be enforced has spawned three distinct judicial viewpoints.<sup>40</sup> Many courts, including the Arkansas Supreme Court, have held that they are enforceable.<sup>41</sup> Other courts have held that such clauses are unenforceable on the theory that they violate rules against the assignability of personal injury claims.<sup>42</sup> Courts following a third approach have held that a traditionally phrased subrogation clause is enforceable against both the insured and a third-party tort-feasor, but that a clause purporting to grant rights in the proceeds of a settlement or judgment is only enforceable as if it were a claim to proceeds.<sup>43</sup>

Even in jurisdictions holding that subrogation clauses in medical and health insurance contracts are enforceable, equitable doctrines may be applied to protect the insured from unjust results.<sup>44</sup> Some courts accomplish this by applying equitable doctrines to determine the priority between the insured and the insurer in proceeds from settlements or judgments against a third-party tort-feasor.<sup>45</sup> Courts

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37. J. Kent Miller, *Subrogation: Principles and Practice Pointers*, 20 *COLO. LAW.* 11, 20 (1991).

38. *Id.*

39. *Id.*

40. KEETON & WIDISS, *supra* note 13, § 3.10(a)(7).

41. *See* Sentry Ins. Co. v. Stuart, 246 Ark. 680, 687, 439 S.W.2d 797, 801 (1969); *see also* Smith v. Travelers Ins. Co., 362 N.E.2d 264, 266 (Ohio 1977); Travelers Indem. Co. v. Vaccari, 245 N.W.2d 844, 846 (Minn. 1976); State Farm Mut. Ins. Co. v. Farmers Ins. Exchange, 450 P.2d 458, 459 (Utah 1969).

42. *See* KEETON & WIDISS, *supra* note 13, § 3.10(a)(7); *see also* State Farm Fire & Casualty Co. v. Knapp, 484 P.2d 180, 181 (Ariz. 1971); Peller v. Liberty Mut. Fire Ins. Co., 34 Cal. Rptr. 41, 42-43 (Cal. Dist. Ct. App. 1963); Travelers Indem. Co. v. Chumbley, 394 S.W.2d 418, 425 (Mo. Ct. App. 1965).

43. KEETON & WIDISS, *supra* note 13, § 3.10(a)(7). Clauses that purport to grant rights in the proceeds of a settlement or judgment are usually designed to circumvent rules prohibiting the assignment of personal injury claims. Because such a claim is enforceable only as a claim to proceeds, it is not enforceable as a claim against the tort-feasor for violation of the subrogee's rights by settling with the insured after notice of these rights. *Id.*

44. *See* Powell v. Blue Cross & Blue Shield, 581 So. 2d 772 (Ala. 1990); Morin v. Massachusetts Blue Cross, Inc., 311 N.E.2d 914 (Mass. 1974); Westendorf v. Stasson, 330 N.W.2d 699 (Minn. 1983).

45. *Powell*, 581 So. 2d at 776-77.

have developed five<sup>46</sup> approaches based on equitable doctrines to determine these priorities.<sup>47</sup>

The majority of courts follow an approach in which the insured is entitled to the proceeds up to the amount necessary to compensate him for any losses not paid by the insurer.<sup>48</sup> Whatever remains after the insured is made whole is then distributed to the insurer up to the amount paid by it pursuant to the contract.<sup>49</sup> Any excess is then paid to the insured so that any windfall is retained by the insured.<sup>50</sup>

The minority approach allows the insurer a priority claim to any proceeds collected from the third party.<sup>51</sup> This priority claim is limited to the amount paid under the insurance policy, and the insured retains all proceeds in excess of the amount paid by the insurer.<sup>52</sup> The insurer is reimbursed even if the insured has not been made whole for his injuries by the tort-feasor.<sup>53</sup> This approach is based on the premise that no inequity results from a contract freely

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46. Although Keeton only lists three in his text, two other approaches are outlined in a footnote. KEETON & WIDISS, *supra* note 13, § 3.10(b)(1), at 234 n.1.

47. KEETON & WIDISS, *supra* note 13, § 3.10(b).

48. KEETON & WIDISS, *supra* note 13, § 3.10(b); *see also* Powell, 581 So. 2d at 778; Allum v. MedCenter Health Care, Inc., 371 N.W.2d 557, 560-61 (Minn. Ct. App. 1985); Skauge v. Mountain States Tel. & Tel. Co., 565 P.2d 628, 632 (Mont. 1977); Wimberly v. American Casualty Co., 584 S.W.2d 200, 203 (Tenn. 1979); Rimes v. State Farm Mut. Auto. Ins. Co., 316 N.W.2d 348, 353 (Wis. 1982); Garrity v. Rural Mut. Ins. Co., 253 N.W.2d 512, 513-14 (Wis. 1977). For example, the insured incurs a \$100,000 total loss for personal injury sustained in a car accident. This \$100,000 figure is composed of medical bills, lost wages, any permanent or partial disability, and pain and suffering. Assume that \$50,000 of that figure is for medical bills which were paid in full by the insured's health insurer who retains a subrogation right pursuant to the policy. Assume further that the insured recovers \$50,000, the policy limit, from the tortfeasor. The health insurer would not be entitled to subrogation because the insured did not receive more than the amount needed to make him whole for the loss. His total loss was \$100,000 and his total recovery was \$100,000.

49. KEETON & WIDISS, *supra* note 13, § 3.10(b); *see also* Frost v. Porter Leasing Corp., 436 N.E.2d 387, 388-89 (Mass. 1982); Union Ins. Soc. v. Consolidated Ice Co., 245 N.W. 563, 564 (Mich. 1932); Thiringer v. American Motors Ins. Co., 588 P.2d 191, 193 (Wash. 1978)(en banc).

50. KEETON & WIDISS, *supra* note 13, § 3.10(b); *see also* Yorkshire Ins. Co. v. Nisbet Shipping Co., 2 Q.B. 330, 336 (1960).

51. Ross, *supra* note 7, at 72; *see also* Higginbotham, 312 Ark. 199, 849 S.W.2d 464 (1993); Culver v. Insurance Co. of North America, 559 A.2d 400, 403 (N.J. 1989); Peterson v. Ohio Farmers Ins. Co., 191 N.E.2d 157, 159 (Ohio 1963). Assume the same facts and dollar figures as in the previous example discussed *supra* note 48. Assume further that the insured recovers \$50,000, the policy limit, from the tort-feasor's insurer. The health insurer would be entitled to the entire \$50,000 received from the tort-feasor, as the insurer had paid \$50,000 in medical bills. This leaves the insured with nothing. This is the approach adopted by Arkansas.

52. KEETON & WIDISS, *supra* note 13, § 3.10(b).

53. KEETON & WIDISS, *supra* note 13, § 3.10(b).

entered into by the parties where the rights of each are clearly delineated.<sup>54</sup>

Three other approaches have been adopted by a few courts.<sup>55</sup> The first of these approaches is to pro rate the proceeds between the insurer and the insured based on the percentage of the total original loss for which the insurer indemnified the insured under the policy.<sup>56</sup> Courts following a second approach hold that the insurer owns the claim against the third party and is entitled to the full amount of the proceeds even if they exceed the amount paid by the insurer.<sup>57</sup> In the third approach, subrogation is rejected completely and the insured, as sole owner of the claim, is allowed to collect from both the insurer and the third-party tort-feasor.<sup>58</sup>

## B. The Development of Insurance Subrogation in Arkansas

The validity of subrogation clauses in medical insurance contracts in Arkansas was first upheld by the Arkansas Supreme Court in *Shipley v. Northwestern Mutual Insurance Co.*,<sup>59</sup> in which the court adopted the view that subrogation clauses in medical and health insurance contracts are valid and enforceable.<sup>60</sup> In *Shipley*, the insured, his wife, and two grandchildren were injured in a car accident caused by the negligence of another driver.<sup>61</sup> Even though Shipley's personal automobile policy provided for reimbursement of medical expenses

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54. KEETON & WIDISS, *supra* note 13, § 3.10(b); *see also Higginbotham*, 312 Ark. 199, 849 S.W.2d 464 (1993); *Powell*, 581 So. 2d 772, 784-85 (Ala. 1990)(Maddox, J., dissenting).

55. KEETON & WIDISS, *supra* note 13, § 3.10(b).

56. KEETON & WIDISS, *supra* note 13, § 3.10(b); *see also Dimick v. Lewis*, 497 A.2d 1221, 1224 (N.H. 1985); *Allstate Ins. Co. v. Clarke*, 527 A.2d 1021, 1024 (Pa. Super. Ct. 1987); *Scales v. Skagit County Medical Bureau*, 491 P.2d 1338, 1340 (Wash. Ct. App. 1971). Assume the same facts and dollar figures as in the previous example discussed *supra* note 48. Under this approach the health insurer would only be entitled to \$25,000 since the insured was only able to recover one-half of the value of the total loss from the tort-feasor, \$50,000 of a \$100,000 total loss.

57. KEETON AND WIDISS, *supra* note 13, § 3.10(b), at 234 n.1; *see Travelers' Ins. Co. v. Brass Goods Mfg. Co.*, 146 N.E. 377, 378 (N.Y. 1925). Assume the same facts and dollar figures as in the previous example discussed *supra* note 48. The health insurer would be entitled to the entire \$50,000 or even more if the tort-feasor's policy limits had been greater than \$50,000.

58. KEETON & WIDISS, *supra* note 13, § 3.10(b), at 234 n.1. Assume the same facts and dollar figures as in the previous example discussed *supra* note 48. The health insurer would be entitled to nothing and the insured would be entitled to \$50,000 or more if the tort-feasor's policy limits had been greater than \$50,000.

59. 244 Ark. 1159, 428 S.W.2d 268 (1968).

60. *Id.* at 1162, 428 S.W.2d at 270.

61. *Id.* at 1160, 428 S.W.2d at 269.



up to \$500.00 per person,<sup>62</sup> Northwestern Mutual Insurance Company (hereinafter "Northwestern") never made any payments to Shipley.<sup>63</sup> Shipley recovered a sum from the at-fault party that the court deemed sufficient to fully reimburse him for all the medical bills he had paid as a result of the accident.<sup>64</sup> Shipley then sued Northwestern to recover payment of the medical bills.<sup>65</sup> Northwestern asserted that it was not obligated to make any payments to Shipley since his insurance policy with Northwestern contained a subrogation clause and he had been fully compensated by the at-fault party.<sup>66</sup> The Arkansas Supreme Court held that, because Shipley had been paid in full for the medical bills and because Northwestern had a valid subrogation clause in the insurance contract, Shipley could not recover from Northwestern.<sup>67</sup> This decision established that subrogation clauses in medical insurance contracts are valid and enforceable in Arkansas.<sup>68</sup> Because the insurance contract in *Shipley* contained a subrogation clause, the court was not required to decide whether the right to subrogation was based on conventional or legal subrogation.<sup>69</sup>

The distinction between legal and conventional subrogation was also not addressed by the Court of Appeals of Arkansas when it reaffirmed the validity of subrogation clauses and extended their effect to those not in privity with the insurer by applying Arkansas contract law in *Storey v. Arkansas Blue Cross & Blue Shield*.<sup>70</sup> In *Storey*, the policyholder's daughter was injured in an automobile accident.<sup>71</sup> The insurer paid \$3,234.05 of the daughter's medical bills under the policy,<sup>72</sup> and her father settled with one of two tortfeasors.<sup>73</sup> The insurer claimed that, under its subrogation clause, it was entitled to repayment of the amounts it had paid.<sup>74</sup> *Storey* argued that, although she had accepted benefits and may have been

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62. *Id.*

63. *Id.* at 1161, 428 S.W.2d at 270.

64. *Id.* at 1162, 428 S.W.2d at 270.

65. *Id.* at 1161, 428 S.W.2d at 270.

66. *Id.* The essence of the subrogation agreement was that "the insurer would be subrogated to any right possessed by the insured to reimbursement of medical expenses from a third party." *Id.* at 1162, 428 S.W.2d at 270.

67. *Id.* at 1161, 428 S.W.2d at 270.

68. *Id.*

69. *Id.* at 1162, 428 S.W.2d at 270.

70. 17 Ark. App. 112, 704 S.W.2d 176 (1986).

71. *Id.* at 113, 704 S.W.2d at 176.

72. *Id.* at 115, 704 S.W.2d at 178.

73. *Id.*

74. *Id.* at 113-14, 704 S.W.2d at 177. It should be noted that the subrogation clause in this case was identical to that in *Higginbotham*. *Higginbotham*, 312 Ark. at 201, 849 S.W.2d at 465.

bound by some provisions of the health insurance contract, she did not have to honor the subrogation clause because there was no privity of contract.<sup>75</sup> In holding that Storey was bound by the contract, the court relied on the principle of Arkansas contract law that a party cannot avoid obligations under a contract where she has accepted benefits under the document.<sup>76</sup> Although this decision did not specifically adopt the view that subrogation clauses in health insurance contracts are governed exclusively by contract law and not affected by equitable doctrines, the fact that the decision was based solely on contract law principles foreshadowed the holding in *Higginbotham*.<sup>77</sup>

When the Arkansas Supreme Court did address the distinction between legal and conventional subrogation, it limited the application of subrogation to those instances where the medical or health insurance contract contains a clause that specifically provides for subrogation.<sup>78</sup> In *American Pioneer Life Insurance Co. v. Rogers*,<sup>79</sup> the court clearly established that subrogation in medical and health insurance contracts in Arkansas exists only by conventional subrogation and that legal subrogation is not available in the health insurance context.<sup>80</sup> The distinction was important in *American* because the defendants, the Rogers, were insured under a major medical insurance policy issued by American Pioneer Life Insurance Company (hereinafter "American")<sup>81</sup> that did not contain a subrogation clause.<sup>82</sup> Roger's daughter, a minor, was seriously injured in an automobile accident.<sup>83</sup> When Rogers filed a claim under the policy on behalf of his daughter, American requested that he complete and sign a standard subrogation form.<sup>84</sup> Even though Rogers refused to do so, American paid the claim.<sup>85</sup> After Rogers recovered from the third-party tort-feasor, American filed suit seeking to assert its subrogation rights.<sup>86</sup> The trial court denied American's claim because the policy did not expressly

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75. *Storey*, 17 Ark. App. at 114, 704 S.W.2d at 177.

76. *Id.* at 114-15, 704 S.W.2d at 177.

77. *Id.*

78. *American Pioneer Life Ins. Co. v. Rogers*, 296 Ark. 254, 753 S.W.2d 530 (1988).

79. 296 Ark. 254, 753 S.W.2d 530 (1988).

80. *Id.* at 259, 753 S.W.2d at 533.

81. *Id.* at 254, 753 S.W.2d at 530.

82. *Id.* at 254-55, 753 S.W.2d at 530.

83. *Id.* at 254, 753 S.W.2d at 530.

84. *Id.*

85. *Id.* at 255, 753 S.W.2d at 530.

86. *Id.*

provide for subrogation.<sup>87</sup> In affirming the trial court's decision, the Arkansas Supreme Court held that a medical expense insurance carrier does not have the right to share in the settlement or recovery from a third party unless the insurance contract contains a specific subrogation clause.<sup>88</sup> In this decision, the court specifically rejected legal subrogation in health insurance cases and held that only conventional subrogation could provide a basis for reimbursement.<sup>89</sup>

This view was modified somewhat in a more recent case, *Shelter Mutual Insurance Co. v. Bough*,<sup>90</sup> in which the Arkansas Supreme Court held that subrogation can also arise by operation of statute and be affected by equitable doctrines.<sup>91</sup> The dispute in *Bough* arose when Bough was injured in an automobile accident as a result of a third party's negligence.<sup>92</sup> Although the car Bough was driving belonged to his mother and stepfather, he was covered by his parents' no-fault insurance policy with Shelter Mutual Insurance Company (hereinafter "Shelter").<sup>93</sup> Shelter paid \$11,960.00 under the medical payments and wage loss provisions of the insurance contract, and Bough settled with the third party's insurer for its policy limit of \$25,000.00 and executed a release covering both the insurer and the tort-feasor.<sup>94</sup> The payments he received, however, were insufficient to fully compensate Bough, so he successfully sued Shelter for benefits under implied underinsured motorist coverage.<sup>95</sup>

The trial court allowed Shelter to deduct from Bough's recovery both the amounts paid by it and the third party's insurer as subrogation rights pursuant to Arkansas law.<sup>96</sup> Bough argued on cross appeal that Arkansas law only provides subrogation for benefits recovered in tort, and, since the underinsured motorist benefits were contractual in nature, Shelter should only have been allowed to offset the

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87. *Id.*

88. *Id.* at 259, 753 S.W.2d at 533.

89. *Id.*

90. 310 Ark. 21, 834 S.W.2d 637 (1992).

91. *Id.* at 28-29, 834 S.W.2d at 641-42.

92. *Id.* at 23, 834 S.W.2d at 638.

93. *Id.*

94. *Id.*

95. *Id.* Bough's parents did not have underinsured coverage, but Bough sued Shelter alleging that Shelter violated ARK. CODE ANN. § 23-89-209 (Michie Supp. 1993) by not offering underinsured coverage to his parents. *Bough*, 310 Ark. at 23, 834 S.W.2d at 638. The court determined that Shelter did violate ARK. CODE ANN. § 23-89-209, and it entered a directed verdict for Bough which implied underinsured coverage to him. 310 Ark. at 23, 834 S.W.2d at 638. The issue of damages then went to a jury which decided that Bough was entitled to a total of \$85,000 as compensation for his injuries. *Id.*

96. 310 Ark. at 24, 834 S.W.2d at 639 (interpreting ARK. CODE ANN. § 23-89-209).

\$11,960.00 it had paid against the \$25,000.00 recovered from the tort-feasor's insurer.<sup>97</sup> He further argued that \$25,000.00 was insufficient to fully compensate him for his damages, and Shelter, thus, had no right of subrogation.<sup>98</sup>

In upholding Shelter's right of subrogation, the Arkansas Supreme Court indicated that equitable doctrines would apply in determining whether subrogation is appropriate.<sup>99</sup> The court also acknowledged the general rule that an insured must be made whole before an insurer can assert its subrogation rights.<sup>100</sup> It found, however, that it was not required to decide the issue because of its holding that Bough's successful claim against Shelter made him whole.<sup>101</sup> The court declined to draw the distinction urged by Bough between contractual and tort benefits in deciding whether Bough had been made whole. Instead it held that, since subrogation was equitable in nature and designed to prevent double recovery by the insured, the insurer should be allowed to assert its right of subrogation if the insured has been made whole for his injuries.<sup>102</sup>

#### IV. REASONING OF THE COURT

##### A. Majority Opinion

On March 1, 1993 the Arkansas Supreme Court held, in *Higginbotham v. Arkansas Blue Cross & Blue Shield*,<sup>103</sup> that a clear and unambiguous subrogation clause in a health insurance contract entitled the insurer to subrogation even before the insured was made whole.<sup>104</sup> The court began its analysis with a discussion of the similarities between *Storey* and *Higginbotham*.<sup>105</sup> The court quoted the portion of the *Storey* opinion that stated that Storey was entitled to benefits pursuant to her father's contract with Blue Cross and that, after making these payments, Blue Cross was entitled to

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97. *Id.* at 27-28, 834 S.W.2d at 640-41 (interpreting ARK. CODE ANN. § 23-89-207(a)).

98. *Id.* at 28, 834 S.W.2d at 641.

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.* If subrogation had been denied to Shelter, Bough would have recovered \$11,960.00 in addition to the \$85,000.00 in damages determined by the jury.

103. 312 Ark. 199, 849 S.W.2d 464 (1993).

104. *Id.* at 202-04, 849 S.W.2d at 466-67.

105. *Id.* at 201, 849 S.W.2d at 465. The subrogation clause at issue in *Storey* was identical to the provision involved in *Higginbotham*. Both *Higginbotham* and *Storey* involved children of public school employees; also, both cases concerned settlements with third parties reached without the consent of Blue Cross and without Blue Cross agreeing to release the carrier and tort-feasor from further liability. *Id.*

subrogation under the same contract.<sup>106</sup> The court also noted that, while Storey could have refused the benefits, she declined to do so.<sup>107</sup> The court then stated the rule announced in *Storey* that the settlement amount was not relevant to the determination of whether the appellee had a right to reimbursement under the contract.<sup>108</sup> However, the court did not rely on the rationale in *Storey* to decide *Higginbotham*.<sup>109</sup>

The majority opinion conceded that there was support for Higginbotham's position from other jurisdictions, but declined to follow them.<sup>110</sup> The court first discussed cases representing the majority view that subrogation is an equitable remedy and that equitable principles prevail even when there are contract provisions expressly providing for subrogation.<sup>111</sup> These cases held that the insured must be made whole for the total loss before the insurer can recover from any funds received by the insured.<sup>112</sup>

While acknowledging the merit of the majority approach, the court rejected it and adopted the minority position which holds that subrogation principles do not override the right to contract.<sup>113</sup> The court then held that the subrogation clause in Higginbotham's insurance policy was clear and unambiguous.<sup>114</sup> In distinguishing *Higginbotham* from *Bough*, the court dismissed as dictum the portion of the opinion in *Bough* indicating that subrogation is only available after a party has been made whole.<sup>115</sup>

The court stated that this excerpt was dictum and that the disputed issue in *Bough* was whether Shelter had made underinsured

106. *Id.* at 201-02, 849 S.W.2d at 465-66 (quoting *Storey*, 17 Ark. App. at 115, 704 S.W.2d at 177).

107. *Id.*

108. *Id.* at 202, 849 S.W.2d at 466 (quoting *Storey*, 17 Ark. App. at 115, 704 S.W.2d at 177-78).

109. *Id.* at 202, 849 S.W.2d at 466.

110. *Id.*

111. *Id.* (citing *Powell v. Blue Cross & Blue Shield*, 581 So. 2d 772 (Ala. 1990); *Rimes v. State Farm Mut. Auto. Ins. Co.*, 316 N.W.2d 348 (Wis. 1982)).

112. *Id.* at 202, 849 S.W.2d at 466.

113. *Id.* (citing *Culver v. Insurance Co. of N. Am.*, 559 A.2d 400 (N.J. 1989); *Powell*, 581 So. 2d 772, 783-88 (Maddox, J., dissenting); *Powell*, 581 So. 2d 772, 788-92 (Houston, J., dissenting); *Rimes*, 316 N.W.2d 348, 359-62 (Wis. 1982) (Steinmetz, J., dissenting)).

114. *Id.*

115. *Id.* at 203, 849 S.W.2d at 466. The relevant portion of the *Bough* opinion states:

"[W]hile the general rule is that an insurer is not entitled to subrogation unless the insured has been made whole for his loss, the insurer should not be precluded from employing its right of subrogation when the insured has been fully compensated and is in a position where the insured will recover twice for some of his or her damages."

*Id.* (quoting *Bough*, 310 Ark. at 28, 834 S.W.2d at 641 (1992)).

benefits available and whether Bough's release had prejudiced Shelter.<sup>116</sup> The court went on to state that equitable principles are appropriate to the doctrine of subrogation by operation of law, but not to conventional subrogation.<sup>117</sup> The court held that there is no reason why broad equitable principles should dominate clear contractual provisions absent public policy considerations.<sup>118</sup> The court concluded that there were no public policy considerations supporting Higginbotham's position.<sup>119</sup> The final authority relied upon by the court in the majority opinion was *Standard Life & Accident Insurance Co. v. Ward*,<sup>120</sup> which held that the courts do not have the right to make contracts for parties nor to modify the contracts to fulfill some notion of abstract justice or moral obligation.<sup>121</sup>

#### B. Dissenting and Concurring Opinions

In his dissent, Justice Glaze asserted that the holding in *Higginbotham* was clearly in conflict with the recent holding in *Bough*.<sup>122</sup> He stated that, in *Bough*, the court had adopted the general rule that subrogation is available to the insurer only if the amount recovered from the third-party tort-feasor and the insurer exceeds the insured's loss.<sup>123</sup> He then cited two treatises in support of the rule that the insured must be made whole before the insurer's right to subrogation arises.<sup>124</sup>

Justice Glaze reiterated the fact that, while Higginbotham's total damages amounted to at least \$60,000.00, he received only \$11,482.08 from Blue Cross and \$25,000.00 from the negligent party's insurance.<sup>125</sup> Justice Glaze stated that there was no proof reflecting that the

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116. *Id.*

117. *Id.* In conventional subrogation, an insurer's subrogation right arises from a clause in the insurance policy or settlement agreement which expressly provides for it. KEETON & WIDISS, *supra* note 13, § 3.10(a). By contrast, legal subrogation is based solely on equitable principles in the absence of any contractual provision. COUCH, *supra* note 11, § 61:2.

118. *Higginbotham*, 312 Ark. at 203, 849 S.W.2d at 466.

119. *Id.*

120. 65 Ark. 295, 45 S.W. 1065 (1898).

121. *Higginbotham*, 312 Ark. at 204, 849 S.W.2d at 467 (quoting *Standard Life & Accident Ins. Co. v. Ward*, 65 Ark. 295, 298, 45 S.W. 1065, 1066 (1898)).

122. *Id.* (Glaze, J., dissenting); *see Bough*, 310 Ark. at 21, 834 S.W.2d at 637.

123. *Id.* (Glaze, J., dissenting).

124. *Id.* at 204-05, 849 S.W.2d at 467 (Glaze, J., dissenting) (citing 6A JOHN A. APPLEMAN & JEAN APPLEMAN, *INSURANCE LAW & PRACTICE* § 4095 (Supp. 1992); GEORGE J. COUCH, *COUCH ON INSURANCE* § 61:20 (2d ed. 1983)).

125. *Id.* at 205, 849 S.W.2d at 467 (Glaze, J., dissenting).

\$36,482.08 payment would fully compensate Higginbotham for his entire loss.<sup>126</sup>

Justice Glaze also attacked the majority's attempt to distinguish between legal and conventional subrogation.<sup>127</sup> He cited *Garrity v. Rural Mutual Insurance Co.*<sup>128</sup> as support for the theory that the distinction between legal and conventional subrogation is irrelevant in determining whether subrogation will be allowed because all subrogation rests upon equitable principles.<sup>129</sup>

Justice Glaze cited a line of cases supporting the proposition that the insured must recover enough to cover his loss before the insurer has a right to share in the proceeds of the recovery.<sup>130</sup> In conclusion, Justice Glaze stated that the rule adopted in *Bough* was applicable to the current situation and that the trial court's decision should have been reversed.<sup>131</sup>

In his concurring opinion, Justice Brown simply stated that Blue Cross should only recover the amount it paid Higginbotham for medical care due to personal injury.<sup>132</sup> He also stated that it was impossible to determine exactly what injury was compensated by the State Farm liability payment of \$25,000.00.<sup>133</sup> Had Higginbotham shown that part of the State Farm benefits were for damages other than medical treatment, Justice Brown, due to public policy reasons, would have disallowed subrogation for any portion of the benefits which were paid for nonmedical damages.<sup>134</sup> Justice Brown suggested that, because this was not done, perhaps both parties understood that the liability coverage applied only to bodily injury.<sup>135</sup>

## V. SIGNIFICANCE

As a result of the Arkansas Supreme Court's decision in *Higginbotham*, many injured parties may now receive less than full

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126. *Id.*

127. *Id.*

128. 253 N.W.2d 512 (Wis. 1977).

129. *Higginbotham*, 312 Ark. at 205, 849 S.W.2d at 467 (citing *Garrity v. Rural Mut. Ins. Co.*, 253 N.W.2d 512, 515 (Wis. 1977)).

130. *Higginbotham*, 312 Ark. at 205, 849 S.W.2d at 467 (Glaze, J., dissenting) (citing *Hardware Dealers Mut. Ins. Co. v. Ross*, 262 N.E.2d 618 (Ill. App. Ct. 1970); *Maryland Casualty v. Cincinnati, Cleveland, Chicago & St. L. Ry. Co.*, 124 N.E. 774 (Ind. Ct. App. 1919); *Providence Wash. Ins. Co. v. Hogges*, 171 A.2d 120 (N.J. Super. Ct. App. Div. 1961); *Lyon v. Hartford Accident & Indem. Co.*, 480 P.2d 739 (Utah 1971)).

131. *Id.* (Glaze, J., dissenting).

132. *Id.* at 204, 849 S.W.2d at 467 (Brown, J., concurring).

133. *Id.*

134. *Id.* at 204, 849 S.W.2d at 468.

135. *Id.*

compensation for the injuries incurred as a result of another party's negligence if the at-fault party has insufficient insurance to cover all damages and the injured individual's health insurance contract provides for subrogation. While this rule may seem harsh and unfair, it reflects legitimate judicial respect for the rights of individuals to contract as they see fit.<sup>136</sup>

The true significance of *Higginbotham*, however, lies not in academic speculation about possible ramifications on the right of an individual to contract, but in the very real effects forecast by those espousing the view that subrogation is equitable in nature even if provided for by contract.<sup>137</sup> Those who urge a result contrary to the court's decision in *Higginbotham* emphasize that most insurance subscribers lack the sophistication and bargaining power to negotiate the individual terms of their contracts. The insurance contracts available to consumers are almost always adhesion contracts.<sup>138</sup> This leaves most individuals without any meaningful choice in contracting for insurance coverage. Since most insurance contracts in Arkansas have language similar to that used by Arkansas Blue Cross and Blue Shield in its contract with *Higginbotham*, Arkansans may not have an opportunity to avoid the hardships *Higginbotham* encountered.<sup>139</sup> The idealist may speculate that this will result in lower premiums because of the substantial savings insurance companies are likely to realize as a result of the elimination of double recovery which will result from the *Higginbotham* decision. The cynic, however, will view this decision as simply another instance of a large corporation increasing its profits at the expense of the injured victim whose expectations in signing the insurance contract and paying the premiums due under it were that she would be fully compensated for any injuries she might incur.

The court's decision in *Higginbotham* may create another problem in that it will remove part of the incentive for the insured to hire an attorney and pursue a claim for personal injury damages. Depending on the amount of third-party coverage available and the amount of medical benefits that have been paid, the insured may be left with little or nothing for her efforts. Meanwhile, the medical carrier reaps the benefit of contractual subrogation without assisting

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136. *Id.* at 203-04, 849 S.W.2d at 466-67.

137. COUCH, *supra* note 11, § 61:20.

138. David L. Leitner, *Enforcing the Consumer's "Reasonable Expectations" in Interpreting Insurance Contracts: A Doctrine in Search of Coherent Definition*, 38 FED'N OF INS. & CORP. COUNS. Q. 379, 380 (1988).

139. Telephone Interview with John Shields, Director of Life & Health Division, Arkansas Insurance Commission (Mar. 9, 1994).



in any litigation. This defeats one of the primary purposes behind the tort recovery system by denying full compensation to the injured victim. Indeed, in many cases where the tort-feasor is underinsured, there will be no incentive for the insured to even attempt to recover from the tort-feasor.<sup>140</sup>

It is important to note that *Higginbotham* does not completely foreclose the possibility that an individual in Higginbotham's position could retain the proceeds of a settlement with the tort-feasor's insurer. The narrow scope of the majority holding and the concurring and dissenting opinions suggest that options may be available for others faced with inadequate recovery for personal injuries.<sup>141</sup>

One option may be for the policyholder to compromise with the subrogating carrier prior to settling the claim with the tort-feasor's insurance company. In light of the holding in *Higginbotham*, a plaintiff's attorney may have little to bargain with other than by convincing the medical carrier that a settlement with discounted subrogation is preferable to the risk of trial and the potential for the plaintiff (and accordingly the health carrier) to lose.

Another possibility is to allocate amounts in the settlement documents to damages not covered by the subrogation clause. Justice Brown suggests this option in his concurring opinion when he states that "[h]ad the appellant shown that part of the State Farm benefits were for damages other than for medical treatment, I [Justice Brown] would disallow subrogation for the non-medical portion of the benefits paid for public policy reasons."<sup>142</sup> While Higginbotham still would have had only four Justices favoring his position, it is likely that a proper case might receive a majority decision in favor of the victim. As a condition of settlement, Higginbotham could have required that State Farm allocate the \$25,000.00 as payment for pain and suffering only. This might have convinced the court to deny Blue Cross subrogation to the settlement proceeds.

Other options would have been to allocate the settlement to lost wages or to a loss of consortium claim if the victim were married. Although this method has not received judicial approval

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140. Contrast this with the Arkansas Workers' Compensation statutes. ARK. CODE ANN. § 11-9-410(a) (Michie Supp. 1993) guarantees a minimum amount of compensation to the injured employee. After reasonable costs of collection are deducted from the settlement, a minimum of one third of the remainder of the settlement goes to the injured employee or his dependents. ARK. CODE ANN. § 11-9-410(a)(2)(B) (Michie Supp. 1993).

141. *Higginbotham*, 312 Ark. at 203-05, 849 S.W.2d at 466-68.

142. *Id.* at 204, 849 S.W.2d at 468 (Brown, J., concurring).

by the Arkansas Supreme Court,<sup>143</sup> it may be the only method which will convince the court to deny subrogation and allow a victim to be made whole. One barrier practitioners may encounter, however, is that insurance companies may not be cooperative in wording settlement documents to benefit victims. A final option would be to seek allocation of damages by the trial court, with or without the participation of the medical carrier. This option might be preferred over self-serving language in settlement documents which are arguably only a thinly-veiled attempt to circumvent contractual language.

The repercussions of the decision in *Higginbotham* remain uncertain. Three weeks after its decision in *Higginbotham*, the Arkansas Supreme Court decided *Conley Transport, Inc. v. Great American Insurance Co.*<sup>144</sup> In *Conley* the court denied subrogation recovery to an insurer on the grounds that the settlement by Conley with the at-fault party's insurer did not violate the contract with Great American.<sup>145</sup> Although the decision was predicated on contract principles, the factual situation in *Conley* was similar to that in *Higginbotham*.<sup>146</sup> The seemingly contradictory holding in *Conley* indicates that the Arkansas Supreme Court may be vacillating on the issue. In fact, Justices Glaze and Brown, while concurring in the judgment, indicated that they would have decided the case on the grounds that Conley had not been made whole.<sup>147</sup>

When all the ramifications of *Higginbotham* are considered, it seems that there is now more uncertainty in insurance law than ever before. The prudent practitioner who represents a tort victim will

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143. Such an allocation was attempted in *Arkansas State Employees Ins. Comm'n v. Manning*, 316 Ark. 143, 870 S.W.2d 748 (1994), but the Arkansas Supreme Court did not rule on the substantive arguments presented due to a lack of subject-matter jurisdiction in the lower court. *Id.* at 146, 870 S.W.2d at 749.

144. 312 Ark. 317, 849 S.W.2d 494 (1993). In *Conley* the principle issue was whether or not the insured had breached the subrogation provision of his insurer's physical damage policy by settling with the tort-feasor and executing a release. The court decided that the \$10,000 settlement was not for physical damage but was for lost net income, although this was not specified in any of the settlement documents. *Id.* at 329, 849 S.W.2d at 495.

145. *Id.* at 320, 849 S.W.2d at 496.

146. *Higginbotham* and *Conley* are similar in that they both involved situations where the insured settled with the third-parties' liability carriers without approval from their own insurance carriers. The insurance companies claimed that they were entitled to reimbursement for payments they had made pursuant to the subrogation clauses, and in both cases it was unclear exactly what the payments from the third-party liability carriers encompassed. See *Higginbotham*, 312 Ark. 199, 849 S.W.2d 464; *Conley*, 312 Ark. 317, 849 S.W.2d 494.

147. *Conley*, 312 Ark. at 320-21, 849 S.W.2d at 496 (Glaze, J., concurring); *Conley*, 312 Ark. at 321-22, 849 S.W.2d at 496-97 (Brown, J., concurring).

carefully examine the possible effects of subrogation before settling any third-party claim. Until the Arkansas Supreme Court issues a more definitive ruling on the matter, perhaps the safest course for the attorney to pursue is to compromise with the subrogating carrier prior to settling with the tort-feasor's insurance company.

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