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# Understanding and Problematizing Contractual Tort Subrogation

*Brendan S. Maher\* & Radha A. Pathak\*\**

A collision with a semi-trailer truck seven years ago left 52-year-old Deborah Shank permanently brain-damaged and in a wheelchair. Her husband, Jim, and three sons found a small source of solace: a \$700,000 accident settlement from the trucking company involved. After legal fees and other expenses, the remaining \$417,000 was put in a special trust. It was to be used for Mrs. Shank's care. Instead, all of it is now slated to go to Mrs. Shank's former employer, Wal-Mart Stores Inc.

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In insurance circles, th[is] recovery practice is called "subrogation."<sup>1</sup>

## INTRODUCTION

Few Americans know or, candidly, care what the unfamiliar legal term "tort subrogation" means.<sup>2</sup> But they should, because it directly

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This article develops ideas formed while litigating two recent cases before the United States Supreme Court: *Sereboff v. Mid Atl. Med. Servs.*, 547 U.S. 356 (2006) and *LaRue v. DeWolff, Boberg & Assocs.*, 128 S. Ct. 1020 (2008). Our work benefited from the input of our colleague, Peter K. Stris, who presented the oral argument in each of these cases, as well as from the insights of the many other participants in sessions held by the Georgetown University Law Center Supreme Court Institute, the Alan Morrison Supreme Court Assistance Project, and the American Health Lawyers' Association. We also owe thanks to Professors Roger M. Baron, John Bronsteen, Patricia Leary, Shaun P. Martin, and Hari Osofsky for their input and encouragement as well as to Elissa Fitzgerald for her outstanding research assistance. Of course, all errors and omissions are ours alone.

1. Vanessa Fuhrmans, *Accident Victims Face Grab for Legal Winnings*, WALL ST. J., Nov. 20, 2007, at A1. The Eighth Circuit affirmed the grant of summary judgment in favor of Wal-Mart in *Administrative Committee of the Wal-Mart Stores, Inc. Associates' Health and Welfare Plan v. Shank*, 500 F.3d 834, 840 (8th Cir. 2007), cert. denied, 128 S. Ct. 1651 (2008). Wal-Mart eventually caved to public pressure and agreed to allow the money to remain in the special trust. See Randi Kaye, *Wal-Mart: Brain-damaged Former Employee Can Keep Money*, CNN.COM, Apr. 2, 2008, <http://www.cnn.com/2008/US/law/04/02/walmart.decision/index.html?iref=newssearch>; Randi Kaye, *Brain-damaged Woman at Center of Wal-Mart Suit*, CNN.COM, Mar. 25, 2008, <http://www.cnn.com/2008/US/03/25/walmart.insurance.battle>.

impacts two of their most significant concerns: their health and their finances. As the opening quote illustrates, modern-day tort subrogation often involves an insurer taking some or all of the injured-insured's recovery from a third-party tortfeasor.<sup>3</sup> That one's insurer has a right to such proceeds is news to many. No doubt this is the reason why tort subrogation was recently covered on the front page of the *Wall Street Journal*.<sup>4</sup>

Yet the idea of subrogation is not at all new; in fact, it has antecedents in Roman law.<sup>5</sup> However, recent developments in subrogation law *are* new, and what modern lawyers call tort subrogation is, in our view, a concept with very different content than its historical forebears.<sup>6</sup> Unfortunately, scholars have paid insufficiently close attention to subrogation's evolution, and no theoretical prism exists through which to assess the merits of tort subrogation's current incarnation or predict its effects. This article endeavors to meet that need.

In Part I.A, we construct a conceptual account of subrogation that enumerates and organizes the doctrine's constituent parts.<sup>7</sup> On its surface, tort subrogation governs how, if, and when an insurer may recover monies that it has paid to its insured. Deeper analysis reveals that subrogation always involves a triggering loss and three players, who we identify as (1) the loss-causer, (2) the loss-victim, and (3) the loss-insurer.<sup>8</sup> Importantly, subrogation's aims revolve around achieving a desired result with respect to all three of these players. From these

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2. This article primarily uses the term "tort subrogation" to refer to subrogation doctrine at the intersection of tort and health insurance, unless context indicates we are using the term more expansively.

3. *E.g.*, *Harris v. Harvard Pilgrim Health Care, Inc.*, 208 F.3d 274, 276 (1st Cir. 2000); *Blue Cross & Blue Shield of Ala. v. Sanders*, 138 F.3d 1347, 1350 (11th Cir. 1998); *Health Cost Controls v. Isbel*, 139 F.3d 1070, 1071-72 (6th Cir. 1997); *Sunbeam-Oster Co., Inc. Group Benefits Plan for Salaried Non-Bargaining Hourly Employees v. Whitehurst*, 102 F.3d 1368, 1369 (5th Cir. 1996); *McIlheran v. Lincoln Nat'l Life Ins. Co.*, 31 F.3d 709, 710 (8th Cir. 1994); *Cutting v. Jerome Foods, Inc.*, 993 F.2d 1293, 1299 (7th Cir. 1993).

4. *See* Fuhrmans, *supra* note 1, at A1 (highlighting the plight of several injured-insureds in the face of subrogation claims by their insurers).

5. *See infra* Part I.B (explaining the origins of the doctrine of subrogation).

6. *See infra* Parts I.B (describing traditional common law limits on subrogation, such as the make whole principle) and II.A (describing modern attempts to contractually circumvent traditional equitable limitations on subrogation).

7. *See infra* Part I.A (providing a generalized analysis of subrogation by identifying its three recurring players and three animating objectives).

8. As we explain later, the concept of subrogation includes the ability of a loss-insurer to collect money from either the loss-causer or the loss-victim. Recovery from the loss-victim is sometimes distinguished as "reimbursement," but we consider it to be in the subrogation family. *See infra* note 21 and accompanying text.

analytic moorings subrogation's three primary policy objectives become manifest: to prevent unjust enrichment of the loss-causer; to deter future loss-causing conduct; and to prevent unjust enrichment of the loss-victim vis-à-vis the loss-insurer. Put simply, subrogation has restitutionary, deterrence, and fairness goals. The attractiveness of any incarnation of the subrogation doctrine must be evaluated in light of those goals.

In Part I.B, we develop a historical account of tort subrogation at common law, noting its origins in Roman, Talmudic, and English jurisprudence before tracing the doctrine's development in the United States.<sup>9</sup> Subrogation was a creature of equity and was thus always cognizant of treating fairly the competing interests of those whom it touched. We examine the care with which American courts in the nineteenth and early twentieth centuries handled subrogation remedies, and we identify the doctrinal boundaries imposed by a judiciary solicitous of the unfortunate position of the loss-victim.

Part II tracks modern tort subrogation's departure from its equitable origins into today's world of subrogation as contract, where subrogation's contours are determined by the parties to the insurance contract.<sup>10</sup> Common contractual terms represent significant moves away from traditional common law limitations on subrogation. Most notably, first-dollar recovery provisions grant medical insurers priority reimbursement rights on tort proceeds, even non-medical awards. Such provisions invert the equitable make whole principle, which required the loss-victim to be entirely compensated before subrogation remedies were available. Although some state courts resisted conceiving of subrogation as pure contract, the Supreme Court's recent decision in *Sereboff v. Mid Atlantic Medical Services*<sup>11</sup> adopted the functional near equivalent of subrogation as contract as its paradigm under the Employee Retirement Income Security Act of 1974 (ERISA).<sup>12</sup> The sweeping preemptive scope of ERISA and the persuasive gravity of Supreme Court jurisprudence, even where preemption is absent, suggest that subrogation as contract is likely to become the dominant paradigm.

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9. See *infra* Part I.B (synthesizing the early history of subrogation and focusing on key cases).

10. See *infra* Part II (describing insurers' attempts to contractually modify subrogation and the federal judiciary's willingness to accept elimination of traditional equitable limits on the doctrine).

11. 547 U.S. 356 (2006).

12. Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 (2000 & West Supp. 2008); *Sereboff*, 547 U.S. at 363–69. Although we are troubled with the Court's apparent conceptual approach in *Sereboff*, the language of the Court's opinion leaves open various issues whose future resolution considerably confines *Sereboff*'s applicability in practice.

Part III completes the development of our central normative thesis.<sup>13</sup> Not only is a pure contract approach to tort subrogation insufficiently connected to the objectives that animate subrogation as a whole and inadequately justified by the history of the doctrine, the contract regime also creates significant negative consequences. The power of contract to supply optimal rules has recognized limitations. In the subrogation setting, those limitations threaten to both undermine the fairness of the contract terms between the loss-victim and the loss-insurer and to starve subrogation's restitutionary and deterrence functions with respect to the loss-causer. The latter consequence is of particular societal concern because it may result in the undercompensation of blameless tort victims and the under-policing of culpable tortfeasors.

In concluding, we identify an unhappy future where the federal courts' conceptual subrogation misstep in ERISA becomes the default national understanding of tort subrogation and where the consequences we predict become reality. To avert this crisis, we urge that the paradigm of tort subrogation as pure contract be abandoned in favor of the historical conception of subrogation as a fundamental equitable doctrine upon which contract operates on the margins. We are reminded of the old bromide: "They don't make 'em like they used to." When it comes to subrogation, they should.

## I. THE FOUNDATIONS OF TORT SUBROGATION

Subrogation is often defined as a doctrine that allows one party to "stand in the shoes" of another for the purpose of recovering money that the former has paid to the latter.<sup>14</sup> Courts and scholars alike have attempted to supply their own definitions, but their formulations rarely stray from the same basic components.<sup>15</sup>

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13. See *infra* Part III (explaining why contractual evisceration of historical limits is problematic).

14. Black's Law Dictionary defines subrogation as "[t]he substitution of one party for another whose debt the party pays, entitling the paying party to rights, remedies, or securities that would otherwise belong to the debtor." BLACK'S LAW DICTIONARY 1467 (8th ed. 2004). Similarly, the much-cited remedies treatise by Dan B. Dobbs provides that "[s]ubrogation simply means substitution of one person for another; that is, one person is allowed to stand in the shoes of another and assert that person's rights against the defendant." 1 DAN B. DOBBS, LAW OF REMEDIES § 4.3(4) (2d ed. 1993); see also 73 AM. JUR. 2D *Subrogation* § 1 (2007) ("Subrogation, a legal fiction, is broadly defined as the substitution of one person in the place of another with reference to a lawful claim or right."); 16 LEE L. RUSS & THOMAS F. SEGALLA, COUCH ON INSURANCE § 222:5 (2007) [hereinafter COUCH ON INS.] ("Subrogation" is the substitution of another person in place of the creditor to whose rights he or she succeeds in relation to the debt, and gives to the substitute all the rights, priorities, remedies, liens, and securities of the person for whom he or she is substituted.").

15. See, e.g., *Aetna Life Ins. Co. v. Middleport*, 124 U.S. 534, 538–39 (1888) ("[S]ubrogation

What the parade of definitions does not provide, however, is a conceptual and historical account of subrogation from the ground up.<sup>16</sup> In our view, a comprehensive understanding of subrogation as a legal concept—and thus an understanding of when and how it should apply, particularly in the tort context—requires a new organizational framework that is cognizant of subrogation’s analytic foundations, its players, and its policy aims. Only with that orientation and a proper historical understanding can modern choices about the optimal content and contours of subrogation doctrine in the tort setting be intelligently made.

### A. A Conceptual Account

*The Players.* In its broadest terms, “subrogation” describes those situations where Party A acquires rights with respect to a wronged Party B’s remedy against third Party C. The traditional example occurs in the surety context, which involves a debtor, creditor, and a surety. The creditor extends a loan to the debtor and the surety promises the creditor that the surety will pay if the debtor cannot. If the debtor defaults and

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... is said to be a legal fiction, by force of which an obligation extinguished by a payment made by a third person is treated as still subsisting for the benefit of the third person.”) (internal quotation marks and citations omitted); *Simpson v. Thompson*, (1877) 3 App. Cas. 279, 284 (H.L.) (appeal taken from Scot.) (noting that subrogation is the right to “be entitled to succeed to all the ways and means by which the person indemnified might have protected himself against or reimbursed himself for the loss”); Roger M. Baron, *Subrogation on Medical Expense Claims: The Double Recovery Myth and the Feasibility of Anti-Subrogation Laws*, 96 DICK. L. REV. 581, 581 (1992) [hereinafter Baron, *Subrogation on Medical Expense Claims*] (“Subrogation enables an insurer who has indemnified an insured to ‘stand in the shoes’ of the insured on the insured’s claim for compensation against a third party, usually a tortfeasor.”); Elaine M. Rinaldi, *Apportionment of Recovery Between Insured and Insurer in a Subrogation Case*, 29 TORT & INS. L.J. 803, 803 (1994) (“The doctrine of subrogation enables an insurer that has paid an insured’s loss pursuant to a policy of property insurance to recoup the payment from the party responsible for the loss.”).

16. Two articles written in the late 1970s by M.L. Marasinghe survey the early history of subrogation as an English doctrine but intentionally provide no treatment of the doctrine in America, in terms of either its policy objectives or history. M.L. Marasinghe, *An Historical Introduction to the Doctrine of Subrogation: The Early History of the Doctrine I*, 10 VAL. U. L. REV. 45, 50–52 (1975) [hereinafter Marasinghe I]; M.L. Marasinghe, *An Historical Introduction to the Doctrine of Subrogation: The Early History of the Doctrine II*, 10 VAL. U. L. REV. 275, 275–99 (1976) [hereinafter Marasinghe II]. Early articles touching on subrogation’s early history in America were largely confined to a recitation of surety and property cases, rather than bodily injury cases, and focused more on summarizing the state of the law than offering an animating theory of the doctrine. *E.g.*, James Morfit Mullen, *The Equitable Doctrine of Subrogation*, 3 MD. L. REV. 201 (1939) (providing a descriptive, rather than normative, account of subrogation); Michael Sean Quinn, *Subrogation, Restitution, and Indemnity*, 74 TEX. L. REV. 1361, 1398–99 (1996) (reviewing CHARLES MITCHELL, *THE LAW OF SUBROGATION* (1994)) (concluding after an analysis of American and English subrogation law that “for theoretical and practical reasons, subrogation needs contemplation, exploration, and exposition”).

the creditor collects from the surety, the surety can attempt to recover from the original debtor money the surety paid to satisfy the debt. The surety's right to recover the money it paid out is a classic and long recognized right of subrogation.<sup>17</sup>

Notably, all subrogation involves loss. Although there are various types of commonly recurring losses in the general subrogation context—for example, a lender's loss on a defaulted debt,<sup>18</sup> a tort victim's medical bills,<sup>19</sup> or property destroyed by fire<sup>20</sup>—some manner of triggering loss is always present. That loss necessarily implicates three players: (1) the party that causes the initial loss, i.e., the loss-causer; (2) the party who suffers the loss, i.e., the loss-victim; and (3) the party who is obligated to compensate the loss-victim, i.e., the loss-insurer. For example, in the surety context, the defaulting debtor is the loss-causer, the creditor is the loss-victim, and the surety is the loss-insurer. In the personal injury context, the loss-causer is the tortfeasor, the loss-victim is the plaintiff, and the loss-insurer is a medical insurer. In any case, whatever the context, in our taxonomy the term “subrogation” refers to those remedies that permit the loss-insurer to recoup the indemnity it paid to the loss-victim. Such remedies can conceivably be asserted against one of two targets: the loss-causer or the loss-victim. Originally, subrogation referred only to the loss-insurer's ability to recover the indemnity from the loss-causer. Seeking to recoup the paid indemnity from the loss-victim after the loss-victim had recovered on a successful suit against the loss-causer was traditionally called “reimbursement.”<sup>21</sup> Our survey of subrogation reveals that both subrogation and reimbursement were available at equity, but with important limitations.<sup>22</sup> Our conceptual model considers both to be

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17. See, e.g., *Fleetwood v. Charnock*, (1629) 21 Eng. Rep. 776 (Ch.) (involving surety); *Peter v. Rich*, (1629) 21 Eng. Rep. 499–500 (Ch.) (same); see also John F. Dolan, *A Study of Subrogation Mostly in Letter of Credit and Other Abstract Obligation Transactions*, 64 MO. L. REV. 789, 819 (1999) (“Historically, subrogation arose in the suretyship setting, since sureties predate other kinds of guaranties and insurance.”).

18. See, e.g., *Hampton Loan & Exch. Bank v. Lightsey*, 152 S.E. 425, 426–27 (S.C. 1930) (noting a bank's loss on a defaulted debt is a “perfect example of the right of subrogation”).

19. See, e.g., *State Farm Fire & Cas. Co. v. Knapp*, 484 P.2d 180, 180–81 (Ariz. 1971) (refusing to enforce subrogation clause in personal injury case).

20. See, e.g., *Powell & Powell v. Wake Water Co.*, 88 S.E. 426, 431 (N.C. 1916) (allowing insurer to file subrogation action against tortfeasor for damage to insured's property). The *Powell* case is discussed in Part II.B, *infra*.

21. See generally 73 AM. JUR. 2D *Subrogation* § 6 (2007) (“‘Subrogation’ and ‘reimbursement’ are different in principle, although similar in effect; with subrogation, an insurer stands in the shoes of the insured, but with reimbursement the insurer has a direct right of repayment against the insured.”).

22. See *infra* Part I.B (describing courts' reluctance to allow subrogation when loss-victim

“subrogation,” but we sometimes distinguish them by referring to the former as “strict subrogation” and the latter as “reimbursement.”

*The Objectives.* As a logical matter, subrogation serves three purposes: (1) to prevent unjust enrichment of the loss-causer, (2) to deter future actors from engaging in loss-causing conduct, and (3) to prevent unjust enrichment of the loss-victim vis-à-vis the loss-insurer. Of course, not every court or commentator has used our phraseology or paid equal attention to all three of these purposes. Indeed, observers almost uniformly fail to consider the full range of policy objectives that subrogation serves.<sup>23</sup> Nonetheless, our synthesis captures the substance of the varying rationales that drive subrogation decisions and commentary. We examine each in turn below.

First, subrogation decreases the chance that the loss-causer will be unjustly enriched by escaping the consequences of his or her loss-causing conduct (such as committing a tort). Such an escape is a risk because of the availability of insurance to a loss-victim.<sup>24</sup> While insurance is desirable for the loss-victim, it confers an unintended benefit on the loss-causer: if a victimized party’s losses are entirely indemnified, there is far less reason for a loss-victim to expend resources in uncertain pursuit of the loss-causer.<sup>25</sup> If complete indemnification of a loss-victim causes the loss-victim to not pursue the loss-causer, the loss-causer is unjustly enriched insofar as s/he gets to keep the “proceeds” of his or her loss-causing conduct. Consider the surety context: where a creditor’s loan is fully guaranteed, the surety

was not made whole and in personal injury cases generally).

23. Professor Roger Baron has argued that reimbursement by medical insurers should be disallowed. See, e.g., Roger M. Baron, *Public Policy Considerations Warranting Denial of Reimbursement to ERISA Plans: It’s Time to Recognize the Elephant in the Courtroom*, 55 MERCER L. REV. 595 (2003). We find much to commend in his work, but our approach differs from his in that we believe a systematic analysis of subrogation is required to provide a sufficiently thorough refutation of the desirability of such claims.

24. 46A C.J.S. *Insurance* § 1993 (2007) (“Subrogation prevents . . . unjust enrichment to the tortfeasor that would result if the tortfeasor were absolved from liability, despite its wrongful actions, just because the insured procured and paid for insurance.”); 16 COUCH ON INS., *supra* note 14, § 222:8 (“From the perspective of the tortfeasor, it has been stated that a wrongdoer who is legally responsible for the harm should not receive the windfall of being absolved from liability because the insured had the foresight to obtain, and had paid the expense of procuring, insurance for his or her protection . . . .”); see also John R. Nicholson, Note, *Mahler v. Szucs: An Impediment to Interinsurer Arbitration and Affordable Personal Injury Protection Coverage*, 23 SEATTLE U. L. REV. 213, 221 (1999) (noting that if “the insured’s loss does not exceed the coverage limits of her property loss policy, she has no reason to litigate with the tortfeasor, because she has already been compensated”).

25. See, e.g., *Hart v. W. R. Corp.*, 54 Mass. (13 Met.) 99, 108 (1847) (involving a wholly compensated insured who refused to sue and in fact released the tortfeasor). *Hart* is discussed at length in Part I.B, *infra*.



will pay upon the original debtor's default. Having been fully repaid, the creditor has no reason to sue the original debtor, and the original debtor gets a "windfall" equal to the unpaid loan proceeds. The same can be true in the tort setting. If a tortfeasor inflicts losses upon a victim that are entirely covered by insurance, the victim has a reduced incentive to expend the resources needed to sue the tortfeasor. This leaves the tortfeasor—the true culpable actor—free to unjustly keep monies that otherwise would be expended to satisfy a judgment against him or her.

One way to decrease the likelihood of unjust enrichment of the loss-causer would be to abolish insurance, but such a "solution" sacrifices far too much. The better solution is subrogation, which permits insurance to continue to exist but protects against the possibility that the subject loss-causer could be unjustly enriched by empowering the loss-insurer to collect from him or her.<sup>26</sup>

Subrogation does more than protect against the unjust enrichment of a particular loss-causer. Its second policy goal is to deter future socially undesirable loss-causing conduct. Actors presumably anticipate that certain acts, such as injuring others or failing to repay loans, will result in negative financial consequences. If potential loss-victims are completely indemnified, subrogation will be the primary means by which a loss-causing actor will be held accountable. Subrogation accordingly supplies a desirable deterrent function.<sup>27</sup>

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26. See, e.g., *Wine v. Globe Am. Cas. Co.*, 917 S.W.2d 558, 562 (Ky. 1996) ("[Subrogation prevents] a windfall to the tortfeasor by benefiting from the payment of the insurance carrier without ultimately bearing at least some of the cost."); *Horace Mann Ins. Co. v. Wauwatosa Bd. of Educ.*, 276 N.W.2d 761, 766 (Wis. 1979) ("Subrogation deprives a wrongdoer who is legally responsible for harm of the windfall of being absolved from liability because the injured party obtained and paid for insurance.") (citation omitted).

27. See, e.g., *Cunningham v. Metro. Life Ins. Co.*, 360 N.W.2d 33, 36 (Wis. 1985) ("The purpose of subrogation is to place the loss ultimately on the wrongdoers.") (quoting 3 J.A. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 1675 (1967 & Supp. 1984)). Placing the loss on the party (here the third-party tortfeasor) who is best able to prevent or avoid the loss-causing incident in the first place is the classic way to deter such conduct. See generally Guido Calabresi & Jon T. Hirschoff, *Toward a Test for Strict Liability in Torts*, 81 YALE L.J. 1055, 1060–62 (1972) (explaining that in the ideal strict liability regime courts impose liability on whichever party is the "cheapest cost avoider"); see also Kenneth S. Abraham & Kyle D. Logue, *The Genie and the Bottle: Collateral Sources Under the September 11th Victim Compensation Fund*, 53 DEPAUL L. REV. 591, 617 (2003) ("[C]ollateral nonoffsets, together with the subrogation principle, are essential to tort law's deterrence function of shifting the costs of accidents from victims to injurers."); Jeffrey A. Greenblatt, Comment, *Insurance and Subrogation: When the Pie Isn't Big Enough, Who Eats Last?*, 64 U. CHI. L. REV. 1337, 1341 (1997) (arguing that subrogation "places the burden of compensation on the tortfeasor and thus deters injurious behavior").

Deterrence of loss-causing as a policy objective is distinguishable from the policy objective of preventing unjust enrichment of loss-causers; there is reason to prevent unjust enrichment on restitutionary grounds even if doing so has no deterrent effect on future actors. Similarly, the benefit of deterring future actors can exist even if some loss-causers are judgment proof and thus incapable of satisfying restitutionary aims.

Subrogation's third major policy goal is to ensure that loss-victims are not unjustly enriched by recovering more money for their loss than they are entitled to keep.<sup>28</sup> This third policy objective—essentially a fairness aim—is largely animated by two concerns: the “windfall” concern and the “double recovery” concern. Ultimately these are simply two ways in which a loss-victim is commonly argued to unfairly benefit should a loss-insurer be denied a right of subrogation. Unfortunately, judges and commentators rarely distinguish the two arguments. But they are not the same, and we examine each below.

The “windfall” concern focuses on the possibility that the loss-insurer agreed to provide insurance in part because it assumed that it would be allowed to seek recovery against the loss-causer. In order to fully understand the “windfall” view, some background is required. One way to view an insurance contract is simply as a risk-allocating deal between the insured and the insurer. An insured pays the insurer's price—the premiums—to shift to the insurer the risk of losses specified under the policy. In determining the appropriate premium, the insurer considers a number of factors, including (1) the expected payout rate based on the risk pool within which the insured falls, (2) the size of the reserve fund for underestimated payouts, (3) costs of administering policies, (4) other business expenses, and (5) a return for the insurance company.<sup>29</sup> The “windfall” concern assumes another factor: that, in setting rates, the insurer calculated expected subrogation recoveries from third party loss-

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28. 16 COUCH ON INS., *supra* note 14, § 222:8 (“[I]t has been stated that subrogation has the objective of preventing the insured from recovering twice for one harm, as would be the case if he or she could recover from both the insurer and from a third person who caused the harm.”); 46A C.J.S. *Insurance*, *supra* note 24, § 1993 (“Subrogation prevents . . . unjust enrichment to the insured that would result from double recovery.”); ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW* § 3.10(7) (1988) (“Recognition and enforcement of a right of subrogation for health insurers is primarily premised on precluding duplicative recoveries.”); *see also* *Standard Accident Ins. Co. v. Pellecchia*, 104 A.2d 288, 292 (N.J. 1954) (explaining that one of subrogation's goals is to protect against the possibility that the “insured would be unjustly enriched by virtue of a recovery from both the insurer and the third party”).

29. KEETON & WIDISS, *supra* note 28, § 1.3(b)(2); *see also* Roger M. Baron, *Subrogation: A Pandora's Box Awaiting Closure*, 41 S.D. L. REV. 237, 244 (1996) [hereinafter Baron, *Subrogation: A Pandora's Box*] (citing KEETON & WIDISS, *supra* note 28).

causers who injure its insureds and accordingly offered the insured lower effective premiums<sup>30</sup> to reflect such subrogation recoveries. When such an insurer is denied subrogation rights, the insured gets a “windfall” benefit if s/he gets to keep the proceeds from litigation against the loss-causer—proceeds that the insurer assumed it would receive in exchange for its *ex ante* offer of lower premiums.

Importantly, the accuracy of the “windfall” argument—that is, whether an insured *actually* receives such a windfall—turns on an empirical question: when setting premium rates, did the insurer lower its premiums on account of expected subrogation recoveries? If the insurer *did* offer subrogation-adjusted (lower) rates, the insured gets a windfall when it collects and retains proceeds from the loss-causer. But if the insurer *did not* offer subrogation-adjusted rates, there is no “windfall” to the insured, because the insured implicitly paid higher premiums for the right to keep tort proceeds. Permitting the insurer subrogation rights in that circumstance results in a windfall *to the insurer*. In short, the windfall argument can cut both ways.<sup>31</sup>

In contrast to the “windfall” concern, the “double recovery” concern does not revolve around whether the insurance deal assumed the loss-insurer would keep tort proceeds. The “double recovery” argument instead focuses on the possibility that the loss-victim will get compensation for her loss “twice”: once through tort and once through insurance.<sup>32</sup> Whatever the terms of the insurance deal, the possibility of

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30. The insurer may offer anything of value in exchange for the right of subrogation. A lower premium is one example, but other examples include broader coverage or a lower deductible. Accordingly, throughout this article, any reference to the premiums, price, or rates offered by the insurer will be intended to encompass the myriad ways in which the insurer can raise or lower the true price of the policy to the insured.

31. More empirical research is needed on whether insurers in fact include expected subrogation recoveries into their rates. Commentators and courts are divided, although it appears the majority view is that insurers have not historically factored subrogation recoveries into rate calculations. *See, e.g.*, *Rimes v. State Farm Mut. Auto. Ins. Co.*, 316 N.W.2d 348, 355 (Wis. 1982) (“[T]here appears to be very little evidence that possible recoveries in subrogation are considered in the determination of insurance premiums.”); *see also* Baron, *Subrogation: A Pandora’s Box*, *supra* note 29, at 243–45 (same); JOHN F. DOBBYN, *INSURANCE LAW IN A NUTSHELL* 284 (3d ed. 1996) (stating that subrogation recoveries are not factored into rates); EDWIN W. PATTERSON, *ESSENTIALS OF INSURANCE LAW* § 33, at 151 (2d ed. 1957) (“Subrogation is a windfall to the insurer. It plays no part in rate schedules.”). *But see* F. Joseph Du Bray, *A Response to the Anti-Subrogation Argument: What Really Emerged from Pandora’s Box*, 41 S.D. L. Rev. 264, 272–73 (1996) (arguing that subrogation recoveries do lower rates). Using our theoretical model, we conclude that it is likely that insurers will not offer lower subrogation adjusted rates even though they will grant themselves a subrogation right. *See infra* Part III.

32. The concerns of double recovery and windfall are often conflated because sometimes the objected-to “windfall” is *in actuality* a duplicative recovery, i.e., where the insured receives a tort

such “double recovery” is argued to be unattractive on moral hazard grounds: that it supplies an undesirable incentive for insureds to allow themselves to be victimized so that they can collect more than their actual losses.<sup>33</sup> Subrogation reduces such a “victimization” incentive.

### B. A Historical Account

The validity of our conceptual account, and in particular our focus on the three distinct policy objectives that subrogation serves, is confirmed by a historical examination of the doctrine. In its modern incarnation, a subrogation right can come from three places: common law, contract, or statute.<sup>34</sup> However, subrogation originated in equity, and the doctrine’s history is largely one of common law. Indeed, only in common law subrogation’s shadows—and often in defiance of its limits—did contractual and statutory subrogation develop.<sup>35</sup> As such, we focus

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recovery for medical damages while also collecting insurance for those damages. But if one paid premiums for the right to have a duplicative recovery, i.e., if one paid for an insurance policy absent subrogation rights, then there is no *windfall*. There is, however, a double recovery, which may pose a moral hazard problem. See *infra* note 33.

33. Certainly the moral hazard associated with overinsurance is a problem in the insurance setting. As insurer Aetna wrote over one hundred and forty years ago: “[T]he insured should never make money by a loss. The contract should never be so arranged, that under any circumstances it would be profitable to the insured to meet with disaster. Any other arrangement is offering a premium for carelessness and roguery.” GUIDE TO FIRE INSURANCE FOR THE REPRESENTATIVES OF THE AETNA INSURANCE CO. 157 (1867), *quoted in* Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237, 250 (1996). Yet the moral hazard associated with a person physically injuring himself to profit is surely comparatively small. See, e.g., Baker, *supra*, at 284–85 (pointing out that “[t]here is no strong evidence that insurance reduces the level of care individuals take to prevent bodily injury” and explaining the result in part on the reality that money does not fully compensate for health loss); cf. *Hudson v. Lazarus*, 217 F.2d 344, 346 (D.C. Cir. 1954) (“Legal compensation for personal injuries does not actually compensate. Not many people would sell an arm for the average or even the maximum amount that juries award for loss of an arm.”). But see Alma Cohen & Rajeev Dehejia, *The Effect of Automobile Insurance and Accident Liability Laws on Traffic Fatalities*, 47 J.L. & ECON. 357, 358 (2004) (noting that although other scholars have reached different conclusions, “we find that automobile insurance has significant moral hazard costs, namely, reducing precautions and increasing traffic fatalities”).

34. 73 AM. JUR. 2D *Subrogation* § 43 (2007) (classifying subrogation as legal, conventional, and statutory); Mullen, *supra* note 16, at 202 (same).

35. Common law subrogation encompasses rights of subrogation that arise by operation of non-statutory law and in the absence of any express contractual grant. Common law subrogation is often referred to as “legal” or “equitable” subrogation. “Common law,” “legal,” and “equitable” subrogation are customarily used as synonyms, merely to distinguish this type of subrogation from subrogation rights arising by statute or contract.

Contractual subrogation encompasses those rights of subrogation that arise as a result of specific provisions in the contract obligating the loss-indemnifier to pay an indemnity. Although contractual subrogation is commonly called “conventional” subrogation, we eschew use of the term “conventional” in this article because we think it a misnomer. Contractual subrogation exists and is necessary only to the extent that contracting parties agree to *depart* from the

heavily on subrogation's common law origins in our survey of the doctrine's American history.

Subrogation is an extremely old legal doctrine: its precise origins are unclear, but scholars have identified subrogation's roots in Roman,<sup>36</sup> Talmudic,<sup>37</sup> and French law.<sup>38</sup> These remote precursors are not immediately relevant to subrogation law in the United States, where the most obvious inspiration was the doctrine as it developed in England.<sup>39</sup> This article will only briefly note the doctrine's early English history, well developed in two companion pieces by M.L. Marasinghe.<sup>40</sup> According to Marasinghe, English subrogation in a modernly recognizable form began as an equitable remedy in sixteenth-century courts under the label of contribution.<sup>41</sup> The doctrine was invoked repeatedly in the seventeenth and eighteenth centuries,<sup>42</sup> but the term "subrogation" did not become routinely used until the middle of the nineteenth century.<sup>43</sup> Nonetheless, the idea that insurers could recover for indemnities paid was, in the words of the United States Supreme Court, "English doctrine settled at an early period."<sup>44</sup>

background rules of traditional, common law subrogation.

Statutory subrogation, of course, is a right of subrogation provided by statute. Statutory subrogation serves as a limit on both the contracting parties' and judges' abilities to define the scope of subrogation rights in those particular contexts within which the legislature has imposed its own judgment. The field of statutory subrogation is an area unto itself, and one we do not here address, other than to encourage legislatures, when considering policy choices, to view subrogation through the theoretical lens we have constructed so as to inform those choices and set necessary empirical research agendas.

36. Marasinghe I, *supra* note 16, at 50–51 (describing the Roman doctrine of *Cessio Actionum*, which he identifies as the precursor of subrogation in England).

37. Greenblatt, *supra* note 27, at 1339 n.10 ("[T]he origin [of subrogation is likely] in Talmudic Law, where a surety who discharges the debt of a debtor may proceed directly against the debtor; his right arises by operation of law.").

38. Marasinghe II, *supra* note 16, at 284–88 (describing the French influence on the development of subrogation in England).

39. The English common law is a source of many American legal concepts, and English decisions were frequently cited in American courts in the eighteenth and nineteenth centuries. *See, e.g.*, *Brink v. Wabash R.R. Co.*, 60 S.W. 1058, 1059 (Mo. 1901) ("It is well understood that the common law of England has been in force in this state ever since its admission into the union of states."); Marasinghe I, *supra* note 16, at 45 ("The migration of the English common law has resulted in introducing into American jurisprudence the English notion of subrogation.").

40. Marasinghe I & II, *supra* note 16.

41. Marasinghe I, *supra* note 16, at 54 (identifying a 1557 case from the Court of Chancery as "the earliest decision which demonstrated contribution").

42. *Id.* at 49 ("By 1782 the common law courts had recognized the doctrine of subrogation and were using it as if it had always been a part of the common law of England.").

43. *Id.* ("However, not until the middle of the nineteenth century did the word subrogation enter the English legal vocabulary.").

44. *Hall v. R.R. Cos.*, 80 U.S. 367, 372 (1871).

As in England, subrogation in the American courts was initially employed and developed in cases involving surety, maritime, or real property disputes.<sup>45</sup> Indeed, the oldest recorded Supreme Court case to confront a subrogation issue, *Pratt v. Law*,<sup>46</sup> involved three joint mortgagors, two of whom failed to pay their share, resulting in the remaining mortgagor paying the entire debt.<sup>47</sup> The Court held that the paying mortgagor was entitled to a lien in equity upon the property equal to the two-thirds of the mortgage he paid.<sup>48</sup> Though the Court did not explicitly use the term subrogation, the relief was clearly subrogatory.<sup>49</sup>

Subrogation in tort received prominent judicial treatment some thirty-two years after *Pratt* when the Massachusetts Supreme Court decided *Hart v. Western Rail Road Corp.* in 1847.<sup>50</sup> *Hart* involved a house severely damaged by a fire started by sparks from a locomotive.<sup>51</sup> The house owner was insured and was paid by his insurer. The insurer—without permission from the house owner, who had released the railroad company from liability—sued the railroad company for the damage it caused to the insured’s house.<sup>52</sup> The *Hart* court upheld the insurer’s right to sue the railroad on a subrogation theory. Specifically, the court explained that once the insured received payment for his loss from the insurer, “he holds the claim against the rail road company in trust for the insurers.”<sup>53</sup> In supporting its reasoning, the court discussed several English subrogation cases<sup>54</sup> and ultimately concluded that the insured, by accepting money from the insurer, “implicitly assign[ed]” its right to sue the tortfeasor to the insurer.<sup>55</sup> The court characterized the assignment as “an equitable assignment, which authorizes the assignee to sue in the name of the assignor, for his own benefit.”<sup>56</sup> Such an

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45. *E.g.*, *Hart v. W. R.R. Corp.*, 54 Mass. (13 Met.) 99, 108 (1847) (allowing property insurer to sue tortfeasor for harm to insured’s property); *Gales v. Hailman*, 11 Pa. 515, 520–22 (1849) (upholding the right of a shipper to recover full losses from the carrier, even though the shipper had received some compensation from an insurer, on the ground that the insurer had an interest in part of those proceeds).

46. 13 U.S. (9 Cranch) 456 (1815).

47. *Id.* at 500.

48. *Id.*

49. HERBERT T. TIFFANY & BASIL JONES, 5 TIFFANY REAL PROPERTY § 1507 (2007) (describing *Pratt* as subrogation case).

50. *Hart v. W. R.R. Corp.*, 54 Mass. (13 Met.) 99 (1847).

51. *Id.* at 100.

52. *Id.* at 100–02.

53. *Id.* at 106.

54. *Id.* at 106–08 (citing and discussing cases).

55. *Id.* at 108.

56. *Id.*

assignment could not be defeated by the insured's attempt to release the tortfeasor.<sup>57</sup>

Decisions echoing *Hart's* reasoning followed.<sup>58</sup> But *Hart* remained the most prominent American decision involving subrogation in tort until the U.S. Supreme Court's decision in *Hall & Long v. Railroad Cos.*<sup>59</sup> *Hall* involved an insured's loss of cotton on account of fire that occurred while the cotton was being transported by the defendant railroad company.<sup>60</sup> The insurer paid the insured and then sued the railroad.<sup>61</sup> The Court in *Hall* held in favor of the insurer's right to sue, premising its decision explicitly on equitable subrogation grounds.<sup>62</sup>

In *Hall*, the Court famously described the insurer's right of subrogation as follows: "[s]tanding thus, as the insurer does, practically, in the position of a surety . . . whenever he has indemnified the owner for the loss, he is entitled to all the means of indemnity which the satisfied owner held against the party primarily liable."<sup>63</sup> Agreeing with the *Hart* decision, which it cited, the Court in *Hall* also confirmed that the insurer's right to sue in the name of the insured was derived from "familiar principles of equity . . . dependent not at all upon [the] privity of contract."<sup>64</sup>

The governing view, clearly, was that equity of its own providence authorized the loss-insurer to "stand in the shoes" of the loss-victim with respect to the loss-causer.<sup>65</sup> No contractual subrogation provision

57. *Id.*

58. *E.g.*, *Conn. Mut. Life Ins. Co. v. N.Y. & New Haven R.R. Co.*, 25 Conn. 265, 265 (1856) ("The principle upon which in any case an insurer is permitted to recover against a party, whose wrongful act has caused the loss which the insurer has been compelled to pay, is . . . based . . . upon the equitable doctrine of subrogation, under which such insurer succeeds to, and is entitled to a cession of, all the means of redress held by the party indemnified, against the party whose act has occasioned the loss."); *Peoria Marine & Fire Ins. Co. v. Frost*, 37 Ill. 333, 337-38 (1865) (holding that insurer can recover against tortfeasor, as long as insurer sues in name of insured); *Rockingham Mut. Fire Ins. Co. v. Boshier*, 39 Me. 253, 255-56 (1855) (acknowledging that insurer can recover against tortfeasor on behalf of insured).

59. 80 U.S. 367 (1871).

60. *Id.* at 367.

61. *Id.*

62. *Id.* at 370 ("It is the doctrine of subrogation, dependent not at all upon the privity of contract, but worked out through the right of the creditor or the owner.").

63. *Id.*

64. *Id.*

65. *Id.* The Court in *Hall* specifically noted:

In respect to the ownership of the goods, and the risk incident thereto, the owner and the insurer are considered but one person, having together the beneficial right to the indemnity due from the carrier for a breach of his contract or for non-performance of his legal duty. Standing thus, as the insurer does, practically, in the position of a surety, stipulating that the goods shall not be lost or injured in consequence of the peril

was necessary.<sup>66</sup> Moreover, equity also required that “if, under an indemnity against the same loss, [the loss-victim] had already received payment, the money recovered in this suit would be held in trust for the insurers who had thus paid.”<sup>67</sup> That quote is an acknowledgement of and reference to the nineteenth-century version of what today would be considered a right of “reimbursement” as between the insurer and its insured.

Accordingly, to at least some degree, historical subrogation at equity recognized both (1) a strict subrogation right, *viz.*, the right of the loss-insurer to stand in the shoes of the insured and proceed against the loss-causer; and (2) a reimbursement right, *viz.*, the right of the loss-insurer to seek to recoup tort proceeds from the loss-victim.<sup>68</sup> Viewing historical subrogation through the organizing framework we introduced in Part I.A, we see that strict subrogation clearly served the first two policy objectives we identify: preventing unjust enrichment of loss-causers and deterring future loss-causing conduct. Equitable reimbursement served the third policy objective: preventing unjust enrichment of loss-victims. But any apparent judicial enthusiasm for the last policy objective was considerably tempered by several common law doctrines that favored loss-victims.

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insured against, whenever he has indemnified the owner for the loss, he is entitled to all the means of indemnity which the satisfied owner held against the party primarily liable.

*Id.*

66. Hart v. W. R.R. Corp., 54 Mass. (13 Met.) 99, 106 (1847).

67. *Id.* at 107. The Supreme Court of Oregon articulated the same principle:

Where the insurance company has paid the owner for the destruction of his property by fire occasioned by the fault of a railroad company, and afterwards the owner receives the amount from the company in satisfaction of his damages, he holds it in trust for the insurance company, and it may recover it from him by a suit in equity.

Home Mut. Ins. Co. v. Or. Ry. & Nav. Co., 26 P. 857, 859 (Or. 1891).

68. There is a dispute across jurisdictions as to whether reimbursement is fairly considered to be a subrogatory remedy at all. *Compare* Auto. Ins. Co. of Hartford v. Conlon, 216 A.2d 828, 829 (Conn. 1966) (“The proposition is well established that an insurer’s right to subrogation . . . includes a claim against any judgment secured by the insured against the party at fault for the amount paid by the insurer in satisfaction of the insured’s damage claim under the policy.”) (citations omitted), *with* Qualchoice, Inc. v. Rowland, 367 F.3d 638, 649–50 (6th Cir. 2004) (“[S]ubrogation allows a plan fiduciary [i.e., the insurer] only to step into the shoes of [an insured] and assert the [insured’s] rights . . . against another; subrogation does not allow a plan fiduciary to obtain a judgment of personal liability against [the insured].”), *abrogated on other grounds* by Sereboff v. Mid Atl. Med. Servs., Inc., 547 U.S. 356 (2006) (holding that insurer’s reimbursement claim against insured constitutes “equitable relief” within meaning of ERISA); *see generally* 16 COUCH ON INS., *supra* note 14, § 222:82 (reimbursement not encompassed by subrogation), § 222:83 (reimbursement encompassed by subrogation). For this Article’s purposes, we consider both strict subrogation and reimbursement to be in the subrogation family.



There is little doubt that subrogation rights arose under common law only if a loss-victim's loss was *completely* indemnified.<sup>69</sup> In other words, payment of partial indemnity did not grant the indemnifier any right of subrogation by law.<sup>70</sup> This was fairly settled even in the 1840s, as *Hart* itself conditioned subrogation on the insured's receipt of the "whole loss."<sup>71</sup> Not coincidentally, in modern times the rule against partial subrogation in the insurance context is often referred to as the make whole principle.<sup>72</sup>

Partial subrogation was in large part traditionally disfavored because judicial solicitude for the loss-victim included the concern that adding the subrogee to the litigation mix would potentially frustrate the loss-victim's ability to recover the entirety of his loss. As the Supreme Court of New Jersey explained in *Receivers of New Jersey Midland Railway Co. v. Wortendyke* in 1876:

The right of subrogation cannot be enforced until the whole debt is paid; and until the creditor be wholly satisfied, there ought and can be no interference with his rights or his securities, which might, even by bare possibility, prejudice or embarrass him in any way in the collection of the residue of his claim.<sup>73</sup>

Forty years later, in *Powell & Powell v. Wake Water Co.*,<sup>74</sup> the Supreme Court of North Carolina surveyed decisional law and scholarly authority before confirming and applying the bar against partial subrogation:

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69. Some courts have suggested that the make whole doctrine did not have wide acceptance. *E.g.*, *Cutting v. Jerome Foods, Inc.*, 993 F.2d 1293, 1297 (7th Cir. 1993) ("It is difficult to say whether the 'make whole' interpretive principle is predominant, let alone universal."). Although that may be true today, historically the doctrine was widely accepted. *Atherton v. Tesch*, 80 So. 832, 832-33 (Ala. 1919) (explaining that "[i]t is a well-settled general rule that before subrogation can be enforced the whole debt must be paid," and collecting authorities).

70. RESTATEMENT (FIRST) OF RESTITUTION § 162 cmt. c (1937) ("Where property of one person is used in partially discharging an obligation owed by another, and the balance of the obligation has not been discharged, the former is not entitled to be subrogated to the position of the obligee.").

71. *Hart v. W. R.R. Corp.*, 54 Mass. (13 Met.) 99, 106 (1847) ("[If the insured] first applies to the insurer, and receives his *whole loss*, he holds the claim against the rail road company in trust for the insurers.") (emphasis added).

72. See 16 RONALD A. ANDERSON & MARK S. RHODES, *COUCH ON INSURANCE* § 61:64 (2d ed. 1983) (explaining that, if an insurer pays less than the insured's total loss, the insurer cannot exercise a right of reimbursement or subrogation until the insured's entire loss has been compensated); see also 83 C.J.S. *Subrogation* § 18 (2007) ("Although subrogation may be granted partially under some circumstances, the doctrine contemplates full substitution. Thus, partial subrogation will not ordinarily be allowed where the debt has not been paid in full.").

73. *Receivers of N.J. Midland Ry. Co. v. Wortendyke*, 27 N.J. Eq. 658, 661 (1876). At the time, the highest court of New Jersey was called the Court of Errors and Appeals, not the Supreme Court.

74. 88 S.E. 426 (N.C. 1916).

The great weight of authority is . . . that, when the loss exceeds the insurance . . . and the right of the insurer is . . . enforced upon the equitable principle of subrogation, the action must be brought by and in the name of the owner of the property, and that he is entitled to recover the entire damages, without diminution on account of the insurance, and that he holds the recovery first to make good his own loss, and then in trust for the insurer.<sup>75</sup>

As *Wortendyke* and *Powell* make clear, make whole protections applied both to strict subrogation rights<sup>76</sup> and any equitable right of reimbursement.<sup>77</sup>

Making full recovery of the loss-victim a precondition for recoupment of the indemnity obviously lessened the frequency of recoupment and transferred to the loss-indemnifier the financial risk that the loss-causer could be partially or totally judgment proof. Nonetheless, courts prioritized full recovery of the loss-victim over maximizing the likelihood of the indemnifier recouping the value of the indemnity it paid out, either by direct subrogation or reimbursement.<sup>78</sup> The common law prioritization of full recovery of the loss-victim considerably restricts the circumstances in which the third policy objective—namely unjust enrichment of the loss-victim—assumes importance. In essence the make whole rule is the formal judicial recognition that no unjust enrichment exists unless the victim has been fully compensated.

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75. *Id.* at 429–30.

76. *Wortendyke*, 27 N.J. Eq. at 661 (“The right of subrogation cannot be enforced until the whole debt is paid.”); *Powell & Powell v. Wake Water Co.*, 88 S.E. 426, 431 (N.C. 1916) (“[I]f the insurance is equal to or exceeds the loss, [the] right of subrogation extends to the whole right of action in the insured, and operates as an equitable assignment and the action may thereafter be prosecuted in the name of the insurer.”) (emphasis added).

77. *Powell*, 88 S.E. at 429–30 (“[W]hen the loss exceeds the insurance, . . . [the insured] holds the recovery *first to make good his own loss and then* in trust for the insurer.”) (emphasis added).

78. *Atherton v. Tesch*, 80 So. 832, 833 (Ala. 1919) (“It is a well-settled general rule that before subrogation can be enforced the whole debt must be paid. Substitution cannot be made as long as the debt of the party whose rights are claimed to be used for the purpose of protecting the interest of the applicant for substitution remains unsatisfied, though it be in part only; ‘for until he shall be wholly satisfied, there ought and can be no interference with his rights or his securities, which might, even by bare possibility, prejudice or embarrass him in any way in the collection of the residue of his claim.’”) (quoting *Carithers v. Stuart*, 87 Ind. 424 (1882)); *Powell*, 88 S.E. at 430 (citing extensive authority for the proposition that, where the insured’s loss exceeded the amount paid by the insurer, suit against the tortfeasor had to be maintained in the name of the insured); *Wortendyke*, 27 N.J. Eq. at 661; *see also Wilkins v. Gibson*, 38 S.E. 374, 383 (Ga. 1901) (“In order, however, to entitle the junior mortgagee to subrogation, the general rule is that the whole debt must be paid, and the senior creditor satisfied. Equity will not generally permit a junior incumbrancer to interfere with a senior lien so long as the lien creditor remains unsatisfied.”).

There was also a subject matter restriction on subrogation: personal injury cases were held to be inappropriate areas in which to afford a subrogation remedy to the insurer.<sup>79</sup> Because insurance that would cover losses associated with bodily injuries (such as medical or disability insurance) was not commonly held before recent times,<sup>80</sup> the question of the proper application of subrogation principles in the bodily injury context was rarely raised before the twentieth century. Nevertheless, it is instructive to consider one of the rare reported nineteenth century cases to encounter the intersection of a potential subrogation claim and bodily injury: *Anthony v. Slaid*.<sup>81</sup> In *Anthony*, plaintiff Anthony had, for a fixed sum of money pursuant to a contract, agreed to pay for necessary care for a town's "paupers."<sup>82</sup> The defendants (Slaid and his wife) injured one of the paupers, and plaintiff Anthony incurred costs treating the pauper's injuries.<sup>83</sup> Anthony (the loss-insurer) sued the Sluids (the loss-causers) for the costs of treating the pauper (the loss-victim). Anthony's claim—bearing substantial similarity to a subrogation claim made by a modern medical insurer—was denied by the Massachusetts Supreme Court because "the damage [to the plaintiff] is too remote and indirect," and "there is no precedent

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79. *Gatzweiler v. Milwaukee Elec. Ry. & Light Co.*, 116 N.W. 633, 634 (Wis. 1908); *Aetna Life Ins. Co. v. J.B. Parker & Co.*, 72 S.W. 168, 168 (Tex. 1903); *see also Mercer Cas. Co. v. Perlman*, 23 N.E.2d 502, 504 (Ohio Ct. App. 1939) (rejecting insurer's attempt to sue tortfeasor); *Holland v. Morley Button Co.*, 145 A. 142, 144 (N.H. 1929), *superseded by statute*, Workmen's Compensation Act of 1947, N.H. Laws, 1947, c. 266, § 12, *as recognized in Gagne v. Garrison Hill Greenhouses*, 109 A.2d 840 (N.H. 1954) ("While authority is scanty, in the law of insurance, subrogation not contracted for in cases of death or accident is not given the insurer, as it is in the cases of fire and liability."); *Suttles v. Ry. Mail Ass'n*, 141 N.Y.S. 1024, 1027 (N.Y. App. Div. 1913) (rejecting accident insurer's argument that it would have been entitled to be subrogated to insured's claim against tortfeasor). The court in *Travelers' Insurance Co. v. Great Lakes Engineering Works Co.* permitted an employer's liability insurance company to be subrogated to the employer's right to sue a tortfeasor that had injured two of the employer's employees, but the court focused heavily on the fact that the insurance company was vindicating an injury to the employer, rather than the personal injuries of the employees. 184 F. 426, 431 (6th Cir. 1911).

80. 10 COUCH ON INS., *supra* note 14, § 144:6 ("Although the origin of medical insurance can be traced to the late 19th century, it was not until the 1930s that indemnification for losses occasioned by illness and disease became readily available.").

81. *Anthony v. Slaid*, 52 Mass. (11 Met.) 290, 290 (1846); *see also Comm'rs Court of Butler County v. McCann*, 23 Ala. 599, 602 (1853) (involving suit by county commissioners against alleged tortfeasor for medical expenses paid by county to treat indigent tort victim); *cf. Bradburn v. Great W. Ry. Co.*, (1874) 10 L.R. Exch. 1 (rejecting defendants' attempt to reduce tort plaintiff's damages by amount received from plaintiff's insurance company).

82. *Anthony*, 52 Mass. (11 Met.) at 290–91 ("[Plaintiff] was a contractor for the support of all the poor of the town of Adams, at a fixed sum per annum, and undertook to support them, in sickness and health, at his own risk . . .").

83. *Id.* at 291 ("The defendant's wife committed an assault and battery upon one of the town paupers, by means of which he was hurt, and the plaintiff was put to increased expense for his cure and support.").

for such action.”<sup>84</sup> In contrast, when a year later that same court, in *Hart*, held that a *property* insurer could maintain a subrogation claim against a tortfeasor, the court described its ruling as “exceedingly well sustained by authorities.”<sup>85</sup> The court’s failure to even consider the possibility of a subrogation theory in *Anthony* underscores the resistance to subrogation in the bodily injury context.<sup>86</sup>

The U.S. Supreme Court later approvingly cited *Anthony* in *Insurance Co. v. Brame*,<sup>87</sup> a case widely known for its holding that there is no wrongful death action at common law.<sup>88</sup> Although *Brame* was not technically a subrogation case,<sup>89</sup> it was understood by subsequent courts to be a general signal that subrogation in matters of death and injury was disfavored.<sup>90</sup> Of particular interest, the Texas Supreme Court, in *Aetna Life Insurance Co. v. J.B. Parker & Co.*, cited *Brame* in concluding that no common law right of subrogation was available to an accident insurer in a case involving bodily injury to its insured.<sup>91</sup> In addition to invoking *Brame* as support for its conclusion, the Texas Supreme Court adopted the opinion of the intermediate appellate

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84. *Id.* Although it is possible that *Anthony* merely stands for the proposition that the loss-insurer does not have a *direct* action against the loss-causer, the opinion reads as if there was *no* claim—direct or subrogatory—of which the loss-insurer could have availed himself. *Id.* Further evidence of this point is that the nineteenth century case law is barren of subrogatory claims by loss-insurers in bodily injury contexts.

85. *Hart v. W. R.R. Corp.*, 54 Mass. (13 Met.) 99, 106 (1847); *see also supra* text accompanying notes 50–57.

86. *See also McCann*, 23 Ala. at 602 (failing to consider subrogation theory in case where county incurred medical expenses as a result of seduction, a tort, of an “inmate of the poor-house”).

87. 95 U.S. 754, 759 (1877) (discussing *Anthony* with approval).

88. *Id.* at 756 (“The authorities are so numerous and so uniform to the proposition, that by the common law no civil action lies for an injury which results in death, that it is impossible to speak of it as a proposition open to question.”).

89. *Brame* involved the death of an insured, McLemore, by a third-party intentional tortfeasor, *Brame*. *Id.* at 754. The insurance company, Mobile Life Insurance, sued *Brame* to recoup proceeds paid out pursuant to a life insurance policy McLemore had taken out prior to his demise. *Id.* The Supreme Court held against *Mobile*, holding that no wrongful death action existed at common law, and thus (by subrogation or otherwise), there was no claim that *Mobile* could assert. *Id.* at 759 (“By common law, actions for injuries to the person abate by death, and cannot be revived or maintained by the executor or the heir.”). Therefore, although *Brame* may on its surface have resembled a subrogation case, technically speaking it was not. The Court’s holding in essence was that the insured had no right to which the insurer could subrogate, not that the insurer could not subrogate.

90. Spencer L. Kimball & Don A. Davis, *The Extension of Insurance Subrogation*, 60 MICH. L. REV. 841, 845 n.16 (1962) (describing *Brame* as a case that is “repeatedly cited for the proposition that there is no subrogation in life insurance”). *But see* *Travelers’ Ins. Co. v. Great Lakes Eng’g Works Co.*, 184 F. 426, 430–31 (6th Cir. 1911) (recognizing that *Brame* was not a subrogation case).

91. *Aetna Life Ins. Co. v. J.B. Parker & Co.*, 72 S.W. 168, 168 (Tex. 1903).

court.<sup>92</sup> Given the thoroughness of the appellate court's opinion and the fact that this was probably the first reported American case to squarely address the issue of whether subrogation was applicable in the personal injury context, the appellate court's opinion in *Aetna*<sup>93</sup> deserves further discussion.

William Shelvy was injured while working for St. Louis Southwestern Railway Company.<sup>94</sup> He released the railroad company from liability, and he sought to recover from his insurance company, Aetna, \$10 per week for every week that he was disabled.<sup>95</sup> In its defense to the suit seeking recovery of the indemnity, Aetna argued that Shelvy had deprived Aetna of its subrogation right by releasing the tortfeasor.<sup>96</sup> The Texas appellate court held that the right of subrogation was inapplicable in the bodily injury context.<sup>97</sup> It acknowledged that a right of subrogation was "well-established" in the property damage context.<sup>98</sup> But it identified "an essential distinction" between the two contexts.<sup>99</sup> In the property damage context, the court explained, "the damage or loss which has been caused by the carrier and that indemnified against is identical."<sup>100</sup> In contrast, in the personal injury context, the only loss indemnified against was loss of time, but the injured insured could seek compensation for "mental and physical suffering, loss of time, diminished capacity to earn money, etc., and in some instances punitive damages."<sup>101</sup> Further, the indemnity was owed regardless of whether the insured was harmed by another's fault, but the insured could seek compensation only for negligence.<sup>102</sup> It was this

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92. *Id.* (adopting the opinion in *Aetna Life Ins. Co. v. J.B. Parker & Co.*, 72 S.W. 621 (Tex. Civ. App. 1902)).

93. *Aetna Life Ins. Co. v. J.B. Parker & Co.*, 72 S.W. 621 (Tex. Civ. App. 1902).

94. *Id.* at 621.

95. *Id.* at 621-22.

96. *Id.* at 621 ("The defendant pleaded as a defense to a recovery upon the policy the right of subrogation to the claim of Shelvy against the railway company for damages on account of the injuries for which indemnity was claimed, and its deprivation of the right by settlement of Shelvy with the railway company and the release of it from all liability.").

97. *Id.* at 622.

98. *Id.* ("The right of subrogation of the insurer to the claim of the insured for loss or damage to property covered by a policy of fire insurance, caused by the negligence of the carrier, is well established.").

99. *Id.* ("[T]here is an essential distinction between a liability for loss of property which has been insured and that for damages on account of injuries inflicted upon a person by the negligence of another.").

100. *Id.* In other words, the insurance covered the entire loss suffered by the loss-victim.

101. *Id.* (articulating the different kinds of losses that would be compensable by tort law).

102. *Id.*

lack of “identity of damage or loss” that stripped the insurer of its right of subrogation.<sup>103</sup>

A few years later, in 1908, when bodily injury subrogation was at issue before the Wisconsin Supreme Court in *Gatzweiler v. Milwaukee Electric Railway & Light Co.*,<sup>104</sup> that court’s review of decisional law revealed no “authority for extending the [subrogation] principle . . . to injuries to the person caused by wrongful conduct of another, where the person injured holds a policy of casualty insurance in whole or in part covering the loss.”<sup>105</sup> Citing the decision of the Texas Supreme Court in *Aetna*, the court in *Gatzweiler* explained that “such a policy is an investment contract giving to the owner or beneficiary an absolute right, independent of the right against any third party responsible for the injury covered by the policy.”<sup>106</sup>

Courts continued to agree that subrogation had no applicability in the personal injury context.<sup>107</sup> They offered multiple justifications for the limit. One technical objection was that because subrogation was viewed as a special type of equitable assignment, subrogation in the personal injury context was seen as running afoul of the public policy prohibitions against assigning personal injury claims.<sup>108</sup> A related

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103. *Id.*

104. 116 N.W. 633 (Wis. 1908).

105. *Id.* at 634.

106. *Id.*

107. *E.g.*, *Suttles v. Ry. Mail Ass’n*, 141 N.Y.S. 1024, 1027 (N.Y. App. Div. 1913) (rejecting accident insurer’s argument that it would have been entitled to be subrogated to insured’s claim against tortfeasor); *Holland v. Morley Button Co.*, 145 A. 142, 144 (N.H. 1929), *superseded by statute*, Workmen’s Compensation Act of 1947, N.H. Laws, 1947, c. 266, § 12, *as recognized in* *Gagne v. Garrison Hill Greenhouses*, 109 A.2d 840 (N.H. 1954) (“While authority is scanty, in the law of insurance, subrogation not contracted for in cases of death or accident is not given the insurer, as it is in the cases of fire and liability.”); *Mercer Cas. Co. v. Perlman*, 23 N.E.2d 502, 504 (Ohio Ct. App. 1939) (rejecting insurer’s attempt to sue tortfeasor); *Crab Orchard Improvement Co. v. Chesapeake & Ohio Ry. Co.*, 115 F.2d 277 (4th Cir. 1940) (holding that, despite worker’s compensation payment to employee, employer did not have common law right of subrogation against tortfeasor that caused employee’s injuries).

108. *See* *Berlinksi v. Ovellette*, 325 A.2d 239, 242–44 (Conn. 1973) (rejecting insurance company’s right of subrogation in personal injury action), *overruled by* *Westchester Fire Ins. Co. v. Allstate Ins. Co.*, 672 A.2d 939 (Conn. 1996) (allowing insurer a subrogation right in automobile accident case); Baron, *Subrogation: A Pandora’s Box*, *supra* note 29, at 239 (citing *Wrightsmen v. Hardware Dealers Mut. Fire Ins. Co.*, 147 S.E.2d 860, 861 (Ga. Ct. App. 1966) (refusing to enforce contractual subrogation provision on the grounds that it constitutes a prohibited assignment of a personal injury cause of action)); Baron, *Subrogation on Medical Expense Claims*, *supra* note 15, at 583 (same); *see also* *Peller v. Liberty Mut. Fire Ins. Co.*, 34 Cal. Rptr. 41, 43 (Cal. Dist. Ct. App. 1963) (refusing to enforce contractual subrogation provision on the ground that it constitutes a prohibited assignment of a personal injury cause of action); *cf.* *Kan. Midland Ry. Co. v. Brehm*, 39 P. 690, 691 (Kan. 1895) (describing the common law prohibition against the assignment of a tort cause of action and rejecting plaintiff’s ability to

technical objection arose out of the fact that the indemnified loss rarely equaled the actual loss. Thus, even setting aside the make whole doctrine, permitting partial subrogation would result in the insured's claim being "split" among the loss-victim and his or her insurer(s).<sup>109</sup> This offended notions of judicial economy and fairness to the loss-causer, who was considered to only have to defend one suit arising out of the wrong caused to a particular loss-victim.<sup>110</sup>

But two rationales for limiting subrogation's application in the bodily injury setting were substantive, that is, rationales that spoke to policy concerns rather than ancient technical limits on common law remedies. The first was the notion that the loss-victim's deal with the insurer for compensation was a deal entirely separate from the loss-victim's right to recover from the tortfeasor: "The plaintiff is entitled to both the insurance money and compensation. He gets his insurance money under a contract as a quid pro quo, having paid his premiums for it; and he is entitled besides to compensation from the company for the legal injury they have committed."<sup>111</sup> Put another way: subrogation was

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assert assigned claims for property damage). *But see* Hosp. Serv. Corp. of R.I. v. Penn. Ins. Co., 227 A.2d 105, 109 (R.I. 1967) (acknowledging that "[i]t is well-settled . . . that the common law forbids the assignment of one's cause of action to recover for personal injuries" but holding that contractual subrogation provision in Blue Cross hospitalization plan was not equivalent to an assignment).

109. *Nationwide Mut. Ins. Co. v. DeJane*, 326 N.E.2d 701, 704 (Ohio Ct. App. 1974) (refusing to allow subrogation because "medical expenses are [not] a separate item of damages from a personal injury claim"); Baron, *Subrogation: A Pandora's Box*, *supra* note 29, at 239 (citing *Nationwide*); Baron, *Subrogation on Medical Expense Claims*, *supra* note 15, at 583 (citing *Nationwide*); *cf. Hosp. Serv. Corp.*, 227 A.2d at 111 (affirming the principle that "a defendant's liability is single, and, unless he consents, it may not be rendered joint or divisible by the fact that a subrogee has been partially indemnified" and tailoring insurer's ability to recover advanced medical expenses in light of that principle).

110. This objection limited subrogation in the property damage context as well. *See Norwich Union Fire Ins. Soc. v. Standard Oil Co.*, 59 F. 984, 987 (8th Cir. 1894) (forbidding insurer from suing tortfeasor in case where value of property exceeded insurance policy because "'the wrongful act is single and indivisible and can give rise to but one liability'"); *Home Mut. Ins. Co. v. Or. Ry. & Nav. Co.*, 26 P. 857, 860-61 (Or. 1891) (forbidding insurer from initiating separate suit against tortfeasor when insurer either has or can initiate a lawsuit on its own behalf, on the grounds that tortfeasor should not "be harassed by a dozen different actions"). *But see Nationwide*, 326 N.E.2d at 704 (suggesting that it may be permissible to pursue a property damage claim separately from a personal injury claim).

111. *Suttles*, 141 N.Y.S. at 1027 (rejecting insurance company's argument that it was entitled to refuse payment to insured because insured had settled with tortfeasor); *see also Gatzweiler v. Milwaukee Elec. Ry. & Light Co.*, 116 N.W. 633, 634 (Wis. 1908) ("We . . . hold that [a casualty insurance policy] is an investment contract giving to the owner or beneficiary an absolute right, independent of the right against any third party responsible for the injury covered by the policy."); *cf. Crab Orchard*, 115 F.2d at 280 (explaining that employer's payment of worker's compensation funds to employee is separate from tortfeasor's obligation to injured employee).

disfavored because it robbed the loss-victim of the full benefit of the bargain he struck with the insurer.<sup>112</sup>

The second substantive objection was that the bodily injury context posed little actual threat of double recovery of the loss-victim. In the surety case, the creditor's loss is easily determinable, and complete recovery for the loss-victim (the creditor) occurs upon payment of monies equal to the debt satisfied by the surety (the loss-insurer). In contrast, the precise loss associated with bodily injury is amenable neither to genuinely full recovery, exact calculation, nor precise compartmentalization.<sup>113</sup> Thus, although a loss-victim might recover from both the loss-causer through tort principles and the loss-insurer through his contract of insurance, the presumptive likelihood of a true double recovery—that is, recovering twice for the exact same sub-component of loss—was considered small, and not enough to justify the negatives<sup>114</sup> associated with a pro-subrogation rule.<sup>115</sup>

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112. This is merely the windfall argument cutting against the insurer. See *supra* note 31 and accompanying text for details on this issue.

113. *Crab Orchard*, 115 F.2d at 281 (“It is this difficulty of appraising human suffering, similar to the difficulty of appraising the value of human lives, that has prompted most of the courts to deny the subrogation feature to accident, as well as life, insurance.”). The Supreme Judicial Court of Massachusetts subsequently agreed:

[T]he insured's receipt of both tort damages and insurance benefits may not produce a measurably duplicative recovery. The insured is likely to have suffered intangible losses that are insusceptible to precise measurement, and the two sources of his recovery may cover different ranges of loss and be differently affected by considerations such as fault.

*Frost v. Porter Leasing Corp.*, 436 N.E. 2d 387, 390 (Mass. 1982); see also *Holland v. Morley Button Co.*, 145 A. 142, 145 (N.H. 1929), *superseded by statute*, Workmen's Compensation Act of 1947, N.H. Laws, 1947, c. 266, § 12, *as recognized in Gagne v. Garrison Hill Greenhouses*, 109 A.2d 840 (N.H. 1954) (explaining that it is impossible to ascertain whether injured employee has enjoyed a double recovery when it recovers from both employer's worker's compensation fund and tortfeasor); cf. *Gatzweiler*, 116 N.W. at 634 (“Under [a casualty insurance policy] the amount payable has no necessary relation to damages actually suffered by the beneficiary.”); *Aetna Life Ins. Co. v. J.B. Parker & Co.*, 72 S.W. 621, 622 (Tex. Civ. App. 1902) (rejecting subrogation in the bodily injury context on the ground that the actual loss suffered is not identical to the indemnity paid under the insurance policy).

114. Those negatives were as follows. Absent a prophylactic prohibition against subrogation, equitable subrogation claims at a minimum would require a determination as to whether the loss-victim has received any payment for losses from the tortfeasor that were indemnified by the loss-insurer. See *Frost*, 436 N.E.2d at 391 (explaining difficulties of allowing subrogation in the personal injury context); see also *Ridge Tool Co. v. Silva*, 515 N.E.2d 945, 946–47 (Ohio Ct. App. 1986) (discussing costs of permitting equitable subrogation in medical insurance cases). Because recoveries—particularly settlements—are difficult to attribute to particular types of losses, satellite litigation would be necessary to resolve this issue, which consumes resources of both the parties and the court. In addition, to the extent a mistake is made in determining how much of a recovery corresponds to an insured loss, the loss-victim faces a double loss: losing non-indemnified recovery and not getting the benefit of the premiums expended to secure indemnified coverage. The rule against subrogation avoided satellite litigation and eliminated the



Thus, historically, the judicially-inspired limitations that attended equitable subrogation's application were considerable. Subrogation's common law limits significantly constrained the ability of loss-insurers to maximize or prioritize recoupment of their insurance payout in the bodily injury tort setting. The means by which loss-insurers addressed those constraints and the success of their efforts is addressed in Section II.

## II. THE MODERN TRANSFORMATION OF TORT SUBROGATION

### A. *The Emergence of Contractual Tort Subrogation*

As explained in Part I.B, the historical limits of common law subrogation meant the doctrine posed little threat that a tort victim would be under-compensated for his injury. As such, loss-insurers possessed a limited ability to recoup their insurance payments to tort victims. Assuming such reimbursement was permitted at all, it was allowed only where a tort victim was made whole through litigation proceeds—a situation that was rare indeed. Loss-insurers therefore turned to contract to help them where the common law did not.<sup>116</sup> Specifically, insurers included in the insurance contract specific provisions that provided them either strict subrogation rights or a subrogation reimbursement right. A standard example of such a provision was as follows:

In the event any hospital service or benefit is provided for, or any payment is made or credit extended to, a subscriber under this

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risk that a loss-victim who had the foresight to purchase insurance went undercompensated.

115. One other matter deserves mention. *Gatzweiler* noted a distinction between “investment” and “indemnity” insurance contracts, with subrogation arising with respect to the latter but not the former. *Gatzweiler*, 116 N.W. at 634. That distinction has frequently been misunderstood and, in any event, is of little heuristic value. Ultimately, all insurance contracts (even life insurance) can be considered to have an indemnity feature because even policies that pay fixed sums upon a specified event supply a liquidated measure of damages corresponding to those the insured expected to incur. Whether an insurance contract indemnifies by a fixed sum or a sum tied to the circumstances is not conceptually relevant to the appropriateness of subrogation; whether the indemnity is partial or full is relevant. Cf. Kimball & Davis, *supra* note 90, at 859–60 (criticizing early courts for using “indemnity nature” reasoning to not apply subrogation to bodily injury matters, and proposing that subrogation should occur whenever “there has been full indemnification of the insured” regarding covered loss). For a view opposing Kimball & Davis, see Uriel Procaccia, *Denying Subrogation in Personal Injury Claims: A Needed Change in Direction*, 15 WM. & MARY L. REV. 93, 99–100 (1973) (arguing that full indemnification can exist only if the insured's total loss is compensated).

116. See Procaccia, *supra* note 115, at 98 (explaining that the “proliferation of subrogation clauses” began in the 1950s); see also Baron, *Subrogation: A Pandora's Box*, *supra* note 29, at 239 (explaining that insurers confronting traditional resistance to subrogation in personal injury claims “redesigned language used in policies to create conventional subrogation”).

agreement, the Corporation shall be subrogated and shall succeed to the subscriber's right of recovery therefor against any person or organization, except insurers on policies of insurance issued to and in the name of the subscriber. The subscriber shall pay over to the Corporation all sums recovered by suit, settlement or otherwise, on account of such hospital service or benefit. The subscriber shall take such action, furnish such information and assistance, and execute such assignments and other instruments as the Corporation may require to facilitate enforcement of its rights hereunder, and shall take no action prejudicing the rights and interests of the Corporation hereunder.<sup>117</sup>

Like most other clauses of its kind, the above provision uses both the language of subrogation ("the Corporation shall be subrogated") and, because insurers were still leery of the old public policy restrictions against the "assignment" of bodily injury claims, the language of reimbursement ("[t]he subscriber shall *pay over* to the Corporation all sums recovered").<sup>118</sup> Regardless of whether such provisions were framed in terms of subrogation, reimbursement, or both, it is clear that they were contractual moves away from the common law rules that limited the application of subrogation in the tort context.

As medical insurance became increasingly available to larger numbers of Americans following World War II, litigation regarding these contractual subrogation clauses proliferated.<sup>119</sup> The litigation issue was straightforward: common law subrogation afforded loss-insurers no or very limited subrogation rights for medical payments made to tort victims, whereas the contractual provisions like the one quoted above granted insurers broad subrogation rights that were grounded in contract and that essentially ignored the common law limits on subrogation. Because the traditional limits on subrogation were believed by many courts to be motivated by public policy justifications, courts wrestled with whether to permit private parties to agree, by contract, to different rules—rules which, conceivably, ran counter to a state's public policies.

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117. *Hosp. Serv. Corp. of R.I. v. Penn. Ins. Co.*, 227 A.2d 105, 108 (R.I. 1967).

118. *Id.* (emphasis added); Baron, *Subrogation: A Pandora's Box*, *supra* note 29, at 239 (noting that insurers often utilized the language of reimbursement rather than "the bolder step of actually allowing the insurer to initiate a subrogation lawsuit" but that "the standard 'subrogation' language was frequently retained or actually recreated").

119. The Supreme Court of Rhode Island noted that "[w]hether [a reimbursement provision] is to be enforced has given rise to extensive litigation throughout the land." *Hosp. Serv. Corp.*, 227 A.2d at 109 (collecting cases).

Two lines of cases emerged.<sup>120</sup> One line of cases considered subrogation clauses to be wholly or largely acceptable, notwithstanding that such clauses were written to grant a far broader subrogation right to insurers than was available at common law.<sup>121</sup> Such decisions, predictably, focused on several things. First, the decisions relied on freedom of contract justifications—if two parties agree to terms and a price, the state should stay out of it.<sup>122</sup> Second, the decisions focused on subrogation's policy objective (discussed in Part I.A) of preventing unjust enrichment of the loss-sufferer, suggesting that to hold a subrogation clause invalid would bestow a "windfall" on the insured.<sup>123</sup>

A second line of cases held contractual subrogation to be wholly or significantly limited by equitable principles, in keeping with subrogation's conceptual origins.<sup>124</sup> The two primary examples of such

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120. A treatment of the divergent case law through the early 1990s on contractual subrogation can be found in the work of Elaine M. Rinaldi and Roger M. Baron. Rinaldi, *supra* note 15, at 805–14; Baron, *Subrogation on Medical Expense Claims*, *supra* note 15, at 583–85.

121. *E.g.*, *Assoc. Hosp. Serv., Inc. v. Milwaukee Auto. Mut. Ins. Co.*, 147 N.W.2d 225, 227 (Wis. 1967) (enforcing contractual subrogation clause in suit by insured against tortfeasor); *Mich. Med. Serv. v. Sharpe*, 64 N.W.2d 713, 714 (Mich. 1954) (holding enforceable contractual provision that granted both subrogation and reimbursement rights to insurer); *see also Collins v. Blue Cross*, 193 S.E.2d 782 (Va. 1973) (treating reimbursement claim as claim for subrogation and allowing such claim by insurer against insured), *superseded by statute*, VA. CODE ANN. § 38.1-342.2 (1973) (prohibiting inclusion of subrogation provisions in health insurance contracts); *Davenport v. State Farm Mut. Auto. Ins. Co.*, 404 P.2d 10, 12–13 (Nev. 1965) (allowing contractual subrogation but not addressing the question of whether any equitable limits would apply); *Bernardini v. Home & Mut. Ins. Co.*, 212 N.E.2d 499, 500–01 (Ill. App. Ct. 1965) (allowing contractual subrogation but not addressing the question of whether any equitable limits would apply); *Travelers Ins. Co. v. Lutz*, 3 Ohio Misc. 144, 149–50 (Ohio Mun. Ct. 1964) (allowing contractual subrogation but not addressing the question of whether any equitable limits would apply); *cf. Reynolds Metals Co. v. Smith*, 241 S.E.2d 794 (Va. 1978) (permitting insurer to deny benefits to insured on the grounds that insured had already recovered from tortfeasor), *superseded by statute*, VA. CODE ANN. § 38.1-342.2 (1979) (prohibiting insurer from denying benefits to insured on the grounds that insured has already recovered from "a third party responsible" for the insured's injuries).

122. *Sharpe*, 64 N.W.2d at 714 ("It is neither unjust, unfair nor inequitable to give effect to an agreement which was not induced by mistake, overreaching, fraud or misrepresentation."); *see also Assoc. Hosp. Serv.*, 147 N.W.2d at 226–27 (concluding that a subrogation clause in a health insurance contract was valid); *Lutz*, 3 Ohio Misc. at 150 ("If the insured and the insurance company wish to enter an agreement whereby the insurance company is subrogated to such medical payments it is impossible to see why this is an unfair or improper result.")

123. *Collins*, 193 S.E.2d at 785 ("To deny this right of subrogation is to permit and condone the unjust enrichment of a participant who has been doubly compensated for the same expenses."); *Miller v. Liberty Mut. Fire Ins. Co.*, 264 N.Y.S.2d 319, 323 (Sup. Ct. 1965) ("[S]ubrogation as to the proceeds of a recovery is not invalid in New York. To hold otherwise would unjustly enrich [the insured] and change the risk coverage assumed by [the insurer].") (emphasis in original).

124. *E.g.*, *Garrity v. Rural Mut. Ins. Co.*, 253 N.W.2d 512, 514–16 (Wis. 1977) (allowing contractual subrogation but subjecting it to the equitable make whole doctrine); *Blue Cross v.*

equitable limits were the make whole rule (the principle, discussed above, that the insured must recoup his entire loss before subrogation rights are triggered)<sup>125</sup> and the application of the common fund principle.<sup>126</sup> The common fund rule provided that where any common fund was recovered by one party for the benefit of others, all benefiting parties were obligated to share in attorneys' fees and other costs of suit in proportion to one's share of the recovery.<sup>127</sup> For example, if a tort victim recovered \$100,000, the insurer had a reimbursement right for \$50,000, and the tort victim's attorneys' fees and costs were \$40,000, the loss-insurer would be entitled to a net of \$30,000 (which is equal to \$50,000 minus fifty percent of the attorneys' fees). How and in what circumstances the make whole, common fund, or other limiting doctrines were applied varied across jurisdictions, but this second line of decisions shared a common view that contractual subrogation was significantly limited by non-contractual considerations.

Buoyed by some members of the judiciary's willingness to consider, if not entirely adopt, contractual expansion of subrogation in favor of the loss-insurer, insurers have become very fond of one particular type of subrogation provision: first-dollar recovery provisions. First-dollar recovery provisions are contractual inversions of the equitable make whole rule: they provide the insurer with an entitlement to the first dollar of an insured's recovery from a tortfeasor, regardless of whether the insured was made whole, regardless of what the insured's recovery

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O'Donnell, 230 So. 2d 706, 709 (Fla. Dist. Ct. App. 1970) (permitting contractual subrogation but imposing equitable limitations); *Hosp. Serv. Corp. v. Penn. Ins. Co.*, 227 A.2d 105 (R.I. 1967); *Fifield Manor v. Finston*, 354 P.2d 1073, 1076–79 (Cal. 1960) (denying subrogation by medical care provider on the grounds that relevant contractual provision constitutes an impermissible assignment of a personal injury cause of action).

125. *Garrity*, 253 N.W.2d at 514 (“[The insured] must first be made whole before the insurer is entitled to share in the amount recoverable from the tortfeasor.”); see also Baron, *Subrogation: A Pandora's Box*, *supra* note 29, at 249–52 (reviewing cases that have applied the make whole limit to subrogation); cf. *N.C. Baptist Hosp. v. Mitchell*, 374 S.E.2d 844, 844–47 (N.C. 1988) (rejecting hospital's attempt to recover settlement funds from insured without regard to whether insured had been made whole).

126. *Hosp. Serv. Corp.*, 227 A.2d at 111 (holding that insured's contractually required reimbursement to insurer should be reduced by “just proportion” of attorneys' fees and other expenses); see also *Mahler v. Szucs*, 957 P.2d 632, 648 (Wash. 1998) (“[I]f [the insurer] wishes to receive the benefit of the funds [the insured] recovered, it must share the expenses of recovering those funds.”); *Lancer Corp. v. Murillo*, 909 S.W.2d 122, 126–27 (Tex. App. 1995) (holding common fund doctrine applicable to insurer's contractual right of subrogation); *O'Donnell*, 230 So. 2d at 709; Baron, *Subrogation: A Pandora's Box*, *supra* note 29 at 255–60 (reviewing cases that have applied the common fund rule).

127. *Internal Imp. Fund Trs. v. Greenough*, 105 U.S. 527, 531–37 (1881) (approving common fund doctrine and reviewing applicability of the doctrine in other contexts).

was for, and regardless of any attorneys' fees incurred by the insured in obtaining a recovery.

First-dollar recovery provisions confer several benefits to insurers. First, rarely do tort recoveries actually make the loss-victim whole. Most tort suits are resolved via settlement, and settlements, by their nature, buy off trial risk in return for accepting less than full compensation.<sup>128</sup> Absent a first-dollar recovery provision, an insurer's ability to recoup indemnity payouts would be severely limited by the various common law versions of the make whole rule. For example, consider a plaintiff whose losses total \$100,000 and are exclusively medical damages. If that plaintiff settles for \$50,000, in the make whole world, the plaintiff keeps it. Under a first-dollar recovery rule, the insurer is entitled to it.

Second, tort recovery involves compensation for more than pure medical damages. It includes lost earnings, pain and suffering, consortium and other heads of damage; the scope of compensable loss is broader than the scope of the insured loss. The insurer, however, only cares about recouping the *amount* of its indemnity payouts from tortfeasors. First-dollar recovery provisions prevent the insurer from having to establish *which* of the dollars recovered from a jury or in a settlement were for medical damages (and thus actually indemnified by the insurer), i.e., which tort recovery dollars corresponded to the insured loss. Proving such a correspondence would logically need to be established in a subrogation provision that lacked such a first-dollar recovery proviso.<sup>129</sup> Proving such a correspondence is uncertain and costly for insurers. Inserting a contractual "workaround" that in essence permits the insurer to recover proceeds even for losses it did *not* insure is far more attractive to the insurer.

Third, first-dollar recovery clauses can explicitly excuse the insurer from having to contribute to the attorneys' fees expended by the insured to secure the very recovery against the tortfeasor from which the insurer takes reimbursement. Thus, apart from serving as a means to circumvent the make whole doctrine, first-dollar recovery provisions are increasingly being written to combat the equitable protections of the common fund rule.<sup>130</sup>

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128. ALLAN D. WINDT, *INSURANCE CLAIMS AND DISPUTES: REPRESENTATION OF INSURANCE COMPANIES AND INSUREDS* § 10.06 (2d ed. 1988) (explaining why victims accept less than full compensation in settlement and urging courts to scrutinize settlements to determine whether insured has in fact been fully compensated after a settlement).

129. *Id.*

130. See 16 COUCH ON INS., *supra* note 14, § 223:112 ("[W]hether a party should contribute to the costs of obtaining funds which benefit that party . . . is increasingly addressed in the

First-dollar recovery provisions embrace and invite a pure contract approach to tort subrogation. Such provisions can potentially displace virtually all traditional equitable limits on tort subrogation. Section III addresses the hazards of pure contractual subrogation.

### *B. The Federalization of Contractual Tort Subrogation*

No current discussion of subrogation can be complete without understanding the dominant effect that federal law now has on the doctrine. Accordingly, the particulars of the various states' approaches to dealing with contractual subrogation (and the increasingly common first-dollar recovery provision) must share attention with the federal approach. In particular, it is necessary to focus on the statute that has consumed the federal judiciary's attention in the tort subrogation setting: the Employee Retirement Income Security Act of 1974 (ERISA).<sup>131</sup>

ERISA is colossal in both its complexity and scope. For the purposes of this article, it is sufficient to explain two things. First, ERISA regulates *all* private employer-provided health plans in America,<sup>132</sup> and the majority of Americans with private health insurance receive it pursuant to an employer-provided plan.<sup>133</sup> With respect to employer-

insurance policy as insurers attempt to create a contractual right to their own full recovery without the need to contribute to the insured's costs of recovery.”).

131. 29 U.S.C. § 1001 (2000 & West Supp. 2008).

132. ERISA regulates “employee welfare benefit plan[s]” and “employee pension benefit plan[s].” 29 U.S.C. § 1003 (2000 & West Supp. 2008) (stating that ERISA applies to “employee benefit plan[s]”); 29 U.S.C. § 1002(3) (2000) (defining employee benefit plans to include welfare and pension benefit plans). Employer-provided health care plans qualify as “employee welfare benefit plan[s].” 29 U.S.C. § 1002(1) (2000) (“The terms ‘employee welfare benefit plan’ and ‘welfare plan’ mean any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that such plan, fund, or program was established or is maintained for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services, or (B) any benefit described in section 186(c) of this title (other than pensions on retirement or death, and insurance to provide such pensions).”).

133. U.S. CENSUS BUREAU, INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2006, at 29, 58 (2007), available at [www.census.gov/prod/2007pubs/p60-233.pdf](http://www.census.gov/prod/2007pubs/p60-233.pdf); see also David A. Hyman & Mark Hall, *Two Cheers for Employment-Based Health Insurance*, 2 YALE J. HEALTH POL’Y L. & ETHICS 23, 26 (2001) (“Although the figures have fluctuated somewhat in the past decade, employment-based coverage seems to have stabilized at approximately 65% of the under-65 population, or roughly 177 million Americans.”) (citing Stephen H. Long & M. Susan Marquis, *Stability and Variation in Employment-Based Health Insurance Coverage, 1993–1997*, 18 HEALTH AFF., Nov.–Dec., 1999, at 133); ROBERT J. MILLS, U.S. CENSUS BUREAU HEALTH INSURANCE COVERAGE: 2000, at 2 (2001), available at

provided health care, ERISA regulates the relationship between the insureds (referred to as participants and beneficiaries in the statute) and those who stand in the shoes of the insurers (referred to as fiduciaries).<sup>134</sup> That is, ERISA imposes substantive rights and obligations on all those involved with employer-provided health care. Most importantly for purposes of this article, as we explain below, ERISA addresses the remedies, such as subrogation, that insurers (plan fiduciaries) may assert against insureds (participants and beneficiaries). Thus, for the millions of working Americans who receive health coverage through their employers, the question of tort subrogation necessarily implicates ERISA.

Second, ERISA does not merely address the remedies available to insurers and insured; it plays a dominant preemptive<sup>135</sup> role with respect to those remedies.<sup>136</sup> ERISA largely preempts the ability of the states to

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<http://www.census.gov/prod/2001/pubs/p60-215.pdf>).

134. 29 U.S.C. § 1002(7) (2000) (“The term ‘participant’ means any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit.”); 29 U.S.C. § 1002(8) (2000) (“The term ‘beneficiary’ means a person designated by a participant, or by the terms of an employee benefit plan, who is or may become entitled to a benefit thereunder.”); 29 U.S.C. § 1002(21) (2000) (defining “fiduciary”).

135. ERISA preemption scholarship, commentary and debate is a world unto itself. See, e.g., Phyllis C. Borzi, *Distinguishing Between Coverage and Treatment Decisions Under ERISA Health Plans: What's Left of ERISA Preemption?*, 49 BUFF. L. REV. 1219 (2001); Phyllis C. Borzi, *Pegram v. Herdrich: A Victory for HMOs or the Beginning of the End for ERISA Preemption?*, 1 YALE J. HEALTH POL'Y, L. & ETHICS 161 (2001); Linda P. McKenzie, *Eligibility, Treatment, or Something In-Between? Plaintiffs Get Creative to Get Past ERISA Preemption*, 23 J. CONTEMP. HEALTH L. & POL'Y 272 (2007); Rebecca A.D. O'Reilly, *Is ERISA Ready for a New Generation of State Health Care Reform? Preemption, Innovation, and Expanding Access to Health Care Coverage*, 8 U. PA. J. LAB. & EMP. L. 387 (2006); Elizabeth Barnidge, *What Lies Ahead for ERISA's Preemption Doctrine After a Judicial Call to Action Is Issued in Aetna Health Inc. v. Davila*, 43 HOUS. L. REV. 125 (2006); Sharon Reece, *Puncturing the Funnel—Saving the “Any Willing Provider” Statutes From ERISA Preemption*, 27 U. ARK. LITTLE ROCK L. REV. 407 (2005); Larry J. Pittman, *A Plain Meaning Interpretation of ERISA's Preemption and Saving Clauses: In Support of a State Law Preemption of Section 1132(a) of ERISA's Civil Enforcement Provisions*, 41 SAN DIEGO L. REV. 593 (2004); L. Darnell Weeden, *HMOs, ERISA's “Relate To” Preemption and a Patient's Right to an External Review of Medical Necessity Decisions and the Implications of Field and Conflict Preemption*, 5 DEPAUL J. HEALTH CARE L. 207 (2002); Alex Turner, *The Denial of Benefits to the Same-Sex Domestic Partners of State Employees: How Do Claims of Discrimination Fare Outside the Shadow of ERISA Preemption?*, 4 U. PA. J. LAB. & EMP. L. 669 (2002); Jeffrey G. Sherman, *Domestic Partnership and ERISA Preemption*, 76 TUL. L. REV. 373 (2001); Thomas R. McLean & Edward P. Richards, *Managed Care Liability for Breach of Fiduciary Duty After Pegram v. Herdrich: The End of ERISA Preemption for State Law Liability for Medical Care Decision Making*, 53 FLA. L. REV. 1 (2001).

136. ERISA's preemptive reach depends, *inter alia*, on whether an employer is “self-insured” or whether it pays a third party-insurer to insure its employees. For a thorough explanation of the

control the relationship between the insured and the insurer.<sup>137</sup> Even in cases where ERISA does not preempt state law, state courts are deferential to federal decisional law speaking to the acceptable scope of contractual subrogation.<sup>138</sup> In short, ERISA-driven subrogation interpretation casts both a preemptive and persuasive shadow that has dramatically altered the world of tort subrogation.

The relevant section of ERISA concerning subrogation is section 502(a)(3), which permits the granting of “appropriate equitable relief” in, *inter alia*, a lawsuit commenced by the insurer (or any plan fiduciary) against the insured to enforce the obligations imposed by the statute or “to enforce the terms of the [health insurance] plan.”<sup>139</sup> No other section permits subrogation type remedies; thus an asserted subrogation right must qualify as “appropriate equitable relief” under 502(a)(3) or it is not permitted. The Supreme Court has attempted to define the meaning of the phrase “appropriate equitable relief” in a series of decisions.<sup>140</sup> These cases have given rise to voluminous scholarship,<sup>141</sup> but they are unnecessary to discuss in any detail here.

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difference between self-insurance and third-party insurance, the different level of preemption faced by each, and how and why even small employers are migrating to self-insurance, see Russell B. Korobkin, *The Battle over Self-Insured Health Plans, or “One Good Loophole Deserves Another,”* 5 YALE J. HEALTH POL’Y & ETHICS 89, 106–07 (2005); see also FMC Corp. v. Holliday, 498 U.S. 52 (1990) (holding that state antisubrogation laws inconsistent with plan subrogation clauses are preempted in self-funded welfare benefit plans).

137. John Bronsteen, Brendan S. Maher & Peter K. Stris, *ERISA, Agency Costs, and the Future of Healthcare in the United States*, 76 FORDHAM L. REV. 2297, 2303 (2008) (“To a degree that often astounds the uninitiated, states have an extraordinarily limited ability to regulate the provision and delivery of healthcare as financed by employer-sponsored plans.”).

138. *E.g.*, Fortis Benefits v. Cantu, 234 S.W.3d 642 (Tex. 2007) (refusing to apply make whole limit on subrogation as a matter of state law but relying in part on U.S. Supreme Court’s interpretation of ERISA, a federal statute).

139. 29 U.S.C. § 1132(a)(3) (2000) (“A civil action may be brought . . . by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan.”).

140. *Sereboff v. Mid Atl. Med. Servs., Inc.*, 547 U.S. 356 (2006); *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204 (2002); *Mertens v. Hewitt Assoc.*, 508 U.S. 248 (1993); *cf.* *Harris Trust & Sav. Bank v. Salomon Smith Barney, Inc.*, 530 U.S. 238 (2000) (holding that a nonfiduciary may be sued under section 502(a)(3) for engaging in a prohibited transaction); *Varity Corp v. Howe*, 516 U.S. 489, 507–16 (1996) (holding that plaintiffs who alleged that they had been fraudulently induced to withdraw from viable employee benefits plan could pursue relief under section 502(a)(3)); *Mass. Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 148–58 (1985) (Brennan, J., concurring) (agreeing that plaintiff’s claim for damages for improper denial of benefits was not remediable under section 502(a)(2) but explaining that 502(a)(3) might provide relief).

141. *E.g.*, Colleen E. Medill, *Resolving the Judicial Paradox of “Equitable” Relief Under ERISA Section 502(a)(3)*, 39 J. MARSHALL L. REV. 827 (2006) (suggesting an approach to section 502(a)(3) and collecting (a)(3) scholarship in note 121); John H. Langbein, *What ERISA Means*



The sum and substance of those decisions is that the Supreme Court's interpretative standard for "equitable relief" is a historical one: relief is equitable and thus available if, under the circumstances of the case at bar, the relief was "typically available in equity" during the days when the courts were divided into law and equity courts.<sup>142</sup>

Ironically, the Supreme Court's standard has been interpreted to permit subrogatory remedies written into the insurance contract<sup>143</sup> as pursuable under ERISA even when the main thrust of the lawsuit is to collect money from the insured pursuant to a contractual reimbursement provision. Even as the Supreme Court was in the midst of developing its particular definition of "appropriate equitable relief" under ERISA section 502(a)(3), lower federal courts regularly permitted insurers to use 502(a)(3) to initiate reimbursement suits against their insureds. These courts elevated the importance of enforcing plan terms, and they were largely unmoved by policy limitations employed in the old equity courts to circumscribe the application of subrogation type remedies.<sup>144</sup>

The Supreme Court's lack of solicitude for the policy boundaries on historical subrogation was revealed in 2006 in *Sereboff v. Mid Atlantic*

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by "Equitable": *The Supreme Court's Trail of Error in Russell, Mertens, and Great-West*, 103 COLUM. L. REV. 1317 (2003) (analyzing and criticizing the Supreme Court's (a)(3) jurisprudence as being insufficiently attentive to the trust law roots of ERISA); David D. Leishman, Note, *Adding Insult to Injury: ERISA, Knudson, and the Error of the Possession Theory*, 89 MINN. L. REV. 1214 (2005) (contending that reimbursement claims by insurers against their insureds should not be remediable under section 502(a)(3)).

142. *Mertens*, 508 U.S. at 255–56; see also *Sereboff*, 547 U.S. at 361–62; *Great-West*, 534 U.S. at 210.

143. The argument that any remedy arising from contract is prohibited under 502(a)(3) because it is *per se* "legal" rather than "equitable" (because contract issues were resolved in courts of the law in the days of the pre-merger bench) has been rejected by the court. *Sereboff*, 547 U.S. at 363 ("ERISA provides for equitable remedies to enforce plan terms, so the fact that the action involves a breach of contract can hardly be enough to prove relief is not equitable; that would make § 502(a)(3)(B)(ii) an empty promise.").

144. *E.g.*, *Admin. Comm. of the Wal-Mart Stores, Inc. Assocs.' Health and Welfare Plan v. Shank*, 500 F.3d 834, 838 (8th Cir. 2007) ("Among the primary purposes of ERISA is to ensure the integrity of written plans and to protect the expectations of participants and beneficiaries. . . . We therefore do not apply common law theories to alter express terms of a written plan."); *Harris v. Harvard Pilgrim Health Care, Inc.*, 208 F.3d 274, 280–81 (1st Cir. 2000) (rejecting application of both common fund and make whole principles to insurer's reimbursement claim against insured); *Blue Cross & Blue Shield of Ala. v. Sanders*, 138 F.3d 1347, 1354–56 (11th Cir. 1998) (holding that a state make whole limitation on reimbursement is preempted by ERISA); *Health Cost Controls v. Isbell*, 139 F.3d 1070, 1072 (6th Cir. 1997) (rejecting application of common fund principle in reimbursement suit by insurer against insured); *Sunbeam-Oster Co., Inc. Group Benefits Plan for Salaried & Non-Bargaining Hourly Employees v. Whitehurst*, 102 F.3d 1368, 1378 (5th Cir. 1996) (enforcing first-dollar recovery provision to the exclusion of make whole principle in reimbursement and subrogation suit); *Cutting v. Jerome Foods, Inc.*, 993 F.2d 1293 (7th Cir. 1993) (holding that make whole limit on reimbursement should not be applied in the face of contrary contractual language).

*Medical Services, Inc.*<sup>145</sup> *Sereboff* involved a fairly common fact pattern for an ERISA subrogation case: Marlene Sereboff's employer sponsored a health insurance plan administered by Mid-Atlantic Medical Services (MAMSI).<sup>146</sup> When Marlene and her husband Joel were injured in a car accident, they received medical benefits from MAMSI totaling approximately \$75,000.<sup>147</sup> They subsequently sued the tortfeasors and received a settlement of \$750,000.<sup>148</sup> MAMSI did not participate in the lawsuit against the tortfeasors, but it did, early in the lawsuit, contact the Sereboffs to assert its right to a lien on any potential litigation proceeds.<sup>149</sup> It asserted this reimbursement right pursuant to the terms of the plan, which included a first-dollar recovery provision.<sup>150</sup>

After the Sereboffs refused to pay the \$75,000, MAMSI initiated a suit under ERISA § 502(a)(3), contending that reimbursement of the medical expenses it had advanced to the Sereboffs constituted "appropriate equitable relief" within the meaning of the statute.<sup>151</sup> The Court agreed. It did not find that MAMSI had a historically cognizable subrogation right. Moreover, it realized, correctly, that the arcane technical conditions necessary to trigger equitable restitution were not present.<sup>152</sup> However, the Court found that MAMSI possessed an equitable remedy the Court called "equitable lien by agreement" whose technical conditions *were*, according to the Court, satisfied under the *Sereboff* facts.<sup>153</sup>

The catch is that equitable lien by agreement as defined by the Court, when applied in the medical insurance context, is potentially identical to uncircumscribed modern subrogation by contract.<sup>154</sup> While it is true

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145. 547 U.S. 356 (2006).

146. *Id.* at 359.

147. *Id.* at 360.

148. *Id.*

149. *Id.*

150. *Id.* at 359 ("The plan . . . requires a beneficiary who 'receives benefits' under the plan for [injuries caused by a third person] to 'reimburse [MAMSI]' for those benefits from 'all recoveries from a third party (whether by lawsuit, settlement or otherwise).' The provision states that '[MAMSI]'s share of the recovery will not be reduced because the beneficiary has not received the full damages claimed, unless [MAMSI] agrees in writing to a reduction.'") (citations and original brackets omitted).

151. *Id.* at 360.

152. *Id.* at 365 (acknowledging that MAMSI could not satisfy the requirements of equitable restitution).

153. *Id.* at 364–65.

154. Notwithstanding our criticism of the *Sereboff* Court's conceptual starting point and orientation, the decision nonetheless left open several avenues by which insureds may erect equitable safeguards around subrogatory remedies under ERISA. For example, the Court's

that insureds will be immune from reimbursement claims in some cases,<sup>155</sup> the Court's decision in *Sereboff* makes it clear that, for a huge number of Americans who receive medical insurance from their employer, any recovery from the tortfeasor will be diminished by the reimbursement of medical expenses advanced by the insurer.

Thus, the Court appeared to place its stamp of approval on an ERISA-authorized remedy that is functionally equivalent to subrogation as contract without actually calling it so and without affirmatively burdening it with the long-settled limitations on common law subrogation.<sup>156</sup> In light of the preemptive reach of ERISA and the persuasive power of the Supreme Court, such jurisprudence constitutes a significant judicial step toward transforming subrogation as contract into the dominant national paradigm.

### III. THE PERILS OF TORT SUBROGATION AS CONTRACT

Viewing subrogation as a concept that can be defined entirely by contract fails to appreciate the effect a pure contract approach to subrogation has on the three players in the subrogation game and on achieving the three policy objectives that justify subrogation as a meritorious legal doctrine.<sup>157</sup> As discussed above in Parts I.B and II,

holding does not make it impossible for litigants to argue that traditional equitable limits are relevant to whether a sought reimbursement remedy is an "appropriate" one, as the statute requires. 29 U.S.C. § 1132(a)(3) (2000). The Court in *Sereboff* held that the petitioner had waived the argument that MAMSI's requested relief was not "appropriate," and thus the Court refused to consider the proposition. *Sereboff*, 547 U.S. at 368–69 n.2. *Sereboff* also involved an amount from which a proportionate share of attorneys' fees had *already* been deducted, likely giving common fund limitations continuing vitality. *Id.* at 360.

155. *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 214 (2002) (rejecting reimbursement claim because insurer could not satisfy all the requirements of pre-merger equitable restitution because the litigation settlement funds were not in victim's possession but rather were lodged in a special needs trust).

156. Indeed, the Court entirely disconnected the insurer's reimbursement claim from the doctrine of subrogation. *Sereboff*, 547 U.S. at 368 ("Mid Atlantic's claim is not considered equitable because it is a subrogation claim. . . . Mid Atlantic's action to enforce [the reimbursement provision] qualifies as an equitable remedy because it is indistinguishable from an action to enforce an equitable lien established by agreement of the sort epitomized by our decision in *Barnes*.").

157. Richard Epstein offered the following conceptual framework for analyzing—in any circumstance—the desirability of contract:

Bargains are interactions thought to advance some overall measure of social welfare. They are not regarded as absolutes in themselves. Essentially, we want to enforce bargains when and only when they satisfy two criteria. First, does the bargain create joint gains for the contracting parties? Second, does the bargain respect the interests of third persons who are not parties to the bargain?

Richard A. Epstein, *Unconstitutional Conditions, State Power, and the Limits of Consent*, 102 HARV. L. REV. 4, 14 (1988). This article explains why subrogation as contract neither encourages

modern day tort subrogation bears little resemblance to its historical forebears.<sup>158</sup> Moreover, as this section will demonstrate, tort subrogation as contract presents problems both of contract and of tort. As with many contractual solutions, subrogation provisions are not well-suited to address societal concerns related to the appropriate treatment of non-contracting players—here, the third player in the subrogation game, the loss-causing tortfeasor. Moreover, in contract terms, modern subrogation provisions do not reflect appropriately bargained-for arrangements. These infirmities threaten to result in a subrogation mechanism that is unsound as a matter of contract and that insufficiently advances the restitutionary, compensatory, and deterrence objectives of tort law.

### A. *The Limits of Contract*

Subrogation as contract is afflicted with the problem that affects all contract solutions: contracts care primarily about the effect the contract terms have on the rights and obligations of the contracting parties. That is, parties contract to benefit themselves, and the consequences a contract may have on third parties is of minimal importance in contract negotiation and formation unless, of course, such consequences impose liability on the contractors. In essence, the effect a contract has on a third party is an unconsidered externality; the benefit or cost incurred by the third party is immaterial to the contracting parties.<sup>159</sup> Liability rules can force the contracting parties to consider negative externalities, but contracting parties will not be held liable when the third party is conferred a *benefit*. Thus, there is little incentive for the contracting parties to incur additional costs—either in contract negotiation or performance—to prevent others from indirectly benefiting.

In the subrogation world, the loss-causer is not a party to the insurance contract; only the loss-victim and the loss-insurer are. Thus, of the three policy objectives subrogation serves, only one assumes primary (if not sole) importance. That, of course, is the policy objective most closely tied to the fortunes of the loss-victim and the loss insurer,

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a fair deal between the insured and insurer nor appropriately addresses itself to third-party tortfeasors.

158. See *supra* Parts I.B, II (describing insurers' attempts to contractually modify subrogation and the federal judiciary's willingness to accept elimination of traditional equitable limits on the doctrine).

159. Mark A. Glick, Darren Bush & Jonathan Q. Hafen, *The Law and Economics of Post-Employment Covenants: A Unified Framework*, 11 GEO. MASON L. REV. 357, 379 (2002) ("An externality arises when the parties to a contract impose uncompensated costs on a third party (negative externality), or a third party receives an unpaid-for benefit (positive externality).").

namely: the third policy objective of preventing unjust enrichment of the loss-victim by having a fair allocation of risk/loss between the loss-victim and the loss-insurer.

The other policy objectives—preventing unjust enrichment of the loss-causer and deterring future actors from engaging in loss-causing conduct—concern the effect subrogation has upon the loss-causing tortfeasor. These policy objectives are relevant to the loss-insurer and loss-victim only insofar as they affect the bargained-for allocation of risk between the victim and insurer. In other words, neither the loss-victim nor the loss-insurer *independently* care about the tortfeasor being unjustly enriched or future tortfeasors being insufficiently deterred. The loss-victim cares about getting full compensation for his losses; the loss-insurer cares about keeping its payouts in line with the rates it charges. If either party can achieve those goals without involving the tortfeasor at all, that may very well be their most attractive option. As contractors, the loss-victim and the loss-insurer only care about the tortfeasor to the extent they can get money from him or her on cheaper terms than they can get it from each other. The content and (effective) prices of such terms depend in significant part on the relative financial and bargaining positions of the parties.

But there are immediate problems with the contract realities of the insurance deal. Importantly, insurance contracts that cover medical expenses are not arms-length bargains. They are classic contracts of adhesion; the insured has little power to alter most terms or reject those that are unappealing.<sup>160</sup> The insured is offered boilerplate provisions and has no audience with any member of the insurer who has the authority, even if s/he has the inclination, to rewrite specific provisions of the insurance contract.<sup>161</sup>

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160. *Allen v. Metro. Life Ins. Co.*, 208 A.2d 638, 644 (N.J. 1965) (“[I]nsurance policies . . . are not ordinary contracts but are ‘contracts of adhesion’ between parties not equally situated. The company is expert in its field and its varied and complex instruments are prepared by it unilaterally whereas the assured or prospective assured is a layman unversed in insurance provisions and practices.”) (citations omitted); *see also* *Arnold v. Nat’l County Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987) (referring to parties’ “unequal bargaining power”); *cf.* Philip G. Peters, Jr., *What We Know About Malpractice Settlements*, 92 IOWA L. REV. 1783, 1786 (2007) (noting superior power of malpractice defendants in litigation: “The superior bargaining power possessed by malpractice defendants probably has several sources. These sources include superior risk tolerance, better access to information, more-experienced attorneys and insurance representatives, [and] easier access to expert[s].”)

161. *Meier v. N.J. Life Ins. Co.*, 101 N.J. 597, 612 n.10 (1986) (“Generally, the person seeking insurance must sign a standardized agreement in order to procure insurance. In fact, the first use of the term ‘contract of adhesion’ was in an article dealing with the formation of insurance contracts.”) (citing Edwin W. Patterson, *The Delivery of a Life-Insurance Policy*, 33 HARV. L. REV. 198, 222 (1919)); *see also* Robert E. Keeton, *Insurance Law Rights at Variance*

Moreover, even were bargaining power close to equal, the insurance company's rate determinations are not transparent or even understandable to consumers. Thus they are not amenable to targeted negotiation, i.e., a demand that an insurance company asking for a subrogation right must pay for that right by offering lower premiums. Nor is it likely that an insured has the time or ability to understand and thus properly negotiate with respect to various provisions in the contract, particularly provisions using legal concepts unfamiliar to non-lawyers, such as subrogation.<sup>162</sup> The average individual insured almost certainly does not comprehend the true meaning and cost of subrogation and particularly the first-dollar recovery rule.<sup>163</sup>

Indeed, if insureds were level with insurers at the bargaining table, one would expect to see two types of medical insurance contracts in the marketplace: (1) insurance with no subrogation clauses, but higher premiums;<sup>164</sup> and (2) insurance with subrogation clauses, and relatively lower premiums. But virtually all modern policies have subrogation provisions, many of which are of the first-dollar recovery variety. No-subrogation medical insurance policies are essentially absent from the modern marketplace.<sup>165</sup> Such uniformity is more likely the result of the clear insurer bargaining advantage than an inexplicable and universal consensus among insureds for such policies. Indeed, there is little evidence that insurers are in fact reducing their premiums<sup>166</sup> in return

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with *Policy Provisions*, 83 HARV. L. REV. 961, 966–67 (1970) (explaining insurance contract as one of adhesion). Keeton also makes clear that “statutory and administrative regulations” do little to change the balance of power between insureds and the insurer, as (then as today) “the provisions prescribed or approved by legislative or administrative action ordinarily are in essence adoptions, outright or slightly modified, of proposals made by the insurers’ draftsmen.” *Id.*

162. See 16A JOHN APPLEMAN, *INSURANCE LAW AND PRACTICE* § 8843, at 231 (1976) (noting generally that “90% of those who do read [insurance policies], including attorneys and jurists, would not understand them”).

163. As Judge Learned Hand put it: “A man must indeed read what he signs, and he is charged, if he does not; but insurers who seek to impose upon words of common speech an esoteric significance intelligible only to their craft, must bear the burden of any resulting confusion.” *Gaunt v. John Hancock Mut. Life Ins. Co.*, 160 F.2d 599, 602 (2d Cir. 1947), *cert. denied*, 331 U.S. 849 (1947).

164. Or the equivalent, such as a higher deductible, a higher or more frequent co-pay requirement, and so on. See *supra* note 30 regarding this point.

165. Abraham & Logue, *supra* note 27, at 604 (“[A]n explicit subrogation clause . . . can be found in almost every first-party insurance policy, except life insurance . . . .”); Ronald B. Grayzel, *Subrogation*, 209 N.J. LAW. 22, 23, June 2001 (“Virtually all private health care plans now also have such subrogation clauses.”).

166. *DeCespedes v. Prudence Mut. Cas. Co.*, 193 So. 2d 224, 228 (Fla. Dist. Ct. App. 1966) (“[A]nticipated recoveries under subrogation rights are generally not reflected in the computation of premium rates.”) (citing treatises); *Travelers Indem. Co. v. Chumbley*, 394 S.W.2d 418, 425 (Mo. Ct. App. 1965); *Allstate Ins. Co. v. Reitler*, 628 P.2d 667, 670 (Mont. 1981); *Allstate Ins. Co. v. Druke* 576 P.2d 489, 492 (Ariz. 1978); Eugene G. Doherty, *Priority of the Subrogation*

for extracting a first-dollar recovery right. Since bargaining power is unequal, this result is unsurprising. At the end of the day, it appears that insurance companies are getting more than they paid for with little or no consumer pressure to address the inequity.

### B. Undermining Tort

In addition to the contractual infirmities of subrogation clauses, the imposition of such terms undermine various aims of tort law. As explained above in Part I.A., two of the policy objectives that animate subrogation are concerned with the appropriate treatment of tortfeasors: ensuring that no individual tortfeasor is unjustly enriched and ensuring that future tortfeasors are deterred by the knowledge that they will be held accountable even if their victim is insured. More succinctly, the doctrine of subrogation cares about tort restitution and deterrence. Unfortunately, subrogation as contract is unconcerned with such matters, and it is possible to see exactly how that indifference plays out by analyzing the effect first-dollar recovery provisions have on tort restitution and deterrence.

To begin, first-dollar recovery provisions significantly undercut an insured's incentive to sue. Any potential plaintiff must determine his or her expected recovery from a lawsuit. The lower a plaintiff's expected recovery, the less likely s/he is to expend effort prosecuting a suit. Lawsuits—particularly those involving injury or death—require time, money, lawyers, and emotional commitment, all of which are costly. In a jurisdiction that has adopted the make whole rule, the plaintiff knows s/he will only have to reimburse the insurer if s/he is made whole. That

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*Interest in the Insured's Personal Injury Recovery*, 80 ILL. B.J. 224, 225 n.19 (1992) ("The 'benefit of the bargain' rationale is especially suspect in light of the contention by some that subrogation recoveries do not affect the premiums charged by insurers.") (citing Reuben Hasson, *Subrogation in Insurance Law—A Critical Evaluation*, 5 OXFORD J. LEG. STUD. 416, 422 (1985)); see also *Maxwell v. Allstate Ins. Co.*, 728 P.2d 812, 815 (Nev. 1986) ("Precluding the subrogation of the insurer does not result in a double recovery for the insured because the insured is merely receiving benefits for which he has already paid. Allowing subrogation . . . results in a windfall recovery for the insurer.") (citations omitted); Baron, *Subrogation on Medical Expense Claims*, *supra* note 15, at 581–82 (1992) (claiming subrogation recovery not factored into premium rates and arguing that subrogation creates "windfall" to the insurer); cf. Harris Ominsky, *Leases: Negligent Tenant's Liability to Landlord's Insurer*, REAL EST. L. REP., Apr. 2003, at 2, 2 (concluding in the real property context that subrogation recoveries are not calculated in rates because real estate insurers do not raise premiums when waiving the right of subrogation in insurance contracts); James M. Fischer, *Why Are Insurance Contracts Subject to Special Rules of Interpretation?: Text Versus Context*, 24 ARIZ. ST. L.J. 995, 1023 n.95 (1992) (noting that "no decision reports that insurers have even attempted to demonstrate a relationship between subrogation rights and premium rates" and suggesting that to quantify this relationship would be costly to insurers).

is, where a jurisdiction has adopted the make whole limitation on subrogation, the loss-victim will be required to pay the insurer back the medical losses the insurer indemnified *only* if the victim's losses are fully compensated by money recovered from the loss-causer. The first-dollar rule, in contrast, poses a considerable threat to plaintiff's recovery. The plaintiff is the junior creditor on the dollars recovered: the first money in goes to the insurer; the next dollars go towards paying the plaintiff's attorneys and costs of suit; and any remaining dollars go to the plaintiff. This is true regardless of whether the damages award is compensating the plaintiff for the medical expenses that have been advanced by the plaintiff's insurer.

The diminution in the plaintiff's litigation expectancy has dramatic consequences in most cases.<sup>167</sup> There are three potential outcomes for a potential plaintiff: s/he may receive a damages award that fully compensates all losses caused by the tortfeasor (full recovery), compensates only some of those losses (partial recovery), or compensates none of the losses (no recovery). Full recovery is rarely obtained.<sup>168</sup> Far more likely is a partial recovery. Under a first-dollar recovery rule, depending on the settlement discount the plaintiff accepts, his or her net recovery may be close to or actually zero, and it may even be negative.<sup>169</sup> Imagine that the plaintiff's damages are \$100: \$50 medical and \$50 lost earnings. If the plaintiff recovers \$50, under the first-dollar recovery rule, the plaintiff keeps nothing, and may be out attorneys fees and/or court costs. In a no-recovery situation, plaintiff's recovery is at best zero—if his or her attorney had a contingent fee agreement, agreed to advance all the costs, and had required virtually no participation for the plaintiff. At worst, plaintiff's recovery in a no-recovery situation will be significantly

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167. Such is true even if one believes the insured knowingly and fairly received an equivalently lower premium in return for the burden of the first-dollar recovery provision. Whatever the fairness of the deal between the insured and the insurer, the larger the percentage of the insured's ultimate tort recovery that must go to the insurer and the higher priority the insurer has with respect to all dollars recovered, the less likely the insured will expend resources suing a third-party tortfeasor.

168. See, e.g., Peters, *supra* note 160, at 1803 (describing data analysis of malpractice settlements as showing that "plaintiffs who receive a settlement are unlikely to recover the full amount of their damages"); Michael J. Saks, *Do We Really Know Anything About the Behavior of the Tort Litigation System—And Why Not?*, 140 U. PA. L. REV. 1147, 1216–22 (1992) (reviewing studies that compared tort compensation to actual economic loss). Even where one's losses are fully recompensed, first-dollar recovery clauses can reduce the value of that outcome to the plaintiff to the extent that the plaintiff's attorneys' fees are entirely subordinate to the first-dollar recovery right. Equitable subrogation, in contrast, is limited by the common fund rule.

169. One would accept such a small or zero return because the costs of proceeding to trial might have a negative expected return. See *infra* note 170.



negative because, for example, the plaintiff had to pay the costs of suit up front or invest considerable time in a case that returned no award.<sup>170</sup> Thus, when considering his or her chances for litigation success, unless a plaintiff burdened by a first-dollar recovery rule envisions a very high likelihood of a complete or near complete recovery, there is little incentive to expend resources and incur the risk associated with a lawsuit.

Insurance companies realize the litigation-detering effect first-dollar recovery provisions (and reimbursement provisions in general) can have, but there is little an insurance company can do to make an insured prosecute a suit the insured does not want to litigate. Of course, insurers can and do reserve a strict-subrogation right to maintain a suit on behalf of the insured—that is, to commence litigation against the tortfeasor themselves.<sup>171</sup> Yet such lawsuits pose considerable transaction costs to insurers: they must bear all or some of the costs of suit, and policyholders may be unmotivated to incur the effort of supplying favorable medical or liability evidence.<sup>172</sup> What is likely more attractive to an insurer than a strict-subrogation policy of recouping payouts by litigation is a “reimbursement plus higher rates” policy of (a) using first-dollar recovery provisions to collect contractual reimbursement from the insured-plaintiffs who sue in spite of the reduced expected return imposed by first-dollar recovery rules and (b) charging higher premiums to cover the significant unrealized recoupment associated with deterring insureds from suing the loss-

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170. The risk of a “no award” result is particularly dangerous because many jurisdictions now have some version of an “offer of judgment” rule—a fee shifting rule of certain litigation expenses that is triggered when a rejected settlement offer is more than the ultimate judgment. See Elaine A. Carlson, *The New Texas Offer-Of-Settlement Practice—The Newest Steps in the Tort Reform Dance*, 46 S. TEX. L. REV. 733, 736 (2005) (discussing prevalence of such rules). Rare is the “no award” case in which the defendant did not make some “offer-of-judgment” so as to capture the benefit of a fee-shifting rule and incent the plaintiff to settle.

171. DAVID L. LEITNER, REAGAN W. SIMPSON & JOHN M. BJORKMAN, 3 LAW AND PRACTICE OF INSURANCE COVERAGE LITIGATION § 42:13 (2005) (discussing actions by subrogee and procedural variations).

172. 16 COUCH ON INS., *supra* note 14, § 226:3 (explaining that insurers favor reimbursement because it avoids “the expense of prosecuting its own action against a third party”); see also Neil D. Okazaki, Note, *People v. Sexton: Insuring an Absurd Result Through Inflexible Interpretation—The Court of Appeal Denies Criminal Restitution to a Victim's Insurance Company*, 31 LOY. L.A. REV. 297, 322 (1997) (noting costly nature of subrogation suits with “uncooperative policyholder[s]”). Even when insurers and insureds cooperate on a strict subrogation claim, transaction costs can be significant. See Thomas S. Brown & M. Jane Goode, *Conflicts of Interest in Subrogation Actions*, 22 TORT & INS. L.J. 16, 26 (1986) (noting that often policyholders and insured differ on “the allocation of the proceeds, fees, and costs, as well as who should have the power to accept or reject an offer of settlement”).

causer. Such policies impose fewer transaction costs and produce more predictable revenues.

Ultimately, the first-dollar recovery rule favors loss-insurer recoupment at the price of loss-causer deterrence and restitution. It does so because loss-causers are denied unjust enrichment by successful suit and deterred by threat of suit. Yet the first-dollar recovery rule makes it considerably less likely that the insured will sue the tortfeasor, for the reasons discussed above. Torts committed against insured people—particularly torts whose primary measure of damage is medical—will be underpoliced relative to those torts in a world absent first-dollar recovery rules.

Nor is the insured loss-victim's incentive to underpolice necessarily made up for by the loss-insurer's incentive to hold the tortfeasor accountable. The loss-insurer can simply structure effective premium rates such that the insurer assumes it will never recover from the tortfeasor. In other words, the insurer can make a decision to offer a higher effective premium to compensate for the fact that the insurer does not wish to discount premium rates as compensation for the uncertain right of subrogation recovery. At the same time, because of unequal bargaining power and the largely non-negotiable nature of the insurance products at issue, loss-insurers can insert first-dollar recovery clauses to capture additional revenue on the backs of the insureds who successfully pursue tortfeasors notwithstanding the burden of a first-dollar recovery provision. In short, the first-dollar recovery feature—and contractual subrogation in general—abandon subrogation's tort policy objectives of preventing unjust tortfeasor enrichment and deterring future tortious conduct in favor of insurer recoupment. Neither historical subrogation nor tort theory justifies such an outcome.<sup>173</sup>

A final consequence remains. Loss compensable in tort is broader than loss compensable through insurance; for example, pain and suffering damages are recoverable only through tort.<sup>174</sup> To the extent

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173. Judicial decisions have noted that contract may and should play some role in subrogation. Certainly our position is not that there is no role for contract. Contract terms can usefully provide, for example, for the orderly administration of the subrogation right. But acknowledgement that contract terms may play a role is very different than the position that contract terms *in all respects* subordinate to nothingness considerations of equity and public policy. Indeed, our central thesis is that, when the question of subrogation as pure contract is analyzed in depth, such a presumption has undesirable consequences.

174. George L. Priest, *Can Absolute Manufacturer Liability Be Defended?*, 9 YALE J. ON REG. 237, 242–43 (1992) (“[F]irst-party insurance provides no coverage whatsoever of pain and suffering loss, while pain and suffering comprises a significant portion of tort law damages for almost all injuries.”).

that truly complete compensation for the insured requires both insurance and tort recovery, subrogation provisions that undermine or destroy the incentive of a loss-victim to sue (and thus recover non-insured losses) frustrate tort law's goal of supplying full compensation for tort victims.

### CONCLUSION

Up until this point, no theoretical framework that describes and encompasses the players in, policy objectives of, and history of subrogation has been employed by policymakers to determine subrogation policy or set an empirical research agenda. The aim of this article is to supply such a tool.

Even in the absence of a synthesizing conceptual framework, neither state legislatures nor state judges have been entirely blind to the various issues subrogation as contract implicates. A pastiche of solutions to the policy difficulties created by tort subrogation as contract has developed among the numerous states to have addressed (either judicially or legislatively) the issue.<sup>175</sup> Some solutions, of course, are better than others. But perhaps the worst solution—a pure subrogation as contract paradigm—has threatened to take hold in the federal courts in the ERISA context, as explained in Section II.B. In our view, the current ERISA subrogation jurisprudence reflects a confused embrace of subrogation as contract, with little heed to historical protections. Lacking the appropriate theoretical prism with which to understand subrogation's aims and limits, the federal judiciary has regrettably issued decisions inconsistent with a comprehensive understanding of the depth and nuances of true tort subrogation doctrine and its multiple policy objectives.<sup>176</sup>

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175. This article does not attempt to catalogue the solutions currently in force in various states. For an introduction to the differing approaches across jurisdictions, see Rinaldi, *supra* note 15, at 807–14 (providing a dated but informative taxonomy of the categories of judicial solutions employed by the states); John Dwight Ingram, *Priority Between Insurer and Insured in Subrogation Recoveries*, 3 CONN. INS. L.J. 105 (1996) (review of illustrative cases); 16 COUCH ON INS., *supra* note 14, §§ 222:41–52 (reviewing statutory treatment of subrogation). Our view generally is that pure contractual subrogation should be judicially disfavored absent a clear indication from the relevant legislature that the concerns outlined in this article are outweighed by a particular legislative aim that would be served by permitting enlarged subrogation rights. We have seen little conclusive evidence that the most commonly offered policy justification—lowered insurance rates—is actually borne out by the facts, or, in any event, that the full range of negative consequences attending pure contractual subrogation have been factored into the judicial, legislative or scholarly analysis of the subject.

176. *E.g.*, Admin. Comm. of the Wal-Mart Stores, Inc. Assocs.' Health and Welfare Plan v. Shank, 500 F.3d 834, 838 (8th Cir. 2007) (“Among the primary purposes of ERISA is to ensure the integrity of written plans and to protect the expectations of participants and beneficiaries. . . . We therefore do not apply common law theories to alter express terms of a written plan.”); Harris

This federal conceptual error threatens to fuel a national crisis, because ERISA's preemptive scope in many instances deprives states of the authority to impose limits on contractual subrogation in the tort setting. The federal judiciary's misguided approach to subrogation, by virtue of ERISA, is to some degree imposed on all states and their citizens. In addition to the preemptive effect of these cases, the influential force of the federal judiciary, particularly the Supreme Court, is enormously powerful and cannot help but pull state benches in its direction.<sup>177</sup> The combination of the federal decisions' preemptive and persuasive force presages a world where the least attractive subrogation rule is the dominant one.

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v. Harvard Pilgrim Health Care, Inc., 208 F.3d 274, 280–81 (1st Cir. 2000) (rejecting application of both common fund and make whole principles to insurer's reimbursement claim against insured); Blue Cross & Blue Shield of Ala. v. Sanders, 138 F.3d 1347, 1354–56 (11th Cir. 1998) (holding that state make whole limitation on reimbursement is preempted by ERISA); Health Cost Controls v. Isbell, 139 F.3d 1070, 1072 (6th Cir. 1997) (rejecting application of common fund principle in reimbursement suit by insurer against insured); Sunbeam-Oster Co., Inc. Group Benefits Plan for Salaried and Non-Bargaining Hourly Employees v. Whitehurst, 102 F.3d 1368, 1378 (5th Cir. 1996) (enforcing first-dollar recovery provision to the exclusion of make whole principle in reimbursement and subrogation suit); McIlheran v. Lincoln Nat'l Life Ins. Co., 31 F.3d 709, 711 (8th Cir. 1994) (interpreting Nebraska law to allow contractual provision to override make whole principle); Fields v. Farmers Ins. Co., Inc., 18 F.3d 831, 836 (10th Cir. 1994) (rejecting application of make whole principle in favor of "clear and unambiguous subrogation provisions of this insurance contract"); Cutting v. Jerome Foods, Inc., 993 F.2d 1293, 1298–99 (7th Cir. 1993) (holding that make whole limit on reimbursement should not be applied in the face of contrary contractual language). Ironically, these decisions would be surprising to the very pre-merger equity authorities the Supreme Court has commanded be consulted in issuing ERISA remedy decisions.

177. Indeed, the Texas Supreme Court recently invoked the Supreme Court's decision in *Sereboff* as persuasive support for its decision to uphold a first-dollar recovery provision. *Fortis Benefits v. Cantu*, 234 S.W.3d 642, 648 (Tex. 2007) (characterizing the U.S. Supreme Court's decision in *Sereboff* as a "refus[al to] apply the 'made whole' doctrine" and relying in part on *Sereboff* to achieve the same result as a matter of state law).