State Specific: Tennessee

Snatching Defeat from the Jaws of Victory: When the Insured Recovers, But You Don't!

BY JENNIE SMITH-HOWARD AND MATTHEW FINK, RATHBONE GROUP, LLC

The lawsuit against the wrongdoer isn't going to trial. The case has been settled! Great! Time to recover the subro dollars, right?

But one obstacle stands in your way: the insured. Insurance policies routinely obligate the insured (and attorney) to refrain from any act that would prejudice the insurer's subrogation rights, such as settling a claim without notifying the insurer and signing a release. Even so, insureds with personal injury claims seek to minimize the subrogation recovery. This article addresses three common tactics used to minimize the subrogation claim and suggestions for how the subrogated carrier should respond. While this article is specific to Tennessee, many other states employ these similar theories.

The common fund doctrine is one tactic invoked by a plaintiff's attorney who has succeeded "in securing, augmenting, or preserving property or a fund of money which other people are entitle to share in common."[1] Specifically, an insured's attorney may seek reduction of the subrogation recovery for the legal services rendered under the premise of an idle subrogated carrier riding the coattail of its insured while the insured's attorney incurs all the costs and effort incident to litigating the claim. The insured's attorney may oblige the insurers, as beneficiaries of the settlement, to contribute to attorney's fee by assessing it directly against the fund or property itself.[2] Under this doctrine, courts typically reduce a subrogation claim by a percentage equal to the attorney's fee arrangement with the insured, usually by one-third. The subrogated carrier can prevent such reduction by notifying the insured and the attorney that they are retaining counsel to protect it subrogation interest, by directing its counsel to actively participate in the litigation (by pleading or otherwise), and offering to defray some of the costs of litigation (expert witness fees, medical record compilation fees, mediation fees, etc.).

Tennessee also adheres to the made-whole doctrine which precludes an insurer's right of subrogation until the insured has been fully compensated or "made whole" by combined

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payments from all applicable sources (i.e., insurance proceeds, tortfeasor payments, etc.). Insurers cannot draft insurance policies to modify or waive the made-whole doctrine or limit the insured's right to settlement by withholding insurer consent or compelling the insured to negotiate for a higher settlement amount.[3]

When faced with a made-whole argument, the subrogated carrier should (1) know the full amount of damages sustained by the insured (other liens, unpaid medical bills, etc.), (2) the amount to be received from the wrongdoer including the amounts of the settlement allocated to each element of damage and (3) review the settlement agreement between the insured and the wrongdoer. When a carrier is precluded from participating in the settlement negotiations between its insured and the wrongdoer or does not expressly waive any subrogation rights, such rights must be honored and the made-whole doctrine is inapplicable.[4] However, the insured has the burden of proving that he has not been made whole. As such, it possible to overcome this presumption by proving that he was not made whole by the settlement or recovery.[5] For example, if the parties agree that the insured has not been made whole or the underlying facts make clear that the recovery is for less than full compensation, the insurer's subrogation claim is extinguished.[6] If the subrogated carrier feels that the settlement was unreasonable, a determination can be made in an evidentiary hearing. However, such a hearing can be costly for the insurer, as medical and other expert testimony may be required. Whether a settlement of the underlying tort action is reasonable should depend on the strength of the liability case against the wrongdoer, the value of the case in the absence of liability issues, the financial resources of the wrongdoer, the financial resources of the plaintiff, the expenses of litigation, whether fault can be allocated to other wrongdoers and other relevant factors.[7] In general, insurers should minimize the made-whole risk by participating and investing in the lawsuit early and documenting such investment.

The third tactic is to argue that a liability release bars subrogation recovery. Since the subrogated carrier is not included in the drafting process, the release is not drafted to favor subrogation. Some plaintiff attorneys negotiate the subrogation claim after the insured signs a release in favor of the wrongdoer. At that stage, the insured is eager to get paid notwithstanding the subrogation issues arising from releasing the wrongdoer. In addition,

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the wrongdoer will not allow settlement of the underlying case that does not also resolve the subrogation claim. As such, the release will contain language obligating the insured to pay all subrogation interests out of the settlement funds which usually results in a reduced subrogation recovery. Once this happens, the carrier can attempt to have the release set aside or modified on equitable grounds, especially if the insured or wrongdoer's attorney has previously agreed to paying the claim. The carrier can further argue that the release should be viewed as subject to the subrogation claim due to the carrier having given notice to all parties of its intent. Early and clear communication with all parties is critical, and the carrier can also intervene so that any dismissal of the suit is protected by judicial review.

When the subrogated carrier is aware of these three settlement tactics used by plaintiff attorneys, it can administer the claim differently to protect its subrogation interest.

Endnotes:

1. *House v. Estate of Edmonson*, 245 S.W.3d 377 (Tenn. 2008) (quoting Travelers Ins. Co. v. Williams, 541 S.W.2d 587, 589-90 (Tenn. 1976)).
2. *Id.*
3. *Wimberly v. Am Cas. Co. of Reading, Pa.*, 584 S.W.2d 200 (Tenn. 1979)
4. *Doss v. Tenn. Farmers Mut. Ins. Co.*, No. M2000-01971-COA-R3-CV, 2001 Tenn.App. December 10, 2001 WL 1565883
5. *Hamrick's Inc. v. Roy*, 115 S.W.3d 468 (Tenn. App. 2002)
6. *Doss v. Tenn. Farmers Mut. Ins. Co.*, No. M2000-01971-COA-R3-CV, 2001 Tenn.App. December 10, 2001 WL 1565883
7. John A. Day *"Made-Whole" Made Fair: A Proposal to Modify Subrogation in Tennessee Tort Actions*, Belmont L. Rev. Vol. 1:41