RATHBONE GROUP

1100 Superior Avenue, Suite 1850
Cleveland, Ohio 44114

800-870-5521

www.RathboneGroup.com

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

The insured has settled their lawsuit. Great! Time to recover the subro dollars! But one thing stands in your way, the insured. Liability 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, insurer (and attorneys) with personal injury claims seek to minimize your subrogation recovery. This article concerns three common efforts and suggestions for how the subrogee should respond. While this article is specific to Tennessee, many other states employ these similar theories.

The common fund doctrine may be invoked if the attorney has succeeded "in securing, augmenting, or preserving property or a fund of money which other people are entitle to share in common.[1] More specifically, an insured's attorney may seek reduction of the subrogation recovery for the legal services rendered under the rationale of an idle subrogee riding the coattail of its insured while the insured or their attorney incurs all the costs and effort incident to litigating the claim. The insured's attorney may oblige the beneficiaries of the fund or property to contribute to his or her fee by assessing that fee directly against the fund or property itself.[2] Under this doctrine, courts will reduce a subrogation claim by a percentage equal to the attorney's fee arrangement with the insured, or by 33%. Subrogees can prevent having their subrogation interest reduced by the common fund doctrine by notifying the insured and the attorney that they are retaining their own counsel to protect their interest, by directing counsel to actively participate in the litigation by pleading or otherwise, and to offer 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 payments from all applicable sources *(i. e. insurance proceeds, tortfeasor payments, etc.).* Insurers cannot use policy terms to modify the made-whole doctrine or limit the insurer's right to settlement by withholding insurer consent or compelling the insured to negotiate higher settlement amounts.[3]

---

[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)

When faced with a made-whole argument, the subrogee should first (1) know the full amount of damages sustained by the insured, (2) the amount to be received from the wrongdoer including the amounts of the settlement allocated to each element of damage and (2) review the settlement agreement between the insured and the wrongdoer. When an insurer 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] The insured has the burden of proving that he is not made whole by the settlement or recovery. [5] If the insurer feels that the settlement was unreasonable, a determination can be made in an evidentiary hearing. Such a hearing can be costly for the subrogee, as medical and other expert depositions may be required. In general, subrogees should minimize the made-whole risk by investing in the claim early and documenting such investment. Sometimes, recovery from insurance proceeds will be barred by the made-whole application, and the subrogee should evaluate whether there is any collection potential from the liable wrongdoer.

The third ploy is the insured's attorney and the wrongdoer's attorney negotiating the settlement agreement (without the insurer) and then arguing that a liability release bars subrogation recovery. Some insureds' attorneys negotiate the subrogee's claim *after* the insured releases liability on a release. Often the release contains language obligating the insured to pay all subrogation interests out of the settlement funds thereby extinguishes the insurer's subrogation rights. The subrogee usually is not privy to these negotiations. However, where the insurer did not participate in the settlement negotiations of the claim and did not waive its right of subrogation, the subrogation claim must be honored and the made-whole doctrine has no application."[6] In this event, the subrogee can attempt to have the release set aside or modified on equitable grounds, especially if the parties have committed to paying the claim.

[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