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SUBROGATION – *RIGHT TRANSFER* MECHANISM IN *RISK TRANSFER* INDUSTRY

Summary

This article is discussing the subrogation as one of the key legal concepts of insurance business. Origin and definition of subrogation, historical background, types of subrogation, common and civil law approaches to this legal concept, legal doctrines made to ameliorate the harshness of subrogation, 'made whole doctrine' as the most widespread one, pros and cons of made whole doctrine are examined in this article. It is also indicated that in spite of its 'blind sides' the made whole doctrine, there is no any alternative. Furthermore, the necessity of modifications is also emphasized.

Annotasiya

Məqalədə sığorta fəaliyyətinin əsas hüquqi konseptlərindən biri olan subroqasiyadan bəhs olunur. Məqalədə təhlil olunan məsələlər sırasında subroqasiyanın anlayışı və mənşəyi, tarixi əsası, subroqasiyanın növləri, anqlo-sakson və roman-german hüquq institutlarının yanaşması, subroqasiyanın sərt mövqeyini yumşaldan hüquqi təlimlər, ən geniş yayılmış 'tam yerinə yetirmə' hüquqi təlimi, bu təlimin üstün və zəif cəhətlərinin təhlili yer tutur. Eyni zamanda bu təlimin zəif cəhətlərinə baxmayaraq alternativsiz olduğu qeyd olunur. Bununla yanaşı, dəyişikliklərə olan ehtiyac da vurğulanır.

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INTRODUCTION

Subrogation! Global community is seldom interested in this term. To be more precise, insurance subrogation has been paid so little critical attention by legal scholars. According to Hasson, as most writing in the law of subrogation has been aimed at practitioners, there is a feeling that "practitioners are not interested in policy debates".[1] Hasson goes further and emphasizes the importance of subrogation by saying that "many lawyers cannot envisage the law of insurance functioning without the doctrine of subrogation".[2] However, it is unreasonable to say that, the term 'subrogation' earned much more importance at the outset of new millennium.

On the other hand, as highlighted by Capwell, although 'subrogation' has recently gained in popularity, "much of the law is unsettled".[3] In other words, there needs to have much heated debate over it. On the positive side, subrogation has not been a 'boilerplate clause' and the doctrine has been changed in many important ways. For instance, in some jurisdictions insurers sought "the creation and enforcement of subrogation rights for payments on medical expenses and other types of claims".[4] In addition, the doctrines designed to pave the way for subrogation and to ameliorate the harshness of it, were also major ingredients of the development recipe.[5] It is worth noting that these doctrines did cause a 180-degree change in prevailing views regarding subrogation. With more attention paid to the doctrines of subrogation, it prospered as never before.

I. ORIGIN AND HISTORICAL BACKGROUND OF SUBROGATION

A. Subrogation in General

In today's parlance, the doctrine of subrogation is like a dime in a dozen in the insurance world. Without doubt, subrogation, as a front page of the *Wall Street Journal* gives right to say this and to emphasize its mushrooming growth.[6] More to the point, in juxtaposition to other institutions of insurance, subrogation has become the cornerstone of the development in insurance

[1] Reuben Hasson, *Subrogation in Insurance Law – A Critical Evaluation*, 5 Oxford J. Legal Stud. 416, p. 416 (1985).

[2] Ibid.

[3] Rex Capwell & Thomas E. Greenwald, *Legal and Practical Problems Arising from Subrogation Clauses in Health and Accident Policies*, 54 Marq. L. Rev. 255, p. 257 (1971)

[4] Roger M. Baron, *Subrogation: A Pandora's Box Awaiting Closure*. 41 S.D. L. Rev. 237, p. 239 (1996).

[5] Ibid.

[6] Vanessa Fuhrmans, *Accident Victims Face Grab for Legal Winnings*, http://www.wsj.com/articles/SB119551952474798582 (last visited April 14, 2016).

industry. Without exaggeration, subrogation has been of vital importance for both parties – insurers and insureds to some extent. In order to provide an accurate picture of subrogation, it is worth to make an excursus into its origin.

1. What is subrogation?

According to Sheldon, subrogation is "the substitution of another person in the place of a creditor, so that the person in whose favour it is exercised succeeds to the rights of the creditor in relation to the debt".[7] This general principle of subrogation can easily be found in the law of insurance. As indicated by King, from the insurance perspective, insurance subrogation is "the substitution by which the insurer who has paid a loss under a policy succeeds to any rights the insured may have against any other person who may be primarily responsible for the loss".[8] In other words, according to legal writers of fame, "the insurer steps into the shoes of the insured and acquires all of the rights the insured may have against a third party".[9] It might be thought, at first blush, that subrogation gives all of the rights to the insurers. However, Parker made it clear that insurer can inherit the rights only possessed by insured against tortfeasor.[10] Nobody finds it odd that, authors have been on the right track when they explain subrogation as the transfer of rights. However, according to several authors, in order to get in-depth analysis of subrogation it is not enough. To be more precise, Maher and Pathak reveals that as one of the widespread legal concepts, understanding of subrogation requires "a new organizational framework that is cognizant of subrogation's analytic foundations, its players and its policy aims".[11] Thus, germane to insurance subrogation, it is important not to focus purely on it as a right transfer mechanism, but to thoroughly analyse it as a complex legal concept.

2. 'Pandora's box' or 'Cash box'?

As mentioned above, insurers insisted upon expansion of subrogation into personal injury claims. No doubt, there were resistance against the expansion of subrogation and it was also emphasized that such expansion would be equivalent to "lifting the lid on a Pandora's Box (term used to describe a source of many troubles) crammed with both practical and legal problems".[12] Baron goes even further by indicating that when subrogation will be

[7] Henry N. Sheldon, The Law of Subrogation, p. 1 (Boston, Soule and Bugbee, 1882).

[8] Cecil King, *Subrogation under Contracts Insuring Property*, 30 Tex. L. Rev. 62, p. 62 (1951).

[9] Johnny Parker, *Made Whole Doctrine: Unraveling the Enigma Wrapped in the Mystery of Insurance Subrogation,* 70 Mo. L. Rev. 723, p. 724 (2005).

[10] Ibid.

[11] Brendan S. Maher & Radha A. Pathak, *Understanding and Problematizing Contractual Tort Subrogation*. 40 Loy. U. Chi. L.J. 49, p. 53 (2008-2009).

[12] Baron, p. 237.

eliminated from the insurance industry, the society will be better off and insurers will be deprived of their 'windfall'.[13] In contrast to Baron, to the best of Bray's knowledge, the insurance subrogation cannot be compared with Pandora's Box and vice versa, it should continue to be enforced.[14]

Central to my argument, as a widespread legal concept, insurance subrogation is not crammed with both practical and legal problems or to be more precise it is not evil to society. Moreover, it is not a novel concept; insurance subrogation derives its roots from Roman law. Nowadays, it would be wrong to say that this legal concept does not need any further analysis. Vice versa, insurance subrogation has to be explored deeply and should be modified according to the new conditions of insurance industry. Thus, it becomes natural to think that the metaphor of Pandora's Box cannot be considered as a description of insurance subrogation, which is "an excellent strategy for recouping insurance losses".[15] It is probably not unreasonable to say that, for insurers, subrogation is a 'cash box' or that is to say 'cash cow', which can easily compensate the amount given to insured by getting it from third parties.

B. An Existence Form of Insurer's Right of Subrogation

As an equitable remedy, insurance subrogation imposes ultimate responsibility on the tortfeasor for a wrong or loss.[16] As mentioned above, the insurer (subrogee) steps into the shoes of the insured (subrogor) in order to enforce the subrogation right. However, the question can arise out of this enforcement. How can this right be enforced? In order to have a clear idea, it is crucial to draw attention to the types of subrogation.

1. Conventional (arising from contract) subrogation

Conventional subrogation is that which arises by virtue of an express contract between 'the insurer' and 'the insured', that the insurer shall be subrogated to the rights of insured.[17] As should be clear by the name, this type of subrogation can only result from the agreement of parties. It is also worth to note that the term 'agreement' does not mean only contracts signed by the parties. The agreement can take many forms, such as a subrogation provision in policy or a release agreement, assignment or trust agreement.[18] In addition, King indicates that subrogation provision in policy is not mandatory, the

[13] Baron, p. 243.

[14] F. Joseph Du Bray, *A Response to the Anti-Subrogation Argument: What Really Emerged from Pandora's Box*, 41 S.D. L. Rev. 264, p. 276 (1996).

[15] Gary L. Wickert & Stan F. Nelson, *Many Insurers Overlook Advantages of Subrogation*, 96 Best's Review 84, p. 84 (1995).

[16] Veal, G. R., *Subrogation: The Duties and Obligations of the Insured and Rights of the Insurer Revisited*, 28 Tort & Insurance Law Journal 69, p. 69 (1992).

[17] Kintanar, A. Y. (1918). Subrogation. *Philippine Law Journal, 4*(8), 243-257, p247.

[18] Parker, p. 726.

conventional right of subrogation may arise through "the taking of a subrogation receipt from the insured at the time he is paid by the insurer".[19]

Conventional subrogation has some specific components of Roman law. For instance, in Roman law, "a person who pays a creditor could be subrogated to the rights of the creditor, provided that the subrogation is done simultaneously with the payment – *quum convenisset, ut mandaretur actiones*".[20] This point of view accepted by most of the Civil Law countries.

In contrast to Roman law, there were some limitations on subrogation rights by Common law. As a result, in order to recoup the losses, insurers turned to conventional subrogation. With the help of contracts, insurers started to include specific provisions in contracts which paved the way for insurers so as to realise 'strict subrogation rights or a subrogation reimbursement right'.[21]

2. Legal (equitable or judicial) subrogation

Apart from conventional subrogation, the law of insurance distinguishes another type of subrogation – legal subrogation. The word 'legal' in this broad sense resembles something according to law, but with regard to its use in legal subrogation, it means that kind of subrogation which arises *ministerio legis* and it also take place upon the concurrence of the required conditions.[22] This type of subrogation also had its origin in Roman law. For example, the subrogation in favour of a subsequent creditor had its origin in *jus offerendi*.[23]

Like most of the Roman law legal principles, it found admirers in not only Continental Europe, but also in Commonwealth countries. Especially, United States of America has made significant steps regarding legal subrogation in contrast to other Common law jurisdictions. Broadly speaking, in the vast majority of instances, "a person who performs the obligation of another does not need to obtain a conventional subrogation by the obligee or the obligor because the law by its direct operation subrogates that person to the right and action of obligee".[24] It has also been assumed that, in doing so, "the law introduces a sort of implied or constructive conventional subrogation".[25]

It should also be noted that the list of types of insurance subrogation is not limited to conventional and legal subrogation. For instance, there is also another type of subrogation which is called statutory subrogation. Although, there are several striking differences between these types, at the same time, these types share specific values which come from 'same root'.

[19] King, p. 69.
[20] Kintanar, p. 249.
[21] Maher & Pathak, p. 72.
[22] Kintanar, p. 256.
[23] Kintanar, p. 255.
[24] Saul Litvinoff, *Subrogation*, 50 La. L. Rev. 1143, p. 1163 (1990).
[25] Ibid.

C. Historical Perspective of Insurance Subrogation

1. From Roman law perspective

In light of the history of insurance subrogation, this legal concept has its roots in both Roman law and Common law. According to Maher and Pathak, being an extremely old doctrine, subrogation's precise origins are unclear, but it is true enough that this legal concept is a 'direct progeny' of Roman, Talmudic and French Law.[26]But, in juxtaposition to Common law, Roman law became the mainstay of subrogation and it can be traced back to two Roman law institutions: *cession or assignment of actions* and *successio in locum creditoris*.[27] The cession or assignment of actions gave all the advantages the creditor had to the third person, while the successio in locum creditoris allowed the third person only the benefit of a particular mortgage rank.[28] These two Roman law institutions were mixed by French *ancient droit* and in 1609; an edict of Henry IV sanctioned the binding force of conventional subrogation.[29]

At the other extreme, most French scholars admits that the French concept was similar to the Roman doctrine of *cessio actionum*.[30] Renusson noted the similarity between French concept and Roman doctrine:

> "The term *cession* is a common and equivocal term that includes many different things. This term is given to the transfer of a debt, to the delegation, the subrogation, and the voluntary transference of a debtor's goods to his creditors, and to the cession of wealth that a debtor does in Law to obtain his freedom of his person. All these things are different: nonetheless they are often called *cession*".[31]

2. From Common law perspective

As mentioned above, the legal principles of Roman law was also admired by Common law jurisdictions. However, in spite of nurturing from same root, without doubt, the Common law approach was different and had its own characteristics. For instance, in contrast to European jurisdictions, at Common law, subrogation is not a matter of strict law, "but a purely equitable doctrine, so that granting a remedy based thereon lies within the discretion of the court".[32]

By the middle of the nineteenth century, equitable remedy was widespread and used by both English equity and Common law courts. However, English

[26] Maher & Pathak, p60.

[27] Litvinoff, p1150.

[28] *Ibid*.

[29] *Ibid*.

[30] M. L. Marasinghe, *Historical Introduction to the Doctrine of Subrogation: The Early History of the Doctrine II, An*, 10 Val. U. L. Rev. 275, p. 284 (1975-1976).

[31] *Ibid*.

[32] Litvinoff, p. 1150.

courts had troubles regarding the label of the concept. Thus, as highlighted by Marasinghe, the English looked to other jurisdictions which had a similar kind of equitable doctrine to name the English concept.[33] Then, the French model was very suitable for its label and the similarities between them were clear and numerous. On the other hand, it is worth noting that English courts did not use the term of 'subrogation' till 1850. Precisely, in 1851, the Privy Council had *Quebec Fire Insurance Company v. Augustin St. Louis and John Molson* which was the first case using the French concept of 'subrogation' and this was very similar to the Roman doctrine of *cessio actionum*.[34]

Bringing us through to modern times, it can be clearly seen that both doctrines - common law doctrine of subrogation and civil law doctrine of *cessio actionum* has some distinctions and similarities. First of all, it is not unreasonable to say that both concepts are the transfer of rights. In other words, both legal systems accept subrogation as a transfer of insured's rights against tortfeasor to insurer. With regard to the distinctions, it is important to emphasize the fundamental difference. At common law, there is no any requirement of any express agreement to transfer rights for applying subrogation, while civil law is in a different position; in *cessio actionum* an express agreement to transfer rights must always precede the payment.[35]

II. MADE WHOLE DOCTRINE: A *DOUBLE EDGE SWORD* OF MODERN INSURANCE INDUSTRY

A. Made Whole Doctrine as a Panacea for the Harshness of Subrogation

All the authors who have hitherto discussed the subrogation as a legal concept, none of them appears to have considered it fair unilaterally and there has not been formed accepted orthodoxy. At one extreme, some scholars sought to discredit subrogation harsh and to support its elimination,[36] at the other extreme, several legal writers of fame oppose this argument.[37] Consequently, these academic discussions and courts' decisions led to the creation of new doctrines which were aimed to ameliorate the harshness of subrogation. These doctrines have been created primarily by courts and include different approaches to the alleviation of harshness of subrogation: outright denial of subrogation, the made whole doctrine, pro rata loss sharing by insured and insurer and the common fund theory.[38] Although, each of these doctrines is

[33] Marasinghe, p. 284.
[34] *Ibid*.
[35] Marasinghe, p. 299.
[36] Baron, p. 243.
[37] *Id* at p. 264.
[38] *Id* at p. 247.

directed to ameliorate the harshness of subrogation, they possess striking differences and particular efficacy ratios.

Central to Parker's argument, in spite of the complexity and confusion surrounding the application of subrogation, nowadays as a cornerstone of the insurance industry, the made whole doctrine has become 'a double edged sword'.[39] In other words, in contrast to other doctrines, made whole doctrine has attracted much more attention and settled on the top agenda of scholars. As highlighted by Greenblatt, this doctrine is an unalterable element of subrogation and can be labelled as 'talismanic doctrine'.[40] In order to get brief idea concerning this doctrine, it is necessary to shed additional light on it.

According to this doctrine, insurer can realize its subrogation right only when the insured party is wholly compensated. Broadly speaking, it is an equitable principle "which limits the ability of an insurer to exercise its right of subrogation until the insured has been fully compensated or *made whole*.[41] In spite of its hegemony over other doctrines, the made whole doctrine did not answer all the questions related subrogation and along with its advantages, this doctrine also has several disadvantages.

B. Holes of Made Whole Doctrine?

As mentioned above, being a staple doctrine of subrogation drew legal scholars' and courts' attention. Although the doctrine was discussed a lot and accepted as the more modern concept, in the opinions of some writers, there is no need to make this doctrine 'sacrosanct'. Because, this doctrine also does have to be reviewed and its drawbacks are modified. For instance, Baron indicates that most courts make decisions about "real or net compensation", but other costs (hiring an attorney, incur court costs, etc.) should also be considered when deciding on compensation.[42] Central to his other argument, "although the made whole doctrine appears to reach an equitable result, one drawback is that it requires policing on a case-by-case basis".[43] In my point of view, these pros and cons pave the way for quintessential examination of made whole doctrine. Upon closer inspection, it is more appropriate to say that, the advantages of this doctrine 'gets the whip hand' of its own setbacks and other doctrines. It is, in a word, fundamental doctrine of subrogation in the face of insured that seeks to get double recovery.

CONCLUSION

The examination of the 'subrogation' as one of the most attractive legal concept of insurance industry has provided an accurate picture of it. In light of

[39] Parker, p. 737.

[40] Jeffrey A. Greenblatt, *Insurance and Subrogation: When the Pie Isn't Big Enough, Who Eats Last?* 64 U. Chi. L. Rev. 1337, p. 1338 (1997).

[41] Parker, p. 737.

[42] Baron, p. 251.

[43] *Ibid*.

the current high volume of large subrogation claims, it can be easily observed that courts more often refer to this legal concept. However, with regard to its theoretical framework and historical background there is *paucity* in research area.

In spite of its Roman law roots, subrogation is a mixture of civil law and common law doctrines. This hybrid nature of subrogation brings several similarities and distinctions of two legal systems to the fore. It should also borne in mind that although subrogation was first used by common law courts in 1850, in contrast to civil law jurisdictions, there have been made staple steps in order to modify this legal concept in common law jurisdictions. In support of this opinion, the doctrines designed to ameliorate the harshness of subrogation could be best examples.

As mentioned earlier, made whole doctrine maintains its dominance over other doctrines and settled on the agenda of insurance industry approximately all around the world. In today's conditions, as Parker indicates, the made whole doctrine is a double-edged sword to the detriment of both parties: insurer and insured.[44] It is also axiomatic that there can be no any doctrine, which will remain impeccable. Thus, there is need to realize modifications of doctrines or to create new ones and only in this way subrogation can keep its actuality.

[44] Parker, p. 737.