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Welcome to BLWM's First Subrogation Newsletter

Kenneth W. Maxwell

"Subrogation" is not in most vocabularies. On first learning its definition, many cringe at the concept of insurance companies suing for repayment of claim payments. This bias mixed with laws distinct to subrogation and tort recovery make subrogation a challenging niche. With this newsletter, BLWM wants to promote industry discussion about improving subrogation recoveries. We hope you find our newsletters beneficial. Please join our discussions about subrogation via our webpage, www.blwmlawfirm.com or, do not hesitate to contact the authors directly. We look forward to hearing from you.

Suspended Subrogation: A Look Into California's Corporation Laws

By: Carl Guerrieri
cguerrieri@blwmlawfirm.com

In subrogation, it is commonly understood that an insurer stands in the shoes of its insured. For most of us, we understand that to mean an insurance company has no greater claims against a defendant than its own insured. However, we sometimes overlook whether the insured even has the ability to bring a claim. In California, if the insured is a suspended corporation at the time of recovery, the answer to this question may be "no."

California, like most states, has laws governing the formation and perpetuation of corporations. For example, corporations are required to file tax returns and pay an annual fee. The failure to comply with these laws may cause the corporation to become suspended. To encourage compliance with these laws, California does not allow a suspended corporation to prosecute a lawsuit. In fact, an attorney who continues to represent a corporation that has been suspended might be subject to sanctions and criminal penalties.

Thus, even if the insured was a viable entity when the insurance was purchased and when the loss occurred, if it becomes suspended prior to trial or a settlement, then the subrogating carrier stepping into the suspended corporation's shoes could be held to "lack capacity" to prosecute its subrogation case. Put another way, a subrogating carrier can only do what its insured can do. If the insured cannot prosecute the case because of its corporate status, then the carrier stepping into its shoes cannot either. Obviously, a corporate suspension could destroy an otherwise good subrogation case.

To avoid these issues, we recommend that a subrogating insurer include verifying the current status of a corporate insured on its checklist of ongoing issues. This information is readily available via the Secretary of State's website. Often, the issue may be cured by something as simple as paying a delinquent fee. However, some issues may require some lead time to address, or may not be fixable. For example, it may be difficult or impossible for a carrier to restore the corporate status to an entity that was suspended for failure to file or pay corporate taxes. Of course, once the case is in litigation, it is a good idea to maintain contact with the corporate insured so that you immediately become aware if the corporate status is in jeopardy.

FIRM ANNOUNCEMENT

BLWM is pleased to announce that **Kenneth Maxwell** and **Scott Loewe** have been invited to join the Claims and Litigation Management Alliance. The CLM is a nonpartisan alliance comprised of thousands of insurance companies, corporations, corporate counsel, litigation and risk managers, claims professionals and attorneys. The CLM's goals are to create a common interest in the representation by firms of companies, and to promote and further the highest standards of litigation management in pursuit of client defense. Selected attorneys and law firms are extended membership by invitation only based on nominations from CLM Fellows.

Partners Kenneth Maxwell and Scott Loewe practice in the Firm's Scottsdale office and may be reached at our Scottsdale location. We look forward to hearing from you.

SCOTTSDALE
8765 E. Bell Road,
Suite 204
Scottsdale, AZ 85260
Tel 480.502.4664
Fax 480.502.4774

RENO
100 N. Arlington Avenue,
Suite 250
Reno, NV 89501
Tel 775.323.8700
Fax 775.323.8707

LAS VEGAS
7575 Vegas Drive,
Suite 110
Las Vegas, NV 89128
Tel 702.462.6300
Fax 702.462.6303

BLWMlawfirm.com

The Allegory of the Orange and the Made Whole Rule

By: Kenneth W. Maxwell and Rachel A. DePena
kmaxwell@blwmlawfirm.com
rdepena@blwmlawfirm.com

A story is told of two brothers' inflexible fight over an orange. To halt hostilities, an arbiter sliced the orange in two, giving half to each. The first took his half, threw away the peel and ate the fruit. The second threw away the fruit, keeping the peel for use in a recipe. Had the brothers known the interests of the other, they could have come to a compromise that netted each twice the benefits. Like the brothers in the allegory, when the made whole rules apply, sometimes carriers and insureds myopically fix their gaze on the prize – a limited recovery fund – and forget to consider the possible benefits of working together. One such benefit may come from using the same counsel.

However, for the carrier and insured to share the same counsel for recovery efforts arising from a partially insured loss, in many jurisdictions, they will have to address the "made whole doctrine." The made whole doctrine varies from jurisdiction to jurisdiction. But, at its core, the doctrine seeks to ensure that if there is not enough money to cover both the claims of the insured and the carrier, the insured is compensated for its entire loss (e.g., "made whole") before the insurance carrier is reimbursed for claims payments. This article explores a few circumstances where the insured might enjoy a better recovery by compromising its made-whole rights in favor of a counsel-sharing arrangement with the carrier than by insisting upon strict application of the made whole rules. Of course, the degree and extent of any such compromise will vary drastically based on the unique circumstances of each case. Here are a few of the possible benefits of an insured's joining forces with the subrogating carrier.

<u>"Some" versus "no" recovery</u>. The made whole rules may require the carrier to reimburse the insured for expenses that do not qualify as recoverable damages (e.g., attorney fees, expert costs, etc.) in an action against the tortfeasor. Those expenses – a sort of "subrogation tax" – will come out of, but will not be part of the subrogation recovery. However, the carrier, who will have its own non-recoverable expenses, does not have to pursue subrogation. Subrogation requires carriers to put money into investigation and recovery costs and invest employee resources in exchange for the prospect of a recovery that will be big enough to recoup its expenses and reimburse it for some of the claims payments. Insurance carriers tend to be conservative risk takers. Thus, a high "subrogation tax" may cause the carrier to discontinue subrogation efforts. Yet, the insured may have no other avenue to recover any portion of its uninsured expenses because it does not have the ability, desire, or financial wherewithal to independently finance a recovery effort of its own. Sometimes the insured's only avenue for reimbursement of any portion of its uninsured damages may be to restore to the carrier financial incentive to pursue subrogation. After all, some recovery is better than no recovery.

<u>Experts</u>. Subrogating carriers often hire experienced experts to evaluate the potential for recovery. But, if the made whole doctrine makes it financially impractical for a carrier to pursue subrogation, it will let its experts go, often with substantial work undone. While the carrier may make its experts available for the insured to hire, many insureds do not want the ongoing risk of paying experts in advance of an unknown recovery potential or during protracted litigation. Sometimes they will compromise made whole rights to enjoy the benefits of a deep-pocket recovery partner who is willing to finance the experts.

<u>Experienced Counsel</u>. Subrogating carriers typically hire lawyers who are experts in their field. This includes repeat exposure to unique factual scenarios (e.g., fire and water losses), intimate knowledge of and skill with the laws applicable to recovery (e.g., tort and products liability), repeat familiarity with many of the typical defendants and their counsel, and recurring exchanges with industry experts. Most insureds cannot find counsel with this concentrated level of expertise. Some insureds may be willing to compromise their made-whole rights so they can use the same counsel as the subrogating carrier.

<u>Affordable Fees</u>. Some subrogating carriers have volume-rate fee agreements with their counsel. But, even with an uninsured claim large enough to attract separate counsel, most insureds will have to pay their attorneys by the hour or pursuant to a higher contingency fee percentage than the carrier is paying subrogation counsel. Some insureds want to take advantage of the carrier's contingency fee rates and use the same lawyers as the carriers.

<u>Speed and efficiency</u>. A well-represented tortfeasor facing door-closing liability in excess of policy limits and/or assets will not consider piecemeal settlements. It cannot deplete the limited pool of money it has to resolve all claims in favor of one claimant without assurances that all remaining claimants will limit their recovery to the left over money. The only viable option is to resolve all claims together. One holdout claimant can delay resolution and cost the other parties substantial time and money. Typically, (often after protracted litigation), the tortfeasor will offer the pool of money to the entire group of claimants. By joining forces and presenting a unified claim, the insured and carrier often accelerate resolution. The parties will get paid sooner. They will also spend less money in pursuit of recovery. Thus, both the insured and carrier will enjoy a higher net recovery.

A limited pool of potential recovery funds need not be the orange in the allegory of the two brothers. While the made whole rule provides important rights that should not be ignored or trivialized, often those rights standing alone do not guaranty the best use of the "orange." Sometimes, the best use of made whole rights is as a bargaining chip in negotiations with the carrier to find a compromise that allows the insured and carrier to jointly pursue a recovery strategy that makes use of both the orange's fruit and peel.