



SUBROGATION: A LARGELY FORGOTTEN PROFIT CENTER

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A rear-end collision. A botched surgery. A building destroyed by fire caused by faulty wiring. Insured victims in these and similar situations may have little incentive to pursue the third-parties responsible for the associated monetary loss. Insurers who pay out loss, on the other hand, frequently have both the incentive to pursue third-party wrongdoers and the right to do so under the subrogation doctrine. Consequently, subrogation would appear to be a valuable profit center for insurers, particularly in the present market that features tightening premiums and increased claims. However, empirical evidence suggests that insurers are not coming close to tapping into the full profit potential that subrogation affords.

Subrogation Rights are Valuable to Insurers . . .

Subrogation rights can arise by contract or by operation of state law, although not all states permit subrogation where it does not exist by contract.¹ Subrogation is an equitable doctrine that has as its goal requiring the party who caused the damage to reimburse the insurer for the payment the insurer has made; in the over-

whelming majority of claims, subrogation is the only way in which an insurer can recoup loss paid out under its insurance policy.² It is for this reason that subrogation is a highly favored doctrine in the law, and courts

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¹Culver v. Ins. Co. of N. Am., 559 A.2d 400, 402 (N.J. 1989) (“Subrogation rights are created in one of three ways: (1) an agreement between the insurer and the insured, (2) a right created by statute . . . or (3) a judicial device of equity to compel the ultimate discharge of an obligation by the one who in good conscience ought to pay it.”) (internal citations omitted).

²Winkelmann v. Excelsior Ins. Co., 650 N.E.2d 841, 843 (N.Y. 1995).

dedicated to subrogation education and training for insurance professionals, has collected data that suggests that subrogation is pursued in only a small fraction of property and auto claims.

In property insurance lines, NASP studies for 2005 show that insurers pursued subrogation in only about 4 percent of the personal property claims, while subrogation rights were pursued in about 12 percent of the commercial property claims. The ratio of net subrogation recovery (which deducts out certain expenses incurred in pursuing subrogation claims) to total indemnity paid for the year was only 2.5 percent in connection with personal property claims, and only about 3.7 percent in connection with commercial property claims.

In auto insurance lines, NASP estimates for 2007 show that insurers pursued subrogation in only about one in five claims nationwide. With respect to personal auto claims, the ratio of net subrogation recovery to total indemnity paid for the year ranges from 12.5 percent for lower performing insurers to 22 percent for higher performing insurers. On the commercial side, the percentage of recovery is even smaller, ranging from 10.2 percent for lower performing insurers to 18 percent for higher performing insurers.

If subrogation in the auto and property insurance lines is used infrequently, the use of subrogation in specialty lines of insurance, such as directors and officer's liability insurance, is virtually non-existent. NASP does not track subrogation in specialty lines and most insurers do not devote any significant resources to pursuing subrogation in these lines, even though the insurers that write specialty lines are typically the largest insurers with dedicated subrogation business units. Conventional wisdom is that specialty insurance is not a candidate for subrogation because it insures against claims against the insured where the insured – rather than a third-party tortfeasor – is the wrongdoer. Complicating subrogation in specialty lines is the fact that several states have an “anti-subrogation rule,” which prohibits an insurer from recovering by means of subrogation against its own insured.⁷ If the insured is the wrongdoer, as is often the case in specialty lines, and the anti-subrogation rule applies, subrogation is not viable absent some exception to the rule.⁸

But even in specialty lines of insurance there may be subrogation opportunities. For example, if an

insured entity fails to indemnify its directors and officers in connection with a litigation defense when the entity is required to do so under its bylaws or applicable law, the insurer may have a subrogation action against the entity for any amounts it paid to the directors and officers under the policy. Other possibilities for subrogation in specialty lines of insurance include corporate frauds where accountants or other professionals assisted in the fraud. Insurers may have a right to pursue subrogation against these contributing professionals for any loss paid on behalf of the insured defrauding company or its directors and officers.⁹

Why is Subrogation Underutilized?

Why are insurers not taking full advantage of their subrogation opportunities? At a macro level, subrogation has not traditionally been a part of the culture of insurers. Insurers devote the vast majority of their time and resources to maximizing premium and claims management, and that is what they do best. Effective and efficient pursuit of subrogation requires a significant shift in this focus particularly on the claims side, where insurers must move away from a solely defensive mentality to one that includes thinking like a creative plaintiff's lawyer. This shift in focus can only come when insurance companies commit at the highest levels to subrogation as a part of their business models.

At a more basic level, the expense and time necessary to pursue subrogation claims may be perceived roadblocks for insurance companies. NASP has estimated that on average it costs insurers eighteen cents of every claim dollar paid to pursue subrogation, and anywhere from 125 to 400 days from the opening of a subrogation investigation to its close. These numbers can be imposing for insurers looking to initiate or expand subrogation opportunities.

BEST PRACTICES

One problem for insurers looking to improve on their subrogation performance is the lack of publicly available information on which to assess their performance. However, through data collected by NASP from industry-wide polling, and discussions with the heads of subrogation units of certain insurers, several common characteristics of successful insurers can be ascertained, including:

⁷Peterson v. Silva, 704 N.E. 2d 1163 (Mass. 1999).

⁸See, e.g., North Star Reinsurance Corp v. Continental Ins. Co., 624 N.E.2d 647, 654 (N.Y. 1993) (determining that the anti-subrogation rule generally does not apply where the claim is barred by policy exclusions).

⁹See, e.g., Dantzer Lumber & Export Co. v. Columbia Cas. Co., 156 So. 116 (Fla. 1934) (concluding that an insurer's subrogation claim could proceed against the insured's accountants).

Business Litigation Committee Newsletter Spring/Summer 2009

- Buy-in from Senior-Level Executives: Mentioned above, the support of senior-level executives is the single most important factor in realizing the full benefits of subrogation. Senior-level executives who control the companies' purse strings have the ability to devote resources to the pursuit of subrogation, including educating and training existing personnel, or by establishing or expanding dedicated subrogation units within the company.
- Centralized Units: A consistent characteristic of the highest performing insurers are centralized business units dedicated solely to the investigation and pursuit of subrogation. A concentration of efforts in subrogation allows insurers to be more efficient and effective by, among other things, realizing efficiencies of scale.
- Creativity: Successful insurers think outside the box to improve on their performance. For example, one insurer has developed a computer program that searches claims files for terms common in claims where an insurer has historically found subrogation opportunities, e.g., "rear-end collision" or "faulty wiring."
- Understanding of Limitations: Subrogation cannot always be investigated, pursued, litigated, and

settled in house. Insurers that understand the limits of their capabilities and expertise have no hesitation in referring subrogation recovery efforts to companies and lawyers that specialize in subrogation.

In conclusion, subrogation is a valuable but often times overlooked right to recover paid loss for insurers. Insurers that have pursued subrogation – particularly insurers that have invested sufficient resources into subrogation investigation and recovery – have reaped great financial rewards. Insurers that have not yet made subrogation part of their business model may well be ignoring an untapped profit center. ⚖️

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