

“MADE-WHOLE” MADE FAIR: A PROPOSAL TO MODIFY SUBROGATION IN TENNESSEE TORT ACTIONS

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INTRODUCTION

Fourteen years ago, the Tennessee Supreme Court wisely held that the made-whole doctrine applied to subrogation interests in personal injury and wrongful death settlements and judgments.¹ Subsequent decisions have consistently recognized and firmly established that both subrogation and the made-whole doctrine are rooted in equity.

To date, however, the Court has not been presented with the opportunity to decide a case that involves an interaction of the law of comparative fault, subrogation, and the made-whole doctrine. The resolution of the individual issues that arise in this context and that will eventually be presented to the Court should be done within a framework that recognizes and respects the equitable nature of subrogation and the made-whole doctrine while giving fair, reasonably predictable treatment to tort defendants, tort plaintiffs, and those holding subrogation interests.

This Article attempts to meet these goals by proposing the adoption of the “Modified Made-Whole Doctrine Proposal” (hereinafter sometimes referred to as the “Proposal”). Part I begins by explaining the roots of the law of subrogation rights and its current jurisprudential inconsistencies. It also explores the relationship between such subrogation rights and the made-whole doctrine in the context of Tennessee tort law as well as how this doctrine would be applied in Tennessee today. Next, Part II briefly outlines some of the general questions regarding Tennessee’s current application of the made-whole doctrine, particularly the unresolved issues surrounding the impact of comparative fault on subrogation rights. These are questions which the author’s suggested Proposal is designed to directly address. The detailed framework of this Proposal, including its five fundamental Principles and their underpinning rules, are set forth at length in Part III. Finally, Part IV concludes by analyzing the practical application of this Proposal throughout the various stages of the litigation process and offers guidance to judges, attorneys, and litigants alike as to how such subrogation disputes can be equitably resolved. In sum, the Modified Made-Whole Doctrine Proposal is meant to provide for the efficient, just

1. *York v. Sevier Cnty. Ambulance Auth.*, 8 S.W.3d 616 (Tenn. 1999); *Blankenship v. Estate of Bain*, 5 S.W.3d 647 (Tenn. 1999).

application of the made-whole doctrine to subrogation interests with respect to Tennessee's law of comparative fault. To better comprehend how this should be achieved, it is necessary to first look at the fundamentals of both subrogation and the made-whole doctrine.

PART I. SUBROGATION RIGHTS AND THE MADE-WHOLE DOCTRINE

A. Subrogation

Subrogation simply means the "substitution of one person for another."² In the context of insurance policies, where it most frequently arises, subrogation allows the insurer³ to "stand in the shoes" of its insured to assert the insured's rights against a tort defendant who caused harm to the insured for which the insurer has paid a covered loss.⁴ In essence, the insurer's payment becomes the tort defendant's debt to the insurer; as a result, the insurer is entitled to all the rights and remedies that its insured would otherwise have.⁵

Subrogation is grounded in equity.⁶ Its rationale is based on furthering principles of indemnification by requiring the party responsible for a debt to pay it, and on preventing unjust enrichment by precluding an insured from recovering twice for the same injury.⁷ Subrogation also serves to assure that a wrongdoer who is legally responsible for the harm does not receive the windfall of being absolved from liability merely because the insured received insurance proceeds.⁸ In practice, however, subrogation principally entails an equitable adjustment of rights between the insured and the insurer.⁹

Despite its equitable roots, a subrogation right is often classified as legal, conventional, or statutory.¹⁰ Legal subrogation arises by operation of

2. DAN B. DOBBS, LAW OF REMEDIES § 4.3, at 404 (2d ed. 1993).

3. An insurer asserting a right of subrogation is a "subrogee," and its insured is a "subrogor." To avoid confusion and enhance readability, however, the Article will primarily use the paired terms "subrogee" and "insured" to refer to the relevant parties.

4. DOBBS, *supra* note 2; *see also* *Wimberly v. Am. Cas. Co. of Reading, Pa.*, 584 S.W.2d 200, 203 (Tenn. 1979); BLACK'S LAW DICTIONARY 1563–64 (9th ed. 2009).

5. DOBBS, *supra* note 2; BLACK'S LAW DICTIONARY, *supra* note 4.

6. *Wimberly*, 584 S.W.2d at 203 ("The doctrine of subrogation in insurance does not arise from, nor is it dependent upon, statute or custom or any of the terms of the contract; it has its origin in general principles of equity and in the nature of the insurance contract as one of indemnity. The right of subrogation rests not upon a contract, but upon the principles of natural justice.").

7. *See* *Castleman Constr. Co. v. Pennington*, 432 S.W.2d 669, 675 (Tenn. 1968); Johnny C. Parker, *The Made Whole Doctrine: Unraveling the Enigma Wrapped in the Mystery of Insurance Subrogation*, 70 MO. L. REV. 723, 725–26 (2005).

8. 16 GEORGE J. COUCH, COUCH ON INSURANCE § 222:8, at 222:31–32 (Lee R. Russ & Thomas F. Segalli eds., 3d ed. 2005).

9. Parker, *supra* note 7, at 725–26.

10. BLACK'S LAW DICTIONARY, *supra* note 4, at 1564; *Blankenship v. Estate of Bain*, 5 S.W.3d 647, 650 (Tenn. 1999).

law or by implication in equity, and so it may sometimes be referred to as judicial or equitable subrogation.¹¹ Conventional,¹² or contractual, subrogation “arises by contract or by an express act of the parties.”¹³ Statutory subrogation arises from legislation that grants a person, entity, or organization a right of subrogation.¹⁴

However, this distinction based on the source of a subrogation right is not always controlling with regard to its legal effect in a given jurisdiction.¹⁵ For example, courts in many jurisdictions consider subrogation rights arising in contract as against public policy or as subject to limitation by traditional equitable principles. Tennessee is one such jurisdiction: subrogation rights are defined by statute in certain circumstances,¹⁶ but subrogation rights arising from insurance contracts are subordinate to the made-whole doctrine.¹⁷

Thus, the inconsistencies in subrogation jurisprudence across jurisdictions may be better understood as a fundamental theoretical rift representing two antithetical approaches to the doctrine. The first approach, referred to here as the “traditional rule,” adheres to subrogation’s conceptual origins in equity¹⁸ and takes the view that contractual subrogation rights are not absolute, but instead limited by common law equitable principles such as the made-whole doctrine.¹⁹ This approach is

11. BLACK’S LAW DICTIONARY, *supra* note 4, at 1564.

12. The term conventional is somewhat of a misnomer given the historical origins of the doctrine in equity. However, one might argue that a shift favoring contractual subrogation is the trend in the law. *See infra* note 27 & accompanying text. For the sake of clarity, this Article will use the term “contractual subrogation.”

13. BLACK’S LAW DICTIONARY, *supra* note 4 at 1564; *Blankenship*, 5 S.W.3d at 650.

14. BLACK’S LAW DICTIONARY, *supra* note 4 at 1564; *Blankenship*, 5 S.W.3d at 650.

15. *Parker*, *supra* note 7, at 727–28; *see also* *Wimberly v. Am. Cas. Co. of Reading, Pa.*, 584 S.W.2d 200, 203 (Tenn. 1979) (stating that the distinction between legal and conventional subrogation is only dispositive of “whether there is a right of subrogation in the first instance, rather than in the enforcement of such right.”); *Castleman Constr. Co. v. Pennington*, 432 S.W.2d 669, 675 (Tenn. 1968) (holding that equitable considerations determine whether a subrogation right is enforceable regardless of the source of the right).

16. *See, e.g.*, TENN. CODE ANN. § 50-6-112(c) (2002); TENN. CODE ANN. § 71-5-117 (2002).

17. *See, e.g.*, *York v. Sevier Cnty. Ambulance Auth.*, 8 S.W.3d 616 (Tenn. 1999) (“[O]ur case law is clear that an insurer is not entitled to subrogation unless and until the insured has been made whole for his or her losses, regardless of what language is contained in the contract.”).

18. For a thorough discussion of subrogation’s origins in equity, see Brendan S. Maher & Radha A. Pathak, *Understanding and Problematizing Contractual Tort Subrogation*, 40 LOY. U. CHI. L.J. 49, 59–72 (2008).

19. Historically at common law the notion that rights of subrogation were subject to the made-whole doctrine was widely accepted. *See e.g.*, *Atherton v. Tesch*, 80 So. 832, 832–33 (Ala. 1919) (explaining that “[i]t is a well-settled general rule that before subrogation can be enforced the whole debt must be paid,” and collecting authorities, to wit: *J.P. Browder & Co. v. Hill*, 136 F. 821 (6th Cir. 1905); *Wilkins v. Gibson*, 38 S.E. 374 (Ga. 1901); *Hubbard v. Le Barron*, 81 N.W. 681 (Iowa 1900); *Gaskill v. Huffaker*, 49 S.W. 770 (Ky. 1899); *London & Nw. Am. Mortg. Co. v. Fitzgerald*, 56 N.W. 464 (Minn. 1893); *Wyckoff v.*

most often justified by pointing out that the insured loss was a risk that the insurer was paid to assume, and had the tortfeasor been judgment-proof and uninsured, the insurer would still have had to bear the loss up to the full amount of the insurance policy.²⁰ Thus, the argument goes, the insured should not have to re-pay its insurer for the loss it agreed to assume unless the insured actually recovers 100% of that loss from the tortfeasor. The traditional rule undoubtedly favors the interests of insureds over subrogees, but also favors tort defendants and their liability insurers because it increases the likelihood that tort claims can be resolved short of trial, often for less money.²¹

The second approach, referred to here as the “contract rule,” views contractual subrogation provisions in insurance policies as wholly enforceable and not subject to limitation or alteration by common law equitable principles.²² In its purest application, the contract rule preserves the insurer’s right to collect its subrogation interest from the very first dollar recovered from the third-party wrongdoer responsible for the loss.²³ This approach to subrogation is most often justified on freedom of contract grounds: where the parties have agreed to terms and the price of an insurance contract, the state should not interfere.²⁴ Proponents of the contract rule maintain that the parties’ respective bargaining power is equal in the marketplace and that subrogation clauses in insurance contracts are granted to the insurer in exchange for valuable consideration in the form of lower premiums for the insured or greater coverage under the policy.²⁵ By

Noyes, 36 N.J. Eq. 227 (Ch. 1882); *Receivers of N.J. Midland Ry. Co. v. Wortendyke*, 27 N.J. Eq. 658 (1876); *Appeal of Allegheny Nat. Bank*, 7 A. 788 (Pa. 1887)).

20. *See, e.g., Wimberly*, 584 S.W.2d at 203–04; John Dwight Ingram, *Priority Between Insurer and Insured in Subrogation Recoveries*, 3 CONN. INS. L.J. 105, 113 (1997). Concededly, however, the latter point would be true under any subrogation regime.

21. This view is based on the argument that where a substantial subrogation interest looms—but where the subrogation right is also recognized to be rooted in equity and thus potentially limited by the made-whole doctrine—the plaintiff can accept less money to settle the case with the tortfeasor because she will be able to compromise and settle the dispute with the subrogee for less than the entire amount of the claimed interest.

22. For a discussion regarding the development of the contract rule, see Maher & Pathak, *supra* note 18, at 72–77.

23. *Id.* at 75–76 (“First-dollar recovery provisions are contractual inversions of the equitable make whole rule: they provide the insurer with an entitlement to the first dollar of an insured’s recovery from a tortfeasor, regardless of whether the insured was made whole, regardless of what the insured’s recovery was for, and regardless of any attorneys’ fees incurred by the insured in obtaining a recovery.”).

24. *Id.* at 74.

25. This is not the view in Tennessee. *See York v. Sevier Cnty. Ambulance Auth.*, 8 S.W.3d 616, 621 (Tenn. 1999) (“The fallacy in this contention is that it presumes the plaintiffs had the bargaining power, leverage, or business acumen to negotiate the terms of this or any other standardized insurance contract. . . . The reality is that the vast majority of insurance policies stem from a group or network plan, in which the individual policy holder had no negotiating input and merely pays the premiums and accepts the terms.”); *see also Hare v. State*, 733 So.2d 277, 284 (Miss. 1999) (holding that “to allow the literal language of an insurance contract to destroy an insured’s equitable right to subrogation ignores the fact

extension of this logic, broader public policy arguments in favor of contract rule subrogation regimes assert that a legal model favoring first-dollar contractual subrogation rights for insurers lowers the risk of loss across the insurance industry, the cost savings from which are passed on to consumers in the form of lower premiums. However, empirical evidence of lower premiums resulting from the inclusion of subrogation clauses in insurance contracts is a topic of debate.²⁶ Despite its assailable underpinnings and unfavorable results to injured insureds, the contract rule approach is a part of subrogation jurisprudence.²⁷ It cannot be denied that the contract rule favors subrogees at the expense of the injured, and experienced lawyers know that this view of subrogation complicates the resolution of tort claims.²⁸

that this type of contract is realistically a unilateral contract of insurance and overlooks the insured's total lack of bargaining power in negotiating the terms of these types of agreements.”).

26. *See, e.g.*, Maher & Pathak, *supra* note 18, at 58 n.31 (citing *Rimes v. State Farm Mut. Auto. Ins. Co.*, 316 N.W.2d 348, 355 (Wis. 1982) (“[T]here appears to be very little evidence that possible recoveries in subrogation are considered in the determination of insurance premiums.”)) (explaining that more empirical research is needed on whether insurers include expected subrogation recoveries into their rates, and noting that while commentators and courts are split on the issue, the dominant view appears to be that insurers have not historically factored subrogation recoveries into rate calculations); EDWIN W. PATTERSON, *ESSENTIALS OF INSURANCE LAW* § 33, at 151 (2d ed. 1957) (“Subrogation is a windfall to the insurer. It plays no part in rate schedules . . .”). *But see* F. Joseph Du Bray, *A Response to the Anti-Subrogation Argument: What Really Emerged from Pandora's Box*, 41 S.D. L. REV. 264, 273–74 (1996) (arguing that subrogation recoveries do lower rates).

27. The argument for a trend toward upholding contractual subrogation clauses in subrogation disputes is based largely on the preemptive effect of the subrogation provisions of the Employee Retirement Income Security Act of 1974 (“ERISA”), 29 U.S.C. § 1132(a)(3), which the U.S. Supreme Court effectively interpreted in *Sereboff v. Mid Atl. Med. Servs., Inc.*, 547 U.S. 356 (2006), as permitting the strict enforcement of contractual subrogation provisions in employer-provided health plans. In addition to ERISA’s preemptive effect and massive scope, however, the argument for a trend in its direction is further supported by the influence that U.S. Supreme Court jurisprudence interpreting ERISA potentially has in persuading state judiciaries to follow it and adopt the ERISA model. *See, e.g.*, *Fortis Benefits v. Cantu*, 234 S.W.3d 642, 648 (Tex. 2007) (characterizing the U.S. Supreme Court’s decision in *Sereboff* as a “refus[al to] apply the ‘made whole’ doctrine” and relying in part on *Sereboff* to achieve the same result as a matter of state law).

28. The author contends that the presence of a significant subrogation interest that the tort claimant has no right to contest can have a significant impact on the ability to settle tort litigation. In a case where several liability applies, disputes over liability, damages, causation, collectability of excess judgments, and the allocation of any recovery among multiple stakeholders necessarily complicate settlement negotiations; but the existence of a subrogee demanding the first dollar of any settlement and every dollar thereafter until paid in full (with no discount for the costs of securing that recovery for subrogee’s benefit and without regard to comparative fault principles) adversely impacts the ability of tort plaintiffs and defendants to settle cases. Thus, the contract rule has an adverse impact on the injured and society—fewer settlements mean more trials (at more expense) and some number of losses by plaintiffs, which often results in the plaintiff seeking public assistance with medical expenses, food, and shelter.

B. The Made-Whole Doctrine in Tennessee

In Tennessee, the made-whole doctrine is a common law equitable principle that precludes an insurer's right of subrogation until the insured has been fully compensated, or "made whole," for injuries caused by a third-party wrongdoer.²⁹ The insurer's right to subrogation is not triggered unless and until the insured's cumulative recovery from the insurer and third-party wrongdoers exceeds the insured's total loss, regardless of any contrary terms in the insurance contract.³⁰

The Tennessee Supreme Court first adopted the made-whole doctrine in the 1971 decision of *Wimberly v. American Casualty Co.*³¹ In this case, the insureds suffered \$44,619 in fire damage to their property when a tortfeasor drove a car into a restaurant they owned.³² The owners recovered \$15,000 from their own insurance carriers, and collected a settlement of \$25,000 from the tortfeasor's insurer.³³ The insureds' total compensation was thus \$40,000, which was less than their total loss.³⁴

The owners' insurance policies each contained a standard subrogation clause, and in addition, the insureds had executed "a proof of loss and subrogation receipt" assigning to the insurers all of the "rights, claims and interests" they might have against any liable third party.³⁵ The insurance companies enforced these subrogation rights, and collected a *pro rata* share of \$8,404.47 from the settlement.³⁶ Their insureds filed suit to recover that amount.³⁷

The trial court ruled in favor of the insureds, but the intermediate appellate court reversed and held that the settlement proceeds should be equally distributed among the insureds and insurers.³⁸ The Supreme Court reversed the court of appeals, and held "that an insured must be made whole before an insurer is entitled to subrogation against a tortfeasor."³⁹ The Court also made it clear that neither the subrogation provisions in the policies nor

29. *Wimberly v. Am. Cas. Co. of Reading, Pa.*, 584 S.W.2d 200, 201 (Tenn. 1979).

30. *Id.* at 203 ("The doctrine of subrogation in insurance does not arise from, nor is it dependent upon, statute or custom or any of the terms of the contract; it has its origin in general principles of equity and in the nature of the insurance contract as one of indemnity. The right of subrogation rests not upon a contract, but upon the principles of natural justice."); *York*, 8 S.W.3d at 621 ("[O]ur case law is clear that an insurer is not entitled to subrogation unless and until the insured has been made whole for his or her losses, regardless of what language is contained in the contract."); *Health Cost Controls, Inc. v. Gifford*, 239 S.W.3d 728, 730–31 (Tenn. 2007).

31. 584 S.W.2d 200.

32. *Id.* at 201.

33. *Id.*

34. *Id.*

35. *Id.* at 201–02.

36. *Wimberly*, 584 S.W.2d at 202.

37. *Id.*

38. *Id.*

39. *Id.* at 201.

the settlement-of-claim receipt signed by the insureds reaffirming the insurers' subrogation rights was determinative, and added that such an outcome would be "at odds with the equitable principles of subrogation."⁴⁰ The practical effect of the ruling was that subrogation provisions in insurance policies were not controlling, and in any event, could not be exercised until the insured was made whole.

Importantly, the loss sustained in *Wimberly* was strictly to property.⁴¹ Therefore, the decision and the relevant facts of the case might be narrowly understood as limiting the application of the made-whole doctrine to cases involving damages to property. However, the *Wimberly* holding was eventually extended to personal injury actions involving the subrogation rights of first-party private insurers.⁴²

Although the Tennessee appellate courts consistently applied the made-whole doctrine to insurers' subrogation rights in the context of personal injury actions beginning in 1992,⁴³ the Tennessee Supreme Court did not have occasion to address the issue until 1999—twenty years after *Wimberly*. In two decisions that year—*York v. Sevier County Ambulance Authority*⁴⁴ and *Blankenship v. Estate of Bain*⁴⁵—the Court firmly established that the made-whole doctrine applied to insurers' subrogation rights in personal injury cases.

In addition to being the first Tennessee Supreme Court decision to apply the made-whole doctrine in a personal injury action, *York* also clarified that reimbursement clauses⁴⁶ in insurance contracts were indistinguishable from subrogation clauses for the purposes of determining the rights of the insurer under the made-whole doctrine.⁴⁷ The issue before

40. *Id.*

41. *Wimberly*, 584 S.W.2d at 201.

42. See *Mullins v. Parkey*, 874 S.W.2d 12, 14–15 (Tenn. Ct. App. 1992) (applying made-whole doctrine to defeat insurer's subrogation claim in personal injury action); *Blue Cross/Blue Shield of Tenn. v. Christopher*, No. 03A01-9412-CH-00429, 1995 WL 229060, at *2–3 (Tenn. Ct. App. Apr. 19, 1995) (applying made-whole doctrine to defeat insurer's subrogation claim in personal injury action); *Waller v. Ammon*, No. 01A01-CV-00260, 1998 WL 321569 at *4–6 (Tenn. Ct. App. June 19, 1998) (applying the made-whole doctrine to an insurer's subrogation claim); see also Todd L. Fulks, *The "Made-Whole" Doctrine: Its Effect on Tennessee Tort Litigation and Insurance Subrogation Rights*, 32 U. MEM. L. REV. 87, 98–107 (2001) (discussing line of cases developing the made-whole doctrine in Tennessee).

43. See *Mullins*, 874 S.W.2d at 12.

44. 8 S.W.3d 616 (Tenn. 1999).

45. 5 S.W.3d 647 (Tenn. 1999).

46. A "reimbursement clause" was a clause inserted into an insurance policy that worked just like a subrogation clause but was used to try to avoid the equitable underpinnings of subrogation.

47. *York*, 8 S.W.3d at 617, 619. The insured in *York* had received a settlement of \$130,000 for injuries sustained in a head-on collision, which the trial court found to be less than the actual damages suffered. *Id.* at 618. When the insurer was impleaded into the lawsuit claiming a right to reimbursement for \$19,149.97 in medical bills pursuant to a

the Court in *York* was “whether an insured must receive full compensation for losses, *i.e.*, be ‘made whole,’ before an insurer may receive reimbursement for medical expenses paid on behalf of the insured.”⁴⁸ Citing to *Wimberly*, the Court first held that there was no practical distinction between an insurer’s contractual right to reimbursement and a contractual right of subrogation, and noted that to hold otherwise “would allow an insurer to circumvent the ‘made whole’ doctrine simply by using a reimbursement provision in lieu of subrogation.”⁴⁹ While the Court did discuss the conceptual and procedural differences between subrogation and reimbursement,⁵⁰ it concluded that “a right of reimbursement raises many of the same equitable issues involved in subrogation and warrants the same conclusion—that the insured must be made whole before the insurer is entitled to reimbursement.”⁵¹

The *Blankenship*⁵² case also addressed application of the made-whole doctrine in the personal injury context, but is distinguishable from *York* in that the insurer asserting subrogation rights was the state’s medical assistance program, TennCare.⁵³ The issue before the Court was whether a person who receives health care benefits under TennCare must be made whole before the State was entitled to subrogation for the medical expenses it paid on the person’s behalf.⁵⁴

The insurer argued that the relevant provision of the TennCare statute, Tenn. Code Ann. § 71-5-117, created a statutory right to subrogation that trumped the common law made-whole doctrine.⁵⁵ Specifically, the insurer relied on the absence of any language in Section

provision in the insurance policy, the trial court refused to allow the reimbursement. *Id.* The Court of Appeals reversed, and the Tennessee Supreme Court granted certiorari. *Id.*

48. *Id.* at 617.

49. *Id.*

50. *Id.* at 619 n.3 (“In their most basic forms . . . subrogation means that party A is substituted for party B and is allowed to raise the rights party B had against party C. Reimbursement simply allows party A to recover from party B payments it made on behalf of party B.”).

51. *Id.* at 620.

52. *Blankenship v. Estate of Bain*, 5 S.W.3d 647 (Tenn. 1999). The insured in *Blankenship* had been injured in a car accident that the trial court found was “caused by the negligence of Joshua Bain.” *Id.* at 649. The insured was enrolled in Tennessee’s TennCare program, through which the insured had acquired a policy with an insurer. *Id.* Under that policy, the insurer had paid medical expenses on the insured’s behalf in the amount of \$20,713.83. *Id.* The insured brought an action against the tortfeasor’s estate and settled for \$125,000, which constituted the policy limits of the defendant’s liability insurance coverage. *Id.* The insurer intervened in the suit and asserted a right of subrogation equal to the amount of benefits provided on its insured’s behalf. *Id.* The Court noted that “(a)lthough the suit was settled for the limit of Bain’s policy, the trial court found that the [insureds] would have been entitled to recover damages well in excess of \$125,000.” *Id.*

53. *Id.* at 649.

54. *Id.*

55. *Id.* at 651.

71-5-117(a) indicating that the State's right to subrogation was subject to the insured's first being made whole.⁵⁶

Medical Assistance paid to, or on behalf of, any recipient cannot be recovered from a beneficiary unless such assistance has been incorrectly paid, or, unless the recipient or beneficiary recovers or is entitled to recover from a third party reimbursement for all or part of the costs of care or treatment for the injury or illness for which the medical assistance is paid. To the extent of payments of medical assistance, the state shall be subrogated to all rights of recovery, for the cost of care or treatment for the injury or illness for which medical assistance is provided, contractual or otherwise, of the recipients against any person.⁵⁷

The Court held that the made-whole doctrine applied⁵⁸ and rejected the insurer's argument and interpretation of the statute.⁵⁹ Noting that the TennCare legislation was enacted post-*Wimberly*, the Court reasoned that the legislature must have been aware of the existing state of the law when drafting the bill, and so must have intended "the statute to reflect the equitable principle that subrogation is subject to the made-whole doctrine."⁶⁰ The Court went on to point out that if the legislature had intended a different interpretation, it could have simply stated in precise language that the made-whole doctrine did not apply to subrogation rights in the context of the TennCare program.⁶¹

The precise manner in which the made-whole doctrine was to be applied by the trial courts—in particular, which sources of the insured's recovery should be factored into determining whether the insured had been made whole—was unclear until a case presented itself to the Court for review of that issue in 2007. In *Health Cost Controls, Inc. v. Gifford*, the Court clarified that an insured's total recovery is to be determined by adding all benefits received as a result of an incident.⁶² The trial court below, in computing the insured's total recovery for the purposes of

56. *Id.*

57. TENN. CODE ANN. § 71-5-117(a) (2013).

58. *Blankenship*, 5 S.W.3d at 653.

59. *Id.* at 651.

60. *Id.* The Court's citing *Wimberly* as representing the state of the law at that time is tenuous given that the Court had not specifically held that the made-whole doctrine applied to personal injury cases until after TennCare's enactment. See *York v. Sevier Cnty. Ambulance Auth.*, 8 S.W.3d 616 (Tenn. 1999).

61. *Blankenship*, 5 S.W.3d at 651. Shortly after the *Blankenship* decision, the legislature responded and made clear its intent with regard to application of the made-whole doctrine to the state's subrogation rights in TennCare cases by amending Section 71-5-117 of the Tennessee Code and superseding *Blankenship*.

62. 239 S.W.3d 728, 731 (Tenn. 2007).

determining whether he was made whole, included the insured's settlement proceeds with the tortfeasor, but failed to include payments received from the insured's health insurance providers in its calculation.⁶³ The Supreme Court rejected this approach and explained that the trial courts should support its made-whole determinations with specific findings of fact regarding the monetary value of the injured party's recovery from all sources and the monetary value of the injured party's total damages.⁶⁴ The Court further held that trial courts should make specific findings as to the value of each separate element of an injured party's damages.⁶⁵ Finally, the opinion made clear that if the trial courts find that the injured party had been made whole, reimbursement should be awarded to the insurer only to the extent that the injured party's total recovery exceeded the injured party's total damages.⁶⁶ The Court noted that these guidelines were necessary to ensure that the made-whole doctrine was applied consistently.⁶⁷

Taken together, the foregoing decisions by the Tennessee Supreme Court essentially represent the corpus of substantive law in the State regarding the interplay between subrogation and the made-whole doctrine in tort litigation. As scarce as precedent is in this area, the current state of the law is clear enough to allow us to explore how the made-whole doctrine would be applied in Tennessee today. Consider the following hypothetical:

Hypothetical 1—Current Application of the Made-Whole Doctrine in Tennessee

A is injured in a car accident with *B*. *B* is undeniably and solely at fault. *A*'s private health insurer, XYZ, pays \$25,000 in medical bills arising from the accident. Reasonable minds agree that *A*'s claim is worth \$200,000. *B* has only \$100,000 in liability insurance (which is paid to *A*), and *B*'s personal obligation to *A* is discharged in bankruptcy. Under the made-whole doctrine, *A* need not pay XYZ any money on its subrogation interest because the sum total of the monies received by *A* (\$100,000 in liability coverage plus \$25,000 in health insurance benefits) is less than the \$200,000 value of the tort claim, i.e., *A*'s made-whole amount.

63. *Id.* at 731–32.

64. *Id.* at 732. Significantly, Gifford further recognized that although requiring such factual determinations would entail the additional time and expense of conducting the equivalent of an additional trial, such a proceeding “may be the only reliable means to determine whether an injured party has been made whole.” *Id.*

65. *Id.* The Proposal refers to this principle as the “strict segregation of damages.” *Infra* Section III(C).

66. *Gifford*, 239 S.W.3d at 732.

67. *Id.*

The table below illustrates how application of the current Tennessee made-whole rule to Hypothetical 1 would result in various recovery scenarios depending on the settlement amount:

<i>A</i> 's Total Loss (<i>A</i> 's "Made-Whole" Amount)	Amount XYZ Paid on <i>A</i> 's Policy for Medical Bills	<i>A</i> 's Settlement with <i>B</i>	<i>A</i> 's Gross Recovery from All Sources (including XYZ's Payment of Medical Bills)	XYZ's Entitlement from Subrogation	<i>A</i> 's Net from All Sources after XYZ's Subrogation	Amount <i>A</i> Actually Receives from <i>B</i> 's Settlement Proceeds
\$200,000	\$25,000	\$100,000	\$125,000	\$0	\$125,000	\$100,000
\$200,000	\$25,000	\$150,000	\$175,000	\$0	\$175,000	\$150,000
\$200,000	\$25,000	\$175,000	\$200,000	\$0	\$200,000	\$175,000
\$200,000	\$25,000	\$200,000	\$225,000	\$25,000	\$200,000	\$175,000

One can see that a strict application of the current made-whole doctrine in Tennessee presents a potential injustice to insurers. A plaintiff may recover 99% of his or her damages and not be required to reimburse the health insurer one nickel for the amount it paid for medical bills on the plaintiff's behalf. While it is true there are lots of injustices in the law, especially in statutory law, the judicial system should work toward the goal of equity for all parties, and thus such a scenario is not ideal.

That being said, the made-whole doctrine has been applied to personal injury and wrongful death cases in Tennessee for over a decade,⁶⁸ and if one were to accept the asserted logic of those who favor the contractual view of subrogation, health insurers and other insurers have already taken this principle into account in setting premiums.⁶⁹ Presumably then, plaintiffs and other insurance policyholders have paid and will continue to pay more for insurance because of the decreased likelihood of recovering a subrogation interest under the made-whole rule.⁷⁰ Thus, each tort claimant facing a subrogation claim has paid for the right to use the made-whole doctrine to his economic advantage.

68. See *York v. Sevier Cnty. Ambulance Auth.*, 8 S.W.3d 616 (Tenn. 1999).

69. See generally *Du Bray*, *supra* note 26.

70. *Id.* at 274 (arguing that insurance carriers recognize subrogation recovery as an appropriate and generally accepted source of revenue, and that "[i]f subrogation recovery were not available or were disregarded, the actual cost of insuring the past known risk would increase accordingly and the projected future costs would likewise have to be adjusted upward. Subrogation costs not recovered are thus reflected in and spread over future premiums among the issuing insurer and all of the insureds purchasing the same insurance. As a result, all who shared the risk during the time the claim was paid, and all who share the future risk, subsidize the payment to an insured who did not honor his or her subrogation agreement.").

**PART II. CHALLENGES PRESENTED BY THE CURRENT BODY OF
TENNESSEE LAW REGARDING THE MADE-WHOLE DOCTRINE
(OR, RATHER, THE ABSENCE OF IT)**

As indicated in the Introduction, the Tennessee Supreme Court has not yet been presented with any cases that test the limits of the made-whole doctrine to determine whether it will stay true to its equitable roots. What follows is a partial list of comparative fault issues that remain undecided with regard to their effect on subrogation rights:

- a. The allocation of fault against an entity protected by the statute of repose;
- b. The allocation of fault against a non-party tortfeasor;
- c. The allocation of fault against a governmental entity that results in a damages assessment against that entity in excess of statutory damage caps;
- d. The allocation of fault against a person or entity in excess of caps on non-economic damages;
- e. The allocation of fault against a governmental entity that is immune from suit;
- f. The allocation of fault against a party not subject to the jurisdiction of the Tennessee courts;
- g. The allocation of fault against a party immune from suit under the common law; and
- h. The allocation of fault against a party who has received a bankruptcy discharge for personal liability over and above applicable liability insurance proceeds.

In addition, there is substantial uncertainty about the following questions:

- a. How does one determine whether a plaintiff has been “made whole”?
- b. What happens if a portion of a judgment is uncollectable or not readily collectable?
- c. Can the subrogation interest be paid from monies awarded for damages unrelated to the subrogee’s expenses?
- d. Can a plaintiff and tort defendant allocate settlement money in an effort to defeat—or in a manner that has the effect of defeating—a subrogation interest?
- e. Must a tort plaintiff secure a subrogee’s approval before settling with a tortfeasor?
- f. If not, can a subrogee contest the reasonableness of that settlement?

- g. Should the monies paid by a tort plaintiff for the cost of obtaining a settlement or judgment that benefits, in part, the subrogee be charged against the subrogation interest?

The resolution of these issues has real-life implications for thousands of Tennesseans every year. Given the way such matters work their way through the court system, it will take decades to answer these questions. And in the absence of a cohesive framework within which to analyze and confront them, it is possible (and perhaps unavoidable) that the determination of cases will turn on facts that will not, in the long run, best serve the equitable foundations of subrogation and the made-whole doctrine.

PART III. THE MODIFIED MADE-WHOLE DOCTRINE: A NEW COMMON LAW MODEL FOR TENNESSEE

As creatures of equity, it should fall to the Tennessee courts, not the legislature, to modify the interplay between subrogation rules, comparative fault law, and the made-whole doctrine to produce a workable model that yields the fairest result.⁷¹ The courts are simply better suited to exercise their inherent power to promulgate the rules governing an equitable doctrine and to adapt that doctrine to new situations as they inevitably arise.⁷²

To assist the courts in adopting a comprehensive approach to future development of made-whole law, the author offers the Modified Made-

71. Objections that this mechanism for modifying the law is judicial activism or “legislating from the bench” are inevitable. Such a cry is always heard from the one side or the other in any dispute or policy debate. Courts in common law jurisdictions have long acted within their power to modify the law where the legislature has not acted or has not been clear, especially in matters of equity. *See, e.g.,* Willard v. Tayloe, 75 U.S. 557, 565 (1869) (holding that courts have wide discretion to fashion relief in cases of equity, and stating that “relief is not a matter of absolute right to either party; it is a matter resting in the discretion of the court, to be exercised upon a consideration of all the circumstances of each particular case.”).

72. This is not to say that the legislature could not enact a subrogation statute that included very broad language to at least establish the framework of a new subrogation model; at least one other jurisdiction has taken this approach. *See* IND. CODE ANN. § 34-51-2-19 (2013) (“If a subrogation claim or other lien or claim that arose out of the payment of medical expenses or other benefits exists in respect to a claim for personal injuries or death and the claimant’s recovery is diminished: (1) by comparative fault; or (2) by reason of the uncollectibility of the full value of the claim for personal injuries or death resulting from limited liability insurance or from any other cause; the lien or claim shall be diminished in the same proportion as the claimant’s recovery is diminished. The party holding the lien or claim shall bear a *pro rata* share of the claimant’s attorney’s fees and litigation expenses.”). However, such sweeping language still requires the courts to develop and fashion the law from such a bare bones statute. The proposed common law approach is preferable because it is more in keeping with the history of the equitable nature of the two doctrines at issue and with the common law roots of comparative fault law.

Whole Doctrine Proposal.⁷³ This Proposal is governed by the following fundamental principles:

PRINCIPLE 1

No subrogee is entitled to recover from its insured monies that the insured did not recover from a tortfeasor. Principle 1 is advanced by applying the following rules, each of which is applied as appropriate under the circumstances to determine the gross subrogation interest⁷⁴ that a subrogee has or would have in the proceeds of a tort lawsuit between its insured and a third party.

Rule 1. *A subrogation interest is reduced by the percentage of comparative fault assessed against the insured.*

Rule 2. *A subrogation interest is reduced by the percentage of comparative fault assessed against a tortfeasor who cannot be sued by the insured because of the expiration of a statute of repose.*

Rule 3. *A subrogation interest is reduced by the percentage of comparative fault assessed against a tortfeasor that enjoys statutory or common law immunity from suit.*

Rule 4. *A subrogation interest is reduced proportionally to reflect the unavailability of those damages assessed against a government entity that would otherwise have been awarded but for a law limiting the amount of damages that can be awarded against the governmental entity.*

Rule 5. *A subrogation interest is reduced by the percentage of comparative fault assessed against a non-party not subject to the jurisdiction of Tennessee courts.*

73. Readers will note substantial similarity between the Proposal and the statute governing TennCare subrogation interests, Tenn. Code Ann. § 71-5-117. In 2000, legislation was introduced to repeal the *Blankenship* decision, which had applied the made-whole doctrine to payments made by insurers participating in the State's TennCare program. See TENN. CODE ANN. § 71-5-117 (2013). The author, as a representative of the Tennessee Trial Lawyers Association, drafted the substitute bill that became the new method of adjusting subrogation rights under TennCare. The author gratefully acknowledges the willingness of the Sundquist Administration and the legislation's sponsors—Senator Jerry Cooper and Representative Jere Hargrove—to negotiate a fair compromise on this issue.

74. The author has defined the following terms that are used in the balance of this Article as follows: An "asserted subrogation interest" is the amount sought by the subrogee. A "gross subrogation interest" is the amount of the subrogation interest after the Rules set forth in Principle 1 have been applied to an asserted subrogation interest. A "net subrogation interest" is what the subrogee has the right to recover after the gross subrogation interest has been reduced by recovery acquisition costs.

Rule 6. *A subrogation interest is reduced by the percentage of the insured's total damages that the insured is unable to collect from a tortfeasor.*

PRINCIPLE 2

The gross subrogation interest is reduced proportionally by the reasonable recovery acquisition costs that the insured paid to secure the tort recovery for his or her benefit and for the benefit of the subrogee. A subrogee is permitted to challenge the reasonableness of the asserted recovery acquisition costs but is not entitled to any discount for the amount it pays to its own counsel in the matter unless the court determines that the subrogee's counsel materially participated in the proceedings.

PRINCIPLE 3

A subrogee does not have a right to collect a subrogation interest from monies awarded for any loss other than the loss giving rise to the subrogation interest.

PRINCIPLE 4

No out-of-court effort by the insured or a tortfeasor to allocate fault, determine insured's damages, or allocate damages among several plaintiffs shall be binding on the subrogee absent consent of the subrogee.

PRINCIPLE 5

An insured and a tortfeasor may settle a tort claim for an amount equal to or more than the entire asserted subrogation interest without the permission of the subrogee. However, if the subrogee later challenges the reasonableness of that settlement, the insured will bear the duty of demonstrating that the settlement was reasonable. An insured and a tortfeasor may not settle a tort claim for an amount less than an asserted subrogation interest without the permission of a subrogee or the court (after notice to the subrogee).

What follows is a more detailed description of each Principle and, with regard to Principle 1, the rules that advance it.⁷⁵

A. Principle 1—Creating an Equitable Subrogation Interest

No subrogee is entitled to recover from its insured monies that the insured did not recover from a tortfeasor.

75. Nothing in the Proposal should be construed as rejection of current law that prohibits an insurance company from inserting language in the insurance policy that purports to waive the application of the made-whole rule. On the contrary, the Proposal is drafted with the assumption and belief that the Principles and Rules cannot be altered by contract.

A subrogee has nothing more, and nothing less, than the right to stand in the shoes of its insured. Every single rule set forth below advances this fundamental precept.

Rule 1: *The asserted subrogation interest is reduced by the percentage of comparative fault assessed against the insured.*

Any workable subrogation model that strives toward equity must first take into account comparative fault principles when calculating subrogation interests.⁷⁶ Rule 1 accounts for the degree to which the plaintiff is at fault and proportionally adjusts the subrogation interest according to that fault assessment.

Rule 1 gets at the essence of the subrogation right. Recall that the insurer's right of subrogation can only arise from and exist against a third-party tortfeasor, and the relevant doctrinal justification for the subrogation right is that the party responsible for causing the harm should pay for the resulting loss. However, the entire purpose of purchasing first-party private insurance (such as health insurance) is to protect one's self against such a loss. A refusal to reduce the insurer's subrogation interest proportionally by the percentage of fault allocated to the insured equates to the insurer recovering directly from its insured the very type of loss it was paid to indemnify—i.e., the insured's own risk to causing herself an injury. In essence, a claim for that money is not a subrogation claim at all, because the insurer is seeking restitution of payment made for a loss caused (albeit in part) by the insured, not a third party. There is simply no rational justification for failing to take the insured's fault into consideration when balancing the equities of a subrogation right.

Hypothetical 2—Reduction by Percentage of Fault Allocated to Insured⁷⁷

A is injured in a motor vehicle wreck involving *B*. *B* asserts the fault of *A*. *A*'s medical bills are \$50,000 and are paid by

76. Tennessee adopted the doctrine of modified comparative fault in 1992. *McIntyre v. Balentine*, 833 S.W.2d. 52, 57 (Tenn. 1992). The purpose of comparative fault is to assess liability in proportion to fault. *Sherer v. Linginfelter*, 29 S.W.3d 451, 455 (Tenn. 2000); *Owens v. Truckstops of Am.*, 915 S.W.2d 420, 430 (Tenn. 1996) (“[W]here the separate, independent negligent acts of more than one tortfeasor combine to cause a single, indivisible injury, each tortfeasor will be liable only for that proportion of the damages attributable to its fault.”).

77. Readers will note that each of the following hypotheticals includes reference to a subrogation interest arising out of a health insurance policy. Subrogation interests also arise in short- and long-term disability policies, medical payment and collision provisions of automobile liability policies, etc. Reference is made to health insurance policies because those are what tort practitioners deal with on a daily basis and, because of the sums involved, present the biggest obstacle to the resolution of tort claims.

her health insurer, XYZ. At trial, the jury awards \$50,000 for medical bills and \$200,000 in other damages, but finds *A* 20% at fault. Thus, when a judgment is entered for *A* against *B*, the judgment amount is \$200,000 (\$250,000 in total damages reduced by the 20% fault allocated to *A*). Under the Proposal, XYZ's asserted subrogation interest is also reduced by 20% (from \$50,000 to \$40,000) to take into account the fact that *A* only recovered \$40,000 of his medical bills because of the 20% allocation of fault to *A*.

Rule 2: *The asserted subrogation interest is reduced by the percentage of comparative fault assessed against a tortfeasor who cannot be sued by the insured because of the expiration of a statute of repose.*⁷⁸

The second Rule addresses statutes of repose. These statutes extinguish the liability of a tortfeasor where a statutorily set amount of time has passed between the time of the tortfeasor's act and the resulting injury or death to a person.⁷⁹ This is a grant of a type of immunity to a special class of persons or entities.⁸⁰

78. The Tennessee Supreme Court has held that the trier of fact should be allowed to consider the fault of a tortfeasor who is protected from liability due to a statute of repose. *Dotson v. Blake*, 29 S.W.3d 26, 29 (Tenn. 2000).

79. Statutes of repose begin to run with the happening of an event that is unrelated to the traditional accrual of a plaintiff's cause of action. *Penley v. Honda Motor Co.*, 31 S.W.3d 181, 184 (Tenn. 2000). The application of a statute of repose may result in the plaintiff losing the right to sue a defendant before that right has arisen; i.e., before the plaintiff was injured or died. *Id.*; see also *Calaway ex rel. Calaway v. Schucker*, 193 S.W.3d 509, 515 (Tenn. 2005) (noting the distinction between statutes of limitations and statutes of repose; "A statute of limitations normally governs the time within which legal proceedings must be commenced after a cause of action accrues. A statute of repose, on the other hand, limits the time within which an action may be brought and is unrelated to the accrual of any cause of action. A further distinction is that statutes of repose are substantive rather than procedural. Statutes of repose are substantive and extinguish both the right and the remedy while statutes of limitations are procedural, extinguishing only the remedy. Thus, a statute of repose typically does not bar a cause of action; its effect, rather, is to prevent what might otherwise be a cause of action from ever arising. . . . The injured party literally has *no* cause of action. The harm that has been done is *damnum absque injuria*—a wrong for which the law allows no redress. The function of the statute is thus rather to define substantive rights than to alter or modify a remedy.") (internal quotation marks and citations omitted). Because a statute of repose can bar a cause of action before it arises, statutes of repose are legislative grants of immunity. See 17 JOHN A. DAY ET AL., TENNESSEE PRACTICE SERIES TENNESSEE LAW OF COMPARATIVE FAULT § 5:12 (2013 ed.).

80. Although the holding in *Dotson* has not yet been extended to any statute of repose other than the one favoring the construction industry, it is virtually certain that the court will apply *Dotson* to all statutes of repose absent legislative action to the contrary. Other than the construction industry (TENN. CODE ANN. § 28-3-202 (2013) (barring claims 4 years after substantial completion of an improvement to real property)), the following groups receive the benefit of immunity in Tennessee in the event a statute of repose enacted for them expires: the medical industry (TENN. CODE ANN. § 29-26-116(a)(3) (2013) (barring medical

In a tort case where a statute of repose protects the sole defendant and suit was not brought within the prescribed period, the tort plaintiff's case is dismissed and the tort plaintiff's subrogee, if any, receives nothing in satisfaction of its subrogation interest. However, in a tort case with multiple defendants, if one of the defendants is protected by a statute of repose and that defendant is granted summary judgment because suit was not brought within the prescribed period, that defendant may still be blamed by the other parties and be attributed fault as a non-party by the finder of fact.⁸¹ The attribution of fault to a non-party under these circumstances diminishes the plaintiff's recovery accordingly.

The rationale in allowing a defendant to assert fault against a non-party who benefits from a statute of repose is that it "achieve[s] the fairest result possible by linking liability with fault" and that to not allow it would impose liability disproportionate to fault, which is "plainly inconsistent" with a comparative fault scheme.⁸² The following hypothetical illustrates the detrimental impact that a statute of repose has on a plaintiff's recovery and shows how Rule 2 of the Proposal is applied to produce a more equitable outcome with regard to the subrogation interest.

Hypothetical 3—Reduction by Percentage of Fault
Allocated to a Non-Party Protected from Suit by Statute of
Repose

A is injured in a car wreck. *A* asserts that *B*'s negligence caused the wreck. *A* sues *B*, and then *B* asserts fault against SSS corporation, the manufacturer of *A*'s vehicle, alleging that *A*'s injuries are substantially due to a defective seat belt in *A*'s vehicle. *A* then adds SSS as a party defendant. SSS moves for and is granted dismissal from the suit under the applicable statute of repose because *A*'s vehicle was

malpractice actions brought "more than three (3) years after the date on which the negligent act or omission occurred except where there is fraudulent concealment on the part of the defendant, in which case the action shall be commenced within one (1) year after discovery that the cause of action exists."); product manufacturers (TENN. CODE ANN. § 29-28-103(a) (2013) (barring claims 10 years "from the date on which the product was first purchased for use or consumption, or within one (1) year after the expiration of the anticipated life of the product, whichever is shorter"); exceptions are made for asbestos injuries (giving no time limit) (TENN. CODE ANN. § 29-28-103(b) (2013)) and silicone breast implants (allowing for 25 years) (TENN. CODE ANN. § 29-28-103(c) (2013)); those involved in the sale of securities (TENN. CODE ANN. § 48-1-122(h) (2013) (2 years after the act or transaction constituting the violation)); and corporate officers and directors (TENN. CODE ANN. § 48-18-601 (2013) (barring claims 3 years "after the date on which the breach or violation occurred, except where there is fraudulent concealment on the part of the defendant, in which case the action shall be commenced within one (1) year after the alleged breach or violation is, or should have been, discovered."); see also DAY ET AL., *supra* note 79, § 5:12.

81. *Dotson*, 29 S.W.3d at 29.

82. *Id.*

more than ten years old at the time of *A*'s wreck with *B*. The case goes to trial, and although *B* is assessed with 50% fault for causing the incident itself and contributing to the injuries, *B* proves that the defective seat belt was the cause of 50% of *A*'s injuries. Under Tennessee's comparative fault scheme, *A* bears the financial consequence of a 50% fault allocation against SSS, and thus *A* can recover only from *B* and may recover only 50% of his total damages. Rule 2 requires a 50% reduction in the asserted subrogation interest (equal to the 50% fault assessed to SSS).

An appropriate subrogation model must take this situation into account. Reasonable minds can debate whether it is "fair" to force *A* to bear the financial consequence of the legislature's decision to grant immunity to SSS under these circumstances. However, no one can deny that if this is the law—and it is—*A* can recover only that percentage of incurred medical expenses that can be assessed against *B*. Rule 2 of the Proposal simply takes this fact into account and would reduce the asserted subrogation interest by 50% because (a) the insured did not receive 50% of her medical bills due to an expired statute of repose as to one tortfeasor (here, SSS), and (b) the subrogee should not be able to recover from its insured money the insured never received.

More fundamentally, the basic concept of equitable subrogation, as defined, justifies this reduction and tells us how to adjust the subrogation interest here: The subrogee stands in the shoes of its insured, and acquires all the rights that the insured has against the third-party tortfeasor. If the insured has lost a right because of a statute of repose defense and does not recover some percentage of his loss as a result, then the subrogee, standing in its insured's shoes, loses the same right and cannot recover a corresponding percentage of its loss.

Rule 3: A subrogation interest is reduced by the percentage of comparative fault assessed against a tortfeasor that enjoys statutory or common law immunity from suit.

This Rule addresses other types of immunity granted to private persons and entities as well as public entities. A defendant to a lawsuit who is determined to be truly immune from suit, such as a governmental entity,⁸³

83. The doctrine of sovereign immunity derives from the ancient legal principle that a sovereign cannot be sued in court. *See* *Schooner Exch. v. McFaddon*, 11 U.S. 116, 132–34 (1812) (Pinkney, A.G., in reply) (“[T]he rights of a foreign sovereign cannot be submitted to a judicial tribunal.”). While the doctrine's enduring legitimacy in the modern context is a topic of voluminous debate beyond the scope of this Article, the U.S. Supreme Court's contemporary jurisprudence has consistently upheld the doctrine with regard to the states’

is simply dismissed from the suit.⁸⁴ However, Tennessee courts have determined that the immediate beneficiaries of this “get out of jail free card” may still be assigned fault at trial if fault is asserted against them by a remaining defendant in the case.⁸⁵ Fault allocation thus diminishes the tort plaintiff’s recovery in the same manner as an allocation of fault against a

immunity from suit; *see, e.g.*, *Alden v. Maine*, 527 U.S. 706 (1999) (holding sovereign immunity broadly protects state governments from being sued in state court without their consent); *Seminole Tribe v. Florida*, 517 U.S. 44 (1996) (limiting ability of Congress to authorize suits against state governments that would undermine state immunity). In Tennessee, the doctrine of sovereign immunity has both a constitutional and statutory basis. TENN. CONST. art. I, § 17; TENN. CODE ANN. § 20-13-102(a) (2013); *Jones v. L & N R.R. Co.*, 617 S.W.2d 164, 170 (Tenn. Ct. App. 1981) (noting both as sources of the doctrine). In its purest sense, sovereign immunity in Tennessee prevents a sovereign governmental entity from even being sued in its own courts absent legislative consent; if a defendant is truly immune, then any action would simply be dismissed as to such defendant. *See Wells v. Tennessee Bd. of Regents*, 231 S.W.3d 912, 916 (Tenn. 2007) (citing *Hawks v. City of Westmoreland*, 960 S.W.2d 10, 14 (Tenn. 1997)); *Williams v. State*, 139 S.W.3d 308, 311 (Tenn. Ct. App. 2004); Lewis L. Jaffe, *Suits Against Governments and Officers: Sovereign Immunity*, 77 HARV. L. REV. 1 (1963). As such, the rationale for taking into account the fault assessed against an immune defendant in determining an insurer’s net subrogation interest mirrors the justifications for taking into account the fault assessed to a non-party. *See Carroll v. Whitney*, 29 S.W.3d 14, 19 (Tenn. 2000) (holding that when a defendant raises the non-party defense in a negligence action, a jury may generally apportion fault to immune non-parties); *infra* Sections III(A) Rules 4–6.

84. Other people and organizations are also granted a degree of immunity as well under certain circumstances. For example, common law immunity still protects parents from suit by their children for “conduct that constitutes the exercise of parental authority, the performance of parental supervision, and the provision of parental care and custody.” *Broadwell by Broadwell v. Holmes*, 871 S.W.2d 471, 476–77 (Tenn. 1994). In addition, while charitable organizations in Tennessee are not immune from tort suits for the negligent acts and omissions of their agents, servants, or employees, any judgment entered against a charitable institution cannot be collected from the property of a charitable trust. *See O’Quin v. Baptist Mem’l Hosp.*, 201 S.W.2d 694, 696 (Tenn. 1947); *Anderson v. Armstrong*, 171 S.W.2d 401, 402 (Tenn. 1943). This creates a situation in which a plaintiff has a right to sue but no right to collect a judgment. *See DAY ET AL.*, *supra* note 79, § 5:16. There are also circumstances in which the law limits a plaintiff’s ability to sue in tort unless the plaintiff can prove more than simple negligence. For example, certain directors and members of governing boards, as well as trustees of certain groups, are immune from suit absent willful, wanton, or gross negligence. *See, e.g.*, TENN. CODE ANN. § 48-58-601(c)–(e) (2013) (listing persons and entities exempted from liability for ordinary negligence). Tennessee law also limits the circumstances under which those who are engaged in equine activities can be held liable for negligence, instead requiring proof of willful or wanton misconduct. TENN. CODE ANN. §§ 44-20-101–105 (2013). Even landowners under certain conditions are immune from suit unless grossly negligent under the Tennessee Landowner Statute. TENN. CODE ANN. §§ 70-7-101–105 (2013). Somewhat related to the concept of immunity are the largely unsettled questions in Tennessee concerning whether “acts of God” or animals may be attributed any degree of comparative fault. *See generally* DAY ET AL., *supra* note 79, §§ 5:18–19 (noting that while Tennessee courts have not ruled on the question of whether God or animals can be found at fault, a “strong argument can be made . . . that fault can only be assigned to a ‘person’ who can be subjected to the judicial process.”).

85. *Carroll v. Whitney*, 29 S.W.3d 14, 19 (Tenn. 2000) (holding that when a defendant raises the non-party defense in a negligence action, a jury may generally apportion fault to immune non-parties).

non-party or a defendant protected from suit by a statute of repose. Consider the following:

Hypothetical 4—Reduction by Percentage of Fault
Allocated to an Immune Non-Party

A is hurt in a car accident involving *B*. *B* asserts that Local Government was at fault in the accident, and *A* joins Local Government as a party defendant. XYZ Insurance Company, *A*'s health insurer, pays \$25,000 for medical bills incurred as a result of the accident and asserts a subrogation interest for that amount. Local Government is dismissed from the case because the court found it to be immune from suit under the discretionary function exception to the Governmental Tort Liability Act. The case proceeds to trial against *B*. The jury attributes 50% of the fault to *B* and 50% of the fault to non-party Local Government. *A*'s total damages are determined to be \$150,000 at trial. Thus, a judgment is entered against *B* for \$75,000, or one half of the total damages suffered by *A*. Rule 3 of the Proposal would reduce XYZ Insurance Company's asserted subrogation interest to \$12,500 to reflect the fact that *A* only recovered half of his medical bills because of the fault allocated to the immune Local Government.

The fundamental premise here is the same as discussed immediately above when addressing statutes of repose: The costs of a decision by our legislature or our courts to give protection from suit to certain people or entities because of their status or function in society must be borne by both the injured person and the subrogee who stands in that injured person's shoes.⁸⁶

Rule 4: *A subrogation interest is reduced proportionately to reflect the unavailability of those damages assessed against a government entity that would otherwise have been awarded but for a law limiting the amount of damages that can be awarded against the governmental entity.*

86. Any contrary view leads to absurd results. For example, if a subrogee can recover nothing from its insured where the sole tortfeasor is immune from suit, what possible basis in law or logic justifies an insured's being held responsible for 100% of the subrogation interest where an immune party is 90% at fault?

This Rule takes into account situations where a governmental entity may be sued for its wrongful conduct, but a statutory damage cap limits its liability.⁸⁷ In such cases, the law of comparative fault forces the plaintiff alone to bear the financial consequences of the damages cap.⁸⁸ In addition to similar justifications previously discussed,⁸⁹ the rationale for limiting the liability of government entities tends to focus on the idea that society as a whole benefits from the bargain struck—that is, if the government is required to pay the full amount of damages for the harm it causes to a citizen or other person or entity, society at large suffers in turn because that loss payment is ultimately passed on to citizens in the form of higher taxes.⁹⁰ Thus, the argument goes, limiting the government’s liability to an artificial cap balances the policy goals of (partially) compensating tort victims for their losses while minimizing the impact on the tax base.⁹¹ Furthermore, the government, as distinguished from the electorate, directly benefits from limited liability in that it has finite resources with which to meet its obligations.⁹²

Therefore, refusing to take into account the limited liability of government entity tort defendants in calculating an insurer’s subrogation interest in a tort suit unjustly enriches the subrogee (who also receives the “benefit” of limited government liability) at the sole expense of the plaintiff-insured. The following hypothetical illustrates the problem and how Rule 4 is applied:

87. The statutory basis for a government entity’s limited liability is set forth in two provisions of the Tennessee Code: the Government Tort Liability Act (“GTLA”) governs claims against counties, municipalities, and other local governmental agencies, but does not apply to state government, its agencies, and departments. TENN. CODE ANN. §§ 29-20-101–408 (2013). Claims against the State of Tennessee are governed by the Claims Commission Act. TENN. CODE ANN. §§ 9-8-301–310 (2013). Each includes a statutory cap on damages on a per person, per accident basis. TENN. CODE ANN. §§ 29-20-311, 9-8-307 (2013).

88. If this Proposal is fully adopted, consistency requires that statutory damage caps on non-economic losses be treated differently. Why? Because recent tort reform legislation caps only non-economic damages, not economic losses such as medical expenses. TENN. CODE ANN. § 29-39-102 (2013). Thus, under Principle 3—segregation of damages—the fact that these statutes do not impact a tort plaintiff’s ability to recover economic losses, including medical expenses, means that a subrogee’s rights should be not be discounted simply because other elements of plaintiff’s losses have been statutorily limited. The statutory caps applicable to state and local governments are different. *See supra* note 87. Because they cap damages regardless of their classification, equity demands that damages lost because of the cap apply proportionately to each category of loss.

89. *See supra* note 83.

90. *See* Lawrence Rosenthal, *A Theory of Governmental Damages Liability: Torts, Constitutional Torts, and Takings*, 9 U. PA. J. CONST. L. 797, 844–47 (2007).

91. *Id.* at 855.

92. *See id.* at 844–47.

Hypothetical 5—Reduction by Percentage of Fault
Allocated to a Limited Liability Government Entity

A is hurt by the negligence of *B* and State Government. XYZ Insurance Company, *A*'s health insurer, pays \$250,000 for medical bills incurred as a result of the accident and asserts a subrogation interest. The jury determines that *B* is 50% at fault and State Government is 50% at fault, and that *A*'s damages are \$1,000,000. In post-trial motions, the trial judge reduces the \$500,000 in damages allocated by the jury to the State Government to \$300,000, consistent with the requirement of the State Board of Claims Act. Thus, *A* receives a judgment against *B* for \$500,000 and against State Government for \$300,000 and the \$200,000 shortfall created by a financial cap on State Government's responsibility reduces *A*'s overall recovery by 20%. Under the Proposal, XYZ's subrogation interest is reduced by 20%, from \$250,000 to \$200,000, to reflect the fact that *A* did not recover \$50,000 of her medical bills because of the limitation on the financial responsibility of State Government.

Under Rule 4, the asserted subrogation interest is reduced by a percentage derived by dividing any uncollectable portion of the judgment assessed against a limited liability government entity by the total damages awarded, where the fault allocated to the government entity, when multiplied by the total dollar value of damages, exceeds the amount of judgment that can be awarded against the entity under state law.

Rule 5: *A subrogation interest is reduced by the percentage of comparative fault assessed against a non-party not subject to the jurisdiction of Tennessee courts.*

A tort plaintiff cannot sue a tort defendant in Tennessee unless Tennessee courts have personal jurisdiction over that defendant.⁹³ Occasionally, Tennessee courts have personal jurisdiction over some, but not all, tort defendants. Under Tennessee's comparative fault law, if the court does not have personal jurisdiction over a tortfeasor and a party defendant asserts fault against an out-of-state tortfeasor, a jury may apportion fault against the non-party out-of-state tortfeasor.⁹⁴ Because the plaintiff cannot receive a judgment against a non-party out-of-state tortfeasor, however, the plaintiff once again bears the financial

93. See TENN. CODE ANN. § 20-2-214(a)(6) (2013); *State v. NV Sumatra Tobacco Trading Co.*, 403 S.W.3d 726 (Tenn. 2013).

94. See, e.g., *Volz v. Ledes*, 895 S.W.2d 677 (Tenn. 1995).

consequences of such a fault allocation. This is demonstrated in the next hypothetical:

Hypothetical 6—Reduction by Percentage of Fault
Allocated to a Non-Party Not Subject to Suit in Tennessee

A is hurt by the fault of *B*, a Tennessee resident. XYZ Insurance Company pays \$50,000 in medical bills arising from the incident on *A*'s behalf. *A* files suit against *B* in Tennessee. *B* blames *C*, a non-resident of Tennessee, for contributing to cause *A*'s injuries. *A* adds *C* as a party defendant to his suit against *B*. *C* moves to dismiss, arguing that it is not subject to the jurisdiction of the Tennessee courts. The trial judge agrees, and the suit against *C* is dismissed. The case is tried and *B* is found 90% at fault and non-party *C* is found 10% at fault. Under the Proposal, XYZ's asserted subrogation interest is reduced by 10% because *A*'s only judgment is against *B*, and *B* is liable for only 90% of the damages.

Once again, the subrogee stands in the shoes of its insured. *A* did not recover ten percent of his damages because fault was assessed against a party that *A* could not sue in Tennessee; thus, XYZ likewise cannot recover its full subrogation interest.⁹⁵

Rule 6: *A subrogation interest is reduced by the percentage of the insured's total damages that the insured is unable to collect from a tortfeasor.*

A fair subrogation model must adjust the subrogation interest to reflect the amount of damages actually collected by the plaintiff from a judgment or settlement. Partial recovery is far more likely than full recovery in many—if not most—instances of significant injury,⁹⁶ so the subrogation interest must proportionately reflect the reality of the plaintiff's actual collected compensation for the insured loss. The following illustrates the application of this Rule:

95. True, if *A* files suit against *C* in *C*'s home state and recovers damages against *C*, then XYZ will recover more of its subrogation interest. However, *A* has no obligation to sue *C*, and, of course, XYZ can sue *C* in *C*'s home state and make a claim for medical expenses. In neither case would the result of the Tennessee state court action be admissible, much less binding, in the second suit.

96. Maher & Pathak, *supra* note 18, at 87 (citing Philip G. Peters, Jr., *What We Know About Malpractice Settlements*, 92 IOWA L. REV. 1783, 1803 (2007) (describing data analysis of malpractice settlements as showing that "plaintiffs who receive a settlement are unlikely to recover the full amount of their damages"))).

Hypothetical 7—Reduction in Subrogation Interest for a Tortfeasor’s Inability to Pay Full Judgment

A is hurt by the fault of *B*, a Tennessee resident. XYZ Insurance Company pays \$50,000 in medical bills arising from the incident. *A* files suit against *B*. *B* has only \$100,000 in liability insurance and obtains a bankruptcy discharge on any further obligation to *A*. The total value of *A*’s claim against *B* is determined to be \$200,000. Under Rule 6, *B*’s inability to pay more than \$100,000 means that *A* is deemed to have collected only fifty percent of each category of his damages, including his medical bills, and thus XYZ’s gross subrogation interest is reduced to \$25,000.

B. Principle 2—Accounting for Recovery Acquisition Costs

The gross subrogation interest is reduced proportionately by the reasonable recovery acquisition costs that the insured paid to secure the tort recovery for his or her benefit and for the benefit of the subrogee. A subrogee is permitted to challenge the reasonableness of the asserted recovery acquisition costs but is not entitled to any discount for the amount it pays to its own counsel in the matter unless the court determines that the subrogee’s counsel materially participated in the proceedings.

Principle 2 takes into account the insured’s expenses in bringing an action to recover from the responsible tortfeasor, a benefit enjoyed by both the insured and the subrogee.⁹⁷ The *pro rata* sharing of these expenses between the insured and the subrogee is justified by the fact that but-for plaintiff’s bringing suit, there would be no recovery of the insured loss by the insurer. The rationale behind it is also well established in Tennessee;⁹⁸ the insurer would be unjustly enriched at its insured’s sole expense if the expenses were not so adjusted.⁹⁹ Consider the following:

97. This Rule can also be called the “there is no such thing as a free lunch Rule.”

98. For example, Tennessee recognizes the equitable common fund doctrine. *See* *Kline v. Eyrich*, 69 S.W.3d 197, 204 (Tenn. 2002) (citations omitted) (“[The common fund] doctrine is designed to spread attorneys’ fees among various beneficiaries to a fund, and it is supported by two primary rationales. First, the doctrine prevents the beneficiaries of legal services from being unjustly enriched by requiring them to pay for those services according to the benefit received. Second, the doctrine serves to spread the costs of litigation proportionally among all of the beneficiaries so that the plaintiff does not bear the entire burden alone. Indeed, in furtherance of this latter rationale, the doctrine may be applied irrespective of whether the other beneficiaries to the common fund actually receive the benefits of the common fund.”).

99. The decision by a subrogee to hire its own counsel is discussed *infra* Section IV(A).

Hypothetical 8—Reduction of Gross Subrogation Interest by Recovery Acquisition Costs to Find Net Subrogation Interest

A is injured by *B*'s negligence. *A*'s health insurer, XZY Insurance Company, pays \$50,000 in medical bills. *A* recovers all incurred medical expenses at trial, where *B* is found solely at fault. The total damages awarded are \$300,000. *A*'s attorneys' fees and expenses (recovery acquisition costs) are \$100,000, an amount determined to be reasonable by the trial judge. *B* pays the entire judgment. XZY's gross subrogation interest of \$50,000 is reduced by the same proportion; i.e., by one-third, or \$16,666.66. Thus, XZY receives \$33,333.34 (its net subrogation interest). *A* paid her lawyer to recover the monies for XZY's benefit and the amount of XZY's subrogation interest is reduced accordingly.

A subrogee has the right to employ a lawyer at its own expense to protect its interest, but doing so does not impair the right of the insured to have the subrogation interest reduced *pro rata* by the reasonable fees (and expenses) the insured paid his or her lawyer to secure the tort recovery, unless the subrogee's lawyer made a material contribution to securing the subrogee's recovery. Simply filing an intervening complaint or attending depositions would not constitute a "material contribution" to securing the funds. Current jurisprudence concerning fee allocation in connection with worker's compensation subrogation interests provides an appropriate way to allocate fees under the Proposal.¹⁰⁰

100. *See, e.g., Summers v. Command Sys. Inc.*, 867 S.W.2d 312, 315–16 (Tenn. 1993) ("Since both the employer and the employee have the right to recover against a third party tortfeasor, each has the right to be represented by its own counsel on such terms as the party and its lawyer shall agree. The employer may engage the employee's lawyer to represent its interest also, on such terms as they, with the consent of the employee, shall agree. Even if separate counsel does not represent the employer, the employee's lawyer is obligated to protect the employer's interest. In that event, the employee's lawyer shall be entitled to reasonable compensation for services rendered to the employee and the employer. The lawyer shall be compensated according to the terms of the employment contract between the lawyer and the employee, provided the trial court shall find that fee agreement to be reasonable. A contingent fee agreement between the employee and his lawyer will apply to the entire recovery, and the attorney's fee will reduce the employer's portion of the recovery by a *pro rata* amount. The lawyers who prosecute the tort action are entitled to receive a reasonable fee based on services rendered. Any dispute regarding the amount and apportionment of attorney fees shall be resolved by the trial court.").

C. Principle 3—Maintaining Strict Segregation of Damages

A subrogee does not have a right to collect a subrogation interest from monies awarded for any loss other than the loss that gave rise to the subrogation interest.

An appropriate subrogation model must strictly segregate damages to preserve the integrity of the judgment or settlement as allocated. This means damages that were not attributed to the loss that gave rise to the insurer's subrogation interest can never be used to satisfy the unrelated subrogation interest.¹⁰¹ This cross-collateralization of unrelated damages is endemic in a first-dollar contractual subrogation regime,¹⁰² but the problem also may arise under the "traditional" subrogation rule. The latter situation occurs where the plaintiff's combined damages (i.e., medical expenses plus pain and suffering plus future earnings) make him whole and trigger the insurer's subrogation right, which the insurer then exercises from any and all damages, including those not allocated to the loss related to the subrogation interest. Consider this hypothetical:

Hypothetical 9—Segregation of Damages

A is injured in a car accident caused solely by B. A incurs medical bills in treatment for injuries received in the car accident for which A's insurer, XYZ Insurance Company, pays \$75,000 and asserts a subrogation claim for that amount in A's lawsuit against B. A receives a judgment of \$25,000 for medical expenses and \$50,000 for pain and suffering, and collects the entire judgment. Even though A's combined payments from XYZ and B equal the total amount of his damages, i.e., A was "made whole," the trier of fact only allocated \$25,000 for medical bills. Should XYZ be permitted to dip into the damages allocated to A's pain and suffering to satisfy its \$75,000 subrogation interest?

Application of Principle 3 answers that question in the negative and XYZ's gross interest would be limited to \$25,000. The problem with allowing XYZ to collect from A's pain and suffering award is that those damages were allocated to a loss unrelated to the medical bills XYZ paid on A's behalf, and thus are unrelated to XYZ's subrogation interest. Under any

101. For example, pain and suffering damages cannot be used to satisfy the insurer's subrogation interest from a loss it incurred paying medical expenses on the insured's behalf.

102. First-dollar contractual subrogation models, as the name implies and depending on the terms of the policy, are unlikely to distinguish between different categories of damages from which the insurer may collect its subrogation interest.

reasonable model, XYZ's gross subrogation interest here should be reduced to \$25,000 because the trier of fact allocated only that amount to compensate the relevant loss, i.e., the medical bills. This strict segregation of damages as allocated is crucial to a workable subrogation regime and is fundamental to the very premise of the subrogation right itself.

D. Principle 4—Preventing Collusive Settlements

No out-of-court effort by the insured or a tortfeasor to allocate fault, determine insured's damages, or allocate damages among several plaintiffs shall be binding on the subrogee absent consent of the subrogee.

As a natural consequence of a strict segregated damages rule, the law must also prohibit and keep in check arbitrary or collusive allocations of damages in settlements as well as bad faith litigation tactics aimed solely at defeating subrogation interests.¹⁰³ For example, it is always possible that an insured and a tortfeasor will try to allocate money in a settlement between the insured and, say, the insured's spouse, in a way that would attempt to defeat a subrogation interest. The following example illustrates this situation:

Hypothetical 10—Collusive Allocation of Damages in Settlement

A is hurt in a car wreck. *A* and his spouse, *B*, assert claims against tort defendant *C*. *A* has \$20,000 in medical expenses which are paid by his health insurer, XYZ Insurance Company. *A*'s case has a value of \$90,000. *B* asserts a loss of consortium claim. XYZ asserts its subrogation interest in *A*'s recovery. *C* has only \$100,000 in liability insurance coverage and cannot reasonably be expected to pay an excess judgment or contribute to a settlement from his own assets. *A* and *B* enter into a settlement with *C* allocating \$50,000 of the insurance proceeds to *A* and \$50,000 to *B* for the loss of consortium claim. XYZ does not participate in negotiation of tort settlement. XYZ can challenge the allocation of the monies that are allocated between *A* and *B* as being unreasonable. *A* retains the burden of proving that the settlement of his

103. One might imagine a situation in which the parties to a settlement agree to categorize all damages as pain and suffering to circumvent a subrogation interest in a medical expenses loss, or a plaintiff in litigation decides for strategic reasons (or in bad faith) to not prove damages related to subrogation interest, either because the damages are not worth it or are overshadowed by plaintiff's other damages. Under the Proposal, the trial court would make a determination as to the parties' conduct at the subrogation hearing phase.

claim for \$50,000 was reasonable under the circumstances, which necessarily implicates the value of the loss of consortium claim.

In summary, insureds and tort defendants should not be able to collude so as to inflate the value of a tort case, allocate money between multiple plaintiffs unreasonably, or otherwise work to defeat a subrogation interest. The settling insured will always bear the burden of establishing the reasonableness of the settlement with the tortfeasor where the subrogee's consent to the settlement amount was not obtained, and the subrogee will not be bound by damage allocations or valuations the insured reached with the tortfeasor without its participation.¹⁰⁴

For example, in *Hunley v. Silver Furniture Mfg. Co.*, the Tennessee Supreme Court provided a workable framework for ensuring that an allocation of damages in settlements involving third-party claims arising from on-the-job injuries is fair and reasonable where a subrogation right is implicated.¹⁰⁵ In essence, this decision permits a court to hear evidence on the matter and determine whether the allocation of damages was reasonable.¹⁰⁶ The subrogee should be given notice of any such hearing and the opportunity to be heard. This concept is incorporated in the Modified Made-Whole Doctrine Proposal.

104. Of course, if the case is tried and the subrogee has notice of the trial and an opportunity to intervene and be heard at the trial, it will be bound by such allocations and determinations. This is discussed in more detail *infra* Section IV(A)(2).

105. See *Hunley v. Silver Furniture Mfg. Co.*, 38 S.W.3d 555, 559 (Tenn. 2001). *Hunley* involved a dispute over whether an employer's statutory right to subrogation under the workers' compensation statute extended to the loss of consortium claim and settlement against a third party tortfeasor brought by an employee's spouse. *Id.* The Court held that the spouse's settlement was not subject to subrogation, and added that

[w]hen presented with a motion to approve a settlement between a third-party tortfeasor and the worker and the worker's spouse, the trial court having jurisdiction over the third-party claim shall review the settlement to ensure that the allocation of settlement proceeds between the worker and the worker's spouse is fair and reasonable. The court should consider both the need to protect the statutory subrogation rights of the employer and the need to encourage good faith settlement of third-party claims. In determining the reasonableness of the allocation of the total damages, the trial court should consider 'the nature and extent of the claimed loss of consortium, the potential value of the dismissed claim, and the expectations and motivations of the settling parties.' If any portion of the settlement allocated for loss of consortium damages is determined not to be fair and reasonable, that portion shall be made subject to subrogation in favor of the employer.

Id. (citations omitted) (quoting *Rains v. Kolberg Mfg. Corp.*, 897 P.2d 845, 848 (Colo. App. 1994)).

106. *Id.*

E. Principle 5—Guidelines for Settlement

An insured and a tortfeasor may settle a tort claim for an amount equal to or more than the entire asserted subrogation interest without the permission of the subrogee. However, if the subrogee later challenges the reasonableness of that settlement, the insured will bear the duty of demonstrating that the settlement was reasonable. An insured and a tortfeasor may not settle a tort claim for an amount less than an asserted subrogation interest without the permission of a subrogee or the court (after notice to the subrogee).

Principle 5 is difficult to discuss in isolation because it overlaps significantly with the other Principles and raises many of the complicated procedural questions inherent to the Proposal. Indeed, Principle 5 attempts to answer one of the most difficult questions arising in a legal system that both encourages the prompt settlement of tort claims but must also consider the implications of that policy on other stakeholders to the claim, i.e., subrogees. Thus, a discussion of Principle 5 will be included in the last sections of this Article.

PART IV. PRACTICAL APPLICATION OF THE PROPOSAL

The first question raised by any practicing attorney encountering changes in the law such as those the Proposal envisions is, “What does it look like on the ground?” The last Section of this Article attempts to answer that question because a workable model for the equitable resolution of subrogation claims must include a description of procedures that can be used by litigants and courts to resolve subrogation disputes. Thus, what follows is a detailed discussion of how subrogation issues are resolved before a tort suit is filed, while a tort suit is pending, after the tort suit is tried, and the resolution of subrogation issues after settlement with one of multiple tortfeasors. As mentioned above, these discussions involve the application of all of the Principles, including Principle 5.

A. Pre-Suit Resolution of Tort Subrogation Claims

In pre-suit settlement negotiations involving subrogation interests, both the insured and the subrogee should consider the factors in the Proposal in resolving their dispute. Because the vast majority of subrogation disputes will be resolved during this stage of the proceedings, a well-defined body of substantive law that clearly articulates the method for determining the amount of a subrogation interest is necessary not only to facilitate but also to promote such settlements.¹⁰⁷

107. Indeed, it is the author’s experience that many of these same factors are being used informally today as subrogees and insureds attempt to resolve subrogation issues.

Where a subrogation interest is asserted in a tort claim and the insured settles the claim against the tortfeasor¹⁰⁸ without filing a lawsuit, one of two things will happen: (1) the insured will simultaneously settle the subrogation claim with the subrogee and no lawsuit of any type will be filed; or (2) the insured and the subrogee will be unable to resolve their dispute and one or the other will file a lawsuit to permit a court to adjudicate the subrogation dispute.¹⁰⁹

1. Tort Case Settles; Subrogation Issues Resolved Without Litigation

There will frequently be simultaneous negotiations between the tortfeasor, the insured, and the subrogee in an effort to reach a global resolution of the matters in dispute. In an ideal world, this would happen in every case and all matters would be resolved without the need to resort to litigation. That being said, the tort plaintiff and the tort defendant have a right to compromise and settle their tort dispute without negotiating a resolution of the subrogation interest if the total amount of the settlement exceeds the asserted subrogation interest.

The tort defendant will not ordinarily permit a resolution of the underlying tort case that leaves open the possibility of further financial liability to the subrogee on the subrogation claim.¹¹⁰ Thus, the tortfeasor will ordinarily require that monies representing the total claimed subrogation interest (or the entire amount of the settlement, whichever is less) either be held in trust by plaintiff's counsel or deposited with the court, pending resolution of the subrogation claim. This protects the tortfeasor and the subrogee. The tortfeasor has "bought his peace" because the subrogee's rights in the tort case have been protected.¹¹¹

108. The tortfeasor will ordinarily be represented by an attorney selected by and paid for by a liability insurance carrier. Thus, the use of the term "tortfeasor" includes a reference to the alleged wrongdoer and the alleged wrongdoer's liability insurance company.

109. If the subrogee files suit first, it will bring a claim for breach of the insurance contract. If the insured files suit first, it will be seeking a declaratory judgment of the amount, if any, of the subrogation interest. A suit by the insured for a declaratory judgment will be met by the subrogee's counterclaim for breach of contract.

110. It is possible for the defendant to undertake responsibility for the entire subrogation claim and agree to indemnify and hold the insured harmless for any liability under the claim. This would relieve the insured of any responsibility to satisfy the subrogation interest, assuming, of course, that the defendant had the financial ability to pay the subrogation interest.

111. This is why Principle 5 allows a tortfeasor and an insured to settle a case for an amount equal to or more than the claimed subrogation interest without seeking the subrogee's prior approval. The tortfeasor's economic interest protects the subrogee. This is not true when the amount of the proposed settlement is less than the subrogee's claimed subrogation interest, demonstrating why Principle 5 requires permission of the subrogee or court order under such facts.

2. Tort Case Settles; Subrogation Issues Litigated

Assuming that the tortfeasor and the insured reach a resolution of the tort claim but the insured and the subrogee cannot resolve the subrogation issue, a lawsuit will be necessary to resolve the issue. Regardless of who files suit, the subrogee will have the burden of proving (a) that it has a subrogation right in the insured's recovery from the tortfeasor; (b) the amount of its interest in the insured's recovery (the "asserted subrogation interest"); and (c) that the expenses it paid for the loss on behalf of its insured were reasonable, necessary, and arose from the injuries for which recovery was made in the underlying settlement.¹¹²

The insured will have the burden of proving the reasonableness of any settlement with the tortfeasor. To do so, the insured will have to (a) demonstrate the value of the tort claim; (b) articulate why the settlement is reasonable notwithstanding the fact that it was for less than the asserted value of the case; and (c) prove which of the factors in the Proposal work to reduce the amount of money the subrogee can recover.

The insured will also have to prove the monies paid (or to be paid) for legal services in securing the settlement with the tortfeasor (the "recovery acquisition cost") and ask the court to reduce the subrogation interest accordingly. Likewise, if the subrogee asserts that it materially participated in obtaining the settlement and thus should not suffer a reduction in its subrogation interest based on the insured's full recovery acquisition costs, the subrogee must produce evidence to support that assertion and ask the court to take the subrogee's participation into consideration in adjusting the subrogation interest.

An insured can avoid the burden of proving that the settlement with a tortfeasor was reasonable by obtaining the subrogee's consent to the settlement. An insured who settles a personal injury claim without obtaining consent of the subrogee or settling the subrogation claim at the same time assumes the risk that the subrogee will later argue that the amount of the settlement was unreasonable, thereby complicating the later subrogation trial and leaving the insured at risk that the settlement will be deemed unreasonable. Thus, a global resolution of the tort claim and the subrogation claim is ordinarily preferable. At a minimum, an effort often would be made to obtain the subrogee's consent to the settlement reached with the tortfeasor.

112. The language here assumes that the subrogation interest arises from the payment of medical expenses paid under a health insurance policy or the medical payments provision of an automobile insurance policy. If the asserted subrogation interest arose out of a different type of policy, the exact proof requirements would vary accordingly.

i. Demonstrating That the Tort Settlement Was Reasonable

Whether a settlement of the underlying tort action is reasonable should depend on the strength of the liability case against the settling tortfeasor, the likely value of the case in the absence of liability issues, the readily available financial resources of the settling defendant, the financial situation of the plaintiff, the expense of continued litigation, the presence or absence of other tortfeasors, the presence or absence of law that immunizes the defendant or others in whole or in part, and other relevant factors.

A settlement is not necessarily reasonable simply because it secures 100% of the liability insurance proceeds available to indemnify a tortfeasor. A tortfeasor is, or at least should be, responsible for the harm caused by its conduct. Financial responsibility is not limited by the amount of liability insurance available to indemnify the tortfeasor for that loss. So, as part of the insured's obligation to prove whether a settlement made without the subrogee's consent was reasonable despite the fact that it was materially less than the asserted value of the tort claim, the insured must also demonstrate financial resources of the tort defendant that were readily available to meaningfully contribute to a settlement or pay a judgment in the case. This evidence will help the court determine whether the settlement reached was reasonable under the circumstances.

"Readily available financial resources" refers to that part of the tortfeasor's assets and present and future income reasonably available to either satisfy a judgment entered in the tort case if the case was tried to a conclusion or to make a meaningful contribution to a settlement of the claim. To determine the amount of readily available financial resources, one should look not only to the liability insurance applicable to the tort event but also the assets, liabilities, and income stream, both current and foreseeable, of the tortfeasor.¹¹³ One should also look to the likelihood that the tort defendant could avoid a judgment in excess of the liability insurance policy limits through discharge after a bankruptcy proceeding. If bankruptcy is not an option because of the nature of the underlying tort, that too should be considered. Also to be considered is the ability of the tort defendant to make a meaningful contribution to payment of an excess judgment in a reasonable period of time after such a judgment would likely be entered, evaluated against the cost of collection efforts and the time value of money. Finally, one should consider any allegation that a liability insurance policy does not provide coverage for the incident in question and weigh the merits of that coverage defense.

113. An insured's lawyer may insist that the tortfeasor provide an affidavit that addresses the tortfeasor's net worth, income, and more. Ordinarily, the insured should have a right to rely on such an affidavit when deciding whether or not to settle a claim. In the event that it is later determined that the tortfeasor gave a materially false affidavit, the underlying settlement should be declared void and the tortfeasor once again should be subject to personal liability.

However, “readily available financial resources” should not include the chance that the tortfeasor could win the lottery and be able to pay the judgment, or other similar speculation. An appropriate inquiry would include a potential inheritance, but only rarely would such an inquiry result in a determination that, other things being equal, the tortfeasor should be required to make an additional contribution to the settlement for the settlement to be reasonable.¹¹⁴

A “meaningful contribution” to settlement of the tort claim is a potential or actual payment, in addition to liability insurance monies, by a tortfeasor to the insured of an amount of money or other asset that is not a *de minimis* amount given the value of the tort claim. The determination of whether the insured should require a tortfeasor to make a personal financial contribution to the settlement of a tort claim, as well as the amount of such a contribution, turns on the application of a “reasonable person” test: After taking into consideration the tortfeasor’s readily available financial resources and the circumstances surrounding the tender of the liability insurance in the tort case, would a reasonably prudent person in the position of the insured require the tortfeasor to make a personal financial contribution to the settlement of the tort case, and if so, in what amount?

To answer this question, one must make a reasonable investigation of a tort defendant’s ability to pay an excess judgment or make a meaningful contribution to the tort settlement.¹¹⁵ That is, one must undertake the degree of effort that would be undertaken by a reasonably prudent person under the circumstances to learn the assets, liabilities, and income stream of the tortfeasor. The following series of hypotheticals explore these concepts.

Hypothetical 11—Settlement Reasonable; Insolvent Defendant

A is injured by *B*. *B* is solely and undeniably at fault. *A*’s health insurer, XYZ, pays \$50,000 in medical bills treating

114. A claim that the tortfeasor might inherit someday from his sixty-year-old mother (who enjoys excellent health) would bear little weight. If the tortfeasor and spouse owned a mortgage-free home as tenants by the entirety, evidence demonstrating that the spouse was suffering from metastatic cancer for which no treatment was available (and thus the tortfeasor would likely own the home free and clear in the near future) would bear more weight.

115. The phrase “meaningful contribution to the tort settlement” is undeniably vague but, in the author’s view, appropriately descriptive. Rarely will a liability insurer be willing to pay 100% of the true value of the claim. Rarely will a tort defendant be able or willing to make a contribution to a tort settlement that, when added to the monies paid by the liability insurer, is 100% of the true value of the claim. Thus, the phrase “meaningful contribution to the tort settlement” is used to permit the parties and, ultimately, the fact-finder to determine if the overall settlement was reasonable without forcing the plaintiff to extract—or the individual defendant to pay—some immaterial amount just to satisfy the desires of the subrogee.

injuries caused by *B*. *B* has liability insurance of \$50,000. *A*'s claim is likely worth \$200,000 but has not been reduced to judgment because no suit has been filed. *A* receives an affidavit from *B* that *B* does not own a home, has less than \$10,000 in personal property items, and earns minimum wage. *B* has the right to bankrupt any judgment entered in litigation with *A*. Under the circumstances, a settlement with *B*'s liability insurer for \$50,000 is reasonable.

Hypothetical 12—Settlement Unreasonable; Defendant Has Personal Assets Beyond Liability Policy

A is injured by *B*. *B* is solely and undeniably at fault. *A*'s health insurer, XYZ, pays \$50,000 in medical bills treating injuries caused by *B*. *B* has liability insurance of \$50,000. *A*'s claim is likely worth \$200,000 but has not been reduced to judgment and no suit has been filed. Investigation reveals that *B* owns in his own name a home worth \$250,000 subject to a mortgage of \$100,000 and earns \$80,000 per year. *B* has no other debt. Notwithstanding his injuries, *A* is able to meet his financial obligations in the same manner as he was before the incident. *A* settlement with the liability insurer for the \$50,000 insurance policy limits would be unreasonable because *B* has the capability of making a meaningful contribution to the tort settlement. The amount of that contribution would depend on consideration of additional factors.

Hypothetical 13—Settlement Reasonable; Insolvent Corporate Defendant

A is injured by *B* who at the time of the incident was working in the course and scope of his employment with Corporation. Liability is admitted. *B* has filed bankruptcy and his obligation to *A* is discharged. Corporation's liability insurance is adequate to pay only 20% of the value of the claim. An affidavit from the sole owner of Corporation reveals that Corporation has no real property and its desks, chairs, and computers are worth less than \$10,000. Accounts payable exceed accounts receivable. The owner has indicated that if *A* files a lawsuit against the Corporation, he will cause the Corporation to file bankruptcy and he will move to Alaska and become a

fishing guide. A settlement with the liability insurer for the insurance policy limits would be reasonable.

Hypothetical 14—Settlement Unreasonable

A is injured by *B* who at the time of the incident was working in the course and scope of his employment with Corporation. Liability is admitted. *B* has filed bankruptcy and his obligation to *A* is discharged. Corporation's liability insurance is adequate to pay only 20% of the value of the claim. The owner of the corporation refuses to cooperate when requested to reveal Corporation's balance statement, income statement, and tax returns. Publically available research reveals that Corporation owns and operates a manufacturing plant with thirty-two employees and has doubled its workforce in the past six months. Notwithstanding his injuries, *A* is able to meet his financial obligations in the same manner as he was before the incident. A settlement with the liability insurer for the insurance policy limits would be unreasonable because (1) Corporation refuses to reveal information that would permit the reasonably prudent person to evaluate whether Corporation can make a meaningful contribution to a settlement and (2) there is some evidence that Corporation is a going, growing concern with some ability to pay.

Notably, the fact that a settlement with a tortfeasor is unreasonable does not always entitle the subrogee to 100% of the insured's settlement proceeds. Rather, the subrogee would have to prove what a reasonable settlement figure in the case would have been. If the subrogee meets this burden, the calculation of the subrogation interest is to be based on that figure.

Hypothetical 15—Unreasonable Settlement; Subsequent Modification of Subrogation Interest by the Court

A is injured by *B*. *B* is solely and undeniably at fault. *A*'s health insurer pays \$50,000 in medical bills treating injuries caused by *B*. *B* has liability insurance of \$50,000. *A*'s claim is likely worth \$200,000 but has not been reduced to judgment and no suit has been filed. Investigation reveals that *B* owns in his own name a home worth \$250,000 subject to a mortgage of \$100,000 and earns \$80,000 per year. *A* is able to meet his financial obligations in the same manner as he was before the

incident. *A* fails to persuade the court that the settlement for the \$50,000 liability insurance policy limit is a reasonable settlement. The subrogee persuades the judge that *B* should have made an additional \$50,000 personal contribution to the settlement. Thus, for purposes of determining the extent of the subrogee's gross subrogation interest, the court should assume that the amount of the settlement was \$100,000 rather than \$50,000.

Many will find this result disturbing because it permits a subrogee (and a trial judge) to second-guess a settlement presumably made in good faith. That may be true, but equity requires that a subrogee not be burdened by the financial consequences of a settlement it played no part in reaching. Thus, the reasonably prudent plaintiff's lawyer will engage the subrogee in settlement negotiations as they are occurring with the tortfeasor, particularly if there is evidence that the tortfeasor has some assets or a middle-class or higher income stream.¹¹⁶ Why? Because the failure to do so will open the door to second-guessing by both the subrogee and a court, thus potentially impacting the insured's net recovery and delaying the complete resolution of the dispute.

Therefore, the insured's lawyer has an incentive to make an effort to persuade the subrogee to accept the compromise tentatively reached with the tortfeasor¹¹⁷ or, at a minimum, force the subrogee to articulate its reasons for objecting to the settlement so that the merit—or lack thereof—of those reasons can be taken into account in determining whether to settle the case without the subrogee's consent. A reasonably prudent subrogee will also engage in such negotiations, knowing that the failure to reach a compromise will result in additional litigation and related expense that may yield little or no additional payments to it.

ii. Other Factors Impacting Reasonableness of Settlements in Tort Actions

Three other points that reflect the economic realities of settlements must be made on this subject. First, whether a settlement with the tortfeasor was reasonable should not depend on the insured's obtaining the full limit of the tortfeasor's liability policy. Liability considerations may weigh in favor of a resolution that constitutes less than liability insurance policy limits. Likewise, the tortfeasor's liability insurer may insist that it must

116. The financial circumstances of the plaintiff may compel a resolution of the case before an agreement can be reached with the subrogee.

117. Counsel for the insured could engage the subrogee in the negotiations with the tortfeasor or reach an agreement with the tortfeasor subject to later approval by the subrogee.

“save a little” and that the tort defendant is able to make a meaningful contribution to the settlement.¹¹⁸

Second, the economic situation of the plaintiff may require a settlement for less than what would otherwise be a reasonable settlement. Fundamental fairness requires that this reality be considered. Every case has a value, but no reasonable lawyer fails to take into account the economic needs of his or her own client when evaluating a case for settlement. However, the mere declaration by an insured that “I needed the money” should not be given any weight in determining the reasonableness of a settlement. Rather, the insured must be able to demonstrate that a degree of financial need existed at the time of the settlement such that any reasonable person, similarly situated, would place weight on that need in settling the case. As a matter of public policy, a subrogee should be bound by the legitimate economic need of its insured: Once again, it stands in the insured’s shoes.

Third, it is not in the interest of tortfeasors, the legal system, or society to force every tortfeasor into bankruptcy simply to prove that a tort settlement was reasonable. The Proposal acknowledges that policy interest and provides a fluid but workable method for resolving the issue. The notion that an insured must litigate an injury case until the tortfeasor seeks and receives a bankruptcy discharge before the insured can seek a reduction in a subrogation interest should be immediately rejected.

One can readily see some challenging and unusual issues in a trial over the proper amount of a subrogation interest.¹¹⁹ Depending on the nature of the injury and other factors, the plaintiff may contest whether some of the medical expenses were reasonable, necessary, or related to the injuries received in the incident. One can also imagine a situation in which an insured tries to increase his or her own fault or increase the fault allocated to a non-party. Indeed, the insured arguably has no incentive to actively work to diminish his or her fault—or decrease the fault allocation to judgment-proof parties or immune non-parties—in situations where the

118. Because liability insurers in Tennessee face no real threat of a “bad faith” action against them by their insureds and they have no legally enforceable duty to deal with plaintiffs in good faith, it is not uncommon for liability insurance adjusters to insist upon some discount from policy limits to settle a case, even if liability is clear and the damages clearly exceed the policy limits. This is a fact of tort litigation in Tennessee. It would be unfair to not take this reality into account in establishing an equitable model for approaching the resolution of subrogation interests.

119. The author is aware of nothing that would prohibit either party from demanding a jury trial in a case between a tort plaintiff and subrogee. To be sure, even in a jury trial some issues would be solely for the court (e.g., whether governmental immunity barred a claim by plaintiff, whether a statute of repose had expired under facts not in dispute, etc. *See* DAY ET AL., *supra* note 79, §§ 5:16–17), but there are issues to be resolved that are traditionally resolved by juries (such as the relative degree of fault of the parties, compensatory damages, etc.). Presumably, however, neither party would demand a jury in the vast majority of such cases given the higher costs of preparing cases for trial by jury, the additional time it takes to try a jury case, and other factors.

damages sought are subject to a subrogation interest.¹²⁰ That being said, a fact-finder will quickly see through any effort by an insured to unfairly diminish a subrogation interest.

Finally, in the event of a subrogation trial where the facts are resolved by a judge, the judge should issue findings of fact and conclusions of law. The ruling should address whether a subrogation right exists and the gross amount of any subrogation interest. It should then determine whether any settlement entered into by the insured was reasonable and what, if any, factors apply to reduce the gross subrogation interest. The court should also determine the reasonableness of any recovery acquisition costs asserted. If any subrogation interest is present, judgment should be entered for the subrogee in that amount, and any funds held in trust or by the court should be released in accordance with the judgment.

iii. Protections for the Subrogee When the Tort Case Is Settled

Principle 5 makes it clear that a tort defendant and an insured cannot settle a claim for less than the amount of the claimed subrogation interest without the consent of the subrogee or permission of the court. Principle 5 is added for completeness, but is of little practical effect because tortfeasors, or at least their insurers, know that they cannot avoid liability on a subrogation claim without getting a release from the subrogee.¹²¹ Thus, tortfeasors and their insurers typically will not settle a tort claim without making some effort to shift the subrogation exposure to the insured and ensuring that the money to pay the subrogee's claim is preserved until the claim is resolved.

That being said, a tort defendant and an insured, after notice to a subrogee, may petition the court for approval of a settlement for an amount less than the subrogation interest, which will require a proceeding in which the Proposal is applied to determine whether the settlement is reasonable and, if so, the net amount of the subrogation interest.

B. Settlement of the Tort Claim After the Insured Has Filed Suit Against the Tortfeasor

Some tort cases are filed before there are any settlement negotiations and others are filed after a breakdown of negotiations. If suit is filed in the underlying tort action, the subrogee can elect to intervene in the case and work with the plaintiff to secure a recovery. Alternatively, the subrogee can elect not to intervene. If the subrogee does not intervene, it loses its right to contest the trial results in the underlying case, including,

120. For a similar example, see *supra* Section III(D).

121. See *supra* Section III(D).

but not limited to, the fault allocation by the fact-finder and the fact-finder's valuation of the plaintiff's claim.¹²²

On the other hand, most personal injury and wrongful death cases are settled before trial. In these cases, whether the subrogee chooses to intervene or not, there frequently will be settlement discussions with the goal of resolving the case at some point in the litigation process. The procedures and factors to consider in settling a subrogation claim while a tort case is pending are identical to those applicable to settling a tort claim before suit is filed.¹²³

In the interest of judicial economy, efforts should be made to enable the same court hearing the tort case to resolve any subrogation dispute and to preserve the available record. If a settlement is reached in the tort case but not in the subrogation dispute and a subrogation trial becomes necessary, the subrogee, if it has not already done so, should intervene in the pending case. If the underlying tort case is dismissed before the subrogee intervenes, a separate suit must be filed to have a court resolve the issue. Again, either the insured or the subrogee can file suit. If a trial is necessary, the procedures described in Section C below should be followed.

C. Resolution of Subrogation Claims After a Court or Jury Decides the Case

As indicated above, if suit is filed in the underlying tort action, the subrogee can elect to intervene in the case and work with the plaintiff to secure a recovery. Alternatively, the subrogee can elect not to intervene and allow the trial to take place without its involvement.

A determination by a jury¹²⁴ of the value of a tort case always sets the value of the case for purposes of calculating a subrogation interest. Thus, after a trial an insured cannot argue that his or her claim is worth "more" than the jury determined, and a subrogee cannot argue that the claim was worth less. The value of the claim is binding absent a remittitur, additur, or a court-ordered new trial.¹²⁵

122. *See* Abbott v. Blount Cnty., 207 S.W.3d 732, 736 (Tenn. 2006) (citations omitted) (quoting Bill Brown Constr. Co. v. Glens Falls Ins. Co., 818 S.W.2d 1, 13 (Tenn. 1991) ("[I]t is the long-standing rule in Tennessee that *any* contractual provision of a policy of insurance, whether part of an insuring, exclusionary, or forfeiture clause, may be waived by the acts, representations, or knowledge of the insurer's agent. Under this principle, an insurer may not fail to act and then seek to enforce exclusionary terms of a policy. It follows that if [subrogee] had knowledge of [insured's] lawsuit and settlement negotiations but did not intervene or warn the insured that [subrogee's] subrogation rights could affect the [insured's] recovery, then [subrogee] will be deemed to have waived those rights.")).

123. This subject is addressed in Section IV(A).

124. Of course, if neither party demands a jury, the fact-finder in the case will be the judge.

125. This assumes the subrogee has notice of the litigation and trial and an opportunity to participate. If for some reason the subrogee receives no notice, it should be not be bound

Likewise, a party to a tort dispute resolved at a trial (or one who had the opportunity to be a party but declined) cannot later take issue with the fault apportionment, damages allocation, legal rulings by the judge regarding statutes of repose or other immunity issues, or other factors that impact the amount of the subrogation claim as set forth in the Proposal.¹²⁶ In other words, if there is a trial of the tort case and the subrogee had the right to participate in it, at the close of the trial all issues in the case relevant to the subrogation issue will be resolved except (a) whether a right to subrogation exists at all, and (b) the amount of the net subrogation interest after consideration of the factors set forth in the Proposal.

Thus, after a trial of the tort case, if there is no dispute about the right to subrogation or the gross amount of the subrogation interest, the trial judge simply applies the factors in the Proposal to determine the payable subrogation interest. The following hypotheticals illustrate how the Proposal might be applied in practice:

Hypothetical 16—Application of the Proposal

A is injured because of the fault of *B* and City. The case is tried. XYZ Insurance Company paid *A*'s medical bills, is given timely notice of the tort trial, and intervenes to assert its subrogation interest for \$100,000 in medical bills it paid on *A*'s behalf. The jury awards \$1 million in total damages (\$100,000 of which are allocated to *A*'s medical expenses, i.e., the full amount of XYZ's asserted subrogation interest), and determines that *A* is 20% at fault, *B* is 40% at fault and City is 40% at fault. Because City's liability is capped by statute at \$300,000, *A*'s gross recovery from both *B* and City can be no more than \$700,000; \$400,000 of which is to be paid by *B* and \$300,000 of which is to be paid by City. No appeal will be taken in the case.

In a post-trial hearing, before judgment is entered against *B* and City, the judge must determine XYZ's net subrogation interest. Under the Proposal, the amount will be determined as follows:

by the results reached in that trial. If the subrogee receives late notice of the litigation or trial and wants to participate in the trial, it should promptly move to intervene to protect its rights.

126. This is not to say that there cannot be an appeal of the legal rulings and findings of fact. Rather, a party to the proceedings (or those who elected not to be parties) cannot make a collateral attack on the results in the trial during the post-trial proceedings to determine the subrogation interest.

XYZ's asserted subrogation interest	\$100,000
Reduction: 20% for A's fault	(\$20,000)
Reduction: 10% for City's liability cap (percentage derived by (i) subtracting the amount of City's liability limit (\$300,000) from the total amount of damages assessed against City (\$400,000) and (ii) dividing that amount (\$100,000) by the total amount of damages awarded (\$1,000,000))	(\$10,000)
Gross subrogation interest before court's adjustment for recovery acquisition costs	\$70,000
Reduction: 40% for A's recovery acquisition costs for the insured loss (assuming the court finds this percentage reasonable based on insured's one-third contingent attorney's fee plus <i>pro rata</i> litigation costs)	(\$28,000)
Net subrogation amount	\$42,000

Once the net subrogation amount is determined, the judge must next enter a separate judgment against each defendant that allocates responsibility for the payment of the net subrogation amount according to the fault assessed against each defendant. Here, *B* is charged with \$400,000 of *A*'s total recoverable damages of \$700,000 (four-sevenths) and City is charged with \$300,000 of *A*'s total recoverable damages of \$700,000 (three-sevenths). Thus, XYZ is entitled to recover four-sevenths of the net subrogation amount from *B* and three-sevenths of the net subrogation amount from City. Stated differently, the judgment of the trial court should require *B* to pay \$24,000 directly to XYZ, and should require City to pay \$18,000 directly to XYZ.¹²⁷ Assuming both judgments are fully collectable, XYZ will recover its entire \$42,000 net subrogation amount.

127. The reader may ask why separate judgments are entered for the tort plaintiff and the subrogee. The rationale is that both tort plaintiff and subrogee made the decision to file suit and go to trial, and thus it is appropriate that each should have separate judgments against the tortfeasors. However, this presents the problem of whether the insured or the subrogee has priority to collect their respective damages from the tortfeasor, especially in situations where the tortfeasor is unlikely to be able to pay the full amount of the judgment. While it would be inimical to deem one court-issued judgment subordinate to the other, the subrogee in most cases presumably will have more resources with which to collect its damages from the tortfeasor, leaving the tort victim at a disadvantage in the collection phase. The alternative, however, is most likely a consolidated judgment for the tort victim, who would then bear the burden of collecting from the tortfeasor alone, remitting payment of the subrogation interest to the subrogee as monies are recovered. What should happen is that the insured and the subrogee join forces to collect the judgment and bear the expense of the same *pro rata*.

However, it should be noted that the separate judgment model only makes sense in the context of a subrogation right, and not where a right of reimbursement forms the basis of the insurer's claim to a subrogation interest. This is because a subrogation right in essence gives the subrogee standing to assert its claim directly against the tortfeasor, whereas a right of reimbursement only gives rise to a cause of action by the insurer against its insured. In the latter instance, it seems like the court would be obligated to enter a judgment for the plaintiff

To complete the picture, the judgments entered in favor of the tort plaintiff (after deducting the amount due to the subrogee) would look like this:

A's Judgment Against B: \$400,000 - \$24,000 = \$376,000

A's Judgment Against City: \$300,000 - \$18,000 = \$282,000

One post-trial issue that may arise is the proper amount of the subrogation interest in the event the damage award allocated by the fact-finder to the insured's loss—usually medical expenses—is less than the claimed subrogation interest. Consider the following hypothetical:

Hypothetical 17—Insured Acts in Good Faith but Fails to Prove the Full Subrogation Interest

A is injured in a car accident with *B*. Health insurer XYZ pays \$20,000 in medical bills for plaintiff between the time of the incident and the time *A's* and *B's* dispute goes to trial. *A* introduces only \$15,000 in medical expenses at the tort trial because *A* cannot find expert support linking the other \$5,000 in bills to the negligence of *B*. XYZ, which has notice of the trial, does not attempt to prove the additional \$5,000 in medical bills. *A* obtains a collectable judgment against *B* that includes an award of \$15,000 in medical bills. Post-trial, XYZ asserts a gross subrogation interest for the entire \$20,000. *A* will object, and the trial judge will decide whether XYZ is entitled to recovery of the extra monies. Under these facts, the trial judge should limit the gross subrogation award to \$15,000 because *A* exercised good faith in attempting to prove the medical bills, could not do so, and XYZ elected not to prove the bills itself.

Note that the key consideration in Hypothetical 17 is the finding that *A* exercised good faith in proving the medical bills in the case. Ordinarily, plaintiffs who bear the burden of proving damages that are subject to a subrogation interest should be required to exercise good faith in getting evidence of those damages admitted and in seeking their recovery.

only. In any case, the distinction may be merely academic; indeed, the Tennessee Supreme Court treats rights to subrogation and reimbursement identically in the context of the current made-whole rule, and so there seems little reason to now make a complicated distinction under the Proposal. *See supra* notes 47–50 & accompanying text.

However, situations readily arise where a plaintiff, while still exercising good faith, might choose not to introduce evidence of certain damages—namely, where the cost of proving the reasonableness and necessity of those damages does not make economic sense.¹²⁸ In these situations, if the subrogee does not introduce the evidence itself, the subrogation interest should be reduced by the amount reasonably left unproven. In any event, it would be prudent for insured's counsel and the subrogee to discuss such matters before the tort trial and reach an agreement on this dilemma. If they do not or cannot, a trial judge can resolve it after the trial.

Conversely, consider this hypothetical:

Hypothetical 18—Insured Strategically Elects Not to Prove Some or All of the Subrogation Interest

A is injured in a motor vehicle wreck with *B*. *A*'s health insurance company pays \$40,000 in medical bills. *A* decides not to introduce evidence of those bills at trial because *A* does not want the small amount of medical bills to have an adverse anchor effect on the jury's potential total damage award. The subrogee does not oppose this litigation strategy and does not prove the amount of the medical expenses. The jury awards \$100,000 in damages, allocating none of it for medical expenses. The judgment is collected. Absent an agreement to the contrary, the subrogee is entitled to a gross subrogation award of \$40,000 even though the jury awarded no money for medical expenses because *A* elected not to prove the medical expenses.

The result in Hypothetical 18 is fair because the subrogee should not suffer from *A*'s decision not to prove medical expenses or its decision not to interfere with *A*'s litigation strategy.¹²⁹ The result would be different if *A* advised the subrogee sufficiently in advance of trial that it intended to make no effort to prove the medical bills and it was the responsibility of the subrogee to do so. In such a case, the subrogee's failure to gather evidence necessary to prove the medical expenses and present that evidence at trial

128. For example, taking an out-of-state medical deposition at a cost of \$3,500 to prove a \$5,000 medical bill is not an economically prudent decision.

129. Nonetheless, it would be prudent for the subrogee to advise the insured in writing before the trial that its agreement not to interfere with insured's trial strategy should not be deemed a waiver of its right to seek subrogation for the full amount of the monies it paid on insured's behalf.

would result in no award for those expenses and consequently the loss of the subrogation claim.¹³⁰

Finally, the hearing on subrogation issues should be held after the trial but before a final judgment is issued. This framework permits a prompt resolution of the subrogation interest and, in the event an appeal is required on any issue in the tort case or the subrogation hearing, ensures that all issues go to the court of appeals at one time on one record.

D. Settlement with One of Multiple Tortfeasors

The decision of an insured to settle with one of multiple tortfeasors is a complicated decision that is extremely fact dependent. The existence of a subrogation interest further complicates the analysis. While a comprehensive discussion about all the factors that go into such an analysis is beyond the scope of this Article, it is appropriate to make several relevant points.

First, a decision to embark upon settlement discussions with one of several tortfeasors furthers the goals of encouraging communication with the subrogee, obtaining the subrogee's approval of any settlement, and reaching an agreement with the subrogee as to how the settlement proceeds should be handled. Because any settling defendant will insist upon being protected from subsequent claims by the subrogee, a tort defendant will ordinarily require that settlement monies representing the claimed subrogation interest or the entire amount of the settlement—whichever is less—be held in trust or be deposited with the court pending the resolution of the subrogation claim. Thus, if the insured's reason for settling with one defendant is that the insured needs money immediately, a settlement for less than the subrogation interest will do the insured little good. However, an insured may seek court permission to withdraw some portion of the money held in trust or in court from a settlement with one of several tortfeasors if the subrogee is given notice of a hearing and the opportunity to be heard. The court should consider all relevant factors in deciding whether to grant an interim distribution of any portion of the monies set aside for satisfaction of the subrogation interest.

Second, it may be in the subrogee's best interest to approve a partial settlement and accept some amount of the funds, and then agree to

130. This scenario would rarely arise in the real world. The insured's lawyer has every incentive to present medical proof, including medical bills, except in those cases where a professional judgment is made that introducing the bills might decrease the value of the case. However, one can imagine a situation in which the subrogee intervenes, irritates insured's counsel and interferes with the pre-trial proceedings, to where plaintiff's counsel refuses to do the extra work necessary to prove the medical expenses. A decision not to assemble the proof necessary to get the medical expenses admitted into evidence should be communicated to the subrogee so that it has a reasonable period of time to prove the medical bills. Likewise, a decision by plaintiff's counsel to shift that work to subrogee's counsel will have an impact on a future reduction of the subrogation interest for recovery acquisition expense.

either a formula for handling any future settlements, or agree to disagree on all other issues pending resolution of the entire case. How this plays out in practice is limited only by the facts, the imaginations of the lawyers, and the flexibility of the parties.

Third, a judge should not hold a hearing to determine the subrogation issues or the reasonableness of any settlement until the underlying tort case is fully resolved by judgment or settlement. There should only be one such hearing; any more would be inefficient and would present more opportunities for inconsistency. That said, the Proposal applies equally in the case of a settlement with one of several tortfeasors and in cases involving a single tortfeasor.

CONCLUSION

The Modified Made-Whole Doctrine Proposal is aimed at achieving the fairest result for all parties when determining a tort subrogation interest by taking into account such fundamental factors as comparative fault, collectability of damages, and recovery acquisition costs. At its core, the Proposal is based on the idea that a subrogee should not be entitled to recover from its insured monies that the insured did not recover from a tortfeasor. After all, a subrogee by definition has only the right to stand in the shoes of its insured; nothing more, nothing less.

The Tennessee Supreme Court is to be commended for applying the law of subrogation and the made-whole doctrine in a manner consistent with the notions of equity underpinning both subjects. It is the hope of the author that this Article will help the Bench and Bar resolve future substantive subrogation issues in a manner consistent with equity and provide procedural guidance for the efficient resolution of subrogation interests.

