

What Is Subrogation?

Claim management service companies, such as Blue Leaf Claims and Vaccaro & Associates, offer subrogation recovery services for insurance companies and self-insured entities.

But what exactly is **subrogation**?

Blue Leaf Claims provides this definition:

“When an insurance company pays a policyholder for a loss, the insurance company has a right of **subrogation** against any person or persons responsible for the loss. The right of subrogation arises out of the automobile insurance policy, which is an indemnity contract. Basically, the right of **subrogation** allows the insurance company to pay its policyholder and then pursue the responsible party for the payments made. When the insurance company collects against the responsible party or its insurance company, the policyholder will receive a pro-rata share of the deductible applied to the original loss payment made to the policyholder. If the subrogation claim is unsuccessful, then the accident may become a chargeable accident to the policyholder and possibly result in a premium increase.

“Generally, the commercial automobile insurance policy will have a section under the policy’s Conditions, with outlines the insurance company’s right of subrogation, such as:

Our Right to Recover from Others:

If we make any payment, we are entitled to recover what we paid from other parties. Any person to or for whom we make payment must transfer to us his or her rights of recovery against any other party. This person must do everything necessary to secure these rights and must do nothing that would jeopardize them.

“Subrogation is quite common in first party automobile and property losses, such as collision and comprehensive claims, as well as building, inland marine and contents losses. An example of a subrogation claim involving an automobile collision claim would be the right of subrogation against the adverse vehicle operator and/or owner who went through the red traffic list striking the insured vehicle. If the insurer paid \$5,000 to be insured, less the \$500 deductible, then typically, the insurer would file a subrogation claim against the adverse party, or its insurer, for the full amount of \$5,000 and then reimburse the insured the full deductible amount (100%) or their pro-rata share, if 100% of the paid loss was not collected in the subrogation claim.

“Subrogation is important because you are recovering claim payments previously paid by the insurance company, or the self-insured entity, which involve losses (or partial losses) not caused by the policyholder’s negligence. If you do not pursue subrogation, insurance premiums will increase as a result of poor loss experience. The loss ratio (1) is calculated by dividing the losses by the premium. The lower the loss ratio the more favorable the loss experience. If the losses were \$250,000 and the premium was \$500,000, then the loss ratio is 50%. If you recovered \$200,000 of the loss payments as a result of subrogation, then the net losses are reduced to \$50,000 and the loss ratio will be reduced to 10%. Each dollar recovered yields an improved loss ratio and loss experience!”

“(1) The *loss ratio* is calculated by dividing the *Incurred Losses* by the *Earned Premium*. *Incurred Losses* are the claim payments plus outstanding reserves less recoveries.

Earned Premium means the premium is earning over the policy period. A twelve month policy earns at a rate of 1/12 each month.”

Blue Leaf Claims indicates a number of considerations are important to successful subrogation claims including investigation, damages, use of experts, legal liability, statute of limitations and forum for collection. See Blue Leaf Claims – Claim Recovery (see next page) for a full explanation of all as well as explanation of third party deductible, contribution & indemnity, salvage, loss and expense refund, workers' compensation & personal injury protection liens, loss transfer and second injury funds.



CLAIM RECOVERY

Blue Leaf Claims, Inc. offers experienced and professional claim management services, including **subrogation recovery services** for insurance companies and self-insured entities. The management and claim technical teams are comprised of high-level, dynamic claim professionals formerly employed by insurance companies, reinsurers and the alternative risk marketplace.

It is important to note that in the insurance industry, **recovery** is a broad term that encompasses various types of claim recovery including **subrogation**.

An explanation of subrogation is detailed below. However, in order to understand the full range of recovery categories, we have also outlined a brief description of each category below.

Recovery

- Subrogation
- Salvage
- Third Party Deductibles
- Contribution & Indemnity
- Loss & Expense Refund
- WC & PIP Liens
- Loss Transfer
- Second Injury Funds

Subrogation

When an insurance company pays a policyholder for a loss, the insurance company has a right of **subrogation** against any person or persons responsible for the loss. The right of **subrogation** arises out of the automobile insurance policy, which is an indemnity contract. Basically, the right of subrogation allows the insurance company to pay its policyholder and then pursue the responsible party for the payments made. When the insurance company collects against the responsible party or its insurance company, the policyholder will receive its pro-rata share of the deductible applied to the original loss payment made to the policyholder. If the subrogation claim is unsuccessful, then the accident may become chargeable accident to the policyholder and possibly result in a premium increase.

Generally, the commercial automobile insurance policy will have a section under the policy's **Conditions**, which outlines the insurance company's right of subrogation, such as:

OUR RIGHT TO RECOVER FROM OTHERS:

If we make any payment, we are entitled to recover what we paid from other parties. Any person to or for whom we make payment must transfer to us his or her rights of recovery against any other party. This person must do everything necessary to secure these rights and must do nothing that would jeopardize them.

Subrogation is quite common in first party automobile and property losses, such as collision and comprehensive claims, as well as building, inland marine and contents losses. An example of a subrogation claim involving an automobile collision claim would be the right of subrogation against the adverse vehicle operator &/or owner who went through the red traffic light striking the insured vehicle. If the insurer paid \$5,000 to the insured, less the \$500 deductible, then typically, the insurer would file a subrogation claim against the adverse party, or its insurer, for the full amount of \$5,000 and then reimburse the insured the full deductible amount (100%) or their pro-rata share, if 100% of the paid loss was not collected in the subrogation claim.

Subrogation is important because you are recovering claim payments previously paid by the insurance company, or the self-insured entity, which involve losses (or partial losses) not caused by the policyholder's negligence. If you do not pursue subrogation, insurance premiums will increase as a result of poor *loss experience*. The *loss ratio*¹ is calculated by dividing the losses by the premium. The lower the loss ratio the more favorable the loss experience. If the losses were \$250,000 and the premium was \$500,000, then the loss ratio is 50%. If you recovered \$200,000 of the loss payments as a result of subrogation, then the net losses are reduced to \$50,000 and the loss ratio will be reduced to 10%. Each dollar recovered yields an improved loss ratio and loss experience!

In order to be successful with a subrogation claim, there are several very important considerations, such as:

- Investigation
- Damages
- Use of Experts
- Legal Liability
- Statute of Limitations
- Forum for Collection

Investigation:

The underlying *investigation* is critical to support the subrogation claim against the responsible party. The extent of the claim investigation will depend on the accident details. For example, an automobile claim involving a question as to which vehicle had the green traffic light will require more investigation than a claim involving a rear end accident.

A claim investigation will typically involve statements being taken from the vehicle operators and witnesses. Statements can be taken by the adjuster in the field as a *signed statement* or *recorded statement*, or by telephone. Statements are important as they support the primary basis for the subrogation claim.

Scene photographs, vehicle photographs and diagrams are also very important to evaluate both liability and damage exposures and should always be considered as part of the adjustment process.

¹ The *loss ratio* is calculated by dividing the *Incurred Losses* by the *Earned Premium*. Incurred losses are the claim payments plus outstanding reserves less recoveries. *Earned Premium* means the premium is earning over the policy period. A twelve month policy earns at a rate of 1/12 each month.

Photographs and diagrams should be considered early on in a claim investigation so that the accident scene or vehicle damages remain substantially unchanged from the accident date.

Copies of official reports should always be requested to evaluate both liability and damage issues. Various types of official reports are outlined below:

- Police Accident Reports
- Police Statements
- Police Photos
- Police Accident Reconstruction Reports
- Fire Reports
- Weather Reports
- Traffic Light Sequence Reports

Damages:

Damages can be in the form of *property damage* or *injury damage*. Typically, if the automobile subrogation claim is for *property damage*, it arises out of the collision or comprehensive claim payment to the policyholder. *Injury damages* may be involved when a subrogation claim is based on the payment of medical and wage benefits paid under a *Personal Injury Protection* or *No Fault* insurance coverage, or some other type of *lien*.

In order to be successful in the pursuit of the subrogation claim, you need to prove the **damage** aspect of the claim, which will involve either a **damage appraisal** or an **estimate**² from a body shop. All types of damages require supporting documentation to perfect the subrogation claim. For example, any subrogation claim arising out of a collision or comprehensive claim payment should have an appraisal done by a licensed automobile appraiser (with photographs), or in the alternative, some type of a desk review by a qualified damage appraiser, to support the subrogation claim.

Typically, in an arbitration proceeding, a qualified damage appraisal report will satisfy the necessary proof for the damage aspect of the subrogation claim. However, if a subrogation claim is pending in litigation, you may need to have the appraiser testify as to the content of the appraisal report.

The subrogation claim may include **indirect damages** such as loss of use or rental reimbursement. Should the insurance policy provide coverage for **Loss of Use** or **Rental Reimbursement**, the adjuster needs to be sure to control the payments of the rental and not overpay, or the damages could be challenged in the subrogation claim.

Damage issues may involve the handling of **total losses**. The adverse party or insurance company could challenge the adjuster by claiming the vehicle was not a total loss or question the value of the salvage. Typically, we consider a vehicle to be a **constructive total loss** if the written appraisal is at 75% to 80% of the actual cash value. When evaluating a **constructive total loss**, you should discuss the potential for **supplemental damage** with the assigned appraiser.

² We recommend an automobile appraisal or a professional review of the damages to support a subrogation claim.

Should the insured wish to retain the salvage, the salvage value should be determined by the appraiser based on the salvage bids. When negotiating the vehicle salvage value, you should keep in mind the processing charges anticipated if the vehicle was picked up by a salvage vendor and delivered to an auction facility. There may also be storage charges and dismantling charges. All of these charges should be considered when evaluating the full exposure of the vehicle total loss and salvage value. When a salvage vendor picks up vehicle salvage, they pre-pay all outstanding charges (storage fees, towing, etc.) and deduct the charges from the gross salvage return. Should the expenses exceed the gross salvage recovery, you will receive an expense invoice. All of these costs are part of the subrogation claim.

Claims involving medical and wage benefits also require documentation to support the payments made. For example, if an adjuster paid *Personal Injury Protection* benefits to a claimant who treated excessively; made overpayment of the wage loss due to a calculation error; or failed to take various statutory offsets such as social security benefits or workers compensation benefits, could have the damage aspect of the subrogation claim challenged. This emphasizes how important the underlying claim handling is to the subrogation claim.

Use of Experts:

The initial investigation may include the prompt assignment of an expert, which are often referred to a *Cause & Origin* expert. The expert is retained to support any potential subrogation claim based on a defect, malfunction, recent work performed, etc. For example, a car may have caught fire as a result of recent service to the engine. The adjuster would retain an expert to inspect the vehicle and prepare a report providing an expert opinion as to whether the damages were causal related to the work performed prior to the loss, thereby supporting the liability position of the subrogation claim.

There are many different types of experts and you need to be sure that you retain the most qualified expert. It should be noted that experts can differ on their opinions and conclusions;

Total Loss Claim Handling

- A detailed written appraisal with a total loss evaluation sheet.
- At least four (4) vehicle digital photographs.
- An estimate of the salvage value, preferably using three (3) salvage bids, if the salvage is going to be disposed of through a competitive bid process.
- A referral to the appropriate salvage auction facility should the vehicle salvage not be retained by the insured.
- A completed ISO Claim Search *Salvage* entry in the event the insured retains the salvage.
- A completed *Affidavit of Salvage Retention* form, if the insured is retaining the salvage.
- A signed and notarized *Proof of Loss* form (a statement of the claim).
- The original vehicle title, signed as the *vehicle seller*, any applicable *lien satisfaction*, and the *vehicle keys*. Note that some states require the vehicle title to be re-processed as a vehicle *salvage title* at the Department of Motor Vehicles.
- A completed *Odometer Statement, Bill of Sale* and *Power of Attorney* from the vehicle owner.
- The vehicle title transfer should be processed in accordance with the state requirements, and typically transferred to the client insurance carrier name.

therefore, it is important to retain a qualified expert experienced in the type of subrogation claim involved.

Legal Liability:

The subrogation claim is based on the **legal liability** of the responsible party. If you are unable to prove legal liability, then your subrogation claim will be unsuccessful. Legal liability statutes and doctrines vary by state and jurisdiction; however, **negligence** is usually the primary liability issue. **Negligence** is basically fault as a result of not using reasonable care. In many jurisdictions, liability is based on the percentage of fault or **negligence** by each party involved in the accident. This is referred to as **comparative negligence**. Some states follow a **modified comparative negligence** law, and if one party is more than 51% negligent, they may be barred from recovery. Some states like New York follow a **pure comparative negligence** law, which means that a party which is 80% negligent could still pursue the other party for 20% of their damages.

If the responsible party is a **public entity**, there are various governmental immunities available to public entities, limiting liability and damages. Public entities (i.e. municipality) may also have a formal **Notice of Claim** requirement, which requires formal pleading prior to litigation within a specified time frame (i.e. 90 days to one year from the accident date). Public entities may also have **Prior Written Notice** statutes, concerning incidents or accidents, only allowing recovery if the public entity had prior written notice of the defective or dangerous condition.

Statute of Limitations:

The **Statute of Limitations** is the time period that one has to file a subrogation claim against the adverse party or insurance company. Typically, the **Statute of Limitations** applies to both claims filed in litigation and arbitration.

The **Statute of Limitations** time period can vary from one year to six years, depending on the state and the basis for the cause of action. The statute of limitations for actions based on **contract law** is usually longer than claims based on **common law**.

Forum for Collection

There are various methods of subrogation collection, ranging from voluntary settlement to litigation.

Typically, after the claim investigation is completed and damages are paid, the claim facility or insurance company pursues the adverse party to facilitate the collection process. **Blue Leaf Claims** follows a 10/30/30 subrogation protocol. The handling adjuster sends the first subrogation recovery notification letter to the adverse insurance carrier and/or responsible party within ten days of the claim payment date. Within thirty days, a second letter is sent as a

Experts

- Electrical Engineer
- Mechanical Engineer
- Chemical Engineer
- Civil Engineer
- Accident Reconstruction
- Accounting
- Legal
- Economist
- Medical
- Insurance

follow-up. Thereafter, if we do not receive a response within another thirty days; the claim will be placed in arbitration, or referred to a subrogation law firm to assist in the subrogation process.

There are various arbitration forums to arbitrate subrogation matters. One such forum is called *Arbitration Forums, Inc.* (www.arbfile.org) which provides a forum for various types of claims including auto physical damage, personal injury protection, property, etc. Most insurance companies and many self-insured entities are members of arbitration forums resulting in mandatory arbitration, versus costly litigation. The decisions are typically binding on both parties involved.

Prior to any referral to a subrogation attorney, we first determine whether there is any available insurance coverage, or assets, on the part of the responsible party. Should there be no available insurance coverage, we conduct an *asset check* to determine whether it will be cost effective to file litigation against the adverse party.

Third Party Deductible

Policy deductibles may include loss and allocated loss adjustment expenses (i.e. legal and adjuster expenses). *Third party deductibles*, a form of retention, are used to retain the smaller losses, and reduce the premium by absorbing what is referred to as a *frequency layer* (where losses are frequent and predicable). Typically, the insurance company pays the loss and expenses and then requests reimbursement from the insured. Depending on the premium and size of the deductible, the insured could be required to post collateral or security to be sure the deductibles will be collected and reimbursed.

Some policies have third party deductibles per loss, as well as *aggregate deductibles*. *Aggregate deductibles* represent the total retained limit during a given policy period. For example, the insured has a *per occurrence deductible* of \$50,000 and an *aggregate deductible* of \$250,000. Basically, the insured can have five losses at \$50,000+, and then will no longer have any occurrence deductibles for the remaining policy period.

Contribution & Indemnity

Contribution and *indemnification* typically refers to those situations wherein you have a third party defendant or co-defendant, or responsible party, either partially responsible or fully responsible for a loss. *Contribution* refers to another party contributing toward a liability claim, either in the form of settlement or by jury verdict. *Indemnification* typically refers to those situations wherein the contribution toward the claim is after a jury verdict, or added as a separate third party action to the pending litigation action. The defendant or responsible party will file a separate or third party action against another responsible party shifting the responsibility to that party, and attempt to recover any dollars paid or to be paid to the plaintiff.

During the course of an investigation or through the legal discovery process, the adjuster will develop information or documentation which will allow a *tender* of a claim to another party. *Tendering* is basically placing the other responsible party on notice and advising them that they

are the responsible party for the claim and demanding that they assume handling of the claim, including the defense and indemnification of the insured.

A contract favoring the insured may have required the insured to be listed on the responsible party's liability insurance policy and naming the insured as an ***additional insured***. As part of our investigation, we secure copies of the ***additional insured endorsements***, as well as the ***insurance certificate*** which provides all the necessary insurance policy information, including the insurance company name, policy number, effective dates, policy limits, and other pertinent information.

Salvage

Salvage basically refers to the undamaged, or sometimes damaged, portion of a loss. For example, if a vehicle is declared a total loss, the vehicle still may have undamaged or damaged parts which can be sold (i.e. engine, tires, steel frame, etc.).

Salvage also exists in property, cargo and marine losses. For example, a manufacturing facility may have sustained a fire loss. The warehouse has damaged items which cannot be sold in the insureds market, but may have salvage value in some secondary market. During the adjustment of these types of losses, it is recommended that you retain a ***salvor*** or ***salvage company*** to assess the salvage value and make an offer to purchase and take it away.

Remember, the salvage value will reduce the gross loss, and any payments reduced by the salvage value will reduce the overall ***incurred loss***. The ***incurred loss*** is equal to reserves + payments - recoveries.

Loss and Expense Refund

Loss Refunds and ***Expense Refunds*** are basically reimbursements as a result of overpayments, improper payments being returned, and any other payment which is reimbursing a payment already processed.

Workers' Compensation & PIP Liens

Often times, there is a ***workers' compensation lien*** or ***personal injury protection lien***, which allows the insurance company or claim facility take an offset against the claimants total recovery in a third party liability claim.

For example, the claimant employee was involved in an automobile accident while driving a vehicle during the course and scope of employment. The insurance company which paid workers' compensation benefits to the claimant will have a lien against the claimant's third party recovery and settlement. If the claimant recovered \$10,000 for the third party liability or ***tort claim***, and the total paid workers' compensation benefits was \$2,500, then the claimant would ultimately be paid \$7,500, with the \$2,500 paid to the workers' compensation carrier to satisfy its lien. Typically, the claimant's attorney may take a percentage of the lien recovery as a fee, with

the workers' compensation carrier only receiving two thirds of the lien recovery, which in this case would be a net recovery of \$1,660.

A **PIP³ lien** is similar to the workers' compensation lien and sometimes applies to *no fault* or *personal injury protection* benefits paid to the claimant. It should be noted that these liens typically only apply to **Additional PIP** benefits, which are over and above the statutory PIP benefits, which provide for increased medical and wage benefits.

Loss Transfer

Loss transfer refers to recovery involving PIP benefits paid to claimants. Loss transfer (i.e. in New York) is usually a recovery transaction between insurance companies and subject to an **arbitration agreement**. PIP loss transfer may only apply in certain circumstances such as one of the vehicles in the accident being 6500 pounds or over, or a vehicle for hire, such as a limousine or shuttle bus.

Second Injury Funds

Certain states have implemented **Second Injury Funds⁴** to encourage employers to hire disabled employees. An example of a second injury fund would be the insurance company only being responsible for the first 104 weeks of workers' compensation benefits. Thereafter, all future payments are refunded by the *Second Injury Fund*. To satisfy the requirement for reimbursement, the employer must have knowledge of a pre-existing injury or illness.

Typically, the *second injury fund* potential is part of the initial claim investigation. If it is determined that the claimant had a pre-existing injury or illness, then a written **knowledge statement** would be secured, as well as an authorization to secure the medical records. A formal submission, with the *knowledge statement* and second injury fund application are submitted to a separate department at the state workers' compensation board or commission.

The *second injury funds* are typically funded from the premium on every workers' compensation policy issued in a particular state.

Blue Leaf Claims, Inc. provides aggressive comprehensive claim recovery services. As our client and NLA Member, you only pay us if we are successful in the recovery process. If we do not recover, you pay nothing! Let us review your claims at no charge – you have nothing to lose and all to gain!

³ PIP means *Personal Injury Protection* benefits.

⁴ Second Injury Funds are being phased out by certain states, such as New York.

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