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Subrogation and Liens in Personal Injury Cases

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SUBROGATION AND LIENS

I.	OVERVIEW OF SUBROGATION, HISTORY, FEDERAL AND STATE BALANCING ACT, AND COMMON LAW EQUITABLE PRINCIPLES	
A.	History of state and federal regulation of insurance	3
B.	Definitions	4
C.	Types of subrogation: contractual, equitable, and effect of pro-rata or other insurance clauses	5
D.	Subrogation in the absence of a contract or statute? No and Yes	7
E.	Equitable Principles	8
1.	Made Whole Doctrine: the plaintiff's right to first recovery	8
A.	Critique of Fortis opinion	12
B.	Possible Solutions not obliterated by Fortis	13
1.	Make sure the policy disclaims Made Whole	14
2.	Do not apply Fortis to all contract provisions	15
i.	Common fund doctrine	15
ii.	PIP and UM/UIM	17
iii.	When subrogation has been waived contractually	18
C.	Options when the plan disclaims Fortis and the client is not made whole	18
1.	Sue the third party tortfeasor	18
2.	Limit the damages sought in the third party suit	18
3.	Invite the plan to an Allocation Hearing	19
4.	Walk away from the case	20
D.	Ideas for Erisa Plans	21
1.	Get the Summary Plan Description	23
2.	Tell the client to spend the Money [risky]	23
3.	Focus on the Conditions Precedent	26
4.	Allocate the Money to family members who don't owe subro	27
5.	Focus on whether or not an "identifiable fund" exists	27
6.	Determine whether or not a lien is required before an "identifiable fund" exists	30
E.	If all else fails: Publicity	31
2.	Common Fund Doctrine: the plaintiff's right to reimbursement of a pro-rata share of the cost of obtaining the recovery	31
a.	Passing the benefit of the common fund doctrine to the client	31
b.	Passing the benefit of the common fund doctrine to the attorney	35
3.	Laches	36
4.	Can the carrier subrogate against itself?	37
5.	Construe all ambiguities against the plan examples re: children, spouses, 3rd parties, liable parties	39
6.	Subrogation as a sword and shield	41

	7. Does bankruptcy by the debtor discharge subro interest or a lien . . .	42
II.	SUBROGATION INTERESTS GRANTED BY FEDERAL LAW (VA, MEDICARE, FEHBA)	42
A.	Veterans Administration	42
	1. The right of reimbursement	42
	2. Made Whole, Pro-Rata Division; Common Fund, Reduction or Waiver .	43
	3. For cases in litigation	45
B.	Medicare	44
	1. The right of reimbursement	45
	1.1. What is Medicare?	45
	1.2. Who receives Medicare benefits?	46
	1.3. Other interests arise out of MCRA & Medicaid	46
	1.4. Medicare's interest arises out of Medicare Secondary Payer Act. .	46
	1.5. PIP/Med Pay are Primary and UM/UIM is subject to Medicare. .	46
	1.6. 2003 Amendment to the MSP	46
	1.7. 2007 Amendment to the MSP	47
	1.8. One slight exception for uninsured tortfeasors	47
	1.9. Medicare's interest is not a Lien	47
	2. Finding the intermediaries and opening the file	47
	2.1. Open the file with COB	47
	2.2. COB assigns file to MSPRC	47
	2.2.1 MSPRC Recovery Portal	48
	2.3. MSPRC interaction with CMS	48
	2.4. FTCA cases	48
	2.5 Documents to send to CMS/MSPRC	48
	3. The amount of reimbursement	48
	3.1. Pre-existing and unrelated conditions	48
	3.2. Formula for reimbursement	49
	3.3. Judgments and their effect	49
	3.4 Wrongful death vs. survival damages	49
	4. Set-aside provisions: Medicare takes a holiday	50
	4.1. Definitions and Options offered for Public Comment by CMS . . .	50
	4.2. In the Meantime: Medicare Set Aside account	55
	4.3 Medicare's position	55
	4.4 MSA has its origins in worker's compensation	55
	4.5 How to do WCMSAs	55
	4.6 Mandatory reporting is now required by Defendants and Plaintiffs	56
	4.7 Penalties for failing to report.	56
	4.8 Reporting effective dates	56
	4.9 Content of the new reporting rules	57
	4.10 De minimus reporting thresholds apply temporarily	57
	4.11 The 180 page answer book	58
	4.12 The amount to be set aside in trust	58

4.13	Comparative negligence of Plaintiff	59
4.14	Penalty for failing to create MSA	59
4.15	Seeking advance approval of MSA	59
4.16	Who establishes and administers the MSA?	60
4.17	Is an MSA required in all cases?	60
5.	The procedure for determining reimbursement	61
5.1.	For past medical expenses: start early	61
5.2.	For future medical expenses	62
5.3.	Confidentiality agreements	63
5.4	Court Allocation of Damages to avoid excessive repayment	63
6.	Asking for a waiver	65
7.	Penalties for failing to reimburse	66
7.1.	Who must reimburse past medical expense subro interest	66
7.2.	Medicare's enforcement options	66
7.3.	Liability of counsel, tort defendants and liability insurers	66
7.4.	Interest on damages	69
7.5	Statute of Limitations	69
7.6.	Constructive notice	70
8.	Naming Medicare, or not, on the settlement checks	70
9.	Medicare Choice HMO's and Medicare Advantage	71
9.1	Authority for alternative plans under Medicare Part C	71
9.2	Does the Medicare Part C Plan have a private cause of action?	72
9.2.1	No, says the U.S. District Judge in <i>Humana v. Reale</i>	72
9.2.2	Yes says the 3 rd Circuit in <i>In Re Avandia</i>	72
10.	May Providers bill the patient instead of submitting to Medicare?	73
10.1.	Providers who bill for claim related injuries	73
10.2.	Seeking conditional payment from Medicare	74
10.3.	Strategy to encourage providers to bill Medicare	74
10.4.	The amount the provider may bill the patient beneficiary	75
11.	Admitting evidence of the subro interest into evidence in 3 rd party claim	75
12.	Recommended Reading	77
13.	Protecting Recoveries in a Special Needs Trust	77
C.	Medical Care Recovery Act, 42 U.S.C.A. Sec. 2651-53 (2002)	77
D.	Federal Employees Health Benefits Act	77
E.	Federal Employees Worker's Compensation Act	80
III.	TEXAS STATUTORY SUBROGATION INTERESTS (BUT NOT WORKER'S COMPENSATION)	81
A.	Medicaid	82
1.	The right of reimbursement	83
2.	Balance billing strictly regulated	83
3.	Finding Medicaid to repay subrogation	84
4.	Preserving Medicaid eligibility	85
5.	Reduction for client	85

	a.	Because the client needs public assistance	86
	b.	Ahlborn: Federal anti-lien statute prohibits assignment of property	86
	6.	Attorney's fees and expenses	89
B.		Texas Rehabilitation Commission	89
C.		Indigent Health Care Treatment Act	89
D.		Health Care to Prisoners	90
E.		Crime Victims Compensation Fund	90
F.		Child Health Plan for Certain Low Income Children (CHIPS)	90
G.		State Employees Health Benefits Act- ERS	91
IV.		TEXAS STATUTORY SUBROGATION INTEREST: WORKER'S COMPENSATION	93
A.		The right of reimbursement	93
	1.	The scope of recovery: from the third party claim	93
	a.	Recovery: from the deductible?	93
	b.	Recovery: Third party does not include employer for gross negl.	93
	c.	Recovery: Third party is not those who contractually waive subrogation against the employer	94
	d.	Recovery: not from the share attributable to employer's negligence	94
	e.	Recovery: The carrier's recovery is 2/3 of NET of claimant's recovery, not off the gross amount	94
	f.	County Law Enforcement Wage Continuation Benefits	95
	g.	The carrier's rights are derivative but independent	95
	h.	The intervening carrier does not recover interest or attorney's fees from the third party recovery	97
	2.	Attorney fees for collecting the subrogation interest	97
	3.	Attorney fees for collecting the attorney fee	100
	4.	Attorney liability for failing to pay the w/c subrogation interest	100
	5.	There is no made whole doctrine in worker's compensation: Allocating the third party recovery and the subrogation interest	100
	6.	Three practice tips	101
	a.	Contested hearing on damages	101
	b.	Segregate each client's damages	102
	c.	Drafting settlement documents	102
	7.	Statute of limitations	103
	a.	Against third party	103
	b.	Against injured worker	103
	8.	Disclosure and consent	103
	9.	Ethical considerations	104
	10.	Uninsured/Underinsured motorist coverage	105
	11.	Substitute policies	107
	a.	Try to Apply Equitable Rules	107
	b.	Waivers are barred	109

	c.	Retaliation is barred under ERISA	109
	12.	When the third party settles the comp lien cheap	109
	13.	Waiver of the worker’s comp lien in contracts	110
	14.	State of Texas self funded worker’s compensation plans	111
	15.	Worker’s Compensation plans cannot subrogate to the Guaranty Assn But Assn can subrogate to Ptf recovery	111
	16.	Admitting evidence of the worker’s comp lien in the third party case . .	111
V.		TEXAS STATUTORY LIENS (HOSPITAL LIENS AND CHILD SUPPORT LIENS)	113
	A.	The hospital lien statute	113
	1.	Regular and Reasonable Rate & Patient Protection/Afford Care Act . .	113
	2.	Emergency hospital care and Emergency medical care	117
	3.	Admission within 72 hours	117
	4.	Constructive notice and the timing of notice	118
	5.	The lien applies to a child’s recovery	119
	6.	Subrogation principles do not apply	119
	7.	Unanswered question if recovery inadequate	119
	8.	Lienholders don’t get interest or attorneys’ fees plus lien (unless)	119
	9.	Balance Billing: Hospitals and emergency care physicians are prohibited by Chapter 146 of Civil Practice and Remedies Code from asserting a lien when health insurance should pay; Chapter 55 of the Property Code reiterates that prohibition to physicians	120
	a.	Chapter 146 and Medicaid and Medicare	121
	b.	Seeking conditional payment from Medicare	121
	c.	Strategy to encourage providers to bill Medicare	122
	d.	The amount the provider may bill the Medicare beneficiary	123
	10.	Crime Victims Compensation Fund	123
	11.	Statutory Remedies for improperly filed lien	124
	12.	Does bankruptcy by the debtor discharge the lien?	124
	13.	Turning a lien into lemonade: The <i>Stowers</i> Doctrine	124
	14.	Hospital liens in other states	125
	B.	The Child Support Lien	126
	1.	Notice of the child support lien: actual or constructive?	126
	2.	The property of the current spouse is not subject to the child support lien . .	128
	3.	Medical liens and attorneys’ fees take priority over child support lien	128
	4.	Letters of protection do not take priority of the child support lien	128
	5.	Child support liens takes priority over an ERISA interest	128
	6.	Lottery winnings may be subject to child support liens	128
VI.		MUNICIPAL OR COUNTY EMPLOYEE STATUTORY SUBROGATION INTERESTS GRANTED BY TEXAS LAW.	129
	A.	Employees of local political subdivisions	129
	B.	Municipal officers and employees	130
VII.		ERISA EMPLOYEE WELFARE BENEFIT PLANS	130

A.	The effect of ERISA (overview of subrogation decisions)	131
B.	Establishing a plan’s status as an ‘employee welfare benefit plan’	135
1.	There must be a plan	135
2.	There must be proper intent and handling	136
3.	The employer must be engaged in an industry or activity affecting interstate commerce	137
C.	Plans that are not ERISA plans	137
D.	Laws that are not preempted by ERISA	137
E.	The child support lien takes priority over an ERISA interest	139
F.	Retaliation is barred under ERISA	139
G.	The beneficiaries’ remedy for ERISA plan’s misrep of its subro rights	130
VIII.	ERISA AND TEXAS COMMON LAW EQUITABLE CONCEPTS, INCLUDING MADE WHOLE AND COMMON FUND, IN AN INSURANCE FUNDED PLAN	140
A.	ERISA does not automatically kill off Texas’ made whole doctrine or common fund doctrine because ERISA’s savings clause preserves state regulation	140
1.	Made whole doctrine and ERISA	141
a.	Do not waive your common law made whole doctrine	143
2.	Common fund doctrine and ERISA	145
IX.	THE DOCUMENTS CONTROL; GET THE SUMMARY PLAN DESCRIPTION AND THE EMPLOYEE WELFARE BENEFIT PLAN	146
A.	ERISA and the Summary Plan Description	146
1.	Statutory requirement	146
2.	The Summary Plan Description requirements; compare it to the underlying policy	148
3.	What constitutes a Summary Plan Description	149
4.	Read the Employee Welfare Benefit Plan’s subrogation provision	150
X.	ERISA AND SELF FUNDED EMPLOYEE WELFARE BENEFIT PLANS	150
A.	The statutory authority	151
B.	Stop Loss coverage	151
C.	The seminal self funded case: FMC v. Holliday	153
D.	5 th Circuit and Supreme Court: what part of “All” don’t you understand? Allowing the plan to sue its own insured for reimbursement	153
E.	Bad news from the 4 th Circuit: Failing to sign subrogation reimbursement forms terminates coverage	157
F.	The Effect of Knudson and Sereboff: The Plan may seek equitable relief, including imposing a constructive trust on identifiable funds	158
G.	Overview of Cases on Appropriate Equitable Relief and the Plan’s Remedies .	159
1.	Liability of the plan member	159
2.	Liability of the plan member’s attorney	168
H.	The plan must plead and prove its ERISA status	169
I.	Four practice tips	169

	a. The subrogation questionnaires	169
	b. Close out the subrogation interest at settlement	171
	c. Know your risks and benefits	171
	d. Ethics: Avoid dual representation of the client and plan	171
XI.	ERISA'S PREEMPTION (OR NOT) OF FEDERAL OR STATE LAW CAUSES OF ACTION	172
	A. State law causes of action and ERISA preemption	172
	B. Federal law causes of action and preemption	173
	C. The Common Fund doctrine and ERISA preemption.	174
	D. Preemption of state court jurisdiction, or not	175
	E. Long Term Disability Policies	176
	F. Additional research sources	177
XII.	USING THE DECLARATORY JUDGMENT ACT TO CONSTRUE AN AMBIGUOUS OR SILENT PLAN DOCUMENT OR TO DETERMINE ENTITLEMENT TO RECOVERY	177
	A. Federal actions authorized by ERISA	177
	B. Action in state court	179
XIII.	NON-ERISA PLANS SUCH AS HMO'S, CHURCH-SPONSORED OR GOVERNMENT PLANS, AND INDIVIDUALLY PURCHASED HEALTH INSURANCE CONTRACTS	180
	A. Non-ERISA plans	180
	B. HMO's	180
	C. Private health insurance	180
	D. Government or church employer sponsored plans	180
XIV.	AUTOMOBILE POLICIES, INCLUDING PIP, MEDICAL PAYMENTS, UM/UIM, AND PROPERTY DAMAGE	181
	A. Preserving the plaintiff's PIP	181
	B. Medical Payments Coverage on auto policies	182
	1. The Common Fund Doctrine	182
	2. The Made Whole Doctrine	183
	C. Uninsured/Underinsured Motorist Coverage	184
	1. The Statutory Authority	184
	a. Preserving the UM/UIM carrier's subrogation rights	184
	b. <i>Stowers</i> and the UIM carrier	185
	c. Preserving the client's full use of UM/UIM coverage free of subro claims	185
	i. When the subrogation interest is ambiguous about its right to subrogate to first party uninsured motorist coverage	185
	ii. Because underinsured motorist coverage is first party coverage, not third	186
	iii. Ignoring the first party-third party distinction would frustrate the purpose of the Insurance Code	186
	D. Vehicle Property Damage	187
XV.	COORDINATION OF BENEFITS AS A MEANS OF AVOIDING PAYMENT BY INSURERS	188
XVI.	ASSIGNMENTS TO CREDITORS, LOPS, AND AGREEMENTS TO REPAY SUBROGATION	189

A.	Assignments to creditors	189
B.	Letters of Protection	192
C.	Agreements to Repay the Subrogation Interest	194
1.	Ethical Issues if the client reneges or the recovery is inadequate	195
2.	Ethical Issues when the Plan is self-funded	195
3.	Does a Reimbursement agreement confer more benefits to the Plan than a Subrogation Agreement	197
4.	Do not sign a Reimbursement Agreement which is broader than the Plan or the Summary Plan Description provisions	197
XVII.	STATUTORY VIOLATIONS BY HEALTHCARE PROVIDERS AND STATUTORY VIOLATIONS BY SUBROGATION COLLECTION AGENCIES	197
A.	Chapter 146, Civil Practice & Remedies Code and Balance Billing	197
B.	Violations of Insurer Federal Fair Debt Collections Practices Act	199
C.	Violations of the Texas Deceptive Trade Practices-Consumer Protection Act ..	199
1.	State law damages available to injured consumers	200
2.	Extra-contractual damages may not be allowed in ERISA Plans	200
D.	Violations by Hospitals of the Patient Protection and Affordable Care Act ...	201
XVIII.	ADVICE TO ATTORNEYS	201
A.	Communicating with the client	201
1.	At the first interview	201
2.	At the time of settlement	201
3.	If a lawsuit against the subrogee is necessary	202
B.	Communicating with the third party liability carrier	202
1.	At the time the file is opened	202
2.	At the time of settlement	203
C.	Communicating with the subrogated insurer or Self-Funded Health Plan	204
1.	At the time the file is opened	204
2.	During the course of the claim	204
3.	At the time of settlement	205
D.	Converting the money ... bad idea	206
1.	Penalties for conversion	206
2.	Protect yourself if the client does not want to repay	207
3.	Statute of limitations	207
E.	Health insurers who refuse to pay bills rather than pay and subrogate	208
XIX.	INDEMNIFICATION AND RELEASE DOCUMENTS	208
XX.	APPENDIX	
	Medicare Attorney Tool Kit overview	
	Medicare Recovery Worksheet	
	Medicare HIPAA Release	
	Medicare MMSEA Claimant Refusal to Release SSN	
	Medicare Claimant Declaration of no Medicare benefits or future medical payments	

Medicare Alert regarding delays in reporting provisions and Dollar Thresholds
US Airways vs McCutchen opinion, 3rd Circuit, Nov. 16, 2011
Patient Protection and Affordable Care Act Notice 2010-39 re: hospital bills

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SUBROGATION AND LIENS

I. OVERVIEW OF SUBROGATION, HISTORY, FEDERAL AND STATE BALANCING ACT, AND COMMON LAW EQUITABLE PRINCIPLES.

A. *History of state and federal regulation of insurance.*

Subrogation is an element of insurance law. In 1944, the United States Supreme Court determined that “insurance” is a form of interstate commerce subject to federal regulation; see *United States v. South-Eastern Underwriters Assoc.*, 322 U.S. 533 (1944). Shortly thereafter, Congress passed the McCarran-Ferguson Act, 15 U.S.C.S. § 1011 and following. The McCarran-Ferguson Act granted authority to the states to regulate the “business of insurance.” Various federal laws continued to govern the “peripherals of the industry (labor, tax, securities).” State laws which regulated the core nature of the insurance business therefore overrode most federal laws to the contrary. This paper is designed to analyze the myriad of state and federal statutes and cases on the topic of subrogation, from the standpoint of the plaintiff’s personal injury practitioner.

In an attempt to harmonize the proliferation of insurance policies and laws, Congress passed the Employee Retirement and Income Security Act, commonly known as ERISA, in 1974. ERISA did not vitiate the McCarran-Ferguson’s grant of state regulation; it did spawn a spate of lawsuits trying to determine which state laws qualify as state regulation (not-preempted by ERISA) and which laws deal with peripheral issues (pre-empted by ERISA). ERISA also recognized that some health plans are self funded, not funded by insurance premiums, and those plans are exempt from state regulation.

The shifting of risk through the payment of premiums is the most fundamental principle of insurance. Subrogation is a bastardization of that risk-shifting principle. Therefore, subrogation should come within the “core business” of insurance and be subject to state regulation for all premium funded insurance policies. A Florida court traced the history and analysis:

[T]he court in *Pilot* looked to case law interpreting the phrase “business of insurance” under the McCarran-Ferguson Act. *Id.* This law, taken as a whole, provided three criteria for

determining whether a practice would fall under the “business of insurance.” *Id.* Namely:

“[F]irst, whether the practice has the effect of transferring or spreading a policyholder’s risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry.” *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129, 102 S.Ct. 3002, 3009, 73 L.Ed.2d 647 (1982) (emphasis in original). *Id.* at 48-49.

However, more recently, in *Kentucky Ass’n of Health Plans, Inc. v. Miller*, 538 U.S. 329, 341-42 (2003), the Supreme Court receded from the McCarran-Ferguson factors, stating:

Today we make a clean break from the McCarran-Ferguson factors and hold that for a state law to be deemed a “law ... which regulates insurance” under § 1144(b)(2)(A), it must satisfy two requirements. First, the state law must be specifically directed toward entities engaged in insurance. See *Pilot Life, supra*, at 50, 107 S.Ct. 1549; *UNUM, supra*, at 368, 119 S.Ct. 1380; *Rush Prudential, supra*, at 366, 122 S.Ct. 2151. Second ... the state law must substantially affect the risk pooling arrangement between the insurer and the insured. Kentucky’s law satisfies each of these requirements.

The majority of cases addressing state subrogation and collateral source statutes have determined that they are laws regulating insurance. In *FMC Corp. v. Holliday*, 498 U.S. 52, 60-61 (1990), the Supreme Court considered whether a Pennsylvania anti-subrogation statute was a law “regulating insurance” and held:

There is no dispute that the Pennsylvania law falls within ERISA’s insurance saving clause.... Section 1720 directly controls the terms of insurance contracts by invalidating any subrogation provisions that they contain. See *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S., at 740-741, 105 S.Ct., at 2389-2390. It does not merely have an impact on the insurance industry; it is aimed at it. See *Pilot Life*

Ins. Co. v. Dedeaux, 481 U.S. 41, 50, 107 S.Ct. 1549, 1554, 95 L.Ed.2d 39 (1987). This returns the matter of subrogation to state law.

Coleman v. BCBS of Alabama, Inc., No. 1D10-1366, (D. Ct of Appeal Florida, 1st Dist. - Dec. 8, 2010)

This paper reviews U.S. and Texas subrogation interests and liens in favor of Veterans Administration, Medicare, Medicaid, workers' compensation, Hospital Liens, or child support liens. It covers conventional/contractual subrogation interests, including ERISA Employee Welfare Benefit Plans and Non-ERISA Plans, Self Funded Pools, Private Health Insurance, Government Employer or Church Sponsored Plans, Medical Payments Coverage, Uninsured/Underinsured Motorist Coverage, Vehicle Property Damage, and HMO's. It also covers equitable subrogation imposed by law. It will also analyze the devastating effect of the Texas Supreme Court's decision in *Fortis Benefits v. Cantu*, 234 S.W.3d 642, 649 (Tex. 2007), No. 05-0791, on the made whole doctrine.

B. *Definitions.*

"Subrogation" has been defined as the "substitution of one person in the place of another with reference to a lawful claim, demand or right." Black's Law Dictionary.

Subrogation is the substitution of one person in the place of another, whether as creditor or as the possessor of some lawful claim, so that he who is substituted succeeds to the rights of the other in relation to the debt or claim. . . . By subrogation, a court of equity, for the purpose of doing exact justice between parties in a given transaction, places one of them, to whom a legal right does not belong, in the position of a party to whom the right does belong. 53 Tex.Jur.2d Subrogation § 1, at 429 (1964).

Subrogation has been characterized by Texas courts as a 'pure equity,' as a 'wholesome rule of equity,' and as 'a doctrine belonging to an age of enlightened policy and refined, although natural justice.' *Chambers & Co. v. Little*, 21 S.W.2d 17, 22 (Tex. App.--Eastland 1929, writ ref'd); *O'Brien v. Perkins*, 276 S.W. 308, 315 (Tex. App.--Amarillo 1925), aff'd sub nom., *Shelton v.*

O'Brien, 285 S.W. 260 (Tex.1926). But recent judicial struggles with the notion of "equity" rely little on notions of fairness.

Texas courts have always been particularly hospitable to the right of subrogation and have been in the forefront of upholding it. As Judge Brown declared in *Faires v. Cockerell*, 88 Tex. 428, 437, 31 S.W. 190, 194, 28 L.R.A. 528 (1895) (quoted in a 1974 opinion):

Perhaps the courts of no state have gone further in applying the doctrine of subrogation than has the court of this state...

The doctrine of subrogation is always given a liberal interpretation and is broad enough to include every instance in which one person, not acting voluntarily has paid a debt for which another was primarily liable and which in equity and good conscience should have been discharged by the latter. *Galbraith-Foxworth Lumber Co. v. Long*, 5 S.W.2d 162, 167 (Tex. App.--Dallas 1928, writ ref'd); *Constitution Indemnity Co. v. Armbrust*, 25 S.W.2d 176, 180 (Tex. App.--San Antonio 1930, writ ref'd); *Independence Indemnity Co. v. Republic Nat'l Bank & Trust Co.*, 114 S.W.2d 1223 (Tex. App.--Dallas 1938, writ dism'd w.o.j.). ...

Where the court can give a policy a construction which, while preserving the protection given the insured under its terms, would also relieve the insurer from the increased hazard against which it undertook to provide, then such construction must be adopted, 'for such was the evident intent of the parties.' *Royal Ins. Co. v. Texas & G. Ry.*, 53 Tex. App. 154, 159, 115 S.W. 117, 120 (1909, writ ref'd).

McBroome-Bennett Plumbing, Inc. v. Villa France, Inc., and Westchester Fire Insurance Company, 515 S.W.2d 32, 36-37 (Tex. App. – Dallas 1974)

The last several subrogation opinions from the Texas Supreme Court start with a first sentence like this:

Over a century ago, we declared that "the courts of no state have gone

further” than Texas “in applying the doctrine of subrogation” because “our decisions recognize the doctrine . . . to its fullest extent.”

Frymire Engineering Company, Inc. by and through Real Party in Interest, Liberty Mutual Insurance Company, v. Jomar International, Ltd. and Mixer S.R.L., No. 06-0755, (TEX. JUNE 13, 2008)

The right of subrogation is not accorded to one who may voluntarily pay the debts of a plaintiff as a gift, but is accorded to one who has a legal obligation to pay the debts of the plaintiff and who, in exchange for that obligation, has been given a subrogation interest or an assignment to the rights of the injured plaintiff.

This right of subrogation arises when an entity, such as a health insurance carrier, pays the medical bills of an injured person and, under the subrogation provision of a contract, succeeds to the rights of the injured person to pursue the injured person's liability claim against the party causing the injury.

The “subrogee” is the entity which paid benefits to the plaintiff and therefore stands in the shoes of the plaintiff, by virtue of their contract, with respect to the plaintiff's liability claims. The “subrogor” is the person who contracted away his or her third party rights of recovery to the subrogee.

A subrogation interest is not the same as a lien and a subrogee is not automatically a secured lienholder.

Caveat: at times, generic reference is made in this paper to the client's "third party claim"; quite often, those references may just as easily apply to first party claims such as underinsured motorist claims, etc. Unless the context clearly limits the reference to a third party claim, to the exclusion of others, consider the term to be a shorthand reference to the primary claim for which the attorney was hired and to distinguish it from the claim for a subrogation interest. However, the subrogation rights accorded to subrogees may vary substantially, depending on

whether the subrogee's claim is asserted against third party or first party recoveries.

C. Types of subrogation interests: conventional, legal, equitable, and “other insurance” or “pro-rata” clauses:

Subrogation interests may be conventional, or granted within the contract documents; statutory, arising by operation of law; or legal or equitable, generally granted in contract without the contract specifying how the subrogation interest is to be handled.

LaSalle National Bank v. White 246 S.W.3d 616 (Tex. December 21, 2007) recognized a common law right to equitable subrogation even though the Texas Constitution appeared to forbid such a right:

Texas has long recognized a lienholder's common law right to equitable subrogation. *See Benchmark Bank v. Crowder*, 919 S.W.2d 657, 661 (Tex. 1996); *Faires v. Cockrill*, 31 S.W. 190, 194 (Tex. 1895); *Oury v. Sanders*, 13 S.W. 1030, 1031 (Tex. 1890). The doctrine allows a third party who discharges a lien upon the property of another to step into the original lienholder's shoes and assume the lienholder's right to the security interest against the debtor. *First Nat'l Bank of Kerrville v. O'Dell*, 856 S.W.2d 410, 415 (Tex. 1993) (citing *Faires*, 31 S.W. at 194). The doctrine of equitable subrogation has been repeatedly applied to preserve lien rights on homestead property. *See, e.g., Benchmark*, 919 S.W.2d at 661; *Farm & Home Sav. & Loan Ass'n v. Martin*, 88 S.W.2d 459, 469-70 (Tex. 1935). If applied in this case, LaSalle's payment of the balance of the purchase-money mortgage and the accrued taxes on White's property would entitle it to assume those lienholders' security interests in the homestead. White contends, though, and the court of appeals held, that article XVI, section 50(e) of the Texas Constitution abrogates all equitable subrogation rights, including those that arise from payment of constitutionally valid debts. 217 S.W.3d at 578-79. We disagree.

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