

Recovering Funds From a Third Party—Contribution, Indemnity & Subrogation

95 percent of all lawsuits ultimately are resolved prior to verdict. The defendants in these cases, whether they be business owners, healthcare providers, landowners, manufacturers of equipment, or employers, wish for some finality in the case rather than a resolution through a verdict. After settlement one should explore whether some form of subrogation or contribution exists to potentially recover funds that are paid by the settling defendant. This presentation will discuss how a defendant, or its insurer, can recover the amounts paid after settlement. The issues presented will include an analysis of subrogation or contribution rights, indemnification, and a few matters to consider such as waiver of subrogation and making certain the insured is on board with pursuing subrogation.

The information below will not include subrogation issues solely involving insurance companies, litigation over venue and choice of law issues, nor a detailed analysis of insurance coverage issues that potentially may arise under many of these factual situations. Furthermore, this presentation is not an exhaustive analysis of indemnity and/or contribution statutes on a state-by-state basis. Most jurisdictions have their own nuances and statutes that may control many of the subjects presented herein. This paper provides an overview of these general principles. The reader is cautioned to research the applicable provisions within a particular jurisdiction by consulting with an attorney familiar with the laws of that state.

I. Subrogation

Subrogation is the right of a party secondarily obligated to recover a debt it has paid from a party primarily obligated to pay the debt. The right of subrogation itself can arise by contract, statute or under common law principals. An assignment is the transfer for value of a right to recover or a cause of action. In the insurance context, this usually occurs where the insurance company makes a payment to an insured and at the same time takes an assignment of their cause of action. A true assignment transfers the cause of action to the insurance company. A settling party is looking to a third party to pay all or a portion of the sums paid. Third-party practice is about spreading or eliminating risk for your client. This can be done by seeking contribution or indemnity from the third party.

II. Contribution

“Contribution” and “Indemnification” are two separate concepts. Contribution is the right that gives one of several persons who are liable on a common debt the ability to recover from each of the others when that one person discharges the debt for the benefit of all; the right to demand that another who is jointly responsible for a third party’s injury. In contrast, indemnity is the reimbursement or compensation for loss, damage or liability in tort; especially the right of a party who is secondarily liable to recover from the party who is primary liable for reimbursement of expenditures paid to a third party for injuries resulting from a violation of a common law duty or a contract. *Black’s Law Dictionary* 784 (8th ed. 2004).

The effect that settlements have upon contribution rights may vary considerably among the different jurisdictions. A settling tortfeasor may or may not have contribution rights according to the applicable law and whether certain conditions are satisfied. For example, the courts are divided on the issue of whether immunity for a lack of direct liability between a non-settling tortfeasor and a claimant precludes a settling tortfeasor from seeking contribution. In some jurisdictions, the courts have held that a settling tortfeasor is not entitled to contribution from any party when the non-settling party was not subject to direct liability to the injured party. In other jurisdictions the courts have held that a lack of direct liability does not preclude contribution. In some jurisdictions, no contribution rights arise in favor of tortfeasors in the absence of a judgment. Michigan requires tortfeasors who anticipate entering into settlement agreements to give advance notice to other tortfeasors so that they can participate in the settlement negotiations in a meaningful way. In Illinois, contribution actions are controlled by the Illinois Joint Tortfeasor Contribution Act (704 ILCS 100/2(e)). In Illinois, a settling defendant can recover contribution from any defendant whose liability the settlement extinguished. Most jurisdictions require that the settling defendant extinguish the liability of the non-settling defendant.

In Missouri, when one of the multiple tortfeasors satisfies the judgment, that tortfeasor has the right to contribution from the other tortfeasors in proportion to the negligence of each individual tortfeasor. By settling, a Defendant extinguishes Plaintiff's claim only against himself, while insulating himself from the contribution claims of other defendants. *Lowe v. Norfolk and Western Ry. Co.*, 753 S.W.2d 891, 894 (Mo. banc 1988). But in procuring this protection, Defendant also triggered the "settlor-barred" doctrine, which precludes one from pursuing contribution claims. *Cardinal Glennon Hospital v. American Cyanamid Company*, 997 S.W.2d 42, 45 (Mo.App.1999). A settling defendant is barred from seeking contribution against another defendant unless the settling defendant has discharged the liability of that defendant. *Id.* at 44.

In *Jendro v. Honeywell, Inc.*, 392 N.W.2d 688 (Minn. Ct. App. 1986) the court held that in the absence of evidence of an intent to cause harm, a knowing violation of consumer hazard reporting rule issued under the U.S. Consumer Product Safety Commission does not bar a settling tortfeasor who manufactures a defective product from obtaining contribution. In that case, the injured party was seriously burned when gas leaked from her furnace and ignited. She filed an action against the gas company and several defendants involved in the manufacture of the furnace and its component parts. The gas company thereafter presented evidence showing that the manufacturer knew that its gas control valves contained defects that could create a substantial product hazard under the CPSA and that the manufacturer failed to report that information in a timely manner to the CPSC. Before the manufacturer entered into a settlement with the plaintiff for in excess of \$3,000,000, a jury apportioned 96 percent of the fault to the manufacturer and 4 percent to the gas company. While allowing contribution, the court said that while the manufacturer's action may have been grossly negligent or even reckless there was no evidence to demonstrate that the manufacturer intended for its valve to fail causing gas explosions. Because there was an absence of intentional wrong doing, in the sense that there was an absence of an intention to cause harm, the court ruled that the settling manufacturer had contribution rights.

Most courts, have recognized that under the particular circumstances presented, it is necessary for a settlement document or release to specifically identify and discharge the common liability of a non-settling tortfeasor in order for contribution rights to exist. A release does not discharge a non-settling tortfeasor from liability unless the tortfeasor is specifically named in the release.

In many cases a trial court's approval of a settlement can establish that a settlement amount was reasonable. In *Johnson v. United Airlines*, 203 Ill. 2d 121, 271 Ill. Dec. 258, 784 N.E.2d 812 (2003), the Illinois Supreme Court held that, when ruling on the issue of whether a settlement between one tortfeasor and a claimant has been entered into in good faith so as to discharge the contribution liability of the settling tortfeasor to another tortfeasor, an Illinois court is not required to hold an evidentiary hearing on the issue if the court has adequate information from the court filings. The court will look to see whether a settlement amount bore a reasonable relationship to the settling tortfeasor's relative culpability for the tort. Trial courts are in the best position to determine what type of hearing is required. It is clear that settlement agreements have to be made in good faith.

Check with your local counsel for the nuances of the statute of limitations for contribution actions. For example in Missouri any claim for contribution by a joint tortfeasor must be brought within five years from the date of the existence of a joint obligation on a liability shared by the tortfeasors. *Rowland v. Skaggs Cos., Inc.*, 666 S.W.2d 770, 773 (Mo. 1984) (en banc). Parties may bring contribution claims in anticipation of some form of liability, but the statute of limitations begins to run only when an actual liability exists. When one tortfeasor agrees to settlement with a plaintiff, the date of which the limitation period begins to run is the actual date of the settlement – not the date of the original accident. *Greenstreet v. Rupert*, 795 S.W.2d 539, 541 (Mo. Ct. App. 1990). In Illinois, if no suit has been filed, the claim must be filed two years from date of contribution plaintiff's payment. If suit has been filed, the claim has to be filed two years from the date the contribution plaintiff was served. Again, check with the attorney in your state at the outset of the claim process to confirm the statute of limitations.

III. Indemnification

Liability can be imposed on a party by operation of law or by contract. Similarly, one can assume the liability of another by way of law or contract. The law can impose liability on a party for his/her actions. If a person is negligent, they are personally liable for the damages that can result. A party can also be held liable for the actions of others. For example, if an employee is negligent while acting in the scope of his or her employment, not only is the employee personally liable, but the employer can also be liable solely because of the employee/employer relationship. Assigning liability to an otherwise blameless party (in a situation where the employer did nothing wrong) for the acts of the employee is called "vicarious" liability and is also liability imposed by law. A defendant must analyze the particular facts of the case to determine whether or not indemnification is available by implication of law.

The most common scenario would be encountered due to the existence of an indemnity agreement within a contract between the parties. By entering into an indemnity agreement one

party has agreed to be legally liable for the actions of others. This liability is based upon a promise to be liable and not because the law imposes the liability on that party. It should be noted that indemnity agreements are not about the failure to fulfill or perform the terms of the contract. To the contrary, indemnity does not relate to breach of contract but rather it has to do with performing the terms of the contract or making good on a promise to take financial responsibility for the liability of another.

An indemnity contract can be complicated by various nuances in the jurisdiction where the case is pending. Indiana specifically recognizes indemnification in this context. In Indiana, absent prohibitive legislation, public policy does not prevent parties from contracting as they desire. *Hagerman Constr. Corp. v. Long Elec. Co.*, 741 N.E.2d 390, 392 (Ind. Ct. App. 2000). Further, a party may contract to indemnify another for the other's own negligence. *Id.* See also *Exide Corp. v. Millwright Riggers, Inc.*, 727 N.E.2d 473, 480 (Ind. Ct. App. 2000); *Moore Heating & Plumbing, Inc. v. Huber, Hunt & Nichols*, 583 N.E.2d 142, 146 (Ind. Ct. App. 1991). The key case in this area is *Moore Heating and Plumbing, Inc. v. Huber, Hunt & Nichols*, 583 N.E.2d 142, 145 (Ind. App. 1st Dist. 1991). In Illinois, the Illinois Construction Contract Indemnification for Negligence Act (Anti-Indemnification Act) (740 ILCS 35/0.01 (West 2008)) prohibits a party from enforcing the provisions of contractual indemnification in a construction setting. Basically, the statute holds that any agreement in a construction contract that attempts to indemnify or hold a person harmless from that person's own negligence is void. Under these circumstances, therefore, the parties would be required to forego any right of indemnification although they would still have a right of contribution, which will be explored further in this article. In Missouri, a party seeking contribution or indemnity need not admit its own fault in its third-party petition but rather can deny liability in its answer to the plaintiff's petition and assert in its third-party petition that if it is liable to the plaintiff, then the third-party defendant is liable to it. *Travelers Prop. Cas. Co. of Am. v. Manitowoc Co., Inc.*, 389 S.W.3d 174, 180 (Mo. 2013)

In the interpretation of an indemnity contract, the main rule is to determine the intention of the parties and to give effect to that intention if it can be done consistently with legal principles. *Luke v. Amer. Sur. Co. of N.Y., Okla.*, 189 Okla. 220 (1941). Indemnity agreements will not be construed to obligate the indemnitor to indemnify the indemnitee against losses arising from the indemnitee's own negligence unless the contract 1) expressly indicates the parties' intention to exculpate in unequivocally clear language; 2) results from an arm's length transaction between parties of equal bargaining power; and 3) does not violate public policy. *Webb v. West. Carter Cty. Water & Sewage Corp.*, 575 P.2d 124, 126 (Okla. App. 1977).

In *National Union Fire Insurance v. A.A.R. Western Skyways*, 784 P.2d 52, 55 (1989), Mid States and its insurer, National Union Fire Insurance Co., (both plaintiffs) sought to recover monies paid out in previous settlements by right of indemnification based on the fact that they were not negligent for the plane crash that resulted in the settlements. The main issue the court considered relating to indemnification was whether a right to indemnity is available to one who, without fault on his own part, has paid damages occasioned by the primary negligence of another, even where there exists no contractual or vicarious liability. The court noted that generally a party who is without fault but forced to pay on behalf of another is entitled to indemnity. In addition, the court finds that Oklahoma law has always premised the right of indemnity on the understanding that a legal relationship exists between the parties. The

indemnitor must owe some sort of duty either in contract or tort to the indemnitee apart from the joint duty they owe to the third party. The court also noted that while the Contribution Statute preserves the right to indemnity, it does not create a right to indemnity where one did not previously exist. Therefore, the court held that because there was no legal relationship between the parties either in contract or tort, Mid-States had no right to indemnification from A.A.R.

Consideration of a particular state's indemnification law and whether a party can seek indemnity, even for its own negligence, pursuant to contract must be explored. This is something that needs to be done at the outset of the presentation of the claim or at the time that litigation ensues. It is imperative that a settling party reserve its claim of indemnification especially when attempting to extinguish its liability to the plaintiff and yet seeks to recover all of the money it paid via operation of the contract. Any releases entered into between the settling party and the plaintiff must be clear and unambiguous that the settlement does not extinguish the settling party's right to seek indemnification against another tortfeasor. A practical problem may arise when the alleged tortfeasor to whom you are going to seek indemnification from is not a party to the litigation or at least not at the time of the resulting trial. A potential problem can exist if the indemnitor is dismissed from the case either via summary judgment or by way of some other form of dispositive motion. If the remaining defendant denies liability but further contends that the plaintiff is the sole and proximate cause of the injuries or damages it may present a practical problem upon settlement and then seek indemnification against the previously dismissed party that would require a showing of fault by that party even to some degree. This will be a problem in a post verdict situation where the settling party has presented its entire case, including lay and expert witnesses, who have testified that the fault lies with the plaintiff with no testimony that the previously dismissed defendant was either the sole cause or a partial cause of the incident in question.

IV. Things to Consider

Make certain there is not a "waiver of subrogation" clause, where the parties to a contract will agree to waive any rights of recovery against each other if the damage is covered by insurance. Thus, the risk of loss gets shifted to the insurer. Courts almost always hold that waiver of subrogation clauses are valid because they advance some important social goals, such as encouraging parties to anticipate risks and procure insurance covering those risks, thereby avoiding future litigation. However, there have been rare instances where courts have invalidated waiver of subrogation clauses on public policy grounds. See *Federal Insurance Co. v. Richard Rubin & Co. Inc.*, 1993 WL 489771 (E.D. Pa. 1993) (waiver of subrogation clause exculpating actions that violate statutes or regulations that are designed to protect human life invalidated). Waiver of subrogation clauses have been validated even in the face of anti-indemnity, anti-exculpatory and anti-subrogation statutes. See *Best Friends Pet Care, Inc. v. Design Learned, Inc.*, 77 Conn. App. 167, 823 A.2d 329 (2003); *May Dept. Store v. Center Developers, Inc.*, 266 Ga. 806, 471 S.E.2d 194 (1996); *747 Third Ave. Corp. v. Killarney*, 225 A.D.2d 375, 639 N.Y.S.2d 32 (1st Dep't 1996). These courts held that waiver of subrogation clauses are *not* intended to relieve a party of liability for its own negligence, but are instead risk allocation clauses. Thus, the clauses did not violate the relevant statutes.

Although courts overwhelmingly consider waiver of subrogation clauses to be valid, there are circumstances under which such clauses will not be enforced. For example, in order to establish a waiver of subrogation, it is necessary to show by clear evidence an intentional relinquishment of the right. Thus, if the waiver of subrogation clause is ambiguous or confusing, if the clause conflicts with other contract provisions, or if the intention of the parties is not unequivocally clear, then courts will not enforce it. See *Sutton Hill Associates v. Landes*, 775 F. Supp. 682 (S.D.N.Y. 1991); *U.S. Fidelity and Guar. Co. v. Friedman*, 540 So. 2d 160 (Fla. Dist. Ct. App. 4th Dist. 1989); *Charter Oak Fire Ins. Co. v. National Wholesale Liquidators of Lodi, Inc.*, 2002 WL 519738 (S.D. N.Y. 2002) (applying New Jersey law). Additionally, courts will not enforce waiver of subrogation clauses where the underlying insurance did not cover the loss at issue. See *State v. Oriental Fire & Marine Ins. Co., Ltd.*, 776 P.2d 776 (Alaska 1989), *Gap, Inc. v. Red Apple Companies, Inc.*, 282 A.D.2d 119, 725 N.Y.S.2d 312 (1st Dep't. 2001); *Chelm Management Co. v. Wieland-Davco Corp.*, 23 Fed. Appx. 430 (6th Cir. 2001) (applying Ohio law). Moreover, some courts will not enforce a waiver of subrogation clause if the loss was the result of gross negligence. *Travelers Indem. Co. of Connecticut v. Losco Group, Inc.*, 204 F. Supp. 2d 639 (S.D.N.Y. 2002) (applying New York law).

Do not always assume sovereign immunity will bar your claim. In Missouri, claims for contribution are not statutorily barred by sovereign immunity when compensatory damage claims for injuries result from dangerous conditions on public property and a joint obligation on the liability is shared by tortfeasors. *McNeill Trucking Co., Inc. v. Missouri State Highway & Transp. Comm'n*, 35 S.W.3d 846, 847 (Mo. 2001)

Finally, always check with your insured before making any claim against a third party for contribution and indemnity. The insured may have a business relationship that could be damaged by making the claim.

IV. Conclusion

How a settling party prepares and preserves its right to subrogation depends upon a myriad of factors: the jurisdiction, the type of settlement, public policy and contractual considerations. The practitioner needs to examine all of these factors to make educated and appropriate decisions in order to successfully recover its funds from another tortfeasor or third party.

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