Profits in Subrogation: An Insurer’s Claim to Be More than Indemnified

I. INTRODUCTION

“[I]f the assured is not entitled to retain an excess against the insurer, and the insurer . . . is not entitled to receive the excess from the assured, what happens to the excess?”¹ This question, posed by Lord Justice Megaw in L. Lucas Ltd. v. Export Credits Guarantee Department,² is bred by the juxtaposition of two subrogation rules. The right to subrogation, being in nature like restitution, entitles the holder of the right only to reimbursement³ and, under a contract of insurance, “the assured . . . shall be fully indemnified, but shall never be more than fully indemnified.”⁴ The confusion that distribution of windfall profits in subrogation has brought to American and English courts derives from both the difficulty of the question and its rarity. Because insurance agreements are contracts of indemnity, the issue of which party is entitled to any possible excess once both insurer and insured have been indemnified has seldom been litigated.

This Comment will evaluate a subrogee’s right to recover more than it paid to the subrogor. The purpose of subrogation and insurance will be outlined, focusing on those few recent cases in England and the United States dealing with the profit-in-subrogation issue. Next, this Comment will examine the circumstances under which a windfall might accrue to the insurer and the possible justifications and consequences of such a windfall award. A flexible approach for courts confronted with allocating a windfall in an equitable subrogation suit will then be proposed. Finally, the implications of choosing a flexible approach to windfalls in subrogation will be contrasted with the view that the windfall be awarded strictly to either the insured or the insurer.

II. PRINCIPLES OF SUBROGATION⁵

A. Subrogation as Restitution

When the condition upon which an insurance contract is

² Id.
⁴ Castellain v. Preston, 11 Q.B.D. 380, 386 (1883).
⁵ Subrogation has been defined as
based occurs and the insured is indemnified by the insurer for his loss, the insured would retain a right of action against the tortfeasor for his damages absent equitable subrogation. In this situation two possibilities emerge, both of which are undesirable: (1) the insured brings an action against the tortfeasor, thereby recovering twice for the loss, or (2) the insured, having been compensated by the insurer, does not bring an action against the tortfeasor, thereby freeing the tortfeasor from responsibility for his wrongful acts. By vesting the cause of action against the wrongdoer in the insurer who paid for the loss, theoretically both these undesirable results can be avoided, with neither the insured nor the insurer recovering more than an indemnity at the expense of the other. Thus subrogation is a restitutious measure, the

R. Horn, Subrogation in Insurance Theory and Practice 13-14 (1964). The term subrogation as used in this Comment will refer, except where otherwise noted, to legal or equitable subrogation created by law as opposed to conventional subrogation created by contract. While there generally is little distinction between legal and conventional subrogation, this Comment deals with when profit may equitably accrue to a subrogee, and not when profit must accrue through enforcement of a contractual right. See 16 G. Couch, Cyclopedia of Insurance Law § 61:2 (2d ed. R. Anderson 1966); Procaccia, The Effect and Validity of Subrogation Clauses in Insurance Policies, 1973 Ins. L.J. 573. For a concise analysis of subrogation theory, see King, Subrogation Under Contracts Insuring Property, 30 Tex. L. Rev. 62 (1951).

6. An insurer's liability under a contract of insurance may be triggered by a variety of circumstances, including the commission of a tort, a breach of contract, or bankruptcy.

7. For simplification, "tortfeasor" will be used throughout this Comment to refer generally to the party liable to the insured.


9. See also 5 J. Joyce, The Law of Insurance § 3537 (2d ed. 1918); W. Vance, Handbook of the Law of Insurance 423 (1904): "If [the insured] were allowed to recover the amount of his loss from the tortfeasor and also from the insurance company, his misfortune would result in profit, rather than loss, and undoubtedly tend to greatly increase the number of such misfortunes."


The right of subrogation is not founded on contract. It is a creature of equity; is enforced solely for the purpose of accomplishing the ends of substantial justice; and is independent of any contractual relations between the parties. All that the appellees can, in good conscience, demand, is reimbursement for their outlay . . . . When relief to that extent is accorded, they will have no just ground to complain . . . .

In Memphis the Court limited the subrogee to six percent interest established by statute as the rate when no rate was agreed upon; the subrogee had claimed it was entitled to eight percent, which was the rate established by the contract between the subrogor and the creditor.
purpose for its creation being to prevent the unjust enrichment of either the insured\textsuperscript{11} or the tortfeasor.\textsuperscript{12}

\section*{B. The Problem of Windfalls}

Because subrogation law was founded on the insurance principles of indemnification,\textsuperscript{13} very few cases arise in which there is a possibility of a profit. The cases that do address the issue of whether an insurer can recover more than it paid on the subrogated claim generally fall into two categories: (1) cases in which the insured is not fully compensated for his losses and the insurer, nonetheless, sues the tortfeasor for the full amount of the insured's injury; and (2) cases in which the insured is fully compensated and the insurer recovers from the tortfeasor more than the amount of the insured's injury.

\subsection*{1. Case of the first type: partial indemnification}

Although the insured is not fully compensated where the amount of the insurance policy is less than the value of the claim insured, the insurer may claim that subrogation entitles him to all of the remedies of the insured, including the right to recover for the full amount of the injuries sustained. An example of this

\begin{itemize}
  \item \textsuperscript{11} See Castellain v. Preston, 11 Q.B.D. 380, 386 (1883):  
[T]his contract means that the assured, in case of a loss against which the policy has been made, shall be fully indemnified, but shall never be more than fully indemnified. That is the fundamental principle of insurance, and if ever a proposition is brought forward which is at variance with it, that is to say, which either will prevent the assured from obtaining a full indemnity, or which will give the assured more than a full indemnity, that proposition must certainly be wrong.
  \item \textsuperscript{12} See American Sur. Co. v. Bethlehem Nat'l Bank, 33 F. Supp. 722, 723 (E.D. Pa.), rev'd, 116 F.2d 75 (3d Cir. 1940), rev'd, 314 U.S. 314 (1941). Accord, Stafford Metal Works, Inc. v. Cook Paint & Varnish Co., 418 F. Supp. 56, 58 (N.D. Tex. 1976) ("the wrongdoer (tortfeasor) is not entitled to a windfall release from his obligation simply because the injured party had the foresight to obtain insurance"); R. Horn, supra note 5, at 24 ("the general purpose of subrogation is to facilitate placement of the financial consequences of loss on the party primarily responsible in law for such loss").
  \item \textsuperscript{13} See, e.g., Crab Orchard Improvement Co. v. Chesapeake & O. Ry., 115 F.2d 277, 281 (4th Cir.), cert. denied, 312 U.S. 702 (1940): "It follows that where the indemnity feature is not present in the insurance contract . . . the subrogation feature has no application"; 5 J. Joyce, supra note 9, § 3537, at 5880: "We have already seen that . . . insurance is a contract of indemnity, and it is for the purpose of carrying out this principle that the doctrine of subrogation has been adopted"; Kimball & Davis, supra note 8, at 849: "[S]ubrogation is justified by the indemnity character of the insurance contract, and denial of subrogation must rest on the fact that the contract of insurance in question is not an indemnity contract."
\end{itemize}
situation is the case of *The Livingstone*.

The insurer of a ship which sunk in a collision with the *Livingstone* paid $25,000 on a valued policy to the owners. The sunken ship was actually worth $37,500, and this amount was recovered from the tortfeasor. After the insurance company was paid $25,000, both the insurer and the owners claimed the remaining $12,500. It was the insurer's position that it was subrogated to all the rights of the owners, while the owners insisted they were to be indemnified for their uninsured loss. The Second Circuit, in awarding the $12,500 to the insured, said that subrogation
does not permit one party to secure an unfair advantage over the other; it does not permit the insurer to speculate, or profit or drive an unconscionable bargain. When he is paid in full equity requires the return of the balance to the insured in payment of his uncompensated loss.

... [E]quity and good conscience do not require the court to go further and permit [the insurer] to realize an enormous profit from the transaction.  

This remedy clearly satisfies the principle of indemnification. Profit to the insurance company could only have come at the direct expense of the owners.

2. *Cases of the second type: full indemnification*

In the second type of case, both the insured and insurer have been indemnified and there is the possibility of recovering additional funds. With the exception of cases where interest on the award makes the amount recovered more than the actual loss,

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14. 130 F. 746 (2d Cir.), *cert. denied*, 194 U.S. 637 (1904). *Cf.* D'Angelo v. Cornell Paperboard Prods. Co., 19 Wis. 2d 390, 120 N.W.2d 70 (1963) (insurer paid insured $120,000 in workmen's compensation, then attempted to recover $300,000 through subrogation).

15. 130 F. at 749, 761.

16. While cases of the first type emphasize that the insurer will not be able to recover a profit if it deprives the insured of an indemnity, the converse is also true:

The general rule of law (and it is obvious justice) is that where there is a contract of indemnity . . . and a loss happens, anything which reduces or diminishes that loss reduces or diminishes the amount which the indemnifier is bound to pay; and if the indemnifier has already paid it, then, if anything which diminishes the loss comes into the hands of the person to whom he has paid it, it becomes an equity that the person who has already paid the full indemnity is entitled to be recouped by having that amount back.


17. Although the addition of interest to the subrogee's award may make the award
this situation is rare—so rare, in fact, that the issue was not presented for judicial review until within the last few years.¹⁴

a. English decisions.¹⁵ The most prominent case, English or American, considering the issues involved in denying or awarding a windfall to an indemnified insurer is *Yorkshire Insurance Co. v. Nisbet Shipping Co.*²⁰ Yorkshire paid Nisbet for the loss of its ship in a 1945 accident with a Canadian vessel. Yorkshire paid Nisbet £72,000 under the policy, but the actual value of the ship was around £75,514. In 1958 when the Canadian Government, the tortfeasor, finally paid the value of Nisbet’s ship in dollars, the pound had been devalued and the dollars were worth £126,971. Both Yorkshire and Nisbet claimed the £55,000 difference. Jus-

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greater than the amount paid to the subrogor, many courts do not view the interest as an extra award by way of damages, but rather as compensation for the use of money. See Brown v. Hiatts, 82 U.S. (15 Wall.) 177, 185 (1872): “Interest is the compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention . . . .”

Interest in some situations, however, may also be profit. In Glenn v. American Sur. Co., 160 F.2d 977 (6th Cir. 1947) the court awarded interest to the surety on a contractor’s bond. The surety sought and was awarded interest on the amount paid on the bond. The dissent stated: “While interest is not generally the equivalent of profit, it may become so . . . . There are relatively few six percent investments in the portfolios of insurance companies.” *Id.* at 983.

18. There are many statements in reported opinions which would purportedly cover the situation where both the insured and insurer have been indemnified and an excess remains to be distributed. Typical of these is the dicta in *The St. Johns*, 101 F. 469, 474-75 (S.D.N.Y. 1900):

If the amount recoverable from the wrongdoer, after payment of the damage-claims of third parties, were in excess of the amount paid by the underwriters to the assured, no doubt that excess would belong to the latter; since the insurer’s right of subrogation in equity could not extend beyond recoupment or indemnity for the actual payments to the assured.

The statement clearly applies to cases where the insurer seeks to make a profit when the insured has not been fully indemnified. See text accompanying notes 14-16 supra. The law simply has not had to confront directly the problem of distributing a profit between subrogee and subrogor because, owing to the indemnifying nature of insurance, there has not been a profit to distribute. An annotated statement similar to the dicta in *The St. Johns* is made at 41 L.R.A. (n.s.) 720 note (1913), but not one of the cases cited deals with a bona fide windfall. Similarly, no cases are cited in support of *Restatement of Restitution § 162, Comment i* (1937): “[The surety] is entitled to be made whole, but he is not entitled to make a profit.” See also R. Keeton, *Basic Text on Insurance Law* 160-62 (1971).


20. [1962] 2 Q.B. 330. The court noted that this suit was the first recorded case where the “quantum of the insurer’s right of subrogation” has been questioned after payment on a total loss (indemnification). *Id.* at 342. For a discussion of *Yorkshire* and its implications for subrogation in England, see Hodgin, *Subrogation in Insurance Law*, 1975 J. Bus. L. 114.
tice Diplock carefully reviewed the major English subrogation decisions as well as the decision in *The Livingstone* and concluded that the insurance company was entitled only to the amount it had paid the insured, £72,000. The court stated that the rule it adopted "renders irrelevant any consideration of the particular concatenation of circumstances which enable the assured to recover from the Canadian Government a sum in sterling in excess of the value of the ship at the time of the casualty."  

A later case commenting on *Yorkshire, L. Lucas Ltd. v. Export Credits*, found that all pounds must be treated the same, without regard for the exchange rate or the purchasing power of the pounds. According to this interpretation, the rule in *Yorkshire* means that the subrogee may recover exactly what he paid and nothing more—perhaps not even interest. *Yorkshire* therefore seems to be inconsistent with the significant number of other English cases in which interest has been awarded to the subrogee.

*Yorkshire* can perhaps also be criticized on another, more fundamental ground. While a certain uneasiness about insurance companies recovering a greater amount than they paid to the insured can be appreciated, *Yorkshire* is one case in which payment of an excess to the insurer would have been justified by principles basic to subrogation. By deciding that the insurance company was entitled to only what it had paid, the court allowed


24. The court said:

[A] pound is always a pound: so that whatever the exchange rates between the pound and any or all other currencies, and whatever may happen between one date and another to the internal purchasing power of the pound, in the eye of the law a pound today is the same as it was yesterday or a year ago or ten years ago . . . . If it were otherwise, I could see strong ground for the argument that the guarantors were not fully indemnified by receiving in 1968 the same number of pounds as they had paid out in 1965. But as the law stands they must be regarded as having been fully indemnified.


Nisbet Shipping to benefit from both the insurance and the tortfeasor’s payment. Nisbet Shipping was paid £72,000 in 1945 for their ship. It had the use of those funds until 1958 when it collected an additional £55,000. The £55,000 is an excessive recovery—in contravention of one of the restitutionary purposes for which subrogation was created—especially because the later award did not reflect the interest that could have been earned on the £72,000 paid in 1945. In contrast, Yorkshire Insurance paid £72,000 in 1945 and recovered £72,000 in 1958; Yorkshire was not even awarded interest. Nisbet Shipping was unjustly enriched at the expense of Yorkshire Insurance.

b. U.S. cases. Federal Deposit Insurance Corp. v. Wilhoit is a well-reasoned opinion in which a Kentucky court applied basic subrogation principles in making an award of interest to an insurer. The FDIC, as the insurer of an insolvent bank, reimbursed the depositors of the bank for their losses. The issue confronted by the court was whether the FDIC was entitled to interest on the amount paid the depositors of a commercial bank several years before the resolution of the suit. The court held that it was. Had the court taken direction from The Livingstone or Yorkshire and denied any award of interest, one of the basic principles of subrogation would have been violated. On the one hand, if the court had awarded the interest to the depositors themselves, they would have received a double recovery of inter-

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26. See text accompanying note 9 supra.
27. Interest is commonly awarded in subrogation cases in England. See note 25 supra.
28. The only solution which would have indemnified Yorkshire Insurance without giving Nisbet Shipping a windfall profit would have been for the Canadian Government to pay the equivalent of £72,000. But this solution would have relieved the Canadian Government from full responsibility for the shipping accident. It would thus violate the subrogation policy of holding the responsible party liable. See note 12 and accompanying text supra.
29. 297 Ky. 339, 180 S.W.2d 72 (1943).
30. The court stated:

It is true that the equitable doctrine of subrogation is enforced solely for the purpose of accomplishing the ends of substantial justice and that there is no inexorable rule by which the right is to be measured. So a court of equity may cut down or lessen rights of the subrogee, as by denying interest, or may even bar subrogation altogether. However, generally the subrogee is placed in the shoes or in the precise position of one to whose rights he is subrogated and is entitled to all legal rights and remedies available to the creditor.

Id. at 348, 180 S.W.2d at 76.

Interest has commonly been awarded in Kentucky subrogation cases. E.g., Glenn v. American Sur. Co., 160 F.2d 997 (6th Cir. 1947); Evan’s Adm’r v. Evans, 304 Ky. 28, 199 S.W.2d 734 (1947); Western Cas. & Sur. Co. v. Meyer, 301 Ky. 487, 192 S.W.2d 388 (1946).
31. See text accompanying notes 8-9 supra.
est on their deposits because they had previously been indemnified by the FDIC with money that could have been invested or deposited and drawing interest itself. On the other hand, if the court had refused to award interest to either the depositors or the FDIC, the result would have been tantamount to awarding the interest to the insolvent bank because the bank would have had the interest-free use of the FDIC’s money.\footnote{32}

The issue of windfall or profit, other than interest, has been raised in at least two decisions in the United States.\footnote{33} The first is Carolina Casualty Insurance Co. v. Local 612, International Brotherhood of Teamsters.\footnote{34} Carolina Casualty, having paid an insurance claim on vehicles damaged in a union-management dispute, sued the union for compensatory and punitive damages. The court first noted that it was unable to find a case directly on point\footnote{35} and then dismissed the claim for punitive damages, citing Corpus Juris Secundum for the general rule that subrogation gives indemnity only.\footnote{36} The “indemnity only” rule is derived from cases like The Livingstone\footnote{37} where the insurer only partially indemnified the insured; nevertheless, the court in Carolina Casualty refused the claim without any discussion of the rule, its origin, or its rationale.

In contrast to Carolina Casualty is the novel decision in Urban Industries, Inc. v. Thevis.\footnote{38} The court in that case held that an insurance company subrogee may recover more than the amount which it paid its subrogor. The defendant, Thevis, had

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\footnote{34} In Brown, the court cited Ga. Code Ann. § 85-1806 (1970) which states: “A right of action is assignable if it involves, directly or indirectly, a right of property; but a right of action for personal torts or for injuries arising from fraud to the assignor may not be assigned.” The court then cited Louisville & N.R.R. v. Street, 164 Ala. 185, 51 So. 306 (1909) to the effect that the right to punitive damages is not property. Also relied upon for the rule that a subrogee is entitled to indemnity only were 83 C.J.S. Subrogation § 14, at 614 (1953) and 50 Am. Jur. Subrogation § 119, at 769 (1944).
\footnote{35} Punitive damages were actually awarded to an insurance company where it was understood that the funds would go to the insured’s widow. American Mut. Liab. Ins. Co. v. Louisville & N.R.R., 250 Ala. 354, 34 So. 2d 474 (1948).
\footnote{36} 136 F. Supp. 941 (N.D. Ala. 1956).
\footnote{37} [R]esearch has failed to reveal a case directly holding that an insurer or a surety suing alone as a subrogee may recover punitive damages against a wrongdoer.” Id. at 943.
\footnote{38} Id.
\footnote{39} 130 F. 746 (2d Cir.), cert. denied, 194 U.S. 637 (1904).
\footnote{40} No. C 75-0342 L(A) (W.D. Ky. July 13, 1978), appeal docketed, No. 78-3615 (6th Cir. Nov. 7, 1978).}

hired two felons to burn the building of his competitor, Urban Industries. Urban was indemnified for its property losses by four insurance companies. Urban and the insurance companies brought suit against Thevis; Urban suing for lost profits (for which it had not been indemnified), the insurers suing on their subrogation rights for the property losses. The jury awarded each of the plaintiffs the compensatory damages claimed plus punitive damages. 39

On a motion for judgment notwithstanding the verdict or, in the alternative, a new trial, the court ruled in favor of Urban Industries and the insurance companies. The court relied on Federal Deposit Insurance Corp. v. Wilhoit40 and refused the Carolina Casualty rule.41 According to the court, the opinion in Wilhoit, which permitted an extra award (interest) to be paid the subrogee, demonstrated that “Kentucky has no policy against the recovery of damages over and above compensatory damages by a subrogee.”42

The Urban Industries decision is unique in several ways.43 First, a major windfall was awarded to the insurers44—a result examined and rejected by Carolina Casualty and Yorkshire. Second, the windfall was not awarded exclusively to the insurers; both the insurers and the insured received excess funds—a possibility not even considered in Yorkshire. The remainder of this Comment will examine the ground upon which the Urban Industries decision might be based and the policy considerations to be scrutinized before a rule favoring either the Urban Industries or Yorkshire approach is adopted.

39. Each of the insurance companies was awarded 10 times its compensatory damages in punitive damages; Urban Industries was awarded slightly more than 57 times its compensatory damages in punitive damages. Id. slip op. at 1.
40. 297 Ky. 339, 180 S.W.2d 72 (1943).
43. The court noted that the questions presented were “interesting and novel” and that “[t]he case at bar, insofar as it pertains to punitive damages, is and will probably continue to be unique, for this Court knows of no instance where an insurance company has been awarded punitive damages ad whose insured also has been awarded such damages.” Id. slip op. at 1, 6.
44. The total judgment against Thevis exceeded $675,000, $450,000 of which went to the four insurance companies. Thevis, hardly judgment-proof, is the president of Global Industries, which operates an “empire” of X-rated theaters and “adult” bookstores. His empire has been valued at $100 million. See Cook, The X-Rated Economy, FORBES, Sept. 18, 1978, at 81; NEWSWEEK, May 29, 1978, at 30; TIME, May 29, 1978, at 25.
III. Subrogation Theories

A. Subrogation as Cession of Property

At Roman law subrogation meant the literal substitution of one party for another. At common law when the insurer paid the debt of the insured, the insured ceded his rights in the action to the insurer. The insurer or subrogee was therefore entitled to precisely the same rights, claims, and defenses of the insured. The idea of cession was evident in the Urban Industries decision; the court noted that an insurance company "becomes subrogated to any claim for the same damages which the insured might have recovered."

45. In Roman law subrogation meant that one official's actions replaced another's actions. The doctrine was called cessio actionum. The transference of rights required a positive action and could be lost through inaction. In contrast, in English law the cession of property was a right automatically conferred by law when the insurer or surety paid the debt of the insured. Marasinghe, An Historical Introduction to the Doctrine of Subrogation: The Early History of the Doctrine I, 10 VAL. U.L. Rev. 45, 45-46, 50 (1976).

Subrogation, as cession of property, is similar to assignment, although the two have been distinguished on the grounds that assignment is merely a contractual transfer of rights. See 6A J.A. Appleman & J. Appleman, Insurance Law and Practice § 4053 (1972) (subrogation is substitution for a party; assignment is a transfer of rights); 16 G. Couch, supra note 5, § 61:22 (subrogation is an act of the law; assignment is a voluntary act of the parties).

This distinction between subrogation and assignment may favor the argument that even though a claim for punitive damages generally may not be assigned, see, e.g., People v. Superior Court, 9 Cal. 3d 283, 507 P.2d 1400, 107 Cal. Rptr. 192 (1973); Dugar v. Happy Tiger Records, Inc., 41 Cal. App. 3d 812, 116 Cal. Rptr. 412 (1974); French v. Orange County Inv. Corp., 125 Cal. App. 587, 13 P.2d 1046 (1932); contra, Dunshee v. Standard Oil Co., 165 Iowa 625, 146 N.W. 830 (1914), allowing a subrogee to recover punitive damages may be justified since the right of subrogation is generally preferred to a claim by assignment, see, e.g., Hardaway v. National Sur. Co., 211 U.S. 552, 561 (1908); Prairie State Bank v. United States, 164 U.S. 227, 232 (1896).

46. The classic statement on English subrogation law is Castellain v. Preston, 11 Q.B.D. 380 (1883). The court said:

[A]s between the underwriter and the assured the underwriter is entitled to the advantage of every right of the assured, whether such right consists in contract, fulfilled or unfulfilled, or in remedy for tort capable of being insisted or already insisted on, or in any other right, whether by way of condition or otherwise, legal or equitable . . . .

Id. at 388.

47. No. C 75-0342 L(A), slip op. at 4. The court based this conclusion on a statement in Bratton v. Speaks, 228 S.W.2d 526, 528 (Ky. 1950): "[The insurer] becomes subrogated to any claim for the same damages which the insured might have recovered from the wrongdoer causing the damages."

The right of an insurance company to collect literally anything the insured could have recovered was upheld in North of Eng. Iron S.S. Ins. Ass'n v. Armstrong, L.R. 5 Q.B. 244 (1870). In Armstrong the policy stated that the value of the insured ship was £6000. When the ship sunk the owner was paid the £6000 from the tortfeasor, but subsequently the owner recovered £9000 from the tortfeasor, the actual value of the ship. The court stated:
The notion of subrogation as substitution of one party for another has had greater significance in the United States than in England; this may explain why the Kentucky court in *Urban Industries* was willing to allow an excess recovery while the English court in *Yorkshire* was not. In England, the subrogee must maintain his action against the wrongdoer in the name of the subrogor; in the United States, the majority rule is that the subrogee must sue in his own name in deference to real-party-in-interest rules. In *Urban Industries*, the insurance companies were by action of law the real parties in interest and seemed entitled, conceptually at least, to the windfall fruits of the suit—punitive damages.

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[If a party chooses to have his vessel or his goods . . . taken at a fixed value, instead of leaving the contract, as in an ordinary policy, simply one of indemnity to the extent of the real value, and if thereby any benefit accrues to the underwriters, the underwriters must be entitled to it.]

*Id.* at 250. *Armstrong* was cited with approval by the Supreme Court in *The Potomac*, 105 U.S. 630, 635 (1881), but was repudiated in *Aetna Ins. Co. v. United Fruit Co.*, 304 U.S. 430 (1938): "'[I]t would in some cases deprive the insured of indemnity, and indeed might enable the insurer to make a profit by recovering more from the insured than the amounts paid on the policy. We are unable to sanction a doctrine involving such consequences." *Id.* at 436.


In subrogation the subrogee is entitled to the rights and remedies of the subrogor while in abandonment the subrogee is entitled to the actual property insured. 10 J. Arnould, *supra* ¶ 1216; R. Goff & G. Jones, *THE LAW OF RESTITUTION* 388 (1966); 25 HALSBURY'S *LAW OF ENGLAND* ¶ 332 (4th ed. 1978).


49. It was felt the insured would become indifferent once the claim was paid, so the insurer was allowed to sue in his own name. L. Donahue, *OUTLINE OF THE LAW OF INSURANCE* 65 (1927). In Kentucky the subrogee must bring the action in his own name as the real party in interest. *Ky. R. Ct.* 17.01. See *Monson v. Payne*, 199 Ky. 105, 250 S.W. 798 (1923); *Bryan v. Henderson Elec. Co.*, 566 S.W.2d 823 (Ky. Ct. App. 1978).

B. The Insurer's Interest

One of the justifications given for the punitive award to the insurers in Urban Industries was the expense incurred by the insurance companies in investigating and pursuing their claim. If the insurance companies had sought and been awarded recovery for their own expenses directly, the suit would have been, in form, an action in tort. That is, the insurers would have been recovering under an independent, nonderivative right to sue the tortfeasor. Although it has been weakly suggested that an insurer may obtain to some independent rights by virtue of a property interest in the insured res, the possibility of other nonderivative insurers' rights has never been confronted. This is probably because resort to such a rationale is not necessary or prudent. In most cases, the right of subrogation is sufficient to protect the interests of the insurers, although good cause might be shown in rare cases for awarding insurance companies the costs of investigating and processing a claim. An award of interest or attorneys' fees might be even more appropriate.

C. Equitable Subrogation Principles

The value of Urban Industries lies not so much in the justification given by the court, but rather in the result and in the rationale that could have been given. The jury's award of compensatory and punitive damages to the subrogees in the case had a certain intrinsic appeal, and it did not offend the basic objectives of subrogation law—it indemnified both the insured and the insurers and held the tortfeasor responsible. But, before the rule can become valid law, there must be a legal justification. Because subrogation is an equitable notion, the flexibility inherent in eq-

50. No. C 75-0342 L(A), slip. op. at 5.

I admit that a man cannot transfer his right to a chose in action; but if the insurer had an original right, he may elect to sue in his own name or in that of the insured. . . . This is not like a wager; it is an insurance on the house, and gives an interest in it.

The idea that the insurer took a cestui's interest in the property insured was never adopted; it was repudiated in Simpson v. Thomson, 3 App. Cas. 279 (1877), because under that rule almost anyone having a relationship with the insured could claim some injury. The resulting suits against the tortfeasor "might be both numerous and novel." Id. at 290. It could also be hypothesized that if the insured negligently damaged his property, the insurer, by virtue of his cestui's interest, would have a defense against the insured, thus canceling the insurance policy.
uitable actions justifies the desirable result reached.\textsuperscript{52}

The equitable notion of subrogation embraces a concept consistent with the purpose for punitive damages—holding the tortfeasor responsible for his actions. Inherent in an award of punitive damages is the idea of civil punishment. If punitive damages are a deterrent and a punishment,\textsuperscript{53} from society’s point of view the identity of the party collecting the award is unimportant.\textsuperscript{54} If the court in \textit{Urban Industries} can be criticized for administering subrogation by principles of “natural justice,” the alternative of not permitting the punitive damages might have unjustly enriched the tortfeasor.

\textbf{IV. Repercussions of a Flexible Approach}

Opting for a flexible rather than a rigid rule regarding who can and who cannot recover any excesses in a subrogation case presents some questions which are worthy of consideration, especially because in the wake of \textit{Urban Industries} it is reasonable to

\begin{quote}
\textsuperscript{52} The court stated in Flannary v. Utley, 3 S.W. 412, 413 (Ky. 1887):
Subrogation is a creation of equity, born of the civil law. Its object is to secure essential justice, without regard to form. Being of purely equitable origin, it is always controlled by equitable principles; and, as between a principal and his sureties, has been applied much more extensively in the American than in English jurisprudence. We do not mean to say, however, that its application is controlled alone by the chancellor’s conception of right. The doctrine cannot be applied . . . where it will work injustice to the rights of others.
\end{quote}


\textsuperscript{53} In early Kentucky decisions punitive damages were intended not only as punishment, but also as compensation for the plaintiff. See Louisville & N.R.R. v. Ritchel, 148 Ky. 701, 147 S.W. 411 (1912); Louisville & N.R.R. v. Roth, 130 Ky. 759, 114 S.W. 264 (1908); Chiles v. Drake, 59 Ky. (2 Met.) 146 (1859). Gradually, the courts have come to view punitive damages more as punishment than compensation. Hensley v. Paul Miller Ford, Inc., 508 S.W.2d 759 (Ky. 1974); Ashland-Dry Goods Co. v. Wages, 302 Ky. 577, 155 S.W.2d 312 (1946).


expect that insurance companies will demand rights to punitive damages and statutory penalties.

A flexible approach can only be taken at the cost of some certainty in the law, but this cost is small when compared to the alternative risks. If *Yorkshire* were the rule, then the insured would always recover any excess resulting from the suit, no matter who brings it, and the insured might benefit without incurring the costs of litigation. If the insured must recover all excesses and the potential extra award is in the form of punitive damages, the insurer might not be able to raise the issue in the pleadings unless the insured either joined the action or brought a separate suit. There would be additional complications in those states where the insured could not bring his own suit for punitive damages because they cannot be awarded without an award of compensatory damages. In such situations the tortfeasor could escape civil responsibility for his action. On the other hand, if there were a fixed rule that all excesses belonged to the insurer, then the insured, who was directly injured, would be denied any benefit resulting from the award of punitive damages. This might encourage the insured to forego the insurance in hopes of getting


56. In *Yorkshire* the insurance company initially bore all of the costs of litigation against the Canadian Government, although the court said:

> By agreement between the parties I can ignore for the purposes of this judgment the costs incurred in the litigation between the assured and the Canadian Government. They have agreed between themselves as to the way in which these will be dealt with, depending upon the ultimate decision in this action upon the question of principle involved.

*Id.* at 338. Presumably, under less amicable circumstances the insurance company might be responsible for all of the litigation expenses even though the insured ultimately collected the windfall.


58. This could be the ultimate result of the decision in *Carolina Cas. Ins. Co. v. Local 612, Int'l Bhd. of Teamsters*, 136 F. Supp. 941 (N.D. Ala. 1956). See text accompanying notes 34-37 *supra*. If the insured in *Carolina Casualty* did not bring a subsequent action for punitive damages, and the insurer was not permitted to collect punitive damages, the tortfeasor escaped without being punished for the malicious and deliberate nature of the tortious act. But even where the insured can bring a suit for punitive damages, there may be little incentive to join costly and time-consuming litigation in hopes of securing such damages. See *Donahue*, *supra* note 49.
both compensatory and punitive damages,\textsuperscript{59} which defeats the purpose for having the insurance.

Unfortunately, little is known about what effect larger subrogation recoveries might have on the behavior of insurance companies.\textsuperscript{60} A recovery of extra damages might encourage insurers to speculate by insuring businesses with high tort risks, compensating for the risk through the subrogation profits.\textsuperscript{61} With the movement toward insuring against punitive damages claims,\textsuperscript{62} allowing insurance companies to collect punitive damages might have little or no deterrent effect on the tortfeasor since the payment of punitive damages would constitute a transfer of funds between insurers. This would frustrate one of the purposes of subrogation by relieving the guilty party of the duty to pay for the egregious act. Finally, if insurers are permitted profit through a flexible subrogation rule, then the insurers should be forced to disgorge the benefits of the premiums either in the lawsuit settlement or through lower future rates.\textsuperscript{63} Since the potential for an increase

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\textsuperscript{59} See, e.g., Travelers' Ins. Co. v. Brass Goods Mfg. Co., 239 N.Y. 273, 146 N.E. 377 (1925) (under then-existing law the insured was required to elect a remedy; he had to either collect workmen's compensation or sue the negligent party).

\textsuperscript{60} Horn states that little information is available on the effect of subrogation on the insurance industry; thus subrogation's impact is speculative. R. Horn, supra note 5, at 146.

\textsuperscript{61} Speculation was one of the evils which subrogation was meant to avoid. See Procaccia, supra note 5, at 575.

\textsuperscript{62} See Levit, Punitive Damages: Recent Developments, 1977 Ins. L.J. 719.

\textsuperscript{63} Unless some allowance were made, the insurer would have the benefits of the premiums and the subrogation award. It would seem proper in such a situation to force insurers to disgorge the benefits of past premiums. There is, however, no direct authority for such a proposition. The Arizona Supreme Court opined that lower premiums generally do not result from subrogation. Allstate Ins. Co. v. Druke, 118 Ariz. 301, 576 P.2d 459 (1978). Patterson notes that "[s]ubrogation is a windfall to the insurer. It plays no part in rate schedules (or only a minor one), and no reduction is made in insuring interests . . . ." E. Patterson, Essentials of Insurance Law 151-52 (1957). At least one court has held that insurers need not disgorge the benefits of past premiums:

It is objected that such a recovery by the surety constitutes a "windfall" in that in the event of such recovery the surety suffers no loss on its surety bond although it has been paid premiums by the insured to reimburse it against just such a loss, as here. This argument loses sight of two fundamental facts: first, that even if the surety recovers against the third party on subrogation it still has been put to the expense of paying agent's commissions . . . [.,] investigating the insured's claim and . . . settling or litigating it, and, second, that the amounts of recoveries by subrogation are taken into consideration in arriving at the amount of premiums to be charged for surety bonds.


If subrogation has not been used in fixing rate schedules, it may be because recoveries under subrogation clauses comprise a very small percentage of claims actually paid. For example, in 1972 insurance companies paid $973,636,000 in fire claims but recovered
in subrogation litigation is great, further consideration by the
courts, the legislatures, and the insurance companies themselves
would be useful.

V. CONCLUSION

In adopting a rule on excess awards in subrogation, first con-
sideration must be given to the insured. Although contrary hold-
ings have been made, most courts have correctly sought to indem-
nify the insured first. After indemnifying the insured, considera-
tion should then be given to reimbursing the insurer. A policy
which ignores these rules must be at variance with the purpose
for either insurance or subrogation. Once both insured and in-
surer have been indemnified, the court should be flexible in its
award of any excess. Although in most cases the excess will natu-
really belong to the insured, the lesson to be learned from
Yorkshire is that there are circumstances in which the insurer
may deserve at least part of the excess. The Urban Industries
decision stands for the proposition that as long as the insured is
indemnified, the courts should be free to adjust the equities
among the insured, insurer, and tortfeasor. On the basis of equi-
table subrogation principles, there should be no absolute pro-
scription of a windfall recovery by an insurer.

Jay S. Bybee

through subrogation only $6,621,000 or .68% of the losses paid. Meyers, Subrogation