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Gwen Veronica Carroll

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Recommended Citation

Gwen V. Carroll, *Insurance Subrogation Actions No Longer Barred by General Releases in Illinois - Home Insurance Company v. Hertz Corporation*, 28 DePaul L. Rev. 189 (1978)

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**INSURANCE SUBROGATION ACTIONS
NO LONGER BARRED BY
GENERAL RELEASES IN ILLINOIS—
*HOME INSURANCE COMPANY V. HERTZ CORPORATION***

When a tortfeasor procures a general release from the insured victim of his wrongdoing, problems arise if an insurer's subrogation¹ action is affected. The majority of jurisdictions in the United States adhere to the general rule that a tortfeasor who obtains a release from the insured with knowledge that the insurance has been paid cannot bar an action by the subrogee insurer against the tortfeasor.² However, for thirty-one years the Illinois appellate courts have been singular in placing the onus of protecting the insurer's subrogation action on the insured.³ In *Inter Insurance Exchange of Chicago*

1. Subrogation is defined generally as "the substitution of one person in the place of another with reference to a lawful claim, demand or right; so that he who is substituted succeeds to the rights of the other in relation to the debt or claim, and its rights, remedies, or securities." BLACK'S LAW DICTIONARY 1595 (rev. 4th ed. 1968). In the law of insurance, subrogation is a substitution by which the insurer who has paid a loss under a policy succeeds to any rights the insured may have against any other third party who may be ultimately responsible for the loss. 8 G. COUCH, COUCH ON INSURANCE § 1997 (1931 & Supp. 1966).

2. See note 11 *infra*.

3. See *Inter Ins. Exch. of Chicago Motor Club v. Andersen*, 331 Ill. App. 250, 73 N.E.2d 12 (1st Dist. 1947). Plaintiff was an auto insurer who sued both its insured, Andersen, for breach of insurance contract, and Kuntz, the tortfeasor, for property damage to its insured's auto. Andersen had sustained personal injury and property damage as a result of a collision due to Kuntz's reckless driving. Andersen at the time carried collision insurance with plaintiff which only covered property damage. Shortly after the accident, plaintiff paid Andersen for the property damage, pursuant to an estimate, and minus the deductible. Subsequent to this payment, tortfeasor Kuntz paid Andersen \$75.00 in return for a release from any and all liability "forever". Plaintiff sued both Kuntz and Andersen and received directed verdicts against both defendants at the close of the evidence. The appellate court found the verdicts against both defendants to be inconsistent and reversed the judgment against tortfeasor Kuntz.

Although the court recognized that "[t]he general rule seems to be that where the wrongdoer procures a release from the insured with knowledge that the insurance has been paid, the release is no bar to an action by the subrogee insurer against the wrongdoer," *id.* at 254, it decided contra to the majority of jurisdictions. In reaching its decision, the court stated:

[T]he purpose of the courts has been to protect the subrogation rights of the insurer, whether the insurer chose to sue the wrongdoer as subrogee or to sue the insured for breach of policy, or both. What lack of unanimity there is arises . . . as to how best the protection can be given, whether by blaming the insured or wrongdoer. Andersen in this case has a contract with the insurer. Kuntz has not. He is a stranger to the contract. His settlement does not bring him into a contractual relationship with the insurer. Where he has knowledge of payment it could be said he has ipso facto knowledge of the subrogated rights and thereby of the new relationship now existing between him and the insurer. On the other hand, placing the onus of protecting the insurer upon the insured would seem more logical and certain. He has the duty of good faith whether expressed or not. He has signed and presumably read the insurance contract.

Id. at 255-56.

*Motor Club v. Anderson*⁴ the First District stated that "[t]he goal of prudence in one's conduct would seem to be reached more truly by making the insured duty-bound to refrain from executing a release except with the approval of the insurer."⁵ The *Andersen* decision's principal distinction lay in its departure from the majority understanding that the right of subrogation attaches immediately upon the insurer's payment to its insured⁶ and that, therefore, the insured, by accepting payment of the insurance, can do nothing thereafter to defeat the insurer's right.⁷

Andersen was the law of insurance subrogation and release cases until May of 1978 when the Illinois Supreme Court handed down its opinion in *Home Insurance Co. v. Hertz Corp.*⁸ In that opinion, the court held that an unlimited release from an insured to a tortfeasor who has knowledge⁹ of the

4. 331 Ill. App. 250, 73 N.E.2d 12 (1st Dist. 1947).

5. *Id.* at 256, 73 N.E.2d at 15. In reaching this conclusion, the *Andersen* court relied on the reasoning in *Illinois Auto Ins. Exch. v. Braun*, 280 Pa. 550, 124 A. 691 (1924). In *Braun*, plaintiff insurance company recovered payments for property damage made to its insured because the insured settled with the tortfeasor instead of pressing suit against it to verdict. While the *Braun* court did not face the question of the status of a subrogation claim in the face of a release, it did decide that the settlement had barred the insurer's subrogation action against the tortfeasor. The court said that "[u]nder conditions such as those contained in the policy before us, an insured cannot settle with the one causing him loss, except with the acquiescence of the insurance company, without putting in peril his status with the latter." *Id.* at 556, 124 A. at 693. Thus the insured was required to reimburse the insurance company for the payments made because it had jeopardized the subrogation action.

6. See *City of New York Ins. Co. v. Tice*, 159 Kan. 176, 152 P.2d 836 (1944); *Powell & Powell v. Wake Water Co.*, 171 N.C. 290, 88 S.E. 426 (1916).

7. *Inter Ins. Exch. v. Andersen*, 331 Ill. App. 250, 255, 73 N.E.2d 12, 14 (1947), *citing, inter alia*, *Hart v. Western R.R. Corp.*, 54 Mass. 99 (1847).

8. 71 Ill. 2d 210, 375 N.E.2d 115 (1978) [hereinafter cited as *Hertz*].

9. It is important that what the tortfeasor has knowledge of is that the insured has *already* been indemnified by the insurer. Either actual or constructive knowledge is sufficient, as long as the tortfeasor knew, or should have known, that insurance had been paid by the time the tortfeasor procures the release. 16 G. COUCH, *COUCH ON INSURANCE* 2d § 61:197 (1966 & Supp. 1977). See also *Pittsburgh, C., C. & St.L. Ry. v. Home Ins. Co.*, 183 Ind. 355, 108 N.E. 525 (1915).

An obvious question in these cases will be: what is sufficient notice? California is representative of the jurisdictions which require clear, unambiguous notification. *Bernhard v. Del-luaitante*, 5 Cal. App. 2d 585, 43 P.2d 338 (1935). The *Bernhard* court found the following letter from the insurer to the tortfeasor to be insufficient notice to the tortfeasor:

Dear Sir: Re: Claim No. 288200 Miss Viola R. Patten.

It has been reported to us that under date of April 24, 1932, your Ford coupe bearing license 1 J 2163 was in collision with the Chevrolet sedan of our assured at the corner of Church Street and First, Tomales, California.

The facts thus far submitted indicate that you are legally liable for the damage done. If you intend to assume liability, kindly advise what arrangement you wish to make with reference to settlement of damage. However, should you feel that you are not at fault, we will thank you to write or call and explain your version of the accident.

Not hearing from you, we will assume that you agree with us as to the liability and shall expect to receive your check for the amount of our claim when we submit

insurer's subrogation rights will not bar the insurer's action against the tortfeasor.¹⁰ This holding roundly reverses the *Andersen* ruling and aligns Illinois with the majority of jurisdictions.¹¹ The *Hertz* rule represents an

invoices and advise you of the amount claimed under our rights as insurance carrier for Miss Patten.

If you are insured for matters of this nature, kindly give us the name and address of your insurance company so that we may communicate with them.

Yours very truly,

George D. Horn,

Adjuster.

Id. at 586-87, 43 P.2d at 338-39. In the pleadings, the defendant positively denied having any notice. In determining the question of whether or not the letter was so clear as to be determinative in insurer's favor, the California court held that the letter did "not even purport to state that the carrier had been subrogated" and that the tortfeasor, reading the letter as a whole, might be able to "assume the carrier had not paid." *Id.* at 587-88, 43 P.2d at 339.

However, in New York, tortfeasor's possession of information which, "reasonably pursued," would have given it knowledge of the insurer's claim of subrogation, has been held to be sufficient notice to invoke the general principle. *Neuss, Hesslein & Co. v. 380 Canal St. Realty Corp.*, 9 Misc. 2d 903, 168 N.Y.S.2d 579 (1957) *appeal dismissed* 13 App. Div. 2d 760, 217 N.Y.S.2d 1017 (1961).

In *Neuss*, the tortfeasor received letters signed by the insured's insurance manager. The letters demanded payment for an itemized list of damage claims. In several places, the letters made reference to "the insured." In determining that the letters constituted sufficient notice to invoke the general rule, the court relied on the authority of *Ocean Accident & Guar. Corp. v. Hooker Electrochemical Co.*, 240 N.Y. 37, 147 N.E. 351 (1925). In *Ocean*, the New York Court of Appeals stated that the release had not

operated to defeat plaintiff's claim for reimbursement founded on subrogation . . . [because] affidavits . . . were offered by plaintiff which . . . permitted the court to find, at least as a matter of fact, that when defendant made its settlement . . . it knew or possessed information which reasonably pursued would have given it knowledge of plaintiff's status as an insurer . . . against claims springing from defendant's fault, and that it had become subrogated to various claims of such a character against the latter.

Id. at 46, 147 N.E. at 352-53.

10. 71 Ill. 2d 210, 215, 375 N.E.2d 115, 118 (1978). In an opinion delivered by Mr. Justice Underwood, the court stated that

an unlimited release executed by an insured-subrogor for consideration not specifically including an amount designated as covering the insurer's subrogation interest does not bar a subsequent subrogation action by an insurer-subrogee against the tortfeasor, if the tortfeasor or his insurance carrier had knowledge of the insurer-subrogee's interest prior to the release.

Id.

11. There is a wealth of case law which enunciates the general rule that a release issued from an insured to a tortfeasor who has knowledge of an insurer's indemnification does not bar the insurer's subrogation claims. *See, e.g.*, cases cited in *Hertz* at 71 Ill.2d 210, 212-13, 375 N.E.2d 115, 117; *Collins v. Mobile & Ohio R.R.*, 210 Ala. 234, 94 So. 631 (1923); *Sentry Ins. Co. v. Stuart*, 246 Ark. 680, 439 S.W.2d 797 (1969); *Mitchell v. Holmes*, 9 Cal. App. 2d 461, 50 P.2d 473 (1935); *Bahn v. Shalev*, 125 A.2d 678 (D.C. Mun. Ct. App. 195); *Pittsburgh, C., C. & St. L. Ry. v. Home Ins. Co.*, 183 Ind. 355, 108 N.E. 525 (1915); *Sharp v. Bannon*, 258 S.W.2d 713 (Ky. Sup. Ct. 1953); *Pennsylvania Fire Ins. Co. v. Harrison*, 94 So. 2d 92 (La. App. 1957); *Cleveland v. Chesapeake & Potomac Tel. Co.*, 225 Md. 47, 169 A.2d 446 (1960); *Wolverine Ins. Co. v. Klomprens*, 273 Mich. 493, 263 N.W. 724 (1935); *General Exch. Ins. Corp. v.*

interpretation that is faithful to the fundamental characteristic of subrogation: once a payment has been made, the insurer effectively *becomes* the insured and therefore any acts of the insured thereafter are void.¹² Central to the *Andersen* court's reasoning was the proposition that the rule formulated would function best to safeguard the subrogated interests of the insurance carrier.¹³ Application of the *Hertz* holding results in protection of the insurer's subrogation rights *and* in preservation of the insurer-insured relationship which had been susceptible to injury under the pre-*Hertz* rule in Illinois.¹⁴ This decision represents a welcome egress from the confining precedent established by *Andersen*.

The purpose of this Note is to examine the *Hertz* decision in light of the anomalous reasoning which preceded it in the Illinois appellate courts. Also, Illinois pre-*Hertz* law will be compared to that of other jurisdictions and the significance of *Hertz's* impact upon Illinois insurance law will be discussed.

Young, 357 Mo. 1099, 212 S.W.2d 396 (1948); Omaha & Repub. Valley Ry. v. Granite State Fire Ins. Co., 53 Neb. 514, 73 N.W. 950 (1898); Davenport v. State Farm Mut. Auto. Ins. Co., 81 Nev. 361, 404 P.2d 10 (1965); Fire Ass'n v. Wells, 84 N.J. Eq. 484, 94 A. 619 (1915); Ocean Accident & Guar. Corp. v. Hooker Electrochemical Co., 240 N.Y. 37, 147 N.E. 351 (1925); Nationwide Mut. Ins. Co. v. Canada Dry Bottling Co., 268 N.C. 503, 151 S.E.2d 14 (1966); Motorists Mut. Ins. Co. v. Gerson, 113 Ohio App. 321, 177 N.E.2d 790 (1960); Aetna Cas. & Sur. Co. v. Associates Transp., Inc., 512 P.2d 137 (Okla. Sup. Ct. 1973); United Pac. Ins. Co. v. Schetky Equip. Co., 217 Ore. 422, 342 P.2d 766 (1959); Hospital Serv. Corp. v. Pennsylvania Ins. Co., 101 R.I. 708, 227 A.2d 105 (1967); Calvert Fire Ins. Co. v. James, 236 S.C. 431, 114 S.E.2d 832 (1960); Continental Ins. Co. v. Weinstein, 37 Tenn. App. 596, 267 S.W.2d 521 (1953); Wichita City Lines, Inc. v. Puckett, 156 Tex. 456, 295 S.W.2d 894 (1956).

12. See King, *Subrogation Under Contracts Insuring Property*, 30 TEX. L. REV. 62 (1951) [hereinafter cited as King]. In discussing the equitable nature of subrogation, the author describes the different ways in which courts have arrived at the recognition that the doctrine of subrogation operates independently of contract provisions. Because of its very nature and purpose, which is to avoid unjust enrichment, the doctrine is best understood in terms of complete substitution.

13. 331 Ill. App. at 255-56, 73 N.E.2d at 15.

14. Plaintiff's petition for leave to appeal described the typical insurer-insured relationship in very practical terms. In noting the irony of the *Andersen* rule, appellant said

[t]he rule only serves the insurance carrier at the expense of its own insured. It constitutes a trap for the unwary plaintiff who would dare to recover for his uncompensated loss. An injured plaintiff expects his insurance carrier to immediately provide funds for his automobile property damage and medical payments. He has bargained for this and paid a premium for it. Customarily an insurance company appraises the loss and arranges for repair, or allows the insured to proceed with the repair with funds provided by the insurer. In turn, the insurance company places the tortfeasor, or the carrier for same, on notice of their subrogation claim. The insured injured party either negotiates a settlement with the carrier's representatives or the tortfeasor's representative for the uncompensated loss including pain and suffering, lost time, and other uncompensated bills.

The procedure is usually carried out by lawyers, adjustors, and insurance claims personnel having knowledge of the disposition of claims. A general release having the boilerplate language is exacted at the conclusion if the case is settled . . . [The *Andersen* rule] is unjust in that it places the burden on injured persons to obtain the subrogated interest. The injured person only expects to be made whole for his

HERTZ'S FACTS AND REASONING

Home Insurance Company's insured was injured when an automobile owned by the defendant Hertz corporation was negligently driven, causing property damage and personal injury. The actual plaintiff, Home Insurance Company, covered its insured's property damage and made some medical payments in the amount of \$2,082.36. The insured then assigned his rights of recovery to the insurance company. The plaintiff gave notice¹⁵ to defendant's parent corporation¹⁶ that plaintiff had paid the loss and was claiming subrogation rights in the total amount of the sums paid to its insured for auto repairs and other expenses.¹⁷

Ten months after the notice had been received by the defendant, the insured sued the tortfeasor and others¹⁸ in the Du Page County Circuit Court for personal injuries and the \$100 deductible portion of property damage sustained in the accident. Thereafter, the insured and defendants agreed to settle, and the insured executed a full and final release of all claims arising out of the accident. He then dismissed the court action and in return, defendants issued a \$6,000 check to the insured.

Seven months after the insured's settlement and release, the plaintiff insurer filed an action in the Circuit Court of Cook County against the same defendants named in the Du Page County suit.¹⁹ As in *Andersen*,²⁰ the plaintiff alleged that it made payments to or on behalf of the insured and that as a result it had become subrogated to the interests of the insured. On

property damage and uncompensated loss. Many times the injured person is unsophisticated and has never heard of the word "subrogation," let alone know of its ramifications. He only knows that he has been injured and suffered a loss and expects full reimbursement for same. The trap is set by a tortfeasor or his carrier by tendering money for the uncompensated portion, telling him that he must sign a general release in order to receive the money. By this time the machinery of the injured party's carrier has placed the tortfeasor's agents on notice. Nonetheless, the notice is disregarded and the general release exacted. Ultimately the injured party's carrier traces down the wrongdoer only to be told that a general release bars the action. The insurance carrier thus is left with only one remedy—obtain the money from its own insured, and not the party who caused the damage.

Petition for leave to appeal for Plaintiff at 12-14.

15. Attention is not given, in either the opinions of the case, or the briefs for the parties, to the kind of notice which was given to defendants.

16. The defendants in the suit were Gary D. Gardner, the tortfeasor-driver; Ingram Barge, Inc., an Illinois corporation and the tortfeasor's employer; and the Hertz Corporation, lessor of the automobile driven by tortfeasor Gardner. Plaintiff sent notice of its subrogated interests to the Ingram Corporation of New Orleans, La., which was not a party defendant but the parent corporation of party defendant, Ingram Barge, Inc.

17. The facts of the case are set out in the appellate court's decision. *Home Ins. Co. v. Hertz Corp.*, 49 Ill. App. 3d 569, 570-71, 364 N.E.2d 591, 592-93 (1st Dist. 1977).

18. See note 16 *supra*. The defendants in the insured's suit were the same parties as in *Hertz*.

19. See note 16 *supra*.

20. See note 3 *supra*.

defendant's motion, the complaint was dismissed because of the execution of a full release by the insured.²¹ The appellate court affirmed²² and the plaintiff appealed to the Illinois Supreme Court which reversed and remanded the cause to the Circuit Court of Cook County.²³ The supreme court found that a departure from the principle of *stare decisis* was warranted by the fundamental unfairness to both the insured and insurer under the prior rule. Thus, *Andersen* was overruled on public policy grounds.

Unpersuaded by a succession of appellate court decisions,²⁴ the Illinois Supreme Court penetrated the moralistic reasoning of *Andersen*²⁵ and decided how the insurer's subrogation rights are best protected based on commercially practical considerations. The court wisely recognized that when an insurer's attempt to enforce its subrogation rights against a tortfeasor is blocked, recovery from its own insured is an "obviously unpalatable alternative".²⁶ The court stated that the *Andersen* rule was effectively "a trap for the unwary insured plaintiff,"²⁷ rather than a good faith protection of the insurer's subrogation rights. This interpretation suggests that the *Andersen* rule encouraged fraud on the part of the tortfeasor.²⁸ Ironically, fraud on the part of the tortfeasor was precisely the danger the *Andersen* court sought to avoid by its decision.²⁹ The *Hertz* court, however, relied primarily on authority from other jurisdictions in which insurers were not barred from enforcing their subrogated claims because of an insured's general release to a tortfeasor who has knowledge of the insurer's interest.³⁰

AN ANALYSIS OF *HERTZ* IN LIGHT OF OTHER JURISDICTIONS

The rationale behind the *Hertz* court's adoption of the general rule is best understood when examined in light of existing law in other jurisdictions.

21. Plaintiff filed a reply to defendants motion to dismiss supported by affidavits.

22. *Home Ins. Co. v. Hertz Corp.*, 49 Ill. App. 3d 569, 364 N.E.2d 591 (1st Dist. 1977). The appellate court determined that since the issue framed in *Hertz* was substantively identical to that in *Andersen*, there was no reason to abrogate the persuasive authority of the *stare decisis* principle. The appellate court cited the Illinois Supreme Court's statement in *Maki v. Frelk*, 40 Ill. 2d 193, 239 N.E.2d 445 (1968), for the proposition that where Illinois law is settled and is not found to be contra to any statute or constitutional principle, then the principle of *stare decisis* ought to be followed. And, although recognizing that "[t]he rule of *stare decisis* is not absolute," the court concluded that "public policy and social needs do not require a departure from these prior decisions." 49 Ill. App. 3d at 573, 364 N.E.2d at 594.

23. *Home Ins. Co. v. Hertz Corp.*, 71 Ill. 2d 210, 213, 375 N.E.2d 115, 117 (1978).

24. *Shaw v. Close*, 92 Ill. App. 2d 1, 235 N.E.2d 830 (1st Dist. 1968); *St. Louis Fire & Marine Ins. Co. v. Garnier*, 24 Ill. App. 2d 408, 164 N.E.2d 625 (3d Dist. 1960); *Inter Ins. Exch. v. Andersen*, 331 Ill. App. 250, 73 N.E.2d 12 (1st Dist. 1947).

25. See note 3 *supra*.

26. 71 Ill. 2d at 213, 375 N.E.2d at 117.

27. *Id.* at 214, 375 N.E.2d at 117.

28. *Id.*

29. *Inter Ins. Exch. of Chicago Motor Club v. Andersen*, 331 Ill. App. 250, 256, 73 N.E.2d 12 (1st Dist. 1947).

30. See note 11 *supra*.

Most jurisdictions hold that an unlimited release issued from an insured to a tortfeasor, who has knowledge that insurance has been paid, does not bar an action by the subrogee insurer against the wrongdoer.³¹ A critical survey of the case law reveals that the individual jurisdictions arrived at this same general rule for divergent reasons.³² The common denominator is a fundamental recognition that the doctrine of subrogation is a creature of equity and derives its operative features from the general indemnity nature of the insurance contract.³³ Because of the equitable foundation of the doctrine, it

31. *See id.*

32. Some jurisdictions hold that insurer's indemnification produces the same effect as if the insured had made an assignment of its claims against the tortfeasor. *See* note 60 *infra*. Others simply call it an equitable assignment. *See* note 63 *infra*. Many jurisdictions maintain that upon insurer's payment to insured, the insurer becomes subrogated by operation of law to the interest of the insured and thus no acts by the insured thereafter can cancel or destroy the interests of the insurer. *See* notes 40, 43 *infra*. *See also*, note 33 *infra*.

33. *See* King, *supra* note 12, at 63-64. *See also* 16 G. COUCH, COUCH ON INSURANCE 2d §61:20 (1966 & Supp. 1977) and cases cited therein recognizing that

The doctrine of subrogation does not arise from, nor is it dependent upon, statute or custom or any of the terms of the contract . . . The right of subrogation rests not upon a contract, but upon the principles of natural justice. The principle of subrogation will be applied or not, according to the dictates of equity and good conscience, and to considerations of public policy, resting, as it does, upon the maxim that no one should be enriched by another's loss.

Id. *See also* Liberty Mut. Ins. Co. v. Kleinman, 149 Cal. App. 2d 404, 308 P.2d 347 (1957) (a surety's right of recovery is limited to those persons who participate in a wrongful act against the principal; as to third parties, a surety must show a superior equitable right); Offer v. Superior Ct., 194 Cal. 114, 228 P. 11 (1924) (subrogation as an operation of law does not require the insurer to go into a court of equity to establish that right); Trinity Universal Ins. Co. v. Moore, 134 A.2d 333 (D.C. Mun. Ct. App. 1957) (equity confers upon the insurer the right to enforce its rights of subrogation against the tortfeasor to recover monies paid); Rursch v. Gee, 237 Iowa 1391, 25 N.W.2d 312 (1946) (an insurer has a right to recover against a tortfeasor for indemnification to the extent the insurer was obligated to pay the insured); Leach v. Commercial Savings Bank, 205 Iowa 1154, 213 N.W. 517 (1927) (a surety is entitled to subrogation upon payment of principal's debt to the extent of the rights possessed by the creditor); Hartford Fire Ins. Co. v. Payne, 199 Iowa 1008, 203 N.W. 4 (1923) (an insurer cannot be subrogated to the shipper to recover against a carrier when such carrier has independently contracted and recovered insurance of a shipment for carrier's own benefit); Fidelity & Deposit Co. v. Bowen, 123 Iowa 356, 98 N.W. 897 (1904) (surety's right to be subrogated to the rights of the principal's creditors is dependent upon the superiority of his equities); Louisville Trust Co. v. Royal Indem. Co., 230 Ky. 482, 20 S.W.2d 71 (1929) (equity will not entitle an insurer, paid to bear a loss, to superior rights of subrogation against a party who receives no benefit from the instant transaction); Illinois Sur. Co. v. Mitchell, 177 Ky. 367, 197 S.W. 844 (1917) (the rights of a general creditor will not be allowed to impair a prior contract between a principal and his surety); Automobile Ins. Co. v. Barnard, 30 So. 2d 142 (La. Ct. App. 1947) (failure to introduce into evidence the insurance policy does not negate an insurer's right to recover by subrogation to the insured's rights. A receipt of money paid is sufficient); Oxford Prod. Credit Ass'n v. Bank of Oxford, 196 Miss. 50, 16 So. 2d 384 (1944) (equity will not allow a surety, paid a consideration to indemnify for losses suffered by its principal, to be subrogated to the rights of another, not a wrongdoer, to whom it was also liable); General Exch. Ins. Corp. v. Young, 357 Mo. 1099, 212 S.W.2d 396 (1948) (suit by insured to recover damages for personal injuries did not bar the insurer's right to recover for property damages to which it was entitled by subrogation

is immaterial whether or not the insurance contract contains a special clause conferring subrogation rights.³⁴

As a result of *Andersen*, the poorly premised progenitor of the Illinois appellate precedent overturned by *Hertz*, Illinois courts were applying a spuriously reasoned minority rule which was an anomaly in the law of insurance subrogation. Before *Hertz*, Illinois courts were obfuscated in their understanding of subrogation, treating subrogees' claims as deriving their au-

due to discharge of policy obligation to insured); *Plate Glass Underwriters Mut. Ins. Co. v. Ridgewood Realty Co.*, 219 Mo. App. 186, 269 S.W. 659 (1925) (the equitable doctrine of subrogation is one that arises by operation of law, whether or not there is privity of contract); *Farm Bureau Mut. Ins. Co. v. Anderson*, 360 S.W.2d 314 (Mo. Ct. App. 1962) (insurer is not required to prove tortfeasor's negligence in order to pursue a subrogation assignment); *Knight v. Calvert Fire Ins. Co.*, 268 S.W.2d 53 (Mo. Ct. App. 1954) (whether or not an insurance policy contains a subrogation clause, an insurer will be entitled to subrogation as a principle of equity); *Ocean Accident & Guar. Corp. v. Hooker Electrochemical Co.*, 240 N.Y. 37, 147 N.E. 351 (1925) (principles of equity require that an insurer who pays damages to its insured should be entitled to collect from the wrongdoer); *Laski v. State*, 217 App. Div. 420, 217 N.Y.S. 48 (1926) (subrogation is an equitable doctrine that will not be permitted where it would work injustice to those having equal or superior equities); *Powell & Powell v. Wake Water Co.*, 171 N.C. 290, 88 S.E. 426 (1916) (insurer's payment to the insured entitles insurer to be subrogated to the rights of the insured as against the wrongdoer); *Baker v. Fargo Bldg. & Loan Ass'n*, 64 N.D. 317, 252 N.W. 42 (1934) (agency which is required to pay premiums to insurance companies is subrogated to rights of insurance companies to collect the premiums); *American Cent. Ins. Co. v. Weller*, 106 Or. 494, 212 P. 803 (1923) (the doctrine of subrogation will be applied where the equities of the case demand it so that no one will be enriched by another's loss); *Insurance Co. of N. America v. Fidelity Title & Trust Co.*, 123 Pa. 523, 16 A. 791 (1888) (the right of the insurer to be subrogated arises out of an actual payment to a creditor, not merely a liability to pay); *Globe & Rutgers Fire Ins. Co. v. Foil*, 189 S.C. 91, 200 S.E. 97 (1938) (an insurer need not be formally subrogated to the rights of the insured, the principles of equity permit the insurer to recover based on the rights of the insured); *Walker v. Queen Ins. Co.*, 136 S.C. 144, 134 S.E. 263 (1924) (subrogation is allowed where one who is secondarily liable discharges the obligation of the one who is primarily liable on the debt); *Salt Lake City v. Schubach*, 108 Utah 266, 159 P.2d 149 (1945) (subrogation ultimately secures the payment or discharge of a debt by the person who in good conscience ought pay it); *Minshull v. American Sur. Co.*, 141 Wash. 440, 252 P. 147 (1927) (sureties are entitled to an equitable apportionment under the doctrine of subrogation).

For a general and thorough discussion of the equitable origins and nature of subrogation, see H. SHELDON, *THE LAW OF SUBROGATION* §§ 1-11, §§ 221-39 (1882).

34. Of course, parties *may* contract for a subrogation clause in their insurance policy. See 16 G. COUCH, *COUCH ON INSURANCE* 2d 61:23 (1966 & Supp. 1977), where the author states that the effect of an express subrogation clause is to make it unnecessary for the insurer to prove facts giving rise to a right of subrogation.

Most insurance policies contain standard subrogation clauses. Where a provision states that an insured is obligated not to do anything to jeopardize the insurer's subrogated interests, and the insured executes a release to a tortfeasor who has knowledge of indemnification, a question regarding insured's breach of contract arises. This was the problem in *Andersen*. The *Andersen* court failed to see that the question of breach of contract becomes moot when the superseding equitable nature of subrogation is understood. Since the insured can do nothing to cancel the subrogee's rights after there has been notification, there can be no resultant damages from the insured's "breach." If the equitable nature of the doctrine is not addressed first in these cases, there is a danger of entrapment into the circular reasoning of *Andersen*. See note 3 *supra*.

thority from specific subrogation provisions in the insurance contract.³⁵ By confining themselves to issues framed by the narrow borders of contractual rights and obligations, the courts avoided the larger arena of discussion governed by the equitable principles of subrogation.³⁶ Illinois policy was also peculiar in its argument that barring the insurer's subrogation claim because of the release would prevent fraud on the part of the tortfeasor.³⁷ In actual fact, the policy was an invitation to shrewd tortfeasors or their carriers to take advantage of the unsophisticated, injured insured.³⁸ The *Hertz* court wisely consulted the intelligence of better reasoned rules in other jurisdictions to arrive at adoption of the general rule based on policy grounds.³⁹

The logic applied by the courts in other jurisdictions has not been burdened by clumsy contractual interpretations of subrogation. For example, New York established a clear and well-reasoned rule in the leading case of *Ocean Accident and Guarantee Corp. v. Hooker Electrochemical Co.*⁴⁰ Although *Ocean* concerned liability insurance rather than property insurance, it has been cited, discussed and followed in many decisions, including *Hertz*,⁴¹ involving property insurance.⁴² The *Ocean* case stated that the

35. In the post-*Andersen* decision of *St. Louis Fire and Marine Ins. Co. v. Garnier*, 24 Ill. App. 2d 408, 164 N.E.2d 625 (3d Dist. 1960), the insured had signed a receipt upon insurer's indemnification in which the insured authorized the insurer to settle the claims for damages against the tortfeasor. The insured warranted that he had not made settlement of the claim and that no such settlement would be made without the consent of insurer. Thereafter the insured, without notice to insurer and unknown to insurer, executed a covenant not to sue the tortfeasor or their insurers on account of damages, losses or injury to property resulting from the accident. In return, the insured received \$600. The insurer sued the insured for breach of contract and claimed \$825 in damages (\$1050 paid to insured minus \$225 insurer received for salvaged automobile). *Id.* at 409-10, 164 N.E.2d at 627-28.

In holding that there had been a breach of contract, the Third District found damages based on *Andersen's* faulty initial premise that the insurer's subrogation was barred because of the release. Had the court addressed the question which is raised when the superseding equitable nature of the doctrine of subrogation is considered, it would have found no damages (*i.e.*, insurer's subrogation action against the tortfeasor would not be barred). In an analytically immature statement, the court stated that, "[w]hether or not the third party's insurance company knew plaintiff had made payment under its policy could, in the absence of fraud or collusion and none is charged here, have no bearing upon the contractual relationship between plaintiff and defendant." *Id.* at 413, 164 N.E.2d at 628. Thus, as late as 1960, Illinois courts were completely circumventing a direct consideration of the doctrine of subrogation.

36. Simply recognizing the equitable principles of subrogation may not mean that in all cases the insurer should indeed be reimbursed for payments made to its insured. *See King*, *supra* note 12 for one author's view that the majority rule does not always represent an equitable solution in these cases. The author feels that primary liability should attach to willful or reckless tortfeasors, but that where a tortfeasor is merely negligent there may be policy reasons for compelling the insurer to bear the burden of payment. *Id.* at 64.

37. *Inter Ins. Exch. of Chicago Motor Club v. Andersen*, 331 Ill. App. at 256, 73 N.E.2d at 15.

38. *See* note 14 *supra*.

39. 71 Ill. 2d at 214, 375 N.E.2d at 117.

40. 240 N.Y. 37, 147 N.E. 351 (1925).

41. 71 Ill. 2d at 213, 375 N.E.2d at 117.

42. *See* note 11 *supra*.

doctrine of subrogation finds its origins in equity, and thus, by operation of law, an insurer becomes subrogated to the interests of the insured immediately upon indemnification.⁴³ In *Ocean*, the insured sold a defectively manufactured chemical which proximately caused multifarious injuries to a large number of persons. The plaintiff insurer was obligated to indemnify the insured against the claims for damages with which it would be confronted and made such payments. The insured brought an action against the negligent manufacturer of the chemical, and after being forced into bankruptcy, settled with the manufacturer by extending a release to it in return for a sum of money.⁴⁴ In ascertaining the effect of the release on the insurer's subrogation action against the negligent manufacturer, the *Ocean* court competently constructed the equitable framework necessary to disposition of the issue:

It is so well settled as not to require discussion that an insurer who pays claims against the insured for damages caused by the default or wrongdoing of a third party is entitled to be subrogated to the rights which the insured would have had against such third party for its default or wrongdoing. This right of subrogation is based upon principles of equity and natural justice [T]he right is in some of its results not different than would be the assignment by the insured of its right of action against the primary wrongdoer for the fault which has caused the damages which would have been paid by the insurer The subrogee acquires rights which as between it and the insured are beyond the power of cancellation and destruction by the latter and . . . is entitled to enforce these rights by an action in its own name and without joining the insured as party.⁴⁵

Although stating that the insurer becomes subrogated to the claims of the insured *pro tanto* upon indemnification, the court stated that the tortfeasor's knowledge⁴⁶ of the insurer's new subrogated interests was necessary for perfection of the insurer's position.⁴⁷ The case law is legion in support of the rule that where the tortfeasor, acting in good faith and without knowledge or

43. In its often quoted opinion, the New York Court of Appeals articulated a sensible justification for its adoption of the general rule:

Charged with the knowledge to which we have referred, . . . [the tortfeasor] knew that plaintiff occupied the position of subrogee and by operation of law, working what amounted to an assignment, had acquired a right of action against [the tortfeasor] . . . which was not controlled by the insured, and which the latter had no right to cancel. The insurer was in no way a party to the settlement and we think that the latter was made subject to its rights and without destruction thereof.

Ocean Accident & Guar. Corp. v. Hooker Electrochemical Co., 240 N.Y. 37, 50-51, 147 N.E. 351, 354 (1925).

44. The facts of this case are laid out at *id.* at 44, 147 N.E. at 352.

45. *Id.* at 47, 147 N.E. at 353, citing *Hart v. West R.R.*, 13 Met. 99, 54 Mass. 99 (1847); *Lord & Taylor, Inc. v. Yale & Towne Mfg. Co.*, 230 N.Y. 132, 129 N.E. 346 (1920).

46. See note 9 *supra*.

47. *Ocean Accident & Guar. Corp. v. Hooker Electrochemical Co.*, 240 N.Y. 37, 47-48, 147 N.E. 351, 353 (1925).

notice of the insurer's payment and subrogation rights, settled with and obtained a full or general release from the insured, such settlement and release constituted a defense to the insurer's action against the tortfeasor.⁴⁸ This rule does not abrogate the principle that subrogation attaches immediately upon insurance payment because the equitable bottom line of the doctrine is a purpose to avoid unjust enrichment.⁴⁹ Although the *Hertz* court did not discuss the equitable origins of subrogation, its decision reveals that such considerations, as embraced by neighboring states' decisions, guided its reasoning. The *Hertz* court found the difficulty of the *Andersen* rule to be its fundamental unfairness to both insured and insurer.⁵⁰ While not specifically addressing the essential nature of subrogation, the court arrived at a decision compatible with its principles.

Reaching the same result as *Ocean*, the Michigan Supreme Court, in *Wolverine Insurance Co. v. Klomprens*,⁵¹ articulated its justification of the rule in stronger terms. Confronted with a fact situation identical to *Hertz*,⁵² the court not only recognized the *pro tanto* operation of subrogation upon insurer's indemnification of insured, but went farther and stated that the procurement of a release by a tortfeasor, who has knowledge of the insurer's subrogated interests, amounts to fraud upon the insurer's right and therefore the release is no defense to the subrogee's action.⁵³ The court evidenced its understanding of the doctrine by pointing out that the conclusion is the same whether or not there is an express provision for subrogation in the contract.⁵⁴

48. See, e.g., *Calvert Fire Ins. Co. v. Maddox*, 38 Ala. App. 194, 82 So. 2d 277 (1955), cert. denied 263 Ala. 698, 82 So. 2d 280 (1955); *Mitchell v. Holmes*, 9 Cal. App. 2d 461, 50 P.2d 473 (1935); *American Auto Ins. Co. v. Clark*, 122 Kan. 445, 252 P. 215 (1927); *Sharp v. Bannon*, 258 S.W.2d 713 (Ky. Sup. Ct. 1953); *Metropolitan Cas. Ins. Co. v. Badler*, 132 Misc. 132, 229 N.Y.S. 81 (1928); *Continental Ins. Co. v. Weinstein*, 37 Tenn. App. 596, 267 S.W.2d 521 (1953).

49. See *King*, *supra* note 12, at 63, in which the author accurately observed that the doctrine of subrogation, while enforceable in a court of law, is equitable in origin, based not on contract, but on the principle of unjust enrichment, and includes every instance in which one who is not a volunteer pays the debt of another. Furthermore, it has been held that since it is a creature of equity, it will not be enforced where enforcement will work an injustice.

50. 71 Ill. 2d at 213, 375 N.E.2d at 117.

51. 273 Mich. 493, 263 N.W. 724 (1935).

52. In *Wolverine*, the insured sustained personal injury and property damage as a result of the tortfeasor's negligent driving. The insurer paid the insured an adjusted sum for the property damage and took an assignment of the insured's claims against the tortfeasor. Subsequently, the insured released the wrongdoers from all claims on account of the collision, including injuries to car and personal property. No formal or written notice of the assignment was given to the defendants until after the settlement and release, but parol evidence showed that the tortfeasor was fully aware and informed of the insurer's subrogated status resulting from its indemnification of its insured. *Wolverine Ins. Co. v. Klomprens*, 273 Mich. 493, 495-96, 263 N.W. 724, 725 (1935).

53. *Id.* at 496, 263 N.W. at 725.

54. *Id.*

It is thought provoking that the Illinois courts, under the pre-*Hertz* rule, were positioned antithetically to the majority of courts in regard to the fraud issue.⁵⁵ The *Andersen* court regarded the actions of a knowledgeable tortfeasor procuring a release from an insured as fraudulent but lay the blame on the insured as the perpetrator of the fraud.⁵⁶ Thus, under the old Illinois rule, the consequence of this particular type of "fraud" was not the invalidation of a release, but the prohibition of a subrogation action against the tortfeasor, forcing the insurer to seek its remedy from its own insured.⁵⁷ The supreme court in *Hertz* did not go so far as to say that tortfeasors' actions in cases such as these are fraudulent. However, the court properly saw that the encouragement of fraud on the part of the tortfeasor was an intrinsic deficiency of the old rule.⁵⁸

Representative of the view that the insurer's payment to its insured operates as an assignment of the insured's claims against the tortfeasor is *Rursch v. Gee*.⁵⁹ Again, faced with facts similar to *Hertz*,⁶⁰ the Iowa court equated the time of indemnification with the act of assignment, and stated that the assignment was completed upon indemnification whether or not the policy expressly contained a subrogation clause.⁶¹ An earlier case decided along the same principles is *Cushman & Rankin Co. v. Boston & Maine Railroad*,⁶² where the Vermont court held that the insurer's payments constituted an equitable assignment which authorized the insurer to sue in the insured's name for its own benefit. The right was held to be protected and a release subsequently given by the insured to the defendant, who had knowledge of such payment, could not bar the action.⁶³

The emergent pattern upon an examination of the case law is a general cognizance that the doctrine of subrogation is rooted in principles of equity and unjust enrichment and that decisions should therefore be guided by those principles. Had Illinois courts considered the early appellate court case of *Chicago, Burlington & Quincy Railroad v. Emmons*⁶⁴ more critically, they would have been properly exercising their judicial intellect instead of indulging the anomalous sentiment of *Andersen*.

55. See note 33 *supra*.

56. *Inter Ins. Exch. of Chicago Motor Club v. Andersen*, 331 Ill. App. 250, 257, 73 N.E.2d 12, 15 (1st Dist. 1947).

57. See note 14 *supra*, for the description in plaintiff's petition for leave to appeal of the real-life terms of the insured-insurer relationship.

58. 71 Ill. 2d at 214, 375 N.E.2d at 117.

59. 237 Iowa 1391, 25 N.W.2d 312 (1946).

60. In *Rursch*, the insured brought an action against the tortfeasor and the tortfeasor requested assignment of error in allowing the action because the insured had been indemnified by its insurer for part of the damages. The court held for the tortfeasor, seeing the insurer's payment as an assignment to the insurer of the rights of the insured against the tortfeasor responsible for the loss. *Id.* at 1396-97, 25 N.W.2d at 315.

61. *Id.* at 1397, 25 N.W.2d at 315.

62. 82 Vt. 390, 73 A. 1073 (1909).

63. *Id.* at 396-97, 73 A. at 1075.

64. 42 Ill. App. 138 (1891).

In *Emmons*, the insured executed a release to the tortfeasor when the railroad tortfeasor expressly stated that it would settle with the insurance company after the insurance company had paid its insured.⁶⁵ The *Emmons* court recognized the equitable origin of subrogation,⁶⁶ viewed the insured as a trustee in equity of the insurance company upon collection of payment,⁶⁷ and declared the release to the tortfeasor void.⁶⁸ It was the tortfeasor's *knowledge* of the insurance payments that rendered the release void,⁶⁹ not the tortfeasor's promises to settle with the insured. Because of its promises, the court held that the tortfeasor was also estopped from asserting the release as a defense.⁷⁰ The *Andersen* court and its offspring failed to consider this distinction and circumvented *Emmons* on artificial grounds.⁷¹ Fortunately for Illinois insurance carriers, the Illinois Supreme Court exhibited a greater depth of judicial analysis than its appellate predecessors.

IMPACT OF *HERTZ* ON ILLINOIS INSURANCE LAW

Hertz establishes a welcome new precedent for Illinois insurance carriers. Its impact will be felt most significantly by insurance companies in their relationships with their policyholders and tortfeasors.⁷² *Hertz* also provides a sound foundation from which Illinois courts in the future may develop a more enlightened and sophisticated approach to subrogation as more complex situations are presented.

The Illinois Supreme Court is to be applauded for its judicious observation of the practical ills embraced by the old rule. Under the pre-*Hertz* rule, the tortfeasor was permitted to escape liability for, and thus payment of, the amount of insurer's indemnification.⁷³ The insured tort victim was, there-

65. *Id.* at 148. The tortfeasor's insurance adjustor told the injured insured that he should get his insurance money and that the tortfeasor's carrier would give him the balance. When *Emmons* (the insured) asked the adjustor if that was the way business was done, the adjustor said, "Yes; you settle with the insurance company and we will settle with them." *Id.*

66. *Id.* at 146-47.

67. *Id.* at 146.

68. *Id.* at 147.

69. *Id.* at 148.

70. *Id.* at 148-49. The court stated clearly:

We hold besides the natural equity which prevents the insured to satisfy the claim in full as against the insurer where he has notice of the payment of the loss by the insurer, . . . the appellant is [also] estopped from taking a satisfaction piece of the insured so as to defeat the claim of the insurance company.

Id.

71. *Inter Ins. Exch. of Chicago Motor Club v. Andersen*, 331 Ill. App. 250, 258, 73 N.E.2d at 12, 16 (1947). The *Andersen* court spuriously dismissed *Emmons* as being distinguishable from the *Andersen* facts. See note 1 *supra*. The court's total treatment of the case is the following statement: "In the *Emmons* case, suit was against the wrongdoer who had made an oral agreement to pay the insurer and not the insured." *Id.*

72. See note 14 *supra*.

73. 71 Ill. 2d at 214, 375 N.E.2d at 117.

fore, not compensated for the amounts paid by the insurer.⁷⁴ Although his suffering was a result of the tortfeasor's actions, the tort victim who executed a release was compelled to reimburse the insurer out of his own pocket.⁷⁵ As a result, the insurer was forced to sue its own insured in order to be paid.⁷⁶ Finally, the chicanery of sharp practice and dishonesty was made readily available to the shrewd tortfeasor or his carrier.⁷⁷

Hertz sweeps away the dust of *Andersen* and offers Illinois insurance carriers a clean and well defined rule by which to be guided in their dealings. The result is a carrier who feels secure that upon its dispatch of notice to the tortfeasor of its subrogated claims, the insurer has perfected its subrogation interest.⁷⁸ An insurer who is unhampered by lingering worries as to what its insured is doing unbeknownst to the company will be more generous to its insured. It will indemnify without restraint, safe in the knowledge that the delicate insured-insurer relationship is not in jeopardy. Preservation of this most important insured-insurer relationship is the most vital effect of *Hertz*.

Hertz also represents a welcome invitation to Illinois courts to develop this area of law along enlightened guidelines that are faithful to the essential nature of subrogation.⁷⁹ In Illinois' first post-*Hertz* decision, *Country Mutual Insurance Co. v. Transit Casualty Co.*,⁸⁰ the Third District applied *Hertz* approvingly.⁸¹ Equipped with the authority of *Hertz's* recognition of the general rule, the *Country Mutual* court articulated the equitable cornerstone of the rule more concisely:

[T]he mainstream of authority holds that once a subrogee has notified a third party alleged to be responsible for the damage to the property or person of the insured, a subsequent release executed by the subrogor in favor of that third party will not bar enforcement of the subrogee's interest. . . . *The keystone to such holdings seems to be the perfection of the subrogee's interest by notification given to the tortfeasor of the existence of a subrogation claim prior to execution of a release.*⁸²

Thus, it is clear that Illinois courts now correctly recognize the equitable backbone of the doctrine of subrogation. It remains for future decisions to shape Illinois policy regarding sufficiency of notice⁸³ and to articulate a precise functional interpretation of the doctrine of subrogation.⁸⁴ The indica-

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.*

78. See note 33 *supra*. See also note 14 *supra*.

79. See note 33 *supra*.

80. 59 Ill. App. 3d 283, 375 N.E.2d 575 (3d Dist. 1978).

81. 59 Ill. App. 3d at 285, 375 N.E.2d at 577.

82. *Id.* (emphasis added).

83. See note 9 *supra*.

84. See note 33 *supra*.

tion from *Hertz* and its earliest progeny, *Country Mutual*, is that Illinois opinions will treat subrogation as operating by law immediately upon indemnification by the insurer to the insured. Thus, a knowledgeable tortfeasor's procurement of a release will be treated as fraud.

CONCLUSION

The increasing importance of insurance in modern tort litigation mandates judicial attention to the delicate insurer-insured relationship. While protection of the insurer's subrogation rights remains the paramount concern of courts, it is encouraging to see that in *Hertz* the Illinois Supreme Court also took judicial notice of the practical realities of the typical insured-insurer-tortfeasor arrangement. Illinois appellate courts had delineated a rule which safeguarded the insurer's rights at the expense of an injured relation with its own insured. *Hertz* reflects the sound reasoning of a commercially sensitive judiciary, and the beneficial result is the preservation of the reciprocal trust which is necessary between an insurer and its client.

Gwen Veronica Carroll

