Nebraska Law Review

Volume 59 | Issue 3 Article 8

1980

Medical Payment Subrogation and the Tort-Feasor's Waiver of the Settlement Defense: Unanswered Questions in Nebraska: *State Automobile and Casualty Underwriters v. Farmers Insurance Exchange*, 204 Neb. 414, 282 N.W.2d 601 (1979)

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Note

Medical Payment Subrogation and the Tort-Feasor's Waiver of the Settlement Defense: Unanswered Questions in Nebraska

State Automobile and Casualty Underwriters v. Farmers Insurance Exchange, 204 Neb. 414, 282 N.W.2d 601 (1979).

I. INTRODUCTION

At first glance, *State Automobile and Casualty Underwriters v. Farmers Insurance Exchange*,[1] appears to be a routine pleading case wherein the plaintiff's attempt to enforce its subrogation claim was dismissed because of its failure to allege the necessary array of facts comprising its cause of action. An examination of the case's history, however, reveals a discrepancy between the proposition advanced by the plaintiff and the basis upon which the case was decided. In fact, it appears that although the plaintiff argued the case under one theory, the court used another with which to dispose of it, thereby refraining from answering any of the substantive subrogation questions presented. When scrutinized, this anomaly illustrates some of the subtleties of contemporary subrogation law and explains why *State Auto* left unanswered the questions of (1) whether an insurer may enforce its subrogation claim against a tort-feasor notwithstanding the effectuation of a settlement between the insured and the tort-feasor when the insurer has previously paid part of the insured's loss and the tort-feasor had notice thereof at the time of the settlement; and (2) whether medical payment subrogation is valid in Nebraska.

1. 204 Neb. 414, 282 N.W.2d 601 (1979).

II. FACTS

On December 22, 1977, the plaintiff, State Auto, filed suit against defendants Clayton Kline and Farmers Insurance Exchange[2] in the District Court of Douglas County. The plaintiff alleged that on June 28, 1974, Kurt Kardell, the plaintiff's insured, sustained property damage and personal injuries when the car he was driving was struck from the rear by a car driven by Kline.[3] State Auto further alleged that it paid Kardell a total of $7,225.89 pursuant to the terms of his insurance policy and notified Kline and Farmers, Kline's insurer "under a policy of insurance applicable to the [a]ccident,"[4] of its subrogation rights under the policy.[5] The plaintiff finally averred that defendant Farmers, after notifying State Auto of its refusal to honor medical payment subrogation, made a payment of $10,303.16 to Kardell in settlement of the insured's claims against Kline arising out of the accident.[6] After this and two substantially similar petitions[7] were dismissed upon demurrer at trial, State Auto elected to stand upon its second amended petition and appealed to the Nebraska Supreme Court.[8]

III. THE SUBSTANTIVE INSURANCE ISSUE

Attempts by plaintiff insurance carriers to recover payments made to their insureds from tort-feasors and their insurers when the tort-feasors' insurers have settled with the plaintiff's insured in

2. Actually, the plaintiff originally joined its insured, Kardell, as a party defendant. However, its second amended petition joined only Kline and Farmers so the case on appeal involved only those two defendants. Record at 67, State Auto and Cas. Underwriters v. Farmers Ins. Exch., 204 Neb. 414, 282 N.W.2d 601 (1979).
3. *Id.* at 2.
4. *Id.* at 3.
5. The subrogation clause provided:
   > SUBROGATION. In the event of any payment under Coverage C-1 of this policy, the company shall be subrogated to the rights of recovery therefor which the insured person or anyone receiving such payment may have against any person or organization and such person shall execute and deliver instruments and papers and do whatever else is necessary to secure such rights. Such persons shall do nothing after loss to prejudice such rights.

   Id. at 68.
6. *Id.* at 3-4.
7. The plaintiff's first amended petition added the allegation that its payments to Kardell completely satisfied his claim for medical expenses and loss of income. Record at 34. It also featured an altered *ad damnum* clause which prayed for recovery only against Farmers (the original petition sought recovery from both defendants). *Id.* at 35. The plaintiff's second amended petition deleted the allegation that its payment had fully satisfied Kardell's claim for medical expenses and loss of income. *Id.* at 68.
8. *Id.* at 91.

disregard of the plaintiff's subrogation claim have spawned litigation since the turn of the century. While most courts have enforced the plaintiffs' otherwise valid subrogation claim in these instances, they have done so only after addressing numerous defenses interposed by the defendants, most relating in some way to the settlement.[9] Courts willing to enforce the subrogation interest

9. *See, e.g.*, Collins v. Mobile & Ohio R.R. Co., 210 Ala. 234, 97 So. 631 (1923) (a settlement with the insured was no defense when made with knowledge of an insurance adjustment and with knowledge of a statute expressly allowing the assignment of such claims); Vigilant Ins. Co. v. Bowman, 128 Ga. App. 872, 198 S.E.2d 346 (1973) (a general release executed by the insured had no adverse effect upon the insurer's subrogation claim when the insurer was without knowledge of the release and the tort-feasor's insurer had actual knowledge of the subrogation claim at the time of settlement); Home Ins. Co. v. Hertz Corp., 71 Ill. 2d 210, 375 N.E.2d 115 (1978) (a general release running from the insured to the tort-feasor and his insurance carrier does not bar a subsequent subrogation action if the release was effected with knowledge of the insurer-subrogee's interest); Pennsylvania Fire Ins. Co. v. Harrison, 94 So. 2d 92 (La. App. 1957) (payment to the insured for the amount of loss in excess of his insurance does not defeat the insurer's subrogation claim when done with full knowledge that the insured had settled previously with his insurance company); Cleaveland v. Chesapeake & Potomac Tel. Co., 225 Md. 47, 169 A.2d 446 (1961) (tort-feasor could not claim the benefit of a release when it was on notice that the release purported to extinguish the claim of a non-party subrogee); Wolverine Ins. Co. v. Klomparens, 273 Mich. 493, 263 N.W. 729 (1935) (by a settlement made with full knowledge, the tort-feasor was held to have acquiesced in the splitting of the causes of action which were thus no bar to the plaintiff's recovery); Travelers Indem. Co. v. Vaccari, 310 Minn. 97, 245 N.W.2d 844 (1976) (the tort-feasor waives his right to invoke the rule against splitting a single cause of action where he has notice of the insurer's subrogation claim prior to settling with the insured); Employers Mut. Cas. Co. v. Meggs, 229 So. 2d 823 (Miss. 1969) (dismissal of insurer's claim was error when the tort-feasor had notice of the insurer's rights at the time of settlement); United States Fidelity & Guar. Co. v. Raton Nat. Gas Co., 86 N.M. 160, 521 P.2d 122 (1974) (where the tort-feasor entered into the settlement with full knowledge of the insurer's subrogation claim, the insurer's rights cannot be defeated by legal proceedings between the tort-feasor and the insured); Kozlowski v. Briggs Leasing Corp., 96 Misc. 2d 337, 408 N.Y.S.2d 1001 (1978) (an attempted destruction or derogation of an insurer's subrogation claim will not have its intended effect where the tort-feasor had, or through reasonable inquiry should have had, notice of the subrogation rights); Nationwide Mut. Ins. Co. v. Canada Dry Bottling Co., 268 N.C. 503, 151 S.E.2d 14 (1966) (consent judgement obtained by insured will not bar an insurer's right of action against the tort-feasor when the tort-feasor made the settlement with knowledge of the insurer's subrogation claim); Hartford Acc. & Indem. Co. v. Elliott, 32 Ohio App. 2d 281, 290 N.E.2d 919 (1972) (a tort-feasor who settled with full awareness of the subrogation interest is liable to the subrogee for the amount paid by such subrogee); Hospital Serv. Corp. v. Pennsylvania Ins. Co., 101 R.I. 708, 227 A.2d 105 (1967) (release procured by a tort-feasor aware of the subrogation claim constitutes no defense to a subsequent action by the insurer to enforce that claim); Southern Pac. Transp. Co. v. State Farm Mut. Ins. Co., 480 S.W.2d 59 (Tex. Civ. App. 1972) (tort-feasor who has been made aware of the insurer's subrogation interest cannot destroy that claim by en-

usually do so in the following manner: they acknowledge at the outset the fundamental tenet that the rights of a subrogor can rise no higher than the rights of its subrogee as against a third party.[10] They also recognize that the insurer's subrogation rights will generally abate to the extent that the settlement and general release executed between insured and tort-feasor extinguishes the insured's claim.[11] Thus, settlement is ordinarily a bar to the subrogor's claim against the tort-feasor and his or her insurer.[12] In a related vein, most courts agree that enforcement of the subrogation interest would impermissibly split the insured's original cause of action.[13]

However, courts often remain willing to enforce the subrogation claim when the settlement was effectuated by the tort-feasor in disregard of the subrogation interest. Enforcement of the claim is proper, the reasoning goes, because by settling with notice of the subrogation interest, the tort-feasor and his or her insurer are deemed to have waived the right to raise the settlement as a defense.[14] Likewise, by disregarding the insurer's interest, the tort-feasor is considered to have consented to a splitting of the cause of action.[15]

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tering into a settlement with and obtaining a release from the company's insured); Transamerica Ins. Co. v. Barnes, 29 Utah 2d 101, 505 P.2d 783 (1972) (if the settlement was made with knowledge, actual or constructive, of the subrogation claim, it is a fraud upon the insurer and will not affect the subrogation right); Lizotte v. Lizotte, 15 Wash. App. 622, 551 P.2d 137 (1976) (an insured's release of a wrongdoer from liability cannot defeat the insurer's rights when the wrongdoer had knowledge of the subrogation right).

10. *E.g.*, Stetina v. State Farm Mut. Auto. Ins. Co., 196 Neb. 441, 446, 243 N.W.2d 341, 344 (1976).
11. *See generally* Annot., 92 A.L.R.2d 102, 106 (1963).
12. 6A J. APPLEMAN, INSURANCE LAW AND PRACTICE § 4092 (rev. ed. 1972).
13. Because the rule against splitting a cause of action is a facet of res judicata and is designed to avoid a multiplicity of law suits, giving a settlement short of judgment the effect of res judicata means that the plaintiff cannot litigate a claim which was subsumed in the earlier settlement. *See* C. CLARK, HANDBOOK OF THE LAW OF CODE PLEADING, 472 (2d ed. 1947).
14. In Cleaveland v. Chesepeake & Potomac Tel. Co., 225 M.D. 47, 169 A.2d 446 (1960) it was observed:

> The cases and text writers generally take the position that where third parties, who may be liable to an insured for a loss, effect a settlement with the latter and obtain a release from all liability with knowledge of the fact that an insurer has already paid the amount of its liability to an insured, the settlement and release will not bar the assertion of the insurer's right of subrogation.

Id. at 51, 169 A.2d at 448.

15. Travelers Indem. Co. v. Vaccari, 310 Minn. 97, 245 N.W.2d 844 (1976) illustrates the typical response to the tort-feasor's defense that a cause of action should not be split:

> Since one of the principal reasons for the rule against splitting actions is to protect a defendant from unnecessary litigation and cost,

This analysis presupposes the viability of the subrogation interest. When the subrogation claim relates to medical payments, some jurisdictions reach the opposite result and hold that the subrogation clause runs afoul of the common law rule prohibiting assignment of personal injury claims.[16] By distinguishing assignment from subrogation, however, most courts have enforced the medical payment subrogation clause.[17]

The reasoning of one case which State Auto used to support its claim for subrogation is atypical of the reasoning employed by courts which choose to enforce the medical payment subrogation clause despite a settlement with notice. In *Travelers Indemnity Co. v. Vaccari*,[18] the plaintiff insurer paid the insured for certain medical expenses and informed the defendant tort-feasor and his insurer of the insurer's subrogation claim. The defendants paid the insured $10,000 and obtained a general release from her. In the suit by the insured's subrogee to enforce its claim against the tort-feasor and its insurance company, the court was called upon to consider the effect of the settlement on the subrogee's right of recovery. Holding that the insurer's claim was enforceable, the court

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the defendant waives this protection if, with notice of an insurer's claim, he voluntarily enters into a separate settlement with the insured. We also note that some courts have simply held that the rule against splitting a cause of action does not apply to an insurer's subrogation interest.

Id. at 101, 245 N.W.2d at 847. *See also* CLARK, *supra* note 13, at 479.

16. Most jurisdictions hold that personal injury claims cannot be assigned absent statutory authorization. Annot., 40 A.L.R.2d 500 (1955); *see also* W. PROSSER, HANDBOOK ON THE LAW OF TORTS 619 (4th ed. 1971). Some courts have found medical payment subrogation clauses to be violative of this common law rule. *See* Allstate Ins. Co. v. Druke, 118 Ariz. 301, 576 P.2d 489 (1978); Peller v. Liberty Mut. Fire Ins. Co., 220 Cal. App.2d 610, 34 Cal. Rptr. 41 (1963); Travelers Indem. Co. v. Chumbley, 394 S.W.2d 418 (Mo. App. 1965).

17. The basis for distinguishing subrogation from assignment is generally said to be that subrogation arises from a pre-existing duty to compensate the injured party, whereas assignment involves a transfer of the claim after the fact. The danger of champerty or inciting the entrance of officious intermeddlers is not enhanced by allowing subrogation. *See, e.g.*, DeCespedes v. Prudence Mut. Cas. Co., 193 So. 2d 224 (Fla. App. 1966), Annot., 19 A.L.R. 3d 1054 (1968).

18. 10 Minn. 97, 245 N.W.2d 844 (1976). Another case relied upon by State Auto is significant in that it relied heavily upon policy considerations, finding the ramifications of a refusal to enforce the clause repugnant:

> In short, adoption of . . . [a rule allowing the insurer recourse only against its own insured] would (1) permit the tortfeasor to escape liability for the amounts paid by the insurer, (2) require the tort victim to go uncompensated as to the amounts paid by the insurer even though he has paid insurance premiums and has also suffered loss at the hands of the tortfeasor defendant, (3) force the insurer to sue his own injured insured, and (4) place a premium on sharp practice and dishonesty.

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

dismissed arguments that enforcement of the interest would constitute an invalid assignment of a personal injury claim[19] and impermissibly split the insured's cause of action.[20] Finding these objections were outweighed by the equitable consideration that as between wrongdoer and insurer, the former should be made to pay,[21] the court evaluated the effect of the settlement as follows:

> To hold that such a settlement destroys an insurer's subrogation rights would have the practical effect of encouraging a tortfeasor or his liability insurer to disregard notice of an insurer's valid subrogation claim and attempt to procure a general release from the insured. We believe that the tortfeasor and his liability insurer have a duty to act in good faith under such circumstances. Therefore we hold that where a tortfeasor and his liability insurer willfully disregard notice of the subrogation claim of the insured person's insurer and enter into a separate settlement with the insured person, such a settlement does not defeat his insurer's subrogation right.[22]

In ruling that the settlement was no bar to the enforcement of the insurer's subrogation claim, the court in *Vaccari* analyzed the tort-feasor's procurement of the release with knowledge of the subrogee's interest in terms of fraud,[23] as numerous other courts had done. Viewed as a fraud upon the insurer, the settlement or release was voided as a defense against the insurer. Regardless of whether the tort-feasor's act is analyzed in terms of fraud or waiver, the result is largely the same: the insurer is allowed to pursue its right of subrogation despite the settlement.

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19. *See* note 17 *supra*.
20. *See* note 15 *supra*.
21. A strong undercurrent manifested in many of the cases, equitable balancing, is typified by the oft-quoted statement that
    > a wrongdoer who is legally responsible for harm should not receive the windfall of being absolved from liability because the insured had had the foresight to obtain, and had paid the expense of procuring, insurance for his protection; since the insured has already been paid for his harm, the liability of the third person should now inure for the benefit of the insurer.

    16 G. COUCH, CYCLOPEDIA OF INSURANCE LAW § 61:18 (2d ed. 1966) (footnote omitted).
22. 310 Minn. at 103, 245 N.W.2d at 848.
23. The term "fraud" has crept into a number of opinions discussing the effect of settlement on the insurer's right of subrogation. *See, e.g.*, Sentry Ins. Co. v. Stuart, 246 Ark. 680, 686, 439 S.W.2d 797, 800 (1969); Home Ins. Co. v. Hertz Corp., 71 Ill. App. 2d 210, 215, 375 N.E.2d 115, 118 (1978); Cleaveland v. Chesapeake & Potomac Tel. Co., 225 Md. 47, 51, 169 A.2d 446, 448 (1960); Wolverine Ins. Co. v. Klomparens, 273 Mich. 493, 496, 263 N.W. 724, 725 (1935); Hospital Serv. Corp. v. Pennsylvania Ins. Co., 101 R.I. 708, 718, 227 A.2d 105, 112 (1967); Transamerica Ins. Co. v. Barnes, 29 Utah 2d 101, 106, 505 P.2d 783, 787 (1972).

    As "fraud" is a generic term, susceptible of several meanings, it is arguably preferable in the interest of clarity to characterize the tort-feasor's action as a waiver. In fact, State Auto's failure to recover in this action derives in part from its interpretation of "fraud" as the term was used in *Vaccari*.

Nebraska's position regarding these issues is not entirely clear.[24] *Omaha & Republication Valley Railway v. Granite State Fire Insurance Co.*,[25] is widely cited for the proposition that a settlement with notice of the insurer-subrogee's interest affords the tort-feasor no defense in a subsequent action by the insurer. Indeed, the case may represent good authority for that position[26]although it has a stronger factual basis for compelling such a result than most courts enjoy when addressing the issue.[27] *Granite State* did not concern medical payment subrogation, however,

24. Elsewhere in the subrogation context, the Nebraska Supreme Court has held that absent other factors, when the payment by the insurer covers only a portion of the damages the insured retains the right of action for the entire amount, reasoning that "the wrongful act was single and indivisible, and gives rise to but one liability. *Upon this theory the splitting of causes of action is avoided and the wrongdoer is not subjected to a multiplicity of suits.*" Krause v. State Farm Mutual Auto Ins. Co., 184 Neb. 588, 593, 169 N.W.2d 601, 604 (1969) (emphasis by the court) (citation omitted).

Regarding the possible effect of Nebraska's real party in interest statute (NEB. REV. STAT. § 25-301 (Reissue 1977)) upon an action by the subrogee, Schmidt v. Henke, 192 Neb. 408, 222 N.W.2d 114 (1974) seems to establish only that the use of a loan receipt agreement effectively preserves the entire cause of action in the insured for purposes of the statute. When a subrogation clause is involved, Jelinek v. Nebraska Natural Gas Co., 196 Neb. 488, 243 N.W.2d 778 (1976), holds that an insurer becomes the only real party in interest after it pays its insured for the full amount of the loss.

25. 53 Neb. 514, 73 N.W. 950 (1898). In *Granite State* the insured brought suit against the tort-feasor "alledging the loss of his property through its negligence, its value as $3,900, and the insurance and payment to him of $1,000 by the insurance company, and prayed damages for $2,900." *Id.* at 518, 73 N.W. at 950. The tort-feasor's answer alleged that because the $1,000 had been assigned to the insurer and the remainder to another party, the insured was no longer a real party in interest. At this point the tort-feasor chose to abandon its assignment defense and settled with the insured. A verdict was returned and a judgment entered upon the settlement for $1,750. When the insurer subsequently brought an action to recover its $1,000 claim, the tort-feasor pleaded the settlement as a defense even though it had initially asserted this very assignment to the insurer as a defense in the insured's previous action.

26. In *Granite State*, the court offered the following observations about the tortfeasor's position in these instances:

> Knowing as it [the tort-feasor] then knew, of the rights of the insurance company, it is not protected, by that voluntary payment of . . . [the insured's] claim, against a valid claim of the insurance company not included in that settlement. Its action was equivalent to express consent to a splitting of the cause of action, and it can claim no estoppel against the insurance company because it acted with full knowledge of its rights and of its intention to assert them.

Id. at 519-20, 73 N.W. at 951.

27. In *Granite State*, the tort-feasor not only settled the preceding suit by the insured with notice of the insurer's claim, but it defended that suit by alleging that the insured was not a real party in interest by virtue of its assignments of the claim to the insurer and another party. In addition, the tort-feasor had consented to judgment upon the settlement in the prior action rendering the issue of fault res judicata. *See* note 25 *supra*.

and no Nebraska case appears to have addressed the issue of whether state courts will enforce medical payment subrogation clauses.

IV. THE PLAINTIFF'S THEORY

Although State Auto had ample authority for the proposition that an insurer is not barred from enforcing its subrogation interest against a tort-feasor who has knowingly settled with and obtained a release from an insured in disregard of the subrogee's claim, State Auto took the position that the cases which spoke in terms of fraud as a means of avoiding the settlement stood for something more. While its appellate brief was not entirely clear on this point,[28] State Auto seems to have posited that these cases established a cause of action in tort arising directly out of the tort-feasor's and its insurer's act of obtaining the release in disregard of the insurer's subrogation claim.[29] As this cause of action was in-

28. Taken alone, State Auto's appellate brief is particularly equivocal in its explanation of its theory of recovery. For example, at one point it states that "[b]ecause this settlement estops the tortfeasor from raising the splitting a cause of action defense, the insurer's cause of action is not barred." Brief for Appellant at 8, State Auto. and Cas. Underwriters v. Farmers Ins. Exch., 204 Neb. 414, 282 N.W.2d 601 (1979). Such a statement clearly implies that reliance was being placed upon the insured's original claim. The argument that a cause of action should not be split was inapposite if State Auto's claim was independent of any claims its insured might have had against the tort-feasor. On the other hand, State Auto's brief is not devoid of expression consistent only with a cause of action independent of the subrogation interest. Its analogy to *Granite State* is instructive in this regard:

> While the . . . [tort-feasor] might have admitted liability in consenting to the entry against it in the earlier case and neither Kline nor Farmers admitted liability in settling this action, there is no difference in the effect on the legal relation of the insurer and the tortfeasor or tortfeasor's insurer. In both instances, the tortfeasor knew of an insurer's subrogation interest before obtaining a release of all claims, whether by consent judgment or settlement, from the insured.

Id. at 9.

To the extent that the plaintiff contended that the tort-feasor's original liability was of no consequence, it necessarily repudiated subrogation as the basis for the present action. Nevertheless, no clear articulation of State Auto's theory appears on record until its motion for rehearing where it argued: "This is not a case of subrogation grounded in rights of subrogation arising out of a negligence cause of action. It is a constructive fraud action which does not require that State Auto plead or prove facts constituting negligence in order to maintain its action against the defendants." Motion for Rehearing at 3, State Auto. and Cas. Underwriters v. Farmers Ins. Exch., 204 Neb. 414, 282 N.W.2d 601 (1979).

29. Both parties chose to call the asserted tort "fraud," apparently because of the use of that term by the authorities enlisted in support of State Auto's position. Motion for Rehearing at 4, n.2, Brief for Appellee at 25; *see* note 12 & accompanying text *supra*. Although the parameters of such an action are, of

dependent of any claims which its insured may originally have had against the tort-feasor, it was not extinguished by the settlement as was the claim of its insured. Instead, it developed as a direct result of the settlement due to the tort-feasor's so-called fraudulent conduct. Under this line of reasoning, any fault which might have initially rendered the tort-feasor liable to the insured was irrelevant to the insurer's claim and thus did not constitute an element of its cause of action.[30] Accordingly, the plaintiff's petition made no pretense of alleging Kline's negligence. Consistent with this theory of relief, State Auto joined both Kline and Farmers as parties defendant, presumably considering them joint tort-feasors as both had knowledge of the subrogee's interest prior to the settlement.[31]

It is safe to say that this position actually represented an extension of existing precedent from Nebraska and every other jurisdiction.[32] While many cases, including *Vaccari*, have mentioned

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course, as of yet undefined, State Auto identified four elements which it considered the basis of its claim: (1) the tort-feasor injures the insured; (2) the insurer pays the insured; (3) the insurer notifies the tort-feasor of its subrogation rights accruing from such payment; and (4) the tort-feasor settles with the insured for a general release in disregard of the insurer's rights. Brief for Appellant at 7-8. Given these elements, no compelling reason for denominating such an action as "fraud" are apparent. The tort, if recognized, would be one with characteristics unique to the law of subrogation. It need not even be an intentional tort. *Cf.* National Ins. Underwriters v. Piper Aircraft Corp., 595 F.2d 546 (10th Cir. 1979) (discussing a similar action in terms of negligence).

30. Brief for Appellant at 9. *See* note 29 *supra*.

31. Direct actions against liability insurance carriers *qua* liability insurers are not allowed in Nebraska. Royal Indem. Co. v. Aetna Cas. & Sur. Co., 193 Neb. 752, 765, 229 N.W.2d 183, 190 (1975). This is precisely what State Auto was attempting to do by suing Farmer's to enforce its subrogation claim. Unless one is willing to assume that the plaintiff was unaware of Nebraska law on that question, a brave supposition to make about an insurance company doing business in Nebraska, the joinder of Farmers is a further indication that the plaintiff's claim was distinct from its subrogation interest.

32. While State Auto's claim has yet to gain judicial approval, it is not an entirely novel contention, a similar argument apparently having been posed in National Ins. Underwriters v. Piper Aircraft Corp., 595 F.2d 546 (10th Cir. 1979) where it was observed:

> The Colorado courts have not addressed the question of whether the failure to protect a known subrogation interest would support an action for negligence. In fact, we are unable to find any state which has allowed such an action. The courts hold instead that where a release obtained from the insurer with knowledge that the latter has already been indemnified by the insurer, such release does not necessarily bar the right of subrogation of the insurer. . . . This is the typical solution, and apparently the only "remedy" afforded in such a situation. It is one thing to hold that the release executed under such circumstances is invalid as to the insurer, but quite another to rule that a breach of its "duty" to protect a subrogation interest would support an action for negligence. The Colorado courts have not gone

fraud as a basis for their holding, the term has never been used to signify a distinct cause of action. It is used as a means of voiding the settlement as a defense.[33] Even so, the plaintiff's argument was premised upon a plausible interpretation of existing cases[34] and may well have been commended by sound policy considerations.[35] In essence though, the Nebraska Supreme Court was being asked to take a step beyond the bounds of existing authority by making an adjudication of fraud, not merely as a device with which to void any defenses otherwise available to the tort-feasor, but as an independent basis of affirmative relief.

V. DISPOSITION OF THE CASE

By sustaining a demurrer to State Auto's original petition, the District Court clearly passed upon the merits of the plaintiff's theory. Apparently considering that the action pursued by State Auto was unsupported by Nebraska precedent, the court dismissed, noting:

> It is the court's opinion that plaintiff's only recourse is against its own insured and that notice to a tort-feasor or his insurance carrier cannot give rise to a cause of action or an estoppel since no duty exists for said parties to protect anything and that notice in and of itself does not give rise to an action for fraud.[36]

Distinguishing *Granite State* because "the insurance company in that case waived its right to a valid defense by consenting to judgment,"[37] the trial court found *Schmidt v. Henke*,[38] another Ne-

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so far as to allow such a negligence action. Also there is no support from other jurisdictions for such a result, and we must hold that there would be no such cause of action provided in the Colorado courts.

Id. at 551 (citations omitted).

33. *See* note 24 & accompanying text *supra*.
34. Since Minnesota, like Nebraska, proscribes direct actions against liability insurers, *see* note 31 *supra*, the fact that the court in *Vaccari* granted recovery directly against the tort-feasor's liability insurer, the insurer having been joined as a co-defendant, is supportive of the plaintiff's interpretation of that case.
35. For example, State Auto argued that in instances where a settlement had already been effectuated, it would be self-defeating to require that the issue of negligence later be litigated between insurers. "This obviously results in multiplicity and increased complexity of actions no matter how clear the tort feasor's liability which, in cases such as this, has resulted in a settlement rather than litigation between the parties to the accident." Motion for Rehearing at 3-4.
36. Record at 29.
37. *Id.* at 30.
38. 192 Neb. 408, 222 N.W.2d 114 (1974). The case is probably distinguishable in that it involved the execution of a loan receipt instead of the use of a subrogation clause. When given legal effect by courts, loan receipts operate in a much different manner than subrogation, being designed to keep the entire

braska insurance case, controlling.[39]

After having two amended petitions dismissed upon demurrer[40] State Auto appealed but fared no better before the Nebraska Supreme Court. The court affirmed the trial court's judgment, agreeing that the plaintiff had failed to "state a cause of action on the merits under any theory against either or both defendants."[41] However, the means by which the Nebraska Supreme Court reached this conclusion bore no semblance to the lower court's reasoning since the appellate court completely abstained from addressing the substantive issues. Instead, the court shifted its focus to the plaintiff's second amended petition and affirmed strictly on the basis of that pleading.

By re-examining the plaintiff's petition and finding it wanting, the court appeared oblivious to the theory of relief actually propounded by State Auto. Instead, it chose to measure the sufficiency of the plaintiff's petition under the assumption that State Auto actually sought to enforce its subrogation claim and accordingly proceeded to "identify the actionable facts necessary to plead a cause of action to enforce rights of subrogation."[42] Because the tort-feasor's negligence would have been crucial to such a subrogation claim, the court naturally found the plaintiff's petition fatally defective.[43] Throughout the course of the opinion, no direct reference was made to any theory resembling the action which had been advocated by State Auto.

VI. THE COURT'S ACTION

As a preliminary matter, it is not clear whether the court actually understood the nature of the plaintiff's theory. While the pro-

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cause of action in the insured. *Schmidt* merely seems to recognize the validity of this device in Nebraska.

39. Record at 30.

40. *Id.* at 66, 87. Both amendments involved only minor changes in the plaintiff's petition. *See* note 7 *supra.*

41. 204 Neb. at 418, 282 N.W.2d at 604.

42. *Id.* at 416, 282 N.W.2d at 603.

43. The court found three things objectionable about the plaintiff's petition:

> [T]he petition alleges no facts supporting a cause of action for negligence on behalf of its insured Kardell against either defendant; it does not allege in any way that Farmers had issued to the apparent tort-feasor, Kline, a policy of *liability* insurance; and, finally, the prayer of the petition is only against Farmers.

Id. at 415, 282 N.W.2d at 603 (emphasis by the court). Since the omission of a prayer for relief is not demurrable in Nebraska, Majerus v. Santo, 143 Neb. 774, 10 N.W.2d 608 (1943), the only basis for dismissal as against Kline apparently was the failure to allege negligence. With regard to Farmers, the court appears to have dismissed primarily because of the absence of a direct action statute in Nebraska. 204 Neb. at 417, 282 N.W.2d at 604. *See* note 31 *supra.*

priety of the court's mode of decision is questionable if it was cognizant of State Auto's claim, as some indications suggest,[44] it is equally possible that the court was never adequately apprised of the plaintiff's position,[45] in which case the onus of the communication failure rightfully devolved upon State Auto as the moving party. In either event, the substantive questions which were put at issue by State Auto's claim were left unresolved by the court's adjudication.

Two subrogation issues which might otherwise have been presented on the facts of *State Auto*, therefore, remain unsettled in Nebraska. On the one hand, some uncertainty must reign as to whether the court will follow other jurisdictions in holding that an insurer is not barred from enforcing its subrogation claim against a tort-feasor who has settled with the insured in disregard of the subrogation interest despite the tort-feasor's knowledge of such an interest.[46] On the other hand, the viability of medical payment subrogation in Nebraska also remains in doubt after *State Auto*.

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44. For example, State Auto's brief did explicitly enumerate the elements which the plaintiff considered necessary to its cause of action. *See* note 29 *supra*. Also, the trial court's observation that "notice in and of itself does not give rise to an action for fraud," Record at 29, suggests that a cause of action existing apart from State Auto's subrogation claim was contemplated below. Finally, the court seems to have been apprised of the nature of the plaintiff's claim at oral argument as indicated by the plaintiff's motion for rehearing where it was asserted:

> This Court, contrary to its assertion that '[i]t is only through assumption and elimination of alternatives that we are able to determine that State Auto's alleged right of subrogation is founded in tort,' asked at oral argument State Auto's theory of recovery and was clearly told that it was a fraud theory.

Motion for Rehearing and Brief in Support Thereof at 3 n.1.

45. Indeed, by placing any amount of reliance upon the plaintiff's appellate brief, as it was certainly justified in doing, the court may well have concluded that State Auto was arguing for nothing more than the proposition that the tort-feasor had waived his defense by settling with knowledge. The language employed by the brief implied as much in several instances. *See, e.g.*, note 28 *supra*.

An inference that State Auto's cause of action was misperceived may also be drawn from speculation in the supreme court's opinion that State Auto might have been "claiming some sort of contract or estoppel theory." 204 Neb. at 417, 282 N.W.2d at 604. Such a theory, as discussed and ultimately rejected by the court, bore only an attenuated relationship to the plaintiff's argument since the court was referring to the situation where the tort-feasor's insurance company assures the plaintiff that it will honor the subrogation claim and then pleads the statute of limitations after the plaintiff has waited in reliance upon the representation. While inapposite to the instant case, the court's conjecture does seem to represent an effort to discern some cause of action independent of the subrogation claim.

46. *See* note 9 *supra*.

Although *Granite State*[47] is plausible authority for the proposition that by settling with notice a tort-feasor waives any defenses otherwise arising from the settlement, its vintage and unique factual underpinning may detract somewhat from its value.[48] While the facts of *State Auto* would seemingly have afforded the court an opportunity to meet this issue directly, the plaintiff's failure or refusal to plead the facts requisite to such a waiver theory effectively precluded the consideration of this question by the court.[49] The waiver doctrine espoused by other jurisdictions thus has yet to receive an unqualified endorsement by the courts of this state. Nevertheless, in light of the widespread support garnered by this doctrine and the apparent support given it by *Granite State*, the court might well be expected to vindicate such a theory when the issue is squarely presented.

The validity of medical payment subrogation, the other issue left undecided by *State Auto*, probably presents a closer question. Because the enforceability of the medical payment subrogation clause was a necessary precondition to the plaintiff's recovery under any theory, its resolution could be avoided only by failing to reach the merits of the case,[50] which of course is precisely what happened. While a disposal of the action in this manner might belie a reluctance on the court's behalf to sanction medical payment subrogation, the court's action more probably represents an un-

47. 53 Neb. 514, 73 N.W. 950 (1898).

48. *See* note 27 *supra*. While the case is an 1898 decision, it does not appear to have since been undermined by any court or legislative action.

49. It is less than clear whether the plaintiff's claim represented a deliberate effort to change existing case law or whether it merely reflected a genuine belief that the case supported its claim.

The possibility that the plaintiff was somewhat uncertain as to the confines of its own "constructive fraud" theory is worth noting. Arguing in terms of estoppel and waiver of splitting defenses, *see* note 28 & accompanying text *supra*, necessarily implied a direct reliance upon the original subrogation interest, a position fundamentally inconsistent with its refusal to plead negligence. Indeed, the plaintiff's first explicit repudiation of an intent to enforce the subrogation interest did not occur until its motion for rehearing. *See* note 44 *supra*.

Alternatively, State Auto may have been fully aware of the fact that no precedent directly supported its theory and consciously chose to couch its argument in more familiar terms in order to minimize the appearance that its theory was truly unprecedented. If such is the case, the tactic obviously backfired since the court appears to have interpreted the cases cited in State Auto's brief to stand for their generally accepted meaning. *See* note 42 & accompanying text *supra*.

50. This is not entirely correct since the court could have recognized the plaintiff's substantive theory of constructive fraud and have rejected it while expressly refusing to reach the question of medical payment subrogation. However, in order for the plaintiff to prevail, the validity of medical payment subrogation necessarily required the court's blessing.

willingness to pass upon an issue of such importance until it is squarely presented.[51] Explained thus, *State Auto* offers no clue as to the court's predisposition regarding medical payment subrogation. Moreover, the lack of unanimity displayed by other jurisdictions addressing the question makes a forecast of the position to be taken by the Nebraska Supreme Court difficult.[52]

VII. CONCLUSION

State Auto resolved none of the questions of substantive law relating to subrogation even though an adjudication of the plaintiff's actual claim would have required the court to either pass upon a somewhat novel question of "constructive fraud" or determine the validity of medical payment subrogation in Nebraska. To this extent, the result of the case is unfortunate regardless of whether one postulates that the court understood the plaintiff's theory. It should be observed, however, that because the court never disposed of the substantive questions at issue, *State Auto* has foreclosed neither the enforceability of medical payment subrogation clauses, the waivability of settlement defenses when effectuated with notice, or for that matter, the viability of the "constructive fraud" theory.

William P. Connealy, '81

51. That this is an issue of considerable importance in Nebraska is evidenced by the fact that the one *amicus curiae* brief filed was devoted almost exclusively to the issue. *See* Brief of Amicus Curiae of Blue Cross and Blue Shield of Nebraska at 6-11, State Auto. and Cas. Underwriters v. Farmers Ins. Exch., 204 Neb. 414, 282 N.W.2d 601 (1979). The issue also received a thorough discussion by State Auto. *See* Reply Brief of Appellant at 2-11.

52. *See* note 16 *supra*.