New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 253—NO. 95
MONDAY, MAY 19, 2015

Outside Counsel

Expert Analysis

Subrogation: Primer and Recent Environmental Cleanup Cases

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Subrogation, a right of recovery conferred by equity, contract or statute, stands alongside contribution and indemnity as one of the three most important doctrines of risk transfer. The doctrine of subrogation is centuries old and is said to have roots that date back to the Roman laws of the 13th century or possibly much earlier.

Most insurance policies contain a subrogation clause that confers a right of subrogation on the insurer. Waivers of subrogation rights may be an important aspect of insurance settlement negotiations. Nevertheless, subrogation is an often overlooked doctrine that rarely makes it into the spotlight. In the last few years, however, insurance disputes concerning subrogation rights related to claims under the Comprehensive Environmental Response Compensation Liability Act (CERCLA) have yielded several interesting decisions. As a result, a primer on subrogation and a discussion of those CERCLA cases is timely and worthwhile.

Subrogation 101

Subrogation is a right "that enables one who is secondarily liable for a debt and who pays it to succeed to the rights, if any, that the creditors hold against the debtor."[1] The subrogee, the person who pays the debt, stands in the shoes of the subrogor, the person who received the payment, to seek recovery from the person who has primary legal responsibility for the loss.

Historically, the classic example of subrogation involved the surety relationship. Under Roman law, a surety who paid a sum to a creditor on behalf of a debtor did not acquire the creditor's rights of recovery unless there was an express agreement prior to the payment. This evolved under English common law, which provided the surety with an automatic right of recovery against the debtor and paved the way for modern day subrogation claims.[2]

Today, a viable subrogation claim must meet four elements: (i) the subrogee must have paid the obligation of the subrogor; (ii) it must not be a voluntary payment; (iii) the subrogee must be secondarily, but not primarily, liable for the payment; and (iv) there must be no injustice if subrogation is permitted. While subrogation was historically an equitable doctrine, today it can be created by equity, contract or statute.

While contractual subrogation remains the most common application of the doctrine, a number of statutes, including CERCLA, expressly provide for subrogation rights.

By far the most frequent example of modern day subrogation occurs in the insurance context. An insurer who pays an insured under the terms of an insurance policy may be subrogated to the insured's right to seek recovery from the third party who caused the loss. The insurer is the subrogee and stands in the shoes of the insured, who is the subrogor.

Because the subrogee stands in the shoes of the subrogor, the subrogee has no greater rights than the subrogor. This fundamental concept comes up again and again in subrogation case law. For example, in *One Beacon v. Whitman Packaging*, the Appellate Division, First Department, denied an insurer's right to recover cleanup costs in subrogation from its insured's co-defendant where the insured had previously executed a consent order that included a release of the co-defendant.[3] Because the insured had already released its right to pursue the third party, the insurer could not maintain a subrogation claim.

An insurer's right to recover in subrogation may also sometimes be complicated by the Made Whole Doctrine, which provides that an insured must first be made whole for its loss before the insurer can proceed with a subrogation claim. The interpretation and application of this doctrine varies from state to state. Some states apply the doctrine more strictly than others, while other states permit parties to contract around the doctrine. In fact, the states apply this doctrine with enough variables to fill an additional Corporate Insurance Law column and then some.[4]

A related issue—allocation of recovered proceeds, can also vary according to state law or according to the terms of the insurance contract. Many insurance policies provide that recoveries are distributed first to the insurer (who typically will bear the expense of the subrogation action) and then, once the insurer is made whole, any additional proceeds are distributed to make the insured whole for any non-insured loss. Expenses incurred for the subrogation action may be allocated on a pro rata basis or simply taken out of the recovery before distribution of the proceeds. However, these terms may vary depending on the language of the policy or, where the policy is silent, the applicable law.[5]

Recent CERCLA Cases

While contractual subrogation remains the most common application of the doctrine, a number of statutes, including CERCLA, expressly provide for subrogation rights.[6] The relevant CERCLA clause provides that "[a]ny person…who pays compen-

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sation pursuant to this chapter to any claimant for damages or costs resulting from the release of a hazardous substance shall be subrogated to all rights, claims and causes of action for such damages and costs of removal that the claimant has under this chapter or any other law."[7]

The case of *Asarco v. Goodwin* presented the U.S. Court of Appeals for the Second Circuit with several interesting issues. The dispute concerned environmental contamination at a former mining complex and a smelter site in Washington state originally operated by John D. Rockefeller near the turn of the 20th century. Decades later, the U.S. Environmental Protection Agency required ASARCO, a subsequent owner and operator, to remediate environmental contamination caused by the discharge of mining waste. ASARCO filed for bankruptcy and, in connection with its reorganization, settled its CERCLA liability for $50.2 million. After emerging from bankruptcy, ASARCO filed suit against the trustees of the Rockefeller estate asserting claims, including a right to subrogation, to recover the costs of remediation.

Putting aside the issue of whether the estate could be held liable under an environmental statute that was not enacted until decades after Rockefeller's death, the Second Circuit denied ASARCO's subrogation claim on the grounds that the ASARCO that had emerged from bankruptcy was the same legal entity that had incurred the original liability. Essentially, the court held that ASARCO was merely standing in its own shoes and, as such, was not permitted to assert a right of subrogation.[8]

In *Chubb v. Space Systems/Loral*, the U.S. Court of Appeals for the Ninth Circuit denied a subrogation claim made by an insurer under different circumstances. Taube-Koret Campus for Jewish Life found itself the owner of two parcels of property in California that had been contaminated by the operations of past owners and operators. As the current owner, Taube-Koret was liable for cleanup costs under CERCLA. Taube-Koret incurred $2.4 million in remediation costs and then sought reimbursement from Chubb under the terms of an environmental insurance policy. Chubb reimbursed its insured and then filed an action against other potentially responsible parties asserting certain claims under CERCLA, including a right to subrogation, and seeking to recover the amounts paid.

The Ninth Circuit rejected Chubb's subrogation claim based on a relatively strict reading of the applicable CERCLA provision. Under the statute, subrogation rights are available only to one who pays compensation to a "claimant." Although it appears that it could have, Taube-Koret did not make a CERCLA claim against the other potentially responsible parties. As a result, the court found that, since Taube-Koret was not a claimant, Chubb could not assert a right to subrogation. Although based on a strict reading of the statute, the ruling underscores the fundamental principle that the subrogee has no greater rights than the subrogor. Since Taube-Koret was not actually a claimant, Chubb could not assert a claimant's rights.[9]

The U.S. District Court for the Eastern District of California also denied a CERCLA subrogation claim made by an insurer. The case concerned Noret, Inc.'s investigation of a contaminated groundwater plume in the City of Chico, Calif. Noret was identified as a liable party under CERCLA and, as of the filing of the case, had incurred defense and response costs in excess of $3 million. Century Indemnity, Noret's insurer, paid $2.8 million as an installment payment to Noret to reimburse it for certain costs subject to a reservation of rights. Century Indemnity then filed a subrogation action against other potentially responsible parties.

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The District Court denied the subrogation claim based on the application of the Made Whole Doctrine. According to the District Court, since Century Indemnity had only paid a portion of the defense and response costs, Noret had not been made whole and Century Indemnity had not satisfied a condition precedent to the subrogation action. In addition, by virtue of its reservation of rights, Century Indemnity's payment could be considered conditional, a fact that the District Court also relied on to preclude the subrogation claim.[10]

In *Chartis v. United States of America*, the District Court for the Northern District of California found that an insurer's subrogation action was sufficient to proceed, denying the United States' motion to dismiss. The case concerned a site in Hollister, Calif. that had been converted from a dairy farm to an ordnance manufacturing site in the 1950s. For several decades thereafter, government contractors manufactured and tested munitions at the site. Whittaker took over manufacturing at the site in 1980 and operated the site for 14 years. As a result, Whittaker was identified as a potentially responsible party under CERCLA and required to perform cleanup operations.

Whittaker sought reimbursement of the response costs incurred from Chartis under the terms of a pollution insurance policy. Following reimbursement, Chartis filed a subrogation action against the United States. The United States moved to dismiss the claim, but the court denied the motion, allowing the claim to proceed at least as to those amounts paid by Chartis within the three-year statute of limitations. Notably, the court found that, unlike Taube-Koret in *Chubb*, Whittaker had filed a claim under CERCLA against the United States and therefore qualified as a claimant under CERCLA.[11]

Looking Forward

Subrogation actions have long been an avenue for insurers to recoup some of the costs incurred to satisfy claims. In the case of statutes like CERCLA, under which insurers incur significant sums and which also provide an express subrogation right, subrogation actions take on added importance. As the insurance industry expands its coverage of climate risks and other newer and potentially significant risks, such as cyber risks, one can expect insurance companies to continue to bring subrogation actions as a method of reducing overall claims loss.

Understanding the elements that are required to establish rights to subrogation can be the difference between being able to make a successful claim or having the claim dismissed. This can be critical both for insurers seeking to collect monies paid through subrogation and for insureds seeking to persuade insurers that a settlement will provide the insurer with effective subrogation rights.

1. R. H. Jerry, II & D. S. Richmond, Understanding Insurance Law §96 at 649 (5th ed. 2012).
2. See, M. L. Marasinghe, "An Introduction to the Doctrine of Subrogation: The Early History of the Doctrine I," 10 Val. U. L. Rev. 45 (1975); see also, B. S. Maher & R. A. Pathak, "Understanding and Problematizing Contractual Tort Subrogation," 40 Loy. U. Chi. L. J. 49, 60 (2008).
3. *OneBeacon Am. Ins. v. Whitman Packaging*, 2014 NY Slip Op 08478 (1st Dept. Dec. 4, 2014).
4. See, J. C. Parker, "The Made Whole Doctrine: Unraveling the Enigma Wrapped In the Mystery of Insurance Subrogation," 70 Mo. L. Rev. 723 (2005).
5. Id. at 773-775.
6. It is important to note that some statutes also expressly prohibit subrogation, particularly in the context of motor vehicle or bodily injury claims.
7. 42 U.S.C. §9612 (c)(2).
8. *Asarco v. Goodwin*, 756 F.3d 191 (2d Cir. 2014).
9. *Chubb Custom Ins. Co. v. Space Systems/Loral*, 710 F.3d 946 (9th Cir. 2013).
10. *California Dep't of Toxic Substances Control v. City of Chico*, 297 F.Supp.2d 1227 (E.D.Cal. 2004).
11. *Chartis Specialty Ins. Co. v. United States*, 2013 WL 3803334 (N.D.Cal. 2013).

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