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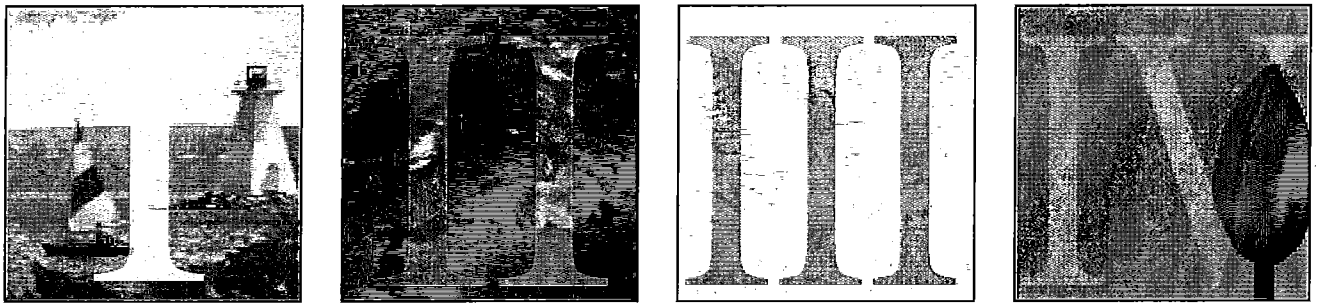

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Recovery Of Penalty Interest Under MCL 500.2006(4) By Subrogated Insurers

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Executive Summary

A conflicts panel of the Court of Appeals has held that the statutory 12% penalty interest for untimely payment of insurance benefits applies without regard to whether the obligation to pay was "reasonably in dispute."

The more difficult question is whether an insurer that pays a claim and thereby becomes subrogated to its insured's interest (or takes an assignment) is also entitled to the penalty interest. The better analysis is that the subrogated or assignee insurer is not allowed to receive penalty interest under the plain language of the statute. The insurer is not a party that is "directly" entitled to receive "benefits" under its insured's policy with the other insurer. Bringing suit in the same of the insured but for the actual benefit of the insurer should not succeed because the insured, having received compensation, is no longer a real party in interest, ant the insurer, which is the real party in interest, does not meet the statutory definition of a qualified third party that is entitled to receive penalty interest.

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Abrogation of the "Reasonably in Dispute" Principle

After the *Griswold Properties* decision,[1] a once murky area of the law has now been settled: insurance policyholders are entitled to 12% penalty interest when an insurance carrier fails to pay insurance benefits on a timely basis under MCL 500.2006(4). It took a conflicts panel of the Court of Appeals to resolve this seemingly straightforward question of statutory interpretation that somehow managed to generate enormous confusion.

Prior to *Griswold*, courts were all over the place in trying to apply and interpret a straightforward legislative statement. Part of the confusion stemmed from whether to follow *obiter dictum* from the Supreme Court's decision in *Yaldo v Northpointe Ins Co*, 457 Mich 341, 578 NW2d 274 (1998). Consequently, some panels held that penalty interest for untimely payments was available to first parties for all untimely payments[2] while other courts held that the "reasonably in dispute" statutory language applied to the imposition of penalty interest for both third-party tort claimants as well as first-party policyholders.[3]

The recent Court of Appeals conflicts panel unanimously resolved this issue in favor of the *Yaldo* view and held that, "a first-party insured is entitled to 12% penalty interest if a claim is not timely paid, irrespective of whether the claim is reasonably in dispute."[4] That issue has now been settled.

Penalty Interest and the Subrogated Insurer

But what happens when an insurer suing on a subrogation basis seeks penalty interest from another carrier it believes should have covered the claim? Is a subrogated insurer entitled to first party penalty interest under MCL 500.2006(4) if it can successfully prove that another insurance policy applied to cover the loss? Despite the prevalence of subrogation claims, these questions have not yet been resolved by a published decision of the Court of Appeals or the Michigan Supreme Court.

Defense lawyers face this dilemma, and sometimes themselves raise these claims as plaintiffs, when there is a dispute among two or more insurers over who bears the responsibility for providing a defense and indemnity to an insured during underlying litigation, usually in defense against a personal injury suit. Often, the plan is for one carrier to cover the claim, even though it believes another carrier is ultimately liable, and to later sue the other carrier.

While the question whether a carrier is entitled to 12% penalty interest is an open one, the enormous weight of persuasive authorities support a finding that a subrogated insurer is not entitled to penalty interest. But, more importantly, the text of the statute specifically defines which entities may seek penalty interest and limits those

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entities to "the insured or an individual or entity directly entitled to benefits under the insured's contract of insurance." MCL 500.2006(4).

> The analysis, naturally, begins with the statute awarding penalty interest in the first place.
>
> If benefits are not paid on a timely basis, the benefits paid shall bear simple interest from a date 60 days after satisfactory proof of loss was received by the insurer at the rate of 12% per annum, **if the claimant is the insured or an individual or entity directly entitled to benefits under the insured's contract of insurance.**[5]

The legislature intended for penalty interest to be awarded only in favor of two entities: the insured or an individual or entity directed entitled to insurance benefits.

Obviously, a subrogated insurer is not "the insured" under the statute and not a party to the insurance contract so it would not meet the first definition.[6] Also doubtful is a claim that the subrogated insurer is "**directly** entitled to benefits under the insured's contract of insurance" because the plaintiff insurer is suing solely because of the legal fiction of subrogation or as an assignee of the policyholder's rights to coverage.[7] That is not a direct entitlement to benefits since insurance benefits are being sought derivatively through the rights of another.

Similarly, under the assignment thesis, while the assignee acquires all the contractual rights of the assignor (and this assignment happens automatically under the "Transfer of Rights of Recovery" provisions found in almost all insurance policies), the insurer is not "directly" entitled to insurance benefits but only gets them because of a transfer of the rights from another entity, the policyholder, who is directly entitled to insurance benefits. The qualifying adverb "directly" should be held fatal to the insurance carrier's claim for penalty interest.

An argument that the insurer could use the "reasonably in dispute" provision applicable to third party claimants under MCL 500.2006(4) to receive penalty interest also violates the statutory language. That provision states:

> If the claimant is a third party tort claimant, then the benefits paid shall bear interest from a date 60 days after satisfactory proof of loss was received by the insurer at the rate of 12% per annum if the liability of the insurer for the claim is not reasonably in dispute, the insurer has refused payment in bad faith and the bad faith was determined by a court of law.

Although the statute provides that penalty interest is available to third parties and strangers to the insurance contract if they can show that the denial of benefits was unreasonable, the "reasonably in dispute" standard only applies to third-party "tort claimants." Certainly, a

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subrogated insurer is not a "tort claimant" and, although a third party to the insurance contract, the language does not support the award of penalty interest to an equitably subrogated insurer even if that insurer can prove that the other insurer was unreasonable in its denial.

Is the Subrogor Insured a Real Party In Interest?

Perhaps recognizing the difficulties dealing with unfavorable statutory language, many attorneys are cleverly bringing suit on behalf of the subrogated insurer but also in the name of the insureds with hopes of enhancing the recovery with 12% interest. After being made whole by one carrier, however, the insureds really have no stake in the outcome of the supplementary proceedings initiated, funded and directed by their insurance carrier; it is unanswered but doubtful that the insureds even have standing to be named as party plaintiffs. When confronted with a crafty gimmick like this, the task of the attorney defending against such a claim is to move to strike the insureds on grounds of subject matter jurisdiction.[8] If the insurer is the last plaintiff standing, its claim for penalty interest becomes even less arguable with the policyholders out of the picture.

Adding the insureds is unnecessary also because an insurance carrier who

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pays on a claim steps into the shoes of the insured (again, either on an equitable subrogation basis or on an assignment basis under the policy) is authorized to enforce any contractual rights the insureds have against the other insurer that declined coverage. Because the insurer acquires the policyholder's contractual rights against a third party, the insured's role in the subrogation action is illusory.[9]

Furthermore, the insurer who paid on the underlying claim "owns" the subrogation lawsuit and is the only entity authorized to sue under a host of Court of Appeals decisions.[10] Under *Sivik*, *supra*, policyholders who have suffered no loss and have been provided a complete defense and total reimbursement of indemnity cannot later sue for insurance benefits from another punitive insurer because their claims have been completely extinguished: "The subrogee is generally recognized as the real party in interest. Generally, an insured, who no longer has any interest in the recovery, cannot sue."[11]

Although this point has not been crystallized by the appellate courts in this particular situation, where an insurance carrier covers a claim it believes should have been covered by another carrier and the insureds are provided a defense and full indemnity, the insurer is the "real party in interest" under MCR 2.201(B) in the subsequent coverage action and the insureds lack standing to bring such claims.[12] The insured, having suffered no damages, could not bring suit in its own behalf, obviously rendering its presence as a co-plaintiff with the insurer legally insignificant except as a means to beef up the recovery with 12% interest.

In this situation, there is nothing left for the policyholders to accomplish; all of their rights have been transferred to the insurer who did cover the claim. The subrogation claim is being pursued by the insurance carrier who pays the lawyers in the subrogation action and directs the prosecution of the claim. The policyholders are not affected in either way and are not real parties in interest under the court rules.

Penalty Interest Is Not Available to a Subrogated Insurer

While there is an argument to be made that the punitive function of penalty interest mandates that it be paid in all circumstances (equitable subrogation claims included), persuasive authority weighs against that proposition and suggests a rule limiting penalty interest to first party policyholders.

First, two non-binding decisions construing MCL 500.2006(4) prior to the *Griswold* decision hold that penalty interest is not available to the subrogated insurer. The federal bankruptcy court, construing Michigan law, rejected a claim for penalty interest under the statute and held that:

> INA [the subrogated insurer] has presented no persuasive argument that it fits within the language of the subsection which requires that INA be 'the insured or an individual or entity *directly* entitled to benefits under the insured's contract of insurance.' Such language implies some entity akin to a named beneficiary, not a co-insurer who sought contribution. INA was not *directly* entitled to benefits under the Debtor's Trans America Policy, but rather, upon settlement of its dispute with the Debtor, INA became entitled under Michigan law to contribution from Trans America.[13]

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Even more on point, the Michigan Court of Appeals issued an unpublished opinion over a decade ago arriving at the same conclusion.

> Defendant correctly notes that plaintiff's claim is based on equitable subrogation relating to its payment of benefits to Sweet not on its direct entitlement to benefits "under the insured's contract of insurance." Because plaintiff is not an "entity directly entitled to benefits under the insured's contract of insurance," the trial court improperly awarded it penalty interest under the statute. We therefore reverse the penalty interest award.[14]

Both the language of the statute as analyzed above and the persuasive case law reject the award of penalty interest to subrogated insurers, but no binding authority has done so. Until finally settled by a published decision of some sort, defense attorneys should expect the opposition to use the jurisprudential vacuum for strategic financial advantage.

The broader penalty interest provision

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of Michigan's No-Fault Act, MCL 500.3142(3), is also held to limit the recovery of penalty interest to insureds only. Michigan's appellate courts have repeatedly rejected the attempts of insurers to recover penalty interest in subrogation claims arising out of motor vehicle accidents.[15] In the *Allstate* decision, the Court of Appeals held: "the model act and intrinsic evidence in Michigan's No-Fault Act suggests that the penalty-interest provision found in section 3142 was not intended to apply between insurers."[16] In another decision, the Court of Appeals held similarly: "We do not believe that the Legislature contemplated payment of such penalty interest under these circumstances inasmuch as the purpose of the penalty provisions is served by awarding attorney fees to the claimant, not the assigned claims to facility representative."[17] The fact that the No-Fault Act penalty interest provision is broader but No Fault carriers are not entitled to penalty interest certainly undercuts an argument that such interest is awardable in non-motor vehicle accident context.[18]

Punitive Nature of Penalty Interest

As hinted at above, there is one strong counter argument. Time and time again, penalty interest statutes are interpreted to be punitive as opposed to compensatory. Therefore, if the purpose of MCL 500.2006(4) is simply to punish an insurer that is wrong on its coverage analysis and fails to live up to its insurance contract, then it really makes no difference who gets the penalty interest as long as the recalcitrant insurer ponies up the 12%.[19] The Court of Appeals has held:

> The purpose of the penalty interest statute is to penalize insurers for dilatory practices in settling meritorious claims, not to compensate a plaintiff for delay in recovering benefits to which the plaintiff is ultimately determined to be entitled.[20]

If this line of reasoning controls, then it is immaterial whether the insured is a party to the action, could have been a party to the action, or was not a real party in interest. And it is immaterial who ultimately receives the penalty interest as long as the insurer who is wrong ends up paying, even if it means that an insurer is rewarded for supplying its insured a defense and indemnity as it promised to do in return for a premium.

But even this counter argument, if implemented, raises more questions. If the insured suffered no loss and was made whole by the subrogated insurer, then on what dollar amount would they be entitled to penalty interest?[21] On damages they never suffered? On insurance benefits they received from another party legally obligated to provide to them? It likewise makes little sense to reward with a windfall profit an insurer who lives up to its insurance commitments to its insureds with a 12% bonanza on top of the premiums already collected.

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Conclusion

Since the subrogated carrier is not the "insured" under MCL 500.2006(4), the question is whether there is any basis for the insurer to acquire not only contractual rights of the insured but also the statutory right to penalty interest. Again, because of the qualifying adverb "directly," the language of the statute does not support an award of penalty interest that is reserved solely for policyholders.

In the end, the carefully chosen words of the statute resolved this dilemma. The Legislature specifically limited penalty interest to policyholders and entities directly entitled to benefits: an equitably subrogated insurer is neither of those things.

Endnotes

1. *Griswold Properties, LLC v Lexington Ins Co*, 276 Mich App 551, 741 NW2d 549 (2007).
2. See *Yaldo v Northpointe Ins Co*, 457 Mich 341, 578 NW2d 274 (1998) (holding that the insurance company can be penalized with 12% interest even if the claim for benefits is reasonably in dispute).
3. See *Arco Industries, Corp v American Motorists Ins Co (On Second Remand, On Rehearing)*, 233 Mich App 143, 594 NW2d 74 (1998) (finding that the statement on penalty interest for first-party claimants in *Yaldo* was *obiter dicta* and rejecting that rationale to hold that insurers had the protection of the "reasonably in dispute" language for third-party tort claimants and first-party policyholders).
4. 276 Mich App 554.
5. MCL 500.2006(4).
6. MCL 500.2006(4).
7. *Frankenmuth Mut Ins Co, Inc v Continental Ins Co*, 450 Mich 429, 446, 537 NW2d 879 (1995) (subrogated insurer steps into the shoes of the insured).
8. MCR 2.201(B) "an action must be prosecuted in the name of the real party in interest...."
9. *Frankenmuth, supra.*
10. *Sinai Hospital of Detroit v Sivik*, 88 Mich App 68, 276 NW2d 518 (1979); *Milbrand Co v Lumbermens Mut Ins Co*, 175 Mich App 392, 438 NW2d 285 (1989); *Drapefair, Inc v Beitner*, 89 Mich App 531, 280 NW2d 585 (1979); *Farmers Ins Group v Progressive Casualty Ins Co*, 84 Mich App 474, 269

NW2d 647 (1978).
11. *Sivik* at 72, quoting *Waters v Schultz*, 233 Mich 143, 206 NW2d 548 (1925).
12. MCR 2:201(B) "an action must be prosecuted in the name of the real party in interest...."
13. *In re Scrima*, 119 BR 539 (1990) (Michigan law).
14. *Fortis Benefits Ins v Trustmark Ins Co*, unpublished per curiam opinion of the Court of Appeals, Docket No. 186948, released April 11, 1997.
15. *All State Ins Co v Citizens Ins Co of America*, 118 Mich App 594, 325 NW2d 505 (1982) (held reversible error to award penalty interest in favor of an insurer suing on an equitable subrogation basis for benefits it paid to its insured); *Darnell v Auto Owners Ins Co*, 142 Mich App 1, 14-15, 369 NW2d 243 (1985); *Spectrum Health v Grahl*, 270 Mich App 248, 715 NW2d 357 (2006) (rule applied to assigned claim under MCL 500.3172).
16. *All State, supra at 607.*
17. *Darnell, supra* at 14-15.
18. See MCL 500.3142(3) ("An overdue payment bears simple interest at the rate of 12% annum.")
19. See *Department of Transportation v Initial Transport, Inc*, 276 Mich App 318, 740 NW2d 720 (2007), *rev'd in part* 481 Mich 862, 748 NW2d 239; *Angott v Chubb Group Ins*, 270 Mich App 465, 717 NW2d 341 (2006); *McCahill v Commercial Union Ins Co, 179 Mich App 761, 446* NW2d 579 (1989); *Sharpe v Daiie*, 126 Mich App 144, 337 NW2d 12 (1983).
20. *Angott, supra*, 270 Mich App at 479.
21. It would be another situation entirely if the insured did bear some out-of-pocket costs in defending or satisfying the underlying action. In that instance, the insured should be held entitled to 12% penalty interest on those out-of-pocket expenses, but not on the whole amount.