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Beware The Doctrine Of Superior Equities

By John Duffy
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Any insurer considering settlement of a claim with the intention of recouping its payment through a subrogation action against co-tortfeasors (third parties), should carefully consider the potential impact of the arcane "doctrine of superior equities." The doctrine of superior equities may have the effect of preventing any recovery against co-tortfeasors who are significantly less at fault than the insured of the settling insurance company.

The doctrine of superior equities is a remnant of the "all or nothing" era of contributory negligence but it can still pack a significant wallop to an unsuspecting insurer that satisfies a claim against an insured and believes it can obtain some contribution toward the payment made to the claimant, from a joint tortfeasor.

Equitable subrogation allows an insurer to stand in the shoes of its insured, and thereby assert a claim against a third party that is also liable for the damages incurred by a claimant. The doctrine of superior equities must be understood in order to be successful on a cause of action for equitable subrogation.

Legally, an insurer may pursue a third party for damages caused by that third party's fault. However, the insurance company must evaluate the factual scenario carefully before making a payment to a claimant to "cap the loss." This "settle and sue" approach is frought with danger, if the co-tortfeasor is not predominately at fault for the injury to the claimant.

The doctrine of superior equities precludes an insurance company from recovering against a third party, unless the claimant has equities superior to those of the third party. In other words, the insurance company's insured must be less at fault for the injury than the third party from whom subrogation is sought.

The doctrine of superior equities was recognized by the California Supreme Court in the case of Meyers v. Bank of America (1938) 11 Cal. 2d 92, 111. Although the tort landscape has changed dramatically in California over the past 70 years, the doctrine of superior equities is a legal concept which is often overlooked by insurance companies when settling a case with the expectation of recouping some of the loss from another negligent party.

The doctrine of superior equities arose at a time when contributory negligence defeated a claim by a plaintiff. Contributory negligence was radically changed in California in 1975, when the California Supreme Court abrogated the "all or nothing" rule of contributory negligence and held that a plaintiff could pursue a claim, even if the plaintiff was comparatively negligent, Li v. Yellow Cab Co. (1975) 13 Cal. 3d 804, 810.

Comparative fault principles were then extended to claims involving multiple tortfeasors seeking indemnification amongst themselves, based upon their percentage share of fault, American Motorcycle Assoc. v. Superior Court (1978) 20 Cal. 3d 578, 597-598.

As a result of the above-referenced cases, tort litigation exploded in California, resulting in numerous cross-complaints amongst various parties, each pointing the finger of liability at the other in an attempt to lessen their liability for a settlement or judgment.

Subsequent to the explosion of litigation generated by the court decision in American Motorcycle v. Superior Court, parties began trying to insulate themselves from liability through indemnity agreements entered into before projects were undertaken. It is in this world of indemnity where an insurance company can be burned by settling an action, thinking it can limit the exposure and then recover some of the money from another party.

In light of the doctrine of superior equities, an insurer must accurately evaluate its insured's percentage share of fault before considering effectuating a settlement based on the assumption of recovering money paid to a claimant from a jointly and severally liable co-defendant. The analysis by the insurance company requires an examination of the type of indemnity provision contained in the contract between its insured and the co-tortfeasor.

If the indemnity agreement is a "Type I" indemnity provision, the insurer can assert that the doctrine of superior equities does not apply because of the contractual obligation entered into by the joint tortfeasor. However, an insurer should be aware that Type I indemnity agreements are disfavored in the law.

The courts will not find that the indemnity provision is a Type I indemnity provision unless all of the elements of such a provision are clearly stated. Therefore, the insurer must weigh the possibility of a court nullifying the "Type I" indemnity provision, and then requiring the insurer to establish it has "superior equities" in order to recover in a subrogation action against a joint tortfeasor.

The doctrine of superior equities has been heavily criticized by courts and legal commentators over the years. Many states have entirely abandoned the doctrine in light of the modern concept of comparative fault, State Farm v. Wells Fargo Bank (2006) 143 Cal.App. 4th 1098.

Failure to consider the ramifications of the doctrine of superior equities in a subrogation action can result in a significant loss to an insurance company seeking reimbursement from a joint tortfeasor that is less at fault than the insured of the subrogating insurance company.

This esoteric and often overlooked doctrine, could very well shield a joint tortfeasor from contribution toward a payment made by an insurance company to a claimant. The doctrine is so archaic that many insurance companies and attorneys are not even aware of its existence. However, it is still the law in California and must be carefully considered by any insurance company deciding to settle the entire claim.

Although it may seem judicious on the part of an insurance company to "cap the loss" by settling a claim, failure to consider the consequences of the doctrine of superior equities could result in the insurance company paying the entire claim without any contribution from joint tortfeasors. Settlement of a catastrophic loss for a "bargain basement" payment may inure to the benefit of a joint tortfeasor.

For example, settlement of a "leg off" case for $3 million may seem like a great settlement which is too good to pass up. However, if the insurance company's insured is 50 percent at fault, and there is no Type I indemnity agreement, the doctrine of superior equities would preclude any recovery from the joint tortfeasor in a subrogation action.

Whereas, if the matter proceeded through litigation, with a settlement of $4 million with each party contributing $2 million toward the settlement, the $2 million contribution from the joint tortfeasor is money that could not have been recovered in a subsequent equitable subrogation action in California, due to the doctrine of superior equities.

The moral of the story is to consider the impact of the arcane doctrine of superior equities when considering settlement of a claim with the intent of pursuing subrogation against a co-tortfeasor.

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