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Subrogation & Recovery Alert
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COZEN O'CONNOR

A Federal Court Subrogation Action Does Not Split a Cause of Action in PA When Insured Filed First

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When the insured and the insurer pursue actions in state and federal court is the subrogating insurer's action barred because it impermissibly split a cause of action or violated either the "made whole" or "first filed" doctrine? In an April 20, 2016 Memorandum & Order denying the Defendant's Motion to Dismiss the action in *Unitrin Auto and Home Insurance Company v. Clayton Corporation of Delaware d/b/a Convenience Products*, No. 1:15-cv-02079 (M.D. Pa. April 20, 2016) (memorandum & order or Op.), the Honorable John E. Jones III of the Middle District of Pennsylvania squarely addressed these points, clarifying that subrogated insurers pursuing recovery will not be categorically barred from bringing a separate action in federal court when an insured first files a separate cause of action in state court.

This case stems from a fire that destroyed the Barrick family home on March 22, 2015. Plaintiffs allege that the fire was caused by defective foam insulation produced by Convenience Products. Mr. Barrick was in the course of applying the foam insulation to his attic when he noticed that the product began to smoke, glow, and burn on the structure of the home. A fire broke out, quickly spreading and ultimately destroying the home. While the adjustment is ongoing, the Barricks have thus far received $429,628.56 from Unitrin Auto and Home (hereinafter Unitrin) pursuant to their policy of insurance and, as a result of its payment, Unitrin became legally, equitably and contractually subrogated to the Barricks' rights to pursue a cause of action for that amount. The insured filed suit in the Perry County Court of Common Pleas. Afterward, Unitrin filed an action in the Middle District of Pennsylvania to recover the amount that it paid the Barricks pursuant to the policy.

The defendant in the federal case, Clayton Corporation d/b/a/ Convenience Products (Convenience), moved to dismiss Unitrin's action pursuant to Fed. R. Civ. P. 12(b)(6). Convenience argued (1) that Unitrin impermissibly split the Barricks' cause of action by filing in federal court while a state action was pending; (2) that the federal "first-filed" rule mandated dismissal of the subsequently filed federal case; and (3) that the equitable "made-whole" rule prohibits the insurer from pursuing recovery in a separate action before the insured has been fully compensated in its state court action. The court rejected these arguments, denying Convenience Products' motion to dismiss, thereby allowing the federal action to proceed.

In a particularly noteworthy portion of the memorandum & order, the court held that the rule prohibiting a plaintiff from "splitting" a cause of action does not apply when the insurer has paid its insured for all or part of its claim. By way of background in Pennsylvania, the rule against splitting causes of action in Pennsylvania derives from Pa. R. Civ. P. 1020(d), which compels plaintiffs to join all claims into a single action if those claims stem from the same "transaction or occurrence." Pa. R. Civ. P. 1020(d). In *State Farm Mutual Automobile Ins. Co. v. Ware's Van Storage*, 953 A.2d 568 (Pa. Super Ct. 2008), the Pennsylvania Superior Court reasoned that multiple plaintiffs can be compelled to join a cause of action arising from the same transaction or occurrence under Pa. R. Civ. P. 1020(d) only when the requirements of Pa. R. Civ. P. 2227 are satisfied. *State Farm Mutual Automobile Ins. Co.*, 953 A.2d 568, 572-73 (Pa. Super Ct. 2008). Pa. R. Civ. P. 2227 provides that multiple parties may be joined when there is a "joint interest in the subject matter of the action." *Id.* at 573. The "joint interest" doctrine, moreover, has "limited application to subrogated insurance claims." *Id.* The Superior Court held, as a result, that a subrogated insurer can only be compelled by Rule 2227 to join in the insured's action when the "unity and identity of interests" are sufficiently identical. *Id.*

Judge Jones held that payment to an insured ends the discussion of compulsory joinder as it "sever[s]" the "unity and identity of interests" between the insurer and its insured. Op. at 8. The

court reasoned that, when money is paid to the insured, the insured is "no longer entitled to recover the entire loss it has suffered." Op. at 8. Therefore, a "joint interest" no longer exists with regard to that portion of the claim. *Id.* at 8-9. Because the insured no longer possesses a right to pursue a claim for the amount paid by the insurer, the insurer does not "split" the insured's action when it pursues recovery in a distinct action premised upon the same facts.

By applying *State Farm* to the facts of this case, the Middle District clarified that any payment to the insured severs the "unity and identity" of interests between the two parties under Pa. R. Civ. P. 2227 irrespective of the damages sought by the parties. The court's reliance on *State Farm* is notable because, in that case, the insured sought to recover for a wholly distinct category of damages, ultimately pursuing compensation for its personal injury while the insurer pursued recovery for property damage. Here, both the insureds and the insurer sought recovery for property damage stemming from the same fire. Regardless, the Middle District held that "[o]nce the [insurer] paid on the claim, the 'unity and identity of the interests' was severed between Plaintiff and the Barricks with regard to the amount paid, and Plaintiff Unitrin cannot be compelled to join in a single action under Rule 2227." Op. at 8.

The court similarly rejected the defendant's invitation to expand the purview of the "first-filed" rule to govern co-pending state and federal cases. In so holding, the court joined the Eastern District of Pennsylvania in determining that this is a rule of federal comity. The Third Circuit's iteration of the first-filed rule provides, as a preliminary matter, that "'in all cases of federal concurrent jurisdiction, the court which first has possession of the subject must decide it.'" *E.E.O.C. v. U. of Pa.*, 850 F.2d 969, 971 (3d Cir. 1998) (quoting *Crosley Corp. v. Hazeltine Corp.*, 122 F.2d 925, 929 (3d Cir. 1941)). The Third Circuit has observed that the rule "encourages sound judicial administration and promotes comity among federal courts of equal rank." *Id.* The District of New Jersey is the lone court in the Third Circuit to expand the first-filed rule to govern co-pending state and federal cases. See *Catlin Specialty Ins. Co. v. Plato Const. Corp.*, No. 10–5722, 2012 WL 924850 (D. N.J. Mar. 19, 2012). The Eastern District of Pennsylvania has, on the other hand, rejected this interpretation by refusing to expand the purview of the rule until the Third Circuit definitively holds that the first-filed rule is more than a rule of federal comity. *Compare Tuno v. NWC Warranty Corp.*, No. 11-3958, 2013 U.S. Dist. LEXIS 107051, at *43-44 n.5 (E.D. Pa. July 31, 2013).

Aligning its position with the Eastern District, the Middle District observed that "[t]he plain language of the rule contemplates cases pending before different, yet equal federal courts." Op. at 9. The court rejected the District of New Jersey's approach in *Caitlin Specialty Ins. Co.*, noting in a footnote that the Third Circuit "has not indicated its approval of such a measure" while similarly observing that the majority of federal courts of appeal "do not appear to be clearly trending" toward the District of New Jersey's expansive interpretation. Op. at 10 n.2. The court, therefore, adhered to the plain-language of the rule, refusing to apply the first-filed rule to co-pending state and federal litigation "[u]ntil the Third Circuit clarifies that the 'first-filed' rule applies to these circumstances." Op. at 10.

Finally, the court dismissed the defendant's interpretation of the equitable "made whole" doctrine. A defense commonly employed by defendants opposing a subrogation action, the made whole doctrine "ensures that the insured is fully compensated for his or her injury before the insurer recovers, **in cases where there are insufficient funds to satisfy both the insured and the insurer.**" *Jones v. Nationwide Prop. And Cas. Ins. Co.*, 32 A.3d 1261, 1271 (Pa. 2011) (emphasis added). The rule transfers the risk of non-recovery to the party paid to assume risk as opposed to an "inadequately compensated insured, who is least able to shoulder the loss." Op. at 11 (quoting *Jones*, 32 A.3d at 1271).

In its memorandum & order, the Middle District clarified that the made whole doctrine will not apply unless the defendant affirmatively demonstrates that the concurrent subrogation action will deplete available funds to such a degree that the insured cannot be fully compensated. Op. at 11. Here, the made whole rule did not apply because Convenience Products failed to show that a "subrogation claim for amounts paid is likely to deprive the [insureds] of full recovery on their loss." Op. at 11. The court reasoned that, "[a]s an equitable principle, the 'made whole' doctrine does not apply as a bar to subrogation where funds are sufficient to make both the insured and the insurer whole." Op. at 11. Here, there was "no indication that the policy limits [were] inadequate to fully compensate the Barricks for their loss." Op. at 11.

The memorandum & order in *Unitrin* can have wide-ranging implications for future subrogation cases. It lends support to the proposition that, in Pennsylvania, an insurer should not ordinarily be compelled to join in its insured's state court action provided that the insurer only seeks recovery for a sum that it has paid pursuant to the applicable policy. With no obligation to join the insured's state court action, the insurer will likely be allowed to pursue recovery in Pennsylvania federal court despite the fact that its action was filed subsequent to the insured's state court action arising from the same transaction or occurrence. Moreover, a tortfeasor in Pennsylvania may not invoke the made whole rule by merely pointing to a co-pending state court action and flatly asserting that the insured's action should be prosecuted in full before the insurer may pursue recovery, rather, the tortfeasor must affirmatively show that the maintenance of the two co-pending actions will deny the insured full recovery in its action.

Cozen O'Connor stands ready to assist with any questions you may have regarding issues discussed in this Alert.