

SUBROGATION AND THE INNOCENT SPOUSE DILEMMA

JOHN F. DOBBYN[†]

INTRODUCTION

The problem of the payment of proceeds under a fire insurance policy to an “innocent spouse” for damage caused by arson committed by the guilty spouse still presents the courts with perplexing conflicts in decision making. The basic problem is simple. A fire insurance policy covers realty, usually a family home, which is owned jointly or in tenancy by the entireties by a husband and wife. One of the spouses deliberately burns the property. Clearly, the arsonist is barred from collecting proceeds by the common law of the jurisdiction or a specific exclusion in the policy for deliberately caused loss. The challenging issue is whether or not the “innocent” co-insured spouse should be allowed to collect on the policy.

In deciding the issue, courts, through the years, worked their way through at least five formulae for decision making in an attempt to resolve the conflicts that trouble judicial minds. At the heart of the issue are opposing pulls and tugs in the sensitive areas of public policy, equity between the parties, willingness to stray from the actual wording of the insurance policy, and fear of opening the insurer and a court to fraud. The three primary interests to be balanced are prevention of profit to the arsonist, fairness to the innocent spouse, and protection of the contracted interests of the insurer.

Courts generally find that they are constrained to choose between two possible outcomes—either granting or denying recovery of proceeds to the innocent spouse. Because of complicating factors, courts are seldom satisfied with either result. If a court grants recovery of proceeds to the innocent spouse, there remains the realistic possibility that the guilty spouse will share in the take. There is also the possibility that the

[†] Professor of Law, Villanova Law School, L.L.M. Harvard Law School, J.D. Boston College Law School, A.B. Harvard College. I would like to recognize and express my appreciation for the outstanding work of three excellent research assistants: Hal Schirmer, Martin Ferro, and Mark Fischer.

“innocent” spouse was actually in collaboration with the “guilty” spouse, but the collaboration could not be proven.¹ If a court denies recovery to the innocent spouse, there is the possibility that the innocent party is being made to suffer for the wrongs of the guilty party. Either way, a decision for or against recovery by the innocent spouse frequently leaves a court with an unsatisfied feeling that total justice was not accomplished. It is difficult to tell how many decisions have been swayed by the prospect of those equivocal feelings.

It is the purpose of this article to discuss an alternative option that would more completely satisfy a court’s sense of total justice and leave a court free to grant the relief that it believes is fair to the innocent spouse.

I. APPROACHES TO SEVERABILITY

To set the scene, the following is a summary of the approaches that have been adopted by courts to date in resolving the issue of granting or denying relief. In all cases, the basis for finding for one insured when a co-insured is barred from recovery is the doctrine of severability of the policy. Each of the different approaches to the issue of severability discussed below is defined by determining which particular interest is to be the focus of the analysis.

A. *Focus on Property Interest—Irrebuttable Presumption*

The oldest approach begins with the traditional analysis of the severability of any contract by determining whether or not there are multiple promises made on each side of the contract such that the promises on one side can be paired up with promises on the other side to provide clear lines along which a contract can be severed. In the context of this approach, a court focuses on the property interest or interests that are insured against fire damage.² If the interests of the spouses in the property are held “in common,” so that the interest of one spouse is legally separate and distinct from the interest of the other, then the policy will be considered severable, and, all else being equal, the innocent spouse may recover proceeds.³ If, as is usually the case, the interests of the spouses are

¹ However, the major concern of the cases denying recovery seems to be a substantial potential for collusion between the spouses. As one court has noted, “[p]articularly in the husband and wife cases, an equally guilty spouse might recover policy proceeds because of the difficulty of proving participation in or knowledge of the arson committed by the other spouse.” *Maravich v. Aetna Life & Cas. Co.*, 504 A.2d 896, 906 (Pa. Super. Ct. 1986) (quoting *Spezialetti v. Pac. Employees’ Ins. Co.*, 759 F.2d 1139, 1141 (3d Cir. 1985)).

² *Vance v. Pekin Ins. Co.*, 457 N.W.2d 589, 590–91 (Iowa 1990).

³ *Steigler v. Ins. Co. of N. Am.*, 384 A.2d 398, 401 (Del. 1978).

held by the entirety, or by any other form of joint interest, courts that adhere to this approach believe that they are bound by a conclusive presumption that the spouses' interests are indivisible.⁴ This presumption has been further solidified by the ancient concept that in a marriage, a husband and wife exist as a single entity.⁵

The courts that follow this approach consider themselves unable to sever the contract and the innocent spouse is not permitted to collect proceeds.⁶ In such cases, courts that chafe at the sense of injustice to the innocent spouse can at least partially console themselves with the thought that they served public policy by preventing the guilty spouse from profiting from misdeeds.⁷

B. Focus on Property Interest—Rebuttable Presumption

A slight modification of the “property interest” approach came into favor with the emergence of the public policy that an innocent insured should not be penalized for the fraud and misdeeds of a co-insured.⁸ It sprang from the desire of some courts to give the innocent spouse a chance to overcome the conclusive presumption of indivisibility that clung to a tenancy by the entirety.⁹ These courts have ruled that the presumption is rebuttable, with the burden of rebutting on the innocent spouse.¹⁰

The problem with this approach is that the escape hatch provided to the innocent spouse is, practically speaking, locked shut.¹¹ It is fine to have the opportunity to prove that a tenancy by the entirety is, under normal tenets of property law, divisible, except that it is settled law that such a tenancy is a form of joint ownership and is therefore indivisible.¹² The interest insured is undivided between the two spouses and therefore all rights under an insurance policy must also be unitary and unseverable.¹³ As a result, it is generally impossible for the innocent spouse to disprove the presumption.¹⁴ The outcome of the claims of innocent spouses under

⁴ *Vance*, 457 N.W.2d at 591. *But see* *Delph v. Potomac Ins. Co.*, 620 P.2d 1282, 1284 (N.M. 1980) (noting that the New Mexico courts had segregated out the joint interests of spouses where “necessary to do so in order to avoid injustice,” such as to satisfy a statutory judgment lien for a personal tort committed by the wife).

⁵ *Vance*, 457 N.W.2d at 591.

⁶ *Id.* at 590–91.

⁷ *Id.* at 591.

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.* at 592.

¹² *Id.* at 590–91.

¹³ *Id.* at 591.

¹⁴ *Id.* at 592.

this approach is, therefore, practically the same as under the “property interest” approach.

C. *Focus on Insurance Policy*

The third approach to emerge actually benefited the innocent insured. Under this approach, the focus is taken off the property interest that is insured and directed onto the wording of the contract of insurance.¹⁵ The basis for this shift is the theory that the property interest should not be equated with the interests under the insurance policy.¹⁶ The policy proceeds are not intended to replace the property; instead, they act as a contractual obligation of the insurer to make the insured whole for a financial loss up to policy limits.¹⁷ The property interest is realty and is governed by the law of property, while the contract right to proceeds is personal and is governed by the law of personal property.¹⁸

This opens the possibility of applying principles of policy interpretation that clearly favor the insured. For example, the exclusion in the policy for any loss deliberately caused is generally worded in such phrases as “any loss arising out of any act committed by or at the direction of the insured.” Courts that apply the doctrine of *contra proferentem*—any word or phrase that is ambiguous—subject to two or more possible meanings—will be interpreted against the interest of the party drafting the language¹⁹—focus on the words “the insured.” The reference could be to each of the insureds, or it could be to the particular insured who committed the act causing the loss. As between the two, a court is impelled to choose the interpretation that limits the reference to the guilty insured, leaving the innocent insured free of the exclusion and able to collect the proceeds.²⁰

This approach favors the innocent insured that cannot prove the divisibility of a property interest held by the entireties. As stated by the court in *American Economy Insurance Co. v. Liggett*:²¹

The legal fiction of the entireties' estate in real estate is designed for the protection of the spouses and the marriage. It was initially designed to prevent the individual creditors of either spouse from taking the marital home. The courts generally, and divorce courts in particular, find no difficulty in dividing an entireties estate. [It is] a perversion of this legal

¹⁵ *Maravich v. Aetna Life & Cas. Co.*, 504 A.2d 896, 904 (Pa. Super. Ct. 1986).

¹⁶ *Id.* at 903.

¹⁷ *Vance*, 457 N.W.2d at 591.

¹⁸ *Id.*

¹⁹ *Id.* at 592.

²⁰ *Morgan v. Cincinnati Ins. Co.*, 307 N.W.2d 53, 54–55 (Mich. 1981).

²¹ 426 N.E.2d 136 (Ind. Ct. App. 1981).

fiction, designed to protect the spouses' rights and marital property, to use it to destroy the property rights of an innocent spouse.²²

The problem for insureds is that some insurers have caught onto the game and have changed the wording of the exclusion to any act committed "by or at the direction of *an* insured."²³ Other insurers use the phrase "any insured." Courts interpreting this language have been forced to conclude that when the exclusion contains the words "an insured" or "any insured," the meaning is clear and unmistakably excludes coverage under the policy for all insureds as long as any of the co-insureds deliberately causes the loss.²⁴ "In short, if any insured commits arson, all insureds are barred from recovering."²⁵

In *Krupp v. Aetna Life & Casualty Co.*,²⁶ the New York court recognized another path to finding for the innocent insured through the ambiguity doctrine. Instead of focusing on specific words in the policy, the court examined the general question of whether the interests of the insureds in the policy generally were joint or several.²⁷ Since the policy did not specify the nature of the interest one way or the other, the court would interpret the "ambiguity" in favor of the innocent insured and allow recovery.²⁸

D. Policy Interest—Doctrine of Reasonable Expectations

The simple act of changing "the insured" to "an insured" or "any insured" and of specifying that the interests of the co-insureds in the policy shall be considered joint rather than several appears, except for two factors, to favor insurers. First, not all insurers have adopted the protective language.²⁹ Secondly, some jurisdictions that apply this "new" approach of focusing on the policy rather than the property interest insured have also adopted the doctrine of reasonable expectations.³⁰ Under this interpretive approach, the actual language of the policy is of little consequence.³¹ It is presumed that the insured will not read or understand the actual language

²² *Id.* at 140.

²³ *Vance*, 457 N.W.2d at 592.

²⁴ *Id.* at 593.

²⁵ *Id.*

²⁶ 103 A.D.2d 252, 479 N.Y.S.2d 992 (2d Dep't 1984).

²⁷ *Id.* at 258, 479 N.Y.S.2d at 997.

²⁸ *Id.*, 479 N.Y.S.2d at 997.

²⁹ *E.g.*, *Maravich v. Aetna Life & Cas. Co.*, 504 A.2d 896, 905 (Pa. Super. Ct. 1986).

³⁰ *See Vance v. Pekin Ins. Co.*, 457 N.W.2d 589, 592 (Iowa 1990); *Krupp*, 103 A.D.2d at 258, 479 N.Y.S.2d at 997.

³¹ *See Krupp*, 103 A.D.2d at 258, 479 N.Y.S.2d at 997 (explaining that ambiguous language in a policy would be interpreted against the insurer).

of the policy.³² The court will therefore rewrite the policy to comport with the “reasonable expectations” of the insured, considering the type of insurance purchased and the amount of premiums paid.³³ The court stated in *Krupp v. Aetna Life & Casualty Co.*:³⁴

Given the reasonableness of the expectation of an insured that his individual interest would be covered by a policy naming him as insured without qualification, a homeowners’ policy which nowhere specified whether the interests of a named insured husband and wife in property held by both as tenants by the entirety were joint or several, would be construed as covering the interests of each separately, and alleged arson by the husband would not defeat the wife’s right to recover on her interest.³⁵

Similarly, in the case of *Madsen v. Threshermen’s Mutual Insurance Co.*,³⁶ the insurer relied on the “increase of hazard” clause of the almost universally used 165 line New York Standard Fire Insurance Policy, under which coverage is excluded when “the hazard is increased by any means within the control or knowledge of the insured.”³⁷ While interpreting that language, the court applied the “reasonable insured” standard and found that “the person owning an undivided interest in property and being a named insured would reasonably suppose that his or her individual interest in the property was covered by the policy.”³⁸ The court found, as a matter of law, that the “increase of hazard” clause did not bar recovery by the innocent spouse.³⁹

This theory of looking to the joint or several interests of the co-insureds in the policy gives the court the greatest freedom to give prominence to the public policy against penalizing an innocent co-insured for the misdeeds of a guilty co-insured. While some courts still apply the “old” approach of focusing on the joint or several nature of the property interest of the insureds, the great majority of courts facing the issue in modern times have opted for the “new” and “best reasoned” approach of

³² See *Atwater Creamery Co. v. W. Nat’l Mut. Ins. Co.*, 366 N.W.2d 271, 277 (Minn. 1985) (noting that courts “recognize that, in the majority of cases, a lay person lacks the necessary skills to read and understand insurance policies, which are typically long, set out in very small type and written from a legalistic or insurance expert’s perspective”).

³³ See *Krupp*, 103 A.D.2d at 260–61, 479 N.Y.S.2d at 998 (requiring “a construction consistent with the reasonable expectations of a policyholder in the shoes of an innocent named insured” whenever ambiguous provisions are present).

³⁴ 103 A.D.2d 252, 479 N.Y.S.2d 992.

³⁵ *Id.* at 258, 479 N.Y.S.2d at 997.

³⁶ 439 N.W.2d 607 (Wis. Ct. App. 1989).

³⁷ *Id.* at 609.

³⁸ *Id.* at 613 (quoting *Hedtke v. Sentry Ins. Co.*, 326 N.W.2d 727, 739 (Wis. 1982)).

³⁹ *Id.*

focusing on interests in the policy, whether under the *contra proferentem* or the reasonable expectations method of interpretation.⁴⁰

E. Focus on the Wrongful Act

One final approach to the issue is to focus on neither the property interests nor the policy interests, but rather on the wrongful act itself.⁴¹ If the act was committed jointly or with collusion between the spouses, the exclusion applies to both. If the act is performed by one spouse separately, with no collusion between them, the innocent spouse can recover regardless of the type of interest in the property or the policy. Since the insurer is seeking the benefit of its exclusion, it bears the burden of proving that the wrongful act was performed jointly by the spouses.⁴²

This theory opens the door for recovery by an innocent spouse who can prove neither the divisibility of property interest nor the severability of contract interests under the policy.

One question that arose, when innocent spouses were permitted to recover, was whether the recovery should be 100% or 50% of the amount of the loss up to the policy limit. Almost universally, the courts have agreed that since rights under the policy are severed down the middle, recovery by the innocent party should be limited to 50%.⁴³ One of the

⁴⁰ See, e.g., *Vance v. Pekin Ins. Co.*, 457 N.W.2d 589, 592 (Iowa 1990) (stating that the rule is “the best reasoned rule because under it courts use a contract analysis and have some concerns for equity.”); *Krupp v. Aetna Life & Cas. Co.*, 103 A.D.2d 252, 258, 479 N.Y.S.2d 992, 997 (2d Dep’t 1984) (“The more modern ‘dominant’ rule focuses on the contract of insurance rather than the property rights of the parties”); *Kulubis v. Tex. Farm Bureau Underwriters Ins. Co.*, 706 S.W.2d 953, 955 (Tex. 1986) (“[T]his test will . . . permit an innocent victim whose property has been destroyed to collect under an insurance policy for a loss reasonably expected to be covered.”).

⁴¹ We hold that the trial court correctly determined that the fraud of the husband was no bar to recovery under the policy by the innocent wife. However, we reach this result irrespective of whether the interests of the wife and husband in the tenancy by the entirety, in the personal property, or in the contract rights under the policy are deemed to be joint or several. The significant factor is that the responsibility or liability for the fraud—here, the arson—is several and separate rather than joint, and the husband’s fraud cannot be attributed or imputed to the wife who is not implicated therein. Accordingly, the fraud of the co-insured husband does not void the policy as to plaintiff wife.

Howell v. Ohio Cas. Ins. Co., 327 A.2d 240, 242 (N.J. Super. Ct. App. Div. 1974).

⁴² *Krupp*, 103 A.D.2d at 259, 479 N.Y.S.2d at 997–98. The test for divisibility of the wrongful act in community property is to determine whether or not the wrong committed by one spouse “was of actual or potential benefit to the community.” *Delph v. Potomac Ins. Co.*, 620 P.2d 1282, 1285 (N.M. 1980). If not, the wrong could be assigned solely to the wrongdoer, and the innocent spouse could collect insurance proceeds. *Id.*

⁴³ See, e.g., *Brown v. Frankenmuth Mut. Ins. Co.*, 468 N.W.2d 243, 247 (Mich. Ct. App. 1991) (“[T]he innocent coinsured spouse is entitled to recover one-half of the actual damages up to the policy limits.”).

extremely rare situations in which 100% recovery has been permitted was when the husband died in the fire that he set and, therefore, all rights under the policy belonged to the surviving and innocent wife.⁴⁴

A more difficult issue arises when the amount of the loss exceeds the limit of the policy. For example, if the policy limit is \$50,000 and the amount of the loss is \$80,000, should the innocent spouse be allowed to recover 50% of the policy limit (\$25,000) or 50% of the loss, as long as it is within the policy limit (\$40,000)? The usual answer to the question is that the innocent insured is allowed to recover 50% of the loss as long as it is within the policy limits.⁴⁵ In the hypothetical, the recovery would be \$40,000.

II. SOURCES OF DISCOMFORT FOR THE COURTS.

Neither a decision for nor against recovery by the "innocent" spouse under any of the approaches discussed above has left courts completely satisfied. If recovery is denied on some technical ground, such as the theoretical indivisibility of a tenancy by the entirety, there is the lingering dissatisfaction that goes with penalizing the innocent spouse for the misdeeds of the guilty spouse that are beyond the knowledge or control of the innocent spouse.⁴⁶ The penalty is a serious one, because the family home may have been destroyed, and replacement or repair may be impossible without insurance proceeds.⁴⁷ The accomplishment of technical legal correctness is of little consolation to the court or the innocent spouse.

On the other hand, a decision for the innocent spouse is riddled with doubt and irresolution. The greatest fear is that the guilty party will indirectly profit from his or her spouse's recovery.⁴⁸ This becomes likely if the spouses remain married and living together after the recovery.⁴⁹ The recovery may only be in the range of 50% of the loss instead of 100%, but nonetheless, courts are seriously troubled by the prospect of placing any

⁴⁴ *Am. Econ. Ins. Co. v. Liggett*, 426 N.E.2d 136 (Ind. Ct. App. 1981).

⁴⁵ *See, e.g., Brown*, 468 N.W.2d at 247.

⁴⁶ *See Kulubis v. Tex. Farm Bureau Underwriters Ins. Co.*, 706 S.W.2d 953, 955 (Tex. 1986).

⁴⁷ *See Hedtcke v. Sentry Ins. Co.*, 326 N.W.2d 727, 740 (Wis. 1982) ("Having lost the property, the innocent insured is victimized once again by the denial of the proceeds forthcoming under the fire insurance policy.") (citing *Am. Econ. Ins. Co. v. Liggett*, 426 N.E.2d 136, 140 n.1 (Ind. Ct. App. 1981)).

⁴⁸ *See Am. Econ. Ins. Co.*, 426 N.E.2d at 140 ("Where there is some prospect that the guilty party might benefit . . . the trial court [can] determine whether that prospect exists and to protect against it.") (citations omitted).

⁴⁹ *See, e.g., Commercial Union Ins. Co. v. State Farm Fire & Cas. Co.*, 546 F. Supp. 543, 547 (D. Colo. 1982).

insurance proceeds under the control of the arsonist spouse. It results in at least a partially successful fraud on both the insurer and the court. Such uneasiness could well influence a court's decision to grant or withhold recovery at all, or even lead a court to adopt as precedent one of the more restrictive approaches to the issue that would bar future innocent spouses from recovery even under circumstances in which the guilty spouse would not benefit.

If a husband and wife are legally separated or divorced, courts tend to be less concerned about the possibility of the guilty spouse sharing in the take.⁵⁰ However, if the insurance proceeds are sufficiently motivating, a court's concern is not completely removed, because the spouses may undertake a temporary separation as part of the fraud on the insurer and the court.⁵¹ Even if the spouses are legally separated or divorced, it is seldom possible for a court to know with certainty the true financial relationship between them.

Only in the rare case in which the arsonist dies in the fire or dies before the payment of proceeds, can a court feel that the entire benefit will go to the innocent spouse.⁵² For example, in *Felder v. North River Insurance Co.*,⁵³ the husband set fire to his family home and then committed suicide with a gun during the fire. The court found no possibility that the husband could profit personally from the proceeds and awarded 100% of the loss in proceeds to the innocent wife.⁵⁴

Even in cases in which the guilty party does not survive, if in some way a portion of the proceeds descends to his personal heirs or legatees, it is possible that he has in some way benefited. On the other hand, courts tend to consider such heirs or legatees as being innocent recipients unmarred by their benefactor's guilt.⁵⁵

In *Madsen v. Threshermen's Mutual Insurance Co.*,⁵⁶ the appellate court assuaged its conscience in allowing recovery by the innocent spouse,

⁵⁰ See, e.g., *Travelers Cos. v. Wolfe*, 838 S.W.2d 708, 711–12 (Tex. App. 1992) (noting that after a divorce the culpable spouse may not receive a benefit for his act of arson).

⁵¹ *Tex. Farmers Ins. Co. v. Murphy*, 996 S.W.2d 873, 877 (Tex. 1999) (recognizing the risk of collusion between spouses to enable coverage through sham partitions or divorces).

⁵² See, e.g., *Am. Econ. Ins. Co.*, 426 N.E.2d at 139–40, 142, 144–45 (finding no reason to deny the innocent plaintiff a full recovery when the arsonist is dead, because the arsonist cannot profit from his wrongdoing).

⁵³ 435 N.W.2d 263 (Wis. Ct. App. 1988).

⁵⁴ *Id.* at 266.

⁵⁵ See, e.g., *Commercial Union Ins. Co. v. State Farm Fire & Cas. Co.*, 546 F. Supp. 543, 547 (D. Colo. 1982) (“It is the Court’s view that in balancing the equities of the case at bar, the facts and circumstances favor the payment to the innocent spouse *and children*. They have lost indemnified property from an event that is fortuitous as to them.”) (emphasis added).

⁵⁶ 439 N.W.2d 607, 613–14 (Wis. Ct. App. 1989).

which could possibly benefit the guilty spouse, by dropping the problem into the lap of the trial court. The case was remanded with instructions to the trial court to undertake the “factual” inquiry as to whether and how the recovery by the wife could be “tailored” so as to prevent the husband from recovering any benefit.⁵⁷ The court did suggest two possible tools that could be useful in the tailoring. One was the issuance of a check made out solely to the innocent wife and the other was the use of a trust to be funded with the proceeds for the sole benefit of the wife.⁵⁸

While each of these tools might protect an unwilling spouse from sharing the proceeds with the guilty spouse at the time of first payment, it is clear that they could not block a subsequent voluntary or even pre-arranged sharing between the spouses.

A concomitant fear of the court when recovery is granted is that the “innocent” spouse was actually in collusion with the guilty spouse in committing the arson, or at least knew of and consented to the act, but that the true facts never came to light. Arson itself is frequently difficult to prove in view of the fact that the evidence is often burned to ashes. There are true experts in the field of fire investigation, but their numbers are generally few and they are expensive to hire. In a difficult case, the amount in controversy may not justify the expense of a top-line investigator. But even if arson is proven, the role of the “innocent” spouse may simply remain undetected or unproven.

Where a court has adopted a theory that allows for the possibility of recovery, another factor may seriously tilt the playing field in favor of a spouse who is in possible, but unproven, collusion with the guilty partner. In the many jurisdictions that have adopted the first-party bad faith cause of action,⁵⁹ the insurer is subject to an effective squeeze play that can seriously hamper its ability to take the time necessary for a full investigation of the innocence of the claimant.⁶⁰ It is not uncommon for the claimant under first party insurance to combine the claim for proceeds with the threat of a cause of action for bad faith failure to pay proceeds without delay.⁶¹

⁵⁷ *Id.* at 613.

⁵⁸ *Id.*

⁵⁹ *See, e.g.*, *Travelers Ins. Co. v. Savio*, 706 P.2d 1258, 1274–75 (Colo. 1985); *White v. Unigard Mut. Ins. Co.*, 730 P.2d 1014, 1017–19 (Idaho 1986); *Pickett v. Lloyds*, 600 A.2d 148, 152–55 (N.J. Super. Ct. App. Div. 1991), *aff'd*, 621 A.2d 445, 458 (N.J. 1993); *Anderson v. Cont'l Ins. Co.*, 271 N.W.2d 368, 376–77 (Wis. 1978).

⁶⁰ *Anderson*, 271 N.W.2d at 377 (“[T]he possibility of scaring insurers into paying questionable claims because of the threat of a bad faith suit and its excessive damages is undesirable.”) (quoting John W. Thornton & Milton S. Blaut, *Bad Faith and Insurers: Compensatory and Punitive Damages*, 12 FORUM 699, 719 (1977)).

⁶¹ *See, e.g.*, *Lissmann v. Hartford Fire Ins. Co.*, 848 F.2d 50, 51–52 (4th Cir. 1988) (finding

In jurisdictions that treat the bad faith cause of action as one sounding in tort rather than contract,⁶² awards may include punitive damages and/or damages for emotional distress. This threat becomes more realistic when the damaged property is not jewelry or a boat but the very home of the insured. Further, neither of these forms of damages would be subject to policy limits. Under this circumstance, an insurer can be forced to shorten the investigation of the “innocent” spouse’s collusion in the arson and pay the claim rather than risk a potentially heavier loss beyond policy limits.

It has been suggested that a solution to the problem of solving the suspected collusion of the claiming spouse might lie in a shift of the burden of proof.⁶³ Once the insurer has proven the existence of arson, the burden could be shifted to the claiming spouse to prove his innocence of either collusion or knowledge and approval.⁶⁴

While such a rule might ease a court’s discomfort in allowing a finding for the claimant, it might also swing the pendulum too far in the opposite direction. It may, in fact, put us back to the days of the “rebuttable presumption” rule discussed above.⁶⁵ To receive proceeds for the destroyed home, the innocent spouse would have to clear the difficult hurdle of proving a negative. Proving a lack of collusion, or even a lack of knowledge and tacit approval of the arson, might be an insurmountable burden when the only evidence is frequently the obviously self-serving testimony of the claimant. The result could be a practical bar to recovery by truly innocent spouses.

III. AN IMPORTANT NEXT STEP

The crux of a court’s discomfort in allowing or disallowing the innocent spouse to recover is the constant tug-of-war between two tenets of public policy: (1) a wrongdoing spouse should not be allowed to profit—directly or indirectly—from his wrongdoing; and (2) an innocent

that an insurer’s unreasonable delay may sometimes constitute bad faith).

⁶² See, e.g., *Braesch v. Union Ins. Co.*, 464 N.W.2d 769, 772–76 (Neb. 1991) (finding that the insurance company’s control of litigation and an implied covenant of good faith and fair dealing gives rise to a fiduciary duty bringing bad faith causes of action into a tort action), *overruled on other grounds by Wortman ex rel. Wortman v. Unger*, 578 N.W.2d 413 (Neb. 1998); *McCullough v. Golden Rule Ins. Co.*, 789 P.2d 855, 857–58 (Wyo. 1990) (following the line of cases finding a cause of action for bad faith against a first-party insurer to be a tort cause of action rather than a contract cause of action).

⁶³ Leanne English Cerven, *The Problem of the Innocent Co-Insured Spouse: Three Theories on Recovery*, 17 VAL. U. L. REV. 849, 871 (1983).

⁶⁴ *Id.* at 871–72.

⁶⁵ See discussion *supra* Part I.A–B.

spouse should not be disadvantaged by the wrongdoing of the guilty spouse.⁶⁶

What frequently turns this tug-of-war into a conundrum that can distort a just solution is the major problem of proof. It is practically impossible in many cases to *prove* either that the “innocent” spouse is truly innocent of all collusion or that the guilty spouse will not reap some benefit from the recovery of proceeds by the innocent spouse. Therefore, when such a fact cannot be proven one way or the other, the finding of fact on which the court’s ruling must be made simply falls by default in favor of the party that does not bear the burden of proof. This can leave the court with an unsatisfactory basis on which to rule, and hard cases, as the saying goes, can indeed make bad law.

There is, however, the possibility of one more step in the process that might help to balance the competing interests more equitably. That step is an action in subrogation by the insurer against the guilty spouse.

The doctrine of subrogation is of equitable origin,⁶⁷ and in its most general statement, applies as follows. If party A pays to party B a debt that ought to have been paid by party C, and party A has paid not as a volunteer, party A should stand in the shoes of party B in having subrogated standing to bring party B’s action against party C to recover the amount paid by party A.⁶⁸ In relating that general doctrine to the present context, if the innocent spouse has a cause of action against the guilty spouse for deliberately burning property in which the innocent spouse has an interest, and the insurer has paid proceeds under contractual obligation to the innocent spouse because of that property loss, the insurer should be subrogated to the innocent spouse’s cause of action against the guilty spouse up to the amount of the proceeds paid.⁶⁹

The two underlying premises of this form of subrogation are: (1) that the insurer should be reimbursed by the wrongdoer for proceeds it was compelled to pay because of the wrongdoer’s act, thereby bringing the loss to rest on the wrongdoer; and (2) that an insured should not be allowed to recover twice for the same loss—once from the insurer and once from the wrongdoer.⁷⁰ By permitting an insurer, who has paid proceeds for a loss to the insured to recover the amount of those proceeds from the wrongdoer,

⁶⁶ See *Am. Econ. Ins. Co. v. Liggett*, 426 N.E.2d 136, 140, 142 (Ind. Ct. App. 1981) (discussing the trial court’s analysis of determining whether the liable party will benefit from the innocent spouse’s recovery).

⁶⁷ *Dix Mut. Ins. Co. v. LaFramboise*, 597 N.E.2d 622, 624 (Ill. 1992).

⁶⁸ See *id.* at 626; WILLIAM R. VANCE & BUIST M. ANDERSON, *VANCE ON INSURANCE* 787–88 (3d ed. 1976).

⁶⁹ *Allstate Ins. Co. v. LaRandeau*, 622 N.W.2d 646, 649–51 (Neb. 2001).

⁷⁰ *Id.* at 649–50.

the insured is made whole for the loss just once, and the actual loss falls on the wrongdoer.

*Allstate Insurance Co. v. LaRondeau*⁷¹ is among the relatively few reported cases that deal with subrogation in this context. Mr. LaRondeau deliberately burned and destroyed the residence jointly owned by himself and his wife.⁷² The insurer paid half of the total value of the property to the wife, in spite of an exclusion in the policy for destruction of property by “[i]ntentional or criminal acts of or at the direction of *any insured person*.”⁷³ The insurer then brought an action against the husband for the amount paid to the wife by claiming that it was subrogated to the cause of action of the wife against the husband.⁷⁴

One potential impediment to the ability of the insurer to bring a subrogated action in this context is the anti-subrogation rule that encompasses the principle that an insurer cannot be subrogated to a cause of action against one of its own insureds under the same policy.⁷⁵ The husband in *LaRondeau* raised two defenses based on public policy.⁷⁶ The first defense was that an insurer should not be permitted to pass part or all of a loss for which it was paid to provide coverage from itself to one of its insureds under the same policy.⁷⁷ The second defense was that allowing subrogation against one of its own insureds could put the insurer in a conflict of interest with that insured.⁷⁸

As stated in *Home Insurance Co. v. Pinski Brothers, Inc.*,⁷⁹ an action in subrogation against its own insured on the same loss would:

- (1) allow the insurer to expend premiums collected from its insured to secure a judgment against the same insured on a risk insured against;
- (2) give judicial sanction to the breach of the insurance policy by the insurer;
- (3) permit the insurer to secure information from its insured under the guise of policy provisions available for later use in the insurer’s subrogation action against its own insured;
- (4) allow the insurer to take advantage of its conduct and conflict of interest with its insured; and
- (5) constitute judicial approval of a breach of the insurer’s relationship with its own insured.⁸⁰

⁷¹ *Id.* at 648, 651.

⁷² *Id.* at 648.

⁷³ *Id.* (emphasis added).

⁷⁴ *Id.*

⁷⁵ *See id.* at 649–50.

⁷⁶ *Id.* at 649.

⁷⁷ *See id.*

⁷⁸ *See id.*

⁷⁹ 500 P.2d 945 (Mont. 1972).

⁸⁰ *Id.* at 949.

Also, the insurer would be conflicted by providing a strong defense for the guilty insured if the insured were sued by a third party for destruction of property because a finding of arson would set up a possible subrogated cause of action against the guilty insured to recover any proceeds paid to a co-insured. In all, as found by the court in the *Pinski Brothers*, there would be a violation of the equity maxims that “[o]ne who seeks equity must do equity . . . [and o]ne who seeks equity must come into court with clean hands.”⁸¹

The court in *LaRondeau* cut the Gordian knot by finding that because the policy excluded coverage for a loss deliberately caused by the husband, as to that loss, the husband should not be considered to be an “insured” under the policy.⁸² Therefore, because Mr. LaRondeau was not considered an insured in this particular instance, the insurer would not be passing liability back to an insured, and the insurer did not incur a conflict of interest with an insured. Neither of the two public policies applied to prevent subrogation.⁸³

The court was led to that interpretation of the term “insured” by concluding that any other interpretation would bar subrogation’s beneficial effect of placing the loss on the guilty party.⁸⁴ As the court stated, “recognition of Allstate’s subrogation claim against [LaRondeau] for the amounts which it paid to his wife, who *was* considered an innocent insured, serves the legitimate purpose of placing ultimate responsibility for the loss upon the intentional wrongdoer.”⁸⁵

Mr. LaRondeau further argued that subrogation should not be allowed because it exists only as to the “rights of the insurer against *third persons*

⁸¹ *Id.*

⁸² *LaRondeau*, 622 N.W.2d at 650.

⁸³ *See id.*

⁸⁴ *Id.* at 651.

⁸⁵ *Id.* There is also precedent in other contexts. For example, in the case of *Perl v. St. Paul Fire & Marine Insurance Co.*, an attorney and his law firm were both insured under a policy of malpractice insurance. 345 N.W.2d 209, 210–11 (Minn. 1984). The attorney was held to have committed a breach of fiduciary duty owed to a client, and the law firm was held vicariously liable as well. *Id.* at 211. The penalty was forfeiture of a \$20,000 fee to the client. *Id.* In an action by the attorney and the law firm for indemnification for the forfeiture under the malpractice policy, the court found that as a matter of public policy, indemnification for the loss due to the breach of fiduciary duty should not be enforceable by the attorney against the malpractice insurer. *Id.* at 215–16. However, since the law firm was only vicariously liable, the court held that the law firm could be indemnified for the \$20,000 forfeiture. *Id.* at 216. The court stated that since coverage for the attorney’s breach of fiduciary duty would not be allowed for the attorney, the attorney was an “insured” in this instance and the insurer could bring a subrogated action against the attorney. *Id.* at 216–17. Clearly the court was seeking an interpretation of the word “insured” that would ultimately place the \$20,000 loss on the wrongdoing attorney.

to whom the insurer owes no duty.”⁸⁶ The court found that since the husband’s deliberate destruction of the property was not covered by the homeowner’s policy, the insurer did not owe the husband a duty under the policy.⁸⁷ The husband in this instance is a third party in regards to the relationship between the insurer and his wife.⁸⁸

One final block thrown by Mr. LaRondeau was the interspousal immunity doctrine that he claimed was a bar to any cause of action by his wife against him as to which the insurer could be subrogated.⁸⁹ The court avoided the block on the grounds that in Nebraska, as in many other jurisdictions, the interspousal immunity doctrine has been abrogated.⁹⁰ Mrs. LaRondeau could clearly bring an action against her husband for waste.⁹¹

In jurisdictions where the interspousal immunity doctrine exists, however, subrogation rights of the insurer are affected. For example, in *Treciak v. Treciak*,⁹² the wife burned down the home owned and insured singly by the husband. The insurer paid to the husband the full claim for the fire damage and then sought to bring a subrogated cause of action against the wife to recover the proceeds paid.⁹³ The court stated that “[t]he Florida Supreme Court has clearly held that a direct action between spouses, even for an intentional tort committed in the midst of a divorce is barred by the doctrine of interspousal immunity.”⁹⁴ The subrogated action of the insurer, therefore, had to fail since “[a]s subrogee, USAA places itself ‘in the shoes of’ the subrogor, i.e. the husband, and has no rights greater than the husband.”⁹⁵

The right of subrogation can arise in either one of two ways. “Conventional” subrogation rights arise under the terms of the contract itself. In *LaRondeau*, for example, the policy provided, “[w]hen we pay for any loss, an *insured person’s* right to recover from anyone else becomes ours up to the amount we have paid.”⁹⁶ Absent a contractual provision, it exists in all jurisdictions as an equity formulation under common law and is referred to as “legal” subrogation.⁹⁷

⁸⁶ *LaRondeau*, 622 N.W.2d at 650.

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *See id.*

⁹⁰ *Id.*

⁹¹ *See id.*

⁹² 547 So. 2d 169 (Fla. Dist. Ct. App. 1989).

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *LaRondeau*, 622 N.W.2d at 648.

⁹⁷ *See VANCE & ANDERSON, supra* note 68, at 793.

In whatever form the right of subrogation arises, it is clearly a child of the court of equity, and as such, it will or will not be enforced by the court in its discretion solely to serve the ends of fairness and justice among the parties concerned. As the court stated in *Dix Mutual Insurance Co. v. LaFramboise*:⁹⁸

Subrogation is allowed to prevent injustice and unjust enrichment but will not be allowed where it would be inequitable to do so. There is no general rule which can be laid down to determine whether a right of subrogation exists since this right depends upon the equities of each particular case.⁹⁹

There are some defined limits to the application of the subrogation doctrine. For example, in *Dix*, a homeowner and a tenant were co-insureds under the same policy.¹⁰⁰ The tenant negligently caused a fire which damaged the insured premises.¹⁰¹ The insurer paid \$40,000 in proceeds to the homeowner and sought to bring an action in subrogation against the negligent tenant.¹⁰² The court denied the insurer the ability to bring a subrogated action against a negligent co-insured on the grounds that it was the intent and reasonable expectation of the parties, based on the lease agreement and the policy as a whole, that any loss negligently caused by any of the insureds should be indemnified by the insurer.¹⁰³ In equity and fairness, one who negligently causes the loss does not sufficiently qualify as a “wrongdoer” to overcome the doctrine disallowing subrogation against a co-insured.¹⁰⁴

An interesting argument was made by the insurer in the case of *Volquardson v. Hartford Insurance Co. of the Midwest*.¹⁰⁵ The plaintiff's husband burned their home to the ground as part of a suicide attempt without the knowledge or complicity of the plaintiff.¹⁰⁶ The plaintiff made a claim against the insurer for the full amount of the policy limit under the Nebraska statute that stated, “[t]he amount of the insurance written in [plaintiff's] policy shall be taken conclusively to be the true value of the

⁹⁸ 597 N.E.2d 622 (Ill. 1992).

⁹⁹ *Id.* at 624.

¹⁰⁰ *Id.* at 623.

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ *See id.* at 626.

¹⁰⁴ *Id.* In *LaSalle National Bank v. Massachusetts Bay Insurance Co.*, the court contrasted the situation of the negligent co-insured with that of the arsonist co-insured and concluded that only in the case of deliberate misconduct does the equitable principle of placing the loss on the wrongdoer permit subrogation against the wrongdoer as a noninsured under the policy. 958 F. Supp. 384, 387–89 (N.D. Ill. 1997).

¹⁰⁵ No. 4:00CV3340, 2003 WL 1191404 (D. Neb. Mar. 14, 2003).

¹⁰⁶ *Id.* at *1.

property insured and the true amount of loss and measure of damages.”¹⁰⁷ Under this statute, the wife was claiming to be entitled to proceeds for 100% of the loss.¹⁰⁸ The insurer raised the defense that under *LaRondeau*, it only needed to pay half of the amount of property damage because of its right of subrogation against the husband.¹⁰⁹ The court rejected this defense on the proposition that since subrogation serves the purpose of reimbursing the insurer for amounts paid, no such right of subrogation exists until the insurer actually pays the claim of the insured plaintiff.¹¹⁰

Another area in which courts exercise their discretion to tailor subrogation to the equities of the case is that of the voluntariness of the payment by the insurer to the innocent spouse. To be entitled to subrogation, the insurer must have paid proceeds under a contractual or other obligation rather than as a volunteer.¹¹¹ In the case of *Hartford Fire Insurance Co. v. Advocate*,¹¹² for example, a property owned and insured by a partnership was severely damaged by fire.¹¹³ The partnership filed a claim for \$332,000, which the insurer paid, in spite of an indication that one of the partners, Michael Advocate, had arranged for the fire for the purpose of destroying personal records that were relevant to his divorce action.¹¹⁴ The insurer brought an action as subrogee of the partnership against the guilty partner.¹¹⁵ The defendant raised the defense that the insurer paid the claim to the partnership as a volunteer, rather than under contractual obligation, and was, therefore, not entitled to subrogation.¹¹⁶ The basis for the argument was that the policy contained an exclusion for any loss “caused by . . . any fraudulent, dishonest or criminal act done by or at the instigation of any insured, partner or joint venturer.”¹¹⁷ Since the same insurer had rejected a claim by Advocate on his separate policy for his personal items destroyed in the same fire on the grounds that there was evidence to show that Advocate deliberately caused the fire, the insurer must have been aware of a valid defense to the subsequent payment of the

¹⁰⁷ NEB. REV. STAT. § 44-501.02 (1998).

¹⁰⁸ *Volquardson*, 2003 WL 1191404, at *5.

¹⁰⁹ *Id.*

¹¹⁰ *Id.* at *6. The *Volquardson* court did not deal with the issue of whether or not the wife is entitled to more than 50% of the loss, since the only argument raised by the insurer in that respect was the offset because of the right of subrogation. *Id.* at *6 n.3.

¹¹¹ See VANCE & ANDERSON, *supra* note 68, at 791–92.

¹¹² 162 A.D.2d 20, 560 N.Y.S.2d 331 (2d Dep’t 1990), *rev’d*, 78 N.Y.2d 1038, 581 N.E.2d 1335, 576 N.Y.S.2d 80 (1991).

¹¹³ *Id.* at 22, 560 N.Y.S.2d at 332.

¹¹⁴ *Id.* at 22–23, 560 N.Y.S.2d at 332.

¹¹⁵ *Id.* at 23, 560 N.Y.S.2d at 332.

¹¹⁶ *Id.* at 23–24, 560 N.Y.S.2d at 333.

¹¹⁷ *Id.* at 22, 560 N.Y.S.2d at 332.

partnership's claim.¹¹⁸ Advocate, therefore, claimed that the payment to the partnership was "voluntary."¹¹⁹

In coming to its decision upholding the right of the insurer to bring the subrogated action, the court was aware that the subrogated claim of the insurer turned on whether the court found the payment to be voluntary or involuntary.¹²⁰ In applying its equitable discretion, the court was also aware that subrogation would not only reward the insurer for making a quick payment of proceeds necessary to its insured, but would also place the loss squarely on the wrongdoer.¹²¹ It is not, therefore, surprising that the court chose to find the payment of proceeds to be under contractual obligation and not voluntary, in spite of the use of the policy words in the exclusion, "criminal act done by or at the instigation of *any* insured, partner or joint venturer,"¹²² and even though, at the time of the payment, "the insurance company had some indication that Advocate may have procured the fire."¹²³ The court dodged the first bullet (the use of the words, "any . . . partner," in the policy) by finding that in causing the fire, Advocate was acting for personal reasons and was not acting in the capacity of "any . . . partner."¹²⁴ It dodged the second bullet—the insurer's awareness of Advocate's arson—by noting that it was only subsequent to the payment to the partnership that a jury made the conclusive finding that Advocate had caused the fire.¹²⁵

While most insurers have been content with a subrogated right to recover the amount paid to the innocent spouse, the insurer in *Madsen v. Threshermen's Mutual Insurance Co.*¹²⁶ expanded the envelope by bringing a subrogated action against the guilty husband seeking not only the amount paid as proceeds under the policy,¹²⁷ but also attorney's fees

¹¹⁸ See *id.* at 24, 560 N.Y.S.2d at 333.

¹¹⁹ *Id.* at 23, 560 N.Y.S.2d at 333.

¹²⁰ See *id.* at 24–27, 560 N.Y.S.2d at 333–35.

¹²¹ See *id.* at 27, 560 N.Y.S.2d at 335.

¹²² *Id.* at 22, 560 N.Y.S.2d at 332 (emphasis added).

¹²³ *Id.* at 27, 560 N.Y.S.2d at 335.

¹²⁴ *Id.* at 22, 27, 560 N.Y.S.2d at 332, 335.

¹²⁵ *Id.* at 27, 560 N.Y.S.2d at 335. The court stated:

As the insurance company acted properly in paying the innocent partnership under its policy, it should not be precluded from seeking recovery of that payment from Advocate via subrogation. "[S]ubrogation is a creature of equity having for its purpose the working out of an equitable adjustment between the parties by securing the ultimate discharge of a debt by the person who in equity and good conscience ought to pay it." It appears to us that Advocate, an obvious wrongdoer, should be obligated to pay for the damages which resulted from his own conduct of setting the fire.

Id., 560 N.Y.S.2d at 335 (citation omitted).

¹²⁶ 439 N.W.2d 607 (Wis. Ct. App. 1989).

¹²⁷ *Id.* at 608. The husband who burned the property conceded the insurer's right to this

expended in proving the guilt of the husband, and the costs of adjusting the claim that resulted from the husband's arson.¹²⁸

The court disallowed the recovery of attorney's fees on the grounds that under what it termed the "'American rule,' the prevailing litigant is not entitled to collect attorney fees unless authorized by statute or contract,"¹²⁹ and no such statutory or contractual authorization existed.¹³⁰ The exception to this rule occurs when the wrongful act of the defendant in the subrogated action has been the proximate cause of involvement of the insurer in litigation with other parties, a situation that did not obtain in this case.¹³¹

The *Madsen* court did, however, find that the insured was entitled to any consequential damages that were the "natural and proximate result" of the wrongful act of the husband.¹³² What specific items would qualify as consequential damages is a question of fact for the jury, but the court noted that this could include, in addition to proceeds paid, the reasonable expenses incurred in adjusting any claims filed for the loss.¹³³ The court also did not rule out the possibility of punitive damages against the arsonist husband.¹³⁴

FINAL ANALYSIS

How then does subrogating the insurer to the claim against the guilty co-insured spouse affect the balance of equities among the innocent insured, the guilty insured, and the insurer?

On the plus side, the major benefit is that it places the loss squarely on the only party who is guilty of wrongdoing—at least to the extent of the ability of the wrongdoer to pay the subrogated judgment out of his personal assets. This particularly appeals to the equity court's sense of justice. This level of assurance that the wrongdoer will not share in any proceeds could act as a major inducement to courts in setting precedents that will more liberally facilitate the ability of the innocent spouse to collect proceeds for his interest in the damaged property. This is no small consideration, since the rebuilding of the family home could depend on receipt of insurance proceeds.

reimbursement. *Id.* at 610.

¹²⁸ *Id.* at 611.

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ *See id.*

¹³² *Id.*

¹³³ *See id.*

¹³⁴ *Id.* ("Additionally, because there are factual disputes relating to the issue of punitive damages against Robert, summary judgment is inappropriate.").

Liberal allowance of subrogation also benefits insurers in more ways than is obvious. Clearly, it is a benefit to be able to recoup proceeds paid to the innocent spouse. But in addition, foresight of the enhanced possibility of recoupment would also allow the insurer to be more liberal and prompt in paying proceeds to the innocent party without standing on every technical defense available to it. This would have the inevitable effect of building good will with its insureds as well as with the courts.

The right of subrogation further gives insurers an incentive to diligently ferret out and take action against arsonists. This is a significant factor, since this form of private enforcement against the destructive and dangerous crime of arson could effectively bolster the efforts of otherwise occupied public prosecutors and law enforcement officials. The net result could be an added deterrent to future arsonists and, therefore, a reduction of the proceeds that insurers are required to pay in the first place. These savings, together with subrogated reimbursements, could be used to reduce premiums to policyholders, as well as to increase profits to the insurers.

These benefits would also flow to innocent insureds in the form of a climate in which, as in the *Advocate* case,¹³⁵ insurers are induced to pay claims more quickly. Precedent such as the *Advocate*¹³⁶ decision would allow proceeds to be paid without the insurer's having to investigate and press every possible defense against the insured out of fear of being considered a "volunteer" for subrogation purposes.

The benefits to the public of liberal allowance of subrogation are also considerable. Primary among these could be the deterrence of arson. Considering the fact that in the year 2000, over \$1.5 billion worth of insured property was destroyed by arsonists, and that according to FBI estimates, only about 17% of the incidents of arson result in arrest because of the difficulty of acquiring proof beyond a reasonable doubt,¹³⁷ civil enforcement, where the standard of proof is merely a preponderance of the

¹³⁵ *Hartford Fire Ins. Co. v. Advocate*, 162 A.D.2d 20, 560 N.Y.S.2d 331 (2d Dep't 1990), *rev'd*, 78 N.Y.2d 1038, 581 N.E.2d 1335, 576 N.Y.S.2d 80 (1991). Note that in the *Advocate* case, the insurer paid the claim of the innocent partnership in the amount of \$332,183.09 in full satisfaction of that insured's claim in spite of the defense available to it in the form of the exclusion from coverage of any loss caused by "any fraudulent, dishonest or criminal act done by or at the instigation of *any* insured, partner or joint venturer," and evidence to indicate that a partner, Michael Advocate, had deliberately caused the fire. *Id.* at 22–23, 560 N.Y.S.2d at 332 (emphasis added).

¹³⁶ *Id.* at 28–29, 560 N.Y.S.2d at 336.

¹³⁷ See Ohio Insurance Institute, 2002 Ohio Insurance Facts: Arson: A Costly Crime, at http://www.ohioinsurance.org/factbook2002/chapter5/chapter5_c.shtml (2002). According to this study, there are indications that the incidence of arson is increasing. *Id.*

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evidence, through a cadre of highly motivated individual insurers seeking subrogation could have a healthy deterrent effect.¹³⁸

Secondly, depending on the willingness of insurers to pass the savings on to insureds, recoupment through subrogation could have a diminishing effect on premiums. One particular benefit to the courts could be that if insurers are more willing to make quick, uncontested payments on claims of innocent insureds, courts would find their dockets less burdened with actions by innocent insureds against insurers on these claims, as well as bad faith causes of action between the same parties.

In cases in which collusion between the spouses is suspected by the court but not proven, if the assets of the two spouses are collusively shared between them, there will be no net increase of assets to share, since the proceeds to the innocent spouse will be offset by the subrogated recovery against the guilty spouse. In addition to having a deterrent effect on the commission of arson in the first place, this could help in satisfying the court that a liberal allowance of recovery by apparently “innocent” spouses will not result in benefits from insurance proceeds to collusive couples. The downside, of course, is that this only works to the extent that the guilty spouse has independent leviable assets to satisfy a subrogated judgment.

The one obvious detriment to allowing liberal subrogation is that if the “innocent” spouse is truly innocent and the couple remains together with shared assets, the innocent spouse will lose the net benefit of the proceeds to rebuild the home to the extent that the guilty spouse can satisfy the subrogated claim of the insurer. This simply means that in this circumstance, the principle of disallowing a wrongdoer to profit from his wrongdoing takes precedence over the principle that an innocent spouse shall not be made to suffer for the wrongs of his spouse.

It should be noted that all of the considerations discussed above translate to other situations in which the property of co-insureds is the object of arson by one of the co-insureds. For example, in situations where the property of a partnership is deliberately destroyed by one of the partners acting alone, payment of the insurance claim to the partnership would surely result in a pro rata sharing of the benefits by the guilty partner as long as the partnership remains intact. This could certainly disparage allowance of the insurance claim by the court to the detriment of the partnership itself and all innocent partners. If, however, the offending partner were considered a non-insured for the purpose of this claim, subrogation of the insurer to the partnership’s tort claim could strip the

¹³⁸ See Ohio Insurance Institute, 2002 Ohio Insurance Facts: The Impact of Insurance Fraud, at http://www.ohioinsurance.org/factbook2002/chapter5/chapter5_d.shtml (2002).

offending partner of a share in the benefit of the proceeds and free the court to uphold the claim of the partnership.¹³⁹

Since the subrogated cause of action would be for the full amount of the covered loss, which would exceed the pro rata share of the single partner in the benefit of the proceeds, the threat of subrogation and the potential net loss to the partner could act as a more effective deterrent than in the case of a guilty spouse.

In the case of corporate property deliberately destroyed by a shareholder, the necessity for subrogation to balance the equities depends on the percentage of corporate stock owned by the shareholder. If the arson is committed by a small shareholder in a publicly held corporation, the personal benefit of the proceeds to the guilty shareholder may be so insignificant as to be a non-factor in the court's decision to grant the insurance claim of the corporation. The deterrent and other equitable benefits of placing the ultimate loss on the wrongdoer instead of the insurer, however, would still remain.

If, on the other hand, the guilty shareholder owns a significant percentage of the corporation's stock and would personally reap a major benefit from the insurance proceeds, subrogation may be a necessary antidote to free the court to allow the corporation's insurance claim. Cases in between will fall on one side or the other of this necessity depending on the discretion of the court.

One complication that might arise when a corporation is the insured and the arsonist is the sole or major shareholder, is that the court might pierce the corporate veil and hold that the shareholder and the corporation are one entity. It would then be difficult to write an opinion that does not attribute the arson to the corporation, which would then be barred from recovering the proceeds under the policy. Even if the act of arson were found to be the sole act of the shareholder acting separately, it would be difficult to find the shareholder, who is then equated with the corporation, a non-insured under the policy for subrogation purposes.¹⁴⁰

In sum, a wholesale swing of precedents toward eliminating impediments to subrogation on the part of insurers, together with a concomitant end run around theoretical doctrines that prevent recovery of proceeds by innocent co-insureds, would seem to advance the twin goal of placing the loss on the wrongdoer and preventing the innocent party from

¹³⁹ See *Advocate*, 162 A.D.2d at 27, 560 N.Y.S.2d at 335 (reasoning that the insurance company should not be prohibited from obtaining retribution from an apparent guilty party through subrogation).

¹⁴⁰ See *Cora Pub., Inc. v. Cont'l Cas. Co.*, 619 F.2d 482, 486 (5th Cir. 1980) (citing *Gen. Elec. Credit Corp. v. Aetna Cas. & Sur. Co.*, 263 A.2d 448 (Pa. 1970)).

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suffering the frequently irreplaceable loss because of the actions of the guilty co-insured.