LEGAL UPDATES

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Classifying Subrogation Claims under State Insurance Liquidation Laws

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When an insurance company becomes insolvent, state liquidation statutes govern how the company's remaining assets are distributed among claimants. Each state has a priority of distribution statute which outlines the priority of each type of claim and requires that higher priority class claims be paid in full before any payments are made to lower priority claimants. One type of claim that is frequently unaccounted for in these priority statutes is subrogation claims. The treatment and priority of these claims is particularly important for insurers and other entities seeking to recover payments made on behalf of insureds.

What is a subrogation claim?

Subrogation occurs when one party (usually an insurer) pays a loss on behalf of another and then "steps into the shoes" of that party to pursue recovery from the responsible party or that party's liability insurer. A classic example drawn from the world of automobile insurance illustrates clearly how subrogation works: Driver A hits Driver B with his car, and Driver B makes a claim with her insurance company for the damages she sustained. Driver B's insurance company pays Driver B for her claim. Driver B's insurance company then files a subrogation claim against Driver A's insurance company to recoup the money it paid to Driver B for her claim since Driver A was at fault.

Importantly, subrogation rights are *derivative*, meaning the subrogee (the insurer) acquires only the rights the original claimant (the insured) had and may only assert claims based on the insured's rights.

The big picture: subrogation claims are not "policy claims."

The priority distribution statute typically grants higher priority to policy claims than general creditor claims. That means policy claims are paid before

general creditor claims. Thus, the question is whether a subrogation claim should be considered a "policy" claimant or a general creditor claimant. Many state liquidation statutes do not expressly mention subrogation claims.

Across the country, subrogation claims are not treated as direct policy claims for purposes of liquidation priority. Instead, subrogation claims are generally classified as general creditor or residual claims, reflecting their derivative nature and the fact that the original insured has already been made whole.

For example:

Statutory Carve Outs. Some state liquidation statutes carve out from Class 2 claims any portion of a loss for which the claimant has already been indemnified by "other benefits or advantages." This carve-out is key. Because subrogation claims arise only after the injured party has already been made whole (i.e., indemnified), courts consistently find that subrogation claims do not belong in Class 2. Instead, they are generally treated as lower-priority claims.

In *Protective Ins. Co. v. Comm'r of Ins.*, 562 P.3d 215 (Nev. 2025), the Nevada Supreme Court held that an insurer's subrogation claim for payments made to its insured did not qualify for priority as a "claim under policies." The court explained that the statutory carve-out for losses already indemnified by "other benefits or advantages" applies, expressly excluding subrogation claims from the higher-priority class and relegating them to a residual, lower-priority class. *Id.* at 217.

Similarly, in *Ario v. Reliance Ins. Co.*, 980 A.2d 588 (Pa. 2009), the Pennsylvania Supreme Court addressed whether subrogation claims should be treated as high-priority policy claims or as lower-priority residual claims under the state's liquidation act. The court concluded that subrogation claims are subject to the statutory carve-out for losses already indemnified and therefore must be classified in the residual class, not as direct policy claims. *Id.* at 595.

Takeaway

The statutes and case law aim to ensure that direct insureds are paid first, while subrogation claimants stand in line with other general creditors.

Contact us

If you have questions regarding insurer receiverships, please contact Kirsten Byrd, Katie Griffin, or your Husch Blackwell attorney