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No. 62767-8-I

IN THE COURT OF APPEALS  
OF THE STATE OF WASHINGTON  
DIVISION I

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FARMERS INSURANCE COMPANY OF WASHINGTON,

Appellant,

v.

PEARL C. AVERILL, on behalf of herself and all others similarly  
situated,

Respondent.

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**APPELLANT'S OPENING BRIEF**

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## I. INTRODUCTION

This appeal involves a single purely legal issue, whether the made-whole doctrine applies to deductibles in car insurance policies. The insurance regulations, a ruling by the Washington Office of Insurance Commissioner (“OIC”), two leading insurance treatises, and every published case to address this issue have concluded that the made-whole doctrine does not apply to deductibles. The trial court reached the opposite conclusion because it was unable to reconcile these authorities with its reading of the Washington Supreme Court’s decision in *Sherry v. Financial Indemnity Co.*, 160 Wn.2d 611, 160 P.3d 31 (2007). CP 266.

The trial court correctly noted that *Sherry* did not address the specific issue “whether the made-whole doctrine requires that an insured be reimbursed for her entire deductible before an insurer is entitled to recover its payments made under the applicable coverage.” CP 266. Nonetheless, it erred in reading *Sherry* so broadly as to create a conflict with the insurance regulations and the unanimous authorities that conclude that the made-whole doctrine does not apply to deductibles. Properly understood, the decision in *Sherry* creates no such conflict. *Sherry* (and every prior Washington case) addressed only the application of the made-whole rule to *insured and underinsured losses*. *Sherry* does not hold that the made-whole doctrine is an absolute rule requiring that the insured must be made whole for *all* of her claimed losses – including the risk she

specifically agreed to retain – before the insurer can seek reimbursement or subrogation for *any* of the payments that covered the insured loss.

To construe *Sherry* so broadly would be a departure from the line of established Washington cases that applied the made-whole doctrine in a more limited fashion, based on the actual coverage offered by the policy. *See Peterson v. Safeco Ins. Co.*, 95 Wn. App. 254, 976 P.2d 632 (1999) (holding that plaintiff's attorney fees and costs to obtain recovery from a tortfeasor are not included in determining the plaintiff's total losses for purposes of the made-whole calculation); *Mahler v. Szucs*, 135 Wn.2d 398, 420-21, 957 P.2d 632 (1998) (in the context of property loss, the insurer is free to contract for a "proper, classical" right to subrogation that is enforceable directly against the third party); *Meas v. State Farm Fire and Casualty Co.*, 130 Wn. App. 527, 123 P.3d 519, 525 (2005), *review denied*, 167 Wn.2d 1018, 142 P.3d 607 (2006) (insured was "made whole for the property loss claimed under his collision coverage when he received payment from State Farm").

The made-whole doctrine is further limited to situations where the insured and insurer compete for a limited fund. When "there is no doubt that the 'pie' is big enough," the made-whole doctrine does not apply. *Paulson v. Allstate Ins. Co.*, 665 N.W.2d 744, 750 n.3 (Wis. 2003); *Schonau v. Geico Gen. Ins. Co.*, 903 So.2d 285, 288 (Fla. Dist. Ct. App. 2005) (made-whole doctrine is not implicated absent the threshold issue of

insufficient funds). Because Averill is free to pursue recovery of the unreimbursed portion of her deductible from the third party the made-whole doctrine does not apply.

The trial court's overbroad reading of *Sherry* effectively requires the insurer to provide the insured a more expensive no-deductible policy that she never bargained or paid for. This result is contrary to the equitable considerations behind the made-whole doctrine. It is also contrary to WAC § 284-30-3905 that reflects the fundamental notion that the deductible represents the amount of self-insured loss that the insured specifically agreed to *retain* when buying the policy. Nothing in *Sherry* (or the made-whole doctrine generally) warrants reducing the retained risk to zero as a prerequisite for subrogation. The trial court's erroneous interpretation of *Sherry* should be reversed and the validity of insurance regulations reinstated.

## **II. ASSIGNMENTS OF ERROR**

The trial court erred in:

(1) granting summary judgment to plaintiff on the breach of contract claim.

(2) denying Farmers' motion to dismiss the breach of contract claim. CP 238-240.

## **III. ISSUES PERTAINING TO THE ASSIGNMENTS OF ERROR**

Whether the made-whole doctrine applies to deductibles.

#### IV. STATEMENT OF THE CASE

##### A. Facts

Ms. Averill's 2007 Honda Accord was insured under an automobile liability insurance policy issued by Farmers Insurance Company of Washington ("Farmers"). CP 23-67. The policy provided that Farmers would pay for loss to the car *less any applicable deductible*, and further provided that Farmers has the right of reimbursement and subrogation:

**Coverage G – Collision.** We will pay for loss to your insured car caused by collision *less any applicable deductibles. Any deductible shall apply separately to each loss.*

...

1. Collision means collision of your insured car with another object . . .
2. Loss means direct and accidental loss or damage to your insured car, including its equipment.

...

**Our Right to Recover Payment.** When a person has been paid damages by us under this policy and also recovers from another, we shall be reimbursed to the extent of our payment after that person has been fully compensated for his or her loss. *Except as limited above, we are entitled to all the rights of recovery of the person to whom payment was made against another.* That person must sign and deliver to us any legal papers relating to that recovery, do whatever is necessary to help us exercise those rights and do nothing after loss to prejudice our rights.

CP 33, 35 (emphasis added). Averill selected the deductible of \$500 for each collision loss. CP 4.

On February 27, 2007, Averill's car was damaged in an accident. The driver of the other car, Kyung Son ("Son"), was insured by State Farm Mutual Insurance Company ("State Farm"). Farmers deemed Averill's car a total loss. It estimated the car's value, with sales tax and DMV fees, to be \$16,254.10. Farmers paid Averill that amount less her \$500 deductible, or \$15,754.10. CP 4.

Farmers' payment to Averill triggered Farmers' subrogation right against Son. Because both State Farm and Farmers are parties to an inter-insurance company agreement, Farmers was able to assert its subrogation right directly against State Farm through an inter-company arbitration. Farmers' subrogation claim against State Farm included:

\$15,754.10 Farmers paid to Averill for the cash value of her car

\$162.00 Farmers paid to tow the car from storage to the Averill's residence

\$167.55 Farmers paid to tow the car from the accident scene to storage

\$386 Farmers paid for loss of car's use

\$114 Farmers paid for car rental

(\$1,472) Farmers received from salvage

Total property damage = \$15,111.65

In addition to asserting *its own* subrogation rights, Farmers also informed Averill that it would pursue, in the same proceeding, a claim for her deductible *on her behalf*. CP 69, 73. Washington insurance regulations specifically authorized Farmers to do so. See WAC § 284-30-3904 (“if your insurer is pursuing collection of its interest, you may request they pursue collection of your deductible for you.”).

The arbitrator determined that Averill and Son were each 50 percent at fault and awarded Farmers half of its net payments to Averill, or \$7,805.83 (1/2 of \$15,111.65 = \$7,555.83). CP 70-71. The arbitrator also awarded Averill half of her deductible, \$250. CP 71. State Farm issued two checks, one to Farmers for \$7,555.83 and the other to Averill’s mother, who was listed on the car’s title as a lien holder, for \$250. CP 5. Averill does not dispute that she received half of her deductible from State Farm. Farmers retained \$7,555.83 it was awarded from State Farm.

#### **B. Procedural History**

On November 2, 2007, Averill sued Farmers for alleged violations of the Consumer Protection Act, bad faith, negligence, breach of contract and unjust enrichment. CP 1-12. She claimed that under *Sherry*, Farmers had to compensate her for the \$250 of her deductible that the arbitrator did not award before Farmers could retain any amounts awarded to it from State Farm. Farmers moved to dismiss the complaint, relying on WAC § 284-30-3905 and unanimous authorities holding that the made-whole

doctrine does not apply to deductibles. CP 74-88; 102-128. Averill cross-moved for partial summary judgment. CP 89-101.

Both motions focused on the same legal issue: whether Farmers was required to compensate Averill for the balance of her deductible that was not awarded by the arbitrator as a condition of exercising its subrogation right against State Farm. The trial court recognized that “the central issue involve[d] the proper interpretation and application of the make-whole doctrine . . . and that the several claims are really just different theories that articulate a single claim for relief.” CP 265. It granted summary judgment to Averill on the breach of contract claim because it concluded that WAC § 284-30-3905 “cannot be reconciled with *Sherry*,” and that the made-whole doctrine required Farmers to reimburse Averill for her entire deductible before it could recover anything on its subrogation claim against Son and his insurer. CP 238-240; 266. The trial court certified its ruling for discretionary review under RAP 2.3(b)(4). CP 266-267. It recognized that the remaining claims (bad faith, CPA and negligence) depend on the resolution of the central legal issue it certified for discretionary review. CP 265.

This Court granted discretionary review, stating that “there clearly are substantive grounds for a difference of opinion whether the make whole doctrine extends to agreed deductibles.” 2/11/09 Court’s Letter to Counsel, at 2.

## V. ARGUMENT

Based on WAC §§ 284-30-3904 and -3905, the OIC advises consumers of car insurance to select the deductible that best meets their insurance needs:

The amount of the deductibles you select will affect your auto rate. For example, you may save money by increasing your collision and comprehensive deductibles from \$100 to \$500.

...

**Deductible** – The dollar amount an insured person must pay for covered charges during a calendar year before the plan starts paying claims.

*OIC's Consumer's Guide to Auto Insurance*, available at [www.insurance.wa.gov](http://www.insurance.wa.gov) at 6. See also *OIC's Consumer's Insurance Glossary*, available at [www.insurance.wa.gov](http://www.insurance.wa.gov).

The trial court's overbroad view of the made-whole doctrine makes the OIC guidance and the insured's choice of risk retention a nullity. It requires the insurer, as a condition of subrogation, to give the insured a policy with no deductible that she never bargained or paid for. Properly understood, neither the made-whole doctrine nor the subrogation principles warrant this result.

### A. **The Made-Whole Doctrine is a Common-Law Exception to the Subrogation Rule**

An insurer that pays its insured's claim is entitled to recover the payment from a third party that caused the insured's covered loss. This

concept is known as subrogation, and can arise by contract, statute or equitable principles. *See Mahler v. Szucs*, 135 Wn.2d 398, 412, 957 P.2d 632 (1998) (subrogation enables an insurer to recoup from a third party the amount that it paid to its insured; the right to subrogation may arise by operation of law (legal or equitable subrogation) or by contract (conventional subrogation)).

The purpose of subrogation is to prevent the insured from obtaining a double recovery and to place the financial responsibility on the party that caused the loss. The insurer's right of subrogation is similar to the right of reimbursement from its own insured. "Subrogation" refers to the insurer's right to "step into the shoes of its insureds and pursue their claims against the tortfeasors." *Mahler*, 135 Wn.2d at 419-20. In contrast, "reimbursement" refers to the insurer's right to recover "*from its insureds . . . the proceeds of [their] settlements.*" *Id.* at 420 (emphasis in the original). Unlike subrogation, the insurer's right of reimbursement is contingent on the insured's actual recovery from the third party. *Id.* ("reimbursement . . . [occurs] when an insured pursues an action or seeks recovery from a tortfeasor."). Subrogation and reimbursement are sometimes referred to collectively as "subrogation." 16 *Couch on Insurance*, § 222:2 (3d Ed.)

The made-whole doctrine is a common-law exception to an insurer's subrogation right. *See Couch*, § 223:133-223:163. The doctrine

precludes an insurer from recovering any third party funds unless and until the insured has been made whole for the loss. The made-whole doctrine is a rule of priority: where the wrongdoer has a fixed amount of assets, it is fair that the insured has priority of compensation before the insurer may seek to collect from the wrongdoer. As one commentator aptly put it, the made-whole doctrine addresses the situation “when the pie isn’t big enough, who eats last?” Jeffrey A. Greenblatt, *Insurance and Subrogation: When the Pie Isn’t Big Enough, Who Eats Last?* 64 U. Chi. L. Rev. 1337 (1997).

The Washington Supreme Court recognized the made-whole doctrine in *Thiringer v. Am. Motors Ins. Co.*, 91 Wn.2d 215, 588 P.2d 191 (1978). At issue in *Thiringer* were the priorities, as between an insurer and its insured, to the proceeds of a lump-sum settlement with the tortfeasor obtained by the insured. The settlement exhausted all of the tortfeasor’s assets but failed to compensate the insured for all his losses. The insurer argued that the lump-sum settlement prejudiced its right of subrogation and argued the settlement proceeds should be allocated first to special damages covered by PIP (and subject to subrogation) and then to the other damages suffered by the insured. The Supreme Court concluded that the allocation that gives the insurer priority of recovery “would be obviously unfair, since the insured pays a premium for the PIP coverage and has a right to expect that the payment promised under this coverage

will be available to him if the amount he is able to recover from other sources . . . is less than his general damages.” *Id.* at 220.

The Court stated the general made-whole rule as follows:

While an insurer is entitled to be reimbursed to the extent that its *insured recovers* payment for the same loss from a tortfeasor responsible for the damage, it can recover only the excess which the insured has received from the wrongdoer, remaining after the insured is fully compensated for his loss.

*Id.* at 219 (emphasis added). *See also Chong v. State Farms Mut. Aut. Ins. Co.*, 428 F. Supp.2d 1136, 1144 n.4 (S.D. Ca. 2006) (“The made-whole rule . . . applies only to a small set of cases where the carrier has elected not to participate in the policyholder’s tort action and the policyholder’s . . . recovery [is] inadequate to fully compensate her for her loss.”).

**B. No Washington Cases Have Applied the Made-Whole Doctrine to Retained Risk Represented by the Deductible**

Washington courts also recognize a separate and independent limitation on the subrogation/reimbursement right based on the “common fund” exception to the American Rule. The common fund doctrine provides that when a person creates or preserves a fund from which another then takes, the two should share, pro rata, the fees and costs reasonably incurred to generate that fund. *Covell v. City of Seattle*, 127 Wn.2d 874, 891, 905 P.2d 324 (1995). The common-fund limitation provides that an insurer’s reimbursement from its insured is subject to the insurer bearing a pro rata portion of the insured’s attorney fees and costs

incurred to obtain the recovery from a third party. *Mahler*, 135 Wn.2d 424, 436 (holding that a PIP insured creates a common fund when, after receiving PIP payments, he or she recovers full compensation from the tortfeasor; if the non-participating insurer shares in that recovery by getting back some of its PIP payments, the insurer is liable to its insured for a proportion of the insured's attorney fees). *See also Winters v. State Farm Mut. Auto. Ins. Co.*, 144 Wn.2d 869, 31 P.3d 1164 (2001).

The Court in *Mahler* clarified that the made-whole principle applies differently to different types of loss, and coverage for that loss. Property loss caused by a car accident (including loss insured by collision coverage) is "usually readily determinable" and often undisputed. In contrast, the non-economic damages (including those insured by PIP) that result from a car accident "are not immediately known, typically amount to many multiples of the economic damages and are almost always disputed." 135 Wn.2d at 414. Non-economic damages therefore raise a heightened concern that all available sources of recovery will not fully compensate the insured for his loss. For that reason, an insurer has no subrogation rights directly against a third party for personal injury and must seek recovery only by reimbursement. In contrast, in the context of property loss, the insurer is free to contract for a "proper, classical" right to subrogation that is enforceable directly against the third party. *Mahler*, 135 Wn.2d at 420-421.

In *Petersen v. Safeco Ins. Co.*, 95 Wn. App. 254, 976 P.2d 632 (1999), the court held that attorney fees and costs to obtain the third-party recovery should not be deducted from the insured's total recovery for purposes of the made-whole calculation. The court reasoned that a rule requiring a deduction of litigation expenses for the purposes of determining whether the insured was made whole would improperly "shift the burden of an [insured's] attorney fees from the plaintiff in a personal injury action to the first party carrier" contrary to the American rule followed by Washington courts. *Id.* at 261. In other words, because attorney fees and costs are not an insured loss,<sup>1</sup> the made-whole doctrine did not apply.

In *Meas v. State Farm Fire and Casualty Co.*, 130 Wn. App. 527, 13 P.3d 519 (2005), *review denied*, 167 Wn.2d 1018, 142 P.3d 607 (2006), the court held that the insurer does not violate the made-whole doctrine when it exercises its subrogation rights against the at-fault driver's insurer after paying its own insured (who was free of fault) the full repair costs of his car under his collision policy plus his deductible. The insured claimed that he was not made whole by these payments because his personal injury claim against the at-fault driver remained unresolved. The Court of Appeals disagreed:

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<sup>1</sup> As discussed *supra* at 11-12, attorney fees are subject to pro-rating when the insured's efforts created a common fund that benefitted the insurer.

*Meas was fully compensated or “made whole” for the property loss claimed under his collision coverage when he received payment from State Farm. Further, State Farm recovered his deductible and paid it to him. Under the express language of the policy and in accordance with *Mahler* and *Thiringer*, State Farm was entitled to directly recover its payment from Allied. . . [T]he subrogated property damage claim was distinctly different and separate from the personal injury . . . State Farm could settle the matter at any time, even prior to the settlement of the personal injury.*

*Meas*, 130 Wn. App. at 538-539 (emphasis added).

*Meas* is consistent with *Mahler* in that both cases applied the made-whole doctrine based on the *specific coverages provided in the policy*. As one court explained:

Often a subrogated amount is not coextensive with the claim against a third party; it usually involves only one element of damage as opposed to several. Nevertheless, the fact that the claims are not coextensive will not prevent recovery by a subrogated insurer.

The mere fact that the claim against the wrongdoer included a claim for losses not covered by insurance [and therefore not subrogated] does not prevent a release from rendering the insured liable to return the insurance money where the contract gives a right of subrogation. An insurance company which has paid a claim for property damage, for instance, to an insured automobile, has a right to share, under the principles of subrogation, in the proceeds of a recovery against or settlement with a tortfeasor in favor of the insured, who has also suffered personal injuries in the same accident.

*Ludwig v. Farm Bureau Mut. Ins. Co.*, 393 N.W.2d 143, 146 (Iowa 1986)

(citation omitted). *See also id.* at 146-147 (“The amounts recovered

against a third party for separate elements of a claim can be identified and credited toward subrogation claims, even though other elements of the third-party claim may not be fully satisfied. . . . In this case, Farm Bureau’s policy did not agree to indemnify Ludwig for pain and suffering or disability. Yet, denial of its claim for medical expenses because Ludwig had not also recovered for other elements of damage would have the effect of making Farm Bureau an insurer against these losses as well. This would be a windfall to an insured who has not paid for such protection.”).

In *Chen v. State Farm Mut. Auto. Ins. Co.*, 123 Wn. App. 150, 94 P.3d 326 (2004), *review denied*, 153 Wn.2d 1024, 110 P.3d 755 (2005), this Court analyzed the same provision in the State Farm policy that was at issue in *Meas* and came to the same conclusion. The insured in *Chen* was injured in a car accident and received both PIP and property-damage benefits from the insurer. The insurer was reimbursed for its PIP payment when the insured settled with the tortfeasor for the personal-injury damages. As in *Meas*, State Farm also recovered its property damage payment directly against the tortfeasor. The Court of Appeals concluded that the policy “treated property damage differently than PIP” and held that State Farm had a “classic subrogation right” to pursue reimbursement directly from the tortfeasor. *Id.* at 157. *See also Meas*, 130 Wn. App. at 537 (stating that the *Chen* court “held as a matter of law that State Farm’s

payment for collision damage, and the insured's acceptance of that payment, triggered the assignment of the insured's right to recover for property damage to State Farm under the policy's express language.").

In *Sherry*, the Supreme Court addressed the application of the make-whole doctrine to PIP benefits. It held that an insurer that provides both UIM and PIP coverage "is entitled to reduce an UIM arbitration award by previously paid PIP benefits only when its insureds are fully compensated for their actual damages, without reduction to account for the insured's fault." 160 P.3d at 38. As in *Mahler*, the Court analyzed "full compensation" specific to the coverage at issue:

It is important to remember that UIM is unique among insurance. Its purpose and focus are very narrow. Rather than full compensation, UIM coverage simply provides additional insurance to cover any judgment. . . . UIM insurance simply insures a driver against someone else not having enough insurance to pay a judgment, rather than insuring for full compensation in the case of an accident.

...

Unlike UIM benefits, PIP benefits are not fault based. . . . Generally speaking, people purchase PIP coverage to cover the immediate costs of an accident, such as medical expenses and loss of income; people purchase UIM coverage against the very real possibility that they will be injured by a motorist who has insufficient insurance to pay a judgment.

*Id.* at 37-38 (citations omitted)

The Supreme Court reasoned that the insured had bargained for protections from each of these risks, and paid separate premiums for each coverage. If the insurer was allowed to offset its no-fault PIP payments against UIM benefits, which are fault-based, the insured “would effectively receive nothing under his PIP coverage; coverage for which he paid a separate premium.” *Id.* at 38. “By offsetting its PIP medical payments, the insurance company essentially seeks to reduce Sherry’s medical insurance because of his own fault. If Sherry had purchased medical insurance from another insurance carrier, there would be no reduction for fault; thus, under FIC’s argument, Sherry is worse off for having purchased both insurance coverage from FIC.” *Id.* Therefore, “an insurer is entitled to reduce an UIM arbitration award by previously paid PIP benefits only when its insureds are fully compensated for their actual damages, without reduction to account for the insureds’ fault.” *Id.*

All of the Washington cases discussed above, including *Sherry*, addressed the application of the made-whole doctrine to *insured or underinsured* losses. None of them support the proposition that the made-whole doctrine requires the insurer to make its insured “whole” for losses it did not insure as a condition to exercising its subrogation rights, much less compensate the insured for the risk she specifically agreed to retain when purchasing the policy. “This would be a windfall to an insured who has not paid for such protection.” *Ludwig*, 393 N.W.2d at 147.

**C. The Insurance Regulations and OIC Ruling State that Made-Whole Doctrine Does Not Apply to Deductibles**

None of the Washington cases that discussed the made-whole doctrine have addressed its relationship, if any, to the deductible. The OIC, however, has addressed the issue and concluded that the made-whole doctrine *does not* apply to deductibles. The OIC promulgated regulations that specifically so state:

**WAC § 284-30-3904. Will my insurer pursue collection of my deductible?** (1) Yes, if your insurer is pursuing collection of its interest, you may request they pursue collection of your deductible for you.

(2) Your insurer will inform you of its efforts relative to collection of your deductible.

**WAC § 284-30-3905. If my insurer collects my deductible back, will I recover the full amount of my deductible?**

(1) At a minimum, recovery will be shared on a proportionate basis with your insurer.

(2) No deduction for expenses can be made from the deductible recovery unless an outside attorney is retained to collect such recovery, and then only for the pro rata share of the allocated loss adjustment expense.

These regulations became effective in October 2003. Their predecessor (former WAC § 284-30-390) provided that “subrogation recoveries shall be shared on a proportionate basis with the first party claimant, unless the deductible amount has been otherwise recovered.” At least nineteen states have promulgated statutes or administrative

regulations that authorize pro-rating of deductibles similar to WAC § 284-30-3095.<sup>2</sup>

WAC § 284-30-3095 and the former WAC § 284-30-390 reflect OIC's long-held view that the made-whole rule adopted in *Thiringer* does not apply to deductibles. The OIC explained that the deductible must be treated differently than uninsured loss because it is specifically bargained for by the insured:

Our construction of WAC § 284-30-390(4) is consonant with the rule in *Thiringer v. American Motors Ins. Co.*, 91 Wn.2d 215 (1978), in that we believe the Thiringer court did not have the subject of what to do with the deductible in mind when it formulated its opinion. (That decision was announced by our court shortly after the unfair claims practices rules were adopted.) We have recognized ***that the deductible is part of the contract bargained for by the insured***, and that it is therefore to be treated differently from other uninsured loss, as to which the *Thiringer* doctrine is applicable.

Appendix A, OIC Letter Ruling dated July 25, 1990 re: WAC § 284-30-395 (4) – Subrogation – Recovery of Insured's Deductible – Expenses (emphasis added).

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<sup>2</sup> See Alaska Admin. Code Tit. 3, § 26.080; Ariz. Admin. Code § R20-6-801; A.C.A. § 054 44 043; 10 Cal. Admin. Code § 2695.7; 215 I.L.C.S. 5/143(b); Iowa Code § 191-15.43 (507B); 806 Ky. Admin. Reg. 12; M.S.A. § 72A.201; Mo. Code Regs. Ann. Tit. 20, § 100-1.050(2)(c); 210 Neb. Admin. Code Ch. 60, § 009; Nev. Admin. Code § 868A.680; N.Y. Ins. Reg. 64, § 216.7(g)(1); Ohio Admin. Code § 3901-1-541(H)(10); Okla. Admin. Code § 365:15-3-8; Or. Admin. Code § 836-080-0240; 31 Pa. Code § 146.8; R.I. Code R. 02 030 073; Utah Admin. Code § R590-190; 14 Va. Admin. Code § 5-400-80; W. Va. Code Ann. § 114-14-7; Wy. Stat. § 26-3-113.

“Although a commissioner cannot bind the courts, the court appropriately defers to a commissioner’s interpretation of insurance statutes and rules,” especially in matters that are “complex, technical, and close to the agency’s expertise.” *Premera v. Kreidler*, 133 Wn. App. 23, 31-32, 131 P.3d 930 (2006) (citations omitted). *See also id.* at 37 (“[W]e defer to the Commissioner’s interpretation of insurance statutes and rules”). The OIC’s position is correct and entitled to deference.

**D. The Made-Whole Rule Does Not Apply**

**1. Averill Made No Showing of Insufficient Funds**

The OIC ruling goes to the heart of the issue. The made-whole doctrine addresses the allocation of risk of insufficient recovery which is unknown and impossible to predict. It affords the insured priority when the amount recoverable from the third party is insufficient to satisfy the claims of both the insurer and the insured. *Couch* §223.133, at 223-145 (“In many instances, the insurer and insured both have rights of recovery against the third party primarily liable for the loss, yet the amount recoverable from the third party is insufficient to completely satisfy the claims of both”). *See also Schonau*, 903 So.2d at 288 (the “threshold issue” that triggers the make-whole doctrine is a “limited pool of money” to cover the insured risk) (citing *Couch*).

In other words, when the pie of available sources of recovery is not big enough, the made-whole doctrine allows the insured to “eat first.” *See*

Greenblatt, *Insurance and Subrogation: When the Pie Isn't Big Enough, Who Eats Last?* *supra* at 10. Because the insurer is better able to absorb the unknown risk of insufficient recovery, the made-whole doctrine provides that the insurer “eats last.” *See Sherry*, 160 P.3d at 35 (“Our jurisdiction in this field is based largely on public policy and, where subrogation-like principles are involved, equitable principles.”). *See also Paulson*, 665 N.W.2d at 750 n.3 (“*Couch* cites . . . a particularly aptly named article [by Greenblatt] in the University of Chicago Law Review . . . this title illustrates the exact situation in which we find that the [made-whole doctrine] appl[ies]; if there is no doubt that the ‘pie’ is big enough,” the made-whole doctrine does not apply).

The deductible does not implicate the “threshold issue of insufficient funds” that triggers the made-whole doctrine. *Paulson*, 665 N.W.2d at 750. Instead, the deductible represents a **known** portion of the loss the insured **agrees to assume** each year before he is entitled to any **recovery** under the policy. *See* OIC’s *Consumer’s Insurance Glossary supra* at 8 (“Deductible – the dollar amount an insured person must pay for covered charges during a calendar year before the plan starts paying claims.”) *See also Stamp v. Dept. of Labor & Industries*, 122 Wn.2d 536, 543, 859 P.2d 597, 601 (1993) (in “common types of direct insurance such as automobile collision coverage . . . there is usually a stated deductible

amount, the effect of which is, in simplest terms, to make the insured ‘self-insured’ up to the amount of the deductible.”).

As this Court has explained in a recent decision, “[t]raditional insurance involves risk shifting, while self-insurance involves risk retention.” *Bordeaux, Inc. v. American Safety Ins. Co.*, 145 Wn. App. 687, 696, 186 P.3d 1188 (2008). *See also id.* (“Self-insurance does not constitute insurance in any traditional form. In self-insurance the company . . . or individual chooses not to purchase insurance but rather *retains the risk of loss*. . . . [I]n a self-insurance situation there is no shifting of the risk from the individual person . . . to a larger group.”) (citation omitted, emphasis added).

This is precisely why the made-whole doctrine does not apply to deductibles. The leading insurance treatise explains:

Note that the made whole doctrine does not apply to deductibles. If the insured were to be reimbursed for the deductible before the insurer is made whole, the insured would be receiving an unbargained for, and unpaid for, windfall. Under the terms of the insurance policy, it was agreed that, as a condition precedent to the insurer being out of pocket for even one dollar, the insured had to be first out-of-pocket the amount of the deductible. The made-whole doctrine deals with situations in which the combination of the amount of the deductible and the amount of the insurance payment is a sum that is sufficient to make the insured whole, and a recovery is made from a third party . . .

2 Allan D. Windt, *Insurance Claims and Disputes* § 10.6 at 10-38, 39 (5th Ed.).<sup>3</sup> See also *Couch* § 223:149 (“Made-whole doctrine did not entitle insured to recover from her automobile insurer her full collision deductible and unpaid rental car bill from subrogation funds that insurer had obtained from liability insurer; insured’s policy specifically provided that insurer would have the right to sue for or otherwise recover loss from anyone else who might be held responsible.”) (citing *Schonau*, 903 So.2d 285).

Like this case, *Schonau* involved a purported class action complaint against a car insurance carrier, seeking to recover, under the made-whole doctrine, the insured’s full collision deductible and the unpaid portion of her car rental bill from the subrogation funds the insurer had obtained from the tortfeasor’s insurer. The trial court dismissed the complaint for failure to state a claim. The Court of Appeals affirmed:

[T]he complaint failed to allege facts that would bring plaintiff within the scope of the “made whole” doctrine, as applied in Florida. Florida law does not appear to recognize an affirmative right or cause of action by an insured against its insurer to be “made whole” ***beyond the payment of insurance policy proceeds***. . . . Decisions applying the “made whole” doctrine essentially hold that where both the insurer and the insured simultaneously attempt to recover all of their damages from a tortfeasor who cannot (because of insolvency, limited insurance coverage, or other reasons) pay the full value of damages, the insured has priority of recovery over the insurer.

*Schonau*, 903 So.2d at 287 (emphasis added).

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<sup>3</sup> CP 108-121.

The *Schonau* court found no authority to support the plaintiff's claim that GEICO must cover her uninsured losses (including the deductible and the uninsured portion of the car rental) before the insurer could pursue its subrogation claim. *Id.* It emphasized that the made-whole doctrine does not require providing the insured a better policy than she purchased. Instead, it is intended only "to protect recoveries obtained by the insured in limited fund scenarios." *Id.* The plaintiff in *Schonau* made no showing that there was an insufficient pool of money and was free to pursue recovery for amounts that were not covered by her policy. *Id.* at 288. *See also Paulson*, 665 N.W.2d at 750-753 (in the absence of some limit on the available funds from the tortfeasor the made-whole doctrine does not apply because "the specter of an insurer competing with the insured for a limited amount of funds is simply not raised;" subrogation does not affect the insured's freedom to pursue recovery from the tortfeasor "beyond [the amount] paid by the insurer").

It is the same here. Averill bought and paid for a policy with a \$500 deductible. In so doing, she agreed to retain the first \$500 of loss every year before any insurance coverage is triggered. CP 33 ("Any deductible shall apply separately to each loss.") Averill received the full value of her collision coverage when Farmers paid her the market value of her car, less her deductible. Farmers subsequently forwarded to Averill the entire portion of her deductible Farmers was able to recover from State

Farm. As in *Schonau*, Averill was not competing with Farmers for a limited pool or recovery. She was free to sue the tortfeasor for the remaining \$250 of her deductible that Farmers did not recover from State Farm. The made-whole doctrine does not apply.

**2. The Made-Whole Doctrine Does Not Require  
The Insurer to Provide the Insured Better  
Coverage Than She Purchased**

The *Sherry* decision shows that the made-whole doctrine goes no further than providing the insured with the full benefit of each of the coverages she bought. *Sherry*, 160 P.3d at 38 (“If FIC had paid Sherry \$10,000 in PIP benefits . . . [and could] offset that \$10,000 against the UIM award . . . Sherry would effectively receive nothing under his PIP coverage . . . for which he paid a separate premium”). Averill distorts the made-whole doctrine by insisting that Farmers should give her *a better* non-deductible policy she *did not buy*. *Allstate Ins. Co. v. Superior Court*, 60 Cal Rptr.3d 782, 794 (Cal. Ct. App. 2007) (“[I]t is not the purpose of the made-whole rule to rewrite the parties’ contract merely because the insurer has more resources than its insured or to interfere with the parties’ reasonable expectations such that it would provide insured with a benefit for which she did not pay for a risk it did not assume.”)

The made-whole doctrine does not trump the contractual risk-retention and risk-allocation. See *Mahler*, 135 Wn.2d at 420-21 (in the context of property loss, the insurer is free to contract for a “proper,

classical” right to subrogation that is enforceable directly against the third party); *Meas*, 130 Wn. App. 538-539 (insured was “made whole for the property loss claimed under his collision coverage when he received payment from State Farm”).

The insured that received the full benefit of her insurance policy must look for any additional recovery to the third party, not the insurer’s subrogation funds. *Paulson*, 665 N.W.2d at 750-753 (“An insured’s right to recover amounts beyond those paid by the insurer is not extinguished by subrogation”). *See also Birch v. Fire Ins. Exchange*, 122 P.3d 696, 699-700 (Utah Ct. App. 2005) (when homeowner’s insurer paid the property owner the replacement value of the damaged fence less the \$500 deductible, the homeowner “had no right to receive that \$500” from the insurer; after the insurer met its contractual obligations, the homeowner “still could recover any remaining uncompensated losses from the tortfeasors, in tort.”).

A contrary rule would not only interfere with the parties’ contract, but also benefit the tortfeasor:

The facts presented in the present case clearly illustrate the inequitable consequences that can result from a strict, across-the-board, application of the “made-whole” rule without regard to the express desires of the insured or the type of insurance involved. In the present case, application of the controlling precedent bars the insurer, who has compensated an injured party for a loss, from pursuing a subrogation action against the alleged

tortfeasor merely because a \$250 deductible was subtracted from the insured's compensation pursuant to the insurance contract, and to the extent of \$250, the insured has not been "made whole." Further, this precedent confers an unjust benefit on the alleged tortfeasor, who is permitted to escape responsibility for his or her alleged wrongdoing.

*State Farm Fire and Cas. Co., v Hannig*, 764 So.2d. 543, 545 (Ala. 2000).

*See also Monte De Oca v. State Farm Fire & Casualty Co.*, 897 So.2d 471, 473 (Fla. Dist. Ct. App. 2004) ("[t]he Insured is demanding the second \$250 of the deductible based on his contention that without his receiving it he has not been made whole. . . . The Insured, as a wrongdoer legally responsible for 50% of the harm, is not entitled to be absolved from liability and must not receive a windfall. His liability as a 50% comparative wrongdoer is for half of the deductible"); *Nat. Continental Ins. Co. v. Perez*, 897 So.2d 492, 492 (Fla. Dist. Ct. App. 2005) ("In *Monte De Oca* . . . we clarified that an automobile insurer will not be held to have violated the made-whole doctrine when it returns to its contributorily negligent insured a properly prorated portion of insured's collision deductible after recovery in a subrogation action.").

The trial court misconstrued *Sherry* as establishing an absolute rule that requires that the insured be compensated for all her claimed losses – including the retained risk represented by the deductible before the insurer can seek any subrogation from the tortfeasor's insurer. So overbroadly interpreted, the made-whole doctrine conflicts with the insurance

regulations that specifically authorize pro-rating the deductibles, and with the parties' bargained-for expectations.

Nothing in *Sherry* or equity, which forms the basis of the make-whole doctrine, supports this result. No courts in the nineteen states that have adopted statutes or regulations that authorize pro-rating of the deductibles similar to WAC § 284-30-3095 have found them to be in conflict with the made-whole rule. All courts that considered the issue and two leading insurance treatises agree that the made-whole doctrine does not apply to deductibles, especially where, as here, there is no showing that the tortfeasor has limited funds for which the insured and insurer must compete. Where, as here, the insured receives the full value of her insurance policy and is free to pursue additional recovery against the tortfeasor, no legal or equitable reasons support forcing the insurer to provide the insured more than she bargained for as a condition for pursuing subrogation.

## VI. CONCLUSION

For the reasons stated, the trial court's order granting summary judgment to Averill on the breach of contract claim should be reversed, and case remanded to the trial court directing dismissal of the breach of contract claim with prejudice.

DATED: MAY 29<sup>th</sup> 2009.

STOEL RIVES LLP



Stevan D. Phillips  
Rita V. Latsinova

Attorneys for Appellant

# APPENDIX

## A

STATE OF WASHINGTON

RICHARD G. (DICK) MARQUARDT  
STATE INSURANCE COMMISSIONER  
DAVID H. RODGERS  
CHIEF DEPUTY

REPLY TO:  
OLYMPIA OFFICE  
INSURANCE BUILDING  
OLYMPIA, WASHINGTON 98504-C  
753-7300. AREA CODE 208

OFFICE OF  
INSURANCE COMMISSIONER

July 25, 1990

Ned C. Wertz  
claim manager  
CNA Insurance Companies  
P.O. Box 240111  
Seattle, WA98124-9611

Re: WAC 284-30-390(4) -- Subrogation - Recovery of Insured's Deductible --- Expenses

Dear Mr. Wertz:

Roberta Gustafson recently reminded me of your inquiry several months ago relative to whether attorney fees incurred by a collection agency, to collect on an assigned subrogation claim, may be pro-rated against the insured's deductible recovery. The question arose in a claim involving your insureds Steven and Janet Deters.

Subsection (4) of WAC 284-30-390 is taken verbatim from the NAIC Unfair Claim Settlement Practices Model Regulation. It establishes a fair and workable method for apportioning allocated loss adjustment expenses mere an outside attorney is retained by the insurer to collect a subrogation recovery. The problem here is that the subrogation claim was assigned by the insurer to a third party for collection, and the third party in turn retained the services of an attorney. Although we are not convinced that a collection agency may, within the scope of its license, accept assignment of an unliquidated subrogation claim grounded in tort, insurers are not currently prohibited by any law or rule we enforce from making such assignments. That practice was not wig when the rule was adopted, and perhaps the rule is in need of amendment to more clearly address such situations,

We have previously held that, in such situations, fees or expenses paid to the collection agency cannot be apportioned by the subrogated insurer against the deductible reimbursement. In her October 30, 1989 letter to CNA's Robert Jones on the Deters complaint, Roberta referred to a memo by Hob Johnson, dated April 10, 1981, setting forth this department's interpretation of WAC 284-30-390(4). I am enclosing another copy of that memo for ease of reference.

Mr. Jones argued in the Deters case that a pro-rata deduction of expenses from the deductible reimbursement was appropriate, because Valley Forge Insurance company had assigned the subrogation claim to a collection agency, and the collection agency ultimately utilized the services of an attorney to obtain the recovery.

Ned C. Wertz  
July 25, 1990  
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WAC 284-30-390(4) does permit deduction for expenses incurred for use of "an outside attorney . . . retained to collect such recovery:" but even then, "the deduction may . . . be for only a pro rata share of the allocated loss adjustment expense." ("Allocated loss adjt expense" is generally defined for statutory accounting purposes as costs allocated directly to a claim, as distinguished from unallocated expenses such as adjuster's salary, overhead, home office expenses, etc.)

The rule permits deduction of a pro-rata share of allocated loss adjustment expenses from the recovery when an outside attorney has been retained to sense the recovery. Typically, where the attorney has been retained by the insurer, the attorney's fee and costs will be paid by the insurer and allocated to the particular claim as an adjustment expense. In cases where the subrogation claim has been assigned to a collection agent, it is our understanding that the usual practice is that the collection agent will remit the recovered amount to the insurer net of his fee, including fees and costs paid by him to the attorney he retained to obtain the recovery. In that situation, only the net subrogation recovery would be credited to the claim, and the adjustment expense is unallocated: thus the rule does not permit deduction of any expenses from the insured's deductible recovery.

With respect to the Deters case, we are told the total amount of the loss was \$607.52, including the insureds' deductible; that you incurred \$334.51 in collection expenses; and that the insureds were reimbursed \$55.06 of their deductible. We are not told how much of the \$334.51 represented actual attorney fees and costs related to suit, how or by whom the attorney's fee was paid, or how much was retained by the collection agency as its own separate fee. We believe the latter, whatever it may be, clearly is not an expense that can be charged against the insured's deductible.

But as discussed above, if the attorney was, as to both Valley Forge and its collection agent, an "outside attorney" within the meaning of WAC 284-30390 (4) , and if the amount charged by the attorney as fees and expenses was paid as an allocated loss adjustment expense by the company, that amount and only that amount -- would be properly deductible from the gross recovery before computing the insured's pro-rata deductible recovery.

Our construction of WAC 284-30-390 (4) is consonant with the rule in Thiringer v. American Motors Insurance Co., 2d 215 (1978) , in that we believe the Thiringer court did not have the subject of what to do with the deductible in mind when it formulated its opinion. (That decision was announced by our court shortly after the unfair claim practices rules were adopted.) We have recognized that the deductible is part of the contract bargained for by the insured, and that it is therefore to be treated somewhat differently from other uninsured loss, as to which the Thiringer doctrine is applicable.

The Thiringer court was not called upon to address the question whether, or in what manner, legal expenses incurred by either party in making the recovery are to be equitably apportioned: but it has said in other cases that legal expenses are to be equitably apportioned when both parties benefit from the recovery.

Ned C. Wertz  
July 25, 1990  
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Our rule allows equitable apportionment of "allocated" legal expenses where the insured has requested inclusion of his deductible in the insurer's subrogation action. It does not, however, allow the insured's portion of the recovery to be diminished because the insurer, for reasons of expediency, elects to give up a percentage of its interest in the claim to a collection agency rather than commit its own personnel and resources to effect the recovery.

Sincerely,

DICK MARQUARDT  
Insurance Commissioner

H. EUGENE DAVIS  
Deputy Commissioner  
Consumer Assistance

Enclosure

c: Roberta Gustafson