

THE CHANGING FACE OF MADE WHOLE IN CALIFORNIA

21st Century Ins. Co. v. Superior Court, 2009 WL 2584765 (Cal. 2009)

On August 24, 2009, the California Supreme Court continued the slow metamorphosis of the made whole doctrine. It clarified that in California, an insured's attorney's fees are not to be deducted before determining if the insured has been made whole. The decision is a positive one for an insurance industry struggling to hold down costs and premiums for all Americans, but it also caps a long trend of judicial decisions which have molded the equitable doctrine into what it is today. A short history lesson is in order.

The made whole doctrine has been viable in California since 1974. *Travelers Indem. Co. v. Ingebretsen*, 113 Cal. Rptr. 679 (Cal. App. 1974). In *Ingebretsen*, multiple insureds recovered insurance proceeds for damages caused to their property by the County of Los Angeles. Each policy contained a standard subrogation clause allowing the company to "require from the insured an assignment of all right of recovery against any part for loss to the extent that payment therefore is made by [the] company", as allowed by § 2071 of the California Insurance Code. Cal. Ins. Code § 2071 (2005). The insureds also executed a subrogation receipt or release, acknowledgment of satisfaction, agreement to immediate cancellation and assignment of subrogation document contemporaneously with receiving the insurance proceeds. After a dispute over third-party proceeds, the court concluded that where the subrogation provision and subrogation assignment convey "all right of recovery against any party for loss to the extent that payment therefore is made by this company," it entitles the insurer to first and total indemnification. However, the insurer's priority of right was conditioned on it having cooperated and assisted in the recovery from the third party.

The insureds in *Ingebretsen* further contended that the insurers were not entitled to recovery because it was impossible to ascertain what portion of the judgment represented damages paid for by the companies. According to the insureds, a portion of the judgment against the county was for non-insured losses, and consequently, the insurers should be denied recovery unless they could prove what portion of the judgment was attributable to covered losses. The court, again relying on the all right of recovery language contained in the subrogation clause, concluded that all claims of the insureds had been transferred to the insurers. Therefore, insurers were not required to prove what portion of the judgment was attributable to covered losses.

The *Ingebretsen* rule applies only narrowly to the sort of facts contained in that case. In *Sapiano v. Williamsburg Nat'l Ins. Co.*, 28 Cal. App.4th 533 (Cal. 1994), the court concluded that in contrast to the policy and insurer in *Ingebretsen*, (1) the language of the subrogation clause in *Sapiano* contained general terms, and (2) the insurer did not cooperate or assist the insured in its efforts to recover from the tortfeasor. As a result, the insured retained priority of right and was entitled to be made whole before the insurer could assert its right to subrogation. Like Alabama, California adheres to the view that the parties are free to agree that the made whole rule does not apply. However, unlike Alabama, which imposes only one condition (*i.e.*, that the agreement be sufficiently specific), California imposes an additional requirement that the insurer cooperate and assist the insured in the recovery. Id.

California, as does Alabama, believes in the potentially harsh and one-sided effect of expanding the principle of conventional subrogation. California courts hold that, in the absence of specific language to the contrary, a general provision that an insurer is subrogated to the rights of an insured does not permit the insurer to recover from third-party tortfeasor until the insured has been

made whole. *Id.* The court also observed that where the insured does not assist in prosecution of the claim, the insured may not be permitted to recover until insured has been made whole.

As applied in California, the made whole doctrine generally precludes an insurer from recovering any funds from the tortfeasor unless and until the insured has been made whole for the loss. *Progressive West Ins. Co. v. Yolo County Superior Court*, 37 Cal.Rptr.3d 434 (Cal. App. 2005); *Barnes v. Independent Automobile Dealers of Cal.*, 64 F.3d 1389 (9th Cir. 1995). However, the doctrine applies only when there is no agreement to the contrary. *Barnes*, *supra*; *Samura v. Kaiser Foundation Health Plan*, 17 Cal. App.4th 1284 (Cal. App. 1993). The applicability of the doctrine generally depends on whether the insured has been completely compensated for all elements of damages, not merely those for which the insurer has indemnified the insured. *Allstate Ins. Co. v. Superior Court*, 151 Cal.App.4th 1512 (Cal. App. 2007) (writ granted by California Supreme Court on September 25, 2007). Some jurisdictions have narrowly construed the made-whole exception as referring only to an insured being fully compensated for the covered losses. *See e.g., Ludwig v. Farm Bureau Mut. Ins. Co.*, 393 N.W.2d 143 (Iowa 1986). However, one California court recently held for the first time that the doctrine applies in a personal injury (reimbursement) context under no-fault Med-Pay insurance coverage. *Progressive West*, *supra*. Even more recently, California held that in the Med-Pay context, the insured's attorney's fees should not be subtracted in order to determine if he or she was made whole. *Allstate Ins. Co. v. Superior Court*, *supra*. Although California recognizes the made whole doctrine, it doesn't apply it as a blanket rule. *Chase v. Nat'l Indem. Co.*, 129 Cal. App.2d 853 (1950); *Sapiano v. Williamsburg Nat'l Ins. Co.*, 28 Cal. App.4th 533 (Cal. 1994); *Chong v. State Farm*, 428 F. Supp.2d 1136 (S.D. Cal. 2006). The made whole doctrine appears to be applied only in cases where the carrier elects not to participate in its insured's third-party action. Therefore, the made whole rule is inapplicable when the insurer funds or actively participates in the prosecution of the claim against the third party. *Travelers Indem. Co. v. Ingebretsen*, 38 Cal.App.3d 858 (Cal. App. 1974); *Malibu Broadbeach, L.P. v. State Farm*, 2008 WL 588998 (Cal. App. 2008).

In *Samura v. Kaiser Foundation Health Plan*, the court responded to a concern about the one-sidedness of negotiating insurance contracts by suggesting that the doctrine of unconscionability could be used to counter this problem. *Samura v. Kaiser Foundation Health Plan, Inc.*, 17 Cal. App.4th 1284 (Cal. 1993). That court stated:

In short, the third party liability provision may sometimes operate in a harsh and one-sided manner without any justification, which raises the possible application of the doctrine of unconscionability. As embodied in Civil Code § 1670.5, subdivision (a), the concept of unconscionability has both a 'procedural' and a 'substantive' element. 'The former includes (1) 'oppression,' which refers to an inequality of bargaining power resulting in no real negotiation and the absence of meaningful choice; and (2) 'surprise,' which occurs when the supposedly agreed-upon terms of the bargain are hidden in a prolix printed form drafted by the party seeking to enforce the disputed terms 'Substantive' unconscionability consists of an allocation of risks or costs which is overly harsh or one-sided and is not justified by the circumstances in which the contract is made.... Presumably both procedural and substantive unconscionability must be present before a contract will be held unenforceable. However, a relatively larger degree of one will compensate for a relatively smaller degree of the other.'

With regard to uninsured motorist subrogation, California has indicated that the subrogee insurance company has priority of rights and is entitled to subrogation even if the insured is not made whole. *Sapiano*, supra.

The made whole doctrine applies equally to both subrogation and reimbursement causes of action. *Progressive West Ins. Co. v. Yolo County Superior Court*, supra. California makes specific note of the fact that subrogees who “sit back without assisting” while the insured prosecutes the third-party action will not be able to recover unless the insured is fully made whole. *Samura*, supra. This means that, where applicable, the made whole doctrine prohibits a carrier from subrogation or reimbursement unless there is a surplus resulting from the insured’s receipt of both insurance benefits and tort damages. *Hodges v. Kirkpatrick Development, Inc.*, 130 Cal.App.4th 540 (Cal. App. 2005).

For years, the made whole doctrine meant the carrier could not recover in subrogation until the insured recouped his loss and some or all of his litigation expenses incurred in the lawsuit – including his attorney’s fees. *Id.*; *Chong v. State Farm*, 428 F. Supp.2d 1136 (S.D. Cal. 2006). However, as of 2007 the California Court of Appeals in *Allstate Ins. Co. v. Superior Court*, suggested that attorney’s fees and costs are not to be deducted from the insured’s third-party recovery before comparing the damages sustained by the insured and amount of the third-party recovery to determine if the insured was “made whole”. *Allstate Ins. Co. v. Superior Court*, 151 Cal.App.4th 1512 (Cal. App. 2007), (writ granted by California Supreme Court on September 25, 2007), *rev. granted and opinion superseded by* 67 Cal.Rptr.3d 178 (Cal. 2007).

In 2009, the California Supreme Court agreed with the *Allstate* decision. *21st Century Ins. Co. v. Superior Court*, 2009 WL 2584765 (Cal. 2009). In *21st Century*, Silvia Quintana was injured in an automobile accident with a third party. She maintained an auto insurance policy with 21st Century that included Med Pay insurance coverage. After 21st Century paid Quintana Med Pay benefits. Quintana settled with the third party for \$6,000, which sum represented her total damages. She paid \$2,000 of the recovery as attorneys’ fees and costs. Her policy required that she reimburse third-party monies that duplicated her recovery under her policy. The California Supreme Court was asked to decide whether the Made Whole Doctrine includes liability for all the attorneys’ fees an insured must pay in order to obtain medical payment compensation from a third-party tortfeasor. The issue focuses the intersection of two well-settled legal doctrines: (1) the Made Whole Doctrine, whereby a third-party recovery must make the insured whole before he or she is obligated to reimburse the insurance company, and (2) the Common Fund Doctrine, whereby a party that benefits from another person’s expenditure of attorney fees is required to bear a proportionate share (but not all) of that expenditure. The court determined that liability for attorneys’ fees is *not* included under the Made Whole Doctrine. Those fees instead are subject to a separate equitable apportionment rule (or pro rata sharing) that is performed as a function of the Common Fund Doctrine.