

SUPREME COURT OF WASHINGTON

Winters v. State Farm Mutual Automobile Insurance Co.

144 Wn. 2d 869 (2001) · Decided October 4, 2001

OPINION

Winters v. State Farm Mutual Automobile Insurance

144 Wash. 2d 869

CHAMBERS, J.

Chambers, J. — We are asked to determine whether a personal injury protection insurer should pay a pro rata share of the legal cost incurred by the insured when, by pursuing an underinsured motorist tortfeasor, the insured created a fund from which the personal injury protection insurer recoups benefits previously paid on behalf of its insured. We conclude that the efforts of the Petitioners created a common fund from which the personal injury protection insurance company benefited. We therefore affirm the decision of the Court of Appeals and remand for the trial court to determine the pro rata share of expenses due from State Farm Mutual Automobile Insurance Company (State Farm) in both cases.

FACTS

WINTERS

Sarah Winters purchased an automobile insurance policy from State Farm. The single policy contained five separate coverages; each was optional and for each she paid a separate premium. These five separate coverages were: “liability” coverage to indemnify her for any damages she might cause to others; “underinsured motorist” coverage (UIM) to protect her for damages she might suffer from an underinsured motorist; “personal injury protection” coverage (PIP) to pay for medical expenses and other out-of-pocket expenses she might incur arising out of the use of her vehicle; “property damage” coverage for damage to her own property; and “emergency road service” coverage. In January 1994, Sarah Winters was injured in a car accident after she was hit head-on by Anna Cunningham and then rear-ended by James Edalgo. Cunningham was insured by Leader National Insurance Company (Leader National), and Edalgo was uninsured. After the accident, State Farm paid Winters \$8,271.86 under her PIP coverage for the medical expenses and loss of earnings that she incurred. In addition, Winters sued Cunningham. As a result Cunningham’s insurer, Leader National, paid Winters \$25,000, representing Cunningham’s full policy limits. Because Winters did not pursue legal action against Edalgo, State Farm assigned its rights to subrogation for payments made to Winters to an attorney. State Farm’s attorney sued and obtained a default judgment against Edalgo for \$8,271.86.1 Meanwhile, believing that she had not been fully compensated for her injuries, Winters presented a UIM claim to State Farm. The claim was assigned for arbitration. Winters and State Farm agreed that Cunningham and Edalgo were at

fault and that Winters was fault-free. The arbitrator awarded total damages of \$40,271, including special medical and wage loss damages of \$8,271 and general damages of \$32,000. The parties agreed that under the terms of the UIM policy, State Farm could deduct the \$25,000 that had been paid by Cunningham's insurance as a set off against the UIM award. They disagreed on whether State Farm could deduct \$8,271 to offset its earlier PIP payments. State Farm unilaterally offset its PIP payments by paying only \$7,000 on the UIM award (\$40,271 award, less \$25,000 liability limits and \$8,271 previous PIP payments). Winters subsequently sued State Farm for an additional \$8,271.86, arguing that State Farm was not entitled to offset the PIP benefits it had paid previously by deducting those payments from her UIM award. Alternatively, she requested that State Farm should be entitled to the offset only if it paid a share of the legal expenses incurred in obtaining the settlement and arbitration award. The parties filed cross motions for summary judgment. The trial court granted State Farm's motion for summary judgment and ordered Winters to pay \$2,500 of State Farm's attorney fees. Winters appealed. The Court of Appeals held that State Farm had the right to reduce the underinsured motorist award by the amount it paid in PIP benefits, but under *Mahler v. Szucs*, 135 Wn.2d 398, 957 P.2d 632, 966 P.2d 305 (1998), that State Farm must pay a pro rata share of the costs and fees incurred by Winters to recover full compensation for her damages. *Winters v. State Farm Mut. Auto. Ins. Co.*, 99 Wn. App. 602, 616, 994 P.2d 881 (2000). We granted review on the issue of costs and fees.

PERKINS

In May 1995, Kyle Perkins was injured in an automobile accident while driving a vehicle owned by Glenn Smith. Like Winters, Glenn Smith purchased a State Farm automobile policy and paid for separate liability, UIM and PIP coverages. Smith's policy covered Perkins, who was not at fault in the accident. Because of his injuries, State Farm paid Perkins \$18,480 in PIP benefits. Perkins settled his claim against the at-fault driver for \$25,000, the policy limits of the tortfeasor's liability insurance. The tortfeasor's insurance company, Guaranty National Insurance Co. (Guaranty National), issued two drafts to pay off the judgment: (1) a check for \$16,780.14 payable to Perkins, his attorney, and State Farm, and (2) a check for \$8,219.86 payable to Perkins, his attorney, and a hospital. The funds for State Farm were held in trust pending the outcome of the UIM case set forth below. Believing that he had not been fully compensated, Perkins made a claim for UIM benefits from State Farm. An arbitration was held in July 1998. The arbitrator found Perkins had incurred damages totaling \$48,000. State Farm tendered Perkins \$4,520, representing his \$48,000 total damages less credits for a set off of the \$25,000 liability limits received from the tortfeasor and for the \$18,480 PIP offset for benefits previously paid by State Farm. Perkins rejected the tender, claiming State Farm was required to reduce its PIP offset by one-third to compensate him for a share of his attorney fees pursuant to *Mahler*, 135 Wn.2d 398. Perkins sued State Farm for a declaration that the company was required to contribute toward Perkins's legal costs associated with the recovery of its PIP payments. Both parties filed cross motions for summary judgment and the trial court granted Perkins's motion. State Farm appealed.

Division Two of the Court of Appeals certified the case to us after we accepted review in *Winters v. State Farm*. After we accepted review, we consolidated the two cases.

ISSUE

The only issue presented to this Court is whether a PIP insurer must pay a pro rata share of its insured's attorney fees associated with recovering full compensation from an UIM insurer.

ANALYSIS

For clarity, we will define several terms as they are used in this opinion. First, there are policy provisions that permit an insurer to recover money it has paid to its insured. Traditional "subrogation" is an equitable doctrine involving three parties, permitting one who has paid benefits to one party to collect from another.² Here, for example, State Farm attempted to subrogate benefits paid to Winters from the third party, Edalgo. An insurer does not have a right of subrogation against its own insured. *Mahler*, 135 Wn.2d at 419 (citing *Stetina v. State Farm Mut. Auto. Ins. Co.*, 196 Neb. 441, 243 N.W.2d 341, 346 (1976)). Therefore, insurers often have reimbursement provisions within their policies. "Reimbursement" permits an insurer to be reimbursed by its insured from proceeds that the insured collects directly from the party at fault. In addition, insurers may be entitled to a credit for sums already received by the insured. A "setoff," as used in this opinion, refers to sums paid to the insured by another party. Here the parties agree that State Farm was entitled to a setoff for the \$25,000 that Winters and Perkins each received from the insurers of the at-fault drivers. An "offset" refers to a credit to which an insurer is entitled for payments made under one coverage against claims made under another coverage within the same policy. Whatever term is used, the insured must be fully compensated before the insurer may recoup benefits paid. *Thiringer v. Am. Motors Ins. Co.*, 91 Wn.2d 215, 219, 588 P.2d 191 (1978); *Mahler*, 135 Wn.2d at 416-17. With these definitions in mind, we will address the questions raised by the parties. We agree with the Court of Appeals on the issues before us and have borrowed liberally from Judge Morgan's opinion. State Farm bases its claim for an offset against its obligation to pay UIM benefits based upon its PIP payments to Winters and Perkins. Paragraph 3 of the Limits of Liability section of State Farm's UIM policies issued to Winters and Perkins contains a "Nonduplication-of-Benefits" clause, which provides: Any amount paid or payable for damages under the first party benefits [PIP] coverage will not be paid again as damages under this [UIM] coverage. This does not reduce the limits of liability of this coverage. *Winters Clerk's Papers (CP Winters)* at 227; *Perkins Clerk's Papers (CP Perkins)* at 89. ^{*877}The Nonduplication-of-Benefits clause is neither a subrogation nor a reimbursement clause. The Nonduplication-of-Benefits clause purports to be a limitation of UIM coverage.³ In *Winters*, the Court of Appeals upheld State Farm's offset and Winters did not cross appeal. Perkins did not challenge State Farm's Nonduplication-of-Benefits clause. The only issue raised by the parties is whether or not State Farm should pay a pro rata share of the legal cost in proving the medical and other costs included within the PIP offset. Winters and Perkins contend that even if State Farm has the right to reclaim its PIP payments by offsetting them against their UIM awards, State Farm

must pay its “pro rata share of the legal costs and expenses, including attorney’s fees, incurred by [them] in the prosecution of [their] liability and UIM claims.” Br. of Appellant at 42. This is true, they say, because the arbitration awards “created the common fund from which the [insurer] . . . withheld ... its PIP advancements.” Id. at 39. The common fund exception to the no-attorney-fees rule applies to cases where litigants preserve or create a common fund for the benefit of others as well as themselves. *Bowles v. Dep’t of Ret. Sys.*, 121 Wn.2d 52, 70-71, 847 P.2d 440 (1993); *Pub. Util. Dist. No. 1 v. Kottsick*, 86 Wn.2d 388, 390, 545 P.2d 1 (1976). The doctrine provides that “when one 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.”⁴ *Winters*, 99 Wn. App. at 609. ^{*878}*Winters* points to the considerable expense she incurred to pursue her claim against Cunningham. Cunningham denied liability, and depositions and/or sworn statements were taken from the investigating officer, Cunningham and everyone else (except Edalgo) who was believed to have firsthand knowledge of the event. *CP Winters* at 159-86. It was not until 27 months post-accident that Leader National abandoned its defenses and agreed to pay Cunningham’s \$25,000 policy limits. Perkins points out that when Glen Smith’s insurer, Guaranty National, paid Smith’s policy limits, it did so with two checks. One of them was payable to both Perkins and State Farm and, pursuant to an agreement with State Farm, \$16,780.14 from that check was placed into a trust account and held subject to a resolution of State Farm’s reimbursement claims. Both *Winters* and Perkins argue they were forced to bear the expense of a contested arbitration hearing in order to win UIM benefits. It was the resulting UIM awards, they argue, which fully compensated them and created a fund from which State Farm’s PIP benefits could be offset. State Farm, on the other hand, argues that its policy language limits its responsibility to pay a share of legal expenses associated with recovering from the party at fault. State Farm’s policy contains Paragraph 3, “Our Right to Recover Our Payments.” Subparagraph d provides in relevant part: “If the insured recovers from the party at-fault and we share in the recovery, we will pay our share of the legal expenses.” *CP Winters* at 238-39; *CP Perkins* at 100-01. The quoted language simply expresses the long established equitable principles set down by this Court. An insurer is not entitled to recover until its insured is fully ^{*879}compensated and restored to his or her pre-accident position. *Thiringer*, 91 Wn.2d at 219. If the insured were forced to pay the costs associated with the insurer’s recovery, then the insured would be left less than fully compensated. *Mahler*, 135 Wn.2d at 425-26 n.17.5 See also *Metro. Life Ins. Co. v. Ritz*, 70 Wn.2d 317, 322, 422 P.2d 780 (1967); *Fisher v. Aldi Tire, Inc.*, 78 Wn. App. 902, 902 P.2d 166 (1995); *Pena v. Thorington*, 23 Wn. App. 277, 281, 595 P.2d 61 (1979). This Court has addressed similar issues by analyzing the common fund doctrine. A PIP insured creates a common fund when, after receiving PIP payments, he or she recovers full compensation from the tortfeasor. In *Mahler*, 135 Wn.2d 398, the plaintiff sustained \$24,000 in damages resulting from an automobile accident for which she was not at fault. Id. at 406. After receiving PIP payments of \$4,173.32, she recovered the full amount of her damages, \$24,000.⁶ The PIP insurer then claimed reimbursement

of the PIP payment, which would leave the insured fully compensated. *Id.* The plaintiff agreed on condition that the PIP insurer pay a pro rata share of the legal expenses that she had reasonably incurred to obtain the liability proceeds. *Id.* at 407. This Court held that each party benefited from a common fund generated by the plaintiff, so each should pay a pro rata share of the expenses necessary to generate that fund. *Id.* at 426-27. See also *Peterson v. Safeco Ins. Co.*, 95 Wn. App. 254, 976 P.2d 632 (1999) (applying the common fund doctrine in another case where the tortfeasor was adequately insured). *880 In cases where the tortfeasor has adequate insurance, the common fund created by a PIP insured consists entirely of proceeds recovered from the tortfeasor's liability carrier, who stands in the shoes of the tortfeasor. Thus, the payments are treated as if the tortfeasor made them. On the other hand, when a PIP insured creates a common fund from liability payments and UIM benefits, the common fund combines liability proceeds from the tortfeasor's insurance carrier and UIM proceeds from the insured's underinsured motorist carrier. The UIM payments are treated as if made by the tortfeasor. *Jain v. State Farm Mut. Auto. Ins. Co.*, 130 Wn.2d 688, 695, 926 P.2d 923 (1996). The combination of liability and UIM insurance compensates claimants for those amounts that they are legally entitled to recover from tortfeasors, up to the total of applicable liability and UIM limits. The Court of Appeals illustrated this with three examples:

(1) Suppose that a fault-free PIP insured is injured in a two-car accident. She suffers total damages of \$40,000. She has PIP and UIM coverages with adequate limits. The other driver is underinsured with liability limits of \$25,000. The PIP insurer pays \$8,000 in PIP proceeds. The other driver pays his \$25,000 liability limits pursuant to settlement or verdict. Because the PIP insured has not received funds in excess of her total damages — she has received only \$33,000 (\$8,000 in PIP proceeds and \$25,000 in liability proceeds) of the necessary \$40,000 — the PIP insurer is not entitled to reimbursement at all, and there can be no “common fund.”

(2) Suppose alternatively that a fault-free PIP insured is injured in a two-car accident. She suffers total damages of \$40,000. She has PIP and UIM coverages with adequate limits. The other driver is underinsured with liability limits of only \$25,000. The PIP insurer pays \$8,000 in PIP proceeds. The PIP insured's carrier pays \$15,000 in UIM proceeds (\$40,000 total damages less the tortfeasor's liability limits of \$25,000). Because the PIP insured has not received funds in excess of her total damages — she has received only \$23,000 (\$8,000 in PIP *881proceeds and \$15,000 in UIM proceeds) of the necessary \$40,000 — the PIP insurer is not entitled to reimbursement at all, and there can be no “common fund.”

(3) Suppose, again alternatively, that a fault-free PIP insured is injured in a two-car accident. She suffers total damages of \$40,000. She has PIP and UIM coverages with adequate limits. The other driver is underinsured with liability limits of only \$25,000. The PIP insurer pays \$8,000 in PIP proceeds. The other driver pays his liability limits of \$25,000. The UIM insurer (who is also the PIP insurer) owes \$15,000 in UIM proceeds (\$40,000 total damages less the tortfeasor's liability limits of \$25,000). Because the PIP insured is now fully compensated — she has received \$48,000

(\$8,000 in PIP proceeds, \$25,000 in liability proceeds, and \$15,000 in UIM proceeds) even though she needs only \$40,000 to be fully compensated — the PIP insurer is entitled to reimbursement; there can be a “common fund” for the first time; and the “common fund” is comprised of the combination of liability proceeds and UIM proceeds.

Winters, 99 Wn. App. at 613-14. The next question is whether the entire common fund was created through the efforts of Winters and Perkins. We hold that it was. In each case, the insured secured the proceeds from the at-fault driver or the driver’s insurer and then recovered from his or her respective UIM carrier. These pooled funds became the common fund from which the PIP insurer was able to recoup payments it had made. This result provides uniformity among insurers. The fact that the same insurer provides both UIM coverage and medical payment coverage through PIP coverage should not result in the insured’s bearing a greater amount of legal expenses. Once a PIP insured has been fully compensated, the insurer may have a right to be repaid for payments it has made if its policy so provides. *Barney v. Safeco Ins. Co. of Am.*, 73 Wn. App. 426, 432, 869 P.2d 1093 (1994). However, the insurer may not recover before the PIP insured has been fully compensated. *Mahler*, 135 Wn.2d at 417-18, 436. *882State Farm contends that our result conflicts with the *Dayton* and *Kenworthy* cases. *Dayton v. Farmers Ins. Group*, 124 Wn.2d 277, 876 P.2d 896 (1994); *Kenworthy v. Pa. Gen. Ins. Co.*, 113 Wn.2d 309, 779 P.2d 257 (1989). In those cases, we applied the American rule; generally, each party must bear his or her own legal expenses. In advancing its argument, State Farm seems to forget that it has written and received premiums for separate and different coverages. In *Dayton* and *Kenworthy*, the issue was whether or not a UIM carrier was responsible for paying for its insured’s legal expenses in making a UIM claim. The question presented here is totally different: whether or not the PIP carrier should pay a pro rata share of legal expenses for its insured in recovering PIP benefits from an UIM insurer. The insured should not be worse off simply because he or she purchased two coverages from the same insurer. State Farm argues that our ruling conflicts with *Daley*, *Barcom*, and *Britton* because those cases applied to “wrongdoers.” *Daley v. Allstate Ins. Co.*, 135 Wn.2d 777, 958 P.2d 990 (1998); *Safeco Ins. Co. v. Barcom*, 112 Wn.2d 575, 773 P.2d 56 (1989); *Britton v. Safeco Ins. Co. of Am.*, 104 Wn.2d 518, 707 P.2d 125 (1985). State Farm argues that it should not be punished as a wrongdoer because it has done nothing wrong. We agree that State Farm has done nothing wrong and is not a wrongdoer. However, our cases have been based not upon punishment, but upon the principle that the insured should be fully compensated before the insurer is entitled to reimbursement. Here, both Winters and Perkins were forced to hire attorneys to pursue claims against their respective parties at fault. After recovering the insurance policy limits of the parties at fault, neither Winters or Perkins was fully compensated. With assistance of counsel, both filed UIM claims against State Farm. State Farm put both to their proof and both proceeded to arbitration against State Farm where both presented evidence to prove that their medical expenses were reasonable and necessary *883and related to their motor vehicle collisions. Winters and Perkins each incurred substantial litigation costs to create a common fund for the benefit of their

PIP carrier. Neither Winters nor Perkins would be fully compensated if forced to bear the entire litigation costs of the common fund. State Farm is not being cast in the position of the wrongdoer. However, as between the insured and the insurer, we balance their interests and decide that the insurer should pay its share of the costs associated with recovery. The Court of Appeals is affirmed and these cases are remanded for the trial court to determine State Farm's pro rata share of expenses. Johnson, Sanders, Ireland, Bridge, and Owens, JJ., concur. Total judgment, including interest and fees, amounted to \$11,851.27. The record does not indicate whether this amount has been paid. "The right to subrogation exists when a party, not a volunteer, pays another's obligation for which the subrogee has no primary liability in order to protect such subrogee's own rights and interests. The right of subrogation is based on equity and will be protected only when justice so requires." *Millers Cas. Ins. Co. v. Briggs*, 100 Wn.2d 9, 13-14, 665 P.2d 887 (1983). Amicus Curiae Washington State Trial Lawyers Association argues that the Nonduplication-of-Benefits clause is impermissible under RCW 48.22.030, which requires insurers to provide UIM coverage for damages the covered person is legally entitled to recover. State Farm correctly points out that this argument was not raised below and we therefore do not reach this argument. *Covell v. City of Seattle*, 127 Wn.2d 874, 891, 905 P.2d 324 (1995); *Bowles v. Dep't of Ret. Sys.*, 121 Wn.2d 52, 70-71, 847 P.2d 440 (1993); *Leischner v. Alldridge*, 114 Wn.2d 753, 756-57, 790 P.2d 1234 (1990); *Miotke v. City of Spokane*, 101 Wn.2d 307, 339, 678 P.2d 803 (1984) (quoting *Public Util. Dist. No. 1 v. Kottsick*, *87886 Wn.2d 388, 390-91, 545 P.2d 1 (1976)); *Painting & Decorating Contractors of Am., Inc. v. Ellensburg Sch. Dist.*, 96 Wn.2d 806, 815, 638 P.2d 1220 (1982); *Seattle Trust & Sav. Bank v. McCarthy*, 94 Wn.2d 605, 612, 617 P.2d 1023 (1980). Winters, 99 Wn. App. at 609 n.20. The Mahler court also noted that according to general principles of equity, [i]t is grossly inequitable to expect an insured, or other claimant, in the process of protecting his own interest, to protect those of the [insurer] as well and still pay counsel for his labors out of his own pocket, or out of the proceeds of the remaining funds. And this is precisely the view taken by the overwhelming majority of decisions, in that a proportionate share of fees and expenses must be paid by the insurer or may be withheld from its share. Mahler, 135 Wn.2d at 425-26 n.17 (quoting 8A John A. Appleman & Jean Appleman, *Insurance Law and Practice* § 4903.85 at 335 (1981)); see also *Peterson v. Safeco Ins. Co.*, 95 Wn. App. 254, 264, 976 P.2d 632 (1999). Winters, 99 Wn. App. at 610 n.25. Mahler settled for either \$24,250 (Mahler, 135 Wn.2d at 406) or \$24,500 {id. at 408 n.2}. For convenience, we rounded off to \$24,000. See Winters, 99 Wn. App. at 609 n.22.