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Opinion by Chin, J., with George, C.J., Baxter, J., Moreno, J., and Corrigan, J. Concurring Opinion by Kennard, J. Concurring Opinion by Werdegar, J.

Issue

Should attorney's fees be included under the made-whole rule for med-pay insurance policy reimbursement?

Facts

Silvia Quintana sustained personal injuries after an automobile accident with a third party.[1] Under her med-pay[2] insurance policy, 21st Century Insurance paid Quintana $1,000.[3] Quintana then brought a personal injury claim against the third party, which was eventually settled for $6,000.[4] To obtain this settlement, Quintana incurred approximately $2,100 in attorney fees.[5] At 21st Century's request for reimbursement, Quintana sent the insurer $600, which amounted to the $1,000 med-pay benefit less a pro rata share of the attorney fees.[6] The insurer accepted this amount as full reimbursement.[7]

Subsequently, Quintana brought a class action lawsuit against 21st Century.[8] Her causes of action alleged a violation of Business and Professions Code section 17200, conversion, unjust enrichment and declaratory relief.[9] Her main argument was that the insurer could not require *any* reimbursement from her, because when taking her attorney fees into account, she had not

1 21st Century Insurance Company v. Superior Court, 213 P.3d 972, 974 (Cal. 2009).

2 A "med-pay" insurance policy provides medical coverage for the insured's medical expenses caused by an accident. *Id.* The amount of coverage is typically low, in exchange for lower premiums. *Id.*

3 *Id.*

4 *Id.*

5 *Id.*

6 *Id.*

7 *Id.* at 974–75.

8 *Id.* at 975.

9 *Id.*

yet been made whole.[10] Essentially, Quintana's reasoning was that, after subtracting the attorney fees from her $7,000 total recovery ($1,000 from med-pay and $6,000 from the settlement) she only recovered approximately $4,900.[11] This fell short of her total actual damages of $6,000, and thus under the made-whole rule the insurer was not permitted to request reimbursement.[12] According to Quintana, the made-whole rule is not satisfied, and thus reimbursement cannot be sought, unless the insured has also recovered the full amount of attorney fees.[13] Her claim represented a class of similarly-situated California policyholders of 21st Century.[14]

21st Century then demurred on the complaint on the grounds that in California, litigation expenses are not included in calculating whether an insured has been made whole.[15] Instead, 21st Century argued that under the common fund doctrine, attorney fees should be separately calculated in equitable apportionment, with the insurer paying a pro rata portion of the fees.[16] The insurer maintained that this was consistent with both the made-whole rule and the common fund doctrine.[17] The trial court overruled the demurrer, and the insurer filed a petition for writ of mandate with the Court of Appeal.[18] In granting the writ, the Court of Appeal held that any attorney fees incurred by an insured in recovering losses from a third party tortfeasor should not be considered when determining whether the insured has been made whole for reimbursement purposes.[19] Accordingly, the Court of Appeal ordered the trial court to vacate the judgment and enter an order to sustain 21st Century's demurrer.[20] Quintana petitioned the California Supreme Court for review.[21]

Analysis

The court catalogued the history of both the made-whole rule and the common fund doctrine in California.[22] The made-whole rule places a limit on when an insurer can invoke its policy's

10 *Id.*
11 *Id.*
12 *Id.*
13 *Id.*
14 *Id.*
15 *Id.*
16 *Id.*
17 *Id.*
18 *Id.*
19 *Id.*
20 *Id.*
21 *Id.*
22 *Id.* at 976–78.

reimbursement clause.[23] Specifically, the made-whole rule provides that there can be no reimbursement until the insured has recovered the entire amount of his or her damages.[24] The court pointed out that the California Court of Appeal has previously defined the made-whole rule in such a way that does not consider attorney fees,[25] and no California court has ever specifically held otherwise.[26] The common fund doctrine provides that a plaintiff who brings an action resulting in the creation or preservation of a common fund may recover his or her attorney fees out of that common fund.[27] This hundred-year-old legal theory was extended to insurance law in 1961,[28] and has been recognized as applicable to insurance reimbursement since 1975 as a way to avoid unjust enrichment to the insurer.[29]

The court noted that in this was a case of first impression because California courts have thus far been unclear as to how the made-whole rule and common fund doctrine are to be applied to attorney fees in the med-pay reimbursement context.[30] As an example, the court pointed to *Plut v. Fireman's Fund Ins. Co.*, where the Court of Appeal held that the insurer is entitled to reimbursement only after the insured has recouped his or her loss plus "some or all" of the litigation expenses, but failed to expand on what "some or all" entailed or discuss the common fund doctrine.[31] The court also looked to *Progressive West Ins. Co. v. Superior Court*, which held that the made-whole rule does apply to reimbursement claims, and that under the common fund doctrine, the reimbursement must be reduced by a proportional amount of incurred attorney fees.[32] As such, thus far California cases have not made clear whether the insured is entitled to recover *some* costs under a pro rata common fund doctrine theory, or *all* costs under the made-whole rule.[33]

Due to the lack of clarity in California jurisprudence, the court looked to other states.[34] Unfortunately, a survey of sister states was inconclusive, because those states recognizing the

23 *Id.* at 976 (citing Plut v. Fireman's Fund Ins. Co., 85 Cal.App.4th 98, 104 (2000); Sapiano v. Williamsburg Nat. Ins. Co., 28 Cal.App.4th 533, 536 (1994)).

24 *Id.* (citing *Plut*, 85 Cal.App.4th at 104).

25 *Sapiano*, 28 Cal.App.4th at 536–37.

26 *21st Century*, 213 P.3d at 976.

27 *Id.* at 977 (citing Lee v. State Farm Mut. Ins. Co., 57 Cal.App.3d 458, 466 (1976)).

28 *Id.* (citing United Servs. Auto Assn. v. Hills, 109 N.W.2d 174 (Neb. 1961)).

29 *Id.* (citing Quinn v. State of California, 539 P.2d 761 (Cal. 1975)).

30 *Id.* at 978.

31 *Id.* (citing Plut v. Fireman's Fund Ins. Co., 85 Cal.App.4th 98, 105 (2000)).

32 *Id.* at 978–79 (citing Progressive West Ins. Co. v. Superior Court, 135 Cal.App.4th 263, 276 (2005)).

33 *Id.* at 979.

34 *Id.*

made-whole rule for insurance law have yet to reach a consensus on the issue.[35]

The court next turned to *Chong v. State Farm Mut. Auto Ins. Co.*, a federal district court decision predicting that California courts would be likely to follow jurisdictions holding that litigation costs incurred by the insured must be included in calculating whether the insured has in fact been made whole.[36] In determining that this was not unfair to the insurance company, the federal district court held that the burden of going unpaid should fall to the insurer because it is being paid to assumed that risk.[37] A contrary holding, the district court reasoned, would allow an insurer to simply "sit on the sidelines" while the insured made the efforts to recover from the third party tortfeasor and then reap the rewards to reimbursement.[38]

The court found the reasoning of *Chong* unpersuasive.[39] First, the assumption that the insurance company has assumed the risk ignores the limited nature of med-pay insurance provisions.[40] In exchange for lower premiums, the policy holder of a med-pay insurance policy has only contracted for the insurer to assume the risk of medial payments; anything beyond this exceeds the insurer's contractual risk.[41] Secondly, the "sit on the sidelines" rationale was not persuasive because an insurer is generally prohibited from intervening in personal injury cases and thus could not participate in the lawsuit if it wanted to.[42] Even if the insurer could intervene, it would likely be met by resistance from the insured's attorney.[43] Further, the court pointed out that the insurer would not have a reason to intervene, since it is unlikely that litigation costs would be larger than the amount of reimbursement.[44] Thus, the court rejected Quintana's implicit reliance on *Chong* to assert that including attorney fees in the made-whole calculation will not give policyholders double recovery.[45]

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35 *Id.* at 979–80.

36 Chong v. State Farm Mut. Auto. Ins. Co. 428 F.Supp.2d 1136, 1147 (S.D.Cal. 2006).

37 *Id.* at 1145 (quoting Skauge v. Mountain States Telephone & Telegraph Co. 565 P.2d 628, 632 (Mont. 1977) (italics omitted)).

38 *Id.* at 1145.

39 *21st Century*, 213 P.3d at 981.

40 *Id.*

41 *Id.*

42 *Id.*

43 *Id.*

44 *Id.*

45 *Id.*

Finally, the court looked to policy considerations, noting again that the primary policy reason for insurance reimbursement is to prevent double recovery on the part of the insured.[46] First, the court found that the collateral source rule was not controlling because it addresses the distribution of litigation costs as between parties to a lawsuit (the injured party and the tortfeasor), and thus was inapplicable as to the distribution of litigation costs as between an insured and non-party insurer.[47] The court also rejected Quintana's reliance on the covenant of good faith and fair dealing, as this doctrine does not apply to med-pay reimbursement disputes.[48] Because med-pay provisions are express contractual provisions, the court refused to read implied terms or impose additional substantive duties.[49] Moreover, the court pointed out that including attorney fees in made-whole calculations would essentially shift the burden of paying attorney fees to the insurance companies, resulting in the additional costs being passed to consumers through increased premiums.[50] This would cause med-pay insurance to become less accessible to those who need it most.[51]

In contrast, the court found that pro rata allocation under the collateral source doctrine balances the interests of both the insurer and the insured for med-pay reimbursement situations.[52] The insured receives the benefit of lower premiums and may retain payments if he or she is unable to recover from the third-party tortfeasor.[53] And, the made-whole rule still guarantees that the insured recover the full amount of actual damages before reimbursement is claimed.[54] So long as it is undisputed that the recovery amount adequately compensates the insured, equity is satisfied when the insurer reduces the amount of reimbursement to account for its fair share of the attorney fees.[55]

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46 *Id.* (citing Helfend v. Southern Cal. Rapid Transit Dist. 465 P.2d 61, 64 n.7 (Cal. 1970)).

47 *Id.* at 981–82. The collateral source rule "prohibits the reduction of damages a tortfeasor owes to the plaintiff because the plaintiff received compensation from an independent source." *Id.* (citing *Helfend*, 465 P.2d at 63).

48 *Id.* at 982 (citing Progressive West Ins. Co. v. Superior Court, 135 Cal.App.4th 263, 276–81 (2005)).

49 *Id.* at 982.

50 *Id.*

51 *Id.*

52 *Id.*

53 *Id.*

54 *Id.*

55 *Id.*

Holding

The court affirmed the Court of Appeal.[56] The court held that attorney fees are not to be included in the made-whole calculation, but rather that pro rata apportionment of attorney fees between insured and insurer is the better allocation of responsibility.[57] Therefore, because Quintana did not dispute the amount of the med-pay provision payment, nor that the $400 originally deducted from reimbursement was less than 21st Century's share, 21st Century properly accounted for its pro rata share and Quintana had effectively been made whole.[58]

Concurrences

Justice Kennard concurred in the judgment, expanding on the reasoning that Quintana's position was contrary to California law.[59] Justice Kennard clarified that although *Plut v. Fireman's Fund Ins. Co.* was imprecise, its statement that reimbursement may be sought only when the insured has recovered "some or all" of his attorney fees is an accurate reflection of California law.[60] This is because recoupment of "some" of the litigation expenses refers to a situation where the insurance payments comprise only a portion of the total loss, in which case the insurer will be responsible for its pro rata share.[61] Recoupment of "all" of the litigation expenses refers to a situation where the insurance payments is equal to the total loss, in which case the insurer's pro rata share would essentially be 100%.[62]

Secondly, Justice Kennard asserted that pro rata allocation of attorney fees is more consistent with the "American rule" under which each party bears his own litigation costs.[63] Justice Kennard pointed out that if the burden of attorney fees cannot be shifted to the actual tortfeasor, it is inconsistent to allow it to be shifted to the insurance carrier.[64] Further, equitable apportionment is also consistent with similar workers' compensation situations, which also requires pro rata share of litigation costs.[65] Lastly, Justice Kennard echoed the sentiment of the majority in explaining that including attorney fees in the made-whole rule would preclude any insurer reimbursement

56 *Id.* at 982–83.
57 *Id.* at 982.
58 *Id.*
59 *Id.* at 983 (Kennard, J., concurring).
60 *Id.* at 984 (citing Plut v. Fireman's Fund Ins. Co. 85 Cal.App.4th 98, 105 (2000)).
61 *Id.* at 984.
62 *Id.*
63 *Id.* at 984–85
64 *Id.* at 985.
65 *Id.*

under med-pay provisions because the average policy limit is lower than average litigation costs.[66] This would force in an increase in the cost of providing med-pay insurance, thus resulting in higher premiums.[67]

Justice Werdegar filed a separate concurrence to provide "alternative rationale" for the court's conclusion.[68] First, Justice Werdegar looked to the relationship between subrogation and reimbursement, and pointed out that the reason insurers seek reimbursement rather than subrogation in personal injury claims is because California bars the assignment of personal injury claims.[69] This is simply a procedural difference, with the principles behind reimbursement and subrogation—that the insured should not be permitted to received double recovery—remains identical.[70] As such, Justice Werdegar reasoned that reimbursement and subrogation cases should have the same *substantive* outcomes.[71] Including attorney fees in the made-whole calculation would yield different results, because under subrogation the insurer would recover its payment less its share of attorney fees, while under reimbursement the insurer would recover nothing.[72] But, under the pro rata theory the results would be identical, with both subrogation and reimbursement resulting in the insured recovering its payment less its share of attorney fees.[73]

Secondly, Justice Werdegar pointed out that if attorney fees were included in the made-whole rule, the amount of reimbursement would be dependent on the extent of the insured's attorney fees.[74] Since contingency fees vary, this would result in disparate treatment of policyholders.[75] This causes a med-pay policy to effectively convert from medical to legal reimbursement, which is not the purpose of med-pay insurance.[76]

Legal Significance

The court's decision precludes an insured who has received med-pay insurance benefits from factoring in his or her litigation costs when determining whether he or she has been "made

66 *Id.*
67 *Id.*
68 *Id.* at 986 (Werdegar, J., concurring).
69 *Id.*
70 *Id.* at 987.
71 *Id.*
72 *Id.* at 987–88.
73 *Id.*
74 *Id.* at 988.
75 *Id.*
76 *Id.*

whole" by amounts recovered from a third party tortfeasor. Instead, once it is undisputed that the insured has received a recovery amount satisfying the full amount of actual damages, the insured may deduct only a pro rata share of attorney fees from the reimbursement amount owed to the insurer.