CUNDIFF V. STATE FARM: ALLOWING DOUBLE RECOVERY UNDER UIM COVERAGE AND WORKERS' COMPENSATION

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INTRODUCTION

In *Cundiff v. State Farm Mutual Automobile Insurance Co.*, the Arizona Supreme Court unanimously held that an insurer may not reduce Underinsured Motorist ("UIM") coverage by the amount of workers' compensation benefits received by an insured.[1] To reach this decision, the court construed the language of Arizona's Uninsured/Underinsured Motorist Act ("UMA"),[2] and found that UMA's definition of UIM coverage precluded an insurer from deducting workers' compensation benefits from an insured's settlement.[3] The court's ultimate outcome is consistent with the majority of other jurisdictions that have addressed the issue of workers' compensation offset provisions.[4]

I. THE ARIZONA SUPREME COURT'S PRIOR TREATMENT OF UIM AND UM OFFSET PROVISIONS

Before *Cundiff*, Arizona courts decided several cases regarding the validity of offset provisions and exclusions from UMA.[5] In particular, the Arizona Supreme Court addressed an insurer's denial of UIM coverage due to an offset provision in *Taylor v. Travelers Indemnity Co. of America*.[6] There, the court

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1. 174 P.3d 270, 271 (Ariz. 2008).
2. ARIZ. REV. STAT. ANN. § 20-259.01 (2002 & Supp. 2007).
3. *Cundiff*, 174 P.3d at 271.
4. *See, e.g.*, Philadelphia Indem. Ins. Co. v. Morris, 990 S.W.2d 621, 626–27 (Ky. 1999); Thamert v. Cont'l Cas. Co., 621 P.2d 702, 704 (Utah 1980); Niemann v. Badger Mut. Ins. Co., 420 N.W.2d 378, 380–81 (Wis. 1988). While the *Cundiff* court focused its decision on statutory interpretation, some state courts have rejected setoff provisions similar to Arizona's on public policy grounds. *See, e.g.*, Allstate Ins. Co. v. Welch, 727 P.2d 268, 270 (Wash. Ct. App. 1986) (holding setoff was void as against public policy where no statutory provision authorized setoff).
5. *See, e.g.*, Taylor v. Travelers Indem. Co. of Am., 9 P.3d 1049 (Ariz. 2000); Schultz v. Farmers Ins. Group of Cos., 805 P.2d 381 (Ariz. 1991); Terry v. Auto-Owners Ins. Co., 908 P.2d 60 (Ariz. Ct. App. 1995).
6. 9 P.3d 1049.

invalidated an insurance company's policy provision that excluded UIM coverage when a party recovered under any other part of the same insurance policy.[7] The UIM coverage issue arose in *Taylor* after a husband negligently injured his wife in an auto accident, and she subsequently recovered under the liability portion of their joint insurance policy.[8] Travelers sought to deny UIM coverage on the theory that allowing recovery under both the liability and UIM portions of a policy would permit stacking coverage.[9] The court, however, noted that the UIM statute has "a remedial purpose and must be construed liberally in favor of coverage, with strict and narrow construction given to offsets and exclusions."[10] The court concluded that the UIM statute does contain an exclusion prohibiting coverage when an insured is injured in his own car.[11] Furthermore, it determined that the legislature intended UIM benefits to apply broadly to those who are not fully indemnified by other methods.[12] The court refused to add exclusions not mentioned by the statute; thus, the court permitted the wife to recover under her UIM coverage.[13]

As part of its analysis, the *Taylor* court summarized a list of previous Arizona cases that similarly rejected writing new exclusions into the availability of UIM coverage.[14] Namely, the court had previously struck down exclusions to UIM coverage where: (1) the insured was riding in an uninsured vehicle;[15] (2) the insured was injured in a vehicle that he owned but insured under a different policy;[16] (3) the insured was injured in a vehicle "furnished for [his] regular use";[17] and (4) the insured's policy contained an excess clause and pro rata limit reduction clause.[18] The overriding message was that the court had struck down "many other[] [exclusions] raised over the years," and it refused to write new exceptions into the statute to reflect an alleged "unexpressed intent" on behalf of the legislature.[19]

On the other hand, Arizona courts have permitted Uninsured Motorist ("UM") provisions to exclude benefits in certain situations. In *Schultz v. Farmers Insurance Group of Cos.*, the court held that a non-duplication provision—which mandated that an insured's UM recovery be reduced by the amount of medical benefits already paid on his behalf—was valid, as long as it did not impede the insured's right to full recovery.[20] The court examined the UMA and concluded that the act supported the insurer's right to prevent double recovery.[21] Additionally, in *Terry v. Auto-Owners Insurance Co.*, the court addressed the validity of workers'

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7. *Id.* at 1057.
8. *Id.* at 1051.
9. *Id.* at 1051–52.
10. *Id.* at 1053.
11. *Id.* at 1054.
12. *Id.*
13. *Id.* at 1057, 1060.
14. *Id.* at 1054.
15. State Farm Mut. Auto Ins. Co. v. Lindsey, 897 P.2d 631, 633–34 (Ariz. 1995).
16. Higgins v. Fireman's Fund Ins. Co., 770 P.2d 324, 326 (Ariz. 1989).
17. State Farm Mut. Auto Ins. Co. v. Duran, 785 P.2d 570, 573 (Ariz. 1989).
18. Brown v. State Farm Mut. Auto Ins. Co., 788 P.2d 56, 60 (Ariz. 1989).
19. *Taylor*, 9 P.3d at 1054–55.
20. 805 P.2d 381, 385 (Ariz. 1991).
21. *Id.* at 382–83.

compensation offset provisions for UM recovery.[22] The court followed its earlier reasoning in *Schultz* and held that UMA does not preclude an insurer from taking measures to preclude double recovery when an insured seeking to use UM coverage has already received workers' compensation benefits.[23] Thus, under *Schultz* and *Terry*, as long as the insured is able to fully recover his damages, a non-duplication endorsement included in a UM policy is likely enforceable.[24]

II. FACTUAL AND PROCEDURAL BACKGROUND IN *CUNDIFF*

In 1997, Pima County Deputy Sheriff Jean Cundiff ("Cundiff") was involved in an auto accident while on the job.[25] Cundiff received $18,695.48 in workers' compensation benefits for medical expenses, and $11,109.35 for lost wages due to the accident.[26] Cundiff sued the driver of the other vehicle, who was found to be at fault for the accident.[27] The parties settled and Cundiff recovered $15,000, the limit of the other driver's liability coverage.[28] Next, Cundiff made an underinsured motorist claim under her own policy with State Farm, which limited UIM coverage to $25,000.[29] An arbitrator ultimately determined that Cundiff's damages were $40,000.[30] Cundiff's policy, however, contained an offset provision that read: "'Any amount payable under [UIM] coverage shall be reduced by any amount paid or payable to or for the insured under any worker[s'] compensation, disability benefits, or similar law. This does not reduce the limits of liability required by law for this coverage.'"[31]

After reviewing this provision, State Farm offered Cundiff $10,000, relying on the offset from her workers' compensation benefits.[32] Cundiff filed suit against State Farm, seeking a declaratory judgment that (1) the workers' compensation offset was either unenforceable per se, or, in the alternative, (2) the application of an offset not entered into evidence at the earlier arbitration hearing deprived her of the right to be made whole.[33]

Although the superior court rejected Cundiff's argument that the offset was unenforceable per se, the court agreed with Cundiff on her second theory and awarded her damages based on its finding that there was no duplication of benefits.[34] Cundiff appealed the court's ruling on the per se unenforceability of the offset provision, and State Farm cross-appealed, arguing that prevailing case law allowed the offset provision to prevent double recovery.[35] The Arizona Court of

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22. 908 P.2d 60 (Ariz. Ct. App. 1995).
23. *Id.* at 62, 64.
24. *Id.* at 63.
25. Cundiff v. State Farm Mut. Auto Ins. Co, 174 P.3d 270, 271 (Ariz. 2008).
26. *Id.*
27. *Id.*
28. *Id.*
29. *Id.*
30. *Id.*
31. *Id.*
32. *Id.*
33. *Id.*
34. *Id.* at 271–72.
35. *Id.*

Appeals sided with State Farm, holding that the offset provision was valid and could be used to reduce UIM coverage by the amount of workers' compensation benefits the insured received.[36] Cundiff petitioned for review, and the Arizona Supreme Court granted the petition to clarify the application of UMA.[37]

III. THE ARIZONA SUPREME COURT'S OPINION AND ANALYSIS

In an opinion written by Chief Justice Ruth McGregor, the court began by outlining its basic approach to construing statutory language.[38] The court noted that "the language of the UMA is clear[,]"[39] and when statutory language is clear and unambiguous, the court should stop there and "'apply it without using other means of construction,' assuming that the legislature has said what it means."[40]

The UMA first requires that insurance companies offer underinsured motorist coverage to their policyholders.[41] Second, the statute defines the scope of UIM coverage, stating that it:

> includes coverage for a person if the sum of the limits of liability under all bodily injury or death liability bonds and liability insurance policies applicable at the time of the accident is less than the total damages for bodily injury or death resulting from the accident. To the extent that the total damages exceed the total applicable liability limits, the underinsured motorist coverage provided in subsection B of this section is applicable to the difference.[42]

Therefore, Arizona Revised Statute section 20-259.01(G) states that UIM coverage is the difference between an insured's total damages for bodily injury or death and the limits of pertinent liability insurance policies.[43] The court noted that the statutory text mandated the reduction of UIM coverage by the "total applicable liability limits" only.[44] Previous attempts to further limit UIM coverage failed because the statute neither contained nor authorized additional exceptions.[45]

The court next addressed the issue of whether workers' compensation benefits constituted "liability insurance"—the only applicable deduction an insurer can make from an insured's UIM benefits under the UMA.[46] The court concluded that workers' compensation is distinct from liability insurance.[47] While liability insurance is "'insurance against legal liability,'" workers' compensation serves to

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36. *Id.*
37. *Id.*
38. *Id.*
39. *Id.*
40. *Id.* (quoting Hughes v. Jorgenson, 50 P.3d 821, 823 (Ariz. 2002)).
41. ARIZ. REV. STAT. ANN. § 20-259.01(B) (2002 & Supp. 2007).
42. *Id.* § 20-259.01(G).
43. *Cundiff*, 174 P.3d at 272.
44. *Id.*
45. *Id.* (summarizing that since the statute's "broad language does not contain exceptions . . . exceptions to coverage not permitted by the statute are void" (quoting Taylor v. Travelers Indem. Co. of Am., 9 P.3d 1049, 1053–54 (Ariz. 2000))).
46. *Id.* at 273.
47. *Id.*

insure for obligations "'accepted by, imposed upon or assumed by employers under law.'"[48] Workers' compensation is not fault-based insurance—in fact, it removes any question of fault from its coverage analysis.[49] Because workers' compensation is not liability insurance, the court concluded that UMA did not permit reducing available UIM coverage by such benefits.[50]

The court bolstered its reasoning by noting its prior decision in *Taylor*, which held that an insurance policy provision denying an insured UIM coverage was invalid under the UMA.[51] There, the court said that it would not redline the statutes "'to permit exclusions that have not been mentioned by the legislature.'"[52]

The court also addressed the differences between the UIM statutes and those governing UM coverage.[53] While the statute defining UM coverage states that such coverage is "subject to the terms and conditions of that coverage,"[54] the UIM statute does not contain a similar provision.[55] Moreover, the court emphasized the distinct nature of the two coverages.[56] Thus, prior Arizona court decisions allowing offset or non-duplication provisions for UM coverage[57] are still good law, but do not apply to the court's reasoning regarding UIM coverage.[58] State Farm argued that the court, by treating UIM and UM cases differently, permitted "double recovery" for some and not for others.[59] The court,

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48. *Id.* (quoting ARIZ. REV. STAT. § 20-252.1–.2 (2002)).
49. *Id.* (comparing to fault-based liability insurance).
50. *Id.*
51. *Id.*
52. *Id.* (quoting Taylor v. Travelers Indem. Co. of Am., 9 P.3d 1049, 1057 (Ariz. 2000)).
53. *Id.* at 273–74.
54. ARIZ. REV. STAT. ANN. § 20-259.01(E) (2002 & Supp. 2007).
55. *Cundiff*, 174 P.3d at 273–74.
56. *Id.* UM and UIM coverages are defined in different statutory provisions. *Compare* ARIZ. REV. STAT. ANN. § 20-259.01(E) (defining UM coverage), *with* ARIZ. REV. STAT. ANN. § 20-259.01(G) (defining UIM coverage). Furthermore, the UMA expresses a clear desire to separate the coverages and their differing applicability. ARIZ. REV. STAT. ANN. § 20-259.01(H) ("Uninsured and underinsured motorist coverages are separate and distinct and apply to different accident situations.").
57. *See* Schultz v. Farmers Ins. Group of Cos., 805 P.2d 381, 386 (Ariz. 1991) (non-duplication endorsement in UM policy upheld so long as it does not prevent the insured from fully recovering her damages); Terry v. Auto-Owners Ins. Co., 908 P.2d 60, 63–64 (Ariz. Ct. App. 1995) (workers' compensation offset provision in UM policy lawful so long as it does not interfere with the insured's full right to recovery).
58. *Cundiff*, 174 P.3d at 274.
59. *Id.* When it distributes benefits, the State Compensation fund acquires a lien on benefits collectible by the injured employee from the tortfeasor. ARIZ. REV. STAT. ANN. § 23-1023(D) (Supp. 2007). However, funds received from a UIM insurer are not included as collectible benefits. *Cundiff*, 174 P.3d at 274. Therefore, an insured with a UIM claim could receive compensation from his or her insurance company that duplicates benefits already received under workers' compensation. However, because the State Compensation fund has no authority to create a lien on the UIM benefits, the insured would be entitled to keep both.

acknowledging that disparate treatment resulted, affirmed that its sole role was to construe the statute's requirements, and leave policy concerns to the legislature.[60]

Finally, the court rejected State Farm's contention that its decision should apply prospectively only.[61] The court noted that civil decisions generally apply both prospectively and retroactively.[62] Solely prospective application is contingent upon three factors: "(1) whether the court establishes 'a new legal principle by overruling clear and reliable precedent or by deciding an issue whose resolution was not foreshadowed'; (2) whether '[r]etroactive application would adversely affect the purpose behind the new rule'; and (3) whether '[r]etroactive application would produce substantially inequitable results.'"[63] State Farm failed to show that any of the three factors were met.[64] Therefore, the court mandated retroactive and prospective application of its decision holding that UMA did not allow insurers to reduce an insured's UIM coverage by the amount of any workers' compensation benefits already received.[65]

IV. DISTINGUISHING THE *CUNDIFF* DECISION FROM THE COLLATERAL SOURCE RULE

The collateral source rule is a well-established doctrine under Arizona law[66] and is codified in the Restatement (Second) of Torts.[67] It states that if an outside source not connected to the tortfeasor makes payments to or confers benefits on an injured party, these payments and benefits cannot be credited against the tortfeasor's liability.[68] In other words, compensation from a collateral source does not reduce the amount of damages that a tortfeasor owes the injured party.[69]

The *Cundiff* court stated that it was not necessary to address the collateral source rule, given its decision in the case.[70] Indeed, its reasoning seems to rest solely on its interpretation of Arizona's UMA. Even so, the *Cundiff* decision is consistent with Arizona's acceptance of the collateral source rule. Arizona statutory law authorizes subrogation against uninsured motorists when an insured recovers damages under his UM coverage.[71] While the right to subrogate

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60. *Cundiff*, 174 P.3d at 274.
61. *Id.*
62. *Id.*
63. *Id.* (quoting Taylor v. Travelers Indem. Co. of Am., 9 P.3d 1049, 1060 (Ariz. 2000)).
64. *Id.* The court was not overturning significant precedent or creating a new rule, and there was no evidence that disparate results would arise if the court applied the decision retroactively.
65. *Id.*
66. Michael v. Cole, 595 P.2d 995, 997 (Ariz. 1979).
67. RESTATEMENT (SECOND) OF TORTS § 920A(2) (1979).
68. Lopez v. Safeway Stores, Inc., 129 P.3d 487, 491 (Ariz. Ct. App. 2006).
69. Hall v. Olague, 579 P.2d 577, 577 (Ariz. Ct. App. 1978).
70. *Cundiff*, 174 P.3d at 272 n.1.
71. ARIZ. REV. STAT. ANN. § 20-259.01(I) (2002 & Supp. 2007).

underinsured motorists was removed from the UMA in 1986,[72] theoretically it would still contradict the collateral source rule to reduce the amount that even an underinsured at-fault party would owe back to the insurance company because the insured party received workers' compensation from another source.

CONCLUSION

In *Cundiff v. State Farm Mutual Automobile Insurance Co.*, the Arizona Supreme Court rejected an insurer's right to reduce UIM coverage by the amount of workers' compensation benefits already received by its insured. The decision is consistent with Arizona's prior treatment of offset provisions for UM and UIM coverage, and the decisions of other jurisdictions. Additionally, the *Cundiff* decision is further supported by the collateral source rule.

72. State Farm Mut. Auto Ins. Co. v. Wilson, 782 P.2d 727, 730 n.3 (Ariz. 1989).