
SUPREME COURT
OF THE
STATE OF CONNECTICUT

CERTIFIED QUESTION FROM
THE U.S. COURT OF APPEALS FOR THE SECOND CIRCUIT

S.C. 18796

FIREMAN'S FUND INSURANCE COMPANY

V.

**TD BANKNORTH INSURANCE AGENCY INCORPORATED
F/K/A MORSE PAYSON & NOYES INSURANCE**

**BRIEF OF AMICUS CURIAE,
NATIONAL ASSOCIATION OF SUBROGATION PROFESSIONALS**

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STATEMENT OF THE ISSUE

In its April 29, 2011 opinion, the United States Court of Appeals for the Second Circuit certified the following question to this Court: "Are insurance policy deductibles subject to Connecticut's make whole doctrine?" Fireman's Fund Ins. Co. v. TD Banknorth Ins. Agency Inc. f/k/a Morse, Payson & Noyes Ins., 644 F.3d 166, 172-73 (2d Cir. 2011).

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STATEMENT OF INTEREST

The National Association of Subrogation Professionals, Inc. (hereinafter "NASP") is a non-profit trade association of insurance companies, third party administrators, subrogation specialists and attorneys practicing in the field of subrogation and recovery.¹ NASP has approximately 2,000 members, representing more than 290 insurance companies and self-funded entities. The purpose of NASP is to "create a national forum for the education, training, networking and sharing of information and, ultimately, the most effective pursuit of subrogation on an industry-wide basis."

NASP has a significant interest in the instant matter since its members, and the policy holders of those members, will be materially affected by the outcome of this matter. NASP submits this *amicus curiae* brief in support of the position taken by the plaintiff-appellant, Fireman's Fund Insurance Company (hereinafter "Fireman's Fund"), that the made whole doctrine does not apply to insurance deductibles.²

^{1/} Neither party's counsel wrote any part of this brief or contributed to the cost of the preparation or submission of this brief. In addition, neither party contributed to the cost of the preparation or submission of this brief.

^{2/} The designation of parties is based on Practice Book § 82-6.

STATEMENT OF FACTS AND NATURE OF PROCEEDINGS

This case arose out of an insurance coverage dispute. In 2005, Haynes Construction Company (hereinafter "Haynes") filed a claim against the defendant-appellee, TD Banknorth Insurance Agency Inc. f/k/a Morse Payson & Noyes Insurance (hereinafter "TD Bank"), alleging negligent procurement of insurance in connection with a housing development project. Fireman's Fund Ins. Co. v. TD Banknorth Ins. Agency Inc. f/k/a Morse, Payson & Noyes Ins., 644 F.3d 166, 168 (2d Cir. 2011). TD Bank in turn filed a claim with its insurer, Fireman's Fund, under an Errors & Omissions policy issued to TD Bank by Fireman's Fund. Id. In 2006, Fireman's Fund and TD Bank settled with Haynes. Id. TD Bank contributed its \$150,000 deductible to the settlement and Fireman's Fund contributed the remainder. Id. Fireman's Fund then brought a subrogation action and recovered \$208,000 from the responsible parties, which was deposited into an escrow account. Id.

In 2008, Fireman's Fund brought suit against TD Bank in the United States District Court for the District of Connecticut, seeking a declaratory judgment that it was entitled to all of the escrowed funds. Id. TD Bank counterclaimed for a declaratory judgment that, under Connecticut's make whole doctrine, it was entitled to recover its \$150,000 deductible from the escrow funds. Id. The District Court found that the subrogation clause in the E & O contract abrogated Connecticut's make whole doctrine, and accordingly granted summary judgment in favor of Fireman's Fund. Id.

On appeal, the United States Court of Appeals for the Second Circuit held that the contract at issue did not abrogate Connecticut's make whole doctrine. Id. at 167. The Second Circuit further concluded, however, that Connecticut law was silent on the more basic issue of whether Connecticut's make whole doctrine applies to insurance deductibles at all. Id. Accordingly, the Second Circuit certified the following question to this Court:

“Are insurance policy deductibles subject to Connecticut’s make whole doctrine?”
Id. at 172-73. For the reasons set forth below, NASP urges the Court to answer the certified question in the negative.

ARGUMENT

The made whole doctrine should not apply to insurance policy deductibles because: (1) a deductible is not an uninsured loss; (2) application of the made whole doctrine to deductibles will interfere with the parties’ contractual agreement; (3) requiring reimbursement of the deductible would violate the equitable principles on which the made whole doctrine is based; and (4) application of the made whole doctrine to deductibles will prevent insurers from pursuing subrogation.

I. BASIC PRINCIPLES OF INSURANCE, DEDUCTIBLES AND SUBROGATION

By definition, insurance is a form of risk management primarily used to protect against the risk of a contingent, uncertain loss. See Swenja Surminski, *Adaptation to climate extremes: Investigating the role of the private sector – the case of the insurance industry* (February 2011). Insurance is defined as the equitable transfer of the risk of a loss, from one entity to another, in exchange for payment. Id. The insured assumes a guaranteed and known loss in exchange for the insurer’s promise to compensate the insured in the event that an unexpected loss occurs. Lusuga Kironde, *Elements of Property Insurance*, DAILY NEWS (April 2, 2011).

In the event that there is no unexpected loss, the insured’s “guaranteed and known loss” takes the form of a premium. The insured and the insurer will reach an agreement as to the amount of the premium based on each party’s calculation of the risks. Presumably, if the insured seeks to be guaranteed full compensation for any loss, no matter how

substantial and costly, the insurer will charge the insured a higher premium in exchange for a higher policy limit. On the other hand, if the insured is willing to accept some risk that it will sustain a loss that exceeds its policy limits, the insurer will charge a lower premium in exchange for a lower policy limit.

In the event that an unexpected loss does occur, the insured's "guaranteed and known loss" may also include a deductible. By definition, a deductible, like a premium, is the amount that the insured is required to pay under the insurance policy in order to guarantee its right to compensation from the insurer in the event that an unplanned loss occurs. See 2 ALLAN D. WINDT, INSURANCE CLAIMS AND DISPUTES § 10:6 (5th Ed. 2009). The deductible and the premium are parts of the contract that the insured and insurer bargain for in defining the terms of the insurance policy.

The function of the deductible is to require the insured to share in the risk of loss, Basler Turbo Conversions, LLC v. HCC Inc., 601 F. Supp. 2d 1082, 1091 (E.D. Wis. 2009), and "to alter the point at which an insurance company's obligation to pay will ripen." General Star Indemnity v. W. Florida Village Inn, Inc., 874 So. 2d 26, 33 (Fla. App. 2004). "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 first be out of pocket the amount of the deductible." 2 ALLAN D. WINDT, INSURANCE CLAIMS AND DISPUTES § 10:6 (5th Ed. 2009).

In the insurance context, subrogation is a derivative right that permits an insurer, who has been contractually obligated to satisfy a loss created by a third party, to step into the shoes of its insured, and to pursue recovery from the responsible third party. See 73 Am. Jur. 2d Subrogation 1 (2007). Subrogation provides an equitable adjustment among

parties to prevent unjust enrichment in two ways. See Johnny C. Parker, *The Made Whole Doctrine: Unraveling the Enigma Wrapped in the Mystery of Subrogation*, 70 Mo. L. REV. 723, 725-26 (2005) (hereinafter "Parker"). First, subrogation compels payment of a debt by one who in equity ought to pay, namely, the tortfeasor. Id. at 726. Second, subrogation precludes an insured from recovering twice for the same loss. Id.

"Balancing the insurer's right to recoup benefits it has paid against an insured's right to obtain full compensation for loss is also an equitable concern in subrogation." Muller v. Society Insurance, 750 N.W.2d 1, 7 (Wis. 2008). Thus, the insurer's right to subrogation does not ordinarily accrue until the insured has been paid in full. 16 L. RUSS & T. SEGALLA, COUCH ON INSURANCE (3d Ed. 2006) § 223:134. This anti-subrogation rule is known as the "made whole" doctrine. Id.

The made whole doctrine is a complex equitable principle designed to achieve fairness between the parties to a subrogation dispute. See Parker at 775. Under the made whole doctrine, an insurer may not enforce its subrogation rights until the insured has been fully compensated for all of its loss. Wasko v. Manella, 269 Conn. 527, 537 (Conn. 2004). As such, if an insured is not fully compensated for its loss under its policy, its insurer would have to use any third party recovery it achieved to make its insured whole before it could keep any money for itself. Though recognized in Connecticut, no court has expressly applied the made whole doctrine to deductibles. See, e.g., 2 ALLAN D. WINDT, INSURANCE CLAIMS AND DISPUTES § 10:6 (5th Ed. 2009) (expressly stating that "the made whole doctrine does not apply to deductibles.").

II. A DEDUCTIBLE IS NOT AN UNINSURED LOSS

By its very definition, the made whole doctrine only allows the insured to recover for uninsured losses. See Wasko, 269 Conn. at 537. A deductible, however, is part of the contract bargained for by the insured, and therefore, it is readily distinguishable from what is typically referred to as an “uninsured loss.”

A deductible is defined as the amount that the insured is required and obligated to pay under the insurance policy. A deductible is not a benefit of the insurance policy. Rather, it is a risk that the insured agrees to accept in exchange for a lower premium or some other contractual benefit. Accordingly, the insured receives all the benefits of the insurance policy regardless of whether the insured receives any reimbursement of the deductible. Indeed, “[i]f the insured were to be reimbursed for its deductible before the insurer is made whole, the insured would be receiving an unbargained for, and unpaid for windfall.” 2 ALLAN D. WINDT, *INSURANCE CLAIMS AND DISPUTES* § 10:6 (5th Ed. 2009).

An insurance policy explicitly states the amount of the deductible, and clearly states that the insured is responsible for the payment of the deductible before the insured is entitled to any compensation from the insurer. The insured is aware of its responsibility for the deductible before the insured sustains any damage. In fact, the amount of the deductible will often reflect the insured’s analysis of the risk that it will incur any damages. Presumably, the insured is willing to accept a higher deductible based on its determination that (1) it has the financial resources to pay for the deductible should it become necessary and (2) the benefits of paying lower premiums outweigh the risks of having to pay the deductible.

III. APPLICATION OF THE MADE WHOLE DOCTRINE TO DEDUCTIBLES WILL INTERFERE WITH THE PARTIES' CONTRACTUAL AGREEMENT

As discussed above, an insurance policy is a contract entered into by the insured and the insurer based on their respective calculation of the risks and their desire to allocate those risks. The insurer and the insured contract to be bound by certain terms, including the policy limits, the premium, the deductible, etc. If the made whole doctrine required the insurer to reimburse the deductible, the insurer will have been effectively compelled to provide the insured with a non-deductible policy despite the express terms of the parties' contract. In essence, the policy will be rewritten in a manner which contravenes the intent of the parties.³

Moreover, if an insurer is required to refund the deductible when it recovers from a third party through subrogation, the deductible does not operate reliably to allocate to the insured the risk that the insured contracted to assume. Rather, if reimbursement of the deductible is required, the insurer still effectively bears the risk of the entire loss notwithstanding the inclusion of the deductible in the insurance policy. Requiring the insurer to reimburse the deductible would reduce the parties' ability to allocate risks

^{3/} This is not consistent with the well settled law that governs interpretation of contracts in Connecticut. See FCM Group, Inc. v. Miller, 300 Conn. 774, 811 (2011) ("it is well established that a contract must be construed to effectuate the intent of the parties."); Voris v. Middlesex Mut. Assur. Co., 297 Conn. 589, 595 (2010) ("an insurance policy is to be . . . enforced in accordance with the real intent of the parties as expressed in the language employed in the policy."); Liberty Mut. Ins. Co. v. Lone Star Indus., 290 Conn. 767, 795 (2009) ("The determinative question is the intent of the parties, that is, what coverage the . . . [insured] expected to receive and what the [insurer] was to provide, as disclosed by the provisions of the policy."); Hammer v. Lumberman's Mut. Casualty Co., 214 Conn. 573, 591 (1990) ("A court cannot rewrite the policy of insurance or read into the insurance contract that which is not there.").

between themselves, thereby reducing the flexibility that an insured and an insurer currently enjoy when defining their obligations under the insurance policy.

IV. REQUIRING REIMBURSEMENT OF THE DEDUCTIBLE WOULD VIOLATE THE EQUITABLE PRINCIPLES ON WHICH THE MADE WHOLE DOCTRINE IS BASED

The made whole doctrine is based on the equitable principle that where either the insurer or the insured must to some extent go unpaid, the loss should be borne by the party who has been paid to assume the risk. 16 L. RUSS & T. SEGALLA, COUCH ON INSURANCE (3d Ed. 2006) § 223:136. In the absence of a deductible, the risk of the entire loss is placed on the insurer, because the insurer has accepted payments to assume the entire risk. *Id.* However, when the insurance policy contains a deductible, the insurer only assumes the risk of paying for losses that exceed the amount of the deductible, and the insured assumes the risk of paying for any loss up to the amount of the deductible. Requiring the insurer to reimburse the insured for the insured's contractually assumed risk of having to pay the deductible will violate the very equitable principles on which the made whole doctrine is based.

In a similar manner, the made whole doctrine is intended to combat the inequitable prospect of an insurer competing with its insured for a limited pool of funds which will fail to make the insured whole. When an insurance policy includes a deductible, there is no competition between the insured and the insurer for the same pool of money. Rather, the insured has agreed to assume the deductible before it is entitled to any recovery. Accordingly, deductibles do not raise the threshold issue of a limited pool of money that would trigger the made whole doctrine. See Shonau v. Geico General Insurance Company, 903 So.2d 285, 287-88 (Fla. App. 2005).

V. APPLICATION OF THE MADE WHOLE DOCTRINE TO DEDUCTIBLES WILL PREVENT INSURERS FROM PURSUING SUBROGATION

Application of the made whole doctrine to deductibles will have a chilling effect on subrogation. If the made whole doctrine requires the reimbursement of deductibles, the insurer will not be able to pursue subrogation until it pays the deductible since the insurer has no subrogation rights until the insured is made full. Consider the following scenario adapted from an Alabama case⁴: The insured sustains damage to his home. The insured submits a claim to his insurer. The insurer pays for the full amount of the damage, less the insured's \$250 deductible. The insurer and insured reach an agreement, whereby the insurer will retain counsel to represent both parties in a suit against the alleged third-party tortfeasor. The parties agree that the insured will receive \$5,250 of any recovery against the tortfeasor. Of this amount, \$5,000 represents compensation for the insured's loss of use of his home and the frustration of having to make repairs. The sum of \$250 represents compensation for the insured's deductible. The insurer files suit against the tortfeasor. The tortfeasor moves for summary judgment, arguing that the insurer's claim is barred because the insurer has not made the insured fully whole. Under that scenario, if the made whole doctrine applies to deductibles, the trial court must grant the tortfeasor's motion.

An appellate court in Alabama accurately described the inherent injustice in such a result:

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 made-whole rule] bars the insurer, who has compensated an injured party for a loss, from pursuing a subrogation action against the alleged

⁴/ State Farm Fire and Casualty Co. v. Hannig, 764 So.2d 543 (Ala. 2000).

tortfeasor merely because a \$250 deductible was subtracted from the insured's compensation pursuant to the insurance contract.

State Farm Fire & Cas. Co. v. Hannig, 764 So. 2d 538, 542 (Ala. Civ. App. 1999). In such circumstances, application of the made whole doctrine to deductibles “confers an unjust benefit on the alleged tortfeasor, who is permitted to escape responsibility for his or her alleged wrongdoing.” Id.⁵ The only parties who suffer harm are the insured and the insurer. Obviously, this is not the intended purpose behind insurance, deductibles and subrogation.

This example plainly illustrates that application of the made whole doctrine to deductibles may have unintended consequences, beyond the facts of this immediate case, that will harm both the insured and the insurer.

^{5/} Ultimately, the Supreme Court of Alabama recognized this unjust result and ordered the Court of Appeals to reverse summary judgment against the insurer.

CONCLUSION

The made whole doctrine should not apply to insurance policy deductibles because: (1) a deductible is not an uninsured loss; (2) application of the made whole doctrine to deductibles will interfere with the parties' contractual agreement; (3) requiring reimbursement of the deductible would violate the equitable principles on which the made whole doctrine is based; and (4) application of the made whole doctrine to deductibles will prevent insurers from pursuing subrogation. Accordingly, NASP urges this Court to answer the certified question in the negative.

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CERTIFICATION OF SERVICE AND COMPLIANCE

Pursuant to Practice Book § 62-7, this to certify that on this 12th day of October, 2011, the original plus twenty five copies of this brief were filed with the Clerk's Office of the Connecticut Supreme Court. Also, a copy was caused to be served via U.S. mail, postage prepaid, on:

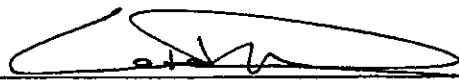
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This is to further certify that the foregoing brief complies with all of Practice Book § 67-2's requirements.



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