

IS SELF-INSURANCE REALLY INSURANCE? UM AND PIP

COVERAGE OBLIGATIONS FOR SELF-INSURERS

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In these tough economic times, many businesses are looking for ways to cut expenses. For many, self-insurance is one solution. Before switching to a system of self-insurance, it is important for businesses to understand the various obligations of self-insurers. For instance, is a self-insurer required to provide personal injury protection (“PIP”) or uninsured/underinsured motorist (“UM”) coverage? This article reviews Washington, Oregon, and California law as it relates to UM and PIP coverage and discusses the corresponding obligations of self-insurers in those states.¹

WHAT IS SELF-INSURANCE?

The term “self-insurance” can be a bit of a misnomer because many view self-insurance as simply no insurance—i.e., all risks not otherwise insured are self-insured.² Self-insurance, however, should be distinguished from what is known as “going bare.”³ Some commentators have noted that a true self-insurance plan includes a fund based on projections of future losses.⁴ The plan identifies possible and actual claims so that money from the fund may be set aside to pay those claims if and when they come due.⁵

¹ There are several other regulatory issues that a business should consider before switching to a system of self-insurance. This article discusses the issue of a self-insurer’s UM and PIP obligations only. In addition, this article does not address the legal implications of using a system of “captive insurance,” where a business forms a wholly-owned insurance company subsidiary to insure the parent company’s risks. Ultimately, a business should seek the advice of experienced counsel before switching to an alternate system of insurance.

² See 1A Steven Plitt et. al., *Couch on Insurance* § 10:1 (3d ed. 2007).

³ Alan D. Windt, *Insurance Claims and Disputes* § 11:31 (5th ed. 2007).

⁴ See, e.g., *id.*

⁵ *Id.*

Choosing to self-insure may be a smart move, especially if a company has a large number of similar risks that are small in relation to the size of the business.⁶ Some of the benefits of self-insurance include greater control over funds and claims, the opportunity to earn interest on reserve funds, the possibility of administering the plan at a lower cost than a commercial insurer, and the ability to keep all monies saved where the loss experienced is less than the loss expected.⁷ In addition, a company can always cap its exposure by purchasing excess insurance or reinsurance to cover claims over a certain amount.

PIP AND UM OBLIGATIONS FOR SELF-INSURERS

An issue can arise for a self-insurer where a self-insured vehicle is involved in an accident with an uninsured or underinsured vehicle. Is the self-insurer obligated to provide PIP and/or UM coverage?

Generally, every motor vehicle liability insurance policy must include PIP and UM coverage unless the named insured rejects the coverage in writing.⁸ For example, Washington law requires the following levels of PIP coverage: medical and hospital benefits of \$10,000; funeral expense benefit of \$2,000; income continuation benefits of \$10,000, subject to a limit of \$200 per week, and loss of services benefits of \$5,000, subject to a limit of \$200 per week.⁹ Typical coverage under a UM statute includes \$25,000 for bodily injury or death of a person, \$50,000 for bodily injury or death of two or more persons, and \$10,000 for property damage.¹⁰

⁶ Eric Mills Holmes et al., Appleman on Insurance §2.18 (2d ed. 1996).

⁷ 1A Steven Plitt et. al., Couch on Insurance § 10:1 (3d ed. 2007). A variety of income and tax implications arise when a business decides to self-insure. Those considerations are not dealt with in this article.

⁸ See Wash. Rev. Code §§ 48.22.030, .085; Cal. Ins. Code §§ 11580, 11580.2. Oregon law allows the insured to elect, in writing, lower limits, so long as the election does not go below the prescribed amount to meet the requirements of Or. Rev. Stat. § 806.070 for bodily injury or death. See Or. Rev. Stat. § 742.502(2)(a).

⁹ Wash. Rev. Code § 48.22.095

¹⁰ See, e.g., Or. Rev. Stat. § 806.070.

Courts in the majority of states have held that self-insurance is not a “motor vehicle liability insurance policy.”¹¹ As a result, additional insureds and third parties cannot make a claim against a self-insurer on the basis that, by virtue of the self-insured retention, it issued insurance in the amount of the retention.¹² The majority of decisions hold that UM requirements apply only to insurance policies that have been “issued” as such.¹³ Because a certificate of self-insurance is not a liability policy and has not been issued, a self-insurer is not required to furnish UM coverage.¹⁴

For example, in *Cann v. King County*, a passenger injured on a King County, Washington, bus brought an action against the self-insured county to recover UM benefits.¹⁵ In response to the plaintiff’s argument that as a self-insurer, King County had a liability policy and was therefore required to provide UM coverage for its passengers, the court observed that the Washington State Supreme Court has held that self-insurance is not a liability policy under the UM statute.¹⁶ Self-insurance does not involve the type of third party relationship that insurance policies contemplate.¹⁷ Therefore, the County, as a self-insurer, had no liability policy and no duty to provide UM coverage.¹⁸

The Washington Supreme Court, in *Kyrkos v. State Farm Mut. Auto Ins. Co.*, discussed why self-insurers have no duty to provide UM coverage. Wash. Rev. Code § 48.01.040 defines “insurance” as “a contract whereby one undertakes to indemnify another or pay a specified

¹¹ See *Cann v. King County*, 86 Wash. App. 162, 937 P.2d 610 (1997); *Thompson v. Estate of Pannell*, 176 Or. App. 90, 29 P.3d 1184 (2001); *O’Sullivan v. Salvation Army*, 85 Cal. App. 3d 58, 147 Cal. Rptr. 729 (1978).

¹² Alan D. Windt, *Insurance Claims and Disputes* § 11:31 (5th ed. 2007).

¹³ *Automobile Liability Insurance* § 19:26 (4th ed. 2008).

¹⁴ *Id.*

¹⁵ *Cann v. King County*, 86 Wash. App. 162, 937 P.2d 610 (1997).

¹⁶ *Id.* (citing *Kyrkos v. State Farm Mut. Auto Ins. Co.*, 121 Wash. 2d 669, 674, 852 P.2d 1078 (1993)); Wash. Rev. Code § 48.22.030(1).

¹⁷ *Id.* at 164.

¹⁸ *Id.* at 163.

amount upon determinable contingencies.”¹⁹ Self-insurance does not involve this type of third party arrangement:

Self-insurance is a misnomer. It is not insurance, but instead is one of four methods by which a person can satisfy the financial responsibility statute. Consequently, the certificate of self-insurance cannot be considered a “policy” for the purposes of underinsured motorist coverage requirements under the statute.²⁰

The *Kyrkos* court held that an exclusion contained in the policy—purporting to exclude vehicles owned or operated by a self-insurer up to the extent that bodily injury UM limits were payable—was void.²¹ The court emphasized that the exclusion impermissibly denied coverage “when the [UM] statute, by its terms, requires coverage.”²² The court also noted that “the Legislature has not authorized these exclusions in defining underinsured motorists even though it has amended the statute a number of times, including authorization of specific exclusions.”²³

Likewise, requiring self-insurers to provide UM coverage in California would require courts in that state to exceed the limits of statutory interpretation and legislate in the area of financial responsibility.²⁴ For example, *Glens Falls Ins. Co. v. Consol. Freightways*, involved a self-insured common carrier engaged in the trucking business.²⁵ There, the court noted that Defendant Consolidated was not an insurance carrier.²⁶

Consolidated is merely an authorized self-insurer or, to put it more exactly, a company to which the motor vehicle department has issued a certificate of self-insurance. Neither the Vehicle Code sections referring to self-insurance (§§ 16055, 16056) nor any other sections of said code contain any provisions that such certificate is or constitutes a policy of motor vehicle liability insurance or that said certificate shall be deemed to incorporate or embrace [*sic*] provisions required in such policies (§ 16451). Indeed the Vehicle Code nowhere intimates

¹⁹ *Kyrkos v. State Farm Mut. Auto Ins. Co.*, 121 Wash. 2d 669, 674, 852 P.2d 1078 (1993).

²⁰ *Id.* at 674–75.

²¹ *Id.* at 672.

²² *Id.*

²³ *Id.* at 673. Interestingly, the Court did not address the fact that the Washington State Office of the Insurance Commissioner had presumably approved the policy at issue in *Kyrkos*.

²⁴ *O’Sullivan*, 85 Cal. App. 3d at 62.

²⁵ *Glens Falls Ins. Co. v. Consol. Freightways*, 242 Cal. App. 2d 774, 785, 51 Cal. Rptr. 789 (1966).

²⁶ *Id.* at 785.

any connection between section 16451 and sections 16055, 16056. A certificate of self-insurance is not a motor vehicle liability policy of insurance.²⁷

“While an extension of the uninsured motorist concept to self-insurers may [] have persuasive social virtues, to date the Legislature in its wisdom has not seen fit to require that of self-insurers.”²⁸

Oregon courts also hold that self-insurance is not a “motor vehicle liability insurance policy.”²⁹ The Oregon financial responsibility statute, however, provides specific coverage obligations for self-insurers. For example, in *Thompson v. Estate of Pannell*,³⁰ the court construed the following statutes:

Or. Rev. Stat. § 806.010 provides for the offense of “driving uninsured,” that is, driving while not in compliance with the motor vehicle-related “financial responsibility” requirements. Or. Rev. Stat. § 806.060 sets out methods by which the financial responsibility requirements can be satisfied. It provides, in part:

(1) To meet the financial responsibility requirements, a person must be able to respond in damages in amounts not less than those established under the payment schedule under ORS 806.070.

(2) A person may only comply with the financial responsibility requirements of this state by establishing the required ability to respond in damages in one of the following ways:

(a) Obtaining a motor vehicle liability policy meeting the requirements under ORS 806.080 that will provide at least minimum limits necessary to pay amounts established under the payment schedule under ORS 806.070.

...

(d) Becoming self-insured as provided under ORS 806.130.

²⁷ *Id.*

²⁸ *O’Sullivan*, 85 Cal. App. 3d at 62.

²⁹ *See Thompson*, 176 Or. App. at 97.

³⁰ 176 Or. App. 90, 29 P.3d 1184 (2001).

Or. Rev. Stat. § 806.070 provides that an insurance policy described under Or. Rev. Stat. § 806.080 must provide for payment of at least \$25,000 because of bodily injury to or death of any one person in any one accident.

Or. Rev. Stat. § 806.130 sets out requirements for self-insurers. A self-insurer must obtain a “certificate of self-insurance” from the Department of Transportation and must “[a]gree to pay the same amounts with respect to an accident occurring while the certificate [of self-insurance] is in force that an insurer would be obligated to pay under a motor vehicle liability insurance policy, including uninsured motorist coverage and liability coverage to at least the limits specified in ORS 806.070.”

The *Thompson* court held that based on a reading of the above statutes, the requirements for a “motor vehicle liability insurance policy” apply to self-insurers only to the extent that those requirements are made applicable to self-insurance by operation of Or. Rev. Stat. § 806.130 or other statutes setting out requirements for self-insurance.³¹ Or. Rev. Stat. § 806.130(3) requires that self-insurers provide UM and PIP coverage to at least the limits set out in Or. Rev. Stat. § 806.070.³²

It is important to note, however, that in Oregon, just because a self-insurer agrees to provide the same level of UM and PIP coverage that a commercial insurer would be obligated to pay, it does not mean that self-insurer provides same “scope of coverage” required in an insurance policy under Or. Rev. Stat. § 806.080(1)(b).³³ Or. Rev. Stat. § 806.080(1)(b) provides the following requirement:

[The motor vehicle liability insurance policy] must insure the named insured and all other persons insured under the terms of the policy against loss from the liabilities imposed by law for damages arising out of the ownership, operation,

³¹ *Thompson*, 176 Or. App. at 98.

³² *Id.*

³³ *Farmers Ins. Co. of Oregon v. Snappy Car Rental, Inc.*, 128 Or. App. 516, 519, 876 P.2d 833 (1994).

use or maintenance of those motor vehicles by persons insured under the policy. The policy must include in its coverage all persons who, with the consent of the named insured, use the motor vehicles insured under the policy, except for any person specifically excluded from coverage under ORS 742.450.³⁴

Or. Rev. Stat. § 806.130, which controls the minimum coverage amounts that self-insurers must provide, makes no reference to Or. Rev. Stat. § 806.080.³⁵ § 806.080 applies “only to insurers who issue insurance policies insuring others against risk in consideration of premiums.”³⁶ Thus, even though self-insurers in Oregon are required to provide UM and PIP coverage at least to the limits set out in § 806.070, they are not required to provide “omnibus coverage” under § 806.080.

“DROP DOWN” COVERAGE REQUIREMENTS FOR EXCESS-INSURERS

Another question can arise when self-insurers purchase excess or umbrella insurance to cap their exposure to cover claims over a certain amount. In such a case, is the excess insurer required to “drop down” to provide PIP or UM benefits? The Washington UM statute provides, in pertinent part, that:

The coverage required to be offered under this chapter is not applicable to general liability policies, commonly known as umbrella policies, or other policies which apply only as excess to the insurance directly applicable to the vehicle insured.³⁷

In *MacKenzie v. Empire Ins. Companies*,³⁸ the Washington Supreme Court concluded that “a comprehensive automobile liability insurance endorsement contained in a special multi-peril policy is exempt from Washington’s [UM] statute insofar as such insurance policy merely provides coverage in excess of the primary automobile coverage.”³⁹

³⁴ Or. Rev. Stat. § 806.080(1)(b).

³⁵ *Snappy Car Rental, Inc.*, 128 Or. App. at 521.

³⁶ *Id.*

³⁷ Wash. Rev. Code § 48.22.030(2).

³⁸ 113 Wash. 2d 754, 782 P.2d 1063 (1989).

³⁹ *Id.* at 760.

The court so held despite plaintiff's argument that there is a general public policy underlying the UM statute of increasing the public's protection against automobile accidents. While recognizing the existence of this general policy, the *MacKenzie* court stated that it "is not sufficient by itself to justify our disregarding the carefully reasoned and well-supported holding in *Thompson v. Grange Association*."⁴⁰ The *Thompson* court had reasoned that "catastrophic-type policies pick up where primary coverages end."⁴¹ "They provide coverage excess to that provided by the primary policies."⁴² The *Thompson* court held, therefore, that Washington's UM statute did not apply to a "catastrophe" or "umbrella" policy.⁴³

In discussing *Thompson* and other applicable authorities, the *MacKenzie* court noted that "umbrella" policies, a type of excess coverage, are different in nature than primary liability coverage:

Umbrella policies serve an important function in the industry. In this day of uncommon, but possible, enormous verdicts, they pick up this exceptional hazard at a small premium . . . it may assume as a primary carrier certain coverage not included elsewhere, such as invasion of privacy, false arrest, etc., but *there is no intention to supplant the basic carriers on the homeowners or automobile coverages. Therefore, these should not even enter into our current consideration [of UM coverage]*.⁴⁴

The *MacKenzie* court went on to observe that the Appleman treatise had "conceded" that some courts have held to the contrary, but concluded that "those decisions reflect a 'misunderstanding of the courts as to the nature of such coverages.'"⁴⁵

The *MacKenzie* court also discussed the fact that in 1985, subsequent to the accident that resulted in the *Thompson* litigation, the Washington legislature had amended the UM statute to,

⁴⁰ *Id.* (citing *Thompson v. Grange Association*, 34 Wash. App. 151, 660 P.2d 307, *rev. denied*, 99 Wash. 2d 1011 (1983)).

⁴¹ *MacKenzie*, 113 Wash. 2d at 759 (citing *Thompson*, 34 Wash. App at 156–157).

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.* at 757-58 (citing Appleman, *Insurance* § 5071.65 at 107).

⁴⁵ *Id.* at 758 (citing Appleman, *Insurance* § 5071.65 at § 5071.65).

“in effect, write the *Thompson* holding into the [UM] statute.”⁴⁶ The amendment added the above-quoted language exempting excess carriers from the UM requirements embodied in Wash. Rev. Code § 48.22.030.⁴⁷

California law is generally on par with Washington Law. For example, in *Wiemann v. Indus. Underwriters Ins. Co.*, the court observed that the California legislature specifically exempted excess or umbrella insurers from the obligations of Cal. Ins. Code § 11580.2:

(a)(1) No policy of bodily injury liability insurance covering liability arising out of the ownership, maintenance, or use of any motor vehicle . . . shall be issued . . . unless the policy contains, or has added to it by endorsement, a provision . . . insuring the insured . . . for all sums within such limits which he . . . shall be legally entitled to recover as damages for bodily injury or wrongful death from the owner or operator of an uninsured motor vehicle. . . . *A policy shall be excluded from the application of this section . . . if the automobile liability coverage is provided only on an excess or umbrella basis.*⁴⁸

Thus, subject to the terms of the excess policy, generally, an excess insurer’s coverage becomes applicable only when the self-insurer’s liability exceeds its self-insured retention.⁴⁹

Of particular note, was the court’s holding in *Wiemann* that an excess insurer is not required to provide UM coverage, even when the insured was not registered with the California Department of Motor Vehicles as a self-insured entity.⁵⁰ The court held that the insured’s failure to obtain a valid D.M.V. certificate as a self-insurer did not create an obligation on the part of the excess insurer to provide UM coverage.⁵¹ The court stated, “[p]etitioner has not supplied this court, nor has our research disclosed, any statutory or decisional law which imposes on an excess carrier [] the duty to supply uninsured motorist coverage or to require its self-insured

⁴⁶ *Id.* at 759.

⁴⁷ *Id.*

⁴⁸ *Wiemann v. Indus. Underwriters Ins. Co.*, 177 Cal. App. 3d 38, 41, 222 Cal. Rptr. 705 (1986) (citing Cal. Ins. Code § 11580.2(a)(1)) (court’s emphasis).

⁴⁹ *Id.* at 43, ft. 2 (citing *O’Sullivan v. Salvation Army*, 85 Cal. App. 3d 58, 147 Cal. Rptr. 729 (1978)).

⁵⁰ *Id.*

⁵¹ *Id.*

policyholder [] to first obtain such a certificate from the D.M.V. before issuing an excess coverage policy.”⁵²

In Oregon, whether an excess insurer is obligated to “drop down” to provide UM or PIP benefits does not appear to be an issue. The Oregon financial responsibility statute provides that self-insurers must “[a]gree to pay the same amounts with respect to an accident occurring while the certificate [of self-insurance] is in force that an insurer would be obligated to pay under a motor vehicle liability insurance policy, including uninsured motorist coverage and liability coverage to at least the limits specified in ORS 806.070.”⁵³ Thus, there would never be a need for the excess insurer to “drop down” to pay the required UM or PIP benefits because the self-insurer is already obligated to do so.

CONCLUSION

Courts in Washington and California seem to rely heavily on the notion that they cannot create obligations for self-insurers in the area of UM and PIP coverage, no matter how socially desirable, because to do so would be to usurp the function of the legislature. Perhaps those states’ legislatures will follow the Oregon state legislature’s lead and create UM and PIP coverage requirements for self-insurers. At any rate, courts in all three states are in agreement that a self-insurer does not, by virtue of its status, issue a “motor vehicle liability insurance policy.”

⁵² *Id.*

⁵³ Or. Rev. Stat. § 806.130.