

# INSURANCE CONSUMER COUNSEL'S COLUMN

## VOIDING AUTO INSURANCE CLAUSES FOR VIOLATING PUBLIC POLICY

BY PROFESSOR GREG MUNRO AND CASSIE COLEMAN<sup>1</sup>

### Introduction

Insurance policies are contracts of adhesion with terms dictated entirely by the insurance company. For example, in auto insurance, the insured has no negotiating power in specifying terms of coverage. Ironically, the insured may find each insurer offering (dictating) essentially the same basic policy provisions. This is so because auto insurers subscribe to a trade association, Insurance Services Organization, Inc., which provides to the competing auto insurers drafts of the policy language recommended for use in their policies. Nevertheless, the auto policy is a contract, and the courts sometimes speak of it as the contract "between the parties" or "to which the parties agreed" as though the insureds had any role or choice in negotiating the terms.

Therefore, when disputes develop about the validity of a clause, the insurer benefits by arguing the sanctity of contract especially if the terms at issue are not ambiguous. However, counsel for the insured or the claimant tort victim cannot just genuflect at the altar of the written insurance contract just because the clause at issue is in black ink on white paper and unambiguous at that. As Professor Corbin said:

[I]t may be pointed out that "liberty of contract" as that term is used by its admirer includes two very different elements. These are the privilege of doing the acts constituting the transaction and the power to make it legally operative. One does not have "liberty of contract" unless organized society both for-

bears and enforces, forbears to penalize him for making his bargain and enforces it for him after it is made.

This is the "liberty of contract" that has so often been extolled as one of the great boons of modern democratic civilization, as one of the principal causes of prosperity and comfort. And yet the very fact that a chapter on "legality" of contract must be written shows that we have never had and never shall have unlimited liberty of contract, either in its phase of societal forbearance or in its phase of societal enforcement. There are many contract transactions that are definitely forbidden by the law, forbidden under pains and penalties assessed for crime and tort; and there are many more such transactions that are denied judicial enforcement even though their makers are not subject to affirmative pains and penalties. Arthur L. Corbin, *Corbin on Contracts* § 1376.<sup>2</sup>

Consequently, an unambiguous clause with detrimental effect to the insured client or claimant must be reviewed to determine whether it is valid. The fact is, a black-and-white contract clause may be invalid. First, it may directly violate a statute. Montana's Insurance Code, Title 33, Montana Code Annotated, is a compendium of roughly 600 pages of statutory regulation of insurance and insurance companies. An auto insurance provision may violate a code section of that title (or any other pertinent title) rendering it invalid. For instance, an auto insurance policy provision providing for immediate cancellation of the policy for nonpayment of premium would violate MCA § 33-23-212(2), which requires

the carrier to cancel only after 10 days' notice of cancellation.

Second, though an insurance clause may not directly violate a statute, it may be found to be invalid for violating public policy as expressed in the state constitution or statutes. As the court said in *Youngblood v. American States Ins. Co.*,<sup>3</sup> "The only exception to enforcing an unambiguous contract term is if that term violates public policy or is against good morals."

Third, a provision that doesn't violate a code provision may be found to be violative of "public policy" and thereby rendered invalid. In *First Bank (N.A.)-Billings v. Transamerica Insurance Company*,<sup>4</sup> the Montana Supreme Court defined "public policy" as "that principle of law which holds that no citizen can lawfully do that which has a tendency to be injurious to the public or against public good." Hence, an insurance provision "injurious to the public or public good" could be void as against public policy. The court, in *First Bank*, set out the sources of public policy for purposes of determining if an insurance practice or policy was in derogation of public policy:

In determining the public policy of this state, legislative enactments must yield to constitutional provisions, and judicial decisions must recognize and yield to constitutional provisions and legislative enactments.

Finally, as insurance scholar Kenneth S. Abraham says, there is "a more diffuse but no less important source of public policy; judicial sen-

sitivity to the difference between good and evil, fairness and unfairness, straight dealing and over reaching. Even when all other tests for the validity of insurance policy provisions have been exhausted, this residual category of restrictions on what may and may not be included in a policy remains.”<sup>5</sup> The Montana Supreme Court in *First Bank* stressed, “Judicial decisions are a superior repository of statements about public policy only in the absence of constitutional and valid legislative declarations.” Nevertheless, if the Montana Constitution and legislative enactments reflect no particular public policy in regard to an insurance provision, the courts may still test the provision against their own statements of public policy. The Montana Supreme Court has been diligent in scrutinizing auto insurance policy exclusions, offsets, conditions and other clauses in the bright light of its own statements of “public policy” to determine whether the provisions or clauses are valid.

Consequently, the lawyer faced with an unambiguous auto insurance policy provision detrimental to his insured or claimant must analyze the

provision to determine if it is invalid for violating:

1. a code provision in Title 33 or Title 61 of the Montana Code Annotated;
2. public policy as expressed in the Montana Constitution;
3. public policy as expressed elsewhere in the Montana Code Annotated;
4. public policy as expressed by the Montana Supreme Court; and
5. public policy on some previously unrecognized argument that the provision is injurious to society.

Auto policies covering motor vehicles operated in Montana commonly contain provisions deemed invalid. While the Rates and Forms Bureau of the Montana Insurance Commissioner’s Office reviews auto policy forms and approves or disapproves their provisions for use in Montana, the policies are drafted by the ISO and generally intended by the insurer for use in many states in which it operates. The Montana Rates and Forms Bureau may not identify a

particular ISO clause as having been declared invalid by the Montana Supreme Court, or the carrier may simply continue using a form with the invalid clause in it.

More importantly, given the reach of interstate commerce and recreation today, tens of thousands of motor vehicles are operated in Montana each year under out-of-state insurance policies. In a line of cases, the Montana Supreme Court has held that out-of-state auto policies applying to accidents that happen in Montana will be construed under Montana law. In *Kemp v. Allstate*,<sup>6</sup> in 1979, the court determined that the law of the place of performance and not place of execution governed the insurance policy contract. After considering the basic insuring agreement, the territoriality provision and the “payment of loss” provision, the court ruled that the place where the judgment would be obtained was the place of performance. In *Youngblood v. American States Ins. Co.*,<sup>7</sup> the Oregon policy involved contained a choice of law provision that specified the “place of performance” and required application of Oregon law. However, the court voided the policy’s provision for subrogation for Medical Payments, holding that it was unenforceable as violative of public policy by reason of the court’s holding in *Allstate Ins. Co. v. Reitler*,<sup>8</sup> which doesn’t allow subrogation for Medical Pay coverage in Montana. In *Swanson v. Hartford Ins. Co. of the Midwest*,<sup>9</sup> the court declared that application of a Colorado choice of law provision violated Montana’s public policy that an insurer could only subrogate when the insured had been “made whole.” In 2003, the court in *Mitchell v. State Farm Ins. Co.*,<sup>10</sup> followed *Kemp* holding that, even under the Restatement of Law (Second), the contract is governed by the law of the place of performance which is the “place where the an insured is entitled to

receive benefits, has incurred accident related expenses, or is entitled to judgment.”

As these cases illustrate, the auto insurance policy involved will often be an out-of-state policy that will likely contain provisions violative of Montana public policy but governed by Montana law. Counsel has the task of identifying the offending clauses and persuading the insurer, or the court if necessary, that the clause is 1) governed by Montana law and 2) invalid and unenforceable insofar as it violates Montana law or public policy.

What follows here is a review of particular insurance clauses that have been ruled as invalid and unenforceable because they violate Montana statutes or public policy as reflected in the Montana Constitution, statutes, or court decisions. Where possible, the authors will quote verbatim the insurance clause from the policy involved or will quote the standard language from the ISO forms that would be the likely equivalent to the clause involved in the case. This article focuses on auto insurance policies as opposed to other casualty policies, and the authors have grouped the cases under the coverage headings. Cases under Bodily Injury Liability coverage generally will reflect issues of validity under the Mandatory Liability Protection Act, MCA § 61-6-301 and the Motor Vehicle Financial Responsibility Act, MCA § 61-6-103 *et seq.* Cases under Uninsured Motorist coverage generally involve issues of validity as a matter of public policy particularly in relation to the UM statute, MCA § 33-23-201. The Underinsured Motorist coverage clauses reflect decisions based on judicially developed public policy grounds particularly the reasonable expectations doctrine. Finally, cases grouped under the Medical Pay coverage clauses will illustrate the recent battleground of coverage issues.

## Insurance Policy Clauses and Provisions Held Invalid in Montana

### Liability Coverage: *The “Household Exclusion”*

In *Transamerica Ins. Co. v. Royle*,<sup>11</sup> a 1983 case, the “household exclusion clause” in Bodily Injury coverage was declared void as against public policy. The policy excluded liability coverage for “bodily injury to any person who is related by blood, marriage, or adoption to [the insured], if that person resides in [the insured’s] household at the time of the loss.” In *Royle*, a catastrophically injured child sued her mother alleging her mother negligently caused the daughter’s injuries while the daughter was a passenger in her mother’s auto. Transamerica denied coverage by reason of the exclusion. The Montana Supreme Court held the exclusion violated public policy implicit in Montana’s Mandatory Liability Protection Act, MCA § 61-6-301 and the Motor Vehicle Safety Responsibility Act, MCA § 61-6-103 *et seq.* The court reasoned that §61-6-301 requires minimum liability coverage to cover “loss resulting from liability imposed by law for injury suffered by any person,” and the act made no exception for injury by family members. The case was also based on a recurring Montana judicial public policy theme of failure to “honor the reasonable expectations” of the insured. Quoting Professor Keeton, the court stated the principle as follows: “The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations.” The court said the insured would reasonably expect the liability coverage to extend to household members.

After *Royle*, insurers modified the household exclusion into what is known as the “step down” household

exclusion which, for family members, blocks coverage for amounts over the minimum \$25,000 limit of liability. In *Shook v. State Farm Mutual Ins. Co.*,<sup>12</sup> State Farm’s household exclusion read as follows:

When Coverage A Does Not Apply: There is no coverage...  
2. For Any *Bodily Injury* to: ... c. *any insured* or any member of *an insured’s* family residing in the *insured’s* household to the extent the limits of liability of this policy exceed the limits of liability required by law.”

Judge Hatfield held that exclusion void by reason of ambiguity. He reasoned that the exclusion defeats the purpose of the Mandatory Liability Protection statutes and is ambiguous as it could be interpreted “as intended to make clear the liability provisions of the policy do not provide personal accident insurance to any insured.”

In companion cases in 1994, the Montana Supreme Court invalidated two “step down” household exclusions and refused to enforce them. In *Leibrand v. National Farmers Union Prop. and Cas. Co.* and *Cole v. Truck Insurance Exchange*,<sup>13</sup> injured family plaintiffs were precluded by step-down household exclusions from recovering anything more than the minimum limits of BI coverage required under the Mandatory Liability Protection Act. In *Leibrand*, the policy excluded “bodily injury to you or any relative to the extent the limits of liability of this policy exceed the limits of liability required by law.” The renewal declarations page stated that “[l]iability payments to household members are limited to the Financial Responsibility limits of the policy state.” Similarly, in *Cole*, an exclusion in an endorsement to the policy precluded coverage “Arising out of the liability of any insured for



bodily injury to you or a family member to the extent the limits of liability of this policy exceed the limits of liability required by law.” The declarations page in *Cole* gave no notice of the limitation of recovery by family members.

The court found the policy provisions in question in each case to be “unclear and ambiguous” because they didn’t provide the consumer untrained in the law any way to know the limit of liability when a family member was the injured claimant. The court declared the provisions invalid and unenforceable. Most importantly, the court prospectively warned of risk that any clarified provision would still be deemed unconscionable because the policies would be contracts of adhesion that “arbitrarily preclude full coverage for family members, as opposed to all other persons” in a market in which family members cannot obtain full coverage. One can reasonably conclude that the step-down household exclusion is invalid in Montana as will be any such provision which is clarified, since any such clarification will likely violate public policy for the same reasons.

Note, however, that the court enforced a household vehicle exclusion in *American Family Mutual Ins. Co. v. Livengood*.<sup>14</sup> The exclusion to the Bodily Injury coverage provided:

This coverage does not apply to: \*\*\* 9. Bodily Injury or property damage arising out of the use of a vehicle, other than your insured car, which is owned by or furnished or available for regular use by you or any resident of your household.

Henninger and her roommate were each insured by American Family. Henninger negligently injured another while driving her roommate’s van. American defended and indem-

nified under the roommate’s policy but refused to indemnify under Henninger’s liability policy because of the above exclusion. Henninger contended the provision, as in *Royle*, violated the Mandatory Liability Protection Act, but the court disagreed saying that the exclusion met the mandate of providing coverage for “all persons.” It simply didn’t provide additional liability coverage for other vehicles.

Similarly, in *Stutzman v. Safeco Ins. Co.*,<sup>15</sup> the court upheld a similar exclusion as applied to UIM coverage on the ground that “there is no statutory mandate for underinsured motorist coverage in Montana.” That exclusion provided:

But underinsured motor vehicle does not include any motor vehicle... 3) owned by or furnished for the regular use of the named insured or any relative.

#### **Liability Coverage: “Without Permission” Exclusion**

In *Allstate Ins. Co. v. Hankinson*,<sup>16</sup> Hankinson, a juvenile, negligently drove someone else’s auto without their permission causing injuries to a third party. His father’s insurer, Allstate, refused to defend or indemnify because Allstate’s coverage of “non-owned” autos extended only to “A non-owned auto used by you or a resident relative with the owner’s permission.” The Montana Supreme Court held that the policy definition was “void as contrary to public policy” because it provides less coverage than is statutorily required by the Mandatory Liability Protection statute, MCA § 61-6-301.

Note that the statute requires vehicles operated in Montana “by the owner or with the owner’s permission” to carry minimum limits of insurance. Consequently, a Bodily Injury coverage exclusion that excludes liability coverage on the auto

if it is driven by someone without permission is valid and enforceable. However, the same clause is void and unenforceable if included in the “other cars” provision, which covers the insured when he or she is driving someone else’s vehicle.

#### **Liability Coverage: “Named Driver” Exclusion**

In 1987, in *Iowa Mutual Ins. Co. v. Davis*,<sup>17</sup> the court invalidated and refused to enforce a named driver exclusion. There, the insurer had agreed to exclude from coverage the insureds’ sons, by name, in order to make the coverage affordable. The clause read as follows:

It is agreed that all insurance and coverage under this policy shall be null and void with respect to any claims arising out of the operation, use, or occupancy of the automobile described in this policy, or out of the operation, use or occupancy of any other automobile to which the terms of this policy otherwise extends, by the following named person(s): Jeffery L. Davis (DOB 12-03-59) & Alan Davis (DOB 8-25-57) Sons of the Insured. Provided, however, this endorsement shall not be effective if the automobile is operated by the named insured or the described automobile is operated by any person other than Jeffery of Alan and such operation of the described automobile is by and under the express permission of the named insured.

The court held that the exclusion violated Montana’s Mandatory Liability Protection Act, reasoning that the Mandatory Liability statutes are designed to provide continuous coverage to the general public, and the named driver exclusion is “repugnant

to this state's interest in protecting innocent victims of automobile accidents." However, the legislature immediately amended the Mandatory Protection Act to expressly authorize the use of named driver exclusions and accompanied the statute with a statement of legislative intent that, as a matter of public policy such exclusions were desirable to allow premiums to be affordable.<sup>18</sup>

**Liability Coverage: The "employee" exclusion as applied to third parties**

The Montana Federal Court held the "employee" exclusion to the auto liability coverage to be overly broad and void if applied to third parties instead of employers in *Fire Ins. Exchange v. Tibi, Kayser and Allstate Ins. Co.*<sup>19</sup> The exclusion stated:

Allstate will not pay for damages an insured person is legally obligated to pay because

of: 4. Bodily injury to an employee of any insured person arising in the course of employment.

The court reasoned that the policy may properly exclude coverage where an employee seeks to recover from the employer (workers' compensation exclusivity) but not where the employee seeks to recover from an insured third party.

**Liability Coverage: Permissive User Exclusion**

In *Swank v. Chrysler Ins. Corp.*,<sup>20</sup> the insurer issued a garage policy to an auto dealer that excluded liability coverage for customers who were permissive users of the dealer's loaner cars. The policy extended coverage to the customers driving loaner cars to the extent the customer did not have personal auto coverage available that met the mandatory minimum limit. (The policy language is not contained in the decision.) The

court held that insofar as the policy excluded permissive use customers who have their own coverage, it is void because it does not provide the statutory mandatory minimum coverage for "all vehicles owned or operated" in Montana. The court reasoned that the policy sets a ceiling of coverage, not the floor, as required by the mandatory minimum coverage statutes require. The exclusion was ruled void because it is contrary to public policy.

**Medical Pay Coverage: Subrogation Clause**

In *Allstate Ins. Co. v. Reitler*,<sup>21</sup> the court held medical payment subrogation clauses are invalid. The standard subrogation clause reads as follows:<sup>22</sup>

**OUR RIGHT TO RECOVER PAYMENT**

A. If we make a payment under this policy and the person to or for whom payment was

made has a right to recover damages from another we shall be subrogated to that right. That person shall do

1. Whatever is necessary to enable us to exercise our rights; and
2. Nothing after loss to prejudice them. \* \* \*

B. If we make a payment under this policy and the person to or for whom payment is made recovers damages from another, that person shall:

1. Hold in trust for us the proceeds of the recovery; and
2. Reimburse us to the extent of our payment.

The court noted that the insured paid a premium for medical pay coverage and is more likely to suffer if med pay benefits must be repaid from third-party recovery. The insured often has to compromise the claim to settle and suffers attorney fees and costs while the insurer claims a right to be reimbursed 100% of the benefits paid. The court noted the public policy against allowing assignment of personal injury actions and held the subrogation clause void as applied to Medical Pay coverage. *Youngblood v. Am. States Ins. Co.*,<sup>23</sup> followed *Reitler* in holding that subrogation clauses for med pay are void as against public policy.

Note that, in 1997, the legislature added the word “subrogation” into §33-23-203(2), so it read:

A motor vehicle liability policy may also provide for other reasonable limitations, exclusions, reductions of coverage, or subrogation clauses that are designed to prevent duplicate payments for the same element of loss...

Consequently, insurers then took the position *Reitler* was overruled by

the statutory amendment. However, *Swanson v. Hartford Ins. Co.*,<sup>24</sup> in 2001, made it clear that the “made whole” rule still applied to subrogation so that a med pay insurer could not subrogate until the insured was made whole including attorney fees. In essence, *Swanson* voided the subrogation clause to the extent that it allowed the insurer to subrogate before the insured has been made whole including costs and attorney fees. Then, the court in *Hardy (2003)*, declared the statute unconstitutional, so *Reitler* again appears to be good law. Hence, subrogation as applied to medical pay coverage is invalid in Montana and, when applied to other coverages, valid but subject to the “made whole” rule.

#### Medical Pay Coverage: Choice of Law Provision

In *Swanson (2001)*, a Colorado policy contained a choice of law provision mandating that any dispute over subrogation be governed by Colorado law. Colorado law allowed subrogation in derogation of the “made-whole” rule while Montana deemed such subrogation to be against public policy. Consequently, the court held that application of the Colorado choice-of-law provision violated Montana public policy and refused to enforce it. As a result, arguably anytime an insurance policy’s choice-of-law provision mandates application of another state’s law which would contravene public interest in Montana, the choice-of-law provision itself may be unenforceable.

#### Medical Pay Coverage: Anti-stacking Clause

*Ruckdaschel v. State Farm Mut. Auto. Ins. Co.*,<sup>25</sup> held the anti-stacking clause in Medical Pay coverage violates Montana’s public policy. The endorsement provided:

2. Policies Issued by Us to

You, Your Spouse or Relatives... If two or more [sic] more policies issued by us to you, your spouse or your relatives provide vehicle medical payments coverage and apply to the same *bodily injury* sustained; a. while occupying a non-owned car, a temporary substitute car; or b. as a pedestrian the total limits of liability under all such policies shall not exceed that of the policy with the highest limit of liability.”

*Ruckdaschel* followed *Bennett v. State Farm Mut. Auto. Ins. Co.*,<sup>26</sup> and reasoned that the same public policy considerations that invalidate anti-stacking clauses in mandatory coverages “apply to optional types of insurance coverage such as, in this case, medical payment coverage.” Those public policy considerations were that “an insurer may not place in an insurance policy a provision that defeats coverage for which the insurer has received valuable consideration,” and that the insured should be entitled to a reasonable expectation of coverage up to the aggregate limits of the policies purchased.

The 1997 amendment of MCA § 33-23-203 to preclude all stacking defeated *Bennett*, *Ruckdaschel*, “*Holeman (I)*”<sup>27</sup> and “*Holeman (II)*”<sup>28</sup> insofar as they allowed stacking. However, when *Hardy (2003)* declared the statute unconstitutional, the holdings of those cases invalidating the clauses on public policy grounds again became good law. Hence, under *Ruckdaschel*, an anti-stacking clause in Medical Pay coverage should be void as against public policy in Montana.

However, one should note that State Farm’s “owned auto” exclusion which effectively blocks stacking of its Medical Pay coverage has been held valid and enforceable. It provides as follows:

There is no coverage. . .

4. For medical expenses for

*Bodily Injury:*

a. Sustained while *occupying* or through being struck by a vehicle owned or leased by *you* or any *relative* which is not insured under this coverage[.]

The court said that clause is not ambiguous and acts as a coverage exclusion so that there is simply no coverage, and no stacking question is involved.

The court in *Farmers Alliance Mut. Ins. Co. v. Holeman*,<sup>29</sup> also held Farmers Alliance Mutual's Med Pay anti-stacking provision to be void. Their provision read:

D. LIMIT OF INSURANCE

1. Regardless of the number of covered 'autos,' 'insureds,' premiums paid, claims made or vehicles involved in the 'accident,' the most we will pay for all damages resulting from any one 'accident' is the LIMIT OF INSURANCE for [AUTOMEDICAL PAYMENTS COVERAGE] shown in the Declarations.

The court followed *Ruckdaschel*, above, and relied upon the public policy statements in *Bennett*. The court held that, "where multiple vehicles are insured under one policy and where a premium is charged for coverage of each motor vehicle listed within the policy" the insurer cannot rely on the policy's exclusionary language to deny coverage.

**Uninsured Motorist Coverage: Liability Offset Clause**

*Grier v. Nationwide Mut. Ins. Co.*,<sup>30</sup> held that a clause providing liability coverage can be offset against recovery of uninsured motorist benefits is invalid. In *Grier*, Nationwide's policy included UM coverage which by definition protected against injury

by both uninsured motorists and underinsured motorists:

We will pay compensatory **bodily injury** (meaning **bodily injury**, sickness, disease, or death) damages that are due **you** by law from the owner or driver of an uninsured **motor vehicle** . . . An uninsured **motor vehicle** is: 2. one which is underinsured. This is one for which there are bodily injury liability coverage or bonds in effect. Their total amount, however, is less than the limits of this coverage. These limits are shown in your policy's Declarations.

Then, under "Limits of Payment," the policy stated, "the limits of this coverage will be reduced by any amount paid by or for any liable parties."

The court held that Grier was actually recovering uninsured motorist benefits under the policy's UM coverage which was protected by the UM statute, MCA § 33-23-201. As such, the offset of liability against the UM coverage benefit violated the legislative intent of the statute of protecting the public against injury by uninsured (in this case underinsured) motorists by offering a minimum limit of UM coverage. The offset was, therefore, void as against public policy.

**Uninsured Motorist Coverage: Work Comp Reducing Clause**

The court in *Sullivan v. Doe*,<sup>31</sup> held that a clause allowing workers' compensation benefits paid to be deducted from UM benefits owed under the auto policy was void. The decision does not reflect the actual language of the policy, so the authors will quote the 1988 ISO language for a sample work comp reducing clause:<sup>32</sup>

B. Any amounts otherwise payable for damages under this

coverage shall be reduced by all sums: \* \* \* 2. Paid or payable because of the "bodily injury" under any of the following or similar law: a. workers' compensation law; or b. disability benefits law, \* \* \*

The court determined that the Montana UM statute mandated that the insurer offer a minimum limit of UM coverage to the insured and that it did not provide for reducing that limit by offsetting workers' compensation benefits. Hence, the offset was void as against public policy.

**Uninsured Motorist Coverage: "No Consent to Settlement" Clause**

*State Farm Mut. Auto. Ins. Co. v. Taylor*,<sup>33</sup> held the "no consent to settlement" clause in UM coverage void. That clause provided:

THERE IS NO COVERAGE:  
1. FOR ANY INSURED WHO, WITHOUT OUR WRITTEN CONSENT, SETTLES WITH ANY PERSON OR ORGANIZATION WHO MAY BE LIABLE FOR THE BODILY INJURY.

The court said, "This court does not support provisions placed on uninsured motorist coverage that restrict or thwart available liability coverage an insured would be entitled to in an accident. \* \* \* The insurance company is obligated to furnish uninsured motor vehicle coverage, whether it can obtain subrogation or not."

**Uninsured Motorist Coverage: Owned Auto Exclusion**

*Jacobson v. Implement Dealers Mut. Ins. Co.*,<sup>34</sup> involved UM coverage with the following exclusion:

This policy does not apply under Part IV: (a) to bodily injury to an insured while

occupying an automobile (other than an insured automobile) owned by the named insured or a relative, or through being struck by such an automobile.

The deceased was killed by an uninsured motor vehicle while he was driving a semi-tractor and trailer owned by the deceased and uninsured. However the deceased carried UM coverage with Implement Dealers Mutual on a pickup truck he owned. The "owned auto" exclusion blocked him from getting UM benefits because he was not "occupying" the insured auto. The court held the exclusion void because it violates the intent of the UM statute, MCA § 33-23-201. The public policy behind the statute is protection of Montanan's against injury by uninsured motorists, and it makes no difference if the victim is asleep in bed, jogging, or driving in an uninsured, but owned, vehicle when injured.

#### **Uninsured Motorist Coverage: Physical Contact Requirement for Hit-and-Run**

*McGlynn v. Safeco Ins. Co.*,<sup>35</sup> involved UM coverage that provided a hit-and-run vehicle was an uninsured motor vehicle for purposes of benefits provided it made physical contact:

'uninsured motor vehicle' includes a trailer of any type and means: (b) a hit-and-run automobile; . . . 'hit-and-run automobile' means an automobile which causes bodily injury to an insured arising out of physical contact of such automobile with the insured or with an automobile which the insured is occupying at the time of the accident. . .

The court held the physical contact requirement was void as against

public policy, reasoning that there is no statutory requirement of contact in the uninsured motorist statute,<sup>36</sup> and the purpose of "mandating" UM coverage is to protect policyholders from negligence of uninsured motorists, not necessarily contact. "It is enough for a claimant to show his injuries were caused by an uninsured or unidentified motorist."

#### **Uninsured Motorist Coverage: Government Vehicle Exclusion**

*Bartell v. Am. Home Assurance Co.*,<sup>37</sup> held the "government vehicle exclusion" to uninsured motorist coverage void. That exclusion provides:<sup>38</sup>

"Uninsured motor vehicle" does not include any vehicle or equipment: . . . owned by any governmental unit or agency.

The court reasoned that Montana's UM statute does not exclude any class of vehicles, and an insurance policy excluding all government vehicles restricts the statutory broad coverage and "is repugnant to the clear public policy of Montana in favor of uninsured motorist coverage and against any limitations upon complete protection."

#### **Underinsured Motorist Coverage: Anti-stacking Provision**

In 1993, in *Bennett v. State Farm Mut. Auto. Ins. Co.*,<sup>39</sup> the court dealt with an "other insurance" clause that effectively prohibited stacking. The clause provided:

If the insured sustains bodily injury as a pedestrian and other underinsured motor vehicle coverage applies: a. the total limits of liability under all such coverages shall not exceed that of the coverage with the highest limit of liability; and b. we are liable only for our share. Our share is that

percent of the damages that the limit of liability of this coverage bears to the total of all underinsured motor vehicle coverage applicable to the accident.

The court held the "other insurance" clause prohibiting stacking of UIM is void as against public policy. The court rejected as irrelevant arguments that such public policy applied only to UM coverage which is protected by statute. MCA § 33-23-201. The court noted that its public policy basis for stacking UM coverage was "that an insurer may not place in an insurance policy a provision that defeats coverage for which the insurer has received valuable consideration." The court stated that "the purpose of underinsured motorist coverage is to provide a source of indemnification for accident victims when the tortfeasor does not provide adequate indemnification." The court reasoned that the public policy that favors adequate compensation for accident victims is supported by the same public policy considerations that invalidated anti-stacking provisions in UM coverage. Finally the court based its decision in the reasonable expectation doctrine:

Montana citizens should have a reasonable expectation that when they purchase separate policies for underinsured motorist coverage, they will receive adequate compensation for losses caused by an underinsured motorist, up to the aggregate limits of the policies they have purchased.

This case has been heavily cited in later decisions for its extensive statement of public policy bases for voiding an insurance clause.

The court in *Farmers Alliance Mut. Ins. Co. v. Holeman*,<sup>40</sup> also

held Farmers Alliance Mutual's UIM anti-stacking provision to be void. Their provision read:

#### D. LIMIT OF INSURANCE

1. Regardless of the number of covered 'autos,' 'insureds,' premiums paid, claims made or vehicles involved in the 'accident,' the most we will pay for all damages resulting from any one 'accident' is the LIMIT OF INSURANCE for [UNDERINSURED] MOTORISTS COVERAGE shown in the Declarations.

The court quoted the public policy language of the *Bennett* case, above, and noted that where separate premiums were paid for each vehicle, stacking should be permitted even though there were not separate policies.

In *Dakota Fire Ins. Co. v. Oie*,<sup>41</sup> the court invalidated the anti-stacking provision under the Uninsured Motorist coverage of Dakota's auto policy. The court noted that the then-applicable anti-stacking statute, MCA § 33-23-203, forbade stacking regardless of the number of vehicles, but not the number of premiums paid. Hence, citing *Bennett* (1993), the court determined that the statute did not supplant the court's public policy that where multiple premiums are received for a personal and portable coverage, the insured is entitled to a reasonable expectation that the coverage can be stacked.

*Hardy v. Progressive Specialty Ins. Co.*,<sup>42</sup> which declared the anti-stacking statute, MCA § 33-23-203, unconstitutional, took up the issue of whether Progressive's anti-stacking provision in its policy was valid. The provision read as follows:

#### LIMITS OF LIABILITY

\* \* \* If an **insured person** is entitled to similar benefits under more than one (1) motor

vehicle insurance policy issued by **us** or an affiliate company, the maximum recovery under all policies shall not exceed the amount payable under the policy with the highest dollar benefit limits. Similar benefits available under more than one (1) motor vehicle insurance policy issued by **us** or an affiliate may not be added together to determine the limits of coverage available under the policies for any one (1) **accident**.

The court in *Hardy* followed *Bennett* and *Chafee v. U.S. Fid & Guar. Co.*,<sup>43</sup> in holding that the "provision belies the insurance consumer's reasonable expectation that he has purchased UIM coverage, which by definition, is personal, portable, and, therefore, stackable. For this reason, we conclude the anti-stacking provision in this case violates Montana public policy."

*Hardy* was followed by *Mitchell v. State Farm Ins. Co.*,<sup>44</sup> which voided the following California anti-stacking clause:

#### Limits of Liability Under Coverage U 4.

The limits of liability are not increased because: (a) more than one vehicle is insured under this policy. . . \* \* \*

**If There Is Other Uninsured Motor Vehicle Coverage:** 4. If the *insured* sustains *bodily injury* while *occupying* a vehicle not owned by *you, your spouse* or any *relative* and: (a) such vehicle is not described on the declarations page of another policy providing uninsured motor vehicle coverage; and (b) its driver is: (1) *you, your spouse* or any *relative*, or (2) any other *person* not insured under another such policy. then (a) the total limits of liability under all ap-

plicable policies issued by us shall not exceed that of the one with the highest limit of liability. . .

The court in *Mitchell* cited *Bennett, Hardy, and Chaffee* for the public policy statements in those cases as they applied to stacking of UIM coverage where the insurer had received five separate premiums for personal and portable coverage. The court concluded, "In short, an anti-stacking provision that permits an insurer to receive valuable consideration by charging premiums for coverage that is not provided violates Montana public policy."

#### Underinsured Motorist Coverage: Subrogation Clause

In *Sorensen v. Farmers Ins. Exchange*,<sup>45</sup> Farmers's refused UIM benefits to its insured because it found out she settled with the tortfeasor and released the insurer's subrogation rights without its consent. In fact, the tortfeasor was judgment proof. The subrogation clause provided:

In the event of any payment under this policy, we are entitled to all the rights of recovery of the person to whom payment was made against another. That person must sign and deliver to us any legal papers relating to that recovery, do whatever else is necessary to help us exercise those rights and do nothing after loss to prejudice our rights.

The court adopted a "no prejudice" rule holding that, unless the insurer was actually prejudiced, it could not deny the insured indemnity benefits under the UIM coverage for releasing its subrogation rights. The court said: We favor this approach as a matter of public policy. The purpose of underinsured motorist insur-



ance is to provide a source of indemnification for accident victims when the tortfeasor does not provide adequate indemnification.

In *Farmers Ins. Exchange v. Christenson*,<sup>46</sup> the court voided the subrogation clause insofar as it might allow an insurer to press “all of the insured’s right of recovery” even if that were more than the insurer paid the insured. The clause provided:

Subrogation. In the event of any payment under this policy, the company shall be subrogated to all the insured’s right of recovery therefore, against any person or organization, and the insured shall execute and deliver instruments and papers and do whatever else is necessary to secure such rights. The insured shall do nothing after loss to prejudice such rights.

The court noted that this clause makes it possible for the insurer to collect more from subrogation than what it originally paid to the insured and said that UM/UIM payments may only be subrogated to the amount the insurer actually paid out.

#### **Underinsured Motorist Coverage: Exhaustion Clause**

*Augustine v. Simonson*,<sup>47</sup> held that “exhaustion” clauses in UIM policies are void. The clause in *Augustine* provided:

We will pay under this coverage only after the limits of liability under any applicable **bodily injury** liability bonds or policies have been exhausted by payment of judgments or settlements.

Hence, the insured could not receive any benefit of the UIM coverage, until he had settled with or received a judgment against the

tortfeasor’s liability insurance. The court reasoned that requiring exhaustion as a precondition of obtaining UIM coverage is contrary to public policy and unenforceable. Exhaustion clauses promote litigation expenses, delay UIM payments, and fail to consider the insured may have a valid reason for accepting less than the tortfeasor’s policy limits. In *Augustine*, Justice Regnier set forth a procedure for demanding and determining UIM benefits after demand was made on the tortfeasor’s insurer for settlement of the bodily injury claim but before settlement of the claim against the tortfeasor.

#### **Underinsured Motorist Coverage: (1) Narrow Definition of UIM and (2) Liability Offset**

The court in *Hardy v. Progressive Specialty Ins. Co.*,<sup>48</sup> declared two important clauses invalid. First, the policy used what the authors call the “narrow” definition of UIM. That is, it defines an underinsured motorist by comparing that motorist’s Bodily Injury liability coverage with the insured’s limit of UIM coverage. Consequently, in any case where the BI coverage available equals or exceeds the insured’s UIM limit, the insured will get no UIM benefit even if his or her damages exceed the BI coverage. The “broad” UIM definition, on the other hand, defines an underinsured motorist by comparing that motorist’s Bodily Injury liability limit with the insured’s tort damages. This is a much more consumer friendly definition. Progressive’s narrow definition provided as follows:

**ADDITIONAL DEFINITIONS 2. “Underinsured motor vehicle”** means a land motor vehicle or trailer of any type to which a **bodily injury** liability bond or policy applies at the time of the **accident**, but the sum of all applicable limits of liability for **bodily**

**injury** is less than the coverage limit for Underinsured Motorist Coverage shown on the Declarations Page. An underinsured motor vehicle does not include any vehicle or equipment. . . (h) that is an **uninsured motor vehicle**.

The UIM coverage also contained an “offset” provision allowing the insurer to reduce UIM benefits owed by any BI liability benefits the injured insured recovered from the tortfeasor.

The Limits of Liability shown on the **Declarations Page** for Underinsured Motorist Coverage shall be reduced by all sums: 1. paid because of **bodily injury** by or on behalf of any persons or organizations who may be legally responsible, including, but not limited to, all sums paid under Part I-Liability to Others.

The declarations page showed that the insured purchased \$50,000 limits of UIM coverage for a separate premium. However, the court’s analysis was that there were almost no situations where the insured would ever recover \$50,000 under the two quoted clauses. For instance, in every case where the tortfeasor carried Montana mandatory minimum (\$25,000) limits of insurance, the \$50,000 limit would be reduced by \$25,000. If the tortfeasor was uninsured, the UIM would not apply at all. In every case where the tortfeasor’s liability coverage was equal to or greater than the insured’s UIM limit, no UIM benefits would be due.

Consequently, the court said, “we conclude that the offset provision, as well as the definition of underinsured motorist, violate Montana public policy because they create an ambiguity regarding coverage, render coverage that Progressive promised to



provide illusory, and defeat the insured's reasonable expectations."

In reaching its holding, the court in *Hardy* took cognizance of the previous decision of the Montana Federal District Court in *Transamerica Ins. Group v. Osborn*.<sup>49</sup> There, Transamerica used the narrow definition of UIM:

a land motor vehicle or trailer of any type to which a bodily injury liability bond or policy applies at the time of the accident but its limit for bodily injury liability is less than the limit of liability for this coverage.

As in *Hardy*, the federal court compared the declarations page with the UIM definition and concluded that the two were inconsistent. The court observed that there were few circumstances in which the insured would recover anything and none in which the insured would recover the \$50,000 represented on the declarations page. The court found the definition to be ambiguous and to violate the reasonable expectations of the insured so as to be against public policy.

*Mitchell v. State Farm Ins. Co.*,<sup>50</sup> followed *Hardy* in holding a similar narrow UIM definition and UIM liability offset void. It is noteworthy that State Farm's policy, unlike Progressive's in *Hardy* contained no separate UIM coverage, the UIM definition being part of the UM coverage, and that no separate premium was paid for the UIM coverage. State Farm's policy defined UIM as follows:

**Underinsured Motor Vehicle** - means a land motor vehicle, the ownership, maintenance or use of which is: 1. insured or bonded for bodily injury liability at the time of the accident, but 2. the limits of the liability

are less than the limits of liability of this coverage. . .

The "limits of liability" section reflected the offset of liability coverage recovered against the UIM:

6. If the damages are caused by an *underinsured motor vehicle*, the most we pay will be the lesser of: (a) the difference between the limits of liability of this coverage and the amount paid to the *insured* by or for any *person* or organization who is or may be held legally liable for the *bodily injury*; or (b) the difference between the amount of the *insured's* damages for *bodily injury*, and the amount paid to the *insured* by or for any *person* or organization who is or may be held legally liable for the *bodily injury*.

In voiding State Farm's UIM definition and the liability offset, the court said the underinsured motorist definition contravenes the insured's expectation that coverage would exist where the tortfeasor's limits of liability are less than the stacked UIM coverage of the insured. The offset provision violates public policy because one premium is charged for UM and UIM coverage and allowing an offset defeats the purpose of the "mandatory" UM coverage. The insurer charged five premiums for UIM coverage.

### Arbitration Clauses

Note: John Morrison, Insurance Commissioner for the State of Montana, prohibits arbitration clauses in contracts of insurance. Consequently, the Rates and Forms Bureau advises the insurers that they may not include them in the policy forms they submit for use in Montana.

### Conclusion

In addition to knowing which provisions in auto insurance have been declared void for violating the code or for contravening public policy, counsel must be able to analyze provisions to identify those which may potentially be void and unenforceable. Review of the above cases reveals that an auto insurance policy provision may be challenged as void and unenforceable if the provision is:

1. in direct violation of the Montana Insurance Code or other Montana statutes;
2. ambiguous so as to be void and unenforceable;
3. against public policy for violating the reasonable expectations of the insured;
4. against public policy for creating "illusory" coverage;
5. against public policy because it takes away coverage for which the insured has paid a premium; or
6. in some other way injurious to the public or against public good.

As these cases illustrate, the courts are highly involved in the regulation of insurance. Counsel should be ever mindful that the courts only hear a challenge to an auto insurance provision if counsel recognizes the provision's violation of public policy and challenges it in court. ♦

### Endnotes

1. Cassie Coleman is a third-year law student at the University of Montana School of Law.
2. (Joseph M. Perillo, ed. West Pub. Co. 1998).
3. 262 Mont. 391, 866 P.2d 203 (1993).
4. 209 Mont. 93, 679 P.2d 1217 (1984).

