Auto Accident
Part I of III

Understanding Auto Insurance Law: maximizing coverage

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This article is the first in a three-part series for the VTLA *Journal*. This article discusses the liability aspect of maximizing coverage and its relationship with underinsured motorist coverage. The second and third parts will continue the analysis with underinsured motorist coverage (Summer 1995) and medical expense benefits coverage (Fall 1995).

I. Introduction

A. The family auto policy

Several types of insurance policies are used today to insure motor vehicles depending on the principal use of the insured vehicle. For example, a commercial vehicle is insured by a standard auto policy; a vehicle used in the automobile business (car dealers, repair shops, public parking garages, etc.) is insured by a garage liability policy; and a vehicle used by the average person and his or her family is insured by a family auto policy, abbreviated FAP. Since most vehicles in Virginia are insured by a standard family auto policy, this article will use the family auto policy to discuss coverage issues.

1. The four coverage parts of the family auto policy

The Family Auto Policy was developed nationally more than 50 years ago to provide basic auto coverage to families.[1] The Family Auto Policy (FAP) consists of four essential coverage parts:[2]

- Part I - Liability
- Part II - Medical expense and income loss benefits coverage
- Part III - Physical damage (Comprehensive, Collision and Towing)
- Part IV - Uninsured Motorist (UM) and Underinsured Motorist Coverage (UIM)

2. The six sub-parts of the family auto policy

Each of the four coverage parts contains

- **An insuring clause** (containing the words "to pay") — describing what and who is covered;
- **Definitions** — Defining Terms;
- **Conditions**[3] — Which must be met for coverage to apply, such as giving notice of an accident;
- **Exclusions** — Describing when coverage does not apply, such as bodily injury "due to war";
- **A limits of liability clause** — Which describes the full extent of coverage for each person with reference to the number of vehicles and persons insured. For example, the Limits of Liability Clause in the standard UM and UIM endorsement prohibits stacking of coverage in the same policy (intra-policy stacking); and
- **The other insurance clause** — Describing when and what the company will pay if an insured is covered under several insurance policies.

3. The declarations page

The declarations page identifies the coverages and premiums; the specific endorsements to the policy; the name and address of the policyholder (named insured); the name and address of the agent; the policy number; the policy period; and a description of the insured vehicles.

Coverage set forth in the declarations page is described as either a "split limit" or as a "single limit." For example, "$25,000/50,000" is a "split limit" of bodily injury liability coverage; $25,000 is the insurance company's maximum liability for "each person" per "each occurrence" and $50,000 is the insurance company's maximum limit of coverage for *all* claims resulting from "each occurrence." Assume David Drake has minimum bodily injury liability limits of "$25,000/50,000" and injures five people, each of whom recovers a $30,000 judgment against David. The maximum bodily injury liability coverage

David's auto insurance company can pay to any one person is $25,000 and the maximum for all payments is $50,000. If his insurance company pays the first plaintiff $25,000, there is only $25,000 left in coverage for the remaining four plaintiffs with judgments totalling $120,000.

A "single limit" *combines* the maximum coverage for each person *and* the maximum coverage for all persons injured in the same occurrence into one limit. For example, if a defendant has single limit bodily injury liability coverage of "$500,000," $500,000 is the maximum the company is obligated to pay to any one claimant or to all claimants who are injured in a single accident.

To obtain an insurance policy, the prospective policyholder must fill out an "application for insurance" with the agent. The insurance company relies upon the representations made by the applicant in deciding whether he/she is a suitable risk, and issues its policy and determines its premium based upon these representations. The insurance company has the right to be told the whole truth by the applicant. Many of the representations made on the "application for insurance" are printed onto the declarations page. The "declarations page" is so named because it contains the "declarations" of the policyholder which were set forth in the insurance application.

Condition 19 in the Family Auto Policy is called "Declarations," by which the policyholder agrees that "the statements in the declarations are his agreements and representations and that this policy is issued in reliance upon the truth of such representations . . ."

Code §38.2-309 allows an insurance company to bar recovery to its policyholder if the company clearly proves that its insured made a misrepresentation which was untrue and material to the risk at the time the insurance company assumed the risk. In *Brant v. Parsio,*[4] Judge Haley of the Circuit Court of Stafford County held a policyholder's "misrepresentation in the declarations of the policy that her address was in New York [when she lived in Stafford County, Virginia] was material to the risk, allowing cancellation of the policy, as one of the Court's grounds for barring the plaintiff from recovering UM benefits under her auto insurance policy.

4. The concept of "owned automobile" and "non-owned automobile"

The Family Auto Policy uses the terms "owned automobile" and "non-owned automobile" as a "two-way valve" to either grant coverage or to exclude coverage in Part I - Liability; in Part II - Medical Expense and Income Loss Benefits; and in Part III - Physical Damage.[5] These terms are insurance policy words of art; understanding their meaning is the key to maximizing coverage.

The Insuring Clause contained in Part I - Liability, is the first introduction in the policy to the terms, "owned automobile" and "non-owned automobile":

PART I - LIABILITY INSURING CLAUSE

> "To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury... arising out of the ownership, maintenance or use of the *owned automobile* or any *non-owned automobile*...."

a. Owned automobile

Originally, auto insurance policies covered the policyholder and his family for each "owned automobile," for a which a specific premium was paid. This was simple.

However, insurance underwriters realized that its policyholder was not fully covered by merely insuring the "owned automobile." For example, if the owned auto broke down, the policyholder would need a temporary substitute auto. In addition, the policyholder might use the owned auto with a trailer or might replace the insured auto with a new one or buy an additional auto.

To provide additional liability coverage to its policyholder, the underwriters expanded the definition of "owned automobile" to include a trailer; a farm automobile; replacement or newly acquired automobiles; and a temporary substitute automobile. (See page 18 for the policy definition of "owned automobile.")

b. Non-owned automobile

The expanded "owned automobile" coverage was still not enough protection since the policyholder might drive a vehicle he did not own, which was not covered under his "owned automobile" coverage. For example, if the policyholder borrowed a friend's uninsured car, he would have no liability coverage.

Insurance companies earn premiums only on the "owned automobiles" set forth in the declarations page. Providing liability coverage on autos the policyholder does not own gives the policyholder extra coverage, "for free," and at the same time increases the insurance company's risk of loss. The more often the policyholder drives a "non-owned automobile," the greater the insurance company's risk of an accident with resulting increased claims and payouts. Therefore, the underwriters did not want to provide additional "free coverage" for non-owned vehicles which were regularly driven by its policyholders.

Casual, infrequent use of an auto owned by another (a "non-owned automobile"), such as when the policyholder borrowed his neighbor's car, was what the underwriters intended when they first developed "non-owned automobile" coverage. Casual, infrequent use would not significantly increase the insurance company's risk of loss, and at the same time would give its policyholder added liability protection.

The Family Auto Policy, Part I - Liability, defines "non-owned automobile":

DEFINITION NON-OWNED AUTOMOBILE

> "**Non-owned automobile** means an automobile or trailer not owned by or furnished for the regular use of either the named insured or any relative, other than a temporary substitute automobile.

This policy definition of "non-owned" automobile" can either include coverage (*language of inclusion*) or exclude coverage (*language of exclusion*). The policy definition accomplishes the underwriter's goal of providing "free" coverage only for the casual, infrequent use of a non-owned automobile. Vehicles regularly used by the policyholder, for which no additional premium is paid, are excluded. For example, if the policyholder were a traveling salesman, a company Ford "furnished for his regular use" while calling on customers would be excluded from coverage on the policyholder's personal auto policy insuring his Chevrolet. The policyholders use of the Ford is not casual or infrequent, and is excluded from coverage since it falls outside the definition of "non-owned automobile."

In addition, if the policyholder owns two cars, each insured with a *separate* insurance company, the *liability* coverage on car-1 does not apply to car-2, and visa-versa. Neither car is an "owned automobile" nor a "non-owned automobile" on the other policy.

Similarly, if the named insured resides in the same household with his son, the son's car is excluded from the definition of "non-owned automobile" since it is "owned by or furnished for the regular use of a relative," and is therefore not covered under the father's liability coverage.[6] As an example, assume a father, who insures his Cadillac for $1 million with GEICO, borrows his son's car, insured with Colonial for $25,000. The standard definition of "non-owned automobile" in the father's policy excludes *liability* coverage to the father, under his GEICO policy, while using his son's car. If the father negligently injured a plaintiff, the only coverage available to the father would be his son's minimum limits policy with Colonial. If the son's car were uninsured, the father would have no coverage.[7] The underwriters presumed that autos which are furnished for the regular use of a relative residing in the same household, would be used by the policyholder (named insured) more than on a casual, infrequent basis. Hence, the term "relative" was inserted into the definition of "non-owned automobile."

Understanding the purpose for "non-owned automobile" coverage is essential to understanding the scope of the coverage. More than 25 years ago, the Supreme Court of Virginia commented on the then "new non-owned automobile coverage" in *Quesenberry v. Nichols and Erie*:[8]

> "In recent years some companies have written policies to cover *a 'non-owned' automobile* . . . Other policies obtain the same result by extending the driver's regular insurance to casual driving of cars other than his own without the payment of extra premium, by the use of the 'drive other cars' clause or 'use of other automobiles' clause . . . *The general purpose . . . is to protect the insured against liability . . . from the infrequent or casual use of automobiles other than the ones described in the policy. Usually excluded is protection against liability with respect to the insured's frequent use of another automobile . . . .*" *[emphasis added]*

5. The other insurance clause

OTHER INSURANCE CLAUSE PART I - LIABILITY

> **Other Insurance.** If the insured has other insurance against a loss covered by Part I (Liability) of this policy the company shall not be liable under this policy for a greater proportion of such loss than the applicable limit of liability stated in the Declarations bears to the total applicable limit of liability of all valid and collectible insurance against such loss; provided, however, the insurance with respect to a temporary substitute automobile or non-owned automobile shall be excess insurance over any other collectible insurance.

The "other insurance clause" is found in each of the four parts of the family auto policy. It describes how much each insurance company will pay if a person is covered by more than one policy.

The "other insurance clause" provides that insurance covering "a temporary substitute automobile" or "non-owned automobile" shall be excess insurance, and provides for coverage to be *pro-rated* amongst the carriers. The "other insurance clause" in Part I (Liability) and in Part III (Physical Damage) are identical. Part IV (UM) has slightly different wording, but the same concept of excess and *pro-rata* coverage applies in contrast to the "other insurance clause" in Part II Medical Expense Benefits (MEB) and Income Loss Benefits (see page 17).

As an example, assume, Albert Anderson borrows his neighbor's car insured with Nationwide, with liability and UM limits of $25,000/$50,000. Albert owns two cars, each insured under a *separate* policy; one with Allstate with $25,000/$50,000 limits and the other with State Farm with $50,000/$100,000 limits. If Albert negligently injures Brenda Brooks, who obtains a judgment against Albert for $100,000, Nationwide, Allstate and State Farm each pays its full liability policy limits totaling $100,000. If Brenda Brooks obtained a $50,000 judgment against Albert, Nationwide must pay its $25,000 liability limits first since the vehicle occupied by the defendant, Albert, provides primary coverage. Since the neighbor's vehicle,

insured with Nationwide, is a "non-owned automobile" under Albert's two separate policies, these two policies "shall be excess insurance over any other valid and collectible insurance" (over the neighbor's Nationwide policy).[8A] Albert's two separate policies, which are excess, must pay the balance of the judgment ($25,000) *pro-rata* as follows:

EXCESS INS. CO.	LIMIT OF LIABILITY	PRO-RATA SHARE	PAYMENT
Allstate	$25,000 limit	1/3 x $25,000	$8,333.33
State Farm	$50,000 limit	2/3 x $25,000	$16,666.67
	$75,000		$25,000.00

Let's turn the tables on Albert. Assume Albert was injured by the negligence of an uninsured motorist. The same analysis and payment of uninsured motorist coverage applies since the "other insurance clause" in Part IV of the family auto policy - the uninsured motorist endorsement - requires the same excess and *pro-rata* coverage. With respect to the UIM coverage endorsement contained in Part IV of the family auto policy, the statutory priority set forth in Code §38.2-2206(B) applies.

In the "Albert Anderson" examples, the plaintiffs cannot complain since maximum insurance covering each judgment was obtained. The only person who should complain is the excess insurance carrier having the higher limit policy since it pays the largest *pro-rata* share. But its complaints will be of no avail, since the Supreme Court of Virginia has held "the other insurance clause" valid and "merely provides an orderly process for determining the distribution of liability among several insurance carriers." *State Farm Mut. Auto. Ins. Co. v. USAA.*[9]

Part II of the family auto policy, Medical Expense and Income Loss Benefit Coverage, contains an "other insurance clause" which is different from the "other insurance clause" contained in the other parts of the policy. It is set forth below:

MEDICAL EXPENSE BENEFITS (MEB) AND INCOME LOSS "OTHER INSURANCE CLAUSE"

> "If other valid and collectible medical expense [income loss] insurance is applicable to the bodily injury of an insured person, the benefits shall be paid according to the following order of priority:
>
> (a) the medical expense [income loss] insurance of the owner of the motor vehicle the injured person was occupying at the time of the accident;
>
> (b) the medical expense [income loss] insurance of the operator of the motor vehicle that the injured person was occupying at the time of the accident;
>
> (c) the medical expense [income loss] insurance of the injured person. [The injured person cannot collect more than his actual medical expense.]

To understand the application of the "other insurance clause" in the medical expense benefits coverage, assume the following example.

Alice Abbot was injured in an auto wreck. She was a passenger in a car owned by Charles Clark, and driven, with permission, by Harry Hunt. Alice Abbot has auto insurance with Allstate with MEB limits of $5,000; Charles Clark's car is insured with Colonial with MEB limits of $1,000; and the driver, Harry Hunt, is insured with Hartford with MEB limits of $5,000. Only one car is insured on each policy. Alice has incurred $10,000 in medical bills. The order of priority for payment applying the "other insurance clause" is:

(1) Colonial
(insuring the car occupied by Alice) $1,000
(2) Hartford
(insuring the driver, Hunt) $5,000
(3) Allstate
(insuring Alice, the injured person) $4,000

Total Medical Expense Benefit (MEB) .. $10,000

B. The three steps of coverage analysis

Coverage analysis involves three steps:

- **RTP** - Read the policy;
- **RTS** - Read the statute;
- **RTC** - Read the cases (especially those found in the annotations to the statute).

When using this 3-step analysis, always keep in mind the four black letter rules of law for maximizing coverage:

(1) If insurance policy terms conflict with and restrict the coverage mandated by the statute, coverage is provided. The offending policy term is void and is replaced by the statutory language. *Bryant v. State Farm Mut. Auto. Ins. Co.*;[10] *State Farm Mut. Auto. Ins. Co. v. Manojlovic*[11]

(2) If the statute does not provide coverage, but the policy does (sometimes the policy is broader than the statute) — coverage is provided. *Hill v. State Farm Mut. Auto. Ins. Co.*[12]

(3) If the insurance policy contains an ambiguity, coverage is provided since insurance policies are liberally construed in favor of coverage if two opposite interpretations are possible. *Granite State Ins. Co. v. Bottoms;*[13] *USAA v. Webb*[14]

(4) If the governing statute is remedial and was enacted for the benefit of injured persons, such as the UM, UIM and Omnibus clause statutes, and the statute itself contains an ambiguity, allowing for two opposite interpretations, the statute will be interpreted liberally to provide coverage. *USAA v. Alexander*[15]

II. You Represent Priscilla Plaintiff

Priscilla Plaintiff was severely injured in an auto wreck caused by the negligence of Larry Student, a third-year law student on his way to the law library.

Priscilla, who was wearing a seat belt, was driving her Chevrolet and Larry was driving his girlfriend's Ford, with her permission.

The defendant, Larry Student, lived at home with his mother and brother as part of the same household. Larry owned a 1982 yellow Toyota Celica. Larry Student, his mother, and brother all had separate minimum liability policies in the amount of $25,000 covering their own vehicles, respectively with Stonewall Dixie, Maryland Casualty, and Bankers and Shippers.

Once a month, Larry Student had dinner at his girlfriend's mother's house. After dinner, Larry would drive his girlfriend's 1992 Ford, insured with Colonial with $25,000 liability coverage, to the law library instead of driving his own 1982 yellow Toyota since he liked to listen to the CD player in his girlfriend's Ford. His old Toyota didn't even have a working radio! En route, this collision occurred.

Priscilla Plaintiff lived at home with her mother and two sisters, Elizabeth and Theresa, as part of the same household. Priscilla's Chevrolet, which was totalled in the wreck, was insured with USAA with UM limits of $25,000 and with medical expense benefits coverage of $2,000. Priscilla's mother had two cars on the same policy insured with Goodville Mutual with UM limits of $500,000 and medical expense benefits limits of $5,000 per car; sister Elizabeth's car was insured with Erie, with UM limits of $300,000 and medical expense limits of $5,000; sister Theresa's car was insured with Travelers with UM limits of $300,000 and medical expense coverage of $5,000.

Priscilla Plaintiff has incurred $300,000 in medical bills and is left with a permanent injury as a result of Larry Student's negligence. A detailed settlement brochure has been submitted to the Colonial Insurance Company, the carrier insuring the car Larry was driving at the time of the wreck. In response, a policy limits offer of $25,000 has been made to settle Priscilla's case. What do you do?

You represent Priscilla Plaintiff.

III. Maximizing Recovery With Excess Liability Coverage

The three steps of coverage analysis are RTP (Read the Policy); RTS (Read the Statute); and RTC (Read the Cases). Let's begin by reading selected standardized parts of the Family Auto Policy - Part I - Liability. (Since the State Corporation Commission pre-approves all auto liability insurance policies, most companies generally use the same standardized format).

A. RTP (Read the policy)

Part I - Liability

Coverage A - Bodily Injury Liability:

To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of: (A) bodily injury . . . arising out of the ownership, maintenance or use of the *owned automobile* or any *non-owned automobile*....

Persons insured

The following are insureds under Part I:

(a) **with respect to the owned automobile,**

(1) the named insured and any resident of the same household;

(2) "Omnibus Clause" — any other person using such automobile with the permission of the named insured, provided his actual operation or (if he is not operating) his other actual use thereof is within the scope of such permission; and

(3) *[deleted - not relevant]*

(b) **with respect to a non-owned automobile,**

(1) the named insured,

(2) any relative, but only with respect to a private passenger automobile or trailer, provided his actual operation or (if he is not operating) the other actual use thereof is with the permission, or reasonably believed to be with the permission, of the owner and is within the scope of such permission, and

(3) *[deleted - not relevant]*

Definitions. Under Part I [selected]:

"**insured**" means a person or organization described under "Persons Insured";

"**relative**" means a relative of the named insured who is a resident of the same household;

"**owned automobile**" means

(a) a private passenger, farm or utility automobile described in this policy for which a specific premium charge indicates that coverage is afforded,

(b) a trailer owned by the named insured,

(c) a private passenger, farm or utility automobile ownership of which is acquired by the named insured during the policy period, provided....

(d) a temporary substitute automobile.

"**non-owned automobile**" means an automobile or trailer not owned by or furnished for the regular use of either the named insured or any relative, other than a temporary substitute automobile.

B. RTS (Read the statute)

The key statute involving liability coverage is Code §38.2-2204; the "omnibus clause" (permissive user) statute. Code §38.2-2204(A) requires all Virginia auto insurance policies have an "omnibus clause" extending liability coverage to all persons using the insured motor vehicle "with the expressed or implied consent of the named insured." The term "omnibus" is derived from the Latin meaning "all persons" — hence the name "omnibus clause." This standard clause is found on page 18, (Part I - Liability "Persons Insured" (a)(2)). Any policy provision which limits this omnibus coverage is void. Code §38.2-2204(D); *Southside Distributing Company v. Travelers*[16].

In the case of Priscilla Plaintiff, the defendant, Larry Student, had permission to drive his girlfriend's car, which was insured with Colonial. Code §38.2-2204(D) requires that Colonial extend "omnibus" (also called "permissive user") liability coverage to Larry Student.

C. RTC (Read the cases)

Two landmark Virginia Supreme Court cases discuss the term "furnished for the regular use" contained in the policy definition of non-owned automobile — "not owned by or *furnished for the regular use* of either the named insured or any relative — " (emphasis added). Both cases involve State Farm: one case is *Smith* and the other case is *Jones*.

1. Casual, infrequent use allowed

Elaine Mellow, four months pregnant, left her furniture and automobile insured by State Farm, in California after her husband died, to stay with her brother-in-law and sister in Norfolk, Virginia, until the birth of her baby. Elaine Mellow drove her brother-in-law's uninsured car 10 times during a two-month period before her auto collision. On three occasions she drove the car for her own purposes and on seven occasions she drove the car to assist her sister, who could not drive. Elaine Mellow was sued by the other driver. Since the car she was driving was uninsured she looked to her State Farm policy back in California to provide liability coverage. State Farm denied coverage on the ground that "non-owned automobile" coverage was excluded because her brother-in-law's car, which was involved in the collision, had been furnished for Elaine Mellow's regular use. The Supreme Court of Virginia in *State Farm Mut. Auto. Ins. Co. v. Smith*[17] held that the brother-in-law's uninsured car was not furnished for Elaine Mellow's regular use since her use of the car was sporadic and controlled (casual and infrequent). Accordingly, it was a "non-owned automobile" and State Farm was required to provide liability coverage to its insured, Elaine Mellow.

2. Frequent use not allowed

Paul Jones was a route salesman for The Southern Vending Company in Richmond. The company furnished Jones a 1978 Ford Van which he used every day in his job. Jones drove the van 30 miles a week, six days a week, over a two- to three-year period. The trial court found coverage on Jones' personal auto policy holding the van was a "non-owned automobile" since the van was not furnished for his regular use but for the regular use of his employer. The Supreme Court of Virginia in *State Farm Mut. Auto. Ins. Co. v. Jones*[18] reversed, holding that the van was furnished to Jones for his regular use and therefore did not qualify as a "non-owned automobile" under the terms of Jones' own State Farm policy. The Virginia Supreme Court quoted from *State Farm Mut. Auto. Ins. Co. v. Smith*, stating the purpose for "non-owned automobile" coverage:

> "The general purpose and effect of such a policy is to protect the insured against liability arising from the use of his automobile, and in addition, from the infrequent or casual use of automobiles other than the one described in the policy. Usually excluded is protection against liability with respect to the insured's frequent use of another automobile."[19]

D. Liability coverage analysis

1. Primary coverage - follow the car occupied by the defendant

Generally, the vehicle the defendant was driving provides primary liability coverage. (Exception - garage policies covering the auto business, such as dealers, repair shops, and parking lots - Code §38.2-2205 provides that such insurance is excess).

Larry Student was driving his girlfriend's car insured with Colonial. Colonial has offered its minimum policy limits of $25,000, which is inadequate in view of the magnitude of Priscilla's injuries. Let's search together for excess liability coverage.

2. The search for excess liability coverage

a. Follow the driver

Larry Student's 1982 yellow Toyota, which was not involved in this collision, is insured with Stonewall Dixie. Larry is covered under his Stonewall Dixie policy if he was driving an "owned automobile" or a "non-owned automobile" at the time of the collision (see page 18). His girlfriend's Ford is not an "owned automobile" under the terms of Larry's policy since it is not described in Larry's policy, nor is it a "newly acquired automobile" nor a "temporary substitute automobile." However, his girlfriend's car is a "non-owned automobile" under the terms of Larry's policy if it was not furnished for Larry's "regular use." *Smith v. State Farm Mut. Auto. Ins. Co.*[20] held that casual, infrequent use is *not* considered "regular use" within the definition of "non-owned automobile." Since his girlfriend's car was only furnished for Larry's use once a month to go to the law library, this most likely will be considered infrequent, casual use, and coverage should be allowed. Accordingly, an additional $25,000 in liability coverage is available under Larry's policy with Stonewall Dixie.

b. Follow the driver home

Following Larry Student home brings us to his mother's $25,000 liability policy with Maryland Casualty and his brother's $25,000 liability policy with Bankers and Shippers. Since Larry was driving a "non-owned automobile" at the time of this collision, he is an insured under both his mother's and brother's policies. (See pages 17-19.) Each policy covers "any relative (residing in the same household)" with respect to a "non-owned automobile" if such automo-

bile is a private passenger automobile or trailer, provided permission from the owner was granted, and "the relative" (Larry) was driving within the scope of permission, which is the case here. Accordingly, Larry is covered under both his mother's liability policy with Maryland Casualty and his brother's liability policy with Bankers and Shippers for an additional $25,000 each per policy.

3. Don't sign that release - enter UIM coverage

Maximizing recovery for Priscilla Plaintiff does not end when all sources of liability coverage have been exhausted. A famous 20th century philosopher commented, "It ain't over 'til it's over."[21] We must look to underinsured motorist coverage (UIM) as an additional source of coverage.

Underinsured motorist coverage was developed in the early 1970's as a form of consumer protection. UIM coverage protects a policyholder against a negligent defendant whose insurance coverage is insufficient to fully compensate the policyholder for serious injuries.

A defendant is underinsured if his/her liability limits are not enough to satisfy the plaintiff's claim *and* the total amount of the plaintiff's UM coverage is greater than the total amount of the defendant's liability coverage. For example, assume the plaintiff's UM coverage is $50,000, the defendant's liability coverage is $25,000, and the plaintiff receives a judgment of $50,000. The defendant is underinsured by the difference, i.e., $25,000, which must be paid by the plaintiff's own insurance company under the UM endorsement. The underinsured defendant's obligation to pay is based upon his/her tort liability, while the UIM carrier's obligation to pay is based upon its contractual liability.

An underinsured motorist claim may be cut off if the plaintiff signs a release, releasing the defendant.[22]

The underinsured defendant is the party who is sued. The UIM carrier is not named as a defendant, but is merely served with a copy of the suit papers, and may answer and defend or "may sit back on the sidelines" and do nothing, Code §38.2-2206(F). The plaintiff must be "legally entitled to recover" against the defendant as a condition precedent to obtaining UM/UIM coverage.[23] Judgment, in the underlying tort action, is rendered only against the underinsured defendant(s). It is *judgment* against the underinsured defendant(s), with valid service of process on the UIM carrier, before judgment, which triggers the UIM carrier's contractual obligation to pay. *State Farm Mut. Auto. Ins. Co. v. Kelly.*[24]

If the plaintiff accepts the defendant's liability limits and signs a release, the defendant is released from liability. If the defendant is released from liability, the underlying tort claim is ended without a judgment against the underinsured defendant. Since a valid judgment against the defendant is what triggers the UIM carrier's obligation to pay, the plaintiff's UIM claim may be cut off with the signing of the liability release unless a total liability and UIM settlement is achieved simultaneously with the consent of the UIM carrier.[25]

An underinsured motorist carrier has subrogation rights, allowing it to seek its money back, against the defendant, Larry Student, after payment of the UIM claim to the plaintiff.[26] If the plaintiff releases the defendant, without the UIM carrier's consent, she has extinguished the UIM carrier's subrogation rights.

To settle both the liability and UIM claims, before judgment, the UIM carrier must give its "consent to settle" and must waive its subrogation rights.[27] After judgment, no release is necessary since the judgment itself triggers the obligation of the liability carrier and the UIM carrier to pay. Once a valid judgment is rendered, the UIM carrier's subrogation rights become fixed by law.

4. Frustrating Virginia public policy

A liability carrier's demand for a release, which cuts off the plaintiff's UIM claim, if signed, and the UIM carrier's refusal to waive its subrogation rights against the defendant by invoking its "consent to settle clause" create a "Catch-22" standoff, frustrating Virginia's public policy of encouraging settlement of meritorious claims. Courts have described this "Catch 22" standoff as "cast[ing] the insured victim into a limbo that utterly frustrates the legislative purpose of providing maximum and expeditious protection to innocent victims of financially irresponsible motorists . . . [and] also frustrates the legitimate expectations of the insured victim who purchases UIM coverage."[28]

A respected professor of insurance law has commented that "subrogation is inimical to the underinsured motorist coverage," stating:

> "The fundamental characteristic of underinsured motorist insurance is that it is only relevant when a tortfeasor's insurance is not adequate to provide indemnification. It is patently inappropriate to consider that the underinsured motorist insurer would be entitled to reimbursement from these funds. In this context, allowing an insurer to be subrogated to amounts which may be recovered from the tortfeasor, joint tortfeasors, or collateral sources (such as workers' compensation) serves to reduce the underinsurance motorist insurance. Thus when possible sources of indemnification against which a subrogation right might be exercised are considered, it seems evident that a persuasive case can be made for precluding an insurer from seeking reimbursement unless the insured has been fully indemnified . . . "[29]

The UIM carrier's refusal to waive its subrogation rights against the defendant by not giving its "consent

to settle" frustrates the legislative purpose of UIM coverage, and is inconsistent with the "exhaustion clause" set forth in standard Virginia UM endorsement, section III(d) "Limits of Liability." The "exhaustion clause" requires the insured to exhaust all limits of defendant(s)' liability coverage by payment of judgments or settlements" *as a condition precedent* to the UIM carrier's obligation to make any underinsured motorist payment.[30] Courts which have examined this inconsistency have concluded, " . . . the exhaustion clause could have led a reasonable person to believe that settlement [with the defendant's liability carrier] without prior notice [to the UIM carrier] was permissible."[31]

The real party-in-interest, in an UIM case, is the underinsured motorist carrier who has the additional insurance coverage. If the UIM carrier makes a fair offer and waives its subrogation rights against the defendant, the case can be settled. The plaintiff signs two releases *at the time of settlement* — one with the liability carrier and the other with the UIM carrier, the latter release containing a clause waiving subrogation rights.

Unfortunately, the UIM carrier need do nothing whatsoever in the underlying suit against the defendant. Code §38.2-2206(F) does not require the UIM carrier to file an answer; does not require the UIM carrier to actively defend the lawsuit; and does not require the UIM carrier to pay the costs of defense. The UIM carrier can get a "free ride" and "sit back on the sidelines" while the liability insurance carrier, which has already offered its policy limits, actively defends the underlying lawsuit against the defendant. Virginia public policy is frustrated since the UIM carrier need do nothing and need pay nothing until a judgment is rendered against the defendant. The defendant's liability insurer incurs additional attorneys' fees, expert witness fees, and costs in defending the suit even after it has offered its policy limits; the plaintiff incurs additional expert witness fees and costs; and the courts' dockets become clogged with cases which should have settled.

Some states have solved this problem by shifting the costs of defense to the UIM carrier after the liability carrier has offered its full policy limits. Other states give the UIM carrier the option of protecting its subrogation rights by tendering to the plaintiff a check in the amount of the liability carrier's policy limit offer or waiving its subrogation rights. These approaches support public policy by encouraging settlement of meritorious claims.

It was hoped that the passage of Code §38.2-2206(K) would solve this problem in Virginia; but it has not. Code §38.2-2206(K) allows settlement with the liability carrier without the need for the plaintiff to sign a release in an UIM case.

CODE §38.2-2206(K) SETTLEMENT WITHOUT RELEASE

> "A liability insurance carrier...may pay the entire amount of its available coverage *without obtaining a release* of a claim if the claimant has underinsured motorist coverage in excess of the amount so paid...[and] shall promptly give notice to its insured and to the insurer which provides the underinsured motorist coverage that it has paid the full amount of its available coverage."

Section 38.2-2206(K) has been rarely used. Most insurance carriers will not settle a liability claim before judgment without obtaining a release since the liability carrier still has a duty to defend the defendant even after it has offered its policy limits. This position is based upon the duties created by the "insuring clause" contained in Part I - Liability of the family auto policy, which creates a duty to pay *and* a duty to defend, declaring ". . . to pay on behalf of the insured . . . *and* defend any suit . . ."

In *Superior Ins. Co. v. Cencewizki,*[32] Judge William H. Ledbetter ruled that in an UIM case, a liability carrier which has offered its policy limits, pursuant to Code §38.2-2206(K), *cannot* "walk away" from the case since it still has a duty to defend.

The Commonwealth of Virginia has been a pioneer in the development of uninsured and underinsured motorist coverage. Through its General Assembly and Supreme Court, Virginia has moved to protect its citizens against the hardships resulting from the negligence of financially irresponsible and inadequately insured drivers. Unfortunately, the legislative purpose of the underinsured motorist statute and the strong public policy of this Commonwealth have become frustrated by a "Catch-22" standoff that "casts the insured victim into a limbo."[33] The liability carrier demands a release upon offering its policy limits, which, if signed, cuts off the insured victim's UIM claim. Meanwhile, the UIM carrier refuses to give its "consent to settle" in an attempt to preserve its subrogation rights against the underinsured defendant. This "Catch-22" standoff requires a legislative or judicial remedy.

Endnotes

1. The basic Virginia Family Auto Policy consists of the SCC approved standard "Family Automobile Form," developed in May of 1958, which has been amended from time to time. The present basic Family Automobile Policy consists of the following amendatory endorsements to the 1958 "Family Automobile Form": Form A799g (9/1/93) "Family-Virginia Amendatory Endorsement" which amends Part I - Liability, Part II - Medical Expense Benefits and Income Loss Benefits, and Part III - Physical Damage, as well as the Conditions section; Form A689i(7/1/93) "Uninsured Motorist Insurance (Virginia)" which contains both the UM and the UIM endorsement (Previously, UIM insurance was covered by a separate endorsement "Supplementary Uninsured Motorists Insurance

(Bodily Injury - Property Damage - Limits - Underinsured Motorists) (Virginia)"); Form A877 (6/66) "Assistance and Cooperation of the Insured"; Form 906h (9/93) "Amendment of Termination Provisions - Virginia"; Form A979a (6/73) "Out-Of-State Insurance Endorsement"; Form E014a (9/77) "Sound Receiving and Transmitting Equipment Excluded"; and Form A925 (5/70) "Sound-Reproducing or Recording Equipment Excluded." In addition, the State Corporation Commission has approved a multitude of optional standard form endorsements, such as "Rental Reimbursement," "Extended Non-Owned Automobile Coverage," "Federal Employees Using Automobiles in Government Business," etc. Code §38.2-2220 requires insurance companies to use the "precise language of the standard forms filed and adopted by the Commission" (State Corporation Commission - Bureau of Insurance).

Insurance companies generally do not send its policyholder a "complete" policy on each renewal date. The industry practice is to send its policyholder only new or amended forms and endorsements. It is important to obtain a complete copy of the insurance policy with all forms and endorsements which were in effect during the policy period covering the accident to properly analyze coverage issues.

2. The State Corporation Commission approves the standard parts of the Family Auto Policy. Carriers generally use the same standardized format for each coverage part. The general instructions governing the standard provisions of the Family Auto Policy suggest that the policy be divided into four essential coverage parts: "Part I - Liability"; "Part II - Expenses for Medical Services"; "Part III - Physical Damage"; and "Part IV - Protection Against Uninsured Motorists." The general instructions for the Family Auto Policy form suggest this sequence; however, the insurance company may choose any order it wishes for these essential coverage parts. For example, Part IV of the State Farm Auto Policy covers automobile death and disability benefits, rather than UM coverage, which is identified as "Coverage U" in the State Farm policy.
3. The Family Auto Policy contains a separate section entitled "Conditions." Nineteen conditions are set forth, which are allocated to the specific four basic parts of the policy. All the conditions need not apply to each sub-part. For example, Condition No. 5 entitled "Assistance and Cooperation of the Insured" only applies to Part I - Liability and to Part III - Physical Damage. In addition, each of the four sub-parts may contain its own specific conditions.
4. *Brant v. Parsio*, 27 Va.Cir. 339 (1992) (Circuit Court of Stafford County, Judge James W. Haley)
5. Part IV - UM and UIM Coverage of the Family Auto Policy does not use the term "owned automobile" and "non-owned automobile" to grant or exclude coverage since the UM statute, Code §38.2-2206(B), mandates that coverage be provided to the policy-holder, his/her spouse, and relatives of either residing in the policyholder's household while in *any* motor vehicle.
6. Approximately six years ago, State Farm amended the definition of "non-owned automobile" in Part I - Liability of its Family Auto Policy — Policy Form 9846F.8 (preferred risks); Policy Form 9946F.8 (higher risks); but *not* Policy Form 9346F.8 (non-voluntary, assigned risks). The "6989AS and 6989AG Amendatory Endorsements" provide: "The definition of 'non-owned automobile' means an automobile or trailer not owned by, or furnished for the regular use of: (a) the named insured; or (b) any relative unless at the time of the accident or loss: (a) the automobile is or has been described on the declarations page of a liability policy within the preceding 30 days; and (2) the named insured or a relative who does not own such automobile is the driver. A temporary substitute automobile is not considered a non-owned automobile."

This State Farm amendment provides excess "non-owned automobile" liability coverage to the policyholder, his spouse, and to relatives residing in the same household who drive each other's owned autos, provided the auto involved in the collision is insured or was insured 30 days before the collision by *any* insurance company. In the example, if the father were insured with State Farm, excess "non-owned automobile" coverage would be provided the father while driving his son's car if the son's car "is or has been described on the declarations page of a liability policy within the preceding 30 days."

This is a significant expansion by State Farm of "non-owned automobile" liability coverage, which normally is not provided by other insurance companies. For example, assume son Gary, insured with GEICO, and son Sam, insured with State Farm, residing in the same household with their father, on separate occasions borrow their father's car, the same Ford, insured with Frontier Insurance Company. Son Gary negligently injures plaintiff-1 and son Sam negligently injures plaintiff-2 while driving their father's car. All autos carry minimum limits liability coverage of $25,000. Both Plaintiff-1 and Plaintiff-2 win $50,000 judgments against son Gary and against son Sam for their separate accidents.

Plaintiff-1 recovers only $25,000 from Frontier, the primary carrier insuring the father's car since Gary's GEICO policy contains the *standard* definition of "non-owned automobile" (page 16). The GEICO policy excludes excess "non-owned automobile" coverage since Gary was driving a car "owned by or furnished for the regular use of . . . any relative," i.e., his father.

Plaintiff-2 recovers $50,000: $25,000 from Frontier *and* $25,000 in excess "non-owned automobile" liability coverage from Sam's State Farm policy which contains the *amended* definition of "non-owned automobile" quoted above.

7. See note 6. In the first example, if the father insured his Cadillac with State Farm, instead of with GEICO, the father would be entitled to $25,000 liability coverage on his son's Colonial policy *and* $1,000,000 in "non-owned automobile" liability coverage under his own State Farm policy. However, in the second example, the father would *not* be entitled to any "non-owned automobile" liability coverage under his own State Farm policy if his son's auto was uninsured for more than 30 days.
8. *Quesenberry v. Nichols and Erie*, 208 Va. 667, at 670, 672 (1968)

8A. *Emick v. Dairyland Ins. Co.*, 519 F.2d 1317, 1327 (4th Cir. 1975) held that non-owned auto coverage issued by a Massachusetts insurance company, Middlesex Mutual, insuring two vehicles on a *single* policy, could not be combined to double coverage by multiplying the number of vehicles on the *same* policy by the policy limits for each. The Court in *dicta, id.* at 1325, suggested the same result even if separate policies were issued on each vehicle to the same named insured. The *dicta* in *Emick* has been criticized since the decision failed to make any distinction between primary and excess liability coverage, nor did the Court "address the 'other coverage' clause," which provides excess coverage "on *all* valid and collectible insurance against such loss." *Parsons v. Parsons*, 413 N.W.2d

184, at 187-188 (Minn.Ct.App. 1987). Coverage under each policy is triggered when the insured drives a non-owned automobile, and the primary lioability coverage has been exhausted. *Id.* at 189.

9. *State Farm Mut. Auto. Ins. Co. v. USAA*, 211 Va. 133, 176 S.E.2d 327 (1970)
10. *Bryant v. State Farm Mut. Auto. Ins. Co.*, 205 Va. 897, 140 S.E.2d 817 (1965)
11. *State Farm Mut. Auto. Ins. Co. v. Manojlovic*, 215 Va. 382, 209 S.E.2d 914 (1974)
12. *Hill v. State Farm Mut. Auto. Ins. Co.*, 237 Va. 148, 375 S.E.2d 727 (1989)
13. *Granite State Ins. Co. v. Bottoms*, 243 Va. 228, 415 S.E.2d 131
14. *USAA v. Webb*, 235 Va. 655, 369 S.E.2d 196 (1988)
15. *USAA v. Alexander*, 248 Va. 185, at 194-195 (1994)
16. *Southside Distributing Company v. Travelers,* 213 Va. 38, 189 S.E.2d 681 (1972).
17. *State Farm Mut. Auto. Ins. Co. v. Smith*, 206 Va. 280, 142 S.E.2d 562 (1965)
18. *State Farm Mut. Auto. Ins. Co. v. Jones*, 238 Va. 467, 383 S.E.2d 734 (1989)
19. *State Farm Mut. Auto. Ins. Co. v. Jones*, 238 Va. 467 at 470
20. *State Farm Mut. Auto. Ins. Co. v. Smith*, *supra* note 17.
21. Yogi Berra, New York Yankees
22. The July 1993 endorsement to Part IV of the Family Auto Policy entitled "Uninsured Motorists Insurance (Virginia) [A689i (7/1/93)]" contains exclusion (a), ("*the consent to settle clause*"), which provides, "this insurance does not apply (a) to bodily injury or property damage with respect to which the insured or his legal representative shall, without written consent of the company, make any settlement with any person or organization who may be legally liable therefor." Failure to obtain "consent to settle," based upon exclusion (a), in an *UM* case has been held to exclude UM coverage on the ground that the UM carrier's subrogation rights have been prejudiced. *Virginia Farm Bur. Mut. Ins. Co. v. Gibson*, 236 Va. 433, 374 S.E.2d 58 (1988). The majority of jurisdictions in the United States hold that an insurance carrier must prove it was prejudiced by its insured's settlement with a third party tortfeasor, in violation of the "consent-to-settle clause," to avoid paying UIM coverage. See for example, *Hernandez v. Gulf Group Lloyds*, 875 S.W.2d 691, 693. (Tex. 1994), citing cases from around the country.

    The July 1, 1993, UM endorsement consolidated the "Uninsured Motorist Insurance (Virginia)" and the "Supplementary Uninsured Motorist Insurance - Underinsured Motorists (Virginia)" separate endorsements into one endorsement, including both UM and UIM coverage.

    The previous UIM endorsement ("Supplementary Uninsured Motorist Insurance - Underinsured Motorists (Virginia)") provided that, "exclusion (a) in the UM endorsement does *not* apply to the UIM coverage afforded by this endorsement." For cases involving the previous UIM endorsement, a strong argument can be made that the UIM carrier waived its subrogation rights and is estopped from taking the position that the plaintiff has cut off his UIM claim by signing a liability release since the former standard UIM endorsement stated that exclusion (a) in the UM endorsement did *not* apply to UIM coverage.
23. Va.Code Ann. §38.2-2206(A)(Repl.Vol. 1994)("to pay the insured all sums he is legally entitled to recover"). *Aetna Cas. & Sur. Co. v. Dodson*, 235 Va. 346, 367 S.E.2d 505 (1988) (holding, an UM carrier has no obligation to pay a claim resulting from the negligence of a co-employee since the plaintiff is "not legally entitled to recover" as the Workers' Compensation statute is the exclusive remedy and bars a negligence claim of one employee against the other for injuries incurred during employment.)

    If the defendant discharges the plaintiff's negligence claim in bankruptcy, is the UIM carrier relieved of its contractual obligation to pay on the ground that the plaintiff is "not legally entitled to recover" on the underlying tort claim? Condition No. 6, entitled "Action Against Company" Part I [Liability] of the Family Auto Policy, provides: "Bankruptcy or insolvency of the insured's estate shall not relieve the company of any of its obligations hereunder." Condition No. 6, which requires the defendant's liability carrier to pay after the defendant's bankruptcy, is not carried forward into Part IV - the UM endorsement of the Family Auto Policy. However, courts which have decided this issue have held the UM/UIM carrier is the real party-in-interest, and liable to the plaintiff if the defendant was legally at fault. The defendant's bankruptcy does not relieve the defendant of "legal liability," but only relieves him of the obligation to pay, which has been discharged in bankruptcy. *Wilkinson v. Vigilant Ins. Co.*, 236 Ga. 456, 244 S.E.2d 167 (1976); *Bauer v. Consolidated Underwriters*, 518 S.W.2d 879 (Tex.Civ.App. 1975).
24. *State Farm Mut. Auto. Ins. Co. v. Kelly*, 238 Va. 192, 380 S.E.2d 654 (1989). However, on the issue of bad faith, two circuit courts have held that an UM/UIM carrier may be liable to the plaintiff for bad faith refusal to negotiate with the plaintiff *before* judgment under Code §8.01-66.1(D)(1). *Copenhaver v. Davis*, 29 Va.Cir.21 (Cir.Ct.Louisa Co. 1992); *Crawford v. Allstate Ins. Co.*, 8 VLW 468 (Cir.Ct.City of Hampton 1993).
25. See note 22.
26. Va.Code Ann. §38.2-2206(G)(Repl.Vol.1994); Family Automobile Policy UM endorsement "A689i (7-1-93) Conditions" incorporates standard condition 13 *subrogation* providing "In the event of any payment under this policy, the company shall be subrogated to all the insured's rights of recovery therefor 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."
27. See note 22.
28. *Daley-Sand v. West American Ins. Co.*, 564 A.2d 965, 971 (Pa.Super. 1989)(citing cases from several jurisdictions)
29. Widiss, *Uninsured and Underinsured Motorist Insurance*, Vol. 2, at 129-130 (2d ed. 1990)
30. The Virginia SCC standard UM endorsement (A689i 7-1-93) section III(d) "Limits of Liability" provides, "*The company shall not be obligated to make any payment* because of bodily injury or property damage to which this insurance applies and which arises out of the ownership, maintenance or use of an underinsured motor vehicle *until after* the limits of liability under *all bodily injury and property damage liability bonds or insurance policies* respectively applicable at the time of the accident to damages because of bodily injury or because of property damage *have been exhausted by payment of judgements or settlements.*" *(emphasis added)*
31. *Progressive Cas.Ins.Co. v. Kraayenbrink*, 370 N.W.2d 455 at 460 (Minn.Ct.App. 1985)
32. *Superior Ins. Co. v. Cencewizki*, Case No. CH 94-155 (Cir. Ct. of City of Fredericksburg, Jan. 27, 1995, Judge Wm. H. Ledbetter.)
33. *Daley-Sand, supra* note 28.

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