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INSURANCE CONSUMER COUNSEL'S COLUMN

THE "HOUSEHOLD" OR "FAMILY" EXCLUSION IN AUTO POLICIES

BY PROFESSOR GREG MUNRO

Casualty insurers often limit their risk by precluding certain classes of persons from coverage. For example, automobile insurance carriers commonly seek to preclude family members from recovering damages against an insured under the insured's liability coverage. Also, even though a family member may, under tort law, be "legally entitled to recover" from a named insured on an auto policy

so as to invoke uninsured or underinsured motorist coverage, the policies will often preclude that family member from being an "insured" so as to block the benefits of the UM or UIM coverage. Such preclusion applies even to friends in some cases and is most recognizable in the policies in the form of the "family exclusion" or the "household exclusion."

One would expect a "family exclusion" to be drafted to prevent members of the insured's family from recovering benefits under a coverage the insured has purchased, while a "household exclusion" would prevent persons who reside with the insured from recovering. In fact, the language of the exclusions is commonly mixed to include both classes, and, for purposes of this article, the terms will be treated as interchangeable.

The family or household exclusion will commonly take such form as:

"This insurance does not apply under Coverage A to bodily injury to any insured

or member of the family of the insured residing in the same household as the insured."¹

The Personal Auto Protection form drafted by the Insurance Services Offices, Inc., trade organi-

Insurers believe they can reduce fraudulent claims by precluding defense or indemnity on claims brought by a family member or person living with the insured.

zation for the property/casualty insurance industry, states:

"We do not provide Liability Coverage... For bodily injury to you or a "family member."²

"Family Member" is defined in the ISO form as "a person related to you by blood, marriage or adoption who is a resident of your household. This includes a ward or foster child."³

Absent any statutory restriction, it is in the power of the insurer to insert such exclusions into the policy. The parties to the insurance contract can limit the insurers liability, and the policy controls so long as the insurer pays as agreed.⁴ The reason advanced for including the family or household exclusions in the policies has been the insurer's fear of collusion by family members in seeking to recover liability coverage where one member was driving while others were passengers.⁵ Insurers believe they can reduce fraudulent claims by precluding defense or indemnity on

claims brought by a family member or person living with the insured.⁶

Keeton and Widiss note that, in the first half of this century, the family exclusion was consistent with the existence of statutes and decisions granting tort immunity for intra-family, inter-spousal, and guest-passenger claims.⁷ Hence, in 1975, in *State Farm Mutual Auto. Ins. Co. v. Leary*,⁸ the Montana Supreme Court upheld both the tort doctrine of interspousal immunity and the insurance household exclusion.

Ultimately, however, the courts began to abrogate the doctrines of tort immunity. In Montana, in *Miller v. Fallon County*,⁹ the court overturned a long line of cases in which the state had retained interspousal tort immunity, noting that "Family harmony will not be destroyed by the filing of a lawsuit."¹⁰ The court said, "The destruction of family harmony is even less of a concern because of insurance. A spouse is normally not seeking redress against the other spouse, but rather spouse's insurance carrier."¹¹ In *Transamerica Ins. Co. v. Royle*,¹² the court abrogated intra-family tort immunity holding that a parent is not immune from liability to a child. In that case, the court noted that it was proper to consider the "prevalence of liability insurance" in deciding whether parental immunity from children's suits should apply.¹³ Ironically, the courts were abrogating the family tort immunities in part because of the existence of insurance, while

the policies still uniformly contained family exclusions negating the insurance.

Historically, the Montana Supreme Court had upheld the family/household exclusion in the auto insurance policy. In 1968, in *Lewis v. Mid-Century Ins. Co.*,¹⁴ the court affirmed that the household exclusion was not prohibited by Montana's Motor Vehicle Safety Responsibility Act,¹⁵ which was enacted in 1951 and only applied to require basic amounts of insurance if a judgment had not been paid. This changed when the Montana Legislature passed the Montana Mandatory Liability Protection Act in 1979.¹⁶ That Act¹⁷ required that any motor vehicle registered and operated in Montana had to be insured against liability for bodily injury and property damage in amounts set forth in the Motor Vehicle Safety Responsibility Act. The public policy statement inherent in the Mandatory Liability Protection Act provided new opportunity to challenge the validity of the family exclusion. Consequently, in *Transamerica Ins. Co. v. Royle*, the court declared the family exclusion invalid on the ground that the Mandatory Liability Protection Act required insurance against bodily injury to "any person" and made no exception for family members. Said the court, "The legislature has

expressly outlawed the 'household' exclusion."¹⁸ It is also important to note that the court in *Transamerica v. Royle* invalidated the household exclusion on the alternative basis that the clause "failed to honor the reasonable expectations of the purchaser of the policy."¹⁹

The "modified" household exclusion limiting coverage to the statutory minimum

When the courts invalidated the family exclusion for liability coverage on the ground that it violated public policy as expressed in the Mandatory Liability Protection Act, some insurers responded by modifying the clause so that it only precluded indemnity of a family member for amounts over the minimum required by the statute. Indeed, the court in *Iowa Mut. Ins. Co. v. Davis*²⁰ seemed to invite them to do so. *Davis* involved the exclusion of a named driver which exclusion the court declared invalid as violating the Mandatory Liability Protection Act. However, the court, in dicta, said:²¹

Our ruling does not, however, prohibit an insurer from entering into agreements with their insureds to limit coverage to the statutory minimum amounts as set forth in § 61-6-103, MCA. Other states have

reached similar conclusions.

Consequently, as was reflected in *Shook v. State Farm Mut. Ins.*,²² State Farm modified its household exclusion to liability "Coverage A" to read:

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.

Under this clause, the family member's recovery under the liability coverage is limited to \$25,000 (the amount stated in the Motor Vehicle Safety Responsibility Act and required by reference in the Mandatory Liability Protection Act).

In *Shook v. State Farm*, husband, Terry, was driving a motor vehicle in an accident in which his wife was injured and subsequently brought a negligence action against him. State Farm refused to tender the liability limit of \$100,000 but instead offered the \$25,000 limit under the modified household exclusion placing the validity of the modified exclusion in issue. Federal Judge Hatfield held that "an exclusionary endorse-

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ment which operates to limit coverage to the statutory minimum amounts established by MCA §61-6-301 is not violative of the public policy inherent in Montana's mandatory insurance law." However, Judge Hatfield went on to find that the positioning of the exclusion in relation to the broad language of the basic coverage agreement created an ambiguity in the exclusion which ran afoul of the reasonable expectations of the insured. For that reason, he denied State Farm's request to declare the exclusion valid and dismiss Shook's action.

The issue of the validity of the modified household exclusion reached the Montana Supreme Court in 1994 in companion cases certified from the United States District Court for Montana. In *Liebrand v. National Farmers Union Property and Casualty Co.* and *Cole v. Truck Insurance Exchange*²³ injured family plaintiffs were each denied the right to recover liability limits on the ground that a modified household exclusion precluded them from recovering anything more than the minimum limits required under the Mandatory Liability Protection statute. In *Liebrand*, 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." In policy renewals, Liebrands received a declarations page that stated that "[l]iability payments to household members are limited to the Financial Responsibility limits of the policy state." Gordon Liebrand was badly injured in a vehicle driven by his

mother, Lois, and NFU paid only \$25,000 under the exclusion refusing the \$100,000 policy limit.

In *Cole*, the named insured, Mary Jo Cole suffered substantial injury when her daughter Lindsey drove a vehicle into her. She demanded from T.I.E. the liability limits of \$500,000 on the Cole policy and received \$25,000 pursuant to the modified household exclu-

The court found the policy provisions in question in each case to be "unclear and ambiguous" and declared them invalid and unenforceable.

sion. That exclusion which appeared by 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." Cole's declarations page simply provided for bodily injury and property damage liability coverage in the amount of \$500,000 for each occurrence and 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" and declared them invalid and unenforceable. Accordingly, the court declined to rule on whether they violated the insureds' reasonable expectations or were void as contrary to public policy of the state. The court found persuasive the reasoning in *Shook*, that determination of whether there is ambiguity requires analysis of the language of the policy "utilized from the viewpoint of a consumer of average intelligence, not trained in the law or in the insurance business."²⁴

The court also adopted reasoning from the Third Circuit case of *Worldwide Underwriters Ins. Co. v. Brady*²⁵ distinguishing between the terms "unclear" and "ambiguous." The Montana Court found that, for a person of average intelligence untrained in law, the provisions of the NFU policy in *Liebrand* and the TIE policy in *Cole* provided no means by which the insured could know the limit of liability available when a family member was the injured claimant. The court found the provisions ambiguous and

unenforceable.

Moreover, the court prospectively warned of risk that any clarified provision would still be deemed unconscionable in light of the fact that these are 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. Consequently, the modified household exclusion in its present form appears to be an unenforceable provision in auto liability coverage, and it has a good chance of being held unconscionable if it is challenged after being better drafted for clarity.

The household exclusion in Underinsured Motorist Coverage

In *Stutzman v. Safeco Ins. Co.*,²⁶ the court reviewed a Safeco policy definition of "underinsured motor vehicle" that constituted a family exclusion.²⁷ It provided:²⁸

But underinsured motor vehicle does not include any motor vehicle: ... (3) owned by or furnished for the regu-

lar use of the named insured or any relative...

Stutzman was suing her husband, John Turcotte, for damages she suffered arising from his negligence in operating a motor vehicle in which she was a passenger. She cited *Transamerica v. Doyle* for the proposition that the family exclusion was invalid as violative of public policy in

Montana.

However, the court refused to invalidate the family exclusion as applied to underinsured motorist cover-

age on the ground that "there is no statutory mandate for underinsured motorist coverage in Montana." She also argued that the household exclusion to UIM coverage was unconscionable insofar as it prohibited her from recovering the UIM benefit solely because it was her husband who injured her as opposed to a third party. The court disagreed saying that she had the "meaningful choice" of purchasing additional liability insurance. To rule otherwise, the court said, would be to convert the UIM coverage into liability coverage, a step the court was unwilling to force on insurers.

Given the fact that UIM coverage is not the subject of any statutory mandate in Montana, challenges to family or household exclusions defeating the coverage cannot rely on the public policy inherent in such legislation. However, other provisions defeating underinsured motorist coverage have been successfully attacked on other public policy grounds that may apply. For example, in *Bennett v. State Farm Mut. Auto. Ins. Co.*,²⁹ the court invalidated an

"other insurance" clause that would have prevented the stacking of a husband and wife's respective limits of UIM coverage on their two cars. The court said:

The public policy embodied in these decisions is that an insurer may not place in an insurance policy a provision that defeats coverage for

However, other provisions defeating underinsured motorist coverage have been successfully attacked on other public policy grounds that may apply.

which the insurer has received valuable consideration.

The court, in *Bennett*, refused the argument that such public policy does not apply to UIM because it lacks the protection of a statutory mandate, and said: "The purpose of underinsured motorist coverage is to provide a source of indemnification for accident victims when the tortfeasor does not provide adequate indemnification."³⁰ Finally, the court dealt with the insurer's assertion that Bennetts had no reasonable expectation of stacking their UIM coverages by citing the fact that it had, in *Transamerica v. Royle*, invalidated the household exclusion on the ground that "it did not honor the reasonable expectations of the insured."³¹ Arguably, these public policy statements could be used to invalidate household exclusions in UIM coverage insofar as they defeat UIM coverage for which the insured has paid, and the insurer has received, valuable consideration.

The "household/vehicle" exclusion

The household exclusion may take many forms. For instance, in *Stutzman*, the court upheld an exclusion that removed from the policy definition of underinsured motor vehicle any vehicle "owned by or furnished for the regular use of the named insured or any relative."³²

The court also enforced a "household/vehicle" exclusion in *American Family Mutual Ins. Co. v. Livengood*,³³ a

case in which American Family Mutual insured under separate policies the vehicles of two people who resided together. Nancy Henninger was driving a van owned by her roommate, Arthur Frehse when she was involved in an accident with Livengoods who were riding a motorcycle. American agreed to defend Livengoods' lawsuit and indemnify Henninger under the liability coverage on Frehse's van but would not tender the coverage on Henninger's vehicle, because it contained a nonowned automobile exclusion as follows:

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.

Livengoods, in appealing the lower court's decision enforcing this household/vehicle exclusion, asserted that the exclusion was in-

valid for violating the Mandatory Liability Protection Act, citing *Transamerica v. Royle*. The court disagreed saying that, in *Royle*, the policy precluded coverage for injuries to relatives which violated the statute requiring coverage for "all persons." The court said that Henninger's policy complied with the statute by providing coverage for all persons and only precluding coverage if she used a vehicle owned by a resident of her household. The court also rejected the argument that the exclusion violated the reasonable expectations of the insured saying that the policy clearly demonstrated an intent to exclude coverage when Henningsen drove a car owned by a resident of her household.

Does the household exclusion of liability trip the UM coverage?

A true advocate, when denied liability coverage for an injured family member because of a household exclusion, will argue that the vehicle has then become uninsured so as to trip the limits of the UM coverage. Invariably the injured family claimant will, by standard UM definitions, be an "insured" entitled to benefits under the UM coverage either by reason of being a passenger occupying the vehicle or by being a family member. On this issue, there are many cases in jurisdictions other than Montana holding that denial of liability coverage to the injured family member does not make the vehicle an uninsured motor vehicle.³⁴ However, there are exceptions. In *Johnson v.*

*State Farm Fire Cas.*³⁵ the court held that, where a family exclusion precluded liability for a passenger who lived with his uncle and cousin, the vehicle was rendered "uninsured" entitling the family member claimant to UM coverage benefits. A nonowned vehicle exclusion likely will apply to the UM coverage precluding the injured family-member passenger from re-

Because exclusions from coverage must be strictly construed against the insurer, counsel should review any form of household exclusion for ambiguity.

covering if injured in a car driven by a resident of the household. This amounts to what we might call a "household/vehicle exclusion." However, notice that such an exclusion would not block claims under the UM coverage of cars parked at home in the garage and not involved in the accident.³⁶

Residence of children of divorced parents

It goes without saying that an insurance clause that attempts to exclude those "residing in the same household" will raise issues regarding the residence of children subject to custody arrangements. For example, in the California case of *National Auto. & Cas. v. Underwood*,³⁷ the court held the term "resident" to be ambiguous. There, the children were in custody of the father but were injured as passengers in their mother's vehicle while with her on scheduled visitation. The court held they were not excluded from recovery by the household exclusion to the liability coverage on her vehicle, because they were not residents of the same household.

Conclusion

The household or family exclusion appears in various forms in the casualty policies. To the extent counsel can show it violates the terms of a statute providing for mandatory liability coverage or uninsured motorist coverage, the court will invalidate it and refuse to enforce it. Otherwise, the exclusions generally will withstand public policy arguments. On the other hand, if the provision can be shown to violate the reasonable expectations of the insurance consumer, the Mon-

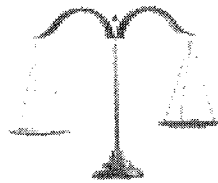
tana Supreme Court may well strike it. Because exclusions from coverage must be strictly construed against the insurer, counsel should review any form of household exclusion for ambiguity. Finally, household exclusions that defeat liability coverage may open the door to argument that the vehicle has been rendered "uninsured" so as to invoke UM coverage especially on those vehicles in which the injured family member is an "insured" and which are not involved in the accident. Courts in Montana will scrutinize household exclusions carefully, if counsel adequately prepares the challenge. This is fair, since the exclusion from coverage of that class of claimants who are family members or live under the same roof appears to be arbitrary, unnecessary and, in practice, unjust.

NOTES

1. *Leary*, 168 Mont. 482, 488, 544 P.2d 444, 448 (1975).
2. ISO form PP 00 01 06 94.
3. *Id.*, Definitions.
4. *Lewis*, 152 Mont. 328, 449 P.2d 679 (1968).
5. KEETON & WIDISS, INSURANCE

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Montana Pattern Instructions



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from page 38

- LAW, PRACTITIONER'S ED., §4.9(c)(1) (1988).
6.*Id.*, at 393.
7.*Id.*
8.*Leary*, 168 Mont. at 488, 544 P.2d at 448.
9.*Miller*, 222 Mont. 214, 721 P.2d 342 (1986).
10.*Id.*, at 218, 721 P.2d at 345.
11.*Id.*
12.*Royle*, 202 Mont.173, 656 P.2d 820 (1983).
13.*Id.*, at 179, 656 P.2d at 823.
14.*Lewis*, 152 Mont. 328, 449 P.2d 679 (1968).
15.R.C.M.1947, § 53-438, now MCA § 61-6-101 et seq.
16.En. § 1, Ch. 592, L. 1979.
17.Codified as MCA §61-6-301 et seq.
18.*Royle*, at 177, 656 P.2d at 823.
19.*Id.*, at 179, 656 P.2d at 824.
20. *Davis*, 231 Mont. 166, 752 P.2d 166 (1988).
21.*Id.*, at 172 752 P.2d at 170.
22.*Shook*, 872 F.Supp. 768, 774 (D.Mont. 1994).
23.*Liebrand* 272 Mont. 1, 898 P.2d 1220 (1995).
24.*Shook*, 872 F.Supp. at 773-74.
25.*Brady*, 973 F.2d 192 (1992).
26.*Stutzman*, 284 Mont. 372, 945 P.2d 32 (1997).
27.The court later referred to this as the "household/vehicle" exclusion in *American Family Mutual Ins. Co. v. Livengood*, 1998 MT 329, 970 P.2d 1054.
28.*Stutzman*, at 378, 945 P.2d at 35.
29.*Bennett*, 261 Mont. 386, 862 P.2d 1146 (1993).
30.*Id.*, at 389, 862 P.2d at 1148. *Citing, State Farm Mut. Auto. Ins. Co. v. Estate of Braun*, 243 Mont. 125, 793 P.2d 253 (1990).
31.*Id.*, at 390, 862 P.2d 1149.
32.*Stutzman*, at 378, 945 P.2d at 35.
33.*Livengood*, 1998 MT 329, 970 P.2d 1054.
34.See, for example, *Allstate Ins. Co. v. Baker*, 543 So.2d 847 (Fla. 1989).
35.*Johnson*, 451 So.2d 898 (Fla.App. 1 Dist. 1984).
36.See, for example, *Porr v. State Farm Mut. Auto Ins. Co.*, 452 So.2d 93 (Fla.App. 1 Dist. 1984).
37.*Underwood*, 9 Cal. App.4th 31 (Cal.App. 3 Dist. 1992).