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THE ENFORCEABILITY OF STEP-DOWN PROVISIONS IN AUTOMOBILE INSURANCE POLICIES

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ABSTRACT

A driver who purchases automobile insurance with bodily injury and property damage liability coverage of $300,000 per occurrence, and subsequently suffers extensive damages from an automobile accident, does not expect to face a post-injury lawsuit from her insurer seeking an order that a "step-down" provision in her policy means the insurer only has to pay $50,000 per occurrence (the statutory minimum coverage amount required). However, that is exactly what happened to Sharmin Walls after she and two friends took a ride in her car together with a third friend who was driving. Despite the friends' pleas, the driver refused to stop for a police blue light, a chase ensued, and ultimately the car crashed, killing one of Sharmin's friends and seriously injuring Sharmin and her remaining friend. When Sharmin and her friends each sought the individual maximum policy of $100,000 per person, the insurer sued for an order that it was not required to pay anything more than $25,000 per person up to a total of only $50,000 for all three claims arising from the accident.

The insurer from whom Sharmin bought $300,000 in coverage asked the court to enforce what is commonly called a "step-down" provision. Step-down provisions allow an insurer to reduce (or "step-down") its total coverage from what was in the declarations of the policy to a lower number, usually the minimum insurance the state requires for any driver.

In Sharmin's case, the South Carolina Supreme Court refused to apply the step-down provision. The decision was based upon application of state insurance laws that require all policies to provide coverage for the named insureds and permissive users "against liability for damage incurred 'within the coverage of the policy.'"

Courts across the country struggle with the enforceability of step-down provisions. Many courts reject step-down provisions as unfair, against public policy, or as ambiguous terms that upon examination do not warrant

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enforcement. Other court decisions focus on the freedom to contract, and many approve the provisions based on specific language of state insurance statutes.

This Article presents a brief history of these provisions, then surveys various judicial decisions attempting to put the different rulings in context with one another. Concluding, the authors suggest decisions like the South Carolina Supreme Court's decision in Sharmin's case are correct because sound public policy and the reasonable expectations of an insured are not served by allowing the provisions to limit coverage.

I. INTRODUCTION

A. The Cautionary Tale of Nationwide v. Walls[1]

On July 11, 2008, Sharmin Walls allowed Korey Mayfield to drive her Chevrolet Lumina.[2] Walls, Randi Harper, and Christopher Timms were passengers in the vehicle.[3] During the ride, a South Carolina Highway Patrol trooper activated his blue light, signaling for Mayfield to pull over.[4] Instead of obeying the signal, Mayfield accelerated and then led the trooper on a high-speed chase with speeds at times exceeding 100 miles per hour.[5] Walls, Harper, and Timms begged Mayfield to slow down, but he refused.[6] Continuing to drive recklessly, Mayfield ultimately crashed the car, killing Timms and seriously injuring Walls and Harper.[7] Mayfield, paralyzed from the single car collision, subsequently entered a plea to charges of reckless homicide.[8]

Walls, Harper, and the Estate of Timms sought coverage from Ms. Walls' automobile policy.[9] The claimants soon learned that Sharmin Walls purchased and maintained liability insurance coverage in excess of the statutory minimums.[10] Her Nationwide policy included bodily injury and property damage liability, and uninsured motorist coverage with limits of $100,000 per person and $300,000 per occurrence.[11] Presumably, this

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[1] Nationwide Mut. Fire Ins. Co. v. Walls, 858 S.E.2d 150 (S.C. 2021).
[2] *Id.* at 151.
[3] *Id.*
[4] *Id. See also* S.C. CODE ANN. § 56-5-750(A) (2016) ("In the absence of mitigating circumstances, it is unlawful for a motor vehicle driver, while driving on a road, street, or highway of the State, to fail to stop when signaled by a law enforcement vehicle by means of a siren or flashing light.").
[5] *Walls*, 858 S.E.2d at 151.
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] *Id.*

policy would allow Walls, Harper, and Timms to each recover up to $100,000 while still remaining within the $300,000 per accident limit of the policy.

However, Nationwide did not pay Walls' claim in accord with these limits.[12] Instead, the insurer asserted it was required only to pay the statutory minimum as provided by section 38-77-140 of the Code of Laws of South Carolina, rather than the liability limits stated in the policy.[13] Nationwide paid only $50,000 in total to the injured passengers, which is the statutory minimum provided by section 38-77-140.[14] Nationwide relied on the policy's "step-down" provision to pay only the minimum coverage of $50,000, as opposed to the $300,000 sought by Walls, Harper, and Timms collectively.[15]

A step-down provision is a policy provision that purports to allow an insurer under certain circumstances to reduce the contracted-for declarations page coverage amount(s) down to the statutory minimum as designated by the state in which the policy is sold or is regulated.[16]

The step-down policy language in Walls' Nationwide policy stated:

> B. This coverage does not apply, with regard to any amounts above the minimum limits required by the South Carolina Financial Responsibility Law as of the date of the loss, to:
>
> ...
>
> 6. Bodily injury or property damage caused by: a) you; b) a relative; or c) anyone else while operating your auto; (1) while committing a felony; or (2) while fleeing a law enforcement officer.[17]

Instead of paying the claims, in Ms. Walls' instance, "Nationwide brought this declaratory judgment action requesting the court declare that the passengers were not entitled to *combined* coverage of more than $50,000 for any claims arising from the accident."[18] Nationwide asserted its step-down provision (quoted above) permitted Nationwide to reduce coverage to the statutory minimum.[19]

"Walls answered, denying there was any evidence that the flight-from-

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[12] *Id.* at 152.

[13] *Id.*

[14] *Id.* (citing S.C. CODE ANN. § 38-77-140(A)(2) (2015) ("An automobile insurance policy may not be issued or delivered in this State . . . unless it contains a provision insuring [at least] . . . fifty thousand dollars because of bodily injury to two or more persons in any one accident.")).

[15] *Id.* at 151–52.

[16] *See* Williams v. Gov't Emps. Ins. Co. (GEICO) 762 S.E.2d 705, 708 (S.C. 2014).

[17] *Walls*, 858 S.E.2d at 151–52.

[18] *Id.* at 152 (emphasis added).

[19] *Id.*

law enforcement and felony provisions [of her policy] applied [to limit the coverage]."[20] Nationwide argued that the injuries to Walls, Harper, and Timms were caused "(1) while committing a felony" and "(2) while fleeing a law enforcement officer."[21]

Walls argued that it was not she who was committing a felony at the time of the accident, and therefore her coverage should not be reduced.[22] Further, as the circuit court determined, when Mayfield chose to operate the vehicle at an excessive rate of speed and then ignored Walls' pleas to stop, Mayfield was no longer operating the vehicle within the permission Walls originally granted.[23] Nonetheless, the insurer attempted to reduce Walls' and the other passengers' coverage to the statutory minimum based upon the language in the step-down clause.[24]

The circuit court ruled against Nationwide.[25] "Nationwide appealed, and the court of appeals reversed," concluding the step-down provisions at issue did not violate South Carolina's public policy or the state's statutory insurance schemes.[26] Walls appealed to the South Carolina Supreme Court.[27]

To answer the question before it, the South Carolina Supreme Court referred first to its 2014 decision in *Williams v. Government Employees Insurance Co. (GEICO)*.[28] In *Williams*, the court ruled that "insurers have the right to limit their liability and to impose conditions on their obligations provided they are not in contravention of public policy or some statutory inhibition."[29] The court ultimately found, however, that Nationwide's attempt to enforce a step-down provision against Walls to "reduce coverage from the contracted-for policy limit of $300,000 per occurrence to the statutory minimum of $50,000 per occurrence for damage caused by an insured while fleeing from law enforcement or engaging in a felony" was improper.[30]

The application of an automobile insurance policy step-down

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[20] *Id.*

[21] *Id. See also* Nationwide Mut. Fire Ins. Co. v. Walls, 831 S.E.2d 131, 134 (S.C. Ct. App. 2019), *rev'd*, 858 S.E.2d 150 (S.C. 2021).

[22] *Walls*, 858 S.E.2d at 152.

[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] *Id.* (citing *Walls*, 831 S.E.2d at 138).

[27] *Id.*

[28] Williams v. Gov't Emps. Ins. Co. (GEICO), 762 S.E.2d 705 (S.C. 2014).

[29] *Id.* at 712 (citing B.L.G. Enters., Inc. v. First Fin. Ins. Co., 514 S.E.2d 327, 330 (S.C. 1999); Burns v. State Farm Mut. Auto. Ins. Co., 377 S.E.2d 569, 570 (S.C. 1989); Cobb v. Benjamin, 482 S.E.2d 589, 593 (S.C. Ct. App. 1997)).

[30] *Walls*, 858 S.E.2d at 154 (explicitly relying on *Williams* and S.C. CODE ANN. § 38-77-142(C) ("Any endorsement, provision, or rider attached to or included in any policy of insurance which purports or seeks to limit or reduce the coverage afforded by the provisions required by this section is void.")).

provision can have far-reaching and devastating consequences for insureds, particularly those who are surprised by the step-down policy after conscientiously insuring themselves and their family members through excess coverage.[31] When an insured like Sharmin Walls purchases and pays for automobile insurance coverage in excess of the statutory minimum, she does so with the expectation that if there are injuries, she and her passengers will have coverage in excess of the statutory minimum. Further, she foregoes other insurance coverage or options to prepare for the contingency that she expects to be covered by her automobile insurance. However, unbeknownst to her, there is a provision in her policy that allows the insurer to reduce that coverage to the statutory minimum of the state where the contract was formed or is enforced. Arguably, this is especially egregious because the insured learns of the provision when she is attempting to recover under the policy when she needs it the most.[32] Questions of fairness, freedom to contract, public policy, and the impact of state insurance laws are just a few of the influences that guide commentators' and courts' analyses of these provisions.[33] The South Carolina Supreme Court's assessment of the step-down provision asserted by Nationwide against Walls highlights the multiple factors that courts and legislatures around the country are facing as they attempt to deal with the legality and enforceability of automobile insurance policy step-down provisions.

In conjunction with proposing the *Walls* case as an example of the timeliness of examination of step-down provisions, this Article presents a brief discussion of the origins and theories of American insurance law and the development of step-down provisions utilized in automobile insurance contracts. Part III of this Article highlights how judicial decisions and legislative actions in some states limit the use of step-down provisions against insureds. Part IV addresses judicial decisions and legislative actions in states where step-down provisions have been approved or permitted to operate. Concluding the Article, Part V suggests that the South Carolina Supreme Court's decisions are guideposts for proper examination of step-down provisions in the context of modern insurance law and that the goal of such analysis should be to prevent the kind of unfair surprise that Sharmin Walls faced when she needed her insurance the most.

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[31] "Excess coverage" is defined by the authors of this Article to be any amount purchased by the policyholder above the statutory minimum automobile coverage required in each state.

[32] *See Williams*, 762 S.E.2d at 716 (quoting Factory Mut. Liab. Ins. Co. of Am. v. Kennedy, 182 S.E.2d 727, 729 (S.C. 1971)) ("[S]tating liability insurance not only affords protection to insured motorists, it serves the important 'public purpose of affording protection to *innocent victims* of motor vehicle accidents.'") (citation omitted in original) (emphasis added in original).

[33] *See* Martin J. McMahon, Annotation, *Validity, Under Insurance Statutes, of Coverage Exclusion for Injury to or Death of Insured's Family or Household Members*, 52 A.L.R. Fed. 4th § 18 (1987 & Supp. 2014) (discussing a variety of scenarios in which courts have examined such provisions, as cited in *Williams*, 762 S.E.2d at 715).

II. THE ORIGINS AND THEORIES OF AMERICAN INSURANCE LAW AND THE DEVELOPMENT OF STEP-DOWN PROVISIONS IN AUTOMOBILE INSURANCE CONTRACTS

"Perhaps no modern commercial enterprise directly affects so many persons in all walks of life as does the insurance business. Insurance touches the home, the family, and the occupation or the business of almost every person in the United States."[34] Because of this importance, there has been much debate about how insurance should be regulated and whether that regulation is within federal jurisdiction or the states' jurisdictions. This confusion is complicated further by the fact that "the business of insurance" is difficult to define because it "is conducted by many companies on an interstate basis, and insureds, particularly drivers, move within and without state lines."[35] The question is whether states or the federal government are in the best position to determine what regulations best serve the public interest.[36]

In 1944, the United States Supreme Court deemed insurance to be subject to antitrust regulation on the federal level, and in 1958, Congress acted to permit continued regulation on the state level to deal with other aspects of insurance governance including taxation.[37] State regulation of insurance is premised upon the idea that states have a keen interest in having their citizens adequately protected, and therefore regulate the insurance industry through state legislatures, regulatory agencies created by statute, and the judiciary.[38] So, for more than fifty years, states have been addressing issues such as rate regulation, ensuring solvency of insurance companies, and protecting the interests of policyholders.[39] That, of course, creates differences among the states according to each state's unique priorities. Some commentators criticize this state-by-state scheme arguing that it creates a disconnected and unpredictable series of regulations, statutes, and judicial decisions in an area governing what is arguably one of the most important aspects of the average American's life.[40]

Uniformity of rules and predictability of standards from state to state are important because insurance plays a vital role in American culture as it

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[34] United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533, 540 (1944), *superseded by statute*, McCarran-Ferguson Act, 15 U.S.C. §§ 1001–1015 (2006).

[35] LEO P. MARTINEZ & DOUGLAS R. RICHMOND, CASES AND MATERIALS ON INSURANCE LAW 40 (8th ed. 2017).

[36] *Id.* at 40–41.

[37] Spencer L. Kimball, *The Purpose of Insurance Regulation: A Preliminary Inquiry in the Theory of Insurance Law*, 45 MINN. L. REV. 471, 476 (1961).

[38] *See generally* Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U. L. REV. 625 (1999) (advocating for an increase in the regulation of the insurance industry).

[39] Kimball, *supra* note 37, at 475–78.

[40] *See generally* Randall, *supra* note 38 (arguing interests protected by insurance are important to public welfare and describing criticism of specific state regulatory practices).

performs important functions in social life.[41] First, it provides a means by which individuals can manage the risks associated with an uncertain world.[42] As one scholar wrote, it "provides the policyholder with a *sense* of security, a *feeling* of confidence about the future, [and] a freedom from *anxiety* about parts of the unknown."[43] When it comes to insurance regulation, insurance regulation is dictated by social, political and economic values within and without the insurance industry.[44] More succinctly, insurance serves an economic purpose by ensuring that those who suffer loss are compensated financially for that loss. In this manner, insurance serves to further fairness (loss shifting), equality (policyholders should be treated without unfair discrimination), and morality (shifting blame to the responsible party) as a means to ensure that those who cause harm compensate those who suffer the harm.[45]

In order for these objectives to be met, there is a reciprocal aspect to an insurance contract that first requires that the insurer's premiums "should be reasonable so that insurance buyers pay only what the coverage is worth."[46]

Second, these social objectives require insurance companies to define coverages "in a way that is unambiguous and not unreasonably strict."[47] In other words, the insurer's duty is "ensuring that the insured gets what he [or she] pays for."[48] Insurance, and consequently the regulation thereof, serves many purposes and often they are in conflict with one another. However, since insurance impacts nearly every person and every transaction, the overarching priority in regulating the industry must be to serve the public interest.

It is helpful to understand states' different approaches that result in different outcomes because insurance is almost exclusively regulated by states, rather than the federal government, in three main ways: the promulgation of insurance statutes by state legislatures, the adoption and enforcement of insurance regulations by state insurance agencies and commissioners, and the interpretation of both by state and federal courts, usually applying state law.[49] This is particularly true since regulation of insurance furthers the general goals of society at large.[50] While the administration of insurance tends to be similar across states, policies of

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[41] Kimball, *supra* note 37, at 478.
[42] *Id.*
[43] *Id.*
[44] MARTINEZ & RICHMOND, *supra* note 35, at 21 (stating "[t]his theme was advanced by" Kimball, *supra* note 37, at 471).
[45] Kimball, *supra* note 37, at 495.
[46] *Id.* at 491.
[47] *Id.*
[48] *Id.*
[49] MARTINEZ & RICHMOND, *supra* note 35, at 21–22, 40.
[50] Randall, *supra* note 38, at 627.

insurance must still conform to each state's particular insurance code and regulations.[51] This leads to a patchwork of varying contracts that include certain provisions that are permissible in one state but may be excluded in the contract or unenforceable in another state.

As state legislatures began to adopt regulatory parameters for auto insurance sold in their respective state, every state adopted some version of a motor vehicle financial responsibility law with the intent to protect individuals by requiring automobile insurance be purchased in at least a minimum amount designated by statute.[52] This is otherwise known as compulsory liability insurance or the "statutory minimum" amount of coverage an automobile owner must have in order to operate a vehicle within the state.[53] Compulsory automobile liability insurance dates back to as early as 1925 when Connecticut required any vehicle owner "to establish financial responsibility."[54] Massachusetts soon followed and passed a law requiring owners to obtain compulsory insurance.[55] After which, other states followed with varying schemes of mandatory liability insurance for owners of vehicles.[56] The statutory minimum varies from state to state depending on what amount the state legislature deems is appropriate.[57] Therefore, the state and corresponding statutory minimum where an insurance policy is enforced can impact not only *if* a step-down provision applies, but also the *amount* of the coverage that is applicable under the statutory minimum.

Turning attention to step-down provisions generally, it is first helpful to explain what a "step-down" provision is and how it operates when applied. A brief discussion of the historical context that gave rise to this two-tier system of treating different classes of insureds differently under the same policy is also warranted.

A step-down provision in an automobile policy limits the coverage applicable to a particular class of individual not based on what the policy declarations reflect or the amount purchased by the policyholder; instead, the coverage is reduced to the minimum limits set by the financial responsibility statute of the state that governs the policy.[58] In other words, the provision allows the insurer to lower the coverage amount to a particularly defined class of insured, under a policy that permits a reduction

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[51] *Id.* at 22.

[52] ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW 809 (6th ed. 2018).

[53] *Id.*; MARTINEZ & RICHMOND, *supra* note 35, at 847.

[54] Act of June 23, 1925, ch. 183, 1925 Conn. Pub. Acts 3956; JERRY & RICHMOND, *supra* note 52, at 808 n.11.

[55] Compulsory Automobile Liability Security Act, ch. 346, 1925 Mass. Acts; JERRY & RICHMOND, *supra* note 52, at 808.

[56] JERRY & RICHMOND, *supra* note 52, at 809.

[57] *See, e.g.*, S.C. CODE ANN. § 38-77-140 (2007) (statutory minimum of $25,000); N.C. GEN. STAT. § 20-279.21 (statutory minimum of $30,000).

[58] Johnny Parker, *The Automobile Liability Coverage Step-Down Clause: The Real Deal or Merely the Calm Before the Storm?*, 10 GEO. MASON L. REV. 33, 35 (2001).

of coverage below the purchased amount, down to the statutory minimum of the state.

This is true, regardless of the actual policy limit for which the policyholder contracted and paid a premium. Clearly, a conflict is created between the way the step-down defines and treats a "particular class of individual" and the way state codes define an "insured," particularly with regard to permissive users of automobiles.

Step-down provisions in insurance contracts first appeared in response to state motor vehicle financial responsibility laws and state statutes that defined who is classified as an insured under the policy.[59] In addition to setting the statutory minimum amount of insurance required, state legislatures adopted statutory definitions for who qualified as an insured, often called "omnibus statutes" or "omnibus clauses."[60] These statutes generally require that every motor vehicle liability policy contain an omnibus clause insuring the named insured "and any other person using or responsible for the use of the motor vehicle with the expressed or implied consent of the named insured."[61] Accordingly, the statutory definition of who qualified as an insured included permissive users as covered drivers and provided the benefits of the insurance coverage to those individuals, even though they were not named in the policy. Once permissive users were deemed insureds, insurance companies were faced with having to cover permissive user insureds for whom they knew nothing about. The insurers had no information about the potential risk(s) associated with these drivers; therefore, the insurers had not calculated such risk(s) into the premium charged to the policyholder for the coverage.

Insurers reacted by developing ways to deal with these "users" and created the concept of a step-down provision to manage this risk.[62] Step-down provisions allowed insurers to reduce the policy coverage for different insureds based upon the classification of the driver, especially permissive users.[63] In other words, insurers initially used step-down provisions to reduce the policy limits from the contracted amount to the statutory minimum if the accident involved a permissive user, even if the permissive user was not at fault.[64] This result followed even though the named insured purchased liability coverage in excess of the statutorily required amount and

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[59] *Id.* at 42.

[60] *See, e.g.*, S.C. CODE ANN. § 38-77-30(7) (2021) ("'Insured' means the named insured and, while resident of the same household, the spouse of any named insured and relatives of either, while in a motor vehicle or otherwise, and any person who uses with the consent, expressed or implied, of the named insured the motor vehicle to which the policy applies and a guest in the motor vehicle to which the policy applies or the personal representative of any of the above.").

[61] VA. CODE ANN. § 38.2-2204(D) (2020). *See also, e.g.,* S.C. CODE ANN. § 38-77-30(7).

[62] Parker, *supra* note 58, at 37.

[63] *Id.*

[64] *Id.* at 33.

the statute defines insureds to include permissive users.[65] The creation of this two-tier system of applying different amounts of coverage within the policy to different classes of drivers permitted insurers to control the risk associated with various users, primarily permissive drivers unknown to the insurer.[66]

As one commentator observed, "The vast majority of courts recognize that two-tier or step-down coverage is not per se illegal."[67] However, when considered outside the vacuum of a single policy and through the lens of general contract principles, a conflict is clear between the freedom to contract and the public policy goals underlying motor vehicle financial responsibility acts adopted by state legislatures, which require liability and other coverages on automobiles. In states where these provisions have been deemed unenforceable, some courts have held that liability insurance must serve the public purpose of protecting the innocent victims of motor vehicle collisions.[68] With that public policy goal in mind, the questions then follow: Does allowing an insurer to include and apply a step-down provision serve innocent victims? What about the principle of freedom of contract? Does the doctrine of reasonable expectations play a role in evaluating these provisions? What role do the goals and purposes of regulation to protect the public interest play?

A. Step-Down Provision Targets: Family, Permissive User, At-Fault, Felony

As introduced above, initially step-down provisions were designed to apply to permissive users as a way for insurers to manage the risk associated with these drivers who were unknown to the insurance company. As step-down provisions became accepted and permitted by courts as a means to limit coverage for permissive users, insurance companies began to expand their use to other classes of drivers. For example, in *Williams v. GEICO*, the insurer included a "family step-down" provision in the policy that applied to family members that reduced the coverage to the statutory minimum where the injured person is the named insured or any family member of the named insured.[69] As a rationale for the expansion of step-down clauses to household or family members, insurers asserted that the reason behind household exclusions was "to protect insurance companies from the possibility of family members colluding to obtain greater compensation for an injured family member than that person rightfully deserves."[70]

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[65] *Id.* at 37.
[66] *Id.* at 43.
[67] *Id.* (citing decisions from jurisdictions across the United States).
[68] *See, e.g.,* Factory Mut. Liab. Ins. Co. of Am. v. Kennedy, 182 S.E.2d 727, 729 (S.C. 1971).
[69] Williams v. Gov't Emps. Ins. Co. (GEICO), 762 S.E.2d 705, 708 (S.C. 2014).
[70] Lewis by Lewis v. W. Am. Ins. Co., 927 S.W.2d 829, 830 (Ky. 1996).

When insurers faced resistance to the general family step-down provisions, insurers then adopted a nuanced family step-down clause that applied only when the household member was at fault in the accident.[71] This was utilized by the insurance company in *Lewis by Lewis v. West American Insurance Co.*, where the step-down provision reduced the liability coverage for the named insured and family members of the named insured.[72] Another variation was used in *Aubrey v. Harleysville Insurance Co.*, where the insurance company, Harleysville, attempted to apply a step-down provision to reduce coverage for the customers of a car dealership to the statutory minimum but maintained the full policy limits for the owner of the dealership and his employees.[73] Yet another variation created by insurers was at issue in *Nationwide v. Walls*, as described previously in this Article, where the insurer incorporated a "felony step-down" provision into the policy that applied when the driver was committing a felony while operating the insured vehicle.[74] When courts dealt with the various types of step-down provisions introduced by insurers—which allowed insurance companies to treat different categories of insureds differently, though they were still recognized as insureds under the policy—it resulted in inequity, which is at the heart of many of the decisions that find step-down provisions unenforceable.

B. Step-Down/Drop-Down Provision versus Exclusion

Under general contract principles, a meeting of the minds is a necessary step to creating an enforceable contract, including insurance contracts, that requires an understanding of the terms in the contract by both parties.[75] This is important because when insurance terms are not clearly defined within a policy, ambiguities can arise. Therefore, it is important to understand the distinction between an exclusion and a step-down provision for several reasons, including the fact that if an ambiguity is created by the utilization of an improper term, policyholders may not understand the provisions in their policy and the policy will often be interpreted against the maker or insurer in such situations.[76] Thus, for both insureds and the insurance company, an understanding of these terms leads to clarity in the contract and a better comprehension of the policy for both parties.

Exclusion in the context of an insurance contract is defined as an

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[71] *Id.* at 832.

[72] *Id.*

[73] Aubrey v. Harleysville Ins. Cos., 658 A.2d 1246, 1248 (N.J. 1995).

[74] Nationwide Mut. Fire Ins. Co. v. Walls, 858 S.E.2d 150, 151–52 (S.C. 2021).

[75] Samuel C. Damren, *A "Meeting of the Minds": The Greater Illusion*, 15 LAW & PHIL. 271, 271 (1996).

[76] MARTINEZ & RICHMOND, *supra* note 35, at 127 (citing J.A. Brundage Plumbing & Roto-Rooter, Inc. v. Massachusetts Bay Ins. Co., 818 F. Supp. 553 (W.D.N.Y. 1993), *vacated by settlement*, 153 F.R.D. 36 (W.D.N.Y. 1994)).

insurance policy provision that denies coverage for certain perils, persons, or locations.[77] Conversely, a step-down provision does not deny the coverage provided by the policy. Instead, the step-down, sometimes called a drop-down provision, reduces the amount of coverage from the contract value to the statutory minimum of the state as mandated by financial responsibility statutes promulgated by the state's legislative bodies.[78]

There are situations where the policy may contain a provision called an exclusion that functions as a drop-down clause or a step-down provision.[79] In such situations, courts wrestle with both the permissibility and applicability of the exclusion and the step-down provision together and separately. The South Carolina Supreme Court commented on the use of the term "exclusion" instead of "step-down" by the insurer in two separate cases.

In *Williams,* where the insurer referred to the provisions in the policy at issue as "family exclusions," the court noted that the provisions were more accurately termed step-down provisions because they did not eliminate the coverage completely but rather reduced it.[80] Also, in *Walls*, where the court explained that while the insurer "characterized the provisions as exclusions, they are more appropriately denominated as step-downs since, in the event the provisions are triggered, [the insurer] is obligated to pay the mandatory minimum limits rather than the liability limit for the parties contracted."[81]

This distinction is important for two reasons: (1) when both the exclusion and the step-down provision are applied, the consequence can result in insureds being completely excluded from coverage under one part of their policy and then having the coverage reduced under another;[82] and (2) when insurers refer to step-down provisions as exclusions, they often appear and are mislabeled under the heading of "EXCLUSIONS IN YOUR POLICY" when in fact, they are not exclusions at all.[83] This can lead to insureds not knowing or understanding what and where to find these provisions in their policy. Using the correct terminology is even more important because generally insurance policies are delivered after the insured has purchased the coverage, and policyholders would not look for a provision that reduces coverage in a place where the provision excludes coverage under the Exclusions heading. Therefore, in order for insureds to notice the presence and to understand the impact of a step-down provision in their policy, they must know where to find it.

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[77] MARTINEZ & RICHMOND, *supra* note 35, at 866 app. B.
[78] *See supra* Part I.A.
[79] *See* Krause v. Krause, 589 N.W.2d 721, 722 (Iowa 1999).
[80] Williams v. Gov't Emps. Ins. Co. (GEICO), 762 S.E.2d 705, 708 n.2 (S.C. 2014).
[81] Nationwide Mut. Fire Ins. Co. v. Walls, 858 S.E.2d 150, 151 n.1 (S.C. 2021).
[82] *See Krause*, 589 N.W.2d at 726.
[83] *Walls*, 858 S.E.2d at 151 n.1.

III. STATES WHERE JUDICIAL DECISIONS AND STATUTES REJECT STEP-DOWN PROVISIONS

The doctrines and factors states use to evaluate step-down provisions vary depending upon the statutory scheme of the state, the public policy goals articulated by the legislature in adopting legislation, regulations and policies enforced by administrative agencies, and protection of social and ideological values that underpin the role of insurance in society. Of course, historical judicial determination in the jurisdiction regarding the interplay of these concepts and factors almost always directs modern results. Following is a discussion of several examples of various states' determinations that step-down provisions are impermissible or unenforceable. This is not an exhaustive survey but is, instead, a highlighting of select examples of how decisions have been based on the legal doctrines discussed.

A. Doctrine of Reasonable Expectations and Review of the Policy as a Whole

In many states, application of the doctrine of reasonable expectations has invalidated step-down provisions. The doctrine of reasonable expectations is a principle for interpreting insurance contracts that looks to the "reasonable expectations of the insured" as the basis for insurance contract interpretation.[84]

In its strongest form, the doctrine of reasonable expectations goes beyond *contra proferentem*, a traditional rule of interpretation. *Contra proferentem* grants coverage to an insured by construing ambiguous policy language against the insurance company. In contrast, the doctrine of reasonable expectations grants coverage when the insured has an objectively reasonable expectation of coverage even in the absence of ambiguous insurance policy language.[85]

States vary as to their approach on the existence, definition, and application of the doctrine. The broadest application is defined as "[t]he 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."[86] The doctrine is an expansion of the contract principle that

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[84] David J. Seno, *The Doctrine of Reasonable Expectations in Insurance Law: What to Expect in Wisconsin*, 85 MARQ. L. REV. 859, 859 (2002) (quoting Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 970 n.14 (1970)) (internal quotations omitted).

[85] *Id.* (citations omitted).

[86] Keeton, *supra*, note 84, at 967. *See also* Seno, *supra* note 84 ("Under the doctrine of 'reasonable expectations,' courts often grant coverage to an insured even when the express language of the policy does not provide coverage.").

contract ambiguities are construed and enforced against the maker.[87] It also recognizes that while insurance carriers have the right to impose reasonable limitations on their coverage, insureds have the right to reasonable expectations about what their policy covers or should cover.[88]

As applied, the reasonable expectations doctrine grants coverage when the insured has an objectively reasonable expectation of coverage, even in the absence of an ambiguity.[89] Also, the concept relies on the premise that an insurer owes an implied duty to the insured of good faith and fair dealing arising out of the contract.[90]

Courts are divided as to whether there is a "duty to satisfy the reasonable expectations of the insured" and whether that duty "evolves from the insurance contract, from the contractual relationship between the parties, or from some other body of law."[91] However, the doctrine has been argued successfully as a basis for finding coverage in policies when the provisions are confusing, conflicting or even expressly prohibit coverage.[92]

1. Colorado

Colorado case law provides an excellent example of the application of the doctrine of reasonable expectations to invalidate a step-down provision in an automobile policy. In *Shelter Mutual Insurance Co. v. Mid-Century Insurance Co.*, the Colorado Supreme Court addressed the issue of sufficiency of the notice to the insured by the insurer of the step-down provision included in an insurance policy.[93] The insured in the case renewed his policy shortly before the accident involving the covered vehicle driven by a permissive user occurred. The insurer included a permissive user step-down provision in the renewal policy that was not present in the original policy that reduced coverage to the statutory minimum for permissive users.[94] The declarations page for the renewed policy listed the coverage at $50,000 per person and $100,000 per occurrence, as was the coverage in the original policy.[95] The court noted that in general when an insurer seeks to restrict coverage, it must not only use "clear and unequivocal language[,]"

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[87] Seno, *supra* note 84, at 865.

[88] *Id.* at 867 (arguing that the doctrine of reasonable expectations is adopted by some courts to avoid an unfair result when insureds believe they have coverage).

[89] *Id.*

[90] Crisci v. Sec. Ins. Co. of New Haven, Conn., 426 P.2d 173, 176 (Cal. 1967); Tyger River Pine Co. v. Md. Cas. Co., 170 S.E. 346, 348 (S.C. 1933).

[91] Willy E. Rice, *Judicial Bias, the Insurance Industry and Consumer Protection: An Empirical Analysis of State Supreme Courts' Bad-Faith, Breach-of-Contract, Breach-of-Covenant-of-Good-Faith and Excess-Judgment Decisions, 1900-1991*, 41 CATH. U. L. REV. 325, 335 (1992).

[92] Seno, *supra* note 84, at 863.

[93] Shelter Mut. Ins. Co. v. Mid-Century Ins. Co., 246 P.3d 651, 655 (Colo. 2011).

[94] *Id.* at 656.

[95] *Id.*

but also "must call such limiting conditions to the attention of the insured."[96]

Further, the Colorado Court of Appeals acknowledged the "long-standing general principle applicable to insurance policies that an insurance company is bound by greater coverage in an earlier policy when a renewal policy is issued but the insured is not notified of the specific reduction in coverage[,]" especially if the limitation first appears in a renewal policy, as it did in *Shelter.*[97] In determining that the insurer failed to give the insured adequate notice of the step-down provision that reduced his coverage for permissive users, the court in *Shelter* found that the insurer failed the notice requirement in several ways, including: (1) failing to give notice to the policyholder of the specific pages where the coverage changed, (2) failing to state the specific amount to which the coverage would be reduced, rather only stating it would be reduced to the "minimum limits of liability insurance coverage" as mandated by statute, and (3) that the declarations page continued to list the same higher levels of coverage, inducing the insured into believing he was getting the same amount of insurance as his previous policy had provided.[98] Therefore, the court invalidated the permissive user step-down provision on the basis that it violated the doctrine of reasonable expectations of what an insured would expect, particularly when renewing a policy that previously did not contain the step-down provision.[99]

The example in *Shelter* addresses a renewal situation as the facts present. Nonetheless, the case provides several instances where the court determined that the insurer failed to give adequate notice to the insured of the inclusion of the step-down provision. Recognizing that the insurer owes a duty to notify the policyholder of the presence and consequences of the step-down provision, the court determined that the insured would expect to have the same coverage as he had previously since the insurer failed to give notice of the change. Accordingly, applying the doctrine of reasonable expectations, the provision was ruled unenforceable.

2. Kentucky

In another case involving the same insurer from the Colorado case discussed above, in *Shelter Mutual Insurance Co. v. Mid-Century Insurance Co.,* the Kentucky Supreme Court decided whether the permissive user step-down provision in an automobile policy was "sufficiently conspicuous, plain and clear to satisfy the doctrine of reasonable expectations."[100] In this case, Danielle Bidwell was seriously injured in a single-vehicle accident

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[96] *Id.* at 657.

[97] Tepe v. Rocky Mountain Hosp. & Med. Servs., 893 P.2d 1323, 1328 (Colo. App. 1994) (quoting Davis v. United Servs. Auto. Ass'n, 273 Cal. Rptr. 224, 230 (Cal. Ct. App. 1990)).

[98] *Shelter*, 246 P.3d at 656–58.

[99] *Id.* at 659.

[100] Bidwell v. Shelter Mut. Ins. Co., 367 S.W.3d 585, 586 (Ky. 2012).

while riding as a passenger in a car operated by Joshua Tarlton.[101] Tarlton was a permissive user of the automobile of the owners and named insureds.[102] Tarlton had no other automobile insurance coverage.[103] The automobile in the accident was insured for $250,000 per person and $500,000 per accident.[104] The insurer applied the permissive user step-down provision in the insured's policy and reduced the coverage to the statutory minimum of $25,000.[105]

Deciding that the specific language and organization in the policy was at issue, the Kentucky Supreme Court carefully reviewed both the language and placement of the step-down clause in the policy and noted that the manner in which the policy is structured is relevant with respect to whether an ambiguity exists.[106] Additionally, the court reiterated Kentucky law with regard to the doctrine of reasonable expectations, explaining that "[t]he gist of the doctrine is that the insured is entitled to all the coverage he may reasonably expect to be provided under the policy. Only an unequivocally conspicuous, plain and clear manifestation of the company's intent to exclude coverage will defeat that expectation."[107]

The court held that the step-down provision violated the doctrine of reasonable expectations for several reasons including that "the [d]eclarations page [was] silent with respect to any limitation included later in the policy, even though the step-down provision radically limits the amount of coverage that is listed on that page."[108] Also, the court determined that the step-down provision was mentioned in limited and confusing terms.[109] Specifically, the court found the provision particularly confusing when it reduced the coverage to some indeterminate figure based on an ambiguous reference to an amount of some financial responsibility law applicable to the accident.[110] Relying on the coverage as outlined on the declarations page, the court determined that it created a reasonable expectation that the amounts listed therein, including $250,000 for bodily injury, were available to individuals injured in the covered automobile, regardless of who was driving.[111] However, the court did not hold that the $25,000 figure in the Kentucky statute setting the statutory minimum for coverage "must be included in the step-down provision, only that the insurer must clearly inform the insured how coverage for permissive users is

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[101] *Id.*
[102] *Id.*
[103] *Id.*
[104] *Id.*
[105] *Id.*
[106] *Id.* at 589.
[107] *Id.* (citing Simon v. Cont'l Ins. Co., 724 S.W.2d 210, 212 (Ky. 1986).
[108] *Id.*
[109] *Id.*
[110] *Id.* at 590.
[111] *Id.* at 590–91.

limited."[112]

Kentucky's approach to the doctrine of reasonable expectations to reject a step-down provision found to be ambiguous is grounded in a reading of the contract as a whole and the requirements that a contract must properly inform the insured of coverage.[113] Accordingly, insurance policies must sufficiently inform the policyholder of the function of the step-down clause or how the reduction is determined.[114] While Kentucky law approaches the doctrine through an analysis of whether an ambiguity exists and therefore a narrow lens, the Kentucky Supreme Court also reviewed the policy language and placement and considered the importance of the declarations page as a place where insureds look to confirm the coverage they purchased and determined that policyholders should be able to reasonably rely on that language to evaluate their coverage.[115]

In both cases involving Shelter Mutual, the Colorado court and the Kentucky court considered the importance of the declarations page to insureds in understanding their coverage.[116] Often, the insurance company asks policyholders to confirm their coverage by reviewing their declarations page.[117] Therefore, it seems advisable that arguments against the enforceability of the step-down clause under reasonable expectations doctrine ought to include reference to what role the declarations page plays in the placement of the coverage and what notice, if any, is included in the declarations page of a step-down provision in the policy.[118]

B. Step-Down Provision Complies with Public Policy, Unless Legislature Determines Otherwise via Statute

1. Illinois

The decision of the Illinois Supreme Court in *State Farm Mutual Automobile Insurance Co. v. Illinois Farmers Insurance Co.* presents the unique situation where the state legislature responded to the inequities created by step-down provisions after judicial notice (arguably an invitation to act) regarding the General Assembly's authority to promulgate statutes that reflect more equitable outcomes.[119] In *State Farm Mutual Automobile Insurance Co.*, the Illinois Appellate Court found that clauses in an insurance policy that limit the eligibility limits for permissive drivers only up to the limits of the Financial Responsibility Law were not contrary to public

[112] *Id.* at 593.
[113] *See id.* at 589.
[114] *Id.* at 593.
[115] *Id.* at 591.
[116] *Id.* at 589–90; Shelter Mut. Ins. v. Mid-Century Ins. Co., 246 P.3d 651, 659 (Colo. 2011).
[117] *Bidwell*, 367 S.W.3d at 591.
[118] *See id.*
[119] State Farm Mut. Auto. Ins. Co. v. Ill. Farmers Ins. Co., 875 N.E.2d 1096, 1096 (Ill. 2007).

policy.[120] The court also held that since the responsibility of setting the liability limits for permissive drivers in insurance contracts is a matter within the exclusive province of the state legislature, the court could only enforce the contractual terms of the policy and permit the insurer to apply the step-down provision for permissive drivers.[121]

The result led the Illinois legislature to question whether step-down provisions or even exclusions of coverage can be applied to permissive users, including permissive non-household family occupants of covered vehicles. So, under Illinois law, step-down provisions were initially found to not offend the public policy of this state.[122] However, after contemplating the question of equity, the Illinois General Assembly was quick to amend the statutes and adopted a revised version, which required that all policies for private passenger automobiles provide "the same limits of bodily injury liability, property damage liability, uninsured and underinsured motorist bodily injury, and medical payments coverage to all persons insured under that policy, whether or not an insured person is a named insured or a permissive user."[123]

Thereafter, the insurer attempted to exclude coverage for non-family, non-household passengers under an exclusion. This exclusion was similar to guest statutes that limited the amount recoverable by passengers in automobiles in accidents resulting from simple negligence on the part of the driver.[124] Historically, insurers argued for the adoption of guest statutes for the same reasons insurance companies currently assert a need for family step-down provisions: to protect insurance companies from collusive and fraudulent suits.[125] Guest statutes have been abolished in most states for the same reasons that perhaps step-down provisions should be.[126]

The Illinois Supreme Court contemplated the question that while step-down provisions with regard to permissive drivers were void, could the insurer insert a provision that excluded permissive *occupants*? While not a step-down provision specifically, the insurer attempted to exclude coverage for persons who would otherwise be insureds under the policy. Thus, it is

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[120] *Id.* at 1103.

[121] *Id.*

[122] *Id.* at 1100.

[123] 215 ILL. COMP. STAT. 5/143.13a (2008); Schultz v. Ill. Farmers Ins. Co., 930 N.E.2d 943, 953, n.1 (Ill. 2010).

[124] JERRY & RICHMOND, *supra* note 52, at 810.

[125] Lewis by Lewis v. West Am. Ins. Co., 927 S.W.2d 829, 831–32 (Ky. 1996) (describing the history of guest statutes).

[126] *See, e.g.*, Brown v. Merlo, 506 P.2d 212 (Cal. 1973) (finding the state guest statute violated equal protection guaranteed by the California and United States Constitutions); Henry v. Bauder, 518 P.2d 362 (Kan. 1974) (holding the state guest statute invalid as violation of equal protection of the laws); McGeehan v. Bunch, 540 P.2d 238 (N.M. 1975) (holding the state guest statute was an unconstitutional denial of equal protection); Whitworth v. Bynum, 699 S.W.2d 194 (Tex. 1985) (holding the state guest statute was unconstitutional); Malan v. Lewis, 693 P.2d 661 (Utah 1984) (holding the state guest statute to be unconstitutional).

instructive to analyze how the court dealt with the distinction between permissive drivers and permissive occupants as it provides an argument against the use of step-down provisions.

The court addressed this issue in *Schultz v. Illinois Farmers Insurance*,[127] and held insurance companies cannot exclude permissive passengers from qualifying as insured parties under a primary auto liability policy's coverage for Underinsured Motorists ("UIM") because the exclusionary practice violated section 5/143a–2(4) of the Illinois Compiled Statutes ("ILCS").[128] The court considered the issue of whether Illinois law permitted insurers to issue motor vehicle liability policies in which occupants of a covered vehicle are afforded uninsured motorist ("UM") coverage but excluded from UIM coverage.[129]

In *Schultz*, the case arose from an automobile accident involving a vehicle driven by Kathleen O'Conner and owned by the Hummelbergs that was struck by a vehicle driven by Alexandria Fotopoulos.[130] Patricia Smetana was a passenger in O'Conner's car.[131] Neither she nor O'Conner were related to the Hummelbergs.[132] Both women were injured, and Smetana later died from her injuries.[133] Kenneth Schultz was then appointed administrator of Smetana's estate.[134] Farmers Insurance Company ("Farmers") insured Fotopolou's vehicle and the laws of Illinois governed.[135] The policy contained liability limits of $100,000 per person and $300,000 per accident.[136] Farmers settled the liability claim with both O'Conner and Smetana's estate for the policy limits.[137]

Farmers also insured the Hummelbergs' vehicle, but it had higher coverage limits of $250,000 per person and $500,000 per accident for bodily injury, UM coverage, and UIM coverage.[138] O'Conner and Smetana's estate each filed claims against Farmers requesting additional compensation

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[127] *Schultz*, 930 N.E.2d at 943 (Ill. 2010).

[128] *See id.* at 953; *see* 215 ILL. COMP. STAT. 5/143a-2(4) (2020) ("For the purpose of this Code the term 'underinsured motor vehicle' means a motor vehicle whose ownership, maintenance or use has resulted in in bodily injury or death of the insured, as defined in the policy, and for which the sum of the limits of liability under all bodily injury liability insurance policies . . . required to maintained under Ill. law applicable to the driver or to the person responsible for such vehicle...and applicable to the vehicle, is less than the limits for underinsured coverage provided the insured as defined in the policy at the time of the accident.")

[129] *Schultz*, 930 N.E.2d at 945.

[130] *Id.*

[131] *Id.* at 945–46.

[132] *Id.* at 946.

[133] *Id.*

[134] *Id.*

[135] *Id.*

[136] *Id.*

[137] *Id.*

[138] *Id.*

under the policy's UIM provisions.[139] Those claims were denied based on policy language pertaining to UIM coverage.[140]

The *Schulz* court explained:

For purposes of UM coverage, the policy defined an "insured person" as the person to whom the policy was issued, a family member, or "[a]ny other person while occupying the car described in the policy." With respect to the UIM coverage, however, the definition of "insured person" omitted occupants of the car. The policy purported to limit UIM coverage to the person to whom the policy was issued or a family member. Because O'Conner and Smetana were not among the persons to whom the Hummelbergs' policy had been issued and were not members of the family of any such person, they could not meet the UIM provision's more restrictive definition. For this reason, their claims were denied.[141]

In considering the case on appeal, the Illinois Supreme Court addressed the question of whether different classes of individuals, here UM and UIM claimants, could be treated differently. The court addressed both *Schultz* and *Weglarz.*[142] Simultaneously, both contemplated permissive user occupants: non-family in *Shultz* and non-resident family occupants of a covered automobile and the denial of UIM coverage in *Weglarz.* In *Weglarz*, a non-household family member occupant (non-resident mother of insured) of a covered automobile was injured in an accident where the vehicle was driven by the named insured.[143] After receiving the liability coverage from the tortfeasor, Weglarz sought coverage under the UIM coverage on the car she occupied.[144] The coverage on the car for UIM was $50,000 per person and $100,000 per occurrence.[145] Since "occupants" was omitted in the definition of "insured" under both the *Schultz* Farmers policy and the *Weglarz* Farmers policy, the insurer denied the UIM claims in both cases.[146]

The Supreme Court of Illinois addressed two issues regarding permissive occupants: (1) whether permissive occupants are contemplated within the definition of permissive users; and (2) whether insurers can treat UM insureds differently from UIM insureds.[147] In addressing the first issue, the court first stated that if insurance terms are clear and unambiguous, they must be enforced unless they violate public policy.[148] Reiterating that public policy is determined by the constitution, statutes, and judicial decisions, and

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[139] *Id.*
[140] *Id.*
[141] *Id.*
[142] Schultz v. Ill. Farmers Ins. Co, 901 N.E.2d 957 (Ill. App. Ct. 2009) [hereinafter *Weglarz*].
[143] *Schultz*, 930 N.E.2d at 946; *Weglarz*, 901 N.E.2d at 959. Weglarz was the mother of the insured but did not reside in the same household. *Id.* at 960.
[144] *Schultz*, 930 N.E.2d at 946–47.
[145] *Id.* at 947.
[146] *Id.*
[147] *Id.* at 949.
[148] *Id.*

that terms of an insurance policy that conflict with statutes are void and unenforceable, the court addressed whether "users" included "occupants."[149] Under Illinois law, insurance policies are required to provide certain liability minimum amounts and must "insure not only the persons named in the policy but also 'any other person using or responsible for the use' of the subject vehicle with the express or implied permission of the insured."[150] Since the language of the statute did not refer to "permissive drivers" but rather "permissive users," and giving the language its plain and ordinary meaning, the court determined that "permissive occupants" fell within the definition of "permissive users" because the occupants are also "using" the covered vehicle at the time of the accident.[151] Therefore, insurers could not exclude non-resident family or non-family member occupants from coverage pursuant to the statutory language.[152]

As to the second issue of whether insurers can treat UM coverage differently from UIM coverage, the court noted that the ILCS required that if the liability coverage exceeded the statutory minimum, the UM provisions must provide the same higher coverage amounts and must extend to all who are insured under the policy's liability provisions unless the insured makes a written election for less.[153] In addition to providing UM coverage, motor vehicle liability policies in Illinois are also required to provide UIM coverage where the UM coverage exceeds the statutory minimums required for liability bodily injury and must extend coverage outlined by the policy.[154] Finding that UM and UIM are "inextricably linked," the court held that insurers must treat an insured the same under UM and UIM coverage.[155] Further, the court concluded that public policy considerations warrant treating UM and UIM coverage the same.[156]

Opposing this result, Farmers argued that because the coverage listed on the declarations page was the same for liability, UM, and UIM, it met the statutory requirement on its face. They further argued the insurer could then reduce the coverage pursuant to a provision in the policy and therefore not violate the statutory language.[157] However, the court rejected Farmers' argument because it would render the statute meaningless and ignore the

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[149] *Id.*
[150] *Id.* (citing 625 ILL. COMP. STAT. 5/7–203, 7–317(b)(3) (2004)).
[151] *Id.* at 949–50.
[152] *Id.* at 950.
[153] *Id.*
[154] *Id.* at 951.
[155] *Id.*
[156] *Id.* (explaining that because uninsured and underinsured motorist policies provide virtually the same coverage to the insured, it would be anomalous to declare insureds ineligible for any UIM benefits under circumstances where they would be entitled to full UM benefits but for the fact that the tortfeasor had minimal insurance rather than none at all. This result would be directly contrary to the legislature's intent when it enacted section 143a–2 of the Illinois Insurance Code.)
[157] *Id.* at 951.

legislative intent to cover permissive users, including permissive occupants, when they are injured while occupying a covered vehicle.[158] Therefore, the court found the provisions of the policy that attempted to exclude permissive occupants as insureds or exclude UIM coverage while providing UM coverage, void and unenforceable under Illinois law.[159]

Shultz, *Weglarz,* and the history of this issue in Illinois illustrate how important statutory language can be in addition to acting as a prerequisite for a court's willingness to reject enforcement of step-down provisions. Interestingly, the insurer in both Illinois cases argued that because the declarations page provided by the insurer listed equal coverage for UM and UIM claimants, it satisfied the statutory requirements on its face, and therefore it could reduce or exclude the coverage for UIM claimants later in the policy and still remain in compliance with the statutory scheme. The Illinois Supreme Court recognized that if it were to accept the insurer's argument that the declarations page met the language of the statute, while the function of the policy was to violate it, the practice would undercut the purpose and legislative intent in adopting the statute to protect insureds and innocent parties by allowing the insurer to meet the requirement in one place, only to violate the statute in another with a provision that treated claimants differently.

2. South Carolina

Two South Carolina cases, including the *Walls* decision highlighted in the Introduction to this Article, look at statutory language and step-downs as framed by the actions or inactions of the state legislature to evaluate when a step-down provision may be enforced.[160] The Illinois legislature reacted to the judicial decision regarding step-down provisions by quickly adopting new statutory language that required the same limits of liability, uninsured, and underinsured motorist bodily injury to all persons insured whether or not an insured person is a named insured or a permissive user.[161] In contrast, when faced with an opportunity to react to or clarify the holding in *Williams* with a statutory change, the South Carolina legislature took no action. This inaction was interpreted by the Supreme Court of South Carolina as the legislature's condonation of the holding in *Williams*. In other words, the court determined that the failure of the South Carolina legislature to act in response to its decision in *Williams v. GEICO*[162] indicated the General Assembly's assent to its analysis of the statute, which precluded step-down

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[158] *Id.*

[159] *Id.*

[160] Nationwide Mut. Fire Ins. Co. v. Walls, 858 S.E.2d 150, 153 n.3 (S.C. 2021) (stating that petitioners abandoned the public policy argument and therefore did not explicitly decide the case on the basis of a violation of public policy); Williams v. Gov't Emps. Ins. Co. (GEICO), 762 S.E.2d 705, 705 (S.C. 2014).

[161] 15 ILL. COMP. STAT. 5/143.13a (2008); *Schultz*, 930 N.E.2d at 953 n.1.

[162] *Williams*, 762 S.E.2d at 705.

provisions under South Carolina law.[163]

In *Williams*, the personal representatives for the estates of Edward and Annie Mae Murry brought actions to obtain the full coverage of a policy owned by the Murrys in the amount of $100,000 in liability proceeds for bodily injury instead of the statutory minimum when the insurer applied a family step-down provision.[164] The Murrys, who were husband and wife, were the only named insureds on the policy when their insured motor vehicle was struck by a train, killing both.[165] It was unknown who was driving the vehicle at the time of the accident.[166] The insurer took the position that since the actual driver could not be determined, both the husband and the wife were subject to the family step-down provision included in the exclusions portion of the policy and attempted to pay the estates $15,000 each, which was the statutory minimum at the time.[167]

The Supreme Court of South Carolina first addressed the issue of ambiguity, and while finding the language of the policy and placement of the step-down provision "not artfully worded," it did not find the policy to be ambiguous.[168] The court then addressed the public policy argument. The court noted that "[w]hile parties are generally permitted to contract as they see fit, freedom of contract is not absolute and coverage that is required by law may not be omitted." The court held that the family step-down provision that reduced the coverage from the stated policy amount to the statutory minimum violated public policy and was therefore void.[169] The court further stated that the provision not only conflicted with the mandates set forth in the statutory construction requiring certain provisions in insurance policies, but also its enforcement would be injurious to the public welfare.[170]

After *Williams*, insurers in South Carolina attempted to enforce other kinds of step-down provisions different from the family step-down clause contemplated in that case. Then, in 2021, the Supreme Court of South Carolina decided *Walls*, wherein the court addressed the viability of a felony step-down provision under South Carolina law.[171] The analysis begins with the court noting the distinction between the family step-down provision contemplated in *Williams* and the felony step-down provision at issue in *Walls* but applying a similar understanding of South Carolina insurance law in reaching its decisions.[172] In reviewing the same statutory provisions, the court held that it made no distinction between mandatory minimum

[163] *Walls*, 858 S.E.2d at 154–55.
[164] *Williams*, 762 S.E.2d at 708.
[165] *Id.*
[166] *Id.*
[167] *Id.*
[168] *Id.* at 711.
[169] *Id.* at 717.
[170] *Id.*
[171] Nationwide Mut. Fire Ins. Co. v. Walls, 858 S.E.2d 150, 150 (S.C. 2021).
[172] *Id.* at 153.

coverage and excess coverage with regard to mandatory provisions required in a policy, including a prohibition on provisions that reduce coverage from the face amount.[173]

In applying the same logic and reasoning in determining *Williams*, the court held the felony step-down provision at issue in *Walls* violated statutory language and the legislative intent to frame public policy on this issue.[174] Specifically, the court applied the same interpretation of the statutory language in *Williams* to determine that South Carolina Code of Laws ("South Carolina Code") section 38-77-142(C) prohibits any step-down provision in a liability policy's coverage.[175] Nationwide presented an argument similar to that of the insurer in *Hardware Mutual Casualty Co. v. General Accident Fire and Life Assurance Corp.*,[176] and it argued that the statute operated as a mere omnibus provision defining who must be covered in a liability policy.[177] Nationwide also argued that other provisions of the South Carolina Code permitted limitations on excess coverage so as to render section 38-77-142(C) inapplicable.[178]

The *Walls* court determined that to give credence to Nationwide's argument would invalidate section 38-77-142(C) completely.[179] The legislature had not altered or amended the statue in response to the *Williams* decision, so the court interpreted the inaction as the legislature's intent to recognize the validity and purpose of section 37-77-142(C).[180] Additionally, the majority took note that in reaching its decision in *Walls*, it was merely remaining faithful to the language of the statute as interpreted in *Williams*, "which the General Assembly has seen fit not to alter . . . ."[181]

In deciding *Walls,* the Supreme Court of South Carolina determined that interpretation of the legislative intent regarding the impropriety of step-down provisions was set forth in *Williams* and remained unchanged regardless of the attempt by the insurer to insert the narrower felony step-down clause. In an unequivocal indication of its rejection of step-down provisions, the court reviewed the legislative intent underlying the statutory scheme, and "the legislature's recognition of the role [that] notice provisions play in insurance contracts."[182] The court further stated that the specific language of the statute adopted by the legislature to protect the public recognized that once an insurer placed required provisions in the policy with agreed-upon limits of coverage, any attempt by the insurer to reduce the

[173] *Id.* at 154.
[174] *Id.*
[175] *Id.*
[176] Hardware Mut. Cas. Co. v. Gen. Accident Fire & Life Assurance Corp., 188 S.E.2d 218, 221 (Va. 1972).
[177] *Walls*, 858 S.E.2d at 153.
[178] *Id.* at 154.
[179] *Id.*
[180] *Id.*
[181] *Id.* at 155 n.4.
[182] *Id.* at 153.

coverage would be void.[183] These South Carolina cases provide good examples of how the judiciary identifies public policy by reviewing the legislative intent in passing legislation, as well as reviewing the specific language in the statute to determine the role policy plays in framing the purpose and intent behind the legislation.

3. Utah

Utah is another state where step-down provisions have been found to violate statutory provisions. In *Shores v. Liberty Mutual*,[184] the Utah Court of Appeals held that a family step-down provision in the policy, called a "household exclusion," violated the statutory definition of an insured and disallowed different treatment between insureds.[185] Additionally, the court noted that a step-down provision is one in which "the coverage 'steps down' from the actual policy limits to the minimum required by the statute[,]" and while labeled an exclusion, it reduced the coverage and functioned as a step-down provision.[186] Under the Utah Code, the court found the step-down provision was expressly prohibited by the statutory language.[187] Specifically, the court noted that the statute states that:

> [W]here a claim is brought by the named insured or a person described in [s]ubsection (1)(a)(iii), the available coverage of the policy may not be reduced or stepped down because . . . the named insured or any of the persons described in this [s]ubsection (a)(1)(iii) driving a covered motor vehicle is at fault in the accident.[188]

The court further observed that pursuant to the statute, those persons described in subsection (a)(1)(iii) are "persons related to the named insured . . . ."[189] Specifically, the policy stated:

> [Liberty Mutual] will pay for 'bodily injury' . . . for which any 'insured' becomes legally responsible because of an auto accident, ...
>
> [t]he following exclusion is added:

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[183] *Id.*
[184] Liberty Mut. Ins. Co. v. Shores, 147 P.3d 456 (Utah Ct. App. 2006).
[185] *Id.* at 458.
[186] *Id.* at 458 n.4 (quoting 1 ROWLAND H. LONG, THE LAW OF LIABILITY INSURANCE § 2.05[5] (2003)).
[187] *Id.* at 459.
[188] *Id.*
[189] *Id.* at 459–60.

> [Liberty Mutual] do[es] not provide Liability Coverage for any 'insured' for 'bodily injury' to you to the extent that the limits of liability for this coverage exceed the applicable minimum limits for liability specified by UTAH CODE ANN. Section 31A-22-304.[190]

The Shores were an elderly couple who were involved in an auto accident while Mr. Shores was driving, and he was primarily at fault.[191] Mrs. Shores was severely injured and permanently disabled as a result of the accident and sought to recover $100,000 under the liability coverage of their policy.[192] Liberty Mutual applied the household exclusion and reduced the coverage to the statutory minimum of $25,000.[193] The court determined that the Utah Code prohibited the application of the family step-down provision "where a claim is brought by the named insured or a [household family member] . . . the available coverage of the policy may not be reduced or stepped-down because . . . the named insured or any [household family member] . . . driving a covered motor vehicle is at fault in causing an accident."[194]

In reviewing the legislation, the court emphasized the legislature's concern that insurance companies were providing minimum liability insurance to family members even though the premiums were paid for a much higher level of coverage, and to address this, the Utah legislature specifically included the words "stepping down" to ensure household step-down provision violated the statute.[195] Oddly, Utah seems to be one of the few states that expressly prohibit family step-down provisions by statute. There are, however, other states that interpret statutory language to exclude step-down provisions from being applied, such as Wisconsin.[196] However, as the *Shores* court stated, the Utah legislature, using specific language, intentionally addressed that step-down clauses violated Utah law in adopting legislation to prohibit their use.[197]

4. Wisconsin

Similar to the issues raised in *Schultz* and *Weglarz* under the Illinois statutes, the Wisconsin Supreme Court contemplated whether an automobile policy could treat insureds with different amounts of coverage based upon the insured's classification, which in function amounted to a

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[190] *Id.* at 458.
[191] *Id.*
[192] *Id.*
[193] *Id.*
[194] *Id.* at 459.
[195] *Id.* at 460.
[196] WIS. STAT. ANN. § 632.32(6)(b) (West 2022).
[197] *Liberty*, 147 P.3d at 460–61.

step-down clause. In *Smith v. National Indemnity Co.*,[198] the insured's policy provided limits of $10,000 per person, $20,000 for individuals who rented a car but provided $100,000 per person, $300,000 per occurrence for the named insured.[199] The issues before the court were whether the omnibus coverage statute applied and whether the coverage for the named insured extended to the renters of the cars.[200] The Wisconsin omnibus statute provided that "no policy of insurance shall be issued or delivered . . . unless it contains a provision reading substantially" that policies must treat and apply "in the same manner and under the same provisions" to the named insured, and to "any person or persons while riding in or operating any automobile described in this policy . . . ."[201]

The Wisconsin Supreme Court interpreted this statutory language to preclude insurers from issuing a policy that granted higher dollar limits of protection to the named insured than to car renters.[202] Specifically, the court held that when the "omnibus statute speaks of the indemnity which must be extended, it is speaking of both coverage in a limited sense and limits of liability . . . ."[203] Therefore, the court found that the insurer could not issue a policy granting higher dollar limits of protection to the named insured than it did to car renters.[204] In other words, the provision in the policy acted as a step-down clause that reduced coverage for automobile renters below those applicable to named insureds and therefore violated the statutory language and thus was impermissible under Wisconsin law. This again is an example where a state court determined that provisions that act like step-down clauses to reduce coverage that apply to different classes of insureds within a policy are impermissible and violate statutory requirements defining who an insured is.

5. Virginia

In *Hardware Mutual Casualty Co. v. General Accident Fire and Life Assurance Corp.*,[205] the Virginia Supreme Court held that step-down provisions violate applicable provisions of the Virginia Code.[206] In *Hardware Mutual*, the issue before the court was whether the "special provisions limiting the amount of coverage on certain insureds were in conflict with the" state omnibus statute.[207] Ultimately, the court ruled broadly that each

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[198] Smith v. Nat'l Indem. Co., 205 N.W.2d 365 (Wis. 1973).
[199] *Id.* at 366.
[200] *Id.*
[201] *Id.* at 367.
[202] *Id.* at 369.
[203] *Id.*
[204] *Id.*
[205] Hardware Mut. Cas. Co. v. Gen. Accident Fire & Life Assurance Corp., 188 S.E.2d 218 (Va. 1972).
[206] *Id.* at 221.
[207] *Id.* at 220.

policy of automobile liability insurance in the state of Virginia must furnish a permissive user the same coverage as is afforded the named insured.[208]

James Brown purchased an automobile, and after the dealer delivered it, he permitted his brother, Persell Brown to operate it.[209] Persell Brown was then involved in an accident, injuring another driver.[210] The trial court determined that Persell was a permissive user of the automobile.[211] The insurer argued that if Persell was a permissive user, thus an insured within the terms of its policy, the limit of the liability was $15,000 (the statutory minimum at the time) and not the $300,000 provided to the named insured under the policy.[212]

The insurer asserted that the step-down provision did not violate the Virginia omnibus statute because the clause provided the "permissive user the same quality of coverage but not necessarily the same quantity of coverage extended [to] the named insured."[213] The insurer also argued that since it recognized the permissive user as an insured under the policy and provided *some* coverage to these individuals, it satisfied the omnibus statute that required insurers to include permissive users as insureds, thereby providing the "quality" of coverage to the permissive user as an insured.[214] Finally, the insurer claimed it was entitled to provide a different *quantity* of coverage to these claimants and thus treat insureds, named insureds and permissive users, differently by applying different limits of coverage to each based upon the classification.[215]

Upon review of the omnibus statute, the court found that the statute requires each policy of automobile liability insurance to furnish a permissive user the same coverage as is afforded the named insured.[216] Further, the court held that the coverage at issue applied to the quantity of coverage as well as the quality of coverage, and, therefore, "[t]he permissive user is entitled to the identical protection in every respect to which the named insured is entitled."[217]

In reaching its decision, the Virginia Supreme Court responded to the insurance company's argument that ruling for the insured would undermine the intent and purpose of the statutes to provide equal coverage to those identified as insureds.[218] Rather than ascertain the intent of the legislature, the court focused on the language of section 38.1-381(a), specifically the

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[208] *Id.* at 221.
[209] *Id.* at 219.
[210] *Id.*
[211] *Id.* at 220.

[212] *Id.*
[213] *Id.* at 221; *see also* VA. CODE ANN. § 38.2-2204 (discussed as the section read in 1965).
[214] *Hardware*, 188 S.E.2d at 221.
[215] *Id.*
[216] *Id.*
[217] *Id.*
[218] *Id.*

words "same coverage."[219] The court stated that "[w]ithout question, the words Same coverage as used above apply to the quantity of coverage as well as the quality of coverage."[220] Accordingly, the court emphasized, "[t]he permissive user is entitled to the identical protection in every respect to which the named insured is entitled."[221] Thus so holding, the Virginia Supreme Court endorsed the public policy goal of equity in insurance which starts with the premise that policyholders should be treated without unfair discrimination.[222]

C. Step-Down Provision Violates Public Policy

Public policy analysis is a cornerstone of many judicial decisions regarding the applicability of and enforceability of insurance policies.[223] Specifically, courts have held that public policy dictates that "every insured, as defined in the policy, is entitled to recover under the policy for damages he would have been able to recover against the negligent motorist if that motorist had maintained a policy of liability insurance."[224] As the cases indicate, courts conclude that step-down provisions public policy when the clause offends the legislative intent in adopting mandatory financial responsibility coverage statutes and omnibus clause provisions that define who is an insured, when the provision transgresses regulatory goals of protecting insureds, or when those policies provide less uninsured motorist coverage than required by statute.

1. Washington

In an early case addressing a family or household exclusion that laid the groundwork for many judicial decisions that ruled that family step-down provisions violated public policy, the Washington Supreme Court affirmed the court of appeals' decision that a family exclusion provision was void as against public policy.[225] The case involved a wife, who was injured while riding with her husband on an insured motorcycle.[226] The husband was negligent in the accident that resulted in serious injuries to the wife, who filed a claim for both liability and underinsured motorist coverage from the

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[219] *Id.*
[220] *Id.*
[221] *Id.*
[222] Kimball, *supra* note 37, at 495.
[223] *See, e.g.*, Travelers Indem. Co. v. Garcia, No. 20-14387, 2021 WL 2935425, at *3 (11th Cir. July 13, 2021); Williams v. Gov't Employees Ins. Co. (GEICO), 762 S.E.2d 705, 705 (S.C. 2014); St. Paul Fire & Marine Ins. Co. v. Smith, 787 N.E.2d 852, 855 (Ill. App. Ct. 2003).
[224] *Garcia*, 2021 WL 2935425, at *3.
[225] Mut. of Enumclaw Ins. Co. v. Wiscomb, 643 P.2d 441, 446–47 (Wash. 1982).
[226] *Id.* at 442.

insurer that provided coverage on the motorcycle.[227] The insurer declined both claims and asserted that it owed no coverage under the family exclusion which denied coverage for family members of the named insured.[228] While not a step-down case, the Washington Supreme Court engaged in an instructive and thorough analysis of what and how public policy is determined, which provided later courts with a blueprint to analyze step-down provisions within the context of public policy. Additionally, the court took the opportunity to address issues raised in an amicus curiae brief offered on behalf of the insurer that addressed the insurance company's freedom of contract argument.[229]

First, the court analyzed public policy by reviewing the state's financial responsibility statute, finding that "the statute creates a strong public policy in favor of assuring monetary protection and compensation to those persons who suffer injuries through the negligent use of public highways by others."[230] In order to achieve this goal, the court determined that while the statute did not require mandatory insurance coverage, the legislature demonstrated its intended policy of providing adequate compensation to those injured through the negligent use of the state's highways.[231] The court recognized that the intended purpose of the state's Financial Responsibility Act was for:

> [T]he benefit of owners and drivers of motor vehicles . . . and, more fundamentally, [it is] designed to give monetary protection to that ever changing and tragically large group of persons who, while lawfully using the highways themselves, suffer serious injury through the negligent use of those highways by others."[232]

Additionally, the court addressed the public policy goals underlying the adoption of uninsured motorist coverage and underinsured motorist coverage statutes in Washington, determining that the statutes served both a public safety and a financial security measure by protecting innocent victims and the public treasury because of accidents caused by insolvent drivers who lacked the resources to compensate those they negligently injured.[233] Specifically, the court held that:

> The family or household exclusion clause strikes at the heart of this public policy. This clause prevents a specific class of innocent victims, those persons related to and living with the negligent driver, from receiving financial protection under an insurance

[227] *Id.*
[228] *Id.*
[229] *Id.* at 446.
[230] *Id.* at 442–43.
[231] *Id.*
[232] *Id.* at 443 (quoting LaPoint v. Richards, 403 P.2d 889 (Wash. 1965)).
[233] *Id.* at 443–44.

> policy containing such a clause. In essence, this clause excludes from protection an entire class of innocent victims for no good reason.
>
> This exclusion becomes particularly disturbing when viewed in light of the fact that this class of victims is the one most frequently exposed to the potential negligence of the named insured.[234]

The court distinguished the family exclusion from other exclusions permitted under Washington insurance law that were based upon the risk associated with the operator of the insured vehicle.[235] For example, the court noted differences between this exclusion and provisions that excluded drivers under the age of twenty-five or when the vehicle was driven by a permissive user who was not a resident family member of the named insured.[236] The court found that the family or household exclusion, by contrast, was directed at a class of innocent victims who have no control over the vehicle's operation and who cannot be said to increase the nature of the insurer's risk.[237] Ultimately, the court rejected the rationale offered by insurance companies as a basis for inclusion of the family exclusion that it protected insurers against collusion and fraud by family members and determined that an exclusion that denies coverage when certain victims are injured was violative of public policy.[238]

The court then took the additional step of addressing the argument raised in the amicus curiae brief that asserted by including a family exclusion provision, the parties were merely exercising their rights under freedom of contract principles and that the family or household exclusion merely reflected a choice by the insurer not to accept additional risks which would increase insurance premiums.[239] Insurance companies further argued that if the insured wished to add that additional coverage, she was free to bargain with another insurer who offered such coverage.[240] The court took issue with this argument, finding that (1) there was no guarantee that other "such coverage" was even available in the state, (2) that if the court permitted one insurer to include a family exclusion, then all insurers would include such an exclusion, and (3) that the exclusion affected persons who were in no position to bargain or contract with the insurer; therefore, the freedom of contract argument was unrealistic under the circumstances and without merit.[241] In conclusion, the court determined that the public policy objective

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[234] *Id.* at 444.
[235] *Id.*
[236] *Id.*
[237] *Id.*
[238] *Id.* at 446.
[239] *Id.* at 445.
[240] *Id.*
[241] *Id.* at 445–46.

was to assure compensation to the victims of negligent and careless drivers and that the strength of this public policy would override any freedom of contract analysis.[242]

This case clearly demonstrates a framework for other courts to analyze and assess the conflict a step-down provision creates with the public policy goals of protecting insureds and innocent victims of accidents, as well as addressing the freedom of contract argument offered by insurers as a basis to include these provisions.

2. Kentucky

Perhaps one of the most direct condemnations of step-down provisions appears in *Lewis by Lewis v. West American Insurance Co.*, where the Kentucky Supreme Court determined the invalidity of family or household exclusion clauses contained in an automobile liability policy.[243] The case involved a minor, Angel Lewis, who was a passenger in an automobile owned and operated by her mother, Loretta Lewis.[244] The vehicle collided with an eighteen-wheeler that resulted in the death of Loretta and serious injuries including brain damage to Angel.[245] West American insured the Lewis automobile for liability coverage in the amount of $100,000 per person and $300,000 per occurrence.[246] However, the policy contained an endorsement entitled "Amendment of Policy Provisions—Kentucky" that included a "family exclusion" specifically limited liability coverage for "bodily injury" to the named insured or any family member of the named insured.[247] While the policy and therefore the court referred to the clause as an "exclusion," the provision operated as a family step-down provision that reduced the coverage to the minimum liability coverage statutorily required by the Kentucky Motor Vehicle Reparations Act.[248] Thus, the insurance policy reduced the policy liability coverage to the $25,000 statutory minimum where the injured person is the named insured or a member of a named insured's family regardless of who is driving the automobile.[249]

In reaching its decision, the court first addressed the rationale offered by insurers that family step-down provisions are necessary to combat collusion between family members to obtain greater compensation than the injured family member rightfully deserves.[250] The court held that family exclusion provisions were invalid based upon public policy arguments, and

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[242] *Id.* at 446.
[243] Lewis by Lewis v. West Am. Ins. Co., 927 S.W.2d 829, 829 (Ky. 1996).
[244] *Id.* at 830.
[245] *Id.*
[246] *Id.*
[247] *Id.*
[248] *Id.*
[249] *Id.*
[250] *Id.*

the actual rate of incidences of collusion among family members compared to the possibility of collusion by a few did not justify the denial of benefits to an entire innocent class.[251]

The court then reviewed guest statutes, interspousal immunity, and parental immunity, finding that each was premised on the belief that they were also necessary to prevent fraud and collusion.[252] Ultimately, the court concluded that it was against public policy to allow insurers to treat different classes of passengers differently based on classification or antiquated bases for immunity such as guest statutes and outdated interspousal immunity and parental immunity.[253] Importantly, with regard to family exclusions, the court noted that family exclusions are "particularly disturbing when viewed in light of the fact that this class of victims is the one most frequently exposed to the potential negligence of the named insured."[254]

The court observed that typical family relations require family members to ride together and permitting such an exclusion would promote socially destructive inequities.[255] Also, the court stated that motor vehicle policies are largely contracts of adhesion given that the insured does not have an opportunity to negotiate the terms of the contract and are offered on a "'take it or leave it' basis."[256] The court noted that consumers, therefore, have no warning of any reduction clauses, including step-down provisions inserted in their policy.[257] In a strongly worded rebuke, the Kentucky Supreme Court held that the "over-inclusiveness of the family exclusion clause is socially destructive and corrosive to our citizenry's confidence in our system of justice."[258] In finding these provisions impermissible and invalid under Kentucky law, the court stated that "fear of collusion is inadequate justification for the existence of the family exclusion."[259]

The court also addressed the public policy argument, noting that public policy is determined by the Constitution, by statutes, and by the highest courts to evaluate whether a contract or agreement "has a tendency to injure the public or is against the public good, or is contrary to sound policy."[260] Observing that "fair compensation for injuries received by innocent victims of another's negligence is the controlling policy consideration," the court held that family exclusions injure citizens because

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[251] *Id.*
[252] *Id.* at 830–32.
[253] *Id.* at 829.
[254] *Id.* at 832–33 (quoting Mut. of Enumclaw Ins. Co. v. Wiscomb, 643 F.2d 441, 444 (Wash. 1982)).
[255] *Id.* at 833.
[256] *Id.* (quoting Jones v. Bituminous Cas. Corp., Ky., 821 S.W.2d 798, 801 (Ky. 1991)).
[257] *Id.*
[258] *Id.* at 834.
[259] *Id.*
[260] *Id.* at 835–36 (quoting City of Princeton v. Princeton Elec. Light & Power Co., 179 S.W. 1074, 1078 (Ky. 1915)).

they deny injured persons the ability to rely on policy declarations purchased by the policyholder.[261] In a rebuke of household step-down provisions, the court held that to uphold the family exclusion would result in perpetuating socially destructive inequities and that "family exclusion provisions in liability insurance contracts violate the public policy of the Commonwealth and are unenforceable."[262]

As one court stated, enforcing step-down provisions in insurance contracts can have devastating consequences for insureds.[263] Consumers purchase automobile insurance coverage out of a sense of personal, legal, financial and social responsibility, and oftentimes they purchase an amount in excess of the mandatory amounts.[264] By purchasing higher insurance limits, the insured provides a method to compensate those injured as a result of the insured's negligence.[265] In addition to liability coverage, policyholders also purchase uninsured motorist coverage and underinsured motorist coverage in excess of the statutory minimum to protect themselves, their family members, their permissive users, and their guests when injured by another driver who may be uninsured or underinsured.[266] Step-down provisions ignore these rationales and goals of insureds, and despite the fact that insureds have purchased excess coverage, these clauses reduce the amount of coverage to the statutory minimum. Therefore, it is important to understand why certain state courts have enforced and applied step-down provisions. The following are general bases by which courts have deemed these provisions permissible. While not an exhaustive list, these bases represent some of the most frequent rationales utilized by state courts in enforcing step-down provisions and where they have been used.

IV. STATES WHERE STEP-DOWN PROVISIONS HAVE BEEN APPROVED OR ENFORCED

A. Rules of Contract Interpretation—Contractual Ambiguity

1. Iowa

A 1999 decision of the Iowa Supreme Court involved a policy with both an exclusion and a step-down provision present in the insurance contract.[267] Ultimately relying upon Iowa's traditional rules of contract interpretation, as previously applied to insurance policies, the Supreme Court of Iowa found a family member exclusion enforceable and a step-down provision applicable to exclude the claim of an injured passenger (the

[261] *Id.* at 836.
[262] *Id.*
[263] *Id.*
[264] *Id.* at 833.
[265] *Id.*
[266] JERRY & RICHMOND, *supra* note 52, at 843, 850.
[267] Krause v. Krause, 589 N.W.2d 721 (Iowa 1999).

driver's wife).[268] The court held that the policy endorsement's step-down provision was "unambiguous" and "enforceable," and that "as a matter of law [the insured] has failed to show that the reasonable expectations doctrine [wa]s applicable."[269]

The case involved a one-car accident where the husband was driving a truck and lost control of the vehicle, injuring his wife who was a passenger in the truck.[270] The husband was at fault in the accident.[271] The application of the exclusion in the policy denied liability coverage for family members resulting in the husband/tortfeasor being deemed an uninsured driver.[272] More specifically, the insurance policy contained an exclusion provision that stated that there was "no liability coverage for any insured for bodily injury sustained by another insured or family member."[273] In other words, the policy contained a family exclusion that denied any coverage to any insured or family members when the at-fault party was a family member. It also contained an endorsement in the policy with a "step-down provision" that reduced the policy coverage from the contracted-for amounts to the statutory minimum in the event there was no liability coverage under the policy for injury to a family member or named insured due to the family member exclusion.[274] This allowed the insurer to deem any insured or family member uninsured, and then apply a step-down provision to reduce coverage for family members injured in the accident other than the tortfeasor.

The wife/passenger then looked to her uninsured motorist ("UM") coverage for recovery. The declarations page of the policy listed the uninsured motorist coverage as $100,000 for each person and $300,000 per occurrence.[275] However, the insurer applied the step-down provision. The result allowed the insurer to apply both the exclusion denying family member liability coverage, meaning the family member/tortfeasor became an uninsured driver, and then to apply the step-down provision to reduce the uninsured motorist coverage to the statutory minimum. When the insurer enforced both the exclusion and the step-down provision, the court held that the exclusion and provision were not ambiguous even if the parties could not agree on the amount of coverage designated by the Iowa statute regarding mandatory minimum coverage.[276]

The court began its analysis by stating:

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[268] *Id.* at 728.
[269] *Id.*
[270] *Id.* at 723.
[271] *Id.*
[272] *Id.*
[273] *Id.*
[274] *Id.*
[275] *Id.*
[276] *Id.* at 726.

> "Because insurance policies are in the nature of adhesive contracts, we construe their provisions in a light most favorable to the insured." *A.Y. McDonald Indus. v. Insurance Co. of N. Am.*, 475 N.W.2d 607, 619 (Iowa 1991). "In the construction of insurance policies, the cardinal principle is that the intent of the parties must control; and except in cases of ambiguity this is determined by what the policy itself says." *Id.* at 618.[277]

The court went on to explain:

> In deciding whether the endorsement language reducing the uninsured motorist coverage was enforceable, the district court considered whether the language was ambiguous. The court noted the rule that "[p]olicy ambiguity exists when, after application of principles of contract interpretation, a genuine uncertainty remains as to which one of two or more meanings is the proper one." *See Kibbee v. State Farm Fire & Cas. Co.*, 525 N.W.2d 866, 868 (Iowa 1994).[278]

Following this analysis, the district court concluded that the UM endorsement language was ambiguous, not because it believed there were multiple possible interpretations of the policy language, but because it believed a layperson would not understand that the phrase "financial responsibility law of Iowa" used in the UM endorsement refers to Iowa Code chapter 321A.[279] The court also believed a layperson would not understand that the liability limits specified in chapter 321A.1(10) would be the applicable limits of UM coverage in the event that there was no liability coverage due to the family member exclusion.[280]

The court stated:

> Upon our consideration of the language of the policy as a whole, including the declarations page and attached endorsements, *see Ferguson v. Allied Mut. Ins. Co.*, 512 N.W.2d 296, 299 (Iowa 1994) (in construing insurance policies, court considers effect of policy as a whole, in light of all declarations, riders, or endorsements), we conclude that the district court incorrectly determined that the language of the UM coverage endorsement is ambiguous.[281]

Having concluded the policy (even as a contract of adhesion) was not ambiguous, the court then examined whether Mrs. Krause's claim that "the

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[277] *Id.*
[278] *Id.*
[279] *Id.*
[280] *Id.*
[281] *Id.*

doctrine of reasonable expectations applied to prevent the uninsured motorist coverage endorsement language from being enforced."[282] Ultimately, the court concluded that while a layperson may have some difficulty matching phrases used in the policy, those issues do not justify application of Iowa's "carefully circumscribed" doctrine of reasonable expectations.[283]

2. Kansas

In *Universal Underwriters Insurance Co. v. Hill*, the Court of Appeals of Kansas held that a step-down provision and language addendum limiting liability to "limits required by Kansas law" might be "stylistically inelegant" but it is not ambiguous such that a reasonable person would not be misled as to the policy limits.[284] In *Universal Underwriters Insurance Co.*, the Kansas court upheld a policy's permissive user step-down provision that reduced the coverage from the declarations page amount of $300,000 per occurrence to the statutory minimum of the state where the accident occurred when the automobile was operated by a permissive user.[285] Since the automobile covered under the policy was a loaner from a car dealership, the operator was deemed a permissive user, and therefore the step-down provision applied to reduce the coverage.[286] Interestingly, since the policy was governed by the law of the state where the accident occurred, it could result in a reduction to an amount less than the statutory minimum required by Kansas law.

The court relied on prior case law that held that if the provision violated the statutory minimum coverage at an amount less than the statutory minimum, the provision was still not void.[287] Rather, the amount was adjusted to the statutory minimum so as to be in compliance with the Kansas motor vehicle liability insurance requirements under the statute and the resulting adjustment would bring the coverage within the statutory requirement.[288] Interestingly, it seems in enforcing the step-down provision, the Kansas court, while recognizing the ambiguous nature of the step-down provision by calling the language "inelegant,"[289] engaged in legal gymnastics and procedural maneuvering to contort the step-down provision language to fit within the Kansas mandatory minimum of coverage by adjusting the actual reduction to an amount that satisfied the statutory requirement. In so doing, the outcome in *Universal Underwriters* conflicts with the policy goals

[282] *Id.* at 727.
[283] *Id.*
[284] Universal Underwriters Ins. Co. v. Hill, 955 P.2d 1333, 1338 (Kan. Ct. App. 1998).
[285] *Id.* at 1336.
[286] *Id.* at 1335.
[287] *Id.*
[288] *Id.*
[289] *Id.*

of fair and equitable treatment of insureds and the contract principles of unambiguous terms and the duty of good faith and fair dealing implicit in every contract.

B. Freedom to Contract

1. South Carolina

While South Carolina has recently determined that step-down provisions violate statutory language and legislative intent and are unenforceable under South Carolina law, the supreme court majority and dissenting opinions addressed the freedom of contract.[290] Therefore, returning to the previous discussion on *Nationwide Mutual Fire Insurance Co. v. Walls*, the dissent in the case argued that the court of appeals correctly followed the policy decision of the legislature in allowing "contracted-for exclusions to reduce coverage."[291] Thus, the dissent argued, since "Walls and Nationwide contracted for liability coverage" in excess of the statutory minimum while containing the step-down provision that allowed for a reduction of that coverage for illegal acts, the contract should be enforced as written.[292] Additionally, the dissent argued that the majority opinion nullified many statutory provisions that allow "parties freedom to contract for additional coverage and additional provisions."[293]

As previously discussed, the Kentucky Supreme Court addressed this issue and the question of strict contract considerations between parties that allows parties the freedom to contract in *Lewis by Lewis v. West American Insurance Co.*[294] While freedom to contract is a basic principle of contract law, and insurance contracts are evaluated by these contract principles, the Kentucky court identified an important distinction with regard to the "freedom to contract" principle and what was permissible in a contract.[295] The court clarified that while freedom to contract any provisions acceptable to both parties is an overarching principle of contract law, it may not apply when the contract involves the public interest.[296]

As discussed earlier, the business of insurance affects many aspects of the lives of individuals and businesses, so states have a keen interest in regulating insurance; thus, it is a matter of public interest. As a result, when the contract involves matters of public policy versus contracts that are strictly private, courts can deem certain provisions unenforceable and violative of

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[290] Nationwide Mut. Fire Ins. Co. v. Walls, 858 S.E.2d 150, 154–55 (S.C. 2021).
[291] *Id.* at 156 (Kittredge, J., dissenting).
[292] *Id.*
[293] *Id.* at 159.
[294] *See generally* Lewis by Lewis v. West Am. Ins. Co., 927 S.W.2d 829 (Ky. 1996) (explaining that public policy considerations may impose a limit on the right to impose limits on insurance coverage).
[295] *Id.* at 834.
[296] *Id.*

public interest and strike those provisions.[297] Additionally, contracts of insurance are recognized as adhesion contracts with little or no bargaining taking place between the parties.[298] Consequently, while freedom to contract is an important tool to evaluate the enforceability of certain contract provisions, if courts determine that provisions are violative of public policy or public interest, they can exclude those clauses as unenforceable and still enforce other portions of the contract.[299] The result in *Walls* ultimately determined that even though the step-down provision was a part of the contract, the clause violated statutory provisions and legislative intent and therefore could not be enforced under South Carolina law.[300]

C. Reduction to Statutory Minimum is Not Against Public Policy, When Coverage is Still Provided at the Applicable Statutory Minimum

1. Minnesota

In *Babinski v. American Family Insurance Group*, the United States District Court for the Eighth Circuit, applying Minnesota law, held that the "household drop-down exclusion" in an automobile policy applied and reduced coverage to the statutory minimum.[301] Specifically, the policy's declarations page capped coverage for liability resulting from bodily injury to $1,000,000.[302] The policy also contained within the exclusions section a "household drop-down exclusion" that provided that the coverage did not apply to "any person related to the operator and residing in the household of the operator."[303] Further, the exclusion stated that it only applied "to the extent the limits of liability exceed the limits of liability required by law."[304] In other words, the insurer took note to reduce coverage specifically when the policyholder purchased coverage in excess of the statutory minimum.

In *Babinski*, the insured/tortfeasor was the husband of the wife/plaintiff who was a passenger in the insured truck at the time of the accident.[305] Both the husband and the wife died from injuries suffered in the accident.[306] The wife's estate made a claim for wrongful death against the

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[297] *Id.* at 835.
[298] *Id.* at 833.

[299] *Id.*
[300] Nationwide Mut. Fire Ins. Co. v. Walls, 858 S.E.2d 150, 154–55 (S.C. 2021).
[301] Babinski v. Am. Fam. Ins. Grp., 569 F.3d 349, 354–55 (8th Cir. 2009). The policy language described the provision as an exclusion. *Id.* at 351. However, it operated as a step-down provision, reducing the coverage from the declarations page amount of $1,000,000 to the statutory minimum amount of $30,000. *Id.* at 352.
[302] *Id.* at 350.
[303] *Id.* at 351.
[304] *Id.*
[305] *Id.*
[306] *Id.*

estate of the husband under the policy.[307] The insurer applied the "household drop-down provision" and reduced the coverage from $1,000,000 to the statutory minimum of $30,000.[308] The wife's estate then filed suit, asserting that the exclusion was unenforceable because it was ambiguous and contrary to the reasonable expectations of an insured.[309]

In applying Minnesota insurance law, the Eighth Circuit found the provision to be unambiguous despite the fact that the provision did not specify the exact amount applicable when the reduction was enforced.[310] Rather, the court held that although the policy simply stated that the coverage was limited to "the MINIMUM dollar amount required" by a state's "motor vehicle financial responsibility laws," it did not create an ambiguity.[311] More specifically, the court stated that Minnesota courts have consistently held that drop-down exclusions are enforceable as long as they satisfy the minimum coverage limits under the state's no-fault act.[312] Therefore, the court held that while not specifying the amount, the provision still resulted in a reduction to the statutory minimum and thus was not a violation of the financial responsibility statute of the state.[313] The court also found that the doctrine of reasonable expectations did not apply to the case because "Minnesota's doctrine of reasonable expectations is extremely narrow" and applies only in "egregious situations" where an insurer has disguised an exclusion.[314]

Curiously, the court noted that because this was an "exclusion" and listed in the exclusions section of the policy, it was "exactly where an insured would expect it to be located."[315] However, as noted above, under general insurance law, exclusions are defined as *denying* coverage whereas step-down or drop-down provisions *reduce* coverage.[316] Thus, while the court and the insurer labeled the drop-down provision as an exclusion, it functioned as a step-down provision that operated to reduce the coverage to the statutory minimum. Consequently, an insured most likely would not look in the exclusions section of the policy to find a provision that reduces coverage based on the classification of the operator. Also, interestingly, while the court restated the limited applicability of the doctrine of reasonable expectations, "Minnesota's doctrine of reasonable expectations is extremely narrow and 'applies only on the few "egregious" occasions

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[307] *Id.*
[308] *Id.*
[309] *Id.*
[310] *Id.* at 352–53.
[311] *Id.* at 352.
[312] *Id.* at 354.
[313] *Id.* at 354–55.
[314] *Id.* at 353.
[315] *Id.*
[316] *See supra* Part II.B.

when an exclusion is disguised in a policy's definitions section.'"[317]

2. Missouri

Missouri has also addressed the relationship between the statutory scheme and permissive user step-down provisions in *Windsor Insurance Co. v. Lucas*.[318] In a case of first impression, the Missouri Court of Appeals held that since Missouri law contains no clear implication that step-down provisions should be prohibited, and that the state's statutory scheme was distinguishable from states whose statutes clearly prohibit step-down provisions, the enforcement of step-down clauses at issue was not against Missouri public policy.[319]

In *Windsor,* Articia Lucas gave her boyfriend, Charles Billups, permission to drive her automobile.[320] While driving, the boyfriend/permissive user was involved in an accident.[321] Lucas was insured by Windsor.[322] Several individuals made claims for compensation against Billups.[323] The applicable insurance policy provided coverage of $100,000 per person and $300,000 per accident.[324] However, the policy contained a step-down provision reducing the coverage to the Missouri statutory minimum of $25,000 per person and $50,000 per accident in the event that the injury was caused by a "non-relative" driver whom the insured permitted to drive the car.[325] The trial court held that the policy was ambiguous based on the fact that the language that "reduced coverage of permissive users was found only in the 'definitions' portion of the policy and not in the 'limits of liability' section."[326] Additionally, the trial court found that the step-down reduction was contradicted in several places in the policy and this created an ambiguity.[327] Lastly, the trial court also declared that step-down provisions for permissive users were against Missouri public policy and held the step-down provision unenforceable.[328]

However, on appeal, the appellate court first addressed the ambiguity issue and then the public policy decision. In reviewing the ambiguity question, the court determined that the policy sufficiently defined the relevant terms and mentioned the step-down provisions several times in

[317] *Babinski*, 569 F.3d at 349.
[318] Windsor Insurance Co. v. Lucas, 24 S.W.3d 151, 155 (Mo. Ct. App. 2000).
[319] *Id.* at 155.
[320] *Id.* at 152.
[321] *Id.*
[322] *Id.*
[323] *Id.*
[324] *Id.*
[325] *Id.*
[326] *Id.* at 152–53.
[327] *Id.* at 153.
[328] *Id.*

calculating the limits for permissive users.[329] Also, in finding that no ambiguity existed, the court stated that "nowhere does the policy state that the limits on the declarations page were final and absolute in every situation."[330] Further, the court recognized that there was no prohibition under Missouri law for an insurance policy to set forth the maximum amount the insurer will pay in one part and describe circumstances under which the insurer may lower the amount it will pay in another part, as long as the language is clear and unambiguous.[331]

Further examining the issue of public policy, the court acknowledged that Missouri courts recognize the freedom to contract in liability insurance.[332] However, the court also noted that in order to find a violation of public policy, there must be definite indications in the law of the sovereignty to justify the invalidation of a contract as contrary to public policy.[333] Specifically, the court must usually find support in statutory provisions to determine if a contractual clause violates public policy.[334] Determining that the Missouri statutory scheme of requiring minimum amounts of automobile coverage was reflective of public policy to ensure that owners and operators of automobiles provided a minimum amount of financial responsibility, and since the step-down provision reduced coverage to that statutory amount, then the court held that the step-down clause did not violate public policy.[335] Rather, the court determined that it met public policy at the point where at least the reduced coverage did not violate the required statutory minimum.[336] Thus, the appellate court held that the step-down provision for permissive users did not violate public policy, was not ambiguous, and was therefore enforceable reversing the trial court's findings.[337]

[329] *Id.* at 154.
[330] *Id.*
[331] *Id.*
[332] *Id.*
[333] *Id.*
[334] *Id.*
[335] *Id.*
[336] *Id.* at 155.
[337] *Id.* at 156.

D. Doctrine of Reasonable Expectations Does Not Apply to Analysis of Step-Down Provisions

1. New Jersey

New Jersey is a state that has also considered the doctrine of reasonable expectations in the context of step-down provisions in insurance policies. In *Morrison v. American International Insurance Co. of America*, the New Jersey Superior Court specifically addressed the issue of whether the doctrine of reasonable expectations applied to set aside the step-down provision clause contained in an insurance policy issued by the insurer.[338] The case involved a permissive user who was operating a vehicle owned and insured by her parents.[339] At the time of the accident, the driver did not live with her parents and was not a named insured on the policy.[340] The policy declarations page reflected limits of $100,000 for liability and underinsured motorist coverage per person and $300,000 per occurrence.[341] The policy contained a permissive user step-down clause that limited recovery to the statutory minimum for persons other than the named insured or resident family members.[342] The insurer applied the permissive user step-down provision to reduce the coverage to the statutory minimum.[343] The district court then addressed the insured's claim that the policy provision was ambiguous and discussed the doctrine of reasonable expectations.[344] The district court concluded that there was no meaningful ambiguity or confusion and that the language of the step-down provision clearly applied to someone in the in the plaintiff's position.[345]

On appeal, the New Jersey Superior Court noted that New Jersey courts endorse "the principle of giving effect to the 'reasonable expectations' of the insured for the purpose of rendering a 'fair interpretation' of the boundaries of insurance coverage."[346] The result is that New Jersey insurance law applies the doctrine of reasonable expectations by interpreting ambiguous language of an insurance policy through the lens of the average policyholder.[347] However, New Jersey courts also apply policy provisions as written when the policy language is clear and unambiguous and hold that it

[338] Morrison v. Am. Int'l Ins. Co. of Am., 887 A.2d 166 (N.J. Super. Ct. App. Div. 2005).
[339] *Id.* at 168.
[340] *Id.*
[341] *Id.*
[342] *Id.*
[343] *Id.* at 169.
[344] *Id.*
[345] *Id.*

[346] *Id.* (citing DiOrio v. N.J. Mfrs. Ins. Co., 398 A.2d 1274 (N.J. Super. Ct. App. Div. 1979)).
[347] *Id.*

is not the job of courts to rewrite policies where no ambiguity exists.[348]

In finding that the policy in *Morrison* was not ambiguous, the court determined that it did not conflict with the doctrine of reasonable expectations.[349] Interestingly, the court admitted that the policy was "far from perfect" and that it may have been more prudent for the insurer to point out to the policyholder the step-down language.[350] Notwithstanding its own statements about the confusing language used by the insurer and the lack of notice to the insured, the court found the specific language defining "insured" and "family member" unambiguous and the contract unambiguous as a whole.[351] Therefore, the court reasoned, the doctrine of reasonable expectations, as defined under New Jersey law, did not apply and the permissive user step-down provision was valid and enforceable.[352]

V. CONCLUSION

Insurance, at its most basic, is to prevent surprise and allocate risk. Any policy provision that significantly alters an insured's expectations or results in surprise should be examined as suspect. When considering such impacts from what have commonly become known as step-down provisions, courts and legislatures alike would be prudent to consider the thoughtful and reasoned approach taken by the South Carolina Supreme Court in *Williams v. Government Employees Insurance Co. (GEICO)*,[353] and *Nationwide v. Walls*.[354]

While the focus of this Article has been to assemble and report on the variety of approaches to resolving disputes related to step-down policies, the authors do endorse the South Carolina Supreme Court's conclusion in *Williams* regarding familial exclusions by step-down provisions: "To allow an insurer to determine the extent to which an injured party can recover within the insured's policy coverage based solely on a familial relationship is arbitrary and capricious and violative of public policy."[355] As cited in *Williams*, the Washington Supreme Court in *Mutual of Enumclaw* succinctly explained:

> [Application of step-down provisions in real life scenarios is] particularly disturbing when viewed in light of the fact that this class of victims is the one most frequently exposed to the potential negligence of the named insured. Typical family relations require family members to ride together on the way to work, church,

[348] *Id.* at 170.
[349] *Id.* at 173.
[350] *Id.*
[351] *Id.*
[352] *Id.*
[353] Williams v. Gov't Emps. Ins. Co. (GEICO), 762 S.E.2d 705 (S.C. 2014).
[354] Nationwide Mut. Fire Ins. Co. v. Walls, 858 S.E.2d 150 (S.C. 2021).
[355] *Williams*, 762 S.E.2d at 716.

> school, social functions, or family outings. Consequently, there is no practical method by which the class of persons excluded from protection by this provision may conform their activities so as to avoid exposure to the risk of riding with someone who, as to them, is uninsured.[356]

The South Carolina Supreme Court's decisions in *Williams* and *Walls* are guideposts for proper examination of step-down provisions in the context of modern insurance law. When faced with an insurer relying on a step-down provision to limit coverage, courts should look first to the language of the policy and determine whether there is any ambiguity. Depending on this determination, a court should examine the specific language of the policy at issue then proceed to apply doctrines such as *contra proferentem* or reasonable expectations ambiguity analysis. Ambiguous contracts should be determined based upon the basic definition that when a term is reasonably susceptible to two or more reasonable constructions an ambiguity is created.[357] In addition, courts should not only consider the interaction between the coverage listed on the declarations page and coverage reduced somewhere later in the policy by a provision, but also where and how such provisions are placed and titled. When examining a non-ambiguous policy, courts should engage in a comprehensive review that includes reference to precedent, legislative determinations, specific statutory language, and public policy considerations raised by enforcement, or denial, of the asserted step-down provision.

Excluding family members via step-down provisions risks "far-reaching effects that can impact a substantial segment of the population, as it serves not only to markedly reduce coverage to family members, but it even reduces the policy's coverage to the *named insureds* . . . ."[358] Furthermore, the social, legislative, and public policy goals to protect the "innocent victims of motor vehicle accidents [would be] eviscerated by [allowing insurers to reduce] coverage to injured family members, who are no less innocent victims in accidents solely because they are injured by the negligence of a family member."[359]

With regard to application of step-down provisions for reductions in

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[356] *Id.* (quoting Mut. of Enumclaw Ins. Co. v. Wiscomb, 643 P.2d 441, 444 (Wash. 1982)). *See also* Factory Mut. Liab. Ins. Co. of Am. v. Kennedy, 182 S.E.2d 727, 729 (S.C. 1971) (stating liability insurance not only affords protection to insured motorists, it also serves the important "public purpose of affording protection to the *innocent victim* of a motor vehicle accident.") (emphasis added).

[357] JEFFREY W. STEMPEL, PETER N. SWISHER & ERIK S. KNUTSEN, PRINCIPLES OF INSURANCE LAW 116 (4th ed. 2011).

[358] *Williams*, 762 S.E.2d at 716 (emphasis in original).

[359] *Id.* ("It would indeed be an unusual public policy that would condone denying coverage to a child where he or she is catastrophically injured while being driven by a parent to school, but would allow recovery where the parent injures a stranger while on the way to work.").

non-familial circumstances, such as permissive user or felony clauses, the authors endorse the South Carolina Supreme Court's decision in *Nationwide v. Walls*, based upon the same reasoning the court adopted in *Williams*. Further, the Walls decision includes the appropriate, arguably necessary, examination of historic or pending legislative action or inaction on the subject in light of prior court decisions, as well as analysis of the impacts of step-down provisions generally. Most important to the considerations, however, are application of doctrines highlighted herein that address fairness and prevent surprise for insureds like Sharmin Walls, who are inevitably dismayed and harmed by the application of step-down provisions within their automobile insurance policies.