

# Underinsurance in Indiana: an Illusion of Coverage?

MARY A. FINDLING\*  
BARBARA J. GERMANO\*\*

## I. INTRODUCTION

In its 1987 session, Indiana's General Assembly expanded the Uninsured Motorist Act,<sup>1</sup> by mandating that insurance carriers offer what is commonly known as underinsurance.<sup>2</sup> Simply stated, underinsurance is first party automobile coverage, intended to protect an insured when he is injured by a negligent third party motorist whose liability coverage is insufficient to compensate him adequately for his damages.<sup>3</sup> Assume that an individual is injured by a negligent motorist with \$25,000 of bodily injury liability coverage. Assume further that the individual has damages exceeding that amount. In such a case, the negligent motorist is typically considered underinsured because his coverage does not adequately compensate the injured person. The injured person would then look to his own underinsurance coverage for additional compensation.

Initially, this Article will briefly outline the historical development of underinsured motorist coverage and the two types of legislative responses to the need for such coverage. The Article will then address Indiana's newly adopted underinsurance provisions and will conclude with an analysis demonstrating how Indiana's provisions may permit Indiana insurance carriers to provide merely an illusion of coverage to their insureds.

## II. THE HISTORICAL AND LEGISLATIVE DEVELOPMENT OF UNDERINSURED MOTORIST COVERAGE

### A. *How the Concept of Underinsurance Arose*

It cannot be denied that people often suffer enormous damages as a result of injuries they sustain in automobile collisions. States originally

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\*Associate with the law firm of Price & DeLaney, Indianapolis, Indiana. B.A., Purdue University, 1972; M.A., University of Michigan, 1974; J.D., Indiana University School of Law-Indianapolis, 1986.

\*\*Student at Indiana University School of Law-Indianapolis. A.B., Indiana University, 1978.

<sup>1</sup>IND. CODE §§ 27-7-5-2 to -6 (1982).

<sup>2</sup>*Id.* § 27-7-5-2, -4, and -5 (Supp. 1987).

<sup>3</sup>2 A. WIDISS, UNINSURED AND UNDERINSURED MOTORIST INSURANCE § 32.1 (2d ed. 1987).

responded to the need for insurance to cover these damages by enacting legislation which prescribed minimum levels of liability insurance.<sup>4</sup> These prescribed limits, however, frequently did not adequately compensate victims of automobile accidents who were severely injured.<sup>5</sup> Furthermore, these financial responsibility laws did not generally mandate that citizens even obtain liability coverage on their vehicles.<sup>6</sup> Consequently, there were many instances when a person, severely injured by a negligent motorist without liability insurance, was left without any automobile insurance protection for his damages.

In order to provide protection for those accident victims injured by an uninsured motorist, the insurance industry developed a new form of coverage, commonly called uninsured motorist insurance.<sup>7</sup> Uninsured motorist insurance was designed as first party insurance which would place insureds in the same position they would have been in had the tortfeasor carried the minimum liability insurance required under the financial responsibility laws of the state.<sup>8</sup>

Shortly after the insurance industry began offering uninsured motorist insurance, many state legislatures enacted statutes either requiring that insurance companies *offer* such coverage to purchasers of liability coverage as optional coverage or requiring that insurance companies *include* such coverage in all liability policies.<sup>9</sup> Uninsured motorist insurance was almost exclusively offered in the same minimum limits prescribed by the financial responsibility laws of the particular state.<sup>10</sup> Although insurance companies were free to offer higher limit uninsured motorist coverage, almost no insurers did so.<sup>11</sup> Thus, as was the case with prescribed minimum levels of liability insurance, there were still many accident victims who suffered damages in excess of any insurance protection.

Because the minimum limit uninsured motorist coverage was inadequate, many state legislatures in the late 1960's and 1970's enacted legislation requiring insurance companies to make higher limit uninsured motorist insurance available to their insureds.<sup>12</sup> Generally, these statutes mandated that insurance carriers offer uninsured motorist protection in

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<sup>4</sup>*Id.* § 31.1.

<sup>5</sup>*Id.*

<sup>6</sup>*Id.* See also 1 *id.* §§ 1.1 - .14.

<sup>7</sup>2 *id.* § 31.1.

<sup>8</sup>*Id.*

<sup>9</sup>*Id.* See also 1 *id.* §§ 1.11 and 2.5. Eleven states have mandatory uninsured motorist legislation. In the remaining states, insurance companies must offer uninsured motorist coverage, but the purchaser may reject the coverage. For a list of these states, see *id.* § 2.5.

<sup>10</sup>2 *id.* § 31.2.

<sup>11</sup>*Id.* n.3.

<sup>12</sup>*Id.* § 31.3. See also 1 *id.* § 8.25.

limits equal to their insureds' liability coverage.<sup>13</sup> Thus, if an insured had \$100,000/\$300,000<sup>14</sup> of liability coverage, he could purchase the same amount of uninsured motorist coverage.

With the introduction of higher limit uninsured motorist insurance, injured accident victims were often compensated more fully if the tortfeasor was uninsured than if the tortfeasor carried the minimum liability coverage mandated by financial responsibility laws.<sup>15</sup> For example, assume that a tortfeasor only carried \$25,000/\$50,000 of liability coverage, the minimum amount required by his state's financial responsibility laws and the the victim carried \$100,000/\$300,000 of uninsured motorist coverage. Assume further that the victim had damages of \$100,000. Naturally, the victim would have preferred to collect the \$100,000 from his own carrier's uninsured motorist coverage rather than be left solely with the \$25,000 from the tortfeasor's liability coverage. Consequently, victims claimed that they were entitled to protection under their uninsured motorist insurance when the tortfeasor's liability coverage inadequately compensated them for their injuries.<sup>16</sup> However, insurance companies routinely denied such claims, arguing that uninsured motorist coverage only became operable when the tortfeasor was not in compliance with the state's minimum financial responsibility laws.<sup>17</sup> The insurance industry's position was generally sustained by the courts.<sup>18</sup> Clearly, the advent of higher limits uninsured motorist coverage created an anomaly that needed a solution.

The concept of underinsurance was developed to address this anomaly. Its purpose was to provide additional first party protection for accident victims who were injured by tortfeasors carrying minimum liability limits.<sup>19</sup> Although insurance companies frequently offered underinsurance to their insureds without a legislative mandate to do so,<sup>20</sup>

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<sup>13</sup>*Id.* § 31.3.

<sup>14</sup>The figure on the left refers to the maximum amount payable to an individual injured by the insured. The figure on the right is the maximum amount payable to any number of individuals injured by the insured in a single occurrence.

<sup>15</sup>2 A. WIDISS, *supra* note 3, § 31.3.

<sup>16</sup>*Id.*

<sup>17</sup>*Id.*

<sup>18</sup>*Id.* See, e.g., *State Farm Mut. Auto. Ins. Co. v. Hallowell*, 426 A.2d 822 (Del. 1981); *Smiley v. Estate of Toney*, 44 Ill. 2d 127, 254 N.E.2d 440 (1969); *Peacock v. Harper*, 95 Nev. 596, 600 P.2d 223 (1979); *Travelers Indem. Co. v. Stearns*, 116 N.H. 285, 358 A.2d 402 (1976). *But see, e.g., Oleson v. Farmers Ins. Group*, 185 Mont. 164, 605 P.2d 166 (1980).

<sup>19</sup>2 A. WIDISS, *supra* note 3, §§ 31.2 and 31.4.

<sup>20</sup>Interview with Donald L. Roll, President of the Insurance Institute of Indiana, Inc. (Sept. 28, 1987). Mr. Roll indicated that all twenty-one member companies of the Insurance Institute were offering underinsured motorist coverage to their insureds prior to the passage of House Bill No. 1390 which enacted underinsurance legislation in Indiana.

many state legislatures during the 1970's and 1980's enacted underinsurance laws.<sup>21</sup> Currently, thirty states have enacted such legislation.<sup>22</sup>

### B. Legislative Response to the Need for Underinsurance

As previously stated, the purpose of underinsured motorist coverage is to provide protection to innocent motorists and passengers who are injured as a result of the negligence of minimally insured drivers.<sup>23</sup> When enacting underinsurance statutes, most state legislatures have integrated provisions on underinsurance into existing uninsured motorist legislation<sup>24</sup> and have typically enacted one of two types of underinsurance statutes.<sup>25</sup> One type focuses on the victim's damages<sup>26</sup> whereas the other type focuses on the amount of the victim's underinsurance coverage.<sup>27</sup> The following sections of the Article will refer to these statutes as Type I and Type II statutes.

1. *Type I Statute.*—A Type I statute is designed to afford protection to the victim for the amount of damages suffered.<sup>28</sup> Type I underinsurance coverage generally applies when the victim's damages exceed the limit of the tortfeasor's liability coverage.<sup>29</sup> A typical Type I statute provides:

<sup>21</sup>2 A. WIDISS, *supra* note 3, § 31.5.

<sup>22</sup>ARIZ. REV. STAT. ANN. § 20-259.01(E) (Supp. 1987); CONN. GEN. STAT. ANN. § 38-175c (West 1987); DEL. CODE ANN. tit. 18, § 3902(b)(3) (Supp. 1986); FLA. STAT. § 627.727 (1984); GA. CODE ANN. § 33-7-11 (Supp. 1987); ILL. ANN. STAT. ch. 73, para. 755a-2 (Smith-Hurd Supp. 1987); IND. CODE §§ 27-7-5-2, -4, and -5 (Supp. 1987); IOWA CODE ANN. § 516A.1 (West 1983); KAN. STAT. ANN. § 40-284 (Supp. 1984); KY. REV. STAT. ANN. § 304.39-320 (Michie/Bobbs-Merrill Supp. 1982); LA. REV. STAT. ANN. § 22:1406 (West 1978); ME. REV. STAT. ANN. tit. 24-A, § 2902 (Supp. 1986); MD. INS. CODE ANN. § 541 (Supp. 1983); MASS. GEN. L. ch. 175, § 113L (1987); MINN. STAT. § 65B.43 (1986); MISS. CODE ANN. § 83-11-103 (Supp. 1987); N.J. STAT. ANN. § 17:28-1.1 (West 1985); N.M. STAT. ANN. § 66-5-301 (1984); N.Y. INS. LAW § 3420 (McKinney 1985); N.C. GEN. STAT. § 20-279.21 (1983); OHIO REV. CODE ANN. § 3937.18 (Anderson Supp. 1986); OKLA. STAT. ANN. tit. 36, § 3636 (West Supp. 1987); S.C. CODE ANN. § 56-9-831 (Law. Co-op. Supp. 1983); S.D. CODIFIED LAWS ANN. §§ 58-11-9.4 and -9.5 (Supp. 1987); TENN. CODE ANN. § 56-7-1201 and -1202 (Supp. 1987); TEX. REV. CIV. STAT. ANN. art. 5.06-1 (Vernon 1981); VT. STAT. ANN. tit. 23, § 941 (Supp. 1986); VA. CODE ANN. § 38.2-2206 (1986); WASH. REV. CODE ANN. § 48-22.030 (Supp. 1987); W. VA. CODE § 33-6-31 (Supp. 1987).

<sup>23</sup>See *supra* text accompanying notes 3 and 19.

<sup>24</sup>2 A. WIDISS, *supra* note 3, § 31.5. Indiana was no exception. The legislature amended Indiana's existing Uninsured Motorist Act to include underinsurance protection. IND. CODE ANN. §§ 27-7-5-2, and -5 (West Supp. 1987).

<sup>25</sup>See *infra* text accompanying notes 28-34.

<sup>26</sup>See *infra* text accompanying notes 28-30.

<sup>27</sup>See *infra* text accompanying notes 31-33.

<sup>28</sup>2 A. WIDISS, *supra* note 3, § 35.2.

<sup>29</sup>*Id.*

[An insurance carrier] shall also offer . . . underinsured motorist coverage . . . to provide coverage in the event that damages are sustained in excess of the liability limits carried by an . . . underinsured motorist.<sup>30</sup>

Thus, under a Type I statute, a comparison is made between the amount of victim's damages and the amount of the tortfeasor's liability coverage. If the victim's damages exceed the tortfeasor's liability coverage, underinsurance will be provided. For example, assume that a victim has suffered a \$75,000 injury and has \$50,000 of underinsurance. Assume further that the tortfeasor has \$25,000 of bodily injury coverage. Under this hypothetical, a Type I statute would operate to provide full compensation to the victim. That is, the victim's damages of \$75,000 are compared to the tortfeasor's liability limits of \$25,000. Because the victim's damages exceed the tortfeasor's liability limits by \$50,000, the victim will be able to collect his \$50,000 of underinsurance coverage. Therefore, the victim has collected his entire \$75,000 in damages—\$25,000 from the tortfeasor and \$50,000 from his own insurance company.

2. *Type II Statute.*—A Type II statute differs from a Type I statute in one very important respect. Under a Type II statute, the focus is *not* on the victim's damages but rather on the amount of the victim's underinsurance. The goal of a Type II statute is to put the victim in the same position he would have been in had the tortfeasor had liability coverage in limits equal to the victim's underinsured motorist coverage.<sup>31</sup> Underinsured motorist coverage applies only when the victim's underinsured motorist coverage exceeds the amount recoverable from the tortfeasor's liability policy.<sup>32</sup> Therefore, a victim will never collect more than the limits of his underinsured motorist coverage even though part or all of his recovery will be from the negligent tortfeasor. A typical statute of this type provides:

The limits of liability for an insurer providing underinsured motorist coverage shall be the limits of such coverage, less those amounts actually recovered under all applicable bodily injury liability bonds and insurance policies covering persons liable to the insured.<sup>33</sup>

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<sup>30</sup>S.C. CODE ANN. § 56-9-831 (Law. Co-op. Supp. 1986). Ten states have enacted Type I statutes. These states are Arizona, Iowa, Kentucky, Louisiana, Massachusetts, Minnesota, Oklahoma, South Carolina, South Dakota, and Washington. For citations to these states' statutes, see *supra* note 22 and accompanying text.

<sup>31</sup>2 A. WIDISS, *supra* note 3, § 35.2.

<sup>32</sup>*Id.*

<sup>33</sup>OHIO REV. CODE ANN. § 3937.18(A)(2) (Anderson Supp. 1986). Twenty states have enacted Type II statutes. Thirteen states define an "underinsured motor vehicle" as one

As the statutory language above indicates, the victim can only collect underinsurance in the amount by which his underinsurance exceeds the amount paid by the tortfeasor's liability coverage. In other words, the amount paid under the tortfeasor's liability coverage operates as a setoff against the victim's underinsurance coverage.

In the above hypothetical, the victim would still collect \$25,000 from the tortfeasor's liability coverage. However, the victim would not collect the additional \$50,000 of underinsurance. Instead, the \$25,000 collected from the tortfeasor would be setoff against the victim's underinsured motorist coverage, and the victim would only collect \$25,000 of his own underinsurance. Consequently, the victim would receive a total of \$50,000 for a \$75,000 injury and would not be made whole for his injuries.

Because there is a strong societal interest in compensating injured parties as fully as possible,<sup>34</sup> it would seem that legislatures should be more inclined to enact Type I statutes which maximize protection afforded the victim as opposed to Type II statutes which often minimize such protection. With this background in mind, the Article will now focus on Indiana's response to the need for underinsurance.

### III. INDIANA'S UNDERINSURANCE STATUTE

The 1987 Indiana General Assembly broadened the Uninsured Motorist Act to include underinsurance.<sup>35</sup> Prior to amending the uninsured

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with liability limits less than the insured victim's uninsured motorist limits. These states include Connecticut, Florida, Georgia, Kansas, Maine, Maryland, Mississippi, New Mexico, New York, Ohio, Tennessee, Vermont, and Virginia. In seven states, underinsurance is a separate form of coverage, and an "underinsured motor vehicle" is one with liability insurance limits less than the victim's underinsurance limits. These states are Delaware, Illinois, Indiana, New Jersey, North Carolina, Texas, and West Virginia. For citations to these states' statutes, see *supra* note 22 and accompanying text.

<sup>34</sup>W. KEETON, PROSSER AND KEETON ON THE LAW OF TORTS § 1 (5th ed. 1984).

<sup>35</sup>See *supra* notes 1-2 and accompanying text. In an interview with George C. Gray, Legislative Chairman for the Indiana Trial Lawyers Association, Corp. (ITLA), Mr. Gray stated that ITLA submitted the original bill on underinsurance. The bill was sponsored by Representative John Thomas of Brazil, Indiana, an ITLA member. This bill was modeled on the Arizona statute, a Type I statute, which provides in pertinent part:

"Underinsurance motorist coverage" includes coverage for a person if the sum of the limits of liability under all bodily injury or death liability bonds and liability insurance policies applicable at the time of the accident is less than the total damages for bodily injury or death resulting from the accident. To the extent that the total damages exceed the total applicable liability limits, the underinsurance motorist coverage provided in subsection C of this section is applicable to the difference.

ARIZ. REV. STAT. ANN. § 20-259.01(E) (Supp. 1987).

However, the insurance lobby supported a bill modeled after the Ohio statute, a

motorist statute, nearly all major insurance companies doing business in Indiana were already offering underinsured motorist protection in conjunction with their uninsured motorist coverage.<sup>36</sup> As of January 1, 1988, however, the legislature has mandated that *all* insurance companies offer underinsured motorist coverage.<sup>37</sup> Automobile liability insurance companies must now provide not only uninsured motorist coverage, but also underinsured motorist coverage in all policies delivered or issued in the state, unless the insured rejects these coverages in writing.<sup>38</sup> The

Type II statute, which provides in relevant part:

Underinsured motorist coverage, which shall be in an amount of coverage equivalent to the automobile liability or motor vehicle liability coverage and shall provide protection for an insured against loss for bodily injury, sickness, or disease, including death, where the limits of coverage available for payment to the insured under all bodily injury liability bonds and insurance policies covering persons liable to the insured are less than the limits for the insured's uninsured motorist coverage at the time of the accident. The limits of liability for an insurer providing underinsured motorist coverage shall be the limits of such coverage, less those amounts actually recovered under all applicable bodily injury liability bonds and insurance policies covering persons liable to the insured.

OHIO REV. CODE ANN. § 3937.18(A)(2) (Anderson Supp. 1986).

According to Mr. Gray, the ITLA bill was defeated in a subcommittee hearing. The ITLA nevertheless supported the modified bill even though it was a Type II statute permitting setoff. The ITLA reasoned that the bill provided certain advantages even with setoff: (1) insurance companies are now required under the act to offer underinsurance; (2) insurance companies must offer underinsurance in limits equal to the insured's liability limits; (3) insurance companies are now required to offer uninsured motorist coverage in limits equal to the insured's liability limits. Interview with George C. Gray, Legislative Chairman of the Indiana Trial Lawyers Association, Corp. (Oct. 2, 1987).

<sup>36</sup>See *supra* text accompanying note 20. According to Mr. Donald L. Roll, all major automobile insurance companies doing business in Indiana offered underinsurance with a setoff provision. The only exception was State Farm Mutual Automobile Insurance Company whose policy did not provide for setoff. Interview with Donald L. Roll, President of the Insurance Institute of Indiana, Inc. (Sept. 28, 1987).

State Farm's policy provided in pertinent part:

5. The most we pay will be the lesser of:
  - a. the difference between the amount of the INSURED'S DAMAGES for BODILY INJURY, and the amount paid to the INSURED by or for any PERSON or organization who is or may be held legally liable for the BODILY INJURY; or
  - b. the limits of liability of this coverage.

State Farm Mutual Automobile Policy, Section III [emphasis in policy].

According to a State Farm spokesman at State Farm's Corporate Headquarters in Bloomington, Illinois, State Farm's policy as of January 1, 1988 will include a setoff provision. Telephone interview with State Farm Mutual Insurance Company Spokesman (Sept. 30, 1987).

<sup>37</sup>IND. CODE §§ 27-7-5-2(a)(1) and -5 (Supp. 1987).

<sup>38</sup>*Id.* § 27-7-5-2(a), (b)(1), (2). House Bill No. 1390 provided in relevant part:  
The uninsured AND UNDERINSURED motorist ~~coverage~~ COVERAGES ~~may~~ MUST

minimum limits of these coverages must comply with the financial responsibility requirements of \$25,000/\$50,000 for bodily injury liability insurance coverage.<sup>39</sup> Additionally, an insurance carrier must provide uninsured and underinsured coverages in limits equal to the insured's bodily injury liability coverage.<sup>40</sup> However, an individual may purchase

be offered PROVIDED by insurers in limits higher than FOR EITHER A SINGLE OR FOR SEPARATE PREMIUMS, IN LIMITS EQUAL TO the limits of liability specified in the bodily injury and property damage liability provisions of an insured's policy, UNLESS SUCH COVERAGES HAVE BEEN REJECTED IN WRITING BY THE INSURED.

(b) The named insured of an automobile or motor vehicle liability policy has the right to reject, in writing, either or both TO:

(1) REJECT BOTH THE UNINSURED MOTORIST COVERAGE AND THE UNDERINSURED MOTORIST COVERAGE PROVIDED FOR IN THIS SECTION; OR

(2) REJECT EITHER THE UNINSURED MOTORIST COVERAGE ALONE OR THE UNDERINSURED MOTORIST COVERAGE ALONE, IF THE INSURER PROVIDES THE COVERAGE NOT REJECTED SEPARATELY FROM THE COVERAGE REJECTED.

Act of May 6, 1987, § 1, 6 1987 Ind. Legis. Serv. 815, 816 (West).

<sup>39</sup>IND. CODE § 27-7-5-2(a)(1), (2) (Supp. 1987). House Bill No. 1390 provided in pertinent part:

. . . Each THE INSURER SHALL MAKE AVAILABLE, IN EACH automobile liability or motor vehicle liability policy of insurance which is delivered or issued for delivery in this state with respect to any motor vehicle registered or principally garaged in this state, insuring against loss resulting from liability imposed by law for bodily injury or death suffered by any person and for injury to or destruction of property to others arising from the ownership, maintenance, or use of a motor vehicle, ~~must provide coverage, either in the policy~~ or in a supplement to it—SUCH A POLICY, THE FOLLOWING TYPES OF COVERAGE:

(1) in limits for bodily injury or death and for injury to or destruction of property NOT LESS THAN THOSE set forth in IC 9-2-1-15 under policy provisions approved by the commissioner of insurance, for the protection of persons insured ~~thereunder~~ UNDER THE POLICY who are legally entitled to recover damages from owners or operators of uninsured OR UNDERINSURED motor vehicles because of bodily injury, sickness or disease, including death, and for THE PROTECTION OF PERSONS INSURED UNDER THE POLICY WHO ARE LEGALLY ENTITLED TO RECOVER DAMAGES FROM OWNERS OR OPERATORS OF UNINSURED MOTOR VEHICLES FOR injury to or destruction of property resulting therefrom; or

(2) in limits for bodily injury or death NOT LESS THAN THOSE set forth in IC 9-2-1-15 under policy provisions approved by the commissioner of insurance, for the protection of persons insured under the policy provisions who are legally entitled to recover damages from owners or operators of uninsured OR UNDERINSURED motor vehicles because of bodily injury, sickness or disease, including death resulting therefrom.

Act of May 6, 1987, § 1, 6 1987 Ind. Legis. Serv. 815, 816 (West).

<sup>40</sup>IND. CODE § 27-7-5-2(a) (Supp. 1987). For the full text of this portion of the statute, see *supra* note 38 and accompanying text.

This Article does not attempt to address all issues this new underinsurance legislation will raise. It should be noted, however, that one important issue may lead to litigation. The legislation requires all insurance companies to *provide*, not merely to *offer*, uninsured and underinsured motorist coverages in limits equal to the insured's bodily injury liability

uninsured or underinsured coverages in limits exceeding his bodily injury liability coverage.<sup>41</sup>

Although this amendment will undoubtedly create many unresolved issues for the courts,<sup>42</sup> this Article does not attempt to address those issues. Instead, the Article will focus on Indiana's decision to enact a Type II statute allowing setoff.

Indiana's amendment provides for setoff in two separate sections. Indiana Code § 27-7-5-4(b) defines an underinsured motor vehicle as including:

[A]n insured motor vehicle where the limits of coverage available for payment to the insured under all bodily injury liability policies covering persons liable to the insured are less than the limits for the insured's underinsured motorist coverage at the time of the accident, but does not include an uninsured motor vehicle as defined in subsection (a).<sup>43</sup>

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limits. IND. CODE § 27-7-5-2(a) (Supp. 1987). The insured is permitted to reject these coverages in writing. *Id.* § 27-7-5-2(b)(1) and (2). Assuming an insurance company provided uninsured and underinsured motorist coverages in limits less than the insured's liability limits, a court could easily find that the insurance company must nevertheless provide coverages at the higher limits. *See e.g.* Prudential Insurance Co. v. Marshall, 1 Ohio Misc. 2d 14, 440 N.E.2d 71 (1982).

From the wording in the statute, it is unclear whether the insured could reject in writing limits equal to his liability limits and then purchase lower limit uninsured and underinsured coverages. It is the authors' opinion that a strong argument could be made that an insurance company would be precluded from selling lower limit uninsured and underinsured coverages.

<sup>41</sup>IND. CODE § 27-7-5-2(a)(2) (Supp. 1987). House Bill No. 1390 provided in relevant part:

UNINSURED MOTORIST COVERAGE OR UNDERINSURED MOTORIST COVERAGE MAY BE OFFERED BY AN INSURER IN AN AMOUNT EXCEEDING THE LIMITS OF LIABILITY SPECIFIED IN THE BODILY INJURY AND PROPERTY DAMAGE LIABILITY PROVISIONS OF THE INSURED'S POLICY.

Act of May 6, 1987, § 1, 1987 Ind. Legis. Serv. 815 (West).

<sup>42</sup>One issue that is sure to arise is the effect of Indiana's Comparative Fault Act upon the new underinsurance legislation.

Imagine the following hypothetical. A victim has \$150,000 of damages and was 50% at fault in causing the collision. The tortfeasor, who was also 50% at fault, carried liability limits of \$25,000/\$50,000. Even after the 50% reduction for the victim's own fault, the victim's damages exceed the tortfeasor's liability limits of \$25,000, and therefore, the victim would be entitled to collect the full \$25,000 from the tortfeasor. Assume further that the victim has \$100,000 of underinsurance protection. Applying Indiana's setoff provision, the maximum amount of underinsurance the victim can collect is \$75,000.

The question that remains unsettled is whether this \$75,000 should be further reduced by the percentage of the victim's fault under the principles of comparative fault. The statute does not specifically allow for such a reduction. Additionally, strong arguments can be advanced that the statute prohibits such reduction.

<sup>43</sup>IND. CODE § 27-7-5-4(b) (Supp. 1987).

This definition compares the amount of the tortfeasors' bodily injury coverage available for payment to the victim with the victim's underinsured motorist coverage. Like all Type II statutes, the focus is on the amount of the victim's underinsurance and *not* on the victim's damages.<sup>44</sup> That is, a vehicle is *underinsured* only when the amount paid to the victim under all tortfeasors' liability policies is less than the victim's underinsurance policy limits. If the amount paid under all tortfeasors' liability policies is greater than or equal to the victim's underinsurance limits, underinsurance will not be available to the victim. In other words, the sum of the amount collected under the tortfeasors' policies is subtracted from or setoff against the victim's underinsurance coverage despite the fact that he may not have been fully compensated for his damages.<sup>45</sup>

The other provision of the amendment allowing setoff actually sets out the method for determining how much underinsurance is available. Indiana Code § 27-7-5-5(c) provides:

- (c) The maximum amount payable for bodily injury under uninsured or underinsured motorist coverage is the lesser of:
  - (1) the difference between:
    - (A) the amount paid in damages to the insured by or for any person or organization who may be liable for the insured's bodily injury; and
    - (B) the per person limit of uninsured or underinsured motorist coverage provided in the insured's policy; or
  - (2) the difference between:
    - (A) the total amount of damages incurred by the insured; and
    - (B) the amount paid by or for any person or organization liable for the insured's bodily injury.<sup>46</sup>

Essentially, the method used is a three-step process. The first step involves computing the difference between the amount that the victim receives from all tortfeasors and the amount of the victim's underinsured coverage.<sup>47</sup> Assume that the victim receives \$50,000 from the tortfeasor(s) and has \$100,000 of underinsurance coverage. The difference is \$50,000.

The second step involves computing the difference between the victim's total damages and the total amount paid by the tortfeasor(s).<sup>48</sup>

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<sup>44</sup>See *supra* text accompanying note 31.

<sup>45</sup>See *supra* text accompanying notes 31-33. For a detailed discussion concerning the operation of this statute in collisions involving more than two seriously injured victims, see *infra* text accompanying notes 52-54.

<sup>46</sup>IND. CODE § 27-7-5-5(c) (Supp. 1987).

<sup>47</sup>*Id.* § 27-7-5-5(c)(1)(A), (B).

<sup>48</sup>*Id.* § 27-7-5-5(c)(2)(A), (B).

Assume the victim's damages are \$200,000 and the victim receives \$50,000 from the tortfeasor(s). The difference is \$150,000.

The third step compares the amounts arrived at in steps one and two. Under this statute, the maximum amount of underinsurance protection the victim can receive is the *lesser* of the two amounts.<sup>49</sup> In the above example, the amount arrived at in step one was \$50,000, whereas the amount arrived at in step two was \$150,000. Because \$50,000 is less than \$150,000, the victim would only receive \$50,000 of his underinsurance despite the fact that he had \$100,000 of such coverage. The victim's total recovery would be \$100,000 — \$50,000 from the tortfeasor and \$50,000 from his own underinsurance.

Clearly, the victim has received some benefit from his underinsurance protection, but that benefit has been minimized by the setoff provision. Had there not been setoff in the above hypothetical, the victim would have collected \$150,000 of his damages, i.e., \$50,000 from the tortfeasor(s) and his full \$100,000 of underinsurance coverage. Although the victim would still not have been fully compensated for his \$200,000 injury, the absence of setoff certainly would have served to maximize his protection.

This minimization occurs every time the victim's recovery from the tortfeasor(s) exceeds or is equal to his underinsurance coverage. In these situations, setoff will always operate to eliminate underinsurance protection for the victim. For example, assume that a victim has \$200,000 in damages and has purchased only \$25,000 of underinsurance. Assume further that the victim has recovered \$25,000 from the tortfeasor, his total liability limits. Because the tortfeasor's \$25,000 of coverage is setoff against the victim's \$25,000 of underinsurance coverage, the victim will collect only the \$25,000 from the tortfeasor. The victim will collect nothing from his underinsurance carrier. The above example is particularly compelling in light of the fact that the minimum limit of bodily injury coverage in Indiana is \$25,000,<sup>50</sup> and the minimum limit of underinsurance is likewise \$25,000.<sup>51</sup> It should be noted, however, that this result can also occur in a higher limit situation. If a victim has \$100,000 of underinsurance coverage, he will find himself without any underinsurance protection if he collects \$100,000 or more from the tortfeasor(s) despite the fact that his damages may be in excess of \$100,000.

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<sup>49</sup>*Id.* § 27-7-5-5(c). For a detailed discussion concerning the operation of this statute in collisions involving more than two seriously injured victims, see *infra* text accompanying notes 52-54.

<sup>50</sup>*Id.* § 9-2-1-15.

<sup>51</sup>*Id.* § 27-7-5-2.

At first blush, an insured might conclude that in the above situations, he has paid a premium and received no real coverage. This is not entirely accurate. For example, underinsurance might be available in an automobile collision involving more than two injured people. Assume that four people suffer total damages in excess of \$50,000 when injured by a tortfeasor with minimum limits of \$25,000/\$50,000. In this case, the maximum shared by all four victims is \$50,000 and the maximum any one victim could recover would be \$25,000. Assuming the \$50,000 is divided equally among the victims, each would receive \$12,500 from the tortfeasor. If a victim also had \$25,000 of underinsurance, the \$12,500 received from the tortfeasor would be setoff against his \$25,000 of underinsurance. Consequently, the victim would receive \$12,500 of his underinsurance protection.

Despite the fact that the victim's underinsurance limits are identical to the tortfeasor's liability limits, the victim's underinsurance premium has indeed paid for some coverage. The language of Indiana's underinsurance amendment ensures this result. Specifically, the statute states that the amount setoff against the victim's underinsurance limits is the amount "available for payment to the insured,"<sup>52</sup> "the amount paid in damages to the insured,"<sup>53</sup> or "the amount paid, by or for any person or organization liable for the insured's bodily injury."<sup>54</sup> In other words, it is not the amount of the tortfeasor's liability coverage that determines the amount to be setoff, rather it is the amount actually recovered from the tortfeasor. Thus, if a victim is involved in a collision with more than two injured people, he may still receive some payment from his underinsurance even when his underinsurance limits are identical to the tortfeasor's liability limits.

Although setoff will not eliminate all underinsurance protection in the limited situation outlined above, there will nevertheless be many situations when setoff does eliminate all such protection.<sup>55</sup> Given this harsh reality, one wonders why Indiana's legislature chose to enact a Type II statute allowing setoff. In an interview with Donald L. Roll, President of the Insurance Institute of Indiana, Inc., Mr. Roll indicated that economic considerations motivated the insurance industry to lobby for setoff provisions.<sup>56</sup> He stated that nearly all major insurance com-

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<sup>52</sup>*Id.* § 27-7-5-4(b). For the full text of this portion of the statute, see *supra* text accompanying note 43.

<sup>53</sup>*Id.* § 27-7-5-5(c)(1)(A). For the full text of this portion of the statute, see *supra* text accompanying note 46.

<sup>54</sup>*Id.* § 27-7-5-5(c)(2)(B). For the full text of the statute, see *supra* text accompanying note 46.

<sup>55</sup>See *supra* text accompanying notes 50-51.

<sup>56</sup>Interview with Donald L. Roll, President of the Insurance Institute of Indiana, Inc. (Sept. 28, 1987).

panies doing business in Indiana were already offering underinsurance with setoff provisions in their policies. He further claimed that a non-setoff amendment would have resulted in increased rates. The insurance industry feared that a rate increase would cause insureds to reject underinsured motorist protection. If that occurred, the insurance industry would not only suffer a loss in premiums, but also the goal of broad protection would be compromised.<sup>57</sup>

Mr. Roll was unable to provide any specific projections of the actual rate increase that would result from offering non-setoff coverage as opposed to setoff coverage.<sup>58</sup> However, figures received from Indiana's Department of Insurance indicate that the rate increase feared by the insurance industry would not have been dramatic enough to cause insureds to reject non-setoff underinsurance coverage.<sup>59</sup>

The table below compares the annual rates of two major insurance companies doing business in Indiana: State Farm Mutual Automobile Insurance Company and American States Insurance Company. These rates were in effect in September of 1987 and were combined rates for both uninsured and underinsured coverages. This comparison is particularly significant because State Farm offered underinsurance without setoff whereas American States' policies included setoff provisions.

*Annual Rate Comparison Table*<sup>60</sup>

<u>Limits of Coverage</u>	<u>State Farm</u>	<u>American States</u>	<u>Difference</u>
\$25,000/\$50,000	\$15.20	\$ 9.00	\$ 6.20
\$50,000/\$100,000	\$22.60	\$14.20	\$ 8.40
\$100,000/\$300,000	\$35.60	\$18.40	\$17.20

Although the annual rate comparison table is limited two companies,

<sup>57</sup>*Id.*

<sup>58</sup>*Id.*

<sup>59</sup>Telephone interview with a spokesperson at the Indiana Department of Insurance (September 29, 1987). The Department of Insurance did not express any opinion concerning whether any increased rate for non-setoff underinsurance would cause consumers to reject such coverage.

<sup>60</sup>*Id.* The Department of Insurance provided the following separate semi-annual rates for uninsured and underinsured motorists coverages charged by State Farm which became effective February 1, 1987, for new policy owners and March 1, 1987, for renewals:

<i>Limits of Coverage</i>	<i>Uninsured</i>	<i>Underinsured</i>
\$25,000/50,000	\$ 3.60	\$ 4.00
\$50,000/100,000	\$ 4.80	\$ 6.50
\$100,000/300,000	\$ 5.80	\$12.00

*Id.* These semi-annual rates were combined and doubled for the rates used in the Annual

it seems reasonable to conclude that the premiums charged are representative, given the competitive nature of automobile insurance underwriters.<sup>61</sup> In view of the moderate differences in premiums between non-setoff coverages and setoff coverages, the insurance industry's assumption that non-setoff underinsurance would be cost prohibitive for insureds is unfounded. It seems unlikely that insureds would reject non-setoff underinsurance based upon the rate differences cited above, assuming, of course, they understood the additional benefits they could receive with non-setoff coverage.

The Indiana Trial Lawyers Association, Corp. (ITLA) originally proposed a bill that would have prohibited setoff.<sup>62</sup> Following the defeat of that proposal in a subcommittee hearing, the ITLA elected to support the insurance industry's bill which was subsequently enacted.<sup>63</sup> The ITLA's decision to support the underinsurance bill allowing setoff was based on three advantages it perceived would result from a bill including setoff as opposed to no bill at all.<sup>64</sup> First, the ITLA believed that because all insurance companies would be required to offer underinsurance, more citizens would benefit from this extra coverage.<sup>65</sup> Second, because the bill mandates that insurance companies offer underinsurance in limits equal to the insured's liability limits,<sup>66</sup> the ITLA believed that insureds would be required to purchase higher amounts of underinsurance coverage than they previously had purchased.<sup>67</sup> Finally, because the bill mandates that insurance companies provide uninsured motorist coverage in limits

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Rate Comparison Chart.

The Department of Insurance provided the following combined semi-annual rates for uninsured and underinsured motorist coverages charged by American States. These rates were in effect in September of 1987:

<i>Limits of Coverage</i>	<i>Uninsured and Underinsured Combined Rates</i>
\$25,000/50,000	\$ 4.50
\$50,000/100,000	\$ 7.10
\$100,000/300,000	\$ 9.20

*Id.* These semi-annual rates were doubled for the rates used in the Annual Rate Comparison Table.

<sup>61</sup>Interview with Donald L. Roll, President of the Insurance Institute of Indiana, Inc. (Sept. 28, 1987).

<sup>62</sup>Interview with George C. Gray, Legislative Chairman for the Indiana Trial Lawyers Association, Corp. (Oct. 2, 1987). *See also supra* note 35 and accompanying text.

<sup>63</sup>*Id.*

<sup>64</sup>*Id.*

<sup>65</sup>*Id.*

<sup>66</sup>IND. CODE § 27-7-5-2(a) (Supp. 1987).

<sup>67</sup>Interview with George C. Gray, Legislative Chairman for the Indiana Trial Lawyers Association, Corp. (Oct. 2, 1987).

equal to the insured's liability limits,<sup>68</sup> the ITLA believed that insureds also would receive additional uninsured motorist protection.<sup>69</sup>

Although on the surface the new underinsurance provisions might appear advantageous to Indiana consumers, the end result of creating legislation in this area may have done consumers more harm than good. Prior to the enactment of underinsurance legislation, nearly all major insurance companies were already offering underinsurance to their insureds.<sup>70</sup> Although most of these companies were writing policies which contained setoff provisions, at least one Indiana arbitration decision struck down that provision and awarded the claimant the full amount of underinsurance coverage listed on her declaration sheet.<sup>71</sup> The arbitrators found that the presence of the setoff provision in the insurance contract gave rise to an ambiguity when considered in light of both the amount of underinsurance shown on the declaration sheet and the stated limit of liability provision contained in the policy. The arbitrators reasoned that if the setoff provision were enforced, the underinsurance limits provided for in the insurance contract could never be recovered in full. That is, enforcement of the setoff provision essentially would make meaningless the dollar amounts of coverage stated in the policy.<sup>72</sup> After concluding the ambiguity existed, the arbitrators resolved the ambiguity against the insurance carrier, consistent with well established principles of insurance law.<sup>73</sup>

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<sup>68</sup>IND. CODE § 27-7-5-2(2)(a) (Supp. 1987). See also *supra* notes 38-40 and accompanying text.

<sup>69</sup>Interview with George C. Gray, Legislative Chairman for the Indiana Trial Lawyers Association, Corp. (Oct. 2, 1987).

<sup>70</sup>Interview with Donald L. Roll, President of the Insurance Institute of Indiana, Inc. (Sept. 28, 1987).

<sup>71</sup>Kopack, *Fortener v. Commercial Union Insurance*, 7 VERDICT 117 (1985).

<sup>72</sup>*Id.* In the *Fortener* case, the claimant had \$100,000 of underinsurance coverage with Commercial Union Insurance. She collected the full \$25,000 of liability limits from the tortfeasor. The insurance company argued for setoff based on the following policy language: "However, the limit of liability shall be reduced by all sums paid because of the bodily injury, or on behalf of persons or organizations that may be at fault." *Id.*

However, another section of the policy and the declaration sheet were used to support the argument that setoff should not be allowed: "The *Limit of Liability* in the Declarations for each person for underinsured motorist coverage is our *maximum* limit of liability for all damages for bodily injury sustained by any one person in any one accident." *Id.*

The three member arbitration panel found that the above policy sections and the declaration sheet created an ambiguity and thus awarded the claimant her full \$100,000 of underinsurance coverage. *Id.*

<sup>73</sup>E. FISCHER & P. SWISHER, PRINCIPLES OF INSURANCE LAW § 1.01 (1986). Under the theory of *contra proferentum*, or the "doctrine of ambiguities," an insurance contract will be strictly construed against the insurer and liberally construed in favor of the insured if the insurance contract is ambiguous. *Id.* See, e.g., *Leist v. Auto Owners Ins. Co.*, 160 Ind. App. 322, 311 N.E.2d 828 (1974).

Similarly, in *Transamerica Insurance Group v. Osborn*,<sup>74</sup> the court held that the presence of a setoff provision in the insurance contract, when read in conjunction with the insured's declaration sheet, gave rise to "an inherent ambiguity in the policy."<sup>75</sup> The ambiguity arose because the insured reasonably believed that he had purchased the full amount of coverage stated on his declaration sheet and *not* some amount diminished by setoff.<sup>76</sup> In resolving the ambiguity in favor of the insured, the court determined that the insured's reasonable expectations deserved protection. Consequently, the court awarded him the full amount of his underinsurance coverage.<sup>77</sup>

Despite the fact that the arguments outlined above were advanced in situations where there were no statutory provisions governing underinsurance, it may still be possible to raise these arguments in Indiana even after legislative approval of setoff. Although the legislature has sanctioned the sale of policies with setoff provisions, the legislature has not sanctioned the sale of ambiguous insurance contracts. In other words, even though the underinsurance policy will be written with reference to the statute,<sup>78</sup> the problem of ambiguity remains. A reasonable person, viewing the amount coverage on his declaration sheet, will still expect that he has purchased the full amount of coverage listed there. Therefore, it may nevertheless be possible to argue that the insurance policy read as a whole is ambiguous. To resolve that ambiguity and to protect the reasonable expectation of the insured, the setoff provision must be voided, and the insured must be provided the full amount of coverage on his declaration sheet.<sup>79</sup>

Additional evidence of the harm that may have resulted from underinsurance legislation permitting setoff is noted in State Farm Mutual Automobile Insurance Company's response to this legislation. Prior to

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<sup>74</sup>627 F. Supp. 1405 (D. Mont. 1986).

<sup>75</sup>*Id.* at 1409. The insured was seriously injured in an automobile collision and collected the policy limits of \$25,000 from the negligent motorist. At the time of the collision, the insured had \$50,000/person of underinsurance coverage listed on his declaration sheet. Because the insured's damages exceeded \$75,000, he made a claim for the full \$50,000 of underinsurance coverage. *Id.* at 1406.

<sup>76</sup>*Id.* 1408-09.

<sup>77</sup>*Id.* 1409-11. Although not in the context of underinsured motorist coverage, the Supreme Court of Indiana has adopted a similar analysis with regard to the interpretation of insurance contracts. If an ambiguity is found, the ambiguity is resolved to protect the reasonable expectations of the insured. *Eli Lilly and Co. v. Home Ins. Co.*, 482 N.E.2d 467 (Ind. 1985).

<sup>78</sup>*See* *Bocek v. Inter-Ins. Exch. of Chicago Motor Club*, 175 Ind. App. 69, 369 N.E.2d 1093 (1977) ("[w]hen a contract of insurance is entered into on a matter surrounded by statutory limitations and requirements such as with uninsured motorist coverage the parties are presumed to have entered into their agreement with reference to the statute.").

<sup>79</sup>*See supra* text accompanying notes 71-77.

the passage of the new statute, State Farm, the largest automobile insurance underwriter in the state, was offering underinsurance coverage without setoff.<sup>80</sup> A State Farm spokesman indicated that had this legislation not been passed, State Farm would have continued to offer underinsurance without setoff. As of January 1, 1988, however, the underinsurance coverage offered by State Farm will contain setoff provisions.<sup>81</sup> Consequently, if this legislation had not been enacted, many Indiana consumers would have been insured under policies without setoff, thereby maximizing their underinsurance protection. State Farm's position has always been that absent statutory approval of setoff, its policies would be written without setoff provisions for the reasons outlined above. That is, State Farm feared litigation over the enforceability of a setoff provision in light of the ambiguity it creates in the insurance contract and the adverse impact it has on reasonable people's expectations.<sup>82</sup> Thus, it would appear that ITLA's position that some legislation in this area was better than none was ill advised.

It is perhaps difficult to fault Indiana's legislature for enacting an underinsurance bill with setoff when the two competing interest groups, the insurance industry and ITLA, both supported its passage. Unfortunately, however, the legislators' constituents, the citizens of Indiana, will be harmed by this bill. The goal of underinsurance legislation should be to compensate innocent victims of automobile collisions as fully as possible. A Type I statute precluding setoff would have achieved this goal. However, Indiana's citizens are now left with a statute which is not designed to afford maximum compensation to injured parties. Instead, the statute will often minimize, if not eliminate, any underinsurance protection citizens thought they had. Furthermore, one can well imagine the outrage of Indiana's citizens when they discover that they do not have the full coverage they thought they had purchased. The Indiana General Assembly should waste no time in amending the newly enacted underinsurance legislation to preclude setoff. Indiana's citizens expect and deserve more than this illusion of coverage.

#### IV. CONCLUSION

In the 1987 session of the Indiana General Assembly, the legislature expanded the Uninsured Motorist Act to include provisions on underinsurance.<sup>83</sup> Insurance carriers doing business in Indiana now must provide

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<sup>80</sup>Telephone interview with State Farm Mutual Insurance Company spokesman (Sept. 30, 1987). See also *supra* note 36 and accompanying text.

<sup>81</sup>*Id.*

<sup>82</sup>*Id.*

<sup>83</sup>IND. CODE § 27-7-5-2, -4, -5 (Supp. 1987).

their insureds underinsured and uninsured motorist coverages in amounts equal to their liability limits, unless the insureds reject those coverages in writing.

The goal of underinsurance should be to maximize protection for victims of automobile collisions who are seriously injured by minimally insured drivers. In fact, because Indiana's General Assembly enacted underinsurance legislation permitting setoff, this goal frequently will not be realized. Furthermore, Indiana's consumers will often find themselves without the coverage they assumed they had purchased. Because in many situations Indiana's consumers will have purchased nothing more than illusory coverage, the legislature should amend the underinsurance provisions to preclude setoff at its first opportunity.