THE EVOLUTION OF VIRGINIA'S UNDERINSURED MOTORIST LAW—WHAT RECENT STATUTORY CHANGES WILL MEAN TO YOUR LIABILITY PRACTICE

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I. The Origins of Underinsured Coverage in Virginia

In 1944, the Virginia General Assembly established the Motor Vehicle Safety Responsibility Act. The purpose of the Act was to safeguard the driving public at large by suspending the driving privileges and motor vehicle registrations of "financially irresponsible motorists" who did not or could not satisfy judgments that resulted from motor vehicle accidents that they caused.[1] Instead of mandating insurance, the statute provided that a driver was required to demonstrate that he had the means to protect others, through insurance, bonds, money on deposit, or a certificate of self-insurance.[2] Although the Act was intended to limit the number of uninsured and/or insolvent risks using the public roadways, it did not directly compensate those who were injured by the negligent acts of motorists without sufficient means to compensate the injured person.

Recognizing this deficiency, the Virginia General Assembly evaluated in subsequent years several possible statutory schemes that would provide additional financial protection against uninsured motorists by placing the burden upon the injured party's own insurer. It studied the uninsured motorist laws of Massachusetts, New York, North Carolina, and New Jersey before creating its own legislation.[3] In 1958, uninsured motorist coverage first became available in Virginia under Virginia Code section 38.1-381(b). The statute's stated intent was protecting injured persons from "the financially irresponsible motorist,"[4] which was de-

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[1] Virginia Department of Motor Vehicles Insurance Verification Program, January 2000.

[2] Virginia Motor Vehicle Safety Responsibility Act, ch. 384, Acts of Assembly (1944) (approved Mar. 31, 1944). *See also* Willis v. Commonwealth, 190 Va. 294 (1949).

[3] *Virginia Takes New Approach to the Uninsured Motorist*, 16 Wash. & Lee L. Rev. 134 (1959), http://scholarlycommons.law.wlu.edu/wlulr/vol16/iss1/17.

[4] Va. Advisory Legis. Council to Governor and Gen. Assembly of Va., The Problem of the Irresponsible Motorist (1957).

scribed as a person who is either without funds or whose funds are, for one reason or another, unavailable in sufficient amount for the satisfaction of a judgment.[5] This also included the protection of individuals from injuries caused by hit-and-run drivers, those driving stolen vehicles, completely uninsured motorists, and those driving automobiles for which the insurance company denies coverage.[6]

Virginia Code section 38.1-381(b) (Supp. 1958) required that every bodily injury or property damage liability insurance policy issued or delivered in Virginia must protect the insured against the negligent acts of an uninsured motorist. It also provided for the creation of the uninsured motorist fund, which was to be under the control of the State Corporation Commission.[7] The fund was to be established through special registration fees assessed on anyone registering his vehicle without evidence of satisfactory liability insurance or other proof of financial responsibility.[8]

Subsequently, the Supreme Court of Virginia interpreted the uninsured motorist statute as "remedial in nature, being for the purpose of protecting through their own insurers the innocent victims of irresponsible motorists."[9] It further held that "[t]he legislation having been enacted for the benefit of the injured parties, it is to be liberally construed so that the purpose intended may be accomplished."[10] Still, the statute did not specifically raise the issue of *underinsured* motorist coverage, and it would not do so for another fifteen years.

II. Addition of Underinsured Motorist Coverage

Before 1974, there was no provision in Virginia for underinsured motorist coverage, that is, coverage that would allow an insured plaintiff to recover sums from an individual who lacked sufficient liability coverage. In 1974, the Virginia State Corporation Commission issued Administrative Order 6840 authorizing an endorsement providing that the definition of *uninsured motor vehicles* be broadened to include underinsured motor vehicles.[11] The language codifying underinsured motorist coverage passed the Virginia General Assembly in 1982, when it amended Virginia Code section 38.2-2206 to enumerate the rights and responsibilities of the underinsured motorist carrier.

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5 Fredric C. Jacobs, *The Financially Irresponsible Motorist: A Survey of State Legislation*, 10(3) Vill. L. Rev. 545 (1965).

6 James L. Tucker, *The Virginia Uninsured Motorist Law: Its Intent and Purpose*, 7 Wm. & Mary L. Rev. 106 (1966).

7 Wash. & Lee L. Rev., *supra* note 3, at 135.

8 John M. Court, *Virginia's Experience with the "Uninsured Motorist" Act*, 3 Wm. & Mary L. Rev. 237 (1962).

9 Storm v. Nationwide Ins. Co., 199 Va. 130, 135, 97 S.E.2d 759, 762 (1957).

10 *Id.*

11 John Douglass & Francis E. Telegadas, *Stacking of Uninsured and Underinsured Motor Vehicle Coverages*, 24 U. Rich. L. Rev. 87 (1989). *See also* S.C.C. Order No. 6840 (1974).

Virginia Code section 38.2-2206(A) established that an underinsured motorist carrier is obligated "to make payment for bodily injury or property damage caused by the operation or use of an underinsured motor vehicle to the extent the vehicle is underinsured." It was understood that, under the statute, if such an insurer was served in a tort case (in which it was allowed to appear and defend as though it were a defendant), and judgment was entered against the tort-feasor, the entry of judgment triggered the underinsured carrier's obligation to pay its insured up to the limits of its coverage, less the available liability limits.

The Supreme Court of Virginia, in *Nationwide Mutual Insurance Co. v. Scott*,[12] evaluated the merits of the amendment codifying underinsured coverage, even noting that the General Assembly's fifteen-year failure to define *underinsured motorist* before the 1982 amendments created a legislative anomaly.[13] Before 1982, a person carrying uninsured motorist coverage who was injured by an insured motorist carrying less coverage was limited in recovery by the amount of the tort-feasor's policy.[14] The Court noted that the legislative purpose behind the 1982 amendments "was to increase the total protection afforded by insurance to claimants injured or damaged by negligent motorists" and to expand that protection not just to those injured by the uninsured, but also to those injured by the underinsured.[15] From that point forward, the definition of *underinsured motorist* and the scope of the insurer's obligations to its insureds injured by such an individual were the subject of considerable case law, laying the foundation for the present-day underinsured motorist statute.

III. Amendments to the Statute to Promote Settlement

In 1988, the Virginia General Assembly added subsection K to Virginia Code section 38.2-2206. The intent of the amendment was to encourage settlement by authorizing a liability insurer handling a claim in which underinsured motorist coverage was also available to pay the limits of its coverage without obtaining a release for its insured. It did not relieve the insurer of its duty to defend its insured. The amendment had little practical effect; many insurers recognized that paying their limits without a release and continuing to defend their insureds left them in an inferior negotiating position with both the plaintiffs and with the underinsured motorist insurers.

After many years of operating under essentially the same statutory scheme, in 2010, the Virginia General Assembly further amended Virginia Code section 38.2-2206 with the addition of subsection L. This subsection was added to promote settlement of cases involving underinsured motorist coverage behind fully exposed and likely-to-be tendered liability limits. The statute permitted a liabil-

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12 234 Va. 573, 363 S.E.2d 703 (1988).

13 National Union Fire Ins. Co. of Pittsburgh, Pa. v. Johnson, 709 F. Supp. 676, 679 (E.D. Va. 1989) (citing Nationwide v. Scott, 234 Va. 573, 576, 363 S.E.2d 703, 705 (1988)).

14 *Scott*, 234 Va. at 573, 363 S.E.2d at 703.

15 *Id.*

ity insurer to irrevocably tender its insured's policy limits to a plaintiff in writing and then make a demand that costs incurred sixty days after that tender be paid by the underinsured motorist carrier. The duty to defend the lawsuit remained with the liability insurer, but the obligation to pay costs associated with the defense could be shifted to the underinsured motorist carrier following the resolution of the case. The statutory change intended to pressure the underinsured motorist insurer to either resolve the case or risk bearing further defense costs.

As a practical matter, the statute was rarely used in the defense community. When a liability insurer suggested it would exercise its rights under the statute, underinsured motorist carriers would often respond with a refusal to waive subrogation, thus leaving the individual defendant exposed to an excess judgment. Likewise, the statute could create a conflict between an insurer, its insured, and counsel retained for the protection of its insured. Defense attorneys were concerned with the ethical implications of becoming involved in such a dispute and often felt obligated to advise the insurers that such tactics were not in the best interest of the attorneys' clients.

The statute was modified again in 2011, making it slightly more favorable to the underinsured motorist carrier. A liability insurer was still permitted to make an irrevocable offer of its limits, but it could be made contingent upon waiver of subrogation by the underinsured motorist carrier. Moreover, the underinsured motorist carrier became obligated for the costs of the defense only if the final judgment was in excess of tendered liability limits. The practical effect of the statutory change in 2011 was limited, and the statute was still infrequently used because the underinsured motorist carrier still controlled what the liability carrier and its insured needed: a waiver of subrogation. The change did little to affect the resolution of such claims or to change the responsibilities of the underinsured motorist carrier. The statute remained practically ineffective.

IV. Significant Changes to the Underinsured Statute in 2015

On July 1, 2015, a sweeping overhaul of the underinsured motorist provisions of the statute went into effect in the hope of accomplishing what the prior modifications to the statute had not: the prompt and orderly settlement of liability claims where the liability limits have been tendered and the underinsured motorist carrier is disputing the value of the case.

In the past, a claimant would avoid settling for the named defendant's limits because the underinsured carrier would assert that the plaintiff breached his insurance contract by materially affecting the insurer's subrogation rights. Nor was it in the best interests of the named defendant/liability insured, because that individual could still be financially exposed if he did not receive a waiver of subrogation. It was not always in the liability carrier's best interest because the duty to defend its insured against the claim would survive the tender (although under the more recent amendment, the liability insurer could, in theory, shift costs).

The difficulty with any partial settlement before this statutory arrangement was the "consent to settle" condition in the standard Virginia policy endorsement. A plaintiff who accepted funds from any insurer lost his claim to the coverage of any nonconsenting underinsured motorist carrier.[16] A settlement completely releasing the tort-feasor would trigger the exclusion and deprive an injured plaintiff access to his own underinsured motorist coverage.[17] The most recent amendment to the statute is designed to eliminate these obstacles to settlement and puts the onus on the underinsured motorist carrier to take an active role in resolution.

The 2015 changes to Virginia Code section 38.2-2206 included amendments to subsections K and L, as well as the addition of new subsections M and N. Subsection K was the provision first modified in 1988 in an attempt to promote settlement, but the 2015 amendment completely changed the responsibilities of a liability carrier. The previous version of the statute allowed the liability carrier simply to pay its limits without obtaining a release for its insured, provided that it gave notice to its insured and the underinsured motorist carrier that it had paid. Subsection K now provides that a liability carrier may pay its policy limits to the plaintiff and obtain a release without prejudice to the plaintiff's claim for underinsured motorist coverage. Because the tort-feasor is released, the liability carrier then has no further duties to its insured, including the duty to defend. Moreover, the underinsured motorist carrier has no right to pursue the liability carrier's insured in subrogation, unless he unreasonably fails to cooperate with the underinsured motorist carrier's defense of the case.[18] In order to obtain that cooperation, the underinsured motorist carrier must pay the reasonable costs and expenses that would be incurred by the individual defendant in cooperating, including any travel costs (if more than 100 miles from the location of his deposition or trial). If the tort-feasor fails to cooperate, the right of subrogation is established.

Because cooperation of the individual defendant with the underinsured motorist carrier was not required before enactment of this statute, in 2015 the Virginia General Assembly simultaneously passed Virginia Code section 8.01-66.1:1, which defines the cooperation obligations of the liability carrier's insureds after the liability carrier pays its limits and obtains a release. A failure to meet any of the four enumerated obligations results in a rebuttable presumption that the released defendant is failing to cooperate with the underinsured motorist carrier. Those obligations include: (1) to attend his deposition or trial if subpoenaed to appear at least twenty-one days in advance of either event; (2) to assist in responding to written discovery; (3) to meet with defense counsel for a

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16 *See* Osborne v. National Union Fire Ins. Co., 251 Va. 53 (1988); Virginia Farm Bur. Mut. Ins. Co. v. Gibson, 236 Va. 433 (1988); Allstate Ins. Co. v. Kinard, 45 Va. Cir. 273 (Richmond City 1998).

17 John D. Eure, Craig R. Gallagher, Kyle McNew, and Randall L. Snow, *A New UM/Subrogation World: Details & Practical Considerations*, presentation at the 2015 VADA Annual Conference.

18 Virginia Code § 8.01-66.1:1 (2015) was enacted to address the issues of cooperation by the underinsured defendant.

reasonable period of time after reasonable notice, by phone or in person, within twenty-one days of being served with any lawsuit and again before his deposition and trial; or (4) to notify counsel for the underinsured motorist benefits insurer of any change in address.

The individual defendant may rebut the presumption that he failed to reasonably cooperate, and if the court finds that his failure to cooperate was not unreasonable or that he "otherwise acted in good faith" in attempting to comply with his duty to reasonably cooperate with the underinsured motorist carrier, then the right of subrogation is not established. If the court finds that the individual defendant satisfied his duty to cooperate with the underinsured motorist carrier or that his failure to do so was not unreasonable, then the court may award him his costs in defending against the subrogation action, including reasonable attorney's fees. Notably, the amended statute does not include a prejudice requirement, so it is an open question whether prejudice is something that a court would consider in deciding whether to grant subrogation rights to the underinsured motorist carrier.

Another significant change to the statute is an amendment to subsection L. Before the 2015 amendment, subsection L addressed the procedure for a liability carrier's "irrevocable offer" that triggered the underinsured motorist carrier's responsibility for the costs associated with defending the case. The newly amended language prescribes the manner in which the liability carrier's settlement set forth in subsection K is obtained. The process is detailed and requires all the parties to properly execute documents, obtain signatures, and provide notices.

Virginia Code section 38.2-2206(L) states that, when a liability insurer settles with the plaintiff, it must notify its insured in a written "notice of release" that is signed by both the plaintiff and the underinsured motorist. The language of the required notice must be provided to the individual defendant verbatim. It advises him that settlement had been reached and that he has specific obligations to cooperate with the underinsured motorist carrier throughout the remainder of the litigation. The statute also requires that the individual defendant must acknowledge the settlement with his signature, and he must initial the notice. The requirement for an acknowledgement and initials of the underinsured motorist is waived if the liability carrier sends a copy of the required notice to the underinsured motorist by certified mail, return receipt requested.

In addition to those two amendments, the Virginia General Assembly added two new provisions to the statute. Subsection M establishes that a lawsuit brought by a plaintiff or his personal representative to recover underinsured motorist benefits after payment of the liability insurer's limits per subsection K is to be filed against the individual defendant (even though he is already conditionally released). A copy of the complaint is then to be served on the underinsured motorist carrier. It is unclear if the individual defendant still needs to be served. If a lawsuit is pending at the time the liability insurer pays its limits to the plaintiff, then the lawsuit shall remain pending against the released defen-

dant. If the case proceeds to verdict, then judgment is to be entered in the name of "Released Defendant" and is enforceable against the underinsured motorist carrier up to its limits.

The other addition to the statute is subsection N. It provides that when a liability carrier reaches a settlement with a person under disability (such as a minor) or as a component of a wrongful death action under subsection K (that compromises, in part, a wrongful death claim), the settlement may be (but is not required to be) court-approved at that time. If it is a wrongful death action and the personal representative elects not to have the settlement with the liability insurer approved by the court any payment made must be held in trust or paid into the court with no disbursements until the compromise is approved by the court. As in subsection K, such a settlement does not preclude the claimant from pursuing his claim through the underinsured motorist carrier.

V. Phase-In of Effect and Applicability of Revised Statute

Although the new version of Virginia Code section 38.2-2206 went into effect in July 2015, the changes will apply only to policies issued on or after January 1, 2016. While working through pre-amendment policies, underinsured motorist carriers will be operating under two statutory schemes under which the obligations of the respective parties could be disparate. Underinsured carriers will have to take great care to ensure that all parties are aware from the outset of the effective date of the applicable policy. The plaintiff will need the effective date to know whether he can agree to settle the case with the liability carrier without risking access to his underinsured coverage. The liability carrier will need to know to determine whether it has the right to settle the claim under newly enacted subsection K. And the underinsured carrier will need to know so that it can be aware of its own obligations and to plan a possible defense to the claim. This is just one of the many concerns that may arise as the new ststute is implemented and interpreted.

VI. Concerns about the Underinsured Carrier's Good Faith

The Supreme Court of Virginia has not considered whether an underinsured motorist carrier has good faith obligations to its insured. However, some recent circuit court decisions have challenged the conventional wisdom that an underinsured motorist carrier owes no duty to its insured until a judgment is rendered against the named defendant. Instead, some plaintiffs have argued that Virginia Code section 8.01-66.1 requires an underinsured carrier to act in good faith even before a judgment is rendered.

For example, a Norfolk Circuit Court opinion held that a plaintiff might be entitled to access portions of an underinsured motorist carrier's claim file to determine if the insurer was acting in "pretrial bad faith."[19] The Norfolk Circuit Court relied upon three other circuit court opinions in holding that an underin-

[19] Chevalier-Seawell v. Mangum (No. CL 14-2789, City of Norfolk, Aug. 3, 2015) (VLW 015-8-092).

sured motorist carrier could indeed have pretrial good faith obligations toward its insured.[20]

It is expected that the recent statutory changes will promote more affirmative involvement on the part of the underinsured carriers. Until all the policies issued under the prior statutory scheme expire and their replacements operate under the new statutory scheme, the rights and responsibilities of all the parties will have to be examined on a case-by-case basis and depending on the effective date of the policy. After that time, with the underinsured motorist carrier taking on a more prominent role in the defense of claims, it is likely that its duties to its insured will face greater scrutiny.

VII. How the Statutory Changes Could Backfire

As with any sweeping changes to a long-standing regulation, the unintended consequences of the new statute for all of the parties to a tort case remain to be seen. While the intent of the statute is to encourage settlement, there will be negative consequences and issues to resolve. The following are some examples of possible negative consequences:

Do nonstandard insurers benefit disproportionately? It is likely that most cases involving nonstandard liability carriers with minimum-limits policies will tender early to avoid the costs of defense and thereby shift those considerable costs to the higher-limits policy of the underinsured motorist carrier. This may, in turn, drive up the costs of these higher-limit policies because of the expected increase in costs and legal fees.

Do persons being sued who opted for lower limits benefit disproportionately? The original uninsured motorist statute went to great lengths to protect the public from the "financially irresponsible motorist." Now, drivers who pay lower premiums for less coverage directly benefit from the higher-limits coverage that the person whom they injured secured for themselves, without any real consequence or risk for being less financially responsible than others.

Will the underinsured motorist carrier be able to play catch-up? Subsection M makes it clear that a claim could be settled between the claimant and the liability defendant before suit is filed. While the underinsured motorist carrier should receive notice under subsection L, that settlement could take place close to the expiration of the statute of limitations. If the liability carrier fails to conduct a complete investigation on the assumption that the limit would be paid, when that settlement is consummated, the underinsured motorist will have access to very little information, will have little access to the physical evidence, and witness recollections may have faded with time.

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[20] Copenhaver v. Davis, 31 Va. Cir. 227 (Louisa 1993); Olson v. Allstate Ins. Co., 44 Va. Cir. 379 (Hampton 1998); and Ballard v. State Farm Mut. Auto. Ins. Co., 1997 Va. Cir. 584 (Va. Beach 1997).

Is there an attorney-client privilege? There are ethical concerns about the newly formed relationship between the underinsured motorist carrier's retained counsel and the conditionally released individual defendant. The individual defendant has an obligation to cooperate, but if potentially confidential information is disclosed during that cooperation, it may be discoverable because there is no attorney-client relationship. A plaintiffs' attorney may be permitted to ask what discussions took place between the released defendant and the underinsured motorist's counsel, and the protection of privilege may be unavailable. An argument could be made that this is now the work product of the underinsured motorist carrier's attorney, but the viability of that protection is questionable without greater clarification by the statute in defining this new relationship.

Is the liability carrier's claim file discoverable? In situations such as the one above, would the liability carrier's claim file be discoverable for use by the underinsured motorist carrier? Can a liability insurer make portions of its claim file available to the underinsured motorist carrier but withhold them from the plaintiff? This would include items not typically available through discovery, such as the defendant's statement, reports or notes from conversations with specially retained experts for which the liability carrier would no longer have any use, witness interviews, and other such materials that would typically be considered part of the claim file. Having lost the right to subrogate against the individual defendant, the underinsured motorist carrier loses any leverage over the liability carrier and the individual defendant to obtain information and assistance from the liability carrier. The statute obligates the individual defendant to cooperate, but it places no such obligations on the liability insurer. This could leave the underinsured motorist carrier and its counsel in an inferior position in obtaining information crucial to the defense. This may prompt Virginia to recognize some form of the common interest doctrine, to the extent that it has not already, to shield any file-sharing between defense and the liability insurer. The liability carrier and the underinsured motorist carrier may also consider a joint defense agreement that could be used to shield the work product.

Could this be strategically abused by a plaintiff? Are there situations in which a demand and settlement is strategically made just weeks before trial? Such a circumstance would result in the underinsured motorist carrier's attorney inheriting first-chair responsibilities, leaving the plaintiff with a possible strategic advantage.

Should there be a reasonable notice requirement to the underinsured motorist carrier? Requiring the plaintiff to put the underinsured motorist carrier on notice of a possible claim, either at the time of first report or at least when a claim is first submitted to a liability defendant's carrier, may eliminate some

of the possible surprise situations in which an underinsured motorist carrier may find itself.

Is the plaintiff making a sacrifice too? When the plaintiff accepts a settlement with the individual defendant under subsection K, he loses his leverage over the defendant because he can no longer threaten an excess judgment. He essentially liquidates his case with the understanding that his maximum recovery is capped by the limits of his underinsured motorist coverage, without any recourse involving the individual defendant.

These are just some of the myriad difficulties that the new statute may present, and they will have to be resolved by the courts in the years to come. How those cases are decided will be affected by the responsible handling of claims and the diligence of the attorneys on the ground.

VIII. Conclusion

The 2015 changes to Virginia's underinsured motorist carrier statute are the most significant since it was codified in 1982. Previous amendments were ineffective in promoting settlement because the underinsured motorist carrier enjoyed the superior position relative to the liability defendant, the liability insurer, and the plaintiff regarding when and for how much a case settled. The liability carrier was required to take the primary role in the defense in order to secure a waiver of subrogation and to meet its duty to defend the insured. Likewise, the plaintiff had to wait for the underinsured motorist carrier to make a suitable offer, as it had no real obligations to the plaintiff until and unless judgment was entered against the liability defendant. For the plaintiff to reach the stage in litigation where he could receive an offer from the underinsured motorist carrier, he may have had to incur considerable litigation expenses in the form of experts and other trial preparation materials. Any corresponding costs to the defense were often incurred by the liability carrier, which still hoped to receive a waiver of subrogation for its insured, and not by the underinsured motorist carrier.

As a practical matter, the conditional waiver of subrogation against the liability insured and the cancellation of the duty to defend by the liability insurer granted by the statute has eliminated the underinsured motorist carrier's leverage over the individual defendant and effectively puts the carrier in the position of the defendant. But actual subrogation against a liability defendant by an underinsured motorist carrier has been relatively infrequent due to the lack of liquidity of the individual, so the loss of the subrogation right appears to be less significant than the loss of the duty to defend. Instead of relying upon the liability insurer to bear the entire litigation cost (or at least sharing the responsibility), the underinsured motorist carrier's litigation costs are likely to expand considerably.

Prudence suggests that early involvement and evaluation by the underinsured motorist carrier will be the best way to address the new statutory scheme. While

nothing in the new version of Virginia Code section 38.2-2206 creates a duty to defend by the underinsured motorist carrier, an underinsured motorist carrier who is aware of a claim or is served with suit papers would be wise to involve itself at an early stage, and to retain counsel to complete its own investigation independent of the liability carrier. This should at least eliminate the difficulties created by a late settlement between the plaintiff and the liability carrier that leaves the underinsured motorist carrier unprepared for a rapidly approaching trial.

While it is reasonable to believe that trial courts will continue cases in exigent circumstances, a demonstration of meaningful involvement by the underinsured motorist carrier and good cause shown will make a continuance more palatable to judges mindful and protective of their dockets.

The lesson appears to be that constant vigilance and early involvement by underinsured motorist carriers will give less ammunition to plaintiffs to use in their attempts to create a common-law or statutory duty of good faith to the insured. It should also protect the underinsured motorist carrier from surprises and from being unprepared to defend a claim if a subsection K compromise is reached. In the meantime, underinsured motorist carriers will have to wait to see how this statute is applied and interpreted in the years to come, mindful that that their behavior will affect the leniency of the interpretation and the possibility of any future favorable amendments to a statute under which the potential problems, pitfalls, and strategies remain largely unknown.