

NO. A06-2445

State of Minnesota
 In Court of Appeals

Patricia A. Frey, as Trustee for the heirs and next-of-kin of
 Stephen J. Frey, Patricia A. Frey, individually,
 and Aven K. Frey, individually,

Respondents,

v.

United Services Automobile Association and Nathan C. Frey,

Appellants.

RESPONDENTS' BRIEF AND APPENDIX

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

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LEGAL ISSUES

In 2001, Dr. Frey moved his family to Elko, Minnesota, and his daughter Aven Frey immediately moved to Grinnell, Iowa to attend college. Three years later, Aven and her fiancé Thomas Alexander were visiting her parents when a one-car accident occurred, killing Thomas and Dr. Frey. Does USAA's Minnesota auto policy unambiguously exclude Aven Frey as a "resident relative"?

Apposite Cases:

Hubred v. Control Data Corp., 442 N.W.2d 308 (Minn. 1989)

Firemen's Ins. Co. v. Viktora, 318 N.W.2d 704 (Minn. 1982)

Fruchtman v. State Farm Mutual Auto. Ins. Co., 274 Minn. 54, 142 N.W.2d 299, 301 (1966)

Statutes:

Minn. Stat. § 65B.43, subdiv. 5 (2006)

To determine whether an insurance policy's exclusions violate the reasonable expectations of the insured, Minnesota courts analyze whether the policy is ambiguous, whether an exclusion is hidden, and whether the exclusion is known by the public generally. USAA's auto policy failed to define resident of household and its multiple definitions and exclusions hid the limited family exclusion from not only the insured but the public. Is USAA's limited family exclusion unenforceable because it violated the reasonable expectations of the Freys that Aven Frey, like her fiancé Thomas Alexander, would not be excluded?

Apposite Cases:

Atwater Creamery Co. v. Western Nat. Mut. Ins., 366 N.W.2d 271 (Minn. 1985)

Hime v. State Farm Fire & Cas. Co., 284 N.W.2d 829 (Minn. 1979)

Beaudette v. Frana, 285 Minn. 366, 173 N.W.2d 416 (1969)

STATEMENT OF THE CASE

On Saturday, November 27, 2004, two days after Thanksgiving, at approximately 11:00 p.m., Nathan C. Frey, just 17, was operating a 1996 Pontiac Sunfire ("Sunfire") on southbound I-35 near Lakeville, MN when an accident occurred. (A.A. 143.) Occupants of the Sunfire included Nathan's father, Dr. Stephen J. Frey; his mother, Patricia A. Frey; his eldest sister, Aven K. Frey; and Aven's fiancé, Thomas Alexander. (*Id.*) Dr. Frey and Alexander were killed. (*Id.*) Patricia and Aven were seriously injured. (A.A. 144)

At the time of the accident, Dr. Frey held two insurance policies with USAA. (A.A. 100.) The primary policy implicated in this accident was a Minnesota policy with liability limits that had just been increased in July 2004 to \$300,000/\$500,000.¹ (*Id.*) It is undisputed that Nathan was covered under this policy, and therefore any claims against him arising out of this accident are to be indemnified by USAA up to the policy limits. The estate of Mr. Alexander has settled its portion of this action, based on the coverage of the Minnesota policy, for the policy limit of \$300,000.² (A.A. 127.) Claims were tendered to USAA for Aven Frey's injuries, but USAA denied coverage above the minimum statutory requirements, \$30,000/\$60,000, based on a "limited family

¹ The six-month premium for this policy was \$2,508.46. The Frey's have been policyholders with USAA since Stephen's service with the United States Navy in 1983.

² For the purposes of this appeal, it is not necessary to determine the propriety of that settlement, nor its effect on the limits available to other claimants. The district court did not reach this question.

exclusion.”³ (A.A. 128.) Respondents, Patricia and Aven Frey, agree that USAA has in all other ways honored its obligations under the Minnesota policy, but contest the application of the limited family exclusion to Aven Frey’s claims.

On June 23, 2005, Patricia Frey and Aven Frey commenced an action against USAA seeking a declaratory judgment that USAA was obligated to cover injuries to the full extent of the Freys’ policy limits. USAA claimed that the limited family exclusion reduced its obligation to the minimum required under Minnesota law. The parties submitted summary judgment motions to Hennepin County District Court Judge Harry Crump, and argument was heard on October 13, 2006. (A.A. 1.) Judge Crump, on October 24, 2006, ruled on several grounds that the limited family exclusion in the Minnesota policy should not be upheld. (*See* A.A. 1-9.) This appeal followed.

STATEMENT OF FACTS

In 2004, Aven Frey and Thomas Alexander were in Minnesota visiting the Freys for the Thanksgiving holiday. (A.A. 127.) On the way back to the Frey home after attending a movie, Nathan Frey lost control of the Pontiac Sunfire owned by Dr. Frey and collided with the guardrails of an overpass. (A.A. 99.) Dr. Frey had been riding in the front passenger’s seat, with Patricia, Aven, and Thomas Alexander in the back seat. (A.A. 125.) Dr. Frey and Mr. Alexander died from the injuries sustained in the accident. (*Id.*) Aven Frey suffered injuries, mostly orthopedic in nature, in excess of \$100,000.

³ In the district court’s order, Hennepin County District Court Judge Harry Crump ordered that Aven and Patricia Frey “shall recover from Defendant up to \$500,000 in liability coverage.” (A.A.1.) For the purposes of this appeal, Respondents are seeking full coverage only for Aven Frey. Appellant does not address the coverage for Patricia’s injuries in its brief, and therefore waives appeal of that element of Judge Crump’s order.

Aven Frey graduated from Ruidoso High School in Ruidoso, New Mexico in 2001. (RA 0002.) In the fall of that year, her family moved to Minnesota, and then, roughly one week later, she moved to Iowa to attend Grinnell College. (*Id.*) During her freshman year at Grinnell, Aven met Mr. Alexander, to whom she eventually became engaged in May 2004. (*Id.*) At the time of the accident, Aven was living in Gates Hall on the campus of Grinnell College with Alexander. (*Id.*) Her mailing address was Grinnell College, College Box 05-24, Grinnell, Iowa 50112. (*Id.*)

Prior to and during their period of engagement, Mr. Alexander and Aven Frey purchased several items jointly, including a 1990 Nissan Axxess, which they did not own at the time of the accident, furniture, a refrigerator, miscellaneous home furnishings, and two cats. (*Id.*) Mr. Alexander and Aven Frey had access to each other's online bank accounts at Wells Fargo, although both also kept separate checking accounts. (RA 0002-3.) In November 2004, Aven Frey was a registered voter in Poweshiek County in the state of Iowa, and voted in multiple elections, including the 2004 presidential election. (RA 0003.) She has never been a registered voter in Minnesota. (*Id.*)

Aven Frey held multiple jobs in Iowa, including working in the dining hall at Grinnell College, All Pets Veterinary Hospital, and in a café in Grinnell, although she has never earned enough money to require her to pay income tax or file a return. (*Id.*) She never held a job in the state of Minnesota. (*Id.*) The Freys paid all room, board, and tuition at Grinnell College. (*Id.*) With the exception of invoices for Aven's education, Aven received all of her mail at her own address at Grinnell College. (*Id.*)

Following Aven's first year of college she spent most of the summer at her parents' home in Elko, Minnesota. (*Id.*) In the summer after her second year of college, she took classes with Mr. Alexander at Colorado College and stayed on campus. (*Id.*) In the latter part of that summer, Mr. Alexander and Aven Frey traveled to New Mexico where they stayed in the Frey family's empty and unsold home in sleeping bags while working at Sonic Restaurant. (*Id.*) In the summer after her third year of college, the two spent June and July at the Freys' home in Elko, Minnesota. (*Id.*) Aven Frey and Mr. Alexander were unemployed at that time. (*Id.*) They then spent the last month of summer break in his home state of Texas with Mr. Alexander's family. (*Id.*)

Although Aven Frey stored many of her clothes and other personal effects at her parents' home in Elko, Minnesota, Mr. Alexander and Aven Frey stored their shared furniture and other large household items in a storage locker in Grinnell, Iowa during periods of extended absence from Grinnell. (RA 0004.)

Mr. Alexander and Aven Frey had no specific wedding date set, but planned to marry some time after their anticipated graduation in May 2005. (*Id.*) Their tentative plan was to stay in Iowa the summer following graduation to study for graduate school entrance exams. (*Id.*) Aven Frey had no intent or any desire to make Minnesota her residence. She had no plans to come to Minnesota to live following graduation. (*Id.*) Mr. Alexander and Aven Frey likely would have moved to California for graduate school or lived in Germany. (*Id.*)

But Aven Frey's life changed after Mr. Alexander died in the accident. Aven Frey was unable to return to Iowa for several months after the accident. She returned in the Fall 2005, graduating from Grinnell May 2006. (A.A. 88.) She now lives in California.

In summary, during the period of time between August 2001 and the date of the accident, Aven Frey's primary residence was in Iowa. She and Mr. Alexander lived together, purchased furniture and a car together there, and traveled to each other's family homes during breaks from school. Aven held several jobs in Grinnell and was registered to vote in Iowa. She has never worked or been registered to vote in Minnesota.

SUMMARY OF ARGUMENT

The district court correctly found that USAA is responsible to Aven Frey for injuries she sustained while riding in a car that was covered by a USAA policy. The district court recognized that the USAA policy was ambiguous in its reference to household residence, and particularly unclear as applied specifically to Aven Frey. Dr. Frey did not reasonably expect his daughter, who had left the family home, to be considered a member of his household and therefore covered in only a limited fashion by the Minnesota Policy. Minnesota law gives significant weight to the intentions of family members, and case law has addressed situations such as Aven Frey's in deciding that a child who has permanently left the home does not qualify as a resident-relative. This represents the common sense understanding of the Freys—Aven Frey had grown up, moved out, and prepared to start her own family. USAA is therefore incorrect in its assertion that she is a resident-relative. But even short of that, the Frey's understanding is sufficiently reasonable to highlight an ambiguity in the policy definition. As

ambiguities in the construction of a policy will be construed against the insurer, this Court should affirm the district court's determination that the full policy limits for which Dr. Frey contracted should be available to cover Aven's significant injuries.

The district court further correctly held that USAA's construction of the limited family exclusion frustrates the reasonable expectations of the insured. The construction created the unexpected situation where two people who live together (Aven Frey and Thomas Alexander), and who were sitting next to one another during the same accident, would have such vastly different access to recovery under the same policy. The district court properly determined that it was unreasonable to assume that the policy's exclusions and definitions would be understood by a consumer in the way USAA claims it should be. Thus, the district court correctly concluded that the limited family exclusion did not apply to Aven Frey, and its order should be affirmed.

ARGUMENT

I. The District Court Correctly Held That USAA's Limited Family Exclusion Was Ambiguous, Particularly In Light Of Aven Frey's Situation.

A. Standard Of Review

This Court reviews the construction of an insurance policy as a matter of law, and therefore the standard of review is *de novo*. *Iowa Kemper Ins. Co. v. Stone*, 269 N.W.2d 885, 886-87 (Minn. 1978) (holding that "[t]he general rule is that the interpretation of the language of an insurance contract is a question of law, as applied to the facts presented.").

B. The District Court Correctly Found That Aven Frey Was Reasonably Apprehended To Be A Resident Of Her Own Iowa Household, And Therefore The Limited Family Exclusion Was Ambiguous.

The primary issue before the district court was the question of whether, in fact, Aven Frey was a member of the Frey's Minnesota household, or whether, in the alternative, it was reasonable for the Frey's to have considered that she was not. If, like Mr. Alexander, Aven was not a resident of the Frey household, then the Limited Family Exclusion would not apply to her. That exclusion reads:

There is no coverage for BI for which a **covered person** becomes legally responsible to pay a member of that **covered person's** family residing in that **covered person's** household. This exclusion applies only to the extent that the limits of liability for this coverage exceed \$30,000 for each person or \$60,000 for each accident.

(A. A. 29) (emphasis in the original).

The district court noted that USAA did not define "resident of your household."

(A.A. 7.) Further, the district court saw that there were multiple interpretations of that phrase. (*Id.*) An insurance clause is ambiguous if it is "susceptible of two meanings."

Hubred v. Control Data Corp., 442 N.W.2d 308, 310 (Minn. 1989).

An insurer has the burden of proving a policy exclusion applies. This court has said [e]xclusions in insurance contracts are read narrowly against the insurer. Any ambiguity in the insurance contract must be construed in favor of the insured.

Id. (internal citations omitted).

USAA argues that the district court erred by using the phrase "reasonably apprehended" in connection to the Freys' understanding that Aven was not a member of the Frey's Minnesota household. (App. Br. at 17-18.) It asserts that the term implies a

subjective belief, but this is not correct. (*Id.*) First, the modifier “reasonable” is employed to signify the exact opposite—that the apprehension will be judged **not** by what the Freys actually thought, but what an objectively reasonable person would understand. “Apprehension” can be defined as “understanding.” To apprehend means “grasp with the understanding, to recognize the meaning of.” *Webster’s New Collegiate Dictionary* 55 (1979).

Contrary to USAA’s characterization, the district court said that, objectively, a reasonable person could have reasonably understood that Aven was not a resident of the Frey Minnesota household. While the district court’s chosen term “reasonable apprehension” may not be found in the case law regarding ambiguity, as an objective standard it is certainly clear and workable. By definition, the district court said that the meaning the Frey’s gave this term was reasonable. Therefore, if USAA’s meaning of Aven’s household is reasonable, then the term is “susceptible of two meanings”— i.e. ambiguous. As ambiguities are to be read to benefit the insured, this Court should affirm the district court’s finding that the limited family exclusion does not apply to Aven Frey.

C. Aven Frey’s Residency In Iowa Is Not Only Reasonably Apprehended, But It Is Also True.

1. Standard of Review

“The determination of whether a person is a resident of a particular household for insurance coverage purposes is a question of fact.” *N. Star Mut. Ins. Co. v. Colonial Penn Ins. Co.*, 1999 WL 17656, No. C7-98-953, at *2 (Minn. Ct. App. Jan. 19, 1999) (*Geyer*) (citing *Fruchtman v. State Farm Mut. Auto. Ins. Co.*, 274 Minn. 54, 55, 142

N.W.2d 299, 300 (1966) (RA 0027.) In *Geyer*, the appellate court stated that, though the “context facts” are undisputed, the “ultimate and dispositive fact issue of residency was disputed.” *Id.* Therefore, with respect to the question of residency the “standard of review is not the summary judgment standard but rather the ‘clearly erroneous’ test that applies to factual determinations.” *Id.*

2. Aven Frey Is Not A Member Of The Freys’ Minnesota Household.

The undisputed facts of this case compel the conclusion that, as a matter of fact, Aven Frey “never actually lived with her parents when they moved to Minnesota.” (A.A. 7.) USAA seeks to exclude Aven Frey from full coverage under the Minnesota policy on the basis that she was a member of the late Dr. Frey’s Minnesota household, and therefore excluded under the “Limited Family Exclusion” clause of Dr. Frey’s Minnesota Auto Policy. (A.A. 149.) The clause reads, in part:

There is no coverage for BI (bodily injury) for which a covered person becomes legally responsible to pay a member of that covered person’s family *residing* in that covered person’s household.

(A.A. 130) (emphasis added). Aven Frey is a member of Nathan Frey’s family, and he will become legally responsible to pay damages to her for bodily injury. However, this clause requires that two elements be met: membership in the family *and* residence in the household.

In Dr. Frey’s Minnesota policy, the term “resident of your household” is not defined. (A.A. 7.) Minnesota law, however, defines what constitutes being a member of a household for the purpose of insurance. Under the No Fault Act, a resident relative is

“[a] person [who] resides in the same household with the named insured if that person's home is *usually* in the same family unit, even though *temporarily* living elsewhere.”

Minn. Stat. § 65B.43, subdiv. 5 (2006) (emphasis added). In *Firemen's Ins. Co. v.*

Viktora, 318 N.W.2d 704 (Minn. 1982), the court articulated a multi-factor analysis to determine residency in a household:

1. Living under the same roof;
2. In a close, intimate and informal relationship; and
3. Where the intended duration is likely to be substantial, where it is consistent with the informality of the relationship, and from which it is reasonable to conclude that the parties would consider the relationship in contracting about such matters as insurance or in their conduct in reliance thereon.

Id. at 706.

Other instances of judicial constructions for the definition of membership in a household have included such criteria as the age of the person, whether a separate residence has been established, whether the person is self-sufficient, the frequency and duration of the stay in the family home, and the intent to return. See *Wood v. Mut. Serv. Cas. Ins. Co.*, 415 N.W.2d 748, 750 (Minn. Ct. App. 1987). Additional factors, taken from jury instructions, include the location of personal effects, mailing address, and legal documentation such as voter registration, driver's license, and car registration. See *State Farm Fire and Cas. Co. v. Short*, 459 N.W.2d 111, 113 (Minn. 1990). All of these factors are judicial attempts to ascertain a more ephemeral concept—when has the child grown up, moved out, and started his or her own life.

As the undisputed facts demonstrate, the first and third of the *Viktora* criteria are absent and Aven Frey cannot be characterized as a resident relative. She rarely dwelled under the same roof and when she did, it was only temporary. As for the third criteria, the fact that Aven Frey was not included on the Minnesota policy indicates that the parties did not “consider the relationship in contracting about such matters as insurance” to include her residence in Minnesota. By establishing an Iowa policy, it is clear that the relationship relied upon was one of a separate residence, and not as part of the Frey’s Minnesota household. Also, Aven Frey did not stay in the Frey household for substantial duration. The longest she stayed in the Minnesota household was for two months with her fiancé during a summer break. (RA 0003.) She was not a Minnesota resident of the Frey’s household, and case law supports this conclusion. For example,

The fact that the family homestead was used as plaintiff’s mailing address is not decisive. It is not an unusual practice for adult, emancipated children attending college away from home, or working at summer jobs elsewhere, or serving in the armed forces, to use their parents’ address as a place where mail is certain to reach them. This is not necessarily an indication of an intention to return to the family circle, but often is merely a matter of convenience. The same may be said of the fact that plaintiff kept a great many of his personal effects in his parents’ home. The court concluded: In our opinion, the words “residing in the same household” imply a more enduring relationship than was here manifested.

French v. State Farm Mut. Auto. Ins. Co., 372 N.W.2d 839, 841 (Minn. Ct. App. 1985) (analyzing *Fruchtman v. State Farm Mut. Auto. Ins. Co.*, 274 Minn. 54, 57, 142 N.W.2d 299, 301 (1966) (internal citation omitted)). Merely visiting, allowing mail to be sent and keeping some belongings in Elko cannot be construed as expressing the “more enduring

relationship” which is necessary to be considered a member of the household. (RA 0004, A.A. 96.)

The factual record supports the district court’s understanding that Aven Frey had moved out from her family’s household, and had begun establishing her own separate life. She worked and voted in Iowa. She was engaged to be married and living with her fiancé. They had purchased furniture, a car, and owned pets together. They were planning their lives after graduation, and these plans did not include Minnesota or the Frey household.

Under *Viktora* and *Fruchtman*, the central question concerns Aven and the Freys’ intentions. *French* held this as a significant factor, referring to the “intention to return to the family circle.” *Wood* lists this as a factor in the analysis. *Viktora* speaks of the “intended duration.” As Aven Frey was an adult at the time of the accident, engaged to be married, and had expressed intent to reside as her own family unit with her husband-to-be, either in Germany, Iowa or California, there is no indication that she had the intent to reside in her parent’s household anywhere, much less in Minnesota, for any extended duration. She had established her own household with Thomas Alexander, having moved out of her parents’ home and started her life with him. The third condition from *Viktora* does not exist, and Aven Frey is not a member of the Frey household under Minnesota law.

Beyond the question of intention, the district court’s memorandum leads to the inevitable conclusion that Aven Frey was not, as a matter of fact, a resident of the Frey’s Minnesota household. The district court stated that Aven “never actually lived with her

parents when they moved to Minnesota.” (A.A. 7.) This is a clear statement that the *Viktora* test was not satisfied at the time of the institution of the Minnesota policy. This is a factual determination by the Court that she was **not** a resident of the Frey’s Minnesota household, and as such this finding should only be overturned if it is clearly erroneous. *See Geyer*, 1999 WL 17656, at *2. Because the record amply supports this finding, this Court should affirm the determination that Aven Frey was not a member of the Frey’s Minnesota household, thus not a resident-relative, and therefore the limited family exclusion does not apply. For these reasons, the district court’s order should be affirmed.

II. USAA’s Application of the Limited Family Exclusion Violates the Reasonable Expectations of the Insured.

A. Minnesota Public Policy Disfavors Excluding Family Members from Automobile Insurance Coverage.

Intra-family tort liability has evolved in recent years from a strict prohibition against intra-family suits to a general allowance of these actions. The concerns that USAA cites as reasons for maintaining the Limited Family Exclusion are competitive balance, the risk of collusion and the uncomfortable nature of defending one family member against another. (RA 0010.) While the first reason is not really at issue here, courts are undoubtedly competent to combat the second rationale, and the third reason contradicts developments in the law and public policy.

Taking the third rationale first, courts and the law have long ago shed the notion of litigation tearing a family apart, largely because of the rise in insurance coverage. *See generally Beaudette v. Frana*, 285 Minn. 366, 173 N.W.2d 416 (1969) (eliminating

interspousal immunity defense), *Silesky v. Kelman*, 281 Minn. 431, 161 N.W.2d 631 (1968) (eliminating parental immunity from a suit by a child), *Balts v. Balts* 273 Minn. 419, 142 N.W.2d 66 (1966) (abrogating the immunity of a child from a suit by his parents for personal injury arising out of child's driving). In fact, until 1974, household exclusions were expressly prohibited by statute. *See* Minn. Stat. § 65B.23, *repealed by* 1974 Minn. Laws, c. 408, § 33. In this context, insurance coverage, as a matter of public policy, strengthens the social fabric by providing a mechanism to financially protect members of one's family.

Minnesota insurance procedures have long presumed the exclusion at issue here to be invalid. At the time Dr. Frey purchased his first auto insurance policy in Minnesota, the Department of Commerce, in its Private Passenger (Personal) Automobile Insurance Manual, had as its written policy that:

[c]ompanies may NOT include provisions limiting coverage under certain circumstances to no more than the statutory minimum limits. Some examples of circumstances under which companies may NOT attempt to "cut back" coverage include, but are not limited to the following: (1) "drop down" limits for bodily injury to named insureds and family members....

The rationale for this procedure is based on "reasonable expectations" of an insured. Specifically, if an insured purchases higher limits, there exists a reasonable expectation on the part of the insured that the higher limits will be available in a loss situation.

(RA 0026 (emphasis added).) Dr. Frey's USAA policy included this provision, which is squarely at odds with the express policy of the state, while it was the obvious intent of the

state insurance regulators to forbid these exclusions. Later, after discussions between the insurance regulators and USAA, this section was removed from the Manual. (RA 0024.)

The Minnesota Department of Commerce's understanding of people's reasonable expectations of coverage for themselves and their families is consistent with the rationale courts employed in striking down common law intra-family immunity. In *Baudette*, the Minnesota Supreme Court stated:

The favored rationale for abrogating any one of the family immunities, as adopted in *Balts*, is that the social gain of providing tangible financial protection for those whom an insured wrongdoer ordinarily has the most natural motive to protect transcends the more intangible social loss of impairing the integrity of the family relationship.

285 Minn. at 371, 173 N.W.2d at 419.

Ten years after *Baudette*, the Minnesota Supreme Court applied this reasoning to the context of automobile insurance. “[The] same social gain [as in *Beaudette*] transcends the arguable social loss of impairing insurance contract provisions that provide for familial exclusions. The sanctity of such a contractual relationship is already diminished by the relative absence of free negotiation, perhaps approaching the nature of a contract of adhesion.” *Hime v. State Farm Fire & Cas. Co.*, 284 N.W.2d 829, 834 (Minn. 1979).

In *Baudette*, *Hime*, and in the Department's Manual, the underlying premise is that the protection of one's family is a “natural motive” for purchasing insurance, and it is inherently reasonable to expect that a person buys insurance as much or more for the reason of covering injuries to Aven as they do to cover injuries to the relative stranger in

the car, Mr. Alexander. This is not to deny that a person **could** choose to exclude resident or non-resident family members from coverage under an insurance policy, but merely that, absent a clearer statement, perhaps on the declarations page, it should not be assumed that this is what a consumer intended. Some states require a separate written declaration when expected coverage is waived.⁴ This sort of affirmative rejection is not part of the statutory scheme governing insurance in Minnesota, but more should be required to overcome the expected intent of the insured than the fact that a technical reading of the policy could have put them on notice that reasonably expected coverage does not exist.

B. The Frey's Situation Is Squarely Within The *Atwater* Doctrine.

1. Reasonable Expectations Doctrine Establishes An Objective Standard In The Face Of Inequitable Bargaining Positions.

The principal case defining this state's reasonable expectations doctrine is *Atwater Creamery Co. v. Western Nat. Mut. Ins.*, 366 N.W.2d 271 (Minn. 1985), in which the court focused primarily on the ability of an insured to reasonably understand the terms of their policy:

Most courts recognize the great disparity in bargaining power between insurance companies and those who seek insurance. Further, they recognize that, in the majority of cases, a lay person lacks the necessary skills to read and understand insurance policies, which are typically long, set out in very small type and written from a legalistic or insurance expert's perspective. Finally, courts recognize that people purchase insurance relying on others, the agent or company, to provide

⁴ See, e.g., Ark. Code Ann. § 23-89-209 (a)(1)(2006); Del. Code Ann. 18 §3902 (a)(1)(2007); Iowa Code Ann. §516A.1 (2006); Tenn. Code Ann. §56-7-1201 (a)(2) as examples of state statutes requiring an affirmative writing to reject expected coverage.

a policy that meets their needs. The result of the lack of insurance expertise on the part of insureds and the recognized marketing techniques of insurance companies is that “[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.”

Id. at 277.

The court later explained that “the [*Atwater*] doctrine asks whether the insured’s expectation of coverage is reasonable given **all** of the facts and circumstances.” *Hubred v. Control Data Corp.*, 442 N.W.2d 308, 311 (Minn. 1989) (emphasis added). “Other factors to be considered are the [1.] presence of ambiguity, [2.] language which operates as a hidden exclusion, [3.] oral communications from the insurer explaining important but obscure conditions or exclusions, and [4.] whether the provisions in a contract are known by the public generally.” *Id.* The ambiguity inherent in the USAA policy has been discussed above, but the district court correctly found that USAA’s interpretation of the policy violated the *Atwater* doctrine, at least based on the second and fourth elements. “[N]othing in our opinion in *Atwater* suggests that the doctrine of reasonable- expectations is not to be applied except in the presence of peculiar circumstances such as ambiguity or a hidden exclusion.” *Id.* Thus, no single factor is dispositive, but all factors must be weighed. *See N. Star Mut. Ins. Co. v. Rongve*, No. C7-93-1856, 1994 WL 146216 at *2 (Minn. Ct. App. Apr. 26, 1994) (explaining *Hudred* to require consideration of numerous factors, including those listed above) (RA 0030).

2. The District Court Correctly Held That The Limited Family Exclusion Is Sufficiently Hidden To Satisfy That Element Of *Atwater*.

The district court properly held that the exclusions were sufficiently hidden, and that understanding the true reach of the limited family exclusion required the sort of “painstaking study” *Atwater* addresses:

Defendant USAA’s ‘bodily injury exclusion’ is not only ambiguous with respect to Aven Frey, but challenges the reasonable expectations of the insured party under the circumstances. First, the ‘bodily injury exclusion’ for family members in Plaintiff Frey’s policy appears second to last among a lengthy list of exclusions limiting liability coverage. Second, in order to determine who a “covered person” is under the exclusion, the insured must go to the definitions of the liability coverage section. Once there, the insured will discover that family members are included as “covered persons”; but for a definition of “family member,” the insured must then look to the general definitions section of the insurance agreement.

After traversing this circuitous path through the policy’s exclusions and definitions, the insured *may* be fortunate to comprehend the obscure, but important meaning of the ‘bodily injury exclusion’....

(A.A. 8-9.)

In situations where an insurance agent is involved the question of reasonable expectations can depend upon the discussions between the insured and the agent for clarification. *See Atwater*, 366 N.W.2d at 278. It should be noted that there is no evidence one way or the other regarding any oral explanation or representations regarding coverage. Because USAA does not use agents, that Dr. Frey contacted USAA itself to raise his coverage limits from \$100,000/\$300,000 to \$300,000/\$500,000. (*See* RA 0013.) USAA argues that Dr. Frey was free to buy insurance from an insurer that does not

include a family exclusion, if this was important to him, but that presupposes that he, or a reasonable consumer of insurance, understood that this limitation existed in his coverage. It is, at the least, not clear that he did.

3. The District Court Correctly Held That Limited Family Exclusions Violate The Fourth Element Of The *Atwater* Test As Not “Known By The Public Generally.”

If coverage for the people most near and dear to the insured is to be limited by 90%, this is obviously a substantial reduction in coverage. (*Id.*) USAA sees no reason, however, for alerting the insured to this fact, through any mention on the declarations page or reference in conversations about policy limits. USAA responds to questions about this by saying that there are many exclusions, conditions and exceptions. (RA 0016.) While this may be the case, this particular exclusion is not expected.⁵ The limited family exclusion is not like an exclusion based on intentional damage, a normal and expected exclusion that serves both corporate and public policy interests. Instead, this exclusion swallows expected coverage—coverage of family members. A notation on the declaration page would solve this problem, but instead USAA chose to bury this exclusion near the end of a long list.

The record does not provide what Dr. Frey’s actual understanding of the limited family exclusion might have been. The district court, however, properly concluded, again under *Atwater*, that this exclusion is not “known by the public generally.”

The broad impact of this exclusion is readily apparent. Soccer-moms and children, fathers and daughters, and families of every

⁵ Other exclusions include denial of coverage for intentional acts, injuries during employment, non-consensual use, or racing.

stripe traveling together to and from school, work, or on holiday -- as was the case here – unknowingly stand to forfeit a substantial portion of the coverage paid for with their premium dollars when involved in an accident; by virtue of their familial and residential status to one another as “covered persons.

(A.A 9.) Family members are likely to be passengers in cars driven by family members.

When an accident occurs, it is probably more likely that a family member will be injured than a non-family member. The district court merely drew the logical conclusion that bodily injury insurance is reasonably expected to cover the bodily injury of passengers in an automobile accident.

It becomes obvious that this sort of exclusion is not generally expected when one considers that if Alexander had been driving, everyone in the car would have been covered. Alexander would be a covered person as a permissive user under the policy definition of “covered person,” and because he was not a family member the limited family exclusion would not apply. (A.A. 27.) If the limited family exclusion was a reasonably expected part of the insurance coverage, one would presume it would become standard procedure (or at least it would not seem absurd) for reasonable policy holders to have non-family members drive their automobiles. Respondent believes that this Court can reasonably conclude that this is not the normal course of automotive behavior.

4. The Limited Family Exclusion Violates The Reasonable Expectations Of The Insured.

USAA provides nothing to contradict the district court’s determination that its limited family exclusion violated the reasonable expectation of the insured. While the Freys only argue that they had no reason to expect that Aven would be excluded, the

district court found that this exclusion would violate the reasonable expectations of **any** insured. USAA responds with little more than conclusory statements. (App. Br. at 18-20.) The district court found the path through the policy's exclusions to be "circuitous," and USAA asserts that it is "in plain view." The district court found the meaning of the exclusion to be hidden, and USAA argues that Dr. Frey received the policy, which speaks for itself. And finally, the district court found that this exclusion is "not known to the public generally," and USAA responds that this exclusion is common in homeowner's policies.

USAA cites two cases for the claim that the reasonable expectations doctrine does not apply. First, *Merseeth v. State Farm*, 390 N.W.2d 16, 17 (Minn. Ct. App. 1986) is distinguishable because the insured relied on his agent for *homeowner's* insurance and later sought coverage for *auto-related* injuries. There was no ambiguity regarding who was insured—the injured party clearly falls under the well-defined description of a covered person. There was no question that motor vehicle injuries were not within the reasonably expected ambit of a homeowners policy, or that the exclusion required any difficult analysis. The court simply found that there was no objectively reasonable expectation that auto coverage was created by a homeowner's policy.

Second, *Gunderson v. Classified Ins. Corp.* 397 N.W.2d 922, 924 (Minn. Ct. App. 1986), stands for a basic proposition of insurance law—that the insured must have an insurable interest in the property. The court correctly saw that an expectation that the insured's son's car would be covered by her policy was not reasonable. Any argument for coverage in that situation revolved around agent representations, which are not

applicable here. More to the point, in *Gunderson* any potential ambiguity in the question of coverage arose out of the misrepresentation of the insured as to the status of the vehicle involved in the accident.

Neither of these cases is directly applicable here. The Freys are not seeking to alter the basic reason for the policy, but merely assert that either the exception should not apply if it is unambiguous because Aven does not meet the required definition, or alternatively, that the exclusion is ambiguous, unexpected, and buried. Neither of USAA's cited cases relate to anything particularly hidden in a policy or in the purpose of the contract, nor is there any issue of definitional applicability. In fact, these cases highlight the real issue here, which is that this exclusion was hidden and unexpected, and **that** is when the reasonable expectations doctrine applies. The Freys' position is aligned with the cases cited for the principle that this doctrine is not about the subjective expectation of the insured but is an objective question of whether a reasonable insured would find, analyze, determine and reasonably assent to the insurer's intended meaning of a term.

CONCLUSION

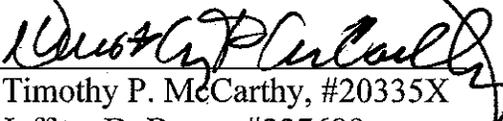
The district court correctly held that USAA was obligated to Aven Frey under Dr. Frey's Minnesota policy for an amount up to the full policy limit of \$500,000. Aven Frey is not a resident relative because she has grown up, left the family home, become engaged, and began her adult life. USAA's limited family exclusion thus does not apply to her, and the undisputed facts fully support this conclusion.

The district court also properly determined that the limited family exclusion at issue is ambiguous, at least as applied to Aven Frey's situation. Ambiguities in insurance policies are construed against the drafter of the policy, and the district court conclusion of ambiguity was legally correct. However, even if the limited family exclusion is not ambiguous, and Aven Frey is a resident of the Freys' Minnesota household, this exclusion is sufficiently hidden and unexpected as to frustrate the reasonable expectations of the insured.

For all these reasons, the district court order's granting summary judgment should be affirmed.

Dated: February 28, 2007

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