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***South Carolina Insurance Co. v. Smith* : Employee Exclusion Clauses in Automobile Liability Insurance Policies**

North Carolina's Motor Vehicle Safety and Financial Responsibility Act¹ was enacted to help ensure that innocent victims of automobile accidents will be able to recover compensation from the driver who caused their injuries.² Together with North Carolina's compulsory insurance law,³ the Financial Responsibility Act requires every owner of a motor vehicle to purchase liability insurance covering the owner and all persons using the vehicle with permission.⁴

The goal behind the Financial Responsibility Act, however, is not always consistent with a vehicle owner's desire to limit his premiums by contracting for exclusions from his automobile insurance coverage. One cost-saving provision commonly included in automobile liability policies excludes the insurer from liability for injuries to employees of the insured. An employee may be without coverage under either workers' compensation or his employer's liability policy if the employer's policy contains a clause excluding all employees rather than only employees who are covered under the state's workers' compensation act.⁵

In *South Carolina Insurance Co. v. Smith*,⁶ the North Carolina Court of Appeals held that an employee exclusion clause is valid only if workers' compensation is available to the employee. This Note examines the issues presented in *Smith* and concludes that the court reached a sound middle ground between the competing goals of compensating victims of highway negligence and maintaining reasonable insurance costs for drivers complying with North Carolina's mandatory automobile insurance laws.

Marvin B. Smith was standing in the back of a truck belonging to his employer, who was at the wheel,⁷ when a freezer in the truck fell on his foot.⁸ He brought suit against his employer, William B. Gore, alleging that Gore's negligence had caused the freezer to fall.⁹ South Carolina Insurance Company, which had issued Gore a liability policy covering the truck, brought a separate action seeking a declaratory judgment that it was not liable for Smith's inju-

1. N.C. GEN. STAT. §§ 20-279.1 to -.39 (1983).

2. See, e.g., *Nationwide Mut. Ins. Co. v. Aetna Life & Casualty Co.*, 283 N.C. 87, 194 S.E.2d 834 (1973) (purpose of the Act is to compensate innocent victims of financially irresponsible motorists); *Allstate Ins. Co. v. Hale*, 270 N.C. 195, 154 S.E.2d 79 (1967); *Howell v. Travelers Indem. Co.*, 237 N.C. 227, 74 S.E.2d 610 (1953).

3. N.C. GEN. STAT. § 20-309 (1983).

4. For a discussion of the history of the two acts, see *infra* notes 37-56 and accompanying text.

5. N.C. GEN. STAT. § 97 (1979 & Cum. Supp. 1983). Workers' compensation acts typically do not include domestic servants, farm laborers, casual employees, and employees who work for an employer with fewer than a statutory minimum number of workers (usually two to six employees). See 1C A. LARSON, *THE LAW OF WORKMEN'S COMPENSATION* §§ 50.10-52.34 (1982 & Supp. 1984). North Carolina's Workers' Compensation Act does not apply to farm laborers, domestic servants, employees in casual employment, and workers employed by an employer having fewer than four employees. N.C. GEN. STAT. § 97-13(b) (1979).

6. 67 N.C. App. 632, 313 S.E.2d 856 (1984).

7. Plaintiff's Complaint at 2.

8. *Id.*

9. *Id.*

ries.¹⁰ The policy contained a clause providing: "We do not provide Liability Coverage for any person: . . . For bodily injury to an employee of that person during the course of employment."¹¹

The insurance company argued that this exclusion relieved it from liability for Smith's injuries. Smith, defendant in the declaratory judgment proceeding,¹² maintained that the exclusion clause did not relieve the company of liability because the clause conflicted with the Motor Vehicle Safety and Financial Responsibility Act. Smith relied on section 20-279.21(e) of the Act, which provides that a "motor vehicle liability policy" issued in compliance with the Act "need not insure against loss from any liability for which benefits are in whole or in part either payable or required to be provided under any workmens' compensation law."¹³ The trial court granted the insurance company's motion for summary judgment, but the North Carolina Court of Appeals reversed, holding that the exclusion was valid only if workers' compensation benefits were available to Smith.¹⁴

In an opinion by Chief Judge Vaughn,¹⁵ the court agreed that the exclusion clause would be valid as written in the absence of a financial responsibility law.¹⁶ The court, however, accepted Smith's argument that a policy issued under North Carolina's compulsory insurance laws must be construed in light of this law.¹⁷ The court held that section 20-279.21(e) of the Financial Responsibility Act allows an exemption from coverage only insofar as there are benefits available to an employee pursuant to North Carolina's Workers' Compensation Act.¹⁸ The Act thus did not invalidate the exclusion clause completely, but rather made its validity contingent on a showing that the injured employee was covered by workers' compensation.¹⁹

The court reasoned that this result was consistent with the rationale behind the Financial Responsibility Act of compensating victims of "financially irresponsible" drivers: "Were we to accept plaintiff's argument, we would likewise

10. *Smith*, 67 N.C. App. at 632, 313 S.E.2d at 858.

11. *Id.* at 633, 313 S.E.2d at 858.

12. Smith's employer, Gore, was also a defendant in the declaratory judgment proceeding. See *id.* at 632, 313 S.E.2d 858.

13. N.C. GEN. STAT. § 20-279.21(e) (1983). For a discussion of the rest of the statute, see *infra* notes 37-56 and accompanying text.

14. The case was remanded for determination of whether workers' compensation was available to Smith. *Smith*, 67 N.C. App. at 640, 313 S.E.2d at 862. The appellate brief submitted by plaintiff-insurance company indicates that workers' compensation benefits were not available. The brief discussed a case in which an employee was not covered by workers' compensation because his employer had fewer than the statutory minimum number of employees, adding that "[t]his is similar to the situation which is involved in this case." Plaintiff-Appellee's Brief at 5. Under the holding in *Smith*, the insurance company will be liable for damages arising out of Smith's injuries if he in fact was not covered by workers' compensation. See also *supra* note 5 (exclusions from North Carolina's Workers' Compensation Act).

15. Judges Braswell and Eagles concurred but did not write separate opinions. *Smith*, 67 N.C. App. at 640, 313 S.E.2d at 862.

16. "The starting point of our analysis is that nothing else appearing, the exclusionary clause in the policy before us would defeat coverage." *Smith*, 67 N.C. App. at 634, 313 S.E.2d at 859.

17. *Id.* at 635-36, 313 S.E.2d at 859.

18. *Id.* at 634, 313 S.E.2d at 859.

19. *Id.*

be making possible situations wherein an injured employee may be left remediless. Such a result would contravene the established purpose of our Financial Responsibility Act."²⁰ The court added that its holding was in accord with the majority of decisions on this issue in other jurisdictions.²¹

Smith was a case of first impression²² on the validity of an employee exclusion clause in light of North Carolina's Financial Responsibility Act. In deciding the case, the court had to resolve the conflict between the employer's desire to lower premiums by contracting for limits on automobile insurance coverage and the state's policy of assuring compensation of automobile accident victims through a mandatory financial responsibility statute.

As the name implies, financial responsibility acts were developed to address the problem of negligent, uninsured motorists unable to compensate accident victims.²³ Connecticut in 1925 passed a statute that revoked the registration of drivers who committed traffic violations of a certain severity and required proof of financial "responsibility" as a condition to reinstatement of the registration.²⁴ Similar acts were in widespread use by the 1930s.²⁵ These early financial responsibility laws required suspension of the driver's license, registration, or both upon conviction for certain traffic violations.²⁶ To get his license or registration restored, the driver had to offer proof of his ability to compensate future accident victims. This proof generally was in the form of a bond, securities, or, more often, a liability insurance policy.²⁷ These acts were intended to encourage dangerous drivers to get liability insurance or, if they refused, to keep such drivers off the road.²⁸

The early laws, however, had shortcomings. They applied only after a driver had committed a serious offense or had an unsatisfied judgment against him, and even then the acts required only proof of responsibility for future damages. Thus, they did nothing to compensate the victim of the driver's first acci-

20. *Id.* at 637, 313 S.E.2d at 860.

21. *Id.* at 639, 313 S.E.2d at 861-62. The court reviewed decisions from other jurisdictions at length, concluding that the cases holding such a clause valid as written were fewer in number and contained weaker reasoning. *Id.*

22. *Id.* at 634, 313 S.E.2d at 858.

23. See *Kesler v. Department of Public Safety*, 369 U.S. 153, 158-59 (1962); 6B J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 4295, at 238 (Buckley ed. 1979); Grad, *Recent Developments in Auto Accident Compensation*, 50 COLUM. L. REV. 300, 308 (1950); Murphy & Netherton, *Public Responsibility and the Uninsured Motorist*, 47 GEO. L.J. 700 (1959); Note, *A Survey of Financial Responsibility Laws and Compensation of Traffic Victims: A Proposal for Reform*, 21 VAND. L. REV. 1050, 1051-52 (1968).

24. Act of June 23, 1925, ch. 183, 1925 Conn. Pub. Acts 3956.

25. In 1936, 30 states had enacted some form of financial responsibility legislation. Brawn, *The Financial Responsibility Law*, 3 LAW & CONTEMP. PROBS. 505, 511 (1936). Most of these statutes were based on one of two model acts: the Uniform Vehicle Code of the National Conference on Street and Highway Safety or the American Automobile Association's Safety-Responsibility Bill. *Id.* at 509. For a discussion of the differences between these model acts, see *id.*

26. See *Kesler v. Department of Public Safety*, 369 U.S. 153, 159 (1962). Apparently the earliest law requiring liability insurance in connection with the operation of a motor vehicle was a 1915 San Francisco ordinance requiring such insurance for all buses. *Id.*

27. Murphy & Netherton, *supra* note 23, at 703-04.

28. *Id.* at 704.

dent.²⁹ These early acts also did not reach many of the drivers who posed the greatest threat to the public. When a driver was unable to compensate his victim, the victim often had little incentive to report the accident or seek a judgment against the driver. Thus, the law often was never called into operation.³⁰

The inadequacies of the early "future proof" financial responsibility laws led to the development of laws designed to provide compensation for all accident victims, rather than merely those injured after a negligent driver had his first reported accident. The first such law was enacted in New Hampshire in 1937³¹ and provided that a driver involved in a serious accident had to deposit "security" with a state agency to be used to pay damages arising out of the past accident.³² Security laws eventually replaced the "future proof" laws; by 1968 every state except Massachusetts had a statute requiring the deposit of security.³³

Typically, security acts require drivers to file a report if involved in accidents causing personal injury or property damage over a certain amount. A state official reviews the report and determines the amount of required security based on the likelihood of damages arising from the accident. If a driver does not provide the required security within a statutory period, his license and registration are revoked. The driver can recover his license and registration by depositing the security, by showing proof of a settlement agreement, or upon the passage of a certain period—usually one year—in which no one files a lawsuit arising from the accident.³⁴ Security laws have been successful in encouraging many drivers to acquire automobile liability insurance,³⁵ but they are not without defects. Like the "future proof" laws, they operate only after an accident has occurred. If, as is often the case, a financially irresponsible driver has caused an accident, then, in the words of one commentator, "the best that the law can do is to force him off the road while his unfortunate victim remains uncompensated."³⁶

North Carolina's first financial responsibility act, a "future proof" statute, was enacted in 1931.³⁷ It provided for revocation of the license and registration

29. This aspect of the "future proof" financial responsibility laws made them vulnerable to the criticism that they were "first bite" laws because they allowed bad drivers, like bad dogs, to get a "first bite" free of consequences. See Murphy & Netherton, *supra* note 23, at 703-04; Note, *supra* note 23, at 1052.

30. Murphy & Netherton, *supra* note 23, at 705; Note, *supra* note 23, at 1052.

31. Act of July 14, 1937, ch. 161, 1937 N.H. LAWS 296-97.

32. Kesler v. Dep't of Public Safety, 369 U.S. 153, 163 (1962); Grad, *supra* note 23, at 705-06.

33. See, Note, *supra* note 23, at 1052. Massachusetts law currently provides that a plaintiff can move for security against a nonresident. See MASS. ANN. LAWS ch. 90, § 3G (Michie/Law. Co-op 1975 & Supp. 1985)

34. See Murphy & Netherton, *supra* note 23, at 706-07; Note, *supra* note 23, at 1052-54.

35. Murphy & Netherton, *supra* note 23, at 706-07.

36. Laufer, *Insurance Against Lack of Insurance? A Dissent From the Uninsured Motorist Endorsement*, 1969 DUKE L.J. 227, 232 (1969). Financial responsibility acts have been upheld against various constitutional challenges. 6B J. APPLEMAN, *supra* note 23, § 4295, at 247; 12A G. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 45:722, at 362-63 (2d ed. 1971). North Carolina's statute was held not to violate the due process clause of the fourteenth amendment in Jones v. State Farm Mut. Auto. Ins. Co., 370 N.C. 454, 155 S.E.2d 118 (1967).

37. Act of March 16, 1931, ch. 116, 1931 N.C. SESS. LAWS 149 (codified at N.C. GEN. STAT. § 20-201 (1943)). See generally Note, *Survey of Statutory Changes in North Carolina*, 9 N.C.L. REV. 384 (1931) (discussing the operation of the new law).

of any driver with a judgment of \$100 or more outstanding against him.³⁸ The license and registration would not be restored unless the driver paid the judgment or furnished proof of financial responsibility for future liability.³⁹

In 1953 the general assembly modernized its financial responsibility law, and North Carolina became the forty-second state⁴⁰ to adopt a security statute.⁴¹ This law, titled the Motor Vehicle Safety and Financial Responsibility Act of 1953, is still in force. It provides that every owner and operator of a vehicle involved in an accident in which there is personal injury or property damage exceeding \$500 is required to deposit security with the Commissioner of Motor Vehicles.⁴² The Commissioner is directed to determine the required amount of security based on the damages likely to arise out of the accident.⁴³ If the owner or operator fails to post the security within a statutory period, the Commissioner must suspend the license of that driver.⁴⁴

The security provision does not apply to several types of drivers, including those who are covered by a motor vehicle liability policy that meets the statutory limits,⁴⁵ those who were legally parked at the time of the accident, and those involved in an accident in which the other party did not sustain personal injury or property damage.⁴⁶ A license suspended under the Act may not be reinstated unless the driver posts the required security, is adjudged to have no liability, or enters a settlement agreement.⁴⁷ The license also may be reinstated if, after the passage of one year, no litigation has been initiated as a result of the accident.⁴⁸

38. Act of March 16, 1931, ch. 116, 1931 N.C. SESS. LAWS 149, 149.

39. Interestingly, the 1931 statute went into effect four years before drivers' licenses became mandatory in North Carolina. See Note, *supra* note 37, at 384-85.

40. See Note, *Survey of Statutory Changes in North Carolina*, 31 N.C.L. REV. 420, 421 n.20 (1953).

41. Act of April 30, 1953, ch. 1300, 1953 N.C. SESS. LAWS 1262 (codified at N.C. GEN. STAT. § 20-279.1 (1983)).

42. N.C. GEN. STAT. §§ 20-279.4 to -.5 (1983). As originally enacted, the threshold amount for requiring a deposit was \$100. See *supra* note 41. The security may be in the form of a bond, a cash deposit, or, for owners of more than 25 vehicles, proof of self-insurance. See N.C. GEN. STAT. §§ 20-279.18, .33 (1983).

43. N.C. GEN. STAT. § 20-279.5(a) (1983).

44. *Id.* § 20-279.5(b).

45. A driver offering proof of a statutory motor vehicle liability policy must submit a certificate from his insurer that the policy is in effect and includes the coverage required by the statute. When the Act was first enacted, a statutory policy had to provide coverage of \$5,000 for bodily injury to or death of one person; \$10,000 for bodily injury to or death of two or more persons; and \$1,000 for property damage. Act of April 30, 1953, ch. 1300, 1953 N.C. SESS. LAWS 1262, 1263. The statute currently requires liability limits of \$25,000 for bodily injury to or death of one person; \$50,000 for bodily injury to or death of one or more persons; and \$10,000 for property damage. N.C. GEN. STAT. § 20-279.21(b)(2) (1983).

The Act also contains an "assigned risk plan" under which coverage of high risk drivers who otherwise would be unable to obtain coverage is allocated among all insurance carriers licensed to write automobile liability insurance in the state. *Id.* § 20-279.34. Participation in the assigned risk plan is mandatory for insurance carriers who write automobile liability insurance in North Carolina. See *Jones v. State Farm Mut. Auto. Ins. Co.*, 270 N.C. 454, 155 S.E.2d 118 (1967). Assigned risk plans are a feature of many financial responsibility laws and help make insurance available to those whom insurance companies would be reluctant to insure otherwise. See 6B J. APPLEMAN, *supra* note 23, § 4295, at 253; Note, *supra* note 23, at 1066.

46. N.C. GEN. STAT. § 20-279.6 (1983).

47. *Id.* § 20-279.7.

48. *Id.*

The operation of these provisions is triggered by filing a mandatory accident report.⁴⁹

The Act defines a "motor vehicle liability policy" in section 20-279.21. That section requires that the policy insure "the person named therein and any other persons, as insured, using any such motor vehicle . . . with the express or implied permission of such named insured . . . against loss from the liability imposed by law for damages arising out of the ownership, maintenance, or use of such motor vehicle."⁵⁰ The section also specifies in detail the requirements a policy must meet in order to exempt the insured from the security requirements of the rest of the Act. The debate in *Smith* turned on the provision that a statutory motor vehicle liability policy "need not insure against loss from any liability for which benefits are in whole or in part either payable or required to be provided under any workmen's compensation law nor any liability for damage to property owned by, rented to, in charge of or transported by the insured."⁵¹

The state legislature in 1957 strengthened the 1953 Act with the enactment of section 20-309.⁵² This Act, titled the Vehicle Financial Responsibility Act of 1957, provides that no vehicle may be registered in North Carolina unless at the time of registration the owner has proof of "financial responsibility."⁵³ Financial responsibility can be demonstrated by qualifying as a self-insurer or by offering proof of a motor vehicle liability policy or bond as defined in the 1953 Act.⁵⁴

The enactment of the 1957 Act made North Carolina one of only three states to require liability coverage for every vehicle registered in the state.⁵⁵ It also obviated criticism that the financial responsibility legislation operated only after an accident had occurred and thus after a victim may have been injured by a financially irresponsible driver. Ideally, the mandatory registration provisions of the 1957 Act deny financially irresponsible drivers a free "first bite" by denying them access to the road until they prove themselves financially responsible.⁵⁶

In decisions since enactment of the 1953 Financial Responsibility Act, North Carolina courts have indicated their intention to interpret the Act expansively. The North Carolina Supreme Court has held that the statute "will be broadly construed to carry out its beneficent purpose of providing compensation

49. *Id.* § 20-279.4.

50. *Id.* § 20-279.21(b)(2). The "omnibus clause" provision applying to all permissive users was added by amendment in 1967. Act of July 6, 1967, ch. 1162, 1967 N.C. SESS. LAWS 1794, 1795.

51. N.C. GEN. STAT. § 20-279.21(e) (1983).

52. Act of June 12, 1957, c. 1393, 1957 N.C. SESS. LAWS 1586 (codified at N.C. GEN. STAT. § 20-309 (1983)).

53. N.C. GEN. STAT. § 20-309(a) (1983).

54. *Id.* § 20-309(b). The 1953 and 1957 acts are complementary and are to be construed by the courts so as to harmonize the acts and give each full effect. *Faizan v. Grain Dealers Mut. Ins. Co.*, 254 N.C. 47, 53, 118 S.E.2d 303, 307 (1961).

55. Massachusetts was the first state to adopt a compulsory insurance law. Act of May 1, 1925, 1925 Mass. Acts 426. It was followed in 1929 by New York. Vehicle and Traffic Law of 1929, ch. 655, § 2, 1929 N.Y. LAWS 1956. Today about half the states have a compulsory insurance system. See 6B APPLEMAN, *supra* note 23, § 4299, at 300-01.

56. For a general discussion of the 1957 Act, see Montgomery, *North Carolina's New Vehicle Financial Responsibility Act*, 24 POPULAR GOV'T 12 (Dec. 1957).

to those who have been injured by automobiles."⁵⁷ The court also has held that the victim's right to recover against the insurer is not derived through the insured, as it is in cases of voluntary insurance, but rather is governed by the statute.⁵⁸

The court's intention to interpret the Financial Responsibility Act expansively was tested in a 1964 case, *Nationwide Mutual Insurance Co. v. Roberts*.⁵⁹ In that case Roberts and the victim had had a violent fight, after which Roberts pursued the victim by car and drove into him, pinning him against a stone wall.⁶⁰ Roberts' insurance company sued for a declaratory judgment that it was not liable for the injuries to the victim because Roberts' conduct was intentional. The insurance policy had a clause stating that it covered "all sums which Insured shall become legally obligated to pay as damages because of bodily injury, sickness or disease . . . sustained by any person, *caused by accident* and arising out of the ownership, maintenance or use of the automobile."⁶¹ The policy also provided that "[a]ssault and battery shall be deemed an accident unless committed by or at the direction of the insured."⁶²

The court noted that such an exclusion was common in the insurance industry and would be valid if the insured had procured the policy voluntarily.⁶³ Roberts, however, had purchased the policy pursuant to the requirements of the state's compulsory insurance laws, and the coverage did not exceed the minimum amounts required under the Financial Responsibility Act.⁶⁴ The court recognized a conflict between the exclusion clause and the statutory goal of providing compensation for victims of traffic accidents.⁶⁵ The clause also conflicted with the express requirement in section 20-279.21 that an automobile liability policy insure against liability "*arising out of the ownership, maintenance or use*" of the automobile.⁶⁶ In such a situation, the court held, the statute must prevail over the terms of the policy:

The primary purpose of compulsory motor vehicle liability insurance is to compensate innocent victims who have been injured by the negligence of financially irresponsible motorists. Its purpose is not, like that of ordinary insurance, to save harmless the tortfeasor himself. Therefore, there is no reason why the victim's right to recover should depend upon whether the conduct of its insured was intentional or negligent. In order to accomplish the objective of the law, the perspective here must be that of the victim and not that of the aggressor [The victim's rights] are statutory and become absolute on the occur-

57. *Moore v. Hartford Fire Ins. Group*, 270 N.C. 532, 155 S.E.2d 128 (1967).

58. *Nationwide Mut. Ins. Co. v. Aetna Life & Casualty Co.*, 283 N.C. 87, 194 S.E.2d 834 (1973).

59. 261 N.C. 285, 134 S.E.2d 654 (1964).

60. *Id.* at 286, 134 S.E.2d at 656.

61. *Id.* at 286-87, 134 S.E.2d at 656 (emphasis added).

62. *Id.*

63. *Id.* at 290, 134 S.E.2d at 659.

64. *Id.* at 289, 134 S.E.2d at 658.

65. *Id.* at 290, 134 S.E.2d at 659.

66. *Id.*

rence of an injury covered by the policy.⁶⁷

Twenty years later the court of appeals in *Smith* examined a conflict between another common policy exclusion and the state's financial responsibility law. The challenged clause in *Smith* is known in the insurance industry as an "employee exclusion clause" and typically provides that an insurer shall not be liable for injury to or death of "employees of the insured" who are injured while "engaged in the business of the insured."⁶⁸ The reasoning behind such an exclusion is to permit an employer to avoid the expense of covering his employees under both the mandatory workers' compensation system and an automobile liability policy.⁶⁹ Like the assault and battery clause of the policy in *Roberts*, an employee exclusion clause is a common feature of automobile liability policies⁷⁰ and has been upheld as a valid means for the insurer to limit its liability and for the insured to limit his expense.⁷¹

Just as some employees could be doubly covered—by both workers' compensation and their employer's automobile liability policy—other employees could be excluded from coverage under either kind of insurance. In many states, workers' compensation does not apply to employers with fewer than a certain minimum number of employees, or to farm or domestic laborers.⁷² If an employee is not covered by the state's workers' compensation system and the employer's automobile liability policy contains an employee exclusion clause, the employee potentially is without insurance protection if he is injured through the use of one of his employer's vehicles. In this situation, courts have been called upon to decide whether enforcement of the employee exclusion clause violates the spirit, if not also the letter, of the state's financial responsibility law.

The decisions have not been uniform.⁷³ One line of cases, relied upon by plaintiff-insurance company in *Smith*, holds that the employee exclusion is valid regardless of whether the employee is eligible for workers' compensation.⁷⁴ In some of these cases, the court simply decided the issue without mention of the state's financial responsibility law. An example cited by the *Smith* court is *Em-*

67. *Id.* See *Allstate Ins. Co. v. Webb*, 10 N.C. App. 672, 179 S.E.2d 803 (1971) (policy excluded liability for assault and battery committed by insured; court, citing *Roberts*, held that the public policy behind the financial responsibility law rendered the exclusion invalid).

68. Annot., 50 A.L.R.2d 78, 79 (1956).

69. "It is well settled that the primary purpose of an (employee) exclusion clause in a public liability policy . . . is to draw a sharp line between employees who are excluded, and members of the general public." *Travelers Corp. v. Boyer*, 301 F. Supp. 1396, 1405 (D. Md. 1969) (quoting *Lumber Mut. Casualty Co. v. Stukes*, 164 F.2d 571 (4th Cir. 1947)); see also Annot., 45 A.L.R. 3d 288, 295 (1972) (discussing the rationale behind employee exclusion cases). A similar and perhaps more common exclusion clause is the "fellow employee" or "cross-employee" exclusion, which relieves the insurer of liability for injuries to one employee arising out of actions by another employee. See *id.*

70. See 6B J. APPLEMAN, *supra* note 23, § 4297, at 280; 8 D. BLASHFIELD, *AUTOMOBILE LAW AND PRACTICE* § 318.6, at 74-81 (3d ed. 1966); Annot., 48 A.L.R.3d 13, 20 (1973).

71. See Annot., 48 A.L.R.3d 13, 30 (1973); Annot., 45 A.L.R.3d 288, 295 (1972).

72. See *supra* note 5.

73. *Preferred Risk Mut. Ins. Co. v. Poole*, 411 F. Supp. 429, 433 (N.D. Miss. 1976) ("treatment of the quoted employee exclusion clause has been far from uniform").

74. The court in *Smith* distinguished cases that discuss the financial responsibility law from those that do not and held that the latter were not precedent for its decision. *Smith*, 67 N.C. App. at 639-40, 313 S.E.2d at 861-62.

ployers Liability Assurance Corp. v. Owens.⁷⁵ In *Owens*, plaintiff was an employee of the insured and was injured while riding as a passenger in a truck driven by his employer.⁷⁶ The Florida Supreme Court upheld a clause in the employer's policy excluding "bodily injury to or sickness, disease or death of any employee of the Insured while engaged in the employment . . . of the Insured."⁷⁷ The majority found this clause to be unambiguous and held that "[t]here are obvious reasons for differentiating between the public as a class and one's own employees."⁷⁸ A dissent argued that the majority had ignored the Florida Financial Responsibility Law⁷⁹ and that the exclusion clause was "repugnant and contrary" to the requirements of that law.⁸⁰

In a subsequent case, the Florida Supreme Court⁸¹ upheld a clause excluding liability for "1) domestic employment by the insured, if benefits therefor are in whole or in part either payable or required to be provided under any workmen's compensation law, or 2) other employment by the insured."⁸² The court again did not discuss the financial responsibility law, resting its decision solely on construction of the exclusion clause: "The [exclusion] clause under discussion makes specific reference to workmen's compensation relative to domestic employment, but none whatever to nondomestic employment. The conclusion seems inescapable that the intent was to exclude from the policy's coverage all employees, other than domestic, whether or not of a category coming under workmen's compensation."⁸³

Other courts have reached the same result by holding that the financial responsibility act did not compel invalidation of the clause. The Missouri Court of Appeals⁸⁴ recently held that a fellow employee exclusion clause⁸⁵ was a "rational exclusion" even though its enforcement "ultimately excludes the plaintiff from any insurance coverage."⁸⁶

In contrast to the cases upholding employee exclusion clauses, a number of decisions have held that the clause is not valid unless the employee is covered by workers' compensation, and that this result is compelled by the state's financial responsibility law. An early case adopting this view is *Hindel v. State Farm*

75. 78 So. 2d 104 (Fla. 1955).

76. *Id.* at 104.

77. *Id.* at 105.

78. *Id.* at 106.

79. Fla. Stat. Ann. §§ 324.011-.251 (West 1978 & Supp. 1984).

80. *Owens*, 78 So. 2d at 108 (Holt, J., dissenting).

81. Griffin v. Speidel, 179 So. 2d 569 (Fla. 1965). *But see* Makris v. State Farm Mut. Auto. Ins. Co., 267 So. 2d 105 (Fla. Dist. Ct. App. 1972) (holding an employee exclusion clause to be in violation of the state's financial responsibility legislation).

82. Griffin v. Speidel, 179 So. 2d 569, 571 (Fla. 1965).

83. *Id.* at 571.

84. Zink v. Allis, 650 S.W.2d 320 (Mo. App. 1983).

85. For a discussion of fellow employee exclusion clauses, see *supra* note 69.

86. Zink v. Allis, 650 S.W.2d 320, 323 (Mo. App. 1983); see also Truck Ins. Exch. v. Gilliam, 659 S.W.2d 16 (Mo. App. 1983) (following *Zink*); Atkins v. Pacific Indem. Ins. Group, 125 Ariz. 46, 607 P.2d 29 (Ct. App. 1979) (fellow employee exclusion clause not inconsistent with state's financial responsibility law).

Mutual Automobile Insurance Co.,⁸⁷ a federal diversity case applying Indiana law. In *Hindel*, plaintiff's decedent was killed while operating a vehicle in the course of his employment. Decedent's employer's insurance company alleged that the policy provided for no liability "to any employee of the insured while engaged in the business of the Assured . . . or to any person to whom the Assured may be held liable under any Workmen's Compensation Law."⁸⁸ The United States Court of Appeals for the Seventh Circuit held that the terms of the policy "are merged in and must give way to" the state's financial responsibility law.⁸⁹ The court cited the Indiana Financial Responsibility Law's⁹⁰ requirement that a policy certified under the law be "for the benefit of all persons who may suffer personal injuries or property damage due to any negligence of the Assured"⁹¹ and added that "[i]f it had been the intention of the lawmakers . . . to exclude an employee, it could, without difficulty, have been so provided."⁹²

More recently, the Arizona Court of Appeals held that a policy clause excluding liability for injury caused by a fellow employee was valid, but only because the injured employee was covered by workers' compensation.⁹³ The court wrote that "[t]here is a significant difference between excluding coverage for injuries to a person for whom another remedy has been provided, and an attempt to exclude certain persons as insureds under the policy."⁹⁴

With its decision in *Smith*, the North Carolina Court of Appeals aligned itself with the courts that will not enforce an employee exclusion clause unless workers' compensation is available to the injured employee. This decision has the obvious advantage of avoiding a harsh result. The cases upholding an employee exclusion clause as written leave the injured employee with no coverage under either workers' compensation or his employer's automobile liability policy. If the employer cannot satisfy a tort judgment,⁹⁵ the employee is without recompense. This apparently would have been the result in *Smith* if the exclusion was enforced as written; the court noted that the record contained no evidence whether *Smith* was covered by workers' compensation,⁹⁶ but the plaintiff's brief indicated that he was not.⁹⁷

The decision also is consistent with the wording of North Carolina's Financial Responsibility Act. Plaintiff argued that the statute did not conflict with the

87. 97 F.2d 777 (7th Cir. 1938).

88. *Id.* at 782.

89. *Id.*

90. IND. CODE ANN. §§ 9-2-1-1 to 9-2-1-45 (Burns 1980 & Supp. 1983).

91. *Hindel*, 97 F.2d at 782.

92. *Id.*

93. *Martinez v. U.S. Fidelity & Guar. Co.*, 119 Ariz. 403, 581 P.2d 248 (Ct. App. 1978).

94. *Id.* at 404, 581 P.2d at 249. See *United States v. Transport Indem. Co.*, 544 F.2d 393 (9th Cir. 1976); *Farmers Ins. Group v. Home Indem. Co.*, 108 Ariz. 125, 493 P.2d 909 (1972); *Paul Masson Co. v. Colonial Ins. Co.*, 14 Cal. App. 3d 265, 92 Cal. Rptr. 463 (1971).

95. If an employee's injury is within the scope of the workers' compensation law, but he is denied recovery under the terms of the statute, the employee is precluded from seeking a tort remedy against his employer. See W. PROSSER & W. KEETON, *THE LAW OF TORTS* § 574 (5th ed. 1984).

96. *Smith*, 67 N.C. App. at 640, 313 S.E.2d at 862.

97. See *supra* note 14.

exclusionary clause in the policy.⁹⁸ The court, however, disagreed and responded that "the plain language of G.S. 20-279.21(e) is alone sufficient to justify our holding."⁹⁹ An argument advanced by defendant but not discussed by the court supports this conclusion. Defendant pointed out that section 20-279.21(e) was amended in 1967¹⁰⁰ and that before amendment the section read: "Such motor vehicle liability policy need not insure any liability under any Workmen's Compensation law *nor liability on account of bodily injury to or death of the insured while engaged in the employment, other than domestic, of the insured . . .*"¹⁰¹ While there is no legislative history on the amendment, the deletion of the italicized part of the section¹⁰² shows an intent to avoid the possibility that a policy qualifying under the statute would exclude coverage of an employee "engaged in" his employer's business but not covered by workers' compensation.

The *Smith* holding also finds support in the public policy behind the state's financial responsibility legislation. Like other financial responsibility acts, section 20-279.1 was enacted to ensure compensation to victims of automobile accidents. Unlike many other states, North Carolina has strengthened its protection for accident victims by requiring liability insurance that meets the specifications of section 20-279.21 as a prerequisite for registration of any vehicle in the state.¹⁰³ Thus, the state's compulsory insurance laws codify a policy of concern for the plight of accident victims, a concern that should send a message to the state's courts to rule accordingly. In *Nationwide Mutual Insurance Co. v. Roberts*,¹⁰⁴ the supreme court indicated its unwillingness to allow a policy exclusion to defeat the purpose of the compulsory insurance laws.¹⁰⁵ With its holding in *Smith*, the court of appeals has taken a consistent stance.

The court of appeals also has succeeded in finding a middle ground between the competing goals of a cost-conscious employer and the financial responsibility law. The decision does not require that an employer's automobile liability policy cover injury to employees who also are covered by workers' compensation. The opinion makes it clear that an exclusion of liability for which workers' compensation benefits are available is valid and enforceable.¹⁰⁶ Thus, the employer does not have to pay for double coverage of his employees, a point often overlooked in the opinions upholding employee exclusion clauses.

Finally, the court's opinion sends a clear message to insurance companies covering vehicles registered in North Carolina that a clause purporting to exclude liability for injuries to employees of the insured regardless of whether they

98. Plaintiff-Appellee's Brief at 4.

99. *Smith*, 67 N.C. App. at 639, 313 S.E.2d at 861.

100. Defendant-Appellant's Brief at 4-5. Section 20-279.21(e) was amended by Act of June 21, 1967, ch. 854, 1967 N.C. SESS. LAWS 1099.

101. Act of April 30, 1953, ch. 1300 § 21(e), 1953 N.C. SESS. LAWS 1262, 1272 (emphasis added).

102. See *supra* text at note 51.

103. See *supra* notes 52-55 and accompanying text.

104. 261 N.C. 285, 134 S.E.2d 654 (1964).

105. See *supra* notes 59-67 and accompanying text.

106. See *Smith*, 67 N.C. App. at 634, 313 S.E.2d at 861.

are covered by workers' compensation will be read as if it excluded only employees covered by workers' compensation. In light of the similarity between the employee exclusion clause in *Smith* and a "cross-" or "fellow-employee" exclusion clause,¹⁰⁷ it is likely that the court would reach a similar conclusion in construing a clause that purports to exclude liability for injuries to an employee resulting from the actions of a fellow employee.

Although *Smith* provided a clear answer to one insurance problem, the decision raises doubts about the interpretation of other common policy exclusions. For example, separate panels of the Michigan Court of Appeals have disagreed over whether that state's financial responsibility law requires invalidation of a policy clause excluding coverage for injuries to members of the insured's household.¹⁰⁸ Future litigation in North Carolina could raise difficult questions about whether a clause excluding coverage of injuries to the insured himself or to members of his family is somehow less repugnant to the letter or spirit of North Carolina's financial responsibility law than a clause excluding coverage for employees or members of the general public.

In conclusion, the North Carolina Court of Appeals in *Smith* demonstrated its commitment to expansive interpretation of the state's compulsory insurance law. The decision that an automobile liability policy cannot exclude an employee who is not covered by workers' compensation ultimately means that the cost of compensating employees such as Smith will be borne by all the state's residents who own motor vehicles and must purchase insurance. The court in *Smith* reaffirmed the policy expressed with the enactment of the state's first financial responsibility act in 1931 that such cost-spreading is a more equitable result than leaving the victims of highway negligence without compensation.

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107. Some of the cases cited by the court in *Smith* as authority for its position concerned fellow employee exclusion clauses rather than the type of employee exclusion clause in Gore's policy. See, e.g., *Atkins v. Pacific Indem. Ins. Group*, 125 Ariz. 46, 607 P.2d 29 (Ct. App. 1979); *Dahm v. Employer's Mut. Liab. Ins. Co.*, 246 N.W.2d 131 (Wis. 1976). For a discussion of fellow employee exclusion clauses, see *supra* note 69.

108. The debate centers around whether the statute requires coverage for injuries of the insured and his household, or only for third parties who may be injured through the use of his vehicle. Compare *State Farm v. Peckham*, 74 Mich. App. 551, 254 N.W.2d 575 (1977) (holding household exclusion clause valid) with *Gurwin v. Alcodray*, 77 Mich. App. 97, 257 N.W.2d 665 (1977) (holding household exclusion clause invalid). See also *Schwab v. State Farm Fire & Casualty Co.*, 27 Ariz. App. 747, 558 P.2d 942 (1976) (holding that a policy clause excluding bodily injury to the insured is not in conflict with the state's financial responsibility law).