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Article 16

Constitutional Law - Statute Allowing Direct Action Against Insurer Upheld Although Prohibited by Policy

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enterprises. These enterprises, in becoming more and more specialized, have included within their activities all the aspects of their business, even those involving the determination of legal questions. The bar associations have jealously guarded against this "Institutional Practice of Law" as it is sometimes called. There are, however, many fields, particularly accounting,[20] taxation,[21] probate research[22] and others, which would take the average practicing attorney a great deal of time to master. The prime consideration of the courts in restricting practice to licensed attorneys is the safeguarding of the public[23] and this serves as the rationale and the basis for the decisions in the jurisdictions following any of the three rules described.

[20] In re Bercu, 273 App. Div. 524, 78 N. Y. S. 2d 209 (1st Dep't, 1948).

[21] Lowell Bar Association v. Loeb, 315 Mass. 176, 52 N. E. 2d 27 (1943).

[22] In re Reilly's Estate, 81 Cal. App. 2d 564, 184 P. 2d 922 (1947).

[23] Auerbacher v. Wood, 142 N.J.Eq. 484, 59 A2d 863, 864 (1948): "In confining the practice of law and nonlegal endeavors within their respective areas, guidance is to be found in the consideration that the licensing of law practitioners is not designed to give rise to a professional monopoly, but rather to serve the public right to protection against unlearned and unskilled advice and service in matters relating to the science of the law."

CONSTITUTIONAL LAW—STATUTE ALLOWING DIRECT ACTION AGAINST INSURER UPHELD ALTHOUGH PROHIBITED BY POLICY

The plaintiff was injured by a product of an Illinois manufacturer which was bought and used in Louisiana. An action was brought directly against the nonresident liability insurer of the tortfeasor. The insurance contract, which was issued in Massachusetts and delivered in Illinois, contained a clause barring a direct action against the insurer until after a suit against the tortfeasor, which clause is binding under the laws of Massachusetts and Illinois. The action was brought in a federal district court sitting in Louisiana, and was based on a Louisiana statute[1] allowing a direct action against the liability insurer of a tortfeasor without regard to a "no direct action" clause and without regard to the fact that the contract of insurance may be made in another state and be binding there. The defendant insurance company had previously complied with another section of the statute[2] requiring consent to such direct suits as a condition precedent to getting a certificate to do business in the state. The Supreme Court upheld the constitutionality of both provisions of the statute and allowed the plaintiff to recover in this direct action. *Watson v. Employers Liability Assurance Corp.*, 348 U.S. 66 (1954).

[1] L.S.A.-Rev. Stat. (1950) § 22:655, as amended by Act 541 of the Louisiana Legislature of 1950.

[2] L.S.A.-Rev. Stat. (1950) § 22:983, as amended by Act 542 of the Louisiana Legislature of 1950.

This decision was a unanimous reversal of four recent federal cases on point.[3] In regard to both statutory provisions, the basic issue in the case is whether the United States Constitution would allow Louisiana to follow its own law and thereby enlarge the obligations of a contract elsewhere validly consummated, or whether it will require Louisiana to follow the law of Massachusetts and Illinois, in which states the "no direct action" clause is valid.

As a preliminary to further discussion of the decision, it might be well to summarize and review the law on the subject prior to this case. First of all, liability insurance may be defined as a protection of the insured against loss arising by virtue of his legal liability to third persons for bodily injury or property damage resulting from negligent or wrongful acts of himself or those for whom he is responsible.[4]

The mere existence of liability insurance creates no right to sue where one would otherwise not exist.[5] In absence of statute or contractual provisions, the cases uniformly hold that an injured party has no right of action at law against the liability insurer of a tortfeasor[6] on the theory that no privity of contract exists. The same rule holds true even though the policy is made payable to the insured for the benefit of the injured person or persons or their legal representatives in case of death.[7] Since the beneficiary of the insurance policy is the insured in the sense that he is the one whom the policy is protecting, the injured person is only an incidental beneficiary of the contract; as such, he cannot successfully maintain an action under the law allowing third party beneficiaries (donee and creditor beneficiaries) to recover.[8] The most commonly expressed limitation on the rule allowing third persons to sue is that the parties must have clearly intended the contract to be for the benefit of the third person,[9] thereby excluding incidental beneficiaries.

The injured person may proceed directly against the insurer where this is permitted by the terms of the policy,[10] and where statutes require the insurer to

[3] Watson v. Employers Liability Assurance Corp., 202 F. 2d 407 (C.A. 5th, 1953); Mayo v. Zurich General Accident and Liability Ins. Co., 106 F. Supp. 579 (W.D. La., 1952); Bish v. Employers Liability Assurance Corp., 102 F. Supp. 343 (W.D. La., 1952); Bayard v. Traders & Gen'l Ins. Co., 99 F. Supp. 343 (W.D. La., 1951).

[4] Hanson, *Manual of Insurance* 51 (1954).

[5] Rozell v. Rozell, 281 N.Y. 106, 22 N.E. 2d 254 (1939).

[6] Carter v. Aetna Ins. Co., 76 Kan. 275, 91 Pac. 178 (1907); Farrell v. Employers Liability Assurance Corp., 54 R.I. 18, 168 Atl. 911 (1933); Pisciotta v. Preston, 170 Misc. 376, 10 N.Y.S. 2d 44 (S. Ct. Sp. Tm., 1938); 29 Am. Jur., Insurance § 1080, at 810 (1940).

[7] Embler v. Hartford Steam Boiler & Inspection Co., 158 N.Y. 431, 53 N.E. 212 (1899).

[8] Aetna Life Ins. Co. v. Maxwell, 89 F. 2d 988 (C.A. 4th, 1937). Carson Pirie Scott & Co. v. Parrett, 346 Ill. 252, 178 N.E. 498 (1931).

[9] In Re Connecticut Co., 95 F. 2d 311 (C.A. 2d, 1938); Evans v. Sperry, 12 F. 2d 438 (E.D. Ill., 1926); 17 C.J.S., Contracts § 519 (1939).

[10] New Amsterdam Cas. Co. v. Jones, 135 F. 2d 191 (C.A. 6th, 1943).

include a provision for direct liability to persons injured.[11] In absence of policy provisions for his benefit, the injured person has only those rights which a statute gives him against the insurer.[12] In either case, the injured party may recover as a third party beneficiary only to the extent that the policy or statute gives him a remedy. An Illinois decision in accord[13] held that the purpose of such a statute is to benefit the people who are injured. This decision was based on a statute, since repealed,[14] requiring the injured person to obtain a judgment against the insurer.

Difficulties first begin to appear in a jurisdiction which, through statute, allows direct action against a liability insurer by the injured person, but the policy contains a clause prohibiting direct action unless the claim was fixed by final judgment or by agreement with written consent of the insurer. Of the few states allowing an injured person to sue the insurer, most require that a judgment first be obtained against the insured. The great majority of cases hold that a statute enabling the injured party to recover from the liability insurer must be read into the insurance contract,[15] and the statute cannot be modified or rendered ineffective by provisions of the contract.[16]

All the courts in this case and related cases agree that the provision enlarging liability in the instant case would be valid against a resident insurance company or in the case of a contract made in Louisiana. The next logical situation involves the facts of the instant case.

In contract cases involving parties in different states which have conflicting laws, the courts have been in substantial disagreement as to how to determine which law will govern. Some courts speak in terms of where the contract is made, some courts allow the intention of the parties to govern, and some apply the law of the place of performance.[17] In the instant case the Court does not mention this aspect; the issues are framed and attacked from a completely different standpoint.

The insurance company contends, first of all, that the two statutory provisions are unconstitutional because they impair the obligation of the defendant's contract with its assured and also because they deny the defendant equal protec-

[11] In most of these cases, the statutes confer this right upon the injured party in the event of the bankruptcy of the insured. See in re Fay Stocking Co., 95 F. 2d 961 (C.A. 6th, 1938); Builders & Mfg. Mut. Cas. Co. v. Hammon, 26 F. Supp. 929 (D.C. Ohio, 1941).

[12] Farrell v. Employers Liability Assurance Corp., 54 R.I. 18, 168 Atl. 911 (1933); Pisciotta v. Preston, 170 Misc. 376, 10 N.Y.S. 2d 44 (1938).

[13] Scott v. Freeport Motor Cas. Co., 392 Ill. 332, 64 N.E. 2d 542 (1946).

[14] Ill. Rev. Stat. (1935) c. 73, § 466 (1), repealed (1937).

[15] New Amsterdam Casualty Corp. v. Jones, 135 F. 2d 191 (C.A. 6th, 1943); Shenandoa Rayon Corp. v. Halifax Fire Ins. Co., 272 N.Y. 457, 3 N.E. 2d 867 (1936).

[16] Ocean Accident & Guarantee Corp. v. Torres, 91 F. 2d 464 (C.A. 9th, 1937); Hoosier Cas. Co. v. Fox, 102 F. Supp. 214 (N.D. Ia., 1952).

[17] Stumberg, Conflict of Laws 224–225 (1951).

tion. In a strongly worded opinion, Mr. Justice Black quickly brushed aside these arguments on the basis that the statute was in force before the insurance contract was executed, and also that no discrimination between rights and privileges between resident and non-resident companies existed.

The crux of the defendant's claim as to the unconstitutionality of the two provisions is as follows:

(1) they deny the defendant its rights to have courts of Louisiana and the federal court sitting in Louisiana give full faith and credit to the legislative acts and decisions of the states of Massachusetts and Illinois;
(2) they deprive the defendant of its property and rights without due process of law by
   (*a*) attaching such a condition precedent to doing business in the state, and
   (*b*) attempting extra-territorial jurisdiction by attempting to regulate and control activities beyond its boundaries.

The defendant relies heavily on previous Supreme Court decisions in a Texas case[18] and a Mississippi case,[19] both of which the Court distinguishes from the instant case. In the first case, Texas was denied the power to alter the obligations of a Mexican contract because the subject matter of the contract was not related to anything done or to be done in Texas. In the second case, Mississippi was denied the power to alter a contract made in Tennessee because Mississippi activities in connection with the policy were found to be too slight and casual.

The Court seems to uphold the constitutionality of the statute on the basis of what Justice Black calls "Louisiana's legitimate (public) interest." He points out that transients and residents may be killed or injured in the state. The state may have to care for them in Louisiana homes, in Louisiana hospitals, and by Louisiana doctors. Since Louisiana has an interest in the injured persons, the state can provide remedies for the recovery of damages. In balancing the Massachusetts and Illinois interests, the Court admits their validity but does not regard them as strong enough to outweigh the Louisiana interests. Massachusetts, so the Court says, is concerned about the financial well-being of a great number of insurance companies whose activities center within that state. Then too, both Illinois and Massachusetts are vitally interested in the scope and nature of the protections and obligations of the insured. Louisiana's interest in safeguarding the rights of persons injured there (residents and transients alike) also gives the state the constitutional right to subject the foreign liability insurers to the direct action laws, whether they consent or not, through a condition precedent to doing business in the state. This is based on the police power of the state.

In a concurring opinion, Mr. Justice Frankfurter criticizes the basis of the decision and the rationale of the remaining members of the Court. His opinion is pregnant with fear of possible future consequences that may ensue from

[18] Home Ins. Co. v. Dick, 281 U.S. 397 (1930).

[19] Hartford Accident & Indem. Co. v. Delta & Pine Land Co., 292 U.S. 143 (1934).

allowing a state to rewrite a foreign contract by statute. He feels that it would have been better to avoid the constitutional issues and to have decided the case completely on the basis of the police power of the state which gives the state the right to impose a condition precedent to doing business in the state. He says:

> . . . the state which fixes the terms of insurance contracts has interests to be protected by the Constitution no less important than has a state which seeks to excise provisions of such a contract.[20]

Since Louisiana has the right to exclude the insurance company unless they agree to the condition precedent required by statute, the case could have been resolved just as easily and with much less danger of future consequences if it had been based completely on the police power of the state, according to Mr. Justice Frankfurter. While speculation as to future consequences will be mere conjecture, this is a point well taken.

Although the Court did not say what might have happened had the insurance company not complied with this condition precedent to doing business in the state, the fact that the majority of the Court seems to cling almost exclusively to the balance of interests between the states indicates that the direct action *might* be allowed even without such compliance. However, this will be decided only by a case squarely on point. Such a decision will completely crystallize the scope of the rights of the injured person against the insurer.

In a companion case[21] decided on the same day, the insurer claimed that the district court in Louisiana had no jurisdiction over the insurer alone because diversity of citizenship existed between the injured person and the insurer, but not between the injured person and the tortfeasor. It was argued that the Louisiana state court should handle the matter. The Court held that the district court had proper jurisdiction because the insurer was a real party in interest and not merely a nominal defendant. The insured is not a necessary party to the action because the statute creates a separate and distinct cause of action against the insurer at the election of the injured person who has the option to sue either one as an only necessary party.

However one may feel about the grounds for the decision, no one can deny the practical importance and potential scope of the holding in the instant case. The public as a whole certainly benefits from such a statute. It would not be surprising if this decision precipitated a flood of legislation all over the country based on the Louisiana direct action statute. Only a strong insurance lobby can prevent the ultimate assimilation of this type of statute into our general pattern of law.

[20] 348 U.S. 66, 77 (1954).

[21] Lumberman's Mut. Cas. Co. v. Elbert, 348 U.S. 48 (1954).