1958

Self-Insurance in Texas - A Penny Wise but Pound Foolish Device

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COMMENTS

SELF-INSURANCE IN TEXAS — A PENNY WISE BUT POUND FOOLISH DEVICE?

SCOPE

The Texas Motor Vehicle Safety-Responsibility Act[1] is a legislative attempt to remove from the highways vehicles driven or owned by persons who demonstrate lack of financial ability to satisfy judgments rendered against them for damages caused by negligent operation of such motor vehicles.[2] The act provides several alternate ways for proving financial responsibility,[3] but there is no doubt that the most widely used method is motor vehicle liability insurance.[4] "Self-insurance" is one method by which the owner of more than twenty-five motor vehicles may satisfy the requirements of the act and yet avoid paying large annual insurance premiums. Self-insurance is specifically authorized by section 34 of the act, which states that "The Department may, in its discretion . . . issue a certificate of self-insurance when it is satisfied with [sic] such person is possessed and will continue to be possessed of ability to pay judgments obtained against such person."

The purpose and scope of this Article is to determine the extent and nature of the risks assumed by persons who become self-insurers under the Texas Motor Vehicle Safety Responsibility Act.

NATURE OF SELF-INSURANCE

Not a Mere Exception to the Act

The basic difficulty and ambiguity presented by section 34 is whether the legislative intent was for a self-insurer to assume broader responsibility and liability than he would ordinarily be subject to under the familiar agency doctrine of respondeat superior.[5] If the legislature did not intend to impose a greater liability than that

[1] Tex. Rev. Civ. Stat. Ann., art. 6701(h) (Supp. 1958).

[2] See §§ 5, 7 of art. 6701(h). The act will be referred to hereafter by section only.

[3] Sections 12-18.

[4] Marryott, "Automobile Accidents and Financial Responsibility," 287 Annals 83, 85 (1953); Association of the Bar of the City of New York, Report on Problems Created by Financially Irresponsible Motorists 1 (1952); 1 Blashfield, Cyclopedia of Automobile Law & Practise iii-ix (1948); Vance, Insurance 24 (3d ed. 1951); 2 Spectator Insurance Year Book, Casualty & Surety xxi-xxiii (1949).

[5] Schroeder v. Rainboldt, 128 Tex. 269, 97 S.W.2d 697 (1936); Ochoa v. Winerich Motor Sales Co., 127 Tex. 542, 94 S.W.2d 416 (1936); Restatement, Agency §§ 219, 228 (1933).

at common-law, it becomes apparent that section 34 is no more than a device by which the Texas Department of Public Safety may in its discretion exempt financially responsible owners of more than twenty-five motor vehicles from the sanctions and mandates of the act. Such a construction would reduce section 34 to a mere exception to the act, as then recovery against the "self-insurer" would be allowed only if the self-insurer would be liable in any event as a principal under traditional agency doctrine. It is believed that such a narrow construction would not properly reflect the legislative intent or purpose; indeed, if a "self-insurer" was intended to assume no more liability than an ordinary principal, a simply worded exception to the act would probably have been employed to effect that end instead of several elaborate sections defining the sphere of self-insurance.[8] It is difficult to arrive at a conclusion other than that the entire import, purpose, and design of the legislature in creating self-insurance, was to impose greater obligations upon self-insurers than they would ordinarily be subject to by the law of agency. However, this question can be determined only by judicial decision, and until a pronouncement is made on this point, a prudent self-insurer would *first*, assume that the act will be so interpreted, and *second*, explore the legal consequences resulting from his unique status as a self-insurer.

An Important Distinction

At this point one may well inquire whether there is a legal distinction to be drawn between a person's (or business entity's) capacity as a common-law "principal" and his capacity of self-insurer under the Texas act, and if there is, of what importance it may be. It is reasonable to assume that in most motor vehicle accident cases where such was caused by the negligence of a self-insured's agent, the principal (self-insurer) would be liable for the damages because the negligent act was done within the scope of the agent's express or implied authority. Such a fact situation presents no difficulties for it is only of academic interest whether the principal is liable under respondeat superior, or because he is an insurer of the motor vehicle operator; he is certainly liable, regardless of the theory employed.

However an unusual situation may arise under section 34 when the negligent operator of a motor vehicle owned by a self-insurer was not an agent, servant, or employee of the self-insurer and/or was not acting within the scope of his express or implied authority

[8] See §§ 5(c), 18(4), 34.

when the accident occurred. This is the precise question to which the remainder of this Article is devoted; namely, what is the liability of a self-insurer when one of his motor vehicles is negligently operated so as to cause injury, but the self-insurer (owner of the vehicle) would not be held liable as a principal under respondeat superior or any other agency doctrine? Before this question can be answered, however, it is necessary to explore the theoretical basis and nature of self-insurance.

Self-Insurance is not Authentic Insurance but a Risk-Shifting Device

It is well agreed that every *genuine* scheme of insurance requires at least the following features:[7]

(a) Possession by the insured of an interest susceptible of pecuniary estimation, *i.e.*, an insurable interest.

(b) The insured is subject to risk of loss of that interest if certain perils occur.

(c) The insurer assumes that risk of loss for the insured.

(d) Such assumption is part of a general scheme to distribute actual losses among a large group of persons, each bearing similar risks.

(e) Insured makes his ratable contribution to the common insurance fund, popularly known as the "premium."

It is time-tested insurance theory that a plan having just the first three features is not true "insurance" but merely a device to shift the losses caused by certain perils and risks from the "insured" to another person.[8] In applying these general criteria to the self-insurance sections of the Texas act, it becomes quite obvious that important deficiencies in the act prevent the classification of self-insurance as true insurance.

No Premiums Are Paid

The most prominent departure from technical insurance requirements is the fact that no premiums are paid by the insured, nor are reserves for possible claims required under the act.[9] The act itself specifically states that the certificate of self-insurance[10] must be " . . . supplemented by an agreement by the self-insurer that

[7] Vance, op. cit. supra note 4, citing National Service Corp. v. State, 55 S.W.2d 209 (Tex. Civ. App. 1932) error dism.; 1 Duer, Marine Insurance 54 (1845).

[8] Vance, op. cit. supra note 4, § 1, pp. 4-5.

[9] See p. 3 of Form SR-1, published by the Texas Department of Public Safety, where information on reserves is requested.

[10] Section 34.

. . . he will pay the same judgments and in the same amounts that an insurer would have been obligated to pay." Apparently it was intended that the general assets of the self-insurer would be available instead of a formal insurance fund.[11]

No Spreading of the Risk Occurs

Another standard insurance feature that is lacking in the self-insurance plan is the requirement of a general scheme to distribute actual losses among large diverse groups of insureds, each subject to similar risks and perils. This deficiency is the *fiat accompli* that reduces the Texas plan of self-insurance to nothing more than a risk-shifting device.[12] The general scheme of widespread loss distributions is the very heart of all insurance theory.[13] The insurance industry has learned through decades of experience that most attempts at insurance underwriting are doomed to failure unless a large enough selection of widespread risks is achieved.[14] The Texas act falls far short of this requirement. Even a self-insurer with well over twenty-five motor vehicles is not "spreading the risks" sufficiently to hope that he could pay several large or even average sized judgments per year and still have a net saving over the amount of insurance premiums that would otherwise have been paid. In short, it may be said that the self-insurer is really gambling that his vehicles will not be involved in accidents, and if he is lucky, insurance premiums will be saved. If he is unlucky, however, his assets may well be consumed in a short period of time.

Other Factors

The remaining three features of a true plan of insurance are satisfactorily fulfilled under the Texas act. The self-insurer clearly possesses an *insurable interest* in the preservation of his assets, and *risk of loss* due to liability imposed by an accident involving one of his motor vehicles is always present. *Shifting of the risk* is not as clearly obvious (for the same person operates in both capacities, *i.e.*, insurer and insured), but it is present in the sense that a self-insurer agrees to pay certain judgments *as if* he were an insurance carrier.[15]

[11] Section 18(4). Note however that this agreement is required only as proof of financial responsibility for the future, i.e., after an accident has occurred. Apparently no such agreement is necessary as a condition precedent to qualification under § 34.

[12] "While a policy under seal for no premium paid would at common law be enforceable as an indemnity bond, it could scarcely be considered a proper insurance contract." Vance, op. cit. supra note 4, p. 5.

[13] Vance, op. cit. supra note 4, at 5, citing Malynes, Lex Mercatoria 105 (3d ed. 1686).

[14] Ibid.

[15] Section 18(4).

From the above analysis, one may conclude that Texas self-insurance certainly is not "insurance" in the traditional sense, but rather is a quasi-insurance[16] scheme whereby the public is supposedly protected against judgment-proof owners and operators of motor vehicles, and a qualified owner is allowed to avoid both the penalties of the act and expensive premiums by assuming his own risks. Theoretically the scheme appears simple and easy of interpretation, but, as often occurs when rights and obligations are created by statutory enactment, peculiar fact situations arise which were not contemplated by the legislators who drafted the act.[17] Thus the ultimate question for decision in this Comment is whether the broad language of the act goes further than was probably intended, and does impose liability on the self-insurer when he would not be liable as a principal, *i.e.*, is his assumption of risk the same as that imposed on an ordinary liability insurance carrier under the standard Texas automobile liability policy.

Liability Assumed By A Self-Insurer

Theoretical Basis of Self-Insurer's Liability

It is believed that the true basis for self-insurers' liability is found in the doctrine of third party beneficiary contract. Contracts for the benefit of parties other than the promisee have been long recognized in the law.[18] Traditionally such third parties are divided into two[19] primary classes: donee beneficiaries and creditor beneficiaries. A donee beneficiary situation is found where "the purposes of the promisee in obtaining the promise of all or part of the performance thereof, is to . . . confer upon him (the donee beneficiary) a right against the promisor to some performance neither due nor supposed or asserted to be due from the promisee to the beneficiary."[20] When this principle is applied to the facts of the present discussion it is obvious that all requistes are satisfied. The "promisor" is any owner of over twenty-five motor vehicles who ap-

[16] See the following workmen's compensation self-insurance cases for a possible analogy. These cases indicate without so holding, that self-insurers are to be treated as insurance carriers for many purposes. Friend Bros., Inc. v. Seaboard Surety Co., 316 Mass. 639, 56 N.E.2d 6 (1944); Salt Lake City v. Industrial Comm'n, 58 Utah 314, 199 Pac. 152 (1921).

[17] See, e.g., Home Indemnity Co. v. Humble Oil & Refining Co., Civil No. 18,533, 134th Jud. Dist. Ct. of Dallas County, Texas, appeal now pending.

[18] Restatement, Contracts, illustration 4, § 133(1)(a) (1932).

[19] Williston, Contracts § 356 (rev. ed. 1936), presents a possible third catagory which is of minor importance in most cases.

[20] National Surety Co. v. Diggs, 272 S.W.2d 604, 611 (Tex. Civ. App. 1954) error ref. n.r.e.; Restatement, Contracts § 356 (1932).

plies for a certificate of self-insurance under section 34;[21] the "promisee" is the state of Texas acting through its duly established administrative agency;[22] the third party beneficiary is any person who suffers bodily harm or property loss "arising out of the ownership, maintenance or use of a motor vehicle" owned by the promisor.[23] In effect the promisor (applicant) contracts with the state of Texas that he will pay for such losses. Sufficient consideration for the promise, if such be necessary, is found in the self-insurer's exemption from penalties imposed in case of violation of the act.[24]

This theory is further sustained by the fact that the Texas act does not require liability insurance or other proof of financial responsibility until *after* an accident occurs,[25] nor does it anywhere purport to make such insurance mandatory; all relations between the state and motor vehicle owners and operators are on a purely voluntary basis. It is submitted that the rights and liabilities of an authorized self-insurer are firmly rooted in the law of contract, and the duties which devolve on the self-insurer will in large part be determined therefrom.

What Liability Does The Self-Insurer Agree To Assume

As a self-insurer's liability is founded on a contractual basis, it is relatively easy to ascertain the extent of that liability by interpretation of the "contract" made between the "self-insurer" and the state.

Section 34 of the act is the basic authorization for self-insurance, as witness its broad language: "The Department may . . . upon . . . application . . . issue a certificate of self-insurance when it is satisfied . . . such person is possessed and will continue to be possessed of ability to pay judgments obtained against such person." This can readily be construed to impose upon the motor vehicle owner the burden of "insuring" anyone driving the vehicle with his express or implied permission, even though not acting at the time of the accident in a capacity which would create a principal-agent relation. This construction would seem to carry out the manifest intent and spirit of the act. Otherwise a self-insurer could loan his motor vehicles to employees and friends for weekends, vacations,

[21] He agrees once an accident occurs to "pay the same judgments and in the same amounts that an insurer would have been obligated to pay. . . . " § 18(4). See note 11 supra.

[22] Namely, the Texas Department of Public Safety. § 1(12).

[23] See § 1(10).

[24] See §§ 5, 6, 7, 9, 12, 13, 14.

[25] Section 5(a) and (b); see also National Surety Co. v. Diggs, 272 S.W.2d 604 (Tex. Civ. App. 1954) error ref. n.r.e.

or overnight[26] (where no agency question could be raised) and not only avoid liability as either a principal or self-insurer, but also save premiums for insurance coverage which would insure *any* lawful operator of the vehicle regardless of an agency relation.[27] Such a result would defeat the very public policy the act was designed to promote. Further inequities are possible, as consider the following: Many drivers of self-insured vehicles carry no personal liability insurance, for example, on their own cars if such be owned, which would cover the driver even when operating a different vehicle.[28] A gross injustice could occur in case of accident, for the injured party likely would be left without a solvent defendant to proceed against. Such a result is diametrically opposed to the avowed purpose of the act (as well as all similar financial responsibility laws)—preventing judgment-proof owners or operators from driving or owning motor vehicles.[29]

Section 18(4) of the act is an additional indication that the legislature intended self-insurers to be responsible even in situations where the agency element is absent. This section provides that proof of financial responsibility may be given after an accident has occurred by filing a "certificate of self-insurance, as provided in Section 34, *supplemented by an agreement by the self-insurer that,* with respect to accidents occurring while the certificate is in force, *he will pay the same judgments and in the same amounts that an insurer would have been obligated to pay under an owner's motor vehicle liability policy if it had issued such a policy to said self-insurer.*" (Emphasis added.) It is a basic principle in automobile liability insurance that the insurance carrier covers anyone operating the vehicle with permission of the named insured.[30] Therefore it should be obvious that the legislature's very words in section 18(4), quoted above, expressly require a self-insurer to assume risks not unlike those assumed by an ordinary insurance carrier.[31] A different

[26] It is believed that such is common practise for firms owning many automobiles and other small motor vehicles.

[27] The Texas standard automobile policy defines "persons insured" as "(1) the named insured." Curry, General Insurance for Texas 77 (1955).

[28] "Persons insured" under the standard Texas policy include with respect to a non-owned automobile, "(1) the named insured." Curry, op. cit. supra note 27.

[29] Ehrenzweig, "Full Aid" Insurance for the Traffic Victim 13 (1954).

[30] See note 27 supra.

[31] See § 21(f)(1)-(2) which states that "the liability of the insurance company with respect to the insurance required by this Act shall become absolute whenever injury or damage covered by said motor vehicle liability policy occurs. . . . " It should be noted that art. III (§§ 4-11) of the act relates to the type of security required following the first accident, to avoid the sanctions and penalties. Compare art. IV (§§ 12-29) which relates to proof of financial responsibility for the future. The latter article does not apply until after the first accident; however, its provisions (that the self-insurer "agree" to

interpretation would be difficult to sustain either in reason, logic, or public policy.

Based on the foregoing principles, the extent of liability assumed by a self-insurer may be summarized as follows: Self-insurers under the Texas act are absolutely liable[32] for damages which occur as a result of the ownership, maintenance or use of any motor vehicle owned by said self-insurer, irrespective of the self-insurer's liability as a principal or employer, and regardless of other insurance protecting either the operator or self-insurer.

Limitation on Liability

Section 21 of the act defines a motor vehcile liability policy in detail and imposes absolute liability[33] on the insurance carrier after an accident occurs, and provides that such liability may not be defeated by acts or agreements of either insured or insurer subsequent thereto. However section 21(g) explicitly provides that the maximum amount for which an insurer may be absolutely liable is to be within "basic limits."[34] "With respect to a policy which grants . . . additional coverage the term 'motor vehicle liability policy' shall apply only to that part of the coverage which is required by this Section."[35] The importance of determining maximum limits of liability, if any, assumed by a self-insurer should be evident. For example, if an employee of a self-insurer causes injury while operating a motor vehicle within the scope of his employment, the self-insured employer is personally liable for the entire amount of damages on *agency* principles discussed above. Since it is clearly established above that a self-insurer takes risks which occur outside the scope of his business—as when the driver is acting on a purely personal mission—the question presented is whether the self-insurer exposes himself to *unlimited* liability as insurer of anyone operating his motor vehicle.

The act is obscure on this very important issue. Several sections mention the minimum amounts required to establish "proof of financial responsibility"[36] but the context of these sections indicates

assume all obligations of an ordinary insurance carrier) will always apply and govern in every case because the alternative methods of giving proof of financial responsibility (§ 18) are just as onerous as filing the "agreement," and if used, would defeat the very advantages sought to be gained by becoming a self-insurer.

[32] Limitation on liability is discussed below.

[33] This is subject, of course, to plaintiff's ultimate recovery of a final judgment. See § 6(4) of the act.

[34] Basic limits are $5,000 per person; $10,000 per accident; $5,000 property damage. Board of Insurance Commissioners, Rules and Rates Governing the Insuring of Automobiles, rule 2 (1955).

[35] Section 21(g).

[36] Sections 1(10), 5(c), 15, 18, 19, 21, 25.

that the legislative intent in establishing limits was, primarily, to provide a bare minimum of responsibility for drivers and owners, and secondarily to provide a method by which the sanctions and penalties of the act can be avoided if and when such minimum responsibility is proved.[37] The act apparently is not concerned with *maximum* insurance coverage, and hence any amount over and above basic limits would be a matter of private contract between the insurance carrier and the insured. It must be strongly emphasized here that section 34 does not limit the amount a self-insurer agrees to pay. This section[38] provides for the certificate to be issued when the Department of Public Safety is satisfied that "such person is possessed and will continue to be possessed of ability *to pay judgments*[39] obtained against such person." (Emphasis added.) From the plain meaning of this section, there is no limit whatsoever to the contractual liability assumed by a self-insurer. Conceivably a generous self-insured employer could allow an employee to use a business motor vehicle over a vacation period, and if that employee is at fault in an accident involving that motor vehicle, the employer could be held liable *as an insurer of the driver* for many thousands of dollars, even though there is no principal-agent question involved. The same holds true for all acts of an agent which take him out of the course of his employment.[40]

Section 18(4) might be the basis of an argument to the contrary, for it provides that the self-insurer ". . . will pay the same judgments and in the same amounts that an insurer would have been obligated to pay under an owner's motor vehicle liability policy if it had issued such a policy to said self-insurer." A "motor vehicle liability policy" is so defined in section 21(b) as to restrict the minimum coverage required by the act to basic limits.[41] This argument would be convincing but for section 21(g) which expressly provides that coverage in excess of basic limits is neither affected by nor subject to the definition of "motor vehicle liability policy" in section 21(b). In other words, only the basic limit amount is controlled by the act, and all excess is a matter of private contract. It is the writer's conclusion that by virtue of the donee beneficiary contract theory as well as the plain meaning of section 34, a self-

[37] See §§ 5(c), 6, 18.
[38] Taken with § 18(4).
[39] " 'Judgment'—Any judgment which shall have become final . . . upon a cause of action arising out of the ownership, maintenance or use of any motor vehicle, for damages. . . . " § 1(12).
[40] See, e.g., Mechem, Outlines of the Law of Agency §§ 520-26 (3d ed. 1923).
[41] See note 34 supra.

insurer "agrees" to pay and be liable for judgments in *any* amount; in effect it is open-face insurance.

OTHER CONSIDERATIONS

Other Collectible Insurance

The Texas standard automobile liability policy provides that when the insured is operating another vehicle, that insurance is secondary to any insurance on the vehicle, and will apply only if there is an excess of uncollected damages over and above any such valid and collectible primary insurance on the vehicle being driven, which is always the "primary" insurance.[42] Thus a very interesting situation is presented when the operator of a self-insured vehicle has liability insurance on his personal automobile. As the "coverage" provided by the self-insurer is the *primary* insurance, and since it has been concluded above that there is no upper limit of liability, the personal insurance of the driver could not be relied upon as "excess insurance" for the simple reason that with open-face primary insurance, there could never be an excess of unsatisfied damages where secondary insurance coverage would be necessary. A possible exception would exist where the self-insured's assets become exhausted and still the final judgment is not satisfied. Then the secondary insurance of the driver would respond up to its policy limits. This situation should rarely occur as most self-insurers have sufficient assets to satisfy even the largest judgments arising out of one accident.

Subrogation

No matter how grossly at fault the operator of the self-insured motor vehicle may be, and even though the accident occurred beyond the scope of the operator's employment, the self-insurer has no cause of action against the negligent operator based on subrogation principles. This is due to the basic rule of subrogation that usually an insurer has no subrogation rights against his insured,[43] and it has been established above that the driver is an "insured" of the self-insured owner.

Parties

An important question arises regarding parties to the suit, for it is well established in Texas trial procedure that the fact of in-

[42] Pasley v. American Surety Co., 253 S.W.2d 86 (Tex. Civ. App. 1952) error dism.; Smith v. Pacific Fire Ins. Co., 178 S.W.2d 170 (Tex. Civ. App. 1944); Curry, op. cit. supra note 27, 88-89.

[43] See § 21(h) for a possible exception.

surance may not be communicated to the jury by the plaintiff where the sole defendant is the operator of the vehicle.[44] This rule is preserved in section 11 of the act which states that neither the reports filed, action taken, nor findings made by the Department of Public Safety ". . . *nor the security filed* as provided by this Article shall be referred to in any way, nor be any evidence of the negligence or due care of either party, at the trial of any action at law to recover damages." (Emphasis added.) The wording of section 34 (b) would seem to permit the plaintiff to join the self-insurer as a co-defendant with the motor vehicle driver, or even as the sole defendant.

These apparently conflicting sections in the same statute present a problem which must be solved by the courts or legislative amendment. It would seem a reasonable solution to allow the self-insurer's joinder only in the situation where he clearly would be liable in any event as a principal, and not to allow his joinder when his liability is founded solely on his "agreement" to insure the driver. This solution is less than perfect for often the agency issue will be a hotly contested point in the case and a matter for the jury to decide. Amendment of the act would be the best way to give certainty of meaning to these ambiguous, conflicting sections.

Conclusion

Self-insurance as allowed in the Texas Motor Vehicle Safety Responsibility Act is not true insurance. The self-insurer assumes much greater risk than is readily apparent and this liability, being founded in the doctrine of third party beneficiary contract, is potent and irrevocable. A different interpretation of the act is unlikely in view of the important social, economic, and public policy motives which led to the enactment of such law. This is further fortified by the fact that a goodly number of large businesses operating many motor vehicles, allow their employees to make personal use of such vehicles for vacations, weekends, and overnight.

No reported case has been found which determined the liability of self-insurers, a fact which circumstantially indicates that self-insurers have been lucky so far. One Texas district court case[45] now on appeal is known to the writer which involves the matters discussed herein. It is the writer's considered opinion that most self-

[44] Mancada v. Snyder, 137 Tex. 112, 152 S.W.2d 1077 (1941); McCormick & Ray, Texas Law of Evidence § 1539 (2d ed. 1956).

[45] See note 17 supra.

insurers are not aware of the full extent of their possible liability and if the premises and conclusions of this Article are correct, all self-insurers could well re-examine the prudence of such practice. Self-insurance may indeed turn out to be a "penny wise but pound foolish" device.

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