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"NO ACTION" CLAUSES IN INDEMNITY INSURANCE

The earlier forms of contracts of indemnity insurance, undertaking to protect the insured, were generally so worded as to cause the courts little difficulty in discovering therein an intent by the parties that the responsibility of the insurers should arise as soon as the insured was subjected to legal liability for the injury he had inflicted, i. e. when the amount and rightfulness of the claim against the insured had been established in a court of competent jurisdiction, and, it was generally held that it was not necessary that such liability should first have been discharged by the insured.[1]

Today there exist two forms of insurance, commonly called indemnity and liability insurance. The distinction arises, as a general rule, by virtue of the provisions and nature of the insurer's undertaking. However, frequently the word "indemnity" is used inaccurately by way of contrast to "liability" to distinguish the two types of policies which today are the subject of much discussion, and which are in reality both strict indemnity policies.[2]

The liability of the insurer accrues differently under the terms of differing contracts. When the agreement of the insurer is to pay "all damages with which the insured may be legally charged, or be required to pay, or for which he may become legally liable," it is clear the insurer can be required to pay as soon as the liability of the insured becomes legally determined.[3] The insurer is not concerned

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[1]37 A.L.R. 645.

[2]24 Columbia Law Review 173, 175 (1924); American Employer's Liability Ins. Co. v. Fordyce, 62 Ark. 562, 569, 36 S.W. 1051, 1053 (1896); McBride v. Aetna Ins. Co., 26 Ark. 528, 532, 191 S.W. 5, 6, (1917); 37 A.L.R. 644; 80 University of Penna. L.R. 195; Malley v. American Indemnity Co., 297 Pa. 216 (1929).

[3]American Employer's Liability Ins. Co. v. Fordyce, 62 Ark. 562, 36 S.W. 1051 (1896); Anoka Lumber Co. v. Casualty Co., 63 Minn. 286, 65 N.W. 353, 30 L.R.A. 689 (1895); Honen v. Assurance Corp., 93 Wis. 201, 67 N.W. 46, 32 L.R.A. 388 (1896); Bains v. Atkins, 181 Mass. 240, 63 N.E. 414, 57 L.R.A. 791 (1902); Seeberger v. Wyman, 118 Iowa 527, 79 N.W. 290 (1899); Stephens v. Penna. Casualty Co., 135 Mich. 189, 97 N.W. 686 (1903); Fritchie v. Miller's Penna. Ex-

with the question whether the insured has paid or can pay the judgment entered against him. The amount of the liability, when so fixed, determines the measure of the insurer's liability to pay, provided, of course, it does not exceed the sum written in the policy. Thus, in an Arkansas case,[4] a certain woman had secured a judgment for personal injury against a street railway company, which had liability insurance containing a term whereby the insurer agreed to pay all damages with which the insured might be legally charged. The railway company was insolvent and wholly unable to pay the judgment, but the receiver nevertheless demanded of the insurer payment of the amount of the judgment. This demand was contested by the insurer on the grounds that the insurance contract could only be for indemnity, and that, since the insolvent insured had not been damnified by the judgment in question, it ought not to ask to be indemnified. But the court held the insurer liable for the full amount of the judgment, clearly stating its reasons for so doing as follows: "This is not simply a contract of indemnity. It is more. It is also a contract to pay liabilities. The difference between a contract of indemnity and one to pay legal liabilities is: Upon the former an action cannot be brought, and a recovery had, until the liability is discharged; whereas, upon the latter, the cause of action is complete when the liability attaches . . . . . "

In *Frye v. Bath Gas & Electric Co.*[5] the insurer had contracted to indemnify the insured "for loss actually sustained and paid by him in satisfaction of a judgment after trial of the issue." A judgment for a large amount was recovered against the insured employer for personal injuries that came within the terms of the insurer's policy. The

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tract Co., 197 Pa. 401, 47 Atl. 351 (1900); Klotzbach v. Bull Dog Auto F. Ins. Ass'n, Mo. App. , 267 S.W. 39 (1924); Capelle v. U. S. Fidelity & G. Co., 80 N.H. 481, 120 Atl. 556 (1922); Ross v. American Employer's Liability Ins. Co., 56 N.J.E. 41, 38 Atl. 22 (1897); See also 37 A.L.R. 645, for a list of the more recent cases upon this point.

[4]American Employer's Liability Ins. Co. v. Fordyce, 62 Ark. 562, 36 S.W. 1051 (1896).

[5]97 Me. 241, 54 Atl. 395, 59 L.R.A. 444.

insured, however, had become insolvent, and an execution issued against it was returned unsatisfied. The plaintiff then filed his bill against the insured, its assignees, the insurer, and the parties in interest, praying that the insurer be compelled to pay in satisfaction of his judgment the amount due under the employer's liability policy. But the court held, aside from the question whether the plaintiff had any rights in the premises, that no payment was due under the insurer's contract until the insured had sustained some actual loss by making actual payment under the judgment. But as the insured was wholly unable ever to discharge its liability to the plaintiff, the insurer had incurred no liability whatever. "There can be no reimbursement," said the court, "where there has been no loss. The contract of insurance contains nothing to show that it was the object or intention of the contracting parties that the insurer should guaranty the gas company's liability for negligence to its employees. It was not a contract of insurance against liability, but of indemnity against loss by reason of liability."[6]

In a New Jersey case[7] the court, construing a provision identical with that in the case just discussed, held that, while "not the amount of the employee's judgment, but the amount paid by the employer thereon, was the sum for which the insurer was responsible," yet a transfer of the employer's property to a trustee in bankruptcy was a sufficient payment to satisfy the terms of the policy and perfect the liability of the insurer. Only such a proportion of the judgment was held payable, however, as corresponded to the percentage of all the assets of the insolvent, excluding the insurance claim, to all the debts, excluding this judgment. Such an amount the insurer was required to pay to the receiver for the use of the complainant.

The distinction between the two is very well expressed in a recent Pennsylvania case,[8] where the late Justice Sad-

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[6]See, to the same effect, Cushman v. Fuel Co., (Iowa) 98 N.W. 509 (1904).

[7]Traveler's Ins. Co. v. Moses, 63 N.J.E. 260, 49 Atl. 720.

[8]Malley v. American Indemnity Co., 297 Pa. 216 (1929).

ler says, "There are two types of indemnity insurance, sometimes called indemnity against liability or 'liability' contracts and indemnity against damage or 'indemnity' contracts. In the first class, the liability of the insured determines enforceability; in the other the policy is only enforceable when the insured has sustained actual loss, as by paying a judgment against him coming within the scope of the policy."[9]

The Pennsylvania courts have recognized the indemnity theory and have said upon numerous occasions[10] that there can be no recovery against the insured until a loss has actually been sustained, as by the payment of a judgment. Thus the courts have adhered to the distinction which arises between "indemnity" and "liability" insurance.

The difference in the two forms has been criticized by various writers because it is claimed that there is no distinction between loss and liability and that loss is sustained not only by having paid a judgment. If the term "loss" is strictly interpreted it would indicate that if one is insolvent so that he is unable to pay his debts or the judgment against him, he can no longer suffer a loss. In an Oklahoma case[11] it was well said, "In our judgment it is faulty reasoning which leads to the conclusion that one can suffer no loss if he is unable to pay that which he is under an obligation to pay. Many modern business men, we dare say, would deem the loss of money insignificant compared to the loss of good name, not to mention the other losses

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[9]See also: Rose & Sons Inc. v. Zurich Gen. Acc. Co., 296 Pa. 206 (1929); Fritchie v. Miller's Pa. Extract Co. 197 Pa. 401 (1901); Md. Casualty Co. v. Peppard, 157 Pac. 160 (Okl. 1915); Harrison v. Transit Co., 192 N.C. 545, 135 S.E. 460 (1926); Wicher v. Happach, 73 U.S. 94, 99.

[10]Rose & Sons, Inc. v. Zurich Gen. Acc. Co., 296 Pa. 206, at 209, Mr. Justice Kephart:—"No right of action accrues, in a simple contract of indemnity, until the indemnitee has suffered a loss against which the covenant runs. The part protected cannot recover until he has actually been damnified."; Pfeiler v. Penn Allen Portland Cement Co., 240 Pa. 468 (1913); West v. MacMillan, 301 Pa. 344 (1930); Malley v. American Indemnity Co., 297 Pa. 216 (1929).

[11]Maryland Casualty Co. v. Peppard, 157 Pac. 108 (Okl. 1915).

which inevitably follow inability to meet honest obligations."

The Pennsylvania courts have shown their inclination toward this view in the most recent decisions upon this point.[12] In the earliest one of these cases, the late Mr. Justice Sadler said, "Loss does not have an inflexible meaning and may consist of many different situations of varying gradations. Voluntary or involuntary separation from one's money is not the only criterion of loss. Any shrinkage in value of estate or property may on proper occasions be rightfully so termed. Any depreciation or depletion of property value through judicial sale or otherwise would likewise come within the definition; the concrete result of these factors as it affects the owner is a loss."

The latter one of these cases is an exemplification of the adoption by the Pennsylvania courts of this theory of "loss". It is said by the court, "A final judgment against an individual was an actual as well as a potential loss within the meaning of the terms of the policy."

The result is somewhat of a rebellion against the division of indemnity insurance and the adoption of a view more compatible with justice, doing away with the fallacious view that there are two forms of indemnity as stated above. The practical effect is to do away with "indemnity" contracts and to make such contract always one of indemnity against liability. The result which follows from this is that a judgment against the insured would not have to be paid before an action could be brought against the insurer. The theory of subrogation would no longer stand in the way as it does in the case of a contract of "indemnity"[13]—that the insured cannot sue the insurer until he has suffered loss. However, these two cases do not come to this ultimate conclusion. They maintain the old rule because of the fear which a court undergoes when it is about to disturb precedent and thereby change the law,

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[12]West v. MacMillan, 301 Pa. 344 (1930); Malley v. American Indemnity Co., 297 Pa. 216 (1929).

[13]U. S. Tube & Iron Co. v. Md. Casualty Co., 220 Pa. 42 (1907).

and decide the case upon a different ground, leaving the courts to decide, in the future, what the law will be. The intention is so strong that it seems highly improbable that the courts will not follow this lead set up by the late Justice Sadler and carried on by Justice Kephart.

The next step taken by the insurance companies was the insertion in the contract of the "no action" clause, i.e., a provision that "no action shall lie under this policy unless for the loss actually sustained and paid in satisfaction of final judgment." One of the most perfect of these clauses from the standpoint of the insurance company issuing the policy reads as follows:

> "No action shall lie against the company to recover for any loss or expense under this policy, unless it shall be brought by the assured for loss or expense actually sustained and paid in money by him after the trial of the issue."[14]

It seems that the reason this clause was inserted in the policy by the insurance company was because the construction of many of the cases had been in favor of the indemnity against liability. This was so, even when the company undertook only to issue against loss from legal liability.[15]

The popularity of this clause is due to the effect it had upon the liability of the insurer; that the latter is not liable to the insured until the judgment against him is paid.[16] It is clearly designed to make payment of the judgment after trial a condition precedent[17] to the duty of the accident company to indemnify the insured. We can therefore safely say that the intended effect of this clause is to relieve the insurer of liability in a number of cases by placing a construction upon this clause that will place the policy in the category of one for indemnity as contrasted to one for liability. All this tends toward the safety of the insurer,

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[14]Patterson v. Adan, 119 Minn. 308, 138 N.W. 281 (1912).

[15]37 A.L.R. 644 at 666.

[16]Cooley, Insurance, 5696.

[17]Employers' Liability Assur. Co. v. Fredette, 3 D.L.R. 64, 66 (1923); 29 Rev. Leg. (N.S.) 93, 95 (1923).

and as was said in a recent Maryland case,[18] "It may be a surprise to many owners of automobiles to find that policies such as we have before use do not afford them the protection that they supposed they had; but however that may be, we cannot change the contract between the parties to meet the special circumstances, if the contracting parties have not protected themselves." That this clause creates the effect of making the policy one of indemnity is supported by much authority.[19]

For twenty years the courts were blinded by this clause, utterly failing to see the great injustice done by the insurance company in the case of the insolvency of the insured, in which event the injured person had no remedy because the court said that there was no right of subrogation until the judgment was actually paid.[20] That there was an injustice created by the "no action" clause there is no doubt. In the case of insolvency the only one who derived any benefit from the policy was the insurer. A personal judgment against the insured was of no benefit to the injured person, it was not an asset in his hands. Any hope of recovery upon it was frustrated by the financial condition of the insured.[21] Looking now at the position of the insured, he is not in the position he was originally. A judgment has been recovered against him which mars his ability to obtain credit, therefore he has suffered a loss. He cannot remove the judgment until he has paid the amount of the obligation. Being unable to do this he is not entitled to sue the insurer and recover it. Apparently the only one who has gained anything is the insurer, who should be the one to undergo the loss, having been paid for the risk. This is well shown by the case cited previous-

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[18]London and Lancashire Indemnity Co. v. Cosgriff, 144 Md. 660, 125 Atl. 529, 532 (1924).

[19]See: 37 A.L.R. p. 647 citing authority from most of the states in this country.

[20]Hollings v. Brown, 202 Ala. 504, 80 So. 792 (1919); Cushman v. Carbondale Fuel Co., 122 Iowa 656, 98 N.W. 509 (1904); Burke v. London Guaranty and Acc. Co., 47 Misc. 171, 93 N.Y., S. 652 (1905).

[21]See: 59 A.L.R. 1125.

ly[22] where no recovery was permitted against the insurer because of the insolvency of the insured and his inability to pay judgment obtained against him.

This is the status of the law in Pennsylvania as shown by a comparatively recent decision.[23] The injured person prayed that he be subrogated to the rights of the bankrupt employer under a "no action" policy which the employer held. The court held that the injured person was not entitled to subrogation to the rights of the bankrupt employer against the insurance company, under an indemnity policy of accident insurance containing a "no action" clause. The conclusion was arrived at with great brevity it being a per curiam opinion. A court of justice should not ignore the rights of the insured and the injured person because of a principle of law, which may be sound theoretically but practically unjust.

The case of *United States Tube and Iron Co. v. Maryland Casualty Co.*[24] is of the same opinion as the case just mentioned. The court said, in effect, that, where a policy of indemnity contains a "no action" clause, an action brought two days before the satisfaction of a judgment against the insured is prematurely brought, and the insured cannot recover thereon. This was also a per curiam opinion of marvelous brevity.

This is in conformity with the majority view of this country which is overwhelming.[25] Following the case of *Malley v. American Indemnity Co.*[26] the most recent case on this point[27] seems to hold with the majority view saying that there will be no recovery from the insurance company unless the judgment is actually paid. The facts of this case were as follows: Plaintiff recovered a judgment for personal injuries and issued an attachment summoning the insurance company as garnishee. The company denied

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[22]Frye v. Bath Gas & Electric Co., 97 Me. 241, 54 Atl. 395 (1902)

[23]Pfeiler v. Penn Allen Portland Cement Co., 240 Pa. 468 (1913).

[24]220 Pa. 42 (1907).

[25]Endorsed by the following states: N. J., Ala., Iowa, Ky., Tenn., N. Y., Wash., Texas, Penna., Ohio, and others.

[26]297 Pa. 216 (1929).

[27]West vs. MacMillan, 301 Pa. 344 (1930).

liability under the policy because the insured had not actually paid the judgment against him. The policy contained a "no action" clause in the usual form, but in addition there was a clause to the effect that the insurance company would defend all actions brought against the insured. It was held by the court, "Where a contract contains a clause defining liability as being indemnity against loss or damage arising or resulting from the happening of a given event, the covenant of indemnity is not broken until the indemnitee has suffered a loss against which the covenant runs, and, generally speaking, an action cannot be sustained until the liability is discharged by payment whether before or after the final judgment."

"Where such a clause is followed by a clause providing that no action shall lie unless brought to recover money actually paid, it does not change the meaning of indemnity; the effect of the 'no action' clause is to rewrite what is ordinarily understood by indemnity, except as it defines the manner and time for payment."

"Where an indemnity contract contains provisions by which the absolute control and determination of the loss may be taken from the indemnitee by the company's assuming entire charge of the defense, the company waives its right to insist on a literal enforcement of the indemnity contemplated by the contract, and an action may be sustained by the indemnitee when the loss has been determined by final judgment."

The case also contains interesting dictum to this effect, "It was shown by the *Malley* case, how a final judgment against an individual was an actual as well as a potential loss within the meaning of that term in the policy."

As the actual ruling of the case is clearly expressed there is no doubt that at the present the court is still following the rule presented by the *Pfeiler* case.[28] The doubt as to what might be the ruling in the future is presented by the dictum in the *West* case, by Mr. Justice Kephart. It seems clear that the confusion of the majority of the

[28]Pfeiler v. Penn Allen Portland Cement Co., 240 Pa. 468 (1913).

courts is caused by the distinction between liability and loss. In a recent article[29] it is said, "Nothing is more obvious than that the traditional distinction is as formal as it is artificial. In this modern commercial age, when credit is the very essence of a commercial enterprise, to assert that a liability is not a loss is to exemplify the subtlety of the sophist."[30] If the distinction between loss and liability is taken away it shatters the foundation of the two forms of insurance, therefore leaving only one to exist; namely, that of indemnity against liability. Unfortunately the court did not make this step so necessary toward advancement but it is hoped that in the future the courts will adopt this dictum and adopt the ruling more in line with justice.

In addition to the "no action" clause was the reservation to the insurer of the right to defend all actions. The court held that the strict indemnity contract was modified by these subsequent acts,[31] and an action might be sustained by the indemnitee when the loss has been determined by final judgment. It was held to be a policy of indemnity against liability.[32] Although this is the minority view it seems to be the rising opinion of the courts in this country and is displacing the view of the majority.

The theory of estoppel is explained by a New Hampshire court[33] in this manner: "If 'to defend' means 'to protect', to secure against attachment, in short, to successfully

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[29]80 University of Penna. Law Rev., p. 215—Laube.

[30]For the reason the distinction is the cause of the injustice, etc., see 80 U. of P. Law Rev., 215.

[31]Malley v. American Indemnity Co. 297 Pa. 216 (1929); Moses v. Ferel and Indemnity Co. of America, 97 Pa. Super. Ct. 13 (1928); Patterson v. Adan, 119 Minn., 308, 138 N.W. 281 (1912).

[32]Patterson v. Adan, 119 Minn. 308, 138 N.W. 281 (1912); Sanders v. Frankfort Ins. Co., 72 N.H. 485, 57 A.L.R. 655 (1904); Elliot v. Belt Automobile Ass'n, 87 Fla. 545, 100 So. 797 (1924); Md. Casualty Co., v. Peppard, 157 Pac. 160 (Okl. 1915); Davies v. Md. Casualty Co., 89 Wash. 571, 155 Pac. 1035 (1916); Picket v. Fidelity Co., 60 S. C. 477, 38 S.E. 160; American Employer's Liability Insurance Co. v. Fordyce, 62 Ark. 562, 36 S.W. 1051 (1896); Kephey v. Casualty Ass'n of America, 355 Mich. 408, 238 N.W. 239 (1931).

[33]Sanders v. Frankfort Ins. Co., 72 N.H. 485, 57 Atl. 655 (1904).

defend, it is perfectly clear that the insurance company agrees to perform their covenant of indemnity against loss by assuming the liability and that payment by the insured was not a condition precedent."

The weight of authority construes "to defend" as meaning merely to contest the suit to final judgment. While in a technical sense to defend a suit is to contest it, the words "to defend" also include the broader meaning suggested by the New Hampshire court.

The Pennsylvania court[34] says "The insurer has safeguarded its own interest by ascertaining through legal channels that a fair loss has been sustained; by its own conduct at the trial, it is estopped from denying its own liability and cannot prevent the indemnitee from recovering, though the indemnitee's liability has not been discharged by payment." This is not new in the Pennsylvania law, it having been asserted previously.[35] Under this theory, the court in the *West* case said, in reference to the "no action" clause, "It is the joker of the policy and has been written out by many legislatures."

We may then conclude that the *West* case does not change the law in Pennsylvania but merely supplies dictum that, if followed in the future, will render a "no action" clause one of indemnity against liability as contrary to indemnity against damages.

The necessity of legislation upon this point is urgent. It should be the duty of the Assembly of Pennsylvania to legislate upon this subject and safeguard this judicious trend set in motion by the two recent cases, as the courts in the future might stay this movement toward advancement.

Adolph D. Weiss.

INJURIES ON GOLF COURSES

The rule seems to be without doubt in Pennsylvania that to maintain an action for damages for an injury

[34]West v. MacMillan, 301 Pa. 344 (1930).

[35]Malley v. American Indemnity Ins. Co., 297 Pa. 216 (1929).