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Should the Financial Irresponsibility Theory Become a Reality?

COMMENTS

SHOULD THE FINANCIAL IRRESPONSIBILITY THEORY BECOME A REALITY?

Employer's immunity for the torts of his independent contractor is subject to many exceptions which add substantial uncertainty to this area of the law. There is evidence of a trend in the direction of further encroachments upon this immunity. This trend is based on a theory of social justice and specifically, upon concern for the uncompensated plaintiff. Dicta in a recent New Jersey case, *Majestic Realty Ass'n, Inc. v. Toti Contracting Co.*,[1] suggests an extension to employer's immunity which completely denudes this apparent trend in the law.

> The injured has no control over or relation with the contractor. The contractee, true, has no control over the doing of the work and in that sense is also innocent of the wrongdoing; but he does have the power of selection and in the application of concepts of distributive justice perhaps much can be said for the view that a loss arising out of the tortious conduct of a financially irresponsible contractor should fall on the contractee.[2]

In other words, the employer or contractee should be liable to a third person for the tort of his independent contractor because the contractor was financially irresponsible.

The common law began with the premise that one man should not be liable for another man's torts. This premise was modified with the development of respondeat superior, a doctrine which owes its creation in part to the assumption that the master is more capable of compensating the plaintiff than is the servant.[3] In early English law employers of independent contractors were no more insulated from liability than were masters,[4] but in 1826 the employer's immunity for the wrongful acts of his independent contractor was established.[5] In 1853, after the employer's immunity seemed complete, the first in a long list of exceptions was created.[6] The case of *Bower v. Peate*[7]

[1] 30 N.J. 425, 153 A.2d 321 (1959).

[2] *Id.* at 325, 153 A.2d at 325.

[3] Morris, *The Torts of an Independent Contractor*, 29 ILL. L. REV. 339 (1934). This is the entrepreneur theory of the development of respondeat superior.

[4] Bush v. Steinman, 1 Bos. & Pul. 404, 126 Eng. Rep. 978 (1799).

[5] Laugher v. Pointer, 5 B. & C. 547, 108 Eng. Rep. 204 (1826).

[6] Jane Ellis v. The Sheffield Gas Consumer Co., 2 El. & Bl. 767, 118 Eng. Rep. 955 (1853). The employer was liable for the negligent acts of his independent contractor if the latter was employed to do an illegal act.

[7] 1 Q.B. 321 (1876).

held that employers are liable for the negligent acts of their independent contractors, provided the work to be done creates an inherent hazard and special precautions are not taken.[8] Since then exception after exception has been added to the employer's immunity doctrine.[9] Chief Justice Gallagher in *Pacific Fire Ins. Co. v. Kenny Broiler and Mfg. Co.*[10] remarked, "[I]t would be proper to say that the rule is now primarily important as a preamble to the catalog of its exceptions."

A general exception to the doctrine exists when the contractee does not select a competent contractor. The Restatement of Torts defines "competent" to mean one who possesses the knowledge, skill, experience and available equipment which a reasonable man would realize is necessary to avoid creating an unreasonable risk of harm.[11] Note that nothing is said about the requirement of financial responsibility. The suggested "financial irresponsibility" theory extends the definition of "competent" to include the ability to respond adequately to a tort claim. It places a duty of reasonable care on the employer to select a financially responsible contractor.

The concept of social justice, which is the basis of the aforementioned liberal trend in the law, is replacing the concept of individual justice. "The shift should not be away from exercising moral bases but in the direction of emphasizing social as against individual morality."[12] Justice Holmes articulated the ideas of individual justice in *The Common Law.* One statement particularly applicable shows one policy behind this attitude: "[T]he public generally profits by individual activity. As action cannot be avoided, and tends to the public good, there is obviously no policy in throwing the hazard of what is at once desirable and inevitable upon the actor."[13] However, modern society seems to be reversing this policy and throwing the hazard of action and development upon the actor on the ground that the rights of the individual actor must be sacrificed to meet the demands of society. "In the larger sense there is no loss of a moral point of view in the rule that one who innocently

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[8] In DILLON, MUNICIPAL CORPORATIONS § 792 (1st ed. 1872), the language of Bower v. Peate was changed to "intrinsically dangerous."

[9] The most commonly accepted exceptions are: (a) when the employer is personally at fault (example, job to be done is a tort); (b) when the employer selects an incompetent contractor; (c) when the employer fails to exercise requisite supervision over part of the operation not delegated under contract; (d) when the employer allows work to be done by dangerous methods; (e) when there is a statutory nondelegable duty; (f) when a nondelegable common law duty exists (example, landlord's duty to keep common approaches in reasonably good condition); (g) when the work is inherently dangerous (sometimes included under nondelegable common law duty). 2 HARPER & JAMES, THE LAW OF TORTS, § 26.11 (1956); RESTATEMENT, TORTS, §§ 410-429 (1935); 39 YALE L. J. 861 (1930).

[10] 201 Minn. 500, 502, 277 N.W. 226, 228 (1937).

[11] RESTATEMENT, TORTS, § 411 (1935).

[12] 2 HARPER & JAMES, THE LAW OF TORTS 753 (1956).

[13] HOLMES, THE COMMON LAW 95 (1881).

causes loss should make it good; but it is social morality, and not personal blame, which is involved." [14] In short, the defendant-mindedness, which was perhaps over-emphasized during the era of rugged individualism, is giving way to an equally over-emphasized plaintiff-mindedness. This movement is labelled "socialization of law." [15]

The suggestion that an employer be required to select a financially responsible contractor is representative of this social movement in the law.[16] Its proponents list as their main argument the socially desirable goal of eliminating from enterprise the financially irresponsible contractor. They argue that an employer who hires a man to perform work, usually on the former's premises, should be required to select a contractor who is able to compensate a plaintiff for injuries. The only conclusive and sound way of accomplishing this, they say, is to place a duty on the contractee to select financially competent contractors. A breach of this duty results in liability to any person who is negligently injured by the contractor. They argue that it is a simple thing for the contractee to require that the contractor have liability insurance or furnish an indemnity bond. This theory permits compensation to the plaintiff without considering fault in the sense of foreseeing an unreasonable risk of harm on the part of defendant as a condition precedent to liability. An employer may be liable even though he used due care to select an otherwise competent [17] contractor and exercised reasonable care in all other respects to prevent the injury.

This liberal view conflicts with the requirement of fault as a prerequisite to liability. The proponents are fearful that if fault were a condition of liability, it would so restrict recoveries as to limit severely the number of compensated plaintiffs.[18] Harper and James advocate, "a wise distribution of accident losses over society, without regard to fault, as under Workmen's Compensation laws." [19]

However, to the conservatives, fault, the moral basis of the law,[20] is a necessary element in finding liability. They argue that we must not sacrifice

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[14] PROSSER, TORTS 16 (2d ed. 1955).

[15] Pound, *The End of the Law as Developed in Legal Rules and Doctrines*, 27 HARV. L. REV. 195 (1914). At page 226 Dean Pound said that the new social movement studies the "satisfaction of human wants, and it seems to put as the end of law the satisfaction of as many human demands as we can with the least sacrifice of other demands. This new stage of legal development may be called 'socialization of law'."

[16] Pound, in listing the areas of the law which have been affected by the socialization of law, mentions as one area the "imposition of liability without fault, particularly in the form of responsibility for agencies employed." Pound, *supra* note 15, at 226.

[17] As defined in RESTATEMENT, TORTS, § 411 (1935).

[18] 2 HARPER & JAMES, THE LAW OF TORTS § 12.4 (1956).

[19] 2 HARPER & JAMES, *supra* note 18, at 753.

[20] Isaacs, *Fault and Liability*, 31 HARV. L. REV. 954 (1917).

this moral notion for the goal of compensation to every innocent plaintiff. The argument is: "[W]hat has to be shown is not merely that the sufferer ought to be compensated, but that he ought to be compensated by the defendant." [21]

The history of our law shows a pattern of alternative approach and retreat from fault as a condition precedent to liability. It is uncertain which came first.[22] Yet, it is certain that liability with fault is a very important concept in our law. Dean Ames commented in 1908: "The ethical standard of reasonable conduct has replaced the unmoral standard of acting at one's peril." [23] Justice Holmes in *The Common Law* quoted Chief Justice Nelson of New York, who said:

> All the cases concede that an injury arising from inevitable accident, or, which in law or reason is the same thing, from an act that ordinary human care and foresight are unable to guard against, is but the misfortune of the sufferer and lays no foundation for legal responsibility.[24]

Holmes argued that if this were not so, any act of the defendant, however remote, could result in legal liability. He said that an "act" required the defendant (actor) to foresee an unreasonable risk of harm and to have a choice between acting reasonably or unreasonably in the circumstances. If the defendant as a reasonable man could not foresee this risk, then the choice was necessarily non-existent and there was no "act." It was this choice which constituted a moral element in the law making the power to avoid damage to the plaintiff a condition precedent to liability. Where this power did not exist, there could be no liability. Concerning the liberal view of liability, Holmes said: "The undertaking to redistribute losses simply on the ground that they resulted from the defendant's act would . . . be open . . . to the still graver one [objection] of offending the sense of justice." [25]

The question, then, is this: is the goal of compensation to the innocent plaintiff, based on liability without fault, so essential that its importance outweighs the desire to retain the moral foundation of the law? And more particularly, is the vicarious liability of the employer for the torts of his insolvent independent contractor one of these essentials? Both questions should be an-

[21] Williams, *The Aims of the Law of Tort*, 4 CURRENT LEGAL PROBLEMS 137 (1951). This was a lecture delivered at the University of London.

[22] Justice Holmes believed it began with liability with fault and it has increasingly developed into a system of liability without fault. On the other hand Wigmore, the author of the current view, thought the law began with man acting at his peril and gradually became moralized until liability was connected with fault. Isaacs, *supra* note 20.

[23] Ames, *Law and Morals*, 22 HARV. L. REV. 97 (1908). Delivered as an address at the 75th Anniversary of the Cincinnati Law School.

[24] HOLMES, *supra* note 13, at 95.

[25] *Id.* at 96.

swered in the negative. Justice Holmes expressed a basic concept of our system of justice when he said a man should not be found liable unless he in some way caused or contributed to the plaintiff's injury. Of course, there are certain situations wherein liability without fault should be and is properly applied. "If the moral notion that links fault with liability must to some extent be violated, our position must not be interpreted as the abandonment of an ideal; it is but a new recognition of a human limitation from which human law cannot be free." [26] It seems, however, that the liability of the employer of an insolvent independent contractor is not one of these situations. There is no real benefit to the community in a rule which subjects an employer to liability in a situation where, as Holmes says, he has no choice of avoiding the injury and therefore, he has committed no act. We would be holding an employer, who has committed no act, liable solely because his independent contractor is financially irresponsible. True, he has a choice of either hiring a financially competent or financially incompetent contractor, but that is not the choice to which Holmes refers. The pertinent question is: does the employer have a choice of *preventing* injury to the plaintiff? In all the exceptions noted in the Restatement of Torts,[27] either the employer was at fault in some way or there is a valid reason for the rule aside from the mere desire to increase compensable situations in favor of accident victims. It may be that the proponents of this "financial irresponsibility" theory are not advocating liability without fault. Instead, they may be advocating liability with fault where the fault is not in causing the platintiff's injury, but in hiring a contractor financially unable to compensate the plaintiff.

There is no judicial discussion of this exact question but a few authorities briefly allude to it:

> [T]he employer must have used care to select a competent contractor. Its sister condition, that the contractor should also be financially responsible, appears always to have met with a cold reception, though it is true that both lack of skill and absence of funds have been used at times to expose the "dummy contractor." [28]

All the cases that treated insolvency of the contractor as a significant point have been concerned with exposing the "dummy" contractor. In these cases insolvency was regarded as one element indicating an invalid contract,[29] or

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[26] Isaacs, *supra* note 20, at 978.

[27] RESTATEMENT, TORTS, §§ 410-429 (1935); *supra* note 9.

[28] Steffen, *Independent Contractor and the Good Life*, 2 U. CHI. L. REV. 501, 505 (1935).

[29] Nelson v. American Cement Plaster Co., 84 Kan. 792, 115 Pac. 578 (1911); Kellogg v. Payne, 21 Iowa 575 (1866); Lawrence v. Shipman, 39 Conn. 586 (1873); Holbrook Cabot & Rollins Corp. v. Perkins, 147 Fed. 166 (1st Cir. 1906); Smith, *Scope of the Business: the Borrowed Servant Problem*, 38 MICH. L. REV. 1222, 1245 (1940).

bearing on the issue of independent contractor versus servant.[30] Apparently, these cases have caused some confusion among the authorities discussing the "financial irresponsibility" theory. Although they have been cited for this proposition, in fact the employer was held liable because there was either a bad faith intent to contract away liability by using a "dummy" device or the alleged contractor was, in reality, a servant.

Professor Morris appears to be the most articulate proponent of this theory.[31] He argues that the "financial irresponsibility" theory is consistent with the policy behind the "inherently dangerous" exception[32] to employer's immunity. Morris states that the purpose of the latter exception is merely to better plaintiff's chances of recovery.

It has been effectively argued that this is not the policy behind the "inherently dangerous" exception. The policy is simply to prevent the employer who is contemplating a venture which involves a high incidence of injury from contracting away his liability.[33] Another policy behind the rule is to prevent injury by providing an incentive to the employer to hire a competent, skillful contractor.[34] If the courts have accepted professor Morris' argument, they have not clearly indicated it in their opinions.

Even if the courts do consider the plaintiff's chances of recovery against a particular contractor in invoking the "inherently dangerous" exception, there is still no effective argument in favor of adopting the "financial irresponsibility" theory. If the courts are plaintiff-minded in the "inherently dangerous" cases, it is because of the high incidence of injury involved. It follows that if the "financial irresponsibility" theory is adopted on the basis of plaintiff-mindedness, it should be limited to the cases involving a high incidence of injury. In fact, the *Majestic* case[35] appears to limit the theory in this way. The

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[30] Hercules Copper Co. v. Crenshaw, 21 Ariz. 15, 184 Pac. 996 (1919); Wallace v. Southern Cotton-oil Co., 19 Tex. 18, 40 S.W. 399 (1897); Fehrenbacker v. Oaksdale Copper Mining Co., 65 Wash. 134, 117 Pac. 870 (1911); Keech v. John L. Roper Lumber Co., 166 N.C. 503, 82 S.E. 836 (1914); Southern Cotton-oil Co. v. Wallace, 23 Tex. Civ. App. 12, 54 S.W. 638 (1899). There are cases where the fact of insolvency had no bearing because the job could be carried out by a person with little or no capital. White v. Olive Hill Fire Brick Co., 169 Ky. 834, 185 S.W. 107 (1916).

[31] Morris, *supra* note 3.

[32] RESTATEMENT, TORTS, § 416 (1935); Bower v. Peate, *supra* note 7.

[33] Stubblefield v. Federal Reserve Bank of St. Louis, 356 Mo. 1018, 204 S.W.2d 718, 722 (1947); Covington and Cincinnati Bridge Co. v. Steinbrock, 61 Ohio St. 215, 55 N.E. 618 (1899); RESTATEMENT, TORTS, Introductory Note, Chapter 15, Topic 2.

[34] Covington and Cincinnati Bridge Co. v. Steinbrock, *supra* note 33; Hardaker v. Idle Dist. Council, 1 Q.B. 335 (1876). J. Cockburn's opinion in Bower v. Peate, *supra* note 7 supports both these policies. Also see 27 AM. JUR., *Independent Contractors*, § 39 (1938) for support of the second policy stated. It states that inherently dangerous work subjects the employer to an absolute, nondelegable duty to see that all reasonable care is taken during its performance to protect third persons from injury.

[35] *Supra* note 1.

court discusses the issue of inherent danger and quotes this statement from an earlier case: "I am not prepared to say that this fact [financial irresponsibility of the contractor] may not be of some weight where the work to be done is hazardous to others." [36] If the court decides that the work is inherently dangerous, the employer will be liable on that basis and the financial inadequacy of the contractor will not be necessary to find liability.

Realizing this, Professor Morris argues that all cases involve a high incidence of injury and inherently dangerous situations. Therefore, the "financial irresponsibility" theory should apply in all cases. However, the courts define the danger arising in the "inherently dangerous" cases as being "incidental to and characteristic of the work itself," whereas the danger in the ordinary case arises from the improper "means and methods" of performance.[37] If the inherent danger case is only a particular segment of independent contractor law, it follows that the "financial irresponsibility" theory should be imprisoned within it and there to be forgotten.

There are other problems concerning the "financial irresponsibility" theory. It imposes on the employer something in the nature of double foreseeability. He is required to foresee an unreasonable risk of harm even though he hires a perfectly competent contractor and takes all other provisions reasonably necessary to prevent the creation of such a risk. In addition, as an insurer he is required to foresee the exact amount of the judgment against the contractor. The logical result of this rule, which would seemingly only be invoked in the absence of some other exception creating joint liability, is that the contractee would be required to pay the difference between what the contractor can pay and the amount of the judgment. How much insurance should the employer require the contractor to have before he employs him?

Then, too, there is the problem of requiring one businessman to guarantee the tort liability of another businessman. Unlike the servant, the independent contractor is carrying on an enterprise of his own rather than being a part of the employer's enterprise[38] and for this reason it appears there is no presumption that the employer has the deeper pocket.

> He is the small businessman, incarnate, the last stubborn refuge of rugged individualism. It is simply impossible to say that he is to pass from the scene

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[36] The case is Lawrence v. Shipman, *supra* note 29, at 590. It appears in the Majestic case on page 324.

[37] Majestic v. Toti, *supra* note 1, at 326; Bergquist v. Penterman, 46 N.J. Super. 74, 134 A.2d 20 (1957); Swearsky v. Stanley Dry Goods Co., 122 Conn. 7, 186 Atl. 556 (1936); 23 A.L.R. 1095. Inherently dangerous work is also described as being "conspicuously, exceptionally, unusually dangerous" and causes a reaction of "DANGER" in the mind of the listener in a way that other work, "perhaps, in fact, equally dangerous does not." MECHEM, AGENCY § 487-488 (1952).

[38] MECHEM, AGENCY, § 427 (1952).

> and give way to a "servant" class in either a lay or a law sense, nor is it incumbent upon the employer ordinarily to question him closely as to his competence or as to his financial ability, as a condition of immunity. Indeed, it is a fair guess that by and large he is financially better able to absorb losses, as he is certainly better able to prevent them than the individual employer himself would be.[39]

There may also be a valid argument against the theory in the fact that it would be too broad. All the other exceptions are limited to negligence of the contractor committed while he is engaged in performing the terms of the contract. The employer is not liable for collateral negligence of his independent contractor.[40] If adopted, would the "financial irresponsibility" theory be similarly limited or would it place liability on the employer for any wrongful acts of a financially inadequate contractor? It might appear that the latter interpretation is more consistent with the stated policy behind the rule—to eliminate the insolvent contractor.

The matter of freedom of opportunity, which is eliminated by this theory, is another problem to be considered. The elimination of freedom of opportunity for the contractor can only be justified if the need for the theory outweighs the benefit to the community of freedom of opportunity.

This theory, if adopted, would add one more exception in the already confused law of independent contractors and employers' immunity. An attempt at understanding the extremely fine distinctions made by the Restatement of Torts in sections 410-429 fails to all but the keenest and most perceptive eye. As one authority said: "Our courts are undermining the old fault principles, little by little in a manner which leaves many of us puzzled and confused about the present state of the law." [41]

With the exception of the dicta in *Majestic v. Toti,* there is very little authoritative discussion on the "financial irresponsibility" theory, despite the fact that it was mentioned in a few old cases and despite the stimulating advocation of it by Professor Morris in 1934. Is this New Jersey case an indication of its future acceptance? We must wait and see!

LEONARD HORN.

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[39] Steffen, *supra* note 28, at 518. See 19 A.L.R. 1168 for examples of independent contractors.
[40] RESTATEMENT, TORTS § 426; Robbins v. The City of Chicago, 18 L. ed. 427 (1867); Rosenquist v. Brookdale Homes, Inc. 133 N.J.L. 305, 44 A.2d 33 (1945).
[41] Gregory, *Trespass to Negligence to Absolute Liability,* 37 VA. L. REV. 359, 396-7 (1951).