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Gray v. Nationwide and Beyond

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GRAY v. NATIONWIDE AND BEYOND

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Few decisions of the Supreme Court of Pennsylvania in recent years have excited as much comment and caused as much speculation as *Gray v. Nationwide Mut. Ins. Co.*[1] It is not only the law as set down in this opinion that merits and excites careful consideration. The implications of the decision will probably have a profound affect upon personal injury litigation. Hence we look beyond *Gray* in this discussion.

BACKGROUND

Gray brought suit against MacLatchie for personal injuries suffered in a collision between their automobiles. MacLatchie was insured by Nationwide under the customary automobile liability policy with limited coverage and Nationwide undertook the defense of the action. The case was tried and resulted in a verdict and judgment in favor of Gray for an amount in *excess* of the policy coverage. The judgment was affirmed by the Pennsylvania Supreme Court[2] and Nationwide paid its policy limits with interest and costs, leaving a substantial balance unpaid on the judgment. Thereafter MacLatchie assigned his rights against Nationwide to Gray, the assignment providing that, regardless of the outcome of Gray's suit against Nationwide, the judgment against MacLatchie would be satisfied at its conclusion. Gray then filed an action in *assumpsit* against Nationwide to recover the balance of the judgment. He pleaded that prior to the trial of the primary action he had offered to settle with Nationwide within MacLatchie policy limits, that Nationwide had refused this offer in bad faith, that MacLatchie therefore had the right to be reimbursed or exonerated to the full extent of the judgment and that, as MacLatchie's assignee, he was entitled to recover from Nationwide the unpaid balance of the judgment. Gray also claimed, in a separate count, that he was a third-party beneficiary of the obligation of Nationwide, created by its policy, to defend and settle in good faith.

Preliminary objections to the complaint were sustained by the late President Judge E. V. Alessandroni.[3] He held that Nation-

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1. 422 Pa. 501, 223 A.2d 8 (1966).
2. 403 Pa. 595, 170 A.2d 590 (1961).
3. Gray v. Nationwide Mut. Ins. Co., No. 209, C.P. No. 5 Phila. County, September Term, 1964.

wide owed no duty whatsoever to Gray until judgment was obtained and that, at that time, it became obligated to pay the limits of its policy, which obligation it admittedly performed; that since MacLatchie had not paid the excess judgment there was no right of action on his behalf (and therefore on Gray's behalf) against Nationwide; that in any event MacLatchie's claim for the excess against Nationwide is of a personal nature and nonassignable; and finally that the assignment would, if permitted, relieve MacLatchie of his liability on the judgment and permit him to combine with Gray against Nationwide, thereby opening a "wide area of fraud."

On appeal to the superior court the judgment was affirmed by an equally divided court.[4] Judge Wright's opinion supporting affirmance held that the cause of action for breach of the insurer's obligation to defend and settle in good faith lay in tort and not in assumpsit and was therefore not assignable. He also held that the attempted assignment violated public policy because of its collusive nature and the opportunity for fraud.[5] Judge Jacobs' separate opinion affirmed on the ground that Gray was a stranger to the insurance relationship and Nationwide owed no duty to him so that no right of his had been affected; that Gray had not been injured by Nationwide's refusal to settle; and, finally, that to permit this type of suit would give the injured plaintiff an unfair bargaining weapon in settlement negotiations.[6] Judge Hoffman's dissenting opinion which was followed almost completely in the Supreme Court decision, will be discussed later. Upon Gray's petition, the case was certified to the supreme court.

PRECEDENT

The principle of law that an insurer may be responsible beyond the limits of its insurance policy for its inadequacies in defense or its failure to settle an action brought against its insured is not of recent origin. In its development the courts of other states have agreed that the relationship created by the insurance policy is a fiduciary one and that the exclusive right given the insurer to defend and settle the claim against the insured imposes upon it a fiduciary duty.[7] This duty has been defined as the duty to act carefully and without negligence[8] or to act in good faith.[9] This

4. 207 Pa. Super. 1, 214 A.2d 634 (1965), noted in 70 DICK. L. REV. 440 (1966), 27 U. PITT. L. REV. 723 (1966).

5. *Id.* at 2, 214 A.2d at 635.

6. *Id.* at 3, 214 A.2d at 635.

7. See authorities reviewed in Cowden v. Aetna Cas. & Sur. Co., 389 Pa. 459, 469, 134 A.2d 223, 227 (1957).

8. This rule is known as the "Stowers doctrine," from Stowers Fur. Co. v. American Indem. Co., 15 S.W.2d 544 (Tex. Comm. App. 1929). See Worden v. Tri-State Ins. Co., 347 F.2d 336 (10th Cir. 1965) (contributory negligence of the insured held to be a good defense); Southern Farm Bur. Cas. Ins. Co. v. Mitchell, 312 F.2d 485 (8th Cir. 1963); Augustin v. General Accident, Fire & Life Ass. Corp., 283 F.2d 82 (7th Cir. 1960), *affirming* 188

basic problem was first met in the Pennsylvania courts in *Cowden v. Aetna Cas. & Sur. Co.*[10] Cowden held that the insurer assumed a contractual duty to its insured which it would breach if it failed to act in good faith in the defense or settlement of the injury claim. The adoption of the "good faith" rule may be assumed[11] notwithstanding the court's later opinion in *Gedeon v. State Farm Mut. Auto. Ins. Co.*,[12] which followed its statement of the "good faith" rule with language more applicable to the "negligence" rule: "If the insurer is derelict in this duty, as where it negligently investigates the claim or unreasonably refuses an offer of settlement, it may be liable regardless of the limits of the policy for the entire amount of the judgment secured against the insured."[13]

Beyond this, Pennsylvania courts had not gone prior to *Gray*. The position taken by the lower court, that payment of the excess by the insured was requisite to the enforcement of the insurer's excess liability, had not been raised or decided.[14] The sharp conflict in the foreign decisions[15] was recognized and decided *against* the payment rule. Justice Jones puts the matter succinctly:

Three very sound reasons justify the adoption of this 'non-

F. Supp. 23 (E.D. Wis. 1959); Alabama Farm Bur. Mut. Cas. Ins. Co. v. Dalrymple, 270 Ala. 119, 116 So.2d 924 (1959); Douglas v. United States Fid. & Guar. Co., 81 N.H. 371, 127 Atl. 708 (1924).

9. Comunale v. Traders & Gen. Ins. Co., 50 Cal.2d 654, 328 P.2d 198 (1958). See generally Cohen, *Liabilities of an Insurance Carrier in Excess of Coverage*, 1964 INS. L.J. 335; Heaslip, *Insurer's Failure to Settle*, 1963 INS. L.J. 415; Annot., 40 A.L.R.2d 178 (1958).

The distinction between negligence and bad faith is sometimes thought to be of little practical importance. See Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1140-42 (1954). *Cf.* Comment, 67 DICK. L. REV. 321 (1963).

10. 389 Pa. 459, 134 A.2d 223 (1957).

11. *Id.* at 471-72, 134 A.2d at 229: ("Especially does this become manifest when it is borne in mind that bad faith, and bad faith alone, was the requisite to render the defendant liable.") In the trial court, the applicability of the good faith rule was assumed. See Cowden v. Aetna Cas. & Sur. Co., 9 Pa. D. & C.2d 1 (C.P. 1955). See also Bell v. Commercial Ins. Co., 280 F.2d 514 (3d Cir. 1960).

12. 410 Pa. 55, 188 A.2d 320 (1963).

13. *Id.* at 59, 188 A.2d at 322.

14. In *Cowden*, as in George v. Nationwide Mut. Ins. Co., 27 Pa. D. & C.2d 773 (C.P. 1962), the excess had been paid by the insured. The federal decisions in Gedeon v. State Farm Mut. Ins. Co., 342 F.2d 15 (3d Cir. 1965), and Bell v. Commercial Ins. Co., 280 F.2d 514 (3d Cir. 1960), did not make final disposition of the cases and assumed, without deciding, that payment was necessary. In Rider v. Fidelity & Cas. Co., 26 D. & C.2d 627 (C.P. 1961), recovery had been permitted without proof of payment but this issue was apparently not raised or discussed.

15. The leading cases supporting the "nonpayment" view are cited in *Gray*, 422 Pa. at 505, 223 A.2d at 10. A peculiar rule requiring partial payment and permitting piece-meal recovery is applied in Texas: Tepeyac v. Bostron, 347 F.2d 168 (5th Cir. 1965); Universal Ins. Co. v. Culberson, 126 Tex. 282, 86 S.W.2d 727 (1935); and in Florida: National Mut. Ins. Co. v. Dotschay, 134 So.2d 248 (Fla. 1961).

> payment' view: (1) such view prevents an insurer from benefiting from the impecuniousness of an insured who has a meritorious claim but cannot first pay the judgment imposed upon him; (2) such view negates the possibility that the insurer would be "less responsive to its trust duties where the insured is able to pay the excess judgment. Were payment the rule, an insurer with an insolvent insured could unreasonably refuse to settle for, at worst, it would only be liable for the amount specified by the policy. To permit this would be to impair the usefulness of the insurance for the poor man". . . (3) such view recognizes that the fact of entry of the judgment itself against the insured constitutes a real damage to him because of the potential harm to his credit rating. . . .[16]

A second and more serious conflict among the foreign decisions appeared on the issue of whether the cause of action against the insurer is in tort or on the contract. The great majority of the precedents either specifically held to the tort theory or obliquely followed it when they held that the insurer owed no duty to the injured party arising from the insurance relationship, that the injured party had been benefited rather than harmed by the failure to settle within the policy limits, or that the recognition of a right of action in the injured party would open the door to fraud.[17]

Practically all of the precedents refused to recognize the patent fact that, if the insured had a cause of action and if it was not essential to this cause of action that he pay the excess judgment, the single issue remaining for determination was whether the cause of action was or was not assignable. Some cases had even taken the position that the insured's cause of action would not pass in bankruptcy to his trustee.[18] Few of these decisions attempted to reach the basic question of assignability. Only the California courts had very early faced up to the problem. There it had been held that the cause of action was assignable, whether based on tort or on contract,[19] and could be prosecuted by the in-

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16. 422 Pa. at 506, 223 A.2d at 10. See also Judge Hoffman's dissenting opinion, 207 Pa. Super. at 5-8, 214 A.2d at 637-38.

17. See Tabben v. Ohio Cas. Ins. Co., 250 F. Supp. 853 (E.D. Ky. 1966); Chittick v. State Farm Mut. Auto Ins. Co., 170 F. Supp. 276 (D. Del. 1958); Wessing v. American Indem. Co., 127 F. Supp. 775 (W.D. Mo. 1955); Canal Ins. Co. v. Sturgis, 114 So.2d 469 (Fla. 1959), *aff'd* 122 So.2d 313 (Fla. 1960); Francis v. Newton, 43 S.E.2d 282 (Ga. 1947); Duncan v. Lumberman's Mut. Cas. Co., 91 N.H. 349, 23 A.2d 325 (1941); Paul v. Kirkendall, 6 Utah 2d 256, 311 P.2d 376 (1957); Murray v. Mossman, 56 Wash. 2d 909, 355 P.2d 985 (1960). Professor Keeton strongly supports these decisions, *supra* note 9, at 1176-77.

18. Harris v. Standard Acc. & Ins. Co., 297 F.2d 627 (2d Cir. 1961); Tabben v. Ohio Cas. Ins. Co., 250 F. Supp. 853 (E.D. Ky. 1966); Schueler v. Phoenix Ass. Co., 223 F. Supp. 643 (E.D. Mich. 1963).

19. Communale v. Traders & Gen. Ins. Co., 50 Cal.2d 654, 328 P.2d 198 (1958); Brown v. Guarantee Ins. Co., 155 Cal. App.2d 679, 319 P.2d 69 (Ct. App. 1957).

sured, his trustee in bankruptcy,[20] his assignee[21] or his judgment creditor.[22] The federal courts in Oklahoma and Texas had followed the California Rule.[23]

On the *Gray* appeals both Judge Hoffman and Justice Jones immediately grasped this basic issue and held that the decision must turn on the assignability of the cause of action.[24] Their dispositions of the issue, however, differed. Judge Hoffman held that although an action in contract might not be improper, even if the cause of action be in tort, it is assignable;[25] that the action does not involve a wrong of a purely personal nature but is based upon an injury to the property interest or estate of the insured. On the other hand, Justice Jones reached the conclusion that the violation of the insured's duty to defend and settle in good faith constitutes a breach of the insurance contract for which an action in assumpsit will lie.[26] He placed great reliance on the bankruptcy cases holding that the cause of action must pass to the trustee and not remain in the insured after he obtains his discharge.[27] The final step in the decision was whether the cause of action in assumpsit was assignable. Since the measure of damage is fixed and the amount of damage is specifically ascertained, there is of course no doubt as to its assignability.[28]

The Jones and Hoffman opinions also dealt with the argument that to allow assignment would foster fraud and collusion between the injured claimant and the insured:

> The fears of the lower court are unwarranted. The possibility of collusion between a judgment holder and an insured is no way increased by an assignment. If the in-

20. Brown v. Guarantee Ins. Co., *supra* note 19.

21. Communale v. Traders & Gen. Ins. Co., 50 Cal.2d 654, 328 P.2d 198 (1958).

22. Critz v. Farmers Ins. Group, 230 Cal. App.2d 788, 41 Cal. Rptr. 401 (Ct. App. 1965).

23. Moore v. United States Fid. & Guar. Co., 325 F.2d 972 (10th Cir. 1963); Palmer v. Travelers Ins. Co., 319 F.2d 296 (5th Cir. 1963).

24. 207 Pa. Super. at 8, 214 A.2d at 638; 422 Pa. at 506, 223 A.2d at 10-11.

25. 207 Pa. Super. at 9, 214 A.2d at 638. *Contra*, Dillingham v. Tri-State Ins. Co., 214 Tenn. 592, 381 S.W.2d 914 (1964); Carne v. Maryland Cas. Co., 208 Tenn. 403, 346 S.W.2d 259 (1961). It should be noted that *Cowden*, George v. Nationwide Mut. Ins. Co., 27 Pa. D. & C.2d 773 (C.P. 1962) and Rider v. Fidelity & Cas. Co., 26 Pa. D. & C.2d 627 (C.P. 1961), were all trespass actions. Gedeon v. State Farm Mut. Ins. Co., 410 Pa. 55, 188 A.2d 320 (1963), was an assumpsit action but on the wrong theory. Bell v. Commercial Ins. Co., 280 F.2d 514 (3d Cir. 1960) and Gedeon v. State Farm. Mut. Ins. Co., 342 F.2d 15 (3d Cir. 1965) were federal court cases in which a choice of action was not required.

26. 422 Pa. at 507-08, 223 A.2d at 11-12.

27. Anderson v. St. Paul Mercury Indem. Co., 340 F.2d 406 (7th Cir. 1965); *In re* Layton, 221 F. Supp. 667 (D. Ariz. 1963).

28. 422 Pa. at 510, 223 A.2d at 12. *Cf.* Crisci v. Security Ins. Co., 52 Cal. Rptr. 288 (Ct. App. 1966) (damages for mental distress claimed but denied).

> sured's liability on the judgment is not affected by the assignment, the interests of the parties are similarly unaffected. Whether the action would be brought in the name of the policy-holder or in the name of the assignee, the policy-holder would be intent upon relieving himself of the excess judgment, and the assignee would be seeking to secure the balance due him. If the insured's liability is terminated by the assignment, as in the present case, the possibility of collusion is more remote. Having been relieved of the judgment, the insured no longer has any pecuniary interest in the outcome of the litigation.[29]

Justice Jones' opinion concludes with an answer to the lower court's concern about the "unfairness" of the rule and a warning that looks to the importance of *Gray* in future litigation:

> Permitting an insured to assign his claim to the injured claimant would put the claimant on more of an equal footing with the insured's insurance company in settlement negotiations without tipping the balance against an insurer who could still refuse to settle in good faith. This result may seem anomalous in that the plaintiff, who previously offered to settle his claim for $5,000, has now acquired the right to maintain against defendant insurer an action which arose by reason of that offer to settle. *But it must be borne in mind that plaintiff merely stands in the shoes of the insured*; it is the insured who has allegedly suffered the wrong at the hands of the insurer. It might be said that the result herein will cause more injured claimants to propose settlement for the policy limit when the insurance company is defending the action against an insured who is apparently judgment-proof. *Yet the insurer has nothing to fear so long as its refusal to settle is made in good faith. And it is fundamental that the law favors settlements.*[30]

Neither of the appellate courts found it necessary to pass upon the further issue of whether the injured party was a third-party beneficiary of this obligation of the insurer. Since *Gray* presented an actual assignment of the right of action which the Court recognized as valid, it was unnecessary to determine whether he had the right to sue in the absence of such an assignment.[31]

In summary, then, *Gray* has taken two giant steps beyond *Cowden* and *Gedeon*: (1) the excess judgment need not be paid before the right of action against the insurer accrues; (2) the right of action is assignable.

Beyond Gray—Procedure

The rights of the injured party (judgment creditor) have now

29. 422 Pa. at 510-11, 223 A.2d at 13, quoting Judge Hoffman's dissenting opinion, 207 Pa. Super. at 10-11, 214 A.2d at 639.

30. 422 Pa. at 511, 223 A.2d at 13.

31. 422 Pa. at 512, 223 A.2d at 13; 207 Pa. Super. at 11, 214 A.2d at 640.

been established in cases where the insured (judgment debtor) is available and willing to execute an assignment of his right of action against his insurer. There remain to be considered a number of situations absent these circumstances.

Suppose the insured has disappeared or refuses to execute an assignment? In either event the judgment creditor might be able to achieve his end by bankruptcy proceedings against the insured. There should be little doubt that the right of action would be held to pass to the trustee as an asset of the bankrupt estate in light of the approval by the supreme court of the rationale of the bankruptcy cases in the *Gray* opinion.[32] Bankruptcy proceedings may be doubtful in some cases, however, and are always costly and time consuming.

Suppose the insured has died and his estate is insolvent? The administrator of such an estate may well refuse to assign the cause of action. An application to the Orphans' Court for an order directing him to make an assignment or removing him for failure to proceed to collect an asset of the estate may afford a proper remedy.[33] This remedy, however, is also uncertain and time consuming.

Short of the application of the third-party beneficiary rule to this situation, the alternate and simpler practice is the use of a writ of execution to attach the insurance carrier as a garnishee and to proceed against it as being indebted to the judgment debtor for the excess of the judgment.[34] To sustain this procedure our courts would have to go only a short step beyond *Gray* by holding that the attachment works an *assignment by operation of law* of the insured's cause of action to his judgment creditor and that the latter's rights are the same as those of his debtor. It has been consistently stated that this is the effect of an attachment.[35] It may reasonably

32. 422 Pa. at 509-10, 223 A.2d at 12.

33. The Orphans' Court undoubtedly has the power to direct the fiduciary to institute the action. See Gongaware's Est., 265 Pa. 512, 518, 109 A.2d 276, 279 (1920). It should also be authorized to direct an assignment. Failure of the fiduciary to act would be cause for removal; PA. STAT. ANN. tit. 20, § 320.331 (1950). *Cf.* Kellberg's Appeal, 86 Pa. 129 (1878); Hartman's Est., 49 Pa. Super. 203 (1912). The burden of proving the fiduciary's default is a heavy one, however, and action lies in the discretion of the Orphans' Court: Glessner's Est., 343 Pa. 370, 22 A.2d 701 (1941). Query, should the judgment creditor be required to prove his case against the insurer when he seeks action against the fiduciary and before he can obtain discovery?

34. Attachment has been held ineffective in Stilwell v. Parsons, 51 Del. 342, 145 A.2d 397 (1954); Paul v. Kirkendall, 6 Utah 2d 256, 311 P.2d 376 (1957); Murray v. Mossman, 56 Wash.2d 909, 355 P.2d 985 (1960). These decisions fail to consider the validity of an assignment or to recognize that the injured party sues in the right of the insured. *Cf.* Sims v. Illinois Nat'l. Cas. Co., 43 Ill. App.2d 184, 193 N.E.2d 123 (1963).

35. See Boyd Est., 394 Pa. 225, 242, 146 A.2d 816, 825 (1958); Trainer Est., 166 Pa. Super. 472, 475-76, 71 A.2d 833, 834 (1950); Colbassani v. Society of Columbus, 159 Pa. Super. 414, 416-17, 48 A.2d 106, 107 (1946); 7 STANDARD PENNSYLVANIA PRACTICE § 559 (1961).

be expected, therefore, that the Pennsylvania courts would hold that an assignment by act of law under an attachment or an assignment by act of law in a bankruptcy proceeding will have the same effect as a *Gray* assignment by act of the insured.

Procedurally, therefore, *Gray* not only confronts the insurer with the legal possibility of liability for excess judgments but also with the practical assurance that the party vitally interested in the prosecution of that liability is now armed with the weapons to proceed against it directly.

Others considerations may arise in which the type of action authorized may be of importance. We have examined the more usual situation in which the insured is not particularly interested in pursuing his right of action. What of the case in which he may *have* to do so actively? He may have assets readily available to the judgment creditor's execution; or, he may have an expectation of acquiring such assets and desire to seek their exoneration; or, in a case in which his insurer has failed to defend the primary action, he will want to claim not only the excess but also his costs and attorney fees.[36] In such cases can or should the insured control the action to the exclusion of his judgment creditor? Ordinarily the institution of his action could not prevent the creditor from executing on his judgment, forcing the sale of his assets and attaching the insurer while his suit is pending. Will the court stay such an execution pending the outcome of the action? This is doubtful since the creditor should ordinarily not be delayed in the collection of his judgment while his debtor is attempting to liquidate an obligation owed to him. There remains the possibility that the court might entertain a declaratory judgment proceeding in which the insurer and the judgment creditor are made parties and the latter is sought to be enjoined from proceeding with execution *pendente lite*. Again it is doubtful that the unusual relationship of the parties to the cause of action is sufficient to justify such an intervention by the court and the imposition of such a limitation on the right to execution. On the other hand, so long as the judgment creditor's interest in the excess right of action is recognized as being derivative from the insured solely and exclusively, there exists some justification for allowing the insured to seek exoneration.[37]

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36. See Gedeon v. State Farm Mut. Auto. Ins. Co., 410 Pa. 55, 59, 188 A.2d 320, 322 (1963): "[T]he recovery for breach of the covenant to defend will ordinarily be the cost of hiring substitute counsel and other costs of the defense. This recovery may be in addition to any other obtained against the defendant."

37. Declaratory judgment has been attempted in Southern Farm Bur. v. Mitchell, 312 F.2d 485 (8th Cir. 1963); Cf. Tepeyac v. Bostrom, 347 F.2d 168, 184 (5th Cir. 1965) (concurring opinion). A novel approach was taken recently in Massachusetts. In Jenkins v. General Acc. Fire & Life Assur. Corp., 212 N.E.2d 464 (Mass. 1965), the court sustained the insured's right to bring the insurer into the primary litigation by third-party complaint,

To this point we have explored situations beyond *Gray* in which only the interests of the injured and the insured in the excess judgment are involved. Let us for a moment re-examine the problem when the interests of third-parties are to be considered, *e.g.*, where the insured has other substantial judgments against him. So long as the rights of the injured party in the excess right of action are delimited by the actual holding in *Gray*, he can be no more than an ordinary judgment creditor of the insured whose interest in the excess recovery may be materially affected by the action of other creditors, whether by execution or bankruptcy. The excess recovery will become a general asset of the insured's estate and the injured party's interest therein will be determined by general priority rules and not by his particular relationship to this asset.

We return, therefore, to the question not passed upon by either appellate court in *Gray*: is the injured party a third-party beneficiary of the policy obligation of the insurer to defend and settle in good faith? If so, his action will lie directly against the insurer and his recovery will not be in the interest of the insured or subject to the rights of the latter's other creditors.

The third-party beneficiary rule has been greatly circumscribed in Pennsylvania.[38] Nevertheless strong public policy considerations inhere in this situation which may dictate its application. An outstanding expression of this position is that of Florida Chief Justice Wigginton:

> There is much force to the contention made by appellee that irrespective of its provisions, every automobile liability insurance policy should be construed as a third-party beneficiary contract entitling a judgment creditor to recover in a direct action against the insured for the excess of his judgment over policy limits in those cases where the insurer is guilty of negligence or bad faith in handling the claim. This argument is predicated on the public policy of Florida as proclaimed in the Florida Financial Responsibility Law.[39]

The relationship of trust and confidence between the insurer and the insured arises from the terms of the policy, not outside the contract. The fiduciary relationship here is no different from that which arises between any principal and agent in a business matter in which the agent also has a separate interest of his own.

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alleging its breach of its duties to defend and settle in good faith and claiming its liability for excess judgment.

38. See Herman v. Stern, 419 Pa. 272, 213 A.2d 594 (1965); Van Cor, Inc. v. American Cas. Co., 417 Pa. 408, 208 A.2d 267 (1965); Farmers Nat'l Bank v. Employers Liab. Assur. Corp., 414 Pa. 91, 199 A.2d 272 (1964); Silverman v. Food Fair Stores, Inc., 407 Pa. 507, 180 A.2d 894 (1962); Spires v. Hanover Fire Ins. Co., 364 Pa. 52, 70 A.2d 828 (1950).

39. Canal Ins. Co. v. Sturgis, 114 So.2d 469, 472 (Fla. 1959) (concurring opinion). *Cf.* PA. STAT. ANN. tit. 75, § 1401 *et. seq.* (1960) (Pensylvania Motor Vehicle Financial Responsibility Act). *But see* Keeton, *supra* note 9, at 1175-76.

The argument that the injured third-party cannot recover because he is not a party to the fiduciary relationship which exists between the insured and the insurer may prove to be unsound. The injured party may be considered to be as much a third-party beneficiary of this obligation as he is of the primary obligation of the insurer to pay under the policy.[40]

The Pennsylvania Supreme Court has cogently stated the interest of the injured party as follows:

> [I]nsurance contracts generally, as related to third-party beneficiaries, are in a class by themselves. An action may be maintained directly thereon against the insurer. Whether the right is created by the agreement, or arises when the event happens which the contract contemplates, or *is imposed directly or indirectly as a matter of public policy by statute*, there is little difference in practical conception, and certainly none in their legal effect. The beneficiary may sue. Take away this right and insurance passes out as a protection not only to property rights, but to the security of estates and the general welfare of that great part of society which in some form or other use it or are its beneficiaries. It should not require an extended discussion to establish, at least its great merit, and none to sustain its legality. It has been stated that cases of this character depend on the nature of the policy as a mercantile instrument . . . having their own rules. We have held, without question, in this State in a host of cases, that the beneficiary in insurance contracts may sue directly, nor is there good reason to exclude contracts like the one before us from the rule.[41]

The action in that case was in assumpsit to recover *within* the limits of the policy, which may well be found to be a distinction without a difference. It will be urged that the obligation of the insurer, if it acts in good faith, is to pay the judgment obtained against its insured within the limits specified in the policy. If the insurer acts in bad faith, this liability is enlarged to pay the full amount of the excess judgment over the specified limits. The insurer, because of its right to negotiate and decide upon settlements, becomes, under the terms of the policy, an agent acting on the behalf of the insured, as the result of which there is a fiduciary relationship of trust and confidence, especially where, as here, the agent is also financially interested in the outcome of the matter over the disposition of which he maintains control.

The argument that the injured third-party cannot recover because he is not a party to the fiduciary relationship which exists be-

40. See 8 APPLEMAN, INSURANCE LAW AND PRACTICE § 4831 (1962).

41. Rose & Son, Inc. v. Zurich Gen. Acc. Co., 296 Pa. 206, 210, 145 Atl. 813, 815 (1929) (indemnity policy with express provision that claimant could sue if assured were bankrupt). See also Graham v. United States Fidelity & Guar. Co., 308 Pa. 534, 162 Atl. 902 (1932); Wildhide v. Keystone Ins. Co., 195 F. Supp. 659 (M.D. Pa. 1961).

tween the insured and the insurer may prove to be unsound. When the circumstances of a future case require it, the court would be justified in applying the third-party beneficiary principle to this situation.[42]

Beyond Gray—Limitations

The establishment by the supreme court of the contract nature of the right of action undoubtedly resolves the statute of limitations question which may arise in some cases. Absent approval of the use of attachment or the application of the third-party beneficiary rule, the institution of an action against the insurer may be delayed for a substantial period of time. The applicable period of limitations is not, of course, determined by the nature of the action. Even though it be accepted that the right of action is now determined to be "on the contract," it must be recognized that proof of the mere breach of contract is not sufficient. The action lies only for "tortious breach of contract," *i.e.* the insurer's failure to act in good faith in the performance of its contractual obligation. Analogy may be drawn to the contractual obligations of an air carrier to carry its passengers in safety, the breach of which must be proved to be "tortious" in order to sustain an action.[43] Of greater importance here is the court's recognition that the claim is a "contractual" one as opposed to a "personal" one.[44] Had the court accepted Judge Hoffman's view that the action basically lay in trespass for tort, it might have equally well concluded that the insured might waive the tort and sue in assumpsit. Analogy could then be drawn to the breach of warranty cases.[45] In either event it may safely be said that, since (1) the cause of action is on the contract and (2) is for damage to property rights and not personal injury, the six-year statute of limitations will apply.

Beyond Gray—Practical Considerations

At this point a strong caveat is in order. We have delineated the establishment of important principles and procedural simplifications created by *Gray* and reasonably to be expected to flow from it. The widespread belief that excess liability of insurers has thus been established in a great majority of personal injury cases is completely erroneous.

In considering the impact of *Gray* on personal injury litiga-

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42. Appleman, *op. cit. supra* note 40, at § 4831 (1966 Supp.).

43. See Griffith v. United Air Lines, Inc., 416 Pa. 1, 9-10, 203 A.2d 796, 800 (1964).

44. 422 Pa. at 509, 223 A.2d at 12. See Gedeon v. State Farm Mut. Ins. Co., 261 F. Supp. 122 (W.D. Pa. 1966) (applying the contract statute of limitations).

45. Compare Berg v. Remington, 207 F. Supp. 65 (E.D. Pa. 1962); Jones v. Boggs & Buhl, 355 Pa. 242, 49 A.2d 379 (1946); Woodland Oil Co. v. Byers Co., 223 Pa. 241, 72 Atl. 518 (1909).

tion it cannot be emphasized too strongly that the excess liability of the carrier is confined exclusively to cases in which it failed to act in *good faith*. In any case in which it reasonably concludes that a jury verdict will be less than its policy limits, it has no obligation to settle. In any case in which it reasonably concludes that, although the damages may exceed its limits, the probability of a jury verdict for the plaintiff on the issue of liability is negligible, it may have no obligation to settle. Only where a case meets the *Cowden* test does the excess liability exposure come into play:

> Since it is obvious that the interest of one or the other party may be imperiled at the instant of decision, the fairest method of balancing the interests is for the insurer to treat the claim as if it were alone liable for the entire amount. But, that does not mean that the insurer is bound to submerge its own interest in order that the insured's interest may be made paramount. It means that when there is little possibility of a verdict or settlement within the limits of the policy, the decision to expose the insured to personal pecuniary loss must be based on a bona fide belief by the insurer, predicated upon all of the circumstances of the case, that it has a good possibility of winning the suit. While it is the insurer's right under the policy to make the decision as to whether a claim against the insured should be litigated or settled, it is not a right of the insurer to hazard the insured's financial well-being. Good faith requires that the chance of a finding of nonliability be real and substantial and that the decision to litigate be made honestly.[46]

It must be realized that insurers had faced the possibility of excess liability for many years before *Cowden* and that this first statement of Pennsylvania law in 1957 was clearly foreshadowed. Yet the practices which we will consider have too often been indulged in by many insurers. The sole justification for the seeming lack of concern for excess liability appears to be the fact that most insureds have little personal estate and no personal desire to pursue their insurers in such cases. The risk of an excess suit by the insured has, therefore, seldom posed a practical problem for the insurer heretofore. It is in the light of this fact that we now ask: what will be the salutary effect of *Gray* upon personal injury litigation? We believe that it will be three-fold: greater disclosure, less disclaimer, and earlier settlement.

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46. Cowden v. Aetna Cas. & Sur. Co., 389 Pa. 459, 470-71, 134 A.2d 223, 228 (1957). It should be noted that recovery was denied in *Cowden* and other recent cases where the good faith rule was applied. See, *e.g.*, Gedeon v. State Farm Mut. Ins. Co., 261 F. Supp. 122 (W.D. Pa. 1966); Harrod v. Meridian Mut. Ins. Co., 389 S.W.2d 74 (Ky. 1964); Kohstedt v. Farm Bureau Mut. Cas. Co., 174 So.2d 672 (La. 1965); Aetna Cas. Co. v. Price, 206 Va. 749, 146 S.E.2d 220 (1966).

Disclosure Practices

Much has been said and written as to the power of the court to require the insurance carrirer to disclose its policy limits and as to the advisability of the exercise of such power, if it exists.

The practice of many insurers to refuse to disclose policy limits has been judicially condemned as preventing early settlements and the action of courts in requiring disclosure has been based upon the public policy favoring such settlements.[47] It must be recognized, as well, that the failure or refusal to disclose limits may effectively terminate settlement negotiations and constitute an act of bad faith on the part of the insurer.[48] Mention should here be made of other disclosure practices that the courts have condemned: the failure to keep its insured advised of settlement offers and negotiations[49] and the failure or refusal of the insurer to advise its *own counsel* of the limits of its coverage.[50] A finding of bad faith may well result from a showing of any of these facts.

So long as there was little or no concern that an excess action would be brought by the insured, these practices could be expected to flourish. *Gray* brings the carrier face to face with the simple fact that it will be arming its new and very interested and militant opponent, the injured person's attorney, with potent ammunition for his excess claim now that it must realize that the policy limit is no longer the horizon of his expectation of recovery.[51] Hereafter every insurer, using good business judgment, will have to weigh this new potential with extreme care. Disclosure may well be expected to become the rule rather than the exception.

Disclaimer Practices

The practice of some carriers of denying coverage and refusing to defend on the slightest evidence of a policy defense of sole ownership, lack of permission, late notice or the like, will likewise need careful reconsideration. Here again the same practical considerations have justified this practice. Extension of exposure from the

47. The controversy has been fully explored in the law reviews: Wilson, *Production and Inspection of Liability Insurance Policies*, 29 INS. COUNSEL J. 258 (1962); Note, 13 HASTINGS L.J. 273 (1961); Note, 39 N.D.L. REV. 107 (1963); Comment, 17 S.C.L.Q. 750 (1965); Note, 64 W. VA. L. REV. 419 (1962); Recent Decision, 48 VA. L. REV. 122 (1962). *Cf.* Cook v. Welty, 253 F. Supp. 875 (D.C. 1966); Hurley v. Schmidt, 37 F.R.D. 1 (D. Ore. 1965); Ash v. Farwell, 37 F.R.D. 553 (D. Kan. 1965).

48. Appleman, *Circumstances Creating Excess Liability*, 1960 A.B.A. SECTION ON INSURANCE 308.

49. See Kinder v. Western Pioneer Ins. Co., 231 Cal. App.2d 894, 42 Cal. Rptr. 394 (1965).

50. Baker v. Northwestern Nat'l Cas. Co., 26 Wis.2d 306, 132 N.W.2d 493 (1965); Western Cas. & Sur. Co. v. Fowler, 390 P.2d 602 (Wyo. 1964).

51. *Cf.* Crisci v. Security Ins. Co., 52 Cal. Rptr. 288 (Ct. App. 1966) (damage claimed for mental distress, denied because it was not within the contemplation of the parties at the time of contract).

limits of coverage to the actual value of the case will require a second look and more careful evaluation of such disclaimers. It may be expected that few cases will arise in which carriers will risk this increased exposure unless the policy defense is almost certain. The refusal to defend, in itself, does not create this exposure as the measure of damage for such refusal is only the cost of the defense;[52] however, the duty to investigate, negotiate and settle within the policy limits is also breached by disclaimer and *Cowden-Gray* liability may well follow.[53]

Settlement Practices

Finally, the most salutary effect of *Gray* on litigation may be expected to be the earlier settlement of substantially clear liability cases in which damages may be expected to exceed policy limits. Those not familiar with actual litigation in this field may find it hard to believe that such cases are not disposed of promptly. Yet it is a fact, of which the insurance industry may well be ashamed, that many carriers, especially in the metropolitan areas, make no real effort to settle such cases until they approach their trial dates, sometimes four or five years after suits have been started. The reason for this attitude is not difficult to ascertain. These carriers have always felt that a settlement of $7500 to $9500 could be effected immediately prior to trial where the coverage was $10,000 and that there was no reason why an earlier offer should be made. The investment of the carriers' reserves during the waiting-for-trial period, of course, produces considerable income. These "facts of life" have led some carriers into establishing company policy either refusing to negotiate at all or refusing to offer more than seventy-five to eighty-five per cent of the coverage in settlement of any case or, finally, insisting that the insured contribute to settlement within the policy limits. In the few cases in which recovery of excess has been sought, these practices have been uniformly condemned.[54] However, as we have seen, the threat of

52. See *supra* note 36. It must be remembered that once the insurer disclaims, the insured is at liberty to stipulate to a reasonable compromise of the claim and to permit a judgment to be entered against him. See Ripepi v. American Ins. Co., 349 F.2d 300 (3d Cir. 1965); Basoco v. Just, 154 Pa. Super. 294, 35 A.2d 564 (1943); Murphy & Co. v. Manufacturers Cas. Co., 89 Pa. Super. 281 (1926).

53. Gedeon v. State Farm Mut. Auto. Ins. Co., 410 Pa. 55, 188 A.2d 320 (1963); Communale v. Traders & Gen. Ins. Co., 50 Cal.2d 654, 328 P.2d 198 (1958).

54. *Refusal to negotiate:* Tully v. Travelers Ins. Co., 118 F. Supp. 568 (N.D. Fla. 1954); Vanderbilt Univ. v. Hartford Acc. & Indem. Co., 109 F. Supp. 565 (M.D. Tenn. 1952); Olympia Fields v. Bankers Indem. Co., 325 Ill. App. 649, 60 N.E.2d 896 (1945).

Policy of offering percentage of coverage: Roberts v. American Fire & Cas. Co., 89 F. Supp. 827 (M.D. Tenn. 1950), *aff'd*, 186 F.2d 921 (6th Cir. 1951); Combs v. Fidelity & Cas. Co., 21 Mo. App. 1206 (1936); Stowers Fur. Co. v. American Indem. Co., 15 S.W.2d 544 (Tex. Comm. App. 1929).

Asking insured to contribute: Maryland Cas. Co. v. Cooke-O'Brien

Cowden liability has not heretofore been great. The vast majority of excess judgments are uncollectable, the insureds are rarely concerned enough to prod the carriers to dispose of the litigation at an early stage, and counsel for the injured parties have ordinarily had to take the practical view that acceptance of settlements at policy coverage less a discount was preferable to trials which could only result in non-collectible judgments.

Gray may effectively discourage these practices. It can be expected that no carrier will any longer refuse to negotiate an early settlement. An offer made by the claimant to settle within the policy limit need not be kept open for an unreasonable period of time[55] and its refusal out of hand may fix the carrier's excess liability long before the case is tried. It can be expected that no carrier will any longer fail or refuse to keep its insured fully advised of settlement negotiations[56]—another practice frequently indulged in in order to eliminate pressure from the insured to achieve early settlement. The tactical value of the *Gray* holding has been expressed by a California court as follows:

> A major portion of today's litigation consists of personal injury actions defended by liability insurers. Settlement practices and timing have a direct effect on the quantity and flow of court business and thus on the administration of justice generally. Public policy permitting or proscribing tactical weapons developed by claimants and insurers

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Constr. Co., 69 F.2d 462 (8th Cir. 1934); American Mut. Liab. Ins. Co. v. Cooper, 61 F.2d 446 (5th Cir. 1932); Davy v. Public Nat'l Ins. Co., 181 Cal. App.2d 387, 5 Cal. Rptr. 488 (1960); Henke v. Iowa Home Mut. Cas. Co., 250 Ia. 1123, 97 N.W.2d 168 (1959); Mendota Elec. Co. v. New York Indem. Co., 169 Minn. 377, 211 N.W. 317 (1942); Spang Baking Co. v. Trinity Univ. Ins. Co., 45 Ohio Abs. 577, 68 N.E.2d 122 (Ct. App. 1946); Boling v. New Amsterdam Cas. Co., 46 P.2d 916 (Okla. 1935); *but see* Dreyfus v. St. Paul Fid. Ins. Co., 384 S.W.2d 245 (Ark. 1964).

Other practices which may result in excess liability are: rejection of counsel's settlement recommendation: State Farm Mut. Auto. Ins. Co. v. Jackson, 346 F.2d 484 (8th Cir. 1965); Kinder v. Western Pioneer Ins. Co., 231 Cal. App.2d 894, 42 Cal. Rptr. 394 (1965); reliance on reinsurance carrier: Spang Baking Co. v. Trinity Univ. Ins. Co., *supra*; American Fid. & Cas. Co. v. All American Bus Lines, 179 F.2d 7 (10th Cir. 1949); Royal Transit, Inc. v. Central Surety & Ins. Corp., 168 F.2d 345 (7th Cir. 1948); refusal to settle *after* judgment: Roberts v. American Fire & Cas. Co., 89 F. Supp. 827 (M.D. Tenn. 1950), *aff'd*, 186 F.2d 921 (6th Cir. 1951); Olympia Fields v. Bankers Indem. Co., *supra*; *cf.* Dawner v. Iowa Mut. Ins. Co., 340 F.2d 427 (5th Cir. 1964).

Cf. Appleman, *Circumstances Creating Excesss Liability*, 1960 A.B.A. SECTION OF INSURANCE 308.

55. Noshey v. American Auto. Ins. Co., 68 F.2d 808 (6th Cir. 1934); Vanderbilt Univ. v. Hartford Acc. & Indem. Co., *supra* note 54; Critz v. Farmers Ins. Group, 230 Cal. App.2d 788, 41 Cal. Rptr. 401 (Ct. App. 1965); Olympia Fields v. Bankers Indem. Co., *supra* note 54; Hilker v. Western Auto. Ins. Co., *supra* note 54.

56. National Farmers Union v. O'Daniel, 329 F.2d 60 (9th Cir. 1964); Critz v. Farmers Ins. Group, *supra* note 55; Norwood v. Travelers Ins. Co., 204 Minn. 595, 288 N.W. 785 (1939).

> should be shaped by two influences: (1) the public interest in encouraging settlements, and (2) fairness, that is, equalization of the contenders' strategic advantages. . . . If the carrier knows that its rejection of an offer to settle within the policy limit may lead to such an assignment, it will weigh the offer more seriously and give greater consideration to the interests of its policy holder. To nullify the assignment discourages settlement just as much as upholding it. The policy favoring settlements is even-handed, pushing the insurer no less than the injured claimant. . . .[57]

We must conclude, therefore, with the court's quotation from *Brown v. Guarantee Ins. Co.*:[58]

> It might be said that the result herein will cause more injured claimants to propose settlement for the policy limit when the insurance company is defending the action against an insured who is apparently judgment-proof. Yet the insurer has nothing to fear so long as its refusal to settle is made in good faith. And it is fundamental that the law favors settlements.[59]

This is a result much to be hoped for in an era of court backlogs which have defied every administrative attack.

57. Critz v. Farmers Ins. Group, 230 Cal. App.2d 788, 798, 41 Cal. Rptr. 401, 408 (1964).
58. 155 Cal. App.2d 679, 319 P.2d 69 (1957).
59. *Id.* at 681, 319 P.2d at 79.