

In addition to the regular members of the staff, the following students have written case comments: J. Nessenfeld, and Maurice Mushlin. Abraham E. Margolin, of the law class of 1929, has been elected by the faculty to membership on the staff.

### THE SAMUEL BRECKENRIDGE LAW REVIEW PRIZE

The staff of the ST. LOUIS LAW REVIEW takes pleasure in announcing that the first award of the Samuel Breckenridge Law Review Prize of fifteen dollars for the best note published in each number, with an additional prize of ten dollars for the best note in each volume, has been made to Abraham E. Margolin, of the Law Class of 1929. This award was made by a committee appointed by Mr. Ralph F. Fuchs, Faculty Adviser to the ST. LOUIS LAW REVIEW, in pursuance of authority given him by the faculty of the Law School. The committee is composed of Mr. Ralph R. Neuhoﬀ and Mr. Harry W. Kroeger, members of the St. Louis Bar. A third member will be appointed later.

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### THE CONCLUSIVENESS UPON AN INDEMNITY INSURER OF A DEFAULT OR CONSENT JUDGMENT REN- DERED AGAINST ITS ASSURED

The extent to which any judgment against an indemnity insurance policyholder<sup>1</sup> should be conclusive as to the insurance company when it is sued for reimbursement under its policy must, of course, depend upon whether the company is to be regarded as a stranger or a party to actions against the assured of which it has been given notice. Judge Freeman once wrote<sup>2</sup> that, "The question how far a judgment or decree

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<sup>1</sup> For the purposes of this note, it may be considered throughout the discussion that indemnity policies have the following usual provisions: The assured agrees to give immediate notice to the company of the occurrence of any accident, the making of any claims, and the bringing of any lawsuits based on such claims of accident; he also agrees to always assist and co-operate with the company in securing evidence and the attendance of witnesses; the assured further agrees not to voluntarily assume any liability under the policy nor incur any expense thereunder; the company besides agreeing to indemnify the assured against loss arising from claims for damages on account of occurrences which come within the provisions of the policy, undertakes to defend all suits upon such claims whether groundless or not, in the name and on behalf of the assured, and to pay all expenses incident to such defense; the company is to have the right to settle any claim at its own cost at any time; no action shall lie against the company to recover for loss under the policy unless brought for loss the amount of which shall have been determined by final judgment after trial of the issue. This last provision is frequently accompanied in the new types of policies by clauses to the effect that the insolvency or bankruptcy of the assured shall not relieve the company from the payment of damages, and if the execution against the assured is returned unsatisfied, the injured party may sue the company under the policy for the amount of his judgment, not exceeding the amount of the policy.

is conclusive . . . against one who is liable over to a defendant and who was not a party to the action, is involved in the greatest confusion. Between the intimate relations which exist between such a person and the defendant in the suit, on the one side, and the fundamental principle that no one ought to be bound by proceedings to which he was a stranger, on the other, the courts have found it difficult to steer." However much confusion may have existed at the time of Freeman's statement, the matter has since been definitely settled. The general rule universally adhered to on this question is thus stated in *American Candy Co. v. Aetna Life Ins. Co.*,<sup>3</sup> "Where the defense in an action is duly tendered to one who may under any aspect of the case be liable over to the party sued, the person to whom the defense is tendered and who has opportunity to defend becomes in legal effect a party to the action and is bound by the judgment." "When a person is responsible over to another, either by operation of law or by contract, and has notice of a suit against the other, and an opportunity to defend, he is not afterwards to be regarded as a stranger to the action but is bound by the judgment therein, whether he appeared or not."<sup>4</sup>

The cases establish the existence, along with this general rule, of a corollary or exception to it, excluding from the operation of the rule cases where there was fraud or collusion in obtaining the judgment against the indemnitee. In such a situation, the indemnitor is not bound by the judgment in the prior action.<sup>5</sup> Other corollaries of the general rule as to the conclusiveness of the prior judgment are that such judgment is binding only as to those decided matters which were necessary to the determination of that suit, and not as to those which were in-

<sup>2</sup> Note in 83 Am. Dec. 380 (1863).

<sup>3</sup> 164 Wis. 266, 159 N. W. 917.

<sup>4</sup> *E. I. Du Pont de Nemours & Co. v. Richmond Guano Co.*, C. C. A. or D. C. 297 F. 580; also, *Fulton County G. & E. Co. v. Hudson R. Tel. Co.*, 200 N. Y. 287, 93 N. E. 1052; *Edinger & Co. v. Southwestern Sur. Co.*, 182 Ky. 340, 206 S. W. 465; *Strong v. Phoenix Ins. Co.*, 62 Mo. 289; *American Paper Prod. Co. v. Aetna Life Ins. Co.*, 204 Mo. A. 527, 223 S. W. 820.

<sup>5</sup> A host of cases state the general rule with the qualifying clause "except if obtained by fraud or collusion." *Equitable Cas. Underwriters v. Industrial Com.*, 322 Ill. 462, 153 N. E. 685; *Littleton v. Richardson*, (N. H.) 66 Am. Dec. 759; *Washington Gas Co. v. Dist. of Columbia*, 161 U. S. 316; *Burley v. Compagnie De Navigation Francaise*, 194 F. 335; *National Surety Co. v. Love*, 105 Nebr. 855, 182 N. W. 490; *Conner v. Reeves*, 103 N. Y. 530; *Cornell v. Traveler's Ins. Co.*, 175 N. Y. 239, 67 N. E. 578; *Dixie Fire Ins. Co. v. American Bond Co.*, 162 N. C. 384, 78 S. E. 430; *Orth v. Consumers Gas Co.*, 280 Pa. 118, 124 Atl. 296; *Brown & Haywood Co. v. Ligou*, 92 F. 851; *Warrington v. Ball*, 90 F. 465; 31 *Corpus Juris* 460, 2 *Black on Judg.* (2nd ed.) Sec. 574. In most of these cases this statement is made merely by way of dictum. But *Collins v. Standard Acc. Ins. Co.*, 170 Ky. 27, 185 S. W. 112; *United States Fid. & Guar. Co. v. Williams*, 148 Md. 289, 129 Atl. 660; and *United States Fid. & Guar. Co. v. Pressler*, 185 S. W. 326 (Tex. Civ. A.) are interesting cases in which the decision was actually rested upon the fact of fraud in the judgment against the assured, or failure to prove such allegation. But see, *contra*, the case of *Georgia Casualty Co. v. Schrepferman*, 70 Ind. App. 11, 122 N. E. 783, in which the insurer's right to attack the judgment against the insured for fraud or collusion is denied. This case apparently stands alone.

volved only incidentally<sup>6</sup>; and that the insurer is not barred by the first judgment from setting up any defense he could not have made had he assumed the defense of the first suit, but he cannot make any defense open to him in that suit.<sup>7</sup> This last statement, of course, includes the principle that the existence of the relation which gives to the indemnitee a remedy over against the indemnitor is always open to inquiry when the latter is sued. The prior action is conclusive as the insured's liability to the injured person but not as to the insurer's liability to reimburse the insured.<sup>8</sup>

With these general principles of indemnity insurance settled, the question next naturally arises as to the effect upon the situation of an additional factor, viz., the fact that the judgment against the policy-holder is a default or consent judgment. Does the company under such circumstances lose the right to rely upon any of the exceptions to the general rule of conclusiveness, stated above? Obviously not, since the fact of default bears absolutely no relation to the reason underlying this rule and its corollaries. Assuming, then, that the company's position in this regard is in nowise weakened by the fact of the failure of itself and its assured to defend the suit of the injured party, has it any defenses in addition to those based upon the above stated corollaries to the rule of conclusiveness, of which it may avail itself when sued to recover the amount expended by the assured in satisfaction of a default judgment, or one entered upon a stipulation?

One matter that has been well settled by the cases is that the insurer is not relieved from his duty to indemnify the assured by the fact that a default judgment violates the usual policy provision making actual trial a condition precedent to recovery.<sup>9</sup> The insured is within his rights in suffering a judgment to be entered against him by default, or in agreeing to the entry of a consent judgment, where the insurer is bound by contract to make the defense, but fails to do so. By the breach of its agreement to defend, the company by implication waives its right to demand that the insured perform his complementary promise to cooperate, and leaves him free to handle the case in his own way and to make any fair compromise.<sup>10</sup> The case of *General Accident, Fire &*

<sup>6</sup> *Dolph v. Maryland Cas. Co.*, 303 Mo. 534, 261 S. W. 330.

<sup>7</sup> 31 *Corpus Juris* 463; *Burley v. Compagnie De Navigation Francaise*, 194 F. 335.

<sup>8</sup> *City of St. Joseph v. Union Ry. Co.*, 116 Mo. 636, 22 S. W. 794; *Central of Georgia Ry. Co. v. Macon Ry. & L. Co.*, 9 Ga. App. 628, 71 S. E. 1076; *Western Union Tel. Co. v. Gest*, 170 N. Y. S. 808; *Burke et al. v. Maryland Cas. Co.*, 192 Mich. 173, 158 N. W. 898; *B. Roth Tool Company v. New Amsterdam Cas. Co.*, 161 F. 709.

<sup>9</sup> See footnote 1.

<sup>10</sup> *Murch Bros. Const. Co. v. Fidelity & Casualty Co.*, 190 Mo. A. 490, 176 S. W. 399; *Tighe v. Maryland Cas. Co.*, 218 Mass. 463, 106 N. E. 135; *St. Louis Dressed Beef & Prov. Co. v. Maryland Cas. Co.*, 201 U. S. 173; *Independent Milk & Cream Co. v. Aetna Life Ins. Co.*, 68 Mont. 152, 216 P. 1109; *Butler Bros. v. American Fid. Co.*, 120 Minn. 157, 139 N. W. 355, 44 L. R. A. N. S. 609; *Kansas City, Memph. & Birm. R. R. Co. v. So. Ry. News Co.*, 151 Mo. 373, 52 S. W. 205, 74 Am. St. Rep. 545, 45 L. R. A. 380; *Mayor, Lane & Co. v. Com-*

*Life Assur. Corp. v. Butler's Ice Cream Factory*,<sup>11</sup> holds that, "the refusal of appellant (insurer) to defend the suit . . . against plaintiff appellee cut at the very root of the mutual obligations in the policy contract, and put an end to appellant's right to demand compliance with the terms of the contract, on the other side." In another case the court goes so far as to hold that no inquiry can be made into the motive inducing the insured's consent to judgment against him where the insurance company alleged that the consent was collusively rested upon an amended pleading which preserved the company's liability over to the insured, saying, "We do not think the motive and purpose is of any particular significance, if the act was within the right of the construction company."<sup>12</sup>

But the law cannot require, merely because an insurer has broken his contract obligation to defend in the name and on behalf of the assured every suit, valid or groundless, brought by an injured person, that such insurer is liable to pay every default or consent judgment against such assured. The insurer is not obligated to the insured by the latter merely paying out money on claims presented.<sup>13</sup> The company has, by the terms of the contract, many rights totally separate from and independent of the defense of suits. It need not pay claims outside the scope of the policy provisions, and it has therefore been held not bound to defend suits based upon claims for which it is not liable.<sup>14</sup> Indeed, if the company should undertake the defense of a suit on behalf of the assured on which it was really not liable, it would be held to have waived this non-liability, and would then not be in a position to deny indemnification to the assured.<sup>15</sup> Thus the courts have evolved the rule that where in the suit against the assured, "there are two or more grounds of liability asserted, for some of which the insurer is liable and for some of which the insured must stand the loss, then it would seem that neither party can exclude the other from participating in the defense,"<sup>16</sup> but

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mercial Cas. Ins. Co., 155 N. Y. S. 75; *South Knoxville Brick Co. v. Empire State Surety Co.*, 126 Tenn. 402, 150 S. W. 92; *U. S. Fid. & Guar. Co. v. Pressler*, 185 S. W. 326 (Tex. Civ. App.); *Kinman v. Charles B. Hurst Co.*, 317 Ill. 251, 148 N. W. 12; *General A., F., & L. Assur. Corp. v. Butler's Ice Cream Factory*, 291 S. W. 674 (Tex. Civ. A. 1927).

<sup>11</sup> 291 S. W. 674 (Tex. Civ. A.).

<sup>12</sup> *Murch Bros. Const. Co. v. Fidelity & Casualty Co.*, 190 Mo. A. 490, 176 S. W. 399, citing *Loewenberg v. De Voigne*, 145 Mo. A. 710, 123 S. W. 99.

<sup>13</sup> *Compton Heights Laundry Co. v. General A., F., & L. Assur. Corp.*, 195 Mo. A. 313, 190 S. W. 382, relying on *Dunham v. Philadelphia Cas. Co.*, 179 Mo. A. 558, 565, 162 S. W. 728.

<sup>14</sup> *United Waste Mfg. Co. v. Maryland Cas. Co.*, 148 N. Y. S. 852, and *Ocean Acc. & Guar. Corp. v. Washington Brick & Terra Cotta Co.*, 139 S. E. 513, (Sept. 1927, Va.) holding that "it is scarcely logical to hold that this provision concerning the right and obligation to defend the suit . . . would be intended to bind the insurer to take charge of and defend a suit in which, under the terms of the policy, it had no interest."

<sup>15</sup> *Ocean Acc. & Guar. Corp. v. Washington Brick & Terra Cotta Co.*, *supra*; and *Metropolitan Cas. Ins. Co. v. Albritton*, 282 S. W. 187 (Ky. 1926).

<sup>16</sup> *Compton Heights Laundry Co. v. General A., F., & L. Assur. Corp.*, 195 Mo. A. 313, 190 S. W. 382; citing *Buffalo Steel Co. v. Aetna L. Ins. Co.*, 136 N. Y.

both may have the right to share therein. Consequently where the insured declines to defend an action by an injured party, it almost becomes the duty of the insured in the interest of his own protection to make an active defense, inasmuch as he cannot shift the liability to the company if it does not come within the policy provisions. In other words, while the failure of the company to defend gives the assured the right to allow judgment to go against him by default, his action is not without some significance, as shown in 14 R. C. L. 62, which states:

Where an indemnitor was notified of the pendency of a litigation which resulted in a judgment against the indemnitee and was afforded ample opportunity to control and manage that litigation, but refused to have anything to do with the defense of the case or settlement of the claim, he is bound by such judgment, though it is the result of a compromise. The effect of the indemnitee's consent to the rendition of the judgment, however, is to reduce the judgment from conclusive to presumptive evidence only of the indemnitor's liability on his contract, and of the amount thereof, and to afford him the right and privilege of showing either that the judgment was procured by a fraudulent collusion, was not founded on a legal liability, or that it exceeded such liability.

The last half of this quotation is taken verbatim from the Missouri case of *Kansas City, etc. Ry. Co. v. Southern Ry. News Co.*,<sup>17</sup> and is the present Missouri law on the question. Other support for the proposition is 22 Am. St. Rep. 204 and the New York case of *Conner v. Reeves*.<sup>18</sup> This principle gives to a consent or default judgment the weight of only a rebuttable presumption. Another salient feature of this statement is that, under the circumstances there premised, it gives to the indemnity insurer the new defenses that the judgment "was not founded on a legal liability, or that it exceeded such liability." The same principle has been expressed in another case<sup>19</sup> as follows: "If the indemnitee settles the suit without trial he may recover the amount from the indemnitor, *providing* it was a reasonable sum to pay, and the *indemnitee was liable in some amount.*"

The result of this doctrine is, of course, that the question of the indemnitee's liability must be determined when he sues the indemnitor for reimbursement. Thus it is stated in *Independent Milk & Cream Co. v. Aetna Life Ins. Co.*,<sup>20</sup> that where the insurer has denied its liability under the policy and has refused to defend an action brought by the person injured, the liability of the insured to such injured person and the extent of that liability may be litigated for the first time in an action

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S. 977; *Fidelity & Casualty Co. of N. Y. v. Stewart D. G. Co.*, 271 S. W. 444 (Ky. 1925); *Ocean Acc. & Guar. Corp. v. Washington Brick & Terra Cotta Co.*, *supra*.

<sup>17</sup> 151 Mo. 373, 1. c. 390, 52 S. W. 205, 74 Am. St. Rep. 545, 45 L. R. A. 380.

<sup>18</sup> 103 N. Y. 530.

<sup>19</sup> *Butler Bros. v. American Fid. Co.*, 120 Minn. 157, 139 N. W. 355, 44 L. R. A. N. S. 609.

<sup>20</sup> 68 Mont. 152, 216 P. 1109, 1. c. 1111.

on the policy between the insurance company and the insured. The Supreme Court of the United States has apparently been of the same opinion.<sup>21</sup> Considerable light is cast upon the question by the following elucidative statement in the *Butler Bros. v. American Fidelity Co.* case,<sup>22</sup> which, despite its length, the writer believes is worthy of full quotation:

The indemnitor is not, however, necessarily liable for the amount paid by the indemnitee in settlement of the case. The question whether the liability of the indemnitee or the assured was one which the contract of indemnity covered is still open, as is the question of the fact and the amount of the liability of the insured. The settlement is not conclusive, either as to the fact that the assured was liable, or as to the amount of such liability. The rule is that these questions are open and may be litigated and determined in the action brought by the insured to recover the amount so paid in settlement. If it appears that there was no liability in the case settled, the amount paid cannot be recovered. In other words, where there is a trial and judgment in the action against the indemnitee, after notice to defend given to the indemnitor, the judgment is conclusive evidence that the indemnitee was liable, and as to the amount. But where there is not trial and judgment establishing the liability, the question remains open for decision.

It has perhaps occurred to the reader that the *Kansas City etc. Ry. Co. v. So. Ry. News Co.* case, *supra*, appeared to place upon the insurance company the burden of showing the non-liability of the assured when sued. The *Butler Bros.* case also expressly puts upon the company the duty of showing that there could have been no recovery against the assured had the action been tried. Contrary to this view is the case of *Mayor, Lane & Co. v. Commercial Cas. Ins. Co.*<sup>23</sup> which holds: "Having failed to defend, its (the insurance company's) liability and the extent thereof would have been conclusively determined by a judgment against the assured where it had notice to defend. When, however, the assured saw fit to settle before a recovery, he assumed the risk in an action against the insurer of showing, not only a liability covered by the policy, but the amount of the liability, and the recovery against the insurer would be limited by the loss sustained, even though the evidence must show that the settlement was for less than the liability." This case thus puts the *onus probandi* upon the insured in this situation of showing his own wrong and liability to the person prosecuting a claim against him. In *Independent Milk & Cream Co. v. Aetna Life Ins. Co.*, *supra*, the question of upon whom lay the burden of proof was not discussed, but it is expressly stated that the plaintiff

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<sup>21</sup> *St. Louis Beef & Provision Co. v. Maryland Cas. Co.*, 201 U. S. 173.

<sup>22</sup> See footnote 19.

<sup>23</sup> 155 N. Y. S. 75. Note, however, that here the parties to the suit against the insurer did not go through the formality of entering judgment upon a stipulation after they had settled the case.

did assume that task. So also, in *Carthage Stone Co. v. Traveler's Ins. Co.*,<sup>24</sup> without any reference to the remark in the earlier case of *Kansas City etc. Ry. Co. v. So. Ry. News Co.*, *supra*, intimating that the company has the burden of proving the insured's non-liability, it is stated that "plaintiff, in order to avoid the effect of the default judgment against it, assumed the burden of trying the Perry case (suit by claimant against the insured) *de novo*, and proving its own negligence in causing Perry's injury." The result of these conflicting decisions is, of course, simply to make the answer to the question as to burden of proof a matter of uncertainty.

Where the policy of insurance contains an insolvency of bankruptcy clause permitting suit upon the policy directly against the company by a claimant who has recovered a judgment against an assured and has been prevented from collecting thereon by the latter's insolvency, it would seem that the same principles as to the conclusiveness of a judgment should apply. Under such policy provisions and under statutes embodying the same principles, it has been held that any defense available to the insurance company as against its assured would be equally available against the injured party.<sup>25</sup> "The rights which an injured party has under the statute against the company are no greater than those which the assured possesses."<sup>26</sup>

But some other decisions follow the opposite rule where the right asserted by the claimant despite the fact that the assured himself had no such right, is the very right to bring the suit.<sup>27</sup> The reasoning underlying these cases is that in the cause of action, or right to sue, of the injured party is independent of the rights of the insured; that the obligation to pay the judgment directly to the claimant creates a primary liability on the part of the company to him, indefeasible by any act of the assured. Particularly true is this in instances where the obligation of the company under the policy is to pay any judgment rendered against the assured rather than to reimburse for loss suffered in payment of claims for which the assured is liable, within the terms of the policy. So it was held in *Kruger v. California Highway Indemnity Exchange*,<sup>28</sup> where the insurance company wished to litigate the question as to the negligence of its assured and whether such negligence was the proximate cause of the injuries to the person suing under an insolvency clause, after obtaining a default judgment: "Appellant (the company) guaranteed the payment to the party securing the same of any judgment rendered against Delavey (the assured) and covering any loss or claim

<sup>24</sup> 186 Mo. A. 318, 172 S. W. 458.

<sup>25</sup> *General Acc., F., & L. Assur. Corp. v. Industrial Accident Commission*, 196 Calif. 179, 237 P. 33; *Schoenfeld v. New Jersey Fid. & P. G. Ins. Co.*, 203 App. Div. 796, 197 N. Y. S., 606; *Coleman v. New Amsterdam Cas. Co.*, 126, Misc. R. 380, 213 N. Y. S., 522; *Hermance v. Globe Indem. Co.*, 221 App. Div. 394, 223 N. Y. S., 93; *U. S. Fid. & Guar. Co. v. Williams*, 148 Md., 289, 129 Atl. 660.

<sup>26</sup> *Hermance v. Globe Indem. Co.*, *supra*.

<sup>27</sup> *McGhee v. Casualty Co. of Amer.*, 15 Oh. App., 457; *Finkelberg v. Continental Cas. Co.*, 126 Wash. 543, 219 P. 12.

<sup>28</sup> 258 P. 602 (Cal. 1927).

under said policy. The undertaking is to pay the judgment to the party injured and not the damages sustained nor the loss incurred as a result of the injury . . . appellant's liability was to pay the judgment and in a contract of that character the promisor is bound by the judgment whether he have notice of the action or not, even though he is not a party thereto." The dissimilarity between such provisions and those of the ordinary policy indemnifying against loss resulting from liability for accidents, etc., is obvious.

ROBERT L. ARONSON, '28.