Extraterritorial Effects of Direct Action Statutes

St. John's Law Review

Follow this and additional works at: https://scholarship.law.stjohns.edu/lawreview

Recommended Citation

This Note is brought to you for free and open access by the Journals at St. John's Law Scholarship Repository. It has been accepted for inclusion in St. John's Law Review by an authorized editor of St. John's Law Scholarship Repository. For more information, please contact lasalar@stjohns.edu.
Extraterritorial Effects of Direct Action Statutes

Introduction

At common law, an injured party was usually unable to recover under the tortfeasor's insurance policy because of strict concepts of privity of contract and clever policy wording on the part of the insurance company. Consequently many judgments proved worthless, since the defendant was often judgment proof and the plaintiff had no right of action against the insurance company. In recent years, largely due to the advent of the automobile, liability insurance has come to be looked upon as a contract entered into primarily for the benefit of the public rather than the insured. Accordingly, statutes have been enacted giving the injured party a right of action against the tortfeasor's insurance company if the judgment against the tortfeasor remains unsatisfied. New York and a majority of other jurisdictions have adopted this type of remedial legislation. However, some states have made a more radical departure from the common law. Rhode Island has enacted a statute permitting a direct action against the insurer if the insured cannot be served within the jurisdiction. Wisconsin's direct action statute, limited to automobile liability policies, permits joinder of the insurance company in an action brought against the insured. Louisiana amended its statute in 1930

---

2 If the policy insured the wrongdoer against liability, a debtor-creditor relationship arose between the insurer and the insured when a judgment was rendered against the insured. The injured party could then reach the insurance by garnishment proceedings against the insurer. See, e.g., Anoka Lumber Co. v. Fidelity & Casualty Co., 63 Minn. 286, 65 N.W. 353 (1895); Hoven v. Employers' Liability Assur. Corp., 93 Wis. 201, 67 N.W. 46 (1896). However, where the policy was one of indemnity, no indebtedness arose on the part of the insurer until the outstanding judgment was paid by the insured. If the insured was insolvent, so that the judgment could not be satisfied, the insurance company was under no obligation to either the insured or the injured party. See, e.g., Allen v. Aetna Life Ins. Co., 145 Fed. 881 (3d Cir. 1906). Consequently, insurance companies issued indemnity rather than liability policies.
4 N.Y. Ins. Law § 167(b). This section provides that no policy shall be issued or delivered within the state unless it contains a provision that the insolvency or bankruptcy of the insured shall not release the insurance company, and that an action may be maintained against the insurer if the judgment against the insured remains unsatisfied for thirty days. The constitutionality of this statute was upheld in Merchants Mut. Automobile Liability Ins. Co. v. Smart, 267 U.S. 126 (1925).
5 See Leigh, supra note 3, at 637.
7 Wis. Stat. §§ 85.93, 260.11 (1953).
to give the injured party an option to bring a direct action against the insurer or against the insurer and insured jointly.\(^8\)

**Conflict of Laws and Constitutional Considerations**

Direct action statutes, as would be expected, have raised many problems, both in the field of conflict of laws and in the area of constitutional law. In transitory causes of action, the general conflict rule is that matters of "substance" are governed by the law of the place where the contract was made and matters of "procedure" are governed by the law of the forum.\(^9\) Conflict problems arise, however, when the jurisdiction in which suit is brought permits a direct action against the insurer, whereas the insurance policy contains a "no action" clause,\(^10\) valid in the state where the contract was made, prohibiting such direct actions. Rhode Island overcame these conflict difficulties, to a large extent, by holding its direct action statute to be substantive and hence restricted in its application to policies entered into within the state.\(^11\) Similarly, Wisconsin has refused to permit direct actions when the policy contains a "no action" clause which would be valid in the state where the contract of insurance was entered into.\(^12\)

The law in Louisiana, on the other hand, has been largely uncertain. Although the courts have sometimes held the statute to be substantive,\(^13\) in conflict situations the statute has generally been held to be procedural, and hence applicable to all liability insurance contracts, including those entered into outside of Louisiana.\(^14\) The statute was revised in 1948, however, and the courts interpreted the revision as limiting the right of direct action to policies issued within the state.\(^15\) Apparently, such was not the legislative intent, for the

\(^8\) See Lassiter, *Direct Actions Against the Insurer*, [1949] Ins. L.J. 411, 413.


\(^10\) The typical "no action" clause provides that no action shall lie against the insurance company until the insured has sustained a loss through payment of a judgment. *See* Michel v. American Fire & Casualty Co., 82 F.2d 583, 587 (5th Cir. 1936). *See* note 2 *supra*.


\(^12\) See Ritterbusch v. Sexsmith, 256 Wis. 507, 41 N.W.2d 611 (1950); Byerly v. Thorpe, 221 Wis. 28, 265 N.W. 76 (1936).


statute was amended shortly thereafter to expressly provide that the right of direct action shall exist with respect to injuries incurred within Louisiana, irrespective of where the policy was written or delivered and regardless of provisions in the policy prohibiting such direct action. At the same time, a statute was enacted requiring that insurance companies consent to direct suit before obtaining a certificate to do business in Louisiana.

Both statutes were immediately subjected to attack on constitutional grounds, but were upheld by the Louisiana courts. However, conflicting decisions as to their constitutionality were rendered when direct action suits were brought in Louisiana federal courts. Underlying this division of authority was a basic difference of opinion as to the requirements of due process. In the cases in which the direct action statute was held unconstitutional, the courts adopted the stricter interpretation of due process advanced by the Supreme Court in a series of cases beginning with Allgeyer v. Louisiana. Under this view, a state may not constitutionally give extraterritorial effect to its laws by enlarging or abridging the obligations of a contract validly entered into in another state. In the decisions upholding the validity of the direct action statute, the courts adhered to the broader “governmental interest” theory of due process as found in Alaska Packers Ass’n v. Industrial Accident Comm’n.23 Under this theory, a statute enacted by a state in the exercise of its police power is not necessarily void if it affects contracts made in other states. If the subject matter was within the reasonable scope of regulation, the end legitimate, and means appropriate, the statute would be upheld as a proper exercise of the state’s police power. This disagreement as to what constitutes due process also led the courts to opposite conclusions on the constitutionality of the statute which conditioned the insurer’s right to do business within the state on consent to direct

17 Id. § 983(E).
20 165 U.S. 578 (1897).
actions. One line of decisions held that such a condition violated due process, in that it deprived the insurance company of a valuable property right, i.e., the "no action" clause, and hence fell within the category of "unconstitutional conditions." The other held that due process was not violated since the condition was a reasonable one in view of Louisiana's vital interest in the subject matter. With the law in this highly unsatisfactory state, there was an obvious need for judicial clarification. This need was met by two recent decisions of the United States Supreme Court.

The Watson and Elbert Cases

The case of Watson v. Employers Liability Assur. Corp. concerned a direct action brought by a Louisiana resident against a manufacturer's liability insurer for injuries sustained through use of the insured's product. The insurance contract had been negotiated and issued in Massachusetts. The policy contained a "no action" clause, which was valid in Massachusetts, prohibiting any action against the insurer until final determination of the liability of the insured. The defendant insurer, however, had consented to direct actions in order to obtain a certificate to do business in Louisiana. The defendant challenged the constitutionality of the direct action statute and the provision requiring consent as a condition of doing business. The Court sustained both statutes through a liberal application of the "governmental interest" theory of due process. Stressing the fact that "[p]ersons injured or killed in Louisiana are most likely to be Louisiana residents, and even if not, Louisiana may have to care for them," the Court concluded that Louisiana had sufficient interest in the subject matter to warrant the enactment of the statutes in question. A similar line of reasoning was employed to answer the defendant's contention that the Full Faith and Credit clause required the application of the contract law of Massachusetts. The Court held that other states were not compelled by the Constitution to automatically subordinate their laws to the law of the state where the contract was made. The Court weighed the interests of both states in the contract and found that the interest of Louisiana in protecting persons injured within her borders "plainly" outweighed whatever interest

26 "... [A] condition attached by a state to a privilege is unconstitutional if it requires the relinquishment of a constitutional right." Hale, Unconstitutional Conditions and Constitutional Rights, 35 Col. L. Rev. 321 (1935).
28 75 Sup. Ct. 166 (1954).
29 Id. at 170.
Massachusetts might have. Finally, the Court held that since the direct action statute was constitutional and could be applied with or without the insurance company's consent, the law compelling insurance companies doing business within the state to consent to such actions was likewise constitutional.

Mr. Justice Frankfurter, although concurring in the result, would have rested the decision solely upon the power of a state to admit a foreign corporation subject to all reasonable conditions, including consent to direct actions. However, he seriously questioned the power of Louisiana, in the absence of such consent, to alter the obligations of the Massachusetts contract. In his view, the recent decisions of the Supreme Court had not made inroads on the principle laid down in the Hartford Indemnity Co. case that a state may not "... enlarge the obligations of the parties [to a contract made in another state] to accord with every local statutory policy solely upon the ground that one of the parties is its own citizen." Moreover, he pointed out that Massachusetts had substantial interest in the enforcement of the "no action" clause, since the financial well-being of insurance companies operating in Massachusetts is of considerable importance to the citizens of that state.

A companion case, Lumbermen's Mutual Casualty Co. v. Elbert, concerned a direct action arising out of an automobile accident which occurred in Louisiana. The plaintiff brought an action in a federal district court against the tortfeasor's insurer, an Illinois corporation, on the basis of diversity of citizenship. The defendant challenged the existence of diversity jurisdiction, alleging that the real controversy was between the injured party and the tortfeasor, both of whom were Louisiana citizens. The defendant also contended that the tortfeasor

---

30 The Court dismissed as being "wholly void of merit" the contention that the statutes violated the Equal Protection clause of the Constitution. The Court found that the statute fell with equal force on all insurance companies, both foreign and domestic. However, the real hardship of the direct action, i.e., the jury factor, falls solely upon the foreign insurance company. This fact was pointed out by Mr. Justice Frankfurter in his concurring opinion in the Elbert case where he recognized that "... by the fortuitous circumstance that this Louisiana litigant could sue directly an out-of-state insurance company, she can avoid her amenability to Louisiana law. In concrete terms, she can cash in on the law governing jury trials in the federal courts, with its restrictive appellate review of jury verdicts, and escape the rooted jurisprudence of Louisiana law in reviewing jury verdicts." Lumbermen's Mut. Casualty Co. v. Elbert, 75 Sup. Ct. 151, 157 (1954). See note 36 infra.
32 Id. at 149.
33 For a discussion of the harsh effects which result from rendering the "no action" clause inoperative, see Bish v. Employers' Liability Assur. Corp., 102 F. Supp. 343, 347-349 (W.D. La. 1952), aff'd mem., 202 F.2d 954 (5th Cir. 1953); Belanger v. Great American Indemnity Co., 89 F. Supp. 736, 740 (E.D. La. 1950), aff'd, 188 F.2d 196 (5th Cir. 1951).
34 75 Sup. Ct. 151 (1954).
was an indispensable party and that failure to join the tortfeasor deprived the court of jurisdiction. Both arguments were rejected, however, and a unanimous Court held that the insurer was the real party in interest, since the direct action statute created a separate and distinct cause of action which the injured party could pursue in lieu of his action against the tortfeasor. The Court reasoned that the bringing of a direct action against the insurer was apparently an abandonment of the cause of action against the tortfeasor, and hence a complete disposition of the entire controversy could be made in the action against the insurer, without joining the tortfeasor. Consequently, direct actions could be brought in federal courts if diversity of citizenship existed between the plaintiff and the defendant insurer, even though the plaintiff and the tortfeasor were citizens of the same state.

The Aftermath of the Watson and Elbert Cases

Although both of these decisions will serve to clarify much of the confusion that has surrounded the application of direct action statutes, many new problems are presented. Now that the Louisiana direct action statute has been upheld, a question immediately arises as to what extent the states are bound to recognize, in actions brought in their courts, another jurisdiction's direct action statute. The answer to this question is important for two reasons. First, it is well known that plaintiffs, in personal injury actions, are inclined to seek out a favorable forum. This tendency is even more marked in Louisiana where appellate review of jury verdicts in civil cases extends to both matters of law and fact. The limited review of jury verdicts and the higher recoveries had in other jurisdictions might cause direct action suits to be brought outside of Louisiana. Moreover, the bringing of such foreign suits is greatly facilitated by the fact that the insurance company is usually incorporated or doing business in several states. Secondly, the mere mention of a tortfeasor's insurance is considered so prejudicial as to be reversible error in all but four states.

However, there is some question as to whether the Louisiana statute creates supplementary remedies rather than a right to elect between the two remedies. See Lafield v. United States Casualty Co., 114 F. Supp. 688 (W.D. La. 1953); see Elbert v. Lumbermen's Mut. Casualty Co., 108 F. Supp. 157, 162-163 (W.D. La. 1952), rev'd on other grounds, 201 F.2d 500 (5th Cir. 1953), aff'd, 75 Sup. Ct. 151 (1954).


In the past, the courts in other jurisdictions found little difficulty in disposing of direct action suits. Since the direct action statute was held to be procedural by the courts of Louisiana, some states disregarded it and applied their own procedure. Further, a Michigan court held that such actions were barred because of policy considerations prohibiting the disclosure of insurance, and in view of the fact that the local statute required an outstanding judgment against the insured before an action could be brought against the insurance company.

It is to be noted, however, that this case was decided prior to the Elbert and Watson cases. Now that the Supreme Court has recognized that the interest of Louisiana in protecting accident victims is sufficient to authorize the enactment of a direct action statute, other states' public policy may not be strong enough to prevent the bringing of direct actions in their courts. In Hughes v. Fetter, the Supreme Court held that the fact that Wisconsin permitted a wrongful death action for deaths caused within the state was sufficient to show that Wisconsin had no strong public policy against wrongful death actions in general. Consequently, the Wisconsin policy against entertaining suits brought under the wrongful death acts of other states was not strong enough to override the requirements of the Full Faith and Credit clause. Many states prohibit the disclosure of insurance and yet have statutes which permit direct actions against the liability insurers of public carriers and certain sureties. Thus if the strict test found in the Hughes case were applied, the public policy of these states might be held insufficient to warrant a denial of a forum to plaintiffs in direct action suits. Moreover, the Supreme Court in the Elbert case apparently adopted the view that the direct action statute was substantive, citing two Louisiana cases. If in the future Louisiana holds its statute to be substantive, the states accepting Louisiana's interpretation could no longer disregard the statute on the ground that it was purely procedural.


40 341 U.S. 609 (1951).


42 E.g., S.C. CODE ANN. tit. 10, § 10-702 (1952). "When an indemnity bond or insurance is required by law . . . against personal injury founded upon tort the principal and his surety . . . may be joined in the same action and their liability shall be joint and concurrent."

Shortly after the Watson and Elbert decisions, an opportunity to pass upon this problem was presented in Collins v. American Automobile Ins. Co., decided by the United States District Court for the Southern District of New York. The Collins case involved a direct action brought on a policy issued and delivered in Louisiana where the accident took place. The plaintiff was a resident of Virginia and the tortfeasor a resident of Louisiana. The defendant insurer moved to dismiss the complaint. The plaintiff, however, claimed to be in the federal court as a matter of right. The court held that neither the Elbert case nor the diversity or venue provisions of the Judicial Code affected the court’s power to transfer the case to a federal court in Louisiana or to dismiss it in the exercise of its discretionary power under the doctrine of forum non conveniens.

The court took notice of the fact that the suit was brought in a jurisdiction which regards the mention of a tortfeasor’s insurance as a sufficient ground for a mistrial, and that the sole reason for bringing suit here was “to obtain the benefit of the reputed largesse of New York City juries.” The suit was dismissed, however, on the ground of forum non conveniens, thus avoiding the question of whether the statute was substantive or procedural, as well as the problem of weighing the public policy of New York against that of Louisiana. Consequently, resolution of the conflict between local public policy and the requirement that the direct action statute be given full faith and credit must await further litigation.

Conclusion

Although Louisiana may be justified in enacting a direct action statute, other states are equally justified in refusing to permit direct actions to be brought in their courts. In Louisiana, recoveries are kept within reasonable limits, at least in the state courts, since there is appellate review of jury verdicts both as to the law and the facts.

46 Id. § 1391(c).
47 Id. § 1404(a). “For the convenience of parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district or division where it might have been brought.”
48 For diversity purposes, a federal court adjudicating a state-created right is, in effect, only another court of the state in which it sits. See Woods v. Interstate Realty Co., 337 U.S. 535 (1949). Consequently a suit will be dismissed if it would have been dismissed in the state courts. See Munch v. United Air Lines Inc., 184 F.2d 630 (7th Cir. 1950); Trust Co. of Chicago v. Pennsylvania R.R., 183 F.2d 640 (7th Cir. 1950).
Where appellate review is limited, however, strong public policy dictates that the presence of insurance should not be disclosed since "... juries are much more apt to return a verdict for the injured party, and for a larger amount, if they know that the loss is to ultimately fall on an insurance company." 50

50 Kuntz v. Spence, 67 S.W.2d 254, 256 (Tex. App. Comm'n 1934). "Once this information [the presence of insurance] has reached the jury ... the juror no longer pictures before him the individual defendant but rather the financially responsible insurance company. All the forces which work against the large corporation defendant again come into play with the added factor that the insurance company has been paid for its coverage and, as the juror sees it, must necessarily have contemplated the payment of unfavorable verdicts against its assureds." Baer, The Relative Roles of Legal Rules and Non-Legal Factors in Accident Litigation, 31 N.C. L. Rev. 46, 55 (1952).