A GENERAL REVIEW OF LIABILITY INSURANCE

A paper presented by
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at a meeting of the British Insurance Law Association
on 26th May, 1964

The title of this talk was my own choice, and I stand by it; it gave me the licence I wanted to roam over the field and pick out what interested me. But I disclaim any pretension to be comprehensive, and, still more vehemently, any pretension to be authoritative. In the present state of the law on this subject, there are a lot of questions, and some of them I ask in the discourse which follows. I hope that the subsequent discussion may throw up some answers; as a great judge once said (I quote from memory), "I have raised these points, which wiser heads may settle!"

My talk falls into three sections: The first I have called general principles. The second deals with the structure and content of a liability policy, and discusses some implications of the form or forms in which such policies are or may be framed. The third leaves the practical world and soars into the stratosphere of speculation (or at least aspires to do so). It asks, in brief, about the consequences, actual and potential, of the practice of liability insurance on the law of tort, and specifically on the law of negligence.

To begin then with what we can find under the heading of general principles.

I put first Public Policy, a tag which really covers two separate but converging principles, namely, public policy strictly and the rule that an insured cannot recover for a loss due to his own deliberate act. Public policy strictly, so far as I know, invalidates only undertakings to indemnify against the consequences of criminal actions. Much trouble and litigation would have been avoided if it had been confined from the start to what I think is its proper field - the criminal consequences of criminal acts - an undertaking to pay a man's fine if convicted in fact. And I am not sure that you could not find support for the view that was what the early cases were about. Shackell v. Rosier, for example.[1] I don't really see why the law should concern itself with indemnity against civil liability in tort merely because that tort happens also to be a crime - though I admit that my view, if pressed to extremes, would lead to some startling consequences. Consider the American case of the taxi company that tried to recover from their insurers the damages awarded against one of their drivers for a rape. But whatever the merits of this argument a priori, it is too late to put it forward now, at any rate in that extreme form.[1a] And so account has to be taken of the fact that a number of torts are, or in certain circumstances may be, crimes, for example, libel, champerty, and various kinds of misbehaviour with a motor vehicle.

The libel question is a bit complex. All that the 1952 Act did was to provide that an agreement for indemnifying any person against civil liability for libel in respect of the publication of any matter should not be unlawful unless at the time of the publication that person knows that the matter is defamatory and does not reasonably believe there is a good defence to any action brought upon it.[2] If one assumes that "shall not be unlawful unless..." at least implies "shall be unlawful if..." (a fairly safe assumption, but, having regard to our rather curious canons of statutory interpretation, not 100%), I remain of the opinion that the statutory rule stretches the common law a little in favour of the insured, for I very much doubt if at common

1. Shackell v. Rosier(1836)2 Bing N.C. 634
1a Haser v. Maryland Casualty 33 ALR sd. 1018
2. S.11

contd.

law the reasonable belief in the existence of a defence would have saved him.

Champerty is covered by the well-known Haseldine case, the ratio decidendi of which is double, which is always troublesome. In effect, the insured was confronted by a dilemma - either the deliberate entering into a champertous agreement is not a "neglect, omission or error" within the terms of the policy, or if it is; such an indemnity is contrary to public policy. The second horn of the dilemma is a clear ruling that insurance against the civil consequences of crime is invalid, at least if the crime is deliberately committed. 3.

The motor car cases would hardly be worth a mention, had it not been for the doubts expressed about them by Scrutton, L.J. in Haseldine's case. Hazardous though it may be to venture a criticism of that very great judge in any commerical case, it does seem to me that in this particular instance he was barking up the wrong tree. The crimes involved were, respectively, exceeding the legal speed limit and driving when drunk. But that was not what the actions were about; the actions, in each case, were about negligence, which is independent of either excess of any particular limit, or of sobriety or its reverse. What might, in theory, be more seriously arguable is the point that negligence itself, where it concerns the driving of a motor vehicle, constitutes (or may constitute) the offence of driving without due care and consideration. The whole argument, to my mind, is rendered academic by the fact that the statutory obligation to insure against third party risks establishes, as it were, a countervailing public policy in favour of the protection of road users against the consequences of negligence by their fellows. For myself, I feel confident that, whatever the technical merits may be, the insured under a motor policy is certain of his indemnity in any case short of deliberately and designedly running his victim down (which can happen in the U.S.A. - see Weis v. Mutual Auto. Insurance) but one hopes is likely to be of infrequent occurrence here. 4. 3. 5.

To sum up, the impression produced on my mind by the cases herein before briefly summarised is:

(a) There is no authority (as opposed to stray dicta) against the proposition that insurance against the civil consequences of negligence or inadvertence is unobjectionable - and a good deal of authority for it.

(b) There is a very valid objection to a claim by an insured to be indemnified against the civil consequences of a deliberately committed crime, but this is not really a question of public policy strictly, but a consequence of the other rule, that an insured person cannot claim for a loss which is the result of his own deliberate act.

Suppose we test this proposition by reference to another type of liability altogether - liability for breach of trust. For this purpose we could classify breaches of trust as follows:

(a) the usual case - inadvertence;

(b) deliberate but non-fraudulent - it is arguable perhaps whether the recent Pauling case comes under (a) or (b); 6.

(c) fraudulent (and therefore criminal).

Insurance against (a) is, so far as I know normal, and surely unobjectionable. Insurance against (c) even if it makes the very

3. (1933) 1 KB 822

4. Turbine v. White Cross (1921) 3 KB327
James v. British General(1927)2 KB 311

5. 49 ALR 2d 694

6 1963 3 All E.R.1

Contd.

large assumption that any insurer would accept a proposal framed sufficiently widely to cover it is, I should have thought, objectionable on any basis. What about (b)? No question of crime is involved, but surely it is ruled out by the second of our general propositions.

The second general issue I want to spend a short time on is that of statutory subrogation, i.e. the extent to which the person who acquires the right against the insured is given a direct right of action against the insurer. I don't myself find the particular point which English law has reached on this road especially interesting in itself - namely (a) the Third Parties (Rights against Insurers) Act, and (b) certain provisions (confined to claims based on death or bodily injury) in the Road Traffic Act. I only want to ask two related questions - (a) what is the policy behind statutory provisions of this kind and (b) how far should it extend? It is noticeable that in the U.S.A. "Direct Action" and "Financial Responsibility" statutes seem to go rather further in this direction than we do, but still so far as I have noticed, seem to be confined to cases of death or bodily injury, and also (a feature not present in our legislation) the latter type, at least, seem usually to carry an upper limit. The extension of provisions of this kind would raise two rather different questions, namely: (a) Is it, as a general principle, just that if I have injured you, and have a claim to an indemnity, you should be able to sue the insurer direct if you can get no satisfaction out of me? If it is, what makes it more just that you should be so entitled if I have broken your leg than if I have smashed up your new car or run over your dog? (b) And this I think is the real nub so far as the insurer is concerned - if "direct action" is to be made effective, experience seems to show that the injured party must be given rights which in certain cases at least are wider than those of the insured. Is this just at all, and if it is just as regards motor cars, why not in other types of liability insurance as well? 7.

The last topic in my first group is that of Conduct of proceedings. Of the necessity, as a practical question, of the group of conditions under this general heading I have no doubt whatever. The insurer is going to pay the piper so he must call the tune. Nor do I propose to discuss the question, which has been endlessly litigated in N. America, about the extent to which taking over the defence of the action acts as a waiver of any right which the insurer may have to repudiate liability to his insured under a clause in the policy, or the effect of "non-waiver" provisions in the policy itself. I omit this subject (since I can't possibly cover everything) simply on the grounds that I can find no evidence that it is a live issue over here. I could easily be wrong, and if I am I hope someone will say so.

What does interest me about this aspect of liability insurance is this: From time to time there is bound to be a conflict of interest; either:-

(a) the insurer, believing that there is a good defence in law, may wish to fight; the insured, to whom (especially if he is a professional man) the case itself, whatever its outcome, might be a disaster, wants to settle. The "N.C." clause appears to provide, and in a large number of cases presumably does in fact provide, a reasonable compromise. But the application of such a clause, as West Wake Price & Co. v. Ching showed, can involve very difficult questions arising out of the form of the policy, and doubts whether the cause of action, if successfully established, is within the risk insured. This aspect of the question I would rather postpone until a little later. 8. Or

(b) The insurer may want to settle, but the insured may want to fight. Groom v. Crocker lays down the impeccable principle (on paper) 9.

7. R.T.A. 1960 ss.206(3) and 207 8. (1956) 3 All E.R.821
9. (1936) Ch.696

contd.

that the action of the insurers must be "bona fide in the interests of the insurers and the insured". But this doesn't always seem to be helpful, for if there is a conflict of interest that is, ex hypothesi, just what you can't do. Groom v. Crocker suggests by implication rather than by actual decision, that if the insurer's decision to settle damages the interests of the insured (which in that case it did not), he must pay for it. What about the converse case, where there is a limit in the policy, and the insurer could have settled within the limit, fights and let his insured in for damages over the limit?

There is a mass of American authority on a related point - what are the consequences if an insurer, wrongly believing the claim to be outside the policy limits, refuses to defend? We can take as a text Weis v. Mutual Auto Insurance. The case itself is fairly simple. It 10.
establishes merely that an insurer who has undertaken to indemnify against liability for death, bodily injury etc. "caused by accident", and arising out of the ownership etc. of an automobile, is not liable for refusing to defend an action based on the deliberate act of the insured bumping into another car. But the very full annotation which follows is mainly of interest as producing a great volume of authority on the consequences of unjustified failure to defend. These are, on the whole, what one would expect, namely:- liability to meet judgment against or settlement by the insured, but only up to the policy limits; liability to pay reasonable expenses, and additional damages if any (cf. Groom v. Crocker); loss of the right to control the defence, to object to a proposed settlement or to insist on notice or proof of loss. On the whole, these conclusions seem logical and correct, but there is an interesting question about costs. In Mannheimer v. Kansas 11.
Casualty, for example, there was a policy limit of £ 5,000. The insurer unjustifiably refused to defend, and there was judgment against the insured for £ 12,000, his costs of the action being £ 1,500. The insurer was held liable for the whole of the latter sum and not 5/12ths of it. Why? It seems to be that there are, in the abstract, two possible lines of argument: either you say that, by failing to defend, the insurer rendered himself liable up to the limits of the policy (which appears to be the prevailing view in the U.S.), or you say that the obligation to defend is separate and distinct from the obligation to indemnify, and the policy limits do not apply to the former at all (but then how do you relate your damages to the breach?) But in either case, I should have thought, damages and costs should go together. Suppose that in the Mannheimer case the policy had contained a clause, such as I have seen in policies in this country, to the effect that "if a payment in excess of the amount of indemnity available under this policy has to be made to dispose of a claim, the underwriter's liability for the costs and expenses incurred with their consent shall be such proportion thereof as the amount of indemnity available under this policy has to the amount paid to dispose of the claim", would the result have been different?

My second heading is concerned with the structure of a liability policy. At this stage my remarks become, I fear, rather disjointed. There is very little material in the Reports, and what I have found to say arises mainly from experience and reflection. This is also the section where I shall be asking questions rather than suggesting answers, and where the assembled wisdom and experience of my audience will be most valuable.

The first step, at least, is an easy one; a liability policy insures against legal liability to which the insured may be subject. But there the easy part ends; for the insistent (and to my mind very difficult) question then arises: What kinds of liability, and how should they be defined?

10. 49 ALR. 2d.694
11. (1921) 184 N.W.189

contd.

Two different approaches to the basic problem have come to my notice; one describes the liability against which indemnity is afforded as arising from accident; the other as arising from negligence, either simply or by reference to "error, neglect or default". I would not care myself to be dogmatic on this point. It seems to me that the diversity of occupations in the course of which cover is required may well justify diverse wordings. For a firm engaged in building, or any other form of physical operations, the former seems appropriate; for a mercantile concern perhaps the latter. But is either adequate in itself? The builder may, for example, involve himself in liability for nuisance; this is hardly the result of accident and is independent of negligence. Will the customer want to cover himself against this particular risk, and if he does will the insurer accommodate him? I suspect he might be wise not to, but if he did, some attractive complexities suggest themselves. Could we divide the possibilities into these?

1. The building contractor, deliberately and knowingly, so conducts his operations as inevitably to cause damage (by vibration) or discomfort (by noise). I should suppose that he is barred from obtaining indemnity under any ordinary form of policy, he has deliberately brought about the situation insured against.

2. The building contractor plans his operations in such a way that, properly conducted, they can do no harm. His workmen, to save themselves trouble or to get a productivity bonus, depart from their instructions and as a result cause damage or discomfort. Accident? Negligence? One could argue this for ages, but (at this stage at least) I'm not going to.

3. As in (2) the building contractor plans his operations with care and skill; this time moreover, they are carried out with care and skill. But for one reason or another, as does happen, damage none the less ensues (subsidence, for example). Accident? I should have thought yes. Negligence? Surely no. 12.

4. Suppose a claim for an injunction. If the insurer contests it he may find that this is a case where the Court could be persuaded to grant damages in lieu. What is the insurer's duty? This situation actually arose in the U.S. The wise course is probably 12a to pay the damages claimed (if any) and keep out.

At this stage I feel bound to tackle a group of cases that I find 13 extremely puzzling, not only in respect of the decisions themselves, which I think I understand and rather sympathise with, but because of the diversity of the judicial reasoning which led to these decisions. A consistent series of decisions have established that a professional liability policy in the ordinary form (errors, neglects and omissions) will not cover liability for the financial defalcations of employees.

In Davies v. Hosken a solicitor's clerk had embezzled a client's money. The liability was held not to arise from "neglect, omission or error". On the part of the clerk, this is clearly so; on the part of the principal? Porter J. said the policy put the clerk and the solicitor on a footing, and if the words were not apt to cover such behaviour by the principal, they did not cover such behaviour by the clerk. Sed quaere.

In Whitworth v. Hosken the insured was a chartered accountant; the policy covered "neglect, default or error" of self or servants in the course of his business. The fraud which gave rise to the claim

12. "damage to property caused by accident" in a Householders' comprehensive policy has recently been held to include liability for nuisance caused by the roots of a tree. Paull J. defined accident as some unexpected event leading to damage. Mills v. Smith (1964) 1 Q.B.30

12a. Casualty v. Hanna 153 ALR. 2d.1125

13. Davies v. Hosken(1937)3 All E.R.192 Whitworth v. Hosken (1939) 65 Ll.L.R. 48. Goddard & Smith v. Frew(1939)4 All E.R.358. West Wake Price & Co. v. Ching(1956)3 All E.R. 821

was committed by a person whom the insured was ill-advised enough to refer to as "my representative" (though he wasn't) and thereby he exposed himself to liability for his "representative's" misdeeds. It was held that this was not "neglect, omission or error" nor in the course of the insured's business.

Goddard and Smith v. Frew was a case of a rent collector whose servant embezzled client's money. The policy covered "any act, neglect, omission, mis-statement or error". The insured failed to recover, but the reasons are obscure. The facts of the West Wake case follow the same general pattern. The judgment of Devlin, J. is an elaborate one, but it boils down to this - is the claim based on the fraud of the servant (outside the policy) or on the negligence of the master (within it)?

Nor is life made any easier by re-reading the decision of the Supreme Court of New South Wales in Simon Warrender Proprietary v. Swain. Can it really be right that the position as between a company and its employees and between a partnership and its employees is fundamentally different? Or is the real distinction between this and the foregoing decisions a simpler and more definable one - namely that the claim against the employer in the Simon Warrender case was based on a neglect - namely a failure to procure a policy for the client - and the fact that the failure was due to a deliberate (and in a sense fraudulent) course of conduct by the employee was therefore irrelevant? 14.

But there is a rather interesting appendix to West Wake in the American case of Employers' Mutual Liability of Wis. v. Hendrix. In the West Wake case, Devlin J. explored the liability of an insurer where a claim was made against the insured which might have been put by the plaintiff (a) in a way prima facie within the policy (b) in a way prima facie out. In the Hendrix case the U.S. Court of Appeals considered the effect of claims or causes of action, some of which are within the indemnity and some of which are not, and came to the conclusion that if the insured decides not to defend he does so at his own risk. The outcome, apparently, depends on the result of the action. 13. 15.

It is time I moved on. The type of liability against which an indemnity is provided is, so far as my experience goes, confined to those incurred in the course of, or arising out of, the business or profession, as the case may be, of the insured; and very reasonably. But what effect has this limitation on the protection of the insured if he is engaged in business of a rather general kind, and how anxiously need the insured, or his advisers, scrutinise the (usually rather general) description of their business embodied in the policy? Even if the scope of the profession or business is on the face of it well defined, there may be awkward borderline cases. Everybody knows that a solicitor or banker, for example, often undertakes tasks outside the scope of what is strictly his profession or business. So, to his cost, did the chartered accountant in Whitworth's case 16.

Sometimes, as in Wood v. Martin's Bank, the employer's liability itself will depend on whether the disastrous activities of the employer are or are not held to be within the scope of the business, and then, presumably, all is well - either no liability or the liability is covered. But this will by no means always be the case. If you are trying to protect a company, or worse still a group of associated companies, can you play safe by covering liability incurred in the course of activities within their memoranda of association, and if you do will the underwriter wear it? 17.

14. (1960) 2 Lloyd's Rep.111
15. 41 ALR. 21 424
16. (1939) 65 LL.L.R.48
17. (1959) 1 Q.B.55

contd.

The concluding part of this section consists of what are, I fear, rather rambling observations on a number of points that suggest themselves for consideration in connection with policies of this type.

The case of Hedley Byrne v. Heller has, naturally enough, caused some consternation; even the Bar is looking anxiously over its shoulder. But a full assessment of its possible implications would be disproportionate to the design of this talk, and I will content myself with the point that it adds a new dimension to insurable risks, the scope of which, it seems to me, is by no means confined to concerns which give advice, or make reports, as a regular or principal activity. All sorts of people, engineers, builders, designers and general contractors may have, on occasion, to make inspections or submit reports, and this decision has widened the area of possible consequence liability to an extent not yet predictable. 18.

The case of Lister v. Romford Ice Co. again, has to my knowledge caused some concern. Employers who would themselves never dream of taking proceedings against employees for breach of duty are alarmed at the prospect of such proceedings being taken, in their name, by insurers in virtue of their right of subrogation. As a matter of law, the risk can easily enough be eliminated, but in practice? If you have a large company, or a group of companies, protected by a liability policy with an upper limit of, say, half a million pounds, how much would it have to pay in additional premium for a "without recourse" clause? 19.

Group liability insurance, effected for example by a trade association for its members, is coming into the picture. Like all group insurance, it suggests difficulties in relation to insurable interest, and the rule that C cannot take an enforceable interest under a contract between A and B. I can only say that, as at present advised, I think that neither difficulty arises in this type of case if the individual members of the association, and not the association itself, are expressed to be the insured.

A due diligence clause is common form in many types of liability policy. The customer doesn't like it. He is afraid that as soon as a claim covered by the policy arises, the clause will be invoked by his insurer. The English cases, so far as they go, suggest that he needn't be frightened, in as much as a single lapse is not going to be treated as a breach of warranty, for the very good reason that so to hold would defeat the purpose of the insurance, but none the less he is. I see no reason to think that a carefully drafted clause making clear what I believe is any case to be the true construction of the clause in its ordinary form would be objectionable to insurers, but I may be wrong.

Finally, a word on overlap, a problem of a peculiarly difficult and exasperating kind. Any large concern, or group of concerns, is likely to have more than one policy afoot covering different aspects of their activities; small concerns and even private householders may in some cases do so. Nothing is more pointless and infuriating than the kind of litigation which is embarked upon in order to decide which of two policies must bear a loss which is certainly within the province of one or other of them, and yet I doubt if anyone would like to say with confidence that he had eliminated any possibility of such a result; I know I wouldn't. Two possible approaches to this problem can be suggested. The first is to place all your business of this type with a single insurance company; this will reduce the risk, but not eliminate it altogether if, for example, policy A has one upper limit of liability and policy B another. The other is to combine all the different kinds of cover you may require in a single document (with, presumably, a

18. (1964) A.C.465
19. (1957) A.C. 555
20. e.g. Woolfall & Rimmer v. Boyle (1942) 1 2.B.66

contd.

single limit of liability, if there is one). This latter course is, I believe, the most theoretically satisfactory solution. The objection to it is purely practical: the resulting document is going to wear such a complex and forbidding aspect that it is doubtful whether any broker would care to try to place it, or any insurer be willing to accept it.

The last part of this talk is concerned with a larger horizon. Academic lawyers, at any rate, on both sides of the Atlantic, are manifesting an increasing dissatisfaction with the working of the law of tort generally. I think, myself, that this is exaggerated, but what is clear is that, within the law of tort, this dissatisfaction is concentrated expressly on the law of negligence, as it is here that liability insurance is either common or, as in the case of motor vehicles, universal and compulsory. The question I want to speculate about for a minute or two is - how far has the prevalence of liability insurance contributed to the situation? 21.

To begin with, it is rather tempting to suppose that the existence of insurance cover against the consequences of negligence impairs the moral basis of the law by rendering the insured less concerned to be careful: tempting, but not, I believe, wise. I do not believe that drivers drive more recklessly, or employers are less careful for the safety of their work people, <u>because</u> they are insured, any more than I believe that people are more careless about fire <u>because</u> they are insured. People <u>are</u> careless - shockingly careless, in all these categories, as the fire and accident figures show, but I don't think they are <u>more</u> careless because they are insured. After all, for one thing, carelessness in any of these situations involves risks against which no insurance can cover you - criminal proceedings, loss of life, a reputation as a bad employer, and so on. And what is more, the insurer can and I think very often does exert a salutary influence, by inspecting premises and safety systems, putting up premium rates against those with bad safety records, or even in extreme cases refusing to insure at all.

The real effect of the prevalence of liability insurance has been, I think, more pervasive and more subtle. The law of tort is machinery for risk-shifting. Where it operates, it does so by taking (so far as pecuniary damages can do so, and ignoring the injunction) the consequences of A's act or omission off the shoulders of B, who has suffered therefrom, and putting them on A's. And, in the classical law of tort at any rate, the basis for this operation has usually been moral - that is to say that it is felt to be just that A should pay, not simply because it was A's act or omission that caused the loss, but because it was A's <u>wrongful</u> act or omission that caused the loss (and in the context with which we are concerned, wrongful may be equated with negligent). What has happened to the law of tort, increasingly in modern times, has been the erosion of this moral basis. There have been several reasons for this, and to my mind the most pervasive has been the insidious growth of vicarious liability, which can be amply justified, I suppose, on general principles of policy (i.e. the employer should pay because he can afford to), but <u>not</u>, I submit, on the simple moral basis of fault. Now it is at this point that, as I see it, the prevalence of liability insurance has had its effect. For insurance is machinery, not for loss-shifting but for loss-spreading, and where it is prevalent, or still more where it is universal, as in motor-vehicle cases, the moral enquiry - whose fault was it? - becomes irrelevant. The decision in a specific case may make a substantial difference to the insurers involved (unless they have done their own second-degree loss-spreading by a knock-for-knock agreement, as they probably have) but the loss is really spread already, over the whole body of insureds.

21. See e.g. Glanville Williams - "The aims of the law of tort" (1951 Current Legal Problems p.137) and in Canada, Wright on Torts.

contd.

In this sort of context, schemes for universal and compulsory loss-spreading (at least so far as negligence is concerned), begin to wear at least a plausible appearance. After all, this has happened, in the specialised field of industrial injuries, in parts at least of Canada and the U.S.A., and I believe would have happened in England if the Trade Union side had not been adamant about preserving their common law rights in addition to the State insurance scheme. It might happen here one day on a much wider scale, and if it does, the law of negligence can be written off as a closed chapter - for good or ill - and liability insurance will be entitled to its own share of the credit - or the blame.