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*"My keenest interest is excited, not by what are called great questions and great cases, but by little decisions which the common run of selectors would pass by because they did not deal with the Constitution or a telephone company, yet which have in them the germ of some wider theory, and therefore of some profound interstitial change in the very tissue of the law."*—OLIVER WENDELL HOLMES, COLLECTED LEGAL PAPERS (1920) 269.

## Comments

### ADMISSIBILITY IN A STATE COURT OF EVIDENCE OBTAINED BY WIRE-TAPPING

In the recent case of *Schwartz v. Texas*,<sup>1</sup> an accomplice of the petitioner, after being in jail for about two weeks, consented to telephone the petitioner, and, with the accomplice's knowledge, a device was set up which enabled an operator to record the telephone conversation between the accomplice and the petitioner. The petitioner was convicted of a crime in Texas on the admission into evidence of the telephone conversation. A Texas statute<sup>2</sup> provided that evidence obtained in violation of the "Constitution of the United States" should not be admissible against the accused in

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1. *Schwartz v. Texas*, 97 L.Ed. 157, 73 Sup. Ct. 232 (1953).

2. *TEX. CODE CRIM. PROC.*, Art. 727a (Vernon's Tex. Stat. 1948).

a criminal case. The petitioner contended, *inter alia*, that Section 605 of the Federal Communication Act<sup>3</sup> prohibited the admissibility of the conversation into evidence. The Court of Criminal Appeals of Texas upheld the conviction,<sup>4</sup> and the United States Supreme Court, in an opinion by Mr. Justice Minton, affirmed the Texas Court. Mr. Justice Black concurred without opinion while Mr. Justice Frankfurter concurred in a separate opinion. Mr. Justice Douglas dissented.

For the first time the Supreme Court answers the question whether evidence secured by a state official in violation of Section 605 bars a state from using such evidence in a criminal trial.

At common law pertinent evidence, no matter how obtained, was admissible. Apparently the theory being that a court would not stop to inquire into collateral matter.<sup>5</sup> However, in *Boyd v. United States*,<sup>6</sup> by way of dictum, it was held that evidence obtained in violation of the Fourth Amendment should not be admissible at the trial.<sup>7</sup> In 1913, in *Weeks v. United States*,<sup>8</sup> the so-called federal rule was firmly established. In the *Weeks* case the doctrine was laid down that evidence secured by a search or seizure which was in violation of the Fourth Amendment, if a motion to suppress the evidence was made before trial, was inadmissible, for to admit the evidence would in effect nullify the value of the rights secured by the Amendment.

In *Burdeau v. McDowell*,<sup>9</sup> over a dissent by Mr. Justice Brandeis (in which Mr. Justice Holmes concurred), the Supreme Court held that, where a federal governmental officer did not have a hand in illegally obtaining the evidence, it could be admitted into evidence. This case was somewhat limited by *Byars v. United States*,<sup>10</sup> where a federal agent participated with the state officer in a wrongful search and seizure. The evidence was held to be inadmissible, for to allow the evidence "would be to disregard the plain spirit and purpose of the constitutional prohibitions intended to secure the people against the unauthorized official action."<sup>11</sup>

In 1928, in a five to four decision, the Court, in the *Olmstead* case,<sup>12</sup> through Mr. Chief Justice Taft, held that wire-tapping was not an illegal search within the Fourth Amendment.<sup>13</sup> The majority emphasized that the purpose of the Fourth Amendment, historically, was to protect a man against illegal searches of material things such as his home or papers, but that the Fourth Amendment was not meant to

3. 48 STAT. 1064 (1934), 47 U.S.C. §§ 151 *et. seq.* (Supp. 1946).

4. *Schwartz v. Texas*, 246 S.W. 2d 174 (Tex. Crim. App. 1952), *reh. den.* 246 S.W. 2d 179 (Tex. Crim. App. 1952).

5. 8 WIGMORE, EVIDENCE § 2183, p. 4 (3rd ed. 1940), and cases cited.

6. 116 U.S. 616, 29 L.Ed. 746, 6 Sup. Ct. 524 (1886).

7. Professor Wigmore severely criticizes *Boyd v. United States*, *supra* note 6, in 8 WIGMORE, *supra* note 5, § 2184, p. 31, stating that the case is ". . . incorrect in its historical assertion, and [travels] . . . outside the question at issue. . . ."

8. 232 U.S. 383, 58 L.Ed. 652, 34 Sup. Ct. 341 (1913).

9. 256 U.S. 465, 65 L.Ed. 1048, 41 Sup. Ct. 574, 13 A.L.R. 1159 (1921).

10. 273 U.S. 28, 71 L.Ed. 520, 47 Sup. Ct. 248 (1927).

11. *Id.* at p. 33.

12. 277 U.S. 438, 72 L.Ed. 944, 48 Sup. Ct. 564, 66 A.L.R. 376 (1928).

13. The decision is criticized by Robert L. Howard, *Admissibility of Evidence*

protect a person against the gathering of evidence by sight or by hearing. Justice Holmes, Brandeis, and Butler wrote dissents. Holmes stated that the government should not use evidence obtained by a criminal act.<sup>14</sup> Brandeis felt that the Fourth and Fifth Amendments should be interpreted more broadly than the strict meaning given by Mr. Justice Taft. Thus, even though a federal agent violated a state law, the evidence was admissible so long as it did not violate a federal constitutional guarantee. "It is possible that the Court in the *Olmstead* case decided the issue in favor of constitutionality in order to permit Congress to regulate wire tapping or outlaw it in accordance with the rise or ebb of the crime wave."<sup>15</sup>

Perhaps in answer to the *Olmstead* case,<sup>16</sup> Congress, in 1934, enacted Section 605, which reads in part: ". . . and no person not being authorized by the sender shall intercept any communication and divulge or publish the existence, content, substance, purport, effect, or meaning of such intercepted communication to any person. . . ."

The words "no person" in Section 605 were construed in the first *Nardone* case<sup>17</sup> to include federal agents. The effect of this decision would seem to be that Section 605 prohibits all persons, including state officers, from doing what is specifically prohibited in the act, not only in criminal cases, but in all proceedings at any level.<sup>18</sup> The second *Nardone* case<sup>19</sup> broadened the effect of Section 605 by holding that information indirectly secured from tapped messages was forbidden, and, in 1939, the Court held that it was immaterial whether the message was interstate or intrastate.<sup>20</sup> However, in *Goldstein v. United States*,<sup>21</sup> in a five to four decision, evidence was allowed on the theory that the defendant, not being a party to the intercepted messages, could not object to its use. This holding would seem to be somewhat inconsistent with the second *Nardone* case, *supra*. Section 605 was construed in *Goldman v. United States*<sup>22</sup> to apply only to messages in the course of transmission, and hence it did not apply to a dictaphone (a device used in the adjoining room to amplify sound in the other room), or to such other apparatuses which did not directly intercept the messages.

In the recent case of *On Lee v. United States*,<sup>23</sup> an acquaintance of the petitioner entered the living quarters of the petitioner carrying a concealed transmitter. The subsequent conversation was broadcast to a federal narcotics agent stationed outside with a receiving set. The Court in a five to four decision held the evidence admissible. The majority reasserted the doctrines of the *Goldman* and the *Olmstead* cases.

14. The evidence was obtained in violation of a Washington Statute: PIERCE'S CODE § 1876 (18) (1921).

15. Rosenzweig, *The Law of Wire Tapping*, 32 CORN. L. Q. 514, 531, 33 CORN. L. Q. 73 (1948). To the same effect, see GREENAN, WIRE TAPPING, ITS RELATION TO CIVIL LIBERTIES p. 30 (1938).

16. But see Note, 53 HARV. L. REV. 863 (1940).

17. 302 U.S. 379, 83 L.Ed. 314, 58 Sup. Ct. 275 (1937).

18. GREENAN, *supra* note 15, at p. 33.

19. 308 U.S., 338, 84 L.Ed. 307, 60 Sup. Ct. 266 (1939).

20. *United States v. Weiss*, 308 U.S. 21, 84 L.Ed. 298, 60 Sup. Ct. 268 (1939).

21. 316 U.S. 114, 86 L.Ed. 1312, 62 Sup. Ct. 1000 (1942).

22. 316 U.S. 129, 86 L.Ed. 1322, 62 Sup. Ct. 993 (1942).

23. 343 U.S. 747, 96 L.Ed. 770, 72 Sup. Ct. 967 (1952).

The dissent in the lower court<sup>24</sup> expressed the belief that there was a violation of the Fourth Amendment, and, in addition, under *McNabb v. United States*<sup>25</sup> and *Anderson v. United States*,<sup>26</sup> which were to the effect that federal courts will not receive evidence obtained in violation of federal or state laws, the evidence should have been excluded. But the majority in the Supreme Court pointed out that there was no violation of a federal law, and, even if there had been a violation of a state law, the evidence would nevertheless be admissible under the *Olmstead* case. There was no reference to the *Anderson* case.

In the instant case (the *Schwartz* case), the Texas statute<sup>27</sup> provided that evidence obtained in violation of the Constitution of the United States was inadmissible. The act had previously read that evidence obtained in violation of the constitution or laws of Texas or of the United States was inadmissible.<sup>28</sup> Mr. Justice Frankfurter in his concurring opinion stated that, although he thought that evidence obtained by the method adopted in the *Schwartz* case was in violation of the United States Constitution, within the meaning of the Texas statute, the Texas Court was bound to follow the previous decisions of the Supreme Court, which were to the effect that there was no constitutional violation. Mr. Justice Douglas in his dissent said that, although prior decisions of the Supreme Court point to affirmance of the Texas Court below, it was his opinion that there was a violation of the Fourth Amendment, but, since Texas had the statute, it would not be necessary to decide whether the Fourth Amendment applied to the states.<sup>29</sup> He stated that he could not "remain silent and bow to the precedents that sanction" such practices as allowed in the present case. Mr. Justice Douglas did not discuss Section 605, but Mr. Justice Frankfurter indicated that he agreed with the majority that Section 605 did not apply to exclude the evidence in this case.

Although the majority concedes that the introduction of the intercepted messages would be a violation of 605, Mr. Justice Minton states that the fact that there is a violation of a federal statute, ". . . in the absence of an expression by Congress, (is) . . . simply an additional factor for a state to consider in formulating a rule of evidence for use in its own courts."<sup>30</sup> The Court then cited several state court decisions which hold that Section 605 does not apply to prohibit state courts from using such communications as evidence.<sup>31</sup> Perhaps the strongest argument

24. 193 F. 2d 306, 318 (2d Cir. 1951).

25. 318 U.S. 332, 87 L.Ed. 819, 63 Sup. Ct. 608 (1942).

26. 318 U.S. 350, 87 L.Ed. 829, 63 Sup. Ct. 599 (1942).

27. *Supra*, note 2.

28. Tex. Laws, 1935, Ch. 49, § 1.

29. See *Wolf v. Colorado*, 338 U.S. 25, 93 L.Ed. 1782, 69 Sup. Ct. 1359 (1949); *Palko v. Connecticut*, 302 U.S. 319, 82 L.Ed. 288, 58 Sup. Ct. 149 (1937); *Twining v. New Jersey*, 211 U.S. 78, 53 L.Ed. 97, 29 Sup. Ct. 14 (1908); *Rowan v. State*, 175 Md. 547, 3 A. 2d 753 (1939).

30. *Supra* note 1, at p. 160, and at p. 234.

31. *Leon v. State*, 180 Md. 279, 23 A. 2d 706 (1942); *People v. Stemmer*, 298 N.Y. 728, 83 N.E. 2d 141 (1948); *Harlem Check Cashing Corp. v. Bell*, 296 N.Y. 15, 68 N.E. 2d 854 (1946); *People v. Channel*, 107 Cal. App. 2d 192, 236 P. 2d 654 (1951).

the court makes may be summed up in one of its sentences: "If Congress is authorized to act in a field, it should manifest its intention clearly."<sup>32</sup>

In speculating, prior to the instant case, as to the possibility of Section 605 excluding from state court trials evidence obtained in violation of the section, one writer<sup>33</sup> stated there were two factors which would leave room for interpreting Section 605 differently than was done in the instant case: (1) The broad terms of the statute would seem to indicate that it would apply to all witnesses, including those in state courts, and (2) that since the bulk of criminal prosecutions are in state courts, the effect of Section 605 as a protection against invasion of privacy would be greatly diminished if such evidence was allowed.<sup>34</sup> The writer then went on to point out that although it may be argued Congress cannot validly impose a restraint on the procedure in a state court, federal laws have done so in certain instances.<sup>35</sup>

However, the important point of the instant case is not what the Supreme Court could have decided, but what it did decide. What could be the possible effect of this decision? Prior to this decision there may have been some caution on the part of state officials in tapping wires for fear of violating Section 605, although there does not seem to be any prosecutions *in the cases* of state officers under that law. Now the officials have a clear field. State officers in those jurisdictions where there is no effective statutory prohibition, can go the full way in this "dirty business" knowing that the court, fortified by the present decision, will accept the evidence to convict the man they are after.

Of course, states are free, in interpreting their search and seizure amendment,<sup>36</sup> to rule contrary to the *Olmstead* case, and hold wire-tapping unconstitutional. In Missouri, and in many other states, such a ruling would have the effect of keeping the information out of evidence,<sup>37</sup> although prior to the *Weeks* case, Missouri followed the common law view of the admissibility of evidence.<sup>38</sup> That a state court would rule contra to the *Olmstead* case, however, seems doubtful, especially since wire-tapping in certain cases has been effective in "trapping" criminals.<sup>39</sup> To declare it unconstitutional would mean that it could not be used at all under any circumstances.

It is unquestionable that there is a serious interference with the right of

32. *Supra* note 30.

33. Rosenzweig, *supra* note 15.

34. See *supra* note 16.

35. *Supra* note 15, at page 79, where it is pointed out that testimony in bankruptcy proceedings cannot be used in subsequent criminal trial, and further that a state court could not compel a federal agent to divulge official information in violation of a treasury regulation prohibiting such divulgence.

36. In Missouri the constitutional provision is Art. I, § 15. All states now have a similar constitutional provision.

37. *State v. Wilkerson*, 349 Mo. 205, 159 S.W. 2d 794 (1942); *State v. Owens*, 302 Mo. 348, 259 S.W. 100 (1924); *People v. Castree*, 311 Ill. 392, 143 N.E. 112 (1924); *State v. Gooder*, 57 S.D. 619, 234 N.W. 610 (1930); for the rules followed in the various states see Appendix to *Wolf v. Colorado*, *supra* note 29.

38. *State v. Pomeroy*, 130 Mo. 489, 497, 32 S.W. 1002 (1895).

39. See *supra* note 16.

privacy when one, without apparent effective hindrance (and even perhaps in cases where there may be a hindrance), may intercept another's communications. It is arguable that wire-tapping is an effective (and thus desirable) means of catching certain types of criminals and of thwarting crime. But is this sufficient to allow its indiscriminate use by police officials? Heed should be given to Mr. Justice Brandeis's words in his dissent in the *Olmstead* case: "The progress of science in furnishing the Government with means of espionage is not likely to stop with wire-tapping. Ways may some day be developed by which the Government, without removing papers from secret drawers, can reproduce them in court, and by which it will be enabled to expose to a jury the most intimate occurrences of the home."<sup>40</sup> The words of Mr. Justice Frankfurter in his dissent in the *On Lee* case<sup>41</sup> should also be in our thoughts: "Of course criminal prosecution is more than a game. But in any event it should not be deemed to be a dirty game in which the 'dirty business' of criminals is outwitted by 'the dirty business' of law officers. The contrast between morality professed by society and immorality practiced on its behalf makes for contempt of law. Respect for law cannot be turned off and on as though it were a hotwater faucet."<sup>42</sup>

As long as it seems that wire-tapping will not be declared unconstitutional, and as long as it seems that Section 605 will not be applied to the states, what is to be done? States must take action to protect the basic rights of their citizens.

New York was the first state to attempt a solution by providing for supervised wire-tapping.<sup>43</sup> Its statute provides for ex parte orders by the court, where there is sufficient grounds, to an officer to tap the wires. However, since New York follows the common law rule as to the admissibility of evidence,<sup>44</sup> the act is notoriously deficient in that it does not provide that evidence obtained without adhering to the terms of the act would be disallowed in a trial. There was a bill before the Missouri Legislature<sup>45</sup> patterned to a degree after the New York act. However, the Missouri bill would have made the interception of messages a felony with a maximum penalty of five years imprisonment and a fine of not more than one thousand dollars; it would also have allowed recovery of the sum of one thousand dollars from the violator by the person whose communications were illegally intercepted, this amount to have been in addition to any actual damage which may have been proved in a civil trial. The bill might have been further strengthened, perhaps, by affirmatively providing that the evidence obtained in violation of the act be excluded from a trial, and that the forfeiture of the thousand dollars be not dependent upon prior conviction of the defendant in a criminal proceeding.

However, on March 10, 1953, the Committee on Criminal Jurisprudence recommended a substitute bill, Senate Bill 198 (which now seems destined to die). The

40. *Supra* note 12, at p. 474.

41. *Supra* note 23.

42. At pages 758-759 of the official report.

43. N. Y. CODE CRIM. PROCED. § 813-a (1942).

44. *People v. Defore*, 242 N.Y. 13, 150 N.D. 585 (1926).

45. S.B. No. 198, 67th General Assembly (1953), read for the first time

substitute bill provides that "It shall be unlawful for any person to intercept or direct the interception of any telegraphic or telephonic communication within this state." The sanctions are the same as was provided in the original Senate Bill 198, but it further states that "Any evidence obtained in violation of this act will not be admissible in evidence in any cause whatsoever." This provision carries out the suggestion above and restates the present Missouri law. However, it is not clear whether the recovery of the one thousand dollars by the party whose message was intercepted is dependent upon a prior criminal conviction.<sup>46</sup>

The difficulty of completely outlawing wire-tapping may arise in the enforcement of the provision. For instance, a law enforcement officer may find it impossible to obtain the proper evidence to convict a person who he is certain is violating a law. The officer, notwithstanding the act, may use wire-tapping, relying upon his friendship and association with the prosecuting attorney to prevent prosecution. A prosecutor would tend to be more sympathetic and understanding with the officer's position where no method was available than where there was a lawful provision which was violated by the officer.<sup>47</sup> The question may then be: Is it more desirable to have a limited lawfully supervised method or a prohibition which might in certain instances be effectively circumvented? Of course, even where a limited provision is available, there would be no insurance that an officer would not first tap the wires to get some evidence, and then apply to the court for the *ex parte* order, and at the trial only use the evidence obtained after the order issued. However, it may be that the Senate Committee substitute for Senate Bill 198, by providing the sanctions outlined above, will effectively deter any officer from being tempted to violate the act.

Thus three courses are available to settle, or at least to clarify, the wire-tapping problem within the states: (1) permit indiscriminate wire-tapping and allow evidence to be admitted at the trial; (2) completely prohibit wire-tapping, with effective sanctions against violators, including the disallowance of the evidence at a trial; (3) supervise wire-tapping along the lines of the New York act or the original Senate Bill 198. Few, if any, would advocate the first course, but arguments can be made for either the second or third.<sup>48</sup>

If one is of the opinion that a state's hands should not be tied in seeking out criminals, then the solution is supervised wire-tapping. One, however, who would rather see some criminals go free than have one person's privacy invaded would advocate complete prohibition of wire-tapping. The course to be followed is for the legislature to determine.

BERNARD SILVERMAN

46. For a classification of the statutes which the various states have enacted on wire-tapping and communications see Rosenzweig, *supra* note 15, pp. 73 *et. seq.* (footnotes 174 through 186 inclusive). From a cursory glance at some of the statutes, it seems that Substitute Senate Bill 198 (67 Mo. Ge. Assembly) provides the most effective sanctions.

47. No prosecutions of law enforcements officers have been found under Section 605 nor under Section 501 (which provides the penalty for violation of Section 605).

48. For the arguments which may be made for each position see Rosenzweig, *supra* note 15, pp. 90-98.

## LIABILITY INSURER'S UNREASONABLE REFUSAL TO SETTLE CLAIM

In the recent case of *Zumwalt v. Utilities Insurance Co.*<sup>1</sup> the assured, plaintiffs in this action, were defendants in a prior suit by B who was injured as a result of the assured's negligence. This first suit was for \$40,000 damages, and the assured was insured to the extent of \$10,000. B offered to settle first for \$8,500 and later for \$6,500, both sums less than the face amount of the policy. The insurer offered to settle for \$4,500. It did not offer more because the second \$5,000 was reinsured and the reinsurers apparently would not pay anything. The insurer told the assured that if the assured would pay \$2,500 the case could be settled. There was testimony that the insurer thought the case could be won. The first case was tried and B secured a judgment for \$15,000.<sup>2</sup> The assured was allowed in the later action to recover from the insurer the entire amount of the judgment on the ground of the insurer's bad faith in refusing to settle the claim.

The court discussed two possible actions which an assured may have against its liability or indemnity insurer for refusing to settle a claim. First, a tort action against the insurer for failing to settle a claim within the policy limit when by reason of such failure the assured becomes liable to the claimant for an amount in excess of the policy. Second, an action upon the contract of insurance for a loss suffered by the assured which the insurer refuses to pay. Ordinarily there is no action on the contract itself for the insurer's refusal to settle with a third person.<sup>3</sup>

## I. TORT THEORY OF RECOVERY

Settlements of claims are of two types: either the assured settles with claimant or insurer settles with claimant who may be the assured or a third person to whom assured has become liable. Usually a liability or indemnity policy reserves to the insurer the exclusive right to settle any claim against the assured. Settlement by the assured without prior consent of the insurer releases the latter from liability on the policy.<sup>4</sup> Thus, the insurer has the sole right, but not necessarily a duty, to settle claims asserted against the assured.<sup>5</sup> "The mere refusal of an insurer to settle a claim for an amount within the policy limits does not, of itself, render the insurer liable for the amount by which a subsequent judgment exceeds the policy limits."<sup>6</sup>

1. 360 Mo., 362, 228 S.W. 2d 750 (1950).

2. Burneson v. Zumwalt Co., 349 Mo. 94, 159 S.W. 2d 605 (1942).

3. Best Building Co. v. Employer's Liability Assur. Corp., 247 N.Y. 451, 160 N.E. 911, 71 A.L.R. 1464 (1928); Note, 3 Miss. L. J. 334 (1931); Note, 34 A.L.R. 750 (1925), supplemented in 37 A.L.R. 1484 (1925), 43 A.L.R. 329 (1926), 71 A.L.R. 1486 (1931), 131 A.L.R. 1500 (1941).

4. Thacher v. Aetna Accident and Liability Co. of Hartford, Conn., 287 Fed. 484, 28 A.L.R. 1280 (8th Cir. 1923); 8 APPLEMAN, INSURANCE LAW AND PRACTICE § 4714 (1942).

5. City of Wakefield v. Globe Indemnity Co., 246 Mich. 645, 225 N.W. 643 (1929); Auerbach v. Maryland Casualty Co., 236 N.Y. 247, 140 N.E. 577, 28 A.L.R. 1284 (1923). The insurer may not settle for more than the policy limit and bind the assured without assured's consent. 8 APPLEMAN, INSURANCE LAW AND PRACTICE § 4711 (1942).

6. *Id.*, 8 APPLEMAN, INSURANCE LAW AND PRACTICE § 4711 (1942).

As the assured may settle with a claimant as to the amount of a claim which exceeds the policy,<sup>7</sup> it can be argued that the assured should not be allowed any tort action against the insurer in the event of the insurer's refusal to settle. Certainly no such action should be permitted where the insurer's refusal or failure to settle is a result of an honest belief that the assured was not liable or that the settlement would be greatly in excess of recoverable damages.<sup>8</sup> If the settlement is close to the limit of liability of the insurer, it may refuse to settle, taking a chance on not having to pay anything by successfully defending the suit, or at least having to pay but little more than the settlement. Though it has been said that the insurer has an option whether to settle, courts generally impose some sort of obligation on the insurer to attempt to settle the claim. If the assured can show the insurer to be guilty of negligence or bad faith, the insurer may be held liable for the entire amount of the judgment against assured. Courts are split as to whether negligence or bad faith is the proper rule in determining the insurer's liability. Some courts say that the insurer does owe a duty to the assured and that the insurer may breach such duty by negligence.<sup>9</sup> It has been said that ". . . a good faith decision on the part of the insurance company upon the question of settlement must be preceded by the exercise of that degree of care and diligence which a man of ordinary care and prudence would exercise in the investigation and adjustment of claims. . . ."<sup>10</sup>

Courts which will not allow recovery due to mere negligence of the insurer will generally allow recovery if the assured can show the insurer guilty of bad faith.<sup>11</sup> Many courts have insisted that the rule of bad faith is the better rule.<sup>12</sup> Which rule is the majority rule is doubtful,<sup>13</sup> but Missouri clearly adopted the bad faith rule in the instant case.<sup>14</sup> The court, speaking through Tipton, J., said,

"We have reviewed many authorities on the question and think the weight of authority is that where the insurer in a liability policy reserves the exclusive right to contest or settle any claim brought against the assured, and prohibits him from voluntarily assuming any liability or settling any claims without the insurer's consent, except at his own costs, and the provisions of the policy provide that the insurer may compromise or settle

7. *General Accident, Fire & Life Assur. Corp. v. Louisville Home Telephone Co.*, 175 Ky. 96, 193 S.W. 1031, 1917D L.R.A. 952 (1917).

8. *Mendota Electric Co. v. N.Y. Indemnity Co.*, 169 Minn. 377, 211 N.W. 317 (1926), *subsequent appeal* in 175 Minn. 181, 221 N.W. 61 (1928).

9. *Douglas v. U.S. Fidelity & Guaranty Co.*, 81 N.H. 384, 127 Atl. 708, 37 A.L.R. 1477 (1924). See cases in note 30, 8 APPLEMAN, INSURANCE LAW AND PRACTICE § 4713 (1942); Note, 30 B.U.L. REV. 550 (1950); Note, 18 B.U.L. REV. 235 (1938); Comment, 40 YALE L.J. 979 (1931); Note, 34 A.L.R. 750 to 758 (1925), n. 3, *supra*.

10. *Hilker v. Western Automobile Ins. Co. of Ft. Scott, Kansas*, 204 Wis. 1, 235 N.W. 413 (1931).

11. Per Fead, J., writing minority opinion in *Wakefield v. Globe Indemnity Co.*, 246 Mich. 645, 225 N.W. 643 (1929); *McCombs v. Fidelity & Casualty Co. of N.Y.*, 231 Mo. App. 1206, 89 S.W. 2d 114 (1935).

12. *Best Building Co. v. Employer's Liability Assur. Corp.*, 247 N.Y. 451, 160 N.E. 911, 71 A.L.R. 1464 (1928).

13. 8 APPLEMAN, INSURANCE LAW AND PRACTICE §§ 4712, 4713 (1942); 30 B.U.L. REV. 550 (1950); 3 MISS. L. J. 334 (1931).

14. Citing *McCombs v. Fidelity & Casualty Co. of N.Y.*, 231 Mo. App.

such a claim within the policy limits, no action will lie against the insurer for the amount of the judgment recovered against the insured in excess of the policy limits, unless the insurer is guilty of fraud or bad faith in refusing to settle a claim within the limits of the policy. There are cases that hold that the insured is entitled to recover upon proof that the insurer in refusing to settle a claim for damages was guilty of negligence. But this test is rejected in the better reasoned cases and we think rightly so.<sup>15</sup>

Courts which purport to follow the negligence rule tend to define negligence in terms of or used in connection with bad faith.<sup>16</sup> Courts which are supposed to adhere to the bad faith rule often speak of insurer's *duty* to consider settlement without bad faith.<sup>17</sup> The difference between the two theories may be slight as to result obtained.

## II. CONTRACT THEORY OF RECOVERY

As recognized in the opinion in the instant case,<sup>18</sup> recovery against the insurer may be upon a contract theory only in the situation of the assured suffering a loss and the insurer refusing to pay the assured. The assured, may, of course, sue the insurer on the contract of liability or indemnity insurance upon proof of a valid claim for the amount owed to the assured. At Common Law, no damages above legal interest were recoverable though the insurer withheld money due the assured.<sup>19</sup> However, Missouri has had for many years a statute which allows the assured to collect up to an additional ten per cent of the loss plus reasonable attorney's fees if he can show that the insurer "vexatiously" refused payment.<sup>20</sup>

15. 360 Mo. 362 at 370, 228 S.W. 2d 750 at 753 (1950).

16. *Hilker v. Western Automobile Ins. Co.*, *supra*, n. 10.

17. *Maryland Casualty Co. v. Cook-O'Brien Const. Co.*, 69 F. 2d 462 at 464 (8th Cir. 1934) ("a duty owing to the insured to exercise skill and care and good faith to the end of saving the insured harmless"); *Boling v. New Amsterdam Casualty Co.*, 173 Okla. 160 (1935) ("an abandonment of this duty to act subsequent to its assumption in part constituted bad faith.").

18. 360 Mo. 362 at 373, 228 S.W. 2d 750 at 756 (1950).

19. *New Orleans Ins. Co. v. Piaggio*, 16 Wall. (83 U.S.) 378, 21 L.Ed. 358 (1873). See 6 APPLEMAN, INSURANCE LAW AND PRACTICE c. 172, on right to recover interest.

20. MO. REV. STAT. § 375.420 (1949). Damages in addition to claim. "In any action against any insurance company to recover the amount of any loss under a policy of fire, cyclone, lightning, life, health, accident, employers' liability, burglary, theft, embezzlement, fidelity, indemnity, marine or other insurance, if it appear from the evidence that such company has vexatiously refused to pay such loss, the court or jury may, in addition to the amount thereof and interest, allow the plaintiff damages not to exceed ten per cent on the amount of the loss and a reasonable attorney's fee; and the court shall enter judgment for the aggregate sum found in the verdict." From G.S. 1865, p. 402, § 1; Laws 1899, p. 254; Laws 1911, p. 282. MO. REV. STAT. ANN. § 375.420 (1949) (historical note). Missouri Laws, 1951, p. 280, extend these provisions to insurers not licensed to do business within the state, as follows: "In any action, suit or other proceeding instituted against any insurance company, association or other insurer upon any contract of insurance issued or delivered in this state to a resident of this state, or to a corporation incorporated in or authorized to do business in this state, if such insurer has failed or refused for a period of thirty days after due demand therefor prior to the institution of such action, suit or other proceeding, to make payment under and in accordance

The instant case holds that this applies only to actions based on the contract of insurance. As only the assured can suffer a loss under the policy, it is "applicable only to a suit by a policy holder against his insurer."<sup>21</sup> "The obvious purpose of the statute . . . is to correct the evil of an arbitrary refusal for the sole purpose of delaying the plaintiff in collection of his claim . . ."<sup>22</sup>

Compromise and settlement are involved under this statute only in instances of the insurer's vexatious refusal to settle with the *assured* as to amount of loss<sup>23</sup> or where the insurer refuses to pay the beneficiary of a life insurance policy for reasons considered by the court as not necessarily those of good faith.<sup>24</sup>

It is frequently emphasized that the statute is highly penal and must be strictly construed,<sup>25</sup> and it has not been construed to include all insurance companies.<sup>26</sup> Neither are all types of insurance included.<sup>27</sup>

"The word 'Vexatiously,' as used in the insurance statute, has often been

with the terms and provisions of such contract of insurance, and it shall appear from the evidence that such refusal was vexatious and without reasonable cause, the court or jury may, in addition to the amount due under the provisions of said contract of insurance and interest thereon, allow the plaintiff damages for such vexatious refusal to pay and attorneys fees as provided in section 375.420. Failure of an insurer to appear and defend any such action, suit or other proceeding shall be deemed prima facie evidence that its failure to make payment was vexatious and without reasonable cause." Mo. REV. STAT. ANN. § 375.168 (1949). The following section makes some exceptions of types of insurance. See generally 6 APPLEMAN, INSURANCE LAW AND PRACTICE c. 173, Damages for Refusal of Payment.

21. *Corder v. Morgan Roofing Co.*, 355 Mo. 127, 195 S.W. 2d 441 (1946).

22. *Boulogny v. Metropolitan Life Ins. Co.*, 179 S.W. 2d 109 at 112 (Mo. App. 1944).

23. *Patterson v. American Ins. Co. of Newark, N.J.*, 174 Mo. App. 37, 160 S.W. 59 (1913).

24. *Friedman v. State Mutual Life Assur. Co. of Worcester, Mass.*, 108 S.W. 2d 156 (Mo. App. 1937); *Butler v. Missouri Ins. Co.*, 187 S.W. 2d 56 (Mo. App. 1945).

25. *Aufrichtig v. Columbian Nat. Life Ins. Co.*, 298 Mo. 1, 249 S.W. 912 (1923); *Mears Mining Co. v. Maryland Casualty Co.*, 162 Mo. App. 178, 144 S.W. 883 (1912); *Miller v. Fireman's Ins. Co.*, 206 Mo. App. 475, 229 S.W. 261 (1921); *Mangelsdorf v. Penn. Fire Ins. Co.*, 224 Mo. App. 265, 26 S.W. 2d 818 (1930).

26. *Sappington v. St. Joseph Town Mutual Fire Ins. Co.*, 77 Mo. App. 270 (1898) (holding that this section did not apply to a town mutual fire insurance company); *Olsen v. Supreme Council of Royal Arcanum*, 205 Mo. App. 260, 224 S.W. 129 (1920) (holding a fraternal benefit society not liable under this section); *Schmidt v. Central Mutual Ins. Ass'n.*, 153 S.W. 2d 99 (Mo. App. 1941) (holding a mutual assessment insurance company is exempt. (See also Mo. REV. STAT. § 379.310 (1949))).

27. *Mears Mining Co. v. Maryland Casualty Co.*, *supra* n. 25, held that prior to amendment, this section did not include indemnity insurance. *Sprinkler leakage insurance* was not included, *Mangelsdorf v. Penn. Fire Ins. Co.*, *supra* n. 25; nor was a supersedeas bond, *Grover v. Aetna Accident & Liability Co.*, 200 S.W. 441 (Mo. App. 1918). A bond that indemnified school district for damages arising from contractor's default was held to be within the statute, *Camdenton Consol. School Dist. No. 6 of Camden County ex rel. W. H. Powell Lumber Co. v. N. Y. Casualty Co.*, 340 Mo. 1070, 104 S.W. 2d 319 (1937). This was based on an earlier case that held a corporation licensed and doing a bonding business for profit and bond executed by that company as surety to be within the statute, *State ex rel. Elberta Peach and Land Co. v. Chicago Bonding & Surety Co.*, 279 Mo. 535, 215 S.W. 20 (1919).

defined by the decisious of this court, and has come to have an established meaning, viz., without reasonable, or probable, cause or excuse."<sup>28</sup> Whether the insurer has been guilty of vexatious refusal to pay is usually regarded as a question of fact to be determined by the jury.<sup>29</sup>

It is frequently added that the vexatious delay must occur before trial and must be judged by the facts as they appeared to the insurer before the trial.<sup>30</sup> Of course, the insurer is not necessarily liable for the penalties merely because the judgment is for the assured. If the statute applied automatically, it would be unconstitutional "for it is only on the fundamental ground of a vexatious refusal to pay that the penalty can be upheld."<sup>31</sup> The insurer is allowed certain defenses to show itself not guilty of vexatious delay. The basic defense is the insurer's belief that it had a valid defense to the claim of the assured.<sup>32</sup>

The insurer is not liable for vexatious delay if there is reasonable doubt of the validity of the claim,<sup>33</sup> or a serious question as to method of arriving at the cash value of the property,<sup>34</sup> or the question of law involved in the construction of the policy is an open question.<sup>35</sup> However, there are decisions that "the mere

28. *Block v. U.S. Fidelity & Guaranty Co.*, 316 Mo. 278 at 305, 290 S.W. 429 at 441 (1926) (*en banc*). Similar definitions are found in other decisions such as "willful and without reasonable cause," *Bouligny v. Metropolitan Life Ins. Co.*, *supra* n. 22; *Bonzon v. Metropolitan Life Ins. Co.*, 143 S.W. 2d 336 (Mo. App. 1940); *Tranham v. Home Ins. Co. of N.Y.*, 137 S.W. 2d 690 (Mo. App. 1940).

29. *Brown v. Railway Passenger Assurance Co.*, 45 Mo. 221 (1870).

30. *Bouligny v. Metropolitan Life Ins. Co.*, *supra* n. 22; *Buffalo Ins. Co. v. Bommarito*, 42 F. 2d 53 (8th Cir. 1930), 70 A.L.R. 1211.

31. *Non-Royalty Shoe Co. v. Phoenix Assur. Co., Ltd. of London, England*, 277 Mo. 399, 210 S.W. 37 (1918).

32. *New York Life Ins. Co. v. Calhoun*, 114 F. 2d 526, 536 (8th Cir. 1940), *cert. denied* 61 Sup. Ct. 141, 85 L.Ed. 455 (1940) summarized nine principles in connection with this statute: (The first six are credited to *Non-Royalty Shoe Co. v. Phoenix Assurance Company*) "(1) The refusal must be vexatious. (2) The defendant is to be allowed an honest difference of opinion as to its liability. (3) The defendant is to be allowed to litigate that difference. (4) (Unless the foregoing latitude of action be allowed to the defendant, the statute would be unconstitutional.) (5) No penalty can be inflicted unless the evidence shows two things: First, that the refusal was willful and, secondly, that it was without reasonable cause; and these things must appear to a reasonable and prudent man before the trial. (6) The adverse outcome of a trial is no reason for inflicting the penalty. In *Aufrichtig v. Columbia National Life Ins. Co.*, 298 Mo. 1, 249 S.W. 912 (1923), the Supreme Court added the following principle: (7) If the insurance company acts in good faith it may contest an issue of either fact or law without the danger of penalties. This further principle is announced in *State ex rel. Continental Life Ins. Co. v. Allen*, 303 Mo. 608, 262 S.W. 43 [1924] (8) The right to resist payment is, primarily, a question of law to be determined by the facts as they reasonably appeared before trial, and not as they may have been found by the jury. Later, the following principle was announced in *State ex rel. Gott v. Fidelity & Deposit Co.*, 317 Mo. 1078, *loc. cit.* 1095, 298 S.W. 83 [1927]. (9) Where the legal question involved is one about which lawyers might well differ, there can be no vexatious delay. See, also, *Camdenton Consol. School Dist. No. 6 v. New York Casualty Co.*, 340 Mo. 1070, 104 S.W. 2d 319 [1937]."

33. *Patterson v. American Ins. Co.*, *supra* n. 23.

34. *Sun. Ins. Office, Ltd. v. Rupp*; *Rupp v. Sun Ins. Office, Ltd.*, 64 F. Supp. 533 (W.D. Mo. 1946).

35. *Mound City Roofing Tile Co. v. Springfield Fire & Marine Ins. Co.*, 218 Mo. App. 395, 277 S.W. 349 (1925).

presence of a real law question in the record will not of itself exculpate the defendant from a charge of wilful obstruction if there is evidence that its attitude was vexatious and recalcitrant."<sup>36</sup> Thus it would seem that clear evidence of the insurer's bad faith may constitute vexatious refusal to pay even though the insurer regarded the matter as an unsettled question of law. Denial of liability without stating any ground for denial has been deemed sufficient evidence to warrant submission of vexatious refusal to the jury.<sup>37</sup>

The plaintiff has the burden of proof of the insurer's vexatious refusal to pay loss.<sup>38</sup> However, as to the degree of proof, it is stated that "direct and positive evidence of insurer's vexatious refusal to pay is not required"<sup>39</sup> or that formal affirmative proof is not required.<sup>40</sup> In addition to deciding whether the insurer has been guilty of a vexatious refusal to pay loss, the jury decides the amount of the assured's attorney's fees (if vexatious delay is found) for which testimony as to the reasonable value of services is admissible.<sup>41</sup> Award by the jury of ten per cent damages on interest allowed on the assured's actual loss was improper.<sup>42</sup> The penalty is, of course, on the amount of loss, not the amount of policy coverage.<sup>43</sup>

R. W. LILLARD

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36. *Lemay Ferry Bank v. New Amsterdam Casualty Co.*, 347 Mo. 793, 802, 149 S.W. 2d 328, 331 (1941), citing *Non-Royalty Shoe Co. v. Phoenix Assur. Co.*, *supra* n. 33; *Fay v. Aetna Life Ins. Co.*, 268 Mo. 373, 388, 187 S.W. 861, 865 (1916); *Young v. Penn. Fire Ins. Co.*, 269 Mo. 1, 21, 187 S.W. 856, 861 (1916).

37. *Block v. U.S. Fidelity & Guaranty Co.*, note 28 *supra*; *Reed v. Prudential Ins. Co.*, 229 Mo. App. 90, 73 S.W. 2d 1027 (1934); *Bennett v. National Fire Ins. Co.*, 235 Mo. App. 720, 729, 143 S.W. 2d 479, 482 (1940).

38. *Concordia Fire Ins. Co. of Milwaukee v. Commercial Bank*, 39 F. 2d 826 (8th Cir. 1930); or insurer's bad faith, *Schaeffer v. Northern Assur. Co.*, 177 S.W. 2d 688 (Mo. App. 1944).

39. *Wiener v. Mutual Life Ins. Co. of N.Y.*, 61 F. Supp. 430 (E.D. Mo. 1945).

40. *Brown v. Railway Passenger Assur. Co.*, 45 Mo. 221 (1870); *Lockwood v. Atlantic Mutual Ins. Co.*, 47 Mo. 50 (1870); *Blackwell v. American Central Ins. Co.*, 80 Mo. App. 75 (1899).

41. *John v. Aetna Life Ins. Co. of Hartford, Conn.*, 100 S.W. 2d 936 (Mo. App. 1936). The amount of attorney's fees may exceed value of policy, *Buchholz v. Metropolitan Life Ins. Co.*, 177 Mo. App. 683, 160 S.W. 573 (1913). The jury may award an attorney's fee but refuse to award the ten per cent additional recovery though vexatious delay is found, *Evans v. Great Northern Life Ins. Co.*, 237 Mo. App. 317, 167 S.W. 2d 118 (1942).

42. *Gosnell v. Camden Fire Ins. Ass'n. of Camden, N.J.*, 109 S.W. 2d 59 (Mo. App. 1937); *Kyle v. Fidelity & Casualty Co. of N.Y.*, 244 S.W. 2d 418 (Mo. App. 1951).

43. *City of Aurora v. Fireman's Ins. Co.*, 180 Mo. App. 263, 165 S.W. 357 (1914).