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Reinsurance—The Third Party's Rights Against the Reinsurer

I. Introduction

Insurance has been said to be a system for wide distribution of fortuitous economic loss. As a part of that system, reinsurance provides a means for even wider distribution of the loss. When an insurer realizes that it has a great concentration of potential loss or liability exposure in one area, or where the loss or liability it wishes to insure against is larger than it can handle, the burden can be reduced by reinsuring. Among other things, the value of reinsurance in business life has been said to be the ability to share possible liability, the spreading of commitments, and the power or ability to accept large risks. There is a general agreement today that reinsurance is beneficial to the general public as well as the insurance companies.

Reinsurance has not been a prodigious source of legal writing. The rights of a third party against the reinsurer have been the subject of even less comment. The possible reasons for this seeming lack of interest are twofold. First, while the history of reinsurance may be traced back many years, it is a relatively new concept in this country. Second, the importance of reinsurance in our modern society has probably been overlooked. However, the present increased use of rei-

2. "Reinsurance" should be distinguished from arrangements often designated as "reinsurance" but which in fact are not. These include: (a) coinsurance, defined as a "relative division of risk between the insurer and the insured, dependent upon the relative amount of the policy and actual value of the property insured, and taking effect only when the actual loss is partial and less than the amount of the policy for a loss equal to or in excess of that amount," Black, Law Dictionary 326 (4th ed. 1951); (b) double insurance, said to exist "when a person who has already insured his property secures a second insurance upon the same property," Vance, Insurance 1067 (3d ed. 1951); and (c) substitution, which is the arrangement made when "so-called 'reinsurers' engage to take the place of the original insurer, and themselves directly to make good losses to the holders of the original policies." Vance, Insurance 1067 (3d ed. 1951).

For purposes of this comment, the following definition, given in Stickel v. Excess Ins. Co. of America, 136 Ohio St. 49, 23 N.E.2d 839, 841 (1939), will be used: "Reinsurance may be defined generally as a contract whereby one for a consideration agrees to indemnify another wholly or partially against loss or liability by reason of a risk the latter has assumed under a separate and distinct contract as insurer of a third party."

4. In this article the following terminology will be used unless the contrary is indicated. First, "policyholder" will be taken to mean the party to whom the policy was issued originally. Second, "injured party" will refer to the party who is injured by the policyholder and the person for whom the policyholder obtained liability insurance protection. Third, "reinsured" is the insurance company which originally issued a policy to the policyholder and the company which later reinsured that policy with the reinsurance company. Finally, "reinsurer" will refer to the reinsurance company itself.

5. Thompson, op. cit. supra note 3, at 32-40.
insurance, especially reinsurance of personal injury liability policies, has caused the problem of a third party's rights against the reinsurer to arise with increased frequency. It is the purpose of this comment to review the present law with regard to this problem, along with the law as it has developed in analogous areas.

II. THE THIRD PARTY'S RIGHTS AGAINST THE REINSURER: CASE LAW

A recent Missouri case set out the rule followed in most states, absent a statute, in regard to a third party's rights against the reinsurer:

An ordinary contract of reinsurance, in absence of provisions to the contrary, operates solely as between the reinsurer and the reinsured. It creates no privity between the original insured and the reinsurer. The contract of insurance and the contract of reinsurance are totally distinct and unconnected.

The basis for this general rule was early laid when it was said that the laws allowing reinsurance were for the benefit of the "whole company insured," and not for the benefit of individual policyholders. The theory is that the original policyholder or the person injured by such policyholder is not a party to the contract, and, because there is no privity, there can be no right of action, legal or equitable, which exists in favor of the third party against the reinsurer. The rule is not, however, without exceptions; these will be discussed in detail below.

A. Exceptions to the General Rule: Construction of the Policy

In a great many cases concerning the rights of a third party under a reinsurance contract, the following statement or its equivalent can be found:

It is true that typical reinsurance agreements do not operate in favor of the original insured. They are merely contracts of indemnity of the insurer and there is no privity of contract between the original insured and the reinsurer. But nothing in the law forbids drafting reinsurance agreements in special terms so that they will operate in favor of the original insured.

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7. O'Hare v. Pursell, 329 S.W.2d 614 (Mo. 1959).
8. Id. at 620. See generally 46 C.J.S. Insurance § 1232a (1946).
10. In all the cases where privity is said to be absent, such absence is held to be fatal to the third party's rights. This result is continually re-asserted without a definition as to what is meant by privity. At the least, it means that the third party is not a party to the contract, since that is the common factor in all the cases where there is said to be no privity. For purposes of this comment, lack of privity will be taken to mean that the third party is not a party to the contract.

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Thus, there is no condemnation of reinsurance contracts drawn to operate in favor of the third party. To the contrary, the courts have often found such "special terms" in reinsurance contracts.

Various provisions in reinsurance contracts have been construed to give the policyholder or injured party a direct action against the reinsurer.\(^{13}\) The more common provisions are those: (a) by which the reinsurer contracts with the reinsured to assume the policies and to pay the holders thereof all such sums as the reinsured may become liable to pay;\(^ {14}\) and (b) where the reinsurer agrees to take charge of and adjust all losses without expense to the reinsured, reserving the right to make changes in the policies reinsured.\(^ {15}\)

The Missouri Supreme Court is among those which have turned to the reinsurance contract to decide the question of the third party's rights against the reinsured. Thus, in the leading case of *Homan v. Employers Reinsurance Corp.*,\(^ {16}\) the court held that where the reinsurance contract was a contract of insurance against liability, as distinguished from a contract of indemnity against loss, a person who had recovered a judgment against the policyholder could maintain an action against the reinsurer after the reinsured became insolvent and could not satisfy the judgment against the policyholder. The court distinguished between contracts of indemnity against loss and insurance against liability, stating:

In the former [contracts of indemnity against loss] the insurance company does not become liable until loss has actually been suffered and the amount of the insurance does not become available until the assured has paid the loss, whereas in the latter case [contracts of insurance against liability] the obligation of the insurance company becomes fixed when the liability attaches to the insured.\(^ {17}\)

While this distinction is referred to throughout the case, the opinion does not make entirely clear whether a determination that a reinsurance contract was one

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Some courts have allowed recovery by a policyholder or injured person under what has erroneously been designated as a reinsurance contract. See, e.g., Coleman Mut. Life Ins. Ass'n v. Lasseter, 173 S.W.2d 321 (Tex. Civ. App. 1943) (one company transferred its business to another company and the transferee in consideration thereof reinsured the risks of the transferor and contracted to pay losses under the transferor's outstanding policies); Western Life Indem. Co. v. Bartlett, 145 N.E. 786 (Ind. App. 1924) (reinsurance agreement provided for issuance by reinsurer of new policies to the new policyholders with the policyholders agreeing); Fisher v. Hope Mut. Life Ins. Co., 69 N.Y. 161 (1877) (reinsurance agreement providing that the reinsuring company was to accept premiums from the policyholder and keep the policy alive). Such arrangements are consistently referred to as reinsurance but are not strict reinsurance contracts and will not be considered in this comment.

16. 136 S.W.2d 289 (Mo. 1939).

17. Id. at 296.
of insurance against liability would automatically give the third party the right to maintain an action against the reinsurer after the insolvency of the reinsured. The case has been said to stand for such a proposition. However, the opinion also asserts that "an insured may not bring an action at law against a reinsurer of the risk under a strict contract of reinsurance because there is no privity of contract between them." The court circumvented this rule by stating that because the reinsurance contract provided that each reinsurance should be "subject to" all terms and conditions of policies reinsured thereunder, the entire reinsurance contract created a personal obligation of the reinsurer to the original insured. Because the reinsurer had taken charge of and managed the defense of the suit against the original insured, the reinsurer was a "privy" to the action. This could be construed to mean that in addition to finding that the reinsurance contract was one of insurance against liability, the policyholder or injured party must show that there was privity between him and the reinsurer.

At least one court has held that both factors must be present. In Melco System v. Receivers of Trans-America Ins. Co., it was said that an "insolvency clause" converted what was otherwise a contract of indemnity against loss into a contract of insurance against liability. However, as to the third party's rights, the Alabama Supreme Court held that this was an ordinary reinsurance contract, which would be construed as setting up no privity between the reinsurer and the policyholder, and the fact that the policyholder might have relied upon a reinsurance rider would not entitle him or his judgment creditor to maintain an action directly against the reinsurer.

The possible conflict between the Missouri and Alabama cases mentioned above is made no clearer by other recent Missouri cases. In O'Hare v. Pursell, the Missouri Supreme Court was faced with the direct question of whether a finding that a reinsurance contract was an insurance against liability would, taken alone, be sufficient grounds for the third party to maintain an action against the reinsurer. The court avoided a straightforward holding and simply reasserted the principles of the Homan case, saying:

In fact, in any case where the contract of reinsurance is more than a mere contract of indemnity, and is made for the benefit of the policyholders of the reinsured, and by it the reinsurer assumes the liability of the latter upon its policies, the liability of the reinsurer may be directly enforced by the insured or by his privies.

19. 136 S.W.2d at 296.
20. 268 Ala. 152, 105 So. 2d 43 (1958).
21. An "insolvency clause" is a provision required by statute in many states to be inserted in a liability policy, in effect providing that the insolvency of the policyholder shall not affect the obligation of the insurance company to the injured party. A similar clause has been enacted in a very few states in regard to reinsurance.
22. 105 So. 2d at 45.
23. Supra note 7.
24. Supra note 7, at 620.
However, the court did not repudiate such a theory, and even implied that it will be followed by the Missouri courts. For this reason, it is necessary to determine what various courts have found to constitute a contract of indemnity against loss as opposed to a contract insuring against liability.

B. Reinsurance Contracts: Indemnification for Loss or Insurance Against Liability?

A few courts have said that "an ordinary contract of reinsurance is one of indemnity against loss, and no action will lie until the loss has been paid." However, the general rule would seem to be to the contrary. A majority of the reported cases indicate that unless the reinsurance contract specifically and unequivocally provides for indemnification for loss only, the courts will view such contracts as obligating the reinsurer to pay the reinsured the whole loss regardless of whether the reinsured has incurred a loss or merely a liability.

The leading case supporting the majority rule is *Allemannia Ins. Co. v. Firemen's Ins. Co.* In that case the reinsured had become insolvent by reason of the filing of a vast number of claims by its policyholders after a large fire in Baltimore. The reinsured could not satisfy these claims unless the reinsurer paid the reinsured; the reinsurer would not pay the reinsured until the reinsured paid the claims. Upon appeal by the defendant reinsurance company, the United States Supreme Court held that the contract was one of insurance against liability and not of indemnity against loss. The Court observed that:

> It is not necessary that the reinsured should first pay the loss to the party first insured before proceeding against the reinsurer upon his contract. The liability of the latter is not affected by the insolvency of the insured or by its inability to fulfill its own contract with the original insured.

The Court reached this result despite a provision in the contract that the reinsured was to forward to the reinsurer a statement of the date and probable amount of loss or damage, and, after having adjusted, accepted proofs or paid such loss or damage, was to forward the proofs and a copy of the original receipts taken upon payment of the loss.

The case usually cited in support of the contrary view is *Fidelity & Deposit Co. v. Pink.* In that case the reinsured issued a fidelity bond and immediately reinsured half the risk with the reinsurer. The policyholder sustained a loss; while this was in the course of adjustment, the reinsured was adjudged insolvent. The reinsurer refused to pay half the claim as demanded by Pink, the Superintendent of Insurance. Pink thereupon instituted proceedings against the reinsurer. The United States Supreme Court reversed the lower court's judgment for Pink, stating:

27. 209 U.S. 326 (1908).
28. *Id.* at 334.
We do not question the general rules concerning the liability of reinsurers announced in the Allemannia case; but the liability under any written contract must be determined upon consideration of the words employed, read in the light of the attending circumstances. Here the two insurance companies stood upon an equal footing; both were experts in the field. The language used differs materially from that found in the Allemannia case.

The Allemannia policy declared that the company "hereby agrees to reinsure," while the standard form of reinsurance agreement used in the Pink case provided that "the reinsurer does hereby reinsure against LOSS." The Supreme Court was of the opinion that the parties adopted the language in the Pink policy intending to impose liability different from that found to exist in the Allemannia case, especially in view of the fact that the language of the standard form in the Pink case was adopted twenty years after the Allemannia decision. Thus the Pink case approved the practice of limiting liability by reinsuring only against loss and not against liability, provided that the contract sufficiently spells out that the reinsurer is liable only when the reinsured has actually paid for losses incurred by policyholders or injured parties. This hardly seems to support the view that the ordinary contract of reinsurance is one of indemnity against loss, unless the contract has provisions which specifically limit the reinsurer's obligation. Despite this, some courts cite the Pink case as supporting such a rule.

The Missouri courts seem to have adopted the minority rule—that ordinarily a contract of reinsurance is one of indemnity against loss only, unless the contract contains provisions to the contrary. However, where the provisions in a reinsurance contract are ambiguous, a different result may be reached. Evidence of this is found in the Homan case itself. The Missouri Supreme Court there said: "If a policy of insurance contains such general language in reference to indemnity or liability as to be ambiguous and uncertain, the policy will be declared as insuring against liability. . . ."

Many instances have been found where reinsurance contracts were construed as insuring against liability. Among them are contracts which provided that "Loss, if any payable pro rata at the same time the reinsured pays." It has likewise been held that the obligation of a reinsurer is not affected by the inability of the

30. 302 U.S. at 225.
31. See, e.g., Fischer v. Excess Ins. Co. of America, 115 F.2d 755 (8th Cir. 1940); Stickel v. Excess Ins. Co. of America, supra note 2; Clark County v. Bergstresser, 233 N.W. 276 (S. Dak. 1930).
32. See Homan v. Employer's Reinsurance Corp., supra note 16.
33. Ibid.
34. See 31 APPLEMAN, INSURANCE LAW AND PRACTICE 469 (1943); 8 COUCH, Cyclopedia of Insurance Law 7414 (1931).
reinsured to fulfill its own contracts with its policyholders; this has been affirmed even when the contract referred to sums “actually paid.”

C. Exceptions to the General Rule: Third Party Beneficiary Theory

Where the courts have recognized a right in the third party to maintain an action against the reinsurer, they usually do so under an application of the third party beneficiary theory. This rule is an equitable rule, adopted for convenience and to avoid circuity of action and the formality of an assignment by the original debtor of the new agreement with him. It is said to be determined strictly in accordance with the intention of the parties to create a liability in favor of a third party.

Despite the liberality of some courts in applying the third party beneficiary concept, it has seldom been applied to reinsurance contracts. The more common reasons given for the failure to apply the concept to reinsurance are: (a) it would be contrary to long standing commercial practice; (b) the law is settled on the matter and the doctrine of stare decisis prevents any change; and (c) to allow a suit by third parties would lead to a multitude of litigation and might result in preferring one creditor over another.

A further limitation upon the application of the third party beneficiary theory to reinsurance results from strict enforcement of the common law requirement of “intention to benefit” the third party. This requirement demonstrates the importance of the initial determination of whether the reinsurance contract is one of indemnity against loss or insurance against liability.

Despite the reluctance of the courts to apply third party beneficiary theories to reinsurance, it is the principal theory used to aid the policyholder or injured party. For this reason, the law of third party beneficiary contracts will be examined in light of the ordinary reinsurance contract.


39. For an excellent discussion of the present law on third party beneficiary contracts, see Comment, 57 COLUM. L. REV. 407 (1957). Much of the discussion in this comment on third party beneficiary contracts will be drawn from that article and frequent reference will be made to it.


41. See Comment, 57 COLUM. L. REV. 407, 408.
1. Common Law Doctrine

If a third party beneficiary of a contract is specifically named, and the contract contains an express obligation to pay the named person, most courts will allow the beneficiary to enforce the contract. The fact that the contract is a reinsurance agreement should not alter this rule. When the nature of the contract is not so clear, however, difficulty arises.

Some courts have made the intention of the parties determinative. In most cases, all this can mean is that the court or jury will decide what the intent was, basing their decision upon the evidence introduced.

Even greater uncertainty results from the various approaches taken as to the intention test. Thus, one line of cases has held that if the contract appears to impose a duty or create a right in favor of the third party, there is a presumption that the contracting parties intended to confer a benefit upon him. Under this view, if the reinsurance contract is one insuring against liability, and it appears to impose a duty on the reinsurer to make payment to the third party, then that party should have the benefit of the presumption. Other courts have taken a more restrictive approach, saying that the parties will be presumed to contract only for themselves and not for the benefit of any third party, unless such intent can be clearly shown. This view would probably prevent a suit by the third party against the reinsurer, absent contractual provisions or other evidence to rebut the presumption.

The obviously unsatisfactory nature of such subjective standards has led to the use of a more objective approach. Under this theory, the courts have distinguished between "intention" and "purpose." "Intention" is used objectively, to refer to the necessary effect of the contract, while "purpose" means the subjective motives attributable to the parties making the contract. In applying this concept, the intention as gathered from the contract is controlling, and it is of no consequence that the "purpose" of the promisee in exacting the promise may have been solely to gain some benefit or immunity for himself rather than to benefit the

42. Massachusetts is the only jurisdiction which refuses to recognize the third party beneficiary theory in some manner or another. See, e.g., Gustafson v. Doyle, 109 N.E.2d 475 (Ohio 1952); Mellen v. Whipple, 67 Mass. (1 Gray) 317 (1854).
43. See cases cited supra note 38.
44. Hamill v. Maryland Cas. Co., 209 F.2d 338 (10th Cir. 1954); Ohio Cas. Ins. Co. v. Beckwith, 74 F.2d 75, 78 (5th Cir. 1934); Daniel-Morris Co. v. Glens Falls Indem. Co., 126 N.E.2d 750 (N.Y. 1955). The cases indicate that this view is used when there is a promise to discharge the promisor's duty to a third party. If the reinsurance contract is one insuring against liability, then the promise could be implied if not expressly contained in the contract.
46. See e.g., Restatement, Contracts §§ 20-23 (1932).
third party.\footnote{48} This approach would seem especially well suited to reinsurance contracts. Usually the reinsured's primary purpose is not to benefit the third party, but rather to protect itself from unexpectedly large liability or loss which might otherwise render it insolvent. Despite this, in looking at "intention" objectively, it is seen that the necessary effect of the contract is to benefit the third party. The reinsured must necessarily have an intent to benefit the third party, since otherwise its purpose of reducing its liability or loss would not be effectuated. This approach is the more modern view adopted by the Restatement of Contracts.

Other states have seen fit to deviate from the strict intention to benefit test, some taking a liberal approach and some a strict approach. The strict views include the requirement that there be a clear promise made, expressly stated to be for the third party's benefit,\footnote{49} the view that it is necessary to show an intention to grant the third party beneficiary the legal right to enforce the promise,\footnote{50} and a degree of benefit test.\footnote{51} Under these approaches, few cases have been found in which the reinsurance contract could be construed as a third party beneficiary contract.

Some of the more liberal tests used are that a third party may maintain an action on a contract for his benefit when he has a direct financial, legal or equitable interest in its performance;\footnote{52} that recovery by the third party will be allowed when it would tend to accomplish the "basic purposes" of the contract;\footnote{53} and the most liberal view, that any person having a beneficial interest in the contract can maintain an action thereon.\footnote{54} Under these approaches, the ordinary reinsurance contract would usually be construed as a third party beneficiary contract. The policyholder or injured party certainly has a "financial interest" in the reinsurance contract. Likewise, one of the "basic" purposes of the reinsurance contract is to relieve the reinsured of some of its liabilities. It follows that to allow a third party to maintain an action against the reinsurer will relieve the reinsured of its liability to that person and thus accomplish one of the "basic purposes." Finally, there can be little doubt that the third party has a "beneficial interest" in the reinsurance contract, regardless of how it is drawn.

\footnote{48} Note that this approach can result in nullifying a clear understanding between the parties that no cause of action was to be established in the third party. See Shoaf v. Palatine Ins. Co., supra note 14.


\footnote{50} See, e.g., Schlicht v. Wengert, 15 A.2d 911 (Md. 1940); Borough of Brooklawn v. Brooklawn Housing Corp., 11 A.2d 83 (N.J. 1940).

\footnote{51} Maumee Valley Elec. Co. v. Toledo, 13 F.2d 98, 104 (6th Cir. 1926); Brill v. Brill, 127 Atl. 840 (Penn. 1925).

\footnote{52} E.g., Chesapeake & Ohio Ry. v. Wadsworth Elec. Mfg. Co., 29 S.W.2d 650 (Ky. 1930).

\footnote{53} See Note, 31 Texas L. Rev. 210, 211 (1952).

\footnote{54} See, e.g., Hamill v. Maryland Cas. Co., 209 F.2d 338 (10th Cir. 1954); Merchants Loan & Trust Co. v. Ummach, 228 Ill. App. 67 (1923). For further discussion of the views and cases cited in notes 42 through 66, see Comment, 57 Colum. Law Rev. 406, 408-14 (1957).
2. The Restatement View

The American Law Institute has taken the position that where performance of a promise will benefit a person other than the promisee, that person is a "donee beneficiary if it appears from the terms of the promise in view of the accompanying circumstances that the purpose of the promisee . . . is to make a gift to the beneficiary." He is a "creditor beneficiary if no purpose to make a gift appears . . . and performance of the promise will satisfy an actual or supposed or asserted duty of the promisee to the beneficiary." All persons not donee or creditor beneficiaries are called "incidental beneficiaries," and have no right against the parties to the contract.

In applying the Restatement view, some courts have found room for a very liberal construction of contracts. Even though no actual promise for the benefit of the third person appears, courts have implied such a promise after finding an intent to benefit from the contract and its surrounding circumstances. Other courts have found that the promised performance would discharge a duty of the promisee to a third party and thus that the contract was for the benefit of the third party.

Applying the Restatement view to reinsurance contracts, the third party would be a creditor beneficiary, since the purpose of the reinsurance contract is not to make a gift to the insured person but is to satisfy the duty owed by the insured to the third party under the original primary policy. The policyholder is a creditor beneficiary because his premiums helped pay for the reinsurance. While the Restatement rules in regard to third party beneficiary contracts have been soundly criticized, when they are followed by a court the necessary result is a finding that the third party is a creditor beneficiary of the reinsurance contract and can recover thereon from the reinsurer.

3. The Missouri Law

In Missouri the third party beneficiary concept has been applied to reinsurance contracts. The test often applied in cases other than those involving reinsurance seems to be the "intent to benefit" concept, with some cases apparently imposing an additional requirement that the promisee owe the intended beneficiary some

55. See Restatement, Contracts §§ 135, 136 (1932) for the classification of donee, creditor, and incidental beneficiaries.
56. Id. at 133 (b).
60. See Comment, 25 Mo. L. Rev. 71 (1960), for a good discussion of the Missouri law on third party beneficiary contracts generally.
61. O'Hare v. Pursell, 329 S.W.2d 614 (Mo. 1959); Homan v. Employers Reinsurance Corp., 136 S.W.2d 289 (Mo. 1939).
legal or equitable duty. Under Missouri law, the intent to confer a benefit on a third party must be essential to the accomplishment of the objective sought by the parties to the agreement. Therefore, it is arguable that the view indicated by the *Homan* case is proper under Missouri’s third party beneficiary view, and that the reinsurance contract which insures against liability is a third party beneficiary contract, since the conferring of a benefit upon the third party is essential to the objective of the contracting parties—to relieve the reinsured of a portion of its liability to the third party.

### III. STATUTORY SOLUTIONS

**A. Statutes Dealing Directly with the Rights of Parties to a Reinsurance Contract**

Missouri has a statute providing that an action shall be brought by the real party in interest. The same statute also grants to the promisee the right to maintain an action on a third party beneficiary contract. This statute was construed in *Ellis v. Harrison* as impliedly allowing the beneficiary to bring an action in his own name. Other jurisdictions have statutes of various description which allow suit by a third party to enforce his rights under a contract made for his benefit. Most statutes of this sort however, are of a general nature, as is the Missouri statute, applying to all contracts regardless of subject matter. Loose wording usually results in their being of little practical aid in the reinsurance area.

There is very little legislation which either expressly permits a policyholder or injured party to maintain an action against the reinsurer, or expressly prohibits such direct action. The legislation which does grant such rights usually provides that the original insured may have the same rights and that the reinsurer will be obligated to the same extent as under the original contract, with the rights and obligations being fixed as a part of the reinsurance contract.

Most of the legislation dealing with the rights of parties to a reinsurance contract has been directed toward nullifying the effect of the *Pink* case. Thus, some

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63. See Comment, 25 Mo. L. Rev. 71 (1960).

64. § 507.010, RSMo 1959.

65. 16 S.W. 198 (Mo. 1891). See WILLISTON, CONTRACTS § 366 (3d ed. 1960) where it is said that this statute confers a right on the third party to maintain an action on the contract. However, little reference has been made to the statute in the Missouri cases. Cf. Wilson & Co. v. Hartford Fire Ins. Co., 254 S.W. 266 (Mo. 1923).

66. CAL. CIV. CODE ANN. § 1559 (West 1954); GA. CODE ANN. § 3-108 (1936); IDAHO CODE ANN. § 29-102 (1948); LA. CIV. CODE ANN. art. 1890 (West 1952); MICH. COMP. LAWS § 691.541-42 (1948); MONT. REV. CODES ANN. § 13-204 (1947); N.D. REV. CODE § 9-0204 (1943); N.J. REV. STAT. §§ 26-3.6 (1937); OKLA. STAT. ANN. tit. 15, § 29 (1937).


The states have put the decision of the *Allemannia* case into statutory form. Such statutes ordinarily provide that "a reinsurance contract is presumed to be a contract of indemnity against liability and not merely against damage." However, the greatest amount of legislation in this area has been patterned after the New York statute, requiring, in effect, that any reinsurance contract be one insuring against liability rather than indemnifying against loss. The New York statute is not mandatory in form. It is effective, however, because it prohibits credit for reinsurance being allowed as an asset to any reinsured unless the reinsurance is payable on the liability of the reinsured without diminution because of the insolvency of the reinsured. The New York legislation, as originally enacted in 1939, required that the reinsurance be made payable to the liquidator or receiver of the insolvent insurer. In 1940, however, the statute was amended so as to make no distinction as to the recipient of payment.

Other states have adopted similar legislation, in order to preclude a windfall for the reinsurer when the reinsurance contract is drawn so as to fall within the rationale of the *Pink* case. Unfortunately, instances of such legislation are scattered, and in most states any statutory aid must be by way of analogy, if at all.

**B. Analogous Statutes Bearing on a Third Party’s Rights Against the Reinsurer**

Early in the history of liability insurance in this country, certain courts held that a policyholder under an indemnity policy had not suffered a "loss" which entitled him to recover from his insurer until he had been obliged by law to pay, and had in fact paid, a judgment rendered against him. Such an interpretation, when insisted upon by the insurer, placed the policyholder in the position of being unable to enforce his policy if it was impossible for him first to pay the judgment. At common law, the right of an injured third party to recover in any way against the insurer of the tortfeasor on a voluntary liability insurance policy was likewise extremely limited. Such a right depended upon whether the policy was construed as a contract of indemnity against loss, when the policy was construed as a contract of indemnity against loss, then insolvency of the insured was a complete defense to the insurer, since loss by the

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70. See CAL. INS. CODE ANN. § 621 (West); N.D. CENT. CODE ANN. § 26-05-02 (1959).
71. N.Y. INS. LAWS § 77 (1949). For a history and discussion of this act, see Comment, 41 COLUM. L. REV. 353 (1941).
72. Note that the instant clause applies to reinsurance. Most states have similar clauses applicable to liability insurance in the event of policyholder insolvency.
73. N.Y. LAWS 1939, c. 882, § 77.
74. An argument could be made that such an amendment was a recognition by the New York legislature of a third party’s need to maintain an action on the contract of reinsurance in given instances.
76. SAWYER, AUTO LIABILITY INSURANCE 2 (1940).
77. See VANCE, INSURANCE § 135 (3d ed. 1951).
78. See, e.g., Ohio Cas. Ins. Co. v. Beckwith, 74 F.2d 75 (5th Cir. 1935). See also Comment, 9 CORNELL L.Q. 329 (1924).
insured was precluded. Under such contracts, the injured party received very little consideration, either under the contract or from the courts. The burden of death and injury had to be borne by the person injured or by the dependents of the victim of the accident. While the courts were sympathetic, few of them offered any relief for such third persons.

Despite, however, the unfavorable treatment originally accorded by courts to injured parties under ordinary liability policies, some few courts, by various means, not all of which were entirely logical, fashioned remedies for the injured third party. To combat this, the insurance companies began to insert “no action” clauses in their policies. The most effective clauses were patterned after the following:

No action shall lie against the company to recover for any loss or expense under this policy, unless it shall be brought by the assured for loss or expense actually sustained and paid in money by him after trial of issue.

Such clauses were given effect by the great majority of courts, so that the insurer was not liable to the assured until the judgment against him was paid.

In comparing the above situation with the present law on reinsurance, a marked analogy is seen. In both instances, courts have held that before the insured or reinsured could recover upon an indemnity against loss contract, an actual loss must have been incurred. In both instances, the insolvency of the party primarily liable precluded satisfaction of the injured party’s judgment. In both cases, the grounds of refusal to aid the third party were that such third party was neither a party nor a privy to the contract. In both cases, the courts generally refused to give the third party any help. Furthermore, one cannot help but notice the analogy between “no action” clauses and the clauses which could be placed in reinsurance contracts following the Pink case; in both areas the courts left the insurance companies free to indemnify against loss only rather than to insure against liability.

The basic effect was the same in both areas. The widespread use of the “no action” clauses precluded any recovery by the injured party in the event of ins-

81. “Of course, however much we may sympathize with appellant in this case, we cannot allow that sympathy to lead us astray or to do otherwise than to administer the law as it exists.” In re Harrington Motor Co., Ltd., [1928] 1 Ch. 105, 124.
82. See, e.g., Cappelle v. United States Fid. & Guar. Co., 120 Atl. 556 (N.H. 1922); Fenton v. Fidelity & Cas. Co., 56 Pac. 1096 (Ore. 1899); Taxicab Motor Co. v. Pacific Coast Cas. Co., 132 Pac. 393 (Wash. 1913).
83. Patterson v. Adan, 138 N.W. 281, 284 (Minn. 1912).
84. Cooley, Briefs on Insurance §696 (2d ed. 1927).
solvency or bankruptcy of the insured policyholder. In cases of insolvency, the only one who benefited from the policy was the insurer. The same is true of the reinsurance contract that is held to be merely a contract of indemnity against loss. In such case, only the reinsurance company benefits.

Carrying the analogy to its final point, it will be noted that a minority of courts have construed reinsurance contracts so as to give them effect as contracts to insure against liability whenever possible. Likewise, a minority of courts have used subterfuges to avoid the consequences of the "no action" clause in the area being discussed. The subterfuge most often engaged in is that when the insurance company assumes the defense of the tortfeasor, this is inconsistent with the "no action" clause, and in some manner nullifies the effect of the clause.

At this point the analogy ends. Dissatisfaction with the then present state of the law, including court approval of "no action" clauses, led to legislation in many states, enabling the injured party to reach the insurance proceeds due the insolvent tortfeasor. But, as indicated earlier, there is a dearth of similar legislation aiding the third party in the reinsurance area.

Legislation nullifying "no action" clauses and similar restrictive contract provisions is of two types. The first type, enacted in at least six states, is patterned after the Massachusetts statute, which provides that an insurance company’s liability is absolute whenever an injury covered by a casualty policy occurs. This means that the liability of the insurance company does not depend upon satisfaction of the final judgment by the insured. Further, the Massachusetts act allows the injured party to proceed in equity to reach the insurance money if his judgment against the tortfeasor has not been satisfied within thirty days.

Many other states have followed the New York type of legislation, which provides that the policy must contain a provision that insolvency or bankruptcy of the policyholder will not release the insurer. That statute also provides that a judgment by the injured party against the tortfeasor is still necessary, but that an action may be brought against the insurer if the injured party’s judgment is not satisfied within thirty days. There is no question as to the constitutionality of either type of legislation, since courts have long recognized that the business of acci-

86. See Comment, 36 Dick. L. Rev. 173, 179 (1932).
87. See Laube, supra note 80.
89. For a thorough discussion of these statutes, see Comment, 46 Harv. L. Rev. 1325 (1933); Comment, 28 Ill. L. Rev. 688 (1934); Annot., 85 A.L.R. 20 (1933).
92. Some of the early states enacting such legislation include Arkansas, California, Illinois, Indiana, Iowa, Louisiana, Maryland, Michigan, Nebraska, New Hampshire, New Jersey, Vermont and Virginia.
dent indemnity is of a peculiar nature and intimately connected with the general welfare.\textsuperscript{64} Are such statutes applicable to the reinsurance problem? Looking closely at a representative statute,\textsuperscript{65} it will be seen that the language is general and, prima facie, indeed applicable to reinsurance. The typical statutory language refers to "every contract of insurance made between an insurance company and any person, firm or corporation..." Further, the intent of the legislature, as evidenced by the history of the legislation, would lend weight to the argument that such legislation should be applied to reinsurance contracts.

In connection with legislation prohibiting "no action" clauses, some consideration should also be given to the statutes which authorize reinsurance contracts. Reinsurance contracts were early recognized as valid at common law.\textsuperscript{66} In addition, nearly all states have statutes authorizing reinsurance. It is submitted that such legislation is for the benefit of the policyholder and injured party. An indication of this legislative intent can be found in statements such as the following:

Another 1917 proposal would have created a board... to reinsure the risks in the state life fund if necessary to protect the interests of the policyholders.\textsuperscript{67}

Since the statutes prohibiting "no action" clauses and the statutes authorizing reinsurance were both enacted for the primary purpose of protecting the third party, they should be construed as being pari materia. Thus, when considering reinsurance contracts which are sanctioned by statutory enactment, reference should also be had to "no action" legislation, since both statutes evince a legislative intent to protect the person who originally sought protection—the policyholder.

The United States Supreme Court was of the opinion that the Missouri statute prohibiting "no action" clauses applied to reinsurance contracts. In Brillhart v. Excess Co. of America, the Court said:

\textsuperscript{94} See, e.g., Merchants Liab. Co. v. Smart, 267 U.S. 126 (1925); Lorando v. Gethro, 228 Mass. 181 (1914).
\textsuperscript{95} § 379.195, RSMo 1959.
In respect to every contract of insurance... between an insurance company, person, firm or association... and any person, firm or corporation by which such person, firm or corporation... is insured against loss or damage... the liability of the insurance company, if liability there be, shall become absolute, and the payment of said loss shall not depend upon the satisfaction by the assured of a final judgment against him for loss, or damage or death, or if insured becomes insolvent or discharged in bankruptcy during the period that the policy is in operation or any part is due or unpaid, occasioned by such casualty.

§ 379.200, RSMo 1959:
Upon the recovery of a final judgment against any person... the judgment creditor shall be entitled to have the insurance money, provided for in the contract of insurance... and if the judgment is not satisfied within thirty days after the date when it is rendered, the judgment creditor may proceed in equity against the defendant and the insurance company to reach and apply the insurance money to the satisfaction of the judgment.

\textsuperscript{96} 17 Wend. 359 (N.Y. Sup. Ct. 1837).
\textsuperscript{97} KIMBALL, INSURANCE AND PUBLIC POLICY 145 (1960).
By statute the liability of the insurance company becomes absolute when loss occurs; and judgment against the insured establishes privity of contract between the injured party and the reinsurer.\(^9\)

This would seem to be the literal interpretation of the statute, in addition to being the interpretation which would effectuate the intent of the legislature.

However, at least three courts which have passed upon the question have held that such statutes do not establish the required privity between the reinsurer and the third party. Thus, in Gurthie v. General Reinsurance Corp.,\(^9\) a New York court refused to apply Section 109 of the New York Insurance Law to a reinsurance contract, saying:

That section is in derogation of the common law. The liability of the insurer to the claimant excludes the liability of a reinsurer under the rule of strict construction.\(^1\)

The same result was reached in Stickel v. Excess Ins. Co.,\(^1\) an Ohio decision. The latest case, Melco System v. Receivers of Trans-America Ins. Co.,\(^1\) discussed previously, likewise held that the legislation in question did not apply to reinsurance contracts and created no privity between the reinsurer and the third party. In Missouri, the Homan case touched upon the matter but did not decide it.\(^1\)

Thus, at the present time the authority is divided. On the other hand, relatively few courts have actually passed upon the question. For those courts which have not yet aligned themselves, it is submitted that to allow a reinsurance contract of indemnity against loss only, so that the third party will not be compensated in event of insolvency of the reinsured, is in direct conflict with the social policy behind the legislation prohibiting “no action” clauses, and the legislation authorizing and sanctioning the use of reinsurance. Likewise, for a court to deny recovery to the third party because of lack of privity, even though it be found that the reinsurance contract is one of indemnity against liability, thwarts the legislative intent and the social policy behind both types of statutes.

### IV. Policy Questions

A. Should the Requirement of Showing Privity be Extended to Reinsurance?

The preceding discussion of the history of casualty liability insurance emphasizes the fact that the injured victim is the person who should benefit by accident insurance. Thus, in discussing the need for the casualty liability insurance legislation which allows a direct suit by the injured against the insurance company, one writer has said:

\(^{98}\) 316 U.S. 491, 495 (1942).
\(^{100}\) 167 Misc. at 610.
\(^{101}\) 136 Ohio St. 49, 23 N.E.2d 839 (1939).
\(^{102}\) 268 Ala. 152, 105 So.2d 43 (1958).
\(^{103}\) See Homan v. Employers Reinsurance Corp., 136 S.W.2d 289, 295 (Mo. 1939), where it was said: “In view of the conclusions we have reached, in this case it is unnecessary for us to pass upon the proposition as to whether or not Secs. 5898 and 5899, R.S. 1929 [379.195, 379.200, RSMo 1959] apply directly to the particular contract of reinsurance under consideration.”

http://scholarship.law.missouri.edu/mlr/vol28/iss2/6
To allow the assets of an accident policy to be appropriated by creditors generally, when the injured party has not been paid for his injuries on the ground that both he and they were strangers to the contract, exalts form and violates common sense and common decency. To call the rights of the injured party to an accident policy, where his life and limb are the subject of the transaction, merely a 'derivative' right and therefore 'secondary' is a legal pedantry that judicial decision does not dignify.¹⁰⁴

Such a statement applies with equal force to reinsurance contracts and the parties' rights thereunder. It would seem equally a violation of "common sense" and "common decency" to allow the assets of a reinsurance contract to be appropriated by creditors of a reinsured company when the injured party has not been paid for his injuries.

The reason normally given by the courts for denying a third party the right to bring an action directly against the reinsurer is that the third party is neither a party to the reinsurance contract nor in privity therewith. It is said, therefore, that the third party is not a beneficiary of the contract. One might well counter such an argument, however, by calling attention to the theory of the third party beneficiary contract. It has been said that:

The basis of the rule permitting the beneficiary to sue has been stated to be that 'the law, operating on the act of the parties, creates the duty, establishes the privity, and implies the promise and obligation, on which the action is founded.' This theory is probably more frequently stated than any other. This, however, is merely an indirect way of saying that privity is not necessary to enable the beneficiary to recover. By saying that the law operating upon the acts of the parties 'establishes the privity,' the courts really mean that the law dispenses with the requirement of privity in the strict sense of the term.¹⁰⁵

It is true that most of the earlier indemnity contracts were for loss of property, both as to regular contracts of insurance and as to reinsurance. In the area of property insurance, privity serves a useful and necessary purpose. This can be demonstrated as follows: Suppose \( X \) insures Blackacre. Subsequently he conveys his property to \( Y \), keeping the policy on Blackacre in force himself. If a loss covered by the policy is suffered, \( X \) cannot recover on the policy because he has no insurable interest.¹⁰⁶ Further, since \( Y \) contributed nothing toward payment of the premiums and has made no attempt to procure insurance to save himself from loss, to allow \( Y \) to recover on the policy would be giving \( Y \) a windfall. In this instance, the privity requirement serves a useful purpose, since the absence of privity between \( Y \) and the insurance company precludes anyone from receiving a windfall. (\( X \) can recover his premiums.)

However, the very feature which makes the privity requirement beneficial in the property field results in an inequitable result when applied to reinsurance.

¹⁰⁴. Laube, supra note 80, at 232.
¹⁰⁵. 12 AM. JUR. Contracts § 278 (1938).
¹⁰⁶. An insurable interest is "such a real and substantial interest in specific property as will prevent a contract to indemnify the person interested against its loss from being a mere wager policy." BLACK, LAW DICTIONARY 942 (4th ed. 1957).
The detrimental effect can be explained in the following manner: If a contract of reinsurance is construed as one of indemnity against loss, then in event of insolvency of the reinsured before satisfaction of an injured party's judgment against the reinsured, the reinsurer has a windfall. In such a case, neither the creditors of the insolvent reinsured nor the injured third party can recover from the reinsurance company because of the strict privity requirement. If the contract is construed as a contract of indemnity against liability, the general rule still denies the third party any direct recovery against the reinsurer. Thus, if the reinsured is insolvent, the reinsurance moneys form part of the general fund for payment of its debts, the sums due from the reinsurer belong to the reinsured's creditors pro rata, and the original insured has not even an equitable lien or preferred claim upon the money due on the contract of reinsurance.\textsuperscript{107} Again, the privity rule gives a windfall to the creditors.

It would seem that there is no justification for subordinating the social and public interest in the welfare of an accident victim to a mechanical application of the contractual privity requirement. The injured party is a real party in interest to the reinsurance contract, and the saving of the parties to the reinsurance contract or their creditors from loss is, from a social point of view, but an incident of the transaction.

It is submitted that when the courts refuse to give the human factor a dominant position, the legislatures of the various states should do so. Many state legislatures have recognized the courts' misconceptions in persisting in the requirement of privity in the case of an injured party maintaining an action against an insurance company directly. It is thought that they should likewise nullify those judicial decisions which declare that the property interests of the reinsured company and its creditors outweigh the interest of society in securing to the injured person compensation for the damage inflicted upon him.

\section*{B. When Should the Reinsurance Contract Be Construed As a Third Party Beneficiary Contract?}

If the courts insist upon the privity requirement and refuse to construe present "no action" legislation as including reinsurance contracts, it is submitted that the courts should adopt the view indicated by the Missouri courts in the \textit{Homan} and \textit{O'Hare} cases—that when a reinsurance contract is found to be one insuring against liability, then the law will supply the privity and the third party can maintain an action against the reinsurer.

If this view be followed, it raises a question as to the validity of the distinction between contracts insuring against liability and contracts indemnifying against loss. If the loss or liability distinction is removed, then there is a basis for only one type of reinsurance, that being the insurance against liability contract.

It has been said that "nothing is more obvious than that the traditional

distinction is as formal as it is artificial. In this modern commercial age when credit is the very essence of a commercial enterprise, to assert that a liability is not a loss is to exemplify the subtlety of the sophist. The rationale of the suggestion that the distinction should be removed can be explained in the following manner. In a contract designated as one indemnifying against loss only, courts generally have said that the reinsured has no rights against the reinsurer until actual payment has been made to an insured party, because prior to the payment no loss has been incurred. But if the reinsured has been rendered insolvent by reason of a large number of unsatisfied claims or judgments against it, it is somewhat a fiction to say that the reinsured has not incurred a loss. The liability, the obligation to pay, is the loss suffered. "Insolvency" has been defined as a relative condition of a man's assets and liabilities such that the assets, if all were made immediately available, would not be sufficient to discharge the liabilities. Therefore, if the reinsured is liable on insurance policies, whether they are liquidated or unliquidated claims, it has suffered a loss despite the fact that it has not yet paid out anything. It is a loss of such magnitude, as a matter of fact, that the reinsured has been rendered insolvent.

This same concept can be illustrated in another way. Suppose the reinsured is in such a position that it has to give its note to satisfy a claim or judgment. A judgment is often a secured liability (if the judgment debtor owns an interest in realty); a note is an unsecured liability. Although the judgment is said to be merely a liability and not a loss until it is paid, payment by note converts it into a loss. Thus, exchange the liability on a judgment for liability on a note, and one suddenly finds a loss. This in itself demonstrates the fiction of any distinction between a liability and a loss contract.

Of course, the only time the distinction is of any consequence is when there is a question as to the solvency of the reinsured. When such a question does arise, the rights and obligations of all three parties (the policyholder or injured, the reinsurer, and the reinsured) may be completely altered depending upon whether the reinsured has satisfied the judgment or claim against it. It is submitted that this fact alone should not affect the obligation of the reinsured or the rights of the third party. No satisfactory reason can be found for leaving an injured party or his dependents uncompensated for their suffering and expense merely because a court finds that certain words in a reinsurance contract make the contract one of indemnity for loss rather than a contract of insurance against liability.

C. Objections to Direct Action by the Third Party Against the Reinsurer

Various proposals have been made in this comment for changing the present law governing the rights of a policyholder or injured party against the reinsurer. Some of the proposals merit more consideration than others. But how do the arguments in favor of change measure up to the arguments against such a change?

Many of the arguments supporting the present law have been dealt with previously. In addition to those arguments, several others should be considered. The first of these is that the reinsurer and the reinsured should be free to contract in any manner they see fit, including an express negation of any right in the policyholder or injured party to maintain an action upon the reinsurance contract. A proper answer to such an argument would be to point out the subordinate position of the freedom of contract concept when the public welfare is involved.

Another argument supporting the present law is that the reinsurer serves a function different from that of the reinsured, in that it is not the business of the reinsurer to settle or defend against policyholder claims, and that to allow a third party to maintain an action against the reinsurer is to subject the reinsurer to unwarranted burdens. One answer to such an argument would be that such a burden is properly an incident of the insurance business. The argument further loses weight when consideration is given to the number of reinsurance contracts wherein the reinsurer expressly reserves the right to defend and deal with the claims made against the reinsured.

Finally, it could be argued that changing the present law would reduce the admitted advantages of reinsurance, since the reinsurers could no longer reinsure at the present favorable rates. As a consequence, the commercial community, and indeed the public as a whole, would suffer. This argument loses force when the number of insurance companies carrying reinsurance is contrasted with the number of such companies which become insolvent, thereby necessitating an action by the policyholder or the injured party. It is submitted that the added expense to the reinsurer of settling, defending and in general handling claims against the insolvent reinsured would be negligible when compared with the total amount of reinsurance, and would have no substantial effect on the continued beneficial use of reinsurance.

The most forceful argument against changing the law could be made by the creditors of the reinsured. The general nature of their argument is that the policyholder or injured party is merely another creditor of the reinsured and should be given no preference. However, such an argument ignores the nature of the policyholder’s or injured party’s claim against the reinsured. Generally, most of the reinsured’s creditors extended credit voluntarily, knowing that the nature of the reinsured’s business was to make an injured party whole in the event the policyholder suffers an involuntary loss. The injured tort claimant is in an entirely different position. To classify the involuntary creditor with all the other creditors and to give him twenty cents on the dollar (or some comparable sum) certainly does not make him whole. The law should not be blind to needed distinctions when they will serve a useful purpose.

V. Conclusion

In the early development of accident insurance, a few courts recognized the fictitious nature of the privity requirement and the need for relief to injured victims. However, due to the general acceptance of the privity theory, and resultant hardships on injured parties, the legislatures were prodded into action.
Today, there is little doubt that the primary purpose of various types of legislation regulating accident insurance is to afford relief to the injured victim.\textsuperscript{110}

The injured party, in seeking relief under reinsurance contracts, has generally met with the same objection he formerly encountered when seeking relief under an accident policy—lack of privity. At the present time, however, there are signs that the courts are becoming less stringent with the privity requirement, especially in Missouri. Privity is being relegated to a back seat position in other areas in the interest of protecting the public.\textsuperscript{111} The trend seems to be in the same direction in the reinsurance field.

The history of the law regarding a third party's rights under a reinsurance contract shows a development similar to accident insurance law. This parallel development diverged when legislatures recognized that accident insurance was for the benefit of the injured party. It is not unlikely, however, that absent court recognition of a third party's rights under a reinsurance contract, there will be a similar legislative recognition of these rights in the near future.

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\textsuperscript{110} See Laube, \textit{supra} note 80, at 231.