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THE EFFECT OF INSURANCE ON THE TORT IMMUNITY OF A GOVERNMENTAL SUBDIVISION

American law has long afforded the state and its subdivisions of government an immunity from liability for tort. The Federal Government, the state, municipal corporations, and quasi-municipal corporations of various types, are exempted from tort accountability for their wrongful acts.[1]

In the past, the subdivisions which are the recipients of this immunity have not been reluctant to accept it. But criticism of this immunity, both as to the social merit of casting the entire burden of injuries caused by the activities of government on the individuals harmed rather than spreading the loss among the public for whose benefit the activities are carried on, and as to the theoretical and factual validity of the reasons which have been advanced for the existence of the rule, has been increasing in recent years.[2] Because of this widespread dissatisfaction, the Federal Government[3] and several states[4] have by statute abrogated or limited in score the immunities to which they are otherwise entitled, and have in many areas permitted themselves to be sued for tort in the same manner as private individuals.

Responsive to the same feeling of moral responsibility to citizens injured through their activities which has motivated more autonomous units of government to waive their immunity by statute, officials of a number of subdivisions have attempted to provide protection for injured persons by securing policies of liability insurance. The right of the person injured by the activities of such an insured subdivision to recover for his damage, for

1 Borchard, Governmental Liability in Tort, 34 Yale L.J. 1, 129, 229 (1924-25), 36 Yale L.J. 1, 757, 1039 (1926-27).

2 Borchard, Governmental Liability in Tort, 34 Yale L.J. 1, 129, 229 (1924-25), 36 Yale L.J. 1, 757, 1039 (1926-27); Harper, Torts § 295 (1933); Borchard, State and Municipal Liability in Tort—Proposed Statutory Reform, 20 A.B.A.J. 747 (1934). Numerous other commentaries are cited in Repko, American Legal Commentary on the Doctrines of Municipal Tort Liability, 9 Law & Contemp. Prob. 214 (1942).

3 Federal Tort Claims Act, 60 Stat 842, 28 U.S.C. §§ 921-946 (1946).

4 See. e. g., Cal. Veh. Code § 400 (1943); Ohio Rev. Code § 701.02 Baldwin 1943. Such a bill, L.B. 334, was introduced at the last session of the Nebraska Legislature. Its passage was urged by a Committee of the Nebraska State Bar Association. The bill was not adopted, but the committee's report urged further efforts to secure its passage. Report of the Special Committee on the State Tort Claims Act, 33 Neb. L. Rev. 191, 192 (1954).

which damage the subdivision would not in the absence of insurance be accountable, is the matter here in question.

In the usual case arising under such a policy of insurance, the insurer pays without question, or defends the suit brought without setting up the defense of the subdivisions immunity, for it is the undertaking of the contract of insurance that it should do so.[5] But numerous cases have arisen in which the insurer defends the action by interposing the defense of the insured's immunity. If such a defense is raised, is recovery no long possible?

Two major objections have been raised against permitting recovery. The first of these is based upon the language and theory of the contract of liability insurance. Such a policy is an agreement to protect the insured against loss through claims for which he may become liable. Its terms do not purport to create liability to anyone until a legal liability of the insured has arisen. Such a policy contains the standard "no-action" clause, the terms of which are similar to the following:

> No action shall lie against the company... until the amount of the insured's obligation to pay shall have been finally determined either by judgment against the insured after actual trial or by written agreement of the insured, the claimant and the company.[6]

Thus, in terms, the liability of the insurer is made to depend on the determination of the legal liability of the insured. If the insured, then, is not liable for the harm, the loss for which the insurer has contracted to indemnify does not occur, and no obligation of the company arises under its contract.[7]

[5] See text and citation, note 27 infra. It is likely that the issue is generally raised only when the insured party and the insurer cannot agree on the amount of damages.

[6] The sample quoted appears in 4 Richards, Insurance § 2051 (5th ed. 1952). Other similar clauses may be seen quoted in Schulte v. Hartford Accident & Indemnity Co., 102 F. Supp. 681 (D. Minn. 1951); Arnold v. Walton, 205 Ga. 606, 54 S.E.2d 424 (1949); Brooks v. Clark County, 297 Ky. 549, 180 S.W.2d 300 (1944); and Hughes v. Hartford Accident & Indemnity Co., 223 Ala. 63, 134 So. 461 (1931).

[7] Cases denying recovery on the basis of such an argument are: Stephenson v. City of Raliegh, 232 N.C. 42, 59 S.E.2d 195 (1950); Hummer v. School City of Hartford City, 112 N.E.2d 891 (Ind. App. 1953); Cushman v. Grafton County, 79 A.2d 630 (N.H. 1951); Schulte v. Hartford Accident & Indemnity Co., 102 F. Supp. 681 (D. Minn. 1951); Ford v. Glens Falls Indemnity Co., 80 F. Supp. 347 (E.D. S.C. 1948); Pohland v. Sheboygan, 251 Wis. 20, 27 N.W.2d 736 (1947); Brooks v. Clark County, 297 Ky. 549, 180 S.D.2d 300 (1944); Ayers v. Hartford Accident & Indemnity Co., 106 F.2d 958 (5th Cir. 1939); Hughes v. Hartford Accident & Indemnity Co., 223 Ala. 59, 134 So. 461 (1931); Boice v. Board of Education, 111 W. Va. 95, 160 S.E. 566 (1931).

The second argument, on the basis of which recovery against an insured subdivision or it's insurer is denied, is that a subdivision of state government lacks the power to insure against claims for which under the law it would not be liable—that the contract of insurance against immune risks amounts to an illegal expenditure of public funds and is therefore void.[8] The contract being beyond the powers of the subdivision, the argument goes, it creates no rights or duties enforceable by the injured person. Apparently, on such a holding the subdivision is entitled to recover premiums paid, because the risk contemplated by the contract has not attached.[9]

Another argument for denial of recovery has been collaterally mentioned in some of these cases. It has been stated that making recovery possible where the subdivision is insured, while no recovery would be allowed in the absence of insurance, would introduce the question of insurance as an issue in the trial of the action. And it is a common principle in some states that to mention in a tort action the fact that the defendant is insured is error prejudicial to the defendant,[10] in that the jury is likely to be influenced in its findings of liability and damage due to a feeling that the loss can more readily be borne by an insurance company than by the damaged individual. However, in the cases stating that rule, insurance was an immaterial matter extraneous to the issues of the case; and in cases where the fact of insurance is related to a relevant line of inquiry its mention is usually permitted, despite the incidental prejudice to defendant.[11] In the

[8] Hummer v. School City of Hartford City, 112 N.E.2d 891 (Ind. App. 1953); Schulte v. Hartford Accident & Indemnity Co., 102 F. Supp 681 (D. Minn. 1951); Stephenson v. City of Raleigh, 232 N.C. 42, 59 S.E.2d 195 (1950); Pohland v. Sheboygan, 251 Wis. 20, 27 N.W.2d 736 (1947); Jones v. Scofield Bros., 73 F. Supp. 395 (D. Md. 1947); Price v. State Highway Commission, 62 Wyo. 385, 167 P.2d 309 (1946); Utz v. Board of Education, 126 W. Va. 823, 30 S.E.2d 342 (1944); Lambert v. City of New Haven, 129 Conn. 647, 30 A.2d 923 (1943); Kesman v. School District of Fallowfield Township, 345 Pa. 457, 29 A.2d 17 (1942); Hartford Accident & Indemnity Co. v. Wainscott, 41 Ariz. 439, 19 P.2d 328 (1933). See also Report of the Attorney General of Nebraska 409 (1949-50).

[9] Adkins v. Western & Southern Indemnity Co., 117 W. Va. 541, 186 S.E. 302 (1936); Board of Education v. Commercial Casualty Ins. Co., 116 W. Va. 503, 182 S.E. 87 (1935); Hartford Accident and Indemnity Co. v. Wainscott, 41 Ariz. 439, 19 P.2d 328 (1933); 15 Appleman, Insurance Law and Practice 145, 171 (1944).

[10] See, e.g., Fielding v. Publix Cars, Inc., 130 Neb. 576, 265 N.W. 726 (1936). Note, 4 A.L.R.2d 761 (1949).

[11] See, e.g., Biggins v. Wagner, 60 S.D. 581, 245 N.W. 385 (1932); Gleason v. Baack, 137 Neb. 272, 289 N.W. 349 (1939). Note, 4 A.L.R.2d 761, 775 (1949).

situation here dealt with, of course, the fact of insurance is quite material, being essential to sustain liability. Moreover, it is not procedurally necessary to consider the issues relating to insurance in the action in which the insured's liability and the injured person's damage are determined. An action could be brought settling these questions, and a judgment rendered conditional on the existence of valid insurance covering the subject matter; then an action could be brought against the insurer at which time the questions of scope, coverage, and validity of the policy, etc., could be determined. This is apparently the practice in Tennessee[12] where, as mentioned later, the rule is that recovery is possible in the presence of insurance though governmental immunity would otherwise defeat it.[13]

At any rate, for one or another of the reasons outlined above, the majority of cases have held that the presence of insurance has no effect on the availability of a remedy for tort damage caused by an immune subdivision.[14] But two recent cases illustrate deviations from the uniform application of this rule, and have extended a remedy because of insurance where otherwise no remedy would be available.

The first of these cases was *Thomas v. Broadlands Community Consolidated School District*,[15] a recent Illinois decision. In that case the court by-passed the above arguments, and allowed recovery on the following rationale: the only substantial basis for the rule of governmental immunity is the desire to protect public funds from dissapation to satisfy private claims; thus when insurance is present as an available fund to satisfy a judgment, then to the extent of that fund the reason for the rule of immunity is absent, and the rule should disappear also. Though the result of the case is pleasing to the sense of justice, the reasoning of the court seems vulnerable. The court bases the removal of immunity on the existence of insurance providing an available fund. But the first argument for denying recovery, mentioned above, is that the nature and language of a liability insurance contract is such that the availability of the insurance depends upon the legal liability of the insured.[16] So, by removing the immunity because of the insurance the court is putting the cart before the horse, because the validity of the insurance by which the

12 Rogers v. Butler, 170 Tenn. 125, 92 S.W.2d 414 (1936).
13 See notes 21 and 22 supra.
14 See notes 7 and 8 supra.
15 348 Ill. App. 567, 109 N.E.2d 636 (1952).
16 See note 7 supra.

immunity is removed depends on the nonimmunity, and susceptability to judgment, of the insured.

The court also disposes quickly of the argument that the policy of insurance, being an illegal expenditure of public funds, is ineffective.[17] The court states that counsel has argued that the School District was not sufficiently autonomous to be entitled to make an effective waiver of its immunity by insuring, but goes on to say, in question-begging fashion, that it need not decide the question of whether the immunity has been waived because the existence of insurance terminates the immunity. Of course, here also the real question which the court avoids is whether the insurance, being a contract purporting to cover risks for which the subdivision is not responsible, is valid and available to serve as a fund by which the immunity may be terminated.

The court also seeks to draw support for its conclusion from an analogy to a line of cases involving charitable institutions, holding that recovery against the charity will be allowed pro tanto where insurance exists, though it would not be possible in the absence of insurance.[18] These cases, though, involve the proposition that the exception of charities from tort accountability in that jurisdiction has never been a true immunity from liability at all, but only an exemption of the trust funds of a charitable institution from execution to satisfy a judgment, so when insurance exists non-trust assets are present upon which execution may be levied.[19] In jurisdictions which regard the "immunity" of charitable organizations as an immunity from liability rather than from execution, as is the immunity of a governmental entity, the rule has been uniform that insurance has no effect.[20]

The other recent case allowing recovery for harm caused by an insured subdivision,[21] decided by a federal court applying

[17] See note 8 supra.

[18] Moore v. Moyle, 405 Ill. 555, 92 N.E.2d 81 (1950); O'Connor v. Boulder Colorado Sanitorium, 105 Colo. 259, 96 P.2d 835 (1939); McLeod v. St. Thomas Hospital, 170 Tenn. 423, 95 S.W.2d 917 (1936).

[19] The Tennessee court expressed the rationale of the rule as follows: "... we think it fairly may be said that the exemption and protection afforded to a charitable institution is not immunity from suit, not nonliability for a tort, but that the protection actually given is to the trust funds themselves. It is a recognition that such funds cannot be seized upon by execution, nor appropriated to the satisfaction of a tort liability." McLeod v. St. Thomas Hospital, 170 Tenn. 423, 95 S.W.2d 917 (1936).

[20] Cristini v. Griffin Hospital, 134 Conn. 282, 57 A.2d 262 (1948); Herndon v. Massey, 217 N.C. 610, 8 S.E.2d 914 (1940); Enman v. Trustees of Boston University, 270 Mass. 299, 170 N.E. 43 (1930); Levy v. Superior Court of California, 74 Cal. App. 171, 239 Pac. 1100 (1925).

[21] Bailey v. City of Knoxville, 113 F. Supp. 3 (E.D. Tenn. 1953).

Tennessee law, is the culmination of a line of Tennessee cases permitting pro tanto recovery against immune entities where insurance is present. The first of these, *Rogers v. Butler*,[22] based its decision on a rather strained interpretation of a statute permitting school districts to require their bus drivers to give a bond for the faithful interpretation of their duties. The court held that this statute sanctioned a practice by which the school district would secure liability insurance for the driving, as being one mode of providing against the consequences of unfaithful performance of the duty of driving busses with due care. Gradually, through intermediate cases, the statutory basis was distilled out of the rule,[23] until this latest case permitted an action against a city airport because there was insurance, where not only was there no statutory authority to insure but also there was a statute declaring operation of a municipal airport to be a governmental function, and providing that "no action or suit shall be brought or maintained against any municipality or its officers, agents, servants, or employees" with reference to such operation.

Except for the cases above-mentioned, the law in this area is overwhelmingly to the effect that, in the absence of statute, insurance does nothing to alter an existing immunity.[24] This result, which requires the injured individual to pay for his own damage rather than cast it on the insurer which contracted to compensate the victims, seems obviously undesirable, and it is not surprising that the *Thomas* case and the Tennessee decisions would defy theory in order to permit the victim to be compensated.

It is submitted that a more careful examination of the insurance contracts involved in the individual cases, and the purposes the parties intended to effectuate by those contracts, might often provide the basis for a reasonable theory on which the injured party might secure relief.

Of course, it is conceivable that an immune subdivision might enter into a liability insurance contract with an insurer which neither party intends should have any effect on the rights of persons injured by the governmental arts of the subdivision, and the parties may contemplate the continuance of whatever immunity may be present. For example, the subdivision might be one of those whose functions are characterized dually as governmental and proprietary—the latter of which may lead to lia-

[22] 170 Tenn. 125, 92 S.W.2d 414 (1936).

[23] Williams v. Town of Morristown, 32 Tenn. App. 274, 222 S.W.2d 607 (1949); Taylor v. Cobble, 25 Tenn. App. 167, 187 S.W.2d 648 (1945).

[24] See notes 7 and 8 supra.

bility; and the insurance might be intended to provide coverage for the non-immune risks. Or even with totally immune entities, a policy could be written, at reduced premium rates, by which the undertaking of the insurer is only to investigate and defend actions brought against the subdivision, to pay court costs, bonds, and other expenses of litigation, and to assume the risk of the abrogation of the immunity rule. Or the policy might contain an "omnibus" or extended coverage clause, by which good insurance would be provided against the personal liabilities of non-immune employees of the subdivision.[25] For example, a school district employing school bus drivers might take out a policy with an omnibus clause, and if the negligence of an employee, driving with the consent of the insured, causes the plaintiff's injury the plaintiff may sue the employee, who is not immune, and the policy would provide coverage to pay a judgment so obtained.

But in the majority of these situations where an immune entity insures, the motivation for securing the policy is to extend protection to anyone harmed by the subdivision's torts. The motivation is altruism, or a feeling of moral obligation to citizens who may be injured, and the contract is meaningless unless it is interpreted as an attempt to confer a benefit or right on any person who may come within the terms of the policy by being negligently harmed by the subdivision. If this is the situation, it would seem that the only reasonable interpretation of the parties' actions, and of the amount of premiums assessed for the policy, is that the injured party is constituted a donee third party beneficiary of the agreement,[26] on which he is entitled to sue despite the company's later decision not to abide by the terms of the contract.

In many of these policies issued to immune subdivisions is a so-called "Municipality Endorsement," similar to the following:

> In consideration of the premium charged for the policy to which this endorsement is attached, it is understood and agreed that

[25] The following is a sample of such a clause. "The unqualified word 'insured' . . . includes the named insured and . . . also includes any person while using the automobile and any person or organization legally responsible for the use thereof, provided the actual use of the automobile is with the permission of the named insured . . . ." 4 Richards, Insurance 2044 (5th ed. 1952). The question of authority of a subdivision to insure against the personal liabilities of its employees would be involved here. See notes 31 and 32 supra.

[26] It is not essential to the creation of a right in a third-party beneficiary that he be identified at the time the contract is made. Restatement, Contracts § 139 (1932).

> the Company will not avail itself of the legal immunity to which the insured may be entitled by reason of its being a public institution, and agrees to handle any claims covered by this policy as though the insured's legal status was that of a private corporation.[27]

Where, by such a clause or by the cost of the premiums paid for the policy it appears that the sole substantial concern of the subdivision, and the sole substantial undertaking of the company, is to extend compensation to anyone injured, notwithstanding the injured's legal right to compensation, it seems indefensible to permit the insurer to avoid its undertaking by setting up an immunity which it plainly agreed should be waived.

Such an interpretation would eliminate the objection that the nature of the policy of insurance is not to add to the plaintiff's rights, because what is involved is not an ordinary liability insurance policy, but a contract to pay the injured party regardless of the legal liability of the subdivision, as a third party beneficiary. Still to be met is the objection that entering into a contract to provide compensation to persons to whom the subdivision is under no legal liability is beyond the powers of the subdivision —that the subdivision lacks autonomy to waive its immunity by securing insurance.[28] But it is submitted that general principles of municipal law do not compel a conclusion that the insurer must be permitted to raise this defense.

In the first place, it seems anomalous to contend that a governmental subdivision, carrying on its activities for the benefit of the public, is not entitled to provide protection for members of the public whom it may negligently injure. Consonant with this position, it has been held that a city may recognize its moral obligation to one injured through its conduct by appropriating money to compensate for his damage, though the city was not legally responsible for his damage; and such compensation does

[27] Samples of such endorsements are set out in the following cases: Schulte v. Hartford Accident and Indemnity Co., 102 F. Supp. 681 (D. Minn. 1951); Stephenson v. City of Raleigh, 232 N.C. 42, 59 S.E.2d 195 (1950); Ford v. Glens Falls Indemnity Co., 80 F. Supp. 347 (E.D.S.C. 1948); Adkins v. Western and Southern Indemnity Co., 117 W. Va. 541, 186 S.E. 302 (1936); Hughes v. Hartford Accident & Indemnity Co., 223 Ala. 63, 134 So. 461 (1931). If such a municipality endorsement and the no-action clause both appear in the policy, there is a surface inconsistency. By application of any of a number of axioms of construction (specific controls general, written controls printed, endorsement controls contrary clause, last expression of intention controls, etc.), the endorsement will override any contrary inference from the noaction clause.

[28] See note 8 supra.

not constitute a gift but a satisfaction of an obligation which the city equitably ought to pay, though not legally required to pay.[29]

Moreover, it would seem that by accepting premiums pursuant to its undertaking, the insurer should be estopped from contending that the contract to which it is a party is an illegal expenditure of public funds.[30]

It has been mentioned above, in passing, that one technique by which it is possible in certain areas to provide protection for those likely to be damaged is to secure insurance, with an "omnibus" or extended coverage clause, by which, though the contract would not impose liability for the acts of the immune subdivision itself, if any of the non-immune employees within the protection of the extended coverage clause are themselves negligent, a personal judgment against them would be covered by the policy. This would arise most frequently where the injury is caused by negligent operation of a motor vehicle. Its most extensive utility would probably be in the area of school bus operation—an area that is productive of a large proportion of the litigation in this field. Where a policy with such a clause exists, and the injury is within the terms of the clause, the problem of the effect of insurance are different than where the subdivision is sued. For here there is no problem of whether the terms of the policy import an obligation of the insurer.

Still remaining is the power of the subdivision to make such a contract; and that problem is not quite the same as where the

29 Evans v. Berry, 262 N.Y. 61, 186 N.E. 203 (1933); McQuillin, Municipal Corporations § 39.24 (3d. ed. 1950); cf. Fairfield v. Huntington, 23 Ariz. 528, 205 P.2d 814 (1922); State v. Sims, 68 S.E.2d 678 (W. Va. 1952); Stone v. State, 251 Ala. 240, 37 So.2d 111 (1948). Though the units of government acting in these cases (states, or cities acting under Home-Rule Charter) are considered to have greater autonomy than is generally imputed to school districts, etc., which are usually involved in the cases with which we are here concerned, still the cases establish the proposition that compensation of equitable obligations is a legitimate public expenditure. And it is submitted that this obligation should also be cognizable even by officials of lesser units of government, as a proper concomitant of the potentially harmful activities in which they engage in the performance of their duties.

30 McCaleb v. Continental Casualty Co., 132 Tex. 65, 116 S.W.2d 679 (1938); McQuillin, Municipal Corporations § 29.133 (3d ed. 1950). Moreover, it is questionable whether an insurer has standing to raise collaterally the objection that insuring constitutes an unlawful expenditure of public funds. It is usually considered that only public authorities or a taxpayer may raise such a question. Schultz v. Krosch, 204 Minn. 585, 284 N.W. 782 (1939).

subdivision insures its own liability. For here it may be argued that the insurance amounts only to additional compensation to the employee, or to additional benefits tending to induce employment with the subdivision. Factors, of course, would be the extent to which the salaries of employees are specifically set by statute, and the degree of flexibility in according additional benefits which it is deemed the statute allows. But it is submitted that such insurance, whether viewed as a means of meeting the subdivision's moral obligation to injured parties, or as providing additional compensation or benefits to employees, should be upheld. The few cases which have considered this type of contract, however, have not differentiated it from the type where the subdivision insures its own immune activities, and have held the contract to be beyond the power of the subdivision.[31] Nebraska's Attorney General has also expressed such an opinion.[32]

The rule of immunity of governmental units is completely without merit in our day, in view of revised opinions of justice to injured individuals, and especially in view of the tremendously increased and stratified activities of government now carried on. The rule should be eradicated completely by the legislatures, and this abolition is being accomplished at a reasonably rapid pace. But the lag of legislative action behind renovated values of society and behind changed social conditions is notorious; and in the period of this lag, the attempts of enlightened officials of governmental units to provide available compensation through insurance should not be impeded or obstructed by an unnecessarily doctrinal approach. The courts could reach the just result and still avoid seriously vulnerable reasoning by treating the contract by which the insurer undertakes to compensate the injured individual, regardless of the subdivision's immunity, as a third party beneficiary contract, and by squarely recognizing that to provide compensation by means of insurance to those negligently injured, being a recognition of an obvious moral obligation, is a desirable and legitimate expenditure of public funds.

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[31] Hartford Accident & Indemnity Co. v. Wainscott, 41 Ariz. 439, 19 P.2d 328 (1933); Board of Education v. Commercial Casualty Co., 116 W. Va. 503, 182 S.E. 87 (1935).

[32] Report of the Attorney General of Nebraska 366, 374 (1945-46.

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