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Insurance—Covenant Not to Sue Defendant-Insured and Primary Insurer—Right of Action Against Defendant As Insured of Excess Insurer.—Deblon v. Beaton

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Insurance—Covenant Not to Sue Defendant-Insured and Primary Insurer—Right of Action Against Defendant as Insured of Excess Insurer.—*Deblon v. Beaton.*[1]—Plaintiff Deblon instituted a negligence action for damages against Foley, the owner of a motor vehicle in which plaintiff's decedent was a passenger, and against Beaton, the driver. Beaton's operation of the vehicle with Foley's permission was covered under the standard "omnibus" clause[2] of Foley's liability insurance policy. This policy, issued by Allstate Insurance Company (Allstate) had a $50,000 limit for this accident, and was the "primary" policy.[3] Beaton also was covered under his own policy written by the Jersey Insurance Company of New York of the Pacific of New York Group (Jersey). The Jersey policy included the standard "other insurance" clause which provides that if an accident is covered by another policy, the $10,000 limit of the policy is to be regarded as "excess" insurance and available only if a judgment in excess of the limits of the other policy is obtained.

Before the trial of the negligence action, plaintiff executed a "covenant not to sue." The instrument recited consideration of $46,500 and released Foley and Beaton to the extent of their personal assets and their Allstate coverage, but reserved plaintiff's rights against Jersey and against Beaton in his capacity as insured of Jersey. The $46,500 consideration was paid entirely by Allstate. Thereafter, plaintiff sought construction of the covenant as preserving her rights against Beaton as insured of Jersey. Jersey was made a party by the court for purposes of construing the instrument, and it moved for dismissal of the action for failure to state a claim.

The issue raised by the motion was whether the covenant, by releasing the personal assets of defendant Beaton, precluded further recovery against his excess insurer, Jersey. In support of the motion to dismiss, Jersey argued, first, that the covenant expressly released Beaton, and thereby precluded an effective reservation of rights against Jersey; and, second, that even if the instrument were construed according to the parties' intent to release all rights except those against Beaton as insured of Jersey, it could not be given legal effect.[4]

The court rejected both of Jersey's contentions and HELD: A plaintiff may divide defendant tortfeasor into three separate and distinct entities, individual, insured of the primary insurer, and insured of the excess insurer, and may release for consideration the individual and the primary insurer while retaining the right of action against the individual as insured of the excess insurer.[5] Thus, plaintiff was permitted to release Foley, Beaton and Allstate but to sue Beaton as insured of Jersey.

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[1] 103 N.J. Super. 345, 247 A.2d 172 (L. Div. 1968).

[2] This clause defines "insured" for purposes of coverage to include, for example, members of the named insured's household, and other persons using the vehicle with permission of the named insured.

[3] A policy is designated "primary" when there is other insurance covering the same liability and the other policy validly provides, for example, that with respect to temporary substitute motor vehicles, or insured's use of motor vehicles other than his own, the other policy shall be excess insurance over any other valid and collectible insurance.

[4] 103 N.J. Super. at 349-50, 247 A.2d at 174-75.

[5] Id.

Jersey's first argument—that release of defendant's personal assets automatically released Jersey—was based on the common law rules for the construction of releases and covenants not to sue. A release extinguishes the cause of action; however, a covenant not to sue has no effect on the cause of action itself, but terminates plaintiff's right to sue the potential defendants who are parties to the instrument.[6] Although the instrument may recite that it is a covenant or a release, the circumstances attending its execution determine whether it will operate as a covenant or a release.[7] The common law recognizes a distinction between covenants and releases based upon the relationship between the party with whom plaintiff executes the instrument (who shall be called A) and the party whom plaintiff then attempts to pursue (B). Where A and B are true joint tortfeasors—both having contributed to plaintiff's injury by independent negligent acts—a rule of construction favors the plaintiff. Thus, the agreement not to sue A need not expressly reserve plaintiff's rights against B since the intent of plaintiff, express or implied, to pursue B is permitted to control.[8] Therefore, the instrument operates as a covenant not to sue A and does not terminate plaintiff's right to sue B. However, where the instrument or circumstances indicate that A has made full satisfaction of plaintiff's claims, an intent to release B will be implied and given effect,[9] for it is a well established rule that the plaintiff may receive but one satisfaction.[10]

Where the liability of B is merely vicarious—that is, that of a master or principal (B) for the torts of his servant or agent (A)—a rule of law rather than a rule of construction governs. The rule is that any instrument releasing A will automatically absolve B regardless of plaintiff's attempt to reserve expressly his rights against the party secondarily liable.[11] Because B's liability arises merely by operation of law, an attempt to execute a covenant not to sue A will operate as a release of B, since there would no longer be any liability which can be imputed to B. Some jurisdictions have abrogated this common law rule and permit construction of the instrument even where B's liability is only derivative.[12] Thus, release of A with an express reservation of rights against B would be permitted to operate as a covenant not to sue A.

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[6] See Hulke v. International Mfg. Co., 14 Ill. App. 2d 5, 142 N.E.2d 717 (1957).

[7] See Bacon v. United States, 321 F.2d 880 (8th Cir. 1963).

[8] 76 C.J.S. Release § 50(a)(2) (1952). See McKenna v. Austin, 134 F.2d 659 (D.C. Cir. 1943).

[9] See Breen v. Peck, 28 N.J. 351, 363-64, 146 A.2d 665, 671-72 (1958).

[10] New Amsterdam Cas. Co. v. O'Brien, 330 S.W.2d 859, 865 (Mo. 1960).

[11] Simpson v. Townsley, 283 F.2d 743 (10th Cir. 1960); Seaboard Air Line R.R. v. Coastal Distrib. Co., 273 F. Supp. 340, 342-43 (D.S.C. 1967); Holcomb v. Flavin, 34 Ill.2d 558, 563-64, 216 N.E.2d 811, 815 (1966); Bergeron v. Gifford-Hill & Co., 137 So. 2d 63 (La. Ct. App. 1962); Barsh v. Mullins, 338 P.2d 845, 848-50 (Okla. 1959).

The rule that a covenant not to sue the servant automatically absolves the master also appears to be followed in New Jersey, Rossum v. Jones, 97 N.J. Super. 382, 389, 235 A.2d 206, 210 (App. Div. 1967), except where plaintiff, at the time when he released the servant, was unaware that he was employed. See Hamburger v. Paterson Tallow Co., 122 N.J.L. 457, 5 A.2d 487 (Sup. Ct. 1939). The rule announced in Breen v. Peck, 28 N.J. 351, 364, 146 A.2d 665, 672 (1958), that "release of one joint tortfeasor does not necessarily release others" appears to have been applied only to true joint tortfeasors.

[12] See United States v. First Sec. Bank, 208 F.2d 424 (10th Cir. 1953), construing the Federal Tort Claims Act, 28 U.S.C. § 2676 (1964); Ellis v. Jewett Rhodes

The foregoing discussion indicates that precedent does exist for the construction of an instrument as a covenant not to sue in order to preserve rights against joint tortfeasors or vicarious obligors.[13] However, the liability of an insurer is distinguishable from both, and logically should be immune from the application of any intent test. Unlike a joint tortfeasor, the insurer commits no independent act of negligence, and unlike a vicarious obligor, the insurer, in the absence of a direct action statute, may not be pursued in the first instance by the injured party. The insurer's obligation is purely contractual and contingent—"to pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages."[14] The obligation of the insurer seems more analogous to that of the guarantor of a debt.[15] It is well settled that the creditor's release of the principal obligor operates as a matter of law as a release of the guarantor's contractual liability.[16] However, the *Deblon* court applied a rule of construction by which the intent of plaintiff to create a covenant rather than a release controlled so that plaintiff was permitted to release Beaton from personal liability without releasing his liability as insured of Jersey. This treatment of the insured-insurer relationship fails without adequate justification to conform to the common law rules.

The court's finding that Jersey was not automatically released by the covenant was only preliminary to the second and more important question: whether plaintiff's intention to split the defendant's liability can be given legal effect.[17] Jersey quite logically argued that, under the insurance contract, its obligation to pay matured only after the insured became legally obligated to pay, that is, after a trial and judgment against the insured.[18] Thus, the release of Beaton's personal assets released his entire liability so that Beaton could not be sued, and Jersey's duty to pay could never mature. Again, the situation might be compared to that of a debtor and surety. It would be im-

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Motor Co., 29 Cal. App. 2d 395, 84 P.2d 791 (1938); Wilson v. New York, 131 N.Y.S.2d 47 (Sup. Ct. 1954).

[13] But see note 11 supra and accompanying text.

[14] 103 N.J. Super. at 350, 247 A.2d at 175.

[15] Jersey's Supplemental Memorandum of Law in Support of Motion at 2.

[16] See S. Williston and G. Thompson, Williston on Contracts § 339 (student ed. 1938).

[17] It should be noted that Jersey did not raise the argument that, because the consideration paid was $46,500 rather than the full $50,000 limit of the Allstate policy, its liability could never become effective because the limits of the primary policy were not exhausted. It has been held that there is no requirement that the limits of the primary policy be exhausted, only that the defendant receive credit for that amount. Benroth v. Continental Cas. Co., 132 F. Supp. 270, 276 (W.D.La. 1955). Where the instrument recited the limits of the policy as consideration, though the amount actually paid left a margin comparable to that in *Deblon*, it was deemed sufficient to ignite the liability of the excess insurer. Futch v. Fidelity & Cas. Co., 136 So. 2d 724, 730 (La. Ct. App. 1961), aff'd, 246 La. 688, 166 So. 2d 274 (1964). The result would probably not vary on the facts of *Deblon*, for it is implicit in the instrument that the full liability of Allstate is released. Moreover, should the judgment be less than $60,000, Jersey would be liable only for that amount which exceeds $50,000.

[18] The court agreed that "a jury verdict of negligence and damages in excess of the primary coverage" is required, 103 N.J. Super. at 351, 247 A.2d at 175, but it would permit the verdict to be reached in a suit against a partial defendant, Beaton, as insured of the excess insurer.

proper to permit the creditor to release the debtor's personal assets and to sue him only as he is secured by the guarantor. Rather, the ability of the creditor to pay should be exhausted before the guarantor's liability ripens. The insurer's liability differs from the surety's only with respect to the time at which it takes effect. The liability of the insurer arises not when the insured's assets are exhausted, but when a liability which would otherwise be executed against those assets is established. In either case, once the liability of the insured or debtor to pay from his personal assets is extinguished, the condition precedent to the insurer's or surety's liability could never be fulfilled.[19] The *Deblon* court appears to view the insurance policy as an unconditional asset of the insured rather than a contingent asset.[20]

The court sustains the covenant's intended effect to split the defendant into more than one suable entity on three grounds. First, the insurance contract was one of liability rather than indemnity.[21] Second, precedent was supplied by decisions in two other jurisdictions which did not turn on the respective direct action and partial release statutes in force in those states.[22] Third, a strong public policy in New Jersey favored the availability of liability insurance to injured parties.[23]

The difference between liability and indemnity insurance lies in the conditions precedent to the accrual of the insurer's obligation to pay.[24] No action may be brought on a contract of indemnity until after the insured has discharged the liability.[25] Then the insured may seek reimbursement for his loss actually sustained. However, a liability insurer takes the place of the insured and pays in his stead a judgment entered against the insured.[26] Although Beaton is not required to pay from his personal assets before pursuing Jersey, the court's use of this distinction is not so persuasive as to satisfy the condition that there be a judgment against Beaton which attaches to his personal assets. Unless the insurer's obligation is considered an absolute asset, it seems technically impossible under the terms of the covenant to fulfill the condition precedent to Jersey's liability.

Second, the court relied on two recent cases which on facts indistinguishable from *Deblon* reached the same conclusion. The first, *Futch v.*

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19 In Defendant's Motion for Leave to Appeal at 7, it was emphasized that it would be technically impossible to enter a judgment according to the intention of the covenant. Under New Jersey law, any judgment in excess of $50,000 would create an automatic lien against Beaton's real property in New Jersey until the liability of Jersey could be established. Id. at 7.

20 Cf. Seider v. Roth, 17 N.Y.2d 111, 216 N.E.2d 312, 269 N.Y.S.2d 99 (1966), which characterized the obligation of an insurer as a debt subject to attachment, and rejected the argument that it is merely a contingent obligation. Criticized in 8 B.C. Ind. & Com. L. Rev. 147 (1966).

21 103 N.J. Super. at 350, 247 A.2d at 175.

22 Id.

23 Id. at 351, 247 A.2d at 175.

24 Id. at 350, 247 A.2d at 175.

25 8 J. Appleman, Insurance Law & Practice § 4831 (1962) [hereinafter cited as Appleman]. See Viddish v. Hartford Accident & Indem. Co., 41 N.J. Super. 221, 225, 124 A.2d 607, 608-09 (App. Div. 1956).

26 Appleman § 4831.

Fidelity & Cas. Co.,[27] arose in Louisiana. Louisiana has a direct action statute permitting a cause of action for negligence to be brought against the insurer in the first instance.[28] The statute has been held not to create an independent substantive cause of action, but to permit the plaintiff to enforce his fundamental cause of action against the insurer.[29] This new remedy is most beneficial for plaintiffs when the person of the defendant is not subject to service of process, since under the statute he is not a necessary or indispensable party. When the defendant is subject to the jurisdiction, the plaintiff is given the choice of pursuing either the tortfeasor or his insurer. However, under the direct action statute the contractual obligation of the insurer remains the same, that is, to pay only when the insured is liable. And if the substantive cause of action against the insured is extinguished by an instrument of release prior to trial, the procedural right of direct action against the insurer falls also by operation of law.[30] Thus, the statute does not encompass the issue whether the release of the insured's personal asset extinguishes the cause of action against the insured which is the necessary foundation for the insurer's liability.

Futch held that release of the primary insurer and the defendant to the extent of his personal assets with reservation of rights against the excess insurer did not operate as a release of the excess insurer. The Louisiana court relied in part on the case of *Benroth v. Continental Cas. Co.*,[31] in which the primary insurer alone was released, with retention of rights against both the tortfeasor and the excess insurer. Thus, *Benroth* did not clearly raise the issue presented in *Futch* and *Deblon* because the person of the defendant was by the terms of the instrument still liable and available as a foundation for the direct action against the excess insurer. *Futch* also supported its holding with a principle of public policy, that "an insurance policy against liability is not issued primarily for the protection of the insured but for the protection of the public."[32] Only to the extent that this policy was clearly articulated by the direct action statute was that legislation essential to the holding. Therefore, only if equal weight can be given to New Jersey's judicially promulgated policies and Louisiana's legislated policy is *Futch* sound precedent for the *Deblon* holding.

The second case relied upon by *Deblon* arose under the Missouri partial release statute.[33] The *Deblon* court stated that *Farmers Mut. Auto. Ins. Co. v. Drane*,[34] like *Futch*, did not turn on the particular statute involved. However, the Missouri statute as construed by its own court was necessary for the decision; therefore, *Drane* is not sound authority for judicial enforcement of defendant-splitting. The statute provided:

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[27] 136 So. 2d 724 (La. Ct. App. 1961), aff'd, 246 La. 688, 166 So. 2d 274 (1964).

[28] La. Rev. Stat. Ann. § 22:655 (1959).

[29] Dumas v. United States Fidelity & Guar. Co., 241 La. 1096, 1118, 134 So. 2d 45, 52 (1961) (on rehearing).

[30] Id. at 1118, 134 So. 2d at 52.

[31] 132 F. Supp. 270 (W.D. La. 1955).

[32] 136 So. 2d at 728-29, citing Davies v. Consolidated Underwriters, 199 La. 459, 476-77, 6 So. 2d 351, 357 (1942).

[33] Mo. Ann. Stat. § 537.065 (Pocket Supp. 1968).

[34] 383 S.W.2d 714 (1964).

> Any person having an unliquidated claim for damages against a tortfeasor, on account of bodily injuries or death, may enter into a contract with such tortfeasor or any insurer in his behalf or both, whereby, . . . [the plaintiff] agrees . . . [that] he . . . will [not] levy execution . . . except against the specific assets listed in the contract and except against any insurer . . . which is not excepted . . . by such contract.[35]

The insurer contended that release of the original tortfeasor's assets for consideration raised a bar to litigation between the plaintiff and the tortfeasor, which bar could not be avoided by any statute. The court replied that the effect of the statute on preexisting legal theories was similar to the effect of a statute which changed the rule that a settlement with one joint tortfeasor constituted a settlement for all tortfeasors.[36] Thus, the court recognized that the statute ostensibly authorized the plaintiff to enter into a contract not to execute against certain assets of defendant, but in effect preserved the liability of the defendant for purposes of reaching his insurer. The court declined to comment on whether the instrument would have operated as a release of the insurer in the absence of the statute, but the fact that the statute was specifically enacted for the *Drane* action during its pendency[37] strongly suggests that the insurer would have been released by the instrument in the absence of statute.

Because both the indemnity-liability distinction and the cases cited by *Deblon* are inherently weak as authority, the essence of the *Deblon* decision is clearly public policy. Indeed, *Futch*, the only applicable precedent, was based on policy as well. The *Deblon* court cited three "jurisprudential guideposts" of New Jersey law to support its conclusion as being in the "public interest." These guideposts indicate a judicial trend toward a policy of expediting full compensation for plaintiff's by (1) making the defendant's liability insurance more available to injured plaintiffs,[38] (2) acknowledging that the injured party acquires an interest in the insurance policy at the time of the accident,[39] and (3) construing the insurance policy to afford the widest possible coverage.[40]

By characterizing the insurance policy as an absolute rather than a contingent asset of the defendant, *Deblon* permits the defendant's liability to be perpetuated by a mitotic process. This characterization is not defensible except as it furthers other public policies having a firmer foundation in logic. First, in instances where there are two liability insurers, the *Deblon* rule encourages the plaintiff to settle with one insurer since recovery from the second insurer will not be precluded, and offers the defendant incentive to agree by protecting his personal assets. *Deblon* also promotes the policy of

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35 Mo. Ann. Stat § 537.065 (Pocket Supp. 1968).

36 383 S.W.2d at 719.

37 Id. at 718.

38 Sneed v. Concord Ins. Co., 98 N.J. Super. 306, 321, 237 A.2d 289, 296 (1967).

39 In re Estate of Gardinier, 40 N.J. Super. 261, 265, 191 A.2d 294, 296 (Sup. Ct. 1963).

40 American Policyholders' Ins. Co. v. Portale, 88 N.J. Super. 429, 439, 212 A.2d 668, 674 (1965).

making the insurer's deep pockets more accessible. The social importance of directing the financial burden away from impecunious defendants and ultimately away from the state cannot be gainsaid. Thus, liability insurance is regarded as an instrument of social policy[41] rather than as a private—albeit adhesion—contract between the insurer and insured, and judicial decisions, such as *Deblon,* which assail the contractual position of the insurer become easier to accept.

The effect of *Deblon* on the insurance contract is to controvert the language of the "no action" clause which provides that the company cannot be sued unless the amount of the insured's obligation has been finally determined by judgment against the insured after actual trial. The purpose of the clause is to avoid jury prejudice by withholding the fact of defendant's insurance from the jury. This prohibition is aimed at joinder and impleader[42] of the insurer, and direct action against the company. Although the court, in effect, permits the plaintiff to proceed only against the excess carrier, it may be assumed that the fiction of defendant-splitting will preserve the benefits of secrecy which are the purpose of the "no action" clause. Presumably, the named defendant in the negligence action will be "Beaton" rather than "Beaton as insured of Jersey" and the jury need not be made aware of (1) the fact that Jersey is involved, (2) the limits of coverage, or (3) Allstate's settlement. Nor does *Deblon* change the position of Jersey in the courtroom, for the insurer's obligation to defend would have required it to provide counsel and preparation for the whole defendant, had not two-thirds of him been released.[43] Thus, *Deblon* achieves the effect of direct action against the insurer without violating the purpose of the "no action" clause.

The effect of *Deblon,* however, is distinguishable from direct action and joinder, other methods for circumventing or negating "no action" provisions in the insurance contract. Direct action statutes permit action against the insurer alone before a judgment is entered against the insured.[44] The public character of insurance is deemed sufficient to confer on the states the broad power to impose such regulations.[45] The *Deblon* result seems analogous to direct action because both characterize the insurer as more than a contingent

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[41] Appleman § 4861.

[42] The standard "No Action" clause was clarified in 1958 . . . to provide that, not only shall the Co. [insurance company] not be sued as a party along with the insured, but also [that] the Co. may not be impleaded by the insured or his legal representative. Thus under the latest revision [of the no action clause], the insured must wait in order to sue the Co. until a judgment has been entered against the insured after an "actual trial".

Gowan, Provisions of Automobile and Liability Insurance Contracts, 30 Ins. Coun. J. 96, 106 (1963) (footnote omitted).

[43] A clause of the insurance contract usually invests the company with the right and duty to defend any suit against the insured seeking damages payable under the terms of the policy, to investigate the accident, and to pay in addition to the applicable limits of liability all expenses and costs incurred by the company in defending the suit.

[44] See Appleman § 4863.

[45] See Comment, Direct-Action Statutes: Their Operational and Conflict-of-Law Problems, 74 Harv. L. Rev. 357, 359 (1960). But see Kuntz v. Spence, 67 S.W.2d 254 (Tex. Comm'n App. 1934).

asset of the injured. However, *Deblon* does not give the plaintiff the substantial benefit of direct action—that defendant insured is not an indispensable party —since in *Deblon* jurisdiction over the insured must be secured.

Judicial sanction of joinder has been permitted on two bases. First, where insurance is required of common carriers by statute or ordinance, some courts decline to enforce the "no action" clause, both because the jury would already be aware that an insurer is involved,[46] and because the statute or ordinance is construed to confer a benefit on the injured party.[47] Second, some jurisdictions have rules of civil procedure providing that "any person may be made a defendant who has or claims an interest adverse to the plaintiff,"[48] and those courts consider the insurer such a real party in interest as to fall within this definition of defendant.[49]

The New Jersey courts have not yet permitted joinder of the insurer in a negligence action. Because New Jersey has no compulsory insurance law for all motor vehicles, its courts would be unable to permit joinder on the ground that no reason for secrecy exists. Nor does New Jersey have a rule of procedure like the rule mentioned above. The *Deblon* rule is distinct from joinder in that under the former the insurer is technically not a separate suable entity, but an asset of the defendant which may be sued *through* the defendant rather than *with* him.[50] Moreover, even where joinder is permitted, a covenant prior to trial releasing the personal assets of the defendant tortfeasor might be construed to release the insurer. Both *Deblon* and joinder effectuate the policy of diminishing piecemeal litigation—the former by encouraging partial settlement before trial and thereby eliminating the need for an action to determine the liability of the primary insurer, and the latter by resolving the issue of insurer's liability as part of the negligence action.

As a general rule, in the absence of a statute or contractual provision, the plaintiff has no right against the tortfeasor's insurer.[51] By permitting the plaintiff to split the defendant into separate and distinct entities—individual, insured of the primary insurer, and insured of the excess insurer—and to release two of these entities for consideration but to retain a right of action against the individual as insured of the excess insurer, *Deblon* has eroded this rule. The policies promotive of at least partial settlement and the establishment of liability insurance as an instrument protecting injured complainants are so strong that any adverse effect of the decision on the "no action" clause of the insurance policy is justified. However, unlike direct action or joinder, the decision does not prevent the achievement of a purpose of the "no action" clause, prevention of jury prejudice through concealment of the fact that

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[46] Appleman § 4862.

[47] Id. See Enders v. Longmire, 179 Okla. 633, 67 P.2d 12 (1937).

[48] E.g., Fla. Stat. Ann., Rules of Civil Proc., R. 1.210(a) (1967).

[49] Bussey v. Shingleton, 211 So. 2d 593 (Fla. 1968); See James v. Young, 77 N.D. 451 43 N.W.2d 692 (1950).

[50] Perhaps *Deblon* may be compared more accurately to a right of limited appearance by which the defendant's liability in the negligence action is limited to the value of stipulated assets. See Developments in the Law—State-Court Jurisdiction, 73 Harv. L. Rev. 909, 953 (1960).

[51] See Chamberlin v. City of Los Angeles, 92 Cal. App. 2d 330, 206 P.2d 661 (1949).

defendant is insured. Nor does *Deblon* make the insurer a separate suable entity as does direct action and joinder, although it approaches that result by characterizing the insurer as something more than a contingent asset of the insured.

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