Boston College Law Review

Volume 7 | Issue 3 Article 27

4-1-1966

Insurance—Direct Action Statutes—Shipowner's Limitation of Liability.—In the Matter of Independent Towing Co.

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have done, in effect reposed in the brand owner a greater amount of flexibility. Further, were New York a "state liquor monopoly" state, having a state agency as wholesaler and buyer from the brand owner, the agency could by force of its economic power or by statute require the same affirmation that the present statute requires, as is done in Pennsylvania.[39] Thus, to declare the statute invalid for reason of the method selected to achieve the desired results would be to penalize the state for granting to the industry more rights and flexibility than it had to give or to penalize the state for not operating its own liquor monopoly. This would put a premium on form and cleverness rather than on substance and straightforwardness.

The Supreme Court has noted jurisdiction.[40] The liquor industry, if it is to prevail, is faced with a formidable task. The industry must convince the Court that the objectives of the statute are not protected by the twenty-first amendment and are an unwarranted exercise of police power[41] or that the method chosen to achieve the objectives is invalid because of the extra-territorial effects that result from the operation of the statute. It is submitted that the statute's objectives are well within the powers granted the states by the twenty-first amendment; that the statute is a valid exercise of police power; and that the indirect extraterritorial effects of the statute are not such as to render the statute unconstitutional.

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Insurance—Direct Action Statutes—Shipowner's Limitation of Liability. —*In the Matter of Independent Towing Co.*[1]—The claimants brought an action in the federal district court in Louisiana against the owners of the tug Itco III for damages suffered in a maritime accident in Louisiana waters. The tug owners, in turn, filed for a limitation proceeding.[2] An injunction was issued prohibiting all suits against the vessel and owners until determination of the limitation proceeding. The claimants then instituted actions against the vessel's insurer pursuant to Louisiana's direct action statute.[3] The insurers, claiming that no direct action could be brought against them until final determination of the limitation proceeding, sought a stay. They maintained that they could not be found liable until the shipowner's liability had been established, and then only up to the amount that the

[39] Supra note 1, at 57, 209 N.E.2d at 704, 262 N.Y.S.2d at 80.

[40] 34 U.S.L. Week 3182 (U.S. Nov. 23, 1965) (No. 545).

[41] The argument can be persuasively made that the statute is a valid exercise of police power, apart from the twenty-first amendment, under the decision in Nebbia v. New York, 291 U.S. 502 (1934), in that a state can protect its citizens from discriminatory pricing. The regulation is valid unless arbitrary, discriminatory, or irrelevant to a policy the legislature is free to adopt. In the present case, the state has enacted a statute aimed at protecting its citizens; the statute can be shown to be neither arbitrary nor discriminatory; and it is sufficiently flexible to allow the industry to adjust prices to a profitable level.

[1] 242 F. Supp. 950 (E.D. La. 1965).

[2] Rev. Stat. § 4283 (1875), 46 U.S.C. § 183 (1964).

[3] La. Rev. Stat. § 22:655 (Supp. 1964).

owner would be required to pay. HELD: Direct action may be brought against the underwriters before final determination of the limitation proceeding.

The relevance of the shipowner's limitation of liability in an action commenced directly against the shipowner's insurer is a problem that has plagued the courts. The limitation of liability statute, passed by Congress in 1851, provides:

> The liability of the owner of any vessel . . . for any loss, or destruction by any person of any property . . . shipped or put on board of such vessel, or for any loss, damage, or injury by collision, or for any act . . . done, occasioned, or incurred, without the privity or knowledge of such owner or owners, shall not . . . exceed the amount or value of the interest of such owner in such vessel, and her freight then pending.[4]

The limitation proceeding was intended to serve a twofold purpose: (1) To encourage investment in the merchant marine by limiting the liability of owners for the acts and accidents of masters of their ships, where such acts were done "without the privity or knowledge"[5] of the owners; and (2) to consolidate into one proceeding all possible claims against a ship or its owners[6] and hence avoid the harassment, inconvenience and expense to the shipowners of defending suits in a number of jurisdictions.

The limitation proceeding, as was first noted by Judge Ware in *The Rebecca*,[7] has traditionally been regarded as a defense personal[8] to the shipowner. Thus, with the advent of the direct action statutes, the question arose whether the defense was also available to the insurer.

Under the Louisiana direct action statute:

> No policy or contract of liability shall be issued or delivered in this state, unless . . . the injured person . . . shall have a right of direct action against the insurer . . . , and such action may be brought against the insurer alone, or against both the insured and insurer jointly and in solido . . . . It is also the intent of this Section

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[4] Rev. Stat. § 4283 (1875), 46 U.S.C. § 183(a) (1964).

[5] Where privity or knowledge exists on the part of the owner, he is unable to claim the benefit derived from the statute. Ibid.

[6] Claims are to be filed within 6 months; later claims may be allowed, but only if not prejudicial to the shipowner. Rev. Stat. § 4285 (1875), 46 U.S.C. § 185 (1964).

[7] 20 Fed. Cas. 373 (No. 11619) (C.C.D. Me. 1831). This was the first United States case recognizing the European common law defense of limitation of liability. As discussed in the opinion, the limitation proceeding was personal to the shipowner and solely for his benefit. Id. at 378-80. Consequently, the limitation of liability was recognized in the United States prior to its formal adoption by the Act of 1851, and has always been regarded as personal to the shipowner.

[8] Among the personal defenses which are not available to the insurer in a direct action are the insolvency of the insured, incapacities arising out of the personal relationships between injured and insured (such as husband-wife or father-son) and, in general, defenses which do not arise out of the contract of insurance. See, e.g., Edwards v. Royal Indem. Co., 182 La. 171, 176, 161 So. 191, 194-95 (1953) (husband and wife).

> that all liability policies . . . are executed for the benefit of all injured persons . . . .[9]

The uniqueness of the Louisiana statute is that suit may be brought by the injured party against the insurer *prior* to the determination of the insured's liability;[10] in the majority of states with direct action statutes, suits against the insurer are allowed only *after* a determination of the insured's liability.[11] Louisiana courts have, in addition, interpreted the statute to deny to the insurer, when sued in a direct action, the personal defenses of the insured.[12] The rationale behind this is simple: the sole reason for allowing personal defenses is that public policy deems them necessary; consequently, when the reason for their necessity fails, so does the right to plead them.[13] In the instant case, the court concluded that public policy demanded protection only for the shipowner, and since there were no policy reasons to extend the limitation to the insurer, he was not allowed to avail himself of the defense.

In denying the availability of the defense to the insurer, however, the court was beset with a new problem: if an action is allowed against the insurer, and he is found liable and pays his liability, the full value of the insurance may be used up; if, afterwards, the insured is sued directly, he would be liable up to the amount determined in a limitation proceeding, and would not be able to look to the insurer for indemnification by reason of the prior extinction of the latter's obligation. Thus, the insured would lose the benefit of his insurance policy.

This precise problem previously reached the United States Supreme Court in *Maryland Cas. Co. v. Cushing*.[14] In that case, as in the instant case, the issue was whether the same Louisiana direct action statute should be applicable in a maritime casualty action. Four of the Justices felt that the application of the statute to maritime claims would defeat the purpose of the limitation proceeding.[15] In considering the possible loss of the insurance benefits by the shipowner, they concluded that "to permit direct actions under the State statute would require that shipowners become self-insurers for liability risks in order to be sure of getting the full protection of the limitation legislation."[16] Four dissenting Justices thought that the direct action should be allowed since otherwise the insurer would be benefited by the limitation proceeding, which is neither the original intent nor a desir-

[9] La. Rev. Stat. § 22:655 (Supp. 1964).

[10] Ibid. See Ruiz v. Clancy, 182 La. 935, 162 So. 734 (1935).

[11] E.g., Conn. Gen. Stat. Ann. § 38-175 (1958); Mass. Ann. Laws ch. 175, §§ 112, 113 (1959); N.Y. Ins. Law § 167. See generally Leigh, Direct Actions Against Liability Insurers, 1949 Ins. L.J. 633, 637 (1949).

[12] Edwards v. Royal Indem. Co., supra note 8, at 174-78, 161 So. at 193-94. In this case the wife of the insured was injured in an automobile accident. In a direct action against the insurer, coverture was pleaded as a defense. The court held that such a defense was personal to the husband and such "personal defenses" were not available to the underwriters.

[13] Ibid. See also Dunlap v. Dunlap, 84 N.H. 352, 367, 150 Atl. 905, 912 (1930).

[14] 347 U.S. 409 (1954).

[15] Id. at 413-23.

[16] Id. at 419.

able extension of the federal statute.[17] Mr. Justice Clark, in a separate opinion, recognized the problem of the loss of insurance benefits but felt that it could be avoided by allowing a direct action to be instituted only *after* determination of the limitation proceeding.[18]

The district court, announcing its intention to resolve the 4-4-1 stalemate of *Cushing*, established the following alternatives:

> I. If the policy limits be sufficient to satisfy the claims established in the direct actions, there the matter ends, and the limitation proceeding as concerns the direct action claimants would become moot.
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> II. Should the insurance coverage be insufficient to satisfy all the claims in the direct action against the insurer, then the court would proceed with the limitation hearing.
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> A. If the limitation is granted and the amount of the limitation fund exceeds the insurance coverage, then the fund would be credited with the insurance recovery, and the remainder would be distributed to the claimants in accordance with the amount and rank of the claims proven.
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> B. If limitation is granted, but the fund is less than the amount of insurance coverage, then the limitation fund is credited with the amount already recovered from the shipowner's insurer, and no further recovery would be allowed.
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> C. If no limitation of liability is granted, then the shipowner would be credited with the amount of damages recovered from the insurer in the direct actions, and then stand liable for the entire amount by which the proven damages exceed the insurance coverage.[19]

In the case at hand, since a limitation proceeding had already been commenced prior to institution of the direct action statute and the plaintiffs in the direct action suit were identical with the plaintiffs in the suit against the shipowner, these alternatives are sufficient. However, where the direct action is commenced prior to any determination of the liability of the insured, the insurer may not plead limitation of liability as a defense. Applying the alternatives set forth by the district court, the insurer would then pay the judgment obtained in the direct action to the claimants therein to the extent of the policy.[20]

Consider the situations this could create: later, before the expiration of the statute of limitations, another claimant who was not a party to the direct action suit might bring a claim against the insured. Even if limitation were granted, since the insured could not be credited with any insurance fund (this having already been extinguished), he would, as a consequence, lose the benefit of his insurance policy. Similarly, if the plaintiffs in the direct action suit are not identical with those in a concurrently instituted

[17] Id. at 427-38.
[18] Id. at 423-27.
[19] In the Matter of Independent Towing Co., supra note 1, at 956.
[20] Ibid. This situation would fall under alternative I.

suit against the shipowner, there is nothing in the court's alternatives to prevent the former plaintiffs from recovering the entire insurance proceeds if their suit is completed first, leaving the latter plaintiffs to satisfy any judgment they might obtain only out of the personal assets of the shipowner.

In the second of these situations, it might be argued that the commencement of the limitation proceedings by the shipowner would force all plaintiffs to join in that suit or be barred by the six month federal statute of limitations. It is likely that this federally guaranteed right to consolidate would not be allowed to be abrogated by a state procedural statute. But where the limitation proceeding is not commenced before judgment is rendered in the direct action suits, the federal statute of limitations cannot begin to run, and hence the insurance funds may be dissipated by the direct action plaintiffs. If the insured, in a later judgment against him, is thus denied the benefits of his insurance, this may result in a deprivation of his federally guaranteed right to a limitation of liability. His out-of-pocket payments really include not only the liability determined in the limitation proceedings but also the amount of the insurance premiums paid in to obtain the insurance fund dissipated in the earlier direct action.

This problem of increasing the shipowner's required payment beyond that determined in the limitation proceeding might be met by allowing the insured to deduct from his liability the amount he has paid out in premums.[21] However, this has the obvious disadvantage of favoring early claimants, and imposing the cost of payments to later claimants, contrary to the usual practice of allowing every claimant to share the total liability of the shipowner in proportion to his claim.

Another solution, and a logical extension of the alternatives put forth by the court, would be to credit the shipowner with any judgments paid by the insurer in a direct action. Although this would give the insured the full benefits of his policy, it would work to the detriment of the injured, contrary to the policy of the Louisiana direct action statute that insurance policies be construed for the benefit of the injured party.[22] A prior limitation proceeding, on the other hand, would serve to consolidate all claims, such that all claimants would share equally and proportionately.[23]

Perhaps it could be required that any sums recovered against the insurer be paid into a court fund until the statute of limitations has run. This would also permit the insured to retain the full benefits of his insurance. This would have the disadvantage, however, of delaying recovery to needy claimants, and to institute such a system would likely require legislative amendment.

Even if a satisfactory solution to this problem can be found, to allow suits against the insurer without a prior limitation proceeding will also defeat a second purpose of the federal limitation statute—the consolidation of suits against the shipowner. A multiplicity of claims filed against the insurer in a variety of jurisdictions would force the insurer to defend all over the

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21 Norwich Co. v. Wright, 80 U.S. (13 Wall.) 104, 119-21 (1871).
22 La. Rev. Stat. § 22:655 (Supp. 1964).
23 49 Stat. 1479 (1936), 46 U.S.C. § 183(b) (1964).

country. Since the witnesses relied on by the insurer in defense of these actions will no doubt include the crew and associates of the insured's ship, the insured will have to allow his employees to partake in these actions thus possibly leaving his ship inactive. On the other hand, if the suits had been brought against the insured, a limitation proceeding would have determined all the factual issues involved, become binding on all claimants, and thus eliminated the need for the employees' testimony at any other trials.[24]

Clearly, then, solutions additional to those proposed by the court must be found. An obvious solution would be to have the insurance company join all possible plaintiffs[25] in a single proceeding. However, this would be possible only where all claimants are within the jurisdiction of the court and, consequently, joinable. Considering the possible ramifications of the present holding,[26] the most practical solution seems to remain that set forth by Mr. Justice Clark in the *Cushing* case—that the Louisiana direct action statute be applicable to cases of marine insurance, but only *after* determination of the shipowner's liability in a limitation proceeding.[27] This would effectuate consolidation of suits, assure the shipowner the maximum benefit of his insurance, and protect all claimants. Although such a solution may appear contrary to existing Louisiana law, this area of maritime insurance requires an exception in the application of the direct action statute if justice is to be better served.

It is likely that the district court was influenced by the feeling that need for limitation proceedings no longer exists, and was responding to congressional inaction in the area; Congress has afforded relief to the injured claimants in maritime casualties only once in the hundred-plus years this statute has been in effect.[28] Now, in a time when insurance has become the dominant consideration of tort liability and such a large part of our way of life, the need for limitation no longer exists. The time is ripe for a legislative re-examination of the area.

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[24] Providence & N.Y.S.S. Co. v. Hill Mfg. Co., 109 U.S. 578, 594-95 (1883).

[25] For possible federal joinder, see Fed. R. Civ. P. 22.

[26] Another possible effect may be a raise in the premium rates on marine insurance, since present rates are based on the assumption that limitation of liability extends to the insurer. Arguably, by not extending the limitation defense, the very party intended to be protected by it, the shipowner, is shouldered with an additional burden. See Maryland Cas. Co. v. Cushing, supra note 14, at 417.

[27] Id. at 427.

[28] Act of June 5, 1936, ch. 521, § 1, 49 Stat. 1479, 46 U.S.C. § 183(b) (1964), amending Rev. Stat. § 4283 (1875):

> [I]f the amount of the owner's liability as limited . . . is insufficient to pay all losses in full, and the portion of such amount applicable to the payment of losses in respect of loss of life or bodily injury is less than $60 per ton . . . , such portion shall be increased to an amount equal to $60 per ton, to be available only for the payment of losses in respect of loss of life or bodily injury. If such portion so increased is insufficient to pay such losses in full, they shall be paid therefrom in proportion to their respective amounts.