

# Michigan Law Review

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Volume 52 | Issue 1

---

1953

## Insurance - Insurer's Right of Restitution For (1) Excessive Payment Made in Discharge of the Liability of a Coinsurer and (2) Costs of Defense

John W. Hupp S.Ed.  
*University of Michigan Law School*

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### Recommended Citation

John W. Hupp S.Ed., *Insurance - Insurer's Right of Restitution For (1) Excessive Payment Made in Discharge of the Liability of a Coinsurer and (2) Costs of Defense*, 52 MICH. L. REV. 123 (1953).  
Available at: <https://repository.law.umich.edu/mlr/vol52/iss1/7>

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INSURANCE—INSURER'S RIGHT OF RESTITUTION FOR (1) EXCESSIVE PAYMENT MADE IN DISCHARGE OF THE LIABILITY OF A CO-INSURER AND (2) COSTS OF DEFENSE—The increasing use of the "pro rata" or "other insurance" clause in liability insurance policies has given rise to new instances of coinsurer relationships. Such a clause typically provides that the insurer will not be liable under its policy for a greater proportion of any loss than the applicable limit of liability of its policy bears to the total applicable limit of all valid and collectible insurance against such loss.<sup>1</sup> It has been frequently stated that the existence of such clauses in two policies covering the same loss renders the liability under each of the policies several and not joint, and accordingly that neither insurer has any right of contribution from the other.<sup>2</sup> It is the purpose of this comment to consider whether this rule is properly applicable in all cases involving a coinsurer relationship.<sup>3</sup>

Crystallization of the rule can be traced to its use in cases involving a voluntary settlement made out of court between the insured and one of the insurers. The question of the legal effect that such a settlement has on the nonparticipating insurer has usually been raised in one of two ways. Either the insurer who is a stranger to the agreement attempts to utilize the settlement as a defense in an action brought by the insured for the defendant company's pro rata share of the total loss,<sup>4</sup> or the payor insurance company attempts to use the settlement as the basis for an action against the other insurer for a proportionate share of the settlement amount.<sup>5</sup> In these situations the courts have uniformly held that an agreement between the insured and one of the insurers is only determinative of the rights and liabilities of these two

<sup>1</sup>The purpose of the clause is to protect the insurer against over-insurance. Smith, "The Proratio Clause," 1949 *INS. L.J.* 83 at 84. Cf. 58 *YALE L.J.* 307 (1949).

<sup>2</sup>21 *A.L.R.* (2d) 611 at 613 (1952); 46 *C.J.S.*, Insurance §1208 (1946); 29 *AM. JUR.*, Insurance §1333 (1940).

<sup>3</sup>Discussion of the numerous rules for apportioning the loss among the coinsurers is beyond the scope of this comment. On this aspect of the coinsurer relationship see 40 *HARV. L. REV.* 878 (1927); 10 *WIS. L. REV.* 114 (1934); 58 *YALE L.J.* 307 (1949); and Ehrenzweig and Ehrenzweig, "Apportionment of Losses Between 'Blanket' and 'Specific' Insurance Policies," 43 *COL. L. REV.* 825 (1943).

<sup>4</sup>*Lucas v. Jefferson Ins. Co.*, 6 *Cow.* (N.Y.) \*635 (1827); *Globe National Fire Ins. Co. v. American Bonding & Casualty Co.*, 205 *Iowa* 1085, 217 *N.W.* 268 (1927); *Rallis v. Connecticut Fire Ins. Co.*, 46 *N.M.* 77, 120 *P.* (2d) 736 (1941).

<sup>5</sup>*Southern Surety Co. v. Commercial Casualty Ins. Co.*, (3d Cir. 1929) 31 *F.* (2d) 817, cert. den. 280 *U.S.* 577, 50 *S.Ct.* 31 (1929); *Fidelity & Casualty Co. of N.Y. v. Fireman's Fund Indemnity Co.*, 38 *Cal. App.* (2d) 1, 100 *P.* (2d) 364 (1940); *Farm Bureau Mutual Automobile Ins. Co. v. Buckeye Union Casualty Co.*, 147 *Ohio St.* 79, 67 *N.E.* (2d) 906 (1946).

parties, and consequently the insurer who is a stranger to the agreement may neither take advantage of, nor be subjected to, the terms of the voluntary settlement. However, the recent case of *Commercial Standard Insurance Co. v. American Employers Insurance Co.*<sup>6</sup> was concerned with the legal significance of the coinsurer relationship in a setting that did not involve the usual voluntary settlement. In the *Commercial Standard* case the insured was covered by a liability policy with a \$10,000 limit issued by plaintiff insurance company, and two \$10,000 limit policies issued by defendant company. Each of the policies contained a pro rata clause, and both companies were obligated to defend any suit against the insured if the loss involved was covered by the policies. Upon the occurrence of an accident, the defendant company erroneously decided that the loss did not come within the coverage of its policies and the plaintiff was left to defend the resulting lawsuit alone, expending about \$3,000 in so doing. The injured party obtained a judgment for \$5,000 which was paid in full by the plaintiff company. Plaintiff then brought an action against defendant company for two-thirds of the judgment and costs of defense incurred in the prior action, contending that the policies of defendant covered the loss. Thus, rather than the case of a payment made pursuant to a voluntary settlement, the *Commercial Standard* case presented the situation where one insurance company wrongfully disclaims coverage and the other insurer, acknowledging coverage by its policy, proceeds to defend the insured against suit and discharges the entire amount of the resulting judgment which is determinative of the insured's total loss. But the court, though agreeing with the plaintiff that the loss involved in the prior litigation was in fact covered by the policies of the defendant, was unwilling to recognize any significant distinction between the two situations. Relying on authority that developed out of the voluntary settlement cases, the court dismissed the action on the ground that here too the payor company is liable only for its proportion of the judgment, and when it pays more it is a mere volunteer.

Little, if any, disagreement can be found with the starting point of the court's decision, i.e., that the plaintiff company was liable only for its proportionate part of the judgment. However, whether the court was justified in concluding that therefore the plaintiff was a volunteer to the extent that its payment exceeded its liability is a matter that is subject to some question. There are several decisions that tend to

<sup>6</sup> (D.C. Ky. 1952) 108 F. Supp. 176.

support the court's conclusion.<sup>7</sup> However, it is believed that a recent Wisconsin case<sup>8</sup> is the only other case that actually involves the *Commercial Standard* situation, and the Wisconsin court held that the payor company should recover the defendant company's share of the discharged judgment. The necessary implication of the Wisconsin decision would seem to be that in this situation the payor is something more than a volunteer when it makes a payment in excess of the amount of its own liability. The *Commercial Standard* decision and the Wisconsin decision offer different answers to the question of the voluntary character of such a payment, with neither decision presenting any substantial analysis in support of its conclusion.

It is submitted that the compelling reason behind the conclusion that the payor company is a mere volunteer when it makes an allegedly excessive payment pursuant to a voluntary settlement with the insured is to be found in the unwillingness of a court to bind the nonparticipating insurer to the terms of an agreement in which it has taken no part.<sup>9</sup> It is clear that this insurer should be given its chance to dispute the existence of any liability on its part and/or the amount of its liability.<sup>10</sup> Thus, the case appears to be one that rather clearly calls for the application of the volunteer rule. In terms of this analysis, the *Standard Commercial* situation offers quite a different case. If it should be decided that defendant's policy does cover the loss, the defendant, having refused to defend the action brought against the insured, is bound by the resulting determinations concerning the existence and amount of liability on the part of the insured. The question whether defendant's policy covers the loss is fully litigated in the action brought by the payor company against the defendant. While in the voluntary settlement case there is merely an allegation that an excessive payment has been made, in the *Commercial Standard* situation it is judicially established that there has in fact been an excessive payment of fixed amount.

<sup>7</sup> *American Casualty Co. v. Maryland Casualty Co.*, (D.C. Pa. 1937) 20 F. Supp. 561; *Traders & General Ins. Co. v. Hicks Rubber Co.*, 140 Tex. 586, 169 S.W. (2d) 142 (1943); *Fireman's Fund Ins. Co. v. Palatine Ins. Co.*, 150 Cal. 252, 88 P. 907 (1907).

<sup>8</sup> *United States Guarantee Co. v. Liberty Mutual Ins. Co.*, 244 Wis. 317, 12 N.W. (2d) 59 (1943). [The Supreme Court of Michigan reached the same result in *Detroit Auto. Inter-Insurance Exchange v. Detroit Mut. Auto. Ins. Co.*, (Mich. 1953) 59 N.W. (2d) 80, decided after this comment was written.—Ed.]

<sup>9</sup> See *Lucas v. Jefferson Ins. Co.*, 6 Cow. (N.Y.) \*635 at 638, 639 (1827); *Globe National Fire Ins. Co. v. American Bonding & Casualty Co.*, 205 Iowa 1085 at 1092, 217 N.W. 268 (1927).

<sup>10</sup> *Southern Surety Co. v. Commercial Casualty Ins. Co.*, (3d Cir. 1929) 31 F. (2d) 817 at 819, cert. den. 280 U.S. 577, 50 S.Ct. 31 (1929).

Once it has been determined that defendant's policy covers the loss, the defendant is no longer able to dispute the fact that it was liable for its proportionate part of the judgment, and the crucial issue is whether plaintiff should be subrogated to the rights of the insured. On this point, the defense against plaintiff's action for restitution of the excessive payment is grounded on the argument that despite the existence of defendant's liability the plaintiff's unsolicited discharge of the liability of another automatically renders the payment subject to the officious volunteer rule and thereby precludes its recovery. That the unsolicited discharge of another's obligations without more is subject to the volunteer rule is well established.<sup>11</sup> Thus, the payor must justify the excessive payment on some judicially recognized basis if it is to escape classification as a volunteer, and in this respect its case appears to be one of a borderline nature. Since the payor faced a serious threat of a lawsuit by the insured if it had chosen to discharge only its proportionate part of the judgment, the cases permitting restitution on the basis of duress through civil litigation seem to offer the most closely analogous ground on which the payor can justify the course of action which it has pursued. But the threat of a lawsuit without more can hardly be said to constitute duress, since it is merely a threat to do what there is a legal right to do.<sup>12</sup> Therefore, successful use of the threat of civil litigation as a basis for the recovery of excessive payment is dependent upon a showing of a fear of some kind of punitive loss resulting from the use of legal process.<sup>13</sup> Recovery of excessive payment has been allowed where the threatened litigation would have injured the payor's credit position,<sup>14</sup> or impaired the present marketability of his property.<sup>15</sup> In all likelihood the threatened litigation involved in the *Commercial Standard* case would have caused some injury to the reputation and goodwill of the payor.<sup>16</sup> While the injury thus threatened is not as tangible and certain as that involved in the

<sup>11</sup> See 36 HARV. L. REV. 330 (1923); 40 MICH. L. REV. 1240 (1942).

<sup>12</sup> Dawson, "Duress Through Civil Litigation," 45 MICH. L. REV. 571 at 579 (1947). For a suggested limitation as to the area in which this proposition is properly applicable see Dawson, "Economic Duress—An Essay in Perspective," 45 MICH. L. REV. 253 at 287 (1947).

<sup>13</sup> 47 HARV. L. REV. 1413 at 1418 (1934).

<sup>14</sup> *Chandler v. Sanger*, 114 Mass. 364 (1874); *Joannin v. Ogilvie*, 49 Minn. 564, 52 N.W. 217 (1892).

<sup>15</sup> *First Nat. Bank of David City v. Sargeant*, 65 Neb. 594, 91 N.W. 595 (1902); *Union Central Life Ins. Co. v. Erwin*, 44 Okla. 768, 145 P. 1125 (1914).

<sup>16</sup> Dawson, "Duress Through Civil Litigation," 45 MICH. L. REV. 571 at 582 (1947). Also see note 18 *infra*.

more typical cases of duress through threat of civil litigation, it may well be urged that the situation in the *Commercial Standard* case is deserving of a slightly relaxed rule in this respect. Some of the reluctance to allow relief on the grounds of duress can probably be attributed to the judicial dislike of permitting the payor to use legal process to recover an excessive payment from one to whom the payor has just made the payment.<sup>17</sup> In the *Commercial Standard* case the payor is not seeking recovery from the very same party to whom the excessive payment was made. There appears to be no compelling policy reason for applying the officious volunteer rule so as to reward the insured who wrongfully disclaimed liability at the expense of the payor company which, while exceedingly adventuresome in its choice of a course of action, was willing to relieve the insured from the entire expense and trouble of the loss, as was contemplated by the policies of both insurers.<sup>18</sup> Consequently, it would seem justifiable to utilize the rationale of the duress through threat of civil litigation cases in order to permit recovery by the payor insurance company.

Regardless of the course of action pursued with respect to the discharge of the judgment, the insurer that acknowledges coverage by its policy is forced to undertake the entire expense of defending the action brought against the insured. In the *Commercial Standard* case this expense amounted to \$3,000. In dismissing the action, the court made no reference to this aspect of plaintiff's claim, apparently feeling that it in no way differed from the claim for a proportionate part of the judgment.<sup>19</sup> While the decision in the *Commercial Standard* case with respect to the claim for defendant's pro rata share of the discharged judgment may be supported on the basis of a strict application of the volunteer concept, it would seem that the plaintiff should nevertheless have been allowed to recover defendant's proportionate share of the

<sup>17</sup> See Dawson, "Duress Through Civil Litigation," 45 MICH. L. REV. 571 at 573 (1947); 47 HARV. L. REV. 1413 at 1415 (1934).

<sup>18</sup> "The insurance company is not a mere buyer of claims. It pays in the protection of legitimate interests, and by this token should fall within the class of involuntary payors. By paying it avoids litigation, and by not disputing a claim, protects its good will in the business community. Of the two, moreover, the wrongdoer in equity and good conscience should pay. All the necessary elements for the application of the doctrine of subrogation are present. It seems, furthermore, unjust to deny a recovery where the defendant has so obviously received a benefit, and where granting the relief places no additional burden upon him." 36 HARV. L. REV. 330 at 333 (1923).

<sup>19</sup> Only one other case could be found in which this specific question was raised, and there too the plaintiff's claim was dismissed without adequate consideration of the circumstances under which plaintiff was forced to make the disbursements. *Traders & General Ins. Co. v. Hicks Rubber Co.*, 140 Tex. 586 at 597, 598, 169 S.W. (2d) 142 (1943).

costs of defense. Even though the applicability of the pro rata clauses is extended to the defense provisions in the respective policies so that the obligation of each insurer to defend is somehow deemed to be several, and not joint, the obvious self-interest which the payor has in the outcome of the litigation provides a sound basis for justifying the discharge of the entire obligation by the payor.<sup>20</sup> Several closely analogous cases can be cited where the self-interest of the payor has been deemed to justify an unsolicited payment. Discharge of a senior mortgage by the junior mortgagee,<sup>21</sup> or discharge by the life tenant of a mortgage which covers both the life estate and the remainder,<sup>22</sup> are but two of the more common instances in which the self-interest of the payor provides the basis for subrogating him to the rights of his payee.<sup>23</sup> Thus, as a matter of legal principle, it is difficult to see how the disbursements made in defense of the action against the insured can properly be classified as mere voluntary payments. In addition, the result reached in the *Commercial Standard* case may well constitute a tempting invitation to an insurer to abstain from fulfilling its contractual obligations.

*John W. Hupp, S.Ed.*

<sup>20</sup> Hope, "Officiousness," 15 CORN. L.Q. 205 at 239 (1930).

<sup>21</sup> 2 JONES, MORTGAGES 572 (1928).

<sup>22</sup> *Bartels v. Seefus*, 132 Neb. 841, 273 N.W. 485 (1937); *Snow v. Arnold*, 132 Fla. 435, 181 S. 7 (1938).

<sup>23</sup> Other cases involving the self-interest justification include the discharge of tax liens by mortgagees, *De Haven v. Roscon Building & Loan Assn.*, 107 Pa. Super. 459, 164 A. 69 (1933), and cases collected in 61 A.L.R. 587 at 601 (1929) and 106 A.L.R. 1212 at 1217 (1937); and the discharge by a wife of liens on her husband's property, *Elmora & West End Building & Loan Assn. v. Dancy*, 108 N.J. Eq. 542, 155 A. 796 (1931); *Moody v. Isselstein*, 106 Wash. 294, 179 P. 855 (1919).