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AGENCY AND INSURANCE: SHOULD THE DEFENSE OF FRAUD BY ITS OWN AGENT BE AVAILABLE TO AN INSURANCE COMPANY ISSUING AUTOMOBILE INSURANCE?

J. DENNIS HYNES*

In April of 1967 Mr. Y, driving at 110 miles per hour on the wrong side of a highway while completely intoxicated, crashed head-on into a car proceeding carefully on its side of the road. Two of the four occupants in the other car were killed, and the other two severely injured. Mr. Y had no significant assets, but was insured up to \$25,000 per accident. The plaintiffs, in seeking redress for the accident, were informed by Mr. Y's insurance company that it chose not to honor the claim since it had discovered that Mr. Y and the insurance agent (an independent broker who wrote policies for several insurance companies) had collusively defrauded the company by falsely stating in the application form that Mr. Y had had no prior accidents, when both the agent and Mr. Y knew that the opposite was true.

The above fact situation, taken from an actual case,¹ poses an interesting problem of agency law as well as of insurance law. Should an insurance company which underwrites automobile insurance be able to assert the traditional remedy of annulment of an outstanding policy on the basis of fraud in the making of the contract?

At first glance, with some possible reservations in the area of agency law, the answer would seem obvious. Anyone who is fraudulently induced to enter into a contract should have the right to annul that contract upon discovering the fraud. This common sense reaction depends in no little part upon the fact that insurance contracts are consensual arrangements, and anything which destroys a good faith, objectively based consent should also destroy the contract, if the defrauded party so desires. It is nevertheless true, however, that this position, which is reflected in the common law today,² must remain viable—or be changed—in the light of changing social conditions. The major impact of automobile accidents

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1. The case, which arose in Colorado, was settled out of court some 10 months after the accident.

2. A contract made under these circumstances is voidable. See 1 CORBIN ON CONTRACTS § 6 (1963). See also PATTERSON, ESSENTIALS OF INSURANCE LAW 490 (2d ed. 1957); 7 COUCH, CYCLOPEDIA OF INSURANCE LAW § 35:109 (2d ed. 1961).

on today's society,³ the ever-increasing interest of the state in the insurance relationship,⁴ and a gradual shift in the underlying policy of tort law toward increasing compensation of victims⁵ supply the change in social conditions. Agency law supplies the vehicle through which the common law can accomplish a broadening of an insurance company's responsibility for its agent's acts.

Traditionally, automobile insurance has served the function of enabling persons to protect their assets against whatever liabilities may arise from pursuing an activity admittedly fraught with risk. This meant that the insurance company only became involved when the insured's assets were imperiled. It was once true, for example, that an insurance company could take refuge behind the economic condition of its insured. An insured had to pay a liability imposed by law against him before his insurance company was liable under its policy, which was a contract of indemnity against loss rather than a contract of indemnity against liability.⁶ If the insured became insolvent and was unable to pay a judgment which had been rendered against him, the company was without obligation to pay under the policy, with the result that there was "a general practice among insurance companies to . . . put the assured through bankruptcy, thereby precluding a recovery on the part of the injured person . . ."⁷

If the insurance relationship is looked upon merely as a two party, private contractual relationship, this result makes perfect sense. An insolvent insured would not need the protection of the policy and the insurer was there to protect the assets, up to the limits of the policy, for

3. It has been estimated that the cost of traffic accidents in the United States is between \$8 billion and \$12 billion a year. This is roughly the same magnitude as the entire annual cost of providing the roadways on which the accidents occur. See Vickery, *Automobile Accidents, Tort Law, Externalities, and Insurance: An Economist's Critique*, 33 LAW & CONTEMP. PROB. 464 (1968).

4. See text accompanying notes 8-12, *infra*.

5. See *Dillon v. Legg*, 69 Cal. Rptr. 72, 441 P. 2d 912 (Sup. Ct. 1968) (negligently inflicted mental distress); *Rowland v. Christian*, 70 Cal. Rptr. 97, 443 P.2d 561 (Sup. Ct. 1968) (rejecting classifications for persons entering the land of others); and Annot. 13 A.L.R.3d 1057 (1967) (describing the expansion of compensation in the area of products liability).

6. A typical indemnity policy read, in relevant part, as quoted in *Patterson v. Adan*, 119 Minn. 308, 309-11, 138 N.W. 281, 282 (1912):

The company agrees to indemnify the assured: Against loss by reason of the liability imposed by law upon the assured for damages on account of bodily injuries, or death accidentally suffered by any person . . . by reason of the maintenance, or use . . . of the insured's automobile . . . No action shall lie against the company to recover for any loss or expense under this policy, unless it shall be brought by the assured for loss or expense actually sustained and paid in money by him after the trial of the issue.

7. C. GREGORY AND H. KALVEN, *CASES AND MATERIALS ON TORTS* 555 (1959), quoting from *Roth v. National Auto. Mut. Cas. Co.*, 202 App. Div. 667, 669, 195 N.Y. Supp. 865, 867 (1922).

one who did.

The state at this point demonstrated an interest in the liability insurance relationship through legislation generally requiring that, in the event of bankruptcy or insolvency of an insured, an injured person could maintain an action against the insurance company under the terms of the policy for the amount of the judgment, not exceeding the limits of the policy.⁸ This type of statute, which forced another function onto liability insurance, survived a constitutional due process attack, with the United States Supreme Court making the argument that:⁹

"... the business of insurance is of such a peculiar character, affects so many people and is so intimately connected with the common good that the State creating insurance corporations and giving them authority to engage in that business may, without transcending the limits of legislative power, regulate their affairs so far at least as to prevent them from committing wrongs or injustice in the exercise of their corporate functions . . . Having in mind the sense of immunity of the owner protected by the insurance and the possible danger of a less degree of care due to the immunity, it would seem to be a reasonable provision by the State in the interest of the public, whose lives and limbs are exposed, to require that the owner in the contract indemnifying him against any recovery from him should stipulate with the insurance company that the indemnity by which he saves himself should certainly inure to the benefit of the person who thereafter is injured. Section 109 does not go quite so far . . ."

Another striking example of the assertion by the public of an interest in automobile insurance has been the adoption by three states of legislation requiring that all drivers carry statutorily prescribed minimum

8. See the New York statute providing that, if execution against the insured is returned unsatisfied because of bankruptcy or insolvency, an action may be maintained by the injured person against the insurance company for the amount of the judgment not exceeding the amount of the policy, as quoted in *Merchants Mut. Auto. Liab. Ins. Co. v. Smart*, 267 U.S. 126, 128 (1925).

9. *Id.* at 129-30. This position has been belatedly recognized by the insurance companies themselves, as evidenced by the current version of the National Standard Policy, which expressly states that bankruptcy or insolvency of the insured or of the insured's estate shall not relieve the company of its obligations under the policy. An interesting question can be raised as to whether the lawyers for the insurance companies in the pre-legislation days might not have foreseen this type of development and advised their clients more wisely at a time when the flexibility and creativity of private law making was available, particularly since two states now have gone so far as to allow direct actions against insurance companies immediately upon the injured party sustaining harm and without the prior satisfaction of any of the conditions in the insurance policy. 12 COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 45: 821 (2d ed. 1964). For an illuminating discussion of this aspect of the lawyer's role, see H. HART AND A. SACKS, *THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW* 263, 287-88 (1958).

amounts of liability insurance,¹⁰ and the adoption by all the remaining states of some variant on the financial responsibility laws.¹¹ Furthermore, nearly all of such statutes withdraw the fraud defense, even when the insured alone has been the cause of the fraud, for persons covered by the statutory provisions.¹²

10. R. KEETON AND J. O'CONNELL, BASIC PROTECTION FOR THE TRAFFIC VICTIM, A BLUEPRINT FOR REFORMING AUTOMOBILE INSURANCE 76 (1965) [hereinafter referred to as Keeton-O'Connell].

11. W. PROSSER, HANDBOOK OF THE LAW OF TORTS 583 (1964). Prosser indicates that all states except Alaska have adopted such legislation. It appears, however, that Alaska has also done so. ALASKA STAT. § 28.20.010 *et. seq.* (1962). These laws typically provide that any driver involved in an accident must furnish proof that he is capable of paying a judgment for that accident up to a specified amount (a liability insurance policy is of course the easiest form of such proof) or deposit security for such payment, on penalty of revocation of his license to drive or of the registration of his automobile. Some jurisdictions draw their statutes more narrowly, with the failure to satisfy a judgment arising out of an automobile accident constituting the triggering event.

12. All but four of the financial responsibility states expressly provide that insurance obtained pursuant to the financial responsibility law becomes absolute in regard to the insurer when loss or damage covered by the policy occurs. The four states without such language are: California: CAL. VEH. CODE §§ 1600 *et. seq.* (West 1960); Connecticut: CONN. GEN. STAT. ANN. §§ 14-112 *et. seq.* (1960); Florida: FLA. STAT. ANN. § 324.011 *et seq.* (1968) and Georgia: GA. CODE ANN. § 92A-601 *et seq.* (1958). New York has a curious combination of compulsory insurance and financial responsibility. The New York Motor Vehicle Safety Responsibility Act, N.Y. VEH. & TRAF. LAW § 345(i) (1) provides that a motor vehicle liability policy shall become absolute whenever loss or damage covered by said policy occurs, but this applies only to policies issued under that Act (dealing with persons whose licenses have been revoked or suspended under any of the statutes in the state), and not to the normal compulsorily issued policy, which is issued under the Motor Vehicle Financial Security Act. *See* National Grange Mut. Liab. Co. v. Fino, 212 N.Y.S.2d 684 (1961), which holds to such effect.

The perceptive reader might ask at this stage whether the above legislation does not resolve the problem raised by this paper. If the experience of Colorado under its statute is at all typical, however (and it might understate the nation-wide statistics somewhat, since the Colorado statute requires a preliminary showing of fault by the Insurance Commissioner before the statutory provisions become effective), a very small percentage of drivers on the road are operating under the financial responsibility laws. It proved impossible to obtain exact information as to the number of persons holding insurance under the Financial Responsibility Act (called SR-22 policies). However, Mrs. Rome of the Financial Responsibility section of Driver Improvement, State Department of Revenue, in a conversation with Mr. Porter on December 10, 1968, estimated that about fifty per cent of those persons whose licenses are suspended each year obtain SR-22 policies, which must be held for three years. In 1967 there were 4,773 suspensions. It is roughly estimated, therefore, that at the present time about 6,500 drivers are carrying SR-22 policies. Mr. Covi, Assistant Chief, Drivers' Licensing, Motor Vehicles Division, State Department of Revenue, in a conversation with Mr. Porter on December 10, 1968, stated that as of December 31, 1967, there were 1,274,773 licensed drivers in Colorado. This means that approximately one-half of one per cent of the drivers on the road in Colorado carry insurance under the Financial Responsibility Act.

A further question can be raised as to why this paper does not follow the pattern of the Financial Responsibility laws and urge abolition of the fraud defense altogether, rather than merely when the agent participates in the fraud. Such a result indeed would follow from the premise of this paper, which is that the interests of the public should be taken into account in this area. But this paper is addressing its position to the courts,

The increased consciousness of the public nature of automobile insurance has not been entirely legislative. Some courts have by common law eroded the strict effect of some of the contractual defenses and conditions contained in insurance policies. Some jurisdictions require, for example, that the insurance company demonstrate actual prejudice to its position arising from the failure of the insured to fulfill some condition of the policy before a third party loses his opportunity to collect under the policy.¹³ And one state has extended this approach so far as to hold that the rights of the third party are not overcome even when the insurance company is actually prejudiced by the failure of the insured to fulfill a condition of the policy.¹⁴

When one takes into account the erosion in the traditional function of automobile liability insurance, the prospect of increasing through the common law the insurer's responsibility for the acts of its agents loses a good deal of its radical nature. The law dealing with an insurance company's responsibilities for its agent's acts has not taken cognizance of the changing nature of automobile liability insurance. It is clear that if an insurance agent participates in a fraud by the insured on the company, the company can avoid the policy,¹⁵ with the result that the insured (along

which could adopt the approach set forth in this paper through the traditional doctrine of *respondeat superior*. An argument urging overthrow of the defense of fraud altogether seems more appropriately addressed to the legislature.

13. See 13 COUCH, CYCLOPEDIA OF INSURANCE LAW § 49:49 (2d ed. 1965) (generally as to the condition requiring notice) and § 49:127 (as to the condition requiring notice in automobile liability policies). A different and interesting example of the judiciary asserting a public interest into the private insurance contract is that of *L'Orange v. Medical Protective Co.*, 394 F.2d 57 (6th Cir. 1968), where the court denied the defendant insurance company its contractual power of cancellation (which was exercised when Dr. L'Orange testified against another doctor who also was insured by the company) on the ground that the company's exercise of such power contravened public policy since the cancellation power was used for the purpose of intimidating a witness.

14. *Edwards v. Fidelity and Cas. Co.*, 123 So. 162, 163 (La. App. 1929). The court's policy reasoning was as follows:

It is therefore not within his [the injured party's] power to give the notice required by the policy, and, if notice is essential to his recovery, his right must, as we have stated, depend upon the other party. We do not think that such was the intention of the legislators. . . .

We are told that it works a hardship on the insurer to be called on to defend an action of this kind, as he has had no prior knowledge of the accident and is not in a position to make a defense. As to the hardship and disadvantage under which the insurer labors, and the difficulty under which the injured party finds himself, we think that the ends of justice require that the benefit of the doubt should be given to the injured party, who is in no way at fault, and whose loss was caused entirely by some one else, as against the insurer who has entered into the contract with full knowledge of the statute [changing the indemnity policy to a liability policy] and for a monetary consideration.

15. 7 COUCH, CYCLOPEDIA OF INSURANCE LAW § 35:205 (2d ed. 1961). An interesting and curious distinction is drawn if the agent merely knows of the misrepresentation of the insured and fails to correct it. Some cases hold that a recovery

with, of course, the injured party) loses his claim against the insurer.¹⁶

An argument can fairly be made that this rule of law is an unjustifiably narrow application of ordinary agency principles. It has generally been held that a principal is liable for the acts—even the fraudulent acts—of his agent who is acting within the scope of his apparent authority.¹⁷ This is true even in cases where an agent has himself directly benefitted from the fraud on his principal and acted solely for his own interests and not at all for those of his principal.¹⁸ The reasons underlying this rule would seem to be that the principal has the power of choice over his agents and has chosen the one involved; he has clothed the agent with apparent authority (consisting in the area of insurance of signs, printed forms, rate books, and so forth); and he is in a business which presumably is bringing him profit.

Part of being in a profit-making enterprise is the responsible assumption of the normal risks which that enterprise entails. This clearly includes—and has included for centuries—the wrongful acts of agents, even though this amounts in effect to strict liability for the principal. The courts early made, and continue to make, these decisions on the theory

can nevertheless be had against the insurer where its agent knew the truth at the time, provided there was no actual collusion, on the theory that the agent's knowledge is imputed to his principal. *Id.* at § 35:202. And where the false statement is made unintentionally by the applicant, it is the general rule that the insurance company is bound, even if the agent knew of its falsity. *Id.* at § 35:201.

16. The theory of denial of recovery under such circumstances is that the insured is the party who benefits from the protection granted by the insurance policy, and a wrongdoer cannot profit from his own wrongdoing. This paper challenges that normally valid position on the theory that other interests call for consideration in the area of automobile insurance. It is true that a broader approach results in the disadvantage of protecting, up to the policy limits, the assets of the insured, who participated in the fraud (although this could be mitigated in a tort action for deceit). The response to this is that, as with so many legal questions, a weighing of interests must take place, with this paper taking the position that the public interest in compensation outweighs such disadvantage.

17. RESTATEMENT (SECOND) OF AGENCY § 165 (1958).

18. This is true if the third party does not have notice of the agent's wrongful intent. *Id.* § 49, Comment g. It is true, of course, that in the circumstance involved in this paper the traditional "third party" (the insured) knows full well of the wrongful motive of the agent, and thus one can argue that the ordinary principles of agency law are inapplicable. It is the thesis of this paper, however, that the "third party" should include the public, who have come increasingly to expect that whoever wrongfully injures them on the highway will have insurance. This reliance of the public has been encouraged by the many actions of state legislatures with precisely this goal in mind. Thus the general rule that a principal can be bound by even the wrongful acts of his agents should carry over by way of analogy where the relying party is the public and the insurance company is aware of that fact, which clearly seems the situation today.

An analogy to this problem of protecting the interests of third parties can be drawn from corporation law, where a subscriber to shares who was induced to subscribe by fraud can be denied his right to rescission if there were relying creditors subsequent to the subscription. See *Burningham v. Burke*, 67 UTAH 90, 245 P. 977 (1926); R. BAKER AND W. CARY, CASES AND MATERIALS ON CORPORATIONS 766 (1958).

that this sort of foreseeable loss belongs to the business.¹⁹ It can and should be represented in their costs and thus (at least theoretically, and in part actually) reflected in the cost of their products to the consumer.²⁰ The medium of insurance has itself been an important factor in most rationalizations of vicarious liability;²¹ there seems to be no reason why the insurance companies themselves should not be subject to the same theory.²²

The argument is admittedly more difficult in the area of misrepresentations by a broker²³ rather than an agent (although they are of course both "agents" in the Restatement of Agency meaning of the term²⁴). But even here the insurance company has entrusted the front-line end of its business to the broker. And the company has broad choice in picking the

19. See *Jones v. Hart*, 2 Salk. 441, 90 Eng. Rep. 1255 (K.B. 1698).

20. For a lengthy and thought-provoking articulation of the economics approach to enterprise liability, see Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499 (1961) [hereinafter referred to as Calabresi]. See also Glanville Williams, *Vicarious Liability and the Master's Indemnity*, 20 MODERN L. REV. 220 (1957); Douglas, *Vicarious Liability and Administration of Risk*, 38 YALE L.J. 584 (1929). It should be noted that the economic rationalization for vicarious liability is rejected in an intelligent article by C.R. Morris, Jr., *Enterprise Liability and the Actuarial Process—The Insignificance of Foresight*, 70 YALE L.J. 554 (1961).

21. The theory is that liability insurance allows the entrepreneur to avoid an upsetting loss by paying a premium, which is a known amount and can easily be calculated into his profit and loss picture. Some authors have thought that the factor of insurance is by itself a sufficient explanation of vicarious liability, since it "spreads the loss." See Smith, *Frolic and Detour*, 23 COLUM. L. REV. 444 (1923); SEAVEY, *STUDIES IN AGENCY* 150-52 (1949).

22. This would seem particularly true in view of the fact that the insurance business is a regulated industry, with rate approval by the states. Any easily definable increased cost, like absolute liability for the acts of agents, would be an item that insurance companies should have no trouble justifying to an insurance commissioner. This would result in a true passing of the cost on to the customers, a fact which is debatable (at least as to the extent of the passing on) in some industries.

23. An insurance broker is defined in 3 COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 25:92 (2d ed. 1960) as follows:

An "insurance broker" is one who acts as middleman between the insured and the insurer, and who solicits insurance from the public under no employment from any special company, and who, upon securing an order, places it with a company selected by the insured, or in the absence of such a selection, with a company selected by himself; whereas an "insurance agent" is one who represents an insurer under an employment by it.

24. RESTATEMENT (SECOND) OF AGENCY § 1, Comment e (1958). See also 3 COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 25:93 (2d ed. 1960):

In determining the problem here involved, it is necessary to remember that a broker is not necessarily the agent of either the insured or the insurer throughout. He may be the agent of one in some of the matters involved and of the other in the remainder. . . . However, an insurance broker, although first employed by one party, may during the process of negotiations become the agent of the other; and in that event, he may acquire rights, have powers and incur obligations with respect to both the insurer and the insured. In fact it is said to be a general rule that an insurance broker acts for the insured for the purpose of making the application and procuring the policy, and for the insurer for the purpose of collecting and remitting the premium and delivering the policy.

brokers upon whom it will rely in contracting business for it. The difference, therefore, in the eyes of not only the insured but even more importantly the public, is one of form only.

Although the present status of the law stands squarely contrary to the position advocated here, a change in the approach of the courts, at least in the area of automobile insurance, is called for. The insurance company retains control; it is in a profit-making business; it can adequately gauge and set up reserves for its losses; it can use its losses to justify an increase in rates before the insurance commissions; imposing liability upon insurance companies may induce a higher standard of care in the selection, supervision and retention of agents and brokers;²⁵ wrongful acts by agents and brokers are a clearly foreseeable risk of the business, and the public will enjoy increased security, slight though it may be. All of these factors require a broader standard than now exists by which to judge the responsibility of an insurance company for the acts of its agents.

This argument is reinforced by the rapidly changing nature of insurance in the area of automobile law. As noted above, in nearly all of the compulsory insurance or financial responsibility legislation the defense of fraud is expressly negated by statute. It is obviously, therefore, a matter of some concern to the body politic. And no reports have come filtering back about bankruptcy facing insurance companies as a result of this legislative action.²⁶

Finally, and perhaps most significant, the entire system of privately issued, liability-coverage-only automobile insurance has come under heavy attack, which in turn has produced a revolutionary response from some insurance companies. The primary catalyst toward change has been the Keeton-O'Connell plan, proposed several years ago after an extensive foundation-financed study.²⁷ The plan, which is basically a variant on the theme of the Saskatchewan approach, combines both recovery without fault and common law tort liability. The cut-off point (where the common law liability comes into play) is when more than \$10,000 "hard specials"²⁸ or more than \$5,000 pain and suffering have been lost. Up to

25. See Morris, *Enterprise Liability and the Actuarial Process—The Insignificance of Foresight*, 70 YALE L.J. 554, 595 (1961).

26. It is true that insurance companies have complained of losses in the compulsory insurance states, but the complaints have not centered on the absence of the fraud defense. Rather, they complain that claims consciousness rises and political pressures keep rates artificially low. C. GREGORY AND H. KALVEN, *CASES AND MATERIALS ON TORTS* 739 (1959).

27. KEETON AND O'CONNELL, *supra* note 10.

28. These are basically the readily determined economic losses arising out of an accident—medical expenses, lost wages, and so forth, as contrasted with such items as pain and suffering.

that point²⁹ the recovery of a party injured in the use of an automobile is non-fault and based on two-party insurance, *i.e.*, the injured party recovers against his own insurance policy, similar to fire and life insurance. The insurance would be compulsory for all drivers, which means that nearly everyone injured in the use of an automobile would be covered. For those few who lack coverage (non-driving pedestrians, for example, who are hit by someone who has failed to obtain insurance) a special fund would be established against which they could recover.

The abolition of the defense of fraud is apparently covered in Section 2.11 of the plan, which leaves a great deal of discretion with respect to policy forms and conditions of coverage in the hands of the Commissioner of Insurance. The Commissioner is solemnly cautioned to "approve only such terms and conditions as are consistent with the purposes of this Act and fair and equitable to all persons whose interests may be affected."³⁰ In view of the position taken by nearly all of the states which have enacted compensatory-type legislation, the drafters doubtless were confident that the insurance would become absolute at the time it was purchased.

The Keeton-O'Connell plan engendered an understandably defensive response from the insurance industry as well as both plaintiffs and defense lawyers.³¹ Recently, however, an extraordinary response has come forth from some of the insurance industry. The American Insurance Association, a trade group of casualty insurers handling about 38 per cent of the nation's automobile insurance coverage,³² has studied the Keeton-O'Connell proposal and has come up with its own variant on that plan.³³ The AIA supports the basic compensation theme of the Keeton-O'Connell plan but would change it in two major respects: (1) the AIA plan would completely eliminate fault-based recovery, going to a total non-fault, two-party insurance system, with full recovery of economic losses;³⁴ and (2) it would eliminate any recovery for pain and suffering, although

29. With the insignificant exception of the first \$100 of damage, which would remain under the common law liability system, Section 2.3(a), KEETON-O'CONNELL, *supra* note 10, at 309. See *Id.* at 275-276, where the theory behind this decision is explained.

30. Section 2.11, KEETON-O'CONNELL, *supra* note 10, at 318.

31. See TRIAL, (Oct./Nov. 1967), which is an entire issue devoted to a pro and con discussion of the Keeton-O'Connell plan.

32. Boulder Daily Camera, Dec. 24, 1968, at 2, col. 3.

33. American Insurance Association, Report of Special Committee to Study and Evaluate the Keeton-O'Connell Basic Protection Plan and Automobile Accident Reparations, Oct. 21, 1968 (available at the office of the American Insurance Association, 85 John Street, New York, N.Y. 10038) [hereinafter referred to as AIA Report]. This report was approved by the Executive Committee of the Association.

34. With the exception of lost wages exceeding \$750 per month. See AIA Report, *supra* note 33, at 5.

persons suffering permanent impairment or disfigurement could receive compensation up to 50 per cent of their hospital and medical expenses.

The underlying premise of these plans is that a certain activity should bear all of the costs, including non-fault losses, that can be reasonably related to engaging in it. A lengthy articulation of this premise is contained in Calabresi's major article on the subject,³⁵ where the author argues, in the spirit of allowing the consumer a full and intelligent choice of purchases, that goods and services should bear what he describes as their "full cost to society",³⁶ including non-fault losses that are caused by the activity. It is true, of course, that Calabresi's definition of "cost" involves a value judgment with which some economists and many accountants would not agree, but the logic of the position, assuming that losses can intelligently be allocated to certain enterprises, seems inescapable. This thesis has been elaborated on in other articles of his,³⁷ and its underlying premise was adopted in the AIA proposal.³⁸ It is true that Calabresi's approach has been intelligently attacked by Professors Blum and Kalven,³⁹ but the mainspring of their attack was the assumption that any automobile compensation plan had to result in an increase in the cost of insurance, a point which has been rebutted by the actuarial estimates of both the AIA proposal⁴⁰ and by an independent actuarial study made of the Keeton-O'Connell plan.⁴¹

In the face of these radical proposals, the change urged by this paper seems small indeed. And if either of the above plans is accepted, the problem of fraud doubtless will disappear. But they might not be accepted, certainly not in all the states, and the problem of fraud described

35. See Calabresi, *supra* note 20.

36. See Calabresi, *supra* note 20, at 505.

37. Calabresi, *The Decision for Accidents: An Approach to Nonfault Allocation of Costs*, 78 HARV. L. REV. 713 (1965); Calabresi, *Fault, Accidents and the Wonderful World of Blum and Kalven*, 75 YALE L.J. 216 (1965); Calabresi, *Views and Overviews*, 1967 U. ILL. LAW FORUM 600; Calabresi, *Transaction Costs, Resource Allocation and Liability Rules—A Comment*, 11 J. LAW & ECON. 67 (1968); Calabresi, *Does the Fault System Optimally Control Primary Accident Costs* 33 LAW & CONTEMP. PROB. 429 (1968).

38. AIA Report, *supra* note 33, at 5:

The committee is of the opinion that the automobile insurance system should be the primary source of indemnity for injuries sustained in automobile accidents, to the extent practicable. The motoring public should bear the cost of motor vehicle accidents.

39. Blum and Kalven, *The Empty Cabinet of Dr. Calabresi, Auto Accidents and General Deterrence*, 34 U. CHI. L. REV. 239 (1967).

40. AIA Report, *supra* note 33, at 8. The AIA actuarial study estimates the cost savings for their total non-fault proposal at approximately 29 per cent, and the cost savings of the Keeton-O'Connell proposal at approximately 28 per cent. Apparently the main savings would come from the elimination of contingent fees for lawyers. *Id.* at 4.

41. TRIAL, Oct./Nov. 1967, at 19.

in this paper is with us today, as witness the fact situation described at the beginning of this paper.

The enterprise liability approach outlined briefly herein has relevance to this paper not only as a description of the direction the law seems to be taking but also because its underlying value judgment fits perfectly into the broader treatment of insurance company responsibility urged in this paper. The trend toward universal coverage for motorists on the highways is distinct and unmistakable. The common law removal of the defense of fraud when an agent of an insurance company is involved fits clearly into this pattern. The defense of fraud is an anachronism which calls for updating.

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