22 Tort & Ins. L.J. 662

Tort and Insurance Law Journal
Summer, 1987

Richard K. O'Donnell [a]

IMPUTATION OF FRAUD AND BAD FAITH: THE ROLE OF THE PUBLIC ADJUSTER, CO-INSURED AND INDEPENDENT ADJUSTER

I. INTRODUCTION

This article's discussion is limited to three topics: 1) whether the misrepresentations of a public adjuster may be imputed to the insured; 2) whether the misrepresentations of one insured may be imputed to an innocent co-insured; and 3) whether the misconduct of an independent adjuster may be imputed to the insurer and considered on any issue of the insurer's bad faith.

The imputation of fraud or bad faith in each of the three identified contexts is the focus of this paper. Cases where actual collusion is shown between the individual making the misrepresentation or acting in bad faith and the individual sought to be held responsible for the misconduct are beyond the scope of this paper. It is presumed throughout this discussion, therefore, that the individual or entity sought to be held responsible for the misconduct did not actively participate in it.

A significant portion of this paper concerns the law of agency. An effort is made to distinguish between agents of an insured or an insurer and ‘insurance agents': the latter referring to individuals in the business of making applications for insurance (the common meaning) and the former referring to those individuals that satisfy the technical requirements of the law of agency (the legal definition). This distinction is necessary, of course, since the imputation of fraud turns on the legal nature of the relationship between the parties and not on common terms which, of themselves, are not legally significant.

In this paper, the term ‘misrepresentation’ is intended to include any misrepresentation, false swearing or concealment which bars an insured's recovery. The precise requirements of each particular jurisdiction's misrepresentation defense are ***663** yond the scope of the paper. Whatever those requirements may be, misrepresentations referred to in this paper, by definition, are deemed to have satisfied those requirements.

The questions discussed in this paper are fairly precise. Unfortunately, the answers are not. The answers vary greatly from jurisdiction to jurisdiction because they are based on legal principles which vary greatly from jurisdiction to jurisdiction. In addition, many of the ultimate answers turn on the exact language of particular policies and/or particular statutes. Precise answers are provided when they are available but, due to the relatively limited length of this paper, its object is to identify the critical issues rather than to provide specific answers for each jurisdiction.

II. MISREPRESENTATIONS BY A PUBLIC ADJUSTER

A public adjuster is an adjuster employed by an insured to assist the insured in making a claim to its insurer. [1] In adjusting a claim on behalf of an insured, the public adjuster is in a position to make material misrepresentations. The discussion under taken in this section of the paper concerns whether any such misrepresentations would be imputed to an ‘innocent’ insured thereby barring his recovery.

A. *Public Adjuster Cases*

As of March 1, 1986, only four cases were discovered which explicitly rule on the effect of alleged misrepresentations by a public adjuster upon an innocent insured's recovery. They are: *Mick v. Royal Exch. Assur.* [2] *('Mick I'); Mick v. Royal Exch. Assur.* [3] *('Mick II'); Bockser v. Dorchester Mut. Fire Ins. Co.*; [4] and *Harold J. Warren, Inc. v. Federal Mut. Ins. Co.* [5] At least one other case exists where a public adjuster very likely assisted in misrepresentations, but the insureds' recovery was barred by their own misconduct rather than through the imputation of fraud. [6]

1. *Mick I*

In *Mick I* [7] the plaintiff/insured owned a hardware store and adjoining lumberyard which were insured with the defendant. The insured's son, aged 19 or 20, had entire ***664** control of the store and lumberyard, although he was not a partner in the business, but was a mere employee. When the insured property was destroyed by fire, the insured hired a public adjuster. The insured entrusted his son and the adjuster with the entire responsibility for collecting the insurance.

The adjuster prepared the proof of loss, which was signed by the insured and forwarded to the insurer. The insurer notified the insured that the proof of loss was not satisfactory. The insured was required to also file a statement of purchases and sales for certain dates. The insured delegated this request to his son, who responded by forwarding copies of some bills of purchases and other records to the insurer's adjuster. Several of these bills were fictitious.

The court noted that '[i]t was a fair, if not a necessary inference that [the son], or [the adjuster], or both, had intentionally procured and put in these false bills to augment the amount of recovery.' [8] There was no evidence that the insured himself knew anything about the false bills.

At the trial of the case, the jury was charged that the insured must have been a party to the fraud in order for his right to recovery to be defeated. If the fraud was solely that of the agent, the insured could still recover. The appellate court ruled that the charge was error and granted a new trial. Pertinent excerpts of the majority opinion of the appellate court appear below:

> The responsibility of an innocent principal for the fraud of an agent has been one of the vexed questions of the law. That an innocent principal cannot, as a general proposition, be permitted to benefit by the fraud of his agent, has been settled in this court. . . . Naturally, when an agent intrusted [sic] with powers to deal with a particular subject matter misuses those powers so as to deal unlawfully, and the principal is sought to be held responsible, the plea is that the powers are exceeded, and the unlawful acts are not within the scope of the agency. But, as was said by Mr. Justice Willes in the leading case of Barwick v. English Joint Stock Bank, L.R.2 Exch. 259; 36 L.J. Exch. 147, 12 E.R.C. 298:
>
> In all these cases it may be said, as it was said here, that the master had not authorized the particular act, but he has placed the agent in his place to do that class of acts, and he must be answerable for the manner in which that agent has conducted himself in doing the business which it was the act of his master to place him in.
>
> . . . The rule is laid down that, irrespective of the question of benefit, the principal is liable for the fraud of the agent acting within the scope of his authority. . . .
>
> But it is said that this rule does not extend to cases where the contract was bona fide entered into, and a forfeiture is claimed by reason of some subsequent act of the agent, fraudulent in its character, though this, if done by the principal himself, would render the policy void because of the operation of the forfeiture clause; and a number of cases are cited in support of this doctrine. An examination of this array of authorities will demonstrate that they are very far from possessing the weight that is claimed of them.

. . ..

> The case is one of first impression in this state, and we are therefore at liberty to declare the rule that seems best to accord with reason and justice. In our view the Vermont rule is the better one. We consider that it is unreasonable and illogical to say that ***665** the owner of insured property who is under the obligations by the terms of his policy to make sworn proofs of loss and to furnish on demand full details of his books, papers, invoices, and vouchers, or copies thereof when lost or destroyed, may, when such demand is made, voluntarily turn over the entire responsibility of complying therewith to an agent, dismiss the matter from his mind, reap the benefit of what the agent does that makes in his favor and is in genuine compliance with the demand, and at the same time evade the penalty that is laid by the policy upon fraud and false swearing. He should not be heard to adopt the agent's acts where they make for him, and disclaim them where they are to his prejudice. It is he, and not the insurance company, who reposes the confidence in the agent; and when that confidence is abused, especially by acts of fraud that if successful will be greatly to his pecuniary advantage at the expense of the company, he that reposes the confidence should pay the penalty. . . .
>
> This is not a case of agency ex necessitate. It is not the case of an insured relying necessarily upon a subordinate or agent for the information required to make up a proof of loss, or revising and supervising it as best he may. Where the insured, though exercising due care, is himself deceived by his own agent, and in good faith presents a statement which turns out to be untrue in respect to matters which could not reasonably have been discovered by the insured in the exercise of due care, there is no fraud, for he has been deceived himself. But where he undertakes to wash his hands of the entire matter, and without question or supervision of any kind delegates to an agent the contractual duty of making a true statement, he cannot be heard to say, where fraud is committed by the agent in the exercise of his general powers, consequences of that fraud should not be visited on him.
>
> We do not overlook the fact that an honest loss may be thus defeated by a dishonest agent. The answer is that he who employs and relies entirely on an agent to deal with others takes the risk of his dishonesty in such dealings. [9]

Three justices dissented in *Mick I*. The dissenters took the position that the fraud provision in the policy [10] required that the fraud be perpetrated by the insured himself or with his consent or knowledge. This construction of the fraud provision, according to the dissenters, was necessitated by the principle that forfeiture provisions are to be construed in favor of the party facing forfeiture. The majority did not construe the fraud provision against the insurer since the language was taken from the state's standard form. [11]

***666** The dissent in *Mick I* seems to be complaining that the decision by the majority permits forfeiture on the mere negligence of the insured, while the policy required fraud or false swearing. [12] In fact, a close reading of the majority opinion indicates that the case, if rigidly restricted to its facts, can be interpreted as not being a case of the imputation of fraud of the agent to the principal at all. As the majority takes care to point out, the insured turned over the entire responsibility for responding to the insurer's requirement for further proof to his son. The insured did not even attempt to look over what was being sent to the insurer. The insured's behavior, therefore, seems to have risen above mere negligence and is more properly characterized as reckless, although the majority did not discuss this distinction. Under this interpretation of the decision, the insured himself actually was guilty of constructive fraud within the terms of the fraud provision in the policy although ‘innocent’ in that he did not have actual knowledge of the fraud. [13]

In fact, despite the complaints of the dissenters, the majority in *Mick I* seems to want to restrict the effect of its holding to reckless—rather than merely negligent—conduct by the insured:

> Where the insured, though exercising due care, is himself deceived by his own agent, and in good faith presents a statement which turns out to be untrue in respect to matters which could not reasonably have been discovered by the insured in the exercise of due care, there is no fraud, for he has been himself deceived. [14]

Cases citing *Mick I*, however, have not limited its application to reckless delegations of responsibility by the insured. [15]

2. *Mick II*

In the second trial of *Mick v. Royal Exch. Assur.* [16] the jury returned another verdict in favor of the insured. An appeal brought the case again to the Court of Errors and Appeals of New Jersey in a decision that will be referred to as *Mick II*. This time, however, the jury verdict was affirmed.

The facts in the second trial developed differently from those in the first trial. In *Mick II*, the court stated that:

> [T]he present record discloses an entirely different situation, for in it there is evidence from which the jury might find, as their verdict indicates they did, that the son was not the agent of the plaintiff to furnish the bills, and that the adjuster did not intentionally furnish false bills, but forwarded those which were furnished to him by the son, without ***667** the knowledge of the plaintiff, and which the adjuster assumed were correct, coming, as they did, from the son who had charge of the buying end of the business. [17]

In affirming the verdict of the second jury, the *Mick II* court held that:

> We think that the weight of authority favors the proposition that where a person employed by the insured to adjust a fire loss, innocently, and without intent to defraud, furnishes to an insurance company upon its demand, without the knowledge or concurrence of the plaintiff, copies of bills of purchases procured for him by a third person whom he might justly assume had knowledge of the facts, and some of the bills proved to be false, such act is not a 'fraud' chargeable to the plaintiff, within a meaning of a clause contained in a policy of insurance that it shall be void for 'fraud or false swearing,' where the insurer has not relied upon it or suffered any loss therefrom. [18]

3. *Bockser*

The misrepresentations of a public adjuster were imputed to the innocent insured in *Bockser v. Dorchester Mut. Fire Ins. Co.* [19] The plaintiff/insured in *Bockser* was a plumbing and heating wholesaler. After suffering a fire loss at his store, he hired a public adjuster. The insured himself priced the stock inventory and totaled it, and the remaining adjustment matters were entrusted to the public adjuster.

The court held that the adjuster was guilty of attempted fraud upon the insurer as a matter of law in submitting two bills for labor and materials which had been marked up by a total of more than $14,000. The only evidence submitted on the insured's knowledge was the insured's testimony that he had no knowledge of the two fraudulent bills until after they had been filed by the adjuster with the insurer's representative.

After discussing the reprehensible nature of the conduct of the public adjuster, the court discussed the consequences to the insured: [20]

> There is still the important question as to the effect of such conduct of the agent upon his principal, the plaintiff. Except for the stock inventory, the plaintiff turned over to Shalek [the public adjuster] the entire charge of adjusting

> the loss and of conducting all dealings with the defendants. The furnishing of such statements as the defendants might require was an essential part of this employment. In general, the fraud of an agent acting in the course of his employment is binding upon his principal. [21] . . . And notice to, or knowledge of, an agent, in the course of the transaction in which he is acting for his principal, is constructive notice to, or knowledge of, the principal. [22] . . .

***668** The precise question is whether an agent's attempt to defraud, which was wholly unsuccessful, should be treated the same as similar conduct on the part of the principal and should result in forfeiture of the principal's rights under the policies. This is a matter upon which there is a difference of opinion in other jurisdiction. [23] . . . The majority, and we think the better reasoned, view is that the attempted fraud of the agent acting in the scope of his employment binds the principal. [24] . . . Any other result would tend to circumvent the public policy which calls for the enforcement of the clause in the Massachusetts standard policy now before us. [25] . . . All that would be necessary is a complete delegation by the insured of the responsibility for the adjustment of the loss to a third party whose acts might be disavowed at the option of the insured to escape the consequences. And in the absence of detection the gain would accrue to the insured. . . . [26]

The *Bockser* court held that the fraud of the public adjuster voided the policies [27] as if the fraud had been perpetrated by the insured himself. The court held that the insurers' motions for directed verdict should have been granted.

4. *Harold J. Warren, Inc.*

The final case directly dealing with an insured's responsibility for the misrepresentations of a public adjuster is *Harold J. Warren, Inc. v. Federal Mut. Ins. Co.* [28] In that case the insured corporation suffered a fire loss and hired a public adjuster. The adjuster had full authority to act for the insured. The public adjuster submitted a claim to the insurer's adjuster for an amount which included work not necessitated by the fire damage. [29] The trial court found that the insured was guilty of misrepresentations that voided the policy.

***669** The Court of Appeals had little trouble in finding that the District Court's judgment was not clearly erroneous. The Court of Appeals noted that the president and treasurer of the insured corporation as well as the public adjuster were aware of the damage done to the building by the fire, the repairs required, as well as the time that it would take to make the repairs. [30] The court further stated:

> Nor can [the insured] derive any comfort from the fact that these misrepresentations were made by [the public adjuster]. It is well settled in Massachusetts that an agent's attempt to defraud is attributable to his principal, if the agent is acting within the scope of his authority. [31] . . . There is no doubt that the public adjuster was acting within the scope of his authority all through the negotiations and proceedings here. [32]

B. *Claims Misrepresentations by Any Agent of the Insured*

Mick I, Mick II, Bockser, and *Harold J. Warren, Inc.*, as was stated earlier, are the only cases which consider the effect of misrepresentations by a public adjuster upon an innocent insured's recovery. The one thing that these cases makes clear is that public adjuster misrepresentation cases may be analyzed under traditional principles of agency law. It is appropriate, therefore, to consider cases discussing the impact of the misrepresentations of agents of an insured other than public adjusters upon an insured's recovery. A number of these cases have been reported and collected. [33]

A review of the agent (not public adjuster) misrepresentation case reveals one clear conclusion: if the agent's misrepresentations are beyond the scope of his authority, the insured may still recover under his policy. [34] Assuming that the misrepresentations are sufficient to void the policy if made by the insured himself and that the ***670** misrepresentations were made within the scope of the agent's authority, there is a split of authority on whether or not the insured's recovery is barred by the agent's misrepresentations. [35] The ultimate result in a case will turn on how the particular court resolves the tensions between: 1) the well-established general rule that a principal is responsible for the fraud of its agent perpetrated within the scope of its authority; 2) the less often recognized exception to this rule which provides that the principal is not bound by the agent's fraud if the principal himself is deceived by the agent; and 3) the particular language in the policy upon which the policy is sought to be declared void.

1. Acting Adversely to the Principal

The general rule that an innocent principal is responsible for the misrepresentations uttered by its agent within the scope of the agent's authority is beyond challenge. [36] Some cases have held, however, that the general rule does not apply when the agent is acting adversely to the principal. [37] One case has applied this exception to permit an insured to recover despite the application misrepresentations of the insured's agent. [38]

A public adjuster, however, will almost never, if ever, be acting adverse to the insured when making misrepresentations. The adjuster may be only interested in bulking up his contingency fee, but this does not mean he is acting adverse to the insured in making the misrepresentations. ‘The mere fact that the agent's primary interests are not coincident with those of the principal does not prevent the latter from being affected by the knowledge of the agent if the agent is acting for the principal's interests.’ [39]

Even assuming that the agent was acting adverse to the principal at the time of the misrepresentation, the ‘acting adversely’ exception to the imputation of the fraud has not received widespread acceptance. Restatement (Second) of Agency ***671** uously rejects this exception. [40] The exception also failed to shield an innocent insured from the imputation of the application and claims misrepresentations of another in *Davis Scofield*, [41] because the insured ratified the agent's by making claim upon the contract. In 1982, the United States Supreme Court stated that a principal is liable for an agent's fraud although the agent acts solely to benefit himself, if the agent acts with apparent authority. [42] The *Maryland Cas. Co.* case [43] should be considered aberrational due to the significant authority to the contrary and due to the weak reasoning exhibited in the opinion itself. [44]

2. Minority Positions Permitting Recovery Despite Misrepresentations of Agent

The discussion above outlines the general proposition that, as a matter of general agency law, an insured will usually bear the responsibility for a public adjuster's misrepresentations made within the scope of his employment. Counsel should be aware, however, that a few courts have permitted the insured to recover despite these misrepresentations. [45] These cases reach their result through a rather tortured ***672** interpretation of the term ‘insured’ in the fraud clause. Each essentially held that since the policy was void only upon misrepresentations by the ‘insured’—a term which also included the insured's legal representatives—the fraud clause did not prohibit misrepresentations by the insured's *agent*. Misrepresentations by the agent would have barred recovery only if the fraud clause specifically referred to ‘agents of the insured.’ This rather extreme construction is very much in the minority, but one must still be aware that it exists.

Another peculiar minority position on claims misrepresentation merits mention. Throughout this section of the paper, the broad language used implies that a claims misrepresentation as to any part of the claim will bar any recovery under the policy by the insured responsible for the misrepresentation. While this is clearly the majority position, this is not always so. A few jurisdictions consider a property insurance policy divisible by coverages. Misrepresentations as to contents in those jurisdictions, for example, bar only the claim as to contents—and not the same insured's claim to building coverage. [46] Of course, the consequences of the misrepresentations by an agent of the insured will not be any less favorable to the insured than if the same misrepresentations were made by the insured himself. A public adjuster's misrepresentations as to contents in such a jurisdiction, therefore, if imputable to the insured, would bar the insured's recovery as to the contents, but not as to the building.

The threshold consideration in determining whether the misrepresentations of a public adjuster will be imputed to the insured is whether the misrepresentations were made in the scope of his employment/authority. [47] If the misrepresentations would bar recovery if made by the insured himself and the misrepresentations by the public adjuster were within the scope of his authority, then the clear majority of jurisdictions would impute the adjuster's fraud to the innocent insured thereby barring his recovery.

III. MISREPRESENTATIONS AND THE INNOCENT CO-INSURED

Whether the misrepresentations of one insured may be imputed to another insured is the subject of this section of the paper. More precisely, the issue discussed is ***673** whether the material misrepresentations of one insured, which would void the policy if this insured were the only insured, will also bar recovery to co-insureds who did not participate in and had no prior knowledge of these misrepresentations.

A. *Defining 'Co-Insured'*

A 'co-insured' for the purposes of this discussion is anyone defined in the policy to qualify as an insured and whose right to recover is not dependent upon a named insured's right to recover. A mere appointee of policy proceeds, therefore, does not qualify as a 'co-insured.' [48]

Mortgagees under a standard mortgage clause are not considered 'co-insureds' for the purposes of this discussion because of the unique protection afforded by the standard mortgage clause. [49] Named and unnamed co-insureds are usually regarded equally in the cases addressed in this discussion. [50]

B. *Guilty Insured as Agent for Innocent Co-Insured*

The arguments developed in the preceding section on the imputation of fraud between principal and agent apply with equal force in this portion of the discussion. If the insured guilty of making misrepresentations is considered the agent of the innocent co-insured and the misrepresentations were made in the scope of the agency, recovery by the innocent co-insured will usually be barred. [51]

***674** The first section of this paper concerns only claims misrepresentation since a public adjuster would not be in a position to make misrepresentations in the application for an insurance policy. There are very significant differences, however, between claims misrepresentation and application misrepresentation with regard to an innocent co-insured.

The rule that misrepresentations by an agent of an insured within the scope of his authority are imputed to the insured is applicable to both claims and application misrepresentation. It is even easier to prove agency in application misrepresentation cases, however.

If an agent, whether a co-insured or not, procures a policy through misrepresentation, the principal/insured ratifies the agency by making claim under the policy or by suing upon it. [52] The principal/insured then is bound by the agent's misrepresentations.

Ratification is a rule of the general law of contracts which does not depend upon any policy language for its vitality. The rule is not without qualification, however. Some cases restrict ratification to situations where an agency already exists, but the acts sought to be declared ratified are outside the scope of the agent's authority. [53] The bringing of suit may also not constitute a ratification if it was brought without knowledge of all material facts. [54] The continuation of suit upon discovery of the material facts, however, constitutes a ratification. [55]

Even if the insured who is guilty of making application misrepresentations is not considered the authorized agent of the innocent co-insured (whether by ratification or otherwise), some jurisdictions would still bar recovery by the innocent co-insured. This result follows from the policy being considered void *ab initio* due to the misrepresentations in its procurement.

Unlike other misconduct resulting in forfeiture, application misrepresentations contaminate the very existence of the contract between the parties. Consequently, in some jurisdictions, whether by statute or otherwise,[56] application misrepresentations void the policy *ab initio*; that is, the contract is rescinded and the parties are returned to *status quo ante*, as if the contract had never existed.[57]

***675** This result was reached in the unpublished conclusion of South Carolina's initial arson innocent co-insured cases: *McCracken v. Gov't Employees Ins. Co.*[58] The husband, in *McCracken*, made fraudulent misrepresentations when he procured the policy in his and his wife's names. The husband intentionally burned the property, but his wife was declared an innocent co-insured entitled to recover.[59] In the published opinion on the arson innocent co-insured issue, the South Carolina Supreme Court expressly sidestepped the application misrepresentation issue.[60] The issue was finally addressed, however, in an unpublished opinion in the United States Court of Appeals for the Fourth Circuit. That court ruled that the policy issued to the McCrackens was void *ab initio*, barring recovery even as to the innocent co-insured.[61]

C. *Misconduct by an Insured Not the Agent of an Innocent Co-Insured*

The agency issues should be separated from the innocent co-insured issue. Both could support separate defenses. For the remainder of this section of the paper, the reader should assume that the guilty insured was not an agent of the innocent insured.

1. Misrepresentation Cases

The jurisdictions are split on the question of whether an innocent co-insured is barred by the application or claim misrepresentations of an insured not the former's agent.[62] An isolated review of these cases does not give the reader an appropriate impression of the current status of the law on misrepresentation and the innocent co- ***676** insured. The judicial environment in which innocent co-insured issues are analyzed has changed dramatically in the past decade, as the more frequently litigated arson cases illustrate. The similarities between arson and misrepresentation cases make an understanding of the relatively recent change in the analysis of arson co-insured cases crucial to an understanding of the present status of the law in misrepresentation co-insured cases.

***677** 2. Arson Cases

The question of whether an innocent co-insured may recover despite the arson of another insured has been litigated for quite a number of years in our courts under a variety of analyses, with varying results. The results of these cases are categorized below followed by a discussion of the general trends of these decisions.

As of March 1, 1986, this writer identified fifty property insurance cases which appear to decide whether one insured's arson bars recovery by an innocent co-insured.[63] Thirty-three of these decisions permitted the innocent co-insured to recover.[64] In 16 cases, arson by one insured barred recovery by the innocent co- ***678** insured.[65] The final of the 50 cases is especially noteworthy in that although the innocent insured had interests in all the categories of coverage, the arson of one ***679** sured barred only the innocent co-insured's recovery as to certain categories of coverage.[66]

Other cases of interest include two decisions where the innocent insured was barred by the spouse's arson, but neither opinion identifies the arsonist as an insured.[67] An additional case barred an innocent co-insured from recovering following intentional destruction of the insured property by another insured, but the court does not identify in its opinion whether or not the intentional destruction was arson.[68] One court ruled that an innocent co-insured would likely have been permitted to recover despite the arson of another insured, but for the fact that counsel did not properly preserve this issue for appeal.[69]

The cases described in the preceding two paragraphs concern property insurance policies. At least two innocent co-insured cases dealing with auto arson have been referred to in the property cases and therefore deserve mention.[70]

A review of the authority included in the preceding few paragraphs makes it clear that the majority of cases and jurisdictions permit an innocent co-insured to recover despite the arson of another insured. A close examination of these cases reveals an especially significant fact for our purposes: the present majority rule has emerged only in the last decade. The well-settled traditional majority rule barring recovery by ***680** an innocent co-insured was dramatically replaced in the past decade with the new majority rule permitting recovery by an innocent co-insured. [71]

Generally the courts use a 'joint versus several' test to determine whether an innocent co-insured may recover despite the misconduct of another insured. [72] Different versions of the 'joint versus several' analysis have been in vogue at different times.

The earliest cases held that an innocent co-insured was barred if the insured property was jointly owned. [73] The joint property interest was determinative for a number of reasons. Joint property owners were required to sue jointly for a recovery. [74] The prevailing rule in these courts was that, in a suit brought by joint plaintiffs, if one plaintiff was barred from recovering, all plaintiffs were thereby barred. [75]

Examination of the ownership interest of the property was also considered justifiable since it was feared that, if the property estate was indivisible, any recovery by one of the joint tenants would inure to the benefit of the arsonist. [76] Also, since the ownership in the property was joint, it seemed to follow that the joint owners' obligations to protect the property were also joint. [77]

Somewhat later cases tended to concentrate on whether the interests of the insureds in the insurance policy, as opposed to the insured property, were joint or several. [78] Sometimes the joint or several interest in the insurance was determinative, but more often this examination was combined with an examination of the ownership interest in the insured property. [79]

As of 1942, all the cases discussing the rights of an innocent co-insured to recover under a policy (whether the misconduct was arson or misrepresentation) based their holdings on the joint versus several nature of the insureds' interest in the insurance ***681** and/or the insured property. [80] The 1942 decision in *Hoyt v. New Hampshire Fire Ins. Co.* [81] led the judicial coup which is responsible for the current status of the law. [82]

Hoyt switched the emphasis from an insurer's to an insured's perspective. While not abandoning the joint versus several distinction, the court declared that the mere fact that the language employed may be sufficient to express a joint covenant is not conclusive.

> Whether the rights of obligees are joint or several is a question of construction (1 Williston, Con., § 325), and in construing an insurance contract the test is not with the insurance company intended the words of the policy to mean but what a reasonable person in the position of the insured would have understood them to mean. [83]

Despite *Hoyt*, the majority of cases continued to follow the traditional analysis. [84] It was not until 1974, in the decision of *Howell v. Ohio Cas. Ins. Co.* [85] that the modern trend was firmly shaped and began to develop momentum.

The policy in *Howell* insured 'Gene K. Howell and/or Donna L. h/w.' [86] The court stated that the use of 'and/or' created an ambiguity which was resolved in favor of the innocent co-insured because of the insureds' reasonable expectations. Although this conclusion supported the court's holding, the court held that it was not controlling.

The *Howell* court first based its holding permitting the innocent co-insured to recover on the court's conclusion that the responsibility for the arson was several rather than joint. In doing so, the court expressly abandoned the traditional analysis.

> [W]e reach this result irrespective of whether the interests of the wife and husband in the tenancy by the entirety, in the personal property, or in the contract rights under the policy are deemed to be joint or several. The significant factor is that the responsibility or liability for the fraud—here, the arson—is several and separate rather than joint,

> and the husband's fraud cannot be attributed or imputed to the wife who is not implicated therein. Accordingly, the fraud of the co-insured husband does not void the policy as to the plaintiff wife. [87]

Howell represented a radical departure, not only because it abandoned the traditional analysis of the interest in the property and the insurance, it even appears to ignore an examination of the hazard, neglect and fraud clauses, upon which many insurers relied in defending arson cases. The opinion could be read to turn on a co-insured's responsibility for the arson, regardless of the contract provisions.

In the 12 years following *Howell*, the well-settled majority rule barring an innocent co-insured from recovery because of another insured's misconduct became the ***682** nority rule. [88] Although more and more cases after *Howell* resulted in recoveries by an innocent co-insured, not all of the cases abandoned an examination of the insurance policy. A number of courts, however, presumably through *Howell*'s influence, have clouded their analysis with tort law. [89]

The modern cases examine the policy language, from an insured's perspective, to see if the policy says, with sufficient clarity, that one insured's misconduct bars recovery by another insured. These cases focus on the clauses specifically prohibiting the misconduct complained of. [90] The courts look to see whether the obligation to refrain from fraud is joint, but they do so by looking at the clauses prohibiting this conduct rather than by trying to derive this conclusion through an examination of the insureds' interests in the insurance and the insured property.

The traditional analysis is still employed in some jurisdictions. [91] One recent decision has gone so far as to declare recovery by an innocent co-insured's spouse following arson by her husband to be contrary to public policy. [92] The language of the opinion indicates that its holding would have application even outside the innocent spouse context. [93]

A very few cases have extended the rule barring recovery by an innocent spouse beyond the bounds of even an insurer's reasonable expectations. Generally, if a loss results from the fraud of one not defined in the policy as an insured, the insurer remains obligated to pay the innocent insured. [94] Two Texas cases, however, allow arson by what appear to be uninsured spouses to bar recovery by the innocent insured spouse [95] —with one of the cases reaching this result as a matter of public policy. [96]

***683** The modern dominant trend in arson cases will have an impact on misrepresentation cases, although important distinctions exist between arson and misrepresentation. Evidence of the influence of the trend is seen in the misrepresentation cases cited earlier. [97] The leading cases barring recovery have been forcefully disapproved in subsequent litigation. [98]

3. Prohibited Conduct of 'The Insured'

A number of arson cases permitting recovery by an innocent co-insured turn on the court's interpretation of the policy's fraud clause (among other clauses). Obviously, these decisions will help indicate what the same courts would decide in misrepresentation cases. These cases permitted an innocent co-insured to recover because the policies under consideration did not clearly state that the policy obligations to refrain from fraud, to preserve the property and/or to not increase the hazard, were joint obligations of all insureds. [99] These obligations according to the terms of the policies, applied to 'the insured.' [100] These courts held that the clauses applied only to the insured guilty of the misconduct, thereby permitting the innocent co-insured to recover. [101]

The analysis employed in these decisions is flawed or, at least, incomplete. While the use of the term 'the insured' is ambiguous when an insurer defines the unqualified term 'insured' in a matter not entirely consistent with other policy references to the insureds, [102] without such an inconsistency the interpretation that 'the insured' means 'the guilty insured' is questionable.

The typical analysis in these cases begins with the finding that the term 'the insured' is ambiguous. [103] The court then resolves the ambiguity in favor of recovery by the co-insured, because any ambiguity should be construed strongly against the insurer as drafter of the clause. [104]

***684** The first problem with this analysis is that the clauses being construed are often required by a state adopted standard policy. [105] This language, therefore, was not drafted by the particular insurer but was required and approved by the state legislatures (or those under their direction). These clauses, therefore, should be given their most reasonable interpretation without construction preference being given to either party to the insurance contract. [106]

It should also be noted that the policy language may still be construed against the insurer if some other construction rule so requires. If, for instance, the preference for constructions avoiding forfeiture is independent of the rule that policies are construed against the drafter, then the construction permitting an innocent co-insured to recover would still prevail.

The second basis for criticism is in construing 'the insured' to apply only to the guilty insured. [107] The clauses under consideration forbid fraud and other misconduct 'by the insured.' [108] A court cannot conclude that the clause applies only to a guilty insured without engaging in policy drafting rather than mere policy construction.

If the policy covers more than one insured, the question becomes whether the voiding of the policy is triggered by the misconduct of 1) an insured or 2) all insureds. These are the only two reasonable constructions permitted by the policy language itself. It is important to notice, however, that although an ambiguity exists as to how many of the insureds must participate in the misconduct before the clause is triggered, the event triggered—the voiding of the 'entire policy'—is unambiguous. [109] ***685** Resolving the ambiguity regarding 'the insured' only determines whether or not the clause is triggered—not that the ultimate result would be the voiding of the entire policy.

If it is appropriate to construe the clause against an insurer, it is not difficult to come to the conclusion that, if all the insureds do not participate in the fraud, this clause is never triggered. The policy remains in effect as to all insureds including the guilty insured. [110]

If the court acknowledges that the language contained in the policy is the responsibility of the legislature rather than of the insurer, a court may very well conclude that the misconduct clauses are triggered by the misconduct of an insured—meaning any one of the insureds. [111] Clearly, no legislature intended for the misconduct clauses to apply only when the policy insured but one person. This, however, is the resulf if the misconduct clauses are deemed to be triggered only by the misconduct of all insureds.

The fact that the misconduct clauses are in the standard policies means that the legislatures intended to prohibit such misconduct. The construction requiring that all insureds participate in the misconduct not only fails to deter such conduct, it rewards it.

No one can deny that the 'the insured' misconduct clauses could have been drafted more precisely. The failure to do so makes both insureds and insurers victims by forcing them into more frequent litigation. Until more precise language is used in the policies, however, our courts should be guided by the most reasonable construction of the misconduct clauses. If the most reasonable interpretation may be said to be the one that is consistent with the intention expressed by the legislatures to deter fraud and other misconduct, the misconduct clauses should be read to be triggered by the misconduct of any insured.

D. *Recent ISO Treatment of Innocent Co-Insureds*

As indicated earlier in this discussion, the courts now concentrate on the policy language in determining whether an innocent co-insured may recover. Some insurers have responded by incorporating clauses in their policy which eliminate any ambiguity and make it absolutely clear that the policy is voided by the misconduct of *any* insured. [112] The 'any insured' language in these policies have uniformily barred recovery by an innocent co-insured, even in those jurisdictions which, absent that ***686** cise language, would permit an innocent co-insured to recover. [113] Some insurers, on the other hand, have issued policies exhibiting a clear intention to insure against the risk of co-insured misconduct—at least as to *misrepresentations*. [114] If the 1984 Homeowners Program prepared by the Insurance Services Office, Inc. ('ISO') is indicative of the general trend in the industry,

then in the next few years more co-insureds will be barred from recovering in arson cases, but more innocent co-insureds will recover in misrepresentation cases.

The ISO has offered varied responses to the judicial invitation to determine the fate of an innocent co-insured with precise policy language. The fraud clause appearing in the 7-77 edition of the ISO homeowners forms is quoted below:

> *Concealment or Fraud.* We do not provide coverage for any *insured* who has intentionally concealed or misrepresented any material fact or circumstance relating to this insurance.

This 'insured *who*' language unambiguously restricts the recovery bar to the guilty insured. An innocent co-insured would recover under a policy with such language despite the misrepresentations of another insured.

In 1982 and 1983, the ISO introduced a test homeowners program (edition 7-82) in California, Colorado, Georgia, Massachusetts, Oregon and Wisconsin. In the 7-82 edition, the fates of an innocent co-insured in arson and misrepresentation cases were treated separately, but similarly. An additional phrase was added to the fraud clause from the 7-77 edition, but the effect was still to permit an innocent co-insured to recover despite the misrepresentations of another insured. [115] The 7-82 edition introduced a new 'intentional loss' exclusion, but this exclusion expressly provided that it did not apply to innocent insureds. [116]

***687** The 4-84 edition is the most recent of the ISO homeowners forms. The fraud clause appearing in the 4-84 edition is identical to that in the 7-82 edition. The 'intentional loss' exclusion, however, was revised so that arson by one insured barred recovery by all insureds. [117]

A mere 15 years ago, the fate of an innocent co-insured was well-settled—especially in arson cases. Today, the fate of an innocent co-insured is no less settled, but with the opposite result. A comfortable majority of our jurisdictions now permit an innocent co-insured to recover despite the fraud of the other insured, in the absence of clear language to the contrary. As this last clause suggests, the courts are permitting the insurance industry to have the final word. If the 4-84 edition of the ISO homeowners forms is the final word, co-insureds innocent of arson will be barred from recovering, but co-insureds innocent of misrepresentations will recover.

IV. INSURER'S RESPONSIBILITY FOR THE BAD FAITH OF AN INDEPENDENT ADJUSTER

This, the final section of this paper, discusses what misconduct on the part of an independent adjuster is imputed to the insurer, thereby subjecting the insurer to exposure for bad faith or other extra-contractual damages. [118] The courts have left a few important questions in this area unanswered.

Insurers are generally serviced by two types of adjusters: staff (in-house) adjusters and independent adjusters. The former are full-time employees of one insurer. The latter are employed by entities independent from a particular insurer.

Obviously, an insurer is vicariously responsible for the acts of its staff adjusters just as it would for any of its other employees. This paper discusses whether the same rules of vicarious liability apply to the conduct of independent adjusters.

A. *Independent Adjuster: Servant or Independent Contractor?*

Generally, an employer is responsible for the conduct of its employee while in the scope of the latter's employment. [119] An employer generally is not responsible for the conduct of an independent contract, however. [120] As these general rules suggest, ***688** the critical issues are whether an independent adjuster qualifies as an 'independent contractor' and, if so, whether the general rule against the imputation of liability to the employer applies to the adjustment of insurance claims.

Traditional negligence and agency law provide: [121] (1) a master/employers is subject to liability for the torts of his servants committed while acting in the scope of their employment; [122] (2) a master/employer would be liable for the torts of a servant acting outside the scope of his employment if, among other things, the conduct violated a nondelegable duty of the master or the servant purported to act or speak on behalf of the principal with apparent authority; [123] and (3) a master/employer is generally not responsible for the misconduct of an independent contractor, unless, among other things, the misconduct concerns a nondelegable duty imposed upon the employer—whether by statute, contract, by franchise or order, or by the common law. [124]

Employees are classified as either servants or independent contractors. [125] Whether the employee is categorized as a servant or an independent contractor depends on whether the employee is subject to the employer's light to control his conduct. [126]

***689** At least a few reported cases exist where a court has been faced with the issue of whether or not the bad faith conduct of an independent adjuster is imputed to the insurer. These cases, however, do not discuss their results with explicit reference to the law outlined above.

Eldridge v. Northwest G. F. Mut. Ins. Co. [127] is the case most squarely addressing these issues. In *Eldrige*, the insured suffered roof damage from high winds. The investigation of the claim was assigned to 'a firm that adjust insurance losses for various insurance companies who retain the firm's services.' [128] Under South Dakota law, if a refusal to pay was vexatious or without reasonable cause, the court could award attorney's fees. In affirming the award of attorney's fees, the court emphasized that this holding was based upon the absence of an adequate, good faith investigation of the claim. The court referred to the adjuster's behavior as 'lackadaisical, if not outright cavalier.' [129]

The insurer in *Eldrige* argued that it should not be held liable for attorney's fees 'because it had engaged a reputable independent adjusting firm to investigate and adjust the loss.' [130] Obviously, the court was of another opinion. All we know of the basis of that opinion, however, is the following:

> We do not believe that defendant can insulate itself from liability by delegating its responsibility to investigate claim losses to third parties. While we do not question defendant's good faith in assigning the claim to the independent insurance adjusting firm for investigation and report, ultimately the liability for the adjusting firm's failure to make an adequate investigation of plaintiff's claim of additional damage must rest upon defendant. [131]

In *Eldrige*, the court does not expressly frame its analysis in terms of the agency principles outlined above, but the language of the opinion is consistent with those principles. It appears that the court is saying that the duty to investigate claims is a nondelegable duty of the insurer when it states that the insurer cannot insulate itself from liability by *delegating its* responsibility to investigate. The court does not refer to the adjusting firm as an independent 'contractor', but it does call the adjusting firm 'independent.'

Unfortunately, the court in *Eldrige* does not reveal the basis for its apparent holding that the duty to investigate a claim is a nondelegable duty of the insurer. Other cases have not been any more explicit.

The misconduct of an independent adjuster was imputed to the insurer in the case of *Dailey v. Integon Gen. Ins. Corp.* [132] In *Dailey*, a jury awarded $20,000 in punitive damages against the insurer for the adjuster's conduct during his investigation. The adjuster apparently notified the insured's neighbors that the insured had ***690** ally burned the house. The adjuster also apparently offered bribes to potential witnesses to testify against the insured. The court permitted the award of punitive damages to survive since the adjuster [133] was deemed to be an agent of the insurer.

The *Dailey* decision is disturbing for two reasons. The first is that agency alone should be insufficient to justify the imputation of the misconduct to the insurer. This is so because an independent contractor may still be the employer's agent without necessarily affecting the general rule disallowing the imputations of the independent contractor's misconduct. [134] The court, therefore, also needed to determine 1) whether the duty to investigate was nondelegable; and 2) if not, whether the adjuster was an independent contractor.

The second disturbing feature of the *Dailey* decision is that the agency alone was sufficient for the imputation of the misconduct on the issue of *punitive* damages. Many courts would require some sort of affirmative authorization from the insurer of the misconduct justifying punitive damages before it could be imputed to the insurer, as is set forth below. [135]

Especially interesting and tangentially relevant are the two *National Sec. Fire & Cas. Co. v. Bowen* cases [136] appearing in the Supreme Court of Alabama in 1982 and 1983. The issue in the first *Bowen* case ('*Bowen I*') was whether or not the insurer was responsible for the bad faith conduct of the independent investigators. The court held that the insurer had ample debatable reason to defend on the basis of arson. As the later *Bowen* case ('*Bowen II*') makes clear, the investigators' misconduct consisted of a rather incredible series of harassment activities which were independent of the question of the insured's guilt for arson. The court seemed to be saying that, since the insurer did not participate in the investigation itself and there was evidence on which an arson defense might be based, the investigator's misconduct did not affect the justification for a denial of the claim. [137]

Bowen II [138] offers especially interesting facts. The misconduct of the independent investigators which came out in the second trial included abusive and threatening telephone calls to the insured and his family at all times of the day, a number of attempted bribes of witnesses, threats to have the insured locked up, threats to kill the insured's son, and threats to kill the insured. In the ultimate act of harassment, the independent investigators allegedly forced the insured to lie on the ground in the ***691** woods and put a gun to his head. This episode lasted approximately one and one-half hours with the investigators pulling the trigger on what turned out to be an empty gun.

In *Bowen I*, [139] the court ruled that the viability of the insurer's arson defense meant that it was not guilty of bad faith, but it did not rule on whether the independent torts alleged against the insurer for malicious prosecution, outrageous conduct, willful failure to pay, and fraud and conspiracy were viable. The second trial on these independent torts alone—without a traditional bad faith claim—resulted in a general verdict of $1.5 million against the insurer. This verdict was affirmed in *Bowen II*.

One might wonder if the fact that recovery was allowed for the independent torts in *Bowen II* while recovery for bad faith was denied in *Borwn I* means that the misconduct of independent investigators is not imputable to an insurer on bad faith, but is imputable to an insurer on independent tort actions. This conclusion does not necessarily follow. For one, the second trial may have developed facts differently from the first trial. The factual differences may have required different results on the imputation of the investigators' misconduct. One might also interpret the *Bowen* cases as saying that the misconduct in both cases actually was imputed to the insurer, but—even assuming the insurer was responsible for the investigator's misconduct—bad faith was not shown. Such an interpretation becomes more credible when one recalls that a claim for bad faith in many jurisdictions is a remedy for an improper refusal to pay—not for unprofessional claims handling or for tortious behavior independent of the duty to pay. The insured must seek recovery under remedies other than a claim for bad faith in those latter situations, as was successfully done in *Bowen II*.

The insurer in *Bowen II* tried to argue that it should be shielded from liability because the investigators were independent contractors. In response to this argument, the court stated:

> If [the investigators] were mere independent contractors, it would seem unlikely that [the insurer's assistant vice president] would become involved with any part of the investigation by traveling with the investigators. Moreover, [the investigators] called on [the assistant vice president] at his office at least twice during the investigation. (The investigation lasted approximately two weeks). Finally, [the assistant vice president's] letter to [one of the investigators] suggests that [the assistant vice president] would have the final authority as to the completion of the investigation. He wrote [one of the investigators] that before the investigation was completed he wanted to talk to the investigator to determine if any further investigation was merited. [140]

The court appears to be saying here that the investigators were more properly characterized as servants than as independent contractors because of the control exhibited by the insurer. Clearly, if the investigators do not qualify as independent contractors, then the vicarious liability bar applying to independent contractors would not be available.

***692** At least oblique support for the argument that the misconduct of an independent adjuster should not be imputed to the insurer is found in the case of *American National Life Insurance Company of Texas v. Montgomery*. [141] The relevant question for our purposes before the court in *Montgomery* was whether the misrepresentations of a soliciting agent as to the conditions under which the insurer will issue a life insurance policy are imputed to the insurer so that the insurer is liable under the Deceptive Trade Practices—Consumer Protection Act. The court found that the soliciting agent was an independent contractor. Noting the 'general rule that a contractee is not answerable for the acts of an independent contractor', [142] the court reversed the trial court and held that the independent contractor status of the agent insulated the insurer from vicarious liability. [143]

B. *Claims Investigation as a Nondelegable Duty of the Insurer*

One of the few references to an independent adjusting company as an independent contractor appears in the dissent in the case of *Hale v. Farmers Ins. Exch.* [144] In his dissent, Justice Kerrigan indicates that he would have held an insurer's in-house claims supervisor and claims examiner personally liable for bad faith. The justice distinguished the famous—or infamous—*Gruenberg* [145] case on the ground that the non-insurer defendants in that case were independent contractors without authority to accept or deny the insured's claim. [146]

The status of independent contractor and the issue of nondelegable duty was discussed with regard to attorneys employed by a liability insurer in *Cotton States Mut. Ins. Co. v. Trevethan*. [147] In *Trevethan*, the claimant sued a tort-feasor's insurer claiming that the insurer had acted in bad faith in refusing to settle the original claim for policy limits. The insurer relied on *Merritt v. Reserve Ins. Co.* [148] for its argument that 'the trial attorney acts as an independent contractor and the insurer is therefore not liable for negligent defense of the action.' [149] The court responded to this argument by stating 'whatever may be the merits of that position (a point we need not decide) suffice it to say that the case *sub judice* does not involve a claim of negligent defense, so the California case is completely distinguishable. [150]

***693** *Merritt v. Reserve Ins. Co.*, [151] is the case referred to in *Trevetban*. It also is a bad faith auto liability case. In *Merritt*, the insured's assignee sued the insured's carrier for bad faith and for negligent defense of the personal injury action brought against the insured. The court entered judgment for the insurer on the bad faith claim on the basis that no settlement offer was made, so there could be no bad faith in failing to settle within policy limits. As to the claim of negligent defense against the insurer, the court held that the trial attorneys hired to defend the insured were independent contractors performing a delegable duty. The court held that the duty to defend the insured was a delegable duty because, quite obviously, the insurer was not permitted to practice law. So ruling, the court stated that the insurer could not be vicariously liable for negligently defending the insured.

Further discussion of the caselaw will only take us further from the heart of the issue. A discussion of the general authorities follows.

Restatement (Second) of Agency offers the following on the nature of a nondelegable duty:

> There are three forms of the duty of protection. First, a person may have a duty to protect another which can be performed either by exercising care personally in protecting the other or by exercising care in the employment of an independent contractor to protect the other. Secondly, there may be a duty to protect another at all hazards, a duty which is not fulfilled unless the other is protected and which is not satisfied by the use of care. This duty normally exists only when undertaken by contract. Thirdly, one may have a duty to see that due care is used in the protection of another, a duty which is not satisfied by using care to delegate its performance to another but is satisfied if, and only if, the person to whom the work of protection is delegated is careful in giving the protection. In this third case, the duty of care is nondelegable. It is beyond the scope of this Restatement of this Subject to do more than state the general rule and indicate the most frequently arising situations in which a master or other principal may be liable, although without personal fault, for conduct of his agents or servants, whether or not they are acting in scope of employment. In fact, a person who has undertaken a specific piece of work is also liable for the failure of those not his servants or agents to carry out the terms of the undertaking. [152]

Nondelegable duties are also discussed in the most recent edition of Prosser's handbook on torts. [153] While noting that such a duty may be imposed by statute, by contract, by franchise or charter, or by the common law, it is stated that:

> ***694** It is difficult to suggest any criterion by which the nondelegable character of such duties may be determined, other than the conclusion of the court's that the responsibility is so important to the community that the employer should not be permitted to transfer it to another. [154]

A ruling that the investigation and adjustment of insurance claims is a nondelegable duty of the insurer is more likely in those jurisdictions which recognize a claim for a breach of a duty of good faith and fair dealing, yet do not permit a direct action against independent adjusters for such a breach. [155] Insureds would argue that the availability of their bad faith remedy should not turn on whether an insurer was clever enough to insulate itself from liability by hiring an independent adjusting firm to handle the claim. [156] It should be noted, however, that the unavailability of a *Gruenberg* remedy does not necessarily mean that an independent adjuster might not be responsible to the insured under some other theory of recovery. [157]

If the adjuster's independent contractor status provides no defense for the insurer, then the insurer will essentially become vicariously liable for all the misconduct of the adjusters it hires. That is the clear implication of *Bowen II* [158] where the Alabama Supreme Court considered the exceptionally egregious misconduct of the investigators to be within the scope of their actual or implied authority in conducting their investigation. [159]

It is certainly conceivable that the adjustment of insurance claims will be considered a duty which is of a sufficient character to be considered nondelegable. *Eldridge* [160] supports this position. *Eldridge*, however, appears to be the only case confronting this issue and the court does not give us the benefit of its reasoning for reaching its conclusion that claims investigation is not a delegable responsibility. The ***695** rather amorphous nature of the nondelegable duty requirement calls for specific litigation on this point to determine whether the independent adjuster is to be treated like an insurer's staff adjuster.

C. *An Innocent Principal's Responsibility for Punitive Damages*

In some jurisdictions, the sufficiently wrongful conduct of an insurer will subject it to exposure for punitive damages. [161] Some courts permit the imputation of the adjuster's misconduct on the issue of punitive damages in the same fashion as that for compensatory damages, [162] as apparently was the case in *Dailey*. [163] Other jurisdictions follow the rule stated in the Restatement of Torts and the Restatement of Agency that punitive damages can properly be awarded against a principal because of an act of an agent only if:

> (a) The principal or a managerial agent authorized the doing and the manner of the act, or
>
> (b) The agent was unfit and the principal or a managerial agent was reckless in employing or retaining him, or
>
> (c) The agent was employed in a managerial capacity and was acting in the scope of employment, or
>
> (d) The principal or a managerial agent of the principal ratified or approved the act. [164]

Obviously, independent claims adjusters do not function in a managerial capacity for insurers. Therefore, assuming the bad faith conduct was initially unauthorized, the acts of a claims adjuster (found to be an agent of the insurer) would be imputed to the

insurer for the purposes of punitive damages only if 1) the claims adjuster was unfit and the insurer was reckless in employing or retaining him, or 2) if the insurer ratified the misconduct.

V. CONCLUSION

This paper discussed misconduct imputation in three contexts: 1) from public adjuster to insured for the former's misrepresentations; 2) from one insured to an innocent insured for the former's misrepresentations; and 3) from an independent adjuster to the employing insurer for the former's bad faith. The conclusions as to all three are set forth separately below.

Generally, the misrepresentations of a public adjuster will bar recovery by an innocent insured, if the misrepresentations were made within the scope of the adjuster's authority. The misrepresentations of the adjuster will usually be considered at least within the scope of the agent's apparent authority if it has anything to do with the adjustment of the claim for the insured. A minority of jurisdictions, however, would permit the innocent insured to recover despite the in-scope ***696** tations of a public adjuster. This minority position is the result of a peculiar construction of a policy's fraud clause. Courts employing the minority position interpret the policy to forbid misrepresentations by an insured alone—and not to forbid those of his agents.

Assuming an insured is truly innocent of any participation in the misrepresentations of a co-insured, the jurisdictions are split on the question of whether the innocent co-insured may still recover. The influence of arson co-insured cases will likely increase the strength of the majority rule that an innocent co-insured will be permitted to recover despite the misrepresentations of a co-insured. The most recent edition of the ISO homeowners form will definitely result in recoveries by innocent co-insured in misrepresentations cases. An innocent co-insured, however, still may be barred if the guilty insured was acting as the agent of the innocent co-insured. In application misrepresentation cases, in particular, recovery by the innocent co-insured will frequently be barred because suing on the policy will usually ratify the agency and make the misrepresentations of the guilty insured those of the innocent co-insured.

The misconduct of an independent adjuster within the scope of his employment has generally been imputed to the employing insurer on the question of the insurer's bad faith. Some courts permit the imputation of the misconduct from independent adjuster to insurer on the basis of agency alone. This should not be so, however, if the independent adjuster was functioning as an independent contractor at the time of the misconduct and the adjuster was not performing a nondelegable duty of the insurer. While one court appears to hold that the investigation of a claim is the nondelegable responsibility of the insurer, the matter is hardly well-settled. The issues of nondelegable duty and independent contractor status should be further litigated. Regardless of how these issues are resolved, however, in a number of jurisdictions, an insurer is liable for punitive damages due to an adjuster's misconduct only where the insurer was reckless in employing an unfit adjuster or where the insurer ratified the adjuster's misconduct.

Each of the three topics discussed in this paper relies heavily on the law of agency for its resolution. Unfortunately, agency law often does not appear in black or white—but only in shades of gray. Consequently, this paper should be used to identify issues and relevant authority, but not to provide unqualified answers to jurisdiction specific inquiries.

Footnotes

a *Richard K. O'Donnell is an attorney with the firm Drew, Eckl & Farnham in Atlanta, Georgia*.

1 *See, e.g.* OFF. GA. CODE ANN. § 33-23-40(a)(10). (‘Public Adjuster’ means an adjuster employed by and representing solely the financial interest of the insured named in the policy.) *See generally*, J. APPLEMAN, INSURANCE LAW AND PRACTICE § 8646 (Rev. Ed. 1981). Although a particular adjuster may be licensed to adjust claims for both insurers and insureds, the adjuster is usually permitted to only represent one or the other on a particular claim. *See, e.g.*, OFF. GA. CODE ANN. § 33-23-58(a). It is presumed throughout this discussion that the public adjuster is representing the interests of the insured alone.

2 87 N.J.L. 607, 91 A.102 (N.J. App. 1914).

3 87 N.J.L. 628, 94 A.808 (N.J. App. 1915).

4 327 Mass. 473, 99 N.E.2d 640, 24 A.L.R.2d 1215 (1951).

5 386 F.2d 579 (1st Cir. 1967) (Mass. law).

6 *See* Valiant v. American Family Mut. Ins. Co., 698 S.W.2d 584 (Mo. App. 1985). In *Valiant*, the insureds reported a burglary loss to the police in the amount of $2,428.00. After hiring a public adjuster, the insureds' claim shot up to $28,139.30—just $60.70 shy of the policy limit. The adjuster *and* the insureds prepared the allegedly fraudulent list of stolen items. The jury was charged on misrepresentation by the insureds and on the insureds' failure to file proof of loss. The jury verdict for the insurer was affirmed, however, the court concentrated on the insureds' failure to file a proof of loss rather than on the misrepresentation defense.

7 *Supra*, note 2.

8 91 A.102, 103.

9 *Mick I, supra* note 2 at 104-06. So much of *Mick I* is quoted above because the discussion is efficiently thorough. An additional argument in favor of holding the 'innocent' insured responsible for the misrepresentations of a public adjuster may be made, however. A contrary ruling would make a public adjuster essentially immune from civil liability for his intentional misrepresentations. The risk of loss for the adjuster's fraud should be on the insured that hired him since the insured would clearly have the right to sue the adjuster for the adjuster's malfeasance—the insured's damages being what he would have recovered under the policy had the adjuster performed properly. If the insurer is forced to pay despite the adjuster's attempted fraud, however, the insurer has no action against the adjuster. This is so because the insurer will have suffered no damage proximately caused by the tortuous conduct of the adjuster. The failure to impute the adjuster's fraud to the insured, therefore, essentially means that the adjuster may attempt to defraud without fear of being held financially responsible if he is caught. (Of course, the adjuster remains subject to criminal penalties, but civil accountability would seem to be a more effective disincentive to fraud.)

10 'This entire policy shall be void in case of fraud or false swearing by the insured touching any matter relating to this insurance, or the subject thereof whether before or after the loss.'

11 *Mick I, supra* note 2 at 103.

12 'Assuming that this verdict is binding upon this court, it follows that, if false vouchers were produced without the respondent's fraud, the most he can be charged with is negligence (which is not made a ground of forfeiture in the policy) unless such forfeiture clause properly construed penalizes him for the fraud of another.' *Mick I, supra* note 2 at 106-07 (dissent).

13 *Accord* Mullin v. Vermont Mut. Fire Ins. Co., 58 Vt. 113, 4 A.817 (1886).

14 *Mick I, supra* note 2 at 106.

15 Note that the term 'reckless' refers to the insured's state of mind, and not that of the guilty person(s). The court had earlier held that the insured's son or the public adjuster had 'intentionally' submitted the false invoices. *Supra*, note 8.

16 87 N.J.L. 628, 94 A.808 (N.J. App. 1915).

17 *Mick II*, 94 A.808, 809.

18 *Mick II*, 94 A.808, 810.

19 327 Mass. 473, 99 N.E.2d 640, 24 A.L.R.2d 1215 (1951).

20 The authorities cited by the court in the immediately following quotation are omitted from the text but are quoted in the footnotes where indicated.

21 'McCarthy v. Brockton National Bank, 314 Mass 318, 325, 50 N.E.2d 196; Golding v. 108 Longwood Avenue, Inc., 325 Mass 465, 466, 91 N.E.2d 342; RESTATEMENT: AGENCY, § 257.'

22 'Suit v. Woodhall, 113 Mass 391, 395; Tremont Trust Co. v. Noyes, 246 Mass 197, 206-207, 141 N.E. 93; New England Trust Co. v. Bright, 274 Mass 407, 412-413, 174 N.E. 469, 73 A.L.R. 416; Union Old Lowell National Bank v. Paine, 318 Mass 313, 323-324, 61 N.E.2d 666; RESTATEMENT: AGENCY, §§ 268, 272.'

23 'COUCH ON INSURANCE, § 1557; 29 AM JUR. INSURANCE, § 1136; 45 CJS, INSURANCE, § 1021(c).'

24 'Davis-Schofield Co. v. Reliance Ins. Co., 109 Conn 686, 690, 145 A.42; Mick v. Corporation of Royal Exchange Assurance, 87 N.J.L. 607, 91 A. 102, 52 L.R.A. N.S. 1074. Compare *Id.* 87 N.J.L. 628, 94 A. 808; Kantor Silk Mills, Inc. v. Century Ins. Co., Ltd. 223 App. Div. 387, 228 N.Y.S. 822, affirmed 253 N.Y. 584, 171 N.E. 793. *See* American Eagle Fire Ins. Co. v. Vaughan, 4 Cir, 35 F.2d 147, 149; Hyland v. Millers National Ins. Co. D.C. N.D. Cal. S.D., 58 F.2d 1003, 1006, *affirmed* 9 Cir. 91 F.2d 735, *certiorari denied* 303 US 645, 58 S. Ct. 644, 82 L. Ed. 1107; National Union Fire Ins. Co. v. Schwab, 241 Ala. 657, 659, 4 So. 2d 128, Saidel v. Union Assurance Society, Ltd. 84 N.H. 232, 149 A. 78; Mullin v. Vermont Mutual Fire Ins. Co. 58 Vt. 113, 4 A. 817; Jervis v. Burlington Mutual Fire Ins. Co. 113 Vt. 518, 521-522, 37 A.2d 374. Contra Metzger v. Manchester Fire Assurance Co., 102 Mich. 334, 63 N.W. 650; cited with approval in Ins. Cos. v. Scales, 101 Tenn. 628, 634-639, 49 S.W. 743, and Virginia Fire & Marine Ins. Co. v. Hogue, 105 Va. 355, 366-370, 54 S.E. 8; restricted to agent ex necessitate in Evans v. Crawford County Farmers' Mutual Fire Ins. Co., 130 Wis. 189, 198-200, 109 N.W. 952, 9 L.R.A. N.S. 485. *See also* Mechanics' Ins. Co. v. Inter-Southern Life Ins. Co. 184 Ark. 625, 631-632, 43 S.W.2d 81.'

25 '*See* Gechijian v. Richmond Ins. Co., 298 Mass 487, 489-490, 11 N.E.2d 478, *supra*.'

26 *Bockser, supra*, note 19.

27 The insured's policies provided that they 'shall be Void . . . if the insured shall make any attempt to defraud the company either before or after the loss . . .,' as prescribed by the Massachusetts standard form.

28 386 F.2d 579 (1st Cir. 1967).

29 An original claim was submitted, which was later revised upward. The parties could not agree on the amount of the loss, so the parties went to reference under the applicable Massachusetts statute. Prior to the referee's award, the insurer denied

liability under the policy and filed this declaratory judgment action to have the policy declared void. The somewhat unusual posture in which this case was brought did not affect the court's analysis on the effect of the misrepresentations on the validity of the policy.

30 The court indicated that, in addition to claiming damage which was not the result of the fire, the rental loss claim was fraudulently inflated.

31 Here the court quoted from Bockser v. Dorchester Mut. Fire Ins. Co., discussed *supra*, notes 19 through 27.

32 *Harold J. Warren, Inc.*, 386 F.2d at 581-82.

33 *See* Annot., *Fraud or Misrepresentation By Insured's Agent After Loss As Within Provision Avoiding Policy For Fraud or Attempted Fraud Of Insured*, 24 A.L.R.2d 1220.

34 The cases uniformly make this pronouncement. *Id.* It should be noted, however, that the cases are not consistent on what is considered to be within the scope of the agent's authority—whether that authority is actual or apparent. The rule that misrepresentations outside the scope of the agent's authority do not affect the insured's recovery may be the same in all courts, but the holdings are not. What exactly is and what is not considered within the scope of an agent's authority is beyond the manageable scope of this paper. On the subject of public adjusters, however, the public adjuster cases discussed *supra* indicate that there will not be many misrepresentations by a public adjuster capable of voiding a policy which could be beyond the scope of the adjuster's authority especially where the claim adjustment is substantially left to the adjuster. *See Bockser, supra*. Although a public adjuster may be authorized by the law of a particular jurisdiction to perform any act in connection with the adjustment of the insured's claim, whether or not the adjuster was acting within the scope of his authority turns on the boundaries of the agreement between the insured and his public adjuster. Thorough counsel will consult the law of the appropriate jurisdiction on the legal effect of the actual as well as the apparent authority of the agent. Some cases appear to concentrate on the authority that the principal actually bestowed upon the agent, while others focus on what the defrauded party reasonably believed were the boundaries of the agent's authority. *Compare* American Eagle Fire Ins. Co. v. Vaughan, 35 F.2d 147 (4th Cir. 1929) (pastor's authority limited to that expressly granted by the congregation) and Ohio Farmers Indem. Co. v. Charleston Laundry Co., 183 F.2d 682 (4th Cir. 1950) (scrutinizing only actual authority in determining of false statement in scope of authority) *with* DeBoer Constr. Inc. v. Reliance Ins. Co., 540 F.2d 486 (10th Cir. 1976) (secret limitations on agent's authority do not affect binding effect of agent's apparent authority).

35 See *Bockser*, 327 Mass. 473, 99 N.E.2d 640 (1951), quoted *supra*, note 27; Annot., 24 A.L.R.2d 1220) (fraud or misrepresentation by insured's agent after loss as within provision avoiding policy for fraud or attempted fraud of insured).

36 *E.g., Am. Soc'y of Mechanical Eng'rs, Inc. v. Hydrolevel Corp.*, 456 U.S. 556, 565-66 (1982); RESTATEMENT (SECOND) OF AGENCY § 257 (1957); 3 G. COUCH, COUCH ON INSURANCE 2d § 25:25.

37 See the cases discussed in Davis Scofield Co. v. Agri. Ins. Co., 109 Conn. 686, 145 A.38, 41-42 (1929).

38 Maryland Cas Co. v. Tulsa Indus. Loan & Inv. Co., 83 F.2d 14 (10th Cir. 1936) (Okla. law). This single case prompted one writer to state that: 'as an exception to the rule that the insured is bound by the fraud of his agent, the fraudulent statements of an agent do not bind the insured when the agent is known to be acting adversely to the insured. Misrepresentations by an officer of the insured do not bind him where such officer was defrauding the insured and was not the insured's sole representative.' COUCH ON INSURANCE 2d § 25:25. *But see* Gordon v. Continental Cas. Co., 181 A.574 (Pa. 1935) ('but the exception has no application where the corporation seeks to enforce the benefit of a fraud perpetrated by

its officer on a third person; that the exception to the rule of imputed knowledge is not a vehicle for the consummation of fraud.')

39 RESTATEMENT (SECOND) OF AGENCY § 282, comment (c): '*Meaning of acting adversely*.'

40 'A person who otherwise would be liable to another for the misrepresentations of one apparently acting for him is not relieved from liability by the fact that the servant or other agent acts entirely for his own purposes, unless the other has notice of this.' RESTATEMENT (SECOND) of agency § 262 (1957); *see also, id.* § 257, comment (d): '*Agent's motive.* The rule stated in this Section [subjecting the principal to liability for an agent's representations] applies although the agent enters into the transaction and makes the misrepresentation from a motive other than that of serving the principal, or acts with a purpose of defrauding him.'

41 *Supra*, notes 19-27. In *Davis Scofield*, the court acknowledged the viability of cases citing the exception to the rule which applied when the agent was acting in his own interests and adversely to his principal. The court held, however, that the exception did not apply in this case, since the insured had ratified the insurance contract by making claim upon it. 'One who claims through a contract procured by the fraud of its agent is in precisely the same legal situation as if it had itself procured the contract through a like fraud.' *Id* at 42.

42 Am. Soc'y of Mechanical Eng'rs, Inc. v. Hydrolevel Corp., 456 U.S. 556, 566 (1982). The court went on to state that business expediency was behind the principal's liability under an apparent authority theory—the desire that third persons should be given reasonable protection in dealing with agents. Id. at 567. 'It is . . . for the ultimate interest of persons employing agents as well as for the benefit of the public, that persons dealing with agents should be able to rely upon apparently true statements by agents who are purporting to act and are apparently acting in the interests of the principal.' *Id.* (quoting RESTATEMENT (SECOND) OF AGENCY, § 262, comment a).

43 *Supra*, note 38.

44 In *Maryland Cas. Co., supra*, note 38, bonds for misappropriation and other employee misconduct were procured through an officer of the insured corporation who, himself, was guilty of embezzlement. The insured corporation recovered under the policy, despite the clear misrepresentations in the application made by the officer. While acknowledging the general rule that the knowledge of an agent in the scope of his authority is imputed to the principal, the court stated that there is an exception to this rule where the agent is acting in his own cause and to defraud the principal—as the court said was the situation in this case. Other courts, it was said, reached the same result by considering the defrauding agent's acts outside the scope of his authority. In rather unconvincing fashion, the court dismisses the argument for ratification by claiming that the insured in this case cancelled its previous bond (whichd would have protected it for the claimed losses) upon the procurement of the subject bonds. Finally, the court states that, even if the agent acts in his own interest and to defraud the principal, the guilty knowledge of the agent is imputed to the principal if the agent is the sole representative of the insured in the transaction. The court counters this argument weakly by suggesting that the insured's board of directors were the true applicants and the defrauding officer was merely acting in a subordinate and ministerial capacity.

45 *See* Metzger v. Manchester Fire Assur. Co., 102 Mich. 334, 63 N.W. 650 (1894); Boston Marine Ins. Co. v. Scales, 101 Tenn. 628, 49 S.W. 743 (1899).

46 *See, e.g.*, Johnson v. South State Ins. Co., 288 S.C. 239, 341 S.E.2d 793 (1986).

47 A word of caution on 'scope of the employment': arson and misrepresentation cases share similarities, but an absolutely critical distinction exists between these two types of cases. An act of arson is almost never considered within the scope of an agent's authority, yet misrepresentations—especially those of a special function agent like a public adjuster—are fairly easily considered within the scope of an agent's authority.

[A]n agent who commits arson is not acting within his authority. A grant of authority to do a lawful act which may encompass its performance in an unlawful manner and a grant of authority to do an unlawful act are not the same; the former is not a legal equivalent of the latter.

Nuffer v. Ins. Co. of N. Am., 45 Cal. Rptr. 918, 923 (Cal. App. 1965) (discussing an agent's arson versus an agent's claims misrepresentation). *See* Zemelman v. Boston Ins. Co., 4 Cal. App. 3d 15, 84 Cal. Rptr. 206 (1970); Henderson v. W. Marine & Fire Ins. Co., 10 ROB. 164 (1845). *See also* Fireman's Mut. Ins. Co. v. Aponaug Mfg. Co., 149 F.2d 359 (5th Cir. 1945) (dictum).

Mick I, Bockser and *Harold J. Warren, Inc.* discussed in detail *supra* this section, all indicate that a public adjuster's misrepresentations will customarily be regarded as within the scope of his employment.

48 Mere loss payees fall under the category of mere appointees. By the terms of the policy, loss payees recover only if the insured recovers. Loss payees, therefore, although 'insured,' in a sense, are not considered candidates for recovery under any co-insured doctrine.

Mere loss payees, of course, are to be distinguished from mortgagees protected by a standard mortgage clause (although the latter are sometimes designated 'loss payees'). *See* Dwyer and Barney, *Analysis of Standard Mortage Clause and Selected Provisions of the New York Standard Fire Policy*, 19 FORUM 639 (1984).

49 *See* Dwyer and Barney, *supra* preceding note.

50 *See infra*, note 64 for cases permitting unnamed insureds to recover despite the misconduct of named insureds. An argument could be made to the contrary where the unnamed insureds are not considered parties to the insurance contract. There is some authority to the effect that the rights of third party beneficiaries are derivative of the rights of the contracting parties. *See* Bird v. Penn Central Co., 341 F. Supp. 291 (E.D. Pa. 1972); Maxfield v. Schwartz, 45 Minn. 150, 10 L.R.A. 606, 47 N.W. 448 (1890); Jentess v. Simpson, 84 Vt. 127, 78 A. 886 (1911). *See also* Simmons v. Western Assur. Co., 205 F.2d 815, 818 (5th Cir. 1953). *But see* Everglades Marina, Inc. v. American E. Dev. Corp., 374 So. 2d 517 (Fla. 1979).

No justification occurs to this writer for treating named and unnamed insureds differently unless the insurer could not protect itself by insisting that the unnamed insured comply with the policy conditions such as filing a proof of loss and submitting to an examination under oath. The fact that an insured is unnamed does not necessarily mean that that insured is excused from complying with the policy's conditions. *See* Barnes v. State Farm Fire & Cas. Co., 623 F. Supp. 536 (E.D. Mich. 1985).

51 *See* Tenore v. Am. and Foreign Ins. Co. of N.Y., 256 F.2d 791 (7th Cir. 1958) (valuation misrepresentations by one partner bars recovery by the other partners since the latter entrusted to the former the duty of making such a valuation and both signed the proof of loss to which the valuation was attached); Johnson v. Truck Ins. Exch., 285 Ark. 470, 688 S.W.2d 728 (1985) (the court did not err in refusing to direct a verdict in favor of the alleged innocent co-insured, since the jury could have found, regardless of her innocence with respect to arson, that the policy would not have been issued in the first instance if the guilty insured, acting for himself and for the allegedly innocent co-insured, had not made misrepresentations; nor did the court err in instructing the jury that the 'innocent' insured was bound by the conduct, acts and representations of the guilty insured, since the 'innocent' insured left all the affairs affecting insurance entirely in the hands of the guilty insured).

For a general discussion of the misrepresentations of an agent barring recovery by the insured, *see* the discussion in the preceding section of this paper, particularly notes 33 through 35 and accompanying text.

52 *See* COUCH ON INSURANCE 2d § 25:9 (Rev. Ed).

53 Shapiro v. Am. Home Assur. Co., 584 F. Supp. 1245 (Mass. Dist. Ct. 1984) (Mass. law; Directors & Officers liability policy; no ratification of application misrepresentations here because critical elements of agency, such as control, not

present). *But cf.* Bird v. Penn Central Co., 334 F. Supp. 255 (E.D. Pa. 1971) *on rehearing* 341 F. Supp. 291 (E.D. Pa. 1972).

54 *See* 3 G. COUCH, COUCH ON INSURANCE 2d § 25:9 (Rev. Ed.).

55 *See* RESTATEMENT (SECOND) OF AGENCY § 97(c).

56 *See generally*, C. Farnham, *Application Misrepresentation and Concealment in Property Insurance—The Elusive Elements of the Defense*, 20 FORUM 299 (1985).

57 *See, e.g.*, Gov't Employees Ins. Co. v. Chavis, 254 S.C. 507, 176 S.E.2d 131 (1970).

58 284 S.C. 66, 325 S.E.2d 62 (1985).

59 *Id.*

60 'Counsel for the respondent argues that the question certified to us is moot because the jury found in the previous trial the husband procured the policy through fraud. Respondent claims that because of that fraud, the policy was void *ab initio*. That issue, however, was not submitted to this Court; therefore, we do not express an opinion on this issue.' *Id.*, S.E.2d at 64.

61 McCracken v. Gov't Employees Ins. Co., No. 85-1146 (4th Cir., August 6, 1985). The per ?? opinion is quoted in full below:

Government Employees Insurance Company (GEICO) appeals from the entry of judgment in favor of Carol McCracken for half the value of a homeowners policy. GEICO's position on appeal is that, because Carol McCracken's husband was found by a jury to have made fraudulent misrepresentations when he procured the policy in his and his wife's names, the policy was void *ab initio*. We are bound to apply the law of South Carolina, whose courts have held that such fraudulent conduct vitiates an insurance policy. *See* Strickland v. Prudential Insurance Company of America, 292 S.E.2d 301, 304 (S.C. 1982); GEICO v. Chavis, 176 S.E.2d 131, 133-34 (S.C. 1970).

Accordingly, because the dispositive issue recently has been decided authoritatively, we dispense with oral argument, vacate the judgment of the district court and remand for entry of judgment for GEICO.

62 Property insurance cases permitting an innocent co-insured to recover include: Haynes v. Hanover Ins. Cos., 783 F.2d 136 (8th Cir. 1986) (Mo. law; claims misrepresentation by the named insured did not bar recovery by the innocent spouse who was an insured by policy definition); Mercantile Trust Co. v. N.Y. Underwriters Ins. Co., 376 F.2d 502 (7th Cir. 1967) (Ill. law; claims misrepresentation by property trustee did not bar recovery to the innocent beneficial life interest holder or to the innocent remainderman); Giacobetti v. Ins. Placement Facility of Pa., 500 Pa. 447, 457 A.2d 853 (1983) (the concealment and fraud clause, among others, did not apply, so the arson and claims misrepresentations of the named trustee did not bar recovery by the innocent beneficiaries of the insured trust). *See also* Fifty States Mgmt. Corp. v. Pub. Serv. Mut. Ins. Co., 67 Misc. 2d 778 (S. Ct. 1971) (the insurer stipulated that one insured was not bound by the alleged acts of increased hazard, concealment or fraud by the co-insured). *Cf.* Watson v. State Farm Fire & Cas. Co., 122 Ill. App. 3d 559, Ill. Dec. 670, 461 N.E.2d 57 (1984) (the insurer admitted liability to the wife despite arson and claims misrepresentation defenses against the husband; judgment in wife's favor affirmed, but judgment for husband reversed and case remanded for trial on arson and claims misrepresentation).

Property insurance cases holding that the misrepresentations of one insured bar recovery by an innocent co-insured include: Monoghan v. Agri. Fire Ins. Co., 53 Mich. 238, 18 N.W. 787 (1884) (claims misrepresentations by one of the joint insureds barred recovery by any of the co-insureds on the policy) sharply limited in Morgan v. Cincinnati Ins. Co., 411 Mich. 267, 307 N.W.2d 53 (1981); Ijames v. Republic Ins. Co., 33 Mich. App. 541, 190 N.W.2d 366

(1971) (reluctantly following *Monoghan, supra*, the court held that the claims misrepresentations of the insured wife barred recovery by the insured husband); Zemelman v. Boston Ins. Co., 4 Cal. App. 3d 15, 84 Cal. Rptr. 206 (1970) (claims misrepresentations by one partner within the scope of his authority as a partner barred recovery by the innocent copartner).

The case of Vernon v. Aetna Insurance Company, 189 F. Supp. 233 (S.D. Tex. 1960) (Texas law) deserves special mention. In that case, the court essentially stated that the fraud of one joint insured is attributable to other joint insureds. This statement is technically dictum, however, since the court ruled in the preceding portion of the opinion that the court was without jurisdiction over the claim of the arguably 'innocent' insured. The authority of this ruling is further diluted by the fact that the case was overruled—although on other grounds—when the 5th Circuit held that misrepresentations by no insured had been demonstrated as a matter of law. Vernon v. Aetna Insurance Company, 301 F.2d 86 (5th Cir. 1962), *cert. denied*, 371 U.S. 819 (1962). *Vernon* concerned a personal property floater policy with a misrepresentation clause essentially identical to corresponding clauses in real property policies of the time.

Liability insurance policies permitting recovery by an innocent co-insured despite the misrepresentations of an insured include: Phoenix Assurance Co. of N.Y. v. Gen. Motors Accept. Corp., 369 S.W.2d 528 (Tex. Civ. App. 1963) (claims misrepresentations by the named insured did not bar recovery by the loss payee, who apparently was not protected by a standard mortgage clause, since the misrepresentations took place after the loss and at which time the loss payee's rights became fixed); Fireman's Fund Ins. Co. v. Knutsen, 132 Vt. 383, 324 A.2d 223 (1974) (application misrepresentations by the insured husband did not bar recovery by the innocent wife who also joined in the application but whose answers were correct, where the policy provided that the insurance applied separately to each insured).

Liability insurance cases denying recovery to an innocent co-insured include: Shapiro v. Am. Home Assurance Co., 584 F. Supp. 1245 (D. Mass. 1984) (in a directors and officers liability policy, the innocent directors were barred by the application misrepresentations of the president of the corporation, where the misrepresentations affected the risk in insuring all the directors and officers) *but see* Shapiro v. Am. Home Assurance Co., 616 F. Supp. 900 (D. Mass. 1984) (where the same court held that, under another insurance policy, the innocent directors were not barred by the misrepresentations of the guilty officers because of a particular clause in the policy providing that the insurance would apply separately to each insured).

Strong dicta on misrepresentations barring an innocent co-insured's recovery under a liability policy appear in Bird v. Penn Central Co., 341 F. Supp. 291 (E.D. Pa. 1972):

It is clear that if valid, when a policy such as the D & O one under consideration insures severally the distinct interests of many people, the act of one insured after issuance in breach of any condition of the policy could result in a forfeiture of only his own rights under the policy. The rights of other insureds to recover under the policy are unaffected, regardless of whether the breach involved fraud or not.

Bird, supra at 293-94. The *Bird* court went on to hold that the guilty insured was the agent of the remaining directors and officers for the purpose of applying for the insurance, so all insureds were barred by the agent's misrepresentations.

63 Each of these cases is identified and categorized in the immediately following discussion in the text. The reader should be advised, however, that this compilation excludes lower court decisions in the same cases which comprise this compilation. *See, e.g.*, Morgan v. Cincinnati Ins. Co., 91 Mich. App. 48, 282 N.W.2d 829 (1979); Howell v. Ohio Cas. Ins. Co., 124 N.J. Super. 414, 307 A.2d 142 (Law Div. 973); Lovell v. Rowan Mut. Fire Ins. Co., 46 N.C. App. 150, 264 S.E.2d 743 (1980). The *Morgan* and *Lovell* decisions cited immediately above bar the innocent co-insured from recovery and both of these holdings were reversed on appeal to their respective state supreme courts. In *Howell*, cited immediately above, the court permitted the innocent co-insured to recover and this portion of the holding was affirmed on appeal. Corporate arson cases are also excluded.

64 Fellman v. Fireman's Fund Ins. Co., 735 F.2d 55 (2d Cir. 1984) (arson by named former wife, named former husband recovers); Fidelity-Phenix Fire Ins. Co. v. Queens City Bus and Transfer Co., 3 F.2d 784 (4th Cir. 1925) (arson by one named lienholder, named corporation recovers); Kellner v. Aetna Cas. & Surety Co., 605 F. Supp. 326 (M.D. Pa. 1984) (arson by named equitable titleholder, additional insured legal title owners of the insured property recover); Commercial Union Ins. Co. v. State Farm Fire & Cas. Co., 546 F. Supp. 543 (D. Colo. 1982) (arson by named husband, named wife recovers); Opat v. State Farm Fire & Cas. Ins. Co., 542 F. Supp. 1321 (W.D. Pa. 1982) *aff'd without opinion* 755 F.2d

922 (3d Cir. 1984) (arson by named wife, named separated husband recovers); Safeco Ins. Co. of Am. v. Kartsone, 510 F. Supp. 856 (C.D. Cal. 1981) (arson by deceased husband, wife recovers); Hosey v. Seibels Bruce Group, S.C. Ins. Co. (arson and misrepresentations by wife, husband recovers); Steigler v. Ins. Co. of N. Am., 384 A.2d 398 (Del. 1978) (arson by named husband, named wife recovers); Everglades Marina, Inc. v. Am. E. Dev. Corp., 374 So. 2d 517 (Fla. 1979) (arson by business owner, third party beneficiaries recover); Auto-Owners Ins. Co. v. Eddinger, 366 So. 2d 123 (Fla. Dist. Ct. App. 1979) (arson by named husband, named wife recovers); Richards v. Hanover Ins. Co., 250 Ga. 613, 299 S.E.2d 561 (1983) (arson by named husband, named wife recovers); Fuston v. Nat'l Mut. Ins. Co., 440 N.E.2d 751 (Ind. Ct. App. 1982) (arson by named husband, named wife recovers); Am. Economy Ins. Co. v. Liggett, 426 N.E.2d 136 (Ind. Ct. App. 1981) (arson by husband who died in fire, wife recovers); Economy Fire & Cas. Co. v. Warren, 71 Ill.App. 3d 625, 28 Ill. Dec. 194, 390 N.E.2d 361 (1979) (arson by wife, husband recovers); Westchester Fire Ins. Co. v. Foster, 90 Ill. 121 (1878) (arson by named mortgagor, named mortgagee to whom the policy was first payable recovers); Hildebrand v. Holyoke Mut. Fire Ins. Co., 386 A.2d 329 (Me. 1978); St. Paul Fire & Marine Ins. Co., 433 A.2d 1135 (Md. 1981); Rent-A-Car Co. v. Globe & Rutgers Fire Ins. Co., 148 A. 252 (Md. 1930) (arson by named proprietor, named chattle mortgagee recovers); Morgan v. Cincinnati Ins. Co., 411 Mich. 267, 307 N.W.2d 53 (1981) (arson by named husband, named wife recovers): Hoyt v. N.H. Fire Ins. Co., 29 A.2d 121 (N.H. 1942) (arson by one named tenant in common, remaining tenants in common recover); Howell v. Ohio Cas. Ins. Co., 130 N.J. Super. 350, 327 A.2d 240 (App. Div. 1974) (arson by named husband who died in fire, named wife recovers); Delph v. Potomac Ins. Co., 95 N.M. 257, 620 P.2d 1282 (1980) (arson by named husband, named wife recovers); Krupp v. Aetna Life & Cas. Co., 103 App. Div. 2d 252, 279 N.Y.S.2d 992 (1984) (arson by named husband, named wife recovers if not involved in arson); Welch v. Com'l Mut. Ins. Co., 119 Misc. 2d 630, 463 N.Y.S.2d 1011 (1983) (arson by named husband who conveyed entire interest to wife before fire, named wife recovers); Winter v. Aetna Cas. & Surety Co., 96 Misc. 2d 297, 409 N.Y.S.2d 85 (N.Y. Sup. Ct. 1978) (husband poured gasoline through house, but apparently did not ignite it, wife recovers); Richardson v. Providence Wash. Ins. Co., 38 Misc. 2d 593, 237 N.Y.S.2d 893 (N.Y. Sup. Ct. 1963) (arson by named purchaser under contract, seller/legal owner recovers); Lovell v. Rowan Mut. Fire Ins. Co., 302 N.C. 150, 274 S.E.2d 170 (1981) (named husband burns, unnamed wife is constructively declared an insured and recovers); Giacobetti v. Ins. Placement Facility of Pa., 500 Pa. 447, 457 A.2d 853 (1983) (arson by named trustee barring this trustee and his 'children or issue' from recovery, but remaining beneficiaries recover); Maravich v. Aetna Life & Cas. Co., 350 Pa. Super. 392, 504 A.2d 896 (1986) (arson by named husband, named wife recovers); McCracken v. Gov't Employees Ins. Co., 284 S.C. 66, 325 S.E.2d 62 (1985) (arson by husband, wife recovers); Ryan v. MFA Mut. Ins. Co., 610 S.W.2d 428 (Tenn. Ct. App. 1980) (arson by wife, husband sues for and recovers for the value of his contents); Kulubis v. Tex. Farm Bureau Underwriters Ins. Co., 706 S.W.2d 953 (Tex. 1986) (arson by named husband destroying non-community property, named wife recovers); Hedtcke v. Sentry Ins. Co., 109 Wis. 2d 461, 326 N.W.2d 727 (1982) (arson by named husband, named wife recovers).

Of these cases, Welch v. Com'l. Mut. Ins. Co., *supra*, deserves special mention. In *Welch*, the insurers sought to have the husband's arson bar recovery by the innocent wife through the increase of hazard clause. This clause provided that the insurer 'shall not be liable for loss occurring . . . while the hazard is increased by any means within the control or knowledge of the Insured.' The policy was initially issued to both the husband and the wife, who held the property as tenants by the entirety. Prior to the fire, however, the husband conveyed his entire interest in the property to his wife, with the wife assuming the outstanding mortgage. As of the time of the fire, the husband remained listed on the policy as a named insured. The court held, however, that the husband did not have an insurable interest in the property. He therefore, in law, was not a 'named insured' for purposes of enforcing the benefits of the policy. (If he is not a party entitled to benefit from the policy, logic dictates that he should not be deemed a party subject to the 'increase of hazard' condition either.) *Welch, supra*, Misc. 2d at 630, N.Y.S.2d at 1011. The court permitted the wife to recover despite the arson of her husband. The court's ruling that the husband was not a named insured despite being listed as a named insured, one must be careful when referring to *Welch* as an innocent co-insured case. (A similar result was reached in a case excluded from the list above: Cox v. Vanguard Ins. Co., 1979 Fire & Casualty Cas. (CCH) 1370 (Tenn. Ct. App. 1979). In *Cox*, the innocent wife was permitted to recover despite the arson of her husband, because the policy as effectively cancelled only as to the husband prior to the fire. This case is not included in the above list due to the fact that the arsonist was not an insured. The innocent party, therefore, may not be considered a co-insured. For similar reasons, corporate arson cases have been excluded.)

65 Spezialetti v. Pacific Employers Ins. Co., 759 F.2d 1139 (3d Cir. 1985) (Pa. law, arson by named husband, named wife barred since the policy stated it does not apply to loss resulting from any dishonest act by 'any' insured); Bryant v. Allstate Ins. Co., 592 F. Supp. 39 (E.D. Ky. 1984) (Ky. law; arson by named husband bars recovery by co-insured wife due to clear language to that effect in the policy); Kellner v. Royal Indem. Co., 605 F. Supp. 322 (M.D. Pa. 1982) (Pa.

law; arson by named equitable titleholder barred recovery by additional insureds/legal owners) essentially rev'd 605 F. Supp. 326 (M.D. Pa. 1984); Mele v. All Star Ins. Corp., 453 F. Supp. 1338 (E.D. Pa. 1978) (Pa. law; arson by insured husband barred recovery by co-insured wife); Home Ins. Co. v. Pugh, 51 Ala. App. 373, 286 So. 2d 49 (1973) (arson by insured husband bars recovery by innocent co-insured wife where spouse is sued jointly if the husband is sane at the time of the fire); Fuselier v. United States Fidelity & Guar. Co., 301 So. 2d 681 (La. Ct. App. 1974) (arson by husband barred recovery by both husband and wife, although it is not clear from the opinion if both were co-insureds); Kosior v. Continental Ins. Co., 299 Mass. 601, 13 N.E.2d 423 (1938) (arson by named husband bars recovery by named wife); Continental Ins. Co. v. Gustav's Stable Club, Inc., 211 Neb. 1, 317 N.W.2d 734 (1982) (the court pierced the corporate veil and ruled that the arson by the guilty partner/husband barred recovery by the innocent partner/wife); Short v. Okla. Farmers Union Ins. Co., 619 P.2d 588, 11 A.L.R. 4th 1217 (Okla. 1980) (arson by named husband bars recovery by named wife); Matyuf v. Phoenix Ins. Co., 27 Pa. D. & C. 2d 351 (1933—although not reported until 1962) (arson by named husband bars recovery by name wife), Snowden v. State Farm Fire & Casualty Co., 1983 Fire & Casualty Cas. (CCH) 206 (Tenn. Ct. App. 1983) (arson by husband barred recovery by wife because property was jointly owned and because the policy provided that it would be void if 'any' insured intentionally concealed or misrepresented any material fact); Jones v. Fidelity & Guar. Ins. Corp., 250 S.W.2d 281 (Tex. Civ. App. 1952) (arson by named husband bars recovery by named wife for their community property); Coop. Fire Ins. Ass'n of Vt. v. Domina, 137 Vt. 3, 399 A.2d 502 (1979) (arson by named husband bars recovery by named wife); Rockingham Mut. Ins. Co. v. Hummel, 219 Va. 803, 250 S.E.2d 774 (1979) (arson by named husband bars recovery by named wife); Bellman v. Home Ins. Co., 178 Wis. 349, 189 N.W. 1028, 27 A.L.R. 945 (1922) (arson by one partner barred recovery by the remaining partner) overruled Hedtcke v. Sentry Ins. Co., 109 Wis. 2d 481, 326 N.W.2d 727 (1982); Clemens v. Badger Mut. Ins. Co. of Milwaukee, 8 Wis. 2d 565, 99 N.W.2d 865 (1959) (arson by named husband bars recovery by named wife) overruled Hedtcke v. Sentry Ins. Co., 109 Wis. 2d 481, 326 N.W.2d 727 (1982).

66 Courts of the Phoenix v. Charter Oak Ins. Co., 560 F. Supp. 858 (N.D. Ill. 1983). The arson of a general partner did not bar recovery of the innocent limited partners in the insured building. The limited partners were barred from recovery as to personal property, however, due to a special exclusion relating to personal property for loss due to any fraudulent, dishonest or criminal act or omission done by or at the instigation of *any* insured, partner, etc.

67 Western Fire Ins. Co. v. Sanchez, 671 S.W.2d 666 (Tex. App. 12 Dist. 1984); Bridges v. Commercial Standard Ins. Co., 252 S.W.2d 511 (Tex. Civ. App. 1952).

68 Knauber v. Cont. Ins. Cos., 435 A.2d 217 (1981).

69 Schultz v. Republic Ins. Co., 124 Ill. App. 3d 342, 79 Ill. Dec. 863, 464 N.E.2d 767 (1984).

70 Federal Ins. Co. v. Wong, 137 F. Supp. 232 (S.D. Cal. 1956) (Cal. law; truck arson by one joint insured barred recovery by the remaining joint insured, mainly because arson is not an 'accidental loss' within the terms of the policy); Bowers Co. v. London Assurance Corp., 90 Pa. Super. 121 (1926) (joint insureds were required to sue jointly, so the auto arson of one barred recovery by the other).

The impact of the *Bowers Co.* decision in innocent co-insured cases has been especially great. *Bowers Co.* was the controlling case on the fate of an innocent co-insured in Pennsylvania for some six decades—until the Pennsylvania Supreme Court renders its decision in Giacobetti v. Ins. Placement Facility of Pa., *supra*, note 64. *See* Kellner v. Aetna Cas. & Surety Co., 605 F. Supp. 326, 328 (M.D. Pa. 1984). What is rather remarkable in that *Bowers Co.* and *Matyuf* (the other early Pennsylvania decision barring recovering by an innocent co-insured, *supra*, note 65) received much discussion in the federal decisions construing Pennsylvania law on innocent co-insureds (*see Kellner, supra* note 64; *Kellner, supra* note 65; *Mele, supra* note 65) yet the Pennsylvania Supreme Court in *Giacobetti*, which is apparently inconsistent with *Bowers Co.* and *Matyuf*, did not mention either decision in its opinion.

71 The trend in these decisions is only discussed generally in this paper. Other sources offer more developed decisions of arson innocent co-insured cases. Ryan v. MFA Mut. Ins. Co., 610 S.W.2d 428 (Tenn. App. 1980) offers one of the better discussions found in the cases. *See* Butler and Freemon, *The Innocent Co-insured: He Burns It, She Claims It—Windfall or Technical Injustice?*, 18 FORUM 187 (1981) for a jurisdiction by jurisdiction review of these cases and a

fine discussion of them. Other general resources include: Note, *The Problem of the Innocent Co-insured Spouse: Three Theories on Recovery*, 17 VAL. U.L. REV. 849 (1983); Note, *Spouse's Fraud as a Bar to Insurance Recovery*, 21 WM. & MARY L. REV. 543 (1979); 24 A.L.R.3d 450; 11 A.L.R.4th 1228.

72 *See* Annot., *Fraud, False Swearing, or other Misconduct of Insured as Barring Recovery on Property Insurance by Innocent Coinsured*, 24 A.L.R.3d 450; Annot., *Right of Innocent Insured to Recover Under Fire Policy Covering Property Intentionally Burned by Another Insured*, 11 A.L.R.4th 1228.

73 *E.g. Matyuf, supra*, note 65.

74 *Id.; Bowers, supra* note 70; Kellner v. Aetna Cas. & Sur. Co., *supra* note 65.

75 *See* Home Ins. Co. v. Pugh, 51 Ala. App. 373, 286 So. 2d 49 (1973).

76 This concern remains in modern cases, especially with regard to property owned as tenants by the entireties. A rather extreme example is Coop. Fire Ins. Ass'n of Vermont v. Domina, 137 Vt. 3, 399 A.2d 502 (1979).

77 *See* St. Paul Fire & Marine Ins. Co. v. Molloy, 433 A.2d 1135 (Md. 1981) (which refers to the traditional rule and the perceived link between joint ownership and joint obligations.)

78 *See, e.g., Kosior, supra* note 65.

79 *Id.*

80 *See Ryan, supra* note 71.

81 29 A.2d 121 (N.H. 1942).

82 *See Ryan, supra* note 71.

83 *Id.* at 123.

84 *See supra* notes 64, 65; *see generally* the references listed *supra* note 71.

85 130 N.J. Super. 350, 327 A.2d 240 (1974).

86 *Id.* at 241.

87 *Id.*, A.2d 240, 242.

88 *See supra* notes 64, 65; *Ryan, supra* note 71.

89 *See* P. Butler and R. Freemon, *The Innocent Coinsured: He Burns It, She Claims—Windfall or Technical Injustice?*, 18 FORUM 187 (No. 2, Fall 1981).

90 Typically, the clauses include the (increase of) hazard clause, the neglect (to preserve the property) clause and/or the fraud clause. *See e.g.* Short v. Okla. Farmers Union Ins. Co., 619 P.2d 588 (Okla. 1980).

91 *Short, supra* preceding note.

92 *Id.*

93 'To allow recovery on an insurance contract where the arsonist has been proven to be a joint insured would allow funds be acquired by the entity of which the arsonist is a member and is flatly against public policy.' *Id.* at 590.

94 *E.g.*, Cox v. Vanguard Ins. Co., 1979 Fire & Casualty Cas. (CCH) 1370 (Tenn. App. 1979) (an innocent wife would have been barred by the arson of her husband, but for the fact that he cancelled the insurance as to himself prior to the loss). If the policy contained a special provision to the contrary, however, and it was not contrary to public policy, it would be followed. *See Minnesota Bond Ltd., infra* note 112.

95 Western Fire Ins. Co. v. Sanchez, 671 S.W.2d 666 (Tex. App. 12 Dist. 1984) (arson by husband with homestead interests in insured property bars recovery by innocent wife who is only named insured on the policy); Bridges v. Com. Standard Ins. Co., 252 S.W.2d 511 (Tex. Civ. App. 1952) (innocent insured husband with a homestead interest in the insured property was barred from recovery because of the arson of his wife who was apparently not named on the policy). Neither of these cases identifies the arsonist as a named insured or as an insured by policy definition.

96 *Sanchez, supra* preceding note.

97 *Supra*, notes.

98 *See* the discussion in Morgan v. Cincinatti Ins. Co., 411 Mich. 267, 307 N.W.2d 53 (1981) of *Monoghan, supra* note 62 and *Ijames, supra* note 62.

99 *See* Opat v. State Farm Fire & Cas. Ins. Co., 542 F. Supp. 1321 (W.D. Pa. 1982) *aff'd without opinions* 755 F.2d 922 (3d Cir. 1984); Steigler v. Ins. Co. of N. Am., 384 A.2d 398 (Del. 1978); Richards v. Hanover Ins. Co., 250 Ga. 613, 299 S.E.2d 561 (1983); Hildebrand v. Holyoke Mut. Fire Ins. Co., 386 A.2d 329 (Me. 1978); St. Paul Fire & Marine Ins. Co. v. Molloy, 433 A.2d 1135 (Md. 1981); Rent-A-Car Co. v. Globe & Rutgers Fire Ins. Co., 148 A.252 (Md. 1930); Morgan v. Cincinnati Ins. Co., 411 Mich. 267, 307 N.W.2d 53 (1981); Maravich v. Aetna Life & Cas. Co., 350 Pa., Super. 392, 504 A.2d 896 (1986).

100 *Id.*

101 *See* the cases cited in the preceding note, except for *Rent-A-Car* (which stated that the only fraud the clause protected against was that of all insureds).

102 *See* Note, *Spouse's Fraud as a Bar to Insurance Recovery*, 21 WM. & MARY L. REV. 543 (1979).

103 *Id.*

104 *See Richards, supra; Steigler, supra; Molloy, supra. Morgan, supra*, is the only case permitting recovery by the co-insured which did not deliberately construe the misconduct clause against the insurer. The court recognized that their legislature rather than the particular insurer was responsible for this language. The court then claimed to determine what the legislature intended. In fact, the court imposed its preferences on the construction of the language, which had long been upheld in Michigan as unambiguous. *See Monoghan, supra* note 62; *Ijames, supra* note 62. The court held that 'the insured' referred to only the guilty insured, because the contrary construction would impose a mutual obligation of suretyship on the insureds which '[w]e no longer consider . . . appropriate in insurance law.' *Id.*, N.W.2d at 55. Regardless of the preferences of the Supreme Court of Michigan, it was up to the legislature to determine whether or not this result should any longer be considered appropriate.

105 The standard policies in the various jurisdictions and their related legislation are set forth in the 'standard fire policies' section of the current volume of CCH's Fire & Casualty Cas. (Ins. L. Rep.).

106 *See, e.g.*, Mick v. Royal Exch. Assur., 87 N.J.L. 607, 91 A.102 (N.J. App. 1914); Kisting v. Westchester Fire Ins. Co., 290 F.2d 141 (W.D. Wis. 1968). *See generally*, 13 APPLEMAN INSURANCE LAW AND PRACTICE § 7407; 2 COUCH, COUCH ON INSURANCE 2d § 15:80; Annot., *Validity, Construction, and Effect of Approval or Disapproval by Insurance Commissioner (or Similar Official) of Form of Policy*, 119 A.L.R. 877. Cases do exist where the standard policy language was still construed against the insurer, *see, e.g.*, Blue Bird Cab Co. v. Amer. Fid. & Cas. Co., 219 N.C. 788, 15 S.E.2d 295 (1941), although these decisions appear to be in the minority. [For more cases, the reader should refer to Insurance key no. 146.9 (for newer cases) and Insurance key no. 1464(4) (for older cases) in the West key system.]

107 A version of the fraud clause does exist which unambiguously applies only to a guilty insured. This clause provides: 'we do not provide coverage for any insured *who* has intentionally concealed or misrepresented any material fact or circumstance relating to this insurance' (emphasis added). *See, e.g.*, Fuston v. Nat'l Mut. Ins. Co., 440 N.E.2d 751 (Ind. Ct. App. 1982). The problem is with the cases reaching the same conclusion with the following or similar language: 'this entire policy shall be void . . . in case of any fraud . . . by the insured,' Steigler v. Ins. Co. of N. Am., 384 A.2d 398 (Del. 1978).

108 *See, e.g.*, Steigler v. Ins. Co. of N. Am., 384 A.2d 398 (De. 1978).

109 If one wished to torture the standard policy language, one could argue that it is not clear whether the 'entire policy' refers to the interests of all insureds or the interest of the guilty insured. It is always possible that a court would so hold, but the unqualified phrase 'entire policy' is unambiguous—it generally being understood that, in such cases, there is but one policy although this one policy may cover more than one insured.

110 This was the construction given the fraud clause in *Rent-A-Car, supra* note 64.

111 One must concede that insurers themselves have contributed to the ambiguity of the phrase 'the insured' by defining the term 'insured' to mean other than the named insureds. Consequently, one writer has concluded that the standard policy's fraud clause in those cases should still be construed against the insurer. Note, *Spouse's Fraud As A Bar to Insurance Recovery*, 21 WM. & MARY L. REV. 543, 554 (1979).

112 Spezialetti v. Pac. Employers Ins. Co., 759 F.2d 1139 (3d Cir. 1985) (Pa. law); Bryant v. Allstate Ins. Co., 592 F. Supp. 39 (E.D.Ky. 1984) (Ky. law); Knauber v. Continental Ins. Co., 435 A.2d 217 (Pa. Super. 1981); Snowden v. State Farm Fire & Cas. Co., 1983 Fire & Casualty Cas. (CCH) 206 (Tenn. App. 1983). *See* Courts of the Phoenix v. Charter Oak Ins. Co., 560 F. Supp. 858 (N.D. Ill. 1983) (where the personal property portion of the innocent co-insured's loss was barred because of the specific exclusion relating to personal property where the loss resulted from the dishonest act of 'any' insured). *Cf.* Minnesota Bond Ltd. v. St. Paul Mercury Ins. Co., 300 Or. 85, 706 P.2d 942, 1985 Fire & Casualty Cas.

(CCH) 904 (1985) (where the arson by a mere employee of the insured corporation barred any recovery due to the policy provision that no coverage available if loss occurs as a result of the dishonest acts of any employee of the insured).

113 *Ryan, supra* note 71. *See Courts of the Phoenix, supra* preceding note.

114 *See, e.g.*, Fuston v. Nat'l Mut. Ins. Co., 440 N.E.2d 751 (Ind. Ct. App. 1982). The policy in *Fuston* contained the following fraud clause:

CONCEALMENT OR FRAUD. We do not provide coverage for any INSURED who has intentionally concealed or misrepresented any material fact or circumstance relating to this insurance.

Id., at 752. The 'who' in this clause eliminates coverage only as to a guilty insured. This is the same clause used in the 7-77 edition of the ISO homeowners forms next discussed.

115 The fraud clause appearing in the 7-82 edition of the ISO homeowners forms provides:

Concealment or Fraud. We do not provide coverage for an *insured* who has:

a. intentionally concealed or misrepresented any material fact or circumstance; or

b. made false statements or engaged in fraudulent conduct; relating to this insurance.

116 The 7-82 'intentional loss' exclusion provides:

We do not insure for loss caused directly or indirectly by . . .

Intentional Loss, meaning any loss arising out of any act committed:

a. by or at the direction of the *insured*; and

b. with the intent to cause a loss.

This exclusion does not apply to an *insured* not participating in the intentional loss.

117 The 4-84 revision of the intentional loss exclusion is identical to the 7-82 version, but for the striking of the 7-82 language which provided: 'This exclusion does not apply to an *insured* not participating in the intentional loss.' The February 16, 1984 ISO Circular introducing the Homeowners Program 1984 Edition included the following comment on the revision to the 'intentional loss' exclusion: 'To minimize collusion, exclusion is revised to bar all insureds from coverage if any insured causes an intentional loss (PPC-83-12: item 4).'

118 An insured's available extra-contractual remedies vary greatly from jurisdiction to jurisdiction. *See generally*, S. ASHLEY, BAD FAITH ACTIONS: LIABILITY AND DAMAGES (1984) (hereafter ASHLEY); W. SHERNOFF, S. GAGE AND H. LEVINE, INSURANCE BAD FAITH LITIGATION (1984) (hereafter SHERNOFF, GAGE AND LEVINE). This paper does not attempt to categorize all the types of remedies available to an insured. All such remedies —whether statutory, bad faith tort, independent tort, etc.—are considered 'bad faith' remedies for the purpose of this paper.

119 *See infra*, note 122 and accompanying text.

120 *See infra*, note 123 and accompanying text.

121 The rules stated in this paragraph apply to compensatory damages. *See* SHERNOFF, GAGE AND LEVINE, *supra*, note 118 at § 7.05. Separate rules apply for the vicarious liability of an employer for punitive damages. *See infra*, notes 157-159 and accompanying text.

122 RESTATEMENT (SECOND) OF AGENCY § 219(1). *See* PROSSER AND KEETON ON THE LAW OF TORTS (W. Page Keeton 5th Ed. 1984) (hereafter PROSSER) § 69, 70; SHERNOFF, GAGE AND LEVINE, *supra* note 118 at § 7.05.

123 RESTATEMENT (SECOND) OF AGENCY § 219(2)(c) and (d).

124 PROSSER, *supra* note 122 § 71. Only the caveats arguably applicable to claims adjusters are included in the general principles identified in this paragraph of the text. For a more complete rendering of the general principles, the reader should consult the referenced authorities.

125 'As the term is here used, independent contractor is the antithesis of servant. It is a technical phrase, used to include all who have agreed with another to act on his account and who are not servants.' RESTATEMENT (SECOND) OF AGENCY, Title B *Torts of Servants*, Introductory Note.

126 *See* RESTATEMENT (SECOND) OF AGENCY § 220; PROSSER, *supra* note 122 at § 70. The full text of RESTATEMENT (SECOND) OF AGENCY § 220 is quoted below:

(1) A servant is a person employed to perform services in the affairs of another and who with respect to the physical conduct in the performance of the services is subject to the other's control or right to control.

(2) In determining whether one acting for another is a servant or an independent contractor, the following matters of fact among others, are considered:

(a) the extent of control which, by the agreement, the master may exercise over the details of the work;

(b) whether or not the one employed is engaged in a distinct occupation or business;

(c) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision;

(d) the skill required in the particular occupation;

(e) whether the employer or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work;

(f) the length of time for which the person is employed;

(g) the method of payment, whether by the time or by the job;

(h) whether or not the work is a part of the regular business of the employer;

(i) whether or not the parties believe they are creating the relation of master and servant; and

(j) whether the principal is or is not in business.

In general, the words 'employee' and 'servant' are synonymous in this context. *Id.* at § 220, comment g.

127 88 S.D. 426, 221 N.W.2d 16 (1974).

128 *Id.*, N.W.2d at 17.

129 *Id.* at 22.

130 *Id.* at 21.

131 *Id.*

132 331 S.E.2d 148, 1985 Fire & Casualty Cas. 886 (N.C. App.) *petition denied* 314 N.C. 664, 336 S.E.2d 300 (1985).

133 This opinion actually refers to more than one adjuster (with the other adjusters being staff adjusters for the insurer). The adjuster accused of the misconduct, however, was employed at that time with INS—an independent firm, of course.

134 *See* RESTATEMENT (SECOND) OF AGENCY, Title B, *Torts of Servants*, Introductory Note, Servants and Independent Contractors. ('The term ['independent contractors'] includes all agents who are not servants, as well as many other persons who render services but are not agents; the presence or absence of a fiduciary relation is immaterial in the idea of 'independent contractor,' although many independent contractors are agents).

135 See section C of this discussion, *infra*, notes 161 through 164 and accompanying text.

136 447 So. 2d 133 (Ala. 1983); 417 So. 2d 179 (Ala. 1982).

137 On application for rehearing in *Bowen I*, the court refers to the insurer's assistant vice president actually being present when the independent investigator allegedly tried to bribe a witness. Still, the insurer was said to not have participated in the investigation and was not guilty of bad faith.

138 447 So. 2d 133 (Ala. 1983).

139 417 So. 2d 179 (Ala. 1982).

140 *Bowen*, 447 So. 2d 133, 138.

141 640 S.W.2d 346 (Tex. App., 9th Dist. 1982) *error refused NRE* (1983).

142 *Id.* at 352.

143 The reader should be aware that in the second half of the *Montgomery* opinion, the court places heavy emphasis on the limited authority of a soliciting agent by statute. This language might be used to weaken the applicability of *Montgomery* to the imputation of bad faith from independent adjuster to insurer.

144 42 Cal. App. 3d 681, 111 Cal. Rptr. 146 (1974).

145 Note 155, *infra*.

146 *Id.* (dissent).

147 390 So. 2d 724 (Fla. App. 1980) *pet. for rev. den.* 392 So. 2d 1373.

148 34 Cal. App. 3d 858, 110 Cal. Rptr. 511 (1973).

149 *Trevethan, supra* note 145 at 728.

150 *Id.*

151 *Supra* note 148.

152 RESTATEMENT (SECOND) OF AGENCY § 214, comment (a). Section 214 is quoted below:

A master or other principal who is under a duty to provide protection for or to have care used to protect others or their property and who confides the performance of such duty to a servant or other person is subject to liability to such others for harm caused to them by the failure of such agent to perform the duty.

The RESTATEMENT ties its definition of 'nondelegable duty' only to the duties of protection. The adjustment of an insurance claim cannot easily be considered an ultrahazardous activity or some other activity giving rise to a duty of protection.

153 PROSSER *supra*, note 122 at § 71, 511-512.

154 *Id.* at 512.

155 *See* Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, Cal. Rptr. 480, 510 P.2d 1032 (1973). *Gruenberg*, of course, is the landmark case recognizing an actionable breach of the duty of good faith and fair dealing in a first party context. The defendants in that case included an independent adjusting firm and its employees, as well as the law firm and the attorney hired to investigate the claim. Gruenberg's complaint did not state a cause of action against these defendants since they were not parties to the insurance contract. They therefore were not subject to the implied duty of good faith and fair dealing. In addition, the plaintiff could not claim that the defendants were part of a conspiracy where the plaintiff alleged in his complaint that the defendants were agents and employees of the insurers and were performing within the scope of their authority at the time of the misconduct upon which the suit was based.

156 *See* SHERNOFF, GAGE AND LEVINE, *supra* note 118 at § 7.05.

157 *See, e.g., Gruenberg, supra* note 157 (which expressly does not decide whether the insured might successfully pursue an independent adjuster under tort theories other than bad faith). *See also, e.g.*, Davis v. Continental Ins. Co., 224 Cal. Rptr. 66 (Cal. App. 1986); Bodenhamer v. Superior Court, 223 Cal. Rptr. 486 (Cal. App. 1986) which subject an independent adjuster to California's Unfair Trade Practices Act. *See generally*, Anno., *Liability of Independent or Public Insurance Adjuster to Insured*, 50 A.L.R. 4th 900 (1986).

158 *Supra* note 136.

159 Just as the scope of a public adjuster's authority is typically considered broad, *supra* note 47, one would expect the authority of an insurer's adjuster to be considered broad.

160 *Supra* note 127.

161 *See* SHERNOFF, GAGE AND LEVINE, *supra* note 118 at § 8.07.

162 *Id.*

163 *Supra*, note 132.

164 RESTATEMENT (SECOND) OF AGENCY § 217C; RESTATEMENT (SECOND) OF TORTS § 909. *See* ASHLEY, *supra* note 118 at § 9.27; SHERNOFF, GAGE AND LEVINE, *supra* note 118 at § 8.07.

22 TILJ 662