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Comment

SOME ASPECTS OF A FIDELITY INSURER'S RIGHTS BY SUBROGATION

Smith Company, needing a new payroll clerk, hires M. Bezzler for the job but requires that he provide a "bond" for protection against his possible dishonesty. Bezzler obtains such a bond from Fidelity Company, paying the required premium. After a weekend in Las Vegas leaves Bezzler short of cash, he adds an imaginary name to the payroll and obtains the check made out to that name, which he indorses and cashes at Brown's Bar and Grill. Brown indorses the check and deposits it in the Last National Bank.

The Last National stamps the check "prior indorsements guaranteed" and sends it to the First National, the drawee, where it is charged to the account of Smith Company.

Smith Company, on discovering its loss, fires Bezzler and files a claim with Fidelity. Fidelity promptly reimburses Smith and brings suit against Bezzler. Fidelity will undoubtedly be allowed to recover, for Bezzler and Fidelity have entered into a contract whereby Fidelity agreed to act as "surety" for Bezzler, who then became the "principal." Bezzler thus agreed to be primarily liable, either by the express terms of the contract or by implication. Fidelity having been called upon to pay for Bezzler's dishonesty, it is not unreasonable to allow Fidelity to be substituted in the place of Smith Company and to pursue Smith Company's rights against Bezzler.¹ Fidelity is then said to be "subrogated."

Suppose, however, as is more likely, that Smith Company purchased the "bond" from Fidelity directly and that Fidelity agreed to reimburse or indemnify Smith for losses which it might suffer through the dishonesty of its employees. Bezzler's name is added to the list of covered employees, perhaps without his knowledge or consent. Fidelity would now seem to be in the position of an insurer who agrees with the insured (Smith Co.) to indemnify it against losses brought about by a particular contingency—the dishonest act of an employee.² Bezzler has not asked, as in the first example, that Fidelity guarantee the performance of his duty to Smith. Still it is not unjust to allow Fidelity, after paying Smith Co. the amount of Bezzler's default, to recover over from him. Thus, as in the former example, Fidelity is allowed to act as the "surety," and Bezzler is treated as the "principal," though inasmuch as he has not agreed to play the latter role, it has become a case of "non-consensual suretyship."³

Suppose, however, as is still more likely, Bezzler is unavailable or has no assets. Bezzler is not the only one besides Fidelity who can be made to answer for this loss. Smith Company has a right to recover from its drawee, the First National, on the payment of a forged indorsement.⁴ May Fidelity be substituted in the place of Smith Company to pursue the latter's rights against the drawee bank? The justice of such a result is not so apparent. Though it might seem fair that the intentional tortfeasor rather than the insurer should ultimately be made to bear the loss which he has caused, not everyone would agree that the insurer should be allowed to shift this loss, for which it had received a premium, to a bank which could not possibly

¹ There are, however, other possible remedies, such as an action directly against Bezzler for reimbursement, or in quasi-contract. See RESTATEMENT, SECURITY §§ 103, 104 (1941).

Indeed, since Smith Co. has no security or other preferred position, there would seem to be little reason for Fidelity to wish to proceed in the right of Smith Co. rather than by some direct theory.

² Since this type of indemnity insurance initially involves three persons, it has been considered as "suretyship" for purposes of the Statute of Frauds. See RESTATEMENT, SECURITY, EXPLANATORY NOTES § 82 (Tent. Draft No. 3, 1939).

³ See generally Campbell, *Non-Consensual Suretyship*, 45 YALE L.J. 69 (1935).

⁴ See BRITTON, BILLS AND NOTES § 128 (1943).

have prevented it. The problem is further complicated by the fact that the bank is often insured against liability incurred through paying checks with forged indorsements. This changes the complexion somewhat, for though one may sympathize with the "innocent" bank, there is less reason to choose between the two compensated insurers.

In the prior example the insurer was cast as a "surety" and the employee as the "nonconsensual principal" and subrogation was allowed. Perhaps here, then, the drawee bank can be called the nonconsensual principal and the insurer subrogated against the bank as its nonconsensual surety. But the surety analogy is purely arbitrary—"an addendum after the fact, and not the basis for the fact itself."⁵ It is only after deciding whether subrogation shall be allowed, and to whom, that the proper labels of "surety" and "principal" can be affixed. It must, therefore, first be determined which shall be primarily liable. Where there is an express contract of suretyship, the problem is easily resolved, for the principal agrees to be ultimately liable.⁶ If there is no such mutual understanding, as here, a relationship must be established "in accordance with the requirements of equity and good conscience, and special economic and social interests involved . . ."⁷ Thus, "the difficult question is to determine whether such third person (the bank) *should*, as against an insurer who is also contractually bound, be ultimately liable."⁸

As between the insurer and the bank, then, which party "in equity and good conscience ought to pay"?⁹ On whom does the "superior obligation" rest?¹⁰

At least four solutions are possible for this type of problem:

- (1) Let the insurer be subrogated to the insured's claims against the bank.
- (2) Let the loss remain with the insurer.
- (3) Allow the insured to recover against *both* insurer and bank.
- (4) Allow the insurer and the bank to divide the loss.

In *Standard Acc. Ins. Co. v. Pellecchia*,¹¹ involving a default by the employee of the drawee bank, the Supreme Court of New Jersey allowed the insurer to be subrogated to the right of the employer bank against the collecting bank on its express guarantee of prior indorsements. Subrogation would be allowed, said the court, "as long as the conduct of the insurer and the insured has not been such as to make the granting of relief unconscionable."¹²

⁵ Note, 17 COL. L. REV. 53, 54 (1917).

⁶ Otherwise, in cases of fidelity bonds, the result could be a sort of liability insurance against the "bonded" party's intentional wrongdoing which would probably be contrary to public policy.

⁷ Campbell, *Non-Consensual Suretyship*, 45 YALE L.J. 69 (1935).

⁸ RESTATEMENT, SECURITY, EXPLANATORY NOTES § 83 (Tent. Draft No. 3, 1939).

⁹ *Arnold v. Green*, 116 N.Y. 566, 23 N.E. 1, 2 (1889). See also RESTATEMENT, SECURITY § 141, comment a (1939).

¹⁰ SHELDON, SUBROGATION 10 (1882).

¹¹ 15 N.J. 162, 104 A.2d 288 (1954).

¹² *Id.* at 182, 104 A.2d at 298.

In the "conduct of the insured and the insurer," the court seems to combine two disparate problems. If subrogation is allowed the insurer, he may pursue the insured's right of action against the third party. But it must of course be established that the insured *has* such a claim. Whether the conduct of the insured is such as to make relief unconscionable would seem then to go to the question of whether the insured has an enforceable claim against the third party, and not to whether the insurer may be subrogated to it, if it exists. On the other hand, the "unconscionable conduct of the insurer" is relevant to the question of subrogation. The court says the insurer may be subrogated *unless* the third party defendant can show such "unconscionable conduct." It is apparently presumed that in every case it is the third party and not the insurer who "in equity and good conscience" should bear the loss.

The New Jersey court takes this position because it is deemed in harmony with "the majority rule in the various types of insurance cases."¹³ The question whether subrogation should be allowed the insurer has arisen in many different circumstances where a third party (other than the insurer) was liable to the insured as an intentional tortfeasor, a negligent tortfeasor, or through strict liability, or in contract. It is well settled that the insurer may be subrogated to the right of the insured against the intentional tortfeasor who brought about the loss insured against, such as the embezzler in the fidelity bond cases.¹⁴ It is also generally agreed that the insurer may be subrogated to the insured's rights against the tortfeasor whose negligence caused the loss.¹⁵ It can be said that, as between the insurer and the tortfeasor, the latter is the one who "in equity and good conscience" should bear the ultimate burden.¹⁶

The insurer will probably also be subrogated to the rights of the insured against third parties liable to the insured through strict or nearly strict tort liability.¹⁷ If the main purpose of such liability is to compensate the person injured, however, there would seem to be less reason to shift the loss to the third party when the injured person has already been compensated by the insurer.¹⁸ Some states which have made the railroads strictly liable by statute for fires along the right of way have attempted to ameliorate this burden by giving the railroad the benefit of any insurance which the ad-

¹³ 15 N.J. 162, 187, 104 A.2d 288, 302 (1954).

¹⁴ See VANCE, *INSURANCE* § 134 (1951).

¹⁵ *Ibid.*

¹⁶ But some say otherwise. In Sweden a statute provides that even subrogation against tortfeasors should be limited to cases of gross negligence. Insurance Contract Law of April 8, 1927 § 25; see 1952 Sveriges Rikes Lag 586. See also Ussing, *The Scandinavian Law of Torts*, 1 AM. J. COMP. L. 359 (1952). It has also been suggested that tort liability might be separated into compensatory and deterrent factors, the former satisfied by insurance without subrogation and the latter by "tort fines" against the tortfeasor. See Ehrenzweig, "Full Aid" Insurance for the Traffic Victim—A Voluntary Compensation Plan, text at notes 82-86 *supra*, this issue.

¹⁷ See Campbell, *Non-Consensual Suretyship*, 45 YALE L.J. 69, 77 (1935).

¹⁸ See Ehrenzweig, 2 AM. J. COMP. L. 562, 564 (1953), reviewing a Swedish treatise on subrogation.

jacent owner might have.¹⁹ Under most of these statutes the railroad is required to bear the cost of this insurance by reimbursing the adjacent owner for the amount of the premiums paid.²⁰ This would appear to be a most equitable arrangement. It has also been suggested that the third party who is strictly liable should be treated as another "insurer" and required only to contribute to the loss.²¹

Where the third party is obligated to the insured by some type of contract liability, the insurer's right to be subrogated may not be so "well settled generally" as the New Jersey court believes it to be.²² In England, however, it can probably be taken as settled. The English courts have defined the insurer's right very broadly, and it seems unlikely that they would be willing to recognize that the insurer could be other than secondarily liable.²³

In the United States, however, it is not so well established that the insurer may be subrogated to contractual rights of the insured. It has been suggested, contrary to the New Jersey court, that the right of the insurer in such cases is extremely limited.²⁴ On the other hand, it cannot be denied that there is language in some cases which is nearly as far reaching as that of the English cases.²⁵ Furthermore, the right may be settled by statute in one state.²⁶

There is at least one type of "contractual" claim of the insured to which the insurer will apparently always be subrogated. That is the right of the mortgagee who insures in his own behalf. The insurer, after paying the mortgagee, may be subrogated to his claim against the mortgagor.²⁷ It has

¹⁹ N. H. REV. LAWS c.300, §§ 1, 2, 3 (1942); ME. REV. STAT. c.42, § 63 (1944); MASS. ANN. LAWS c.160, § 234 (1948); COLO. STAT. ANN. c.139, § 78 (1935) (liability imposed "shall not pass by assignment or subrogation to any insurance company . . .").

²⁰ *Ibid.*, except for Colorado. This is done by allowing the railroad to reduce its liability to the adjacent owner by the amount of the insurance proceeds less the premium and "expense of recovery" (of the insurance proceeds, apparently).

²¹ Langmaid, *Some Recent Subrogation Problems in the Law of Suretyship and Insurance*, 47 HARV. L. REV. 976, 991-2 (1934). The argument that the railroad was an "insurer" of the shipper and should be treated as such was raised unsuccessfully in *Hall & Long v. R.R.*, 80 Wall. 367 (U.S. 1871).

²² *Standard Acc. Ins. v. Pellicchia*, 15 N.J. 162, 178, 104 A.2d 288, 296 (1954).

²³ Thus in the leading case of *Castellain v. Preston*, 11 Q. B. Div. 330 (1883), the English court allowed the vendor's insurer, after paying the vendor for damage suffered by the premises, to be subrogated to the vendor's claim for the unpaid price of the property. This is a rather harsh result for the vendee if he has neglected to insure from the time of signing the contract of sale. It has been avoided in this country by various means, one of which is to deny the right to subrogate, and has been changed by statute in England. See VANCE, *INSURANCE* §§ 131, 134 (1951).

²⁴ PATTERSON, *ESSENTIALS OF INSURANCE LAW* 121 (1935); RICHARDS, *INSURANCE* § 188 (5th ed. 1952).

²⁵ See, e.g., *Amer. Tobacco Co. v. U.S.*, 166 U.S. 468 (1897); *F. H. Vahlsing, Inc. v. Hartford Fire Ins. Co.*, 108 S.W.2d 947 (Tex. Civ. App. 1937).

²⁶ In 1945 the Michigan Standard Fire Insurance Policy was amended to provide that the subrogation clause "shall be deemed to include contractual as well as tort rights of action . . .". MICH. COMP. LAWS § 532.7a (1948).

²⁷ See VANCE, *INSURANCE* § 130 (1954).

been said by one writer that this right is dependent upon an express subrogation clause in the policy,²⁸ and by another that it is not.²⁹

In other types of contract claims there are cases which allow the insurer to be subrogated,³⁰ and others which do not.³¹ Perhaps, if these were all added together, the "majority rule" might now be that the insured may be subrogated to the contractual claims of the insured. But such a "majority rule" would have little significance, for aside from the mortgagee cases the decisions are few and scattered. Furthermore, the propriety of allowing the insurer to be subrogated to contract claims at all has been disputed by writers in the field.³²

Whatever may be the result in other insurance situations, in those cases where the insurer has endeavored to recover the loss from the drawee bank or other party whose liability to the insured stems from the fact that the defaulting employee used a negotiable instrument, the New Jersey court does not seem to be in accord with the majority in allowing the insurer to be automatically subrogated. Indeed, as recently as 1941, one note writer could say that the "overwhelming weight of authority" supported the view that the insurer is not subrogated in every case to the rights of the insured

²⁸ PATTERSON, *ESSENTIALS OF INSURANCE LAW* 124 (1935).

²⁹ Campbell, *Non-Consensual Suretyship*, 45 *YALE L.J.* 69, 100 (1935). It is rather harsh to require the uninsured mortgagor to pay off the mortgage on his now destroyed property when an insurer had been paid a premium to carry the risk, and it has been suggested that the fairest result would be to give the mortgagor the benefit of the insurance. See King, *Subrogation Under Contracts Insuring Property*, 30 *TEX. L. REV.* 62, 76 (1951). If it is considered improper to give him the benefit of insurance for which he has paid no premium, then let him reimburse the mortgagee for the premium expense, as is done in the statutes giving the railroad the benefit of the adjacent owner's insurance. See note 20 *supra*.

³⁰ Against lessee or lessor who promised to repair: *Chicago, St. L. & N.O. R.R. v. Pullman Southern Car Co.*, 139 U.S. 79 (1891); *Continental Ins. Co. v. I. Bahcall, Inc.*, 39 F. Supp. 315 (E.D. Wis. 1941) (this case may rather be based on the tort liability of a contractor); *F. H. Vahlsing, Inc. v. Hartford Fire Ins. Co.*, 108 S.W.2d 947 (Tex. Civ. App. 1937). Against bailee: *Nat. Fire Ins. Co. v. Mogan*, 186 Ore. 285, 206 P.2d 963 (1949). Against carrier: *Luckenbach v. McCahan Sugar Co.*, 248 U.S. 139 (1918); *Hall & Long v. R.R.*, 80 Wall. 367 (U.S. 1871); see also *Hart v. Western R.R.*, 54 Mass. 99 (1847).

³¹ Against lessor promising to repair: *Plate Glass U.M. Ins. Co. v. Ridgewood P. Co.*, 219 Mo.App. 186, 269 S.W. 659 (1925).

Against water company which agreed to furnish water for fires: *William Burford & Co. v. Glasgow Water Co.*, 223 Ky. 54, 2 S.W.2d 1027 (1928) (if subrogation is allowed, "the citizens and property owners will not only pay for fire protection premiums sufficient to cover the risk assumed, but will also pay higher water rates for the purpose of relieving the insurance companies of the liability which they have been paid to assume."). See also *Georgetown Water Co. v. Neale*, 137 Ky. 197, 125 S.W. 293 (1910); and *Warren Co. v. Hanson*, 17 Ariz. 252, 150 Pac. 238 (1915) (where the water company was given the benefit of insurance proceeds received by the insured). *But cf. Powell & Powell v. Wake Water Co.*, 171 N.C. 290, 88 S.E. 426 (1916) where subrogation was allowed on a tort theory.

³² See King, *Subrogation Under Property Insurance*, 30 *TEX. L. REV.* 62 (1951); Comment, 28 *COL. L. REV.* 202 (1928); RICHARDS, *INSURANCE* § 183 (5th ed. 1952); "[I]t is submitted that this equitable right of subrogation is neither 'equitable' nor a 'right', but constitutes a valuable privilege bestowed upon insurance companies by courts long indifferent to the doctrine of true indemnity in their zeal to respect the literal language of such unilateral contracts of insurance. Courts have mouthed the utterances of astute insurance counsel that subrogation is necessary to preclude double recovery by the insured"

against the bank.³³ These courts hold that the insurer is subrogated only if its "equities" are "superior" to the "equities" of the bank³⁴ and so indicate the belief that in some cases, at least, it is the insurer who in equity and good conscience ought to bear the loss.³⁵

In *Meyers v. Bank of America*,³⁶ a leading case in support of this view, the California Supreme Court decided that the insurer might not be subrogated to the right of the insured against the collecting bank since the insurer had no "superior equities." The insurer is thus held primarily liable and must bear the ultimate incidence of the loss. Unless this primary liability is due simply to the fact that the insured chose to look first to the insurer, it should follow that the bank, had it been called upon to pay first, should be subrogated to the insured's claim against the insurer. Some courts, however, do not purport to fix the relation between the insurer and the bank so that the ultimate incidence of loss will be the same regardless of how the case arises. They hold only that a "superior equity" is required to shift the loss from the party upon whom it fell, and if the "equities" are equal, then the loss will be allowed to remain on whichever party the insured called upon first.³⁷ This would not seem to be a satisfactory solution, since it allows the "final disposition of loss . . . to depend on accidental, capricious, collusive, or corrupt action . . ." by the insured.³⁸

Thus it has been recognized that a denial of subrogation to the insurer should imply that, had the bank been asked to pay the insured first, it would be subrogated to the insured's rights against the insurer.³⁹ The question then is, or should be, not shall the insurer be subrogated but who shall be subrogated against whom—subrogation which way?

³³ Note, 137 A.L.R. 700, 701 (1941).

³⁴ See, e.g., *Amer. Surety Co. v. Bank of Calif.*, 133 F.2d 160 (9th Cir. 1943); *Nat. Surety Corp. v. Edwards House Co.*, 191 Miss. 884, 4 So.2d 340 (1941); and see generally Note, 137 A.L.R. 700 (1941). "When it is sought to exercise the right of subrogation, something more must be shown than that the defendant could have been compelled by the principal creditor to pay the debt to it. It must appear that, as between plaintiff and defendant, it is the latter and not the former which in equity should bear the loss." *U.S. Fid. & G. Co. v. Title G. & S. Co.*, 200 Fed. 443 (D. Md. 1912).

³⁵ According to the New Jersey court in the *Pellecchia* case, the doctrine that the insurer may recover only if he has shown a "superior equity" is an inaccurate application of equitable language to the question of the insured's contributory negligence. 15 N.J. 162, 178, 104 A.2d 288, 296 (1954). Being subrogated to the insured's claim against a tortfeasor for example, the insurer can not recover if the insured's negligence contributed to the accident. But this is clearly not the meaning of the "superior equity" requirement. Whether the insured has an enforceable claim against the third party and whether the insurer may be subrogated to that claim are two quite separate questions. The requirement of a "superior equity" for subrogation by the insurer relates only to the second of these and assumes that there is an existing enforceable claim of the insured to which the insurer might be subrogated. The "superior equity" discussion is, or should be, an attempt to decide which of the two parties whose liability to the insured is established—the insurer and bank—shall be deemed ultimately liable.

³⁶ 11 Cal.2d 92, 77 P.2d 1084 (1938) [noted in 27 CALIF. L. REV. 88 (1938); 12 SO. CALIF. L. REV. 490 (1939)].

³⁷ *Wash. Mech. Sav. Bank v. Dist. Title Ins. Co.*, 65 F.2d 827 (D.C. Cir. 1933). See also *Amer. Bonding Co. v. State Savings Bank*, 47 Mont. 332, 133 Pac. 367 (1913).

³⁸ *Campbell, Non-Consensual Suretyship*, 45 YALE L.J. 69, at 69 (1935).

³⁹ See *Amer. Surety of N.Y. v. Lewis State Bank*, 58 F.2d 559 (5th Cir. 1932); and Notes, 27 CALIF. L. REV. 88 (1938), 35 VA. L. REV. 647 (1949), 30 MICH. L. REV. 800 (1932).

Though it has seldom been recognized that "no subrogation" for the insurer might, or perhaps should, imply that subrogation would be allowed the bank in a proper case, the New Jersey court recognizes that the bank will thereby get the "benefit" of the insurance.⁴⁰ The court objects to such a result since the bank has paid no premium⁴¹ and there is no contractual or other relationship between it and the insurer.⁴² But if "no subrogation" for the insurer is conceded to mean that the bank may be subrogated, the latter difficulty at least would seem to disappear, for subrogation does not require privity of contract between the subrogee (the bank in that case) and the party against whom subrogation is sought (the insurer).⁴³ If the insurer is to be subrogated against the bank, then clearly the insured gets the "benefit" of the insured's "contract" with the bank. Would the insurer admit that its lack of any "contractual relationship" with the bank precluded it from the "benefit" of the bank's liability to the insured and hence from being subrogated to that liability? The problem then is which party is primarily liable, for the other party will then be permitted to avail himself of the "benefit" of that liability, either as a defense or to shift the loss if it falls initially upon him.

Some of the cases which purport to rely upon the rule that the insurer may be subrogated only if its equities are superior involved official bonds, required by statute to cover "anyone injured" by the default of the official.⁴⁴ Unquestionably the bank is properly given the "benefit" of the insurance if it is written, in part, expressly for its benefit. The bank, or other holder of the forged instrument being injured by the default, would then be one of those insured under the bond. If the bank had suffered the loss initially, it would have recourse against the insurer on the bond, not this time by subrogation to the claim of the insured, it would seem, but in its own right as a third party beneficiary of the express contract. Therefore, it would be illogical to allow the insurer to be subrogated to the claim against the bank when the latter, in turn, would have the right to be reimbursed by the insurer for the loss which that claim would cause.⁴⁵

It would seem that, in cases where the insurance expressly covers "anyone injured" by the default, language indicating that superior equities are required for subrogation by the insurer can be no more than dictum, for

⁴⁰ *Standard Acc. Ins. Co. v. Pellecchia*, 15 N.J. 162, 188, 104 A.2d 288, 302 (1954).

⁴¹ In the railroad liability statutes referred to in note 20 *supra*, this objection was obviated by the third party (railroad) reimbursing the insured for premiums paid. To be completely exact, however, the third party ought only reimburse for that proportion of the premium attributable to the risk with which he is connected, *i.e.*, fires caused by trains, or in this case embezzlements perpetrated through forged checks.

⁴² *Standard Acc. Ins. Co. v. Pellecchia*, 15 N.J. 162, 188, 104 A.2d 288, 302 (1954).

⁴³ *Hall & Long v. R.R.*, 80 Wall. 367, 370 (U.S. 1871); *Offer v. Superior Court*, 194 Cal. 114, 118, 228 Pac. 11, 13 (1924).

⁴⁴ *National Surety Co. v. Arosin*, 198 Fed. 605 (8th Cir. 1912); *Amer. Bonding Co. v. State Savings Bank*, 47 Mont. 332, 133 Pac. 367 (1913); *Stewart v. Commonwealth*, 104 Ky. 489, 47 S.W. 332 (1898).

⁴⁵ *Amer. Bonding Co. of Baltimore v. Welts*, 193 Fed. 978 (9th Cir. 1912).

the bank is an insured against whom subrogation could not lie.⁴⁶ In other cases the defaulting employee involved was a public official, but it did not appear from the opinions that the bond covered "anyone injured,"⁴⁷ so these decisions would seem to support the rule that the insurer will not always be permitted to subrogate. This still leaves many well considered opinions in which this rule is expressed and relied upon.⁴⁸

In the latest California case involving the insurer and the drawee bank which honored the forged check of the insured's defaulting employee,⁴⁹ a new theory was relied upon to deny subrogation to the insurer. The District Court of Appeal held that the insurer might not be subrogated for the insured had made an "election of remedies."⁵⁰ The insured, therefore, could pursue his remedy against either the insurer or the bank, but an action against one discharged the other. This theory would seem to have no merit and should be discarded. It is based on a Texas decision⁵¹ which has since been reversed.⁵² Furthermore, to permit an "election" by the insured to decide the ultimate incidence of the loss is undesirable. It is preferable to determine the ultimate incidence of loss by fixing the relationship between the insurer and the bank without regard to the actions of the insured.

Assuming that, because of the superior equities of the bank, the insurer will not be subrogated to the claims of the insured against the bank, may the insurer take an express assignment of this claim and recover as an assignee? Several courts have allowed the insurer to recover on the assignment, either without regard to the problem of subrogation⁵³ or by giving

⁴⁶ *But see* *Nat. Surety v. State Savings Bank*, 156 Fed. 21 (8th Cir. 1907) where the insurer (or surety in that case) successfully argued that the bank's loss was caused by its cashing a forged instrument, and that the employee's default was only a "remote cause." Therefore the bank was not covered and subrogation would lie as it had been "negligent." Reversed, seemingly on this point, in *Nat. Surety Co. v. Arosin*, 198 Fed. 605 (8th Cir. 1912) (rehearing of same case).

⁴⁷ *Amer. Surety of N.Y. v. Lewis State Bank*, 58 F.2d 559 (5th Cir. 1932); *Amer. Surety Co. of N.Y. v. Bank of Roswell*, 294 Fed. 609 (8th Cir. 1923); *U.S. Fid. & G. Co. v. Title G. & S. Co.*, 200 Fed. 443 (D.Md. 1912); *Nat. Surety Co. v. Edwards House Co.*, 191 Miss. 884, 4 So.2d 340 (1941).

⁴⁸ *Amer. Surety Co. v. Bank of Calif.*, 133 F.2d 160 (9th Cir. 1943); *N.Y. Title and Mtg. Co. v. First Nat. Bank*, 51 F.2d 485 (8th Cir. 1931); *Meyers v. Bank of America*, 11 Cal.2d 92, 77 P.2d 1084 (1938); *Louisville Trust Co. v. Royal Indemnity Co.*, 239 Ky. 482, 20 S.W.2d 71 (1929).

⁴⁹ *Hensley-Johnson Co. v. Citizens Nat. Bank*, 122 Cal.App.2d 22, 264 P.2d 973 (1953).

⁵⁰ The court took the view that, to recover from the insurer, the insured must allege that the bank had paid the insured's money to the embezzler, thereby causing a loss which the insurer must indemnify; while to recover from the bank, the insured must take the position that the bank, in paying the forged check, used its own money and not that of the insured. These positions the court thought inconsistent. But this ignores the possibility that in suing the bank the insured need not assert that its money is "still there," but may allege that it was wrongfully paid out by the bank in cashing the check. There is then no inconsistency, so no "election" is required. See *U.S. Fid. and Guar. Co. v. 1st Nat. Bank in Dallas*, 172 F.2d 258, 264 (5th Cir. 1949) (dissenting opinion).

⁵¹ *Liberty Mut. Ins. Co. v. 1st Nat. Bank in Dallas*, 239 S.W.2d 738 (Tex. Civ. App. 1951).

⁵² 151 Tex. 12, 246 S.W.2d 237 (1951).

⁵³ *E.g.*, *Home Indemnity Co. v. State Bank of Fort Dodge*, 233 Iowa 103, 8 N.W.2d 757 (1943); *Grubnau v. Centennial Nat. Bank*, 279 Pa. 501, 124 Atl. 142 (1924).

added weight to the insurer's right.⁵⁴ One writer suggests recognition of the assignment as a means of avoiding the problem of subrogation.⁵⁵

*Meyers v. Bank of America*⁵⁶ is a leading case for the opposite view that the assignment adds nothing to the right and if it be decided that the insurer may not be subrogated, then neither may it recover on an assignment. In support of this view it may be pointed out that by denying subrogation to the insurer, the court determines that the insurer has the primary liability. Payment by the one primarily liable discharges the other party⁵⁷ and there is nothing left to assign. Thus, though before any payments are made to the insured his claim against the insurer is undoubtedly assignable, could the embezzler repay the amount of his default, take an assignment of the insured's claim against the insurer and be permitted to recover on the assignment? Obviously he could not. Assignability prior to payment by the other party does not mean that an enforceable claim will survive that payment.

As in the New Jersey case, the bank is frequently insured against its liability for paying forged indorsements. If the "equities" of the bank and the insurer are to be weighed in deciding whether the insurer ought to be subrogated to the insured's claim against the bank, will the "equity" of the bank be lowered by its having insured against this contingency? Courts are often led to protect the bank by the thought that if the insurer is allowed to be subrogated, it will escape a loss which it has been paid a premium to assume.⁵⁸ But if the bank is insured as well, denying the insurer subrogation against the bank permits the bank's insurer to escape a risk which it has received a premium to carry.⁵⁹ The New Jersey court stressed the latter point. It called decisions denying subrogation to the insurer unrealistic in ignoring the fact that the third party is usually also insured.⁶⁰ But the realistic quandary would seem to be: Which insurer shall escape the loss for which it received a premium?

The third solution mentioned above, that of allowing the insured to

⁵⁴ E.g., *Metro. Cas. Ins. Co. v. 1st Nat. Bank*, 261 Mich. 450, 246 N.W. 178 (1933). *Cf. Nat. Surety Co. v. Nat. City Bank*, 184 App.Div. 771, 172 N.Y.S. 413 (1st Dep't 1918).

⁵⁵ Mason, *Assignments for the Purpose of Avoiding Technical Rules of Subrogation*, 25 A.B.A.J. 933 (1939).

⁵⁶ 11 Cal.2d 92, 77 P.2d 1084 (1938).

⁵⁷ This was first pointed out by Lord Mansfield in the early English case of *Mason v. Sainsbury*, 3 Doug. K.B. 61, 99 Eng. Rep. 538 (1782). If the insurer is "first liable," said Lord Mansfield, then payment by the insurer is a "satisfaction" and the other party is not liable.

⁵⁸ See, e.g., *Amer. Surety Co. v. Bank of Calif.*, 133 F.2d 160 (9th Cir. 1943); *N.Y. Title & Mtg. Co. v. 1st Nat. Bank*, 51 F.2d 485 (8th Cir. 1931). But the type of risk which it received a premium to assume depends in part on whether subrogation is possible. The insurer's premium may have covered only the risk including the right to subrogate. The New Jersey court thinks so, 15 N.J. 162, 188, 104 A.2d 288, 302 (1954), but most writers feel that the right to subrogate plays an insignificant part in the computation of premiums. See PATTERSON, *ESSENTIALS OF INSURANCE LAW* 121 (1935). *Contra*: Billings, *Significance of Subrogation in Auto Insurance Practice*, [1948] *INS. L.J.* 707.

⁵⁹ Furthermore it is doubtful that this would aid the bank at all, for it must be insured against other forgeries and could probably not get a lower premium if it excluded coverage for checks forged by bonded employees.

⁶⁰ *Standard Acc. Inc. Co. v. Pellecchia*, 15 N.J. 162, 190, 104 A.2d 288, 303 (1954).

recover from both, has apparently not been used in this type of case. In one case, however, it may have been implied.⁶¹ To permit the insured to recover from both parties is to deny subrogation to either. There can be no problem of whether the loss may be shifted from the insurer to the bank if it is to be allowed to fall upon both. On the other hand, a decision that the insured ought not recover twice only decides that subrogation may be allowed to someone, but in no way establishes to whom. The insured has been allowed to retain the benefit of both liabilities in some cases involving other types of insurance,⁶² however, and at least one writer believes it to be the preferable result.⁶³

The fourth alternative solution, to allow the insurer and the bank to divide the loss, giving a right of contribution rather than of complete subrogation, has been suggested by several writers.⁶⁴ Though it may have much to commend it in other types of insurance cases, it would appear to be extremely impracticable in the forgery situation. Who is to be required to contribute? The insured may have an action against several banks and indorsers.⁶⁵ Shall all these, plus the insurer, be asked to contribute? But if not in every case, perhaps contribution is at least appropriate where the third party against whom subrogation is sought has also insured.⁶⁶ Rather than allow either insurer to escape liability, let them share it. This result seems to have been reached in at least one case.⁶⁷ In the negotiable instrument forgery cases, however, the same problem arises as to how many of those potentially liable should contribute.

Conclusion

Subrogation in insurance has the effect of allowing the incidence of a loss, already shifted from the injured party, to be shifted once more. When the result is to place the loss on the intentional tortfeasor whose liability

⁶¹ N.Y. Title & Mtg. Co. v. 1st Nat. Bank, 51 F.2d 485 (8th Cir. 1931). The employee had forged deeds as well as checks, and the title insurer sought to be subrogated to the rights of the insured against the drawee bank on the checks. The court denied subrogation to the title insurer because it had no superior equity, but the court also stressed the point that the claim against the bank was a "wholly separate and independent contract." The implication may be that the insured could still recover from the bank and retain the proceeds of both contractual liabilities.

⁶² See, e.g., *Alexandra Restaurant Inc. v. New Hampshire Ins. Co. of Manchester*, 71 N.Y. S.2d 515 (1947), *aff'd*, 297 N.Y. 858, 79 N.E.2d 268 (1948).

⁶³ RICHARDS, *INSURANCE* § 188 (5th ed. 1952).

⁶⁴ See Langmaid, *Some Recent Problems in the Law of Suretyship and Insurance*, 47 HARV. L. REV. 976 (1934); King, *Subrogation Under Property Insurance*, 30 TEX. L. REV. 62 (1951); Note, 27 CALIF. L. REV. 88 (1938).

⁶⁵ See, e.g., *Nat. Surety Co. v. Edwards House Co.*, 191 Miss. 884, 4 So.2d 340 (1941).

⁶⁶ See Note, 60 HARV. L. REV. 1348 (1947).

⁶⁷ *Dixey v. Fed. Compress & Warehouse Co.*, 140 F.2d 820 (8th Cir. 1944). Bailor stored its cotton with the bailee who was required, by statute, to insure and to collect the insurance and pay it over to the bailor. Bailor had also insured. Bailor's insurer sought to be subrogated against the bailee. Since the bailee's insurer had also been brought into the case, the court decided that the two insurers should apportion the loss. The New Jersey court says in the *Pellicchia* case, 15 N.J. 162, 190, 104 A.2d 288, 303 (1954), that this was a case of damage to property insured by separate insureds. But if, in the forgery cases, the bank also insures, is this not the same risk insured by separate insureds?

stems from society's desire to admonish and deter him as well as to compensate the injured party, the additional litigation required to shift the loss from the insurer to him is perhaps justifiable. When, however, the liability of the third party stems chiefly from the desire of society to compensate the injured party,⁶⁸ there would seem to be less justification for further adjustment of the loss after the injured party has been compensated by the insurer.

It was undoubtedly such reasoning as this which led the legislatures of several states to limit the insurer's right of subrogation against railroads liable for fires along the right of way.⁶⁹ The purpose of that liability was not so much to punish the railroad as to protect the adjoining landowners and, when they were already protected by insurance, that purpose was fulfilled. Similarly, in Sweden, the insurer's right to be subrogated even against tortfeasors is limited to cases of gross negligence.⁷⁰ The major purpose of tort liability is considered to have been fulfilled by the injured party's own insurance. It may be, therefore, that courts should begin to examine not only the "equities" of the third party against whom subrogation is sought but the basic purpose behind his liability to the insured.

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⁶⁸ Even liability for "negligence" may be chiefly "compensatory" in nature. See EHRENZWEIG, *NEGLIGENCE WITHOUT FAULT* §§ 1, 3-8 (1951).

⁶⁹ See note 19 *supra*.

⁷⁰ See note 16 *supra*.

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