Prepayment and Assignment Under the Texas Stowers Doctrine

In a case decided more than forty years ago, the Texas Supreme Court adopted a principle which has come to be known in this state as the Stowers doctrine.[1] Basically, it is that an insurer must exercise ordinary care to protect his insured from a judgment in excess of the policy limits. Specifically, the insurer who wrongfully refuses to accept an offer to settle a case within the limits of the policy may be liable to the insured for the entire amount of any judgment obtained against him by an injured third party. The fact that many judgments are thousands of dollars in excess of the limits of the policy causes the doctrine to be of particular importance.[2]

In Texas the cause of action for the sums in excess of policy limits is a tort grounded in negligence.[3] One court of civil appeals has held that

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1. G.A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved), *noted in* 8 TEXAS L. REV. 152 (1929).

2. This doctrine, accepted virtually nationwide, has been the subject of extensive commentary. *See, e.g.*, 7A J. APPLEMAN, INSURANCE LAW AND PRACTICE §§ 4711-15 (1962); Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136 (1954); Meyers, *Gray v. Nationwide and Beyond*, 71 DICK. L. REV. 257 (1967); Comment, *Insurer's Duty to Settle—Strict Liability for Excess Judgments: Has the Time Come?*, 9 B.C. IND. & COM. L. REV. 188 (1967); Comment, *An Insurance Co.'s Duty to Settle: Qualified or Absolute?*, 41 S. CAL. L. REV. 120 (1968); Comment, *Insurer's Liability for Judgments Exceeding Policy Limits*, 38 TEXAS L. REV. 233 (1959); 52 CORNELL L.Q. 778 (1967); 60 MICH. L. REV. 517 (1962); 60 YALE L.J. 1037 (1951).

3. The *Stowers* case, as did the case upon which its holding was based, Douglas v. United States Fid. & Guar. Co., 81 N.H. 371, 127 A. 708 (1924), spoke in classical tort concepts. The insurer was said to have breached the duty of due care owed the insured and this was held to be negligent conduct. Subsequent cases involving the Stowers doctrine have deviated not at all from this interpretation. For example, the Texas Supreme Court in Linkenhoger v. American Fid. & Cas. Co., 152 Tex. 534, 260 S.W.2d 884, 886 (1953), expressly referred to the injury to the insured as a tort.

Some other jurisdictions consider this cause of action to arise from a breach of contract or at least a tort arising out of contract. *E.g.*, Critz v. Farmers Ins. Group, 41 Cal. Rptr. 401, 404 (Dist. Ct. App. 1964); Grundy v. Manchester Ins. & Indem. Co., 425 S.W.2d 735, 737 (Ky. 1968); Gray v. Nationwide Mut. Ins. Co., 422 Pa. 500, 223 A.2d 8, 11 (1966); Southern Fire & Cas. Co. v. Norris, 250 S.W.2d 785 (Tenn. Ct. App. 1952).

Traditionally, courts throughout the United States have been concerned with two major tests, negligence and bad faith, as criteria to be used in determining whether the insurer's conduct has been sufficiently wrongful to give rise to the cause of action on behalf of the insured. *E.g.*, Comment, *Insurer's Liability for Judgments Exceeding Policy Limits*, 38 TEXAS L. REV. 233 (1959). The differences between the two tests are highly conceptual and often not understood. In discussing them in his treatise, Appleman says that there is more of a difference in verbiage than there is in the results of the cases. Some courts use the terms interchangeably so that the conclusion must be drawn that mere terminology means little. He concludes, "it rather is the factual situation which is significant in the light of the duty which exists, and normally the trier of fact must make the

there are, in effect, two causes of action, one for the sums contracted to be paid under the policy and one in tort for the excess of the judgment above these sums.[4] Since the Texas courts are firmly committed to the negligence test, it is not surprising to find that the standard against which they measure the insurer's conduct is that of the ordinary prudent man.[5] In cases involving the Stowers doctrine the question of liability will then turn upon whether the insurer breached the duty of ordinary or due care owed to the insured. However, due care leaves room for an error in judgment without liability necessarily resulting.[6] Under the Stowers doctrine the insurer is the agent of the insured and must under the circumstances give the rights of his principal at least as much consideration as he does his own.[7] He is under a duty to use ordinary care in obtaining a settlement, and the duty to settle implies the duty to negotiate, and the two cannot be separated.[8] But at the same time, there can be no breach of the insurer's duty in refusing to accept a conditional offer of settlement[9] because a conditional offer holds too many risks for the insurer.[10] There is no requirement that the insurer actively seek a

determination of liability or non-liability." 7A J. APPLEMAN, *supra* note 2, § 4712, 561-78. For purposes of this discussion it is sufficient to say that the Texas courts have rejected the bad faith test in favor of negligence. Highway Ins. Underwriters v. Lufkin-Beaumont Motor Coaches, Inc., 215 S.W.2d 904, 927 (Tex. Civ. App.—Beaumont 1948, writ ref'd n.r.e.). Although Texas relies on negligence, an argument can certainly be made that the terms are not mutually exclusive and that it would be possible to have in one case the elements of both present.

4. Highway Ins. Underwriters v. Lufkin-Beaumont Motor Coaches, Inc., 215 S.W.2d 904, 906 (Tex. Civ. App.—Beaumont 1948, writ ref'd n.r.e.).

5. "[The insurance company], by the very terms of the contract, assumed the responsibility to act as the exclusive and absolute agent of the assured in all matters pertaining to the questions in litigation, and, as such agent, it ought to be held to that degree of care and diligence which an ordinarily prudent person would exercise in the management of his own business . . . ." G.A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544, 547 (Tex. Comm'n App. 1929, holding approved).

6. Jones v. Highway Ins. Underwriters, 253 S.W.2d 1018, 1023 (Tex. Civ. App.—Galveston 1952, writ ref'd n.r.e.); *accord*, Chancey v. New Amsterdam Cas. Co., 336 S.W.2d 763, 765 (Tex. Civ. App.—Amarillo 1960, writ ref'd n.r.e.).

7. G.A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544, 548 (Tex. Comm'n App. 1929, opinion adopted); *cf.* Fidelity & Cas. Co. v. Robb, 267 F.2d 473, 476 (5th Cir. 1959), in which it was held reversible error not to inform the jury that the insurer is to consider the interests of the insured, not exclusively, but under settled principles of law in conjunction with its own. This instruction had to be given in addition to one informing the jury that the insurer by taking charge of the settlement obligates himself as the insured's agent to take the insured's interest into consideration.

8. Chancey v. New Amsterdam Cas. Co., 336 S.W.2d 763, 765 (Tex. Civ. App.—Amarillo 1960, writ ref'd n.r.e.).

9. Jones v. Highway Ins. Underwriters, 253 S.W.2d 1018, 1022 (Tex. Civ. App.—Galveston 1952, writ ref'd n.r.e.).

10. In Danner v. Iowa Mut. Ins. Co., 340 F.2d 427, 429 (5th Cir. 1964), the insurance company was held to have acted with ordinary prudence in refusing a conditional offer to settle. The

settlement while a case is on appeal, because such a requirement would deprive the insurer of his right to an appeal.[11]

Although the insurer may have refused the offer of settlement long before the case comes to trial, the cause of action does not accrue nor does the statute of limitations begin to run until there is a final judgment against the insured. Until then his rights have not been invaded by the insurer's failure to accept the terms of the proposed settlement.[12]

Recent cases in the federal courts involving Texas law have raised several questions concerning the Stowers doctrine.[13] Two problems of particular interest are whether continuation of the prepayment rule is justified and whether the Stowers cause of action may be freely assigned.[14]

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court implied that the offer to settle must be for a specific sum and said that although the *Stowers* case requires the insurer to make overtures to settle a claim on the policy, it does not require the insurer to accept a conditional offer carrying risks of further liability.

11. Chancey v. New Amsterdam Cas. Co., 336 S.W.2d 763, 766 (Tex. Civ. App.—Amarillo 1960, writ ref'd n.r.e.).

12. Linkenhoger v. American Fid. & Cas. Co., 152 Tex. 534, 260 S.W.2d 884, 887 (1953).

13. *E.g.*, Seguros Tepeyac, S.A., Compania Mexicana v. Bostrom, 347 F.2d 168 (5th Cir. 1965); *accord*, Smith v. Transit Cas. Co., 281 F. Supp. 661 (E.D. Tex. 1968); Lacy v. Mid-Continent Cas. Co., 247 F. Supp. 667 (S.D. Tex. 1965).

14. There are numerous aspects to the cause of action for wrongful refusal to settle, and one needs only to consult the many articles and comments on the subject to obtain a sampling. For example, two proposals have been made which it is felt would simplify judicial disposition of these cases. The first is that cases involving wrongful refusal to settle be taken from the jury. *See* Comment, *Excess Liability: Reconsideration of California's Bad Faith Negligence Rule*, 18 STAN. L. REV. 475, 481-82 (1966). It is argued that in excess liability cases the insurer is at a particular disadvantage since juries are generally thought to be more favorable to an individual than an insurance company in an action between the two. A suggested remedy for this "deep pocket jury bias" is to try the case to the judge alone or to submit the question of wrongful refusal to settle to arbitration.

The second proposal is that strict liability for refusal to settle be imposed upon the insurer. *E.g.*, Comment, *Insurers' Duty to Settle—Strict Liability For Excess Judgments: Has The Time Come?*, 9 B.C. IND. & COM. L. REV. 188 (1967). In favor of the strict liability proposal it may be said that there is a tremendous amount of disparity in bargaining power between an insurance company and an individual, and many times when the insured is involved in an accident he is literally at the mercy of his insurer regarding offers of settlement from one injured as a result of the insured's wrong. Moreover, since the insured has placed his trust (and his money) in the hands of the insurer there is a relatively higher standard of care owed to the insured from the company. The question then becomes should this higher standard of care be extended to the point of strict liability? Although this particular question is beyond the scope of this discussion, it should be noted that if strict liability were imposed, it is possible that the insurer would be forced to accept any and every offer of settlement whether bona fide or not; otherwise he would be held fully liable for any judgment later rendered against the insured regardless of whether his refusal to settle was the result of a mere mistake in judgment. An additional argument against adopting the strict liability rule is that to do so might result in a large increase insurance rates.

These two proposals, although interesting, have not met with appreciable success. There is no evidence that any state has made an effort to take these cases from the jury, and although strict liability has been proposed by several commentators, no judicial reaction favorable to it has been found.

Texas adopted the prepayment rule in *Universal Automobile Insurance Co. v. Culberson.*[15] The essence of the rule is that a negligent insurer within the meaning of the Stowers doctrine need not pay the excess judgment rendered against his insured until the insured himself satisfies the judgment. The rationale for the prepayment rule is that the insured does not suffer a loss until he pays money.[16] The question of whether the Stowers cause of action may be assigned has not been directly litigated by the Texas courts. It is important, however, because an insured, having established negligence on the part of his insurer in refusing to settle, may wish to remove himself from the litigation by assigning his rights under the Stowers doctrine to the injured third party who holds a judgment against him.

A typical fact situation involving the Stowers doctrine, and in which the questions of prepayment and assignment arise, is *Smith v. Transit Casualty Co.*[17] The case involved an automobile accident in which the car owned and driven by Mrs. Smith collided with another owned and driven by a Mr. Selz who died of injuries received in the accident. The accident apparently occurred when a third automobile driven by a Mrs. Morris pulled from the right shoulder onto the highway. When this happened Mrs. Smith turned into the left lane and into the path of the Selz automobile.

Mrs. Smith commenced suit in the state district court, and subsequently Mrs. Selz, the executrix of her husband's estate, filed a cross action against Mrs. Smith and Mrs. Morris. Transit Casualty Company, the insurer of Mrs. Smith then undertook defense of the claim against her. An instructed verdict was rendered against Mrs. Smith as to her claim for damages against the Selz estate and a verdict was rendered against her on the cross action in the sum of $81,375. Prior to rendition of judgment against Mrs. Smith, Transit, acting against the advice of its attorney, refused an offer of settlement of $4,500. The limits of the policy carried by the company on Mrs. Smith were $5,000, and the amount of the judgment rendered against her was finally set at $51,375. Mrs. Smith, an elderly retired schoolteacher was virtually judgment proof. Writ of execution on the state court judgment was returned nulla bona. Thereafter, Mrs. Smith executed a note in the amount of the judgment to Mrs. Selz and tendered an initial payment of $5.00 on the

15. 126 Tex. 282, 86 S.W.2d 727 (Comm'n App. 1935, opinion adopted).

16. The prepayment rule was not at issue in the *Stowers* case since the insured there paid the excess judgment in favor of the injured third party prior to commencing suit against the insurer for the amount of the excess judgment.

17. 281 F. Supp. 661 (E.D. Tex. 1968).

judgment. Mrs. Smith also made a written assignment of her claim against the insurance company for its failure to settle within the limits of the policy. Then both Mrs. Smith and Mrs. Selz joined as co-plaintiffs in an action against Transit for its negligent refusal to settle. Following removal to the United States district court, Transit was found to have breached the duty of ordinary care to protect its insured which resulted in the entry of the $51,375 judgment against Mrs. Smith. Therefore, Transit became liable to Mrs. Smith for the full amount of the judgment.

Although Transit was liable for the entire judgment, the prepayment rule in Texas prevented either Mrs. Smith or her assignee Mrs. Selz from collecting it. The district judge found that the note executed by Mrs. Smith purporting to pay the judgment to Mrs. Selz was a sham designed to avoid the prepayment rule. However, the court did find that since Mrs. Smith had made a $5.00 payment to Mrs. Selz, a cause of action against the insurer existed for that amount and for any additional amount paid on the excess judgment.

Throughout the United States judicial opinion has divided as to the validity of the prepayment rule. The older cases which dealt with insurers' liability for excess judgments freely adopted it[18] whereas the more recent decisions have tended to adopt the so called judgment rule.[19] The judgment rule is simply that the entry of judgment rather than its payment by the insured completes the actionable wrong, and it is sufficiently injurious to permit the insured to recover damages from the insurer.[20] Although recognizing that there are undesirable aspects to the

18. State Auto. Ins. Co. v. York, 104 F.2d 730, 734 (4th Cir. 1939); Attleboro Mfg. Co. v. Frankfort Marine, Acc. & Plate Glass Ins. Co., 240 F. 573, 580 (1st Cir. 1917); Dumas v. Hartford Acc. & Indem. Co., 92 N.H. 140, 26 A.2d 361, 362 (1942); Boling v. New Amsterdam Cas. Co., 173 Okla. 160, 46 P.2d 916, 918 (1935); Universal Auto. Ins. Co. v. Culberson, 126 Tex. 282, 86 S.W.2d 727, 730 (Comm'n App. 1935, opinion adopted).

19. Lee v. Nationwide Mut. Ins. Co., 286 F.2d 295, 296 (4th Cir. 1961); Alabama Farm Bureau Mut. Cas. Ins. Co. v. Dalrymple, 270 Ala. 119, 116 So. 2d 924, 925-26 (1959); Farmer's Ins. Exch. v. Henderson, 82 Ariz. 335, 313 P.2d 404, 409 (1957); Brown v. Guaranty Ins. Co., 155 Cal. App. 2d 679, 319 P.2d 69, 76-77 (Dist. Ct. App. 1957); Henke v. Iowa Home Mut. Cas. Co., 250 Iowa 1123, 97 N.W.2d 168, 180-81 (1959); Southern Fire & Cas. Co. v. Norris, 35 Tenn. App. 657, 250 S.W.2d 785, 791-92 (1952).

20. *See* 60 MICH. L. REV. 517, 518 (1962). It has been noted that with one exception, there have been no decisions adopting the prepayment rule since 1942, while there have been at least nine adopting the judgment rule. The exception, Harris v. Standard Acc. & Ins. Co., 297 F.2d 627 (2d Cir. 1961), *cert. denied*, 369 U.S. 843 (1962), perhaps can be explained by the fact that the court found that there must be "actual loss" under the law of the forum where the act was committed (New York). The court felt that this element of actual loss was not present in *Harris* since the insureds were insolvent prior to rendition of the judgment, had paid no part of the excess, and were discharged in bankruptcy from all future liability arising under the judgment. Therefore, it was reasoned, they had suffered no "actual loss." 11 U.C.L.A.L. REV. 382, 385 (1964). One should note

prepayment rule,[21] federal courts construing the Stowers doctrine have refused to modify it saying that if the rule is to be changed, "it must be the Texas courts who do it."[22]

There is limited authority for the proposition that the prepayment rule applies only in cases in which the insurance policy in question is one of indemnity.[23] Thus it has been asserted that the leading federal case applying the Texas prepayment rule[24] represented a misreading of the *Culberson* case and failed to distinguish between liability and indemnity policies.[25] An argument could be made that since *Culberson* dealt with what was clearly an indemnity policy, its holding should be confined to policies of that type.[26] However, the Court of Appeals for the Fifth

that the fact situation in *Harris* differs markedly from one in which the insured is solvent prior to the rendition of the excess judgment, becomes liable to the injured claimant for its full amount, and perhaps is forced into bankruptcy as a direct result of the entry of the judgment. Presumably in this hypothetical situation, the elements of "actual loss" are present.

21. Judge Wisdom recognized "in principle" the fact that the existence of the excess judgment is a "mortgage on the insured's future." Seguros Tepeyac, S.A., Compania Mexicana v. Bostrom, 347 F.2d 168, 178 (5th Cir. 1965).

22. *Id.* at 179. As long as the federal courts adhere to the principle that they are "*Erie* bound" to follow the Texas law on the subject of excess judgments rendered against the insured, the insurance companies will have a substantial advantage over their assureds. In recent years the Texas Supreme Court has had little opportunity to construe the Stowers doctrine as most of the cases involving it have been in the federal courts. Since these courts have consistently refused to modify the rule of prepayment, the insurer who is assured of getting any negligence suit against him removed to the federal courts may disregard bona fide offers of settlement as long as he is certain that the insured will not be able to pay the excess judgment to the injured third party claimant. Such an insurer may refuse all offers of settlement within policy limits gambling on the possibility that there will be a denial of recovery to the injured party at a trial of the issues. If a judgment many times in excess of the policy limits is rendered, such an insurer must only pay to the insured the face amount of the policy, while his insured, with little or no assets, may be left with a large judgment outstanding against him as a result of the prepayment rule. His only remedy as suggested by the *Bostrom* and *Lacy* cases is to go to the United States district court for a declaratory judgment after having established negligence in refusing to settle on the part of the insurer. The result of the declaratory judgment will be that any amounts paid by the insured to the injured claimant must be repaid by the insurer to the insured without a separate suit each time a small amount is paid on the judgment. *See* Seguros Tepeyac, S.A., Compania Mexicana v. Bostrom, 347 F.2d 168, 184 (5th Cir. 1965) (Brown, J., concurring opinion); *accord*, Lacy v. Mid-Continent Cas. Co., 247 F. Supp. 667 (S.D. Tex. 1965).

23. *See* 11 U.C.L.A.L. REV. 382, 384 (1964).

24. Seguros Tepeyac, S.A., Compania Mexicana v. Bostrom, 347 F.2d 168 (5th Cir. 1965).

25. *See* Howell, *Stowers Doctrine in Texas*, 32 TEX. B.J. 374 (1969).

26. The court in the *Culberson* case said, "We construe (the policy in question) as an indemnity obligation, rather than a liability contract, and . . . Culberson could assert no cause of action against the insurance company on account of the judgment in favor of Miss Witt until he has paid the same or some portion thereof, and then only to the extent he has paid." Universal Auto. Ins. Co. v. Culberson, 126 Tex. 282, 86 S.W.2d 727, 730 (Comm'n App. 1935, opinion adopted). As the district judge in Lacy v. Mid-Continent Cas. Co., 247 F. Supp. 667, 671 (S.D. Tex. 1965) recognized, this language leaves open the possibility that a different rule might apply in the case of liability policies.

Circuit has said that regardless of whether the policy is one of indemnity or liability, Texas courts limit recovery to the amount the insured has paid the injured party.[27] The court reasoned that in either type of policy, there is no injury to the insured until he has paid the judgment against him.[28]

This argument—that the insured is not damaged until he has paid money—is not the only one used to justify the rule of prepayment. In addition it has been argued that the injured third party claimant is a stranger to the relationship between the insurer and insured, and that the claimant is benefited rather than harmed as a result of the insurer's failure to settle.[29] Whatever its merits, the insurer can utilize this argument only when, as in *Bostrom*, the action is brought directly by the injured claimant on behalf of himself. Moreover, if the insured executes a valid assignment of any right of action which he may have against the insurer to the injured third party as was done in *Smith*, this argument, that the injured claimant is not privy to the relationship between insurer and insured and could thus assert no cause of action against him, is rendered invalid. It would not be unreasonable to suggest that most of the courts throughout the United States have rejected all such arguments in favor of the prepayment rule since the prepayment rule while formerly in the majority is now clearly a minority position.[30]

The assertion that the insured in a Stowers situation suffers no loss until he has paid the judgment against him is clearly erroneous. The *Bostrom* court while upholding the prepayment rule, recognized that the very existence of a large judgment represents a mortgage on the insured's

27. Sequros Tepeac, S.A. Compania Mexicana v. Bostrom, 347 F.2d 168, 178 (5th Cir. 1965). The court also said that the distinction between types of policies goes only to claims based on the policies, not Stowers claims sounding in tort which are for sums above the policy limits.

Whether the policy is one of indemnity or liability should be immaterial when a judgment in excess of the policy limits is rendered. If a suit in a Stowers situation actually involves two causes of action, the insured's right to recover from the insurer should be governed by the insurance contract up to the amount of the policy limits, but it should not be governed by the contract as to the amount in excess of the policy limits. This is sound when one considers that the tort inflicted upon the insured as a result of the insurer's negligence is a separate wrong entirely divorced from the contractual aspects of the policy.

28. "The basis for this principle is clear in the case of indemnity insurance; the insurer is obligated only to indemnify the insured for his loss. Although less obvious in the case of liability insurance, the principle is essentially the same: recovery in tort depends on a showing of injury; the insured is not injured until he pays all or some of the judgment against him." *Id.* Any such distinction between liability and indemnity insurance is virtually meaningless now since as pointed out in the Howell article, note 25 *supra*, at 375, the provisions of the Texas Safety Responsibility Act, TEX. REV. CIV. STAT. ANN. art. 6701h, § 21(a) (1969), require a liability policy, the result being that most of the policies in Texas are now liability policies.

29. *See* Keeton, *supra* note 2, at 1176.

30. *See* 27 U. PITT. L. REV. 726, 727 (1966).

future.[31] Moreover, the result of the prepayment rule is destruction of the insured's credit rating and in many cases insolvency with the attendant possibility that the insured will be forced to suffer the stigma of bankruptcy.

There are other persuasive arguments in support of abrogation of the prepayment rule.[32] It has been suggested that its existence is not justified because it results in a windfall to the insurer fortunate enough to have insured an insolvent.[33] Also, when prepayment is required, the insurer may be less responsive to its trust duties in situations where the insured is insolvent than in cases in which he has sufficient property out of which to satisfy any excess judgment which may be rendered against him.[34] Finally, the prepayment rule may be analogized to tort actions for personal injuries involving prepayment of medical expenses, the rule in such cases being that where the amount of liability is fixed and definite, prepayment is not required.[35] In addition to these arguments, there seems

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31. *See* note 26 *supra*. Other federal judges have criticized the prepayment rule. Judge Brown, concurring in *Bostrom*, makes a spirited criticism of its injustice. The result of the case was that Bostrom had obtained a large judgment against Jernigan whose negligent operation of an automobile had left Bostrom injured for life. (Bostrom in this case was suing in his own right as a third party beneficiary to the insurance contract.) Jernigan's insurance company had negligently refused to settle with Bostrom within the $5,000 limits of the policy and because of the prepayment rule Jernigan, a young man, was left with a large judgment facing him. In speaking of the prepayment rule and its application to Jernigan, Judge Brown made the following observation: "Perhaps I reflect a parochial tendency, but I am confident that the Supreme Court of Texas would not in this day and era forecast for one of its young citizens a life so bleak and economically unrewarding as this legal theory necessarily implies." 347 F.2d at 186.

Later, before the same court, Jernigan himself attempted to hold the negligent insurer responsible for the judgment which Bostrom held against him and which was still uncollectible. Seguros Tepeyac, S.A., Compania de Mexciana v. Jernigan, 410 F.2d 718 (5th Cir. 1969). The court again denied recovery feeling that it was bound by the *Erie* doctrine to follow the prepayment rule. In speaking to the issue the court said, "We find both authority and persuasive reasoning in favor of its abolition." 410 F.2d at 724. However, the court pointed out some difficulties which would result if prepayment were abolished:

> One need only consider the vagaries of the attachment process, the temptations which might attend the receipt of a large judgment, and the possible ignorance of the injured claimant that his once judgment-proof debtor is now an enriched man, to realize the necessity for some guarantee that the insured's recovery will not be dissipated or concealed before it inures to the rightful benefit of the injured party.

The court continued "that while such protection is necessary, the price exacted for it, as embodied in the prepayment requirement, may be too high." *Id.* at 724-25.

32. *E.g.*, 60 MICH. L. REV. 517, 518-19 (1962); 27 U. PITT. L. REV. 726, 728-29 (1966).

33. Southern Fire & Cas. Co. v. Norris, 35 Tenn. App. 657, 250 S.W.2d 785, 791-92 (1952). The court in *Bostrom* rejects this argument saying that it only avoids the crucial question of whether the insured has suffered a loss. 347 F.2d at 182. While this is no doubt correct, the court in its reaffirmation of the prepayment rule with little or no discussion of its shortcomings just as effectively avoided the issue of loss to the insured.

34. Southern Fire & Cas. Co. v. Norris, 35 Tenn. App. 657, 250 S.W.2d 785, 791-92 (1952).

35. *Id.* In cases involving the Stowers doctrine the amount for which the insured is liable becomes fixed and definite as soon as the excess judgment rendered against him becomes final.

to be no doubt that termination of the prepayment rule would reduce the volume of litigation in at least two ways. First, it would provide an incentive to insurers who are willing to risk the possibility of a judgment against their clients far in excess of the policy limits to accept reasonable and bona fide offers of settlement from injured third parties. In addition to this, a suit for declaratory judgment or a suit for reimbursement against the insurer for any amounts paid the injured third party by his judgment debtor, the insured, would be unnecessary if the prepayment rule were abolished.

A step in the direction of termination of the prepayment rule has been taken by the court of civil appeals in the case of *Hernandez v. Great American Insurance Co.*,[36] decided only recently. In this case the insured began an action under the Stowers doctrine approximately six years after an excess judgment was rendered against him, but less than two years after the judgment had been partially satisfied by execution on insured's property. The court held that this action was barred by limitations and based its holding upon *Linkenhoger v. American Fidelity & Casualty Co.*[37] and *Atkins v. Crosland*,[38] two Texas Supreme Court decisions. *Linkenhoger* held as to the Stowers cause of action, "limitation did not begin to run in any event until the judgment in the former case became final . . . ."[39] In *Atkins*, the court was not dealing with the Stowers doctrine, but it was there held that "the test to determine when the statute of limitations begins to run against an action sounding in tort is whether the act causing the damage does or does not cause a legal injury . . . ."[40] The *Hernandez* court concluded that contrary to the prepayment rule as stated in *Culberson*, payment of the excess judgment is not a condition precedent to a suit by the insured against his insurer and that the entry of judgment in the former case is an injury to the insured.[41] The court distinguished *Culberson* on the basis that the policy there was one of indemnity whereas the policy in *Hernandez* was liability insurance.[42]

If it is held, as this court of civil appeals did, that the statute of

36. 456 S.W.2d 729 (Tex. Civ. App.—Corpus Christi 1970, writ filed).

37. 152 Tex. 534, 260 S.W.2d 884 (1953).

38. 417 S.W.2d 150 (Tex. 1967).

39. 260 S.W.2d at 887.

40. 417 S.W.2d at 153.

41. 456 S.W.2d at 733-34. The court following the "weight of authority in the United States" held, "it is not realistic to say that an insured has not been damaged because a judgment that remains unsatisfied is held against him."

One justice dissented on the basis that the prepayment rule is still the law in this state, and if it is to be abolished it should be the supreme court which does so. *Id.* at 736.

42. It is submitted that any such distinction is unsound. *See* notes 27 and 28 *supra*.

limitations begins to run when there is a final judgment against the insured, there is no alternative but to declare the prepayment rule invalid since its very existence presupposes that there is no injury to the insured until he has paid the excess judgment, and, as pointed out by the *Hernandez* court, there must be an injury before a cause of action arises.[43] If *Linkenhoger* can be read for the proposition that the entry of judgment against the insured constitutes the completed tort and starts the running of the statute of limitations, then the result in *Hernandez* (abrogation of the prepayment rule) would be the logical result. If the Texas Supreme Court accepts this reasoning then certainly a significant step will be taken toward more equitable treatment of insureds asserting the Stowers doctrine. It may be, however, that any such decision should be applied prospectively, for *Linkenhoger* notwithstanding, the consensus has been up until now that an insured could not recover under a cause of action based upon the Stowers doctrine until he has paid the excess judgment against him.

Turning now to the question of assignment, it is clear that if the cause of action is regarded as one for breach of contract there is little difficulty in declaring it assignable.[44] However, in Texas, there is no question but that the cause of action is a tort grounded in negligence.[45] Regardless of this, an analysis of the Texas law of assignment will lead to the conclusion that the Stowers type cause of action may be freely assigned in this state.

Early Texas cases followed the common law rule that a personal tort could not be assigned.[46] However, it was also recognized at an early date that if an injury affects one's property rather than his person or character then the right of action arising therefrom may be assigned.[47] Today the Texas law of assignment is quite liberal. All or any part of a cause of action may be assigned[48] and the rules governing assignment of an existing cause of action for a negligent tort are said to be founded in equity.[49] Furthermore, a statute now provides that all causes of action for personal injuries survive the death of the tortfeasor and the injured

43. 456 S.W.2d at 733.

44. *See, e.g.*, Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958); Gray v. Nationwide Mut. Ins. Co., 422 Pa. 500, 223 A.2d 8 (1966).

45. *See* note 5 *supra*.

46. Jones v. Matthews, 75 Tex. 1, 12 S.W. 823, 824 (1889).

47. Wartman v. Empire Loan Co., 101 S.W. 499, 501 (Tex. Civ. App.—1907, no writ).

48. Friedman v. Martini Tile & Terrazzo Co., 298 S.W.2d 221, 225 (Tex. Civ. App.—Fort Worth 1957, no writ).

49. Fort Worth & Denver Ry. v. Ferguson, 261 S.W.2d 874, 879 (Tex. Civ. App.—Fort Worth 1953, writ dism'd).

party, whether the injuries are to the health, reputation, or the person.[50] Therefore there is no doubt that the Texas Supreme Court would be justified in holding the insured's cause of action under the Stowers doctrine to be assignable. In doing so, the court would align itself with the majority of other courts which have dealt with the question.[51]

Despite the fact that the cause of action for wrongful refusal to settle is generally held to be freely assignable, there have been some suggestions that it be limited. In fact, it may be that assignment of the Stowers cause of action will need to be limited, if only for reasons of public policy. In the first place, if assignment of this cause of action is freely allowed, there is a possibility of collusion and fraud on the part of the insured and the injured third party to the detriment of the insurer.

> It is feared that an insolvent insured will arrange for an assignment of his cause of action to his judgment creditor in return for a release from liability under the judgment and that the insured and judgment creditor will then fraudulently co-operate in a suit against the insuer.[52]

Perhaps an additional argument against allowing assignment is that to do so would increase the cost of insurance.[53] However, it may well be that the higher cost, if indeed it is higher, would be offset by the increased number of settlements which would probably result if insurers

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50. TEX. REV. CIV. STAT. ANN. art. 5525 (1958).

51. Most cases hold the cause of action to be assignable under some form of contract theory such as assumpsit arising out of contract as did Gray v. Nationwide Mut. Ins. Co., 422 Pa. 500, 223 A.2d 8, 11 (1966). Others such as Grundy v. Manchester Ins. & Indem. Co., 425 S.W.2d 735 (Ky. 1968), theorize that although the cause of action is a result of a breach of contract, this gives rise to a tort which flows from the contract and therefore the cause of action is assignable. The better reasoned and more realistic view is that the cause of action may be assigned regardless of whether it is considered as sounding in tort or in contract. *E.g.*, Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 328 P.2d 198, 202 (1958).

The notable exception to the view that the insured's cause of action may be freely assigned is Tennessee. Its supreme court in the case of Carne v. Maryland Cas. Co., 208 Tenn. 403, 346 S.W.2d 259, 261 (1961), declared that although the cause of action arose out of the insurance contract, it is still plainly an action *ex delicto*. Since the insured in the case died before suit was commenced the court held that his cause of action was not assignable "since under the common law death gave rise to no causes of action and terminated all those for personal torts." *Cf.* Dillingham v. Tri-State Ins. Co., 214 Tenn. 592, 381 S.W.2d 914 (1964), in which the insured had not died. The court held here, however, that whether he was alive or dead was of no moment since the whole question of whether the cause of action could be assigned was dependent upon whether it would survive the death of its owner. Since the court was of the opinion that it would not survive its owner's death it reaffirmed its holding in *Carne* that the right of action could not be assigned.

52. Note, 52 CORNELL L.Q. 778, 786 (1967).

53. If assignment is not permitted, at least three separate cases must be heard by the courts: "the original action; an excess judgment action by the insured against the insurer; and an action by the judgment creditor against the insured." Note, 16 OKLA. L. REV. 110, 112 (1963).

were not as free to disregard reasonable and bona fide offers of settlement as they may now be under the present status of the law.[54] In fact, one of the better arguments in favor of assignment is that it will probably encourage settlements and decrease the amount of litigation.

Conclusion

A clarification of the present status of the Texas Stowers doctrine is needed particularly with regard to the outmoded and archaic prepayment rule. The rationale of the prepayment rule is not valid for it is indisputable that the insured suffers a discernible loss when an excess judgment is rendered against him notwithstanding the fact that he has not paid the judgment. The Supreme Court of Texas should revise and update the Stowers doctrine, but there are certain questions of public policy to be considered. Should, for example, assignment of the Stowers cause of action be permitted since there is a possibility of collusion between insured and injured at the expense of the insurer? Also, there are safeguards which will be needed if prepayment is abolished. Foremost among these is the need to ensure that the money for which the insurer is liable is not squandered by the insured, but instead goes to the judgment creditor who has been injured as a result of the insured's negligence. Until there is a reform of the prepayment rule of the Stowers doctrine, those citizens of this state who are unfortunate enough to suffer an excess judgment as a result of an insurer's negligence, and who cannot pay such a judgment, will have no meaningful relief available to them.

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54. Note, 52 CORNELL L.Q. 778, 788-89 (1967).