The Role of Declaratory Relief and Collateral Estoppel in Determining the Insurer's Duty to Defend and Indemnify

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NOTES

THE ROLE OF DECLARATORY RELIEF AND COLLATERAL ESTOPPEL IN DETERMINING THE INSURER’S DUTY TO DEFEND AND INDEMNIFY

Under a liability insurance policy, an insurance company undertakes two basic obligations: to defend and to indemnify its insured within the terms of the policy. When the facts and pleadings in a suit against the insured are covered by the terms of the policy, the insurance company must not only defend the insured, but also must pay any judgment rendered against him, or reimburse the insured if he pays the judgment. The duties to defend and to indemnify, however, are not necessarily coextensive, for in some cases the insurance company may be obligated to defend its insured but will not be obligated to pay a judgment rendered against him.

If a policy holder is sued for damages that the insurer believes are not covered by the policy, the insurer may seek to avoid any liability by refusing either to defend or indemnify the insured. Should the insurance company be uncertain of its obligations under the insurance contract, however, it is confronted with a dilemma; by relying on its own determination that it has no duty to defend the insured and refusing to do so, it may be liable for breaching the insurance contract and can be held liable for damages to the full extent of an ad-

2. There is a distinction between a liability and indemnity insurance policy. An action against the insurer in an indemnity policy lies only after an actual loss has occurred and the insured has discharged his liability. The coverage in a liability policy attaches when the insured becomes liable. American Employer's Liab. Ins. Co. v. Fordyce, 62 Ark. 562, 36 S.W. 1051 (1896); Fenton v. Fidelity & Cas. Co., 36 Ore. 283, 56 P. 1096 (1899); Shealey v. American Health Ins. Corp., 220 S.C. 79, 66 S.E.2d 461 (1951). In a liability policy the payment is due when judgment is rendered against the insured. Miholevich v. Mid-West Mut. Auto Ins. Co., 261 Mich. 495, 246 N.W. 202 (1933). These terms will not be used according to their technical meaning here, however, because the distinction is not important within the context of this article.
verse judgment. This is so even though the policy in question provides that the company has only the duty to defend, not to indemnify.\textsuperscript{6} If, on the other hand, the company chooses to defend the insured, it must bear the cost of the defense; but what is more important, in cases where the damage complained of is adjudged to be of a type that is covered by the insurance policy, the insurer may be collaterally estopped from asserting its defense of noncoverage in a later action on the policy.\textsuperscript{7} Thus, the insurer, by refusing to defend an action against its policy holder, may be breaching its contract with him, while if it does defend the action it may be forfeiting its rights under the policy's exclusions.

### Declaratory Relief

#### The Value of Declaratory Relief

The insurance company can solve this dilemma by resorting to declaratory relief while the action against its insured is still pending.\textsuperscript{8} Through this widely used\textsuperscript{9} discretionary remedy\textsuperscript{10} a court can determine

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\textsuperscript{7} Statutes generally enable the injured party to sue the insurer directly once a judgment has been rendered within the terms of the policy. Night, Determination of Liability Insurance Policy Defenses by Declaratory Actions, 8 SYRACUSE L. REV. 27, 28 n.4 (1956); see, e.g., CAL. INS. CODE § 11580.

\textsuperscript{8} While the availability of declaratory relief provides a legal channel by which the insurer might determine its coverage, as a practical matter, it is not a panacea. The declaratory action will frequently not proceed to trial until after the personal injury suit has been decided, thereby defeating the purpose of the declaratory action. See IV J. MOORE, FEDERAL PRACTICE ¶ 0.411 [6], at 1558 n.19 (2d ed. 1965); see note 10 infra.


\textsuperscript{10} CAL. CODE CIV. PROC. § 1061 provides: "The court may refuse to exercise the power granted by this chapter in any case where its declaration or determination is not necessary or proper at the time under the circumstances." The court's discretionary power is implied in the Federal Declaratory Judgment Act, 28 U.S.C. §§ 2201-02 (1964). Aetna Cas. & Sur. Co. v. Quarles, 92 F.2d 321 (4th Cir. 1937). According to Borchard, the crucial question in the insurer's attempt to gain a declaration of noncoverage while the personal injury suit is pending is the discretionary power of the court: "The insurance cases which have attracted the most attention to the declaratory judgment are those in which a casualty company institutes an action against the insured, joining or not joining the injured parties, for a declaration that the company is not under a duty to defend or to pay any eventual judgment, because the injury or death is not within the coverage of the policy or because the company has some defense which exempts
the rights of parties before those rights have been violated. If the court exercises its discretion to grant declaratory relief on both the duty to defend and the duty to indemnify, the insurance company can ascertain its obligations under the policy and have any disputed facts decided before undertaking the insured's defense.

Courts have found declaratory relief to be a simple and socially valuable method to determine the insurer's duty to defend. In most jurisdictions, the insurer has an obligation to defend if the facts, as alleged in the complaint, fall within the coverage of the policy. The court's decision is upheld unless it constitutes an abuse of discretion.

The courts, especially in New Hampshire and the federal courts, having at once conceded that the issue presented a 'case' or 'controversy,' made the propriety of issuing the declaration turn on questions of policy and discretion in trying the issue of non-liability or limited liability before the suit of the injured person for negligence had been litigated to judgment, and raised the question whether that suit should be stayed or the company relegated to its defense in that suit.” E. Borchard, Declaratory Judgments 646-47 (2d ed. 1941).


15. See E. Borchard, supra note 10, at 634.

court, therefore, need only consider the language of the complaint together with the language of the policy to determine whether the insurer has a duty to defend the action. If the insurer is able to obtain this preliminary declaration of its duties to defend and indemnify, it may be able to avoid both the defense costs and any possible indemnity obligations under the policy. A declaratory judgment which determines that the insurer has both the duty to defend and to indemnify the insured at least avoids the necessity of a second suit on the policy. Even though the declaratory judgment may establish only that the insurer must defend its insured and leaves the indemnity question undecided, the insurance company is not forced to suffer the consequences of its own determination of the legal question of whether it has a duty to defend.

To help clarify the insurer's legal obligations, courts generally grant declaratory relief to the extent of deciding the insurer's duty to defend. They have been more hesitant, however, in granting declaratory relief with respect to the duty to indemnify. In some situations, the obligations to defend and to indemnify are determined by different tests and where this is so, the duty to defend is greater. As a result, the insurer may have an obligation to defend its insured though it may not be required to pay a judgment against him; in such a case a court will not decide the indemnity question by a declaratory judgment.


17. Universal Carloading & Distributing Co. v. Merchants Cas. Co., 9 Misc. 2d 177, 178, 167 N.Y.S.2d 655, 657 (Sup. Ct. 1957). "[T]he general purpose of an action for a declaratory judgment is to serve some practical end in quieting or stabilizing an uncertain or disputed jural relation . . . ." Id. Borchard stated that "[n]ot only is the company relieved by a judgment in its favor from defending a negligence action against the insured, but the determination of the fundamental economic fact that there is 'no coverage' enlightens and guides the injured person and the insured. Indeed, such a determination has basic importance for all parties concerned in the negligence action, whether an injunction against its continuance is issued or not, for a suit against an impecunious insured unsupported by a responsible insurer may not be pursued, or else the passive indifference of the insured may well be converted into self-reliant defense." E. BORCHARD, supra note 10, at 634-35.

18. See text accompanying notes 27-43 infra.

19. See text accompanying notes 27-30 infra.


21. See text accompanying notes 27-43 infra.
Grounds of Asserted Noncoverage—The Determinant of the Scope of Declaratory Relief

When the insurer sues for a declaration of its obligations under the insurance contract, its theory of noncoverage determines whether the declaratory judgment will settle both issues of the duty to defend and the duty to indemnify. There are three ways by which the insurer can avoid having to pay a judgment against its insured. The first is by proving that the insured breached some basic condition of coverage under the policy, for instance by failing to pay his premiums or failing to give the insurer prompt notice of the accident which gave rise to the suit. The second is that if the interpretation of the language in the policy is in dispute but the facts of the case are undisputed, the insurer can avoid having to indemnify its insured by showing that the language of the policy does not cover those undisputed facts. The third is that if there is a dispute in the facts of the case but no dispute over the interpretation of the policy language, the insurer can avoid paying the judgment by showing that the injury complained of is not covered by the terms of the policy.

Where the insurer is successful in any of the three situations described, it has no duty to pay a judgment rendered against its insured. In addition, in the first two situations, where the insurer successfully shows that the insured has breached a condition of coverage or that the policy does not extend to the undisputed facts of the case, there ordinarily is not even a duty to defend. In these two situations the duty to defend is coextensive with the duty to indemnify, so a declaratory judgment on the insurer's duty to defend a suit against its insured

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would be determinative of both duties.\textsuperscript{26}

In the third situation, however, where the insurer denies coverage on the ground that the disputed facts of the case are not covered by the undisputed terms of the policy, the duty to defend and the duty to indemnify are not coextensive.\textsuperscript{27} This is because, in the declaratory judgment action, for purposes of determining the existence of a duty to defend, the plaintiff's allegations are assumed to be true, while the issue of the insurer's duty to indemnify is not settled until the issues of fact are decided in the main action. The courts properly refuse to determine issues of fact basic to the main action in the declaratory judgment action brought by the insurer;\textsuperscript{28} such a premature determination of facts would entail a useless expense of time, effort and money if the insured were subsequently found not liable.\textsuperscript{29}

It often happens that the same factual issues determine both the liability of the insured and the indemnity obligation of the insurer.\textsuperscript{30} Where this is so, the courts also consider it desirable to postpone litigation of the indemnity issue until the outcome of the injured party's


\textsuperscript{29} E. Borchard, supra note 10, at 654. "[A] declaration need not be granted if it will not serve a useful purpose." Id.


suit. This situation arises in two ways. First, it arises when the same facts both establish noncoverage and exempt the insured from liability. For example, in *Nationwide Mutual Insurance Co. v. Dennis,* an automobile liability policy covered both the named insured and those who drove his car with his permission. The automobile was involved in an accident while another person was driving. The insurance company sought a declaration that it had neither the duty to defend nor the duty to indemnify the driver or the insured because the driver was driving without the permission of the insured. Since a finding in the main suit that the driver was driving without permission would have relieved the owner of any liability, the court granted a declaration that the insurer had to defend both the driver and the insured, but refused to decide whether it also had a duty to indemnify them. The court reasoned that, since the insurer could present the permission issue and have it determined in the pending suit, it was not necessary to litigate that issue in a separate action.

The same facts also determine both the insured's liability and the insurer's indemnity obligation where the facts that would establish noncoverage would harm the insured's interests in his litigation with the injured party; but of course, the insurer cannot assert such a fact in the later suit, because to do so would breach its duty to defend in the insured's best interests. For example, in *Employer's Fire Insurance Co. v. Beals,* the policy covered negligence but not intentional torts. The action against the insured alleged both negligence and an intentional tort. The insurance company sued for a declaration that the injuries were intentionally caused and that it therefore had no duty either to defend in the main action or to pay any judgment. The court held that the insurer had a duty to defend but denied declaratory relief on the issue of indemnification. It argued that, since the injured party was joined as a plaintiff in the declaratory judgment action, a declaration on the intentional nature of the tort would force a "dress rehearsal" of the most important issue to be tried in the personal injury suit and

31. See text accompanying notes 32-43 infra.
32. See, e.g., cases cited note 30 supra.
thereby unjustly wrest control of the litigation from the injured party.39

A further reason for postponing determination of the insurer's indemnity obligation in a situation like that presented in the *Beals* case is that a declaratory judgment on this issue would prejudice the rights of the injured party by the operation of collateral estoppel.40 Since the injured party is a party to the declaratory action, the judgment there would bind him in any subsequent litigation against the insured.41 Suppose, for instance, the injured party plans to base his suit on a theory of intentional tort so that he can ask for punitive damages. If the insured's actions are held to be within the coverage of the policy, the injured party would be prevented from asserting in the personal injury action that the insured's conduct was intentional.

In refusing to declare whether or not the facts exempt the insurer from an obligation to indemnify, courts have generally relied upon such narrow reasons as those discussed above.42 The cases, however, support a general rule that the insurer cannot obtain a declaration that it need not indemnify its insured unless the court's decision would at the same time resolve the issue of the defense obligation. Nevertheless, the courts have not yet stated their conclusion this broadly.43

**Declaratory Relief in California Prior to Determination of the Insured's Liability**

Present California law is unsettled on the question whether declaratory relief can be used to determine that the disputed facts of a case exclude the injury complained of from insurance coverage. Two California cases have allowed declaratory relief for this purpose. In *Fireman's Fund Insurance Co. v. Chasson*,44 the insurance company sought a declaration that its automobile liability policy excluded an accident from coverage because at the time of the accident the insured's vehicle was being used as a public or livery conveyance, though the injured party's complaint did not allege any facts to exclude the accident from policy coverage. In *General Insurance Co. v. Whitmore*,45 the injured party's complaint alleged negligence, a theory of liability clearly covered by the policy; but the insurer contended that the insured intentionally caused the injuries so that the case was excluded from coverage. In both cases the courts allowed declaratory relief to determine whether the insurers had any obligations under their policies.

39. *Id.* at 400.
40. See note 78 *infra*.
41. See text accompanying notes 78-82 *infra*.
42. See text accompanying notes 27-29 *supra*.
43. See cases cited note 28 *supra*.
44. 207 Cal. App. 2d 801, 24 Cal. Rptr. 726 (1962).
Both courts concluded that the injuries were not covered by the insurance; therefore, the insurers were obligated neither to defend their insureds nor to pay any judgment rendered against them.\textsuperscript{46}

Although apparently in conflict with the rule in other jurisdictions, these cases are reconcilable with the refusal of other courts to grant a declaratory judgment on the indemnity obligation of an insurer who must defend a suit.\textsuperscript{47} When the insurer denies coverage by claiming the injury sued on is not covered by the terms of the policy, jurisdictions other than California first determine whether the insurer must defend\textsuperscript{48} by examining the allegations in the injured party’s complaint.\textsuperscript{49} These courts disregard any disputed facts of the case in deciding whether the insurer must defend; and once a duty to defend arises it continues until judgment in the main action, unless the complaint is amended.\textsuperscript{50}

The California courts in the \textit{Chasson} and \textit{Whitmore} cases agreed with the majority view that the language of the complaint initially determines the duty to defend and that the duty to defend continues until the case is clearly placed outside the policy’s coverage.\textsuperscript{51} These courts, however, departed from the procedure followed by other courts by considering the insured’s duty to indemnify before they considered its duty to defend. Since the duty to defend continues only until the injury sued on is clearly excluded from coverage, the California courts held that the duty to defend ceased when the decision that there was no indemnity obligation became final and the time for appeal had run.\textsuperscript{52} By reversing the order in which the duties to defend and indemnify are decided, these cases necessarily lead to the conclusion that in a declaratory relief action the duty to defend is determined by the actual facts, whereas in other jurisdictions the defense obligation is determined by

\begin{itemize}
  \item \textsuperscript{47} See text accompanying notes 27-43 \textit{supra}.
  \item \textsuperscript{48} For this purpose the court assumes the plaintiff’s allegations to be true. See text accompanying notes 27-28 \textit{supra}.
  \item \textsuperscript{49} See cases cited note 16 \textit{supra}.
  \item \textsuperscript{50} See, e.g., Lee v. Aetna Cas. & Sur. Co., 178 F.2d 750 (2d Cir. 1949). The court explained that whenever the complaint alleges tortious misconduct within the indemnity coverage of the policy, the case has not been placed outside the policy’s coverage and the duty to defend exists. If the insurer cannot compel the injured party to change the allegations, the indemnity obligation will remain uncertain until the end of the trial. \textit{Id.} at 752-53.
\end{itemize}
the allegations in the complaint. These cases thus extend the scope of declaratory relief in California to allow determination of disputed facts that would exclude the injury sued on from indemnity coverage. They remain consistent, however, with the majority rule that a court in a declaratory judgment action will not decide whether the insurer has an indemnity obligation to its insured unless that decision would also settle the question of the insurer's defense obligation.

Gray v. Zurich Insurance Co., a recent case decided by the California Supreme Court, was an action in which an insured sued his comprehensive liability insurer for the amount of a judgment rendered against him for assault and battery. Although the policy contained an exclusion for injuries intentionally caused, the court held the insurer liable to Gray, the insured, because it had breached its duty to defend. At no time did the insurer seek a judicial declaration that it had no policy obligations. Thus, the case did not directly present the question of whether the insurer could obtain such a declaration. The broad language of Gray, however, weakens the Chasson and Whitmore cases as authority for the position that declaratory relief is available to determine the insurer's indemnity obligation.

The opinion in Gray contains two separate holdings. The court first interpreted the terms of the policy to require the insurer to defend a suit for assault and battery. The policy guaranteed the defense of any suit, even if the allegations in the complaint were "groundless, false or fraudulent," and the court interpreted this broad language to require the insurer to defend against claims that its insured had acted wrongfully, even if the pleadings alleged that the injuries were caused intentionally.

The court ruled that, although the policy's exclusion would not require the company to indemnify its insured for assault and battery, it still had the obligation to defend such suits, since the policy did not

53. See text accompanying notes 22-29 supra.
55. Id. at 276-77, 419 P.2d at 177, 54 Cal. Rptr. at 113; see Note, The Insurer's Duty to Defend Made Absolute: Gray v. Zurich, 14 U.C.L.A.L. REV. 1328, 1330 (1967).
56. See text accompanying notes 63-66 infra.
58. Id. at 267, 419 P.2d at 170, 54 Cal. Rptr. at 106 (1966).
59. Gray rejected the insurer's contention that the defense coverage was limited to claims which were payable under the policy: "The basic promise [to defend] would support the insured's reasonable expectation that he had bought the rendition of legal services to defend against a suit for bodily injury which alleged he had caused it, negligently, nonintentionally, intentionally, or in any other manner." Id. at 273, 419 P.2d at 174, 54 Cal. Rptr. at 110 (1966).
clearly exclude them from coverage.\textsuperscript{60} Because the court held that the exclusionary clause applied only to the indemnity obligation,\textsuperscript{61} a declaratory judgment that the case was excluded from indemnity coverage would not have released the insurer from its duty to defend. For that reason, in any case involving the same standardized exclusion for intentional misconduct construed in \textit{Gray}, the insurer will not be able to obtain a decision on whether it must indemnify its insured until the issue of the insured's liability is decided.\textsuperscript{62}

In its second holding, the court said that, even if the duty to defend had to be determined by the allegations in the injured party's complaint against the insured, as argued by the defendant insurance company, the insurer's argument still failed, for the complaint alleging an intentional tort potentially sought damages within the scope of the policy.\textsuperscript{63} This holding necessarily assumed, \textit{arguendo}, that the policy

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  \item \textsuperscript{60} Id. at 274-75, 419 P.2d at 174-76, 54 Cal. Rptr. at 110-12 (1966).
  \item \textsuperscript{61} Id.
  \item \textsuperscript{62} Although \textit{Gray} dealt with a specific policy exclusion in a comprehensive insurance policy, the courts may also interpret other policy exclusions, including those in automobile, homeowners', and other forms of liability insurance, to limit only the indemnity coverage and to require the insured's defense. Based on the reasoning in \textit{Gray}, in all cases where the insurer must defend, declaratory relief will not be available to settle the indemnity question.
  
  Since \textit{Gray}, a new standardized policy has been widely used. Although the new policy stresses that the extent of the insurer's defense obligation is limited by the policy's exclusions, it has been suggested that the new policy will probably be interpreted so as to require a defense for intentional misconduct. B. Crocker, \textit{The Continuing Importance of Gray v. Zurich}, 43 Los Angeles B. Bull. 239, 260-62 (1968).
  
  \textsuperscript{63} 65 Cal. 2d 263, 275-77, 419 P.2d 168, 176-77, 54 Cal. Rptr. at 112-13 (1966). In California, the theory on which any plaintiff relies may be easily changed. For example, although the injured party pleads an intentional tort, he may eventually recover on a theory of negligence. As the court in \textit{Gray} stated: "Since modern procedural rules focus on the facts of a case rather than the theory of recovery in the complaint, the duty to defend should be fixed by the facts which the insurer learns from the complaint, the insured, or other sources. . . .

  \texttt{"[D]espite Jones' pleading of intentional and wilful conduct, he could have amended his complaint to allege merely negligent conduct." Id. at 276-77, 419 P.2d at 176-77, 54 Cal. Rptr. at 112-13. Thus, under the test of \textit{Gray} the insurer cannot avoid the obligation to defend even if the allegations in the complaint are outside the policy's coverages. Id. at 275-77, 419 P.2d at 176-77, 54 Cal. Rptr. at 112-13.}


  The court used the potential indemnity coverage, rather than the injured party's pleadings, as the test of the insurer's defense obligation. It realized that the actual
exclusion applied to the insurer's defense obligation as well as to its indemnity obligation. The effect of this holding was that, even if the policy exclusion for injuries intentionally caused was clearly intended to limit the defense duty, the insurer would still have been obliged to defend the suit for assault and battery because the injured party might eventually recover on a theory of liability not originally urged in the complaint. In its statement that the insurer must defend any suit "which potentially seeks damages within the coverage of the policy," the court recognized that the duty to defend exists until it is clearly established that the case is outside the indemnity coverage of the policy. This statement of the test of the duty to defend extends that duty beyond the limits established in most jurisdictions.

Since Gray, only one California case has raised the question whether declaratory relief is available to the insurer to establish that the disputed facts of a case exclude the injury complained of from coverage. In General of America Insurance Co. v. Lilly, the driver and owner of a truck were joined as defendants in an action for damages. The injured party alleged that the driver had used the vehicle with the owner's permission. The insurer sought a declaration that it had no policy obligations, claiming that the driver did not have the permission of the owner-insured, as required for coverage under the policy. The court ruled that the insurer had to defend but then refused to grant the insurer a declaration of its indemnity obligation.

This refusal is reconcilable with the two earlier California cases that granted declaratory relief. In those cases the facts establishing noncoverage would have weakened the insured's position if presented in the main suit brought by the injured party. The insurer in the Chasson case could not assert in the main suit its policy defense that the vehicle was used as a public or livery conveyance without damaging the insurer, for a finding to that effect would have established that the injured

facts of the case, which determine the duty to indemnify, could not be used to determine the duty to defend, since these facts necessarily remained unsettled until the conclusion of the main suit: "Although insurers have often insisted that the duty to defend arises only if the insurer is bound to indemnify the insured, this very contention creates a dilemma. No one can determine whether the third party suit does or does not fall within the indemnification coverage of the policy until that suit is resolved . . . . The carrier's obligation to indemnify inevitably will not be defined until the adjudication of the very action which it should have defended." 65 Cal. 2d 263, 271-72, 419 P.2d 168, 173, 54 Cal. Rptr. 104, 109 (1966).

64. 65 Cal. 2d at 275-77, 419 P.2d at 176-77, 54 Cal. Rptr. at 112-13.
65. Id. at 275, 419 P.2d at 176, 54 Cal. Rptr. at 112 (Italics in original).
66. See cases cited note 16 supra.
parties were passengers rather than guests and subjected the insured to liability for ordinary negligence rather than for wilful misconduct or misconduct due to intoxication. Likewise, in Whitmore, the insurer could not properly argue in the main suit that the insured injured the plaintiff in the main action intentionally rather than negligently. In the Lilly case, on the other hand, if the insurer could have established that the driver had not had the owner's permission to use the truck which caused the injury, the owner would have been exempt from liability. Thus, unlike the situations in the two earlier California cases, the facts in Lilly that would have established exclusion from the policy also would have promoted the insured's interests, so the insured was not harmed by the insurer being required to wait until the main suit to raise the facts that would have established noncoverage.

The different results in Lilly and the two earlier cases are further warranted because courts generally construe an insurance contract most strongly in favor of the insured. In Lilly, a finding in the main suit that the driver used the vehicle with the owner's permission would necessarily have placed the case within the meaning of "permission" as used in the insurance policy, so that establishment of the insured's liability in the main suit would also have settled the insurer's indemnity obligation. In a situation like that presented by the Lilly case then, the insurer's coverage obligations would be settled in the suit between the injured party and the insured without requiring the insurance company to bring a second suit against the insured to assert its policy exclusion.

The findings in a personal injury action, however, do not always indicate whether the insured is entitled to indemnity coverage. The reason is that, while courts liberally construe the coverage provisions

69. CAL. VEH. CODE § 17158: "No person riding in or occupying a vehicle owned by him and driven by another person with his permission and no person who as a guest accepts a ride in any vehicle driven by another person upon a highway without giving compensation for such ride, nor any other person, has any right of action for civil damages against the driver of the vehicle or against any other person legally liable for the conduct of the driver on account of personal injury to or the death of the owner or guest during the ride, unless the plaintiff in any such action establishes that the injury or death proximately resulted from the intoxication or wilful misconduct of the driver."

A public or livery conveyance is defined as a "vehicle used for carrying passengers for compensation." BALLANTINE'S LAW DICTIONARY 746, 1020 (3d ed. 1969) (citing cases).

70. 258 Cal. App. 2d at 470-71, 65 Cal. Rptr. at 754.


of insurance contracts in favor of the insured, they place a strict interpre-
tation on the policy exclusions. For example, a finding in the main
suit that the insured committed an intentional tort does not necessarily
establish intentional misconduct under the meaning of the policy ex-
clusion. Likewise, a finding that the occupant of an automobile paid
for a ride does not establish by itself that the vehicle was used as a
public conveyance. In such situations, then, the injury sued on is not
necessarily excluded from coverage, and the insurer may be forced to
bring a subsequent suit to have its indemnity obligation adjudicated.
Therefore, in cases such as Chasson and Whitmore, where an argu-
ment of noncoverage in the main action cannot be made because it
would prejudice the insured’s interests against the injured party, it seems
not unreasonable for courts to allow declaratory relief in a separate
action before the main suit. This gives the insurer a forum in which
to assert its argument of noncoverage and also protects it from the ex-
pense of additional litigation if it is successful in the declaratory judgment
action.

Collateral Estoppel Subsequent to the Main Suit

The wisdom of California courts in granting declaratory relief on
the issue of the insurer’s indemnity obligation cannot be fairly evaluated
without considering the doctrine of collateral estoppel. This doctrine
applies in a subsequent suit between the same parties to a prior action
or their privies to prevent them from relitigating matters that were tried
and determined in, and essential to, the final judgment of that prior
action.

Conflicting Views

When the insurance company has the obligation and opportunity
to defend its insured in a suit, it is a privy with the insured in that

73. Cases cited note 71 supra.
& n.12, 177, 54 Cal. Rptr. 104, 110 & n.12, 113 (1966).
75. See Fireman’s Fund Ins. Co. v. Chasson, 207 Cal. App. 2d 801, 805, 24
Cal. Rptr. 726, 728 (1962).
76. See text accompanying note 44 supra.
77. See text accompanying notes 45-50 supra.
78. Cromwell v. County of Sac, 94 U.S. 351, 352-53 (1876); F. JAMES, CIVIL
PROCEDURE § 11.18, at 575-76 (1965); Polasky, Collateral Estoppel—Effect of Prior
Litigation, 39 IOWA L. REV. 217, 217-18 (1953); Developments in the Law—Res
Judicata, 65 HARV. L. REV. 818, 840 (1952). Collateral estoppel has also been re-
ferred to as “estoppel by judgment,” Spence v. Erwin, 200 Ga. 672, 673, 38 S.E.2d
394, 395 (1946), and “estoppel by verdict,” Wolfson v. Northern States Management
Co., 221 Minn. 474, 477, 22 N.W.2d 545, 547 (1946).
79. BLACK’S LAW DICTIONARY 1362 (4th ed. 1951) defines “privy” as “[o]ne who
is a partaker or has any part or interest in any action, matter, or thing.”
action. If the insured is adjudged liable for an injury determined to be within the coverage of the policy, the injured party becomes a judgment creditor and therefore can sue the insurance company on the policy. In a subsequent suit brought either by the injured party as a judgment creditor of the insured, or by the injured party himself for indemnification, the law is unsettled whether collateral estoppel will preclude the insurer from asserting noncoverage. Even where the insurer could not have raised that issue in the main suit because of its prejudicial effect on the insured, some authority indicates that the insurer is estopped from raising the defense of noncoverage in a subsequent suit between it and a party to the personal injury action. Most proponents of this view, however, advocate that an alternative remedy be made available by allowing the insurer to raise its defense in a declaratory action before the outcome of the personal injury suit. Other authorities deny the use of declaratory relief to settle the insurer's in-


81. E.g., CAL. INS. CODE § 11580(b)(2).

82. The indemnitor is bound by the judgment against his indemnitee if he was given reasonable notice and an opportunity to defend. RESTATEMENT OF JUDGMENTS, § 107(a) (1942); F. James, Civil Procedure § 11.27, at 590 (1965). The insurer is bound by the judgment if it defends. See, e.g., Commercial Union Assurance Co. v. American Central Ins. Co., 68 Cal. 430, 9 P. 712 (1886). It is also bound by the judgment if it does not defend. See Ford v. Providence Washington Ins. Co., 151 Cal. App. 2d 431, 438, 311 P.2d 930, 933 (1957).

83. The dissenting judge in Farm Bureau Mut. Ins. Co. v. Hammer, 177 F.2d 793 (4th Cir. 1919), cert. denied, 239 U.S. 914 (1950), wrote: "The fact that the company could not assert in the original case that the injury was not negligent but intentional without prejudicing the defense of that case means merely that the defense which it had undertaken was difficult. It furnishes no ground for absolving the company from application of the well settled rule that judgment rendered is binding upon it as to issues actually adjudicated; and there can be no question but that the judgment adjudicated that the injury in question resulted from the insured's negligence." Id. at 802. See Miller v. United States Fidelity & Cas. Co., 291 Mass. 445, 197 N.E. 75 (1935); Jusiak v. Commercial Cas. Co., 11 N.J. Misc. 869, 169 A. 551 (Sup. Ct. 1933); Stefus v. London & Lancashire Indem. Co., 111 N.J.L. 6, 166 A. 339 (Ct. Err. & App. 1933); Comment, Liability Insurer's Duty to Defend Suits for Intentional Injury, 24 WASH. & LEE L. REV. 271, 285-287 (1967).

84. "It cannot be denied that an insurer . . . is on the horns of a dilemma, insofar as the action against the insured is concerned: given notice and an opportunity to defend, the insurer is bound by the judgment on the negligence claim, whether or not he defends; and, if he does defend, he cannot contend that the insured was guilty of intentional wrong-doing. But the insurer is not entirely without a remedy: a suit against the insured and the injured claimant for a declaratory judgment of non-coverage, prior to the rendition of judgment in the suit against the insured, may be entertained at the discretion of the appropriate court." IB J. Moore, Federal Practice, ¶ 0.411[6] n.19, at 1557 (2d ed. 1965); see 3 VAND. L. REV. 798, 801-02 (1950).
dennity obligation but would allow the insurer to raise its noncoverage defense in a suit subsequent to the personal injury action.\textsuperscript{85}

\textit{Miller v. United States Fidelity \& Casualty Co.} \textsuperscript{86} is the leading case applying collateral estoppel. After a judgment was rendered against the insured on a complaint which alleged only negligence, the court held that the insurer, who had refused to defend, was precluded from raising the defense that the injuries were intentionally caused. The court said:

Where an action against the insured is ostensibly within the terms of the policy, the insurer, whether it assumes the defense or refuses to assume it, is bound by the result of that action as to all matters therein decided which are material to recovery by the insured in an action on the policy.\textsuperscript{87}

Since the insurer was a privy in the personal injury action, it was conclusively bound by the finding that the plaintiff's injury was negligently caused, even though it could not have represented its own interests in that action.\textsuperscript{88}

The leading case representing the contrary point of view, and refusing to apply collateral estoppel on facts similar to those in \textit{Miller}, is \textit{Farm Bureau Mutual Automobile Insurance Co. v. Hammer}.\textsuperscript{89} After judgment in the main action on a theory of negligence, the insurer, who had refused to defend the insured, asserted its nonliability on the grounds that the insured had intentionally caused the injuries. The court allowed the insurer to raise the defense of noncoverage, recognizing that the purpose of collateral estoppel is to prevent the relitigation of the same facts and issues between parties who have already received a judicial hearing, the situation when the interests of the insurer and the insured are aligned.\textsuperscript{90} The court held that to the extent

\textsuperscript{85} See Great Am. Ins. Co. v. Ratliff, 242 F. Supp. 983, 990 (E.D. Ark. 1965); Pow-Well Plumbing \& Heating, Inc., v. Merchant's Mut. Cas. Co., 195 Misc. 251, 89 N.Y.S.2d 469 (Sup. Ct. 1949); Comment, The Insurer's Duty to Defend Under A Liability Insurance Policy, 114 Pa. L. Rev. 734, 741 (1966). The court in \textit{Ratliff} wrote: "In many instances it is more orderly and efficient and is in the best interest of all parties concerned to have the question of coverage litigated in advance of the trial of the basic controversy between the insured and the injured party. However, the question of coverage need not necessarily be determined in advance of the determination of the basic controversy, and the Court is of the opinion that advance determination of the matter of coverage is not desirable where, as here, that question is closely and directly connected with the issue of the insured's personal liability to the injured party." Great Am. Ins. Co. v. Ratliff, \textit{supra} at 990.

\textsuperscript{86} 291 Mass. 445, 197 N.E. 75 (1935).

\textsuperscript{87} \textit{Id}. at 448, 197 N.E. at 77.

\textsuperscript{88} \textit{See id}.

\textsuperscript{89} 177 F.2d 793 (4th Cir. 1949), \textit{cert. denied}, 339 U.S. 914 (1950).

\textsuperscript{90} \textit{Id}. at 799. The court in State Ins. Fund v. Low, 3 N.Y.2d 590, 148 N.E.2d 136, 170 N.Y.S.2d 795 (1958), said that two public policies underlie the application of collateral estoppel: "The first is that a question once tried out should not be relitigated
that the interests of the parties and their privies were not aligned, collateral estoppel could not properly be applied because to do so would estop the insurer by the acts of parties in a transaction in which it has no concern and over which it has no control. The doctrine of collateral estoppel should prevent a litigant from asserting its arguments twice, not from having his day in court.\textsuperscript{91}

The court in \textit{Hammer} posed two alternative courses of action for an insurance company faced with a suit against its insured in which it believed it had a possible noncoverage policy defense:

When the insurer desires to make the defense that the injuries are not within the coverage of the policy it may take the risk of refusing to defend the suit against the insured or it may be able to reserve the defense of non-coverage for a subsequent suit under a non-waiver agreement.\textsuperscript{92}

The court's choice of a second alternative, which was dictum, indicated that it believed collateral estoppel \textit{would} operate in a case where the insurer elected to defend the insured without securing a reservation of rights.

In \textit{Great American Insurance Co. v. Ratliff},\textsuperscript{93} the insured had rammed and overturned the injured party's car. He denied any involvement in the incident, however; and the insurance company elected to defend the suit brought by the injured party for damages based on negligence. In a subsequent suit on the policy, the insurer denied coverage of the incident because the policy it had issued excluded coverage for the insured's intentional torts. The insured and the injured parties claimed that, since the main suit conclusively determined that the insured was liable for negligence, the insurer was estopped from later denying it.\textsuperscript{94}

The court, however, decided that the issue of the character of the insured's conduct was still triable. Although the insurer did secure a nonwaiver agreement as recommended in \textit{Hammer},\textsuperscript{95} the court apparently did not rely on this as the basis for its holding. Except for a recitation in the facts that the insurer had procured a nonwaiver agree-

\begin{itemize}
\item \textsuperscript{91} \textit{Id.} at 799-800.
\item \textsuperscript{92} \textit{Id.} at 780.
\item \textsuperscript{93} \textit{Id.} at 799-800.
\item \textsuperscript{94} \textit{Id.} at 983 (E.D. Ark. 1965).
\item \textsuperscript{95} \textit{Id.} at 985.
\end{itemize}
ment, there was no additional reference to it in the opinion. The court instead emphasized the nonalignment of the interests of insurer and insured. The court concluded that collateral estoppel did not apply because the insurer had not yet had an opportunity to assert its contention that the conduct of the insured was intentional:

[T]he question of the quality of Holland's conduct was raised in the State court only as an issue in the primary controversy between Ratliff and Holland. The question was not raised, and indeed could not have been raised in that court, as a policy defense available to the Company as a party adverse to Holland or Ratliff, or both.96

The common feature of both these cases is that where the interests of insurer and insured conflict, the insurer has no effective opportunity to litigate the issue of noncoverage in the personal injury action. The application of collateral estoppel to the insurer and the insured is predicated on their identity of interests and their common opportunity to protect those interest in the main suit.97 When the extent of the policy's coverage is at issue, however, as it was in Hammer and Ratliff, the interests of insurer and insured are in conflict. The insurance company cannot defend the insured in good faith and, at the same time, protect its own interests.

The Sound Approach

A court that applies collateral estoppel indiscriminately in noncoverage cases fails to recognize the distinction between cases in which the insurer and the insured have aligned interests, and those in which their interests conflict. Their interests will be aligned when the same facts both establish noncoverage and exempt the insured from liability.98 Their interests will conflict when the facts that would establish noncoverage would also tend to establish the insured's liability.99 To apply the doctrine of collateral estoppel to the latter situation is to pervert the doctrine's underlying policy. Therefore, the refusal of the courts in Hammer and Ratliff to apply collateral estoppel to their particular facts was both practically and theoretically correct.

A further reason for not applying collateral estoppel when the interests of insurer and insured are not aligned rests on public policy. As the court in Ratliff apparently recognized, the application of collateral estoppel enables the injured party to circumvent the exclusionary clause in the insured's policy.100 He can mold his complaint to allege facts

96. Id. at 986.
98. See text accompanying note 32 supra and notes 105-09 infra.
99. See text accompanying note 36-37 supra.
100. See 242 F. Supp. at 986; accord, Stefus v. London & Lancashire Indem. Co., 111 N.J.L. 6, 8-10, 166 A. 339, 340 (Ct. Err. & App. 1933) (dissenting opinion); Note,
within the coverage of the insured’s policy even though the actual facts are clearly excluded from coverage. Through collateral estoppel, the insurer is then precluded from showing that the injured party fabricated his complaint in order to reach the insurance company’s deep pocket and, in effect, circumvent the public policy which prohibits insuring an individual against liability for intentional torts. 101 The possibility of such collusive conduct where the interests of the insurer and the insured are in conflict, is perhaps the most compelling reason for refusing to apply the doctrine of collateral estoppel.

Collateral Estoppel in California

The limitations on the application of collateral estoppel to cases in which policy coverage is at issue are still unclear in California. Several decisions have used language so broad as to suggest a preference for applying the doctrine in all cases. 102 The cases that have applied collateral estoppel, however, involved situations in which the insurer’s defense of noncoverage was also a defense to the insured’s liability. 103 Since the interests of both insured and insurer were fully aligned in the main suit, collateral estoppel was properly applied. 104

There are four situations in which collateral estoppel has been applied in California: (1) where the insurer attempted to relitigate The Insurer’s Duty to Defend Made Absolute: Gray v. Zurich, 14 U.C.L.A. L. Rev. 1328, 1335 n.28; 63 Harv. L. Rev. 898, 899 (1950).

101. The injured party had attempted to do exactly this in Ratliff. After his car was rammed with him inside, he procured a warrant for the insured’s arrest on a charge of assault with intent to kill and filed a civil action alleging that the insured deliberately rammed his vehicle, but later changed the theory of recovery in the civil action to negligence and dropped the criminal charges because his attorneys realized that otherwise the insured’s policy exclusion might apply. Since the injured party could not secure satisfaction from the impecunious insured, he strategically shaped his complaint to recover from the funds of the insurance company. 242 F. Supp. at 986.


103. See text accompanying notes 104-09 infra.

104. E.g., Escobedo v. Travellers Ins. Co., 227 Cal. App. 2d 353, 38 Cal. Rptr. 645 (1964). In that case the insurer attempted to deny coverage under its automobile policy on the basis that the driver, driving with permission of the insured, had been guilty of wilful misconduct. The court decided, contrary to the insurer’s contention, that the jury in the main action had found the driver merely negligent. Since a finding of wilful misconduct would have exonerated both insured and insurer, the insurer was collaterally estopped from asserting this defense after the decision in the main suit.
the question of the insured's negligence after a default judgment estab-
lished his liability on that theory;\textsuperscript{105} (2) where the insurer attempted
to relitigate the question whether the obviously negligent conduct was
committed by the insured;\textsuperscript{106} (3) where the insurer's contention of non-
coverage was first put in issue by the plaintiff's complaint;\textsuperscript{107} and (4)
where the contention of noncoverage was first put in issue as an affirm-
ative defense.\textsuperscript{108} In all these cases collateral estoppel was properly ap-
plied because the insurer's interest in the main suit was aligned with
the interests of the insured.\textsuperscript{109}

The courts generally do not apply collateral estoppel where a default judgment was
rendered in the prior action because no issues were litigated there. Lovejoy v. Ash-
worth, 94 N.H. 8, 45 A.2d 218 (1946); F. James, Civil Procedure § 11.19, at 578
nn. 11-12 (1965); Development in the Law—Res Judicata, 65 Harv. L. Rev. 818, 840-41
(1952). However, the indemnitor, if afforded reasonable notice and an opportunity to
defend, is bound in an action for indemnity by a default judgment that establishes the
liability of the indemnitee. Restatement of Judgments § 107, comment f at 516-17
(1942).

(1957).


\textsuperscript{108} Jones v. Zurich Gen. Accident & Liab. Ins. Co., 121 F.2d 761 (2d Cir. 1941);
(1957).

The insurer's efforts to escape liability in Artukovich were ironic. The injured
party had sued under the Workmen's Compensation Act. The action was dismissed be-
because the Industrial Accident Commission found that the injured party was not acting
within the scope of his employment with the insured at the time of the accident. The
injured party then sued in a tort proceeding which the insurer defended, contending
that the injured party was acting in the course of his employment at the time of the
accident and was therefore confined to proceedings under the Workmen's Compensation
laws. If the insurer succeeded in its argument, the injured party would have been
effectively foreclosed from asserting his claim anywhere since the judgment of the pre-
vious action barred him from any further proceedings under the Workmen's Compensa-
tion Act. But the insurer was unsuccessful. The court found that the order of the In-
dustrial Accident Commission was binding on the employment issue and the suit pro-
ceeded to judgment against the insured. 65 Cal. App. 2d at 317, 310 p.2d at 463.

As a result of the insurer's efforts, however, it was estopped in the subsequent
indemnity action from raising the exclusion in its policy of injuries incurred by an
employee of the insured acting in the scope of his employment. \textit{Id.} at 318, 310 P.2d at
464. The court in the indemnity suit found that the employment question was con-
clusively determined in the personal injury action where the insurer was the insured's
privy. \textit{Id.} Yet the court in the latter case settled the employment issue on the basis
of the conclusive determination of that question in the Workmen's Compensation pro-
cedings—a proceeding in which the insurer had not been party or privy because of the
policy exclusion. \textit{Id} at 317, 310 P.2d at 463. Therefore, if the insurer had not
raised the employment issue in the personal injury action, it would not have been
estopped from contesting it in the indemnity litigation. As a result of the insurer's at-
tempt to keep the injured party from any forum in which to assert his claim, the in-
surance company was itself barred from effectively raising the issue of noncoverage.

\textsuperscript{109} See text accompanying notes 104-08 supra.
California courts have not yet determined the limit of collateral estoppel in cases where the interests of the insurer and insured are not aligned. *Gray v. Zurich Insurance Co.*[^110] is the point of departure in this area. The insurance company in *Gray* claimed that if it had defended the insured, its duty to him would have required it to deny that he had intentionally caused the injuries. At the same time, its own interests under the policy's exclusions would prompt it to admit intentional conduct; thus it could not have defended the insured because the defense would have embroiled it in a conflict of interests.[^111] The insurer apparently believed that if it did not defend its own interests in the personal injury suit, it would be estopped to assert its rights in the subsequent suit on the issue of coverage. The court discarded the insurance company's argument:

> Since . . . the court in the third party suit does not adjudicate the issue of coverage, the insurer's argument collapses. The only question there litigated is the insured's liability. The alleged victim does not concern himself with the theory of liability; he desires only the largest possible judgment. Similarly, the insured and insurer seek to avoid, or at least to minimize, the judgment. As we have noted, modern procedural rules focus on whether, on a given set of facts, the plaintiff, regardless of the theory, may recover. Thus the question of whether or not the insured engaged in intentional conduct does not normally formulate an issue which is resolved in that litigation.[^112]

As a result, there was no conflict of interest, the court said, between the insurer and the insured; the insurance company should have defended the suit.

The court's reasoning was based upon the definition of collateral estoppel. If the issue was either not litigated or not essential to the decision in the prior action, then a party is not precluded from litigating that issue in a subsequent suit.

If one accepts the theory that application of collateral estoppel is warranted only to the extent that the interests of the parties in a suit are the same as the interests of their privies, but not where the interests of the insurer and the insured conflict, clearly the California Supreme Court in *Gray* only went part way in setting the proper limits for the doctrine's application. The court recognized that its holding would not apply when the theory of the insured's liability was clearly determined either by a special jury verdict or in some other manner in the personal injury suit. In such cases, by the court's own reasoning, the theory of liability was litigated and essential to the final judgment; therefore, collateral estoppel would apply.[^113] When the time comes

[^111]: Id. at 278-79, 419 P.2d at 178, 54 Cal. Rptr. at 114.
[^112]: Id.
[^113]: Id. 279 n.18.
when the court is squarely faced with this fact situation, it will have great difficulty in avoiding the application of collateral estoppel because of its reasoning in *Gray.* It would not have been presented with the problem if it had simply adopted the policy reasons underlying the *Ratliff* and *Hammer* decisions.\(^{114}\)

The court in *Gray* attempted to circumvent this potential trouble spot in advance by suggesting:

> In any event, if the insurer adequately reserves its rights to assert the noncoverage defense later, it will not be bound by the judgment. If the injured party prevails, that party or the insured will assert his claim against the insurer. At this time the insurer can raise the noncoverage defense previously reserved. In this manner the interests of the insured and insurer in defending against the injured party’s primary suit will be identical; the insurer will not face the suggested dilemma.\(^{115}\)

The court in *Centennial Insurance Co. v. Miller*\(^{116}\) made this suggested solution to the dilemma the basis of its holding that collateral estoppel could not be invoked against the insurance company.\(^{117}\) In *Centennial* the issue of collateral estoppel was raised by the defendants when the insurer, after a prior personal injury action had determined that the insured was merely negligent, brought a declaratory suit to determine policy coverage and attempted to raise the policy defense that the insured had intentionally caused the injuries. The court, faced with a finding of liability clearly based on negligence,\(^{118}\) determined that it need not decide whether collateral estoppel applied in a case where the interests of the insurer and insured conflict. A reservation of rights obtained by the insurer from the insured, said the court, placed the case “outside the ambit of collateral estoppel. The parties to a lawsuit may agree in advance to reserve the right to litigate matters in a subsequent suit which might otherwise be precluded by res judicata or estoppel.”\(^{119}\)

Although the dictum in *Gray* and the holding in *Centennial* established that a reservation of rights by the insurance company can preclude the application of collateral estoppel in any case where the interests of the insurer and the insured are not aligned, there are several reasons why this patchwork arrangement does not serve as well as the type of approach used in *Ratliff.* A reservation of rights by the insurance company has several important disadvantages. First, as with any provision of an

\(^{114}\) See text accompanying notes 97-101 *supra.*

\(^{115}\) 65 Cal. 2d at 279, 419 P.2d at 178, 54 Cal. Rptr. at 114.


\(^{118}\) 264 F. Supp. at 433.

\(^{119}\) *Id.* at 435.
insurance contract drawn in favor of the insurer, a reservation of rights is strictly construed in favor of the insured. If the insurer is not careful to include all possible contingencies in the reservation, a court may well hold that collateral estoppel in a given set of circumstances is not precluded by the particular reservation of rights involved. Furthermore, the insurer must make his reservation of rights promptly after ascertaining that a possible defense exists.

Second, there is some doubt whether, technically, a reservation of rights, of itself, should preclude the operation of estoppel. The doctrine of collateral estoppel is based upon the public policy ground of effective judicial administration. The parties to the insurance contract should not be permitted to circumvent this policy by private agreement.

The courts who do allow a reservation of rights to preclude the operation of collateral estoppel in cases like *Centennial*, however, may be justified in doing so because the insurer in such a case does not really have a chance to litigate issues concerning its own interests. But as *Ratliff* seemed to indicate, the reason that a judgment is not binding in that case is not because of a reservation of rights, but because the conflict of interests destroys any basis for collateral estoppel. Once again, it becomes apparent that courts should approach the matter of collateral estoppel directly rather than circumvent it by circuitous theories. *Centennial* provides some encouragement that California may eventually take this direct approach. Referring to the statements in *Gray* quoted above, the court stated:

This statement by the Supreme Court of California might be sufficient evidence of the state of the law in California to decide that collateral estoppel does not apply to an insurer who has defended, *even if there were no reservation of the right to litigate coverage later.*

**Conclusion**

In California an injured person who becomes a judgment creditor can sue the defendant's insurance company on the policy which it issued to the defendant insured, whether or not the insurance company was a party to the action. The injured party, however, is not bound by any suit between the insurer and the insured unless he is a party to that

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123. See text accompanying notes 95-96 *supra*.
125. CAL. INS. CODE § 11580(b)(2).
suit. Thus a declaratory judgment that the facts of the case exclude
the injury from coverage is of little use to the insurance company if the
injured person is not a party to the declaratory action. For that reason,
the injured party is usually joined in an action for declaratory relief;\footnote{126} any determination in that action has the binding effect of collateral
estoppel in the subsequent suit between the injured party and the in-
sured.\footnote{127} A declaration that the insured acted intentionally within the
meaning of the policy, then, would necessarily establish the insured's
liability to the injured party.

This result violates public policy. Declaratory judgments are prop-
erly denied when they do substantial injury to the rights of the parties.\footnote{128} The presentation of the tort issue in a declaratory relief action to deter-
mine contract rights prejudices the position of the insured. He pays
regular premiums to insulate his assets from the sudden shock and
depletion of an adverse liability judgment. This protection is one of
the social policies favoring insurance. The insurance company's use of
declaratory relief, however, changes its relationship to the insured. It
then jeopardizes, rather than protects, the insured's savings, for if the
insurance company succeeds in the declaratory suit, the insured loses
the security of insurance and may have his own liability conclusively
established.\footnote{129}

Without insurance, the injured party would then be the insured's
only foe in the controversy over his liability. In a declaratory relief
action, the insurer and the injured party are aligned against the insured.
This result is particularly harsh because a major reason motivating
the insured to purchase liability insurance is that the attorneys provided
by the insurance company may be more highly skilled than the attorney
which the insured could afford.\footnote{130}

The insurer violates its duty to defend in good faith if it maintains
anything in the main suit which harms the insured's interests.\footnote{131} If
the action is for declaratory relief, rather than a trial for damages, the in-
surance company can, with impunity, establish facts fatal to the in-
sured's interests in the suit for damages. For these reasons, the in-
surer's use of declaratory relief ironically contradicts the purpose and
policy favoring insurance. The courts should not allow this procedural
jockeying to transform the insurer from the insured's defender into

\footnotesize{126. See 20 J. APPLEMAN, INSURANCE LAW AND PRACTICE § 11371, at \textit{166-68 (1963).}}
\footnotesize{127. See text accompanying note \textit{78 supra}.}
\footnotesize{128. See Great Am. Ins. Co. v. Ratliff, 242 F. Supp. 983, 990 (E.D. Ark. 1965);
\footnotesize{129. See text accompanying notes \textit{77-78 supra}.}
Rptr. 104, 114 (1966).}
\footnotesize{131. See cases cited note \textit{37 supra}.}
his prosecutor. Thus, in any case in which the facts that establish noncoverage would harm the insured’s interests in the main suit, the insurer should not be allowed to raise its claim of noncoverage until after the determination of the insured’s tort liability is made.

If the insurer defends, and the jury determines that the case is within the policy coverage, some courts collaterally estop the insurer from later raising the defense of noncoverage, even though the insurer could not have asserted it in the prior action.\textsuperscript{132} Although one suggestion would be to allow the insurer to seek a declaratory judgment that the facts were excluded from coverage,\textsuperscript{133} the better rule would be to allow the insurer to raise any point as a policy defense in a subsequent action on the policy that it could not have asserted in the main action. California law on this subject is still unsettled, but Gray and Centennial have established a trend that suggests that California courts will eventually completely adopt the better rule and allow the insurer to assert the defense of noncoverage against its insured after the personal injury action, even if it obtains no reservation of rights.

\textit{William P. Wasserman*}

\begin{itemize}
\item \textsuperscript{132} See cases cited note 83 \textit{supra}.
\item \textsuperscript{133} See cases cited note 16 \textit{supra}.
\end{itemize}

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