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Limitation of Liability and the Direct Action Statute: A Troubled Marriage

*Chester D. Hooper**

Ironically, direct action statutes¹ seem to have bestowed on underwriters and removed from the legislatures and the courts much of the authority to determine who may limit the underwriter's liability and the amount of the limitation. This irony is due to the courts' eagerness to apply the direct action remedy as widely as possible to resolve limitation proceedings as they, rather than Congress, wish to resolve them. This eagerness has been bound only by the four corners of the insurance contract. Insurers have thus been left to set the limits in the terms of their insurance contracts.

This ironic position seems to have evolved from a desire to prevent an insurer from denying an injured person the ability to collect the proceeds of an insurance policy which might have been bought for the injured person's benefit. This desire is reasonable in an automobile accident setting. A state may have required a motorist to purchase insurance to pay for injuries the motorist may

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1. While a number of states have enacted direct action statutes, more maritime cases arise under Louisiana's direct action statute than other states' enactments. Louisiana's direct action statute provides in relevant part:

B. (1) The injured person or his or her survivors or heirs . . . at their option, shall have a right of direct action against the insurer within the terms and limits of the policy; and, such action may be brought against the insurer alone, or against both the insured and insurer jointly and in solido

(2) This right of direct action shall exist . . . whether or not such policy contains a provision forbidding such direct action, provided the accident or injury occurred within the state of Louisiana. Nothing contained in this Section shall be construed to affect the provisions of the policy or contract if such provisions are not in violation of the laws of this state.

C. It is the intent of this Section that any action brought under the provisions of this Section shall be subject to all of the lawful conditions of the policy or contract and the defenses which could be urged by the insurer to a direct action brought by the insured, provided the terms and conditions of such policy or contract are not in violation of the laws of this state.

D. It is also the intent of this Section that all liability policies within their terms and limits are executed for the benefit of all injured persons and their survivors or heirs to whom the insured is liable; and, that it is the purpose of all liability policies to give protection and coverage to all insureds . . . for any legal liability said insured may have as or for a tortfeasor within the terms and limits of said policy.

La. R.S. 22:655 (1977 & Supp. 1994).

inflict on others. If the motorist does injure someone, the injured person should not be denied compensation simply because he or she could not find and serve process on the insured motorist. The victim should be able to sue the insurer directly.

The direct action theory does not make as much sense in an admiralty context, particularly when it is used to circumvent limitation of liability.² The marine insurance authority, Leslie J. Buglass, has noted:

Several states in the United States have direct action statutes which permit claims to be pursued directly against underwriters for damages recoverable against a shipowner, even though such damages may exceed that shipowner's limitation fund. The startling philosophy (from underwriters' viewpoint) behind such statutes is that liability insurance is for the benefit of the injured party rather than for the protection of the assured.³

A glimpse of some rationale used in attempts to interpret the limitation issue and the direct action issue may show how these issues have become intertwined and, at times, almost strangled each other. The United States Supreme Court has said:

We are not only satisfied that the law does not compel the shipowner to surrender his insurance in order to have the benefit of limited liability, but that a contrary result would defeat the principal object of the law. That object was to enable merchants to invest money in ships without subjecting them to an indefinite hazard of losing their whole property by the negligence or misconduct of the master or crew, but only subjecting them to the loss of their investment. Now to construe the law in such a manner as to prevent the merchant from

2. The original Limitation of Shipowners' Liability Act, 46 U.S.C. app. §§ 181-188 (1988 & Supp. V 1993) (hereinafter the Limitation Act), enacted in 1851, "provides a procedure in admiralty to enjoin all pending suits and to compel them to be filed in a special limitation proceeding so that liability may be determined and limited to the value of the shipowner's vessel and freight pending." The idea's origin can be traced back to the medieval sea codes. "Its justification was that running a ship was an inherently risky business, a fact well known to all parties to a marine venture, and the imposition of full and one-sided liability on a shipowner would discourage maritime commerce." 2 Thomas J. Schoenbaum, *Admiralty and Maritime Law* § 15, at 298-99 (1987).

The Limitation Act provides in relevant part:

The liability of the owner of any vessel, whether American or foreign, for any embezzlement, loss, or destruction by any person of any property, goods, or merchandise shipped or put on board of such vessel, or for any loss, damage, or injury by collision, or for any act, matter, or thing, loss, damage, or forfeiture, done, occasioned, or incurred, without the privity or knowledge of such owner or owners, shall not . . . exceed the amount or value of the interest of such owner in such vessel, and her freight then pending.

46 U.S.C. app. § 183(a) (1988).

3. Leslie J. Buglass, *Marine Insurance and General Average in the United States* 434 (3d ed. 1991).

contracting with an insurance company for indemnity against the loss of his investment is contrary to the spirit of commercial jurisprudence. Why should he not be allowed to purchase such an indemnity? Is it against public policy? That cannot be, for public policy would equally condemn all insurance by which a man provides indemnity for himself against the risks of fire, losses at sea, and other casualties. To hold that this cannot be done tends to discourage those who might otherwise be willing to invest their money in the shipping business. It would virtually and in effect bring back the law to the English rule, by which the owner is made liable for the value of the ship before collision—the very thing which, in all our decisions on the subject, we have held it was the intention of Congress to avoid by adopting the maritime rule. That this would be the result is evident, because all shipowners insure the greater part of their interest in the ship, and by losing their insurance they would lose the value of their ship in every case. No form of agreement could be framed by which they could protect themselves. This is a result entirely foreign to the spirit of our legislation.⁴

The United States Fifth Circuit Court of Appeals in *Olympic Towing Corp. v. Nebel Towing Co.*⁵ said:

Underlying this principle [of direct action] is the public policy of Louisiana which proclaims that liability insurance—including purported indemnity insurance—is issued primarily for the protection of the public rather than the insured. We think it clear, therefore, that the clause relied upon here does not preclude a direct action.

The dissenting opinion in *Nebel Towing Co.* quoted the very language of Louisiana's direct action statute:

It is also the intent of this section that all liability policies *within their terms and limits* are executed for the benefit of all injured persons * * * and that it is the purpose of all liability policies to give protection and coverage to all insureds * * * for any legal liability said insured may have as or for a tort-feasor *within the terms and limits of said policy.*⁶

4. *Place v. Norwich & N.Y. Transp. Co.*, 118 U.S. 468, 504-05, 6 S. Ct. 1150, 1163 (1886) [hereinafter *City of Norwich*].

5. 419 F.2d 230, 237, 1969 A.M.C. 1571, 1580 (5th Cir. 1969), *cert. denied*, 397 U.S. 989, 90 S. Ct. 1120 (1970), *overruled by Crown Zellerbach Corp. v. Ingram Indus., Inc.*, 783 F.2d 1296, 1986 A.M.C. 1471 (5th Cir.), *cert. denied*, 479 U.S. 821, 107 S. Ct. 87 (1986).

6. *Id.* at 241 (Brown, C.J., dissenting from a denial of rehearing) (quoting the Louisiana direct action statute).

The same dissenting opinion went on to state:

As long as the Direct Action Statute subjects the insurer to no greater liability than the assured would have, it fulfills the Louisiana policy of public protection and avoids troublesome questions of conflict between state and federal maritime law. The Court's reading rewrites the contract, imposes liability beyond that of the assured and ignores substantive limitations on liability under maritime principles. The essential uniformity of the admiralty is at an end when for a like casualty across the line in Texas the "liability" of the shipowner is less—by the amount of total damages and the policy limits—than it is in Louisiana.⁷

Another Fifth Circuit dissenting opinion has said:

Although the trial court, having been *Nebel*-awed, presumably thought that anything which forbade 100% recovery was somehow outlawed, it is plain that application of any such approach would produce absurd results which even the most potent *Nebelizer* would protest.⁸

The disputes concerning limitation and direct action statutes have not centered on the issue one might anticipate: whether an insurance company or even a protection and indemnity club might be sued directly. That aspect appears to have been settled.⁹ Even protection and indemnity clubs may be sued directly despite the indemnity nature of the coverage.¹⁰ The ability to sue even an indemnity insurer should satisfy the theory that insurance exists to protect

7. *Id.* at 246 (Brown, C.J., dissenting from a denial of rehearing).

8. *Crown Zellerbach Corp. v. Ingram Indus., Inc.*, 745 F.2d 995, 1001 (5th Cir. 1984) (Brown, C.J., dissenting in part), *vacated en banc*, 783 F.2d 1296, 1986 A.M.C. 1471 (5th Cir.), *cert. denied*, 479 U.S. 821, 107 S. Ct. 87 (1986).

9. *See Grubbs v. Gulf Int'l Marine, Inc.*, 625 So. 2d 495 (La. 1993). *Crown Zellerbach Corp.* quoted the following explanation from *Hidalgo v. Dupuy*, 122 So. 2d 639 (La. App. 1st Cir. 1960), which in turn quoted *Nebel Towing Co.*: "The statute simply voids any policy clause which conditions the right of the injured person to enforce against the insurer its contractual obligation to pay the insured's debt upon, as prerequisite, the obtaining by the injured person of a judgment against the insured." *Crown Zellerbach Corp.*, 783 F.2d at 1299, 1986 A.M.C. at 1476 (quoting *Hidalgo*, 122 So. 2d at 644-45).

10. Typical protection and indemnity club rules provide:

All insurance afforded by the Association is by way of indemnity

If any Member shall incur liabilities, costs or expenses for which he is insured, he shall be entitled to recovery from the Association out of the funds . . . PROVIDED that actual payment (out of monies belonging to him absolutely and not by way of loan or otherwise) by the Member of the full amount of such liabilities, costs and expenses shall be a condition precedent to his right of recovery

The London Steam-Ship Owners' Mutual Insurance Association, R. 1.1, 3.1 and 3.1.1.

injured persons. The direct action has, however, been used to obtain even more for the injured person than the law would require the insured to pay.

A return to the basic, straightforward explanation offered by Mr. Justice Bradley in *City of Norwich*¹¹ would help the "marriage" between direct action statutes and limitation. That case involved a collision on Long Island Sound between the steamboat City of Norwich and the schooner General S. Van Vilet. The owners of the steamboat filed a limitation petition. The issue discussed by the court and relevant to this article was whether insurance proceeds should be added to the limitation fund. The Supreme Court first reviewed the laws of the United States, England, Prussia, the German states, and France. After that review, the Court held insurance proceeds should not be added to the limitation fund.¹² The rationale used by the Court in that case should help resolve problems that are present today.¹³

The Court asked whether insurance should constitute a part of that interest and decided it should not:

This view is corroborated by reference to a rule of law which we suppose to be perfectly well settled, namely, that the insurance which a person has on property is not an interest in the property itself, but is a collateral contract, personal to the insured, guaranteeing him against loss of the property by fire or other specified casualty, but not conferring upon him any interest in the property. That interest he has already, by virtue of his ownership. If it were not for a rule of public policy against wagers, requiring insurance to be for indemnity merely, he could just as well take out insurance on another's property as on his own, and it is manifest that this would give him no interest in the property.¹⁴

The Court was faced, in 1886, with the same emotional issues often faced today. The claimants stressed the hardship inflicted upon them. They argued it would be unjust to allow the shipowner to be entirely indemnified (by insurance) for the loss of his vessel while the parties who suffered loss due to the fault of the shipowner's employees would not be indemnified. The Supreme Court's answer to that argument was refreshing. It explained simply that the injured parties could have bought insurance themselves which would have indemnified them. The Court's rationale is quite clear and self-explanatory:

It is not an irrelevant consideration in this regard, that the owner of the property is under no obligation to have it insured. It is purely a

11. 118 U.S. 468, 6 S. Ct. 1150 (1886).

12. *Id.* at 493-502, 6 S. Ct. at 1156-61.

13. The Court first looked to the Limitation Act, which was then only 35 years old. The Court noted: "The statute, section 4283, declares that the liability of the owner shall not exceed the amount or value of his interest in the vessel and her freight . . ." *Id.* at 493, 6 S. Ct. at 1157. *See also supra* note 2.

14. *City of Norwich*, 118 U.S. at 494, 6 S. Ct. at 1157.

matter of his own option. And being so, it would seem to be only fair and right, and a logical consequence, that if he chooses to insure, he should have the benefit of the insurance. He does not take the price of insurance from the thing insured, but takes it out of the general mass of his estate, to which his general creditors have a right to look for the satisfaction of their claims. They are the creditors who have the best right to the insurance.

Stress is laid upon the hardship of the case. It is said to be unjust that the shipowner should be entirely indemnified for the loss of his vessel, and that the parties who have suffered loss from the collision by the fault of his employees should get nothing for their indemnity. This mode of contrasting the condition of the parties is fallacious. *If the shipowner is indemnified against loss, it is because he has seen fit to provide himself with insurance. The parties suffering loss from the collision could, if they chose, protect themselves in the same way. In fact, they generally do so; and when they do, it becomes a question between their insurers and the shipowner whether they or he shall have the benefit of his insurance. His insurers have to pay his loss. Why should not the insurers of the other parties pay their loss?* The truth is, that the whole question, after all, comes back to this: Whether a limited liability of shipowners is consonant to public policy or not. Congress has declared that it is, and they, and not we, are the judges of that question.¹⁵

While the *City of Norwich* Court quite clearly held that insurance proceeds should not be part of, and thus should not increase the limitation fund,¹⁶ the issue became somewhat muddled in a 4-1-4 decision of the United States Supreme Court in *Maryland Casualty Co. v. Cushing*.¹⁷ In that case, the tugboat *Jane Smith*, while attempting to pass under a bridge over the Atchafalaya River in Louisiana, collided with a concrete pier and capsized. The owner and the charterer of the *Jane Smith* filed consolidated petitions to limit their liabilities. Representatives of the five deceased seamen brought, in the same federal district court, actions against the owner of the bridge and the liability underwriters of the owner and charterer of the *Jane Smith*. They argued they had the right to bring a direct action against the underwriter in addition to and separate from the limitation proceeding. In other words, they wished to recover from the owner and charterer of the *Jane Smith*, in the limitation proceeding, the value of the *Jane Smith* at the end of her voyage plus freight pending, and from

15. *Id.* at 495, 6 S. Ct. at 1157-58 (emphasis added).

16. *Id.* at 504, 6 S. Ct. at 1163.

17. 347 U.S. 409, 74 S. Ct. 608, 1954 A.M.C. 837 (1954) [hereinafter *Jane Smith*].

the underwriter directly the balance of their damages. These damages, they argued, should be limited only by the amount of the insurance policy.¹⁸

One can predict a response to this argument—limit the amount of insurance coverage to the amount of the insured's limitation fund and argue that the plaintiff could recover only one limitation fund. The district court granted a motion for summary judgment dismissing the suit against the underwriters on the rationale, *inter alia*, that allowing a direct action against the underwriters would "contravene the essential purpose expressed by the Act of Congress in a field already covered by [the Limitation] Act."¹⁹ The Fifth Circuit reversed on the theory that the district court had read the Louisiana direct action statute too restrictively. The appellate court reasoned that the statute was nothing more than a permissible regulation of insurance and was not in conflict with any substantive admiralty law.²⁰

In the United States Supreme Court, Mr. Justice Frankfurter, announcing the judgment of the Court and joined by Mr. Justice Reed, Mr. Justice Jackson, and Mr. Justice Burton, would have reversed the judgment of the Fifth Circuit and reinstated the district court opinion dismissing the direct action. They reasoned that the effect of the direct action would disturb the limitation proceeding. They viewed it as "a disturbing intrusion by a State on the harmony and uniformity of one aspect of maritime law."²¹

18. *Id.* at 409-11, 74 S. Ct. at 608-09, 1954 A.M.C. at 838-40.

19. *Cushing v. Texas & Pac. Ry.*, 99 F. Supp. 681, 684, 1951 A.M.C. 1878, 1883 (E.D. La. 1951).

20. *Cushing v. Maryland Casualty Co.*, 198 F.2d 536, 538-39, 1952 A.M.C. 1803, 1806-08 (5th Cir. 1952).

21. *Jane Smith*, 347 U.S. at 422, 74 S. Ct. at 615, 1954 A.M.C. at 847. The rationale expressed by these Justices reads as follows:

Of course, liability underwriters are not entitled to "limitation of liability" as that phrase is used as a term of art in admiralty. To state the issue in these terms is to misconceive it. The question is whether the Court is to disregard the effect of a direct action on the federal proceedings. The Louisiana statute, as applied to authorize suits against the insurers of shipowners and charterers who have instituted limitation proceedings, is a disturbing intrusion by a State on the harmony and uniformity of one aspect of maritime law. It is accentuated by the fact that the federal law involved is not a more or less ill defined area of maritime common law, incursion upon which need not be here considered, but an Act of Congress, well-defined and consciously designed, with detailed rules for its execution established by this Court.

"If the courts having the execution of [the Limitation Act] administer it in a spirit of fairness, with the view of giving to ship owners the full benefit of the immunities intended to be secured by it, the encouragement it will afford to commercial operations (as before stated) will be of the last importance: but if it is administered with a tight and grudging hand, construing every clause most unfavorably against the ship owner, and allowing as little as possible to operate in his favor, the law will hardly be worth the trouble of its enactment. Its value and efficiency will also be greatly diminished, if not entirely destroyed, by allowing its administration to be hampered and interfered with by various and conflicting jurisdictions."

Four Justices held the contrary view. Mr. Justice Black, Chief Justice Warren, Mr. Justice Douglas, and Mr. Justice Minton did not think insurance companies should be beneficiaries of the Limitation Act, which they considered a "shipowners' relief act."²² They viewed the application of the direct action statute in that case as a remedy Louisiana had provided for wrongful death due to a maritime tort. Somewhat emotional arguments stated that "[a]t one time insurance companies were commonly able to avoid payment of a single dollar on their policies whenever the insured was insolvent and therefore judgment-proof."²³ The Justices thought that "unless Congress has specifically forbidden states to protect seamen [through a direct action system], Louisiana's statute is valid and should be enforced."²⁴

The 4-4 tie was broken by Mr. Justice Clark. His position was characterized by Mr. Justice Frankfurter as follows:

[T]he direct action suits should not be permitted to impair the ship owner's and charterer's right to indemnification, but . . . the District Court [should be allowed] to adjudicate the liability of the [vessel owner] to the [plaintiffs] after the limitation proceeding has run its course.²⁵

Mr. Justice Clark agreed with the holding in *City of Norwich*—that "the owner of the ship has the same right to protect his investment in the ship by insurance against damage claims . . . as he has to protect his investment from damage to the ship itself."²⁶ He did not consider this view to benefit the shipowner at the expense of the families of the deceased seamen. He realized that, had the owner not purchased liability insurance, the claimants could not have recovered under any condition more than the value of the damaged vessel at the end of the voyage if the owner had no privity or knowledge of the cause of the collision.²⁷

Jane Smith did allow a direct action against the underwriters, but required the limitation proceeding to be completed before the direct action could be heard. As was later learned, if the insurance policy were worded so that the insurance coverage would be exhausted by payment of the limitation amount, nothing would be left to be paid in the direct action. In this way, the direct action has allowed the underwriter, rather than the legislature, to determine the amount of compensation to be received by plaintiffs.

Id. at 421-22, 74 S. Ct. at 615, 1954 A.M.C. at 847-48 (quoting *Providence & N.Y.S.S. Co. v. Hill Mfg. Co.*, 109 U.S. 578, 588-89, 3 S. Ct. 379, 386 (1883)).

22. *Id.* at 427, 74 S. Ct. at 620, 1954 A.M.C. at 851 (Black, J., dissenting).

23. *Id.* at 431, 74 S. Ct. at 620, 1954 A.M.C. at 854 (Black, J., dissenting).

24. *Id.* at 432, 74 S. Ct. at 620, 1954 A.M.C. at 855 (Black, J., dissenting).

25. *Id.* at 422-23, 74 S. Ct. at 615, 1954 A.M.C. at 848.

26. *Id.* at 424, 74 S. Ct. at 616, 1954 A.M.C. at 849 (Clark, J., concurring).

27. *Id.* (Clark, J., concurring).

The development of the relationship between the Limitation Act and direct action statutes continued to take place predominantly in the Fifth Circuit. The late Judge John R. Brown, former Chief Judge of the Fifth Circuit, has had a very great effect on the relationship, if any, between the Limitation Act and Louisiana's direct action statute.

*Ex parte Tokio Marine & Fire Insurance Co.*²⁸ was decided some nine years after the Supreme Court's *Jane Smith* decision. *Tokio Marine & Fire Insurance Co.* came before the Fifth Circuit because of what Judge Brown euphemistically called the "rivalry"²⁹ between two district courts within the Fifth Circuit. The matter arose out of a collision on the Mississippi River between a tanker and two adrift barges which had allegedly been inadequately secured by the owner of the servicing tug. The owner of the tug filed a petition for limitation of liability in the United States District Court for the Southern District of Texas. Subsequently, the tanker interests filed suit under Louisiana's direct action statute in the United States District Court for the Eastern District of Louisiana against the tug's underwriters. The tug's limitation proceeding in the Southern District of Texas precluded the tanker interests from filing suit against the tug or her owner, but did not preclude the tanker interests from filing suit against the tug's underwriters. The tanker interests petitioned the Fifth Circuit for writ of mandamus against the Texas judge before whom the tug's limitation of liability proceeding was pending. The petition asked that the judge be required to transfer the tug's limitation proceeding to the Eastern District of Louisiana where it could be consolidated with the tanker's proceeding against the tug's underwriters. The Fifth Circuit denied the petition.³⁰

The tug next petitioned the Fifth Circuit for writ of mandamus or prohibition to prevent litigation from proceeding in the Eastern District of Louisiana. The Fifth Circuit took "a practical view."³¹ Judge Brown reasoned that the denial of the petition to transfer the limitation proceeding from Texas to Louisiana meant the Texas proceeding should go forward. Judge Brown noted that the Texas proceeding involved the same facts as the Louisiana suit.³² Further noting that "the direct action insurer stands as a party-litigant in exactly the same shoes as the assured,"³³ Judge Brown stayed the Louisiana suit against the underwriters of the tug and her owners and operators until the limitation proceeding in Texas was concluded.³⁴ In doing so, however, Judge Brown did not decide whether the tug's underwriters were liable for plaintiff's damages that exceeded the limitation fund. Judge Brown wrote:

We ought not to muddy up those waters by attempting to divine what the Supreme Court might now say it might have meant by its 4-1-4

28. 322 F.2d 113, 1964 A.M.C. 308 (5th Cir. 1963).

29. *Id.* at 114, 1964 A.M.C. at 309.

30. *In re Humble Oil & Refining Co.*, 306 F.2d 567, 1964 A.M.C. 321 (5th Cir. 1962).

31. *Tokio Marine & Fire Ins. Co.*, 322 F.2d at 116, 1964 A.M.C. at 312.

32. *Id.*, 1964 A.M.C. at 313.

33. *Id.*

34. *Id.* at 117, 1964 A.M.C. at 314.

decision [in *Jane Smith*] until such time as it becomes certain that the question is really presented.³⁵

In *In re Independent Towing Co.*,³⁶ a limitation of liability proceeding, the district court held the Louisiana direct action statute deprived insurers of the insured's personal defenses. The court reasoned that limitation of liability was "personal" to shipowners and, therefore, was not available to their insurers.³⁷ It denied assertion of limitation of liability by the shipowner's liability insurer. Of course, the district court struggled with the concerns expressed in *Jane Smith* and *Tokio Marine & Fire Insurance Co.* While admitting that certain procedural problems could arise,³⁸ the court nevertheless forged ahead and denied insurers the benefit of limitation of liability.

The personal defense theory was subsequently endorsed in *Torres v. Interstate Fire & Casualty Co.*³⁹ In that case, the United States District Court for the District of Puerto Rico followed *Independent Towing Co.* It denied the insurer the opportunity to rely on limitation of liability, reasoning that Puerto Rico should give the same construction to its direct action statute⁴⁰ as Louisiana courts gave to Louisiana's statute because the Puerto Rico statute was modeled after Louisiana's.⁴¹

The personal defense theory then went before the Fifth Circuit and withstood the challenge of Judge Brown. The issue in *Olympic Towing Corp. v. Nebel Towing Co.*⁴² was the very issue which had not been decided in *Tokio Marine & Fire Insurance Co.*

The underlying facts were simple. While attempting to avoid collision with Nebel's tug, Olympic's tug struck an underwater object and sank. Olympic brought suit against Nebel and, pursuant to the Louisiana direct action statute, Nebel's insurer. Nebel thereafter petitioned for limitation of liability under the Limitation Act. The district court held Nebel was entitled to limit its liability, but its insurer was not. It reasoned that the Limitation Act was a personal defense available only to the shipowner.⁴³

On appeal, Nebel's insurer made numerous arguments,⁴⁴ all of which the Fifth Circuit rejected. First, the insurer argued Louisiana's direct action statute was

35. *Id.* at 116, 1964 A.M.C. at 313.

36. 242 F. Supp. 950, 1965 A.M.C. 818 (E.D. La. 1965).

37. *Id.* at 954, 1965 A.M.C. at 824.

38. *Id.* at 956 n.13, 1965 A.M.C. at 827 n.13.

39. 275 F. Supp. 784 (D.P.R. 1967).

40. P.R. Laws Ann. tit. 26, §§ 2001-2004 (1977 & Supp. 1994).

41. *Torres*, 275 F. Supp. at 789.

42. 419 F.2d 230, 1969 A.M.C. 1571 (5th Cir. 1969), *cert. denied*, 397 U.S. 989, 90 S. Ct. 1120 (1970), *overruled by* *Crown Zellerbach Corp. v. Ingram Indus., Inc.*, 783 F.2d 1296, 1986 A.M.C. 1471 (5th Cir.), *cert. denied*, 479 U.S. 821, 107 S. Ct. 87 (1986).

43. *Id.* at 231-32, 1969 A.M.C. at 1572.

44. Among the arguments were two technical arguments related to jurisdiction and concursus of claims in admiralty. These arguments, both dismissed, will not be addressed in this article.

in conflict with the Limitation Act and, therefore, should fall before paramount federal law. The Fifth Circuit referred to *Jane Smith* and noted that the United States Supreme Court had not invalidated Louisiana's direct action statute.⁴⁵

Second, the insurer argued the shipowner would be deprived of the benefit of its insurance if funds were exhausted in direct action suits in other fora, especially state fora, before the conclusion of its limitation proceeding. The Fifth Circuit noted that the federal court sitting in admiralty had "ample injunctive power for the purpose of insuring the orderly and effective operation of the Limitation Act."⁴⁶

Third, the insurer contended that denying insurers the benefit of limitation of liability would result in higher premiums to shipowners and would undermine the purpose of the Limitation Act. The Fifth Circuit rejected this argument noting, *inter alia*, that spreading losses through higher premiums would be perfectly compatible with the Limitation Act because the benefit of the full recovery is often retained within the maritime industry, and because the Limitation Act was intended to limit the amount of premiums paid by shipowners on insurance.⁴⁷

Fourth, the insurer argued marine insurance was not subject to Louisiana's direct action statute. The Fifth Circuit dismissed this argument, noting it had already decided this issue.⁴⁸

Fifth, the insurer argued the nature of a protection and indemnity policy did not permit a direct action. The argument was founded on the indemnity, or the pay-to-be-paid, nature of shipowners' protection and indemnity coverage. The Fifth Circuit rejected that argument, which the court said was contrary to the underlying public policy of Louisiana—liability insurance is issued primarily for the protection of the public rather than the insured.⁴⁹

Finally, the insurer argued the right to limit liability is not a "personal defense" under Louisiana law and, therefore, should be available to the insurer. The Fifth Circuit explained that a "personal" defense attaches to the status because the law grants it to all members of a chosen class as a matter of public policy. The court noted the Limitation Act "was in no way intended to benefit the insurance industry."⁵⁰

After the Fifth Circuit rendered its decision, the appellants petitioned for rehearing. The petition was denied, but Judge Brown wrote a forceful dissenting opinion. Judge Brown argued the Louisiana direct action statute had been misconstrued. He argued the statute was not intended to create a new liability against the insurer, but "was intended merely to afford a direct, non-circuitous means of satisfaction of a claim judicially determined to be owing by the assured and which is within the limits and terms of the coverage afforded by the insurance

45. *Nebel Towing Co.*, 419 F.2d at 234, 1969 A.M.C. at 1575-76.

46. *Id.*, 1969 A.M.C. at 1576-77.

47. *Id.*, 1969 A.M.C. at 1578.

48. *Id.* at 236, 1969 A.M.C. at 1578-79.

49. *Id.* at 237, 1969 A.M.C. at 1579-80.

50. *Id.* at 238, 1969 A.M.C. at 1580-82.

policy."⁵¹ His view, Judge Brown argued, was founded and supported by the very language of Louisiana Revised Statutes 22:655, which at that time provided in part:

It is also the intent of this section that all liability policies within their terms and limits are executed for the benefit of all injured persons . . . and that it is the purpose of all liability policies to give protection and coverage to all insureds . . . for any legal liability said insured may have as or for a tort-feasor within the terms and limits of said policy.

Judge Brown further opined that treating the shipowner's right to limit his liability as a personal defense under Louisiana law was "completely wrong."⁵² He argued the right to limit liability was not one which inheres in the "person" of the shipowner and distinguished it from other personal defenses. He argued limitation was available not to all shipowners under any circumstances but "to a shipowner of a specific vessel under some circumstances."⁵³ Judge Brown's major concern was the effect the Louisiana treatment of limitation of liability would have on the uniformity of the admiralty principles.

Nebel Towing Co. came two years after a Fifth Circuit panel, which included Judge Brown, decided *Alcoa Steamship Co. v. Charles Ferran & Co.*⁵⁴ Perhaps Judge Brown, convinced *Alcoa Steamship Co.* represented the correct direction in which the law should move to preserve uniformity in admiralty, feared *Nebel Towing Co.* would play havoc.

Alcoa Steamship Co. discussed a ship repair contract and the contractor's liability insurance. The S.S. *Alcoa Corsair* underwent repair in New Orleans provided by C. Ferran & Co. Ferran carried liability insurance, limited to \$300,000; that limit was a term of the repair contract. The shipowner brought suit against the repair contractor on a negligence theory and, under Louisiana's direct action statute, against the contractor's liability insurance carrier for damages in excess of the \$300,000 policy limit.⁵⁵

The Fifth Circuit affirmed the district court's holding that the contractor and its insurer were liable, but limited their liability to the \$300,000 policy limit. While acknowledging that a "personal defense" would not have been available to the insurer, the Fifth Circuit explained that a "limitation of liability agreed to by parties in relatively equal bargaining positions does not fall into that category [of personal defenses]."⁵⁶

Following *Alcoa Steamship Co.*, Judge Brown may have thought courts would stay the course and preserve uniformity in admiralty. Thus, the majority

51. *Id.* at 240 (Brown, C.J., dissenting from a denial of rehearing).

52. *Id.* at 243 (Brown, C.J., dissenting from a denial of rehearing).

53. *Id.* (Brown, C.J., dissenting from a denial of rehearing).

54. 383 F.2d 46, 1967 A.M.C. 2578 (5th Cir. 1967), *cert. denied*, 393 U.S. 836, 89 S. Ct. 111 (1968). The district court decision affirmed by the Fifth Circuit is located at *Alcoa S.S. Co. v. Charles Ferran & Co.*, 251 F. Supp. 823, 1966 A.M.C. 1029 (E.D. La. 1966).

55. *Alcoa S.S. Co.*, 383 F.2d at 48-49, 1967 A.M.C. at 2579-80.

56. *Id.* at 56, 1967 A.M.C. at 2592.

opinion in *Nebel Towing Co.* was, to Judge Brown, "completely wrong." The opportunity to correct the "wrong" came in 1984, fifteen years after *Nebel Towing Co. Crown Zellerbach Corp. v. Ingram Industries, Inc.*,⁵⁷ was argued before a panel of three Fifth Circuit judges including Judge Brown. The case concerned a collision by a tug-barge against a water intake structure on the Mississippi River above Baton Rouge, Louisiana, in heavy fog and rain. Suit was filed by the owner of the water intake structure against the tug owner and its protection and indemnity (P & I) insurers. The tug owner relied on the Limitation Act, and the P & I insurers relied on their policy limit. The district court limited the tug owner's liability, but held the P & I insurers liable for nearly \$2 million in excess of the tug owner's limitation, despite the terms of the P & I insurance contract which limited the dollar amount of the coverage to the amount to which the insured could limit his liability.⁵⁸

"Unable to find any valid distinction,"⁵⁹ the majority of the panel felt compelled to follow *Nebel Towing Co.* The majority said the insurer could not, under *Nebel Towing Co.*, reduce its liability solely on the basis of the ship-owner's statutory right to limit his liability. It viewed the insurer's argument as merely an "indirect" attempt to bring about the same result the *Nebel Towing Co.* court had expressly denied. The majority affirmed the district court's decision; the insurers had to pay more than \$2 million over and above the fixed liability under the insurance policy.

Judge Brown dissented. He argued in his thorough dissent that "there must be a legal liability on part of the assured for the insurer to have a direct action liability."⁶⁰ He reasoned that a provision of the policy which limited the insurer's liability was a separate issue to be distinguished from the statutory right *Nebel Towing Co.* addressed; a policy defense, as opposed to a statutory defense, could not be a personal defense.⁶¹

An application for rehearing en banc was made and the Fifth Circuit granted the request. In the en banc hearing,⁶² the Fifth Circuit not only reversed the district court's decision, but also overruled *Nebel Towing Co.* Judge Brown wrote for the court and adopted, in large part, his dissenting opinion from *Crown Zellerbach Corp. I.*

Judge Brown first reviewed the *Nebel Towing Co.* decision. He agreed the term of the P&I insurance policy which limited coverage to the sums the insured

57. 745 F.2d 995, 1986 A.M.C. 305 (5th Cir. 1984) [hereinafter *Crown Zellerbach Corp. I.*], *vacated en banc*, 783 F.2d 1296, 1986 A.M.C. 1471 (5th Cir.), *cert. denied*, 479 U.S. 821, 107 S. Ct. 87 (1986).

58. *Id.* at 997, 1985 A.M.C. at 306-07.

59. *Id.* at 998, 1985 A.M.C. at 309.

60. *Id.* at 1000, 1985 A.M.C. at 313 (Brown, C.J., dissenting in part).

61. *Id.* at 1002-05, 1985 A.M.C. at 319-21 (Brown, C.J., dissenting in part).

62. *Crown Zellerbach Corp. v. Ingram Indus., Inc.*, 783 F.2d 1296, 1986 A.M.C. 1471 (5th Cir.) (en banc) [hereinafter *Crown Zellerbach Corp. II.*], *cert. denied*, 479 U.S. 821, 107 S. Ct. 87 (1986).

had paid ran afoul of the Louisiana direct action statute.⁶³ But he disagreed with *Nebel Towing Co.*'s dictum that indicated limitation of liability was a defense personal to the shipowner and not available to the insurer.⁶⁴

Judge Brown made a simple and clear distinction between the underwriter's argument in *Nebel Towing Co.* and the underwriter's argument in the case before the court. In *Nebel Towing Co.*, the underwriter claimed it had a right to the *statutory limitation*. Here, the underwriter relied on the terms of its insurance coverage which happened to limit that coverage to the amount to which the insured could limit his liability.

This observation caused the majority in *Crown Zellerbach Corp. II* to frame the issue as follows:

Since there can be no question that Rule 8(i) is one of the ". . . lawful conditions of the policy or contract," it brings us face to face with the critical provision of the Louisiana Direct Action Statute that "any action brought hereunder shall be subject to . . . the defenses which could be urged by the insurer to a direct action brought by the insured"⁶⁵

Judge Brown explained that the policy limit at issue in *Crown Zellerbach Corp. II* could not be contrary to Louisiana law or to the public policy of the state. The supporting precedent was set forth in two Louisiana Supreme Court decisions.⁶⁶ The result reached in *Nebel Towing Co.* could not, however, stand in the face of that precedent:

The [direct action] statute does not purport to interfere with the right of an insurance company to limit the so-called coverage, "in any policy against liability," to "liability imposed upon him [the assured] by law," as this policy provides. An insurance company therefore, may—as the company did in this instance—limit the coverage, or liability of the company, to pay only such sums as the insured shall become obligated to pay by reason of the liability imposed upon him by law.⁶⁷

Judge Brown also saw no violation of public policy in the "wholesome economic principle" that the underwriters pay up to, but not beyond, the

63. The policy limited the insurer's liability to "such sums as the assured . . . shall have become legally liable to pay and shall have paid on account." *Id.* at 1299, 1986 A.M.C. at 1476.

64. *Id.*

65. *Id.* at 1300, 1986 A.M.C. at 1478 (quoting the Louisiana Direct Action Statute, La. R.S. 22:655 (1977 & Supp. 1994)).

66. *Burke v. Massachusetts Bonding & Ins. Co.*, 209 La. 495, 24 So. 2d 875 (1946); *Ruiz v. Clancy*, 182 La. 935, 162 So. 734 (1935).

67. *Crown Zellerbach Corp. v. Ingram Indus., Inc.*, 783 F.2d 1296, 1301, 1986 A.M.C. 1471, 1479-80 (5th Cir.) (quoting *Ruiz v. Clancy*, 182 La. 935, 941, 162 So. 734, 735 (1935)) (alteration in original), *cert. denied*, 479 U.S. 821, 107 S. Ct. 87 (1986).

assured's legal liability. As Judge Brown put it, "Whatever the assured is liable for, [the insurer] will pay, 100% in full with no discount, but no more."⁶⁸

Judge Brown also confronted *Nebel Towing Co.*'s personal defense theory. He referred to the *Alcoa Steamship Co.* district court's detailed analysis, and presumed the *Nebel Towing Co.* court must have been persuaded by that analysis. The district judge in *Alcoa Steamship Co.* had concluded that a defense was personal if the law granted it, as a matter of public policy, to all members of a class. The district judge in *Alcoa Steamship Co.* also reasoned that limitation of liability must be "personal" because it was granted to all shipowners.⁶⁹ The *Nebel Towing Co.* court had adopted that analysis in its entirety.⁷⁰

Judge Brown explained that some, but not all shipowners were allowed to limit. If the defense were personal, each member of an "identified" class would be allowed the defense. This distinction compelled the conclusion that limitation of liability was not a defense personal to the shipowner.⁷¹ Indeed, if anything were personal in character, Judge Brown wrote, the policy defense would be personal to the underwriters.⁷²

To be sure, there was a dissenting opinion, which asserted that insurance policies had been sold and their rates determined on the basis of *Nebel Towing Co.* While urging adherence to the *Nebel Towing Co.* holding that limitation of liability is a personal defense,⁷³ the dissenting opinion failed to explain why courts should continue to do so.

Since *Crown Zellerbach Corp. II*, two cases involving the Louisiana direct action statute and the Limitation Act have gone before the Fifth Circuit. One of the two, *Brister v. A.W.I., Inc.*,⁷⁴ was no more than an affirmation of *Crown Zellerbach Corp. II*. The *Brister* court observed, as one might anticipate, that the inclusion of so-called "Crown Zellerbach" clauses had become routine in marine insurance policies.⁷⁵

Most recently, *In re Magnolia Marine Transport Co.*⁷⁶ was before the Fifth Circuit. The underlying facts in *Magnolia Marine Transport Co.* were simple:

68. *Id.* at 1302, 1986 A.M.C. at 1480.

69. *Alcoa S.S. Co. v. Charles Ferran & Co.*, 251 F. Supp. 823, 830-31, 1966 A.M.C. 1029, 1058-60 (E.D. La. 1966), *aff'd*, 383 F.2d 46, 1967 A.M.C. 2578 (5th Cir. 1967), *cert. denied*, 393 U.S. 836, 89 S. Ct. 111 (1968).

70. *Olympic Towing Corp. v. Nebel Towing Co.*, 419 F.2d 230, 237-38, 1969 A.M.C. 1571, 1581-82 (5th Cir. 1969), *cert. denied*, 397 U.S. 989, 90 S. Ct. 1120 (1970), *overruled by Crown Zellerbach Corp. v. Ingram Indus., Inc.*, 783 F.2d 1296, 1986 A.M.C. 1471 (5th Cir.), *cert. denied*, 479 U.S. 821, 107 S. Ct. 87 (1986).

71. *Crown Zellerbach Corp. II*, 783 F.2d at 1303, 1986 A.M.C. at 1482.

72. *Id.*

73. *Id.* at 1305-06, 1986 A.M.C. at 1485-86 (Tate, J., dissenting). Judge Tate was joined by Judges Rubin, Politz, Johnson, and Williams.

74. 946 F.2d 350 (5th Cir. 1991).

75. *Id.* at 359.

76. 964 F.2d 1571 (5th Cir. 1992). *Magnolia Marine Transp. Co.* reversed *Magnolia Marine Transp. Co. v. Frye*, 755 F. Supp. 149, 1991 A.M.C. 1190 (E.D. La. 1991).

The master of one of two ships involved in a collision on the Mississippi River drowned as a result of the collision. Procedurally, however, *Magnolia Marine Transport Co.* was anything but simple. The widow of the drowned master sued her late husband's employer and Mississippi Marine, the owner of the vessel her late husband had commanded, in state court. She later joined Magnolia Marine, the owner of the other colliding vessel, and Magnolia's marine insurance underwriters. Magnolia petitioned to limit its liability in the federal district court, and the limitation proceeding stayed the state court action. The widow argued Magnolia's insurance contract, as worded, might not allow the insurers to limit their liability. Persuaded by the argument, the district court stayed the limitation proceeding to allow the state court to interpret the policy language. Magnolia and its underwriters urged the federal court that it, rather than the state court, should interpret the policy. They sought a declaratory judgment, and the declaratory judgment suit in the federal district court was consolidated with the limitation proceeding. Following the consolidation, the widow moved to dismiss the declaratory judgment suit.⁷⁷ The district court, relying on *Crown Zellerbach Corp. II*, determined it should interpret the insurance policy because interpretation of insurance policy language was "more properly a function of the limitation proceeding."⁷⁸ The widow appealed.

Among the issues before the Fifth Circuit was whether the Limitation Act afforded the underwriters of a shipowner a right of limitation. The court found no such statutory basis.⁷⁹ The court further found that a liability-term in a marine insurance policy did not give the underwriters standing under the Limitation Act to assert limitation defensively.⁸⁰ While noting that admiralty jurisdiction encompasses issues arising from marine insurance contracts, the court held federal courts had concurrent, not exclusive, jurisdiction over such matters with state courts. The Fifth Circuit held interpretation of Louisiana marine insurance contracts was a task for Louisiana's state courts.⁸¹ *Magnolia Marine Transport Co.* read *Crown Zellerbach Corp. II* restrictively and determined the insurer's right to limit its liability depends upon the terms of its contract of insurance.⁸²

Since the Supreme Court's *Jane Smith* decision, the relationship between limitation of liability and the direct action statute has continued to evolve. Without guidance from Congress or Louisiana's legislature, however, courts have had to devise solutions of their own.

The amount of compensation due injured parties in limitation situations seems to have been left in the hands of the insurer. If the P&I insurer relies only on the statutory right of its insured to limit, the injured parties will probably

77. *Magnolia Marine Transp. Co.*, 755 F. Supp. at 151, 1991 A.M.C. at 1191-92.

78. *Id.*, 1991 A.M.C. at 1193.

79. *Magnolia Marine Transp. Co.*, 964 F.2d at 1576.

80. *Id.*

81. *Id.* at 1576-77.

82. *Id.* at 1576-77.

have an unlimited amount of insurance available to them. If, on the other hand, the P&I insurer limits the amount of its coverage to coincide with the dollar value of its insured's limitation, the injured parties will only have that limited fund to pay for their injuries.

This semantic resolution of the problem does not seem satisfactory. If the Limitation Act causes a problem, it should be fixed rather than circumvented. David Steel, Q.C., pointed to faults of the United States Limitation Act in a paper he presented on September 27, 1994, in Cambridge, England.⁸³ Mr. Steel observed that "the greater the maritime catastrophe, the smaller the fund under current U.S. law."⁸⁴ Thus, the greater the injuries, the less each victim will be compensated.

It is obvious many judges simply do not like the Limitation Act and are willing to use avenues such as direct action statutes to circumvent it. This situation leaves neither the injured parties nor the shipowners with the predictability they deserve. Trying a limitation action in the United States is quite a gamble. The shipowners bear the burden of proving the cause of the catastrophe and the lack of the owner's privity and knowledge of that cause. If successful, a shipowner is liable only for the value of his ship at the end of the casualty voyage plus the freight earned on that voyage and an additional fund for personal injury and wrongful deaths of \$420 for each gross registered ton. If a ship were lost, the value of the ship would, of course, be zero. If the shipowner were not able to limit, he and his underwriter would be liable without limitation.

The United States Congress would be well advised to change the Limitation Act to take advantage of the finite but sizeable insurance available to pay injured parties.⁸⁵ On one hand, the United States should encourage investment in shipping and the availability of insurance by limiting a shipowner's liability to an amount he can insure for a reasonable cost. On the other hand, a reasonable amount should be available to pay injured parties. Both considerations could be met through a more certain limitation based on the tonnage of the ship plus, perhaps, an additional fund for each person injured or killed by the vessel.

Ratification and possible amendment of the 1976 Limitation Conference⁸⁶ could accomplish this purpose. The shipowner, her charterer, and others may limit their liabilities pursuant to the 1976 Limitation Conference unless the claimants bear the burden to show that the persons attempting to limit intentionally caused the catastrophe or that they acted recklessly with actual, subjective knowledge that the recklessness would probably cause damage. This limitation

83. David Steel, Q.C., *Ships Are Different: The Case for Limitation of Liability*, The David Underwood Memorial Lecture (Sept. 27, 1994). The lecture was organized by the Cambridge Academy of Transport and sponsored by the Swedish Club.

84. *Id.* at 2.

85. One needs only to look at the problems created by the Oil Pollution Act of 1990, 33 U.S.C. §§ 2701-2761 (Supp. V 1993), to realize insurance is finite.

86. See Official Records of the Int'l Conference on Limitation of Liability for Maritime Claims, London, November 19, 1976.

fund is based on the tonnage of the vessel, which does not decrease with the severity of the catastrophe.

The United States should work with the international maritime community to establish a satisfactory limit and should ratify whatever result is reached by these efforts.