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Torts

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TORTS

I. PRODUCTS LIABILITY

A. *State of the Art Evidence Admissible in Design Defect Cases*

In *Reed v. Tiffin Motor Homes, Inc.*,[1] the Fourth Circuit Court of Appeals held that, if presented with the issue, the South Carolina Supreme Court would permit the introduction of state of the art evidence to determine the existence of a design defect in a strict products liability suit.[2] Although the appeals court failed to define the term "state of the art,"[3] it held that evidence of this type would be relevant, although not conclusive, to a finding of strict liability.[4]

The plaintiffs in *Reed* were returning to their home in Flor-

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1. 697 F.2d 1192 (4th Cir. 1982).

2. *Id.* at 1196. As distinguished from negligence actions, strict liability suits do not require an inquiry into the defendant's due care. The theory of strict liability is outlined in the RESTATEMENT (SECOND) OF TORTS § 402A (1965) and accompanying comments. South Carolina legislatively adopted § 402A in S.C. CODE ANN. § 15-73-10 (1976), which provides:

> (1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer, or to his property, is subject to liability for physical harm caused to the ultimate user or consumer, or to his property, if
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> (a) The seller is engaged in the business of selling such a product, and
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> (b) It is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.
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> (2) The rule stated in subsection (1) shall apply although
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> (a) The seller has exercised all possible care in the preparation and sale of his product, and
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> (b) The user or consumer has not bought the product from or entered into any contractual relation with the seller.

Section 15-73-30 (1976) incorporates by reference the comments to § 402A.

3. The phrase "state of the art" has varied meanings. Courts may define the phrase as the latest technology, the most advanced technology available on the market, the most advanced technology available that is also economically feasible, or, technology that is customarily used by the industry. For discussions explaining the various meanings given the phrase "state of the art," see Robb, *A Practical Approach to Use of State of the Art Evidence in Strict Products Liability Cases*, 77 NW. U.L. REV. 1 (1982), and Spradley, *Defensive Use of State of the Art Evidence in Strict Products Liability*, 67 MINN. L. REV. 343 (1982).

4. 697 F.2d at 1197-98.

ida when the motor home in which they were traveling was struck by an automobile in South Carolina.[5] Upon impact, the motor home burst into flames. Plaintiffs filed suit in federal district court in South Carolina, seeking actual and punitive[6] damages from the vehicle manufacturer. The case was tried on a theory of strict liability.[7]

During trial, the defendant offered evidence of state of the art and the custom of trade to demonstrate that the design of the motor home's fuel system was not defective.[8] The plaintiffs objected, claiming that the proffered evidence was irrelevant in a strict liability case.[9] The trial judge overruled the objection, and

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5. *Id.* at 1195.

6. The South Carolina Supreme Court has not had occasion to decide whether punitive damages may be recovered in strict liability suits. 697 F.2d at 1195 n.1. Although the court in *Reed* maintained that it was not deciding the issue of whether punitive damages may be recovered in suits filed under a theory of liability without fault, *id.*, the court mentioned the possibility of punitive damages as another reason to admit state of the art evidence in design defect, strict liability cases. *Id.* at 1198. The court reasoned that the defendant's compliance with industry standards and state of the art in designing the motor home would be probative on the issue of the wantonness, willfulness, and maliciousness of the placement of the vehicle's fuel tank in the instant case. *Id.* For a discussion of the treatment of punitive damages in strict liability cases, see J. BEASLEY, *Products Liability and the Unreasonably Dangerous Requirement*, 651-70 (1981). Also, *see generally* Owen, *Problems in Assessing Punitive Damages Against Manufacturers of Defective Products*, 49 U. CHI. L. REV. 1 (1982); Note, *Punitive Damages in Strict Products Liability Litigation*, 23 WM. & MARY L. REV. 333 (1981); Note, *Punitive Damage Awards in Strict Products Liability Litigation: The Doctrine, the Debate, the Defenses*, 42 OHIO ST. L.J. 771 (1981).

7. 697 F.2d at 1195. The federal court was required to apply South Carolina law to settle the issue because jurisdiction was based on the diversity of the parties. *Id.*

8. *Id.* The defendant used the testimony of the defendant's president and the introduction of a number of motor home brochures to show that a large number of motor home manufacturers used a similar fuel system design. Brief of Appellee at 4.

9. The plaintiffs had also introduced evidence of industry standards and state of the art concerning fuel systems and the placement of fuel tanks in motor homes. The Reeds presented expert testimony comparing different designs and assessing the fire hazards associated with fuel tank placement. 697 F.2d at 1195 n.2. On appeal, the defendant maintained that the plaintiffs could not challenge their defensive use of state of the art evidence when the plaintiffs had placed the matter in issue. *See* Brief of Appellee at 10-16. The plaintiffs contended that they offered the evidence for the limited purposes of qualifying an expert witness, showing the feasibility of other fuel system designs, discrediting one of the defendant's expert witnesses, and establishing grounds for punitive damages. 697 F.2d at 1195. The appeals court concluded that, based on the plaintiffs' expert testimony showing knowledge of safety features within the industry, the jury could infer that Tiffin had designed a defective and unreasonably dangerous product not meeting industry standards and state of the art, *id.* at 1195 n.2. However, the court refused to hold that the plaintiffs' use of such evidence barred their claim. *Id.* at 1195.

the jury returned a verdict for the defendant from which the plaintiffs appealed.[10]

The Fourth Circuit Court of Appeals affirmed the lower court decision.[11] Although the South Carolina Supreme Court had not ruled on the admissibility of state of the art evidence in design defect products liability cases,[12] the appeals court predicted that the supreme court, following the majority of jurisdictions that have considered the matter, would allow the evidence.[13] In reaching this conclusion, the court relied on two recent South Carolina cases, *Claytor v. General Motors Corp.*[14] and *Young v. Tide Craft, Inc.*[15]

Reed focused on the cost-benefit analysis adopted by the supreme court in *Claytor*.[16] The court in *Claytor* stated that factors such as the product's usefulness and desirability, the cost of added safety, the likelihood and potential seriousness of injury, and the obviousness of potential damages must be balanced to determine whether a product's design is defective.[17] The appeals court cited *Young* for a design defect test based on consumer expectation.[18] *Young* relied on comments to the *Restatement (Second) of Torts* that support finding a product defective only if it was "dangerous to an extent beyond that which would be contemplated by the ordinary consumer who purchases it with the ordinary knowledge common to the community as to its

10. 697 F.2d at 1194.

11. *Id.* at 1194, 1200.

12. *Id.* at 1195.

13. *Id.* at 1196. The court in *Reed* cited Singleton v. International Harvester Co., 685 F.2d 112 (4th Cir. 1981); Bruce v. Martin-Marietta Corp., 544 F.2d 442 (10th Cir. 1976); Raney v. Honeywell, Inc., 540 F.2d 932 (8th Cir. 1976); Hoppe v. Midwest Conveyor Co., 485 F.2d 1196 (8th Cir. 1973); Welch v. Outboard Marine Corp., 481 F.2d 252 (5th Cir. 1973), and J. BEASLEY, *supra* note 6, at 393-410, in support of the admissibility of the evidence. The court in *Reed* rejected cases cited by the plaintiffs which banned the use of state of the art evidence, including Holloway v. J.B. Systems, Ltd., 609 F.2d 1069 (3d Cir. 1979); and Walker v. Trico Mfg. Co., 487 F.2d 595 (7th Cir. 1973). The court distinguished these cases on the ground that Pennsylvania and Illinois had adopted strict liability statutes which differed substantially from S.C. CODE ANN. § 15-73-10 (1976). 697 F.2d at 1197. For an extensive listing of cases on the use of state of the art evidence in design defect cases see Robb, *supra* note 3, at 11.

14. 277 S.C. 259, 286 S.E.2d 129 (1982). For a analysis of *Claytor*, see *Torts, Annual Survey of S.C. Law*, 35 S.C.L. REV. 184 (1983).

15. 270 S.C. 453, 242 S.E.2d 671 (1978).

16. 697 F.2d at 1196-97.

17. 277 S.C. at 265, 286 S.E.2d at 132.

18. 697 F.2d at 1197.

characteristics."[19] The court in *Reed*, reasoning that the *Claytor* cost-benefit test was "necessarily" relevant to the *Young* determination of consumer expectations,[20] concluded that state of the art evidence aided the jury in determining whether a product was unreasonably dangerous beyond the expectations of the ordinary consumer.[21] The court stated that it was compelled to uphold the lower court. The appeals court, however, maintained that while state of the art evidence is "necessary and probative,"[22] it is not conclusive as to the issue of liability.[23]

The court's determination that state of the art evidence is helpful in gauging consumer expectations may be questioned. Neither the court in *Reed*,[24] nor the South Carolina Supreme Court[25] has explained the meaning of the term "state of the art." If state of the art is defined as industry custom or standards, the evidence would be probative of consumer expectations. However, state of the art may also describe the most technologically advanced product developments,[26] which may be unavailable in the marketplace and, therefore, would not be within the knowledge of the ordinary consumer. A further criticism is that state of the art evidence deflects the focus of inquiry from the defendant's product to the conduct of other manufacturers in designing similar goods.[27] This shift appears to violate the mandate of South

19. 270 S.C. at 471, 242 S.E.2d at 680 (quoting RESTATEMENT (SECOND) OF TORTS § 402A comment i (1965)).

20. 697 F.2d at 1197.

21. *Id.*

22. *Id.*

23. *Id.* at 1197-98.

24. It is apparent, however, that the court means something more than industry custom alone. The court held that, "[S]tate of the art *and trade customs* are relevant in helping the jury make a determination of whether the product is unreasonably dangerous when used in a manner expected by the ordinary consumer in the community." 697 F.2d at 1197 (emphasis added).

25. Because there have been few decisions by the court in the area of products liability since the legislature adopted strict liability in tort in 1976, the South Carolina Supreme Court has not had occasion to explain what is meant by the term "state of the art." Major products liability decisions such as *Young*, *Claytor*, and the recent case of Schall v. Sturm, Ruger Co., 278 S.C. 646, 300 S.E.2d 735 (1983), provide no guidance concerning the court's interpretation of the term.

26. *See supra* note 3 and accompanying text.

27. A widely quoted opinion espousing this view is Bailey v. Boatland of Houston, Inc., 585 S.W.2d 805 (Tex. App. 1979), *rev'd*, 609 S.W.2d 743 (Tex. 1980). The Texas Court of Civil Appeals held that the use of state of the art evidence of boat-stopping safety switches would emasculate the doctrine of strict products liability and lead to a

Carolina legislation allowing the defendant to be held strictly liable even when all possible care has been exercised in the preparation and sale of the product.[28] Such comparisons of conduct arguably return the court to a negligence analysis.

In *Schall v. Sturm, Ruger Co.*,[29] a case decided after *Reed*, the South Carolina Supreme Court made clear that negligence and strict liability theories are not to be blended in South Carolina. The court in *Schall* stated that an "entirely new species of action came into being" in South Carolina when the legislature adopted strict liability in tort.[30] The supreme court interpreted the legislation as a rejection of "hybrid" versions of strict liability statutes that combine elements of warranty or negligence with strict liability.[31] Insofar as *Reed* injects elements of negligence analysis into a strict liability suit, it may, in light of *Schall*, have been wrongly decided.

Despite its analytical problems, *Reed* can be supported. If state of the art is defined as industry custom or standards, the evidence may aid the trier of fact in determining consumer expectations.[32] A jury may also find that an ability to apply empirical evidence, such as conduct, makes the test easier to understand. Certainly, a clearly defined and comprehensible test of liability will assist manufacturers and sellers in predicting the costs of foreseeable injuries associated with new products. The ability to predict these costs would permit the seller to alter the product's design or to obtain adequate insurance before marketing the product.

Even if state of the art is defined as the most advanced technology in existence, this evidence may be helpful in deciding whether to hold the defendant strictly liable. The trier of fact may decide that the imposition of strict liability is unreasonable if the feature which would have made the product's design safer

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return to a negligence analysis. *Id.* at 809. The Texas Supreme Court disagreed with the appeals court's analysis and ruled that state of the art evidence was properly admitted during the trial. 609 S.W.2d at 745.

28. *See supra* note 2.

29. 278 S.C. 646, 300 S.E.2d 735 (1983).

30. *Id.* at 648, 300 S.E.2d at 736.

31. *Id.* at 649, 300 S.E.2d at 736.

32. For a discussion of the considerations affecting what test of liability to apply, see generally Hubbard, *Efficiency, Expectation, and Justice: A Jurisprudential Analysis of the Concept of Unreasonably Dangerous Product Defect*, 28 S.C.L. REV. 587 (1977).

was not in existence when the product was sold.[33] One commentator suggests that courts that refuse to allow evidence of the existing state of technical knowledge improperly extend the doctrine of strict liability to one of absolute liability.[34]

Reed is persuasive but not controlling authority for the South Carolina Supreme Court. Defendants may argue the *Reed* approach to the admissibility of evidence should be adopted because state of the art evidence would facilitate the determination of whether a product's design is unreasonably dangerous. Plaintiffs may be expected to urge that the supreme court reject the Fourth Circuit analysis as contrary to legislative intent and to policy arguments contained in the recent supreme court decision of *Schall v. Sturm, Ruger Co.*

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B. Inapplicability of Strict Liability Statute to Products Entering Market Before Statute's Enactment

Sellers who placed defective products into the stream of commerce before July 9, 1974, will not face suit under South Carolina's strict products liability laws. The South Carolina Supreme Court held that no cause of action in strict liability exists if the product entered the market prior to the enactment of South Carolina's strict liability statute,[35] even if that product causes injury after the statute's effective date.[36] The supreme court is among the first of the state courts to address the retroactivity of a strict liability statute.

In *Schall v. Sturm, Ruger Co.*,[37] the plaintiff was injured in 1980 when he dropped a loaded revolver that was manufactured and sold in 1972.[38] The plaintiff filed suit against the gun manu-

33. *But see* Spradley, *supra* note 3, at 422-23. Spradley suggests that when the defendant in a design defect strict liability case is a manufacturer, the commercial unavailability of a safety device at the time his product was manufactured should not necessarily result in a finding of no liability. He suggests that such a rule might encourage manufacturers as a group to make a bare bones product and thus delay the development of safety features. *Id.*

34. *See* Robb, *supra* note 3, at 16.

35. S.C. CODE ANN. § 15-73-10 (1976)(text set out *supra* note 2).

36. 278 S.C. 646, 300 S.E.2d 735 (1983).

37. *Id.*

38. *See* Brief of Plaintiff at 2. The gun was purchased by the plaintiff in 1979. *Id.*

facturer in federal court under South Carolina's strict products liability statute.[39] The federal district court certified to the state supreme court the question of whether a cause of action exists under section 15-73-10 of the South Carolina Code when the product that produced the injury after the effective date of the statute was sold before the law was enacted.[40] The South Carolina Supreme Court answered the question in the negative.[41]

The supreme court explained its refusal to find a cause of action by defining strict liability. The court stated that "an entirely new species of action" was created by the General Assembly when it adopted strict liability in tort.[42] The legislature's decision to codify the *Restatement (Second) of Torts'* version of strict liability[43] was interpreted as a rejection of hybrid statutory forms that combine elements of warranty or negligence.[44]

The state's strict liability statute does not address when a cause of action arises.[45] The court determined that an analysis of the concept of liability without fault likewise failed to yield a time when liability may be said to exist.[46] The court noted that the operative events for a determination of liability are the date of sale, under warranty law, and the date of injury, under the law of negligence.[47] The court maintained, however, that any search for an operative event under strict liability would distort its unique nature.[48] Key to the court's refusal to isolate a single point in the sequence of events composing a strict liability cause

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39. S.C. CODE ANN. § 15-73-10 (1976).

40. *See* S.C. SUP. CT. R. 46(1), which provides in pertinent part:

> The Supreme Court in its discretion may answer questions of law certified to it by any federal court of the United States or the highest appellate court or an intermediate appellate court of any other state, when requested by the certifying court if there are involved in any proceeding before that court questions of law of this state which may be determinative of the cause then pending in the certifying court as to which it appears to the certifying court there is not controlling precedent in the decisions of the Supreme Court.

S.C. SUP. CT. R. 46(1).

41. 278 S.C. at 648, 300 S.E.2d at 735.

42. *Id.*, 300 S.E.2d at 736.

43. RESTATEMENT (SECOND) OF TORTS § 402A (1965). For a discussion of strict liability in tort, see W. PROSSER, HANDBOOK OF THE LAW OF TORTS (4th ed. 1971) §§ 75-81.

44. 278 S.C. at 649, 300 S.E.2d at 736.

45. S.C. CODE ANN. § 15-73-10 (1976)(text set out *supra* note 2).

46. 278 S.C. at 649, 300 S.E.2d at 736.

47. *Id.*

48. *Id.*

of action is the court's finding that, "Strict liability would best be analogized to a legal status: inchoate at the moment when the product leaves the seller's hands in a defective condition that is unreasonably dangerous; ripe for determination at the instant of injury; and fixed by action and final judgment."[49]

The court turned to policy considerations in resolving the timing question. In the absence of specific statutory provisions, or clear legislative intent to the contrary, the court stated it would follow the "well settled rule" in South Carolina that a statute may not be applied retroactively.[50] The court concluded that a cause of action based on strict liability does not exist in South Carolina if the injury-producing product entered the stream of commerce before July 9, 1974, the effective date of section 15-73-10.[51]

When the supreme court decided *Schall*, three other state supreme courts had addressed the question of whether plaintiffs should be permitted to file suit under strict liability statutes when a defective product sold before the law's passage produced a post-enactment injury.[52] The supreme courts of Arkansas[53]

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49. *Id.*

50. *Id.* at 650, 300 S.E.2d at 737. For cases cited by *Schall* that hold statutes may not be retroactively applied absent specific provision or clear legislative intent to the contrary, see Fidelity & Casualty Ins. Co. of New York v. Nationwide Ins. Co., 278 S.C. 332, 295 S.E.2d 783 (1982); Merchants Mut. Ins. Co. v. South Carolina Second Injury Fund, 277 S.C. 604, 291 S.E.2d 667 (1982); Boyd v. Boyd, 277 S.C. 416, 289 S.E.2d 153 (1982); Hercules, Inc. v. South Carolina Tax Comm'n, 274 S.C. 137, 262 S.E.2d 45 (1980); and Hyder v. Jones, 271 S.C. 85, 245 S.E.2d 123 (1978). The court's decision in *Schall* was perhaps foreshadowed by Hatfield v. Atlas Enter., Inc., 274 S.C. 247, 262 S.E.2d 900 (1980)(where an allegedly defective product was sold and had produced an injury prior to the effective date of § 15-73-10, the strict liability statute could not be applied retroactively). For a discussion of *Hatfield*, see *Torts, Annual Survey of S.C. Law*, 33 S.C.L. REV. 173-80 (1981).

51. 278 S.C. at 650, 300 S.E.2d at 737. A plaintiff injured by a defective product may still file suit under a theory of warranty. *See generally* S.C. CODE ANN. §§ 36-2-312 to -318 (1976)(South Carolina's U.C.C. provisions concerning warranty). Injured plaintiffs may also file suit under traditional common law negligence theories. Strict liability is an attractive theory for plaintiffs because it eliminates from negligence analysis the need to prove breach of a duty of due care and does away with the privity requirements of warranty law.

52. For a discussion of the problem of retroactive application of laws, see *generally* Schaefer, *Prospective Rulings: Two Perspectives*, 1982 SUP. CT. REV. 1-24; Munzer, *A Theory of Retroactive Legislation*, 61 TEX. L. REV. 425-80 (1982).

53. Forrest City Mach. Works, Inc. v. Aderhold, 273 Ark. 33, 616 S.W.2d 720 (1981). The court in *Forrest* found that the jury's verdict of negligence mooted the strict liability question. *Id.* at 41, 616 S.W.2d at 725. In dicta, however, the court indicated that the

and Maine[54] indicated they would permit such suits, while the supreme court of Georgia refused to allow the action.[55] In its decision the South Carolina Supreme Court rejected the reasoning of all three state courts.[56]

The Arkansas Supreme Court in *Forrest City Machine Works, Inc. v. Aderhold*[57] reasoned that the strict liability statute merely provided a new remedy for an existing claim.[58] The court concluded that there was no new substantive right to be applied retroactively.[59] The South Carolina Supreme Court refused to characterize section 15-73-10 as remedial in nature, and declared that a new cause of action was created when the strict liability statute was enacted.[60]

The Supreme Judicial Court of Maine, in *Adams v. Buffalo Forge Co.*,[61] permitted suit under the strict liability statute, determining that the plaintiff's cause of action did not arise until the defective product caused an injury.[62] Therefore, retroactivity was not at issue as the injury occurred after the statute's enactment. The Maine court noted that the sale of the product prior to the passage of the strict liability law was simply an event leading to the ultimate cause of action. The court observed: "All new laws, when applied, are applied to a state of affairs created by past events."[63]

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strict liability statute would be applicable, notwithstanding sale of the product prior to the statute's enactment. *Id.* at 42, 616 S.W.2d at 725.

54. Adams v. Buffalo Forge Co., 443 A.2d 932 (Me. 1982); Goodman v. Magnavox Co., 443 A.2d 945 (Me. 1982).

55. Wansor v. George Hantscho Co., 243 Ga. 91, 252 S.E.2d 623 (1979).

56. 278 S.C. at 649, 300 S.E.2d at 736.

57. 273 Ark. 33, 616 S.W.2d 720 (1981).

58. *Id.* at 41-42, 616 S.W.2d at 724-25.

59. *Id.* at 41, 616 S.W.2d at 725. The court explained that remedial statutes do not disturb vested rights or create new obligations but rather supply a new remedy to enforce existing rights. *Id.* at 42, 616 S.W.2d at 725 (quoting Harrison v. Matthews, 235 Ark. 915, 917, 362 S.W.2d 704, 705 (1962)). In addition, the Arkansas legislature had specifically stated that the strict liability statute was remedial in nature. *Id.* at 42, 616 S.W.2d at 725.

60. 278 S.C. at 648, 300 S.E.2d at 736.

61. 443 A.2d 932 (Me. 1982).

62. *Id.* at 942.

63. *Id.* at 942-43 (citing Whipple v. Howser, 291 Or. 475, 488, 632 P.2d 782, 790 (1981)). The court stated that legislation which readjusts rights and burdens is not unlawful merely because it upsets otherwise settled expectations, even though the effect of the law imposes a new duty based on past acts. 443 A.2d at 943 (citing Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 16 (1976)).

The court in *Schall* rejected the reasoning in *Adams*.[64] The court in *Adams* had held that the strict liability cause of action arises at the date of injury and therefore used that date to determine whether the statute was retroactively applied.[65] Without explaining its rationale, the South Carolina Supreme Court instead selected a point near the beginning of the relevant chain of events, the date the product was marketed, to determine retroactivity.[66]

The Georgia Supreme Court, in *Wansor v. George Hantscho Co.*,[67] also chose to measure retroactivity by the date the defective product was sold.[68] The Georgia court stressed that legislative enactment of strict liability in tort created a new cause of action in that state.[69] However, the court in *Schall* rejected the *Wansor* analysis as well.[70] Georgia's strict liability statute was held to differ substantially from section 15-73-10, as the Georgia statute appeared to be based upon a warranty theory.[71]

The South Carolina Supreme Court failed to provide policy reasons for its decision to use the defective product's marketing date as the first point in analyzing retroactivity. However, sound reasons support the choice. If a law altering liability is passed after a product is sold, the manufacturer has no opportunity to alter his previously sold products. The law cannot deter acts which have already taken place. The manufacturer would also be deprived of any opportunity to shift the cost of increased liabil-

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64. 278 S.C. at 649, 300 S.E.2d at 736.

65. 443 A.2d at 943.

66. 278 S.C. at 650, 300 S.E.2d at 737.

67. 243 Ga. 91, 252 S.E.2d 623 (1979).

68. *Id.* at 93, 252 S.E.2d at 625.

69. *Id.* at 92-93, 252 S.E.2d at 624-25.

70. 278 S.C. at 649, 300 S.E.2d at 736.

71. *Id.* In fact, the wording of the Georgia strict liability statute differs notably from the South Carolina statute:

> The manufacturer of any personal property sold as new property directly or through a dealer or any other person shall be liable in tort, irrespective of privity, to any natural person who may use, consume, or reasonably be affected by the property and who suffers injury to his person or property because the property *when sold* by the manufacturer was not *merchantable and reasonably suited to the use intended*, and its condition *when sold* is the proximate cause of the injury sustained.

GA. CODE ANN. § 51-1-11(b)(1)(1982)(emphasis added). *Compare* S.C. CODE ANN. § 15-73-10 (1976), set forth *supra* note 2.

ity to the marketplace.[72] Considerations of fairness are also important. The manufacturer, faced with a strict liability suit stemming from a product marketed several years before the statute's enactment, may find it difficult to construct a defense. The passage of time may make the gathering of evidence extremely burdensome.

Schall is an important contribution to products liability law in South Carolina. Of obvious impact is the supreme court's statement that no cause of action in strict liability exists if a defective product entered the marketplace before July 9, 1974. The decision is, however, significant not only for drawing a clear time line, but also for providing a theoretical characterization of strict liability.[73] Future litigants should note the court's emphasis that a strict liability claim will not be analyzed under warranty or negligence concepts. Theories of recovery and defense strategies should be tailored accordingly.

Mary Donne Peters

II. Right to Indemnity Where Indemnitor Is Liable in Strict Tort and Indemnitee Is Liable for Negligence

In *Stuck v. Pioneer Logging Machinery, Inc.*,[74] the South Carolina Supreme Court expanded the remedy of indemnity to include a right of indemnity from a strictly liable defendant to a defendant whose liability is founded on a theory of negligence. This case was one of first impression in South Carolina.

In January 1977, Stuck contacted Pioneer Logging Machinery concerning the purchase of mechanical harvesting equipment. Pioneer's salesman recommended that Stuck purchase a used Barko loader mounted on a used International truck. After Pioneer's agents drove this vehicle to Stuck's job site for a demonstration, Stuck purchased the equipment. On January 25, 1977, Stuck's employee drove the equipment for the first time. After being operated for less than a mile, the truck's rear axle assembly shifted, causing the driver to lose control of the vehicle and to collide with an approaching car. The collision killed the

72. *See generally* Munzer, *supra* note 52, at 426-444.
73. *See supra* note 49 and accompanying text.
74. 279 S.C. 22, 301 S.E.2d 552 (1983).

driver of the oncoming vehicle and seriously injured a passenger.

In a wrongful death action against Stuck, the jury returned a verdict against him.[75] Stuck then sought indemnification from Pioneer, alleging that the sole proximate cause of the accident was the defective condition of the truck.[76] His cause of action was founded upon statutory provisions regarding breach of an express warranty,[77] breach of an implied warranty of fitness for particular purpose,[78] and strict liability in tort.[79] The trial court found that, at the time of the accident, the truck was being used for its intended purpose, and that the truck was in an unreasonably dangerous and defective condition at the time of the sale.[80] Stuck's obligation to the decedent was based on his justifiable reliance on the representations and warranties of Pioneer regarding the condition of the vehicle.[81] Therefore, the parties were not joint tortfeasors, and Stuck was entitled to indemnity.[82]

The South Carolina Supreme Court, applying modern equitable principles,[83] held that Pioneer had an obligation to indemnify Stuck because Stuck was exposed to liability by the wrongful act of Pioneer in selling defective equipment in an unreasonably dangerous condition, and because Stuck did not join in this wrongful act.[84] The court further held that Stuck's failure to discover and correct the defects did not excuse Pioneer's breach.[85]

In ruling that Stuck and Pioneer were not joint tortfeasors,

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75. *Id.* at 23, 301 S.E.2d at 553.

76. *Id.*

77. *See* S.C. CODE ANN. § 36-2-313 (1976).

78. *See* S.C. CODE ANN. § 36-2-315 (1976).

79. *See* S.C. CODE ANN. § 15-73-10 (1976).

80. Brief of Respondent at 7-8.

81. *Id.*

82. 279 S.C. at 24, 301 S.E.2d at 553.

83. The court stated:

> According to equitable principles, a right of indemnity exists whenever the relation between the parties is such that either in law or in equity there is an obligation on one party to indemnify the other, as where one person is exposed to liability by the wrongful act of another in which he does not join.

279 S.C. at 24, 301 S.E.2d at 553 (citing 41 AM. JUR.2D *Indemnity* § 2 (1968); 42 C.J.S. *Indemnity* § 21 (1944)).

84. 279 S.C. at 24, 301 S.E.2d at 553.

85. *Id.* at 25, 301 S.E.2d at 553. *See also* RESTATEMENT (SECOND) OF TORTS § 402A comment n (1966).

the court reasoned that Stuck's action was not based on negligence, but rather on strict tort liability and breach of warranty.[86] This step was necessary to the court's analysis, since South Carolina follows the common law rule that no right of indemnity exists among joint tortfeasors.[87] This rule is premised upon the principle that "the Courts are not open to wrongdoers to assist them in adjusting the burdens of their misconduct, and that the law will not lend its aid to one who founds his cause of action on a delict."[88] Therefore, the court reasoned that it was not overruling any established principles.

In *Atlantic Coast Line Railroad v. Whetstone*,[89] the leading case prior to *Stuck*, the right to indemnity was barred because both parties were found to be negligent to some degree. Stuck avoided this bar by basing his action against the defendant on the theories of strict tort liability and breach of warranty. Therefore, a more equitable result followed. Even though Stuck had been found negligent in the wrongful death suit, the two parties in the indemnity action were not joint tortfeasors and a right of indemnity existed. The conclusion emerging from *Stuck* is that a party which has been adjudged negligent should, when seeking indemnity, plead a theory other than the negligence of the indemnitor.

The court in *Stuck* placed great weight on the decision in *South Carolina Electric & Gas Co. v. Utilities Construction Co.*[90] In that case the defendant, an independent contractor, en-

86. 279 S.C. at 24, 301 S.E.2d at 554.

87. The leading case on this point is Atlantic Coast Line R.R. v. Whetstone, 243 S.C. 61, 132 S.E.2d 172 (1963). *Whetstone* arose when an employee of the railroad was injured while riding on the front of a tank car which struck a scaffold erected by the defendant. The employee filed a claim against the railroad under the Federal Employers' Liability Act (FELA), 45 U.S.C. §§ 51-60 (1976). After settling the employee's claim, the railroad asserted that it was entitled to indemnity from the defendant upon the theory that the employee's injury was directly and proximately caused by the defendant's "active gross negligence and carelessness," 243 S.C. at 66, 132 S.E.2d at 174, in erecting and permitting the unlit and unmarked scaffold to remain too close to the railroad tracks. In rejecting this claim, the court held that no right of indemnity exists among joint tortfeasors. *Id.* at 68, 132 S.E.2d at 175. The court reasoned that since a finding of negligence is required to impose liability under the FELA, the railroad's settlement had effected an admission of negligence. *Id.* Therefore, the railroad had admitted that it was a joint tortfeasor and had no right of indemnity from the defendant. *Id.*

88. 243 S.C. at 68, 132 S.E.2d at 175 (citing 27 AM. JUR. *Indemnity* § 18 (1940)).

89. See discussion of factual background, *supra* note 87.

90. 244 S.C. 79, 135 S.E.2d 613 (1964).

tered into a written contract with the plaintiff, an electric company, to perform maintenance work on a sidewalk. The contract included an express provision whereby the contractor agreed to indemnify the electric company for any claims for damages arising out of the work performed by the contractor.[91] Due to the contractor's defective repairs, a pedestrian was injured in a fall. The electric company, which was liable to the pedestrian pursuant to a city ordinance,[92] settled the pedestrian's claim and then sought indemnification from the contractor under the express provision of the contract, and under a right of indemnity implied in law.[93] The defendant, contending that the electric company was negligent in failing to discover and correct the defect, argued that they were joint tortfeasors and, thus, no right to indemnity existed.[94] The court concluded that the parties were not joint tortfeasors since the plaintiff was negligent only through the imputation to it, by operation of law, of the negligence of the defendant, and upheld the indemnity claim by virtue of the express contractual provision.[95]

In both *Stuck* and *South Carolina Electric & Gas Company*, the indemnitee was liable to the injured party on some theory of imputed negligence.[96] This similarity suggests that the court's reliance on *South Carolina Electric & Gas Company* was well founded. *Stuck*, however, extends the basic theory of *South Carolina Electric & Gas Company* by allowing recovery even in the absence of an express indemnity provision. By granting recovery on the theory of an implied contract of indemnity, arising from breach of warranty and strict tort liability, *Stuck* raises the

91. The provision read, "The Contractor hereby agrees to indemnify and to hold the Company harmless from any and all claims for damages to persons and/or property arising out of or in any way connected with the performance of any work covered by this contract." *Id.* at 83, 135 S.E.2d at 614.

92. *Id.*

93. *Id.* at 84, 135 S.E.2d at 615.

94. *Id.* at 87, 135 S.E.2d at 616.

95. *Id.* at 90-91, 135 S.E.2d at 617-18. For a discussion of indemnity based on express contracts, see 41 AM. JUR. 2D *Indemnity* §§ 6-18 (1968); 42 C.J.S. *Indemnity* §§ 4-19 (1944).

96. In *South Carolina Electric & Gas Company*, the electric company's liability to the pedestrian was based upon a breach of a statutory duty. The only party at fault was the contractor, whose negligence was imputed to the electric company. The plaintiff in *Stuck* was found to be negligent in a wrongful death action. His negligence was based on the principle of *respondeat superior*, Brief of Respondent at 2, with the alleged wrong of his employee being imputed to him.

possibility of an implied contract for indemnification in every consumer transaction where the merchandise is not delivered in the condition represented before sale. The special legal relationship inherent in the sales transaction imposes certain duties on the seller which, if subsequently breached, permit an implied contract of indemnification to arise.[97]

An examination of other jurisdictions reveals a more liberal approach to the problem of indemnity among tortfeasors. Many of these decisions extend recovery to an indemnitee who is liable for actual negligence. In *Suvada v. White Motor Co.*,[98] the Supreme Court of Illinois entertained an indemnity action by the owners of a milk truck that collided with a bus, against the manufacturer of the truck's defective brake system. The defendant argued that the plaintiffs, by reason of their actionable negligence, were precluded from seeking indemnity. The court rejected this argument, stating that, "Plaintiffs' liability for damage to the bus and injuries to the bus passengers must, of course, be based on their negligence, as [defendant] suggests. It does not follow, however, that plaintiff's [sic] negligence will, as a matter of law, as [defendant] argues, prevent them from seeking indemnity from [defendant]."[99] Subsequent cases have reinforced the *Suvada* reasoning.[100]

The analysis used in *Suvada* may be the next stage in the

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97. For a general discussion of the theory of an implied contract of indemnification, see 41 AM. JUR. 2D *Indemnity* §§ 19-27 (1968); 42 C.J.S. *Indemnity* §§ 20-27 (1944).

98. 32 Ill. 2d 612, 210 N.E.2d 182 (1965).

99. *Id.* at 624, 210 N.E.2d at 188.

100. In Texaco, Inc. v. McGrew Lumber Co., 117 Ill. App. 2d 351, 254 N.E.2d 584 (1969), the plaintiff, which had settled a claim against it by a workman injured in a fall from defective scaffolding, sought indemnity from the lumber company that had supplied the scaffolding. While recognizing that the plaintiff had been negligent in failing to discover the defective plank, the court nevertheless allowed indemnity based on the policy considerations announced in *Suvada*. *Id.*, 254 N.E.2d at 588. The court reasoned that there was a strong public policy in favor of placing the economic burden on the party which places a product in the stream of commerce with the knowledge of its intended use, *id.*, and stated that this policy can even go to the extent of ignoring the indemnitee's fault. *Id.* at 357-58, 254 N.E.2d at 588.

Hawkeye Security Ins. Co. v. Ford Motor Co., 199 N.W.2d 373 (Iowa 1972), also relied on *Suvada*. A truck equipped with defective brakes collided with a farm tractor. A judgment obtained against the insured was satisfied by the plaintiff, Hawkeye, which then sought indemnity from Ford, the manufacturer of the truck. The court noted that since the plaintiff's action was based on strict tort liability, the insured's negligence in failing to discover the defect did not absolve Ford of liability in the indemnity action. *Id.* at 380.

evolution of the law in South Carolina. Because Stuck's negligence was based on imputed negligence, the court did not confront the *Suvada* situation where the indemnitee was guilty of actual negligence. The broad language in *Stuck*, suggesting that a failure to discover and correct defects does not defeat a claim to indemnity,[101] suggests, however, that the court would be inclined to overlook the indemnitee's actual negligence when the indemnitor is strictly liable. Since the doctrine of indemnity is an "all-or-nothing" remedy, this approach is more equitable, as it places the financial burden on the party actually responsible for initiating the injury. Indeed, public policy considerations justify the shift of the economic burden onto the party which has placed the defective product into the stream of commerce with knowledge of its intended use.[102]

Some legal authorities have suggested that the remedy of indemnity has been expanded to such an extent that contribution would be a more appropriate remedy.[103] The doctrine of contribution apportions the financial responsibilities among the multiple defendants according to their relative degrees of fault,[104] possibly eliminating the confusion over the technicalities of indemnity. Thus, the doctrine mitigates the harshness of the "all-or-nothing" indemnity remedy while maintaining the policy of placing the major responsibility on the more culpable party. Although a majority of the states have statutorily adopted the doctrine of contribution,[105] South Carolina has not.[106] Perhaps it is time for South Carolina to make an attempt to enact comparative fault legislation, thus bringing itself into line with

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101. 279 S.C. at 25, 301 S.E.2d at 553.

102. *See* RESTATEMENT (SECOND) OF TORTS § 402A comment c (1966).

103. *See generally* Oldham and Maynard, *Indemnity and Contribution Between Strictly Liable and Negligent Defendants*, 28 FED'N INS. COUN. Q. 139 (1978); Sales, *Contribution and Indemnity Between Negligent and Strictly Liable Tortfeasors*, 12 ST. MARY L.J. 323 (1980).

104. 18 AM. JUR. 2D *Contribution* § 1 (1965).

105. *See* Oldham and Maynard, *supra* note 103, at 145.

106. Contribution is entirely a creature of statute and exists in states that recognize the principle of comparative fault. W. PROSSER, HANDBOOK OF THE LAW OF TORTS 305-10 (4th ed. 1971). South Carolina once had a comparative fault statute, S.C. CODE ANN. § 15-1-300 (1976), that was declared to be unconstitutional because it applied only to those involved in automobile accidents. Marley v. Kirby, 271 S.C. 122, 245 S.E.2d 604 (1978).

the majority of states that follow more equitable principles.

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III. Bad Faith Refusal to Pay First Party Benefits

In *Nichols v. State Farm Mutual Automobile Insurance Co.*,[107] the South Carolina Supreme Court adopted a new cause of action in tort for an insurer's bad faith handling of a claim for first party benefits. The effect of this decision is to expand significantly the recoverable damages beyond those which have historically been available under a breach of contract theory. *Nichols* places South Carolina among the growing number of jurisdictions which have recognized this cause of action.[108]

The dispute arose after Nichols' automobile had been stolen from a parking lot. Although the car, which was insured against theft through State Farm, was later recovered, it had been badly damaged. After State Farm declined to pay the full claim for reimbursement, Nichols brought suit on two causes of action, breach of contract and bad faith refusal to pay first party benefits. The jury found for Nichols on both causes of action. The trial judge, however, reasoning that Nichols was not entitled to double recovery of actual damages under both the contract and tort actions, reformed the verdict. The judge struck the damages on the contract action but sustained the award on the tort ac-

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107. 279 S.C. 336, 306 S.E.2d 616 (1983).

108. The cause of action for bad faith refusal to pay first party benefits has been recognized in over 25 states. *Id.* at 339, 306 S.E.2d at 618. *See, e.g.*, Craft v. Economy Fire & Cas. Co., 572 F.2d 565 (7th Cir. 1978) (applying Indiana law); Phillips v. Aetna Life Ins. Co., 473 F. Supp. 984 (D. Vt. 1979); Escambia Treating Co. v. Aetna Cas. & Sur. Co., 421 F. Supp. 1367 (N.D. Fla. 1976); United States Auto. Assoc. v. Werley, 526 P.2d 28 (Alaska 1974)(dicta); Noble v. Nat'l Am. Life Ins. Co., 128 Ariz. 188, 624 P.2d 866 (1981); Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973); Grand Sheet Metal v. Protection Mut. Ins., 34 Conn. Sup. 46, 375 A.2d 428 (1977); Ledingham v. Blue Cross, 29 Ill. App. 3d 339, 330 N.E.2d 540 (1975), *rev'd on other grounds*, 64 Ill.2d 338, 1 Ill. Dec. 75, 356 N.E.2d 75 (1976); United States Fidelity v. Peterson, 91 Nev. 617, 540 P.2d 1070 (1975); Corwin Chrysler-Plymouth, Inc. v. Westchester Fire Ins. Co., 279 N.W.2d 638 (N.D. 1979); Kirk v. Safeco Ins. Co., 28 Ohio Misc. 44, 273 N.E.2d 919 (1970); Christian v. Am. Home Assur. Co., 577 P.2d 899 (Okla. 1978); Diamon v. Penn. Mut. Fire Ins. Co., 247 Pa. Super. 534, 372 A.2d 1218 (1977); Bibeault v. Hanover Ins. Co., 417 A.2d 313 (R.I. 1980); MFA Mut. Ins. Co. v. Flint, 574 S.W.2d 718 (Tenn. 1978); Anderson v. Continental Ins. Co., 85 Wis. 2d 675, 271 N.W.2d 368 (1978).

tion.[109] Attorney's fees were also awarded.[110]

The supreme court affirmed the adoption of the new cause of action, holding that an insured who can demonstrate bad faith or unreasonable action by the insurer in processing a claim under the insurance contract has stated a cause of action in tort.[111] As a result, the insured is no longer limited to contractual damages, but may recover all actual and consequential damages incurred.[112] If the insured can further demonstrate that the insurer's actions were willful or in reckless disregard of his rights, punitive damages are recoverable.[113]

While the court acknowledged that a plaintiff may elect to plead both contract and tort causes of action,[114] the court noted that where a jury finds in favor of the plaintiff on both causes of action, the verdict must be reformed to prevent double recovery of actual damages.[115] The court further held the statutory provision[116] for attorney's fees inapplicable to a tort action, and vacated the award.[117]

The court relied on the seminal case of *Gruenberg v. Aetna Insurance Co.*,[118] in which the Supreme Court of California first allowed an action in tort for bad faith refusal to pay first party benefits. Building upon California precedents that had established an insurer's duty to deal fairly and in good faith with an insured in a third party claim context,[119] the California court reasoned that the duty of the insurer to act fairly in the han-

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109. 279 S.C. at 339, 306 S.E.2d at 618.

110. 279 S.C. at 342, 306 S.E.2d at 620. The trial judge recognized that attorney's fees of up to $2,500 had long been authorized in breach of contract suits against insurers. *See* S.C. CODE ANN. § 38-9-320(1)(1976). The supreme court rejected this extension of award of attorney's fees to the tort action. 279 S.C. at 342, 306 S.E.2d at 620.

111. 279 S.C. at 340, 306 S.E.2d at 619.

112. *Id.*

113. *Id.*

114. The rationale for pleading both causes of action is that in the breach of contract suit, the plaintiff need only show that his claim is valid, whereas in the tort action the plaintiff must prove bad faith or unreasonable conduct. 279 S.C. at 340-41, 306 S.E.2d at 619. Thus, a jury may find for the plaintiff on the contract action, and the insurer on the tort action.

115. *Id.* at 341, 306 S.E.2d at 619.

116. S.C. CODE ANN. § 38-9-320(1)(1976).

117. 279 S.C. at 342, 306 S.E.2d at 620.

118. 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

119. *See, e.g.*, Crisci v. Sec. Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958).

dling of claims by third persons against the insured extended to first party claims.[120] The court considered the duty as one imposed by law, not arising from the contract itself.[121] Thus, the court held that the implied covenant of good faith and fair dealing which exists in every insurance contract subjects an insurer who unreasonably withholds first party benefits to tort liability.[122]

South Carolina precedent, commonly referred to as the "Tyger River Doctrine,"[123] has established an insurer's duty to deal fairly concerning third party claims. In *Tyger River Pine Co. v. Maryland Casualty Co.*,[124] the court held that an insurer's unreasonable refusal to settle within policy limits subjected it to tort liability. The court in *Nichols* considered its holding to be an extension of the Tyger River Doctrine.[125] The court's reasoning tracked the development of California law in *Gruenberg* concerning the similarity between first party and third party bad faith actions.[126]

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120. 9 Cal. 3d at 573, 510 P.2d at 1037, 108 Cal. Rptr. at 485.

121. *Id.* at 574, 510 P.2d at 1037, 108 Cal. Rptr. at 485.

122. *Id.*

123. *See* 170 S.C. 286, 170 S.E. 346 (1933).

124. *Id.* In *Tyger River*, an employee of Tyger River Pine Company suffered a permanent arm injury on the job. The Maryland Casualty Company insured the employer for employee claims of up to $5000. The employer promptly notified the insurer of the accident, but the insurer failed to start an investigation until seven months later. Although the employer urged the insurer to settle, stating that the employee was willing to settle for less than the policy limit, the insurer refused. Even after receiving a verdict of $7000, the employee offered to settle for $5000 but the insurer insisted upon appealing. The appeal was dismissed and the employer was compelled to pay the $2000 excess over the policy limit. The insurer was held liable for breaching its implied duty to act reasonably and in good faith in settlement negotiations and in defense of the insured. *Id.* at 293, 170 S.E. at 349.

125. 279 S.C. at 340, 306 S.E.2d at 619.

126. Several distinctions, however, remain between third party and first party bad faith actions. The former may derive from the standard indemnity policy's reserving to the insurer the exclusive right to defend any suit arising under the policy, and to investigate, evaluate, and settle claims or suits as it deems advisable. The insurer is under the implied duty to act in good faith in performing these tasks, and the insured is under the duty to cooperate with the company. The insured-insurer relationship creates a fiduciary obligation which is breached when the insurer fails to act in good faith as the agent of the insured. The insurer faces an inherent conflict between its own interest and that of the insured which it is representing when there is an action or claim against the insured for an amount in excess of the policy coverage and a corresponding offer to compromise the claim for an amount at or slightly below the policy limit. An insurer which rejects a reasonable settlement offer within the policy limits could be held liable for breach of the duty of good faith if it fails to give adequate consideration to the interests of the insured

The court, citing several public policy reasons for creating the new cause of action,[127] recognized the distinct advantages of a tort remedy over a contractual remedy. Under the contract action, an insurer might deny valid claims with impunity realizing that it will ultimately be liable only for the amount of the claim and possible attorney's fees.[128] If the insurer utilizes dilatory tactics, it might so exhaust insured's energy and resources as to cause him to abandon the claims or accept grossly inadequate settlements.[129] Also, during the period of dilatory tactics and ensuing litigation, the insurer benefits from the use of the insured's money.[130] The threat of a tort action would prevent such behavior on the part of the insurer since it may now be held liable for extra-contractual damages.

Until *Nichols*, South Carolina courts applied general rules of contract law to limit recovery to the face amount of the policy in actions by an insured to recover under his policy.[131] The basis for this limitation of damages was that an insurance policy was simply a contract to pay money.[132] Although it may be argued

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in rejecting the settlement offer. Myers, *Bad Faith: A Tort Expands to Protect the Insured*, TRIAL, March 1982, at 56.

The inherent conflict of interest does not exist in the same way in first party coverage where the insured seeks benefits directly payable under an insurance contract from his own insurance company. The insurer does not undertake to perform any other service for the insured and may unambiguously oppose the insured in seeking to deny all or part of the benefits under the policy. The risk of a judgment outside the policy limits does not exist in first party coverage cases. The insured is, however, no less injured by his insurance company's failure to act in good faith with him as he would be had the insurer unreasonably refused to settle with a third party. This practical consideration seems to be part of the reason underlying the court's expansion of the "Tyger River Doctrine."

127. The court noted that the insurance industry is affected with a public interest. 279 S.C. at 340, 306 S.E.2d at 619 (citing Hinds v. United Ins. Co. of America, 248 S.C. 285, 149 S.E.2d 771 (1966)). The court recognized that the insured ordinarily possesses no bargaining power or means to protect himself against unfair treatment by the insurer. 279 S.C. at 340, 306 S.E.2d at 619.

128. 279 S.C. at 340, 306 S.E.2d at 619.

129. *Id.*

130. *Id.*

131. *Id.*

132. This rule simply followed the common-law rule limiting damages for breach of contract that was established in Hadley v. Baxendale, 156 Eng. Rep. 145 (Ex. 1854). First, certain damages are recoverable as being contemplated by the parties since they naturally flow from the breach. Second, consequential damages are recoverable as being contemplated by the parties if the promissor, at the time of making the contract, knows or should know of special circumstances giving rise to those damages. The consequential damages which an insured might seek for the insurer's breach of an insurance contract would be for economic loss and/or emotional distress. Courts applying the rule of *Hadley*

that treating the insurance contract like any other contract provided certainty and stability to the law of insurance, some victims of the insurer's breach were unable to recover compensation for economic loss and the mental distress caused by the breach.

The concept of an implied covenant of good faith and fair dealing is not peculiar to insurance contracts.[133] In the insurance area, however, the implied-in-law duty of good faith and fair dealing was first applied in third party "duty to settle" cases because the breach resulted in monetary damages which were not recoverable from the insurer in an action on the insurance contract.[134] By contrast, in the first party cases, the insured could always maintain an action to enforce the contract. The insured, however, could not recover consequential damages proximately caused by the insurer's breach. The duty of good faith was thus extended to first party situations because insurance policies, not being ordinary commercial contracts,[135] involve a special fiduciary relationship arising from the insurer's traditional role as protector of its insured.[136] The expansion of recovery for economic loss and emotional distress under the tort cause of action appears to provide a more equitable means of dealing with the problem of an insurer's refusal to pay first party benefits.

The practitioner should be aware that other tort causes of action are available to recover extra-contractual damages for an insurer's bad faith refusal to pay first party benefits. First, several states permit recovery against an insurer on the basis of the independent tort of intentional infliction of emotional distress[137]

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v. Baxendale strictly would probably find damages for emotional distress not to be foreseeable at the time the contract was made. Also, the insured would be denied punitive damages under *Hadley v. Baxendale* since punitive damages are not contemplated when an insurance contract is made. Tornehl, *Insurer's Liability for Wrongful Refusal to Honor First Party Claims*, 29 FED'N INS. COUN. Q. 397, 399-400 (1979). *See generally* Zurek, *First Party Insurance: Claims, Practices and Procedures in Light of Extra-Contractual Damage Actions*, 27 DRAKE L. REV. 666 (1978).

133. *See* U.C.C. § 1-203 (1976)("[e]very contract or duty within this Act imposes an obligation of good faith in its performance or enforcement") and RESTATEMENT (SECOND) OF CONTRACTS § 231 (1981)("[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement").

134. 170 S.C. at 288-89, 170 S.E. at 347.

135. 279 S.C. at 340, 306 S.E.2d at 619.

136. *Id.*

137. *See, e.g.*, Fletcher v. W. Nat'l Life Ins. Co., 10 Cal. App. 3d 376, 89 Cal. Rptr.

if the insurer's conduct in processing a claim has been extreme and outrageous. Second, an action may also lie in fraud. If the insurer induces the insured to purchase the policy by misrepresenting the terms or benefits of the policy or the means of handling claims, an action for fraud in the inducement may be appropriate.[138] If, after a claim has been made, the insurer misrepresents its obligations under the policy in order to induce a reduced settlement or abandonment of the claim, fraud may also lie.[139] Under a theory of fraudulent inducement, some states, including South Carolina,[140] will allow the insured to recover damages in excess of the policy coverage.[141] The problem, however, in pursuing either of these two theories is the difficulty of proof.[142] However, even if the insurer's bad faith does not rise to either of these two causes of action, it may support an action for bad faith refusal to pay first party benefits.

One issue unresolved by the court in *Nichols* is the question of to whom the duty to act in good faith extends. This issue was partially answered by the court in the companion cases of *Richard E. Carter v. American Mutual Fire Insurance Co.*[143] (hereinafter *Carter I*) and *Diane Carter v. American Mutual Fire Insurance Co.*[144] (hereinafter *Carter II*). After the Carters' home had been damaged by fire, the insurer refused to compensate Mr. Carter, the policyholder, for the loss. The supreme court, in *Carter I*, relied on *Nichols*, holding that Mr. Carter had stated a

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78 (1970). *See also* RESTATEMENT (SECOND) OF TORTS § 46 (1965) which lists the following elements for the cause of action for intentional infliction of emotional distress:

(1) outrageous conduct by the defendant;

(2) the defendant's intention of causing or reckless disregard of causing emotional distress;

(3) the plaintiff's suffering severe or extreme emotional distress; and

(4) actual and proximate causation of the emotional distress by the defendant's outrageous conduct.

138. Tornehl, *supra* note 132, at 415.

139. *Id.*

140. *See* Corley v. Coastal States Life Ins. Co., 244 S.C. 1, 135 S.E.2d 316 (1964)(award of punitive damages in a contract action when the breach amounted to, or was accompanied by, a fraudulent act).

141. Tornehl, *supra* note 132, at 415.

142. *See* Ford v. Hutson, 276 S.C. 157, 276 S.E.2d 776 (1981) (intentional infliction of emotional distress); O'Shields v. S. Fountain Mobile Homes, Inc., 262 S.C. 276, 204 S.E.2d 50 (1974)(fraud).

143. 279 S.C. 367, 307 S.E.2d 225 (1983).

144. 279 S.C. 368, 307 S.E.2d 227 (1983).

cause of action for bad faith refusal by an insurer to pay first party benefits.[145] The court, however, in *Carter II* barred Ms. Carter's action for bad faith refusal of an insurer to pay first party benefits, holding that a mere contingent interest, such as an inchoate dower interest, in the insured property did not confer standing to bring an action for bad faith refusal to pay first party benefits.[146] The court stated that the action extended only to one who was a party to the policy or was a named insured under the policy.[147]

The court appears to rely on the contract to limit the tort cause of action. Most jurisdictions have approached this issue in a similar manner.[148] Perhaps the courts feel that a broad cause of action such as bad faith refusal to pay first party benefits should be limited by the language of the contract.

A related issue is the question of who may be held liable for breach of the duty to deal in good faith. The insurer is invariably a corporation, acting only through its agents and employees, raising a question about the duties imposed on or assumed by the insurer's agents and employees in performing their duties of employment. The corporate insurer is liable for the torts of its officers, agents and employees under the doctrine of *respondeat superior*.[149] In *Austero v. National Casualty Company of Detroit, Michigan*,[150] the court held that since the insurer's claims representative was not a party to the contract of insurance, he was under no personal duty to act in good faith or deal fairly

145. 279 S.C. at 368, 307 S.E.2d at 226.

146. 279 S.C. at 370, 307 S.E.2d at 227.

147. *Id.*

148. *See* Austero v. Nat'l Cas. Co. of Detroit, Mich., 62 Cal. App. 3d 511, 133 Cal. Rptr. 107 (1976), in which the insured under a disability policy was an attorney suffering from a disease that rendered him mentally incompetent. His wife, who was neither a named beneficiary nor an insured under the disability policy, filed a claim for disability benefits. When the insurer refused to pay policy benefits, the wife sued the insurer as guardian ad litem of her husband, and individually on her own behalf, seeking damages for breach of the implied covenant of good faith and fair dealing. The court held that the insurer's duty was owed solely to its insured and, possibly, to express beneficiaries of the policy. 62 Cal. App. 3d at 517, 133 Cal. Rptr. at 111. Since the wife in *Austero* was at most an incidental or remote beneficiary of the disability benefits, she had no cause of action against the insurer.

149. *See* 53 AM. JUR. 2D *Master and Servant* § 417 (1970); 3 C.J.S. *Agency* § 423 (1973).

150. 62 Cal. App. 3d 511, 133 Cal. Rptr. 107 (1976).

with the insured in adjusting losses.[151] The court stated that one who was not a party to the underlying contract may not be held liable for breach of the implied covenant of good faith.[152] Therefore, unless the agent becomes a party to the contract, only the insurance company may be held liable for breach of duty to deal in good faith.

The court in *Nichols* did not address the defenses available to an insurer who has been sued for bad faith refusal to pay first party benefits. Since both parties to an insurance contract are subject to the duty to act fairly and in good faith in performing their obligations under the contract, it might be argued that the insurer would be excused from the obligation to indemnify if the insured breached his obligations under the policy. The court in *Gruenberg* rejected such an approach, holding that the insurer's duty is unconditional and independent of the performance of the insured's contractual obligations.[153] Since the supreme court followed the *Gruenberg* analysis so closely in adopting this cause of action in South Carolina, it is likely that the court would similarly find that the non-performance by one party of its contractual duties cannot excuse a breach of the duty of good faith and fair dealing by the other party.

The insurer may, of course, refute allegations of bad faith by demonstrating that its denial of benefits was undertaken in good faith. For an insurer's decision to be made in good faith, it must be based on a knowledge of the facts and circumstances upon which the contested liability is predicated.[154] Such a defense can be justified only if the insurer has made an adequate investigation that revealed facts indicating a likelihood of success if the claim were litigated.[155] Therefore, a lack of reasonable diligence and the insurer's refusal to determine the extent of liability evidences bad faith.[156] Under such a test the insurer may still challenge debatable claims, being held liable only when it has intentionally withheld benefits without a reasonable basis.[157]

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151. *Id.* at 516, 133 Cal. Rptr. at 110.

152. *Id.*

153. 9 Cal. 3d at 578, 510 P.2d at 1040, 108 Cal. Rptr. at 488.

154. *See* Anderson v. Continental Ins. Co., 85 Wis. 2d 675, 692, 271 N.W.2d 368, 375 (1978).

155. *Id.* at 693, 271 N.W.2d at 377.

156. *Id.* at 692, 271 N.W.2d at 375.

157. *Id.* at 693, 271 N.W.2d at 377.

In reaching its decision in *Nichols*, the South Carolina Supreme Court has continued its liberal approach to consumer protection by recognizing a new cause of action in tort for an insurer's bad faith in handling a claim for first party benefits. This expansion of liability and the availability of consequential and punitive damages will have a profound impact on the insurance industry. This new cause of action will provide a measure of protection to individual policyholders in dealing with insurance companies. This protection was much needed since heretofore, many insurance transactions between an insurer and the insured were weighted heavily in favor of the insurer. The court has made a sound and well-reasoned decision in placing South Carolina among the growing number of jurisdictions recognizing this cause of action.

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IV. MALICIOUS PROSECUTION: A CONVICTION CONCLUSIVELY ESTABLISHES PROBABLE CAUSE

In *Deaton v. Leath*,[158] the South Carolina Supreme Court held that, in a malicious prosecution action, a conviction, even though subsequently reversed or set aside, conclusively establishes probable cause for the defendant's having brought the prior action. Absent a showing that the conviction was obtained through fraud, perjury or other undue means, it will serve as a defense in the malicious prosecution action. In this case of first impression in South Carolina, the supreme court followed the majority rule.[159]

The dispute preceding the malicious prosecution action arose when the Leaths had Deaton arrested and charged with trespassing and disorderly conduct. Found guilty by the trial court,[160] Deaton filed a notice of intent to appeal. As a result of

158. 279 S.C. 82, 302 S.E.2d 335 (1983).

159. The majority rule is as follows: "The conviction of the accused by a magistrate or trial court, although reversed by an appellate tribunal, conclusively establishes the existence of probable cause, unless the conviction was obtained by fraud, perjury or other corrupt means." RESTATEMENT (SECOND) OF TORTS § 667(1)(1977). *See also* W. PROSSER, HANDBOOK OF THE LAW OF TORTS 845-47 (4th ed. 1971).

160. After having waived his right to a jury trial, Deaton was convicted by the Myrtle Beach City Recorder. 279 S.C. at 84, 302 S.E.2d at 336. A recorder's court was a form

an equipment malfunction, a transcript of the proceedings below could not be furnished. Because of the malfunction, the court set aside Deaton's conviction. Upon retrial before a different judge, he was acquitted.

Deaton subsequently brought an action for malicious prosecution[161] against the Leaths, who moved for summary judgment on the ground that Deaton's initial conviction conclusively demonstrated their probable cause[162] for bringing the action. The motion was granted, and the supreme court affirmed on appeal.

In adopting the majority view that a conviction conclusively establishes probable cause, the court reasoned that, in determining the existence of probable cause, the inquiry is whether the malicious prosecution defendant had reasonable cause to believe the plaintiff guilty, and not whether the plaintiff was guilty or innocent.[163] The court asserted that an initial conviction necessarily indicates that the court had evidence before it which could convince a reasonable man of the accused's guilt.[164] In the absence of fraud in the original conviction, a subsequent reversal does not demonstrate a lack of probable cause, particularly where the ground for setting aside the conviction is a technical-

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of municipal court authorized under the former S.C. CODE ANN. § 14-25-920 (1976). The provisions pertaining to recorder's courts were repealed by 1980 S.C. Acts 480, effective January 1, 1981, which provided for a uniform municipal court system. Although S.C. CODE ANN. § 14-25-115 (1981) still allows the appointment of ministerial recorders, their judicial power has been curtailed.

161. To commence an action for malicious prosecution, the plaintiff must allege the following elements: (1) a criminal proceeding was instituted by the defendant against the plaintiff; (2) the prior proceeding terminated in favor of the plaintiff; (3) the defendant lacked probable cause for the proceeding; and (4) the defendant brought the proceeding for "malice," or for a primary purpose other than that of bringing an offender to justice. *See* Eaves v. Broad River Elec. Corp., 277 S.C. 475, 477, 289 S.E.2d 414, 415 (1932); RESTATEMENT (SECOND) OF TORTS § 653 (1977); W. PROSSER, HANDBOOK OF THE LAW OF TORTS 835 (4th ed. 1971). *See generally* Note, *Malicious Prosecution*, 33 S.C.L. REV. 317 (1981).

162. Probable cause for a criminal prosecution has been defined as a reasonable ground for suspicion, supported by circumstances sufficiently strong in themselves to warrant a prudent man in the belief that the party is guilty of the offense with which he is charged. W. PROSSER, HANDBOOK OF THE LAW OF TORTS 841 (4th ed. 1971). For an interpretation of the probable cause requirement in South Carolina, see Parrott v. Plowden Motor Co., 246 S.C. 318, 322, 143 S.E.2d 607, 609 (1977).

163. 279 S.C. at 84, 302 S.E.2d at 336 (citing Kinton v. Mobile Home Industries, Inc., 274 S.C. 179, 262 S.E.2d 727 (1980)).

164. 279 S.C. at 84, 302 S.E.2d at 336.

ity.[165] Concluding that the majority rule was a "well reasoned one,"[166] the court accepted it.

The court cited numerous decisions illustrating application of the majority rule,[167] including *Falkner v. Almon*,[168] a North Carolina case in which the malicious prosecution plaintiff had, as had Deaton, been convicted of trespass. In the ensuing appeal, the State, entered a nolle prosequi.[169] The plaintiff obtained a jury verdict in the subsequent malicious prosecution action. The court of appeals, however, reversed, holding that the original trespass conviction conclusively established probable cause.[170]

The court's reliance on *Falkner* is noteworthy in several respects. Application of the majority rule in nolle prosequi cases is not free from criticism. One inference arising from a prosecutor's decision to abandon an appeal is that the prosecutor, reviewing the merits of the case, decided that the evidence of probable cause or guilt beyond a reasonable doubt could not be sustained.[171] Invocation of the majority rule in such circumstances may seem unnecessarily harsh. Contrary authority, however, maintains that a malicious prosecution defendant should not be prejudiced by the prior actions of a public prosecutor over whom he has no control.[172] Application of the majority rule should, therefore, proceed. The court in *Deaton* did not have to resolve

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165. *Id.* at 85, 302 S.E.2d at 336.

166. *Id.* at 84, 302 S.E.2d at 336.

167. The majority cited Falkner v. Almon, 22 N.C. App. 643, 207 S.E.2d 388 (1974); Boxer v. Slack, 124 W. Va. 149, 19 S.E.2d 606 (1942); Ricketts v. J.G. McCrory Co., 138 Va. 548, 121 S.E. 916 (1924); and Georgia Loan & Trust Co. v. Johnston, 116 Ga. 628, 43 S.E. 27 (1902) in which the respective courts set forth the majority rule without a great deal of analysis.

168. 22 N.C. App. 643, 207 S.E.2d 388 (1974).

169. A nolle prosequi is a formal entry by the prosecuting officer in which he declares that he will not prosecute the case further. State v. Gaskins, 263 S.C. 343, 347, 210 S.E.2d 590, 592 (1974).

170. 22 N.C. App. at 645, 207 S.E.2d at 389.

171. *See* Lipford v. M'Collum, 19 S.C.L. (1 Hill) 82 (1833)(the filing of a nolle prosequi by a public prosecutor will, as a matter of law, be held as prima facie evidence of lack of probable cause). *But compare* White v. Coleman, 277 F. Supp. 292 (D.S.C. 1967)(discontinuation of prosecution through entry of nolle prosequi constitutes no evidence of want of probable cause).

172. *See* RESTATEMENT (SECOND) OF TORTS § 665(2)(1977). This theory recognizes that several different factors may influence a prosecutor to abandon an appeal. While a lack of probable cause may be one factor, it is possible that the crime may be only a minor violation, not warranting the expense of an appeal.

this debate. Arguably *Deaton* presented a more compelling case for the conclusive presumption of probable cause since the ground for setting aside the conviction was a technicality.[173] Use of the North Carolina precedent does, however, suggest that the court might be willing to invoke the majority rule in a context broader than that presented in *Deaton*.

The majority rule has received support from the United States Supreme Court. In *Crescent City Live-stock Landing and Slaughter-house Co. v. Butchers' Union Slaughter-house and Live-stock Landing Co.*,[174] the Court considered the effect in a malicious prosecution action of a guilty verdict that was later reversed. Quoting with approval Maine precedent[175] illustrating the majority rule, the Court remarked that the majority rule was "well grounded in reason, fair and just to both parties, and consistent with the principle on which the action for malicious prosecution is founded."[176]

Important public policy considerations underlie the majority rule. The Court in *Crescent City* stated that the rule was founded on the policy grounds of vindicating the dignity and authority of judicial tribunals and of according force and sanctity to judgments.[177] The Court reasoned that the integrity of the judicial system rested upon the invincible presumption that a judicial tribunal acted impartially and honestly.[178] Because the rule respected the verity of a previous court, and not of the parties involved, only fraud in procuring the prior judgment could defeat the conclusive presumption of probable cause.[179]

In addition to those policy grounds espoused in *Crescent City*, others can be offered. The basis for the majority rule may

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173. Chief Justice Lewis rejected the adoption of the majority rule. 279 S.C. at 85-87, 302 S.E.2d at 336-37. In the alternative he argued that, even if the majority rule is valid, the present case might constitute an exception to the majority rule. The Chief Justice reasoned that without a transcript there is no way to determine whether the conviction was obtained through fraud or perjury. *Id.* at 86-87, 302 S.E.2d at 337.

174. 120 U.S. 141 (1887).

175. "If there be a conviction before a magistrate having jurisdiction of the subject-matter, not obtained by undue means, it will be conclusive evidence of probable cause." Payson v. Caswell, 22 Me. 212, 226 (1842), *quoted in Crescent City*, 120 U.S. at 151.

176. 120 U.S. at 151.

177. *Id.* at 159.

178. *Id.* at 159-60.

179. *Id.* at 159.

lie in the disfavored status[180] of the malicious prosecution action. Courts believe that honest litigants should be encouraged to seek justice and should not be deterred by fear of a malicious prosecution action in return.[181] Public policy requires that citizens be shielded from the unrestricted verdicts of juries when those citizens initiate proceedings against others whose conduct they reasonably, albeit mistakenly, believe to be illegal.[182] The majority rule fulfills this policy objective by removing the question of probable cause from the hands of the jury.

In his dissent, Chief Justice Lewis advocated adoption of the more flexible minority rule that a conviction is only prima facie evidence of probable cause which the plaintiff may rebut.[183] Reasoning that a multitude of factors distinguish one reversal from another, he noted that some jurisdictions apply a different presumption to convictions depending upon the status of the convicting court.[184] He maintained that the majority's premise, that if a court proceeded to conviction it necessarily had evidence before it of guilt beyond a reasonable doubt, was conclusively refuted by previous decisions in which the court reversed convictions on the ground that no evidence at all existed to support the conviction.[185]

In support of the minority rule, Chief Justice Lewis cited *Chapman v. City of Reno*,[186] in which the malicious prosecution plaintiff, convicted by a non-record municipal court, was acquitted upon a trial de novo. The Nevada court reasoned that the minority rule was appropriate when the plaintiff is acquitted in a trial de novo in a court of record, on appeal from a conviction in a minor non-record court.[187] This was so because without a

180. W. PROSSER, HANDBOOK OF THE LAW OF TORTS 846 (4th ed. 1971).

181. *Id.* at 851.

182. Annot., 87 A.L.R.2d 183, 192 (1963).

183. 279 S.C. at 85-86, 302 S.E.2d at 336-37 (Lewis, C.J., dissenting).

184. 279 S.C. at 85, 302 S.E.2d at 337. Those minorty rule jurisdictions making distinctions based on the nature of the convicting court appear to rely on a type of due process argument that some inferior courts, for example, police courts or justices of the peace, do not afford the accused the same incentive to fully litigate the issue of guilt as a normal court of record would. *See, e.g.*, Hanser v. Bieber, 271 Mo. 326, 197 S.W. 68 (1917) (a conviction in police court, followed by reversal on appeal, is not conclusive evidence of probable cause when the police court's jurisdiction is limited to recovery of fines, penalties, and forfeitures for violations of city ordinances).

185. 279 S.C. at 86, 302 S.E.2d at 337.

186. 85 Nev. 365, 455 P.2d 618 (1969).

187. *Id.* at 369, 455 P.2d at 620.

record it is impossible to know what transpired in the court below, including evidence of fraud, perjury or undue means, the universally recognized exceptions to the majority rule.[188] The *Chapman* reasoning applies with full force to the situation in *Deaton*, in which there was also no transcript available. Chief Justice Lewis' well chosen authority points up the majority's failure to reconcile Deaton's acquittal upon retrial with the majority's flat assertion that the sole ground for setting aside his conviction was a technicality.

The difference between the majority and minority rules may largely be one of semantics. Since proceeding without probable cause will ordinarily constitute a fraud upon the court, thus avoiding invocation of the majority rule, the practical effect of the two rules may be the same.[189] The Supreme Court of Illinois similarly recognized that the difference between the two rules is more verbal than substantive.[190] The court observed, "That which is prima facie evidence of a fact may be overcome by contrary evidence, and a presumption which may be destroyed by evidence of fraud, false testimony, or other unfair or unlawful means is not conclusive."[191]

The conclusiveness of a prior guilty verdict, subsequently reversed, in a malicious prosecution action is an issue that has provoked two responses. In *Deaton*, the South Carolina Supreme Court adopted the majority rule, which has persuasive historical and public policy support. While the majority did not attempt to isolate its reasons for preferring one rule over another, this omission might have been prompted by the court's inability to draw discernible distinctions between two rules that, in practice, mean the same thing. Still the court has not considered the question whether the nonavailability of a transcript constitutes an exception to the majority rule. Perhaps, then, *Deaton* should be construed simply as a case of poor pleading. Future plaintiffs, with a foundation for alleging fraud, perjury, or other undue

188. *Id.*

189. W. PROSSER, HANDBOOK OF THE LAW OF TORTS 846 (4th ed. 1971).

190. McElroy v. Catholic Press Co., 254 Ill. 290, 294, 98 N.E. 527, 528 (1912).

191. *Id.*, 98 N.E. at 528-29.

means in the prior proceeding, should note the need to allege explicitly such factors in order to avoid the *Deaton* bar.

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