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INSURANCE LAW

I. A SIGNED INSURANCE LOAN RECEIPT DOES NOT BAR A FIRST-PARTY CLAIM

In *Ketterman v. South Carolina Farm Bureau Mutual Insurance Co.*[1] the South Carolina Court of Appeals held that an insured's signature on a loan receipt does not preclude the insured from seeking first-party benefits under the insurance contract if the loan receipt does not contain any language that prevents the insured from pursuing a claim against the insurer and the insured has not negotiated the draft or signed a release.

The loan receipt is a device whereby the insurer advances to the insured the full amount of a loss in the form of a loan that is repayable only to the extent of the insured's recovery from a responsible third party. The insurer retains the option to pursue potentially responsible parties and to exercise exclusive control over any such action.[2] Conversely, full payment to the insured ordinarily subrogates the insurer under equitable principles.[3] By using the loan receipt arrangement, the insured remains the real party in interest and the insurer may prosecute the action in the name of the insured.[4]

Most cases involving loan receipts concern either the responsible party's attempt to raise the insurer's payment as a bar to an action prosecuted by the insurer in the insured's name or the effect of a settlement between the insured and tortfeasor without the knowledge or consent of the insurer. In contrast, *Ketterman* presented a very un-

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1. 395 S.E.2d 187 (S.C. Ct. App. 1990).

2. *See* 44 AM. JUR. 2D *Insurance* § 1819 (1982).

3. *E.g.*, Frank B. Hall & Co. v. Vic Bailey Lincoln-Mercury, Inc., 298 S.C. 282, 284, 379 S.E.2d 892, 894 (1989) (per curiam).

4. *Ketterman*, 395 S.E.2d at 188-89; *see, e.g.*, Luckenbach v. W.J. McCahan Sugar Ref. Co., 248 U.S. 139, 145-49 (1918); Martin v. McCleod, 241 S.C. 71, 73-75, 127 S.E.2d 129, 130-31 (1962); *see also* Annotation, *Insurance: Validity and Effect of Loan Receipt or Agreement between Insured and Insurer for a Loan Repayable to Extent of Insured's Recovery from Another*, 13 A.L.R.3D 42 (1967). *But see* Note, *The Real Party Under Rule 17(a): The Loan Receipt and Insurers' Subrogation Revisited*, 74 MINN. L. REV. 1107 (1990) (collecting federal cases dealing with Rule 17(a) of the Federal Rules of Civil Procedure and arguing superiority of minority rule requiring insurers to bring actions in their own names); Boynton, *The Myth of the "Loan Receipt" Revisited Under Rule 17(a)*, 18 S.C.L. REV. 624 (1966) (arguing purpose of Rule 17(a) of the Federal Rules of Civil Procedure necessitates piercing loan receipt arrangements under certain circumstances).

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usual situation: an insured's claim for benefits under the policy after the insured signed a loan receipt.

In *Ketterman* the South Carolina Farm Bureau (the Farm Bureau) insured a chicken house owned by the Kettermans. The roof of the chicken house collapsed following a snowfall. The Farm Bureau investigated the claim and tendered a draft to Mr. Ketterman. The reverse side of the draft contained a release agreement. Mr. Ketterman never signed the release or negotiated the draft. However, Mr. Ketterman did sign a loan receipt. The court of appeals noted that the loan receipt "contain[ed] the standard language necessary to effectuate its purpose."[5] Specifically, the loan receipt stated that the amount of the draft was a loan repayable only to the extent of recovery from any third person liable for the loss. Further, the agreement authorized the Farm Bureau to control any claim Mr. Ketterman might have against potentially liable third parties.

When the parties failed to agree on the amount of damage to the chicken house, the Kettermans brought suit against the Farm Bureau for breach of an insurance contract and bad faith refusal to pay first-party benefits under an insurance contract. At trial the Farm Bureau argued that the loan receipt barred any recovery by the Kettermans. The trial judge rejected the argument and granted the Kettermans' motion to strike the defense. The jury returned a verdict against the Farm Bureau for actual and punitive damages. The Farm Bureau appealed.[6]

The court of appeals affirmed the decision of the trial court. The *Ketterman* court focused on the words of the agreement. The court noted that the loan receipt did not contain any language that precluded Mr. Ketterman from pursuing a claim against the Farm Bureau.[7] The court also noted that the loan receipt did not contain language releasing the Farm Bureau from any potential claim for additional benefits under the insurance contract.[8] The court held that these omissions, coupled with Mr. Ketterman's decision not to negotiate the draft or sign the release, rendered the Farm Bureau amenable to suit by Mr. Ketterman on the insurance contract.[9]

Decisions from other jurisdictions involving loan receipts sometimes state in dicta that when the insurer fails to establish the liability of another party or elects not to pursue a responsible party, the loan is

5. *Ketterman*, 395 S.E.2d at 189.

6. *Id.* at 188.

7. *Id.* at 189.

8. *Id.* Interestingly, the Farm Bureau adjuster handling the Kettermans' case testified that he did not consider the loan receipt a release. *Id.*

9. *Id.*

transformed into an absolute payment.[10] The *Ketterman* opinion properly avoided giving broad effect to this dicta. Upon closer inspection, it is apparent that those cases merely intended to express the obvious effect of a loan receipt transaction: absent recovery from a responsible third party, the insured owes nothing towards the "loan." In a sense, the "loan" becomes final. Partial payment does not, however, automatically release the insurer from a claim by the insured for additional contractual benefits.

In *Luckenbach v. W.J. McCahan Sugar Refining Co.*[11] the United States Supreme Court approved of the use of a loan receipt over the contention "that to treat it as if it were a loan, is to follow the letter of the agreement and to disregard the actual facts; and to give it effect as a loan is to sanction fiction and subterfuge."[12] The Court responded, "But no good reason appears either for questioning its legality or for denying it effect."[13] Insurers that use loan receipts have relied on *Luckenbach* and decisions from other jurisdictions that followed *Luckenbach*.[14]

Although the *Ketterman* court found that the loan receipt did not bar an action on the policy, courts should not read the opinion too broadly. The court focused on the language of the loan receipt at issue and attempted to give effect to the intent of the parties as expressed in the written agreement. The court's fact-specific analysis does not preclude an insurance company from agreeing with its insured that a payment evidenced by a loan receipt constitutes a complete discharge of the insurer's policy obligations. This result may be accomplished through language in a loan receipt or in a separate writing. If clearly and unambiguously expressed, courts should give effect to such an agreement.

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10. Luckenbach v. W.J. McCahan Sugar Ref. Co., 248 U.S. 139, 148 (1918); L.W.&P. Armstrong, Inc. v. The Mormacmar, 196 F.2d 752, 755 (2d Cir. 1952); Dejean v. Louisiana W.R.R., 167 La. 111, 118, 118 So. 822, 824 (1928); 44 AM. JUR. 2D *Insurance* § 1819 (1982).

11. 248 U.S. 139 (1918).

12. *Id.* at 148.

13. *Id.*

14. The *Luckenbach* Court applied federal common law pursuant to Swift v. Tyson, 41 U.S. 1 (1842), *overruled*, Erie R.R. v. Tompkins, 304 U.S. 64 (1938). The decision, therefore, did not bind state courts. However, a majority of jurisdictions, including South Carolina, chose to follow *Luckenbach*. Phillips v. Clifton Mfg. Co., 204 S.C. 496, 501-02, 30 S.E.2d 146, 148 (1944); *see* Boynton, *supra* note 4, at 628-29.