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Lorence H. Slutzky

ILLINOIS NATIONAL INSURANCE COMPANY v. ROSE: SUBSEQUENT INSOLVENCY OF AN INSURER AND ITS EFFECT UNDER AN UNINSURED MOTORIST PROVISION

INTRODUCTION

Insurance coverage under an uninsured motorist clause provides financial compensation to the innocent victim of an automobile accident in which the negligent party was either uninsured and financially unable to respond in damages, or the accident was a hit-and-run. The innocent party was recompensed by his own insurer under the terms of the insurance contract.

The General Assembly of Illinois, in 1963, amended the Insurance Act. The amended act[1] required that no policy of insurance would be issued or delivered in this state with respect to any motor vehicle garaged in this state unless coverage was provided up to the statutory requirement[2] against owners or operators of uninsured motor vehicles and hit-and-run motor vehicles.

In 1967, another amendment[3] was enacted which, among

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[1] ILL. REV. STAT. ch. 73, §755a (1963), *as amended*, ILL. REV. STAT. ch. 73, §755a (1) (1967).

> On and after the effective date of this amendatory Act of 1963, no policy insuring against loss resulting from liability imposed by law for bodily injury or death suffered by any person arising out of the ownership, maintenance or use of a motor vehicle shall be delivered or issued for delivery in this state with respect to any motor vehicle registered or principally garaged in this state unless coverage is provided therein or supplemental thereto, in limits for bodily injury or death set forth in Section 7-203 of the "Illinois Motor Vehicle Law", approved July 11, 1957, as heretofore and hereafter amended, for the protection of persons insured thereunder who are legally entitled to recover damages from owners or operators of uninsured motor vehicles and hit-and-run motor vehicles because of bodily injury, sickness or disease, including death, resulting therefrom, except that the named insured shall have the right to reject such coverage, and except that, unless the named insured requests such coverage in writing, such coverage need not be provided in or supplemental to a renewal policy where the named insured had rejected the coverage in connection with a policy previously issued to him by the same insurer.

[2] ILL. REV. STAT. ch. 95½, §7A-203 (1969).

In order for a motor vehicle insurance policy or bond to be effective in this state the statute provides minimum limits of coverage. The minimum limits of coverage are $10,000 to any one person killed or injured, $20,000 for any two persons killed or injured in any one accident, and not less than $5,000 because of injury or destruction of property.

[3] ILL. REV. STAT. ch. 73, §755a (2) (1967), *amending*, ILL. REV. STAT. ch. 73, §755a (1963).

> For the purpose of this coverage the term "uninsured motor vehicle" includes, subject to the terms and conditions of such coverage, a motor vehicle where on, prior to or after the accident date the liability insurer thereof is unable to make payment with respect to the legal liability of its insured within the limits specified in the policy because of the entry by a court of competent jurisdiction of an order of rehabilitation or

other things, expanded the term "uninsured motor vehicle" to include the situation where the negligent party's liability insurer becomes unable to indemnify its insured because of rehabilitation, liquidation or insolvency.[4] However, the amendment was to be applied prospectively only.[5]

Several insurers contracted, prior to the effective date of the prospective statute, to provide coverage for their insureds when they were the victims of a hit-and-run accident, or where the tortfeasor had no insurance coverage applicable at the time of the accident, or where a tortfeasor was insured but his insurer denied coverage. The issue in *Illinois National Insurance Company v. Rose*,[6] was whether coverage would be extended under the "denial of coverage" clause of such a policy where the negligent party's insurer becomes insolvent subsequent to the accident.

STATEMENT OF FACTS

On September 19, 1964, a collision occurred in Peoria, Illinois between an automobile owned and driven by John P. Rose and an automobile owned and driven by the alleged tortfeasor, Anna Jordan. On November 6, 1964, Rose and his wife Gertrude, a passenger in the car, commenced a negligence action against Jordan claiming damages in the amount of $7,500 and $45,000 respectively. An appearance was filed on December 31, 1964, on behalf of the alleged tortfeasor by an attorney for Bell Mutual Casualty Company, who thereafter failed to defend the lawsuit. A default judgment was entered.

Rose, on December 11, 1964, gave notice of claim to his insurer, the Illinois National Insurance Company, in compliance with the uninsured motor vehicle provision[7] of the policy issued

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liquidation by reason of insolvency on or after the accident date. An insurer's extension of coverage, as provided in this subparagraph, shall be applicable to all accidents occurring after the effective date of this Act during a policy period in which its insured's uninsured motor vehicle coverage is in effect. Nothing in this Section may be construed to prevent any insurer from extending coverage under terms and conditions more favorable to its insureds than is required hereunder.

The amendment was the direct result of a tremendous number of insurance companies going into receivership causing detrimental financial effect to innocent parties insured by those companies. *See*, Fitspatrick, Editorial Note, 54 ILL. B.J. 381-2 (1954).

[4] ILL. REV. STAT. ch. 73, §799 *et. seq.* (1967). A court of competent jurisdiction may order the director to take possession of the property, business and affairs, and take such steps towards removal of the causes and conditions which have made such proceedings necessary as may be expedient. He may then rehabilitate it or liquidate it depending upon the financial position of the company.

[5] ILL. REV. STAT. ch. 73, §755a (4) (1967), *amending*, ILL. REV. STAT. ch. 73, §755a (1963).

[6] Illinois Nat. Ins. Co. v. Rose, 93 Ill. App. 2d 329, 235 N.E.2d 675 (1968). (Hereinafter cited as *Rose*.)

[7] *Id.* at 330, 235 N.E.2d at 676 (1968).

by his insurer, alleging that "either the alleged tortfeasor . . . had no liability insurance or that it was being contested."[8] On September 9, 1965, Bell Mutual Casualty Company was declared insolvent.[9]

PROCEDURAL HISTORY

On March 24, 1967, a demand for arbitration was made with the American Arbitration Association on behalf of Rose against Illinois National Insurance Company, in accordance with the insured's policy.[10] Illinois National Insurance Company refused to submit to arbitration and filed suit for a declaratory judgment and an injunction to prevent Rose from further pursuing his demand for arbitration.[11]

THE TRIAL COURT'S DECISION

The trial court, after hearing argument and considering briefs of counsel, concluded that the tortfeasor was insured at the time of the accident but was denied coverage because of the subsequent insolvency of tortfeasor's insurer. The issue then was whether Rose, the innocent victim, could receive compensation under his own policy issued by Illinois National which provided coverage under the uninsured motor vehicle provision.

The policy issued by Illinois National defined "uninsured automobile" as follows:

> An automobile or trailer with respect to the ownership, maintenance or use of which there is in at least the amount specified by the Financial Responsibility Law of the State in which the insured automobile is principally garaged, *no bodily injury liability bond or insurance policy applicable at the time of the accident* with respect to any person or organization legally responsible for the use of such automobile, or with respect to which there is a bodily injury liability bond or *insurance policy applicable at the time of the ac-*

[8] Brief for Appellee at 11, *Rose*.

[9] *Rose*, 93 Ill. App. 2d at 330, 235 N.E.2d at 676 (1968). A recent report for the United States Department of Transportation rates Illinois as having the highest number of insolvent domestic insurers in the country. 1970, Dep't of Transp., Automobile Insurance and Compensation Study, *Insolvencies Among Automobile Insurers*, at 5, n. 1.

[10] Brief for Appellee at 13-14, *Rose*. The following provision is a standard bureau form used by a great many insurers including Illinois National:

> To pay all sums which the insured or his legal representative shall be legally entitled to recover as damages from the owner or operator of an uninsured automobile because of bodily injury, sickness or disease, including death, resulting therefrom, herein called 'bodily injury', sustained by the insured, caused by accident and arising out of ownership, maintenance or use of such uninsured automobile; provided, for the purpose of this coverage, determination as to whether the insured or such representative is legally entitled to recover such damages, and if so, the amount thereof, shall be made by agreement between the insured or such representative and the company or, if they fail to agree, by *arbitration*. (Emphasis added.)

[11] Brief for Appellee at 14, *Rose*.

cident but the company writing the same denies coverage thereunder.[12]

The trial court held that the subsequent insolvency of the tortfeasor's insurer was tantamount to denial of coverage under the policy issued by Illinois National. Thus, the court held that the uninsured motorist provision was applicable to the situation where tortfeasor's insurer becomes insolvent. Plaintiff's prayer for an injunction was denied.[13]

THE INSURER'S THEORY ON APPEAL

The plaintiff-appellant's theory of the case was based on a determination of the words "denial of coverage." Illinois National argued that "denial of coverage" was limited to affirmative acts of the tortfeasor's insurer based upon conduct of the insured tortfeasor.[14] Illinois National relied on the Pennsylvania Appellate Court's decision in *Pattani v. Keystone Insurance Company*,[15] which contained the exact same factual situation. The Pennsylvania statute[16] required all insurance companies issuing automobile liability insurance policies within the Commonwealth to provide, as part of the protection, coverage for the damages caused by uninsured owners and uninsured operators of motor vehicles. The Pennsylvania statute, identical to the Illinois statute,[17] failed to define uninsured motorist. However, the insurance policy in *Pattani I* contained an uninsured motorist clause identical to the one in the policy issued to Rose.[18] Simi-

[12] Brief for Appellee at 14, *Rose*. (Emphasis added.) Earlier bureau policies as in Dreher v. Aetna Casualty & Surety Co. 83 Ill. App. 2d 141, 143, 226 N.E.2d 287, 288 (1967) defined "uninsured motor vehicle" as follows:

> . . . an automobile with respect to the ownership, maintenance or use of which there is no bodily injury liability bond or insurance policy applicable *at the time of the accident* with respect to any person or organization legally responsible for the use of such automobile. . . . . (Emphasis supplied [by the court].)

That court specially held under the above definition of "uninsured motorist" that a person insured at the time of the accident does not become uninsured because his insurance company becomes insolvent; and such insolvency does not relate back to the time of the accident. In the later policies, as in *Rose*, the insurer voluntarily extended coverage to include an uninsured motor vehicle, one with respect to which a policy was applicable at the time of the accident but coverage under such policy was denied.

In the *Dreher* decision, the court recognized the significance of the phrase 'where the insured denies coverage thereunder.' It also noted that legislation had been proposed to alleviate the problem.

[13] Brief for Appellee at 15-16, *Rose*.

[14] Appellant's Brief at 12-13, *Rose*.

[15] Pattani v. Keystone Ins. Co., consolidated with Levy v. Keystone Ins. Co., 209 Pa. Super. 15, 223 A.2d 899 (1966), *rev'd sub nom*, Pattani v. Keystone Ins. Co. 426 Pa. 332, 231 A.2d 402 (1967); Levy v. Keystone Ins. Co. 426 Pa. 340, 231 A.2d 406 (1967).

Plaintiff-appellant relies on the appellate court decision, hereinafter referred to as *Pattani I;* defendant-appellee relies on the supreme court decision, hereinafter referred to as *Pattani II*.

[16] Laws of Pennsylvania, Act of August 14, 1963, P.L. 909, §1, 40 P.S. §2000.

[17] See note 1.

[18] See text at note 12.

larly, the tortfeasor was denied coverage because of his insurer's subsequent insolvency.

In *Pattani I,* the court reasoned that "in light of the reasons behind uninsured motorist coverage and especially the legislative concern which resulted in the Act of 1963, a liberal construction should be given to any such provision in an insurance policy."[19] Furthermore, any ambiguity in a contract of insurance is to be construed in favor of the insured and against the insurer.[20] However, the court could find no ambiguity in the contract and could not expand the definition of the uninsured motorist as provided in the contract of insurance to the facts of the case.[21] The court said, "denial of coverage means a rejection of the policyholder as an insured and a refusal to accord him the protection he contracted for. It does not mean inability to collect the full amount of the damages from the insurer."[22] The court declared that denial of coverage contemplates affirmative action by the insurance company and that a decree of liquidation by a court of competent jurisdiction or the appointment of a receiver is not affirmative action by the company denying coverage.[23] The court concluded by acknowledging the detrimental effect upon the innocent parties but added, "[A]ny broadening of the coverage provided by such insurance must . . . be the result of legislation

[19] *Pattani I,* 209 Pa. Super. 15, 19-20, 223 A.2d 899, 901 (1966).
[20] *Id.* at 19, 223 A.2d at 901.
[21] *Id.* at 20, 223 A.2d at 901.
[22] *Id.*
[23] *Id.*

An affirmative act may be defined as a wilful, deliberate or intentional act which expresses the quality of the conduct of the person guilty of the breach of contract. Corbin states that the above terms have seldom been defined in any meaningful way. 3A. CORBIN, CONTRACTS §707 (1960).

In a footnote Corbin refers to Commercial Discount Co. v. Town of Plainfield, 120 Conn. 274, 180 A. 311 (1935). In that case the court held that failure to complete performance because of an inability to obtain funds was not a wilful or affirmative act and therefore not a breach which would prohibit recovery of *quantum meruit.* Denial of coverage based upon the reasoning of the above cited case acquires greater meaning in light of this interpretation. The following cases seem to define those affirmative or wilful acts which fulfill the requirement of "denial of coverage" under the policy issued by Illinois National:

Carroll v. Preferred Risk Ins. Co., 60 Ill. App. 2d 170, 208 N.E.2d 801 (1966), held that failure of prospective applicant for insurance to disclose facts materially affecting the acceptance of the policy was a violation of the terms of the policy so that although insurer had accepted the policy, liability was disclaimed for failure of the condition of notice. This was an effective denial of coverage and was covered by the innocent victim's uninsured motorist provision as an effective denial of coverage.

In McDaniel v. State Farm Mut. Ins. Co., 205 Va. 815, 139 S.E.2d 806 (1965), plaintiff was allowed recovery under the uninsured motorist provision where tortfeasor's insurer denied coverage because of tortfeasor's failure to cooperate in the preparation for trial.

St. Paul Mercury Ins. Co. v. Am. Arb. Ass'n, 425 Pa. 548, 229 A.2d 858 (1967) held that where tortfeasor's insurer unequivocally indicated that it had denied coverage under the policy, this was sufficient to fulfill the uninsured motorist provision.

Buck v. United States Fidelity & Guar. Co., 265 N.C. 285, 144 S.E.2d

or contractual bargaining, and not by this court."[24]

Illinois National argued that it did not contract to be guarantor of every other insurance company, nor was it required by the statute then applicable.[25] The policy issued by Illinois National, it alleged, was designed to protect the insured from the occurrence of ordinary accidents equal to or in excess of the statutory limit (dependent on premiums paid), plus where the party at fault had no insurance at the time of the accident, or the party at fault was subject to a policy defense, for example, where coverage was denied because of some action by the insured.[26]

Illinois National noted that the policy issued to Rose was not a standard bureau policy.[27] The policy issued by Illinois National extended coverage to include incidents which fulfill the policy defense clause allowing tortfeasor's insurer to "refuse to recognize or acknowledge . . . responsibility"[28] or, in the policy's terms, "deny coverage" because of some failure of the insured to fulfill the terms of the policy. National argued that this did not contemplate insolvency of the insurer.

Finally, Illinois National argued that Rose at all times had total coverage in accordance with their contract.[29] Neither upon the payment of the premiums by Rose, nor upon the acceptance of that payment by Illinois National did either party contemplate or intend that the contract would protect the insured from insolvency of tortfeasor's insurer. Therefore, the contract does not permit the straining of plain and unambiguous language to create ambiguity where none exists as to the terms of the contract.[30]

THE INSURED'S THEORY ON APPEAL

In answer, the defendant-appellee's theory was based upon the legislative purpose of the 1963 Insurance Act[31] and a construction of the insurance policy to accomplish the objective enunciated by the public policy of the state.

Rose contended that the "obvious legislative purpose" of the

34 (1965) held that an employee who was driving his employer's vehicle without his knowledge, permission or consent was outside the scope of employment, therefore he was not an agent of the owner and was not covered by the employer-owner's policy and was an uninsured vehicle. The vehicle was insured but the unauthorized driver was not. This was held an uninsured vehicle for the purpose of collection under the uninsured motorist clause. Therefore, in this instance there was no coverage at the time of the accident.

[24] *Pattani I*, 209 Pa. Super. at 21, 223 A.2d at 902.

[25] Brief for Appellant at 9, 10, *Rose*.

[26] Brief for Appellant at 13, *Rose*.

[27] See note 12 *supra*.

[28] Appellant's Reply Brief at 5, *Rose*.

[29] Appellant's Reply Brief at 2, *Rose*.

[30] Appellant's Reply Brief at 7, *Rose*.

[31] ILL. REV. STAT. ch. 73, §755a (1963), *as amended*, ILL. REV. STAT. ch. 73, §755a (2) (1967).

1963 Act was to establish minimum financial responsibility coverage for protection of persons insured who are legally entitled to recover damages from the operators of uninsured vehicles because of bodily injury.[32] The public policy of the state and the meaning of the statute command that when the tortfeasor's insurance company fails to assume its responsibility under the existing contract between company and tortfeasor, that tortfeasor is an uninsured motorist. Rose argued:

> This public policy is based on the social problem inherent in the widespread, ever increasing use of the automobile and the consequent rise in automobile created injuries, which in turn, has induced legislation (sic) action, attempting to assure monetary compensation for those so injured and thus prevent many of these injured from becoming public charges due to expenses of medical and hospital care and family support during convalescence, and the period their lawsuit is pending.
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> . . . The statutory objective is not obtained by giving the insured a claim against an insolvent.[33]

Therefore, the injured person's insurance carrier should provide substitute coverage as it contracted for under its uninsured motor vehicle provision as required by statute. Counsel for Rose asked, "what 'protection' is afforded the innocent injured insureds . . . by giving them a claim against an insolvent . . . when they would be given uninsured motorist vehicle coverage if tortfeasor . . . had no insurance at all . . . ?"[34]

Rose contended that contracts of insurance must be construed according to the sense and meaning of the terms which the parties have used and if the provisions limiting liability are ambiguous or equivocal, then they should be construed most strongly against the insurer.[35] Furthermore, since the 1963 Act did not define uninsured motor vehicle, the statute should be interpreted with regard to whether insolvency was a denial of coverage in light of the 1967 amendment.[36]

Rose argued that there was nothing in the letter, spirit, or purpose of the Insurance Code or the insurance policy that required a denial of coverage to be expressed or to require affirmative action on the part of the tortfeasor's insurer.[37] Denial of coverage in any meaningful sense of the term may be effectively made by voluntary or involuntary conduct of the tortfeasor's insurer.[38] Therefore, failure to defend or pay claims or satisfy

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[32] Brief for Appellee at 20, 21. *Rose.*
[33] *Id.* at 28-29.
[34] *Id.* at 21.
[35] *Id.* at 23.
[36] *Id.* at 41.
[37] *Id.* at 35.
[38] *Id.*

a judgment or otherwise fail to afford the protection it contracted to give the insured was a denial of coverage.

Appellee noted that the Pennsylvania Appellate Court case on which appellant relies, which held that an affirmative act was indispensable to a "denial of coverage," was reversed by the Supreme Court of Pennsylvania.[39]

Rose acknowledged that the case was novel in Pennsylvania, but asserted that the issue had been decided in other jurisdictions.[40] The Supreme Court of Virginia, in *State Farm Mutual Insurance Company v. Brower*,[41] held that the refusal of the insolvent insurance carrier to provide coverage, constituted a denial of coverage, and that a denial of coverage clearly may be as effectively made by the conduct of the insurer as by its spoken or written word. The Supreme Court of South Carolina, in *North River Insurance Company v. Gibson*,[42] held that the right of the insured to recover under his uninsured motorist coverage is not necessarily determinable at the date of the collision. An insurer denies coverage to its insured when it fails or refuses to accord him the protection it contracted to give. The Appellate Court of California, in *Katz v. American Motorist Insurance Company*,[43] held that an insurer who becomes insolvent denies coverage thus the innocent party is entitled to the protection afforded by the policy written with respect to the uninsured motorist.

Rose further refuted the contention of Illinois National that the policy issued by it was broader than the standard bureau policy of the insurance industry in 1964. Rose noted that commencing January 1, 1963, the large casualty companies had broadened their uninsured motorist coverage to include coverage against hit-and-runs which Illinois National had not.[44] Therefore, Illinois National's policy was not as broad as the 1963 standard family auto policy.

Finally, Rose concluded by relying on the reasoning of the Pennsylvania, Virginia, South Carolina, and California courts.

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[39] *Id.* at 31-32. The appellate court held that the term "denial of coverage" was so clear and unambiguous as to be restricted in its meaning to only affirmative acts by the insurer based on conduct of the insured. The supreme court, on the other hand, held that the term was *not* so clear and unambiguous as to be so restrictive in its meaning, but could include *any failure or refusal* to provide coverage.

[40] *Id.* at 32.

[41] 204 Va. 887, 134 S.E.2d 277 (1964).

[42] 244 S.C. 393, 137 S.E.2d 264 (1964).

[43] 53 Cal. Rptr. 669 (1966). The *Pattani* and *Rose* cases were identical to the Virginia, South Carolina and California cases except in Illinois and Pennsylvania the statutes did not define uninsured motor vehicle, whereas the other state statutes did. However, the policies issued by the insurer in *Rose* and *Pattani* defined uninsured motor vehicle in almost the exact same terms as the statute in the other states.

[44] Brief for Appellee at 19, *Rose*.

The defendant argued that the reasoning was sound and consistent with the letter and spirit of the Illinois statute and the policy written thereunder; therefore, insolvency is tantamount to a denial of coverage, Rose did not receive what he had contracted for, and the judgment of the circuit court should be affirmed.

THE HOLDING AND REASONING OF THE APPELLATE COURT

The appellate court noted that at the time of the collision between Rose and Jordan the only statute in effect was the 1963 Act concerning uninsured motor vehicle protection.[45] That provision described the minimum limits of coverage in all liability policies issued in the state unless rejected in writing by the insured.[46] But more significantly the provision did not define uninsured motorist but left the definition to the individual policy.[47]

The appellate court distinguished between the terms of the earlier policies and later policies which provided for uninsured motorist protection. The earlier policies defined uninsured motor vehicle to include "one with respect to which there was no applicable liability policy."[48] In later policies the definition was extended to include as an uninsured motor vehicle, "one with respect to which such policy was applicable but coverage under such policy was denied."[49] These were the terms in the policy issued by Illinois National: (1) the total lack of applicable liability insurance or, (2) if there was such insurance applicable, coverage had been denied.[50]

The appellate court rejected plaintiff-appellant's contention that "a denial of coverage means and is limited to those affirmative acts of the insurer . . . generally characterized as "policy defenses" and that the subsequent insolvency of the insurer is not such an affirmative act."[51] The appellate court recognized *Pattani I*, which determined that "subsequent insolvency of a liability carrier did not constitute a denial of coverage."[52] However, the court in *Rose* acknowledged that the decision was "reversed by the highest court in Pennsylvania"[53] in *Pattani II*. The reasoning employed in *Pattani II* reflects the decisions in *Brower, Gibson,* and *Katz* that subsequent insolvency *does* constitute a denial of coverage. Relying on those decisions the appellate court declared that the "insured's rights, with respect to protection which the liability carrier has agreed to provide, are just as effectively

[45] *Rose*, 93 Ill. App. 2d at 330, 235 N.E.2d at 676 (1968).
[46] *Id.*
[47] *Id.*
[48] *Id.*
[49] *Id.*
[50] See text at note 12 *supra.*
[51] *Rose*, 93 Ill. App. 2d at 331, 235 N.E.2d at 677 (1968).
[52] *Id.*
[53] *Id.*

denied whether the insurer's conduct be voluntary or involuntary."[54]

The appellate court pointed out that the 1967 amendment of the Insurance Act[55] provides coverage for an insolvent insurer but by its terms is prospective. Nevertheless, the meaning of the policy which the court construed "is not and does not depend upon a retroactive application of the amendment."[56] The court declared: "[W]e have applied the generally established meaning of the policy provision even though it is true that the precise question would not have arisen had the amendment been in effect."[57]

Thus the appellate court, independent of the prospectively applicable amendment to the uninsured motorist provision, declared that the subsequent insolvency of a liability insurance carrier was a denial of coverage, as the term was used in an uninsured motorist provision.

CONCLUSION

The 1967 legislative enactment amending the 1963 Act in essence made the *Rose* decision moot, except where coverage had been denied prior to the effective date of the amendment and included the denial of coverage clause.

The necessity of greater automobile insurance coverage is exemplified by the legislative enactments and the judicial declarations of the insured's right to coverage from his insurer when the tortfeasor or the tortfeasor's insurer cannot provide coverage. The strength of *Rose* lies in the public's need for all inclusive protection — from the negligent driver *and* the insurer who contracts to provide coverage with such drivers. It also points out the need for stronger safeguards to protect the unsuspecting public from the financially precarious insurer.

Lorence H. Slutzky

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[54] *Id.* at 332, 235 N.E.2d at 677.
[55] *Id.* at 333, 235 N.E.2d at 677.
[56] *Id.*
[57] *Id.*