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LIABILITIES OF AN INSURANCE CARRIER IN EXCESS OF COVERAGE

RICHARD COHEN

The failure of an insurer to effect a settlement with an injured party under certain circumstances has become the basis of extending the insurer's liability beyond the policy limit. How and under what circumstances the insurer may be held liable for the portion of the judgment in excess of the policy limits will be the subject of this study.

There are primarily two tests involved in determining whether an insurer may be liable for an amount in excess of the policy limit. These tests are the "negligence" test, and the "bad faith" test.¹ The provisions of the policy are determinative in ascertaining the duty upon which the liability of the insurer is based. Some courts have felt that negligence is the basis of the breach,² while others have felt that the bad faith refusal of the insurer to settle is the basis of the breach.³ Others have brought bad faith and negligence together in determining whether the insurer has breached its duty to the insured; the negligence of the insurer being at least a relevant consideration in determining good faith.⁴

"The bad faith rule is now the majority one and the negligence test the minority."⁵ Under the bad faith rule, the breach occurs when the insurer in bad faith fails to or refuses

¹ Radcliffe v. Franklin National Insurance Co., 208 Ore. 1, 298 P.2d 1002 (1956).

² Linkenhogor v. American Fidelity & Casualty Co., 152 Tex. 534, 260 S.W. 2d 884 (1953); Attleboro Mfg. Co. v. Frankfort Marine Accident & Plate Glass Ins. Co., 240 Fed. 573, 578 (1st Cir. 1917).

³ Henke v. Iowa Mutual Casualty Co., 250 Iowa 1123, 1129, 97 N.W. 2d 168, 172 (1959); Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 682, 319 P.2d 69, 74 (Dist. Ct. App. 1957).

⁴ Hilker v. Western Automobile Insurance Co., 204 Wis. 1, 231 N.W. 257, 235 N.W. 413 (1930); Ballard v. Ocean Accident & Guaranty Co. 86 F.2d 449 (7th Cir. 1936); American Fidelity & Guaranty Co. v. Greyhound Corp., 258 F. 2d 705 (5th Cir. 1958).

⁵ 1957 Ins. L. J. 483 (August 1957).

to settle.⁶ Appleman, however, believes that the majority rule falls under the negligence test.⁷

Did the insurer exercise that degree of skill, judgment, and consideration for the welfare of the insured which it, as a skilled professional defender of law suits having sole charge of the investigation, settlement, and trial of the suit may have been expected to utilize?⁸

In the early cases there was an absence of any duty to settle on the part of the insurer. The insurer was given absolute discretion as to effecting a settlement. In *McDonald v. Royal Indemnity Insurance Co.*, the court, without discussing the issues of bad faith or negligence, granted a nonsuit in an action by an insured against his insurer for failing to accept a compromise within the policy limits, the court saying that the insurer did not agree to and was not obliged to settle the action, and that the decision whether or not to settle was committed to it by contract.⁹

Under both tests, the wrongful refusal by the insurer to settle has been considered a tort.¹⁰ The negligent failure of an insurer to effect a settlement within the policy limits has given rise to a new tort which may be considered to arise out of the insurer's exclusive reservation of the right to negotiate the settlement of claims and defend actions against the insured, as well as the effect of the co-operation clause which prohibits the insured from admitting any liability or incurring any expense without the company's permission.¹¹

Ordinarily a breach of contract is not a tort but a contract may create the state of things which furnishes the occasion for the tort. The relation which is essential to the existence of the duty to exercise care may arise through an

⁶ Henke v. Iowa Mutual Casualty Co., *supra*. Note 3.

⁷ 8 APPLEMAN, INSURANCE LAW AND PRACTICE, § 4712 (1962).

⁸ APPLEMAN, INSURANCE LAW AND PRACTICE, *supra* Note 7.

⁹ McDonald v. Royal Indemnity Ins. Co., 109 N. J. L. 308, 162 A. 620 (1932); Long v. Union Indemnity Co., 277 Mass. 428, 178 N. E. 737 (1931).

¹⁰ Ivy v. Pacific Auto. Ins. Co., 156 Cal. App. 2d 652; 320 Ins. L. J. 483 (August 1957).

¹¹ 320 Ins. L. J. 483 (August 1957).

express or implied contract. Accompanying every contract is a common law duty to perform with care, skill, reasonable expedience and faithfulness the thing agreed to be done, and a negligent failure to observe any of these conditions is a tort as well as a breach of contract.¹²

The typical insurance policy gives the insurer the exclusive right to defend and settle claims which arise against the insured. As an example of such a provision, examine the following:

With respect to such insurance as is afforded by this policy for bodily injury liability and for property damage liability, the company shall:

(a) defend any suit against the insured alleging such injury . . . and seeking damages on account thereof, even if such suit is groundless, false, or fraudulent; but the company may make such investigation and settlement of any claim or suit as it deems expedient . . .¹³

The majority of courts which have passed on the question have held that the liability insurer, having assumed control of the settlement of all claims against the insured, may become liable in excess of its undertaking if it fails to exercise "good faith" in considering offers of compromise for an amount within the policy limits.¹⁴

Many of the courts have refused to hold the insurer liable upon the negligence theory. Some courts have even held that the negligence theory fails to state a cause of action.¹⁵

¹² 30 Am. Jur. *Negligence*, § 20 (1941).

¹³ PATTERSON & YOUNG, *CASES ON INSURANCE* 698 (4th ed. 1961).

¹⁴ *Brown & McCabe Stevedores v. London Guarantee & Accident Co.*, 238 Fed. 298 (D.C. Ore. 1915); *American Mutual Liability Insurance Co. v. Cooper*, 61 F. 2d 446 (5th Cir. 1932); *Cert. den.* 289 U. S. 736, 77 L. Ed. 1483, 53 S. Ct. 595; *Hall v. Preferred Accident Insurance Co.*, 204 F. 2d 844 (5th Cir. 1953) (rejecting negligence); *Maryland Casualty Co. v. Cook-O'Brien Construction Co.*, 69 F.2d 462, *Cert. den.* 293 U. S. 569, 79 L. Ed. 668, 55 S. Ct. 81 (8th Cir. 1934).

¹⁵ *Abrams v. Factory Mutual Liability Insurance Co.*, 288 Mass. 141 10 N. E. 2d 82 (1937); *Georgia Casualty Co. v. Colton Mills Products Co.*, 159 Miss. 396, 132 So. 73 (1931).

Thus, where there is no duty to settle, no negligence may arise from a failure to settle.¹⁶

The bad faith test is used in lieu of the negligence test in some jurisdictions and avoids the problem of determining what reasonable minds would consider to be negligent.¹⁷

How much consideration the insurer must give to the insured's interest varies from jurisdiction to jurisdiction. It has generally been regarded that the insurer must give equal consideration to the insured's interest, and a failure to do so has been held to be bad faith.¹⁸ Thus, where the insurer rejects a reasonable offer of settlement within the policy limits, such refusal is a manifestation of bad faith toward the insured's interest.¹⁹ Some jurisdictions have gone so far as to require the insurer to give more consideration to the insured's interest than it does to its own.²⁰ One jurisdiction has held that the insurer may consult its own interests as long as it does not abuse its power and recklessly and contumaciously refuse to settle.²¹ Another has held that the insurer merely has to exercise an honest judgment in order to act in good faith.²² The Oklahoma courts have held that the insurer should treat the claim as if it were liable for the whole amount with New Jersey and California in accord,²³ while the Ver-

¹⁶ *Best Building Co. v. Employer's Liability Assurance Corp.*, 247 N.Y. 451, 160 N.E. 911 (1928).

¹⁷ *Supra* note 16.

¹⁸ *Southern Fire and Casualty Co. v. Norris*, 35 Tenn. App. 557, 250 S.W. 2d 785 (1952); *Johnson v. Hardware Mutual Casualty Co.*, 109 Vt. 481, 1 A. 2d 817 (1938); *American Fidelity & Casualty Co. v. G. A. Nichols Co.*, 173 F. 2d 830, 832 (10th Cir. 1949) (dictum); *National Mutual Casualty Co. v. Britt*, 203 Okla. 175, 200 P. 2d 407, 411 (1948) (dictum); *Abrams v. Factory Mutual Liability Insurance Co.*, *supra* note 15.

¹⁹ *J. Spang Baking Co. v. Trinity Universal Insurance Co.*, 45 Ohio Abs. 573 68 N.E. 2d 122 (1946).

²⁰ *Zumwalt v. Utilities Insurance Co.*, 360 Mo. 362, 228 S. W. 2d 750 (1950); *American Mutual Liability Insurance Co. v. Cooper*, *supra* note 14; *Neuberger v. Preferred Accident Insurance Co.*; 18 Ala. App. 72, 89 So. 90, *Cert. den.* 206 Ala. 700, 89 So. 924 (1921).

²¹ *Cleveland Wire Spring Co. v. General Accident F & L Assurance Corp.*, 6 Ohio App. 344 (1917).

²² *Wakefield v. Globe Indemnity Co.*, 246 Mich. 645, 225 N.W. 643 (1929).

²³ *American Fidelity & Casualty Co. v. L. C. Jones Trucking Co.*, 321 P.2d 685, 687 (Okla. 1952) (dictum); *Radio Taxi Service, Inc. v. Lincoln Mutual Ins. Co.*, 31 N.J. 299, 157 A. 2d 319 (1960); *Davy v. Public National Ins. Co.*, 181 Cal. App. 2d 387 (5 Cal. Rep. 488 (1960)).

mont court has said that the insurer may look after its own interests, but is bound to have due regard for the interests of the insured.²⁴ When the insurer is considered to be in a fiduciary relationship with the insured and breaches such relationship, such breach has been held to be an indication of a lack of good faith and amounts to gross negligence.²⁵

In *Hilker v. Western Automobile Insurance Co.*,²⁶ a case often quoted when propounding the negligence theory, the court concluded that "good-faith" performance of the insurer's obligation required it to be held to that degree of care and diligence which a man of ordinary care and prudence would exercise in the management of his own business were he investigating and adjusting such claims.

From the above it is plain to see that the tests used from state to state in determining negligence or bad faith vary considerably.

The Oklahoma court in *Boling v. New Amsterdam Casualty Co.*, made the following apropos statement:

It may be stated as a rule of law that where an insurance company agrees to indemnify against loss from personal injury claims, conditional upon insured's surrendering to the insurance company control of investigations, adjustments of claims, and defenses of law suits, and where the insurance company does, pursuant to contract, take control of such matters, a relationship arises between insured and insurer which imposes on the insurer the duty owing to the insured to exercise skill, care and good faith to the end of saving the insured harmless, as contemplated by the contract to indemnify and save the insured harmless as it has contracted to do—to the extent, if necessary that it must make whatever payment and settlement an honest judgment and discretion dictate, within the limits of the

²⁴ *Johnson v. Hardware Mutual Casualty Co.*, *supra* note 18.

²⁵ *American Fidelity & Casualty Co. v. All American Bus Lines, Inc.*, 179 F. 2d 7 (10th Cir. 1949).

²⁶ *Hilker v. Western Automobile Insurance Co.*, *supra* note 4.

policy, and an abandonment of this duty to act subsequent to its assumption in part constituted bad faith.²⁷

BAD FAITH

Bad faith may be defined as an intentional disregard of the financial interests of the insured in the hope of escaping the full responsibility imposed by the policy provisions.²⁸ It is for the jury to determine if the insurer's refusal to settle was made in good faith and upon reasonable grounds to preclude liability.²⁹ The courts should analyze the conduct of the insurer in terms of specific acts. When the insurer is not justified in refusing a compromise offer, his refusal may constitute bad faith. This section will outline the circumstances in which an insurer has been considered to have acted in bad faith and has become liable for an amount in excess of the policy limits.

The insurer has frequently been found to have acted in bad faith in refusing to compromise when it has, after taking charge of the insured's defense, failed to properly investigate the circumstances so as to ascertain evidence on the issues of liability and damages. Where the insurer had notice of witnesses to an accident and made no attempt to interview them nor investigate the merits of the case and thereafter refused offers to compromise within the policy limits, the refusal was considered to be an act in bad faith.³⁰ The insurer's failure to investigate prevented him from being in a position to act intelligently or in fairness to the insured in considering the settlement offers. The negligence of an insurer in failing to properly investigate a case can be considered as bearing on the issue of good faith since the insurer could not fairly consider its duty to settle without knowledge of the circumstances of the case.³¹

²⁷ *Boling v. New Amsterdam Casualty Co.*, 173 Okla. 160, 46 P. 2d 916, 919 (1935).

²⁸ *Johnson v. Hardware Mutual Casualty Co.*, *supra* note 18.

²⁹ *Mendota Electric Co. v. New York Indemnity Co.*, 169 Minn. 377, 211 N.W. 317 (1926).

³⁰ *American Mutual Liability Insurance Co. v. Cooper*, *supra* note 14. *Radio Taxi Service, Inc. v. Lincoln Mutual Insurance Co.*, *supra* note 23.

³¹ *Southern Fire & Casualty Co. v. Norris*, *supra* note 18; *Tyger River Pine Co. v. Maryland Casualty Co.*, 170 S.C. 286, 170 S. E. 346 (1933).

Likewise, the failure of the insurer to locate and interview key witnesses showed an absence of the exercise of reasonable diligence in ascertaining the true facts. A refusal to settle rather than to permit adverse testimony has also been held to be an indication of lack of good faith.³²

The failure of the adjuster to inform the insurer that a large adverse verdict was expected, which resulted in a refusal by the insurer to settle for a favorable amount, was considered to be bad faith on agency principles.³³

If an insurer ignores the repeated recommendations of its attorney and adjusters to settle the claim within the policy limits, knowing well after a careful examination of the information as to the circumstances and facts involved that there will probably be an excess verdict, such refusal is sufficient to raise the issue of bad faith.³⁴ But the mere showing by the insurer that it acted upon its attorney's advice will not absolve it from responsibility or bad faith.³⁵

When the insurer fails to inform its counsel of all the facts, circumstances, and information which it possesses, such failure may constitute bad faith.³⁶

When the insurer has an opportunity to settle for an amount below the policy limit but refuses to do so because the insured will not contribute to the settlement, such refusal may be regarded as showing bad faith on the part of the insurer.³⁷

³² *Hilker v. Western Automobile Insurance Co.*, *supra* note 4; *Ballard v. Citizens Casualty Co.*, 196 F. 2d 96 (7th Cir. 1952).

³³ *Johnson v. Hardware Mutual Casualty Co.*, *supra* note 18.

³⁴ *Ibid.*; *Royal Transit Inc. v. Central Surety & Ins. Corp.*, 168 F. 2d 345, *Cert. den.* 335 U.S. 844, 93 L. Ed. 395, 69 S. Ct. 68 (7th Cir. 1948).

³⁵ *Sumas v. Hartford Accident & Indemnity Co.*, 94 N.H. 484, 56 A. 2d 57 (1947).

³⁶ *Douglas v. United States Fidelity and Guaranty Co.*, 81 N.H. 371, 127 A. 708 (1924).

³⁷ *Brown & McCabe Stevedores, Inc. v. London Guarantee & Accident Co.*, *supra* note 14; *American Mutual Liability Insurance Co. v. Cooper*, *supra* note 14; *Maryland Casualty Co. v. Cook-O'Brien Construction Co.*, *supra* note 14; *J. Spang Baking Co. v. Trinity Universal Ins. Co.*, *supra* note 19; *Brunswick Realty Co. v. Frankfort Ins. Co.*, 99 Misc. 639, 166 N.Y.S. 36 (1917).

If the insurer, after a verdict in excess of the policy limits has been rendered against the insured, is presented with an opportunity to settle for an amount below the policy limits and refuses such offer, such refusal may be evidence of bad faith.³⁸

The insurer's duty of exercising good faith in effecting a settlement of a claim includes in addition to making a proper investigation of the facts and circumstances surrounding the accident, the duty of informing the insured of these facts so that he might take any steps open to him for his own protection.³⁹ However, where the policy does not provide for notice to the insured of compromise offers, the failure to give such notice does not constitute bad faith.⁴⁰ The duty of informing the insured about compromise offers extends to the insurer's agents—investigators—who owe a duty to report such an offer to the counsel for the insurance company.⁴¹

Where the insurer after carefully studying the results of its investigation realizes that there is only a slight chance⁴² of the verdict being less than the policy limits, or there is more than an equal chance of losing the case,⁴³ or there is a clear case of primary negligence,⁴⁴ and the insured's liability is obvious,⁴⁵ and thereafter refuses to effect a settlement within the policy limits, such refusal may constitute bad faith.

³⁸ *Roberts v. American Fire & Casualty Co.*, 89 F. Supp. 827 (N.D. Tenn. 1950), *aff'd* 186 F.2d 921 (6th Cir. 1951). *Olympia Fields Country Club v. Bankers Indemnity Ins. Co.*, 325 Ill. App. 649, 60 N.E. 2d 895 (1945).

³⁹ *Hilker v. Western Automobile Insurance Co.*, *supra* note 4.

⁴⁰ *Kleinschmit v. Farmers Mutual Hail Ins. Assoc.*, 101 F. 2d 987 (8th Cir. 1939).

⁴¹ *American Fidelity & Casualty Co. v. Greyhound Corp.*, *supra* note 4; *Brown v. Guarantee Ins. Co.*, 155 Cal. App. 2d 679, 319 P. 2d 69 (1958); *Maryland Casualty Co. v. Wyoming Valley Paper Co.*, 84 F. 2d 683 (1st Cir. 1936).

⁴² *Maryland Casualty Co. v. Cook-O'Brien Construction Co.*, *supra* note 14.

⁴³ *Attleboro Manufacturing Co. v. Frankfort Marine & Plate Glass Insurance Co.*, *supra* note 2.

⁴⁴ *American Fidelity and Casualty Co. v. G. A. Nichols Co.*, *supra* note 18.

⁴⁵ *National Mutual Casualty Co. v. Britt*, *supra* note 18; *Traders & General Insurance Co. v. Rudco Oil & Gas Co.*, 129 F. 2d (10th Cir. 1942).

In *Vanderbilt University v. Hartford Accident & Indemnity Co.*,⁴⁶ a leading case, the court termed as a wanton and intentional disregard of the insured's interest and a gamble, the insurer's refusal to settle within the policy limit when the insurer realized from the facts that a large judgment in excess of the policy limits was probable and made no attempt over a long period of time to effect a settlement after repeated offers and with knowledge of the co-defendant's lack of liability. Such an undue delay in endeavoring to effectuate a settlement constituted bad faith.

The showing by the insured that the insurer disregarded the potentiality of the claim against him because of the claimant's race, religion, or nationality renders such disregard discriminatory and evidence of such discrimination may be shown to indicate bad faith.⁴⁷

In a case in which the insurer has a substantial part of the risk reinsured and in the event of a loss would not stand to lose more than his share, a refusal to settle under these circumstances may be evidence of bad faith.⁴⁸ The primary insurer may also be guilty of bad faith toward his reinsurer when he refuses to accept an offer to settle which is made while the action against the insured is pending.⁴⁹ If the reinsurer refuses to contribute to the settlement, such refusal does not relieve the primary insurer from any duty which it owes the insured.⁵⁰

Evidence that the insurer informed his insured that he should transfer his property in order to avoid possible excess liability has been considered to be an indication of bad faith on the part of the insurer.⁵¹

⁴⁶ 109 F. Supp. 565 (S.D. Tenn. 1952).

⁴⁷ *Roberts v. American Fire & Casualty Co.*, *supra* note 38.

⁴⁸ *J. Spang Baking Co. v. Trinity Universal Insurance Co.*, *supra* note 19.

⁴⁹ *American Fidelity & Casualty Co. v. All American Bus Lines*, *supra* note 25.

⁵⁰ *Zumwalt v. Utilities Insurance Co.*, *supra* note 20; *Central Surety & Ins. Corp.*, *supra* note 34.

⁵¹ *Maryland Casualty Co. v. Cook-O'Brien Construction Co.*, *supra* note 14.

The size of the insurer's reserve may be a fact indicating bad faith when it is substantially in excess of the settlement value fixed by the insurer.⁵² Other facts being equal, the insurer is more likely to be held liable where it gambles a large amount of the insured's money while trying to save a comparatively smaller amount of its own.⁵³

A quick reflection on the foregoing will show in part that bad faith on the part of the insurer has been founded on:

- (1) Failure to properly investigate all the facts and circumstances.
- (2) Failure to interview key witnesses.
- (3) Failure of the adjuster to inform the insurer of the possibility of an excess judgment.
- (4) Failure to heed the recommendations of adjusters and counsel.
- (5) Failure to inform counsel of all the facts.
- (6) Asking the insured to contribute to the settlement.
- (7) Failure to inform the insured of steps available for his protection.
- (8) Failure to inform the insured of compromise offers.
- (9) Failure to settle when it is clear that primary negligence is present and a decision on the merits will be unfavorable.
- (10) Failure to effect a settlement with proper speed.
- (11) Failure to settle because reinsured.
- (12) Gambling with the insured's money.

GOOD FAITH REFUSAL

In the preceding section the refusal of the insurer to effect a settlement was not justified and his refusal constituted bad

⁵² *Lanferman v. Maryland Casualty Co.*, 226 Wis. 406, 267 N.W. 300 (1936).

⁵³ *Annot.*, 40 A.L.R. 2d 220 (1955). *Annot.*, 68 A.L.R. 2d 883 (1959).

faith. This section will endeavor to point out under what circumstances the insurer is justified in refusing to settle within the policy limits.

Generally, the insurer has a right of electing whether or not it will settle, and, if in good faith it rejects an offer of settlement and a final judgment is recovered for a greater amount, it is not liable for the excess over the amount limited in the policy.⁵⁴

Some courts have regarded the option left to the insurer to settle as imposing no duty to settle, and uphold the contract provisions as they are strictly written—no duty being imposed.⁵⁵

Although a situation exists in which a verdict in excess of the policy limits may be rendered, the mere refusal of an offer to effect a settlement does not constitute bad faith. A bona fide rejection of the settlement offer rather than a gamble of defeat is necessary for the refusal to be made in good faith.⁵⁶ Good faith and ordinary care are both required of the insurer in its decision not to settle.⁵⁷

Where the policy gives the insurer the option to compromise, the insurer has been considered justified in refusing to compromise within the policy limits unless the insured agreed to contribute.⁵⁸

If the insurer after carefully considering the settlement proposal in good faith believes that it can defeat the action or

⁵⁴ 45 C.J.S., *Insurance*, § 936 (1946).

⁵⁵ *Georgia Casualty Co. v. Colton Mills Products Co.*, *supra* note 15.

⁵⁶ *National Mutual Casualty Co. v. Britt*, *supra* note 18; *Wakefield v. Globe Indemnity Co.*, *supra* note 22.

⁵⁷ 67 HARV. L. REV. 1136 (1954); *Douglas v. United States Fidelity & Guaranty Co.*, *supra* note 36; *G.A. Stowers Furniture Co. v. American Indemnity Co.* 15 S.W. 2d 544 (Tex. Comm. App. 1929).

⁵⁸ *Auerback v. Maryland Casualty Co.*, 236 N.Y. 247, 140 N.E. 577 (1923); *Sones v. Maryland Casualty Co.*, 16 La. App. 253, 133 So. 769 (1931).

hold the amount of the verdict within the policy limits and refuses to settle, such refusal will not constitute bad faith even though there has been a mistake of judgment.⁵⁹

The majority of courts have held that mere inadvertence or mistake of judgment alone does not constitute bad faith.⁶⁰ Thus, the insurer was held not to be guilty of bad faith in rejecting offers for the settlement of a claim when the company's adjusters and attorney concluded that the company was not liable.⁶¹

The insurer is justified in refusing to effect a settlement when the insured refuses to give it the true facts.⁶² The insured's failure to co-operate with the insurer in the defense of his claim has been held to be a breach of a condition upon which the insurer's obligation to settle is dependent.⁶³

When the insurer suspects collusion on the part of the insured and his wife, the claimant, it is justified in refusing to effect a settlement.⁶⁴ Justification also exists when the insured's misconduct induces the rejection of a compromise offer.⁶⁵

When the insured joins with the insurer in refusing to accept a compromise offer, he will not be heard later to com-

⁵⁹ *Christian v. Preferred Accident Ins. Co.*, 89 F. Supp. 888 (N.D. Cal. 1950).

⁶⁰ *Mendota Electric Co. v. New York Indemnity Co.*, *supra* note 29; *Georgia Casualty Co. v. Mann*, 242 Ky. 447, 46 S.W. 2d 777, 779 (1932); *Burnham v. Commercial Casualty Insurance Co. of Newark, N. J.*, 10 Wash. 2d 624, 117 P. 2d 644 (1942); *Berk v. Milwaukee Automobile Insurance Co.*, 245 Wis. 597, 15 N.W. 2d 834 (1944); *Norwood v. Travelers Insurance Co.*, 204 Minn. 595, 284 N.W. 785 (1939).

⁶¹ *Berk v. Milwaukee Automobile Ins. Co.* *supra* note 60; *Fidelity & Casualty Co. v. Stewart Dry Goods Co.*, 208 Ky. 429, 271 S.W. 444 (1925).

⁶² *Hall v. Preferred Accident Insurance Co.*, *supra* note 14, *Buffalo v. United States Fidelity & Guaranty Co.*, 84 F. 2d 883, 885 (10th Cir. 1936).

⁶³ *United States Fidelity & Guaranty Co. v. Wyer*, 60 F. 2d 856 (10th Cir. 1932); *Ohrbach v. Preferred Accident Insurance Co.*, 227 App. Div. 311, 237 N.Y.S. 494 (1929).

⁶⁴ *Wakefield v. Globe Indemnity Co.*, *supra* note 22; *State Automobile Mutual Insurance Co. of Columbus, Ohio v. York*, 104 F. 2d 730, *Cert. den.* 308 U.S. 591, 84 L. ed. 494, 60 S. Ct. 120 (4th Cir. 1939) (collusion).

⁶⁵ *Hall v. Preferred Accident Insurance Co.*, *supra* note 14.

plain of bad faith on the part of the insurer for failing to effect a settlement.⁶⁶ Absent other circumstances, the mere failure of the insurer to inform the insured of an offer to settle is not sufficient to show bad faith.⁶⁷

If the insurer possesses a contractual right of appeal under the policy, it may refuse a compromise offer after the verdict for an amount equal to the policy limit and not be chargeable with bad faith.⁶⁸

If the insured's mental condition prohibits him from assenting to a settlement offer, the insurer is justified in not making such an offer.⁶⁹ The established policy of the insurer to effect settlements when possible,⁷⁰ and the absence of a record of past refusals to settle⁷¹ may point to the belief that the insurer was justified in refusing to effect a settlement.

When the insurer and its attorney believe that a fighting chance exists to defeat the claim against the insured, or that the judgment, if there is one, will be for an amount within the policy limits, a decision to try the case rather than settle it will not constitute bad faith.⁷² Thus, if a litigable issue exists and the insurer believes that it has a reasonable ground for contesting the claim, the refusal to compromise when made in good faith is justified.⁷³

Thus the insurer may be justified in refusing to settle when:

⁶⁶ *Royal Transit v. Central Surety & Ins. Corp.*, *supra* note 34.

⁶⁷ *Norwood v. Travelers Insurance Co.*, *supra* note 60.

⁶⁸ *Davis v. Maryland Casualty Co.*, *supra* note 58.

⁶⁹ *Douglas v. United States Fidelity & Guaranty Co.*, *supra* note 36.

⁷⁰ *Johnson v. Hardware Mutual Casualty Co.*, *supra* note 18.

⁷¹ *Berk v. Milwaukee Automobile Insurance Co.*, *supra* note 60.

⁷² *Wilson v. Aetna Casualty & Surety Co.*, 145 Me. 370, 76 A. 2d 111 (1950); *Masoney v. Allstate Insurance Co.*, 12 Wis. 2d 197, 107 N. W. 2d 261 (1961); *Henke v. Iowa Home Mutual Casualty Co.*, *supra* note 3; *New Orleans & C.R. Co. v. Maryland Casualty Co.*, 114 La. 153, 38 So. 89 (1905).

⁷³ *New York Life Insurance Co. v. Watson*, 48 Ga. App. 211, 172 S.E. 602 (1934); *White v. New York Life Insurance Co.*, 91 F. Supp. 125 (N.D. Ga. 1950); *Lawson & Nelson S & S Co. v. Associated Indemnity Corp.*, 204 Minn. 50, 282 N.W. 481 (1938).

- (1) The insurer has the option to compromise and doesn't exercise it.
- (2) The insurer believes that it has a fighting chance of defeating a claim or holding the amount within the policy limits.
- (3) The insurer makes a mere mistake of judgment.
- (4) The insured refuses to give the insurer the true facts.
- (5) The insurer suspects collusion on the part of the insured.
- (6) The insured is guilty of misconduct.
- (7) The insured joins the insurer in rejecting a compromise offer.
- (8) The insurer possesses a contractual right of appeal.
- (9) The insured's mental condition prohibits him from assenting to a settlement.

NEGLIGENCE IN FAILING TO SETTLE

When an insurer undertakes to settle a claim for an insured, it is under a duty to exercise due care in considering a settlement offer within the policy limits.⁷⁴ The degree of care which is required under the "negligence test" of liability is usually considered to be that degree of care which an ordinarily prudent person would exercise in the conduct of his own affairs.⁷⁵ Slight variations of this standard have developed in other states.⁷⁶ When the insurer fails to exercise this degree of care, it has been deemed negligent.⁷⁷ Thus, where the insurer undertakes to effect a settlement, it has a duty to exercise reasonable care and skill, and when this duty is breached,

⁷⁴ *Sumas v. Hartford Accident & Indemnity Co.*, 92 N.H. 140, 26 A. 2d 361 (1942).

⁷⁵ *Ibid.*

⁷⁶ *G. A. Stowers Furniture Co. v. American Indemnity Co.*, *supra* note 57.

⁷⁷ *Douglas v. United States Fidelity & Guaranty Co.*, *supra* note 36.

the breach may amount to such negligence as to impose excess liability on the insurer.⁷⁸ The question of the insurer's negligence is for the jury to determine.⁷⁹

The refusal by an insurer to effect a settlement when based upon a negligent investigation of the facts and circumstances surrounding a claim has been held to be sufficient negligence to justify a recovery in excess of the policy limits.⁸⁰ The failure of the insurer to accept its attorney's advice to settle has likewise been considered to be evidence of actionable negligence.⁸¹

An insurer, after admitting that a case is very dangerous and likely to result in an excess judgment, is not justified in refusing to settle within the policy limits, such refusal being considered to be sufficient to state a cause of action for negligence.⁸²

A refusal by the insurer to settle within the policy limits after learning that the insured's case as to liability and damages is inferior to that of the claimant has been considered to be a relevant consideration in determining negligence on the part of the insurer.⁸³ Thus, the refusal of the insurer to settle for \$4,750.00 was held to be negligence when the out-of-pocket expenses of the claimant were almost \$3,000.00 and the insurer knew that the claimant had suffered serious and disabling injuries.

Undue delay on the part of the insurer in acting upon a compromise offer until such offer was withdrawn was deemed to be sufficient negligence to create excess liability for the insurer.⁸⁴

⁷⁸ *Attleboro Mfg. Co. v. Frankfort Marine Accident & Plate Glass Ins. Co.*, *supra* note 2.

⁷⁹ *Tyger River Pine Co. v. Maryland Casualty Co.*, *supra* note 32; *Douglas v. United States Fidelity & Guaranty Co.*, *supra* note 36.

⁸⁰ *Dumas v. Hartford Accident & Indemnity Co.*, *supra* note 35.

⁸¹ *Attleboro Mfg. Co. v. Frankfort Marine Accident & Plate Glass Ins. Co.*, *supra* note 2.

⁸² *G. A. Stowers Furniture Co. v. American Indemnity Co.*, *supra* note 57.

⁸³ *Dumas v. Hartford Accident & Indemnity Co.*, *supra* note 35.

⁸⁴ *Tyger River Pine Co. v. Maryland Casualty Co.*, *supra* note 32.

The insurer is liable for the negligent acts of its agents.⁸⁵ Thus, the negligent conduct of an attorney appointed by the insurer to defend a claim against the insured was imputed to the insurer.⁸⁶

An attempt by the insurer to "hold up" the insured by requiring a contribution to a settlement offer and a refusal by the insured to so contribute may create sufficient negligence on the part of the insurer to create excess liability when the insurer refuses to settle.⁸⁷

At a quick glance, the insurer may be considered to be negligent in failing to effect a settlement when:

- (1) It fails to use reasonable care in effecting a settlement.
- (2) It makes a negligent investigation.
- (3) It fails to accept its attorney's advice.
- (4) It refuses to settle after admitting the possibility of an excess judgment.
- (5) It refuses to settle when it realizes that it is liable to lose.
- (6) It unduly delays in acting on a compromise offer.
- (7) The conduct of its agents is negligent.
- (8) It attempts to force the insured to contribute to a settlement within the policy limits.

It is important to note that when these factors, of which the above are only a few, occur, they usually occur in groups.

⁸⁵ *Dumas v. Hartford Accident & Indemnity Co.*, *supra* note 35.

⁸⁶ *Attleboro Mfg. Co. v. Frankfort Marine Accident & Plate Glass Ins. Co.*, *supra* note 2.

⁸⁷ *Brown & McCabe Stevedores, Inc. v. London Guarantee & Accident Co.*, *supra* note 14.

NOT NEGLIGENT IN FAILING TO SETTLE

It has been held that negligence on the part of an insurer cannot be based on the insurer's failure to exercise an option or reservation which is made for the optioner's benefit—the insurer's right to settle.⁸⁸

The absence of a clear showing that the claim against the insured might have been settled for an amount within the policy limits has been considered sufficient to preclude liability on the part of the insured. Thus, a conditional offer was considered insufficient as a basis for a suit for damages for the alleged negligent failure of the insurer to accept a settlement offer for an amount within the policy limits.⁸⁹

The refusal by an insurer to accept a compromise offer because the mental condition of the injured party would not allow the compromise to be binding, has been considered a jury question in determining whether the insurer negligently failed to compromise.⁹⁰

When the evidence in an action against the insured shows that there are litigable issues as to his liability and the amount of damages, the insurer has not been considered negligent in failing to accept a compromise offer.⁹¹ The court said that lawyers who represented insurance companies could not be expected to be prophets, and that a good faith mistake of judgment in forecasting the outcome of the litigation would not be considered negligence where the attorney acted in a reasonable manner.⁹²

. . . The insurer is negligent in failing to settle if, but only if, such ordinary prudent insurer would consider that choosing to try the case (rather than to settle on the terms by which the claim could be settled) would be taking an unreasonable risk—that is, trial would involve chances of

⁸⁸ Georgia Casualty Co. v. Cotton Mills Products Co., *supra* note 15.

⁸⁹ Jones v. Highway Insurance Underwriters, 253 S.W. 2d 1018 (1952).

⁹⁰ Douglas v. United States Fidelity & Guaranty Co., *supra* note 36.

⁹¹ American Casualty Co. v. Howard, 187 F. 2d 322 (4th Cir. 1951).

⁹² *Ibid.*

unfavorable results out of reasonable proportion to the chances of favorable results.⁹³

The insurer has been considered to have used due care in refusing to settle when:

- (1) It has an option to settle and doesn't exercise it.
- (2) It is not clear that it could have settled within the policy limits.
- (3) The mental condition of the injured party would have prevented a settlement from being binding.
- (4) Litigable issues as to the insurer's liability exist, and an ordinary prudent insurer would choose to try the case.
- (5) The insurer's agent makes a good faith mistake of judgment.

The above are only examples of situations in which the insurer has been found to have used due care in rejecting a compromise.

LIABILITY OF THE INSURER FOR THE EXCESS

An insured may bring suit against his insurer for its bad faith or negligent refusal to effect a settlement within the policy limits. The burden of proof is on the insured to prove bad faith on the part of the insurer.⁹⁴ When the suit is based on the tort theory, the insured may recover the excess over the policy limits and the proven damages suffered.⁹⁵ The insured has been allowed to recover counsel fees as an element of damages.⁹⁶

The statute of limitations for bringing suit against the insurer commences to run from the date of the final judgment in

⁹³ *Dumas v. Hartford Accident & Indemnity Co.*, *supra* note 35.

⁹⁴ *Johnson v. Hardware Mutual Casualty Co.*, *supra* note 18.

⁹⁵ *Chittlick v. State Farm Mutual Automobile Ins. Co.*, 170 F. Supp. 276, 279 (D. C. Del. 1958) (dictum).

⁹⁶ *Maryland Casualty Co. v. Elmira Coal Co.*, 69 F. 2d 616 (8th Cir. 1934).

the first suit by the injured party against the insured, and not from the date of the insurer's refusal to settle.⁹⁷ The insured's right of action may pass to his trustee in bankruptcy or the administrator of his estate.⁹⁸ Most courts refuse to permit the injured party to bring suit against the insurer for the amount in excess of policy limits. The duty to settle arises out of the policy and since no relation exists between the insurer and the injured party, no duty is owed.⁹⁹ The duty to use due care has been held to be personal and cannot be used for the injured party's benefit.¹⁰⁰ However, in California, the injured party has been permitted to bring a suit for liability against the insurer on an assignment theory.¹⁰¹

Evidence which is admissible against the insured in the original trial is admissible against the insurer when it is the defendant in a negligence suit brought by the insured for a wrongful refusal to settle.¹⁰² It is even permissible for the injured party to testify at the later trial.¹⁰³

The states are not in agreement as to whether or not the payment of a judgment by the insured is a prerequisite to recover from the insurer for its tortious failure to accept a settlement.¹⁰⁴ Some states hold that the insured is not required to show that he has paid the amount in excess of the policy limit in order to recover.¹⁰⁵ Former holdings that required the insured to have the capacity to, or make payment of the excess

⁹⁷ *Linkenhog v. American Fidelity & Casualty Co.*, *supra* note 2.

⁹⁸ *Brown v. Guarantee Insurance Co.*, *supra* note 41; *Lee v. Nationwide Mutual Insurance Co.*, 286 F. 2d 295 (4th Cir. 1961).

⁹⁹ *Duncan v. Lumberman's Mutual Casualty Co.*, 91 N. H. 349, 23 A. 2d 325 (1941).

¹⁰⁰ *Chittlick v. State Farm Mutual Automobile Ins. Co.*, *supra* note 95.

¹⁰¹ *Comunale v. Traders and General Insurance Co.*, 328 P. 2d 198 (Cal. 1958).

¹⁰² *Highways Insurance Underwriters v. Lufkin-Beaumont Motor Coaches, Inc.*, 215 S.W. 2d 904 (Tex. Civ. App. 1948).

¹⁰³ *G. A. Stowers Furniture Co. v. American Indemnity Co.*, *supra* note 57.

¹⁰⁴ *Weissin v. American Indemnity Co.*, 127 F. Supp. 775 (W. D. Mo. 1955).

¹⁰⁵ *Harris v. Standard Accident & Insurance Co.*, 191 F. Supp. 538 (S. D. N. Y. 1961) (insured insolvent); *Universal Automobile Insurance Co. v. Culbertson*, 54 S.W. 2d 1061 (Tex. Civ. App. 1932).

before it had a right of action against the insurer were criticized for making the insurer less responsive to its fiduciary duties.¹⁰⁶

A judgment against the insured has been held to constitute a legal injury regardless of whether or not it has been paid.¹⁰⁷

In Florida, the courts take the position that if the policy holder is financially irresponsible, he is precluded from maintaining an action for the excess over the policy limit against the insurer.¹⁰⁸ Other courts are in agreement.¹⁰⁹ The view requiring the insured to have the capacity to make payment before it can maintain an action against the insurer for the excess has been criticized because it

. . . only serves as a windfall to an insurer fortunate enough to have insured an insolvent. The insurer in such a case stands in the position of having been derelict in the performance of its duty under a policy for which it accepted a premium paid by the insured in good faith . . . If the insured had not felt the need of the protection offered by the policy and the services of the Company in handling claims against him it is to be assumed he would not have taken the policy. The claim is now adjudged liability which he can escape only by a discharge in bankruptcy or by payment. If he chooses the former course his credit is impaired. If he does not the outstanding judgment against him is likely to prove an insurmountable barrier to payment. If payment is not required in cases of this kind the insurer is likely to be less responsive to its trust duties in cases where the insured is insolvent than in cases where the insured is able to discharge any judgment in excess of the policy limit which may be rendered against him.¹¹⁰

¹⁰⁶ *Southern Fire & Casualty Co. v. Norris*, *supra* note 18.

¹⁰⁷ *Schwartz v. Norwich Union Indemnity Co.*, 212 Wis. 593, 250 N.W. 446 (1933).

¹⁰⁸ *Canal Insurance Co. v. Sturgis*, 114 So. 2d 469, 472 (1st S.C.A. Fla. 1959), 122 So. 2d 313 (Fla. 1960).

¹⁰⁹ *Sumas v. Hartford Accident & Indemnity Co.*, *supra* note 35; *State Auto Mut. Ins. Co. v. York*, 104 F.2d 730, 734, *Cert. den.* 308 U.S. 591 (4th Cir. 1939) (*dictum*).

¹¹⁰ *Southern Fire and Casualty Co. v. Norris*, *supra* note 18.

The insurer may possibly safeguard itself from excess liability by preparing a memorandum to the effect that it wishes to settle and placing such memorandum with the court. A more elaborate spelling out of the rights of the parties in the contract itself might also prove beneficial. Certainly the employment of competent agents as well as strictly adhering to its fiduciary responsibility will be of benefit to the insurer. The settling of claims when an excess judgment is anticipated will also prevent many problems from arising.