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Insurance: Liability of Insurance Company for Refusal to Settle within Policy Limits (Crisi v. Security Ins. Co., 58 Cal. Rptr. 13, 426 P.2d 173, 1967)

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ment, and (2) the social need for effective sanitation and safety programs. To accomplish both of these ends while requiring the type of warrant traditionally known in the search for evidence of crime was not possible. The strictness of the "probable cause" standards required in a search pursuant to criminal investigation would make a warrant difficult, if not impossible, to obtain. Even if this were possible, such a method would be unlikely to permit a search of all the buildings in a particular district—a procedure which is necessary if an area inspection is to be effective. The Court in *Camara* solves the dilemma by setting reduced standards of "probable cause" to warrant an administrative inspection. The *Camara* solution is reasonable and a long standing constitutional question is finally settled, but the resolution of the practical administrative problems created by the decision will not be found quickly.

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INSURANCE: LIABILITY OF INSURANCE COMPANY FOR REFUSAL TO SETTLE WITHIN THE POLICY LIMITS. Plaintiff owned a building which was insured for general liability by the defendant. Plaintiff's tenant fell through a stairway which was negligently maintained. The tenant, who suffered severe mental and physical injuries, brought an action against the plaintiff claiming $400,000 in damages but subsequently offering to settle for $9,000. Although the insurance policy had a limit of $10,000, the insurer refused the offer of settlement. The tenant pursued her action against the plaintiff and recovered a judgment of $101,000. The insurer paid the $10,000 policy limit and disclaimed further liability. Plaintiff then brought this action to recover the excess of the judgment over the policy limits from the insurer. *Held,* by refusing the resonable settlement offer, the defendant breached its duty to act in good faith and was liable for the entire judgment against the plaintiff. *Crisci v. Security Ins. Co.,* 58 Cal. Rptr. 13, 426 P.2d 173 (1967).[1]

In the instant case, the insurer paid $116,000[2] more than its policy limit because it refused to settle the claim within the limits of the policy. This case illustrates the conflict between the interests of the insurer and insured, which arises whenever an injured party offers to settle within the policy limits.[3] Liability insurance contracts require the insurer to pay only the sums which the law determines the insurer owes to the injured party.[4] Often it serves the insurer's financial interests to refuse to settle because a subsequent court action may determine: (a) that there is no

[1] *See also* Potomac Ins. Co. v. Wilkins Co., Inc., 376 F.2d 425 (10th Cir. 1967).
[2] The insurer paid a total of $126,000: $10,000 policy limits, $91,000 excess judgment, and $25,000 for mental suffering caused by the insurer's refusal to settle.
[3] Radcliff v. Franklin National Ins. Co., 208 Ore. 1, 298 P.2d 1002, 1011 (1956).
[4] *Id.*

liability; (b) that there is liability, but less than the settlement offer; or (c) that there is liability, but on a ground outside the coverage of the policy.[5] The insured, and not the insurer, will be liable for any amount in which the judgment exceeds the policy limit. The insured's interests are best protected if the insurer frees him from any financial responsibility by settling within the policy limit.[6] The conflict between the insured's interest in having the claim settled prior to trial, and the insurer's interest in allowing the insured to be sued, becomes apparent when the settlement offer approaches the policy limit. For example: The injured sues for $50,000; the insured is covered up to $5,000, and the injured party offers to settle for $4,500. The insurer could accept the offer and protect the insured from potential financial liability or it could refuse to settle and attempt to recover a judgment under $4,500. Since only $500 separates the settlement offer from the policy limit, the insurer might decide to risk paying the $5,000 limit in the hope of winning a favorable verdict. Virtually all of the risk of loss would then fall on the insured because he would be exposed to a potential excess judgment of $45,000.[7] In attempting to save $4,500, the insurer would be gambling with $45,000 of the insured's money.[8]

Does an insurer have any duty to accept settlement offers within the policy limits? The typical liability insurance contract does not impose an express duty on the insurer to accept any offer of settlement.[9] Insurance companies have vigorously advocated literal interpretations of insurance contracts and some courts have held that insurers have no duty except as expressly provided in the contract.[10] These courts have strictly interpreted the liability insurance contracts which merely allow settlement if it seems expedient to the insurer.[11]

A majority of courts recognize that insurance companies owe some

[5]Tomerlin v. Canadian Indem. Co., 39 Cal Rptr. 731, 394 P.2d 571, 576 (1964); *Instant case* at 177.

[6]*Tomerlin v. Canadian Indem Co., supra* note 5 at 576; Keeton, *Liability Insurance & Responsibility for Settlement*, 67 HAR. L. REV. 1136, 1142 (1956).
[7]*Radcliff v. Franklin Nat'l Ins. Co., supra* note 3, at 1011.

[8]*Id.* "The indemnity companies . . . are in a position to say to the insured: 'heads I win, tails you loose.'" Tyger River Pine Co. v. Maryland Cas. Co., 170 S.C. 286, 170 S.E. 346, 348 (1933); 60 YALE L. J. 1037.

[9]*See* note 11 *infra;* Olson v. Union Fire Ins. Co., 174 Neb. 375, 118 N.W.2d 318, 321 (1962); Duprey v. Security Mut. Cas. Co., 43 Misc.2d 811, 252 N.Y.S.2d 375, 378 (1964).

[10]St. Joseph Transfer & Storage Co. v. Employer's Indem. Corp., 224 Mo. App. 221, 23 N.W.2d 215, 220 (1930); *accord*, Brochstein v. Nationwide Mut. Ins. Co., 226 F. Supp. 223, 225 (E.D.N.Y. 1967); Rumford Falls Paper Co. v. Fidelity & Cas. Co., 92 Me. 574, 43 A. 503, 506 (1899); Wisconsin Zinc Co. v. Fidelity & Dep. Co., 162 Wis. 39, 155 N.W. 1081, 1085 (1961); *cf.* Auerbach v. Maryland Cas. Co., 236 N.Y. 247, 140 N.E. 577, 579 (1923).

[11]*Potomac Ins. Co. v. Wilkins Co. Inc., supra* note 1, at 426.
The policy under which the suit was brought stated:
> "II. Defenses, Settlement, Supplementary Payments. With respect to such insurance as is afforded by this policy, the company shall: (a) defend any suit against the insured alleging such injury, sickness, disease, or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent; but the company may make such investigation, negotiation and settlement of any claim or suit as it deems expedient . . . ."

duty to settle despite the specific language of the contract.[12] The theories upon which liability is imposed vary widely, however. Some courts would hold insurers liable if fraudulent refusals to accept settlement offers could be proven.[13] This reasoning does not depend upon the express terms of the insurance contract, but rather upon the general abhorrence which the law has for fraud in any legal relationship.[14] However, this is the most primitive approach; most jurisdictions do not require active fraud in order to charge insurers with excess liability.[15] Instead, excess liability has been imposed upon insurers because of either negligence[16] or bad faith[17] during settlement negotiations. In some instances the negligence and bad faith theories have been used without distinction.[18] A reading of these decisions indicates that any distinction between bad faith and negligence is semantical rather than factual.[19]

The majority rule requires an insurer to give as much consideration to the financial interests of the insured as it gives to its own interests.[20] This duty is imposed on the insurer because, by the terms of the insurance contract, it has the absolute right of control over litigation and settlement.[21] If the insurer refuses to settle without giving the insured equal consideration, it shall have breached its duty and will be liable for

[12]Ivy v. Pac. Auto Ins. Co., 156 Cal App.2d 652, 320 P.2d 140, 145 (1958); Brown v. Guaranty Ins. Co., 155 Cal. App.2d 679, 319 P.2d 69, 71 (1958); Hilker v. W. Auto Ins. Co., 204 Wis. 1, 231 N.W. 257 (1930), *aff'd on rehearing*, 204 Wis. 12, 235 N.W. 413, 414 (1931); *see generally* annot., 40 A.L.R.2d 168 (1955).

[13]*Auerbach v. Maryland Cas. Co., supra* note 10, at 579; City of Wakefield v. Globe Indem. Co., 246 Mich. 643, 225 N.W. 643, 644 (1929).

[14]*City of Wakefield v. Globe Indem. Co., supra* note 13, at 645.

[15]*Potomac Ins. Co. v. Wilkins Co., Inc., supra* note 1, at 427 (Colo.); Fetter Livestock Co. v. National Farmers Union Property & Cas. Co., 257 F. Supp. 4, 10 (D. Mont. 1966); Jessen v. O'Daniel v. National Farmers Union Property & Cas. Co., 210 F. Supp. 317, 326 (D. Mont. 1962), *aff'd*, National Farmers Union Property & Cas. Co. v. O'Daniel, 327 F.2d 60 (9th Cir. 1964); Farmers Ins. Exch. v. Henderson, 82 Ariz. 335, 313 P.2d 404, 406 (1957); Comunale v. Traders Gen. Ins. Co., 50 Cal. App. 654, 328 P.2d 198, 200 (1958); Bennett v. Conrady, 180 Kan. 485, 305 P.2d 823, 827 (1957); National Mut. Cas. Co. v. Britt, 203 Okl. 175, 200 P.2d 407, 411 (1948); *Radcliff v. Franklin Nat'l Ins. Co., supra* note 3, at 1006 (Ore.); Murray v. Aetna Cas. & Sur. Co., 61 Wash.2d 618, 379 P.2d 731, 733 (1963; *see also*, annot., 40 A.L.R.2d 168 (1955).

[16]For a breakdown of criteria utilized by individual jurisdictions, *see* Wymore, *Safeguarding Against Claims in Excess of Policy Limits*, 28 INS. COUNSEL GUIDE 44, 49 (1961); annot., 40 A.L.R.2d 169 (1955).

[17]*Id.*

[18]*Id.*

[19]Lee v. Nationwide Mut. Ins. Corp., 184 F. Supp 634, 639 (D. Md. 1960); *Jessen v. O'Daniel v. National Farmers Union Property & Cas. Co., supra* note 15, at 326; *Radcliff v. Franklin Nat'l Ins. Co., supra* note 12, at 1018; *Hilker v. Western Auto. Ins. Co., supra* note 12 at 414; Wymore, *Safeguarding Against Claims in Excess of Policy Limits, supra* note 16, at 45; Keeton, *Liability Insurance & Responsibility For Settlement, supra* note 6, at 1141; 48 MICH. L. REV. 95 (1949).

[20]United States Fidelity & Guar. Co. v. Lembke, 328 F.2d 569, 572 (10th Cir. 1964); *Instant case* at 178; *Comunale v. Traders & Gen. Ins. Co., supra* note 15, at 201; *Ivy v. P. Auto Ins., supra* note 12, at 146.

[21]Moore v. United States Fidelity & Guar. Co., 325 F.2d 972, 974 (10th Cir. 1963); Traders & Gen. Ins. Co. v. Rudco Oil & Gas Co., 129 F.2d 621, 627 (10th Cir. 1942); *Comunale v. Traders Gen. Ins. Co., supra* note 15, at 200; *Radcliffe v. Franklin Nat'l Ins. Co., supra* note 3, at 1006; *Hilker v. W. Auto Ins. Co., supra* note 12, at 414; Wooten v. Central Mut. Ins. Co., 166 So.2d 747, 751 (La. 1964).

the entire judgment against the insured.[22] Courts have developed a basic list of inquiries to aid in deciding whether the insurer discharged its duty of equal consideration. The following is a representatve compilation of criteria utilized by courts:

> (1) whether, by reason of the severity of the plaintiff's injuries, any verdict is likely to be greatly in excess of the policy limits; (2) whether the facts of the case indicate that a defendant's verdict on the issue is doubtful; (3) whether the company has given due regard to the recommendations of its trial counsel; (4) whether the insured has been informed of all settlement offers; (5) whether the insured has demanded that the insurer settle within the policy limits; (6) whether the company has given due consideration to any offer of contribution made by the insured.[23]

Before an insurer can make an informed decision to settle, it must make an adequate determination of the extent of damage and probable liability.[24] A cogent argument can be made for a finding of bad faith if the insurer had refused a settlement without having conducted a proper investigation, if proper research would have revealed a real probability of an adverse judgment.[25] Once an investigation has been made, good faith requires the insurer to respond in accordance with that investigation.[26] The insurer which refuses to heed the advice of its trial counsel, who after investigation, advocates settlement, shall have breached its duty and will be liable for any excess judgment.[27] Hence, the determination of breach of duty revolves primarily around the character of the plaintiff's injuries and the likelihood of an adverse judgment.

> It [breach of duty] is most readily inferable when the severity of the plaintiff's injuries is such that any verdict against the insured is likely to be greatly in excess of the policy limits, and further when the facts in the case indicate that a defendant's verdict on the issue of liability is doubtful. When these two factors coincide, and the company still refuses to settle, the inference of bad faith is strong.[28]

While a refusal to settle in spite of a probability of an excess judgment against an insured is persuasive evidence of breach of duty, it is not determinative in itself.[29] All of the factors[30] are utilized by the courts in deciding whether the insurer failed to give equal consideration to the interests of the insured and breached its duty. The ultimate test for the

[22] *Potomac Ins. Co. v. Wilkins Co., supra* note 1, at 427.

[23] *Jessen v. O'Daniel v. National Farmers Union Property & Cas. Co., supra* note 15, at 326, 327; *see also*, Brown v. Guar. Ins. Co., 155 Cal. App. 679, 319 P.2d 69, 75 (1958); annot., 40 A.L.R.2d 168 (1955).

[24] Southern Fire & Cas. Co. v. Norris, 35 Tenn. App. 657, 250 S.W.2d 785, 791 (1952).

[25] Henke v. Iowa Home Mut. Cas. Co., 250 Iowa 1123, 97 N.W.2d 168, 174 (1959); *Hilker v. W. Auto Ins. Co., supra* note 12, at 415.

[26] Royal Transit v. Central Sur. & Ins. Corp., 168 F.2d 345, 346 (7th Cir. 1948).

[27] *Brown v. Guar. Ins. Co., supra* note 12, at 75.

[28] Harris v. Standard Accident & Ins. Co., 191 F. Supp. 538, 540 (S.D.N.Y. 1961); *Henke v. Iowa Home Mut. Cas. Co., supra* note 12, at 75.

[29] *Jessen v. O'Daniel v. National Farmers Union Property & Cas. Co., supra* note 15, at 327; *Brown v. Guar. Ins. Co., supra* note 12, at 75.

[30] *See* text at note 22, *supra*.

determination of breach of duty, which presupposes consideration of all the criteria, was expressed in *Radcliff v. Franklin National Ins. Co.:*

> [T]he controlling rule should balance the risks involved and thereby cause the insurer in settlement affairs to behave as if it were liable for the entire judgment that may be eventually entered.[31]

In order to prevent excess liability, the insurer must act as if there were no limit on the policy and must be as quick to accept the settlement offer as if it were liable for the entire judgment in the first instance.[32] Under the proper circumstances, after due consideration of the insured's interests, the insurer can safely refuse to settle within the limits and not be held for an excess judgment.[33]

As an extension of the insurer's duty to consider the insured's interests, it has been occasionally contended that it be held strictly liable for any excess judgment rendered subsequent to a refusal to settle within the policy limit.[34] In the past, this rationale has been consistently rejected by the courts.[35] With the possible exception of one case,[36] courts have uniformly held that insurers can exercise discretion to determine whether to settle, and are not compelled to accept offers merely because they are within the policy limits.[37] In the instant case, however, it was seriously contended that the insurer be held strictly liable for the excess judgment merely because it refused to accept the offer to settle within the policy limit.[38] Although the court found the insurer liable for a bad

[31] *Radcliff v. Franklin Nat'l Ins. Co., supra* note 3, at 1023; Keeton, *Liability Insurance & Responsibility for Settlement, supra* note 6, at 1136.

[32] *Instant case* at 176; Dumas v. Hartford Accident & Indem. Co., 94 N.H. 484, 56 A.2d 57, 60 (1947).

[33] Two cases which arose in Montana demonstrate that insurers can refuse to settle and and not incur liability for the excess judgment. In *Fetter Livestock Co. v. National Farmers Union Property & Cas. Co., supra* note 15, the court held that a rejection based on a proper investigation and consideration of the insured's interests would not result in liability. In spite of severe injuries to the plaintiff, the insurer's counsel had advised against settlement. An excess judgment was recovered against the insured but the insurer was not liable for it. The refusal to settle based on the counsel's mistaken judgment (no bad faith shown) was not sufficient to predicate liability on the insurer. In the other case, *Jessen v. O'Daniel v. National Farmers Union Property & Cas. Co., supra* note 15, the court found liability on the insurer for the excess judgment. The insurer incurred liability because it failed to heed the advice of its attorney and because its counsel failed to communicate a settlement offer to the insured.

[34] Noshey v. American Auto. Ins. Co., 68 F.2d 808, 809 (6th Cir. 1934); Blue Bird Taxi Corp. v. American Fidelity & Cas. Co., 26 F. Supp. 808, 810 (D.S.C. 1939); Kingan Co. v. Maryland Cas. Co., 65 Ind. App. 301, 115 N.E. 348, 351 (1917); *Rumford Falls Paper Co. v. Fidelity & Cas. Co., supra* note 10, at 505; Tyger River Pine Co. v. Maryland Cas. Co., 170 S.C. 286, 170 S.E. 346, 348 (1933).

[35] *Noshey v. American Auto. Ins. Co., supra* note 34; *Blue Bird Taxi Corp. v. American Fidelity & Cas. Co., supra* note 34, at 810; *Kingan Co. v. Maryland Cas. Co., supra* note 34, at 351; *Rumford Falls Paper Co. v. Fidelity & Cas. Co., supra* note 10, at 506.

[36] The insurer contracted to hold the insured harmless. "If, in the effort to do this, its own interests conflicted with those of the respondent, it was bound, under its contract of indemnity and in good faith, to sacrifice its interests in favor of the respondent." *Tyger River Pine. Co. v. Maryland Cas. Co., supra* note 34, at 348.

[37] *Lee v. Nationwide Mutual Ins. Co., supra* note 19, at 639; American Cas. Co. v. Howard, 187 F.2d 322, 329 (4th Cir. 1951).

[38] The argument was made that: "[W]henever an insurer receives an offer to settle within the policy limits and rejects it, the insurer should be liable in every case for

faith refusal to accept the settlement, it did not reject the proposed strict liability theory. In fact, the court justified tentative acceptance of it.

> In light of the common knowledge that settlement is one of the methods by which an insured receives protection under a liability policy, it may not be unreasonable for an insured who purchases a policy with limits to believe that a sum of money equal to the limits of the policy is available and will be used so as to avoid liability on his part with regard to any covered accident.[39]

The manner in which the strict liability theory came to the court's attention in the instant case indicates that California is interested in the proposed rule. Strict liability was not mentioned in the report of the case until it reached the Supreme Court.[40] An *amicus curiae* injected the first mention of strict liability. In addition to being favorably impressed by this argument, the court was influenced by commentators who also advocate strict liability in the settlement situation.[41] The court concurred with them that policy rates would increase slightly and the burden on insurers would remain substantially the same if a strict liability theory were accepted.[42]

The language used by the court strongly suggests that California may accept the proposed rule in the future.

> [M]ost importantly, there is more than a small amount of elementary justice in a rule that would require that, in this situation where the insurer's and insured's interests necessarily conflict, the insurer, which may reap the benefits of its determination not to settle, should also suffer the detriments of its decision.[43]

The actual ruling in the instant case did not effect the law in the area of insurer's excess liability. It was decided on a conventional bad faith basis. However, the dicta in the case suggests approval of the strict liability rule. The practical effect of strict liability would be to erase the policy limit in insurance contracts in certain circumstances. If the insurer refused to accept a settlement offer within the coverage, the policy limits would be replaced by liability to the extent of any judgment which the injured party might recover. Even if the proposed rule were accepted, however, it would not substantially increase the number of excess judgments against insurers. It would be efficacious only in circumstances in which the insurer refused to settle but did not breach its duty to protect the interests of the insured.

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the amount of the final judgment whether or not within the policy limit.'' *Instant case* at 177.

[39]*Instant case* at 177.

[40]Crisci v. Security Ins. Co., 52 Cal. Rptr. 288 (1966).

[41]18 STAN L. REV. 475, 482-485 (1966); 60 YALE L. J. 1037, 1041 (1951); *Insurance—Liability of Insurer For Judgment in Excess of Policy Limits*, 48 MICH. L. REV. 95, 102 (1949); 13 U. CHI. L. REV. 105, 109 (1945).

[42]*Instant case* at 177.

[43]*Id.*

In order to justify such an imposition of liability, it would be necessary to decide that the insurer's exclusive right to control the litigation carries with it a correlative duty to accept every offer to settle within the policy limit. Charging an insurer with a strict duty may be justifiable in view of the unequal bargaining positions of insurance companies and the individual insured parties. However, it appears to be stretching the insurance contract to the breaking point if strict liability is to be based on an insurance clause which does not express any duty to consider the insured's interests. In effect the insurance contract would be judicially rewritten so that its effect would be diametrically opposed to its literal meaning.

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TRIALS: QUESTIONING JURORS ON VOIR DIRE CONCERNING RELATIONSHIP TO INSURANCE COMPANIES. Plaintiff sued the City of Anaconda for damages for injuries sustained as a result of a fall on a sidewalk maintained by the city. Counsel for the plaintiff requested the court to permit the following question during the *voir dire* examination of jurors: "Are you or is any other member of your family, a stockholder in the Glacier Insurance Company, a Montana corporation, with its main office in Missoula, Montana?" The court sustained the defendant's objection to that question, but allowed general questions involving prospective jurors being investors in any insurance company. When these questions were asked, the defendant objected and moved for a mistrial. The motion was denied and *voir dire* questioning continued. *Held,* this type of questioning on *voir dire* was prejudicial and constituted reversible error. *Avery v. City of Anaconda,* 428 P.2d 465 (Mont. 1967).

The right of trial by an impartial jury is secured to each citizen of the State of Montana.[1] The determination of whether a juror is qualified is usually made during the *voir dire* examination of the prospective jurors.[2] In the majority of jurisdictions, courts recognize the need for allowing counsel wide latitude in ascertaining jurors qualifications[3] and counsel is generally allowed to question prospective jurors concerning their relationship with insurance companies.

The decision in the *Avery* case reflects the very restricted view that any injection of the issue of insurance into a trial is reversible error.[4]

[1]MONT. CONST. art. 3, §§ 16, 23; Shane v. Butte Electric Ry. Co., 37 Mont. 599, 97 P. 958, 959 (1908). "The right to unbiased and unprejudiced jurors is an inseparable and inalienable part of the right to a trial by jury guaranteed by the Constitution."

[2]State v. Russell, 73 Mont. 240, 235 P. 712, 715 (1925).

[3]Kiernan v. Van Schaik, 347 F.2d 775 (3rd Cir. 1965).

[4]Avery v. City of Anaconda, 428 P.2d 465 (Mont. 1967).