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COMMENTS

CRISCI'S DICTA OF STRICT LIABILITY FOR INSURERS' FAILURE TO SETTLE: A MOVE TOWARD RATIONAL SETTLEMENT BEHAVIOR

Limited liability insurance policies typically bind the insurer to defend the insured against all claims arising within the coverage of the policy. The insurer is allowed, but not required, to make any settlement it deems expedient. Because the insured promises to cooperate with the insurer in defense of these claims, insureds are usually precluded from taking the initiative in seeking settlement.¹ When the claim against the insured is potentially in excess of policy limits, insurer and insured may desire different settlement conduct. The insurer's primary aim is to minimize its payments. It may litigate where settlement demands are excessive, or where institutional interests are served by refusing to settle.² However, any settlement within policy limits will protect the insured, at no additional cost to him,³ from risk of judgment in excess of his insurance protection.

To regulate the insurer's conduct, most jurisdictions hold that where the insurer, acting in bad faith or negligently, has rejected a settlement offer within policy limits, an action will lie with the insured to recover from the insurer the excess of a subsequent judgment over policy limits.⁴ But a duty framed in these general terms

¹The Aetna Casualty & Surety Company's Family Automobile Policy (Custom-Rite) provides:

[The Company promises to] pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as damages...and the Company shall defend any suit...even if...groundless, false or fraudulent; but the Company may make such investigation and settlement of any claim or suit as it deems expedient.

The Insured shall cooperate with the Company and, upon the Company's request, assist in making settlements...The Insured shall not, except at its own cost, voluntarily make any payment, assume any obligation or incur any expense other than for such...as shall be imperative at the time of accident.

²Since an insurer is an institutional litigant, it views each claim in light of its potential effect upon other claims. It may have reasons lying outside the appraisal of an individual case for wishing to litigate, for example, avoidance of a reputation as an "easy mark" for claimants. See Pretzel, *The Economics of Trial vs. Settlement*, 1965 INS. L.J. 453; Comment, *Excess Liability: Reconsideration of California's Bad Faith Negligence Rule*, 18 STAN. L. REV. 475, 482-83 (1966).

³The insured has, of course, already incurred the costs represented by the insurance premiums.

⁴See Annot., 40 A.L.R.2d 168 (1955) and cases cited therein. Some jurisdictions, such as Washington, apply both the good faith and the negligence standards concurrently. Cf. *Murray v. Mossman*, 56 Wn. 2d 909, 355 P.2d 985 (1960). Other juris-

is an inadequate substitute for analytic determination of the specific interests of insurer and insured under the insurance contract. Also it conceals the tests of insurer conduct actually applied by the courts.⁵ These tests include holding the insurer liable only for actual bad faith, or liable when it has litigated with less than an even chance of winning.⁶ Recent years have seen increased application of a "no-limit" test requiring the insurer to treat a claim as if it were a claim against an insured whose policy was not limited.⁷ And the California Supreme Court has indicated that a better rule might be one requiring the insurer to pay the full judgment any time it has rejected an offer within policy limits.⁸

This comment attempts to explore the interests of the insurer and insured under the insurance contract, to differentiate between different tests applied by the courts, and to determine what effect these different tests will have on insurer's conduct. Finally, the comment examines what courts have actually done in their process of defining insurer duties and presses for a more conscious exercise of their role in facilitating rational settlement behavior. Adoption of a rule of strict liability is advocated.

LIMITED LIABILITY INSURANCE AND THE SETTLEMENT SYSTEM

A settlement is an agreed valuation of rights in lieu of a valuation arrived at by court contest. A settlement system is the process by which those settlements are reached. It is an auxiliary system of

dictions allegedly follow the good faith rule, but do so in terms more appropriate to negligence. *See, e.g.,* *Communale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958); Comment, note 2 *supra*, at 476-77.

The courts' use of the good faith rubric while achieving negligence standards seems to stem in part from a fear that refusal to settle within policy limits will appear negligent per se when a subsequent excess verdict is recovered:

A defense, however, showing reasonable and probable cause for rejecting the compromise offer vindicates the insurer's good faith, even though the defense is unsuccessful.

Larson v. Anchor Cas. Co., 249 Minn. 339, 82 N.W.2d 376, 378 (1957).

⁵ *See* Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1140-48 (1954).

⁶ *See, e.g.,* *Best Bldg. Co. v. Employers' Liab. Assurance Corp.*, 247 N.Y. 451, 160 N.E. 911 (1928) (actual bad faith); *Henke v. Iowa Home Mut. Cas. Co.*, 250 Iowa 1123, 97 N.W.2d 168, 174 (1959) (less than even chance of winning).

⁷ New Jersey has most recently adopted this test. *See* *Bowers v. Camden Fire Ins. Ass'n*, 51 N.J. 62, 237 A.2d 857 (1968).

⁸ *Crisci v. Security Ins. Co.*, —Cal. 2d —, 426 P.2d 173, 58 Cal. Rptr. 13 (1967) (dicta).

This comment restricts itself to a consideration of the tests which courts have applied which refer to *evaluation* of a claim rather than the care to be exercised in processing it. Tests of the latter type, *e.g.*, a requirement prohibiting concealment of offers received, continue to play a major part in excess liability cases, but are not susceptible to the type of analysis this comment attempts. *See* Annot., 40 A.L.R.2d 168 (1955); Comment, *supra* note 2, and cases cited therein.

conflict resolution, operating beside and intertwined with the formal court system.⁹ Settlements may reflect many factors, but the law has an interest that they reflect as far as possible *legally relevant* criteria.¹⁰ Disputes would then be resolved without recourse to the formal court system, but at values derived from legal principles.¹¹

Courts cannot control settlement behavior to such an extent that settlements reflect only legally relevant factors. But courts have some control over settlement behavior when they define the insurer's duty to settle. A model of the settlement system will be constructed to illustrate the derivation of settlements from the facts of a claim.¹² This model, while not reflecting all the variations of real life, will nevertheless provide a framework for analysis. The impact of the various formulations of the settlement duty upon parties to a single settlement and upon settlements in the aggregate will then be explored to indicate the extent to which they foster or impede *rational settlement behavior*—behavior guided by legally relevant criteria.

In the simplest case, the amount of damages is known, and only the existence of liability is in question. Assume a plaintiff has sustained damages of \$25,000. If he can recover at trial, he will receive a judgment for \$25,000. But assume there are factors which reduce the likelihood of recovery to 30 percent.¹³ His claim then has a *percentage judgment value* of only \$7500.¹⁴ This value would be

⁹ For example, less than 2% of the claims made each year in New York City are directly controlled by court adjudication. See Franklin, Chanin & Mark, *Accidents, Money, and the Law: A Study of the Economics of Personal Injury Litigation*, 61 COLUM. L. REV. 1, 10 (1961). See also Rosenberg & Sovern, *Delay and the Dynamics of Personal Injury Litigation*, 59 COLUM. L. REV. 1115 (1959); A. CONRAD, *et al.*, MICHIGAN LEGAL STUDIES, AUTOMOBILE ACCIDENT COSTS AND PAYMENTS (1964).

¹⁰ "Relevant" factors include those matters of which the jury, as well as the judge, is cognizant in determining liability and damages. For example, the demeanor of a potential witness is a legally relevant factor, since in court it would have a bearing on credibility.

¹¹ Of course the objective value of a claim may be discounted by the parties in light of their personal circumstances and the costs of litigation. This point is developed in note 15 *infra*.

¹² Discussion will be confined to the settlement practices applicable to substantial claims, since it is these claims which potentially present the excess liability problem. For economic data on the settlement of serious injury cases, see A. CONRAD, *et al.*, *supra* note 9, at 159-236.

¹³ One example of such a factor would be the likelihood of defendant's proving an affirmative defense such as contributory negligence. But within the definition of legal relevancy (see note 10 *supra*), another factor might be the demeanor of a witness.

¹⁴ More complex cases represent to a large extent only aggregates of the same factors. Even the most complex case can be subjected to a form of "vector analysis" which reduces it to measurable component parts. See *Crisci v. Security Ins. Co.*, —Cal. App. 2d —, 52 Cal. Rptr. 288, 291 (1966), *rev'd on issue of general damages*, —Cal. 2d —, 426 P.2d 173, 58 Cal. Rptr. 13 (1967). The dichotomy between damages and percent chance of recovery is, even in the simplest cases, an oversimplification,

equivalent to the average of verdicts returned in similar cases over some past period. The \$7500 percentage judgment value is economically neutral between settlement and litigation, because it statistically reflects the prediction of all legally relevant criteria. If all other things were equal,¹⁵ it would be *rational settlement behavior* for plaintiff to accept any offer of \$7500 or more, and to reject any offer of less. Since both plaintiff and defendant face the same potential judgment and the same chance of its recovery, the percentage judgment value is normally shared by the two parties.¹⁶

since many factors which allegedly influence likelihood of recovery (*e.g.*, contributory negligence) in fact may vary the jury's award of damages. Both lawyers and insurers are well aware of such possibilities, however. Insofar as claim assessment involves an unarticulated amalgam of liability and damage considerations, the *value* which is assessed is in any case the percentage judgment value.

The usefulness of the settlement system model does not depend upon complete accuracy in its reflection of claim evaluation. It is clear that in investigating a claim, at least some initial attempt is made at isolation of the amount of damages on the one hand, and the likelihood of recovery on the other. And many problems have arisen because the insurer has given too much attention to only one factor—likelihood of recovery—which clearly suggests that it has been isolated. *See, e.g., Crisci v. Security Ins. Co., —Cal. 2d —, 426 P.2d 173, 58 Cal. Rptr. 13 (1967)*. Plaintiff had suffered physical injuries valued at \$3000, with clear liability. In addition, there was conflicting expert testimony as to whether the accident had caused plaintiff's severe psychosis. The insurer had been advised that if causation was established, the verdict would likely run to at least \$100,000. The insurer nevertheless rejected an offer of \$9000, of which the insured was willing to contribute \$2500. Since the rejected offer included \$2500 recoverable from the insured, and \$3000 in settlement of the physical injury, the insurer showed itself unwilling to pay \$2500 to purchase the contingent liability of \$97,000. Had the insurer regarded itself as potentially liable for the full amount of any judgment, it would have pursued this course of conduct only if it believed there was less than a 5% chance of the mental suffering being established (5% of \$97,000 = \$4850). Obviously the insurer's conduct is more easily inferred as the result of a consideration of only the insurer's own economic interests, since in this case the insured had only a \$10,000 policy.

With this somewhat abstract view, the reader may wish to compare P. HERMANN, *BETTER SETTLEMENT/THROUGH LEVERAGE* (1965). See especially *id.*, § 2:11.

¹⁵ All other things are rarely equal. Starting with the common percentage judgment value, the parties will evaluate the probable loss or benefit resulting from litigation as opposed to settlement at an offered valuation. Factors personal to the parties, such as their economic strength, may make one of them more willing to accept a certain lesser amount of money in settlement, rather than the contingent amount reflected in the percentage judgment value. The parties may adjust the percentage judgment value to reflect these considerations, arriving at a second *settlement* value. By definition, the parties take into account considerations legally irrelevant to the valuation of a claim in arriving at their personal settlement values. The law allows such action not because it approves of the criteria used by the parties, but simply because their action is beyond the law's reach so long as the parties voluntarily submit themselves to the informal settlement process rather than the formal court process. To the extent that the discrepancy between a party's settlement value and the percentage judgment value is known to the other party, it may itself be the object of compromise, because for both parties there is the incentive of avoiding forcing the opponent to trial. Differences between the parties' percentage judgment values are more fundamental, however. They go to a discrepancy in the estimated *trial* valuation itself, from which there is no recourse.

¹⁶ This assumes equal knowledge of the relevant facts of the case and equal appraisal of them. While that is unlikely, the important fact is that the percentage judgment value is an objective valuation inhering in the claim; both parties will approach that valuation as their valuation becomes more refined.

Limited liability insurance complicates the settlement process. The party now defending against the claim is the insurer, but it has only a limited interest in any judgment potentially in excess of the policy limits. The result is that plaintiff and insurer now have disparate percentage judgment values.¹⁷ This is quickly seen by returning to the previous hypothetical of a \$25,000 claim with a 30 percent chance of recovery. Insured has a \$10,000 policy. Assume that the insurer owes its insured no duty in managing settlement efforts and may make any settlement it deems expedient. The plaintiff still has a potential judgment liability of \$25,000, but the insurer's potential liability is only \$10,000.¹⁸ Since plaintiff and insurer face the same likelihood of the claim's recovery, their respective percentage judgment values are \$7500 and \$3000. The insured is very anxious for the insurer to accept any offer of settlement within the policy limits. But relative to its expected average trial loss, the insurer will lose money on any settlement it makes unless it can force the plaintiff's settlement demand down to or below \$3000.¹⁹

The settlement system depends upon adversaries' ability to reach a similar estimate of the trial valuation of a claim, even though they may later discount this trial valuation in light of litigation costs and personal circumstances.²⁰ The limited liability insurance contract upsets the system's balance by giving the insurer, who has only a limited financial interest, control over the disposition of the entire claim. The insurer, in negotiating on the basis of a limited interest not shared by the plaintiff, may reject settlement offers which are reasonable in light of the entire claim—a result contrary to the aim of the settlement system and unfair to the insured.

Faced with this situation, the courts recognized a cause of action in the insured against the insurer for wrongful failure to settle. They realized that insurer control of defense and settlement was a necessity

¹⁷ If parties adjust their settlement values in light of legally irrelevant personal conditions, they still will be making such adjustments from the different bases of their disparate percentage judgment values. *See* note 15 *supra*.

¹⁸ Since the insured's personal assets are typically limited, the major interest of the plaintiff is in the solid asset of the insurance policy. There is a split of authority on the question of the plaintiff's right to discovery of insurance coverage. *See* Annot., 13 A.L.R.3d 822 (1967). *See* note 56 *infra* on the effect of knowledge of the policy limits upon conduct under the strict liability rule.

¹⁹ The assumption made here is that the insurer's settlement value (*see* note 15 *supra*) will be at or below the claim's percentage judgment value. This assumption is justified because of the insurer's institutional status and great economic wealth relative to its average protagonist. *See* text p. 815 *infra*. An exception, of little concern to an analysis of excess liability litigation, is the small nuisance claim.

²⁰ *See* notes 15, 16 and 17 *subra*.

of insurance practice, but thought that fairness required that the insurer be prevented from abusing the power given him. Accordingly, they imposed a duty of good faith.²¹ So long as the duty prohibited only actual fraud, concealment or dishonesty, it did not require the insurer to base its decision whether to accept or reject a settlement offer on anything other than its limited percentage judgment interest (\$3000 in the previous hypothetical).

The continued imposition of heavy liabilities upon insureds in the face of insurer rejection of offers which were reasonable in light of the percentage judgment value of the entire claim (\$7500 in the previous hypothetical), led courts to broaden the insurer's duty to proscribe constructive bad faith or negligence in addition to actual bad faith. This broader duty may force the insurer to consider the *economic* interests of the insured by making the insurer liable for failure to accept offers which are in excess of the insurer's limited percentage judgment interest. Adoption of such a test creates a new *legal* interest in the insured, because it provides additional insurance coverage which the insured has failed to purchase.²² The amount by which any settlement offer which the insurer is duty bound to accept exceeds the insurer's limited percentage judgment interest is a reflection of the amount by which the total claim exceeds policy limits.²³

²¹ See, e.g., *Brassil v. Maryland Cas. Co.*, 210 N.Y. 235, 104 N.E. 622 (1914). See also authorities cited in note 4 *supra*.

²² This would not be so if a liability insurance contract were regarded as an asset, equal to the policy limit, available to the insured in settlement as well as litigation. However, the typical contract forecloses such a possibility with its defense clause (see note 1 *supra*) and its payment clause. The discussion in *Duprey v. Security Mut. Cas. Co.*, 43 Misc. 2d 811, 252 N.Y.S.2d 375, 378-79 (Sup. Ct. 1964) is indicative of the courts' usual interpretation:

It is obvious that the defendant company did not undertake to pay any and all claims or settle any and all lawsuits up to the limits of the policy. The company contracted only to pay sums which the insured became legally obligated to pay as damages . . . Does an insured become legally obligated to pay any and all claims and any and all law suits instituted against him? The answer is obvious. The very crux of any lawsuit is to determine whether the insured, in this instance, is legally responsible in damages. This cannot be determined until after a trial by a court of competent jurisdiction.

As has been demonstrated (see text p. 803 *supra*), a literal interpretation of the defense and payment clauses would allow an insurer to follow uneconomic, irrational conduct, from the viewpoint of disposition of the entire claim. A strict liability rule, however, would preclude this by effectively converting the policy into an asset available either in settlement or litigation. Such a result probably is closer to a layman's understanding of the policy. This is one justification which the California Supreme Court has advanced in support of a strict liability rule. See *Crisci v. Security Ins. Co.*, —Cal. 2d —, 426 P. 2d 173, 177, 58 Cal. Rptr. 13, 17 (1967).

²³ This assumes that an insurer is not duty bound, under a constructive bad faith test, to accept an offer which is in excess of the reasonable valuation of the entire claim, i.e., the claim's percentage judgment value. That this is accurate will be seen when the requirements of particular tests are developed, pp. 806-11 *infra*. Presumably the insurer, acting in its own interest, will accept offers below its own limited per-

The disparity between the two amounts arises directly from the insured's failure to carry higher policy limits.

When courts require the insurer to accommodate the uninsured interest of the insured by accepting settlement offers which are higher than the insurer's limited percentage judgment interest, they impose the economic equivalent of a *pro tanto* waiver of the policy limits.²⁴ Even though any such broader duty prescribes economic conduct in derogation of the insurance contract, no new rationale for its adoption has been given. Instead, courts continue to rely on the old rationale that an implied duty of good faith arising from the contract's defense clause required the insurer to "consider the interests of the insured."²⁵

centage judgment interest. The additional offers which the constructive tests require the insurer to accept therefore fall between the insurer's limited percentage interest and the percentage judgment value of the entire claim.

²⁴ For a demonstration of this see note 52 *infra*. In recognition of this functional effect, a policy provision in one case provided for doubling the limits on liability if a settlement offer within limits were rejected. *Georgia Life Ins. Co. v. Mississippi Cent. R. Co.*, 116 Miss. 114, 76 So. 646 (1917). This provision assured that the insurer would attempt to settle any claim with a fair valuation (percentage judgment value) within the policy limits, if the claim had at least a 50% chance of recovery, simply to further its own economic interests. This may be demonstrated by the following table of claims, all of which are assumed to have a 50% likelihood of realization:

Potential Claim	P. J. V.	Insurer's limited percentage judgment interest w/limit of	
		10k	20k
10,000	5000	5000	5000
15,000	7500	5000	7500
20,000	10,000	5000	10,000
30,000	15,000	5000	10,000

The insured in the above case was a railroad, which suggests the obvious: the standard defense clause of insurance policies is the product of insurers' draftsmanship in a setting of patent non-bargaining.

²⁵ Seemingly, a good faith consideration of the insured's interests would be satisfied by honesty, diligence, and keeping the insured appraised of the progress of settlement negotiations. The insured might then contribute an amount proportionate to its limited interest in a potential judgment, in which case the insurer would be duty bound to settle. In fact, courts have rejected such an approach, and efforts by the insurer to secure contribution by the insured have come to be looked upon as indicative of bad faith. *See, e.g., Brown v. Guarantee Ins. Co.*, 155 Cal. App. 2d 679, 319 P.2d 69, 75 (1957). The fact that there was an alternative consistent with the insurance contract which the courts chose to reject, and that they instead adopted broad rules of constructive bad faith, in derogation of the contract, making the insurer financially responsible for the uninsured interest of the insured (*see* note 52 *infra*) makes it incumbent upon them to produce a rationale which justifies their action. The courts have offered little more substantial than the "underlying duty of good faith", which is equally consistent with contribution, and a consideration of "the position of the parties," which, without more, is equally insufficient.

There may be substantial reasons for rejecting contribution in the individual case. It may afford too much opportunity for over-reaching by the insurer. The insured may lack the ready assets to contribute, or may not have foreseen that a limited liability policy protects him to its face value only in the event of a judgment, rather than making that amount available in settlement as well.

In short, there may well be reasons why the courts should not ratify a "contract" which was drawn to the specifications of the insurer to meet its needs. (*See* note 29 *infra*). But if the courts are to reshape the contract to provide a better, more

Such a formulation begs the question. The insurer contracted to safeguard the interests of the insured within the contract, not to safeguard against uninsured losses. Rather than stating in conclusory terms a result discernable only from silent logic, the courts' reasons for manufacturing this new interest should be articulated.²⁶

The most plausible rationale for the imposition on the insurer of a duty to assume protection of this new interest is that it will encourage rational settlement behavior.²⁷ The courts have evidently sought to restore the dynamics of the settlement system and reduce unfairness to the insured by requiring the insurer to have some regard for the claim as a whole. The judicially imposed duty is a higher duty than that contractually assumed.²⁸ However, in the face of contravening and more compelling policy demands, there is no need to stand in awe of contract in an area of patent inequality of bargaining power.²⁹ Moreover, insurers do not suffer financially from the imposition of such a duty because they are in a position to spread among their clients whatever higher economic burdens are imposed.³⁰

SETTLEMENT BEHAVIOR UNDER FORMER TESTS OF INSURERS' CONDUCT

Courts have already shown a willingness to reshape the insurance contract to facilitate more rational settlement behavior. The dispositive question in determining what settlement duty to impose on an insurer therefore should be, "What duty will best encourage rational settlement behavior?"

Neither bad faith nor negligence is a term descriptive of the tests which courts have actually been applying, nor are they sufficiently precise to guide insurer conduct. Whether adjudicating under a good

rational form of coverage, as they have done for many years in their apparent attempt to foster more rational settlement behavior, they should make clear the premises from which they are proceeding, in order that the goal toward which they are tending will likewise become clear.

²⁶ The unfortunate tendency to derive the insurer's duty either from a fictional construction of the contract or in tort out of the relation of the insurer and its insured, although clearly inadequate for the imposition of the broader constructive tests (*see note 25 supra*), still continues. Perhaps one of the most unfortunate examples is recent language by the California Supreme Court suggesting that a rule of strict liability could be so derived. *Crisci v. Security Ins. Co.*, —Cal. 2d —, 426 P. 2d 173, 177, 58 Cal. Rptr. 13, 17 (1967). *See note 48 infra*.

²⁷ Language suggesting such a rationale appears in the opinions, but the rationale has not been rigorously developed, or its full implications explored.

²⁸ *See note 25 supra*, and *note 52 infra*.

²⁹ *Cf. Henningsen v. Bloomfield Motors*, 32 N.J. 358, 161 A.2d 69 (1960); *see generally Kessler, Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943).

³⁰ *Cf. Escola v. Coca-Cola Bottling Co.*, 24 Cal. 2d 453, 150 P.2d 436, 440 (1944) (Traynor, J., concurring).

faith or a negligence rubric, the courts have formulated three narrower standards: actual bad faith,³¹ failure to settle claims with a "great risk" of loss,³² and failure to treat the claim as if there were no limit to the insured's policy.³³ These tests have been loosely formulated under continued application of nebulous good faith or negligence language. They have not been submitted to analysis. One result is that opinions not infrequently express more than one standard in the same opinion.³⁴ In addition to these tests under the negligence or good

³¹ Actual bad faith, involving dishonesty, fraud or concealment, appears to have been the conduct originally proscribed by the good faith rule. See, e.g., *Best Bldg. Co. v. Employers' Liab. Assurance Corp.*, 247 N.Y. 451, 160 N.E. 911 (1928). Since courts later applied the much broader test of constructive bad faith, the fact that a jurisdiction applies "the good faith rule" says little about the actual standards to which an insurer is held. For an example of the confusion which may prevail under the good faith rubric, see note 34 *infra*. Cf. Comment, note 2 *supra*.

³² This "great risk" formulation was used by the California Supreme Court in *Commune v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958). It is treated here as a requirement that the insurer settle cases where the odds of a successful defense are 50% or less. The California court may have meant by this great risk formulation to require settlement where an offer is below the claim's percentage judgment value, see note 46 *infra*, but the term "no-limit" test is used throughout this comment to describe that standard. California has subsequently adopted the no-limit test in unambiguous terms in *Crisci v. Security Ins. Co.*, — Cal. 2d —, 426 P.2d 173, 58 Cal. Rptr. 13 (1967). Other courts speak vaguely of requiring "equal consideration" of the interests of the insured, sometimes meaning to apply the great risk test, and sometimes the no-limit test. See *National Mut. Cas. Co. v. Britt*, 203 Okla. 175, 200 P.2d 407 (1948); Keeton, *supra* note 5, at 1146 n.24.

³³ This is the broadest of the constructive tests applied under the good faith rule. It has also been applied under the negligence rule. See, e.g., *Dumas v. Hartford Accident & Cas. Co.*, 94 N.H. 484, 56 A.2d 57 (1947). The insurer is liable to its insured for the full excess of any subsequent judgment over policy limits whenever it rejects an offer which is both within the policy limits and at or below the entire claim's percentage judgment value. Courts of course have not referred to the percentage judgment value *in haec verba*.

³⁴ *Cowden v. Aetna Cas. & Sur. Co.*, 389 Pa. 459, 134 A.2d 223, 228 (1957) (emphasis added), provides an example:

Some courts have held that where the interests of the parties are conflicting, the insurer need not consider those of the insured. On the other hand, it has been held in at least one jurisdiction that in such a situation the interest of the insurer must yield. The predominant majority rule is that the insurer must accord the interest of its insured the same faithful consideration it gives its own interest. . . . Since it is obvious that the interest of one or the other party may be imperiled at the instant of decision, *the fairest method of balancing the interests is for the insurer to treat the claim as if it alone were liable for the entire amount.* [no-limit test?] But, that does not mean that the insurer is bound to submerge its own interest in order that the insured's interest may be made paramount. It means that where there is little possibility of a verdict or a settlement [sic] within the limits of the policy, the decision to expose the insured to personal pecuniary loss must be based on a bona fide belief by the insurer, predicated upon all the circumstances of the case, that it has a good possibility of winning the suit. [great risk?] While it is the insurer's right under the policy to make the decision as to whether a claim should be litigated or settled, it is not a right of the insurer to hazard the insured's financial well-being. *Good faith requires that the chance of a finding of nonliability to be real and substantial and that the decision to litigate be made honestly.* [or actual bad faith?].

faith rules, a rule of strict liability for failure to accept offers within policy limits has been suggested by the California Supreme Court in *Crisci v. Security Ins. Co.*³⁵ Since *Crisci* involves the great risk and no-limit tests, as well as the proposed rule of strict liability, the opinion provides a convenient vehicle for analysis.

In *Crisci* the court states:³⁶

[T]he implied obligation of good faith and fair dealing requires the insurer to settle in an appropriate case although the express terms of the policy do not impose the duty; . . . in determining whether to settle the insurer must give the interests of the insured at least as much consideration as it gives to its own interests. . . .

Beyond stating that there is an implied duty, the first statement is only a tautology in the absence of an extrinsic definition of "appropriate." The second statement attempts to provide this definition, but it does so by reference to an undefined "interest" of the insured. This interest cannot be a contractual interest, because the contract is carefully drawn to preclude such a settlement interest in the insured. To say that it is an interest arising under the settlement duty is circular because the duty has just been defined by reference to the interest. Rather, the interest must be the economic interest which the insured has in safeguarding his uninsured portion of the claim. The insurer is now directed to consider this uninsured interest, not protected in any way under the contract, and an uninsured economic interest is thereby transformed into a legal interest under the contract. This marvelous transformation is accomplished without benefit of rationale by failing to differentiate between legal and economic interests.

Moreover, the "equal consideration" which the insurer is to give these economic interests is ambiguous. It might mean any one of three things: (1) the insurer must settle where the chances of losing are as great as the chances of winning—i.e., 50 percent; (2) the insurer must treat the claim as if it were made against an insured with no limits to his policy; (3) the insurer must process the claim with an undefined state of mind embodying fundamental equitable principles.

In its brief statement, the court highlights the two fundamental

³⁵— Cal. 2d —, 426 P.2d 173 58 Cal. Rptr. (1967). The court applied the no-limit test, and suggested strict liability in lengthy dicta. The facts in *Crisci* giving rise to excess liability are summarized in note 14 *supra*. The case has been widely noted; see, e.g., 41 S. CAL. L. REV. 120 (1967).

³⁶426 P.2d at 176, 58 Cal. Rptr. at 16.

problems of excess liability opinions: failure to recognize explicitly that the interest being protected is an uninsured interest and to provide a rationale for requiring its protection by the insurer; and failure to provide the insurer with an unambiguous guide for its settlement conduct.

In its attempt to give substance to the good faith standard, the court continues:³⁷

[W]hen "there is a great risk of a recovery beyond the policy limits so that the most reasonable manner of disposing of the claim is a settlement which can be made within those limits, a consideration in good faith of the insured's interest requires the insurer to settle the claim."

The court's choice of the phrase "great risk" was unfortunate. This phrase is easily understood to apply only to a claim's likelihood of recovery, thus supporting the "equal chances—50 percent" interpretation of the court's earlier remark on equal consideration of interests. Such an interpretation is consistent with the common understanding of the word "risk,"³⁸ and other jurisdictions have defined good faith in just such a manner.³⁹ It is also consistent with what the insurer may well regard as its duty to its insured: to settle those claims where the likelihood of recovery is greater than 50 percent.⁴⁰

Adopting a narrow interpretation of the great risk test, insurers would (1) accept every offer within policy limits where the likelihood of realizing a judgment in excess of these limits is greater than 50

³⁷ *Id.* (Quoting from *Communale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958)).

³⁸ While in insurance parlance risk may refer to the amount of a loss, its primary connotation is that of probability. WEBSTER'S NEW INTERNATIONAL DICTIONARY 1961 (3d unabr. ed. 1961):

- risk . . . 1: the possibility of loss, injury, disadvantage, or destruction . . .
- 2: someone or something that creates or suggests a hazard or adverse chance: a dangerous element or factor— . . .
- 3:a(1): the chance of loss or the perils to the subject matter of insurance covered by a contract
 - (2): the degree of probability of such a loss
 - b: amount at risk
 - c: a person or thing judged as a (specified) hazard to an insurer . . .
 - d: an insurance hazard from a (specified) cause or source . . .
- 4: the product of the amount that may be lost and the probability of losing it . . .

³⁹ See, e.g., *Henke v. Iowa Home Mut. Cas. Co.*, 250 Iowa 1123, 97 N.W.2d 168, 174 (1959); *National Mut. Cas. Co. v. Britt*, 203 Okla. 175, 200 P.2d 407 (1948).

⁴⁰ See Hume, *Excess Liability Claims and Proper Preventative Investigation*, 14 FED'N INS. COUN. Q., Fall 1963, at 61, 63:

So that there wil [sic] be no misunderstanding of terms, I want to define what I mean by "questionable". I am referring to those cases in which, in your best judgment, your chances of an outright defendant's verdict are 50-50 or better.

Up until about five years ago cases falling in this category gave little concern as to possible liability for amounts in excess of our policy limits.

percent, and (2) continue to settle cases where a settlement offer could be reduced to or below the insurer's limited percentage judgment interest (\$3000 in our previous hypothetical).⁴¹

Using the great risk test, insurers would rarely settle claims such as our hypothetical: 30 percent chance of recovery, \$25,000 potential judgment, and \$10,000 policy limits. Unless the insurer could force a settlement offer below its limited percentage judgment interest (\$3000) it would be against its economic interest to settle this claim. And since the chance of recovery is less than 50 percent, the insurer would conclude it could reject any offer without violating its duty under the great risk test. Focusing only upon the low probability of recovery, the insurer would resist a \$10,000 demand on a \$10,000 policy with equal tenacity, whether the potential judgment be \$10,000 or \$50,000.⁴² In all such cases, the great risk test falls short of fulfilling the goal of encouraging rational settlement behavior.

Although a satisfactory basis for the insurer's duty is still not developed by the court, the quoted passage does contain language suggestive of the settlement behavior rationale: when the most reasonable manner of disposing of a claim is settlement, *then* a consideration of the insured's interests requires the insurer to settle.⁴³ The traditional formulation has been quite the opposite—that "consideration of the insured's interests" dictated some kind of settlement conduct. There was no guarantee that the traditional rule would provide rational settlement conduct, since settlement conduct was a result, not a premise. Reversal of the emphasis, predicating consideration of the "insured's interests" upon the basis of rational settlement conduct, avoids the complaint lodged against the traditional formulation: that it is actually a boot-strapping operation, creating the very interest which is then required to be considered.⁴⁴ Such an emphasis, beginning with the avowed aim of rational settlement behavior, would seem

⁴¹ This assumes that the insurer's settlement value is at or below the claim's percentage judgment value. See note 19 *supra*.

⁴² Indeed, for real or imagined institutional reasons, the insurer may regard the larger claim as evil per se, and resist it more strongly. The insurance industry has criticized itself frequently in recent years for failing to resist small nuisance claims, while not choosing those large claims which should be resisted with sufficient discernment. See, e.g., Pretzel, *The Economics of Trial versus Settlement*, 1965 *INS. L.J.* 453, 460; Schroeder, *How Excessive Awards and Unmeritorious Claims Work Against the Public Interest*, 1960 *INS. L.J.* 371, 374.

⁴³ Unfortunately, in both *Crisci* and in *Commune v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958), from which the court is quoting, the effect of this suggestive language was lost in a sea of contractual language. See also the criticism of the *Crisci* court's approach in note 26 *supra*.

⁴⁴ See text following note 36 *supra*.

to require *at least* the adoption of a no-limit test, for that test attempts to refer the insurer to the objective reasonable offer—the percentage judgment value of the entire claim.⁴⁵

Continuing in the direction of a rational settlement system, *Crisci* concluded by holding:⁴⁶

In determining whether an insurer has given consideration to the interests of the insured, the test is whether a prudent insurer without policy limits would have accepted the settlement offer.

Under the no-limit test, the insurer will be liable for any excess judgment if it rejected an offer within policy limits which was reasonable from the point of view of a defendant who must pay all of any judgment in favor of plaintiff. As we have seen, the objectively reasonable offer is the percentage judgment value of the entire claim.⁴⁷ At least in form, this test seems to satisfy the goal of encouraging settlement of claims where settlement is the most rational way of disposing of them. Since it is the only test applied under the good faith or negligence rules which on its face accomplishes this result, further discussion will be restricted to the comparative effectiveness of the no-limit test and a strict liability rule in enforcing rational settlement behavior.

REAL AND IMAGINED BURDENS OF A STRICT LIABILITY RULE

The *Crisci* court, although applying the no-limit test, suggested in extensive dicta that in the future it may adopt a rule of strict liability, holding the insurer liable for excess judgments whenever any

⁴⁵ See text accompanying note 14 *supra*.

⁴⁶ 426 P.2d at 176, 58 Cal. Rptr. at 16. The formulation of the great risk test in *Communale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958), may have meant to adopt the no-limit standard. It was so read by the lower appellate court in the first case following *Communale*, *Davy v. Public Nat. Ins. Co.*, 181 Cal. App. 2d 387, 5 Cal. Rptr. 488 (1960), which adopted the no-limit test explicitly. *Davy* had a failing common in excess liability opinions: lengthy recitation or discussion, without explicit disposition, of a number of general principles of good faith before arriving at the chosen test. Although a careful reading of the opinion will reveal that the court regarded the no-limit test as the final formulation of the duty, the case has been badly miscited. See *Olson v. Union Fire Ins. Co.*, 174 Neb. 375, 118 N.W.2d 318, 322 (1962) (quoting *Davy*: bad faith implies actual dishonesty or fraud). *But see* Hume, *supra* note 40, at 65 (citing *Davy* as requiring settlement even if insurer's odds of winning are better than 50-50). The extent of confusion in California prior to *Crisci* is best seen that while the *Crisci* court cites a number of lower appellate decisions as applying the no-limit test, in the next paragraph it cites three of the same cases as containing language which suggests that bad faith consists only of actual fraud, dishonesty or concealment: *Davy*, *Palmer v. Financial Indem. Co.*, 215 Cal. App. 2d 419, 30 Cal. Rptr. 204 (1963); and *Critz v. Farmers Ins. Group*, 230 Cal. App. 2d 788, 41 Cal. Rptr. 401 (1964). The confusion has led some commentators to prefer a factual analysis of the cases, stating that if one or more facts are present, a jury finding against the insured will not be disturbed. See Comment, *supra* note 2, at 477-78.

⁴⁷ See text accompanying note 14 *supra*.

offer within policy limits has been rejected.⁴⁸ The court indicated that such a rule may not impose substantial additional burdens, and came close to suggesting that the choice is simply one between two mechanisms for requiring the same insurer conduct.

Both the no-limit test and the strict liability rule do attempt to enforce the same settlement criterion, the percentage judgment value, although they do so by different means. The no-limit test utilizes the mechanism of a second jury trial to determine whether a rejected offer was a reasonable offer in view of the entire potential claim.⁴⁹ The strict liability rule removes the second trial's jury evaluation, and relies upon the insurer's immediate economic self-interest. The insurer is liable for the full amount of a judgment whenever it rejects an offer within policy limits; presumably, it will appraise these offers reasonably. Since the percentage judgment value is the objectively

⁴⁸ 426 P.2d at 177, 58 Cal. Rptr. at 17. One portion of the court's suggested rationale deserves special condemnation: the proposition that a strict liability rule would be appropriate because "contracts are ordinarily strictly construed." *Id.* Certainly in the world of insurance, it is questionable whether appeals to the normal rules of contract law should be overworked. Typically there is a patent lack of bargaining power on the part of the insured. Moreover, if one were to look to the contract itself, the duty imposed upon the insurer would be to defend or settle wholly as it deemed expedient. See note 25 *supra*. The duty with which the court would actually be demanding strict compliance is the court's own "implied duty of good faith." Quite apart from the fact that implied duties in contract are normally enforced substantially (reasonably) rather than strictly, it is a fiction of the first order for the court to demand strict compliance with its own imposed duty on contract theory.

The origin of the insurer's duty in the status of the parties and the imposition of the duty by the court rather than by the parties point toward tort rather than contract. It is not the intention to begin again here the rather stale and unproductive debate as to whether the cause of action for wrongful refusal to settle sounds in tort or contract. The failure in reasoning goes deeper. Under neither contract nor tort theory have the courts explained explicitly why the insurer's control over the entire claim must make it financially responsible for the entire claim in some situations. Nor is this financial responsibility of the insurer the only alternative. (See note 25 *supra*). There are good reasons, however, for adopting the path on which the courts have set out, and these are grounded in the desire to rationalize settlement behavior. In following their present path to its logical end, a rule of strict liability, the courts should acknowledge the settlement behavior rationale, and discard reliance on strained and unconvincing constructions.

⁴⁹ The no-limit test is usually phrased in terms of the expected conduct of a prudent insurer without policy limits. Objectively, this means that offers at or below the percentage judgment value should be accepted. The jury has less experience than an insurer in claim evaluation, and may rely heavily on the hindsight afforded by the excess judgment recovered. To the extent that it does, there will be an overestimation of the reasonableness of rejected offers. The insurer's tactical position before the jury is thus quite weak. See Comment, *supra* note 2, at 480; 48 MICH. L. REV. 95, 101 (1949). This tendency of the jury to err in overestimating the reasonableness of settlement offers will be great in cases involving a large verdict. The average jurymen may lack an appreciation of the statistical reasonableness of exposing someone to a crushing contingent liability, even though the chance of its being imposed is low. Also, if the chance of recovery is quite high, the jury may not see why the insurer is not anxious to snap up any offer lower than the eventual recovery. In short, the jury may have difficulty adopting the role of an institutional litigant with large wealth reserves and an interest in average valuations.

reasonable offer,⁵⁰ it is the value which both mechanisms attempt to enforce. The strict liability rule adds an economic inducement to the insurer to use it as its settlement criterion; the no-limit rule also enforces this criterion, but the criterion is not definitively valued until the second jury trial of the excess liability suit. Where settlement offers are reasonable and so long as the duties are consistently enforced, the same economic burden is imposed under either rule.⁵¹

On the other hand, disparate economic burdens are imposed by the two rules when the plaintiff makes only an unreasonably high offer within policy limits. Consider once more the \$25,000 claim with a 30 percent chance of realization, and assume that plaintiff will not reduce his settlement offer below the \$10,000 policy limits. As this offer is well above the \$7500 percentage judgment value, the insurer should refuse it because over the long run it would pay out less in litigation. But in any *particular* case, the insurer may lose. If it does so, under the no-limit test it will pay out only its policy limits of \$10,000, but under the strict liability rule it will be responsible for the entire loss of \$25,000. In aggregate terms, this means that under the no-limit test the insurer will pay only its limited percentage judgment interest when offers are unreasonably high, while under the strict liability rule it will pay the percentage judgment value of the entire claim.⁵² This has the effect of waiving policy limits in a new

⁵⁰ See note 15 *supra* and accompanying text.

⁵¹ Under the no-limit test, there is no guarantee that the insurer will have to pay for failure to consider the economic interests of its insured. In every case where the insurer in fact violated its duty, but for some reason the insured does not or cannot bring suit, the insurer pockets its savings. Since the insurer loses no *more* when it is effectively curbed by its insured than it would lose through compliance with the duty in the first instance, the insurer may have something to gain and nothing to lose through ignoring its duty. The above propositions are demonstrated in note 52, *infra*.

⁵² Consider a set of 100 cases with the facts of our hypothetical (\$7,500 percentage judgment value, \$10,000 policy limit), where the plaintiff makes only an unreasonable demand of \$10,000. In that case the insurer pays:

Under the no-limit test:

	\$ per case	\$ total
70 cases won—	0	0
30 cases lost—	\$10,000 (policy limit)	\$300,000
		<u>\$300,000</u>
		or a per case average of its limited percentage judgment interest (\$3000);

Under the strict liability rule:

	\$ per case	\$ total
70 cases won—	0	0
30 cases lost—	\$25,000 (full judgment)	\$750,000
		<u>\$750,000</u>
		or a per case average of the per- centage judgment value (\$7500).

set of cases, those with unreasonable offers within the policy limits.⁵³

In *Crisci*, the court states that "it is not entirely clear that [the strict liability rule] would place a burden on insurers substantially greater than that which is present under existing law."⁵⁴ This conclusion is sound in so far as it refers to incremental burdens imposed beyond the burden theoretically borne under the no-limit test.⁵⁵ Although a new source of burden exists under the strict liability rule, a number of factors operate to prevent this new burden source from producing a substantial additional burden.⁵⁶

The new source of burden is the set of cases in which the plaintiff prevails after making an unreasonable offer within policy limits.⁵⁷ To the extent that pressures operate within the settlement system to reduce plaintiff's offers to a reasonable limit, cases will not fall within this set. The institutional structure of insurance places far more

The strict liability rule differs from other tests of insurer conduct not in the presence of this waiver effect, but in the set of cases to which the rule applies. In every case where the insurer is forced to consider the entire claim, the insurer forfeits the benefit of the limited interest afforded by its policy limits. Thus the great risk test waives policy limits, but does so in the narrower set of cases where there is an offer within policy limits and the likelihood of recovery is greater than 50%. The incremental set of cases which the strict liability rule includes and the no-limit test does not is the set of cases with only an unreasonable offer within policy limits. Whether or not the strict liability rule actually adds substantial additional burdens depends in the first instance on the number of cases which fall within this set.

It is imperative that the reader realize that when an insurer faces a settlement duty, the policy limits are waived as to the set of cases within the duty's scope, whether the insurer fails to meet the duty and has it enforced against him, or whether he meets it in settlement. Thus, in our hypothetical, if an insurer fails to meet the no-limit test and has it enforced against him, the average cost to him would be \$7500 (the cost in a particular case would be \$25,000). But to comply with the test, the insurer must likewise be willing to meet any settlement offer up to \$7500. Of course in settlement, the policy limits are only waived ratably as the sum in settlement exceeds the insurer's limited percentage judgment interest (\$3000 in our hypothetical), up to the full effectuation of waiver at the percentage judgment value (\$7500 in our hypothetical).

⁵³ See notes 24, 52 *supra*. Some cases in this set may already be included by the no-limit test because of jury prejudice and error. See note 49 *supra*.

If an offer is in excess of the policy limits, liability should still attach if the insured is willing and able to contribute the difference between the offer and the policy limits.

⁵⁴ 426 P.2d at 177, 58 Cal. Rptr. at 17.

⁵⁵ The amount of savings afforded insurers through the inadequacies of the no-limit test as an enforcement mechanism are of course not known. To the extent that such savings do exist they are a strong argument for adoption of the strict liability rule. Burdens are objectionable only in so far as they go beyond the quantum necessary to enforce the percentage judgment value, the proper criterion to guide rational settlement behavior.

⁵⁶ However, particularly in those states where the insured's policy limits may be discovered by the plaintiff, the number of offers at the policy limits may be expected to increase. This will not change the validity of the analysis of the rule's economic burdens, but an anticipated long-range result might be to induce insurers to write policies with more realistic limits. Such a result would be desirable, for at least two reasons: (1) insureds would receive more of the protection which they sought, but which with lack of sophistication about verdict levels they did not get; (2) injured plaintiffs would be more frequently provided with a reliable source of compensation.

⁵⁷ See note 53 *supra*.

effective pressures upon individual plaintiffs than upon insurers. The plaintiff is typically on the "short side" of the suit, being immediately out of pocket.⁵⁸ The financial ability of the insurer to withstand extended negotiation is markedly better than that of the typical plaintiff, despite such mitigating factors as contingent fee counsel. And law suits are a one-time affair for most plaintiffs, who wish, and sometimes desperately need, to get *some* money and conclude the matter as quickly as possible.⁵⁹ A combination of these pressures should limit sharply the number of cases in which the insurer cannot obtain a reasonable offer from the plaintiff.⁶⁰

Such additional burden as does arise under the strict liability rule may be offset in part by the elimination of certain hidden costs under the no-limit test. Litigation costs surrounding the second trial, for instance, are eliminated or reduced sharply by the strict liability rule's simplicity of administration.⁶¹ And the recent menace of awards for mental suffering to the insured may be foreclosed by adoption of strict liability.⁶²

⁵⁸ Without indulging in muckraking, it should be noted that the existence of out-of-pocket expenses places the insurer in an enviable position. Prompt payment of these expenses can be bartered for reduction or elimination of demands for general damages.

⁵⁹ In addition to the operation of the foregoing factors, a jurisdiction may encourage rationality on the part of plaintiff by enactment of a statute allowing defendant to tender an offer, and taxing a successful plaintiff for costs where the verdict recovered is less than the amount of the rejected offer. *See* WASH. CIV. R. SUPER. CT., 68; CAL. CIV. PRO. CODE § 997 (West Supp. 1967). A statutory predecessor of the present Washington court rule was interpreted as eliminating the common law rule barring tender in tort actions. *Patrick v. Ilwaco Oyster Co.*, 189 Wash. 152, 63 P.2d 520 (1937).

Such a statute is clearly more effective in inducing rational settlement behavior in cases where damages are uncertain than in those cases where liability is uncertain. In the latter situation, a reasonable offer will of course reflect the uncertainty of recovery, and the plaintiff may well believe that if he does recover, his recovery will be greater than a reasonable settlement offer.

⁶⁰ If the insurer does receive an unreasonable offer, it has an incentive to attempt by means of counter-offers or other stratagems to reduce the offer to a reasonable level. In this endeavor it may be aided by cost-shifting statutes (*see* note 59 *supra*). This situation should be contrasted with the position of the insurer under the no-limit test, where at least theoretically it would be in the insurer's interest not to receive an offer reasonable in light of the entire claim. In the absence of a reasonable offer, the preconditions of liability under the no-limit test have not been met, thus allowing the insurer to litigate and pay on the average its limited percentage judgment interest, rather than the larger percentage judgment value of the entire claim. *See* note 52 *supra*.

⁶¹ Since the strict liability rule requires the proof of only two facts, an excess judgment and a rejected offer within policy limits, both of which are normally easily established, in the majority of cases the insurer will probably simply tender payment. Otherwise, the plaintiff should usually succeed on motion for summary judgment. Whether the plaintiff in the original action will be able to take the action against the insurer directly, or whether instead the insured must proceed is developed *infra*, p. 818.

⁶² In *Crisci*, the court allowed recovery of \$25,000 for mental suffering of the insured proximately caused by the insurer's wrongful conduct. 426 P.2d at 178-79, 58 Cal. Rptr. at 18-19. *See* 46 TEX. L. REV. 113 (1967). Development of this practice

The remaining burden is probably negligible in terms of the total claims volume of the insurer against which it is properly measured.⁶³ If it is not, it can be spread among all insureds in the form of premiums. As an end result, the insured is afforded a type of coverage which, upon reflection, he would probably prefer to purchase, but which he is far too weak to attain by bargaining.⁶⁴

The superiority of the strict liability rule as an enforcement mechanism is apparent.⁶⁵ Because substantial savings are available to the insurer in any particular case if it shirks its settlement duty, it is important to any duty's effectiveness that it be clear and certain in its enforcement.⁶⁶ The no-limit test is entirely dependent upon the successful prosecution of suits by insureds. And it requires a second trial, as well as a jury inquiry into the insurer's entire handling of the original action.⁶⁷ At the time an insurer must make its decisions, the no-limit test speaks with the muted authority of a contingency upon a contingency. In contrast, the strict liability rule speaks to the insurer in economic terms alone, and with an immediacy at the moment of decision which a less objective test cannot achieve. Its ability to deter nonconforming insurer conduct is accordingly higher.

The application of the strict liability rule in some few particular cases⁶⁸ may seem unfair. But viewed in the aggregate, its effect upon

could lead to awards overshadowing the economic loss to the insured in some cases. Such awards might be foreclosed by recognition of a primary cause of action in the judgment creditor, preventing liability from attaching to the insured. See text p. 818 *infra*, and notes accompanying. The strict liability rule, however, may be of sufficiently mechanical application to allow the effective discharge of the insured by the prosecution of the excess suits by the original plaintiff, so long as liberal assignment is allowed.

⁶³ Due to the method by which insurers compute their losses, adoption of the rule would almost certainly have no immediate effect. See generally Morris, *Enterprise Liability and the Actuarial Process—The Insignificance of Foresight*, 70 YALE L.J. 554 (1961). Over the course of years, the existence of any duty imposed upon the insurer is likely to contribute to rising premiums. But the marginal burden of the strict liability rule must be viewed in light of the total claims volume of the insurer. Since the impact of the rule will be slight and gradual, the relevant question is whether the rule provides a desirable form of insurance coverage which may be legitimately borne as a cost of the system. Its benefits are evident, and would easily justify slight premium increases which might occur over time.

⁶⁴ See the policy provision in note 24 *supra*, where the insured was a railroad and could bargain. The court suggests in *Crisci* that the insured may well believe that under the policy it has purchased, money is available, up to the amount of the policy limits, to protect him by settlement as well as defense. 426 P.2d at 177, 58 Cal. Rptr. at 17. See note 22 *supra*.

⁶⁵ See note 61 *supra*.

⁶⁶ See notes 51, 52 *supra*.

⁶⁷ See note 49 *supra*.

⁶⁸ The factors resulting in only a small number of cases coming within the marginal extension of coverage afforded by the strict liability rule are set forth on p. 815 *supra*.

the settlement system is salutary. Its application forces the insurer to pay in the aggregate no more than the fair valuation of claims.⁶⁹ Yet it removes the unavoidable invitation to gamble with the insured's money which still exists under the no-limit test. The insurer, even taking into account the possibility of liability in an excess liability suit under the no-limit test, may realize that it will not be markedly worse off than if it had complied with the test in the first instance⁷⁰—liability to the plaintiff is still only a contingency. Yet in any case where the insurer is able to avoid enforcement of the test, it may reap substantial savings by paying out sums reflecting its limited percentage judgment interest rather than the claim's percentage judgment value.⁷¹ The strict liability rule removes the benefit formerly available to the insurer who evaded consideration of the percentage judgment value which both the strict liability rule and the no-limit test attempt to enforce. For the first time, the insurer is effectively disciplined.

CONCOMITANT SAFEGUARDS

Despite the desirability of the strict liability rule, its adoption should be accompanied by certain concomitant safeguards. These are necessary to assure that the rule will attain its goal of streamlining the settlement system.

It is imperative that an offer should not be valid for the purpose of attaching strict liability until at least a certain stage of the proceedings. The most logical time is clearly at the conclusion of discovery proceedings. The rule only will be able to facilitate more reasonable settlements after the parties are afforded an opportunity to

⁶⁹ Insurers may object that any particular insurer faces a statistically insignificant number of excess liability cases. All this means is that a separate quantum of premium traceable to excess liability suits cannot be isolated. Because insurers do not compute their premiums in such a manner as to require such isolation, the point is irrelevant. See Morris, *Enterprise Liability and the Actuarial Process—The Insignificance of Foresight*, 70 YALE L.J. 554, 560-69 (1961). The loss is treated as is any other loss, and the burden, by the insurers' own premise, will not be statistically significant. If insurers did wish statistical predictability of excess liability cases, they could simply pool their information, as they do in computing a number of types of risks.

⁷⁰ The only burden the insurer suffers through neglect and subsequent enforcement which it would not bear through compliance with the duty is payment of litigation costs. Offset against this must be the savings available in all cases of non-compliance. There are of course cases in which the insurer does not comply with the duty of accepting a reasonable offer and is still able to defeat the claim. This set of cases is the converse of the set of cases resulting in the incremental burden of the strict liability rule. It is possible that this is the set-off of wins and losses which the *Crisci* court finds consonant with elementary justice. 426 P.2d at 177, 58 Cal. Rptr. at 17. The reader may wish to refer to note 52 *supra*.

⁷¹ See note 52 *supra*.

gather the facts necessary for an intelligent evaluation of the claim.⁷²

There should also be assurance that offers will remain open for sufficient time to allow their evaluation. Because an offer will not be effective until after the completion of discovery, this time need not be long, and in fact probably should not be. It would not be amiss, and might avoid future litigation, if the courts accompanied adoption of the rule with language suggesting a specific recommended period for offers to remain open.⁷³ In framing these issues, courts should be careful to avoid the reintroduction of disputable jury questions, lest the elimination of the second jury trial, one of the great advantages of the strict liability rule, be forfeited.

Finally, courts must allow the plaintiff to reach the amount of the excess liability in the hands of the insurer. Procedural blocks to such a recovery substantially impair any rule's ability to enforce rational settlement behavior.⁷⁴ Some jurisdictions have already accomplished the desired result by taking a liberal view toward assignment of excess liability claims.⁷⁵ Although this view has been criticized because of the alleged possibilities for collusion between plaintiff and insured,⁷⁶ such fears are unwarranted.⁷⁷ Liberal assignment under the strict liability rule will allow effective enforcement actions by the original plaintiff.⁷⁸ The insured is spared mental anguish, and the door to

⁷² Courts may use their discretionary powers over discovery proceedings to prevent unduly dilatory tactics.

⁷³ In *Critz v. Farmers Ins. Group*, 230 Cal. App. 2d 788, 41 Cal. Rptr. 401 (1965), the court allowed recovery where an offer remained open for only one week. The offer was made after the insurer had fully investigated the claim. By that time, the insurer should have its own evaluation of the claim completed, and a week's time is sufficient to allow it to decide upon acceptance or rejection, even if communication with a distant home office is necessary. No interest is served by holding the offer open indefinitely, encouraging a dilatory, cat-and-mouse process which is the antithesis of rational settlement conduct.

⁷⁴ See note 51 *supra*.

⁷⁵ California is the most liberal jurisdiction. In *Critz v. Farmers Ins. Group*, 230 Cal. App. 2d 788, 41 Cal. Rptr. 401 (1964), the court allowed a suit on an assignment executed before the original personal injury trial and without the insurer's knowledge. While it is not clear that Washington is so liberal, the court has characterized the position of non-assignability as "clearly untenable." *Bench v. State Auto. & Cas. Underwriters, Inc.*, 67 Wn. 2d 999, 408 P.2d 899 (1965) (per curiam). For further discussion of the assignment issue, see Meyer, *Gray v. Nationwide and Beyond*, 71 DICK. L. REV. 257 (1967).

⁷⁶ See Comment, *supra* note 2, at 480, 482 (criticizing *Critz v. Farmers Ins. Group*, 230 Cal. App. 2d 788, 41 Cal. Rptr. 401 (1965) as encouraging collusion). But see Note, *Insurer's Liability to Judgment Creditor of Insured for Wrongful Refusal to Settle a Claim*, 52 CORNELL L.Q. 778, 786-87 (1967) (finding more danger of collusion where claims are not assignable).

⁷⁷ Since the typical liability insurance contract binds the insured to co-operate with the insurer in defense of the claim, the collusion argument is not convincing.

⁷⁸ Another solution might be a direct action by the plaintiff against the insurer. Courts have been hostile to such an action, but its recognition would be consistent with the settlement behavior rationale for imposing the insurer's duty. Keeton, note

awards of such damages may be closed.⁷⁹

CONCLUSION

For over half a century, American courts have developed and expanded a duty of the insurer to protect its insured by settlement within policy limits. As the scope of this duty expanded, it became increasingly clear that it was founded in a desire to attain rational settlement behavior.⁸⁰

The strict liability rule proposed by the California Supreme Court is the first rule equal to the task before it. It speaks with simplicity and clarity; its sanctions are effective. Its adoption should be premised upon an explicit rationale of promoting rational settlement behavior, and it should be accompanied by the adoption of certain concomitant safeguards. Strict liability enjoys a clear superiority over previous tests for attaining ends the courts have long desired. Adoption of the rule must be eagerly awaited.

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5 *supra*, at 1175-77, would disallow such an action. His reasoning, however, depends on the idea of a cause of action arising out of an insurer's wrong-doing vis-a-vis its insured. That has been the nominal underpinning of the negligence and good faith rules. Keeton's reasoning is generally inapplicable to a rationale imposing a duty for the benefit of rational settlement behavior. This is of course the correct foundation for the strict liability rule.

Keeton's position that the action is only one to recompense the insured for his actual losses is further weakened by authority rejecting payment of the judgment by the insured as a prerequisite to suit. See Comment, *The Role of Prepayment in Excess Judgment Actions*, 11 U.C.L.A. L. Rev. 382 (1964), and cases cited therein.

Recognition of such an action would carry with it its own problems, however. For instance, query whether the original plaintiff, failing in an action against the insurer, could then go against the insured. Presently, in exchange for executing the assignment of the excess liability suit, the insured usually receives a release.

In the past, the issue of a direct action has most often been raised by an attempt by the original plaintiff to garnish the insurer. See, e.g., *Murray v. Mossman*, 56 Wn. 2d 909, 355 P.2d 985 (1960), noted in 36 WASH. L. Rev. 125 (1961); *Steen v. Aetna Cas. & Sur. Co.*, 157 Colo. 99, 401 P.2d 254 (1965). See also Meyer, *supra* note 75, at 262-67.

⁷⁹ The question of allowance of punitive damages remains open. There appears to be little authority for allowing such damages in the cases. See Annot., 40 A.L.R. 2d 168, 192-93 (1955).

⁸⁰ Over the years, the relationship of litigation and settlement and conceptions of the insurer's function in the tort liability system have also changed. See *Abramson v. Kenwood Laboratories, Inc.* 223 N.Y.S.2d 1005, 1007 (Sup. Ct. 1961), *rev'd on other grounds*, 17 App. Div. 2d 626, 230 N.Y.S.2d 247 (1962) (mem.):

A casualty company is somewhat in the position of a trustee of a fund created from fixed premiums for the payment of meritorious claims.

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