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INSURERS' DUTY TO SETTLE—STRICT LIABILITY FOR EXCESS JUDGMENTS: HAS THE TIME COME?

A contract for liability insurance usually provides that the insurer must defend any lawsuit against the insured for damages payable under the terms of the insurance contract, but may settle any such claim or lawsuit.¹ The permissive "may settle" clause has given little help to the courts on a question of law which has bothered judges and commentators for most of this century—what, if any, is the duty of the insurer with regard to settlement.² This question frequently arises in the following fact pattern. An insured, who has rather limited personal resources, takes out a liability insurance policy with a \$5,000 limit. An accident occurs and the insured is served with process in a suit in which the plaintiff seeks \$30,000 damages. The injured party then makes an offer to settle for \$3,500. The insurance company, which is conducting the defense of the lawsuit pursuant to the provisions of the insurance contract, rejects this offer and proceeds to trial. The insured suffers a judgment of \$7,500, of which the insurer is obligated to pay only \$5,000. Insured then initiates suit against the insurer to recover that part of the judgment not satisfied by the insurance company.³ It is now the task of the court to determine on what basis the insurer will or will not be held liable for the excess liability—that part of the verdict in excess of the \$5,000 covered by insurance. It is the intent of this comment to explore briefly the standards presently imposed by courts when faced with an excess-liability problem, to comment on two recent cases which expressed concern for the inadequacy of present standards, and then to consider whether it is an appropriate solution to the excess-liability dilemma to hold an insurer strictly liable for any excess verdict subsequently rendered against the insured.

I. PRESENT STANDARDS

Although some early authority indicated that there was no duty in regard to settlement,⁴ that approach was short-lived.⁵ In recognizing that an insurer has at least some duty in the matter of settlement, most courts point

¹ The court in *Henke v. Iowa Home Mut. Cas. Co.*, 250 Iowa 1123, 97 N.W.2d 168 (1959), quotes a standard clause used by insurers to express their obligation in this matter. The policy requires an insurer to "Defend any suit against the insured alleging such injury, . . . 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." *Id.* at 1128, 97 N.W.2d at 172.

² For extensive discussion of this subject see Annot., 40 A.L.R.2d 168 (1955); 7A J. Appleman, *Insurance Law and Practice* §§ 4711-13 (1962); Kceton, *Liability Insurance and Responsibility for Settlement*, 67 *Harv. L. Rev.* 1136 (1954).

³ This fact pattern is a simplified version of the facts in *Blue Bird Taxi Corp. v. American Fid. & Cas. Co.*, 26 F. Supp. 808 (E.D.S.C. 1939) (applying S.C. law).

⁴ *Kleinschmit v. Farmers Mut. Hail Ins. Ass'n*, 101 F.2d 987, 989-90 (8th Cir. 1939); *Schmidt v. Travelers Ins. Co.*, 244 Pa. 286, 289, 90 A. 653, 654 (1914). Although there were no specific allegations of negligence or bad faith in those cases, the courts used language which is sufficiently broad to be taken to mean that the insurer had no duty at all in the matter of settlement.

⁵ See *American Mut. Liab. Ins. Co. v. Cooper*, 61 F.2d 446 (5th Cir. 1932).

STUDENT COMMENT

to the position of trust and confidence which an insurer holds while exercising its contractual privilege of exclusive control over the lawsuit.⁶ The New Jersey court, deciding for the first time in that state what standard should be imposed on an insurer, emphasizes in typical fashion the sensitive position held by an insurer and the consequent need to impose at least some duty in the strategic area of settlement.

Search for the just rule must be engaged in with an understanding that the purpose of insurance of this type is to protect the insured from liability within the limits of the coverage. And in interpreting the policy, the courts cannot allow the insurer to frustrate that purpose by a selfish decision as to settlement which exposes the insured to and results in a judgment beyond the specific monetary protection. . . .⁷

Despite cognizance of this need, courts have by no means been uniform in their selection of a standard to be imposed on insurers. Courts frequently consider the choice of a good-faith norm as opposed to a due-care standard when deciding what test an insurer must meet.⁸ Numerous writers have similarly classified the jurisdictions under the headings of due-care and good-faith.⁹ There is little value, however, in attempting to group the jurisdictions simply under those headings because the standards applied are really far more divergent.¹⁰ Furthermore, some commentators have even suggested that despite the clear distinction in the wording of good-faith and due-care tests, the different jurisdictions tend to reach the same results in similar fact patterns.¹¹

A close examination of some of the standards applied reveals not only the futility of a simplistic categorization of the tests but also the absence of any consensus as to a sound, acceptable solution to the excess-liability dilemma. As Professor Keeton has pointed out, there are really two distinct issues to be decided by a court in ascertaining the standard of conduct to which an insurer is to be held: (1) whether the basis of liability is bad faith or negligence; and (2) what degree of consideration must an insurer give to

⁶ E.g., *Stowers Furniture Co. v. American Indem. Co.*, 15 S.W.2d 544, 547 (Comm'n App. Tex. 1929).

⁷ *Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co.*, 31 N.J. 299, 304, 157 A.2d 319, 322 (1960).

⁸ E.g., *Georgia Cas. Co. v. Mann*, 242 Ky. 447, 46 S.W.2d 777 (1932); *Cowden v. Aetna Cas. & Sur. Co.*, 389 Pa. 459, 134 A.2d 223 (1957).

⁹ E.g., *Heaslip, Insurer's Failure to Settle*, 12 Clev.-Mar. L. Rev. 85 (1963); *Comment, Insurer's Liability for Judgments Exceeding Policy Limits*, 38 Texas L. Rev. 233 (1959).

¹⁰ But see *Wilson v. Aetna Cas. & Sur. Co.*, 145 Me. 370, 76 A.2d 111 (1950). The court states that on the question of "the duty of an insurer, if any, in the negotiation of a settlement, there is a clean-cut conflict of authority whether liability may be grounded in negligence, or exists only where fraud or bad faith is proved." *Id.* at 375, 76 A.2d at 113.

¹¹ 7A J. Appleman, *supra* note 2, § 4712; *Comment, Insurer's Liability to Insured for Judgments Exceeding Policy Limits*, 7 Drake L. Rev. 23, 27 (May 1958); *Comment, Liability of Insurer for Judgment in Excess of Policy Limits*, 48 Mich. L. Rev. 95, 100 (1949).

the insured's interests in comparison with its own.¹² It would be meaningless to classify jurisdictions only according to the position which they take on the first issue. For example, among three jurisdictions which purport to hold the insurer to a good-faith standard, one permits the insurer to consider its own interest paramount in case of conflict of interest;¹³ another requires that the insured's interest be given equal consideration;¹⁴ and the third insists that the insured's interest be given priority.¹⁵

A close examination of the standards applied also reveals that the employment of differently worded rubrics contributes to the present diversity. For instance, although two jurisdictions purport to apply a negligence test, one court questions whether the insurer exercised such care as an ordinarily prudent person would exercise under the same or similar circumstances,¹⁶ and the other tribunal asks whether a prudent insurer without policy limits would have accepted the settlement offer.¹⁷

Another factor militating against a simple classification of the standards is the requirement, by some courts, of a combination of good faith and due care from the insurer. Some of these jurisdictions impose a good-faith standard on the insurer's decision whether to accept an offer of compromise, but also include a due-care requirement in that standard by requiring an insurer to make a reasonably diligent effort to ascertain facts before making any decision as to settlement.¹⁸ Other jurisdictions insist on a combination of good faith and due care without applying a heterogeneous standard. That is, these courts insist that the insurer meet a dual requirement of two distinct stan-

¹² Keeton, *Ancillary Rights of the Insured Against His Liability Insurer*, 28 *Ins. Counsel J.* 395, 396-97 (1961).

¹³ *St. Joseph Transfer & Storage Co. v. Employers Indem. Corp.*, 224 *Mo. App.* 221, 231, 23 *S.W.2d* 215, 220 (Kansas City Ct. App. 1930).

¹⁴ *American Fid. & Cas. Co. v. Nichols Co.*, 173 *F.2d* 830, 832 (10th Cir. 1949) (applying Okla. law).

¹⁵ *Tyger River Pine Co. v. Maryland Cas. Co.*, 170 *S.C.* 286, 170 *S.E.* 346 (1933). In this case, unlike *St. Joseph Transfer & Storage Co.*, 224 *Mo. App.* 221, 23 *S.W.2d* 215 (Kansas City Ct. App. 1930), and *American Fid. & Cas. Co.*, 173 *F.2d* 830 (10th Cir. 1949), where the courts talked only in terms of good faith, the court clearly holds that in addition to a requirement of good faith an insurer must also meet a due-care standard in the matter of settlement. The South Carolina court, however, does not utilize either of the other courts' "good faith" tests as one of its two standards. Rather, the court states that if an insurer's "interests conflicted with those of respondent [insured], it was bound, under its contract of indemnity, and in good faith, to sacrifice its interests in favor of the respondent." 170 *S.C.* at 292, 170 *S.E.* at 348.

¹⁶ *State Farm Mut. Auto. Ins. Co. v. Jackson*, 346 *F.2d* 484, 488 (8th Cir. 1965) (applying Ark. law).

¹⁷ *Crisci v. Security Ins. Co.*, 426 *P.2d* 173, 58 *Cal. Rptr.* 13 (Sup. Ct. 1967).

It should be noted here that Keeton has criticized the "equal consideration" phrasing of an insurer's duty and has strongly recommended that the standard be altered. It was he who suggested that the good-faith or negligence rules be phrased in terms of what "an insurer with no policy limit applicable to the claim" would have done. Keeton pointed out that it could be misleading for a court to require "equal consideration" for the interests of the insured and insurer, and then to allow a decision as to settlement at which the interests of one party would very definitely be sacrificed. Keeton, *supra* note 2, at 1146-48.

¹⁸ E.g., *Hilker v. Western Auto. Ins. Co.*, 204 *Wis.* 1, 235 *N.W.* 413 (1931).

STUDENT COMMENT

dards. In these jurisdictions an insurer will be liable for the excess liability if it violates either the standard that it exercise good faith throughout the settlement stage or the standard that it act with due care.¹⁹ Whether the combination is of the former or of the latter type, it is clear that these standards lend further support to the proposition that classification of the jurisdictions into good-faith and due-care categories is inappropriate and that there is no real consensus as to a standard to be imposed on insurers in the matter of settlement.

II. RECENT CASES

Two courts recently expressed their dissatisfaction with standards currently imposed on insurers in the matter of settlement. Both were faced with excess-liability situations and both concluded that there was ample room for improvement in this area of the law. It is interesting to note that the two courts imposed radically divergent standards on the insurer.

In *Brochstein v. Nationwide Mut. Ins. Co.*,²⁰ a federal district court applied New York law and relied on three 1920 cases in reaching its decision. The court found that although New York's good-faith standard would not allow an insurer to engage in fraud or dishonesty, there was no violation of the good-faith norm when the insurer pursued its own interest in refusing to settle and did not consider the insured's exposure to excess liability.²¹ Apparently, New York law does not require the insurer to give equal consideration to the interests of the insured in deciding whether to settle. The district court expressed concern for the inadequate protection of the insured's interests, and it suggested that an insurer should be obligated to appoint a lawyer for the insured who would represent solely the insured's interests at the settlement stage. The court thought that such a measure would be appropriate because there is "no open, safe and familiar mode of dealing with . . . the need for a controlled arms-length discussion between the assured and the insurer about their respective interests in the settlement."²²

In *Crisci v. Security Ins. Co.*,²³ the Supreme Court of California was faced with an extreme fact situation. The insured had \$10,000 of insurance coverage under a general liability policy. An accident occurred and claimant

¹⁹ *Tyger River Pine Co. v. Maryland Cas. Co.*, 170 S.C. 286, 170 S.E. 346 (1933).

²⁰ 266 F. Supp. 223 (E.D.N.Y. 1967).

²¹ *Id.* at 225.

²² *Id.* at 227. In developing its interesting solution for this bothersome area of law, the court points out that this lawyer would be appointed to articulate and to advance the insured's interest in an area formerly dominated by the insurer. The court believes that the insurer could be obligated to appoint such a lawyer for the insured by reading that duty into the insurer's covenant to defend, since the insurer assumed the obligation to defend and since the most important aspect of most defenses is the negotiation of settlement. Such an appointment would not only guard against a completely self-interested decision by the insurer to go to trial, but also would encourage frank discussion of the respective interests of insured and insurer in an area where insurers are often uncertain as to their privileges and obligations.

For another interesting and novel suggestion, see Felton, *Excess Coverage Bought after the Accident?* 1963 *Ins. L.J.* 517.

²³ 426 P.2d at 173, 58 Cal. Rptr. 13 (Sup. Ct. 1967).

sued the insured for \$400,000. Some time before judgment was entered, the insurer refused an offer to settle for \$9,000 even though insured offered to pay \$2,500 of the settlement amount. Judgment was then rendered against the insured for \$100,000. Holding that the insurer had breached its duty to consider the insured's interests in proposed settlements, the California court affirmed a judgment against the insurer for the excess liability and for \$25,000 in damages as compensation for insured's mental suffering. The court here imposed a standard on the insurer which must be placed at the opposite end of the legal spectrum from the standard applied in *Brochstein*. Not only does California speak in terms of reasonable care and prudence rather than in terms of good faith, it also applies the test of "whether a prudent insurer without policy limits would have accepted the settlement offer"²⁴ to determine whether an insurer gave sufficient consideration to the interests of the insured. In contradistinction to New York's test, the California rule is especially favorable to the insured. Even so, the California court is not completely satisfied with its standard and intimates, in significant dictum, that strict liability may well be the ultimate solution to the excess-liability problem.²⁵

III. STRICT LIABILITY

The strict liability rule would impose liability on an insurer for any subsequent judgment if the insurer had previously refused an offer to settle within policy limits. Although strict liability is receiving growing favorable comment from writers,²⁶ who present it as a suitable rule in an area where there has been no widespread agreement as to an acceptable norm, most judicial comment has thus far been hostile. Numerous courts explain the standard that they are applying either by pointing out that there is no absolute duty to settle or by stressing that the contract does not require an insurer to be gifted with powers of accurate prophecy.²⁷ Such explanatory language certainly can be interpreted as inimical toward a strict liability approach. Furthermore, there are some early cases which explicitly reject strict liability contentions.

In *Kingan & Co. v. Maryland Cas. Co.*,²⁸ for example, it was argued that the insurer has a duty to effect a settlement, if it can do so without exceeding the policy limits, "regardless of the apparent merits of the claim or reason-

²⁴ Id. at 176, 58 Cal. Rptr. at 16.

²⁵ Id. at 177, 58 Cal. Rptr. at 17.

²⁶ Since 1945 several commentators have recommended strict liability as an acceptable solution to the excess-liability problem. Ertsgaard, *Liability Beyond Insurance Policy Limits*, 1958 Ins. L.J. 404, 406-07; Keeton, *Liability Insurance and Responsibility for Settlement*, supra note 2, at 1183-84 (one of four recommendations); Comment, *Liability of Insurer for Judgment in Excess of Policy Limits*, supra note 11, at 101-02; Comment, *Excess Liability: Reconsideration of California's Bad Faith Negligence Rule*, 18 Stan. L. Rev. 475, 482-85 (1966); Note, *Liability Insurer's Duty to Settle*, 13 U. Chi. L. Rev. 105, 109 (1945); Note, *Insurer's Refusal to Settle—A Proposal for Imposition of Liability above Policy Limits*, 60 Yale L.J. 1037, 1041-42 (1951).

²⁷ E.g., *Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co.*, 31 N.J. at 312, 157 A.2d at 326; *Cowden v. Aetna Cas. & Sur. Co.*, 389 Pa. 459, 470, 134 A.2d 223, 228 (1957).

²⁸ 65 Ind. App. 301, 115 N.E. 348 (1917).

ableness of the sum demanded."²⁹ If the court accepted the contention that an insurer must settle so long as the settlement offer was within policy limits, and the insurer violated that duty by refusing to settle, it is safe to assume that the insurer would be held liable for the immediate consequences of its wrong—the excess liability. In effect then, the court was asked to impose strict liability on the insurer. The court, however, refused to do so, saying that an insurer may elect between settling and defending and that the insurance company is not obligated to assume the risk of any future judgment should it refuse an offer to settle and decide to defend the suit at trial.

The Supreme Judicial Court of Maine has also rejected a strict liability contention. In *Rumford Falls Paper Co. v. Fidelity & Cas. Co.*,³⁰ the court expressed concern for the consequences of a rule which would require an insurer to accept claimant's offer of settlement within limits or defend legal proceedings at the risk of any judgment that might be recovered. The court felt that such a standard would free the insured from liability for damages in most instances and that such freedom would, in turn, have serious repercussions. Utilizing reasoning which might well be challenged as unrealistic, the court expressed its apprehension that an insured, freed of the risk of liability, would have little incentive to defend against claims devoid of merit and would tend to relax the ordinary "rules of prudence and vigilance."³¹

In *Blue Bird Taxi Corp. v. American Fid. & Cas. Co.*,³² a federal district court found that allowing an insured to demand, as a matter of legal right, that the insurer settle within limits if the opportunity arose would result in opening the door to fraud and would promote collusion in the framing of actions for damages. Nor would the least of the pejorative results be a great increase in premium rates.³³

In view of this rather weak precedent rejecting strict liability and in view of the dissatisfaction with present standards, it is not surprising that the strict liability theory has been gaining momentum. Although most judicial comment on strict liability has not been favorable, the California Supreme Court stated in *Crisci* that "there is more than a small amount of elementary justice"³⁴ in that solution to the excess-liability dilemma. Since 1945, several writers have suggested it as an acceptable answer to the problem.³⁵ In the small, but growing, body of authority favoring strict liability there are discernible four basic points which form the nucleus of the argument for that rule.

The first point in favor of strict liability is that it is an appropriate standard in view of the nature and purposes of a liability insurance policy.³⁶ There are five steps in reasoning to such a conclusion. First, the essential

²⁹ *Id.* at 311, 115 N.E. at 351.

³⁰ 92 Me. 574, 43 A. 503 (1899).

³¹ *Id.* at 586-87, 43 A. at 506.

³² 26 F. Supp. 808 (E.D.S.C. 1939).

³³ *Id.* at 810.

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

³⁵ Authorities cited note 25 *supra*.

³⁶ See *Crisci*, 426 P.2d at 177, 58 Cal. Rptr. at 17 (dictum).

purpose of liability insurance is to remove the risk of having to pay legal judgments with one's own funds. Second, in all but exceptional circumstances,³⁷ an insured is especially interested in avoiding the risk of excess liability because an excess judgment would present the very situation that liability insurance is supposed to avoid—having to pay a legal judgment with one's personal resources. Third, one of the accepted modes of relieving an insured from the risk of liability is settlement. Fourth, an insurer, confronted with the possibility of excess liability, has only one means of protecting the insured's vital interest in avoiding the risk of an excess legal judgment. That one means of protection is settlement within the policy limits, if the opportunity arises. Fifth, an insurer's refusal to adopt that one means of adequate protection and its decision to go to trial can be explained only as a preference of its own interests over those of the insured. In such circumstances, it is appropriate for the insurer to be liable for any subsequent judgment.

Reading this standard into a liability insurance policy would certainly abolish excess-liability suits for an insurer's wrongful refusal to settle within limits. Furthermore, such protection is consistent with the basic purposes of liability insurance. It is relevant to point out, however, that a court trying to determine a proper standard for the insurer is met with an explicit contractual provision. Although desirable policy considerations should not be excluded from the decision as to an insurer's duty regarding settlement, the obvious meaning of the contractual language and the clear intent of the contracting parties deserve a pre-eminent position in a judicial proceeding. Thus, a court, impressed with an argument which stresses the purposes and goals of the insurance contract, in advocating strict liability must also concern itself with the explicit statements in the policy—*must* defend but *may* settle—which certainly do not present the insurer's function regarding settlement in strict, mandatory terms. Here, judicial action should await some sound, convincing discussion which not only presents strict liability as a theory consonant with the goals of liability insurance, but which also presents strict liability as a reasonable reading of the "may settle" language.

A second argument for the acceptance of strict liability is that insurers often abuse their fiduciary position in the matter of settlement and that present standards do not effectively police the insurers in that sensitive capacity.³⁸ Here, an aspect to be emphasized is that, by reserving exclusive control over settlement, the insurer has the insured's interests within its complete control, and there are, of course, very significant interests of the insured at stake when there is an opportunity to settle within policy limits. The most effective way, then, of protecting those interests is to penalize the

³⁷ There undoubtedly are exceptional situations where an insured would prefer to run the economic risk of an excess judgment because of his interest in proving that he was without fault in the accident. Such an instance might arise when an insured, who has already suffered a large number of accidents, fears cancellation of the policy or a major increase in premiums unless he is able to acquit himself of fault in this particular accident.

³⁸ See Ertsgaard, *supra* note 26, at 406-07; Note, *Insurer's Refusal to Settle—A Proposal for Imposition of Liability above Policy Limits*, *supra* note 26, at 1037, 1041.

insurer by means of strict liability whenever the insured's interests are injured by a refusal of an offer to settle within the limits and a subsequent excess judgment. Such a plan would insure proper protection for the insured's interest in contrast to present standards, which entail difficulties in proof and allow the insurer substantial leeway to prefer its own interest.

The third point is that the proposed rule is simple to apply, and avoids the inherent practical problems in the application of the present standards.³⁹ It is readily apparent that a standard does not lend itself to efficient application when a jury of laymen may be called upon to decide such a typically nebulous standard as whether an expert in the matter of insurance claims, who has rejected an offer to settle within limits, was acting like a prudent insurer without policy limits. Nor are present standards applied in a facile manner when a jury, completely unfamiliar with the settlement of law suits, has to decide whether the insurer gave "equal consideration" to the interests of the insured in determining whether or not to settle.

A fourth point in favor of strict liability is that it will not be substantially more expensive than the present standards. Moreover, it can be argued that even if somewhat higher premiums ensued, such a development is consistent with public policy which favors a greater distribution of the risk.⁴⁰

These four arguments present the strict liability solution in its most favorable light. To them should be added a fifth, in view of a significant aspect of the *Crisci* case. The California court upheld an award of \$25,000 for the mental suffering of the elderly insured, who attempted suicide on several occasions, suffered periods of hysteria, and experienced a general decline in physical health after suffering the excess-liability judgment. Although another court has denied damages for mental pain and suffering caused by the execution of an excess-liability judgment,⁴¹ it is possible that damages for mental suffering could become an element of recovery in excess-liability suits in states other than California. Naturally, if the strict liability rule were accepted, an insured like Mrs. Crisci would not be subjected to the mental suffering which may accompany the prospect of having to pay an excess judgment and the insurer would not be subject to the financial threat of liability based on insured's mental suffering.

Although the court in *Crisci* expressly refrained from investigating whether there might be some countervailing considerations precluding adoption of the proposed rule of strict liability,⁴² and although most courts have not expressly rejected strict liability as an acceptable solution, there is more

³⁹ See *Crisci*, 426 P.2d at 177, 58 Cal. Rptr. at 17; Comment, Liability of Insurer for Judgment in Excess of Policy Limits, *supra* note 11, at 100-01; Comment, Excess Liability: Reconsideration of California's Bad Faith Negligence Rule, *supra* note 26, at 484.

It would be erroneous, however, to think that criticism of the workability of the present standards originated with the proponents of strict liability. See, e.g., Appleman, Duty of Liability Insurer to Compromise Litigation, 26 Ky. L.J. 100, 109 (1938).

⁴⁰ Ertsgaard, *supra* note 26, at 407; Comment, Excess Liability: Reconsideration of California's Bad Faith Negligence Rule, *supra* note 26, at 484-85; Note, Liability Insurer's Duty to Settle, *supra* note 26, at 110.

⁴¹ *Farmers Ins. Exch. v. Henderson*, 82 Ariz. 335, 313 P.2d 404 (1957).

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

to consider about strict liability than the advantages which were set out in the five points above. There are at least three adverse considerations.

There is an initial rebuttal that liability policies are correctly construed to impose only a limited duty in the matter of settlement. It is argued that so long as an insurer complies with its duty of due care or good faith, an insured should have no right to compel the insurance company to offer an amount up to the limits of the policy in order to settle and protect insured against an excess judgment. The rationale stressed here is that insurers are in the business of trying to sell policies with high limits and that it would be incongruous to require an insurer to bear the same financial risk when it sells a \$5,000 policy and there is a \$30,000 claim and a subsequent offer to settle within policy limits, as when it sells a \$30,000 policy to an insured who is sued for \$30,000. Behind such a rationale is an insistence that any discussion regarding excess liability should entail a recognition that an insured can readily secure all needed protection by purchasing a policy with a high limit of liability on the insurer for relatively smaller additional premiums.⁴³

Such an approach does not seem to recognize the very forceful point that an insurer's fiduciary responsibility is significantly greater when the limits are \$5,000 and the claim may result in a judgment \$25,000 in excess of the policy limits, than when the claim is for \$30,000 and the limits are for \$30,000. Nor should the fact that an insured *could* have purchased a policy with higher limits lessen the insurer's extremely sensitive duty of protecting the insured's interests when there is an offer to settle within limits.

A second adverse consideration, which *courts* should ponder before adopting a strict liability rule, is that, almost without exception, there is recognition that such a change should be effected by legislation or by the insertion of new terms into the policy.⁴⁴ Professor Keeton stresses that these two modes of change are proper. On the other hand, he states that adoption of strict liability "is not reasonably open to the courts at the present time because of the firmly established precedent to the contrary, and the fact that the established precedent has been one of the assumptions on which the premium rates have been determined for policies coming before the courts."⁴⁵

This obstacle to court adoption of the strict liability rule is the product of a reasonable reading of the insurance contract which numerous courts have made over the past thirty years. The vast precedent to which Keeton refers held that when an insurer contracted that it *must* defend but *may*

⁴³ See *American Cas. Co. v. Howard*, 187 F.2d 322, 329 (4th Cir. 1951) (applying S.C. law); *Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co.*, 31 N.J. at 304-05, 157 A.2d at 322; Jarrett, *Lawsuits for Wrongful Refusal to Defend or to Settle*, 28 *Ins. Counsel J.* 58, 65 (1961).

⁴⁴ Among the proponents set out at note 26 *supra*, only one commentator does not explicitly recommend either legislation or writing new policy terms. That writer suggests that the strict liability standard be read into the insurer's covenant to defend. Note, *Insurer's Refusal to Settle—A Proposal for Imposition of Liability above Policy Limits*, *supra* note 26, at 1042. Another commentator recommends change via legislation simply because the courts are unlikely to adopt strict liability. Note, *Liability Insurer's Duty to Settle*, *supra* note 26, at 110. See also Levit, *The Crisci Case—Something Old, Something New*, 2 *U. San Fran. L. Rev.* 1, 10 (1967).

⁴⁵ Keeton, *supra* note 2, at 1184.

STUDENT COMMENT

settle a claim, the insurance company was assuming a limited duty of acting either with good faith or with due care in the matter of settlement—however those terms may be defined. The reasoning behind such precedent would certainly be inconsistent with an interpretation of the “may settle” language which would require an insurer to be strictly liable for any excess judgment. There is, however, more than simply a vast body of judicial precedent inconsistent with the strict liability rule. There has been a noticeable lack of support, from judicial or nonjudicial sources, for the proposition that a strict liability rule may reasonably be read into the specific contractual language regarding defense and settlement. In effect then, a court, which contemplated the adoption of strict liability, would be confronted not only by extensive precedent interpreting the settlement language in a manner incompatible with strict liability but also by a marked absence of reasonable recommendations as to the manner of reading strict liability into the “may settle” language.

A third point, which has not been explored thoroughly but which may well be decisive, militates against acceptance of the strict liability rule. It is the possibility that the present balance of negotiating power between the claimant and insurer will be upset to such an extent that the cost of settlement will greatly increase. It has already been noted that there is an argument in favor of strict liability, namely, that it will not be substantially more expensive than present standards and that cost is therefore not an obstacle. None of the writers, however, has considered explicitly the effect of strict liability on settlement negotiations and some have been content to dismiss the cost problem in cursory fashion.⁴⁶ It is not inconceivable that the effect of such a rule on those negotiations could be significant when the problem is raised in the following terms. There are, undoubtedly, many instances in which an insured's personal resources are negligible or so difficult to attach that the claimant is interested only in the amount that he can collect from the insurer. In such a situation, the settlement negotiations would be carried on and settlement offers would be framed with a keen eye toward the limited amount sought to be collected from the insurer. In short, when a claimant is seeking to make an attractive settlement offer to an insurer, who is aware that the policy limits are the most that claimant can hope to collect, the claimant is apt to frame his settlement figure well within policy limits. On the other hand, there would be a strong tendency for that same claimant to frame his settlement offer so as to be just under policy limits, if the jurisdiction required an insurer to pay any subsequent judgment if the insurer had previously refused any offer to settle within limits. In more concrete terms, if the claimant could only hope to recover the \$5,000 policy limit at trial, his settlement figure may well be in the \$2,500-\$3,000 range. Yet, if he knows that the full \$30,000, which he is seeking, must be paid by the insurer if claimant wins at trial and insurer has rejected a settlement within policy limits, there is a good chance that claimant will demand \$4,900 because of the disadvantageous position of the insurer. In this type of situation, then, a very significant interference with the balance of negotiating power of the

⁴⁶ See authorities cited note 40 supra.

insurer and of the claimant is quite likely. It is evident then, that regardless of whether the problem of judicial adoption of strict liability is resolved so as to justify judicial implementation of the rule rather than legislative effectuation of that standard, serious and exhaustive consideration of that rule's effect on settlement negotiations and on other factors which significantly influence the cost of insurance should precede the enforcement of a strict liability rule.

Satisfactory resolution of the excess-liability dilemma would be an admirable accomplishment for the legal profession. A solution like strict liability, however, should be considered with extreme caution. It achieves a desirable social goal by shifting the risk of loss from the insured to the insurance industry in those deplorable excess-liability situations where there was an opportunity to settle within limits. Nevertheless, important questions such as the appropriate means of effectuating that rule and the ultimate effect on insurance costs remain to be resolved.

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