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# In California Excess Liability Cases, Does “Bad Faith” In Law Equal “Strict Liability” In Practice?

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## **In California Excess Liability Cases, Does “Bad Faith” In Law Equal “Strict Liability” In Practice?**

Insurance provides an element of security in a world where it does not exist naturally. Confronted with the possibility of financial loss, many individuals use insurance to help provide financial security. Once a policy of insurance is purchased it becomes a valuable asset to those protected by it.

It is a matter of common knowledge that a majority of insurance claims are settled without conflict. However, in reference to those claims which are litigated, the courts play an important role supervising claims settlements and providing for the resolution of future disputes through the doctrine of stare decisis. In accomplishing this task of claims supervision the courts must strike a delicate balance between preserving the insurer's claim fund against unfounded claims and upholding the reasonable expectations of policy holders. In an effort to strike this balance, the California Supreme Court has held that there is an implied covenant of good faith and fair dealing in every contract of insurance.<sup>1</sup>

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1. *Comunale v. Traders & General Ins. Co.*, 50 Cal. 2d 654, 658, 328 P.2d 198, 200 (1958).

Cases involving the breach of the implied covenant of good faith and fair dealing have come to be known as bad faith cases. The California courts have not yet formulated a precise definition of the term "bad faith." It has been made clear that bad faith will be found in cases involving fraud, dishonesty and concealment.<sup>2</sup> It is equally clear that these elements are not necessary to sustain a cause of action for breach of the implied covenant of good faith and fair dealing.<sup>3</sup>

It should be emphasized that the term bad faith does refer to a specific class of cases involving insurance and the implied covenant of good faith and fair dealing. However, use of this term, other than as a convenient label for these cases, can be misleading and a source of much confusion. This is because liability is not necessarily predicated upon a finding of bad faith in the guise of fraud, dishonesty, concealment, evil, malice or ill will.<sup>4</sup> The courts have reasoned that liability is impressed upon the insurer for failing to accept reasonable settlement offers, a duty which is imposed under the implied covenant of good faith and fair dealing.<sup>5</sup>

The duty of good faith and fair dealing has been held to apply to all first and third party cases.<sup>6</sup> First party bad faith cases arise when the insured or his selected beneficiary makes a direct claim against the insurance company and the company unreasonably refuses to make payments due and owing under the policy.<sup>7</sup>

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2. *Critz v. Farmers Ins. Group*, 230 Cal. App. 2d 788, 41 Cal. Rptr. 401 (1965); *Palmer v. Financial Indem. Co.*, 215 Cal. App. 2d 419, 30 Cal. Rptr. 204 (1963); *Davy v. Public National Ins. Co.*, 181 Cal. App. 3d 387, 5 Cal. Rptr. 488 (1960).

3. *Crisci v. Security Ins. Co. of New Haven Conn.*, 66 Cal. 2d 425, 430; 426 P.2d 173, 176, 58 Cal. Rptr. 13, 16-17 (1967).

4. See *Johansen v. California State Auto. Assn. Inter-Ins. Bureau*, 15 Cal. 3d 9, 538 P.2d 744, 123 Cal. Rptr. 288 (1975); *Cain v. State Farm Mutual Automobile Insurance Co.*, 47 Cal. App. 3d 783, 121 Cal. Rptr. 200 (1975); *Gruenberg v. Aetna Insurance Co.*, 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973); *Garner v. American Mut. Liability Ins. Co.*, 31 Cal. App. 3d 843, 107 Cal. Rptr. 604 (1973); *Crisci v. Security Insurance Co. of New Haven Conn.*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); *Comunale v. Traders & General Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958).

5. *Id.*

6. *Gruenberg v. Aetna Insurance Company*, 9 Cal. 3d 566, 573, 510 P.2d 1032, 1036, 108 Cal. Rptr. 480, 486 (1973).

7. *Silberg v. California Life Insurance Co.*, 11 Cal. 3d 452, 521 P.2d 1103, 113 Cal. Rptr. 711 (1974), for the withholding of payments under a health insurance policy; *Greenberg v. Aetna Insurance Company*, 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973), for the withholding of payments under a fire insurance policy; *Richardson v. Employers Liab. Assur. Corp.*, 25 Cal. App. 3d 232, 102 Cal. Rptr. 547 (1972), for the withholding of payments under the uninsured motorist provision of an automobile insurance policy; and *Fletcher v. Western National Life Ins. Co.*, 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970), for the withholding of payments under a disability insurance policy.

Third party bad faith cases arise when the insurer fails to accept an offer to settle a claim against its insured within liability policy limits and thereby exposes its insured to excess liability.<sup>8</sup> This article will explore the principles of bad faith as they are applied to excess liability actions (*i.e.*, third party actions). Although the jurisdictions have formulated several approaches to this issue, this article will emphasize the principles adopted by California courts.<sup>9</sup>

### THE BASIS OF LIABILITY IN EXCESS LIABILITY CASES

#### *Introduction*

An insurance company, through the terms of liability insurance policies and subject to the stated limits of liability, promises to pay all claims which the insured shall become legally obligated to pay as damages because of bodily injury or property damage.<sup>10</sup> Once a claim for damages is presented for an amount in excess of the coverage limits an insurance company must decide whether to meet a demand to settle the claim within the policy limits or to have the issue and extent of liability determined through judicial processes.<sup>11</sup> In California, if the insurer elects to

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8. See the following cases dealing with the failure to settle claims within liability policy limits: *Johansen v. California State Auto. Assn. Inter-Ins. Bureau*, 15 Cal. 3d 9, 538 P.2d 744, 123 Cal. Rptr. 288 (1975); *Cain v. State Farm Mutual Automobile Insurance Co.*, 47 Cal. App. 3d 783, 121 Cal. Rptr. 200 (1975); *Garner v. American Mut. Liability Ins. Co.*, 31 Cal. App. 3d 843, 107 Cal. Rptr. 604 (1973); *Crisci v. Security Insurance Co. of New Haven Conn.*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); and *Comunale v. Traders & General Ins. Co.*, 50 Cal. 3d 654, 328 P.2d 198 (1958).

9. For a discussion of the theories of liability for failing to settle, see *An Insurance Company's Duty to Settle: Qualified or Absolute?* 41 SOUTHERN CAL. L. REV. 120 (1967-68).

10. The typical insuring clause states that the company will pay, on behalf of the insured, all sums which an insured shall become legally obligated to pay as damages because of bodily injury, sickness or disease, including death at any time resulting therefrom, sustained by any person. While deceptively simple on the surface, no less than eight elements must be considered in determining the extent of coverage provided. These include definitions of property, perils, hazards, losses, persons, places, time period and the amount of coverage.

11. For consideration of this issue as it's treated outside California, see *General Acc. Fire & Life Assur. Corp. Ltd. v. Little*, 103 Ariz. 435, 443 P.2d 690 (1968) in which the Arizona Supreme Court noted defense counsel's estimate of four chances in ten of losing the case; with a possibility of a verdict greatly in excess of policy limits, these facts created a situation where it was not difficult to sustain a jury's finding of bad faith. *Contra* are the following cases, which stand for the proposition that trial attorneys do not always have the gift of foretelling the future: *American Cas. Co. v. Howard*, 187 F.2d 322 (4th Cir. 1951); *Olson v.*

litigate the issue of liability or damages and a verdict in excess of policy limits is rendered, the insurer may be subject to actions for (1) liability in excess of the policy limits, (2) emotional distress and (3) punitive damages, all of which would be founded upon a breach of the implied covenant of good faith and fair dealing.<sup>12</sup> In California the implied covenant of good faith and fair dealing has been held to impose a duty upon the insurer to give equal consideration to the interests of the insured.<sup>13</sup>

When there is great risk of 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. Its unwarranted refusal to do so constitutes a breach of the implied covenant of good faith and fair dealing.<sup>14</sup>

The California courts have reasoned that this test is proper because the insurer has reserved control over the litigation and settlement of claims and because the insured often receives protection through the settlement of claims without litigation.<sup>15</sup> The question of whether the insurance company has acted in bad faith in considering and rejecting the settlement offer is one of fact to be determined by a jury.<sup>16</sup> As discussed *infra*, whether the obligation to accept a reasonable settlement offer has been fulfilled in a particular case is tested, at best, by a vague standard.

#### *Who May Bring The Suit?*

Once a judgment in excess of policy limits has been entered against an insured, an initial consideration is whether a party other than the insured may bring a bad faith action against the insurer to recover that excess. The law is well settled in California that the claimant may acquire the insured's cause of action either through a voluntary assignment from the insured<sup>17</sup> or by

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Union Fire Ins. Co., 174 Nebr. 375, 119 N.W.2d 318 (1962); Ferris v. Employers Mutual Cas. Co., 255 Ia. 511, 122 N.W.2d 263 (1963).

12. See n. 7-8 *supra*.

13. Johansen v. California State Auto. Assn. Inter-Ins. Bureau, 15 Cal. 3d 9, 16, 538 P.2d 744, 748, 123 Cal. Rptr. 288, 292 (1975); Crisci v. Security Insurance Co. of New Haven, Conn., 66 Cal. 2d 425, 429, 426 P.2d 173, 176, 58 Cal. Rptr. 13, 16, (1967); Comunale v. Traders & General Ins. Co., 50 Cal. 2d 654, 659, 328 P.2d 198, 201 (1958).

14. Comunale v. Traders & General Ins. Co., 50 Cal. 2d 654, 659, 328 P.2d 198, 201 (1958).

15. Crisci v. Security Insurance Co. of New Haven, Conn., 65 Cal. 2d 425, 429, 426 P.2d 173, 176, 58 Cal. Rptr. 13, 16 (1967); Comunale v. Traders & General Ins. Co., 50 Cal. 2d 654, 659, 328 P.2d 198, 201 (1958); and Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 682, 319 P.2d 69, 71 (1957).

16. Marasango v. Automobile Club of So. Cal., 1 Cal. App. 3d 688, 696, 82 Cal. Rptr. 92, 97 (1969).

17. Comunale v. Traders & General Ins. Co., 51 Cal. 2d 654, 661, 328 P.2d 198, 200 (1958).

taking an assignment from a trustee in bankruptcy.<sup>18</sup> *Murphy v. Allstate Insurance Company*<sup>19</sup> has recently held that the claimant may not bring a direct action against the insurer without acquiring an assignment.

### *Origins Of The Current Test Of Liability*

An insurance policy in its basic form is a contract whereby an insurance company promises to "stand in the shoes" of the insured when the insured suffers a loss covered by the policy. If a law suit is filed against its insured, the company has the option to settle the claim or to defend the action. If it defends the action and the insured is found liable the company will pay the claim up to the policy limits that the insured has chosen.<sup>20</sup> This degree of control over the claim and the ultimate authority to settle or defend an action is necessary in order to write reasonable rates that policy holders can afford. This settlement authority, however, must be exercised in good faith.

The procedure whereby the insurer retains complete control over the settlement of claims, subject to judicial review, incorporates the balance that must be struck between providing protection to policy holders as a group and providing that protection at reasonable rates.<sup>21</sup> However, this theory does not necessarily provide a balance between the interests of the insurer and those of the individual policy holder. Efforts to protect the solvency of the insurance fund for policy holders as a group might occasionally result in unfair treatment to an individual policy holder.

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18. *Brown v. Guarantee Ins. Co.*, 155 Cal. App. 2d 679, 693, 319 P.2d 69, 77 (1957).

19. 17 Cal. 3d 937, 553 P.2d 584, 132 Cal. Rptr. 424 (1976).

20. The insuring clause in liability insurance policies is very broad in setting forth the applicable coverage. However, the coverage provided is subject to exclusions, conditions, definitions, and limits of liability. The major provisions over which the insured has control are those which concern the type and amount of coverage which will be purchased.

21. If insurance companies are to serve the public efficiently they must provide coverages at reasonable costs. If insurance is to provide this service to the public, rates must be adequate to ensure that the claims fund will be adequate to pay all losses. Improper management, excessive expenses and passive/over-generous claims philosophies can create insolvency. Likewise, control over claim settlements is deemed necessary to ensure that solidity will be sustained for the protection of policy holders as a group.

An attitude too often adopted by less experienced claims managers is that there is nothing to gain by settling a claim unless settlement can be obtained for less than policy limits. It is difficult to imagine that, when confronted with a \$450,000 suit, an insurance policy with limits of \$10,000, a final demand of \$10,000 and the possibility of a final judgment in the amount of \$225,000, the insurer had the interests of the insured in mind when he offered only \$9,500 to settle the claim.<sup>22</sup> This is but one of several instances that evidences a reluctance on the part of some insurers to offer full policy limits to settle claims.<sup>23</sup> This type of conduct is difficult to justify even from the insurer's point of view. In the case above it is doubtful that the insurer would have offered \$9,500 to settle the claim had it not felt that its insured was legally liable. Yet, in an attempt to save \$500, the insurer was willing to expend a much larger sum of money to defend an action against its insured. Such claims practices illustrated a very uneconomical aspect of insurance company operations; and an examination of the recent cases indicates that this type of claims conduct has been discontinued. Judicial responses to these and other similar practices have produced the current test of "bad faith" in excess liability cases.

This test directs an insurance company to consider the interests of the insured, analyze the factors surrounding a claim and requires that, when an offer to settle a claim is received, a determination whether to settle must be made as if there were no policy limits. If it is determined that a prudent insurer would have accepted an offer of settlement under those conditions, a breach of the implied covenant of good faith and fair dealing

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22. *Lysick v. Walcom*, 258 Cal. App. 2d 136, 65 Cal. Rptr. 406 (1968).

23. *Crisci v. Security Insurance Co. of New Haven, Conn.*, 66 Cal. 2d 425, 58 Cal. Rptr. 13, 426 P.2d 173 (1967) where policy limits were \$10,000, final demand was \$9,000, a counter-offer of \$3,000 was made (the insured was willing to contribute \$2,500) and a judgment for \$101,000 was entered; *Kinder v. Western Pioneer Insurance Co.*, 231 Cal. App. 2d 894, 42 Cal. Rptr. 394 (1965), where policy limits were \$10,000, final demand was \$8,000, a counter-offer of \$7,500 was made and a judgment of \$30,000 was entered; *Critz v. Farmers Ins. Group*, 230 Cal. App. 2d 788, 41 Cal. Rptr. 401 (1964), where the policy limits were \$10,000, final demand was \$10,000, a counter-offer of \$8,250 was made and a judgment of \$40,000 was entered; *Martin v. Hartford Acc. & Indem. Co.*, 228 Cal. App. 2d 178, 39 Cal. Rptr. 342 (1964) where policy limits were \$10,000, final demand was \$10,000, the counter-offer was \$9,000 and the judgment was \$25,000; *Davy v. Public National Ins. Co.*, 181 Cal. App. 2d 387, 5 Cal. Rptr. 488 (1960) where policy limits were \$5,000, the final demand was \$4,500, the counter-offer was \$3,000 (the policy holder was willing to pay the difference but the lawyer for the insurer said it was against company policy) and a judgment of \$24,268 was entered; *Brown v. Guarantee Ins. Co.*, 155 Cal. App. 2d 679, 319 P.2d 69 (1957), where policy limits were \$5,000, final demand was \$5,000, a counter-offer of \$4,000 was made and a judgment of \$15,000 was entered.

will be found if an offer to settle within policy limits has been rejected.<sup>24</sup>

*Cases Where Liability Or Damages Are In Issue*

An examination of *Crisci v. Security Insurance Co. of New Haven, Conn.*,<sup>25</sup> *Garner v. American Mut. Liability Ins. Co.*<sup>26</sup> and *Cain v. State Farm Mutual Automobile Ins. Co.*<sup>27</sup> supports the proposition that, although the doctrine of strict liability in "bad faith" cases does not exist "at law," it may exist in practice.

California Supreme Court dictum in *Crisci v. Security Insurance Co. of New Haven, Conn.*<sup>28</sup> considered an argument urging the application of strict liability principles to bad faith cases. The court noted the arguments made in earlier decisions that the insured normally receives protection through the settlement of claims and that the insurer exercises control over claims to the point that the insured ordinarily cannot compel the insurer to settle the claim against him.<sup>29</sup> The court went on to state that, when a judgment in excess of policy limits is entered against the insurer, it is the insured who will be liable for the excess; the company will be in the same position as if the case had been settled. Thus, if the insurer fails to settle within policy limits, it has "gambled" with the insured's money.<sup>30</sup> The court reasoned that there is some justice in a rule that places the exposure to loss upon the insurer who "may reap the benefits of its determination not to settle."<sup>31</sup> Thus, according to dictum in *Crisci*, even through an insurer has a litigable issue, if it chooses to defend rather than to settle it does so at its own risk.<sup>32</sup>

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24. *Crisci v. Security Insurance Co. of New Haven, Conn.*, 66 Cal. 2d 425, 426 P.2d 173, 176, 429, 58 Cal. Rptr. 13, 16 (1967); *Kender v. Western Pioneer Ins. Co.*, 231 Cal. Appr. 2d 894, 900, 42 Cal. Rptr. 395, 398 (1965); *Critz v. Farmers Ins. Group*, 230 Cal. App. 2d 788, 798, 41 Cal. Rptr. 401, 408 (1964); *Martin v. Hartford Acc. & Indem. Co.*, 229 Cal. App. 2d 178, 183, 39 Cal. Rptr. 342, 345 (1964); *Hodges v. Standard Accident Ins. Co.*, 197 Cal. App. 2d 564, 579, 18 Cal. Rptr. 17, 26 (1961); *Davy v. Public National Ins. Co.*, 181 Cal. App. 2d 387, 409, 5 Cal. Rptr. 488, 497 (1960).

25. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

26. 31 Cal. App. 3d 843, 107 Cal. Rptr. 604 (1973).

27. 47 Cal. App. 3d 783, 121 Cal. Rptr. 200 (1975).

28. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

29. *Id.* at 430-31, 426 P.2d at 177-78, 58 Cal. Rptr. at 17.

30. *Id.*

31. *Id.*

32. *In Rova Farms Resort, Inc. v. Investors Ins. Co. of Amer.*, 65 N.J. 474, 323



The *Crisci* court, however, did not deem it necessary to adopt a theory of strict liability for failure to settle, for it concluded that the evidence at trial supported the conclusion that the insurer had breached its duty to consider the interests of the insured when the company failed to accept an offer to settle the claim within policy limits.<sup>33</sup>

Also of major significance in *Crisci* is a jury instruction which has found approval in the California courts. This instruction, in effect, provides that a judgment in excess of policy limits furnishes an inference that the most reasonable method of handling the claim would have been to settle that claim within the policy limits.<sup>34</sup>

In *Garner v. American Mutual Liability Ins. Co.*<sup>35</sup> a malpractice insurance policy was issued to the insured with liability limits of \$100,000. The terms of the policy provided that the company "shall not settle or compromise any claim or suit [for malpractice] without the consent"<sup>36</sup> of a medical review board. On two separate occasions the medical review board concluded

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A.2d 495 (1974) the N.J. Supreme Court recognized the dictum in *Crisci* that supported a rule of strict liability for failing to settle. The California Supreme Court in *Johansen v. California State Auto Assn. Inter-Ins. Bureau*, 14 Cal. 3d 9, 538 P.2d 744, 123 Cal. Rptr. 288 (1975), added additional emphasis to its dictum in *Crisci*. In *Johansen* at note 6 the court states that the N.J. Supreme Court had adopted the strict liability rule in *Rova Farms*. A reading of *Rova Farms* discloses that the N.J. Supreme Court discussed in dicta (quoting the *Crisci* dictum on strict liability) whether to adopt a rule of strict liability for failing to settle. The N.J. Supreme Court, however, decided that it was unnecessary to adopt such "an extended rule" to decide the case. 65 N.J. at 502, 323 A.2d at 510. The N.J. Supreme Court, however, in note 9 to its opinion, indicates a willingness to adopt the strict liability rule:

... [T]here is no constitutional mandate that a court may not go beyond what is necessary to decide a case at hand. Whether an issue will be dealt with narrowly or expansively calls for a judge's evaluation of many things, including the need for guidance for the bar or agencies of government or the general public. To that end, the Court may express doubts upon existing doctrines. . . . 65 N.J. at 502, n.9, 323 A.2d at 510, n.9.

*Johansen* appears once again to state the California Supreme Court's favorable position toward a principle of strict liability and a willingness to adopt it in a proper case.

33. 66 Cal. 2d at 431-32, 426 P.2d at 177-78, 58 Cal. Rptr. at 17-18.

34. The size of the judgment recovered in the personal injury action when it exceeds the policy limits, although not conclusive, furnished an inference that the value of the claim is the equivalent of the amount of the judgment and that acceptance of an offer within those limits was the most reasonable method of dealing with the claim.

*Crisci v. Security Insurance Co. of New Haven, Conn.*, 66 Cal. 2d 425, 431, 426 P.2d 173, 177, 58 Cal. Rptr. 13, 17 (1967); *Accord Johansen v. California State Auto. Assn. Inter-Ins. Bureau*, 15 Cal. 3d 9, 17, 538 P.2d 744, 749, 123 Cal. Rptr. 288, 293 (1975); *Cain v. State Farm Mutual Automobile Insurance Co.*, 47 Cal. App. 3d 783, 796-97, 121 Cal. Rptr. 200, 208-09 (1975).

35. 31 Cal. App. 3d 843, 107 Cal. Rptr. 604 (1973).

36. *Id.* at 846, 107 Cal. Rptr. 606.

that there was no malpractice on the part of the insured physician with respect to a single claim.<sup>37</sup> There was a demand for the policy limits but, due to the findings of the medical review board and the terms of the policy, the demand was not accepted even though the insured had requested that settlement be made. The trial verdict was for \$225,000, \$125,000 over the policy limits.

In a suit for the excess judgment, the trial court found that the insurance company was not permitted by the terms of the policy to settle the case without the approval of the medical review board and found for the defendant. This finding was not contested by the plaintiff on appeal and the court of appeal accepted it. However, the appellate court reversed the judgment in favor of the defendant, concluding that the insurer was liable for the excess judgment of \$125,000 notwithstanding the policy term prohibiting settlement without the medical review board's concurrence.

In support of this holding, the appellate court reasoned that there are many factors which must be considered by the insurance company in determining whether to settle a case.<sup>38</sup> Further,

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37. Under most liability policies the insurance company has full control over the settlement of claims. In malpractice insurance it is common to have a provision in the policy to the effect that settlement of a suit or claim cannot be made without the consent of the insured. One rationale for this clause is that the doctor's reputation is involved. In this case, the decision rested with the medical review board. This type of provision provides the insurer with sound independent medical advice as to whether malpractice exists.

38. 31 Cal. App. 3d at 849-50, 107 Cal. Rptr. at 608.

Since the ultimate determination of the risk and exposure of plaintiff was vested in 12 lay jurors in a courtroom, the obligation to protect plaintiff also included, of necessity, a careful measuring of the legal facets of the case, the probabilities of a verdict and its anticipated range if adverse, the strengths and weaknesses of all of the evidence to be presented on either side so far as known, the nature of the surgical or medical result, the experience and capacity of counsel, and the history of the particular jurisdiction in similar litigation. Finally, defendant owed to plaintiff its experience and expertise in total claims evaluation as an insurance company. In assessing plaintiff's exposure, it may not ignore its own claims assessment based upon its experience in the given geographic area with cases of similar nature and with similar medical results, if any. It must fairly and reasonably appraise and weigh a number of determinative factors including such ponderables as the relative appearance and likely appeal or the lack thereof, of the claimant and its insured, as well as the known witnesses, together with the seriousness of the medical result. In short, it must bring to bear on the case on behalf of its insured an amalgam of medical, legal and claims judgments which dictate the course, nature and intensity of any pretrial settlement negotiations. In such a composite of judgments it may not ignore the desires or instructions of the insured, for in the final analysis the exposure, the ultimate risk of loss, is his.

it found that the insurer, in considering the interests of the insured, had failed to make an independent evaluation of the claim.<sup>39</sup>

This case demonstrates that proof of “bad faith” in the sense of fraud, dishonesty, concealment, evil, malice or ill will is not necessary to sustain an action for breach of the implied covenant of good faith and fair dealing.<sup>40</sup> An examination of the court’s decision reveals that the only basis for the compensatory award was the insurer’s failure to make an independent determination of liability, an omission which was construed as a failure to consider the interests of the insured. It is apparent, even from the opinion of the court that the insurer acted in good faith by adhering to the terms of the policy and submitting the malpractice issue to an independent medical review board, not once, but twice. Had the medical review board concluded that there was malpractice and had the insurer disregarded its opinion, the court’s decision would have been supported to the extent that the insurer had failed to give equal consideration to the insured’s interest and that it had likewise acted in traditional “bad faith.”

The insurance company erred in this case when it placed its settlement authority solely upon the decision of the medical review board. Insurance companies and their employees are generally not experts in the field of medicine, but medical review boards comprised of licensed doctors usually are. Insurance companies, as a portion of the overall settlement process, must be allowed to rely on the opinions of medical review boards in order to make educated determinations of malpractice. But they must proceed further. They must also consider the numerous other factors involved in any negligence action including for example, whether trial will be to the court or to the jury, the experience and capacity of counsel for plaintiff and defendant, the strengths and weaknesses of witnesses and of the evidence, the seriousness of the injuries, the probability of a verdict for the plaintiff, the verdict potential, the likelihood of appeal, and the prior decisions on this subject of the jurisdiction selected.<sup>41</sup>

In *Cain v. State Farm Mutual Automobile Insurance Co.*<sup>42</sup> the only bad faith issue before the court was whether State Farm had given equal consideration to the interests of its insured. It was agreed that State Farm had conducted a thorough investigation of the claim, had kept its insured informed of all settlement

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39. *Id.* at 849, 107 Cal. Rptr. at 608.

40. *Id.* at 851, 107 Cal. Rptr. at 609.

41. 31 Cal. App. 3d at 849-50, 107 Cal. Rptr. at 608.

42. 47 Cal. App. 3d 782, 121 Cal. Rptr. 200 (1975).

offers and had retained "experienced counsel."<sup>43</sup> Thus, a finding that the implied covenant of good faith and fair dealing had been breached could be based only upon the ground that the insurer failed to give equal consideration to the interests of the insured.

On August 11, 1964, Bing Woo Jew (State Farm's insured) and Elaine Cain were involved in a one-car accident.<sup>44</sup> Elaine Cain sued Bing Woo Jew for the injuries she received as a result of the accident. There was a dispute as to whether Elaine Cain or Bing Woo Jew was driving the vehicle. If Elaine Cain was the driver of the vehicle at the time of her injury, then her injury would have been the proximate result of her own actions.<sup>45</sup>

The facts adduced at trial would have supported a finding in favor of either party on this issue.

#### The facts most favorable to the plaintiff revealed that

At the scene of the accident, Jew told the police officer that he had been driving, to keep Elaine Cain's name out of the police report, to protect his marriage . . . . Subsequently, in the early morning hours after the accident, while defendant, Jew, and the police officer were at the hospital, Jew changed the story and told the police officer that he had not been driving and in fact Elaine Cain was the driver of the fated vehicle . . . [after he was told that Elaine Cain could possibly die from the critical injuries that she sustained and the case could possible involve a manslaughter charge . . . . The windshield of the vehicle was broken on the right side, generally in front of the passenger's seat, yet Jew sustained no severe head injuries, but for some minor cuts from splintering glass . . . . Yet Elaine Cain had a depressed skull fracture on the right side of her head, . . . [t]hat the right side of the vehicle, including the front door window and windshiel were blood-spattered and that Jew had not received any head injuries or serious bleeding . . . [t]hat Mr. Snedden [the ambulance attendant] . . . found the girl mainly in the center toward the right passenger side of the front seat and remembered that she had severe injuries to the right side of her head.<sup>46</sup>

#### The facts most favorable to the defense revealed that

In this third recorded statement, Jew again reiterated and represented to State Farm that Cain was the driver of the vehicle. . . . It was reported to State Farm by a private investigator that "Olsen [the investigating police officer] considered that Woo's subsequent story that the girl had been driving was true and he cancelled the citation that had already been made out to Woo and prepared the Official Reort indicating that Miss Cain had been driving the car."

43. *Id.* at 791-92, 121 Cal. Rptr. at 205.

44. Brief for Appellant, 1-2, *Cain v. State Farm Mutual Automobile Insurance Co.*, 47 Cal. App. 3d 783, 121 Cal. Rptr. 200 (1975).

45. *Id.* at 4.

46. Brief for Respondents, 1-11, *Cain v. State Farm Mutual Automobile Insurance Co.*, 47 Cal. App. 3d 783, 121 Cal. Rptr. 200 (1975).

Olsen had telephoned Harbor Emergency Hospital and spoke to ambulance steward Marks, who had removed the victim from the scene. . . . Marks told Olsen that the girl's hips and legs had been under the steering wheel of the vehicle, the upper torso of her body to the right across the center of the front seat of the vehicle and her head and shoulders resting in the lap of a male passenger who was seated on the right portion of the front seat, there being no evidence that this had not been the original position of the occupants of the vehicle because the right door—the passenger's door—had been involved in the collision with the pole and the ambulance personnel could not visualize how the male occupant could have gotten himself handily into the position in which they found him had he not been there originally.<sup>47</sup>

The jury returned a verdict in favor of the plaintiff for almost \$58,000 and the insurer paid the policy limits of \$25,000. At this time Bing Woo Jew assigned his cause of action against State Farm for the excess judgment to Elaine Cain and reserved to himself any cause of action for physical injuries sustained as a result of the failure to settle. Elaine Cain and Bing Woo Jew jointly brought the action in issue against State Farm. The jury returned a verdict for the amount of the excess in favor of Elaine Cain and awarded \$25,000 in compensatory damages and \$115,000 in punitive damages to Bing Woo Jew.<sup>48</sup>

The issue confronting the appellate court in *Cain* may be stated in this manner: in considering the interests of the insured, may the insurer defend an action if there is a reasonably founded factual dispute as to liability and then not be held liable for the excess if it loses the case? On the basis of the decision in this case, the answer is no.

There was no dispute that the insurer had an opportunity to settle the claim within policy limits. Thus, to determine whether the insurer had acted in violation of the implied covenant of good faith the test applied was "whether a prudent insurer without policy limits would have accepted the settlement offer."<sup>49</sup>

In *Merritt v. Reserve Insurance Company*<sup>50</sup> the court stated in dicta that "the carrier is not required to predict at its' peril the outcome of the suit, or the credibility of the witnesses."<sup>51</sup> It has been stated that

The gift of prophesy has never been bestowed on ordinary mortals, and as yet their vision has not reached a state of perfection that they have the power to predict what will be the verdict of a jury on disputed facts in a personal injury case.<sup>52</sup>

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47. Brief for Appellant, 4-7, *Cain v. State Farm Mutual Automobile Insurance Co.*, 47 Cal. App. 3d 783, 121 Cal. Rptr. 200 (1975).

48. 47 Cal. App. 3d at 789-90, 121 Cal. Rptr. at 204.

49. 47 Cal. App. 3d at 792, 121 Cal. Rptr. at 205.

50. 34 Cal. App. 3d 858, 110 Cal. Rptr. 511 (1973).

51. *Id.* at 874, 110 Cal. Rptr. at 522.

52. *Georgia Cas. Co. v. Mann*, 242 Ky. 447, 46 S.W.2d 777 (1932).

In *Cain*, the issue of liability was in dispute and the credibility of the insured as a witness was in issue. *Cain* holds that an insurer is responsible for judging the credibility of witnesses and predicting the outcome of a suit.<sup>53</sup> This decision requires the insurer to "second-guess" twelve jurors and to determine in advance how and in what manner they will react to a given set of facts. The *Cain* Court referred to the expertise of the claims department of the insurer<sup>54</sup> and concluded that, in applying that expertise to the evaluation and negotiation of claims, the insurer knew or should have known what the final results were going to be.

Whether a prudent insurer should have settled a case within policy limits can easily be determined by hindsight. In any case where there exists a reasonable factual dispute concerning liability or damages an insurance company must, under this decision, proceed at its peril. When an insurance company considers the interests of its insured it will always be in the best interests of the insured to settle the claim.

As stated in *Crisci*, the insurer who defends an excess liability case has nothing to lose except the costs of litigation and everything to gain should it win the case. The insured, on the other hand, has nothing to gain by non-settlement of the claim within policy limits. The jury must decide whether the insurance company has given equal consideration to the interests of the insured.<sup>55</sup> However, a decision against the insurance company becomes even more likely in a suit for an excess judgment when the judge instructs the jury that the amount of the judgment provides an inference that the most reasonable method of dealing with the claim would have been to accept the settlement demand.

#### *Excess Liability Cases Where Policy Coverage Is In Issue*

The California Supreme Court in *Comunale v. Traders and General Ins. Co.*,<sup>56</sup> considered the effect of a disclaimer of coverage by the insurer. Here, the insurer had not only denied coverage but had also refused to defend the insured. The Court's reasoning was persuasive with regard to its finding of liability:

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53. 47 Cal. App. 3d at 790-91, 121 Cal. Rptr. at 204.

54. 47 Cal. App. 3d at 790-91, 121 Cal. Rptr. at 204-05.

55. *Id.* at 791-92, 121 Cal. Rptr. at 206.

56. 50 Cal. 2d 654, 328 P.2d at 198 (1958).

where an insurer denies coverage and fails to defend the insured it should be placed in no better position than if it had assumed the defense and then declined to settle.<sup>57</sup> The *Comunale* decision is partially responsible for the current practice in the insurance industry of offering the insured a defense under a “nonwaiver and withhold payment of the claim until the coverage question can be resolved” format. As will be seen *infra*, the decision in *Johansen v. California State Auto Assn. Inter-Ins. Bureau*<sup>58</sup> has made this practice obsolete in excess liability cases. Further it has been held that reasonable attorney’s fees are recoverable where the insurer has caused the insured to seek counsel to protect his interests.<sup>59</sup>

In *Johansen* the court considered the effect of a disclaimer of coverage by the insurer. In that case the policy limits were \$10,000, there was a demand of \$10,000 and a verdict of \$34,000. The insurer’s reason for not accepting the settlement demand was based upon a belief that the policy did not provide coverage. The insurer defended the insured in the personal injury action but reserved the right to litigate the coverage question.

In the declaratory relief action<sup>60</sup> the insurer contended that the insured had not reported a newly acquired vehicle within thirty days as required by the policy. The trial court ruled in favor of the insurer on this issue. This decision was reversed on appeal but not until 3½ years after the plaintiff had obtained the \$34,000 verdict in the personal injury action.<sup>61</sup> In an action for the amount of the excess judgment, the California Supreme Court reversed the holdings of the trial and appellate courts and found the carrier liable for the excess judgment.

In support of its holding, the court reaffirmed the principle that there is an implied covenant of good faith and fair dealing in every insurance contract which imposes a duty upon the insurer to settle a claim when recovery in excess of policy limits is

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57. *Id.* at 660, 328 P.2d at 202.

58. 15 Cal. 3d 9, 538 P.2d 750, 123 Cal. Rptr. 294 (1975).

59. See *Mustachio v. Ohio Farmers Insurance Company*, 44 Cal. App. 3d 358, 118 Cal. Rptr. 581 (1975), where the court in a first party action held that attorney’s fees are recoverable from an insurer who has breached the implied covenant of good faith and fair dealing and thereby caused the insured to seek the aid of counsel to protect his interests.

Since at least 1910 Georgia has allowed an award of attorney’s fees where the insurer has acted in bad faith, has been stubbornly litigious or has caused the insured unnecessary trouble and expense. See *State Farm Mutual Automobile Insurance Co. v. Smoot*, 381 F.2d 331 (5th Cir. 1967), a case in which \$21,929.20 was awarded as reasonable attorney fees.

60. *Cal. State Auto Assn. Inter-Ins. Bureau v. Dearing*, 259 Cal. App. 2d 717, 66 Cal. Rptr. 852 (1968).

61. *Id.*

likely;<sup>62</sup> that an insurer litigates a coverage question at its own risk;<sup>63</sup> and that an insurer's "*good faith through erroneous belief in non-coverage affords no defense to liability flowing from the insurer's failure to accept a reasonable settlement offer;*"<sup>64</sup> that the insurer must conduct negotiations as though there were no policy limits;<sup>65</sup> that there is an inference that the value of the claim is equivalent to the amount of the judgment and that settlement would be the most reasonable method of handling the claim;<sup>66</sup> and that liability is not based on a refusal to defend but is based rather on "the refusal to accept an offer of settlement within policy limits."<sup>67</sup>

In *Johansen* the insurer contended that the principle announced by the court would require an insurer to settle in all cases, regardless of whether the policy provided coverage, to protect itself from exposure to excess liability should the coverage question be decided in favor of the insured.<sup>68</sup> The court's position that the insurer can seek reimbursement from the insured is theoretically sound. However, it is questionable as to how many "insureds" will possess sufficient assets to satisfy claims for reimbursement.

Thus, the only permissible consideration in evaluating the reasonableness of the settlement offer becomes whether, in light of the victim's injuries and the probable liability of the insured, the ultimate judgment is likely to exceed the amount of the settlement offer. Such factors as the limits imposed by the policy, a desire to reduce the amount of future settlements or a belief that the policy does not provide coverage should not affect a decision as to whether the settlement offer in question is a reasonable one.<sup>69</sup>

62. *Johansen v. California State Auto. Assn. Inter-Ins. Bureau*, 15 Cal. 3d 9, 14, 15, 538 P.2d 744, 747, 123 Cal. Rptr. 288, 291 (1975).

63. *Id.* at 15, 538 P.2d at 748, 123 Cal. Rptr. at 292.

An insurer who denies coverage does so at its own risk and although its position may not have been entirely groundless, if the denial is found to be wrongful, it is liable for the full amount which will compensate the insured for all the detriment caused by the insurer's breach of the express and implied obligation of the contract.

64. *Id.* at 16, 538 P.2d at 748, 123 Cal. Rptr. 25, 292. (Emphasis added)

65. *Id.*

66. *Id.* at 17, 538 P.2d at 749, 123 Cal. Rptr. at 293.

67. *Id.*

68. *Id.* at 19, 538 P.2d at 750, 123 Cal. Rptr. at 294.

69. *Id.* at 16, 538 P.2d at 748-49, 123 Cal. Rptr. at 292-93.



Together these excess liability cases yield the principle that the "reasonable expectations"<sup>70</sup> of policy holders include the expectations that, when the opportunity to settle within policy limits without prejudice to the insured,<sup>71</sup> is presented, the insurer will settle the claim or be liable for the full amount of any judgment in excess of the policy limits.

### *Is There An Affirmative Duty To Seek Settlement?*

Although it is clear that an insurer may subject itself to liability beyond the policy limits by failing to accept a demand within those limits, it remains to be conclusively determined whether a California insurer has an affirmative duty to negotiate a settlement within the policy limits. Courts in other jurisdictions have concluded that insurance companies may be held liable for excess judgments even though demands for settlement have not been made.<sup>72</sup> These cases have placed affirmative fiduciary duties upon the insurers which required them to initiate settlements. To avoid liability these insurers must show that it was not possible to obtain settlements within policy limits and that settlements could not be achieved through contributions, by their insureds, of the excess amounts.

The California courts have not yet imposed this duty upon insurance companies. In *Merritt v. Reserve Insurance Company*<sup>73</sup> the court considered the bad faith issue as it related to a conflict of interest between the insurance company and the insured. The court determined that as long as settlement within

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70. The following language from a first party action provides:

In determining what benefits or duties an insurer owes his insured pursuant to a contract of title insurance, the court may not look to the words of the policy alone, but must also consider the reasonable expectations of the public and the insured as to the type of service which the insurance entity holds itself out as ready to offer. *Jarchow v. Transamerica Title Insurance Company*, 48 Cal. App. 3d 917, 942, 122 Cal. Rptr. 470, 487 (1975).

71. In the excess liability cases discussed *supra*, the basis of liability has turned on the issue of whether the insurance company had given equal consideration to the interests of the insured. In *Coe v. State Farm Mutual Automobile Insurance Co.*, (1st Dist., Civ. No. 37977 decided Feb. 9, 1977), the court reversed a lower court decision finding the insurer guilty of bad faith in failing to accept a settlement offer. State Farm rejected the offer because it failed to make any provision for consent or participation by another insurance company. Acceptance of the offer as postulated would have left the insured open to a recoupment action by the other insurance company. The court held that it cannot be bad faith to reject an offer whose terms would themselves represent bad faith.

72. *Cernocky v. Indemnity Ins. Co. of No. Amer.*, 69 Ill. App. 2d 196, 216 N.E.2d 198 (1966); *State Auto Ins. Co. of Columbus, Ohio v. Rowland*, 221 Tenn. 421, 427 S.W.2d 30 (1968); *Self v. Allstate Ins. Co.*, 345 F. Supp. 191 (1972). *Rova Farms Resort, Inc. v. Investors Ins. Co. of Amer.*, 65 N.J. 474, 323 A.2d 495 (1974).

73. 34 Cal. App. 3d 858, 110 Cal. Rptr. 511 (1973).

policy limits was not feasible the interests of the insured and the company were the same, *i.e.*, that of defending the action. An examination of the facts in *Merritt* makes it clear that settlement within policy limits was not feasible whether the insured contributed his own assets or not. No demand for settlement was ever made and the insurer and its counsel did not foresee any possibility of settlement. The court therefore reasoned that a conflict of interest had never developed between the insured and his insurer and that the situation was one in which an issue of bad faith had not arisen.<sup>74</sup>

It is to be noted that *Merritt* should not be cited for the proposition that an insurer does not have a duty to promote settlements. The facts of this case present a rare situation. Where settlement within policy limits would be feasible, a duty to promote settlement will probably be found to exist, especially when the insured has made a demand that the company make an offer of settlement within the policy limits. It is also doubtful that an insurer could avoid liability for an excess judgment by merely arguing that no settlement demand had been made by the insured or by the plaintiff.

#### EMOTIONAL DISTRESS DAMAGES IN BAD FAITH CASES

In a bad faith action, either first party or third party,<sup>75</sup> the insured apparently has two options for seeking recovery for emotional distress.

If the conduct by the insurance company may be categorized as "outrageous and extreme,"<sup>76</sup> the insured may bring an action

74. *Id.* The insurance policy limit was \$100,000 and the suit was for \$650,000. There was a workmen's compensation lien against any recovery by Merritt. \$76,000 had already been paid under workmen's compensation and a reserve had been established in the amount of \$145,000 for future payments. The insured's net worth prior to trial was approximately \$40,000 and at trial Merritt received a verdict in the amount of \$434,000.

75. *Crisci v. Security Insurance Co. of New Haven, Conn.*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); *Gruenberg v. Aetna Insurance Company*, 9 Cal. 3d 666, 510 P.2d 1032, 105 Cal. Rptr. 480 (1973).

76. For a complete discussion on good faith and first party claims, see *Good Faith and Fair Dealing in Insurance Contracts; Gruenberg v. Aetna Insurance Co.*, 24 HASTINGS L.J. 699 (1974); and *Eckenrode v. Life of America Ins. Co.*, 470 F.2d 1, 4-5 (7th Cir. 1972). In *Eckenrode* the court supported a decision concerning the proceeds of a life insurance contract by reasoning that

Peace of mind is a personal interest of sufficient importance to receive the law's protection against intentional invasion by outrageous conduct

based on the tort of intentional infliction of emotional distress.<sup>77</sup> However, in California, it is clear that an award of damages for emotional distress need not be based on this theory, but may be based upon emotional distress as a compensatory damage flowing from the commission of another tort.<sup>78</sup>

The rule, most recently affirmed in *Gruenberg v. Aetna Insurance Co.*<sup>79</sup> is that if a bad faith cause of action is otherwise established, damages may be given for mental suffering naturally ensuing from the acts complained of and that without attempting to distinguish between pain on the one hand and suffering on the other, the term "pain and suffering" includes recovery for fright, nervousness, grief, anxiety, worry, mortification, shock, humiliation, indignity, embarrassment, apprehension, terror, or ordeal.<sup>80</sup> Admittedly, these terms describe subjective states in the insured and represent a damage which often can be translated into a monetary recovery only with difficulty.<sup>81</sup>

The absence of expert medical testimony will not itself prevent recovery for emotional distress. Commonly, the plaintiff's own testimony establishes the damage.<sup>82</sup> Even in the absence of any explicit evidence showing "pain and suffering," the jury may

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. . . outrageous character of a person's conduct may arise from an abuse by that person of a position which gives him power to affect the interests of another; and that in this sense extreme bullying tactics and other high pressure methods of insurance adjusters seeking to force compromises or settlements may constitute outrageous conduct. . . insurer's alleged bad faith refusal to make payment on the policy, coupled with its deliberate use of economic coercion to force a settlement, clearly rises to the level of outrageous conduct to a person of ordinary sensibilities. . . the very risks insured against presuppose that upon the death of the insured the beneficiary might be in difficult circumstances and thus particularly susceptible and vulnerable to high pressure tactics by an economically powerful entity.

*See also, Fletcher v. Western National Life Insurance Co.*, 10 Cal. App. 3d 376, 90 Cal. Rptr. 78 (1970).

77. *State Rubbish Etc. Assn. v. Siliznoff*, 38 Cal. 2d 330, 240 P.2d 282 (1952). The elements of a prima facie case for the tort of intentional infliction of emotional distress are:

- 1) outrageous conduct by the defendant;
- 2) the defendant's intention of causing or reckless disregard of the probability of causing emotional distress;
- 3) the plaintiff's suffering severe or emotional distress; and
- 4) actual and proximate causation of the emotional distress by the defendant's outrageous conduct.

*See also, Fletcher v. Western National Life Insurance Co.*, 10 Cal. App. 3d 376, 394, 90 Cal. Rptr. 78, 88 (1970).

78. *Crisci v. Security Insurance Co. of New Haven, Conn.*, 66 Cal. 2d 425, 432, 425 P.2d 173, 178, 48 Cal. Rptr. 13, 18 (1967).

79. 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

80. *Id.* *See also Caplouto v. Kaiser Foundation Hospitals*, 7 Cal. 3d 889, 892-93, 500 P.2d 880, 883, 103 Cal. Rptr. 856, 859 (1972).

81. *Caplouto v. Kaiser Foundation Hospitals*, 7 Cal. 3d 889, 893, 500 P.2d 880, 883, 103 Cal. Rptr. 856, 859 (1972).

82. *Id.* at 895, 500 P.2d at 884-85, 103 Cal. Rptr. at 860-61.

infer such pain, if the jury in its common experience knows that the injury complained of normally is accompanied by such pain.<sup>83</sup> Courts have also allowed damages for mental suffering where there were no personal injuries, apart from the mental distress, the only injury being an interference with property rights.<sup>84</sup> The facts in the bad faith cases which awarded compensatory damages for emotional distress, indicated an independent injury such as demonstrable decline in physical health,<sup>85</sup> or actual pecuniary loss.<sup>86</sup> In *Crisci*, the court reasoned that the existence of these "other damages" provide the court with a sufficient guarantee of the genuineness of the claim to mitigate the danger of fictitious claims.<sup>87</sup>

In *Jarchow v. Transamerica Title Ins. Co.*<sup>88</sup> the court of appeal articulated the rule as

[T]he [*Crisci*] court was attempting to resolve the fundamental jurisprudential conflict engendered by the "impact or injury" rule. To ascertain the genuineness of a claim the court decided to look to the facts of the case to determine whether plaintiff had suffered an empirically verifiable injury: a detriment whose impact was readily observable and identifiable; an injury which could not be easily fabricated as mental distress, since proof of it could, and should be drawn from sources other than the plaintiff's own mouth. Thus, if a complaint indicates (for example) that a plaintiff was deprived of the use of his real property or his financial resources; or suffered physical injury; or was deprived of the possession of a piece of personalty, he may reasonably have been said to have suffered substantial damages. Sufferance of injuries such as these permit the reasonable inference that plaintiff's claim of mental distress is genuine.<sup>89</sup>

The foregoing discussion would indicate that recovery for emotional distress is predicated upon proof of three elements; proof of the tort, a showing of some "other damage" and "some evidence" of the plaintiff's emotional distress causally connected to the tort.<sup>90</sup>

83. *Id.* at 896, 500 P.2d at 885, 103 Cal. Rptr. at 861.

84. *Crisci v. Security Insurance Co. of New Haven, Conn.*, 66 Cal. 2d 425, 426 P.2d 173, 45 Cal. Rptr. 13 (1967) and cases cited therein.

85. *Id.* at 429, 426 P.2d 176, 58 Cal. Rptr. 16.

86. *Id.* at 429, 426 P.2d 176, 58 Cal. Rptr. 16; *Gruenberg v. Aetna Insurance Company*, 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973); *Jarchow v. Transamerica Title Ins. Co.*, 48 Cal. App. 3d 917, 122 Cal. Rptr. 470 (1975).

87. *Crisci v. Security Insurance Co. of New Haven, Conn.*, 66 Cal. 2d 425, 434, 426 P.2d 173, 179, 48 Cal. Rptr. 19 (1967).

88. 48 Cal. App. 3d 917, 122 Cal. Rptr. 470 (1975).

89. *Id.* at 936, 122 Cal. Rptr. at 484.

90. *Supra*, notes 85-89. See also CAL. CIV. CODE § 3333 (West 1970) which states the general rule of damages in tort, that the insured party may recover an

In *Cain v. State Farm Mutual Automobile Insurance Co.*,<sup>91</sup> the court of appeal affirmed an award of \$25,000 compensatory damages for emotional distress in favor of State Farm's insured, Bing Woo Jew. In reaching its decision, the court reviewed only the evidence supporting the finding of a breach of the implied covenant of good faith and fair dealing. By failing to state the evidence in the record sustaining a finding of emotional distress<sup>92</sup> and by failing to analyze this evidence in relation to the rules of law pertaining to recovery for emotional distress,<sup>93</sup> the *Cain* court appears to accept the proposition that no proof other than proof of the tort is required to support an award of compensatory damages for emotional distress.<sup>94</sup>

### PUNITIVE DAMAGES IN BAD FAITH CASES

It is not the purpose of this paper to present an exhaustive discussion of the issue of exemplary damages; however, an examination of the subject is in order since *Cain* was the first California case to award punitive damages in an excess liability case.

In *Cain*, an award of punitive damages in the amount of \$115,000 was sustained.<sup>95</sup> The court held that the insurer had

tortiously breached the implied covenant of good faith and fair dealing by its wrongful refusal to settle within policy limits and by failing to give equal consideration to the interests of the insured.<sup>96</sup>

The court further held that the insurer had acted with a con-

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amount which will compensate him for all the detriment proximately caused, whether it could have been anticipated or not.

91. 47 Cal. App. 3d 783, 121 Cal. Rptr. 200 (1975).

92. In the section of its opinion entitled "Sufficiency of the Evidence as to the Awards of Compensatory Damages" the court characterizes State Farm's contention as "[The verdict] should be reversed on the grounds that there is *insufficient evidence to support a finding of bad faith*." The remaining portion of the discussion in that section is devoted to reviewing the evidence which establishes the breach of the implied covenant of good faith and fair dealing.

A review of the appellant's brief and respondent's brief, however, discloses that the issue joined on the appeal could be fairly characterized as—given the breach of the covenant of good faith and fair dealing, is there sufficient evidence of emotional distress to support an award of \$25,000 compensatory damages? Apparently there is many a slip twixt cup and lip. Brief for appellant at 22, *Cain v. State Farm Mutual Automobile Insurance Co.*, 47 Cal. App. 3d 783, 121 Cal. Rptr. 200 (1975). Brief for respondent at 30, *Cain v. State Farm Mutual Automobile Insurance Co.*, 47 Cal. App. 3d 783, 121 Cal. Rptr. 200 (1975).

93. Compare the discussion in *Cain*, 47 Cal. App. 3d at 791-92, 121 Cal. Rptr. at 205-06 with the discussion of emotional distress damages in *Crisci* and *Gruenberg*, note 75 *supra* and *Jarchow*, n.88 *supra*.

94. See note 92 *supra*.

95. *Cain v. State Farm Mutual Automobile Insurance Co.*, 47 Cal. App. 3d 783, 790, 121 Cal. Rptr. 200, 204 (1975).

96. *Id.* at 794, 121 Cal. Rptr. at 207.

scious disregard of the insured's interests in that State Farm Insurance Company had

. . . after the verdict in *Cain v. Jew* . . . refused to accept any responsibility for the excess amount, and contrary to advice of their own counsel, rejected an offer to settle the excess verdict for \$55,000 even though they were aware that their insured's personal assets would be wiped out without satisfying the excess verdict, thereby forcing him into bankruptcy . . . that the relationship between the insured Jew and Miss Cain would be exposed resulting in the possible termination of Jew's marriage.<sup>97</sup>

According to the *Cain* court, State Farm demonstrated a conscious disregard of the insured's rights when it refused to accept a post judgment settlement offer, contrary to the advice of attorney Robert A. Seligson. This recommendation to settle was contained in correspondence referred to by the court as the "Seligson Letter," to the insurance company from attorney Robert A. Seligson a member of the firm retained by State Farm to represent the defendant in the *Cain v. Jew* suit, which was written shortly after the verdict had been returned against the insured.

In the letter, Mr. Seligson advised State Farm to settle the excess claim, basing his opinion on "quoted excerpts from the *Crisci* opinion."<sup>98</sup> The *Cain* trial court in admitting the letter into evidence admonished the jury that the letter contained dictum (such as strict liability for failure to settle) and that it did not reflect the current state of the law.<sup>99</sup>

Yet the *Cain* court appears to place great emphasis upon the insurance company's failure to follow Mr. Seligson's advice to settle, even though his recommendation was based on the strict liability dictum from *Crisci*.<sup>100</sup> Under current California law recovery of the excess is not based on strict liability, but rather on the tortious breach of the implied covenant of good faith and fair dealing.<sup>101</sup> Therefore, if an excess verdict is returned, the insured has no automatic right to payment of the excess by the insurance company. Before the right to payment arises, the insured must prove this tortious breach. Admittedly, as a general point of law a legal right may be exercised in a manner which would support an

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97. *Id.*

98. *Id.* at 798, 121 Cal. Rptr. at 210.

99. *Id.*

100. *Id.* at 794, 121 Cal. Rptr. at 207.

101. See note 33 and accompanying text *supra*.

award of punitive damages.<sup>102</sup> However, the court fails to clearly delineate how State Farm's decision to put the plaintiff to the test of proving the tortious breach was an act in "conscious disregard"<sup>103</sup> of the plaintiff's rights. The court in its punitive damage discussion states

Although the Supreme Court did not explicitly discuss the issue of punitive damages . . . the major thrust of the *Gruenberg* holding is that *such action on the part of insurers will not be tolerated* and a breach of . . . [the covenant] of good faith and fair dealing will lead the imprudent insurer down the path of exemplary damages.<sup>104</sup>

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102. "Callous disregard of whether a legal act will harm another equates with a calculated intent to exercise a legal right irrespective of its consequences." *Farmy v. College Housing Inc.*, 48 Cal. App. 3d 166 at 176 n.3, 121 Cal. Rptr. 658 at 665 n.3 (1975).

103. CAL. CIV. CODE § 3294 (West 1970) provides that

In an action for the breach of an obligation not arising from contract, where the defendant has been guilty of *oppression, fraud, or malice, express or implied*, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant. (Emphasis added.) The cases interpreting section 3294 make it clear that in order to warrant the allowance of punitive damages the act complained of must not only be wilful in the sense of intentional, but it must also be accompanied by aggravating circumstances, amounting to malice. The malice required implies an act conceived in a spirit of mischief or with criminal indifference towards the obligations owed to others. There must be an intent to vex, annoy or injure. Mere spite or ill will is not sufficient; and mere negligence, even gross negligence is not sufficient to justify an award of punitive damages. *Ebaugh v. Rabkin*, 22 Cal. App. 3d 891, 894, 99 Cal. Rptr. 706 (1972), and cases cited therein.

Actual malice must be shown in order for punitive damages to be awarded, but this malice, including malicious intent, may be inferred from the circumstances of the case . . . "Oppression" has a well established meaning. It means subjecting a person to cruel and unjust hardship in conscious disregard of his rights. *Richardson v. Employers Liab. Assur. Corp.*, 25 Cal. App. 3d 232, 245-46, 102 Cal. Rptr. 547, 566 (1972), and cases cited therein.

As between oppression and malice, there must be some evidence of one or the other of these elements to justify the jury in making the award. It follows that a tort committed by mistake, in the assertion of a supposed right, or without any wrong intention, and without such recklessness as evinces malice or a conscious disregard of the rights of others, does not warrant punitive damages . . . The only question is whether or not a jury might rightfully draw an inference from the evidence produced that there was a conscious disregard for the rights of others which constituted an act of subjecting plaintiffs to cruel and unjust hardship. In all classes and kinds of cases in which exemplary damages are sanctioned, there must be made to appear to the satisfaction of the jury the evil motive, the *animus malus*, shown by malice in fact or by its allied malign traits and characteristics evidenced by fraud or "oppression." An award of exemplary damages cannot be based on mere speculation; it depends instead on a definite showing of a willingness to vex, harass, or injure consistent with a wrongful intent to injure . . . The wrongful personal intention to injure is the factor that calls forth the penalty of exemplary damages. *Roth v. Shell Oil Co.*, 185 Cal. App. 2d 676, 682, 8 Cal. Rptr. 514, 517-18 (1960).

104. *Cain v. State Farm Mutual Automobile Insurance Co.*, 47 Cal. App. 3d at 893, 121 Cal. Rptr. at 206 (emphasis added) quoting from Note, *Goodfaith and Fair Dealing in Insurance Contracts: Gruenberg v. Aetna Insurance Co.*, 25 HASTINGS L.J. 699, 714 (1974).

In the sentence immediately preceding the quoted portion, the court refers to

The *Cain* court next found that State Farm showed a conscious disregard of the insured's rights when the company proceeded as it did knowing that its insured might be forced into bankruptcy.<sup>105</sup>

But it seems clear that a verdict in excess of the policy limits automatically exposes the insured to a risk of financial loss. Even if he has a cause of action against the insurance company for a tortious breach, his potential liability continues until he proves his claim or the insurance company voluntarily pays or settles the excess. It is possible depending upon the assets of the insured that this risk will result in severe financial hardship for the insured, and may even force the insured into bankruptcy.

Absent a judicial determination of the tortious breach of the implied covenant of good faith and fair dealing the insured has no right to have the excess paid by the insurance company. While knowledge of the insurer that the insured may face financial hardship if an excessive verdict is rendered is a factor in determining whether a breach of the implied covenant of good faith and fair dealing has occurred,<sup>106</sup> the court fails to clearly disclose how this knowledge may also lead to a determination of "conscious disregard"<sup>107</sup> of the plaintiff's rights.

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the holdings in *Fletcher* and *Gruenberg*. *Fletcher* was a 1st party action affirming liability for intentional infliction of emotional distress and an award of punitive damages. *Gruenberg* was an appeal from a judgment of dismissal. The court held that the insured's actions, under the facts of the case, were justified and that the duty of good faith and fair dealing was absolute. The court reversed and directed reinstatement of the complaint. Although Gruenberg's complaint asked for punitive damages, they were not in issue on the appeal.

Accepting the validity of the punitive damage award in *Fletcher* and assuming the facts pled in *Gruenberg* were established and led to an award of punitive damages, it is easily seen that "such actions will lead the insurer down the path of exemplary damages." *But compare* these "actions" with the "actions" in *Cain*.

Additionally, mere breach of the covenant of good faith and fair dealing will not support punitive damages, *Silberg v. California Life Insurance Co.*, 11 Cal. 3d at 462, 521 P.2d at 1110, 113 Cal. Rptr. at 718.

By leaving the words *such action* without a clear antecedent, the reader is left in doubt as to the future application of punitive damage principles in third party excess cases.

105. *Cain v. State Farm Mutual Automobile Insurance Co.*, 47 Cal. App. 3d at 794, 121 Cal. Rptr. at 207.

106. *Garner v. American Mut. Liability Ins. Co.*, 31 Cal. App. 3d 843, 107 Cal. Rptr. 604 (1973).

107. See discussion n.8, *supra* and *Beck v. State Farm Mutual Automobile Insurance Co.*, 54 Cal. App. 3d 347, 126 Cal. Rptr. 502 (1976).



Finally the court found that State Farm demonstrated a conscious disregard of the insured's rights in that by refusing to pay the excess verdict, State Farm created the possibility "that the relationship between the insured and Miss Cain would be exposed, resulting in the possible termination of the insured's marriage."<sup>108</sup>

The logical basis for this determination is the existence of a duty on the part of the insurance company to protect the insured from such exposure. But the court's rationale for such a conclusion is obscure. In the first place there is some question as to whether an interest existed which could be protected. The occurrence of a one-car accident involving both parties and the filing of a suit by one party against the other would inevitably result in a considerable exposure of the relationship. Moreover, Mr. Jew's claim that Miss Cain was driving the car both highlighted the existence of some relationship between them and made some investigation of that relationship necessary.<sup>109</sup>

If the court had taken the position that the potential for such exposure should be considered as a factor in deciding whether to settle a claim before trial, much as the financial situation of the insured is to be considered, the holding would be less confusing, providing the court explained why such conduct rose to the level of conscious disregard. However, in this case the court clearly placed the issue within the context of a post judgment failure to pay an excess verdict, thus adding to the confusion surrounding the rationale for the holding.

One of the main factors contributing to the obfuscation in this case is the almost total lack of reasoning or explanation presented by the opinion. Lacking such clarification and considering that the overriding purpose of allowing punitive damages is to punish the defendant for conduct the law seeks to preclude, one is left to ponder just what State Farm did which the law

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108. 47 Cal. App. 3d at 794, 121 Cal. Rptr. at 207.

109. See the facts as discussed in Brief for Appellant, 2 and Brief for Respondent, 5-6, *Cain v. State Farm Mutual Automobile Insurance Co.*, 47 Cal. App. 3d 783, 121 Cal. Rptr. 200 (1975). From Mr. Jew's admissions it was clear that he told the police officer that he and not Elaine Cain was driving the vehicle in an effort to keep his relationship with Miss Cain from his wife. However, after being informed that Miss Cain might die and that manslaughter charges might be brought, his version of who was driving changed. Possibly his concern over exposing the relationship varied with the potential liability he faced. In addition, can it be said on the basis of the facts as disclosed in *Cain*, that State Farm acted in conscious disregard of Mr. Jew's rights vis-a-vis this relationship given his own shifting viewpoint towards exposure?

found so objectionable that punitive damages were appropriate.<sup>110</sup>

Until the decision in *Cain*, the issue of punitive damages had only been considered in first party cases. An examination of these first party cases discloses extensive analysis by the courts of the conduct which gave rise to punitive damages and establishes quite clearly that there exists a quantum differential between that conduct which will support a finding of a breach of the implied covenant of good faith and fair dealing and that conduct necessary to support an award of punitive damages.<sup>111</sup> Further, study of these first party actions reveals that "outrageous"<sup>112</sup> conduct was a factor common to those insurers against whom punitive damages were awarded, although such behavior is not required to sustain an action for bad faith.

In *Silberg v. California Life Insurance Company*<sup>113</sup> the California Supreme Court emphasized that the basic intent required for the imposition of punitive damages was that the defendant must have acted with "intent to vex, injure, or annoy, or with a conscious disregard of the plaintiffs' rights."<sup>114</sup>

*Silberg* makes it clear that a breach of the implied covenant of good faith and fair dealing will not, by itself, make imprudent insurers liable for punitive damages. It is also well settled that a finding of negligence, or even of gross negligence, is not sufficient to justify an award of punitive damages.<sup>115</sup> Therefore, a finding that an insurer has acted with a conscious disregard for the interests of the insured should include the requirement that the insurer's conduct was more than wrongful, in that it was willful or wanton.<sup>116</sup>

110. Compare the discussion on the issue of punitive damages in *Cain*, 47 Cal. App. 3d at 793-94, 121 Cal. Rptr. 206-07 with the cases cited note 111, *infra*.

111. See *Silberg v. California Life Insurance Co.*, 11 Cal. 3d 452, 521 P.2d 1103, 113 Cal. Rptr. 811 (1974); *Neal v. Farmers Insurance Esch.*, 64 Cal. App. 3d 966, — Cal. Rptr. — (1976); *Beck v. State Farm Mutual Automobile Insurance Co.*, 54 Cal. App. 3d 347, 126 Cal. Rptr. 502 (1976); *Richardson v. Employers Liab. Assur. Corp.*, 25 Cal. App. 3d 232, 102 Cal. Rptr. 547 (1972); and *Fletcher v. Western National Life Insurance Co.*, 10 Cal. App. 3d 376, 90 Cal. Rptr. 78 (1970).

112. *Id.*

113. 11 Cal. 3d 452, 521 P.2d 1103, 113 Cal. Rptr. 711 (1974).

114. *Id.* at 462, 521 P.2d at 1110, 113 Cal. Rptr. at 718. See also n.8 *supra*.

115. *Ebaugh v. Rabkin*, 22 Cal. App. 3d 891, 894, 99 Cal. Rptr. 706 (1972).

116. See *Farmy v. College Housing Inc.*, 48 Cal. App. 3d 166, 176, 121 Cal. Rptr. 658, 664 (1975).

Something more than the mere commission of a tort is always required

An examination of *Beck v. State Farm Mutual Automobile Insurance Co.*<sup>117</sup> lends further support to these principles. In *Beck* the court of appeal reversed a judgment awarding punitive damages. The insurer had unreasonably refused to negotiate or settle an uninsured motorist claim. In affirming the judgment concerning the breach of the implied covenant of good faith and fair dealing, the court characterized the insurer's position as "patently untenable."<sup>118</sup> However, the court went on to point out that such conduct was not sufficient to support an award of punitive damages.

Thus, it does not follow that, because State Farm took an unreasonable position on the validity of a defense to coverage under Beck's policy, State Farm acted with intent to harm Beck . . . A State Farm claim representative testified that he knew the withholding of benefits from Beck might vex and oppress her; but that would be true of any insured. The circumstances here do not permit an inference of actual malice or oppression.<sup>119</sup>

When discussing the implied covenant of good faith and fair dealing, the courts have traditionally "borrowed" principles from either first or third party cases,<sup>120</sup> even though these types of actions are not identical in all respects. Although, conflicts of interest may develop leading to a breach of the covenant of good faith and fair dealing, the level of adversity that exists between the insurance company and insured in first party cases is not present in a third party case. Thus, it becomes quite critical to clearly delineate that conduct by the insurance company which can be said to support exemplary damages. This is *Cain's* most glaring weakness. The opinion does not acknowledge that there are differences between first and third party actions and a shifting relationship between the insurance company and the insured.

In a first party action the contractual duty is one of indemnification, that is to return the insured<sup>121</sup> to the place he was prior to the loss. The obligation under the covenant of good faith and fair dealing associated with this contractual duty is generally re-

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for punitive damages. There must be circumstances of aggravation or outrage, such as spite or malice, or a fraudulent or evil motive on the part of the defendant, or such a conscious and deliberate disregard of the interests of others that his conduct may be called wilful or wanton. Prosser, W., *The Law of Torts*, 9-10 (4th Ed. 1971).

117. 54 Cal. App. 3d 347, 126 Cal. Rptr. 602 (1976).

118. *Id.* at 355, 126 Cal. Rptr. at 606.

119. *Id.* at 356, 126 Cal. Rptr. at 607.

120. *Gruenberg v. Aetna Insurance Company*, 9 Cal. 3d 566, 573, 510 P.2d 1032, 1036, 108 Cal. Rptr. 480, 486 (1973).

121. Insured means the named insured or his selected beneficiary under the policy.

ferred to as the duty not to unreasonably withhold payments due under the policy.<sup>122</sup>

The policies usually involved in first party cases are property, casualty and disability policies, where the insured himself has suffered property damage or physical injury which is ostensibly covered by the policy. The insurance company must evaluate the policy with reference to the claim and the only issues generally arising are whether the loss in fact occurred and whether the loss is covered by the policy. Negligence on the part of the insured is usually not a factor in resolving these questions.

In a first party action, true adversity may exist between the insurance company and the insured when contracted for benefits are withheld. Within the context of this adversity, the actions of the insurance company which may be viewed as perpetrated with an intent to vex or injure or with a conscious disregard of the insured's rights are more readily perceived.

In a third party action the contractual duty of the insurance company is to defend its insured and to pay those sums (up to the policy limits) which the insured becomes legally obligated to pay. The obligation under the implied covenant of good faith and fair dealing is usually defined as the duty to accept reasonable settlement offers.

The insurance policies seen in third party actions are liability policies. The insured is usually alleged to have committed a tort arising out of his negligent conduct. The issues generally presented are whether the policy provides the coverage claimed and whether the insured actually committed the tort alleged.

It is possible that even after rejecting a settlement offer, which admittedly may be a breach of the covenant of good faith and fair dealing, the insurance company can still carry out its contractual obligation of defense and payment of the policy limits.

Previous third party cases have evaluated the conduct of insurance companies occurring between the act of the insured giving rise to potential liability for him and the decision whether to settle or litigate.<sup>123</sup> If, in the court's opinion, the conduct which

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122. See note 7, *supra*.

123. See *Johansen v. California State Auto. Assn. Inter-Ins. Bureau*, 14 Cal. 3d 9, 538 P.2d 744, 123 Cal. Rptr. 288 (1975); *Garner v. American Mut. Liability Ins. Co.*, 31 Cal. App. 3d 943, 107 Cal. Rptr. 604 (1973); *Crisci v. Security Insurance Co.*

supports an award of punitive damages occurs prior to the decision to litigate, the court should be extremely careful to delineate just how the activity giving rise to punitive damages differs from that which led to the breach of the implied covenant of good faith and fair dealing. Obscurity in this analysis invites the inference that the court is willing to accept the proposition that mere breach of the implied covenant of good faith and fair dealing will lead to punitive damages. A proposition which is in conflict with *Silberg* and the general purpose of punitive damages.<sup>124</sup>

If the award of punitive damages, based on a conscious disregard of the insured's rights, is to be upheld by concentrating on conduct which occurs after the excess verdict, the court should carefully define the obligations of the insurer to the insured, consider the level of adversity existing between the parties and analyze the conduct of the insurer with a view toward demonstrating circumstances which "permit an inference of actual malice or oppression."

Judged by these criteria, the decision in *Cain* provides an unsatisfactory analysis of State Farm's conduct with regard to liability for punitive damages. The disquieting feature of *Cain* is that one cannot determine with any degree of certainty the type of conduct on the part of an insurance company which will make it liable for punitive damages in future cases involving excess liability.

#### CONCLUSION

A negligent tortfeasor without insurance is exposed to liability to the full range of his assets; however, he retains full control over the decision whether to settle or litigate. In obtaining a liability insurance policy he obtains a measure of protection for his assets. However, the insurance company demands complete control over the investigation, settlement and litigation processes as a *quid pro quo* for this protection. The courts, in response, have reasoned that the expectations of the individual policy holders include a belief that upon receipt of a reasonable demand a claim will be settled within policy limits. When viewed from the position of the insured this expectation has merit.

For the benefit of the policyholders as a group a delicate balance must be struck between upholding the reasonable expectations of the individual policyholders and the preservation of the claim fund from unfounded claims.

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of New Haven Conn., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); and *Comunale v. Traders & General Ins. Co.*, 50 Cal. 3d 654, 328 P.2d 198 (1958).

124. See note 111 *supra*.

. . . [I]n the distribution of the fund, the principle of solidity is merely one of a pair of goals which contend with each other in precarious balance. In distributing the fund, a task supervised by the courts, the need to preserve the fund against unreasonable claims which threaten its existence must continually be weighed against the aim of ensuring that policyholders' reasonable expectations are fulfilled.<sup>125</sup>

In the traditional treatment given excess liability cases the bifurcated obligations of an insurance company have tended to be obscured. While the concern for the claim fund is seldom an explicit consideration in reaching a settlement decision in a particular case, this factor does influence the procedures the insurance company establishes to assure itself that the claim is warranted.

The law in California has not yet been expanded so as to impose strict liability on insurers for refusing to accept "reasonable" settlement offers within policy limits. However, a review of excess liability cases reveals that the application of the current test of bad faith leads to nearly certain recovery of the excess where the insurance company has rejected a "reasonable" settlement offer. The apparent ease with which the *Cain* decision affirmed the award of emotional distress and punitive damages postulates another step toward the practical imposition of strict liability. Unquestionably the threat of large emotional distress and punitive damage recoveries will provide an added impetus for the insurance companies to settle. If strict liability in law does not exist, something virtually undistinguishable from it exists in practice.

The California approach to the question of liability for excess judgments, founded upon bad faith, leaves some serious concerns.

1. Under the current system of liability based upon fault, where a dispute exists as to coverage, liability or damages what may an insurance company in good faith consider to justify its defending an action and still not be held liable for any excess judgment that may result?<sup>126</sup>
2. To what extent may an insurance company seek to protect the insurance claim fund against apparently unwarranted claims? The

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125. S. Kimball, *The Purpose of Insurance Regulation: A Preliminary Inquiry in the Theory of Insurance Law*, in *Essays in Insurance Regulation* at 4-5 (1966).

126. See, *Merritt v. Reserve Ins. Co.*, 34 Cal. App. 3d 858, 873-77, 110 Cal. Rptr. 511, 517-21 (1973) for a discussion of the dilemma an insurance company faces when it undertakes the settlement/litigation decision.

current test used in excess liability cases is framed in terms of "equal consideration", implying that the insurance company has some legitimate interest.<sup>127</sup>

In *Crisci v. Security Insurance Co.* the California Supreme Court indicated its hospitality to imposing strict liability in the proper case.<sup>128</sup> Strict liability also presents some concerns relating to the efficacy of this approach in serving the interests of all parties involved in a claim settlement question.

1. Would adoption of strict liability result in increased or reduced litigation?<sup>129</sup>
2. Under the strict liability test considered in *Crisci*, should liability be predicated upon a "reasonable" settlement offer. If so, how should a "reasonable" settlement offer be determined? Does the current "inference instruction" provide the necessary insight?<sup>130</sup>

Under either approach, other concerns are presented.

1. What impact does comparative negligence have on the determination to accept reasonable settlement offers?<sup>131</sup>
2. What function should liability insurance serve in society? Where is

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127. *Id.*

128. 66 Cal. 2d 425, 430-31, 426 P.2d 173, 177-78, 58 Cal. Rptr. 13, 17 (1967).

129. Admittedly, adopting a rule of strict liability would remove, in most cases, the second lawsuit founded on bad faith, wherein recovery of the excess would be sought. This approach would also remove the potential for emotional distress and punitive damages. However, the insurance company's decision whether to litigate a claim tends to be made with one eye on its evaluation of the insured's liability and the other on the costs involved, which include potential liability for any excess, damages for emotional distress and punitive damages. If two of these factors are removed from the decisional equation, will the numbers of claims litigated move up or down from the current point?

130. Under strict liability the offer necessary to trigger strict liability is generally defined as one capable of acceptance. In *Coe v. State Farm Mutual Auto Ins. Co.* (1st Dist., Civ. No. 37977, decided Feb. 9, 1977), the insurance company was confronted with a demand for the policy limits, an offer which *might* have been construed as "being capable of acceptance." However, the settlement offer did not include a release of another insurance carrier who had a right of recoupment. Acceptance of this settlement offer would have left the insured exposed to this recoupment action, so the insurance company rejected the offer. The trial resulted in an excess verdict and the insurance company was sued for this excess. The court of appeal determined that it cannot be unreasonable to reject an offer that it would be unreasonable to accept.

131. *American Motorcycle Assn. v. Superior Court*, 65 Cal. App. 3d 694, 704, 135 Cal. Rptr. 497, 503 (1977), concerned the right of a named defendant to bring persons not named into the action as defendants. The court held:

[T]hat the adoption of the rule of pure comparative negligence in *Li* abrogates the pre-existing rule of joint and several liability of concurrent tortfeasors. Where the *Li* rule applies, liability among concurrent tortfeasors must be apportioned according to their respective degrees of negligence with each liable to the plaintiff *only* for his proportion (emphasis added).

Insurance company responsibility for excess verdicts is theoretically sound under a system of joint and several liability. For, absent a finding of contributory negligence, the insured defendant can be liable for the full extent of the judgment, irrespective of his proportionate degree of fault.

How should the insurance company approach a settlement conflict under the rule of *American Motorcycle*?

the balance properly struck between providing maximum and timely compensation to injured parties and providing protection to individual policy holders at a cost which the maximum number of insurance consumers can afford?

3. If one concludes that the social function of liability insurance is to compensate victims, rather than to protect the insured, does "no fault insurance" provide a better solution?

Insurance carriers charge a premium for exposure before the actual losses are determined. Past experience enables a company to establish rates that will be reasonably accurate and reliable through the use of the "law of large numbers." Once the rate is established in relation to the risk, an additional amount is included to provide for expenses and profit.

Through this method of rating and providing coverage virtually any exposure to loss can be insured. However, as the probability of loss increases in relation to the coverage provided, or as the policy is expanded to cover losses from other risks, the policy must become more expensive. The result is a socialization of the "risk." The key to insurance coverage is to provide the most comprehensive coverage possible to the public while keeping the premium affordable. The net result for the policy holders as a group will be a socialization of the risk for which a price will have to be paid by each individual policy holder in the form of increased premiums.

Virtually all negligence law involves a decision on the extent of loss shifting from the plaintiff to someone else, and generally from that someone to still others. Where, as in California, tort law is imbedded in the concept of socialization of loss; the "others" are taxpayers, consumers, or purchasers of insurance . . .

The policy choice must thus be made in light of the social costs involved.<sup>132</sup>

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132. *American Motorcycle Assn. v. Superior Court*, 65 Cal. App. 3d 702, 135 Cal. Rptr. 502 (1977).



