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The Insurer's Liability for Judgements in Excess of Policy Limits and the Movement toward Strict Liability: An Assessment

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Abstract

Standard liability insurance policies typically contain a clause vesting in the insurer the right to "make such investigation, negotiation and settlement of any claim or suit as it deems expedient."

KEYWORDS: liability, limits, policy

The Insurer's Liability for Judgments in Excess of Policy Limits and the Movement toward Strict Liability: An Assessment*

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Standard liability insurance policies typically contain a clause vesting in the insurer the right to "make such investigation, negotiation and settlement of any claim or suit as it deems expedient."¹ While this clause gives the insurer complete control over the settlement of claims arising under the policy, it also forms the basis of the insured's right to recover damages for liability in excess of policy limits incurred as a result of the insurer's wrongful refusal to settle claims within those limits.² It is to be noted at the outset that this right of the insured presupposes the existence of several variables, since it is, at best, questionable whether an insurer must accept every settlement offer or be liable for the excess.

The scope of the insurer's liability for failure to settle claims within policy limits is a controversial issue in the law of insurance, replete with an extensive bibliography.³ The purpose of this article is not merely to

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1. See, e.g., R. Keeton, *Insurance Law—Basic Text* 658, Appendix G (1971), where the clause states:

[T]he company shall have the right and duty to defend any suit against the insured seeking damages, even if any of the allegations of the suit are groundless, false or fraudulent, and may make such investigation and settlement of any claim or suit as it deems expedient. . . .

2. See Note, *Insurer's Liability to Judgment Creditor of Insured for Wrongful Refusal to Settle a Claim*, 52 CORNELL L.Q. 778 (1967).

3. See generally Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136 (1954), for a most expansive but somewhat dated analysis of the conduct of an insurer regarding settlement and the rights and duties arising therefrom. See also Annot., 39 A.L.R.3d 739 (1971); Appleman, *Circumstances Creating Excess Liability*, 1960 INSURANCE L.J. 553; Appleman, *Duty of Liability Insurer to Compromise Litigation*, 26 KY. L.J. 100 (1938); Arnall, *Excess Liability Suits—The Mounting Need for Strict Liability*, 13 ST. LOUIS U.L.J. 292 (1968); Cochran, *The Obligation to Settle within Policy Limits*, 1970 INSURANCE L.J. 583; Annot., 68

delineate the metes and bounds of the insurer's liability for its wrongful refusal to settle within policy limits, but also to explore the considerations underlying the growing demand that an insurer be absolutely liable for any judgment in excess of policy limits following its refusal to settle a claim. The best point at which to begin is with *Crisci v. Security Insurance Co.*,⁴ the first modern case to give serious consideration to the strict liability approach.

The facts in *Crisci* are substantially as follows: The plaintiff, a seventy-year-old widow, purchased a \$10,000 general liability policy to protect herself against any liability she might incur as a result of injuries sustained on the premises of her apartment building. As in most liability policies, Mrs. Crisci's policy contained a clause authorizing her insurer to conduct her defense and to negotiate any settlement which the insurer might deem expedient. June DiMare, one of the plaintiff's tenants, sustained serious injuries as a result of falling through the stairs in plaintiff's building. Consequently, an action was filed by the tenant against Mrs. Crisci claiming damages of \$400,000.⁵

Pursuant to this defense clause contained in Mrs. Crisci's policy, Security Insurance Company assumed the defense against the claim, and twice rejected offers of settlement within the policy limits, even in the face of several factors indicating that a verdict substantially in excess of the policy limits was highly probable. The insurer's counsel and claims adjuster, in fact, believed that a verdict of at least \$100,000 would

A.L.R.2d 892 (1959); Comment, *Crisci's Dicta of Strict Liability for Insurer's Failure to Settle: A Move toward Rational Settlement Behavior*, 43 WASH. L. REV. 799 (1968); Erstgaard, *Liability beyond Insurance Policy Limits*, 1958 INSURANCE L.J. 404; Annot., 40 A.L.R.2d 168 (1955); Comment, *Insurer's Liability for Failure to Settle*, 9 MD. L. REV. 349 (1948); Note, 13 U. CHI. L. REV. 105 (1945); Evans, *The Practical Handling by Defense Counsel of Lawsuits in Excess of Policy Limits*, 1960 INSURANCE L.J. 565; Note, 60 YALE L.J. 1037 (1951); Comment, *Insurer's Liability for Judgments Exceeding Policy Limits*, 38 TEX. L. REV. 233 (1960); Note, 32 SO. CAL. L. REV. 314 (1959); Comment, *Liability of an Insurer for Failure to Settle Claims*, 6 U.C.L.A. L. REV. 124 (1959); Note, 10 HASTINGS L.J. 198 (1958); Levit, *The Crisci Case—Something Old, Something New*, 1968 INSURANCE L.J. 12; Note, *Direct Action by Injured Judgment Creditor against Insurer for Excess of Policy Limits*, 14 N.Y.L.F. 629 (1968); Luvaas, *Excess Judgments—Defense Counsel's Liability*, 18 DEFENSE L.J. 259 (1968); Comment, 43 N.Y.U.L. REV. 199 (1968); Comment, 28 MD. L. REV. 166 (1968); Note, 27 PITT. L. REV. 726 (1967); Note, 46 TEX. L. REV. 113 (1967); Note, *Insurer's Liability to Judgment Creditor of Insured for Wrongful Refusal to Settle a Claim*, 52 CORNELL L.Q. 778 (1967); Note, *Excess Liability: Reconsideration of California's Bad Faith Negligence Rule*, 18 STAN. L. REV. 475 (1966).

4. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

5. DiMare v. Cresci, 58 Cal. 2d 292, 373 P.2d 860, 23 Cal. Rptr. 772 (1962).

be returned if the jury believed the claimant's persuasive evidence that the injuries resulting from her fall proximately caused the development of her psychosis. Notwithstanding the insurer's inability to produce evidence which would impeach the claimant's allegations, the insurer continued to reject offers for settlement within policy limits.⁶

As a result, the injured tenant recovered judgment for \$101,000, and Mrs. Crisci, through her efforts to meet the \$91,000 balance, became indigent. In addition, Mrs. Crisci suffered a decline in her mental and physical well being and attempted on several occasions to commit suicide.

Mrs. Crisci brought suit against her liability insurer for wrongfully refusing to settle the claim within the limits of her policy. At trial, the court found that Security Insurance breached its duty to settle the claim in good faith, and awarded plaintiff the amount of the excess judgment plus interest accrued since the day judgment was entered against her. In addition, the court awarded the plaintiff \$25,000 for the mental suffering which she endured as a result of being forced to dispose of her property to satisfy the judgment.⁷

The California Supreme Court upheld Crisci's recovery against the insurer, holding, *inter alia*, that Security Insurance had breached its implied covenant of good faith and fair dealing.⁸ What is of greater significance, however, is the California Court's willingness to find "more than a small amount of elementary justice"⁹ in the suggestion made by *amicus curiae* that an insurer be held absolutely liable when an excess judgment follows an insurer's refusal to settle within policy limits.¹⁰ The adoption of a strict liability standard for insurers would, no doubt, mark a drastic turning point in this area of insurance law.¹¹

6. See 28 MD. L. REV. 166 n.1 (1968).

7. 66 Cal. 2d 425, 428-29, 426 P.2d 173, 175, 58 Cal. Rptr. 13, 15.

8. *Id.* at 429, 426 P.2d at 176, 58 Cal. Rptr. at 16. The implied covenant of good faith and fair dealing as applied in the *Crisci* case requires that the parties to the insurance policy conduct themselves so as not to impair the rights of the other party to receive benefits under the contract. Among the benefits inuring to the insured is peace of mind and security. The court also reasoned that the settlement of claims without litigation is another benefit owed by the insurer to its insured and, *a fortiori*, a duty is imposed upon the insurer to accept reasonable settlement offers as if the policy in question were without limits.

9. *Id.* at 432, 426 P.2d at 177, 58 Cal. Rptr. at 17.

10. *Id.* at 431, 426 P.2d at 177, 58 Cal. Rptr. at 17.

11. See Annot., 40 A.L.R.2d 168, 177-78 (1955), indicating that such an approach has not been successfully contended. *But see, e.g.*, Arnall, *Excess Liability Suits—The Mounting Need for Strict Liability*, 13 St. Louis U.L.J. 292 (1968); Note, *Excess*

I. THE EXISTING STANDARDS

It is often stated that a claimant's offer to settle a claim against an insurer for an amount within the limits of a policy nearly always creates a conflict of interest between the liability insurer and its insured.¹² The insurer's interest is often best served by accepting only the lowest possible settlement offer, since, in normal cases, the insurer's potential liability is fixed by the limits of the policy. Hoping to further limit his liability through litigation, the insurer may also reject, in toto, an offer of settlement. The interest of the insured, on the other hand, is cast in a different mold, since it would distinctly be to his advantage to have all claims settled within policy limits so as to foreclose forever the risk of excess liability. The temptation would seem great, then, for the unconscionable insurer to gamble with the money of its insureds by rejecting all settlement offers, proceeding to litigation, and virtually saying to the insured, "heads I win, tails you lose."¹³

Since insurers, in drafting policy provisions, have reserved for themselves the right to negotiate the settlement of claims, the courts have responded by imposing a duty upon the insurer to consider the interests of the insured when negotiating settlement.¹⁴ The question remaining, however, is how much weight is to be given to these conflicting interests in reaching the decision to settle a given case.

Early decisions indicate that an insurer is not bound to consider the interest of an insured to the prejudice of its own interest when conflicts arise during the negotiation of a settlement.¹⁵ Opinions of other courts

Liability; Reconsideration of California's Bad Faith Negligence Rule, 18 STAN. L. REV. 475, 482-85 (1968); Note, 60 YALE L.J. 1037, 1041-42 (1951)—all calling for the adoption of a strict liability standard.

12. See *Rova Farms Resort, Inc., v. Investors Ins. Co. of Am.*, 65 N.J. 474, 323 A.2d 495 (1974). See generally Note, 52 CORNELL L.Q. 778, 780 (1967); Annot., 40 A.L.R.2d 168, 170 (1955); Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1142 (1954).

13. See *Tyger River Pine Co. v. Maryland Cas. Co.*, 170 S.C. 286, 293, 170 S.E. 346, 348 (1933). In an age of mounting consumerism, it is highly questionable whether the insurance industry would risk a substantial loss of its business by outwardly manifesting such an attitude.

14. See *Fidelity & Cas. Co. v. Gault*, 196 F.2d 329 (5th Cir. 1952); *Zumwalt v. Utilities Ins. Co.*, 360 Mo. 362, 228 S.W.2d 750 (1950). Cf. Annot., 40 A.L.R.2d 168, 170-71 (1955); Keeton, *Liability Insurance and Responsibility for Settlement*, *supra* note 3, at 1138.

15. *Neuberger v. Preferred Acc. Ins. Co.*, 18 Ala. App. 72, 89 So. 90, *cert. denied*, 206 Ala. 700, 89 So. 924 (1921); *Abrams v. Factory Mut. Liab. Ins. Co.*, 298 Mass. 141, 10 N.E.2d 82 (1937); *McDonald v. Royal Indem. Ins. Co.*, 109 N.J.L. 308, 162

have varied as to the relative weight to be accorded the interests of the insured. Some courts have held that the insurer may give paramount consideration to its own interests,¹⁶ while others firmly insist that it is the insured's interest which must be the primary concern.¹⁷ What seems to be the most widely accepted standard is that the insurer give equal consideration,¹⁸ or at least as great consideration,¹⁹ to the interest of the insured, although, compared to the more extreme positions, this is the most difficult standard to administer.²⁰

The duty imposed upon the insurer to consider the interests of the insured in negotiating settlement offers has taken on different dimensions in its construction by the courts. One standard upon which the courts have predicated a finding of the insurer's liability for not consid-

A. 620 (1932); *Schmidt & Sons Brewing Co. v. Travelers Ins. Co.*, 244 Pa. 286, 90 A. 653 (1914). It is interesting to note that New York has been one of the few jurisdictions which strongly supports this view. *See Brochstein v. Nationwide Mut. Ins. Co.*, 266 F. Supp. 223 (1967); *Best Bldg. Co. v. Employers Liab. Assur. Corp.*, 247 N.Y. 451, 160 N.E. 911 (1928); *Auerbach v. Maryland Cas. Co.*, 236 N.Y. 247, 140 N.E. 577 (1923); *Brunswick Rlty. Co. v. Frankfort Ins. Co.*, 99 Misc. 639, 166 N.Y.S. 36 (Sup. Ct. 1917).

16. *See, e.g., Hilker v. Western Auto. Ins. Co.*, 204 Wis. 1, 231 N.W. 257 (1930); *City of Wakefield v. Globe Indem. Co.*, 246 Mich. 645, 651-53, 225 N.W. 643, 645 (1929).

17. *National Mut. Cas. Co. v. Britt*, 203 Okla. 175, 200 P.2d 407 (1948); *but see Keeton, Liability Insurance and Responsibility for Settlement*, *supra* note 3, at 1141 n.1, for a brief discussion of the uncertainties of the Oklahoma rule. *See also Tyger River Pine Co. v. Maryland Cas. Co.*, 170 S.C. 286, 292, 170 S.E. 346, 348 (1933).

18. *See, e.g., Farmers Ins. Exch. v. Henderson*, 82 Ariz. 335, 340, 313 P.2d 404, 407 (1957), where the court stated:

By refusing the \$4,000 plus property damage and submitting to trial, the limit of the company's hazard under the policy limits was an additional \$1,200. Admittedly the property damage could not exceed \$1,500. The jury might infer under the conditions that a plaintiff's verdict was strongly probable; that the insured's loss hazard was much greater than that of the company. After the case was submitted but before verdict, the insurer, by not settling for \$6,000 incurred a \$500 loss hazard and . . . [the insured] a great deal more. The jury could conclude that the company in turning down the opportunities to terminate this litigation was guided principally by its own risk and ignored or at least did not give equal consideration to the risk which it compelled [the insured] to incur. The jury therefore was entitled to conclude that the company did not act in good faith.

19. *See Douglas v. U.S. Fidelity & Guar. Co.*, 81 N.H. 371, 127 A. 708 (1924); *Dumas v. Hartford Accident & Indem. Co.*, 94 N.H. 484, 56 A.2d 57 (1947); *see also Keeton, Liability Insurance and Responsibility for Settlement*, *supra* note 3, at 1145 n.23.

20. *See Keeton, Liability Insurance and Responsibility for Settlement*, *supra* note 3, at 1146.

ering the interest of his insured is the negligence standard.²¹ In applying this, courts must determine whether an ordinarily prudent person in business would have rejected or accepted a particular settlement offer.²² This test, however, is subject to variation²³ when framed in terms of what action an ordinarily prudent insurance company would take in reaching a determination on a particular offer if the policy were without limits.²⁴

Apparently the basis of the negligence formulation is twofold. First, since the insured has divested himself of the right to control the defense and settlement of claims, he is entitled to expect reasonable care and circumspection in the insurer's conduct.²⁵ Secondly, "when one knows or has reason to anticipate that the person, property, or rights of another are so situated . . . that they may be injured through his conduct, it becomes his duty to so govern his actions as not negligently to injure the person, property, or rights of another."²⁶ Thus, it would seem that an insurer's honest mistake in judgment would not, under the negligence formulation, render it liable for refusing to settle a claim within policy limits.²⁷ The negligence test has found success when applied in situations where the insurer fails to consider the extent of the plaintiff's injuries,²⁸ refuses to act upon the advice of counsel,²⁹ or has

21. See Annot., 40 A.L.R.2d 168, 186-90 (1955), and the cases cited therein, along with additional cases cited in the updated supplement to the annotation, for a detailed analysis of the negligence standard.

22. See, e.g., *Dumas v. Hartford Accident & Indem. Co.*, 94 N.H. 484, 56 A.2d 57 (1947), wherein the insurer refused an opportunity to settle the claim for \$1,000 less than the policy limit, whereupon a subsequent judgment was entered against the insured for an amount in excess of his policy limit. The court found that, in light of the claimant's expenses and the permanence of her injuries, a prudent businessman would have accepted the settlement offer. *Accord*, *Douglas v. U.S. Fidelity & Guar. Co.*, 81 N.H. 371, 127 A. 708 (1924).

23. See note 21, *supra*, at 186-90.

24. See, e.g., *Dumas v. Hartford Accident & Indem. Co.*, 94 N.H. 484, 56 A.2d 57 (1947), where the court used the negligence test interchangeably with the test of the ordinarily prudent businessman.

25. *Boling v. New Amsterdam Cas. Co.*, 173 Okla. 160, 46 P.2d 916 (1935).

26. *Dumas v. Hartford Accident & Indem. Co.*, 94 N.H. 484, 56 A.2d 57 (1947).

27. *Highway Ins. Underwriters v. Lufkin-Beaumont Motor Coaches, Inc.*, 215 S.W.2d 904 (Tex. Civ. App. 1947).

28. *G.A. Stowers Furniture Co. v. American Indem. Co.*, 15 S.W.2d 544 (Tex. Com. App. 1929).

29. *Royal Transit, Inc. v. Central Sur. & Ins. Corp.*, 168 F.2d 345 (7th Cir. 1948), *cert. denied*, 335 U.S. 844 (1948); *accord*, *Lanferman v. Maryland Cas. Co.*, 222 Wis. 406, 267 N.W. 300 (1936).

acted upon the advice of misinformed counsel.³⁰ Moreover, the negligence standard is frequently employed to hold insurers liable for failing to properly investigate a claim.³¹

Another widely adopted standard used for evaluating an insurer's liability is that of good faith, which, unlike the negligence standard, requires a showing of an intentional disregard of the financial interests of the insured.³² It may be said that the good faith rule requires convincing evidence that the company rejected a settlement offer which, in fact, it considered to be reasonable.³³ One writer suggests that the distinction between the good faith and negligence tests is less marked than those terms, on their face, would suggest.³⁴ Perhaps the major flaw of the good faith standard is the difficult, if not impossible task of proving an intentional disregard of the insured's interests. In theory, all that an insurer need show under this standard is some rational basis to support its decision to litigate rather than settle a claim.³⁵ Examples of conduct construed to be acts of bad faith have been found in an insurer's inducing an insured to contribute to the amount needed to settle a claim within policy limits;³⁶ advising an insured to place his property beyond the reach of an anticipated judgment;³⁷ failing to investigate a claim so as to ascertain adequate evidence on the issues of liability and the amount of anticipated damages;³⁸ setting up a reserve of funds to cover possible liability to the policyholder;³⁹ refusing to accept settlement offers recommended by the adjuster or counsel;⁴⁰ fail-

30. *Douglas v. U.S. Fid. & Guar. Co.*, 81 N.H. 371, 127 A. 708 (1924).

31. *See, e.g., Southern Farm Bureau Cas. Ins. Co. v. Mitchell*, 312 F.2d 485 (8th Cir. 1963).

32. *Johnson v. Hardware Mut. Cas. Co.*, 109 Vt. 481, 1 A.2d 817 (1938). *See generally Keeton, Liability Insurance and Responsibility for Settlement, supra* note 3, at 1139 n.6.

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

34. *See Keeton, Liability Insurance and Responsibility for Settlement, supra* note 3, at 1140.

35. *See Note, Insurer's Refusal to Settle—A Proposal for Imposition of Liability above Policy Limits*, 60 YALE L.J. 1037, 1040, n.13 (1951).

36. *Boling v. New Amsterdam Cas. Co.*, 173 Okla. 160, 46 P.2d 916 (1935).

37. *Noshey v. American Auto Ins. Co.*, 68 F.2d 808 (6th Cir. 1934).

38. *Maryland Cas. Co. v. Elmira Coal Co.*, 69 F.2d 616 (8th Cir. 1934); *accord, Southern Farm Bureau Cas. Ins. Co. v. Mitchell*, 312 F.2d 485 (8th Cir. 1963).

39. *Lanferman v. Maryland Cas. Co.*, 222 Wis. 406, 267 N.W. 300 (1936).

40. *State Farm Mut. Auto Ins. Co. v. Jackson*, 346 F.2d 484 (8th Cir. 1965); *see also Maryland Cas. Co. v. Elmira Coal Co.*, 69 F.2d 616 (8th Cir. 1934); *American Mut. Liab. Ins. Co. v. Cooper*, 61 F.2d 446 (5th Cir. 1932), *cert. denied*, 289 U.S. 736 (1933);

ing to settle when the chances of prevailing at court are extremely doubtful and the accumulated expenses of the case have already exceeded policy limits;⁴¹ and delaying unnecessarily the negotiation of a settlement offer.⁴²

It matters little what terminology is used to describe the standard by which the conduct of the insurer in negotiating settlements will ultimately be judged, for the standard, as applied, is neither good faith nor negligence but rather a curious blending of the two, designed to meet the exigencies of a given case.

Before returning to the strict liability analysis suggested in *Crisci*, brief mention should be made of the legal underpinnings of an insurer's duty regarding settlement.

It has often been thought that an action against an insurer for the wrongful refusal to settle a claim within policy limits sounds in tort;⁴³ however, it is to be noted that aggrieved insureds have also successfully based their claims in contract.⁴⁴ Generally, the measure of damages will depend upon the theory utilized by the plaintiff in framing his complaint. In contract actions, damages are frequently recoverable for breach of contract only to the extent that they were within the contemplation of the parties at the time of the making of the contract, whereas in tort, the doctrines of foreseeability and proximate cause are determinative of the amount of compensation.⁴⁵ As Professor Robert Keeton suggests, however, the theoretical characterization is rarely critical, except perhaps in cases involving differing statutes of limitation.⁴⁶

Whether one will ultimately view the obligation of an insurer to settle a claim as a tort or contract obligation depends upon whether the duty is deemed to arise from the insurer's implied covenant of good

Olympia Fields Country Club v. Bankers Indem. Ins. Co., 325 Ill. App. 649, 60 N.E.2d 869 (App. Ct. 1945).

41. *City of Wakefield v. Globe Indem. Co.*, 246 Mich. 645, 225 N.W. 643 (1929).

42. *Hilker v. Western Auto. Ins. Co.*, 204 Wis. 1, 231 N.W. 257 (1930).

43. R. KEETON, *INSURANCE LAW—BASIC TEXT* § 7.8 (a), 509 n. 3 (1971).

44. *See, e.g., Crisci v. Security Ins. Co.*, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

45. *See Note*, 43 N.Y.U.L. REV. 199 (1968) for more detailed coverage on this point.

46. *See R. KEETON, INSURANCE LAW—BASIC TEXT*, § 7.8 (a), 509 (1971), where the author states:

There are a few situations, though only a few, in which the classification is critical. For example, characterizing the cause of action as one sounding in contract may result in the application of a longer period of limitation and tends to favor assignability of the chose in action. On the other hand, characterizing the cause of action as one sounding in tort may broaden the measure of damages.

faith, or from the nature of the relationship existing between the liability insurer and its insured. A contract action is proper if the duty to settle is deemed to have arisen out of the insurer's covenant of good faith. Although no rigid formula exists for determining when an insurance contract will give rise to a relationship of such independent significance that a breach of duty arising therefrom will be deemed a tort, it is safe to say that this will occur in situations where one party contractually limits himself to such an extent that he is dependent upon the other party for that protection which he would otherwise be able to provide for himself.⁴⁷ The California cases are particularly interesting in this regard, since an injured plaintiff may bring his action in either tort or contract.⁴⁸

2. THE *CRISCI* ANALYSIS—TOWARD STRICT LIABILITY

Though it refused to pass on the merits of the strict liability claim, the court in *Crisci*⁴⁹ did regard as meritorious the suggestion that insurers be held absolutely liable for their conduct regarding a claim settlement.⁵⁰ The court based its findings on four factors: First, the court recognized that it is within the reasonable expectation of the insured that his policy coverage will protect him against any claim which may be settled within policy limits. Second, the court reasoned that, given the conflict between the interests of the insurer and its insured, and since only the insurer stands to benefit by refusing a settlement offer and proceeding to trial, the insurer should be the party to bear the risk of an adverse judgment. Third, the court stated that since the insurer requires the insured to divest himself of the valuable right to settle claims,

47. *Eads v. Marks*, 39 Cal. 2d 807, 249 P.2d 257 (1952); *cf. Ritchie v. Anchor Cas. Co.*, 135 Cal. App. 2d 245, 286 P.2d 1000 (1955).

48. *See, e.g., Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

49. *Id.*

50. *Id.* at 432, 426 P.2d at 177, 58 Cal. Rptr. at 17, where the court states:

[T]he duty of the insurer to consider the insured's interest . . . arises from an implied covenant in the contract, and ordinarily contract duties are strictly enforced and not subject to a standard of reasonableness. . . . [T]he rejection of a settlement within the limits where there is any danger of a judgment in excess of the limits can be justified, if at all, only on the basis of the interests of the insurer, and, in light of the common knowledge that settlement is one of the usual methods by which an insured receives protection under a liability policy, it may not be unreasonable for an insured . . . to believe that a sum of money equal to the limits is available.

the contractual duties of the insurer should be strictly enforced. Finally, the court based its recognition of strict liability as a viable theory on considerations of "elementary justice."

At first glance, the arguments favoring the adoption of a strict liability standard appear persuasive and certainly merit discussion. It is only in light of the potentially deleterious results of such a standard that the nonfeasibility of this approach becomes apparent. To this, the court in *Crisci* did not address itself.

The strict liability approach to excess recovery would provide a larger measure of clarity and certainty than the frequently uncertain and often arbitrarily applied standards of reasonableness and good faith.⁵¹ Its adoption could eliminate the insurer's difficult task of evaluating whether a jury will make the determination, based upon a given set of facts, that a reasonably prudent insurer, in the exercise of good faith, would have settled the claim within policy limits if the policy were unlimited. Too often, the only evidence against the insurer is its refusal to settle within policy limits which, without more, is neither negligence nor bad faith.⁵² Moreover, it is argued that, in a private law suit, an individual who rejects a settlement believing he can benefit through litigation will be obligated to pay the entire judgment in the event that he loses. An insurer, more skilled in evaluating risks and better able to distribute losses, should be treated no more favorably.⁵³

Strict liability would also shift the burden of loss to the insurer, and create a conclusive presumption of unreasonableness against the insurer who refuses to settle a claim within policy limits.⁵⁴ Under the existing formulations, it is not the clearly culpable insured who suffers, but rather those defendants whose fault is not as clearly established. In the case of the clearly culpable defendant, it may be said with some confidence that the insurer would be eager to settle for the lowest possible amount within the policy limits.

The strict liability approach would further serve to undercut the temptation of liability insurers to adopt a "no settlement" or "selective

51. See Note, 43 N.Y.U. L. REV. 199, 202 (1968).

52. See, e.g., *Farm Mut. Ins. Co. v. Viclana*, 123 F.2d 692 (2nd Cir. 1942), cert. denied, 316 U.S. 672 (1942); *Georgia Cas. Co. v. Mann*, 242 Ky. 447, 46 S.W.2d 777 (1932).

53. See generally *Critz v. Farmers Ins. Group*, 230 Cal. App. 2d 288, 41 Cal. Rptr. 401 (3rd Dist. 1964). See also *Excess Liability: Reconsideration of California's Bad Faith Negligence Rule*, 18 STAN. L. REV. 475, 484 (1966).

54. See *Radio Taxi Serv. Inc. v. Lincoln Mut. Ins. Co.*, 31 N.J. 299, 304-06, 157 A.2d 319, 323 (1960).

settlement" policy. In essence, the insurer would be prevented from using the court system, at the expense of its insured, to establish favorable economic policies. Absolute liability would demand responsible decision-making. Strict liability would operate to force insurers to police their own conduct or suffer harsh consequences.

Finally, by holding the liability insurer strictly liable for judgments in excess of policy limits, the public policy consideration of compensating injured claimants would be better served, since a judgment-proof insured is not likely to be able to pay an excess judgment. Thus, the protection that would be afforded through the adoption of strict liability would run not only to the insured but to the injured claimant as well.

Advocates of the strict liability approach agree that the insurer should be held to the standard of a fiduciary in light of the valuable right of settlement foregone by the insured under the policy.⁵⁵ Certainly, it cannot be doubted that an insurer should be held to something stricter than the morals of the marketplace,⁵⁶ yet strict liability, even though it offers several advantages, is not the answer. Perhaps a fairer and more conscientious application of the good faith and reasonableness standard

55. *See Rova Farms Resort Inc. v. Investors Ins. Co.*, 65 N.J. 474, 323 A.2d 495 (1974), where the court stated:

We, too, hold that an insurer, having contractually restricted the independent negotiating power of its insured, has a positive fiduciary duty to take the initiative and attempt to negotiate a settlement within the policy coverage. Any doubt as to the existence of an opportunity to settle within the face amount of the coverage or as to the ability and willingness of the insured to pay any excess required for settlement must be resolved in favor of the insured unless the insurer, by some affirmative evidence, demonstrates there was not only no realistic possibility of settlement within policy limits, but also that the insured would not have contributed to whatever settlement figure above that sum might have been available.

Id. at 490, 323 A.2d at 507. *See also* Annot., 40 A.L.R.2d 168, 173 n.8 (1955).

56. *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928), where Chief Judge Cardozo said of the fiduciary:

[Fiduciaries] owe to one another . . . the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arms length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrated erosion" of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd.

Id. at 461, 164 N.E. at 546.

by the courts would be better suited to cope with the problem of excess liability.

Although the arguments supporting strict liability appear attractive, the adoption of such an approach would serve only to create more serious problems which, in the long run, would work to the detriment not only of the insurance industry, but, more importantly, of the insured public as well. Oversimplified and specious, the arguments supporting strict liability appear to propose solutions, but in truth they create new problems.

Strict liability has the undesirable potential of creating new moral hazards in the field of liability insurance. First, it would allow insureds to receive what in essence amounts to excess liability coverage without properly paying for it. No matter how high an insured's liability coverage is, it is always possible that some unfortunate event could take place which would expose the insured to liability in excess of his policy limits. If the claims asserted against the insured are unreasonable, it seems neither fair nor consistent with elementary justice to force an insurer to settle such a claim. Strict liability has this effect; it precludes the liability insurer from protecting its financial interest. The insured, on the other hand, may well gain "blanket coverage" arising from the insurer's simple refusal to settle—a situation that neither he nor his insurer contemplated at the time of making the policy. It would seem that "elementary justice" should be applicable not only to the insured's interests but to those of the insurer as well. When an insured purchases a policy with established limits, he assumes the risk that a judgment could be entered in excess of those limits. When an action is filed against an insured for an amount in excess of the policy limits, the threat of excess judgment should be heavily considered by the insurer in negotiating a settlement, but it should not be controlling.

On its face, the absolute liability standard would seem the easiest to apply, since the issues are narrowly confined to whether a good faith offer of settlement was made, communicated to the insurer, and rejected. But, in fact, judicial administration becomes a more onerous task in light of the greater likelihood of collusion between the insured and the claimant which would undoubtedly accompany the implementation of strict liability. Since the insured would be free from the threat of excess liability once a settlement offer were made within policy limits, it would be to the insured's advantage to urge the claimant to make a settlement offer. If the claimant is assured of receiving the excess judgment from the insurance company, the two might easily conspire to mislead the insurer to believe that the chance of recovery is slight. Once an offer of settlement is made and rejected, the insured would find

himself with excess coverage, and the insurer would incur the additional expense.⁵⁷ Perhaps such collusion would be rare, but strict liability is, at the least, encouragement for claimants to pursue the insurer instead of the wrongdoer. The risk seems hardly worthwhile.

A further consideration arises when an insured is subject to multiple claims stemming from a single occurrence, particularly when the totality of the claims substantially exceeds the policy limit. In this situation, strict liability provides a strong incentive for the insurer to settle a single claim within the stated obligations of the policy. In so doing, the insurer is discharged from further liability with respect to the other claims.⁵⁸ Such situations are potentially harmful. Frequently the insured's interests are best protected by litigating the multiple claims to avoid excess recovery. Strict liability would not only cause an insurer to act with circumspection and restraint, but also would deter the insurer from pursuing litigation when litigation might, in the long run, be the best course of action.

In addition, the strict liability approach not only encourages the insurer to settle specious claims, but also provides a better bargaining position for a claimant's so-called nuisance value claims.⁵⁹ Certainly, strict liability would provide a climate conducive to an increase in the number of such claims.

The ultimate detriment of the strict liability formulation would run not to the insurer, as intended by its proponents, but to the insuring public who will find the effects of this policy reflected in higher premium rates. Strict liability would further encourage insurers to raise the minimum coverage of liability policies so as to minimize excess recoveries. As a result of such risk-spreading, those of moderate income could be forced either to forego liability coverage altogether or pay a substantially higher premium.⁶⁰

3. THE OTHER SIDE OF THE COIN

There are a series of cases, though few in number, which refuse to

57. See Note, *An Insurance Company's Duty to Settle: Qualified or Absolute*, 41 SO. CAL. L. REV. 120, 139-42 (1968).

58. Note, 43 N.Y.U. L. REV. 199, 203 (1968).

59. *Id.* at 203, 204, where the author states: "To a certain extent, such a development seems unavoidable; at least, nuisance plaintiffs would obtain a stronger bargaining position."

60. See, e.g., *Rova Farms Resort, Inc. v. Investors Ins. Co. of America*, 65 N.J. 474, 323 A.2d 495 (1974).

hold an insurer liable for failing to settle claims within the limits of the policy. The most recent noteworthy case is *Brochstein v. Nationwide Mutual Insurance Co.*,⁶¹ in which the court decided that an action could not be predicated on an insurer's wholly self-interested refusal to settle within policy limits. The court explicitly rejected the suggestion propounded by Professor Keeton that an insurer must, in good faith, approach settlement negotiations as if the policy had no limit.⁶² Such a view is not without support.

In *Rumford Falls Paper Co. v. Fidelity Casualty Co.*,⁶³ an insured employer brought an action against Fidelity for the amount of the judgment in excess of policy limits on the ground that the insurer's refusal to settle an employee's claim within policy limits created a contractual obligation on the part of the insurer to pay the excess judgment. Although the court did recognize that the insured could be placed in a position of substantial economic danger by the insurer, the court rejected the plaintiff's reasoning, holding that the alternative of compelling an insurer to settle all cases or be liable for any excess would leave the insured free to disregard "those rules of prudence and vigilance which are indispensable for the reasonable protection of the laborers engaged in [the insured's] service."⁶⁴ The court ultimately found that the settlement clause contained in the policy evidenced the intention of the contracting parties to vest in the insurer absolute discretion regarding decisions to settle claims.⁶⁵ The court clearly recognized that giving an insured the power to control the settlement of his own case encourages the settlement of claims which may well prove unfounded if litigated.

In *Auerbach v. Maryland Casualty Co.*,⁶⁶ both the insurer and its insured agreed that the claim in question should be settled rather than litigated. Disagreement resulted when the parties failed to agree upon their respective contributions, the insurer insisting that it would contribute only 70% of the policy limit, the insured demanding the entire policy limit.⁶⁷ Consequently, no settlement was reached, and the claimant recovered judgment for an amount substantially in excess of the policy limit. The court reasoned that an insurance policy, like other contracts,

61. 266 F. Supp. 223 (E.D.N.Y. 1967).

62. *Id.* at 226.

63. 92 Me. 574, 43 A. 503 (1899).

64. *Id.* at 587, 43 A. at 506.

65. *Id.* at 580, 43 A. at 504.

66. 236 N.Y. 247, 140 N.E. 577 (1923).

67. *Id.* at 253, 140 N.E. at 579.

should be construed according to the sense and meaning of the terms used by the parties. Since the insurance contract unambiguously gave the insurer complete control over settlement, the insurer was free from liability for the excess.⁶⁸ Subsequent cases have adopted this approach,⁶⁹ which, simply stated, indicates that, for an insurer to be liable, fraud or misrepresentation amounting to concealment of relevant facts from the insured must be shown.⁷⁰

In a similar case, *Best Building Co. v. Employer's Liability Insurance Co.*,⁷¹ the injured claimant offered to settle at an amount equal to 85% of the insured's policy limit. The insurer, however, refused to settle for more than 65%. Based on an excess judgment of 160% of the policy limit, the insured brought suit, alleging that if the insurer had advised him of the claimant's settlement offer, he would have contributed the difference to avoid excess liability. Adhering to past New York decisions, the court reaffirmed the reasoning that without a clear showing of negligence or bad faith, the insurer will not be liable. A further holding was that an insurer is under no duty to settle claims.

In *Brochstein*, the claim against the insurer was based upon the insurer's failure to accept an offer to settle the case at 80% of the policy limit. The verdict returned against the insured amounted to 212% of the policy.⁷² The insurer had offered to settle for 70% of the policy limit. The claimant refused to settle for less than 90%. The insurer, unable to reach an amenable settlement figure, apprised the insured that it would be in his best interest to hire independent counsel, and further warned the insured of the possibility of an excess verdict. The insured, however, chose to take no action, relying solely upon the insurer to handle the case. The court found that there was no mismanagement of the insurer's investigation or of the court proceedings, and further found that there was neither a breach of contract nor any other wrong on the insurer's part.⁷³ As a result of the factual finding, the court dismissed the action on the merits, holding that a liability insurer is under no duty to settle

68. *Id.*

69. *See, e.g., Streat Coal Co. v. Frankfort Gen. Ins. Co.*, 237 N.Y. 60, 142 N.E. 352 (1923).

70. *Id.*

71. 247 N.Y. 451, 160 N.E. 911 (1928).

72. 266 F. Supp. at 224. It should be noted, however, that the actual judgment was for an amount equal to 190% of the policy limit. Costs and interest brought the total figure to 212% of the policy limit.

73. *Id.* at 224.

within policy limits;⁷⁴ that bad faith is not shown by refusal to settle or by other acts suggesting that the insurer pursued its own interest;⁷⁵ and that a liability insurer is not liable for any implicit negligence or lack of due diligence if neither fraud nor bad faith is proven.⁷⁶

At least one writer criticized the *Brochstein* opinion for not considering New York precedents which would have favored the insured. Realistically viewed, however, the *Brochstein* case is merely a fair application of the good faith rule. When one examines the many cases involving the issue of an insurer's liability for refusing to settle claims within policy limits, it becomes apparent that almost all of the cases are decided in favor of the insured. Could it be that over the years liability insurers have grown to adhere to a standard of wholly self-interested, bad faith conduct? It is possible that many jurists and legal scholars have become missionaries for insureds in many cases where the insurer acts in good faith and with reasonable care. *Brochstein* comes at an appropriate time, for it reveals the court's willingness to hold an insurer liable for judgments in excess of policy limits, but only if fraud or bad faith conduct is clearly shown. Such a practice, it is urged, will best serve the principles of "elementary justice" by protecting the rights of both parties, as opposed to the harsh standard of strict liability which will leave the insurer and the insuring public without the right to protect their own interests.

74. *Id.* at 226.

75. *Id.* at 225.

76. *Id.* at 226.