

1958

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Christopher Nardi

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Recommended Citation

Christopher Nardi, *Absolute Liability for Failure to Settle below Policy Limits*, 9 Cas. W. Res. L. Rev. 485 (1958)

Available at: <http://scholarlycommons.law.case.edu/caselrev/vol9/iss4/12>

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ords and treatises and liberality in qualification of the medical expert are among the infiltrators. The fear expressed by the medical profession is that the scale is tipping too far, especially in such liberal states as California. There may be justification for such apprehension, but the consequences are not inevitable — for if the physician comes into court with an open and impartial mind, seeking the truth, the scales will strike a balance.

HAROLD FRIEDMAN

Absolute Liability For Failure To Settle Below Policy Limits

"Is an indemnity policy to be a shield in the hands of the assured or a sword in the hands of its antagonist?"¹

The following fact situation is illustrative of the problems with which this article will be concerned: The insurance company issues a liability policy to Insured with a \$10,000 per person limitation of liability. Claimant alleges that due to insured's negligence he has suffered injuries for which he claims \$40,000. However, claimant graciously offers to settle for \$9,000. The company refuses settlement. The case is tried and claimant recovers \$20,000.²

It is clear that a conflict in interests has arisen in this situation because of the presence of these elements: (1) A claim against the insured for an amount in excess of the policy limits and (2) An offer to compromise the claim for a figure within such limits. The primary conflict arises out of the fact that the policyholder desires any settlement so long as it is within the policy limits, while the insurer is increasingly tempted to gamble with trial as the settlement figure approaches the limits of the policy, since he has less to lose.³ There has been a mass of litigation upon the very problem set forth herein — costly litigation which is certain to continue and expand until the evolution of the law strikes upon a more satisfactory solution than that now being provided.⁴ Because of the presence of conflicting interests, the following questions arise: (1) Does the

¹ *Rumford Falls Paper Co. v. Fidelity & Cas. Co.*, 92 Me. 574, 587, 43 Atl. 503, 505 (1899).

² This article will be confined to consideration of settlement problems only, although its reasoning also applies to the analogous problems presented by a failure of the insurer to undertake or continue in defense of a claim. See 40 A.L.R.2d 168 (1955).

³ *Ga. Life Ins. Co. v. Miss. Cent. R.R. Co.*, 116 Miss. 114, 76 So. 646 (1917); *VANCE, INSURANCE* 1004 (3d ed. 1951); 13 U. CHI. L. REV. 105 (1945).

⁴ Comment, 48 MICH. L. REV. 95 (1949); Note, 60 YALE L.J. 1037 (1951).

company have a duty to the insured to settle within the limits of the policy? If so, what is its scope and by what standard is it to be judged?⁵

(2) What can the insured do in case of a violation of this duty?

(3) What is the practical result of an attempt to prove a violation of this duty by the insured?

AN ANALYSIS OF THE PROBLEMS

The typical policy provision provides: ". . . the company may make such investigation, negotiation and settlement of any claim or suit as it deems expedient." At first, courts construed this contractual provision very narrowly and held there was no duty to settle.⁶ "The contract must govern . . . (and) whether the interests of the insured were sufficiently guarded, it is unnecessary to consider."⁷ It was not long until the courts realized that this rule failed to give adequate protection to the insured.⁸ The judiciary decided that there should be a duty imposed upon the insurer in regard to settlement. But — and now we come to the most perplexing question of all — by what standard is this duty to be judged?⁹

The rationale behind the imposition of a duty in this situation is that since the company's actions affect the interest of the insured, it should be required to assume responsibility for its exercise.¹⁰ Obviously, when the company decides to defend, the insured is involuntarily burdened with the bulk of the risk and at the same time is deprived of virtually any voice in the matter. Of course, insured is often permitted to hire his own attorney and participate in the litigation, but this does not lessen the problem, since the company still maintains the exclusive right to decide on settlement. It was as a result of this inequality of position that the courts concluded that protection must be given the insured despite any contractual provision to the contrary.¹¹

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

⁶ *Rumford Falls Paper Co. v. Fidelity & Cas. Co.*, 92 Me. 574, 43 Atl. 503 (1899); *Schmidt v. Travelers Ins. Co.*, 244 Pa. 286, 90 Atl. 653 (1914).

⁷ *Rumford Falls Paper Co. v. Fidelity & Cas. Co.*, 92 Me. 574, 587, 43 Atl. 503, 506 (1899).

⁸ *New Orleans & Cent. R.R. Co. v. Md. Cas. Co.*, 114 La. 153, 38 So. 89 (1905); *Schenke Piano Co. v. Phila. Cas. Co.*, 216 N.Y. 662, 110 N.E. 1049 (1915); *Kingan & Co. v. Marland Cas. Co.*, 65 Ind. App. 301, 115 N.E. 348 (1917); *Cleveland Wire Spring v. Gen. Acc. Fire & Life Assur. Corp.*, 6 Ohio App. 344 (1917).

⁹ Comment, 48 MICH. L. REV. 95 (1949).

¹⁰ *Ga. Cas. Co. v. Mann*, 242 Ky. 447, 46 S.W.2d 777 (1932); *Cunningham, Liability In Excess Of Policy Limits*, 1957 INS. L. J. 483 (Aug. 1957); 13 U. CHI. L. REV. 105 (1945).

¹¹ Keeton, *Liability Insurance and Responsibility For Settlement*, 67 HARV. L. REV. 1136 (1954).

The mere election to defend does not make the insurer liable for a judgment in excess of the policy limits,¹² but he may be liable if certain elements are in evidence. There are two lines of authority. The diversity stems from the question of whether the insurer's obligation is only to refrain from acting in "bad faith"¹³ or whether it must come up to a standard of "due care"¹⁴ in its actions. Bad faith usually consists of the company intentionally disregarding the interests of the insured.¹⁵ Negligence consists in the rejection of an offer which a reasonable businessman would have accepted.¹⁶ Obviously the variations on the elements constituting "negligence" and "bad faith" are vast¹⁷ and many times the two doctrines tend to coalesce.¹⁸

CRITICISM OF THE "NEGLIGENCE" AND "BAD FAITH" TESTS

"One line is run here, another there. We have a filigree of threads and cross threads, radiating from the center and dividing one another into sections and cross sections."¹⁹ The preceding quotation aptly describes the prevailing situation as to what constitutes "good faith" or "reasonable-

¹² Ga. Cas. Co. v. Mann, 242 Ky. 447, 46 S.W.2d 777 (1932); Hart v. Rep. Mut. Ins. Co., 152 Ohio St. 185, 87 N.E.2d 347 (1949); VANCE, INSURANCE 1004 (3d ed. 1951).

¹³ Noshey v. American Auto. Ins. Co., 68 F.2d 808 (6th Cir. 1934); Christian v. Preferred Acc. Ins. Co. 89 F. Supp. 888 (N.D.Cal. 1950); Ga. Cas. Co. v. Mann, 242 Ky. 447, 46 S.W.2d 777 (1932); Abrams v. Factory Mut. Liab. Ins. Co., 298 Mass. 141, 10 N.E.2d 82 (1937); Wakefield v. Globe Indem. Co., 246 Mich. 645, 225 N.W. 643 (1929); Farmers Gin Co. v. St. Paul Mercury Indem. Co., 186 Miss. 747, 191 So. 415 (1939); Zumwalt v. Utilities Ins. Co., 360 Mo. 362, 228 S.W.2d 750 (1950); Hart v. Republic Mut. Ins. Co., 152 Ohio St. 185, 87 N.E.2d 347 (1949); Johnson v. Hardware Mut. Cas. Co., 108 Vt. 269, 187 Atl. 788 (1936).

¹⁴ Cavanaugh v. Gen. Acc. Fire & Life Assur. Corp., 79 N.H. 186, 106 Atl. 604 (1919); Tyger River Pine Co. v. Md. Cas. Co., 170 S.C. 286, 170 S.E. 346 (1933); Universal Auto. Ins. Co. v. Culberson, 54 S.W.2d 1061 (Tex. Civ. App. 1932); Ballard v. Ocean Acc. & Guar. Co., 86 F.2d 449 (7th Cir. 1936).

¹⁵ So. Fire & Cas. Co. v. Norris, 35 Tenn. App. 657, 250 S.W.2d 785 (1952); Johnson v. Hardware Mut. Cos. Co., 108 Vt. 269, 187 Atl. 788 (1936).

¹⁶ Comment, 48 MICH. L. REV. 95 (1949).

¹⁷ If insurer knows he only has an equal chance of winning and also if he loses the verdict will exceed policy limits, he has a higher standard to live up to. Nat'l Mut. Cas. Co. v. Britt, 203 Okla. 175, 200 P.2d 407 (1948). It can be stated that bad faith is a state of mind. However, the state of mind may be inferred from the circumstances and the acts of the insurance company's agents. Johnson v. Hardware Mut. Cas. Co., 109 Vt. 481, 1 A.2d 817 (1938).

¹⁸ See Annot., 40 A.L.R.2d 168, 186 (1955), pointing out that in many cases the courts have equated good faith with negligence, or at least held that negligence might be an element of bad faith.

¹⁹ Cardozo, as quoted in 1957 INS. L. J. 483, 493 (Aug. 1957).

ness." Aside from the almost imperceptible distinction in the practical application of the two terms, there has been a conspicuous failure on the part of the courts to come forward with any express statement regarding the relative weight to be given the interests of the parties by the insurer when it deliberates settlement.²⁰ Ostensibly, it would appear that "equal consideration" would be the most equitable. However, by saying "equal consideration" must be given to the conflicting interests, a jury question is usually presented and this is one of the chief weaknesses in the application of either test.²¹ It does not appear consonant with justice that the insured should be exposed to the hazard of unenlightened jury action in this situation. Apart from the difficulties a jury is confronted with in dealing with the vague notion of either test in this area, another problem is apparent. The attention of the jury is seldom directed to the fact that the insurer's decision to defend was not accompanied by a proportionate share of the risk.²² In the vast majority of cases the only evidence against the company is a simple refusal to settle, which amounts to neither negligence nor bad faith.

It is obvious that neither rule eliminates the source of all difficulty in this area — the divergent interests of insurer and insured in regard to settlement.²³ The company hopes that the insured will come forward with an airtight defense so that it can deny liability completely, but the policyholder finds himself in a position of jeopardy. If the insured asserts that he was without fault the company will refuse to settle and a verdict in excess of the policy limits may well go against the insured.

Presently, the insurer is inevitably influenced by two factors. If it makes a bad guess as to the outcome, it need not bear all the consequent financial burden.²⁴ "It may legitimately be inferred that the all controlling motive of the company was to get out of these cases as cheaply as possible."²⁵ And here it is well to realize that when the interests of the parties are to be weighed against each other, the actor's state of mind may be an important factor in the scale. Secondly, it is aware of the fact that it has the insured virtually at its mercy and may deliberately gamble with insured's money in refusing to settle — knowing the policyholder's difficulty in proving bad faith in a separate action.²⁶

²⁰ Comment, 48 MICH. L. REV. 95 (1949).

²¹ *Ibid.*

²² See Note, 68 HARV. L. REV. 1436 (1955) discussing "duty to defend."

²³ *Ibid.*

²⁴ 13 U. CHI. L. REV. 105 (1945).

²⁵ Ga. Life Ins. Co. v. Miss Cent. R.R. Co., 116 Miss, 114, 122, 76 So. 646, 649 (1917) (dissent).

²⁶ Note, 60 YALE L. J. 1037 (1951).

CONCLUSION

By conferring absolute power to control litigation and settlements upon the insurance company without a pro rata responsibility for the consequences, the courts have created an inequitable relationship which must result in hardship to the insured.²⁷ It appears that the best solution to the problem would be the existence of a relationship between the company and the insured which is less dependent on issues of fact.²⁸ It is more expedient and less harsh from a standpoint of "social engineering"²⁹ to make the liability of the company in this situation so extensive as to cover all excess over the policy limits.³⁰ Such a doctrine would virtually compel the company to act reasonably.³¹ Actually, the problem is to determine the manner in which the law may most effectively adjust the rights of the parties in the light of the social interests involved. The company should be held liable here "merely because, as a matter of 'social engineering,' the conclusion is that the responsibility should be his."³²

Today, we are backing down from the position that "fault" involves a large element of moral blame — "social fault" does not necessarily coincide with blameworthiness.³³ When the insurance company decides to contest rather than settle, there is usually neither certainty of harm on the one hand nor a great risk of harm, which might constitute negligence, on the other. Here "there is an irreducible risk of harm which can't be avoided, a risk which the reasonable man would take . . ."³⁴ because refusal to settle has great utility in the sense that it is essential to combat flagrant, false and vexatious claims. In other words, the fact that the insurance company decides to contest rather than settle is an activity which may be valuable to the community.³⁵ But is there anything inconsistent or immoral with saying to the company, "We will not stop you from doing this, but if you go ahead and do it for your own purposes

²⁷ See *Zumwalt v. Utilities Ins. Co.*, 360 Mo. 362, 228 S.W.2d 750 (1950), a case in which the court said the insurance company was bound to sacrifice its interests in favor of the insured. A logical extension of this would compel the insurer to settle whenever given the opportunity to do so within the policy limits.

²⁸ PROSSER, TORTS § 3 (2d ed. 1955).

²⁹ Ames, *Law and Morals*, 22 HARV. L. REV. 97, 110 (1908). "The law is utilitarian. It exists for the realization of the reasonable needs of the community. That is why on many occasions the innocent must suffer and the wicked go unpunished."

³⁰ Comment, 48 MICH. L. REV. 95 (1949).

³¹ *Ibid.*

³² PROSSER, TORTS § 3 at 14 (2d ed. 1955).

³³ For an excellent discussion on the failure of lawyers to appreciate absolute liability in tort law, see, ELDREDGE, MODERN TORT PROBLEMS 32 (1941).

³⁴ *Ibid.*

³⁵ PROSSER, *supra* note 32.