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 Comments

APPROACHING STRICT LIABILITY OF INSURER FOR REFUSING TO SETTLE WITHIN POLICY LIMITS

I. THE DILEMMA

Conflicting interests must be served whenever insurance settlements are negotiated. A direct conflict arises when an insurance company has an opportunity to settle a claim against the insured within the policy limits, the company declines the offer, and subsequently a judgment is rendered in excess of the policy coverage. The insured seeks redress against the company for that portion of the judgment exceeding the actual coverage on the theory that his liability would have been totally extinguished had the insurance company accepted the offer to settle. On the other hand, the insurer will argue that by litigating, the company seeks to lessen its own liability within the policy limits. The courts have resolved who must pay the excess judgment by determining whether the insurer breached its "duty" to the insured by refusing to accept the settlement offer.

Traditionally the insurer has been held liable to the insured when the company fails to conform either to the standard of due care, good faith or both in conducting the settlement negotiations. The standards presently applied by the courts were adopted from an early line of cases and are now the common law of almost every state. These early generalizations were made in relation to the facts and circumstances of particular cases under which the insurer's conduct was appraised. Notwithstanding this early line of cases the exact content for these standards with respect to all details of application is not so easily settled. Perhaps the two standards are really the product of too early an attempt to lay down a universal proposition on the basis of a few particular cases.

A recent case in California has discredited the use of the two standards as a universal proposition by taking favorable judicial notice of a strict liability proposal.\(^1\) Like all ideas, the proposed rule emerges from the judicial process as a bare skeleton. The muscle and flesh will have to be added through a variety of processes of growth. Among these growth processes is further exploration by courts and law reviews. An attempt to add some flesh to the proposed rule is the purpose of this comment. To evaluate the propriety of the proposal, an analysis of the early and present rules, with their criticism, will be necessary.

The questions under consideration are: (1) Because of this un-
avoidable conflict of interests should strict liability be imposed
upon a carrier who refuses to accept a sub-coverage offer? (2) If not,
in what circumstances is the company subject to liability in excess
of the policy limits? (3) Assuming liability is established, what
elements of damages are recoverable?

The problem is illustrated in the recent case, Crisci v. Security
Insurance Co.,2 in which the California Supreme Court took judicial
notice of the strict liability proposal and inferred that it may be
applied in the appropriate circumstances. The facts of the Crisci
case disclose that the defendant insurance company issued a 10,000
dollar public liability policy to the plaintiff-landlord. An injured
tenant brought suit against the landlord for 400,000 dollars as com-
penration for physical injuries and a very severe psychotic condition
that allegedly resulted when a tread broke on a wooden staircase.
Before the trial, the insurance company refused one offer by the
injured party to settle for 10,000 dollars and later rejected a second
9,000 dollar settlement demand even after the landlord offered to pay
2,500 dollars of this amount.3 This refusal to settle was based on
the insurer's assumption that the physical injury was relatively
minor and that the jury would only believe the psychiatric evidence
presented by the insurance company. The case proceeded to trial
and the jury returned a verdict against Mrs. Crisci, the landlord,
for 100,000 dollars plus 1,000 dollars for the tenant's husband. The
insurer appealed unsuccessfully4 and then paid 10,000 dollars, the
limit of the policy, leaving their insured liable for the remainder.
After a settlement with the injured party, in which Mrs. Crisci
assigned her cause of action against the Security Insurance Com-
pany, this action was initiated in the insured's name to recover the
excess amount over the policy limits. In this excess judgment
action, the trial court awarded the plaintiff 91,000 dollars against
the insurance company for wrongful refusal to settle and also
awarded 25,000 dollars for mental suffering. This judgment was
affirmed on the principle of stare decisis and concluded that the
adoption of the amicus curiae proposal for strict liability was
unnecessary under the particular facts of this case.

2 Id.
3 The court did not infer any evidence of bad faith of the insurer by
Mrs. Crisci's offer to contribute to a settlement within the policy limits.
See note 25 infra for elements which may indicate bad faith.
4 Di Mare v. Cresci, 58 Cal. 2d 292, 373 P.2d 860, 23 Cal. Rptr. 772 (1962).
Note that Cresci in the 1962 litigation appears as Crisci in the 1967 case.
II. PRESENT STANDARDS OF LIABILITY AND DAMAGES

A. LIABILITY

The question of whether an insurer can be held liable in excess of policy limits has been the subject of litigation in most jurisdictions. Generally, liability insurance policies contain no express provisions requiring the insurer to accept an offered settlement. In most insurance forms the only pertinent language concerning settlement is found in the basic insuring agreement at or near the beginning of the policy. The typical policy contains provisions which vest in the insurer the exclusive right to decide whether a claim against the insured should be settled or litigated.\(^5\)

Initially, opinions seemed to hold that the insurer is not liable under any circumstances to consider the interests of the insured in accepting a settlement offer and that the policy coverage limit was the only possible liability.\(^6\) Opposing argument unsuccessfully attempted to impose upon the insurer an absolute duty to settle, if an offer was made within the policy limits.\(^7\) Both of these positions of no liability under any circumstances and absolute duty to settle have been rejected by the majority of courts today.

\(^5\) That involved in the Crisci case and the typical liability insurance policy contain a provision substantially as follows: "As respects the insurance afforded by the other terms of this policy... the company shall: (a) defend any suit against the insured alleging such injury, sickness, disease or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent; but the company may make such investigation, negotiation and settlement of any claim or suit as it deems expedient...." Keeton, Liability Insurance and Responsibility for Settlement, 67 Harv. L. Rev. 1136, 1137, n.1 (1954) [hereinafter cited as Keeton].

\(^6\) Rumford Falls Paper Co. v. Fidelity & Cas. Co., 92 Me. 574, 43 A. 503 (1899); Auerbach v. Maryland Cas. Co., 236 N.Y. 247, 140 N.E. 577 (1923); Schmidt v. Travelers' Ins. Co., 244 Pa. 286, 90 A. 653 (1914) (In these early cases it is not apparent whether the insured ever sought liability on the negligence or bad faith theory).

\(^7\) There are no decisions which have expressly held that there is an absolute duty to settle within policy limits, and the argument has been rejected in favor of liability under either bad faith or negligence. See Blue Bird Taxi Corp. v. American Fid. & Cas. Co., 26 F. Supp. 808 (E.D.S.C. 1939) (Saying a rule of strict liability would open the door for fraud and collusion, and increase premium charges); Georgia Cas. Co. v. Cotton Mills Products Co., 159 Miss. 396, 132 So. 73 (1931) (rejecting the theory that duty of insurance company to settle was absolute); Schmidt & Sons Brewing Co. v. Travelers' Ins. Co., 244 Pa. 286, 90 A. 653 (1914) (held no liability in absence of a showing of bad faith or negligence); Rumford Falls Paper Co. v. Fidelity & Cas. Co., 98 Me. 574, 43 A. 503 (1899) (rejecting argument that complete control over settlement required liability for any excess judgment); Noshey
Anchored between these two extremes is the present view requiring the insurer to give some consideration to the interests of the insured when negotiating a settlement. The rationale behind the imposition of a duty is that the company's decision affects the interests of the insured; therefore, the company should be required to assume some responsibility for the right to exercise this control. If the offer to settle is near the amount of the policy limits, when the company decides to litigate, the insured is involuntarily burdened with the bulk of the risk and simultaneously is deprived of any participation in the decision. This resulting inequality of position is what prompted the courts to conclude very early that at least some protection must be given the insured despite any contractual provision to the contrary.

The California courts have adopted similar reasoning in prior cases, and the Crisci court reaffirmed this position saying:

[I]n every contract, including policies of insurance, there is an implied covenant of good faith and fair dealing that neither party will do anything which will injure the right of the other to receive the benefits of the agreement;...that the implied obligation of good faith and fair dealing requires the insurer to settle in an appropriate case although the express terms of the policy do not impose the duty...

This court-imposed duty is usually treated as one sounding in tort rather than contract; however, it has been noted that the distinction is rarely essential to a decision.

Merely acknowledging this duty has not solved the present problem. In testing the minimum amount of consideration an insurer must give the insured's interest to meet its legal obligation, the courts have experienced difficulty. Multi-standards have re-

v. American Auto Ins. Co., 68 F.2d 808 (6th Cir. 1934) (rejecting argument that failure to accept settlement offer breached implied contract to so accept); Kingan & Co. v. Maryland Cas. Co., 65 Ind. App. 301, 115 N.E. 348 (1917) (in absence of fraud, liability could not be based upon failure to settle); Wisconsin Zinc Co. v. Fidelity & Deposit Co., 162 Wis. 39, 155 N.W. 1081 (1916) (no agreement could be implied from the policy).


Keeton, supra note 5, at 1138.


suited from this confusion. Some courts have announced that the company must sacrifice its interests before the insured's. Other jurisdictions do not require the insurer to take note of the insured's interests, or state that the insurer may weigh its own interests heavier. A compromise position has arisen in other jurisdictions which required equal consideration to be given the insured's interest. The present majority of the courts have adopted this latter position, including the Crisci court which stated:

[1]n determining whether to settle the insurer must give the interests of the insured at least as much consideration as it gives to its own interests; and that when "there is great risk of a recovery beyond the policy limits so that the most reasonable manner of disposing of the claim is a settlement which can be made within those limits, a consideration in good faith of the insured's interest requires the insurer to settle the claim. . . . In determining whether an insurer has given consideration to the interests of the insured, the test is whether a prudent insurer without policy limits would have accepted the settlement offer.

The courts have adopted two approaches upon which liability for failure to settle will be imposed. The two lines of authority stem from the central issue of whether the insurer's obligation is only to act in "good faith" or whether the company must come up to a

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12 Keeton, supra note 5, at 1142.
15 Wisconsin Zinc Co. v. Fidelity & Deposit Co., 162 Wis. 39, 155 N.W. 1081 (1916).
18 66 Cal. 2d at 429, 426 P.2d at 176, 58 Cal. Rptr. at 16.
19 "Good faith implies honesty, fair dealing and full revelation. . . . Bad faith implies dishonesty, fraud and concealment. . . . Neither mistaken judgment nor unreasonable judgment is the equivalent of bad faith. . . . As a consequence, liability upon the part of the insurer for refusal to accept an offer of settlement may not be predicated upon its failure to correctly predict the outcome of the action it is defending." Davy v. Public Nat'l Ins. Co., 181 Cal. App. 2d 387, 396, 5 Cal. Rptr. 438, 492-93 (4th Dist. 1960); Olson v. Union Fire Insurance Co., 174 Neb. 375, 118 N.W.2d 318 (1963).
negligence standard of "due care" in its actions. Variations in the elements held to constitute bad faith, negligence, or both are numerous, with some courts even holding that negligence is an indication of bad faith. Aside from the difference in legal verbiage, the results achieved are similar regardless of which theory is applied.

Although the number of jurisdictions is in a state of flux, California follows the present majority position requiring a showing of bad faith to hold the insurer liable. An extensive list of factors which may indicate bad faith were set out in the California case of Brown v. Guarantee Ins. Co. as follows:

"In all matters pertaining to the questions in litigation... it ought to be held to that degree of care and diligence which an ordinarily prudent person would exercise in the management of his own business; and if an ordinarily prudent person, in the exercise of ordinary care, as viewed from the standpoint of the assured, would have settled the case, and failed or refused to do so, then the agent... should respond in damages." G. A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544, 547 (Texas Comm'n of App. 1929); Dumas v. Hartford Acc. & Indem. Co., 94 N.H. 484, 56 A.2d 57 (1947); See also Douglas v. United States Fid. & Guar. Co., 81 N.H. 371, 127 A. 708 (1924).

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

The question is always: 'Did the insurer exercise that degree of skill, judgment, and consideration for the welfare of the insured which it, as a skilled professional defender of lawsuits having sole charge of the investigation, settlement, and trial of the suit may have been expected to utilize'? If it did, there is no problem; it is not liable.... If it did not, then a court could easily describe its conduct as being negligent, or as not in accordance with the high duty of good faith which it owed to its insured." 7A J. Appleman INSURANCE LAW AND PRACTICE § 4712, at 562 (1942).


Id. at 689, 319 P.2d at 75. An extensive list was summarized in Jarrett, LAWSUITS FOR WRONGFUL REFUSAL TO DEFEND OR TO SETTLE, 28 Ins. COUNSEL J. 58 (1961); also a number of these important factors were discussed in Annot., 40 A.L.R.2d 168, 266 (1955).
Several earlier cases had equated the bad faith test to a showing of dishonesty, fraud, and concealment. In an attempt to give further concrete meaning to the elements that enter into a determination of bad faith the Crisci court grounded the decisions on the proposition that:

The language used in the cases, however, should not be understood as meaning that in the absence of evidence establishing actual dishonesty, fraud, or concealment no recovery may be had for a judgment in excess of the policy limits.... Liability is imposed not for a bad faith breach of the contract, but for failure to meet the duty to accept reasonable settlements, a duty included within the implied covenant of good faith and fair dealing.\(^{26}\)

This duty to accept reasonable settlements, included within the implied covenant of good faith, could approach absolute liability. Liability under either the good faith or negligence standard is dependent on the particular fact situation; therefore, these standards may be broadened by the courts to such an extreme that absolute liability is the result, although the terms good faith and negligence will still be applied. This element of reasonableness may also have been defined by the Crisci court. Whenever there is a rejection of a settlement offer within policy limits, the refusal can be justified only on the basis of the insurer's interests in most cases. Usually any settlement within the policy limit would be the best approach from the insured's position. Also, from the viewpoint of expectations in the purchase of insurance, the court further states:

[I]n 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 who purchases a policy with limits to believe that a sum of money equal to the limits is available and will be used so as to avoid liability on his part with regard to any covered accident. In view of such expectation an insurer should not be permitted to further its own interests by rejecting opportunities to settle within the policy limits unless it is also willing to absorb losses which may result from its failure to settle.\(^{27}\)

Although the Crisci court acknowledged that adoption of the strict liability proposal was unnecessary to the decision, apparently the court was fully aware of the possible ramifications of its decision. Taking favorable note of an amicus curiae brief and several

\(^{26}\) 66 Cal. 2d at 430, 426 P.2d at 176-77, 58 Cal. Rptr. at 16-17 (emphasis added).

\(^{27}\) Id. at 431, 426 P.2d at 177, 58 Cal. Rptr. at 17.
law review articles, which urged the adoption of strict liability, the court stated:

There is more than a small amount of elementary justice in a rule that would require that, in this situation, where the insurer's and insured's interests necessarily conflict, the insurer, which may reap the benefits of its determination not to settle, should also suffer the detriments of its decision.

Previously, it was noted, that most courts impose a duty on the insurer, arising from an implied covenant in the contract, to consider the interests of the insured. The present Crisci decision found support for the absolute liability rule by stating: "[C]ontract duties are strictly enforced and not subject to a standard of reasonableness." Therefore, "the proposed rule is a simple one to apply and avoids the burdens of a determination of whether a settlement offer within the policy limits was reasonable."

B. DAMAGES

The second major issue considered in the Crisci opinion was the proper amount of damages recoverable in a successful excess liability suit. The usual amount of recovery is limited to the excess of the claimant's judgment over the policy limits. Attorney's fees incurred by the insured which are related to the claimant's suit have been allowed as damages. Fees incurred, however, in the excess liability suit between the insured and the insurance company have consistently been held not recoverable. Limited numbers of previous courts have gone further in holding the insurer liable for other types of damages. Farmers Insurance Exchange v. Henderson allowed recovery against the insured for destruction of the insured's business, levied upon to satisfy the claimant's judgment, in addition to the excess judgment over the policy limits. The

28 Id. at 431, 426 P.2d at 177, 58 Cal. Rptr. at 17. The court cited the following articles: Note, 18 STAN. L. REV. 475, 482-485 (1966); Note, 60 YALE L.J. 1037, 1041-42 (1951); Comment, 48 MICH. L. REV. 95, 102; Note, 13 U. CHI. L. REV. 105, 109 (1945). See also Keeton, supra note 9, at 1183-86; 17 U. MIAMI L. REV. 557, 566 (1963).
29 66 Cal. 2d at 431, 426 P.2d at 177, 58 Cal. Rptr. at 17.
30 Id. at 430-31, 426 P.2d at 177, 58 Cal. Rptr. at 17.
32 E.g., Maryland Cas. Co. v. Elmira Coal Co., 69 F.2d 616 (8th Cir. 1934).
34 82 Ariz. 335, 313 P.2d 404 (1957).
majority of cases still deny absolutely any recovery for consequential damages.\(^3\)

The question of whether the insured's cause of action lies in contract or tort gains importance in determining the propriety of the trial court's allowance of damages. The trial court awarded Mrs. Crisci a judgment for the excess of the claimant's suit over the policy limit plus damages for mental suffering incurred by Mrs. Crisci. An earlier California case *Comunale v. Traders & General Ins. Co.*,\(^3\) stated the action as "sounding in both contract and tort;" however, the opinion was mainly based on the contract aspects. A later case\(^7\) drew the conclusion from *Comunale* that the California rule did not permit a tort recovery. The conflict and difference of opinion, both in the field of contracts and torts, is revived with the *Crisci* decision. Normally, contract damages are awarded for mental suffering only where the suffering accompanies a bodily injury, where caused intentionally, or when wanton or reckless. Sometimes similar results are reached with a merely negligent breach; however, such cases are limited to contracts involving deep personal feelings.\(^3\) Most common of this type have been engagements to marry, contracts for proper disposition of bodies, and contracts for the delivery of death messages. Although it must be admitted that damages are allowed in certain cases growing out of contract rights, usually the injured party may, if he elects, bring an action sounding in tort.

Against this background of prior case law the *Crisci* court has now placed California with the majority and expressly overruled any prior cases holding the action as one of contract only.\(^3\)

*Crisci* expressly held that the action sounds in tort, and in reliance on Civil Code § 3333\(^4\) allowed the insured to recover for all detriment suffered. The court stated:

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\(^3\) 50 Cal. 2d 654, 328 P.2d 198 (1958).


\(^3\) 5 A. *Corbin, Corbin on Contracts* § 1076, at 429 (1964).

\(^3\) 66 Cal. 2d at 433, 426 P.2d at 178, 58 Cal. Rptr. at 19.

\(^4\) *Cal. Civ. Code* § 3333 (West 1954), "For the breach of an obligation not arising from contract, the measure of damages, except where otherwise expressly provided by this Code, is the amount which will compensate for all the detriment proximately caused thereby, whether it could have been anticipated or not."
In accordance with the general rule, it is settled in this state that mental suffering constitutes an aggravation of damages when it naturally ensues from the act complained of, and in this connection mental suffering includes nervousness, grief, anxiety, worry, shock, humiliation and indignity as well as physical pain. 41

So in accordance with California's general rule of damages, the unanimous court upheld the allowance of damages for mental suffering incurred by Mrs. Crisci stating:

We are satisfied that a plaintiff who as a result of a defendant's tortious conduct loses his property and suffers mental distress may recover not only for the pecuniary loss but also for his mental distress. 42

Although the present court overruled the earlier cases holding the action was solely in contract, it is questionable whether California has completely rid itself of all such actions in contract. The same court later draws an analogy to the breach of contract cases, allowing contract damages for a wormy funeral casket, stating:

Among the considerations in purchasing liability insurance... is the peace of mind and security it will provide in the event of an accidental loss, and recovery of damages for mental suffering has been permitted for breach of contracts which directly concern the comfort, happiness or personal esteem of one of the parties. (Chelini v. Nieri, 32 Cal. 2d 480, 482 [196 P.2d 915].) 43

Punitive damages were not allowed by the court; although, the trial court indicated that had they found a reckless disregard for the insured's rights, such damages would have been proper. 44

III. CRITICISM OF PRESENT LIABILITY STANDARDS

The present standards used by the courts have been attacked bitterly on several grounds by writers 45 and judges. First, the critics claim that courts tend to merge bad faith and negligence until the distinction between the two standards is more apparent than real. 46 Second, no workable standard exists upon which to base the determination of the necessary elements for either bad faith or negli-

41 66 Cal. 2d at 433, 426 P.2d at 178, 58 Cal. Rptr. at 18.
42 Id. at 433-34, 426 P.2d at 179, 58 Cal. Rptr. at 19.
43 Id. at 434, 426 P.2d at 179, 58 Cal. Rptr. at 19.
45 The standards have been attacked for various reasons in Appleman, Duty of Liability Insurer to Compromise Litigation, 26 Ky. L.J. 100 (1938); Keeton, Liability Insurance and Responsibility for Settlement, 57 Harv. L. Rev. 1136 (1954); 17 U. Miami L. Rev. 557 (1963).
46 Appleman, supra note 45, at 111.
gence. The California cases are evidence for these first two attacks. The first California appellate decision, *Brown v. Guarantee Ins. Co.*, established a bad faith standard. Only a year later, the California Supreme Court decision of *Comunale v. Traders & General Ins. Co.*, while following the *Brown* bad faith rule, established a divergent definition of bad faith. Therein the court's standard is much like the ordinary definition of negligence. The liability standard established in *Comunale* requiring reasonableness under all circumstances has been followed in all subsequent California cases. Confusion is thus evident, as the courts are stating that bad faith is not negligence, but if an insurance company does what is unreasonable, it is acting in bad faith. Paradoxically, California expressly states that they do not apply the negligence standard.

In attempting to apply these generalized standards, the California courts have used two factual questions: (1) Would the insurer have settled had the policy been unlimited? (2) Did the insurer give as much consideration to the insured's interests as it

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49 "substantial culpability... bad faith rather than mere negligence." Id. at 688, 319 P.2d at 74.
50 50 Cal. 2d 654, 328 P.2d 198 (1958).
51 "When there is great risk of a recovery beyond the policy limits so that the most reasonable manner of disposing of the claim is a settlement which can be made within those limits, a consideration in good faith of the insured's interest requires the insurer to settle the claim." Id. at 659, 326 P.2d at 201 (emphasis added).
53 "A determination respecting... good faith involves an inquiry into motive, intent and state of mind." Davy v. Public Nat'l Ins. Co., 181 Cal. App. 2d 387, 397, 5 Cal. Rptr. 488, 493 (4th Dist. 1960). Earlier in this same opinion the court stated: "The refusal to accept a proposed settlement which, under all of the circumstances, is reasonable, constitutes a failure to exercise good faith.... Stated otherwise, an unwarranted or unreasonable rejection of an offer of compromise constitutes bad faith.... On the other hand, the duty to exercise good faith is not commensurate with the duty to exercise the care of an ordinarily prudent person under the same circumstances. Bad faith and negligence are not legally synonymous.... Neither mistaken judgment nor unreasonable judgment is the equivalent of bad faith." Id. at 394-95, 5 Cal. Rptr. at 492-93.
did to its own? With these two questions the jury is in effect asked to reevaluate decisions made by experts—the company's attorney and claims manager. The court's submission of these issues to a jury culminates as the third major weakness in the practical application of either standard. Determination of the excess liability issue is based mainly on testimony regarding the credibility and character of the insurer's acts rather than objective facts. This is unlike the jury function in the normal negligence action; therefore, either standard is unworkable in actual practice. Despite criticism, most courts persist in submitting these issues to a jury.

Fourth, in submitting this issue to the jury in the excess liability suit, hindsight will likely influence the verdict, and since both standards are based essentially on questions of fact, appellate reversal is unlikely. In addition, the attention of the jury is seldom directed to the fact that the insurer's decision to litigate was not accompanied by a proportionate share of the risk; and the insured, who may ultimately be liable for the excess judgment, did not participate in the decision not to settle.

At least one author has maintained that a greater duty than mere good faith should be demanded of the insurer since it holds

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57 See Note, 13 U. Chi. L. Rev. 105 (1945).
58 Appleman, supra note 45, at 111 wherein he stated: "No jury whatsoever is competent to consider such an issue when even attorneys, experts in the field of personal injury and insurance law, might well differ upon the question of due care by or good faith of the insurer in such a situation." See also note 53 supra.
59 In Douglas v. United States Fidelity & Guaranty Co., 81 N.H. 371, 374, 127 A. 708, 710 (1924) the court stated: "It is also urged that the issue of negligence in this case is one that could not be fairly and intelligently passed upon by a jury, that it involves intricate questions of law not within the understanding of jurors, and upon which they could not pass in any event without the aid of expert testimony. The extent of the right to trial by jury is settled.... With some exceptions which do not bear upon the present controversy, the right to trial by jury in suits at law is absolute." But see Ivy v. Pacific Auto. Ins. Co., 156 Cal. App. 2d 652, 320 P.2d 140 (1st Dist. 1958) (bad faith of company and attorney found as matter of law); Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958) (company refused settlement offer and refused to defend under the policy; held, only question of fact was reasonableness of settlement offer).
60 See note 59 supra.
itself out as a professional. The typical argument is that when the insurer, in order to protect itself, pursues a course of conduct that exposes its insured to greater liability, it cannot reasonably be said to be fulfilling its contractual obligations in good faith and should therefore be held for any excess judgment incurred.

IV. REFLECTIONS ON AN ABSOLUTE LIABILITY STANDARD

One solution which could solve many of the problems previously discussed is to make the company strictly liable without regard to fault for the entire judgment if the company declines to accept a subcoverage offer to settle. The Crisci court took favorable notice of several law reviews and amicus curiae briefs soliciting the adoption of strict liability. Nevertheless, the court stated that affirmance is dictated by relying upon Comunale, so: "We need not ... here determine whether there might be some countervailing considerations precluding adoption of the proposed rule...." Although reference to these proposals was dictum, a full-fledged discussion of the strict liability proposal is now advantageous for analysis and comparison.

As suggested by the various writers, the ideal solution is to narrow the question for the jury and attempt to make the problem predominantly a question of law. This has the advantage of certainty and nondependence of fact issues regarding the nature of the insurer's conduct. Several proposals suggest the insurer can elect to settle or not, but the risk of an excess judgment would be on the insurer. The jury's only role under this proposal would be to determine if there had been a non-collusive offer of settlement.

62 See 7A J. Appleman Insurance Law and Practice § 4687, at 479-80 (1962); "[The insurer] is a professional which advertises by all media of mass communication its skill in the investigation, settlement, and litigation of liability cases. It asks the individual...to substitute its skill for his, its judgment for his judgment, and its conduct for his own acts. It then becomes chargeable with a greater duty—even as the brain surgeon must exercise a greater knowledge, judgment, and skill in a brain operation than would a general practitioner of medicine....It is not a comfortable spot for a liability insurer to occupy, but it seeks the business upon the basis of its skill."

63 See note 28 supra.

64 66 Cal. 2d at 431, 426 P.2d at 177, 58 Cal. Rptr. at 17.

65 See Appleman, Duty of Liability Insurer to Compromise Litigation, 26 Ky. L.J. 100, 111 (1938); Jarrett, Lawsuits for Wrongful Refusal to Defend or to Settle, 28 Ins. Counsel J. 58, 63 (1961); Comment, 48 Mich. L. Rev. 95, 100-101 (1949).

66 This solution has been suggested in 48 Mich. L. Rev. 95, 99-100 (1949); 13 U. Chi. L. Rev. 105, 109-10 (1945); 60 Yale L.J. 1037, 1041-42 (1951); 18 Stan. L. Rev. 475, 482-85 (1966).
Professor Keeton, in one of the more extensive articles written on this subject, favors a different solution. This proposal consists of dual limits. The lower limit, of no duty to consider the interests of the insured, applies if no firm offer of settlement is made; and the higher limit, of making the company absolutely liable, applies if a firm settlement offer is refused. The essence of this proposal is actually an express recognition of absolute liability similar to the other proposal. Merits of this suggestion are only found in the requirement, as a condition precedent to recovery, of offer of settlement; and without this offer, no liability attaches. Theoretically, this condition of tendering a firm offer of settlement would be implemented in any of these proposals.

The underlying rationale of these proposals is to prevent the advantages gained by the insurance company when it alone has strategic control of the case. By retaining strategic control, the gamble of litigating under the negligence or bad faith theory is dwarfed. The insurance company may win a verdict, and in any event can lose nothing more than the amount of the policy limit and the cost of an unsuccessful defense, unless the insured recovers in an excess liability suit.

When exclusive control by the company is renounced, the basis for imposing excess liability is removed. Any rule allowing the insured to bind the company in a settlement would, however, encourage less prudent settlements at higher figures. From the view of public interest in effective operation of the insurance mechanism, this is a disadvantage. Insurance costs could rise, since settlements made by the insured and reimbursed by the company would necessarily be reflected in higher rates.

Unless both parties are required to agree to a settlement, which may be impossible, the only reasonable alternative existing under the present system would be to allow the insurance company to retain its present control. Absent any reasonable alternative, with the retention of control the risk of paying for any subsequent harm may ultimately rest upon the company in the near future. Even if the proposed rule were adopted, it would not compel the company to accept all settlement offers; rather, it only requires that the entire risk of a subsequent judgment exceeding those policy limits would be on the company.

This risk is presently being borne by the insurance company in many cases today. As a consequence of the present difficulty in

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COMMENTS

formulating and applying any valid standard, the courts have subjected the insurer to the equivalent of absolute liability in many cases. There being almost no degree of predictability, the insurer is faced with a duty to settle with nothing but the jury’s determination of “good faith” or “negligence” to protect it from the consequences of a refusal to settle. Supported by the past fourteen decisions on excess liability in California, with only one holding for the insurer, one author concluded that the insurance company will be held liable on a bad faith refusal to settle if it makes a “bad guess plus one.” This has not, however, proven to be a universal prediction; since Nebraska, under a bad faith test, has consistently denied recovery against an insurance company.

All of the arguments supporting absolute liability—reduction of litigation between the insured and the insurance company, the company’s complete control over the decision concerning settlement, the ability of the insurer to shift or spread any loss, elimination of the unenlightened jury question, relief for the policyholder from excess judgments, decrease in the time and cost of handling the claim—apply in full force to most excess liability cases. Notwithstanding the force of these arguments, the courts have been reluctant to implement them as the rationale for their decisions, just as the courts are reluctant to extend absolute liability in any other area of the law.

Perhaps one reason for this reluctance is that “there is an irreducible risk of harm which can’t be avoided, a risk which a reasonable man would take....” Because refusal to settle has some utility in the sense that it is essential to combat flagrant, false and vexatious claims, this argument has some merit. In other words, the insurance company’s decision to contest, rather than settle, is an activity which may be valuable to the community. But, in every case, the company will attempt to protect its own interests, and since it is difficult or impossible to measure this factor, the best solution would still be to hold the company absolutely liable.

70 Id. at 477-79.
71 Kleinschmit v. Farmers Mut. Hail Ins. Ass’n., 101 F.2d 987 (8th Cir. 1939) (For defendant insurer); State Farm Mutual Auto Ins. Co. v. Bonacci, 111 F.2d 412 (8th Cir. 1940) (For insurer; if the insured’s own actions are the cause of the insurer’s failure to settle, the insurer cannot be held for bad faith); Olson v. Union Fire Insurance Co., 174 Neb. 375, 118 N.W.2d 318 (1962) (For defendant insurer; no showing of bad faith).
72 L. Eldredge, Modern Tort Problems 40 (1941).
The strict liability rule would also eliminate the arbitrariness resulting from hindsight decisions. The very fact the claimant won an excess verdict, after offering to settle within policy limits, is a difficult obstacle to overcome in defending either a charge of bad faith or negligence. The Crisci court stated:

The size of the judgment recovered in the personal injury action when it exceeds the policy limits, although not conclusive, furnishes 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.74

Under the proposed rule, failure to settle would afford a conclusive presumption and in itself establish liability. The court's only role in the excess liability suit would be to decide whether or not there had actually been a non-collusive offer to settle. An absolute obligation to settle eliminates all questions of fact involving good faith or reasonableness, and would also render irrelevant any question of how a prudent insurer without policy limits would have reacted to the settlement offer.

Under this proposal, any extra cost of paying these claims will not be cast on the individuals who incurred them, but will be distributed over the whole group of policy holders carrying insurance for this type of risk.75 The questions of utmost importance then are: How much will this extra cost add to the premiums? Whether on a balancing of this and other pertinent factors it is desirable or just to "spread the risk" of the extra cost in this way? Very few studies have been made as to the influence of a new rule of law on existing premium rates.76 Insurance companies themselves do not even try to find out what part of their loss is attributable to any given legal doctrine. Rates for a locality are computed on the basis of gross losses paid out and a multitude of other factors, many or most of them non-legal.77 The tendency of the court to write

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74 66 Cal. 2d at 43, 426 P.2d at 177, 58 Cal. Rptr. at 17 (emphasis added).
75 "Of prime importance is the fact that whenever there is widely held insurance, tort liability no longer merely shifts a loss from one individual to another, but it tends to distribute the loss according to the principals of insurance, and the person nominally liable is often only a conduit through whom this process of distribution starts to flow." James, Accident Liability Reconsidered: The Impact of Liability Insurance, 57 YALE L.J. 548, 551 (1948).
76 McCleary, The Bases of the Humanitarian Doctrine Reexamined, 5 Mo. L. Rev. 56, 87 (1940) (Concluded Missouri rates are high, but it is hard to show how much if any is attributable to the humanitarian doctrine).
77 47 BEST INS. NEWS, No. 11, 17 (1947) (claim consciousness of the populous and standard of living were important considerations).
opinions in legal concepts and doctrines, rather than in terms of distribution of losses, obscures what the courts consider calculable "enterprise" hazards in many situations.

Yet still another obstacle awaits us if we seek to impose a rule of absolute liability. A recurring argument made by the insurance company is that the decision to impose liability upon the insurer will force the company to raise premium rates automatically. This proposed rule would probably increase rates only a fraction, if at all. A presupposition, even under the present doctrine, is that the company will accept any reasonable offer; consequently, under the proposed rule there should be little, if any, added settlement expense. The end result would be interchangeable under both systems if the insurer thinks the settlement offer is unreasonable, since he would litigate. Admittedly, if the insurer loses, the company would be liable for any excess, but even under the present system, the insurance company is usually liable for the whole if only a minimum of bad faith is shown. Conclusively, savings would result from not having to defend an excess liability suit. Furthermore, the insurer would not be exposed to damages for mental suffering to the insured. Plus, reducing unpredictable losses to predictable expenses would seem to more than offset any increase in disbursements occasioned by this proposal.

Accompanying adoption of a rule of absolute liability, some limit must be placed upon the elements of damages recoverable. Therefore, from this analysis, two propositions can be deduced: (1) The insurance company should be required to settle within policy limits when it has an opportunity to do so. "Due care" or "good faith" as criteria for an insurance company's liability for failure to settle can only make unpredictable the outcome of the decision not to settle. (2) The legal sanction, damages, for failure to settle should be no more and no less than the amount of the excess judgment—the amount which will place the insured in the position he would have been without an unavoidable conflict of interest between the insured and the insurer. It is not desirable to settle all claims; therefore, with the adoption of the proposed rule of absolute liability and the limitation of damages to the excess over the policy limit, an insurance company would be able to evaluate prospectively the amount of possible liability when it decides to litigate.

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