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Comments and Casenotes

INSURER'S LIABILITY FOR FAILURE TO SETTLE

So numerous are the factors which must be assayed in a determination of an insurer's choice between trial or settlement that it would be impracticable here to attempt more than a brief outline of them. Among the many elements to be considered we find the temper of the people in the forum, as it affects a jury, the size of prior verdicts in similar cases, the standing of the plaintiff and defendant in the community, together with any bias which might find its way in. Then, of course, the injuries of the plaintiff, and the probability of total recovery must be weighed, and balanced against the facts of the case along with an evaluation of the ability of opposing counsel. As every case presents a varied set of facts, so too are the factors varied which go towards the insurer's final determination in any one case. Nevertheless such decisions must be, and are made daily by all the large insurance carriers, and as human frailties exist, there as everywhere, mistakes in judgment sometimes arise.

However, it is not until a case has been tried and a verdict rendered which exceeds the policy limits that there comes into focus the insured's contention that a mistake was made and that the insurer erred in trying a case which it ought to have settled. His complaint, when presented to a tribunal, is not merely that an error was made, but that because of it he was damaged and he demands redress. In such actions one of two allegations are made, either that the insurer was guilty of bad faith in failing to settle, or that his failure to do so was due to negligence. The American courts are not in complete accord in their decisions in such cases. "According to the old majority rule, the insured could recover the excess of a judgment above the policy limits from the insurer, because of a failure to effect a settlement for a smaller sum, only if the company was guilty of actual fraud or bad faith . . . this bad faith rule is tending to become the minority rule, being displaced by the rule of negligence . . ."¹ It is a purpose of this comment to discuss these two concepts, as they can be found pre-

¹ 8 APPLEMAN, INSURANCE LAW AND PRACTICE (1942) Sec. 4712.

sented in the cases, and through examination of each to see whether they differ or are in accord.

Some little background will perhaps be useful here, before the problem can be directly approached. The insurance contract itself furnishes the basis for suit in all these cases. The insured claims breach of some duty owed him, and resulting damage, while the insurer defending says there was no breach. It is at this point that we find the negligence and bad faith rules springing up. It would seem then that the first query should be as to the broad general duty imposed on both insurer and insured by the contract. After that is resolved, the other fine distinctions between the conflicting rules may then more readily be drawn. The National Standard Automobile Liability Policy² will serve as a convenient basis for study, as it is a typical policy. It sets forth the rights and duties of both parties in much the same manner as any of the other specialized policies in use to-day.

Briefly the duties of the insurer are as follows:

"The company agrees with the insured, named in the declarations, in consideration of the payment of the premium . . . and subject to . . . exclusions, conditions, and other terms of this policy:

1—To pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury, sickness or disease . . . including death resulting therefrom . . . sustained by any person, caused by accident and arising out of the ownership, maintenance or use of the automobile.

2—The company shall:

(a) defend any suit against the insured alleging such injury, sickness or disease, and seeking damages on account thereof . . . ; but the company may make such investigation, negotiation or settlement of any claim or suit as it deems expedient; . . ."

The terms of the policy dealing with the duties of the insured provide that:

²The National Standard Automobile Liability Policy was drawn up by a joint committee of the National Bureau of Casualty & Surety Underwriters and the American Mutual Alliance appointed in March 1934. On May 15, 1935 the Standard Policy was promulgated to become effective on January 1, 1936. For full discussion see E. W. Sawyer, *AUTOMOBILE LIABILITY INSURANCE* (McGraw-Hill Book Co., Inc., 1936).

"1—When an accident occurs written notice shall be given by or on behalf of the insured to the company or its agent as soon as practicable. . . .

2—If claim is made or suit is brought against the insured, the insured shall immediately forward to the company every demand, notice, summons . . . received by him.

3—The insured shall cooperate with the company and, upon the company's request, shall attend hearings and trials and shall assist in effecting settlements . . . and in the conduct of suits. The insured shall not, except at his own cost, voluntarily make any payment, assume any obligation or incur any expense, other than for such immediate medical and surgical relief to others as shall be imperative at the time of accident. . . ."

Nowhere in this language can one find on the part of the insurer an *express* promise to settle any case rather than defend it. Instead it retains the option to settle if it deems it expedient, and it is over the exercise of this option that the courts have differed.

The policyholder on the other hand gives up all control over the handling of the claim or suit against him, and is forbidden, save at his own expense, to make any payments to, or assume any obligations towards, the injured party other than those as are imperative for first aid. These restrictions are quite understandable. The company, having agreed to handle all claims and suits, naturally desires to be able to do it in its own manner, free from any untoward interference from the insured, be he well meaning or not. The courts raise this point continuously in their handling of these cases,³ though usually it is used mainly as a plus factor to bolster the decision whichever way it goes. By itself it means little, but by using it as a lever, the courts favoring the negligence doctrine impress on an insurer a duty not expressly undertaken, viz., that of exercising reasonable care in its handling of claims and suits against the insured.

The bad faith rule, followed by respectable authority⁴

³ Wisconsin Zinc Co. v. Fidelity & Deposit Co., 162 Wis. 39, 155 N. W. 1081 (1916). See also, United States Casualty Co. v. Johnston Drilling Co., 161 Ark. 158, 255 S. W. 890, 34 A. L. R. 727, 738 (1923).

⁴ Noshey v. American Automobile Ins. Co., 68 F. (2d) 808 (C. C. A. 6th, 1934); State Automobile Ins. Co. v. York, 104 F. (2d) 730 (C. C. A. 4th,

has been defined as "the intentional disregard of the insured's financial interest in the hope of escaping the full responsibility imposed on the insurer by the policy."⁵ A North Carolina Court hastens to add, however, that "a mistake honestly made does not subject the company to liability."⁶ In one of the leading cases supporting the bad faith rule⁷ the defendant insured the plaintiff against loss arising from injuries to employees. There was a \$10,000 limit for each person injured. After a serious injury an employee offered to settle for \$8,500. The insurer's offer of \$6,500 was never increased and the parties went to trial. The employer was never notified of the negotiations and contended that he would have contributed the extra \$2,000 to settle the case. At trial an \$18,000 verdict and judgment resulted. The plaintiff employer was thus required to pay the \$8,000 excess itself, and it brought an action to recover this amount from the insurer. The complaint alleged negligence in failing to settle, and plaintiff secured a verdict in the lower court. The verdict was set aside, and this action was affirmed on appeal.

The court brushed over the bad faith rule here with but few words saying:^{7a}

"that the insurance company in the handling of the litigation or in failing to settle is liable for its fraud or bad faith is conceded"

but it then went on in the following vein:⁸

"... It has been held by this court that the company is not liable on its contract for a failure to settle; a contract imposes on it no such duty. . . . There is no im-

1939), *cert. denied*, 308 U. S. 591 (1939); *Kingan & Co. v. Maryland Casualty Co.*, 65 Ind. App. 301, 115 N. E. 348 (1917); *Abrams v. Factory Mut. Liability Ins. Co.*, 298 Mass. 141, 10 N. E. (2d) 82 (1937); *Mendota Electric Co. v. Indemnity Co.*, 175 Minn. 181, 221 N. W. 61 (1928); *Brassil v. Maryland Casualty Co.*, 210 N. Y. 235, 104 N. E. 622 (1914); *Cleveland Wire Spring Co. v. General Accident Fire & Life Assurance Corporation*, 6 Ohio App. 344 (1917); *Boling v. New Amsterdam Casualty Co.*, 173 Okla. 160, 46 P. (2d) 916 (1935). See also, 8 APPLEMAN, *INSURANCE LAW AND PRACTICE*, *supra*, n. 1, for complete citations.

⁵ *Johnson v. Hardware Mutual Casualty Co.*, 109 Vt. 481, 491, 1 A. (2d) 816, 820 (1938).

⁶ *Wynnwood Lumber Co. v. The Travelers' Insurance Co.*, 173 N. C. 269, 271, 91 S. E. 946, 947 (1917).

⁷ *Best Building Co. v. Employers Liability Assurance Corp.*, 247 N. Y. 451, 160 N. E. 911 (1928).

^{7a} *Best Building Co. v. Employers Liability Assurance Corp.*, 247 N. Y. 451, 453, 160 N. E. 911, 912 (1928).

⁸ *Ibid.*

plied obligation in the insurance policy in this case that the company must or will settle according to the offer made."

The opinion does not give a comprehensive discourse on bad faith. No doubt it was felt a relative matter that can only be decided from the facts at hand and not be solved by rule of thumb. Many of the other courts, in accord with this view,⁹ say substantially the same thing. They then pass on, with little discussion, having classified the particular acts complained of as either fraudulent or legitimate.

The Wisconsin Court, while following the bad faith rule, felt obligated to attempt a more comprehensive definition of bad faith than had hitherto been laid down. It said:¹⁰

"The good faith performance of the obligation which the company assumed when it took to itself the complete and exclusive control of all matters that determine the liability of the insured requires that it be held to that degree of care and diligence which a man of ordinary care and prudence would exercise in the management of his own business were he investigating and adjusting such claims."

This the Court felt was the standard by which *bad faith vel non* should be tested. At this point it is very interesting to read a definition of negligence as given by Chief Justice Rosenberry of Wisconsin in his charge to a jury.¹¹ When read in conjunction with the *Hilker* case above, it seems that the Justice is defining bad faith in terms of negligent conduct. This will be adverted to more fully further on, and it serves at this point merely to point out that the courts following the bad faith doctrine have tried to find a workable rule by which to decide their cases. In their search

⁹ *Supra*, n. 4.

¹⁰ *Hilker v. Western Automobile Ins. Co.*, 204 Wis. 1, 12, 235 N. W. 413, 414 (1931), affirming 204 Wis. 1, 10, 231 N. W. 257, 261 (1930).

¹¹ Compare this but for a moment with Chief Justice Rosenberry's definition of negligence:

"Every person is negligent when, without intending to do any wrong, he does such an act or omits to take such a precaution that under the circumstances present he, as an ordinarily prudent person, ought reasonably to foresee that he will thereby expose the interests of another to an unreasonable risk of harm. . . . a person is required to take into account such of the surrounding circumstances as would be taken into account by a reasonably prudent person and possess such knowledge as is possessed by an ordinarily reasonable person and to use such judgment and discretion as is exercised by persons of reasonable intelligence and judgment under the same or similar circumstances," *Osborne v. Montgomery*, 203 Wis. 223, 242, 234 N. W. 379 (1931).

they have turned to the same type of standard of conduct as we find them applying in deciding negligence cases.

Passing on now to the negligence rule, we find its most outspoken and prolific champion in New Hampshire,¹² though several other states have seen fit to follow its lead.^{12a} Stated generally, the rule seems to be that since the insurer has absolute control over negotiations for settlement, it will be held to that degree of care and diligence which a man of ordinary prudence should exercise in the management of his own business. If it fails to meet this standard, it becomes liable to the insured for any excess judgment.

A recent case illustrative of the negligence view is *Dumas v. Harford Accident & Indemnity Co.*¹⁸ There the plaintiff was insured under an auto policy, with limits of \$5,000 for any one person injured. He ran into a pedestrian at an intersection and the injured woman suffered 33% permanent disability in her left leg. Her settlement price was \$4,000 and the insurer's offer of \$2,500 was never increased. At trial she was awarded \$12,000, and the insured had to make up the excess \$7,000. The insured then brought action against the insurer, and he obtained a verdict which was affirmed on appeal. The Court discussed the conflict of authorities as to the liability of an insurance company for negligence in failing to settle a claim. In this discussion it pointed out that the bad faith rule is becoming displaced to-day by the negligence rule.

Let us consider for a moment whether or not there is any justification on the part of the Court for impressing on an insurer a duty not expressly undertaken in the policy, i.e., that of exercising reasonable care in its handling of claims and suits against the insured. Casualty insurance has had gigantic growth since the turn of the century. This is indicated by the fact of a premium growth from 8.5 million

¹² *Attleboro Mfg. Co. v. Frankfort Marine, Etc., Ins. Co.*, 240 F. 573 (C. C. A. 1st, 1917); *Dusten v. Curtis*, 74 N. H. 266, 67 A. 220 (1907); *Cavanaugh Bros. v. General Accident Fire & Life Assur. Corp.*, 79 N. H. 186, 106 A. 604 (1919); *Douglas v. U. S. F. & G. Co.*, 81 N. H. 371, 127 A. 708 (1924).

^{12a} *Ballard v. Ocean Accident & Guaranty Co.*, 86 F. (2d) 449 (C. C. A. 7th, 1936); *Auto Mut. Indemnity Co. v. Shaw*, 134 Fla. 815, 184 So. 852 (1938); *Tiger River Pine Co. v. Maryland Casualty Co.*, 163 S. C. 229, 161 S. E. 491 (1931), later appeal in 170 S. C. 286, 170 S. E. 346 (1933); *Universal Automobile Ins. Co. v. Culberson*, 54 S. W. (2d) 1061 (Tex. Civil App. 1932), *aff'd*, 126 Tex. 282, 86 S. W. (2d) 727 (1935), rehearing denied, 126 Tex. 291, 87 S. W. (2d) 475 (1935).

¹⁸ 94 N. H. 484, 56 A. (2d) 57 (1947).

in 1890 to some 1.9 billion in 1946,¹⁴ as well as by the great increase in the number of operative insurance companies during the same period.¹⁵

Liability insurance at first presented a challenge to the courts, for it tended to undermine one of the fetishes of the common law, that of personal responsibility. The early attitude of the courts was to construe all policies narrowly so as to allow the insurer to assume only the least possible part of the insured's common liability to third parties, consonant with the policy terms. However, it was soon demonstrated that such policy on the part of the courts wreaked injustice on the innocent injured party much more often than it accomplished any worthwhile end. All too frequently the insurer was allowed to excuse himself from payment because of a technicality and the injured party then became the possessor of a worthless judgment against the insured. It was with the advent of the auto that the courts and legislatures both came to a clear realization of

¹⁴ National Bureau of Casualty Underwriters, *Facts and Figures of the Casualty Insurance Underwriters* (1947) Table 1, Sheet 1:

Year	Stock Cas. Co.	Mutual Cas. Co.	Cas. Reciprocal and Lloyds	Total Premiums
1890	8,450,301	146,253	None	8,596,554
1900	26,357,200	425,464	None	26,782,664
1923	424,228,318	62,749,729	37,597,898	524,575,945
1937	753,780,952	217,536,843	47,791,455	1,019,109,250
1938	739,842,813	214,704,529	41,970,629	996,517,971
1939	743,218,512	221,321,759	46,702,483	1,011,242,754
1940	781,266,569	239,745,481	47,894,040	1,068,906,090
1941	894,353,818	292,102,061	62,913,926	1,249,369,805
1942	991,189,480	341,063,364	68,140,302	1,400,393,146
1943	987,483,088	338,124,926	64,455,210	1,390,063,224
1944	1,053,502,656	353,016,848	69,389,670	1,475,909,174
1945	1,140,387,274	388,127,543	75,724,841	1,604,239,658
1946	1,398,150,024	487,705,078	99,063,697	1,984,918,799

¹⁵ *Supra*, n. 14:

Year	Stock Cas. Co.	Mutual Cas. Co.	Cas. Reciprocal and Lloyds	Total Companies
1890	23	5	None	28
1900	45	9	None	54
1923	121	121	72	314
1937	155	147	40	342
1938	158	140	39	337
1939	168	149	45	362
1940	165	144	45	354
1941	172	140	43	355
1942	169	139	45	353
1943	171	157	49	377
1944	176	160	51	387
1945	183	161	52	396
1946	193	158	53	404

the injustice so frequently done. They saw that the average person could usually find some means of procuring a car and enough gasoline to run it, but that in most cases he was utterly unable to respond in money damages for its misuse. In an attempt to remedy such situations we find many of the states passing Financial Responsibility laws¹⁶ so as to make more probable some recompense to those insured through the negligence of others. The insurance companies are the institutions selected to make this reimbursement. Perhaps it would be more accurate to say that for a price they offer their services in this capacity. Is it surprising then, in light of these facts, to find the courts closely scrutinizing all their dealings both with policyholders and those injured? It would probably not be going too far to say that today insurance companies occupy a position approaching that of public servants, for certainly their influence pervades all fields of endeavour. In view of these facts, can it be argued that an insurers duty to the insured is only to refrain from acting towards him in bad faith? The insured through his purchase of insurance has tried to protect his own property so that if his negligence causes injury to others the resultant loss will be absorbed by his insurer and not fall directly on him. Clearly this purpose is not effected if the company negligently fails to settle a case and the trial results in a verdict over the policy limit, leaving the insured responsible for the excess. Since the company has control over all negotiations and may refuse to accept any compromise offer within the policy limits with the attendant possibility of a large excess verdict, it is perhaps not unreasonable to require that the insurer not be guilty of negligence in refusing favorable settlements.

With this foregoing treatment of the two doctrines a rationale of the problem can be set up, together with a discussion of the difficulty inherent in any attempted separation of negligence and bad faith.¹⁷ It is well nigh impossible to draw any clean cut distinctions between them which really separate them, for we find the edges of the picture so blurred that it is more than difficult to say where one begins and the other ends. We find New York fully cognizant of this difficulty in its rhetorical question:¹⁸

¹⁶ For complete list, see, Note, *Automobile—Protection of the Accident Victim, Survey of Financial Responsibility Laws* (1942) 20 N. Car. L. R. 198, 202.

¹⁷ Cf. those twilight zones of misfeasance, malfeasance and nonfeasance for difficulty in drawing any clear lines of demarcation.

¹⁸ *Supra*, n. 7.

"We may ask what would constitute negligence in the failure to settle a case, as distinguished from bad faith. Even when there was little likelihood of recovery many reasonable persons would think it wise to settle rather than to take any chance with a jury. In most of the accident cases, disputed questions of fact arise. Is the insurance company to determine at its peril whether reasonable minded men would believe the plaintiffs witnesses in preference to its own? Again even on conceded facts, as frequently happens, a serious question of law arises as to the nature or extent of the liability if any. Is a jury to say that the insurance company was guilty of negligence in choosing to try out such a question in the courts rather than to settle? These questions suggest the wisdom of adhering to the contract of insurance which the parties have made. . . ."

In any case of this sort there are three possible factual situations, as follows: first, there may not be enough evidence of negligence or bad faith to enable plaintiff to recover; second, the plaintiff may present enough evidence to allow a judge or jury to say that the company was negligent in failing to settle; and, third, there may be enough to enable the court or jury to find not only negligence but also bad faith on the company's part. All courts agree that in the first situation the insured must lose and in the last situation he will win. However, when we come to the second possibility we find those courts subscribing to the negligence rule allowing recovery, while the other opposing courts refuse it.

From the foregoing it appears that the courts feel that there is some point of cleavage between negligence and bad faith. Yet when the opinions of certain courts having opposing views are studied it is very difficult to harmonize their language with the result reached. We have already seen how the Wisconsin court, while following the bad faith rule, has so defined its position as to make it appear that the ordinary concepts of negligence are to be applied in order to supply a solution.¹⁹

Then, consider language from a Court of the opposing school:²⁰

"It has been held that an insurer which assumes the duty of defending a claim owes the assured the duty

¹⁹ *Supra*, n. 10 and n. 11.

²⁰ *Cavanaugh v. General Accident Fire & Life Assur. Corp.*, *supra*, n. 12.

of settling the claim if that is the reasonable thing to do, and if the company fails to make any efforts to do it the company will be held liable for an excess verdict."

Though the results are opposed yet one finds therein language which might be transposed from the one opinion into the other without causing any marked discord in the final result.

These cases are but a few of the many conflicting decisions but they serve to point up the inherent difficulty of any complete separation of the two standards of conduct. How then can two such opposing views on the same problem be justified or rationalized. It is believed that the solution lies not so much in what the courts consider as negligence or bad faith, but rather is dependent upon the social philosophy of the forum, as set forth in the opinion. That one is treading treacherous ground when going behind an opinion is more than recognized, yet there seems to be no other key to the problem. Some courts require less proof than others in awarding a verdict. Those requiring the less proof seem to follow a social policy of protection of the insured, even at times to the detriment of the insurer; and they find justification for the result by arguing that the insurer who sells protection to the insured and then negligently fails to protect his interests should be held liable to him for any damage he sustains. On the other hand those courts requiring more proof to make for guilt on the part of the insurer refuse to interest themselves with the protection afforded the insured other than not to allow an insurer to defraud a policyholder. Their position is stated succinctly in these words:²¹

"If the insurance company is to be obligated to make a settlement under any given circumstances it must be a matter to be dealt with between the insured and the insurer, or else regulated by the legislature."

To date Maryland has never been called on to answer the problem, and it will be interesting indeed to see whether it will favor the old order or the new; but, regardless of its decision it is clear that nation-wide accord will never be achieved until the courts begin to base their decisions not upon impossible distinctions between bad faith and negligence, but upon the firm ground of the correlative rights and duties between insurer and insured.

²¹ *Supra*, n. 7.