Insurer's Liability for Refusal to Settle

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A is insured by B insurance company for $10,000. Subsequently, X is injured by A and brings an action against A for an amount in excess of $10,000. Query: If X is willing to settle with B insurance company for an amount within the limits of A's policy, what are the rights and duties of B company in considering the compromise offer? There appears to be no definitive answer to this question. Some jurisdictions state that the insurer has absolute discretionary powers in deciding whether to accept compromise demands while others state that the insurer is bound to give at least some, if not equal, consideration to the insured's interest.

The majority viewpoint favors the position that the insurer must consider the insured's interest along with its own when considering whether to accept a compromise demand within the policy limits. However, whether the insurer will be liable for a judgment rendered against the insured in excess of the policy coverage depends upon a determination of how the insurer-insured interest relationship should be balanced. Within this determination lies the subsidiary question of whether the insurer should be liable for an excess judgment if merely negligent, or whether its liability should be limited to a showing of "bad faith." Although the majority rule is that the insured can only recover if the insurer has acted in "bad faith" in refusing to effect a compromise within the policy limits, the critical problem still remains as to what constitutes "bad faith."

It is the purpose of this note to scrutinize the relationship of the insurer and insured to determine what elements are necessary to impose liability on the insurer (with almost complete emphasis on the issue of "bad faith"), and, finally, to determine whether the

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2 Fidelity & Cas. Co. v. Robb, 267 F.2d 473 (5th Cir. 1959); Kinder v. Western Pioneer Ins. Co., 231 Cal. App. 2d 894, 42 Cal. Rptr. 394 (1965); Cowden v. Aetna Cas. & Sur. Co., 389 Pa. 459, 134 A.2d 223 (1957). It has been suggested that the insurer be held absolutely liable if he fails to negotiate a settlement demand within the policy limits, but apparently no court has been willing to accept this position. See Annot., 40 A.L.R.2d 168, 172-73, 177 (1955), which provides a summary of the case law in the area of insurer bad faith. See also Keeton, Liability Insurance and Responsibility for Settlement, 67 Harv. L. Rev. 1136 (1954).


4 Cunningham, Liability in Excess of Policy Limits, 1957 Ins. L.J. 483. It was predicted in 1942 that the majority view would become one that allowed mere negligence for failure to settle to be the controlling factor. See J. Appleman, INSURANCE LAW AND PRACTICE § 4712 (1942). However, this trend never materialized. See Annot., 40 A.L.R.2d 168 (1955).
courts are handling the situation in the most advantageous and equitable manner possible both for the insurer and the insured.

**The Duty of the Insurer**

The usual insurance policy provides:

With respect to such insurance as is afforded by this policy . . . the company shall . . . defend any suit against the insured alleging such injury . . . and seeking damages on account thereof, even if such suit is groundless, false, or fraudulent; but the company may make such investigation and settlement of any claim or suit as it deems expedient.  

As such, the insurer appears to have the exclusive right to defend and settle claims which arise against the insured. In determining the duty of the insurer to effect settlements, case law has evidenced varying approaches ranging from that which allows the insurer to give paramount consideration to its own interests to that which requires that in certain circumstances the insurer must subordinate its own interests to those of the insured. It appears, however, that the majority viewpoint today is that the insurance company's and the insured's interests should be equally weighed.

Admitting the insurer's duty to concern himself with the insured's interests, the liability of the insurance company for the amount of a judgment against the insured in excess of the policy limit arises from the insurer's failure to adhere to the express or implied provisions of the insurance contract. Thus, whether one characterizes the insurer's position vis-à-vis the insured as that of agent or independent contractor, the insurer will be held liable if it fails to adequately consider the insured's interests.

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8 Hernandez v. Employers Mut. Liab. Ins. Co., 346 F.2d 154 (5th Cir. 1965); Kinder v. Western Pioneer Ins. Co., 231 Cal. App. 2d 894, 42 Cal. Rptr. 394 (1965). In Kinder, the court stated that the insurer must give at least as much consideration to the insured's interest as it does to its own.
9 Ivy v. Pacific Auto. Ins. Co., 156 Cal. App. 2d 652, 320 P.2d 140 (1958); Sweeten v. National Mut. Ins. Co., 233 Md. 52, 194 A.2d 817 (1963). Thus, the insurer has committed a tortious act by failing to perform its contractual agreement. "Ordinarily, a breach of contract is not a tort, but a contract may create the state of things which furnishes the occasion of a tort. . . . Accompanying every contract is a common-law duty to perform with care, skill, reasonable expedience, and faithfulness the thing agreed to be done, and a negligent failure to observe any of these conditions is a tort, as well as a breach of the contract." 38 Am. Jur. Negligence § 20 (1941).
There are two bases upon which liability of an insurer for a judgment in excess of policy coverage may be predicated: negligence and "bad faith." Under the negligence theory, which is the minority rule, an insurer is held negligent for refusing to settle within the policy limits when it fails to exercise that degree of care which an ordinary person would exercise in the management of his own business. This ultimately becomes a jury question. The liability of the insurance company is dependent upon whether the jury determines that the insurer neglected to concern itself with the insured's interest either wilfully or as the result of an unjustifiable mistake of fact. For example, in Douglas v. United States Fidelity & Guaranty Co., insurer's contention that he had no reason to believe the insured to be liable was rejected. The court held that plaintiff-insured had introduced sufficient evidence to raise a jury question as to whether defendant-insurer's claims adjuster had knowledge of the pertinent facts. Therefore, the jury was justified in finding that the adjuster knew the facts, and on agency principles his knowledge was imputed to the insurer. Defendant insurer could not claim justifiable ignorance of the insured's liability for negligence, and was held liable for the judgment in excess of the policy limits.

For purposes of the majority rule, "bad faith" has been defined as an intentional disregard of the financial interests of the insured in the hope of escaping the full responsibility imposed by the policy provisions. This definition has, at times, been so liberally construed that the insurer has been held liable for the amount of the judgment in excess of the policy limit even though he has not intentionally disregarded the insured's interest. However, in contrast to the negligence theory, the "bad faith" rule ap-

( insurer considered agent of insured and held liable ); Atteboro Mfg. Co. v. Frankfort Marine Acc. & Plate Glass Ins. Co., 240 F. 573 (1st Cir. 1917) (insurer considered independent contractor and held liable).

11 See generally Radcliffe v. Franklin Nat'l Ins. Co., 208 Ore. 1, 298 P.2d 1102 (1956), where the court reviewed many cases involving the bad faith and negligence tests.

12 Cunningham, supra note 4.


14 See Cunningham, supra note 4.


16 Potomac Ins. Co. v. Wilkins Co., 376 F.2d 425 (10th Cir. 1967). Also important is the fact that acting in bad faith and perpetrating a fraud are not equivalent. Rather, what is emphasized is the failure of the insurer to meet its contractual obligation to safeguard the insured's interest. Cernockey v. Indem. Ins. Co., 69 Ill. App. 2d 196, 216 N.E.2d 198 (1966).
pears to be more favorable to the insurer, in that conduct imposing liability on the insurer for negligence will not necessarily impose liability for "bad faith." 18

Although the "bad faith" theory predominates in most jurisdictions, it is nevertheless important not to overlook the negligence concept both because of its application in certain minority jurisdictions and, even where the courts apply what is termed the "bad faith" test, the issue of negligence plays an important role in determining liability.19

It would also appear that a primary consideration in determining whether the insurer has acted negligently or in "bad faith" is whether the insurer would have accepted a compromise offer if an unlimited liability policy had been issued.20 As stated in Kuzmanich v. United Fire & Casualty Co., "in determining whether to settle claims against the insured, the insurer must act as if it were liable for the entire judgment that might eventually be entered against the insured." 21

The "Bad Faith" Rule

Because most jurisdictions predicate liability upon the "bad faith" acts of the insurer, it is necessary to analyze and determine what specific acts constitute "bad faith." Generally speaking, as long as the insurer acts in a reasonable manner, with an intelligent knowledge of the law and facts governing the particular situation he is not liable for the excess amount of a subsequent judgment against the insured.22 However, at times, the insurer has been held liable under the "bad faith" test under circumstances where its conduct could not be easily characterized as unreasonable. Thus, in Potomac Insurance Co. v. Wilkins Co.,23 the insurer was held liable for the amount of an excess judgment even though the court found that he had made a diligent investigation of the accident and had concluded that the company was free from negligence. With an apparent emphasis on the insurer's duty to the insured, the court stated:

23 376 F.2d 425 (10th Cir. 1967).
But certainly the defendant and its counsel realized that there was always the chance that their judgment and opinion would be wrong, and that this case could result in a verdict, and if they did, they certainly were advised of the probabilities that there would be a very substantial excess judgment.\(^{24}\)

While there are no definitive standards for determining "bad faith" with each case depending to a great extent upon its own facts, certain factors appear fairly universal and, thus, provide a reasonable guide in determining what is meant by "bad faith."\(^{25}\) The factors which contribute to a finding of "bad faith" may be categorized as follows:

(1) failure of the insurer to give a "qualified" consideration to the settlement offer made by the injured party; (2) failure to properly consider the fact that the insurance contract is for the benefit of the insured; (3) active or passive acts by the insurer evidencing what may be considered as acute negligence or wilful and wanton conduct; (4) failure of the insurer to act reasonably in light of past policy decisions.

Failure of Insurer to Give a "Qualified" Consideration to the Settlement Offer Made by the Injured Party

An insurer gives "qualified" consideration to a settlement demand when its decision is based upon adequate knowledge of the facts and law. Therefore, if the insurer fails properly to investigate and prepare for the case, it cannot claim to have acted in a "qualified" manner in refusing to settle.\(^{26}\) In *American Mutual Liability Insurance Co. v. Cooper*,\(^{27}\) the insurer's liability for the amount of the judgment in excess of the policy coverage was predicated upon the insurer's failure to investigate. The insurer had failed to interview witnesses, had ignored counsel's recommendation to settle, and had neglected to make any effort to determine the creditability of the alleged claim against the insured. As such, the court stated that the insurer was not in a position to act intelligently, or in fairness to the insured, when it rejected the compromise offer. Moreover, if the insurer refuses to adhere to its attorney's advice or its adjuster's assessment of liability when the facts demand such adherence, its "qualified" position may be

\(^{24}\) Id. at 427.

\(^{25}\) See Jessen v. O'Daniel, 210 F. Supp. 317, 326-27 (D. Mont. 1962), where it is stated that although bad faith is to be judged on a case-by-case method, there are certain factors fairly common to many bad faith claims.


\(^{27}\) 61 F.2d 446 (5th Cir. 1932).
in doubt. Furthermore, when the extent of injuries to the claimant are such that their seriousness establishes the possibility of a judgment in excess of policy coverage, the insurer cannot be held to have acted in a "qualified" manner if, in refusing settlement, it fails to have knowledge of such extensive injuries.

Failure to Properly Consider the Fact that the Insurance Contract is for the Benefit of the Insured

When the insurer refuses to inform the insured of the facts of the case so that the insured might take affirmative steps for his own protection, "bad faith" may be evidenced. And, likewise, "bad faith" may be predicated upon the failure of the insurer to notify the insured of a compromise demand. Thus, in *Brown v. Guarantee Insurance Co.*, it was stated that it is the insurer's duty to inform the insured of such a demand.

In addition, when the insurer is presented with an opportunity to settle after a judgment has been rendered in excess of the policy limits against the insured, a refusal to accept the compromise demand may be evidence of "bad faith." *Olympic Fields Country Club v. Bankers Indemnity Insurance Co.*, indicates that an insurer's unreasonable refusal to settle both before and after judgment is rendered against the insured, contrary to the advice of its own attorney, will render an insurer liable for a judgment in excess of the policy coverage on the grounds of "bad faith."

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30 Roberts v. American Fire & Cas. Co., 89 F. Supp. 827 (M.D. Tenn. 1950). *See also* Henke v. Iowa Home Mut. Cas. Co., 250 Iowa 1123, 97 N.W.2d 168 (1959), where it is stated that an insurance company cannot refuse to settle within the policy limits if it has less than a fifty-fifty chance of winning and the verdict will, without a doubt, exceed the policy limit.


33 See Roberts v. American Fire & Cas. Co., 89 F. Supp. 827 (M.D. Tenn. 1950), aff'd, 186 F.2d 921 (6th Cir. 1951); *Olympia Fields Country Club v. Bankers Indem. Ins. Co.*, 325 Ill. App. 649, 60 N.E.2d 896 (1945) (dictum). It should be recognized, however, that bad faith is not inferred merely because the settlement offer followed judgment, since the insurer may have a meritorious appeal. *Hazelrigg v. American Fid. & Cas. Co.*, 228 F.2d 953 (10th Cir. 1955), aff'd on rehearing, 241 F.2d 871 (10th Cir. 1957).

34 325 Ill. App. 649, 60 N.E.2d 896 (1945).
Finally, where the court finds that the insurer has been in essence "gambling" with the insured's money, "bad faith" may be found.\textsuperscript{35} The concept of "gambling" in such cases is based upon the comparative financial risks involved. Thus, where the insurer stands to lose very little and the insured stands to become deeply indebted by the insurer's choice of litigating rather than settling for an amount within the policy limit, the insurer may be guilty of "gambling" since, as a practical matter, all it stands to lose if a judgment is rendered in excess of the policy limits is the insured's money.\textsuperscript{36}

Active or Passive Acts by the Insurer Evincing What May be Considered Acute Negligence or Wilful and Wanton Conduct

In this category fall acts both of the insurer and his agents. For example, the failure of the company's adjusters to inform the insurer that a large adverse verdict is expected has been considered to constitute "bad faith" on agency principles.\textsuperscript{37} Also, the undue delay of the insurer in effecting settlement,\textsuperscript{38} as well as the insurer's failure to adequately authorize its agents or, at times, the insured to settle,\textsuperscript{39} have been considered as evidence tending to establish "bad faith." Thus, in Vanderbilt University v. Hartford Accident & Indemnity Co.,\textsuperscript{40} when the insurer realized from the facts that a large judgment in excess of the policy limits was probable and made no attempt over a long period of time to effect a settlement after repeated demands by the injured party, such undue delay constituted "bad faith." In Noshey v. American Automobile Insurance Co.,\textsuperscript{41} the insurer, admitting possible liability, was held liable for failing to carry out an oral agreement to authorize the insured to compromise the claim where the insurance policy prohibited such settlement without written authorization from the insurer.

In addition, courts have stated that the failure of the insurer to settle because of the insured's refusal to contribute to the settle-
ment offer may constitute "bad faith." For example, in Lamferman v. Maryland Casualty Co., where there was a reasonable belief by the insurer that a judgment would be rendered in excess of the insured's policy coverage, the insistence that the insured contribute toward the amount demanded as a condition to settlement constituted action which warranted a finding of insurer "bad faith."

Furthermore, when the insurer disregarded the interests of its policy holder because of the insured's race, religion or nationality, such prejudice was indicative of "bad faith." And, evidence that the insurer had told the insured to transfer his property in order to avoid excess liability has also been considered to establish insurer liability for the amount of the judgment in excess of policy coverage.

Failure of the Insurer to Act Reasonably in Light of Past Policy Decisions

Although, due to the necessity of adhering to the particular factual pattern of each case, past actions are anything but controlling, they are, nonetheless, a contributing factor in determining whether one has acted in "bad faith." Therefore, when the insurer has an established policy of settling claims, this should have some weight in determining liability for refusal to settle. Also, the fact that the insurer has or has not been subject to liability in the past for refusing to settle should give some indication as to its good or bad faith. Thus, in Berk v. Milwaukee Automobile Insurance Co., the court rejected the insured's contention that the insurer's attorneys and adjusters had acted in "bad faith" for failing to conclude that the insured was negligent. Recognizing that the insurer's investigators and attorneys were men of wide experience and recognized ability who had handled thousands of lawsuits and that never before had a single charge of "bad faith" been made against the insurance company, the court considered it to be both reasonable and natural for the insurer to rely, in this instance, upon the judgment of its attorneys and adjusters.

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43 222 Wis. 406, 267 N.W. 300 (1936). In respect to this, however, a 1957 Kentucky case has implied that such action by the insurer, in the absence of other factors constituting bad faith, may not be fatal to the insurer's defense. American Sur. Co. v. Schneider & Son, 307 S.W.2d 192 (Ky. Ct. App. 1957).
47 245 Wis. 597, 15 N.W.2d 834 (1944).
New York’s Rule Establishing “Bad Faith”

Under early New York cases, the insurer was afforded almost absolute discretion in deciding whether to settle claims so that even a reckless refusal to compromise, short of fraud, was not actionable.\(^4\) Apparently, the first erosion of the virtual immunity afforded insurance companies with respect to their conduct in handling claims against their policy holders occurred in Brassil v. Maryland Casualty Co.\(^4\) There, the insured had successfully prosecuted an appeal from an adverse judgment after the insurer had refused to do so. In a suit by the insured for the expenses of the appeal, the Court found that, under the circumstances where the insurer had first defended the insured and after an adverse judgment had refused to pursue a meritorious appeal, it had failed to carry out its contractual obligations in good faith.

Also, in Schencke Piano Co. v. Philadelphia Casualty Co.,\(^5\) the Court of Appeals apparently adhered to the concept of good faith. Subsequent to an adverse judgment against the insured, the company, over the insured’s protests, had initiated an appeal which was ultimately successful in that a new trial was granted. Upon the second trial, the injured party recovered a judgment in excess of the policy coverage. The Court, allowing the insured to recover only costs of the trial, directed a verdict for the insurer, holding that, in the absence of proper allegations of fraud or bad faith, the insurer could not be held liable for any excess judgment.

Despite this requirement of good faith, McAlleenan v. Massachusetts Bonding & Insurance Co.\(^5\) indicated that New York law still afforded the insurer complete discretion in deciding whether to compromise claims against its insured. The insured and the injured party had reached an agreement whereby the injured party would accept $3,750 in consideration of reducing any verdict against the insured to the $5,000 policy limit. Although the insured was willing to pay the settlement himself and the insurer would thus not have had its liability increased, the insurer refused to acquiesce, warning that it would consider the insurance


\(^5\) 210 N.Y. 235, 104 N.E. 622 (1914).
contract breached if the insured went through with the compromise. In an action by the insured for the judgment in excess of the policy coverage, it was held that since, under the insurance contract, the insured had foregone all rights to settle the claim, the refusal of the insurer to allow the compromise, even where no risk of increased liability to the insurer was present, was not actionable.

In addition, the views presented by Levin v. New England Casualty Co. and Brunswick Realty Co. v. Frankfurt Insurance Co. illustrate the confusion that existed as to when liability should be imposed under the insurance contract. In Brunswick, the insured alleged that the defendant refused to carry out its implied obligation of good faith by refusing, when an excess judgment was apparent, to accept a compromise offer. The court, realizing the absolute control of the insurer in effecting a settlement offer, held that the complaint sufficiently alleged facts upon which a finding of “bad faith” could be predicated. Relying on Brassil, the court stated:

While the defendant has the right to consult what it deemed to be its own interest in making a settlement, it could not abuse the power vested in it and recklessly and contumaciously refuse to settle if it was apparent that in all reasonable probability its conduct must not only result in damage to the [insured], but also in loss to itself.

In Levin, the insurer, after several unsuccessful attempts to effect a settlement, was finally extended a compromise demand. Although the policy coverage was $5,000, the insurer refused to pay more than $2,400 of the $3,150 demand. The insured, upon payment of the difference, sought reimbursement from the insurer on the ground that he was coerced into paying because of fear of a judgment greatly in excess of the policy limit. The court reversed a lower court determination in favor of the insured and directed a dismissal of the insured’s complaint. Rejecting the claim of coercion, the court held the defendant-insurer had been under no duty to settle. Making no mention of the Brassil case, the court implied that only when the insurer litigates the issue of the insured’s liability may his absolute discretionary power be questioned under the “bad faith” rule. Thus, although the insurance contract was ineffectual in protecting the insured’s interests, absent fraud or coercion, the insured had no cause of

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53 99 Misc. 639, 166 N.Y.S. 36 (Sup. Ct. 1917).
54 Id. at 642, 166 N.Y.S. at 38.
action against the insurer if both parties had accepted and paid the settlement demand.

Furthermore, in *Auerbach v. Maryland Casualty Co.*, the insurer had conditioned its acceptance of a settlement agreement which exceeded the policy limit by $1,500 upon the contribution to the compromise of $3,000 by the insured. The insured refused and a judgment far in excess of the insurance coverage was rendered against him. In a suit by the insured for the judgment in excess of the policy coverage, the New York Court of Appeals held that the complaint failed to state a cause of action since the insurance company was within its rights in refusing to settle and, in the absence of allegations of negligence, fraud or misrepresentation on the part of the insurer, the insured could not recover. The Court stated that the *McAlleenan* case was indistinguishable while it failed to mention the *Brassil* case.

It was in *Best Building Co. v. Employers Liability Assurance Corp.* that the New York Court of Appeals finally decided what is today the New York rule governing insurer liability for failure to settle within the insured's policy limits. There, the insurer refused to accept a settlement demand of $3,500, offering only $6,500 while the policy coverage was $10,000. The insured, alleging negligence in that he was never given notice of the offer, stated that had he known of the possibility of compromise, he would have readily paid the $2,000 difference. Reaffirming the position in *Auerbach* that the insurer is not under an absolute duty to negotiate settlement, the Court rejected the contention that liability could be imposed for the insurer's negligent conduct. Negligence, the Court stated, is a term difficult to define when related to the insurance contract. Thus, the insurance company should not have "to determine at its peril whether reasonable-minded men would believe the plaintiff's witnesses in preference to its own. . . ." 

While rejecting negligence as a basis for liability, the Court approved the earlier cases holding the insurer liable for fraud or "bad faith." Although not necessary for its decision, the Court

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55 236 N.Y. 247, 140 N.E. 577 (1923).
56 It is important to note that although *Auerbach* referred to possible liability for negligent failure to settle within the policy limits, the point was not settled. Moreover, an opposing view was apparently expressed earlier in *Schencke* where, although the complaint alleged negligence, the Court of Appeals affirmed a judgment for the insured for partial costs only, stating that the complaint was insufficient because of failure to allege fraud or "bad faith." *Schencke Piano Co. v. Philadelphia Cas. Co.*, 216 N.Y. 662, 110 N.E. 1049 (1915). For the facts of *Schencke*, see *Streat Coal Co. v. Frankfort Gen. Ins. Co.*, 237 N.Y. 60, 142 N.E. 352 (1923).
58 Id. at 455, 160 N.E. at 912.
reiterated the Brassil principle that there is an implied obligation in the insurance contract by which the duty to exercise good faith in deciding whether to settle a claim against its insured is imposed upon the insurer.

Applicability of the New York “Bad Faith” Rule

The “bad faith” rule expressed in Best is now well recognized as the law in New York. This may be illustrated by reference to two federal cases applying New York law.

In Harris v. Standard Accident Insurance Co., the injured party brought an action against the insured who had $10,000 insurance coverage and his joint-tortfeasor who had only a $5,000 policy. Upon failure of the insurer to accept a compromise demand unless the insured contributed the amount requested over and above the coverage afforded his joint-tortfeasor, a verdict was rendered for $105,000 against the co-defendants. The district court, in allowing the insured to recover the full amount of the unpaid judgment, premised its decision upon the Best rule and found that defendants’ refusal to settle was in “bad faith.” The court stated that “bad faith” was evidenced upon the facts before it since “bad faith” is most readily inferable when the severity of the plaintiff’s injuries is such that any verdict against the insured is likely to be greatly in excess of the policy limits, and further when the facts [as in the case at bar] indicate that the defendant’s verdict on the issue of liability is doubtful.

In addition, the fact that the co-defendants’ insurance company had been willing to contribute the full amount of its coverage to a settlement offer appeared to further justify the decision that the insurer had acted in “bad faith.”

In Brown v. United States Fidelity & Guaranty Co., the co-defendants were holders of an insurance policy affording coverage of $10,000 for each person injured and a $20,000 total for each accident. After settlement with two of the four injured persons, the remaining claimants commenced an action against the insured and secured judgments totaling $45,000. The insured, seeking reimbursement, alleged that the insurance company failed to negotiate the settlement overtures in good faith. Holding the evidence of “bad faith” sufficient to warrant a jury investigation, the court stated that in “the absence of a clear, recent pronounce-

60 Id. at 540.
61 314 F.2d 675 (2d Cir. 1963).
ment on the subject, we are convinced that the good-faith settlement standard controls in New York. . . . [T]he opinion of the highest state tribunal in the Best Building Co. case comports with the modern trend of the law." 62 Thus, failure to consider the insured's interest as well as its own when making decisions as to settlement, failure to properly investigate the circumstances of the accident to ascertain the evidence against the insured, and recurrent negligence on the part of the carrier, were all considered by the court as factors which could lead to a conclusion of insurer "bad faith." 63

**Evaluation of the "Bad Faith" Rule**

It is necessary to reemphasize that no one of the factors which contribute to a showing of "bad faith" on the part of the insurer in refusing to settle a claim against the insured is to be considered controlling in determining the insurer's liability. Not only does the law vary from jurisdiction to jurisdiction but, in addition, within a single jurisdiction, the conclusion reached in any case will vary with the presence or absence of the several factors indicating a lack of good faith on the part of the insurer.64

In New York, the sui generis nature of the determinations is unquestionable. Not only is the Best case the last Court of Appeals decision to have ruled on the "bad faith" issue but even on the appellate division level there seems to be reluctance to deal with the matter. Thus, in Chili Avenue Garage v. Empire Mutual Insurance Co.,65 the appellate division reaffirmed the lower court's order dismissing the insured's complaint without stating an opinion concerning the allegation of "bad faith" made by the insured.

One of the reasons why the "bad faith" test was employed was to avoid the problem arising under the negligence test of determining whether the insurer has, in refusing to compromise, made a reasonable business decision under the circumstances. How-

62 Id. at 678.

63 Id. at 680. The most recent New York case concerned with the good faith issue is Cappano v. Phoenix Assurance Co., 28 App. Div. 2d 639, 280 N.Y.S.2d 695 (4th Dep't 1967), where the court held that the trial court had erred in defining good faith settlement standards by charging as elements: a sinister motive; guilty knowledge; and the deliberate doing of something the actor knew to be wrong.

64 See, e.g., Aetna Cas. & Sur. Co. v. Price, 206 Va. 749, 146 S.E.2d 220 (1966), where, although the insurer had refused to accept both compromise offers and counsel's recommendation to settle, the court held such action to be in good faith since the insurer's proper investigation substantiated his belief that the insured was not negligent.

ever, experience has shown that it is just as difficult for the jury to decide whether a refusal to settle was in "bad faith" by reference to vague notions of "good faith" or "reasonableness." 66

Given that the "bad faith" test presents serious obstacles to a reasoned determination of insurer liability, is it possible to resolve this problem within the contractual relationship of the parties? At the outset, it seems clear that attempts by the insurer to contractually limit its liability for "bad faith" refusal to compromise would violate public policy. 67 Also, it would be of no avail for the parties to attempt to eliminate the problem by having the insurance company obtain the insured's consent before rejecting any proposed compromise agreement. The impracticability of this proposal is evidenced by the fact that the insured could only lose by consenting, since this would eliminate any possibility of pursuing the insurer on a theory of "bad faith" refusal to settle. Thus, the wise insured would consistently refuse to approve of the insurer's position. 68 In addition, the type of contractual solution found in Georgia Life Insurance Co. v. Mississippi Central Ry. 69 may be eliminated. There, the insurance contract provided that if the insurer elected to defend rather than settle within the policy limits, the amount of coverage afforded the insured would be doubled. The insured in that case was a large railroad company which, because of its size and wealth, enjoyed an equal bargaining position with the insurer. In contrast, the insured in most cases, because of his limited resources, is in no position to bargain with the insurer for such liberal coverage. 70

Because of the failure of these alternatives to adequately cope with the problem of the insurer's liability, the question then becomes whether there are any alternatives to the "bad faith" rule which will present an effective and equitable means by which the insured's and insurer's interests may be balanced. Having eliminated the likelihood of amendment of the insurance contract by insurer-insured agreement, the discussion inevitably turns toward a legislative solution. Should the insurer, in certain circumstances, be held strictly liable for the excess amount over the policy limit if it refuses to settle? It is proposed that this question be answered affirmatively.

67 See American Fid. & Cas. Co. v. G. A. Nichols Co., 173 F.2d 830 (10th Cir. 1949).
69 116 Miss. 114, 76 So. 646 (1917).
70 See Note, supra note 66 at 109-10 (1945).
In 1950, a bill which would have imposed strict liability on the insurer was introduced before the New York State Legislature. It stated:

In any case where the insurer refuses or neglects to accept a bona fide offer to settle the claim of an injured person or any other person against the insured or his personal representative within the amount of the applicable limit of the coverage under any such policy or contract, then the insurer shall be liable for the full amount of any subsequent settlement or judgment obtained upon such claim.\textsuperscript{71}

The bill died in committee in both houses. It is possible that, aside from adhering to the "bad faith" rule, insurance-oriented legislators might have felt that if the insured desires more protection, he should obtain greater policy coverage.\textsuperscript{72}

The refusal of the New York State Legislature to adopt strict liability standards should not, however, negate the possibility of such adoption nor should it render one incapable of visualizing the advantages, at times, inherent in a strict liability approach. It is obvious that the insured (when insurance is not compulsory) obtains coverage in order to be protected against the larger accident claims. The small claim is of very little significance to him since its amount is usually equal to, if not less than, the amount of premiums that the insured pays. Thus, when potential liability is great, the insured's reason for having the coverage must be kept in mind as must be the fact that the insurance contract is basically for the insured's benefit. Since, under the insurance contract, the insured has relinquished complete control in the handling of claims against him to the insurer, if any money should be risked, it should be the company's. Indeed, the fact that the insurer may have been found to have acted in good faith will offer small consolation to the newly-indebted insured.

With a realization of the potential harm to the insured, the Supreme Court of California, in \textit{Crisci v. Security Insurance Co.},\textsuperscript{73} has handed down what appears to be a landmark decision on the issue of insurer liability. The reasoning of the court tends to illustrate that statutory and case law requiring that the insurer be strictly liable, at times, for failing to settle, may not be too far


\textsuperscript{72} That obtaining greater insurance protection would alleviate the problem is questionable. No matter what coverage is afforded, the insurer may still refuse to settle. To illustrate, what difference does it make if the insured is covered for $10,000 or $20,000 if the suit is for $30,000 and the insurer fails to settle for $8,000? In either event there may be excess liability.

\textsuperscript{73} 426 P.2d 173, 58 Cal. Rptr. 13 (1967).}
away. Although the insurer had acted unreasonably, and it was not necessary to impose strict liability, there was dictum to the effect that the insurer may be held strictly responsible for the amount of a judgment in excess of the policy limits if it refuses to settle. According to the court, such a rule would not only avoid litigation wherever a settlement was possible but would also eliminate the insurer's "gambling" with the insured's money. In addition, it was stated that whenever there appeared to be an insurer-insured conflict, the insurer who will reap the benefits of the determination not to settle should also bear the burdens of its decision. Finally, on the facts before it, the court, in addition to expressing the strict liability position, held the insurance company liable for the mental suffering of the insured caused by the insurer's refusal to settle.

Conclusion

It is apparent that whether the insurer is liable for the amount of a judgment in excess of the policy limits because it has acted in "bad faith" is, oftentimes, extremely difficult to determine. Unless the insurer has acted in a manner which evidences a total disregard of the insured's interest, liability is dependent upon whether the insurer has acted reasonably in the practice of its business.

The strict liability approach attempts to avoid jury determination of this issue. However, strict liability, when applied to all insurer-insured situations, also has its shortcomings. Indeed, although the insurance contract is primarily for the protection of the insured, the insurer also derives financial benefit. As such, it would be inequitable to handicap the insurance business by making the insurer liable when it honestly and reasonably believes that it has acted in the best interests of the insured. Even in Crisci, there is evidence that the insurer's liability should not be absolute. The dictum of the court in that case indicates that strict liability would only be imposed in certain situations, viz., when insurers, pursuing a calculus of self-interest, abandon their policyholders to the improvidence of chance.

When, therefore, should strict liability be imposed on the insurer? It is submitted that there are two instances upon which the insurer should be strictly liable if it refuses to settle within the policy limits: (1) when the pre-trial judge recommends that the insurer settle for the amount proposed by the injured party, and (2) when the insurer, instead of settling after an adverse judgment, elects to appeal on some issue; procedural or otherwise, not bearing upon the insured's liability to the injured party.

In jurisdictions such as New York where a pre-trial examination is conducted prior to actual trial, the pre-trial judge should
be given authority to determine whether the insurer should accept a compromise offer. And, in jurisdictions where pre-trial examinations are not available, some type of hearing could be conducted whereby selected and highly-qualified individuals would similarly judge the merits of the insurer's defense. In making this determination, the questions of proper investigation by the insurer and comparative financial risks should be carefully considered. Under such a system, whenever the designated party concludes that the insurer should compromise the claim rather than litigate and the injured party is willing to accept an amount within the policy limit, a refusal by the insurer to heed the recommendation should render it strictly liable for any excess amount of a subsequent judgment rendered against the insured.

If liability to the injured party has already been established after a trial on the merits, and there are no substantial questions as to the insured's liability which may provide the basis of an appeal, the insurer should not be allowed with impunity to seek reversal of the judgment on a collateral issue which does not bear directly on liability when the injured party is willing to negotiate a settlement offer within the policy limit. Where the insurer knows that the finder of fact has already decided against him on the question of the insured's liability, it should not be able to gamble the insured's money by seeking reversal on a technicality in the hope that a subsequent trial on the issue of liability will reach a different conclusion.

These proposals will limit the application of the "bad faith" rule to litigation on the undetermined question of liability for which the insurer has obtained official approval. Also limited would be the confusion inherent in the "bad faith" rule, i.e., whether the insurer reasonably considered the interests of the insured when it failed to accept a settlement offer.

ATTORNEY'S WORK-PRODUCT PRIVILEGE IN THE FEDERAL COURTS

The "sporting theory of justice," which long prevailed in our judicial system, has been rejected in the Federal Rules of Civil Procedure relating to discovery.1 The purpose of the rules is to assure a correct and speedy result on the merits. Discovery facilitates this end in that it tends to narrow the issues; to leave for trial only those issues actually contested; to insure that all relevant evidence will be adduced at the trial; to expose fraudulent and groundless claims; and to serve as a basis for pretrial settle-