INSURANCE—INSURER LIABLE FOR EXCESS JUDGMENT UPON FAILURE TO ACCEPT REASONABLE SETTLEMENT DEMAND IN GOOD FAITH; MERITS OF ABSOLUTE LIABILITY GIVEN FAVORABLE CONSIDERATION. *Crisci v. Security Insurance Co.* (Cal. 1967).

Defendant, Security Insurance Company, issued a general liability insurance policy to plaintiff Mrs. Crisci, owner of an apartment building. Under the terms of the policy, Security was obligated to defend actions against Mrs. Crisci and authorized to make suitable settlement up to the $10,000 limit of the policy. A tenant in Mrs. Crisci's apartment building fell through an opening in a staircase and dangled fifteen feet above the ground. She suffered physical injuries and developed a severe psychosis. The tenant sued Mrs. Crisci, alleging negligence in inspecting and maintaining the stairs.

Security, undertaking the defense of the action, hired an experienced attorney. The attorney and the claims manager of the insurance company believed that if the jury did find that the psychosis had been triggered by the accident, a verdict of at least $100,000 would result. The injured party found psychiatrists who would testify that the accident had caused her mental illness, while Security relied on psychiatrists at the treating hospital who felt that the psychosis was not related to the accident. All the psychiatrists who agreed to testify conceded, however, that a sudden fear of falling to one's death could precipitate a psychosis. Security apparently felt that the psychiatrists, who planned to testify for the plaintiff, would not be believed, since they refused to accept any demand of settlement on the mental illness issue. Although the insured had offered to contribute $2,500, Security rejected demands of $10,000 and $9,000, offering only $3,000 for the physical injuries.

The suit resulted in a judgment of $100,000 for the tenant and $1,000 for the tenant's husband.[1] Security paid $10,000, the limits of the policy, and Mrs. Crisci was obligated to pay the balance. Mrs. Crisci and the tenants arranged a settlement of $22,000, an interest in real property, and an assignment of Mrs. Crisci's interest in the cause of action against Security.[2] Mrs. Crisci was left an indigent

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

2 The assignment made by Mrs. Crisci was not an assignment of her cause of action but of all her right, title and interest in the money collectible under the judgment. Letter from Marvin E. Lewis, attorney for the plaintiff, to the *San Diego Law Review*,

seventy-year-old widow, suffering a decline in physical and mental health and making several suicide attempts.[3]

Mrs. Crisci brought this action against Security, alleging breach of the implied covenant of good faith in refusing to settle. Finding for the plaintiff the trial court awarded $91,000, the difference between the policy limits and the earlier judgment, and $25,000 for Mrs. Crisci's mental suffering.[4] The decision was upheld by the District Court of Appeal and the insurance company appealed to the California Supreme Court, *held*, affirmed: By failing to accept a settlement demand which was reasonable, the insurance company breached its duty to act in good faith. *Crisci v. Security Ins. Co.*, 66 Adv. Cal. 435, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

The usual provision in a liability insurance contract obligates the insurance company to defend any actions brought against the insured and provides that the insurance company may make any settlement which it deems expedient.[5] The duty to defend is expressed in the terms of the contract while the duty to settle is implied.[6] This implied

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Nov. 13, 1967. *See also* Brown v. Guar. Ins. Co., 155 Cal. App. 2d 679, 693-95, 319 P.2d 69, 78-79 (1957) (discusses assignment of cause of action of this nature to trustee in bankruptcy); Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 661, 328 P.2d 198, 202 (1958) (cause of action assignable whether considered as tort or contract action).

3 Mrs. Crisci died several days after receiving the award of damages. Letter from Marvin E. Lewis, attorney for the plaintiff, to the *San Diego Law Review*, Nov. 13, 1967.

4 The issue of damages for Mrs. Crisci's mental suffering was also considered by the court. Since the breach of contract also constituted a tort the court relied on the fundamental principle that a wrongdoer should compensate an injured party for all damage of which he is the proximate cause. The court found that peace of mind is a factor considered in purchasing liability insurance. Therefore, damages for mental distress proximately caused by a wrongful refusal to settle are not improper. Crisci v. Security Ins. Co., 66 Adv. Cal. 435, 443, 426 P.2d 173, 178, 58 Cal. Rptr. 13, 19 (1967).

5 Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1137 & n.1 (1954). The typical insurance policy contains a provision as follows:

> As respects the insurance afforded by the other terms of this policy . . . the company shall:
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> (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 . . . .

6 *E.g.*, Davy v. Pub. Nat'l Ins. Co., 181 Cal. App. 2d 387, 394, 5 Cal. Rptr. 488, 491-92 (1960).

> If not expressed, the obligation to exercise good faith is implied in every such contract. Where an offer of settlement is the subject under consideration, the obligation so imposed on the insurer is to exercise good faith in considering the interest of the insured in settlement. As a consequence, an insurer guilty of bad faith in refusing to settle a claim within policy limits breaches its contract and is liable for the entire amount of a judgment recovered against its insured, including any portion in excess of policy limits.

obligation to settle is derived from the insurer's control over the litigation and settlement procedure.[7] The obligation is usually held to arise from the relationship created by the contract rather than from any express terms of the contract itself. The action for failure to settle is, therefore, usually in tort.[8] The plaintiff, however, does have an election between theories of recovery, since the action is said to sound in both tort and contract.[9]

Most jurisdictions find an obligation to settle; however, there exists a split of authority concerning the theory upon which liability is imposed for failure to settle. The majority of courts[10] reason that the insurer should be held to a standard of good faith, thus imposing liability only upon a showing of bad faith[11] in the settlement negotiations. As the relationship is said to be similar to that of principal and agent, or beneficiary and trustee, most courts have based liability on bad faith rather than negligence.[12] There exist, however, variations as to what constitutes bad faith encompassing fraud, intentional disregard of the financial interests of the insured, and something considerably less than intentional disregard of the insured's interests.[13] Another view, held in a minority of jurisdictions, is that liability for a judgment, which is rendered in excess of the limits of the policy, should be imposed where the insurer has acted negligently.[14] Under

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7 *E.g.*, Brown v. Guar. Ins. Co., 155 Cal. App. 2d at 684, 319 P.2d at 72.

8 Keeton, *supra* note 4, at 1138-39 & n.5.

9 Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d at 663, 328 P.2d at 203.

10 *See generally* Brown v. U.S. Fidelity & Guar. Co., 314 F.2d 675 (2d Cir. 1963) (good faith standard controls in New York); Royal Transit, Inc. v. Cent. Surety & Ins. Corp., 168 F.2d 345 (7th Cir. 1948) (under Wisconsin law insurer held to standard of good faith); Murach v. Massachusetts Bonding & Ins. Co., 339 Mass. 184, 158 N.E.2d 338 (1959); Annot., 40 A.L.R.2d 168 (1955).

11 Slater v. Motorists Mut. Ins. Co., 174 Ohio St. 148, 149, 21 Ohio Op. 2d 420, 421, 187 N.E.2d 45, 46 (1962). "A lack of good faith is the equivalent of bad faith, and bad faith, although not susceptible of concrete definition, embraces more than bad judgment or negligence."

12 *E.g.*, Brown v. Guar. Ins. Co., 155 Cal. App. 2d at 687, 319 P.2d at 74.

13 *See* Detenber v. Am. Universal Ins. Co., 372 F.2d 50, 52-53 (6th Cir. 1967) (bad faith implies conscious doing of wrong); Davy v. Pub. Nat'l Ins. Co., 181 Cal. App. 2d at 396, 5 Cal. Rptr. at 492-93 (dishonesty, fraud and concealment are implied in term bad faith; good faith implies honesty, fair dealing and full revelation); Cernocky v. Indem. Ins. Co., 69 Ill. App. 2d 196, 203-08, 216 N.E.2d 198, 203-05 (1966) (fraud standard is not required to show bad faith); Cappano v. Phoenix Assurance Co., 28 App. Div. 2d 639, 640, 280 N.Y.S.2d 695, 697 (1967) (memorandum decision) (charge which defined bad faith as involving intent to harm or deprive one of his rights and property or intent to injure by a willful refusal to perform an obligation was prejudicial to insured and negated good faith standard); Hilker v. W. Auto. Ins. Co., 204 Wis. 1, 231 N.W. 257 (1930), *aff'd on rehearing*, 204 Wis. 12, 235 N.W. 413 (1931) (bad faith requires less than intentional disregard of the interests of the insured).

14 *See generally* Fidelity & Cas. Co. v. Robb, 267 F.2d 473 (5th Cir. 1959);

the negligence standard, the obligation is not met "when [the insurer] fails to exercise that degree of care an ordinary prudent person would exercise in the management of his own business."[15]

Inherent in both standards is the determination by the courts that equal consideration must be given by the insurer to its own interests and those of the insured.[16] When the demand is near the limits of the policy, the insurer, rather than reaching a settlement, would prefer to try the case in hopes of escaping all payment. On the other hand, the policy holder prefers that the insurer accept the settlement demand, so that he will not be exposed to a judgment in excess of his coverage.[17] It is the insurance company's conduct, at the time of this conflict, that is to be judged by either the negligence or good faith standard. If the interests of one party were to be deemed paramount, the use of either standard would in practice be meaningless. The interests of the insured dictate settlement and, if these interests were primary, the insurer would settle or be liable for failure to do so. If the interests of the insurer were given paramount consideration, it would have no legal duty to settle.[18]

The good faith and negligence standards may seem workable in the abstract but, when applied to an individual fact situation, difficulties are encountered. The presence of bad faith or negligence is a question of fact;[19] therefore, the acts for which liability will be imposed vary from case to case. For example, a California court, in *Brown v. Guarantee Ins. Co.*,[20] offered a multitude of factors to be considered in determining whether there had been a breach of the obligation to exercise good faith:

Douglas v. United States Fidelity & Guar. Co., 81 N.H. 371, 127 A. 708 (1924); Murray v. Mossman, 56 Wash. 2d 909, 355 P.2d 985 (1960); Annot., 40 A.L.R.2d 168 (1955).

15 Comment, *Insurer's Liability for Judgments Exceeding Policy Limits*, 38 TEXAS L. REV. 233, 236 & n.18 (1959). Here the commentator discusses interpretations of the standard. Does it mean what a reasonable insurer would do, what a reasonable insured would do, or what an objective third party would do? Since a reasonable insurer in all likelihood would not settle while a reasonable insured would settle, the only workable standard is what a reasonable objective third party would do. An alternate test is found in Radio Taxi Ser., Inc. v. Lincoln Mut. Ins. Co., 31 N.J. 299, 312, 157 A.2d 319, 327 (1960). An insurer is liable for the excess judgment if it fails to settle when a reasonable man with unlimited exposure in the exercise of due care would have settled.

16 *See* Ivy v. Pac. Auto. Ins. Co., 156 Cal. App. 2d 652, 659, 320 P.2d 140, 146 (1958).

17 60 YALE L.J. 1037, 1038 (1951).

18 Keeton, *supra* note 4, at 1145-46.

19 Martin v. Hartford Accident & Indem. Co., 228 Cal. App. 2d 178, 182, 39 Cal. Rptr. 342, 345 (1964).

20 155 Cal. App. 2d 679, 319 P.2d 69.

> [T]he strength of the injured claimant's case on the issues of liability and damages; attempts by the insurer to induce the insured to contribute to a settlement; failure of the insurer to properly investigate the circumstances so as to ascertain the evidence against the insured; the insurer's rejection of advice of its own attorney or agent; failure of the insurer to inform the insured of a compromise offer; the amount of financial risk to which each party is exposed in the event of a refusal to settle; the fault of the insured in inducing the insurer's rejection of the compromise offer by misleading it as to the facts; and any other factors tending to establish or negate bad faith on the part of the insurer.[21]

The many and varying elements which must be considered have led several commentators to conclude that a determination of bad faith is an extremely difficult question for a jury.[22] Indeed, the courts themselves acknowledge the difficulty of applying the test of good faith, as evidenced in the following excerpt from the opinion in *Radio Taxi Service, Inc. v. Lincoln Mutual Ins. Co.*[23]

> Concededly, the administration of the good faith test is not easy for either party to the insurance contract. Many elements, both objective and subjective, enter into the fashioning of an honest decision to proceed to trial. Considerations of experience, expertise and judgment are particularly important and significant.[24]

The good faith test has been criticized as essentially one which turns on credibility.[25] The jury or judge must determine the issue primarily on the basis of testimony relating to states of mind and intent[26] rather than to the existence of objective facts. Since these are subjective elements, the issue will be decided in favor of the party whom the judge or jury believes.

The negligence test has been critized as too severe, the sentiment being that it would be unjust to hold an insurer liable for a judgment in excess of the policy limits without requiring a finding of greater culpability than mere negligence. Courts, which prefer the bad faith test to the negligence test, believe that often it may be reasonable

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21 *Id.* at 689, 319 P.2d at 75.

22 Appleman, *Duty of Liability Insurer to Compromise Litigation*, 26 Ky. L.J. 100, 111 (1938); 48 Mich. L. Rev. 95, 101 (1949); 18 Stan. L. Rev. 475, 481 (1966) (discusses arguments for and against absolute liability).

23 31 N.J. 299, 157 A.2d 319.

24 *Id.* at 305, 157 A.2d at 323.

25 18 Stan. L. Rev. 475, 481 (1966).

26 Davy v. Pub. Nat'l Ins. Co., 181 Cal. App. 2d at 397, 5 Cal. Rptr. at 493. "A determination respecting the presence or absence of good faith involves an inquiry into motive, intent and state of mind."

conduct to settle rather than chance a jury trial, even in a situation where there is little likelihood of recovery.[27]

Additionally, the use of either good faith or negligence standards involves inquiry during trial into the determination made in prior litigation. The amount of the excess judgment in the personal injury action, while not conclusive, does give rise to an inference that the amount awarded is the value of the claim.[28] In retrospect, it may appear that the failure to accept the demand within the limits of the policy was inconsistent with conduct in good faith or with due care. The impact of this reasoning upon the judge or jury, as well as the consequent practical difficulty of applying the standards, is not to be discounted.

In the case under discussion, the court found sufficient evidence to hold that Security breached its duty to act in good faith since it failed to discharge the claim in the most reasonable manner.[29] Therefore, the judgment for Mrs. Crisci was affirmed. The court applied the test used in *Comunale v. Traders & General Ins. Co.*[30]

> 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.[31]

The California courts, in applying this test, have added another dimension to the theories upon which liability is imposed for failure to settle. California is said to be one of the jurisdictions in which the good faith approach is used yet, as may be seen from the above quotation, a determination, as to what constitutes the most reasonable manner of disposing of the claim, must be made in applying this so-called good faith standard. Admittedly the distinction between bad faith and negligence is not always clear;[32] indeed, the California

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27 Brown v. Guar. Ins. Co., 155 Cal. App. 2d at 688, 319 P.2d at 74; Georgia Cas. Co. v. Mann, 242 Ky. 447, 451-52, 46 S.W.2d 777, 779-80 (1932); Best Bldg. Co. v. Employers' Liab. Assurance Corp., 247 N.Y. 451, 455-56, 160 N.E. 911, 912-13 (1928).

28 Crisci v. Security Ins. Co., 66 Adv. Cal. at 442, 426 P.2d at 177, 58 Cal. Rptr. at 17.

29 *Id.* at 442, 426 P.2d at 177-78, 58 Cal. Rptr. at 17-18. Among the facts which led to the finding of breach of duty were the decision to proceed to trial in light of the prediction of counsel and claims manager and the speculation that the testimony of only the defense psychiatrists would be believed.

30 50 Cal. 2d 654, 328 P.2d 198.

31 *Id.* at 659, 328 P.2d at 201.

32 Brown v. U.S. Fidelity & Guar. Co., 314 F.2d at 677. *See also* Gaskill v. Pre-

approach seems to have added to this lack of clarity by mixing the criteria of good faith and reasonableness.[33] The insurer must settle, if settlement is the most reasonable manner of dealing with the claim. The difficulties of applying the good faith and negligence tests are thus compounded in the approach used by California.

At the urging of *amicus curiae*, the court does discuss at some length an alternative to the good faith and negligence tests—absolute liability for failure to settle—and finds considerable merit in this approach.

> The proposed rule is a simple one to apply and avoids the burdens of a determination whether a settlement offer within the policy limits was reasonable. The proposed rule would also eliminate the danger that an insurer, faced with a settlement offer at or near the policy limits, will reject it and gamble with the insured's money to further its own interests. . . .
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> Finally, and most importantly, 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.[34]

The court found the absolute liability approach to be both simple and just, and a way to resolve the confusion and difficulty which exists in interpreting and applying the good faith and negligence approaches. This is essentially a determination that the interests of the insured are to be given paramount consideration when the interests of the parties conflict.

One might ask why the court, in view of the approval which it seemingly gives to the rule of absolute liability, did not adopt the rule. Admittedly, it is a bold step which most commentators feel should be taken by the legislature or the insurance companies themselves rather than by the courts.[35] Notice is given to those who deal in insurance that the court finds merit in a rule of absolute liability for failure to settle.

Rather than announcing a new rule, the opinion suggests and discusses changes in the law. The value of this approach is question-

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ferred Risk Mut. Ins. Co., 251 F. Supp. 66, 67-68 (D. M.D. 1966) (duty to settle includes elements of both good faith and reasonable care).

33 18 STAN. L. REV. 475, 476-77 (1966).

34 66 Adv. Cal. at 441-42, 426 P.2d at 177, 58 Cal. Rptr. at 17.

35 *See e.g.*, Keeton, *supra* note 4 at 1184; 48 MICH. L. REV. 95, 102 (1949).

able, for it leads to difficulty in understanding the law's current position.

It was not found necessary, in *Crisci*, to adopt the proposed rule because the fact situation presented enabled a decision grounded in precedent. Therefore, possible countervailing considerations to the adoption of the rule of absolute liability were not discussed. The court considered only the advantages of absolute liability, avoiding a discussion of the disadvantages. However, many of the disadvantages are found in the concepts which have been used to support the application of both the good faith and negligence standards.[36] Since these concepts have been considered in prior decisions, a reconsideration of them may not have been an essential prerequisite for the adoption of an absolute liability rule. If this be the case, the opinion could be construed to be an approval of absolute liability. On the other hand, this same failure to consider the disadvantages may be taken as evidence of the court's hesitancy to approve the new rule and of the uncertainty of its thought in the area.

If the *Crisci* court believes in the simplicity and justice of absolute liability, as it seems to, but is cautious about adopting such an untried concept, will a fact situation ever be discovered which cannot be squeezed into the good faith or negligence tradition? The definitions of the terms good faith and negligence are not independent of the fact situations in which they are found to exist. These definitions may be broadened by the courts to such an extent that absolute liability will be the fact, although the terms good faith and negligence will still be chanted.

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[36] *E.g.*, Noshey v. Am. Auto. Ins. Co., 68 F.2d 808, 810 (6th Cir. 1934) (policy contains no promise, express or implied, that the insurer will settle in any and all circumstances); Brown v. Guar. Ins. Co., 155 Cal. App. 2d at 688-89, 319 P.2d at 75 (liability should require a greater showing of culpability than mere negligence, let alone imposing absolute liability); Dumas v. Hartford Accident & Indem. Co., 94 N.H. 484, 485, 56 A.2d 57, 59 (1947) (only the obligation to use due care is imposed by law on those who undertake a service); Radcliffe v. Franklin Nat'l Ins. Co., 208 Ore. 1, 298 P.2d 1002 (1956).