Insurance: Duty of Liability Insurer to Accept Offer of Settlement within Policy Limits

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INSURANCE: DUTY OF LIABILITY INSURER TO ACCEPT OFFER OF SETTLEMENT WITHIN POLICY LIMITS

"To settle or not to settle" has been a problem confronting automobile liability insurance companies since the turn of the century. Offers directed to automobile insurers to settle lawsuits before and during trial have steadily increased in volume as a result of the rapid expansion of the automobile industry and the consequent increase in the number of automobile accidents and collisions.

There is no express provision in the standard automobile insurance policy requiring the insurer to accept an offered settlement. The insurer usually has exclusive control with regard to settlement and defense under the terms of the standard automobile insurance policy. By virtue of the so-called "no-action" clause written into most automobile insurance policies, the insured may not assume any obligation or make any payment except at his own cost. The automobile insurance company, nevertheless, is faced with a difficult choice when it is presented with an offer to settle within the policy limits. It must consider not only its own interests but also, by law, the possibly conflicting interests of the insured.

Acceptance of the offered settlement by the insurance company would naturally be in the insured's best interest since such action would exonerate him from any personal liability. On the other hand, the company might feel that its own interests would be best served by rejecting the offer in the expectancy that a recovery by the claimant in a legal action would be less than the amount of the offered settlement. This latter alternative, however, might subject the insured to great personal liability in the event the claimant obtains a verdict in excess of the policy limits.

The ever-present possibility of a verdict in excess of the policy limits against the insured necessitates the exertion of some restraint upon the insurer. The courts recognize that the company has exclusive control over the decision concerning settlement within policy coverage and that the insurance company and insured often have conflicting interests as to whether settlement should be made. On this basis all courts now agree that under certain circumstances liability may be imposed upon the insurer for failure to settle, such liability stemming from the breach of a duty on the part of the insurer to exercise good faith in negotiating settlement offers.

1 The standard liability insurance policy, used almost exclusively in the United States, contains a provision substantially as follows:

As respects such insurance as is afforded by the other terms of this policy the company shall:

(a) defend in his name and behalf any suit against the insured alleging such injury or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent; but the company shall have the right to make such investigation, negotiation and settlement of any claim or suit as may be deemed expedient by the company.


The great majority of the cases and apparently all the recent cases have treated the insurer’s duty in this respect as one sounding in tort rather than contract. It is felt that the company’s power to affect the interests of the insured should be accompanied by responsibility for its reasonable exercise. Since such responsibility is not expressed in the insurance policy the insurer’s duty is held to arise from the relationship of insurer and insured created by the insurance contract.

The California Supreme Court ignored this trend of authority in the recent case of Comunale v. Traders & General Insurance Company. In so doing, it provided a new avenue by which insured persons may recover judgments in excess of policy limits against insurance companies which unreasonably refuse to accept an offered settlement from the injured party and thus expose the insured to greater liability than that for which he had purchased protection.

The facts of the Comunale case disclose that defendant Traders & General Insurance Company had insured Percy Sloan under an automobile policy containing bodily injury liability limits of $10,000 for each person injured and $20,000 for each accident. On March 27, 1948, Sloan struck Anthony and Carmela Comunale while they were in a marked pedestrian crosswalk. The Comunales commenced a personal injury action against Sloan. Traders refused to defend this action on the ground that the accident was not covered because Sloan was driving a truck not owned by him at the time of the personal injury to the Comunales. Sloan employed his own counsel to represent him. During the trial the Comunales offered to settle the claim for $4,000. Traders refused to agree to a settlement. Judgment was subsequently rendered in favor of Mr. Comunale for $25,000 and Mrs. Comunale for $1,250, which Sloan was financially unable to satisfy. The Comunales then brought an action against Traders under a provision in the policy that permitted an injured party to maintain an action, within the policy limits, against the insurer after obtaining an unsatisfied judgment against the insured. It was found by the court that Traders’ refusal to defend the action against Sloan was due to their erroneous interpretation of the policy provisions. The California District Court of Appeal affirmed a judgment in favor of Mr. Comunale for $10,000, the policy limits for each person injured. This judgment was satisfied by Traders.

After obtaining an assignment of Sloan’s rights against Traders, Comunale initiated an action against Traders in May, 1954 to recover the portion of his unsatisfied judgment against Sloan in excess of the policy limits. The California Supreme Court held that defendant Traders was liable for the entire judgment against the insured though the amount of the judgment exceeded the policy limits. The court based its decision on the premise that the insurer, in refusing to accept the offer to settle, violated its obligation to consider in good faith the interest of the insured in the settlement, and that this implied obligation was founded upon the insurance contract.

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5 50 Cal. 2d at ..., 328 P.2d 198 (1958).
7 The court also affirmed a judgment in favor of Mrs. Comunale for $1,250, which was satisfied by Traders. This completely satisfied any cause of action Mrs. Comunale had against Sloan or Traders.
8 50 Cal.2d at ..., 328 P.2d at 203.
The position of the California Supreme Court that the insurer's duty to settle may be predicated on the basis of contract is a bold one. As pointed out the decisions on this point have heretofore confined the basis of the insurer's liability to the field of tort. The courts have experienced their greatest difficulty in this field when called upon to determine the exact nature of the insurer's duty to accept an offer of settlement within the policy limits. There is a conflict of authority as to whether the insurer's duty should be confined to the exercise of good faith or whether liability should be extended to cases where the insurer is negligent in rejecting an offer to settle a claim irrespective of its good faith. California rejects the negligence test and only requires that the insurer exercise good faith when negotiating offers of settlement. In determining whether the insurer has acted in good faith, the majority of courts applying that test look to whether the insurer has given "equal consideration" to the interests of the insured and its own interests. In Comunale the court correctly applied the "duty of equal consideration" principle in regard to the offered settlement but implied that such duty arose from the terms of the insurance policy.

The terms of Sloan's automobile policy did place Traders under a contractual duty to defend any suit against the insured. The insurer's wrongful refusal to defend an action does not have the effect of exposing it to greater limits of liability than those stated in the policy. The reason is that if the insured defends the action through his own counsel, it does not necessarily follow that a judgment for a lesser sum would have resulted if the insurer had defended the action. The insurer's refusal to defend, in itself, cannot be said to be the cause of any additional detriment to the insured as a result of a verdict in excess of the policy limits. This reasoning, however, does not apply where the insurer wrongfully refuses to effect an immediate settlement. Such refusal can often expose the insured to liability in excess of the policy limits by compelling the insured to submit to a court action.

As has been seen, the California Supreme Court rationalized its decision by holding that the insurer has a contractual duty to exercise good faith in settlement negotiations. Yet the policy provision concerning settlement of claims was actually permissive in form. That is, by the express terms of the policy settlements of claims would be made only when deemed expedient by the insurer. Nevertheless the court read into the terms of the insurance policy an implied promise by the insurer to exercise good faith in conducting settlement negotiations.

The California Code of Civil Procedure provides in effect that an action not founded upon a written instrument is subject to a two year period of limitation. Comunale was barred from bringing a tort action since he failed to commence the action within two years after the cause of action arose. He did file suit within four

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See note 2 supra.
Clause II of the policy provided in part that "... the company shall defend in his name and behalf any suit against the insured ... even if such suit is groundless, false or fraudulent ... ."
Clause II of the policy provided in part: "... but the company shall have the right to make such investigation, negotiation and settlement of any claim or suit as may be deemed expedient by the company."
CAL. CODE CIV. PROC. § 339(1) provides in part that an action "upon a contract, obligation or liability not founded upon an instrument in writing ... ." is subject to a two year period of limitation.
years after the cause of action arose. The court, apparently to enable Comunale to maintain his action, resorted to another section of the Code of Civil Procedure which provides that a four year period of limitation applies to an action upon a liability founded upon a written instrument. In holding that Traders was contractually liable for failing to settle, the court stated that the implied promise arising out of the contract, obligating Traders to exercise good faith in considering the interests of the insured in determining whether to accept an offer of settlement, was as much a part of the instrument as if it were written out.

The court relied heavily on O'Brien v. King, which discussed the applicability of section 337 to a promissory note:

... [W]e must regard, as included in the terms of the writing, all obligations and promises which its words necessarily import.

Applying this interpretation in the Comunale case, the words of the insurance policy providing that "the company shall have the right to make such ... settlement of any claim or suit as may be deemed expedient by the company; ..." are rendered virtually meaningless. Where can there be found in these words any necessary importation of a promise by the insurer to settle a claim under any given circumstances? It is further stated in O'Brien:

It is sufficient if the words import a promise or agreement, or that this can be inferred from the terms employed.

Again, there is not the slightest inference contained within the policy terms, of a promise or agreement by the insurer to settle. As pointed out in the New York case of Best Bldg. Co. v. Employers Liability Assur. Corp.:

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 and has been repeatedly stated in all the cases bearing on the subject. So also it has been held by this court that the company is not liable on its contract for a failure to settle; a contract imposes upon it no such duty. (Emphasis added.)

And again in the words of the Michigan Supreme Court:

[The courts] are also unanimous that the ... policy contains no express or implied contract obligation of the insurer to compromise claims, and that an action in assumpsit or on the contract will not lie for the excess of judgment over policy limit.

The above cases appear to represent the weight of authority and negate any notion of contractual liability for a failure to settle.

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10 Cal. Code Civ. Proc. § 337(1) provides in part that an action "upon any contract, obligation or liability founded upon an instrument in writing ..." is subject to a four year period of limitation.

17 50 Cal.2d at ..., 328 P.2d at 203.
18 174 Cal. 769, 774, 164 Pac. 631, 633 (1917).
19 Ibid.
To support its decision in *Comunale*, the court relied on two recent California cases, *Brown v. Guarantee Ins. Co.*\(^{23}\) and *Ivy v. Pacific Automobile Ins. Co.*\(^{24}\). These cases, although factually distinguishable from *Comunale*, also involved the question of the liability insurer's duty to settle. Both cases held that the liability insurer is required to exercise good faith, but in each decision the insured's recovery was in *tort*. Further, in *Brown*\(^{25}\) the court quoted from *Noshey v. American Automobile Insurance Co.*\(^{26}\):

> Nor within the policy limits has the insurer any contract obligation to effect settlement, as the policy contains no promise that it will do so under any and all conditions or circumstances, and none is to be implied . . . .

It is submitted that the duty of the liability insurer to exercise good faith in considering offers of settlement does not arise from nor is it founded upon the terms of the written instrument. The duty arises out of the contractual *relationship*; it arises because the insured, in exchange for services and protection, has given the insurer exclusive control in the handling of all settlement offers. To that extent he has placed himself at the mercy of the insurer, for which, in turn, the insurer owes the duty of exercising good faith\(^{27}\) or due care.\(^{28}\)

Perhaps the liberal interpretation of the insurance policy provision concerning offers of settlement by the court in the *Comunale* case was prompted by reasons of public policy. The decision appears to follow the modern trend of favoring the "innocent policy holder" whenever the "powerful insurance company" is suspected of behaving incorrectly.

It appears more likely that the court resorted to contractual liability in this case as the only means available to provide relief for an insured who had obviously been wronged. The statute of limitations barred the assertion of the usual theory of *tort* liability. It is clear that Traders proceeded with amazingly little consideration for the interests of the insured in the negotiations following the accident. Undoubtedly feeling that Traders should not profit from its own wrong, the court attempted to justify its decision by reading an implied promise into the terms of the insurance policy. Conceding that the *result* in this case is meritorious, the court's reasoning and method by which the desired result is achieved may be open to a fair amount of criticism from the viewpoint of proper legal analysis.

The decision in *Comunale* will have the effect of placing the policy holder in a more advantageous position when his insurance company is faced with an offer to settle a claim. The insurer, in spite of the express non-obligatory settlement clause in the insurance contract, will have to use the utmost discretion and good faith in order to avoid not only liability on the basis of *tort*, but also *contractual* liability. In turn the insurer will be exposed to a longer period during which an action may be brought against it.

The legal impact of the decision in the *Comunale* case should prove disheartening to California liability insurance companies. Now subject to restriction and control by state and federal insurance regulations, the automobile insurer will be


\(^{25}\) 155 Cal. App.2d at 687, 319 P.2d at 74.

\(^{26}\) 68 F.2d 808, 810 (6th Cir. 1934).

\(^{27}\) Hilker v. Western Auto. Ins. Co., 204 Wis. 1, 231 N.W. 257 (1930), aff'd, 204 Wis. 1, 235 N.W. 413 (1931).