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CASE NOTES

Insurance—Liability Insurer's Duty to Settle—[Illinois]. The defendant insurance company issued a public liability policy to the plaintiff country club, with liability limited to $10,000 for bodily injuries to any one person. An invitee on the plaintiff's premises sustained injuries on a toboggan slide and brought suit against the plaintiff. Before trial the insurance company refused an offer by the injured party to settle for $3,500. The claimant recovered a judgment for $20,000. Before appeal she offered to settle for $8,000, and was again refused. The judgment was affirmed by the Appellate Court.[1] The defendant paid the claimant $10,815. The plaintiff paid the balance due on the judgment and sued to recover that amount from the defendant. The trial court instructed the jury that "when defendant . . . . arbitrarily and unreasonably refused to compromise . . . . it failed to exercise good faith." The jury found for the plaintiff. On appeal, *held*, the trial court should have left to the jury the question whether the refusal to settle was in "bad faith." Judgment reversed

[1] Halladay v. Olympia Fields Country Club, 295 Ill. App. 622, 15 N.E. 2d 345 (1938).

and remanded for new trial. *Olympia Fields Country Club* v. *Bankers' Indemnity Insurance Co.*[2]

The insurer by the terms of the usual accident-liability policy has complete control of the defense of any claim arising under its terms, including the right to settle or compromise any claim against the insured.[3] Such control may be referred to in the contract as an "option to settle,"[4] an "exclusive right to contest or settle,"[5] or "the entire management and defense of the suit";[6] and the assured is usually forbidden to "interfere in any negotiation for settlement"[7] or "assume any liability"[8] without the consent of the insurer.

Justification for this exclusive control is said to rest upon the probability that, if the insurer did not retain management of the defense af all claims, the assured would seek to compromise any claim below the liability limit.[9] The courts have recognized that there is an unavoidable conflict of interest between the insurer and the assured when an offer of settlement by the injured party is for an amount below the maximum coverage of the policy.[10] The assured will want to accept any such settlement

[2] 325 Ill. App. 649, 60 N.E. 2d 896 (1945).

[3] In the Olympia Fields case the contract provided: "In addition to the Above the Company Agrees: (2) To Make Such Investigation at its own cost of all accidents reported to the Company to which this Policy applies, and to undertake such negotiations for settlement, or to make such settlements of any claims for damages made against the Assured, as the Company may deem expedient; and in the event of suit being brought against the Assured on account of such an accident, to defend such suit, even if groundless, in the name and on behalf of the Assured, unless or until the Company shall elect to effect settlement thereof." Ibid., at 651 and 897.

[4] Brassil v. Maryland Casualty Co., 210 N.Y. 235, 104 N.E. 622 (1914).

[5] Lanferman v. Maryland Casualty Co., 222 Wis. 406, 267 N.W. 300 (1936); City of Wakefield v. Globe Indemnity Co., 246 Mich. 645, 225 N.W. 643 (1929).

[6] American Mutual Liability Ins. Co. v. Cooper, 61 F. 2d 446 (C.C.A. 5th, 1932).

[7] Hilker v. Western Automobile Ins. Co., 204 Wis. 12, 235 N.W. 413 (1931), affirming 204 Wis. 1, 231 N.W. 257 (1930).

[8] Farmers Gas Co. v. St. Paul Mercury Indemnity Co., 186 Miss. 747, 191 So. 415 (1939). Exclusive control of the defense or settlement of any claim by the insurer applies only to claims for an amount less than the policy limit. The assured may compromise his own possible liability in excess of the maximum coverage of the policy. Gen'l Accident Fire & Assur. Corp. v. Louisville Home Telephone Co., 175 Ky. 96, 193 S.W. 1031 (1917); see City of Wakefield v. Globe Indemnity Co., 246 Mich. 645, 225 N.W. 643 (1929).

[9] See Tyger River Pine Co. v. Maryland Casualty Co., 170 S.C. 286, 293, 170 S.E. 346, 348 (1933); Hilker v. Western Automobile Ins. Co., 204 Wis. 1, 14, 235 N.W. 413, 414 (1931).

[10] See Abrams v. Factory Mutual Liability Ins. Co., 298 Mass. 141, 143, 10 N.E. 2d 82, 83 (1937); Tyger River Pine Co. v. Maryland Casualty Co., 170 S.C. 286, 292–93, 170 S.E. 346, 348 (1933); Georgia Casualty Co. v. Mann, 242 Ky. 447, 451, 46 S.W. 2d 777, 779 (1932); Douglas v. United States Fidelity & Guaranty Co., 81 N.H. 371, 377, 127 Atl. 708, 711 (1924). But see Traders & Gen'l Ins. Co. v. Rudco Oil & Gas Co., 129 F. 2d 621, 627 (C.C.A. 10th, 1942), referring to the "common interests" of the parties.

regardless of the possibility of obtaining a judgment for a lower amount; he can only lose by contesting. The insurer, on the other hand, may believe the chance of obtaining a judgment for an amount smaller than the proffered settlement, or even a complete discharge on the merits of the case, justifies a refusal to compromise. The certainty of this conflict becomes more obvious as the offer tends to proximate the maximum coverage of the policy.[11]

The courts have agreed that the insurer does have certain obligations to the assured, not explicit in the terms of the policy.[12] To prevent the insurer from taking advantage of its complete control over the defense or settlement of the claim courts have sometimes held it liable for the entire amount of any judgment subsequently entered or affirmed, even though the amount exceeded the maximum coverage of the policy. The courts have struggled to establish a standard by which the decision of the insurer to refuse a settlement below the policy might be measured. In some cases the liability of the insurer to the assured has been predicated upon the "negligence" of the insurer in failing to accept a proffered settlement.[13] The test of negligence as used to assess the failure of the insurer to make a careful investigation[14] or accept the advice of its investigators[15] is inadequate to resolve the conflict of interest between insurer and assured when a settlement offer is below the face of the policy. The decision of the insurer to litigate rather than settle will inevitably increase the risk to the assured regardless of the "reasonableness" of the insurer's decision.[16]

[11] In the principal case the refusal of the insurer to accept the $3,500 settlement offer meant that it was risking the loss of an additional $6,500 against a maximum possible gain of $3,500. When the offer was $8,000 a refusal to settle meant that the insurer stood to lose only $2,000 by contesting, while, if the appellate court reversed the award of $20,000, it would gain $8,000. The risk to the assured was greater at the time of the $8,000 offer, since the lower court had already entered judgment for $20,000.

[12] See cases cited in notes 13 and 17, infra.

[13] Douglas v. United States Fidelity Guaranty Co., 81 N.H. 371, 127 Atl. 708 (1924); Ballard v. Ocean Accident & Guarantee Co., 86 F. 2d 449 (C.C.A. 7th, 1936); Maryland Casualty Co. v. Wyoming Valley Paper Co., 84 F. 2d 633 (C.C.A. 1st, 1936). A few courts have held that a showing of negligence is not sufficient to hold the insurer liable for failure to accept a settlement below the maximum coverage of the policy. Abrams v. Factory Mutual Liability Ins. Co., 298 Mass. 141, 10 N.E. 2d 82 (1937).

[14] Ballard v. Ocean Accident & Guarantee Co., 86 F. 2d 449, 452 (C.C.A. 7th, 1936).

[15] City of Wakefield v. Globe Indemnity Co., 246 Mich. 645, 225 N.W. 643 (1929).

[16] The courts that apply the "negligence" test say it is the duty of the insurer to settle the claim if it is the "reasonable thing to do." Tyger River Pine Co. v. Maryland Casualty Co., 170 S.C. 286, 294, 170 S.E. 346, 349 (1933); Cavannaugh Bros. v. Gen'l Accident, Fire & Life Assur. Corp., 79 N.H. 186, 104 Atl. 604 (1919). It is difficult to tell what this means. The risk of litigation may be "reasonable" from the point of view of the insurer though "unreasonable" as far as the assured's interests are concerned. Note 11, supra.

More frequently it is said that the test is whether the insurer acted in "good faith" toward the assured in deciding to contest, rather than settle, the claim.[17] The standard of good faith has not been satisfactory. As observed in the principal case[18] the decisions are in "hopeless disagreement" as to when the refusal of the insurer to accept settlement will constitute "bad faith."[19] The test of good faith seems to imply a duty on the part of the insurer to consider the interests of the assured.[20] One explanation for the confusion may be the failure of the courts to recognize that, if good faith means "due regard for" the assured's interests,[21] the refusal of the insurer to accept any offer below the policy limit is, in itself, an act of bad faith toward the assured.

The standard of good faith has apparently developed out of the belief that the relationship between the insurer and the assured is that of agent and principal.[22] In the attempt to stake out the limits of an insurer's liability for a failure to settle, the courts have borrowed from the law of agency a yardstick that was not designed to measure the rights and duties of the parties to an insurance contract. The agent-principal relationship does not inexorably involve a conflict of interest between the agent and his principal. A conflict *may* arise between them, but, unlike the limited-lia-

[17] Traders & Gen'l Ins. Co. v. Rudco Gas & Oil Co., 129 F. 2d 621 (C.C.A. 10th, 1942); Berk v. Milwaukee Automobile Ins. Co., 245 Wis. 597, 15 N.W. 2d 834 (1944); Maryland Casualty Co. v. Cook O'Brien Construction Co., 69 F. 2d 462 (C.C.A. 8th, 1934), cert. den. 293 U.S. 569 (1934); Hilker v. Western Automobile Ins. Co., 204 Wis. 1, 231 N.W. 257 (1930).

[18] Olympia Fields Country Club v. Bankers Indemnity Ins. Co., 325 Ill. App. 649, 660, 60 N.E. 2d 896, 901 (1945).

[19] ". . . . the disagreement results from a difference of opinion as to the nature and kind of proof that the insured must introduce to make out a prima facie case of bad faith against the insurer," ibid.; see Johnson v. Hardware Mutual Casualty Co., 109 Vt. 481, 494, 1 A. 2d 817, 822 (1938); City of Wakefield v. Globe Indemnity Co., 246 Mich. 645, 651, 225 N.W. 643, 645 (1929).

[20] Tyger River Pine Co. v. Maryland Casualty Co., 170 S.C. 286, 291, 170 S.E. 346, 348 (1933) (the insurer must "*sacrifice its interests in favor of those of the insured*"); Georgia Casualty Co. v. Mann, 242 Ky. 447, 451, 46 S.W. 2d 777, 779 (1932) (the insurer "may look to its own interests as well as those of the insured"); American Mutual Liability Ins. Co. v. Cooper, 61 F. 2d 446, 447 (C.C.A. 5th, 1932). But see Hilker v. Western Automobile Ins. Co., 204 Wis. 12, 235 N.W. 413 (1931), where the court said the insurer need look only to its own interests. The court, however, held that the failure to settle was in bad faith, implying that the insurer should have considered the interests of the assured; see Abrams v. Factory Mutual Liability Ins. Co., 298 Mass 141, 145, 10 N.E. 2d 82, 83 (1937).

[21] Johnson v. Hardware Mutual Casualty Co., 109 Vt. 481, 491, 1 A. 2d 817, 820 (1938).

[22] Hilker v. Western Automobile Ins. Co., 204 Wis. 1, 7, 231 N.W. 257, 259 (1931), overruling on this point Wisconsin Zinc Co. v. Fidelity & D. Co., 162 Wis. 39, 52, 155 N.W. 1081, 1086 (1916); see Douglas v. United States Fidelity & Guaranty Co., 81 N.H. 371, 376, 127 Atl. 708, 711 (1924); Traders & Gen'l Ins. Co. v. Rudco Oil & Gas Co., 129 F. 2d 621, 627 (C.C.A. 10th, 1942); Ballard v. Ocean Accident & Guarantee Co., 86 F. 2d 449, 453 (C.C.A. 7th, 1936); but see Georgia Casualty Co. v. Mann, 242 Ky. 447, 451, 46 S.W. 2d 777, 779 (1932).

bility contract, the agreement between the parties does not by its very terms forecast a conflict of interest. The adverse interest of the agent who buys in the market at the same time that he buys for his principal,[23] or who acts as agent for a seller as well as agent for a buyer,[24] does not inhere in the contract relation between the parties. The standard of good faith as employed to judge the acts of an agent should not be carried over into the field of insurance law.[25]

The confusion is not relieved by passing on to the jury, as in the principal case, the task of deciding whether the failure to settle was in "bad faith."[26]

One way out of the present uncertainty would be to require the insurer to pay the full amount of any judgment rendered subsequent to a refusal to accept an offer of settlement below the maximum coverage of the policy. The point is not that the insurer must accept every offer of settlement which is below the policy limit. Rather, it would appear reasonable that, if the insurer insists upon complete control of the defense or settlement of any claim, it should be willing to assume the risks as well as claim the benefits resulting from its decision to litigate rather than settle. Under the current rules the insurer, at the best, cannot avoid being influenced by the knowledge that, if it makes a bad guess as to the outcome of the litigation, it need not bear all the consequent financial burden. At the worst, the insurer will deliberately gamble with the assured's money, forcing the assured to prove, in a separate action, that the failure to settle was in bad faith. The nearer the offer is to the policy limit, the less the insurer has to lose by contesting the claim, though court costs and lawyers' fees may be, in any case, some deterrent to rash action by the insurer.

The result of such a departure from the present confusion is not so shocking as might at first appear. In at least one case, the terms of the liability policy provided that if the insurer refused an offer of settlement below the maximum coverage of the policy the coverage of the policy would be doubled.[27] The fact that in this case the assured was a railroad corpora-

[23] Rest., Agency § 393, Comment (b) (1933).

[24] Ibid., § 392.

[25] But see Hilker v. Western Automobile Ins. Co., 204 Wis. 1, 6, 231 N.W. 257, 259 (1930).

[26] But see Douglas v. United States Fidelity & Guaranty Co., 81 N.H. 371, 374, 127 Atl. 708, 710 (1924).

[27] "It is further agreed and understood that when the company has the opportunity to settle the claim of any injured employee within the limit designated in this policy, viz., five thousand dollars ($5,000), and fails to take advantage of such opportunity for settlement within the time provided in the preceding paragraph, the company shall thereafter protect the assured from any judgment not in excess of ten thousand dollars. . . . . " Georgia Life Ins. Co. v. Mississippi Cent. R. Co., 116 Miss. 114, 116, 76 So. 646, 647 (1917).

tion suggests that the more common provisions giving the insurer complete control without additional financial responsibility for an error in judgment simply reflect the inferior bargaining position of most policy holders.[28] Courts do take notice of the superior bargaining position of most insurers.[29] If higher premiums were the result of imposing full responsibility upon the insurer, where settlement offers below the policy limit are refused, such a consequence would not be contrary to a public policy favoring greater distribution of risk.[30]

The practical consequences of such a step probably would be the redrafting of insurance contracts expressly to exempt insurers from such unlimited liability. This effect might be sufficient justification for a harsher rule, if it called attention to the consequences of placing complete control in the hands of the insurer. In any case, the contract should provide expressly for the rights and duties of the parties in the event that the insurer refuses to accept a settlement offer below the face of the policy.[31] Who shall bear the risk of the decision to contest rather than settle a claim should not be determined by reference to vague notions of "good faith" or "reasonableness." Judicial reluctance to discard the good faith test,[32] however inappropriate, suggests that any radical departure from current rules will have to be taken by the legislature.[33]

If courts continue to demand, as the Illinois court did in the principal case, that juries try to determine whether or not a refusal to settle was in

[28] "In this case the insurance company no longer holds the assured 'in the hollow of its hands,' " ibid., dissent, at 135 and 653; see Tyger River Pine Co. v. Maryland Casualty Co., 170 S.C. 286, 293, 170 S.E. 346 (1933), referring to the insurer's exclusive power to settle or contest as a "heads I win; tails you lose" proposition.

[29] Ehrenzweig and Kessler, Misrepresentation and False Warranty in the Illinois Insurance Code, 9 Univ. Chi. L. Rev. 209 (1942).

[30] Douglas, Vicarious Liability and Administration of Risk, 38 Yale L. J. 584, 720 (1929); Loss Shifting and Quasi-Negligence: A New Interpretation of the Palsgraf Case, 8 Univ. Chi. L. Rev. 729 (1941).

[31] See Best Building Co. v. Employers Liability Assur. Corp., 247 N.Y. 451, 456, 160 N.E. 911, 913 (1928). If most assureds are not in a strong enough bargaining position to demand double indemnity in the event that the insurer refuses a settlement offer, the contract might provide that if the insurer decides to contest rather than settle a claim, it will pay half of the amount by which any subsequent judgment is above the liability limit.

[32] In some of the early cases assureds asserted that the refusal to settle, ipso facto, placed the burden of any subsequent judgment upon the insurer. The courts said that such unlimited liability could not be read into a limited liability contract. Rumford Falls Paper Co. v. Fidelity & Casualty Co., 92 Me. 574, 43 Atl. 503 (1889); Georgia Casualty Co. v. Cotton Mills Product Co., 159 Miss. 396, 132 So. 73 (1931).

[33] For a discussion of legislation designed to readjust the rights and duties of the parties under other provisions in insurance contracts see Ehrenzweig and Kessler, op. cit. supra, note 28; Statutes Affecting Representation in Insurance Contracts, 32 Col. L. Rev. 522 (1932).

bad faith, the attention of the jury should be drawn to the fact that a refusal to settle by the insurer was not accompanied by an assumption of all the risks of such a decision even though the insurer had complete control over the management of the defense or settlement of the claim. Furthermore, it should be proper for a trial court to point out to the jury that the proximity of the settlement offer to the maximum coverage of the policy might influence the insurer's decision to contest, rather than to settle, a claim.[34]

HERBERT N. WOODWARD*

Conflict of Laws—Torts—Rules in Phillips v. Eyre—[Canada].—The plaintiff and the defendant were residents of Quebec. The plaintiff, in Quebec, accepted the defendant's invitation to make a trip to Ottawa as a gratuitous passenger in the defendant's automobile. In an accident, which happened in Ontario when the defendant, in rainy weather, was driving down a hill at great speed, the plaintiff was injured. An action for damages was brought in Quebec. An Ontario statute expressly exempts the driver of an automobile from liability to a passenger;[1] under another statutory provision of Ontario a person "who drives a motor vehicle on the highway without due care and attention" is guilty of an offense, and is punishable by fine or imprisonment.[2] Under Quebec law the negligent driver of an automobile is liable to a gratuitous passenger.[3] The Supreme Court of Quebec affirmed a judgment in favor of the plaintiff, and its decision was affirmed by the Supreme Court of Canada. *McLean* v. *Pettigrew*.[4]

The case illustrates the difference between the British and the American approach to tort cases involving problems of conflict of laws. An American court, applying the rule that problems of the law of torts are to be decided under the law of the place where the alleged wrong took place,[5] would almost certainly have applied to the case the law of Ontario, where the accident occurred. English courts have not found it necessary to decide tort cases brought before them under any foreign law. Rules of jurisdiction may preclude an action from being brought in England at all, for instance, when the defendant neither resides in England nor can be personally served there. If, however, the action can be brought in England, the court will decide it under its own law. If, under an

[34] Note 11, supra.

* Member of the Illinois Bar.

[1] Highway Traffic Act, § 47(2). [2] Highway Traffic Act, § 27.

[3] In an extensive discussion of decisions of Quebec courts, French cases, and French textwriters, this liability was held to be based upon tort (quasi-délit) rather than upon a contract of gratuitous transportation (contract de bienfaisance); per Taschereau, J. [1945] 2 D.L.R. 65, at 66–76.

[4] [1945] 2 D.L.R. 65. [5] See Restatement of Torts, §§ 379 et seq.