INSURANCE CARRIER'S DUTY TO SETTLE: A PROBLEM OF FAITH

Stanley Miller lay on his back, unable to move his arms and legs. He would remember January 15, 1962 all his life. It was "body building day" for his junior high school gym class. One of the exercises performed by the students consisted of jumping onto a springboard and thereafter somersaulting over parallel bars covered with gym mats. In attempting this exercise, which was not new to Stanley, he landed on his back and sustained severe injuries. Though doctors predicted that his life would not be shortened if he received the proper care, his sexual capacity would be impaired and his earning ability either destroyed or severely limited. A negligence suit was instituted on Stanley's behalf against the Board of Education, which was insured to a limit of $200,000.[1] A lengthy trial followed, resulting in a verdict for the plaintiff of $1,215,140. The trial court reduced that amount to $335,140. Alleging that the insurance company could have settled the case within the policy limits, the Board brought an action against the carrier for the amount of the verdict in excess of the policy limit.[2] The grounds alleged were bad faith and negligence.[3]

Before considering the implications of the decision in this case, a review of the relevant law is warranted. Views regarding the duty of carriers to accept compromise offers within policy limits have sometimes been diametrically opposed. Insurers have maintained that they owe no such duty and some early decisions supported that contention.[4] These decisions were based upon policy language describing the carrier's settlement power, language which appeared to reserve complete discretion in such matters to the insurer.[5] On the other hand, some insured plaintiffs have attempted to impose an absolute duty on the

1 Miller v. Board of Educ., No. L-7241-62 (N.J. Super. Ct., Law Div., judgment entered July 7, 1964).

2 Board of Educ. v. Lumbermens Mut. Cas. Co., 293 F. Supp. 541 (D.N.J. 1968), *aff'd*, App. No. 17,871 (3d Cir., filed Dec. 4, 1969).

3 *Id.* at 543.

4 Kleinschmit v. Farmers Mut. Hail Ins. Ass'n, 101 F.2d 987 (8th Cir. 1939); McDonald v. Royal Indem. Ins. Co., 109 N.J.L. 308, 162 A. 620 (Ct. Err. & App. 1932); Auerbach v. Maryland Cas. Co., 236 N.Y. 247, 140 N.E. 577 (1923); Levin v. New England Cas. Co., 97 Misc. 7, 160 N.Y.S. 1041 (App. T. 1916). *See* Annot., 40 A.L.R.2d 168, 174-77 (1955).

5 The applicable language in the current standard automobile liability policy reads as follows: "The company . . . *may make such investigation and settlement of any claim or suit as it deems expedient*, but the company shall not be obligated to pay any claim or judgment or to defend any suit after the applicable limit of the company's liability has been exhausted by payment of judgment or settlement." (Emphasis added.)

carriers to accept compromise offers, although such efforts have usually been unsuccessful.[6]

The great majority of the courts have chosen neither extreme, requiring the carrier to afford some consideration to the policyholder's interest in a potential excess verdict case.[7] Two views have prevailed. One obligates the insurer only to act in *good faith* when considering a compromise offer. Courts have, however, disagreed on the correct test of good faith. Some have established criteria of actual fraud,[8] intentionally disregarding the risk to the insured,[9] or contumacious and reckless refusal to settle in the face of a reasonable probability that harm would result to the insured.[10] Others have found bad faith in merely failing to give the insured's interest the same weight as the carrier's.[11] The other "middle road" view requires the insurer to exercise "due care," imposing liability for a negligently caused excess verdict, be it the result of improper investigation or of careless rejection of a compromise offer.[12]

Actually, there is no clear division between the two concepts.[13] Many ingredients of one are present in the other. For example, most courts applying the good faith rule have also required an investigation conducted without negligence. Failure to investigate in such a manner has been deemed bad faith. However, it seems clear that it is easier for a carrier to meet this test of good faith. The negligence test is more strict.[14] From the purely administrative point of view, the cases recognizing no duty or those finding an absolute duty would be the preferred authorities.[15] There would be no need for excess verdict litigation.

6 Kingan & Co. v. Maryland Cas. Co., 65 Ind. App. 301, 115 N.E. 348 (App. Ct. 1917); Rumford Falls Paper Co. v. Fidelity & Cas. Co., 92 Me. 574, 43 A. 503 (1899). *See* Annot., 40 A.L.R.2d 168, 177-78 (1955).

7 Maryland Cas. Co. v. Elmira Coal Co., 69 F.2d 616 (8th Cir. 1934); Brassil v. Maryland Cas. Co., 210 N.Y. 235, 104 N.E. 622 (1914); G. A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544, 29 N.C.C.A. 140 (Tex. Comm. App. 1929). *See* Annot., 40 A.L.R.2d 168, 178-81, 186-90 (1955).

8 Johnson v. Hardware Mut. Cas. Co., 108 Vt. 269, 187 A. 788 (1936). *See* Annot., 40 A.L.R.2d 168, 181-83 (1955).

9 *Id.*

10 Wisconsin Zinc Co. v. Fidelity & Deposit Co., 162 Wis. 39, 155 N.W. 1081 (1916). *See* Annot., 40 A.L.R.2d 168, 181-83 (1955).

11 American Fid. & Cas. Co. v. G. A. Nichols Co., 173 F.2d 830 (10th Cir. 1949); National Mut. Cas. Co. v. Britt, 203 Okla. 175, 200 P.2d 407 (1948). *See* Annot., 40 A.L.R.2d 168, 181-83 (1955).

12 *E.g.*, Attleboro Mfg. Co. v. Frankfort Marine, Accid. & Plate Glass Ins. Co., 240 F. 573, 17 N.C.C.A. 1068 (1st Cir. 1917). *See* Annot., 40 A.L.R.2d 168, 186-90 (1955).

13 St. Paul-Mercury Indem. Co. v. Martin, 190 F.2d 455 (10th Cir. 1951). *See* Annot., 40 A.L.R.2d 168, 171 (1955).

14 *See* Annot., 40 A.L.R.2d 168, 171 (1955).

15 *Id.* at 172.

The fairer rule would appear to require some fault on the part of the carrier before imposing liability. However, both of the middle ground standards are difficult to administer consistently and justly.[16]

New Jersey law on the subject was established in *Radio Taxi Service, Inc. v. Lincoln Mutual Insurance Company*,[17] decided in 1960. The claimant had contended that the taxi went through a stop sign, causing the accident. She had alleged injuries, property damage and loss of income. Her attorney had made a compromise of $3,600. Defense counsel had rejected that offer and advanced no counter-proposals. Radio Taxi had purchased a $5,000 liability insurance policy. A verdict of $13,500 had resulted from the trial of the accident suit.

The court heard arguments endorsing each of the "middle road" theories of liability, negligence and bad faith. Speaking for a majority of the New Jersey Supreme Court, Justice Francis rejected the negligence test and stated, "[T]he obligation assumed by the insurer with respect to settlement is to exercise good faith in dealing with offers of compromise, having both its own and the insured's interests in mind."[18] The good faith concept was treated at length, it being held that the carrier's decision must be honest and intelligent, to the extent required by its expertise.[19] The court's decision rested on the idea that a fair weighing of the *probable* outcome of the accident litigation must dictate the course followed by the carrier.[20] The insurer must not be unduly venturesome at the expense of the insured, nor must the danger of an adverse verdict itself be so great as to circumstantially provide an inference of bad faith.[21] Only where reasonable and probable cause appears can the carrier decline to meet the offer and try the case with safety.[22]

The perimeter of bad faith was clearly delineated by statements excluding certain conduct from the concept. Where the carrier has made a mistake in judgment, the question of bad faith cannot even be submitted to the jury.[23] If even a prima facie case of bad faith could result from a mere mistake, a danger would exist that a jury might hold

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16 *Id.*

17 31 N.J. 299, 157 A.2d 319 (1960).

18 *Id.* at 304, 157 A.2d at 322. The court added that this rule includes a duty to make a reasonably diligent effort to ascertain the facts of the accident. No breach of this duty was found. (This provides an example of the overlap between the negligence and good faith rules previously discussed, *supra*).

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

20 *Id.*

21 *Id.* at 313, 157 A.2d at 327.

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

23 *Id.* at 305, 312, 157 A.2d at 323, 326.

the carrier liable based on little more than the excess verdict itself.[24] In fact, the court made it clear that the excess verdict itself can play no part in the jury's determination.[25] The jury must decide on the basis of the facts known to the carrier at the time the offer was made.[26] The positive requirements of good faith and the exclusions of certain conduct from the bad faith concept can be easily correlated. The court's mandate is clearly this: a carrier must deal with settlement offers in good faith. Where an excess verdict results from a mistaken decision not to settle, not even a jury question of bad faith is created. Absent obvious elements that would prove the subjective mental state of bad faith, a jury must consider the facts as known by the carrier at the time of the claimant's offer and decide whether the probable outcome of the matter creates a circumstantial inference that bad faith must have dictated the carrier's decision.

It is important to note that the appeal in *Radio* grew out of the decision of the Superior Court, Law Division, to grant defendant's motion for a judgment of dismissal. Consequently, plaintiff's arguments of bad faith never reached a jury. Justice Francis expressed the court's agreement with this treatment as he stated: "In such a situation, to allow a jury to review the decision not to accept the settlement offer is to subject every such case where the verdict exceeds the policy limit to reappraisal *by their [sic] uninformed judgment*." (Emphasis added.)[27] The decision to dismiss was affirmed.

There was a strong dissent—written by Justice Jacobs—endorsing the rule requiring both *good faith* and *due care* in all phases of the handling of the claim. He maintained that the majority had not considered whether the jury, on any reasonable view of plaintiff's evidence, could have found a valid cause of action. Briefly, the dissent argued that there was a jury question and that the majority had assumed the task of deciding it. While the final decision reached in *Radio* was probably correct,[28] the dissent raised so many valid issues that there

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

25 *Id.* at 308, 157 A.2d at 324.

26 *Id.* at 306, 309, 157 A.2d at 323, 325.

27 *Id.* at 313, 157 A.2d at 327.

28 Evidence, especially the statement of the only independent witness to the accident, was clearly preponderant in showing that the taxicab went through the stop sign. There was some question of Mrs. Myers' possible contributory negligence. Some small substance can be found there. However, it is felt that such facts would bring plaintiffs' verdicts in 75-90% of the trials. But, the special damages and injuries were such that, even in a perfect case of liability, a verdict in excess of the policy limit would have been abnormal. Incidentally, the trial judge disagreed with the amount of the verdict, even though he refused to set it aside.

seems little doubt but that the jury should have been allowed to decide the case.

The fact that the supreme court was sharply divided over the result of applying a rule of law to a set record may indicate that the *Radio* rule is either so broad or so vague as to seriously restrict its uniform and accurate application.[29] If that statement appears strong, it can at least be safely stated that the result discloses a range of subjective interpretation available under the rule. Whatever the faults of such a broad rule, they are probably unavoidable. Many factual situations can give rise to a potential bad faith problem. A narrow rule, easily and objectively applied, could not encompass such diverse situations and provide useful guidance.

With respect to its breadth and flexibility, the New Jersey bad faith rule is similar to the "reasonable man" concept utilized in negligence cases. Noting such a similarity calls to mind another factor that might have substantially influenced the majority's decision. While particularly suited to determine negligence from the reasonable man standard, a jury is normally unqualified to weigh the evidence in a bad faith action. Only people with substantial experience in the fields of accident litigation and insurance have the necessary insight to determine a probable verdict range. Possibly it was because the court recognized this shortcoming that it decided to withhold the matter from the jury. An incorrect jury verdict would have been doubly harmful in that the limitations of the bad faith concept defined by the court might have been obfuscated. It is likely that any restrictions are not properly highlighted if the final decision runs counter thereto. That danger was obviated by the court's decision.

It is interesting to explore possible motives behind the majority's selection of the bad faith rule over the negligence rule. Probably, the court, aware of the unpredictable vicissitudes of litigation, wished to require substantial tortious conduct before holding the carrier liable. To guarantee that such wrongdoing would be a pre-condition to liability, the rule more lenient on the insurer was selected. Additionally, a difficulty of the negligence rule is the problem of proximate causation.

The next bad faith case was *Kaudern v. Allstate Insurance Company*,[30] decided by the U.S. District Court for New Jersey in November, 1967. Under the doctrine of *Erie v. Tompkins*,[31] the court, also acting

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29 To maintain the logic of this argument, it should be noted that the dissent found a jury question even by applying the more liberal majority rule. 31 N.J. 299, 317, 157 A.2d 319, 329 (1960).

30 277 F. Supp. 83 (D.N.J. 1967).

31 304 U.S. 64 (1938).

as trier of the facts in this non-jury trial, was bound to apply the law of *Radio*. The court must have realized from a study of this case that a fresh approach was necessary. Not only was the structure different, but, foreshadowing the *Chatham* case, the probable verdict range was ephemeral. *Kaudern* presented a problem of first impression; it was a case in which a plaintiff's verdict, if there were one, would almost surely exceed the policy limit. The likelihood of any plaintiff's verdict at all was the heart of the matter. However, while presenting such a new problem, the structure of *Kaudern* also seemed to suggest bad faith. Although the liability in the original accident was questionable, very serious personal injuries were involved. The damages demanded in the suit amounted to $1,050,000. Although such demands are, for the most part, grossly inflated, the claimant did have medical and other expenses amounting to almost $35,000 at the time of trial. Kaudern had purchased a $10,000 insurance policy,[32] which amount the claimant offered to take in settlement.

Allstate could, consequently, save none of its policy by settlement. Moreover, it also had nothing to lose by going to trial. Because almost any verdict would exceed the policy limit, simply on the basis of elementary justice, the situation suggested that the matter could not be tried fairly unless there were substantial possibilities of a "no cause" verdict. If Allstate argued that specific point, its $5,500 offer just before trial would seem to have been inconsistent with such a position. A verdict of $175,000 resulted from the trial against the Allstate insured and the co-defendant, an uninsured with no assets. It was affirmed by the Appellate Division.

While it must have been persuasive to the court, such a structure alone probably did not furnish an adequate foundation for the decision holding Allstate liable for bad faith. If the court had gone no further, critics might have argued that the excess verdict itself had been influential in the decision, a clear contravention of the *Radio* mandate. With a possible tacit recognition of this point, Judge Coolahan indicated that the *Radio* rule incorporated, directly or impliedly, considerations stated in a California case, *Brown v. Guarantee Insurance Company*.[33] In that case, the court listed seven criteria that facilitate a determination. These are:

1. The strength of the injured claimant's case on the issues of liability and damages;

[32] Actually, the limits for bodily injury liability were $10,000 for injuries to one person and $20,000 for injuries to any number of people in one accident. Such a policy is euphemistically known as a "ten-twenty."

[33] 155 Cal. App. 2d 679, 319 P.2d 69 (Dist. Ct. App. 1957).

2. Attempts by the insurer to induce the insured to contribute to the settlement;
3. Failure of the insurer to properly investigate the circumstances involved in the accident, which would result in its inability to effectively weigh the evidence against the insured;
4. The insurer's rejection of advice of its own attorney or agent;
5. Failure of the insurer to inform the insured of the compromise offer;
6. The amount of financial risk to which each party is exposed in the event of a refusal to settle; and
7. The fault of the insured in inducing the insurer's rejection of the compromise offer by misleading it as to the facts.[34]

To these, the court added an eighth item: An insurer must not undertake to give independent legal advice to an insured, and then utilize house counsel without fully disclosing to the policyholder the nature of the relationship.[35]

Of the criteria, item one requires the same determinations as the probability concept utilized in *Radio.* The difficulties in this respect have already been discussed. If it was true that any verdict was likely to exceed the policy limit, it was equally true that the likelihood of a verdict for the plaintiff was difficult to ascertain. The remainder of the criteria can be applied rather objectively, since major subjective value judgments are not required. Some of the standards focus on the overt conduct of the carrier and its counsel. For example, the attorney handling the original trial for Allstate advised that every effort should be made to settle the case, including offering the policy limit. The fact that this advice was disregarded is but one example of conduct on the part of the carrier that was less than exemplary.

The bad faith verdict in *Kaudern* is well supported by the inferences suggested by its structure with the additional evidence provided by an application of the criteria. In addition, *Kaudern* cannot be criticized for deviating from the rule of *Radio.* The holding in the latter case was simply a general requirement of good faith. The fact that the *Kaudern* court necessarily utilized a different approach in deciding its case does not prevent a finding that it is consistent with *Radio.*

There is an immediate danger to the validity of the technique used in this case that includes an evaluation of the actual conduct of carrier personnel or counsel. Armed with the knowledge that prior bad

34 277 F. Supp. 83, 88-89 (D.N.J. 1968). The origin of the criteria is interesting. They are found as subheadings in the annotations at 40 A.L.R.2d 168 (1955). It seems likely that the *Brown* court extracted them from that source.

35 *Id.* at 91.

faith decisions have been influenced greatly by such conduct, the individuals involved could comply with every one of the objective requirements, while retaining a true bad faith intent to try a case at the probable expense of the insured. For example, an attorney could protect the carrier from criticism for disregarding his advice by either placing no opinion in the file or, cynically and unethically, putting a self-serving opinion in the file that contradicts his true beliefs.

There is another closely related hazard. The trials in these cases include testimony of carrier personnel, carrier trial counsel, trial counsel for the original claimant, and counsel possibly retained by the insured upon notification of the excess problem. They are questioned on their evaluations of the original case. The opportunities for self-serving and well-schooled statements are unlimited. If there were an easy test of bad faith, such statements would pose no real problem. However, where the quest for a determination of good or bad faith is itself tortuous, such testimony exacerbates the problem of achieving an accurate and just result.

Though individual criteria may be objective, their utilization as a whole still requires subjective value judgments. How many violations of the objective tests must be found before a carrier can be found liable for bad faith? Perhaps, as in this case, the criteria can only substantiate an opinion created by the inferences drawn circumstantially from the case. This notion will be reinforced later when it will be shown that even a perfect score on the list as a whole does not require a finding of good faith.

Whenever applying the law of *Radio* to any particular case, the restrictions enunciated by the court must be remembered. There must be some substantial wrongdoing provable either by actual conduct showing a subjective mental state of bad faith, or circumstantially by evidence that the carrier disregarded the merits of the accident and, therefore, acted in bad faith. The excess verdict must play no part in such a determination, except as a pre-condition giving rise to the entire proceeding. In *Kaudern*, the structure of the case, together with the actual misconduct of the carrier, makes it clear that the finding of bad faith did not exceed the limitations of that concept.

The next decision on bad faith, *Bowers v. Camden Fire Insurance Association*,[36] was decided on January 22, 1968 by the New Jersey Supreme Court. Bowers struck a 21 month old infant with his automobile. Since there were no witnesses, and because of the age of the child, it was necessary to infer negligence from the circumstances if a

[36] 51 N.J. 62, 237 A.2d 857 (1968).

verdict was to be rendered against him. The severely injured child could not, as a matter of law, have been contributorily negligent. There was a demand by the claimant's attorney in the amount of $20,000, the policy limit. The carrier made substantial offers, but not to the limit of the policy. The trial resulted in a verdict of $29,000. A motion was made for a new trial on grounds that the facts proved were insufficient to justify a verdict for the plaintiff and that the verdict was against the weight of the evidence. It was denied. The battle lines were not yet drawn; for, unlike prior cases, no claim was made that the insurer's actions prior to trial were motivated by bad faith. The carrier then proceeded to appeal on similar grounds,[37] declining to accept another offer by the infant's attorney to settle for the policy limits. The Appellate Division dismissed that appeal in a short per curiam opinion.[38]

Suit was brought by the insured on the narrow issue of whether the refusal to accept the demand for the policy limit and instead pursuing an appeal in the face of an excess verdict constituted bad faith. A jury found for Bowers in the Superior Court, Law Division.[39] The Appellate Division reversal[40] was followed by a decision for Bowers in the Supreme Court.[41]

Because only the interests of the insured were being jeopardized and only the carrier stood to profit by the appeal, the New Jersey Supreme Court announced that it seemed obvious that the good faith test had to be more exacting at that stage. The court stated:

> [I]n circumstances such as existed in the present case, . . . the facts must point to the probability of a reversal. . . . If the evidence is such as to create any reasonable basis for disagreement among reasonable minds as to whether the insurer discharged its duty of good faith, the question must be submitted to the jury. . . .[42]

It is interesting to observe that the court, using the principle of probabilities, placed the burden on the insurer rather than the insured. The court pointed out that the insurer should have realized that an appeal from the initial verdict for damages against Bowers would probably be futile as an appellate tribunal rarely reverses the trial court's findings that the evidence was sufficient to support the jury verdict.[43]

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37 The appellant argued that there was insufficient evidence to submit the issue of negligence to a jury, and that the court erred in refusing defendant's motion for involuntary dismissal. *Id.* at 70, 237 A.2d at 861.

38 *Id.* at 70, 237 A.2d at 861.

39 *Id.* at 66, 237 A.2d at 859.

40 93 N.J. Super. 302, 225 A.2d 715 (App. Div. 1967).

41 51 N.J. 62, 237 A.2d 857 (1968).

42 *Id.* at 73, 237 A.2d at 863.

43 *Id.* at 74, 237 A.2d at 863.

These then were the New Jersey precedents available to the parties and the court in the bad faith litigation that ensued from the accident of Stanley Miller. *Board of Education of the Borough of Chatham v. Lumbermens Mutual Casualty Company*[44] was unique in many respects. The verdict against the insured, even after the reduction by the court, was higher than in any of the prior bad faith cases.[45] Moreover, *Chatham* was the first New Jersey case on bad faith that did not result from an automobile accident. Because the type of accident involved here was much more complex, the difficulty of determining a probable outcome was correspondingly exacerbated.

As in *Kaudern*, this action was tried in the U.S. District Court for New Jersey. The case was heard by Judge Wortendyke without a jury. The court discarded the negligence theory alleged and considered the case solely on the issue of bad faith.

The obligation to apply New Jersey law must have been discomforting to the court. None of the preceding cases had a similar structure, so that no forerunner utilized an approach that could be applied to the case at bar. As has been seen, the approach of *Radio* relied upon an ability to establish a probable result. It might be stated accurately that a verdict against the Board, unless severely mitigated by the jury due to the questionable liability, was likely to exceed the policy limit of $200,000.[46] As in *Kaudern*, the problem was primarily to predict the likelihood of a verdict for the plaintiff. Moreover, the approach of *Kaudern*, standing alone, was of little value. This court's reference to the criteria stated in that case afforded no conclusive results, and was in fact possibly favorable to the carrier. In addition, the makeup of this case did not clearly suggest bad faith since the insurer risked a substantial amount of its own money. The *Bowers* holding was strictly limited to a specific situation, one of appeal. Therefore it was not applicable to the *Chatham* matter.

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44 293 F. Supp. 541 (D.N.J. 1968), *aff'd*, App. No. 17,871 (3d Cir., filed Dec. 4, 1969).

45 The court's reduction of the verdict exemplifies the unpredictability of a jury. Clearly, this characteristic increases the burden of the carrier in a potential bad faith situation. Review of jury verdicts by the court does little to assuage this problem for only shocking verdicts are set aside.

46 Stanley's special damages at the time of trial were in excess of $18,000. In his brief, counsel for the Appellee Board estimated the lifetime monetary outlay as follows:

A.	Urological care	$ 92,560.00
B.	Therapy	85,280.00
C.	Neurological care	40,560.00
D.	Companion care	454,520.00
E.	Loss of earnings	450,000.00
	Total	$1,122,920.00

This did not include an award for pain and suffering. Brief for Appellee at 6, Board of Educ. v. Lumbermens Mut. Cas. Co., App. No. 17,871 (3d Cir., filed Dec. 4, 1969).

In his opinion, Judge Wortendyke reviewed the law on the problem of bad faith and then went on to summarize, in considerable detail, the evidence adduced at trial. He went to great lengths to sift through the conflicting testimony to ascertain the genuine opinions that motivated the actions of the various parties. As already discussed, testimony of witnesses in bad faith suits is often unreliable as they know all-too-well what opinions they should espouse. Consequently, the record is often replete with self-serving statements. This case was no exception.

A review of the essential factors will suffice for our purposes. The initial investigation by carrier personnel resulted in an opinion that the Board was statutorily immune and that the physical education instructor probably was not negligent.[47] The Board retained an attorney who asked to be advised of all significant developments. When the attorney for Stanley Miller demanded $200,000, the policy limit, counsel for the Board wrote to Lumbermens to demand that the case be settled in that amount.[48] The carrier was advised that it would be held accountable for any liability incurred by the Board in the event of an excess judgment. The trial court advised the carrier that the Millers would consider a $150,000 settlement.[49] The carrier's representative had obtained authority to offer $100,000. No definite offer of that amount was made because the Millers' attorney stated that it would not settle the case.[50]

After reading the lengthy and detailed recapitulation, one is struck by the fact that nowhere in the opinion did the court, through either emphasis or comment, designate any feature as being especially significant in its conclusion that Lumbermens was liable to the Board. Instead, the judge proceeded to the decision itself, leaving one to feel frustrated by the inconclusiveness of such a lengthy treatment. The inference arises that it was the considered judgment of the court that no valid conclusions could be isolated. Then the court's discretion would seem to have required silence rather than a candid announcement that might, by itself, bring an appeal.

The criteria of *Kaudern* were then applied to test the good faith of Lumbermens. Curiously, this afforded extremely vague and inconclusive results. On the first item, the strength of the claimant's case on the issues of liability and damages, the court merely indicated that the Miller case was strong on damages but was initially considered weak on liability. The liability was recognized by the carrier to have

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47 293 F. Supp. 541, 546 (D.N.J. 1968).

48 *Id.*

49 *Id.* at 547.

50 *Id.* at 553.

been enhanced by the severity of the injuries. The remainder of the criteria were applied to *Chatham* with results favorable to the carrier, with one possible exception. It was stated in passing that the carrier did attempt to induce the Board to contribute to the settlement.[51] Neither in *Chatham* nor in *Kaudern*, where there was no such effort, is it made clear if such efforts are regarded as virtuous or suspect. This confusion was demonstrated in the subsequent appeal. Both parties raised the point, apparently feeling that it reinforced their position.[52] The criteria originally appeared as subheadings in an article on the excess verdict problem in *American Law Reports Annotated, Second Series*,[53] where it is clearly stated that the conduct that is subject to criticism is the attempt by the carrier to have its policyholder contribute to a settlement *within* the policy limits. Such was not the case in *Chatham*. The carrier did recognize the possibility of an excess verdict. A warning was given to the insured and the carrier urged that the Board consider a settlement of the excess possibilities prior to trial.[54]

Conceptually, the two actions are dissimilar. To coerce a policyholder to contribute to a settlement within the policy limits is to shirk the responsibility assumed by contract. Conversely, to encourage an insured to protect itself from foreseeable excess liability, while also, coincidentally, ridding a carrier of the threat of an excess suit when the advice is implemented, seems to be sound counsel. Certainly, the activities of carrier personnel in this regard cannot be disparaged under the checklist.

Actually, the criteria shed some favorable light on the action of the carrier in another area. Here was a situation where the decision of Lumbermens not to settle exposed the insured to excess liability. However, at the same time it also exposed at least $50,000 more of insurance company money. Assuming that the case could have been settled for $150,000, the carrier had that amount remaining in the policy limit. Surely such a circumstance would afford inferences favorable to the carrier. Application of the checklist thus clearly did not bring any results that might support a determination of bad faith.

The court then adverted to dictum found in *Bowers* where the New Jersey Supreme Court had pointed out that, in a situation where the carrier recognizes the *probability* of an adverse verdict in excess of

[51] Criterion number two is: "Attempts by the insurer to induce the insured to contribute to the settlement." *Id.* at 545.

[52] Brief for Appellant at 29, Brief for Appellee at 50, Board of Educ. v. Lumbermens Mut. Cas. Co., App. No. 17,871 (3d Cir., filed Dec. 4, 1969).

[53] Annot., 40 A.L.R.2d 168, 197-205 (1955).

[54] 293 F. Supp. 541, 547 (D.N.J. 1968).

the policy limits, the boundaries of good faith become more compressed in favor of the insured. When such a probability exists, the insurer must treat the settlement offer as if it had full coverage for any verdict. Only in such a circumstance will the refusal of an offer be in good faith.[55]

The exact words of Judge Wortendyke are important: "The evidence in the instant case persuades me that Lumbermens . . . was not acting in good faith. As was stated in *Bowers*, . . . 'when it is *probable* that an adverse verdict will exceed the policy limit . . . ,' " the carrier can only act in good faith by treating any offer to settle as though it had full coverage for any verdict.[56] (Emphasis added by the *Chatham* court.) Clearly, the court based its decision on a finding that it was probable that there would be an adverse verdict and that it would exceed the policy limit. The difficulty in such a conclusion is that nowhere in the opinion does the court provide any specifics to support it. Instead, there is a mere statement of that conclusion after a lengthy review of the evidence.

The next point is crucial. "The criterion expressed in *Bowers* . . . was applied in Potomac Insurance Company v. Wilkins Company, Inc. . . ."[57] Commenting that the Court of Appeals had found that Potomac was not negligent in its investigation or preparation of the case, that it was properly tried, and that the conclusion of non-liability by Potomac was *arrived at honestly*, the court then quoted from the *Potomac* opinion. "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 it did, they certainly were advised of the probabilities that there would be a very substantial excess judgment." (Emphasis added.)[58] Judge Wortendyke went on to quote a further excerpt from *Potomac*, namely, ". . . While we do not cast upon Potomac the requirement of prescience, we nevertheless are satisfied that the nature of [the] suit indicated a *reasonable possibility* that the case would be submitted to a jury and that a recovery substantially in excess of the . . . policy limit would result." (Emphasis added.)[59]

In finding for the Board, the court found a "striking parallelism"[60] between *Potomac* and *Chatham*. Some similarities between the cases are

[55] 51 N.J. 62, 71-72, 237 A.2d 857, 862 (1968).
[56] 293 F. Supp. 541, 554 (D.N.J. 1968).
[57] *Id.* at 554.
[58] 376 F.2d 425, 427 (10th Cir. 1967).
[59] *Id.* at 428.
[60] 293 F. Supp. 541, 555 (D.N.J. 1968).

readily apparent. Potomac had substantial policy limits, $100,000. The insured retained counsel to protect it from the excess hazard. That attorney made demand upon the carrier that the matter be settled within the policy limits. The case could have been settled within the limits, but the insurer refused to offer more than $25,000, asserting that there was no proof of liability. A verdict resulted in the amount of $300,048.38, subsequently reduced through settlement negotiations. It is evident that the structure is similar to that of *Chatham*. Deductively, it would appear, however, that the reasons for citing the case were primarily that there was no overt evidence of bad faith of the carrier, that the issue of liability was unclear and involved conflicting evidence, and that it involved very serious injuries so that, if a verdict for the claimant did result, it would have been likely to exceed the policy limit.[61]

This court's technique of referring to a similarly structured case to obtain a decision may reinforce a conclusion that general defining language is of little assistance in a determination of good faith in a case like *Chatham*. This approach would seem to provide evidence that perhaps the most useful precedent in an action of bad faith is that involving a similar factual situation. Be that as it may, the use of *Potomac* is disconcerting. When juxtaposed with language of *Radio*, the quotations above from *Potomac* are clearly seen to conflict with New Jersey law. "But certainly the defendant . . . realized that there was always the chance that their judgment and opinion would be wrong . . ."[62] certainly runs counter to the dictates of *Radio* that a "mere mistake of honest judgment" does not even create a jury question of bad faith.[63] Moreover, there is no doubt that the "reasonable possibility" of a case going to a jury and resulting in an excess verdict differs fundamentally from the New Jersey concept of "probabilities." Therefore, the analyst is confronted with a decision based initially on dictum and reinforced with case law involving differing legal principles. The link between them is a spurious statement that the latter embodies the principle of the former.

Appeal was made by Lumbermens to the Court of Appeals, Third Circuit.[64] In an opinion filed December 4, 1969, that court chose not

61 The *Potomac* court stated the matter in terms of "probabilities that there would be a very substantial excess verdict." But this followed a discussion of whether there would be a plaintiff's verdict. It is clear that the "probabilities" concept of our law relates to the fact of an excess verdict itself and *not* to a structure where, *if* there is a verdict, it would exceed the policy limit.

62 376 F.2d 425, 427 (10th Cir. 1967).

63 31 N.J. 299, 305, 157 A.2d 319, 323 (1960).

64 Board of Educ. v. Lumbermens Mut. Cas. Co., App. No. 17,871 (3d Cir., filed Dec. 4, 1969).

to respond to appellant's fundamental and substantial arguments, but instead affirmed in a per curiam opinion which addressed itself to alleged errors in facts found by the court below. The court summarily dismissed those arguments, not a major part of the appellant's case, as establishing error that was not significant in the final result. A petition for rehearing was denied. No further action is contemplated by the appellant.[65]

It can be seen that our law of bad faith has progressed from a state where insurance carriers and insureds alike could predict with some accuracy the outcome of most bad faith litigation, limited perhaps only by their ability to concur with the jury on the probable verdict of a case, to a situation where the true rationale behind the most recent bad faith decision is something of a riddle. It could be argued that the court applied a retrospective test and in fact felt that an excess verdict establishes a certain inference of bad faith. Such an accusation cannot be effectively denied, as *Chatham* showed a lack of proof of the subjective mental condition of bad faith, not uncommon in bad faith cases, accompanied by a lack of cogently presented circumstantial evidence from which bad faith could be inferred. Of importance to the principle of judicial consistency is the fact that such a retrospective test would run counter to the very essence of *Radio.*

To state the above conclusion alone is unfair. The extreme difficulty or, perhaps, impossibility of applying, with reasonable logic, the prior holdings of this state to *Chatham* has already been shown. Any court might have been hard pressed to frame a compelling opinion utilizing existing law. However, the state of New Jersey law after *Chatham* is far from ideal. Speculation that the court merely paid lip service to precedent while, in reality, applying a retrospective test neither increases the confidence of those confronted with a bad faith problem nor does it engender proper respect for the bench.

Even if true, such criticism might be unjust. A federal court judge has no power to revise the substantive law of a state. Judge Wortendyke was required to reach a fair decision, an unenviable task when one realizes that the legal principles available to him did not fit the situation as well as might be desired and that he was powerless to fashion new ones.

Predicting the result of future New Jersey cases on bad faith is difficult. One must first deal with the problem of interpreting what has gone before. The more essential task of defining a trend is exacerbated by the somewhat indefinite foundation. In any event, one might suppose it safe in a particular case to reject settlement offers and risk a

65 Private communication with counsel for appellant.

trial when the liability and damages can be transposed into a meaningful prediction of the verdict range. The courts might be relied upon to continue protecting the carrier from jury excesses. However, for cases where the damages are so sizeable that any verdict would be likely to exceed policy limits, but where liability is truly questionable, the message is clear. Tread with care. If the accident litigation is lost, the problem will probably be compounded by the imposition of bad faith liability.

If our law is to be revised to correct the problems raised by *Chatham*, the difficulty of finding a better concept will have to be met. Clearly, either of the extreme views, imposing either an absolute duty on the carrier or no duty at all, would be preferred from the narrow viewpoint of facile legal administration.[66] The likelihood of even nominal consideration of the latter alternative appears small. However, the former is discussed in *Crisci v. Security Insurance Company*,[67] a California case. That opinion indicates that the courts of that state are moving to the concept of strict liability. The simplicity of application was of course applauded. More surprisingly, it was also argued that it is not clear that the proposed rule would place a substantially greater burden on the carrier.

In reality, it does not seem likely that either extreme view will be followed by New Jersey courts, or many others for that matter, if for no other reason than that those views are extreme.[68] Instead, it is likely that some fault concept will be followed. If the *Chatham* case represented a conscious subversion of prior New Jersey law, reflecting dissatisfaction in a policy sense with its results, it would seem that a trend toward more frequent liability of the carrier will result. Any such shift should of course be declared. A possible rule that might accomplish that shift would involve the transferring of the burden of proof.[69] The insurance carrier could be held liable for the excess verdict unless it were able to prove its exercise of good faith. In other words, an excess verdict alone would create a prima facie case against the carrier. One initial advantage is that of obviating a situation where it is stated that the excess verdict itself is to play no part in the determination of the carrier's good faith, but where doubts arise as to whether such a mandate has been followed because the opinion is written so as not to reveal the foundation of its decision. The rule would have the virtue of straightforwardness.

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66 Annot., 40 A.L.R.2d 168, 172 (1955).

67 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

68 *See* Annot., 40 A.L.R.2d 168, 173 (1955).

69 *Id.*

It is unclear, moreover, that such a rule would impose additional burdens on the carrier. Application of it to the *Chatham* case would almost surely bring the same result. Situations where a carrier could prove its good faith would probably be limited to cases structured along *Radio*'s lines, where it could be argued that a jury exceeded the probable verdict range. The parties might well stand where they do today, but with the advantage of increased knowledge of the nature of their footing.

Our bad faith law might be confronted with other changes. Recently, a carrier was held liable for bad faith in a situation lacking one of the classical prerequisites, namely, that the case could be settled within the policy limits.[70] The case involved a $20,000 insurance limit and a demand of $40,000. The Second Circuit Court of Appeals upheld the argument of the plaintiff that the carrier should have notified it of the demand, even though it exceeded the policy limits, to enable it to contribute to a settlement. In addition, the court theorized that a counteroffer by the carrier, within the limits, might have induced a settlement within those policy bounds.

Whatever our law of bad faith is, it can only be hoped that a candid declaration of a rule and the policy reasons behind it will be the norm, not the exception.

Charles R. Church

[70] Young v. American Cas. Co., 416 F.2d 906 (2d Cir. 1969).