COMMENTS

INSURANCE CARRIER'S DUTY TO SETTLE: STRICT LIABILITY IN EXCESS LIABILITY CASES?

An improper refusal to settle a claim may constitute a breach of contract which can result in liability on the part of an insurance company in excess of its policy limits. This is known as an "excess case." While all types of casualty and liability insurers may be subjected to excess suits, certain basic elements common to all such cases include: a claim against the policyholder in excess of the policy limits; a refusal by the insurer to settle the claim prior to trial; and a judgment against the insured which cannot be wholly satisfied by the policy. Where the refusal by the insurer to settle is improperly motivated or constitutes a breach of duty to the insured, courts have found that a cause of action may lie against the insurance carrier.[1]

---

[1] The facts which give rise to an excess case are generally uniform. Most cases follow a pattern similar to that demonstrated in the following example: the insurance company writes a liability policy for the insured with a face value of $10,000.00. Claimant sustains an injury, the type of which was contemplated by the policy, as a result of the insured's negligence and institutes suit against the insured for $20,000.00. The insurance company has an opportunity to settle the claim for the face value of the policy (or anything less), but rejects it in favor of going to trial. A verdict is entered in favor of the claimant for $20,000.00, of which the insurance company pays $10,000.00 and the insured is personally liable for the remainder.

Professor Lewis has outlined eight separate theories upon which the original claimant may proceed:

> (1) by joinder or direct action [where permitted by statute or policy]; (2) by subrogation or substitution [which is also based on statutory provisions]; (3) by assignment [which is the most common theory]; (4) by levy and purchase at execution sale [where the claimant proceeds first against the insured as a judgment creditor]; (5) by garnishment [which is a limited approach]; (6) by suit as a third party beneficiary; (7) by appointment of a receiver through judgment debtor examination proceedings; (8) by a creditor's bill for equitable execution.

Lewis, *Insurer's Liability To Insured For Judgments Exceeding Policy Limits*, 7 DRAKE L. REV. 23, 34 (1958). The last two theories would require than an action be filed against the insured for the appointment of a receiver who would then proceed against the insurer in favor of the initial claimant. *Id.* at 37.

It is clear that the failure of the insurance company to settle the claim here is a sine qua non of the subsequent personal liability of the insured. In an excess case, the plaintiff attempts to show that the failure to settle is a breach of some duty owed the insured, with resulting damages measured by the extent of the insured's personal liability. *See, e.g.*, Yeomans v. Allstate Ins. Co., 130 N.J. Super. 48, 52, 324 A.2d 906, 908 (App. Div. 1974). The measure of damages may extend beyond this limit if the plaintiff can show additional injury. *See, e.g.*, Crisci v. Security Ins. Co., 66 Cal. 2d 425, 432, 426 P.2d 173, 178, 58 Cal. Rptr. 13, 18 (1967). *See also* Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1177-79 (1954).

The plaintiff in an excess case is either the insured, or as is frequently the case, the claimant. The claimant, although a stranger to the relationship of the insurer and the insured, may establish himself as a party in interest. *Id.* at 1176.

The entire question of excess liability arises out of the relationship between the policyholder and his insurance company. The responsibilities and duties which are imposed by this relationship arise not only from the four corners of the contract, but also from judicial interpretation of that contract,[2] which becomes necessary when the interests of the contracting parties conflict. Since the company's liability is limited by the terms of the policy and the insured's liability is unlimited, conflicts over the issue of settlement naturally arise to complicate the insured/insurer relationship.

Ordinarily the insurer has two express duties, the duty to defend and the duty to pay.[3] The insurer must afford a legal defense for the policyholder whenever it is alleged that the insured has committed an act, the result of which has caused injuries or damages for which the policy affords coverage. The duty to pay subsequently arises when the insured becomes legally obligated to such an injured claimant.

The insurer's assumption of duties under the insurance contract is usually accompanied by the exclusive right to control all

When the insured initiates the action, the general rule has developed that he need not pay the excess judgment in order to acquire standing. *See, e.g.*, Chitty v. State Farm Mut. Auto. Ins. Co., 38 F.R.D. 37, 41 (E.D.S.C. 1965); Alabama Farm Bureau Mut. Cas. Ins. Co. v. Dalrymple, 270 Ala. 119, 122, 116 So. 2d 924, 925 (1959); Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 690, 319 P.2d 69, 75 (Dist. Ct. App. 1957). This is premised on the theory that final judgment against the insured, rather than payment, gave rise to the cause of action against the insurer for failure to settle. State Farm Mut. Auto. Ins. Co. v. Marcum, 420 S.W.2d 113, 118 (Ky. Ct. App. 1967). *See generally* Note, 52 CORNELL L.Q. 778, 783 (1967).

[2] *See* Hilker v. Western Auto. Ins. Co., 204 Wis. 1, 4, 231 N.W. 257, 258 (1930) (rights of insured extend beyond surface of policy).

For example, while there is no duty to settle under accepted contract principles, the courts have implied such a duty from the insurer's exclusive control of the claim. Wooten v. Central Mut. Ins. Co., 166 So. 2d 747, 750 (La. Ct. App. 1964). Similarly arising from this exclusive control is the insurer's implied duty to deal fairly and exercise good faith in considering the interests of the insured, and to give equal weight to the interests of the insured. Southern Fire & Cas. Co. v. Norris, 35 Tenn. App. 657, 669-70, 250 S.W.2d 785, 790 (1952) (insurer must subordinate its interests to those of insured). *See* Prickett v. Hawkeye-Security Ins. Co., 282 F.2d 294, 299-300 (10th Cir. 1960); Davy v. Public Nat'l Ins. Co., 181 Cal. App. 2d 387, 395, 5 Cal. Rptr. 488, 492 (Dist. Ct. App. 1960).

[3] A typical liability insurance policy provision is:

> The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of
> A. bodily injury or
> B. property damage
> to which this insurance applies . . . and the company shall have the right and duty to defend any suit against the insured seeking damages on account of such bodily injury or property damage, even if any of the allegations of the suit are groundless, false or fraudulent . . . .

R. KEETON, INSURANCE LAW, app. G, at 658 (1971). *See* Chappell & Epps, *Insurer's Liability in Excess of Policy Limits: Some Aspects of the Problem*, 44 VA. L. REV. 267, 268 (1958). *See also* Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 868, 110 Cal. Rptr. 511, 517 (Dist. Ct. App. 1973).

litigation against the insured.[4] This can be an onerous burden upon the policyholder when a claim is made in excess of the policy limits, as he has only limited rights to participate in the defense of an action which may result in substantial personal liability.[5] In addition, the carrier has the contractual right to settle any claim at his discretion.[6] Under these circumstances, the crucial question is whether there exists under a policy a duty to settle.[7]

This conflict brings the carrier's duty to consider the interests of the insurer under the close scrutiny of the courts. Such duty by the insurance company embraces the investigation and negotiation aspects of the claim as well as the transmission of all such relevant or pertinent information to the policyholder.[8] Within this conflicting relationship, the defense attorney representing both interests becomes intimately involved with the investigation and the negotiation of any claim, and his conduct will also come within the purview of a court considering an excess liability case.[9]

At the heart of the excess case is the manner in which the

---

[4] *See, e.g.*, Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 660, 328 P.2d 198, 201 (1958); Georgia Cas. Co. v. Mann, 242 Ky. 447, 451, 46 S.W.2d 777, 779 (1932); Johnson v. Hardware Mut. Cas. Co., 108 Vt. 269, 277, 187 A. 788, 792 (1936). *See* Keeton, *supra* note 1, at 1137.

The defense of an action against the insured has been referred to as both a duty and a right. This is a proper characterization since the duty to defend benefits the insured, while the right to defend is essential to the protection of the insurer. Podolsky v. Devinney, 281 F. Supp. 488, 494 (S.D.N.Y. 1968). *See generally* 7A APPLEMAN, INSURANCE LAW AND PRACTICE § 4681 (1962) [hereinafter cited as APPLEMAN].

In addition, the insurer is usually entitled to prompt notification of all claims and complete cooperation from the insured throughout the litigation. For an example of an automobile comprehensive liability policy form see R. KEETON, INSURANCE LAW, app. G, at 655 (1971).

[5] *See, e.g.*, Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 870, 110 Cal. Rptr. 511, 519 (Dist. Ct. App. 1973). The status of the insured is little improved by the retention of separate counsel because

> separate representation usually amounts to nothing more than independent legal advice to the assured, since control of the litigation remains in the hands of the carrier.

Id.

[6] *See, e.g.*, Long v. Union Indem. Co., 277 Mass. 428, 430, 178 N.E. 737, 738 (Sup. Jud. Ct. 1931); Best Bldg. Co. v. Employers' Liab. Assurance Corp., 247 N.Y. 451, 453, 160 N.E. 911, 912 (1928); Auerbach v. Maryland Cas. Co., 236 N.Y. 247, 252, 140 N.E. 577, 579 (1923).

[7] The basis of any insured's complaint is that there is a duty to settle. Lewis, *supra* note 1, at 23. Courts have generally held there is no obligation to settle. LaRocca v. State Farm Mut. Auto. Ins. Co., 329 F. Supp. 163, 168 (W.D.Pa. 1971, *aff'd*, 474 F.2d 1338 (3d Cir. 1973); Olson v. Union Fire Ins. Co., 174 Neb. 375, 379, 118 N.W.2d 318, 321 (1962). *See also* Chappell & Epps, *supra* note 3, at 268, in which the authors note that "[n]owhere in the policy . . . is any duty expressly conferred upon the insurer *to settle.*" (Emphasis in original.)

[8] Lewis, *supra* note 1, at 27-32. The insurer must investigate all factual and legal aspects of the case, negotiate with protection of the insured's interests in mind, and transmit all relevant information to the insured. *Id.*

[9] *See, e.g.*, Ivy v. Pacific Auto. Ins. Co., 156 Cal. App. 2d 652, 663, 320 P.2d 140, 148 (Dist. Ct. App. 1958) (covenants of good faith and fair dealing imposed on attorney).

carrier arrives at the determination of whether to settle a claim or go to trial. This decision, resting solely within the discretion of the insurer, affects substantial interests of the insured, since in the event of an excess verdict his liability is limited only by the value of his personal assets.[10] The apparent inequity of risk in this arrangement has forced the courts to intercede in the insured/insurer relationship. The New Jersey judiciary has recognized

> the emergence and development of those principles of equity, fair dealing and good faith . . . which breathed new life-giving honesty into the bare contractual relationship sometimes mentioned as existing between insured and insurer.[11]

Through the vehicle of the excess case, the courts have fostered a new relationship and have instilled in the insurance contract respect for that relationship.[12]

HISTORY OF THE ACTION

An historical analysis of the excess liability case demonstrates a general shift in the courts' treatment of this issue from the law of contracts to the law of torts,[13] which has evolved through four separate theories.[14]

At the outset,[15] courts addressed the issue of excess liability in terms of pure contract law, attempting to ascertain the duties of

---

[10] *See* Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 870, 110 Cal. Rptr. 511, 519 (Dist. Ct. App. 1973).

[11] Rova Farms Resort, Inc. v. Investors Ins. Co., 65 N.J. 474, 491, 323 A.2d 495, 504 (1974).

[12] *Id. See also* American Fidelity & Cas. Co. v. G.A. Nichols Co., 173 F.2d 830, 832 (10th Cir. 1949) (insurer must consider insured's interests); Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 868, 110 Cal. Rptr. 511, 518 (Dist. Ct. App. 1973) (where conflict exists, carrier is bound to protect interest of the insured as well as its own).

[13] The earliest excess cases were based on contract theory. *See, e.g.,* McDonald v. Royal Indem. Ins. Co., 109 N.J.L. 308, 310, 162 A. 620, 620 (Ct. Err. & App. 1932); Auerbach v. Maryland Cas. Co., 236 N.Y. 247, 252, 140 N.E. 577, 578 (1923); C. Schmidt & Sons Brewing Co. v. Travelers Ins. Co., 244 Pa. 286, 288-89, 90 A. 653, 654 (1914). There has been a general shift to the tort theories. *See, e.g.,* Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co., 31 N.J. 299, 303, 157 A.2d 319, 322 (1960). In fact, "[m]ost courts are now in agreement that the problem is one of *tort* law exclusively." Lewis, *supra* note 1, at 24 (footnote omitted) (emphasis in original).

[14] *See* notes 15-28 *infra* and accompanying text (basic contract principles); notes 29-41 *infra* and accompanying text (bad faith test); notes 42-63 *infra* and accompanying text (negligence-due care); notes 64-84 *infra* and accompanying text (good faith test).

[15] The issue of excess liability was considered by the courts as early as 1899. In Rumford Falls Paper Co. v. Fidelity & Cas. Co., 92 Me. 574, 587, 43 A. 503, 506 (1899), the Maine court stated that it was powerless to add to or take away from the terms of the contract. Additionally, the court suggested that expanded liability might persuade the insured to relax "those rules of prudence and vigilance which are indispensable for . . . reasonable protection." *Id.*

the insurance company strictly from the four corners of the policy.[16] When the issue of excess liability was one of first impression in New Jersey, the highest court stated:

> "The rights of the parties are to be determined by the agreement into which they entered. By the provisions of the policy the insurance company was obliged to defend at its own cost any action against the insured, and the entire management of the defense was expressly intrusted to it, and the insured was forbidden to settle any claim, or to interfere in any negotiations for the settlement, or in any legal proceeding against it. The insurer was under no obligation to pay in advance of trial, and the decision whether to settle or to try was committed to it. *The plain words of the policy have no other meaning.*"[17]

In *McDonald v. Royal Indemnity Insurance Co.*,[18] the original claim arose from an automobile accident which could have been settled for $2,000.[19] The insurer refused the settlement offer and a subsequent excess verdict of $7,500 was recovered by the claimant.[20] After the judgment was set aside, the claimant offered to settle for $3,500, but this was also rejected. Judgment was subsequently entered against McDonald for $20,000.[21] In McDonald's suit against the insurer for damages amounting to the excess over the policy limits, the court held that in the contract of insurance, the insurer "did not agree to and was not obliged to settle,"[22] thus vindicating the insurance company for their conduct.

Other early cases established the insurer's complete discretion in the area of settlement negotiations.[23] Applying strict contract law, it was determined that no excess liability could be imposed on an insurer for failure to settle because the policy limits are absolute, and the insurer had no contractual duty to settle.[24] This conclusion was a product of the early reluctance of the courts to

---

[16] *See* cases cited note 6 *supra*. *See also* Chappell & Epps, *supra* note 3, at 268; Lewis, *supra* note 1, at 24.

[17] McDonald v. Royal Indem. Ins. Co., 109 N.J.L. 308, 310, 162 A. 620, 620 (Ct. Err. & App. 1932) (quoting from C. Schmidt & Sons Brewing Co. v. Travelers Ins. Co., 244 Pa. 286, 288-289, 90 A. 653 654 (1914)) (emphasis added).

[18] 109 N.J.L. 308, 162 A. 620 (Ct. Err. & App. 1932).

[19] *Id.* at 309, 162 A. at 620.

[20] *Id.*

[21] *Id.*

[22] *Id.* at 310, 162 A. at 620.

[23] Georgia Cas. Co. v. Mann, 242 Ky. 447, 451, 46 S.W.2d 777, 779 (1932) (insurer has "sole right to settle"); Rumford Falls Paper Co. v. Fidelity & Cas. Co., 92 Me. 574, 583, 43 A. 503, 505 (1899) (insured, under policy, surrenders full and absolute control over settlement to insurer); C. Schmidt & Sons Brewing Co. v. Travelers Ins. Co., 244 Pa. 286, 289, 90 A. 653, 654 (1914) (insurer is not obliged to pay prior to trial).

[24] *See* Keeton, *supra* note 1, at 1138 & n.4.

look beyond the insurance contract in order to determine the rights and duties of the parties. This approach to the excess liability question has, today, generally been rejected by the majority of jurisdictions in favor of the application of more liberal tort doctrines.[25]

As an alternative to the strict contract approach, under which the insurer would be liable for failure to settle only if the duty to settle were specifically stated in the policy, the courts turned to the law of torts.[26] Every contract, by virtue of common law, imposes on the parties to it an obligation to perform their respective duties with care, skill, reasonableness and good faith.[27] Failure by the insurer to observe these implied convenants of good faith and fair dealing when performing its duties has been held to give rise to a cause of action in favor of the insured or the original claimant, in the event of an excess judgment.[28]

Historically in excess cases, courts have alternatively adopted three basic standards to analyze the tortious breach of these implied covenants. The standards have included bad faith, negligence (due care), and good faith.[29]

---

[25] One commentator has noted that the contract theory "has been almost universally rejected by the courts today." Lewis, *supra* note 1, at 24. It has been similarly observed that "[t]he question is one of tort law." Chappell & Epps, *supra* note 3, at 269. Furthermore, "[t]he majority opinion seems to be that the cause of action sounds in tort." Note, *Excess Liability: Reconsideration of California's Bad Faith Negligence Rule,* 18 STAN. L. REV. 475, 476 (1966) (footnote omitted).

[26] This action has been characterized as a "new tort," which emanates from the insurer's exclusive control of the claim. Cunningham, *Liability in Excess of Policy Limits,* 1957 INS. L.J. 483, 483. The cause of action arises out of "a breach of the implied covenant of good faith and fair dealing." Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 659, 328 P.2d 198, 201 (1958). *See also* Keeton, *supra* note 1, at 1138; Comment, *Excess Liability Suits—The Mounting Need for Strict Liability,* 13 ST. LOUIS U.L.J. 292, 296-97 (1968); Annot., 131 A.L.R. 1499, 1500 (1941).

[27] *See* Cunningham, *supra* note 26, at 483. A California court has stated that

> [i]n every policy of insurance "there is an implied covenant of good faith and fair dealing that neither party will do anything which will injure the right of the other to receive the benefits of the agreement" . . . .

Lysick v. Walcom, 258 Cal. App. 2d 136, 148, 65 Cal. Rptr. 406, 414 (Dist. Ct. App. 1968). *See also* Hills & Pivnicka, *Development and Direction of the California Bad Faith Insurance Doctrine or "O Ye of Little Faith,"* 8 U. SAN FRANCISCO L. REV. 29, 32 (1973).

[28] *See, e.g.,* Crisci v. Security Ins. Co., 66 Cal. 2d 425, 430, 426 P.2d 173, 177, 58 Cal. Rptr. 13, 17 (1967); Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 872, 110 Cal. Rptr. 511, 520 (Dist. Ct. App. 1973); Comunale v. Traders & Gen. Ins. Co.,50 Cal. 2d 654, 658, 328 P.2d 198, 200 (1958). *See also* Lewis, *supra* note 1, at 25; Note, *Recent Developments in the Excess Judgment Suit,* 36 BROOKLYN L. REV. 464, 464 (1970).

[29] While the "reasonable man" standard of the negligence test is well recognized, the concepts of good faith and bad faith have been hopelessly confused by both courts and writers. In employing the test which analyzes the many facets of the insurer's conduct, the court in Kaudern v. Allstate Ins. Co., 277 F. Supp. 83 (D.N.J. 1967), stated that it was using

The bad faith standard was the first to be widely used by the courts in order to assess the conduct of insurance companies in their approach to the issue of settlement. Bad faith, as applied to excess cases, has been defined as

> the intentional disregard of the financial interests of the [insured] in the hope of escaping the full responsibility imposed upon [the insurer] by its policy.[30]

This disregard is normally motivated by the insurer's desire to protect its own interests. Thus, in *Martin v. Travelers Indemnity Co.*,[31] the Fifth Circuit applied a standard which it termed "far less stringent"[32] than the good faith test. The court held that

> an insurer cannot be found liable in excess of its policy limits for failing to settle an action unless its refusal to settle was so arbitrary and unreasonable as to constitute fraud.[33]

---

the "good faith theory." *Id.* at 87. Nonetheless, it concluded that the insurer acted in bad faith. *Id.* at 92. This test was similarly characterized as the good faith theory in Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co., 31 N.J. 299, 303, 157 A.2d 319, 322 (1960), and as the good faith test in Annot., 40 A.L.R.2d 168, 171 (1955). However, this same multi-faceted test was termed the "bad faith" test in National Mut. Cas. Co. v. Britt, 203 Okla. 175, 179, 200 P.2d 407, 412 (1948). *See also* Davy v. Public Nat'l Ins. Co., 181 Cal. App. 2d 387, 395, 5 Cal. Rptr. 488, 492 (Dist. Ct. App. 1960); Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 689, 319 P.2d 69, 75 (Dist. Ct. App. 1957).

Similar confusion arises with legal writers. *See* Appleman, *Duty of Liability Insurer to Compromise Litigation*, 26 Ky. L.J. 100, 104 (1937), in which the author states that fraud is an aspect of the bad faith rule. However, Hills and Pivnicka suggest that bad faith is really a breach of the covenants of good faith and fair dealing. They observed that "the terms bad faith or a breach of the obligation of good faith are used loosely and sometimes interchangeably, especially by practitioners." Hills & Pivnicka, *supra* note 27, at 33, 43.

An examination of the nomenclature in this area reveals only the confusion to which Hills and Pivnicka allude. In an effort to clarify this terminology, for the purposes of this Comment, the bad faith rule or test requires proof of fraud or dishonesty on the part of the insured, while the good faith rule or test requires a tortious breach of the contractual covenants of good faith and fair dealing. This analysis is supported by Garner v. American Mut. Liab. Ins. Co., 31 Cal. App. 3d 843, 848, 107 Cal. Rptr. 604, 607 (1973) (bad faith is not only ground for recovery; it may also be based on good faith); Aetna Cas. & Sur. Co. v. Kornbluth, 28 Colo. App. 194, 198, 471 P.2d 609, 610-11 (1970) (duty to exercise good faith, proof of bad faith, and negligence of insurer are three tests). *See also* Comment, *supra* note 26, at 301 n.49 (nonfeasance is characteristic of good faith while misfeasance indicates bad faith). Keeton suggests that the courts have irreconcilably merged the language of the two tests, often "requiring only good faith as to the *decision* regarding settlement but requiring also ordinary care in the investigation leading to such decision." Keeton, *supra* note 1, at 1141 (emphasis in original) (footnote omitted).

[30] Johnson v. Hardware Mut. Cas. Co., 109 Vt. 481, 491, 1 A.2d 817, 820 (1938). *See also* Detenber v. American Universal Ins. Co., 372 F.2d 50, 53 (6th Cir. 1967) (bad faith implies conscious wrongdoing and assumes the characteristics of fraud).

[31] 450 F.2d 542 (5th Cir. 1971).

[32] *Id.* at 551.

[33] *Id.*

Similarly, in *Bentley v. Farmers' Insurance Exchange*,[34] it was held that excess liability must be predicated upon conduct which amounted to fraud or bad faith.[35]

As a species of fraud, the bad faith test[36] placed the onus on the plaintiff of coming forward with evidence sufficient to show that the insurer's refusal to settle was arbitrary and unreasonable.[37] An allegation of bad faith suggested more than bad judgment or negligence; it implied conscious wrongdoing.[38] Thus, liability for an excess judgment could arise only where an insurer "fraudulently or in bad faith refuse[d] to settle within the policy limits."[39]

By the very nature of the bad faith test, a plaintiff's recovery in an excess suit was difficult and unusual. This test did not readily admit to bringing much pressure to bear on recalcitrant insurance companies, nor did it accurately reflect the high standards of conduct to which insurers are held today.[40] As a result, several jurisdictions have abandoned the bad faith test in favor of the more liberal "negligence test."[41]

Under the negligence test, an insurer incurs excess liability when "it fails to settle when a reasonable man with unlimited exposure in the exercise of due care would have settled."[42] Thus, in light of its expertise[43] the insurer, as a professional, owes to its

---

[34] 289 F.2d 59 (6th Cir. 1961).

[35] *Id.* at 60.

[36] *See* Berk v. Milwaukee Auto. Ins. Co., 245 Wis. 597, 15 N.W.2d 834 (1944), in which the Wisconsin court stated that "[b]ad faith is a species of fraud, and the evidence to sustain a finding thereof must be clear, satisfactory, and convincing." *Id.* at 601, 15 N.W.2d at 836. *See also* Chappell & Epps, *supra* note 3, at 269.

[37] Martin v. Travelers Indem. Co., 450 F.2d 542, 551 (5th Cir. 1971). *See also* Appleman, *supra* note 29, at 106.

[38] *See, e.g.*, Detenber v. American Universal Ins. Co., 372 F.2d 50, 53 (6th Cir. 1967).

[39] 289 F.2d at 60.

[40] *See* notes 122-48 *infra* and accompanying text.

[41] *See, e.g.*, Fidelity & Cas. Co. v. Robb, 267 F.2d 473, 476 (5th Cir. 1959) (applying Texas law); Aetna Cas. & Sur. Co. v. Kornbluth, 28 Colo. App. 194, 199, 471 P.2d 609, 611 (1970); Dumas v. Hartford Accident & Indem. Co., 94 N.H. 484, 487, 56 A.2d 57, 59 (1947). *But see* Wasserman v. Buckeye Union Cas. Co., 32 Ohio St. 2d 69, 290 N.E.2d 837 (1972), in which it was held that bad faith was more than negligence; it required a dishonest motive or an intent to mislead. *Id.* at 73, 290 N.E.2d at 840.

[42] Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co., 31 N.J. 299, 303, 157 A.2d 319, 322 (1960).

[43] The relationship between the insurer's expertise and its subsequent decision whether or not to settle is discussed in McChristian v. State Farm Mut. Auto. Ins. Co., 304 F. Supp. 748 (W.D. Ark. 1969), where it was stated that

> [a] good-faith decision is . . . simply an honest and intelligent one, giving equal consideration to the interest of the insured, made in light of the company's expertise in the field.

Id. at 753 (footnote omitted). *See also* APPLEMAN, *supra* note 4, § 4713.

policyholder a duty of exercising due care.[44] The negligence rule permits a retrospective analysis of the insurer's conduct with respect to the ultimate settlement decision.[45]

New Hampshire, in *Douglas v. United States Fidelity & Guaranty Co.*,[46] was one of the first jurisdictions to demonstrate the application of this approach. In *Douglas*, the plaintiff held a $5,000 liability policy with the defendant insurer.[47] Elliot, the plaintiff's servant, suffered an injury, covered by the defendant's policy and offered a $1,500 settlement to the defendant.[48] The carrier refused, went to trial, and lost. The court, entering judgment in excess of the policy limits, held that the insured had a right to expect the insurer to "act in a reasonable way" concerning settlement negotiations,[49] thereby recognizing that in an excess liability situation,

> "the assured helplessly await[s] the determination of the question whether in that instance its policy of indemnity was to be a shield in its own hands, or a sword in the hands of its antagonist."[50]

In traditional negligence parlance, the court stated that the insurer was therefore bound to conduct the settlement negotiations with the skill of an "average man."[51]

The negligence theory was expanded in *Dumas v. Hartford Accident & Indemnity Co.*,[52] where a negligence action was brought for the insurer's failure to settle a claim on a policy with a $5,000

---

[44] Dumas v. Hartford Accident & Indem. Co., 94 N.H. 484, 488, 56 A.2d 57, 60 (1947), recognized that the law imposes an obligation to exercise due care upon all those who render a service to the public:

> [W]hen one knows or has reason to anticipate that the person, property, or rights of another are so situated as to him that they may be injured through his conduct, it becomes his duty so to govern his action as not negligently to injure the person, property, or rights of that other.

See also Douglas v. United States Fidelity & Guar. Co., 81 N.H. 371, 377, 127 A. 708, 712 (1924).

[45] *See* Cunningham, *supra* note 26, at 487, in which the author has set out the following areas as germane to the issue of the insurer's conduct:

> [C]orrespondence between the insurer and its attorneys and investigators; medico-legal aspects; discussion and conclusions as to evaluation; and consideration of the liability issues, causal relation, proximate cause and, in fact, all facts and circumstances leading to the decision not to accept the settlement proposed.

[46] 81 N.H. 371, 127 A. 708 (1924).

[47] *Id.* at 373, 127 A. at 709.

[48] *Id.*

[49] *Id.* at 379, 127 A. at 712.

[50] *Id.* at 377, 127 A. at 711 (quoting from Rumford Falls Paper Co. v. Fidelity & Cas. Co., 92 Me. 574, 583, 43 A. 503, 505 (1899)).

[51] 81 N.H. at 379, 127 A. at 713.

[52] 94 N.H. 484, 56 A.2d 57 (1947).

liability limit on each injured person.[53] Prior to trial, the injured party, permanently crippled and having incurred $3,000 in expenses, made three settlement offers within the policy limits, all of which were refused by the insurance company.[54] Although Dumas' policy had a maximum limit of $5,000, at trial the jury returned a $12,000 verdict for the claimant.[55] When the excess suit was brought, the court remarked that "[t]he standard of care is at least what a reasonable man would exercise in the management of his own affairs."[56] In applying the negligence test, the court appeared to be suggesting that the insurance company had an affirmative duty to consider the interests of the insured rather than a negative duty, as required by the bad faith test, to refrain from intentionally injuring the policyholder's interests. Furthermore, although the negligence standards were less precise than those under the bad faith test, they substantially enhanced the plaintiff's position. While the failure to execute a settlement within the policy limits was not per se negligent,[57] the standard obviated the necessity of demonstrating the malicious misconduct or fraud required by the bad faith test.[58] Since the tendency of juries is to be unsympathetic toward insurance companies,[59] the application of the negligence test increased the policyholder's chance for a favorable verdict.

In 1938, Professor Appleman observed that the negligence test was apparently becoming the majority rule, supplanting the bad

[53] *Id.* at 485-86, 56 A.2d at 58.

[54] *Id.* at 489-90, 56 A.2d at 61.

[55] *Id.* at 485, 56 A.2d at 58.

[56] *Id.* at 488, 56 A.2d at 60. *See also* Appleman, *supra* note 29, at 106-09.

[57] *See* Waters v. American Cas. Co., 261 Ala. 252, 258, 73 So. 2d 524, 529 (1953). The court, noting the importance of distinguishing between negligence and bad faith, stated that "[b]oth of those terms have a well understood meaning, and we do not see any reason why we should stumble over their application." *Id.*

[58] A rejection of the bad faith test is clearly set out in Robertson v. Hartford Accident & Indem. Co., 333 F. Supp. 739, 741 (D. Ore. 1970), wherein the court stated that it was

> not . . . necessary . . . to find that an insurance company is guilty of malicious misconduct or fraud in order to impose upon it liability for negligence in allowing a judgment to be suffered by an insured when the judgment could have been prevented by ordinary due care in the management of an accident claim.

See also Appleman, *supra* note 29, at 106. Under the bad faith standard, the plaintiff in an excess case has the burden of producing evidence which demonstrates either an intent on the part of the insurance company to commit fraud or that the insurer is guilty of willful misconduct. *See* text accompanying notes 37-39 *supra*.

[59] *See* Jarrett, *Lawsuits for Wrongful Refusal to Defend or to Settle,* 28 INS. COUNSEL J. 58, 62 (1961), in which the author stated:

> The real danger in all these cases is that juries are prone to be most unsympathetic with insurance companies and sympathetic with the plaintiff-insured (or his judgment creditor assignee) who presents a pathetic and destitute position. Once the jury has sympathized a verdict for the plaintiff, an appellate court seldom overrules it.

faith test.[60] However, in excess cases, the application of this test created the same confusion that existed in other areas of the law where the reasonable man standard is applied.[61]

Thus, it appears that neither of these traditional tests proved to be effective since neither established any affirmative guidelines by which insurers could guide their conduct or courts could evaluate it. The bad faith test merely stated what an insurer could not do—act fraudulently or dishonestly in refusing to settle a claim.[62] Similarly, the negligence test never specifically enumerated the duties of the insurer beyond the exercising of due care and reasonableness.[63] To correct this deficiency, the courts today have attempted to state definitively the duties and responsibilities of an insurer in what is known as the "good faith" test which specifically delineates the conduct necessary to meet the insurer's duty to properly protect the policyholder's rights. This good faith doctrine, which has been adopted by a majority of American jurisdictions,[64] arises out of the implied covenants of good faith and fair dealing which are inherent in all contracts.[65]

In New Jersey, the good faith test was first adopted in *Radio Taxi Service, Inc. v. Lincoln Mutual Insurance Co.*,[66] wherein the supreme court 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.[67]

---

[60] Appleman, *supra* note 29, at 104-11.

[61] The confusion is attributable primarily to the alleged incompetence of the jury to evaluate the negligence issue. *See* Lewis, *supra* note 1, at 39-40. *See also* Appleman, *supra* note 29, at 109, wherein the author discusses the negligence test:

> The real difficulty in this test lies in one proposition, and that, to the writer, totally destroys it [*sic*] efficacy. It is unworkable in actual practice. The question is submitted to a jury of 12 men, none of whom have any legal training whatsoever, nor any experience of any nature with insurance claims or litigation. Under the circumstances those men are totally incompetent to say whether or not a certain offer of settlement was reasonable.

The author has also lamented the jury's inability to handle either the bad faith test or the negligence test. *Id.* at 111.

[62] *See* text accompanying notes 37-39 *supra* (relating to bad faith).

[63] *See* notes 42-44 *supra* and accompanying text.

[64] *See* sources cited in Annot., 40 A.L.R. 2d 168, 178 (Supp. 1975).

[65] *See, e.g.*, Crisci v. Security Ins. Co., 66 Cal. 2d 425, 430, 426 P.2d 173, 177, 58 Cal. Rptr. 13, 17 (1967); Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 658, 328 P.2d 198, 200 (1958). *See also* Cunningham, *supra* note 26, at 483, in which it is stated that "[a]ccompanying every contract is a common law duty to perform with care, skill, reasonable expedience and faithfulness the thing agreed to be done."

[66] 31 N.J. 299, 157 A.2d 319 (1960).

[67] *Id.* at 304, 157 A.2d at 322.

Subsequently a seven-part good faith test, designed to evaluate the insurer's conduct, was enunciated in *Kaudern v. Allstate Insurance Co.*[68] In *Kaudern*, a multiple automobile accident gave rise to a claim on Kaudern's $10,000 insurance policy which had been written by Allstate.[69] Allstate investigated the claim and determined that there was insufficient evidence to sustain insurer liability.[70] Recognizing the weakness of the liability aspect of the case, the claimant's attorney offered to settle the matter for $10,000, to which neither Allstate nor the insured replied.[71] A jury returned a verdict for $175,000 against Kaudern and a codefendant, who was judgment proof, leaving Kaudern personally liable for the payment of $165,000.[72]

In reaching a decision, the court applied the seven-part test to the insurer's conduct. Testimony conflicted as to whether there had been contact between the Kaudern vehicle and the claimant's vehicle, but physical examination of the cars revealed that such contact had occurred.[73] The insurer failed to make a complete and adequate investigation of the alleged accident and determined that " 'no liability' " existed before any depositions were taken. Though claimant's injuries were severe, the insurer failed to advise Kaudern of his right to make a contribution to any settlement offers by the claimant.[74] Considering the severe injuries and the information which was revealed through subsequent depositions, the court suggested "that it would be difficult, at best, for a reasonable appraisal of the liability aspects of the case to result in a conclusion of certain 'no-liability.' "[75] Both Allstate's claim examiners and attorney suggested that the issue of liability was far from closed; on

---

[68] 277 F. Supp. 83 (D.N.J. 1967). The seven factors enumerated by the court are:

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

Id. at 88-89 (footnote omitted).

[69] *Id.* at 84.

[70] *Id.* at 84-85. The claimant, Julia Collins, sustained severe permanent injuries. *Id.* at 84.

[71] *Id.* at 86. Mrs. Collins' medical expenses had amounted to $34,843.34. *Id.* at 85.

[72] *Id.* at 86.

[73] *Id.* at 89-92.

[74] *Id.* at 85, 90.

[75] *Id.* at 90.

the contrary, Allstate's attorney recommended that every effort be made to settle the matter.[76] The rejection of this advice indicated that Allstate had adopted a hardline no settlement approach to the case. The lack of interaction of the parties suggested to the court that there was no communication among the relevant decision-making parties which resulted in the absence of periodic reviews of the file and "the inability of either Allstate or the [attorneys of record] to intelligently make recommendations on the issue of liability and settlement."[77] The court then reviewed the degree of financial risk to which each party was exposed, noting that, since plaintiffs had never offered to settle for less than the policy limit, the insurer risked nothing by going to trial. It determined that "Allstate's disinterest with settlement seem[ed] to have been motivated by a desire to gamble on the outcome of the trial."[78] The court then considered the relationship between the attorneys of record and Allstate to determine if there had been "independent legal assistance"[79] provided for Kaudern in view of the potential excess judgment. It appeared that the Marley firm, Kaudern's counsel, was merely an alter ego of Allstate, since all expenses of litigation were paid by the insurer.[80] Finally, the court stated that the course of conduct adopted by Allstate was demonstrative of bad faith, and thereby held the insurer liable for the entire excess judgment from the *Collins* case.[81]

Since settlement opportunities traditionally present themselves prior to trial, the court directed its attention to two areas of pre-

[76] *Id.* at 91.

[77] *Id.*

[78] *Id.*

[79] *Id.*

[80] *Id.*

[81] *Id.* at 92. Although the court concluded that Allstate acted in bad faith, the court applied what it termed a "good faith theory." *Id.* at 87.

Besides the seven standards enunciated in *Kaudern*, legal writers have offered other factors which could be considered. Jarrett, *supra* note 59, at 65, enumerated eleven additional factors affecting good faith: (1) did the insurer reject a compromise offer after an excess verdict had been entered; (2) does the insurer have reinsurance as protection; (3) did the insurer advise its insured to transfer his assets to parties immune from a potential excess judgment; (4) did the insurer make any remark regarding the low limit of the policy as being an advantage of the case; (5) did the insurer make a subjective evaluation of the claimant's witnesses; (6) did the insurer favor going to trial because the insured was judgment proof; (7) did the insurer reject a settlement because all the plaintiffs refused to join; (8) did the insurer increase its reserves after it rejected a settlement offer; (9) did the insurer establish an arbitrary settlement figure lower than the policy limits; (10) did the insurer have a representative at the trial to increase the settlement offer if the trial went badly; and (11) did the insurer indicate a willingness to offer the full amount and then fail to do so or did the agent fail to offer all that was available? For a further discussion of factors affecting good faith and examples of such categories see Lewis, *supra* note 1, at 29-31 n.20. *See also* CAL. INS. CODE § 790.03(h)(1)-(13) (West Supp. 1975), in which the state legislature has codified 13 unfair claims settlement practices.

trial practice: the preparation of the defense and the negotiation of the settlement.[82] The good faith test clearly places the burden of proof upon the insurer because as the likelihood of a verdict in excess of the policy limits increases, "the boundaries of good faith become more compressed in favor of the insured."[83] Thus, the court has virtual carte blanche authority to inquire into any facet of the insurer's conduct during settlement negotiations which led to the insurer's decision of whether to settle or to go to trial. The court has also established a set of objective questions which could be submitted to the jury for final evaluation, thus relieving that body of its duty, under the negligence test, to be totally subjective.[84]

THE CONFLICTING RELATIONSHIP

Excess liability cases arise out of the conflicting relationships between the insured and the insurer, and among the insured, the insurer's attorney and the insurer.[85] As a business, the insurance company wants to pay as little as possible. Under contract, the company has a duty to defend,[86] thus putting itself and its attorney in the position of trying to reconcile the collateral duty to pay with the business aim of making a profit.

The Insured/Insurer Relationship

In recent years, the nature of the insured/insurer relationship has been the focal point of judicial treatment in excess cases.[87]

[82] 277 F. Supp. at 88. An analysis of the evaluative factors suggested in note 81 *supra* will reveal that nearly all possible considerations arise prior to trial. *See* notes 8-10 *supra* and accompanying text.

[83] Bowers v. Camden Fire Ins. Ass'n, 51 N.J. 62, 71, 237 A.2d 857, 862 (1968).

[84] *See* notes 59 & 61 *supra* and accompanying text. Appleman, in reference to the negligence test, suggests that

> [i]n no sense of the word could any of [the jury members] be considered a judge capable of analyzing the actions of the company to determine whether or not under the circumstances negligence was shown.

Appleman, *supra* note 29, at 109.

[85] *See* Hills & Pivnicka, *supra* note 27, at 44. The attorney, hired by the insurer and representing the insured, is an integral part of this conflict and his conduct may form the basis of an insured's excess suit. *See, e.g.*, Lysick v. Walcom, 258 Cal. App. 2d 136, 150, 65 Cal. Rptr. 406, 416 (Dist. Ct. App. 1968); Ivy v. Pacific Auto. Ins. Co., 156 Cal. App. 2d 652, 659, 320 P.2d 140, 145 (Dist. Ct. App. 1958).

[86] *See* note 3 *supra* and accompanying text.

[87] The evolution of the excess case itself is mirrored by the evolution of the judicial analysis of the insured/insurer relationship. *See, e.g.*, Georgia Cas. Co. v. Mann, 242 Ky. 447, 451, 46 S.W.2d 777, 779 (1932) (principal/agent); Rova Farms Resort, Inc. v. Investors Ins. Co., 65 N.J. 474, 492, 323 A.2d 495, 505 (1974) ("inherent fiduciary obligation"); Johnson v. Hardware Mut.

Some of the earlier cases suggested that the contractual relationship between the company and the policyholder obligated the insurer to consider his own interests and those of the insured as equal.[88] The insured "had a right to look after its own interests, but it was bound to have due regard for the [insured's] interests, as well."[89] Today, the law has moved decidedly away from this approach and has become more supportive of the policyholder's interests. Recognizing that conflicting interests are inherent in any settlement decision,[90] courts have stated that such a conflict can only be resolved when

> the insurer treats any settlement offer as if it had full coverage for whatever verdict might be recovered, regardless of policy limits . . . .[91]

This approach appears to resolve the conflicting interests between the insurance company and the policyholder, since the insurer is deemed to treat any settlement decision as if it had unlimited liability. The volume of excess cases, however, demonstrates that such disposition of this conflict is purely superficial.[92] Inevitably, there will be occasions where the insurer will decide not to settle, but to go to trial, thereby risking an excess verdict. This risk, therefore, great or small, is borne entirely by the policyholder. Consequently, whenever the claim exceeds the policy limits, the basic problem of the excess liability case continues to exist.

Other decisions have suggested that the insurance company

Cas. Co., 109 Vt. 481, 490, 1 A.2d 817, 820 (1938) (mutually fiduciary). *But see* Netzley v. Nationwide Mut. Ins. Co., 34 Ohio App. 2d 75, 76, 296 N.E.2d 550, 560 (Ct. App. 1971) (insurer has no obligation to act as fiduciary to insured).

[88] *See, e.g.*, Bell v. Commercial Ins. Co., 280 F.2d 514, 515-16 (3d Cir. 1960); Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 659, 328 P.2d 198, 201 (1958). In *Comunale*, the California supreme court stated:

> The insurer, in deciding whether a claim should be compromised, must take into account the interest of the insured and give it at least as much consideration as it does to its own interest.

Id.

[89] Johnson v. Hardware Mut. Cas. Co., 109 Vt. 481, 490, 1 A.2d 817, 820 (1938).

[90] *See, e.g.*, Coppage v. Firemen's Fund Ins. Co., 379 F.2d 621, 623 (6th Cir. 1967); Crisci v. Security Ins. Co., 66 Cal. 2d 425, 431, 426 P.2d 173, 177, 58 Cal. Rptr. 13, 17 (1967).

[91] Bowers v. Camden Fire Ins. Ass'n, 51 N.J. 62, 71, 237 A.2d 857, 862 (1968). *See also* Board of Educ. v. Lumbermens Mut. Cas. Co., 293 F. Supp. 541, 544 (D.N.J. 1968), *aff'd*, 419 F.2d 837 (3d Cir. 1969).

[92] Research has indicated that while this rule was expressed as early as 1959, the number of excess cases has not abated. *Compare* Murach v. Massachusetts Bonding & Ins. Co., 339 Mass. 184, 187, 158 N.E.2d 338, 341 (1959) *with* APPLEMAN, *supra* note 4, §§ 4711-13 (Supp. 1975), and cases cited therein.

owes to its policyholder the duties of a fiduciary.[93] Traditionally, a fiduciary relationship has been defined as one

> where, by reason of friendship, agency, business association and experience, trust and confidence are reposed by one person in another, who, as a result, gains an influence and superiority over the other.[94]

Such a relationship imposes upon the party in this position the duty to exercise scrupulous good faith and candor with respect to those who are affected by his conduct.[95] However, the fiduciary nature of the insured/insurer relationship has not been defined by these strict traditional standards.[96] Thus, it is evident that the insurer is permitted to give less than full consideration to the interests of the insured.

Insured/Attorney/Insurer Relationship

The discordant interests in this relationship originate in the insurance company's duty to defend. The conflict becomes acute when there is an opportunity to settle a claim within the limits of the policy.[97] Such an opportunity can place the unwary attorney in an untenable position—torn between the interests of two competing clients.

Canon 5 of the *Code of Professional Responsibility* requires of an attorney an undivided loyalty to his client.[98] The *Code* recognizes

---

[93] *See, e.g.*, LaRocca v. State Farm Mut. Auto. Ins. Co., 329 F. Supp. 163, 171 (W.D. Pa. 1971), *aff'd*, 474 F.2d 1338 (3d Cir. 1973); Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 582, 510 P.2d 1032, 1043, 108 Cal. Rptr. 480, 491 (1973); Rova Farms Resort, Inc. v. Investors Ins. Co., 65 N.J. 474, 492, 323 A.2d 495, 505 (1974).

Occasionally, the insured/insurer relationship has been described as "mutually fiduciary." *See, e.g.*, Johnson v. Hardware Mut. Cas. Co., 109 Vt. 481, 490, 1 A.2d 817, 820 (1938). Appleman characterized the relationship as being "somewhat of a fiduciary one." APPLEMAN, *supra* note 4, at 553. *See also* Note, *Good Faith and Fair Dealing in Insurance Contracts: Gruenberg v. Aetna Insurance Co.*, 25 HASTINGS L.J. 699, 713 (1974) ("relationship as almost a fiduciary one"); American Fidelity & Cas. Co. v. G.A. Nichols Co., 173 F.2d 830, 832 (10th Cir. 1949) (while fiduciary relationship exists, insurer may still consider its own interests).

[94] De Phillips v. Mortgage Associates, Inc., 8 Ill. App. 3d 759, 763, 291 N.E.2d 329, 332 (1972). *See also* 3 W. FLETCHER, PRIVATE CORPORATIONS § 838, at 176 & n.92 (perm. ed. 1965).

[95] Svanoe v. Jurgens, 144 Ill. 507, 513, 33 N.E. 955, 957 (1893).

[96] *See* note 137 *infra* and accompanying text.

[97] Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 870, 110 Cal. Rptr. 511, 519 (Dist. Ct. App. 1973). *See also* Hills & Pivnicka, *supra* note 27, at 44, in which the authors suggest that when the attorney becomes a part of this conflict, he may become involved in a legal malpractice action.

[98] EC 5-1 provides:

> The professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of his client and free of comprising influences and

that there may be occasions when an attorney is called upon to represent multiple clients and the attorney must carefully assess the situation in order to avoid "the possibility that his judgment may be impaired or his loyalty divided if he accepts or continues the employment."[99] The *Code* clearly states that all doubts should be resolved against entering or continuing representation in such a multiple client status.[100] Whenever an attorney determines that he can ethically represent more than one client, he must fully disclose such representation and its possible ramifications to all parties in interest.[101] The *Code* further enumerates several "[t]ypically recurring situations" which involve multiple representations by an attorney, one of which is the insured/insurer dichotomy.[102]

An attorney may obtain a policyholder as a client in two ways: He may be an insurance company house counsel, or he may be an independent counsel, retained for a specific case.[103] In both situations, the attorney's fees are paid by the company, thereby raising the serious issue of conflict of interests.

The crucial problem faced by a company-retained counsel is the standard of conduct which is owed to both clients. It has become established that, while the company may be paying the fees,[104] the attorney "owes to his client, the assured," the same "undeviating and single allegiance"[105] he would owe had he been personally retained by the policyholder.[106] Considering this conflict

> loyalties. Neither his personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute his loyalty to his client.

ABA CANONS OF PROFESSIONAL ETHICS No. 5 (footnote omitted).

[99] *Id.* EC 5-15.

[100] *Id.*

[101] *Id.* EC 5-16 provides that

> before a lawyer may represent multiple clients, he should explain fully to each client the implications of the common representation and should accept or continue employment only if the clients consent.

(Footnote omitted.)

[102] *Id.* EC 5-17.

[103] While independent counsel may be retained on a case-by-case basis, the relationship between the company and the attorney is normally a continuing one. Consequently, the attorney has a vested interest, in terms of future employment, in catering to the insurer rather than the insured. Based on this, one commentator has suggested that "independent" counsel retained or suggested by the insurance company is therefore only a guise. *See* Hills & Pivnicka, *supra* note 27, at 45.

[104] *Id.* at 36. While ostensibly the insurer pays counsel fees for the defense, such are merely another expense for which the insured has paid through his premiums. *Id.*

[105] American Employers Ins. Co. v. Goble Aircraft Specialties, Inc., 205 Misc. 1066, 1075, 131 N.Y.S.2d 393, 401 (Sup. Ct. 1954). Such duty of the lawyer to the policyholder is considered "paramount." *Id.*

[106] *See, e.g.,* Lysick v. Walcom, 258 Cal. App. 2d 136, 146, 65 Cal. Rptr. 406, 413 (Dist. Ct. App. 1968); Crum v. Anchor Cas. Co., 264 Minn. 378, 391-92, 119 N.W.2d 703, 712 (1963). *See* note 111 *infra* and cases cited therein.

situation, a California court has suggested that, generally, no conflict will arise since the interests of the company and insured are presumably the same.[107] Should a conflict arise, however, the dual representation need not be terminated as long as the attorney complies with the directives of the *Code of Professional Responsibility*[108] in making a full disclosure of the conflict to the insured and obtaining his consent.[109] Whether such disclosure to an inexperienced insured can ever afford adequate protection of the insured's interests is doubtful.[110]

As has been exemplified in the excess cases, the attorney's conflicting interests become intensified during the period of pretrial negotiation.[111] The insured has contracted with his insurance company for the defense of all suits which might be brought against him arising out of injuries or damages for which the policy would afford coverage.[112] The question which then arises with respect to settlement negotiations is: Whom does the attorney represent during those negotiations for settlement?

Attempting to answer the question, a New York court, in

---

[107] Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 869, 110 Cal. Rptr. 511, 518 (Dist. Ct. App. 1973).

[108] *See* note 101 *supra* and accompanying text.

[109] *See* Lysick v. Walcom, 258 Cal. App. 2d 146, 147, 65 Cal. Rptr. 406, 413-14 (Dist. Ct. App. 1968). *See also* Keeton, *supra* note 1, at 1169; Hills & Pivnicka, *supra* note 27, at 36-37. It may be argued that the issue of consent does not arise since the insured has "consented" in the insurance contract to relinquishing control over his defense. However, such "consent" does not comply with the requirements of EC 5-16 of the *Code*. For text of EC 5-16 see note 101 *supra*.

[110] *See* notes 165-70 *infra* and accompanying text.

[111] *See* notes 81-82 *supra*. At trial, a different, although equally problematic conflict, may arise. Quite often, an insured may be charged with several counts, only some of which the policy covers. Such a case arises when the plaintiff alleges both negligent and intentional torts, the latter not covered by standard insurance policies.

If the liability issue is likely to be decided against the insured, the attorney may be placed in a peculiar position. If the attorney is loyal to the insured, he will attempt to show that the tort was committed negligently, at the consequent expense of the insurer. Alternatively, the attorney may favor the company and foster the idea of an intentional tort, thus preserving the insurer's position.

New Jersey courts have taken two approaches to limit the effect of this potential conflict. First, the courts have construed the term "intentional act" very narrowly. Not only must the act be intended, but the specific injury must also be intended. Thus, in Hanover Ins. Group v. Cameron, 122 N.J. Super. 51, 298 A.2d 715 (Ch. 1973), in which the defendant punched the plaintiff's deceased husband, who subsequently struck his head on the floor and died, the court found that the defendant had not intended to kill the decedent and hence the wrongful death action would be covered by the policy. *Id.* at 61, 298 A.2d at 721. Second, in a more procedural approach to the problem, the New Jersey supreme court has indicated that where such an insoluble conflict arises, the insured should be permitted to retain personal counsel and, in the event that it is subsequently determined that the claim was one which the insurer was obligated to pay, should be reimbursed by the company for legal expenses. *See* Burd v. Sussex Mut. Ins. Co., 56 N.J. 383, 390, 267 A.2d 7, 10 (1970).

[112] *See* note 3 *supra*.

American Employers Insurance Co. v. Goble Aircraft Specialties, Inc.,[113] stated:

> The attorney may not seek to reduce the company's loss by attempting to save a portion of the total indemnity in negotiations for the settlement of a negligence action, if by so doing he needlessly subjects the assured to judgment in excess of the policy limit. His duty to the assured is paramount.[114]

A contrary view has been expressed by Professor Keeton who suggests that the attorney-client relationship does not extend to the area of settlement, and that in this aspect of the litigation, the attorney represents only the interests of the insurance company.[115] Citing Professor Keeton's article, the California court of appeals, in *Lysick v. Walcom*,[116] emphasized that while the attorney-client relationship existed with respect to the legal defense of the claim, "the attorney ha[d] no duty to the insured in the matter of settlement."[117]

The insurance company has two primary concerns at settlement negotiations which must be protected by the attorney. Initially, the attorney must guard the interests of the company[118] with respect to liability and damages, and must evaluate the claims and attempt to reach an acceptable settlement figure. Then the attorney, as agent for the insurer, must also protect the company "against liability for failure to discharge its duties to [the] insured."[119] It is in this latter duty that the attorney's greatest problem will arise, since "[t]he obligation of fair dealing and the duty to act in good faith rest equally upon the insurance company and the attorney."[120]

---

[113] 205 Misc. 1066, 131 N.Y.S.2d 393 (Sup. Ct. 1954).

[114] *Id.* at 1075, 131 N.Y.S.2d at 401.

[115] Keeton, *supra* note 1, at 1169. In fact, it has been suggested that the insurer acts rather as an independent contractor in effecting settlements. Foremost Dairies, Inc. v. Campbell Coal Co., 57 Ga. App. 500, 509, 196 S.E. 279, 285 (1938).

[116] 258 Cal. App. 2d 136, 65 Cal. Rptr. 406 (Dist. Ct. App. 1968).

[117] *Id.* at 149-50, 65 Cal. Rptr. at 415.

[118] *See* Keeton, *supra* note 1, at 1169.

[119] *Id.*

[120] Ivy v. Pacific Auto. Ins. Co., 156 Cal. App. 2d 652, 663, 320 P.2d 140, 148 (Dist. Ct. App. 1958). While not yet the subject of specific judicial scrutiny, the role of the defense attorney in an excess case may be precarious. The attorney has no direct responsibility to the insured during settlement negotiations. His duty is primarily to safeguard the interests of the insurance company. However, in discharging this duty, the attorney must take into consideration the interests of the insured and endeavor to avoid the possibility of involving the company in an excess suit. Lysick v. Walcom, 258 Cal. App. 2d 136, 150, 65 Cal. Rptr. 406, 416 (Dist. Ct. App. 1968). *See* note 115 *supra*. The insured has no cause of action against the attorney, Keeton, *supra* note 1, at 1169, but query if the company might not have an action against the attorney for

The judicial analysis of these two relationships, the insured/insurer and the insured/attorney/insurer, has formed the polestar around which the excess cases have evolved. The insured/insurer relationship is now viewed by the courts in favor of the policyholder.[121] Also, the attorney's duties and responsibilities have become oriented toward the insured rather than the insurer, thus evidencing the true nature of the insurer's responsibilities in the excess case.

RECENT DEVELOPMENTS

The past decade has witnessed a general evolution and expansion of the good faith test in many jurisdictions.[122] This development has been fostered by the realization that in an excess case, the insured has no "effective control over the lawsuit" nor, by his independent action, can he limit what may prove to be serious and substantial financial losses.[123]

The Supreme Court of New Jersey, in *Rova Farms Resort, Inc. v. Investors Insurance Co.*,[124] in a four-part opinion, analyzed a typical excess case[125] in traditional good faith standards. The court

indemnity based on malpractice. It has been suggested that if the attorney's recommendation regarding settlement

> is negligently made and [the] company reasonably relies upon it to its detriment in reaching its decision, there is no apparent reason for exonerating the attorney.

Id. at 1173. In *Ivy, supra* at 663, 320 P.2d at 148, the conduct of the defense attorney was the basis for the insured's action against the insurer. It would appear that this was a prima facie breach of the attorney's duty to protect the insurer from excess liability.

[121] The trend toward favoring the policyholder is gaining judicial acceptance. *See* note 93 *supra*.

[122] *See* Annot., 40 A.L.R.2d 168, 178 (Supp. 1975).

[123] Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 870, 110 Cal. Rptr. 511, 519 (Dist. Ct. App. 1973). There, the California court stated that while it is always in the interests of the insured to settle, the interests of the insurer are governed by mathematical probabilities. *Id.* at 869-70, 110 Cal. Rptr. at 518-19. Furthermore, since the insurer has reserved the exclusive right to settle the claim, the insured may face substantial loss which can be averted only by the insurer's action over which the insured has no control. *Id.* at 870, 110 Cal. Rptr. at 519.

[124] 65 N.J. 474, 323 A.2d 495 (1974).

[125] The facts which gave rise to the *Rova Farms* excess case are a classic example of inadequate liability evaluation and institutional decision-making. On July 25, 1965, Lawrence McLaughlin, as a commercial invitee of Rova Farms Resort, dove into three or four feet of water in Rova's lake. McLaughlin v. Rova Farms, Inc., 56 N.J. 288, 298, 266 A.2d 284, 289 (1970). Striking the bottom of the lake, the plaintiff suffered severe injuries, which resulted in his becoming "almost a total quadriplegic and the condition [was] permanent." *Id.* at 299, 266 A.2d at 290. In the face of these "tragic" injuries and $50,000 coverage of its insured, Rova Farms, Investors Insurance Company offered McLaughlin $12,500 to settle his claim. 65 N.J. at 481, 323 A.2d at 499. At no time through the trial and the subsequent appeal was this offer increased. *Id.*

McLaughlin presented a pathetic figure to the jury, appearing before the court strapped

focused on two aspects of the insurer's conduct. First, the insurer had the affirmative obligation to explore all settlement possibilities and, if necessary, to initiate negotiations with the claimant.[126] Second, the insurer could not bargain defensively, but had to take positive steps toward settling within the policy limits.[127] When a plaintiff demonstrated a breach of either of these duties, bad faith was shown and a prima facie case established.[128] At that point, the burden shifted to the insurer to demonstrate that there was no possibility of effecting a settlement within the policy limits or at a higher figure to which the insured might have contributed.[129] This was the holding of the court, as expressed in the first two points of the opinion. It has been recently followed by the New Jersey appellate division in the case of *Yeomans v. Allstate Insurance Co.*[130]

The landmark feature of the *Rova Farms* opinion was expressed by Chief Justice Hughes in the third point.[131] Employing substantial language from both *Merritt v. Reserve Insurance Co.*[132] and *Crisci v. Security Insurance Co.*,[133] the supreme court observed that an insured faced with a potential excess verdict is not in an enviable position.[134] Quoting from *Merritt,* the court stated:

> "The assured is not in a position to exercise effective control over the lawsuit or to further his own interests by independent

---

into a wheelchair. In light of these extensive and permanent injuries, the jury came back with a verdict in favor of the plaintiff for $225,000. *Id.* This verdict was reversed by the appellate division in an unreported opinion and the cause was remanded for a new trial. However, before a new trial could be held, the supreme court granted certification, 55 N.J. 162, 259 A.2d 914 (1969), and reinstated the verdit of the trial court. McLaughlin v. Rova Farms, Inc., *supra* at 313, 266 A.2d at 297. Throughout this entire period of protracted litigation, Investors' position of non-liability never waivered.

Milton Liebowitz, Investors' attorney retained to represent Rova, had indicated to the insurer that on retrial of the matter, a $500,000 verdict would be possible in view of the severity of the injuries. 65 N.J. at 482, 323 A.2d at 499. Despite this advice, Investors' remained adamant against making any further settlement offers. *Id.* at 489, 323 A.2d at 503. It appeared throughout the case that settlement could have been had if $50,000, the maximum limit of the policy, had been offered by Investors. *Id.* at 485, 323 A.2d at 501.

[126] 65 N.J. at 493, 496, 323 A.2d at 505, 507.

[127] *Id.* at 495-96, 323 A.2d at 506-07. The court, citing State Auto. Ins. Co. v. Rowland, 221 Tenn. 421, 427 S.W.2d 30 (1968), observed that the issue of good faith did not hinge on the claimant's settlement offer. 65 N.J. at 495-96, 323 A.2d at 506-07.

[128] 65 N.J. at 496, 323 A.2d at 507.

[129] *Id.*

[130] 130 N.J. Super. 48, 51, 324 A.2d 906, 908 (App. Div. 1974). The court in *Yeomans* indicated that such a prima facie case established damages to the extent of the difference between the policy limits and the amount of the excess verdict. *Id.* at 52, 324 A.2d at 908-09.

[131] 65 N.J. at 496-502, 323 A.2d at 507-10.

[132] 34 Cal. App. 3d 858, 110 Cal. Rptr. 511 (Dist. Ct. App. 1973).

[133] 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

[134] 65 N.J. at 497, 323 A.2d at 507.

> action, even when those interests appear in serious jeopardy. The assured may face the possibility of substantial loss which can be forestalled only by action of the carrier. Thus the assured may find himself and his goods in the position of a passenger on a voyage to an unknown destination on a vessel under the exclusive management of the crew."[135]

This "exclusive management" is the source of the fiduciary aspects of the insured/insurer relationship,[136] yet the good faith test permits the insurer to avoid those most stringent duties which are traditionally imposed upon fiduciaries in areas other than insurance law.[137] The court noted that "the good faith norm, as presently construed, permits the insurer to be less responsive to the fiducial obligation than is any other type of fiduciary."[138] Even where the company approaches the settlement as if it has full coverage, any decision against settling is necessarily against the best interests of the policyholder,[139] and

> "the rejection of a settlement within the limits where there is any danger of a judgment in excess of the limits can be justified, if at all, only on the basis of interests of the insurer . . . ."[140]

The result is that the fiduciary insurer is permitted to weigh his own personal interests against those of his principal, the insured.[141] This position is incongruous with all common law fiduciary principles.[142]

---

[135] *Id.* (quoting from Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 870, 110 Cal. Rptr. 511, 519 (Dist. Ct. App. 1973)).

[136] 65 N.J. at 492, 323 A.2d at 505.

[137] Such traditional fiduciary duties are the duty to act solely for the interests of the principal, and that the interests of the agent must be subservient to those of the principal unless otherwise agreed. RESTATEMENT (SECOND) OF AGENCY §§ 39 & 393 (1958). For a discussion regarding the fiduciary duties of corporate management personnel see H. HENN, LAW OF CORPORATIONS §§ 235-41, at 457-82 (2d ed. 1970). *But see* Merritt v. Reserve Ins. Co., 34 Cal App. 3d 858, 874, 110 Cal. Rptr. 511, 521 (Dist. Ct. App. 1973), in which the court notes that a completely different standard has arisen with regard to insurance companies as opposed to trustees, agents or public officers when confronted with conflicting interests. *See also* note 93 *supra* and cases cited therein, which indicate that the courts have compromised the strict duties of a fiduciary in favor of the insurer.

[138] 65 N.J. at 499, 323 A.2d at 509.

[139] *Id.* at 498, 323 A.2d at 508.

[140] *Id.* at 501-02, 323 A.2d at 510 (quoting from Crisci v. Security Ins. Co., 66 Cal. 2d 425, 430-31, 426 P.2d 173, 177, 58 Cal. Rptr. 13, 17 (1967)).

[141] 65 N.J. at 500, 323 A.2d at 509.

[142] *Rova Farms* reaffirms the language of the *Merritt* court:

> "In most legal relationships determination of the merits of conflicting interests by one of the parties to the conflict is forbidden. No man can be judge in his own case; no trustee may weigh his personal interest against that of his beneficiary; no agent may evaluate his personal profit against that of his principal; and no public officer may balance private gain against public interest."

In refusing to settle, the insurer has independently determined to sacrifice the interests of the insured in favor of its own.[143] This unilateral decision-making process prompted the supreme court to suggest that since only the insurer can profit from the gamble of going to trial, then only the insurer should bear the risks of an excess verdict.[144] This rule, which implies that an insurer will be absolutely liable for an excess verdict whenever it refuses to settle, had been previously advocated by various legal authorities.[145] Such a rule would finally resolve the inherent conflicts which arise between the insurance company and its policyholder. The insurer would then be free to settle or try any case without compelling the insured to bear the burden of that decision.[146] As the California supreme court noted in *Crisci,*

> an insurer should not be permitted to further its own interests by rejecting opportunities to settle within the policy limits unless it is also willing to absorb losses which may result from its failure to settle.[147]

The future direction of the New Jersey supreme court appears to be the imposition of absolute liability on the insurer whenever a refusal to settle is followed by an excess verdict. While this rule, expressed in point three of the *Rova Farms* decision, is merely dictum, Chief Justice Hughes indicated that it was the duty of all courts "to prevent the law from inflicting unjust results."[148]

CONCLUSIONS

Two pertinent questions are raised by point three of the opinion in *Rova Farms.* First, will the courts of New Jersey, in an appropriate situation, apply the doctrine of strict or absolute liabil-

Id. at 499-500, 323 A.2d at 509 (quoting from Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 874, 110 Cal. Rptr. 511, 521 (Dist. Ct. App. 1973)).

[143] 65 N.J. at 498, 323 A.2d at 508. The decision to go to trial rather than to settle has been recognized as a selfish one, designed to save insurance company money at the risk of exposing the policyholder's money. *Id. See also* Note, *supra* note 25, at 483.

[144] 65 N.J. at 500, 323 A.2d at 509.

[145] *See id.* at 500-01, 323 A.2d at 510 and sources cited therein. *See also* Comment, *supra* note 26, at 306-10. For a discussion of the effect of strict liability on the excess case see notes 149-70 *infra* and accompanying text.

[146] 65 N.J. at 500, 323 A.2d at 509.

[147] 66 Cal. 2d at 431, 426 P.2d at 177, 58 Cal. Rptr. at 17.

[148] 65 N.J. at 502 & n.9, 323 A.2d at 510. *See also* Crisci v. Security Ins. Co., 66 Cal. 2d 425, 430, 426 P.2d 173, 177, 58 Cal. Rptr. 13, 17 (1967), wherein the theory of strict liability was suggested to the court in a brief filed by amicus curae. While recognizing some merit in the theory, the California court stated that the facts of the *Crisci* case did not require the adoption of such a rule. *Id.* at 431-32, 426 P.2d at 177-78, 58 Cal. Rptr. at 17-18.

ity to an insurance excess case? A close reading of point three suggests that the answer to this question is in the affirmative. The court noted that, in recent years, substantial protection has been extended to the general class of consumers, of which an insurance purchaser is one.[149] A policyholder has purchased a specific amount of protection and is entitled to expect that amount to be exercised in his favor whenever a settlement can be effected.[150] The court indicated that where the insurer decides not to settle, it should be the insurer alone who bears the risk of a possible excess verdict.[151] Quoting *Crisci,* the court noted that justice demands that " 'the insurer, which may reap the benefits of its determination not to settle, should also suffer the detriments of its decision.' "[152] Furthermore, the court characterized the projected new rule as one "requiring the carrier *in all cases* to bear the financial consequences of its failure to offer its policy in settlement."[153]

In an effort to protect consumers, the doctrine of strict liability has been uniformly applied to products liability cases in New Jersey.[154] Viewing the policyholder as simply another consumer, the application of strict liability to the insurance excess case is not beyond the scope of recent judicial trends. The language of the supreme court is couched in terms of absolute liability.[155] While the rule in New Jersey today with regard to insurance excess cases is not strict liability, it can be said that, given the appropriate factual setting, such a rule should be applied by the court.

The second question which arises from *Rova Farms* is that, assuming that strict liability will be applied in this state, what effect will it have on the practice of insurance law? This effect can be most easily analyzed in terms of the three parties associated with any insurance litigation: the policyholder, the insurance company, and the defense attorney.

The Policyholder

Clearly, the policyholder stands to gain the most from the application of the strict liability doctrine. The Supreme Court of

[149] 65 N.J. at 497, 323 A.2d at 507.

[150] *Id.* at 500, 323 A.2d at 509.

[151] *Id.*

[152] *Id.* at 502, 323 A.2d at 510 (quoting from Crisci v. Security Ins. Co., 66 Cal. 2d 425, 431, 426 P.2d 173, 177, 58 Cal. Rptr. 13, 17 (1967)).

[153] *Id.* at 500 n.7, 323 A.2d at 509 (emphasis added).

[154] *See, e.g.*, Scanlon v. General Motors Corp., 65 N.J. 582, 590, 326 A.2d 673, 677 (1974), and cases cited therein.

[155] 65 N.J. at 501-02, 323 A.2d at 510.

New Jersey commented that "[i]t is always to the benefit of the insured to settle and thereby avoid the danger of an excess verdict." [156] Such logic was similarly stated by the California court in the *Crisci* case.[157]

In addition, the policyholder would no longer be the victim of those "institutional considerations" which reflect themselves in the insurer's settlement decision, but which have no relation to the claim itself. It has been observed that

> insurance companies . . . adopt "no settlement" or "selective settlement" programs to numb the public's claim-consciousness, to fight organized fraudulent claims, or to create a tight-fisted image for plaintiffs' attorneys.[158]

A strict liability rule would protect a policyholder from these "institutional considerations" that unjustly affect the final settlement decision.

The Insurance Company

Superficially, it would appear that the insurance company might be irreparably harmed by the application of the strict liability doctrine. It has been suggested that such a rule would promote low-limit policies, with the hope on the part of the insured that the company would bear the risk of the excess verdict.[159] An insured with limited assets is going to purchase a low-limit policy (if, in fact, he has any insurance at all) regardless of the state of the law with regard to excess cases. Similarly, an insured with substantial assets to risk in the case of an excess verdict would not, in all good sense, purchase a low-limit policy on the slim chance that any excess verdict would be absorbed by the insurer. The degree of risk of personal assets in such a situation could never be compensated by the difference in premium payments. It has also been contended that plaintiffs in suits with only "nuisance" value would gain additional bargaining strength under a strict liability rule.[160] The court in *Rova Farms* answers this contention directly:

> [U]nder the doctrine presently in force the company, supposedly, is already making settlement decisions as though it would be

[156] *Id.* at 498, 323 A.2d at 508.

[157] 66 Cal. 2d at 430, 426 P.2d at 177, 58 Cal. Rptr. at 17. The court stated:

> Obviously, it will always be in the insured's interest to settle within the policy limits when there is any danger, however slight, of a judgment in excess of those limits.

Id.

[158] *See* Note, *supra* note 25, at 482.

[159] *Id.* at 484.

[160] *See* Comment, *supra* note 26, at 309. *See also* 65 N.J. at 500 n.7, 323 A.2d at 509.

> liable for the entire sum of any adverse verdict. Therefore, a carrier should be no more willing to settle under such a broadened rule than it is at present, and should in such an event prove no easier prey to unreasonable plaintiff demands than now. Were a carrier to settle more often or at higher figures than it presently does, this fact would only suggest that the company has been ignoring the standards set forth by this Court.[161]

Regardless of these illusory problems, there are distinct advantages from which the insurer would benefit under a rule of strict liability. Essentially, the insurer would be permitted to indulge its own personal interests to the fullest extent desired.[162] An insurer could properly base its refusal to settle on those "institutional considerations" or on any other factors it deemed relevant. It could freely conduct extensive litigation if it were seeking to establish favorable, low-verdict precedents.[163] Finally, a rule of strict liability would substantially clarify the law in the area of excess liability and would place the insurer on notice as to what conduct is expected when a claim in excess of the policy limits is made.[164] Such a rule would allow the insurer to govern itself accordingly, and actually, with proper management, the insurer could eliminate excess liability entirely.

The Defense Attorney

Serious questions of propriety must exist when an attorney represents both the insured and the insurer[165] when a claim is made against the insured in excess of the policy limits. While the *Code of Professional Responsibility* suggests that an attorney may, with adequate disclosure, represent both the insured and the insurer, one is forced to wonder if a policyholder, unfamiliar with legal practice and procedure, can comprehend the problems which can arise from this tripartite relationship and the irreversible damage which can be caused if the attorney is forced to withdraw therefrom.[166]

Justice Pashman, in *In re Lanza,*[167] addressed the issue of dual

---

[161] 65 N.J. at 500-01 n.7, 323 A.2d at 509-10.

[162] *Id.* at 500, 323 A.2d at 509.

[163] By establishing low-verdict precedents, the insurance company would be seeking to create a new "bargaining tool" in settlement negotiations. *Id.* at 499, 323 A.2d at 508-09.

[164] *See* Comment, *supra* note 26, at 308.

[165] *See* notes 97-121 *supra* and accompanying text

[166] Such disclosure to the clients has been characterized as "illusory." *In re* Lanza, 65 N.J. 347, 357, 322 A.2d 445, 451 (1974) (Pashman, J., concurring).

[167] 65 N.J. 347, 322 A.2d 445 (1974) (Pashman, J., concurring).

representation in the context of an attorney representing both the seller and the buyer of real estate. He noted that

> [a]t the very foundation of our adversary system reposes the basic tenet that one attorney may not represent two clients having conflicting interests at the same legal or judicial proceeding.[168]

In the home-buying situation, Justice Pashman considered that even the potential for conflict was so great that perhaps there should be a rule prohibiting such dual representation.[169] Justice Pashman's analysis of the attorney in conflict is no less applicable to the insured/insurer relationship. In the excess situation, conflict is not merely potential, but actual and inevitable. The interests of the parties are not the same and conflicts necessarily arise.[170] Therefore, it becomes impossible for the attorney to maintain his undivided allegiance to both the insured and the insurer. Furthermore, if the attorney is eventually required to withdraw from the matter, both parties may suffer irreparable injury while being forced to retain new counsel. In any case, the policyholder has been denied his right to adequate and effective counsel.

Under a rule of strict liability, however, the conflicts are effectively resolved since the interests of the insured would no longer be affected by the insurer's final decision regarding settlement. Hence, the attorney is not plagued by a burden of representing two clients with conflicting interests.

The application of the strict liability rule to insurance excess cases would have the same sobering effect on insurance carriers as the application of the rule in products liability cases has on manufacturers. By holding an insurer strictly liable for excess judgments, no longer would "institutional decisionmaking" play havoc with the rights of the insured. Nor, if the obligation to either settle or to pay the excess were absolute, would conflicting interests arise to affect the attorney's duty of undivided loyalty. And finally, the policyholder would be afforded the coverage for which he had paid. From a practitioner's point of view, the application of the strict liability rule would clarify the insured/insurer relationship and establish the insurer's absolute duty to settle or assume the responsibility of paying in full any judgment which may arise from a claim. The merits of strict liability are undeniable and the need for

---

[168] *Id.* at 353, 322 A.2d at 449 (Pashman, J., concurring).

[169] *Id.* at 357, 322 A.2d at 451.

[170] 66 Cal. 2d at 431, 426 P.2d at 177, 58 Cal. Rptr. at 17. *See* notes 85-121 *supra* and accompanying text.

such a rule is compelling. The New Jersey supreme court has taken the first positive step toward the adoption of such a rule. This will finally afford insurance policyholders their full and deserved measure of protection.[171] What is necessary is a direct and straightforward approach by the courts to the issue of strict liability. Pursuing the analogy of the excess case to products liability, Dean Prosser's words are most apropos:

> If there is to be strict liability in tort, let there be strict liability in tort, declared outright, without an illusory contract mask. Such strict liability is familiar enough in the law of animals, abnormally dangerous activities, nuisance, workmen's compensation, and respondeat superior. There is nothing so shocking about it today that it cannot be accepted and stand on its own feet in this new and additional field, provided always that public sentiment, public demand, and "public policy" have reached the point where the change is called for.[172]

David Novack

---

[171] The New Jersey legislature has recently recognized the importance of such protection by amending N.J. STAT. ANN. § 17:29B-4 (1963) to enumerate specific acts which constitute unfair claim settlement practices when performed "with such frequency as to indicate a general business practice." Law of May 22, 1975, ch. 100, [1975] N.J. SESS L. SERV. 178, 180.

[172] Prosser, *The Assault upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099, 1134 (1960).