INSURANCE LAW—SUBROGATED EXCESS INSURER ENTITLED TO RECOVER POLICY LIMIT FROM A PRIMARY CARRIER WHO WRONGFULLY FAILS TO SETTLE ON BEHALF OF THEIR INSURED—*Fireman's Fund Insurance Co. v. Security Insurance Co.*, 72 N.J. 63, 367 A.2d 864 (1976).

The New Jersey case of *Fireman's Fund Insurance Co. v. Security Insurance Co.*[1] arose following the settlement of malpractice suits which were initiated against a law firm.[2] As insurers of the law firm, both Security and Fireman's Fund had entered the malpractice litigation to defend the firm.[3] Security had acted as the primary insurer because the events which formed the basis of the malpractice litigation had occurred while Security's coverage of the law firm was in effect.[4] Fireman's Fund was involved in the underlying litigation as a result of a relation-back clause[5] in its policy which covered preexisting liabilities.[6]

The federal court malpractice suits, which were based upon the firm's improper preparation of a real estate prospectus, had been settled by Security.[7] The primary insurer refused, however, to nego-

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[1] 72 N.J. 63, 367 A.2d 864 (1976) (four-to-three decision).

[2] *Id.* at 67, 367 A.2d at 866.

[3] *Id.*

[4] Brief on Behalf of Plaintiff-Respondent at 23–26, Fireman's Fund Ins. Co. v. Security Ins. Co., No. A–133–73 (N.J. Super. Ct. App. Div. Jan. 15, 1975) [hereinafter cited as App. Div. Brief for Plaintiff], *aff'd*, 72 N.J. 63, 367 A.2d 864 (1976). The trial court decision stated that

> [t]he operative facts which ultimately gave rise to the institution of [the] malpractice actions against the . . . law firm occurred during the coverage period afforded by defendant's policy, although claim or suit was not made until the coverage period of plaintiff's policy. . . . By reason thereof, defendant [Security] became the primary insurer with respect to the claim and the plaintiff [Fireman's Fund] became the secondary insurer. . . . Additionally, the proofs at the trial showed that the parties by words and conduct recognized the primary-secondary nature of their relationship with respect to the claims. . . .

Fireman's Fund Ins. Co. v. Security Ins. Co., No. L–31304–69, letter opinion at 2 (N.J. Super. Ct. Law Div. July 12, 1973), *aff'd*, No. A–133–73 (N.J. Super. Ct. App. Div. Jan. 15, 1975), *aff'd*, 72 N.J. 63, 367 A.2d 864 (1976).

[5] A relation-back clause in an insurance policy is based on the concept that "an act done at one time is considered by a fiction of the law to have been done on a preceding date." BALLENTINE'S LAW DICTIONARY 1083 (3d ed. 1969). Under a relation-back clause, the insured is afforded coverage even though the policy was effective after the date of any incidents which might form the basis for potential suits.

[6] App. Div. Brief for Plaintiff, *supra* note 4, at 1.

[7] Fireman's Fund Ins. Co. v. Security Ins. Co., No. L–31304–69, letter opinion at 2–3 (N.J. Super. Ct. Law Div. July 12, 1973), *aff'd*, No. A–133–73 (N.J. Super. Ct. App. Div. Jan. 15, 1975), *aff'd*, 72 N.J. 63, 367 A.2d 864 (1976); Brief on Behalf of Defendant-Appellant at 4–5, Fireman's Fund Ins. Co. v. Security Ins. Co., No. A–133–73

tiate a settlement of the state court malpractice actions,[8] asserting the insurer's lack of liability with regard to those claims.[9]

The amount sought in damages in the state court actions[10] greatly exceeded the policy limits.[11] A finding for the plaintiffs probably would have guaranteed damages of at least $100,000 beyond the firm's coverage, for which the firm would have been responsible.[12] In contrast to this potential liability, the requested settlement figure was within the coverage afforded the law firm under its two policies.[13]

The Fireman's Fund agent was convinced that the insured would be found liable.[14] Therefore, as the excess insurer and with the par-

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(N.J. Super. Ct. App. Div. Jan. 15, 1975) [hereinafter cited as App. Div. Brief for Defendant], *aff'd*, 72 N.J. 63, 367 A.2d 864 (1976). In order to settle the federal court claims, Security paid its share of the negotiated sum which amounted to $24,275. Letter opinion at 3. Different issues were presented in the federal and the state court suits. The federal actions dealt with the firm's failure to comply with the requirements of the Securities Act of 1933, App. Div. Brief for Defendant, *supra* at 4–5, while the state court actions were based upon "[im]proper advice with respect to real estate syndications," letter opinion at 2.

[8] Fireman's Fund Ins. Co. v. Security Ins. Co., No. L–31304–69, letter opinion at 3–4 (N.J. Super. Ct. Law Div. July 12, 1973), *aff'd*, No. A–133–73 (N.J. Super. Ct. App. Div. Jan. 15, 1975), *aff'd*, 72 N.J. 63, 367 A.2d 864 (1976). Actions had been instituted against the law firm by its client and the client's receiver in bankruptcy. 72 N.J. at 67, 367 A.2d at 866.

[9] App. Div. Brief for Defendant, *supra* note 7, at 5.

[10] 72 N.J. at 68, 367 A.2d at 866. The anticipated verdict in the state court actions was at least $400,000, and was probably as much as $542,000. *Id.* The law firm's failure to escrow certain real estate receipts in a trust fund had resulted in a loss to the firm's client of $415,000. Fireman's Fund Ins. Co. v. Security Ins. Co., No. L–31304–69, letter opinion at 4 (N.J. Super. Ct. Law Div. July 12, 1973), *aff'd*, No. A–133–73 (N.J. Super. Ct. App. Div. Jan. 15, 1975), *aff'd*, 72 N.J. 63, 367 A.2d 864 (1976). Fireman's Fund contended that the exposure of the insured in the malpractice suit amounted to $542,000, which "constituted an ascertained liquidated amount, not a speculative figure." App. Div. Brief for Plaintiff, *supra* note 4, at 2. It is unclear from both the supreme court opinion and the plaintiff's appellate brief whether there was any specific provision for liquidated damages or whether the damages were merely based upon the figures involved in the real estate transaction. *See* 72 N.J. at 68, 367 A.2d at 866; App. Div. Brief for Plaintiff, *supra* note 4, at 2.

[11] *See* 72 N.J. at 67–68, 367 A.2d at 866. Security, as the primary insurer, had a policy limit of $50,000. *Id.* at 68, 367 A.2d at 866. Fireman's Fund covered the law firm for an additional $250,000. *Id.* at 67, 367 A.2d at 866. The anticipated verdict amount, *see* note 10 *supra*, exceeded the firm's coverage.

[12] *See* notes 10–11 *supra*. Even if the lowest expected judgment amount of $400,000 had been entered, the $300,000 coverage would have required the defendant firm to pay $100,000.

[13] *See* 72 N.J. at 67–68, 367 A.2d at 866–67. The settlement amount requested in the state court action was $147,000. *Id.* at 67–68, 367 A.2d at 866. The actual settlement figure, which was negotiated by Fireman's Fund and the insured firm, amounted to only $135,000. *Id.* at 68, 367 A.2d at 867. Both of these figures were within the firm's $300,000 coverage.

[14] Fireman's Fund Ins. Co. v. Security Ins. Co., No. L–31304–69, letter opinion

ticipation of the insured, Fireman's Fund settled with the complaining parties in a " 'package' " agreement.[15] This settlement was in direct contravention of an express provision in the insured's policy with Security which prohibited any settlement before judgment without Security's consent.[16] In order to effect the settlement of the claims, Fireman's Fund had loaned the necessary amount to its insured.[17] Thereafter, as subrogee of the insured, Fireman's Fund brought suit against the primary insurer to recover the policy limit extended to the insured by Security.[18] Additionally, Fireman's Fund sought an award of punitive damages for the primary insurer's failure to settle.[19]

At trial, Security was held liable for its $50,000 coverage plus interest, but Fireman's Fund was denied its claim for punitive damages.[20] The appellate division and later the Supreme Court of New Jersey affirmed the trial court's ruling.[21]

The supreme court held that, under certain circumstances, a claim against an insured can be settled by the insured before judgment is entered and in excess of the policy limits.[22] The availability of this remedy depends on the existence of several factors: first, the insured must establish that the insurer has acted in bad faith by re-

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at 3–5 (N.J. Super. Ct. Law Div. July 12, 1973), *aff'd*, No. A–133–73 (N.J. Super. Ct. App. Div. Jan. 15, 1975), *aff'd*, 72 N.J. 63, 367 A.2d 864 (1976).

[15] 72 N.J. at 67, 367 A.2d at 866. According to the terms of the settlement offer, this malpractice action and another malpractice suit which was pending against the law firm had to be concluded immediately. *Id.* Since time was of the essence, the question of an unreasonable delay by the primary insurer was presented to the court. *Id.* at 73–74, 367 A.2d at 869–70; *see* notes 121–22, 142–43 *infra* and accompanying text for a discussion of Security's unreasonable delay.

[16] *Id.* at 66, 367 A.2d at 865. This provision is a standard term of insurance contracts. *See* cases discussed note 24 *infra*.

[17] App. Div. Brief for Defendant, *supra* note 7, at 11; *see* 72 N.J. at 68, 367 A.2d at 866.

[18] 72 N.J. at 68, 367 A.2d at 866; App. Div. Brief for Defendant, *supra* note 7, at 11.

Subrogation is "an equitable right arising from [a] relationship whereby a party having paid a debt succeeds by substitution to the rights of the creditor whom he has paid." 11 J. APPLEMAN, INSURANCE LAW AND PRACTICE § 6505, at 299 (1944). Subrogation, in the context of primary and excess insurance carrier liability, requires that the subrogee: (1) have a "direct interest" in paying the debt, (2) is "secondarily liable," and (3) act equitably toward other involved parties. *See id.* § 6501, at 292.

[19] 72 N.J. at 68, 367 A.2d at 866; App. Div. Brief for Plaintiff, *supra* note 4, at 27–31.

[20] Fireman's Fund Ins. Co. v. Security Ins. Co., No. L–31304–69, letter opinion at 6 (N.J. Super. Ct. Law Div. July 12, 1973), *aff'd*, No. A–133–73 (N.J. Super. Ct. App. Div. Jan. 15, 1975), *aff'd*, 72 N.J. 63, 367 A.2d 864 (1976).

[21] Fireman's Fund Ins. Co. v. Security Ins. Co., No. A–133–73, slip op. at 6 (N.J. Super. Ct. App. Div. Jan. 15, 1975), *aff'd*, 72 N.J. 63, 367 A.2d 864 (1976); 72 N.J. at 79, 367 A.2d at 873.

[22] 72 N.J. at 75, 367 A.2d at 870.

fusing to settle; second, the amount in controversy must be greater than the policy limit involved, thereby exposing the insured to personal liability; and third, the settlement arranged by an insured must be reasonable and made in good faith.[23]

Insurance provisions are binding contractual obligations.[24] An insured's failure to comply with an express requirement of an insurance contract, such as a prohibition of prejudgment settlements without the consent of the insurer, violates a condition precedent to the insurer's performance.[25] As a result, the insurer's duties under the policy are excused.[26] It has been recognized, however, that an

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[23] *See id.* at 66–67, 75, 367 A.2d at 865–66, 870.

[24] Note, *The Availability of Excess Damages for Wrongful Refusal to Honor First Party Insurance Claims—An Emerging Trend*, 45 FORDHAM L. REV. 164, 167 (1976). Because "[a]n insurance policy is a contract between an insurance company and the insured . . . the general rules of contract law have traditionally been applied to deny recovery beyond the face amount of insurance policies." *Id.* At the outset, courts addressed the issue of excess liability in the context of pure contract law, attempting to ascertain the duties of the insurance company only from within the terms of the policy. Comment, *Insurance Carrier's Duty to Settle: Strict Liability in Excess Liability Cases?*, 6 SETON HALL L. REV. 662, 666 (1975); *see, e.g.*, Long v. Union Indem. Co., 277 Mass. 428, 430, 178 N.E. 737, 738 (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, 578–79 (1923). *See also*, Epps & Chappell, *Insurer's Liability in Excess of Policy Limits: Some Aspects of the Problem*, 44 VA. L. REV. 267, 268 (1958). Later, courts began to deal with insurance contracts as standard agreements, rather than as individualized policies. Sackville, *The Duty of the Insurer To Settle Within the Policy Limit—A Case of the Standard Contract of Adhesion*, 1968 UTAH L. REV. 72, 72. Therefore, the insurance contract was viewed as adhesive because the provisions were consistently utilized without recognition of the individual needs of the insured. *See id.* & n.1; Grunfeld, *Reform in the Law of Contract*, 24 MOD. L. REV. 62, 63 (1961).

[25] Kindervater v. Motorists Cas. Ins. Co., 120 N.J.L. 373, 199 A. 606 (Ct. Err. & App. 1938). When the express contract terms do not permit the insured "to 'voluntarily assume any liability, settle any claim or incur any expense,' " an insured who makes the prohibited admission of liability relieves the insurer of his duties under the contract. *Id.* at 375–78, 199 A. at 607–09. The *Kindervater* court stated that "[t]he insurer's liability was in clear and unmistakable language made contingent upon the fulfillment [by the insured] of the specified conditions." *Id.* at 377, 199 A. at 608.

The decision in *Kindervater* was based upon the freedom of the parties in entering the contractual arrangement. *Id.* at 376, 199 A. at 608. Because the insurer achieves an advantage by authoring the contract, insurance agreements have recently been viewed as adhesive. Lenhoff, *Contracts of Adhesion and the Freedom of Contract: A Comparative Study in the Light of American and Foreign Law*, 36 TUL. L. REV. 481, 483 (1962); *see* Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 631 (1943); note 24 *supra*.

[26] In Kindervater v. Motorists Cas. Ins. Co., 120 N.J.L. 373, 378, 199 A. 606, 608 (Ct. Err. & App. 1938), the court of errors and appeals found that

> [t]he terms of the [insurance] contract, as understood by a person of reasonable intelligence, measure the insurer's obligation; and there can be no recovery, in

insurer's reservation of the right to control settlement of any claims, which is a typical provision of modern insurance contracts,[27] carries with it an implied obligation of good faith.[28] If the insurer's primary duty of good faith is breached, its stipulated right to control the litigation is deemed waived, and the insured may act independently to protect his own interest.[29]

Under New Jersey law, the duty owed by an insurer is measured

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> the absence of the elements of estoppel or waiver, where the assured has breached in matters of substance a reasonable protective provision made determinative of liability. This regulation of the assured's conduct is essentially reasonable.

Id.; *see, e.g.*, American Auto. Ins. Co. v. Fidelity & Cas. Co., 159 Md. 631, 152 A. 523 (1930); Hudson Cas. Ins. Co. v. Garfinkel, 111 N.J. Eq. 70, 161 A. 195 (Ct. Err. & App. 1932); Coleman v. New Amsterdam Cas. Co., 247 N.Y. 271, 160 N.E. 367 (1928).

[27] In general, when an insurer assumes "duties under the insurance contract," it also acquires "the exclusive right to control all litigation against the insured." Comment, *supra* note 24, at 663–64. The insurer also has "the contractual right to settle any claim at [its] discretion." *Id.* at 664; *see, e.g.*, Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 660, 328 P.2d 198, 201 (1958) (in bank); Georgia Cas. Co. v. Mann, 242 Ky. 447, 450–51, 46 S.W. 2d 777, 779 (1932); Rova Farms Resort, Inc. v. Investors Ins. Co. of America, 65 N.J. 474, 479, 323 A.2d 495, 498 (1974); Johnson v. Hardware Mut. Cas. Co., 108 Vt. 269, 277, 187 A. 788, 792 (1936); Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1137 (1954). Absent an express provision requiring settlement of claims by the insurer, no obligation to pursue a settlement arose. Best Bldg. Co. v. Employers' Liab. Assurance Corp., 247 N.Y. 451, 453, 160 N.E. 911, 912 (1928); Streat Coal Co. v. Frankfort Gen. Ins. Co., 237 N.Y. 60, 66–68, 142 N.E. 352, 354–55 (1923); Auerbach v. Maryland Cas. Co., 236 N.Y. 247, 252–53, 140 N.E. 577, 579 (1923); Schmidt v. Travelers Ins. Co., 244 Pa. 286, 288–89, 90 A. 653, 654 (1914).

[28] Under principles of common law, every contract imposes an obligation on the parties to the agreement "to perform their respective duties with care, skill, reasonableness and good faith." *E.g.*, Bak-A-Lum Corp. of America v. Alcoa Bldg. Prods., Inc., 69 N.J. 123, 129–30, 351 A.2d 349, 352 (1976); Cunningham, *Liability in Excess of Policy Limits*, 1957 INS. L.J. 483, 483; Comment, *supra* note 24, at 667. A duty is implied in every contractual relationship

> that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract; in other words, in every contract there exists an implied covenant of good faith and fair dealing.

5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 670, at 159 (3d ed. Jaeger 1961).

The requirement of good faith is present in a contract between an insurer and insured, and this standard prohibits unreasonable acts by either party whether or not such acts are intentional. Sackville, *supra* note 24, at 96. Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 658, 328 P.2d 198, 200 (1958) requires that the insurer accept a reasonable settlement within the policy limit as a result of the presence of the good faith standard in an insurance agreement.

[29] *E.g.*, Traders & Gen. Ins. Co. v. Rudco Oil & Gas Co., 129 F.2d 621, 628 (10th Cir. 1942); Fireman's Fund Ins. Co. v. Security Ins. Co., 72 N.J. 63, 75, 367 A.2d 864, 870 (1976); Evans v. Continental Cas. Co., 40 Wash. 2d 614, 627–28, 245 P.2d 470, 478–79 (1952).

by the good faith standard.[30] This standard requires that the insurer recognize both its own interest and that of the insured when considering a proposed settlement agreement.[31] New Jersey decisions have established that the good faith standard requires an insurer to review a settlement proposal as if no policy limit existed.[32] The insurer, therefore, must make a settlement decision as though it would be accountable for the entire sum in controversy. Determinations regarding settlement possibilities "must be thoroughly honest, intelligent and objective,"[33] and must be based on a conscientious study of the factors involved.[34] Case law respecting the rights of an insured when his insurer breaches the contract has developed primarily in

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[30] This standard is evident in four cases litigated in New Jersey. These cases also explicate basic New Jersey law concerning the insurer's duty to consider settlement. *See* Board of Educ. v. Lumbermens Mut. Cas. Co., 293 F. Supp. 541 (D.N.J. 1968); Kaudern v. Allstate Ins. Co., 277 F. Supp. 83 (D.N.J. 1967); Bowers v. Camden Fire Ins. Ass'n, 51 N.J. 62, 237 A.2d 857 (1968); Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co., 31 N.J. 299, 157 A.2d 319 (1960).

[31] Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co., 31 N.J. 299, 304, 157 A.2d 319, 322 (1960). In *Radio Taxi*, the Supreme Court of New Jersey accepted the good faith theory as governing the insurer's duty to consider settlement. *Id.* A federal court later interpreted the New Jersey good faith standard as requiring that "at least equal consideration" be given to the insured's interests. Board of Educ. v. Lumbermens Mut. Cas. Co., 293 F. Supp. 541, 544 (D.N.J. 1968).

[32] Bowers v. Camden Fire Ins. Ass'n, 51 N.J. 62, 71, 237 A.2d 857, 862 (1968). The requirement of viewing the situation as if there were no policy limit is necessary because an inherent conflict exists between the insurer's best interest and its duty to the insured with regard to considering settlement offers in excess of the policy limit. *Id.* As a judgment against the insured in excess of the policy coverage becomes more probable, the duty of the insurer increases in response to the needs of the insured. Board of Educ. v. Lumbermens Mut. Cas. Co., 293 F. Supp. 541, 543 (D.N.J. 1968). In Rova Farms Resort, Inc. v. Investors Ins. Co. of America, 65 N.J. 474, 323 A.2d 495 (1974), the majority found that "where . . . any adverse verdict at trial is likely to exceed the policy limit, the boundaries of good faith become more compressed in favor of the insured." *Id.* at 493, 323 A.2d at 505.

[33] Bowers v. Camden Fire Ins. Ass'n, 51 N.J. 62, 71, 237 A.2d 857, 861–62 (1968). In Board of Educ. v. Lumbermens Mut. Cas. Co., 293 F. Supp. 541, 543 (D.N.J. 1968), the insurer was judged by the same standard, requiring that the "decision not to settle . . . be thoroughly honest, intelligent, objective and realistic *when tested by the necessarily assumed expertise of the insurer.*" *Id.* (emphasis added). The insurance company was liable in the *Bowers* case because it had gambled unreasonably with the insured's interests, and because the insurer had failed to exercise its expertise; no malice or intent to injure the insured was necessary. 51 N.J. at 78–79, 237 A.2d at 865–66.

[34] Board of Educ. v. Lumbermens Mut. Cas. Co., 293 F. Supp. 541, 543 (D.N.J. 1968). All probabilities must be considered with regard to the future jury verdict. *Id.*; *see* Bowers v. Camden Fire Ins. Ass'n, 51 N.J. 62, 72–79, 237 A.2d 857, 862–66 (1968) (analysis of the insurer's reaction, as an expert, to the circumstances of the case as they arose). The expertise of the insurance company must be utilized in its study of the factors involved in the action brought against its insured. Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co., 31 N.J. 299, 304–05, 157 A.2d 319, 322–23 (1960).

jurisdictions other than New Jersey. Those opinions have provided the foundation for current New Jersey law on this subject.

In the context of an insurer's wrongful failure to settle, the presence of a failure to defend[35] was a significant factor in the earliest rulings. In *Traders & General Insurance Co. v. Rudco Oil & Gas Co.*,[36] the Court of Appeals for the Tenth Circuit held that the rights of an insurer to defend and to settle are not absolute, but are subject to an implied duty of good faith.[37] Rudco had been issued a standard insurance policy with a provision against settlement by the insured before judgment or without the insurer's consent.[38] The potential liability in the tort actions brought against the insured was in excess of the policy coverage.[39] Although Traders did not deny its obligation to defend the suits if the policy covered the accident, it sought a declaratory judgment of its own lack of liability under the insurance contract.[40] Since the liability of Rudco was probable and the likelihood of a jury verdict greatly in excess of its coverage was substantial, Traders' suit for declaratory judgment was equivalent to a failure to defend the tort action.[41] Traders was informed of the planned settlement discussions and of the need for immediate action, but refused to participate in settlement negotiations, awaiting instead the outcome of the declaratory judgment suit.[42] The insured reached a settlement of the tort claims,[43] and brought suit against Traders to recover the policy limit expended in the settlement.[44]

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[35] An insurer's failure to defend had been recognized as permitting the insured to settle the claim and to recover the amount paid in settlement. New Jersey Mfrs. Indem. Ins. Co. v. United States Cas. Co., 91 N.J. Super. 404, 408–09, 220 A.2d 708, 709–10 (App. Div. 1966).

[36] 129 F.2d 621 (10th Cir. 1942).

[37] *Id.* at 627.

[38] *Id.* at 623. The *Traders* court referred to the contract as a "standard type public liability insurance policy." *Id.* at 622.

[39] *Id.* at 623. The negligence of the insured had caused a gas line to explode, causing serious injuries or death to the victims and damaging their home. *Id.* In contrast to the severity of plaintiffs' damage, the coverage afforded the insured under its policy with Traders amounted to only $10,000 for each accident. *Id.* at 622–23.

[40] *Id.* Under typical contract terms, an insurer can invoke the right to act on behalf of the insured while reserving the right to contest its liability under another policy provision. *See* 17 G. COUCH, CYCLOPEDIA OF INSURANCE LAW § 67:402, at 638 (2d ed. Anderson 1967).

[41] *See id.* at 623. The insured "was convinced of its legal liability" and sure that the jury award would exceed its coverage. *Id.* Nevertheless, the insurer demanded that Rudco promise to pay its attorneys fees before it would cease to pursue a suit for a declaratory judgment of its lack of liability. *Id.*

[42] *Id.* at 623–24.

[43] *Id.* at 624.

[44] *Id.*

The court found that by unreasonably challenging its liability and by failing to settle a claim which would obviously result in an award exceeding the policy limit, Traders had breached its duty of good faith to the insured.[45] Traders' particular dereliction of this implied duty of good faith consisted of its failure to consider the best interests of its insured equally with its own protection.[46] The court concluded that, as a result of the insurer's breach, the insured could settle to protect its own interest, and then recover the policy limit from the insurer.[47]

In a subsequent case, *Evans v. Continental Casualty Co.*,[48] a failure to consider settlement, which served as the basis for the insurer's liability, was compared to a failure to defend.[49] The Supreme Court of Washington upheld the insured's right to recover any reasonable, good faith settlement amount paid up to the limit afforded under his policy.[50]

The insured in *Evans*, an owner of a car rental agency, had been sued for damages arising out of an automobile accident.[51] Continental proceeded to defend the action brought against the insured, but insisted on the possible relevance of an escape clause[52] which was present in the policy.[53] This escape clause would have denied coverage to Evans if he had rented to a person who was intoxicated at the time of the rental.[54] In order to exercise the escape clause, the insurer was,

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[45] *Id.* at 627–28. The *Traders* court found that because the potential for excess liability existed, the right of the insurer to control settlement was "not absolute"; this right was "subject to . . . the rule of right and justice." *Id.* at 627. This "right to control" settlement demanded the "correlative duty to exercise diligence, intelligence, good faith, honest and conscientious fidelity to the common interest of the parties." *Id.* The court also found that the insured had secured a "fair, just and reasonable" settlement of the claims. *Id.* at 624.

[46] *Id.* at 628. The court stated that "[e]ach of the parties to the [insurance] contract owed to the other an express and implied duty to respect its rights and interests" and to study the situation practically and fairly. *Id.* Thus, based on their relationship, the insurance company owed the duty of loyalty to Rudco. *Id.* at 627.

[47] *Id.* at 628. The insurer could not merely invoke the policy clause against settlement by the insured, but had to show affirmatively its own good faith and fair dealing. *Id.*

[48] 40 Wash. 2d 614, 245 P.2d 470 (1952).

[49] *Id.* at 627–29, 245 P.2d at 478–79.

[50] *Id.* at 628, 245 P.2d at 479.

[51] *Id.* at 615, 618–19, 245 P.2d at 471, 473–74. The accident was caused by a driver who had rented an automobile from Evans, the insured. *Id.* at 618–19, 245 P.2d at 473.

[52] An escape clause is a term "in a contract relieving a promisor of liability for nonperformance in the event of contingent developments rendering performance impossible." BALLENTINE'S LAW DICTIONARY 415 (3d ed. 1969).

[53] 40 Wash. 2d at 618–20, 245 P.2d at 473–74.

[54] *Id.* at 619, 245 P.2d at 473.

in effect, required to prove the plaintiff's tort action against the insured.[55] Although it sought to escape liability, Continental insisted on concurrently exercising its right to control the litigation.[56] In the face of Continental's conflicting position, Evans demanded that full liability be accepted by the insurer's withdrawal of the escape clause option.[57] In the alternative, Evans proposed that he be allowed to handle the defense at the insurer's expense.[58] When both demands were rejected, the insured proceeded to settle the claims on his own and brought a subsequent suit to recover the policy limit from Continental.[59]

The *Evans* court analogized Continental's refusal to participate in settlement arrangements to a denial of liability or a failure to defend.[60] The comparison was founded on the insurer's cognizance of its insured's potential personal liability.[61] The court did not base its decision upon Continental's assertion of its reservation right and its retention of litigation control, which allegedly had caused a conflict of interest and a breach of its duty to defend.[62] Although these other elements were present, the court based its decision solely on the insurer's wrongful refusal to consider settlement in the face of a

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[55] *Id.* at 622, 245 P.2d at 475. The insured urged, in his argument to the court, that his insurer "had placed itself in a position where its interests conflicted with and were antagonistic to his." *Id.* The interests of Evans and Continental were irreconcilable

> in that it would be to [the insurer's] advantage to allow or help the plaintiffs in the tort actions to prove that [the person who had rented the automobile] was under the influence of intoxicants at the time he rented or extended the rental of the automobile.

Id. This particular fact situation aggravated the usual conflict of interest predicament that exists between insurer and insured. For a discussion of this underlying conflict of interest, see note 32 *supra*.

[56] 40 Wash. 2d at 620–21, 245 P.2d at 474.

[57] *Id.* at 618–21, 245 P.2d at 473–75. For an explanation of a reservation of rights, see note 40 *supra*.

[58] 40 Wash. 2d at 621, 245 P.2d at 474.

[59] *Id.* at 615, 621, 245 P.2d at 471, 474.

[60] *Id.* at 628–29, 245 P.2d at 479. The breach of an insurer's duty of good faith allows an insured to settle actions brought against him when his insurer has failed to defend or has refused coverage. *Id.* The court held that, by reserving its right to exercise the escape clause, the insurer had in effect failed to defend as required under the contractual agreement. *Id.* at 630, 245 P.2d at 480.

[61] *Id.* at 625, 245 P.2d at 477. The insurer was charged with knowledge of the great probability of an excess verdict against its insured, and therefore should have acted on such information accordingly. *Id.*

[62] *See id.* at 621–22, 630, 245 P.2d at 475, 480. An element of the case which probably affected the court's ruling was the evidence that the insurer had required that the insured be personally responsible for part of any settlement sum, even though the settlement proposals were within the policy limit. *Id.* at 621–22, 245 P.2d at 475.

strong possibility of excess liability.[63] This failure to settle, under the circumstances, was itself a breach of the insurer's implied duty of good faith.[64] When this breach occurs, the insured is entitled, but not required, to make a reasonable settlement before judgment is reached.[65]

The insured's right to settle in contravention of a policy clause was premised upon the insurer's denial of liability coupled with a failure to act *or* an unreasonable delay.[66] Subsequently, the concept that unreasonable delay in itself was sufficient to permit settlement by the insured was definitively stated in *Isadore Rosen & Sons, Inc. v. Security Mutual Insurance Co.*[67] In *Rosen*, the New York court of appeals held that an unreasonable delay by the insurer constitutes a

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[63] *See id.* at 628–30, 245 P.2d at 479–80. The court relied heavily on the *Rudco* holding and its requirement that the insurer fully perform its duty of good faith with the interests of the insured in mind. *Id.*

[64] *Id.*

[65] *Id.* at 628–29, 245 P.2d at 479. The court stated that when a settlement has been arranged in contravention of a contract clause, there are two prerequisites for recovery of the policy limit: (1) the insurer must have acted in bad faith and (2) the insured must have secured a good faith settlement. *Id.* at 628, 245 P.2d at 479. The court concluded that these two conditions had been met in the *Evans* case, based upon an agreement by the parties that the insured's settlement was "reasonable" and made "in good faith," *id.*, and a finding by the court that the insured had acted in bad faith, *id.* at 627, 245 P.2d at 478.

[66] Home Indemnity Ins. Co. v. Snowden, 223 Ark. 64, 70, 264 S.W.2d 642, 645–46 (1954). This case, decided by the Supreme Court of Arkansas, permitted an insured to recover his policy limit, even though the insured had acted in violation of a term in the contract by settling prior to judgment without the consent of his insurer. *Id.* at 70–71, 264 S.W.2d at 645–46.

Snowden was sued for the wrongful death of an independent contractor who had been performing services on Snowden's property at the time of the fatal accident. *Id.* at 65–68, 264 S.W.2d at 643–44. Home Indemnity, Snowden's insurer, evidenced an intention to deny coverage by initially urging its lack of liability on the basis that the deceased was an employee rather than an independent contractor. *Id.* at 68–69, 264 S.W.2d at 645. In addition, the insurer advised that Snowden retain independent counsel. *Id.* at 67–68, 264 S.W.2d at 644.

Although a warning to retain counsel is usual when the potential for excess liability exists, *id.* at 72–73, 264 S.W.2d at 647, this suggestion by the insurer apparently contributed to the court's conclusion that the insurer had not performed its duty of good faith to the insured's interests, *id.* at 73, 264 S.W.2d at 647. *See id.* at 67–68, 264 S.W.2d at 644. The court stated that a contract clause against settlement by an insured was not effective when the insurer had acted in bad faith with regard to the interests of the insured. *Id.* at 70, 264 S.W.2d at 645–46. The *Snowden* court recognized two ways in which an insurer might breach its contract with the insured: (1) by denying liability, in conjunction with a failure to defend or to settle, or (2) by unreasonably delaying investigation after notice of the incident. Upon either of these breaches by the insurer, the insured might reasonably settle a claim brought against him and recover the policy limit. *Id.*

[67] 31 N.Y.2d 342, 291 N.E.2d 380, 339 N.Y.S.2d 97 (1972).

waiver of the policy clause prohibiting settlement.[68] The insurer in *Rosen* refused to settle, even though the pendency of the claim placed great financial pressure on the insured, who could not receive payment for work performed under a subcontract until the negligence suit was resolved.[69]

Under New York law, when an insurer unreasonably refuses to defend, the insured is permitted to settle the action.[70] Breach of the insurer's duty of good faith occurs when the insurer, by its nonaction, unreasonably causes the insured to settle without a promise of coverage.[71] Thus, an unreasonable delay, in itself, may constitute a breach which is equivalent to a failure to defend, thereby permitting settlement by the insured.[72] The *Rosen* court, therefore, reasoned

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[68] *Id.* at 347–48, 291 N.E.2d at 382–83, N.Y.S.2d at 101–02. The *Rosen* case was remanded so that a jury determination could be made as to whether, under the particular circumstances involved in this case, the insurer had unreasonably delayed. *Id.*, 291 N.E.2d at 383, 339 N.Y.S.2d at 101–02.

[69] *Id.* at 345, 291 N.E.2d at 381, 339 N.Y.S.2d at 98–99. The insured subcontractor could not receive payment of the $80,000 it was owed by the general contractor until the insured permitted the general contractor to deduct $15,648, which was owed to the general contractor because the insured had supposedly damaged a roof of a structure while performing its work. *Id.* If such damage was caused by the negligence of the insured, it would have been "a covered risk" under the insurance policy involved in this litigation. *Id.* The insurer contended that no liability existed on its part due to a policy provision forbidding settlement of claims by the insured until judgment or consent by the insurer. *Id.* Rosen alleged that due to the time element involved, it " 'had no choice but to make its own settlement with the general contractor.' " *Id.* The duty to act within a reasonable time, therefore, formed the mainstay of the *Rosen* decision.

[70] *Id.* at 347, 291 N.E.2d at 382, 339 N.Y.S.2d at 101. The court stated that under "the New York rule,"

> where an insurer " 'unjustifiably refuses to defend a suit, the insured may make a reasonable settlement or compromise of the injured party's claim, and is then entitled to reimbursement from the insurer, even though the policy purports to avoid liability for settlements made without the insurer's consent.' "

Id. (quoting from Cardinal v. State, 304 N.Y. 400, 410, 107 N.E.2d 569, 573 (1952), *cert. denied*, 345 U.S. 918 (1953) (quoting from 7A J. APPLEMAN, INSURANCE LAW AND PRACTICE § 4690, at 492 (1962))).

Settlement by an insured, when the insurer has failed to defend, has long been recognized as a proper action which would afford a remedy against the insurer. *See* St. Louis Beef Co. v. Maryland Cas. Co., 201 U.S. 173 (1906). The New York courts permitted the insured to settle when the insurer had failed to defend. Hasbrouck v. Buffalo Housewrecking & Salvage Co. (*In re* Empire State Sur. Co.), 214 N.Y. 553, 108 N.E. 825 (1915).

[71] 31 N.Y.2d at 347, 291 N.E.2d at 382, 339 N.Y.S.2d at 101. The court stated that the insurer's duty of good faith

> may be breached by neglect and failure to act protectively when the insured is compelled to make settlement at his peril; and unreasonable delay by the insurer, in dealing with a claim, may be one form of refusal to perform which could justify settlement by the insured.

Id.

[72] *Id.* at 348, 291 N.E.2d at 383, 339 N.Y.S.2d at 101–02. A factor of reasonable time

a policy provision against settlement before judgment and without the consent of the insurer cannot be utilized unfairly in order to harm the insured.[73]

The cases already discussed allowed recovery of the policy limit in situations where the insurer was found to have breached its duty to consider settlement, the insured settled the claim prior to judgment, and the recovery was within the policy amount. In *Comunale v. Traders & General Insurance Co.*,[74] the Supreme Court of California permitted recovery of the *full judgment amount* when the insurer had wrongfully failed to settle a claim.[75] When an action was brought against its insured as a result of a vehicular accident, Traders denied coverage.[76] Because Traders failed to defend, the insured hired a personal attorney to protect his interests, and the case proceeded.[77] After the plaintiffs in the negligence suit won their action against the insured, they sought to enforce their judgment against Traders.[78]

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has been recognized in other cases. In Interstate Cas. Co. v. Wallins Creek Coal Co., 164 Ky. 778, 176 S.W. 217 (1915), the court commented that failure to act for a period of three months was a sufficient basis for the insured to realize that the insurer was "in effect den[ying] its liability." *Id.* at 784–86, 176 S.W. at 220–21. The court allowed the insured to settle the claim and recover the policy limit. *Id.* at 781–82, 176 S.W. at 219. The court found the settlement to be fair and made in good faith. *Id.* Since the insurer had the "power of control over the matter, it should not be allowed by inaction or indifference to prejudice the rights of the insured." *Id.* at 782, 176 S.W. at 219. Lack of action was found to be at least as prejudicial to the rights of the insured as an absolute denial of liability, since

> [i]f [the insurer] denies its liability, [the insured] should say so, and if it admits its liability, [the insurer] should advise what steps it wants the insured to take. Unless it does one of these things with reasonable promptness, the insured, by [the insurer's] indifference to its rights, is placed at a disadvantage that it ought not to be subjected to.

Id.

[73] 31 N.Y.2d at 347–48, 291 N.E.2d at 382–83, 339 N.Y.S. 2d at 100–02. The court emphasized that when the insurer's delayed action on a pending claim is unreasonable, it may not rely on a policy clause prohibiting settlement by the insured. *Id.* at 348, 291 N.E.2d at 383, 339 N.Y.S.2d at 101. For a statement of the good faith standard which prohibits an insurer's unreasonable delay, see note 71 *supra*.

In Otteman v. Interstate Fire & Cas. Co., 172 Neb. 574, 111 N.W.2d 97 (1961), the insurer's delay was held to constitute a denial of coverage when no action was taken by the insurer for seven months. *Id.* at 581–83, 111 N.W.2d at 102. The failure to act amounted to a waiver of any contract provision forbidding the insured to settle prior to judgment without consent of the insurer. *Id.*; *see* Thomas Kilpatrick & Co. v. London Guarantee & Accident Co., 121 Neb. 354, 237 N.W. 162 (1931) (the insured's duty to comply with contract provisions was abrogated when the insurer, prior to the insured's breach, had practically denied its liability).

[74] 50 Cal. 2d 654, 328 P.2d 198 (1958) (in bank).

[75] *Id.* at 660, 328 P.2d at 201–02.

[76] *Id.* at 657–58, 328 P.2d at 200.

[77] *Id.*

[78] *Id.* The insured was unable to pay the amount awarded by the jury in the tort

As in earlier cases, the insurer was found to have breached its implied duty of good faith by failing to settle for an amount within the policy limit.[79] Liability for failure to settle was also based upon the insurer's breach of the obligation to consider the insured's interests equally with its own protection.[80] Consideration of those interests requires that the insurer settle when a judgment in excess of the policy limit is likely.[81] Unlike earlier cases, where the insured acted to protect his own interests, the *Comunale* court found that by failing to settle, Traders had damaged its insured to the *full extent of the judgment*. Because the entire claim could have been settled well within the afforded coverage if the insurer had not breached its duty to settle, liability was imposed on the insurer for the entire amount—even for that portion in excess of the policy limit.[82]

The Supreme Court of California took a further step in *Crisci v. Security Insurance Co.*,[83] when it not only granted recovery in excess of the policy limit, but also allowed an award for mental distress to the insured.[84] Even though it was clear that the insured would be unable to controvert the claim brought against her,[85] Security had

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action, so the Comunales sought to enforce their judgment against the insurer. Recovery of the judgment equaling $26,250 would require the insurer to pay both the policy amount and the excess over the policy limit. *Id.*

[79] *Id.* at 659, 328 P.2d at 201.

[80] *Id.* at 658–59, 328 P.2d at 200–01. The Supreme Court of California, basing its finding on the prior cases of Brown v. Superior Court, 34 Cal. 2d 559, 564, 212 P.2d 878, 881 (1949) (in bank), and Hilker v. Western Auto. Ins. Co., 204 Wis. 1, 4–5, 231 N.W. 257, 258 (1930), stated that "[t]here is an implied covenant of good faith and fair dealing in every contract that neither party will do anything which will injure the right of the other to receive the benefits of the agreement." 50 Cal. 2d at 658, 328 P.2d at 200. The insurer was required to give at least equal consideration to the interests of its insured. Ivy v. Pacific Auto. Ins. Co., 156 Cal. App. 2d 652, 660, 320 P.2d 140, 146 (Dist. Ct. App. 1958). The insurance contract did not give the insurer the authority "to sacrifice the interests of the insured in order to protect its own interests." *Id.* at 659, 320 P.2d at 146.

[81] 50 Cal. 2d at 659–60, 328 P.2d at 201–02. The California supreme court found that

> [w]hen there is great risk of a recovery beyond the policy limits so that the most reasonable manner of disposing of the claim is a settlement which can be made within those limits, a consideration in good faith of the insured's interest *requires the insurer to settle the claim*. Its unwarranted refusal to do so constitutes a breach of the implied covenant of good faith and fair dealing.

Id. at 659, 328 P.2d at 201 (emphasis added).

[82] *Id.* at 660, 328 P.2d at 202. The insured should not have to suffer the results of the insurer's breach of its obligation. *Id.* at 660–61, 328 P.2d at 201–02.

[83] 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967) (in bank).

[84] 66 Cal. 2d at 431–34, 426 P.2d at 177–79, 58 Cal. Rptr. at 17–19.

[85] *Id.* at 428, 431–32, 426 P.2d at 175, 177–78, 58 Cal. Rptr. at 15, 17–18.

failed to settle the matter.[86] The resulting litigation produced a judgment which exceeded the policy limit.[87]

As illustrated in *Comunale*, California law requires an insurer who retains settlement control to react to a settlement offer with awareness of the insured's interests.[88] Since Security had breached that duty, it was held liable for the entire judgment, including the amount exceeding its coverage.[89] The insurer was liable for all consequential losses flowing from the breach of its settlement obligations.[90] Thus, damages for mental distress were also found to be justified because a great personal loss resulted to the insured from the insurer's failure to perform its duty to settle.[91]

Questions raised and decided in these prior cases are significant in current New Jersey case law concerning the rights of an insured. In a recent case, *Rova Farms Resort, Inc. v. Investors Insurance Co.*,[92] the Supreme Court of New Jersey allowed recovery of the entire judgment, including the amount over the policy limit, because the insurer had breached its duty to settle.[93] The claim in *Rova Farms* was based on the bad-faith refusal of Investors to make more than an insignificant settlement offer in a suit against Rova Farms.[94] Under the typical provisions of the insurance contract, Investors was entitled to control the defense and settlement of tort suits brought against its insured, and Rova Farms was prohibited from making settlements without the insurer's consent or before judgment.[95]

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[86] *Id.* at 428, 431, 426 P.2d at 175, 177–78, 58 Cal. Rptr. at 15, 17.

[87] *Id.* at 428, 426 P.2d at 175–76, 58 Cal. Rptr. at 15–16. The jury verdict amounted to $101,000. *Id.* Under the policy, the insured was covered for liability to the extent of $10,000, *id.*, 426 P.2d at 175, 58 Cal. Rptr. at 15, and was therefore personally liable for the excess judgment sum of $91,000, *id.* at 427, 426 P.2d at 175, 58 Cal. Rptr. at 15. Security had been aware that if liability were found by the jury, the award would exceed the policy limit, *id.*, since the amount requested by the plaintiff in the tort action was $400,000, *id.* at 427–28, 426 P.2d at 175, 58 Cal. Rptr. at 15.

[88] *Id.* at 429, 426 P.2d at 176, 58 Cal. Rptr. at 16. For a discussion of the requirement that the insurer settle claims against the insured under certain circumstances, see note 81 *supra*.

[89] 66 Cal. 2d at 432, 428 P.2d at 178, 58 Cal. Rptr. at 18.

[90] *See id.* at 433–34, 426 P.2d at 178–79, 58 Cal. Rptr. at 18–19.

[91] *Id.* Because a fiduciary relationship exists between an insurer and insured, the court applied a tort theory of damages; the remedy was not based upon the insurance contract. *Id.* In order for the insured to recover for tortious injuries, the insurer's breach of duty had to "constitut[e] a tort." *Id.* at 434, 426 P.2d at 179, 58 Cal. Rptr. at 19.

[92] 65 N.J. 474, 323 A.2d 495 (1974).

[93] *Id.* at 490, 496, 323 A.2d at 504, 507.

[94] *Id.* at 487–90, 323 A.2d at 502–04.

[95] *Id.* at 479, 323 A.2d at 498.

The earlier personal injury case against the insured involved a serious diving accident on the property of Rova Farms which had rendered the youthful victim a quadriplegic.[96] The nature of this accident made it probable that the jury verdict would greatly exceed the policy limit.[97] After an excess verdict was actually returned against Rova Farms in this tort action, and while the case was on appeal, Investors still did not increase its settlement offer.[98] Although the judgment against Rova Farms was reversed by the appellate division, the supreme court later reinstated the jury verdict.[99] Rova Farms then instituted a suit against Investors.[100]

In that later suit, Investors contended in its defense that no specific settlement offer had been made during negotiations by the plaintiff in the tort action and that the insured had not disclosed its willingness to contribute toward a settlement figure.[101] The trial court found the insurer guilty of bad faith and liable for the entire judgment against the insured.[102] After the appellate division upheld the trial court's finding, the supreme court granted certification.[103]

The supreme court concluded that the insurer had breached its duty of good faith because the likelihood of a verdict in excess of the policy limit should have been apparent to an expert insurance carrier.[104] The court stated that the insurer should have negotiated

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[96] *Id.* The permanent and serious nature of the injuries caused Rova Farms' independent counsel and the counsel for Investors to stress the likelihood of a large jury verdict against Rova Farms. *Id.* at 479–82, 323 A.2d at 498–99. It was the probability of an excess verdict that had prompted Rova Farms to retain independent counsel to protect its interest. *Id.*

[97] *Id.* at 478–79, 323 A.2d at 497–98. A similar case had been previously decided by the Tenth Circuit. *See* Potomac Ins. Co. v. Wilkins Co., 376 F.2d 425 (10th Cir. 1967).

[98] 65 N.J. at 481–82, 323 A.2d at 499–500. A jury verdict totaling $225,000 was awarded, *id.* at 481, 323 A.2d at 499, but the coverage afforded to the insured was limited to $50,000 under the policy agreement, *id.* at 479, 323 A.2d at 498. Investors had never raised its settlement offer to more than 25% of the policy coverage. *Id.* at 481, 323 A.2d at 499. The supreme court stated that the appellate division had reversed the trial court's decision because "the insured's negligence . . . was not so gross as to justify a finding of willful, wanton conduct." *Id.* at 481–82, 323 A.2d at 499.

[99] *Id.* at 482, 323 A.2d at 499.

[100] *Id.* at 482–83, 323 A.2d at 499.

[101] *Id.* at 483, 323 A.2d at 500. By these two arguments, the insurer sought to dispel the finding that it was guilty of bad faith and attempted to shift at least partial responsibility for the failure to settle onto Rova Farms, its insured. *Id.*

[102] *Id.*

[103] *Id.*

[104] *Id.* at 490, 323 A.2d at 504. The supreme court quoted the *Bowers* decision, finding "that '[a] decision not to settle must be a thoroughly honest, intelligent and objective one. It must be a realistic one when tested by the necessarily assumed expertise of the company.' " *Id.* at 489–90, 323 A.2d at 503 (quoting from Bowers v. Camden

more openly and without regard to the insured's response to its request for contribution. In fact, the contribution request itself was held to evidence a lack of good faith on the part of the insurer.[105] Application of the duty to attempt settlement, therefore, did not depend on a specific settlement proposal by the adversary.[106] The *Rova Farms* court found that an insurer, as a fiduciary, has a positive obligation to pursue actively any settlement opportunities.[107] This obligation exists even if, in so proceeding, the insurer has to act against its

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Fire Ins. Ass'n, 51 N.J. 62, 71, 237 A.2d 857, 861 (1968)). The *Rova Farms* court added that "[t]his expertise must be applied, in a given case, to a consideration of *all the factors* bearing upon the advisability of a settlement for the protection of the insured." 65 N.J. at 490, 323 A.2d at 503 (emphasis in original). In addition to the insurer's evaluation of liability, these factors include:

> The anticipated range of a verdict, should it be adverse; the strengths and weaknesses of all of the evidence to be presented on either side so far as known; the history of the particular geographic area in cases of similar nature; and the relative appearance, persuasiveness, and likely appeal of the claimant, the insured, and the witnesses at trial.

Id. at 490, 323 A.2d at 503–04. The court found that the insurer, in order to evaluate a settlement possibility fairly, must approach the situation as if no policy limit existed. *Id.* at 497–98, 323 A.2d at 508. Other decisions have held that this same duty to consider settlement without regard to policy limits is pertinent with regard to bad faith on the part of the insurer. *See, e.g.*, Luke v. American Family Mut. Ins. Co., 476 F.2d 1015 (8th Cir. 1973); Young v. American Cas. Co., (*In re* York Laudromat), 416 F.2d 906 (2d Cir. 1969), *cert. dismissed*, 396 U.S. 997 (1970); Board of Educ. v. Lumbermens Mut. Cas. Co., 293 F. Supp. 541 (D.N.J. 1968); Bowers v. Camden Fire Ins. Ass'n, 51 N.J. 62, 237 A.2d 857 (1968). For a discussion of the requirement that the insurer consider settlement without regard to the policy limit, see note 33 *supra*.

[105] 65 N.J. at 486–87 & n.3, 323 A.2d at 501–02.

[106] *Id.* at 491, 323 A.2d at 504. The "development of [the] principles of equity, fair dealing and good faith" enlarged the responsibilities owed to the insured, and the view that an insurer was merely required to respond to settlement proposals was too narrow. *Id.* In Knobloch v. Royal Globe Ins. Co., 38 N.Y.2d 471, 479, 344 N.E.2d 364, 368–69, 381 N.Y.S.2d 433, 437–38 (1976), the insurer was required to respond honestly and fairly to its insured's inquiries concerning settlement opportunities. The *Knobloch* court also found that an insured could maintain suit for the full judgment verdict, recovering from the insurer an amount in excess of the policy coverage, if the jury found that the insurer had breached its duty of good faith by failing to settle. *Id.* at 476–77, 480, 344 N.E.2d at 366–67, 369–70, 381 N.Y.S.2d at 435–36, 438.

[107] 65 N.J. at 492–93, 323 A.2d at 504–05. Because the insurer acts as an agent on its insured's behalf, the relationship is that of a fiduciary who is bound to exercise care and loyalty for the benefit of the principal. *Id.*; Bowers v. Camden Fire Ins. Ass'n, 51 N.J. 62, 237 A.2d 857 (1968).

The duty owed by a fiduciary was described in Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928), a decision written by Judge Cardozo.

> Many forms of conduct permissible in a workday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate.

own best interest.[108] The *Rova Farms* decision, therefore, established the right of an insured to recover the *entire* amount of a judgment if an insurer's failure to settle a claim is unreasonable under New Jersey law.[109]

In the *Fireman's Fund* decision, the supreme court has further developed the law pertinent to the settlement rights of the insured. When an insurer fails to make reasonable settlements prior to judgment, *Fireman's Fund* permits recovery by an insured who negotiates a reasonable settlement. The extent of recovery in this situation is limited to the policy amount.[110] However, there must be a potentiality that a trial on the merits would have resulted in an excess judgment against the insured.[111]

The supreme court in *Fireman's Fund* accepted the trial court's uncontroverted finding that Security had acted in bad faith regarding its contractual duties.[112] An insurer's duty to settle is implied from the obligation of good faith, which is inherent in all contractual

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Id. The insurer-insured fiduciary relationship is atypical because of the inherent conflict of interest which exists when excess liability is probable and settlement opportunities arise. *See* 65 N.J. at 497–502, 323 A.2d at 508–10. For a discussion of this conflict of interest on the part of the insurer, see note 32 *supra*. As a result, the *Rova* court stated affirmatively

> that an insurer, having contractually restricted the independent negotiating power of its insured, has a positive fiduciary duty to take the initiative and attempt to negotiate a settlement within the policy coverage. Any doubt as to the existence of an opportunity to settle within the face amount of the coverage . . . must be resolved in favor of the insured unless the insurer, by some affirmative evidence, demonstrates there was not only no realistic possibility of settlement within policy limits, but also that the insured would not have contributed to whatever settlement figure above that sum might have been available.

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

[108] *See* 65 N.J. at 497–502, 323 A.2d at 508–10. The fiduciary duty of an insurer obliges it to settle when excess liability is probable. *Id.* at 497–500, 323 A.2d at 508–09. The insurer is not permitted to "gamble with the insured's money to further its own interests." *Id.* at 502, 323 A.2d at 510. The supreme court found that "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." *Id.*

[109] *Id.* at 497–502, 323 A.2d at 508–10.

[110] 72 N.J. at 73, 367 A.2d at 869.

[111] *Id.* at 75, 367 A.2d at 870. In addition to proving the likelihood of an adverse judgment, the insured is required to show "the insurer's default [in order] to recover from it the amount of its policy limits." *Id.* at 73, 367 A.2d at 869.

The *Fireman's Fund* court rejected Security's contention that under the insurance policy it was entitled to control the settlement of claims against the insured, even though, as an insurer, it had acted in bad faith. *Id.* at 71, 367 A.2d at 868. The insured was permitted to act to protect its own interest since there was the potentiality that liability in excess of coverage would result if a trial ensued. *Id.* at 75, 367 A.2d at 870.

[112] *Id.* at 68, 367 A.2d at 866.

undertakings.[113] The supreme court held that Security, as an experienced carrier, had failed to evaluate fairly the circumstances surrounding the settlement and to consider settlement opportunities as if the insurer was responsible for its insured's entire potential liability.[114] These good faith responsibilities are imposed under existing New Jersey case law.[115]

The express terms of the insured's contract with Security provided against any settlement by the insured which was negotiated without the consent of Security or prior to judgment.[116] By its decision in *Fireman's Fund*, the New Jersey supreme court is refusing to permit an insurer to rely on these express contract provisions in cases where the insurer breaches its duties. In such cases, the express statement against settlement is subordinate to the insured's right to act in protection of his own interests.[117] The implied duties of the insurer were found by the *Fireman's Fund* court to be equivalent to the express requirements of insurance contracts.[118] Upon the insurer's breach, the insured may settle and then recover the amount expended for the settlement arrangement up to his policy limit.[119]

The court found that it was not necessary for an insurer to refuse to defend or to deny coverage, in conjunction with a failure to settle, in order that a breach by the insurer be established.[120] With regard to settlement opportunities, unreasonable delay in itself is sufficient to breach the insurer's duty to settle,[121] and an insured is thereby permitted to act.[122]

Because the excess insurer in *Fireman's Fund* was the subrogee

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[113] *Id.* at 72–73, 367 A.2d at 869. The supreme court defined Security's breach as a failure "to exercise good faith in *considering* an offer to settle for an amount in excess of its policy limits," *id.* (emphasis added); the *Comunale* rule imposes a duty to settle when circumstances require such action, *see* 50 Cal. 2d at 659, 328 P.2d at 201. An insurer's duty to settle was also found to exist in *Rova Farms*. 65 N.J. at 496, 323 A.2d at 507.

[114] *See* 72 N.J. at 68–69, 367 A.2d at 866–67.

[115] For a discussion of the insurer's good faith duties under New Jersey law, see notes 31–35 *supra* and accompanying text.

[116] 72 N.J. at 66, 367 A.2d at 865.

[117] *Id.* at 73, 367 A.2d at 869.

[118] *Id.* at 70–73, 367 A.2d at 868–70. The court held that the "implied covenant of good faith and fair dealing" was required in all actions taken by the insurer even though an "absolute, unrestricted right to exercise [contractual] powers" existed under the terms of the policy. *Id.* at 72, 367 A.2d at 869.

[119] *Id.*

[120] *Id.* at 77–78, 367 A.2d at 872.

[121] *Id.* at 73–74, 367 A.2d at 869–70. For a discussion of unreasonable delay, see notes 69–73 *supra* and accompanying text.

[122] 72 N.J. at 73, 367 A.2d at 869.

of its insured, the court held that Fireman's Fund stood in the same position as its insured[123]—responsible for its duties and entitled to its rights. Arguably, punitive damages were not allowed because, as subrogee and as a corporate party, Fireman's Fund did not suffer damages arising from a personal loss which could occur in the case of an individual insured.[124]

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[123] *Id.* at 68 n.1, 367 A.2d at 866. St. Paul-Mercury Indem. Co. v. Martin, 190 F.2d 455, 457 (10th Cir. 1951) (holding that a duty of good faith exists between excess and primary insurers); Peter v. Travelers Ins. Co., 375 F. Supp. 1347, 1349–50 (C.D. Cal. 1974) (under the doctrine of equitable subrogation, excess insurer can recover the policy limit afforded the insured by the primary insurer); Transport Ins. Co. v. Michigan Mut. Liab. Ins. Co., 340 F. Supp. 670, 675–76 (E.D. Mich. 1972) (holding that primary insurer could not act in bad faith); Continental Cas. Co. v. Reserve Ins. Co., 238 N.W.2d 862, 867–68 (Minn. 1976) (insured's liability and showing of bad faith on part of primary insurer required for excess insurer to recover); Home Ins. Co. v. Royal Indem. Co., 68 Misc. 2d 737, 740, 327 N.Y.S.2d 745, 748, *aff'd*, 39 App. Div. 2d 678, 332 N.Y.S.2d 1003 (1972) (deciding that request that an excess insurer contribute to a settlement within the coverage of the primary insurer established bad faith on part of primary insurer). *But see* United States Fidelity & Guar. Co. v. Tri-State Ins. Co., 285 F.2d 579, 581–82 (10th Cir. 1960) (excess insurer not entitled to recover against primary insurer for a successful defense of claims against insured). See 25 DRAKE L. REV. INS. L. ANNUAL 923 (1976) for a discussion of several of these cases. *See* Lanzone, *Resolving Conflicts Between Primary and Excess Insurers*, 1975 INS. L.J. 733. Basically, the primary insurer's duty to "an excess insurer is identical to that owed the insured." Peter v. Travelers Ins. Co., 375 F. Supp. 1347, 1350.

[124] Reply Brief on Behalf of Defendant-Appellant, at 1–3, Fireman's Fund Ins. Co. v. Security Ins. Co., No. A–133–73 (N.J. Super. Ct. App. Div., Jan. 15, 1975), *aff'd*, 72 N.J. 63, 367 A.2d 864 (1976); Cole, *Can Damages Properly Be Punitive?* 6 J. MAR. L.Q. 477 (1941); *see* 72 N.J. at 79, 367 A.2d at 873. Punitive damages have not been allowed in a commercial setting unless special circumstances, such as a relationship between the parties or an omission to perform a duty, are presented to the court. Sandler v. Lawn-A-Mat Chem. & Equip. Corp., 141 N.J. Super. 437, 448–49, 358 A.2d 805, 811–12 (App. Div. 1976); *see* Frega v. Northern N.J. Mortgage Ass'n, 51 N.J. Super. 331, 339, 143 A.2d 885, 890 (App. Div. 1958) (punitive damages not available in a breach of contract suit). As a practical consideration, punitive damages are not usually favored by courts. Fisher v. Volz, 496 F.2d 333, 347 (3d Cir. 1974). An award of punitive damages is permissible in New Jersey only where malice is proven, Tidewater Oil Co. v. Camden Securities Co., 49 N.J. Super. 155, 164, 139 A.2d 318, 324 (Ch. Div. 1958), and compensatory damages have been allowed, Penwag Properties Co. v. Landau, 148 N.J. Super. 493, 501–02, 372 A.2d 1162, 1166 (App. Div. 1977); O'Connor v. Harms, 111 N.J. Super. 22, 30, 266 A.2d 605, 608–09 (App. Div. 1970); Barber v. Hohl, 40 N.J. Super. 526, 534, 123 A.2d 785, 789 (App. Div. 1956).

Because the relationship between insurer and insured with regard to settlement is now characterized as fiduciary in nature, a trend toward awarding punitive damages for an insurer's failure to settle has emerged. *See* Kosce v. Liberty Mut. Ins. Co., No. L–23265–75, slip op. at 9–10 (N.J. Super. Ct. Law Div. August 4, 1977) (a recent New Jersey case indicating, in dicta, that punitive damages should be available when an insurer breaches its duty to settle based upon fiduciary relationship of the parties). *Cf.* Rova Farms Resort, Inc. v. Investors Ins. Co., 65 N.J. 474, 504, 323 A.2d 495, 511 (1974) ("a wrongful failure to settle, wherein the insurer has breached the fiduciary obligation imposed by virtue of its policy, sounds in both tort and contract"); Crisci v. Security Ins. Co., 66 Cal. 2d 425, 433–34, 426 P.2d 173, 178–79, 58 Cal. Rptr. 13, 18–19 (1967) (in

With regard to the argument that the amount of the insured's loss was not adequately shown, the court accepted the settlement figure, which it found to be reasonable.[125] The court reasoned that the actual loss could not be determined because the insured, by its actions, had negated the possibility of a judgment, and therefore, concluded that judgment was not an essential element in establishing the insured's damages.[126]

The dissent, written by Justice Clifford,[127] argued that the insurer had not breached any duty to the insured. The absence of a failure to defend or of a denial of coverage was found to be a critical distinction between this case and other cases holding an insurer liable for a failure to settle.[128] According to the dissent, without at least one of these added elements, the insured should not be permitted to act in his own interest and later sue under his insurance contract.[129] Because Security had not withdrawn its coverage or its defense of the claim, Justice Clifford argued that the insurer had not neglected the interests of the insured.[130] By its willingness to act on behalf of the insured, Security retained its right to control the litigation in all respects, including negotiations and settlement agreements.[131]

The failure to defend was considered by the dissent to pose a more serious threat to the interests of an insured than a failure to settle.[132] If an insurer unreasonably fails to settle, the insured is ade-

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bank) (damages awarded for mental distress suffered by the insured after the insurer wrongfully failed to settle). *See generally* World Ins. Co. v. Wright, 308 So.2d 612 (Fla. Dist. Ct. App. 1975); Eckenrode v. Life of America Ins. Co., 470 F.2d 1 (7th Cir. 1972); Liberty Mut. Ins. Co. v. Davis, 412 F.2d 475 (5th Cir. 1969); Robertson v. Hartford Accident & Indem. Co., 333 F. Supp. 739 (D. Or. 1970); Smith v. Transit Cas. Co., 281 F. Supp. 661 (E.D. Tex. 1968), *aff'd*, 410 F.2d 210 (5th Cir. 1969) (per curiam); Chapman, *Insurance Companies' Liabilities in Respect to Settlements—Some Explicit and Implicit New Dimensions*, 19 TRIAL LAW. GUIDE 424, 438–43 (1976); Note, *supra* note 24, at 174–77; 48 NOTRE DAME LAW. 1303 (1973).

[125] 72 N.J. at 78–79, 367 A.2d at 872–73.

[126] *Id.*

[127] *Id.* at 79, 367 A.2d at 873 (Clifford, J., dissenting).

[128] *Id.* at 81–83, 367 A.2d at 874–75.

[129] *Id.*

[130] *Id.* at 82–83, 367 A.2d at 875.

[131] *Id.* at 83, 367 A.2d at 875.

[132] *Id.* at 82, 367 A.2d at 875. The dissent cited Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1162 (1954), in order to highlight the "distinction between the breach of an implied covenant of good faith and fair dealing . . . and the insurer's denial of coverage and wrongful refusal to defend." 72 N.J. at 82, 367 A.2d at 875. Professor Keeton discusses "the *requirement* that [the] company defend" in comparison to the discretionary ability of the insurer to settle claims against the insured. Keeton, *supra* at 1162 (emphasis in original). Another important consideration raised by Professor Keeton is the "uncertainty as to whether *any* damage will result" from a failure to settle. *Id.* at 1163 (emphasis in original).

quately protected by being entitled to bring suit later to recover any excess liability.[133] According to the dissent, when an insured settles in contravention of the express terms of his insurance contract, insurance coverage may properly be denied.[134] This loss is required because the insured interfered with the express contractual rights of the insurer and because public policy requires that the insurer, with its greater ability to protect the interests involved, present the defense in the cause of action against its insured.[135]

With respect to the insurer's failure to settle, the dissent found that the insured, by its own actions, had destroyed all possibility of showing its actual damages.[136] Unlike the majority, which would have accepted the settlement figure as a measure of damages, the dissent would have required substantiation of the entire amount being claimed.[137] Justice Clifford concluded that the insured, by its premature action, had been unable to make a sufficient showing to permit recovery.[138]

The conclusions of the dissent were based on public policy grounds. Justice Clifford viewed the majority's holding as "an unwarranted intrusion"[139] into the insurer's right to protect the interests involved under the contractual relationship.[140] The new ruling was

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[133] 72 N.J. at 85–86, 367 A.2d at 877. The dissent concluded that the earlier *Rova Farms* decision enabled the insurer "to gamble . . . but not with the *insured's* money." *Id.* at 85, 367 A.2d at 877 (emphasis in original). As a result, "if the insurer wrongfully refuses to settle, it will become liable for any excess verdict." *Id.*

[134] *See id.* at 79, 367 A.2d at 873.

[135] *Id.* at 84, 367 A.2d at 876. Justice Clifford characterized the insurer-insured relationship as follows:

> In order for an insurance carrier effectively to discharge its duty to defend, its control over the negotiation and litigation must be complete, not undercut by the separate undertakings of the insured. By purchasing insurance, the insured acquires the expertise and competence of the carrier in claims proceedings. This in turn necessitates a turning over of complete control to the insurer. Likewise, the insured is under the obligation to cooperate with the insurer, and to refrain from negotiating independently. . . . The efficient disposition of claims dictates that the one party with the expertise, the carrier, be in sole control. If it be otherwise, there is created the risk of claimants playing off the insurer against the insured, holding out for the higher stakes the insured will pay if the insurer does not because of the threat of excess liability.

Id. (citation omitted).

[136] *Id.* at 86–87, 367 A.2d at 877.

[137] *Id.* at 86, 367 A.2d at 877.

[138] *Id.* at 86–87, 367 A.2d at 877.

[139] *Id.* at 87, 367 A.2d at 877.

[140] *Id.* at 83–85, 87, 367 A.2d at 875–77. Under the contract, "the carrier [is granted] the exclusive control of settlement[s]." *Id.* at 83, 367 A.2d at 875; *see id.* at 86, 367 A.2d at 877. The dissent cited Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co., 31 N.J. 299,

characterized as unduly affecting the cost of insurance coverage to the public and as decreasing the efficiency of insurance operations.[141]

Basically, three elements are required to recover under the *Fireman's Fund* holding: proof of the insurer's bad faith in refusing to settle, threat of personal liability above the policy limit, and good faith and reasonableness with regard to the settlement arranged by the insured. These elements must be shown to the satisfaction of the court in order that an insured, who has settled before judgment, may receive his policy coverage in a subsequent suit.

The uncertainty surrounding the point at which a breach of settlement duties occurs is an obstacle to the implementation of the *Fireman's Fund* ruling. The test utilized by the *Fireman's Fund* court demands that the insurer's failure to perform its settlement obligation be shown by the particular circumstances of each case. Therefore, no concrete standard for the determination of a breach is offered. Further complicating any decision made by an insured is the fact that the insured's action will be evaluated at a later time—when unknown or unforeseen events may influence the court's estimation of the matter.

In accepting the finding that Security was guilty of bad faith by failing to perform its duty to settle, the court discussed unreasonable delay as a factor contributing to its decision.[142] The extent to which this element influenced the decision is not clear. In *Fireman's Fund*, in order to settle the claims brought against it, the insured had to comply with a definite time limitation; immediate action was mandatory if the insured was to make any settlement of the pending claims.[143] In all probability, other cases presented to the courts

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157 A.2d 319 (1960), wherein it was stated that the insurer, " 'by the contract, reserved the right to control the settlement of claims. *Such right is a necessary incident of the operation of its business.*' " 72 N.J. at 85, 367 A.2d at 876 (emphasis by the court).

[141] 72 N.J. at 79, 84–85, 367 A.2d at 873, 876. For a statement of the insurer-insured relationship, see note 135 *supra*.

[142] 72 N.J. at 73–74, 367 A.2d at 869–70. The majority found that the insurer was required to act in its insured's interest "within a reasonable time," and that

> [i]f the insurer delays unreasonably in investigating and dealing with a claim asserted against its insured, the insured may make a good faith reasonable settlement and then recover the settlement amount from the insurer, despite the policy provision conditioning recovery against the insurer on its policy on the prior entry of a judgment against the insured or acquiescence by the insurer in the settlement.

Id. at 73, 367 A.2d at 869. For a discussion of unreasonable delay, see notes 70–73 *supra*.

[143] 72 N.J. at 69, 367 A.2d at 867.

would not as clearly evidence an unreasonable delay by an insurer. Again, by opting to settle, the insured would be placed in the dilemma of weighing the necessity of this factor prior to an ultimate decision by the court.

The cited *Traders* and *Evans* decisions, as analyzed by the dissent, depend substantially upon a failure of an insurer to defend or upon an insurer's denial of coverage.[144] *Fireman's Fund*, in that regard, is an extension of these decisions and, in reality, an adoption of the *Comunale* rationale, that the failure to settle in itself imposes liability on the insurer.[145] Because the insured in *Comunale* had not arranged for settlement of the tort claims, that case was concerned with a recovery of the full judgment amount, not the policy limit. In *Comunale*, the judgment award, which greatly exceeded the policy coverage, served as additional proof of the insurer's breach of its good faith duty to settle.

In response to the difficulties encountered in imposing liability for the breach of an insurance carrier's settlement duty, strict liability for this failure has been urged in some jurisdictions.[146] In *Fireman's*

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[144] *Id.* at 74–78, 80–83, 367 A.2d at 870–75.

[145] For a discussion of the *Rudco*, *Evans* and *Comunale* cases, see notes 36–63, 74–82 *supra* and accompanying text. Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 659, 328 P.2d 198, 201 (1958) (in bank), imposed the *duty to settle* upon the insurer when a likelihood of excess liability to the insured exists. In Rova Farms Resort, Inc. v. Investors Ins. Co. of America, 65 N.J. 474, 323 A.2d 495 (1974), the Supreme Court of New Jersey found "that an insurer, having contractually restricted the independent negotiating power of its insured, has a *positive fiduciary duty to take the initiative and attempt to negotiate a settlement within the policy coverage.*" *Id.* at 496, 323 A.2d at 507 (emphasis added). Prior cases, such as Traders & Gen. Ins. Co. v. Rudco Oil & Gas Co., 129 F.2d 621, 628 (10th Cir. 1942), and Evans v. Continental Cas. Co., 40 Wash. 2d 614, 627–28, 245 P.2d 470, 478–79 (1952), merely required that the insurer *fairly consider settlement possibilities.*

[146] 72 N.J. at 69–71, 367 A.2d at 867–68. In suggesting strict liability, the Supreme Court of New Jersey, in *Rova Farms*, stated that

> where the carrier chooses not to offer the limits of coverage, one wonders whether it should not bear the unhappy financial result of that unilateral decision, since it alone profits from the opposite result of the gamble. This resolution would enable the insurer to pursue its own interests in great measure without sacrificing those of its insured so long as it was clear by whom the burden of mistake should be borne. The kind of rule we project, which would settle the nagging conflicts of interest under present law, has already been regarded favorably by some.

65 N.J. at 500, 323 A.2d at 509–10 (footnote omitted); *see* Comment, *supra* note 24, at 684–85, 688–89.

Although no state has instituted a strict liability theory with regard to performance of the insurer's duties, in California, "a review of excess liability cases reveals that the application of the current test of bad faith leads to nearly certain recovery of the excess where the insurance company has rejected a 'reasonable: [*sic*] settlement offer." Com-

Fund, the New Jersey supreme court refused, however, to develop further the implication in *Rova Farms*[147] that strict liability might exist for an insurer's failure to settle. Nevertheless, the possibility of adopting strict liability for insurance carriers in situations where a breach of duty to the insured exists has not been foreclosed by the *Fireman's Fund* ruling.

As a public policy consideration, the imposition of punitive damages for breaches of an insurer's duty to make good faith settlements would discourage insurance companies from pursuing test cases for the purpose of establishing law against their liability. Although punitive damages have traditionally not been permitted in commercial settings,[148] the availability of such a remedy, based on the fiduciary relationship between an insurer and insured, would seem adequate to protect the insured from suffering unwarranted difficulties and trauma.

In most situations, *Fireman's Fund* will lack significance because its relevance depends on the presence of a secondary insurer or of an insured who is willing to risk personal assets. The *Fireman's Fund* decision must be justified on the ground that *Rova Farms*, which permits full recovery by the insured after judgment is entered and upon proof of the insurer's bad-faith refusal to settle, is somehow insufficient. When liability is truly not in doubt, the insurer's breach of good faith is most extreme, and the need to apply the *Rova Farms* decision could cause unnecessary publicity of the insured's tortious actions[149] and the waste of insurance funds by larger judgment awards. The application of the *Fireman's Fund* rule, however, may result in decreased corporate efficiency and in similar increased insurance costs. These contrasting considerations must be weighed.

The cost of insurance will obviously increase whether or not the *Fireman's Fund* ruling is implemented. Under *Fireman's Fund*, increased insurance costs will likely result from inexperienced insureds

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ment, *In California Excess Liability Cases, Does "Bad Faith" in Law Equal "Strict Liability" in Practice?*, 4 PEPPERDINE L. REV. 115, 143 (1976); *see* Comment, *Wrongful Refusal to Settle: The Implications of* Grundy *in Kentucky*, 65 KY. L.J. 220, 224 (1976); 23 U. FLA. L. REV. 201 (1970). Strict liability for breaches of duty regarding insurance settlements has been urged. Hirsch, Carpenter & Carpenter, *Strict Liability: A Response to the Gruenberg-Silberg Conflict Regarding Insurance Litigation Awards*, 7 SW. U.L. REV. 310 (1975); Comment, *Excess Liability Suits—The Mounting Need for Strict Liability*, 13 ST. LOUIS U.L.J. 292 (1968); 60 YALE L.J. 1037 (1951).

[147] 65 N.J. at 500–01, 323 A.2d at 509–10.

[148] *See* note 124 *supra*.

[149] *See* Fireman's Fund Ins. Co. v. Security Ins. Co., No. L–31304–69, letter opinion at 5 (N.J. Super. Ct. Law Div. July 12, 1973), *aff'd*, No. A–133–73 (N.J. Super. Ct. App. Div. Jan. 15, 1975), *aff'd*, 72 N.J. 63, 367 A.2d 864 (1976).

handling settlements of pending claims. On the other hand, liability for large jury awards will result from the application of the *Rova Farms* decision, which allows recovery of the entire judgment amount.

Since the express prohibitions against action by an insured are based upon the corresponding implied obligation of an insurer to settle when appropriate, action by the insured should logically be permitted upon an insurer's prior breach of its obligation. The enforceability of contractual obligations is, therefore, not impaired by the implementation of the *Fireman's Fund* ruling.

Uncertainty is always present when decisions must be made prior to a court determination. Under present New Jersey law, the insured now has a choice when his insurer breaches its duty to settle: to compromise the claim prior to trial and receive the policy limit, or to wait until after a verdict is entered and recover the full judgment amount. Since the protection guaranteed under the *Rova Farms* ruling is not sufficient when an insurer has most flagrantly breached its duty to settle, the *Fireman's Fund* decision, which affords the beneficial aspect of another avenue of action to the insured, is necessary to protect the rights of the insured, and its value is not outweighed by its minimal adverse effect on corporate efficiency.

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