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Ralph Strandberg

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## INSURANCE—ACCIDENT INSURER'S LIABILITY FOR MORE THAN FACE AMOUNT OF POLICY

Under certain conditions an insurance company may be liable to the insured for an amount in excess of the limit on the face of the accident policy. This question was decided in favor of the insured in a recent Ohio Case.<sup>1</sup>

The liability of the insurance company to the insured was based on a certain type of "no action" clause in the policy. This type of clause is written into many liability and casualty policies, and reserves to the insurance company the exclusive right to defend any action, or settle any claim, which may be brought against the insured by an injured party.

As a result of such clauses courts have held that a definite relationship arises between the insurance company and the insured. The problem is of importance especially where a settlement is offered by the injured party. To what extent does the insurance company have the duty to settle? When may it decide to contest, even though ultimately the judgment may be far in excess of the policy limits?

In the case referred to, an Ohio court held the insurer may be liable for a negligent failure to settle a claim for an amount within the limits of the policy and may be liable for a total judgment against the assured. The case was remanded for jury action on the question of negligence and good faith.<sup>2</sup>

The majority of courts have stated that the liability of an insurer is not on an implied contract, but rather is based on the negligence or bad faith of the insurer in its conduct of the negotiations in the case. No duty is imposed on the insurer by the contract to settle a claim for an amount within the policy. But where the insurer is guilty of fraud or bad faith, it may be held liable in tort for refusing to settle, to the extent of any excess of a judgment recovered against the insured over the amount payable by the terms of the policy.<sup>3</sup> The Oklahoma Court, holding the basis of the liability to be

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<sup>1</sup> The defendant insurance company decided not to settle the action for \$5,500 against the insured within the policy limits of \$10,000 unless the insured contributed \$1,200. Both parties realized the seriousness of the injury and that very likely judgment would be in excess of \$10,000. The final judgment against the insured was \$11,600. *Held*—The insurance company owes the duty of good faith in conducting its assured's defense and negotiations for settlement of claims made against such assured that come within the terms of a policy of insurance issued by the insurer to the insured.

A petition claiming allegations based on bad faith or negligence in the performance of a contract and sounding in tort is sufficient and not demurrable. The record discloses substantial evidence in support of the issues presented by the pleading. The issues of fact must be submitted to the jury. *J. Spang Baking Co. v. Trinity Universal Insurance Co.*, Court of Appeals, Cuyahoga County, Ohio, 68 N.E. (2d) 122 (1946).

<sup>2</sup> *J. Spang Baking Co. v. Trinity Universal Ins. Co.*, *supra*.

<sup>3</sup> *Lanferman v. Maryland Casualty Co.*, 222 Wis. 406, 267 N. W. 300 (1936).

indemnity, states that the relationship between the parties imposes on the insurer a duty to exercise skill, care, and good faith to the end of saving the insured harmless, and this contemplated by the contract.<sup>4</sup>

A division of opinion exists in the various courts as to whether a showing of mere negligence is sufficient for recovery by the insured,<sup>5</sup> or whether the insured must show that the insurance company acted in bad faith in refusing settlement.<sup>6</sup> The latter decisions require the proof offered by the insured to be more than a mere preponderance of the evidence, and necessitate clear and satisfactory proof of the bad faith of the insurer.

The Wisconsin Court has held that the insured must prove bad faith to recover. The difficulties involved in defining the insurer's duty led to the well written decision, on rehearing, in *Hilker v. Western Automobile Insurance Co.*<sup>7</sup> In the original case the court stated the insurance company ought to be held to that degree of care and diligence which an ordinarily prudent person would exercise in the management of his own business. This, a definition apparently founded upon negligence as a basis of recovery, was recast by the court on rehearing:<sup>8</sup>

"\* \* \* Where an injury occurs for which a recovery may be had in a sum exceeding the amount of the insurance, \* \* \* a duty on the part of the insurer to the insured arises. It arises because the insured \* \* \* has contracted with the insurer that it shall have the exclusive right to settle or compromise the claim, to conduct the defense, \* \* \* It is a right to be exercised by the insurer in its own interest.

"It is the right of the insurer to exercise its own judgment upon the question of whether the claim should be settled or contested. But because it has taken over this duty, and because the contract prohibits the insured from settling \* \* \* or interfering \* \* \* its exercise of this right should be accompanied by considerations of good faith. Its decision not to settle should be an honest decision. \* \* \* If upon such consideration it decides that its interest will be better promoted by contesting than by settling the claim, insured must abide by whatever consequences flow from that decision. \* \* \* In order that it be honest and intelligent it must be based upon a knowledge of the facts and circumstances upon which liability is predicated, and upon a knowledge of the nature of the injuries so far as they reasonably can be ascertained. \* \* \*

<sup>4</sup> *Boling v. New Amsterdam Casualty Co.*, 173 Okla. 160, 46 Pac. 2d 916 (1935).

<sup>5</sup> *Cavanaugh Bros. v. General Accident Fire & Life Co.* 79 N.H. 186, 106 Atl. 604.

<sup>6</sup> *New Orleans R. Co. v. Maryland Casualty Co.*, 114 La. 154, 38 So. 89, 1 LRA 562; *Wis. Zinc Co. v. Fidelity Co.*, 162 Wis. 39, 155 N W 1801; *Auerback v. Maryland Casualty Co.* 236 N.Y. 247.

<sup>7</sup> *Hilker v. Western Auto. Ins. Co.*, 204 Wis. 1, 235 N W 413, 231 N W 257 (1931).

<sup>8</sup> *Hilker v. Western Auto Ins. Co.*, *supra*.

"We go only so far as to say that it should exercise reasonable diligence \* \* \* which means such diligence as the great majority of persons use in same or similar circumstances."

Thus it appears that the insurer, although liable only if its actions are in bad faith, may be found guilty of bad faith where the conduct of its investigation, as in the case above quoted, was so negligent as to clearly and obviously amount to a breach of the duty of ordinary care.<sup>9</sup>

The decision in the *Hilker* case has been approved in a later Wisconsin Case,<sup>10</sup> holding the test is not whether the defendant acted negligently, but whether it acted in good faith toward the plaintiff. Bad faith is an element of fraud, and the evidence to sustain a finding thereof must be clear, satisfactory and convincing.

It appears from the *Berk* case that it is not bad faith where counsel for the insurer refuse settlement under a bona fide belief that they might defeat the action, or at least can keep the verdict within the policy limits.<sup>11</sup> Although the insurer may consult what it deems to be its own interests, it cannot refuse to settle in a case where the probable judgment will be a loss to both the insured and itself.<sup>12</sup>

But the very fact that the company could have settled for a smaller sum than the ultimate judgment may be persuasive evidence of good faith. For an insurance company will likely settle for a smaller sum unless it decides the claim can be defeated completely.<sup>13</sup>

<sup>9</sup> The jury found bad faith and court held evidence sustained the verdict. The injured girl was taken to the hospital by a witness and the insurer made no effort to inquire at the hospital as to his name or to interview him. The insurer did not find and interview known eye witnesses. Such witnesses' testimony was a major item of proof in plaintiff's case in *Stoffle v. Hinkler*, 189 Wis. 414, 418 N W 185.

"The insurer made an inadequate, a careless if not shiftless, investigation of the facts and was never at any time in position to exercise a sound or good faith judgment."

*Hilker v. Western Auto Ins. Co.*, supra.

<sup>10</sup> *Berk v. Milwaukee Auto Insurance Co.* 245 Wis. 597, (1944).

<sup>11</sup> *Wakefield v. Globe Indemnity Co.*, 246 Mich. 645, 225 N W 643. Quoted by Wisconsin Court in *Berk v. Milwaukee Auto Insurance Co.*, supra. at page 614.

<sup>12</sup> "While the defendant had the right to consult what it deemed to be its own interest in making a settlement it could not abuse the power vested in it and recklessly and contumaciously refuse to settle if it was apparent that in all reasonable probability its conduct would not only result in damages to the plaintiff but also in loss to itself. Neither could it exercise the right conferred on it for the purpose of perpetrating a fraud on the plaintiff." *Wisconsin Zinc Co. v. Fidelity and Deposit Co. of Maryland*, 162 Wis. 39, 155 N W 1081 (1916).

<sup>13</sup> "There is some evidence that the *Kuhle* Case could have been settled for either \$750 or \$1500 before the trial. The fact that the defendant declined such offers and contested the action, when it could have settled at either figure, appears to be persuasive evidence of the good faith of the defendant." *Berk v. Milwaukee Auto Insurance Co.* 245 Wis. 597, at 608, supra 10.

The decision not to settle must be made in good faith and on reasonable ground for the belief "that an excessive amount is demanded for a settlement".<sup>14</sup>

The Wisconsin decisions seem to hold that where a decision to contest is made honestly in the hope of a lesser judgment, even it may not be in the very best interest of the insured, it is a decision made in good faith. The language of a Vermont case<sup>15</sup> restricts the insurer more closely and forbids the insurer to entirely disregard the interests of the insured in making its decision. While the policy necessitating a showing of bad faith is just, where the offer of settlement is close to the limits of the policy the decision of the insurer to contest should be scrutinized very closely for evidence of total disregard of the insured's interest. For, as the Oklahoma Court has said, the contract is one to hold the insured harmless as result of any action brought against him up to a certain policy limit. It would seem that, as between the two parties to the insurance contract, the insured's interest ought to have priority.

A mere error of judgment as to liability under the law, if made honestly, is not bad faith. But the insurer should not be absolved of liability when it acts upon what it considers to be its own interest, unless it also appears that it considered and dealt fairly with the interest of the insured.

RALPH J. STRANDBERG

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<sup>14</sup> *Mendota Electric Co. v. N. Y. Indemnity Co.*, 169 Minn. 377, 211 N W 317 (1926).

<sup>15</sup> "If in what it did and refused to do it acted honestly and according to its best judgment this suit must fail. If on the contrary it used its authority . . . to save itself from as much of the loss as possible in disregard of the plaintiff's rights, consciously risking loss to the plaintiff to save loss to itself, the suit must succeed for that would be bad faith.

"As applied to this case bad faith on the part of the defendant would be the intentional disregard of the financial interests of the plaintiff in the hope of escaping the full responsibility imposed upon it by its policy." *Johnson v. Hardware Mutual Casualty Co.*, 109 Vt. 481, 1 Atl 817 (1938).