



CSU
College of Law Library

Cleveland State Law Review

Volume 20 | Issue 1

Article

1971

Limitless Horizons of Limited Policies of Insurance

Harry H. Lipsig

Follow this and additional works at: <https://engagedscholarship.csuohio.edu/clevstlrev>



Part of the [Insurance Law Commons](#), and the [Torts Commons](#)

[How does access to this work benefit you? Let us know!](#)

Recommended Citation

Harry H. Lipsig, *Limitless Horizons of Limited Policies of Insurance*, 20 Clev. St. L. Rev. 1 (1971)
available at <https://engagedscholarship.csuohio.edu/clevstlrev/vol20/iss1/54>

This Article is brought to you for free and open access by the Journals at EngagedScholarship@CSU. It has been accepted for inclusion in Cleveland State Law Review by an authorized editor of EngagedScholarship@CSU. For more information, please contact library.es@csuohio.edu.

Limitless Horizons of Limited Policies of Insurance

Harry H. Lipsig*

LIMITED POLICIES have limitless horizons due to the selfishness of insurers. Why should insurers accept settlement offers that are close to the policy limits? After all, in most instances the insurers have nothing to lose except the insureds' money. Gambling with insureds' funds has led many to suggest that insurers be absolutely liable for all excess judgments subsequent to a rejection of settlement.

Because of its far reaching dictum, *Crisci v. Security Insurance Co. of New Haven, Conn.*,¹ is of central importance in any discussion of an insurer's liability for refusal to settle. Although the idea of imposing absolute liability is not new,² it has yet to be adopted in any jurisdiction.³ The court in *Crisci* indicates, however, that in the appropriate case it will hold that whenever an insurer rejects an offer of settlement within the policy limits, it will be absolutely liable for any judgment, even if it is not within those limits. It will always be in the interest of the insured to settle within the policy limits whenever there is a possibility that an excess judgment will be returned. The court also states, in this regard:

... in light of the common knowledge that settlement is one of the usual methods by which an insured receives protection under a liability policy, it may not be unreasonable for an insured who purchases a policy with limits to believe that a sum of money equal to the limits is available and will be used so as to avoid liability on his part with regard to any covered accident. In view of such expectation 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.⁴

The reasons given in support of such a rule are as follows: (1) The rule is simple to state and apply and eliminates the necessity for a decision as to whether the refusal was reasonable⁵; (2) It also eliminates the possibility that the insurer will gamble with the insured's money when an offer is made close to the policy limits⁶; (3) It is suggested that an absolute liability rule might not increase the burden on

* Member of the Bar of the City of New York; former Director, International Academy of Trial Lawyers; etc.

¹ 58 Cal. Rptr. 13, 426 P. 2d 173 (1967).

² An amendment to the insurance law was introduced in the New York legislature in 1948. The bill was never reported out of committee.

³ Bad faith or negligence are the current standards used to determine an insurer's liability for refusal to settle.

⁴ 58 Cal. Rptr. 13, 17, 426 P. 2d 173, 177 (1967).

⁵ *Id.*

⁶ *Id.*

insurers. "The size of the judgment recovered in the personal injury action when it exceeds the policy limits although not conclusive, furnishes an inference that the value of the claim is the equivalent of the amount of the judgment and that acceptance of an offer was the most reasonable method of dealing with the claim"⁷; (4) It is elementary justice to require that the insured who would reap the benefits if a judgment is less than the settlement offer, should also suffer the detriment if a judgment is more than the settlement offer.⁸

Some of the court's arguments in support of the rule are inadequate. While it states that it is always in the insured's interest to settle within the policy limits whenever there is a possibility of an excess judgment,⁹ it fails to balance the insured's interest in low rates against his interest in complete coverage.

Prior to its adoption by any court or legislature, a number of questions with respect to the proposed rule should be resolved. To what extent, would a rule of absolute liability increase insurance rates? Would people tend to buy low limit policies? Would it encourage unfounded claims?

Direct Action Against the Insurer

Although, when considered in its entirety, there may be some unexplored difficulties with the proposed rule, one important aspect, the right of direct action by the injured party against the insurer, has received some consideration and has been implemented in a number of jurisdictions. It will be argued herein that the injured party at the very least should have the right of direct action against the insurer for wrongful refusal to settle in *all* jurisdictions.

Injured parties have succeeded in bringing direct actions against the insurer in a number of jurisdictions for failing to bargain and negotiate in good faith or in a reasonable manner. Whenever policies have included provisions allowing for such actions, or whenever, according to the law of the particular jurisdiction, there have been valid and proper assignments of the insured's cause of action, or, more recently, whenever state insurance statutes have been so interpreted by their courts to allow such suits, the injured party has been successful in bringing direct action suits.

Some cases have held that if the insurance policy gives the injured party the insured's rights against the insurer, these would include the right to bring an action for bad faith or negligent refusal to settle. In *Auto Mutual Indemnity Company v. Shaw*,¹⁰ the injured claimant re-

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ 134 Fla. 815, 184 S. 852 (1938).

covered a judgment in excess of the policy limits, and it appeared there was some question as to the good faith of the insurer in refusing settlement. The policy had a clause which provided in pertinent part: "where the judgment cannot be collected against the insured, the judgment creditor is vested with the insured's rights against the insurer." Here it was held that if the insured could collect for the insurer's refusal to negotiate in good faith, so could the injured party.

A similar policy provision in *Kleinschmit v. Farmers Mutual Hail Ins. Association*,¹¹ was invoked to support a suit by the injured party against the insurer for bad faith refusal to compromise, after a judgment against the insured in excess of the policy limits was returned unsatisfied. The policy provided: in case an execution against the insured on final judgment is returned unsatisfied, the judgment creditor has a right of action against the insurer to the same extent the insured would have had if he had paid such judgment. In this action, however, it was held that the insured did not have a right of action against the insurer for bad faith settlement and therefore neither did the injured party.

It is obvious that few policies will contain a clause entitling the judgment creditor to proceed against the insurer directly. Absent a specific provision, in the past it has been consistently held that the injured party may not sue the insurance carrier directly for alleged wrongful failure to settle.¹² The following reasons are often given by courts in refusing to allow such suits: (1) There is no privity of contract between the insurer and the injured party at the time of the alleged wrong. The insurer's duty in respect to settlement negotiations arises out of the relationship created by the contract and injured party has no such relationship to the insurer as he is not a party to the contract¹³; (2) The injured party is not a third party beneficiary of the insurance contract¹⁴; (3) The injured party was not damaged when the judgment exceeded the amount offered in the proposed settlement¹⁵; (4) The injured party cannot be permitted to appropriate the tort claim which the insured may have against the insurance company.¹⁶

Assigning the Cause of Action

By assigning the insured's cause of action, some jurisdictions have circumvented the dilemma faced by the injured and insured parties when the injured party has recovered a judgment in excess of the

¹¹ 101 F. 2d 982 (8th Cir. 1939).

¹² Francis v. Newton, 75 Ga. App. 341, 43 S.E. 2d 282 (1947).

¹³ Seguros Tepeyec, S.A., v. Bostrom, 347 F. 2d 168 (5th Cir. 1965) *rehearing denied*, 360 F. 2d 154 (1966).

¹⁴ Browdy v. Statewide Insurance Company, 56 Misc. 2d 610, 289 N.Y.S. 2d 711 (1968).

¹⁵ Ammerman v. Farmers Ins. Exchange, 19 Utah 2d 261, 430 P. 2d 576 (1967).

¹⁶ *Id.*

policy limits and the insured has a cause of action against the insurer for bad faith or negligent refusal to settle. Although not all jurisdictions have recognized the assignability of these causes of action, it is well settled in those that have that these assignments are not against public policy.¹⁷

The law of assignments in most jurisdictions provides that all choses in action except torts are assignable.¹⁸ There is a great deal of disagreement as to whether the insured's cause of action for wrongful refusal to settle arises from tort or contract. It appears that many jurisdictions would claim it arises in tort¹⁹; however, in *Smith v. Transit Casualty Company*,²⁰ the court stated:

Although the cause of action, if any, sounds primarily in tort, the duty owed to use ordinary care in settlement negotiations also constitutes an implied contractual warranty in its policy to exercise at all times due care when utilizing the expertise in the exclusive control of investigating and defending claims against the insured. Thus, an action based on breach of this duty also sounds in contract, and may therefore be properly assigned.²¹

Applying California law, the court in *Commune v. Traders and General Insurance Company*²² held that an action for damages in excess of the policy limits based on an insurer's wrongful failure to settle was assignable whether the action was considered as sounding tort or contract.

"The rights of the judgment creditor under liability policy are purely derivative arising no higher than those of the assured."²³ The injured party as the assignee of the insured's cause of action for wrongful failure to settle is said to stand in the shoes of the insured-assignor. The insurance carrier's file is open to the injured claimant.²⁴ The injured claimant also has the right to trial by jury.²⁵ Insurer can assert its defenses as fully against the assignee as against the insured and furthermore, payment of any judgment by the insurer would discharge the insurer of any further obligation and forever bar any action by the injured party.

¹⁷ *United States Fidelity & Guaranty Co. v. Evans*, 116 Ga. App. 93, 156 S.E. 2d 809 (1967).

¹⁸ Kans. Gen. Stat., 1949 § 60-401.

¹⁹ *Dillingham v. Tri-State Insurance Company*, 214 Tenn. 592, 381 S.W. 2d 914 (1964).

²⁰ 281 F. Supp. 661 (D.C. Tex. 1967).

²¹ *Id.*, at 668.

²² 50 Cal. 2d 659, 328 P. 2d 198 (1958).

²³ *Atlantic City v. American Casualty Insurance Company*, 254 F. Supp. 396, 398 (D.C. N.J. 1966).

²⁴ *Chitty v. State Farm Mutual Automobile Insurance Company*, 36 F.R.D. 37 (E.D. So. Car.).

²⁵ *Supra* n. 22.

The consideration for the assignment by the insured very often is a covenant by the judgment creditor not to execute beyond the policy limit. "This is a convenient way for the insured to fully satisfy the injured party, and in the case of an insolvent insured it may net the injured party far more than the existing judgment against the insured can do."²⁶ In the *Critz* case,²⁷ the Court held that the covenant not to execute did not destroy or eliminate damages; however, in the *Smith* case, where the insured also assigned his cause of action for wrongful refusal to settle to the injured party, the Court stated:

Under Texas law, one of the requirements for asserting a cause of action against an insurer for negligent failure to settle is that the insured must have actually paid the judgment in favor of claimant before seeking indemnity from the insurer, the rationale of such rule being that the insured is in no way damaged until he pays money.²⁸

A note given by the insured in this action to the injured party which purported to be payment of the judgment, was found not to be bona fide and would not enable insured to avoid the Texas rule of prepayment before suit could be brought by the insured against the insurer, but there did exist a valid cause of action for \$5.00 since there was a \$5.00 payment in the judgment and the injured party could properly assert this under the assignment.²⁹

Harris v. Standard Accident Insurance Company,³⁰ recognized that New York law requires proof of actual loss to support recovery by the insured or his estate for the insurer's bad faith failure to settle. In *Young v. American Casualty Company of Reading, Penn.*,³¹ the court held that where the insured becomes insolvent after rendition of the excess judgment, is discharged in bankruptcy, and the judgment is cancelled, the trustees in bankruptcy of the assured may recover for bad faith refusal to settle and may recover not only the amount actually paid by the insolvent insured on the judgment but the entire amount of the judgment. The discharges were held to be personal to an insolvent insured affording a defense to subsequent prosecutions against him as an individual on the claim. The estates in bankruptcy were held not to be affected by the discharge in bankruptcy, and therefore the cause of action against the insurer could be validly assigned to the injured

²⁶ Peterson, *Excess Liability: Reconsideration of California's Bad Faith Negligence Rule*, 18 *Stanford L. Rev.* 475 (1965).

²⁷ *Critz v. Farmers Insurance Group*, 230 Cal. App. 2d 788, 41 Cal. Rptr. 401 (1965).

²⁸ *Supra* n. 20 at 662.

²⁹ The court also entered a declaratory judgment stipulation that any future payments made by the insured in excess of the limits should be reimbursable by the insurer, if the insurer had wrongfully refused to settle.

³⁰ 191 F. Supp. 538 (S.D. N.Y. 1961).

³¹ 416 F. 2d 906 (2d Cir. 1969).

party by the trustees. One can easily see the importance of allowing the injured claimant to proceed against the insurer as opposed to the insured in this type of situation.

Atlantic City v. Caproni American Casualty Company,³² highlights both the advantages and disadvantages of using assignment as the means by which an injured party may sue the insurer for wrongful refusal to settle. Plaintiff, the injured party, recovered a judgment against Atlantic City in the amount of \$600,000.00 for personal injuries. A liability policy was issued to Atlantic City by American Casualty with limits of \$100,000.00 to be contributed voluntarily by the insurer and \$250,000.00 by the insured. "When the insurer rejected this proposal, the insured, recognizing the insurer's exclusive control over settlement negotiations and trial under the terms of its policy, independently executed, prior to trial, an agreement with the injured party, whereby the City settled its liability with him for \$250,000.00 and in consideration therefor partially assigned to him a share in any cause of action it might have against the insurer to recover the excess over the policy limits.

The defendant insurer moved for an order dismissing his complaint for failure to assert a claim, relying on *Chittick v. State Farm Mutual Automobile Insurance Co.*,³³ which held that a judgment creditor had no standing to sue the insurer directly. The injured party asserted that he was the real party in interest by virtue of a partial assignment from the insured. This court distinguishes *Chittick* on the basis that the complaint there alleged "subrogation to the rights of the assured by operation of law." In *Chittick*, the court stated:

It is this right of action of the insured that the plaintiff claims has, in some manner, become vested in her. No assignment, substitution or other transfer by the insured has been suggested but the term "subrogated" is used in the complaint.³⁴

The court in *Atlantic City* held: "Clearly *Chittick* intimates that a vested interest by way of assignment, as in the instant case, would demonstrate a suable right in an assignee and take the case outside of its ruling."³⁵ Here the court held that the injured party had a real and mature claim for damages and the court denied the motion to dismiss the complaint as to the injured party.

The assignment which was made before trial but after the alleged wrongful refusal was not void because premature or because contrary to public policy. Assignment was not a breach of the insured's promise

³² *Supra* n. 23.

³³ 170 F. Supp. 276 (D.C. Del. 1958).

³⁴ *Id.* at 279.

³⁵ *Supra* n. 23 at 398.

to cooperate with the defense, since its validity turned on a prior breach of contract by the company, after which the insured no longer owed the company any duty. Assignment afforded the injured party the means by which he could sue the insurer. Of course, the great disadvantage to assignment is that its presence greatly increases the chances of collusion between the insured and the injured party thereby impairing settlement negotiations.

As previously indicated, not all jurisdictions have recognized or even passed upon the question of the assignability of the insured's cause of action for wrongful refusal to settle. A recent development in Connecticut using one of its insurance laws as the basis eliminates the need for assignment as it permits the judgment creditor a direct right of action against the insurer for wrongful refusal to settle.

Need for Direct Action Suits

In *Bourget v. Government Employees Insurance Company*,³⁶ plaintiff, the injured party, recovered a judgment of \$94,000.00. Insurance coverage amounted to only \$20,000.00. Plaintiff, unsuccessful in collecting the balance of it from the insured, brought an action against GEICO, the insurer, pursuant to CGSA 38-175 for wrongful refusal to settle. This statute subrogated the injured party to all of the insured's rights against the insurer whenever a judgment was obtained and remained unsatisfied for more than 30 days.³⁷

The lower court stated:

Furthermore, this court has specifically held that a judgment creditor may bring a direct action against the debtor's insurer to recover the excess over the policy limits. *Turgeon v. Shelby Mutual Plate Glass & Casualty Company*, 112 F. Supp. 355 (D. Conn. 1953) (Smith, D.J.). In *Turgeon*, Judge Smith stated:

It may be conceded, as defendant contends, that plaintiffs, even if treated as creditor third-party beneficiaries, could recover on the policy itself only the policy limits. The plaintiffs, however, base their claims on the statute which by its terms subrogates them to all the insured's rights against the defendant. Insured's right of action in negligence ordinarily would not be assignable to plaintiffs, but there is no reason to doubt the power of the legislature to transfer this right if it chose to do so.

Its primary purpose in the act in question was to provide protection for those injured by judgment proof insureds. We cannot say whether it had specifically in mind the insured's right of action for negligence against the insurer as well as his right of action for breach of the contract to pay up to a specified amount on behalf of the insured. Both were, however, potential assets of the insured

³⁶ 48 F.R.D. 29 (S.D. N.Y. 1969).

³⁷ Conn. Gen. Stat. Anno. C.38 § 175.

and one may as well be marshalled for the satisfaction of the insured's judgment debt to the injured party as the other.

The language of the statute is broad enough to cover both.³⁸

The court held therefore that plaintiff's complaint stated a good cause of action against the defendant GEICO.

On appeal, GEICO argued that the legislative history of this section did not indicate that the legislature was concerned with verdicts over the policy limits. The court held that courts are required to follow the plain language of the statute. In *Barr v. US*, the court went on:

But if Congress has made a choice of language which fairly brings a given situation within a statute, it is unimportant that the particular application may not have been contemplated by the legislator.³⁹

The primary evidence of legislative intent is always the language of the statute. It is the language which determines the rule by which those who read it must determine their conduct. Only if the language is unclear or ambiguous should the reader resort to legislative history.⁴⁰

In *Bourget*, the court notes that there is little authority from other jurisdictions on this point since Connecticut seems to be one of the few states to have such a statute.⁴¹ It is unfortunate that the court is correct for the Connecticut statute eliminates many of the problems involved with the assignability of the insured's cause of action. It eliminates the necessity of determining whether the cause of action sounds in tort or in contract, which frequently precludes assignment, and it also avoids the necessity of finding a way to circumvent the prepayment rules which exist in many jurisdictions.

Another approach for allowing direct actions is for the courts to recognize the injured party as a third party beneficiary of the insurance contract. One of the implicit terms in any liability insurance policy is that the insurer will attempt to negotiate a settlement in good faith or in a reasonable manner. This is a right vested in not only the insured but also in the injured party. The "Motor Vehicle Financial Security Act" of the State of New York prohibits any person from operating any motor vehicle without liability coverage. The declared purpose of this action is as follows:

The legislature is concerned over the rising tolls of motor vehicle accidents and the suffering and loss thereby inflicted. The legislature determines that it is a matter of grave concern that motorists shall be financially able to respond in damages for their negli-

³⁸ 287 F. Supp. 108, 110 (D.C. Conn. 1968).

³⁹ 342 U.S. 83, 90 (1945).

⁴⁰ *Safeway Store, Inc. v. Arnall*, 196 F. 2d 510, 513 (Emer. Ct. App. 1952), judgment vacated on other grounds 344 U.S. 803 (1952).

⁴¹ *Supra* n. 36 at 36.

gent acts, so that innocent victims of motor vehicle accidents may be recompensed for the injury and financial loss inflicted upon them. The legislature finds and declares that the public interest can best be served in satisfying the insurance requirements of this article by private enterprise operating in a competitive market to provide proof of financial security through the methods prescribed herein.⁴²

Under well-settled and long-recognized principles of law, when two parties enter into an agreement for the benefit of a third, the latter has the right to bring suit for breach of that agreement. Why shouldn't these principles apply to insurance contracts? It has been held in some jurisdictions that the injured party is the third party beneficiary of an insurance contract for purposes of bringing a direct action suit for wrongful refusal to settle,⁴³ and it is strongly suggested that other jurisdictions follow suit.

Conclusion

The proposed rule of absolute liability, as stated in *Crisci*,⁴⁴ is having its impact in all jurisdictions. It raises a number of questions which should be carefully considered and studied before its adoption. At the very least, however, all jurisdictions should move rapidly to allow injured parties the right of direct action against the insurer. The article offers a number of approaches for allowing such suits and it is strongly urged that they be considered by all jurisdictions seeking "the limitless horizons of limited policies."

⁴² Vehicle and Traffic Law of New York § 310.

⁴³ *Supra* n. 23.

⁴⁴ *Supra* n. 1.