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Insurance - Expanded Liability for Failure to Defend

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CASES NOTED

INSURANCE—EXPANDED LIABILITY FOR FAILURE TO DEFEND

The insured called upon his insurer to defend an action for damages growing out of an automobile accident. The insurer claimed that the policy had expired and therefore refused to defend the suit. During the course of the suit the insured had an opportunity to settle within the limits of the policy, but because of insufficient funds he was unable to do so. The offer to settle was not communicated to the insurer. A judgment against the insured was entered in an amount in excess of the policy limits. The present action was instituted by the insured against his insurance company to recover the entire amount of the adverse judgment entered against him. The trial court granted the plaintiff's motion for summary judgment. On appeal, the First District Court of Appeals, *held*, affirmed: An insurer who unjustly denies coverage and refuses to defend an action against the insured, in which there was an opportunity to settle within the limits of the policy, is liable for the amount of the adverse judgment even though it exceeds the policy limits and even though the offer to settle was not communicated to the insurer. *American Fid. Fire Ins. Co. v. Johnson*, 177 So.2d 679 (Fla. 1st Dist. 1965).

Early indemnity policies, as distinguished from liability policies,¹ required that the insured attend to his own defense and pay any loss.² After loss was actually incurred by the insured, the insurer was required to indemnify the insured to the extent of the amount stipulated in the policy, provided, however, that the defense had been honestly conducted.³

Today, liability insurance policies generally provide that the insurer shall defend any action brought against the insured in which there are allegations of facts and circumstances⁴ covered by the policy.⁵ The duty of the insurer to defend is accompanied by a correlative right which en-

1. *Davies v. Maryland Cas. Co.*, 89 Wash. 571, 154 Pac. 1116 (1916).

2. *Id.* at 1117.

3. *Ibid.*

4. The rule in most jurisdictions is that the duty of the insurer to defend an action against the insured will be determined from the allegations of the complaint or declaration filed against the insured. *E.g.*, *Butler v. Maryland Cas. Co.*, 147 F. Supp. 391 (E.D. La. 1956); *New Amsterdam Cas. Co. v. Knowles*, 95 So.2d 413 (Fla. 1957); *Commercial Cas. Ins. Co. v. Tri-State Transit Co.*, 190 Miss. 560, 1 So.2d 221 (1941). There are a number of jurisdictions, however, which determine the insurer's duty to defend on the basis of actual facts known to the insurer. *E.g.*, *Loftin v. United States Fire Ins. Co.*, 106 Ga. App. 287, 127 S.E.2d 53 (1962); *Indemnity Ins. Co. of No. America v. Murphy*, 205 Misc. 332, 128 N.Y.S.2d 424 (1954). For a comprehensive discussion of these rules see APPLEMAN, *INSURANCE LAW & PRACTICE* § 4682 (1962).

5. For a typical defense and settlement policy provision see APPLEMAN, *AUTOMOBILE LIABILITY INSURANCE* 83 (1938).

titles the insurer to assume complete control of the defense of an action against the insured.⁶ Such control includes the right to make any good faith⁷ settlement within the policy limits⁸ and to receive full cooperation from the insured.⁹ The duty of the insurer to defend will normally operate to the benefit of both the insurer and the insured.¹⁰ The insurer has the benefit of complete control of the defense of an action which could result in a loss to the insurer equal to the dollar limits specified in the policy. On the other hand, the insured may have neither the necessary funds nor the experience to conduct an adequate defense in his own behalf.

The breach of the obligation to defend will not ordinarily render the insurer liable for an amount greater than the limits stated in the policy.¹¹ However, where the refusal to defend or settle was attributable to bad

6. *General Acc. Fire & Life Assur. Corp. v. Louisville Home Tel. Co.*, 175 Ky. 96, 193 S.W. 1031 (1917); *Farmers Gin Co. v. St. Paul Mercury Indem. Co.*, 186 Miss. 747, 191 So. 415 (1939); *Johnson v. Maryland Cas. Co.*, 103 Neb. 371, 171 N.W. 908 (1919); *Brassil v. Maryland Cas. Co.*, 210 N.Y. 235, 104 N.E. 622 (1914). Exclusive control of the defense by the insurer is justified by the probability that if the insured was allowed to retain control he would try to settle any claim below the policy limits. *Tyger River Pine Co. v. Maryland Cas. Co.*, 170 S.C. 286, 170 S.E. 346 (1933); *Hilker v. Western Auto. Ins. Co.*, 204 Wis. 1, 235 N.W. 413 (1931).

7. *American Fire & Cas. Co. v. Vliet*, 148 Fla. 568, 4 So.2d 862 (1941); *Langford v. Milwaukee Ins. Co.*, 101 Ga. App. 92, 113 S.E.2d 165 (1960); *American Sur. Co. v. J. F. Schneider & Son, Inc.*, 307 S.W.2d 192 (Ky. 1957); *Long v. Union Indem. Co.*, 277 Mass. 428, 178 N.E. 737 (1913); *Dumas v. Hartford Acc. & Indem. Corp.*, 92 N.H. 140, 26 A.2d 361 (1942).

8. *Ivy v. Pacific Auto. Ins. Co.*, 156 Cal. App. 2d 652, 320 P.2d 140 (Dist. Ct. App. 1958); *American Sur. Co. v. J. F. Schneider & Son, Inc.*, *supra* note 7; *Long v. Union Indem. Co.*, *supra* note 7; *Dumas v. Hartford Acc. & Indem. Co.*, 92 N.H. 140, 26 A.2d 361 (1942); *Best Bldg. Co. v. Employers' Liab. Assur. Corp.*, 247 N.Y. 451, 160 N.E. 911 (1928).

9. *General Acc. Fire & Life Assur. Corp. v. Rinnert*, 170 F.2d 440 (5th Cir. 1948); *State Farm Mut. Auto. Ins. Co. v. Hubbard*, 272 Ala. 181, 129 So.2d 669 (1961); *Valladao v. Fireman's Fund Indem. Co.*, 13 Cal. 2d 322, 89 P.2d 643 (1939); *United Nat. Indem. Co. v. Zullo*, 143 Conn. 124, 120 A.2d 73 (1956); *Imperiali v. Pica*, 338 Mass. 494, 156 N.E.2d 44 (1959); *Courtney v. Stapp*, 232 Miss. 752, 100 So.2d 606 (1958).

10. The defense clause is generally construed by the courts to be for the benefit of the insurer. *E.g.*, *Lumberman's Mut. Cas. Co. v. McCarthy*, 90 N.H. 320, 8 A.2d 750 (1939); *Davies v. Maryland Cas. Co.*, *supra* note 1; *Johnson v. Hardware Mut. Cas. Co.*, 108 Vt. 269, 187 Atl. 788 (1936).

11. In *Manheimer Bros. v. Kansas Cas. & Sur. Co.*, 149 Minn. 482, 484, 184 N.W. 189, 191 (1921), the court stated:

The question presented is controlled by the general rule that the measure of damages for the breach of a contract for the payment of money is the amount agreed to be paid with interest. The fact in this case that the defendant's obligations under the contract extended beyond the payment of the amounts stated and included the promise to conduct the defense of the action cannot be held to enlarge the limitation as to the amount fixed as reimbursement for injuries to persons. The failure to defend exposed defendant only to the additional liability for the cost and expense which plaintiff was put to by reason of defendant's breach of the contract in that respect.

But see, *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 656, 328 P.2d 198, 201 (1958), where the court held, although deciding the case on the issue of failure to settle, that:

The policy limits restrict only the amount the insurer may have to pay in the performance of the contract as compensation to a third person for personal injuries caused by the insured; they do not restrict the damages recoverable by the insured for a breach of contract by the insurer.

faith¹² or, in some cases, negligence,¹³ on the part of the insurer, the insurer has been held liable for the entire amount of the judgment against the insured even though the judgment exceeded the policy limits.¹⁴

The insurer in the instant case,¹⁵ relying on an apparently valid cancellation of the policy, had refused to defend an action against the insured. The court held that the refusal to defend was unjustified and on the basis of a settlement offer which the insured was unable to accept, found that the insurer acted in bad faith,¹⁶ and was, therefore, liable for the entire amount of the judgment against the insured.¹⁷

The principal case relied upon by the insurer was *Manheimer Bros. v. Kansas Cas. & Sur. Co.*¹⁸ The Minnesota Supreme Court in *Manheimer* held that the insurer was not liable for the amount of the judgment in excess of the policy limits.¹⁹ Although there was an unjustified refusal to defend by the insurer in *Manheimer*, the court stated that:

12. The majority of jurisdictions require that the insurer exercise "good faith" in the defense or settlement of an action against the insured. The "bad faith" which will render the insurer liable for judgments in excess of the policy limits must be something more than mere negligence or an error in judgment. It implies conscious wrongdoing by breaching a known duty. *Farmers Ins. Exch. v. Henderson*, 82 Ariz. 335, 313 P.2d 404 (1957); *Comunale v. Traders & Gen. Ins. Co.*, *supra* note 11; *Casualty & Sur. Co. v. Reville*, 97 Ga. App. 888, 104 S.E.2d 643 (Ct. App. 1958); *Olympia Fields Country Club v. Bankers Indem. Ins. Co.*, 325 Ill. App. 649, 60 N.E.2d 896 (1945); *Kingan & Co. v. Maryland Cas. Co.*, 65 Ind. App. 301, 115 N.E. 348 (1917); *Henke v. Iowa Home Mut. Cas. Co.*, 250 Iowa 1123, 97 N.W.2d 168 (1959); *American Sur. Co. v. J. F. Schneider & Son*, *supra* note 8; *Davis v. Maryland Cas. Co.*, 16 La. App. 253, 133 So. 769 (1931); *Abrams v. Factory Mut. Liab., Ins. Co.*, 298 Mass. 141, 10 N.E.2d 82 (1937); *Boerger v. Am. Gen. Ins. Co.*, 257 Minn. 72, 100 N.W.2d 133 (1959); *Brassil v. Maryland Cas. Co.*, *supra* note 6; *Alford v. Textile Ins. Co.*, 248 N.C. 224, 103 S.E.2d 8 (1958); *Hart v. Republic Mut. Ins. Co.*, 152 Ohio St. 185, 87 N.E.2d 347 (1949); *American Fid. & Cas. Co. v. L.C. Jones Trucking Co.*, 321 P.2d 685 (Okla. 1958); *Cowden v. Aetna Cas. & Sur. Co.*, 389 Pa. 459, 134 A.2d 223 (1957); *Peerless Cas. Co. v. Cole*, 121 Vt. 258, 155 A.2d 866 (1959); *Maraney v. Allstate Ins. Co.*, 12 Wis. 2d 197, 107 N.W.2d 261 (1961).

13. In what is apparently a growing number of jurisdictions a rule of negligence, rather than bad faith, is applied which requires that the insurer exercise "due care" in determining whether to defend or settle. The objective test of "reasonableness" is used to determine whether the necessary "due care" was exercised. *Hoyt v. Factory Mut. Liab. Ins. Co.*, 120 Conn. 156, 179 Atl. 842 (1935); *Bennett v. Canrody*, 180 Kan. 485, 305 P.2d 823 (1957); *Dumas v. Hartford Acc. & Indem. Corp.*, 92 N.H. 140, 26 A.2d 361 (1942); *Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co.*, 31 N.J. 299, 157 A.2d 319 (1960).

14. *American Fire & Cas. Co. v. Davis*, 146 So.2d 615 (Fla. 1st Dist. 1962) and cases cited *supra* notes 12 & 13.

15. *American Fid. Fire Ins. Co. v. Johnson*, 177 So.2d 679 (Fla. 1st Dist. 1965).

16. Florida, although aligned with the majority of jurisdictions requiring "good faith" on the part of the insurer, has adopted the rule that negligence may be considered in determining whether the insurer has acted in good faith. *American Fid. & Cas. Co. v. Greyhound Corp.*, 232 F.2d 89 (5th Cir. 1956); *Tully v. Traveler Ins. Co.*, 118 F. Supp. 568 (N.D. Fla. 1954). Other jurisdictions adopting similar "merged" or "hybrid" rules which combine negligence and bad faith, include e.g., *Southern Farm Bureau Cas. Ins. Co. v. Parker*, 232 Ark. 841, 341 S.W.2d 36 (1960); *Georgia Cas. Co. v. Mann*, 242 Ky. 447, 46 S.W.2d 777 (1932); *Norwood v. Travelers Ins. Co.*, 204 Minn. 595, 284 N.W. 785 (1939); *Tyger River Pine Co. v. Maryland Cas. Co.*, *supra* note 6.

17. *Supra* note 15, at 683.

18. 149 Minn. 482, 184 N.W. 189 (1921).

19. *Id.* at 486, 184 N.W., at 191.

The fact in this case that the defendant's obligation under the contract extended beyond the payment of the amounts stated and included the promise to conduct the defense of the action cannot be held to enlarge the limitation as to the amount fixed as reimbursement for injuries to persons.²⁰

The court in the instant case distinguished the *Manheimer* case on the fact that no question of settlement was involved.²¹

The court in the instant case also considered the case of *Comunale v. Traders & Gen. Ins. Co.*²² where an insurer was held liable for the amount of judgment in excess of the poliicy limits. The court in *Comunale* stated that:

[A]n insurer, who wrongfully declines to defend and who refuses to accept a reasonable settlement within the policy limits in violation of its duty to consider in good faith the interest of the insured in the settlement, is liable for the entire judgment against the insured even if it exceeds the policy limits.²³

An important difference between the facts in *Comunale* and those of the instant case is that in *Comunale* the settlement offer was actually communicated to the insurer,²⁴ while in the instant case the settlement offer was not communicated to the insurer.²⁵ The court in this case, in effect, imputed knowledge of the settlement offer to the insurer by holding that:

Surely [the insured] should not be penalized for failure to do the idle act of notifying [the insurer] of the settlement offer after it had renounced the contract and washed its hands of the whole affair.²⁶

The insurer was admonished by the court for failing to have determined the question of liability under the policy, through a declaratory judgment proceeding²⁷ at the inception of litigation.²⁸ This decision makes it even more perilous for the insurer to make its own determination of liability under the policy. The possibility, if not the probability,

20. *Ibid.*

21. *American Fid. Fire Ins. Co. v. Johnson*, *supra* note 15, at 682.

22. 50 Cal. 2d 654, 328 P.2d 198 (1958).

23. *Id.* at 661, 328 P.2d, at 202.

24. *Id.* at 655, 328 P.2d, at 200.

25. *American Fid. Fire Ins. Co. v. Johnson*, *supra* note 15, at 681.

26. *Id.* at 683.

27. FLA. STAT. § 87.01 (1965):

The circuit courts of the state . . . shall have the power upon a filed complaint, to declare rights, status and other equitable or legal relations whether or not further relief is or could be claimed or prayed. . . . The circuit court's declaration may be either affirmative or negative in form and effect and such circuit court declaration shall have the force and effect of a final decree, judgment or order.

28. *American Fid. Fire Ins. Co. v. Johnson*, *supra* note 15, at 683.

of a settlement offer is inherent in all civil litigation.²⁹ It would be especially foolhardy for an insurer not to take advantage of the declaratory judgment proceeding when faced with the possibility of being held liable for a judgment in excess of the policy limits.

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29. *Douglas v. United States Fid. & Guar. Co.*, 81 N.H. 371, 375, 127 Atl. 708, 712 (1924).

It is a matter of common knowledge that the great majority of claims arising under these policies are settled. The percentage of litigated cases is small. Settlement is the rule and contest the exception.