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INSURANCE-LIABILITY OF INSURANCE COMPANY FOR NEGLIGENCE IN EXERCISING ITS OPTION TO SETTLE OR DEFEND

INSURANCE—LIABILITY OF INSURANCE COMPANY FOR NEGLIGENCE IN EXERCISING ITS OPTION TO SETTLE OR DEFEND.—In a recent New Hampshire case, the plaintiff had insured with defendant company against liability for personal injuries to plaintiff's employees not exceeding $5,000.00. The policy under the title of "Service" provided that defendant would investigate all claims and settle them "according to the law". The defendant insurer also agreed to defend such suits as might be brought against plaintiff because of such injuries. One of plaintiff's employees was injured and though he offered to settle for $1,300.00, the defendant refused the offer. Thereupon the employee sued and recovered $13,500.00 in an action defended by defendant company according to their contract. The plaintiff then sued the defendant company for negligently failing to settle the suit out of court, it knowing that the plaintiff would be liable for a judgment in excess of the face of the policy. The court held that the defendant was liable for the entire judgment recovered by the employee against the plaintiff. *Douglas v. U. S. Fid. & Guaranty Co.* (N. H. 1924) 127 Atl. 708.

The ordinary liability or indemnity insurance contract usually contains an obligation on the part of insurer to investigate all claims and defend all actions arising from such claims, or at its election to settle the same out of court, and there is usually a provision whereby the assured is prohibited from interfering in the negotiations for settlement or in the defense of the suit. Though the contract or policy in the instant case was worded a little differently and contained no express prohibition of assured from interfering in the settlement or defense, the court expressly denies this as a distinction, or a reason for the decision.

There is good and sufficient reason for such provisions in the policy. In order to prevent collusion between employer and employee at the expense of the insurer, it is necessary that the settlement and defense of the claim should be wholly in the insurer's hands, and it is for this reason that any objection to such a provision as invalid on the ground of maintenance has failed. *Gen. Acc. Fire & Life Ass. Co. v. Louisville H. Tel. Co.* 175 Ky. 96, 104; 193 S. W. 103. But to allow the insurance company absolutely free rein in the matter of settlement or defense is to make the employer stand by and watch the proceedings, wondering whether his supposedly beneficial contract "is to be a shield in his own hand or a sword in the hands of his opponent". There must be some limit to the insurer's discretion to refuse to settle if the employer, the assured, is to have due protection. The principal case sets a defi-

[14]See Bangor House Proprietary v. Brown, 33 Me. 309; Hopkinson v. McKnight, 31 N. J. L. 422; Robinson v. Myers, 67 Pa. 9; Plumer v. Johnston, 63 Mich. 165, 173.

[15]See Gedded Coarse Salt Co. v. Power Co., 207 N. Y. 500; Johnson v. Arnold, 91 Ga. 659; Stark & Wales v. Coffin, 105 Mass. 328; Jarstadt v. Morgan, 48 Wis. 245; Paine v. Storage Co., 71 Fed. 626.

In the contrary view emphasis seems to be placed on the fact that the grantor (platter) may change his mind and either change the street location or not open the streets at all. In determining the appropriate construction would it not seem more reasonable to proceed on the assumption that the grantor will carry out his announced intentions?

nite if somewhat restricted limit on the exercise of this discretion and goes on the broad ground, as it says, that in all its dealings with the employee's claim, the insurance company was bound to act reasonably and with due diligence. The case stands almost alone, though an earlier New Hampshire decision, *Cavanaugh v. Corporation*, 79 N. H. 186, 106 Atl. 604, is in accord, but it was decided with little argument and no citation of authority.

The weight of authority is indicated by the following decisions: *Rumford Falls Paper Co. v. Fid. & Cas. Co.* 92 Me. 574; 43 Atl. 503; *New Orleans & Carrolton R. R. Co. v. Md. Cas. Co.* 114 La. 153; 38 So. 89; *Schmidt & Sons Brew. Co. v. Travellers Ins. Co.* 244 Pa. 286; 90 Atl. 653; *Schenke Piano Co. v. Phila. Cas. Co.* 216 N. Y. 662; 110 N. E. 1049. In all these cases the facts were much the same as in the principal case but the court refused to allow a recovery, saying that the insurance company had an absolute option to settle or defend, that there was no possibility of agency between insured and insurer because of their adverse interests, and that therefore the insurance company was not bound to consult the assured's interests in making a settlement.

The New Hampshire court distinguished all these cases on the ground that they were brought on the contract itself on the theory that the duty to settle was absolute and the question of care or negligence in exercising the right to elect was not considered. The court in the principal case further argued that because the defendant had an exclusive option did not mean he could act arbitrarily, and that since the defendant had undertaken a service, the common law imposed on him a duty of using due care as in the case of all those who undertake a service for another. *Burnham v. Stillings*, 76 N. H. 122, 79 Atl. 987. It also said that an agency could exist despite the adverse interests if the parties so agreed.

To what standard are we to hold the insurer in the exercise of his option? Granted that the option by right and expedience lies with him, is the assured to be left wholly at the insurer's mercy? The courts have not gone that far. All hold that if the insurer exercises his option in bad faith he is liable for the excess recovered by the injured employee. *Brunswick Realty Co. v. Frankfort Ins. Co.* 99 Misc. 639, 166 N. Y. S. 36; *Brown & McCabe v. London Co.* 232 Fed. 298. But courts are reluctant to find bad faith and to set up a standard of bad faith. *Levin v. N. E. Cas. Co.* 101 Misc. 402, 166 N. Y. S. 1055; 8 MINN. L. REV. 151.

But admitting bad faith in exercising the option as a ground of recovery, should we go a step further and allow negligence as a basis? To do so there is no need to find agency between the plaintiff and defendant. The defendant insurer can be in the position of an independent contractor and still be held to a duty of care. The court so holds in *Attleborro Mfg. Co. v. Frankfort Marine etc. Ins. Co.* 240 Fed. 573, 153 C. C. A. 377, which although it was a case for negligent defense is an authority on this point. Also as to allowing recovery for negligent defense despite the lack of agency see *Brassil v. Md. Cas. Co.* 210 N. Y. 235; 104 N. E. 622; *Anderson v. Southern Surety Co.* 107 Kan. 375, 191 Pac. 583. Besides, it would seem that agency is possible in such a relation if the parties, knowing of the adverse interests still contract in that way. MECHEM ON AGENCY, (2nd ed.), sec. 177; *Colby v. Copp*, 35 N. H. 434.

If we once admit the court's argument that the defendant has undertaken a service and so is bound to use due care, and this seems a rational interpretation of the defendant's duties inasmuch as the plaintiff is excluded from interfering in the settlement or defense, we must admit that the defendant insurer is liable in tort for the negligent failure to settle. Yet how are we to account for the weight of authority against our proposition? The New Hampshire court, as was said above, distinguishes these cases on the ground that they were brought in contract, declaring on the policy, instead of in tort as they should have been. If we do not find in the policy itself an implied duty to use care, the distinction is valuable and the method of obtaining relief should be in tort. *Randolph's Adm. v. Snyder,* 139 Ky. 159; 129 S. W. 562. The cases allowing recovery for negligent defense set out above were in tort, the policy being set up only as inducement. This seems to bear out the distinction.

In the *Rumford Falls Paper Co.* case, *supra,* the court said: "full and absolute control over all defenses to actions brought as well as all negotiations for the settlement of claims was surrendered by the assured to the defendant company". If this means all that it sounds like, there is no liability for bad faith in exercising the right to settle and we saw above that the courts do hold the insurer liable for bad faith in exercising the option. The court is right in saying that the contract so provides, and consequently no recovery even for bad faith should be had on the contract. But its liability arises outside of the contract as a result of a privilege given by the contract. That is, the insurer by the contract promised to undertake a service. For failing to undertake that service there is a breach of contract action: for failings or derelictions in the manner of conducting that service there is a tort action resulting from a breach of that duty which the law imposes on all those who undertake a service for another. That reasoning is substantiated in the *Attleboro* case, *supra,* where the court said that a suit for negligent defense was not a suit for failure to perform the contract, but a suit for failure to comply with the duty of using care, that duty arising not out of the contract but out of the act of undertaking the defense. The *Brassill* case, *supra,* was brought on the contract but it was in reality not a suit for negligent defense but for refusal to defend, to take an appeal, and what the court says as to good faith and due care being a part of the contract is only dictum.

Besides, if the suit for negligent failure to settle were to be allowed on the policy on the ground that the use of due care is an implied term, it would seem that the amount of recovery, at the outside, is the face of the policy itself, thus not helping the assured at all. *Mannheimer Bros. v. Kansas Cas. & Surety Co.,* 149 Minn. 482; 184 N. W. 189.

If tort is the proper remedy for the plaintiff under the circumstances and not a suit on the contract, then there is really only one case contra. *Wis. Zinc Co. v. Ins. Co.,* 162 Wis. 39; 155 N. W. 1081, where the court sustained a demurrer to a count in tort for negligence under the same facts.

If we allow negligence as a ground of recovery, there should be no reasonable chance of the success of a trial before the defendant is held liable for a failure to settle. That is, the insurer need not exercise its election with a sole view to the interests of the assured. The standard of care should be that exercised by a prudent person after giving his own and the assured's interests equal weight. R. F. H.