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UNDERSTANDING THE TORT OF THIRD-PARTY BAD FAITH IN WYOMING: *Western Casualty & Surety Company v. Fowler* REVISITED

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I. INTRODUCTION

Since the case of *Western Casualty and Surety Co. v. Fowler*[1] was decided by the Wyoming Supreme Court some twenty-seven years

1. 390 P.2d 602 (Wyo. 1964).

ago, the duty of liability insurers to settle claims asserted against their Wyoming policyholders by third parties has been clearly established, even though such a duty may not be found anywhere in the contract of insurance.[2]

A violation of this duty is commonly referred to as "third-party" bad faith.[3] Unlike "first-party" bad faith,[4] which arises when insurers refuse to pay contract benefits directly to their insureds without a "fairly debatable"[5] basis for such refusal, an action for "third-party"

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2. The author has yet to review a liability policy of any type in which a liability insurer has contractually assumed a duty to settle. In the research that was undertaken for this article, moreover, only one case was discovered where the liability insurer's duty to settle was expressly addressed in the contract. In Georgia Life Ins. Co. v. Mississippi Cent. R. Co., 116 Miss. 114, 76 So. 646, 647 (1917), a liability insurer addressed its duty to settle by inserting the following provision in its contract of insurance: "It is further agreed and understood that when the company has the opportunity to settle the claim of any [third-party] within the limit designated in this policy, viz. five thousand dollars ($5,000.00), and fails to take advantage of such opportunity . . . , [the insurer] shall thereafter protect the [insured] from any judgment not in excess of ten thousand dollars ($10,000.00) . . . ." Presumably, the insurer in this case evaluated the risk and cost of judgments in excess of policy limits and factored this analysis into its rating structure. In any event, this provision has been endorsed by the California Supreme Court in Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 319 P.2d 69 (1957) and the Oregon Supreme Court in Radcliffe v. Franklin Nat'l Ins. Co., 208 Or. 1, 298 P.2d 1002 (1956), as an acceptable method of dealing with the question of who should bear the burden of a judgment entered in excess of policy limits when an opportunity existed to settle the claim within the limits of the policy.

3. As defined by one authority, "third-party" insurance is liability insurance characterized by the following:

> It always involves a claim of loss and three distinct parties: an injured claimant, an insured, and the insured's insurance company. In contrast to first-party insurance, which applies to the insured's own claimed losses, third-party insurance is intended to protect the insured from the expense of defending and paying the claim of a third party within the policy's limits.

D. WALL, LITIGATION AND PREVENTION OF INSURER BAD FAITH § 3.01, at 20 (1985) (footnotes omitted).

Many of the text writers also characterize a liability insurer's breach of its duty to defend as "third-party" bad faith, *e.g.*, W. SHERNOFF, S. GAGE & H. LEVINE, INSURANCE BAD FAITH LITIGATION §§ 3.20-.28 (1984) [hereinafter SHERNOFF], even though an insurer's bad faith refusal to defend seems to be determined by standards applicable to "first-party" bad faith. *See, e.g.*, Lund v. American Motorists Ins. Co., 797 F.2d 544 (7th Cir. 1986). In any event, the law of bad faith as it pertains to an insurer's duty to defend is beyond the scope of this article, except insofar as an insurer's refusal to defend also causes the insurer to reject a settlement offer within policy limits. *See infra* notes 47-68 and accompanying text.

4. Examples of "first-party" insurance contracts in which the insurer promises to pay certain benefits directly to the insured are life insurance, health and accident insurance, comprehensive, collision, uninsured motorists and medical payments coverages in policies providing automobile insurance, title insurance, property insurance and homeowner's insurance. *See* SHERNOFF, *supra* note 3, § 5.01, at 5-3.

5. The phrase "fairly debatable" was adopted by the court in McCullough v. Golden Rule Ins. Co., 789 P.2d 855 (Wyo. 1990), to describe the standard which applies to determine whether a first-party insurer has committed bad faith. In the author's view, the adoption of this phrase was unfortunate for reasons expressed in the first segment of this article. *See* Smith, *Understanding the New Tort of First Party Bad Faith In Wyoming:* McCullough v. Golden Rule Insurance Company, 26 LAND & WATER L. REV. 225, 253 (1991). In any event, the precise standard adopted by *McCullough* consists of the following two-part test: "To show a claim for bad faith, a plaintiff must show the absence of a reasonable basis for denying benefits of the policy and the

bad faith can be prosecuted by an insured only against his liability insurer for failure to exercise good faith in settling claims asserted against the insured by third parties. If a liability insurer knowingly or recklessly fails to give equal weight to the interests of its insured in rejecting a policy limits settlement offer,[6] the insurer will be held liable for (a) any resulting judgment against the insured in excess of policy limits; (b) consequential damages; and (c) where willful and wanton behavior is established, exemplary damages.[7]

This article was written as a corollary article to *Understanding the New Tort of First-party Bad Faith in Wyoming:* McCullough v. Golden Rule Insurance Company,[8] for several reasons. First of all, in view of the recent adoption by the Wyoming Supreme Court of the tort of first-party bad faith in *McCullough*, it is critically important for the Wyoming practitioner who becomes involved in a bad faith case to recognize and clearly distinguish between the two causes of action. Because the elements and nature of the two causes of action are distinctly different,[9] so are the standards used to determine whether insurers have committed acts of first-party and third-party bad faith. Thus, the practitioner who evaluates a third-party bad faith case on the basis that the insurer's refusal to settle was "fairly debatable"[10] may be making a mistake as potentially fatal as that made by

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defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim." *McCullough*, 789 P.2d at 860.

6. *See infra* notes 114-134 and accompanying text.

7. *See infra* notes 278-308 and accompanying text. It should be noted that not every judgment in excess of policy limits, even where the insurer had the opportunity to settle within policy limits, will result in a finding of third-party bad faith.

8. Smith, *Understanding the New Tort of First Party Bad Faith In Wyoming*: McCullough v. Golden Rule Insurance Company, 26 LAND & WATER L. REV. 225 (1991).

9. *Compare* the elements of the first-party bad faith cause of action, *supra* note 5, *with* the elements of the third-party bad faith cause of action; *see infra* note 46 and accompanying text.

10. The Arizona Supreme Court has recently held in Clearwater v. State Farm Mut. Auto. Ins. Co., 164 Ariz. 256, 260, 792 P.2d 719, 723 (1990), that a first-party, "fairly debatable" instruction is improper in a third-party bad faith claim based upon an insurer's refusal to accept a settlement offer within policy limits. In support thereof, the court explained:

> Thus, an insurer owes its insured the same duty of good faith and fair dealing in both first- and third-party actions. [citations omitted] The standard for determining whether the insurer has breached its duty, however, is different in the two types of cases because of the different relationships and duties that exist between the parties. In third-party actions, the insurer exclusively controls settlement and the insured bears a disproportionate share of the risk if the insurer fails to accept a reasonable settlement offer within policy limits. The insured faces personal liability for an award exceeding policy limits, while the insurer's potential liability remains constant at policy limits. Therefore, although the "fairly debatable" standard sufficiently protects both parties' interests in first-party actions, it inadequately protects the insured's interests in third-party actions.

Id.

Thus, the court's basis for refusing to give a "fairly debatable" instruction in a third-party case was the fact that it would give undue weight to a single factor, whereas a determination of whether the insurer gave "equal consideration" to the interests of the insured in refusing to settle within policy limits requires a consideration of several factors. *Id.* Unfortunately, other courts have applied a "fairly debatable" standard to determine whether a lia-

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his counterpart who determines that an insurer is guilty of first-party bad faith because it failed to give the same consideration to the interests of its insured as it did to its own.[11] This may become particularly confusing when "third-party" and "first-party" coverages are offered in the same policy of insurance, as they often are.[12]

Second, *Fowler* unfortunately does not articulate any helpful standards for determining when the actions of a liability insurer cross the often uncertain line between good faith and bad faith,[13] nor does *Fowler* address a multitude of other questions which the prosecution or defense of a third-party bad faith claim necessarily entails. Indeed, a defense attorney who reads the decision hoping to advise a liability insurer when it may safely reject a policy limits offer in Wyoming will find that *Fowler* lends little, if any, assistance. Likewise, the plaintiff's attorney in Wyoming who looks to *Fowler* for guidance in advising an insured whether to reject the insurer's defense and settle the action directly with the third-party claimant because his or her insurer has violated its duty to settle will find it necessary to refer to other sources and authorities. It should be noted, however, that the failure of *Fowler* to respond to such questions is not the result of an analytically deficient opinion. To the contrary, the issues on appeal in *Fowler* simply did not lend themselves to a comprehensive treatment of the subject of third-party bad faith. As a matter of fact, the only issues raised on appeal by the appellant insurer in *Fowler* were (1) whether the evidence was sufficient to show a bad faith refusal to settle and (2) whether the trial court properly instructed the jury on the definition of bad faith.[14] For purposes of the appeal, in other words, both litigants assumed that a cause of action for third-party bad faith existed in Wyoming before it was ever established at the appellate level.

Third, even though *Fowler* was decided long ago, it represents the only case law in Wyoming on the subject of third-party bad faith.[15]

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bility carrier has acted in bad faith in rejecting a settlement offer within policy limits. *E.g.*, Calenda v. Allstate Ins. Co., 518 A.2d 624 (R.I. 1986).

11. Conversely, it is clear that the "equal consideration" instruction which the Wyoming Supreme Court approved in *Fowler*, if applied to first-party cases, would result in a finding of bad faith in a disproportionate number of cases and hence would operate unfairly to first-party insurers. A first-party insurer, in other words, could refuse to consider the interests of the insured altogether, but still have a reasonable basis for refusing to pay a first-party claim. Unfortunately, the "equal consideration" test has been applied in first-party cases. *E.g.*, Davis v. Blue Cross of N. Cal., 25 Cal. 3d 418, 600 P.2d 1060, 158 Cal. Rptr. 828 (1979).

12. For example, refer to "Personal Automobile Insurance Coverages" set forth in R. KEETON & A. WIDISS, INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND COMMERCIAL PRACTICES, app. H, at 1116 (Student ed. 1988) [hereinafter KEETON & WIDISS]. Liability coverage for property damage and bodily injury is set forth in the same policy form as coverages for uninsured motorists, medical payments coverage and collision and comprehensive coverages.

13. *See supra* notes 136-152 and accompanying text.

14. *Fowler*, 390 P.2d at 606.

15. There are only two other Wyoming Supreme Court opinions on the subject of insurer bad faith. The first, a case involving uninsured motorists coverage, is Mountain W. Farm Bureau v. Arnold, 707 P.2d 161 (Wyo. 1985). The second, McCullough v.

Because the Wyoming Supreme Court has not had the occasion to further address or develop the third-party bad faith cause of action, most practitioners in Wyoming who seek to represent a client in a third-party bad faith case must navigate in near darkness.[16] The purpose of this article, therefore, along with others expressed, will be to address some of the more important questions concerning the cause of action for third-party bad faith that have yet to form the subject of an appellate opinion in Wyoming.

Finally, if it was ever accurate to label "third-party" bad faith as a less than dynamic area of the law, such is no longer the case. To the contrary, attorneys who undertake the representation of insurers, insureds or third-party claimants will find it necessary to refamiliarize themselves with this particular area of the law today more so than at any time in the past.[17] At least two reasons explain the need to do so. First, the number of situations in which existing liability policy limits are inadequate to resolve third-party claims appear to be increasing, which in turn increase the number of situations in which a conflict between the interests of the liability insurer and the insured may develop. This is attributable to many factors, including (1) the movement by liability insurers to build defense costs within policy limits[18]

Golden Rule Ins. Co., 789 P.2d 855 (Wyo. 1990), established the tort of first-party bad faith in Wyoming.

16. In addition to a mature body of case law which establishes the third-party bad faith cause of action in nearly every American jurisdiction, there are a number of excellent texts which provide comprehensive treatment of the third-party bad faith cause of action, including: S. ASHLEY, BAD FAITH ACTIONS: LIABILITY AND DAMAGES (1984); G. KORNBLUM, M. KAUFMAN & H. LEVINE, CALIFORNIA PRACTICE GUIDE: BAD FAITH (1990) [hereinafter KORNBLUM]; P. MAGARICK, EXCESS LIABILITY: THE LAW OF EXTRA-CONTRACTUAL LIABILITY OF INSURERS (3d ed. 1990); J. MCCARTHY, RECOVERY OF DAMAGES FOR BAD FAITH (5th ed. 1990); W. SHERNOFF, *supra* note 3; D. WALL, *supra* note 3; and A. WINDT, INSURANCE CLAIMS AND DISPUTES: REPRESENTATION OF INSUREDS & INSURERS (2d ed. 1988). An excellent journal devoted exclusively to the topic of bad faith is Mathew Bender's BAD FAITH LAW UPDATE.

17. To be sure, the practitioner in Wyoming, or elsewhere for that matter, is still more likely to encounter cases involving "first-party" bad faith than "third-party" bad faith, simply because more first-party claims are asserted against insurers than liability claims where the total damages claimed are in excess of policy limits.

18. As stated by KORNBLUM, *supra* note 16, § 7:107, at 7-36:

> Some liability policies now provide that defense costs are included in the coverage limits, or that such limits are reduced by the amount of defense costs incurred by the insurer.
>
> Under such policies, the longer the case continues, the *lower the policy limits available* to the injured party, and the greater risk of an excess judgment. Arguably, this increases the insurer's duty to settle *early* whenever possible (emphasis as in the original).

A typical policy provision providing for defense costs within policy limits states as follows:

> Regardless of the number of insureds under this insurance or of the number of claims made or suits brought, the company's liability is limited as follows:
>
> . . . All claim expenses shall first be subtracted from the limits of liability, with the remainder, if any, being the amount available to pay as damages. If the limits of liability hereunder are exhausted prior to settlement or judgment of any pending claim or suit, the company shall have the right to withdraw from the further investigation or defense thereof by tendering control of such investigation

and to utilize "aggregate" limits;[19] (2) the proliferation of "low-limit" automobile liability policies;[20] (3) the increasing cost of paying for bodily injury and property damage claims, both from the standpoint of defense costs and claim payments, and the tendency of insureds to underinsure against the exposure created by third-party claims, either by underestimating the exposure involved or through a desire to minimize premium costs. The effect of all of these factors is to decrease the total amount of liability coverage available to the insured at any one time relative to the damage claimed by a third-party, thus increasing the likelihood that a claim will be asserted against the insured which equals or exceeds the remaining policy limits. As a result, allegations by insureds that their liability insurers are guilty of bad faith in refusing to settle claims made against them within the limits of the policy, thus exposing the insured to personal liability, will increase correspondingly.

Second, and perhaps equally important, the entire body of third-party bad faith law, as it has evolved to determine when a liability insurer has acted in bad faith toward its insured, has been extended and applied to the relationship which exists between primary liability insurers and excess insurers.[21] Frequently, a corporate or individual

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or defense to the insured.

KEETON & WIDISS, *supra* note 12, app. K(1), at 1170.

19. A typical "aggregate limits" policy provision reads as follows:

> Regardless of the number of INSUREDS under this [insurance] or of the number of claims made or SUITS brought, the company's liability is limited as follows:
>
> The total liability of the company for all damages and claims expenses because of all claims or SUITS to which this [insurance] applies shall not exceed the limit of liability stated in the [declarations] as 'aggregate.'

KEETON & WIDISS, *supra note* 12, *app.* K(1), *at 1170 (footnotes omitted).*

Under an "aggregate limits" policy, therefore, the insured is provided with certain limits which must be used to satisfy all claims and claim expenses during the policy term. If the "aggregate limits" of a particular policy are $500,000, in other words, and the insurer has paid two claims during the policy term totaling $450,000, the insured has only $50,000 worth of coverage for the remainder of the term. Again, "aggregate limits" decrease the coverage available to the insured and thus increase the risk of a judgment in excess of policy limits.

20. *See infra* notes 309-311.

21. An excess insurer may assert it rights against the primary insurer on the basis of equitable subrogation in the same fashion that an insured or his assignee may assert his rights against the insurer under the doctrine of third-party bad faith. *See* Insurance Co. of N. Am. v. Medical Protective Co., 768 F.2d 315 (10th Cir. 1985); Bohemia Inc. & Employers Mut. Casualty Co. v. Home Ins. Co., 725 F.2d 506 (9th Cir. 1984); Fireman's Fund Ins. Co. v. Continental Ins. Co., 308 Md. 315, 519 A.2d 202 (1987); Commercial Union Ins. Co. v. Medical Protective Co., 136 Mich. App. 412, 356 N.W.2d 648 (1984), *aff'd in part*, 393 N.W.2d 479 (1986). *See also* Wall, *Bad Faith Excess Liability Actions By or Against Excess Insurers*, 48 INS. COUNS. J. 311 (1981).

In Peter v. Travelers Ins. Co., 375 F. Supp. 1347 (Cal. 1974), the court listed the elements of an equitable subrogation action by an excess carrier against a primary carrier as follows:

(1) The primary insurer provided coverage for a loss suffered by the insured;

(2) The excess insurer was called upon to provide a portion of the settlement or judgment or to pay the insured for his or her liability;

(3) The insured had an existing assignable cause of action against the primary insurer, which he or she could have asserted had the insured not been paid by the excess insurer;

insured will not only have purchased a primary liability policy, but also an excess or umbrella policy, to ensure that his policy limits are high enough to protect his business or personal assets from the vast majority of conceivable claims which may be asserted against him.[22] As a result, the plaintiff in a third-party bad faith action may just as frequently be an excess carrier as an insured.[23] Although a small number of cases have held that the primary insurer owes a direct duty to excess carriers to settle claims within the primary carrier's policy limits,[24] it is now well settled in most jurisdictions which have addressed the issue that an excess carrier "stands in the shoes of the insured." As a subrogee, the excess carrier may maintain an equitable action against the primary insurer if the unwarranted refusal of the primary insurer to settle a claim within the limits of the primary policy results in a judgment which penetrates the limits of the excess policy.[25] Thus,

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(4) As a result of the conduct of the primary insurer, the excess insurer suffered damages;

(5) The excess insurer's damages were a sum certain; and

(6) Justice required that the loss be shifted from the excess insurer to the primary insurer.

Id. at 1349-50.

22. A true excess policy provides higher-limit coverage identical to the primary policy and is activated at such time as the primary limits of the underlying policy are exhausted. An umbrella policy differs from an excess policy only in that the umbrella policy also offers some primary coverages, such as protection against libel, slander, false arrest, false imprisonment, invasion of privacy, and malicious prosecution. *See* 8A J. APPLEMAN, INSURANCE LAW AND PRACTICE § 4909.85, at 452-53 (1981).

23. A recent third-party bad faith case emanating from the United States District Court for the District of Wyoming involved the relationship between a primary carrier and an umbrella carrier. In Hocker v. New Hampshire Ins. Co., 922 F.2d 1476 (10th Cir. 1991), the primary carrier issued a liability policy to the insured with policy limits of $500,000. The insured, an oil drilling company, also purchased an umbrella policy with limits of $10,000,000. Both the primary insurer and the excess insurer, after receiving notice of a third-party claim, failed to defend the insured, resulting in the entry of a default judgment against the insured in the sum of $2,865,568.13. After a jury found that both insurers had acted in bad faith toward their common insured, the umbrella carrier pursued an action against the primary carrier, alleging that the primary carrier's failure to defend and subsequently settle the third-party claim within its policy limits gave the umbrella carrier the right to "stand in the shoes" of the insured for purposes of pursuing the primary carrier in an action for bad faith. While recognizing that the remedy of equitable subrogation was available to the umbrella carrier under ordinary circumstances, the court upheld the trial court's determination that the umbrella carrier had also acted in bad faith toward the insured, and hence was barred from pursing its equitable subrogation claim against the primary carrier under the "unclean hands" doctrine. *Id.* at 1485-86.

24. Although a few decisions hold that a direct duty exists on the part of the primary carrier toward the excess carrier, *e.g.*, Ranger Ins. Co. v. Home Indem. Co., 714 F. Supp. 956 (N.D. Ill. 1989); Transit Casualty Co. v. Spink Corp., 94 Cal. App. 3d 124, 156 Cal. Rptr. 360 (1979), *overruled on other grounds*, Commercial Union Assurance Co. v. Safeway Stores, Inc., 26 Cal. 3d 912, 610 P.2d 1038, 164 Cal. Rptr. 709 (1980); and Hartford Accident & Indem. Co. v. Michigan Mut. Ins. Co., 93 A.D.2d 337, 462 N.Y.S.2d 175 (1983), *aff'd*, 463 N.E.2d 608 (1984), most impose the duty through the doctrine of equitable subrogation.

25. *E.g.*, Puritan Ins. Co. v. Canadian Universal Ins. Co., 775 F.2d 76 (3d Cir. 1985); Insurance Co. of N. Am. v. Medical Protective Co., 768 F.2d 315 (10th Cir. 1985); Certain Underwriters of Lloyd's v. General Accident Ins. Co. of Am., 699 F. Supp. 732 (S.D. Ind. 1988); Firemen's Fund Ins. Co. v. Continental Ins. Co., 308 Md.

if the primary carrier receives a settlement demand within the limits of the primary policy from a third-party claimant, the primary carrier must, in responding to the demand, consider the interests of the excess carrier in the same fashion as it is required to consider the interests of the insured where no excess insurance is involved.[26] Its failure to do so will render the primary carrier liable to the excess carrier in the same manner as the primary carrier is held accountable to the insured in situations where no excess insurance exists.[27]

II. THE BASIS FOR THE THIRD-PARTY BAD FAITH CAUSE OF ACTION

The cause of action for third-party bad faith, or more specifically,

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315, 519 A.2d 202 (1987); Commercial Union Ins. Co. v. Medical Protective Co., 426 Mich. App. 412, 393 N.W.2d 479 (1986); Maine Bonding & Casualty Co. v. Centennial Ins. Co., 298 Or. 514, 693 P.2d 1296 (1985); F. B. Washburn Candy Corp. v. Fireman's Fund, 373 Pa. Super. 479, 541 A.2d 771 (1988). *See also* Annotation, *Excess Carrier's Right to Maintain Action Against Primary Liability Insurer for Wrongful Failure to Settle Claim Against Insured*, 10 A.L.R.4th §§ 1-4, at 879-96 (1981).

26. In Maine Bonding & Casualty Co. v. Centennial Ins. Co., 298 Or. 514, 521-22, 693 P.2d 1296, 1301-02 (1985), the court stated as follows:

> In the absence of excess insurance, the insured becomes his own excess insurer. With the purchase of excess insurance, the excess insurer steps into the shoes of the insured as to the potential liability covered by the excess policy. The rationale was stated by the Supreme Court of Minnesota in Continental Casualty Co. v. Reserve Ins. Co., 307 Minn. 5, 8-9, 238 N.W.2d 862, 864 (1976):
>
> "We hold that an excess insurer is subrogated to the insured's rights against a primary insurer for breach of the primary insurer's good-faith duty to settle. *See*, Peter v. Travelers Ins. Co., 375 F. Supp. 1347 (C.D. Cal. 1974). As one commentator has observed, 'In the case of excess coverage, the primary insurer should be held responsible to the excess insurer for improper failure to settle, since the position of the latter is analogous to that of the insured when only one insurer is involved.' R. KEETON, INSURANCE LAW, § 7.8(d). When there is no excess insurer, the insured becomes his own excess insurer, and his single primary insurer owes him a duty of good faith in protecting him from an excess judgment and personal liability. If the insured purchases excess coverage, he in effect substitutes an excess insurer for himself. It follows that the excess insurer should assume the rights as well as the obligations of the insured in that position."

Id. (footnote omitted).

It is clear, therefore, that the primary insurer owes an excess insurer the same duty to settle claims within policy limits as it owes to an insured. In considering the manner in which it will respond to a policy limits settlement offer, the primary insurer may consider its own interests, but it must give equal consideration to the interests of the excess insurer as well where excess insurance is involved. *See infra* notes 114-134 and accompanying text.

27. In Firemen's Fund Ins. Co. v. Continental Ins. Co., 308 Md. 315, 318-20, 519 A.2d 202, 204-05 (1987), the court noted:

> Clearly [the insured] would have a cause of action against [the primary insurer] for bad faith refusal to settle a claim within policy limits if it did not have excess liability coverage. . . .
>
> Glen Falls overlooks, however, that its insured, Publication Press, would have a cause of action against it if Publication Press had no excess liability policy. If such an action were successful, Glen Falls would have to pay its insured's portion of the judgment. Thus, if the excess carrier has no cause of action against the primary, the primary insurance company retains whatever it would have to pay to an insured with no excess liability coverage. Under these circumstances, Glen Falls would be unjustly enriched if it wrongfully failed to settle the suit against Publication Press within the primary policy limits.

Id. (citations omitted).

the breach of the implied covenant of good faith and fair dealing imposed upon liability insurers for violating their duty to settle claims within policy limits, first arose in the early part of the twentieth century to combat and control abuses practiced by liability insurers in exercising their right to control the defense of third-party claims.[28] Liability policies are explicit and absolute in the control they give to insurers to settle or compromise claims asserted against their insureds. In order to exert this control, the insurer need only assume or agree to assume the insured's defense by acknowledging an obligation to defend under the policy. A typical policy provision which grants liability insurers the exclusive right to control the defense of a third-party claim, in part, reads as follows:

> We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. . . . We will have the right and duty to defend any "suit" seeking those damages.
>
> (2) *We may investigate and settle any "claim" or "suit" at our discretion* . . . [emphasis added].[29]

The contractual right of liability insurers to settle cases, quite obviously, is one which is frequently exercised. It is common knowledge that the vast majority of claims do not mature into lawsuits, and the vast majority of lawsuits are settled before they ever reach trial. This right is also one which is necessary to the orderly and economical defense of claims asserted against an insurer's insureds. It has been argued that if liability insurers did not assume exclusive control over the defense and settlement of claims against their insureds, liability insurance would not be affordable, because insureds in every instance would require that their claims be settled within policy limits if the opportunity existed to do so.[30]

In exercising the necessary, yet very formidable, power to settle claims and lawsuits, however, liability insurers have not contractually assumed any corollary duty to settle such claims and lawsuits where to do so would protect the insured from an obvious danger of a judgment in excess of policy limits.[31] Liability insurers, who draft their own contracts of insurance, have not assumed any such duty because they apparently believe it is not in their best interests to do so.[32]

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28. One such abuse, for example, consisted of liability insurers requiring insureds to contribute to the settlement as a condition of accepting a policy limits offer. *See* S. ASHLEY, *supra* note 16, § 2:02, at 2-3.

29. *See, e.g.*, KEETON & WIDISS, *supra* note 12, app. J(1), at 1149.

30. *See* Comment, *In California Excess Liability Cases, Does "Bad Faith" in Law Equal "Strict Liability" in Practice?*, 4 PEPPERDINE L. REV. 115, 119 (1976).

31. Comment, *Approaching Strict Liability of Insurer for Refusing to Settle Within Policy Limits*, 47 NEB. L. REV. 705, 707 (1968).

32. Provided that unambiguous contractual provisions do not contravene public policy, insurers are virtually free to insert any provisions in contracts of insurance that

Thus, under the express contractual language adopted by standard liability policies, an insurer can completely ignore the insured who demands that the insurer accept a policy limits settlement offer,[33] even though the insured has a great deal to lose and the insurer has little to gain by declining to settle. Similarly, the insurer can safely ignore the insured who, for reasons of his own, demands that the insurer refuse to settle a claim and take a particular case to trial.[34]

The facts of *Fowler*, even though the case itself is a rather blatant example of third-party bad faith, serve to illustrate the conflict which arises between the interests of the insured and those of the insurer when the insurer refuses to settle a case within policy limits. In *Fowler*, the insured bought an employer's liability policy with policy limits of $10,000 to protect him from the third-party claims of others, including claims made by employees. Subsequently, one of the insured's employees was injured in a fall from a ladder. The evidence tended to support a showing of negligence on the part of the insured in furnishing an unsafe and defective ladder to the employer for use during the course of employment. The injured employee offered to settle his claim against the insured for $2,813.80, but when this offer was refused by the liability insurer, suit was filed, in which judgment was rendered in favor of the employee and against the insured for $18,102.50. Thereafter, in order to avert an appeal, the injured employee accepted $15,000.00 in full satisfaction of the judgment, with the liability insurer paying its $10,000.00 policy limits and the insured employer paying the difference of $5,000.00. The insured thereafter filed suit against his own liability insurer for bad faith in an effort to recover his $5,000.00 contribution toward discharging the judgment.

In *Fowler*, the insurer, having assumed the defense of the claim asserted against the insured, used its contractual power and right to settle cases to reject the plaintiff's offer to settle his claim against the insured for $2,813.80. In doing so, the insurer obviously sought to advance its own interest. By rejecting the offer of settlement, the insurer hoped to resolve the claim for less than $2,813.80.[35] By rejecting the

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they deem necessary. *Infra* notes 312-314. The fact that liability insurers have not attempted to define their duty to settle or the remedies available upon breach can be rationalized only on the basis that such insurers do not deem it in their best interests to do so.

33. *See, e.g.*, Mitchum v. Hudgens, 533 So. 2d 194 (Ala. 1988); Eklund v. Safeco Ins. Co. of Am., 41 Colo. App. 96, 579 P.2d 1185 (1978); Peterson v. American Family Mut. Ins. Co., 180 Minn. 482, 160 N.W.2d 541 (1968).

34. Some liability policies, particularly those which insure professionals against third-party claims, now give the insured the right to approve a settlement agreement. S. ASHLEY, *supra* note 16, § 3:24, at 3-59. Where the insured urges the rejection of the settlement offer because he fears that settlement may adversely affect his professional reputation, he cannot later be heard to complain if an excess judgment is entered. *See, e.g.*, Spindle v. Chubb/Pacific Indem. Group, 89 Cal. App. 3d 706, 152 Cal. Rptr. 776 (1979).

35. The insurer in *Fowler* indicated a willingness to settle the claim for the rather meager sum of $500.00. *Fowler*, 390 P.2d at 603.

offer, however, the insurer unnecessarily caused a judgment to be entered against the insured which was $8,102.50 in excess of policy limits. The issue on appeal, therefore, dealt with whether the insurer should be held liable for the excess judgment. Indeed, given the fact that insureds who have purchased liability insurance, such as the insured in *Fowler,* have no contractual right or power to require their insurers to accept offers of settlement within policy limits, the thrust of "third-party bad faith" case law in this century has been to define those situations in which a liability insurer will be held liable for a resulting excess judgment.

The absence of any explicit promise by liability insurers to protect the insured from judgments in excess of policy limits explains why insureds in early cases were unable to hold insurers liable under a breach of contract theory whenever an insurer's failure or refusal to settle resulted in a judgment in excess of policy limits.[36] Thus, in *Rumford Falls Paper Co. v. Fidelity and Casualty Co.,*[37] where an excess judgment of $2,500.00 was entered against an insured with policy limits of $1,500.00 after the insurer rejected a $1000.00 offer of settlement, the court held:

> The defendant company nowhere agrees to settle any judgment, or to indemnify the assured against any judgment that may be recovered against it, beyond the specified limits of $1,500 and the cost of defending the suit. This is clearly the contract which the parties made, and the one which they are entitled to have enforced according to its terms.[38]

Because of the obvious inequities in a rule of law which granted absolute immunity to liability insurers beyond the limits of the policy when they unreasonably refused to accept an offer of settlement within policy limits, other theories of liability soon emerged which yielded better results from the standpoint of the insured. Indeed, actions brought against insurers for negligence,[39] fraud[40] and breach of fiduciary duty[41] enjoyed some initial success. It remained, however, for

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36. *See* Neuberger v. Preferred Accident Ins. Co., 18 Ala. App. 72, 89 So. 90, *cert. denied,* 89 So. 924 (1921); Kingan & Co. v. Maryland Casualty Co., 65 Ind. App. 301, 115 N.E. 348 (1917); Fidelity & Casualty Co. v. Stewart Dry Goods Co., 208 Ky. 429, 271 S.W. 444 (1925); New Orleans & C. R. Co. v. Maryland Casualty Co., 114 La. 153, 38 So. 89 (1905); Long v. Union Indem. Co., 277 Mass. 428, 178 N.E. 737 (1931); Georgia Casualty Co. v. Cotton Mills Prod. Co., 159 Miss. 396, 132 So. 73 (1931); Mears Mining Co. v. Maryland Casualty Co., 162 Mo. App. 178, 144 S.W. 883 (1912); Streat Coal Co. v. Frankfort Gen. Ins., 237 N.Y. 60, 142 N.E. 352 (1923); C. Schmidt & Sons Brewing Co. v. Travelers Ins. Co., 244 Pa. 286, 20 A. 653 (1914); Wisconsin Zinc Co. v. Fidelity & Deposit Co., 162 Wis. 39, 155 N.W. 1081 (1916).

37. 92 Me. 574, 43 A. 503 (1899).

38. *Id.* at 588, 43 A. at 506.

39. *See* Attleboro Mfg. Co. v. Frankfort Marine, Accident & Plate Glass Ins. Co., 240 F. 573 (1st Cir. 1917).

40. *See* Tiger River Pine Co. v. Maryland Casualty Co., 163 S.C. 229, 161 S.E. 491 (1931).

41. *Id.*

a New York court in *Brassil v. Maryland Casualty Co.*[42] and the Wisconsin Supreme Court in *Hilker v. Western Auto Insurance Co.*[43] to establish that an insurer's breach of its duty to settle claims within the limits of the policy constitutes a breach of the implied covenant of good faith and fair dealing. Thus, in *Hilker*, the court engaged in the following, often-quoted analysis:

> In express terms the contract imposes no duty at all a breach of which makes the insurer liable to the insured for a failure to settle or compromise a claim. However, all courts are agreed that the insurer does owe to the insured some duty in this respect. This duty is implied as a correlative duty growing out of certain rights and privileges which the contract confers upon the insurer. By the terms of this contract the absolute control of the defense of such actions is turned over to the insurer, and the insured is excluded from any interference in any negotiations for settlement or legal procedure. It is generally understood that these are rights and privileges which it is necessary for the insurer to have in order to justify or enable it to assume the obligations which it does in the contract of insurance. So long as the recovery does not exceed the limits of the insurance, the question of whether the claim be compromised or settled, or the manner in which it shall be defended, is a matter of no concern to the insured. However, where an injury occurs for which a recovery may be had in a sum exceeding the amount of the insurance, the interest of the insured becomes one of concern to him. At this point a duty on the part of the insurer to the insured arises. It arises because the insured has bartered to the insurance company all of the rights possessed by him to enable him to discover the extent of the injury and to protect himself as best he can from the consequences of the injury.[44]

The specific cause of action for third-party bad faith established by *Hilker* is now recognized in some form in every American jurisdiction but one.[45] However, the elements of the third-party bad faith cause of action, including methods of determining whether an insurer has violated its duty to settle, differ from jurisdiction to jurisdiction. The following section of this article examines the various elements as enunciated by the courts, with particular emphasis on the standard for determining when an insurer has violated its duty to settle as adopted by *Fowler*.

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42. 210 N.Y. 235, 104 N.E. 622 (1914).
43. 204 Wis. 1, 235 N.W. 413 (1931).
44. 235 N.W. at 414.
45. S. ASHLEY, *supra* note 16, § 2:04, at 2-7. Mississippi alone appears to deny any cause of action absent conduct equivalent to fraud. *See* Nichols v. State Farm Mut. Auto. Ins. Co., 345 F. Supp. 212, 216 (N.D. Miss. 1972).

III. ELEMENTS OF THE THIRD-PARTY BAD FAITH CAUSE OF ACTION

It is often said that the elements which the insured must ordinarily plead and prove in order to establish a third-party bad faith cause of action against a liability insurer are the following: (1) assumption of the defense by the insurer; (2) an opportunity on the part of the insurer to settle within policy limits; (3) a "bad faith" refusal to settle on the part of the insurer; and (4) a resulting judgment against the insured in excess of policy limits.[46]

The above "elements" of the third-party action, however, are not entirely without controversy or exception. As will be seen below, for example, it may not be necessary for the insurer to assume the defense before it can be found liable for violating its duty to settle. A liability insurer, moreover, may be found liable for third-party bad faith even if it never receives a settlement offer from the third-party claimant. The standards for determining whether a liability insurer has acted in bad faith vary from simple negligence to conduct which is equivalent to fraud. Finally, as will be seen below, it is possible for an insurer to incur liability for failure to settle within policy limits even though the insured has no assets with which to pay the judgment.

A. *Accepting defense of the claim—must the liability insurer actually assume the defense before it can be held liable for rejecting a settlement offer?*

Ordinarily, an insurer must assume the defense of a claim before it has any obligation to settle claims within policy limits.[47] Unless the insurer actually undertakes the defense of a claim, it has not reserved unto itself the exclusive right to settle the claim, which is the basis upon which the duty to consider the insured's interests arises.[48]

There is one situation, however, where a liability insurer may be held liable for a judgment in excess of policy limits even though the defense of a third-party claim was never undertaken or assumed by the insurer. Frequently, a settlement offer within policy limits is received by a liability insurer who has erroneously determined that it has no obligation to defend its insured.[49] After declining to undertake

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46. *See* KORNBLUM, *supra* note 16, §§ 7:39 & 7:57.6, at 7-11 to 7-18. *See also* W. SHERNOFF, *supra* note 3, § 3.05.

47. *See* 14 COUCH ON INSURANCE 2D § 51:3, at 381-85 (rev. ed. 1982) and A. WINDT, *supra* note 16, § 5.06, at 196.

48. *See supra* note 46.

49. Wyoming adheres to the general rule that an insurer's duty to defend is broader than its duty to indemnify. *See* Aetna Ins. Co. v. Lythgoe, 618 P.2d 1057, 1061 (Wyo. 1980). Because an insurer must defend an action if there is the *potential* of liability under its policy, it has a duty to defend actions that may not ultimately result in an obligation to indemnify. *Id.* at 1061-62. In other words, just because a liability insurer may ultimately establish that a third-party claim which it was called upon to defend did not fall within the coverage of the policy does not mean it did not have a duty to defend the very same claim. The failure on the part of many liability insurers

the defense of the claim asserted against its insured, the insurer will usually reject offers of settlement because of its belief in the absence of coverage for the loss. Subsequently, a judgment may be entered against the insured in excess of policy limits,[50] or, alternatively, the insured may enter into a settlement agreement with the third-party claimant in excess of policy limits.[51] Does the liability insurer then become liable for the excess judgment even though it believed in good faith that it had no duty to defend?

The majority of courts who have considered this issue appear to have held that the insurer is liable for the entire judgment.[52] The leading case is *Comunale v. Traders & Gen. Ins. Co.*,[53] where the California Supreme Court held that an insurer who rejects a settlement offer because it has determined that it has no duty to defend does so at its own peril:

> We do not agree with the cases that hold there is no liability in excess of the policy limits where the insurer, believing there is no coverage, wrongfully refuses to defend and without justification refuses to settle the claim. [citations omitted] An insurer who denies coverage does so as its own risk, and, although its position may not have been entirely groundless, if the denial is found to be wrongful it is liable for the full amount which will compensate

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to differentiate between their duty to defend and their duty to indemnify has too often led to a decision not to defend because of a belief that coverage did not exist.

50. If the insured is not being defended, he may allow a default judgment to be entered against him if he does not have the financial resources to hire his own counsel. The authorities are split, however, on the issue of whether the insured must hire an attorney to defend himself against the third-party claim if he has the financial resources to do so. Some decisions indicate that the insured's duty to mitigate his damages requires that he defend himself. A. WINDT, *supra* note 16, § 4.16, at 132. A majority of courts appear to disagree. *Id.*

Counsel should note that if the insurer wrongfully refuses to defend, however, and the insured does not have the financial resources to defend himself, the insurer may be held liable for a default judgment in excess of policy limits even though a policy limits settlement offer is never received by the insurer. In such cases, the insurer should be held liable for the excess judgment because the insured was not financially able to prevent the entry of the default judgment. In this instance, the insurer's wrongful refusal to defend was the proximate cause of the insured's damage. *See* A. WINDT, *supra* note 16, § 4.34, at 169.

51. *See infra* notes 253-267 and accompanying text.

52. It should be noted that if the insurer wrongfully refuses to defend, but the insurer did not have the opportunity to accept an offer of settlement within policy limits, the insurer's liability will generally not exceed its policy limits, at least in situations where the insured was able to defend himself. As stated by Windt:

> The liability of the insurer is ordinarily not increased beyond the policy limits because it wrongfully refuses to defend the insured. In most such cases, there is no basis for concluding that a judgment would have been for a lesser amount had the defense been conducted by counsel provided by the insurer. As a result, it cannot be said that the detriment suffered by the insured as a result of a judgment in excess of the policy limits was proximately caused by the insurer's refusal to defend.

A. WINDT, *supra* note 16, § 4.34, at 210.

53. 50 Cal. 2d 654, 328 P.2d 198 (1958).

the insured for all the detriment caused by the insurer's breach of the express and implied obligations of the contract. *Certainly an insurer who not only rejected a reasonable offer of settlement but also wrongfully refuses to defend should be in no better position than if it had assumed the defense and then declined to settle. The insurer should not be permitted to profit by its own wrong.*[54]

Although there are a few cases which hold that the insurer's duty to settle does not, under any circumstances, arise unless the insurer has actually assumed the defense of a third-party action,[55] recent decisions appear to have followed the lead of the *Comunale* decision.[56] Yet other cases, exemplified by the New York decision of *Gordon v. Nationwide Mutual Insurance Co.*,[57] impose liability upon the insurer for an excess judgment only if the original insurer's decision not to undertake the defense of the claim was itself made in bad faith. As the Eighth Circuit Court of Appeals pointed out in a case interpreting South Dakota law,[58] however, as long as the judgment in excess of policy limits was a foreseeable result of the insurer's wrongful refusal to defend, the good faith or bad faith of the insurer is not at issue. As stated by the court:

> There exists an important difference between the liability of an insurer who performs his obligation to defend the insured but fails to exercise good faith in settling within the policy limits and an insurer who breaches his contract and who then rejects a reasonable offer to settle.
>
> When it is alleged that the sole breach of duty by the carrier is its refusal to settle within the policy limits, good faith becomes the central issue to be decided. On the other hand, good faith is not relevant to an insurer's wrongful breach of its contract to provide coverage. A breach of contract is never justified simply because the offending party in good faith believed he was entitled to refuse performance. When a breach occurs the basic question then concerns the proper measure of damages which flow from

54. *Id.* at 201-02 (emphasis added).

55. *E.g.*, Fidelity & Casualty Co. of N.Y. v. Gault, 196 F.2d 329 (5th Cir. 1952); Landie v. Century Indem. Co., 390 S.W.2d 558 (Mo. Ct. App. 1965); Gordon v. Nationwide Mut. Ins. Co., 30 N.Y.2d 427, 285 N.E.2d 849, 334 N.Y.S.2d 601 (1972).

56. *E.g.*, Luke v. American Family Mut. Ins. Co., 476 F.2d 1015 (8th Cir. 1973), *cert. denied*, 414 U.S. 856 (1973); Blakely v. American Employers' Ins. Co., 424 F.2d 728 (5th Cir. 1970); Seward v. State Farm Mut. Auto. Ins. Co., 392 F.2d 723 (5th Cir. 1968); Western Casualty & Sur. Co. v. Herman, 405 F.2d 121 (8th Cir. 1968); Buntin v. Continental Ins. Co., 525 F. Supp. 1077 (D.V.I. 1981); Alexander Underwriters Gen. Agency, Inc. v. Lovett, 177 Ga. App. 262, 339 S.E.2d 368 (1985); Jenkins v. General Accident, Fire & Life Assurance Corp., 349 Mass. 699, 212 N.E.2d 464 (1965); Lujan v. Gonzalez, 84 N.M. 229, 501 P.2d 673 (N.M. Ct. App.), *cert. denied*, 501 P.2d 663 (1972); Prince v. Universal Underwriters Ins. Co., 143 N.W.2d 708 (N.D. 1966).

57. 30 N.Y.2d 427, 285 N.E.2d 849, 334 N.Y.S.2d 601 (1972).

58. Luke v. American Family Mut. Ins. Co., 476 F.2d 1015 (8th Cir. 1973).

the breach.[59]

What is the significance of the above discussion to the Wyoming practitioner? If circumstances otherwise warrant, counsel for the third-party claimant should always submit a policy limits offer to the defendant's liability carrier.[60] Indeed, if it appears as if there may be coverage[61] or the defendant is otherwise judgment-proof, counsel for the third-party claimant should investigate the possibility of accepting an assignment of the insured's cause of action against the insurer in exchange for a covenant not to sue.[62]

Counsel for the insurer in Wyoming should assume that the danger of the insurer being held liable for a judgment in excess of policy limits exists each and every time a decision not to defend is made. Indeed, since the insured's financial status is not often known at such time as the decision not to defend is made,[63] the insurer runs the risk that an insured without the necessary resources to defend himself will simply allow the claimant to take a default judgment against him. To minimize this danger, third-party claims should be defended under a reservation of rights if there is the slightest chance that coverage may be found to exist.[64] There are at least two compelling reasons to do so.

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59. *Id.* at 1020 (footnotes omitted).

60. *Supra* note 52. Presenting the insurer who has refused to defend with an offer to settle within policy limits, as discussed above, may provide the insured or the third-party claimant with the basis to impose a judgment in excess of policy limits upon the insurer. Unless the insurer had the opportunity to prevent the excess judgment from being entered, or unless the insurer caused the insured to incur the excess liability in some other way, such as where a default judgment was entered because the insured could not afford to hire his own attorney, the insurer's liability will generally be restricted to its policy limits.

61. Counsel should note that where the settlement offer is rejected by the insurer who has wrongfully refused to defend, the plaintiff in a subsequent bad faith action does not have to prove that the rejection of the settlement offer was in bad faith in order to recover an excess judgment from the insurer. Rather, he must prove only that the third-party claim fell within the coverage of the policy. *See* Steil v. Florida Physicians' Ins. Reciprocal, 448 So. 2d 589, 592 (Fla. Dist. Ct. App. 1984), where the court rejected the argument that the plaintiff's burden should only have to show the "potential" for coverage in order to recover on the theory that the insurer breaches its duty to defend if there was a possibility of coverage. Instead, the court held that coverage in fact must be established.

In spite of some limited authority to the contrary, counsel representing the insured or his assignee should argue that where the insurer refuses to defend, and thus does not take advantage of a policy limits settlement offer, a resulting judgment in excess of policy limits was proximately caused by the insured's breach of its duty to defend, not by its duty to indemnify. Whereas the insurer's breach of its duty to indemnify can be established only by proving coverage under the policy, the breach of the duty to defend may be established by showing only a potential for coverage under the policy. *See* Alm v. Hartford Fire Ins. Co., 369 P.2d 216 (Wyo. 1962). Arguably, therefore, the proper standard for determining whether the insurer is liable for the judgment in excess of policy limits is whether there was a potential for coverage, not coverage in fact.

62. *See infra* notes 217-232 and accompanying text.

63. *Supra* note 50.

64. A letter from the insurer notifying the insured that (1) the insurer maintains the third-party's claim may not be covered under the policy and (2) the insurer does

First, as noted by the Eighth Circuit in the South Dakota case, in order to prevail in an action seeking to recover the entire excess judgment against the insurer who rejected a reasonable settlement opportunity because it wrongfully refused to defend, the insured or third-party claimant need only establish that coverage existed or, in other words, that the insurer breached its duty to defend.[65] On the other hand, if the insured or third-party claimant seeks to hold the insurer liable for refusing to accept a policy limits offer where the insurer has undertaken the defense of the claim, an unreasonable or "bad faith" refusal to settle must be established.[66] Second, once the insurer's decision not to defend has been made, the insurer may not have a chance to reevaluate its decision at such time as it receives a policy limits offer. Once it is determined that the insurer has breached the contract by erroneously refusing to defend, the insured cannot be compelled to accept the insurer's belated offer to defend.[67]

Finally, the insured who is informed that his liability insurer will not defend him against the claims of a third party should attempt to interest the third-party claimant in accepting an assignment of his potential cause of action against the insurer in exchange for a covenant not to sue.[68] In those situations where the insured is not financially able to satisfy a judgment in excess of policy limits, the third-party claimant will likely be interested in entering into such an assignment. The insured will then be protected from any further liability as a result of the suit filed against him, and the third-party claimant, who may have been faced with the difficult task of executing upon a judgment-proof insured, has the opportunity of collecting the judgment from a solvent defendant if it can be established that coverage did in fact exist.

B. Opportunity to settle—can a liability insurer be held liable for a judgment in excess of policy limits if it does not receive a settlement offer within policy limits?

It is often said that a liability insurer cannot be held liable for a judgment in excess of policy limits in a third-party bad faith action unless the third-party claimant actually extended a settlement offer

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not waive its right to dispute such coverage by defending the insured constitutes a reservation of rights. "[P]rudence almost always dictates that the insurer defend the insured and preserve its right to dispute coverage by sending the insured a reservation of rights." S. ASHLEY, *supra* note 16, § 4:13, at 4-33.

65. *Supra* note 59.

66. *Id.* Ordinarily, it is an easier task to establish coverage, which is generally a question of law involving the construction of an insurance contract, than it is to prove that the insurer acted in bad faith in refusing to settle a third-party claim.

67. Hartford Accident & Indem. Co., 33 Cal. App. 3d 26, 108 Cal. Rptr. 737 (1973). "[A]n unwarranted refusal to defend deprives the insurer of its rights under the policy. The insurer may not later insist on controlling the insured's defense." S. ASHLEY, *supra* note 16, § 4:08, at 4-15.

68. *See infra* notes 272-273 and accompanying text.

within policy limits to the insured or the insured's liability carrier.[69] The basis for such a rule is that a conflict of interest between the insured and his liability carrier can develop only when the third-party claimant communicates an offer to settle the claim within policy limits.[70] If an offer to settle is not received by the insurer, in other words, bad faith cannot exist because the conflict which requires the insurer to give consideration to the insured's interests never arises.[71]

As pointed out by one authority, however, the notion that a conflict of interest between the insured and his liability carrier arises only after the insurer is provided with an offer of settlement within policy limits is fallacious:

> In fact, however, a conflict of interest between the insurer and insured, at least with regard to settlement, arises as soon as a third party makes a claim against the insured which exceeds the policy. The insured's interests demand that the insurer seek out the third party and attempt to settle the claim within the policy limits. The insurer's interests call for the insurer to avoid settlement discussions with the third party because a policy limits settlement offer might force the insurer to pay its full policy limits, while litigating the case holds out the possibility, however remote, of a defense verdict and escape from any liability beyond costs and attorney's fees. Thus, the Merritt court mistakenly concluded that the insurer's and insured's interests remain parallel and do not conflict until the third party makes a policy limits settlement offer.[72]

In line with the view that a conflict of interest between insurer and insured arises as soon as a claim is made against the insured in excess of policy limits, a majority of jurisdictions which have considered the issue now recognize that an insurer has an affirmative duty to initiate settlement negotiations with the third-party claimant,[73] at

69. SHERNOFF, *supra* note 3, § 3.05[2][a]. This rule applies, of course, only when the third-party claimant is seeking damages in excess of the policy limits. *See infra* notes 76-77.

70. Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 110 Cal. Rptr. 511 (1973).

71. *Id.*

72. S. ASHLEY, *supra* note 16, § 3:18, at 3-39.

73. *E.g.*, Texoma AG-Prods., Inc. v. Hartford Accident & Indem. Co., 755 F.2d 445 (5th Cir. 1985); Lienemann v. State Farm Mut. Auto Fire & Casualty Co., 540 F.2d 333 (8th Cir. 1976); Daniels v. Horace Mann Mut. Ins. Co., 422 F.2d 87 (4th Cir. 1970); Abernathy v. Utica Mut. Ins. Co., 373 F.2d 565 (4th Cir. 1967); Puritan Ins. Co. v. Canadian Universal Ins. Co., 586 F. Supp. 84 (E.D. Pa. 1984); Tannerfors v. American Fidelity Fire Ins. Co., 397 F. Supp. 141 (D.N.J. 1975), *aff'd without opinion*, 535 F.2d 1247 (3d Cir. 1976); Self v. Allstate Ins. Co., 345 F. Supp. 191 (M.D. Fla. 1972); Kavanaugh v. Interstate Fire & Casualty Co., 35 Ill. App. 3d 350, 342 N.E.2d 116 (1975); Rector v. Husted, 214 Kan. 230, 519 P.2d 634 (1974); Commercial Union Ins. Co. v. Liberty Mut. Ins. Co., 426 Mich. 127, 393 N.W.2d 161 (1986); Roberts v. Personal Serv. Ins. Co., 12 Ohio App. 3d 92, 467 N.E.2d 257 (1983); Maine Bonding & Casualty Co. v. Centennial Ins. Co., 298 Or. 514, 693 P.2d 1296 (1985); Johnson v. American Family Mut. Ins. Co., 93 Wis. 2d 633, 287 N.W.2d 729 (1980).

least where it is probable that the insured is liable to the third-party claimant.[74] In a leading case, the New Jersey Supreme Court explained the duty as follows:

> We, too, hold 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 or as to the ability and willingness of the insured to pay any excess required for settlement 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.[75]

Notice that the rule which requires the insurer to affirmatively initiate settlement negotiations applies only to those claims where the prayer or request for damages exceeds policy limits. As stated by the court in *Hilker v. Western Auto Insurance Co.*, "[s]o long as the recovery does not exceed the limits of the insurance, the question of whether the claim be compromised or settled, or the manner in which it shall be defensed, is a matter of no concern to the insured."[76] If the amount in dispute does not exceed the policy limits, there is no conflict of interest between the insurer and insured and, therefore, no duty to settle exists.[77]

On the other hand, it goes without saying that if the insurer receives a settlement offer in excess of policy limits, it has an affirmative duty to counteroffer or seek to lower the claimant's offer of settlement to an amount which is within policy limits.[78] If the insurer is unsuc-

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74. *E.g.*, Covill v. Phillips, 452 F. Supp. 224 (D. Kan. 1978); Burnham v. Commercial Casualty Ins. Co., 10 Wash. 2d 624, 117 P.2d 647 (1941); Fulton v. Woodward, 26 Ariz. App. 17, 545 P.2d 979 (1976); Henke v. Iowa Home Mut. Casualty Co., 250 Iowa 1123, 97 N.W.2d 168 (1959); and Spray v. Continental Casualty Co., 86 Or. App. 156, 739 P.2d 40 (1987).

75. Rova Farms Resort, Inc. v. Investors Ins. Co. of Am., 65 N.J. 474, 323 A.2d 495, 507 (1974) (citation omitted).

76. *Hilker*, 235 N.W. at 413.

77. It should also be noted that the insurer has an affirmative duty to disclose its policy limits to counsel for the third party. *E.g.*, Davis v. Nationwide Mut. Fire Ins. Co., 370 So. 2d 1162 (Fla. Dist. Ct. App. 1979). If the insurer fails to do so upon request, the insurer may not rely on the fact that the claimant's offer of settlement exceeds the policy limits as a defense to its duty to settle. *Id.* at 1163.

78. "[W]hen the claimant has offered to settle for an amount in excess of the policy limits, some courts have held that the insurer at the very least has the affirmative duty to seek a reduction of the settlement demand to an amount at or within the policy limits." SHERNOFF, *supra* note 3, § 3.05[2][b], at 3-28.3. *See also* Rector v. Husted, 214 Kan. 230, 519 P.2d 634 (1974). (Even if insurer has no duty to accept an offer because it is too high, insurer must nevertheless make a good faith attempt at negotiating a settlement and may be subject to liability if its counteroffer is unreason-

cessful, it then has the equally important duty of reporting its progress, or lack thereof, to the insured so that the insured may determine for himself if he wants to contribute to the insurer's policy limits in order to settle the claim.[79]

Were the issue to come before it, there is little reason to believe that the Wyoming Supreme Court would not join the majority of jurisdictions which have imposed an affirmative duty upon the liability insurer to initiate settlement negotiations, the only real issue being whether Wyoming would align itself with jurisdictions which impose the duty outright or with jurisdictions which impose the duty only where investigation shows a likelihood that the insured is liable for damages in excess of policy limits.[80] Indeed, one of the provisions of the Wyoming Unfair Claims Settlement Practices Act[81] which prohibits the practice of "[n]ot attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear"[82] could be argued in support of such a duty. While there is little indication that the legislature intended the provisions of the Wyoming Unfair Claims Settlement Practices Act to create a private right of action in favor of the insured,[83] the above provision arguably defines part of the insurer's duty toward the insured under the implied covenant of good faith and fair dealing.[84] An insurer can hardly effectuate an equitable settlement on behalf of its insured in situations where liability is reasonably clear without some contact with the third-party claimant's counsel.

In any event, counsel for insurers transacting the business of insurance in Wyoming should assume that insurers have an affirmative duty to initiate settlement negotiations in Wyoming when claim is first made against one of their insureds, particularly where the evaluation of the claim establishes the likelihood that the insured will be found liable to the third-party claimant and the claimant's damages will likely exceed policy limits.[85] To satisfy this duty, counsel for the insurer, after investigating the claim, should contact counsel for the

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ably low.)

79. *E.g.*, Kooyman v. Farm Bureau Mut. Ins. Co., 315 N.W.2d 30 (Iowa 1982). The insurer should make every effort to make certain the insured understands the consequences of rejecting a policy limits settlement offer.

80. *Supra* notes 73-74.

81. WYO. STAT. § 26-13-124 (1983).

82. *Id.* § 26-13-124(a)(vi).

83. The Wyoming act is patterned after model legislation adopted by the National Association of Insurance Commissioners. As stated in S. ASHLEY, *supra* note 16, § 9:03, at 9-6: "It seems clear that the National Association of Insurance Commissioners did not expect that its model act would expand the cause of action open to insureds and third parties in bad faith cases." Most decisions which have considered the issue have held that state unfair settlement practices acts do not give rise to a private right of action on the part of first-party insureds. For a collection of cases, *see* S. ASHLEY, *supra* note 16, § 9:03, at 9-8 n.13-14.

84. *See* KORNBLUM, *supra* note 16, § 7:99, at 7-30. *See also* WYOMING CIVIL PATTERN JURY INSTRUCTIONS § 2.09 (rev. ed. Oct., 1988).

85. *Supra* note 73.

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third-party claimant and ascertain the claimant's requirements for settling the case.[86] If the settlement requirements of the claimant are unrealistically high, counsel for the insurer still has an obligation in certain cases to attempt settlement within policy limits. Indeed, the insurer may be found liable for bad faith in some cases if it makes no further efforts at settlement or even if its counteroffer is unreasonably low.[87] The insurer, moreover, should not categorically refuse to negotiate the settlement of any case, even where it is obvious that the two parties have substantially different ideas about the worth of the case.[88] Finally, all offers made and received by the insurer's counsel should be promptly communicated in writing to the insured.[89]

On their face, it would appear that the above rules of law are the product of little more than common sense. In the author's experience, however, the practical suggestions set forth above are known more for their breach than their adherence. Indeed, one author has recently advocated in a national publication that all civil cases be tried.[90] This particular author begins his article with the following statements:

> I hate settlements. If I had my druthers, I would take all my cases to trial, and beyond if necessary. I consider settlements and the drive toward settlement that infects the courts and trial bar as *the* problem with the civil justice system, at least in Central Pennsylvania where I practice.
>
> Lest the reader conclude that a fool has taken up his pen, let me state quickly that I have settled many cases and doubtless will settle many more. In a given case a settlement before trial *is* the proper defense goal. Nevertheless, I oppose settlements in virtually all my cases and view the great impetus toward settlement in each case filed in state and federal court as wrong-headed and detrimental to the public, to the civil justice system, and to trial lawyers themselves.[91]

The philosophy espoused by the above author directly contradicts much of the law that has evolved in third-party insurance cases and

86. *Supra* note 72.
87. *Supra* note 78.
88. Insurance Co. of N. Am. v. Medical Protective Co., 570 F. Supp. 964 (D. Kan. 1983).
89. *See infra* notes 200-207 and accompanying text.
90. Rubendall, *I Hate Settlements: A Defense Lawyer's Lament*, FOR THE DEF. 11 (Feb. 1990).
91. *Id.* (italics as in the original). The author's thesis is that (1) settlements encourage other lawsuits to be filed; (2) settlements make the filing of other lawsuits against the same entity more likely; (3) settlements prevent our best judicial minds from performing the function they were elected or appointed to perform; (4) settlements reward inadequate preparation and sloppy practice; (5) settlements encourage plaintiff's attorneys to accept marginal cases and file suit; (6) settlements undermine the valuable innovation of alternate dispute resolution; and (7) settlements ruin "good defense lawyering." *Id.*

virtually ensures that insurance attorneys who specialize in bad faith law will not have to learn another trade.[92]

C. Determining bad faith—what consideration must the liability insurer give to the interests of the insured in responding to settlement offers within policy limits?

As noted by one author,[93] the purpose and goal of judicially developed standards by which the bad faith of liability insurers is to be determined are to provide insurers with the guidance necessary to know when an offer of settlement within policy limits can be rejected without incurring liability for a subsequently obtained judgment against the insured in excess of policy limits. Conversely, such standards should inform insureds as to when they should reject the insurer's defense and settle the action directly with the third-party claimant. Judged by these goals, the courts have not, in adopting various standards to determine when the insurer has acted in bad faith, materially aided either party to the insurance contract.

1. Confusing standards

The standards promulgated by the courts to determine when a liability insurer's conduct rises to the level of third-party "bad faith" are, to say the least, confusing and irreconcilable. Some cases apply a simple negligence standard in determining whether a liability insurer has violated its duty to settle a claim within policy limits.[94] It has been held, however, that the "bad faith" of the insurer is one factor by which a determination of such negligence can be made.[95] Other

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92. The recommendations made by Mr. Rubendall, if followed by counsel hired by a liability insurer to defend its insured against a third-party claim, virtually guarantee a finding of third-party bad faith. He states:

> The second step is far easier. Do not mention settlement to the plaintiff's attorney. Do not make an offer until the plaintiff's attorney has made a demand. My personal preference is to reject the first demand out of hand and to deal only with the second demand. An attitude of breezily looking forward to trial and a complete avoidance of the word 'settlement' are the easiest and most effective ways to convince the plaintiff's attorney that a defense verdict following trial is your one and only aim.

Id. at 14.

93. S. ASHLEY, *supra* note 16, § 2:08, at 2-23.

94. Jurisdictions which have adopted a negligence standard include: Colorado, Farmers Group, Inc. v. Trimble, 691 P.2d 1138 (Colo. 1984); Georgia, Home Ins. Co. v. North River Ins. Co., 192 Ga. App. 551, 385 S.E.2d 736 (1989); Indiana, Bennett v. Slater, 154 Ind. App. 67, 289 N.E.2d 144 (1972); Kansas, Anderson v. Southern Sur. Co., 107 Kan. 375, 191 P. 583 (1920); Massachusetts, Attleboro Mfg. Co. v. Frankfort Marine, Accident & Plate Glass Ins. Co., 240 F. 573 (1st Cir. 1917); New Hampshire, Shaheen v. Preferred Mut. Ins. Co., 668 F. Supp. 716 (D.N.H. 1987); Oregon, Spray v. Continental Casualty Co., 86 Or. App. 156, 739 P.2d 40 (1987); South Carolina, Tyger River Pine Co. v. Maryland Casualty Co., 170 S.C. 286, 170 S.E. 346 (1933); Texas, Ranger County Mut. Ins. Co. v. Guin, 723 S.W.2d 656 (Tex. 1987).

95. *E.g.*, Highway Ins. Underwriters v. Lufkin-Beaumont Motor Coaches, 215 S.W.2d 904 (Tex. Ct. App. 1948).

courts clearly apply a bad faith standard, but have held that evidence of negligence is admissible to support a showing of bad faith.[96] The "bad faith" standard in many jurisdictions consists of a requirement that the insurer give some degree of consideration to the interests of the insured,[97] while in others it requires proof of subjective ill will, dishonest purpose, or some intent to harm the insured.[98] Among the jurisdictions which only require the insurer to give some degree of consideration to the interests of the insured in considering a policy limits offer, there is more confusion and uncertainty. A few older decisions support the view that the insurer may consider its own interests as paramount to those of the insured.[99] Others adhere to the opposite

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96. *E.g.*, Kooyman v. Farm Bureau Mut. Ins. Co., 315 N.W.2d 30 (Iowa 1982); North River Ins. Co. v. St. Paul Fire & Marine Ins. Co., 600 F.2d 721 (8th Cir. 1979); American Fidelity & Casualty Co. v. Greyhound Corp., 258 F.2d 709 (5th Cir. 1958); Kivi v. Nationwide Mut. Ins. Co., 695 F.2d 1285 (11th Cir. 1983); and Fireman's Fund Ins. Co. v. Continental Ins. Co., 308 Md. 315, 519 A.2d 202 (1987). *See also* D. WALL, *supra* note 3, § 3.23, at 58 ("In most jurisdictions, however, evidence of the liability insurer's negligence concerning settlement is admissible as evidence tending to show bad faith and unfair dealing in settlement.").

97. Alabama, American Mut. Liab. Ins. Co. v. Cooper, 61 F.2d 446 (5th Cir. 1932); Arizona, Farmers Ins. Exch. v. Henderson, 82 Ariz. 335, 313 P.2d 404 (1957); Gibbs v. State Farm Mut. Ins. Co., 544 F.2d 423 (9th Cir. 1976); Easley v. State Farm Mut. Auto. Ins. Co., 528 F.2d 558 (5th Cir. 1976); Moore v. Columbia Casualty Co., 174 F. Supp. 566 (S.D. Ill. 1959); Simpson v. Motorists Mut. Ins. Co., 494 F.2d 850 (7th Cir.), *cert. denied*, 419 U.S. 901 (1974); Kooyman v. Farm Bureau Mut. Ins. Co., 315 N.W.2d 30 (Iowa 1982); Carruba v. Transit Casualty Co., 443 F.2d 260 (6th Cir. 1971); Louisiana, Southern Am. Ins. Co. v. Hartford Accident & Indem. Co., 498 So. 2d 280 (La. Ct. App. 1986); Maryland, Fireman's Fund Ins. Co. v. Continental Ins. Co., 308 Md. 315, 519 A.2d 202 (1987); Massachusetts, Murach v. Massachusetts Bonding & Ins. Co., 339 Mass. 184, 158 N.E.2d 338 (1959); Michigan, Commercial Union Ins. Co. v. Liberty Mut. Ins. Co., 137 Mich. App. 381, 357 N.W.2d 861 (1984), *aff'd*, 393 N.W.2d 161 (1986); Minnesota, Riske v. Truck Ins. Exch., 490 F.2d 1079 (8th Cir. 1974); Missouri, United States v. Conservation Chem. Co., 653 F. Supp. 152 (W.D. Mo. 1986); Montana, Fowler v. State Farm Mut. Auto. Ins. Co., 153 Mont. 74, 454 P.2d 76 (1969); Nebraska, Hadenfeldt v. State Farm Mut. Auto. Ins. Co., 195 Neb. 578, 239 N.W.2d 499 (1976); New Jersey, Tannerfors v. American Fidelity Fire Ins. Co., 397 F. Supp. 141 (D.N.J. 1975), *aff'd without opinion*, 535 F.2d 1247 (3d Cir. 1976); New Mexico, Ambassador Ins. Co. v. St. Paul Fire & Marine Ins. Co., 102 N.M. 28, 290 P.2d 1022 (1984); New York, All State Vehicles v. Allstate Ins. Co., 620 F. Supp. 444 (S.D.N.Y. 1985); North Carolina, Coca-Cola Bottling Co. v. Maryland Casualty Co., 325 F. Supp. 204 (W.D.N.C. 1971); Ohio, Roberts v. Personal Serv. Ins. Co., 12 Ohio App. 3d 92, 467 N.E.2d 257 (1983); Oregon, Portland Gen. Elec. Co. v. Pacific Indem. Co., 574 F.2d 469 (9th Cir. 1978); McDowell-Wellman Eng'g Co. v. Hartford Accident & Indem. Co., 711 F.2d 521 (3d Cir. 1983); Rhode Island, Voccio v. Reliance Ins. Co., 703 F.2d 1 (1st Cir. 1983); North River Ins. Co. v. St. Paul Fire & Marine Ins. Co., 600 F.2d 721 (8th Cir. 1979); Tennessee, Brown v. St. Paul Fire & Marine Ins. Co., 604 S.W.2d 863 (Tenn. Ct. App. 1980); Vermont, Myers v. Ambassador Ins. Co., 146 Vt. 552, 508 A.2d 689 (1986); Virginia, Swiatlowski v. State Farm Mut. Auto. Ins. Co., 585 F. Supp. 965 (W.D. Va. 1984); Wisconsin, Mowry v. Badger State Mut. Casualty Co., 129 Wis. 2d 496, 385 N.W.2d 171 (1986).

98. *E.g.*, Valentine v. Liberty Mut. Ins. Co., 620 F.2d 583 (6th Cir. 1980); Martin v. Travelers Indem. Co., 450 F.2d 542 (5th Cir. 1971); Gordon v. Nationwide Mut. Ins. Co., 30 N.Y.2d 427, 285 N.E.2d 849, 334 N.Y.S.2d 601 (1972), *cert. denied*, 410 U.S. 931 (1973); Centennial Ins. Co. v. Liberty Mut. Ins. Co., 62 Ohio St. 2d 221, 404 N.E.2d 759 (1980).

99. Cases which have held that an insurer may give more consideration to its own interests than to those of the insured include: New Orleans & C.R. Co. v. Maryland

rule and hold that the insurer must give paramount consideration to the interests of the insured,[100] while most courts hold that the insurer must accord the interest of its insured the same faithful or "equal" consideration it gives its own interest.[101] Many courts, regardless of whether they have adopted a negligence standard or a bad faith standard, now adhere to the "disregard the limits" test,[102] while still

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Casualty Co., 114 La. 153, 38 So. 89 (1905); Zumwalt v. Utilities Ins. Co., 360 Mo. 362, 228 S.W.2d 750 (1950); Auerbach v. Maryland Casualty Co., 236 N.Y. 247, 140 N.E. 577 (1923); Cleveland Wire Spring Co. v. General Accident, Fire & Life Assurance, 6 Ohio App. 344 (1917); Wisconsin Zinc. Co. v. Fidelity & Deposit Co., 162 Wis. 39, 155 N.W. 1081 (1916).

100. Cases in which the court has held that the insurer must give greater consideration to the interests of the insured than to its own include: United States Fidelity & Guar. Co. v. Evans, 116 Ga. App. 93, 156 S.E.2d 809, *aff'd*, 158 S.E.2d 243 (1967); Hidalgo v. Frenchman's Wharf Apartments, 464 So. 2d 981 (La. Ct. App. 1985); Lieberman v. Employers Ins., 84 N.J. 325, 419 A.2d 417 (1980); Tyger River Pine Co. v. Maryland Casualty Co., 170 S.C. 286, 170 S.E. 346 (1933).

101. Jurisdictions which have held that an insurer has a duty to give equal consideration to the interests of the insured include: Arizona, City of Glendale v. Farmers Ins. Exch., 126 Ariz. 118, 613 P.2d 278 (1980); Arkansas, State Farm Mut. Auto. Ins. Co. v. Jackson, 346 F.2d 484 (8th Cir. 1965); California, Commercial Union Ins. Co. v. Ford Motor Co., 599 F. Supp. 1271 (N.D. Cal. 1984); Colorado, Potomac Ins. Co. v. Wilkins Co., 376 F.2d 425 (10th Cir. 1967); Connecticut, United Servs. Auto. Ass'n v. Glens Falls Ins. Co., 350 F. Supp. 869 (D. Conn. 1972); Florida, Self v. Allstate Ins. Co., 345 F. Supp. 191 (M.D. Fla. 1972); Georgia, Davis v. Cincinnati Ins. Co., 160 Ga. App. 813, 288 S.E.2d 233 (1982); Illinois, Salvator v. Admiral Merchants Motor Freight, 156 Ill. App. 3d 930, 509 N.E.2d 1349 (1987); Iowa, Loudon v. State Farm Mut. Auto. Ins. Co., 360 N.W.2d 575 (Iowa Ct. App. 1984); Kansas, Covill v. Phillips, 452 F. Supp. 224 (D. Kan. 1978); Louisiana, Hernandez v. Employers Mut. Liab. Ins. Co., 346 F.2d 154 (5th Cir. 1965); Maryland, Sobus v. Lumbermens Mut. Casualty Co., 393 F. Supp. 661 (D. Md. 1975), *aff'd*, 532 F.2d 751 (4th Cir. 1976); Minnesota, Short v. Dairyland Ins. Co., 334 N.W.2d 384 (Minn. 1983); Mississippi, Hartford Accident & Indem. Co. v. Foster, 528 So. 2d 255 (Miss. 1988); Montana, Gibson v. Western Fire Ins. Co., 210 Mont. 267, 682 P.2d 725 (1984); New Hampshire, Douglas v. United States Fidelity & Guar. Co., 81 N.H. 371, 127 A. 708 (1924); New Jersey, Board of Educ. v. Lumbermens Mut. Casualty Co., 293 F. Supp. 541 (D.N.J. 1968), *aff'd*, 419 F.2d 837 (3d Cir. 1969); New Mexico, Ambassador Ins. Co. v. St. Paul Fire & Marine Ins. Co., 102 N.M. 28, 690 P.2d 1022 (1984); New York, Peterson v. Allcity Ins. Co., 472 F.2d 71 (2d Cir. 1972); Ohio, Netzley v. Nationwide Mut. Ins. Co., 34 Ohio App. 2d 65, 296 N.E.2d 550 (1971); Oklahoma, State Farm Mut. Ins. Co. v. Skaggs, 251 F.2d 356 (10th Cir. 1957); Oregon, Kriz v. Government Employees Ins. Co., 42 Or. App. 339, 600 P.2d 496 (1979); Pennsylvania, United States Fire Ins. Co. v. Royal Ins. Co., 759 F.2d 306 (3d Cir. 1985); Rhode Island, Voccio v. Reliance Ins. Co., 703 F.2d 1 (1st Cir. 1983); South Dakota, Crabb v. National Indem. Co., 87 S.D. 222, 205 N.W.2d 633 (1973); Tennessee, Coppage v. Firemen's Fund Ins. Co., 379 F.2d 621 (6th Cir. 1967); Utah, Ammerman v. Farmers Ins. Exch., 19 Utah 2d 261, 430 P.2d 576 (1967); Virgin Islands, Cay Drivers, Inc. v. Raven, 627 F. Supp. 453 (D.V.I. 1986), *rev'd on other grounds*, 812 F.2d 866 (3d Cir. 1987); Washington, Tank v. State Farm Fire & Casualty Co., 105 Wash. 2d 381, 715 P.2d 1133 (1986).

102. Jurisdictions in which the "disregard the limits" rule is followed include: Arizona, Clearwater v. State Farm Mut. Auto. Ins. Co., 164 Ariz. 256, 792 P.2d 719 (1990); California, Betts v. Allstate Ins. Co., 154 Cal. App. 3d 688, 201 Cal. Rptr. 528 (1984); Delaware, McNally v. Nationwide Ins. Co., 815 F.2d 254 (3d Cir. 1987); Florida, Florida Physicians Ins. Reciprocal v. Avila, 473 So. 2d 756 (Fla. Dist. Ct. App. 1985); Illinois, Bailey v. Prudence Mut. Casualty Co., 429 F.2d 1388 (7th Cir. 1970); Iowa, Wierck v. Grinnell Mut. Reinsurance Co., 456 N.W.2d 191 (Iowa 1990); Kansas, Insurance Co. of N. Am. v. Medical Protective Co., 570 F. Supp. 964 (D. Kan. 1983); Massachusetts, Murach v. Massachusetts Bonding & Ins. Co., 339 Mass. 184, 158 N.E.2d 338 (1959); Minnesota, Continental Casualty Co. v. Reserve Ins. Co., 307 Minn. 5, 238

others follow a standard based upon the probability of success in defending the insured.[103] Finally, many courts apply both a negligence and a bad faith standard at the same time.[104]

Given the judicially created lack of clarity which permeates this area of the law, the confusion exhibited by the court in such cases as *Davy v. Public National Ins. Co.* should come as no surprise. In that case the court observed:

The refusal to accept a proposed settlement which, under all cir-

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N.W.2d 862 (1976); New Jersey, Tannerfors v. American Fidelity Fire Ins. Co., 397 F. Supp. 141 (D.N.J. 1975), *aff'd without opinion*, 535 F.2d 1247 (3d Cir. 1976); New York, Brockstein v. Nationwide Mut. Ins. Co., 417 F.2d 703 (2d Cir. 1969); Oklahoma, American Fidelity & Casualty Co. v. L.C. Jones Trucking Co., 321 P.2d 685 (Okla. 1958); Oregon, Spray v. Continental Casualty Co., 86 Or. App. 156, 739 P.2d 40 (1987); Pennsylvania, Bell v. Commercial Ins. Co., 280 F.2d 514 (3d Cir. 1960); Rhode Island, Voccio v. Reliance Ins. Co., 703 F.2d 1 (1st Cir. 1983); South Dakota, Helmbolt v. LeMars Mut. Ins. Co., 404 N.W.2d 55 (S.D. 1987); Virgin Islands, Buntin v. Continental Ins. Co., 525 F. Supp. 1077 (D.V.I. 1981); Washington, Hamilton v. State Farm Ins. Co., 83 Wash. 2d 787, 523 P.2d 193 (1974).

103. *E.g.*, California, Hodges v. Standard Accident Ins. Co., 198 Cal. App. 2d 564, 18 Cal. Rptr. 17 (1962); Georgia, Hall v. Preferred Accident Ins. Co., 204 F.2d 844 (5th Cir. 1953); Covill v. Phillips, 452 F. Supp. 224 (D. Kan. 1978); Louisiana, Younger v. Lumbermens Mut. Casualty Co., 174 So. 2d 672 (La. Ct. App.), *cert. denied*, 176 So. 2d 145 (1965); Nebraska, Olson v. Union Fire Ins. Co., 174 Neb. 375, 118 N.W.2d 318 (1962); Michigan, Transport Ins. Co. v. Michigan Mut. Liab. Ins. Co., 496 F.2d 265 (6th Cir. 1974); Minnesota, Larson v. Anchor Casualty Co., 249 Minn. 339, 82 N.W.2d 376 (1957); New York, Mendota Elec. Co. v. New York Indem. Co., 169 Minn. 377, 211 N.W. 317 (1926); New Jersey, Kaudern v. Allstate Ins. Co., 177 F. Supp. 83 (D.N.J. 1967); Oklahoma, Hazelrigg v. American Fidelity & Casualty Co., 228 F.2d 953 (10th Cir. 1955); Pennsylvania, Bell v. Commercial Ins. Co., 280 F.2d 514 (3d Cir. 1960); Tennessee, State Auto. Ins. Co. v. Rowland, 221 Tenn. 421, 427 S.W.2d 30 (1968); Wisconsin, Byrnes v. Phoenix Assurance Co., 303 F.2d 649 (7th Cir. 1962).

104. States which have applied both standards include: Alabama, State Farm Mut. Auto. Ins. Co. v. Hollis, 554 So. 2d 387 (Ala. 1989); Arkansas, McCall v. Southern Farm Bureau Casualty Ins. Co., 255 Ark. 401, 501 S.W.2d 223 (1973); Connecticut, United Servs. Auto. Ass'n v. Glens Falls Ins. Co., 350 F. Supp. 869 (D. Conn. 1972); Delaware, Maguire v. Allstate Ins. Co., 341 F. Supp. 866 (D. Del. 1972); Florida, Florida Physicians Ins. Reciprocal v. Avila, 473 So. 2d 756 (Fla. Dist. Ct. App. 1985); Georgia, McCall v. Allstate Ins. Co., 251 Ga. 869, 310 S.E.2d 513 (1984); Idaho, Openshaw v. Allstate Ins. Co., 94 Idaho 192, 484 P.2d 1032 (1971); Illinois, National Union Fire Ins. Co. v. Continental Illinois, 673 F. Supp. 267 (N.D. Ill. 1987); Indiana, Anderson v. St. Paul Mercury Indem. Co., 340 F.2d 407 (7th Cir. 1965); Kansas, Insurance Co. of N. Am. v. Medical Protective Co., 768 F.2d 315 (10th Cir. 1985); Louisiana, Bohn v. Sentry Ins. Co., 681 F. Supp. 357 (E.D. La. 1988), *aff'd without opinion*, 868 F.2d 1269 (5th Cir. 1989); Michigan, Commercial Union Ins. Co. v. Medical Protective Co., 136 Mich. App. 412, 356 N.W.2d 648 (1984), *aff'd*, 393 N.W.2d 479 (1986); Montana, Gibson v. Western Fire Ins. Co., 210 Mont. 267, 682 P.2d 725 (1984); North Carolina, State Auto. Mut. Ins. Co. v. York, 104 F.2d 730 (4th Cir.), *cert. denied*, 308 U.S. 591 (1939); Ohio, J. Spang Baking Co. v. Trinity Universal Ins. Co., 68 N.E.2d 122 (Ohio Ct. App. 1946); Oklahoma, American Fidelity & Casualty Co. v. L.C. Jones Trucking Co., 321 P.2d 685 (Okla. 1958); Oregon, Maine Bonding & Casualty Co. v. Centennial Ins. Co., 298 Or. 514, 693 P.2d 1296 (1985); Pennsylvania, Clark v. Interstate Nat'l Corp., 486 F. Supp. 145 (E.D. Pa.), *aff'd without opinion*, 636 F.2d 1207 (3d Cir. 1980); South Carolina, Smith v. Maryland Casualty Co., 742 F.2d 167 (4th Cir. 1984); Tennessee, Holt v. Continental Ins. Co., 440 F.2d 652 (6th Cir. 1971); Washington, Hamilton v. State Farm Ins. Co., 83 Wash. 2d 787, 523 P.2d 193 (1974); West Virginia, Daniels v. Horace Mann Mut. Ins. Co., 422 F.2d 87 (4th Cir. 1970); Wisconsin, A.W. Huss Co. v. Continental Casualty Co., 735 F.2d 246 (7th Cir. 1984).

> cumstances, is reasonable, constitutes a failure to exercise good faith. [citations omitted] Stated otherwise, an unwarranted or unreasonable rejection of an offer of compromise constitutes bad faith . . . .
>
> On the other hand, the duty to exercise good faith is not commensurate with the duty to exercise the care of an ordinarily prudent person under the same circumstances. Bad faith and negligence are not legally synonymous . . . .
>
> Neither mistaken judgment nor unreasonable judgment is the equivalent of bad faith.[105]

Having created a myriad of tests and standards by which the bad faith of a liability insurer is to be determined, many authorities, as well as several courts themselves, conclude that the resulting confusion is relatively insignificant because there is no practical or substantive difference between the two standards. Thus, some authorities have stated that the negligence standard and the bad faith standard are "interchangeable."[106] Others state that "there is more of a difference in verbiage than there is in result,"[107] because the courts look to the same evidentiary factors in either case to determine whether a liability insurer should be held liable for a judgment in excess of policy limits.[108] Other authorities not only disagree that the two standards necessarily produce the same results,[109] but further disagree as to which standard favors the insured. One authority states, "In theory a jury instructed that it must hold the insurer liable for negligence should have a greater propensity to impose liability than one instructed that it may impose liability only for bad faith."[110] Yet another states, "Strangely enough, more verdicts for plaintiffs seem to emerge when the case is tried upon a bad faith theory than upon a

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105. Davy v. Public Nat'l Ins. Co., 181 Cal. App. 2d 387, 394-96, 5 Cal. Rptr. 488, 492-93 (4th Dist. 1960) (citations omitted).

106. *E.g.*, Hamilton v. State Farm Ins. Co., 83 Wash. 2d 787, 523 P.2d 193 (1974).

107. 7C J. APPLEMAN, INSURANCE LAW AND PRACTICE § 4712, at 425 (1979).

108. *See* Koenen, *Bad Faith and Negligence Approaches to Insurer Excess Liability for Failing to Settle Third-Party Claims: Problems and Suggestions*, DEF. COUNS. J. 179, 183-84 (April 1987). As stated by another authority:

> In many cases, it seems likely that an insurer's liability will not depend on whether the standard is one of good faith, bad faith, or negligence. Virtually the same evidence will be presented by an insured, regardless of the standard of conduct which has been articulated in the judicial precedents, to prove the negligent breach of duty, the absence of good faith, or the presence of bad faith. The general reaction of the jury to the evidence in a particular case about the insurer's decision not to settle is likely to be similar, if not identical, in most instances regardless of the standard of conduct which is applied in a particular jurisdiction.

KEETON & WIDISS, *supra* note 12, § 7.8, at 883 (footnotes omitted).

109. Different results will certainly be obtained from those jurisdictions which require proof of ill will, malice or intent to harm, *supra* note 98, than from jurisdictions which adhere to either a negligence standard, *supra* note 94, or a bad faith standard in which such proof is not required, *supra* note 97.

110. S. ASHLEY, *supra* note 16, § 2:06, at 2-17.

negligence theory—something like the outcome in airlines cases where *res ipsa* is invoked, where the plaintiff usually loses."[111]

Last, but not least, the various jurisdictions not only disagree as to the standard to be applied in determining when a liability insurer has violated its duty to settle, they differ as to the burden of proof which must be sustained by the plaintiff. Some jurisdictions still require the plaintiff to establish bad faith by "clear and convincing" proof,[112] while others adhere to the "preponderance of the evidence" standard.[113]

2. The standard adopted by *Fowler*

Most of the third-party bad faith decisions, including *Fowler*, have described the duty owed by the insurer to the insured as one of loyalty rather than one in which the exercise of "due care" is required.[114] As a result, misconduct on the part of liability insurers has been described in terms of bad faith rather than negligence by a majority of the courts.[115] The apparent basis for this result is found in the relationship between the liability insurer and the insured. In order to receive the insurer's guarantee that it will indemnify the insured, within policy limits, against claims asserted by third parties, the insured is required to surrender his right to settle the case to his insurer. Having done so, a fiduciary relationship is created between the insurer and the insured,[116] for now "[t]he insured is wholly dependent

111. 7C J. APPLEMAN, INSURANCE LAW AND PRACTICE § 4712, at 497 (1979).

112. *E.g.*, United States Fire Ins. Co. v. Royal Ins. Co., 759 F.2d 306 (3rd Cir. 1985); State Farm Mut. Auto. Ins. Co. v. Floyd, 235 Va. 136, 366 S.E.2d 93 (1988); Johnson v. American Family Mut. Ins. Co., 93 Wis. 2d 633, 287 N.W.2d 729 (1980).

113. One authority states that the trend is toward applying the "preponderance of the evidence" standard. S. ASHLEY, *supra* note 16, § 2:05, at 2-9. *See also* American Fidelity & Casualty Co. v. Greyhound Corp., 258 F.2d 709, 714 (5th Cir. 1958); General Accident Fire & Life Assurance Corp. v. Little, 103 Ariz. 435, 443 P.2d 690, 698-99 (1968); Kunkel v. United Sec. Ins. Co., 84 S.D. 116, 168 N.W.2d 723, 732 (1969).

114. S. ASHLEY, *supra* note 16, § 2:06, at 2-21 n.3.

115. The bad faith standard has received its fair share of criticism. Windt, for example, adheres to the following view:

> There is, therefore, no theoretical justification for the bad faith requirement. It is not a component of the insurer's actual breach, and it is superfluous to a consideration of the damages for which the carrier should be liable as a result of that breach. Bad faith has, apparently, been considered solely because of the potentially large amount of consequential damages that can result from an insurer's breach of its duty to settle. One court, for example, has referred to the insurer's potential liability as a "punitive measure of damages." Nevertheless, it seems only fair that if, in fact, the insurance company has, by wrongfully refusing to settle, caused the insured to incur substantial damages, it should be the company, not the insured, that should ultimately be responsible. To conclude otherwise is to say that the insurer should not be responsible for the damages it has caused because the amount of the damage it caused was so great.

A. WINDT, *supra* note 16, § 5.11, at 255-56.

116. As the Oregon Supreme Court noted in Farris v. United States Fidelity & Guar. Co., 284 Or. 453, 458-60, 587 P.2d 1015, 1018-19 (1978):

> In an action for failure to settle within the policy limits, the insurance company is charged with acting in a fiduciary capacity as an attorney in fact representing the

upon the insurer to see that, in dealing with claims by third parties, the insured's best interests are protected."[117] Because the relationship between liability insurer and insured is a fiduciary one, the duty owed is one which is characterized by such subjective terms as "honesty," "intelligence," "fidelity" or "good faith."[118]

In affirming a verdict for the insured, the Wyoming Supreme Court in *Fowler* thus gave explicit approval to the following jury instruction:

> [The defendant has the duty] to exercise intelligence, good faith, and honest and conscientious fidelity to the common interest of the plaintiff as well as of the defendant and give at least equal consideration to the interest of the insured, and, if it fails to do so, it acts in bad faith.[119]

On the basis of the above instruction, interestingly enough, one authority has classified Wyoming as a jurisdiction which applies both a "negligence" and a "bad faith" standard to determine liability for third-party bad faith.[120] In actual fact, however, the jury instruction adopted in *Fowler* does not describe a negligence standard in which the insured must only establish that the insurer failed to exercise "due care" in responding to policy limit settlement offers.[121] Rather, it describes a bad faith standard, in which the insurer must give consideration to the interests of the insured in an "honest," "intelligent," and "good faith" manner.[122] Consistent with the majority view among jurisdictions which have adopted the bad faith standard, the degree of consideration which liability insurers must give to the interests of the insured in responding to settlement offers within policy limits under *Fowler* is that of "equal" consideration.[123]

Clearly, under the *Fowler* test a finding of third-party bad faith cannot be based upon negligence alone,[124] although the negligence of

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> insured's interest in litigation. The company's interest comes into conflict with that of the insured's while representing him; and, arguably, acting in its own interests to the detriment of the insured's interest while acting in such a fiduciary capacity is a tort.

See also Beck v. Farmers Ins. Exch., 701 P.2d 795 (Utah 1985).

117. *Beck*, 701 P.2d at 799.

118. *See, e.g., Fowler*, 390 P.2d at 606.

119. *Id.*

120. S. ASHLEY, *supra* note 16, § 2:06, at 2-21 n.3.

121. In jurisdictions which have adopted a negligence standard, the duty of the insurer toward the insured in responding to settlement offers is invariably expressed as one which requires the exercise of due care. *See* KEETON & WIDISS, *supra* note 12, § 7.8, at 883, and § 7.8(b)(1), at 880-81. This standard is one which "calls for the factfinder to determine whether a person of ordinary prudence, in the exercise of that degree of care which such a person would use in the management of his affairs, would have accepted the settlement offer." S. ASHLEY, *supra* note 16, § 2:04, at 2-7.

122. *Supra* note 118.

123. *Supra* note 101.

124. *E.g.*, North River Ins. Co. v. St. Paul Fire & Marine Ins. Co., 600 F.2d 721 (8th Cir. 1979); Commercial Union Assurance Co. v. Safeway Stores, Inc., 96 Cal. App.

the insurer may be a factor in determining whether the insurer has acted in bad faith.[125] While mere negligence alone is insufficient to substantiate a finding of bad faith, however, *Fowler* clearly does not adopt the bad faith standard embraced by Ohio,[126] Mississippi,[127] or New York,[128] where actual dishonesty, fraud or intent to harm must be established before a liability insurer will be held to have acted in bad faith. In these jurisdictions, bad faith "imports a dishonest purpose, moral obliquity, conscious wrongdoing, breach of a known duty through some ulterior motive or ill will partaking of the nature of fraud," and requires an "actual intent to mislead or deceive another."[129] Rather, the mental element required under *Fowler* is one where the insurer intended to act, but not necessarily harm, the insured. As articulately stated by an Arizona court:

> We disagree, however with plaintiffs' assertion that mere reasonableness is the sole standard for establishing bad faith or that an insurer's unreasonable conduct alone is sufficient to establish liability. For if, as plaintiffs argue, reasonableness under the circumstances is the sole standard for bad faith, the tort would simply be equivalent to a negligence action. Yet it has long been established in Arizona that negligence alone is insufficient to impose liability on an insurer for the tort of bad faith. On the other hand, while the tort of bad faith is often referred to as an "intentional" tort, it is clear that a bad faith claim does not rise to the level of a traditional intentional tort in the sense that the insurer must know with substantial certainty that its actions will bring particular harm to the insured. Rather, the courts' references to the "intentional" aspect of the tort of bad faith have been largely limited to the insurer's "conscious conduct"—as opposed to mere mistake or oversight—rather than to a knowledge of impending harm to its insured. Thus, in *Apodaca*, our supreme court stated:
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>> The "intent" required [to establish a bad faith claim] is

3d 449, 158 Cal. Rptr. 97 (1979), *aff'd*, 610 P.2d 1038, 164 Cal. Rptr. 709 (1980); Boston Old Colony Ins. Co. v. Gutierrez, 386 So. 2d 783 (Fla. 1980); Campbell v. Government Employees Ins. Co., 306 So. 2d 535 (Fla. 1974); Kooyman v. Farm Bureau Mut. Ins. Co., 267 N.W.2d 403 (Iowa 1978); Ambassador Ins. Co. v. St. Paul Fire & Marine Ins. Co., 102 N.M. 28, 690 P.2d 1022 (1984).

The majority rule which clearly holds that negligence is a factor in determining whether the insurer has acted in bad faith is inconsistent with the notion that bad faith is the product of an intentional or reckless act. *See infra* notes 129-134 and accompanying text. Indeed, this rule exemplifies the failure of the courts to clearly distinguish between bad faith and negligence.

125. *Supra* note 96.

126. *Supra* note 98.

127. *Id.*

128. *Id.*

129. Centennial Ins. Co. v. Liberty Mut. Ins. Co. 62 Ohio St. 2d 221, 224, 404 N.E.2d 759, 762 (1980) (citing Slater v. Motorists Mut. Ins. Co., 174 Ohio St. 148, 187 N.E. 2d 45 (1962)).

> an "evil hand"—the intent to do the act. *Mere negligence or inadvertence is not sufficient*—the insurer must intend the act or omission and must form that intent without reasonable or fairly debatable grounds. But an "evil mind" is not required; the insurer need not intend to harm the insured . . . .[130]

Thus, the *Fowler* standard requires that an insurer act with an "evil hand," rather than an "evil mind."[131] As a practical matter, this means that a liability insurer in Wyoming will not be held liable for bad faith if its refusal to accept a settlement offer within policy limits was a result of mistake, carelessness or inadvertence because the act of denying the settlement offer requires an intentional act or a reckless disregard of or indifference to the facts.[132] Thus, if a policy limits settlement offer is received by the insurer but is inadvertently destroyed in the mail room, causing a judgment in excess of policy limits to be entered, the insurer has not acted in bad faith.[133] If an insurer rejects a policy limits settlement offer in Wyoming while cognizant of

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130. Trus Joist Corp. v. Safeco Ins. Co. of Am., 153 Ariz. 95, 735 P.2d 125, 133-34 (Ariz. App. 1986) (citations omitted) (emphasis original). To the extent *Trus Joist* held that there is no legal distinction between the duty of good faith owed by an insurance company when dealing with first-party claims and that owed by an insurer when dealing with third-party claims, it has since been overruled by Clearwater v. State Farm Mut. Auto. Ins. Co., 164 Ariz. 256, 792 P.2d 719 (Ariz. 1990). The case nonetheless represents good law as to the mental element necessary to a finding of bad faith in either a first- or third-party case.

131. The three standards used by the courts to determine when first-party insurers have acted in bad faith in refusing to pay claims are identical to the three standards used by the courts to determine when a third-party insurer has violated its duty to settle claims. In both first-party cases and third-party cases some courts have adopted a negligence standard, others have adopted a standard characterized by malice or intent to harm, and the majority of courts in either case have adopted an "intermediate" standard which falls somewhere between the "negligence" standard and the "malice" standard. *See* Smith, *Understanding the New Tort of First Party Bad Faith In Wyoming,* McCullough v. Golden Rule Insurance Company, 26 LAND & WATER L. REV. 225, 251-64 (1991).

The view that actual malice, ill will or intent to harm is not required proof under the *Fowler* standard is supported by the court's decision in *McCullough.* There the court was faced with the task of adopting a standard for determining when a first-party insurer has violated the implied covenant of good faith and fair dealing in denying claim payments. In so doing, the court rejected both the "negligence" standard and the "malice" standard and, instead, opted for the "intermediate" or "objective" standard exemplified by Anderson v. Continental Ins. Co., 85 Wis. 2d 675, 271 N.W.2d 368 (1978). There is no reason to believe that the standard adopted by the court in *Fowler* should be interpreted any differently.

132. Koenen, *Bad Faith and Negligence Approaches to Insurer Excess Liability for Failing to Settle Third-Party Claims: Problems and Suggestions*, DEF. COUNS. J. 179, 185 (April 1987). In *McCullough*, 789 P.2d at 860, the court held that if the insurer recklessly disregards the lack of a reasonable basis for denying the claim, such as where it fails to conduct an adequate investigation, the knowledge requirement for establishing bad faith will be imputed to the insurer. Since the *Fowler* court very clearly indicated that failure to conduct an adequate investigation is a factor indicating bad faith, *infra* note 179, it must be assumed that the element of "knowledge" may also be imputed to the insurer in a third-party case.

133. *Trus Joist Corp.*, 153 Ariz. at 104, 735 P.2d at 134.

the fact that additional investigation of the third-party claim should be undertaken, however, the insurer will be held liable for a resulting judgment in excess of policy limits.[134]

3. Problems with applying the *Fowler* standard

Ironically, the very standard which the majority of jurisdictions, including Wyoming, has adopted to determine when a liability carrier has violated its duty to settle has produced the least satisfactory results and has proven to be the most unworkable of any of the standards devised to date. As a practical matter, it is impossible for an insurer to give irreconcilable interests "equal" treatment. In considering a policy limits offer where damages are alleged to have exceeded policy limits, the insurer must follow one of two courses of action. It must either sacrifice its interest in reducing its own claim cost below the amount of the settlement offer by accepting the offer of settlement, or it must sacrifice the insured's interest in avoiding personal liability for a judgment in excess of policy limits by rejecting the offer of settlement. By virtue of the fact that the insurer must favor either its own interests or those of the insured, the interests of one of the parties to the contract will not receive "equal" consideration.[135]

Because it is impossible for the insurer to accord "equal" treatment to irreconcilable interests, the standard adopted by *Fowler* suffers from another weakness, even more so than other standards adopted by the courts. It does not provide insurers with the guidance necessary to determine when they may safely reject offers of settlement within policy limits. As stated by one authority:

> [T]he notion that the insurer should give the insured's interests 'equal consideration' has enjoyed enormous popularity; yet, despite this standard's egalitarian appeal, it is difficult to imagine a rule of law providing less guidance to an insurer forced to choose between its own interests and its insured's interests than one which requires the insurer to treat the parties' irreconcilable interests 'equally.'[136]

Because of the manner in which the "equal consideration" test

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134. *See, e.g.*, Warren v. American Family Ins. Co., 122 Wis. 2d 381, 361 N.W.2d 724 (Wis. Ct. App. 1984).

135. Thus, in *Rova Farms Resort, Inc.*, 323 A.2d at 508, the court observed:

> Yet however much the carrier considers the interests of its insured in pondering the decision as to settlement, the moment it decides not to settle, it in effect, however reasonably, sacrifices the interests of the insured in order to promote its own. It is always to the benefit of the insured to settle and thereby avoid the danger of an excess verdict. Since an insurer serves only its own interests by declining to compromise within the insurance coverage, a decision not to settle is perforce a selfish one. In attempting to save some of its own money on the policy, the company necessarily and automatically exposes the insured to the risk of an excess judgment.

136. S. ASHLEY, *supra* note 16, § 2:08, at 2-23 (footnotes omitted).

has been phrased, the inference is created that the insurer, if it decides to favor its own interests over those of the insured, must somehow refrain from sacrificing the insured's interests in the process. What is intended by the test, but what is not actually indicated by the manner in which the test has been devised, is a means by which the insurer can stand back as an impartial third party and objectively determine whether *the interests of the insured can be sacrificed* because the interests of the insurer in a given factual situation are at least equally important. Needless to say, the insurer is not well equipped to make this determination in an objective fashion when its own interests are at stake.

The greatest difficulty in applying the "equal consideration" test, however, is that the courts have not clearly defined or limited the type of interests which the insurer is required, or allowed, to consider in evaluating the likelihood that a judgment in excess of policy limits will be entered against the insured. What action does the liability insurer in Wyoming take, for example, if it receives a policy limits settlement offer of $50,000 in a case where the insurer estimates that there is a twenty-five percent chance that the insured will be held liable for total damages in the sum of $250,000? Is the insurer's interest in saving the sum of $50,000, at least where the odds favor the entry of a defense verdict on the issue of liability, equal to the insured's interest in avoiding personal liability for the sum of $200,000 in the unlikely event the third-party claimant wins at trial?[137]

The answer to this question may very well depend on what "interests" the insurer is allowed or required to consider. Is the insurer, for example, allowed to consider the degree of financial harm the insured will suffer if the rejection of a policy limits offer results in the entry of a judgment in excess of policy limits? If so, neither an insolvent insured, from whom a judgment cannot be collected, nor a very wealthy insured, who can easily afford to pay a judgment in excess of policy limits, will be harmed by an insurer's violation of its duty to settle as much as an individual who has exactly enough assets to discharge the excess judgment. If the financial condition of the insured is the type of "interest" to which the insurer must accord "equal" consideration, therefore, an objective consideration of the interests of insureds with moderate assets may require that the insurer protect those assets by accepting settlement offers within policy limits. On the other hand, a consideration of the insurer's own interests, all other things being "equal," may outweigh the interests of an insured who

137. Note should be taken in this example that the insurer may not actually be placing its entire policy limit of $50,000 at risk by accepting the policy limits offer, because in many cases the insurer will be found liable for less than the amount of its policy limits, but more than zero. In order for the insurer to have $50,000 at risk in this example, in other words, it must be assumed in all cases that one of two results will obtain: either the insurer will receive a complete defense verdict, or a judgment in excess of policy limits will be entered. Quite obviously, this is not a realistic assumption.

would not sustain a serious economic loss if a judgment in excess of policy limits was entered against him.[138] Moreover, economic harm is a relative term. Should the insured be able to argue that the potential loss of $10,000 would cause as much economic harm to the insured and his family as the potential loss of $100,000 would to an insurer?

Other potential "interests" raise even more compelling questions. Can the insurer properly deny a policy limits settlement offer because of the insurer's legitimate belief that no coverage is afforded by the policy? Put differently, is it proper for the insurer to favor its own interests over the interests of its insured because of the probability that no coverage exists under the policy? Is it appropriate for the insurer to consider the personal characteristics of the insured? Should the interests of an insured who would not make a good witness at trial because of his peculiar personal characteristics be accorded more protection because there is more of a likelihood that a judgment in excess of policy limits will be entered against him? Should the insurer be required to consider the characteristics of the third-party claimant? If the negligence of the insured is alleged to have caused the permanent paralysis of the claimant, in other words, should the interests of the insured be given more consideration simply because the sympathy that a victim of paralysis would inevitably generate increases the likelihood of an excess verdict? What about the insured who intentionally underinsures himself? Since, by purchasing a low-limit policy, he purposefully decides to assume a greater risk that an excess judgment will be entered against him, is he entitled to the same degree of protection as the insured who purchases adequate insurance to protect himself from the third-party claims of others?[139] In other words, is it ever appropriate to consider the manner in which the insured himself defined his own interests at the time he purchased the policy, or must the insurer always evaluate such interests as of the time a settlement offer is received without regard to the amount of coverage selected by the insured?[140]

The insurer itself may have legitimate interests which are far broader than its immediate interest in minimizing the cost of any particular claim. The insurer, for example, may have an interest in containing settlement costs and discouraging future claims. To further that interest, it may be necessary for the insurer to project an image of a company which will not negotiate the settlement of questionable claims in order to prevent such claims from being filed in the future.[141] Furthermore, the insurer may have an interest in establishing

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138. The insurer could make the same argument concerning its own size or financial condition. Should an insurer with minimal assets be allowed to argue that its interest in saving $50,000 is much greater, relative to the interests of the insured, than the interests of an insurer who has billions of dollars in assets?

139. *See* Comment, *An Insurance Company's Duty to Settle: Qualified or Absolute?*, 41 S. CAL. L. REV. 120, 136-37 (1968).

140. *Id.*

141. *Id.* at 136.

a legal precedent (such as where the liability insurer for a tobacco company wants to establish that the warning label on cigarette packages is sufficient to warn other claimants of the dangers of smoking cigarettes) to govern the disposition of future claims.[142] Indeed, the insurer may want to designate a specific claim as the vehicle for overturning or modifying an existing precedent. The interest of the insurer may consist of establishing low-range settlement values for certain types of cases in order that the insurer may have a bargaining tool to settle similar claims it expects to receive in the future.[143] Is it appropriate for the insurer to consider such interests in responding to settlement offers within policy limits? If so, how is it possible to balance an insurer's "institutional" interests, which have nothing to do with the individual claim asserted against the insured, with the insured's individual interest in avoiding personal liability?

With few exceptions, the courts simply have not addressed such questions. One issue which has been litigated in the courts is whether the insurer can take coverage issues into account when responding to a policy limits settlement offer. The majority rule is represented by *Johansen v. California State Automobile Association Inter-Insurance Bureau*,[144] where the court held that the insurer's belief that the policy does not provide coverage cannot be allowed to affect the insurer's decision as to whether a policy limits settlement offer should be accepted. Instead, the court indicated that the insurer should evaluate the settlement offer as if there was no doubt about coverage and reserve the defense of non-coverage if necessary. In a separate action, the insurer may then seek reimbursement from the insured if it should succeed in establishing a lack of coverage under the policy.[145]

Another issue which has been addressed by the courts is whether the insurer may take the insured's financial condition into consideration in responding to a policy limits offer settlement. The courts seem generally agreed that insurers may not accord the interests of the insured any less protection simply because the insured has few assets or is insolvent at the time the settlement offer within policy limits is received by the insured.[146] Indeed, the majority rule imposes liability

142. *Id.*
143. *Id.*
144. 15 Cal. 3d 9, 538 P.2d 744, 123 Cal. Rptr. 288 (1975).
145. *Id.* at 19, 123 Cal. Rptr. at 294, 538 P.2d at 750.
146. *E.g.*, Moutsopoulos v. American Mut. Ins. Co., 607 F.2d 1188 (7th Cir. 1979); Riske v. Truck Ins. Exch., 490 F.2d 1079 (8th Cir. 1974); Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 319 P.2d 69 (1957); Ammerman v. Farmers Ins. Exch., 22 Utah 2d 187, 450 P.2d 460 (1969); Crabb v. National Indem. Co., 87 S.D. 222, 205 N.W.2d 633 (1973); Wolfberg v. Prudence Mut. Casualty Co., 98 Ill. App. 2d 190, 240 N.E.2d 180 (1968).

Insurers will not likely encounter many claims where a "wealthy" insured is underinsured. A corporated insured with unlimited assets, for example, is likely to have adequate limits of insurance or be self-insured. *See* Comment, *Excess Liability: Reconsideration of California's Bad Faith Negligence Rule*, 18 STAN. L. REV. 475, 477 (1966).

upon the insurer even if the insured was deceased at the time the offer to settle was rejected and the insured's estate was totally without assets.[147] Insurers, therefore, must assume an anomaly. In responding to settlement offers, liability insurers must assume that the insolvent insured is exposed to the same financial risk as the insured who can completely satisfy an excess judgment without insurance. It is the likelihood of a judgment being entered against the insured in excess of policy limits which the insurer must consider, in other words, and not the harm which may occur to the insured if an excess judgment is actually obtained.[148]

Whether the insurer is required to ignore, or allowed to consider, the personal characteristics of the insured when considering settlement offers is much less certain.[149] One of the few authorities to address the issue argues that the insurer is required to take into account such factors:

> In sum, those personal characteristics of the insured which bear on the consequences of a trial on the merits of the claim and of a resultant excess judgment are all characteristics which may reflect that the insured's best interests lie with settlement rather than trial. It is clearly self-destructive for a liability insurer to refuse to settle because of an individual insured's race, religion, or sexual preferences. However, those characteristics should each be taken into account if they can reasonably be said to have the potential to affect *adversely* the outcome of the case at trial. Each such characteristic then becomes, in conjunction with all other factors, an indication to the ordinary and prudent liability insurer that the insured's best interests may lie with the settlement of a given case. Whether other factors favor a given settlement or not, such factors as the known presence of dislike, bias, or prejudice which may adversely affect a given insured must also be taken

147. *See* SHERNOFF, *supra* note 3, § 3.07[2], at 3-39 ("Moreover, the majority and sounder view is that the insurer can be held liable for the excess judgment even though the insured or his or her estate is insolvent and would therefore have no assets from which to pay the excess judgment," citing, *e.g.*, Torrez v. State Farm Mut. Auto. Ins. Co., 705 F.2d 1192 (10th Cir. 1982)). For an authority who advocates the minority rule, *see* A. WINDT, *supra* note 16, § 5.18, at 215-17.

148. There is some limited authority in support of the view that the insurer's liability should be restricted to the actual harm suffered by the insured, taking into account the insured's age, economic prospects, skills, and health. *See* Stockdale v. Jamison, 416 Mich. 217, 330 N.W.2d 389 (1982) and Thurston v. Continental Casualty Co., 567 A.2d 922 (Me. 1989).

149. One of the few cases to address the issue is *Rova Farms Resort, Inc.*, 323 A.2d at 503-04, where the court held:

> While the view of the carrier or its attorney as to liability is one important factor, a good faith evaluation requires more. It includes consideration of 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* (emphasis added and citation omitted).

into account.[150]

To the extent a consideration of the personal characteristics of the claimant or the insured affects the evaluation of the claim from the standpoint of liability and damages, the better rule is to require the insurer to consider such factors, whether they favor rejection or acceptance of the settlement offer. A contrary rule would encourage, if not require, insurers to evaluate cases in a manner which would not accurately reflect the insured's exposure to liability and damages. The inequity that results, of course, is that less deserving insureds will receive greater protection from excess judgments because insurers will be more inclined to settle cases with greater exposure within the limits of the policy.[151] Likewise, the financial interests of the insured may be jeopardized by personal characteristics of the insured or claimant over which the insured has no control. In attempting to defend a rejection of a policy limits offer in a third-party bad faith case, therefore, counsel for the insurer should emphasize personal characteristics of the insured or the claimant which negatively affect the claimant's case.

It would also appear that in considering its own interests, the insurer is restricted to a consideration of the financial risk to which it is exposed in the event it should reject a particular settlement offer.[152] The rationale for this view is sound. The insurer who advances its "institutional" interests by refusing to settle cases, by definition, ignores the individual interests of the insured in settling the case. As a practical matter, however, most insurers consider such factors to some degree in responding to settlement offers. In attempting to prove bad faith, therefore, counsel for the insured or his assignee should attempt to establish that the insurer rejected a policy limits settlement offer as a result of its claim philosophy, its interest in discouraging future claims, or any other factor which has little or nothing to do with the

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150. D. WALL, *supra* note 3, § 3.15, at 44-45. The author, however, cites no authority in support of the above proposition.

151. This issue was addressed by the court in *Rova Farms Resort, Inc.*, 323 A.2d at 508, in the following terms:

> Moreover the rule which permits a carrier to escape liability for excess unless its decision to go to trial is marred by dishonesty, bad faith or negligence creates an anomalous situation for insureds. Where a settlement opportunity exists, the more faultless the client seems to have been the more feasibly he may be subjected by the company to a trial of the case and all the dangers it entails. In the case of an obviously blameworthy client, the carrier would normally take advantage of a settlement opportunity within policy limits since any other disposition would be unduly optimistic. The least blameworthy insured, however, may more readily be delivered to face the risk of excess judgment, since a refusal to compromise a case thought to be a "no liability" case would not be regarded as unreasonable. Thus, in those cases where a compromise may be effected within policy limits the more innocent an insured appears to be, the worse position he is in and the more he is exposed to loss.

152. Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 319 P.2d 69, 75 (1957) ("Equal consideration" requires an evaluation of the amount of financial risk to which each party is exposed in the event of a refusal to settle.).

particular claim at issue.

In short, the insurer cannot have arrived at a good faith conclusion that the insured will not likely be found liable to the third-party claimant or that damages which the claimant has sustained will not likely exceed policy limits if the insurer bases its evaluation upon factors which the courts will not permit it to consider. Factors which favor the insured, quite obviously, will not receive the same scrutiny as those which allow the insurer to favor its own interests.

4. "Disregard the limits" rule

Widespread dissatisfaction with the "equal consideration" standard adopted by such decisions as *Fowler* has resulted in efforts to develop a less confusing and somewhat more equitable standard for determining when a liability insurer has acted in bad faith.[153] The most successful product of such efforts to date is the "disregard the limits" rule. First popularized by Professor Robert Keeton in 1954,[154] it has since received widespread acceptance in jurisdictions which otherwise adhere to the "equal consideration" bad faith standard.[155] This rule frames the insurer's obligation to settle as follows: "In deciding whether to settle a claim against an insured, a liability insurer should evaluate whether to accept a proposed settlement in the same way as would be used by an ordinarily prudent defendant who will be fully liable for any judgment that may be subsequently rendered."[156]

Thus, this rule proposes to ask the insurer how it would respond to a settlement offer within policy limits if there were no limits, that is, if the insurer were required to withstand the entire amount of any judgment which may be entered against its insured. If a reasonably prudent insurer under such circumstances would have accepted the claimant's offer of settlement, then the insurer's failure to accept the actual policy limits offer would result in a finding of bad faith and the insurer would become liable for the entire amount of any judgment entered in excess of policy limits. In the previously cited example,[157] therefore, where a policy limits settlement offer of $50,000 is received in a case where the insurer estimates that there is a twenty-five percent chance that the insured will be held liable for total damages in the sum of $250,000,[158] the "disregard the limits" rule would require the insurer to accept the policy limits offer. A reasonably prudent in-

153. *See* S. ASHLEY, *supra* note 16, § 2:12, at 35.
154. Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136 (1954).
155. *Supra* note 101.
156. KEETON & WIDISS, *supra* note 12, § 7.8[b][2], at 885 (footnote omitted).
157. *See infra* note 137 and accompanying text.
158. Under the "disregard the limits" rule, the insurer must not only reasonably evaluate the prospects of a defense verdict, but also the total damages which will likely be awarded in the event the third-party claimant prevails. *See infra* note 178.

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surer who issued a policy of insurance with no limits of liability would not risk $62,500 ($250,000 x 25%) in order to save $50,000, particularly if the cost of defending the case is considered.[159]

The *Fowler* court makes no mention of the "disregard the limits" rule, perhaps because the rule had not gained widespread acceptance or notoriety when *Fowler* was decided in 1964. A jury instruction in Wyoming incorporating the "disregard the limits" rule, however, would not be entirely incompatible with the "equal consideration" standard adopted by *Fowler*. The rule promotes, rather than alters, the result the "equal consideration" rule seeks to accomplish, because the competing interests of the insured and insurer are treated as being held by a single entity, one which has no self-interest in sacrificing one interest over the other.[160] Indeed, out of some eighteen jurisdictions that have approved of the rule,[161] the vast majority follow the same "equal consideration" standard which the *Fowler* court adopted.[162]

This rule does not in any way serve as a "cure-all" for the problems involved in applying the *Fowler* standard and has received its own share of criticism.[163] An insurer with the ability to absorb large losses which could not be absorbed by the individual insured, for example, is more likely to take risks in rejecting offers of settlement which the individual insured would never take.[164] Moreover, the rule

159. In reality, the costs of defense usually figure into an insurer's decision to accept or reject a policy limits settlement offer. In evaluating the amount of financial risk which the insurer is exposed to in the event of a refusal to settle, taking defense costs into consideration is certainly permitted, if not required. Indeed, in attempting to establish bad faith, counsel for the insured or assignee should argue, in appropriate cases, that the insurer's savings by not settling the case would have been nominal, particularly under a low-limit policy, because any such savings would have been consumed by costs of defense. Thus, where liability is evaluated at fifty percent, damages are estimated at $100,000, and the insurer receives a policy limits settlement offer of $50,000, the issue may not be whether it is appropriate for the insurer to gamble $50,000 of the insured's assets in order to save $50,000 of its own, but whether it is appropriate to gamble $50,000 of the insured's assets in order to save $50,000 of its own, *minus defense costs.*

160. KEETON & WIDISS, *supra* note 12, § 7.8[b][2], at 884.

161. *Compare supra* note 101, *with supra* note 102.

162. *See S. Ashley, supra* note 16, § 2:12, at 2-36 n.5.

163. *E.g.*, Rova Farms Resort, Inc. v. Investors Ins. Co. of Am., 65 N.J. 474, 323 A.2d 495, 503-04 (1974); Crisci v. Security Ins. Co., 66 Cal. 2d 425, 58 Cal. Rptr. 13, 426 P.2d 173 (1967). Critics of the "disregard the limits" rule are invariably advocates of the "strict liability" rule, which imposes liability upon the insurer whenever the rejection of a policy limits offer results in an excess judgment. The strict liability rule has yet to be adopted by any American jurisdiction. *See* SHERNOFF, *supra* note 3, § 3.03[2], at 3-12 n.15, for a listing of commentators who advocate the adoption of a strict liability rule.

164. *See* Koenen, *Bad Faith and Negligence Approaches to Insurer Excess Liability for Failing to Settle Third-Party Claims: Problems and Suggestions*, 54 DEF. COUNS. J. 179, 184 (1987). One author argues that because the insurer will behave as a person of unlimited wealth and play the averages, while the insured with moderate assets would try much harder to settle the case, the "equal consideration" standard and the "disregard the limits" rule may produce different results. Comment, *Excess Liability: Reconsideration of California's Bad Faith Negligence Rule*, 18 STAN. L. REV.

may encourage the insurer to consider its own "institutional" interests to the detriment of the insured.[165] On the other hand, an application of the "disregard the limits" rule solves some of the problems associated with whether the insurer should take the financial condition of the insured into consideration when responding to a policy limits settlement offer, because the inquiry under this rule is restricted to whether a reasonable insurer would have accepted the offer if there were no policy limits. Absent other useful standards, therefore, liability insurers in Wyoming should utilize the "disregard the limits" rule in determining whether to accept or reject settlement offers within policy limits. Under *Fowler*, it is doubtful that any liability insurer would be found to have acted in bad faith if it can establish that a reasonably prudent insurer without policy limits would not have accepted the claimant's settlement offer. Conversely, the rule provides useful guidance for the insured who, having seen a policy limits offer rejected by his insurer, must determine whether to declare a breach of the insurer's duty to settle and take control of his own defense or assume the risk that if he is found liable to the third party, the judgment will not exceed policy limits.

D. The resulting judgment—must the insured pay the judgment before asserting a bad faith claim against the insurer?

In spite of some earlier authority to the contrary,[166] it is now well settled that the actual payment of the excess judgment by the insured is not a prerequisite to the assertion of a third-party bad faith action against a liability insurer.[167] The vast majority of courts now reject the argument that, unless the judgment is paid, the insured has not suffered any harm as a result of a judgment in excess of policy limits having been entered against him.[168] Arguments that point to the danger of the insured converting the proceeds to his own use if he is allowed to recover without first discharging the judgment have been similarly rejected.[169]

This so-called "prepayment rule" has been advanced most often not because the insured is capable of paying the judgment and has not

475, 477 (1966).

165. Comment, *Excess Liability: Reconsideration of California's Bad Faith Negligence Rule*, 18 STAN. L. REV. 475, 482-83 (1966).

166. *See* Annotation, *Insured's Payment of Excess Judgment, or a Portion Thereof, as Prerequisite of Recovery Against Liability Insurer for Wrongful Failure to Settle Claim Against Insured*, 63 A.L.R.3d 627, 637-41 (1975).

167. *See* S. ASHLEY, *supra* note 16, § 3:22, at 3-47 ("Most courts, however, take the view that the insured acquires a cause of action against an insurer guilty of bad faith as soon as an excess judgment against him becomes final and need not first pay the excess judgment."). *See also* Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 110 Cal. Rptr. 511 (1973).

168. *See* Annotation, *Insured's Payment of Excess Judgment, or a Portion Thereof, as Prerequisite of Recovery Against Liability Insurer for Wrongful Failure to Settle Claim Against Insured*, 63 A.L.R.3d 627, 637 (1975).

169. *Id.* at 638.

done so, but because the insured was bankrupt, insolvent, or otherwise judgment-proof at the time the excess judgment was entered.[170] In such cases the courts have generally shown little sympathy for the insurer,[171] generally because (1) the mere existence of the judgment in excess of policy limits constitutes legal injury to the insured, that is, the judgment itself may impair the insured's future credit;[172] (2) the "prepayment rule" allows insurers to benefit from the impecuniousness of their insureds;[173] and (3) the rule encourages insurers to be less responsive to their contractual obligations.[174] Thus, in *Farmers Insurance Exchange v. Schropp*, the court held:

> On the contrary, we see no reason why the insolvency of an insured or his estate should excuse the insurer from exercising the same good faith it would be expected to exercise, were the insured fully financially responsible. Further, an insured need not wait until his property is seized under an excess judgment before commencing action against an insurer whom the insured claims has acted negligently or in bad faith in failing to settle a claim within policy limits. *The action lies, whether or not the insured has paid or can pay an excess judgment.*[175]

IV. FACTORS INDICATING BAD FAITH ON THE PART OF THE LIABILITY INSURER

Because the courts have not been able to develop adequate standards which inform either party to the insurance contract when an insurer's duty to settle arises, factors which evidence third-party bad faith have usually been relied upon to determine whether an insurer should be held liable for a judgment in excess of policy limits.[176] As

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170. *E.g.*, Glenn v. Fleming, 799 P.2d 79, 92 (Kan. 1990).

171. *Supra* notes 146-148.

172. *See, e.g.*, Moutsopoulos v. American Mut. Ins. Co., 607 F.2d 1185 (7th Cir. 1979); Riske v. Truck Ins. Exch., 490 F.2d 1079 (8th Cir. 1974); Carter v. Pioneer Mut. Casualty Co., 67 Ohio St. 2d 146, 423 N.E.2d 188 (1981).

173. *See, e.g.*, Levantino v. Insurance Co. of N. Am., 102 Misc. 2d 77, 422 N.Y.S.2d 995 (1979); Gray v. Nationwide Mut. Ins. Co., 422 Pa. 500, 223 A.2d 8 (1966); Ammerman v. Farmers Ins. Exch., 22 Utah 2d 187, 450 P.2d 460 (1969).

174. *See, e.g.*, Riske v. Truck Ins. Exch., 490 F.2d 1079 (8th Cir. 1974); Crabb v. National Indem. Co., 87 S.D. 222, 205 N.W.2d 633 (1973); Ammerman v. Farmers Ins. Exch., 22 Utah 2d 187, 450 P.2d 460 (1969).

175. 222 Kan. 612, 567 P.2d 1359, 1369 (1977) (emphasis added). *See also* Maguire v. Allstate Ins. Co., 341 F. Supp. 866 (D. Del. 1972) and Edwins v. General Casualty Co., 78 Ill. App. 3d 965, 397 N.E.2d 1231 (1979). There is some authority to the contrary, at least where the insured is deceased and his estate was insolvent at the time of the insurer's failure to settle. *See* Shapero v. Allstate Ins. Co., 14 Cal. App. 3d 433, 92 Cal. Rptr. 244 (1971).

176. In Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 319 P.2d 69, 75 (1957), the California Supreme Court held:

> In resolving the question of settlement the insurer must take into account, and give fair and objective consideration to, the insured's interests. In deciding whether the insurer's refusal to settle constitutes a breach of its duty to exercise good faith, the following factors should be considered; the strength of the injured

appropriately phrased by one court, "[i]n resolving such dilemmas the courts have done little more than list a number of factors that may be considered in evaluating the propriety of the carrier's decision."[177] While none of the factors listed below constitute bad faith *per se*, they nonetheless illustrate the type of situations in which bad faith will likely be found to have occurred.

A. *Duty to adequately investigate the third-party claim*

Fowler makes it clear that one of the factors which may warrant a finding of third-party bad faith is the failure of the insurer to investigate the claim so that a determination of the insured's liability to the third-party claimant can be intelligently made.[178] As stated by *Fowler*:

> [I]t is said that evidence of bad faith is present when the insurer fails to investigate the claim properly so as to be able to intelligently assess the probabilities. Although the investigator testified he did not make the decisions but only reported to his principal, the insurance company, the facts as he found them, the actions of the investigator in failing to inquire of the injured employee about the condition of the ladder, what she was doing on the ladder, how often she used it, why or how she fell, or how the accident happened, were not in keeping with a proper and adequate investigation upon which to form an intelligent judgment as to the employer's liability.[179]

> claimant's case on the issues of liability and damages; attempts by the insurer to induce the insured to contribute to a settlement; failure of the insurer to properly investigate the circumstances so as to ascertain the evidence against the insured; the insurer's rejection of advice of its own attorney or agent; failure of the insurer to inform the insured of a compromise offer; the amount of financial risk to which each party is exposed in the event of a refusal to settle; the fault of the insured in inducing the insurer's rejection of the compromise offer by misleading it as to the facts; and any other factors tending to establish or negate bad faith on the part of the insurer.

Similarly, the Montana Supreme Court in Gibson v. Western Fire Ins. Co., 682 P.2d 725, 736-37 (Mont. 1984) listed the following factors as indicating bad faith: (1) whether a verdict in excess of policy limits was likely; (2) whether a verdict of liability is doubtful; (3) whether the insurer has given due regard to the recommendations of his trial counsel; (4) whether the insured has been informed of all settlement demands and offers; (5) whether the insured has demanded that the insurer settle within policy limits; and (6) whether any offer of contribution has been made by the insured.

177. Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 876, 110 Cal. Rptr. 511, 523 (1973).

178. Thus, the insurer is clearly obligated to objectively evaluate not only whether its insured is liable to the third-party claimant, but the extent of the claimant's damages as well. In Young v. American Casualty Co., 416 F.2d 906 (2nd Cir. 1969), *cert. dismissed*, 396 U.S. 997 (1970), for example, a judgment in excess of policy limits was affirmed against a liability insurer where the insurer did not interview the owners of an insured laundromat about a slip and fall claim, did not seek to interview any employees of the insured laundromat, and failed to review relevant documentation of the insured before trial of the claim.

179. *Fowler*, 390 P.2d at 605. It may be proper to request a separate jury instruction on a liability insurer's duty to investigate. The following jury instruction, for example, was approved by the Fifth Circuit Court of Appeals, applying Florida law, in

The rationale for the above rule as enunciated in *Fowler* is obvious. A liability insurer cannot claim to have acted in good faith in rejecting a policy limits settlement offer when it has not made a proper effort to ascertain the facts concerning the extent of the insured's liability and the claimant's damages.[180] However appealing this rationale may sound, it has been criticized on the basis that an adequate or inadequate claim investigation is totally irrelevant to the question of whether a third-party insurer commits bad faith in violating its duty to settle.[181]

Relevant to the liability insurer's duty to adequately investigate third-party claims in Wyoming is the Wyoming Unfair Claims Settlement Practices Act.[182] This act enumerates as one of several unfair claims settlement practices "[the refusal] to pay claims without conducting a reasonable investigation based upon all available information."[183] Again, it can be argued that certain provisions of the unfair claims settlement practices act define part of the insurer's duty toward the insured under the implied covenant of good faith and fair dealing, a violation of which may support a finding of bad faith.[184]

There is some authority that in order to constitute bad faith, a liability insurer's failure to investigate must have caused the insurer to have rejected a settlement offer that it otherwise would have accepted. As argued by one authority, "[i]f a prudent insurer, knowing all the facts, would still have rejected the settlement offer, then the mere failure to investigate should not support an award of damages."[185] In fact, however, the weight of authority seems to indicate that a negligent investigation in and of itself can support a finding of

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Liberty Mut. Ins. Co. v. Davis, 412 F.2d 475, 482-83 (5th Cir. 1969):

> [O]n the question of good faith in rejecting an offer of settlement within the policy limits, only a decision made by an insurer who exercises diligence in apprising himself of the material facts is entitled to consideration as having been made in good faith.
>
> Therefore, you may consider on this question of good faith or bad faith whether the investigation made by the insurance company was thorough enough to permit it to come to some fair, honest, and intelligent decision regarding the settlement opportunities in light of the then existing probabilities.

See also Clearwater v. State Farm Mut. Auto Ins. Co., 164 Ariz. 256, 258, 792 P.2d 719, 721 (1990).

180. *See* SHERNOFF, *supra* note 3, § 3.04[4], at 3-25.

181. As stated by one authority:

> An inadequate investigation, by itself, does not injure the insured. For example, if the injured party would have been unwilling to settle for an amount less than the judgment that was entered, the insurance company cannot be guilty of a breach of its duty to settle. Whether it conducted an adequate investigation would not have made the injured party's settlement offer any less unreasonable, the fact that the insurer conducted an inadequate investigation will necessarily also be irrelevant.

A. WINDT, *supra* note 16, § 5.14, at 260.

182. WYO. STAT. § 26-13-124 (Supp. 1990).

183. *Id.* § 26-13-124(a)(iv).

184. *Supra* notes 81-82. *See* KORNBLUM, *supra* note 16, § 7:154, at 7-40.8.

185. S. ASHLEY, *supra* note 16, § 3:03, at 3-4.

bad faith.[186]

B. Presence of strong evidence against insured as to liability and damages

Even if the third-party claim itself has been thoroughly investigated, a liability insurer nonetheless has a duty to objectively evaluate the third-party claim on the basis of such investigation in an honest, intelligent and knowledgeable manner.[187] Thus, if a liability insurer ignores evidence against the insured as to the liability of its insured, as well as to damage suffered by the claimant, a finding of bad faith refusal to settle may result.[188] In *Fowler*, for example, the insurer was aware of the fact that the ladder upon which the injured claimant fell was defective and unsafe, but elected to ignore such information in rejecting an offer of settlement within policy limits. As a result, the court held that such evidence provided a strong indication that the insurer had acted in bad faith.[189] The insurer was also aware, but chose to ignore, that the offer of settlement consisted of nothing more

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186. *See* Moutsopoulos v. American Mut. Ins. Co., 607 F.2d 1185 (7th Cir. 1979); Daniels v. Horace Mann Mut. Ins. Co., 422 F.2d 87 (4th Cir. 1970); Liberty Mut. Ins. Co. v. Davis, 412 F.2d 475, 482 (5th Cir. 1969); Brown v. United States Fidelity & Guar. Co., 314 F.2d 675 (2d Cir. 1963); Covill v. Phillips, 452 F. Supp. 224 (D. Kan. 1978); Board of Educ. v. Lumbermens Mut. Casualty Co., 293 F. Supp. 541, 545, 553 (D.N.J. 1968); General Accident Fire & Life Assurance Corp. v. Little, 103 Ariz. 435, 443 P.2d 690 (1968); Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 319 P.2d 69 (1957).

187. Covill v. Phillips, 452 F. Supp. 224 (D. Kan. 1978); Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 110 Cal. Rptr. 511 (1973); State Farm Mut. Auto. Ins. Co. v. Marcum, 420 S.W.2d 113 (Ky. 1967), *overruled on other grounds*, Manchester Ins. & Indem. Co. v. Grundy, 531 S.W.2d 493 (Ky. 1975), *cert. denied*, 429 U.S. 821 (1976); Landie v. Century Indem. Co., 390 S.W.2d 558 (Mo. App. 1965); Cowden v. Aetna Casualty & Sur. Co., 389 Pa. 459, 134 A.2d 223 (1957); Perry v. United States Fidelity & Guar. Co., 49 Tenn. App. 662, 359 S.W.2d 1 (1962); Aetna Casualty & Sur. Co. v. Price, 206 Va. 749, 146 S.E.2d 220 (1966).

One authority lists the following factors as being relevant to a good faith claim evaluation:

> (1) an informed and careful weighing of the facts in light of applicable standards in the community; (2) the strengths and weaknesses of all the evidence on either side so far as known; (3) a careful measuring of the legal facets of the case, the probabilities of a verdict and its anticipated range if adverse; (4) results obtained in the past in similar litigation in the same community; (5) the experience and capabilities of counsel; (6) whether the claimant appears to be a sympathetic witness with a believable case; (7) what sort of appearance the insured and other witnesses will make on the witness stand; and (8) the desire or instructions of the insured in regard to settling the case.

KORNBLUM, *supra* note 16, § 7:157, at 7-40.9.

See also, *Rova Farms Resort, Inc.*, 323 A.2d at 503-04, where the court held that a good faith evaluation includes:

> [C]onsideration of 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.

188. Western Casualty & Sur. Co. v. Fowler, 390 P.2d 602 (Wyo. 1964).

189. *Id.* at 605.

than the claimant's medical bills. This factor was significant because the injured claimant, having failed to settle his claim, would have likely sought additional damages at trial, thus increasing the likelihood that a judgment in excess of policy limits would be obtained.[190]

Thus, if the insurer either knows or should have known at the time it receives a policy limits settlement offer that (1) the insured will probably be found liable to the third-party claimant, and (2) damages sustained by the claimant will probably exceed policy limits, the insurer should accept the offer. Its failure to do so in Wyoming will likely result in a finding of bad faith and render the insurer liable for a judgment in excess of policy limits.[191] If the insurer ignores the probability that the insured will be found liable for damages in excess of policy limits, the interests of the insurer will not have been accorded equal consideration by the insurer. Indeed, even if the insurer in good faith concludes that the chance of its insured being found liable is less than fifty percent, a finding of bad faith may nonetheless result if the damage exposure to the insured was great enough. If damages are evaluated at $1,000,000, for example, and the claimant offers to settle the claim within the $100,000 limits of the policy, the implied covenant of good faith and fair dealing may require that the offer be accepted even if the insurer believes that the chances of receiving an unfavorable verdict are only one in three.[192]

Fowler makes it clear that the issue of whether a liability insurer has acted in bad faith is one which depends upon the facts known or available to the insurer at the time the offer to settle within policy limits was made.[193] This is significant from the standpoint that the insured cannot use the amount of a judgment actually entered in excess of policy limits to establish that the insurer failed to properly evaluate the claim.[194] In other words, the amount of the actual judgment has no bearing on the issue of whether the insurer rejected the

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190. *Id.* at 606.

191. In Western Casualty & Sur. Co. v. Fowler, 390 P.2d 602 (Wyo. 1964), the court specifically approved a jury instruction which stated that good faith meant a bona fide belief that the insurer had a good possibility of winning the lawsuit or that the claimant's recovery in the lawsuit would not exceed the limits of the insurance policy. Conversely, bad faith would logically occur if the insurer rejected a policy limits settlement offer with knowledge that the insurer did not have a good possibility of winning the lawsuit and that the claimant's recovery would likely exceed the limits of the insurance policy.

192. *See* Miller v. Elite Ins. Co., 100 Cal. App. 3d 739, 161 Cal. Rptr. 322 (1980) and Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 110 Cal. Rptr. 511 (1973). As Ashley points out, a rule which places all of the emphasis on the probability of winning the lawsuit and none on the amount the third party will recover in the event of a plaintiff's verdict will produce absurd results. S. ASHLEY, *supra* note 16, § 2:10, at 2-30 to 2-31. By placing all of the attention on the issue of liability, this means that with policy limits of $100,000, a fifty-five percent probability of winning the lawsuit, and anticipated damages of $101,000, the insurer should settle for $100,000, even though the actual, average exposure of such risk to the insurer would equate to $55,550 ($101,000 x 55%).

193. *Fowler*, 390 P.2d at 605.

194. *Id.* at 606.

policy limits settlement offer in good faith. The insurer has not acted in bad faith simply because it fails to correctly predict the outcome of the third party's action against the insured, provided that the insurer conducted an adequate investigation and fairly evaluated the third-party claimant's settlement offer.[195]

Although not an issue in *Fowler*, it is clear from case law in other jurisdictions that the duty to fairly evaluate a third-party claim is a continuing one.[196] Thus, even though a liability insurer may in good faith determine from an initial investigation that acceptance of a policy limits offer is not warranted, it may nonetheless incur liability for bad faith refusal to accept such an offer if subsequent events indicate otherwise.

C. *Ignoring advice to settle*

In a surprising number of situations, the issue of bad faith has been raised where the insurer rejected the advice of its own attorneys or adjusters to settle a claim within policy limits,[197] resulting in the

195. *See* North River Ins. Co. v. St. Paul Fire & Marine Ins. Co., 600 F.2d 721 (8th Cir. 1979); Moore v. United States Fidelity & Guar. Co., 325 F.2d 972 (10th Cir. 1963); Frank B. Connet Lumber Co. v. New Amsterdam Casualty Co., 236 F.2d 117 (8th Cir. 1956); Ballard v. Citizens Casualty Co., 196 F.2d 96 (7th Cir. 1952); General Accident Fire & Life Assurance Corp. v. Little, 103 Ariz. 435, 443 P.2d 690 (1968); Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 874, 110 Cal. Rptr. 511 (1973); Rector v. Husted, 214 Kan. 230, 519 P.2d 634 (1974); Georgia Casualty Co. v. Mann, 242 Ky. 447, 46 S.W.2d 777 (1932); Younger v. Lumbermens Mut. Casualty Co., 174 So. 2d 672 (La. App.), *cert. denied*, 176 So. 2d 145 (1965); Murach v. Massachusetts Bonding & Ins. Co., 339 Mass. 184, 158 N.E.2d 338 (1959); Olson v. Union Fire Ins. Co., 174 Neb. 375, 118 N.W.2d 318 (1962); Radio Taxi Serv., Inc. v. Lincoln Mut. Ins. Co., 31 N.J. 299, 157 A.2d 319 (1960).

196. *E.g.*, Kaudern v. Allstate Ins. Co., 277 F. Supp. 83 (D.N.J. 1967).

197. *See* Insurance Co. of N. Am. v. Medical Protective Co., 768 F.2d 315 (10th Cir. 1985); Portland Gen. Elec. Co. v. Pacific Indem. Co., 574 F.2d 469 (9th Cir. 1978); Daniels v. Horace Mann Mut. Ins. Co., 422 F.2d 87 (4th Cir. 1970); Smith v. Transit Casualty Co., 281 F. Supp. 661 (E.D. Tex. 1968), *aff'd*, 410 F.2d 210 (5th Cir. 1969); State Farm Mut. Auto. Ins. Co. v. Jackson, 346 F.2d 484 (8th Cir. 1965); Maryland Casualty Co. v. Elmira Coal Co., 69 F.2d 616 (8th Cir. 1934); Royal Transit v. Central Sur. & Ins. Corp., 168 F.2d 345, 349 (7th Cir.), *cert. denied*, 335 U.S. 844 (1948); Nationwide Mut. Ins. Co. v. Smith, 280 Ala. 343, 194 So. 2d 505 (1966); Chenoweth v. Financial Indem. Co., 13 Ariz. App. 313, 476 P.2d 519 (1970); Coe v. State Farm Mut. Auto. Ins. Co., 66 Cal. App. 3d 981, 990, 136 Cal. Rptr. 331, 335 (1977); American Fire & Casualty Co. v. Davis, 146 So. 2d 615 (Fla. Dist. Ct. App. 1962); Great Am. Ins. Co. v. Exum, 123 Ga. App. 515, 181 S.E.2d 704 (1971); Olympia Fields Country Club v. Bankers Indem. Ins. Co., 325 Ill. App. 649, 60 N.E.2d 896 (1945); Henke v. Iowa Home Mut. Casualty Co., 250 Iowa 1123, 97 N.W.2d 168 (1979); Commercial Union Ins. Co. v. Liberty Mut. Ins. Co., 426 Mich. 127, 393 N.W.2d 161 (1986); Mendota Elec. Co. v. New York Indem. Co., 169 Minn. 377, 211 N.W. 317 (1926); Fowler v. State Farm Mut. Auto. Ins. Co., 153 Mont. 74, 454 P.2d 76 (1969); Fireman's Fund Ins. Co. v. Security Ins. Co., 72 N.J. 63, 367 A.2d 864 (1976); Netzley v. Nationwide Mut. Ins. Co., 34 Ohio App. 2d 65, 296 N.E.2d 550 (1971); Kunkel v. United Sec. Ins. Co., 84 S.D. 116, 168 N.W.2d 723 (1969); State Auto. Ins. Co. v. Rowland, 221 Tenn. 421, 427 S.W.2d 30 (1968); Johnson v. Hardware Mut. Casualty Co., 108 Vt. 269, 187 A. 788 (1936); Tyler v. Grange Ins. Ass'n, 3 Wash. App. 167, 473 P.2d 193 (1970). *See also* Annotation, *Reliance on, or Rejection of, Advice of Counsel as Factor Affecting Liability in Action*

subsequent entry of a judgment in excess of policy limits. It is not surprising, however, that such conduct has been held to support a finding of bad faith.[198] The insurer can hardly argue that it has given its own interests no more consideration than those of its insured when it ignores the advice of its own representatives to settle the case.

If the insurer elects to ignore the advice of the attorney hired to defend the insured against a third-party claim, a finding of bad faith is particularly likely, since the attorney hired by the insurer is charged with protecting the interests of both the insurer and the insured.[199]

D. Failure to inform the insured of settlement offers and negotiations

The authorities are unanimous in their view that the insurer has a duty to convey all settlement offers to the insured and to otherwise keep the insured informed of the status of all settlement negotiations.[200] Failure to do so is a factor indicating bad faith on the part of a liability insurer.[201] Such conduct, according to one authority:

> [T]ends to confirm the insurer's guilty knowledge that it wrongfully rejected the settlement offer, rebuts the suggestion that the insurer considered the offer objectively before rejecting it, and deprives the insured of the opportunity to contribute to the settlement, to inform the insurer of facts showing the wisdom of accepting the offer, or to take other steps to protect its interests.[202]

The basis upon which bad faith liability is most often imposed

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Against Insurer for Wrongful Refusal to Settle Claim, 63 A.L.R.3d 725 (1975).

198. *See supra* note 197.

199. Kinder v. Western Pioneer Ins. Co., 231 Cal. App. 2d 894, 42 Cal. Rptr. 394 (1965). Ironically, the question of whether the insurer relied upon the advice of its own attorney comes to light as a result of the insurer's failure to hire separate legal counsel to protect the interests of the insured when a conflict arises as a result of a third-party claim in excess of policy limits. When the same attorney attempts to represent the interests of both the insurer and the insured, the advice the insurer receives from the attorney concerning settlement does not fall within the insurer's attorney-client privilege because the attorney providing such advice is also the insured's attorney. *See* S. ASHLEY, *supra* note 16, § 3:05, at 3-12 n.6.

200. *See* Continental Casualty Co. v. Great Am. Ins. Co., 711 F. Supp. 1475 (N.D. Ill. 1989); Bohn v. Sentry Ins. Co., 681 F. Supp. 357 (E.D. La. 1988), *aff'd without opinion,* 868 F.2d 1269 (5th Cir. 1989); Bohemia, Inc. v. Home Ins. Co., 725 F.2d 506 (9th Cir. 1984); O.K. Lumber Co. v. Providence Wash. Ins. Co., 759 P.2d 523 (Alaska 1988); Farmers Group, Inc. v. Trimble, 691 P.2d 1138 (Colo. 1984); Fidelity & Casualty Co. v. Copy, 444 So. 2d 1041 (Fla. Dist. Ct. App. 1984), *rev'd on other grounds,* 462 So. 2d 459 (1985); Gibson v. Western Fire Ins. Co., 210 Mont. 267, 682 P.2d 725 (1984); Ranger County Mut. Ins. Co. v. Guin, 723 S.W.2d 656 (Tex. 1987); Myers v. Ambassador Ins. Co., 146 Vt. 552, 508 A.2d 689 (1986); State Farm Mut. Auto. Ins. Co. v. Floyd, 235 Va. 136, 366 S.E.2d 93 (1988); Tank v. State Farm Fire & Casualty Co., 105 Wash. 2d 381, 715 P.2d 1133 (1986); Warren v. American Family Mut. Ins. Co., 122 Wis. 2d 381, 361 N.W.2d 724 (Wis. Ct. App. 1984).

201. *See supra* note 200.

202. S. ASHLEY, *supra* note 16, § 3:09, at 3-21.

upon an insurer for its failure to inform the insured of offers of settlement is that without knowledge of the offer, the insured is deprived of the opportunity to contribute to a possible settlement, thus protecting the insured against the danger of a larger excess judgment.[203] If the insured's policy limits are $50,000, for example, and the insurer neglects to inform the insured that the claimant offered to settle the case for $60,000, the insured is deprived of the opportunity to protect himself from further liability by contributing $10,000 toward settlement of the case. If a total judgment of $100,000 is thereafter entered, and the insured can persuade a jury that he would have contributed $10,000 toward a settlement of the case had he known about the offer of settlement,[204] the insurer will be held liable for the entire judgment.[205]

The duty of an insurer to keep the insured informed goes beyond the mere communication of settlement offers. It is generally held that if the insurer intends to reject a settlement offer and there is any risk that a potential judgment may exceed policy limits, the insurer must (1) advise the insured of the risk of an excess judgment; (2) explain how this may affect the insured's rights; and (3) explain to the insured that he may secure private counsel to represent his interests in the litigation.[206] Because failure to do so may result in a finding of bad faith,[207] the insurer's counsel should always communicate in writing the full facts and circumstances surrounding every offer of settlement, along with the consequences to the insured of rejecting the offer.

E. Other factors indicating bad faith

Attempts by the insurer to induce the insured to contribute to a policy limits settlement as a condition of accepting an offer to settle within policy limits have, from the earliest days of third-party bad faith cases, resulted in a finding of bad faith on the part of the insurer.[208] The insurer, however, also has a duty to keep the insured

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203. *See* Kooyman v. Farm Bureau Mut. Ins. Co., 315 N.W.2d 30 (Iowa 1982) and Kaudern v. Allstate Ins. Co., 277 F. Supp. 83 (D.N.J. 1967).

204. In such situations, counsel for the insured should always contend that he would have contributed to the settlement, at least if it can be shown that he was financially able or could have borrowed the funds to do so. For obvious reasons, it is difficult for the insurer to rebut such a contention.

205. *Supra* note 194.

206. Kooyman v. Farm Bureau Mut. Ins. Co., 315 N.W.2d 30 (Iowa 1982).

207. *Id.*

208. *See* Brockstein v. Nationwide Mut. Ins. Co., 417 F.2d 703 (2d Cir. 1969); Springer v. Citizens Casualty Co., 246 F.2d 123 (5th Cir. 1957); American Mut. Liab. Ins. Co. v. Cooper, 61 F.2d 446 (5th Cir. 1932), *cert. denied*, 289 U.S. 736 (1933); Covill v. Phillips, 452 F. Supp. 224 (D. Kan. 1978); Board of Education v. Lumbermens Mut. Casualty Co., 293 F. Supp. 541 (D.N.J. 1968), *aff'd*, 419 F.2d 837 (3d Cir. 1969); Brown & McCabe, Stevedores, Inc. v. London Guarantee & Accident Co., 232 F. 298 (D. Or. 1915); Chenoweth v. Financial Indem. Co., 13 Ariz. App. 313, 476 P.2d 519 (1970); Coe v. State Farm Mut. Auto. Ins. Co., 66 Cal. App. 3d 981, 136 Cal. Rptr. 331 (1977); Ferris v. Employers Mut. Casualty Co., 255 Iowa 511, 122 N.W.2d 263 (1963); State Farm Mut. Auto. Ins. Co. v. White, 248 Md. 324, 236 A.2d 269 (1967); Commercial

informed of all settlement offers and to advise the insured of his right to contribute to an excess offer so that the insured, if he decides it is in his best interests to do so, may contribute a sum in excess of the insurer's policy limits in order to settle the case. The insurer must make certain, therefore, that in advising the insured of his right to contribute to a potential settlement in excess of policy limits, it does not convey to the insured the message that he must do so.[209]

Occasionally, the third-party claimant will obtain a judgment in excess of policy limits and then, to eliminate the time, expense and uncertainty of an appeal, offer to settle the case within policy limits. It has been held that the failure of the insurer to accept a "post-judgment" settlement offer is a factor indicating bad faith.[210] It has also been held that if the cancellation or nonrenewal of an insured's liability policy is shown to have been in retaliation for the insured's demand that the insurer accept a policy limits settlement offer, bad faith is indicated.[211]

There is authority which holds that the amount of the excess judgment itself will support a finding of bad faith.[212] Whatever the rule is elsewhere, however, this is clearly not the law in Wyoming. In *Fowler*, the court specifically approved a jury instruction which told the jury not to consider or give any weight to the fact that the employee subsequently recovered a judgment for more than the amount of the settlement offer.[213] The question of whether a liability insurer acted in bad faith in rejecting a policy limits settlement offer, in other words, must be determined at the time the offer to settle was made and rejected.[214]

Finally, some decisions indicate that the insured's failure to demand that his insurer accept a policy limits settlement offer may indicate an absence of bad faith on the part of the insurer.[215] The better rule, however, is that the insured need not do so, particularly when the insurer usually insists upon the insured's cooperation in the defense of the third-party claim.[216]

Union Ins. Co. v. Liberty Mut. Ins. Co., 426 Mich. 127, 393 N.W.2d 161 (1986); Zumwalt v. Utilities Ins. Co., 360 Mo. 362, 228 S.W.2d 750 (1950); Netzley v. Nationwide Mut. Ins. Co., 34 Ohio App. 2d 65, 296 N.E.2d 550 (1971); Boling v. New Amsterdam Casualty Co., 173 Okla. 160, 46 P.2d 916 (1935); Kunkel v. United Sec. Ins. Co., 84 S.D. 116, 168 N.W.2d 723 (1969); Johnson v. Hardware Mut. Casualty Co., 109 Vt. 481, 1 A.2d 817 (1938); Lanferman v. Maryland Casualty Co., 222 Wis. 406, 267 N.W. 300 (1936).

209. *See* S. ASHLEY, *supra* note 16, § 3:09, at 3-16.

210. *Id.* § 3.05, at 3-12.

211. Davy v. Public Nat'l Ins. Co., 181 Cal. App. 2d 387, 5 Cal. Rptr. 488 (1960).

212. Cain v. State Farm Mut. Auto. Ins. Co., 47 Cal. App. 3d 783, 121 Cal. Rptr. 200 (1975).

213. *Fowler*, 390 P.2d at 606.

214. *Id.*

215. *E.g.*, Gibson v. Western Fire Ins. Co., 210 Mont. 267, 682 P.2d 725 (1984).

216. S. ASHLEY, *supra* note 16, § 3.24, at 3-60.

V. ASSIGNMENT OF THE THIRD-PARTY BAD FAITH CAUSE OF ACTION

If the third-party claimant obtains a judgment in excess of policy limits after offering to settle the case within policy limits, it is not unusual for the insurer to offer its policy limits to the third-party claimant. As happened in *Fowler*, the insured may then pay the third-party claimant the difference between the amount of the judgment and the limits of the policy and, having done so, file suit against his insurer to recover the excess portion of the judgment.[217]

In most cases, however, the insured, whether an individual or a business entity, will not have sufficient assets to satisfy a large excess judgment. Indeed, if the insured is insolvent or judgment-proof, he may have little incentive to pursue a bad faith cause of action against his insurer unless he sustains significant damage above and beyond the amount of the judgment for which the insured is personally liable, or unless the conduct of the insurer was such as to warrant a punitive damage instruction. Because the third-party claimant (1) cannot force the insured to pursue a bad faith action against his insurer[218] and (2) may not be able to proceed directly against the liability insurer absent an assignment,[219] the claimant's success in executing upon the excess judgment will likely depend upon whether he can acquire the insured's bad faith cause of action against the liability insurer. To do so, the claimant must ordinarily promise that he will look only to the insurer to satisfy the excess judgment. Thus, the insured's second option, at least in most jurisdictions, is to assign his right to collect the amount of the excess judgment against his insurer to the third-party claimant in exchange for a covenant not to sue. By assigning the claim, the insured has shifted his personal liability for the excess judgment to either the liability insurer or the third-party claimant, depending upon whether the claimant can carry his burden of establishing that the insurer rejected the offer in bad faith.[220]

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217. The insured may also pursue a bad faith action against the insurer without discharging the excess portion of the judgment. In that event, there is certainly nothing which precludes the third-party claimant from executing upon the assets of the insured while the insured is pursing his bad faith action against the insurer. As a practical matter, however, the insured and third-party claimant will often have reached agreement as to how any recovery on the part of the insured will be divided between the insured and the third-party claimant. As part of such agreement, the claimant will often execute a covenant not to sue in favor of the insured. *See infra* notes 238-248.

218. The third-party claimant may be able to force the insured into bankruptcy, in which case any claim the insured may have had against his insurer passes by operation of law to the insured's bankruptcy trustee. *See* Purdy v. Pacific Auto. Ins. Co., 157 Cal. App. 3d 59, 203 Cal. Rptr. 524 (1984), even though the judgment against the insured is not yet final. In some cases, the insured's cause of action against the insurer may represent the only sizeable asset the insured has. In that event, the trustee is empowered to enter into assignments or to otherwise work out an agreement with the third-party claimant as to how the action is to be pursued. If the insured's claim was previously assigned to the injured party, however, the insured's bankruptcy will not affect the right of the assignee to pursue the bad faith claim.

219. *Infra* notes 221-224.

220. Provided there is coverage, the third-party claimant will always be able to

The following section addresses a number of issues concerning the ability of the insured to assign his third-party bad faith cause of action to the claimant, which counsel for the insurer, the insured and the third-party claimant should be familiar with.

A. Is the insured's assignment of a bad faith claim to the third-party claimant recognized in Wyoming?

In most jurisdictions[221] a third-party claimant cannot bring suit directly against the insurer to collect a judgment in excess of policy limits absent a statutory cause of action,[222] a policy provision authorizing such a suit,[223] or an assignment from the insured of the insured's cause of action against the insurer.[224] There is no statutory cause of action in Wyoming permitting such a suit,[225] nor is a third-party

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attach the policy limits of the liability insurer in partial satisfaction of the judgment. Thus, where the judgment in question does not significantly exceed the insured's policy limits, the claimant may not be interested in pursuing anyone but the insured.

221. *See* Annotation, *Right of Injured Person Recovering Excess Judgment Against Insured to Maintain Action Against Liability Insurer for Wrongful Failure to Settle Claim*, 63 A.L.R.3d 677 (1975).

222. *E.g.*, Bourget v. Government Employees Ins. Co., 287 F. Supp. 108 (D. Conn. 1968); Davis v. National Grange Ins. Co., 281 F. Supp. 998 (E.D. Va. 1968); Trask v. Iowa Kemper Mut. Ins. Co., 248 N.W.2d 97 (Iowa 1976).

223. *E.g.*, Cue v. Casualty Corp. of Am., 537 P.2d 349 (Okla. Ct. App. 1975); Vaughn v. Vaughn, 23 Wash. App. 527, 597 P.2d 932 (1979).

224. *E.g.*, Clement v. Prudential Property & Casualty Ins. Co., 790 F.2d 1545 (11th Cir. 1986); Moutsopoulos v. American Mut. Ins. Co., 607 F.2d 1185 (7th Cir. 1973); Luke v. American Family Mut. Ins. Co., 476 F.2d 1015 (8th Cir. 1973); Liberty Mut. Ins. Co. v. Davis, 412 F.2d 475 (5th Cir. 1969); Oppel v. Empire Mut. Ins. Co., 517 F. Supp. 1305 (S.D.N.Y. 1981); Smith v. Transit Casualty Co., 281 F. Supp. 661 (E.D. Tex. 1966), *aff'd*, 410 F.2d 210 (5th Cir. 1969); General Accident Fire & Life Assurance Corp. v. Little, 102 Ariz. 435, 443 P.2d 690 (1968); Murphy v. Allstate Ins. Co., 17 Cal. 3d 937, 132 Cal. Rptr. 424, 553 P.2d 584 (1976); Kennedy v. Kiss, 89 Ill. App. 3d 890, 412 N.E.2d 624 (1980); DiMarzo v. American Mut. Ins. Co., 389 Mass. 85, 449 N.E.2d 1189 (1983); Lisiewski v. Countrywide Ins. Co., 75 Mich. App. 631, 255 N.W.2d 714 (1977); Lange v. Fidelity & Casualty Co., 290 Minn. 61, 185 N.W.2d 881 (1971); Fredericks v. Home Indem. Co., 101 A.D.2d 614, 474 N.Y.S.2d 870 (1984); Kriz v. Government Employees Ins. Co., 42 Or. App. 339, 600 P.2d 496 (1979); Gray v. Nationwide Mut. Ins. Co., 422 Pa. 500, 223 A.2d 8 (1966); Vaughn v. Vaughn, 23 Wash. App. 527, 597 P.2d 932 (1979).

225. The United States District Court for the District of Wyoming in Julian v. New Hampshire Ins. Co., 694 F. Supp. 1530 (1988), held that the Wyoming Unfair Claims Settlement Practices Act does not create a private right of action on the part of third-party claimants against liability insurers. As stated by the court:

> As with acts in other states, Wyoming penalizes unfair claims settlement practices that are committed or performed with such frequency as to indicate a general business practice. As such, "it does not readily lend itself to enforcement by a private cause of action arising from a single claim." Second, the Wyoming Insurance Commissioner has power to examine and inquire into violations of the Insurance Code, enforce the Insurance Code with impartiality, execute the duties imposed upon him by the Insurance Code, and has the powers and authority expressly conferred upon him by or reasonably implied from this code. Finally, as illustrated by WYO. STAT. §26-15-124(c), the Wyoming Legislature knows how to expressly create a private right of action if it chooses to do so. Having reviewed WYO. STAT. §26-13-124 . . . this court cannot conclude that the legislature intended to create a private right of action under this section.

claimant in Wyoming likely to succeed in bringing a direct suit against a liability insurer as a judgment creditor,[226] a third-party beneficiary,[227] or as a garnishor, at least prior to the time the insured has liquidated the debt through his own action against the insurer.[228]

Although there is no direct authority in Wyoming,[229] virtually all courts have allowed the insured to assign his right of recovery against the insurer for the wrongful refusal to settle a claim in excess of policy limits,[230] even though the policy of insurance may contain a provision

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Id. at 1533. The reasons set forth in the above opinion are persuasive and, as a result, it is not likely that such a cause of action would be recognized by the Wyoming Supreme Court.

226. *See* A. WINDT, *supra* note 16, § 9.13. *See also* Page v. Allstate Ins. Co., 126 Ariz. 258, 614 P.2d 339 (Ariz. Ct. App. 1980); Murphy v. Clancy, 83 Ill. App. 3d 779, 404 N.E.2d 287 (1980); Cue v. Casualty Corp. of Am., 537 P.2d 349 (Okla. Ct. App. 1975); Auerbach Co. v. Key Sec. Police, Inc., 680 P.2d 740 (Utah 1984).

Courts holding that a third-party claimant cannot sue in the capacity of a judgment creditor reason that it is not appropriate to resolve the issue of bad faith in a garnishment proceeding. *See, e.g.*, Linder v. Hawkeye-Security Ins. Co., 472 S.W.2d 412 (Mo. 1971), *cert. denied*, 405 U.S. 950 (1972).

227. Only Florida has allowed such an action under a third-party beneficiary theory, *e.g.*, Boston Old Colony Ins. Co. v. Guitierrez, 386 So. 2d 783 (Fla. 1980).

228. The majority of jurisdictions reject the argument that a third party may litigate under statutes permitting a creditor to bring a direct cause of action to garnish a debt owed to the creditor's debtor on the ground that the third party may not bring an action against the insurer until the insured has liquidated the debt through his own action against the insurer. *See* Rowe v. United States Fidelity & Guar. Co., 421 F.2d 937 (4th Cir. 1970); Ring v. State Farm Mut. Auto. Ins. Co., 147 Ariz. 33, 708 P.2d 457 (Ariz. Ct. App. 1985); Steen v. Aetna Casualty & Sur. Co., 157 Colo. 99, 401 P.2d 254 (1965); Stevenson v. Samkow, 142 Ill. App. 3d 293, 491 N.E.2d 1318 (1986); Linder v. Hawkeye-Security Ins. Co., 472 S.W.2d 412 (Mo. 1971), *cert. denied*, 405 U.S. 950 (1972); Pringle v. Robertson, 258 Or. 394, 483 P.2d 814 (1971); Cook v. Superior Ins. Co., 476 S.W.2d 363 (Tex. Civ. App. 1972); Paul v. Kirkendall, 6 Utah 2d 256, 311 P.2d 376 (1957); Murray v. Mossman, 56 Wash. 2d 909, 355 P.2d 985 (1960).

Note that in Wyoming, a prejudgment writ of garnishment can be obtained by a judgment creditor anytime after a complaint is filed, but before a judgment is obtained, against the defendant. *See* WYO. STAT. § 1-15-401(b) (1977).

229. The issue of whether a bad faith claim is assignable has not arisen in Wyoming. However, assignments in other contexts have been recognized, *e.g.*, *In re* Boyd's Estate, 606 P.2d 1243 (Wyo. 1980) (an assignment is an act or expression of intention by which one person causes to transfer, set over or vest in another a right or property or interest therein).

230. *See* D. WALL, *supra* note 3, § 7.02, at 246 ("Every jurisdiction in which the courts have addressed the question allows the insured to assign its right to sue the liability carrier for bad faith to a third-party claimant."). Tennessee, however, appears to be an exception. *See* Dillingham v. Tri-State Ins. Co., 214 Tenn. 592, 381 S.W.2d 914 (1964). *See also* Annotation, *Assignabililty of Insured's Right to Recover Over Against Liability Insurer for Rejection of Settlement Offer*, 12 A.L.R.3d 1158 (1967).

The only time a question may arise is if a court views a cause of action based on a failure to settle as sounding solely in tort, *e.g.*, Baker v. Auger, 709 F.2d 1063 (6th Cir. 1983), where the court held that a bad faith claim, being in the nature of an action for fraud, was not assignable. Most of the cases which have addressed the issue, however, have held that a claim for a bad faith refusal to settle, although sounding in tort, is assignable. *See* Clement v. Prudential Property & Casualty Ins. Co., 790 F.2d 1545 (11th Cir. 1986); Moutsopoulos v. American Mut. Ins. Co., 607 F.2d 1185 (7th Cir. 1979); Luke v. American Family Mut. Ins. Co., 476 F.2d 1015 (8th Cir. 1973); Smith v. Transit Casualty Co., 281 F. Supp. 661 (E.D. Tex. 1966), *aff'd*, 410 F.2d 210 (5th Cir. 1969); General Accident Fire & Life Assurance Corp. v. Little, 103 Ariz. 435, 443 P.2d 690 (1968); Woolett v. American Employers Ins. Co., 77 Cal. App. 3d 619, 143 Cal.

directly prohibiting assignments.[231] Given the recognition which the vast majority of courts have accorded to the insured's right to assign his bad faith cause of action to a third-party claimant, there certainly is no reason to believe that the Wyoming Supreme Court would prevent the insured from assigning his bad faith cause of action to a third-party claimant if the issue were to come before it.[232]

B. What defenses can be asserted against the assignee who prosecutes a bad faith claim against the insurer?

According to ordinary principles of contract law, the third-party claimant takes the assignment subject to any defenses which the insurer could have otherwise asserted against the insured had the insured himself brought suit against the insurer for bad faith.[233] Where the claim assigned is the insurer's violation of its duty to settle and the question of coverage is not at issue, this means that proof of the insurer's good faith will negate the assignee's claim against the insurer for the excess judgment.[234]

Rptr. 799 (1978); Bracato v. Prairie State Farmers' Ins. Ass'n, 166 Ill. App. 3d 986, 520 N.E.2d 1200 (1988); Dimarzo v. American Mut. Ins. Co., 389 Mass. 85, 449 N.E.2d 1189 (1983); Lisiewski v. Countrywide Ins. Co., 75 Mich. App. 631, 255 N.W.2d 714 (1977); Lange v. Fidelity & Casualty Co., 290 Minn. 61, 185 N.W.2d 881 (1971); Fredericks v. Home Indem. Co., 101 A.D.2d 614 474 N.Y.S.2d 870 (1984); Kriz v. Government Employees Ins. Co., 42 Or. App. 339, 600 P.2d 495 (1979); Gray v. Nationwide Mut. Ins. Co., 422 Pa. 500, 223 A.2d 8 (1966); Vaughn v. Vaughn, 23 Wash. App. 527, 597 P.2d 932 (1979).

231. Murphy v. Allstate Ins. Co., 17 Cal. 3d 937, 132 Cal. Rptr. 424, 553 P.2d 584 (1976).

232. The policy reasons, moreover, for allowing the assignment of third-party bad faith claims are sound. As the court stated in Liberty Mut. Ins. Co. v. Davis, 412 F.2d 475, 485 (5th Cir. 1969):

> There are strong policy considerations in favor of approving assignment of failure-to-settle claims to the injured claimant. A holding to the contrary would leave many judgment creditors without recourse. The claimant awarded damages may be left with a judgment-proof debtor whose only valuable asset is his cause of action against his insurer. It is unlikely that such an insured would undertake a complex and expensive suit against the insurer offering him no direct benefits. This would leave the insured party without recourse for his damages and would allow insurance companies to play fast and loose with claims against their less affluent policyholders. Here, assignability would benefit the assignor as well as the assignee to the extent that it diminished the wage garnishment to which he would be subjected. The policy reason against permitting an assignment of the claim is that it might encourage fraud and collusion between the insured and the injured claimant. This reasoning is inapplicable if, as in this case, the insurer has already rejected the settlement.

233. *See* KORNBLUM, *supra* note 16, § 7:215, at 7-53. *See also* Ceresino v. Fire Ins. Exch., 215 Cal. App. 3d 814, 264 Cal. Rptr. 30 (1989) and Jones v. Central States Inv. Co., 654 P.2d 727 (Wyo. 1982), where the court held that the assignee stands in the shoes of the assignor and receives such right, title and interest as is possessed by the assignor and which the parties make the subject of the contract.

234. As stated in Clearwater v. State Farm Mut. Auto. Ins. Co., 164 Ariz. 256, 258, 792 P.2d 719, 721 (1990):

> The type of claim is not determined by the identity of the party bringing the bad faith action against the insurer. For example, a third party action might be brought by the *insured* in the event that he is subjected to excess liability by

The rule as to the assignability of bad faith claims applies with equal force where the insurer wrongfully refuses to defend[235] or incorrectly asserts a coverage defense[236] against its insured. Where the assignee has asserted a bad faith claim against the insurer for its wrongful failure to settle and the insurer is claiming that it had no duty to defend or that the claim does not fall within the coverage of the policy, the assignee need only prove that the claim falls within the coverage of the policy.[237] If the assignee fails to meet his burden of proof, he receives no recovery from the insurer beyond policy limits.

The burden of proof which the third-party assignee must carry in order to collect a judgment in excess of policy limits will obviously influence the claimant's willingness to execute an assignment with the insured. Unless the claimant is relatively certain that he can establish the bad faith of the liability insurer, he is likely to accept an assignment only from an insolvent or judgment proof insured.

C. Will the third-party claimant/assignee be allowed to collect an excess judgment from the insurer if he executes a covenant not to sue or releases the insured from liability?

As a practical matter, the insured will not likely assign his cause of action for bad faith unless the third-party claimant promises not to attempt collection of the excess judgment from the insured. Absent a covenant not to sue, there is little incentive for the insured to relinquish his claim against his insurer, because the third-party claimant who unsuccessfully asserts a third-party bad faith claim against the insurer may, years later, look back to the insured for satisfaction of the excess judgment. If the purpose for allowing the insured to assign

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reason of the insurer's bad faith refusal to settle. In that event, the standards applicable to third-party claims would govern the action, although it was brought by the insured, rather than a third-party assignee.

235. Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958).

236. If, for example, the insurer assumes the defense of a third-party claim subject to a reservation of rights, the insured can, in many jurisdictions, reject the defense. The insurer then has one of two choices. The insurer can either affirm the policy, defend the suit, and pay any resulting advserse judgment, regardless of the existence of any policy defenses, or can refuse to defend and take its chances that its denial of coverage will be validated in a subsequent suit on the policy. *See* A. WINDT, *supra* note 16, § 4.24. In such jurisdictions, the insured can declare a breach of contract, assume control of the defense, and enter into a settlement agreement with the third-party claimant, *e.g.*, United States Aviation Underwriters, Inc. v. Olympia Wings, Inc., 896 F.2d 949 (5th Cir. 1990). If the settlement agreement is enforceable against the insurer by the insured, it can be assigned to the third-party claimant. *Supra*, note 230.

237. *See* Steil v. Florida Physicians' Ins. Reciprocal, 448 So. 2d 589 (Fla. Dist. Ct. App. 1984), where the court rejected the insured's argument that he should only have to establish that there was a potential for coverage in order to recover an excess judgment from the insurer, because the insurer's breach of the duty to defend led to the excess judgment being entered against the insured. The court held that a determination of whether the insurer wrongfully refused to defend was necessary only to determine whether the insurer could rely on its "no-action" clause.

his bad faith claim is to be meaningfully served, therefore, the third-party claimant must be able to promise the insured that the claimant will look only to the insurer for recovery.[238]

In several cases, however, liability insurers have argued that the assignee should not be allowed to collect an excess judgment from the insurer if the claimant, by executing a covenant not to sue, has effectively released the insured from all liability for the judgment.[239] Because all obligations to pay on the part of the insurer are predicated upon the insured's liability to the claimant,[240] in other words, insurers have argued that they cannot be held accountable to the assignee when the insured has been discharged from liability by the assignee without making any payment.[241]

With some notable exceptions,[242] this argument has been rejected by most of the courts which have considered the issue.[243] In *Gray v.*

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238. *See* S. ASHLEY, *supra* note 16, § 7:18, at 7-30.

239. In Gray v. Grain Dealers Mut. Ins. Co., 871 F.2d 1128, 1132 (D.C. Cir. 1989), the insurer's "metaphysical contention" was phrased by the court as follows: "That brings us to question whether or not the assignment and release were self-contradicting. According to the insurance company, the release nullified the assignment of the claim because the release extinguished the basis for the assignment. If so, that which Speed assigned to Gray was worthless upon transfer."

240. Most liability policies require the insurer to pay only as to amounts the insured is "legally obligated to pay." S. ASHLEY, *supra* note 16, § 7:18, at 7-29.

241. Steil v. Florida Physicians' Ins. Reciprocal, 448 So. 2d 589 (Fla. Dist. Ct. App. 1984).

242. Freeman v. Schmidt Real Estate & Ins., 755 F.2d 135 (8th Cir. 1985); Bendall v. White, 511 F. Supp. 793 (N.D. Ala. 1981); American Casualty Co. v. Griffith, 107 Ga. App. 224, 129 S.E.2d 549 (1963); Huffman v. Peerless Ins. Co., 17 N.C. App. 292, 193 S.E.2d 773, *cert. denied*, 195 S.E.2d 689 (1973); and Stubblefield v. St. Paul Fire & Marine Ins. Co., 267 Or. 397, 517 P.2d 262 (1973).

One of the few cases to discuss the issue in the context of a settlement agreement has held that neither the insured nor his assignee can enforce a settlement agreement in excess of policy limits where the insured does not face at least the potential of personal liability. Thus, in National Union Fire Ins. v. Continental Ill., 673 F. Supp. 267, 274-75 (N.D. Ill. 1987), the court held:

> At several points in the preceding analysis this opinion has stressed the need for the insured to be at risk for the settlement amount in excess of the policy limits before it can seek to thrust that risk onto its insurer. That after all is the factor that builds into the equation the elements of the settlement's reasonableness and the insured's bona fides—that at-risk requirement provides the equivalent of an adversary litigation that produces a judgment in excess of the policy limits. If the insured is speculating only with the insurer's dollars—a sort of 'Heads I win, tails I lose nothing'—there is no rational limit imposed on the putative settlement.

243. *E.g.*, Steedly v. London & Lancashire Ins. Co., 416 F.2d 259 (6th Cir. 1969) (assignment/release did not free insurer from liability; if insured "had satisfied judgment by making full payment . . . in return for the release, [the insurer] agrees that he could have then brought an action against it or have assigned this right"); Zander v. Casualty Ins. Co., 259 Cal. App. 2d 793, 66 Cal. Rptr. 561, 568 (1968) (settlement with insured does not release insurer because to do so penalizes insured for attempt to minimize damages); Critz v. Farmers Ins. Group, 230 Cal. App. 2d 788, 41 Cal. Rptr. 401, 404 (1964) (assignment of chose of action in exchange for release from liability before judgment entered against insured not void against public policy because assignment's value is determined by bad faith of insurer); LaRotunda v. Royal Globe Ins. Co., 87 Ill. App. 3d 446, 408 N.E.2d 928 (1980) (agreement not to collect against insured given in exchange for assignment of rights against insurer does not evidence collusion); Metcalf

Grain Dealers Mutual Insurance Co.,[244] one of the more recent cases to discuss the issue, the court explained why the contentions of the insurer had little merit:

> [W]e see no reason why, under D.C. and North Carolina law, we should not construe the assignment and release to give full effect to its terms. After all, if the release of [the insured] extinguished the claim [the insured] had against the insurance company simultaneously with the assignment of the claim, that would also be true of that part of the claim [the insured] had against the insurance company within the policy limits. As appellee points out, appellant's argument reduces to an absurd conclusion: if the insured were to have paid the judgment in full and obtained a release from the injured party, he would have no right to proceed against the insurer for indemnification. We think appellant's self-destruct interpretation of the document can only be adopted for policy reasons quite apart from appropriate legal methods of document construction . . . .[245]

The practitioner should note that substantive differences between a release and covenant not to sue still persist. "Covenants not to execute are different than releases, as the legal liability remains in force against those who have covenants, whereas a release represents total freedom from liability."[246] Although in general the courts have not drawn this distinction in upholding assignments which transfer the insured's bad faith claim to the third-party claimant,[247] it may, nonetheless, be prudent for the third-party claimant to always execute a covenant not to sue rather than an outright release of liability in acquiring the insured's right to proceed against the insurer.[248]

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v. Hartford Accident & Indem. Co., 176 Neb. 468, 126 N.W.2d 471, 475-76 (1964) (rejecting insurer's contention that consent judgment created no legal obligation to pay). *See also* State Farm Mut. Auto. Ins. Co. v. Paynter, 122 Ariz. 198, 593 P.2d 948 (1979); Steil v. Florida Physicians' Ins. Reciprocal, 448 So. 2d 589 (Fla. Dist. Ct. App. 1984); Bishop v. Crowder, 101 Ill. App. 3d 933, 428 N.E.2d 1021 (1981); American Family Mut. Ins. Co. v. Kivela, 408 N.E.2d 805 (Ind. App. 1980); Miller v. Shugart, 316 N.W.2d 729 (Minn. 1982) Griggs v. Bertram, 8 N.J. 347, 443 A.2d 163 (1982).

244. 871 F.2d 1128, 1133 (D.C. Cir. 1989). *See also* Glenn v. Fleming, 799 P.2d 79 (Kan. 1990).

245. The "policy reasons" referred to by the court rest upon the concern that the use of covenants not to execute will impart a collusive character to a personal injury suit. These arguments have been specifically rejected in Gray v. Nationwide Mut. Ins. Co., 422 Pa. 500, 223 A.2d 8 (1966) and Critz v. Farmers Ins. Group, 230 Cal. App. 2d 788, 41 Cal. Rptr. 401 (1964).

246. Gray v. Grain Dealers Mut. Ins. Co., 871 F.2d 1128, 1133 n.7 (D.C. Cir. 1989).

247. *Id.*

248. Counsel may also note the procedure used in Bishop v. Crowther, 101 Ill. App. 3d 933, 428 N.E.2d 1021 (1981) and Griggs v. Bertram, 88 N.J. 347, 443 A.2d 163 (1982). In those cases, the settlement agreement provided that the injured party could not execute against any of the insured's assets except for his or her claim against the insurer. Under this type of agreement, it could be argued that the insured is still legally obligated to the injured party and, if so, the insurer is liable to the assignee for the excess judgment.

D. What rights can be assigned?

It is generally held that tort damages which are personal to the insured, such as a claim for emotional distress[249] or damage to the insured's credit reputation, are not assignable in a third-party bad faith action.[250] The jurisdictions are split, however, on the issue of whether the insured's punitive damage claim is assignable, with the majority view apparently favoring assignability.[251]

Because of the general prohibitions against splitting causes of action, it has been held that the insured's assignment of his entire bad faith claim constitutes a waiver of any claims which were not assignable.[252] To avoid this problem, the insured who wants to preserve his tort claims or punitive damage claims against the insurer must (1) execute a partial assignment and (2) join with the third-party claimant as a party in the latter's bad faith action against the insurer.[253] This procedure permits recovery of damages which are deemed personal to the insured, along with the amount of the excess judgment by the third-party claimant.[254] Alternatively, the insured may bring suit in his name only for all damages, including the judgment in excess of policy limits, and simply agree in advance to pay part of his recovery to the third-party claimant.[255]

E. Can the parties to the action enter into a settlement agreement following breach of the insurer's duty to settle and then enforce the agreement against the insurer?

Following an insurer's breach of its duty to settle, both the third-party claimant and the insured may have reasons to enter into a settlement agreement, which the claimant would thereafter attempt to enforce against the insurer by way of assignment. By settling the case, the third-party claimant avoids a trial where he would have to carry the burden of proving liability and damages. The insured, on the other hand, may reduce his overall exposure to the claimant by entering into a settlement agreement and spare himself the time, expense and emotional turmoil of an adversary proceeding. Where he is not being defended by his insurer, moreover, he may save the costs of as-

249. *See* Cuson v. Maryland Casualty Co., 735 F. Supp. 966 (D. Haw. 1990), and Murphy v. Allstate Ins. Co., 17 Cal. 3d 937, 132 Cal. Rptr. 424, 553 P.2d 584 (1976).

250. *See generally* Annotation, *Assignability of Proceeds of Claim for Personal Injury or Death*, 33 A.L.R.4th 82 (1984).

251. *Compare* Cuson v. Maryland Casualty Co., 735 F. Supp. 966 (D. Haw. 1990) *and* Clearwater v. State Farm Mut. Auto. Ins. Co., 780 P.2d 423, 427 (Ariz. App. 1989) *rev'd on other grounds*, 792 P.2d 719 (Ariz. 1990) *with* Murphy v. Allstate Ins. Co., 17 Cal. 3d 937, 132 Cal. Rptr. 424, 553 P.2d 584 (1976).

252. Purcell v. Colonial Ins. Co., 20 Cal. App. 3d 807, 97 Cal. Rptr. 874 (1971).

253. This procedure was specifically approved in Cain v. State Farm Mut. Auto. Ins. Co., 47 Cal. App. 3d 783, 121 Cal. Rptr. 200 (1975).

254. *Id.*

255. Purcell v. Colonial Ins. Co., 20 Cal. App. 3d 807, 97 Cal. Rptr. 874 (1971).

suming his own defense.[256]

In spite of contentions on the part of insurers that an unauthorized settlement agreement violates the "no-action" clauses typically found in liability insurance policies,[257] the courts have universally allowed the insured to enter into a settlement agreement with the claimant following the insurer's violation of its duty to settle.[258] The right of the insured to do so has been held to be indistinguishable from the insured's right to control his own defense, and hence settle all claims asserted against him, where the insurer wrongfully refuses to defend its insured.[259]

Insurers have also argued to no avail that the third-party bad faith cause of action can arise only after a judgment in excess of policy limits has been entered against the insured.[260] It is now clear that an actual judgment in excess of policy limits is not a prerequisite to the third-party bad faith cause of action. As a result, following breach of the insurer's duty to settle, the insured has the right to enforce a settlement agreement against the insurer,[261] provided that it is reasonable and entered into in good faith[262] and the potential judgment ex-

256. In many cases, the insured, if he believes that his insurer has wrongfully refused to defend him against a third-party claim, will simply allow a default judgment to be entered against him. Under the theory that the insured must mitigate his damages where it is reasonable to do so, however, some jurisdictions require that the insured hire his own attorney and defend against the third-party claim, particularly if the insured has the financial resources to do so. *See* S. ASHLEY, *supra* note 16, § 4:07 and A. WINDT, *supra* note 16, § 4.16.

257. *See* Annotation, *Validity, Construction, and Effect of "No-Consent-to-Settlement" Exclusion Clauses in Automobile Insurance Policy*, 18 A.L.R.4th 246, 266-71 (1982).

A typical "no-action" clause reads as follows:

> No legal action may be brought against us until:
> 1. We agree in writing that the "insured" has an obligation to pay; or
> 2. The amount of that obligation has been finally determined by judgment after trial.

KEETON & WIDISS, *supra* note 12, APP. H(2), at 1128.

258. Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958). As stated by S. ASHLEY, *supra* note 16, § 3.26, at 3-63 to 3-64:

> If the insurer rejects a settlement offer in bad faith, it breaches a duty which is as much a part of the contract as if it were written out and forfeits its right to demand that the insured comply with the prohibitory provisions of the policy, such as that prohibiting the insured from settling with the third party.

259. National Union Fire Ins. v. Continental Ill., 673 F. Supp. 267, 273 (N.D. Ill. 1987) ("Illinois law allows an insured to effect a reasonable settlement on its own after the insurer has breached the duty to settle, just as after the insurer has breached the duty to defend").

260. *Supra* note 257. *See also* 7C J. APPLEMAN, INSURANCE LAW AND PRACTICE § 4712, at 431 (1979).

261. As stated by National Union Fire Ins. v. Continental Ill., 673 F. Supp. 267, 274 (N.D. Ill. 1987), "[A]ll of the courts that have considered the question have allowed insureds (1) to effect reasonable settlements on their own after their insurers have breached their duty to settle and (2) to enforce those settlements against the insurers if reasonable and made in good faith."

262. *E.g.*, Wolf v. Maryland Casualty Co., 617 F. Supp. 456, 460 (S.D. Ill. 1985) (insurer must pay the judgment or reasonable settlement absent collusion or bad faith by the insured and the injured party).

ceeds the limits of the policy.[263] As stated by one author:

> Following an insurer's breach of its duty to settle, the only condition precedent to a cause of action is damages. There is no logical reason why those damages must take the form of an excess judgment as opposed to a reasonable settlement in excess of policy limits. In fact, to so hold would penalize an insured for merely acting prudently. The insured, being faced with the potential of an adverse judgment in excess of policy limits, should not be forced to ignore advantageous settlement offers on the grounds that to accept such an offer would deprive the insured of extracontractual rights against the insurer.[264]

There is some older authority for the position that settlement agreements entered into between the insured and third-party claimant may be enforced against the insurer only to the extent of the insurer's policy limits.[265] The argument in favor of restricting the insurer's liability to the extent of its policy limits centers primarily on the danger of collusion between the insured and third-party claimant.[266] As noted in *National Union Fire Ins. v. Continental Illinois*,[267] however, such a rule is unnecessary because incentives exist for the insured not to enter into an unreasonable settlement agreement with the third-party claimant:

> [S]o long as the insured cannot look to the insurer for that excess amount without proving the insurer's negligence or bad faith, the insured has ample incentive to be reasonable in negotiating settlements itself—for it will be out of pocket if it cannot sustain its burden of proof. . . .
>
> Again, so long as the insurer's breach of its duty to settle is shown to have deprived the insured of the opportunity for a favorable settlement, no rational distinction separates the insured's striking the next best deal it can make from the insured's going to trial and getting hit with a larger judgment. Either way the insured has been compelled to accept liability because of the insurer's negligence or bad faith in rejecting the more favorable settlement.

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263. *See* Merritt v. J.A. Stafford Co., 68 Cal. 2d 619, 68 Cal. Rptr. 447, 440 P.2d 927 (1968). If the potential judgment does not exceed policy limits, the insured has no fear of personal exposure, and hence no need to protect himself by entering into an unauthorized settlement agreement.

264. A. WINDT, *supra* note 16, § 5.16, at 213.

265. *Compare, e.g.*, Fireman's Fund Ins. Co. v. Security Ins. Co. of Hartford, 72 N.J. 63, 367 A.2d 864 (1976) *with* National Union Fire Ins. v. Continental Ill., 673 F. Supp. 267 (N.D. Ill. 1987) *and* Glenn v. Fleming, 799 P.2d 79 (Kan. 1990).

266. This concern was specifically noted in the recent decision of Glenn v. Fleming, 799 P.2d 79, 92 (Kan. 1990). *See also* Fireman's Fund Ins. Co. v. Security Ins. Co. of Hartford, 72 N.J. 63, 367 A.2d 864 (1976), where the court opined: "We do express concern over the reasonableness of assignment/covenants in which the amount of the judgment assigned has been determined by agreement of the parties."

267. 673 F. Supp. 267 (N.D. Ill. 1987).

As an additional safeguard against the possibility of fraud or collusion, some courts impose the initial burden of going forward with evidence that the settlement agreement was reasonable and entered into in good faith upon the insured.[268]

There is no reason why the right to enforce a settlement agreement in excess of policy limits against the insurer cannot be assigned to the third-party claimant, in Wyoming or elsewhere. In those jurisdictions where the actual liability of the insured is not a prerequisite to an insurer's liability for a settlement in excess of policy limits, moreover, the third-party claimant's covenant not to execute upon the insured will not destroy the right to collect from the insurer.

Finally, it has been held that the insured, following the insurer's breach of its duty to settle, has no obligation to notify the insurer that it has received an offer of settlement from the third-party claimant.[269] Similarly, the insured has no obligation to notify the insurer that he intends to assign his cause of action for bad faith.[270]

F. Summation—practical considerations for the insurer, insured, and third-party claimant

Whenever a third party asserts a claim for damages against an insured in excess of the insured's policy limits, the insured, insurer and claimant all have separate interests to protect. The interests of the insurer require an effort to minimize its liability, if possible, below the limits of the policy or the offer of settlement made by the third-party claimant. The interests of the insured require an effort to avoid personal liability for a judgment in excess of policy limits. Finally, the interests of the third-party claimant require an effort to ensure that a claim for damages in excess of policy limits is fully paid.

The insurer, first of all, should recognize that the ability of the insured to assign the right to enforce a judgment or settlement agreement in excess of policy limits can only work to its overall disadvantage. Where an assignment is made and the third-party claimant becomes the plaintiff in a bad faith action, a jury will be more inclined to sympathize with an injured victim than with an insured who has been accused of wrongdoing. As a practical matter, therefore, the insurer should seriously evaluate the circumstances of the third-party claimant before denying a settlement offer within policy limits, be-

268. Glenn v. Fleming, 799 P.2d 79 (Kan. 1990); Griggs v. Bertram, 8 N.J. 347, 443 A.2d 163 (1982); and Steil v. Florida Physicians' Ins. Reciprocal, 448 So. 2d 589 (Fla. Dist Ct. App. 1984).

269. *See, e.g.*, Florida Farm Bureau Mut. Ins. Co. v. Rice, 393 So. 2d 552 (Fla. Dist. Ct. App. 1980). *See also* A. WINDT, *supra* note 16, § 5.06, at 245 ("Courts should not penalize an insured for failure to perform the idle act of notifying the company after the company has renounced the contract."). *See also S. Ashley, supra* note 16, § 3.26, at 3-65.

270. *See* Samson v. Transamerica Ins. Co., 30 Cal. 3d 220, 178 Cal. Rptr. 343, 636 P.2d 32 (1981).

cause the chances are excellent that in the event an action is filed against the insurer for third-party bad faith, the third-party claimant will be the plaintiff.

When a third-party claimant is seeking damages against the insured in excess of policy limits and the insurer subsequently rejects an offer by the claimant to settle the claim within policy limits, the insured has several choices to make. If the insured is not being defended because of a coverage dispute and clearly has the resources to defend himself, he must first decide whether to hire his own attorney to defend the third-party claim. If the insured has the financial resources to hire an attorney, but not respond to a potentially large judgment in excess of policy limits, he may best be advised to do so.[271] His counsel may then determine whether to defend the claim on its merits or, if the third-party claimant is amenable, to settle the claim for a reasonable sum and assign his claim for bad faith to the claimant in exchange for a covenant not to sue. Prior to doing so, however, the insured should always make a policy limits offer, if circumstances otherwise warrant, because the failure to do so may prevent the insured or his assignee from asserting a claim in excess of policy limits against the insured.[272] By assigning the bad faith claim in exchange for a covenant not to sue, the insured has not only eliminated any personal exposure he may otherwise have above the limits of his policy, but he has also transferred the burden of proving coverage to the third-party claimant.[273] At the same time, moreover, the insured may reserve the right to assert a claim for personal damages against the insurer and join the third-party claimant in a bad faith suit against the insurer. If the insured does not have the financial resources to defend himself or is otherwise insolvent or judgment-proof, it is not likely that he will

271. The authorities are split on the issue of whether the insured must hire his own counsel if the insurer wrongfully refuses to defend him. *Compare* LaRotunda v. Royal Globe Ins. Co., 87 Ill. App. 3d 446, 408 N.E.2d 928 (1980) *and* Cornwell v. Safeco Ins. Co., 42 A.D.2d 127, 346 N.Y.S.2d 59 (1973) *with* Western Casualty & Sur. Co. v. Herman, 405 F.2d 121 (8th Cir. 1968) *and* Rensi v. Langston, 499 F. Supp. 720 (W.D. Pa. 1980).

According to one authority, the majority, and better, rule is that the insured has no such duty:

> Having contracted to have the insurer defend, the insured should be able to do nothing more than cooperate with the insurer when a suit encompassed by the policy is filed. The insured did not impliedly covenant to attempt to minimize the insurer's exposure in the event of the insurer breaching its duty to defend, and, for policy reasons, the duty to mitigate damages should not be applicable. Having itself refused to take any action in an effort to minimize its potential exposure in the pending lawsuit, the insurer cannot expect the insured to take such action.

A. WINDT, *supra* note 16, § 4.16, at 167-68.

In spite of the above, Wyoming counsel should not automatically assume that the insured will be excused from hiring counsel to defend himself, provided he has the financial resources to do so. The general duty to mitigate damages, where it is reasonable to do so, is still observed in Wyoming. *See* WYOMING CIVIL PATTERN JURY INSTRUCTIONS § 4.08 (rev. ed. 1988).

272. *Supra* note 60.

273. *See supra* notes 230-234 and accompanying text.

have to seek out the third-party claimant in order to obtain a covenant not to sue, because the ability of the claimant to collect any sum in excess of policy limits may depend upon the claimant acquiring the insured's bad faith cause of action against the insured. In that event, the insured may be in a favorable position to negotiate a division of any potential recovery with the claimant.

Where the insured is being defended by the insurer at such time as the insurer rejects a policy limits settlement offer, the insured must decide whether to take control of his own defense, a decision which must usually be made by determining whether the insurer has violated its duty to settle. In the event the insurer's actions in rejecting the settlement offer appear reasonable under the circumstances, the insured is best advised to permit the insurer to continue the defense of the action. If it should be determined that the insurer has not violated its duty to settle and the insured takes control of the defense, the insured may be held to have violated policy provisions giving the insurer the exclusive right to defend or settle the case. In that event, the insured will be personally liable for his own attorney's fees, if any, and any sum of money above policy limits that the third-party claimant may be entitled to collect from him.[274] If, however, the insured is confident that the insurer has violated its duty to settle, the insured with assets to protect may want to reject the defense provided for him by the insurer in order to attempt settlement of the case within the limits of the policy or, at the very least, minimize his liability to the third-party claimant for a sum in excess of policy limits. In the event the insured is not able to obtain a covenant not to sue from the claimant for some reason, on the other hand, the insured will remain personally liable for any sum he is liable to pay in excess of policy limits in the event his insurer is found not to have acted in bad faith.

For the above reasons, there are few advantages to the insured in asserting his own bad faith claim against the insurer, at least where the insured has some assets to protect and the option of obtaining a covenant not to sue from the claimant. As a result, the insured should attempt to eliminate his personal exposure for damages in excess of policy limits whenever possible and, at the same time, reserve the right to assert any personal damage claims he may have against the insurer.

Finally, where damages are claimed in excess of policy limits, the

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274. If the insured breaches his contract of insurance, is the insurer liable to pay policy benefits to the third-party claimant? Although no cases have been found in which this issue was raised, it is doubtful that the insurer would be able to assert the insured's breach of contract as a defense to a third-party claimant's garnishment action. It has been held, moreover, that the plaintiff's failure to abide by policy provisions does not constitute a defense to an action for bad faith, *e.g.*, Viles v. Security Nat'l Ins. Co., 788 S.W.2d 566 (Tex. 1990). If the insurer has no basis for withholding policy limits other than the fact that the insured erroneously concluded that the insurer violated its duty to settle, the insurer would be liable for payment of under a bad faith theory.

interests of the third-party claimant will always require a thorough investigation of the insured's financial status. If it appears that the insured does not have the present or future ability to pay a claim within policy limits, the claimant should always extend an offer to settle within policy limits to the insured. If the insurer accepts, then the claimant is assured of receiving some compensation for his injuries. If the insurer does not act in good faith in rejecting the offer, then it will always be in the best interests of the claimant to execute a covenant not to sue the insured in exchange for an assignment of the insured's possible bad faith cause of action against the insurer, because the claimant's ability to satisfy his damage claim will depend upon being able to proceed against the insurer. If the insured does have the assets to respond to the claimant's damage claims, however, it will seldom be to the claimant's advantage to acquire the insured's bad faith cause of action in exchange for a covenant not to sue.[275] By asserting the bad faith claim himself, the claimant will have assumed the burden of establishing that the insurer acted in bad faith by refusing to settle within policy limits. If he fails, he will not only have expended a considerable sum in costs and perhaps attorney's fees, but he will have likely bargained away his right to collect the excess judgment from the insured in order to acquire the assignment. One of the few instances in which the claimant might decide to execute a covenant not to sue, notwithstanding the assets held by the insured, is where the insured has an exceptionally strong punitive damage case against the insurer.

Where the insurer has refused to defend the insured because of coverage problems, the claimant's interests will generally be better served by obtaining a default judgment against the insured in order to avoid any argument by the insurer that the claimant acted collusively with the insured in establishing damages. Where the insurer does assume the defense of the underlying action and the insured decides to take control of his own defense following a rejection of a policy limits offer of settlement, the claimant may desire to enter into a reasonable settlement agreement with the insured for several reasons. First, the claimant avoids having to prove liability or damages in the underlying case against the insured. Second, the claimant may avoid, to some extent, the problem of paying for attorney's fees twice, once in the underlying action and again by asserting the bad faith claim against the insurer. Finally, settlement of all claims with the insured will speed up the process of collecting damages in excess of policy limits considerably. If a decision to settle the case is made, the third-party claimant and insured may want to retain an independent "appraiser" to evaluate damages in order to avoid claims of collusion by the insurer.

275. It may be possible for the claimant to secure the insured's cause of action without executing a covenant not to sue, particularly where the insured is insolvent or judgment-proof. The claimant, for example, could agree to withstand the costs of pursuing a bad faith action against the insurer as consideration for the assignment.

If the claimant's attorney does decide to pursue settlement with the insured, caution must be exercised. If the insured is still being represented by counsel furnished by the insurer, ethical considerations may preclude any direct negotiations between the claimant's counsel and the insured without defense counsel's knowledge and consent.[276]

VI. DAMAGES

Whether or not the insurer violates its duty to settle, it must always respond with its policy limits if a judgment is subsequently obtained against the insured in excess of policy limits, regardless of whether the insurer or insured controls the defense at such time as the judgment is entered. In other words, the liability of the insured to the third-party claimant, and not the insurer's bad faith, determines whether the insurer's policy limits are payable to the third-party claimant.[277]

A. *Excess judgments*

Where the insurer has violated his duty to settle, all jurisdictions, including Wyoming,[278] allow the insured or his assignee to recover the difference between the amount of the excess judgment and the policy limits of the insurer,[279] regardless of the theory of recovery upon

276. *See* WYOMING RULE OF PROFESSIONAL CONDUCT FOR ATTORNEYS AT LAW 4.2 (1986). *See also* M. KAUFMAN & H. LEVINE, CALIFORNIA PRACTICE GUIDE: BAD FAITH § 7:227.1, at 7-56 (1990).

277. Policy provisions typically provide that policy proceeds are directly payable to the third-party claimant if the insured is legally liable to the claimant.

278. Western Casualty & Sur. Co. v. Fowler, 390 P.2d 602 (Wyo. 1964).

279. *See* Torrez v. State Farm Mut. Auto. Ins. Co., 705 F.2d 1192 (10th Cir. 1982); Moutsopoulos v. American Mut. Ins. Co., 607 F.2d 1185 (7th Cir. 1979); Tennessee Farmers Mut. Ins. Co. v. Wood, 277 F.2d 21 (6th Cir. 1960); Trimper v. Nationwide Ins. Co., 540 F. Supp. 1188 (D.S.C. 1982); Buntin v. Continental Ins. Co., 525 F. Supp. 1077 (D.V.I. 1981); Covill v. Phillips, 452 F. Supp. 224 (D. Kan. 1978); United Services Auto. Ass'n v. Glen Falls Ins. Co., 350 F. Supp. 869 (D. Conn. 1972); McChristian v. State Farm Mut. Auto. Ins. Co., 304 F. Supp. 748 (W.D. Ark. 1969); Davis v. National Grange Ins. Co., 281 F. Supp. 998 (E.D. Va. 1968); Southeastern Fire Ins. Co. v. Helton, 192 F. Supp. 441, (S.D. Ala. 1961); Brisco v. Meritplan Ins. Co., 132 Ariz. 72, 643 P.2d 1042 (Ariz. App. 1982); Betts v. Allstate Ins. Co., 154 Cal. App. 3d 688, 201 Cal. Rptr. 528 (1984); Beck v. Kelly, 323 So. 2d 667 (Fla. Dist. Ct. App. 1975), *overruled on other grounds*; General Accident Fire & Life Assurance Co. v. American Casualty Co., 390 So. 2d 761 (Fla. Dist. Ct. App. 1980), *petition denied*, 399 So. 2d 1142 (1981); McCall v. Allstate Ins. Co., 251 Ga. 869, 310 S.E.2d 513 (1984); Adduci v. Vigilant Ins. Co., 98 Ill. App. 3d 472, 424 N.E.2d 645 (1981); Terrell v. Western Casualty & Sur. Co., 427 S.W.2d 825 (Ky. 1968); Hodges v. Southern Farm Bureau Casualty Ins. Co., 411 So. 2d 564 (La. Ct. App. 1982), *cert granted*, 427 So. 2d 863 (1983); State Farm Mut. Ins. Co. v. Schlossberg, 82 Md. App. 45, 570 A.2d 328 (1990); City of Wakefield v. Globe Indem. Co., 246 Mich. 645, 225 N.W. 643 (1929); Continental Casualty Co. v. Reserve Ins. Co., 307 Minn. 5, 238 N.W.2d 862 (1976); Dyer v. General Am. Life Ins. Co., 541 S.W.2d 702 (Mo. Ct. App. 1976); Reifenstein v. Allstate Ins. Co., 92 A.D. 2d 715, 461 N.Y.S.2d 104 (1983); Hoskins v. Aetna Life Ins. Co., 6 Ohio St. 2d 272, 452 N.E.2d 1315 (1983); American Fidelity & Casualty Co. v. L.C. Jones Trucking Co., 321

which the plaintiff proceeds.[280] Indeed, in most third-party cases, the amount of the excess judgment will constitute the primary damage component of the case.[281]

Where an actual excess judgment has been entered against the insured by a court of law, the insurer cannot collaterally attack the amount of the judgment in a subsequent action for bad faith.[282] The difference between the policy limits of the insurer and the amount of the excess judgment, in other words, is always recoverable by the insured or his assignee, provided that the insurer acted in bad faith in rejecting a settlement offer within policy limits.[283] Where the liability of the insured in excess of policy limits is created by agreement between the insured and the third-party claimant, however, the insurer may always question whether the amount of the settlement agreement was reasonable or whether the agreement itself was characterized by fraud, collusion or bad faith.[284]

B. Other compensatory damages

The question of whether compensatory damages in addition to the amount of the excess judgment are recoverable by an insured[285] from an insurer in a third-party bad faith action is determined, to some extent, by whether the action is characterized as one sounding in contract, tort or both. In jurisdictions which classify the cause of action as sounding in tort, all proximately caused damages are recoverable,[286] whereas in jurisdictions in which the action sounds only in contract, only those damages which were reasonably foreseeable when the policy was issued are recoverable by the insured.[287] The theory of

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P.2d 685 (Okla. 1958); Kriz v. Government Employees Ins. Co., 42 Or. App. 339, 600 P.2d 495 (1979); Shearer v. Reed, 286 Pa. Super. 188, 428 A.2d 635 (1981); Kunkel v. United Sec. Ins. Co., 84 S.D. 116, 168 N.W.2d 723 (1969); Myers v. Ambassador Ins. Co., 146 Vt. 552, 508 A.2d 689 (1986).

280. SHERNOFF, *supra* note 3, § 7.03[2][a], at 7-10 ("[E]ven the courts that treat the insurer's breach of its duty to settle as sounding in contract rather than tort will permit the insured to recover one very significant item of consequential damages: the amount of the judgment entered in the third-party action in excess of the policy limits.").

281. *Id.* at § 7.05, at 7-35.

282. A. WINDT, *supra* note 16, § 6.20, at 330-32.

283. *Id.* The insurer's good faith, quite obviously, is a complete defense to any action on the part of an insured or his assignee to recover an excess judgment against the insurer.

284. *E.g.*, Fireman's Fund Ins. Co. v. Security Ins. Co., 72 N.J. 63, 367 A.2d 864 (1976).

285. *Supra* notes 249-250. Such damages are not recoverable by an assignee of the insured's cause of action if they are "personal" to the insured.

286. *See, e.g.*, SHERNOFF, *supra* note 3, § 7.03[3]. *See also* Atlas Constr. Co. v. Slater, 746 P.2d 352 (Wyo. 1987).

287. *See, e.g.*, Kewin v. Massachusetts Mut. Life Ins. Co., 295 N.W.2d 50 (Mich. 1980), and Lawton v. Great S.W. Fire Ins. Co., 392 A.2d 576 (N.H. 1978). *See also* the discussion contained in White v. Unigard Mut. Ins. Co., 730 P.2d 1014 (Idaho 1986), where the court observed that damage to the insured arising from a foreclosure of a second mortgage, caused when policy proceeds were withheld from the insured, would

recovery, therefore, may determine whether an insurer may be held liable for such damage components as emotional distress,[288] damage to credit reputation,[289] lost profits,[290] and loss of a business,[291] at least where such damages were not reasonably within the contemplation of the insurer at the time the policy of insurance was issued.[292]

There are a few cases,[293] including a very recent decision from the Kansas Supreme Court, which specifically adopt the position that a liability insurer's bad faith failure to settle gives rise only to a breach of contract action. In *Glenn v. Fleming*,[294] for example, the court held that a wrongful failure to settle arises from the insurer's contractual obligation to defend and, accordingly, an action to enforce that obligation is based on breach of contract. In deciding this case, however, the Kansas Supreme Court acknowledged the confusion it had previously created by applying a standard of care normally associated with tort law to a breach of contract:

> We have adopted, in our development of the substantive case law, the principle that the insurer's duties are contractually based and then approved a tort standard of care for determining when the contract duty has been breached. Perhaps this contract/tort relationship has contributed to the confusion arising from our efforts to describe the duty of good faith and to identify the situations involving bad faith/negligent duty to settle and to defend, From *Bennett v. Conrady*, and *Bollinger v. Nuss*, forward, we have used 'negligence,' 'due care,' and other tort expressions to describe the substance of what is a contract duty.[295]

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not be recoverable under a breach of contract theory. Since the second mortgage was executed after the policy was issued, damage arising from the foreclosure could not have been foreseen by either party to the contract.

288. *Compare* Crisci v. Security Ins. Co., 66 Cal. 2d 425, 58 Cal. Rptr. 13, 426 P.2d 173 (1967) *with* Lawton v. Great Southwest Fire Ins. Co., 118 N.H. 607, 392 A.2d 576 (1978). *See* Annotation, *Emotional or Mental Distress as Element of Damages for Liability Insurer's Wrongful Refusal to Settle*, 57 A.L.R.4th 801 (1987).

289. Farmers Group, Inc. v. Trimble, 658 P.2d 1370 (Colo. Ct. App. 1984), *aff'd*, 691 P.2d 1138 (1984).

290. *E.g.*, Salvator v. Admiral Merchants Motor Freight, 156 Ill. App. 3d 930, 509 N.E.2d 1349 (1987).

291. Assicurazioni Generali, S.P.A. v. Milsap, 760 S.W.2d 314 (Tex. Ct. App. 1988).

292. As stated in one article: "The practical consequence of allowing recovery in tort is that the parties to the contract are no longer limited by the strict foreseeability rule for measuring contractual damages. Under tort law, the only significant limitation on recovery is the necessity of showing plaintiff's damages were 'proximately caused.'" P. MAGARICK, EXCESS LIABILITY: THE LAW OF EXTRA-CONTRACTUAL LIABILITY OF INSURERS § 8.03, at 8-10 (3d ed. 1990) (quoting *Aetna Life Ins. Co. v. Lavoie: Does Bad Faith Law Raise Questions of Constitutional Dimension?*, INS. LITIGATION REP. (Oct. 1985-Feb. 1986)).

293. *E.g.*, Gordon v. Nationwide Mut. Ins. Co., 30 N.Y.2d 427, 334 N.Y.S.2d 601, 285 N.E.2d 849 (1972).

294. 799 P.2d 79, 92 (Kan. 1990).

295. *Id.* at 90 (citations omitted).

The vast majority of jurisdictions, however, label the cause of action for third-party bad faith as one which sounds in tort.[296] Even though *Fowler* itself does not definitively resolve the question in Wyoming, there can be little doubt about which way the Wyoming Supreme Court would decide the issue if presented. By holding that the cause of action for first-party bad faith gave rise to an independent tort in *McCullough v. Golden Rule Insurance Co.*, the majority opinion relied upon *Fowler*, in part, as authority for doing so.[297]

In Wyoming, therefore, there is every reason to assume that the insured may recover for emotional distress and other types of economic harm in a third-party bad faith action. Indeed, the only restriction on the type of actual damage that the insured may recover in a third-party bad faith action, economic or otherwise, is that such damage must have proximately resulted from the bad faith actions of the insurer.[298] It should also be noted that an actual excess judgment may not be necessary to an award of compensatory damages for the insurer's wrongful failure to settle. If the insurer rejects the offer of settlement in bad faith, and the insured incurs economic damage as a result, the insurer may be held liable for such damage even though the case is thereafter settled within policy limits.[299]

Conceivably, the theory of liability in a third-party case may also determine the type of damages which an assignee of the insured's bad faith claim can recover from the insured.[300] Since damages for "personal torts" are not assignable, the assignee may want to style his bad faith action against the insurer as a breach of contract action,[301] at least in cases where the insured does not expressly reserve the right to pursue certain damages.[302] By doing so, the claimant may be able to recover the insured's pecuniary or economic losses.[303] Regardless of

296. *See* S. ASHLEY, *supra* note 16, § 2:22, at 2-65.

297. As Justice Urbikit noted in *McCullough*, 789 P.2d at 858:

> Wyoming law has a consistent thread running from the 1964 case of Western Casualty and Surety Co., 390 P.2d 602 involving the third-party situation of a failure to settle and Arnold, 707 P.2d 161 involving first-party uninsured motorist coverage, so that recognition of the independent action for the tort of first-party bad faith would be structurally consistent and could be expected.

298. One case has allowed the cost of inflation as a proximately caused damage. Leslie Salt Co. v. St. Paul Mercury Ins. Co., 637 F.2d 657 (9th Cir. 1981).

299. Larraburu Brothers, Inc. v. Royal Indem. Co., 604 F.2d 1208 (9th Cir. 1979).

300. *Supra* notes 249-251.

301. There seems to be no reason why the plaintiff in a third-party bad faith action could not plead the action as a breach of contract and, alternatively, as a tort action at the same time. *See, e.g.*, Larraburu Bros., Inc. v. Royal Indem. Co., 604 F.2d 1208 (9th Cir. 1979).

302. The insured, of course, can always give a partial assignment and join in the action to recover the damages which he does not assign. *Supra* notes 253-254.

303. As stated in Clearwater v. State Farm Mut. Auto. Ins. Co., 780 P.2d 423, 427 (Ariz. App. 1989), *rev'd on other grounds*, 792 P.2d 719 (1990):

> We must now address the question of what effect the assignment has on the issue of damages when an insured assigns his claim for bad faith failure to settle to a third party. The insured gives up all of his claims arising from the bad faith failure to settle because the cause of action for bad faith cannot be split, and the

how the action is styled, however, it is well established that an assignee cannot recover damages for the insured's emotional distress.[304]

C. *Punitive damages*

The issue of whether punitive damages are recoverable in a third-party bad faith action may also depend upon whether the action is characterized as one sounding in contract or tort, particularly in jurisdictions such as Wyoming, where punitive damages are not recoverable in contract actions absent fraud at the inception of the contract.[305]

Since the third-party bad faith action is undoubtedly one which sounds in tort in Wyoming, there can be little question but that punitive damages are recoverable in a proper case.[306] It is just as clear in Wyoming, however, that the insured or his assignee is not automatically entitled to a punitive damage instruction simply because bad faith on the part of the insurer has been proved.[307] The failure of the insurer to give equal consideration to the interests of the insured alone, in other words, does not expose the insurer to liability for punitive damages. In addition to acting in bad faith, the actions of the insurer must have been committed in a willful and wanton manner.[308]

D. *Attorney's fees*

In a first-party case, attorney's fees are recoverable in Wyoming if the refusal to pay policy benefits by an insurer is unreasonable. Wyoming Statutes section 26-15-124(c) provides:

> In any actions or proceedings commenced against any insurance company on any insurance policy or certificate of any type or kind of insurance, or in any case where an insurer is obligated by a liability insurance to defend any suit or claim or pay any judgment on behalf of a named insured, if it is determined that the company refuses to pay the full amount of a loss covered by the policy and that the refusal to pay is unreasonable or without cause, any court in which judgment is rendered for a claimant may also award a reasonable sum as an attorney's fee and interest at ten percent (10%) per year.

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assignee is the only person who can assert the claim. The third party's claim is in reality the insured's claim, but the third party cannot recover damages personally suffered by the insured such as pain and suffering, embarrassment, mental anguish and humiliation. The assignee can only recover the insured's pecuniary losses.

304. *Supra* note 233.

305. Arnold v. Mountain West Farm Bureau Mut. Ins. Co., 707 P.2d 161 (Wyo. 1985).

306. *See* Mayflower Restaurant Co. v. Griego, 741 P.2d 1106, 1115 (Wyo. 1987).

307. *McCullough*, 789 P.2d at 860-61.

308. *Id.*

It seems clear, however, that this statute does not allow for the recovery of attorney's fees in third-party bad faith cases because the statute provides for such fees only where the insurer refuses to pay the full amount of a loss "covered by the policy." Since excess judgments are not "covered by the policy," the statute does not permit an award of attorney's fees, even where the excess judgment was caused by the insurer's refusal to defend. If the insurer unreasonably refuses to tender its policy limits after a third-party judgment is entered against its insured because of a coverage dispute or some other reason, the result would be different, whether the judgment obtained is in excess of policy limits or not. The question then becomes one of whether the actions of the insurer in refusing to pay the claim up to the limits of its policy were reasonable.

Unless provided by statute or contract, the recovery of attorney's fees in Wyoming is generally prohibited.[309] It should be noted that this rule would not apply in the event that the insurer's violation of its duty to defend or settle causes the insured to incur attorney's fees in connection with the underlying action.[310] Neither would there be a prohibition on the recovery of attorney's fees incurred as a result of entering into a settlement agreement with the third-party claimant following the insurer's violation of its duty to settle or defend.[311]

VII. CONCLUSION

It has been the rather ambitious goal of this article to review the third-party bad faith cause of action in Wyoming. The author has attempted to do so by integrating a discussion of *Western Casualty & Surety Co. v. Fowler* with developments in the area of third-party bad faith in other jurisdictions. A conscious effort has also been made to discuss the practical considerations and different interests which come into play for insurers, insureds and third-party claimants when a third-party bad faith claim arises.

It may be appropriate at this point to mention that the danger to the insured of incurring personal liability in excess of policy limits, and the corresponding likelihood of a bad faith action being asserted against a liability insurer, is one which in most cases lies within the control of either party to the insurance contract. In the vast majority of cases, the insured who is concerned that he may be held personally liable for what otherwise amounts to an insured loss can simply purchase higher policy limits,[312] particularly with the current prolifer-

309. Werner v. American Sur. Co. of N.Y., 423 P.2d 86 (Wyo. 1967).
310. *E.g.*, Lowell v. Maryland Casualty Co., 65 Cal. 2d 298, 54 Cal. Rptr. 116, 419 P.2d 180 (1966), and Lujan v. Gonzales, 84 N.M. 229, 501 P.2d 673 (1972).
311. *Supra* note 258.
312. With automobile insurance, particularly, it is rather naive to assume that everyone has the ability to purchase adequate policy limits. Indeed, a significant percentage of all Wyoming drivers have no insurance at all. In an article written by the author of this article in 1976, twenty-five percent of all Wyoming drivers were estimated to

ation of excess and umbrella policies on the market. Similarly, the insurer who is concerned about the possibility of being held liable for a judgment in excess of policy limits because it cannot accept all, or even most, policy limit offers can avoid selling liability policies with unusually low limits, an example being the automobile liability coverage with policy limits which do not exceed the minimum limits mandated by the Wyoming Safety Responsibility Act.[313] The greatest danger of an insured incurring personal liability as a result of a third-party claim or, alternatively, the greatest likelihood of a liability insurer incurring liability for a judgment in excess of policy limits, occurs where an insured is willing to buy, and the insurer willingly sells, a low-limits policy.

Finally, the legal debate concerning the question of who should bear the cost of judgments and settlements in excess of policy limits when the insurer had an opportunity to settle the case within policy limits will continue to rage. Given the fact that insurers will continue to consider their own interests when determining whether to accept offers of settlement within policy limits, as they must, judgments in excess of policy limits will continue to be a fact of life, as will the third-party bad faith suits that will inevitably follow. Liability insurers in Wyoming and elsewhere, therefore, should give very serious consideration to the development of a contractual remedy to address the problems created by the decisions liability insurers must make in responding to settlement offers. As stated by one of the very few authorities to advance this notion:

> The cause of action for bad faith exists in third-party cases because the silence of insurance policies regarding the insurer's duties in responding to policy limits settlement offers forced the courts to fill this gap and define the insurer's responsibilities. Insurers could avoid the dilemma they face in responding to settlement offers by adding provisions to their liability policies expressly defining the insurer's duties and limiting the insurer's exposure to liability when it rejects a policy limits settlement offer. But insurers seem to act as if their policies, once printed, are carved in stone and cannot be changed no matter how great the

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have no liability insurance. Smith, *The Wyoming Uninsured Motorist Act: A Regulatory Reconciliation of Mandated Coverages with the Standard Uninsured Motorist Endorsement*, 11 LAND & WATER L. REV. 213, 213 n.2 (1976). A significant percentage of drivers who do have insurance purchase low-limit policies (1) because of cost; (2) because of a lack of assets to protect; (3) because certain rating factors, such as the insured's driving record, leave no other alternative. With other types of liability insurance, however, there are fewer reasons to be underinsured, particularly among business insureds and professionals.

313. WYO. STAT. § 31-9-405(b)(ii) (1977). In Wyoming, motorists are required to maintain liability insurance within minimum limits of $25,000 because of bodily injury to or death of any one person in and one accident; $50,000 because of bodily injury to or death of two or more persons in any one accident; and $20,000 because of injury to or destruction of property of others in any one accident.

liability the company incurs.[314]

By creating a contractual remedy to redress the claims of insureds whose interests are not adequately considered by insurers in responding to settlement offers, insurers could limit the damages they would otherwise be held liable for, and at the same time provide for unlimited discretion in accepting or rejecting settlement offers. In return, insureds who become personally liable for an excess judgment because of the insurer's refusal to settle within policy limits would be compensated without regard to the bad faith or good faith of the insurer. Because the enforceability of such a provision depends only on (1) its lack of ambiguity[315] and (2) compliance with "public policy,"[316] innovative liability insurers could virtually eliminate their exposure to damages for bad faith and punitive damage awards and perhaps even lower the overall cost of liability insurance.[317] The alternative for insurers is the continued prospect of liability for judgments in excess of policy limits, consequential damages which emanate therefrom and, where appropriate, punitive damage awards.

314. S. ASHLEY, *supra* note 16, § 3:28, at 3-69.

315. Worthington v. State, 598 P.2d 796 (Wyo. 1979).

316. *See, e.g.*, Tate v. Mountain States Tel. and Tel. Co., 647 P.2d 58 (Wyo. 1982) (contract which is contrary to public policy will not be recognized by the court, and the parties to the contract will be left as the court finds them).

317. Premium savings should result from a contractual provision of this type for several reasons. First, insurers would realize a substantial reduction in litigation costs in third-party bad faith lawsuits. Second, punitive damage awards would be more infrequent. Third, the certainty of limited contract damages would replace the uncertainty of large bad faith damage awards.