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The "Set Up" Defense and the Comparative Fault Defense: New Wrinkles in Bad Faith Claims Against Insurers

THE "SET UP" DEFENSE AND THE COMPARATIVE FAULT DEFENSE: NEW WRINKLES IN BAD FAITH CLAIMS AGAINST INSURERS

In 1914 courts first began to recognize that insurance contracts create an implied duty of good faith and fair dealing.[1] If an insurer breaches its duty of good faith and fair dealing, courts provide insureds an extra-contractual tort cause of action for bad faith.[2] Courts have applied a bad

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1. *See* Brassil v. Maryland Casualty Co., 210 N.Y. 235, 242, 104 N.E. 622, 624 (1914) (universal duty of good faith and fair dealing underlies insurance contracts); *see also* Auto Mut. Indem. Co. v. Shaw, 134 Fla. 815, ____, 184 So. 852, 859 (1938) (same); Hilker v. Western Auto. Ins. Co., 204 Wis. 1, ____, 231 N.W. 257, 259-60 (1930) (same).

2. *See, e.g.*, Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 660, 328 P.2d 198, 201-02 (1958) (if insurer, in bad faith, refuses to settle, insurer is liable in tort for excess judgment against insured); Southern Fire & Casualty Co. v. Norris, 35 Tenn. App. 657, 668, 250 S.W.2d 785, 790 (Ct. App. 1952) (insurer's bad faith refusal to settle renders insurer liable in tort); W. SHERNOFF, INSURANCE BAD FAITH LITIGATION § 1.01, at 1-2 to 1-3 (1986) (courts used flexibility of tort law to accomplish desirable social goal of protecting insureds); Halbert, *Insurers Bad Faith Refusal to Settle—Excess Liability Consequences*, 57 PA. B.A.Q. 38, 38 (Jan. 1986) (noting courts' recognition that some check on insurers' power to handle claims was necessary if insurers had absolute authority over settlement); Note, *Excess Liability of Insurers For Bad Faith Refusal to Settle: A Boon to the Individual Insured That Works to the Detriment of Consumers*, 18 SUFFOLK U.L. REV. 377, 377-99 (1984) [hereinafter Note, *Excess Liability*] (discussing evolution and current status of bad faith claims). Courts originally allowed insureds to sue their insurers under a cause of action for bad faith failure to settle because insureds, in their insurance contracts, gave up their right to settle claims against them. *See Southern Fire*, 35 Tenn. App. at 668, 250 S.W.2d at 790 (because insured loses right to settle claims against him by signing insurance contract, insured has right to assume that insurer will not abandon insured's interest). Insurance policies contractually limit an insurer's liability to a preset amount. *See* M. GREEN & J. TRIESCHMANN, RISK AND INSURANCE 254 (5th ed. 1981) (purpose of insurance policy is to limit insurer's liability contractually). An insurer ordinarily has exclusive authority to handle claims against its insured, including the right to make decisions regarding claims settlements. *See* Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 870, 110 Cal. Rptr. 511, 519 (Ct. App. 1973) (insurer has exclusive authority over settlement); Aetna Casualty & Sur. Co. v. Kornbluth, 28 Colo. App. 194, 199, 471 P.2d 609, 611 (Ct. App. 1970) (insurance policy precludes insured from interfering in settlement negotiations). A typical insurance contract provides that:

> [t]he company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury or property damage to which this insurance applies . . . and may make such investigation and settlement of any claim or suit as it deems expedient.

Brittle, *Avoiding Insurer's Excess Liability*, 28 FED'N INS. COUNS. Q. 298, 299 n.1 (1978). An insurer that refuses an offer to settle within an insured's policy limit leaves its insured in a precarious position. *See* Crisci v. Security Ins. Co., 66 Cal. 2d 425, ____, 426 P.2d 173, 176, 58 Cal. Rptr. 13, 16 (1967) (insured is responsible for amount of judgment over insured's policy limit). If a plaintiff claiming monetary damages against an insured obtains a judgment against the insured that exceeds the insured's policy limit, the insured is responsible to the plaintiff for the excess amount. *See id.* (insured is responsible for amount of judgment over insured's policy limit); Note, *Liability Insurers and Third-Party Claimants: The Limits of Duty*, 48 U. CHI. L. REV. 125, 126-27 (1981) [hereinafter Note, *Liability Insurers*] (discussing

faith cause of action to insurance contracts particularly because courts have

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Crisci decision); *infra* notes 44-52 and accompanying text (same). An insured in a bad faith action generally attempts to shift liability for an excess judgment to the insurer if the insurer wrongfully refused to settle within the insured's policy limit. *See Comunale*, 50 Cal. 2d at 660, 328 P.2d at 201 (insurer is liable for entire judgment against insured if insurer, in bad faith, refuses to settle); *Southern Fire*, 35 Tenn. App. at 668, 250 S.W.2d at 790 (insurer is liable in tort for excess judgment because of insurer's bad faith refusal to settle); *see also infra* notes 13-15 and accompanying text (plaintiffs have strong motivation to shift liability to insurers because insurers ordinarily have greater financial resources than insureds). Bad faith claims are now commonplace. *See infra* note 7 (listing court decisions involving claims of bad faith). Insurer liability for bad faith refusal to settle, however, is a relatively new cause of action. *See supra* note 1 and accompanying text (courts first began to recognize bad faith claims in 1914).

Courts first examined a cause of action for bad faith around the turn of the century, but rarely allowed plaintiffs to recover from insurers for bad faith. *See, e.g.*, Rumford Falls Paper Co. v. Fidelity & Casualty Co., 92 Me. 574, ____, 43 A. 503, 506 (1899) (insurer does not have to settle all claims against insured); McDonald v. Royal Indem. Ins. Co., 109 N.J.L. 308, 310, 162 A. 620, 620 (1932) (insurer has no obligation to settle claims absent contractual agreement to settle claims); Auerbach v. Maryland Casualty Co., 236 N.Y. 247, 252, 140 N.E. 577, 579 (1923) (insurer has no duty to settle claims prior to trial); C. Schmidt & Sons Brewing Co. v. Travelers' Ins. Co., 244 Pa. 286, 289, 90 A. 653, 654, (1914) (insurer has no duty to pay claim before trial). *But see* New Orleans & C.R.R. v. Maryland Casualty Co., 114 La. 153, 160, 38 So. 89, 92 (1905) (insurer must exercise good faith and act intelligently in evaluating settlement offers); Cavanaugh Bros. v. General Accident Fire & Life Assurance Corp., 79 N.H. 186, 187, 106 A. 604, 604 (1919) (insurer is under duty to act as average person would act in settling claim). In early decisions involving bad faith claims, courts, after examining the express terms of insurance contracts, generally found that, while insurers had the option to compromise claims, insurers had no legal obligation to settle claims before trial. *See Auerbach*, 236 N.Y. at 252, 140 N.E. at 579 (insurer has no legal duty to settle claims prior to trial); *Schmidt*, 244 Pa. at 289, 90 A. at 654 (insurer has no duty to pay claim before trial). Insurers, therefore, had unfettered discretion to defend or settle claims against their insureds. *See* Henke v. Iowa Home Mut. Casualty Co., 250 Iowa 1123, 1128, 97 N.W.2d 168, 172 (1959) (language of insurance policy permitted insurer to use its discretion with regard to settlement); Note, *Excess Liability*, *supra*, at 380 (under early bad faith decisions, insurers had absolute discretion to decide whether to settle third-party claims against insured).

Courts gradually began to recognize that allowing insurers complete discretion regarding claims settlements created a conflict of interest between insurers and insureds. *See* Note, *Excess Liability*, *supra*, at 387 (only insurer can profit from refusing to settle claim against insured). If an insurer had absolute discretion over whether to settle a third-party claim against an insured, the insurer had a strong incentive to gamble with its insured's money, even if its insured had only a small chance of a favorable verdict. *See* Rova Farms Resort, Inc. v. Investors Ins. Co. of Am., 65 N.J. 474, 498, 323-A.2d 495, 508 (1974) (insurer, in attempting to save its own money, exposes insured to liability for excess judgment). Since an insurer never could lose more than its insured's policy limit, an insurer whose policy holder had even a slim chance of a favorable verdict had a strong incentive not to settle. *See id.* (insurer, by exposing insured to excess verdict, can attempt to save money). Even if the liability of an insured appeared certain, an insurer, although expecting to lose the amount of its insured's policy limit, still might refuse to settle since a jury conceivably could find for the insured. *See Crisci*, 66 Cal. 2d at ____, 426 P.2d at 177, 58 Cal. Rptr. at 17 (insurers, hoping for favorable verdicts, have strong incentive to gamble with insureds' money). If the insurer's gamble failed, the insurer would pay the policy limit and force the insured to pay the excess amount of the judgment. *See id.* at ____, 426 P.2d at 176, 58 Cal. Rptr. at 16 (insured is responsible for amount of judgment over insured's policy limit). Since insurers had exclusive authority to

perceived that insureds have an inferior financial position to and an unequal bargaining power with insurers.[3] Insurers ordinarily have exclusive contractual authority to handle third parties' claims against insureds, including authority over settlement, and, as a result, can refuse to settle those claims.[4] Courts have determined that an insurer who wrongfully refuses to settle a claim against its insured within the insured's policy limit acts in bad faith.[5] By claiming that an insurer has acted in bad faith, an insured can recover damages for an insurer's wrongful refusal to settle within an insured's policy limit if the insured becomes liable for an amount in excess of his policy limit.[6]

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settle claims, courts decided to afford insureds some protection. *See, e.g.*, American Mut. Liab. Ins. Co. v. Cooper, 61 F.2d 446, 448 (5th Cir. 1932) (insurer's duty to insured arises because insurer assumes all power over settlement through contract), *cert. denied*, 289 U.S. 736 (1933); Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, ____, 319 P.2d 69, 71 (Ct. App. 1958) (courts should protect insured's interests from insurer misconduct); Southern Fire & Casualty Co. v. Norris, 35 Tenn. App. 657, 668, 250 S.W.2d 785, 790 (Ct. App. 1952) (insured, by signing insurance contract, gives his insurer right to settle third-party claims against insured and, therefore, insured has right to assume that insurer will not abandon insured's interest); Hilker v. Western Auto. Ins. Co., 204 Wis. 1, 13, 235 N.W. 413, 414 (1931) (insurer's duty to insured arises from insured's assignment of certain rights and privileges to insurer).

3. *See* Healy Tibbits Constr. Co. v. Employers' Surplus Lines Ins. Co., 72 Cal. App. 3d 741, 749, 140 Cal. Rptr. 375, 382 (Ct. App. 1977) (insurance policies are adhesion contracts); Dobbyn, *Is Good Faith in Insurance Contracts a Two-Way Street*, 62 N.D.L. REV. 355, 355 (1986) (comparing courts' protective treatment of insureds with courts' treatment of sailors, infants, and incompetents). Because insureds have an inferior financial position to and an unequal bargaining power with insurers, courts perceive insureds as easily disadvantaged and economically intimidated. *See infra* note 14 and accompanying text (annual premiums of insurance industry in 1979 were equivalent to one-eighth of total disposable income for all Americans).

4. *See supra* note 2 (discussing typical insurance contract provision that grants authority over claims settlements to insurer).

5. *See* Torrez v. State Farm Mut. Auto. Ins. Co., 705 F.2d 1192, 1194 (10th Cir. 1982) (claimant's estate brought action against tortfeasor's insurer for wrongfully refusing to settle plaintiff's claim within tortfeasor's policy limit); Liberty Mut. Ins. Co. v. Davis, 412 F.2d 475, 477 (5th Cir. 1969) (insurer, in bad faith, refused to settle personal injury claims against insured within insured's policy limits). Courts generically denominate claims that an insured brings against an insurer for breach of the duty of good faith and fair dealing as "bad faith" actions because bad faith is the typical standard of conduct that will expose an insurer to liability. *See* P. MAGARICK, EXCESS LIABILITY § 10.02, at 164 (2d ed. 1982) (courts in majority of states hold that bad faith is necessary to find in favor of insured against insurer). Although the majority of courts considering bad faith claims against insurers require a finding of "bad faith," some courts have allowed insureds to establish insurers' liability after the insureds showed that the insurer acted negligently in handling a claim. *See infra* notes 38-41 and accompanying text (discussing negligence criterion in certain jurisdictions); *see also infra* notes 34-37 and accompanying text (defining "bad faith"). Examples of insurer conduct that evidence bad faith include an insurer's wrongful refusal to pay a claim if the insurer owes the insured directly under an insurance policy, and the negligent defense of or refusal to defend the insured in a third-party claim if the insurer has a contractual duty to defend. *See* LePley, *Bad Faith Updated*, 21 TRIAL 44, 44-46 (Apr. 1985) (describing insurer conduct that might support bad faith claim); *supra* note 2 (discussing cause of action for bad faith refusal to settle).

6. *See* Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 660, 328 P.2d 198, 201

Although courts uniformly have determined that insureds can recover damages for bad faith from insurers,[7] courts differ on the standard of proof necessary to subject insurers to liability.[8] Traditionally, courts have placed a fairly heavy burden on plaintiffs to demonstrate insurers' bad faith.[9] Recent decisions, however, increasingly have reduced insureds' burdens of proving insurers' bad faith.[10] To protect themselves from plaintiffs' expanding ability to recover in bad faith claims, insurers increasingly have attempted to immunize themselves from liability by claiming various defenses.[11] For example, insurers recently have claimed that third-party plaintiffs have "set up" insurers for bad faith claims.[12] Insurers claim that, because insureds ordinarily use the money recovered from insurers in bad

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(1958) (insurer is liable for entire judgment against insured if insurer, in bad faith, refuses offer of settlement); Southern Fire & Casualty Co. v. Norris, 35 Tenn. App. 657, 668, 250 S.W.2d 785, 790 (Ct. App. 1952) (insurer is liable in tort for excess judgment because of bad faith refusal to settle).

7. *See, e.g.*, Continental Casualty Co. v. Pacific Indem. Co., 134 Cal. App. 3d 389, 398, 184 Cal. Rptr. 583, 587 (Ct. App. 1982) (insurer's breach of duty of good faith and fair dealing gives insured cause of action for bad faith); National Emblem Ins. Co. v. Pritchard, 140 Ga. App. 350, 350, 231 S.E.2d 126, 126 (Ct. App. 1976) (same); Openshaw v. Allstate Ins. Co., 94 Idaho 192, ____, 484 P.2d 1032, 1034 (1971) (same); Rova Farms Resort, Inc. v. Investors Ins. Co., 65 N.J. 474, 482, 323 A.2d 495, 511 (1974) (same); State Auto. Ins. Co. v. Rowland, 221 Tenn. 421, ____, 427 S.W.2d 30, 33 (1968) (same); *see also* Halbert, *supra* note 2, at 38 (every jurisdiction has some form of bad faith claim). *But see* Martin v. Travelers Indem. Co., 450 F.2d 542, 551 (5th Cir. 1971) (to recover in bad faith action under Mississippi law, insured must show fraud by insurer).

8. *See* Halbert, *supra* note 2, at 38-39 (no clear distinction between courts' approaches to what constitutes bad faith). *Compare infra* note 34 and accompanying text (listing courts which hold that insurers' failure to consider insureds' interests equally with insurers' interests is bad faith) *with infra* note 35 and accompanying text (listing courts which hold that insurers may consider their own interests superior to their policy holders' interests).

9. *See* McDonald v. Royal Indem. Ins. Co., 109 N.J.L. 308, 310, 162 A. 620, 620 (1932) (unless insurer contractually agrees to settle claims, insurer has no obligation to settle); Auerbach v. Maryland Casualty Co., 236 N.Y. 247, 252, 140 N.E. 577, 579 (1923) (insurer has no duty to settle claims before trial).

10. *See, e.g.*, Rova Farms Resort, Inc. v. Investors Ins. Co., 65 N.J. 474, 493, 323 A.2d 495, 505 (1974) (claimant's offer of settlement is not prerequisite to imposing liability on insurer); State Auto. Ins. Co. v. Rowland, 221 Tenn. 421, 432, 427 S.W.2d 30, 34 (1968) (holding insurer liable for bad faith refusal to settle claim even though claimant never made firm settlement demand); Alt v. American Family Mut. Ins. Co., 71 Wis. 2d 340, 347, 237 N.W.2d 706, 711 (1976) (whether or not claimant makes settlement demand, insurer has affirmative duty to seek settlement if settlement is in best interest of insured).

11. *See* LePley; *supra* note 5, at 48-50 (discussing circumstances that might produce defenses to bad faith claims).

12. *See, e.g.*, Samson v. Transamerica Ins. Co., 30 Cal. 3d 220, 240, 636 P.2d 32, 44, 178 Cal. Rptr. 343, 355 (1981) (insurer alleged that plaintiffs attempted to create excess liability action against insurer); DeLaune v. Liberty Mut. Ins. Co., 314 So. 2d 601, 603 (Fla. Dist. Ct. App. 1975) (insurer argued that plaintiff's offer was "set up" for bad faith suit), *cert. denied*, 330 So. 2d 16 (1976); Kriz v. Gov't Employees Ins. Co., 42 Or. App. 339, ____, 600 P.2d 496, 500 (1979) (insurer argued that plaintiff, in making settlement demand, intended to "set up" insurer for bad faith claim).

faith actions to satisfy third parties' outstanding judgments against insureds[13] and because insurers usually have much greater financial resources than insureds,[14] third-party plaintiffs have strong motivations to "set up" insurers for bad faith claims if the plaintiffs' damages are likely to exceed an insured's personal resources.[15] In claiming the "set up" defense, an insurer must assert that a plaintiff acted in bad faith by making an unreasonable settlement offer, and that the insurer acted reasonably in refusing the settlement offer.[16] If a court determines that a third-party plaintiff "set up" the insurer, the plaintiff will not recover any damages in the bad faith action.[17] In addition to the "set up" defense, at least one court has allowed an insurer to claim comparative fault as a defense.[18] In claiming comparative fault, the insurer must show that the plaintiff's own misconduct was at least partially responsible for the insurer's failure to settle a claim.[19] Unlike the "set up" defense, which can serve only as an absolute defense,[20]

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13. *See* Note, *Excess Liability*, *supra* note 2, at 387 (insured that recovers judgment against insurer in bad faith action ordinarily uses funds to discharge debt to claimant).

14. *See* Los Angeles Times, July 15, 1979, § IV, at 1, col. 5 (annual premiums of insurance industry in 1979 were equivalent to one-eighth of total disposable income for all Americans).

15. *See* Martin v. Hartford Accident & Indem. Co., 228 Cal. App. 2d 178, ____, 39 Cal. Rptr. 342, 347 (Ct. App. 1964) (insurer argued that, if court imposed excess liability under existing circumstances, more plaintiffs would offer to settle for insured's policy limits if insured was insolvent); P. MAGARICK, supra note 5, § 11.06[1], at 189 (discussing plaintiffs' interest in "setting up" insurers).

16. *See, e.g.*, Kivi v. Nationwide Mut. Ins. Co., 695 F.2d 1285, 1286 (11th Cir. 1983) (insurer contended that it had no reasonable opportunity to settle claim against its insured within insured's policy limits); Baton v. Transamerica Ins. Co., 584 F.2d 907, 913 (9th Cir. 1978) (insurer alleged that insurer did not act in bad faith because time period that plaintiff attached to her offer of settlement was unreasonably short); Ashbrook v. Kowalick, 332 F. Supp. 77, 82 (E.D. Pa. 1971) (insurer argued that plaintiff's failure expressly to keep his settlement offer open beyond two-week period was unreasonable as matter of law).

17. *See, e.g.*, Baton v. Transamerica, 584 F.2d 907, 913 (9th Cir. 1978) (because insurer reasonably assumed that ten-day time period which plaintiffs attached to their offer was inapplicable to insurer's evaluation of settlement, insurer did not act negligently or in bad faith in failing to settle claim); DeLaune v. Liberty Mut. Ins. Co., 314 So. 2d 601, 603 (Fla. Dist. Ct. App. 1975) (court upheld dismissal of plaintiffs' complaint because time limit that plaintiffs attached to offer of settlement was unreasonable under circumstances), *cert. denied*, 330 So. 2d 16 (1976); Adduci v. Vigilant Ins. Co., 98 Ill. App. 3d 472, 477, 424 N.E.2d 645, 649 (App. Ct. 1981) (plaintiffs' complaint adequately did not allege breach of duty by insurer because plaintiffs alleged no facts to indicate why plaintiffs could not accept insurer's late offer of settlement).

18. *See* California Casualty Gen. Ins. Co. v. Superior Court, 173 Cal. App. 3d 274, 282-83, 218 Cal. Rptr. 817, 822 (Ct. App. 1985) (comparative fault can constitute at least partial defense to plaintiff's action against insurer for breach of duty of good faith and fair dealing).

19. *Id.* at 283, 218 Cal. Rptr. at 823 (if insured fails to furnish information to insurer, insured's own conduct has contributed to insured's economic loss or emotional distress).

20. *See, e.g.*, Grumbling v. Medallion Ins. Co., 392 F. Supp. 717, 721 (D. Or. 1975) (despite insurer's argument that plaintiff's offer was unreasonable, court found that insurer's conduct constituted bad faith and lack of due care toward insured), *aff'd*, 545 F.2d 686 (9th

comparative fault can act as either a partial or an absolute defense by reducing or eliminating an insured's damages.[21] The "set up" defense is more difficult to prove than the comparative fault defense because assertions of "set up" involve the underlying question of an insurer's good faith or bad faith.[22] Under the comparative fault defense, however, an insurer, even if guilty of bad faith, can reduce the amount of damages that the insurer must pay to a plaintiff.[23]

I. The Origin And Evolution Of Bad Faith Claims Against Insurers

Although the "set up" and comparative fault defenses may assist insurers in defending bad faith actions, no court ever had recognized a cause of action for bad faith under an insurance contract until 1914 when, in *Brassil v. Maryland Casualty Co.*,[24] the Court of Appeals for the State of New York determined that every insurance contract implies a duty of "good faith and fair dealing."[25] In *Brassil*, the court considered whether an insured could recover expenses that an insured incurred during an appeal of a judgment against him.[26] The insurer in *Brassil* refused an injured plaintiff's offer to settle the plaintiff's claim within the insured's policy limit.[27] At trial, the plaintiff received a judgment against the insured that exceeded the insured's policy limit.[28] The insurer in *Brassil* refused to appeal the judgment and simply offered to pay the insured his policy limit.[29] The *Brassil* court reasoned that the insurer's failure to prosecute an appeal after

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Cir. 1976); Ashbrook v. Kowalick, 332 F. Supp. 77, 82 (E.D. Pa. 1971) (despite instruction that plaintiff's time limitation was unreasonable, jury found that insurer acted in bad faith); Samson v. Transamerica, 30 Cal. 3d 220, 240, 636 P.2d 32, 46, 178 Cal. Rptr. 343, 357 (1981) (insurer asserted that insured tried to "set up" insurer for bad faith claim, but court determined that plaintiffs' settlement offer was reasonable as matter of law).

21. *See California Casualty*, 173 Cal. App. 3d at 282-83, 218 Cal. Rptr. at 822 (comparative fault of insured can constitute at least partial defense to insured's bad faith claim); *see also infra* notes 163-93 and accompanying text (defining and explaining comparative fault defense); *infra* note 178 and accompanying text (comparative fault possibly can operate as absolute defense to bad faith claims).

22. *See* Martin v. Hartford Accident & Indem. Co., 228 Cal. App. 2d 178, ____, 39 Cal. Rptr. 342, 347 (Ct. App. 1964) (critical test in bad faith claim is insurer's good faith or bad faith, which courts should determine from circumstances of each case).

23. *See* Fleming v. Safeco Ins. Co., 160 Cal. App. 3d 31, 36-37, 206 Cal. Rptr. 313, 316 (Ct. App. 1984) (reducing plaintiff's compensatory damages by twenty-six percent, which represented amount proportional to plaintiff's fault).

24. 210 N.Y. 235, 104 N.E. 622 (1914).

25. Brassil v. Maryland Casualty Co., 210 N.Y. 235, 235, 104 N.E. 622, 622 (1914).

26. *Id.* at 237, 104 N.E. at 623.

27. *Id.* at 236, 104 N.E. at 622.

28. *Id.* at 236, 104 N.E. at 623.

29. *Id.* In *Brassil v. Maryland Casualty Co.*, an insured employed his own attorney to appeal an adverse judgment against the insured and eventually secured a reversal of the judgment. *Id.* at 236-37, 104 N.E. at 623. The appellate court, however, did grant the plaintiff a new trial against the insured. *Id.* at 237, 104 N.E. at 622. No new trial ever occurred, and the court subsequently dismissed the plaintiff's action. *Id.*

the insurer had controlled the insured's defense at trial severely prejudiced the insured.[30] The *Brassil* court recognized that, while the insurer technically might have acted in accordance with the insurance contract, the insurer owed its insured the same universal duty of good faith and fair dealing that underlies all written contracts.[31] The *Brassil* court concluded that the insurer's failure to pursue an appeal if good grounds for appeal existed violated the insurer's duty of good faith to its insured.[32]

Since *Brassil*, courts uniformly have recognized that insurers owe their insured policy holders a duty of good faith and fair dealing.[33] Courts, however, use different standards in determining whether an insurer acted in good faith and dealt fairly with its insured regarding settlement of a claim. The majority of courts have determined that, to act in good faith, insurers considering claims settlements must consider the insured's interests equally with the interests of the insurers.[34] Other courts, unlike the majority, have

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30. *Id.* at 241, 104 N.E. at 624.

31. *Id.* at 242, 104 N.E. at 624.

32. *Id.*

33. *See* Annotation, *Duty of Liability Insurer to Settle or Compromise*, 40 A.L.R.2D 168 (Supp. 1980) (listing courts that recognize duty of good faith and fair dealing). While the Court of Appeals for the State of New York, in *Brassil*, addressed only the duty of good faith and fair dealing incumbent upon the insurer, other courts have held that the duty of good faith and fair dealing is a "two-way street" that extends to both the insured and the insurer. *See Brassil*, 210 N.Y. at 242, 104 N.E. at 624; Commercial Union Assurance Cos. v. Safeway Stores, Inc., 26 Cal. 3d 912, 918, 610 P.2d 1038, 1041, 164 Cal. Rptr. 709, 712 (1980) (duty of good faith and fair dealing runs from insured to insurer); White v. Unigard Mut. Ins. Co., 112 Idaho 94, ____, 730 P.2d 1014, 1016 (1986) (contract imposes duty of good faith upon insured and insurer); Modisette v. Foundation Reserve Ins. Co., 77 N.M. 661, ____, 427 P.2d 21, 25 (1967) (obligation to deal fairly and honestly applies equally to insurer and insured).

34. *See, e.g.*, Springer v. Citizens Casualty Co., 246 F.2d 123, 126 (5th Cir. 1957) (insurer must be at least as zealous in looking after insured's interest as in looking after insurer's interest); National Mut. Casualty Co. v. Britt, 203 Okla. 175, ____, 200 P.2d 407, 411 (1948) (insurer must consider rights of insured at least as much as its own rights); Western Casualty & Sur. Co. v. Fowler, 390 P.2d 602, 606 (Wyo. 1964) (insurer must give equal consideration to insured's interest); *see also* 14 M. RHODES, COUCH ON INSURANCE 2D § 51:4, at 387 (rev. ed. 1982) (same). To determine whether an insurer gave an insured's interests equal consideration, courts often consider whether an insurer failed to settle a third-party's claim against an insured even though its insured had a slim chance of success at trial and had a high probability of an excess verdict. *See* Ashbrook v. Kowalick, 332 F. Supp. 77, 82 (E.D. Pa. 1971) (insurer is liable for bad faith because insurer knew that insured had no defense to third-party's claim and that plaintiff's recovery greatly would exceed insured's policy limits); Crisci v. Security Ins. Co., 66 Cal. 2d 425, ____, 426 P.2d 173, 177-78, 58 Cal. Rptr. 13, 18 (1967) (court determined that insurer knew insured probably would be found liable to claimant and that damages probably greatly would exceed insured's policy limit). Additionally, courts commonly consider an insurer's failure adequately to investigate claims against its insured, failure to keep its insured informed of settlement decisions, failure to consider the advice of counsel, and failure to commence or engage in settlement negotiations. M. RHODES, *supra*, §§ 51:13 to 51:17, at 401-07.

Rather than define insurers' duties by relating insurers' interests to insureds' interests, other courts require insurers, under the duty of good faith and fair dealing, to consider

determined that insurers engaging in claims settlements may place their own interests above their insured policy holder's interests.[35] Finally, some courts have determined that insurers must give the insured's interest paramount consideration to the insurers' interests.[36] Because courts have no uniform standard for evaluating bad faith claims against insurers, insurers cannot determine with accuracy whether refusing to settle a particular claim will result in liability for bad faith.[37]

Rather than attempt the difficult task of defining and applying the various bad faith standards, a few courts have chosen to use ordinary negligence principles in determining whether an insurer acted in bad faith.[38] In defining an insurer's negligence, courts inquire into the actions that a reasonable insurer in a similar situation would have undertaken in considering a third-party's claim against an insured.[39] Like determinations of bad

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settlement offers without reference to an insured's policy limit. *See, e.g.*, Koopie v. Allied Mut. Ins. Co., 210 N.W.2d 844, 848 (Iowa 1973) (modern courts require insurers to evaluate settlement as if no policy limit existed); Bowers v. Camden Fire Ins. Ass'n, 51 N.J. 62, 71-72, 237 A.2d 857, 862 (1968) (insurer must treat settlement offer as if insurer had full coverage for any verdict that plaintiff might recover); Cowden v. Aetna Casualty & Sur. Co., 389 Pa. 459, 470-71, 134 A.2d 223, 228 (1957) (insurer must treat claim against insured as if insurer alone was liable for entire amount).

35. *See* New Orleans & C.R.R. v. Maryland Casualty Co., 114 La. 153, ____, 38 So. 89, 91-92 (1905) (insurer must act in good faith but insurer has absolute right to decide whether to settle claims); St. Joseph Transfer & Storage Co. v. Employers' Indemnity Corp., 224 Mo. App. 221, ____, 23 S.W.2d 215, 220 (Ct. App. 1930) (if interests of insurer and insured conflict, insurer's only duty to insured is express contractual duty).

36. *See* Zumwalt v. Utilities Ins. Co., 360 Mo. 362, ____, 228 S.W.2d 750, 754 (1950) (if insurer's interests conflict with insured's interests, insurer must sacrifice its own interests in favor of insured's interests); Tyger River Pine Co. v. Maryland Casualty Co., 170 S.C. 286, ____, 170 S.E. 346, 348 (1933) (same).

37. *See* Brittle, *supra* note 2, at 304 (standards of conduct for insurers demonstrate confusion in courts).

38. *See, e.g.*, Aetna Casualty & Sur. Co. v. Kornbluth, 28 Colo. App. 194, 199, 471 P.2d 609, 611 (Ct. App. 1970) (in suits for breach of duty of good faith and fair dealing, courts more easily can measure insurer's duty using negligence standard); Dumas v. Hartford Accident & Indem. Co., 94 N.H. 484, 488, 56 A.2d 57, 59 (1947) (insurer owes insured duty of due care); G.A. Stowers Furniture Co. v. American Indem. Co., 15 S.W.2d 544, 547 (Tex. Com'n App. 1929) (insurer's duty of due care arises because of insurer's absolute control over litigation).

39. *See* Dumas v. Hartford Accident & Indem. Co., 94 N.H. 484, ____, 56 A.2d 57, 60 (1947) (insurer, in considering settlement offer, must act as reasonable man would have acted in managing his own affairs). The negligence criterion for bad faith claims evolved because courts perceived that applying subjective standards to bad faith claims against insurers created unfair results for insureds. *See id.* (applying any standard other than objective standard to bad faith claims against insurers would allow insurers to be unduly venturesome at expense of insureds). Although most jurisdictions have applied a reasonable man standard to bad faith claims, a few jurisdictions continue to avoid any objective standard and examine bad faith claims in terms of the insurer's subjective state of mind. *See* Awrey v. Progressive Casualty Co., 728 F.2d 352, 354-55 (6th Cir. 1984) (under Michigan law, insurer consciously must commit wrongful or dishonest act before insurer can be liable for bad faith), *cert. denied*, 106 S. Ct. 250 (1985); Martin v. Travelers Indem. Co., 450 F.2d 542, 551 (5th Cir. 1971) (under Mississippi law, insurer must commit fraud before insurer is liable to insured for bad faith).

faith, determinations of whether an insurer was negligent require a court to consider the reasonableness of the insurer's actions under the existing circumstances.[40] Although some courts have applied negligence standards instead of bad faith standards to insureds' bad faith actions against insurers, the results that courts have reached under either standard are virtually identical because courts in jurisdictions that purportedly use a bad faith standard often have determined that insurers which act negligently also act in bad faith.[41]

Although courts that use bad faith standards and courts that use negligence standards normally have reached uniform results in considering bad faith claims, courts potentially might increase insurers' liability by

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40. *See, e.g.*, Guin v. Ha, 591 P.2d 1281, 1283 (Alaska 1979) (duty of good faith and fair dealing encompasses obligation of insurer to accept reasonable offers of settlement); Austero v. National Casualty Co., 84 Cal. App. 3d 1, 31, 148 Cal. Rptr. 653, 671 (Ct. App. 1978) (ultimate test of insurer's liability is reasonableness of insurer's decision to reject settlement offer); Champion v. Farm Bureau Ins. Co., 352 So. 2d 737, 740 (La. Ct. App. 1977) (determination of bad faith failure to settle depends on facts and circumstances of each case), *writ denied*, 354 So. 2d 1050 (1978).

41. *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, 185 (Apr. 1987) (differences between bad faith and negligence approaches are illusory). *Compare supra* note 34 (listing courts that, under bad faith standard, required insurer to consider settlement offer as if no policy limit existed) *with* Maine Bonding & Casualty Co. v. Centennial Ins. Co., 298 Or. 514, ____, 693 P.2d 1296, 1299 (1985) (under negligence standard, insurer must consider settlement offer as if insurer had no policy limit). The illusory differences between the bad faith standard and the negligence standard become evident after examining the consequences of negligence by an insurer in bad faith jurisdictions. At least one court has determined that an insurer's negligence in failing to settle a third-party's claim against an insured is per se "bad faith." *See Maine Bonding & Casualty Co.*, 298 Or. at ____, 693 P.2d at 1299 (using bad faith standard, insurer was liable to insured for excess judgment because insurer failed to use due care). Other courts have determined that an insurer's negligence is a factor that juries should consider in determining whether an insurer acted in bad faith. *See, e.g.*, Knudsen v. Hartford Accident & Indem. Co., 26 Conn. Supp. 325, ____, 222 A.2d 811, 812 (Super. Ct. 1966) (insurer's negligence is factor that relates to insurer's bad faith); State Farm Mut. Auto. Ins. Co. v. White, 248 Md. 324, ____, 236 A.2d 269, 271-73 (1967) (upholding jury instruction which stated that insurer had to be free from negligence as well as bad faith before jury could find that insurer was not liable); Baker v. Northwestern Nat'l Casualty Co., 26 Wis. 2d 306, 315, 132 N.W.2d 493, 498 (1965) (extent and character of insurer's negligence are factors that jury should consider in determining whether insurer acted in bad faith). A few jurisdictions, however, by defining bad faith in subjective terms, have determined that evidence of negligence is irrelevant because an insurer actually must have known that the insurer's conduct was wrongful. *See* Gordon v. Nationwide Mut. Ins. Co., 30 N.Y.2d 427, 436-37, 285 N.E.2d 849, 852, 334 N.Y.S.2d 601, 608-09 (1972) (negligence is insufficient to render insurer liable for bad faith), *cert. denied*, 410 U.S. 931 (1973). The factors that courts consider in evaluating insurer conduct, however, are similar under either the bad faith or negligence standard. *See* Koenen, *supra*, at 185 (evidentiary factors that courts consider under bad faith and negligence standards are nearly identical). As a result, the outcomes in applying both standards are fairly uniform. *See id.* (because evidentiary factors that courts consider under bad faith and negligence standards are nearly identical, results under each standard are consistent).

adopting a strict liability standard in bad faith actions against insurers.[42] Although no court expressly has held an insurer liable using a strict liability standard,[43] the Supreme Court for the State of California, in *Crisci v. Security Insurance Co.*,[44] suggested that strict liability effectively might balance the interests of both insurers and insurance policy holders during settlement procedures.[45] In *Crisci*, the California Supreme Court considered whether, after an insurer refused an offer of settlement within an insured's policy limit, the insured could recover an excess judgment from her insurer.[46] In *Crisci*, an insurer refused a plaintiff's offer to settle within the insured's policy limits after the plaintiff, a tenant of the insured, fell through a negligently maintained staircase.[47] After the plaintiff recovered damages from the insured, the trial court allowed the insured to recover the amount of the judgment that exceeded the insured's policy limits from her insurer.[48] In affirming the judgment of the trial court, the *Crisci* court did not formally recognize that insurers should be strictly liable for bad faith, but the court favorably discussed the possible application of strict liability to bad faith claims.[49] The *Crisci* court explained that the strict liability rule which the court had advocated in dicta would make an insurer liable whenever a plaintiff recovered an excess judgment from an insured following an insurer's refusal to settle within an insured's policy limits.[50] The *Crisci*

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42. *See* Note, *Excess Liability*, *supra* note 2, at 379 (insurers' duty to settle is approaching strict liability).

43. *See id.* at 385 (no court expressly has held that insurer is strictly liable to party claiming that insurer acted in bad faith).

44. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

45. Crisci v. Security Ins. Co., 66 Cal. 2d 425, 431, 426 P.2d 173, 177, 58 Cal. Rptr. 13, 17 (1967); *see* Rova Farms Resort, Inc. v. Investors Ins. Co. of Am., 65 N.J. 474, 496, 323 A.2d 495, 509-10 (1974) (advocating strict liability for insurers in bad faith claims).

46. *Crisci*, 66 Cal. 2d at ____, 426 P.2d at 173, 58 Cal. Rptr. at 13.

47. *Id.* at ____, 426 P.2d at 175, 58 Cal. Rptr. at 13. The plaintiff in *Crisci v. Security Insurance Co.* developed a severe psychosis following her accident. *Id.* at ____, 426 P.2d at 175, 58 Cal. Rptr. at 15. Mrs. Crisci had a $10,000 liability policy with her insurer, and the plaintiff offered to settle for $10,000. *Id.* The insurer knew that the injured plaintiff had experts who would testify that the plaintiff's mental illness was a result of the accident. *Id.* Additionally, the insurer knew that, if the jury believed the plaintiff's expert testimony, damages would be at least $100,000. *Id.* The insurer in *Crisci*, however, found its own experts who were willing to testify that the accident had not caused the plaintiff's mental illness. *Id.* The insurer hoped that the jury would disbelieve the plaintiff's evidence and believe the insurer's expert testimony. *Id.* After the insurer refused to settle, the plaintiff recovered a $101,000 judgment at trial. *Id.* at ____, 426 P.2d at 176, 58 Cal. Rptr. at 16. The plaintiff's attempts to collect the excess judgment from Mrs. Crisci left the insured insolvent, physically ill, and suicidal. *Id.*

48. *Id.* at ____, 426 P.2d at 173, 58 Cal. Rptr. at 13. In *Crisci*, the trial court, in addition to determining that the insured could recover the amount of the judgment in excess of her policy limit, ruled that Mrs. Crisci could recover damages for her emotional suffering. *Id.* The insurer appealed the Superior Court's decision to the Supreme Court for the State of California. *Id.*

49. *Id.* at ____, 426 P.2d at 177, 58 Cal. Rptr. at 17.

50. *Id.*

court reasoned that courts easily could apply a strict liability standard to bad faith claims because the use of a strict liability standard would eliminate the danger that insurers, hoping for favorable verdicts, might gamble with their insureds' money.[51] The California court noted that, because insurers conceivably might profit from refusing to settle claims, insurers should face potential liability if they fail to settle.[52] Following the *Crisci* court's dicta, several courts have raised the standard of conduct that insurers must satisfy in settling claims to a level that resembles a strict liability standard.[53] The courts that have raised an insurer's standard of conduct, however, have failed to recognize that, because a strict liability standard would force insurers to pay any settlement offer within an insured's policy limits, regardless of whether a settlement offer was unreasonable, the costs of insurers' attempts to maintain business would increase substantially under a strict liability standard.[54] If more courts attempted to adopt the standard that the *Crisci* court advocated, insurers undoubtedly would pass the increased costs of doing business to consumers by increasing the costs of insurance premiums.[55] Many commentators feel that imposing strict liability on insurers would be detrimental to consumers, whose interests the courts consistently have tried to protect.[56]

Although recognizing a strict liability standard in insurer bad faith actions substantially would increase the costs that insureds would have to pay for insurance, several courts that have adopted standards similar to strict liability do not require that a plaintiff make a firm offer of settlement as a prerequisite to maintaining an insurer's liability.[57] Because these courts

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51. *Id.*

52. *Id.*

53. *See, e.g.*, Rova Farms Resort, Inc. v. Investors Ins. Co. of Am., 65 N.J. 474, 493, 323 A.2d 495, 505 (1974) (claimant's offer of settlement is not prerequisite to imposing liability on insurer); State Auto. Ins. Co. v. Rowland, 221 Tenn. 421, 432, 427 S.W.2d 30, 34 (1968) (holding insurer liable for bad faith refusal to settle claim even though claimant never made firm settlement demand); Alt v. American Family Mut. Ins. Co., 71 Wis. 2d 340, 348-49, 237 N.W.2d 706, 711 (1976) (whether or not claimant makes settlement demand, insurer has affirmative duty to seek settlement if settlement is in best interest of insured).

54. *See* Note, *Excess Liability*, *supra* note 2, at 397 (insurers' costs would rise if courts raised requisite standard of insurer conduct because insurers, to reduce excess liability exposure, would have to settle more claims).

55. *Id.* at 396 (insurers are likely to increase rates to offset large bad faith recoveries and increased number of settlements).

56. *See, e.g.*, Brittle, *supra* note 2, at 308-09 (if courts impose strict liability on insurers in bad faith claims, costs of insurance will increase because insurers will bear same risk regardless of size of policy); Dobbyn, *supra* note 3, at 366 (because public relies on insurance at affordable rates, strict liability is detrimental to interests of public); Note, *Excess Liability*, *supra* note 2, at 379 (insurers are likely to increase premiums as duty to settle approaches strict liability, which will injure consumers in general).

57. *See, e.g.*, Rova Farms Resort, Inc. v. Investors Ins. Co. of Am., 65 N.J. 474, 493, 323 A.2d 495, 505 (1974) (claimant's offer of settlement is not prerequisite to imposing liability on insurer); State Auto. Ins. Co. v. Rowland, 221 Tenn. 421, 432, 427 S.W.2d 30, 34 (1968) (holding insurer liable for bad faith refusal to settle claim even though claimant never made

do not require firm offers of settlement, insurers safely cannot wait for plaintiffs to make settlement offers.[58] Under decisions of these courts, insurers have an affirmative duty actively to pursue settlement if settlement is in the best interest of an insured.[59] By placing an affirmative duty to settle upon insurers, courts effectively shift the burden of proof in bad faith actions to insurers, allowing insurers to escape liability only if insurers can demonstrate that no reasonable possibility of settling within the policy limit existed and that a settlement above the policy limit, with the insured contributing the excess, was unlikely.[60] The heightening of the bad faith standard and the trend toward strict liability gravely concerns insurers and the insurance defense bar.[61]

II. INSURERS' DEFENSES TO BAD FAITH CLAIMS

In response to concerns regarding strict liability, insurers increasingly have attempted to immunize themselves from liability under bad faith claims.[62] For example, insurers have attempted to prevent bad faith claims by examining conduct that courts have determined violates an insurer's duty to its insured and establishing firm policies for handling claims.[63] In addition

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firm settlement demand); Alt v. American Family Mut. Ins. Co., 71 Wis. 2d 340, 348-49, 237 N.W.2d 706, 711 (1976) (whether or not claimant makes settlement demand, insurer has affirmative duty to seek settlement if settlement is in best interest of insured).

58. *See* Rova Farms Resort, Inc. v. Investors Ins. Co. of Am., 65 N.J. 474, 493, 323 A.2d 495, 507 (1974) (insurer has positive fiduciary duty to take initiative and attempt to achieve settlement).

59. *See id.* (insurer has positive duty to attempt to achieve settlement); Alt v. American Family Mut. Ins. Co., 71 Wis. 2d 340, 348-49, 237 N.W.2d 706, 712 (same).

60. *See Rova*, 65 N.J. at 496, 323 A.2d at 507 (insurer, to establish lack of bad faith, must demonstrate that no reasonable possibility of settlement existed and that settlement above policy limit was unlikely).

61. *See* Ashley, *Guidelines for the Insurer in Avoiding Bad Faith Exposure*, 36 FED'N OF INS. & CORP. COUNS. Q. 103, 103-20 (Wtr. 1986) (discussing conduct that insurance practitioners and adjusters should avoid); Brittle, *supra* note 2, at 310-26 (same).

62. *See supra* note 61 (listing articles that help insurers to avoid bad faith claims).

63. *See* Ashley, *supra* note 61, at 103-18 (instructing insurers how to avoid bad faith exposure). One commentator has developed specific guidelines for insurers to follow in attempting to reduce the likelihood that plaintiffs successfully could maintain bad faith actions against the insurers. *Id.* The commentator has argued that, because courts consider certain factors in evaluating bad faith claims, insurers, by addressing those factors before third-parties file a claim against insureds, can reduce the likelihood that a court will find bad faith. *Id.* at 103. First, the commentator has advised insurers cautiously to determine whether to defend a particular claim against an insured. *Id.* at 103-05. Second, the commentator has advised insurers fully and fairly to investigate claims against their insureds. *Id.* at 105-06. The commentator also has noted that insurers should respond fully, accurately, and in a timely fashion to demands or inquiries from insureds. *Id.* at 106-07. Additionally, insurers should avoid making statements or taking actions that courts may view as tortious or unfair toward insureds. *Id.* at 107-08. The commentator has advised insurers to settle and evaluate claims earlier rather than later. *Id.* at 108-09. According to the commentator, insurers also should adopt reasonable settlement positions based on appropriate considerations. *Id.* at 109-12. Insurers should keep insureds informed about claims against the insureds. *Id.* at 112. Insurers

to adopting preventive measures to reduce the likelihood that a plaintiff successfully can maintain an action for bad faith, many insurers have begun to seek possible defenses to bad faith actions.[64] Because bad faith claims involve an inquiry into the reasonableness of circumstances, however, the development of novel defenses to liability for bad faith claims has been difficult.[65] Since claims of bad faith normally depend on specific factual disputes, a majority of courts continually require that questions regarding bad faith claims go to juries.[66] These courts, however, have allowed insurers to assert certain affirmative defenses under specific circumstances.[67] For example, some courts have determined that the assertion by an insurer that both insurer and insured have acted in a certain manner loosely constitutes a "defense" to a bad faith action.[68] As a result, inappropriate conduct by

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also should exercise care in recognizing and resolving coverage problems with insureds. *Id.* at 113-16. Insurers should avoid conflict of interest situations. *Id.* at 116-17. Finally, the commentator advises insurers to avoid creating a potential bad faith situation in underwriting or marketing an insurance policy. *Id.* at 117-18.

64. *See infra* note 68 and accompanying text (discussing possible defenses to bad faith claims).

65. *See* Ashley, *supra* note 61, at 103 (insurers cannot insulate themselves entirely from bad faith liability).

66. *See, e.g.*, Jones v. National Emblem Ins. Co., 436 F. Supp. 1119, 1125 (D. Mich. 1977) (insurer's bad faith in handling settlement negotiations normally is question for jury); Boston Old Colony Ins. Co. v. Gutierrez, 386 So. 2d 783, 785 (Fla. 1980) (question of insurer's failure to act in good faith in handling claim against insured is for jury), *cert. denied*, 450 U.S. 922 (1981); Farmers Ins. Exch. v. Schropp, 222 Kan. 612, ____, 567 P.2d 1359, 1366 (1977) (whether insurer was negligent or acted in bad faith in refusing offer of settlement is question for trier of fact). Although an insurer's bad faith ordinarily is a jury question, a minority of courts have determined that an insurer's conduct was reasonable or unreasonable as a matter of law. *See* Samson v. Transamerica Ins. Co., 30 Cal. 3d 220, 243, 636 P.2d 32, 45, 178 Cal. Rptr. 343, 357 (1981) (affirming summary judgment ruling for plaintiffs because plaintiffs' settlement offer was reasonable as matter of law); Adduci v. Vigilant Ins. Co., 98 Ill. App. 3d 472, 477, 424 N.E.2d 645, 649 (App. Ct. 1981) (upholding dismissal of plaintiffs' complaint because complaint failed to allege reason that plaintiffs could not accept insurer's dilatory offer of settlement for amount equal to policy limits).

67. *See* J. MOORE, MOORE'S FEDERAL PRACTICE § 8.27[3], at 8-192 (2d ed. 1987) (at common law, affirmative defense concedes apparent right in opposite party and relies on some new matter by which defendant defeats that apparent right).

68. *See* Maroney v. Allstate Ins. Co., 12 Wis. 2d 197, ____, 107 N.W.2d 261, 263 (1961) (insured's refusal to contribute amount in excess of policy limits toward settlement implied insured's agreement to try suit). In defending a bad faith claim, an insurer plausibly can argue that the insurer should not be liable for bad faith after failing to settle a third-party's claim against an insured if the insured, like the insurer, refused to settle the claim. An insurer can claim this defense if an insured refuses to contribute to a settlement in excess of the insured's policy limits. *See, e.g.*, Royal Transit v. Central Surety & Ins. Corp., 168 F.2d 345, 347 (7th Cir. 1948) (insurer does not act in bad faith if insured agrees to refuse settlement offer), *cert. denied*, 335 U.S. 844 (1948); Hadenfeldt v. State Farm Mut. Auto. Ins. Co., 195 Neb. 578, ____, 239 N.W.2d 499, 503 (1976) (sustaining insurer's demurrer because insured refused to contribute amount in excess of limits toward settlement after insurer offered policy limits); *Maroney*, 12 Wis. 2d at ____, 107 N.W.2d at 263 (insured's refusal to contribute amount in excess of policy limits toward settlement implied insured's agreement to try suit). Similarly, an insured's active concurrence or ratification of its insurer's decision to reject a

an insured may give an insurer a valid defense to a bad faith claim.[69]

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settlement offer or try a particular case can foreclose an insured's bad faith claim against its insurer. *See, e.g.*, Jackson v. St. Paul Mercury Indem. Co., 339 F.2d 40, 44 (6th Cir. 1964) (insured cannot recover from insurer if insured actively concurs in rejection of compromise offer); Stevens v. Northwestern Nat'l Casualty Co., 305 F.2d 513, 514 (6th Cir. 1962) (insurer is not liable because insured agreed with insurer's decision to try case), *cert. denied*, 374 U.S. 812 (1963); Royal Transit v. Central Surety & Ins. Corp., 168 F.2d 345, 347 (7th Cir. 1948) (insurer cannot be liable for bad faith if insured agreed to or joined in insurer's refusal to settle), *cert. denied*, 335 U.S. 844 (1948).

Another possible defense that an insurer can use against a bad faith claim is that an insured failed to purchase insurance coverage that was adequate to protect the insured's interests. *See* P. MAGARICK, *supra* note 5, § 12.02[1], at 223 (insured's failure to protect himself probably is most neglected element in bad faith decisions). Especially if an insured is a business, an insured's failure to anticipate and secure the proper level of insurance coverage necessary to protect the insured's interests could operate to mitigate an insurer's failure to settle a claim. *See* Coca-Cola Bottling Co. v. Maryland Casualty Co., 325 F. Supp. 204, 206 (W.D.N.C. 1971) (insured, as responsible business firm, should have known that it could obtain more coverage by requesting increased coverage and paying higher premiums).

In addition to the insured's failure to request more insurance coverage, an insured's failure to take other affirmative action sometimes can constitute an insurer's defense to a bad faith claim. *See* Southern Fire & Casualty Co. v. Norris, 35 Tenn. App. 657, ____, 250 S.W.2d 785, 792 (Ct. App. 1952) (plaintiff's failure to mitigate his damages by contributing toward settlement would be valid defense if plaintiff was able to contribute towards settlement). At least one court has suggested that an insured, to mitigate damages in his action against an insurer and to protect his own interests, may have a duty to settle a third-party plaintiff's claim in excess of his policy limits. *See id.* (plaintiff may have duty to settle claim in excess of plaintiff's policy limit). Most courts, however, do not allow insurers successfully to assert as a defense to a bad faith claim that an insured had a duty to mitigate his damages. *See* Noshey v. Am. Auto. Ins. Co., 68 F.2d 808, 810 (6th Cir. 1934) (if insurance policy provision forbids insured from settling case, insured is under no duty to imperil his protection under contract by breaching contract); Olson v. Union Fire Ins. Co., 174 Neb. 375, ____, 118 N.W.2d 318, 321 (1962) (insured has no duty to attempt to mitigate his excess liability).

Although courts generally do not allow insurers to claim that insureds had to mitigate damages, some courts have permitted evidence of an insurer's past good faith and fair dealing to establish a presumption that an insurer acted in good faith in refusing a third-party's settlement offer. *See, e.g.*, Douglas v. U.S. Fidelity & Guar. Co., 81 N.H. 371, ____, 127 A. 708, 712 (1924) (insurer demonstrated that insurer settled great majority of claims that it handled); Johnson v. Hardware Mut. Casualty Co., 109 Vt. 481, ____, 1 A.2d 817, 822 (1938) (insurer showed that its established policy was to settle claims rather than risk excess liability); Berk v. Milwaukee Auto. Ins. Co., 245 Wis. 597, ____, 15 N.W.2d 834, 839 (1944) (insurer argued that no plaintiff ever had brought excess liability claim against insurer or charged insurer with bad faith). As a result, evidence of an insurer's prior history may constitute a defense to an insured's bad faith claim. For example, an insurer which demonstrates that its established corporate policies have favored fair dealing in considering settlement offers, or that no insured has succeeded in a bad faith claim against the insurer, may be in a more favorable position with both the jury and the court than an insurer which offers no evidence of its corporate policies. *See supra* note 66 (courts ordinarily send bad faith claims to jury). Courts that permit an insurer to show that its established corporate policies have favored fair dealing in considering settlement offers, however, usually allow plaintiffs to offer rebutting evidence that demonstrates an insurer's past practice of bad faith. *See* Moore v. American United Life Ins. Co., 150 Cal. App. 3d 610, 637, 197 Cal. Rptr. 878, 884 (Ct. App. 1984) (pattern of insurer's unfair claims practices are relevant to justify punitive damages); Colonial Life & Accident Ins. Co. v. Superior Court, 31 Cal. 3d 785, 792, 647 P.2d 86, 90, 183 Cal.

Additionally, courts have recognized that improper conduct by a third-party

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Rptr. 810, 814 (1982) (other instances of unfair settlement practices are highly relevant to plaintiff's claim for punitive damages).

Another defense to a bad faith claim arises if an insurer bases its decision not to settle on misrepresentations or wrongful acts by its insured. *See, e.g.*, Hall v. Preferred Accident Ins. Co., 204 F.2d 844, 848 (5th Cir. 1953) (insurance contract entitles insurer to honest statement by its insured); Williams v. Employers Mut. Liab. Ins. Co., 131 F.2d 601, 603 (5th Cir. 1942) (if insured fails to cooperate with insurer, insurer is not liable in damages); Home Indem. Co. v. Standard Accident Ins. Co., 167 F.2d 919, 925 (9th Cir. 1948) (same). Courts ordinarily allow an insurer to rely on information that its insured supplies concerning a claim, so an insured's misrepresentation or bad faith in supplying information usually negates an insurer's liability. *See* Younger v. Lumbermen's Mut. Casualty Co., 174 So. 2d 672, 678-79 (La. Ct. App. 1965) (if insured induces rejection of settlement, insured later cannot sue insurer for rejecting settlement); *see also infra* notes 163-93 and accompanying text (discussing comparative fault and possibility of apportioning relative blame). *But see* Klingman v. Nat'l Indem. Co., 317 F.2d 850, 854 (7th Cir. 1963) (to act in good faith, insurer might have to disbelieve information that insured supplies).

Another possible bar to a bad faith action is an insurer's final settlement of an excess judgment. *See* Kricar, Inc. v. General Accident Fire & Life Assurance Corp., 542 F.2d 1135, 1136 (9th Cir. 1976) (insurer did not act in bad faith if insurer settled claim against insured). Even if a settlement occurs after a claimant obtained an excess judgment and after an insured filed his claim against his insurer, the elimination of the excess judgment normally eliminates the bad faith action. *See id.* (insurer's subsequent satisfaction of judgment negated any finding of bad faith). Because an insured normally cannot receive any consequential damages unless compensatory damages exist, a settlement of an excess judgment vitiates an insured's claim for consequential damages. *See id.* (insured cannot recover consequential damages if insured suffered no compensatory damages).

Although an insured's refusal to settle or an insured's concurrence in an insurer's decision not to settle may constitute defenses to a suit that an insured brings against his insurer, more outrageous conduct by an insured also can comprise a defense to a bad faith claim. For example, an insurer can argue that its insured, colluding with a third party, attempted to hold the insurer liable for the third-party's claim against the insured. *See* State Auto Ins. Co. v. York, 104 F.2d 730, 734 (4th Cir. 1939) (collusion occurs if members of family conspire to secure unjustified recovery from insurer), *cert. denied*, 308 U.S. 591 (1939); Wakefield v. Globe Indem. Co., 246 Mich. 645, ____, 225 N.W. 643, 645 (1929) (insurer does not act in bad faith if insured and claimant conspire to hold insurer liable for bad faith). Additionally, an insurer can argue that its insured failed to cooperate in settling a third-party's claim against its insured. *See, e.g.*, Kleinschmit v. Farmers Mut. Hail Ins. Ass'n, 101 F.2d 987, 989 (8th Cir. 1939) (insured's failure to cooperate justified insurer's withdrawal from case); Buffalo v. United States Fidelity & Guar. Co., 84 F.2d 883, 884 (10th Cir. 1936) (insured's breach of cooperation clause in insurance contract negated insurer's liability); Ohrbach v. Preferred Accident Ins. Co., 227 A.D. 311, 312, 237 N.Y.S. 494, 496 (App. Div. 1929) (under cooperation clause, insured did not give full support to insurer). The duty of good faith and fair dealing is incumbent upon insureds as well as insurers. *See, e.g.*, Commercial Union Assurance Cos. v. Safeway Stores, Inc., 26 Cal. 3d 912, 918, 610 P.2d 1038, 1041, 164 Cal. Rptr. 709, 712 (1980) (duty of good faith and fair dealing runs from insured to insurer); White v. Unigard Mut. Ins. Co., 112 Idaho 94, ____, 730 P.2d 1014, 1016 (1986) (contract imposes duty of good faith upon insured and insurer); Modisette v. Foundation Reserve Ins. Co., 77 N.M. 661, ____, 427 P.2d 21, 25 (1967) (obligation to deal fairly and honestly applies equally to insurer and insured). An insured, therefore, owes its insurer a reciprocal duty of good faith and fair dealing. *See supra* note 33 and accompanying text (insured owes insurer reciprocal duty of good faith and fair dealing). An insured's failure to cooperate with an insurer also can arise as a defense to a bad faith claim because insurance policies consistently contain

plaintiff can provide an insurer with a defense to a bad faith claim.[70]

A. The "Set Up" Defense

A third-party plaintiff's conduct can comprise a defense to a bad faith claim if a third-party plaintiff would receive substantial benefits from the bad faith action.[71] Because insureds generally have weaker financial positions

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clauses requiring insureds to cooperate with insurers in handling claims. *See* J. McCarthy, Punitive Damages in Bad Faith Cases § 1.23, at 72 (4th ed. 1987) (insurance policies commonly provide that insureds must cooperate with insurers). An example of an insured's failure to cooperate that can nullify an insurer's liability for refusal to settle is an insured's failure to disclose certain information to an insurer. *See Hall*, 204 F.2d at 846 (insured's failure to supply truthful information to insurer concerning insured's conduct precluded insurer's bad faith). Although courts generally recognize an insured's duty to cooperate, courts inconsistently define this general duty to cooperate. *See* P. Magarick, *supra* note 5, § 12.02[1], at 223 (person should not assume that he can tell what constitutes insured's refusal to cooperate).

69. *See supra* note 68 and accompanying text (discussing conduct by insured that might provide insurer with defense to bad faith claim).

70. *See id.* (insurer does not act in bad faith if insured and claimant conspire to hold insurer liable for bad faith).

71. *See* Note, *Excess Liability*, *supra* note 2, at 387 (insured that recovers judgment against insurer in bad faith action ordinarily uses funds to discharge debt to third-party plaintiff). An insured that successfully prosecutes a bad faith claim against an insurer ordinarily recovers damages equivalent to the excess judgment. *See, e.g.*, Moutsopoulos v. American Mut. Ins. Co., 607 F.2d 1185, 1188 (7th Cir. 1979) (amount of judgment in excess of policy limit is measure of insurer's liability); McNulty v. Nationwide Mut. Ins. Co., 221 So. 2d 208, 210 (Fla. Dist. Ct. App. 1969) (same); Gordon v. Nationwide Mut. Ins. Co., 30 N.Y.2d 427, 437, 334 N.Y.S.2d 601, 609, 285 N.E.2d 849, 854 (1972) (same), *cert. denied*, 410 U.S. 931 (1973). An insured subsequently uses the money that he recovered as damages in his bad faith action to satisfy the third-party plaintiff's outstanding judgment. *See* Note, *Excess Liability*, *supra* note 2, at 387 (insured recovers judgment from insurer and then pays claimant). Moreover, a rapidly emerging trend allows third-party claimants to proceed directly against insurers. *See* Note, *Liability Insurers*, *supra* note 2, at 140-52 (discussing judicial attempts to create direct actions for third-party plaintiffs in bad faith claims). An injured party may pursue a bad faith claim directly against an insurer in one of three different ways. First, a claimant, after an insured assigns his rights against an insurer to the claimant, may bring suit against the insurer in a derivative action. *Id.* at 125 (claimant may proceed against insurer as insured's assignee). Second, claimants sometimes can sue insurers in an independent private action under state unfair business practices acts. *See* Royal Globe Ins. Co. v. Superior Court, 23 Cal. 3d 880, 889, 592 P.2d 329, 332-34, 153 Cal. Rptr. 842, 845 (1979) (third-party claimant may sue insurer for bad faith refusal to settle under state unfair practices act); Jenkins v. J.C. Penney Casualty Ins. Co., 280 S.E.2d 252, 255-58 (W. Va. 1981) (recognizing implied private right of action for insurer's bad faith under state statute). *But see* Seeman v. Liberty Mut. Ins., 322 N.W.2d 35, 43 (Iowa 1982) (state statute prohibiting insurers from engaging in unfair or deceptive business practices does not create private right of action for individual entitled to insurance proceeds); Royal Globe Ins. Co. v. Chock Full O'Nuts Corp., 86 A.D.2d 315, 317-18, 449 N.Y.S.2d 740, 743 (1982) (no private cause of action for insurer's bad faith exists under state unfair claims practices statute). *See generally* Mecherle & Overton, *A New Extra Contractual Cloud Upon the Horizon: Do the Unfair Claim Settlement Practice Acts Create a Private Cause of Action?*, 50 Ins. Couns. J. 262, 262-68 (1983) (discussing whether state statutes create private bad faith causes of action). Finally, claimants in jurisdictions in which

than insurers, third-party plaintiffs have strong incentives to prosecute bad faith claims against insurers.[72] Even if an insurer successfully defends a bad faith action, an insured remains liable to a third-party plaintiff for any judgment against the insured.[73] The liability of an insured, however, does not eliminate a third-party plaintiff's interest in a bad faith claim against an insurer.[74] The worth of a judgment depends upon a plaintiff's ability to convert the judgment into money.[75] Because insurers typically have greater assets than insureds,[76] plaintiffs that have large judgments against insolvent insureds often attempt to use bad faith claims to recover damages from insurers.[77]

Because third-party plaintiffs have an inherent motivation to "set up" insurers for excess judgments, insurers, claiming a "set up" defense, have attempted to show that unreasonable conduct by a claimant prevented the insurer from accepting a settlement offer within an insured's policy limits.[78] Although courts roundly condemn plaintiffs' attempts to "set up" insurers,[79]

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courts have chosen to allow independent suits may bring suit pursuant to a judicially fashioned independent right of action. *See* Note, *Liability Insurers*, *supra* note 2, at 140 (courts increasingly are willing to provide claimants with direct means of recovery); Note, *Excess Liability*, *supra* note 2, at 387 (minority of courts recognize right of third party to proceed directly against insurer). Regardless of who pursues a bad faith claim, the injured claimant is the real party in interest. See Note, *Liability Insurers*, *supra* note 2, at 140 (third-party claimant is intended beneficiary of bad faith actions).

72. *See* Note, *Excess Liability*, *supra* note 2, at 387 (courts recognized right of third parties to proceed directly against insurers because third parties may not be able to recover from insureds).

73. *See* Halbert, *supra* note 2, at 38 (insured is liable for difference between amount of judgment and insured's policy limits).

74. *See* Note, *Excess Liability*, *supra* note 2, at 387 (because insured may file for bankruptcy or fail to pursue bad faith claim against insurer, claimants want to recover from insurer).

75. *See* S. SHERWIN, DEBTORS' AND CREDITORS': RIGHTS AND REMEDIES 16 (1969) (mere fact that plaintiff obtains judgment does not mean that plaintiff will receive any money).

76. *See* W. SHERNOFF, *supra* note 2, § 1.01, at 1-1 to -2 (discussing unequal bargaining position between insurer and insured); *see also* Shernoff, *Insurance Company Bad Faith Law*, 17 TRIAL 22, 23 (May 1981) (Americans annually pay almost as much for insurance coverage as for individual income taxes).

77. *See* Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 696, 319 P.2d 69, 77 (Ct. App. 1957) (discussing insurer's argument that, by imposing excess liability on insurer, courts would cause injured claimants that have large judgments against insolvent insureds to propose settlement within policy limits).

78. *See* Critz v. Farmers Ins. Group, 230 Cal. App. 2d 788, ____, 41 Cal. Rptr. 401, 406 (Ct. App. 1964) (insurer argued that one-week time limit that plaintiff placed on settlement offer was unreasonable).

79. *See, e.g.*, Baton v. Transamerica Ins. Co., 584 F.2d 907, 914 (9th Cir. 1978) (no Oregon case permits plaintiffs to "set up" insurers); Grumbling v. Medallion Ins. Co., 392 F. Supp. 717, 721 (D. Or. 1975) (cautioning that plaintiff's attorney cannot "set up" insurer); DeLaune v. Liberty Mut. Ins. Co., 314 So. 2d 601, 603 (Fla. Dist. Ct. App. 1975) (plaintiff's refusal to accept insurer's tender of amount equal to policy limits shortly after time limit on offer of settlement expired may have been part of charade to "set up" insurer for excess judgment); *see also infra* notes 147-50 and accompanying text (discussing *Grumbling* court's dicta against "setting up" insurers).

few courts have considered the viability of a "set up" attempt by the plaintiff as an insurer's defense to a bad faith action.[80] In asserting the "set up" defense, an insurer must argue that, because the claimant's settlement offer was unreasonable, the insurer's failure to accept the offer was reasonable.[81] Because a plaintiff normally must make a settlement demand before he can file a bad faith claim,[82] most insurers claiming that plaintiffs have set them up have complained that a plaintiff placed an unreasonable time limit on the settlement demand.[83] Typically, a plaintiff will make a settlement offer within the insured's policy limits and state that the offer will expire at a specified time.[84] If the insurer fails to accept the plaintiff's offer within the time limit, the plaintiff withdraws the offer.[85] After withdrawing the offer, the plaintiff is in a position to assert a bad faith claim.[86] Attorneys that represent plaintiffs in bad faith claims advocate placing a time limit on all settlement offers,[87] and courts have recognized that plaintiffs have a right to limit their offers in this fashion.[88]

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80. *See* McNally v. Nationwide Ins. Co., No. 83-865-WKS, mem. op. at 3 (D. Del. Feb. 15, 1985), *aff'd on other grounds*, 815 F.2d 254 (3d Cir. 1987). In *McNally v. Nationwide Insurance Co.*, the United States District Court for the District of Delaware considered whether an insurer's allegation that a plaintiff's attorney intended to "set up" the insurer for an excess judgment was a valid ground for the insurer's motion to dismiss the plaintiff's complaint. *Id.* The *McNally* court determined that nothing in public policy or existing law requires a court to dismiss a plaintiff's complaint if the plaintiff's counsel intended to "set up" an insurer. *Id.* The *McNally* court observed that, for an insurer to be liable, an insurer would have to breach its duty to its insured by rejecting settlement. *Id.*

81. *See id.* (insurer argued that, because one-week time limit in plaintiff's offer was unreasonable, insurer's failure to accept plaintiff's offer was reasonable).

82. *See, e.g.*, Baton v. Transamerica Ins. Co., 584 F.2d 907, 913 (9th Cir. 1978) (plaintiff's settlement demand is prerequisite to bad faith action); Merritt v. Reserve Ins. Co., 34 Cal. App. 3d 858, 877, 110 Cal. Rptr. 511, 523-24 (Ct. App. 1973) (same); Ranger Ins. Co. v. Travelers Indem. Co., 389 So. 2d 272, 277 (Fla. Dist. Ct. App. 1980) (complaint in bad faith action ordinarily must include allegation that plaintiff offered to settle claim).

83. *See, e.g.*, Kivi v. Nationwide Mut. Ins. Co., 695 F.2d 1285, 1286 (11th Cir. 1983) (insured alleged that claimant's settlement demand, which remained open for thirty-day period, was unreasonable); Coe v. State Farm Mut. Auto. Ins. Co., 66 Cal. App. 3d 981, 987, 136 Cal. Rptr. 331, 333 (Ct. App. 1977) (plaintiff's offer of settlement imposed eleven-day deadline for acceptance); Adduci v. Vigilant Ins. Co., 98 Ill. App. 3d 472, 474, 424 N.E.2d 645, 647 (App. Ct. 1981) (plaintiff's demand letter set twenty-eight day deadline).

84. *See, e.g.*, Ashbrook v. Kowalick, 332 F. Supp. 78, 81 (E.D. Pa. 1971) (plaintiff's offer stated that insurer should consider offer withdrawn unless insurer accepted offer within two weeks of offer's receipt); Phelan v. State Farm Mut. Auto. Ins. Co., 114 Ill. App. 3d 96, 98, 448 N.E.2d 579, 580 (App. Ct. 1983) (plaintiff's offer of settlement stated that plaintiff no longer would accept policy limits after specified date); Kriz v. Government Employees Ins. Co., 600 P.2d 496, 498 (Or. Ct. App. 1979) (plaintiff's offer declared that plaintiff would withdraw offer of settlement after ten-day period).

85. *See* Grumbling v. Medallion Ins. Co., 392 F. Supp. 717, 718 (D. Or. 1975) (plaintiff's attorney withdrew offer of settlement after expiration of plaintiff's self-imposed time limit).

86. *See* Note, *Liability Insurers*, *supra* note 2, at 132 (if insurer does not accept offer of settlement within insured's policy limits before plaintiff's deadline, preliminary elements of bad faith action exist).

87. *See* Kinerk, *Laying the Foundation for a Bad Faith Action*, 18 TRIAL 50, 50-51 (Dec.

Because courts recognize plaintiffs' right to place time limits on their settlement offers, the "set up" defense's viability as a useful defense for insurers is doubtful. Settlement offers containing a time limit are valid offers that an insurer must consider.[89] Failure to settle within a specified time limit can constitute bad faith.[90] Failure to accept an offer, however, will not constitute bad faith if the time limitation that the plaintiff imposed was unreasonable.[91] The "set up" defense requires a court to determine whether the plaintiff's conduct was so unreasonable that the conduct made the insurer's failure to settle reasonable.[92] Because the reasonableness of the insurer's conduct is still the key issue, the "set up" defense does not alter the standard bad faith claim.[93] Assertions that a claimant "set up" an insurer are simply evidence for the jury to consider in determining whether an insurer's failure to settle was reasonable.[94]

1982) (plaintiff's letter demanding settlement of bad faith claim should state time limit within which insurer must accept offer of settlement).

88. *See, e.g.*, Baton v. Transamerica Ins. Co., 584 F.2d 907, 913 (9th Cir. 1978) (under Oregon law, insurer may be liable for failing to accept settlement offer within reasonable time limits); Critz v. Farmers Ins. Group, 230 Cal. App. 2d 788, ____, 41 Cal. Rptr. 401, 406 (Ct. App. 1964) (plaintiff had right to attach time limit to her offer); Martin v. Hartford Accident & Indem. Co., 228 Cal. App. 2d 178, ____, 39 Cal. Rptr. 342, 347 (Ct. App. 1964) (same). Persons in the insurance trade generally refer to a settlement offer on which a plaintiff places a deadline as a "plaintiff's bad faith letter." *See* Kivi v. Nationwide Mut. Ins. Co., 695 F.2d 1285, 1286 (11th Cir. 1983) (describing plaintiff's "bad faith letter" to insurer); *see also* Note, *Liability Insurers*, *supra* note 2, at 132 (describing term "plaintiff's bad faith letter").

89. *See* Martin v. Hartford Accident & Indem. Co., 228 Cal. App. 2d 178, ____, 39 Cal. Rptr. 342, 345 (Ct. App. 1964) (plaintiffs have right to place time limits upon their offers of settlement).

90. *See, e.g.*, Kivi v. Nationwide Mut. Ins. Co., 695 F.2d 1285, 1288 (11th Cir. 1983) (insurer's failure to accept plaintiff's offer of settlement within thirty-day time limit constituted bad faith); Grumbling v. Medallion Ins. Co., 392 F. Supp. 717, 721 (D. Or. 1975) (insurer's failure to accept settlement offer within fifteen-day time limit amounted to bad faith); Phelan v. State Farm Mut. Auto. Ins. Co., 114 Ill. App. 3d 96, 104, 448 N.E.2d 579, 584 (App. Ct. 1983) (affirming jury's finding of bad faith after insurer failed to accept plaintiff's offer of settlement within five-week deadline).

91. *See, e.g.*, Baton v. Transamerica Ins. Co., 584 F.2d 907, 913-14 (9th Cir. 1978) (insurer did not act in bad faith by failing to accept offer of settlement with sudden-death time limit); DeLaune v. Liberty Mut. Ins. Co., 314 So. 2d 601, 603 (Fla. Dist. Ct. App. 1975) (insurer's failure to accept plaintiff's offer of settlement was not in bad faith because offer's ten-day time limit was totally unreasonable); Adduci v. Vigilant Ins. Co., 98 Ill. App. 3d 472, 477, 424 N.E.2d 645, 649 (App. Ct. 1981) (plaintiff's time limit on offer of settlement was unreasonable because plaintiff produced no evidence to show that time limit was necessary and, therefore, insurer's failure to accept offer breached no duty to insured).

92. *See* DeLaune v. Liberty Mut. Ins. Co., 314 So. 2d 601, 603 (Fla. Dist. Ct. App. 1975) (because ten-day time limit that plaintiff placed on offer of settlement was unreasonable, insurer's failure to accept plaintiff's offer was reasonable).

93. *See* Critz v. Farmers Ins. Group, 230 Cal. App. 2d 788, ____, 41 Cal. Rptr. 401, 405 (Ct. App. 1964) (good faith or bad faith is question of fact in each case); Martin v. Hartford Accident & Indem. Co., 228 Cal. App. 2d 178, ____, 39 Cal. Rptr. 342, 345 (Ct. App. 1964) (same).

94. *See* Coe v. State Farm Mut. Auto. Ins. Co., 66 Cal. App. 3d 981, 994, 136 Cal.

Several courts have determined that claims that a third-party has "set up" an insurer only relate to the question of the insurer's good faith. For example, in *Martin v. Hartford Accident and Indemnity Co.*,[95] the District Court of Appeal for the State of California considered whether a time limit that a plaintiff had imposed on a settlement offer bound an insurer.[96] In *Martin*, an insurer, after the deadline on a plaintiff's settlement offer had expired, offered to settle a third-party's claim against an insured within the insured's policy limits.[97] In considering the plaintiff's complaint, the *Martin* court noted that, because the critical issue in a bad faith claim is the insurer's good faith or bad faith,[98] bad faith claims essentially involve an issue of ultimate fact.[99] The court in *Martin* recognized that a plaintiff has a right to place a reasonable time limit upon a settlement offer.[100] The *Martin* court determined, however, that a time limit which a plaintiff places on a settlement offer does not necessarily bind insurers.[101] The *Martin* court noted that an insurer will not be liable if the insurer's refusal to settle is in good faith.[102] After considering all the circumstances, the California court determined that the time limit with which the plaintiff had restricted her offer of settlement appeared reasonable because the plaintiff made the offer near the date of trial, a time by which the insurer thoroughly should have

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Rptr. 331, 338 (Ct. App. 1977) (whether insurer acted reasonably in failing to accept plaintiff's offer of settlement within eleven-day deadline was question for jury).

95. 228 Cal. App. 2d 178, 39 Cal. Rptr. 342 (1964).

96. Martin v. Hartford Accident & Indem. Co., 228 Cal. App. 2d 178, ____, 39 Cal. Rptr. 342, 347 (Ct. App. 1964).

97. *Id.* In *Martin v. Hartford Accident and Indemnity Co.*, the Superior Court of Monterey County, California had sustained the insurer's demurrer for failure to state facts sufficient to allege a cause of action. *See id.* at ____, 39 Cal. Rptr. at 342 (discussing superior court's decision). Following the Superior Court's decision, the plaintiff appealed to the District Court of Appeal for the State of California. *Id.* The District Court of Appeal for the State of California considered whether the plaintiff's complaint stated a cause of action. *Id.*

Prior to the insured's trial, the plaintiff in *Martin* had offered by letter to settle her claim against the insured within the limits of the insured's insurance policy. *Id.* at ____, 39 Cal. Rptr. at 344. After the insurer failed to accept the plaintiff's initial offer, the plaintiff wrote another letter two months later stating that she would withdraw the offer ten days before the trial if the insurer did not accept the offer by that time. *Id.* Seven days before the trial began, and three days after the plaintiff's deadline had passed, the insurer in *Martin* offered to pay the plaintiff the insured's policy limits. *Id.* The plaintiff refused the insurer's late tender of the policy limits and, on the opening day of trial, the insurer formally withdrew its offer to settle the plaintiff's claim. *Id.* In her complaint in her bad faith action, the plaintiff in *Martin* alleged that the insurer knew that the probability of the plaintiff succeeding in the personal injury action was very high. *Id.* The plaintiff also alleged that the insurer knew that, if the plaintiff did succeed, the plaintiff's damages would exceed the insured's policy limit. *Id.*

98. *Id.* at ____, 39 Cal. Rptr. at 347.

99. *Id.* at ____, 39 Cal. Rptr. at 345.

100. *Id.*

101. *Id.*

102. *Id.*; *see* Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 696, 319 P.2d 69, 77 (Ct. App. 1957) (insurer is not liable if its refusal to settle claim against insured was in good faith).

investigated the plaintiff's claim.[103] The *Martin* court, therefore, concluded that the plaintiff's complaint stated a cause of action for bad faith.[104] Even if an insurer alleges a "set up," therefore, the insurer always must demonstrate that the plaintiff's conduct was unreasonable.[105]

After *Martin*, the District Court of Appeal of California, in *Critz v. Farmers Insurance Group*,[106] considered whether a one-week time limitation in a settlement offer precluded a finding of bad faith.[107] In *Critz*, a negligent insured injured the plaintiff in an automobile accident.[108] Five months after the accident, the plaintiff offered to settle her claim against the insured for an amount of money equal to the insured's policy limit.[109] The plaintiff's settlement offer required that the defendant accept within one week.[110] The insurer refused to accept the plaintiff's offer and made a lower counteroffer.[111] Citing *Martin*, the *Critz* court determined that the plaintiff had a right to place time limits upon her offer of settlement.[112] Like the court in *Martin*, the *Critz* court examined the reasonableness of the plaintiff's time limit in terms of the particular facts of the case and ignored evidence that would have supported a possible "set up."[113] The California court noted

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103. *Martin*, 228 Cal. App. 2d at ____, 39 Cal. Rptr. at 346.

104. *Id.* at ____, 39 Cal. Rptr. at 347.

105. *See supra* notes 98-104 and accompanying text (discussing *Martin* court's holding that, although insurer alleged that plaintiff "set up" insurer, ultimate test of insurer's liability still is overall reasonableness of circumstances).

106. 230 Cal. App. 2d 788, 41 Cal. Rptr. 401 (Ct. App. 1964), *disapproved on other grounds sub nom.* Crisci v. Security Ins. Co., 66 Cal. 2d 425, 58 Cal. Rptr. 13 (1967).

107. Critz v. Farmers Ins. Group, 230 Cal. App. 2d 788, ____, 41 Cal. Rptr. 401, 406 (Ct. App. 1964), *disapproved on other grounds sub nom.* Crisci v. Security Ins. Co., 66 Cal. 2d 425, 58 Cal. Rptr. 13 (1967).

108. *Id.* at ____, 41 Cal. Rptr. at 402.

109. *Id.*

110. *Id.* at ____, 41 Cal. Rptr. at 403.

111. *Id.* In *Critz v. Farmers Insurance Group*, the insured assigned all of her potential rights against her insurer to the plaintiff. *Id.* The Superior Court for Sacramento County determined that the insured's assignment was void. *See id.* (discussing superior court decision in *Critz*). The plaintiff appealed to the District Court of Appeal for the State of California. *Id.* The *Critz* court determined that the insured's potential cause of action for bad faith was assignable even before the plaintiff had secured an excess judgment against the insured. *Id.* at ____, 41 Cal. Rptr. at 404. The *Critz* court, therefore, concluded that the assignment to the plaintiff was valid. *Id.*

112. *Id.*

113. *Id.* The plaintiff's attorney in *Critz* procured a document that the insured had signed. *Id.* at ____, 41 Cal. Rptr. at 403. In the document, the insured had specified that the insurer unreasonably refused the plaintiff's offer of settlement and had exposed the insured to potential excess liability. *Id.* Additionally, the document assigned to the plaintiff any right that the insured had against the insurer. *Id.* The *Critz* court noted that the insured and the plaintiff accomplished these arrangements before the plaintiff instituted the personal injury suit against the insured. *Id.* The insurer did not discover that the insured had assigned her rights to a bad faith claim to the plaintiff until several months after the insured's assignment. *Id.* When the insurer in *Critz* discovered the assignment, the insurer offered to tender the amount of the policy limits to the plaintiff. *Id.* The plaintiff, however, refused the insurer's offer shortly before trial. *Id.* The court nonetheless found that the insurer acted in bad faith. *Id.* The short

that the insurer's investigation of the claim against the insured was complete.[114] The *Critz* court determined that, because the insurer's investigation was complete, the plaintiff could regard the insurer's counteroffer as an invitation to litigate.[115] Accordingly, the *Critz* court concluded that a one-week time limit on the settlement offer did not preclude a finding of bad faith.[116] Decisions like *Martin* and *Critz* reveal that courts use a totality of the circumstances analysis in bad faith claims, and that courts ordinarily are unwilling to dismiss bad faith actions before both parties offer their own versions of the facts.[117] Evidence of a "set up" attempt only is useful to insurers insofar as the attempt demonstrates the plaintiff's unreasonableness and, conversely, the insurer's reasonableness in failing to accept a settlement offer.[118]

Although the courts in *Martin* and *Critz* were willing to accept a plaintiff's contention that evidence of an insurer's bad faith existed, at least one court has looked beyond conclusory allegations of bad faith in a complaint and required plaintiffs to justify reasons for imposing time limits. In *Adduci v. Vigilant Insurance Co.*,[119] the Appellate Court for the State of Illinois considered whether an insurer's offer to pay the policy limits after the plaintiffs' settlement offer had expired could preclude a finding of bad faith.[120] The plaintiffs in *Adduci* made a settlement demand to the defendant which provided that the plaintiffs would withdraw their offer if the insurer did not tender an amount equal to the policy limits within twenty-eight days.[121] The insurer, however, did not offer to pay the policy

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time limit that the plaintiff in *Critz* placed upon the offer of settlement, coupled with the content and timing of the assignment document, indicated a "set up" attempt by the plaintiff's attorney.

114. *Id.* Like the court in *Martin v. Hartford Accident & Indem. Co.*, the court in *Critz* carefully noted that, at the time that the plaintiff offered to settle, the insurer knew that the court almost certainly would find the insurer liable. *Id.* at ____, 41 Cal. Rptr. at 407. Additionally, the *Critz* court noted that the insurer, although denying the plaintiff's offer of settlement, knew that the plaintiff's damages were likely to exceed the insured's policy limit. *Id.*; *see* Martin v. Hartford Accident & Indem. Co., 228 Cal. App. 2d 178, ____, 39 Cal. Rptr. 342, 344 (Ct. App. 1964) (plaintiff alleged that insurer knew that probability of plaintiff's success was high and that plaintiff's damages probably would exceed insured's policy limit).

115. *Critz*, 230 Cal. App. 2d at ____, 41 Cal. Rptr. at 407.

116. *Id.* at ____, 41 Cal. Rptr. at 406.

117. *See id.* at ____, 41 Cal. Rptr. at 405 (good faith or bad faith is question of fact in each case); Martin v. Hartford Accident & Indem. Co., 228 Cal. App. 2d 178, ____, 39 Cal. Rptr. 342, 345 (Ct. App. 1964) (plaintiff's allegation of bad faith is essentially one of ultimate fact).

118. *See* DeLaune v. Liberty Mut. Ins. Co., 314 So. 2d 601, 603 (Fla. Dist. Ct. App. 1975) (insurer's failure to accept plaintiff's offer of settlement was not in bad faith because offer's ten-day time limit was totally unreasonable).

119. 98 Ill. App. 3d 472, 424 N.E.2d 645 (App. Ct. 1981).

120. Adduci v. Vigilant Ins. Co., 98 Ill. App. 3d 472, 475, 424 N.E.2d 645, 647 (App. Ct. 1981). In *Adduci v. Vigilant Insurance Co.*, the trial court granted the insurer's motion to dismiss the plaintiffs' complaint. *Id.* at 473, 424 N.E.2d at 646. The plaintiffs appealed to the Appellate Court for the State of Illinois. *Id.*

121. *Id.* at 477, 424 N.E.2d at 647.

limit until forty-four days after the deadline.[122] The plaintiffs claimed that, because the insurer in *Adduci* had not responded to the plaintiffs' demand within the time limit, the insurer acted in bad faith.[123] The *Adduci* court, unlike the courts in *Martin* and *Critz*, refused to deem the time limit that the plaintiffs placed upon their settlement offer as reasonable, even though, as in *Martin* and *Critz*, the insurer apparently knew that liability was certain and that damages exceeded the policy limits.[124] The court in *Adduci* placed on the plaintiffs the burden of showing reasons that the plaintiffs could not accept the insurer's tender of the policy limits after the settlement offer had expired.[125] Even though the plaintiffs offered a reason for refusing the late offer,[126] the Illinois court determined that no facts existed which would indicate reasons that the plaintiffs could not accept the late tender of the policy limits.[127] The *Adduci* court, therefore, concluded that the insurer's conduct was reasonable as a matter of law.[128]

Although the *Adduci* decision appears directly to contrast with the holdings in *Martin* and *Critz*,[129] the Appellate Court for the State of Illinois, in *Phelan v. State Farm Mutual Automobile Insurance Co.*,[130] determined that *Adduci* did not change the rule that the *Martin* court established. The *Phelan* court considered whether the *Adduci* decision precluded a finding of bad faith on the part of the insurer if the insurer had made a dilatory offer of the policy limit.[131] The plaintiff in *Phelan* made both a verbal and a written offer to settle his claim within the insured's policy limit.[132] Rather than accept the plaintiff's settlement offer, the insurer in *Phelan* made a

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122. *Id.* In *Adduci*, the settlement demand, in addition to allowing the insurer twenty-eight days to accept the plaintiff's offer, provided for the possibility of a written extension based upon reasonable grounds. *Id.*

123. *Id.* After the jury in *Adduci* rendered an excess judgment for the plaintiffs, the insured assigned her cause of action against the insurer to the plaintiffs. *Id.*

124. *Id.* at 478, 424 N.E.2d at 648.

125. *Id.* at 477, 424 N.E.2d at 647.

126. *Id.* The plaintiffs in *Adduci* alleged that they failed to accept the insurer's late offer of the policy limits because they had to undertake further preparation for trial. *Id.* Since the additional preparation was more costly, alleged the plaintiffs, the plaintiffs had to negotiate a different fee arrangement with their counsel. *Id.* The plaintiffs in *Adduci* claimed that the new fee arrangement made the insurer's late offer of the insured's policy limits inadequate. *Id.*

127. *Id.*

128. *Id.* at 477, 424 N.E.2d at 650. The *Adduci* court affirmed the trial court's dismissal of the plaintiffs' complaint. *Id.*

129. *See* Critz v. Farmers Ins. Group, 230 Cal. App. 2d 788, ____, 41 Cal. Rptr. 401, 403 (insurer offered to settle case for insured's policy limits after insurer learned of insured's assignment of insured's cause of action against insurer to plaintiff); Martin v. Hartford Accident & Indem. Co., 228 Cal. App. 2d 178, ____, 39 Cal. Rptr. 342, 344 (insurer offered to settle for insured's policy limits after plaintiff's offer of settlement expired).

130. 114 Ill. App. 3d 96, 448 N.E.2d 579 (App. Ct. 1983).

131. Phelan v. State Farm Mut. Auto. Ins. Co., 114 Ill. App. 3d 96, 103, 448 N.E.2d 579, 581 (App. Ct. 1983).

132. *Id.* at 98, 448 N.E.2d at 580.

counteroffer.[133] Over a month later, the insurer offered the policy limit, which the plaintiff refused.[134] The insurer in *Phelan* argued that the plaintiff's refusal to accept the policy limits one month after the plaintiff's deadline had expired was unreasonable.[135] In distinguishing *Adduci*, the *Phelan* court recognized that, in *Adduci*, no factual evidence demonstrated that the plaintiffs could not accept the insurer's late offer, but that, in the present case, ample evidence existed concerning the necessity of a time limit.[136] The *Phelan* court concluded that *Adduci* did not require that any settlement offer forty days after the time limit expired preclude a finding of bad faith by the insurer, but, instead, involved the allegation of insufficient facts.[137] While the *Phelan* court's analysis appears technically sound, the *Phelan* court actually accepted the same reason for the plaintiff's imposition of a time limit that the *Adduci* court rejected.[138] The only difference between the two cases was that the plaintiff in *Phelan* had an opportunity to present and develop evidence at trial in support of her reason, while the plaintiffs in *Adduci* lost on motion to dismiss.[139] This apparent inconsistency amplifies the fact-bound nature of bad faith claims.

Although the *Phelan* court seemed to ignore possible efforts to "set up" insurers, explicit judicial awareness of "set up" attempts does exist. For example, in *Grumbling v. Medallion Insurance Co.*,[140] the United States District Court for the District of Oregon considered whether an insurer had a duty to use telecommunications to accept an offer of settlement with a fifteen-day time limit.[141] In *Grumbling* the plaintiff made an offer to settle

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133. *Id.*

134. *Id.* In *Phelan v. State Farm Mutual Automobile Insurance Co.*, the plaintiff's letter demanding settlement contained a time limit of approximately five weeks, and the plaintiff subsequently extended the time limit an additional five days. *Id.* After the jury in *Phelan* rendered a verdict for the plaintiff in excess of the insured's policy limit, the trial court granted a judgment notwithstanding the verdict to the insurer and granted the insurer a new trial. *Id.* The plaintiff appealed to the Appellate Court for the State of Illinois. *Id.*

135. *Id.* at 99, 448 N.E.2d at 583.

136. *Id.* In *Phelan*, the plaintiff produced evidence at trial which demonstrated that the plaintiff's attorney had to secure the services of a trial specialist to try the case and that the plaintiff had incurred other expenses in preparation for trial which justified the plaintiff's refusal to accept the insurer's counteroffer. *Id.* Moreover, a jury had found that the insurer in *Phelan* had breached its duty to its insured. *Id.* at 100, 448 N.E.2d at 583.

137. *Id.*

138. *See supra* note 126 and accompanying text (plaintiffs in *Adduci* alleged that failure to accept insurer's late offer of settlement was because plaintiff incurred increased expenses in preparation for trial); *supra* note 136 and accompanying text (plaintiff's evidence at trial in *Phelan* showed increased expenses because of preparation for trial).

139. *Compare* Phelan v. State Farm Mut. Auto. Ins. Co., 114 Ill. App. 3d 96, 104, 448 N.E.2d 579, 584 (App. Ct. 1983) (plaintiff's evidence at trial demonstrated necessity of incurring additional expenses) *with* Adduci v. Vigilant Ins. Co., 98 Ill. App. 3d 472, 477, 424 N.E.2d 645, 649 (App. Ct. 1981) (plaintiffs' allegations of necessity of incurring additional expenses were insufficient as matter of law).

140. 392 F. Supp. 717 (D. Or. 1975).

141. Grumbling v. Medallion Ins. Co., 392 F. Supp. 717, 721 (D. Or. 1975).

within the insured's policy limits that would remain open for fifteen days.[142] Because the insurer's company procedures did not allow the insurer to accept the offer by telephone, however, the insurer failed to accept the plaintiff's offer within the time limit.[143] The *Grumbling* court determined that the insurer had known that the liability of the insured was certain and knew that damages greatly exceeded the policy limits.[144] The district court determined that the sole reason for the insurer's failure to accept the plaintiff's offer before the offer had expired was because of the insurer's failure to use the telephone.[145] Under the circumstances, the court in *Grumbling* held that the insurer's failure to use the telephone constituted bad faith.[146] In dicta, however, the *Grumbling* court added that the court would not allow a plaintiff's attorney to "set up" an insurer for an excess judgment by making an offer of settlement with an unreasonable time limit.[147] The *Grumbling* court recognized the validity and necessity of offers that contained time limits, especially of offers that plaintiffs made near to or in the middle of trial.[148] The district court noted, however, that, if the offer expired before the insurer's investigation of the claim was complete, the plaintiff would not necessarily prevail.[149] The court concluded that whether a time limit is reasonable depends upon the sequence of events leading to the settlement offer, the stage of the proceedings at which a plaintiff makes a settlement offer, and all the other circumstances surrounding the offer.[150]

Decisions like *Grumbling* demonstrate that the "set up" defense basically is an effort by an insurer to establish that the insurer, acting in good faith, was unable to accept an offer that contained an unreasonable time limit.[151] The success of such a "defense" normally hinges on the totality of the circumstances[152] and the timing of the insurer's argument.[153] As a result,

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142. *Id.* at 719.

143. *Id.* In *Grumbling*, the insurer's company procedures provided exclusively for written acceptance of settlement offers. *Id.* Subsequently, the insurer, although making a late offer to tender the insured's policy limits, offered to pay an amount in excess of the insured's policy limits. *Id.* The plaintiff in *Grumbling* rejected the insurer's offer and recovered an excess judgment at trial. *Id.*

144. *Id.* at 721.

145. *Id.*

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.*

151. *See id.* (insurer claimed that plaintiff's fifteen-day time limit was unreasonable); *see also* Kriz v. Government Employees Ins. Co., 42 Or. App. 339, ____, 600 P.2d 496, 500 (Ct. App. 1979) (insurer argued that plaintiff's demand letter was "carefully ambiguous," and that offer contained sudden death timetable that plaintiff unreasonably designed to set up insurer for bad faith claim).

152. *See supra* note 40 and accompanying text (listing decisions emphasizing that bad faith claims depend on reasonableness of circumstances).

153. *See supra* note 66 and accompanying text (question of insurer's bad faith ordinarily is question for jury).

the "set up" defense is probably of limited value to insurers.[154] At least one commentator has suggested that, because evidence of a "set up" is prima facie evidence of the insurer's good faith and the plaintiff's unreasonableness, courts closely should examine cases in which an allegation or evidence of such conduct occurs.[155] Even if courts more carefully scrutinize cases in which evidence of a "set up" exists, however, courts still will look only at the overall factors that determine whether the conduct in issue was "reasonable."[156] If a claimant's attempt to "set up" an insurer made an insurer's failure to settle reasonable, the insurer will prevail.[157] If, however, a claimant's attempt to hold an insurer liable for the excess judgment did not contribute to an insurer's failure to settle, a claimant may recover.[158] A court's evaluation of a bad faith claim, therefore, remains exactly the same as if the insurer made no allegation of "set up."[159] The "set up" defense's potential as an absolute defense to a bad faith claim is negligible.[160] Even if a court feels that an insurer exercised good faith as a matter of law, the "set up" defense operates only as one piece of evidence that a court examines in making its determination regarding the insurer's good faith.[161] Moreover, a court's finding that an insurer's conduct constitutes good faith or bad faith as a matter of law is a relatively unusual finding

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154. *See supra* note 80 and accompanying text (discussing *McNally* court's holding that nothing in public policy or existing law requires a court to dismiss plaintiff's complaint because plaintiff's counsel intended to "set up" insurer).

155. *See* P. MAGARICK, *supra* note 5, § 11.06[1], at 103 (courts, in considering bad faith claims, should determine whether any reasonable cause for plaintiff's time limit existed, and whether insurer's failure to accept offer before time limit expired prejudiced insured in any way).

156. *See supra* note 63 and accompanying text (listing factors that courts often use to determine whether insurers' conduct was reasonable).

157. *See, e.g.*, Baton v. Transamerica Ins. Co., 584 F.2d 907, 913-14 (9th Cir. 1978) (insurer did not act in bad faith by failing to accept settlement offer with sudden-death time limit); DeLaune v. Liberty Mut. Ins. Co., 314 So. 2d 601, 603 (Fla. Dist. Ct. App. 1975) (insurer's failure to accept plaintiff's settlement offer was not in bad faith because offer's ten-day time limit was totally unreasonable); Adduci v. Vigilant Ins. Co., 98 Ill. App. 3d 472, 477, 424 N.E.2d 645, 649 (App. Ct. 1981) (plaintiff's time limit on settlement offer was unreasonable because plaintiff produced no evidence to show that time limit was necessary and, therefore, insurer's failure to accept offer breached no duty to insured).

158. *See, e.g.*, Kivi v. Nationwide Mut. Ins. Co., 695 F.2d 1285, 1288 (11th Cir. 1983) (insurer's failure to accept plaintiff's settlement offer within thirty-day time limit constituted bad faith); Grumbling v. Medallion Ins. Co., 392 F. Supp. 717, 721 (D. Or. 1975) (insurer's failure to accept settlement offer with fifteen-day time limit amounted to bad faith); Phelan v. State Farm Mut. Auto. Ins. Co., 114 Ill. App. 3d 96, 106, 448 N.E.2d 579, 584 (App. Ct. 1983) (affirming jury's finding of bad faith after insurer failed to accept plaintiff's offer of settlement within five-week deadline).

159. *See* McNally v. Nationwide Ins. Co., No. 83-865-WKS, mem. op. at 3 (D. Del. Feb. 15, 1985) (no principle of law requires court to dismiss bad faith claim simply because plaintiff's attorney intended to "set up" insurer for bad faith action), *aff'd on other grounds*, 815 F.2d 254 (3d Cir. 1987).

160. *See id.* (denying "set up" allegation as affirmative defense).

161. *See supra* note 40 and accompanying text (listing decisions which emphasize that bad faith claims depend on reasonableness of circumstances).

that probably is not affected by an allegation that the insurer was "set up."[162]

B. *The Comparative Fault Defense*

Although the "set up" defense offers insurers only limited assistance in defending bad faith claims, courts recently have begun to allow insurers to claim comparative fault as a defense to bad faith actions.[163] Unlike the "set up" defense, the recent recognition of the comparative fault defense conceivably may prove of importance to insurers.[164] Comparative negligence has evolved from the basic principle that a party may not recover for injuring himself.[165] The comparative fault defense allows courts to reduce the amount that insurers must pay to an insured by an amount proportional to the relative fault of the plaintiff.[166] For example, in *California Casualty*

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162. *See supra* note 66 and accompanying text (courts rarely hold that insurer conduct is reasonable or unreasonable as matter of law).

163. *See* California Casualty Gen. Ins. Co. v. Superior Court, 173 Cal. App. 3d 274, 283, 218 Cal. Rptr. 817, 822 (Ct. App. 1985) (comparative fault can constitute at least partial defense to bad faith claim); *see generally* Houser, Ashworth, & Francis, *Comparative Bad Faith: The Two Way Street Opens For Travel*, 23 IDAHO L. REV. 367, 367-77 (1986-87) (discussing impact of recent recognition of comparative fault); Wood, *Comparative Fault as a Partial Defense to Actions for Breach of the Implied Covenant of Good Faith and Fair Dealing*, 53 INS. COUNS. J. 566, 566-72 (Oct. 1986) (same). The reciprocal duty of good faith incumbent upon insureds could afford insurers a cause of action against insureds for insureds' breach of the duty of good faith and fair dealing. *See* Dobbyn, *supra* note 3, at 355-79 (discussing whether courts should afford insurers reciprocal bad faith cause of action).

164. *See* California Casualty Gen. Ins. Co. v. Superior Court, 173 Cal. App. 3d 274, 283, 218 Cal. Rptr. 817, 822 (Ct. App. 1985) (comparative fault can constitute at least partial defense to bad faith claim).

165. *See* Butterfield v. Forrester, 11 East 60, ____, 103 Eng. Rep. 926, 937 (1809) (one person's fault will not dispense with another person's duty to use ordinary care to protect himself).

166. *See* Fleming v. Safeco Ins. Co., 160 Cal. App. 3d 31, 36, 206 Cal. Rptr. 313, 316 (Ct. App. 1984) (reducing plaintiff's compensatory damages in amount proportional to plaintiff's fault); Prosser, *Comparative Negligence*, 51 MICH. L. REV. 465, 465 n.2 (1953) (comparative negligence statutes and rules provide method for division of damages between parties). Over one-half of the jurisdictions in the United States have adopted comparative negligence principles as a defense to tort claims. *See* W. PROSSER & W. KEETON, THE LAW OF TORTS § 67, at 471 (5th ed. 1984) (listing jurisdictions that have adopted comparative negligence principles). Different states, however, have adopted comparative negligence in different forms. *See id.*; 3 S. SPEISER, C. KRAUSE & A GANS, THE AMERICAN LAW OF TORTS § 13.3, at 693-703 (1986) (discussing evolution of comparative negligence doctrine). Some states apply pure comparative negligence standards to tort claims so that a plaintiff who is ninety-nine percent at fault still can recover one percent of his damages. *See, e.g.*, Li v. Yellow Cab Co., 13 Cal. 3d 804, 827, 119 Cal. Rptr. 858, 875, 532 P.2d 1226, 1232 (1975) (adopting pure comparative negligence in California); Alvis v. Ribar, 85 Ill. 2d 1, 28, 421 N.E.2d 886, 896-98 (1981) (abolishing doctrine of contributory negligence and adopting pure comparative negligence in Illinois); Lamborn v. Phillips Pac. Chem. Co., 89 Wash. 2d 701, ____, 575 P.2d 215, 221 (1978) (affirming damage award that represented one percent of plaintiff's actual damages). Other jurisdictions, however, allow a plaintiff to recover only if his negligence was less than the negligence of the defendant. *See, e.g.*, Smith v. American Oil Co., 77 Ga. App. 463, 491,

General Insurance Co. v. Superior Court,[167] the Court of Appeal for the State of California considered whether an insurer could assert comparative fault as an affirmative defense to a bad faith claim.[168] The plaintiff in *California Casualty* claimed that an insurer, in bad faith, refused to pay the plaintiff for damages that the plaintiff had received in an automobile accident.[169] The plaintiff alleged that, because of the insurer's bad faith failure to pay the plaintiff's claim, the court should award the plaintiff both compensatory and punitive damages.[170] The insurer in *California Casualty* argued that the plaintiff was partially responsible for his damages and that the court, using comparative negligence principles, should reduce the plaintiff's damages proportionally.[171] The *California Casualty* court recognized that no court previously had recognized the validity of the comparative fault defense to a bad faith claim.[172] In assessing the compar-

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49 S.E.2d 90, 108 (Ct. App. 1948) (if plaintiff's negligence equals or exceeds defendant's negligence, plaintiff cannot recover), *disapproved on other grounds sub nom.* Grayson v. Yarbrough, 103 Ga. App. 243, 119 S.E.2d 41 (Ct. App. 1961); Forsythe v. Coats Co., 230 Kan. 553, ____, 639 P.2d 43, 46 (1982) (in Kansas plaintiffs can recover if plaintiffs' own negligence contributed forty-nine percent or less to plaintiffs' damages); Bradley v. Appalachian Power Co., 163 W. Va. 332, 342, 256 S.E.2d 879, 885 (1979) (plaintiff can recover in tort if plaintiff's negligence does not equal or exceed negligence of other parties). Still other states permit courts to apply the comparative fault doctrine only if a plaintiff's fault was not greater than a defendant's fault. *See* Acampora v. Asselin, 179 Conn. 425, ____, 426 A.2d 797, 798 (1980) (plaintiff's negligence does not bar plaintiff's recovery if plaintiff's negligence was not greater than defendant's negligence); Leyva v. Smith, 557 S.W.2d 169, 170-71 (Tex. Civ. App. 1977) (plaintiff may recover in tort if plaintiff's negligence was not greater than defendant's negligence). Finally, two states allow plaintiffs to recover under comparative negligence if a plaintiff's negligence was "slight" and a defendant's negligence was "gross." *See* Bezdek v. Patrick, 167 Neb. 754, ____, 94 N.W.2d 482, 489 (1959) (to define "slight" and "gross" in state comparative fault statute, court must compare relative degree of parties' negligence); First Northwestern Trust Co. v. Schnable, 334 N.W.2d 16, 19-20 (S.D. 1983) (affirming judgment for defendant because plaintiff's negligence was more than "slight"). Because jurisdictions apply different comparative fault standards to bad faith claims, insurers' potential use of comparative fault as a defense to bad faith claims may depend upon highly technical rules of law. In states that have adopted no form of comparative fault, however, the comparative fault defense is not available to insurers at all. *See* W. SHERNOFF, S. GAGE & H. LEVINE, INSURANCE BAD FAITH LITIGATION § 4.06, at 4-27 (1986) (in states in which contributory negligence is total bar to recovery, comparative negligence defense is unavailable).

167. 173 Cal. App. 3d 274, 218 Cal. Rptr. 817 (Ct. App. 1985).

168. California Casualty Gen. Ins. Co. v. Superior Court, 173 Cal. App. 3d 274, 274, 218 Cal. Rptr. 817, 817 (Ct. App. 1985).

169. *Id.* at 276, 218 Cal. Rptr. at 818. In *California Casualty General Insurance Co. v. Superior Court*, the plaintiff first took her bad faith claim to arbitration and received a favorable award. *Id.*

170. *Id.* After the insurer in *California Casualty* answered the plaintiff's complaint, the insurer moved for leave to amend its answer to assert the defense of comparative fault. *Id.* at 277, 218 Cal. Rptr. at 818-819. The plaintiff opposed the insurer's motion to amend, and the trial court denied the motion. *Id.* Subsequently, the Court of Appeal for the State of California granted the insurer an alternative writ of mandate and agreed to consider whether the denial of the insurer's motion to amend was proper. *Id.*

171. *Id.*

172. *Id.* at 278, 218 Cal. Rptr. at 821.

ative fault defense, however, the *California Casualty* court noted that misconduct by the plaintiff would be admissible to show the insurer's reasonableness in failing to settle and to calculate the plaintiff's damages.[173] The *California Casualty* court decided that juries should consider evidence of the plaintiff's bad faith by using comparative negligence principles rather than in some unknown and unguided manner.[174] The *California Casualty* court concluded that, because the duty of good faith and fair dealing applies both to the insured and to the insurer, a breach of the duty of good faith and fair dealing by the insured could constitute at least a partial defense to the insured's bad faith claim against the insurer.[175]

In determining that an insured's breach of duty can constitute a partial defense for the insurer, the *California Casualty* court recognized that the foundation of the comparative fault defense is the reciprocal duty of good faith that the insured owes the insurer.[176] Comparative fault is similar to other defenses that depend upon the insured's misconduct to mitigate the insurer's failure to pay a claim.[177] Unlike other defenses that depend upon the insured's misconduct, however, the comparative fault defense is primarily a partial defense.[178] While other defenses that depend upon the insured's

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173. *Id.* at 279, 218 Cal. Rptr. at 822.

174. *Id.*

175. *Id.*

176. *Id.*; *see* Wood, *supra* note 163, at 572 (comparative fault defense depends upon degree to which insured fulfilled his duty of good faith and fair dealing).

177. *See supra* note 68 (discussing defenses to bad faith claims).

178. *See* California Casualty Gen. Ins. Co. v. Superior Court, 173 Cal. App. 3d 274, 278, 218 Cal. Rptr. 817, 819 (Ct. App. 1985) (insurer requested court to give jury instruction that, if jury found plaintiff partially at fault, jury should reduce plaintiff's damages by amount proportional to plaintiff's fault). Although the *California Casualty* court discussed comparative fault only as a partial defense, comparative fault may have the potential to operate as an absolute defense to a bad faith claim. *See* Los Angeles Memorial Coliseum Comm'n v. National Football League, 791 F.2d 1356, 1362 (9th Cir. 1986) (if both parties breach implied duty of good faith and fair dealing, neither party can recover for other party's breach), *cert. denied*, 108 S. Ct. 92 (1987). In *Los Angeles Memorial Coliseum Commission v. National Football League*, the United States Court of Appeals for the Ninth Circuit considered whether, if both parties to a contract breach their contractual duties of good faith and fair dealing, the doctrine of comparative fault could operate as a partial or absolute defense for a defendant in an action for breach of the duty. *Id.* at 1361. In *Los Angeles Memorial*, the Los Angeles Coliseum Commission and the Oakland Raiders football team brought an antitrust action against the National Football League for, among other things, the League's breach of its contractual duty of good faith and fair dealing. *Id.* at 1359. The Ninth Circuit determined that, if neither the team nor the League had breached the duty of good faith and fair dealing, the team could not recover damages. *Id.* The Ninth Circuit determined that no precedent existed concerning whether a plaintiff's breach of duty could constitute a defense to a plaintiff's suit against a defendant for its breach of duty. *Id.* The Ninth Circuit, however, failed to recognize that, in *California Casualty*, the Court of Appeals for the State of California had determined that a plaintiff's breach of the duty of good faith and fair dealing could constitute at least a partial defense to a plaintiff's action for a defendant's breach of duty. *Compare Los Angeles Memorial*, 791 F.2d at 1362 (no California court has considered case in which both parties to contract breached their duties of good faith and fair dealing) *with California Casualty*, 173 Cal. App. 3d at 283, 218 Cal. Rptr. at 822 (comparative fault of plaintiff can constitute at least partial

misconduct either entirely preclude the insured's recovery if the insurer successfully pleads its defense or allow the insured full recovery if the insurer's defense fails, the comparative fault defense can reduce the insured's damages by from one to ninety-nine percent.[179] The comparative fault defense, therefore, is markedly different from the "set up" defense.[180] While the "set up" defense involves one piece of evidence in an insurer's attempt to demonstrate that it acted reasonably, comparative fault involves an equitable reduction in damages in an amount proportional to the degree of the plaintiff's fault.[181] A claim that an insurer was "set up" will be successful only if evidence helps entirely to negate charges of bad faith against an insurer because a jury ordinarily has no method for apportioning relative fault.[182] A comparative fault defense, however, will assist an insurer who clearly acted in bad faith by reducing the damages that the insurer will have to pay.[183]

Although the comparative fault defense may be more beneficial to insurers than the "set up" defense, the comparative fault defense cannot assist in solving all insurers' difficulties under bad faith claims. The use of comparative fault creates a problem if a plaintiff claims punitive damages from the insurer because of the different standard of conduct necessary for the imposition of punitive damages.[184] In *Fleming v. Safeco Insurance Co.*,[185]

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defense to bad faith claim). The Ninth Circuit in *Los Angeles Memorial* adopted a rule under which mutual breaches of the duty of good faith and fair dealing during the "same episode or transaction of the relationship" counteract each other. *Los Angeles Memorial*, 791 F.2d at 1356. The Ninth Circuit concluded that, if both parties to the contract breached the implied contractual duty of good faith and fair dealing, then neither party could recover. *Id.* at 1362. Although *Los Angeles Memorial* failed to recognize existing California precedent concerning mutual breaches of the duty of good faith and fair dealing, the decision raises the possibility that courts could allow an insured's breach of duty to constitute an absolute defense to a bad faith claim. *See id.* (mutual breaches of duty of good faith and fair dealing extinguish each other so that neither party can recover for the other party's breach of duty).

179. *See* Lamborn v. Phillips Pac. Chem. Co., 89 Wash. 2d 701, 710, 575 P.2d 215, 221 (1978) (affirming damage award that represented one percent of plaintiff's actual damages); *supra* note 166 and accompanying text (discussing various methods of adopting comparative negligence).

180. *Compare supra* notes 71-162 and accompanying text (discussing "set up" defense) *with supra* notes 163-93 and accompanying text (discussing comparative fault defense).

181. *See* 3 S. SPEISER, C. KRAUSE, & A. GANS, *supra* note 166, § 13:1, at 687 (comparative negligence allows courts to apportion responsibility in relation to relative fault of parties).

182. *See id.*, § 13:2, at 691 (comparative fault allows juries to accomplish apportionment of damages between parties).

183. *Compare* DeLaune v. Liberty Mut. Ins. Co., 314 So. 2d 601, 603 (Fla. Dist. Ct. App. 1975) (insurer's failure to accept plaintiff's settlement offer was not in bad faith because offer's ten-day time limit was totally unreasonable) *with* Grumbling v. Medallion Ins. Co., 392 F. Supp. 717, 721 (D. Or. 1975) (insurer's failure to accept settlement offer with fifteen-day time limit amounted to bad faith).

184. *See* Silberg v. California Life Ins. Co., 11 Cal. 3d 452, 462, 521 P.2d 1103, 1110, 113 Cal. Rptr. 711, 718 (1974) (defendant must be guilty of oppression, fraud, or malice before court can impose punitive damages).

185. 160 Cal. App. 3d 31, 206 Cal. Rptr. 313 (Ct. App. 1984).

the Court of Appeals for the State of California questioned whether a court, in considering a bad faith action, could reduce a punitive damage award against an insurer because of an insured's comparative misconduct.[186] The insurer in *Fleming* offered to settle the insured plaintiff's claim for less than the insured's policy limits, but the plaintiff refused.[187] In considering the plaintiff's bad faith claim, the trial court reduced the plaintiff's compensatory damages by twenty-six percent, but did not reduce the award of punitive damages.[188] The *Fleming* court recognized that, in California, no precedent for a comparative reduction of punitive damages in a bad faith claim existed.[189] The *Fleming* court reasoned that comparing a plaintiff's bad faith with a defendant's malice, oppression, or fraud was impossible because the standards of conduct in issue were completely different.[190] Additionally, the California court recognized that, because the insurer did not raise the issue of comparative negligence with respect to punitive damages at trial, the insurer could not raise the issue on appeal.[191] Numerous courts have supported the *Fleming* court's refusal to use comparative negligence principles to reduce an award of punitive damages.[192] If both the

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186. *See* Fleming v. Safeco Ins. Co., 160 Cal. App. 3d 31, 36, 206 Cal. Rptr. 313, 315 (Ct. App. 1984). In *Fleming v. Safeco Insurance Co.*, an uninsured motorist injured the insured, an occurrence that the insured's insurance policy with the defendant insurer covered. *Id.* The *Fleming* case, like the *California Casualty* case, involved an insurer who owed an insured directly under the terms of the insured's policy. *See Fleming*, 160 Cal. App. 3d at 36, 206 Cal. Rptr. at 315 (insurer refused to pay claim under terms of insurance contract with plaintiff); California Casualty Gen. Ins. Co. v. Superior Court, 173 Cal. App. 3d 274, 277, 218 Cal. Rptr. 817, 818 (Ct. App. 1985) (same).

187. *Fleming*, 160 Cal. App. 3d at 36, 206 Cal. Rptr. at 315. In *Fleming*, an arbitration award to the plaintiff of the insured's full policy limits about one and one-half years after the plaintiff's accident eventually settled plaintiff's claim with the insurer. *Id.* Subsequently, the plaintiff sued the insurer, alleging that the insurer owed her compensatory and punitive damages because of the insurer's bad faith in refusing to settle her claim. *Id.*

188. *Id.* The jury in *Fleming* had determined that the insurer's bad faith accounted for seventy-four percent of the plaintiff's damages and that the plaintiff's own bad faith resulted in twenty-six percent of the plaintiff's damages. *Id.* at 36-37, 206 Cal. Rptr. at 316.

189. *Id.* at 42, 206 Cal. Rptr. at 321.

190. *Id.* The *Fleming* court assumed the existence of malice, fraud, or oppression by the insurer because, under California law, the existence of at least one of these elements is a prerequisite to an award of punitive damages. *See* Silberg v. California Life Ins. Co., 11 Cal. 3d 452, 462, 521 P.2d 1103, 1110, 113 Cal. Rptr. 711, 718 (1974) (defendant must be guilty of oppression, fraud, or malice before court can impose punitive damages); *Fleming*, 160 Cal. App. 3d at 44, 206 Cal. Rptr. at 320 (same).

191. *Fleming*, 160 Cal. App. 3d at 44, 206 Cal. Rptr. at 320. The *Fleming* court did not disturb the comparative reduction of plaintiff's compensatory damages. *Id.* The *Fleming* court, however, did not recognize expressly the unique concept of comparative fault because the insurer, on appeal, did not contest the award of compensatory damages. *Id.* at 45, 206 Cal. Rptr. at 321. Nevertheless, the *Fleming* decision laid the groundwork for recognizing the comparative fault defense. *See* California Casualty Gen. Ins. Co. v. Superior Court, 173 Cal. App. 3d 274, 281 n.2, 218 Cal. Rptr. 817, 821 n.2 (Ct. App. 1985) (although noting that *Fleming* decision did not constitute judicial recognition of comparative fault defense, court approved comparative fault as defense to bad faith claims).

192. *See, e.g.*, Shahrokhfar v. State Farm Mut. Auto. Ins. Co., 634 P.2d 653, 658-59

plaintiff and the insurer engaged in conduct that would support a punitive damages award, however, no apparent reason exists for a court to disallow insurers from claiming the comparative fault defense.[193] In situations in which punitive damages are not at issue, the comparative fault defense greatly assists insurers in defending themselves from growing numbers of bad faith claims.

III. Conclusion

By allowing insurers to use the comparative fault defense against claims of bad faith, courts have recognized that the duty of good faith and fair dealing applies equally to the insurer and the insured, and exemplifies the equitable principle that a plaintiff should not recover for self-inflicted harm.[194] By apportioning the fault between insurer and insured, courts can effect a partial or complete reduction of a plaintiff's damages and can protect insurers from paying damages to parties who partly are to blame for their own injuries.[195] Unlike the comparative fault defense, the "set up" defense does not appear significantly to assist insurers in defending bad faith claims.[196] Because, under the "set up" defense, evidence that a plaintiff "set up" an insurer shows the plaintiff acted unreasonably, the "set up" defense actually does not constitute a real defense, but merely shows that the insurer acted reasonably and in good faith.[197] Both the comparative fault and the "set up" defenses, however, offer insurers assistance in defending against increasing plaintiffs' claims.[198] The evolution of bad faith claims against insurers reveals a decided trend toward protecting insureds.[199]

(Mont. 1981) (award of punitive damages bears no reasonable relationship to plaintiffs' conduct); Anderson v. Trent, 685 S.W.2d 712, 714 (Tex. Ct. App. 1984) (use of comparative negligence statute to reduce exemplary damages is inappropriate because imposition of punitive damages requires gross negligence, which is different from ordinary negligence and not subject to comparison); Wangen v. Ford Motor Co., 97 Wis. 2d 260, ____, 294 N.W.2d 437, 446 n.7 (1980) (comparative negligence is not applicable to punitive damages because purpose of punitive damages is punishment and deterrence of wanton, willful, or reckless misconduct).

193. *See* Wood, *supra* note 163, at 571 (*Fleming* court could have reduced punitive damages if jury had compared fault on punitive damages and jury had found malice, fraud, or oppression by plaintiff).

194. *See* California Casualty Gen. Ins. Co. v. Superior Court, 173 Cal. App. 3d 274, 279, 218 Cal. Rptr. 817, 822 (Ct. App. 1985) (duty of good faith and fair dealing applies equally to insurer and insured); Fleming v. Safeco Ins. Co., 160 Cal. App. 3d 31, 36, 206 Cal. Rptr. 313, 315 (Ct. App. 1984) (same).

195. *See California Casualty*, 173 Cal. App. 3d at 278, 218 Cal. Rptr. at 819 (insurer requested court to give jury instruction that, if jury found plaintiff partially at fault, jury should reduce plaintiff's damages by amount proportional to plaintiff's fault).

196. *See supra* notes 71-162 and accompanying text (discussing "set up" defense).

197. *See supra* note 63 and accompanying text (under "set up" defense, courts still will look only at overall factors that determine whether insurer's conduct was reasonable).

198. *See supra* notes 71-162 and accompanying text (discussing "set up" defense); *supra* notes 163-93 and accompanying text (discussing comparative fault defense).

199. *See supra* notes 42-61 and accompanying text (discussing trend toward strict liability); Note, *Excess Liability*, *supra* note 2, at 396 (large recoveries for bad faith have become commonplace).

Insurers naturally are receptive to methods for blunting this increasing liability, and thoroughly should examine new and unique issues in bad faith claims.[200] By allowing insurers to utilize the "set up" defense and particularly the comparative fault defense, courts will hold insurers responsible for damages that the insurers proximately cause and will not allow plaintiffs to recover for the plaintiffs' own misconduct.[201] More importantly, courts, although compensating individuals that suffer needlessly, still will allow the general public to be able to purchase necessary insurance at affordable rates.[202]

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200. *See* Ashley, *supra* note 61, at 103 (insurers should invest time, thought, and money to bring their claims handling procedures into compliance with court directives).

201. *See supra* note 166 and accompanying text (comparative fault defense apportions damages according to relative fault of insurer and insured).

202. *See supra* notes 54-56 and accompanying text (increasing insurers' liability under bad faith claims probably would cause consumers' insurance premiums to rise).