An Insurer's Duty of Good Faith and Fair Dealing as it Applies to the Settlement of Claims

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Overview

Canadian authorities confirm that an insurer's obligations to its insured are those imposed by the express terms of its policy, plus an implied obligation of good faith and fair dealing that includes certain elements of fiduciary duty. (Reference: *Adams v. Confederation Life Insurance Company* (1994), 18 Alta. L.R. (3d) 324 (Q.B.), at pp. 345, 347)

Part and parcel of this obligation of good faith and fair dealing is the duty to act both promptly and fairly when investigating, assessing and negotiating the settlement of claims made by and against the insured. As outlined in the case law, during this process, insurers are bound to afford the insured's interests priority equal to their own. (Reference: *702535 Ontario Inc. v. Non-Marine Underwriters, Lloyd's of London* (2000), 184 D.L.R. (4th) 687 (Ont. C.A.), at p. 694; *Fredrikson v. I.C.B.C.* (1990), 44 B.C.L.R. (2d) 303 (S.C.), at pp. 336-337)

The leading Canadian case regarding an insurer's obligation to exercise good faith in the settlement of claims is *Shea v. Manitoba Public Insurance Corp.* (1991), 55 B.C.L.R. (2d) 15 (S.C.). There, Finch J. ruled that insurers are bound by a positive duty to consider the insured's interests on equal footing with their own where settlement is concerned. He further established the existence of a duty to make the policy limits available in settlement where the risks warrant. (at p. 69, 77-78, 85-86; see also, Richard J. Berrow, "More questions than answers in law of excess liability", (October 17, 1997), The Lawyers Weekly, Vol. 17, No. 22, at p. 10)

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While the Canadian jurisprudence regarding an insurer's duty to settle within policy limits remains markedly underdeveloped, the limited number of decisions that have referenced this duty have endorsed the principles and approaches established in the leading cases of *Shea* and *Fredrikson v. I.C.B.C.* (1990), 44 B.C.L.R. (2d) 303 (S.C.). Accordingly, it appears to be settled law in Canada that insurers may be held liable in circumstances where they refuse a settlement offer within the policy limits and thereby expose the insured to liability beyond those policy limits. (Reference: Gordon Hilliker, *Liability Insurance Law in Canada*, 4th Edit., (Markham, Ont.: LexisNexis Butterworths, 2006, at p. 112)

The issue of bad faith conduct by insurers is one that has received a great deal of judicial attention in the United States. Not surprisingly, therefore, there is a vast and well-developed body of American case law canvassing this issue.

While not all of the decided American cases are entirely uniform in their characterization of (and manner of enforcing) an insurer's duty of good faith in relation to the settlement of insurance claims, the broad principles that tend to guide judicial inquiry in this regard may be summarized as follows:

> "Generally, the insurer owes a duty to deal fairly and in good faith with its insureds; this duty emanates from the special relationship which exists between the parties, not necessarily from the terms of the contract. A liability insurer, therefore, having assumed control of the right of settlement of claims against the insured, may become liable in excess of its undertaking under the policy provisions if it fails to exercise good faith in considering offers to compromise the claim for an amount within the policy limits. It is also bad faith for an insurer to act irresponsibly in settlement negotiations with respect to the insured's risk in that part of the claim in excess of coverage. …
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> Notwithstanding good faith as the general standard, however, some courts do not limit the insurer's duty to the exercise of good faith toward the insured and have found that there might be liability for negligence in rejecting a reasonable compromise offer. Further, at times the "good faith" and "negligence" standards have tended to coalesce, so that even

> courts which have in terms rejected the "negligence" test agree that negligence is a relevant consideration in determining whether an insurer has exercised the requisite good faith." (Reference: 44 *Am. Jur. 2d Insurance* § 1390, online, LEXIS, at p. 1)

There is American authority to the effect that the duty of good faith by which an insurer is bound encompasses the obligation to protect the insured from a judgment above the insured's policy limits. Accordingly, if the insurer fails to consider a reasonable settlement offer, and the insured is subsequently exposed to an excess judgment, the insured may have a claim for bad faith against the insurer. (Reference: *Crisci v. Security Ins. Co. of New Haven, Conn.*, 426 P. 2d 173 (1967); *Kransco v. American Empire Surplus Lines Ins. Co.*, 2 P. 3d 1 (2000); *Kelly v. Iowa Mut. Ins. Co.*, 620 N.W.2d 637 (Iowa 2000); *Ward v. State Farm Mut. Auto. Ins. Co.*, 539 F.2d 1044 (5th Cir. 1976))

The Canadian Perspective

Broadly stated, "an insurer's obligations to its insured are those imposed by the express terms of its policy, plus an implied obligation of good faith and fair dealing that includes certain elements of fiduciary duty." (Reference: *Adams v. Confederation Life Insurance Company* (1994), 18 Alta. L.R. (3d) 324 (Q.B.), at pp. 345, 347; *Fredrikson v. I.C.B.C.* (1990), 44 B.C.L.R. (2d) 303 (S.C.), at p. 336-337)

The duty of good faith is owed at every stage of the insurance process and a breach of that duty is a breach of a contractual duty. It arises due to the special nature of the relationship, which places each party in a position of vulnerability to the other at different times throughout the life of the contract. (Reference: Craig Brown et al., *Insurance Law in Canada,* Looseleaf Edit., (Scarborough, Ont.: Carswell, 1999-), at p. 10-22; *Insurance Corp. of British Columbia v. Hosseini* (2006), 49 B.C.L.R. (4th) 250 (S.C.), at p. 273)

In the prominent case of *Fredrikson v. I.C.B.C.* (1990), 44 B.C.L.R. (2d) 303 (S.C.), discussed in greater detail below, Chief Justice Esson expressed the view that while an insurer is not in a fiduciary relationship with its insured, "certain of the fundamental elements which give rise to fiduciary duty are present in the relationship of insurer and insured." Accordingly, the insurer is obligated to "exercise its power having regard to the interests of its insured, and in a manner entailing, in some sense, an obligation of good faith." (at pp. 336-337)

The essence of the duty of good faith and fair dealing is further explained by author Craig Brown in the following passage taken from his text *Introduction to Canadian Insurance Law*, 2nd Edit., (Markham, Ont.: LexisNexis Butterworths, 2006):

> "[The] right to control the litigation from the defence point of view carries with it certain obligations. In particular, the insurer must conduct itself in accordance with a duty of good faith and fair dealing in relation to its customer. In addition to the general obligation to treat its customer fairly, … good faith imposes an additional requirement on a liability insurer. If the person bringing the lawsuit makes an offer of settlement within the policy limits, the insurer may not reject it without taking account of its customer's interest. … The test is, did the insurer give at least equal consideration to the customer's interest as it did its own interest?" (at p. 85)

(Also reference: *Shea v. Manitoba Public Insurance Corp.* (1991), 55 B.C.L.R. (2d) 15 (S.C.), at p. 64; and *Whiten v. Pilot Insurance Co. et al.* (2002), 209 D.L.R. (4th) 257 (S.C.C.), where the Supreme Court of Canada held that the good faith obligation, while founded on the contractual relationship between insurer and insured, is distinct from the obligation to honor the contract and this distinction is sufficient to qualify its breach as a separate wrong.)

It should be emphasized, however, that despite the volume of commentary endeavoring to explain the nature and scope of an insurer's duty of good faith, what constitutes "good" or "bad" faith on the part of an insurer in relation to the handling and settlement of claims remains dependent upon the circumstances in each case.

As noted by Denis Boivin, in his text *Insurance Law*, (Toronto: Irwin Law, 2004),

> "Good faith, like due care, defies definition, and instances of bad faith in contract performance can be as varied as instances of negligence. The most that can be done, in either case, is to formulate a *standard of conduct* that can be applied with a reasonable degree of predictability. …"
> (at p. 227)

It is significant that case law has established that the notion of good faith and fair dealing imposes a heightened duty on insurers to accommodate the interests of the policyholder in the process of settling claims. Specifically, when resolving claims, insurers are bound to afford the customer's interests priority equal to their own. (Reference: *Insurance Law in Canada*, *supra*, at p. 10-24; *702535 Ontario Inc. v. Non-Marine Underwriters, Lloyd's of London* (2000), 184 D.L.R. (4th) 687 (Ont. C.A.), at pp. 694-695)

With specific reference to the law regarding an insurer's duty to settle within policy limits, author Gordon Hilliker chronicles the developments in the jurisprudence in his text, *Liability Insurance Law in Canada*, 4th Edit., (Markham, Ont.: LexisNexis Butterworths, 2006). He begins:

> "**In both the United States and Canada … insurers have been held liable in circumstances where they have refused a settlement offer within the policy limits, and an excess judgment has gone against the insured.**
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> . . .
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> In Canada, the issue of the insurer's duty to settle was first touched upon in *Pelky v. Hudson Bay Insurance Co.* [(1981), 35 O.R. (2d) 97 (H.C.J.)], a case in which counsel appointed by the insurer to defend the action on behalf of the insured negligently failed to relay to either party the plaintiff's offer to settle the claim for the policy limits. The action proceeded to trial, with the result that an excess judgment was awarded against the insured. The insured then sought an order that the insurer pay the excess and referred the Court of American authority dealing with

> the obligation of the insurer to settle claims within the policy limits. It was conceded by counsel for the insurer, however, that the insurer was vicariously liable for the negligence of the lawyer appointed to assume conduct of the defence. Since the insurer acknowledged that it would have accepted the settlement offer had it been received, the Court chose not to reach any conclusion on the obligation of the insurer to settle claims within the policy limits. Instead, the Court simply held the insurer vicariously liable for the negligence of its lawyer." (at pp. 112-113)(emphasis added)

As Hilliker goes on to recount, this issue was next considered in *Dillon v. Guardian Insurance Co.* (1983), 2 C.C.L.I. 227 (Ont. H.C.J.). In that case, after a motor vehicle accident action, judgment was given against the insured for $77,959. His policy limits were $50,000. The insured thus claimed the difference of $27,959 from his insurer on the grounds that it could have settled the motor vehicle accident claim within the policy limits.

In *Dillon*, the injured party in the personal injury action suffered a severe brain injury. His counsel advised the insurers counsel that the claim could be settled for $45,000 or $46,000. The insurer's claims manager advised its counsel that it would settle for $40,000 general and special damages. He had been advised by its counsel, however, that its insured was probably wholly at fault.

While Justice Fitzpatrick relied on the oft-cited California decision of *Crisci v. Security Ins. Co. of New Haven, Connecticut* 426 P. 2d 173 (1967), to adopt an American-type strict liability approach to the duty to settle claims within policy limits, he opted not to discuss the basis for that duty. Nonetheless, his comments are instructive:

> "I am not aware of any Canadian jurisprudence with respect to the standard to be applied to the conduct of the insurer. At one time there appeared to be three standards in the United States: 1. absolute liability; 2. liability for failing to act reasonably; 3. liability for bad faith. There is presently a widely held view in that country that the second two standards for determining liability have merged. If an insurer does not use reasonable care in settling a claim against its insured, that want of

> care is a want of good faith. The standard of absolute liability is that if an insurer can settle a claim against an insured within its limits and does not do so, it is liable to reimburse its insured for whatever claim goes against him.
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> Some reasons for that position are given in *Crisci v. Security Ins. Co. of New Haven, Connecticut*, which is reported at (1967), 426 P.2d 173. They are as follows:
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>> "Amicus Curiae argues that, whenever an insurer receives an offer to settle within the policy limits and rejects it, the insurer should be liable in every case for the amount of any final judgment whether or not within the policy limits.
>>
>> The proposed rule is a simple one to apply and avoids the burdens of a determination whether a settlement offer within the policy limits was reasonable. The proposed rule would also eliminate the danger that an insurer, faced with a settlement offer at or near the policy limits, will reject it and gamble with the insured's money to further its own interests.
>>
>> Finally, and most importantly, there is more than a small amount of elementary justice in a rule that would require that, in this situation where the insurer's and insured's interests necessarily conflict, the insurer, which may reap the benefits of its determination not to settle, should also suffer the detriments of its decision."
>
> I find them persuasive, but I do not have to decide what the standard is here, because in this case the Guardian is liable by any standard. …" (at pp. 228-229)

In the above-referenced case of *Fredrikson v. Insurance Corp. of B.C.*, *supra*, Esson C.J.S.C. dealt with the issue of the duty of an insurer to its insured in respect of third party settlement negotiations of a motor vehicle liability claim. Importantly, the claim exceeded policy limits.

In considering and explaining the nature of the relationship between an insurer and its insured, Esson C.J.S.C. rejected the American view such a relationship might be characterized as a fiduciary one. He also declined to import into Canadian law the

American doctrine of "bad faith refusal to settle". He went on, however, to contend as follows:

> "That is not to say that liability insurers are under no obligation to consider the interests of their insured in deciding whether to settle. Where there is a potential for a judgment over the limits, the interests of the insured are significant. The insurer has assumed by contract the power of deciding whether to settle. Although, for the reasons which I have already stated, I would not find the insurer to be under a fiduciary duty in the strict sense applied in cases such as *Guerin*, it is clear that certain of the fundamental elements which give rise to fiduciary duty are present in the relationship of insurer and insured. … [Although] the insurer is not subject to the strict duty of a fiduciary, it must nevertheless exercise its power having regard to the interests of its insured, and in a manner entailing, in some sense, an obligation of good faith. …
>
> … Because of the power reposed in the insurer by its control over the question whether to settle, and the potential vulnerability of the insured, there is a basis for imposing a somewhat analogous duty [to the duty of utmost good faith] upon the insurer." (at pp. 336-337)

In the end result, therefore, while his judgment confirmed that "in some cases there could be a basis for holding the insurer liable for failing to settle a claim within policy limits," Chief Justice Esson found it unnecessary to decide the exact nature and scope of the duty owed because the insurer had more than met its duty in that regard. (at p. 337)

The next relevant case to be decided in this regard was *Shea v. Manitoba Public Insurance Corp., supra*. The *Shea* decision remains one of the leading Canadian cases in relation to the positive obligations borne by insurers as they investigate and resolve claims in good faith.

Shea involved an action against a public liability insurer ("MPIC") as a result of its conduct of earlier litigation in which it undertook the defence of the plaintiffs, Shea and Nepinak. These plaintiffs were sued in a tort action by Shea's infant son, acting by his mother, and then guardian ad litem, Mrs. Shea. The child had been seriously injured while riding as a passenger in a motor vehicle driven by his father and owned by his uncle.

Although it was clear from the start that the tort claim alone was beyond the policy limit of $300,000 (and despite the plaintiff having offered to settle for that policy limit), the tort action proceeded through trial and judgment was ultimately entered for more than $800,000 beyond the policy coverage.

The plaintiffs (who had assigned their rights against the insured to the child) then brought an action in the name of all three parties claiming that MPIC was liable to indemnify the insureds for the amount by which the judgment exceeded the available insurance because of its negligence, breach of contract or breach of fiduciary duty in failing to settle the liability claim. For its part, MPIC denied any liability.

In deciding the case, Justice Finch stressed that at all material times the tort claimant's case was worth in excess of the insured's policy limit. He also highlighted the fact that while in every case where a claim may exceed policy limits there lies an inherent conflict between insurer and insured, on the facts before him, the potential conflict had blossomed into an actual *lis* between insurer and insured.

After considering a plethora of authorities (both Canadian and American) and the evidence of the case, Finch J. concluded that the defendant insurer was or ought to have been aware that its desire to settle the case on its terms had jeopardized its insured's interests, and that it had been open to the insurer to negotiate a settlement on terms that would protect its insured. According to Justice Finch, the insurer either did not appreciate that conflict, or did not act on it. (at pp. 77-78)

Ultimately, therefore, because the insurer failed to extend to its insured the same consideration of his interests as it gave to its own, Finch J. found that the insurer had failed to comply with its contractual obligations to its insured, and was liable to the insured for the judgment in excess of the policy limits.

In his course of his reasons, Justice Finch examined, in considerable detail, the nature and scope of the duties owed by an insurer to its insured in relation to the settlement of claims. He summarized his conclusions in this regard as follows:

> "I would summarize my view of the law touching on the insurer's duty to its insureds in the circumstances of this case as follows:
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> 1. The relationship between the insurer and insured is a commercial one, in which the parties have their own rights and obligations;
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> 2. Within the commercial relationship, special duties may arise over and above the universal duty of honesty, which do not reach the fiduciary standard of selflessness and loyalty;
>
> 3. The exclusive discretionary power to settle liability claims given by statute to the insurer … places the insured at the mercy of the insurer;
>
> 4. The insured's position of vulnerability imposes on the insurer the duties:
>
>   a) of good faith and fair dealing;
>
>   b) to give at least as much consideration to the insured's interests as it does to its own interests; and
>
>   c) to disclose with reasonable promptitude to the insured all material information touching upon the insured's position in the litigation, and in the settlement negotiations.
>
> 5. The fact that the insured is at the mercy of the insurer for the purposes of settlement negotiations gives rise to a justified expectation in the insured that the insurer will not act contrary to the interests of the insured, or will, at least fully advise the insured of its intention to do so;
>
> 6. While the commercial nature of the relationship permits an insurer to assert or defend interests which are opposed to, or are inconsistent with, the interests of its insured, the duty to deal fairly

and in good faith requires the insurer to advise the insured that conflicting interests exist, and of the nature and extent of the conflict;

7. The insurer's statutory obligation to defend its insured imposes on the insurer, where conflicting interests arise, a duty to instruct counsel to treat the interests of the insured equally with its own; and where one counsel cannot adequately represent both conflicting interests, an obligation to instruct separate counsel to act solely for the insureds, at the insurer's own cost;

8. **The insurer's duty to defend includes the obligation to defend on the issue of damages, and to attempt to minimize by all lawful means the amount of any judgment awarded against the insured.** …" (at pp. 69-70)(emphasis added)

His reasons for judgment continued,

> "**In my view, the exclusive power to settle conferred on M.P.I.C. by the Regulations requires it to use reasonable efforts on the insureds' behalf to settle within policy limits. Those reasonable efforts include affirmative attempts to settle, and where a finding of liability is highly probable, and where the judgment to be awarded will probably exceed the policy limits, include the affirmative duty to offer to pay the third party liability policy limits in exchange for a release of its insureds.** …"
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> . . .
>
> The fault in the position taken by M.P.I.C. is that it did not analyze in advance the obligations it owed to its insured, nor how it could discharge those obligations with prejudice to its own position. …
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> … M.P.I.C. cannot escape liability on [the ground that the plaintiffs failed to make an unequivocal offer of settlement] because it had a positive duty to attempt to settle the tort claim for third party policy limits if that could have been done. (at pp. 85-86)(emphasis added)

The *Shea* decision thus both endorses the view that insurers are bound by a positive duty to consider the insured's interests on equal footing with their own where settlement is concerned, and establishes the existence of a duty to make the policy limits available in settlement where the risks warrant. (Reference: Richard J.

Berrow, "More questions than answers in law of excess liability", (October 17, 1997), The Lawyers Weekly, Vol. 17, No. 22, at p. 10)

There is a well-developed body of American jurisprudence confirming the potential liability of insurers for negligence or bad faith in relation to the handling of claims and the settling of those claims within policy limits. In Canada however, the converse is true. In fact, despite the progressive tenor of the *Fredrickson* and *Shea* decisions (and their consideration and endorsement of certain of the American approaches to considering this issue), there has been little development in the law in this regard since those cases were decided.

A case containing a very brief discussion of the affirmative obligation borne by an insurer in attempting to settle a claim within policy limits is that of *Drummond v. Fortune*, [1994] O.J. No. 2805 (Gen. Div.). There, the court said:

> "**I do not subscribe to this view that there is no duty upon an insurer to attempt to settle a claim. In fact the reverse is true particularly where the responsibility to divest itself of the complete coverage is obvious.**
>
> Insurers should be encouraged to approach settlement at an early date in a conscientious way. …" (QL, at para. 18-19)(emphasis added)

While it was a case concerned primarily with discovery of a solicitor's file, *Abick v. Continental Insurance Co. of Canada* (2001), 25 C.C.L.I. (3d) 212 (Ont. Master), involved a situation in which the insurer – in relation to an accident victim's action for injuries sustained in a motor vehicle accident – had rejected settlement offers falling within policy limits and had made counter offers below policy limits.

When judgment was ultimately awarded in an amount well in excess of the policy limits, the insured commenced an action against the insurer for bad faith and negligence in failing to settle motor vehicle action. The insurer responded by bringing a third party action against the solicitor retained to act for both the insurer and the insured at a time that the insurer knew that an action for bad faith was possible.

Another judgment in which allegations of bad faith conduct were leveled against the insurer is *Snair v. Halifax Insurance Nationale-Nederlanden North America Corp.* (1995), 142 N.S.R. (2d) 229 (N.S.C.A.).

The issue in the appeal was whether the court below properly exercised its discretion in granting an interlocutory order permitting the respondent to amend his statement of claim to plead bad faith against his insurer, the appellant, and in staying proceedings under the amendment until the issues it raised matured to the point that the case could be heard.

As recounted by the Nova Scotia Court of Appeal, in the court below it appeared to be accepted by the parties that an insurer may be found to be in bad faith if it refuses a settlement within policy limits that leaves the insured exposed to risks in excess of policy limits. Nevertheless, the Court did identify the following as being the elements underlying such a claim:

> "(1) that the insurer had a pre-trial opportunity to settle the matter within policy limits and declined;
>
> (2) that the insured was held liable at trial; and
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> (3) that the damages assessed against the insured exceeded the policy limits." (at p. 230)

Yet again though, it appears that no additional consideration of the issues in this case were undertaken by any level of court and this specific judgment has not been considered or referred to since it was rendered.

The American Perspective

A review of American law and commentary regarding "bad faith" conduct by insurers in the handling and settling of insurance claims reveals that, broadly speaking, insurers in the United States are required to settle cases within policy limits if that is the prudent course. It is equally clear, however, that the American decisions (state-to-state) are not entirely uniform in their treatment of this issue.

In an article penned for the Boston Bar Journal, Martin Pentz provides the following overview of the general principles endorsed by the American courts with respect to the duties owed by insurers to their insureds, particularly with regard to the settlement of claims:

> "The insurer's reservation of a privilege to control settlement "imports a reciprocal obligation for its exercise," i.e., an obligation to settle claims that should be settled. [*Murach v. Massachusetts Bonding & Ins. Co.* 339 Mass. 184 (1959)]. Where the case clearly will be resolved within policy limits – whether it is settled or tried – the insurer ordinarily will be free to pursue settlement as it sees fit. …
>
> Where the lawsuit threatens liability in excess of policy limits, the insurer is not free to favor its own self-interest. "Good faith requires that it make the decision (whether to settle a claim within the limits of the policy or to try the case) as it would if no policy limit were applicable to the claim." *Murach*, 339 Mass. at 187. An insured prejudiced by an insurer's failure to settle within the policy limits may assert both contract and tort claims, see *Hartford Casualty Ins. Co. v. New Hampshire Ins. Co.*, 417 Mass. 115, 121 (1994), and may also have claims under G.L. c. 93A, § 9 and 176D, § 3(9) (in the case of consumers) or G.L. c. 93A, § 11 (in the case of businesses). See *Kiewit Constr. Co. v. Westchester Fire Ins. Co.*, 878 F. Supp. 298, 302 (D. Mass. 1995). The insurer may be liable without regard for policy limits, where "no reasonable insurer would have failed to settle the case within the policy limits." *Hartford Casualty*, *supra*, 417 Mass. at 121." (Reference: Martin Pentz, "Where are the Limits?: Insurer Control of Defense and Settlement of Third Party Lawsuits, (January/February 2003), 47 B.B.J. 21, LEXIS, at p. 6-7 of 7)

An even more extensive description of the manner in which American courts have tended to characterize the nature of an insurer's duty of good faith and fair dealing as it relates to settlement of claims appears in the following excerpt from Douglas R. Richmond's article entitled "Advice of Counsel and Insurance Bad Faith" (2003), 73 Miss. L.J. 95:

> "A duty of good faith and fair dealing is implied in every insurance policy. The implied duty of good faith and fair dealing fundamentally requires that the insurer do nothing to injure the insured's right to receive benefits due under its policy. In most jurisdictions an insurer that breaches its duty of good faith and fair dealing commits the tort of bad faith. "Bad faith" is actionable as a tort only in the insurance context. Courts have fashioned a tort duty of good faith and fair dealing to protect insureds from insurers' exploitation of their superior bargaining power and exclusive control over claims processing, and because the business of insurance affects the public interest.
>
> "Bad faith" cannot be uniformly described or defined. To be guilty of bad faith an insurer generally must do more than breach its contract with its insured. Most courts require intentional wrongdoing by an insurer to impose bad faith liability. As the Arkansas Supreme Court explained in *Columbia National Insurance Co. v. Freeman* [64 S.W. 3d 720 (Ark. 2002)]:
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>> An insurance company commits the tort of bad faith when it affirmatively engages in dishonest, malicious, or oppressive conduct in order to avoid a just obligation to its insured. We have defined "bad faith" as dishonest, malicious, or oppressive conduct carried out with a state of mind characterized by hatred, ill will, or a spirit of revenge. Mere negligence or bad judgment is insufficient so long as the insurer is acting in good faith. The tort of bad faith does not arise from a mere denial of a claim; there must be affirmative misconduct.
>
> Some states disavow this sort of high standard, however, instead allowing insureds to recover extra-contractual damages for insurers' mere negligence." (at pp. 99-100)

He continues:

> "In the liability insurance context, many bad faith claims are attributable to an insurer's failure to settle a covered claim or suit against its insured

> within policy limits followed by a verdict or judgment against the insured in excess of its policy limits. The insurer's failure or refusal to settle a covered claim or suit must be unreasonable in order to expose the insurer to liability beyond its policy limits. Determining whether an insurer acted unreasonably and thus in bad faith in this common scenario requires a weighing of such factors as (1) the probability of the insured's liability; (2) the amount of the policy limits; (3) the extent of the claimant's damages; (4) the adequacy of the insurer's investigation; (5) the adequacy of the defense provided by the insurer; (6) whether the insurer followed the defense attorney's advice regarding settlement; (7) whether the insurer heeded its own adjusters' advice regarding settlement; (8) the insurer's willingness to engage in settlement negotiations; (9) whether the insured made any misrepresentations that may have misled the insurer in settlement negotiations; (10) the openness of the communication between the insurer and the insured; (11) whether the insurer kept the insured informed of settlement negotiations; and (12) any other conduct demonstrating that the insurer felt or showed greater concern for its financial interests than it did for its insured's financial risk.
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> . . .
>
> Regardless of the context, the unreasonableness of the insurer's conduct is the essence of bad faith. …" (at pp. 100-102)

And finally, the oft-cited insurance treatise *Couch on Insurance 3d*, Looseleaf, (St. Paul, Minn.: Thomson/West, [2005]-), summarizes the prevailing American view of the basis of an insurer's duty to settle within policy limits as follows:

> "**The basis of the insurer's duty to settle within policy limits is the insurer's exclusive control over settlement negotiations and defense of litigation, which results in a conflict of interest between the insurer and the insured** [*Haddick ex rel. Griffth v. Valor Insurance*, 763 N.E. 2d 299 (2001)]. … **In determining whether or not to settle within policy limits, an insurer must give at least as much consideration to the interest of the insured as it does its own interest** [*Anguiano v. Allstate Ins. Co.*, 209 F. 3d 1167 (9th Cir. 2000); *Crisci v. Security Ins. Co. of New Haven, Conn.*, 426 P. 2d 173 (1967)]. **Thus, the insurer has a duty implied by law to settle within policy limits where recovery in excess of those limits is substantially likely, in order to protect the insured from a gamble by the insurer on which only the insured could lose** [*Kransco v. American Empire*

> *Surplus Lines Ins. Co.*, 2 P. 3d 1 (2000)]." (Vol. 14, Chpt. 203, at para. 203:13)(emphasis added)

The text continues, identifying the key components of the insurer's duty of good faith in the context of settlement and the decisions establishing or endorsing them:

> "The right to control settlement carries with it a corresponding duty of good faith and fair dealing to the insured [*Hartford Acc. & Indem. Co. v. Foster*, 528 So. 2d 255 (Miss., 1988)]. **The implied covenant of good faith and fair dealing requires an insurer to settle where appropriate even if the duty is not expressly imposed in the terms of the policy** [*LensCrafters, Inc. v. Liberty Mut. Fire Ins. Co.*, 2008 W.L. 410243 (N.D. Cal. 2008)]. **An insurer may breach the duty of good faith by refusing the settle within policy limits where the insured is clearly liable, and the decision not to settle is made in bad faith and without a reasonable belief that the amount of the settlement offer is excessive** [*Ortega-Maldonado v. Allstate Ins. Co.* 519 F. Supp. 2d 981 (D. Minn. 2007)]. **If the insurer breaches its good faith obligation, it may be liable to the insured for the entire amount of the judgment, including amounts in excess of coverage limits** [*Kransco v. American Empire Surplus Lines Ins. Co.*, *supra*]. … Where an insurer refuses to accept an offer of settlement within policy limits without a bona fide belief that it has a good chance of winning, it breaches its duty of good faith to its insured [*Birth Center v. St. Paul Companies, Inc.*, 787 A. 2d 376 (2001)]. …" (at para. 203:14)(emphasis added)

The authorities clearly indicate that an insurer may breach the insurance contract by failing to settle not only where it acts in bad faith, but also where it acts negligently. (Reference: *Couch on Insurance* 3d, *supra*, at para. 203:24)

In this regard, some decisions hold that mere negligence serves only to create liability on the part of the insurer up to the policy limits. Others state that negligence is sufficient to render the insurer liable for any judgment in excess of the policy limits. (Reference: *Couch on Insurance 3d*, *supra*, at para. 203:24; *Kelly v. Iowa Mut. Ins. Co.* 620 N.W. 2d 637 (Iowa 2000); *Kingsley v. State Farm Mut. Auto. Ins. Co.*, 353 F. Supp. 2d 1242 (N.D. Ga. 2005); *Meixell v. Superior Ins. Co.* 230 F. 3d 335 (7th Cir. 2000))

Of course, there are also judgments holding that mere negligence on the part of the insurer is not sufficient to impose liability against an insurer for failing to settle a claim against its insured. In these cases, the insured must establish that the insurer's conduct constituted a deliberate or reckless failure to place the interests of the insured on equal footing with its own when considering a settlement offer. (Reference: *Couch on Insurance 3d*, *supra*, at para. 203:24; *Johnson v. Tennessee Farmers Mut. Ins. Co.* 205 S.W. 3d 365 (Tenn. 2006); *Greenidge v. Allstate Ins. Co.* 312 F. Supp. 2d 430 (S.D.N.Y. 2004))

Conclusion

Thus it seems clear that, although there is little recent law discussing an insurer's duty of good faith regarding settlement within policy limits, the framework has been set in place in Canadian jurisprudence, and is well established in American jurisprudence.

END