Insurer's Defense Obligation: When Does it Include a Duty to Appeal

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THE INSURER'S DEFENSE OBLIGATION: WHEN DOES IT INCLUDE A DUTY TO APPEAL?

I. Introduction

It has been stated many times that the duty to defend its insured, an obligation which is imposed upon insurance companies in most liability insurance contracts, does not necessarily encompass a further duty to appeal adverse decisions rendered against the insured; nevertheless there are circumstances when courts will require an insurance company to appeal on behalf of its insured in order to fulfill its contractual obligation to provide an adequate defense. In the past most of the decisions finding a duty to appeal have relied on a good-faith versus bad-faith analysis of the insurance company's action; and, upon finding bad faith in the failure to appeal, have declared a breach of contract by the company. A few recent decisions have attempted to go beyond this limited analysis and have more readily placed upon the insurance company a duty to appeal. This note will focus upon these recent cases and attempt to examine how they may affect the already troublesome area of the insurer's defense obligation.

The question of whether an insurance company has a duty to appeal only becomes important when the trial court has rendered a judgment against the insured which is in excess of the policy limits. Obviously, the insured would be satisfied to allow a judgment within policy limits to stand since the insurer must bear the entire burden of the judgment. The possibility of a duty to appeal, however, does not arise only after an excessive judgment has been rendered. As soon as plaintiff's complaint is drawn it is apparent whether the insured could be liable for damages exceeding the policy limits. The most recent case in this area, Ursprung v. Safeco Insurance Company of America, is illustrative of the fact situation in which this question arises and of the new approach courts have been taking.

The original action which gave rise to the duty to appeal question in Ursprung involved an automobile accident between Sherry Ann Clark, who was insured by Safeco, and James Ursprung, a motorcyclist. Ursprung had originally sued Clark for $182,500 but her coverage with Safeco amounted only to $10,000. Since there was such a great divergence between the policy limits and the amount claimed as damages, Safeco advised Clark that she might retain additional counsel although they would defend her at the trial in any event. Despite the fact that they met several times before the trial, there was no offer to settle by either the insurer's attorneys or Ursprung's attorneys, and judgment was rendered.
in favor of Ursprung for $22,969.30. The insurer chose to pay its $10,000 liability rather than appeal and advised Clark of its decision. The insurer’s attorneys felt that Clark had a good chance of establishing a defense of contributory negligence as a matter of law on appeal, but Safeco nevertheless wanted to withdraw. In spite of this, Clark, on advice from her lawyer-friend, made no demand that Safeco appeal, refused to accept a post-trial settlement offer from Ursprung for $15,000, and refused to appeal on her own. Instead she assigned to Ursprung, in satisfaction of the judgment in excess of the policy limits, her claim against Safeco for failure to settle the claim in good faith and for failure to appeal.

This resulted in an action by Ursprung to recover the $12,969.30 differential between his original judgment and the policy limits which were already paid to him. The question was whether Safeco’s actions in handling Clark’s defense were such that she could have held them liable for the excess judgment had she not assigned her claim to Ursprung. Although the Court of Appeals of Kentucky ruled in favor of Safeco, its reasoning established a most important precedent.

The court immediately dismissed the failure to settle issue by relying on the trial court’s determination that there was no bad faith involved, but it found a duty to appeal (a duty from which the insurer was released because Clark’s lawyer-friend had informed the insurer that other methods for her protection had been arranged). In order to establish this duty the court rejected the idea that an insurer could pay its policy limits to the court or to the insured and thus negate its defense duty. Instead it found that the agreement to indemnify was separate from the agreement to defend. Despite payment, an insurer must continue in good faith to defend the insured and a complete defense includes proper appeals. In addition it found the bad-faith standard for determining an insurer’s liability for failure to take an appeal to be insufficient. Despite this being a case of first impression in Kentucky, the court chose to follow a series of New York cases, which are in the distinct minority, holding that an insurer must appeal on behalf of his insured whenever there are reasonable grounds for appeal. In their haste to reach the desired result, the court overlooked much precedent in this area, and consequently its decision may have unexpected ramifications. To place this case in perspective, this note will backtrack and examine the different concepts and practicalities involved in imposing upon an insurer a duty to appeal and construe the role of the new standard within this framework.

II. The Insurance Contract Provisions

There are three types of liability insurance contracts generally used which concern the defense duty. Individual insurance companies may add or subtract a few terms at times or deviate from the model to suit their own needs, but these three are the standard policies proposed by the insurance industry. The provision most commonly used before 1955 took this form: “As respects the insur-
ance afforded by the other terms of this policy under coverages A [Bodily Injury Liability] and B [Property Damage Liability], the company shall [defend, etc.]. . . . This type of policy has often been found by courts to impose a defense duty upon the insurer despite the tendering or exhaustion of policy limits. In an attempt to avoid this interpretation, the insurers began revising their policies in 1955 to read as follows:

With respect to such insurance as is afforded by this policy for bodily injury liability and for property damage liability, the company shall:

(a) defend any suit against the insured alleging such injury, sickness, disease or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent. . . .

Despite the high hopes that the insurance industry had concerning the 1955 revision, they were still left dissatisfied by the cases. Thus, in 1966 they offered another type of revision which is the most current one to date. This policy provision put the two duties, defense and indemnification, in the same paragraph and added the following phrase: "but the company shall not be obligated to pay any claim or judgment or to defend any suit after the applicable limit of the company's liability has been exhausted by payment of judgments or settlements."

Because there is generally no express mention of a duty to appeal in insurance contracts, it is to one of these provisions that the courts must look in order to impose this duty, if in fact there is one. In addition, the question of whether the twin duties of indemnification and defense are separate or integrated will effect to a large extent a court's determination of whether there is a duty to appeal. Thus contract interpretation is essential. Public policy often dulls this interpretation, however, and plays an important part in cases of this nature. To date, the pre-1955 and the 1955 revision policies have been extensively litigated, but the 1966 revision has yet to be definitively interpreted. All three policies are still in existence, and the decisions to date offer insight into how the 1966 revision may be received by the courts.

III. The Duty to Defend vs. The Duty to Pay

The situation which must be examined in connection with this topic may be summarized as follows: Suppose X, who is insured by Y company, is sued for a tort, which is within policy coverage, by A and B. After an unsuccessful defense or settlement for policy limits of A's action against X, the limits of the insurance policy are exhausted. Now Y brings a declaratory judgment suit to determine whether it must defend X in B's suit or, in the alternative, X sues Y after B's suit for failure of Y to defend the second action. What results? The situation may

also arise another way: Suppose X, again insured by Y company, is sued by A and loses despite a defense by Y. Can Y automatically pay to the court its policy limits and withdraw or must it appeal under some circumstances? The question, then, is to what extent does the duty to pay control the duty to defend after the insured has completed an adequate defense on the trial court level?\(^\text{12}\)

There are two lines of reasoning concerning this question involving both the pre-1955 and the 1955 revision policies. An example of an interpretation of a pre-1955 policy holding that the duty to defend no longer exists after the policy limits have been exhausted is *Lumberman's Mutual Casualty Co. v. McCarthy*.\(^\text{13}\) In that case the insurance company brought a declaratory judgment against its insured in order to determine if it had a duty to defend a second action brought against the insured after the policy limits had been exhausted in the first action. The pertinent part of the contract read as follows: "the plaintiff agreed to defend on behalf of the insured and in his name 'any suit, coming within the terms of this Policy, seeking damages . . . even if such suit is groundless, false or fraudulent.'"\(^\text{14}\) The court interpreted this provision to be subordinate to the duty to indemnify, thus negating the duty to defend once payment occurred. It found that the policy placed many duties upon both the insurer and insured but none of these duties could survive indemnification.

As we construe the policy it obligates the insurer to pay the liability of the insured up to the policy limits, and in addition thereto to pay those items of expense which it has definitely assumed. Until these duties of payment are fully performed, it also has the duty either to settle or to conduct the defense of actions against the insured. But, upon performance of its duties of payment its duty to defend ceases to exist and the further defense of any action pending thereafter must be conducted and may be controlled by the insured.\(^\text{15}\)

A 1955 revision case holding the same way is *Liberty Mutual Insurance Co. v. Mead Corporation*.\(^\text{16}\) This was an action by an insured to recover costs and attorney's fees for settling cases which were within policy coverage but were ignored by the insurer since it had exhausted its policy limits in settling two prior suits resulting from the same accident. The contract provisions which had to be interpreted were identical to the 1955 revision policy cited in Part II of this

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\(^{12}\) This note will not discuss the situation which results when an insurer refuses to defend at all, whereby the insured claims an abrogation of the total defense duty and not just the duty to appeal. Under these circumstances courts hesitate to find for the insurer because, if the duty to defend is to have any meaning, insurers cannot be allowed to indemnify in lieu of defending (or settling) on the trial court level. *See* Nat'l Union Ins. Co. v. Phoenix Assur. Co. of N. Y., 301 A.2d 222, 224 n.4 (D.C. 1973): "The court was careful to point out, however, that the insurer may not initially pay the policy limit and place the full burden on the insured from the beginning...." *See also* Anchor Cas. Co. v. McCaleb, 178 F.2d 322 (5th Cir. 1949); Simmons v. Jeffords, 260 F. Supp. 641 (E.D. Pa. 1966); Nat'l Cas. Co. v. Ins. Co. of North America, 230 F. Supp. 617 (N.D. Ohio 1964); Sutton Mut. Ins. Co. v. Rolph, 109 N.H. 142, 244 A.2d 186 (1968); Grand Union Co. v. General Accident, Etc., Assur. Corp., 254 App. Div. 274, 4 N.Y.S.2d 704 (1938). For a contrary view see Denham v. LaSalle-Madison Hotel Co., 168 F.2d 576 (7th Cir. 1948); Comm. Union Ins. Co. of N. Y. v. Adams, 231 F. Supp. 860 (S.D. Ind. 1964).

\(^{13}\) 90 N.H. 320, 8 A.2d 750 (1939).

\(^{14}\) *Id.* at 321, 8 A.2d at 751.

\(^{15}\) *Id.* at 323, 8 A.2d at 752.

\(^{16}\) 219 Ga. 6, 131 S.E.2d 554 (1965).
article. This court, unlike the *McCarthy* court, was extremely meticulous in analyzing the contract. It asked two questions:

Does "such insurance as is afforded by this policy" refer only to the several *types* of liability coverage afforded by the policy . . . ? Or does "such insurance as is afforded by this policy" refer to the types of coverages *and* the *amount* of those coverages?³⁷

The court felt that the policy limit on liability was too important to be ignored in this context and thus that the duty to defend was necessarily limited by the amount of liability coverage:

Insurance is composed not only of *type* of coverage, but also *amount* of coverage. To be insured only as to type of coverage is no protection at all. Another dimension is involved, the *amount* of that coverage.²⁸

In *American Employer's Insurance Co. v. Goble Aircraft Specialities, Inc.*,²⁹ the interpretation of a pre-1955 policy was again in question but the answer from this court was directly opposite that of the *McCarthy* and *Mead* courts. Policy coverage for the insureds in this case contained a $300,000 limit, but eleven actions were initiated against the insured seeking an aggregate recovery of approximately one and one half million dollars. This action was an attempt by the insurers to have the court declare that there was no duty to defend once the $300,000 limit had been exhausted. The court denied the insurer's request. They found the language in the contract imposing a duty to defend upon the insurer to be "clear, positive and unambiguous" and not dependent upon the amount of coverage. In support of their contention they cited the dissent in *McCarthy* which had intimated that the defense duty should be construed for the benefit of the insured and not the insurer. Furthermore, they tried to read the contract as a layman would. In their view one reading the contract would not suppose that all obligations terminated upon indemnification.

If plaintiff intended to reserve the right to withdraw counsel and cease to defend such actions as might be pending after payment of the total amount for which it indemnified, or to refuse to defend any new action commenced after such payments, it was under a duty to so state in the policy which it issued. The language required is such as would be clear and comprehensible to the average businessman without legal assistance.²⁰

In accord with the *Goble* line of thinking is *Travelers Indemnity Company v. East.*²¹ This case involved the standard 1955 revision policy and a somewhat different factual situation. The insurer had defended three insureds in the same action and was successful in getting a directed verdict for two of them, but the third party was held liable for a judgment in excess of the policy limits thus

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³⁷ Id. at 8, 131 S.E.2d at 535.
³⁸ Id. at 9, 131 S.E.2d at 536.
⁴⁰ Id. at 1073-74, 131 N.Y.S.2d at 400.
⁴¹ 240 So. 2d 277 (Miss. 1970).
exhausting the insurer's coverage. Subsequently, the two insureds who received
the directed verdict were forced to defend an appeal in that case which the
insurer claimed it now had no obligation to defend. The present suit was one
by these two insureds to recover attorney's fees expended in connection with that
appeal. The court began by recognizing that the 1955 revision was an attempt
to restrict the duty to defend but it declined to interpret the new contract as
opposed to the pre-1955 provisions. Instead it took notice of the two divergent
views in this area and chose to follow the view it felt was expressed in prior
Mississippi cases. The opinion placed great reliance on a pre-1955 case and it
admitted that the cases it was relying on as precedent were not on point factually.
Obviously groping for a way to implement a public policy concern, the court
settled for arbitrarily declaring that "the appellant ... was required to defend
the insured under the terms of its policy although it had paid the full amount of
its money coverage and is consequently liable for a reasonable attorney's fee
necessarily incurred in the appeal of the case."

It appears from these four representative cases that there is an irreconcilable
conflict on this issue with regard to both the pre-1955 and 1955 revision
policies. Courts which hold that the duty to defend is subordinate to the duty
to pay have generally read the contract literally and strictly (a four-corners'
interpretation), while courts holding the opposing view feel compelled to imple-
ment a desired public policy. In accord with the latter line of reasoning is a
feeling that an ordinary man would, if he read the standard contracts, feel that
the insurer should defend him despite policy limit exhaustion. In addition,
these courts maintain that the insured pays for this total defense service as part
of his premium. The 1966 revision policy would not seem to resolve this conflict
either. Read literally, of course, this policy plainly reveals that the insurer has
no duty to defend a suit once policy limits are exhausted. This may not deter
courts like the one in East from imposing this duty upon insurers. Since insurance
companies are large corporate entities and since they write the terms of the con-
tract and do not bargain for terms with the ordinary customer, a court could
easily find the 1966 revision policy to be an adhesion contract which is uncon-
scionable. Already one distinguished commentator has expressed such a view.
In addition, courts like the Goble court, which specifically stated that if more
exact language had been inserted in the policy they might have found for the
insurer, may find that because consumerism has increased greatly in importance
during the past twenty years, public policy demands a result more in step with
the times. All of the foregoing points to the fact that the 1966 policy is not likely
to terminate the split of opinion. It is necessary, therefore, to determine how
both views affect the duty to appeal.

22 Id. at 280.
23 See also American Cas. Co. of Reading, Pa. v. Howard, 187 F.2d 322 (4th Cir. 1951),
A.2d 765 (1960) following the McCarthy rationale despite a 1955 revision policy.
24 R. Kerton, supra note 1, at 482: "This provision, like many others in the 1966 revision,
seems objectionable from policyholder and public interest points of view. It is likely that it
will receive unfriendly treatment at the hands of the courts."
25 205 Misc. at 1073, 131 N.Y.S.2d at 400.
IV. The Duty to Appeal

As was mentioned in the Introduction, there are now two standards by which to judge an insurer's duty to appeal an adverse decision rendered against its insured: (1) the bad-faith standard and (2) the reasonable-grounds-for-appeal standard. Under the first standard an insurer will be held liable for not appealing only if it has handled its defense duty (both trial court and failure to appeal) or its negotiation of settlement offers in a grievously negligent or fraudulent manner. A statement summarizing this standard which courts are fond of quoting is as follows:

A liability insurer, in determining whether to take an appeal from an adverse judgment against the insured, must take into consideration not only its own rights but the rights of others for which it is responsible; the insurer becomes liable to such parties for refusal to take an appeal only if it acts fraudulently or in bad faith.26

The insurer is charged with considering the rights of the insured under this standard, but it is liable only when it seriously disregards those rights. On the other hand, the reasonable grounds for appeal standard places a much more affirmative duty upon the insurer. Whenever the trial court record or the facts surrounding the case suggest a legitimate or feasible basis for appeal, the insurer is obligated to appeal; and, if it refuses, the court has the luxury of determining the reasonableness of its actions by hindsight. Only a reasonable probability of success in the action need be shown, but failure or success on appeals actually taken by the insured will affect the determination of reasonableness.

Before deciding which standard to apply, however, the courts will usually consider the duty to pay versus the duty to defend controversy as a preliminary question. Those courts holding that an insurer can negate the defense duty upon indemnification will apply the bad-faith standard because they believe that the insurer has the contractual right to terminate the contract upon indemnification unless it has been grossly unfair to its insured. Once they reach the determination that exhaustion of policy limits controls the duty to defend, it would be illogical to hold that an appeal must be taken whenever there are reasonable grounds for one. Obviously an obligation which is subservient to the main duty must terminate when the main duty terminates unless there is some overriding concern, here the lack of good faith, which is read into every contract. If they tried to apply the reasonable-grounds standard, they would be allowing an insurer to terminate the contract upon indemnification but then reimposing a contract duty subsequent to termination. The reasonable-grounds standard, then, is applicable only to those cases which hold the duty to defend to be separate and distinct from the duty to pay. Under this interpretation, the insurer's contractual obligation to defend can survive indemnification; thus there is no conflict between the two principles. So far, despite the split of authority on the duty to pay versus the duty to defend question, there have been only two jurisdictions enforc-

ing this second standard: New York and Kentucky (since Ursprung). This is not to say that the duty to appeal has been absent when the bad-faith standard has been applied. Both standards have produced decisions favorable to the insured and cases in both areas must be discussed in order to get a complete picture of the duty to appeal.

Courts applying the bad-faith standard have the task of determining which actions by the insurer can be viewed as sufficiently detrimental to the insured to occasion a realignment of contract duties. At times, however, the courts will only take a cursory view of the facts and rely largely upon the indemnification-defense rationale. One such case is General Casualty Co. of Wisconsin v. Whipple. Here the court had already decided that there was no bad faith on the part of the insurer in connection with the failure to settle issue; so when it determined that policy limit exhaustion terminates the defense duty, it felt it had answered the duty to appeal question. Obviously the court felt that lack of bad faith in connection with one duty made it highly unlikely that there was bad faith in connection with the other. The approach used by this court is one of examining the entire insurer-insured relationship, not only the events connected with the question of prosecuting an appeal. This approach was also used by the court in Smoot v. State Farm Mutual Automobile Ins. Co., but in a different manner producing a different result. In reversing a summary judgment entered against the insured, this court held that the failure to appeal may be valuable evidence in the insured's case as proof of bad faith in the general handling of the defense or in the insured's refusal to settle:

First, it [the failure to appeal] was a further illustration of bad management and handling of the case demonstrating, so the Assured urged, that the Insurer acted both imprudently and in callous disregard of the Assured's interests, hence in bad faith.

In determining whether the insurer acted in bad faith, then, issues such as a failure to settle may be intertwined with the characterization of the failure to appeal.

A more particularized analysis of the bad faith standard, focusing on an individual fact situation, appears in Hawkeye-Security Ins. Co. v. Indemnity Ins. Co. The litigants in this suit were the primary and excess insurers. The excess insurer, after having been forced to pay a judgment which exceeded the coverage of the primary insurer because of the failure of the latter to prosecute an appeal, sued to recover its contribution to the judgment. The question which was central to the case was whether it was bad faith for the primary insurer to

27 Some jurisdictions have attempted to apply a standard somewhat stricter than the bad-faith approach without using the reasonable grounds criteria. For an example, see Mannheimer Bros. v. Kansas Cas. and Surety Co., 149 Minn. 482, 184 N.W. 189 (1921), where it was suggested that the duty to defend incorporates a duty to appeal if necessary to vindicate the rights of the insured.
28 328 F.2d 353 (7th Cir. 1964).
29 Id. at 357-58.
30 299 F.2d 525 (5th Cir. 1962).
31 Id. at 533.
32 260 F.2d 361 (10th Cir. 1958).
refuse to appeal despite the recommendation of its counsel that an appeal would be desirable. The court answered that the insurer had the right to make the final decision on whether to prosecute on appeal, and thus not following counsel's advice, was not in itself bad faith.

An attorney employed to defend litigation is, of course, in complete charge . . . but the fact that he has authority to represent his client in the trial and conduct the litigation gives him no right to prosecute on appeal. That is so because his employment has come to an end. Of course, his recommendations with respect to an appeal are entitled to consideration, but whether an appeal should be taken is a question for determination by the principal . . . the failure to take the advice of counsel employed to try a case, that an appeal should be taken, in itself, and without more, is insufficient to sustain a finding of bad faith.33

Two other cases using a more specific analysis but finding for the insured are Brassil v. Maryland Casualty Co.34 and Lincoln Park Arms Building Corp. v. United States Fidelity & Guaranty Co.35 In Brassil the insured was able to prove a bad faith failure to appeal despite a policy which was weighted heavily in the insurer's favor. The contract gave the insurer the choice of either paying the insured the policy limits and not providing any defense at all, settling the suit as best it could, or defending the suit. The insurer chose to defend but was unsuccessful. A judgment resulted which was four times the policy limits, but it refused to appeal in spite of this excess judgment. The court cited the following as proof of bad faith in this refusal to appeal: (1) the failure of the insurer to settle for the policy limits before the trial left the insured liable for the excess judgment; (2) the insurer refused to indemnify the insured for the policy limits, despite its refusal to appeal, until the insured had satisfied the entire judgment against him—an acceptance of this offer would have destroyed any right which the insured had to appeal; and (3) there was "a good ground of appeal."36 All these elements added together led the court to the determination that the insurer had left the insured in a perilous situation for which it was largely responsible. Thus, the court invoked the "implied obligation of good faith and fair dealing not expressed in the terms of its written contract,"37 in order to protect the insured. Similarly, the Lincoln Park case involved an insurer's interference with an insured's opportunity to appeal. The court found that the insurer acted in bad faith when it failed to notify the insured that a judgment had been rendered against it, that an appeal was possible, and that the insurer chose not to appeal.38 Ironically, the insurer had requested and had been granted leave to appeal, but it never informed the insured of this. The court found this disregard for the insured's interests to be not only bad faith but also a breach of the duty to defend.

33 Id. at 363.
34 210 N.Y. 235, 104 N.E. 622 (1914).
36 210 N.Y. at 241, 104 N.E. at 624.
37 Id. at 242, 104 N.E. at 624.
38 287 Ill. App. at 538-39, 5 N.E.2d at 781.
In analyzing the bad-faith standard, then, courts have chosen to look to the overall relationship of the insurer and insured or to the effect of the insurer's specific actions upon the insured. There has generally been no talk of intent to deceive despite the lip service paid to fraudulent actions as an element of bad faith; instead, the courts have characterized the insurer's actions as bad faith when they felt equity and fair dealing demanded it.

In contrast to the bad-faith standard, courts using the reasonable grounds for appeal approach must look ideally not to the actions of the insurer but to the facts and substantive law of the case. This concept is so new that methods of approach have not been established by the cases. An example of the reasoning to date is the case which firmly rooted this approach into New York law, Kaste v. Hartford Accident & Indemnity Co. In this case the insured was suing for the reasonable costs of an appeal which the insurer had refused to take and which, as a result, the insured prosecuted on his own. Surprisingly enough this court went directly to the main issue involved and ignored the duty to pay versus duty to defend controversy. Despite this neglect, the court unequivocally held that "the covenant to defend embraces the duty to prosecute an appeal from a judgment against an insured 'where there are reasonable grounds for appeal.'" Furthermore, since the insured had taken an appeal on his own and won, the court considered this conclusive proof that the appeal was reasonable. As a result, no standards were delineated by which to judge "reasonableness," nor was any analysis made of the fact situation. The New York cases following Kaste have not had occasion to offer much assistance in this regard, and Ursprung, the Kentucky case, followed Kaste boldly and blindly without analysis of any sort. Some of the effects this standard will have and the questions it will present to Kentucky and other jurisdictions adopting it are evident, and this will be the topic of the next two sections.

V. Remedies and Proof of Damages Under Both Standards

An insured, faced with an insurer who refuses to appeal an excess judgment, has three avenues of approach by which to remedy the situation: (1) he can appeal on his own and, if he wins, sue the insurer for the costs of the appeal; (2) he can appeal on his own and, if he loses, sue the insurer for the costs of the appeal plus the amount of excess over the policy limits; or (3) he can let

40 The court did not relate enough facts for the reader to determine whether the insurer claimed that indemnification negated the duty to defend. But it is possible, even if it was an issue, that the court felt that Goble and Grand Union (see note 12, supra) had settled the controversy in New York.
41 5 App. Div. 2d at 204, 170 N.Y.S.2d at 616.
42 5 App. Div. 2d at 204-05, 170 N.Y.S.2d at 616:
The successful prosecution of the appeal is conceded in the respondent's answer. In the light of the result of the appeal, it would seem that the issue relative to the presence of reasonable grounds for appeal has been determined.
Injury to the insured flowing from respondent's failure to prosecute the appeal is demonstrated by the direction for a new trial consequent on the appeal prosecuted by the insured.
the time allowed within which an appeal must be perfected to pass and sue the insurer immediately for the excess judgment. Under both the bad faith standard and the reasonable grounds standard, alternative number one offers the insured the best hope of success. The difference between the two standards, however, surfaces when one considers the weight to be given a victory by the insured when he appeals on his own behalf. Brassil, a bad-faith case, refused to hold that the obligation to defend necessarily encompasses a duty to appeal, but found the insured's appeal victory to be an important element in the bad-faith formula. The victory by itself would not have been enough to maintain the suit, however. On the other hand, as evidenced by Kaste, the reasonable-grounds standard makes such a victory on appeal conclusive proof that the insurer failed in its duty to defend. It is logical that a bad-faith jurisdiction require a larger quantum of proof in order to sustain the suit since the insurer, while exercising a good-faith judgment, could still anticipate the risks and costs of an appeal, even with reasonable grounds, to be prohibitive.

If the insured loses an appeal, his chances of recovering under the bad-faith standard diminish considerably. It is difficult to prove bad faith when an appellate court has denied the claim which the insured had wanted the insurer to appeal. Furthermore, courts are hesitant to enter judgments for the excess unless they can find that bad faith was in evidence throughout the entire trial. The Hawkeye case offers this rationale:

In some of the cases finding liability for failure to take an appeal, the fact that the appeal was successful was alluded to as a fact to take into consideration. While we do not feel that the result of an appeal has a bearing on the question of good or bad faith, the result of this appeal tends to indicate that the Company's judgment as to the possible result of an appeal was sounder than was that of its attorney.

Under the reasonable-grounds standard, however, losing on appeal should not affect the insured's claim against the insurer to such a great extent. Ideally, a court applying this standard should realize that reasonable appeals do not always prove successful. A case holding in favor of an insured and applying this logic is Cornwell v. Safeco Insurance Co. of America. Although the insured's appeal was unsuccessful, the court found that the insurer's attorneys had been so negligent at the trial court that the insured's chances of winning on appeal were greatly diminished. Thus the court felt that the insured's loss on appeal should not adversely affect their decision of whether there were reasonable grounds for appeal.

Since the appeal by Cornwell and Ross was lost not on the merits of their

44 The reasoning of the courts appears to follow the same lines when the insurer brings a declaratory judgment suit seeking to establish that it need not appeal or need not pay the costs of an appeal already taken by the insured. In this situation, the insured will usually counterclaim for damages caused by the insured's failure to appeal and thus the insured will be confronted with one of the alternatives heretofore set out.
45 See text accompanying note 36 supra.
46 See note 42, supra.
47 260 F.2d at 364.
substantive arguments but due to strategic and tactical errors made by trial
counsel as a result of his conflict of interests, for which they were not respon-
sible, the court was correct in ruling that the expense of such appeal was
occasioned by Safeco’s actions and that Cornwell and Ross should have
recovery for their expenses.49

The *Cornwell* court’s approach to the reasonable-grounds standard, looking into
all aspects of the appeal before deciding reasonableness, negates some of the
stigma resulting from a loss on appeal; and, if followed in any other jurisdictions
applying this standard, would give great advantages to their insureds over the
bad-faith approach.

The third alternative, suing the insurer without taking an appeal at all, is
the least desirable from the insured’s point of view under the bad-faith standard
since he has little upon which to base his proof of damages. In addition to being
uncertain about how the case would have gone on appeal, the insured also has
no expenses of appeal to claim.50 A few older cases have held that without an
appeal the insured cannot prove any damages because it is not known to what
extent he was injured, if at all.51 Also, with no appeal record before them, the
courts find it difficult to judge the soundness of the insured’s denial to appeal
(an element in a determination of whether the insured acted in bad faith). De-
spite these impediments, though, the insureds in *Lincoln Park* were able to get
a judgment without appealing; but this case can be distinguished because it was
the bad-faith actions of the insurer which denied the insured the opportunity to
appeal.52 In general, the courts applying the bad-faith standard are reluctant
to render a judgment for the insured in this situation.

Although no cases have been decided which are directly on point, it can
be surmised that an insured choosing this third alternative would present a rea-
sonable-grounds court with a dilemma. In theory, a court should be able to as-
certain whether there were reasonable grounds for appeal without the benefit
of a record of an appeal actually taken. If reasonable grounds are found, it
would seem that the insured has a valid claim for any amount exceeding the
policy limits in the trial court judgment since not appealing when there are rea-
sonable grounds is tantamount to a breach of the contract to defend. In addition,
a court in this situation, after determining that there were reasonable grounds
for appeal, would be hard put to hold that the damages were speculative since
reasonable grounds for appeal implies the probability of success on appeal. Thus
a favored escape route of the bad-faith courts disappears. Courts may find this
to be an inequitable result in light of the facts that the insured has taken no
action to vindicate his rights and that the insurer has not seriously prejudiced
him. A possible approach that courts might consider taking would be to require
a showing of bad faith in this situation and only apply the reasonable-grounds

49 *Id.* at —, 346 N.Y.S.2d at 72.
50 See Gavin, *supra* note 11, at 108: “It should be noted that it is, as the Insureds in
*Whipple* discovered, more difficult to bring a claim against an insurance company when no
appeal has been taken and the expenses claimed are all speculative than where an actual appeal
has been taken by the insured on his own behalf.”
52 See text accompanying note 37 *supra*. 
standard when the insurer has taken action on his own. In effect, the insurer would benefit by a presumption of fair dealing when the insured refuses to act responsibly. Until some cases are forthcoming, however, the practical effect of the reasonable-grounds standard upon this situation remains uncertain.

A fourth alternative, not previously mentioned because its effect would be to render the same result in both bad-faith and reasonable-grounds jurisdictions as far as the insured is concerned, is an assignment of the cause of action for the failure to appeal by the insured to the trial court plaintiff in satisfaction of the excess judgment. Such a tactic would not prevent the courts from hearing the questions discussed previously since the assignee will now present them, but it can be a valuable tool for negating any injury to the insured caused by the failure to appeal. In *Ursprung*, Clark's lawyer-friend effectively employed this device and saved Clark the burden of a costly suit against the insurer. Furthermore, despite protestations of the insurers, there is precedent for this device among cases allowing assignment of a cause of action for the failure of an insurer to defend at all.

After a loss has occurred and rights under the policy have accrued, an assignment may be made without the consent of the insurer, even though the policy prohibits assignments. Under such circumstances, the assignment of a right under the policy is not regarded as a transfer of the policy itself, but rather of a chose in action.

Some courts have gone so far as to allow prejudgment assignments coupled with covenants not to execute upon judgment to stand as long as no evidence of collusion is shown. Analogously, the assignment of a cause of action for the failure to appeal should not present any problem in enforcement.

There are two factors which might make a victorious plaintiff unwilling to accept such an assignment. The first is exemplified in *Ursprung*. When Clark's lawyer-friend told the insurer that there was no need to appeal because he had other means to protect his client, he effectively destroyed the possibility of the assignee recovering from the insurer. Despite the Kentucky court's willingness to accept standards more favorable to the insured's assignee, the court was forced to consider the lawyer's actions to be a release from the duty to appeal. Secondly, since assignment would be effected in lieu of an appeal, the assignee would have the worst chance of succeeding under both standards (alternative number three). The possibility of an inadvertent release and the difficulty of proving damages, then, may deny an insured this alternative; but if there is a real probability that the entire judgment would be overturned if the insured appealed, as in *Ursprung*, it may still be the least costly and most efficacious route for both the plaintiff and the insured.

The insured, then, has several possibilities for obtaining a remedy when confronted with an insurer who refuses to appeal. His best opportunity for succeeding, under both standards, comes when he appeals on his own and either

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53 497 S.W.2d at 727.
57 497 S.W.2d at 731.
has the judgment reversed or reduced to within policy limits. Despite this one similarity between the standards, though, an insured gains considerable advantages when the court applies the reasonable-grounds criterion: his burden of proving a breach of contract and damages is reduced, and he benefits from a conclusive presumption of reasonableness whenever he wins on appeal. The essential difference between the standards in this regard, the difference which benefits the insured, is revealed when one looks at the nature of the two standards: the bad-faith standard imposes liability upon the insurer only after proof that he has not done something, i.e., act in good faith, while the reasonable-grounds standard imposes this same liability upon the insurer if facts exist which make its action mandatory. It is the difference between negative proof (proof that he did not do something) and affirmative proof (proof that he should have done something), and this difference is vitally important.

VI. Conclusion: Old Problems and New Standards

A court applying this new standard may be plagued by an argument which has been advanced whenever courts have been asked to impose a duty to defend: (1) after the policy limits have been exhausted or (2) when it is uncertain whether the injury alleged falls within policy coverage. Insurers confronted with one of these situations often claim that causing an insurer to control litigation after it no longer has an interest in the outcome is unsound and may be an unlawful exercise of the corporate practice of law. This argument has been refuted by Professor Keeton and other commentators, and it has been suggested that, at the very least, insurers could be required to pay for the services of independent attorneys if they felt themselves too disinterested. Perhaps the best response to the insurance company's position is found in Mead Corp. v. Liberty Mutual Insurance Co.: The argument that the insurance company has no further pecuniary interest in the outcome of the litigation because it has paid out the policy limits is erroneous, because it is also obligated to fulfill its other obligations for which it received a premium payment. To contend that it would not be to the best interests of the insured to leave his defense to the insurance company and counsel chosen by it after the company had ceased to have a pecuniary interest in the indemnity aspects of the case, and that such a defense might in that event be carelessly or frivolously handled, would be a reflection on the insurance industry and the counsel who represent them. Attorneys, whether or not paid by insurance companies, owe their primary obligation to the insured they are employed to defend, and the insurance company likewise owes to its insured the duty to provide competent investigative and legal representation. In furnishing this, the insurance company is not itself "practicing law".

59 R. Keeton, supra note 1, at 480.
60 Gavin, supra note 11, at 110.
62 Id. at 171, 129 S.E.2d at 165. This case was reversed by the Supreme Court of Georgia (see text accompanying notes 16, 17 & 18, supra) but that court made no mention of the corporate practice of law question.
Another problem may surface if the insured prosecutes an appeal on his own behalf without checking to ascertain the insurer's position with respect to continuing the defense of the action. In most liability insurance contracts the duty to defend incorporates the notion that the insurer has complete control of the defense at all times. Thus an insured who prosecutes an appeal or files an appeal and then settles before the appellate court's decision may be charged with breach of contract. This problem is familiar in cases involving settlement issues, and it could frustrate an insured's remedy in this situation as well. It is best, then, as the insured in Ursprung did, to wait for notice from the insurance company before filing an appeal or seeking a postjudgment settlement.

If an insured can avoid these two problems, any court should be able to see its way clear to enforcing a reasonable-grounds standard. In this age of increasing judgments, this may be a method for courts to implement a desired public policy, i.e., exposing insureds to as few excess judgments as possible by requiring the insurer to exercise reasonable care in protecting the interests of its insureds at all times. In addition, it may provide the insured with a service he thought he was paying for all along—a complete defense. The 1966 revision may hold the key to the future of this area since if interpreted literally it could force a perpetuation of the bad-faith standard. The meaning of bad faith could be expanded by some courts, of course, to incorporate some of the elements of the reasonable-grounds standard and this may be a sufficient compromise protecting both insurer and insured. With the recent resurgence of interest in consumer affairs, though, the reasonable-grounds standard would seem to be the standard for the future. Insurers should recognize that a more expansive definition of the duty to defend, despite the 1966 revision, may be just around the corner. "It may be safer for the Co. to carry an excess judgment on to a final appeal, thus establishing that everything possible was done to protect the interests of the insured.""