THE ENFORCEABILITY OF RELEASES IN PROPERTY INSURANCE CLAIMS

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This article discusses the contexts in which disputes arise over the execution of liability releases by the property holder in the course of settling property loss claims. The article analyzes two conflicting interpretations of these disputes, each of which yields a markedly different result. The article explains the nature of this conflict, rooted in principles of contract law and insurance law, before outlining the arguments favoring full indemnification for the claimant and the counter arguments for the insurer in seeking to avoid additional liability. Put another way, the public policy interest in the full payment of insurance claims is pitted against the insurer's interest in the final resolution of disputes. The article concludes by siding with the claimant in arguing that most releases, should they be deemed enforceable, actually encourage improper claim practices and, as such, should be held unenforceable as a matter of public policy.

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A property owner suffers accidental damage to its property and makes a claim for the loss under its insurance policy. The insurance company sends an adjuster to determine whether the loss is covered, scope the damage, and estimate the cost of repair. The adjuster and the owner inspect the property and discuss the issues, perhaps with the assistance of experts. The adjuster offers an amount to settle the claim and the owner accepts payment of that amount. In some but not all cases, the adjuster may ask or require the owner to execute a release as a condition of payment. Subsequently the owner discovers that the assessment of the loss at the time payment was made failed to account for all of the damage for which it was entitled to indemnity under the policy. The owner files a claim with

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the company for additional compensation, and the company proffers the release as a defense to any further liability. Is the company obligated to pay, or does the release bar any further claim?

The answer to this question illustrates a common situation in insurance law. The answer begins with an ordinary contract law doctrine—the pre-existing duty rule. But insurance law is not simply contract law,[1] and the application of the pre-existing duty rule implicates two potentially conflicting policies and two different interpretations of the underlying facts. The nature of insurance is to provide full compensation for covered losses, which favors the owner's further claim, but the public policy favoring the final resolution of disputes and the enforcement of settlements agreed to favors the company's attempt to enforce the release. Which of these policies is most salient in a particular case depends on whether the process yielding the payment is seen as part of the fluid process of adjusting the claim, in which case the process is not final at the point of payment and the release is not enforceable, or as the resolution of a dispute about the amount the company owes, so that the release is binding.

This article discusses the contexts in which disputes such as this arise and the rules and policies that determine whether and when releases in those contexts are enforceable. Part I of the article explains the process of adjusting property losses and how releases are sometimes used in that process. Part II discusses the application of the pre-existing duty rule to this process. The rule makes a release ineffective unless it is given as part of the resolution of a good faith, genuine dispute between insurer and insured; in the ordinary case of adjusting a loss there is no good faith, genuine dispute so a release is unenforceable. Part III addresses issues of public policy. It concludes that the application of the pre-existing duty rule to releases in ordinary property loss adjusting situations is supported by the strong public policy favoring the payment of insurance claims in full, and the public policy favoring the settlement of disputes is not relevant in those situations.

I. RELEASES IN PROPERTY INSURANCE CLAIMS

When an insured under a homeowners' policy or other property policy suffers a loss potentially covered by the policy, the formal steps in

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[1] "What do they know of the law of the insurance contract who only the law of contract know?" EDWIN H. WOODRUFF, SELECTION OF CASES ON THE LAW OF INSURANCE 5 (2d ed. 1924).

adjusting the loss are outlined in the policy itself. Under the HO-5 homeowners' policy, for example, the policyholder must give the company prompt notice of the loss, keep an accurate record of any repair expenses, cooperate in the investigation of the claim, prepare an inventory of and document the loss of personal property, submit to an examination under oath, and submit a proof of loss.[2] The company may not require the policyholder to perform every duty in every case, such as submit to an examination under oath, and other duties may be required in particular circumstances, such as reporting a theft loss to the police. The company has fewer specified duties in the event of loss. If the parties fail to agree on the amount of loss, either may demand an appraisal to which the other party must submit.[3] Ultimately, the company has a duty to pay for a covered loss within sixty days of agreement with the policyholder, appraisal, or judgment.[4]

The formal steps outlined in the policy are only the skeleton on which the body of property loss adjusting is constructed. Once the policyholder reports a loss, the policyholder and the company jointly embark on a process of investigating and verifying the facts of the loss and the extent of coverage for it.[5] Investigating the facts and verifying the loss in turn require determining the scope of damage and pricing the costs of repair or replacement.[6] The policyholder may be assisted in the process by a public adjuster or an attorney, and the company may be represented by its own claims personnel or an independent adjuster. Either or both parties may call on contractors, engineers, or other experts to provide technical assistance in scoping and estimating the claim, and on lawyers in interpreting the policy.

Sometimes the policyholder and company are unable to reach a satisfactory resolution of the claim and litigation ensues. In the overwhelming majority of claims, however, the parties arrive at a mutual understanding on the extent of the covered loss and the amount needed to indemnify the policyholder, and the insurance company pays the claim. The company may simply pay the claim or it may accompany the payment

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[2] *Homeowners 5 – Comprehensive Form*, NEV. DEP'T OF INS. 13 (1999), http://doi.nv.gov/scs/HomeownersPolicyForms/HartfordForms/Hartford_HO_00_05_10_00.pdf.

[3] *Id*. at 15.

[4] *Id*.

[5] 1 PROPERTY LOSS ADJUSTING 209 (James J. Markham ed., 2d ed. 1995).

[6] 2 PROPERTY LOSS ADJUSTING 1 (James J. Markham ed., 2d ed. 1995).

with a request or demand that the policyholder execute a release, even though the policy does not require that the policyholder execute a release as a condition of payment.

In many cases, the amount paid to the policyholder is sufficient to effect repair or replacement, no further damage is discovered, and the insurance policy has served its purposes of easing the burden of financial loss and providing peace of mind for the insured. In some cases, however, after the time when initial payment is made on the claim, the insured discovers damage that was not apparent earlier, the extent of damage is greater than previously understood, or the amount paid is insufficient to effect repair or replacement. Then the insured may go back to the company and ask for a further amount due under the policy. The company may recognize the validity of its further obligation and pay an additional amount, or it may refuse and, in instances in which it has received a release along with its payment, proffer the release as a bar to the further claim.

It is difficult to document when a release is demanded as a condition of payment of claim and when payment is made without a release. Certainly not all companies demand releases on payment of every claim. Anecdotally, practitioners report that requiring releases has become more common and that they tend to be used more often by some companies than others, in larger claims, and following catastrophes. It is clear that they are used in some large claims, and when they are used, they are sweeping. The language can be simple, framed as a receipt with broad language of release:

> Received from Hartford Ins. Co. the sum of $763,066.67 in full payment, release and discharge of all claims or demands against the said Company, arising from or connected with any loss or damage on or to Building & Loss of Rents at 5601-5611 Georgia Ave., N.W., Washington, D.C., Property Owned by GLM Partnership which loss or damage arose or occurred on or about the 5th day of August 1993.[7]

Or it can be more detailed:

> For and in consideration of the total sum of [$149,203.16 paid to plaintiffs, plaintiffs] forever compromise, release,

[7] GLM P'ship v. Hartford Cas. Ins. Co., 753 A.2d 995, 998 (D.C. App. 2000).

> acquit, and discharge General Star Indemnity Company . . . from any and all claims [plaintiffs] ha[ve] or may have against the Released Parties under General Star Indemnity Company Policy Number IAG360043 . . . whether for building or contents loss or damage, or any other insured and covered loss and damages . . . and any and all other claims and damages of whatsoever kind or nature without limitation whatsoever arising out of the application for insurance, the binding of insurance, the issuance of a policy of insurance, the policy of insurance itself, or out of the hail storm and resulting loss and damage to the aforesaid insured premises and property located thereon, which occurred on or about January 23, 2000 ("the Incident"), as well as of and from any and all claims arising out of the claim itself . . . and, indeed, any and all other claims resulting from, related to, or arising out of or arising from said hail storm whether known or unknown, and whether they have occurred or may occur or become manifest at some future date, without any limitation whatsoever.[8]

The release may be general, as above, or it may specifically address the possibility of undiscovered losses:

> [T]he undersigned hereto understand and acknowledge that they may discover facts different from, or in addition to, those which they now know or believe to be true with respect to the subject matters encompassed by this Release, and agree that this Release shall be and remain effective in all respects notwithstanding any subsequent discovery of different and/or additional facts.[9]

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[8] Tulane Prop., Ltd. v. Gen. Star Indem. Co., No. Civ. A. 02-2020, 2003 WL 1824705 (E.D. La. 2003).

[9] Bonita Villas Condo. Ass'n, Inc. v. Empire Indem. Ins. Co., No. 09-21887-CIV, 2010 WL 2541763, at *1 (S.D. Fla. June 23, 2010). California law expressly authorizes the waiver of future claims in a release. CAL. CODE. REGS. tit. 10, § 2695.4(e)(2) (2013). Following Hurricane Andrew, the Florida insurance department "request[ed] that insurers limit the use of general releases to those settlements for which they are appropriate, and insert in said releases language to

Whether the language of the release is general or specific, concise or florid, the fundamental question faced by policyholders and insurers when the subsequent claim arises is whether the release is enforceable. The determination of enforceability rests not on the language of the release but on the law as applied to the context in which the release is executed.

II. THE PRE-EXISTING DUTY RULE

The fundamental principle governing the enforceability of a release is an ordinary rule of contract law—the pre-existing duty rule. The pre-existing duty rule states, "[p]erformance of a legal duty owed to a promisor which is neither doubtful nor the subject of honest dispute is not consideration."[10] Under the rule, a release is effective if the releasing party (here, the policyholder) agrees to accept a payment in full satisfaction of its claim and therefore to release the released party (the insurance company) from any further obligation to pay; the consideration for that promise is the company's payment and its own agreement not to assert that it has an obligation to pay less than the agreed amount.

A different doctrinal approach is to treat the execution and performance of the release as an accord and satisfaction. A release satisfies an existing contractual obligation. An accord and satisfaction, by contrast, substitutes a new obligation for the existing obligation under the original contract; the promise to pay is the accord and the payment itself is the satisfaction.[11] The law on the enforceability of an accord and satisfaction is the same as the consideration analysis. The difference in treatment is only relevant where the parties arguably have agreed to a compromise payment but the compromise has not actually been paid, and that situation rarely arises.[12]

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the effect that the release shall not constitute a final waiver of claims which are reasonably unforeseen on the date of the release." Fla. Information Bulletin 93-005, 1993 WL 13545478 (Mar. 24, 1993).

[10] RESTATEMENT (SECOND) OF CONTRACTS: PERFORMANCE OF LEGAL DUTY § 73 (1981). *See also* 66 AM. JUR. 2D *Release* § 11 (2013); 46A C.J.S. *Insurance* § 1881 (2013). For examples of the rule's use in insurance cases, see, for example, *Keller v. State Farm Ins. Co.*, 536 N.E.2d 194, 198 (Ill. App. 1989) (property insurance settlement) and *Hoffman v. Geico Ins. Co.*, 347 Fed. Appx. 295, 296-97 (9th Cir. 2009) (underinsured motorist insurance).

[11] *See* E. ALLAN FARNSWORTH, CONTRACTS § 4.24 (4th ed. 2004).

[12] Different still are the cases in which the insured executes a release and subsequently sues the insurer for fraud in connection with the claim payment.

Accordingly, the policyholder's promise to release the company from any further obligation is not supported by consideration if it is only given in return for the company paying something that it already owes under the policy. This result is an application of the oldest instance of the pre-existing duty rule, first announced by Lord Coke in *Pinnel's Case*[13] in 1602 and enshrined in the doctrine of consideration in 1884 by the House of Lords in *Foakes v. Beer*.[14]

Under the pre-existing duty rule, a release is enforceable only if two conditions are met: First, the company's promise to pay and subsequent payment is not the performance of a duty it already owes under the policy. Second, the company's obligation to pay the amount promised is doubtful or the subject of an honest dispute (i.e., if it is a good faith dispute). Conversely, the release lacks consideration and is unenforceable if the company's promise to pay and subsequent payment is only the performance of a duty it already owed under the policy, or if the company's obligation to pay the amount promised is neither doubtful nor the subject of an honest dispute (i.e., if it is not a good faith dispute).

Many early cases applied the doctrine to cases involving life insurance policies, dealt with under doctrines of release, accord and satisfaction, or surrender and rescission.[15] Results variously favored insurers and policyholders, but courts consistently adhered to the requirement that there be a genuine dispute to make a release enforceable. In *The Praetorians v. Taunton*, for example, the Florida Supreme Court applied the pre-existing duty rule to render ineffective a release where the life insurance company had paid the beneficiary less than the value of the policy.[16] Where "the amount due under the terms of the policy has been paid and a receipt delivered and received acknowledging receipt in full and release of the balance due," the release was enforceable only if there was a

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Some courts require rescission of the release and return of the payment prior to the bringing or the successful conclusion of the fraud action. *See* Vill. Northridge Homeowners Ass'n v. State Farm Fire & Cas. Co., 237 P.3d 598 (Cal. 2010).

[13] Pinnel's Case, (1602) 77 Eng. Rep. 237; 5 Co. Rep. 117a ("Payment of a less sum on the day in satisfaction of a greater, cannot be any satisfaction for the whole.")

[14] Foakes v. Beer, [1884] 9 H.L. 605 (Eng.).

[15] *See* Note, *Role of the Check in Accord and Satisfaction: Weapon of the Overreaching Debtor*, 97 U. PA. L. REV. 99 (1948).

[16] The Praetorians v. Taunton, 160 So. 676, 676-677 (Fla. 1935).

dispute, as where there was a "valid foundation" or "bona fide cause" for the insurer's denial of liability "in good faith."[17]

Even where courts focused in a relatively formal manner on the presence of an agreement to release claims, a dispute was required. In *Lehaney v. New York Life Insurance Co.*, for example, the insurer disputed whether the insured had died from an accident, which would have entitled the beneficiary to double indemnity, or partly from illness, in which case only the face amount of the policy would be due.[18] The Michigan Supreme Court focused on the beneficiary's endorsement of checks that stated "in full settlement of all claims" as resolving the issue, although it noted that that result would follow only if there was a bona fide dispute resulting in an unliquidated claim.[19]

A. THE DUTY OWED

The first step in determining the enforceability of a release is to determine what duty the company owes under the policy, because performance of a duty owed fails to provide consideration for a release. In many respects this issue is tied into the second—whether the claim is doubtful or the subject of an honest dispute. But there is the independent issue of the company's obligation to pay even if it does not receive a release from the policyholder.

An insurance company's basic obligation is to pay a claim within the terms of the policy. A company could expressly condition its obligation to pay on receipt of a release from the insured, but policies typically do not do so. The standard homeowners' policies, for example, in their statement of "Conditions," includes duties of the policyholder such as giving written notice of an occurrence and filing proof of loss, but they do not require the execution of a release as a condition of payment.[20]

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[17] *Id*.

[18] Lehaney v. New York Life Ins. Co., 11 N.W.2d 830 (Mich. 1943). *See also* Woodbery v. New York Life Ins. Co., 227 N.Y.S. 699 (App. Div. 1928).

[19] *Lehaney*, 11 N.W.2d at 832. *See also* Hallmark v. United Fid. Life Ins. Co., 286 S.W.2d 133 (Tex. 1956) (reviewing authorities).

[20] *E.g.,* INS. SERV. OFFICE, HOMEOWNERS 3 – SPECIAL FORM 20-21 (1999), *available at* http://doi.nv.gov/scs/HomeownersPolicyForms/HartfordForms/Hartford_HO_00_03_10_00.pdf; INS. SERV. OFFICE, HOMEOWNERS 5 – COMPREHENSIVE FORM 21 (1999), *available at* http://doi.nv.gov/scs/HomeownersPolicyForms/CSAAForms/AAA_HO_00_05_10_00.pdf.

That a policy's express terms do not condition the company's duty to pay on the execution of a release also prevents the interpretation of the policy to imply such a condition. The policy expressly states that the policyholder must take several defined steps in pursuing a claim, such as giving notice of an occurrence, filing a proof of loss and, in the event of dispute over the value of a loss, submitting to appraisal. A fundamental maxim of interpretation is e*xpressio unius est exclusio alterius*—"the expression of one is the exclusion of others." The specification of certain requirements in the policy drafted by the company excludes by implication any other requirements.

The law of tender provides a useful analogy. A tender is an unconditional act made to satisfy an obligation or a condition, distinguished from a proposal, which is a conditional offer. The tenderer is under an obligation to render performance without condition; for example, if a tender of payment is accompanied by a demand for a release or even for a receipt, it is ineffective.[21] The Nebraska Supreme Court applied the analogy to an insurance case, stating,

> As there is no affirmative provision therein which expressly or by necessary implication requires the execution of a receipt in full by the assured on payment of a loss under the terms of the policy, no such requirement may be lawfully exacted. The demand for a "receipt in full" relied upon in the instant case was wholly unsupported by the agreement or by authority of law.[22]

This understanding of the company's duty to fully pay a claim demonstrates the error made by a few courts in regarding the payment as a choice among alternatives that satisfies the requirement of consideration. In *GLM Partnership v. Hartford Casualty Insurance Co*., for example, the court found consideration for a release because the policy gave the insurer the option in the event of loss to either (1) Pay the value of lost or damaged property; (2) Pay the cost of repairing or replacing the lost or damaged property; (3) Take all or any part of the property at an agreed or appraised value; or (4) Repair, rebuild or replace the property with other property of like kind and quality.[23]

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[21] 86 C.J.S. *Tender* § 26 (2013).

[22] Jensen v. Lincoln Hail Ins. Co., 249 N.W. 94, 98 (Neb. 1933).

[23] 753 A.2d 995, 1000 (D.C. Cir. 2000) (citation omitted).

Hartford's choice to pay the claim under option (1) and to forgo the other means of satisfying its obligation was held to provide consideration for the policyholder's promise to release further claims. The court cited in support the revision of *Corbin on Contracts*, which states the rule about choosing among alternative performances as consideration.[24] But the finding of consideration and the citation are inapt. Choosing among alternative performances provides consideration only where the performance rendered fully satisfies the duty chosen. The treatise offers the example of a contract under which A is bound to deliver either a specified car or truck to B; the delivery of the car instead of the truck is consideration for B's promise to pay additional compensation. If A delivers a car that does not conform to the contract, however, its choice to forego delivering the truck is not consideration. Similarly, an insurance company's choice to pay rather than to actually repair is consideration only if the payment constitutes all that actually is due under the policy.

The insurance company also is obligated to pay without demanding a release because of its duty to perform under the policy in good faith. It is axiomatic that there is a duty of good faith implied in every contract including, of course, insurance contracts.[25] In most jurisdictions

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[24] *Id.* (citing 2 JOSEPH PERILLO & HELEN BENDER, CORBIN ON CONTRACTS § 7.12 (rev. ed. 1995)) ("If one has an option between two performances, the giving up of this option, or the exercise of it in one way rather than the other, is consideration for a return promise given in exchange. If one has the privilege of performing in one way rather than another . . . the forbearance to exercise the privilege . . . can be consideration.")

[25] An early case is *Brassil v. Maryland Casualty Co.*, 104 N.E. 622 (N.Y. 1914); leading third-party and first-party cases declaring the principle are *Gruenberg v. Aetna Insurance Co.*, 510 P.2d 1032, 1038 (Cal. 1973), and *Anderson v. Continental Insurance Co.*, 271 N.W.2d 368, 375 (Wis. 1978). Statutory statements of the obligation include COLO. REV. STAT. § 10-3-1113 (2006) ("In any civil action for damages founded upon contract, or tort, or both against an insurance company, the trier of fact may be instructed that the insurer owes its insured the duty of good faith and fair dealing, which duty is breached if the insurer delays or denies payment without a reasonable basis for its delay or denial."); LA. REV. STAT. ANN. § 22:1220 (A) (2007) ("An insurer, including but not limited to a foreign line and surplus line insurer, owes to his insured a duty of good faith and fair dealing."); WASH. REV. CODE ANN. § 48.01.030 (West 2012) ("The business of insurance is one affected by the public interest, requiring that all persons be actuated by good faith, abstain from deception, and practice honesty and equity in all insurance matters. Upon the insurer, the insured, their providers,

there is a cause of action for bad faith breach of an insurance contract, and the cause of action may lie in contract or tort or as a statutory remedy. But that cause of action is only a particular product of the general duty of good faith. The general duty is broader in scope although it provides narrower remedies.[26] The obligation of good faith both gives content to the express terms of the contract and supplies terms omitted from the contract.

The most egregious violation of the obligation of good faith is opportunistic behavior.[27]

Opportunism is typically defined as taking selfish advantage of circumstances without regard for principle or prior commitment, such as the commitment made by contract.[28] In entering into a contract, a party limits its future freedom of action in exchange for the benefits it receives under the contract. A deliberate attempt to retain those benefits while avoiding the limits on its own freedom violates the essential nature of the contract.[29] One device for operationalizing this approach is the hypothetical contract; the good faith obligation is "a stab at approximating the terms the parties would have negotiated had they foreseen the circumstances that have given rise to their dispute."[30]

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and their representatives rests the duty of preserving inviolate the integrity of insurance.").

[26] The damages available for breach of the good faith obligation are ordinary contract damages and therefore do not include such items as emotional distress, attorneys' fees, and punitive damages, and, for insurance contracts, may not even include consequential damages. In the release cases, the typical remedy will be the amount to which the policyholder is entitled under the policy, which constitutes the general expectation damages. The difference in remedy is both a disadvantage and an advantage to the policyholder; it is a disadvantage because the potential recovery is less, but it is an advantage because the cause of action can be brought without regard to the procedural and substantive restrictions on the bad faith cause of action. *See* Jay M. Feinman, *The Law of Insurance Claim Practices: Beyond Bad Faith*, 47 TORT TRIAL PRACTICE & INS. L.J. 693 (2012).

[27] *See* Market St. Assocs. v. Frey, 941 F.2d 588, 595 (7th Cir. 1991) (Posner, J.) ("The office of the doctrine of good faith is to forbid the kinds of opportunistic behavior that a mutually dependent, cooperative relationship might enable in the absence of rule.").

[28] *See* Oliver E. Williamson, *Opportunism and its Critics*, 14 MANAGERIAL & DECISION ECON. 97 (1993).

[29] Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 373-78 (1980).

[30] *Mkt. St. Assoc.*, 941 F.2d at 595.

Therefore, the use of a release most clearly violates the duty of good faith when it arises from a deliberate attempt to avoid the company's obligation to pay what it owes. At the moment it sold the policy, the company defined the extent of its obligation by the terms of the policy; it is a violation of good faith to attempt to recapture the opportunity to pay less than it owes by demanding and enforcing a release. The parties surely would not have agreed that the company could use the release in such a way to avoid its obligations. If the company demands or enforces a release with the intent of limiting its obligation to a policyholder, either in an individual case or as part of a general scheme, it is not performing in good faith.

More broadly, an insurer's use of a release violates the duty of good faith if it is not in accord with the reasonable expectations of the policyholder. As the Restatement (Second) of Contracts states in an approach to good faith that has been widely adopted, "Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party."[31]

The most fundamental expectation of a policyholder is that if a loss occurs, the insurance company will pay what it owes under the policy, no more but no less.[32] Companies present themselves on this basis; among the iconic slogans of American advertising are expressions of this expectation—Allstate's "You're in good hands with Allstate" and the image of cradling hands, State Farm's "Like a good neighbor, State Farm is there," and Nationwide's promise, represented by a security blanket, that "Nationwide is on your side." Therefore, as courts have recognized, in acting on a claim the company has an "almost adjudicatory responsibility. The insurer evaluates the claim, determines whether it falls within the coverage provided, assesses its monetary value, decides on its validity and passes on payment."[33]

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[31] RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (2012).

[32] "Insureds buy financial protection and peace of mind against fortuitous losses. They pay the requisite premiums and put their faith and trust in their insurers to pay policy benefits promptly and fairly when the insured event occurs. Good faith and fair dealing is their expectation. It is the very essence of the insurer-insured relationship." Campbell v. State Farm Mut. Auto. Ins. Co., 98 P.3d 409, 415 (Utah 2004) (quoting ERIC MILLS HOLMES, 2-8 HOLMES' APPLEMAN ON INSURANCE 2D § 8.7 (2d ed. 1996)).

[33] Rawlings v. Apodaca, 726 P. 2d 565, 570 (Ariz. 1986).

The use of a release to bar a policyholder from recovering all that it is owed under the policy violates the policyholder's reasonable expectations. If a company evaluates a claim and demands a release as a condition of its payment and the policyholder later discovers that the payment was not for the full value to which it is entitled under the policy, either through error by the company or worse, the company fails to act in good faith if it uses the release to prevent paying what it owes.

B. THE REQUIREMENT OF A DISPUTE

The second step in determining the enforceability of a release under the pre-existing duty rule is to determine whether the release was the product of an honest, good faith dispute. The pre-existing duty rule does not bar the enforcement of a release that is the product of the settlement in good faith of a genuine dispute.[34] Where the parties settle an honest, good faith dispute, each party gives up the valuable right to assert its full claim, so their subsequent performances do not constitute the performance of pre-existing duties. However, this exception only applies where there is a settlement of a genuine dispute or a doubtful claim, or where the surrendering party (here, the insurance company) has a genuine, good faith belief that the claim is doubtful, or both.[35]

The authorities differ on the precise statement of the requirements of honesty and good faith, but the core concept is that the dispute be genuine, so that the insurer is actually giving up something of value—its ability to assert a smaller obligation owed to the insured—in return for the release. *Couch on Insurance* lists several of the common formulations:

> * A dispute in good faith after a reasonable investigation.
> * An honest difference between the parties.
> * An honest doubt between the parties as to the amount due on a policy, whereupon the beneficiary accepts in full satisfaction the amount which the insurer concedes to be due.

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[34] Vasconcellos v. Arbella Mut. Ins. Co., 853 N.E.2d 571, 575 (Mass. App. Ct. 2006).

[35] *See* RESTATEMENT (SECOND) OF CONTRACTS § 73 cmt. b, § 74(1) (1981); 1 C.J.S. *Accord and Satisfaction* § 46 (2013); FARNSWORTH, *supra* note 11, §4.23; 15 LEE R. RUSS & THOMAS F. SEGALLA, COUCH ON INSURANCE §§ 215:8, :29, :31, :34, :35, 216:22 (3d ed. 2012).

> * A doubtful bona fide claim which is the subject of a bona fide dispute, and concerning which the parties are on equal footing as to knowledge or want of knowledge of the facts.[36]

All of these situations are contrasted with a case in which the dispute is "raised by the insurer in bad faith and without any reasonable ground therefor in law or fact . . . [f]or example, where the position of the insurer is attained only by asserting a legal conclusion which is manifestly wrong."[37]

The key to determining the application of the pre-existing duty rule and so the enforceability of a release in a particular case is to assess whether or not the release is the product of the resolution of a genuine, good faith dispute. This issue in turn depends on an understanding of the nature of property loss adjusting.

Courts have sometimes characterized the insurance relation as a special relationship of a fiduciary or quasi-fiduciary nature.[38] The insurance relationship is not truly fiduciary, but these characterizations emphasize that adjusting is not an adversarial relationship, but one in which the insurer must reasonably take account of the insured's interests. For example, the company must be forthcoming with information and assist the insured in processing the claim,[39] advise the insured of the coverage available and the procedure needed to invoke that coverage,[40] and assist the insured in complying with policy conditions and the insurer's requirements.[41] The company has a duty to investigate a claim adequately and objectively,[42] including to seek evidence that potentially supports a

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[36] 15 RUSS & SEGALLA, *supra* note 35, § 215:34; *see also* §§ 215:35, 215:8, 216:21.

[37] *Id.* § 215:34.

[38] *Id.* § 198:7.

[39] Bowler v. Fid. & Cas. Co. of N.Y., 250 A.2d 580, 588 (N.J. 1969).

[40] *See, e.g.*, 10 CAL. CODE REGS. tit. 10, § 2695.4(a) (2012) ("Every insurer shall disclose to a first party claimant all benefits, coverages, time limits or other provisions that may apply to the claim."); IOWA ADMIN. CODE r. 191-15.41(507B) (2012).

[41] *See, e.g.*, N.J. ADMIN. CODE § 11:2-17.6 (2012).

[42] State Farm Fire & Cas. Co. v. Simmons, 963 S.W.2d 42, 45 (Tex. 1998) (investigation must be objective and not "outcome-oriented"); Indus. Indem. Co. of the Nw., Inc. v. Kallevig, 792 P.2d 520, 526 (Wash. 1990) ("An insurer does not have a reasonable basis for denying coverage and, therefore, acts without

claim, not just evidence that favors a denial,[43] and to investigate bases for coverage even beyond those advanced by the insured.[44]

Given this relationship, the typical case of loss adjusting is a process through which the policyholder and the adjuster arrive at a joint conclusion about the proper payment due under the policy; it is not a bargained settlement between parties who are disputing the amount owed. The steps in the process are the policyholder's reporting of a loss, the investigation of the facts and the coverage, and the verification of the extent of loss.[45] Investigating the facts and verifying the loss in turn require determining the scope of damage and pricing the costs of repair.[46] The complexity of this process varies with the extent and complexity of the loss, and the more complex, the more likely that the parties may not agree on the applicable coverages, the scope of damage, or the cost of repair. As classic texts used to train claims personnel state, "The value of most insurance claims is uncertain or must be determined with an element of judgment."[47] "Estimating is not an exact science, and legitimate differences are common."[48] "[D]ifferences may arise from consciously stated positions, but they are more likely to result from unspoken assumptions and misunderstandings."[49] "A difference need not be a disagreement,

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reasonable justification when it denies coverage based upon suspicion and conjecture.").

[43] *See* Bernstein v. Travelers Ins. Co., 447 F. Supp. 2d 1100, 1112 (N.D. Cal. 2006) ("As these articulations of a carrier's duty indicate, a carrier can be found liable on a bad faith theory for conducting an investigation that is unjustifiably superficial or perfunctory *or that looks only in one self-serving direction* for evidence about the source, nature, or extent of the claimed losses." (emphasis in original)); 15 RUSS & SEGALLA, *supra* note 35, § 207:25 ("Implicit in the duty to investigate is the requirement that the investigation be adequate and fair. Adequacy and fairness means that the insurer has a duty to diligently search for evidence which supports insured's claim and not merely seek evidence upholding its own interests."); DORIS HOOPES, THE CLAIMS ENVIRONMENT 10.7 (2000) ("Claims representatives should investigate in an unbiased way, pursuing all relevant evidence, especially that which establishes the legitimacy of a claim.").

[44] Jordan v. Allstate Ins. Co., 56 Cal. Rptr. 3d 312, 319 (Ct. App. 2007).

[45] 1 PROPERTY LOSS ADJUSTING 209 (James J. Markham ed., 2d ed. 1995).

[46] 2 PROPERTY LOSS ADJUSTING 1 (James J. Markham ed., 2d ed. 1995).

[47] JAMES J. MARKHAM ET AL., THE CLAIMS ENVIRONMENT 176 (1st ed. 1993).

[48] *Id.* at 176.

[49] *Id.* at 176.

although it often is. A difference exists whenever there is a lack of agreement between the parties."[50]

Differences that arise during the course of adjusting ordinarily are resolved by a process of sharing information and educating each other about the scope of damage or the cost of repair. They also may be resolved by negotiation between the policyholder and the adjuster, but negotiation in itself does not indicate the presence of a dispute that must be compromised. Instead, negotiation is part of the process of give-and-take that occurs as the parties exchange information, make arguments, and concede points to resolve different understanding of the situation. "Negotiation need not imply an adversarial transaction; it can be cooperative and informative."[51] Therefore, in the typical case, at the conclusion of the process of loss adjusting there is no actual dispute, even if a release accompanies the claim payment, so the company is not giving up a right to assert a lower value of a claim and its payment does not provide consideration for the policyholder's release.

Payment in the absence of a genuine dispute does not provide consideration for a release, and this result is particularly clear in two types of cases. One instance is where the insurer makes a partial payment admittedly due under the policy; under the basic application of the pre-existing duty rule that payment of a lesser sum cannot be satisfaction for the whole, the partial payment is not consideration for release of any further claim.[52] Another instance arises under valued policy laws where a settlement for less than the face value of the policy is not enforceable; here the valued policy law makes the entire face value due, so payment of only a part lacks consideration and violates the public policy underlying the valued policy law.[53]

Sometimes, of course, the differences that arise in the loss adjustment process cannot be resolved, the parties deadlock, and the deadlock is resolved by the policyholder accepting a smaller payment than it believes it is entitled to in exchange for the insurer making a larger

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[50] *Id.* at 175.

[51] *Id.* at 177.

[52] Hallmark v. United Fid. Life Ins. Co., 286 S.W.2d 133, 135 (Tex. 1956); Am. Nat'l Ins. Co. v. Walker, 81 S.W.2d 1061 (Tex. Civ. App. 1935); Scott v. Missouri Ins. Co., 246 S.W.2d 349, 353 (Mo. Ct. App. 1952).

[53] *E.g.*, Britton v. Farmers Ins. Group, 721 P.2d 303, 307 (Mont. 1985); Gimbels Midwest, Inc. v. N.W. Nat'l Ins. Co. of Milwaukee, 240 N.W.2d 140 (Wis. 1976).

payment than it believes it owes.[54] It is only in those cases in which the pre-existing duty rule does not apply and a release demanded by the insurer is enforceable to bar a subsequent claim by the insured.

III. EVALUATING THE APPLICATION OF THE PRE-EXISTING DUTY RULE

The pre-existing duty rule has come in for criticism, and deservedly so. As the Restatement comments point out, the rule "has been much criticized as resting on scholastic logic."[55] The rule has been rejected in some jurisdictions, either by judicial decision or statute[56] and the Uniform Commercial Code abandons it for sale of goods cases.[57] Nevertheless, the modern understanding of the rule and the exceptions to it actually support the application of the rule to prevent the enforcement of an insurance release that is the product of the ordinary loss adjusting process.

A. PURPOSES OF THE RULE

"The fundamental goal of contract modification law is to promote enforcement of freely-made alterations of existing contractual arrangements and to deny enforcement of coerced modifications."[58] In carrying out this goal, the modern rationale of the pre-existing duty rule is to serve a policing function. The Farnsworth treatise, for example, discusses the rule, including its application to claims settlements, under the topic "Policing of Modification and Discharge." The rule and its exceptions distinguish between cases in which the parties have made "an equitable adjustment" in their relationship and those in which they have not.[59]

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[54] *E.g.*, Jones v. Admiral Ins. Co., 395 S.E.2d 234 (Ga. App. 1990) (insurer paid maximum despite skepticism about amount of loss).

[55] RESTATEMENT (SECOND) OF CONTRACTS § 73 cmt. c. *See also* Frye v. Hubbell, 68 A. 325, 332 (1907) ("the absurdity of the results of the rule . . . has been commented upon in case after case, but persistence in error . . . still calls that right which is recognized to be wrong.")

[56] *See* FARNSWORTH, *supra* note 11, § 4.25.

[57] *See* U.C.C. § 2-209.

[58] Robert A. Hillman, *Contract Modification under the Restatement (Second) of Contracts*, 67 CORNELL L. REV. 680, 681 (1982).

[59] RESTATEMENT (SECOND) OF CONTRACTS § 73 cmt. c. (1981).

Parties to a contract may agree to modify their contract for legitimate commercial reasons, and the modern exceptions to the pre-existing duty rule make such promises enforceable. One example is unanticipated circumstances arising during the course of performance that would render one party's performance unfairly burdensome. If a builder's cost of performance increases dramatically because of a subsurface condition of which the builder did not know or have reason to know at the time of contracting, the owner's promise to pay the additional cost is not held unenforceable for lack of consideration.[60] The Uniform Commercial Code has abrogated the rule entirely in sales cases; § 2-209 provides that a modification needs no consideration to be binding. A buyer may, for example, agree to accept goods of a lesser quantity or quality than was contracted for, and the fact that the seller is already under a duty to perform a greater obligation is no bar to enforcement of the buyer's promise; the law recognizes the commercial reality that a contracting party may value a bird in the hand more than two in the bush. However, the power to create an enforceable modification under the Code is not unlimited; the modification is policed by the requirement of good faith, which requires that the new agreement be honest and in accord with "reasonable commercial standards of fair dealing."[61]

On the other hand, modifications or (as in the insurance release cases) discharges that are not commercially reasonable attempts to adjust the relationship or to make the best of a bad situation do not deserve to be enforced. In these cases the pre-existing duty rule serves an appropriate policing function in two ways.

First, it embodies the essential definition of contract law as the body of law that enforces exchanges.[62] Exchange is the foundation of the doctrine of consideration, which makes enforceable only those promises that are bargained for.[63] By definition, an exchange is two-sided, and the pre-existing duty rule enforces that definition. Where nothing in legal contemplation is exchanged on one side—where a party such as an insurance company does no more than make a payment it is otherwise obligated to make—there is no exchange and therefore no enforceable promise.

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[60] RESTATEMENT (SECOND) OF CONTRACTS § 89 (1981).

[61] U.C.C. §§ 1-201(b)(20); 2-209 cmt. 2. (1977).

[62] FARNSWORTH, *supra* note 11, § 1.1 at 4.

[63] RESTATEMENT (SECOND) OF CONTRACTS § 71 (1979).

Second, in some cases one party will take advantage of the lack of expertise or leverage of the other party to obtain a modification or discharge that is unfair or disproportionate. Other policing doctrines such as fraud and duress may not provide a remedy because courts understandably do not apply those doctrines expansively. In those cases, the pre-existing duty rule provides a backstop to prevent the enforcement of modifications or discharges that were unfairly obtained, are unreasonable, or lack business efficacy.

B. PUBLIC POLICIES

One of the criticisms of the pre-existing duty rule is that it upsets the resolution of disputes parties have achieved themselves and permits litigation that reopens settled claims. This effect is at odds with the strong public policy favoring the settlement of disputes, a policy that grants a presumption of validity to releases.[64] The policy favoring settlement has several roots. From the contract law perspective, it reflects the value of personal autonomy and choice that is a core value of contract law. From the legal system perspective, it permits parties to avoid the costs and uncertainties of litigation and reduces the social expenditure on litigation.

In fact, as properly stated the public policy favoring settlement is entirely consistent with the application of the pre-existing duty rule to insurance releases. The public policy, prosaically stated, is as follows:

> The purpose of compromise is to avoid trial of sharply disputed issues and to dispense with wasteful litigation. The settlement of cases serves the dual and valuable purposes of reducing the strain on scarce judicial resources and preventing the parties from incurring significant litigation costs.
>
> The law and public policy generally supports a presumption in favor of voluntary settlement of litigation, and settlement agreements should therefore be upheld whenever equitable and policy considerations so permit.[65]
>
> . . .

[64] 66 AM. JUR. 2D, *Release* § 2 (2011).
[65] 15A C.J.S. *Compromise & Settlement* § 1 (2013).

> A compromise agreement fairly made, based on good consideration, and assented to by both parties, is valid and binding on both.[66]

There are three relevant elements to this policy.

First, it is only implicated if there is a controversy or dispute to be resolved. That requirement parallels the pre-existing duty rule's requirement of a genuine, good faith dispute to render a release enforceable.

Second, it applies only to releases that are "fairly made" and "assented to by both parties." This is a statement about the process of arriving at a settlement, not a substantive review of its fairness. It requires that both parties have reason to know of the nature of the dispute and of the effect of the release.

Both of these elements become problematic when the release is given in the ordinary process of adjusting. In that process the parties arrive at a common understanding of the loss, which is not the same as resolving a dispute, and the policyholder has no reason to understand the situation in any other way.

Third, the policy favoring settlement must be balanced against any conflicting public policy. In the release cases, that policy is the broad public policy underlying the provision and regulation of insurance.

As a risk management tool, the purchase of insurance is a transaction through which the insured trades a small, certain loss (the premium) to protect against a larger, uncertain loss (the risk insured against). For many policyholders, particularly consumers and small businesses, insurance is seen more broadly as a vehicle to secure oneself against financial catastrophe. The Arizona Supreme Court was one among many courts to recognize the dual role of insurance:

> In delineating the benefits which flow from an insurance contract relationship we must recognize that in buying insurance an insured usually does not seek to realize a commercial advantage but, instead, seeks protection and security from economic catastrophe. Thus, the insured's object in buying the company's express covenant to pay claims is security from financial loss which he may sustain from claims against him and protection against economic

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[66] 15A C.J.S. *Compromise & Settlement* § 4 (2013).

> catastrophe in those situations in which he may be the victim. In both cases, he seeks peace of mind from the fears that accompany such exposure."[67]

Requiring the insurance company to fully perform its obligations is particularly important because of the lack of an available substitute if the company fails to perform. In a typical contract, if one party does not perform, the other party can procure a substitute performance, sue for any added cost, and, at least in concept, be made whole by the provision of damages. But if a property owner suffers a loss and its insurance company fails to pay the claim in full, there is no adequate substitute, as no company will sell insurance to compensate for a loss that has already occurred.[68]

Therefore, there is a strong public policy favoring the provision of insurance and the payment of claims in full. The policy is embodied throughout insurance law.[69] Interpretation doctrines state that ambiguities in policies should be construed against the insurance company, that grants of coverage should be interpreted broadly and exclusions narrowly, and, in many jurisdictions, the reasonable expectations of policyholders are protected even in the face of contrary policy language.[70] Doctrines of waiver and estoppel lead to payment of claims that would not necessarily

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[67] Rawlings v. Apodaca, 726 P.2d 565, 569-71 (Ariz. 1986) (citations omitted); *See also* Decker v. Browning-Ferris Indus. of Colo., Inc., 931 P.2d 436, 443 (Colo. 1997) ("[A]n insured who enters into a contract of insurance seeks to obtain 'financial security and protection against calamity.'") (quoting Farmers Grp., Inc. v. Trimble, 691 P.2d 1138, 1141 (Colo. 1984)); Andrew Jackson Life Ins. Co. v. Williams, 566 So. 2d 1172, 1179 n.9 (Miss. 1990) ("[A]n insured bargains for more than mere eventual monetary proceeds of a policy; insureds bargain for such intangibles as risk aversion, [and] peace of mind.") (alteration in original).

[68] *See* Foley v. Interactive Data Corp., 765 P.2d 373, 396 (Cal. 1988) ("[A] breach in the employment context does not place the employee in the same economic dilemma that an insured faces when an insurer in bad faith refuses to pay a claim or to accept a settlement offer within policy limits. When an insurer takes such actions, the insured cannot turn to the marketplace to find another insurance company willing to pay for the loss already incurred.").

[69] *See* Bob Works, *Excusing Nonoccurrence of Insurance Policy Conditions in Order to Avoid Disproportionate Forfeiture: Claims-Made Formats as a Test Case*, 5 CONN. INS. L.J. 505, 574 (1998-89).

[70] *See, e.g.,* Rodman v. State Farm Mut. Ins. Co., 208 N.W.2d 903, 905-08 (Iowa 1973) (explaining the reasonable expectations doctrines in insurance law).

be covered otherwise.[71] Statutes impose requirements of intent to deceive or materiality on misrepresentations by insureds before the insurer can use the misrepresentation as a basis for avoiding the claim.[72] In a variety of cases courts interpret particular policy conditions favorably to coverage, sometimes more favorably than their plain meaning or drafting history might justify.[73] The Model Unfair Claims Settlement Practices Act promulgated by the National Association of Insurance Commissioners and adopted in most states requires insurers to attempt "in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear" and not "for less than the amount that a reasonable person would believe the insured or beneficiary was entitled by reference to written or printed advertising material accompanying or made part of an application."[74]

In ordinary property loss adjusting cases, the public policy favoring settlement is not relevant. Only where a release follows the resolution of a genuine dispute in good faith is the policy properly applied and not inconsistent with the public policy favoring insurance coverage. Moreover, the principal reason courts refuse to enforce a contract on the grounds of public policy is to discourage undesirable conduct. Enforcing a release would actually encourage improper claim practices. The release operates to limit a company's ultimate liability in cases in which it underpays claims due to simple error, negligence, failure to train or employ qualified personnel, bias, or even a systematic strategy of denying valid claims in whole or part. If releases could be demanded as a condition of the payment of claims and were enforceable, the economic benefits of requiring releases would become apparent. A company then would be encouraged to require a release as a condition of payment of a claim in every case. And given market pressures to limit costs, all companies would have an incentive to act in the same way. These effects would undermine

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[71] *See, e.g.,* Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co., 682 P.2d 388, 395 (Ariz. 1984) (en banc); Jenkins v. Indem. Ins. Co. of N. Am., 205 A.2d 780, 783-84 (Conn. 1964).

[72] *E.g.*, IOWA CODE ANN. § 515.101 (West 2001) (effective July 1, 2009); MASS. GEN. LAWS. ANN. ch. 175 § 186 (West 2007) (effective Feb. 5, 2009).

[73] *See, e.g.*, Owens-Illinois, Inc. v. United Ins. Co., 650 A.2d 974 (N.J. 1994) (discussing trigger of coverage in asbestos cases); Voorhees v. Preferred Mut. Ins. Co., 607 A.2d 1255 (N.J. 1992) (dealing with emotional harm as bodily injury); Ambassador Ins. Co. v. Montes, 388 A.2d 603 (N.J. 1978) (dealing with an intentional act in liability policy).

[74] MODEL UNFAIR CLAIMS SETTLEMENT PRACTICES ACT § 4 (NAIC 2007).

the nature of insurance and the requirement of fair claim practices. As a result, there would be more cases in which policyholders did not receive the benefits they had contracted for and to which they were entitled. Therefore, a release that is required as a condition of payment of a claim and that is not the product of settlement of a genuine, good faith dispute, should be held unenforceable as a matter of public policy.

IV. CONCLUSION

The essential obligation of an insurance company is to pay what it owes under the policy if its insured suffers a loss. In property loss cases, that obligation is effectuated through a fluid process of adjusting that involves uncertainty, expertise, and judgment. Most of the time, that process results in an agreement on the amount owed. Because the process is uncertain, that amount may turn out to be incorrect, and if it is, the company cannot avoid its essential obligation to the policyholder by claiming that a release signed at the time of payment—a release that it is not entitled to demand under the policy—limits its obligation. A hoary rule of contract law and the public policy that recognizes the value of insurance coalesce to dictate this result.