

# DOES AN INSURED HAVE A DUTY TO MITIGATE DAMAGES WHEN THE INSURER BREACHES?

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*This article explores the uncertainty behind an insured's duty to mitigate losses after the insurer has breached its contract. The article explores the arguments for and against mitigation and concludes that the duty to mitigate should be imposed on insureds who are seeking damages for the insurer's breach of a contractual obligation regardless of the type of insurance policy in question. The failure by the insured to act reasonably post-breach should result in them being held responsible for losses that could have been avoided.*

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## I. INTRODUCTION

The principle that a plaintiff must make reasonable efforts to mitigate damages is well entrenched in the law of contract and tort,<sup>1</sup> although the origins of the requirement are somewhat obscure.<sup>2</sup> The so-called “duty”<sup>3</sup> to mitigate operates to reduce damages to the extent losses could have been avoided had the plaintiff, post-breach, acted reasonably under the circumstances. When insurers breach their obligation under an

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<sup>1</sup> Sutherland identified the origins of the mitigation principle as being equitable in nature, although it is not clear whether the reference was to equity jurisprudence or to general concerns for fairness. 1 J.G. SUTHERLAND, *THE LAW OF DAMAGES* §149 (3d ed. 1903).

<sup>2</sup> One scholar traces mitigation principles back to Roman law. Saul Litvinoff, *Damages, Mitigation, and Good Faith*, 73 TUL. L. REV. 1161, 1164 (1998–1999).

<sup>3</sup> The mitigation of damages obligation is discussed in detail in JAMES M. FISCHER, *UNDERSTANDING REMEDIES*, §13 (2d ed. 2006).

The plaintiff's obligation should not be understood as arising to the level of a legal duty, such as would create affirmative rights exercisable by the defendant. Rather, a plaintiff's failure to mitigate, when mitigation is reasonable and would operate to reduce the plaintiff's loss, will result in a dollar for dollar reduction in the recovery by the amount not mitigated.

*Id.*

insurance contract, however, there is substantial uncertainty whether the insured has a duty to mitigate. There are surprisingly few decisions that specifically address this issue. Most that do address the question rather casually. Sometimes, a duty to mitigate is assumed;<sup>4</sup> other times, the duty to mitigate is rejected.<sup>5</sup> This article explores the reasons for this state of affairs. The article concludes that a duty to mitigate should be recognized and imposed on insureds who are seeking damages for insurer breach of an insurance contractual obligation.

#### A. THE DUTY TO MITIGATE – AN OVERVIEW

A plaintiff's recovery may be reduced if the plaintiff fails to make reasonable efforts, post-breach or post-injury, to lessen damages. These efforts may be positive in the sense that the plaintiff must take affirmative, proactive steps to ameliorate the scope or severity of the loss, for example, submitting to reasonable medical procedures to reduce the injury or to hasten the healing process. Alternatively, the obligation may be negative, in the sense that the plaintiff may be required to cease and desist from incurring further loss, as, for example, a contractor continuing to expend labor and materials, and thereby increasing the loss, after the owner has breached the construction contract.<sup>6</sup> The fundamental justification for the mitigation requirement is that compensation should be tied to causal responsibility for the loss.<sup>7</sup> The plaintiff is seen as the cause of any losses that could have been avoided by post-breach action. The plaintiff is not allowed to sit idle and allow losses to grow and accumulate, but must act reasonably to reduce the quantum of loss caused by defendant's legal wrong.

Mitigation resembles several liability doctrines, such as contributory negligence and comparative fault. The doctrinal line that separates mitigation from contributory negligence and comparative fault is

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<sup>4</sup> See, e.g., *Campbell v. Norfolk & Deham Mut. Fire Ins. Co.*, 682 A.2d 933, 936 (R.I. 1996) (per curiam) (holding that insured need not await actual, physical collapse of insured structure before loss will be deemed covered because such a requirement would subvert insured's duty to mitigate damages).

<sup>5</sup> See, e.g., *Miller v. Mut. Life Ins. Co. of N.Y.*, 289 N.W. 399, 402 (Minn. 1939) (holding that disabled insured could not be denied benefits because insured failed to take insulin necessary to control his diabetes, which was his disabling condition under the policy).

<sup>6</sup> RESTATEMENT (SECOND) OF CONTRACTS § 350 cmts. ab (1981).

<sup>7</sup> RESTATEMENT (SECOND) OF TORTS § 918 cmt. c (1979) ("The factors determining whether an injured person has used care to avert the consequences of a tort are in general the same as those that determine whether a person has been guilty of negligent conduct . . .").

the time of the wrong and resulting injury. Plaintiff's pre-injury activities that contribute to the loss are addressed through liability-based doctrines, such as negligence and comparative fault. Plaintiff's post-injury activities that contribute to the extent or magnitude of the loss are addressed through remedial-based doctrines, such as mitigation.<sup>8</sup> The distinction can be significant because mitigation raises pure loss sharing issues, while contributory negligence does not and comparative fault may not.<sup>9</sup>

The mitigation obligation is subject to several constraints. A plaintiff need only expend reasonable efforts to mitigate damages; the plaintiff need not do what is unreasonable or impractical. A plaintiff, who is financially unable to mitigate, need not do what he cannot do.<sup>10</sup> Mitigation is rarely a complete defense; rather, damages are only reduced by the amount of damages reasonable efforts would have avoided. For example, assume an insured has a duty to mitigate after the insurer breached its duty to defend. If the insured unreasonably failed to accept the claimant's offer to settle the matter for \$25,000 and the claimant thereafter recovered \$50,000, the insured's general, economic damages would be limited to \$25,000 – the amount of damages the insured would have incurred had the insured acted reasonably, after the insurer's breach, by settling with the claimant.

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<sup>8</sup> *Kocher v. Getz*, 824 N.E.2d 671, 675 (Ind. 2005) (“While a plaintiff's postaccident conduct that constitutes an unreasonable failure to mitigate damages is not to be considered in the assessment of fault, a plaintiff ‘may not recover for any item of damage that [the plaintiff] could have avoided through the use of reasonable care.’”) (alteration in original) (footnote omitted).

<sup>9</sup> *See Del Tufo v. Twp. of Old Bridge*, 685 A.2d 1267, 1282 (N.J. 1996). In *Del Tufo*, an arrestee died from a cocaine overdose while in police custody. *Id.* at 1267. His estate brought a wrongful death action alleging that the police had negligently delayed securing proper medical care for the decedent. *Id.* Under New Jersey's comparative fault statute, the plaintiff had to show that defendant was more than 50% responsible for the decedent's injuries. *Id.* at 1282. The court held that, on these facts, the trial court should have instructed the jury on comparative fault and the failure to do so constituted prejudicial error since the decedent's voluntary ingestion of cocaine was a substantial contributing factor to his death. *Id.* Because New Jersey's comparative fault statute would bar recovery if the trier of fact found that the decedent was more responsible than defendant for his death from a cocaine overdose, the estate argued on that remand it could receive a mitigation instruction, which would allow for some recovery based on the principles of pure fault. *Id.* Thus, if decedent were found to be 80% responsible for his death, the estate could still recover 20% of his damages, which reflected defendant's share of responsibility. The court held that mitigation principles did not apply and that the decedent's actions should be evaluated under faultbased principles. *Id.*

<sup>10</sup> FISCHER, *supra* note 3, at § 13.2.

## B. INSURANCE AND MITIGATION

Courts have been inconsistent in their application of mitigation principles to insurance disputes regardless of the type of insurance involved,<sup>11</sup> although most of the disputes have involved liability insurance. This article considers both breaches of the duty to defend (liability insurance) and breaches of the duty to pay (disability and property insurance). While both duties involve distinct obligations of the insurer, neither duty presents unique issues or concerns pertinent to the mitigation obligation when the insured seeks damages. The basic issue whether the insurer has a duty to mitigate does not turn on whether the insurer has breached the duty to defend or the duty to pay because in each case by seeking damages the insured has monetized the claim. Whether the insured has acted reasonably in seeking to mitigate damages may be influenced by the nature of the duty the insurer breached, but that is a topic for later work. Here the focus is on the existence *vel non* of the duty to mitigate.

### 1. Liability Insurance

Liability insurance policies commonly provide a defense for insureds when the insured is sued and the insurer may be required to provide indemnification.<sup>12</sup> Insurers do not agree to defend their insureds against all claims and whether the insured is or is not owed a defense under the policy is a fertile ground for litigation between insured and insurers.<sup>13</sup>

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<sup>11</sup> LEE R. RUSS & THOMAS F. SEGALLA, *COUCH ON INSURANCE* 3D § 168:9 (3d ed. 2005) (“[T]he concept of mitigation of loss in insurance has not developed as cohesively as the doctrine of mitigation of damages in other fields.”).

<sup>12</sup> Charles Silver & Kent Syverud, *The Professional Responsibilities of Insurance Defense Counsel*, 45 *DUKE L.J.* 255, 302 (1995) (demonstrating that insurance law burdens the company with two relevant duties: a duty to defend the insured and a duty to behave reasonably in settlement. The first duty requires the company to provide a lawyer to defend the insured. The second duty requires the company to consider the insured’s interests along with its own when exercising its settlement discretion.); see James Fischer, *Insurer or Policyholder Control of the Defense and the Duty to Fund Settlements*, 2 *NEV. L.J.* 1, 32–34 (2002) (discussing separation of insurer’s contractual duty to provide a defense from the insurer’s contractual right to control the defense).

<sup>13</sup> The insured’s duty to defend is triggered by the insured’s tender of a third party claim against the insured to the insurer. The tendered claim must be within the coverage promised by the insurer under the terms of the liability insurance policy, although this standard is liberally applied to the insured’s benefit. First, the duty to defend is broader than the duty to indemnify and is triggered in many jurisdictions by a claim that raises the potentiality of coverage under the insurance policy. KENNETH S. ABRAHAM, *INSURANCE LAW AND REGULATION* 624 (5th ed.

If the insurer refuses to provide a defense and the insured seeks damages for breach, does the insured, putting aside issues of capability under the precise circumstances of the situation, have a duty to mitigate damages by providing a defense? As one commentator observed, the resolution of this issue is “unclear” as courts are divided – some courts holding that mitigation principles apply, other courts concluding that they do not.<sup>14</sup>

## 2. Disability Insurance

Disability insurance policies provide payments that substitute for compensation the insured could have earned but for the disability the insured has incurred. Usually the payments are on a monthly basis and continue until the disability is resolved or the policy expires, whichever is earlier. In *Heller v. The Equitable Life Insurance Assurance Soc’y of the U.S.*,<sup>15</sup> the insured, a cardio-vascular surgeon, developed carpal tunnel syndrome, which precluded him from performing surgery. His insurer claimed that he failed to mitigate his losses by submitting to surgery to relieve the condition. The insurer relied on a provision in the insurance policy requiring, as a condition of receiving benefits, that the insured be “under the regular care and attendance of a physician” as requiring the insured to submit to surgery when recommended by an attending physician.

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2010). Even if the jurisdiction follows the less liberal “pleading” test, which compares the actual allegations in the claim to the terms of the insurance policy, the test is applied liberally in the insured’s favor. *Zurich Am. Ins. Co. v. Nokia, Inc.*, 268 S.W.3d 487, 492 (Tex. 2008). Second, many jurisdictions follow the rule that if the duty to defend exists as to part of the claim, the insurer must defend the entire claim. 3 NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION § 17.01 (3)(a) (Francis J. Mootz, III, et al. eds., LexisNexis 2012). Third, many jurisdictions impose a high standard for insurer escape when the duty to defend is contested. *Montrose Chem. Corp. v. Superior Court*, 861 P.2d 1153 (Cal. 1993):

[I]f the plaintiff’s complaint against the insured alleged facts which would not have supported a recovery covered by the policy, it was the duty of the defendant to undertake the defense, *until it could confine the claim to recovery that the policy did not cover* . . . . [T]he insurer may terminate its defense obligation by proving that the underlying claim falls outside the scope of policy coverage, but not by demonstrating that the claim lacks merit, or might have merit only on some theory outside the scope of coverage.

*Id.* at 1159 (citations omitted) (brackets added) (italics in original).

<sup>14</sup> ALLAN D. WINDT, 1 INSURANCE CLAIMS AND DISPUTES § 4.18 (5th ed. 2007) (collecting decisions).

<sup>15</sup> *Heller v. Equitable Life Assurance Soc’y*, 833 F.2d 1253 (7th Cir. 1987).

The court rejected the insurer's interpretation of the provision, rejecting the insurer's argument that the insured was obligated to reduce or ameliorate his loss by submitting to surgery absent express language requiring such in the policy.<sup>16</sup> The court even more broadly rejected the argument that the insured had an implied obligation to mitigate his disability if he can do so without reasonable risk or pain.<sup>17</sup> *Heller* is consistent with the general approach in disability insurance disputes to resist imposing a duty to mitigate on the insured, although there is some contrary authority.<sup>18</sup>

### 3. Property Insurance

Property insurance often has an exclusion to coverage that is triggered if the insured neglects to use "all reasonable means to save and preserve property at and after the time of loss."<sup>19</sup> This language creates an express, contractual obligation to mitigate.<sup>20</sup> Some courts have found a

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In the absence of a clear, unequivocal and specific contractual requirement that the insured is obligated to undergo surgery to attempt to minimize his disability, we refuse to order the same. To hold otherwise and to impose such a requirement would, in effect, enlarge the terms of the policy beyond those clearly defined in the policy agreed to by the parties. Thus, under the terms of this disability policy, Dr. Heller is not required to undergo surgery for treatment of his carpal tunnel syndrome condition before he receives disability income payments.

*Id.* at 1257–58 (footnote and citation omitted); *but see infra* note 44 (noting contrary authority as to interpretation of "care and attendance" provision).

<sup>17</sup> "Although we might not choose to follow the same course of conduct and path of reasoning as Dr. Heller, there is no moral, much less legal obligation or compelling reason to second guess an insured's, and in this case Dr. Heller's, decision to forgo surgery." *Id.* at 1259 (footnote omitted).

<sup>18</sup> *Compare* *Miller v. Mutual Life Ins. Co. of N.Y.*, 289 N.W. 399, 402 (Minn. 1939) (rejecting duty to mitigate) *with* *Provident Life & Accident Ins. Co. v. Van Gemert*, 262 F. Supp. 1047, 1052 (C.D. Cal. 2003) (applying California law and holding that that disability policy's "care and attendance" provision required insured to comply with physician's recommendations that would mitigate disabling condition).

<sup>19</sup> Insurance Service Office Homeowner's Policy (H0 00 03 10 00), Section 1 Exclusions, Exclusion A5.

<sup>20</sup> *RUSS & SEGALLA, supra* note 11, § 149.69 ("Distinct from the question of whether there is coverage for loss when an insured voluntarily removes imperiled goods in order to avoid or reduce his or her loss, the policy of insurance may expressly impose upon him or her such a duty. Such a provision is in effect an

duty on the insured's part to mitigate damages even apart from a contractual obligation to do so. In *Real Asset Management, Inc. v. Lloyd's of London*<sup>21</sup> the court held that Louisiana's general common law duty to mitigate damages applied to an insured who claimed property loss under its property insurance policy. The court reversed an award to the insured. The trial court had excused the insured's failure to comply with the contractual duty to mitigate because the insurer had breached its duty to pay, thus excusing the insured's duties of performance under the insurance contract. The Fifth Circuit Court of Appeals concluded that the insurer's breach did not excuse the insured's failure to mitigate and remanded for a determination of the extent to which the failure to mitigate contributed to the loss claimed by the insured.<sup>22</sup>

### C. THE ARGUMENTS AGAINST MITIGATION IN THE INSURANCE CONTEXT

#### 1. Insured's Reasonable Expectations

The most common argument against a mitigation requirement for insurer breach of the contract of insurance, absent an express contractual obligation, is that such a requirement defeats the insured's reasonable expectations under the insurance contract. Here's how Windt puts it in the context of the insurer's duty to defend under a liability insurance policy:

What is unclear, however, is whether insureds have a duty to defend themselves after their insurers have unjustifiably refused to defend them. Some courts have indicated that they do. The majority, and better, rule, however, is to the contrary. Having contracted to have the insurer defend, the

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exception to the coverage, and in the event of failure to make reasonable efforts to protect the property from peril, the insurer is not liable on its policy") (footnotes omitted).

<sup>21</sup> *Real Asset Mgmt., Inc. v. Lloyd's of London*, 61 F.3d 1223 (5th Cir. 1995) (applying Louisiana law).

<sup>22</sup> *Id.* at 1229–30 ("We find, however, no legal support for the proposition that an insured's duty to mitigate terminates when the insurer breaches his duty to timely settle a claim. Under Louisiana law it is clear a plaintiff has a duty to do what it can to mitigate losses") (citations and footnote omitted); *see Jablonsky v. Girard Fire & Marine Ins. Co.*, 174 A. 689, 691 (N.J. 1934) (noting split in authority whether the insured's violation of the policy requirement that the insured expend reasonable efforts to protect the insured property postloss voids the policy; the court concluded, however, that the better rule is that the insured's failure to protect will only affect the amount of recovery to the extent the insured's failure compounded the loss).

insured should be able to do nothing more than cooperate with the insurer when a suit encompassed by the policy is filed. The insured did not impliedly covenant to attempt to minimize the insurer's exposure in the event of the insurer breaching its duty to defend, and, for policy reasons, the duty to mitigate damages should not be applicable. Having itself refused to take any action in an effort to minimize its potential exposure in the pending lawsuit, the insurer cannot expect the insured to take such action.<sup>23</sup>

This argument against mitigation appears to consist of two claims. First, mitigation is only required when there is an express contractual obligation to do so, an implied obligation should not be read into the agreement. Second, a mitigation obligation violates public policy, at least in the context of an insurer's breach of the duty to defend. There are, however, difficulties with this mitigation position. If it is against public policy to impose a mitigation obligation on an insured, that public policy applies regardless of the content of the insurance policy. It is a cardinal rule of Insurance Law that the terms of the policy may not violate public policy.<sup>24</sup> To the extent they do, the terms are ignored.<sup>25</sup> Thus, if public policy rejects a duty to mitigate, the inclusion of an express mitigation provision in the insurance policy would not alter that result.

The contention may be that public policy does not bar mitigation *per se*, but does bar implying an obligation to mitigate.<sup>26</sup> That approach avoids logical inconsistency, but does so by neutering public policy of any meaning. As revised, the public policy argument becomes a gloss on the

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<sup>23</sup> WINDT, *supra* note 14, § 4.18 (footnotes omitted).

<sup>24</sup> 16 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 49.12 (Richard A. Lord, ed., 4th ed. 2000) ("A contract of insurance, or a clause or provision in it, which is contrary to law or public policy is invalid and unenforceable.") (footnotes omitted).

<sup>25</sup> See *Welin v. American Family Mut. Ins. Co.*, 717 N.W.2d 690, 702 (Wis. 2006) (noting that "when an insurance policy violates a statutory provision, the remedy is to enforce the policy as though it conformed to the statutory requirement"); see also *J.C. Penney Cas. Ins. Co. v. M.K.*, 804 P.2d 689, 694 (Cal. 1991) (noting that statutory requirements are implied terms of insurance contracts).

<sup>26</sup> There is a conflict in the decisional law as to the extent, if at all, implied statutory requirements may be written over by the contracting parties. Compare *Julian v. Hartford Underwriters Ins. Co.*, 110 P.3d 903, 907-08 (Cal. 2005) (noting that the statutory causation test could not be overwritten by contracting parties), with *State Farm Fire & Cas. Co. v. Bongen*, 925 P.2d 1042, 1045 (Alaska 1996) ("[A]n insurer may expressly preclude coverage when damage to an insured's property is caused by both a covered and an excluded risk.").



proper interpretation of insurance contracts, much like the doctrine of *contra proferentum* (construction against the drafter). As so understood, a duty to mitigate should not be implied. This position, however, does not raise a meaningful public policy argument because it does not substantiate why contractual silence as to the mitigation issue supports or creates a “no mitigation” public policy rule.<sup>27</sup>

I may, however, be over-reading Windt's use of the term “implied.” Perhaps Windt is arguing that public policy absolutely precludes imposing a duty to mitigate damages on the insured. That position, however, is not substantiated by Windt. More fundamentally, this public policy claim is inconsistent with the judicial willingness, noted earlier, to enforce express mitigation provisions in insurance policies. If a mitigation duty violated public policy, these express provisions would be unenforceable.

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<sup>27</sup> This is not to say that public policy arguments against mitigation are necessarily unsubstantial. Several courts have, for example, concluded that it may violate public policy to impose a duty to mitigate on the United States. In *Fed. Deposit Ins. Corp. v. Bierman*, 2 F.3d 1424, 1438-41 (7th Cir. 1993), the government had seized control of the assets of a failed banking institution and paid the obligations of the institution pursuant to the deposit insurance guarantee. The government then sued the officers and directors of the institution seeking reimbursement. The directors and officers contended the government had failed to mitigate damages by unreasonably managing the assets it had seized, thereby increasing losses above that which prudent action would have realized. The court agreed with the government that there was no duty to mitigate. Such a duty would conflict with the discretionary function exception on the Federal Tort Claims Act. *See also* *Fed. Deposit Ins. Corp. v. Mijalis*, 15 F.3d 1314, 1323-25 (5th Cir. 1994) (following *Bierman* in holding that the FDIC is not required to mitigate damages when it sues former directors and officers in their official capacities to recover losses sustained by insolvent financial institutions):

We also overrule the third assignment of error in which appellant asserts, in essence, that the rest home had a duty to mitigate damages (that is, to stop the buildup of charges in her mother's account) after appellant had denied any responsibility for the deficiency. First, this claim was not made before the trial court and cannot therefore be raised on appeal. Second, we are not persuaded that the rule requiring mitigation of damages applies against a rest home so as to require it to evict an elderly woman with minimal resources and unknown ability to cope by herself the moment her daughter denies liability for her support.

*St. Clare Ctr., Inc. v. Mueller*, 517 N.E.2d 236, 239 (Ohio Ct. App. 1986).

Neither the argument of no implied duty, nor the argument of violation of public policy explain why a mitigation requirement is inconsistent with principles of insurance law. It is common to impose a duty to mitigate to contract breaches across the board. Courts have consistently deemed efforts to reduce the harm associated with a breach of obligation, whether that obligation sounds in Contract or Tort, as consistent with public policy.<sup>28</sup> Is there something about insurance contracts and duties arising out of the insured – insurer relationship that warrants a different approach?

One argument is that the insurer has promised a particular performance, e.g. defend the insured, provide monthly payments as long as the insured is disabled, etc., and imposing a mitigation obligation would negate the insurer's promised performance, which the insured has paid consideration (premium) to receive. The problem with this argument is that a mitigation obligation is frequently applied to non-insurance contracts that envision a particular performance – indeed, the purpose of all contracts is to obtain a performance in return for consideration. If a plaintiff contracts for 1000 widgets at a particular price, the defendant's breach does not excuse the plaintiff's duty to mitigate. In fact, the duty to mitigate is so strong, that the cost of the substitute performance (cover) may be seen as a substitute measure of damages.<sup>29</sup> Most contracts provide for reciprocal performances, e.g. buyer buys what seller sells, contractor builds what owner acquires, etc. Each party to the contract renders a performance, even if the performance is no more than the payment of consideration for the other party's performance.

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<sup>28</sup> RESTATEMENT (SECOND) OF CONTRACTS § 350 (1981):

- (1) Except as stated in Subsection (2), damages are not recoverable for loss that the injured party could have avoided without undue risk, burden or humiliation.
- (2) The injured party is not precluded from recovery by the rule stated in Subsection (1) to the extent that he has made reasonable but unsuccessful efforts to avoid loss.

RESTATEMENT (SECOND) OF TORTS § 918 (1979):

- (1) Except as stated in Subsection (2), one injured by the tort of another is not entitled to recover damages for any harm that he could have avoided by the use of reasonable effort or expenditure after the commission of the tort.
- (2) One is not prevented from recovering damages for a particular harm resulting from a tort if the tortfeasor intended the harm or was aware of it and was recklessly disregardful of it, unless the injured person with knowledge of the danger of the harm intentionally or heedlessly failed to protect his own interests.

<sup>29</sup> U.C.C. § 2712 (2011).

The contention that insurance contracts are different does not advance the “no mitigation” argument without identifying how insurance contracts are different from other contracts insofar as a mitigation requirement is concerned. Insurance contracts have some unique characteristics. First, the insured always performs, e.g. pays the premium for the insurance policy. Second, the insurer’s performance is conditional on the happening of an insured event, e.g. the insured suffers a covered loss during the policy period. If no such loss occurs, the insurer retains the premium, but never renders a reciprocal performance.<sup>30</sup> These characteristics of the insurance contract do not, however, explain why a duty to mitigate should not be recognized. The conditional nature of the insurer’s performance may require protections to assure that the promised performance is provided if the condition occurs;<sup>31</sup> however, the insured’s duty to mitigate is distinct from the insurer’s duty to perform. The duty to mitigate is based on the tenet that when the non-breaching party fails to exercise due diligence post-loss to ameliorate the loss, the factual cause of the avoidable portion of the loss lies with the non-breaching party.<sup>32</sup> Of course, the non-breaching party may be incapable of exercising due diligence. For example, if the insurer refuses to defend, the insured may lack the resources to retain a lawyer. Mitigation only requires what is reasonable under the circumstances.<sup>33</sup> In the duty to defend context, the insured may not be able to accept a settlement offer because the insured

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<sup>30</sup> RESTATEMENT (FIRST) OF CONTRACTS § 291 (1932) (“An ‘aleatory promise’ in the Restatement means a promise condition on the happening of a fortuitous event, or an event supposed by the parties to be fortuitous.”). For this reason, insurance contracts have sometimes been classified as “aleatory” contracts; *see id.* cmt. a (noting that a fortuitous event may be one that is beyond the power of any human being to control; it may be within the control of third persons; it may be an event in the past if the fact is unknown to the parties; it may be positive or negative or an occurrence or failure to occur); 14 WILLISTON, *supra* note 24, § 43:9 (noting that an aleatory promise is a contract in which one party is under a duty that is conditional on the occurrence of an event).

<sup>31</sup> If a right or duty of an injured party to perform is conditional on a fortuitous event, the injured party cannot treat his remaining duties to render performance as discharged unless he or she manifests his or her intent to do so to the other party before the other party has an adverse change in his or her situation. RESTATEMENT (SECOND) OF CONTRACTS § 379 (1981).

<sup>32</sup> Injured person is required to exercise no more than reasonable judgment or fortitude and is only barred from recovery when it was unreasonable for the injured person to refuse or fail to take action to prevent further loss. RESTATEMENT (SECOND) OF TORTS § 918 cmt. c (1979).

<sup>33</sup> *Cf. Valencia v. Shell Oil Co.*, 147 P.2d 558, 561 (Cal. 1944) (noting that the duty to mitigate damages does not require an injured person to do what he or she cannot reasonably afford to do).

lacks the resources to fund the settlement and the offer is conditioned on immediate funding. In this situation no breach of the duty to mitigate would occur. Moreover, the standard of due diligence may be set very low,<sup>34</sup> but obligation and capability should not be conflated or confused. Incapability, while it may excuse the particular instance of a failure to mitigate, is not a substitute for a general duty to mitigate.

Alternatively, it may be argued that a non-breaching party should not, under the guise of a duty to mitigate, be deprived of the essential bargain he struck with the breaching party.<sup>35</sup> For example, if the plaintiff agrees to sell Blackacre to defendant for \$10,000 over the property's actual market value (\$100,000) and defendant breaches, the duty to mitigate does not require the plaintiff to engage in reasonable efforts to resell the property if the plaintiff only wishes to claim the \$10,000 profit he would have made had defendant performed. The law treats the \$10,000 profit as fixed at the moment the contract was executed. It might be argued that the insured has similarly bargained for an essential performance that is fixed and immutable at the moment of the insurer's breach, thus, negating a duty to mitigate.

The first problem with this argument is that it doesn't travel very far outside the narrow area of benefit of the bargain. When the benefit of the bargain is spread over time, as in the case of employment contracts,

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<sup>34</sup> *Heller*, 833 F.2d at 1258 n.11 (noting that Illinois law gives substantial deference to a person's personality, beliefs, and fears regarding the desirability of surgery when the defendant contends that the plaintiff failed to mitigate damages by submitting to surgery).

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This was the argument made and accepted in *Miller*, 289 N.W. at 401: In the situation herein involved, the breach of contract was defendant's refusal to continue payments under the policies. It is for an amount equivalent to these unpaid benefits that this action was instituted. In other words, they represent the amount of damages plaintiff has suffered by the breach. They are not in an amount in excess of the actionable breach. There is not involved in this case the question of increasing damage after the breach. What is being demanded is the equivalent to the agreed performance. How then can the doctrine be applicable? By the policies, defendant undertook to pay benefits if and when plaintiff became disabled. It did not require submission to treatment. Plaintiff's refusal to take insulin is not increasing the damage after breach. It is simply a refusal to do what there is not a duty to perform and for which defendant did not demand the obligation to perform.

courts consistently impose a duty to mitigate on the non-breaching party.<sup>36</sup> Moreover, because the essence of an insurance contract is indemnity, not profit, it is difficult to see how the insured could be brought within the narrow exception that permits recovery of bargain benefits without a corresponding duty to mitigate. Insurance contracts may be profitable for insurers, but the whole force of insurance law is that they are not a profit center for insureds.<sup>37</sup> This point is addressed in more detail in Part D of this Article *infra*.

The second problem with the argument is that it misapprehends why the mitigation requirement is not applied to the plaintiff's bargain expectancy. If a mitigation requirement was imposed it would depreciate what belongs to the plaintiff, the expectancy itself. Reconsider the plaintiff who sold property for \$110,000, realizing a \$10,000 profit (expectancy). When the buyer breaches, the plaintiff retains the property, which is worth \$100,000. The difference between what the plaintiff has and what the plaintiff is entitled to have is \$10,000.<sup>38</sup> In other words, the plaintiff is entitled to have \$110,000; however, because of the buyer's breach the plaintiff has only \$100,000; thus, the plaintiff is entitled to \$10,000 from the buyer. Should the plaintiff have to resell the property to reduce the damages? Reselling the property would not reduce plaintiff's loss, although it might reduce the amount the buyer will have to pay as damages. The plaintiff has \$100,000 in the form of the property. Reselling the property at its market value (\$100,000) will not reduce plaintiff's loss. It will simply substitute one asset (cash) for another asset (property), but both assets are of equal value. Imposing a mitigation requirement on the plaintiff would require the plaintiff to find another buyer who would pay an above market price for the property. A reasonable plaintiff can assume that a resale will be at the market price, but a market sale price does not affect the plaintiff's damages. Imposing a mitigation requirement assumes that reasonable efforts on the plaintiff's part would produce another buyer who would overpay for the property. That view is, however, completely

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<sup>36</sup> 3 DAN B. DOBBS, LAW OF REMEDIES § 12.21(2) (2d ed. 1993); FISCHER, *supra* note 3, § 13.2.2.

<sup>37</sup> Besides the basic indemnity principle one can identify a plethora of insurance doctrines that are centered on the proposition that insurance should indemnify against loss, not provide a possibility of gain, for example, insurable interest requirements, subrogation rights, coinsurance requirements. Indeed, a primary argument for distinguishing insurance contracts from gambling contracts is that the prospect of gain only attaches to the latter.

<sup>38</sup> P. S. ATIYAH, THE RISE AND FALL OF FREEDOM OF CONTRACTS 759 (1979); Louis E. Wolcher, *The Accommodation of Regret in Contract Remedies*, 73 IOWA L. REV. 797, 876 (1988). I put aside arguments that the seller should not recover his expectancy.

inconsistent with the theory behind market valuation. If there were other buyers who would pay more than \$100,000 for the property, \$100,000 does not accurately reflect the property's actual market value. And if the property is actually worth more than \$100,000, this necessarily reduces the plaintiff's expectancy. Either way, a mitigation obligation would have no impact on the measure of the plaintiff's loss.

Decisions like *Miller v. Mutual Life Ins. Co. of New York*<sup>39</sup> thus misapprehend when the mitigation principle is applied to a contract expectancy. The contract for widgets creates an expectancy, but the duty to mitigate still applies because the plaintiff has the power post-breach to ameliorate the scope of the loss. It is only in those situations when the plaintiff is entitled to the expectancy and reasonable conduct by the plaintiff, post-breach, will not affect the expectancy that the mitigation principle is set aside.

## 2. Confusion of the Insured's Legal Position

In an early case, *Noshey v. American Auto. Ins. Co.*,<sup>40</sup> the court excused the non-breaching party (the insured) from a duty to mitigate. Imposing such a requirement the court thought might subject the insured to a claim by the breaching party (the insurer) that it (the insured) had violated terms of the insurance contract in the effort to mitigate, particularly the no-settlement without insurer consent provision.<sup>41</sup> The idea that mitigation does not require a party to undermine its legal right is well settled. A party need not mitigate when doing so would compromise the mitigating party's legal position vis-a-vis that party's adversary. For example, a party need not mitigate when seeking the remedy of specific performance because the duty to mitigate is directly inconsistent with the legal right.<sup>42</sup>

To the extent that the insured faces a credible threat that mitigation efforts may compromise the claim against the insurer, no duty to mitigate should be imposed. An insured who has been denied disability benefits because the insurer contends she is able to work should not be required to

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<sup>39</sup> See *Miller*, 289 N.W. at 402. For further discussion, see *supra* note 35.

<sup>40</sup> *Noshey v. Am. Auto. Ins. Co.*, 68 F.2d 808 (6th Cir. 1934).

<sup>41</sup> *Id.* at 810.

<sup>42</sup> *Redman v. Dep't of Educ.*, 519 P.2d 760, 769 (Alaska 1974) (finding that an employee is not required to accept alternative employment that would compromise her claim to reinstatement); *Billetter v. Posell*, 211 P.2d 621, 623 (Cal. Ct. App. 1949) (stating that one employed for a definite period of time, at an agreed rate and wrongfully discharged before the expiration of his period of employment may refuse his employer's offer of reinstatement when the acceptance of such an offer would amount to a modification of the original contract or to a waiver of his rights to recover according to its terms).

seek and accept work to mitigate damages.<sup>43</sup> Here, plaintiff's efforts to mitigate damages (work) would compromise the merits of her legal claim that she is entitled to disability benefits because she cannot work. Mitigation adds nothing to the controversy. Either the plaintiff can work – in which case she is not entitled to benefits – or she cannot work – in which case she is entitled to benefits.<sup>44</sup> On the other hand, when no reasonable likelihood exists that mitigation would compromise the insured's legal claim against the insurer, mitigation should not be precluded *per se*. This will often be the case in the context of breach of the duty to defend. The insurer's breach of its duty to defend typically excuses the insured's compliance with other terms and conditions of the policy such as the bar on settlements without the insurer's consent.<sup>45</sup> When the danger of confusing

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<sup>43</sup> *Moots v. Bankers Life Co.*, 707 P.2d 1083, 1086 (Kan. Ct. App. 1985) (“It is well known that severely disabled persons, for reasons of physical and mental health, are frequently encouraged by their physicians to take some type of work as therapy. If insureds were able to follow such valuable medical advice only at the peril of losing their only real means of financial survival, we would create for the already disabled a heavy burden indeed. Further, an opposite result would put all insureds at the absolute mercy of their insurers. In such a situation, the insurer could simply terminate disability benefits, wait until the insured is driven by dire necessity to seek *any* kind of employment, and then justify the termination retrospectively based on the subsequent employment. In a society which values work and applauds extraordinary effort by the handicapped such a result would be anomalous, to say the least.”).

<sup>44</sup> This is typically the case with disability insurance because the policies contain a “care and attendance” provision. This provision requires the insured to be under the care and attendance of a physician to receive benefits. Some courts have interpreted this provision as requiring the insured to abide by the physician's recommendations regarding treatment to continue to be eligible to receive benefits. *See Van Gemert*, F. Supp. 2d at 1051 (applying California Law: a disability policy that requires an insured claiming benefits to be “under the care and attendance” of a physician cannot reflect an intent of the parties that the insurer will be obligated to pay benefits even if the insured stubbornly refuses the only appropriate “care” recommended). Other courts, however, have read “care and attendance” provision as not requiring the insured to abide by a physician's recommendation of surgery in order to retain benefits. *See Tittsworth v. Ohio Nat'l Life Ins. Co.*, 6 Tenn. App. 206 (1927).

<sup>45</sup> *McNicholes v. Subotnik*, 12 F.3d 105, 108 (8th Cir. 1993) (applying Minnesota law) (“When an insurer denies coverage, an insured defendant does not breach his duty to cooperate by entering a settlement with the plaintiff that serves the insured's best interests; indeed the defendant is expected to do so.”). *See Ellen Smith Pryor, Comparative Fault and Insurance Bad Faith*, 72 TEX. L. REV. 1505, 1525 (1994) (“[G]enerally, the insurer's material breach of an express or implied duty will excuse the insured from complying with contractual duties.”) (footnote omitted).

and/or compromising the insured's legal claim against the insurer does not reasonably exist, the argument against mitigation is mooted.

### 3. Lack of Connectivity Between Breach and Avoidable Losses

It has been argued the failure to settle after the insurer's refusal to defend its insured is not connected or sufficiently related to the loss; therefore, it should not be considered as reasonable, required mitigation. For example, one commentator argues:

Failure to mitigate damages is a contract defense designed to reduce damages because the nonbreaching party failed to make reasonable and required efforts to minimize its losses. It applies against a claim that a liability insurer wrongfully failed or refused to defend, but it includes only conduct going to the provision of a defense, such as the insured's failure to hire a lawyer. It does not include matters not directly related to the provision of a defense. The insured's damages must flow as a result of the duty breached and as a result of the insured's self-protective responses to that breach. Thus, there is no duty under these circumstances to "mitigate damages by effecting a favorable settlement..."<sup>46</sup>

There are necessarily constraints on the scope of the duty to mitigate, but these are normally framed in terms of reasonableness. While it is true the insurer's contractual duty to defend does not, by its terms, include a duty to settle, the issue is the insured's proper response when the insurer breaches its obligation. The breaching party's duties do not define the measure of the non-breaching party's mitigation obligation, which accrues after breach and is responsive to the conditions created by the breach. Moreover, it is contestable that the duty to defend does not include a duty to settle; some courts have concluded that it does.<sup>47</sup> Finally, treating

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<sup>46</sup> DENNIS J. WALL, *LITIGATION & PREVENTION OF INSURER BAD FAITH* § 5.28 (3d ed. 2011) (footnotes omitted).

<sup>47</sup> *Goddard ex rel. Estate of Goddard v. Framers Ins. Co. of Oregon*, 22 P.3d 1224, 1227 (Or. Ct. App. 2001) ("The duty to defendant includes the duty to settle the case within the policy limits if it would be reasonable to do so."). *But see* *Mowry v. Badger State Mut. Cas. Co.*, 385 N.W.2d 171, 187-88 (Wis. 1986) (Steinmetz, J., concurring) (distinguishing between contractual duties (defend and indemnify) from the extra contractual duty to settle). *See generally* Cindie Keegan McMahon, *Duty of Liability Insurer to Initiate Settlement Negotiations*, 51 A.L.R.



loss mitigation (settlement) as distinct from the breach is hard to square with the reality that the insured is seeking compensation for the breach that is the equivalent to what, in theory, could have been avoided. It is logically inconsistent to contend that the insured's losses are not connected to the breach for mitigation purposes, when measured in terms of avoidable losses (mitigation), but are caused by the breach when measured in terms of damages.

#### 4. Mitigation Deprives the Insured of the Right to Specific Performance of the Insurer's Contractual Obligations

It is commonly recognized that no mitigation requirement attaches to a specific performance claim because a mitigation requirement is mutually exclusive to the claim.<sup>48</sup> If the plaintiff must mitigate, the plaintiff will lose the right to claim the defendant's contracted for performance. Although specific performance is not a perfect fit to the usual insurer breach claim, the thinking underlying the specific performance exception appears to underlie much of the reluctance to recognize a mitigation obligation when the insured seeks damages for insurer breach.

Jerry and Richmond identify a number of courts that have held, in the context of a breach of the duty to defend, that the duty to defend is excused because it is foreseeable that the non-breaching party (the insured) will not mitigate damages.<sup>49</sup> Jerry and Richmond note that under this rationale these courts excuse the duty to mitigate only for general damages; the duty to mitigate is imposed as to consequential damages. When the insurer breaches the duty to defend, the courts following this approach permit recovery up to policy limits (general damages) without imposing a mitigation requirement, but do impose such a requirement to the extent the insured seeks an excess-of-limits recovery (consequential damages).<sup>50</sup>

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5th 701 (1997) (noting split in authority whether duty to defend includes the duty to settle).

<sup>48</sup> *Ash Park, LLC v. Alexander & Bishop, Ltd.*, 783 N.W.2d 294, 311 (Wis. 2010) (declining to impose a duty to mitigate on a seller who requests interest in addition to specific performance because recognizing such a duty would create practical that would effectively negate the availability of specific performance); see Thomas S. Ulen, *The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies*, 83 MICH. L. REV. 341, 390 (1984) ("With specific performance there is no such obligation to mitigate, nor is it easy to see how such an obligation could be imposed under that contract remedy."); see *supra* note 42.

<sup>49</sup> ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW §111(i) (5th ed. 2012).

<sup>50</sup> This same rationale appears in duty to pay cases. See *Miller*, 289 N.W. at 402. For further discussion, see *supra* note 35.

Jerry and Richmond rightly question whether the distinction can be squared with the test of foreseeability the courts purport to apply:

The logic apparently underlying this rule is that it is foreseeable at the time of contracting that the insured will be unable to provide her own defense if the insurer fails to do so. The logic underlying recovery for the default judgment up to the policy limits but not in excess thereof is not as apparent. Insureds understandably argue that the entire amount of the judgment is the consequence of the insurer's breach, not just the portion within the policy limits.<sup>51</sup>

Jerry and Richmond are correct that the distinction drawn by courts is less than supportable under a foreseeability test; however, the limitation of the duty to mitigate to consequential damages is understandable when viewed through the lens of specific performance. If the gist of the action is to require the insurer to perform its contractual obligations, e.g., provide/pay for a defense and indemnify the insured up to policy limits, imposing a mitigation requirement can be seen as detracting from the insurer's contracted-for performance.

The specific performance argument is essentially the same as the "reasonable expectations" argument discussed earlier.<sup>52</sup> The "no mitigation" position lacks traction here as it did there. The fact is that the plaintiff is rarely suing for specific performance, which is equitable relief, or for temporary equitable relief, e.g., a preliminary injunction. The insured is seeking compensation for the harm incurred by the insurer's breach of its obligation. Confusion arises because the insurer's obligation is partially phrased in terms of an obligation to provide and pay for a defense and indemnify the insured. When the insured seeks monetary compensation for the insurer's breach of a duty to pay, it is easy to see how this may be equated to a performance like remedy. That equating, however, is neither accurate nor helpful. The insured does not seek an equitable remedy when suing the insurer for damages. The ability of the plaintiff to be fully made whole by an award of damages militates against a finding that specific performance is an appropriate remedy. The insured's claim against the insurer is no different from a seller's claim against a buyer. In both cases the claims are for money damages resulting from a contract. In neither case, absent a showing of irreparable injury, does the claim seek the actual performance due under the contract. Rather, in both

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<sup>51</sup> JERRY & RICHMOND, *supra* note 49, at 828.

<sup>52</sup> See *supra* notes 23-39 and accompanying text.

cases, the claim seeks compensation for losses caused by the defendant's breach.

It may be argued that, in the duty to defend context, insureds contract for a specific performance that only insurers can provide. Insurers are sophisticated, repeat players in the defense of civil actions. Insurers also employ experienced attorneys, at discount prices, to defend insureds. Insureds for the most part cannot duplicate these advantages that insurers bring to civil litigation defense. This argument, while factually accurate in its assertions regarding insurer capabilities is misplaced when it comes to the issue of the insured's duty to mitigate.<sup>53</sup>

The no mitigation position has some salience if the insured actually seeks specific performance of the insurer's duty to defend to obtain the benefits listed above.<sup>54</sup> In this context, the insured is claiming a specific performance (defense by the insurer) that would be negated if the insured was required to mitigate damages, such as by assuming the defense of the claim. That is a rare occurrence. Few insureds seek specific performance because it is unlikely a court would treat the injury alleged (failure of the insurer to provide a defense) as sufficiently unique and irreplaceable as to satisfy the irreparable injury requirement that is a precondition to equitable relief.<sup>55</sup>

A defense by counsel retained by the insurer is not likely to be meaningfully different from a defense by counsel retained by the insured. This is not to denigrate the experience and competence of retained defense

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<sup>53</sup> An anonymous reviewer suggested this perceptive argument while the *Connecticut Insurance Law Journal* was considering this article for publication.

<sup>54</sup> See *XL Specialty Ins. Co. v. Level Global Investors, L.P.*, 874 F. Supp. 2d 263, 273-74 (S.D.N.Y. 2012) (holding that insurer's failure to pay defense costs under a professional liability policy at the time they were incurred constituted an immediate and direct injury sufficient to satisfy the irreparable harm requirement for preliminary injunction).

<sup>55</sup> See *Dover Steel Co. v. Hartford Accident & Indem. Co.*, 806 F. Supp. 63, 66-67 (E.D. Pa. 1992) (holding that insured had an adequate remedy at law by way of damages for insurer's failure to pay defense costs; moreover, granting preliminary injunction would give the insured the very relief the insured was seeking in the litigation); cf. *Weathersby v. Gore*, 556 F.2d 1247, 1258-59 (5th Cir. 1977):

Weathersby was adequately protected from any damages occasioned by Gore's breach of the contract, if any occurred. He could have acquired additional cotton on the open market when Gore informed him he would no longer perform under contract. He did not do so and thus, if entitled to damages at all, must settle for the difference between the contract and the market price at the time Gore cancelled.

counsel hired by insurers. It simply reflects the reality that an insured who can mitigate damages, i.e., has the resources to retain defense counsel, faces no significant impediment to securing competent legal assistance. Of course, if the insured lacks the financial resources to secure counsel, the mitigation issue is elided. The insured need not do what he is not reasonably able to do. If the insurer's refusal to defend is deemed wrongful, the insurer will ultimately reap the consequences of its shortsighted decision.

Even if retained defense counsel provided by the insurer were deemed qualitatively better than defense counsel that would be retained by the insured, it is questionable whether a court would specifically enforce the insurer's duty to defend. A court might have reservations about its ability to specify in sufficient detail the insurer's obligations if specific performance was ordered. What after all is the content of the duty to defend? An order that the insurer defend the insured, without further elaboration, would be vulnerable to the claim that the order was imprecise and uncertain.<sup>56</sup> Providing the required precision might involve the court in a degree of day-to-day supervision of the defense that courts would prefer to avoid.<sup>57</sup> Should the order to defend specify whether depositions should be taken and, if so, of whom? Should the order specify whether experts are to be retained and, if so, whom and how much should they be paid? Should the order specify whether the matter should be jury tried, whether summary judgment motions should be filed, etc. How would a court determine whether the order to defend was being observed by the insurer? Either the order would be massively detailed or the parties would be constantly before the court seeking clarification and instruction. Neither approach is likely to encounter judicial favor.

If the insured seeks damages, as is generally the case when the insured fails to defend, the insured has conceded that monetary compensation is an adequate remedy for the insurer's breach. When damages become the issue, the focus is now properly directed on the actual cause of the monetary losses. This brings into consideration the issue of mitigation, which asks no more than who (plaintiff or defendant) was the

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<sup>56</sup> See 1 DOBBS, *supra* note 36, §2.8(7), at 12 (noting that "as a matter of substantive and procedural justice" injunctions must be clear and understandable as to what the defendant must or must not do, otherwise the injunction is not valid); FISCHER, *supra* note 3, §34, at 1 ("An injunction must be 'specific and definite' if it is to be enforceable.").

<sup>57</sup> See 1 DOBBS, *supra* note 36, §2.5(4), at 12 (noting traditional judicial reluctance to issue orders in private disputes that require substantial judicial oversight); FISCHER, *supra* note 3, §24, at 1 (noting traditional judicial reluctance to issue orders in private disputes that require substantial judicial oversight).

actual cause of the monetary losses the plaintiff seeks to recover.<sup>58</sup> Whether the plaintiff (insured) acted reasonably in seeking to mitigate damages post-breach is not the issue here – although it clearly will play a significant role in actual cases. The issue here is whether there is a duty to mitigate at all, which is anterior to the question whether the plaintiff properly discharged that duty.

Insureds contract for specific types of performances by insurers. The failure on the insurer's part to provide that performance does not mean that the insured's claim for damages is analogous to a specific performance claim. Insurance contract exceptionalism, insofar as the duty to mitigate is concerned, must turn on public policy factors that are unique to insurance contracts. It is to that issue, this paper now turns.

### 5. Insurer Bad Faith Should Excuse the Duty to Mitigate

Should the duty to mitigate turn on whether the insurer acted in bad faith?<sup>59</sup> The mitigation obligation has not been deemed to turn on the defendant's state of mind or motivation for breaching its legal obligation. This follows from the causal underpinnings of the mitigation requirement,<sup>60</sup> which applies independently from the defendant's motivation and state of mind. There is some support for excusing the mitigation requirement when the defendant engages in intentional misconduct,<sup>61</sup> but this exception is buttressed on the thesis that the mitigation requirement should not require the plaintiff to surrender a right of substantial value, e.g., submit to extortionistic demands to mitigate damages.<sup>62</sup> As discussed previously, in the insurance context a mitigation requirement does not require the plaintiff insured to surrender a right of substantial value.<sup>63</sup>

Excusing the duty to defend when the insurer acted in bad faith would be difficult to implement as a practical matter. The line that separates simple breach from bad faith breach is difficult to define in practice. Disagreement whether insurer conduct evidenced bad faith or not

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<sup>58</sup> See *supra* note 7 and accompanying text; see *infra* notes 65-66 and accompanying text.

<sup>59</sup> The reviewer of this article perceptively raised this question.

<sup>60</sup> See *supra* note 7 and accompanying text.

<sup>61</sup> RESTATEMENT (SECOND) OF TORTS § 918(2) (1977).

<sup>62</sup> Compare *Sinclair v. Fotomat Corp.*, 189 Cal. Rptr. 393 (Cal. Ct. App. 1983), ordered not published per Cal. R. Court 976(c) (requiring plaintiff to pay illegal charge of \$1 to reacquire his property (film) in order to mitigate his damages), with *O'Brien v. Isaacs*, 116 N.W.2d 246 (Wis. 1962) (requiring plaintiff to pay \$1 illegal charge to retrieve his property (car)).

<sup>63</sup> See *supra* notes 29-39 and accompanying text.

is endemic among lawyers and commentators.<sup>64</sup> And even if a bad faith exception were recognized, the determination whether the breach was in bad faith or not would occur long after the time mitigation would have practical value. An insured who by passed a reasonable opportunity to mitigate in effect assumes the risk that the court will ultimately conclude the insurer acted in bad faith. If the court finds that the insurer breached, but the breach did not amount to bad faith, the insured would be deemed to have failed to mitigate. One suspects that even if a bad faith exception to the duty to mitigate was recognized in theory, insureds who could mitigate would mitigate rather than assume the risk that they would be exposed to a *ex post* mitigation requirement.

D. SHOULD INSUREDS BE REQUIRED TO MITIGATE WHEN SEEKING DAMAGES CAUSED BY INSURER BREACH?

The duty to mitigate is modernly predicated on the belief that losses resulting from a legal wrong should be minimized and that regardless of the initial cause of the loss, when a party could, through reasonable care, ameliorate an existing loss, the law should incentivize that party to act.<sup>65</sup> The basic principle is one of legal responsibility for loss that reasonable conduct could have avoided.<sup>66</sup>

The idea that a plaintiff must always seek to reduce his losses through the exercise of reasonable diligence has not been enthusiastically embraced by all commentators. Professor Dobbs, for example, argued that mitigation is not required in two situations: (1) when a party bargains to avoid the requirement and (2) when enforcement of a mitigation

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<sup>64</sup> Bad faith is an imprecise label for what is essentially unreasonable insurer conduct. See Sharon Tennyson & William J. Warge, *The Law and Economics of FirstParty Insurance Bad Faith Liability*, 16 CONN. INS. L.J. 203, 208 (2009) (noting uncertainty over proper standard to determine whether an insurer has engaged in bad faith regarding a coverage decision and discussing various approaches used by courts to address the issue).

<sup>65</sup> RESTATEMENT (SECOND) OF CONTRACTS §350 cmt. a (1981) (stating that the policy behind the mitigation requirement is to encourage parties to avoid further loss); *cf.* RESTATEMENT (SECOND) OF TORTS §918 cmt. c (1977) (stating that mitigation principle is based on principle of causation; the party that fails to exercise reasonable care to prevent further loss should bear the loss that party has caused).

<sup>66</sup> See Douglas H. Cook, *Personal Responsibility and the Law of Torts*, 45 AM. U.L. REV. 1245, 1252 (1996) (noting that the mitigation is one of a number of common law doctrines that allocated to the plaintiff's responsibility for losses sustained through the actions of another).

requirement would encourage breach.<sup>67</sup> More directly, Dobbs suggested that these principles were particularly relevant to insurance contracts. First, insureds, as a group, bargain for a specific performance that a mitigation requirement would negate. Second, a mitigation requirement would subject insureds to opportunistic leverage by the insurer. Dobbs's first argument, exemplified by the duty to defend cases, that the insured has contracted for a specific performance – a defense, which a mitigation requirement would negate, has already been addressed in this paper. While insureds no doubt bargain for a specific performance, insureds are no different from all contracting parties who bargain for specific performances by their reciprocal contracting parties. Bargaining for a specific performance is, however, vastly different from the remedy of specific performance and Dobbs unfortunately confuses the two.

Dobbs's second argument is evidenced by the disability insurance cases. Here, the insured has contracted for benefits because he is unable to engage in certain types of gainful employment; yet, a mitigation requirement would require him to work and, at the same time, provide the insurer with some evidence that the insured is not disabled and not entitled to continuing benefits. Dobbs argues that a mitigation obligation would require the plaintiff to undermine his or her own claim and, thus, incentivize insurers to deny claims in the hope that the plaintiff's mitigation effort would demonstrate the correctness of the denial. In this sense Dobbs treats the mitigation requirement as opportunistic (my characterization not Dobbs) in that it allows the insurer to use the requirement to force the insured to undermine her own claim.

The "no mitigation" argument relieves the insured of any duty to exercise reasonable care to reduce his losses. The problem is carving out a "no mitigation" requirement exception for insurance contracts cannot be justified by treating insurance contracts as different from other contracts without identifying a reason for different treatment. The proponents of a "no mitigation" requirement have not done this.<sup>68</sup> Every claim that is subject to a mitigation requirement presents the potential that the plaintiff's efforts to mitigate will work against the overall success of the claim. The landlord who must relet to mitigate damages defeats, to some extent, the claim against the tenant who abandons the leasehold, as does the buyer who must cover to mitigate losses when the seller breaches and refuses to

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<sup>67</sup> 1 DOBBS, *supra* note 36, §3.9, at 385.

<sup>68</sup> This is not to say that insurance contracts are not different in some respects from ordinary contracts. I acknowledge that they are. *See supra* notes 29-39 and accompanying text. The issue is whether the differences warrant nonapplication of the general requirement that a plaintiff exercise a reasonable care to mitigate losses.

deliver contracted-for goods. The insured who must mitigate is in no different position. It is difficult to see how tenants or sellers are any more or less opportunistic than insurers when it comes to breach.

While a generalized, unproven concern regarding incentives to breach does not justify negating a mitigation requirement, there are situations when a mitigation requirement should not be recognized because it may confuse rather than enlighten. For example, in the disability cases there is usually a substantial overlap between the insurer's claim the insured is not disabled and the mitigation issue – are there reasonable steps the insured could take to ameliorate the disabling condition. In some cases, a duty to mitigate should not be recognized because the mitigation requirement is directly at odds with the contentions raised by the insurer as to its coverage obligations. Cases such as *Moots v. Bankers Life Company*<sup>69</sup> illustrate this point. When the insurer contends the insured can work and, therefore, is not disabled, imposing a mitigation requirement on the insured that the insured find work can be reasonably understood as tending to encourage the breach. A mitigation requirement would give insurers unfair leverage in this situation.

Decisions like *Heller*<sup>70</sup> and *Miller*<sup>71</sup> are different, although the difference can be fine and nuanced. In these cases, there is some overlap between the insurer's no coverage position and the mitigation obligation. In *Heller* the issue is whether the insured should submit to surgery to ameliorate the disabling condition (Carpal Tunnel Syndrome). In *Miller* the issue is whether the insured should take insulin and watch his diet to control his disabling condition (diabetes). In these cases the insurer is not contending, as in *Moots*, that the insured is not disabled; rather, the insurer is conceding present disability if the condition is untreated, but arguing that the insured has the means to end the disabling condition. The position argued here is that in the latter situation the mitigation requirement is properly imposed. An insured should be required to expend reasonable efforts to reduce damages.

One can justify the “no mitigation” rule in true specific performance cases because specific performance is an equitable remedy that requires that the remedy at law be inadequate. In most cases, this requires that the subject matter for the contract be unique. A mitigation requirement may be truly inconsistent with the plaintiff's desired remedy because mitigation would deny the plaintiff the specific, unique thing that was contracted for initially and for which money is not an adequate substitute. Insurance contracts are, on the other hand, all about money.

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<sup>69</sup> See *supra* notes 43-44 and accompanying text.

<sup>70</sup> *Heller*, 833 F.2d 1253, discussed *supra* notes 15-17 and accompanying text.

<sup>71</sup> *Miller*, 289 N.W. 399, discussed *supra* note 35 and accompanying text.



There is nothing unique about the subject matter of the insurer's performance.<sup>72</sup> While an insurer's performance itself may not be substitutable because, in most cases, the insured cannot purchase a substitute insurance policy to cover a known, existent loss,<sup>73</sup> the fact remains that the insurer's performance is essentially an obligation to pay money, whether for a defense or for indemnity, and money is not unique.

Insurance contracts are different in some respects from other contracts and this has caused courts to treat them differently, particularly insofar as remedies for breach as concerned. I offered several doctrinal justifications for this approach in a prior paper.<sup>74</sup> Because of these differences, many courts permit tort-based<sup>75</sup> or extra-contractual remedies<sup>76</sup>

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<sup>72</sup> See *supra* notes 55-58 and accompanying text.

<sup>73</sup> ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW* §5.3(a), at 475 (1988) (stating that it is a basic principle that insurance cover only the risk of fortuitous loss); 1A *COUCH ON INSURANCE* 3D §13:15 (2010) ("When the insured knows or has reason to know when it purchases a policy of insurance that there is a substantial probability that it will suffer or has already suffered a loss, the risk ceases to be contingent and becomes an uninsurable "known loss."); see *Foley v. Interactive Data Corp.*, 765 P.2d 373, 39596 (Cal. 1988) (noting the special dilemma faced by an insured who cannot secure replacement insurance to cover the same loss).

<sup>74</sup> James M. Fischer, *Why Are Insurance Contracts Subject to Special Rules of Interpretation: Text Versus Context*, 24 *ARIZ. ST. L.J.* 995 (1992) (noting, for example, the (1) quasipublic status of insurers, (2) informational asymmetry between insurer and insured, and (3) the desire to require insurers to internalize the costs of breach, among others).

<sup>75</sup> See DOUGLAS LAYCOCK, *MODERN AMERICAN REMEDIES* 6062 (4<sup>th</sup> ed. 2010) (stating that if the insurer refuses or delays payment in bad faith, the insured may recover consequential and punitive damages for nonpayment of a legitimate claim); Roger C. Henderson, *The Tort of Bad Faith in FirstParty Insurance Transactions: Refining the Standard of Culpability and Reformulating the Remedies by Statute*, 26 *U. MICH. J.L. REFORM* 1, 2226 (1992) (describing the creation of the tort of insurer bad faith); see generally A. S. Klein, Annotation, *Insurer's Liability for Consequential or Punitive Damages for Wrongful Delay or Refusal to Make Payments Due Under Contracts*, 47 *A.L.R.3d* 314 (1973).

<sup>76</sup> *BiEconomy Market, Inc. v. Harleystown Ins. Co. of New York*, 886 N.E.2d 127, 132 (N.Y. 2008) (holding that an insured may recover consequential damages flowing from an insurer's breach of an insurance contract); the traditional rule in the United States when a breaching party failed to pay a claim was to limit the nonbreaching party's recovery to the sum owed but not paid by the breaching party, plus delay damages in the form of prejudgment interest. See, e.g., *Loudon v. Taxing Dist.*, 104 U.S. 771, 774 (1881) (holding that an aggrieved party in a contract action is entitled only to the amount owed and any interest that has accrued during the delay period). See generally 11 SAMUEL WILLISTON, *A TREATISE ON THE LAW OF CONTRACTS* §1410, at 60406 (Walter H.E. Jaeger ed., 3d

to discourage opportunistic breaches by insurers. Would a mitigation requirement encourage insurers to breach? If so, this would support not imposing such a requirement on insureds.

There is no empirical evidence one way or the other as to whether a mitigation requirement has any impact on the insurer's decision to breach. It is reasonable to suppose that any rule that reduces the cost of breach produces some incentive, to a rational actor, to breach, all other things being equal. This supposition may not, however, reflect the actual world of insurer breaches. All other things are rarely equal and the incremental push toward breach that a mitigation requirement could provide in theory may be too small to measure in practice, much less attribute significance to in calculating legal responses. For example, the threat of consequential and punitive damages for breach may nullify any offsetting benefits a rational insurer could derive from breach. The assumption that the insurer acts rationally in deciding whether to breach may also be questioned. Insurers are large, diverse organizations and identifying how a decision is made, much less why it was made, may be challenging. Moreover, rationality may be compromised or preempted by cognitive biases that distort decision making and result in decisions inconsistent with the actual facts and not in the best interests of the insurer. Incentives don't work effectively unless the responding parties understand the signal the incentive is sending.

While one must be respectful of known unknowns, the lack of empirical evidence and the uncertainty of reasoned speculation cuts both ways; a mitigation requirement is neither supported nor derailed. Notwithstanding this uncertainty, the position taken here is that a mitigation requirement should be imposed on the insured for the following reasons.

First, mitigation does not impose a heavy burden on the insureds. An insured must act reasonably to mitigate breach related losses.<sup>77</sup> Moreover, what is reasonable is determined based on the facts realistically available to the insured when mitigation is required.<sup>78</sup> A party who makes, with the benefit of 20/20 hindsight, a bad choice does not fail to mitigate damages if the choice was reasonable under the circumstances as they existed at the time of the party acted.<sup>79</sup>

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ed. 1968) (citing several cases in which the only relief awarded in a suit for nonpayment of a debt was the debt itself plus interest from the time due); CHARLES T. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES §139, at 569 n.28 (1935) (citing cases in which recovery for "normal damage" resulting from breach of contract to lend money was limited to excess costs incurred in securing a loan elsewhere).

<sup>77</sup> FISCHER, *supra* note 3, at 134.

<sup>78</sup> *Id.*

<sup>79</sup> RESTATEMENT (SECOND) OF CONTRACTS § 350(2) cmt. b (1981).

Second, mitigation does not require a party to do what that party cannot do. It is a difficult proposition to sustain, as the “no mitigation” advocates must, that acting reasonably is undesirable. If the insurer refuses to defend the insured, the insured need not reduce himself to poverty to defend the claim.<sup>80</sup> Rather the insured may enter into a reasonable, non-collusive settlement of the dispute even if the insured has a good defense to the claim.<sup>81</sup> In disability insurance context, why should an insured be incentivized to reject reasonable efforts to reduce or cure the disabling condition? In *Miller v. Mutual Life Ins. Co. of New York* the court upheld the insured’s decision to refrain from taking insulin or following a physician recommended diet to control his disabling condition (diabetes) on the rationale the insured owed no duty to mitigate damages.<sup>82</sup> What social policy is advanced here? Recognizing a duty to mitigate would at least permit a trier-of-fact to assess whether the insured’s conduct was reasonable. If the insured has a reasonable basis for not taking insulin or watching his diet, the mitigation requirement is met. The “no mitigation” approach encourages unreasonable conduct. How is that beneficial or a goal to be advanced by insurance law?

Third, mitigation doctrine has always been respectful of the right of the plaintiff to maintain his bodily and personal integrity, which need not be compromised to reduce the defendant’s damages exposure. The plaintiff need not expose himself to risk nor must the plaintiff accept a materially different outcome as a substitute for the defendant’s promised performance.<sup>83</sup> The mitigation requirement has always been tempered with the realization that the plaintiff’s mitigation obligation is not one that was voluntarily assumed, but is one that has been imposed by the defendant’s commission of a legal wrong. In this regard, courts and juries tend to give plaintiffs substantial space by viewing the reasonableness requirement elastically and with a pro-plaintiff bias.<sup>84</sup> Concerns that a mitigation requirement will provide insurers with a cudgel they can use to attack their insureds are unrealistic.

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<sup>80</sup> See *Damron v. Sledge*, 460 P.2d 997, 999 (Ariz. 1969) (stating that when the insured is exposed by his insurer “to the sharp thrust of personal liability . . . [h]e need not indulge in financial masochism”).

<sup>81</sup> See *Arizona Prop. & Cas. Ins. Guar. Fund v. Helme*, 735 P.2d 451, 460 (Ariz. 1987) (holding that insurer breach permits the insured to enter into a reasonable settlement, as long as the settlement is not fraudulent, collusive, or against public policy). 2 WINDT, *supra* note 14, §6.29, at 6236.

<sup>82</sup> *Miller*, 289 N.W. at 402.

<sup>83</sup> 1 DOBBS *supra* note 36, § 3.9, at 382 (“The plaintiff is not required to accept great risks, undertake heroic measures, or accept great personal sacrifice to minimize damages for the benefit of the defendant.”).

<sup>84</sup> See FISCHER, *supra* note 3, at 135.

Fourth, it is difficult to avoid the force of the basic argument that the insured should act reasonably, when he can do so to mitigate damages. It may be argued that greater damages will result in a greater sanction and, thus, greater deterrence to insurer breach. There is, no doubt, some truth to the basic proposition, but the question courts must ask is how much sanction can one impose before the sanction loses its compensatory element and become punitive? And even if a punitive measure of damages is warranted, is encouraging the insured to act unreasonably a good method of punishing the insurer for its breach?

Fifth, courts have not extended the “no mitigation” rule to contractual expectancies that contain a durational element. By a durational element I mean a contract that envisions that a party’s performance will extend over a period of time. A contract of sale is usually not a durational contract because it envisions a specific closing date when performance is due. Employment contracts are examples of contracts that are durational.<sup>85</sup> The bargained for earnings are a contract expectancy, yet since the 19<sup>th</sup> century courts have imposed a mitigation obligation on the non-breaching employee. The underlying reason here was moral concerns over encouraged idleness and abnegation of a social duty to be a productive member of society. Insurance contracts often possess this durational element. In the liability and disability insurance context where the mitigation argument has been most frequently claimed and challenged, the insurer’s obligations are often continuing, for example, the providing of a defense to a claim against the insured or the providing of periodic payments to an insured. In this sense, insurance contracts possess an element that aligns them with employment contracts.

This common element supports assigning a mitigation requirement to insureds even though they are seeking nothing more than the performance that was promised them under the insurance contract. The durational element creates the opportunity post-breach for the insured to reduce the quantum of loss. Because the loss is ongoing, mitigation efforts parallel the onset of each loss producing event. And because the insurance contract is designed to indemnify against loss, rather than produce a windfall, mitigation efforts directly correlate with both the actual realization of loss and the quantification of that loss. The insured has meaningful control over the realization or size of the loss. This is a valid reason for requiring the insured to act reasonably to mitigate that loss.

A reviewer of this Article raised the provocative question whether instead of imposing a duty to mitigate on insureds a better approach would be to require insurers to timely commence declaratory relief actions when coverage disputes arise between the insurer and the insured. Quicker

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<sup>85</sup> *See Id.* at 136-39.

resolution of coverage disputes would address some of the concerns raised in this paper. Unfortunately, use of declaratory relief is unlikely to affect the mitigation issue unless the insurer is required to perform under the insurance contract (e.g., pay or defend) until the declaratory relief action is resolved. Insurers are unlikely to accept this as a fair resolution of the controversy. Absent the imposition of an ongoing duty to perform, institution of declaratory relief does not avoid the mitigation issue. Litigation tends to be a long, drawn out process, to which declaratory relief is no exception.<sup>86</sup> During that time period, the insured may be able to ameliorate his losses by exercising reasonable care. The position asserted in this Article is that when that situation presents, the insured should be required to exercise reasonable care to do so. If he does not, his recovery should be reduced *pro tanto*.

#### D. CONCLUSION

The duty to mitigate has been aptly described as “an application of common sense.”<sup>87</sup> Rejecting a duty to mitigate adopts the views that damages post-injury should be augmented rather than lessened. Mitigation asks no more of the plaintiff than to act reasonably under the circumstances to ameliorate the plaintiff's own injuries. That is not an unreasonable expectation. If the plaintiff fails to act reasonably, that is ample justification to hold the plaintiff responsible for the resulting losses reasonable care would have avoided.

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<sup>86</sup> In some jurisdictions, courts defer resolving declaratory relief claims (e.g. no duty to defend) until the related litigation (claim against the insured for which the insured seeks a defense) is resolved. *See Johansen v. California State Auto. Ass'n InterIns. Bureau*, 538 P.2d 744, 752 (Cal. 1975) (holding that the insurer does not have right to delay trial of a personal injury action in which its insured is a defendant pending resolution of a declaratory relief action in which the issue of coverage is to be determined); *cf. Zurich Ins. Co. v. Rombough*, 180 N.W.2d 775, 778 (Mich. 1970) (holding that permitting insurer to pursue declaratory relief would impede resolution of the underlying lawsuit).

In these jurisdictions, resort to declaratory relief would not help resolve the mitigation issue. Other jurisdictions take the opposite approach, seeing declaratory relief as an expeditious means of reducing confusion and avoiding needless delay and expense. *See Elliot v. Donahue*, 485 N.W.2d 403, 406 (Wis. 1992) (requiring insurer to institute declaratory relief action to resolve coverage dispute with insured). *See generally* Davis J. Howard, *Declaratory Judgment Coverage Actions: A Multistate Survey and Analysis and State Versus Federal Law Comparison*, 21 OHIO N.U. L. REV. 13 (1994).

<sup>87</sup> 3 JACOB A. STEIN, *PERSONAL INJURY DAMAGES TREATISE* § 18:1 (3d ed. 2012).