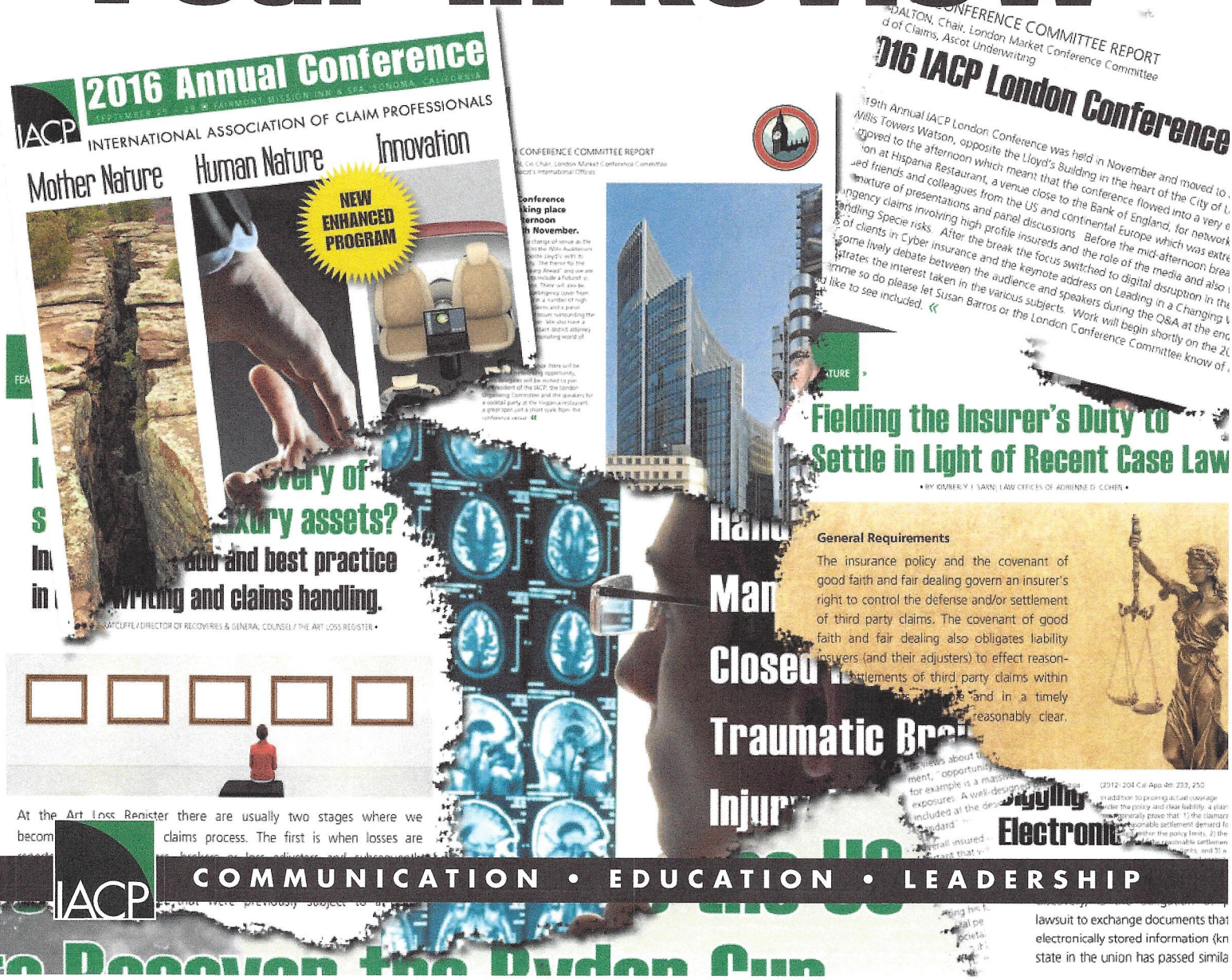
INTERNATIONAL ASSOCIATION OF CLAIM PROFESSIONALS

DECLARATIONS

SPRING 2017

2016-2017 Year In Review



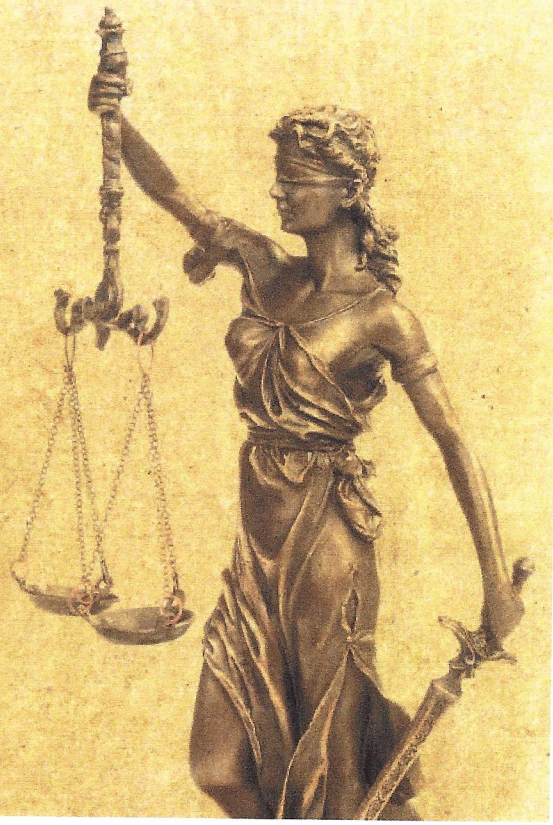
FEATURE »

Fielding the Insurer's Duty to Settle in Light of Recent Case Law

• BY KIMBERLY J. SARNI, LAW OFFICES OF ADRIENNE D. COHEN •

General Requirements

The insurance policy and the covenant of good faith and fair dealing govern an insurer's right to control the defense and/or settlement of third party claims. The covenant of good faith and fair dealing also obligates liability insurers (and their adjusters) to effect reasonable settlements of third party claims within the policy limits available and in a timely manner, where liability is reasonably clear.



Comunale v. Traders & Gen. Ins. Co. (1958) 50 C3d 654, 658. One of the basic premises of the implied covenant of good faith and fair dealing is that an insurer will give its insured's interests at least as much consideration as it does its own in evaluating the reasonableness of a settlement demand, and to settle the claim within the policy limits, if possible.

An insurance carrier is called upon to balance the insured's interests in resolving a claim within policy limits against the possibility that liability for the claim may ultimately denied by a trier of fact, or that the damages awarded will be less than the amount of the demand. Claims professionals are charged with conducting an investigation seeking to affirm coverage for the claim under the policy and of liability and damages alleged by the third party. Thereafter, an evaluation must be performed respecting the potential for exposure of the insured to personal liability in excess of the policy limits in the event that there is liability and a causal connection between the insured's action and the damages alleged.

The threshold requirement for an action for bad faith refusal to settle is that the subject liability policy actually covers the claim to be settled. An insurer has a duty to accept a settlement offer only with respect to a covered claim. *DeWitt v. Monterey Ins. Co.* (2012) 204 Cal.App.4th 233, 250.

In addition to proving actual coverage under the policy and clear liability, a plaintiff must generally prove that: 1) the claimant made a reasonable settlement demand for an amount within the policy limits; 2) the insurer rejected the reasonable settlement demand within the policy limits; and 3) a monetary judgment was entered against the insured in excess of the policy limits.

The California Judicial Council adopted a jury instruction, based upon the California Supreme Court's decision in *Johansen v. California State Auto. Ass'n Inter-Ins. Bureau*, (1975) 15 Cal.3d 9, defining the qualifications for a "reasonable" settle-

ment demand; "A settlement demand is reasonable if the insurer knew or should have known at the time the demand was rejected that the potential judgment was likely to exceed the amount of the settlement demand, based on the claimant's injuries or loss and the insured's probable liability." CACI 2334.

A claim for "wrongful refusal to settle" requires proof that an insurer *unreasonably* failed to accept an offer within the policy limits within the timeframe specified for acceptance. Conversely, when an insurer timely tenders its full policy limits, the insurer has generally acted in good faith as a matter of law. That is, unless it acts unreasonably in the ultimate completion of the settlement, as recently outlined by the Court in the recent *Barickman* decision.

Can an Insurer Timely Accept a Reasonable Settlement Demand Within the Policy Limits and Still be Liable for Bad Faith Refusal to Settle a Claim?

Barickman v. Mercury Casualty Co. (2016) 2 Cal.App.5th 508

Bad faith liability may be imposed where an insurer engages in unreasonable conduct that prevents a settlement, following the timely tender of policy limits to settle a third party's claim. In *Barickman v. Mercury Casualty Co.* (2016) 2 Cal.App.5th 508, Mercury's insured hit two pedestrian plaintiffs with his vehicle while he was intoxicated. Following the accident, Mercury's insured was sentenced to three (3) years in state prison and ordered to pay $165,000 in restitution. Shortly after it was notified of the accident, Mercury offered its policy limits to plaintiffs in settlement of their bodily injury claims. Plaintiffs accepted the settlement offer. Thereafter Mercury provided a proposed Release, which plaintiffs signed, albeit with a modification to insert the phrase, "[t]his [release] does not include court-ordered restitution." Concerned that the added language would adversely affect its insured's right to offset the amount of the settlement against his criminal restitution obligation, Mercury refused to agree to the modification of the release. Plaintiffs filed a lawsuit, and obtained a stipulated judgment against the insured driver for $3 million. A bad faith lawsuit followed, and the parties agreed to a bench trial before an appointed referee. The referee found that Mercury was liable for the excess judgment because it had unreasonably refused to agree to the release modification proposed by the plaintiffs.

In affirming the lower court's finding, the Court of Appeal found that even though Mercury initially acted in good faith by making a timely tender of the policy limits, it subsequently engaged in unreasonable conduct that prevented the settlement from being consummated. The Court noted that Mercury could have proposed clarifying language for the modification, but elected not to do so.

Is There a Duty for the Insurer to Affirmatively Pursue a Settlement Within Policy Limits to Avoid Liability for Bad Faith Refusal to Settle?

Graciano v. Mercury General Corp. (2014) 231 Cal.App.4th 414

Of particular interest is the question of whether an insurer has an affirmative duty to pursue a third party settlement within the policy limits, and if so, whether it must be done within a specific time from inception of the claim in order to effectively preclude a claim for bad faith refusal to settle.

In *Du v. Allstate Ins. Co.* (2012) 697 F.3d 753, following an initial, differing version of its opinion which was ultimately depublished,

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the United States Court of Appeal held that when the issue of settlement is broached at a sufficiently early time in the litigation, it vitiates any claim (against the insurer) for failure to initiate a settlement discussion. In deflecting a ruling on the ultimate issue of whether an insurer had an affirmative duty to pursue settlement within the policy limits, the Court found that the insurer could not make an earlier offer because it lacked corroborating proof of the extent of the claimant's injuries and medical expenses. *Id.* at 758. While no specific time frame was articulated, the *Du* Court's ruling suggested that a carrier cannot be expected to make a settlement offer to a claimant without confirming liability and corroborating the damages alleged by the claimant, which required sufficient time.

In determining that an insured's claim for wrongful refusal to settle cannot be based on his or her insurer's failure to *initiate* settlement *overtures* with the injured third party, the Court in *Graciano v. Mercury General Corp.* (2014) 231 Cal.App.4th 414 stated that proof is required that the third party made a reasonable offer to settle the claims against the insured for an amount within the policy limits. Relying on the Court's holding in *Reid v. Mercury Ins. Co.* (2013) 220 Cal.App.4th 262, 277, the Graciano Court went on to conclude that, "nothing in California law supports the proposition that bad faith liability for failure to settle may attach if an insurer fails to initiate settlement discussions, or offer its policy limits, as soon as an insured's liability in excess of policy limits has become clear." Instead, proof is required that the third party made a reasonable offer to settle the claims against the insured for an amount within the policy limits.

Multiple Insurers on the Risk: Is an Excess Judgment Always Required?

Ace American Ins. Co. v. Fireman's Fund Ins. Co. (2016) 2 Cal. App.5th 159

Where multiple insurance policies provide coverage, each insurance carrier's obligation is to cover the full extent of the insured's liability, up to the policy limits. *Howard v. American Nat'l Firer Ins. Co.* (2010) 187 Cal.App.4th 498. 525. An excess insurer is exposed to

continued on page 16

FEATURE »

Fielding the Insurer's Duty to Settle...

continued from page 15

liability by a primary insurer's refusal to settle a case in which there is a likelihood of a judgment in excess of the primary insurer's policy limits. *Diamond Heights Homeowners Ass'n v. National American Ins. Co.* (1991) 227 Cal.App.3d 563, 579. As such, a primary insurer must conduct settlement negotiations so as to not expose the excess insurer to unwarranted liabilities. *Id.* An excess insurer may therefore recover against a primary insurer when the primary insurer refuses to accept a settlement offer within its policy limits, and there is a substantial likelihood of recovery in excess of the primary policy's limits. *Commercial Union Assurance Companies v. Safeway Stores, Inc.* (1980) 26 Cal.3d 912, 917. Specifically, an excess insurer can recover against a primary insurer for a judgment in excess of the policy limits caused by the primary insurer's refusal to settle, and the excess insurer is permitted to assert all claims against the primary insurer that the insured could have so asserted. *Id.* at 918.

In *Ace American Ins. Co. v. Fireman's Fund* (2016) 2 Cal.App.5th 159, a "bad faith refusal to settle" claim was brought by an excess carrier against a primary insurer who it claimed unreasonably refused to accept a third party settlement demand within its policy limits. The underlying third party action involved a worker who was seriously injured in a special effects accident, and filed suit against Warner Brothers Entertainment and related entities for damages and loss of consortium. Fireman's Fund insured Warner Brothers with liability policies totaling $5 million, and Ace American provided excess coverage under a liability policy with limits of $50 million. Fireman's Fund provided a defense to the insured, Warner Brothers Entertainment. Fireman's Fund allegedly unreasonably refused to accept a settlement demand within its $5 million limits, and the lawsuit later **settled** for an amount substantially more than $5 million. Fireman's Fund consented to and contributed its policy limits of $5 million, and Ace funded the balance of the settlement.

Ace then sued Fireman's Fund for "bad faith refusal to settle" under an equitable subrogation theory. Fireman's Fund filed a demurrer on the grounds that the underlying action was settled, arguing that the absence of a judgment barred the bad faith claim pursuant to the Court's holding in *RLI Ins. Co. v. CNA Cas. Of Cal.* (2006) 141 Cal. App.4th 75. The trial court sustained the demurrer without leave to amend, holding that "*RLI* is directly on point. *RLI* was clear: Until the judgment is actually entered, the mere possibility or probability of an excess judgment does not render the refusal to settle actionable."

Ace appealed, and the Court of Appeal reversed, holding that *RLI* was wrongly decided and that Ace had a viable claim. The Appellate Court analyzed California Supreme Court precedent, and found that the subject case was most similar to *Isaacson v. California Ins. Guarantee Assn.* (1988) 44 Cal.3d 775, in which the Supreme Court allowed an insured who actually contributed money toward a settlement to bring a "bad faith failure to settle" action against the insurer to recover the money paid. The Ace Court further noted that its holding was consistent with cases from other jurisdictions, in which it has been adjudicated that an insured or excess insurer that contributes to a settlement can pursue the primary insurer for failing to accept a reasonable settlement demand within the primary policy's limits.

Practical Application

Recent case law has further defined the circumstances under which both insureds and excess carriers can bring actions against primary insurers for "bad faith refusal to settle." These actions have resulted from unreasonable actions taken by a primary insurer following the timely tender of policy limits, or the primary carrier's refusal to accept a reasonable settlement demand within its own policy limits.

One of the best protections against an action for bad faith refusal to settle is the timely evaluation of the claim. To that end, an insurance carrier does not have to have all of the information respecting the claim, but rather enough information upon which to make a decision respecting potential liability and the value of the damages. Obtaining medical records, police reports, expert reports, witness statements or costs to repair, depending on the nature of the claim, from the claimant and/or his or her counsel or through the discovery process if the claim is in litigation, generally provides an adequate basis for an appropriate evaluation.

Moreover, communication of the carrier's desire for information and cooperation with the third party claimant or counsel can go a long way toward assuring that there is no actionable claim against the carrier for bad faith refusal to settle. In the event that a policy limits' demand is made before a sufficient evaluation of the claim can be made, the carrier or defense counsel can request an extension to respond, or provide the claimant with an explanation of the additional information necessary to complete the investigation and respond to the demand.

Finally, even after a settlement is reached, a carrier should continue its reasonable efforts to complete the settlement process by cooperatively working with the third party claimant and/or counsel to agree on the settlement terms, and to bring the settlement to completion as soon as practical. As long as the carrier continues to give as much weight to its insured's interests as its own, its efforts will be in good faith. «

KIMBERLY J. SARNI

Kimberly J. Sarni is a Principal with the Law Offices of Adrienne D. Cohen, a well-recognized insurance coverage and defense firm with offices in Santa Ana and San Rafael, California.

Ms. Sarni has experience in all aspects of general liability defense, including construction defect, personal injury and commercial litigation. She has had the privilege of representing insurance carriers and the California Insurance Guarantee Association in first party coverage and defense matters, as well as policyholders in third party claims litigation, in her more than 20 years of practice. She regularly conducts California Insurance Regulations Training for claims adjusters in California and Arizona, and counsels carriers on best practices for claims resolution in California.