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The duty-to-settle analysis after *Pinto*

WAS THE INSURER'S FAILURE TO SETTLE THE RESULT OF UNREASONABLE CONDUCT ON THE PART OF THE INSURER?

The duty of good faith and fair dealing requires a third-party liability insurer to settle a lawsuit against its insured when there is a clear and unequivocal offer to settle within policy limits, liability is reasonably clear, and there is a likelihood of a recovery in excess of the policy limits. In *Comunale v. Traders & General Ins. Co.*(1958) 50 Cal.2d 654, the Supreme Court held that "the implied obligation of good faith and fair dealing requires the insurer to settle in an appropriate case although the express terms of the policy do not impose such a duty." (*Id*. at 659.) In deciding whether a claim against an insured should be settled, the insurer "must take into account the interest of the insured and give it at least as much consideration as it does to its own interest." (*Ibid*.) Last year, in *Pinto v. Farmers Ins. Exchange*, (2021) 61 Cal.App.5th 676 ("*Pinto*"), the Court of Appeal analyzed an insurer's duty to settle under California law. This article will address the effect of the *Pinto* decision.

CACI 2334 prior to *Pinto*

The law pertaining to the duty of good faith and fair dealing in the context of the duty to settle is set forth in CACI 2334, which prior to *Pinto*, stated:

> [Name of plaintiff] claims that [he/she/it] was harmed by [name of defendant]'s breach of the obligation of good faith and fair dealing because [name of defendant] failed to accept a reasonable settlement demand in a lawsuit against [name of plaintiff]. To establish this claim, [name of plaintiff] must prove all of the following:
> 1. That [name of plaintiff in underlying case] brought a lawsuit against [name of plaintiff] for a claim that was covered by [name of defendant]'s insurance policy;
> 2. That [name of defendant] failed to accept a reasonable settlement demand for an amount within policy limits; and
> 3. That a monetary judgment was entered against [name of plaintiff] for a sum greater than the policy limits.
>
> "Policy limits" means the highest amount available under the policy for the claim against [name of plaintiff].
>
> A settlement demand for an amount within policy limits is reasonable if [name of defendant] knew or should have known at the time the demand was rejected that the potential judgment was likely to exceed the amount of the demand based on [name of plaintiff in underlying case]'s injuries or loss and [name of plaintiff]'s probable liability. However, the demand may be unreasonable for reasons other than the amount demanded.

As set forth above, the focus of CACI 2334 prior to *Pinto* was on the reasonableness of the settlement *demand*. For several years before *Pinto*, the insurance industry argued that, in addition to establishing the reasonableness of the settlement demand, an insured also needed to prove that the failure to settle was as a result of unreasonable *conduct* on the part of the insurer. In fact, when CACI

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2334 was first promulgated in 2003, this is how the instruction read. It was changed to its current form in 2007. In 2016, the CACI committee debated modifying CACI 2334 to once again include this additional element and discussed the issue in the instruction's use notes, as follows:

> Under this instruction, if the jury finds that the policy-limits demand was reasonable, then the insurer is automatically liable for the entire excess judgment. Language from the California Supreme Court supports this view of what might be called insurer "strict liability" if the demand is reasonable. (See *Johansen v. California State Auto. Assn. Inter-Insurance Bureau* (1975) 15 Cal.3d 9, 16 [123 Cal.Rptr. 288, 538 P.2d 744] ["[W]henever it is likely that the judgment against the insured will exceed policy limits 'so that the most reasonable manner of disposing of the claim is a settlement which can be made within those limits, a consideration in good faith of the insured's interest requires the insurer to settle the claim,' "italics added].)
>
> However, there is language in numerous cases, including several from the California Supreme Court, that would require the plaintiff to also prove that the insurer's rejection of the demand was "unreasonable." (See, e.g., *Hamilton v. Maryland Cas. Co.* (2002) 27 Cal.4th 718, 724-725 [117 Cal.Rptr.2d 318, 41 P.3d 128] ["An *unreasonable* refusal to settle may subject the insurer to liability for the entire amount of the judgment rendered against the insured, including any portion in excess of the policy limits," italics added]; *Graciano v. Mercury General Corp.* (2014) 231 Cal.App.4th 414, 425 [179 Cal.Rptr.3d 717] [claim for bad faith based on an alleged wrongful refusal to settle also requires proof the insurer *unreasonably* failed to accept an otherwise reasonable offer within the time specified by the third party for acceptance, italics added].) Under this view, even if the policy-limits demand was reasonable, the insurer may assert that it had a legitimate reason for rejecting it. However, this option, if it exists, is not available in a denial-of-coverage case. (*Johansen*, *supra*, 15 Cal.3d at pp. 15-16.)
>
> None of these cases, however, neither those seemingly creating strict liability nor those seemingly providing an opportunity for the insurer to assert that its rejection was reasonable, actually discuss, analyze, and apply this standard to reach a result. All are determined on other issues, leaving the pertinent language as arguably dicta.
>
> For this reason, the committee has elected not to change the elements of the instruction at this time. Hopefully, some day there will be a definitive resolution from the courts. Until then, the need for an additional element requiring the insurer's rejection of the demand to have been unreasonable is a plausible, but unsettled, requirement. For a thorough analysis of the issue, see the committee's report to the Judicial Council for its June 2016 meeting, found at https://jcc.legistar.com/View.ashx?M=F&ID=4496094&GUID=53DBD55C-AF07-498F-B665-D6BDD6DEFB28.
>
> While the CACI committee acknowledged the debate about whether there should be an additional element in CACI 2334 of unreasonable conduct on the part of the insurer, it declined to modify the instruction until there was a more definitive resolution from the courts. This set the stage for the *Pinto* decision.

The *Pinto* decision

Pinto involved the insurer's failure to settle a personal-injury case within policy limits, resulting in an excess verdict. In the bad-faith trial, the special-verdict form was patterned on CACI 2334 and thus did not include the additional element asking whether the insurer's conduct was unreasonable. Rather, the focus under CACI 2334 was on the reasonableness of the settlement demand. The jury returned with a verdict in favor of the plaintiff. But the Court of Appeal reversed the judgment because the special-verdict form did not ask the jury to make a finding that the insurer's failure to settle was unreasonable.

The *Pinto* court reasoned that "[a] claim for bad faith based on the wrongful refusal to settle thus requires proof the insurer unreasonably failed to accept an offer." (*Id.* at 688.) The *Pinto* court noted that under CACI 2334, "[n]o element addresses whether the insurer's failure to settle was unreasonable" (*Id.* at 690). The court went on to hold that the "special verdict here was facially insufficient to support a bad faith judgment because it included no finding that Farmers acted unreasonably in failing to accept Pinto's settlement offer." (*Id.* at 689).

The *Pinto* court also indicated what would have been the correct modification to CACI 2334 as follows: "Farmers proposed that a special verdict question mirroring CACI No. 2334 be modified to ask whether Farmers's failure to accept Pinto's settlement offer was 'the result of unreasonable conduct by Farmers'…This would have been the correct question, but Pinto successfully objected to it." (*Id.* at 694). In light of *Pinto*, the CACI 2334 instruction was modified to include an added element that the failure to settle was the result of unreasonable conduct on the part of the insurer.

The effect of *Pinto* on the duty-to-settle analysis

It is worth noting what the *Pinto* decision did not change. That is, a plaintiff must still establish that the settlement demand was reasonable in the first instance and meet the criteria of a reasonable settlement demand as defined in CACI 2334. The demand must be for an amount within policy limits, at a time when the potential judgment was likely to exceed the amount of the demand based on the probable liability and damages. Moreover, the demand must also be reasonable in other respects, separate and apart from the amount demanded. Things such as the amount of time to respond to the demand, the information provided to support the demand, and the terms and conditions of the demand must all be reasonable. That was the case before *Pinto*, and it's also the

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case after. Of course, the reasonableness of all these moving parts will largely depend on the circumstances of each case and will be very fact dependent.

What *Pinto* now adds is an element that the failure to accept the demand, (i.e., a reasonable settlement demand), was the result of unreasonable conduct on the insurer's part. In most cases, if a plaintiff satisfies the criteria of proving that a reasonable settlement demand was made in the first instance, it will be the rare case where the carrier's failure to accept such a reasonable settlement demand was still found to be reasonable. Indeed, the *Pinto* court forecasted such a limited circumstance when it stated: "Simply failing to settle does not meet this standard. A facially reasonable demand might go unaccepted *due to no fault of the insurer*, for example, if some emergency prevents transmission of the insurer's acceptance." (*Id*., at 688, emphasis added.)

Short of an "emergency" that "prevents transmission of the insurer's acceptance" it is hard to imagine a circumstance where a carrier's failure to accept a reasonable settlement demand, thereby exposing its insured to an excess judgment, was reasonable. That said, the issue is most likely to come up when the insurer makes a request for an extension to respond to a policy-limit demand.

"...through no fault of the carrier"

For example, assume that a reasonable settlement demand is made that is within policy limits at a time when liability is reasonably clear, and the damages are likely to exceed the amount of the demand. Moreover, assume the demand is reasonable in all other respects in that there is appropriate information provided, sufficient time to respond, and the terms and conditions of the demand are also reasonable. Further assume that one of the reasonable conditions requires the carrier to provide a declaration of its insured representing under oath that there is no other available insurance and no "course and scope" of employment that could trigger other coverage. This is a reasonable, common and necessary condition to be required by a claimant before accepting a policy-limit payment in exchange for a full release.

Against this backdrop, assume that the carrier diligently proceeds and is prepared to meet all of the terms and conditions of this hypothetical reasonable settlement demand. However, through no fault of the carrier, it is unable to obtain their insured's signature to the declaration representing that there is no other insurance and no "course and scope" of employment. As the time for expiration of the demand approaches, assume the carrier requests an extension to respond to the demand and explains the due diligence that it has done to timely meet the demand requirements and why it needs additional time to accept the demand.

As the claimant's lawyer, what do you do? If you do not grant the extension, you may find yourself in the later bad-faith case of being able to prove that you made a reasonable settlement demand in the first instance, but that the carrier has a good argument that its conduct was reasonable in attempting to accept the demand and the policy may not be open. On the other hand, if you grant the extension, you give the carrier the additional time that it needs and if still not accepted, you will be in much stronger position to argue the policy is open.

In contrast, assume the same reasonable settlement demand is made but instead of a carrier acting diligently to respond to it, assume the carrier fails to take any action to timely respond. That is, the carrier does not attempt to contact its insured to obtain the necessary declaration of no other insurance and no "course and scope," and/or fails to obtain the internal authority to agree to pay the policy limit demand. In the later bad-faith case, the claimant will be in a position to prove that there was a reasonable settlement demand and that the failure on the part of the carrier to accept is was unreasonable.

Of course, these are two polar hypothetical examples and there will invariably be many different fact patterns falling somewhere in between. But the takeaway for claimant's lawyers is to always ask yourself two things:

1.) Did I make a reasonable settlement demand?

2.) Does the carrier have a defense that it is acting reasonably in attempting to accept my reasonable settlement demand?

That is why when faced with a request by a carrier for an extension to respond to a policy-limit demand, claimant lawyers should have a "help me help you" mentality.

When considering whether to grant or deny an extension of time to respond to a demand, I would suggest asking the carrier, in writing, questions such as why it needs the additional time. What has it done with the information that has been provided? What efforts has it made to comply with the terms and conditions of the demand? What information does it believe it is missing? How will that additional information affect its decision on whether or not to accept the demand?

I would let the carrier know that you are open to granting the extension but you want to see what its responses to the questions are before deciding. Do the responses demonstrate a carrier that is acting reasonably and trying to do the right thing? Or does it expose a carrier that is dragging its feet and not being diligent? Either way, the carrier's response will help guide the claimant's lawyer's decision about whether to grant an extension.

Finally, it is worth noting that the issues involved in the bad-faith failure-to-settle context (i.e., the reasonableness of a settlement demand and/or the reasonableness of the carrier's conduct) are usually very fact dependent and therefore lend themselves to triable issues of fact to be resolved in trial and not on summary judgment. The reasonableness of the settlement demand and/or the carrier's conduct will largely depend on the factual circumstance of each case.

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What did not change after *Pinto*

What *Pinto* also did not change was the rule expressed by the California Supreme Court in *Johansen v. California St. Auto. Assn. Inter-Ins. Bur.* (1975) 15 Cal.3d 9. In some cases, an insurer's decision not to settle is based on its belief that there is no coverage under the policy. In other words, the carrier takes the position that the claim may be worth more than the policy limit, and there may very well be a reasonable settlement demand made, but that there is simply no coverage available under the policy and therefore the demand is not accepted.

In such cases, it is important to note that the Supreme Court in both *Comunale* and *Johansen* specifically addressed the issue of considering a carrier's "good faith" decision to not settle based on a position of non-coverage. In both cases the Court concluded that such considerations were irrelevant. As the Court explained in *Johansen*:

> Defendant asserts, however, the *Comunale* principle does not apply to an insurer whose refusal to settle stems from a bona fide belief that the policy does not provide its insured coverage. In *Comunale*, the insurer asserted a virtually identical claim…This court nevertheless held the insurer liable for the excess judgment against its insured, stating: 'an insurer who denies coverage does so at its own risk, and although its position may not have been wrongful it is liable for the full amount which will compensate the insured for all the detriment caused by the insurer's breach of the express and implied obligations of the contract….accordingly, *an insurer's good faith though erroneous belief in noncoverage affords no defense to liability flowing from the insurer's refusal to accept a reasonable settlement offer*.'

(*Id*. at 16-17, emphasis added.)

Moreover, in footnote 4 in *Johansen*, the Court made it clear that a "wrongful" decision of noncoverage in the text quoted above does not mean "culpable," but rather simply means an "erroneous" decision:

> Defendant seeks to avoid the import of this language by asserting that 'wrongful' must be equated with 'culpable', a proposal for which there is absolutely no support in *Comunale*. Indeed, the language immediately preceding this portion of *Comunale* expressly states that the insurer denies coverage at its own risk. Viewed in context, it becomes apparent that a *'wrongful'* denial of coverage as used in *Comunale* means *merely an erroneous denial of coverage* required by the policy.

(*Id*., at 16-17, fn 4) (Emphasis added).

The "advice of counsel" defense

When a carrier is faced with the decision of whether to settle, it is not permitted to even consider coverage issues in making that decision. This is the standard that is clearly set forth in *Johansen*:

> Moreover, in deciding whether or not to compromise the claim, the insurer must conduct itself as though it alone were liable for the entire amount of the judgment. [cite]. Thus, the *only* permissible consideration in evaluating the reasonableness of the settlement offer becomes whether, in light of the victim's injuries and the probable liability of the insured, an ultimate judgment is likely to exceed the amount of the settlement offer. *Such factors as the limits imposed by the policy, a desire to reduce the amount of future settlements, or a belief that the policy does not provide coverage, should not affect a decision as to whether the settlement offer in question is a reasonable one*.

(*Id*. at 16, emphasis added).

In many cases, an insurer that has refused to settle based on a belief that there is no coverage will later argue that it relied on the advice of its coverage lawyers in refusing to settle, commonly known as the "advice of counsel" defense. But this provides no defense to payment of the entire excess judgment because a carrier is not permitted to even consider coverage issues when deciding whether or not to compromise a claim in the first instance. Accordingly, the reasonableness of its coverage position is therefore irrelevant; it remains liable for the entirety of the underlying judgment so long as there is coverage.

The mere timely tender of policy limits does not equate to reasonable conduct as a matter of law

Carriers will often argue that, based on the holdings in *Graciano v. Mercury Gen. Corp.* (2014) 231 Cal.App.4th 414, a mere tender of the policy limits means that it acted in good faith as a matter of law. But the Second District has explicitly rejected this broad interpretation of *Graciano*. In *Barickman v. Mercury Casualty Co*. (2016) 2 Cal.App.5th 508, the insurer similarly argued that under *Graciano*, it "acted in good faith as a matter of law because it timely … offered [the insured]'s policy limits to [the injured claimants]." (*Id*. at pp. 518-519.)

The Court of Appeal rejected this argument in a detailed discussion under the heading, "The offering of the policy limits was not sufficient in and of itself to defeat a bad faith claim as a matter of law." (*Id*. at p. 518.) The Court of Appeal concluded that the insurer "reads far too much into the holding and analysis of *Graciano*." *(Id.* at p. 519.)

As *Barickman* ruled, *Graciano* requires a finding of good faith as a matter of law only when it is undisputed that "'by offering the policy limits in exchange for a release, the insurer has *done all within its power to affect a settlement*.'" (*Graciano*, 231 Cal.App.4th at p. 426, quoting *Lehto v. Allstate Ins. Co.* (1994) 31 Cal.App.4th 60, 73, emphasis added). *Barickman* also analyzed the two cases cited in *Graciano*: *Lehto* and *State Farm v. Crane* (1990) 217 Cal.App.3d 1127. *Barickman* concluded: "Neither case stands for the proposition … that, regardless of any other circumstances, a timely policy limits settlement offer insulates an insurer from a claim of bad faith." (*Barickman*, 2 Cal.App.5th at p. 520, fn. 5.)

Barickman held that even though the insurer made a timely offer of policy limits, "there were disputed facts … as to whether [the insurer] did all within its power to effect a settlement …." (*Barickman*, 2 Cal.App.5th at p. 520-

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521.) Affirming a bad-faith judgment against the insurer, the Court of Appeal concluded there was substantial evidence to support the finding that the insurer breached its duty of good faith and fair dealing by unreasonably refusing to accept language in the release excluding court-ordered restitution. (*Id*. at pp. 518-522.)

The notion that tendering the policy limits insulates a carrier from bad-faith liability was likewise discounted in *Hedayati v. Interinsurance Exchange of the Automobile Club* (2021) 67 Cal.App.5th 833, where the court ultimately found it was a question of fact as to whether a settlement was consummated while terms of a release were outstanding. In *Hedayati*, the insurer advanced what it labeled "the *Graciano* 'safe harbor'" argument against bad-faith liability based on the timely tender of its policy limits. But that argument was expressly rejected by the *Hedayati* court:

> …[T]he *Graciano* court considered on the question of timeliness whether the insurer had done "'all within its power to effect a settlement'" "'by offering the policy limits in exchange for a release ….'" [citations] The importance of a release as an essential settlement term illustrates that "'the reasonableness of an insurer's claims-handling conduct'" must be assessed "'based on the whole record.'" [citations] In its October 31 letter Auto Club gave no indication of the scope of the release it would demand in exchange for Vanwyk's $25,000 policy limits. That did not become clear until mid-December 2012, a further delay that a jury reasonably could consider as evidence that at every point Auto Club claims it was ready to settle, in fact it was not. Instead, it was still negotiating. Such conduct was arguably inconsistent with Auto Club's good faith obligation to its insured. The reasonableness of all these actions is fundamentally a factual question to be resolved at trial.

(*Hedayati*, 67 Cal.App.5th at 850-851.)

The *Hedayati* court went on to analyze whether the Auto Club had done all within its power to effectuate a settlement offer where the terms of the release had yet to be agreed upon, finding that a trier of fact could conclude that it had not:

> But the well-established rule under California law remains clear: 'the critical issue being the reasonableness of the insurer's conduct under the facts of the particular case.' [citation]. Implicit in the rule which requires timely settlement efforts is that untimely ones are tantamount to an unreasonable refusal to settle. [citations] Obstructing or preventing the very settlement an insurer itself proposes may constitute a bad faith refusal to settle.

(*Id.* at 852.)

Thus, notwithstanding cases where the carrier has tendered its policy limit, a carrier may still be found to have acted unreasonably and liable for bad faith based on all the circumstances of a particular case.

Conclusion

How much of an impact will *Pinto* have on the overall duty-to-settle analysis? Time will tell. The obligation to present a reasonable settlement demand has not changed. The impermissible consideration of coverage defenses in responding to a settlement demand has not changed. What has changed is that a jury must now decide not only whether the settlement demand was reasonable, but also whether the insurer's conduct in failing to accept the reasonable settlement demand was unreasonable. But the mere tendering of policy limits alone does not equate to reasonable conduct as a matter of law. So, how many cases will be affected by the added element of proving unreasonable conduct? Time will tell indeed, but it will depend on the specific facts of each case and, in most cases, will have to be decided by a jury.

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