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Revising California's Jury Instructions on Bad Faith Failure to Settle: Should a Settlement Demand Be Necessary?

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This is the last in a series of posts examining the implications of recent revisions to the Judicial Council of California Civil Jury Instructions (CACI) on insurance bad faith. This post explores whether CACI No. 2334's requirement of a formal settlement demand should be abandoned.

If the reasonableness of the insurer's conduct is a relevant consideration for the jury, a formal settlement demand arguably should not be an element of the plaintiff's case. There are circumstances---such as where the insured's liability is clear and the claimant's injuries so serious that a judgment in excess of policy limits is likely---that a reasonable insurer would initiate settlement negotiations and not sit back and wait for a demand from plaintiff's counsel. CACI 2334, however, unambiguously conditions an insurer's duty to settle on the claimant making a settlement demand, which is consistent with the weight of California authority.[1] Although case law imposing an affirmative duty to initiate settlement negotiations whenever the insurer's investigation reveals a likelihood of liability in excess of policy limits exists outside California, the California cases clearly supporting a duty to initiate are either no longer citable[2] or not directly on point.[3]

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[1] *Merritt v. Reserve Ins. Co.,* 34 Cal.App.3d 858, 877, 110 Cal.Rptr. 511, 524–25 (2d Dist. 1973) ("bad faith can occur 'only' when a formal offer to settle an excess claim within policy limits is made").

[2] *Du v. Allstate Ins. Co.*, 681 F.3d 1118 (9th Cir. 2012).

[3] *Boicourt v. Amex Assurance Company,* 78 Cal.App.4th 1390, 1399, 93 Cal.Rptr.2d 763 (4th Dist. 2000).

Reid v. Mercury Insurance Company

The California's Second Appellate District's decision in *Reid v. Mercury Insurance Company,* 220 Cal.App.4th 262, 162 Cal.Rptr.3d 894 (2d Dist. 2013), provides the strongest support in California for the policyholder position on the duty to initiate settlement negotiations. The *Reid* opinion rejects the position that bad faith liability can be based solely on an insurer's failure to initiate settlement negotiations, but also backs away from language in previous California decisions stating that a formal demand from the claimant is a prerequisite to an insurer's duty to settle. Under *Reid,* the insurer's liability for an excess judgment depends on proof either that the claimant conveyed to the insurer an "interest" in discussing settlement, or that the insurer did something to foreclose the possibility of settlement.

At least as applied by the *Reid* court, this approach is likely to benefit insurers more often than policyholders or their assignees. Although an expression of "interest" in settling is enough to trigger the insurer's duty to negotiate, the expression must be substantive; the claimant must communicate to the insurer that settlement may "feasibly be negotiated"—which is not much different substantively from a settlement demand. The *Reid* court found that the claimant's inquiries about the amount of the insured's policy limits did not qualify as an expression of "interest" in discussing settlement. Moreover, the *Reid* court found that the insurer's repeated insistence on taking a recorded statement from the claimant and refusal to discuss settlement without that statement despite knowing that the claimant was in intensive care did not give rise to a triable issue of fact regarding whether the insurer foreclosed the possibility of settlement.

Alternatives to CACI No. 2334's Formal Demand Requirement

A close examination of the seminal California Supreme Court decisions recognizing a cause of action for bad faith failure to settle casts doubt on the validity of the *Reid*'s holding that a likelihood of liability in excess of policy limits, by itself, does not trigger a liability insurer's duty to engage the claimant in settlement negotiations. In *Comunale v. Traders & General Insurance Co.,* 50 Cal.2d 654 (1958), and *Crisci v. Security Insurance Co.,* 66 Cal.2d 425, 429 (1967), the California Supreme Court based the insurer's duty on the conflict of interest that exists between the insurer and the insured whenever there is a substantial likelihood of a judgment in excess of policy limits—a conflict that exists regardless of whether the claimant has made a settlement demand. Later California Supreme Court decisions, such as *Johansen v. Cal State Auto. Ass'n. Inter–Ins. Bureau,* 15 Cal.3d 9, 123 Cal.Rptr. 288, 292–93, 538 P.2d 744 (1975), holding that a liability insurer "must conduct itself as if it alone were liable for the entire judgment," provide additional support for requiring liability insurers to open settlement negotiations with the claimant. After all, no rational defendant would sit back and allow a high exposure case to go to trial without at least attempting to settle simply because the plaintiff shows no interest in settling. True, the Supreme Court's decisions often refer to a duty to accept reasonable settlement offers, but that is because cases before the court and the cases on which the court relied all involved an insurer's rejection of a policy limits settlement demand. Nothing in the Court's reasoning makes a settlement demand a *sine qua non* of a cause of action for bad faith failure to settle.

Given the theoretical justification for imposing a duty to initiate, plaintiffs might consider challenging the formal settlement demand requirement in CACI 2334 and proposing an alternative instruction similar to that recently proposed by Dennis J. Wall:

> The lack of a formal offer to settle does not preclude a finding of bad faith. Bad faith may be inferred from a delay in settlement negotiations which is willful and without reasonable cause. Where liability is clear, and injuries so serious that a judgment in excess of the policy limits is likely, an insurer has an affirmative duty to initiate settlement negotiations.[4]

Mr. Wall's proposed special instruction was based on the language of what is perhaps the leading case to recognize a duty to initiate settlement negotiations, *Powell v. Prudential Prop. & Cas. Ins. Co*., 584 So. 2d 12, 14 (Fla. 3d DCA 1991).

[4] Dennis J. Wall, "The American Law Institute and Good Faith Settlement Duties of Liability Carriers: The Scope of a Duty to Initiate Settlement Negotiations, What the ALI Restatement of the Law of Liability Insurance Has to Say about It, and the ALI Reporters' Notes," 37 *Insurance Litigation Reporter* 597, 604-605 (Dec. 23, 2015).