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Revising California's Jury Instructions on Insurance Bad Faith: Tort Liability for Unreasonable Settlement Decisions

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My July 1, 2016 post discussed briefly two significant revisions to the Judicial Council of California Civil Jury Instructions (CACI) on insurance bad faith. On July 2, 2016, I examined in greater depth revisions designed to clarify the nature of the tort of insurance bad faith. Today's post discusses the second, and more controversial, revision: Proposed changes to CACI No. 2334 on a liability insurer's bad faith failure to settle.

The controversy surrounding the revisions CACI No. 2334 concerns the nature of the jury's inquiry in bad faith failure to settle cases. As initially presented to the California Judicial Council, the revisions to CACI 2334 would have required plaintiffs (or their assignees) to prove both that the claimant's settlement demand was reasonable and that the insurer acted unreasonably in rejecting the settlement offer. The prior version of CACI No. 2334 required proof only of the reasonableness of the settlement demand in light of the insured's potential liability.

In the end, the California Judicial Council decided to punt the controversy back to the trial courts. At its June 24, 2016 meeting, the Judicial Council voted to drop proposed language requiring the jury to assess the reasonableness of the insurer's decision, but included language in the sample instruction's "Directions for Use" allowing trial courts to insert such a requirement.

This post will examine the legal arguments for and against including a second reasonableness inquiry in the jury instruction on bad faith failure to settle. Tomorrow's, Friday's, and next week's posts will examine the parties' public policy arguments in an effort to shed light on the nature of the tort of bad faith failure to settle.

Bad Faith Failure to Settle: One or Two Reasonableness Inquiries?

California courts have not provided clear guidance on whether the reasonableness of the insurer's conduct is a relevant consideration in a bad faith failure to settle case. Some courts focus only on the reasonableness of the settlement demand and impose liability if it is likely that a trial will result in a judgment in excess of policy limits. In *Johansen v. California State Auto. Assn. Inter–Ins. Bureau,*15 Cal.3d 9, 15–16, 123 Cal.Rptr. 288, 291–292, 538 P.2d 744 (1975)] for example, the California Supreme Court, stated "whenever 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, in *Johansen,* the insurer had refused to settle based on a coverage defense. The opinion therefore does not establish the nature of the inquiry when the insurer refuses to settle based on its assessment of the claimant's damages and the insured's liability

Other California Supreme Court decisions, such as *Hamilton v. Maryland Cas. Co.,* 27 Cal.4th 718, 724–725 (2012)], *Kransco v. International Ins. Co.,* 23 Cal. 4th 390, 401, 97 Cal. Rptr. 2d 151 (2000)], and *Commercial Union Assurance Companies v. Safeway Stores, Inc.,* 26 Cal. 3d 912, 916-17, 610 P.2d 1038 (1980)], contain language suggesting that plaintiffs must prove the insurer's decision not to settle was unreasonable. But none of these decisions turn on the reasonableness of the insurer's rejection of the policy limits demand, and they provide no analysis of the issue.

The *Graciano* Decision

The impetus for the proposed changes to CACI No. 2334 was the California Court of Appeal's decision in *Graciano v. Mercury General Corporation,* 231 Cal.App.4th 414, 179 Cal.Rptr.3d 717 (4th Dist. 2014)]. The *Graciano* court discussed the elements of a cause of actions for bad faith failure to settle at length, clarifying that a plaintiff must prove *both* that "the third party made a reasonable offer to settle the claims against the insured for an amount within policy limits" *and* that "the insurer unreasonably failed to accept an otherwise reasonable offer within the time specified by the third party for acceptance." The *Graciano* court did not, however, decide the case based on either the reasonableness of the settlement demand or the reasonableness of the insurer's conduct in failing to accept the demand. Instead, the court held the plaintiff failed to prove the threshold element of a bad faith failure to settle cause of action: The existence of a demand to settle within policy limits. The court's discussion of the reasonableness of the insurer's settlement conduct therefore is arguably *dicta.*