Alas, A Very Hot Issue in California Insurance Law is Decided (At Least for Now): Insurers Have No Affirmative Duty to Settle as Long as They Do Not Foreclose the Possibility of Settlement and/or Absent a Within-Policy-Limits Settlement Demand

One of the hottest issues in California insurance law has been whether a breach of the good faith duty to settle can be found in the absence of a within-policy-limits settlement demand, thus giving rise to an insurer's liability for an excess judgment.

The frenzy of interest came with the Ninth Circuit case of *Du v. Allstate Insurance Co*., 681 F.3d 1118 (9th Cir. 2012) which held that under California law "an insurer has a duty to effectuate settlement where liability is reasonably clear, even in the absence of a settlement demand." However, on October 5, 2012, the Court issued an amended opinion in the case, *Du v. Allstate Ins. Co.,* 697 F.3d 753 (9th Cir. 2012), in which it expressly declined to resolve the legal issue of whether a breach of the good faith duty to settle can be found in the absence of a settlement demand within-policy-limits. As a result, *Du* may no longer be cited for this proposition. Nevertheless, there existed some uncertainty as to whether an insurer can be exposed to liability under California law for breach of the implied covenant of good faith and fair dealing if it fails to settle in the absence of a within-policy-limits settlement demand.

> For bad faith liability to attach to an insurer's failure to pursue settlement discussions, in a case where the insured is exposed to a judgment beyond policy limits, there must be, at a minimum, some evidence either that the injured party has communicated to the insurer an interest in settlement, or some other circumstance demonstrating the insurer knew that settlement within policy limits could feasibly be negotiated.

For now, the California Court of Appeals has put this issue to rest with its decision in *Reid v. Mercury Insurance Company*, *Reid v. Mercury Insurance Company*, __ Cal. App. 4th __, 2013 Cal. App. LEXIS 798, 2013 WL 5517979 (October 7, 2013). In *Reid*, that court held that absent a settlement demand or some indication the injured party is interested in settlement, an insurer is not liable for a failure to act, so long as the insurer did not foreclose the possibility of settlement. In fact, the court clarifies that even when there is clear liability and a high likelihood that recovery would exceed policy limits, an insurer is not liable for failing to act if it did not foreclose the possibility of settlement.

The case involves a multi-vehicle collision in which the Plaintiff Shirley Reid ("Plaintiff"), through her son, Paul Reid ("Reid"), brought an action against Defendant Mercury Insurance Company that insured Zhi Yu Huang ("Huang"), the other driver's insurer. Mercury covered Huang under a policy that provided coverage for up to $100,000.00 per person and $300,000.00 per accident. On June 24, 2007, Huang failed to stop at a red light and collided with the Plaintiff, her passenger and another vehicle. The Plaintiff was hospitalized, and her son communicated with Mercury on her behalf. Reid requested Huang's policy limits, but Mercury declined to

provide the information. Upon further inquiry, Mercury told Reid the investigation was still ongoing, and therefore they could not discuss policy limits. Reid was interested in Huang's policy coverage and his mother's underinsured motorist coverage. Before Reid could collect under the underinsured motorist policy, he had to first settle the claim with Mercury. Therefore, Reid hired an attorney to settle the claim "as quickly as possible." Reid's attorney provided Mercury with proof of injury and requested Huang's policy information. According to Reid, his attorney informed him in August 2007 that the policy limits were $100,000.00, but Mercury did not want to settle. Reid asserted that he would have accepted a $100,000.00 settlement from Mercury to recover the underinsured motorist insurance from his mother's insurance company. Reid's attorney declined to write a demand letter to Mercury, because Mercury previously stated it did not have enough information to resolve the case. In October 2007, the Plaintiff sued Huang. Later that month, Mercury again informed the Plaintiff that the claim was "still pending."

Finally in May 2008, Mercury agreed to tender its $100,000.00 policy limit to the Plaintiff to "resolve the matter in its entirety." The Plaintiff rejected the offer. After a successful trial against Huang and assignment of the bad faith claim and breach of contract claim, the Plaintiff filed suit against Mercury for breach of the implied covenant of good faith and fair dealing and breach of contract based on the asserted bad faith failure to settle.

Mercury moved for summary judgment, arguing it could not be held liable for refusing to settle because Reid never made a formal settlement demand. The trial court granted the motion.

The California Court of Appeals affirmed. The court ruled that for an insurer to be held liable for bad faith in pursuing settlement discussions, the injured party must have communicated their interest in settling the matter to the insurer. Without that, the insurer could not be liable for bad faith failure to settle:

> An insurer's duty to settle is not precipitated solely by the likelihood of an excess judgment against the insured. In the absence of a settlement demand or any other manifestation the injured party is interested in settlement, when the insurer has done nothing to foreclose the possibility of settlement, we find there is no liability for bad faith failure to settle.

The court's decision addressed several arguments advanced by the Plaintiff. First, the court conceded that a formal settlement demand was not necessary for bad faith liability to attach. However, the insurer must know of the claimant's interest in settlement and have ignored it. In the case at hand, Reid never made a clear settlement demand, and there was no evidence to suggest Mercury knew Reid was willing to settle. Furthermore, the Mercury's responses did not constitute rejections of opportunities to settle or discourage demands. In light of the facts, the court decided Mercury could not be held liable for bad faith failure to settle. Second, the Plaintiff cited to *Rova Farms Resort, Inc. v. Investors Insurance Company of America*, 323 A.2d 495 (N.J. 1974) as requiring an insurer to explore settlement possibilities. The court distinguished this case because there were many instances where the claimant made informal requests to settle. Therefore, *Rova Farms* did not apply to the present facts.

Next, the court rejected the Plaintiff's argument that Insurance Code section 790.03 (h)(5) "expressly imposes" an "affirmative duty" on insurers to settle when liability is clear. The court clarified that an insurance

company may be liable for bad faith if its general business practices include refusing to settle on issues of clear liability. However, the Insurance Code does not create a private cause of action if an insurer commits one of the acts listed in the subsection. Accordingly, the court held that the Plaintiff's interpretation of the statute is overly broad, and no such affirmative duty exists.

The court rejected Plaintiff's request for an instruction that an insurer's failure to effectuate settlement after liability is established constitutes bad faith. The Plaintiff relied on *Du* which originally held that bad faith liability may be premised on an insurer's failure to effectuate settlement in the absence of a reasonable demand. However, the Ninth Circuit Court of Appeals noted held there was no evidentiary basis showing the insurer could have made an earlier settlement offer, and therefore no basis for such an instruction. Similarly, the California Court of Appeal found no basis for the instruction in the present case. Therefore, the court argues, there is no precedent to impose this duty to settle on insurers.

Finally, the court rejected the Plaintiff's contention that Mercury's requests for medical records and interviews served to discourage the Plaintiff from making a settlement demand, stating no reasonable juror could reach that conclusion.

Ultimately, the California Court of Appeals agreed that the Plaintiff could not support his case for bad faith failure to settle claim based on the evidence. Absent a demonstrated interest in settlement or demand for settlement within policy limits, the court refused to impose an affirmative duty on insurers to settle claims for the insured.

This case is likely to be appealed to the California Supreme Court given the gravity of the issue and its implications to policyholders. It will be interesting to see what transpires next. Nonetheless, this case gives some clear guidance on how to set up a within-policy-limits- demand , or at least the steps an insured must take to attempt to make one, that will give rise to insurer liability for an excess judgment. Therefore, it is good reading.