Pinto v. Farmers gives a big boost to insurers defending bad-faith claims

Court sides with defense, says CACI 2334 is missing the required element of unreasonable conduct by the insurer

By Arnie Levinson

A California Court of Appeal has held that CACI bad faith instruction 2334 is incorrect and that an insurance company can avoid an excess judgment even where it turns down a reasonable policy limit demand. (*Pinto v. Famers Insurance Exchange*, (March 8, 2021) ____ Cal.App.5th ____, 2021 WL 857776.)

There has been a debate for a number of years now between plaintiffs' bad-faith attorneys and the insurance bar over the correctness of CACI 2334. Plaintiffs' counsel have maintained that it is per se bad faith for an insurer to reject a settlement demand as long as the demand was reasonable. An insurer's duty is to its insured – not the third-party claimant. Rejecting a reasonable demand which could have settled the case exposes the insured to an excess judgment. Plaintiffs have thus contended that an insurer is, in essence, strictly liable if the settlement demand it failed to accept was reasonable under the circumstances.

Insurers have argued that there are circumstances where a reasonable demand may not have been accepted, but the insurer's conduct was, nonetheless reasonable. In these circumstances, it should not be responsible for an excess judgment.

CACI 2334 is consistent with the view maintained by Plaintiffs. The Court in *Pinto* came down on the side of the insurers and held that CACI 2334 is missing the required element of unreasonable conduct by the insurer.

Here are the facts, the holding and suggestions regarding the future.

The facts

While Plaintiffs made a wide range of claims in the trial court, the Court of Appeal boiled the pertinent facts down to essentially these. Mr. Pinto was injured in an accident. The potentially liable insured had $50,000 of insurance coverage from Farmers Insurance Exchange. A policy limit demand was made to Farmers for the $50,000 with a two-week expiration date. That demand contained certain conditions. Farmers purported to accept the offer. Pinto claimed that the offer was not accepted because Farmers did not comply with some of the conditions. These included declarations from all potential insureds that they were not in the course and scope of employment and had no other insurance. Farmers contended that it could not reasonably have satisfied those conditions before the deadline for the offer expired.

Pinto thereafter settled with the insured wherein the parties agreed that the settlement would be the equivalent of a $10 million judgment and the insured assigned her claims against Farmers to Pinto. Pinto then filed suit against Farmers as the insureds' assignee.

The jury was given a special verdict form based on CACI 2334, which permitted the jury to award Pinto the $10 million if it found two things: (1) the settlement demand was reasonable, and (2) Farmers failed to accept a reasonable settlement demand within policy limits. The jury so found and awarded the $10 million.

The holding

As framed by the Court of Appeal, "The issue is whether, in the context of a third party insurance claim, failing to accept a reasonable settlement offer constitutes bad faith per se. We conclude it does not." The following language from the Court sets forth its analysis:

> [F]ailing to accept a reasonable settlement offer does not necessarily constitute bad faith. "[T]he crucial issue is ... the basis for the insurer's decision to reject an offer of settlement." [cite omitted] . . . 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.
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> "An insurer that breaches its implied duty of good faith and fair dealing by *unreasonably* refusing to accept a settlement offer within policy limits may be held liable for the full amount of the judgment against the insured in excess of its policy limits" [cite omitted].
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> The [Supreme] Court has never held that failure to accept a reasonable settlement is per se unreasonable. Although CACI No. 2334 describes three elements necessary for bad faith liability, it lacks a crucial element:

> Bad faith. To be liable for bad faith, an insurer must not only cause the insured's damages, it must act or fail to act without proper cause, for example by placing its own interests above those of its insured.
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> 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.

Discussion

Plaintiffs will file a petition for review with the California Supreme Court. They will contend that the Court of Appeal misstated the principles of bad faith. They will cite Court delineations of the excess verdict principles, such as these: "The implied covenant of good faith and fair dealing imposes a duty on the insurer to settle a claim against its insured within policy limits whenever there is a substantial likelihood of a recovery in excess of those limits." (*Johansen v. California State Aut. Assn Inter-ins. Bureau* (1975) 15 Cal.3d 9, 14.) "Liability is imposed not for a bad faith breach of the contract but for failure to meet the duty to accept reasonable settlements, a duty included within the implied covenant of good faith and fair dealing." (*Crisci v. Security Insurance Co. of New Haven, Connecticut* (1967) 66 Cal.2d 425,430.) Given these principles, Plaintiffs will claim that as long as the demand is reasonable and the insurer refused to accept it, the insurer has failed to protect its insured and is, in effect, strictly liable for the consequences – i.e., the excess verdict. In this analysis, there is only one test of reasonableness and that is the settlement demand.

Plaintiffs liken it to an insured's payment of premiums. The insured is strictly "liable" for the failure to pay premiums. If a premium payment is sent in the mail and, for example, a pandemic happens, which delays the mail such that the premium is late, the insurer will lapse the policy upon non-payment of the premium. There is no "reasonable" exception to paying a late premium. Either it was paid or it wasn't. The policy is either in effect or it is not. Similarly, where a policy limit demand is rejected, the insured is exposed to an excess judgment. Regardless of how reasonable or unreasonable the insurer's conduct may have been, the damage suffered by the insured has been done. As such, Plaintiffs claim that the insurer should bear the burden of that result.

Insurer contentions

Insurers contend that there are circumstances where it is either impossible or impractical for them to be able to timely accept a demand no matter how reasonable. Despite an insurer's best intentions, it is sometimes simply unreasonable to expect that the insurer could have protected its insured. They further claim that attempts to induce insurers into failing to accept a policy limit demand has become an art form and it is time for the courts to step in. Unlike the payment of premiums, responding to a policy limit demand is not a simple process. Nor should it be treated with a simple solution. Why, insurers contend, should they be liable for amounts far in excess of the risk they agreed to accept when their conduct was reasonable? In this analysis, there are two aspects to the reasonable test: (1) the reasonableness of the demand and (2) the reasonableness of the insurer's conduct. The two are not necessarily the same.

If review is denied or the *Pinto* Court's analysis is eventually adopted by the Supreme Court, the ultimate question will be this: Was the insurer's conduct in failing to accept a *reasonable* policy limit demand reasonable? We have few guidelines thus far to make that determination. Plaintiffs will contend that, given the severe consequences to the insured, any such reasonable exception must be narrowly confined. Insurers will claim that, as long as its conduct was reasonable – regardless of the circumstances – there is no excess liability. Former Justice Walter Croskey, who long served as the foremost authority on bad faith at the California Court of Appeal, may be stirring in his grave thinking about all of the permutations of this paradigm if the *Pinto* ruling survives Supreme Court inspection.

What does all this mean?

I have mediated many potential-excess-verdict cases before the underlying case has even gone to trial or while the underlying case is on appeal. Those negotiations may now be more complex. If the Supreme Court accepts review, we will be in a grey zone for a couple of years. Both Plaintiffs and insurers have expressed confidence that their position will prevail in the Supreme Court. Plaintiffs believe there is a friendly Supreme Court, which will reverse *Pinto* and that failing to do so will undo decades of settled law. Plaintiffs essentially claim that, as a matter of law, an insurer cannot reasonably reject a reasonable demand. The defense believes that the facts of *Pinto* are so untenable that the Supreme Court is not going to permit an excess verdict to stand under the circumstances of this case. To understand the insurers' claims and the Court's decision in *Pinto* that an additional element of reasonable conduct needs to be satisfied, let's take a deeper dive into the facts in *Pinto*, as set forth by the Court.

Background of the case

When Mr. Pinto was hurt, he was a passenger in a truck which was returning home from a party in Havasu, Arizona. There was drinking and drug use at the party. The truck swiped a guardrail, went off the road, up an embankment, flipped over and landed on its roof. Mr. Pinto was rendered a paraplegic. The truck was owned by Alexandrea Martin. Shortly after the accident Farmers contacted Ms. Martin. Unfortunately, she had suffered brain damage in the accident and could not initially remember who was driving. She did, however, remember that she had been drinking and that she had given

her keys to someone else. Ms. Martin's mother told Farmers that Dana Orcutt had been driving but that Orcutt was now denying that she had been driving.

About four weeks after the accident Orcutt allegedly told Farmers that she also could not remember who was driving but was sure it wasn't her because she had been drinking, had a prior DUI and had resolved never to drink and drive again. Martin then advised Farmers that she recalled that Orcutt was driving. The police report listed Orcutt as the driver even though she told the police that she could not recall who was driving. Others were allegedly overheard saying that Orcutt was driving and Orcutt herself told the police that "everyone keeps saying I was driving." Another witness advised Farmers that Orcutt was extremely intoxicated and was reported to have said "I'm going to jail for what I did."

Three months after the accident, Pinto offered to settle the case against Martin for her policy limits of $50,000. Martin was referred to in the settlement demand as the insured. The demand required that, in addition to paying the limits, "the insured" was to provide a declaration stating that the insured had not been acting within the course and scope of her employment and that there was no other insurance. A copy of any applicable insurance coverage was to be provided. Pinto's counsel had the fax number of the Farmers adjuster. However, the limits demand letter was mailed to Farmers' document center in Oklahoma. By the time the Farmers adjuster received the demand, she had eight work days to accept. The offer did not refer to Orcutt. However, were she the driver, she would likely have been insured under the Farmers policy as a permissive user.

Farmers forwarded the offer to both Martin and Orcutt the next day. Having received no response from Orcutt, Farmers hired an investigator to locate her. Orcutt reportedly told the investigator that she had no other insurance and was not in the course and scope of employment. However, "Orcutt never responded . . . to [Farmers'] many requests for [the required] declaration."

Five days before the expiration of the settlement demand, Farmers called Pinto's counsel three times and left messages asking for an extension. Farmers did not receive a response to those requests. The day before the demand expired, Farmers' counsel faxed a letter to Pinto's counsel tendering the limits on behalf of "any and all insureds under the policy." The letter asked if the demand was intended to include both the named insured and the permissive driver and advised that Farmers could not pay the limits without a release for all of its insureds. The letter also sought clarification of the language of the requested declaration and whether Pinto intended to sue the auto manufacturer, which could prompt a cross-complaint against the insureds. The letter also sought clarification regarding whether Pinto was married and advised that there was insufficient time to comply with the declaration requests. It requested a 30-day extension.

The day before the demand expired, Pinto's counsel advised that the permissive user was considered an insured in his demand, did not respond to Farmers' other concerns and advised that the limits demand expired the following day at 5 p.m. Before that deadline, Farmers hand-delivered a letter accepting the demand and enclosing a check for the limits and a release. Later that day, it faxed the requested declaration from Martin. It was "never able to obtain [a declaration] from Orcutt."

Pinto rejected the tender because Farmers had failed to "unconditionally accept" his offer because it didn't include the Orcutt declaration. He also stated that Farmers had not been diligent in obtaining Orcutt's declaration, which was critical information for Pinto.

Pinto then filed suit against Martin and Orcutt. He settled with them for payment of the $50,000 Farmers policy and a $15,000 policy Orcutt had through her mother. Martin and Orcutt also agreed that the settlement would be treated as the equivalent of a $10 million judgment and assigned their rights to collect that "judgment" against Farmers to Pinto. Pinto then commenced suit against Farmers.

As noted, the jury found that (1) the demand was reasonable, and (2) Farmers did not accept it. The jury found that Farmers was responsible for the entire $10 million judgment. The jury also found that (a) Orcutt failed to cooperate; (b) Farmers used reasonable efforts to obtain Orcutt's cooperation; and (c) Orcutt's lack of cooperation prejudiced Farmers. The appellate court stated, "The jury made no findings that Farmers acted unreasonably in any respect."

The issue was thus joined. Who is to bear the burden of an excess judgment if a reasonable policy limit demand is rejected, the insured or the insurer? The insureds argue that the only two questions are whether the demand was reasonable and whether it was accepted. They argue, in essence, that an insurer cannot reasonably reject a reasonable limits demand. Insurers claim that there are circumstances, such as those here, where an insurer's conduct will be deemed entirely reasonable, that it simply could not have accepted the demand and that holding the insurer responsible in this situation is not mandated by insurance bad faith law. To the contrary, they argue that insurance bad faith requires unreasonable conduct and, under the facts here, there was nothing unreasonable about its conduct. Given the jury's finding that it used reasonable efforts to obtain Orcutt's cooperation, they claim it was literally impossible to have accepted the demand – reasonable or not.

Waiting on the Supreme Court?

Until now, a lot of attorneys have adopted the approach that, where the insurer turns down a reasonable policy limit demand, one can rightly assume that the limits are off the policy. In other words, there are no circumstances where an insurer could have acted reasonably if the demand was reasonable and it was not

accepted. That is a pretty good assumption if the per se approach of CACI 2334 is correct. If, however, the Supreme Court accepts review, it will be unclear for the next two to three years whether insurers will have excess exposure when a limits demand is rejected. To stir the pot even more, if there is to be any reasonableness test that needs to be satisfied, in addition to the current CACI 2334 requirements, it may be difficult for claimants in some situations to determine whether the insurer may have a "reasonableness" defense.

It is common now for parties to mediate the bad faith excess case during the pendency or appeal of the underlying case. There will now be an added twist to those mediations unless and until the Supreme Court rules otherwise. Only the insurer is fully aware of the circumstances behind its rejection of the demand. And, while the underlying case is ongoing, the insurer does not have to and, in my experience, is highly unlikely to provide its claims file to claimant's counsel. A bad faith case for failure to settle cannot be filed until the underlying case is final. Thus, the only way to know for sure why the insurer did not accept the demand is to take the underlying case to verdict, sustain that verdict on appeal, obtain an assignment from the insured, file suit against the insurer and then obtain the claim file.

There is always the temptation to obtain some form of agreed judgment in order to shorten the process, as was done here. The nature of that agreement is not clarified in *Pinto*. Suffice to say, that the circumstances under which such an agreement or judgment would be enforceable are far from clear. (*Hamilton v. Maryland Cas. Co*. (2002) 27 Cal.4th 718, 726 [Insurer controls defense and insured has no right to reach a settlement directly with the third party as long as the insurer is defending.].)

Even if an insurer is entitled to argue that its conduct was reasonable, it is unclear what circumstances would permit an insurer to make that contention. What if the insurer's acceptance was a day or an hour late? Is that unreasonable? If not, what about two days, a week or a month? In circumstances where a declaration such as that sought here was requested, will the right to an excess verdict case come down to what the insurer did or was required to do to get that declaration? Will conduct by the claimant, such as refusing to grant an extension or having the demand letter written with the assistance of undisclosed counsel be factors that can be used to judge the reasonableness of the insurer's conduct? Is the insurer's conduct reasonable if it submits the medical records to an expert but does not hear back from the expert in time to respond by the expiration of the offer? You get the idea. The questions and circumstances under which an insurer may claim that its conduct was reasonable despite rejecting a reasonable limits demand are uncabined at this point.

Conclusion

Many attorneys feel that it is their duty to obtain the maximum recovery for their clients and that includes holding the insurer's feet very close to the fire under penalty of opening the limits. The greater the pressure on the insurer, the more likely to both spring the limits or open the limits in the event of a rejection of a limits demand. I expect that some attorneys may take a more nuanced approach until this CACI 2334 issue is clarified. In some senses, the more complicated the demand, the greater the chance that a reasonable demand may not be properly accepted. However, if *Pinto* or any semblance of it survives, that approach might also give the insurer a greater opportunity to escape excess exposure by claiming that its conduct was reasonable in light of the conditions which accompanied the demand. As such, some counsel may choose to go the opposite route and make the demand as simple as possible. With no conditions to satisfy, an insurer which fails to accept a reasonable demand, may have fewer avenues to claim that its conduct was nonetheless reasonable.

It is, of course, impossible to predict what, if anything, the California Supreme Court will do with *Pinto*. It would not surprise me if the Supreme Court granted review. It could overrule *Pinto* and affirm the correctness of CACI 2334 as many Plaintiffs confidently predict. Insurers believe that the facts in *Pinto* present a difficult case for the Court to permit CACI 2334 to continue unmodified. They seek an additional element of reasonableness to be added to the instruction. Perhaps the Court will adopt some middle ground by concluding that there are circumstances where an insurer can reasonably fail to accept a reasonable settlement demand, but those circumstances are limited. Perhaps the Court may attempt to give some guidance as to what types of conditions can be fairly attached to a policy limits demand in order to trigger excess exposure. Some attorneys have suggested that the Court may adopt an approach that will focus on whether the insurer accepted the amount of the demand and permit an insurer which accepts the principal dollar amount more leeway to satisfy other conditions of the demand. Others suggest the Court will focus on one issue – did the insurer attempt in good faith to timely accept the demand. Or …

In the meantime, it may be worth looking anew at how policy limit demands in on-going cases are made, evaluated and addressed.


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