New Questions About A Liability Carrier's Duty to Settle

By Peter S. Selvin[1]

In a recent decision, the Court of Appeal made an important clarification in a key area of insurance law.

In its March 13, 2012 decision in *DeWitt vs. Monterey Insurance Company*, (March 13, 2012), --- Cal.Rptr.3d ----, 12 Cal. Daily Op. Serv. 2972, the Court addressed the circumstances under which a liability insurance carrier will face bad faith liability for failing to accept a reasonable settlement offer on behalf of its insured. The appeal in *DeWitt* arose from an alleged instructional error by the trial court which highlighted the core question in the decision: Under what circumstances is a carrier obliged to accept a reasonable settlement offer on behalf of its insured?

The facts in *DeWitt* are somewhat complicated, but the essence was that DeWitt was sued in connection with a personal injury lawsuit. The liability carrier denied his tender and a default judgment was entered against him.

After the entry of the default judgment, the claimant made a $1 million settlement demand to DeWitt, which DeWitt forwarded to the carrier. The carrier declined to accept the settlement demand.

The carrier eventually settled on DeWitt's behalf with the claimant, thereby resulting in the satisfaction of the default judgment.

DeWitt then sued the carrier for bad faith, alleging, among other things, that the carrier had wrongfully failed to accept the settlement $ 1 million demand.

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After the trial court refused to give the standard jury instruction on an insurer's refusal to accept a reasonable settlement offer on behalf of its insured (CACI No. 2334), the jury exonerated the carrier, finding no bad faith concerning the carrier's conduct. DeWitt appealed the resulting judgment, contending that the trial court had erred by refusing to give the pertinent instruction.

The Court of Appeal affirmed, and its opinion is noteworthy for two points for attorneys who practice in this area:

1. Scope of CACI No. 2334. The "Directions for Use" for CACI No. 2334 provide that the instruction is to be used "if the insurer has assumed the duty to defend the insured, but failed to accept a reasonable settlement offer". The Court of Appeal noted that this language in the jury instruction is incorrect. As the Court noted, the decision in *Comunale v. Traders & General Ins. Co*., 50 Cal.2d 654 (1958) "makes clear that an insurer who 'wrongfully refuses to defend' on the ground that the claim is not covered may be liable for failing to accept a reasonable settlement offer if the claim is in fact covered by the policy."

2. Requirement of proving that the underlying claim is "covered". Most of the discussion in *DeWitt* revolved around the plaintiff's failure to have established that his claim was in fact "covered" by the underlying policy.

In this regard, a liability carrier is liable for the bad faith refusal to accept a settlement offer only as to a *covered* claim. See, e.g., *Mary Y. vs. General Star Indemnity*, 110 Cal.App.4th 928, 958-59 (2003) (holding that in this context "coverage" is synonymous with "indemnity"); *Johansen v. California State Automobile Association Inter-Insurance Bureau*, 15 Cal.3d 9, 19 (1975). Thus, where there is no coverage under

the policy (i.e., where the carrier has no duty to indemnify), the carrier will have no potential liability for failing to accept a settlement offer.

DeWitt unsuccessfully argued that the carrier's failure to have defended him meant that the carrier had waived any right to contest its obligation to indemnify him under the policy. The Court held, however, that even where a liability carrier breaches its duty to defend, it may nonetheless may contest coverage for purposes of its obligation to indemnify. See, e.g., *Hogan v. Midland National Ins. Co*., 3 Cal.3d 553, 564 (1970).

In *DeWitt*, his counsel had expressly withdrawn his request for any jury instructions that would have permitted the jury to determine whether the liability carrier owed DeWitt a duty to indemnify. At the jury instruction conference, counsel advised that the "jury's not deciding the breach of the duty to indemnify". As a result, there was apparently no evidence submitted at trial to establish that there was an obligation on the carrier's part to indemnify DeWitt under the policy.

The principle that a liability carrier that has wrongfully refused to defend its insured bears no responsibility for declining a settlement offer *unless* the underlying claim is in fact covered under the policy can be criticized on the following grounds:

- It incentivizes carriers in close cases to deny an insured a defense. By denying a defense to its insured, the carrier puts the insured to the double burdens of defending itself against the claimant and then demonstrating coverage in its suit against the carrier. The latter task may be especially difficult if the insured has settled with the claimant. In that event there will have been no factual findings in the liability case – findings which could have aided the insured in its suit against its carrier.

- It incentivizes insureds to allow a default to be entered where the carrier has refused to provide a defense. In this regard, *Amato v. Mercury Casualty Co*., 53 Cal.App.4th 825, 833 (1997) stands for the proposition that where a liability carrier wrongfully refuses to defend its insured, and a default judgment against the insured is thereafter entered, the carrier is *not* allowed to contest coverage. In other words, the insured may cut off its carrier's right to contest coverage if it allows a default to be entered.

- It is unnecessary in light of *Blue Ridge Insurance Company v. Jacobsen*, 25 Cal.4th 489 (2001). In *Blue Ridge*, the California Supreme Court held that an insurer defending its insured under a reservation of rights may settle with the claimant over its insured's objections and thereafter pursue the insured for recoupment if the claim is not in fact covered under the policy. Put differently, in view of the fact that the carrier has an adequate remedy under *Blue Ridge*, it is inappropriate for the risk created by the uncertainty about coverage to be shouldered by the insured.

In any event, and although the *DeWitt* decision does not break any new ground, the lessons that can be distilled from the decision are these:

Notwithstanding the language in its "Directions for Use", CACI No. 2334 is properly given in cases where the liability insurer has refused to defend its insured.

In trying a bad faith case arising from a liability carrier's refusal to settle, it is critical that the question of the insurer's obligation to indemnify be determined. Put differently, the insured cannot rely merely on the carrier's wrongful refusal to defend. Instead, the insured must also prove in its case in chief that the carrier would have been responsible to indemnify its insured had the underlying liability case gone to judgment.