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Good faith and fair dealing by insurers in pre-litigation of auto accidents

A review of the rulings that hold the insurer liable for failure to reasonably settle within policy limits

By Zachary J. Buchta

It is almost always in our clients' best interests to settle a third-party liability automobile accident case in pre-litigation through a demand letter and settlement discussions rather than through expensive and time-consuming litigation. This can be especially true when your client's damages exceed the defendant's automobile insurance policy limits. A pre-litigation policy-limit settlement often can be achieved through a well-prepared demand letter that clearly establishes the liability of the defendant and demonstrates that the plaintiff's damages exceed the available policy limits.

The *Comunale* rule

In California, every contract, including insurance contracts, contains an implied covenant of good faith and fair dealing. (*Comunale v. Traders & General Ins. Co.* (1958) 50 Cal.2d 654, 658.) This implied covenant of good faith and fair dealing requires both parties to a contract not to do anything that would impair the right of the other party to the contract from receiving the benefits of such contract. (*Ibid.*)

In *Comunale*, the California Supreme Court ruled that in the context of an automobile insurance contract, the implied covenant of good faith and fair dealing requires the insurer to settle in appropriate cases despite the fact that the express terms of the insurance policy do not impose such a duty on the insurer. (*Id.* at p. 659.) The implied covenant of good faith and fair dealing requires that when an insurer is deciding whether to compromise and settle a claim for an amount within the insurance policy limit, the insurer must consider the welfare and interests of the insured at least as much as it considers its own interests. (*Ibid.*) When an insurer fails to settle an appropriate case within the policy limits, liability is not imposed on the insurer for a bad-faith breach of the contract, but rather for a failure to meet the duty to accept reasonable settlements. (*Crisci v. Security Insurance Co. of New Haven, Connecticut* (1967) 66 Cal.2d 425, 430.)

The standard for determining when an insurer can be held liable for damages in excess of the policy limits is whether a prudent insurer would have accepted the settlement offer if it alone were to be liable for the entire judgment. (*Betts v. Allstate Ins. Co.* (1984) 154 Cal.App.3d 688, 706.) This means that an insurer must settle an automobile insurance liability claim if the plaintiff makes a reasonable offer to settle the claim within policy limits and there is a substantial likelihood of a recovery by the plaintiff at trial in excess of those policy limits. (*Ibid.*)

When evaluating the reasonableness of the plaintiff's policy limit settlement offer, the permissible considerations are whether in light of the plaintiff's injury and the probable liability of the insured, the ultimate judgment is likely to exceed the amount of the settlement offer. (*Betts, supra*, at p. 706-707.)

When an insurer fails to accept a reasonable settlement offer within the policy limits and the case proceeds to a judgment, the insurer may be held liable for the entire judgment against the insured in excess of its policy limits due to its breach of the implied covenant of good faith and fair dealing. (*Betts, supra*, at p. 706-707.) This liability will still be imposed on the insurer despite an absence of dishonesty, fraud or concealment on the part of the insurance company. (*Id.* at p. 706.)

Betts v. Allstate Ins. Co. (1984) 154 Cal.App.3d 688

In *Betts*, Debra Betts brought a claim against Allstate Insurance Company alleging a breach of the implied covenant of good faith and fair dealing due to Allstate's bad faith refusal to accept a settlement within her insurance policy limits in an underlying case with a third party. (*Betts, supra*, at p. 697.)

In that underlying case, Ms. Betts had a $100,000 policy with Allstate and was involved in an automobile accident with Anne Gallucci in which one of the drivers ran a red light. (*Id.* at p. 696.) As a result of that accident, Ms. Gallucci suffered severe injuries, including brain damage, with her total damages easily exceeding Ms. Betts's $100,000 policy limit. (*Id.* at p. 699.) In her initial statement after the accident, Ms. Betts claimed that she had not run the red light and did not cause the accident, and Allstate denied liability accordingly. (*Id.* at p. 697.)

Allstate defended the case but denied liability and refused settlement discussions throughout the case. (*Id.* at p. 697.)

As discovery proceeded in the case, it eventually became clear that Ms. Betts was responsible for the accident and that Allstate was liable for the damages to Ms. Gallucci. (*Id.* at p. 701-704.)

Throughout the course of the case, Ms. Gallucci's attorney made several offers to settle the case within the policy limits. (*Id.* at p. 702.) Two of Allstate's local claims representatives that were handling the case eventually recommended that Allstate accept the policy limit settlement offers. (*Ibid.*) However, with full knowledge of all the facts regarding liability, Allstate never informed Ms. Betts of the potential liability, never informed Ms. Betts of the settlement recommendations, and completely rejected all offers to settle the case for the policy limits. (*Id.* at p. 702-703.) In fact, Allstate continued to encourage Ms. Betts to fight the case and informed her that she could just file for bankruptcy to discharge the debt should she lose at trial. (*Id.* at p. 703.)

After the trial concluded, but before a jury verdict was reached, Ms. Gallucci's attorney made another offer to settle the case for the $100,000 policy limit, which was once again rejected by Allstate. (*Id.* at p. 703.) The jury then returned a verdict in favor of Ms. Gallucci for $450,000. (*Ibid.*) During the appeal process, Allstate continued to reject policy limit settlement offers in fear that the money could not be retrieved should Allstate win a motion for a new trial on appeal. (*Id.* at p. 704.)

Eventually, Ms. Betts sued Allstate for the $450,000 judgment against her due to Allstate's bad faith refusal to accept the policy limit settlement offer. (*Id.* at p. 697.) The jury awarded her $500,000 in compensatory damages and $3 million in punitive damages. (*Ibid.*) On appeal, the court found that Allstate's failure to investigate and fairly appraise Ms. Gallucci's claim against Ms. Betts was a breach of the covenant of good faith and fair dealing. (*Id.* at p. 708.) Additionally, the court found that there was sufficient evidence to support the jury's conclusion that Allstate unreasonably rejected Ms. Gallucci's multiple policy limit settlement offers. (*Ibid.*) Accordingly, the court affirmed the compensatory damages award for Ms. Betts. (*Ibid.*)

Practice tips when drafting a demand letter

In light of the knowledge that an insurance company can be held liable for an entire judgment against its insured for unreasonably rejecting a settlement within the policy limits, it's important for a plaintiff's attorney to clearly demonstrate the insured's entire potential exposure when presenting a demand letter to an insurance company. By doing so, it will put pressure on the insurance company to settle the case within the policy limits in order to protect the rights of their insured and prevent itself from being liable for damages in excess of the policy limits. Below are several practice tips for settling a case in pre-litigation.

Request the policy limits

When sending your initial letter of representation to the defendant's insurance company, make sure to request the defendant's policy limits for all insurance applicable to the case. Upon demand by a plaintiff for the insured's policy limits, an insurer must request its insured's consent to disclose the limits and must advise the insured of the benefits of disclosing the policy limits or be at risk for bad faith. (*Boicourt v. Amex Insurance Company* (2000) 78 Cal.App.4th 1390.) If you can get the policy-limit information, it will make it easier to negotiate for a policy limit settlement. The demand letter should then be written to demonstrate that the damages exceed the policy limits and should clearly state that the plaintiff is willing to settle the claim for the policy limits.

Establish liability of the defendant

It is important for a demand letter to clearly demonstrate that the insured is liable for all damages suffered by the plaintiff in your case. One of the considerations in determining if a policy limit settlement offer is reasonable is a showing that the insured is liable for the damages caused by the accident. (*Betts*, *supra*, at p. 706-707.) This liability can be established in a demand letter through the use of traffic collision reports, witness statements, and accident reconstruction reports. By doing the work up front to show that the defendant was responsible for the accident and is liable for the damages, it will show the insurance company that your case is strong and that you are prepared to litigate the case if they are unwilling to settle for the policy limits.

Show the damages exceed the policy limits

The second consideration for determining if a policy limit settlement offer is reasonable is whether the ultimate judgment is likely to exceed the amount of the settlement offer. (*Betts*, *supra*, at p. 706-707.) When drafting a demand letter, you must show all of the damages that the plaintiff suffered in the accident. The client's medical records can be used to show that the client suffered real injuries, that the injuries were caused by the accident, and that the injuries will require medical treatment into the future. From there, the medical bills can be used to establish the client's past and future medical expenses. Similarly, the client's medical records showing treating doctors taking the client off work can also be used to justify the client's lost wages in the past and in the future. When explaining the client's total damages, be sure to include all damages suffered by the client, including medical expenses, lost wages, out-of-pocket expenses, loss of household services, loss of consortium, and the client's general damages. All documentation related to liability, medical injuries, medical treatment, and wage loss should be included as attachments to the demand letter. These are the documents the insurance company will need to properly evaluate the case. By including supporting documentation in the demand letter, it will be more difficult for the insurance company to argue that its

refusal to settle the case was reasonable based on the information available to them.

Conclusion

In California, all insurance contracts contain an implied covenant of good faith and fair dealing which requires an insurer to settle an automobile insurance liability claim if the plaintiff makes a reasonable offer to settle the claim within policy limits and there is a substantial likelihood of a recovery by the plaintiff in excess of those policy limits. (*Betts*, *supra*, at p. 706.) If the insurer fails to accept a reasonable settlement offer within the policy limits, the insurer may be held liable for the entire judgment against the insured in excess of its policy limits. (*Ibid*.) Plaintiff's attorneys can use this to their advantage by sending a demand letter that clearly establishes the liability of the defendant and demonstrates that the potential recovery greatly exceeds the policy limits. In doing so, a plaintiff's attorney will put pressure on the insurance company to settle the case for the policy limits in pre-litigation rather than potentially expose itself to damages in excess of the policy limit in litigation.

Zachary J. Buchta is an associate in the Rains Lucia Stern St. Phalle & Silver, PC Personal Injury Group. He represents persons who have suffered serious injury from automobile accidents, defective products, dangerous premises, negligence, and intentional torts.


Buchta