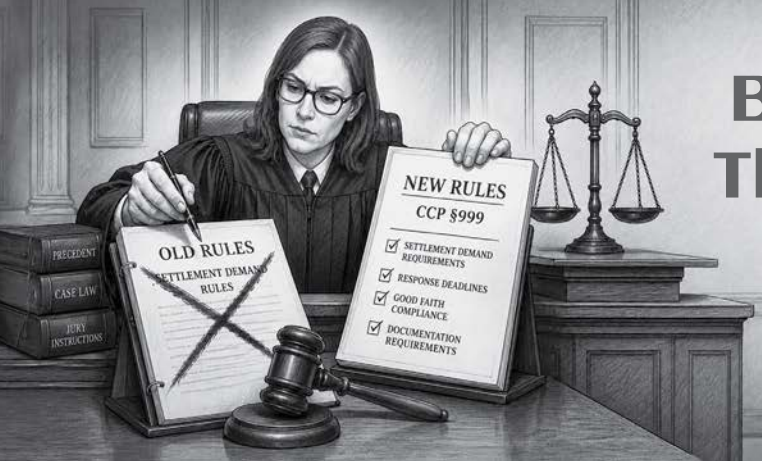

Bad Faith Instructions – The Post-*Pinto* Universe

Hon. Vedica Puri (Ret.) | **ADR Services, Inc.**

It is rare, especially in the insurance coverage universe, when a case holding results in a change in something as vital as a California jury instruction. But that's exactly the effect of *Pinto v. Farmers Ins Exchange* (2021) 61 Cal.App.5th 67, requiring major revisions to CACI 2334. So, what's happened since the advent of the new CACI 2334? While precious few cases have come down on the subject, the California Legislature has enacted a new series of statutes (CCP §999.1-5) in 2023 aimed at leveling the playing field between carriers and insureds with respect to demands from insureds' counsel. This is the first time the Legislature has weighed in with specific requirements for both sides handling policy limit demands with time limits.

The *Pinto* Case Holding & Settlement Demand Timeline

It is important to understand the cases that likely led to the enactment of CCP §999.1-5. The Pinto Court of Appeal vacated a jury verdict in favor of the insured because the verdict was premised on a deficient jury instruction that took its language directly from then-existing CACI 2334 (Bad Faith – Refusal to Settle).

It is well known that California law permits a bad faith action to lie against a carrier who refuses in bad faith to settle a third-party claim. The California Supreme Court has specifically held that one aspect of the duties imposed on insurers by the implied covenant of good faith and fair dealing is to accept reasonable settlement demands within policy limits to avoid exposing insureds to personal liability in excess of those limits. (*Comunale v. Traders & Gen. Ins. Co.* (1958) 50 Cal.2d 654, 659.) However, what is less clear is the level of evidence required to prove a carrier acted in bad faith. *Pinto* sheds light on the answer to this question. Ms. Pinto was the victim of a terrible car accident in 2013. She sued the car owner (who was driving was disputed) and submitted a settlement demand with certain requirements. Farmers responded by tendering its limits – within the deadline specified – but without a requested declaration. Ms. Pinto rejected that settlement as nonconforming to her terms. Ms. Pinto then obtained a judgment against the car owner of nearly $10 million – far in excess of policy limits. She obtained an assignment of rights from the car owner and sued Farmers for bad faith refusal to settle.

At the bad faith trial between Ms. Pinto and Farmers, extensive evidence was presented by both sides concerning the reasonableness of Farmers' conduct in adjusting Ms. Pinto's claim and in failing to accept the settlement demand. The special verdict form asked three questions based on the then-existing version of CACI 2334, which were in essence: (1) Did Pinto make a reasonable settlement demand? (2) did Farmers fail to accept a reasonable settlement demand? and (3) was a monetary judgment entered against Farmers' insured in Pinto's earlier lawsuit? (*Id.* at p. 686.)

The jury answered all three in favor of the insured.

However, the verdict form asked nothing about the reasonableness of the insurer's conduct. As the Court of Appeal subsequently held:

> 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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> A special verdict based solely on an insufficient jury instruction cannot support a judgment. The jury was neither asked to nor did find that Farmers acted unreasonably or without proper cause in failing to accept Pinto's settlement offer. Because a cause of action for bad faith requires a finding that the insurer acted unreasonably, the absence of such a finding precludes judgment for the plaintiff on that claim.

The Court of Appeal went on to explain that there was no evidence that Farmers caused the settlement to fail. *Id.* at 693-4. Not only did the Court of Appeal vacate the existing judgment, it entered judgment in favor of Farmers.

After this case came down, CACI 2334 was revised in accordance to add specific questions around the unreasonableness of an insurer's conduct. (The current version of CACI 2334 can be found at the end of this article.)

The Hedayati Case & Thanksgiving Timeline

The single most relevant case citing *Pinto* is in *Hedayati v. Inter Insurance Exchange of the Automobile Club* (2021) 67 Cal .App.5th 833. In *Hedayati*, the Court of Appeal reversed a summary judgment order in favor a carrier on the issue of a bad faith refusal to settle.

Ms. Hedayati was a 43-year-old medical student, taking a walk during a break from

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studying for exams, when a car struck her while she was in a crosswalk. Her injuries were severe – one leg was severed, and she was in a coma and on life support for weeks. Her claim was tendered to the driver's carrier, Auto Club, the next day. The adjuster reported after the first interview with its own insured that the driver "makes a very poor witness for himself." (*Id.* @ p. 838). Immediately upon reviewing the adjuster's report, which included a newspaper account of the accident and a description of Hedayati's injuries, an Auto Club manager wrote in the company's files: "Would appear that our $25K limit is gone."

All of this occurred in October, and the parties engaged in multiple exchanges of information and negotiations during October and November, during which time the claim was assigned from one adjuster to another. After some delay in receiving documents requested from the Auto Club, Hedayati's attorney sent a settlement demand for policy limits of $25K conditioned on receiving the insured's declaration that he wasn't in the course and scope of his employment and that no other insurance applied. The settlement demand was sent during the week of Thanksgiving and critically, demanded a one-week turnaround. After the demand had expired, the insurer asked for an extension of time to respond and the answer was "no."

In the underlying case, Hedayati secured a $26M judgment against the insured driver, received an assignment of the driver's policy rights, and sued Auto Club for the bad faith refusal to settle. In recounting the parties' evidentiary showing on summary judgment, the Court of Appeal noted many gaps in the Auto Club's evidence from which a jury might draw an inference of unreasonable behavior, including the fact that the Auto Club claim manager was unable to offer any explanation for why no one at Auto Club "appeared to have seen or acted on Hedayati's offer for more than a week after it arrived." (*Id.* at p. 841.) Regardless, the trial judge showed little patience with the tight turn-around time, during a national holiday week. In granting the Auto Club's summary judgment, the trial judge ruled: "All plaintiff has shown is that defendant failed to respond by plaintiff's self-imposed, arbitrary deadline to a demand defendant received the day before Thanksgiving for not just $25,000, but also for a signed declaration from the insured attesting to certain facts." The judge concluded that, because there was no real reason for plaintiff's "mega-short" deadline, Auto Club's response, or lack thereof, was "immaterial." *Id.* at 842.

The Court of Appeal reversed and found triable issues of facts with respect to why no one at Auto Club saw the demand and why Auto Club failed to convey Hedayati's settlement offer to its insured. In assessing the trial court order, the Court of Appeal held with respect to the insured (Mr. Vanwyk):

> In essence, the [trial] court found that no reasonable trier of fact could conclude Auto Club's conduct in failing to meet the clear terms of Hedayati's

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settlement offer and secure a release constituted a breach of its duties to Vanwyk under his liability policy.

In other words, as a matter of law, the trial court found Auto Club did not violate its implied promise to Vanwyk to handle policy claims with good faith and fair dealing regarding his interests.

We disagree with this analysis. *Id.* at 842.

The Court of Appeal also rejected the Auto Club's characterization of its failure to review the demand before the deadline as "reasonable" under the circumstances of a one-week deadline during the week of Thanksgiving.

CCP Section 999: Helping to Define When a Policy May or May Not Be Open As a Result of an Insurer's Response to a Limits Demand.

In 2023, a few years after the *Pinto* and *Hedayati* decisions, at the urging of carriers who felt plaintiff's counsel were improperly setting up bad faith claims, the California Legislature enacted a series of statutes governing time limits demands. None have been interpreted by courts – yet. This is the first time policyholders and insurers have been given statutory guidelines applicable to limits demands for purposes of holding a third-party insurer liable for bad faith.

Defining a Time Limited Policy Limits Demand

CCP section 999 applies before suit is filed and sets forth certain requirements that both claimants and insurers must abide by when issuing and responding to pre-litigation limits demands made on/after January 1, 2023. Section 999.5 defines a time-limited demand as:

> An offer prior to the filing of the complaint or demand for arbitration to settle any cause of action or a claim for personal injury, property damage, bodily injury, or wrongful death made by or on behalf of a claimant to a tortfeasor with a liability insurance policy for purposes of settling the claim against the tortfeasor within the insurer's limit of liability insurance, which by its terms must be accepted within a specified period of time.

This section applies only to (1) property damage, personal or bodily injury, and wrongful death claims (2) made under automobile, homeowner, motor vehicle, and commercial premises liability insurance policies. (§ 999.4-5).

Material Terms & Service Requirements Imposed on the Insured

The most important change ushered in by these statutes is that no time limit demand can require an insurer response in less than 30 days (or 33 days if sent by mail). This eliminates the issues at the heart of *Pinto* and *Hedayati* surrounding unilateral or "mega short" deadlines.

Another provision that balances the parties' interests is that the insured must include the following terms for their time limited policy limits demand to qualify as reasonable:

- a clear and unequivocal offer to settle all claims within policy limits, including satisfying all liens;
- an offer of a complete release from all present and future liability for the occurrence and
- specific details including: the date and location of the loss, the claim number, a description of all known injuries sustained by the claimant.

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The demand must also be supported by *reasonable proof*, which may include, if applicable, medical records or bills sufficient to support the claim; and the demand must be sent to the assigned claims adjuster, or to the liability insurer's email or address *designated* for time-limited demands that is listed with the Department of Insurance.

(§ 999.1(a)-(g); § 999.2.)

One question for courts to answer will be – what qualifies as "reasonable proof?" This will likely be the subject of future litigation.

If a policyholder does not substantially comply with section 999, then the limits demand will not be considered a "reasonable offer to settle." (§ 999.4) and a carrier will not be subject to extracontractual damages.

Response Requirements Imposed on the Insurer

If the insurer rejects the limits demand, a carrier must do so in writing and explain the basis for the rejection. (§ 999.3(a)-(c)). The statute warns that the rejection communication is relevant in any later bad faith lawsuit. However, the statute leaves open the question how thorough the explanation must be.

The statute makes clear that asking within the 30-day period for clarification, additional information, or more time to respond is not a rejection or counteroffer. But the statute does not make clear what result obtains if the plaintiff's counsel declines to provide the requested information or extension.

Not responding to a qualifying demand is not an option under section 999.3. But the statute dos not explain what happens if the insurer – whether through reasonable or unreasonable inadvertence – fails to affirmatively accept or reject the offer.

Although no cases interpreting these statutes have come down, it is important for all counsel to be aware of these statutory requirements when framing a demand or responding to a limits demand.

CURRENT CACI 2334

1. [That *[name of plaintiff]* was insured under a policy of liability insurance issued by *[name of defendant]*;

2. That *[name of claimant]* made a claim against *[name of plaintiff]* that was covered by *[name of defendant]*'s insurance policy;

3. That *[name of claimant]* made a reasonable demand to settle *[his/her/nonbinary pronoun]* claim against *[name of plaintiff]* for an amount within policy limits;

4. That *[name of defendant]* failed to accept this settlement demand;

5. That *[name of defendant]*'s failure to accept the settlement demand was the result of unreasonable conduct by *[name of defendant]*; and

6. [That a judgment was entered against *[name of plaintiff]* for a sum of money greater than the policy limits.] [or]

7. [That *[name of defendant]*'s failure to accept the settlement demand was a substantial factor in causing *[name of plaintiff]*'s harm.]