



AN INSURER'S BAD FAITH FAILURE TO SETTLE

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AN INSURANCE COMPANY that is defending a lawsuit against its insured usually has the right to litigate or settle. However, that right is limited by the insurance company's duty to act in good faith when evaluating a settlement demand. An insurer must agree to a reasonable settlement demand that is within policy limits. So, what is a reasonable settlement demand?

Under California law, the reasonableness of a settlement demand is evaluated by considering whether, in light of the plaintiff's injuries and the probable liability of the insured, a judgment is likely to exceed the amount of the settlement demand. A mathematical formula is effective in evaluating the reasonableness of a settlement demand. For example, in one case, a \$5,000 settlement demand was determined to be reasonable, where the insurer assessed the plaintiff's damages at \$11,000 and estimated that the insured's liability was a 50 percent certainty.

Under this standard, an insurer may have a duty to accept a settlement demand within policy limits when the plaintiff's damages are significant, even if there is a small chance that the plaintiff will prevail at trial. This often happens when automobile accidents cause injuries in the millions of dollars, and the at-fault driver has minimal insurance coverage. For example, suppose that the insured has a policy with a \$100,000 limit of liability, the plaintiff's damages are \$10 million, and the insured's chances of being found liable are approximately one percent. Since the \$100,000 policy limit is one percent of \$10 million, the insurer arguably would have a duty to accept a \$100,000 policy limit settlement demand. Thus, an insurer may be obligated to pay the policy limits on claims of marginal liability where the damages are significant.

Under California law, when an insurer rejects a reasonable settlement demand within policy limits and the insured suffers a judgment in excess of policy limits, this is a breach of the covenant of good faith and fair dealing, otherwise known as "bad faith." The insurer will be liable for all damages caused by the insurer's bad faith, including the full amount of the judgment, regardless of the policy limits and the attorneys' fees incurred to establish bad faith. Thus, in certain cases, the potential for a finding of bad faith may motivate an insurer to settle a claim against its insured rather than risk going to trial.

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