LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
WEDNESDAY, MAY 7, 2025

Is the policy open or not? The role of 'reasonableness' in settlement dealings

Whether an insurance carrier is on the hook for damages beyond policy limits requires a close analysis of fact patterns, case law and statute.

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When I mediate personal injury cases, the issue about which parties seem to disagree the most vehemently is whether the defendant's insurance policy is 'open' - making the insurance carrier responsible for all damages, even those that exceed policy limits. In almost every case, the insurance carrier believes that the policy is firmly closed, leaving the defendant on the hook for anything beyond the policy limits.

In cases where the defendant's policy limit is high and the plaintiff's claimed losses are minimal, it isn't even a discussion point during mediation. But if the plaintiff's damages potentially exceed policy limits, this can become a major sticking point in settlement discussions because the insurance carrier understandably does not want to pay any amount over the policy limit.

Two hypothetical scenarios

Let's look at two hypothetical scenarios in which the open-or-closed policy question becomes central to the mediation. In each case, the insurance carrier has rejected the plaintiff's pre-litigation demand for the full policy limit at some point prior to mediation, a necessary prerequisite for the policy to be deemed open. Both plaintiffs contend that the insurance policies are now open and insist that any settlement amount must exceed the policy limits; in both cases, the insurance carrier argues that the policies are still closed and refuses to consider any amount above the policy limits. Until we can reach at least some consensus as to whether or not the policies are open, how can we settle these cases in mediation?

Hypothetical plaintiff #1, a 68-year-old man, was rear-ended by defendant's truck, sustaining soft-tissue injuries and a mild reaggravation of a preexisting spinal injury requiring several months of conservative treatment (e.g., chiropractic care, physical therapy, over-the-counter pain medication) and two weeks off from work. The vehicle was totaled. Liability is not disputed; only the amount of damages is at issue. Plaintiff #1's bottom-line demand at mediation is $225,000, $25,000 above the limit on the defendant's insurance policy. While plaintiff #1's attorney provided medical records and bills to support the pre-mediation policy-limits demand, plaintiff #1's total claimed damages at the time of the demand (including a moderate amount of projected future losses) appear to be less than $150,000. Plaintiff #1's attorney concedes that the calculation of claimed damages has not changed as of the date of mediation.

Hypothetical plaintiff #2, a 37-year-old woman, suffered severe orthopedic injuries resulting from a head-on traffic collision caused by defendant's negligence. She underwent surgery (but continues to suffer from pain and physical limitations), was unable to work for several months and shows potential signs of a traumatic brain injury. The defendant's policy is capped at $500,000, but plaintiff #2's bottom-line demand at mediation is $1 million. Her pre-mediation policy limits demand was accompanied by extensive medical records (including imaging reports, a surgical report, regular notes from visits with her orthopedic doctors and physical therapy progress notes), itemized medical bills and wage statements to support a claim for lost wages.

Is the policy open?

"In each policy of liability insurance, California law implies a covenant of good faith and fair dealing. This implied covenant obligates the insurance company, among other things,

to make reasonable efforts to settle a third party's lawsuit against the insured. If the insurer breaches the implied covenant by unreasonably refusing to settle the third party suit, the insured may sue the insurer in tort to recover damages proximately caused by the insurer's breach." *PPG Industries, Inc. v. Transamerica Ins. Co.* (1999) 20 Cal.4th 310, 312.

In deciding if a settlement offer is "reasonable," insurance carriers first consider whether their insured is liable and, if so, the amount of that liability. If an insurance carrier fails to accept a reasonable settlement offer within policy limits, it may have to pay the entire judgment, even if it exceeds those limits. *Rappaport-Scott v. Interinsurance Exch. of the Auto. Club* (2007) 146 Cal.App.4th 831, 836.

"[T]he only permissible consideration in evaluating the reasonableness of the settlement offer becomes whether, in light of the victim's injuries and the probable liability of the insured, the ultimate judgment is *likely to exceed* the amount of the settlement offer." (Emphasis added.) *Johansen v. California State Auto. Assoc. Inter-Insurance Bureau* (1975) 15 Cal.3d 9, 16.

Code of Civil Procedure (CCP) Section 999 (effective January 1, 2023) lays out a pre-litigation framework for rendering policies open. Before an insurance carrier can be held liable for damages above the policy limits, claimants who offer to settle before filing a lawsuit must satisfy certain requirements. They must properly prepare their policy-limit demands or those demands will not be considered "reasonable offers to settle" and the claimants will not be able to open the policy limits.

Unreasonable rejection?

Under California Insurance Code Section 790.03 (h), an insurance carrier could be found to have acted in bad faith if it unreasonably delayed responding to the claim, failed to properly investigate it, or undervalued it. It is pretty well-settled in California that carriers are obligated to settle lawsuits against their insureds when there is a clear and unequivocal offer to settle within policy limits and liability is reasonably clear. *Comunale v. Traders & General Ins. Co.* (1958) 50 Cal.2d 654.

California Civil Jury Instruction CACI No. 2334 provides as follows:

"A settlement demand for an amount within policy limits is reasonable if [the insurance carrier] knew or should have known at the time it failed to accept the demand that a potential judgment against [the insured] was likely to exceed the amount of the demand based on [the injured party's] injuries or losses and [the insured's] probable liability. However, the demand may be unreasonable for reasons other than the amount demanded."

Bad faith may, however, require more than a reasonable offer that was refused. In *Pinto v. Farmers Ins. Exch.* (2021) 61 Cal.App.5th 676, the Court of Appeal held that the amount of a plaintiff's demand is just one of the factors an insurance carrier should examine when determining whether to accept a demand. Even with "reasonable" demands, failure to accept might not necessarily be bad faith. (*Pinto*, supra at 687-688.) Under the unique circumstances of the case, such a rejection might actually have been reasonable.

To constitute bad faith, a carrier's rejection of a settlement demand must have been unreasonable (*Pinto*, supra at 688). The plaintiff must be able to show that the settlement offer was for a reasonable amount within the policy limits and that the carrier's refusal to accept it was unreasonable in light of all circumstances. Once a plaintiff makes this showing, he or she can open the policy to cover damages beyond its limits.

As an aside, California courts have long recognized that an insurance carrier's duty to defend its insured may conflict with the carrier's own interests, resulting in the need for independent counsel to protect the insured when the interests of the carrier and the insured diverge. (See, e.g., *San Diego Federal Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358.) In 1987 the California Legislature enacted Section 2860 of the Civil Code, which codified the *Cumis* rule. That section provides in relevant part: "(a) If the provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, the insurer shall provide independent counsel to represent the insured..."

In *Golden Eagle Ins. Co. v. Foremost Ins. Co.* (1993) 20 Cal.App.4th 1372, the Court of Appeal held that if an insurance carrier pursues a settlement in excess of the policy limits and does not have the insured's consent to do so, the carrier has created a conflict of interest for the counsel appointed by the carrier to represent the insured, by leaving the insured exposed to liability not covered by the policy. (*Golden Eagle*, supra at 1396.) In other words, this discussion of whether or not a policy is open might also unwittingly create a conflict of interest that needs to be considered by the defense counsel and the insurance adjuster appearing at mediation.

Sufficient information?

If an insurance carrier doesn't have enough information to make a reasonableness determination, it cannot formulate an intelligent response to a settlement offer. The more "reasonable proof" a plaintiff can provide to the defense, the stronger the case will be for an open policy if an offer is refused. In fact, for pre-litigation demands, CCP Section 999.3 provides as follows: "Upon receipt of a time-limited demand, an attempt to seek clarification or additional information or a request for an extension due to the need for further information or investigation, made during the time within which to accept a time-limited demand, shall not, in and of itself, be deemed a counteroffer or rejection of the demand." In other words, CCP Section 999 gives insurance carriers the ability to buy time to make a reasonableness determination by requiring claimants to provide more information to support a policy-limits demand.

Plaintiffs must therefore do their homework before making demands. They should be prepared to substantiate their demands with pictures of their injuries, police reports (if any), medical records (including imaging), expert reports (if already obtained), medical bills, witness statements and anything else that supports their demand.

Insurance companies, for their part, should ask plaintiffs for more information to fill in any perceived gaps. At the very least, they should expect to see treating physician notes, physical therapist or chiropractor progress reports, imaging records and medical bills, all of which are needed to gain a full understanding of a plaintiff's injuries and claimed losses. Only when insurance carriers have a full picture of potential damages can they formulate a reasonable response to a plaintiff's policy-limits demand.

The hypotheticals revisited

Let's revisit the two hypothetical cases we looked at earlier. Both hypothetical plaintiffs made pre-litigation policy limits demands that were rejected and both cases are now in mediation. The parties have taken firm positions on the issue of whether or not the insurance policy in question is open or not. The hypothetical plaintiffs argue that the policies are open; the hypothetical defendants (and their insurance carriers) say they are not. No settlement is likely to happen until the issue is resolved.

Hypothetical plaintiff #1 only suffered soft-tissue injuries and a mild reaggravation of a preexisting spinal injury requiring several months of conservative treatment and two weeks off from work. The vehicle was totaled, however, and liability is not disputed. Plaintiff #1 demanded the full $200,000 policy limit in a CCP Section 999 demand prior to filing suit. Plaintiff #1's bottom-line demand at mediation is $225,000. Although plaintiff #1's attorney provided medical records and bills to support the pre-mediation policy-limits demand, plaintiff #1's total claimed damages at the time of the demand (including a moderate amount of projected future losses) appear to be less than $150,000 and plaintiff #1's attorney concedes that the calculation of claimed damages has not changed as of the date of mediation.

Taking into account that medical bills/liens are often negotiated down by plaintiff's counsel, plaintiff #1 received only conservative treatment, has never been considered a candidate for surgery, only missed two weeks of work and has otherwise returned to essentially the same lifestyle as prior to the traffic collision, it would be difficult to successfully argue, based on plaintiff's losses and the defendant's conceded liability, that any potential judgment would be likely to exceed the amount of the $200,000 policy-limits demand. Assuming that the carrier complied with CCP Section 999.3's requirement to notify the claimant, in writing, of its decision and the basis for its decision, the carrier's rejection of the policy-limits demand would appear to be reasonable.

Hypothetical plaintiff #2's situation is starkly different, however. She suffered severe orthopedic injuries as a result of a head-on traffic collision caused by defendant's negligence. She underwent surgery (but continues to suffer from pain and physical limitations), was unable

to work for several months and shows potential signs of a traumatic brain injury. Her pre-mediation policy limits demand of $500,000 was accompanied by extensive medical records (including imaging reports, a surgical report, regular notes from visits with her orthopedic doctors and physical therapy progress notes), itemized medical bills and wage statements to support a claim for lost wages.

Even taking into account any negotiation of medical bills/liens, plaintiff #2 was required to have surgery due to severe orthopedic injuries (which were not pre-existing), has a potential traumatic brain injury and continues to suffer from pain and physical limitations, significantly limiting her quality of life. The carrier might have asked plaintiff #2 to provide additional information/documentation in response to her CCP Section 999 demand, but ultimately, its rejection of the policy-limits demand would appear to be unreasonable in this case.

Conclusion

In both of the hypothetical cases, despite the very different fact patterns, the mediator is unfortunately caught between plaintiff's counsel and defense counsel, on either side of the policy limit. Although no one is likely to concede that their position is wrong, a thorough evaluation and discussion of the open-or-closed policy question at the start of the mediation–*prior to negotiating*–is a critical step toward ensuring that settlement will be possible.

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