# CASE STUDY PREPARED FROM ORIGINAL PUBLISHED OPINION

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## *GRACIANO, v. MERCURY GENERAL CORPORATION* 11/12/14

**Insurance Bad Faith; Covenant of Good Faith and Fair Dealing; Wrongful Refusal to Settle a Third Party Claim**

In the early morning hours of October 20, 2007, Graciano was severely injured when she was struck by a 2004 Cadillac driven by Saul, who had been drinking before the accident. Saul was a named insured on a CAIC policy, in effect on the date of the accident (Saul's policy) with a policy limit of $50,000. The Cadillac was a listed vehicle on Saul's policy. CAIC had also insured Jose Saul Ayala under a separate policy (Jose's policy), and the Cadillac was also a listed vehicle on Jose's policy. Jose's policy, which had policy limits of $15,000, had been canceled approximately six months before the accident.

**October 23, 2007:**

Late on the afternoon of October 23, 2007, CAIC first learned of the accident when Saul contacted an adjuster working for CAIC to report he had been in an accident in the early morning hours of October 21, 2007. Saul reported he fell asleep while driving and had struck a woman and injured her. Saul's claim was handled by the adjusters of the Vista claims unit, and CAIC immediately began investigating this claim. CAIC contacted the California Highway Patrol (CHP) that same day to order a copy of the police report and, at that time, learned the actual date of the accident was October 20, 2007. CAIC also contacted the tow yard the following day and learned the CHP had an "evidence hold" on the Cadillac, which would require permission from the CHP to allow CAIC to inspect it.

**October 30, 2007**:

Based on the preliminary information, CAIC believed the driver was 100 percent at fault. By October 30, 2007, CAIC's adjuster believed it would likely be an "excess bodily injury claim," meaning the amount for which Saul was liable would exceed the amount of coverage provided by CAIC's policy. However, CAIC apparently did not know at that point the identity of the person injured by Saul.

Three days after Saul's report, counsel for the plaintiff, Ms. DeDominicis contacted a CAIC call center in Texas to report her client Graciano had been injured by a driver insured by CAIC. DeDominicis reported Graciano was injured on October 21, 2007, gave the call center a policy number with CAIC, and told CAIC the driver's name was "Saulay Ala."

CAIC assigned this report to a different claim identification number, which identified Jose as the insured and identified his last effective policy number. Graciano's claim was assigned to the La Mesa claims unit. The La Mesa claims unit transferred Graciano's claim to the Factfinder unit in Sacramento, which did coverage investigations, because the listed policy appeared to have been canceled before the date of the accident and the Factfinder unit needed to determine whether the policy had validly been canceled. Ms. Talley of the Factfinder unit attempted to contact Jose without success, requested the underwriting file, and also confirmed it appeared Jose's policy had been canceled in April 2007. Talley also corresponded with DeDominicis on November 1, 2007, to inform DeDominicis it was investigating a "coverage problem" for Jose under his policy and had been unable to confirm coverage. Talley also spoke with DeDominicis on November 6, 2007, confirming the coverage investigation was still ongoing but had not been completed.

**November 5, 2007**:

On November 5, 2007, DeDominicis mailed a demand letter to Talley. The letter identified Jose as the "named insured," under the policy, with the "Date of Loss October 21, 2007," and described Graciano's extensive injuries. DeDominicis stated she had been retained to pursue Graciano's remedies "arising out of an event in which *your above-referenced insured and/or their vehicle* struck Graciano." DeDominicis stated that, considering Graciano's extensive injuries:

> "demand is made that Mercury immediately provide a copy of the declaration page and payment of the maximum bodily injury policy limits to Mrs. Graciano. **The offer to settle for verified policy limits shall expire within ten days of today's date, and shall not be renewed**. Thereafter, Mrs. Graciano shall take the position that Mercury is responsible for any extra-policy judgment that is certain to be rendered . . . . If there is anything else you need to consider and respond in a timely fashion to this policy limit demand, please do not hesitate to call **immediately**. . . ."

That letter was not received by Talley until November 8. The previous day, Talley first received the police report of the incident. The police report correctly reflected Saul was the driver but still listed Jose's old policy as the applicable insurance policy.

**November 8, 2007**:

In the late afternoon of Thursday, November 8, 2007, although its initial investigation indicated Jose's policy had been canceled for underwriting reasons, CAIC nevertheless requested DeDominicis grant an extension on Graciano's demand for a policy limits settlement to give it time to complete its coverage investigation before responding to her demand. DeDominicis refused CAIC's request.

**November 12, 2007:**

By Monday, November 12, CAIC's investigation of Graciano's report and claim had determined Saul, whom the newly obtained police report listed as the driver who struck Graciano, was a "non-listed driver" on Jose's policy and, according to the police report, did not reside at Jose's address. However, CAIC was still concerned Saul could have been the son of the named insured, even though Saul's address did not match that of Jose. That day, CAIC again tried, without success, to speak with DeDominicis about Graciano's claim.

**November 14, 2007**:

On November 14, 2007, CAIC responded to DeDominicis's "policy limit demand" on Jose's policy and informed her that its preliminary investigation over the preceding seven days, although not yet complete, made it appear that Jose's policy was not in force at the time of the accident, and therefore CAIC could not accept DeDominicis's policy limit demand before the November 15, 2007, deadline. CAIC cautioned that its determination was not final, but did advise Graciano to pursue her Uninsured Motorist coverage with her own insurer.

On the late afternoon of November 14, Talley of the Factfinder unit again called Jose to inform him the claimant was seriously injured and might pursue Jose. Talley also left messages with the driver named in the police report, Saul, to ask whether Saul had any insurance. However, Talley did not at that time know whether Saul had any insurance, much less that he had insurance with CAIC.

**November 15, 2007**:

Shortly after noon the following day, Talley spoke on the phone with Saul, who told Talley he did have insurance and that his insurance was with CAIC. This was the first time Talley discovered a claim under Saul's name and policy had already been opened in the Vista claims unit. Talley immediately gave Graciano's claim and demands to the persons in the Vista claims unit handling Saul's claim. Around 1:45 p.m., an adjuster in the Vista claims unit contacted DeDominicis to explain they were the unit handling Saul's claim and had just found out that Graciano was the person whom Saul had reported he had injured, and asked DeDominicis for a 24-hour extension to respond to her settlement demand. DeDominicis refused and stated that if CAIC could not "get its act together on what policy handles what, it's not her problem." The adjuster immediately forwarded his recommendation to the Vista claims supervisor, who recommended CAIC make a full policy limits offer on Saul's policy to settle Graciano's claims against him, and the supervisor immediately approved this offer.

CAIC immediately prepared a letter offering $50,000, which it identified as the full policy limits on Saul's policy, in full and final settlement of Graciano's injury claim. The letter specified the settlement would include any lien claims

(noting the hospital at which Graciano was treated would have a statutory lien) and any loss of consortium claims, and asked DeDominicis to advise whether Graciano was married. Graciano stipulated DeDominicis received CAIC's settlement offer letter before the deadline of her demand on Jose's policy expired.

Graciano did not accept CAIC's offer to settle her claims against Saul. Instead, she pursued her action against Saul. Graciano obtained a judgment against Saul for over $2 million and obtained an alleged assignment of Saul's rights against CAIC.

**Trial:**

Graciano introduced evidence that CAIC could have more promptly obtained the police report, or at a minimum could have more promptly obtained the "face pages" from the police report of the accident, but negligently did not do so. Had CAIC earlier obtained these pages, it would have earlier learned the driver's identity. Once the driver's identity was known, CAIC could have searched its computers to determine whether CAIC insured the driver.

Although the Factfinder unit did receive the police report on November 7, and therefore knew Saul was the driver, no one in the Factfinder unit searched its computerized database under "Saul Ayala" to determine if he was insured by CAIC. Had anyone conducted that search, they could have earlier learned he was insured by CAIC, and this could have led the Factfinder unit to learn of the claim Saul had opened two weeks earlier being processed by the Vista claims unit. Additionally, the Factfinder unit had (by November 12) made a preliminary determination that Jose's policy had expired and therefore there was no coverage, and at that time the supervisor noted (among other tasks to be performed) someone should contact Jose to determine if he had any "excess" coverage that might be applicable, and also "verify if [Saul] has his own insurance." These calls to Jose and Saul were made two days later, and when Saul returned this call the next day, Talley first learned of his insurance with CAIC.

When CAIC tendered their policy limits on November 15, it was unaccompanied by either a check or by the declarations page for Saul's policy. This offer was also subject to the conditions that the policy limits offer of

settlement would include (1) any loss of consortium claim and (2) all lien claims "known and unknown."

The court excluded evidence proffered by the defense to support its argument that DeDominicis's offer to settle for the policy limits was not a genuine offer and that, once CAIC informed her that it appeared there was no coverage under Jose's policy, its subsequent efforts to settle on behalf of Saul were hampered by DeDominicis's machinations. For example, although DeDominicis knew (not later than November 7, 2007) that the driver's name was Saul Ayala, Jr., her November 5 demand letter, as well as her November 7 letter enclosing Graciano's medical bills and her November 8 letter reiterating the November 15 deadline for CAIC to respond, continued to refer solely to Jose and Jose's policy number without any mention of Saul. Additionally, the court excluded evidence that CAIC tried to reach DeDominicis telephonically on the afternoon of November 15 to convey the offer to settle, but those calls went unanswered, and excluded evidence that CAIC's efforts to fax the offer of policy limits during this same time frame were prevented because DeDominicis had (in a departure from ordinary procedures) turned her fax off.

Graciano disregarded CAIC's full policy limits offer and instead pursued her previously filed action against Saul. In that action, she obtained a judgment of over $2 million and obtained a partial assignment of Saul's rights against CAIC to pursue the present action.

The second action alleged a claim for insurance bad faith based on CAIC's alleged unreasonable refusal to settle Graciano's claim against Saul. The jury in that case returned a verdict in Graciano's favor, and CAIC timely appealed.

**Appeal:**

Because this action was limited to a claim that CAIC breached its duties to Saul by not taking reasonable steps to settle Graciano's claim against him, the Fourth District Court of Appeal outlined the principles applicable to the claim. "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.) The standard of good faith and fairness examines the reasonableness of the insurer's conduct, and mere errors by an insurer in discharging its obligations to its insured " 'does not necessarily make the insurer liable in tort for violating the covenant of good faith and fair dealing; to be liable in tort, the insurer's conduct must also have been *unreasonable.*" (*Brandt v. Superior Court* (1985) 37 Cal.3d 813, 819; *Tomaselli v. Transamerica Ins. Co.* (1994) 25 Cal.App.4th 1269, 1280-1281.)

**An insured's claim for bad faith based on an alleged wrongful refusal to settle first requires proof the third party made a reasonable offer to settle the claims against the insured for an amount within the policy limits. The offer satisfies this first element if (1) its terms are clear enough to have created an enforceable contract resolving all claims had it been accepted by the insurer (*Coe v. State Farm Mut. Auto. Ins. Co.* (1977) 66 Cal.App.3d 981), (2) all of the third party claimants have joined in the demand, (3) it provides for a complete release of all insureds (*Strauss v. Farmers Ins. Exchange* (1994) 26 Cal.App.4th 1017), and (4) the time provided for acceptance did not deprive the insurer of an adequate opportunity to investigate and evaluate its insured's exposure. (*Critz v. Farmers Ins. Group* (1964) 230 Cal.App.2d 788, 798)**

A claim for bad faith based on an alleged wrongful refusal to settle also requires proof the insurer unreasonably failed to accept an otherwise reasonable offer within the time specified by the third party for acceptance. However, **when a liability insurer *timely* tenders its "full policy limits" in an attempt to effectuate a reasonable settlement of its insured's liability, the insurer has acted in good faith as a matter of law.** When a claim is based on the insurer's bad faith, alleging either the insurer unreasonably refused to pay policy benefits or did not conduct an adequate investigation, **the ultimate test is whether the insurer's conduct was unreasonable under all of the circumstances.** (*Chateau Chamberay Homeowners Assn. v. Associated Internat. Ins. Co.* (2001) 90 Cal.App.4th 335) Although "the reasonableness of an insurer's claims-handling conduct is ordinarily a question of fact, it becomes a question of law where the evidence is undisputed and only one reasonable inference can be drawn from the evidence." **An insured's claim for "wrongful refusal to settle" cannot be based on his or**

**her insurer's failure to *initiate* settlement overtures with the injured third party (*Reid v. Mercury Ins. Co.* (2013) 220 Cal.App.4th 262), but instead requires proof the third party made a reasonable offer to settle the claims against the insured for an amount within the policy limits.** The Justices conclude there is no substantial evidence Graciano ever offered to settle her claims *against Saul* for an amount within *Saul's* policy limits.

The only settlement "offer" CAIC could have accepted was DeDominicis's November 5, 2007, letter. It identified *Jose* as the named insured, the relevant policy as *Jose's policy*, and after describing Graciano's extensive injuries stated DeDominicis had been retained to pursue Graciano's remedies "arising out of an event in which *your above-referenced insured and/or their vehicle* struck Graciano", and demanded that CAIC "immediately provide a copy of the declaration page and payment of the maximum bodily injury *policy limits . . . .*" Even assuming (as Graciano contends on appeal) the letter implicitly contained an agreement to release "the above referenced insured" in exchange for the "policy limits" of the referenced policy, the plain import of this letter is that Graciano offered *only* to settle her claims against Jose. Because Graciano never demanded payment of *Saul's* policy limits in exchange for a release of *Saul's* liability, Saul would not have been protected even had CAIC accepted the terms of Graciano's demand.

Graciano cited no authority that an offer to release one potentially liable party (here, Jose) in exchange for that party's policy limits, if rejected by the insurer, can serve as the basis for a "wrongful refusal to settle" claim by a different potentially liable party (here, Saul), and analogous authorities suggest a contrary rule. In *McLaughlin v. National Union Fire Ins. Co.* (1994) 23 Cal.App.4th 1132, the injured party made a settlement demand that was apparently within policy limits, but the offer contained no suggestion the injured party would release the insured, and the *McLaughlin* court rejected the argument that such offer could support the verdict against the insurer for wrongful refusal to settle. Similarly, in *Strauss v. Farmers Ins. Exchange, (1994)* 26 Cal.App.4th 1017, the plaintiff's demand for policy limits did not include an offer to release *all* of the insureds, and the court concluded rejection of such an offer could not support an action for wrongful refusal to settle.

Graciano argued these cases do not support reversal because claimants are not required "to begin settlement overtures with letter-perfect offers to which insurers need only respond 'Yes' or 'No.' An insurer's duty of good faith would be trifling if it did not require an insurer to explore the details of a settlement offer that could prove extremely beneficial to its insured." (*Allen v. Allstate Ins. Co.* (9th Cir. 1981) 656 F.2d 487, 490) Indeed, Graciano's argument on appeal is that *McLaughlin* and *Strauss* are distinguishable because her November 7 letter never refused to release Saul; by the same token, however, neither did her November 7 letter ever offer *to* release Saul in exchange for Saul's policy limits. Graciano also suggests that, even if there was some ambiguity as to whether Saul would have been encompassed in her settlement demand, "if CAIC had contacted Ms. DeDominicis before the settlement expiration date to verify her client would sign releases, as did the insurer in *Coe*, that issue could have been resolved." This argument, however, ignores the undisputed evidence CAIC *did* contact Ms. DeDominicis *before* the settlement expiration date to inquire whether her client *would* agree to release Saul in exchange for his policy limits, and those inquiries were rebuffed.

Graciano alternatively argued that, even assuming the November 7 demand letter incorrectly identified the insured and the applicable policy number, those defects were attributable to CAIC because it was CAIC that, in response to Graciano's report of the injury, changed the driver's name from "Saulay Ala" (as reported by DeDominicis) to Jose. Graciano argued it is CAIC—not a third party—who is obligated to investigate claims against its insured, and therefore any defect in her demand letter must be attributed to CAIC's default of their obligations. However, the undisputed evidence is that CAIC *did* comply with its obligations to investigate potential coverage on this reported claim, because once CAIC received *this* report from Graciano (which tied her claim to an apparently canceled policy) it tried to contact Jose, immediately began investigating whether the policy had been validly canceled, and kept Graciano apprised of its progress. The defect in her demand letter thus had its genesis in the defect in DeDominicis' first report of Graciano's claim, and was not impacted by the investigation undertaken by the Factfinder unit in response to her initial claim.

A claim for "wrongful refusal to settle" requires proof the insurer unreasonably failed to accept an otherwise reasonable offer within the time specified by the third party for acceptance. (*Critz* 230 Cal.App.2d at p. 798.) **The third party is entitled to set a reasonable time limit within which the insurer must accept the settlement proposal** (*Martin v. Hartford Acc. & Indem. Co.* (1964) 228 Cal.App.2d 178, 185), **and even a one-week limitation attached to a settlement offer does not preclude a finding of bad faith rejection under some circumstances.** Although the insurer "need not be governed by whatever time limit counsel for plaintiff in a personal injury action may impose", whether the insurer has satisfied its duty to seek to settle in protection of its insured "must be measured in the light of the time limitation which plaintiff had placed on her offer." When a liability insurer *does* timely tender its "full policy limits" in an attempt to effectuate a reasonable settlement of its insured's liability, the insurer has acted in good faith as a matter of law because "by offering the policy limits in exchange for a release, the insurer has done all within its power to effect a settlement." (*Lehto v. Allstate Ins. Co.* (1994) 31 Cal.App.4th 60)

Here, in the three weeks after it first learned Graciano was alleging someone insured by CAIC had injured her, CAIC was able to (1) determine that the policy identified by Graciano (Jose's policy) could *not* provide a source of compensation for her, (2) identify that a person (Saul) *different* from the one identified by Graciano ("Saulay Ala") was responsible for Graciano's injuries, (3) determine Saul *did* have a policy available as a source of compensation, and (4) tender CAIC's "full policy limits" in an attempt to effectuate a settlement of Saul's liability. Although there was substantial evidence from which a jury could have concluded CAIC was able to resolve the confusion engendered by Graciano's misidentification of the applicable insured and insurance policy *earlier* than it did, and to offer to settle earlier than it did, perfection is not required (see, e.g., *Adelman v. Associated Internat. Ins. Co.* (2001) 90 Cal.App.4th 352, 369 ["to recover in tort for an insurer's mishandling of a claim, it must allege *more* than mere negligence"]), and Graciano's evidence showed, at most, that CAIC could have resolved the confusion more promptly.

More importantly, the undisputed evidence showed CAIC did timely tender Saul's full policy limits in an attempt to settle Graciano's claim, and therefore acted in good faith as a matter of law "by offering the policy limits in

exchange for a release thereby doing all within its power to effect a settlement." (*Lehto* at p. 73.) Although Graciano argued the evidence could have permitted a trier of fact to conclude the tender of Saul's policy limits was *not* timely, Graciano herself selected November 15 as the deadline for offering full policy limits in settlement. Although an injured third party's unilateral selection of a deadline does not conclusively govern whether a *later* tender of policy limits would have been *untimely* the Justices conclude at a minimum that the insurer *has* satisfied its duty to seek to settle in protection of its insured when, "in the light of the time limitation which plaintiff had placed on her offer", the insurer tenders its full policy limits *within* the time limits imposed by an injured party's demand letter.

The judgment is reversed. Defendants shall recover their costs on appeal.