



Alerts

California Supreme Court Makes Bad Faith Settlements a Bigger Challenge for Insurers

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Insurance Coverage Alert

In *Leung v. Verdugo Hills Hospital*, 2012 WL 3601616 (Cal. Aug. 23, 2012), the California Supreme Court eliminated the long-standing common law “release rule” in favor of a “setoff-with-contribution” approach. The court concluded that the release rule — whereby a plaintiff’s settlement with and release of one joint tortfeasor also releases from liability all other joint tortfeasors as to economic damages — results in unjust and inequitable results. For example, where a plaintiff settles with one joint tortfeasor for an amount less than the plaintiff’s total economic damages, the plaintiff is precluded from receiving further compensation for his or her economic damages from the nonsettling tortfeasors. With the “setoff-with-contribution” approach, a plaintiff would be fully compensated for a joint wrong, even where there is a partial “bad faith” settlement that is not proportionate to the settling tortfeasor’s liability.

In *Leung*, a six-day-old infant suffered irreversible severe brain injury as a result of negligent discharge from the hospital while exhibiting jaundice and other indicators of kernicterus (a condition leading to severe brain damage). The negligence continued post-discharge when defendant physician again failed to diagnose kernicterus.

Plaintiff sued the treating physician as well as the hospital. Prior to trial, plaintiff settled with the physician for his \$1 million policy limit, even though that amount was less than the physician’s anticipated share of liability. For this reason, the trial court denied plaintiff’s motion that the settlement be deemed to be in good faith pursuant to Cal. Code of Civ. Proc. §§ 877 and 877.6(c), and the physician remained in the lawsuit.

At trial, plaintiff was awarded \$15 million in economic damages, and the jury apportioned negligence 55 percent to the physician, 40 percent to hospital, and 2.5 percent to each parent. The judgment stated that, subject to the \$1 million settlement with the physician, the hospital was jointly and severally liable for 95 percent of all economic damages. The Court of Appeal held that, under the common law release rule, plaintiff’s settlement with the physician also released the nonsettling hospital from liability for plaintiff’s economic damages.

Revisiting the legal and public policy grounds for the common law release rule, the California Supreme Court reversed. The Court found that forcing a plaintiff to waive his or her right to full recovery of all economic damages as a result of his or her settlement with one joint tortfeasor was an unreasonably harsh result. Where, as here, there is a “bad faith” settlement, or where the settlement amount does not reflect the settling defendant’s liability, the Court found that public policy considerations and fairness required elimination of the release rule. The release rule essentially forced plaintiffs to enter into good faith settlements or no settlement, but the Court found that there were valid reasons — “the settling defendant’s limited resources or relatively minor role in causing the plaintiff’s injury” — for a plaintiff to accept less from one tortfeasor than may compensate for all economic damages. Doing so should not force plaintiff to accept less than full recovery on joint and several economic damages.

As to how to credit nonsettling defendants with the prior settlement, the court adopted a “setoff-with-contribution” methodology. The Court concluded that this method comes closest to allocating defendants’ ultimate liabilities consistent with their fault, while ensuring that the plaintiff receives full recovery. Under the “setoff-with-contribution” approach, a nonsettling defendant that pays more than its proportional share of economic damages under a joint and several damage determination may sue the settling defendant for contribution. The net result is that the plaintiff recovers the total economic



damages amount. In the Court's view, this methodology will promote settlements made in good faith because it does not change the respective liabilities of the joint tortfeasors.

Practice Note

The full effects of *Leung* could be substantial. While the opinion states that the "setoff-with-contribution" approach will not encourage bad faith settlements, it seems more likely that plaintiffs' counsel will now need to consider such settlements with underinsured or uninsured defendants in most cases, given the potential benefits of helping fund further litigation against the deep-pocket defendants, and securing greater level of cooperation from the settling defendant which will help ensure an advantageous trial result. Insurers facing high-value claims and joint and several liability with underinsured or uninsured defendants may need to consider greater use of tools, such as joint defense agreements, which help maintain a unified defense through trial and provide more certainty as to the funding of joint and several liabilities post-trial.

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