The Strategic Use of Statutory Offers Pursuant to Code of Civil Procedure § 998

By Howard A. Kapp

Since the notorious decision in *Moradi-Shalal v. Fireman's Fund Ins. Co.* (1989) 46 Cal.3d 287, plaintiffs' attorneys have few weapons in their arsenal of legal tools to encourage the defense side to agree to a prompt, fair or reasonable settlement of reasonably good claims. The threat of a trial and adverse verdict remains, but this can be largely ineffective in the face of a defense firm determined to maintain its hourly billings and an intransigent insurance company who is determined to make the plaintiff's attorney work as hard as possible for minimal dollars.

The statutory demand procedure set forth in Code of Civil Procedure § 998 provides one frequently-overlooked such weapon. No one contends that § 998 provides a total solution for this very common problem, but it is a tool that, if used strategically, can have a powerful impact on the ultimate result.

Traditionally, a successful plaintiff in a liquidated (e.g., breach of contract) claim case is entitled to statutorily-established amount of pre-judgment interest. The long-established rate in California is 10% simple (non-compounding) interest. The court could, in a liquidated damages case, objectively determine the identity of the prevailing party and the principal on which to impose pre-judgment interest and thus mathematically determine the right to, and amount of, interest. Conversely, a plaintiff in a non-liquidated (e.g., personal injury) claim was not entitled to such interest since the court had no objective method of determining the winner or the amount of the principal.

Section 998 eliminates, in part, this distinction by allowing either party to, in effect, temporarily "liquidate" the claim by making a written offer for a specific amount. If the adverse party does not accept the offer, the court may, without difficulty, determine the prevailing party (i.e., the offerer whose statutory offer was not accepted), the date to begin the pre-judgment interest calculation, and the principal. There is, of course, an element of intended punishment of the loser who failed to accept the statutory offer (*T.M. Cobb Co. v. Superior Court* (1984) 36 Cal.3d 273, 280, 286, 287) which is now deemed to have been "liquidated" ex post facto.

The plaintiff who is deemed the prevailing party stands to gain, in substance, two ways. First, the plaintiff is entitled to traditional pre-judgment interest. In a prolonged and/or large value case, this can eventually result in a very substantial extra recovery. (For example, a prevailing plaintiff who obtains a judgment of $300,000 after a section 998 offer is entitled to an "extra" $60,000 recovery.[1]) In a smaller case, or a larger case rapidly approaching trial, the amount of the potential pre-judgment interest may be so small that it will provide little disincentive to the defense to continue the case.

Secondly, the prevailing plaintiff may be, within the discretion of the court, entitled to recover expert witness fees. Unlike the threat of pre-judgment interest, this potential quasi-penalty may represent a credible threat to the defense even in a smaller personal injury case as the cost of expert witnesses may be substantial compared with the potential verdict. Expert witness fees are generally related to fixed factors (i.e., the amount of time to appear) unrelated to the value of the case The fees of an orthopedic expert, for ex ample, are generally related to the los time involved in testifying in court, an the travel distance and time involved i testifying in a smaller case may be th same as in a huge case. Any experience personal injury litigator knows that spend ing $2500 or $3500 for a doctor's appear ance fee in a trial with a low verdic potential is a very risky proposition; th deliberate use of a well-used statutor demand can make that concern mutual.

The Strategic Objectives

Statutory demands ("998s") should not b considered a true settlement device; thi has been noted in the authorities.[2] Whil the 998 practice has many other potenti benefits for the parties and the taxpaye supported court system, it is a very poo settlement vehicle. The very fact that suc demands remain open for such a long tim period mitigates against its use as an open ing gambit to settlement.

The 998 process is largely useless fo the plaintiff if the defense accepts th offer. If the defense was willing to accep such a demand, then, invariably, the plai tiff would have done better through som other device. An accepted statutory de mand, while providing some short ter benefit, should be considered a long ter disaster: the plaintiff will get less for th case than what it was ultimately "wort (for settlement purposes).

Thus, the objective is to make a deman which is low enough to make it likely th the plaintiff will obtain the intended stat tory benefit but which is high enough th it probably will not be accepted.

The demand should *always* be made soon as possible because:

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1. In the usual case, plaintiff's counsel generally has a better understanding of the potential recovery than defense counsel in the early stages of the case.
2. Defense counsel are almost always institutionally compelled, as an article of faith, to believe that "more discovery" and "more investigation" is required. While the plaintiff and defense bars can debate whether their interest is sincere or related to generating more fees, the point is: it is the rare defense lawyer who would encourage early settlement.
3. The defense is probably still politically committed to any pre-litigation offers authorized by the adjuster. Since these unaccepted offers are generally considered "low ball" offers, the defense institutions (insurer and defense counsel) are, until the litigation process itself unfolds, structurally frozen into an unreasonable posture. Take advantage of it.
4. The earlier the demand, the higher the pre-judgment interest will be. Since pre-judgment interest is the result of the passage of time from the date of the demand to the day of the judgment, this is *always* true. Moreover, since the defense should become more flexible as the plaintiff's position is unveiled, the longer the plaintiff waits, the higher the demand must be to insure its rejection.
5. The defense, unlike the demanding plaintiff, must factor in the possibility of a defense verdict (or a verdict which is substantially reduced by comparative negligence). The demanding plaintiff should NOT consider, at this stage, the prospect of losing since the procedure is only invoked after plaintiff has prevailed. Thus, the defense and the plaintiff's side are actually considering vastly different things.
6. Since the defense is institutionally committed to an unreasonably low demand in the early stages of the case, the plaintiff has the temporary luxury of being able to serve a low demand. ***The lower the demand, the more likely the plaintiff is to be deemed to be the prevailing party.***

The Risks of an Early "Low Ball" Demand

The most obvious "risk" of an early "low ball" demand is that the defense will accept it. This is actually, in practice, a very uncommon occurrence. In nearly 20 years of faithfully applying this practice, for example, this author has only had a literal hand-full of acceptances. In each of those cases, we had grossly underestimated the sophistication, integrity and knowledge of our adversaries. Such adversaries are, for better or worse, very rare indeed.

The other potential downside to an early "low ball" statutory demand is that the defense will assume the demand to be a *bona fide* attempt at settlement. This is reflected in two ways. First, plaintiff's counsel can assume that the insurance adjuster will use that number in calculating the insurance company's internal "reserve" amount, which can be institutionally relevant to their later settlement posture. Secondly, the defense may actually consider the early "low ball" demand to represent a number from which they can negotiate downwards. They will later point to the ancient and long-expired statutory demand as an "indication" of plaintiff's settlement position.

I have, for nearly 20 years, attempted – not always successfully – to eliminate these certain downsides by always including a letter explicitly advising the defense of the non-settlement intended purpose of this statutory demand. This letter should be:

1. Served and physically attached to the demand itself.
2. Filed in *both* your correspondence file and the file in which your office places statutory demands (e.g., the pleadings file).
3. Not only referred, but *physically attached as an exhibit* to any future settlement or mediation briefs. There is a virtual 100% chance that the defense will simply refer to your early low ball demand as evidence of the plaintiff's "present willingness" to accept that as a figure from which a settlement may be negotiated downward. This alleged willingness, and consequent "evidence" of bad faith bargaining, should be definitively shown to be fraudulent. It has been my experience that, unless the cover

letter is physically attached to such briefs, the settlement officer will not accept plaintiff's protests as to the pre-established limitations of the statutory demand.

The Client's Role in the "998" Process

Plaintiff's counsel must, of course, recognize that the client does have the ultimate legal right to control the settlement of the case: this applies, obviously, to any formalized settlement process, including the processing of a statutory demand. It is both unethical and malpractice not to obtain the client's written prior consent to the section 998 demand. Such a demand is, at least in form, a settlement device which is capable of being accepted for 30 (or, if mailed, 35) days. Since we are recommending a demand which is, in fact, a "low ball" demand, the client does need to understand the potential benefits and risks involved (i.e., acceptance and/or a later hardening of the defense position) as well as the potential benefits of an early demand.

While the confirmation letter must be clear and in writing, there is no required form and it is not necessary to explicitly explain everything in the letter, unless the letter is the only communication on the subject with the client.

Determining the Amount to be Demanded

In order for a statutory demand to have its intended long term impact, it is necessary that the demand be as low as possible. A demand is strategically useless unless, as the litigation winds its course, it becomes apparent to your adversary that it is reasonably likely, if not certain, that the verdict will be higher than the long-expired statutory demand. In other words, the demand must be low enough that, eventually, your adversary will appreciate that it was a mistake to have rejected the award.

Considering the institutionally-mandated early defense intransigence, this task is actually easier than it would seem. This is especially true in cases where the defense usually fights to the death: e.g., medical malpractice, products liability, intentional injury, wrongful termination and slip-and-fall cases. In some cases, the plaintiff's attorney knows that the internal settlement approval processes themselves are so onerous or time-consuming that there is little chance that defense counsel could timely respond, even if defense counsel recognized that the demand was beneficial to them. These classes of cases. while usually presenting a difficult settlement target, provide an easy target for a low-ball demand. No matter how low it is. the defense will reject the demand anyway out of general principle. Their hostility and arrogance can, in this context, be used to the obvious long-term benefit of the plaintiff.

In an extreme case, the court may consider the demand to have been made in bac faith if the defense was really blind-sidec by the case. The case law on the non-statutory bad faith exception (see, e.g. Weil & Brown, *California Practice Guide / Civil Procedure Before Trial*, "Settlement Procedures," ¶ 12:705, et seq.) generally relates to token defense offers, bu it is possible that a court may find that the plaintiff's seizing an advantage based o a defendant's unavoidable early ignorance may constitute bad faith. This may be eliminated by a letter putting the defense on notice of relevant facts.

The Special Case of the Policy Limits Demand

All plaintiff personal injury attorneys need to be familiar with the unique considerations of a case where the exposure exceeds the available policy limits: clearly, such knowledge is mandated by the standard of care and, frankly, the attorney's enlightened self-interest in maximizing the client's recovery. An insurer which, on behalf of its insured, rejects a reasonable demand within policy limits is *ipso facto* placing its insured's personal assets at risk. Such a rejection, it has long been held (see, e.g., *Comunale v. Traders & General Insurance Company* (1958) 50 Cal.2d 654), exposes the insurer to "excess liability" through proper management and understanding of the involved law, to the plaintiff by assignment of the insured's rights against the insurer to the plaintiff.

The prototype of this form of case is where the exposure is greatly in excess of the policy limits but liability is questionable. For example, if the plaintiff has a million dollar injury, but only a 10% chance of prevailing, a reasonable insurer should tender its policy limits if they are $100,000 or less. An insurer that refuses such an offer is, quite literally, gambling with its insured's money and may be essentially strictly liable for the excess if the plaintiff prevails.

Thus, the statutory demand, in that context, serves the secondary, but very important, purpose of establishing that the insurer had an actual opportunity to settle within its policy limits.[3] The 998 procedure is an excellent vehicle for this, since it is quite formalized (i.e., a pleading) and is subject to acceptance for a reasonably long time. Thus, not only does the rejected statutory demand serve this secondary function, it also proves the de facto elements of the availability of a less-than-policy-limits demand *and* that the insurer had plenty of time to consider it.

Unless the case is very obviously below the policy limits, the demand should be made just within policy limits (e.g., $99,999.99 where the policy limit is $100,000). *The 998 demand should NEVER be above the policy limit unless the defendant is an entity or person that is no less judgment-proof than the insurance company.* A statutory demand in excess of the policy limits is largely useless for this secondary purpose.

It takes very little additional work to deal with the excess policy limits case. It is highly desirable to be quite explicit about this secondary function in the letter *and that plaintiff will thereafter proceed in settlement without consideration of the policy limits*. This letter may, under the right conditions, become "Exhibit A" in the excess liability case: this contemporary document may be quite powerful evidence to a jury that the insurer knew (or should have known) of the inevitable consequences and that the plaintiff's demands would thereafter go up, exposing the insured's personal assets.

A rejection of a policy limits demand in a bona fide excess exposure case is a powerful tool in and of itself. Insurers don't like being sued by their insureds in this context and are generally well aware that a rejection of a policy limits demand essentially renders the policy limit irrelevant for future purposes, i.e., it "blows the lid off of the policy." It is critical that, unless you are truly willing to accept less than full value (e.g., the liability is weak), plaintiff's counsel must consistently and insistently stick to this position. If the defense detects a weakening of plaintiff's attorney's resolve in this context, the ultimate settlement will be adversely affected.

Closing the Deal

If the plaintiff's lawyer has done his or her job correctly, the statutory demand *and its explanatory cover letter* should be readily obtainable. The demand must be mentioned and the cover letter physically attached to *any* settlement or mediation brief. Indeed, it should always be mentioned in any settlement correspondence.

It is a certainty that, as serious settlement approaches, both your adversaries and any ADR officer will discount, if not completely ignore, the value-enhancing aspects of a rejected statutory demand. For every year of delay, the prejudgment interest alone adds 10% to the core value of the case; in addition, the costs of experts may be a substantial factor in evaluating the case. In many cases, these numbers can materially add to the core value of the case.

While the defense's reasoning is obvious, the settlement officer's motive may be less well understood since the process is allegedly to focus on the jury value range of the claim. Remember that the settlement officer's job is get the parties to focus on the "deal" and that additional focus on the punitive aspects of a rejected demand may not be helpful in creating an appropriate atmosphere to settlement.

Thus, in the usual context, the plaintiff's attorney is alone, very alone. Even the client may be motivated by an unreasonable fear of trial to agree to a lower settlement. Nonetheless, it is the always plaintiff's attorney's acknowledged job to maximize the recovery.

The plaintiff's attorney must, then, establish the parameters from the beginning of any settlement talk: remind them of the rejected demand and tell them what you want. Do not allow the subject to migrate to the potential stripped down verdict only. *Your client has as much "right" to the 998 penalties as he or she does to the estimated value of the jury verdict.* Make it clear to the other side that you expect that your client will be compensated for all legally-recoverable damages and that there were real-life consequences of a rejected offer, of forcing you and your clients into prolonged litigation. Make the settlement officer and your opponent understand that you expect a jury verdict "plus" recovery. After all, your job is not to be their friend, but to use all of the legally available tools to maximize the legal recovery for your clients. Besides, why shouldn't they pay for the delay that they caused through their arrogance, over-confidence or neglect? ■

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[1] Since the pre-judgment interest is calculated *on the amount of the eventual verdict*, the amount of the demand is irrelevant to the calculation of interest as long as the offering plaintiff's verdict exceeds the demand.

[2] See, e.g., Weil & Brown, *California Practice Guide / Civil Procedure Before Trial*, "Settlement Procedures," ¶ 12:647, quoting *Bank of San Pedro v. Superior Court* (1992) 3 Cal.App.4th 797, 804 [12 Cal.Rptr.2d 696].

[3] This is an element of the potential excess liability claim.