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## Loosing the Fox amongst the Chickens: The California Supreme Court Overrules Royal Globe in *Moradi-Shalal v. Fireman's Fund Insurance Companies*

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**LOOSING THE FOX AMONGST THE CHICKENS: THE  
CALIFORNIA SUPREME COURT OVERRULES  
ROYAL GLOBE IN MORADI-SHALAL v.  
FIREMAN'S FUND INSURANCE  
COMPANIES**

**I. INTRODUCTION**

In 1979, the California Supreme Court decided the landmark case, *Royal Globe Insurance Co. v. Superior Court*.<sup>1</sup> In *Royal Globe*, the court held that California Insurance Code section 790.03(h)<sup>2</sup> provided third-party claimants with an implied right of action against insurance compa-

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1. 23 Cal. 3d 880, 592 P.2d 329, 153 Cal. Rptr. 842 (1979).

2. CAL. INS. CODE § 790.03(h) (West 1972 & Supp. 1989). Section 790.03(h) prohibits the following:

(h) knowingly committing or performing with such frequency as to indicate a general business practice any of the following unfair claims settlement practices:

(1) Misrepresenting to claimants pertinent facts or insurance policy provisions relating to any coverages at issue.

(2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies.

(3) Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies.

(4) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss requirements have been completed and submitted by the insured.

(5) Not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear.

(6) Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds, when such insureds have made claims for amounts reasonably similar to the amounts ultimately recovered.

(7) Attempting to settle a claim by an insured for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application.

(8) Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of, the insured, his representative, agent, or broker.

(9) Failing, after payment of a claim, to inform insureds or beneficiaries, upon request by them, of the coverage under which payment has been made.

(10) Making known to insureds or claimants a practice of the insurer of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration.

(11) Delaying the investigation or payment of claims by requiring an insured, claimant, or the physician of either, to submit a preliminary claim report, and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information.

(12) Failing to settle claims promptly, where liability has become apparent, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage.

(13) Failing to provide promptly a reasonable explanation of the basis relied

nies that commit the various enumerated unfair or deceptive practices.<sup>3</sup> For the next decade the decision served as the legal linchpin in third-party bad faith claims.<sup>4</sup>

Last year, the same court in *Moradi-Shalal v. Fireman's Fund Insurance Cos.*<sup>5</sup> spun 180 degrees and overruled *Royal Globe*, holding that section 790.03(h) does not contain a right of action for third-party claimants.<sup>6</sup> In addition, the court ruled that *Royal Globe* actions pending at the time of the *Moradi-Shalal* decision would require a final judgment of liability against the insured before the insurer could be held liable to third parties under section 790.03(h).<sup>7</sup>

This Note first summarizes California's bad faith laws governing the insurance industry prior to *Moradi-Shalal*. The Author then analyzes the reasoning of the *Moradi-Shalal* court in overruling *Royal Globe* and discusses the possible ramifications of that decision. Finally, this Note suggests that the Legislature reinstate the *Royal Globe* holding.

## II. BACKGROUND

### A. Common-Law Bad Faith Actions Against Insurers

Given the importance of insurance contracts in providing society with financial security, it follows that such contracts are affected with a substantial public interest.<sup>8</sup> Unfortunately, there exists such a disparity in bargaining power between insurance carriers and private individuals<sup>9</sup> that the courts have found it necessary to impose a duty on insurers to deal fairly and in good faith with their insureds and others affected by an

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on in the insurance policy, in relation to the facts or applicable law, for the denial of a claim or for the offer of a compromise settlement.

(14) Directly advising a claimant not to obtain the services of an attorney.

(15) Misleading a claimant as to the applicable statute of limitations.

*Id.*

3. *Royal Globe*, 23 Cal. 3d at 884, 592 P.2d at 332, 153 Cal. Rptr. at 845.

4. See, e.g., *Afuso v. United States Fidelity & Guar. Co.*, 169 Cal. App. 3d 859, 215 Cal. Rptr. 490 (1985); *Vega v. Western Employers Ins. Co.*, 170 Cal. App. 3d 922, 216 Cal. Rptr. 592 (1985); *Rodriguez v. Fireman's Fund Ins. Co.*, 142 Cal. App. 3d 46, 90 Cal. Rptr. 705 (1983).

5. 46 Cal. 3d 287, 758 P.2d 58, 250 Cal. Rptr. 116 (1988).

6. *Id.* at 304, 758 P.2d at 68, 250 Cal. Rptr. at 126.

7. *Id.* at 313, 758 P.2d at 74-75, 250 Cal. Rptr. at 133.

8. See *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970) (insurance business offers services quasi-public in nature and is affected with a public interest).

9. *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 269-71, 419 P.2d 168, 171-72, 54 Cal. Rptr. 104, 107-08 (1966). This disparity is both in financial bargaining power and in bargaining expertise when negotiating an insurance contract. *Id.*

insurance contract.<sup>10</sup> Originally, this duty extended only to insureds and was based on the implied covenant of good faith and fair dealing present in all contracts.<sup>11</sup>

Effectively, this covenant has forced liability insurers to attempt settlement whenever a risk of a judgment against the insured in excess of the policy's coverage limit exists.<sup>12</sup> If an insurer unreasonably refuses to settle within the policy limits and an excess verdict follows, a cause of action for common-law bad faith arises in favor of the insured.<sup>13</sup> Originally, recovery was limited to the amount of the judgment against the insured that exceeded the policy limits.<sup>14</sup> This amount could only be recovered in a bad faith action brought by the insured<sup>15</sup> since the duty to act fairly is implied in the actual insurance contract and, therefore, extends only to the insured.<sup>16</sup> A third-party claimant<sup>17</sup> could bring a common-law bad faith action only after having first obtained an assignment of the bad faith cause of action from the insured.<sup>18</sup>

The California Supreme Court then began to broaden insurers' potential scope of liability. In the seminal case of *Crisci v. Security Insurance Co.*,<sup>19</sup> the court transformed the good faith rule into an affirmative duty owed by insurers to their insureds to accept reasonable settlements, the breach of which could lead to tort liability.<sup>20</sup> After *Crisci*, an insured could recover general tort damages for breach of the implied covenant of good faith and fair dealing, and could also recover punitive damages where the insurer engaged in fraud, oppression or malice.<sup>21</sup>

This duty to accept reasonable settlements, like the earlier duty to attempt to settle, was ruled to inure only to the insured in *Murphy v.*

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10. *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958).

11. *Id.* at 658, 328 P.2d at 200. This implied covenant states that "neither party will do anything which will injure the right of the other to receive the benefits of the agreement." *Id.*

12. *Id.*

13. *Id.* at 660, 328 P.2d at 201-02.

14. *Id.*

15. *Id.*

16. *Id.* at 658, 328 P.2d at 200.

17. There are essentially two types of bad faith claims. A "first-party" claim is made by the insured itself. A "third-party" claim is made by one who has been injured by the insured. Thus, a first-party bad faith claim arises when the insurer unreasonably refuses to settle a claim made by its insured; a third-party bad faith claim is brought by a claimant who has received an assignment of the insured's cause of action for the excess amount of the verdict. W. SHERN-OFF, S. GAGE & H. LEVINE, *INSURANCE BAD FAITH LITIGATION* § 3.01 (1987).

18. *Id.* § 2-16.5.

19. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

20. *Id.* at 430, 426 P.2d at 177, 58 Cal. Rptr. at 17.

21. *Id.*

*Allstate Insurance Co.*<sup>22</sup> In *Murphy*, the California Supreme Court reiterated that the only way an injured third-party claimant could sue an insurer for its bad faith failure to settle a claim within the policy limits was to obtain a judgment in excess of the policy limits against the insured and then an assignment of the insured's cause of action against the insurer.<sup>23</sup> Recovery in such an action was limited to the excess amount of the verdict against the insured.<sup>24</sup> Thus, after *Murphy*, there was no way for a third-party claimant to directly recover any tort damages from the insurer.

### B. *The Unfair Practices Act*

In California, the insurance industry is regulated not only by judicially created doctrines, but also by a statutory scheme.<sup>25</sup> This state statutory scheme was precipitated by developments at the federal level.<sup>26</sup>

Until 1944, the insurance industry was not considered commerce within the meaning of the commerce clause of the United States Constitution; thus, the states, not Congress, had the power to regulate insurance.<sup>27</sup> The industry's status abruptly changed, however, after *United States v. South-Eastern Underwriters Association*.<sup>28</sup> There, the Supreme Court of the United States held that insurance was indeed commerce and therefore, subject to federal antitrust laws.<sup>29</sup>

Congress responded swiftly to the *South-Eastern Underwriters* decision by passing the McCarran-Ferguson Act in 1945.<sup>30</sup> In the Act, Congress declared that federal antitrust laws apply to the insurance industry only insofar as the insurance industry is not regulated by state law.<sup>31</sup> Thus, the Federal Trade Commission would have jurisdiction over the insurance industry only in states where no state statutory scheme regulated insurance.<sup>32</sup>

To aid states in regulating the insurance industry on their own, the

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22. 17 Cal. 3d 937, 553 P.2d 584, 132 Cal. Rptr. 424 (1976).

23. *Id.* at 941-42, 553 P.2d at 586-87, 132 Cal. Rptr. at 426-27.

24. *Id.* at 941, 553 P.2d at 586, 136 Cal. Rptr. at 426.

25. See CAL. INS. CODE §§ 790-790.10 (West 1972 & Supp. 1989).

26. See CAL. INS. CODE § 790 (West 1972).

27. See *Paul v. Virginia*, 75 U.S. 168, 183 (1868), *overruled*, *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944).

28. 322 U.S. 533 (1944).

29. *Id.* at 552-53.

30. McCarran-Ferguson Act, ch. 20, 59 Stat. 33-34 (1945) (codified as amended at 15 U.S.C. §§ 1011-1015 (1982 & Supp. 1986)).

31. 15 U.S.C. § 1012(b) (1986).

32. *Id.*

National Association of Insurance Commissioners (NAIC)<sup>33</sup> in 1947 drafted a Model Act for the regulation of the insurance industry.<sup>34</sup> The purpose of the Model Act was to provide a statutory framework for state supervision of unfair trade practices by insurers.<sup>35</sup> California adopted most of the Model Act in 1959 by passing the Unfair Practices Act (UPA).<sup>36</sup> The purpose of the UPA mirrored that of the NAIC Model Act—to regulate California's insurance trade practices and avoid federal supervision.<sup>37</sup>

Several provisions of the UPA, codified in the California Insurance Code, merit comment. First, section 790.03 defines those acts prohibited as unfair or deceptive practices.<sup>38</sup> Section 790.03 was expanded in 1972 by the addition of subsection (h), which prohibits insurers from "[k]nowingly committing or performing with such frequency as to indicate a general business practice" any of the fifteen acts enumerated therein, such as misleading a claimant as to the applicable statute of limitations or advising a claimant not to seek legal representation.<sup>39</sup> Section 790.03(h) was likewise patterned after a provision of the revised NAIC Model Act.<sup>40</sup>

The UPA also granted enforcement powers to the Insurance Commissioner<sup>41</sup> which supplement enforcement powers already granted to the Commissioner by other provisions of the Insurance Code.<sup>42</sup> The In-

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33. The NAIC is a voluntary association of state insurance commissioners.

34. AN ACT RELATING TO UNFAIR METHODS OF COMPETITION AND UNFAIR AND DECEPTIVE ACTS AND PRACTICES IN THE BUSINESS OF INSURANCE, *reprinted in 2 NAT'L ASS'N INS. COMM'RS PROCEEDINGS* 392 (1947).

35. *Id.* at 392.

36. 1959 Cal. Stat., ch. 1737, § 1, 4187 (codified at CAL. INS. CODE §§ 790-790.10 (West 1972 & Supp. 1989)).

37. CAL. INS. CODE § 790 (West 1972). Section 790 states:

The purpose of this article is to regulate trade practices in the business of insurance in accordance with the intent of Congress as expressed in the [McCarran-Ferguson Act] by defining, or providing for the determination of, all such practices in this State which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined.

*Id.*

38. *Id.* § 790.03.

39. 1972 Cal. Stat., ch. 725, § 1, 1314 (codified at CAL. INS. CODE § 790.03(h) (West 1972 & Supp. 1989)). See *supra* note 2 for the complete text of the 15 "unfair claims settlement practices" prohibited by section 790.03(h). Section 790.03(h) originally listed only thirteen unfair practices. 1972 Cal. Stat., ch. 725, § 1, 1314. The last two unfair practices were added in 1975. 1975 Cal. Stat., ch. 790, § 1, 1812.

40. AN ACT RELATING TO UNFAIR METHODS OF COMPETITION AND UNFAIR AND DECEPTIVE ACTS AND PRACTICES IN THE BUSINESS OF INSURANCE *reprinted in 1 NAT'L ASS'N INS. COMM'RS PROCEEDINGS* 493-501 (1972).

41. CAL. INS. CODE §§ 790.04-.08, 790.10 (West 1972 & Supp. 1989).

42. *Id.* § 790.08. Section 790.08 provides: "The powers vested in the commissioner in this

insurance Code authorizes the Commissioner to scrutinize and investigate business affairs,<sup>43</sup> issue orders to show cause,<sup>44</sup> hold hearings and issue injunctive orders,<sup>45</sup> impose fines and penalties,<sup>46</sup> and suspend or revoke insurers' licenses for up to one year.<sup>47</sup> The Commissioner is also authorized to promulgate rules necessary to enforce the UPA.<sup>48</sup>

### C. *Pre-Royal Globe Courts and the Unfair Practices Act*

Prior to *Royal Globe v. Superior Court*,<sup>49</sup> several courts concluded that the UPA contained a private right of action. The first of these decisions is *Greenberg v. Equitable Life Assurance Society*.<sup>50</sup> *Greenberg* involved a class action suit by insureds against their insurer.<sup>51</sup> The insureds alleged that the insurer was illegally requiring persons seeking home loans from the insurer to also buy a policy of whole-life insurance.<sup>52</sup> The insureds argued that such a "tie-in" arrangement<sup>53</sup> violated section 790.03(c) of the Insurance Code as an unlawful restraint of trade, entitling them to damages under section 790.09.<sup>54</sup> Section 790.09

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article shall be additional to any other powers to enforce any penalties, fines or forfeitures, denials, suspensions or revocations of licenses or certificates authorized by law with respect to the methods, acts and practices hereby declared to be unfair or deceptive." *Id.*

43. *Id.* § 790.04.

44. *Id.* §§ 790.05-.06.

45. *Id.* § 790.06.

46. *Id.* § 790.07.

47. *Id.*

48. *Id.* § 790.10.

49. 23 Cal. 3d 880, 592 P.2d 329, 153 Cal. Rptr. 842 (1979).

50. 34 Cal. App. 3d 994, 110 Cal. Rptr. 470 (1973).

51. *Id.* at 996, 110 Cal. Rptr. at 472.

52. *Id.* A whole-life insurance contract entails payment of premiums at a fixed period for so long as the insured may live. BLACK'S LAW DICTIONARY 723 (5th ed. 1979). In contrast, a term-life insurance policy only provides coverage and requires payment of premiums for a fixed period, which may be renewed at a new rate. *Id.* A whole-life insurance policy also accrues a cash reserve, which term insurance does not. *Id.*

53. A "tie-in" or tying agreement is "an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier." Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5-6 (1958). Tie-in agreements are illegal per se "whenever a party has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product." *Id.* at 6.

54. *Greenberg*, 34 Cal. App. 3d at 998-99, 110 Cal. Rptr. at 473-74. Section 790.03(c) prohibits "[e]ntering into any agreement to commit, or by any concerted action committing, any act of boycott, coercion or intimidation resulting in or tending to result in unreasonable restraint of, or monopoly in, the business of insurance." CAL. INS. CODE § 790.03(c) (West 1972 & Supp. 1989). Tie-in sales agreements generally violate the Cartwright Act, California's antitrust statute. CAL. BUS. & PROF. CODE §§ 16600-17101 (West 1987 & Supp. 1989). However, the Unfair Practices Act has been held to supersede the Cartwright Act in regulating insurers. *Greenberg*, 34 Cal. App. 3d at 999 n.2, 110 Cal. Rptr. at 474 n.2.

provides:

No order to cease and desist issued under this article directed to any person or subsequent administrative or judicial proceeding to enforce the same shall in any way relieve or absolve such person from any administrative action against the license or certificate of such person, civil liability or criminal penalty under the laws of this State arising out of the methods, acts or practices found unfair or deceptive.<sup>55</sup>

Rejecting the insurer's argument that only the Insurance Commissioner is empowered to enforce section 790.03, the court of appeal held: "Section 790.09 . . . contemplates a private suit to impose civil liability irrespective of governmental action against the insurer for violation of a provision of the Insurance Code. The fair construction is that the person to whom the civil liability runs may enforce it by an appropriate action."<sup>56</sup> Thus, since 1973, private parties have not been required to rely upon the Commissioner to enforce the Insurance Code since section 790.09 was held to create a private right of action.<sup>57</sup>

Like *Greenberg*, *Sherhoff v. Superior Court*<sup>58</sup> was also a class action suit.<sup>59</sup> In *Sherhoff*, a group of title insurers were sued for damages on the grounds that they had conspired to fix title insurance rates.<sup>60</sup> The trial court had stayed the action on the grounds that only the Insurance Commissioner had jurisdiction over rate-fixing claims.<sup>61</sup> The California Court of Appeal lifted the stay, holding that "the Commissioner's jurisdiction is 'primary,' not 'exclusive.'" <sup>62</sup> Moreover, the court noted, section 790.09 expressly preserves civil remedies despite the Commissioner's issuing a cease-and-desist order.<sup>63</sup> Relying on the *Greenberg* court's interpretation of section 790.09, the *Sherhoff* court held that a private party injured by an insurer's violation of section 790.03 could bring a suit for damages under section 790.09.<sup>64</sup>

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55. CAL. INS. CODE § 790.09 (1972).

56. *Greenberg*, 34 Cal. App. 3d at 1001, 110 Cal. Rptr. at 475. In a footnote, the court also stated that "[a]ny other construction would overturn by implication the rule of *Crisci v. Security Insurance Co.*" *Id.* n.5 (citation omitted).

57. *Id.* at 1001, 110 Cal. Rptr. at 475. <sup>1</sup>

58. 44 Cal. App. 3d 406, 118 Cal. Rptr. 680 (1975).

59. *Id.* at 408, 118 Cal. Rptr. at 681.

60. *Id.*

61. *Id.* at 409-10, 118 Cal. Rptr. at 682.

62. *Id.* at 409, 118 Cal. Rptr. at 681.

63. *Id.* at 409-10, 118 Cal. Rptr. at 682.

64. *Id.* (citing *Greenberg v. Equitable Life Assurance Soc'y*, 34 Cal. App. 3d 994, 110 Cal. Rptr. 470 (1973)).



#### D. Royal Globe v. Superior Court

Although prior to *Royal Globe Insurance Co. v. Superior Court*<sup>65</sup> it had been established that third-party claimants could not sue insurers for breach of the covenant of good faith and fair dealing,<sup>66</sup> the California Supreme Court had not decided whether a claimant could sue an insurer for violations of the Unfair Practices Act (UPA).<sup>67</sup> This question was resolved in *Royal Globe*. In *Royal Globe*, the plaintiff filed an action for personal injuries after a slip-and-fall accident in a market.<sup>68</sup> Joined with the market as defendants were Royal Globe, the market's insurer, and an insurance adjuster employed by Royal Globe.<sup>69</sup> The plaintiff alleged two violations of Insurance Code section 790.03:<sup>70</sup> first, that Royal Globe refused to attempt in good faith to settle the claim with the injured plaintiff;<sup>71</sup> and second, that Royal Globe's adjuster had advised the plaintiff not to consult an attorney.<sup>72</sup> Royal Globe demurred on three grounds: (1) that the Insurance Commissioner was the sole enforcer of the UPA; (2) that the plaintiff lacked standing to sue; and (3) that a third-party claimant may not sue both the insured and the insurer in the same suit.<sup>73</sup>

The supreme court agreed with the courts of appeal in *Greenberg v. Equitable Life Assurance Society*<sup>74</sup> and *Shernoff v. Superior Court*<sup>75</sup> that section 790.09 creates a private cause of action for violation of the UPA,<sup>76</sup> and further held that an insurer's duty under the Act runs to claimants as well as insureds.<sup>77</sup> Thus, a third-party claimant could sue an insurer for any violations of section 790.03 committed by the insurer during the claims-settlement process.<sup>78</sup> The court further held that the phrase from Insurance Code section 790.03(h), "[k]nowingly committing or performing with such frequency as to indicate a general business practice,"<sup>79</sup> allowed a statutory bad faith action for single acts of bad faith

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65. 23 Cal. 3d 880, 592 P.2d 329, 153 Cal. Rptr. 842 (1979).

66. *Murphy v. Allstate Ins. Co.*, 17 Cal. 3d 937, 941-42, 553 P.2d 584, 586-87, 132 Cal. Rptr. 424, 426-27 (1976).

67. CAL. INS. CODE §§ 790-790.10 (West 1972 & Supp. 1989).

68. *Royal Globe*, 23 Cal. 3d at 884, 592 P.2d at 331, 153 Cal. Rptr. at 844.

69. *Id.*, 592 P.2d at 331-32, 153 Cal. Rptr. at 844-45.

70. *Id.*, 592 P.2d at 332, 153 Cal. Rptr. at 845.

71. *Id.*; see CAL. INS. CODE § 790.03(h)(5) (West 1972 & Supp. 1989).

72. *Royal Globe*, 23 Cal. 3d at 884, 592 P.2d at 332, 153 Cal. Rptr. at 845; see CAL. INS. CODE § 790.03(h)(14) (West 1972 & Supp. 1989).

73. *Royal Globe*, 23 Cal. 3d at 884, 592 P.2d at 332, 153 Cal. Rptr. at 845.

74. 34 Cal. App. 3d 994, 110 Cal. Rptr. 470 (1973).

75. 44 Cal. App. 3d 406, 118 Cal. Rptr. 680 (1975).

76. *Royal Globe*, 23 Cal. 3d at 885-86, 592 P.2d at 332-33, 153 Cal. Rptr. at 845-46.

77. *Id.* at 890, 592 P.2d at 335, 153 Cal. Rptr. at 848.

78. *Id.*

79. CAL. INS. CODE § 790.03(h).

that were knowingly committed by the insurer.<sup>80</sup>

The *Royal Globe* court did agree with the insurers' contention that a claimant may not sue both the insured and the insurer in the same action.<sup>81</sup> The court, in its desire to avoid prejudicing the defense of the insured,<sup>82</sup> held that "the third party's suit may not be brought until the action between the injured party and the insured is concluded."<sup>83</sup>

The *Royal Globe* decision stood undisturbed for a decade.

### III. *Moradi-Shalal v. Fireman's Fund Insurance Companies*

#### A. *The Facts*

In *Moradi-Shalal v. Fireman's Fund Insurance Cos.*,<sup>84</sup> the plaintiff, Parvaneh Moradi-Shalal (Moradi-Shalal), sued Fireman's Fund Insurance Companies (Fireman's) after having settled her personal injury suit<sup>85</sup> against Fireman's insured.<sup>86</sup> As part of the settlement agreement, the personal injury suit against the insured had been dismissed with prejudice.<sup>87</sup> Moradi-Shalal based her complaint against Fireman's on alleged violations of section 790.03, subdivisions (h)(2), (3), and (5).<sup>88</sup> Specifically, Moradi-Shalal alleged that Fireman's total failure to respond to her attorney's two requests for settlement after the accident<sup>89</sup> constituted bad faith within the meaning of section 790.03.<sup>90</sup>

The plaintiff's complaint, which sought both compensatory and pu-

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80. *Royal Globe*, 23 Cal. 3d at 891, 592 P.2d at 336, 153 Cal. Rptr. at 849.

81. *Id.*

82. *Id.* at 892, 592 P.2d at 337, 153 Cal. Rptr. at 850.

83. *Id.* at 884, 592 P.2d at 332, 153 Cal. Rptr. at 845.

84. 46 Cal. 3d 287, 758 P.2d 58, 250 Cal. Rptr. 116 (1988).

85. *Id.* at 293, 758 P.2d at 60, 250 Cal. Rptr. at 118. Plaintiff's suit against defendant's insured arose out of an auto accident in which defendant's insured negligently collided with plaintiff. *Id.*

86. *Id.* at 292-93, 758 P.2d at 60, 250 Cal. Rptr. at 118.

87. *Id.*

88. *Id.*; see CAL. INS. CODE § 790.03(h)(2),(3),(5) (West Supp. 1989). See also *supra* note 2 for the complete text of section 790.03(h).

89. *Moradi-Shalal*, 46 Cal. 3d at 293, 758 P.2d at 60, 250 Cal. Rptr. at 118-19. The auto accident with Fireman's insured occurred in July of 1983. *Id.*, 758 P.2d at 60, 250 Cal. Rptr. at 118. Plaintiff's attorney wrote Fireman's in April 1984 requesting settlement of plaintiff's claim against Fireman's insured on the basis of evidence enclosed in the letter. *Id.* Plaintiff's attorney again tried to obtain some response to the settlement request with another letter to Fireman's dated June 6, 1984. *Id.* Having received no acknowledgment of either request, plaintiff filed suit against Fireman's insured on June 21, 1984. *Id.* Plaintiff's suit against Fireman's insured was settled in September 1984. *Id.* Plaintiff then brought her *Royal Globe* bad faith action against Fireman's. *Id.*

90. *Id.*, 758 P.2d at 60, 250 Cal. Rptr. at 118-19. Plaintiff's specific allegations were that Fireman's "did not acknowledge or act upon [her attorneys'] communication, did not promptly investigate or process the claim, and did not attempt in good faith to effectuate a

nitive damages, was dismissed without leave to amend when the trial court sustained Fireman's general demurrer.<sup>91</sup> The trial court sustained Fireman's demurrer on the grounds that the plaintiff had failed to obtain a final judicial determination of the insured's liability.<sup>92</sup> The California Court of Appeal reversed, holding that a settlement followed by a dismissal with prejudice sufficiently concludes a lawsuit against an insured to allow a claimant to bring a *Royal Globe* action against the insurer.<sup>93</sup>

The California Supreme Court originally granted review in order to resolve whether the insured's liability must be judicially established before a third-party *Royal Globe* action may be brought.<sup>94</sup> However, the court went beyond this original purpose and considered the continuing viability of the *Royal Globe* precedent as a whole.<sup>95</sup>

## B. Reasoning of the Court

### 1. The majority opinion

On appeal, with Chief Justice Lucas writing for the majority, the court in *Moradi-Shalal v. Fireman's Fund Insurance Cos.*<sup>96</sup> began its analysis by reconsidering the validity of *Royal Globe Insurance Co. v. Superior Court*.<sup>97</sup> The court focused its attention on *Royal Globe's* interpretation of Insurance Code sections 790.03 and 790.09 as creating a private right of action allowing both insureds and third-party claimants to sue for the bad faith acts prohibited by the Unfair Practices Act (UPA).<sup>98</sup> The *Moradi-Shalal* court summarized in three paragraphs the majority opinion in *Royal Globe*<sup>99</sup> and followed this with a lengthy in-depth summary of Justice Richardson's dissent in *Royal Globe*.<sup>100</sup>

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prompt, fair and equitable settlement of the claim, in which liability was reasonably clear." *Id.*, 758 P.2d at 60, 250 Cal. Rptr. at 119.

91. *Id.*

92. *Id.*

93. *Id.*, 758 P.2d at 61, 250 Cal. Rptr. at 119.

94. *Id.* at 292, 758 P.2d at 59-60, 250 Cal. Rptr. at 118.

95. *Id.*

96. 46 Cal. 3d 287, 758 P.2d 58, 250 Cal. Rptr. 116 (1988).

97. 23 Cal. 3d 880, 592 P.2d 329, 153 Cal. Rptr. 842 (1979).

98. *Moradi-Shalal*, 46 Cal. 3d at 294, 758 P.2d at 61, 250 Cal. Rptr. at 119 (citing *Royal Globe Ins. Co. v. Superior Court*, 23 Cal. 3d 880, 592 P.2d 329, 153 Cal. Rptr. 842 (1979)).

99. *Id.* See *supra* notes 65-83 and accompanying text for a summary of the *Royal Globe* opinion.

100. *Moradi-Shalal*, 46 Cal. 3d at 294-96, 758 P.2d at 61-62, 250 Cal. Rptr. at 119-20. In this summary of the two opinions in *Royal Globe*, Chief Justice Lucas chose to focus the majority of his attention on the dissent. The Chief Justice devoted twice as much ink to a dissent roughly half as long as the majority opinion.

In his dissenting opinion in *Royal Globe*, Justice Richardson criticized the majority's decision to allow private litigants to sue under the Unfair Practices Act as being both "gratuitous"

*a. stare decisis*

The court next addressed some "well established principles governing the respect [the court] confer[s] upon [its own] prior opinions. . . ." <sup>101</sup> First, "prior applicable precedent usually must be followed even though the case, if considered anew, might be decided differently by the current justices." <sup>102</sup> The court acknowledged the valuable role stare decisis plays in maintaining the predictability of the law so as to allow society to act "with reasonable assurance of the governing rules of law." <sup>103</sup>

The court stated that this desire for stability in the law must be balanced with the need for flexibility to correct past judicial errors. <sup>104</sup> The ability to correct past errors, the court continued, is particularly valuable when the mistakes are tied to a matter of continuing public concern or when subsequent developments demonstrate either the impropriety of an earlier judgment or its ripeness for reconsideration. <sup>105</sup>

Having carved out these discretionary exceptions to the general rule of stare decisis, the court turned its attention to an analysis of developments occurring after the *Royal Globe* decision. <sup>106</sup> The court concluded that in light of subsequent events it was necessary to overrule *Royal Globe*. <sup>107</sup>

*b. subsequent developments*

*i. rejection by other states*

The first development listed by the *Moradi-Shalal* court as indicative of *Royal Globe*'s unsound reasoning was that other states' courts re-

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and "wholly inconsistent . . . with a fair and reasoned analysis of [sections 790.03 and 790.09]." *Royal Globe*, 23 Cal. 3d at 898, 592 P.2d at 341, 153 Cal. Rptr. at 854 (Richardson, J., dissenting).

101. *Moradi-Shalal*, 46 Cal. 3d at 296, 758 P.2d at 62, 250 Cal. Rptr. at 121.

102. *Id.*

103. *Id.*, 758 P.2d at 62-63, 250 Cal. Rptr. at 121 (quoting 9 WITKIN, CAL. PROCEDURE, Appeal, § 758, at 726 (3d ed. 1985)).

104. *Id.*, 758 P.2d at 63, 250 Cal. Rptr. at 121.

105. *Id.* at 296-97, 758 P.2d at 63, 250 Cal. Rptr. at 121 (citing *People v. Anderson*, 43 Cal. 3d 1104, 742 P.2d 1306, 240 Cal. Rptr. 585 (1987)). The court also cited *Monell v. New York City Dept. of Social Serv.*, 436 U.S. 658, 695 (1978), for the proposition that stare decisis should not automatically bar overruling prior interpretations of statutes. *Moradi-Shalal*, 46 Cal. 3d at 296-97, 758 P.2d at 63, 250 Cal. Rptr. at 121.

106. *Id.* at 297-304, 758 P.2d at 63-68, 250 Cal. Rptr. at 121-26.

107. *Id.* at 296-97, 758 P.2d at 63, 250 Cal. Rptr. at 121. The court also asserted that not overturning *Royal Globe* would result in further "inequitable results, costly multiple litigation, and unnecessary confusion . . ." *Id.*

fused to follow the *Royal Globe* rule.<sup>108</sup> The court found this significant because the UPA, which includes Insurance Code sections 790.03 and 790.09, was derived from the National Association of Insurance Commissioners' Model Act, which has been codified by 48 states.<sup>109</sup> The court observed that, of the 19 states having considered the issue, only two other than California hold their versions of section 790.03 to create a private right of action.<sup>110</sup>

The court offered *Morris v. American Family Mutual Insurance Co.*,<sup>111</sup> a Minnesota decision, as representative of the way other states have interpreted statutes patterned after the Model Act.<sup>112</sup> The *Morris* court had rejected the notion that the Model Act was intended to create anything other than an administrative remedy.<sup>113</sup> The *Moradi-Shalal* court noted that California's UPA differed in some respects from the statutes in those states whose decisions it cited, but maintained that any

108. *Id.*

109. *Id.* See *supra* notes 25-48 and accompanying text for a discussion of the Unfair Practices Act.

110. *Moradi-Shalal*, 46 Cal. 3d at 297-98, 758 P.2d at 63-64, 250 Cal. Rptr. at 121-22. The court cited the following cases as having "expressly acknowledged, but declined to follow, *Royal Globe*": *A & E Supply Co. v. Nationwide Mut. Fire Ins. Co.*, 798 F.2d 669 (4th Cir. 1986), *cert. denied*, 479 U.S. 1091 (1987) (applying Virginia law); *Earth Scientists v. United States Fidelity & Guar.*, 619 F. Supp. 1465 (D. Kan. 1985); *Tweet v. Webster*, 610 F. Supp. 104 (D. Nev. 1985); *White v. Unigard Mut. Ins. Co.*, 112 Idaho 94, 730 P.2d 1014 (1986); *Scroggins v. Allstate Ins. Co.*, 74 Ill. App. 3d 1027, 393 N.E.2d 718 (1979); *Seeman v. Liberty Mut. Ins. Co.*, 322 N.W.2d 35 (Iowa 1982); *Patterson v. Globe American Casualty Co.*, 101 N.M. 541, 685 P.2d 396 (1984); *Kranzush v. Badger State Mut. Casualty Co.*, 103 Wis. 2d 56, 307 N.W. 2d 256 (1981). *Moradi-Shalal*, 46 Cal. 3d at 297 & n.4, 758 P.2d at 63 & n.4, 250 Cal. Rptr. at 121-22 & n.4.

The *Moradi-Shalal* court cited the following cases as implicitly rejecting *Royal Globe*: *Young v. Michigan Mut. Ins. Co.*, 139 Mich. App. 600, 362 N.W.2d 844 (1984); *Morris v. American Family Mut. Ins. Co.*, 386 N.W.2d 233 (Minn. 1986); *Lawton v. Great S.W. Fire Ins. Co.*, 118 N.H. 607, 392 A.2d 576 (1978); *Farris v. United States Fidelity & Guar. Co.*, 284 Or. 453, 587 P.2d 1015 (1978); *D'Ambrosio v. Pennsylvania Nat'l Mut. Casualty Ins. Co.*, 494 Pa. 501, 431 A.2d 966 (1981); *Swinton v. Chubb & Son, Inc.*, 283 S.C. 11, 320 S.E.2d 495 (1984); *Russel v. Hartford Casualty Ins. Co.*, 548 S.W.2d 737 (Tex. Civ. App. 1977); *Wilder v. Aetna Life & Casualty Ins. Co.*, 140 Vt. 16, 433 A.2d 309 (1981); *Tank v. State Farm Fire & Casualty Co.*, 38 Wash. App. 438, 686 P.2d 1127 (1984). *Moradi-Shalal*, 46 Cal. 3d at 297-98 & n.5, 758 P.2d at 63-64 & n.5, 250 Cal. Rptr. at 122 & n.5.

The *Moradi-Shalal* court also noted that even those two states that agreed with *Royal Globe* as to the existence of a private statutory bad faith right of action were unwilling to hold a single transgression as sufficient grounds for awarding damages. *Id.* at 297-98 & n.6, 758 P.2d at 64 & n.6, 250 Cal. Rptr. at 122 & n.6 (citing *Klaudt v. Flink*, 202 Mont. 247, 253, 658 P.2d 1065, 1068 (1983) and *Jenkins v. J.C. Penney Casualty Ins. Co.*, 167 W. Va. 597, 610, 280 S.E.2d 252, 259-60 (1981)).

111. 386 N.W.2d 233 (Minn. 1986).

112. *Moradi-Shalal*, 46 Cal. 3d at 298, 758 P.2d at 64, 250 Cal. Rptr. at 122 (citing *Morris v. American Family Mut. Ins. Co.*, 386 N.W.2d 233 (Minn. 1986)).

113. *Morris*, 386 N.W.2d at 235.

differences were largely insignificant.<sup>114</sup> The court also acknowledged that no out-of-state precedent is binding on California courts.<sup>115</sup> However, the court viewed this "clear consensus" rejecting *Royal Globe's* interpretation of a Model Act adopted by almost every state as a reason to question the wisdom behind the *Royal Globe* decision.<sup>116</sup>

## ii. unfavorable legal commentary

The second development the court saw as lending significant support to the reconsideration of *Royal Globe* was the existence of legal commentary "generally critical of [*Royal Globe*]."<sup>117</sup> The court found the "breadth of the criticism leveled at *Royal Globe*" by the several law review articles "disturbing."<sup>118</sup> Likening the scholarly criticism to the previously mentioned out-of-state precedents, like *Morris*, the court found cause to reconsider the correctness of *Royal Globe's* interpretation of the UPA.<sup>119</sup>

## iii. the 1980 NAIC report

The next development that the court claimed required the overturning of *Royal Globe* was a 1980 report by the National Association of

114. *Moradi-Shalal*, 46 Cal. 3d at 298, 758 P.2d at 64, 250 Cal. Rptr. at 122.

115. *Id.*

116. *Id.*

117. *Id.* at 298-99, 758 P.2d at 64, 250 Cal. Rptr. at 122-23. The court cited the following articles: Allen, *Insurance Bad Faith Law: The Need for Legislative Intervention*, 13 PAC. L.J. 833 (1982); Price, *Royal Globe Insurance Co. v. Superior Court: Right to Direct Suit Against an Insurer by a Third Party Claimant*, 31 HASTINGS L.J. 1161 (1980); Note, *Extending the Liability of Insurers for Bad Faith Acts: Royal Globe Insurance Co. v. Superior Court*, 7 PEPERDINE L. REV. 777 (1980) [hereinafter Note, *Extending the Liability of Insurers*]; Note, *Bad Faith: Defining Applicable Standards in the Aftermath of Royal Globe v. Superior Court*, 23 SANTA CLARA L. REV. 917 (1983); Note, *Rodriguez v. Fireman's Fund Insurance Companies, Inc.: An Illustration of the Problems Inherent in the Royal Globe Doctrine*, 15 SW. U.L. REV. 371 (1985); Comment, *Liability to Third Parties for Economic Injury: Privity as a Useful Animal, or a Blind Imitation of the Past*, 12 SW. U.L. REV. 87 (1981); Comment, *Liability Insurers and Third-Party Claimants: The Limits of Duty*, 48 U. CHI. L. REV. 125 (1981). The court generalized these articles as

emphasiz[ing] both the erroneous nature of our holding (i.e., the strained interpretation of the statutory provisions, and the misreading or disregard of available legislative history) and the undesirable social and economic effects of the decision (i.e., multiple litigation, unwarranted bad faith claims, coercive settlements, excessive jury awards, and escalating insurance, legal and other "transaction" costs).

*Moradi-Shalal*, 46 Cal. 3d at 299, 758 P.2d at 64, 250 Cal. Rptr. at 123. See *infra* notes 250-60 and accompanying text for a discussion of the contents of several of the articles cited by the court.

118. *Moradi-Shalal*, 46 Cal. 3d at 298, 758 P.2d at 65, 250 Cal. Rptr. at 123.

119. *Id.* at 299, 758 P.2d at 65, 250 Cal. Rptr. at 123.

Insurance Commissioners (NAIC).<sup>120</sup> The court believed that the report was relevant because it contained statements indicating that the drafters of the Model Act provision upon which section 790.09 was based intended that private parties could not bring actions against insurers.<sup>121</sup>

iv. "additional" and "subsequent" legislative history

The court also considered what it labeled "additional legislative history" presented by a law review article.<sup>122</sup> The court focused on the California Legislative Analyst's Report and the Legislative Counsel's Digest.<sup>123</sup> Both documents, submitted to the Legislature along with section 790.03, described the statute as providing the Insurance Commissioner only with an administrative remedial power.<sup>124</sup> The court noted that a private right of action against insurers was not mentioned in either legislative report.<sup>125</sup> The court found that these reports indicated that the Legislature did not intend to create a private remedy when it enacted section 790.03.<sup>126</sup>

The court coupled this "additional legislative history" with what it deemed "'subsequent' legislative history."<sup>127</sup> The court accorded great significance to the state Senate's having passed legislation that would have expressly overruled *Royal Globe* almost immediately after the decision was handed down by the court.<sup>128</sup> The court found that the Senate's passage of the bill, Senate Bill 483, indicated a legislative dissatisfaction with *Royal Globe's* creation of a private right of action.<sup>129</sup>

The plaintiff had argued that the Senate Bill 483's failure to pass the Ways and Means Committee of the State Assembly constituted a legisla-

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120. *Id.* (citing Ratchford, *Regarding a Private Right of Action Under Section 4(9) of the NAIC Model Unfair Trade Practices Act*, 2 NAT'L ASS'N INS. COMM'RS PROCEEDINGS 344 (1980)).

121. *Moradi-Shalal*, 46 Cal. 3d at 299, 758 P.2d at 65, 250 Cal. Rptr. at 123. The court seems to have assumed that by determining the intent of the NAIC it would also determine the intent of the California Legislature.

122. *Id.* at 300, 758 P.2d at 65, 250 Cal. Rptr. at 123. The court cited Price, *supra* note 117 at 1178-79.

123. *Moradi-Shalal*, 46 Cal. 3d at 300, 758 P.2d at 65, 250 Cal. Rptr. at 123 (citing PIERSON, ANALYSIS OF ASSEMBLY BILL 459 (Apr. 28, 1972); LEGISLATIVE COUNSEL'S DIGEST TO A.B. 459 (1972)).

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*, 758 P.2d at 65, 250 Cal. Rptr. at 123-24. The proposed legislation referred to by the court is Senate Bill 483 and was presented to the legislature in May of 1979. Cal. S.B. 483 (1979) (as amended).

129. *Id.*, 758 P.2d at 65, 250 Cal. Rptr. at 124.

tive rejection of bill 483.<sup>130</sup> The court rejected this argument for two reasons. First, the court maintained that the bill's failure in the Assembly was not "determinative of the intent of the Assembly as a whole."<sup>131</sup> Second, the majority asserted that a legislative rejection of Senate Bill 483 could not be deemed an acceptance of *Royal Globe*.<sup>132</sup> However, the court added that "[u]npassed bills, as evidences of legislative intent, have little value."<sup>133</sup>

The court also refuted the plaintiff's argument that the legislative amendment of section 790.03(h) in 1983, without mentioning *Royal Globe*, indicated a legislative acquiescence with that opinion.<sup>134</sup> The justices stated that a court may freely reexamine and overturn a prior statutory interpretation unless the Legislature either expressly or impliedly *adopts* the holding of a particular case.<sup>135</sup> The court concluded its discussion of subsequent "history" by asserting that such legislative equivocation cast "considerable doubt" on the accuracy of the *Royal Globe* court's perception of legislative intent when it interpreted section 790.03 to contain a private right of action.<sup>136</sup>

#### v. adverse effects of the *Royal Globe* decision

The court then returned to the legal commentary it had previously analyzed,<sup>137</sup> using it to document the adverse effects that *Royal Globe* had imposed upon society.<sup>138</sup> Among these effects mentioned by the court were multiple litigation,<sup>139</sup> unwarranted or inflated settlements,<sup>140</sup>

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130. *Id.*, 758 P.2d at 65-66, 250 Cal. Rptr. at 124.

131. *Id.*

132. *Id.*

133. *Id.* (quoting *Dyna-Med, Inc. v. Fair Employment & Hous. Comm'n*, 43 Cal. 3d 1379, 1396, 743 P.2d 1323, 1333, 241 Cal. Rptr. 67, 76 (1987)).

134. *Id.* at 300-01, 758 P.2d at 66, 250 Cal. Rptr. at 124. Plaintiff offered as authority in support of her argument *Estate of McDill*, 14 Cal. 3d 831, 837-38, 537 P.2d 874, 878, 122 Cal. Rptr. 754, 758 (1975). *Moradi-Shalal*, 46 Cal. 3d at 300-01, 758 P.2d at 66, 250 Cal. Rptr. at 124.

135. *Id.* at 301, 758 P.2d at 66, 250 Cal. Rptr. at 124 (citing *Cianci v. Superior Court*, 40 Cal. 3d 903, 710 P.2d 375, 221 Cal. Rptr. 575 (1985)). The court relied on *Cianci* for the rule that legislative silence on an issue cannot be viewed as implied legislation. *Id.* at 300-01, 758 P.2d at 66, 250 Cal. Rptr. at 124.

136. *Id.*

137. See *supra* notes 117-19 and accompanying text.

138. *Moradi-Shalal*, 46 Cal. 3d at 301-03, 758 P.2d at 66-67, 250 Cal. Rptr. at 124-25. The court relied on these texts even though it admitted that it was not "in a position to verify the accuracy of each of their observations." *Id.* at 301, 758 P.2d at 66, 250 Cal. Rptr. at 124.

139. *Id.* The court stated that by creating a private right of action against insurers, *Royal Globe* provided for a second law suit against the insurer for its violations of the Insurance Code in addition to the initial determination of the insured's liability. *Id.*



increased insurance costs to society,<sup>141</sup> drained judicial resources,<sup>142</sup> conflicting interests imposed on insurers,<sup>143</sup> and a group of practical problems regarding the judicial administration of *Royal Globe* actions.<sup>144</sup>

vi. analytical difficulties

The *Moradi-Shalal* court continued by examining the analytical problems created by *Royal Globe*.<sup>145</sup> The majority maintained that California courts were having difficulty precisely defining the scope of *Royal Globe* liability.<sup>146</sup> The court pointed to the fact that twenty-five cases involving *Royal Globe* issues were awaiting its review.<sup>147</sup> The court stated that *Moradi-Shalal* was a typical example of the analytical problems presented by third-party *Royal Globe* actions.<sup>148</sup> The court emphasized that several courts of appeal had reached conflicting conclusions concerning when an action against the insured is concluded for *Royal Globe* purposes.<sup>149</sup> The majority also noted the problem of defining how a plaintiff can prove that an insurer is conducting unfair practices with such frequency to indicate a "general business practice."<sup>150</sup> The court acknowledged that such proof is not required under *Royal Globe*,<sup>151</sup> but stated that this difficulty in proving a "pattern" of unfair

140. *Id.* The court asserted that the threat of a bad faith action would coerce larger or unfounded settlements from insurers simply out of fear of such a suit. *Id.*

141. *Id.* The court, on the basis of several legal commentaries, noted the possibility that the costs of increased litigation and inflated settlements would be passed on to society through increased insurance rates. *Id.* at 301-02, 758 P.2d at 66-67, 250 Cal. Rptr. at 124-25.

142. *Id.* at 301, 758 P.2d at 66, 250 Cal. Rptr. at 124. In support of this proposition the court quoted Allen, *supra* note 117, at 851; Price, *supra* note 117, at 1186-87, and Note, *Extending The Liability of Insurers*, *supra* note 117, at 790-91. *Moradi-Shalal*, 46 Cal. 3d at 301, 758 P.2d at 66, 250 Cal. Rptr. at 124.

143. *Id.* at 302, 758 P.2d at 67, 250 Cal. Rptr. at 125. The court believed that the need for the insurer to protect itself from a bad faith action by a claimant conflicted with the duty the insurer owed its insured, thus disrupting the settlement process. *Id.*

144. *Id.* The court focused on the lack of specific standards and definitions governing the pursuit of a *Royal Globe* action by a third-party claimant. *Id.* The court cited the *Royal Globe* opinion as the primary cause of the confusion. *Id.* at 302-03, 758 P.2d at 67, 250 Cal. Rptr. at 125.

145. *Id.* at 303, 758 P.2d at 67, 250 Cal. Rptr. at 125.

146. *Id.*

147. *Id.*

148. *Id.* A third-party claim involves a claim against the insured. W. SHERNOFF, S. GAGE & H. LEVINE, *supra* note 17, § 3.01. A first-party claim involves a claim by the insured against its insurer (e.g., life or health insurance claims). *Id.*

149. *Moradi-Shalal*, 46 Cal. 3d at 303, 758 P.2d at 67, 250 Cal. Rptr. at 125-26.

150. *Id.*, 758 P.2d at 67-68, 250 Cal. Rptr. at 126 (quoting CAL. INS. CODE § 790.03(h) (West 1972 & Supp. 1989)).

151. *Id.* Under *Royal Globe*, a single violation of the Unfair Practices Act knowingly committed was sufficient to support a third-party bad faith claim against an insurer. *Royal Globe*, 23 Cal. 3d at 891, 592 P.2d at 336, 153 Cal. Rptr. at 849.

practices symbolized the *Royal Globe* court's error in creating a private right of action under section 790.03.<sup>152</sup>

The court concluded that resolving the problems accompanying *Royal Globe* would require a balancing of many competing interests.<sup>153</sup> The court decided that such an undertaking was best left to the Legislature.<sup>154</sup> Since *Royal Globe* was the cause of all these analytical problems, the court asserted that reconsideration of *Royal Globe* was the most effective judicial solution.<sup>155</sup>

c. *The aggregate effect*

The *Moradi-Shalal* court concluded its discussion of developments subsequent to *Royal Globe* by finding that the combination of all of the aforementioned factors<sup>156</sup> composed an "irrefutable" argument in favor of overturning *Royal Globe*.<sup>157</sup> The court garnished its holding with a warning that insurers need not feel free to ignore the proscriptions of section 790.03(h), citing the specter of administrative enforcement of that section by the Insurance Commissioner.<sup>158</sup> The majority discounted the lack of reported cases involving enforcement of section 790.03 by the Commissioner, and would not assume that this meant the statute was not being enforced.<sup>159</sup> The court also stressed that California courts still had the power to hear civil suits against insurers based on common-law causes of action,<sup>160</sup> and that some of those actions would allow for recovery of punitive damages and prejudgment interest.<sup>161</sup> Additionally, the court reminded the Legislature of its ability to create, should it choose to do so, a private right of action under section 790.03.<sup>162</sup>

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152. *Moradi-Shalal*, 46 Cal. 3d at 303, 758 P.2d at 68, 250 Cal. Rptr. at 126.

153. *Id.*

154. *Id.* at 303-04, 758 P.2d at 68, 250 Cal. Rptr. at 126.

155. *Id.* at 304, 758 P.2d at 68, 250 Cal. Rptr. at 126.

156. *See supra* notes 108-55 and accompanying text.

157. *Moradi-Shalal*, 46 Cal. 3d at 304, 758 P.2d at 68, 250 Cal. Rptr. at 126.

158. *Id.*, 758 P.2d at 68, 250 Cal. Rptr. at 126-27.

159. *Id.* The court offered three alternatives that it thought made such an assumption impossible. *Id.* at 304, 758 P.2d at 68, 250 Cal. Rptr. at 127. First, it was possible that none of the Commissioner's enforcement actions had ever been appealed. *Id.* Second, any cases that had been appealed may have gone unreported. *Id.* Finally, the Commissioner may have thought administrative enforcement superfluous in light of the civil remedy created in *Royal Globe*. *Id.*

160. *Id.* at 304-05, 758 P.2d at 68-69, 250 Cal. Rptr. at 127. The traditional common-law actions against insurers include fraud and intentional infliction of emotional distress. *Id.* Actions for breach of contract and breach of the covenant of good faith and fair dealing are also available, but only to insureds. *Id.*

161. *Id.* at 305, 758 P.2d at 69, 250 Cal. Rptr. at 127.

162. *Id.*

## 2. Pending *Royal Globe* actions

### a. *prospective judgment*

The court next turned to the problem of then-pending *Royal Globe* cases.<sup>163</sup> The *Moradi-Shalal* court decided not to apply the general rule of retroactivity of judgments<sup>164</sup> to its holding in fairness to the many plaintiffs with pending *Royal Globe* actions.<sup>165</sup>

### b. *defining a concluded action for Royal Globe purposes*

The court then embarked on an examination of the standards governing recovery in the pending *Royal Globe* third-party claims.<sup>166</sup> The first standard set by the court in this examination was the definition of a concluded action for *Royal Globe* purposes.<sup>167</sup> The specific issue was "whether settlement of the third party's claim against the insured 'concludes' the action within the meaning of *Royal Globe*," thus allowing a claimant to bring a *Royal Globe* action against the insurer without having to actually obtain a judgment of liability against the insured.<sup>168</sup> Several courts of appeal had concluded that a judgment against the insured must be obtained before an insurer may be sued under *Royal Globe*.<sup>169</sup> The court of appeal in the case at bar, however, held that a settlement of the claim against the insured was sufficiently conclusive to allow a *Royal Globe* action.<sup>170</sup>

The *Moradi-Shalal* court began by reexamining the reasons of the *Royal Globe* court for not allowing a joint action by a third-party claim-

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163. *Id.*

164. *Id.* The general rule of retroactivity given by the court is that " 'a decision of a court of supreme jurisdiction overruling a former decision is retrospective in its operation. . . . We have recognized exceptions to that rule when considerations of fairness and public policy preclude full retroactivity.' " *Id.* (quoting *Peterson v. Superior Court*, 31 Cal. 3d 147, 151-52, 642 P.2d 1305, 1306-07, 181 Cal. Rptr. 784, 785-86 (1982)).

165. *Id.*

166. *Id.*

167. *Id.* The court noted that *Royal Globe* had set a requirement that a bad faith claim based on section 790.03 could only be brought after the underlying claim against the insured was concluded, but failed to give a precise definition of what constituted a sufficient conclusion. *Id.*

168. *Id.*

169. *See, e.g.,* *Heninger v. Foremost Ins. Co.*, 175 Cal. App. 3d 830, 221 Cal. Rptr. 303 (1985); *Williams v. Transport Indem. Co.*, 157 Cal. App. 3d 953, 203 Cal. Rptr. 868 (1984); *Nationwide Ins. Co. v. Superior Court*, 128 Cal. App. 3d 711, 180 Cal. Rptr. 464 (1982). *See infra* notes 179 and 185 and accompanying text for the court's discussion of cases holding that a judgment against the insured is a prerequisite to bringing a *Royal Globe* action against the insurer.

170. *Moradi-Shalal v. Fireman's Fund Ins. Cos.*, 201 Cal. App. 3d 1126, 1130, 226 Cal. Rptr. 333, 336, *rev'd*, 46 Cal. 3d 287, 758 P.2d 58, 250 Cal. Rptr. 116 (1988).

ant against both insured and insurer.<sup>171</sup> The first reason is that such joinder would result in a patent violation of California Evidence Code section 1155.<sup>172</sup> The admission of such evidence was viewed by the *Moradi-Shalal* majority as highly prejudicial to both the insured<sup>173</sup> and the insurer.<sup>174</sup>

The second reason for not allowing a joint trial is the hindrance such joinder may impose on the insured's defense against liability.<sup>175</sup> Joinder of the insurer and the insured would lead to prolonged, burdensome discovery against the insurer.<sup>176</sup> The *Moradi-Shalal* court feared the possibility that evidence prejudicial to the insured might be found as the result of discovery against the insurer.<sup>177</sup> The court also asserted that any damages suffered by the claimant as a result of the insurer's bad faith can be more accurately determined after the initial liability action has ended.<sup>178</sup> The court concluded that *Royal Globe* required a judicial determination of the insured's liability in a separate action before any bad faith suit could be brought against the insurer under section 790.03(h)(5) of the Insurance Code.<sup>179</sup>

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171. *Moradi-Shalal*, 46 Cal. 3d at 306, 758 P.2d at 69-70, 250 Cal. Rptr. at 127-28.

172. *Id.*; see also *Royal Globe*, 23 Cal. 3d at 891, 592 P.2d at 336-37, 153 Cal. Rptr. at 849-50. Evidence Code section 1155 prohibits, for the purpose of establishing fault, admission of evidence that a defendant is insured. CAL. EVID. CODE § 1155 (West 1966). The *Royal Globe* court viewed this as necessary to avoid prejudicing the insured defendant's case. *Royal Globe*, 23 Cal. 3d at 891, 592 P.2d at 336-37, 153 Cal. Rptr. at 849-50.

173. *Moradi-Shalal*, 46 Cal. 3d at 306, 758 P.2d at 69, 250 Cal. Rptr. at 128.

174. *Id.* at 311-12, 758 P.2d at 73-74, 250 Cal. Rptr. at 131-32.

175. *Id.* at 306, 758 P.2d at 70, 250 Cal. Rptr. at 128. The specific concern is the effect that a claimant engaging in discovery against the insurer will have on the insured's ability to defend itself against liability. *Id.*

176. *Id.*

177. *Id.*

178. *Id.*

179. *Id.* at 311, 758 P.2d at 73, 250 Cal. Rptr. at 131. The *Moradi-Shalal* court supported its holding with a discussion of several lower court decisions supporting its view. *Id.* at 306, 758 P.2d at 70, 250 Cal. Rptr. at 128. First, in *Williams v. Transport Indemnity Co.*, the California Court of Appeal relied principally on the indemnifying function of insurance contracts to support the conclusion that no claim against an insurer existed until the liability of the insured was established. 157 Cal. App. 3d at 959-60, 203 Cal. Rptr. at 871-72. The *Moradi-Shalal* court focused on *Williams'* rejection of the argument that in a section 790.03(h) action an insurer's unfair practices are at issue, not the insured's liability. *Moradi-Shalal*, 46 Cal. 3d at 307, 758 P.2d at 70, 250 Cal. Rptr. at 128.

The court also discussed *Heninger v. Foremost Insurance Co.*, a case in which the court of appeal relied on the indemnification principle, reasoning that allowing a bad faith action under 790.03 without first requiring a judicial determination would essentially turn the UPA into a form of statutory liability without fault. 175 Cal. App. 3d at 834, 221 Cal. Rptr. at 305-06. The court agreed with the conclusion in *Heninger* that there can be no insurer bad faith under section 790.03 without a previous determination of the legal liability of the insured. *Moradi-Shalal*, 46 Cal. 3d at 307, 758 P.2d at 70-71, 250 Cal. Rptr. at 128-29.

The court disposed of the plaintiff's argument that section 790.03 liability revolved around the insurer's unfair practices, which is separate from the liability of the insured.<sup>180</sup> The court distinguished between the insurer's statutory duty to refrain from unfair practices and the claimant's right to recover for a breach of that duty under *Royal Globe*.<sup>181</sup> The court found the right to recover under *Royal Globe* comparable to the right to recover for legal malpractice<sup>182</sup>—just as a plaintiff in a legal malpractice suit must first prove that he or she would have prevailed in the action giving rise to the malpractice action, a third-party claimant in a *Royal Globe* action must establish his or her right to recover against the insured before the *Royal Globe* suit may be brought.<sup>183</sup>

The court next considered the plaintiff's contention that, even after a settlement, a court could still determine whether the insured was actually liable to the claimant by incorporating the inquiry into the *Royal Globe* action itself.<sup>184</sup> The court rejected the argument, holding that to gain standing to bring a *Royal Globe* action, the claimant must first obtain a final judgment against the insured.<sup>185</sup>

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180. *Id.*

181. *Id.*

182. *Id.* at 307-08, 758 P.2d at 71, 250 Cal. Rptr. at 129.

183. *Id.*

184. *Id.* at 308, 758 P.2d at 71, 250 Cal. Rptr. at 129.

185. *Id.* The court analyzed two lines of court of appeal cases in reaching its holding. The first line of cases originated in *Doser v. Middlesex Ins. Co.*, 101 Cal. App. 3d 883, 162 Cal. Rptr. 115 (1980). *Doser* and its progeny require a separate judicial determination of the insured's liability before a *Royal Globe* action can be brought. *Id.* at 891, 162 Cal. Rptr. at 119; see also *Heninger*, 175 Cal. App. 3d at 834, 221 Cal. Rptr. at 304-05; *Williams*, 157 Cal. App. 3d at 959-60, 203 Cal. Rptr. at 871-72; *Nationwide Ins. Co. v. Superior Court*, 128 Cal. App. 3d 711, 713, 180 Cal. Rptr. 464, 465 (1982).

The second line of cases began with *Rodriguez v. Fireman's Fund Ins. Co.*, 142 Cal. App. 3d 46, 90 Cal. Rptr. 705 (1983). This line of cases does not require a separate determination of the insured's liability prior to the *Royal Globe* action. *Id.* at 53, 90 Cal. Rptr. at 709; see also *Vega v. Western Employers Ins. Co.*, 170 Cal. App. 3d 922, 926, 216 Cal. Rptr. 592, 595 (1985); *Afuso v. United States Fidelity & Guar. Co.*, 169 Cal. App. 3d 859, 863, 215 Cal. Rptr. 490, 493 (1985).

The court of appeal in *Moradi-Shalal* had relied on the *Rodriguez* line of cases when it held that settlement, followed by a dismissal with prejudice of all claims against the insured, sufficiently concluded the action for *Royal Globe* purposes. *Moradi-Shalal*, 201 Cal. App. 3d at 1130, 226 Cal. Rptr. at 336. The court of appeal maintained that the concerns that led the *Royal Globe* court to forbid a claimant's joint action against both the insured and the insurer, see *supra* notes 171-79 and accompanying text, did not exist when settlement protected the insured from any of the prejudicial effects of joinder. *Moradi-Shalal*, 201 Cal. App. 3d at 1128-29, 226 Cal. Rptr. at 335. In reversing the court of appeal's decision, the supreme court adopted the indemnification-based reasoning of the *Doser* line of cases, which requires a separate judicial determination of the insured's liability as a prerequisite to a *Royal Globe* action. *Moradi-Shalal*, 46 Cal. 3d at 311, 758 P.2d at 73, 250 Cal. Rptr. at 131. In rejecting the *Rodriguez* line of cases, the supreme court expressly stated that even an admission of liability

The court offered several justifications for its holding. First, the Legislature's purpose in enacting section 790.03(h) was to encourage settlements.<sup>186</sup> Permitting litigation beyond the settlement stage would run counter to that purpose.<sup>187</sup> Second, the court discussed "various other legal and practical considerations" that it viewed as supporting the requirement.<sup>188</sup> The first consideration was the evidentiary conflict that forbade the joinder of the two actions under *Royal Globe*.<sup>189</sup> The court regarded the jury's knowledge that the defendant was an insurer and that there was an insurance policy involved as potentially prejudicing the insurer's case in violation of Evidence Code section 1155.<sup>190</sup> The court also viewed the admission of evidence of the settlement as similarly prejudicial and in violation of Evidence Code section 1152,<sup>191</sup> which prohibits admitting evidence of settlement as proof of the settling party's liability.<sup>192</sup>

The *Moradi-Shalal* court also reasoned that a *Royal Globe* action following settlement denies parties the main benefit of their bargain, since it would force the insurer and insured to litigate the issue they had attempted to avoid when they settled the underlying liability claim.<sup>193</sup> The court characterized that scenario as a penalty against the insurer, and a windfall for the claimant.<sup>194</sup> The court also judged that permitting a *Royal Globe* action after settlement would result in a conflict of interest for the insurer.<sup>195</sup> The court admitted that section 790.03 created a duty owed by the insurer to the claimant, but found that the indemnifying purpose of the insurance contract outweighed this duty.<sup>196</sup> As a final consideration, the court added that a settlement of the underlying liability claim followed by a dismissal with prejudice arguably precludes litigation of the insured's liability under the doctrine of collateral estoppel.<sup>197</sup>

The court concluded by dismissing the plaintiff's claim against Fireman's because the plaintiff had failed to obtain the required final judg-

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by the insured would not be a sufficient means of determining the insured's liability prior to the *Royal Globe* action. *Id.*

186. *Id.*

187. *Id.*

188. *Id.*

189. *Id.*

190. *Id.* See *supra* notes 172-74 and accompanying text.

191. CAL. EVID. CODE § 1152 (West 1966 & Supp. 1989).

192. *Moradi-Shalal*, 46 Cal. 3d at 311-12, 758 P.2d at 73-74, 250 Cal. Rptr. at 132.

193. *Id.* at 312, 758 P.2d at 74, 250 Cal. Rptr. at 132.

194. *Id.*

195. *Id.*

196. *Id.*

197. *Id.* at 312-13, 758 P.2d at 74, 250 Cal. Rptr. at 132-33.

ment against Fireman's insured prior to filing its *Royal Globe* action.<sup>198</sup> The court admitted that its "predetermination" requirement was flawed, but saw it as the best rule in light of the competing interests accompanying the surviving *Royal Globe* actions.<sup>199</sup>

### 3. Justice Mosk's dissent

Justice Mosk wrote a scathing dissent which he began by declaring that the majority's ruling constituted a " 'Royal Bonanza' for insurance carriers, i.e., total immunity for unfair and deceptive practices committed on innocent claimants."<sup>200</sup> Noting that the case at bar had been granted review merely for the purpose of eliminating some of *Royal Globe*'s analytical difficulties, Justice Mosk stated that "[t]he insurance industry asked for a loaf of bread. The majority, with remarkable unanimity, [gave] it the whole bakery."<sup>201</sup>

Justice Mosk went on to attack the majority's reasoning. First, he described as "fatuous" the majority's assertion that the legislative intent behind section 790.03 was limited to protecting insureds.<sup>202</sup> To emphasize this point, Justice Mosk quoted all of those segments of section 790.03(h) omitted by the majority which expressly offered protection to claimants as well as insureds.<sup>203</sup>

198. *Id.* at 313, 758 P.2d at 75, 250 Cal. Rptr. at 133.

199. *Id.*

200. *Id.* at 313-14, 758 P.2d at 75, 250 Cal. Rptr. at 133 (Mosk, J., dissenting).

201. *Id.* (Mosk, J., dissenting). Justice Mosk accused the majority of cowering in the face of the fundamental issues needing resolution, stating:

In most cases, of course, it would make our task relatively uncomplicated if we could evade interpreting the law with finality by simply changing the law. On the other hand, making our job easier is no justification for totally destroying a cause of action authorized by statute, approved by decisions of this court and of Courts of Appeal, and acquiesced in by the Legislature for nearly a decade.

*Id.*, 758 P.2d at 75, 250 Cal. Rptr. at 133-34 (Mosk, J., dissenting).

202. *Id.* at 316, 758 P.2d at 76, 250 Cal. Rptr. at 135 (Mosk, J., dissenting). The majority had only quoted the following segments of section 790.03:

The following are hereby defined as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance.

(h) Knowingly committing or performing with such frequency as to indicate a general business practice any of the following unfair claims settlement practices:

(2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies.

(3) Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies.

(5) Not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear.

203. *Id.* at 314-16, 758 P.2d at 76, 250 Cal. Rptr. at 134 (Mosk, J., dissenting). See *supra* note 2 for the complete text of Insurance Code section 790.03(h).

Justice Mosk took similar exception to the majority's finding that section 790.03 requires a litigant to show that a particular violation of 790.03 is part of a pattern of unfair business practices.<sup>204</sup> He thought it unjust to forbid a claimant or insured from obtaining relief from a single deceptive act that was knowingly committed, asserting that: "[W]hile repetition of prohibited acts may be relevant to the duty of the Insurance Commissioner to issue a cease and desist order, to an aggrieved private litigant who can demonstrate that the insurer acted deliberately, the frequency of the insurer's misconduct and its application to other victims are irrelevant."<sup>205</sup>

Justice Mosk's dissent reached a crescendo when he addressed the majority's assertion that the Insurance Commissioner would provide adequate protection for claimants by exercising the enforcement powers granted the office under the Insurance Code.<sup>206</sup> Justice Mosk faulted the majority for encouraging the Insurance Commissioner to "continue" to enforce the law when in fact the court failed to show that the Commissioner ever had.<sup>207</sup>

Justice Mosk next addressed the majority's contention that the equivocations of the Legislature indicated its rejection of *Royal Globe*; to the contrary, the dissenting justice regarded the death of Senate Bill 483<sup>208</sup> as significant in "represent[ing] legislative approval of and confirmation of the *Royal Globe* decision."<sup>209</sup> Justice Mosk further argued that by amending section 790.03 in 1983 without disturbing the *Royal Globe* holding, the Legislature demonstrated its acquiescence in that holding.<sup>210</sup>

Seeming somewhat resentful of the majority's "attempt to give an impression that *Royal Globe* was some kind of aberration, wholly unprec-

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204. *Moradi-Shalal*, 46 Cal. 3d at 316-17, 758 P.2d at 77, 250 Cal. Rptr. at 135 (Mosk, J., dissenting).

205. *Id.* (Mosk, J., dissenting).

206. See *supra* notes 158-59 and accompanying text.

207. *Moradi-Shalal*, 46 Cal. 3d at 317, 758 P.2d at 77, 250 Cal. Rptr. at 135 (Mosk, J., dissenting). To support his assertion, Justice Mosk offered the facts that

[s]ince 1959 when [the Unfair Practices Act was] adopted, 62 volumes of California Reports and 297 volumes of California Appellate Reports have been published. In those 359 volumes there are more than 300,000 pages. On not one page of one volume is a single case reported in which the Insurance Commissioner has taken disciplinary action against a carrier for "unfair and deceptive acts or practices in the business of insurance" involving a claimant. *Not one case in 29 years.*

*Id.* (Mosk, J., dissenting) (emphasis in original).

208. See *supra* notes 122-36 and accompanying text for a discussion of Senate Bill 483 and the significance attributed to it by the majority.

209. *Moradi-Shalal*, 46 Cal. 3d at 318, 758 P.2d at 78, 250 Cal. Rptr. at 136 (Mosk, J., dissenting).

210. *Id.*, 758 P.2d at 77, 250 Cal. Rptr. at 136 (Mosk, J., dissenting).



edented and unanticipated,"<sup>211</sup> Justice Mosk, the author of *Royal Globe*, noted that *Royal Globe* was the fourth in a series of cases holding that the Unfair Practices Act provided a private right of action.<sup>212</sup> Justice Mosk concluded that "it is clear [when looking at these three prior cases] that *Royal Globe* was preordained."<sup>213</sup> Justice Mosk perceived the majority's holding as implicitly overruling these previous cases, as well as the *Royal Globe* holding itself.<sup>214</sup>

Justice Mosk also insinuated that the majority had fabricated the overwhelming analytical difficulties it asserted as a reason for overruling *Royal Globe* by stating that "Courts of Appeal have had remarkably little difficulty in interpreting and applying [*Royal Globe*] as authority."<sup>215</sup> Moreover, Justice Mosk viewed with contempt the majority's reliance on contrary out-of-state precedent to support its overruling *Royal Globe*,<sup>216</sup> stating that: "California courts alone have the responsibility of interpreting the laws adopted by the California Legislature, and they cannot be deterred from that duty by what other states have done or failed to do under laws enacted by their legislative bodies."<sup>217</sup>

Concluding his dissent, Justice Mosk reflected upon the irony that the insurance industry, despite its political influence and public relations machinery, was unable to convince the Legislature that *Royal Globe* should be overruled, only to succeed "in persuading justices of this court that [the industry] is entitled to immunity from the same type of responsibility required of every other business and individual that commit deceptive practices."<sup>218</sup> Justice Mosk asserted that the majority failed to answer the question of "why [the insurance] industry is entitled to be above the law that applies to every other segment of society," because the question was beyond any rational answer.<sup>219</sup>

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211. *Id.* (Mosk, J., dissenting).

212. *Id.* at 318-19, 758 P.2d at 78-79, 250 Cal. Rptr. at 136-37 (Mosk, J., dissenting). Justice Mosk cited *Homestead Supplies, Inc. v. Executive Life Ins. Co.*, 81 Cal. App. 3d 978, 147 Cal. Rptr. 22 (1978), *Sherhoff v. Superior Court*, 44 Cal. App. 3d 406, 118 Cal. Rptr. 680 (1975), and *Greenberg v. Equitable Life Assurance Soc'y*, 34 Cal. App. 3d 994, 110 Cal. Rptr. 470 (1973), as three cases preceding *Royal Globe* in holding that the Unfair Practices Act affords private litigants a right of action. *Id.* (Mosk, J., dissenting). See *supra* notes 49-64 and accompanying text for a discussion of cases preceding *Royal Globe*.

213. *Moradi-Shalal*, 46 Cal. 3d at 319, 758 P.2d at 79, 250 Cal. Rptr. at 137 (Mosk, J., dissenting).

214. *Id.* at 320, 758 P.2d at 79, 250 Cal. Rptr. at 137 (Mosk, J., dissenting).

215. *Id.* (Mosk, J., dissenting).

216. See *supra* notes 108-16 and accompanying text.

217. *Moradi-Shalal*, 46 Cal. 3d at 320, 758 P.2d at 79, 250 Cal. Rptr. at 138 (Mosk, J., dissenting).

218. *Id.*, 758 P.2d at 79-80, 250 Cal. Rptr. at 138 (Mosk, J., dissenting).

219. *Id.* at 321, 758 P.2d at 80, 250 Cal. Rptr. at 138 (Mosk, J., dissenting).

## IV. ANALYSIS

The *Moradi-Shalal v. Fireman's Fund Insurance Cos.*<sup>220</sup> majority's overturning of *Royal Globe Insurance Co. v. Superior Court*<sup>221</sup> raises many questions. The scope of this Note, however, is limited to two issues. First, this section critiques the reasoning of the *Moradi-Shalal* court and analyzes the opinion's treatment of the doctrine of stare decisis. Second, it considers *Moradi-Shalal*'s immediate and potential effects on insurance bad faith litigation in California.

A. *The Reasoning of the Moradi-Shalal Majority*1. The decision to overrule *Royal Globe*

In overruling *Royal Globe Insurance Co. v. Superior Court*,<sup>222</sup> the majority in *Moradi-Shalal v. Fireman's Fund Insurance Cos.*<sup>223</sup> stated that negative subsequent developments—*Royal Globe*'s rejection by other state courts, adverse scholarly commentary and subsequent legislative history—presented an “irrefutable” argument that *Royal Globe* should be overruled.<sup>224</sup> A closer look at these developments reveals that the cited sources of doubt are not persuasive.

a. *rejection by other state courts*

The *Moradi-Shalal* court found it significant that courts of seventeen states had considered their own versions of the NAIC Model Act and had concluded that they did not create a private right of action.<sup>225</sup> The court cited seventeen out-of-state cases that it characterized as having either expressly or implicitly rejected *Royal Globe*'s interpretation of the Model Act.<sup>226</sup>

The court, however, disregarded two important facts. First, only eight of the seventeen out-of-state opinions cited by the court as rejecting the *Royal Globe* holding were rendered by state supreme courts.<sup>227</sup> Sec-

220. 46 Cal. 3d 287, 758 P.2d 58, 250 Cal. Rptr. 116 (1988).

221. 23 Cal. 3d 880, 592 P.2d 329, 153 Cal. Rptr. 842 (1979).

222. 23 Cal. 3d 880, 592 P.2d 329, 153 Cal. Rptr. 842 (1979).

223. 46 Cal. 3d 287, 758 P.2d 58, 250 Cal. Rptr. 116 (1988).

224. *Id.* at 304, 758 P.2d at 68, 250 Cal. Rptr. at 126. See *supra* notes 108-55 and accompanying text for a summary of the court's treatment of these issues.

225. *Moradi-Shalal*, 46 Cal. 3d at 297-98, 758 P.2d at 63-64, 250 Cal. Rptr. at 121-22.

226. *Id.* See *supra* note 110 for a complete list of the cases cited by the *Moradi-Shalal* court.

227. *E.g.*, *White v. Unigard Mut. Ins. Co.*, 112 Idaho 94, 730 P.2d 1014 (1986); *Seeman v. Liberty Mut. Ins. Co.*, 322 N.W.2d 35 (Iowa 1982); *Morris v. American Family Mut. Ins. Co.*, 386 N.W.2d 233 (Minn. 1986); *Lawton v. Great S.W. Fire Ins. Co.*, 118 N.H. 607, 392 A.2d 576 (1978); *Farris v. United States Fidelity and Guar. Co.*, 284 Or. 453, 587 P.2d 1015 (1978);

ond, two state supreme courts have approved *Royal Globe*.<sup>228</sup> Thus, three of the eleven state supreme courts—27%—that have considered the issue have held that a statute based on the Model Act confers a private right of action.<sup>229</sup> This percentage of approving state supreme courts certainly does not support the *Moradi-Shalal* majority's assertion that *Royal Globe* has been rejected with "near unanimity" by other states.<sup>230</sup> Also, the Model Act was adopted, in one form or another, by forty-eight states.<sup>231</sup> With only eleven states having spoken with finality, thirty-seven states remain undecided on the issue. This "rejection" of *Royal Globe* by other state courts cannot even qualify as a majority rule.

An examination of the opinions cited by the *Moradi-Shalal* court reveals that many of the out-of-state courts did not wholly "reject" *Royal Globe*; rather they distinguished their state's version of the Unfair Practices Act from California's. For example, in *Morris v. American Family Mutual Insurance Co.*,<sup>232</sup> the Minnesota Supreme Court decision deemed "typical of the majority approach" by the *Moradi-Shalal* court,<sup>233</sup> made mention of the "unique" language in California's Unfair Practices Act (UPA) that led to the *Royal Globe* decision.<sup>234</sup>

Other cases mentioned by the *Moradi-Shalal* court also distinguished their states' Unfair Practices Act, but with more vigor than the Minnesota court.<sup>235</sup> Comparing Wisconsin's version of the NAIC Model Act with California Insurance Code section 790.09,<sup>236</sup> the Wisconsin Supreme Court found "no analogous provision in [Wisconsin's] insurance laws."<sup>237</sup> The Wisconsin court also noted language in Wisconsin's version<sup>238</sup> of section 790.03 which expressly requires that an insurer commit an unfair practice both "without just cause and . . . with such frequency as to indicate a general business practice."<sup>239</sup>

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D'Ambrosio v. Pennsylvania Nat'l Mut. Casualty Ins. Co., 494 Pa. 501, 431 A.2d 966 (1981); Wilder v. Aetna Life & Casualty Ins. Co., 140 Vt. 16, 433 A.2d 309 (1981); Kranzush v. Badger State Mut. Casualty Co., 103 Wis. 2d 56, 307 N.W.2d 256 (1981).

228. See *Klaudt v. Flink*, 202 Mont. 247, 658 P.2d 1065 (1983); *Jenkins v. J.C. Penney Casualty Ins. Co.*, 167 W. Va. 597, 280 S.E.2d 252 (1981).

229. See *Royal Globe*, 23 Cal. 3d at 884, 592 P.2d at 332, 153 Cal. Rptr. at 845; *Klaudt*, 202 Mont. at 252, 658 P.2d at 1067; *Jenkins*, 167 W. Va. 607, 280 S.E.2d at 258.

230. *Moradi-Shalal*, 46 Cal. 3d at 298, 758 P.2d at 64, 250 Cal. Rptr. at 122.

231. *Id.* at 297, 758 P.2d at 63, 250 Cal. Rptr. at 121.

232. 386 N.W.2d 233 (Minn. 1986).

233. *Moradi-Shalal*, 46 Cal. 3d at 298, 758 P.2d at 64, 250 Cal. Rptr. at 122.

234. *Morris*, 386 N.W.2d at 237 n.6.

235. See, e.g., *Seeman*, 322 N.W.2d at 42; *Kranzush*, 103 Wis. 2d at 82, 307 N.W.2d at 269.

236. CAL. INS. CODE § 790.09 (West 1972).

237. *Kranzush*, 103 Wis. 2d at 82, 307 N.W.2d at 269.

238. WIS. ADMIN. CODE, Ins. § 6.11(3)(a) (Mar. 1979).

239. *Kranzush*, 103 Wis. 2d at 80, 307 N.W.2d at 269 (quoting WIS. ADMIN. CODE, Ins.

Another example of a state court distinguishing its statute from California's is *Seeman v. Liberty Mutual Insurance Co.*<sup>240</sup> In *Seeman*, the Iowa Supreme Court distinguished Iowa's Unfair Practices Act from California's.<sup>241</sup> The court concluded that the difference in language evinced a legislative intent not to create a private cause of action, unlike the language in California's Act.<sup>242</sup> However, the *Seeman* court also stated:

Were it not for our conclusion that the legislature intended administrative sanctions to be the exclusive enforcement mechanism enforcing [the Unfair Practices Act], we believe a private cause of action would be consistent with the underlying purposes of the Act. An action for money damages provides an injured party with a meaningful incentive to seek enforcement of the chapter's prohibitions and also provides a meaningful deterrent against future violations.<sup>243</sup>

Thus, these out-of-state cases cited by the *Moradi-Shalal* court as interpreting their states' UPA did not "reject" *Royal Globe* so much as determine that their legislatures intended something less than did the California Legislature.<sup>244</sup>

Another weakness in the cases cited by the *Moradi-Shalal* court is that several are from jurisdictions that, at most, recognize only a *contrac-*

§ 6.11(3)(a) (Mar. 1979)). Section 790.03 provides "[k]nowingly committing or performing with such frequency as to indicate a general business practice . . ." CAL. INS. CODE § 790.03(h) (West 1972 & Supp. 1989). In *Earth Scientists v. United States Fidelity and Guar.*, 619 F. Supp. 1465, 1470-71 (D. Kan. 1985), the federal district court for the district of Kansas also distinguished the language in Kansas' Unfair Practices Act from California's section 790.09. *Accord A & E Supply Co. v. Nationwide Mut. Fire Ins. Co.*, 798 F.2d 669, 675 n.6 (4th Cir. 1986), *cert. denied*, 479 U.S. 1091 (1987); *Seeman*, 322 N.W.2d at 42; *Patterson v. Globe American Casualty Co.*, 101 N.M. 541, 543, 685 P.2d 396, 397 (1984).

240. 322 N.W.2d 35 (Iowa 1982).

241. *Id.* at 42.

242. *Id.*

243. *Id.* at 43.

244. Moreover, one of the cases cited by the *Moradi-Shalal* court did not in any way address *Royal Globe* nor interpret an adopted version of the NAIC Model Act. *Tweet v. Webster*, 610 F. Supp. 104 (D. Nev. 1985), makes no mention of the Nevada Unfair Practices statute but merely refers to *State ex rel. Allen v. District Court*, 69 Nev. 196, 245 P.2d 999 (1952), to support its blanket assertion that "[w]hile California recognizes the existence of a statutory duty to negotiate settlements in good faith . . . Nevada does not." The only issue in *Allen* was whether claimants could use the discovery process to ascertain the coverage limits of an insurance policy; it had nothing to do with insurer bad faith and focused only on perpetuation-of-testimony statutes. 69 Nev. at 198, 245 P.2d at 1001. Further, the most recent statute considered in *Allen* was passed in 1929. *Id.* The Model Act was not even drafted until 1947. AN ACT RELATING TO UNFAIR METHODS OF COMPETITION AND UNFAIR AND DECEPTIVE ACTS AND PRACTICES IN THE BUSINESS OF INSURANCE, *reprinted in* 2 NAT'L ASS'N INS. COMM'RS PROCEEDINGS 392 (1947).

*tual* action for bad faith failure to settle within policy limits.<sup>245</sup> One cited jurisdiction has only recently begun to recognize bad faith actions against insurers.<sup>246</sup> It would be quite a leap for a court of such a jurisdiction to elevate an action limited by privity to an implied statutory action extending protection to third-party claimants. Even the progressive California courts took the intermediate step of recognizing that an insurer's bad faith sounds in tort as well as contract.<sup>247</sup>

Moreover, as Justice Mosk noted, the cases cited by the majority were legally irrelevant: "California courts alone have the responsibility of interpreting the law adopted by the California Legislature, and they cannot be deterred from that duty by what other states have done or failed to do under [their own] laws . . ." <sup>248</sup> As demonstrated above, every state's version of the Model Act differs in some way from the California statute.<sup>249</sup> Each state legislature and court system faces problems unique to that state, and consequently, promulgates or interprets laws in conformity with those concerns. That a Minnesota court found a purpose behind a Minnesota statute different from that found by a California court behind a California statute is not surprising—it should be expected.

*b. adverse scholarly commentary*

The *Moradi-Shalal* court asserted that "[c]ommentary on *Royal Globe* has been generally critical of that decision."<sup>250</sup> The court cited seven articles which it painted as:

[E]mphasiz[ing] both the erroneous nature of our holding (i.e., the strained interpretation of the statutory provisions, and the misreading or disregard of available legislative history) and the undesirable social and economic effects of the decision (i.e., multiple litigation, unwarranted bad faith claims, coercive settlements, excessive jury awards, and escalating insurance, legal and other "transaction" costs).<sup>251</sup>

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245. *Earth Scientists*, 619 F. Supp. at 1469; *Lawton*, 118 N.H. at 613-14, 392 A.2d at 580-81; *Morris*, 386 N.W.2d at 237; *Swinton*, 283 S.C. 11, 14, 320 S.E.2d 495, 496 (1984).

246. *Young v. Michigan Mut. Ins. Co.*, 139 Mich. App. 600, 607 & n.1, 362 N.W.2d 844, 847 & n.1 (1984).

247. *See Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967). *See supra* notes 8-83 and accompanying text for a summary of California's evolving insurance bad faith laws.

248. *Moradi-Shalal*, 46 Cal. 3d at 320, 758 P.2d at 79, 250 Cal. Rptr. at 138 (Mosk, J., dissenting).

249. *See supra* notes 232-44 and accompanying text.

250. *Moradi-Shalal*, 46 Cal. 3d at 298, 758 P.2d at 64, 250 Cal. Rptr. at 122. *See sources cited supra* note 117.

251. *Id.* at 299, 758 P.2d at 64, 250 Cal. Rptr. at 123.

The court considered this "breadth of criticism" disturbing enough to warrant reconsideration of *Royal Globe*.<sup>252</sup>

The court overgeneralized the character and content of the authority it cited. Of the seven articles, six admittedly are critical of the reasoning of the *Royal Globe* court.<sup>253</sup> Only two of the articles cited, however, assert that any negative effects have in fact resulted from *Royal Globe*,<sup>254</sup> while the rest merely speculate. Even those claiming that *Royal Globe* has actually resulted in adverse effects upon society fail to cite any empirical evidence to substantiate their assertions.<sup>255</sup> Thus, the tidal wave of scholarly criticism which the majority represents to exist barely qualifies as a flood tide.

Moreover, there are articles which came to praise *Royal Globe*, and not to bury it, which the court fails to mention.<sup>256</sup> One of these articles<sup>257</sup> is among the seven cited by the *Moradi-Shalal* court as being derogatory; yet most of its analysis focuses on the positive ramifications of *Royal Globe* and ultimately concludes that the decision furthered California public policy.<sup>258</sup> All told, there are six pieces of legal commentary that view *Royal Globe* as a step in the right direction toward protecting society from capricious acts of insurers.<sup>259</sup> In light of this balance of legal commentary in favor of *Royal Globe*, Chief Justice Lucas' assertion that commentary regarding *Royal Globe* has been generally negative<sup>260</sup> is incorrect.

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252. *Id.*, 758 P.2d at 65, 250 Cal. Rptr. at 123.

253. The article that is not critical of *Royal Globe* is Note, *Extending The Liability of Insurers*, *supra* note 117. The Note does not critique *Royal Globe*'s reasoning, but focuses on its possible ramifications, both positive and negative.

254. See Note, Rodriguez v. Fireman's Fund Insurance Companies, Inc.: *An Illustration of the Problems Inherent in the Royal Globe Doctrine*, 15 SW. U.L. REV. 371 (1985); Comment, *Bad Faith: Defining Applicable Standards in the Aftermath of Royal Globe v. Superior Court*, 23 SANTA CLARA L. REV. 917 (1983).

255. The only subsequent "adverse" development which is actually documented is the number of *Royal Globe* actions pending review before the California Supreme Court. *Moradi-Shalal*, 46 Cal. 3d at 303, 758 P.2d at 67, 250 Cal. Rptr. at 125.

256. See Aitken & Abeltin, *When Does "The Fat Lady Sing" For Purposes of a Royal Globe Action? Endless Litigation Over What Does or Should Constitute the Resolution of a Claim*, 14 W. ST. U. L. REV. 55 (1986); Beck & Horwitz, *Insurer's Day In Court: New Limits On Royal Globe*, 8 L.A. LAW. 31 (May 1985); Lambert, *Tom on Torts*, 23 AM. TRIAL LAWS. ASS'N L. RPTR. 338, 342-43 (1980); Shernoff, *Insurance Company Bad Faith Law: A Potential Weapon For Consumer Protection*, 17 TRIAL 22 (May 1981); Comment, *A Statutory Action For Insurer Bad Faith—The Reasonably Clear Remedy for the Third Party Claimant*, 11 PAC. L.J. 945 (1980) [hereinafter Comment, *A Statutory Action For Insurer Bad Faith*].

257. Note, *Extending the Liability of Insurers*, *supra* note 117.

258. *Id.* at 788-89, 791.

259. See sources cited *supra* notes 256-57.

260. *Moradi-Shalal*, 46 Cal. 3d at 298, 758 P.2d at 64, 250 Cal. Rptr. at 122.

c. "additional" and "subsequent" legislative history

i. additional legislative history

The *Moradi-Shalal* majority implied that perhaps not all of Insurance Code section 790.03's legislative history was considered by the *Royal Globe* court.<sup>261</sup> The *Moradi-Shalal* court stated that certain documents, discussed by a legal commentator,<sup>262</sup> were not mentioned in either the majority or dissenting *Royal Globe* opinions.<sup>263</sup> Specifically, the *Moradi-Shalal* court was concerned with the Legislative Analyst's Report and the Legislative Counsel's Digest—two pieces of extrinsic legislative history that allegedly show that section 790.03 was to provide only administrative remedies.<sup>264</sup> However, a careful reading of the legal commentary,<sup>265</sup> and the *Royal Globe* majority opinion reveals that the court did consider both the Report and the Digest, but adjudged them "too general or remote to provide any firm guidance."<sup>266</sup> Thus, the *Moradi-Shalal* court fabricated an evidentiary controversy where none existed, using the opportunity to reevaluate evidence that had already been considered by the *Royal Globe* court. The court also failed to reconsider all of the evidence examined by the *Royal Globe* court.<sup>267</sup> The *Moradi-Shalal* court therefore speciously analyzed the evidence of legislative intent: It mocked *stare decisis*, which it so carefully espoused early in the opinion,<sup>268</sup> and it selectively evaluated the evidence, analyzing only those

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261. *Id.* at 300, 758 P.2d at 65, 250 Cal. Rptr. at 123.

262. See Price, *supra* note 117, at 1178-79.

263. *Moradi-Shalal*, 46 Cal. 3d at 300, 758 P.2d at 65, 250 Cal. Rptr. at 123.

264. *Id.*

265. Price, *supra* note 117, at 1178-79.

266. *Royal Globe*, 23 Cal. 3d at 887, 592 P.2d at 334, 153 Cal. Rptr. at 847.

267. For example, the *Royal Globe* court examined the reasoning in *Homestead Supplies, Inc. v. Executive Life Ins. Co.*, 81 Cal. App. 3d 978, 992, 147 Cal. Rptr. 22, 30 (1978), *Shernoff v. Superior Court*, 44 Cal. App. 3d 406, 409-10, 118 Cal. Rptr. 680, 682 (1975), and *Greenberg v. Equitable Life Assurance Soc'y*, 34 Cal. App. 3d 994, 1001, 110 Cal. Rptr. 470, 475 (1973), three cases preceding *Royal Globe* and holding that Insurance Code section 790.03 creates a private right of action. *Royal Globe*, 23 Cal. 3d at 885-87, 592 P.2d at 333, 153 Cal. Rptr. at 846. The *Moradi-Shalal* court made no such examination, merely mentioning those cases in its summary of Justice Richardson's dissent in *Royal Globe*. *Moradi-Shalal*, 46 Cal. 3d at 295, 758 P.2d at 62, 250 Cal. Rptr. at 120. Other pieces of evidence presented to and evaluated by the *Royal Globe* court include letters from former insurance commissioner Barger and Assemblyman Pierson, sponsor of the 1971 amendment to the Unfair Practices Act, testimony given by a Department of Insurance representative to "various legislative committees," and a "Bill Analysis" by the Department of Insurance. *Royal Globe*, 23 Cal. 3d at 887-89, 592 P.2d at 333-35, 153 Cal. Rptr. at 846-48. None of these are even mentioned by the *Moradi-Shalal* court.

268. The *Moradi-Shalal* court stated: "It is, of course, a fundamental jurisprudential policy that prior applicable precedent usually must be followed even though the case, if considered

items that would lead to an apparently preordained result.<sup>269</sup>

ii. subsequent legislative history

The *Moradi-Shalal* court's use of "subsequent" legislative history<sup>270</sup> should be forever remembered as one of the great self-contradictions in the history of California jurisprudence. The court began by finding the Senate's passage of Senate Bill Number 483<sup>271</sup> indicative of a legislative dissatisfaction with *Royal Globe*.<sup>272</sup> However, the court then discounted the argument that the failure of the bill to pass the Assembly constituted an approval of *Royal Globe* by stating that "[u]npassed bills, as evidences of legislative intent, have little value."<sup>273</sup>

If the rule is that unpassed bills have little evidentiary value, that rule must be applied consistently. Thus, the Senate's passage of Senate Bill 483 has the same evidentiary value as the Assembly's failure to pass it: zero. Conversely, if the history of unenacted bills does have evidentiary value, then the checkered life of Senate Bill 483 at best represents a legislative "wash."

Moreover, by according significance to a bill passed only by the Senate, the court ignored the bicameralism requirement of the California Constitution.<sup>274</sup> It is true that the bicameralism requirement is addressed only to the making of laws, not to legislative-intent analyses; but to afford credibility to one house of the Legislature at the expense of the other violates the spirit of the constitution.<sup>275</sup>

Satisfied that no one had noticed that the emperor had no clothes, the majority next side-stepped the fact that the Legislature had expressly modified section 790.03 in 1983 without disturbing subdivision (h) or the

anew, might be decided differently by the current justices." *Moradi-Shalal*, 46 Cal. 3d at 296, 758 P.2d at 62, 250 Cal. Rptr. at 121.

269. *Id.* at 300, 758 P.2d at 65, 250 Cal. Rptr. at 123.

270. *Moradi-Shalal*, 46 Cal. 3d at 300, 758 P.2d at 65, 250 Cal. Rptr. at 123-24.

271. Senate Bill 483 would have expressly eliminated civil liability under California Insurance Code section 790.03(h) and overruled *Royal Globe*. Cal. S.B. 483 (1979) (as amended).

272. *Moradi-Shalal*, 46 Cal. 3d at 300-01, 758 P.2d at 65-66, 250 Cal. Rptr. at 123-24.

273. *Id.* at 300, 758 P.2d at 66, 250 Cal. Rptr. at 124 (quoting *Dyna-Med, Inc. v. Fair Employment & Hous. Comm'n*, 43 Cal. 3d 1379, 1396, 743 P.2d 1323, 1333, 241 Cal. Rptr. 67, 76 (1987)).

274. CAL. CONST. art. IV, §§ 1, 8. Article IV, section 1 of the California Constitution states that "[t]he legislative power of this State is vested in the California Legislature which consists of the Senate and the Assembly." *Id.* § 1 (emphasis added). Article IV, section 8(b) states that "[t]he Legislature may make no law except by statute and may enact no statute except by bill. No bill may be passed unless . . . a majority of the membership of each house concurs." *Id.* § 8(b) (emphasis added).

275. *See id.* § 1.



*Royal Globe* holding.<sup>276</sup> The court deemed the Legislature's failure to mention *Royal Globe* "mere silence" and stated that *Cianci v. Superior Court*<sup>277</sup> forbade such silent acquiescence<sup>278</sup> from being "'elevated into a species of implied legislation'" which might prohibit review of *Royal Globe*.<sup>279</sup>

*Cianci* is patently distinguishable from *Moradi-Shalal*. In *Cianci*, the Legislature had not altered *any portion* of the statute in question after its most recent judicial interpretation<sup>280</sup>—truly "mere silence." In contrast, the Legislature *after Royal Globe* had fully reconsidered section 790.03, leaving subdivision (h) untouched.<sup>281</sup> To equate the situations in *Cianci* and *Moradi-Shalal* is to require the Legislature to expressly ratify judicial constructions of statutes to preserve those constructions as precedent.

Until *Moradi-Shalal*, the rule of interpretation was that if the Legislature failed to change the law in a specific area, when the general subject was before it and other changes were made, then the legislative intent was to leave the law as it was in the areas not amended.<sup>282</sup> This principle was firmly established in *Estate of Bannerjee*,<sup>283</sup> *Estate of McDill*,<sup>284</sup> *Bailey v. Superior Court*,<sup>285</sup> and *People v. Olsen*.<sup>286</sup> Justice Mosk, in his dissent, asserted that the majority's attempt to avoid these precedents "stands the concept of legislative intent on its head."<sup>287</sup> Under the

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276. *Moradi-Shalal*, 46 Cal. 3d at 300-01, 758 P.2d at 66, 250 Cal. Rptr. at 124.

277. 40 Cal. 3d 903, 710 P.2d 375, 221 Cal. Rptr. 575 (1985).

278. *Id.* at 923, 710 P.2d at 386, 221 Cal. Rptr. at 586.

279. *Moradi-Shalal*, 46 Cal. 3d at 301, 758 P.2d at 66, 250 Cal. Rptr. at 124 (quoting *Cianci v. Superior Court*, 40 Cal. 3d 903, 922-23, 710 P.2d 375, 386, 221 Cal. Rptr. 575, 586 (1985)).

280. *Cianci*, 40 Cal. 3d at 922-23, 710 P.2d at 386, 221 Cal. Rptr. at 585-86.

281. 1972 Cal. Stat., ch. 725, § 1, 1134 (codified at CAL. INS. CODE § 790.03(h) (West 1972 & Supp. 1989)).

282. *Estate of McDill*, 14 Cal. 3d 831, 837-38, 537 P.2d 874, 878, 122 Cal. Rptr. 754, 758 (1975).

283. 21 Cal. 3d 527, 537, 580 P.2d 657, 662-63, 147 Cal. Rptr. 157, 162-63 (1978) (assumption that Legislature amends statutes with present judicial interpretation in mind is generally accepted principle).

284. 14 Cal. 3d 831, 837-38, 537 P.2d 874, 878, 122 Cal. Rptr. 754, 758 (1975) (Legislature's change of general area of law without disturbing prior interpretation indicates intent to leave law as it stands).

285. 19 Cal. 3d 970, 977-78 n.10, 568 P.2d 394, 398 n.10, 140 Cal. Rptr. 669, 673 n.10 (1977) (failure to change law in specific area when general subject is reconsidered equivalent to legislative satisfaction with present state of law).

286. 36 Cal. 3d 638, 647 n.19, 685 P.2d 52, 57 n.19, 205 Cal. Rptr. 492, 497 n.19 (1984) (Legislature is assumed to be aware of existing law when passing a statute).

287. *Moradi-Shalal*, 46 Cal. 3d at 318, 758 P.2d at 78, 250 Cal. Rptr. at 136 (Mosk, J., dissenting).

*Moradi-Shalal* rule the Legislature is required to bestow on the courts a legislative “‘atta’ boy!” to uphold their statutory interpretation.

The court’s equivocal language in explaining the pertinent rules of interpreting legislative intent reflects its self-contradictory analysis. The court stated: “[T]he foregoing legislative history, although somewhat inconclusive, nonetheless casts considerable doubt upon the correctness of *Royal Globe*’s interpretation of legislative intent.”<sup>288</sup> It would be difficult to find a more evasive way of saying *we now disagree with our previous interpretation of legislative intent*.

*d. adverse consequences of Royal Globe*

The *Moradi-Shalal* court asserted that *Royal Globe* was having a substantial negative impact on society.<sup>289</sup> The court stated that the cost of handling insurance claims increased because of *Royal Globe*, and that the cost has been passed on to society through higher insurance premiums.<sup>290</sup> Even so, this cost must be balanced against *Royal Globe*’s benefits, which are not mentioned in the majority opinion. For example, *Royal Globe* actions offer claimants protection from blatantly unfair insurer conduct, thereby compensating for the unequal bargaining powers of the litigants.<sup>291</sup> Legal commentators early recognized the need to protect third-party claimants.<sup>292</sup> One commentator has stated: “Because the victim [of the insured’s negligence] has suffered a casualty loss adversely affecting his financial position and must negotiate with the insurer, he is often in need of protection from the insurer’s bad faith conduct.”<sup>293</sup>

It is recognized that insured first-party claimants can suffer real harm as a result of an insurer’s conduct.<sup>294</sup> Common sense dictates that

288. *Id.* at 301, 758 P.2d at 66, 250 Cal. Rptr. at 124.

289. *Id.* See *supra* notes 137-44 and accompanying text for a summary of the adverse effects the court saw as stemming from *Royal Globe*.

290. *Moradi-Shalal*, 46 Cal. 3d at 301-02, 758 P.2d at 66, 250 Cal. Rptr. at 124-25.

291. Comment, *Liability to Third Parties For Economic Injury: Privity as a Useful Animal, or a Blind Imitation of the Past*, 12 Sw. U.L. REV. 87, 120 (1981).

292. See, e.g., Comment, *A Statutory Action For Insurer Bad Faith*, *supra* note 256, at 952; Comment, *Extending the Insurer’s Duty of Good Faith and Fair Dealing to Third Parties Under Liability Insurance Policies*, 25 UCLA L. REV. 1413 (1978) [hereinafter Comment, *Extending the Insurer’s Duty*].

293. Comment, *Extending the Insurer’s Duty*, *supra* note 292, at 1416.

294. See *Silberg v. California Life Ins. Co.*, 11 Cal. 3d 452, 521 P.2d 1103, 113 Cal. Rptr. 711 (1974). In *Silberg*, the insurer’s unwarranted refusal to pay a claimant’s medical bills resulted in damage to the claimant’s credit reputation, a forced change of residence, repossession of the claimant’s wheelchair, the claimant’s inability to obtain pain medication and, ultimately, a nervous breakdown. *Id.* at 457-60, 521 P.2d at 1106-08, 113 Cal. Rptr. at 714-16.

such harm can also befall innocent third-party claimants.<sup>295</sup> Public policy should dictate that an insurer be held liable for all damages proximately caused by its bad faith dealings with claimants.<sup>296</sup>

The commentator most heavily relied upon by the *Moradi-Shalal* court,<sup>297</sup> a student, recognized no injury to claimants resulting from an insurer's conduct, stating that "the claimant cannot be harmed by the actions of the insurance company."<sup>298</sup> The rationale for this argument is that there is no privity of contract between the injured claimant and the insurer.<sup>299</sup> The commentator failed to recognize that privity is merely a label used to characterize certain legal relationships.<sup>300</sup> Whether parties are in privity has no bearing on the very real harm that can be inflicted on third parties by an insurer's bad faith. Consider the case of an automobile accident victim who is severely injured by an insured's negligence. The victim will often be placed in a precarious financial position if the insurer does not timely pay the victim's claim.<sup>301</sup> The victim could suffer damage to his or her credit reputation, emotional distress and have difficulty paying medical bills or even obtaining needed medical treatment.<sup>302</sup> Such injuries do not depend on the presence of privity.

Another benefit of *Royal Globe* that flows both to insureds and third-party claimants is that *Royal Globe* has forced insurers to actually investigate a claim before declining to either pay or negotiate a settlement.<sup>303</sup> Under *Royal Globe*, the insurer's attorneys and other claims management personnel must thoroughly investigate a claim and take only actions that are reasonably consistent with the results of that investigation.<sup>304</sup>

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295. See Comment, *Extending the Insurer's Duty*, *supra* note 292, at 1416. "[A]n insurer's obligation to pay on a liability policy is triggered by the insured's injuring a third party . . . . Because the victim has suffered a casualty loss adversely affecting his financial position and must negotiate with the insurer, he is often in need of protection from the insurer's bad faith conduct." *Id.*

296. Ryan, *The Bad Faith Blast*, 28 FOR THE DEF. 20, 22 (Mar. 1986).

297. Price, *supra* note 117.

298. *Id.* at 1176.

299. *Id.*

300. See *MacPherson v. Buick Motor Corp.*, 217 N.Y. 382, 385, 111 N.E. 1050, 1051 (1916).

301. See *supra* note 293 and accompanying text.

302. See *supra* note 294 and accompanying text.

303. Knepper, *Review of Recent Tort Trends*, 30 DEF. L. J. 1, 24 (1981).

304. In the words of one commentator:

In short, attorneys, claims managers, litigation supervisors and adjusters are now forced to get away from the old "gut" reaction or "smell" test in the handling of claims and suits. If the investigative report does not contain facts which constitute a reasonable basis for denial of a claim, the insurer will be compelled to proceed with the adjustment and settlement of the claim. Otherwise, the company may face the

Finally, the *Moradi-Shalal* court viewed as an "unfortunate consequence" that *Royal Globe* created a conflict of interest between an insurer's contractual duty to protect its insured's interest and the insurer's right to protect itself from statutory bad faith liability to claimants.<sup>305</sup> This "conflict of interest," however, can easily be eliminated by the insurer. By responsibly investigating claims and declining to pay or settle claims only where there exists a rational basis for doing so, the insurer both fulfills its contractual duty to its insured and avoids any grounds for bad faith liability.<sup>306</sup> Essentially, if an insurer does not violate the Unfair Practices Act, it cannot be liable to anyone.<sup>307</sup>

Moreover, under present law, this "conflict of interest" is illusory. In *Bogard v. Employers Casualty Co.*,<sup>308</sup> the court of appeal held that the insured has no cause of action against the insurer for breach of the implied covenant of good faith and fair dealing if the insurer settles a claim with a third party, even if the insurer did not adequately investigate the true value of the claim.<sup>309</sup> While it is possible that such a settlement might technically breach the contractual duty to defend, it would be a rare occasion where the interest of the insured lay in costly litigation rather than in the reasonable settlement counseled by the insurer.<sup>310</sup> Also, where such a conflict of interest does arise, the insurer's contractual duty to defend requires the insurer not only to inform the insured of the conflict,<sup>311</sup> but also to provide independent counsel who will protect the interests of the insured.<sup>312</sup> Thus, an insurer who is willing to reason-

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consequences of exposure far above and apart that underwritten by the policy of insurance.

Fanning, *Bad Faith and Other Extra-Contractual Actions Against Insurers*, 27 FOR THE DEF. 11, 17 (Nov. 1985).

305. *Moradi-Shalal*, 46 Cal. 3d at 302, 758 P.2d at 67, 250 Cal. Rptr. at 125.

306. Comment, *A Statutory Action For Insurer Bad Faith*, *supra* note 256, at 952-53.

307. This, of course, assumes that the jury will be objective and that the claimant will act with good faith during the settlement negotiations. This is not always the case. *See, e.g., White v. Western Title Ins. Co.*, 40 Cal. 3d 870, 900, 710 P.2d 309, 327, 221 Cal. Rptr. 509, 527 (1985) (Kaus, J., concurring and dissenting) (third-party claimants often attempt to trap insurers into committing bad faith violations).

308. 164 Cal. App. 3d 602, 210 Cal. Rptr. 578 (1985).

309. *Id.* at 615, 210 Cal. Rptr. at 586-87. The court did not hold that the insurer, under similar facts, would never face liability for breach of its contractual duty to defend. *Id.*

310. "Obviously, it will *always* be in the insured's interest to settle within the policy limits when there is *any* danger, however slight, of a judgment in excess of those limits." *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 430, 426 P.2d 173, 177, 58 Cal. Rptr. 13, 17 (1967) (emphasis added).

311. *Bogard*, 164 Cal. App. 3d at 611, 210 Cal. Rptr. at 584.

312. *See Tomerlin v. Canadian Indemnity Co.*, 61 Cal. 2d 638, 647-48, 394 P.2d 571, 574-77, 39 Cal. Rptr. 731, 736-37 (1964); *San Diego Navy Fed. Credit Union v. Cumis Ins. Co.*, 162 Cal. App. 3d 358, 371, 208 Cal. Rptr. 494, 503 (1984); *Purdy v. Pacific Auto. Ins. Co.*, 157

ably negotiate a settlement offer within the policy limits can avoid liability to its insured by informing the insured of the conflict and providing the insured with the required independent counsel.<sup>313</sup> The insurer can also avoid liability to the third-party claimant by notifying the claimant that it is no longer in charge of handling the claim.<sup>314</sup> Should the insured later be held liable, the insurer faces no extra-contractual liability. The insured, by insisting on defending the claim, has relieved the insurer both of its duty under *Crisci v. Security Insurance Co.*<sup>315</sup> to accept reasonable settlement offers<sup>316</sup> and its statutory duty to reasonably negotiate a settlement.<sup>317</sup>

It is also disingenuous to maintain, as the court seems to, that eliminating the *Royal Globe* cause of action will thereby eliminate this so-called conflict of interest. Assuming that the court is correct that the Insurance Commissioner has sufficient power to punish insurers that violate section 790.03(h) and further assuming that the Commissioner would use the power,<sup>318</sup> the "conflict of interest" remains: The remedial mechanism changes but the parties' relationships and interests do not.

*e. unanswered questions and analytical difficulties*

The only complaint the *Moradi-Shalal* court leveled against *Royal Globe* that is supported by case law is that *Royal Globe* raised more questions than it answered.<sup>319</sup> Indeed, as the majority observed, several *Royal Globe* actions were then awaiting supreme court review.<sup>320</sup>

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Cal. App. 3d 59, 76, 203 Cal. Rptr. 524, 533-34 (1984); see also CAL. CIV. CODE § 2860 (West Supp. 1989).

313. See *Tomerlin*, 61 Cal. 2d at 647-48, 394 P.2d at 574-77, 39 Cal. Rptr. at 736-37; *Cumis*, 162 Cal. App. 3d at 371, 208 Cal. Rptr. at 503; *Purdy*, 157 Cal. App. 3d at 76, 203 Cal. Rptr. at 533-34. Most indemnity insurance contracts give control over the decision to settle to the insurer. W. SHERNOFF, S. GAGE & H. LEVINE, *supra* note 17, §§ 3.01, 3.23[1]. In such cases, the insurer may also be required to assign this power of settlement within the policy limits to the insured in order to avoid bad faith liability. It must be remembered that the situation is one where the insurer wishes to settle within the policy limits, but the insured insists on a defense of the claim.

314. Comment, *A Statutory Action For Insurer Bad Faith*, *supra* note 256, at 965.

315. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

316. *Id.* at 430, 426 P.2d 176-77, 58 Cal. Rptr. at 16-17.

317. CAL. INS. CODE § 790.03(h)(5) (West 1972 & Supp. 1989).

318. See *supra* note 159 and accompanying text for a discussion of the court's reasons for not assuming that the Insurance Commissioner would not enforce section 790.03. In his dissent, Justice Mosk noted that in the 29 years since the Unfair Practices Act was added to the Insurance Code there is not one reported case of the Insurance Commissioner disciplining an insurer for its unfair or deceptive acts against a claimant. *Moradi-Shalal*, 46 Cal. 3d at 317, 758 P.2d at 77, 250 Cal. Rptr. at 135 (Mosk, J., dissenting).

319. *Id.* at 303, 758 P.2d at 67, 250 Cal. Rptr. at 125.

320. *Id.*

The analytical difficulties cited by the court, however, are not insurmountable. Ironically, the majority eliminated one of these difficulties by concluding that a final judicial determination of the insured's liability must be obtained before a *Royal Globe* action may be brought against the insurer.<sup>321</sup> The rest of these difficulties could just as easily be resolved, were the court willing to do so.

The court asserted that the primary analytical difficulty with *Royal Globe* was its failure to formulate a standard of liability for bad faith refusal to settle with a third party.<sup>322</sup> Under section 790.03(h)(5), if there is no rational basis for refusing a claim, the insurer who refuses to reasonably negotiate with a claimant would be liable for bad faith. Contrary to the court's assertion,<sup>323</sup> section 790.03's plain language does not require an insurer to actually settle. In relevant part, section 790.03 provides that an insurer must "attempt[ ] in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear."<sup>324</sup> Furthermore, before an insurer can be held liable under section 790.03, a plaintiff must prove that the insurer knowingly failed to attempt to negotiate.<sup>325</sup> A reasonableness test would, therefore, work quite well. The standard of liability should be no more complicated than: *Whether a reasonable insurer would knowingly refuse to attempt in good faith to negotiate a settlement of the claim?*

Insurers could not complain that this standard would be unprecedented. Insurers have been held to a reasonableness standard under common-law first-party actions for bad faith failure to settle a claim.<sup>326</sup> This rule, established in *Comunale v. Traders & General Insurance Co.*<sup>327</sup> and reaffirmed in *Crisci v. Security Insurance Co.*,<sup>328</sup> binds insurers, under the implied covenant of good faith and fair dealing, to act reasonably in the investigation and handling of claims.<sup>329</sup>

The court also cited as an "analytical difficulty" the issue of whether to allow punitive damages and excessive awards to claimants who suffered only minor damage as a result of insurer bad faith or against insurer-

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321. *Id.* at 313, 758 P.2d at 74-75, 250 Cal. Rptr. at 133. See *supra* notes 166-99 and accompanying text.

322. *Moradi-Shalal*, 46 Cal. 3d at 303, 758 P.2d at 67, 250 Cal. Rptr. at 125.

323. *Id.* at 302, 758 P.2d at 67, 250 Cal. Rptr. at 125.

324. CAL. INS. CODE § 790.03(h)(5) (West 1972 & Supp. 1989).

325. *Id.* § 790.03(h).

326. See, e.g., *Crisci*, 66 Cal. 2d at 430, 426 P.2d at 176-77, 58 Cal. Rptr. at 16-17; *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958).

327. 50 Cal. 2d 654, 328 P.2d 198 (1958).

328. 66 Cal. 2d 425, 426 P.2d 173, 132 Cal. Rptr. 424 (1976).

329. See *supra* notes 8-24 and accompanying text for a discussion of the implied covenant of good faith and fair dealing.

ers who only negligently violated section 790.03(h).<sup>330</sup> The problem could easily have been resolved through applying existing law.<sup>331</sup> For punitive damages to be awarded, California Civil Code section 3294 requires that a plaintiff prove a defendant's fraud, oppression or malice with clear and convincing evidence, and that the defendant act in "conscious disregard" of a person's rights.<sup>332</sup> Applying these requirements in *Royal Globe* actions based on an insurer's negligent violation of section 790.03(h)<sup>333</sup> would have resulted in no award of punitive damages unless the insurer acted with "conscious disregard."<sup>334</sup> Thus, insurers would have been subject to the same damages that firms in any other industry would be bound to pay should their actions cause injury to someone.<sup>335</sup>

Based on this simple resolution of two of the "analytical difficulties" created by *Royal Globe*,<sup>336</sup> it is apparent that the *Moradi-Shalal* court could have attempted to resolve these difficulties. Instead, the majority found "[r]econsideration of [*Royal Globe*] a far better alternative than allowing ourselves to be swept deeper into the developing interpretive whirlpool it has created."<sup>337</sup>

Overruling *Royal Globe* is arguably efficient and will undoubtedly result in a less crowded supreme court docket. The court, however, sidestepped its primary duty to settle disputes when there is no easy, mutually agreeable answer. As Justice Mosk pointedly accused:

Instead of concentrating on the issues raised and argued throughout these and other pending proceedings, the majority have chosen to avoid fundamental answers by permanently eliminating the question. In most cases, of course, it would make our task relatively uncomplicated if we could evade interpreting the law with finality by simply changing the law. On the other hand, making our job easier is no justification for totally destroying a cause of action.<sup>338</sup>

The court had an opportunity to clarify several of *Royal Globe*'s analytical difficulties and to make *Royal Globe* a more workable precedent; it chose not to.

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330. *Moradi-Shalal*, 46 Cal. 3d at 302, 758 P.2d at 67, 250 Cal. Rptr. at 125.

331. Kornblum, *Punitive Damage Awards Against Insurers: Is This the Era of Abuse of the Remedy*, 13 BRIEF 9 (Fall 1984).

332. CAL. CIV. CODE § 3294 (West 1972 & Supp. 1989).

333. CAL. INS. CODE § 790.03(h) (West 1972 & Supp. 1989).

334. CAL. CIV. CODE § 3294.

335. Kornblum, *supra* note 331, at 10.

336. *Moradi-Shalal*, 46 Cal. 3d at 303, 758 P.2d at 67, 250 Cal. Rptr. at 125.

337. *Id.* at 304, 758 P.2d at 68, 250 Cal. Rptr. at 126.

338. *Id.* at 314, 758 P.2d at 75, 250 Cal. Rptr. at 133 (Mosk, J., dissenting).

The judicial effort in clarifying the parameters of the common-law tort/contract action against insurers for breach of the covenant of good faith and fair dealing is an example of the court fulfilling its duty and making a new precedent workable. After the tort's creation in *Comunale v. Traders & General Insurance Co.*,<sup>339</sup> the courts went on to clarify many of the duties and analytical difficulties that attended this new cause of action. In *Crisci v. Security Insurance Co.*,<sup>340</sup> the court determined that damages for emotional distress could be recovered if they were the proximate result of the insurer's bad faith failure to accept a reasonable settlement offer within the policy limits.<sup>341</sup> Other difficult issues, similar to those cited by the *Moradi-Shalal* majority as being too difficult to resolve,<sup>342</sup> were likewise resolved by the courts. Among these were the issues of punitive damages,<sup>343</sup> attorney's fees,<sup>344</sup> liability for the actions of individual employees,<sup>345</sup> the effect of an insurer's good faith in denying coverage,<sup>346</sup> actions for contribution,<sup>347</sup> the effect of an insured's insol-

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339. 50 Cal. 2d 654, 328 P.2d 198 (1958).

340. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

341. *Id.* at 433-34, 426 P.2d at 177, 58 Cal. Rptr. at 18-19.

342. *See supra* notes 145-55 and accompanying text.

343. *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 819-20, 598 P.2d 452, 457-58, 157 Cal. Rptr. 482, 487 (1979) (punitive and exemplary damages awards held appropriate in common-law bad faith cases); *Neal v. Farmers Ins. Exch.*, 21 Cal. 3d 910, 922, 582 P.2d 980, 986, 148 Cal. Rptr. 389, 395 (1975) (finding of insurer bad faith does not warrant punitive damages absent showing of requisite intent); *Chodos v. Insurance Co. of N. A.*, 126 Cal. App. 3d 86, 104, 178 Cal. Rptr. 831, 841 (1981) (sustaining award of \$200,000 where compensatory and emotional distress damages totalled \$5,146.71).

344. *Brandt v. Superior Court*, 37 Cal. 3d 813, 819, 693 P.2d 796, 800, 210 Cal. Rptr. 211, 215 (1985) (attorney's fees recoverable as damages in bad faith action may not exceed amount attributable to attorney's efforts to obtain amount due under insurance contract); *Twentieth Century-Fox Film Corp. v. Harbor Ins. Co.*, 85 Cal. App. 3d 105, 112-14, 149 Cal. Rptr. 313, 318-19 (1978) (attorney's fees incurred prosecuting bad faith action against insurer not recoverable); *Mustachio v. Ohio Farmers Ins. Co.*, 44 Cal. App. 3d 358, 361-64, 366, 118 Cal. Rptr. 581, 582-84, 586 (1975) (California Civil Code section 3333 authorizes recovery from insurer of attorney's fees incurred in reaching settlement after insurer's breach of covenant of good faith and fair dealing).

345. *Egan*, 24 Cal. 3d at 821-24, 598 P.2d at 458-59, 157 Cal. Rptr. at 488-90 (actions of employees exercising broad discretion in handling claims can give rise to bad faith claim for punitive damages against insurer). *But see* CAL. CIV. CODE § 3294(b) (West 1972 & Supp. 1989) (employer not liable for punitive damages for acts of employees unless employer had advance notice of employee's unfitness or employer had either authorized or ratified wrongful conduct).

346. *Johansen v. California State Auto. Ass'n Inter-Ins. Bureau*, 15 Cal. 3d 9, 19, 538 P.2d 744, 748, 123 Cal. Rptr. 288, 294-95 (1975) (insurer liable for amount of judgment against insured regardless of insurer's good faith belief that there was no coverage of claim).

347. *Chicken Delight of Cal., Inc. v. State Farm Mut. Auto. Ins. Co.*, 35 Cal. App. 3d 841, 848, 111 Cal. Rptr. 79, 83 (1973) (contributor to settlement who is not party to insurance contract may not sue insurer for bad faith failure to defend action).



veny,<sup>348</sup> the effect of a third party's approval of a settlement offer being required,<sup>349</sup> defining the availability of emotional distress damages,<sup>350</sup> subrogation<sup>351</sup> and the conflict of interest between the insurer and the insured.<sup>352</sup>

The courts' ability to make *Comunale* and *Crisci* workable law is positive proof that there are very few analytical problems that cannot be overcome by a diligent judiciary. Thus, the so-called analytical difficulties in *Royal Globe*, the only documented adverse effect of *Royal Globe* cited by the *Moradi-Shalal* court,<sup>353</sup> comprise no more substantial an argument for overturning *Royal Globe* than any of the other unsubstantiated contentions of the majority. It is painfully obvious that the *Moradi-Shalal* court first decided to overrule *Royal Globe* and then attempted to marshal evidence to support its decision.

## 2. Judicial determination of the insured's liability as a prerequisite for bringing a *Royal Globe* action

The majority expended considerable ink<sup>354</sup> explaining its ruling that *Royal Globe* requires a claimant to first receive a liability judgment against the insured before bringing a statutory bad faith action against the insurer.<sup>355</sup> The court offered several policy arguments for its hold-

348. *Shapero v. Allstate Ins. Co.*, 14 Cal. App. 3d 433, 438, 92 Cal. Rptr. 244, 247-48 (1971) (insolvent estate held unable to sue insurer for bad faith failure to settle within policy limits if there are no assets or financial interests to be harmed by excess judgment).

349. *Coe v. State Farm Mut. Auto. Ins. Co.*, 66 Cal. App. 3d 981, 990-92, 136 Cal. Rptr. 331, 335-37 (1977) (settlement offers made without approval of necessary third party are ineffective, and insurer's refusal cannot give rise to a bad faith claim by insured).

350. *Bogard*, 164 Cal. App. 3d at 617, 210 Cal. Rptr. at 587-88 (insurer's disclaiming any duty to represent insured's interests at crucial stage of underlying action is "outrageous" conduct warranting award of emotional distress damages in bad faith action against the insurer); *Richardson v. Employers Liab. Assurance Corp.*, 25 Cal. App. 3d 232, 241, 102 Cal. Rptr. 547, 553 (1972) (defining what constitutes sufficient evidence to support recovery for emotional distress in a *Crisci* action).

351. *Commercial Union Assurance Cos. v. Safeway Stores, Inc.*, 26 Cal. 3d 912, 917-18, 610 P.2d 1038, 1041, 164 Cal. Rptr. 709, 712 (1980) (duty owed excess liability insurer by primary insurer is identical to that owed insured).

352. *Bogard*, 164 Cal. App. 3d at 611, 210 Cal. Rptr. at 583-84 (once conflict arises, insurer may not compel insured to surrender control of litigation). *Accord Purdy*, 157 Cal. App. 3d at 76, 203 Cal. Rptr. at 533-34; *Cumis*, 162 Cal. App. 3d at 371, 208 Cal. Rptr. at 503.

353. *Moradi-Shalal*, 46 Cal. 3d at 303-04, 758 P.2d at 67-68, 250 Cal. Rptr. at 125-26.

354. The majority opinion is twenty-one pages long. Eight of these pages are devoted solely to the requirement of a prior judicial determination of the insured's liability in pending *Royal Globe* cases. *Moradi-Shalal*, 46 Cal. 3d at 305-13, 758 P.2d at 69-75, 250 Cal. Rptr. at 127-33. Justice Mosk's dissent is eight pages long. *Id.* at 313-21, 758 P.2d at 75-80, 250 Cal. Rptr. at 133-38 (Mosk, J., dissenting).

355. *Id.* at 305-13, 758 P.2d at 69-75, 250 Cal. Rptr. at 127-33.

ing.<sup>356</sup> But the main pillar on which the court rested its ruling was a line of California Court of Appeal cases that interpret *Royal Globe* as requiring as a prerequisite a final judicial determination of the insured's liability.<sup>357</sup> This line of cases began with *Doser v. Middlesex Mutual Insurance Co.*,<sup>358</sup> in which the court held that *Royal Globe* required a determination of the insured's liability as a condition precedent to a *Royal Globe* action against the insurer.<sup>359</sup> *Nationwide Insurance Co. v. Superior Court*,<sup>360</sup> *Williams v. Transport Indemnity Co.*,<sup>361</sup> and *Heninger v. Foremost Insurance Co.*<sup>362</sup> all followed *Doser*. The *Moradi-Shalal* majority held that these cases correctly interpreted *Royal Globe*.<sup>363</sup>

Careful examination, however, reveals a basic flaw in the reasoning of those cases which undermines their interpretation of *Royal Globe*. The *Doser* court interpreted *Royal Globe* to require a judgment of the insured's liability as a prerequisite to a third-party *Royal Globe* action based on the following quotation from *Royal Globe*: "[T]he third party suit may not be brought until the action between the injured party and

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356. *Id.* at 311-12, 758 P.2d at 73-74, 250 Cal. Rptr. at 131-32. First, the court asserted that the need to prove the insured's liability during the *Royal Globe* action against the insured was prejudicial to the insurer on the grounds that the existence of an insurance policy would be known to the jury. *Id.* at 311, 758 P.2d at 73-74, 250 Cal. Rptr. at 131-32. The court held this as being in conflict with Evidence Code section 1155, which forbids introducing "[e]vidence that a person was, at the time a harm was suffered by another, insured wholly or partially against loss arising from liability for that harm . . . to prove negligence or wrongdoing." *Id.* (quoting CAL. EVID. CODE § 1155 (West 1966)). The court further viewed the jury's knowledge that the defendant in a *Royal Globe* action is an insurer and that insurance was an integral part of the case as prejudicing the determination of the liability of the insured. *Id.*

Second, the court saw the introduction of evidence of a settlement between the insured and the claimant as also being prejudicial to the insurer. *Id.* However, Evidence Code section 1152 prohibits the admission of a settlement into evidence to prove the settling party's liability. CAL. EVID. CODE § 1152 (West 1966 & Supp. 1989). Thus, this prejudice will never occur and is therefore illusory.

Third, the court reasoned that allowing a suit against an insurer after a settlement would rob the settling parties of the advantage of settlement by forcing them to litigate the very claim they had sought to avoid. *Moradi-Shalal*, 46 Cal. 3d at 312, 758 P.2d at 74, 250 Cal. Rptr. at 132. The court actually viewed such a post-settlement suit as a penalty against the insured, who has already paid a settlement, and a windfall to the claimant, who received that settlement. *Id.* The court ignored the possibility that the claimant may have suffered significant injuries as a result of the insurer's bad faith. It is entirely likely that the insurer's bad faith refusal to settle has forced the claimant to accept a settlement far below its actual worth. To insulate insurers from bad faith liability merely because a claimant has accepted a settlement for his claim against an insured is to allow insurers to retain the fruits of their bad faith acts.

357. *Id.* at 306-09, 758 P.2d at 70-72, 250 Cal. Rptr. at 128-30.

358. 101 Cal. App. 3d 883, 162 Cal. Rptr. 115 (1980).

359. *Id.* at 891, 162 Cal. Rptr. at 120.

360. 128 Cal. App. 3d 711, 180 Cal. Rptr. 464 (1982).

361. 157 Cal. App. 3d 957, 203 Cal. Rptr. 868 (1984).

362. 175 Cal. App. 3d 830, 221 Cal. Rptr. 303 (1985).

363. *Moradi-Shalal*, 46 Cal. 3d at 308, 758 P.2d at 71, 250 Cal. Rptr. at 129.

the insured is concluded . . . [and] the liability of the insured is first determined . . . ."<sup>364</sup> This quotation is entirely misleading as to the actual contents of the *Royal Globe* opinion because the ellipses represents a seven page gap.<sup>365</sup> Such a flagrant misrepresentation of the contents of an opinion should not serve as the foundation for legitimate interpretation. Thus, *Doser* and its progeny are a hastily constructed house of cards, and cannot legitimately support the *Moradi-Shalal* holding.

The California Supreme Court itself said in *Coleman v. Gulf Insurance Co.*,<sup>366</sup> "[t]he more plausible interpretation of [section 790.03], subdivision (h)(5) is that the provision was intended to apply only to prejudgment conduct."<sup>367</sup> This focus on the insurer's prejudgment conduct, together with *Royal Globe's* purpose of curtailing unfair practices and encouraging fair settlements, leads to the conclusion that no prior judgment against the insured ought to be required of an injured claimant as a condition for bringing a *Royal Globe* suit.<sup>368</sup>

*Rodriguez v. Fireman's Fund Insurance Co.*<sup>369</sup> recognized the "possibility of abuse by insurance companies who might entice a settlement by unfair practices, [and] then seek to hide behind the cloak of that settlement."<sup>370</sup> For example, assume that an insurer advises a claimant not to obtain the services of an attorney (a violation of section 790.03(h)(14))<sup>371</sup> and subsequently misleads the claimant as to the applicable statute of limitations (a violation of section 790.03(h)(15)).<sup>372</sup> As a direct result of the insurer's violations of the Unfair Practices Act, the claimant has lost its entire cause of action against the insured and will be unable even to negotiate a settlement, let alone obtain the necessary judicial determination of the insured's liability. Under this set of facts the insurer is actually rewarded for its violations of section 790.03.<sup>373</sup> The

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364. *Doser*, 101 Cal. App. 3d at 891, 162 Cal. Rptr. at 120 (quoting *Royal Globe Ins. Co. v. Superior Court*, 23 Cal. 3d 880, 884, 892, 592 P.2d 329, 332, 337, 153 Cal. Rptr. 842, 845, 850 (1979)).

365. See *Royal Globe Ins. Co. v. Superior Court*, 23 Cal. 3d 880, 592 P.2d 329, 153 Cal. Rptr. 842 (1979). The seven page gap represents the complete text of the *Royal Globe* opinion excluding the statement of facts. *Id.* at 884-92, 592 P.2d at 332-37, 153 Cal. Rptr. at 845-50.

366. 41 Cal. 3d 782, 718 P.2d 77, 226 Cal. Rptr. 90 (1986).

367. *Id.* at 796-97, 718 P.2d at 85, 226 Cal. Rptr. at 98-99.

368. Abeltin & Aitken, *supra* note 256, at 67.

369. 142 Cal. App. 3d 46, 190 Cal. Rptr. 705 (1983).

370. *Id.* at 56, 190 Cal. Rptr. at 711.

371. CAL. INS. CODE § 790.03(h)(14) (West 1972 & Supp. 1989).

372. *Id.* § 790.03(h)(15).

373. Another danger is that in violating the Unfair Practices Act, an insurer will most likely compel much lower settlements than they would normally pay for a particular claim. Since this illegally reached settlement shields the insurer from any liability for its actions, the *Moradi-Shalal* court's ruling actually encourages insurers to violate the Unfair Practices Act.

majority's requirement of a prior judicial determination of the insured's liability actually encourages insurers to make certain that their unfair practices result in a settlement, thereby barring *any* liability for the violations. Thus, to permit *Royal Globe* actions after settlement is the only way to protect claimants who are forced to accept a minimal settlement as a result of an insurer's bad faith and still encourage the equitable settlement of claims.

### 3. Stare decisis

The *Moradi-Shalal* court legitimized its review of *Royal Globe* by first paying homage to the doctrine of stare decisis.<sup>374</sup> The majority presented a survey of cases that support the reconsideration of precedent "when subsequent developments indicate an earlier decision was unsound, or has become ripe for reconsideration."<sup>375</sup> The court then found *Royal Globe* and developments subsequent to it to fit within this view.<sup>376</sup>

However, a reading of the two cases principally relied upon by the *Moradi-Shalal* majority reveals that the court stretched them to the breaking point. The court cited *People v. Anderson*<sup>377</sup> as demonstrating how subsequent circumstances can require review of an earlier case.<sup>378</sup> The *Anderson* court had reviewed and ultimately overruled *Carlos v. Superior Court*,<sup>379</sup> a California death penalty case, due to interim changes in federal law.<sup>380</sup>

The subsequent changes in federal law that necessitated review of *Carlos* were two cases decided by the Supreme Court of the United States, *Cabana v. Bullock*<sup>381</sup> and *Tison v. Arizona*,<sup>382</sup> which flatly contra-

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Of course, the injured claimant is free to complain to the Insurance Commissioner. See *supra* notes 207-08 and accompanying text to ascertain the likelihood of success using this method.

374. *Moradi-Shalal*, 46 Cal. 3d at 296, 758 P.2d at 62, 250 Cal. Rptr. at 121. The court stated the "fundamental jurisprudential policy [is] that prior applicable precedent usually must be followed even though the case, if considered anew, might be decided differently by the current justices." *Id.* As mentioned above, the court was more than willing to violate this "fundamental jurisprudential policy" in its discussion of "additional legislative history." See *supra* notes 261-69 and accompanying text.

375. *Moradi-Shalal*, 46 Cal. 3d at 297, 758 P.2d at 63, 250 Cal. Rptr. at 121 (citing *People v. Anderson*, 43 Cal. 3d 1104, 1138-41, 742 P.2d 1306, 1331, 240 Cal. Rptr. 585, 604-06 (1987)).

376. *Id.* at 297, 758 P.2d at 63, 250 Cal. Rptr. at 121.

377. 43 Cal. 3d 1104, 742 P.2d 1306, 240 Cal. Rptr. 585 (1987).

378. *Moradi-Shalal*, 46 Cal. 3d at 297, 758 P.2d at 63, 250 Cal. Rptr. at 121.

379. 35 Cal. 3d 131, 672 P.2d 862, 197 Cal. Rptr. 79 (1983) (requiring intent to kill in order for a defendant convicted of felony murder to receive the death penalty).

380. *Anderson*, 43 Cal. 3d at 1147, 742 P.2d at 1331, 240 Cal. Rptr. at 611.

381. 474 U.S. 376 (1986).

382. 481 U.S. 137 (1987).

dicted *Carlos*' interpretation of the Eighth Amendment. Undoubtedly, such a profound subsequent change in constitutional law justifies review of prior opinions that contradict present law. But to equate the mythical and inconclusive developments which the court insisted followed *Royal Globe* with a pair of directly relevant, dispositive United States Supreme Court opinions is to engage in gross exaggeration.<sup>383</sup>

The *Moradi-Shalal* majority cited *Cianci v. Superior Court*<sup>384</sup> for the proposition that stare decisis ought not prevent correction of judicial blunders,<sup>385</sup> and that scholarly criticism justifies reviewing prior decisions " 'to determine [their] continuing viability.' " <sup>386</sup> *Cianci* overruled *Willis v. Santa Ana Community Hospital Association*<sup>387</sup> by holding that the medical profession is within the purview of California's antitrust statute, the Cartwright Act.<sup>388</sup>

Again there is a great disparity between the quantity and quality of developments supporting the court's review of prior precedent in *Cianci* and that which occurred prior to *Moradi-Shalal*. In *Cianci*, two prior California Supreme Court opinions had implicitly contradicted *Willis* by giving the Cartwright Act broad application in similar areas.<sup>389</sup> Also, there was a change in federal law that encouraged a reexamination of *Willis*' narrow reading of the Cartwright Act.<sup>390</sup> In *Goldfarb v. Virginia State Bar*,<sup>391</sup> the Supreme Court of the United States interpreted the Sherman Antitrust Act to include professions.<sup>392</sup> This change directly affected the interpretation of the Cartwright Act, because the Cartwright Act had intended to go beyond the Sherman Act in its regulation of trade practices.<sup>393</sup>

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383. As demonstrated above, few if any of the subsequent developments listed by the *Moradi-Shalal* court withstand close scrutiny. See *supra* notes 225-353 and accompanying text.

384. 40 Cal. 3d 903, 710 P.2d 375, 221 Cal. Rptr. 575 (1985).

385. *Moradi-Shalal*, 46 Cal. 3d at 296, 758 P.2d at 63, 250 Cal. Rptr. at 121 (citing *Cianci v. Superior Court*, 40 Cal. 3d 903, 924, 710 P.2d 375, 387, 221 Cal. Rptr. 575, 587 (1985)).

386. *Id.* at 299, 758 P.2d at 65, 250 Cal. Rptr. at 123 (quoting *Cianci v. Superior Court*, 40 Cal. 3d 903, 921, 710 P.2d 375, 385, 221 Cal. Rptr. 575, 585 (1985)).

387. 58 Cal. 2d 806, 376 P.2d 568, 26 Cal. Rptr. 640 (1962).

388. *Cianci*, 40 Cal. 3d at 924-25, 710 P.2d at 387-88, 221 Cal. Rptr. at 587; see CAL. BUS. & PROF. CODE §§ 16700-17101 (West 1987 & Supp. 1989).

389. See *Speegle v. Board of Fire Underwriters*, 29 Cal. 2d 34, 43-45, 172 P.2d 867, 873-74 (1946) (Cartwright Act protects against restraint of insurance trade); *Marin County Bd. of Realtors v. Palsson*, 16 Cal. 3d 920, 928, 549 P.2d 833, 835-36, 130 Cal. Rptr. 1, 5 (1976) (Cartwright Act applies to service industries).

390. *Cianci*, 40 Cal. 3d at 920, 710 P.2d at 384, 221 Cal. Rptr. at 584.

391. 421 U.S. 773 (1975).

392. *Id.* at 787.

393. *Cianci*, 40 Cal. 3d at 920, 710 P.2d at 384, 221 Cal. Rptr. at 584.

As for the assertion that *Cianci* supports review of precedent met with scholarly criticism, the *Cianci* court merely mentioned in a single sentence the existence of commentary critical of the *Willis* decision.<sup>394</sup> Such fleeting language hardly supports the *Moradi-Shalal* court's basing a substantial portion of its "irrefutable" argument that *Royal Globe* should be overruled on the existence of negative legal commentary.<sup>395</sup>

By insisting that the developments following *Royal Globe* fit within the *Anderson* and *Cianci* holdings, the *Moradi-Shalal* court ignored the heart of the doctrine of stare decisis. Under *Moradi-Shalal*, to obtain review of a particular precedent a party need only show that some legal commentators did not agree with the court's reasoning or feel that a particular precedent is no longer viable,<sup>396</sup> and that the decision is rumored to have resulted in some non-verifiable difficulties.<sup>397</sup> This highly discretionary standard is fundamentally inconsistent with the "assumption that certainty, predictability and stability in the law are the major objectives of the legal system," which allows parties to "regulate their conduct and enter into relationships with reasonable assurance of the governing rules of law."<sup>398</sup>

#### VI. IMPLICATIONS OF *MORADI-SHALAL V. FIREMAN'S FUND INSURANCE COMPANIES*

The majority in *Moradi-Shalal v. Fireman's Fund Insurance Cos.*<sup>399</sup> maintained that its holding is confined to overruling *Royal Globe Insurance Co. v. Superior Court's*<sup>400</sup> interpretation of Insurance Code sections 790.03<sup>401</sup> and 790.09;<sup>402</sup> that is, that the sections do not confer on third-party claimants a private cause of action against insurers.<sup>403</sup> Even so, the majority's holding and means of reaching it will have several immediate and possibly long-range effects upon society and California law.<sup>404</sup>

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394. *Id.* at 921, 710 P.2d at 385, 221 Cal. Rptr. at 585.

395. *Moradi-Shalal*, 46 Cal. 3d at 304, 758 P.2d at 68, 250 Cal. Rptr. at 126.

396. *Id.* at 296-97, 758 P.2d at 62-63, 250 Cal. Rptr. at 121. See *supra* notes 250-60 and accompanying text for a discussion of the *Moradi-Shalal* court's use of critical legal commentary.

397. *Moradi-Shalal*, 46 Cal. 3d at 296-97, 758 P.2d at 62-63, 250 Cal. Rptr. at 121. See *supra* notes 289-353 and accompanying text for a discussion of the *Moradi-Shalal* court's use of subsequent developments and analytical difficulties.

398. *Moradi-Shalal*, 46 Cal. 3d at 296, 758 P.2d at 62-63, 250 Cal. Rptr. at 121 (quoting 9 WITKIN, CAL. PROCEDURE, *Appeal* § 758, at 726 (3d ed. 1985)).

399. 46 Cal. 3d 287, 758 P.2d 58, 250 Cal. Rptr. 116 (1988).

400. 23 Cal. 3d 880, 592 P.2d 329, 153 Cal. Rptr. 842 (1979).

401. CAL. INS. CODE § 790.03 (West 1972 & Supp. 1989).

402. CAL. INS. CODE § 790.09 (West 1972).

403. *Moradi-Shalal*, 46 Cal. 3d at 304-05, 758 P.2d at 68-69, 250 Cal. Rptr. at 126-27.

404. The most immediate effect of *Moradi-Shalal* is that it implicitly overrules *Homestead*

First, third-party claimants' only recourse is to complain to the Insurance Commissioner.<sup>405</sup> It is doubtful that individuals who suffer significant harm at the hands of an insurer will regard this as adequate relief. The Insurance Commissioner has no power to order damages be paid over to claimants.<sup>406</sup> Thus, in a situation where a claimant suffers significant financial injury due to the insurer's bad faith, the Insurance Commissioner cannot provide adequate relief.<sup>407</sup>

The adequacy of the administrative remedy was further crippled by the *Moradi-Shalal* court's ruling that an insurer may be held to have violated the Unfair Practices Act<sup>408</sup> only if the violation is committed "knowingly" and "with such frequency as to indicate a general business practice."<sup>409</sup> Thus, third-party claimants may not even claim administrative relief against insurers for negligent or even reckless violations of the Insurance Code during the claims settlement process.<sup>410</sup> Moreover, even intentional violations are beyond the jurisdiction of the Insurance

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Supplies, Inc. v. Executive Life Ins. Co., 81 Cal. App. 3d 978, 147 Cal. Rptr. 22 (1978), *Sherhoff v. Superior Court*, 44 Cal. App. 3d 406, 118 Cal. Rptr. 680 (1975), and *Greenberg v. Equitable Life Assurance Soc'y*, 34 Cal. App. 3d 994, 110 Cal. Rptr. 470 (1973). These three cases preceded *Royal Globe* and held that section 790.09 provides a private right of action. See *supra* notes 49-64 and accompanying text for a discussion of the *Greenberg* and *Sherhoff* opinions. Justice Mosk, in his dissent, assumed that these cases were now overruled and accused the majority of being "curiously silent about it." *Moradi-Shalal*, 46 Cal. 3d at 320, 758 P.2d at 79, 250 Cal. Rptr. at 137 (Mosk, J., dissenting).

The demise of *Greenberg* is particularly distressing. In *Chicago Title Ins. Co. v. Great W. Fin. Corp.*, 69 Cal. 2d 305, 444 P.2d 481, 70 Cal. Rptr. 849 (1968), the California Supreme Court held that both California's antitrust "statutes and the common law . . . are now expressly superseded and contravened by [section 790.03] of the Insurance Code." *Id.* at 322, 444 P.2d at 492, 70 Cal. Rptr. at 860. The *Greenberg* court held that a private litigant may sue an insurer who violates section 790.03 by restraining trade. *Greenberg*, 34 Cal. App. 3d at 1001, 110 Cal. Rptr. at 475. Thus, by implicitly overruling *Greenberg*, the *Moradi-Shalal* court has left consumers with no avenue of redress for damages caused by an insurer's restraint of trade.

405. CAL. INS. CODE § 790.04 (West 1972).

406. The Insurance Commissioner is empowered only to issue cease-and-desist orders, issue injunctions to restrain illegal conduct, invoke fines and penalties and suspend licenses for one year. *Greenberg*, 34 Cal. App. 3d at 1001, 110 Cal. Rptr. at 475; see also CAL. INS. CODE §§ 790.05-.07 (West 1972).

407. See *Silberg v. California Life Ins. Co.*, 11 Cal. 3d 452, 521 P.2d 1103, 113 Cal. Rptr. 711 (1974). See *supra* note 293 for a discussion of *Silberg* and the harm suffered by the plaintiff claimant as a result of the insurer's bad faith during the claim settlement process. There is no way a cease-and-desist order or an injunction against future conduct could make the plaintiff in *Silberg* whole.

408. CAL. INS. CODE §§ 790-790.10 (West 1972 & Supp. 1989).

409. *Moradi-Shalal*, 46 Cal. 3d at 303, 758 P.2d at 67-68, 250 Cal. Rptr. at 126 (quoting CAL. INS. CODE § 790.03(h) (West 1972 & Supp. 1989)).

410. The only claimants who will be protected are those first-party claimants that are claiming under their own insurance policies. The only claimants able to sue an insurer are those that can prove an insurer's fraud or suffer such severe harm as to give rise to a claim to

Commissioner unless they can be shown to be part of a pattern indicating a "general business practice."<sup>411</sup> Under *Moradi-Shalal*, insurers may violate section 790.03 whenever they feel it is in their best interest without fear of penalty so long as they do not do it often enough to make it a general business practice.<sup>412</sup> The *Moradi-Shalal* majority warned that its decision "is not an invitation to the insurance industry to commit the unfair practices proscribed by the Insurance Code."<sup>413</sup> This is akin to saying an unguarded pot of honey is not an invitation for a bear to come to dinner.

Second, the *Moradi-Shalal* decision could portend the eventual abandonment of *Crisci v. Security Insurance Co.*,<sup>414</sup> the bedrock of common-law bad faith actions.<sup>415</sup> The *Greenberg* court observed that unless the Insurance Code is construed to allow "the person to whom the civil liability runs . . . [to] enforce it by an appropriate action," *Crisci* would be overturned "by implication."<sup>416</sup> The *Crisci* court, in holding that an insurer's bad faith gives rise to tort as well as contract damages,<sup>417</sup> relied upon the fundamental principle that "for every wrong there is a remedy and that an injured party should be compensated for all damage proximately caused by the wrongdoer."<sup>418</sup> By limiting claimants' causes of action against insurers for harm suffered during the claims settlement process to fraud and infliction of emotional distress,<sup>419</sup> the *Moradi-Shalal* court has essentially denied a remedy for conduct that the Legislature views as harmful. And in the case of insurer negligence, there is not even available the minimal satisfaction of an administrative remedy.<sup>420</sup> Under

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emotional distress. *Moradi-Shalal*, 46 Cal. 3d at 304-05, 758 P.2d at 68-69, 250 Cal. Rptr. at 127.

411. *Id.*

412. Since insureds are still able to sue under the covenant of good faith and fair dealing, the most likely target of insurer abuse will be the third-party claimant. The inequitable nature of this insulation of the insurance industry from liability is particularly outrageous in light of the strict liability imposed on other industries under the products liability doctrine. What if a pharmaceutical manufacturer was allowed to escape liability for its negligent manufacture of a dangerous drug? Or an auto-maker faced no liability for intentionally placing a dangerous vehicle on the market because it had only done so once? Such results are, of course, unthinkable, yet rulings nearly as obnoxious will be obtained through application of the *Moradi-Shalal* holding.

413. *Moradi-Shalal*, 46 Cal. 3d at 304, 758 P.2d at 68, 250 Cal. Rptr. at 126.

414. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

415. See *supra* notes 19-21 and accompanying text.

416. *Greenberg*, 34 Cal. App. 3d at 1001 & n.5, 110 Cal. Rptr. at 475 & n.5 (1973).

417. *Crisci*, 66 Cal. 3d at 533, 426 P.2d at 178, 58 Cal. Rptr. at 18.

418. *Id.*, 426 P.2d at 178-79, 58 Cal. Rptr. at 18-19.

419. *Moradi-Shalal*, 46 Cal. 3d at 304-05, 758 P.2d at 68-69, 250 Cal. Rptr. at 127.

420. See *supra* notes 405-13 and accompanying text.



*Moradi-Shalal*, the *Crisci* doctrine mandating there be a remedy for every harm may be no longer operative.

Even if *Moradi-Shalal* has not implicitly overruled *Crisci*, the court has laid the foundation for eventually overruling the case. Applying *Moradi-Shalal*'s new approach to stare decisis<sup>421</sup> reveals how easily the California Supreme Court could overrule *Crisci* if it is so inclined. First, since regulation of the insurance industry is a "matter of continuing concern" to the community at large,<sup>422</sup> there is just as much "need" to reexamine *Crisci* for "court-created error" as there was to reexamine *Royal Globe*.<sup>423</sup>

Second, the court would have no more trouble contriving negative subsequent developments resulting from *Crisci* than it did in *Moradi-Shalal*.<sup>424</sup> For example, some states have followed *Crisci*;<sup>425</sup> others have refused to do so,<sup>426</sup> or have limited some facet of the *Crisci* holding.<sup>427</sup> Although this rejection of *Crisci* is not as broad as the rejection of *Royal Globe*,<sup>428</sup> an active court could pounce upon these rejections as a "negative subsequent development" under *Moradi-Shalal*. As for legal com-

421. See *supra* notes 374-98 and accompanying text.

422. *Moradi-Shalal*, 46 Cal. 3d at 296, 758 P.2d at 63, 250 Cal. Rptr. at 121 (quoting *People v. Anderson*, 43 Cal. 3d 1104, 1147, 742 P.2d 1306, 1331, 240 Cal. Rptr. 585, 611 (1987)).

423. *Id.* (quoting *Cianci v. Superior Court*, 40 Cal. 3d 903, 924, 710 P.2d 375, 387, 221 Cal. Rptr. 575, 587 (1985)).

424. See *supra* notes 225-353 and accompanying text for an analysis of the subsequent developments used by the *Moradi-Shalal* court in overruling *Royal Globe*.

425. See, e.g., *Continental Ins. Co. v. Bayless & Roberts, Inc.*, 608 P.2d 281 (Alaska 1980); *State Farm Auto. Ins. Co. v. Civil Serv. Employees Ins. Co.*, 19 Ariz. App. 594, 509 P.2d 725 (1973); *Grand Sheet Metal, Inc. v. Protection Mut. Ins.*, 34 Conn. Supp. 46, 375 A.2d 428 (1977); *White v. Unigard Mut. Ins. Co.*, 112 Idaho 94, 730 P.2d 1014 (Idaho 1986); *Trahan v. Century Mut. Ins. Co.*, 219 So. 2d 287 (La. 1969); *Gibson v. Western Fire Ins. Co.*, 210 Mont. 267, 682 P.2d 725 (1984); *Lujan v. Gonzales*, 84 N.M. 229, 501 P.2d 673, cert. denied, 84 N.M. 219, 501 P.2d 663 (1972); *Christian v. American Home Assurance Co.*, 577 P.2d 899 (Okla. 1977); *Diamon v. Pennsylvania Mut. Fire Ins. Co.*, 247 Pa. Super. 534, 372 A.2d 1218 (1977); *Tyler v. Grange Ins. Ass'n*, 3 Wash. App. 167, 473 P.2d 193 (1970).

426. See, e.g., *United States Fidelity & Guar. Co. v. Evans*, 116 Ga. App. 93, 156 S.E.2d 809, aff'd, 223 Ga. 158, 158 S.E.2d 243 (1967); *Koppie v. Allied Mut. Ins. Co.*, 210 N.W.2d 844 (Iowa 1973); *Manchester Ins. & Indem. Co. v. Grundy*, 531 S.W.2d 493 (Ky. 1976), cert. denied, 429 U.S. 821 (1976); *Craig v. Iowa Kemper Mut. Ins. Co.*, 565 S.W.2d 716 (Mo. App. 1978); *Lawton v. Great S.W. Fire Ins. Co.*, 118 N.H. 607, 392 A.2d 576 (1978); *Newton v. Standard Fire Ins. Co.*, 291 N.C. 105, 229 S.E.2d 297, 303 (1976); *Santilli v. State Farm Life Ins. Co.*, 278 Or. 53, 562 P.2d 965 (1977); *English v. Fischer*, 660 S.W.2d 521 (Tex. 1983).

427. See, e.g., *Sanford v. Western Life Ins. Co.*, 368 So. 2d 260, 264 (Ala. 1979) (does not allow damages for emotional distress caused by insurer's bad faith); *Farmers Group, Inc. v. Trimble*, 658 P.2d 1370, 1375 (Colo. App. 1982) (requires insurer to act intentionally or willfully before common-law bad faith liability can be imposed); *Hartford Accident & Indem. Co. v. Foster*, 528 So. 2d 255, 266-67 (Miss. 1988) (limiting instances giving rise to insurer liability).

428. See *supra* notes 108-16 and accompanying text.

mentary, *Crisci* has generated its fair share of scholarly criticism. At least eight legal commentaries view *Crisci* negatively.<sup>429</sup> Furthermore, the court will not need to manufacture any subsequent or additional legislative history to overrule *Crisci* because it is a judicially created doctrine. That the Legislature has not affirmatively embraced *Crisci* may leave it open to review under *Moradi-Shalal*'s new approach to stare decisis.<sup>430</sup> Only the court's imagination will limit formulation of adverse consequences and analytical difficulties resulting from *Crisci*.<sup>431</sup> Clearly, should the court wish to overrule *Crisci*, it has already laid the groundwork for constructing another "irrefutable" argument.

## VII. CONCLUSION

There can be no doubt that *Moradi-Shalal v. Fireman's Fund Insurance Cos.*<sup>432</sup> is a major victory for the insurance industry. The industry is now free to treat third-party claimants as it wishes, with the only stick over its head being the enforcement powers of the Insurance Commissioner. It is true that the Insurance Commissioner is now an elected official.<sup>433</sup> However, the insurance industry represents one of the most powerful political forces in the state.<sup>434</sup> This strength was demonstrated

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429. See, e.g., Hills & Pivnicka, *Development and Direction of the California Bad Faith Insurance Doctrine* or "O Ye of Little Faith," 8 U.S.F. L. REV. 29 (1973); Louderback, *Standards For Limiting the Tort of Bad Faith Breach of Contract*, 16 U.S.F. L. REV. 187 (1982); Mallor & Roberts, *Punitive Damages: Towards a Principled Approach*, 31 HASTINGS L.J. 639, 659 (1980); Marchiano, *State Farm Mutual Auto Insurance Co. v. Partridge: Expanding The Scope of Insurance Liability in California*, 7 PAC. L. J. 859 (1982); Nye, Gifford, Webb, & Dewar, *The Causes of the Medical Malpractice Crisis: An analysis of Claims Data and Insurance Company Finances*, 76 GEO L. J. 1495, 1560 (1988); Putz, *Commercial Bad Faith: Attorney Fees—Not Tort Liability—Is the Remedy For "Stonewalling,"* 21 U.S.F. L. REV. 419, 451 (1987); Roberts, *The "Good Faith" Settlement: An Accommodation of Competing Goals*, 17 LOY. L.A.L. REV. 841, 910-11 n.281 (1984); Tuohey, *Negligent Infliction of Emotional Distress Arising From a Breach of Contract: Jarchow v. Transamerica Title Insurance Co.*, 8 SW. U.L. REV. 655, 661-64 (1976). One of the articles cited by the *Moradi-Shalal* court perceives California's bad faith laws as a failed experiment that sought to reduce the costs of administering the tort recovery system by encouraging or coercing settlement. Allen, *supra* note 117, at 852-54.

430. See *supra* notes 374-98 and accompanying text for a discussion of the *Moradi-Shalal* court's treatment of stare decisis.

431. Several commentators have accused *Crisci* of increasing the costs of settlement for insurers. See, e.g., Roberts, *supra* note 429, at 911 n.281. Others have argued that *Crisci* has hampered the settlement process by creating conflicting duties and interests for the insurer. See, e.g., Marchiano, *supra* note 429, at 75.

432. 46 Cal. 3d 287, 758 P.2d 58, 250 Cal. Rptr. 116 (1988).

433. CAL. INS. CODE § 12900 (West Supp. 1989). Section 12900 was added to the Insurance Code when Proposition 103 was ratified in the 1988 general election.

434. *Moradi-Shalal*, 46 Cal. 3d at 320, 758 P.2d at 79, 250 Cal. Rptr. at 137 (Mosk, J., dissenting).

in the last election, where the insurance industry spent over sixty million dollars combating propositions intended to regulate automobile insurance rates.<sup>435</sup> Therefore, since it is likely that the next Insurance Commissioner will be the candidate supported by the insurance industry, the Unfair Practices Act<sup>436</sup> now appears to be a law without gums let alone teeth.

The *Moradi-Shalal* holding could be overturned by the California Legislature.<sup>437</sup> This remedial legislation need only state that California Insurance Code section 790.03(h) affords private litigants, including third-party claimants, the right to sue an insurer for any violations of that section.<sup>438</sup> Such an addition to the Insurance Code by the Legislature would affirmatively embrace the *Royal Globe Insurance Co. v. Superior Court*<sup>439</sup> holding and partially overrule *Moradi-Shalal*. If the Legislature wishes to completely overrule *Moradi-Shalal*, it is suggested that the Legislature further revise the Insurance Code to allow private litigants to sue for individual violations of section 790.03(h),<sup>440</sup> and to enable the suing party to establish the insured's liability as part of the action against the insurer.<sup>441</sup> Reinstatement of *Royal Globe* would restore the statutory protection from insurer bad faith which third-party claimants need<sup>442</sup> and are deprived of under *Moradi-Shalal*.

It is not likely, however, that such legislation will be passed. As demonstrated above, the insurance industry is capable of overwhelming lobbying efforts. Thus, it is reasonable to predict that *Royal Globe* will remain little more than a reminder of a time when the insurance industry was required to actually pay for the damages it caused in bad faith dealings with insureds and claimants.

Although this insulation of the insurance industry is certainly distressing, the greatest cause for alarm is the ease with which the court was willing to destroy an entire cause of action it had created in a decade-old landmark case. Essentially, no decision is safe if it has been criticized in

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435. Reich, *Insurance: Lawyers vs. Insurers*, L.A. Times, Nov. 6, 1988, part I, at 3, col. 1.

436. CAL. INS. CODE §§ 790-790.10 (West 1972 & Supp. 1989).

437. The *Moradi-Shalal* court invited the Legislature to pass legislation expressly creating such a cause of action. *Moradi-Shalal*, 46 Cal. 3d at 305, 758 P.2d at 69, 250 Cal. Rptr. at 127.

438. *Id.*

439. 23 Cal. 3d 880, 592 P.2d 329, 153 Cal. Rptr. 842 (1979).

440. See *supra* notes 408-13 and accompanying text.

441. See *supra* notes 166-99 and accompanying text. The Legislature could also address some of the difficulties cited by the *Moradi-Shalal* court, such as the test for liability or punitive damages. See *supra* notes 145-55 and accompanying text.

442. Comment, *A Statutory Action For Insurer Bad Faith*, *supra* note 256, at 952-53.

legal periodicals or, in the case of a statutory interpretation, if it has not been affirmatively embraced by the Legislature.

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