

1-1-1986

California Casualty General Insurance Co. v. Superior Court: Bad Faith for All

Matthew E. Karanian

Follow this and additional works at: <https://scholarlycommons.pacific.edu/mlr>

Part of the [Law Commons](#)

Recommended Citation

Matthew E. Karanian, *California Casualty General Insurance Co. v. Superior Court: Bad Faith for All*, 18 PAC. L. J. 307 (1986).
Available at: <https://scholarlycommons.pacific.edu/mlr/vol18/iss1/21>

This Notes is brought to you for free and open access by the Journals and Law Reviews at Scholarly Commons. It has been accepted for inclusion in McGeorge Law Review by an authorized editor of Scholarly Commons. For more information, please contact mgibney@pacific.edu.

California Casualty General Insurance Co. v. Superior Court: Bad Faith for All

Ideally, contract negotiations are carried out at arms-length between parties of equal bargaining power. In practice, the variance in bargaining position between insurance companies and those insured or seeking an insurance policy¹ is frequently vast.² This disparity,³ together with the desire to guarantee that insurance companies promptly and fairly act on the claims of their insureds,⁴ has prompted many states,⁵ including California,⁶ to impose upon the insurer a duty of good faith and fair dealing.⁷

1. An insurance policy is a contract between insurer and insured whereby, for premium paid by insured, the insurer undertakes to indemnify the insured against loss, damage, or liability arising from a contingent or unknown event. *Fraser-Yamor Agency, Inc. v. Del Norte County*, 68 Cal. App. 3d 201, 213, 137 Cal. Rptr. 118, 125 (1977).

2. W. SHERNOFF, S. GAGE & H. LEVINE, *INSURANCE BAD FAITH LITIGATION* § 1.03 (1984). The agreements entered into by insurers and insureds have been labeled contracts of adhesion because of the almost total elimination of bargaining power for the average insurance buyer. *Id.* The insurance contract "is drawn up by the insurer, and the insured, who merely 'adheres' to it, has little choice as to its terms." Patterson, *The Delivery of a Life Insurance Policy*, 33 HARV. L. REV. 198, 222 (1919).

3. The relationship of insurer and insured has been called "inherently unbalanced." Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 820, 598 P.2d 452, 457, 157 Cal. Rptr. 482, 487 (1979). "[T]he adhesive nature of insurance contracts places the insurer in a superior bargaining position." *Id.*

4. See, e.g., 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).

5. See Annot., 40 A.L.R. 2d 168, 178 (1955).

6. See, e.g., *Communale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958) (applied to contracts of insurance the general rule of *Brown v. Superior Court*, 34 Cal. 2d 559, 564, 212 P.2d 878, 881 (1949), that there is an implied covenant of good faith and fair dealing in every contract that neither party will do anything which will injure the right of the other to receive the benefits of the agreement). See also *infra* notes 58-72 and accompanying text.

7. See, e.g., W. SHERNOFF, S. GAGE & H. LEVINE, *supra* note 2, § 1.03. The commentators are persuasive in their explanation of the need for judicial intervention:

Thus, the courts have recognized that in the relationship between the insurer and the insured, the insurer normally has overwhelmingly superior economic power, bargaining position, and semantic sophistication. . . . [R]ecognition of these aspects of the relationship, along with the recognition of the importance of insurance to society and the need to assure full performance of duties by insurance companies, is an important part of the rationale for their imposition of tort liability on the insurer for breach of its duty to act fairly and in good faith toward its insured. In a sense, the imposition of such liability may be seen as an effort to equalize the parties' dealings with one another and to assure that the policy holder gets the benefits he or she bargained for.

Id. (footnote omitted, emphasis added).

The breach of the duty of good faith and fair dealing, referred to as an actionable wrong of "bad faith,"⁸ entitles the plaintiff to recovery of damages in a tort or contract action.⁹ Opening this avenue for recovery in tort significantly broadened the range of remedies available to an insured,¹⁰ and has marked California as a trend setter in the development of insurance law.¹¹ Good faith and fair dealing, however, protects insurers as well as insureds.¹² An insurance company possibly could assert a bad faith claim against an insured in an appropriate case, although few such decisions have been reported.¹³

The implied covenant of good faith and fair dealing is considered independent and absolute.¹⁴ Therefore, the bad faith of one party has not been allowed to excuse similar conduct by the other.¹⁵ The California Court of Appeal for the Fourth District, however, recently applied comparative fault principles¹⁶ to bad faith insurance litigation. The court permitted an insurance company to assert the com-

8. See, e.g., LOSSING, BAD FAITH INSURANCE LITIGATION, California Continuing Education of the Bar Program Material 5, 8 (April/May 1985). The term "bad faith" is used in this Note as a shorthand reference to a breach by the insurer or insured of the duty of good faith and fair dealing.

9. See, e.g., *Cisci v. Security Ins. Co.*, 66 Cal. 2d 425, 432, 426 P.2d 173, 178, 58 Cal. Rptr. 13, 18 (1967) (action sounds in both contract and in tort, and plaintiff has freedom of election between the causes of action); *Fletcher v. Western National Life Ins. Co.*, 10 Cal. App. 3d 376, 401, 89 Cal. Rptr. 78, 93 (1970) (violation by insurer of duty of good faith and fair dealing sounds in tort notwithstanding that violation may also constitute breach of contract). See *infra* note 87 and accompanying text.

10. For example, the restriction on recovery in contract claims, based on the rule in *Hadley v. Baxendale*, 9 Ex. 341, 345-53 (1854), that the damages must have been reasonably foreseeable to the parties at the time the contract was made, is removed. Additionally, punitive damages, which traditionally are not available in contract actions, may be awarded to the insured in an appropriate case. See also *infra* note 55 and accompanying text.

11. See, e.g., Comment, *Bad Faith: Defining Applicable Standards in the Aftermath of Royal Globe v. Superior Court*, 23 SANTA CLARA L. REV. 917 (1983) (California courts have been the pace-setters in the development of insurance law). See also Comment, *A Statutory Action for Insurer Bad Faith—The Reasonably Clear Remedy for the Third Party Claimant*, 11 PAC. L.J. 945 (1980) (California an acknowledged leader in crusade to increase consumer protection in insurance dealings).

12. See *Liberty Mut. Ins. Co. v. Altfillisch Constr. Co.*, 70 Cal. App. 3d 789, 797, 139 Cal. Rptr. 91, 95 (1977) (covenant of good faith and fair dealing devolves alike upon the insured as well as the insurer); *Commercial Union Assurance Cos. v. Safeway Stores, Inc.*, 26 Cal. 3d 912, 918, 610 P.2d 1038, 1041, 164 Cal. Rptr. 709, 712 (1980) (good faith and fair dealing is a "two-way street"); See also *infra* notes 110-12 and accompanying text.

13. See *infra* notes 109-31 and accompanying text (there is an implied covenant of good faith and fair dealing in every contract that neither party do anything to injure the right of the other to receive the benefits of the agreement).

14. *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 578, 510 P.2d 1032, 1040, 108 Cal. Rptr. 480, 483 (1973); see *infra* note 132 and accompanying text.

15. See *infra* note 132 and accompanying text.

16. Under comparative fault or comparative negligence doctrines, negligence is measured as a percentage, and any damages allowed are diminished in proportion to the amount of negligence attributable to the plaintiff. *Li v. Yellow Cab Co.*, 13 Cal. 3d 804, 532 P.2d 1226, 119 Cal. Rptr. 458 (1975).

parative bad faith of an insured who had filed a bad faith claim against the company as an affirmative defense.¹⁷ Writing for a unanimous court in *California Casualty General Insurance Co. v. Superior Court of San Bernardino County*,¹⁸ Justice Marcus Kaufman stated that the court could conceive of no sound reason for the doctrine of comparative fault to be inapplicable in bad faith cases.¹⁹ *California Casualty* is the first appellate court decision to expressly sanction comparative bad faith as a defense in insurance bad faith litigation.²⁰

Part I of this Note sets forth the facts and decision of *California Casualty*.²¹ Part II will discuss the historical and legal background of this case.²² Part III will explain the legal ramifications of the opinion.²³

I. THE CASE

A. The Facts

Paula Gorgei obtained an automobile insurance policy from California Casualty General Insurance Company which included a provision for uninsured motorist coverage.²⁴ This coverage is designed to permit an insured to recover directly from his or her insurer those damages that the insured would be legally entitled to recover from the owner or operator of the uninsured motor vehicle.²⁵ Gorgei was in a car crash on December 2, 1981, in which she claimed to have suffered

17. *California Casualty Gen. Ins. Co. v. Superior Court*, 173 Cal. App. 3d 274, 283, 218 Cal. Rptr. 817, 822 (1985).

18. 173 Cal. App. 3d 274, 218 Cal. Rptr. 817 (1985).

19. *Id.* at 283, 218 Cal. Rptr. at 823.

20. See *Court OK's Comparative Bad Faith as a Defense*, NAT'L L.J., Nov. 4, 1985, at 10, col. 1. The only case prior to *California Casualty* to discuss comparative bad faith did not signify judicial approval or recognition of the defense. *Fleming v. Safeco Ins. Co.*, 160 Cal. App. 3d 31, 206 Cal. Rptr. 313 (1984). In *Fleming*, the defense was presented and determined by stipulation. *California Casualty*, 173 Cal. App. 3d at 281 n.2, 218 Cal. Rptr. at 821 n.2.

21. See *infra* notes 24-48 and accompanying text.

22. See *infra* notes 49-133 and accompanying text.

23. See *infra* notes 134-43 and accompanying text.

24. *California Casualty*, 173 Cal. App. 3d at 276, 218 Cal. Rptr. at 818. The California Insurance Code requires that any policy of automobile liability insurance include coverage against bodily injury or wrongful death for which the owner or operator of an uninsured motor vehicle would be responsible. CAL. INS. CODE § 11580.2(a)(1). The code provides in part that:

No policy of bodily injury liability insurance covering liability arising out of the ownership, maintenance or use of any motor vehicle, . . . shall be issued or delivered in this state to the owner or operator of a motor vehicle, . . . unless the policy contains [coverage] for all sums within such limits which [the insured] shall be legally entitled to recover as damages for bodily injury or wrongful death from the owner or operator of an uninsured motor vehicle.

Id.

25. CAL. INS. CODE § 11580.2(a)(1). The Insurance Code also requires underinsured motorist coverage. *Id.* § 11580.2(n).

injuries covered by the uninsured motorist provisions of her policy with California Casualty.²⁶ Gorgei filed a claim, but the insurance company refused to pay more than \$10,000, prompting Gorgei's attorney to pursue the matter in arbitration in May 1982.²⁷ After ten months, the arbitrator determined that Gorgei's claim was worth \$15,000.²⁸ Gorgei then brought a bad faith suit against California Casualty seeking both compensatory and punitive damages.²⁹ The suit alleged that the insurer failed to reasonably and promptly investigate and process her claim, failed to exercise good faith in seeking a prompt, fair, and equitable settlement, and wrongfully withheld payment on her claim, notwithstanding the knowledge that plaintiff was entitled to recovery.³⁰ Gorgei alleged that these acts by California Casualty amounted to a breach of the insurer's duty of good faith and fair dealing as well as a breach of statutory duties under the Unfair Practices Act³¹ of the California Insurance Code. The insurance company answered with three affirmative defenses: alleging the negligence of Gorgei; requesting an allocation of damages against other negligent

26. *California Casualty*, 173 Cal. App. 3d at 276, 218 Cal. Rptr. at 818.

27. *Court OK's Comparative Bad Faith*, *supra* note 20, at 10, col. 1.

28. *Id.*

29. *California Casualty*, 173 Cal. App. 3d at 276-77, 218 Cal. Rptr. at 818.

30. *Id.*

31. The Unfair Practices Act of the California Insurance Code, §§ 790-790.10, provides that insurers may not engage in any practice which the article defines as an unfair method of competition or an unfair or deceptive act or practice in the business of insurance. CAL. INS. CODE § 790.02. As written, the Unfair Practices Act does not expressly permit a private cause of action by those injured by violations of the act, but rather, provides for enforcement by the Insurance Commissioner. *See id.* § 790.05. The right to a private cause of action has been implied from the provisions of the statute, however. The court in *Greenberg v. Equitable Life Assurance Society of the United States*, 34 Cal. App. 3d 994, 110 Cal. Rptr. 470 (1973), for example, held that enforcement of California Insurance Code § 790.03, which lists prohibited acts and practices, was *not* vested exclusively in the Insurance Commissioner. *Id.* at 1001, 110 Cal. Rptr. at 475. *See also* *Shernoff v. Superior Court*, 44 Cal. App. 3d 406, 118 Cal. Rptr. 680 (1975) (Insurance Commissioner's jurisdiction to restrain insurance company's wrongful practices is primary, but not exclusive). The California Supreme Court expressly held in *Royal Globe Insurance Company v. Superior Court*, 23 Cal. 3d 880, 885-90, 592 P.2d 329, 332-35, 153 Cal. Rptr. 842, 845-48 (1979), that a violation of the unfair claims settlement practices provisions of § 790.03(h) gave rise to a private civil cause of action for money damages. Approval by *Royal Globe* of the use of private civil claims against insurers based on statutory violations put some bite into the statute and may have been encouraged by the inadequacy of self-policing efforts by the insurance industry. Shortly before the decision in *Royal Globe*, the California legislature received a report on the inadequacy of attempts by the insurance industry at self regulation. *See* *Shernoff & Levine, The Evolution of Insurance Bad Faith Actions: Emerging Damages Issues*, 16 CAL. TRIAL LAW. A.J. 131, 142 (1977). The report stated in part that:

[t]he Department of Insurance's organization and procedures for investigating and resolving public complaints against insurance companies and agents are seriously deficient. Little effort is made to investigate overall patterns of complaints about insurers' business practices upon which serious discipline might be based. Although the Department more effectively addresses public complaints against insurance agents,

parties; and alleging that Gorgei's action was frivolous and had not been brought in good faith.³²

While the *California Casualty* case was still pending, the California Court of Appeal for the Second District decided a bad faith insurance case³³ which referred to comparative bad faith. This reference³⁴ prompted California Casualty to urge that Gorgei stipulate to a fourth affirmative defense which would permit any damages against the company to be reduced by the alleged bad faith of the plaintiff and her lawyers. The company contended that Gorgei and her counsel had used dilatory tactics, including not promptly forwarding a doctor's report and delaying in seeking arbitration.³⁵ Gorgei refused to stipulate to the proposal.³⁶ The defendants then filed a motion with the trial court seeking leave to amend their answer to add this defense. The trial court denied the insurer's motion, without explanation.³⁷ California Casualty sought review of this ruling in the California Court of Appeal for the Fourth District.

B. The Decision

In a unanimous opinion by a three judge panel,³⁸ the California Court of Appeal for the Fourth District reversed the ruling of the

[there is an] inadequate management of the investigations and unnecessary backlog of work. The Department's fragmented organization of investigative and disciplinary functions and a lack of uniform procedures compound these problems.

Id. at 143 (citing Joint Legislative Audit Committee, REPORT TO THE CALIFORNIA LEGISLATURE: REVIEW OF THE DISCIPLINARY FUNCTIONS OF THE DEPARTMENT OF INSURANCE, Summary, 1 (1977)). Some commentators believe the *Royal Globe* decision has encouraged insurance carriers to settle claims more promptly and fairly. *See, e.g.*, Sacramento Bee, Apr. 6, 1986, (A Special Report: The Bird Court), at 4, col. 2. "You get in an accident on the way home, and you'll get a call from your insurance adjuster tonight." *Id.*

32. *California Casualty*, 173 Cal. App. 3d at 277, 218 Cal. Rptr. at 818.

33. *Fleming v. Safeco Ins. Co.*, 160 Cal. App. 3d 31, 206 Cal. Rptr. 313 (1984). In *Fleming*, the parties had stipulated to a set-off for the insured's bad faith. *Court OK's Comparative Bad Faith*, *supra* note 20, at 10, col. 1. Although the decision of the court did not recognize comparative bad faith on the part of the insured as a valid theory, the issue was specifically reserved. *Fleming*, 160 Cal. App. 3d at 45, 206 Cal. Rptr. at 321 (the court saw no need to determine the "propriety" of comparing bad faith of the insured with bad faith of the insurance company).

34. The reference in *Fleming* to comparative bad faith gave "public recognition" to this idea for the first time. *California Casualty*, 173 Cal. App. 3d at 280, 218 Cal. Rptr. at 820.

35. *Court OK's Comparative Bad Faith*, *supra* note 20, at 10, col. 1.

36. *California Casualty*, 173 Cal. App. 3d at 277, 218 Cal. Rptr. at 818-19.

37. *California Casualty*, 173 Cal. App. 3d at 278, 218 Cal. Rptr. at 819. Although the minute order issued by the trial court which denied the motion to amend did not state any particular ground for the ruling, the trial judge stated at the hearing on the motion that he believed the proposed amendment failed to state a defense. "I am inclined to think if it is subject to demurrer that I should deny the motion just to avoid multiplicity of court appearances, if nothing else." *California Casualty*, 173 Cal. App. 3d at 278, 218 Cal. Rptr. at 819.

38. Justices McDaniel and Morris concurred in the opinion by Justice Kaufman.

trial court in *California Casualty*.³⁹ The court ruled that the denial of defendant's motion to amend to include comparative bad faith as an affirmative defense was an abuse of judicial discretion by the trial court.⁴⁰ The court of appeal ordered the issuance of a writ of mandate directing the trial court to vacate the order and to enter a new order granting the motion.⁴¹ Plaintiff Gorgei contended that no authority recognized "comparative bad faith" as a defense to an action for bad faith, and that since the proposed defense of California Casualty was not legally recognized, the defense was "disfavored."⁴² The court in *California Casualty* rejected this argument. According to the court, the absence of judicial recognition of comparative bad faith made the defense novel, but not necessarily disfavored. Defenses are disfavored not for being novel, but rather, for public policy reasons.⁴³ The *California Casualty* court was persuaded that no policy reason precluded the assertion of comparative bad faith at least as a partial defense to either an insured's action for damages against an insurer for the insurer's breach of any statutory duties under the Unfair Practices Act,⁴⁴ or for the insurer's breach of the duty of good faith and fair dealing.⁴⁵ Therefore, the court applied the doctrine of comparative fault⁴⁶ to this bad faith case.⁴⁷ Although the duty of good faith and fair dealing arises out of the contractual relationship of the parties, breach of the duty is nonetheless governed by tort principles, thereby justifying the comparative fault analogy.⁴⁸

39. *California Casualty*, 173 Cal. App. 3d at 284, 218 Cal. Rptr. at 823.

40. *Id.*

41. *Id.*

42. *Id.* at 280, 218 Cal. Rptr. at 820.

43. *Id.* at 281, 218 Cal. Rptr. at 821.

44. The statutory duties owed the insured by an insurer are identified by negative implication in § 790.03(h) of the California Insurance Code, in which the following procedures are proscribed: "(h) Knowingly committing or performing with such frequency as to indicate a general business practice any of the following unfair claims settlement practices: . . . (5) Not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear." CAL. INS. CODE § 790.03(h).

45. *California Casualty*, 173 Cal. App. 3d at 283, 218 Cal. Rptr. at 823.

46. See *Li v. Yellow Cab Co.*, 13 Cal. 3d 804, 532 P.2d 1226, 119 Cal. Rptr. 858 (1975) (negligence is measured as a percentage, with the proportionate negligence of the plaintiff reducing the damages recoverable from the defendant).

47. *California Casualty*, 173 Cal. App. 3d at 283, 218 Cal. Rptr. at 823. The doctrine of comparative fault has been applied between two negligent actors, *Li v. Yellow Cab Co.*, 13 Cal. 3d 804, 532 P.2d 1226, 119 Cal. Rptr. 858 (1975), between a strictly liable defendant and a negligent plaintiff, *Daly v. General Motors Corp.*, 20 Cal. 3d 725, 575 P.2d 1162, 144 Cal. Rptr. 380 (1978), between a tortfeasor whose liability is based on strict products liability and a tortfeasor whose liability is based on negligence, *Safeway Stores, Inc. v. Nest-Kart*, 21 Cal. 3d 322, 579 P.2d 441, 146 Cal. Rptr. 550 (1978), and between a negligent and an intentional tortfeasor *Sorensen v. Allred*, 112 Cal. App. 3d 717, 169 Cal. Rptr. 441 (1980).

48. *California Casualty*, 173 Cal. App. 3d at 283-84, 218 Cal. Rptr. at 823.

II. LEGAL BACKGROUND

A. *Bad Faith of the Liability Insurer*

The relationship between the purchaser of a policy of insurance and the insurer is contractual in nature, and the rights of the parties have traditionally been enforced purely as contractual obligations.⁴⁹ As the courts have long recognized,⁵⁰ however, contracts for insurance do not reflect the traditional ideal of freedom of contract. Insurance companies operate from a position of superior bargaining power⁵¹ which allows the insured little choice beyond the terms already drafted by the insurer.⁵² The special relationship⁵³ that exists between insurer and insured, and the public trust with which insurers are endowed,⁵⁴ contribute to the willingness of the courts to intervene in insurance contracts.

Rather than force an insured to rely upon traditional contract remedies, which may be wholly inadequate,⁵⁵ courts have tended to require that the insurer render the "basic protection" impliedly pro-

49. See Note, *Good Faith and Fair Dealing in Insurance Contracts*: Gruenberg v. Aetna Insurance Co., 25 HASTINGS L.J. 699 (1974).

50. The California Supreme Court in 1910 tacitly recognized the insurance policy as an adhesion contract. *Raulet v. Northwestern Nat'l Ins. Co.*, 157 Cal. 213, 107 P. 292 (1910). The court wrote: "It must be presumed, ordinarily, that persons are familiar with the terms of written contracts to which they are parties, and in the absence of fraud they are justly bound by the provisions therein, *but the rule should not be strictly applied to insurance policies.*" *Id.* at 230, 107 P. at 298 (emphasis added).

51. E. PATTERSON, *ESSENTIALS OF INSURANCE LAW* § 1, at 2-3 (2d ed. 1957).

52. R. KEETON, *BASIC TEXT ON INSURANCE LAW* § 6.3(a), at 350 (1971). The superior bargaining power of the insurer is caused by several factors: "[t]he inability of most insureds to understand the technical nature of an insurance contract, the various conditions of governmental regulations afforded such contracts, the economic necessity of mass production and sales of contracts of insurance, and the characteristic disparity in financial backing between the parties." See PATTERSON, *supra* note 51, § 1, at 3. As a result, insurance contracts are usually contracts of adhesion which place the insureds in inferior bargaining positions. See, e.g., *Healy Tibbits Constr. Co. v. Employers' Surplus Lines Ins. Co.*, 72 Cal. App. 3d 741, 749, 140 Cal. Rptr. 375, 379 (1977).

53. A nineteenth century court, in one of the earliest cases to recognize the special relationship between the parties, explained that the relationship was built on mutual confidence, and reasoned that a spirit of good faith and fair dealing between the parties should mark every insurance contract. *Germania Ins. Co. v. Rudwig*, 80 Ky. 223, 235 (1882).

54. *Tobriner & Grodin, The Individual and the Public Service Enterprise in the New Industrial State*, 55 CALIF. L. REV. 1247, 1265 (1965). See also *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 820, 598 P.2d 452, 457, 157 Cal. Rptr. 482, 487 (1979). The *Egan* court wrote that the obligations of an insurer are rooted in their status "as purveyors of a vital service labeled quasi public in nature." *Id.* "Insurers hold themselves out as fiduciaries, and with the public's trust must go private responsibilities consonant with that trust." *Id.*

55. Contract law principles have historically precluded many insureds from recovering damages as a result of tortious breaches of insurance contracts. *Levine, Demonstrating and Preserving the Deterrent Effect of Punitive Damages in Insurance Bad Faith Actions*, 13 U.S.F.L. REV. 613, 616 (1979). See *Christensen v. Slaughter*, 173 Cal. App. 2d 325, 343 P.2d 341 (1959); *California Press Mfg. Co. v. Stafford Packing Co.*, 192 Cal. 479, 221 P. 345 (1923); *Overstreet*

mised to the insured.⁵⁶ The California judiciary has promoted parity in the relationship between insurer and insured through the application of tort principles.⁵⁷ Beginning with the premise that all contracts for insurance contain an implied covenant of good faith and fair dealing,⁵⁸ the California Supreme Court ruled in the landmark case *Comunale v. Traders & General Insurance Co.*⁵⁹ that an insurer who unreasonably refuses to settle a liability claim brought against an insured by a third party, is liable for the full amount of the harm caused the insured.⁶⁰ This protection of the insured is acutely necessary in third party cases⁶¹ because of the inherent risk of excess liability the insured faces when an insurer refuses to settle a liability claim within policy limits.

The nature of this risk was recognized by the California Supreme Court in *Comunale*. In *Comunale*, the insured was covered under a liability policy with a \$10,000 policy limit for each person injured and a \$20,000 maximum payment for each accident.⁶² While operating a truck, the insured struck two pedestrians, one of whom suffered serious injuries.⁶³ The insurance company was notified of the accident, but denied coverage and refused to accept an offer to settle the claim within policy limits for \$4,000.⁶⁴ The insured was financially unable to settle without the support of the insurance carrier, and so was forced to defend against the claim in court.⁶⁵

The injured pedestrians, Mr. and Mrs. Comunale, prevailed, and the more severely injured Mr. Comunale was awarded \$25,000.⁶⁶ The insured assigned all of his rights against their insurance carrier, Traders

v. Merrit, 186 Cal. 494, 200 P. 11 (1921); *Hunt Bros. Co. v. San Lorenzo Water Co.*, 150 Cal. 51, 87 P. 1093 (1906); see also *Hadley v. Baxendale*, 156 Eng. Rep. 145 (1854) (only those damages reasonably foreseeable to the parties at the time of forming of contract may be recovered).

56. *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 280, 419 P.2d 168, 179, 54 Cal. Rptr. 104, 115 (1966).

57. See, e.g., W. SHERNOFF, S. GAGE & H. LEVINE, *supra* note 2, § 1.03 (the imposition of tort liability is an effort to equalize the parties' dealings with one another).

58. *Brown v. Superior Court*, 34 Cal. 2d 559, 564, 212 P.2d 878, 881 (1949). The covenant provides that "neither party will do anything which injures the right of the other to receive the benefits of the agreement." *Id.*

59. 50 Cal. 2d 654, 328 P.2d 198 (1958).

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

61. In third party or liability coverage cases, the insured is faced with a claim by a third party and seeks indemnity from his or her insurer for the claim. W. SHERNOFF, S. GAGE & H. LEVINE, *supra* note 2, § 3.01. First party insurance, by contrast, involves an insured who seeks direct coverage from the insurer for losses covered by the policy. *Id.*

62. *Comunale*, 50 Cal. 2d at 657, 328 P.2d at 200.

63. *Id.*

64. *Id.*

65. *Id.*

66. *Id.*

& General Insurance Company, to the Comunales, who sued for the amount in excess of the policy coverage. The court ruled in favor of the Comunales, and held that when the risk of recovery beyond the policy limit is great, so that the claim would most reasonably be disposed of by settling within those limits, a good faith consideration of the interest of the insured requires the insurer to settle the claim.⁶⁷ Failure to settle under these circumstances was held to be a breach of the implied covenant of good faith and fair dealing.⁶⁸ This decision marked the first time this duty was applied to insurers by the California Supreme Court.⁶⁹

In the absence of the rule permitting recovery of excess liability in third party insurance coverage cases, an insurer would have little to lose by refusing to settle any case in which claimed liability is at or near the policy limits. If the insurer could lose no more than the policy limit on any given liability claim, the insurer would have little reason to refrain from gambling with the insured's money and taking every case to trial.⁷⁰ Virtually all jurisdictions recognize this temptation, and hold the insurer liable for excess judgments against an insured when the insurer has in bad faith, failed to settle a third party claim within the policy limits.⁷¹

Excess liability for failure to settle third party claims against the insured will not be imposed on the insurer in every case, however.⁷² The insurer need only exercise good faith and fair dealing when deciding whether to accept a settlement offer. As explained by the California Supreme Court, the test for determining whether the insurer has met this standard is whether a prudent insurer without policy limits would have accepted the offer.⁷³ Although some commentators have suggested that an insurer be held strictly liable for the excess judgment if the insurer refuses to settle within policy limits,⁷⁴ no

67. *Id.* at 659, 328 P.2d at 201.

68. *Id.*

69. W. SHERNOFF, S. GAGE & H. LEVINE, *supra* note 2, § 1.07(2). An appellate court one year earlier had allowed an excess judgment suit against an insurer, on similar grounds. *Brown v. Guarantee Ins. Co.*, 155 Cal. App. 2d 679, 689-90, 319 P.2d 69, 75-76 (1957).

70. Court costs would likely deter litigation only in exceptionally small cases. Attorney fees generally exceed court costs, but may represent a fixed annual expense for larger insurance companies, and would therefore be a minimal deterrent to litigation.

71. W. SHERNOFF, S. GAGE & H. LEVINE, *supra* note 2, § 3.03(1)(a).

72. *See, e.g.,* *Hodges v. Standard Acc. Ins. Co.*, 198 Cal. App. 2d 564, 18 Cal. Rptr. 17 (1961) (no bad faith in the absence of an overt conflict of interest between insured and insurer).

73. *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 429, 426 P.2d 173, 176, 58 Cal. Rptr. 13, 16 (1967).

74. *See, e.g.,* Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1137 (1954); Comment, *In California Excess Liability Cases, Does "Bad Faith" in Law Equal "Strict Liability" in Practice?*, 4 PEPPERDINE L. REV. 115, 143-45 (1977).

jurisdiction has accepted this proposition.⁷⁵

Recovery by the insured or by a person who has received an assignment of rights from the insured is not limited to the amount of the excess judgment, because breach of the duty to settle constitutes bad faith and is a tort.⁷⁶ The insurer is liable for all damages proximately caused to those who are owed the duty.⁷⁷ In *Crisci v. Security Insurance Co.*,⁷⁸ for example, the court upheld an award for mental distress suffered by the insured after the insurer refused to settle a third party's tort claim within policy limits.⁷⁹ Punitive damages may also be awarded in an appropriate case, although few courts have awarded exemplary damages in excess judgment cases.⁸⁰

75. The court in *Crisci* considered the issue of strict liability and characterized the proposed rule as "a simple one to apply [which] avoids the burden of a determination whether a settlement offer within the policy limits was reasonable." *Crisci*, 66 Cal. 2d at 431, 426 P.2d at 177, 58 Cal. Rptr. at 17. *Crisci* did not need to decide the issue to find liability, however, and therefore sidestepped the issue. *Id.* The California Supreme Court again reviewed the argument for strict liability in *Johansen v. California State Auto Ass'n Inter-Ins. Bureau*, 15 Cal. 3d 9, 538 P.2d 744, 123 Cal. Rptr. 288 (1975). The court left the matter undecided because the "defendant's liability for the excess judgment may be predicated on its rejection of a reasonable settlement offer." *Johansen*, 15 Cal. 3d at 17 n.6, 538 P.2d at 749 n.6, 123 Cal. Rptr. at 293 n.6. Although strict liability in a situation like that in *Crisci* would eliminate gambling with the insured's policy benefits, no court outside California has adopted strict liability either. W. YOUNG, E. HOLMES, *CASES AND MATERIALS ON INSURANCE*, 381 (2d ed. 1985). The New Jersey Supreme Court considered adopting a strict liability rule in *Rova Farms Resort, Inc. v. Investors Ins. Co. of Am.*, 323 A.2d 495 (1974), but the court later ruled that *Rova Farms* had not eliminated "bad faith" as requisite to establishing liability. *Fireman's Fund Ins. Co. v. Security Ins. Co.*, 72 N.J. 63, 367 A.2d 864 (1976).

76. See, e.g., *Crisci*, 66 Cal. 2d at 433-34, 426 P.2d at 179, 58 Cal. Rptr. at 19 (rejecting the contention that the action for wrongful refusal to settle sounds solely in contract); *Comunale*, 50 Cal. 2d at 663, 328 P.2d at 203 (acknowledging that wrongful refusal to settle has generally been treated as a tort).

77. See Comment, *supra* note 4, at 1418.

78. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

79. *Crisci*, 66 Cal. 2d at 432-34, 426 P.2d at 178-79, 58 Cal. Rptr. at 18-19.

80. W. SHERNOFF, S. GAGE & H. LEVINE, *supra* note 2, § 3.07(5). An award of punitive damages in a third party liability case was upheld, however, in *Miller v. Elite Ins. Co.*, 100 Cal. App. 3d 739, 758, 161 Cal. Rptr. 322, 332-33 (1980). The California Court of Appeal for the First District explained in *Miller* that more than bad faith must exist before a punitive award can be made against an insurer. *Miller*, 100 Cal. App. 3d at 758-59, 161 Cal. Rptr. at 332-33. An act which constitutes fraud, malice, or oppression must also exist. See CAL. CIV. CODE § 3294. The Civil Code provides that "[i]n an action for the breach of an obligation not arising from contract, where the defendant has been guilty of oppression, fraud, or malice, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant." *Id.* § 3294(a). A bad faith failure to settle a third party claim does not necessarily include these components. *Miller*, 100 Cal. App. 3d at 759, 161 Cal. Rptr. at 333. *Miller* noted that oppression in this context has been defined as a conscious disregard of the insured's rights by the insurer. *Silberg v. California Life Ins. Co.*, 11 Cal. 3d 452, 462, 521 P.2d 1103, 1110, 113 Cal. Rptr. 711, 718 (1974). See CAL. CIV. CODE § 3294(c)(2) (defining oppression as subjecting a person to cruel and unjust hardship in conscious disregard of that person's rights). The court found oppression present in the conduct of the Elite Insurance Company. *Miller*, 100 Cal. App. 3d at 758-59, 161 Cal. Rptr. at 332-33.

B. Insurer Bad Faith in First Party Litigation

Judicial recognition of the tort of bad faith in the first party casualty insurance context⁸¹ has not been as pervasive as the acceptance of the tort theory when the insured is being sued by a third party for conduct covered by an insurance policy.⁸² This reluctance appears to have been the result of the different considerations that apply in first party insurance relationships when the insurer is liable directly to the insured. In first party insurance coverage, no conflict of interest exists, unlike the situation arising from third party cases in which the insurer might be tempted to gamble with the insured's money.⁸³ If the insurer fails to pay the claim of the insured, the insured's contractual remedy for breach of the duty to pay the claim is generally adequate protection. In addition, the potential for injury resulting from the denial of first party claims is small compared to the damages likely to be incurred when a third party obtains an excess liability verdict against the insured⁸⁴ after the insurance company has refused to settle.

In *Fletcher v. Western National Life Insurance Co.*,⁸⁵ a California appellate court nevertheless rejected these arguments against extending bad faith tort liability to first party insurers, primarily because of the presumed superior bargaining power of the insurer.⁸⁶ *Fletcher* held that the duty of good faith and fair dealing requires a disability insurer not to withhold payments maliciously or without probable cause.⁸⁷ Breach of the duty sounds in tort as well as in contract,⁸⁸

81. First party coverage refers to the type of insurance coverage under which the insurer contracts to pay benefits directly to the insured. W. SHERNOFF, S. GAGE & H. LEVINE, *supra* note 2, § 5.02. First party coverage includes life insurance, health and accident insurance, disability insurance, title insurance, property damage insurance, fire insurance, medical payments coverage, and other types of policies providing for payments to be made directly to the insured. *Id.*

82. See 16A APPLEMAN, INSURANCE LAW AND PRACTICE § 8878.15, at 424 (1981). Many courts have failed to protect insureds adequately because they have limited themselves to actions for breach of contract. *Id.* Courts in a few jurisdictions have expressed disfavor toward the imposition of bad faith tort liability on first party insurers. See, e.g., Santilli v. State Farm Life Ins. Co., 562 P.2d 965, 969-70 (Or. 1977) (the Supreme Court of Oregon noted that the unique relationship that gives rise to the special duty of liability insurers to settle within policy limits does not arise in cases involving an insurer's duty to pay an insured for a casualty).

83. See Comment, *supra* note 4, at 1422.

84. See Comment, *Insurance Bad Faith Law: The Need for Legislative Intervention*, 13 PAC. L.J. 833, 837 (1982).

85. 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

86. See Comment, *supra* note 4, at 1415. In the casualty insurance context, the insured is often in such severe financial straits that he is quite vulnerable to a coerced and unreasonably low settlement demand. *Id.*

87. *Fletcher*, 10 Cal. App. 3d at 401, 89 Cal. Rptr. at 93.

88. *Id.*

and can support an action for intentional infliction of emotional distress.⁸⁹

The California Supreme Court dispelled any doubts about the duty owing in first party cases three years later with the decision in *Gruenberg v. Aetna Insurance Co.*⁹⁰ The court ruled that in every insurance contract a covenant of good faith and fair dealing is implied.⁹¹ The covenant of good faith is immanent in the contract whether the company is attending to the claims of the insured or to the claims of third persons against the insured.⁹² Accordingly, an insurer who unreasonably and in bad faith withholds payment of the claim of its insured is subject to liability in tort.⁹³ Since *Gruenberg*, an insurer's liability for bad faith has not been restricted to cases in which the insurer has unreasonably withheld payment on an insured's claim. Liability has also attached when the insurer has failed to make a proper investigation before denying the claim⁹⁴ and when the insurer used fraudulent or deceptive practices in the course of the investigation of the insured's claim.⁹⁵

The California courts have adopted a similar approach in uninsured motorist insurance cases,⁹⁶ analyzing uninsured motorist provisions as a type of first party coverage. An appellate court applied

89. *Id.* at 401-02, 89 Cal. Rptr. at 93-94. A lack of clarity in *Fletcher* regarding the conduct that would be needed for an insurer to breach the duty of good faith and fair dealing clouded later interpretation of the decision. See Note, *supra* note 49, at 704.

90. 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

91. *Id.* at 575, 510 P.2d at 1038, 108 Cal. Rptr. at 486.

92. *Id.*

93. *Id.*

94. *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 817, 598 P.2d 452, 455-56, 157 Cal. Rptr. 482, 485-86 (1979).

95. See, e.g., *Noble v. Sears, Roebuck & Co.*, 33 Cal. App. 3d 654, 659-60, 109 Cal. Rptr. 269, 272 (1973); *Unruh v. Truck Ins. Exch.*, 7 Cal. 3d 616, 627-28, 498 P.2d 1063, 1071, 102 Cal. Rptr 815, 823 (1972). Although other jurisdictions have followed the California approach to first party bad faith, the decisions of the California courts have not been universally accepted. Kottke, *Plugging the Cracks: The Basis and Extent of Liability for First Party Bad Faith Claims*, 32 FED'N INS. COUNS. Q. 79, 93 (1981).

96. See generally *Neal v. Farmers Ins. Exch.*, 21 Cal. 3d 910, 582 P.2d 980, 148 Cal. Rptr. 389 (1978) (recognizing cause of action against insurer for bad faith failure to pay uninsured motorist benefits to insured); *Richardson v. Employers Liab. Assur. Corp.*, 25 Cal. App. 3d 232, 102 Cal. Rptr. 547 (1972) (tortious breach of contract for an insurer to in bad faith withhold payment of uninsured motorist benefits to an insured, when insurer knew claim to be valid). From an analytical standpoint, uninsured motorist coverage is a type of first party insurance. W. SHERNOFF, S. GAGE & H. LEVINE, *supra* note 2, § 4.01. At least one commentator would apply third party bad faith doctrine to uninsured motorist insurance, however: Assume motorist A has uninsured motorist coverage with the common \$15,000 per person injury limit and motorist B does not. Motorist B causes an automobile accident, involving motorist A. Motorist A is not at fault, but the costs of his injury are well beyond the uninsured motorist limits of \$15,000. Although A will now be making a claim against his own insurance company, the bad faith doctrine is still applicable. If that insurance company acts in bad faith toward A, it should be liable

the *Fletcher* standard of good faith and fair dealing to an uninsured motorist claim in *Richardson v. Employers Liability Assurance Corp.*,⁹⁷ and imposed tort liability upon the insurer for unreasonably refusing to pay the claim of the insured.⁹⁸ In *Richardson*, the insurance carrier refused to pay the claim of an insured under an uninsured motorist provision for months after the company knew the claim was valid.⁹⁹ The insurance company forced the plaintiff into an arbitration hearing despite the knowledge that the company had no defense and then compelled the plaintiff to resort to litigation to have the arbitration award judicially confirmed.¹⁰⁰ The court ruled that this conduct was unconscionable and amounted to a tortious breach of contract.¹⁰¹

The California Supreme Court ruled on the standard of liability in uninsured motorist cases for the first time in *Neal v. Farmers Insurance Exchange*.¹⁰² *Neal* reaffirmed the premise of *Richardson*, later articulated in *Gruenberg*, that an insurer has a duty not to unreasonably withhold payments due under a policy,¹⁰³ and treated uninsured motorist coverage as just another type of first party insurance.¹⁰⁴ The *Neal* court reiterated an earlier ruling¹⁰⁵ that an insurer has a duty to act fairly and in good faith when handling claims submitted by an insured as well as when responding to claims made against an insured.¹⁰⁶ Mrs. Frances Neal had filed for benefits under the uninsured motorist provision of an insurance policy which she had obtained from Farmers Insurance Exchange. Farmers Insurance had refused to pay Mrs. Neal's claim in full, despite knowing there was "no colorable defense" to her claim.¹⁰⁷ The court held that this

for the damages which exceed the policy limits. After all, this is just another claim by an accident victim against an insurance carrier.

Hills & Pivnicka, *Development and Direction of the California Bad Faith Doctrine or "O Ye of Little Faith,"* 8 U.S.F.L. REV. 29, 46-47 (1973) (emphasis added, footnote omitted).

97. 25 Cal. App. 3d 232, 102 Cal. Rptr. 547 (1972).

98. *Id.* at 239, 102 Cal. Rptr. at 552.

99. *Id.*

100. *Id.*

101. *Id.* The approach of the court in imposing liability for an unreasonable failure to pay claims is the same approach as is used in other first party coverage cases. In the third party situation, tort liability is imposed for unreasonable failure to settle within policy limits. *Id.*

102. 21 Cal. 3d 910, 582 P.2d 980, 148 Cal. Rptr. 389 (1978).

103. *Gruenberg*, 9 Cal. 3d at 573, 510 P.2d at 1037, 108 Cal. Rptr. at 485.

104. See W. SHERNOFF, S. GAGE & H. LEVINE, *supra* note 2, § 4.03(2). A later appellate court decision premised the bad faith liability of an insurer in an uninsured motorist coverage case on the insurer's handling of the issuance of the policy itself, as well as the handling of a subsequent claim. See *Delos v. Farmers Ins. Group*, 93 Cal. App. 3d 642, 664-65, 155 Cal. Rptr. 843, 857-58 (1979) (insurer fraudulently induced policy holders to waive their uninsured motorist coverage).

105. *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

106. See *Neal*, 21 Cal. 3d at 920, 582 P.2d at 985, 148 Cal. Rptr. at 394.

107. *Id.* at 921, 582 P.2d at 985-86, 148 Cal. Rptr. at 394-95.

failure was a breach of the duty to deal fairly and in good faith with an insured.¹⁰⁸

C. *Bad Faith of the Insured*

The extent to which an insured may be liable to an insurer for a breach of the duty of good faith and fair dealing has been the subject of controversy and uncertainty.¹⁰⁹ The implied covenant of good faith and fair dealing found in every contract requires that *neither* party do anything to injure the right of the other to receive the benefits of the agreement.¹¹⁰ This principle has been held applicable to policies of insurance.¹¹¹ Nevertheless, the liability of an insured from the breach of this covenant appears significantly less grave than that which would be incurred by an insurance company for a like breach,¹¹² since the damages incurred by the insurance company are likely to be less than those incurred by the insured.¹¹³

A breach of the duty of good faith and fair dealing owed to an insurer may arise when the insured contracts with third parties. In *Liberty Mutual Insurance Co. v. Altfillisch Construction Co.*,¹¹⁴ the insured leased equipment to a third party and, without consulting the insurer, agreed to hold the third party harmless for any damage to the equipment.¹¹⁵ This agreement cut off the insurer's right of subrogation,¹¹⁶ precluding the insurer from recovery after the third party negligently damaged the equipment. The court held that given the insurer's expectation of the right of subrogation against any negligent third party in the event of a loss suffered by the insured, the insured had acted in bad faith when contracting away that right.¹¹⁷

108. *Id.*

109. See generally Note, *Insurance Settlements; An Insured's Bad Faith*, 31 DRAKE L. REV. 877 (1981-1982) (the bad faith of an insured should be determined by the same analysis used to determine whether an insurance company has acted in bad faith).

110. *Brown v. Superior Court*, 34 Cal. 2d 559, 564, 212 P.2d 878, 881 (1949).

111. *Comunale*, 50 Cal. 2d at 658, 328 P.2d at 200.

112. See generally *Liberty Mut. Ins. Co. v. Altfillisch Constr. Co.*, 70 Cal. App. 3d 789, 139 Cal. Rptr. 91 (1977) (implied covenant of good faith and fair dealing has been the source of "spectacular jury awards" against insurance companies).

113. The insured, having already suffered a loss, is burdened further by a bad faith delay in settlement by the insurance company. The insurer, in contrast, benefits by any delay in payment since the insurance company retains assets for a longer period.

114. 70 Cal. App. 3d 789, 139 Cal. Rptr. 91 (1977).

115. *Id.* at 793-94, 139 Cal. Rptr. at 92-93.

116. Subrogation is the lawful substitution of a third party in place of a party having a claim against another party. BLACK'S LAW DICTIONARY 1279 (5th ed. 1979). Insurance companies generally have the right to step into the shoes of the party whom they compensate and sue any party whom the compensated party could have sued. *Id.*

117. *Altfillisch*, 70 Cal. App. 3d at 797, 139 Cal. Rptr. at 95.

Despite the use of “bad faith” language by the court, however, the breach by the insured was not treated as a tort.¹¹⁸ Recovery by the insurer was limited by the measure of traditional contract damages, and the *Liberty Mutual* court described the insured’s breach as having the same legal consequences as any “garden variety” breach of contract.¹¹⁹

Perhaps a more compelling illustration of the desirability of holding the insured to the same good faith and fair dealing standard as the insurance carrier exists in the context of large-scale liability insurance litigation. Suppose, for example, that *M*, a manufacturer of widgets, has a liability insurance policy with *X*, covering losses up to one million dollars, with a \$250,000 deductible. Suppose further that a third party, when using one of *M*’s widgets, is seriously injured and sues *M* for \$500,000. After *X* has conducted an investigation of the accident, *X* concludes that the risk of a verdict in excess of the amount of *M*’s deductible is substantial, and enters into negotiations with the claimant in an effort to settle the claim. The claimant agrees to settle for \$100,000, but *M*, proud of his widgets, refuses to settle the lawsuit. The parties go to trial and the claimant is awarded \$500,000. Because of the refusal of the *insured* to settle, the insurance carrier is liable for a \$250,000 judgment that the carrier would not have had to pay if *M* had accepted the settlement.¹²⁰ If the roles of the parties had been reversed, the liability of the insurer for the amount of the excess judgment would have been clear, based on the California Supreme Court holdings in *Comunale*, *Crisci*, and *Johansen*.¹²¹

Although no California court has directly addressed the issue of liability for bad faith failure to settle by an *insured*, a few cases have presented similar issues. In *Transit Casualty Co. v. Spink Corp.*,¹²² a liability insurance policy had provided that the insurer could not settle any claim without the written consent of the insured,¹²³ and the insured did not consent in writing to a proposed settlement. Holding that the settlement clause did not permit an insured to unreasonably reject a settlement offer,¹²⁴ the court noted that the

118. The breach of the duty of good faith and fair dealing sounds in both contract and in tort. *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 432, 426 P.2d 173, 178, 58 Cal. Rptr. 13, 18 (1967).

119. *Altfillisch*, 70 Cal. App. 3d at 797, 139 Cal. Rptr. at 95.

120. See W. YOUNG & E. HOLMES, *CASES AND MATERIALS ON INSURANCE* 387 (2d ed. 1985).

121. See *supra* notes 62-83 and accompanying text.

122. 94 Cal. App. 3d 124, 156 Cal. Rptr. 360 (1979).

123. *Id.* at 129 n.1, 156 Cal. Rptr. at 363 n.1.

124. *Id.* at 136, 156 Cal. Rptr. at 367.

unreasonable refusal of the insured to accept a settlement had contributed to the verdict against the excess insurer.¹²⁵

The California Supreme Court, in another case brought by an excess insurer¹²⁶ against the insured and the insured's primary insurance carrier,¹²⁷ said that status as an insured is not a license to subvert the legitimate rights and expectations of an excess insurance carrier.¹²⁸ The court nevertheless ruled that the insured's covenant of good faith and fair dealing did not impose upon the insured a duty that is commensurate with the duty owed an insured by the primary insurer.¹²⁹ An insured contemplating settlement, therefore, need not place the excess carrier's financial interests on an equal footing with the insured's own.¹³⁰

Commentators disagree as to the desirability of allowing insurers a cause of action in tort against insureds when the insured breaches a duty of good faith and fair dealing.¹³¹ Courts have made clear, however, that the duty of good faith and fair dealing is absolute and independent, and that the bad faith of an insurer will not be excused by the failure of the other party to perform contractual obligations.¹³² The independence of bad faith claims is consistent with the logic of the California courts that prompted rejection of contributory negligence as an absolute bar to recovery in a negligence action.¹³³ Since both the insurer and the insured may assert bad faith causes of action against each other, the decision of *California Casualty* permitting comparative bad faith to be pleaded as an affirmative defense is nothing more than an extension of comparative fault principles. This extension is a logical refinement of bad faith doctrine.

125. *Id.* at 136-37, 156 Cal. Rptr. at 368.

126. A policy of excess insurance is one that provides that the insurer is liable only for the excess above and beyond that which may be collected on other insurance. BLACK'S LAW DICTIONARY 505 (5th ed. 1979).

127. *Commercial Union Ass. Cos. v. Safeway Stores, Inc.*, 26 Cal. 3d 912, 610 P.2d 1038, 164 Cal. Rptr. 709 (1980).

128. *Id.* at 921, 610 P.2d at 1043, 164 Cal. Rptr. at 714.

129. *Id.*

130. *Id.*

131. *See, e.g.*, Note, *supra* note 109, at 896 (insurers should be able to protect themselves and be allowed to recover damages they may suffer when the insured acts in bad faith); W. SHERNOFF, S. GAGE & H. LEVINE, *supra* note 2, § 2.03(3)(a) (the considerations that have led the courts to impose tort liability on the insurer for breach of the duty of good faith do not apply to the insured).

132. *See Gruenberg*, 9 Cal. 3d at 578, 510 P.2d at 1040, 108 Cal. Rptr. at 488.

133. *See, e.g.*, *Li v. Yellow Cab Co.*, 13 Cal. 3d 804, 532 P.2d 1226, 119 Cal. Rptr. 458 (1975).

III. LEGAL RAMIFICATIONS

The decision in *California Casualty* permitting an insurance carrier to plead comparative bad faith as a defense to a bad faith claim by an insured is without precedent¹³⁴ and is a milestone in the development of bad faith doctrine in California. Considering the history of comparative fault principles in California, however, the decision should not have been unexpected. Comparative fault among negligent tortfeasors was adopted by the California Supreme Court more than ten years ago¹³⁵ and since that time has been applied to an increasingly broad array of tortfeasors.¹³⁶ Comparative bad faith follows logically from the comparative fault doctrine.¹³⁷ This progressive refinement of bad faith doctrine, however, may amount to a judicial *retreat* from previous efforts to strengthen the bargaining positions of insureds relative to insurers.

Imposing the duty of good faith and fair dealing upon insurers has had the effect of elevating the bargaining position of the insured.¹³⁸ In casualty or uninsured motorist cases, insureds are able to reject low claim settlement offers. Thus, prompt performance by the insurance carriers is encouraged.¹³⁹ The message to insurers has been simple: give careful consideration to the financial and emotional interests of the insured.¹⁴⁰ Comparative bad faith, however, may have

134. See *California Casualty*, 173 Cal. App. 3d at 281, 218 Cal. Rptr. at 821 (acknowledging that comparative bad faith had not been recognized in any published appellate decision as a partial or complete defense to bad faith). See also *Fleming*, 160 Cal. App. 3d at 31, 206 Cal. Rptr. at 313 (noting that comparing the bad faith of the parties appears to have no precedent in bad faith insurance litigation, but leaving the propriety of such a comparison undecided, since the issue had not been raised); *Court OK's Comparative Bad Faith*, *supra* note 20, at 10, col. 1 (the *California Casualty* decision is believed to mark the first time an appellate court has stated explicitly that comparative bad faith is a valid defense).

135. See *Li v. Yellow Cab Co.*, 13 Cal. 3d at 828-29, 532 P.2d at 1243, 119 Cal. Rptr. at 875.

136. See *supra* note 47 and cases cited therein. In 1980 an appellate court identified a trend in the decisions of the California Supreme Court that pointed toward the adoption of an apportionment of the fault doctrine, without regard for the nature of the alleged operative negligence or other basis for liability in a particular case. See *Sorensen v. Allred*, 112 Cal. App. 3d 717, 723, 169 Cal. Rptr. 441 (1980).

137. *California Casualty*, 173 Cal. App. 3d at 283, 218 Cal. Rptr. at 822-23.

138. See Comment, *supra* note 4, at 1423.

139. *Id.* at 1423-24.

140. Hiltz, *Insurers' Refusal to Settle Claims: Intentional Creation of Distress*, 23 DEF. L.J. 335, 351 (1974). The increased bargaining strength of insureds, stemming from the application of a theory of recovery in tort, rather than just contract, against an insurer is reflected in the following advice to insurers:

First, conduct a thorough investigation and develop all the facts relating to the damages. Second, ascertain the nature of such facts prior to declining any claim. Third, if there are any doubts, resolve the doubts in the favor of an insured. Finally, make all payments of losses as promptly as possible.

Raymont, *Punitive Damages and Property Claims*, 76 BEST'S REV. 32-33 (1975).

muzzled the theory that led to this heightened sense of concern¹⁴¹ by insurers. The *California Casualty* doctrine could encourage more heavy-handed claims settlement practices by insurers, who may anticipate the availability of a damages set-off should a bad faith case be litigated.

When the insured and the insurer have relatively equal bargaining power, however, the doctrine of comparative bad faith and the equal application between both insurer and insured of the good faith and fair dealing standards seems fair. Rather than distinguish between insureds who are able to bargain equally with insurers and those who are not, the doctrine announced in *California Casualty* sends a warning to *all* insureds to deal with insurance companies with the same good faith the companies are bound to employ. The *California Casualty* court might instead have held that bad faith is such a serious breach of an insurance contract that *any* bad faith of an insured should entirely preclude recovery from an insurer for bad faith. This would have unduly benefited insurers, however, and would have failed to take into account the varying degrees of bad faith which may be demonstrated by the conduct of the parties.

As a practical matter, comparative bad faith may come to be routinely pleaded by insurance companies in every bad faith case.¹⁴² Attempts may be made to taint even innocuous behavior. Insurers may be expected to be tempered in their pleadings, however, to avoid an affront to the sensitivities of juries.¹⁴³

CONCLUSION

The decision in *California Casualty* marks the first time any court has accepted a pleading of comparative bad faith as an affirmative defense to a bad faith claim by an insured. Although the decision at first blush appears to come as a blow to consumers and as a surprise in a state which many consider to be at the forefront of the protection of consumer rights, comparative bad faith should not wreak

141. This heightened sense of concern was evident in the lament of one commentator, made after *Fletcher* was decided, that "the time is past when the insurance industry was governed primarily by the law of contracts." See Hiltz, *supra* note 140, at 351. Cf. Levine, *supra* note 56, at 626 (absent the development of the tort theory of recovery, which allows for exemplary awards, claims practices of insurers would likely be no less unconscionable than they were before substantial punitive awards were first imposed).

142. L.A. Daily J., Oct. 16, 1985, at 1, col. 4.

143. *Court OK's Comparative Bad Faith*, *supra* note 20, at 10, col. 1. The lawyer for California Casualty quipped after announcement of the decision "With the way juries feel about insurance companies, no defense attorney in his right mind is going to assert [comparative bad faith] at trial unless there's something to hang your hat on." *Id.*

havoc on individual insureds. The court did not interpret an insured's bad faith to be an absolute bar to recovery by the insured. Instead, the court has announced an intention to balance equitably the comparative fault of the insured and the insurer, no insured can reasonably object to paying a price for deplorable behavior toward an insurer. In *California Casualty*, the insurance carrier alleged that the plaintiff had used the same dilatory tactics for which the company was being sued. California Casualty General Insurance Company accurately perceived the law as imposing a good faith standard on both insurers and insureds. The comparative bad faith approach employed by the California Court of Appeal for the Fourth District is fair to both parties and should encourage them to deal fairly and in good faith during the investigation and settlement of claims.

Matthew E. Karanian

