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Extending The Liability of Insurers for Bad Faith Acts: Royal Globe Insurance Company v. Superior Court

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Extending The Liability of Insurers for Bad Faith Acts: *Royal Globe Insurance Company v. Superior Court*

Breaking through previously erected theoretical barriers, the California Supreme Court has held that the Unfair Practices Act imposes a duty upon insurers, to act fairly and in good faith in their negotiations with third party claimants. The implications of such a decision promise to be far-reaching, and subsequent decisions will undoubtedly clarify the issue. An analysis of the decision and its ramifications is herein presented.

INTRODUCTION

The California Supreme Court decision in *Royal Globe v. Superior Court*[1] establishes that third party claimants, as well as insured claimants, have a right to sue insurers for violations of the Unfair Practices Act.[2] The decision also establishes that a claim-

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

2. CAL. INS. CODE § 790 (West 1976). All references, unless otherwise stated, will be to CAL. INS. CODE § 790.03(h) (West 1976) which provides:

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:

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

(2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising out of 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

ant may base an action against an insurer on a single instance of unfair conduct specified in the statute. The decision re-establishes that a plaintiff may not bring an action against the insured and the insurer in the same lawsuit.[3]

The plaintiff in *Royal Globe* was the victim of a slip and fall accident at a food market. She filed a personal injury action as a result of the injuries she sustained. The complaint joined the food market with its insurer, Royal Globe Insurance Company. The plaintiff alleged that the insurer had violated California Insurance Code Section 790.03 (h)(5) because it had refused to attempt, in good faith, a prompt, fair, and equitable settlement even though liability had become reasonably clear.[4] Furthermore, the complaint charged Royal Globe with a violation of California Insurance Code section 790.03 (h)(14), alleging that its independent adjuster had advised the plaintiff not to obtain the services of an attorney.[5] Royal Globe demurred to the complaint and made a Motion for Judgment on the Pleadings asserting three arguments. First, the California Insurance Commissioner has exclusive power to enforce the Unfair Practices Act. Second, a third party does not have standing to bring an action under the act. Finally, the plaintiff may not sue the insured and the insurer in the same action. The trial court overruled the demurrer and denied the motion. The California Supreme Court chose to review the case on the defendant's writ of mandate to reverse.

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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 was 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 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 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.

3. *See* notes 61-65 and accompanying text *infra*.

4. Royal Globe v. Superior Court, 23 Cal. 3d at 884, 592 P.2d at 332, 153 Cal. Rptr. at 845.

5. *Id.*

I. A Basic Illustration

In order to better appreciate the impact of the *Royal Globe* decision, it is necessary to examine the nature of the duty of good faith owed by insurers.[6] The following hypothetical situation will establish the framework for this discussion: *A*, a pedestrian, is legally crossing the street; *B* illegally drives through a red light and strikes *A*, injuring him. *A* files an action for personal injuries against *B*. *B*'s liability insurer, *C*, assumes the defense on behalf of *B*. *B*'s insurance policy limit is $20,000. After discovery procedures have been substantially completed, it becomes clear that *B* is liable for *A*'s injuries because of his negligent driving. *A* is willing to settle the claim for $12,000, but *C* refuses the settlement offer, even though it is well within the policy coverage. The case subsequently goes to trial and *A* receives a judgment award of $30,000. *C* pays the $20,000 due on the policy, leaving *B* liable for the $10,000 balance. *B* does not pay this to *A*, resulting in an unsatisfied judgment.

This hypothetical is illustrative of a typical bad faith settlement by an insurer.[7] A breach of a covenant of good faith results from *C*'s refusal to accept the settlement offer within the policy limit, even though the likelihood of a judgment award for an amount greater than that limit was very real.[8] In this situation, *B* would have a claim against *C* for the bad faith action. He may act on this right in one of two ways. The first option would be for *B* to pay *A* the $10,000, and then sue *C* for reimbursement. The allegation being that *C*'s refusal to settle within the policy limits damaged *B*.[9] Under the second option, *B* would assign to *A* the

6. It has been well established in California law that an insurer owes a duty of good faith and fair dealing to insureds. *See, e.g.*, Johansen v. California State Auto Ass'n., 15 Cal. 3d 9, 538 P.2d 744, 123 Cal. Rptr. 288 (1975); Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973); Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); Comunale v. Traders and General Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958).

7. *See, e.g.*, Murphy v. Allstate Ins. Co., 17 Cal. 3d 937, 553 P.2d 584, 132 Cal. Rptr. 424 (1976).

8. *See* note 6 *supra*.

9. *See* Johansen v. California State Auto Ass'n., 15 Cal. 3d at 17, 538 P.2d at 749, 123 Cal. Rptr. at 293 (quoting crom Crisci v. Security Ins. Co., 66 Cal. 2d at 431, 426 P.2d at 177, 58 Cal. Rptr. at 17):

> The size of the judgment recovered in the personal injury action when it exceeds the policy limits, although not conclusive, furnishes an inference that the value of the claim is the equivalent of the amount of the judgment and that acceptance of an offer within those limits was the most reasonable method of dealing with the claim.

right to sue *C* for the breach of the good faith duty.[10] Prior to *Royal Globe* the duty of good faith was due exclusively to the insured.[11] A third party claimant such as *A* had no right to sue an insurer for bad faith actions because the duty of good faith did not flow to such a claimant.

II. Prior Cases Dealing With the Third Party Question

Austero v. National Casualty Co.[12] and *Murphy v. Allstate Insurance Co.*[13] typify the handling of the third party issue by California courts prior to the *Royal Globe* decision. In *Austero*, the defendant insurer refused to deliver the benefits owed to the insured under a disability policy. The insured's wife filed an action against the insurer for a bad faith delay in paying the benefits. In dismissing the claim, the court said: "an insurer's duty of good faith and fair dealing is owed solely to its insured, and, perhaps an express beneficiary of the insurance policy."[14]

This holding may, however, be limited to the particular fact situation in *Austero*. There, the wife was not a victim of a separate tort by the insured, as is found in the customary bad faith illustration, as previously described. Furthermore, she was not injured by the insurer's refusal to deal in good faith, since the benefits of the policy were owed not to her, but rather to the policyholder, her husband. Thus, it may be argued that *Austero* merely reflects the position that a non-victim third party has no right to sue for the bad faith indiscretions of insurers. Although the scope of the *Austero* decision is limited, the underlying denial of third party rights remains significant.

In *Murphy v. Allstate Insurance Co.*, the court addressed a fact situation similar to that found in the *Royal Globe* case. In *Murphy*, the plaintiff sued the insured for the wrongful death of her nine-year-old son. The liability insurer rejected settlement demands of $23,500 and $25,000, even though the policy limit of $25,000 was not exceeded. The case subsequently went to trial and the plaintiff was awarded a judgment of $42,000. The insurer then paid the $25,000 due on the policy. The plaintiff subsequently sued the insurer for the outstanding $17,000, without having the claim assigned to her by the insured. The basis of this suit was that the insurer had acted in bad faith during settlement negotiations. The plaintiff cited the Financial Responsibility

10. *E.g.*, Murphy v. Allstate, 17 Cal. 3d at 937, 553 P.2d at 584, 132 Cal. Rptr. at 424 (1976).
11. *Id.*
12. 62 Cal. App. 3d 511, 133 Cal. Rptr. 107 (1976).
13. 17 Cal. 3d 937, 553 P.2d 584, 132 Cal. Rptr. 424 (1976).
14. 62 Cal. App. 3d at 517, 133 Cal. Rptr. at 110.

Law[15] which provides that victims are third party beneficiaries of the insurance contract. The duty to deal in good faith was owed not only to the insured, but to the plaintiff as an injured third party beneficiary.[16]

Although the *Murphy* court confirmed that there is an implied covenant of good faith and fair dealing in every contract,[17] it rejected the contention that a third party beneficiary analysis affords a third party a right to sue for a violation of the duty:

> The insurers' duty to settle does not directly benefit the injured claimant. In fact he usually benefits from the duty's breach. Instead of receiving an award near policy limits, he stands to obtain judgment exceeding policy coverage. For instance, in the present case, plaintiff has already received an amount equal to her highest settlement demand, and is holding an unsatisfied judgment for an additional $17,000.[18]

The apparent "benefit" occasioned by an insurer's breach is somewhat misleading, since it may be argued that the *Murphy* court's analysis only involves a discussion of the primary tort wherein the third party was in some way victimized by the insured. The court, in effect, is stating that the third party plaintiff stands to receive an award exceeding her settlement wishes. However, this view neglects to consider the additional injury incurred by a third party who is the victim of a bad faith practice. This injury is the result of a separate and distinct bad faith action on the part of the insurer. Accordingly, a third party plaintiff will not receive a larger judgment award on the primary tort, but rather, compensation for a violation of the duty of good faith owed by insurers to third parties.

Inasmuch as the *Murphy* court does not directly address the second injury, the question of a separate duty owed directly to a third party for such an injury is left unanswered. The holding of *Murphy* may be limited to the principle that a third party has no

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15. CAL. INS. CODE § 11580 (West 1972), provides in part:

(b) Such policy shall not be thus issued . . . unless it contains all the following provisions . . .

. . . .

(2) A provision that whenever judgment is secured against the insured or the executor or administrator of a deceased insured in an action based upon bodily injury, death, or property damage, then an action may be brought against the insurer on the policy and subject to its terms and limitations, by such judgment creditor to recover on the judgment.

16. *See* notes 19-31 and accompanying text *infra*.

17. *See* note 7 *supra*, at 940, 553 P.2d at 556, 132 Cal. Rptr. at 428 (1976) (quoting from Brown v. Superior Court, 34 Cal. 2d 559, 564, 212 P.2d 878, 883 (1949)).

18. *Id.* at 941, 553 P.2d at 557, 132 Cal. Rptr. at 429 (1976).

right to sue an insurer for the breach of a duty which flows only between the insurer and the insured.

III. A THIRD PARTY BENEFICIARY APPROACH TO THE EXTENSION OF AN INSURER'S DUTY OF GOOD FAITH

The plaintiff in *Murphy* attempted to gain standing to sue the insurer by arguing for a third party beneficiary right.[19] Many arguments made by third parties[20] have been similarly based on this assertion, which argues that a third party is the intended beneficiary of a contract between an insurer and the insured.[21] The reasoning being good faith is implied in the contract, therefore, third parties should be permitted to sue for a breach of the duty.[22]

In *Zahn v. Canadian Indemnity Co.*,[23] the plaintiff and his wife were injured by the insured. The plaintiff insisted the liability insurer settle his claim separately from that of his wife. When the insurer refused, the Zahns sued the insurer for acting in bad faith during the settlement conferences. Like the plaintiff in *Murphy*,[24] the Zahns contended that the Financial Responsibility Law[25] made them third party beneficiaries to the contract. The court in *Zahn*, by implication, agreed that a victim is a third party beneficiary, but only for purposes of the primary claim brought against the insured. The court stated, "[W]hatever rights may inure to the injured party as a third party beneficiary of a contract of liability insurance, they do not include any right to require the insurer to negotiate or settle with him prior to the establishment of the insured's liability."[26]

The *Zahn* holding was consistent with the general rule in California that third parties may sue the insurer for an unpaid judgment within the policy limits, but that no such right exists for a second injury caused by the insurer's bad faith refusal to settle

19. *Id.*
20. *See* notes 21-28 and accompanying text *infra*.
21. *See* Biakanja v. Irving, 49 Cal. 2d 647, 650, 320 P.2d 16, 19 (1958):

> The determination whether in a specific case the defendant will be held liable to a third person not in privity is a matter of policy and involves the balancing of various factors, among which are the extent to which the transaction was intended to affect the plaintiff, the forseeability of harm to him, the degree of certainty that the plaintiff suffered injury, the closeness of the connection between the defendant's conduct and the injury suffered . . . .

22. *Contra*, Zahn v. Canadian Indemnity Co., 57 Cal. App. 3d 509, 514, 129 Cal. Rptr. 286, 291 (1976).
23. *Id.* at 509, 129 Cal. Rptr. 286.
24. Murphy v. Allstate, at 943, 553 P.2d at 589, 132 Cal. Rptr. at 429 (1976).
25. *See* note 15 *supra*.
26. *See* note 22 *supra* at 514, 129 Cal. Rptr. at 291 (1976).

the claim.[27] Thus, the courts have determined the insurance contract is divisible for third party beneficiary purposes. On the one hand there are the rights and duties stemming from the primary tort of the insured, and on the other, there are different rights and duties which relate to the bad faith act of the insurer. It can be seen, therefore, that the third party is a beneficiary only insofar as the contract relates to the tortious conduct of the insured.[28]

In order for a third party to convince a court that he should have a right to sue for the bad faith actions of an insurer, it must first be shown that the third party is a beneficiary for purposes of the entire contract, and not merely for that part which protects him from the tortious conduct of the insured. In other words, a third party must prove that a breach of the duty of good faith is as detrimental to a third party as is the original injury suffered at the hands of the insured. Based on the *Murphy* and *Zahn* decisions, however, it is highly unlikely that a plaintiff would be successful with such an argument since the court in those cases refused to find a third party beneficiary status under the Financial Responsibility Law. Moreover, there is no indication that such an interpretation would have been found under the Unfair Practices Act.[29] Thus, had the *Royal Globe* plaintiff argued the third party beneficiary analysis, she would have met with the same results[30] as did the third party claimants in *Murphy* and *Zahn*.

Fortunately for the plaintiff in *Royal Globe*, the court found no need to develop a third party beneficiary analysis. Rather, it interpreted the Unfair Practices Act in a manner which identified a separate and distinct duty of good faith owed directly to the third

27. *See, e.g.*, Johnson v. Holmes Tuttle Lincoln Mercury, 160 Cal. App. 2d 290, 297, 325 P.2d 193, 197 (1958).

28. Austero v. National Casualty Co., 62 Cal. App. 3d 511, 516-17, 133 Cal. Rptr. 107, 110 (1976):

> Whether for better or worse, the historical development of a tort is an important factor in determining its scope . . ., thus far, liability for 'bad faith' has been strictly tied to the implied-in-law covenant of good faith and fair dealing arising out of an underlying contractual relationship. Where no such relationship exists, no recovery for 'bad faith' may be had.

29. *See* note 2 *supra*.

30. In other words, the *Royal Globe* court would have had to hold that since the Unfair Practices Act afforded private litigants a cause of action (*See* notes 51-57 and accompanying text *infra*.), third parties, being private litigants, inure to the benefits of the act as incorporated into the insurance contract. Such a holding would have acted to overrule the decisions in *Zahn* and *Murphy*.

party claimant.[31]

IV. ANALYSIS OF ROYAL GLOBE V. SUPERIOR COURT

1. The Rights of Third Parties

The keystone of the *Royal Globe* decision is that the insurer owes a duty of good faith directly to the third party claimant. The court arrived at this conclusion by examining the language[32] of Section 790.03 of the California Insurance Code and interpreting it so as to provide a cause of action for third parties victimized by a bad faith act.[33] For example, Code Section 790.03(h) (15),[34] which prohibits misleading a claimant regarding the applicable statute of limitations, and Section 790.03 (h) (14),[35] which prohibits advising a claimant not to obtain the services of an attorney, each contain language which explicitly refers to duties owed to claimants.[36] The court concluded that since the Unfair Practices Act refers to claimants, the insurer owes a direct duty of good faith to third party claimants as well as to insured claimants.[37] In further supporting its decision, the court cited the legislative history of the act as another indication that the Legislature intended it to protect third parties. The court pointed out that in 1972, before the bill's enactment, a representative of the Department of Insurance testified before committees that the act "could be construed to affect third parties."[38] Additionally, the Department of Insurance sent a "Bill Analysis" to the Assembly arguing the act needed clarification inasmuch as it appeared to apply to third par-

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31. Royal Globe v. Superior Court 23 Cal. 3d 880, 890, 592 P.2d 329, 335, 153 Cal. Rptr. 842, 848 (1979).

32. *Id.* at 888, 592 P.2d at 334, 153 Cal. Rptr. at 847.

33. *Id.*

34. *Id.* at 888, 592 P.2d at 334, 153 Cal. Rptr. at 847. *See also* CAL. INS. CODE § 790.03 (h)(5).

35. *Id.*

36. The court stated:

> Of the two subdivisions on which plaintiff's action is based, one refers specifically to a claimant, i.e., subdivision (h)(14), which prohibits 'advising a claimant not to obtain the services of an attorney, and the other appears to cover both claimants and insureds in providing that it is an unfair practice to fail to attempt 'in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear.'

Royal Globe v. Superior Court, 23 Cal. 3d at 888, 592 P.2d at 334, 153 Cal. Rptr. at 847.

37. The court stated: "[S]ome of the subdivisions refer to claimants and insureds separately [CAL. INS. CODE § 790.03 (h)(10), (h)(11)], and others only to insureds [CAL. INS. CODE § 790.03 (h)(6), (h)(7)]. Thus, the subdivision by its own terms extends certain of its protections to claimants, some to insureds, and others to both claimants and insureds." *See* note 36 *supra*; Royal Globe v. Superior Court, 23 Cal. 3d at 888, 592 P.2d at 334, 153 Cal. Rptr. at 847.

38. Royal Globe v. Superior Court, 23 Cal. 3d at 888, 592 P.2d at 334, 153 Cal. Rptr. at 847.

ties. Since no action was taken by the Legislature on the recommendation, the court concluded that "it is a reasonable implication that the committees' inaction represented a deliberate decision that third party claimants were to enjoy the protection of the bill."[39]

Finally, the court distinguished the *Murphy v. Allstate*[40] decision. According to the court, the plaintiff in *Murphy* asserted that she had a right to sue for the breach of a duty owed to the insured. In *Royal Globe*, however, the plaintiff was not relying on a duty owed to the insured, but rather on a statutory duty owed directly to the plaintiff.[41]

2. *The Measure of Damages in a Third Party Action*

The court in *Royal Globe* did not fully address the damages issue with respect to the third party claimant's newly-created right of action against the insurer who refuses to attempt a good faith settlement.[42] In viewing the issue along traditional lines of analysis, it becomes apparent that the damages recoverable by the third party claimant in such an action are not precisely the same as those available to the insured himself.

In the traditional bad faith action, an insured may recover damages from the insurer for economic loss, emotional distress, attorney's fees, exemplary damages, and the excess of a judgment award beyond policy limits where applicable.[43] Often, a third

39. *Id.* at 889, 592 P.2d at 335, 153 Cal. Rptr. at 414.

40. 17 Cal. 3d 937, 553 P.2d 584, 132 Cal. Rptr. 414 (1976).

41. While the majority distinguished the *Murphy* holding, the dissent viewed it as applicable to the facts in *Royal Globe*:

> Only three years ago we unanimously held in *Murphy v. Allstate* . . ., that the insurer's duty to settle runs to the insured and not to the injured party, and that, accordingly, the latter may not recover from the insurer for breach of that duty in the absence of a proper assignment of the insured's cause of action (citations omitted).

Royal Globe v. Superior Court, 23 Cal. 3d at 892, 592 P.2d at 337, 153 Cal. Rptr. at 850.

42. *See* note 2 *supra*.

43. Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967). In *Crisci* a tenant in Mrs. Crisci's apartment fell through a wooden staircase. Although the tenant offered to settle the claim for $10,000, the policy limit, the insurer refused. The tenant subsequently recovered a $101,000 judgment award; Security Insurance Co. paid only the $10,000 due on the policy. Mrs. Crisci then sued Security Insurance for a breach of the good faith duty in not accepting the settlement offer. Her claim being that the bad faith act permitted the action to go to trial which resulted in a verdict of $91,000 in excess of policy coverage. Mrs. Crisci alleged that the situation caused her emotional distress and mental suffer-

party claimant is able to obtain an assignment[44] of the insured's cause of action for the excess judgment award. Under *Royal Globe*, an injured third party claimant may now recover all suffered damages proximately caused by the insurer's breach of the statutory duty. With respect to violations of California Insurance Code Section 790.03 (h)(5),[45] such awards might include elements of economic loss, emotional pain and suffering, attorney's fees, and exemplary damages.

The decision in *Royal Globe* should not, however, be read so as to provide a third party claimant with a direct right of recovery against the insurer for awards in excess of the insured defendant's policy limits. As was pointed out in *Murphy v. Allstate*,[46] a decision which was not expressly overruled in *Royal Globe*, such a right of recovery would not be consonant with traditional theories of damages and proximate causation.[47]

The *Murphy* court reasoned that since the third party plaintiff was once willing to accept a sum within policy limits in full settlement of his claim against the insured, he could not logically argue that he incurred any loss or "damage" as a result of the insurer's refusal to settle. Rather, the insurer's refusal to accept such a settlement offer would effectively serve to *benefit*[48] the plaintiff, to the extent that his judgment exceeds the settlement sum for which he was previously willing to execute a release, and a voluntary dismissal of his action against the insured.

Thus, absent further clarification of the court's ruling, it remains necessary for the third party claimant to obtain an assignment of the insured's cause of action against the insurer, in order to seek recovery from the insurance company for an amount awarded to the claimant in excess of the insured's limit of coverage.[49] While such a result is clearly warranted under pure legal

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ing as well as economic loss. The California Supreme Court affirmed the trial court's award of the $91,000 in excess as reimbursement in addition to $25,000 for mental suffering.

44. However, no assignment is permitted with regard to the emotional distress issue: Purcell v. Colonial Ins. Co., 20 Cal. App. 3d 807, 97 Cal. Rptr. 874 (1971).

45. *See* note 2 *supra*.

46. 17 Cal. 3d 937, 553 P.2d 584, 132 Cal. Rptr. 424 (1976).

47. The court in *Murphy* stated: "Because an insurer's refusal to accept a reasonable settlement does not diminish the injured claimant's recovery, the policy of compensating persons injured by negligent motorists is not frustrated." Murphy v. Allstate Ins. Co., 17 Cal. 3d at 944, 553 P.2d at 589, 132 Cal. Rptr. at 429.

48. The court further stated: "Breach of the duty to settle will, if anything, allow the injured party to recover the amount of the offered settlement, perhaps an additional sum to the extent of the policy limits, and sums in excess of those limits from the negligent motorist." *Id.*

49. Since it is often difficult for a third party claimant to obtain an assignment from a hostile or insolvent insured tortfeasor, many such claimants will still be left with no way of recouping the full amount of actual loss incurred at the hands of

analysis, as was applied in *Murphy*,[50] the need for further clarification or expansion of the third party's rights may be voiced in the very near future by litigants, jurists and legislators alike.

3. *The Unfair Practices Act Provides for a Private Remedy*

In *Royal Globe*, the insurer contended that a third party could not sue for a violation of the act, and that no private litigant could bring an action to impose civil liability for a violation.[51] It was maintained that only the Commissioner of Insurance could enforce the act by issuing a cease and desist order to prevent future violations.

The court rejected these contentions, holding that a private litigant may bring an action to enforce the Unfair Practices Act. Initially, the court looked to Section 790.09 of the California Insurance Code, which provides that a cease and desist order issued by the commissioner does not absolve an insurer from "civil liability or criminal penalty under the laws of this State arising out of the methods, acts, or practices found unfair or deceptive."[52] This section was deemed to afford private litigants a cause of action against insurers who engage in the unfair practices defined in § 790.03 (h).[53] In support of this conclusion, the court cited three prior decisions[54] which reached a similar holding. In *Greenberg v. Equitable Life Assur. Society*,[55] for example, the court held that § 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."[56]

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the insured, notwithstanding the noteworthy expansion of a third party's rights under *Royal Globe*.

50. *See* notes 47-48 and accompanying text *supra*.

51. Royal Globe v. Superior Court, 23 Cal. 3d at 884, 592 P.2d at 332, 153 Cal. Rptr. at 845.

52. CAL. INS. CODE § 790.09 (West 1972), 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.

53. *See* note 2 *supra*.

54. Homestead Supplies Inc. v. Executive Life Ins. Co., 81 Cal. App. 3d 978, 147 Cal. Rptr. 22 (1978); Shernoff v. Superior Court, 44 Cal. App. 3d 406, 118 Cal. Rptr. 680 (1975); Greenberg v. Equitable Life Ins. Co., 34 Cal. App. 3d 994, 110 Cal. Rptr. 470 (1973).

55. 34 Cal. App. 3d 994, 110, Cal. Rptr. 470 (1973).

56. *Id.* at 1001, 110 Cal. Rptr. at 476.

4. *An Isolated Incident of Bad Faith is Sufficient To Find a Violation of the Act*

The court in *Royal Globe* held that a single instance of bad faith is sufficient to sustain a cause of action under the Unfair Practices Act since the language "[K]owingly committing or performing with such frequency as to indicate a general business practice . . ."[57] is ambiguous and therefore subject to different interpretations.[58] The language suggests there are two alternative methods by which violations of the act may be shown: (1) a violation occurs when the prohibited acts are *knowingly* committed on a single occasion; or (2) if knowledge cannot be established, it will be sufficient if the acts were performed with such frequency as to indicate a general business practice.[59]

The issue of the sufficiency of a single instance of unfair conduct is further discussed in connection with the court's conclusion that a private party is afforded a cause of action under the act.[60] Since the act affords the private remedy it is inconceivable that the legislative intent was to require a private litigant to show that the insurer had committed similar acts on prior occasions. Therefore, it is more logical to assume that a private litigant need only show that he, on the particular occasion in question, has been victimized.

5. *A Plaintiff May Not Sue the Insured and the Insurer in the Same Lawsuit*

The court, in *Royal Globe*, agreed with the defendant insurer's contention that a plaintiff may not sue the insured and the insurer in the same lawsuit. California Evidence Code Section 1155[61] provides that evidence of insurance is not admissible to prove negligence. Evidence of offers of settlement by the insurer

57. *See* note 2 *supra*.

58. Royal Globe v. Superior Court, 23 Cal. 3d at 890, 592 P.2d at 336, 153 Cal. Rptr. at 849.

59. This suggestion originates from the California Trial Lawyers Association and has been proposed in 7 PACIFIC L.J. 484 (1976).

60. The court in *Royal Globe* stated:

> Although the language of the statute is not clear, if the premise is accepted that a private party may bring an action for an insurer's violation of subdivision (h) under the rationale of *Greenberg* and *Shernoff*, then a single violation knowingly committed is a sufficient basis for such an action.

Royal Globe v. Superior Court, 23 Cal. 3d at 891, 592 P.2d at 336, 153 Cal. Rptr. at 849.

61. CAL. EVID. CODE § 1185 (West 1966):

> Liability Insurance. Evidence 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 is inadmissible to prove negligence or other wrongdoing.

are also prejudicial for two reasons: (1) It may suggest to a jury that the insured tortfeasor has admitted responsibility for the injury suffered by the claimant,[62] and (2) the jury, knowing that the tortfeasor is insured, may be more apt to find for the plaintiff, believing the judgment will be paid by the insurance carrier.[63]

In addition, the court argues the damages suffered by a third party for an insurer's violation of the Unfair Practices Act may best be determined after the conclusion of the suit brought by the injured party against the insured.[64] The court reasoned that a judgment award over and above the policy limits is often an indication of the damages suffered as a result of a bad faith act.[65]

V. RAMIFICATIONS OF THE NEW DUTY OF GOOD FAITH

1. *Positive Implications*

As the focus of the *Royal Globe* decision is on the newly found duty of good faith due third parties, a discussion of the ramifications of such a duty, beginning with a discussion of the positive results of the extended duty, is in order.

First, a third party claimant is now afforded a more equal bargaining position when negotiating with the insurer.[66] To attain perspective, it it helpful to refer to the hypothetical illustration discussed earlier.[67] In the hypothetical, *A*, the injured pedestrian,

62. *See* Rising v. Veatch, 117 Cal. App. 404, 3 P.2d 1023 (1931); Citti v. Bava, 204 Cal. 136, 266 P. 954 (1928).

63. *See* Neumann v. Bishop, 59 Cal. App. 3d 451, 130 Cal. Rptr. 786 (1976); Roberts v. Home Ins. Indemnity Co., 48 Cal. App. 3d 313, 121 Cal. Rptr. 862 (1975).

64. Additionally, the court states:

> Moreover, unless the trial against the insurer is postponed until the liability of the insured is first determined, the defense of the insured may be seriously hampered by discovery initiated by the injured claimant against the insurer.

Royal Globe v. Superior Court, 23 Cal. 3d at 892, 592 P.2d at 337, 153 Cal. Rptr. at 850.

65. *See* Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

66. The same policy considerations exist with respect to insureds who are claimants. Insureds have long been afforded a cause of action for the bad faith actions of insurers. *See* notes 6-7 *supra*. *Compare* Note *Good Faith and Fair Dealing in Insurance Contracts: Gruenberg v. Aetna Ins. Co.*, 25 HASTINGS L.J. 707 (1974):

> A severe inequality of bargaining power between the insurer and the insured is caused by many factors: the inability of most insureds to understand the technical nature of the insurance contract, . . . and the characteristic disparity in financial backing between the parties.

67. *See* text accompanying note 2 *supra*.

incurred substantial medical expenses as a result of the injuries suffered in the accident.[68] The failure on the part of *C*, the insurer, to effectuate a quick settlement once liability was reasonably established, may have served to pressure *A* into accepting a lower settlement agreement, since the injured party was in immediate need of funds.[69] It is well to remember, that prior to *Royal Globe*, *A* would have no direct recourse against *C* for such an indiscretion.[70] Consequently, the superior bargaining position of the insurer was further strengthened by the inability of a third party to bring a cause of action for a bad faith settlement practice. However, now that third parties have a cause of action, insurers will be increasingly inclined to recognize a more equal counterpart at the negotiating table.

Secondly, a party who has been injured twice may now recover for both the primary tort of the insured and for the later breach of the good faith duty by the insurer. It will be recalled that *A* was victimized twice: initially, when struck by *B*'s vehicle, and again when *C* refused to settle the claim once liability became reasonable clear. Without the extended liability, *A*'s only cause of action would have been for the primary tort of *B*.[71]

Finally, third party standing to enforce the Unfair Practices Act may serve as a deterrent to insurers who engage in bad faith settlement practices. As a result, it will frequently be more economical for insurers to settle quickly, rather than risk the possibility of a lawsuit for unfair settlement practices. Paradoxically, this decision, while encouraging insurers to settle when liability is clear and when the settlement demand is fair, may also serve to persuade insurers to settle when the settlement demand is unfair.[72]

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68. *See* Fletcher v. Western Nat'l Life Ins. Co., 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970). The *Fletcher* case represents a situation where the insurer was in dire financial straits after suffering a disability. The insurer refused to pay on the policy which directly caused the insured further and continuing deprivation.

69. *See* Franklin, Chanin, & Mark, *Accidents, Money and the Law: A Study of the Economics of Personal Injury Litigation*, 61 COLUM. L. REV. 1, 30 (1961):

> Extended delay may vitiate the relief finally obtained, especially if the money is urgently needed . . . . Another, and related aspect of the delay is its possible coercive effect that encourages victims to settle early for less than the full value of their claim, rather than to wait indefinitely for trial in the hope of getting a larger amount.

70. *See e.g.*, Murphy v. Allstate Ins. Co., 17 Cal. 3d 937, 553 P.2d 584, 132 Cal. Rptr. 424 (1976).

71. *See generally*, notes 64-68 *supra*. The idea that if an insured claimant may recover for an analogous, if not exact injury, then an injured third party claimant should also be afforded relief.

72. The dissent in *Gruenberg v. Aetna Ins. Co.*, described the majority's holding as putting insurers in a no-win situation: "if it (insurer) expects to avoid a *Crisci* or *Fletcher* lawsuit, there is only one safe course: Pay all claims and investigate afterwards, assuming, of course, payment doesn't waive that right." 9 Cal. 3d 566, 592, 510 P.2d 1032, 1049, 108 Cal. Rptr. 480, 497 (1973).

With these considerations in mind, the negative implications of the extended duty of good faith should be examined.

2. Negative Implications

The possibility of unwarranted bad faith claims now hangs as an ominous cloud over insurer-third party claimant settlement conferences. The insurer will often find itself faced with a difficult choice wherein it must either settle the claim for more than it is fairly worth, or contest it and face the economic realities of litigating a bad faith action brought by the third party.[73] Of course the same choice exists when the claimant is the insured.[74] In that situation, however, public policy dictates that a balancing test be used which weighs the risk of unwarranted lawsuits against the necessity of guaranteeing the insured an equitable bargaining position in negotiations with the insurer. The question then becomes one of whether the same balancing test should be used with respect to third parties, or whether such a development would strengthen the bargaining position of third parties to a disproportionate extent.

It is one thing for an insurer to face the possibility of a suit for bad faith acts from an insured who has paid premiums, is in privity of contract, and retains a fiduciary relationship with the insurer.[75] It is quite another matter for an insurer to face a bad faith claim from a non-party to the contract since a third party stands in opposition to the insured, who is most likely being defended by the insurer in the primary tort action. An obvious conflict of interest is created[76] when the insurer must defend the insured while at the same time protecting the interests of the third party claimant.

The conflict is inherent in the adversary positions of the parties subsequent to a tort by the insured. On one side of the settle-

73. *See generally* R. CONSTANTIN, SUE OR SETTLE 9-10 (1968):

> In the industry's [insurance] view . . . many people go into the jury box who are anxious to help the 'little guy' . . . . The trouble is that the companies are not that rich, so that the juries are actually forcing up their own insurance rates . . . . And there is no question that awards are, in fact, increasing sharply.

74. *See* notes 6-7 and accompanying text *supra*.

75. *See generally* Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 598 P.2d 452, 157 Cal. Rptr. 482 (1979); Rove Farms Resort Inc. v. Investors Ins. Co., 65 N.J. 474, 323 A.2d 495 (1974).

76. *See* P. MAGARICK, EXCESS LIABILITY: DUTIES AND RESPONSIBILITIES OF THE INSURER 45-54 (1976). *See also* notes 6-7 *supra*.

ment conference table sits the insurer as a representative of the insured defendant. The goal of the insured and the insurer is to gain as low a settlement agreement as possible. On the other side of the table sits the injured third party, who wishes to obtain a high settlement on the claim. The result is that the insurer must balance the interests of the insured with the injured party so as not to breach the duty of good faith owed to both parties.

The conflict of interest difficulty is minimized since liability to third parties is limited to situations where there is no reasonable dispute as to the liability of the insured in the primary claim. Arguably, this protects the interests of the insured when his liability is in question, thereby preventing the insurer from delaying settlement with the third party victim when liability on the primary claim is reasonably clear.[77]

The problem of defining what is "reasonably clear,"[78] still remains and can be determined only on a case-by-case basis as a question of fact. This is of small consolation to insurers who must contest such facts before juries who are often sympathetic to injured claimants.[79]

CONCLUSION

The insurance industry has reacted negatively to the *Royal Globe* decision.[80] Such a reaction is understandable and justifiable in some respects because of the court's heavy reliance on the ambiguous language of the act in determining that it was intended to benefit third parties.[81] As was discussed earlier, such an interpretation creates an onerous burden for insurers. It is a

77. *See* notes 6-7 *supra*.

78. *See* note 72 *supra*.

79. *See* note 73 and accompanying text *supra*.

80. Senator Beverly on March 1, 1979 introduced and sponsored Senate Bill 483 in the California State Senate; the bill represents the insurance industry's response to the *Royal Globe* decision. Initially it sought to prevent any insured, third party claimant, or any other individual other than the California Insurance Commissioner from enforcing California Insurance Code Section 790.03. The stated intent was to overrule the *Royal Globe* decision. As amended on September 4, 1979, the bill restated its intent as being to:

> [M]odify the holding in *Royal Globe Insurance Company v. Superior Court* insofar as it established a cause of action by a third party claimant based upon a violation of subdivision (h) of Section 790.03. In enacting this act, the Legislature finds that the duties owed a third party claimant by an insurer are subject to conflicting duties owed by the insurer to the insured. Therefore, in order to avoid conduct by insurers that might impair the obligation of the insurer to represent the insured in an adversary proceeding, the Legislature denies to third party claimants any cause of action pursuant to subdivision (h) of Section 790.03.

However, S.B. 483 has met with much opposition and as of this writing has not made it out of committee.

81. *See* notes 32-37 and accompanying text *supra*.

burden that will likely be passed on to insureds through the imposition of higher premiums.[82]

While the *Royal Globe* decision was to the chagrin of insurers, it remains just one example of the recent trend in a number of California cases[83] to extend the liability of insurers for their prior bad faith indiscretions. The courts thus determined that public policy dictates that insurers be more responsive to the wishes and demands of claimants, insureds and third parties alike.

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82. As insurers, liability extends, they must raise their premiums in order to pay for the added costs inherent to increased liability.

83. Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 598 P.2d 452, 157 Cal. Rptr. 482 (1979). *Egan* is a case where the insurer refused disability payments to its insured, Egan, without first investigating the validity of the claim. The court held such a failure is in violation of the insurer's good faith duty; and further, allowed punitive damages for the indiscretion.