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Moradi-Shalal v. Fireman's Fund Insurance Companies: The Overruling of Royal Globe and its Ramifications

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MORADI-SHALAL v. FIREMAN'S FUND INSURANCE COMPANIES:
THE OVERRULING OF ROYAL GLOBE AND ITS RAMIFICATIONS

I. INTRODUCTION

In Moradi-Shalal v. Fireman's Fund Insurance Companies plaintiff was injured in an automobile accident when her automobile was negligently struck by the insured. Plaintiff filed suit against the insured for her personal injuries and subsequently made settlement offers to the insured. Fireman's Fund Insurance Companies, the insurance company for the insured, did not reply to plaintiff's settlement offers. Ultimately, plaintiff settled with the insured for an amount that was substantially less than the original settlement offer she had submitted to Fireman's.

Since plaintiff was not a party to the insurance contract between the insured and the insurer, she filed a third party action against Fireman's pursuant to Royal Globe Insurance Company v. Superior Court of Butte County. In 1979, Royal Globe held that California Insurance Code Section 790.03(h) provided third

§ 790.03(h) prohibits the following:
(h) knowingly committing or performing with such frequency as to indicate a general business practice any of the following unfair claims settlement practices:
(1) Misrepresenting to claimants pertinent facts or insurance policy provisions relating to any coverages at issue.
(2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies.
(3) Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies.
(4) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss requirements have been completed and submitted by the insured.
(5) Not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear.
(6) Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in

345
party claimants with an implied right of action against insurers that commit unfair or deceptive practices. This decision served as the basis for third party bad faith claims against the insurer.

In 1988, Moradi-Shalal overruled Royal Globe and held that Insurance Code Section 790.03(h) did not create a private cause of action for a third party claimant against an insurer. The court also held that a final judicial determination of liability must be rendered against the insured before the insurer could be held liable to third party claims. This Note will analyze the reasoning utilized by the Moradi-Shalal court in overruling Royal Globe and also analyze its concomitant effects upon the rights of third party claimants.

Third party claimants’ alternatives to actions brought by the insureds, when the insureds have made claims for amounts reasonably similar to the amounts ultimately recovered.

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

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

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

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

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

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

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

(16) Delaying the payment or provision of hospital, medical, or surgical benefits for services provided with respect to acquired immune deficiency syndrome or AIDS-related complex for more than 60 days after the insurer has received a claim for those benefits, where the delay in claim payment is for the purpose of investigating whether the condition pre-existed the coverage. However, this 60-day period shall not include any time during which the insurer is awaiting a response for relevant medical information from a health care provider.

4. Royal Globe, 23 Cal. 3d at 884, 592 P.2d at 332, 153 Cal. Rptr. at 845.
5. Moradi-Shalal, 46 Cal. 3d at 304, 758 P.2d at 68, 250 Cal. Rptr. at 126.
6. Id. at 313, 758 P.2d at 74-75, 250 Cal. Rptr. at 133.
7. This Note shall not review California's bad faith law governing the insurance in-
Royal Globe action will then be considered, such as third party actions by assignment from the insured, and third party private causes of action against insurers pursuant to California Business & Professions Code Section 17200 et seq.8

II. MORADI-SHALAL v. FIREMAN’S FUND INS. COS.

Before Royal Globe, third party claimants could not sue insurers for breach of the implied covenant of good faith and fair dealing.9 In Royal Globe, the California Supreme Court decided that a claimant could sue an insurer for violations of the Uniform Practices Act (UPA).10

In Royal Globe the plaintiff filed an action for personal injuries against the defendant’s insurer after a slip-and-fall accident, alleging two violations of Insurance Code Section 790.03.11 The first violation alleged that Royal Globe Insurance Company did not attempt to settle in good faith with the injured plaintiff.12 The second allegation was that Royal Globe’s adjuster had advised the plaintiff not to consult an attorney.13 Royal Globe demurred on three grounds.14 It argued that the Insurance Commissioner was the sole authority to enforce the UPA; that plaintiff was a third party and therefore lacked standing to sue the

8. CAL. Bus. & PROF. CODE § 17200 is also known as the “Unfair Competition Statute”.
11. Royal Globe, 23 Cal. 3d at 884, 592 P.2d at 331-32, 153 Cal. Rptr. at 844-45; plaintiff alleged that defendant Royal Globe Insurance Company had violated subdivision (h)(5) of the act “in that it refused ‘to attempt in good faith to effectuate a prompt, fair and equitable settlement’ of plaintiff’s claim although ‘liability . . . [had] become reasonably clear,’ ” and its agent had advised plaintiff not to obtain the services of an attorney, in violation of subdivision (h)(14). Id.
12. Id.
13. Id. at 884, 592 P.2d at 332, 153 Cal. Rptr. at 845; See CAL. INS. CODE § 790.03(h)(14) (West 1972 & Supp. 1990).
insurer and that a third party claimant cannot sue both the insured and the insurer in the same suit. 16

The California Supreme Court overruled the demurrer, and validated the rulings of Greenberg v. Equitable Life Assurance Society of the United States 16 and Shernoff v. Superior Court of Los Angeles County. 17 These decisions held that California Insurance Code Section 790.09 18 created a private cause of action for a violation of the UPA and that an insurer's duty under the Act ran to third party claimants as well as insureds. 19 Third party claimants could sue insurers for any violation of the UPA. 20

The court also analyzed Insurance Code Section 790.03(h), particularly the phrase, “[k]nowingly committ[ed] or perform[ed] with such frequency as to indicate a general business practice” and held that this section allowed for a statutory bad faith action against the insurer. 21 The California Supreme Court further held that an injured claimant had an actionable claim against an insurer who had knowingly committed a single act of unfair conduct. 22

In Moradi-Shalal, the California Supreme Court granted review to resolve whether an insured's liability had to be judicially established before a “Royal Globe action” could be brought. The court also used the case as a means of reviewing the viability of Royal Globe. 23

The majority began by observing that there was "widespread confusion" surrounding the application of Royal Globe. 24 In an effort to validate its reexamination of Royal Globe, the majority cited Cianci v. Superior Court of Contra Costa

15. Id.
20. Royal Globe, 23 Cal. 3d at 890, 592 P.2d at 335, 153 Cal. Rptr. at 848.
21. Id. at 884, 592 P.2d at 332, 153 Cal. Rptr. at 845; CAL. INS. CODE § 790.03(h) (West 1972 & Supp. 1990).
22. Royal Globe, 23 Cal. 3d at 891, 592 P.2d at 336, 153 Cal. Rptr. at 849.
23. Moradi-Shalal, 46 Cal. 3d at 292, 758 P.2d 59-60, 250 Cal. Rptr. at 118.
24. Id.
County for its proposition that scholarly criticism of a decision justifies reexamination of prior decision, "to determine its continuing viability." The Cianci court actually found that reexamination of prior decision is proper where there exists a contrary United States Supreme Court decision and adverse legal commentary. The court's apparent miscasting of the Cianci opinion may be an indication of its eagerness to attack Moradi-Shalal. After noting the history and exceptions to the rule of stare decisis, the court announced its decision to depart from precedent.

In overruling Royal Globe, the Moradi-Shalal majority cited numerous jurisdictions which "rejected" Royal Globe, adverse commentary, and legislative history as arguments that Royal Globe should be overruled.

A. REJECTION OF ROYAL GLOBE BY OTHER STATE COURTS

The court stressed that the UPA was derived from the National Association of Insurance Commissioners' Model Unfair Claims Practices Act (Model Act), adopted by 48 states. The

26. Moradi-Shalal, 46 Cal. 3d at 299, 758 P.2d at 65, 250 Cal. Rptr. at 123.
27. Cianci involved the reconsideration of whether the Cartwright Act (This Act is California's statutory antitrust provision and was codified in CAL. BUS. & PROF. CODE § 16700 et seq.) was applicable to the medical profession. Cianci reasoned that the underlying decision of Willis v. Santa Ana Etc. Hospital Ass'n., 58 Cal. 2d 806, 376 P.2d 568, 26 Cal. Rptr. 640 (1962), should be reconsidered not only because of criticism in legal commentaries but because of the United States Supreme Court holding in Goldfarb v. Virginia State Bar, 421 U.S. 173 (1975) and also because of the California Supreme Court decision in Marin County Board of Realtors v. Palsson, 16 Cal. 3d 920, 549 P.2d 833, 130 Cal. Rptr. 1 (1976). Cianci, 40 Cal. 3d at 921, 924, 710 P.2d at 385, 387, 221 Cal. Rptr. at 585, 587. Based on these developments, inter alia, Cianci reexamined Willis and concluded that the Cartwright Act was applicable to the medical profession. Cianci, 40 Cal. 3d at 924-25, 710 P.2d at 387-88, 221 Cal. Rptr. at 587.
28. Moradi-Shalal, 46 Cal. 3d at 296, 758 P.2d at 62-63, 250 Cal. Rptr. at 121. According to the majority, stare decisis is a fundamental jurisprudential policy that prior applicable precedent usually must be followed. This policy held true "even though the case, if considered anew, might be decided differently by the current justices." Stare decisis "is based on the assumption that certainty, predictability, and stability in the law are the major objectives of the legal system". Despite these "general concepts" the majority noted that stare decisis is a "flexible policy". Thus, the court said it could reconsider, and ultimately depart from its own prior precedent in an appropriate situation. id.
29. Moradi-Shalal, 46 Cal. 3d at 297, 758 P.2d at 63, 250 Cal. Rptr. at 121. This Model Act originated in 1947 after Congress passed the McCarran-Ferguson Act which subjected the insurance industry to federal regulation only to the extent that it was not
court found it significant that seventeen of the nineteen state courts which considered the issue raised by *Royal Globe* rejected California’s approach.\textsuperscript{30}

Interestingly, the *Moradi-Shalal* majority conceded that state statutes which have rejected a private cause of action did not contain precisely the same language as sections 790.03 and 790.09.\textsuperscript{31} However, the court considered the differences insignificant.\textsuperscript{32}

Despite acknowledging the principal that out-of-state decisions were not binding on California courts the court found that the “near unanimity of agreement by [out-of-state] courts in ‘rejecting’ *Royal Globe*” brought into question California’s minority approach.\textsuperscript{33}

More significantly, the “rejection” of *Royal Globe* by out-of-state courts is a mischaracterization. Rather than “rejecting” *Royal Globe* outright, other state courts have chosen not to follow the *Royal Globe* analysis because of differences with California’s statutory language. For example, *Morris v. American Family Mutual Insurance Company*\textsuperscript{34} (cited by the majority as the “typical” approach in other jurisdictions) involved the same legal issue that was decided in *Royal Globe*. The *Morris* court noted the “unique statutory language” in California’s version of the UPA which served as the basis for a third party private cause of action against the insurer.\textsuperscript{35} However, the *Morris* court decided to dismiss the third party claimant’s action by finding

\begin{quote}

30. *Moradi-Shalal*, 46 Cal. 3d at 297, 758 P.2d at 63, 250 Cal. Rptr. at 121. “The courts in 17 of these 19 states have refused to recognize such a cause of action, either expressly rejecting the *Royal Globe* analysis, or interpreting statutory language similar to sections 790.03, subdivision (h), and 790.09 in a manner contrary to *Royal Globe* without mentioning that case.” *id.*

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

32. *Id.*

33. *Id.*

34. 386 N.W.2d 233 (Minn. 1986).

35. *Id.* at 237 n.6.
\end{quote}
she had no private cause of action against the insurer. The *Morris* court held that a private person does not have a cause of action against an insurer under Minnesota’s UPA.36

In *Seeman v. Liberty Mutual Insurance Company*,37 the Iowa Supreme Court held “... that the legislature implicitly intended the insurance commissioner’s powers to be the exclusive means of enforcing ...” the state’s UPA.38 Specifically, the court noted that Iowa’s UPA provided that, “[n]o order of the commissioner under this chapter or order of a court to enforce the same shall in any way relieve or absolve any person affected by such order from any liability under any other laws of this state. (Emphasis added)”39 The *Seeman* court noted that in California, “[t]he *Royal Globe* court found that the elimination of the word “other” from the California Act indicated that the legislature intended to provide a private cause of action.”40 Thus, states that have eliminated the word “other” from their version of the UPA have found that a private cause of action may be brought against the insurer.

Two general observations may also undermine the persuasiveness of the out-of-state decisions cited by the *Moradi-Shalal* majority. First, several of the jurisdictions denying a *Royal Globe* action recognize only a contractual basis for bad faith failure to settle within policy limits.41 This is significant in that states that do recognize a *Royal Globe* action also recognize a tort basis for insurer bad faith. The intermediate step of tort liability is a prerequisite to the *Royal Globe* action, since the *Royal Globe* action represents an expansion of tort liability.

Second, only eight of seventeen courts cited by *Moradi-Shalal* are state Supreme Courts.42 Moreover, two state supreme

36. Id. at 238.
37. 322 N.W.2d 35 (Iowa 1982).
38. Id. at 42.
39. Id.
40. Id. citing *Royal Globe*, 23 Cal. 3d at 886, 592 P.2d at 333, 153 Cal. Rptr. at 846.
courts recognize a *Royal Globe* action.\(^{48}\) This hardly constitutes a unanimous number of state jurisdictions rejecting *Royal Globe*.

B. "Scholarly Criticism" of *Royal Globe*

The court noted seven law review articles that emphasized the "erroneous" nature of the holding in *Royal Globe*.\(^{44}\) The court cited "strained interpretation" of the statutory provisions and the "misreading" of available legislative history as evidence of the erroneous nature of *Royal Globe*\(^{46}\).

In citing these articles, the majority failed to mention that six articles also praised *Royal Globe* for protecting society from the unfair practices of insurers.\(^{48}\) Moreover, of the seven articles


cited by the majority, only two claimed Royal Globe had “negative effects.”47 These two articles failed to support their attacks on Royal Globe with any factual evidence.48

The court also relied on the 1980 Report of the National Association of Insurance Commissioners (N.A.I.C.) and found that the report was “instructive” regarding the intent of the framers.49 The court failed to point out, however, that the N.A.I.C. is an organization of state officials who supervise the insurance industry and promote uniformity of legislation and regulation affecting insurance to protect the interests of policyholders.50 Moreover, since California’s legislature adopted a modified version of the Model Act, the intent of the Model Act’s framers is irrelevant to interpreting California’s UPA. The court should have considered the intent of the California legislators who drafted and passed the UPA.

C. LEGISLATIVE HISTORY OF INSURANCE CODE SECTION 790.03

The Moradi-Shalal majority considered “additional” legislative history allegedly “overlooked” by the Royal Globe court.51 The court examined the state’s Legislative Analyst’s Report52 and the Legislative Counsel’s Digest,53 which both described Section 790.03 as calling for “administrative enforcement”.54

48. One author delineated the problems with the Royal Globe decision, did not support his criticism of Royal Globe with factual evidence, and then concluded his article by proposing solutions to these problems. Casey, Bad Faith: Defining Applicable Standards in the Aftermath of Royal Globe v. Superior Court, 23 SANTA CLARA L. REV. 917, 939-44 (1983).
49. Moradi-Shalal, 46 Cal. 3d at 299, 758 P.2d at 65, 250 Cal. Rptr. at 123. The court said: “In the words of the 1980 N.A.I.C. report, ‘The 1971 Model Act does not contain an individual right of action provision . . . ’” id.
51. Moradi-Shalal, 46 Cal. 3d at 300, 758 P.2d at 64, 250 Cal. Rptr. at 123.
53. Legislative Counsel’s Digest to A.B. 459 (1972).
54. The Insurance Commissioner may issue a cease and desist order to insurance companies that are in violation of California’s UPA.
Since neither the Legislative Analyst nor the Legislative Counsel said that the new act created a private right of action, the *Moradi-Shalal* court interpreted this as a strong indication that the Legislature never intended to create such a right of action.\(^{56}\) This characterization by the court was misleading at best, since the *Royal Globe* court did consider both the Report and the Digest. However, the *Royal Globe* court found these sources to be too remote or too generalized to be of any use in interpreting Section 790.03.\(^{58}\)

The *Moradi-Shalal* majority was also guided by “subsequent legislative history” Senate Bill No. 483\(^{57}\) which provided that no civil liability would be imposed on any insurer.\(^{58}\) The court said that the bill’s intent was to overturn *Royal Globe*, but did not find that the failure of the bill to reach the Assembly indicated that the movement to overturn *Royal Globe* lacked support.\(^{59}\) The court instead emphasized that the Senate agreed that *Royal Globe* should be abrogated.\(^{60}\)

Finally, the *Moradi-Shalal* court addressed the argument that the Legislature’s 1983 modification of Section 790.03 without changing subdivision (h) or addressing the *Royal Globe* issue was, in effect, a “silent Legislative approval” of the *Royal Globe* decision.\(^{61}\)

*Cianci v. Superior Court of Contra Costa County*\(^{62}\) provided the general rule that if the Legislature fails to change a law in a specific area, when the “general subject” is before it and other changes are made, the legislative intent is to leave the law as it is, in the area not amended.\(^{63}\) The *Moradi-Shalal* majority expanded upon this general rule. The court cited *Cianci* for the proposition that “something more than mere silence should be required before that acquiescence is elevated into a species of

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55. *Moradi-Shalal*, 46 Cal. 3d at 300, 758 P.2d at 65, 250 Cal. Rptr. at 123.
58. *Moradi-Shalal*, 46 Cal. 3d at 300, 758 P.2d at 65, 250 Cal. Rptr. at 124.
59. Id. This bill “stalled” in the Ways and Means Committee. id.
60. Id.
63. *Cianci*, 40 Cal. 3d at 923, 710 P.2d at 386, 221 Cal. Rptr. at 588.
implied legislation . . ." 64 Under the majority's reasoning, in order for a statute to be "upheld" the Legislature should give direct approval of all provisions left intact during the process of statute modification. 65

D. THE CONSEQUENCES OF ROYAL GLOBE

The court delineated the "negative impact" of Royal Globe by pointing out that Royal Globe promoted multiple litigation. 66 The court found that Royal Globe encourages two lawsuits by the injured claimant; an initial suit against the insured, followed by a suit against the insurer for bad faith refusal to settle. 67 Royal Globe also tended to encourage "unwarranted" settlement demands by claimants and coerced inflated settlements by insurers trying to avoid a bad faith action. 68 However, these arguments are questionable since a Royal Globe action will only be brought if an insurer violates any of the provisions as set forth in the UPA. Moreover, it is disengenous to imply that injured claimants will not settle in good faith with an insurer for the tactical advantage of a subsequent Royal Globe action. It is the insurer who holds the "upper hand" in settlement negotiations since the claimant is often in immediate need of capital to pay for medical costs as well as recover lost wages.

If the injured claimant does use the original settlement as a "tactic" to bring a Royal Globe action and collect a "windfall" the insurer can point this out to the court. If the argument is persuasive, then the court will find for the insurer. Furthermore, if the court determines that the Royal Globe action was frivolous, the court could award the insurer sanctions. 69

Another feared consequence of Royal Globe was that it would cause insurance costs to rise since the insurer would make

64. Moradi-Shalal, 46 Cal. 3d at 301, 758 P.2d at 66, 250 Cal. Rptr. at 124.
65. As Justice Mosk put it "the majority's [reasoning] stands the concept of legislative intent on its head". Moradi-Shalal, 46 Cal. 3d at 318, 758 P.2d at 78, 250 Cal. Rptr. at 136.
66. Id. at 301, 758 P.2d at 66, 250 Cal. Rptr. at 124.
67. Id.
68. Id.
69. See CAL. CIV. PROC. CODE § 128.5 (West 1982 & Supp. 1990). Under § 128.5 "[c]very trial court may order a party . . . to pay any reasonable expenses . . . incurred by another party as a result of bad faith actions or tactics that are frivolous . . ." id.
greater expenditures to pay the costs of coerced settlements, excessive jury awards, and higher attorney fees. However, neither the court nor the legal commentaries cited any factual evidence in support of these claims.

The court also found that Royal Globe created a conflict of interest since the insurer had a direct duty to its insured as well as to third party claimants. This “conflict of interest”, meant that the settlement process could be disrupted and the insured disadvantaged. Unfortunately, this argument ignores the well-established practice in the insurance industry of providing independent counsel where a potential conflict of interest is created. By providing independent counsel an insurer’s duty to both the insured and the third party claimant is preserved.

E. DIFFICULTY IN APPLYING THE ROYAL GLOBE DECISION

The court observed that approximately 25 other Royal Globe cases were awaiting review, and that “many” had reached “conflicting conclusions” in the courts of appeal. The court said this evidenced “analytical difficulties” which the lower

70. Moradi-Shalal, 46 Cal. 3d at 301, 758 P.2d at 66, 250 Cal. Rptr. at 124-25.
71. Id. at 302, 758 P.2d at 67, 250 Cal. Rptr. at 125.
72. Id.
73. See San Diego Navy Fed. Credit Union v. Cumis Ins. Co., 162 Cal. App. 3d 358, 371, 208 Cal. Rptr. 494, 503 (1984). In Cumis, the court considered a situation where an insurer is required to pay for independent counsel for an insured “when the insurer provides its own counsel but reserves its right to noncoverage at a later date. [The court] conclude[d] under these circumstances there is a conflict of interest between the insurer and the insured, and therefore the insured has a right to independent counsel paid for by the insurer.” id. at 361, 208 Cal. Rptr. at 496. See alsoCAL. CIV. CODE § 2860 (West 1974 & Supp. 1990). § 2860 provides, “If the provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, the insurer shall provide independent counsel to represent the insured . . . .” id.
74. The court also asserted that Royal Globe left several unanswered questions regarding the practicality of actions against insurers pursuant to CAL. INS. CODE § 790.03. The court found that Royal Globe failed to define a “bad faith” refusal to abide by § 790.03, specify the stage at which the insurer’s duty to settle arises, discuss whether mutual good faith obligations are imposed on third party claimants, and failed to address “a host of constitutional problems such as vaguefulness, the right to a jury trial, and the right to contract.” Moradi-Shalal, 46 Cal. 3d at 302, 758 P.2d at 67, 250 Cal. Rptr. at 125. With respect to these “unanswered questions” allegedly created by Royal Globe, the court did not address these questions other than simply mentioning them. By not addressing them at all, the court undermined their alleged import.
75. Moradi-Shalal, 46 Cal. 3d at 303, 758 P.2d at 67, 250 Cal. Rptr. at 125.
The majority stated that one analytical problem which lower courts had in interpreting *Royal Globe* was that a third party claimant must wait until the “conclusion” of the action against the insured before suing the insurer for breach of Section 790.03(h). Lower courts had difficulty in determining whether a settlement can constitute such a “conclusion” for a *Royal Globe* suit, or whether a prior judicial determination of the insurer’s liability is required.

The *Moradi-Shalal* court held that settlement is an insufficient conclusion of the underlying action and ruled that there must be a “conclusive judicial determination” of the insured’s liability before the third party can succeed in an action against the insurer under Section 790.03. The court recalled that in *Royal Globe* a joint lawsuit against both the insured for negligence and the insurer for violating its duties under Section 790.03(h) would be improper. By holding that a determination of the insured’s liability to a third party claimant was a prerequisite to a recovery in a *Royal Globe* action, the court adopted the reasoning of *Williams v. Transport Indemnity Company* and *Heninger v. Foremost Insurance Company*.

The *Moradi-Shalal* court next turned to the specific issue of

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76. Id.
77. Id.
78. Id.
79. Id. at 305-306, 758 P.2d at 69, 250 Cal. Rptr. at 127.
80. Id. at 306, 758 P.2d at 69, 250 Cal. Rptr. at 127-28. The court stated three reasons for this conclusion. First, a joint trial would violate Cal. Evid. Code § 1155 which provides that evidence that an alleged tortfeasor is insured is inadmissible to prove the insured’s negligence or wrongdoing. The purpose of § 1155 is to prevent the prejudicial use of such evidence during an action against an insured. Id. Second, a joint trial would hamper the defense of the insured on the issue of liability. Id. Third, an injured party’s damages resulting from an insurer’s violation of Cal. Ins. Code § 709.03(h)(5) and (h)(14) would be best determined after the conclusion of the action by the third party claimant against the insured. Id.
81. 157 Cal. App. 3d 953, 203 Cal. Rptr. 868 (1984). In *Williams*, the court held that if the insured is not liable to the claimant, then the insurer is also not liable on the claim. Id. at 960, 203 Cal. Rptr. at 872.
82. 175 Cal. App. 3d 830, 221 Cal. Rptr. 303 (1983). The *Heninger* court relied on *Williams*, concluding that Cal. Ins. Code § 790.03 did not require an insurer to pay or settle every claim presented by a third party claimant without regard to whether its insured is liable on the underlying claim. *Heninger*, 175 Cal. App. 3d 835, 221 Cal. Rptr. at 306.
defining a "concluded action" for a *Royal Globe* action. The court was interested in whether a settlement met this requirement. The court noted that some courts of appeal followed *Doser v. Middlesex Mutual Insurance Company*, *Nationwide Insurance Company v. Superior Court*, *Williams v. Transport Indemnity Company*, and *Heninger v. Foremost Insurance Company*, which collectively hold that a viable cause of action for an alleged violation of [section 790.03(h)] may not be filed until the twin requirements of conclusion of the dispute between the injured party and the insured and a final determination of the insured's liability are alleged.

The court of appeal in *Moradi-Shalal* departed from the *Nationwide* analysis and instead adopted an alternative analysis. Under this analysis the court of appeal relied upon *Rodriquez v. Fireman's Fund Insurance Company* and concluded that plaintiff could maintain a Section 790.03 action following a

84. Id.
85. 101 Cal. App. 3d 883, 162 Cal. Rptr. 115 (1980). *Doser* was the first opinion after *Royal Globe* to refer to "determination of liability" as a condition precedent to a Cal. Ins. Code § 790.03 cause of action.
89. In *Doser*, the court held that an insured's cause of action for bad faith of the insurer could not arise until the insured incurred a binding judgment in excess of the policy limit. *Doser*, 101 Cal. App. 3d at 891, 162 Cal. Rptr. at 119-20.
*Nationwide Ins. Co. v. Superior Court*, 128 Cal. App. 3d 711, 180 Cal. Rptr. 464 (1982) cited *Doser*. The Nationwide court held that because the judgment against the insured could be reversed on appeal and the case retried, *Royal Globe*’s concerns regarding discovery and determination of damages were fully applicable. Thus, the court concluded that *Royal Globe*’s language about determination of liability and conclusion of the action "could only have had reference to a final determination and conclusion, a final judgment." *Nationwide*, 128 Cal. App. 3d at 714, 180 Cal. Rptr. at 466.


In *Heninger v. Foremost Ins. Co.*, 175 Cal. App. 3d 830, 221 Cal. Rptr. 303 (1985) the court cited *Nationwide* and *Williams* and concluded that a *Royal Globe* action could not be brought unless the twin requirements of conclusion of the dispute between the injured party and the insured and a final determination of the insured's liability were alleged. *Heninger*, 175 Cal. App. 3d at 834, 221 Cal. Rptr. at 305.
90. *Moradi-Shalal*, 46 Cal. 3d at 309-310, 758 P.2d at 72, 250 Cal. Rptr. at 130.
settlement and a dismissal with prejudice of the underlying claim. 92

The Moradi-Shalal majority found the court of appeal's reliance on Rodriguez to be "misplaced" since there was no admission of liability by defendant. 93 The majority rejected this approach and instead adopted the reasoning of Nationwide for four reasons. 94

First, allowing the claimant to sue the insurer after settling the underlying claim would mean the establishment of the insured's liability within the Royal Globe action itself. 95 The majority was apprehensive of the evidentiary problem this would cause, since evidence of insurance would make up an essential part of the case and would have an obvious potential to prejudice the jury's determination of the insured's liability. 96

92. Id. The court of appeal believed that the obvious purpose of the Royal Globe requirement of a "conclusion" of the underlying action was to avoid prejudicing the defense of the insured in the underlying case. In addition, this requirement could be used to ascertain the amount of the damages, suffered by the injured plaintiff. id. This requirement should not shield an errant insurer from the consequences of its tortious breach of its duties to an injured claimant. id.

The Moradi-Shalal majority noted that the court of appeal seemed confused about the requirements for a Royal Globe action. The court of appeal stated that "the language in Royal Globe 'until the liability of the insured is first determined' was not necessary to and did not serve the purpose of determining any of the facts or issues of that case which deferred the determination of the Section 790.03 action until after the conclusion of the underlying action." id. Later, the court of appeal demonstrated its inconsistency by stating "we must next determine whether the insured's liability has been conclusively established". id. The court of appeal said such a determination was a prerequisite to bringing an unfair practice bad faith action against the insurer. id.

In support of its holding the court of appeal relied upon Rodriguez v. Fireman's Fund Ins. Co., 142 Cal. App. 3d 46, 190 Cal. Rptr. 705 (1983). In Rodriguez, the court held that there was a proper Royal Globe action where the insured admitted liability. id. at 53, 190 Cal. Rptr. at 709. Such an admission made a prior judgment determining liability unnecessary. id.


93. Moradi-Shalal, 46 Cal. 3d at 310, 758 P.2d at 73, 250 Cal. Rptr. at 131.
94. Id. at 311, 758 P.2d at 73, 250 Cal. Rptr. at 131.
95. Id.
96. Id. In Royal Globe the California Supreme Court held that CAL. EVID. CODE §
A second problem would involve the difficulty in preventing the jury from considering the settlement as evidence that the insured was liable. The court noted that California Evidence Code Section 1152 prohibited the admission of such evidence to prove the settling party's liability on the settled claim.

Third, establishing the insured's actual liability after settlement would involve litigation of the very issue that the insured and the insurer attempted to avoid litigating. By allowing a post settlement Royal Globe suit, the third party claimant would obtain a windfall. Because of the potential windfall to the injured party, the court was suspicious that the insurer might not discharge its duties to the insured in an impartial manner.

Finally, the majority reasoned that a settlement combined with a dismissal with prejudice legally precluded litigating the liability of the insured. In effect, a settlement served the purpose of a final conclusion as to the underlying action for liability and damage claims.

A fair reading of the Royal Globe opinion could show that the Royal Globe majority did not necessarily require a final judicial determination of the underlying action between the insured and the third party claimant as a condition precedent for a third

1155 prohibits a third party claimant from suing both the insurer (under Cal. Ins. Code § 790.03) and the insured (on the underlying claim) in the same lawsuit. § 1155 prohibits the introduction of evidence that a person was insured for the harm caused. Such evidence could not be used to prove negligence or other wrongdoing.

97. Moradi-Shalal, 46 Cal. 3d at 312, 758 P.2d at 74, 250 Cal. Rptr. at 132.
100. Moradi-Shalal, 46 Cal. 3d at 312, 758 P.2d at 74, 250 Cal. Rptr. at 132; the court believed that allowing for post settlement litigation would penalize the insurer for choosing to settle a claim by subjecting the insurer to subsequent litigation on the liability issue already settled.
101. Id. A third party plaintiff could settle and retain the benefits of the settlement. He could then sue the insurer for additional compensation if the insurer failed to award an adequate settlement on the underlying claim.
102. Id.
103. Id.
party to sue the insurer.\textsuperscript{105} When the \textit{Royal Globe} majority stated that a third party action could be brought once "liability of the insured is first determined",\textsuperscript{106} it was not eliciting additional conditions for filing the action. Arguably, under \textit{Royal Globe}, a third party action against an insurer could first be filed when the action between the insured and the third party was "concluded".\textsuperscript{107} Trial between the third party and the insurer could not commence until the liability of the insured was first determined.\textsuperscript{108} This rationale is supported by \textit{Rodriguez v. Fireman's Fund Insurance Company},\textsuperscript{109} \textit{Afuso v. United States Fidelity & Guaranty Company},\textsuperscript{110} and \textit{Vega v. Western Employers Insurance Company}.\textsuperscript{111}

Furthermore, the \textit{Rodriguez} court articulated a more compelling policy than elicited by \textit{Moradi-Shalal} for not requiring a final judgment as a prerequisite to a \textit{Royal Globe} action. \textit{Rodriguez} recognized the "possibility of abuse by insurance companies who might entice a settlement by unfair practices, then seek to hide behind the cloak of that settlement."\textsuperscript{112}

Most importantly, the California Supreme Court said in \textit{Coleman v. Gulf Insurance Group},\textsuperscript{113} "the more plausible interpretation of [section 790.03], subdivision (h)(5) is that the provision was intended to apply only to prejudgment conduct."\textsuperscript{114} This focus on the insurer's prejudgment conduct together with \textit{Royal Globe}'s goal of prohibiting unfair practices and encouraging good faith settlements\textsuperscript{115} logically points to the conclusion that no prior judgment against the insured ought to be required of an injured claimant as a condition precedent for a \textit{Royal Globe} suit.

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105. \textit{Royal Globe}, 23 Cal. 3d at 884, 592 P.2d at 332, 153 Cal. Rptr. at 845.
107. \textit{Id.}
108. \textit{Id.}
113. 41 Cal. 3d 782, 718 P.2d 77, 226 Cal. Rptr. 90 (1986).
114. \textit{Coleman}, 41 Cal. 3d at 796-97, 718 P.2d at 85, 226 Cal. Rptr. at 98.
\end{flushleft}
F. RETROACTIVITY OF THE MORADI-SHALAL DECISION

In overruling Royal Globe, the Moradi-Shalal majority said its decision would not apply retrospectively. As to all Royal Globe actions filed before Moradi-Shalal, the court required a prior determination of liability.

III. THE DISSENT

Justice Mosk stated that the issues on review had not been addressed, and that the court chose to eliminate plaintiff’s cause of action entirely. Mosk declared that an objective reading of Section 790.03 to be prima facie evidence that the legislature intended the statute to provide redress for insureds as well as third party claimants. He noted that a violation of the UPA took place even where only a single deceptive act could be proved, and section 790.03(h) created two methods by which the prohibited acts may be shown.

Justice Mosk did not believe that the majority's warning to the insurance industry not to commit the unfair practices prohibited by the Insurance Code would be a significant deterrent to unfair practices. Mosk further stated that "in 29 years there did not exist a single case where the Insurance Commissioner has disciplined an insurance carrier for violations of the insurance code."

116. Moradi-Shalal, 46 Cal. 3d at 305, 758 P.2d at 69, 250 Cal. Rptr. at 127.
117. Id. at 313, 758 P.2d at 74-75, 250 Cal. Rptr. at 133.
118. Id. at 314, 758 P.2d at 75, 250 Cal. Rptr. at 133.
119. Id. at 314, 758 P.2d at 75, 250 Cal. Rptr. at 134.
120. Id. at 314-16, 758 P.2d at 75-76, 250 Cal. Rptr. at 134.
121. Moradi-Shalal, 46 Cal. 3d at 316, 758 P.2d at 76-77, 250 Cal. Rptr. at 135; a violation of the subdivision occurs if the prohibited acts are knowingly committed on one occasion or if knowledge cannot be established, then it will suffice if the acts are performed with such frequency as to indicate a general business practice. See Sherwood & Packer, Review of Selected 1975 California Legislation, 7 Pac. L.J. 237, 484 (1976).
122. Moradi-Shalal, 46 Cal. 3d at 316, 758 P.2d at 76-77, 250 Cal. Rptr. at 135; Mosk believed that statutory language regarding repetition of misconduct may be relevant to the Insurance Commissioner to issue a cease and desist order but such language is irrelevant to an aggrieved private litigant who can show that the insurer acted deliberately. See Delos v. Farmers Ins. Group, 93 Cal. App. 3d 642, 653, 155 Cal. Rptr. 843 (1979).
123. Moradi-Shalal, 46 Cal. 3d at 316-17, 758 P.2d at 76, 250 Cal. Rptr. at 135.
124. Id. at 317, 758 P.2d at 77, 250 Cal. Rptr. at 135.
Mosk then turned to the Legislature's failure to enact bills that would have overruled Royal Globe. Mosk believed this failure represented an affirmative legislative approval of Royal Globe. Moreover, in 1983 the Legislature amended section 790.03 without addressing or changing subdivision (h) or the Royal Globe decision. Mosk believed that such non-action by the Legislature indicated an intent to leave the law undisturbed.

Mosk refuted the majority's argument that Royal Globe was an "aberration" in that he found previous cases held that the Insurance Code authorized action by claimants and not exclusively by the state's administrative agency. Mosk noted Schlauch v. Hartford Accident & Indemnity Company where the court stated that "[t]he decision in Royal Globe was thus merely a change in remedy of enforcing the duty of an insurer." Moreover, contrary to the majority's findings Mosk

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125. Id. at 317-18, 758 P.2d 77-78, 250 Cal. Rptr. at 135-36. The first such bill was Senate Bill No. 483 (1979 Reg. Sess.). This bill passed the Senate and was referred to the Assembly. Ultimately, the bill "died" in the Assembly. id.
127. Moradi-Shalal, 46 Cal. 3d 318, 758 P.2d at 78, 250 Cal. Rptr. at 136.
129. Moradi-Shalal, 46 Cal. 3d at 318-19, 758 P.2d at 78-79, 250 Cal. Rptr. at 136-37; The first case was Greenberg v. Equitable Life Assurance Society, 34 Cal. App. 3d 994, 110 Cal. Rptr. 470 (1973). In Greenberg, the court held that "Section 790.09 thus contemplates a private suit to impose civil liability irrespective of governmental action against the insurer for violation of the Insurance Code. The fair construction is that the person to whom civil liability runs may enforce [the statute] by an appropriate action." Greenberg, 34 Cal. App. 3d at 1001, 110 Cal. Rptr. at 475. The Greenberg court stated that any other construction would overturn Crisci v. Security Ins. Co., 66 Cal. 2d 425, 435 P.2d 173, 58 Cal. Rptr. 13 (1967) by implication. id. at 1001 n.5, 110 Cal. Rptr. at 475 n.5.
130. Second, in Shernoff v. Superior Court, 44 Cal. App. 3d 406, 118 Cal. Rptr. 680 (1975) the court said that the Insurance Commissioner's disciplinary authority is limited to restrain against future illegal conduct. The court relied on § 790.09 which clearly states that no cease and desist order absolves a person from civil liability. id. at 409, 118 Cal. Rptr. at 682.
131. The third case was Homestead Supplies, Inc. v. Executive Life Ins. Co., 81 Cal. App. 3d 978, 147 Cal. Rptr. 22 (1978). In Homestead, the court held that the Insurance Code is directed at insurers, not insureds. In fact, one of the statutory purposes is to protect the public. id. at 992, 147 Cal. Rptr. at 30.
133. Moradi-Shalal, 46 Cal. 3d at 319, 758 P.2d at 79, 250 Cal. Rptr. at 137, citing
found that courts of appeal did not have difficulty in applying *Royal Globe*.\(^{132}\)

Justice Mosk concluded in his dissent that by overruling *Royal Globe* the *Moradi-Shalal* majority was also overruling by implication *Greenberg v. Equitable Life Assurance Society of the United States*,\(^{133}\) *Shernoff v. Superior Court of Los Angeles County*,\(^{134}\) and *Homestead Supplies, Inc. v. Executive Life Insurance Company*.\(^{135}\)

### IV. THE EFFECT OF *MORADI-SHALAL* AND A THIRD PARTY CLAIMANT’S ALTERNATIVES TO A *ROYAL GLOBE* ACTION

The *Moradi-Shalal* decision eliminated a third party bad faith action against the insurer based upon the California Insurance Code and restored the bad faith principles that prevailed prior to *Royal Globe*.\(^{136}\)

#### A. THIRD PARTY BAD FAITH ACTIONS BY ASSIGNMENT

As a result of the *Moradi-Shalal* decision, bad faith actions may still be maintained by the insured against the insurer for breach of the good faith covenant that is implied in all insurance contracts. However, the third party claimant cannot assert a cause of action for an alleged breach of the implied covenant since the covenant arises from the insurance contract to which the claimant is not a party.\(^{137}\)

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Schauch, 146 Cal. App. 3d at 934, 194 Cal. Rptr. at 663.


Despite the Moradi-Shalal decision, it should be noted that an insured’s claim for economic damages resulting from a breach of the implied covenant is assignable to a third party. Under such an assignment, a third party can maintain a bad faith action against the liability insurer.\(^{138}\)

**B. THE UNFAIR COMPETITION STATUTE: A NEW STATUTORY BASIS FOR A THIRD PARTY CLAIMANT TO SUE AN INSURER FOR BAD FAITH**

In the 1988 general election, Californians passed Proposition 103 and California Insurance Code Section 1861.03(a) to offset the victory for the insurance industry, *inter alia*, in Moradi-Shalal.\(^{139}\) The new law provides that insurance companies will be subject to the state laws governing unfair competition in trade practices, civil rights, and state antitrust laws and that the insurance industry shall now be subject to the laws applicable to any business.\(^{140}\) Since California Insurance Code Section 790.03 applies exclusively to the “business of insurance”, it seems improbable that the quoted language could reasonably be interpreted to resurrect a private *Royal Globe* cause of action.\(^{141}\)

Proposition 103 also makes insurers expressly subject to the numerous and complex provisions of the state's unfair business practices laws.\(^{142}\) The purpose of the unfair business trade practice statutes is to “safeguard the public against the creation or perpetuation of monopolies and to foster and encourage competition, by prohibiting unfair, dishonest, deceptive, destructive, fraudulent, and discriminatory practices by which fair and honest competition is destroyed or prevented.”\(^{143}\) California courts interpret “unfair competition” to mean any unfair business

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139. See California Ballot Pamphlet, analysis of Prop. 103 by Legislative Analyst, as presented to voters, Gen. Elec., Nov. 8, 1988, at 98, 140.
141. L.A. Daily J. Rpt., Dec. 16, 1988, at 10, col. 1. Proposition 100, which would have explicitly revived private *Royal Globe* claims, was defeated at the polls. *id.*
143. CAL. BUS. & PROF. CODE § 17001 (West 1987).
practice prohibited by law.144

Recently, in Beatty v. State Farm Mutual Automobile Insurance Company145 the California Court of Appeal interpreted the state's prohibition on unfair competition to include unfair business practices by the insurance industry. In Beatty, the court of appeal held that California Business and Professions Code Section 17200 et seq. could serve as a proper basis for remedying the unfair practices of insurers.146 The court noted that the adoption of the unfair competition statute by the Legislature reflected an expansion of common-law notions of unfair competition. "[T]he Legislature, by adopting [Civil Code] [S]ection 3369, broadened the scope of legal protection against wrongful business practices generally, and in so doing extended to the entire consuming public the protection once afforded only to business competitors."147

The court pointed out that this ruling was not in conflict with Moradi-Shalal since that decision merely eliminated a private cause of action pursuant to Insurance Code Section 790.03.148 In fact, Moradi-Shalal recognized the continued validity of "administrative remedies" and "appropriate common law actions" against insurers.149

Section 17200 et seq. has long been interpreted as a consumer protection statute.150 Its purpose was to ferret out unfair business practices wherever they might occur and in whatever guise human ingenuity can devise.151 Moreover, the statute's standing provision, section 17204 also evinces the Legislature's intention that the statute be applicable to all businesses including the insurance industry.152

146. Id. at 385, 262 Cal. Rptr. at 83.
147. Beatty, 213 Cal. App. 3d at 383, 262 Cal. Rptr. at 81-82, citing Barquis v. Merchants Collection Ass'n., 7 Cal. 3d 94, 109, 496 P.2d 817, 827-28, 101 Cal. Rptr. 745, 755-56 (1972). Until 1977, the Unfair Competition Statute was located in CAL. CIV. CODE § 3369, at which time it was substantially re-enacted in its present form and location in the Business and Professions Code.
149. Id.
150. Id. at 383, 262 Cal. Rptr. at 81.
151. Id. at 387, 262 Cal. Rptr. at 84.
152. Id. at 384, 262 Cal. Rptr. at 82.
As stated in *Barquis v. Merchants Collection Association*, \(^{153}\) "[s]ection [17200 et seq.] demonstrates a clear design to protect consumers as well as . . . any member of the public to sue on his own behalf or on behalf of the public generally. If the legislature had been solely concerned with protection against . . . unfair competitive advantage, it would certainly have more narrowly circumscribed the class of persons permitted to institute such actions."\(^{154}\) Despite this new theory under which third party claimants can sue an insurer for unfair practices it must be pointed out that Section 17200 et seq. contains no provision for damages for violation of any of its provisions. Section 17200 et seq. merely provides a third party claimant with injunctive relief as a remedy for an insurer's bad faith acts.

V. CONCLUSION

In the final analysis, it appears that the insurance industry achieved a great victory when the California Supreme Court overruled *Royal Globe*. The benefits, however, may be short-lived.

The reasoning utilized by the *Moradi-Shalal* majority contains the seeds for its own destruction. To arrive at its proffered result, the California Supreme Court bent the principle of stare decisis to such an extreme that in its present "watered-down" form, the *Moradi-Shalal* decision, itself could conceivably be swept away in the same manner as *Royal Globe*. Under *Moradi-Shalal*’s analysis any prior court decision may be "properly" reconsidered and overruled where there exists contrary out-of-state decisions and legal commentary critical of the underlying court decision.

In addition, state legislative action or a public referendum that is more comprehensive than Proposition 103, could create a new statutory basis for a *Royal Globe* action. In the alternative, legislative action or a public referendum could also be used to add some "teeth" (by providing a damages provision) to the cause of action available to third party claimants under Califor-


\(^{154}\) *Barquis*, 7 Cal. 3d at 110-11 n.11, 496 P.2d 828-29 n.11, 101 Cal. Rptr. at 756-57 n.11.
nia's Unfair Competition Statute. Only in this way can a third party claimant be given protection from the insurer's potential unfair practices.

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