CASE STUDY PREPARED FROM ORIGINAL PUBLISHED OPINION

ERNEST A. LONG
Alternative Dispute Resolution
❖ Resolution Arts Building ❖
2630 J Street, Sacramento, CA 95816
ph: (916) 442-6739 • fx: (916) 442-4107
elong@ernestalongadr.com • www.ernestalongadr.com

Zhang v Superior Court

Business & Professions Code section 17200; Unfair Insurance Practices Act, Insurance Code section 790.03

Plaintiff Yanting Zhang bought a comprehensive general liability policy from California Capital Insurance Company. Later, she sued her insurer in a dispute over coverage for fire damage to her commercial property. The complaint included causes of action for breach of contract, breach of the implied covenant of good faith and fair dealing, and violation of the Unfair Competition Law (UCL). She alleged Cal Capital had "engaged in unfair, deceptive, untrue, and/or misleading advertising" by promising to provide timely coverage in the event of a compensable loss, when it had no intention of paying the true value of its insured's covered claims.

Cal Capital demurred to the UCL claim on the basis that it was an impermissible attempt to plead around the bar against private actions for unfair insurance practices under section 790.03. (*Moradi-Shalal v Fireman's Fund Ins. Companies* (1988) 46 Cal.3d 287) The trial court agreed, sustaining the demurrer. The Court of Appeal reversed. California Capital then sought review.

Justice Corrigan began the opinion for the California Supreme Court by noting that the Unfair Competition Law (Business and Professions Code section 17200) defines unfair competition as any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising. The UCL "borrows" rules set out in other laws and makes violations of those rules independently actionable. (*Cel-Tech Communications, Inc. v Los Angeles Cellular Telephone Co.* (1999) 20 Cal.4th 163) A practice may violate the UCL even if it is not prohibited by another statute. The UCL is not an "all-purpose substitute for a tort

or contract action." Instead, it provides an equitable means through which public prosecutors and private individuals can bring suit to prevent unfair business practices and restore money or property to victims of these practices.

Prevailing plaintiffs are generally limited to injunctive relief and restitution. Compensatory damages are not recoverable as restitution. (Pineda v Bank of America, N. A. (2010) 50 Cal.4th 1389) In addition, the voters restricted private enforcement of the UCL through Proposition 64 in 2004. Standing under the UCL is now limited to those who have suffered injury in fact and have lost money or property as a result of unfair competition. A private plaintiff must be able to show economic injury caused by unfair competition. (Kwikset Corp. v Superior Court (2011) 51 Cal.4th 310)

The question presented to the Supreme Court is the extent to which relief under the UCL is limited by the holding in Moradi-Shalal. That case abolished a 790.03 cause of action that had been approved by Royal Globe Ins. Co. v Superior Court (1979) 23 Cal.3rd 880) The Court in that case decided that Insurance Code section 790.03 permitted third party plaintiffs to sue insurers for unfair acts or practices proscribed by the statute. Moradi-Shalal overruled Royal Globe in 1988, but left intact administrative remedies and common law theories of private recovery against insurers. These included fraud, infliction of emotional distress, and either breach of contract or breach of the implied covenant of good faith and fair dealing. Thus, first party bad faith actions were unaffected by Moradi-Shalal. Later, Zephyr Park v Superior Court (1989) 213 Cal.App. 833 held that Moradi-Shalal's bar against actions under 790.03(h) applied to insureds as well as third party claimants, but it noted that insureds retain the right to bring common law causes of action for bad faith settlement practices.

Justice Corrigan explained that after Moradi-Shalal, the law regarding UCL claims against insurers went through a complicated evolution. Several appellate court decisions rejected attempts to state UCL causes of action against insurers in bad faith cases. In Manufacturer's Life Ins. Co. v Superior Court (1995) 10 Cal 4th 257, the Supreme Court made it plain that the Insurance Practices Act does not generally exempt insurers from UCL liability. In that case, an insurance agency alleged a conspiracy by other elements of the insurance industry to retaliate for its practice of disclosing to attorneys the actual costs of settlement annuities. The

complaint asserted claims under the Insurance Practices Act and the Cartwright Act, California's antitrust statute. The Court held that although a plaintiff could not plead around Moradi-Shalal by basing a UCL claim on conduct violating only 790.03, that a UCL claim was supported when the insurer's conduct independently violated the Cartwright Act. This was not an attempt to use the Unfair Competition Law to enforce 790.03, and therefore was not barred by Moradi-Shalal.

The case was followed by *State Farm Fire & Casualty Co. v Superior Court* (1996) 45 Cal.App.4th 1093, where insured homeowners sought damages for breach of the implied covenant of good faith and fair dealing, breach of contract, and fraud, based on the insurers alteration of their earthquake coverage. They also pursued UCL remedies. State Farm's writ followed an overruled demurrer. The Appellate Court held the UCL action was supported by the insureds' allegation of fraud and common law bad faith, which included examples of all three kinds of prohibited business practices: unlawful, unfair and fraudulent. The Court found the claims were "independent bases for plaintiffs'" UCL cause of action. This was consistent with the Supreme Court's recent finding that the independent Cartwright Act violation was sufficient to support a claim under the UCL, notwithstanding the fact the acts complained of also violated section 790.03. The Court made it clear the remedies were limited and there could be no claim under the UCL for compensatory or punitive damages. Thus the argument that *Royal Globe* would be resurrected was rejected.

Later cases echoed the concept that *Moradi-Shalal* was not meant to impose sweeping limitations on private antitrust or unfair competition actions. When specific legislation provides a "safe harbor" plaintiffs may not use the general unfair competition law to assault that harbor. (*Cel-Tech Communications, Inc. v Los Angeles Cellular Telephone Co. (1999) 20 Cal.4th 163*) A plaintiff may not plead around an absolute bar to relief simply by recasting the action as one for unfair competition. (*Manufacturers Life*, at p. 283.) But, to forestall an action under the UCL, another provision in the law must actually bar the action or clearly permit the conduct. (*Cel-Tech*, at p. 182)

In 2004, a split in Court of Appeal opinion was created by *Textron Financial Corp. v National Union Fire Ins. Co.* (2004) 118 Cal.App.4th 1061. Textron included a

UCL claim within its bad faith claim against its insurer. The trial court sustained the insurer's demurrer to the UCL claim and the Court of Appeal upheld that decision, disapproving *State Farm*. The Court refused to allow Textron to "plead around *Moradi-Shalal* by merely relabeling their cause of action as one for unfair competition." Justice Corrigan noted that here, the Court of Appeal had disagreed with the *Textron* ruling, and endorsed *State Farm* in concluding that an insurer is not protected from UCL liability simply because its claims handling practices may be prohibited by section 790.03. California Capital demurred herein based on the *Textron* rule that a UCL claim may not be brought for settlement practices prohibited by the Unfair Insurance Practices Act (UIPA) in section 790.03. Since the crux of the claim was for improper claims handling, Cal Capital argued the allegation of unfair competition was merely an attempt to plead around the bar of *Moradi-Shalal*.

California Capital urged the Supreme Court to follow *Textron* and the *Safeco* line of cases and to disapprove of *State Farm*. Justice Corrigan returned to the language of *Manufacturers Life* and its holding that the UIPA (790.03) does not exempt insurers from liability for anticompetitive conduct, and therefore acts violating both the UIPA and the Cartwright Act could give rise to a UCL claim. Thus, the *State Farm* court correctly recognized that this reasoning supports claims for UCL relief based on conduct proscribed by the UIPA, if it is independently actionable under the common law of insurance bad faith. (*State Farm*, at p. 1108) As explained in *Cel-Tech*, to bar a UCL action, another statute must absolutely preclude private causes of action or clearly permit the defendant's conduct. *Moradi-Shalal* creates no bar to common law fraud and bad faith actions, even if a 790.03 claim is not actionable.

As noted in State Farm, bad faith insurance practices may qualify as any of the three statutory forms of unfair competition. They are *unlawful*; the insurer's obligation to act fairly and in good faith to meet its contractual responsibilities is imposed by the common law as well as by statute. They are *unfair* to the insured; unfairness lies at the heart of a bad faith cause of action. They may also qualify as *fraudulent* business practices. Under the UCL it is necessary only to show that the plaintiff was likely to be deceived and suffered economic injury as a result of the deception. *Textron* improperly concluded that the *State Farm* opinion had been undermined by *Cel-Tech*, but that latter opinion did not disapprove of the

unfairness standard applied in <u>*State Farm*</u> for purposes of consumer actions. <u>*Textron*</u> also relied on <u>*Safeco*</u> improperly, as that was a third party action in which the plaintiff had no common law claim against the insurer.

<u>*Moradi-Shalal*</u> barred only claims brought under section 790.03 and expressly allowed first party bad faith actions, thus preserving the gist of first party UCL claims based on allegations of bad faith. <u>*Textron*</u> distinguished <u>*Manufacturers Life*</u> on the basis it dealt only with a Cartwright Act violation. Justice Corrigan explained that that case was not meant to impose sweeping limitations on private unfair competition claims. Instead, <u>*Manufacturers Life*</u> stands for the proposition that a cause of action neither barred by <u>*Moradi-Shalal*</u> nor absolutely precluded by other law may serve as the basis for a UCL claim. (<u>*Manufacturers Life*</u>, at p. 284) As the <u>*State Farm*</u> court observed, <u>*Moradi-Shalal*</u> was concerned with the adverse effects of recognizing an implied right of action for damages under section 790.03, whereas UCL remedies are limited generally to injunctive relief and restitution. A UCL claim does not duplicate the contract and tort causes of action involved in bad faith litigation, where damages are central. (<u>*Korea Supply Co. v Lockheed Martin Corp.*</u> (2003) 29 Cal.4th 1134)

The Supreme Court disapproves of <u>*Textron Financial Corp. v National Union Fire Ins. Co.*</u>, to the extent it is inconsistent with this opinion. The ruling here does not affect opinions in third party cases, which are beyond the scope of this case. Plaintiff Zhang's bad faith claims and her false advertising claims support the UCL claim. The allegations in the complaint of unreasonable delays, withholding of policy benefits and falsely telling her mortgage holder that she did not intend to repair the property, resulting in foreclosure proceedings, are sufficient to support a claim of unlawful business practices. (See <u>*Gruenberg v Aetna Ins. Co.*</u> (1973) 9 Cal.3d 566)

When the Legislature enacted the Unfair Insurance Practices Act, it contemplated only administrative enforcement by the Insurance Commissioner. Private UIPA actions are barred and a litigant may not rely on 790.03 as the basis for a claim. However, when insurers engage in conduct that violates both the UIPA and obligations imposed by other statutes or the common law, a UCL action may proceed. The Legislature did not intend that the UIPA operate as a shield against any civil liability.

The decision of the Court of Appeal is affirmed.

/////

This case study is provided in the hope it may prove useful in your practice or in the handling of litigated cases. If you receive a forwarded copy of this message and would like to be added to the mailing list, let me know.

Mediation and Binding Arbitration are economical, private and final. Alternative dispute resolution will allow you to dispose of cases without the undue time consumption, costs and risks of the courtroom. Your inquiries regarding an alternative means to resolve your case are welcome.