Bar Raised for Claims Against Insurers

The California Supreme Court ruled over 20 years ago that there is no private right of action for violations of the Uniform Insurance Practices Act (Insurance Code Section 790.03, *et seq.*) However, a recent decision, *Zhang v. Superior Court*, 09 C.D.O.S. 13302 (Oct. 29, 2009), gives plaintiffs an end-run around the bar on claims for violation of the Uniform Insurance Practices Act. The *Zhang* decision potentially opens the door for class actions against insurance companies for engaging in "fraudulent" conduct in violation of California's unfair competition laws.

The Uniform Insurance Practices Act prohibits certain unfair or deceptive acts by insurance companies, such as "misrepresenting pertinent facts or insurance policy provisions relating to any coverages at issue." In *Moradi-Shalal v. Fireman's Fund Ins. Cos.*, the California Supreme Court held that there is no private right of action for third parties against insurance companies for Uniform Insurance Practices Act violations. Plaintiffs may still bring common law claims against insurers such as breach of contract or breach of the implied covenant of good faith and fair dealing. *Moradi-Shalal* has since been extended to bar claims by first parties (i.e. claims by an insured against its insurer) for Uniform Insurance Practices Act violations.

Enterprising plaintiffs' counsel have attempted to plead around the holding of *Moradi-Shalal* by alleging that insurers violated the Unfair Competition Law (UCL) by engaging in conduct prohibited by the Uniform Insurance Practices Act. These claims have almost always been rejected because they would render *Moradi-Shalal* meaningless.

In *Zhang*, the plaintiff alleged that the defendant breached the insurance policy at issue in bad faith by refusing to authorize adequate payments for the repair and restoration of her commercial premises following a fire. The plaintiff also brought a cause of action for violation of the UCL, and alleged that the insurance company engaged in misleading advertising because it promised its insureds that it would timely pay covered claims, but it had no intention of doing so.

Zhang's cause of action for violation of the UCL concerned conduct expressly prohibited by the Uniform Insurance Practices Act. The court previously held in a nearly identical case that the plaintiff could not plead around *Moradi-Shalal* by alleging that the defendant insurance company violated the UCL by misrepresenting pertinent facts relating to any coverages or insurance policy provisions at issue in violation of the Uniform Insurance Practices Act.

The *Zhang* court reversed the trial court's order sustaining the defendant's demurrer, concluding that the plaintiff made "specific additional allegations" that brought them outside the scope of the Uniform Insurance Practices Act - namely, that the insurance company engaged in fraudulent conduct prohibited by the UCL by "promulgat[ing] misleading advertising." But this is a distinction without a difference, as the conduct at issue was squarely within the confines of conduct prohibited by the Uniform Insurance Practices Act.

While it is true that the burden of proof for a claim of fraudulent conduct under the UCL is different than the burden of proof for a claim for fraud, this militates towards sustaining the defendant's demurrer rather than allowing the case to go forward. A claim for fraud requires the plaintiff to prove intent to defraud, and that the representations were actually false. There are no such requirements under the UCL. Moreover, the requirement that the plaintiff prove that she relied upon the defendant's false or misleading statements to her detriment is relaxed in a UCL action. It makes no sense to allow the plaintiff's case to go forward under such circumstances where the alleged conduct falls within the scope of the Uniform Insurance Practices Act.

The *Zhang* case was not pled as a class action, but it could be used by plaintiffs to turn a case for breach of contract and bad faith into a false advertising class action. The California Supreme Court's recent decision in *In re Tobacco II Cases* opens the door to such claims.

The Court concluded that relief under the UCL is available on a class basis "without individualized proof of deception, reliance and injury." Thus, a court could conceivably certify a class consisting of a lead plaintiff who suffered an injury in fact and a class that has suffered no injury.

Although the remedies under the UCL are limited to injunctive relief and restitution, the exposure for carriers sued in false advertising class actions is potentially very large, as the plaintiff class could seek restitution for all premiums paid for a certain policy or policies issued over a period of four years or more.

When faced with a false advertising class action, counsel should argue that *Zhang* was wrongly decided, and that the carrier did not engage in "fraudulent" conduct because it provided coverage in accordance with the terms of the policy. But what can carrier counsel do to defeat class certification in a case in which the insured alleges that the carrier misrepresented that it would timely pay all covered claims? Another recently decided case, *Kaldenbach v. Mutual of Omaha Life Ins. Co.*, 09 C.D.O.S. 13062 (Oct. 26, 2009), provides some valuable guidance.

The *Zhang* decision potentially opens the door for class actions against insurance companies for engaging in 'fraudulent' conduct in violation of California's unfair competition laws.

In *Kaldenbach*, the plaintiff sought to certify a class of purchasers of "vanishing premium" life insurance policies. The policies required the purchaser to pay a premium that was higher than usual in the early years of the policy, and the premiums were then invested. The policies were marketed on the premise that enough cash value would accumulate so that at a fixed date, policyholders would be relieved of any further obligations to pay premiums. When the plaintiff was informed twelve years after he purchased his policy that the accumulated cash reserves were no longer adequate and he would be required to make additional premium payments, he filed suit on behalf of a purported class of all purchasers located in California of the type of policy he purchased.

The *Kaldenbach* court began its analysis by noting that while the *Tobacco II* court held that absent class members were not required to submit individualized proof of deception, reliance and injury, a plaintiff moving for class certification must still meet the requirements of Code of Civil Procedure Section 382. This requires the plaintiff to establish, among other things, the existence of predominant common questions of law or fact among the class members.

The *Kaldenbach* court acknowledged that the plaintiff did not need to establish that each class member relied upon the alleged misrepresentations by the defendant, but it concluded that the plaintiff did not meet the requirements of Section 382 because individualized issues predominated and could not be proven on a class-wide basis. The plaintiff alleged that the defendant used uniform sales materials and training in marketing the life insurance policies, but the evidence presented by the defendant contradicted the plaintiff's allegations. Therefore, there were individualized issues regarding whether the defendant's insurance agents took its voluntarily training courses and read its manuals, whether the agents actually followed the training manuals, and what materials, disclosures, representations and explanations were given to individual purchasers.

The *Kaldenbach* opinion therefore teaches that an insurance company may defeat a motion for class certification in a false advertising class action by showing that the alleged misrepresentations regarding its policies were not uniform across the class. For instance, if the plaintiff in *Zhang* amends her complaint in an attempt to represent a class of plaintiffs, the defendant should attempt to produce evidence that the agents selling its policies made representations that were not uniform, and that the agents did not uniformly follow the insurer's guidelines for selling those policies.

Zhang was decided against the great weight of authority of cases that hold that a plaintiff may not bring a cause of action for violation of the UCL for conduct that is prohibited by the Uniform Insurance Practices Act. The California Supreme Court should overturn *Zhang* at its first opportunity but, until then, insurance carrier counsel must argue that the case was wrongly decided. If a plaintiff files a false advertising class action, carrier counsel should argue that the case is not suitable for class certification because of a lack of uniformity of the representations made when the policies were sold.

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Judicial Branch at a Crossroads

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Justice severely delayed has real economic consequences. Delays of the sort soon to come will harm our economy and California's capacity to recover from recession. Contracts will go unenforced, vital capital will be tied up in an interminable judicial limbo, and cases of every kind will stagnate for years. In the current economic environment, when so much effort is being put into stimulus, and uncertainty plagues the economy, the state cannot afford for court delays to become a brake on economic recovery.

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The potential damage to our justice system produced by the coming budget cuts is so unthinkable that we, as a branch, have found it impossible to presently face and make the choices in priorities required to mitigate the terrible harms that otherwise will occur.

Some take the narrow view that the problem is primarily external to the courts. This view sees the solution mostly in persuading the Legislature to appropriate more money for the courts or to shift looming new cuts onto others. That was not possible last year, and nothing suggests a different outcome in the years ahead, with even deeper cuts at hand. If the Judiciary is to be sheltered from new larger cuts, then on whom will the cuts fall? Health care? Education?

In the end, the answer to our Judicial Branch budget problems must be found mostly within the resources presently accessible to the court system - not through competing against other worthy state institutional interests in a vain effort at shifting burdens onto other already devastated government constituents.

Last year trial courts statewide received much needed budget relief when a portion of trial court funds dedicated to development of large new computer systems was redirected to protect court operations. A choice among internal priorities was made, and rightly so. While the computer funds can be tapped again, much more is urgently needed to cope with the huge cuts ahead.

Fortunately, one other viable source exists within the Judicial Branch. That is SB 1407, the $5 billion revenue bond for courthouse construction and renovation. The bonds, which have not yet been sold, are supported by a new revenue stream in the form of added court fees and fines. Collections on those fees and fines began on Jan. 1, 2009, and the money is accumulating at the rate of about $280 million per year.

A relatively small portion of the SB 1407 stream was used last year to absorb necessary budget cuts. The Legislature and governor possess the power to lawfully redirect more in the coming years. Sale of the bonds can prudently be postponed for a period long enough to preserve courtroom operations through the recession. Then the stream can be put back to work supporting sale of the bonds, and new courthouses can become a reality. Any portion of the SB 1407 stream not now needed to save trial court operations can be used to advance new courthouse projects where possible.

We are indeed at a crossroads where a crucial decision on priorities will determine our future path.

Will we go down the path of rushing to build new courthouses at the cost of: massive, permanent courtroom and courthouse closures; layoffs of thousands of skilled court employees; substantial delays in the timely processing of cases; a growing denial of access to justice for those most in need; and significant damage to California's already hurting economy? Or will we take the path where resources now available to the Judicial Branch are devoted first to preserving trial court operations so that, when new courthouses are eventually built, we will have healthy trial courts to occupy them?

Los Angeles has five new courthouse projects funded by SB 1407. We accept the fact that those projects may need to be delayed to cope with the state's growing budget crisis.

By placing the consequences of our choices fully in the balance, the decision comes clear. Preserving existing courtroom operations takes priority in the scales where justice matters most.