SUTHERLAND

LEGAL ALERT

August 7, 2013

From Insurer's Shield to Insured's Sword: California Supreme Court Authorizes Policyholder Unfair Competition Law Claims for Unfair Insurance Practices

On August 1, 2013, the California Supreme Court ruled in *Zhang v. The Superior Court of San Bernardino County*, No. S178542 (Cal. Aug. 1, 2013) that insurance practices violating the state's Unfair Insurance Practices Act (UIPA) may also support a first-party action under California's Unfair Competition Law (UCL). Click here for the opinion.

The UCL prohibits acts of "unfair competition," which are defined as "any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising." Cal. Bus. & Prof. Code § 17200. By prohibiting "any unlawful" business act or practice, the UCL generally makes violations of other laws independently actionable via first-party claims. Yet in a previous ruling, the California Supreme Court held that the UIPA does not "create a private cause of action against an insurer that commits one of the various acts listed [in the Insurance Code]." *Moradi-Shalal v. Fireman's Fund Ins. Companies*, 46 Cal.3d 287, 304-05 (1988). The majority's decision in *Zhang* partly resolved an ambiguity that arose after the *Moradi-Shalal* ruling regarding the viability of UCL claims against insurers whose practices allegedly violate the UIPA.

In *Zhang*, the plaintiff insured bought a comprehensive general liability policy from insurer California Capital. Following a dispute over coverage for fire damage to her commercial property, the plaintiff sued California Capital for breach of contract, breach of the implied convenant of good faith and fair dealing, and violation of California's UCL. The plaintiff, in her UCL claim, alleged that the insurer "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 timely paying the true value of its insureds' covered claims. The insurer sought to dismiss the plaintiff's claim as "an impermissible attempt to plead around" the bar against private actions for unfair insurance practices under the UIPA, as articulated in *Moradi-Shalal*. Though the trial court agreed and sustained a demurrer to the action, the California Court of Appeal reversed, holding that the false advertising claim was an independent viable basis for an action under the UCL.

On review, a majority of the California Supreme Court affirmed the Court of Appeal's reversal, concluding that the UIPA does not "operate as a shield" to immunize insurers from UCL liability for conduct that may violate other laws in addition to the UIPA. (Slip op. at 24) The court's majority found it significant that the plaintiff's claim under the UCL sought to recover from the insurer for allegedly false advertising – a bad faith insurance practice that qualifies as one of three statutory forms of unfair competition. After analyzing *Moradi-Shalal* and its "rather complicated evolution," the court noted that nothing in that decision or its progeny supports the view that "UCL actions may not be brought for the *types* of activities covered by the UIPA." *Id.* at 18 (emphasis added). Rather, *Moradi-Shalal* "itself established that while violations of [the UIPA] are themselves not actionable, there is no bar to common law fraud and bad faith actions." *Id.* at 17-18. In the majority's view, because *Moradi-Shalal* barred only UIPA claims and expressly allowed first-party bad faith actions, it "preserved the gist of first party UCL claims based on allegations of bad faith." *Id.* at 19.

Thus, while a plaintiff may not "plead around an absolute bar to relief simply by recasting the cause of action as one for unfair competition," the *Moradi-Shalal* rule does not "prohibit an action under the [UCL] merely because some other statute on the subject does not, itself, provide for the action or prohibit the challenged conduct." *Id.* at 14. Rather, to forestall an action under the UCL, "another provision must actually bar the action or clearly permit the conduct." *Id.*

In concluding that the *Moradi-Shalal* rule did not bar the *Zhang* plaintiff's UCL claim, the majority opinion also noted that "UCL actions by private parties are equitable proceedings, with limited remedies" and thus are "quite distinct from the claims for damages with which *Moradi-Shalal* was concerned." (Slip op. at 2) Because UCL remedies are limited in scope (generally extending only to injunctive relief and restitution), the court dismissed concerns that UCL claims would duplicate contract and tort causes of action involved in bad faith litigation, where damages are central.

The majority also minimized concerns raised by the insurer that the litigation of the plaintiff's UCL cause of action would be unmanageable, because it would require "the examination of [the insurer's] claims handling practices in thousands of cases." *Id*. at 22. First, the majority noted that, were the plaintiff seeking to recover on behalf of the other insureds, the plaintiff would be required to certify a class action. Second, how plaintiff might ultimately go about proving her claim was irrelevant in the majority's view: on demurrer review "the possible difficulty of proving the plaintiff's allegations is not a relevant consideration." *Id*. at 22-23. Lastly, and perhaps most importantly, the majority noted that a UCL claim may be based on a lone instance of unfair business practice.

A concurring opinion by Associate Justice Kathryn M. Werdegar rejected the majority's interpretation of *Moradi-Shalal*, asserting instead that UCL claims under the "unlawful" prong are permitted when predicated on violations of the UIPA. According to the concurring view, the *Moradi-Shalal* court held only that the California legislature did not create a right of action in the UIPA, not that it intended to foreclose any private right of action.

Nonetheless, the majority's opinion makes it clear that "[p]rivate UIPA actions are absolutely barred; a litigant may not rely on the proscriptions of [the UIPA] as the basis for a UCL claim." *Id*. at 23. Yet "when insurers engage in conduct that violates both the UIPA and obligations imposed by other statutes or the common law, a UCL action may lie." *Id.* at 24.

■ ■ ■

If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

Authors

Phillip E. Stano	202.383.0261	phillip.stano@sutherland.com
Steuart H. Thomsen	202.383.0166	steuart.thomsen@sutherland.com
David W. Arrojo	202.383.0866	david.arrojo@sutherland.com
Wilson G. Barmeyer	202.383.0824	wilson.barmeyer@sutherland.com

Related Attorneys

Thomas M. Byrne	404.853.8026	tom.byrne@sutherland.com
Nicholas T. Christakos	202.383.0184	nicholas.christakos@sutherland.com
Thomas W. Curvin	404.853.8314	tom.curvin@sutherland.com
Ellen M. Dunn	212.389.5071	ellen.dunn@sutherland.com
John S. Pruitt	212.389.5053	john.pruitt@sutherland.com