BULLIVANTHOUSER

Samuel H. Ruby
San Francisco,
Shareholder-in-Charge

Direct Dial: 415.352.2723
Fax: 415.352.2701
Email Attorney

Back on the Menu in California Bad Faith Litigation: Unfair Competition Claims

By Samuel H. Ruby

Late last week, the California Supreme Court decided in *Zhang v. Superior Court* that a policyholder may use claims handling conduct as the basis of a suit for violation of California's unfair competition law. The decision resolves a split of authority that had developed in the state's intermediate appellate courts and may lead to more unfair competition claims in bad faith litigation, thereby increasing defense costs. Because the remedies for unfair competition are limited, however, the decision may not significantly increase the ultimate exposure of insurers in such litigation.

Zhang is the latest development in California's saga of statutory bad faith, which traces back to *Royal Globe Ins. Co. v. Superior Court* (1979), 23 Cal.3d 880. In *Royal Globe*, the Supreme Court held that private litigants could sue insurers for violations of California's Unfair Insurance Practices Act (Insurance Code § 790 et seq.; "the UIPA"). Nine years later, in *Moradi-Shalal v. Fireman's Fund Ins. Companies* (1988), 46 Cal.3d 287, the Supreme Court changed its mind and held that the UIPA does not provide a private cause of action and can only be enforced administratively by the Insurance Commissioner. The decision left intact, however, common law claims for breach of the covenant of good faith and fair dealing known as "bad faith."

In an effort to maintain statutory bad faith claims, policyholders turned to California's statutory unfair competition law (Bus. & Prof. Code, § 17200 et seq.; "the UCL"), which governs all businesses. The UCL prohibits "unfair competition," which it defines as "any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising." Policyholders argued that because claim-handling conduct that violates the UIPA is "unlawful," conduct amounting to such violations could be the predicate for a UCL claim. Courts, however, rejected such arguments, viewing them as improper "bootstrapping" to evade *Moradi-Shalal*. The rule emerged that a UCL claim cannot be brought solely because the conduct at issue is barred by the UIPA.

Policyholders have since attempted to bring UCL claims without relying on the UIPA. They have argued that irrespective of the UIPA, conduct amounting to common law bad faith is "unlawful, unfair and [sometimes] fraudulent," so it should be a valid predicate for a UCL claim. In *State Farm Fire & Casualty Co. v. Superior Court* (1996), 45 Cal.App.4th 109, a California appellate court accepted this argument and allowed a plaintiff to piggyback a UCL claim on a common law bad faith claim. However, in *Textron Financial Corp. v. National Union Fire Ins. Co.* (2004), 118 Cal.App.4th 1061, a different Court of Appeal rejected the argument, finding it just another impermissible attempt to "plead around" *Moradi-Shalal*.

In *Zhang*, the Supreme Court has endorsed *State Farm* and disapproved *Textron*. It is now clear that "bad faith insurance practices may qualify as any of the three statutory forms of unfair competition" and that *Moradi-Shalal* does not preclude UCL claims based on such practices. Consequently, policyholders who sue for bad faith may now be more likely to include an additional cause of action for unfair competition.

As consolation, however, the Supreme Court predicts that the impact will not be far-reaching. A UCL claim is an equitable claim that allows only injunctive relief and restitution. In a typical bad faith case, there is no injunction against future conduct to be issued—just restitution for harm that has already occurred. Such restitution, the Supreme Court implies, would be limited to return of premiums—and even that would not be allowed if the policyholder elects to retain the policy and collect benefits due under it.

Furthermore, policyholders bringing UCL claims can only recover restitution based on their own injuries and "may not represent the interests of others without meeting the requirements for a class action." Thus, outside of class actions, any harm suffered by policyholders other than the plaintiff as a result of the insurer's alleged practices will not be a proper subject of the UCL claim. And because UCL claims are equitable in nature, they are decided by the judge—not the jury.

Perhaps most importantly, the Supreme Court has limited *Zhang* to UCL claims brought by policyholders. The court expressly reserved judgment on whether third parties (such as injured parties asserting liability claims against a policyholder) may bring a UCL claim based on claim-handling conduct. The court noted, however, that allowing such claims would implicate the parade of horribles that led the court to adopt *Moradi-Shalal*. The court strongly implied that it has no desire to revisit that decision and "resurrect" third-party bad faith claims.