B183487

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT, DIVISION FIVE

THE STATE OF CALIFORNIA ex rel.
LINDA NEE AND JOHN METZ,

Plaintiff and Appellant,

vs.

UNUM PROVIDENT CORPORATION, ET AL,

Defendants and Respondents.

Appeal from the Superior Court for the County of Los Angeles,
The Hon. Carl West, Judge Presiding
LASC Case No. BC 299196

BRIEF OF *AMICI CURIAE* CONSUMER ATTORNEYS OF CALIFORNIA AND UNITED POLICYHOLDERS IN SUPPORT OF PLAINTIFF AND APPELLANTTHE STATE OF CALIFORNIA

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STATEMENT OF INTEREST OF THE *AMICI CURIAE*

Consumer Attorneys of California - is a voluntary membership organization representing over 6,000 associated consumer attorneys practicing throughout California. The organization was founded in 1962 and its members predominately represent individuals subjected in a variety of ways to, among other things, consumer fraud practices, personal injuries, employment torts and insurance bad faith. Consumer Attorneys of California has taken a leading role in advancing and protecting the rights of consumers and small businesses in both the courts and the Legislature.

The issue of the enforceability of the insurance statutes and the Penal Code in insurance cases through Insurance Code section 1871.7 is of particular interest to our members. Because a number of Consumer Attorneys of California's members practice in the insurance context – on behalf of both individuals and small businesses - it has a compelling interest in assuring that insurance companies are held to the highest standards of ethical conduct and good faith.

United Policyholders - The financial security that insurance policies provide is critical to business and property owners and an integral

part of the fabric of our economy and our society. United Policyholders, ("UP") is a non-profit charitable organization founded in 1991that is helping preserve the integrity of the insurance system by serving as an information resource on policyholders' interests, rights and duties. Donations, grants and volunteer labor support the organization's work.

UP monitors the national insurance marketplace with a particular focus on California and areas impacted by large scale natural disasters. The organization's staff and volunteers participate in public policy forums, disseminate information about the claim process, and file *amicus* briefs in cases involving coverage and claim disputes. UP serves as a clearinghouse on consumer issues related to commercial and personal lines insurance products. www.unitedpolicyholders.org

In this brief, United Policyholders seeks to fulfill the "classic role of amicus curiae by assisting in a case of general public interest, supplementing the efforts of counsel, and drawing the court's attention to law that escaped consideration." *Miller-Wohl Co., Inc. v. Commissioner of Labor & Indus.*, 694 F.2d 203, 204 (9th Cir. 1982). .

United Policyholders has filed over one hundred and thirty five *amicus* briefs since it was founded. UP's *amicus* brief was cited in the

U.S. Supreme Court's opinion in *Humana Inc. et al v. Mary Forsyth*, 525 U.S. 299 (1999) UP was the only national consumer organization to submit an amicus brief in the landmark case of *State Farm v. Campbell*, 538 U.S. 408 (2003*)*. We have been invited by several divisions of the California Court of Appeal, to participate in oral argument as *amicus curiae.*

INTRODUCTION

This action – based on violations of Penal Code sections 549 and 550(b) - was brought pursuant to Insurance Code section 1871.7. In their demurrer, the defendant insurers asserted several grounds for their argument that they are not subject to this section 1871.7 qui tam-type action brought on behalf of the plaintiff State of California by two relators, Linda Nee and John Metz. The trial court granted the demurrer without leave to amend, essentially concluding that regulation of fraud claims under Insurance Code section 1871.7 applies to everyone ***except*** the entities expressly and specifically regulated under the Insurance Code – insurers. As amply demonstrated in the merits briefs of the plaintiff and the briefs of other amici, such a conclusion is at odds with the plain language of the statutes at issue.

But another issue raised by the defendant insurers requires further elucidation. Essentially, the insurers argue that allowing private citizens, through the section 1871.7 qui tam device, to sue insurers constitutes an improper and impermissible "end run" around the Supreme Court's decision in *Moradi-Shalal v. Fireman's Fund Ins. Cos*. (1988) 46 Cal.3d

287. That argument is not only insupportable in light of the public policy concerns expressed in *Moradi-Shalal*, it is also in direct conflict with the clear and unambiguous purpose of section 1871.7.

Section 1871.7 is a legislative mandate to foster what are essentially law enforcement actions – not ***private*** actions – against rogue insurers who refuse to follow the mandates of the Insurance Code and the Penal Code. Refusing to apply section 1871.7 to insurers not only undermines the fundamental purpose of the statute, but places an additional, unresourced burden on the Department of Insurance and the Attorney General to enforce the standards of ethical behavior that apply to insurance companies.

Accordingly, the proposition that section 1871.7 is barred by *Moradi-Shalal* is insupportable and should be rejected.

LEGAL ARGUMENT

1.

MORADI-SHALAL BARS ONLY PRIVATE ACTIONS PREDICATED SOLELY ON THE INSURER'S FAILURE, UNDER THE UNFAIR PRACTICES ACT TO TIMELY SETTLE A CLAIM. SINCE THIS IS, IN ESSENCE, A LAW ENFORCEMENT ACTION FOR VIOLATIONS UNRELATED TO THE UNFAIR PRACTICES ACT, *MORADI-SHALAL* HAS NO RELEVANCE TO THIS CASE.

Defendants' attempt to invoke *Moradi-Shalal* as a basis for precluding this action must fail because the argument is based on an unreasonably overbroad application of the case and because the allegations in this case simply do not fall within the *Moradi-Shalal* parameters.

A. *Moradi-Shalal* limits an insurer's liability only for a private action that is based *solely* on the violation of the Unfair Practices Act and which relates to the refusal to timely settle a claim – and nothing more.

In *Moradi-Shalal v. Fireman's Fund Ins. Cos*. (1988) 46 Cal.3d 287, the California Supreme Court overturned its decade-old decision in *Royal Globe Ins. Co. v. Superior Court* (1979) 23 Cal.3d 880. In *Royal Globe*, the court had previously held that the third-party injured victim of an insured tortfeasor had standing to bring a private action against the tortfeasor's insurer for the insurer's failure to reasonably and timely settle the third-party victim's injury claim once the liability of the tortfeasor was reasonably clear. The predicate for the duty to reasonably settle was the obligations specifically detailed in Insurance Code section 790.03(h), part of the Unfair Practices Act, Insurance Code at section 790.01, et seq.

In *Moradi-Shalal*, the Supreme Court reassessed the reasoning and public policy issues surrounding *Royal Globe's* establishment of a third-party right of action and concluded, for a host of public policy reasons, that the statute did not properly

confer private-party standing to bring an action for failing to timely settle a claim in violation of section 790.03(h)(5).

Immediately after the *Moradi-Shalal* decision, a number of appellate courts stringently enforced the ban on private-party standing under *Moradi-Shalal* and even went so far as to hold that an unfair competition law (UCL) action, brought under Business and Professions Code section 17200, was precluded by *Moradi-Shalal* as an illegitimate effort to "bootstrap" a private claim for damages around the bar of *Moradi-Shalal*. (See, e.g., *Safeco Ins. Co. v. Superior Court (Hanna)* (1990) 216 Cal.App.3d 1491.)

Notably, the cases decided in the immediate aftermath of *Moradi-Shalal* and holding that *Moradi-Shalal* applied in various contexts, all addressed actions that were predicated squarely on violations of section 790.03(h). (See, e.g. *Maler v. Sup.Ct. (Federal Ins. Co.)* (1990) 220 CA3d 1592, 1598; *Industrial Indemnity Co. v. Superior Court* (1989) 209 Cal.App.3d 1093; *Lee v. Travelers Companies* (1988) 205 Cal.App.3d 691, 694-695; *Doctors' Co. Ins. Services v. Superior Court* (1990) 225 Cal.App.3d 1284, 1289; *American Internat. Group, Inc. v. Superior Court* (1991) 234

Cal.App.3d 749, 768.)

But as subsequent cases evolved, a clear distinction began to be drawn by the courts between cases which were solely predicated on violations of section 790.03(h) and cases which were predicated on the violation of some other statute, regulation or duty that, only incidentally, may have also constituted a violation of section 790.03(h). Those situations, the courts – including the Supreme Court – have made clear are ***not*** barred by *Moradi-Shalal*. (See, e.g., *Manufacturer's Life Ins.Co. v. Superior Court* (1995) 10 Cal.4th 257, 283-284; *Neufeld v. Balboa Ins. Co.* (2000) 84 Cal.App.4th 759; *State Farm Fire & Cas. Ins. Co. v. Superior Court (Allegro)* (1996) 45 Cal.App.4th 1093, 1105-1108, disapproved on other grounds in *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal.4th 163, 185-186.)

For example, in *Manufacturers Life*, the plaintiff alleged that the insurer's conduct constituted a violation of the Cartwright Act. The insurer argued that *Moradi-Shalal* precluded the action because the misconduct alleged constituted a violation of section 790.03(h) and was therefore immune from even a UCL action. The

Supreme Court rejected that argument:

> We have since held in *Moradi-Shalal*, *supra*, 46 Cal.3d 287, 304-305, that neither section 790.03 nor section 790.09 creates the basis for a private cause of action, ***but that insurance companies do have civil liability for such conduct***. The Court of Appeal below correctly understood that "*Moradi-Shalal* marks a return to the fundamental principle that the UIPA [section 790.01, et seq.], like all statutes, is to be applied according to its terms. Its language neither creates new private rights ***nor destroys old ones***. This was the view of Justice Richardson [] [who, in his dissent,] wrote that section 790.09 'preserves ***any*** preexisting civil or criminal liability which the insurer might face under ***other statutory or decisional*** law.' (*Royal Globe*, *supra*, 23 Cal.3d at p. 893 ...)." This court did not, as defendants argue, hold in *Moradi-Shalal* that insurers are subject to common law, but not statutory, civil liability for anticompetitive activities and unfair business practices. We said, with respect to third parties and insureds who had no cause of

action under section 790.03 ***for bad faith refusal to settle***: "[C]ourts retain jurisdiction to impose civil damages or other remedies against insurers in appropriate common law actions, based on such traditional theories as fraud, infliction of emotional distress, and (as to the insured) either breach of contract or breach of the implied covenant of good faith and fair dealing." (*Moradi-Shalal*, *supra*, 46 Cal.3d 287, 304-305.) Bad faith refusal to settle is not conduct encompassed by the Cartwright Act. ***Whether statutory causes of action under the Cartwright Act and the UCA may be stated against an insurance company was not an issue in Moradi-Shalal*** which, ***in the context of bad faith refusal to settle claims***, overruled *Royal Globe Ins. Co.*, *supra*, 23 Cal.3d 880, and confirmed that section 790.03, subdivision (h), was not the source of a private right of action against an insurer for that conduct. (*Manufacturers Life*, at 279-280; initial emphases in original, other emphases added.)

Manufacturers Life thus expressly and strictly limited the effect of *Moradi-Shalal*: *Moradi-Shalal* limits ***only*** actions predicated on a bad faith refusal to settle an insurance claim. Actions predicated on other conduct – or on ***different duties requiring the insurer to settle*** – are not precluded. (See, also, *Stop Youth Addiction v. Lucky Stores, Inc.* (1998) 17 Cal.4th 553, 560-566, in which the Supreme Court extensively discusses its holding in *Manufacturers Life* and the meaning and effect of *Moradi-Shalal*.) These two distinctions were clearly enunciated in two appellate cases following and applying *Manufacturers Life*.

First, in *Allegro*, Division 3 of this Court held that because the insurer had an independent duty to reasonably settle the claims, under common law bad faith principles, *Moradi-Shalal* did not preclude the insured's bad faith action predicated on the breach of that duty – even though the same conduct also breached the statutory duty to settle under section 790.03(h)(5).

Second, in *Neufeld*, the court held that the insurer's violation of a regulation requiring insurers to notify insureds of applicable statute of limitations dates was not precluded by *Moradi-Shalal*, even though the regulation was promulgated as part of the Unfair Practices Act. In

rejecting that argument by the defendant, the *Neufeld* court held that the premise that *Moradi-Shalal* precludes imposition of liability on an insurer for ***every*** violation of section 790.03 sweeps too broadly:

> [Defendant's] theory is untenable. The essential problem is that it assumes too broad a view of *Moradi-Shalal*. *Moradi-Shalal* demonstrated that as a matter of ***statutory analysis***, it is wrong to conclude that the Unfair Practices Act was intended to include private causes of action.
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> * * *
>
> To the degree that the decision rested on sound policy independent of what the Legislature intended, *Moradi-Shalal* was not directed at the Unfair Practices Act ***generally*** – much less a regulation promulgated pursuant to its authority – ***but at what the court majority perceived to be the extremely bad idea, initially set forth in Royal Globe [ ], of allowing third-parties to sue insurers for not settling fast enough when liability was reasonably clear***. (*Neufeld*, at 762-763; initial emphasis in original, other

emphasis added.)

Thus, as the *Manufacturers Life* court held and as subsequent courts confirmed, all that *Moradi-Shalal* limits is an insurer's liability in a ***private action*** brought **solely** under section 790.03(h) and **solely** for the failure to timely settle a claim. Since, as discussed in the next section, this is neither a private action nor one predicated on the insurers' failure to timely settle a claim under section 790.03(h), *Moradi-Shalal* has no application whatsoever.

B. This action is predicated on statutes which are not even related to, let alone dependent on, the Unfair Practices Act, is not a private action for personal damages and does not seek to impose liability for failure to settle claims timely and, as such, is not barred by *Moradi-Shalal*.

First, as in *Manufacturers Life*, the allegations in this case are not predicated on violations of the Unfair Practices Act. Rather, like in *Manufacturers Life*, the defendant's liability in this case is predicated on acts that are forbidden by statutes ***other than*** the Unfair Practices Act. In *Manufacturers Life*, the basis for the

action was the insurer's violation of the Cartwright Act, which was being enforced through the UCL. In this case the basis for the action is defendants' violations of Penal Code sections 549 and 550, which is being enforced through section 1871.7.

Second, the allegations in this case are not about the defendants' failure to timely settle claims. Rather they are about fraudulent misrepresentations made by insurers to claimants in the handling of claims, and in the sale and marketing of their insurance products, as precluded under the relevant Penal Code sections.

And third – and perhaps most important – this is not a private action in any sense of the word. Indeed, this is an action that is brought on behalf of the State of California itself, invoking the police powers of the State and the Insurance Commissioner to enforce the law.

Insurance Code section 1871.7 has been characterized as a "qui tam" action. (*People ex rel. Allstate Ins. Co. v. Muhyeldin* (2004) 112 Cal.App.4th 604, 608.) Traditional qui tam actions under either Federal (31 USC sections 3729-3736) or State (Government Code section 12652) law are essentially predicated on seeking

recovery of money spent by the government as the result of fraud.[1]

A "classic" qui tam action would be a federal action against a defense contractor for fraudulently providing the government with $500 hammers. Traditional qui tam statutes essentially allow a private person – with "insider" information about the defendant's fraud against the government – to bring an action, under seal, on behalf of the government. At its option, the government can either intervene and prosecute the action on its own behalf or allow the private plaintiff to proceed in the name of the government. Either way, the private plaintiff is granted a financial incentive to bring the action and, especially, to prosecute it in the event the government declines to do so.

Insurance Code section 1871.7 adopts the traditional qui tam

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[1] These traditional qui tam actions have an ancient lineage. (Richard A. Bales, *A Constitutional Defense of Qui* Tam, 2001 Wis.L.Rev. 381, 385-388, 2001.) They were originally developed as part of Roman law and were adopted into English common law as early as 695 A.D. (*Id.*) Naturally, the English common law qui tam procedure was adopted as part of American common law from its inception. (*Id.*) The first American qui tam statute was enacted shortly after the Constitution was ratified and the current False Claims Statute was originally enacted in 1863. (Valerie R. Park *The False Claims Act, Qui Tam Relators, and the Government: Which is the Real Party to the Action?*, 43 Stanford L.Rev. 1061, 1063-1066.)

procedural process, but is unique in that it does not have to be predicated on fraud against the ***government***. Rather, the statute may be used to prosecute fraud against an insurer or, as delineated in Penal Code sections 549 and 550(b), ***against anyone who misrepresents information in connection with, or opposing an insurance claim***. (See Insurance Code section 1871.7(b), (e)(1); Penal Code sections 549, 550(b).)

And as with traditional qui tam actions, an action under 1871.7 is not brought as a ***private*** action, but is brought by a private person ***in the name of the government***, i.e., as a public action. (Insurance Code section 1871.7(e)(1).) And although both the federal and state false claim acts, and section 1871.7, state that the action may be brought on behalf of the both the individual and the government, standing analyses of traditional qui tam actions make clear that the individual is not bringing the action in their own interest (i.e., for individual damages) apart from the allocated incentive provided by the statute itself. (Bales, at 398-402.)

Thus, a qui tam action, both the traditional form and the 1871.7 form, is essentially an action brought "by" the government

to enforce the law. It is not a private action. It is not a class action. It is not concerned with restoring any individual's property. It does not seek to obtain damages for anyone other than the government (in the traditional qui tam context) and, in fact, only permits recovery of civil ***penalties*** under section 1871.7(b). It is not a tort action. And it is not an action under the UCL to enforce any part of the Unfair Practices Act.

Such law enforcement-type actions brought on behalf of the public have long been approved of by the courts for the very purpose of assuring that the available protections are, in fact, invoked for the benefit and protection of the government and its citizens. (*Graham v. DaimlerChrysler Corp.* (2005) 34 Cal.4th 553, 565 ["' . . . [T]he private attorney general doctrine "rests upon the recognition that ***privately initiated lawsuits are often essential to the effectuation of the fundamental public policies embodied in constitutional or statutory provisions*** . . . ."'" (Emphasis added)]; *City of Santa Monica v. Stewart* (2005) 126 Cal.App.4th 43, 83 [same]; *Great Lakes Properties, Inc. v. City of El Segundo* (1977) 19 Cal.3d 152, 159, fn 2, dis. Op. of J. Tobriner [citizen suits to

enforce environmental laws]; *People v. Pacific Land Research Co.* (1977) 20 Cal.3d 10, 17.)

And such law enforcement-type actions are specifically necessary because government agencies simply do not have the resources to bring the actions themselves. As the court recently noted in *Wal-Mart Real Estate Business Trust v. City Council of the City of San Marcos* (2005) 132 Cal.App.4th 614, 624-625, quoting from *Nestande v. Watson* (2003) 111 Cal.App.4th 232, 240, "'The private attorney general theory is based in part on the supposition that even in cases in which public enforcement is possible, public agencies ***are often unwilling or incapable because of insufficient staffing to protect important rights***.'" (Emphasis added.)

Because a qui tam action brought pursuant to section 1871.1 is not a private action to enforce the Unfair Practices Act provisions requiring an insurer to timely settle a claim, *Moradi-Shalal* is not even relevant to the analysis.

CONCLUSION

Defendants' assertion of *Moradi-Shalal* as a basis for precluding the plaintiff's claims in this action is a red herring of the worst sort. An analysis of the argument reveals that it has no merit, yet it has consumed, and will consume, considerable effort on the part of the parties, amicus and this Court to clear out the underbrush in order to get to that conclusion. But that is the conclusion that must inevitably be reached. Accordingly, the trial court's order cannot be supported on this basis and the arguments submitted by defendants on this ground must be rejected.

Dated: April 17, 2006

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CERTIFICATION AS TO LENGTH OF BRIEF

The word count for this Brief, excluding Table of Contents, Table of Authorities, Proof of Service, and this Certification is approximately 3,294 words. This count was calculated utilizing the word count feature of Microsoft Word.

Dated: April 17, 2006

Respectfully submitted,

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