S161008

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

VILLAGE NORTHRIDGE HOMEOWNERS ASSOCIATION,

Plaintiff and Appellant,

vs.

STATE FARM FIRE & CASUALTY COMPANY, et al.,

Defendant and Respondent.

Review After a Decision by the Court of Appeal, Second Appellate District, Division Eight, 2nd Civil No. B188718
Los Angeles County Superior Court Case No. BC265328

AMICUS BRIEF OF UNITED POLICYHOLDERS

SHARON J. ARKIN
(SBN: 154858)
THE ARKIN LAW FIRM
333 S. Grand Avenue, 25th Floor
Los Angeles, CA 90071
T: 213.943.1344
F: 866.571.5676

Attorney for *Amicus Curiae* United Policyholders

INTRODUCTION

In its reply brief, defendant and respondent State Farm Fire & Casualty Company posits the issue in this case as a very general one, i.e., "[d]id the Court of Appeal err in refusing to follow established precedents of this Court, *Garcia* and *Taylor*." (State Farm's Reply Brief, 2008 WL 2805914, at *16.) But the issue in this case is not so general. Rather, as expressed by this Court in granting review, the issue in this case is limited to the insurance context, and ***only*** the insurance context:

> This case presents the following issue: After settling a first party claim by accepting money from and executing a release of the insurer, may an insured sue the insurer for fraud in inducing the settlement and seek to avoid the release without returning the money the insurer paid?

The narrowness of the issue in this case requires a different focus from the general proposition set forth in *Garcia v. California Truck Co.* (1920) 183 Cal. 767 and *Taylor v. Hopper* (1929) 207 Cal. 102 that a settlement agreement and release in a personal injury case cannot be set aside except by an action for rescission, which must include the return of the settlement funds. This is so because the relationship of insured and insurer is unique. Not only has this Court's jurisprudence established that there is a quasi-fiduciary duty on the part of an insurer to its insured, including an actionable duty of good faith and fair dealing (*Frommoethelydo v. Fire Ins. Exch.* (1086) 42 Cal.3d 208, 215;*Gruenberg v. Aetna Ins. Co.* (1973) 9 Cal.3d 566, 573; *Egan v. Mutual of Omaha Ins. Co.* (1979) 24 Cal.3d 809, 818), but the Legislature has also stepped in and imposed express requirements on insurers in dealing with their insureds – including the mandate that an insurer must not misrepresent coverage. (Insurance Code section 790.03(h)(1).) Furthermore, the Insurance Commissioner has promulgated regulations intended to enforce the provisions of section 790.03(h). Those regulations affirmatively require ***full disclosure*** by the insurance company to the policyholder of ***all*** benefits and coverage under the policy. (10 Cal. Code of Regs., section 2695.4.) As mandated in that regulation, an insurer "***shall*** disclose to a first party claimant or beneficiary, ***all benefits, <u>coverage</u>, time limits or other provisions*** of any insurance policy issued by that insurer that may apply to the claim presented by the claimant." (Section 2695.4(a); emphasis added.) This section imposes on the insurer a duty to speak; a duty to disclose. (*Spray, Gould & Bowers v. Associated International Insurance Company* (1999) 71 Cal.App.4th 1260, 1272-1273; *Neufeld v. Balboa Insurance* (2000) 84 Cal.App.4th 759, 761-762.)

As discussed below, the issue in this case really focuses on the tension between the public policy fostering settlements and the public policy requiring insurers to treat their insureds fairly, including the duty to disclose – truthfully – the coverage under the policy. While the public policy fostering settlements is important, it must give way to the common law, statutory and regulatory duties imposed on insurers to be honest and forthright with their insureds – especially when negotiating a settlement and full release of the insurer. As this Court held in *White v. Western Title Ins. Co.* (1985) 40 Cal.3d 870886, fn. 9), litigation initiated by the insured does not suspend or abrogate the insurer's duty of good faith and fair dealing. That duty continues, even during litigation. Thus, even in negotiating a litigation release, the insurer has a duty to speak, and to speak honestly. Any other rule would undermine – and virtually extinguish – the decades of jurisprudence and the statutory and regulatory framework that is designed to protect insureds from the unmitigated exercise of power by insurers.

INTEREST OF THE *AMICUS*

The financial security that insurance policies provide is critical to consumers and is an integral part of the fabric of our economy and our society. United Policyholders is a non-profit charitable organization founded in 1991 that 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

United Policyholders monitors the national insurance marketplace with a particular focus on California. 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. United Policyholders serves as a clearinghouse on consumer issues related to commercial and personal lines insurance products. (www.unitedpolicyholders.org.)

This case falls squarely within the parameters of United Policyholders' interests because it deals with the fraud of an insurance company in misrepresenting the policy's limits to the insured. Such a misrepresentation goes to the core of the insurer/insured relationship, and thus to the core of United Policyholders' mission.

LEGAL ARGUMENT

THE PUBLIC POLICY CONCERNS UNDERLYING ENFORCEMENT OF SETTLEMENT AGREEMENTS MUST GIVE WAY TO THE PROTECTION OF INSUREDS, EVEN WHEN SETTLING LITIGATION AGAINST THEIR INSURERS

Although there are strong public policies in California that foster the settlement of civil litigation, those policies are not inviolate. Where those policies conflict with other public policies, they can – and must – give way. Just such a circumstance exists in this case.

A. The public policy supporting settlement of civil litigation, while important, is not inviolate and, in the proper circumstance, must give way to other public policy concerns.

As a general rule, public policy supports settlement of civil litigation and the enforcement of settlement agreements. (*Assemi v*. Assemi (1994) 7 Cal.4th 896, 910; *Poster v. Southern California Rapid Transit District* (1990) 52 Cal.3d 266, 270; *Osumi v. Sutton* (2007) 151 Cal.App.4th 1355, 1359.) That policy does not, however, necessarily control where there are other public policy interests at stake.

For example, in *Timney v. Lin* (2003) 106 Cal.App.4th 1121, 1127, the court noted that while enforcement of settlement agreements was an important public policy, that "does not allow a court to endorse or enforce a provision in a settlement agreement which is illegal, contrary to public policy, or unjust," citing to this Court's decision in *California State Auto. Assn. Inter-Ins. Bureau v. Superior Court* (1990) 50 Cal.3d 658, 664. As such, the *Timney* court went on to hold, "even though there is a strong public policy favoring the settlement of litigation, this policy does not excuse a contractual clause that is otherwise illegal or unjust." (*Id*. at 1127.)

Similarly, in *Cariveau v. Halferty* (2000) 83 Cal.App.4th 126, the appellate court affirmed the trial court's refusal to enforce a confidentiality provision in a settlement agreement between a securities broker and a former client which precluded the client from discussing the broker's defalcations with her employer or reporting her conduct to regulatory authorities. The court engaged in an extensive analysis balancing the public policy considerations underlying the enforcement of settlement agreements with statutory and regulatory public policies promoting disclosure of malfeasance and concluded that the policy supporting enforcement of settlement agreements must fall to the more compelling public policy permitting full disclosure of malfeasance to regulatory authorities.

In *Ryan v. Garcia* (1994) 27 Cal.App.4th 1006 the appellate court refused to enforce a settlement agreement where the only evidence of the agreement arose from confidential mediation discussions. The court held that the public policy supporting confidentiality of mediation discussions overrides the public policy supporting enforcement of settlement agreements. In another example, the court in *Barndt v. County of Los Angeles* (1989) 211 Cal.App.3d 397 held that enforcement of a settlement agreement must take a back seat to the general public policy that an employer cannot be compelled to accept the personal services of a specific employee.

These cases – and many more – all demonstrate that the public policy supporting enforcement of settlement agreements is not the end of the query, but merely its beginning. When there are other, competing public policies at stake, balancing those public policies may require that a settlement agreement be set aside. This is just such a case.

B. The public policy concerns underlying the insurance relationship override the need to assure enforceability of settlement agreements.

Although important, assuring the enforceability of settlement agreements must give way to the public policies protecting insureds established both in this Court's jurisprudence and in statutory and regulatory mandates.

Nearly three decades ago, this Court explained in *Egan* the public policies that justify imposition of tort liability on an insurer for what would otherwise be a "mere" breach of contract:

> As one commentary has noted, "The insurers' obligations are ... rooted in their status as purveyors of a vital service labeled quasi-public in nature. Suppliers of services affected with a public interest must take the public's interest seriously, where necessary placing it before their interest in maximizing gains and limiting disbursements ... (A)s a supplier of a public service rather than a manufactured product, the obligations of insurers go beyond meeting reasonable expectations of coverage. The obligations of good faith and fair dealing encompass qualities of decency and humanity inherent in the responsibilities of a fiduciary. Insurers hold themselves out as fiduciaries, and with the public's trust must go private responsibility consonant with that trust."

(Goodman & Seaton, Foreword: Ripe for Decision, Internal Workings and Current Concerns of the California Supreme Court (1974) 62 Cal.L.Rev. 309, 346-347.)

The importance of the principle that an insurer must act in good faith with respect to its insured cannot be overstated and has been repeatedly reaffirmed by this Court on numerous occasions. (See, e.g., *Communale v. Traders & Gen. Ins. Co.* (1958) 50 Cal.2d 654, 658; *Gruenberg v. Aetna Ins. Co., supra; Silberg v. California Life Ins. Co.* (1974) 11 Cal.3d 452, 461-462; *Egan, supra*; *Foley v. Interactive Data Corp.* (1988) 47 Cal.3d 654, 683; *Cates Construction, Inc. v. Talbot Partners* (1999) 21 Cal.4th 28, 44; *Jonathan Neil & Associates, Inc. v. Jones* (2004) 33 Cal.4th 917, 940.)

And the precept that an insurer owes a special obligation to its insured to handle claims fairly and in good faith has been reinforced by the Legislature and by the Commissioner of Insurance. The Legislature passed Insurance Code section 790.03(h) imposing specific obligations on insurers in settling claims by their insureds. Indeed, the very first mandate expressed by the Legislature was to bar insurers from "[m]isrepresenting to claimants pertinent facts or insurance policy provisions relating to any coverages at issue." (Ins. Code section 789.03(h)(1).) The Legislature's public policy concerns could not be any clearer: An insurer ***must*** accurately disclose policy coverages to an insured.

Additionally, the Insurance Commissioner has promulgated regulations pursuant to section 790.03(h). Among other things, those regulations require insurers to fully disclose to their insureds "***all benefits, coverage, time limits or other provisions of any insurance policy*** issued by that insurer that may apply to the claim presented." (10 Cal.Code Regs. 2695.4(a); emphasis added.)

Under section 790.03 and regulation 2695.4(a) then, State Farm was expressly precluded from misrepresenting the policy limits to Village Northridge and, under the regulations had an affirmative duty to speak, i.e., to disclose the coverage limits of the Village Northridge policy, and to speak ***honestly***, i.e., to **accurately** disclose the **actual** limits. Village Northridge's complaint – the allegations of which must be accepted as true, given that the issues come up on demurrer (Weil & Brown, *California Practice Guide: Civil Procedure Before Trial* (Rutter 2008) ¶¶ 7:45-7:45) – alleges, in fact, that State Farm not only violated this mandate during the course of its handling of its insured's claim, but also did so during the negotiation of the settlement of the litigation initiated by the insured.

And that brings up another important point that has not been addressed by the parties. State Farm's argument is predicated on the implication that once litigation commenced, and settlement talks were initiated, its duty of good faith and fair dealing disappeared and it could function in an arms' length relationship with Village Northridge. Not so. As this Court explained in *White v. Western Title Ins. Co.* (1985) 40 Cal.3d 870, 886, initiation of litigation against the insurer by the insured does ***nothing*** to dispel, abrogate or limit the insurer's duty of good faith and fair dealing. That duty – and the duty to speak, and speak honestly – continues.

Thus, in negotiating the settlement of not only the litigation, but the policy claims as well, State Farm had the duty to tell Village Northridge of the true policy limits. Anything short of that violated its duty of good faith and fair dealing, its obligations under section 790.03(h)(1) and the mandates of section 2695.4(a). Because State Farm violated those mandates, it cannot be allowed to hamstring its insureds by asserting the settlement agreement as a bar to the insured's fraud claim.

Another issue needs to be addressed in this context, i.e., State Farm's assertion that section 790.03 and the regulations promulgated pursuant to it cannot form a basis for the rationale in this case because to do so would violate this Court's ruling in *Moradi-Shalal v. Firemans' Fund Ins. Cos.* (1988) 46 Cal.3d 287, 305 that no private right of action can be stated on the basis of section 790.03. (State Farm's Reply Brief, 2008 WL 2805914, at *17.)

There are three responses to that argument. The first is that numerous courts have held since *Moradi-Shalal* was issued that although a private right of action cannot be based on a violation of section 790.03, violation of that section is evidence of bad faith. (See, e.g., *State Farm Mut. Auto. Ins. Co. v. Superior Court (Allegro)* (1996) 45 Cal.App.4th 1093, 1105.) Indeed, the courts in *Spray, Gould & Bowers* and *Neufeld* expressly rejected that very same argument made by the insurers in those cases when examining the applicability of section 2695.4. That conclusion is also consistent with this Court's holding in *White v. Western Title* that evidence of an insurer's bad faith settlement offers made during litigation are not barred by the litigation privilege.

The second response is that Village Northridge is not seeking to enforce section 790.03, *per se*. Rather, section 790.02 and its regulations establish a duty to speak, and to speak honestly. Where a party has a duty to speak and remains silent or, even worse, speaks falsely, it commits fraud. (See 10 Witkin, Summary, 10th Ed. (2005) Torts, §§ 793, 799.) It is the fraud that is the basis for Village Northridge's claim, not the violation of section 790.03.

And finally, reference to section 790.03 and the regulations, like the reference to this Court's jurisprudence on an insurer's duty of good faith and fair dealing, simply demonstrates the existence of an important public policy requiring insurers to speak, and to speak the truth. As this Court recognized in *Green v. Ralee Engineering Co.* (1998) 19 Cal.4th 66, 80, "fundamental public policy may be enunciated in administrative regulations that serve the statutory objective." In fact, statutes, regulations and common law are all sources of public policy. (*Cariveau v. Halferty* (2000) 83 Cal.App.4th 126, 132.) As discussed previously, all three sources are present in this case: This Court's jurisprudence on the existence of the duty of good faith and fair dealing, as well as the fact that the duty does not evaporate when the insured sues the insurer; section 790.03(h)(1) which expressly forbids an insurer from misrepresenting policy coverages; and, section 2695.4(a), which requires an insurer to provide accurate information about the policy coverages.

There is, therefore an unequivocal public policy that requires insurers to not only treat their insureds fairly, but which requires insurers to be open and honest with their insureds about what the policy covers. In weighing the public policies considerations between enforcement of settlements and allowing an insured to affirm a settlement agreement and sue for fraud where the insurer has lied to the insured about the coverage available in the negotiation of the settlement agreement, the public is best served by permitting the latter.

And the reasons for coming down on the side of permitting such an action by an insured were eloquently explained by the court in *DiSabatino v. USF&G* (1986) 635 F.Supp. 350:

> Simply as a matter of policy this cause of action should be deemed to exist. First, insurance companies would have everything to gain and nothing to lose by systematically defrauding tort claimants into accepting low settlement offers. In such cases, the company gambles that the deceit will not be uncovered. If the fraud is uncovered, then the company only faces litigation, or the costs of reimbursement, that it would have had to confront without a settlement. In economic terms, some insurance carriers calculate an "opportunity cost" which is artificially low." (*Id.*, at 355-356.)

More importantly, the reverse scenario simply does not arise. In other words, the threat of malicious prosecution makes it entirely unlikely that an insured would pursue such a fraud action arising out of a settlement (or that an attorney would take such a case) if there was no realistic basis for asserting that the insurer misrepresented material provisions of the policy that affected the insured's decision to settle. Thus, an "innocent" insurer is not likely to be subjected to unwarranted litigation, and a guilty insurer must not be permitted to take advantage of its insured by coercing a settlement at a certain level by lying about the coverage limits available.

Permitting an insured to affirm the settlement and seek damages for the fraud of its insurer achieves the appropriate balance: The insured has recourse to obtain the policy benefits it was actually entitled to – without the unrealistic expectation that it will be required to return money that has already been spent to restore the property – while yet protecting an "innocent" insurer that has been wrongly accused by allowing a malicious prosecution action against the insured should it turn out that the insured's claims are frivolous.

CONCLUSION

Although California's public policy of enforcing settlement agreements is important, it is not inviolate. Where, as here, an insurer's fraud in procuring a settlement – in violation of its duty of good faith and fair dealing and in violation of statutory and regulatory mandates – the public policy supporting enforcement of settlements must give way to the policy of holding insurers responsible for their contractual obligations.

Dated: December 8, 2008

THE ARKIN LAW FIRM

By:________________________

SHARON J. ARKIN
Attorney for *Amicus Curiae*
United Policyholders

CERTIFICATE OF LENGTH OF BRIEF

I, Sharon J. Arkin, declare under penalty of perjury under the laws of the State of California that the word count for this Brief, excluding Tables of Contents, Tables of Authority, Proof of Service and this Certification is 3,184 words as calculated utilizing the word count feature of the Word:Mac 2008 software used to create this document.

Dated: October 28, 2008

____

SHARON J. ARKIN