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COMMON-LAW BAD FAITH IN *WHITE V. WESTERN TITLE INSURANCE CO.*: THE DUTY CONTINUES

I. INTRODUCTION

California courts have held that an implied covenant of good faith and fair dealing exists in every contract.¹ This covenant requires that neither party prevent the other from receiving the fruits of their agreement.² Traditionally, only compensatory damages were recoverable in a claim for breach of this covenant.³ Courts have found, however, that a breach of the covenant of good faith and fair dealing may be tortious in cases involving insurance contracts⁴ thereby providing additional remedies to injured insureds.⁵ By elevating bad faith breach of contract to a tort, courts have enabled injured plaintiffs to collect damages that other-

1. The list of cases that have so held is too lengthy to warrant mention in this Note. However, see *Brown v. Superior Court*, 34 Cal. 2d 559, 564, 212 P.2d 878, 881 (1949) and *Universal Sales Corp. v. California Press Mfg. Co.*, 20 Cal. 2d 751, 771, 128 P.2d 665, 677 (1942) for the earliest California cases which held that this covenant is implied in all contracts. Many subsequent cases which discuss the implied covenant of good faith and fair dealing cite either or both of these cases as controlling authority. See, e.g., *Koehrer v. Superior Court*, 181 Cal. App. 3d 1155, 1169-70, 226 Cal. Rptr. 820, 828 (1986) and *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 1116, 207 Cal. Rptr. 123, 127 (1984).

2. See *supra* note 1; see also 1 B.E. WITKIN, *SUMMARY OF CALIFORNIA LAW* § 576, at 493 (8th ed. 1973); 3 A. CORBIN, *CORBIN ON CONTRACTS* §§ 570-71 (1960); 6 S. WILLISTON, *A TREATISE ON THE LAW OF CONTRACTS* § 887 (3d ed. 1962).

3. Traditional contract law provides that damages recoverable for breach of contract are limited to the anticipated benefits arising from performance of the contract. Section 3300 of the California Civil Code states that the measure of contract damages is "the amount which will compensate the party aggrieved for all the detriment proximately caused thereby, or which, in the ordinary course of things, would be likely to result therefrom." CAL. CIV. CODE § 3300 (West 1970). This language incorporates the requirement of foreseeability as originally set forth in *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145 (1854). Consequently, contractual damages have been limited to those that naturally arise from the breach of contract or were reasonably foreseeable by the parties at the time of contract formation.

4. See *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 598 P.2d 452, 157 Cal. Rptr. 482 (1979); *Neal v. Farmers Ins. Exch.*, 21 Cal. 3d 910, 582 P.2d 980, 148 Cal. Rptr. 389 (1978); *Murphy v. Allstate Ins. Co.*, 17 Cal. 3d 937, 553 P.2d 584, 132 Cal. Rptr. 424 (1976); *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973); *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958); *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

5. Tort recovery entails a much broader damages standard than traditional contract recovery. Tort concepts allow compensation for "all the detriment proximately caused" by the wrongful conduct "whether it could have been anticipated or not." CAL. CIV. CODE § 3333 (West 1970). Tort damages, therefore, need not be foreseeable to be recovered, and damages for emotional distress, physical injury and economic loss are recoverable under a tort theory. See, e.g., *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 598 P.2d 452, 157 Cal. Rptr. 482

wise would not have been available in an action sounding solely in contract. Insurers, consequently, are being forced to pay out vast sums of money, imposing a heavy burden on the insurance industry. Rather than attempting to alleviate this problem, the California courts have perpetuated it. They have continually handed down decisions expanding insurers' liability while placing insurers in a position where their defense is greatly impeded. One such decision is *White v. Western Title Insurance Co.*⁶

In *White*, the California Supreme Court held that the duty of good faith and fair dealing continues between the parties even after a lawsuit is instituted.⁷ The *White* court allowed as admissible evidence (1) the insurer's settlement offers made in the course of the lawsuit,⁸ (2) the insurer's unsuccessful attempt to secure summary judgment,⁹ and (3) other actions taken by the insurer in defending its case which the insured argued were bad faith acts undertaken for the purpose of delaying the insured's rightful payment.¹⁰ This Note will discuss the flaws inherent in the *White* court's reasoning and rationales. Additionally, it will demonstrate the negative practical effects of such a decision on the future of bad faith litigation and will argue that *White* places undue hardship on both insurers and their attorneys when attempting to defend against a first-party bad faith action.

II. STATEMENT OF THE CASE

A. Facts

In *White v. Western Title Insurance Co.*,¹¹ plaintiffs, the Whites, agreed to purchase two lots of land which contained substantial subsurface water.¹² The original owners of the land had conveyed to a water company, River Estates Mutual Water Corporation ("River Estates"), an "easement for a right-of-way for the construction and maintenance of a water pipeline and for the drilling of . . . wells . . ." to take up water.¹³ The deed conveying this interest was duly recorded the day af-

(1979). Punitive damages are also recoverable in a tort action upon a showing of oppression, fraud or malice. See CAL. CIV. CODE § 3294 (West Supp. 1987).

6. 40 Cal. 3d 870, 710 P.2d 309, 221 Cal. Rptr. 509 (1985).

7. *Id.* at 886, 710 P.2d at 317, 221 Cal. Rptr. at 517.

8. *Id.* at 889, 710 P.2d at 319, 221 Cal. Rptr. at 519.

9. *Id.* at 879, 894 n.4, 710 P.2d at 312, 323 n.4, 221 Cal. Rptr. at 512, 523 n.4.

10. See *infra* note 198.

11. 40 Cal. 3d 870, 710 P.2d 309, 221 Cal. Rptr. 509 (1985).

12. *Id.* at 877, 710 P.2d at 311, 221 Cal. Rptr. at 511.

13. *Id.*

ter it was executed.¹⁴ The Whites requested preliminary title reports from defendant, Western Title Insurance Company ("Western Title").¹⁵ Although both reports purported to list all recorded easements, liens and encumbrances, neither report mentioned the water easement of record.¹⁶ Western Title, at the close of escrow, issued the Whites two standard California Land Title Association title insurance policies which excluded from coverage unrecorded easements and "'water rights, claims or title to water.'" ¹⁷ Neither policy mentioned the recorded water easement.¹⁸

Approximately six months after escrow closed on the property, River Estates notified the Whites of its intention to enforce its easement.¹⁹ The Whites refused to allow River Estates on their property.²⁰ River Estates filed suit to quiet title to its easement.²¹ After the Whites had duly notified Western Title of the pending action, River Estates decided not to enforce its interest in the property and dismissed the suit.²²

The Whites hired an appraiser to estimate the decrease in value of their lots resulting from the potential loss of groundwater due to the easement. Based on the appraiser's estimate, the Whites made a claim under their policy for \$62,947.²³ Western Title refused to pay contending that the Whites' claim was based entirely on decrease in value due to loss of groundwater and not on decrease in value due to the existence of the easement.²⁴ Western Title maintained that it was not responsible for the loss in value due to loss of groundwater since such a decrease was excluded by the policy. However, it admitted responsibility for whatever loss in value was attributable to River Estates' right to enter the property and the occupation of the Whites' land by wells and pipes.²⁵

B. Procedural Posture

In October 1979, the Whites filed suit against Western Title alleging causes of action for breach of the insurance contract and negligence in

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.* at 877-78, 710 P.2d at 311, 221 Cal. Rptr. at 511 (emphasis omitted).

18. *Id.* at 877, 710 P.2d at 311, 221 Cal. Rptr. at 511.

19. *Id.* at 878, 710 P.2d at 311, 221 Cal. Rptr. at 511.

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.* at 878, 710 P.2d at 311-12, 221 Cal. Rptr. at 511.

24. *Id.* at 878, 710 P.2d at 311, 221 Cal. Rptr. at 511.

25. *Id.* at 878, 710 P.2d at 311-12, 221 Cal. Rptr. at 511.

the preparation of the preliminary title reports.²⁶ Soon thereafter, Western Title made an unsuccessful motion for summary judgment based on the claims asserted against it for breach of contract and negligence.²⁷ In May 1980, based on its own appraisal report, Western Title offered to settle the case for \$3000.²⁸ The Whites rejected the offer since it was, they felt, unquestionably low, and because Western did not provide them with a copy of the appraisal.²⁹ One month later, pursuant to section 998 of the California Code of Civil Procedure,³⁰ Western Title served the Whites with a compromise offer of \$5000.³¹ The Whites rejected the offer and successfully sought leave of court to amend their complaint to include a count for breach of the covenant of good faith and fair dealing.³²

The trial court bifurcated the issues of liability and damages, and trial was had without a jury on the issues of negligence and breach of contract.³³ Since abstractor's liability was still valid California law when the preliminary title reports were issued,³⁴ the court rendered an interlocutory judgment holding Western Title liable for negligence and breach of contract.³⁵ Western Title then made a new compromise offer of \$15,000 and furnished the Whites with a copy of its appraisal. The Whites rejected this offer, and the remaining issues were tried before a

26. *White v. Western Title Ins. Co.*, 40 Cal. 3d 870, 878-89, 710 P.2d 309, 312, 221 Cal. Rptr. 509, 512 (1985).

27. *Id.* at 879, 710 P.2d at 312, 221 Cal. Rptr. at 512.

28. *Id.*

29. *Id.*

30. *Id.* Section 998 provides in pertinent part:

Not less than 10 days prior to commencement of trial, any party may serve an offer in writing upon any other party to the action to allow judgment to be taken in accordance with the terms and conditions stated at that time. . . . If the offer is not accepted prior to trial or within 30 days after it is made, whichever occurs first, it shall be deemed withdrawn, and *cannot be given in evidence upon the trial.*

CAL. CIV. PROC. CODE § 998(a) (West Supp. 1987) (emphasis added).

31. 40 Cal. 3d at 879, 710 P.2d at 312, 221 Cal. Rptr. at 512.

32. *Id.*

33. *Id.*

34. *Id.* at 884, 710 P.2d at 316, 221 Cal. Rptr. at 516. In California, before January 1, 1982, title reports were deemed to be abstracts of title—the title insurance company's representation as to the condition of title to real property. Accordingly, the insurance company, as the abstractor of title, had a duty to list in its preliminary title report all matters of public record relating to the subject property. *See Wilkinson v. Rives*, 116 Cal. App. 3d 641, 650, 172 Cal. Rptr. 254, 258 (1981). On January 1, 1982, however, the legislature enacted section 12340.11 of the California Insurance Code which abolished abstractor's liability for breach of its duty to list all matters of public record. Under that statute, "[a]ny such report . . . shall constitute [only] a statement of the terms and conditions upon which the insurer is willing to issue its title policy. . . ." CAL. INS. CODE § 12340.11 (West Supp. 1987).

35. *White*, 40 Cal. 3d at 879, 710 P.2d at 312, 221 Cal. Rptr. at 512.

jury.³⁶ The jury fixed damages for loss of value to the Whites' property at \$100 per acre, or \$8400.³⁷

At trial on the issue of bad faith, the Whites told the court of their intention to present evidence of Western Title's conduct, including settlement offers, during the entire course of litigation.³⁸ Western Title objected, and the court ruled that it would limit the evidence as to those events which occurred *prior* to the interlocutory judgment.³⁹ The Whites testified accordingly, and the jury returned a verdict for \$20,000 in compensatory damages.⁴⁰ No allowance was made for punitive damages. Western Title appealed, claiming that the trial court's admission of its settlement offers and conduct during trial, and the trial court's finding of Western Title's liability for negligence and breach of contract, constituted error. The California Supreme Court disagreed and affirmed the decision of the trial court.⁴¹

III. REASONING OF THE COURT

A. *Majority Opinion*

In its discussion of Western Title's liability for breach of the covenant of good faith and fair dealing, the majority, comprising Justices Broussard, Bird, Mosk and Reynoso, determined that: (1) the duty of good faith and fair dealing continues after the commencement of litigation,⁴² (2) the imposition of a duty of good faith after litigation does not prevent an insurer from adequately defending the suit,⁴³ and (3) the admission of the two settlement offers in this case did not violate section 1152 of the California Evidence Code or section 998 of the California Code of Civil Procedure.⁴⁴

1. Continuation of the covenant of good faith and fair dealing after the commencement of litigation

In *White v. Western Title Insurance Co.*,⁴⁵ the court not only admitted the two settlement offers into evidence, but also permitted introduc-

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.* at 890, 710 P.2d at 320, 221 Cal. Rptr. at 520.

42. *White v. Western Title Ins. Co.*, 40 Cal. 3d 870, 885-86, 710 P.2d 309, 316-17, 221 Cal. Rptr. 509, 516-17 (1985).

43. *Id.* at 886, 710 P.2d at 317, 221 Cal. Rptr. at 517.

44. *Id.* at 888-89, 710 P.2d at 318-19, 221 Cal. Rptr. at 518-19.

45. 40 Cal. 3d 870, 710 P.2d 309, 221 Cal. Rptr. 509 (1985).

tion of Western Title's general trial conduct.⁴⁶ The court reasoned that this evidence was admissible because of the continuing duty of good faith and fair dealing.⁴⁷ Western Title, on the other hand, argued that once an insured has initiated a lawsuit against an insurer the parties become adversaries,⁴⁸ and the insurer no longer owes the insured a duty of good faith and fair dealing.⁴⁹ Therefore, it contended, "all evidence relating to events after plaintiffs filed suit should have been excluded."⁵⁰

The issue was one of first impression for the California Supreme Court.⁵¹ Consequently, the court did not cite case law for precedent but instead formulated its own examples to support its conclusion that the duty continues after the commencement of litigation.⁵²

The court stated that "the issue can be resolved as a matter of principle. It is clear that the contractual relationship between insurer and the insured does not terminate with commencement of litigation."⁵³ As an example in support of its statement, the court described an insurer's duties under an automobile liability policy. Although an insured and insurer might be litigating coverage of one accident, in the event of a subsequent accident, the insured would continue to be protected by the insurance contract.⁵⁴ Additionally, the court reasoned that insurance companies generally provide policy benefits, such as defense during litigation, while simultaneously bringing declaratory suits to determine whether they must provide those benefits to the insured.⁵⁵ Under such circumstances, the court stated, the insurer owes the insured a duty of good faith after suit has been filed.⁵⁶

Since the court was bound by a strong "policy of encouraging prompt investigation and payment of insurance claims,"⁵⁷ it concluded that no situation would warrant a differentiation between conduct before and after a suit was filed.⁵⁸ If the duty of good faith and fair dealing terminated upon the filing of litigation, then the insured "would find it difficult to prove the prelitigation conduct unreasonable if it could not

46. See *infra* note 198.

47. *White*, 40 Cal. 3d at 885-86, 710 P.2d at 317, 221 Cal. Rptr. at 517.

48. *Id.* at 885, 710 P.2d at 316, 221 Cal. Rptr. at 516.

49. *Id.*

50. *Id.*

51. *Id.*

52. See *id.* at 885-86, 710 P.2d at 317, 221 Cal. Rptr. at 517.

53. *Id.* at 885, 710 P.2d at 317, 221 Cal. Rptr. at 517.

54. *Id.* at 885-86, 710 P.2d at 317, 221 Cal. Rptr. at 517.

55. *Id.*

56. *Id.* at 886, 710 P.2d at 317, 221 Cal. Rptr. at 517.

57. *Id.*

58. *Id.*

present evidence of the postlitigation conduct by way of contrast.”⁵⁹ Under Western Title’s proposed rule, the court reasoned, insurers would force insureds to file suits as early as possible since their conduct would no longer be restricted by a duty of good faith and fair dealing. To accomplish this result, insurers would delay investigation and settlement negotiations until such time when they were not bound by a duty to the insured,⁶⁰ thus undermining the policy of prompt investigation and settlement of claims.⁶¹

The defendant contended that imposing a duty of good faith and fair dealing after the filing of a lawsuit would interfere with the insurer’s defense.⁶² First, the defendant insisted that any investigation of an insured’s claim would be hampered since the insurer would be obligated to disclose to the insured any information it found which was favorable to the insured’s claim.⁶³ Second, the defendant argued that the attorney who prepared the case for trial could not actually litigate it since that lawyer would be a key witness to the insurer’s good faith during the pre-trial period.⁶⁴

The court responded unsympathetically to the defendant’s arguments. It stated that:

[n]either of these concerns . . . justify [sic] a distinction between the period before suit is filed and the period after it is filed. Certainly the insurer should have investigated the factual basis of the claim before suit is filed, and may well have utilized counsel to evaluate that claim. The issue of contractual liability can be tried separately, and prior to the trial on the good faith claim, as was done in [*White*].⁶⁵

In other words: (1) the insurer, before trial, should have diligently investigated the insured’s claim and revealed all the favorable facts supporting that claim; and (2) the issues of liability and good faith can be bifurcated, and the lawyer who prepared the issue of liability could try that issue

59. *Id.*

60. The court’s invalidation of Western Title’s proposed rule regarding the termination of the duty of good faith and fair dealing is unsound. In speculating about the effects of such a rule, the court failed to consider that an insurer’s delaying investigation or settlement negotiations before suit was filed would itself constitute bad faith. Under Western Title’s rule, this conduct would be provable since it occurred before suit was filed. An insurer, consequently, would not engage in these pre-litigation tactics even if the duty of good faith terminated upon the filing of a lawsuit.

61. *White*, 40 Cal. 3d at 886, 710 P.2d at 317, 221 Cal. Rptr. at 517.

62. *Id.* at 886, 710 P.2d at 317, 221 Cal. Rptr. at 517.

63. *Id.*

64. *Id.*

65. *Id.*

even if needed as a witness in the trial on good faith. Impliedly conceding that another attorney would have to try the issue of good faith if the liability attorney were a critical witness to the insurer's good faith, the court concluded that good faith and fair dealing must be determined on a case-by-case basis. Thus, the insurance company's hardship is having to engage new counsel.

Additionally, the court expressed great confidence in the ability of jurors to "evaluate the insurer's conduct in relation to [the adversarial posture of the parties]."⁶⁶ In other words, the court seemed confident that jurors would not confuse litigation tactics with bad faith conduct or settlement offers with an admission of liability. Moreover, the court reasoned, under section 352 of the California Evidence Code a trial court has discretion to "exclude evidence if its probative value is substantially outweighed by the probability that its admission will . . . create substantial danger of undue prejudice, of confusing the issues, or of misleading the jury,"⁶⁷ thereby affording insurers adequate protection from prejudice.⁶⁸

2. Admissibility of settlement offers under section 1152 of the California Evidence Code and section 998 of the California Code of Civil Procedure

The defendant also contended that the admission of the settlement offers of \$3000 and \$5000 violated section 1152 of the California Evidence Code.⁶⁹ Section 1152 prohibits the introduction of settlement offers if the purpose of their introduction is to prove liability for the original loss. However, the court found that these settlement offers were not introduced to prove liability for breach of contract, but rather "to prove [the insurer's] failure to process the claim fairly and in good faith."⁷⁰ In other words, the evidence was admissible to prove the "instrumentality" of the tort.

In support of its distinction between proof of liability and proof of instrumentality, the court cited *Fletcher v. Western National Life Insurance Co.*⁷¹ In *Fletcher*, the insurer wrote two letters to the insured accusing him of fraudulently concealing a congenital back defect. The second letter offered to settle the insured's claim by allowing him to retain the

66. *Id.*

67. CAL. EVID. CODE § 352 (West 1966).

68. *White*, 40 Cal. 3d at 886-87 n.9, 710 P.2d at 317 n.9, 221 Cal. Rptr. at 517 n.9.

69. *Id.* at 887, 888, 710 P.2d at 317, 319, 221 Cal. Rptr. at 517, 519.

70. *Id.* at 887, 710 P.2d at 318, 221 Cal. Rptr. at 518.

71. 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

payments he had already received under a disability policy.⁷² The insured refused the offer and, over objection, introduced both letters into evidence at a trial against the insurer on a bad faith claim.⁷³ The *Fletcher* court stated:

“[Defendants’ suggestion] that their letters were improperly admitted into evidence is not meritorious [T]he applicable code provision (Evid. Code, § 1152) prohibits the introduction into evidence of an offer to compromise a claim *for the purpose of proving liability for that claim*. If the letter of October 4, 1966, were considered an offer to compromise, it would be an offer to compromise the claim of liability under the policy. Plaintiff, however, did not offer the letter to prove liability under the policy, but, rather, as a part of his proof of the instrumentality of the tort. Section 1152, therefore, did not preclude its admission.”⁷⁴

Western Title attempted to distinguish *Fletcher*⁷⁵ on the ground that the letters in *Fletcher* were sent before litigation was commenced, whereas in *White*, the settlement offers were made after suit was filed.⁷⁶ The *White* court found this distinction to be immaterial reasoning that the “duty of good faith and fair dealing does not disappear with the filing of suit”⁷⁷

Finally, Western Title argued that its second offer, filed as an offer to compromise under section 998 of the California Civil Procedure Code,⁷⁸ was erroneously admitted by the trial court.⁷⁹ Western Title contended that *Fletcher’s* reasoning was inapplicable to section 998⁸⁰ compromise offers since section 998, unlike section 1152, is an express bar. Section 998 states that any offer made pursuant to it “cannot be given in evidence upon the trial.”⁸¹ The *White* court, however, disagreed with Western Title stating “that despite their difference in wording sections 1152 and 998 should receive a parallel construction.”⁸² The court

72. *Id.* at 390, 89 Cal. Rptr. at 85-86.

73. *Id.* at 391, 396, 89 Cal. Rptr. at 86, 90.

74. *White*, 40 Cal. 3d at 887, 710 P.2d at 318, 221 Cal. Rptr. at 518 (quoting *Fletcher v. Western Nat’l Life Ins. Co.*, 10 Cal. App. 3d 376, 396, 89 Cal. Rptr. 78, 90 (1970)) (emphasis in original).

75. *Id.*

76. *Id.*

77. *Id.*

78. See *supra* note 30.

79. *White*, 40 Cal. 3d at 888, 710 P.2d at 319, 221 Cal. Rptr. at 518-19.

80. *Id.*

81. CAL. CIV. PROC. CODE § 998(b)(2) (West Supp. 1987).

82. *White*, 40 Cal. 3d at 888, 710 P.2d at 319, 221 Cal. Rptr. at 519.

sought to reconcile the two statutes:

[s]ection 1152 states that offers are inadmissible to prove "liability for the loss or damage," which we have construed to refer to liability for that loss or damage to be compromised by the offer. Section 998 . . . states that an offer cannot be "given in evidence upon the trial."⁸³

Accordingly, the *White* court concluded that the language in section 998 refers only "to the trial upon the liability which the offer proposed to compromise."⁸⁴ Since evidence of the settlement offers was not introduced at the trial on the issue of contractual liability—the trial on liability which the offer sought to compromise—but rather at the trial on breach of the covenant of good faith and fair dealing, the court held that the offers were not barred by section 998.⁸⁵

Conversely, the supreme court affirmed the trial court's exclusion of evidence offered by Western Title of a \$15,000 settlement offer made after the interlocutory judgment against Western Title.⁸⁶ The court based its affirmation on the ground that "[o]nce the court had determined liability, defendant's willingness to make a reasonable settlement offer has little tendency to prove that defendant has been acting fairly and in good faith toward its insured."⁸⁷

B. Concurring Opinion of Justice Grodin

Justice Grodin fundamentally agreed with the reasoning of the majority opinion. He saw no reason why the implied covenant of good faith and fair dealing should become inoperative upon the filing of a lawsuit.⁸⁸ He argued that in a case where an insurer has acted in bad faith by unreasonably withholding payment of policy benefits before suit has been filed and continues to act in bad faith after the commencement of litigation, "there seems to be no compelling reason why the right to recover for that continuing wrong should terminate either because the insurer decides to file a preemptive action for declaratory relief or because the

83. *Id.* (quoting CAL. CIV. PROC. CODE § 998 (West 1966)).

84. *Id.* at 889, 710 P.2d at 319, 221 Cal. Rptr. at 519.

85. *Id.*

86. *Id.* at 889 n.12, 710 P.2d at 319 n.12, 221 Cal. Rptr. at 519 n.12. Western Title offered evidence of the \$15,000 settlement offer to show that it *was* acting in good faith during litigation. In light of an \$8400 interlocutory judgment, an offer of \$5000 does not seem unreasonable especially since the *White's* damages were not easily ascertainable. After such a judgment, a \$15,000 offer seems even less unreasonable.

87. *Id.*

88. *White v. Western Title Ins. Co.*, 40 Cal. 3d 870, 891, 710 P.2d 309, 320, 221 Cal. Rptr. 509, 520 (1985) (Grodin, J., concurring).

insured, under the compulsion of the insurer's recalcitrance, decides to file suit himself."⁸⁹ Accordingly, he concluded that the covenant of good faith and fair dealing continues after the time when a lawsuit has been initiated.⁹⁰

Justice Grodin also concurred with the majority's conclusion that the continuation of a duty of good faith and fair dealing does not interfere with an insurer's defense.⁹¹ He interpreted the majority opinion as meaning "that all of an insurer's litigation tactics [would not] be subject to scrutiny by a jury on the basis of a bad faith claim."⁹² Normal rules of litigation, he said, would be adequate protection against any abuse by the insured.⁹³

Additionally, Justice Grodin analogized the admissibility of settlement offers under these circumstances to the legislative decision that evidence of settlement offers be admissible to prove a violation of section 790.03(h)(5) of the California Insurance Code.⁹⁴ He opined that from a

89. *Id.* at 891, 710 P.2d at 320-21, 221 Cal. Rptr. at 520 (Grodin, J., concurring).

90. *Id.* at 891, 710 P.2d at 320, 221 Cal. Rptr. at 520 (Grodin, J., concurring).

91. *Id.* (Grodin, J., concurring).

92. *Id.* (Grodin, J., concurring).

93. *Id.* (Grodin, J., concurring).

94. *Id.* at 891 n.2, 710 P.2d at 321 n.2, 221 Cal. Rptr. at 521 n.2 (Grodin, J., concurring).

Section 790.03(h)(5) of the California Insurance Code states that an insurer acts unfairly by "[n]ot attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear." CAL. INS. CODE § 790.03(h)(5) (West Supp. 1987). Justice Grodin's implication in this footnote is that evidence of an insurer's settlement offers would have to be admissible to prove a violation of this *statutory* duty.

One author argued that this reliance on section 790.03(h)(5) to justify admitting evidence of settlement offers was illogical. He distinguished between the statutory and common-law duty of good faith and fair dealing.

A first party action for breach of the implied covenant of good faith and fair dealing, such as that pled in *White*, is fundamentally different from a third party action under section 790.03(h)(5). If an action for breach of the implied covenant is separated from the breach of contract action, it becomes apparent that the basis for the alleged bad faith is, in fact, the breach of the contract itself. In a section 790.03(h)(5) action by a third party, the basis of the claim is an incident unrelated to the violation of the statute. The playing out of the third party litigation would embody the bad faith. The distinction is essential to the understanding of the misconception in *White*. In the first party context the breach of contract is the act from which the bad faith arises. The bad faith action arises at the moment of the breach. In the third party context it is the failure to attempt to settle when liability becomes reasonably clear that gives rise to the cause of action.

This attempt by the *White* majority to apply the standards of section 790.03(h)(5) to a first party breach of the implied covenant action is the stumbling block. The distinction between the two causes of actions is considerable and important. In the section 790.03(h)(5) action the insurer and the third party claimant are not in adversarial positions in the same sense that the insured and insurer are when breach of the implied covenant is alleged.

Nelsen, *White v. Western Title: Unsettled Waters*, 14 W. ST. U.L. REV. 173, 181 (1986) (footnotes omitted).

policy standpoint⁹⁵ there was no distinction between the common-law duty and the statutory duty regarding the admissibility of settlement offers to prove the elements of the tort.⁹⁶

Justice Grodin's viewpoint diverged from that of the majority in his brief discussion of the court's exclusion of the \$15,000 offer made after the interlocutory judgment.⁹⁷ He believed that the third settlement offer should have been admitted because the jury's knowledge of that offer might have aided it in its evaluation of the bad faith claim.⁹⁸ The first two offers, he argued, only weakly supported the insured's theory.⁹⁹ Moreover, Justice Grodin reasoned that by excluding the third offer, the court gave the jury an incomplete picture on which to base their final determination.¹⁰⁰ Since the verdict was relatively modest, however, Justice Grodin concluded that the error did not require a reversal and remand.¹⁰¹

C. *Concurring and Dissenting Opinion of Justice Lucas*

Justice Lucas argued that the majority's conclusion—that the duty of good faith and fair dealing continues between the parties after the filing of a lawsuit—was misplaced. He contended that the majority's analysis should have "focus[ed] on the nature of the relationship between the parties *as to the particular claim at issue*."¹⁰² In support of his contention, Justice Lucas stated that "[o]ne [who] has . . . negligently injured another continues thereafter to have a duty to refrain from inflicting new harm upon the victim. Nonetheless, he is still subject to suit *and* entitled to defend himself on the issue of whether the completed transaction involved negligence on his part."¹⁰³

Furthermore, Justice Lucas analogized to the situation faced by an

95. The policy which both the statutory and common-law duties purport to promote is the prompt, fair and equitable settlement of claims.

96. 40 Cal. 3d at 891 n.2, 710 P.2d at 321 n.2, 221 Cal. Rptr. at 521 n.2 (Grodin, J., concurring). *But see supra* note 94.

97. *Id.* at 891, 710 P.2d at 321, 221 Cal. Rptr. at 521 (Grodin, J., concurring).

98. *Id.* (Grodin, J., concurring).

99. *Id.* (Grodin, J., concurring). Justice Grodin argued that the \$15,000 settlement offer would have supported Western Title's contention that it acted in good faith during litigation. He said that such evidence "might have been helpful to the jury's evaluation *despite* its somewhat disparate context . . ." *Id.* (Grodin, J., concurring) (emphasis added).

100. *Id.* (Grodin, J., concurring).

101. *Id.* (Grodin, J., concurring).

102. *White v. Western Title Ins. Co.*, 40 Cal. 3d 870, 892, 710 P.2d 309, 322, 221 Cal. Rptr. 509, 522 (1985) (Lucas, J., concurring and dissenting) (emphasis in original).

103. *Id.* at 892-93, 710 P.2d at 322, 221 Cal. Rptr. at 522 (Lucas, J., concurring and dissenting) (emphasis in original).

attorney sued for malpractice.¹⁰⁴ In such cases, the lawyer's defense is not burdened by the attorney-client privilege.¹⁰⁵ There is no " 'continuing duty of good faith' " ¹⁰⁶ as to that particular claim. As to all other matters, however, which the attorney may be handling on this client's behalf, the attorney-client privilege remains intact. Reasoning that there is a "fundamental shift in the nature of the attorney-client relationship when a malpractice suit is filed,"¹⁰⁷ Justice Lucas concluded that there is a similar alteration of the insured-insurer relationship when the insured files a lawsuit on a claim disputed by the insurer.¹⁰⁸

Unlike the majority, Justice Lucas saw the early filing of suits as beneficial. He reasoned that earlier filing would "force earlier serious investigation and [might] therefore lead to earlier payment of benefits to the insured."¹⁰⁹ If, as the majority stated, insurers would attempt " 'to delay serious investigation until after suit was filed,' " ¹¹⁰ then early commencement of litigation would be preferred because it would promote investigation and early resolution of the claim.

Justice Lucas then turned to the question of the insurer's right to an adequate defense. His argument predominantly centered around the evidence which would be allowed under the majority's formulation of the rule. Since the majority did not limit the type of evidence that could be introduced at a subsequent trial, Justice Lucas feared that "[a]ny aspect of the defendant's 'conduct' during the first trial [would] now be fair game."¹¹¹ Consequently, if the insurer is unsuccessful in the first trial on liability, then anything the insurer did to defend his position at that trial may be considered conduct engaged in to preclude the insured from receiving the fruits of the insurance contract.¹¹²

Justice Lucas especially objected to the admission of litigation strategies and tactics.¹¹³ Juries are understandably ignorant of litigation

104. *Id.* at 893, 710 P.2d at 322, 221 Cal. Rptr. at 522 (Lucas, J., concurring and dissenting).

105. *Id.* (Lucas, J., concurring and dissenting).

106. *Id.* (Lucas, J., concurring and dissenting).

107. *Id.* (Lucas, J., concurring and dissenting).

108. *Id.* (Lucas, J., concurring and dissenting).

109. *Id.* at 894, 710 P.2d at 322-23, 221 Cal. Rptr. at 522 (Lucas, J., concurring and dissenting).

110. *Id.* at 893, 710 P.2d at 322, 221 Cal. Rptr. at 522 (Lucas, J., concurring and dissenting).

111. *Id.* at 895, 710 P.2d at 323, 221 Cal. Rptr. at 523 (Lucas, J., concurring and dissenting).

112. *Id.* at 895, 710 P.2d at 323-24, 221 Cal. Rptr. at 523-24 (Lucas, J., concurring and dissenting) (emphasis in original).

113. *Id.* at 895, 710 P.2d at 324, 221 Cal. Rptr. at 524 (Lucas, J., concurring and dissenting).

practices and techniques.¹¹⁴ As a result, they may misunderstand and misinterpret defensive tactics such as the defendant's motion for an extension of time, its motion for summary judgment, or its request for interrogatories, as being relevant to the issue of the defendant's bad faith. Juries may "second guess the defendant's rationales for taking a particular course."¹¹⁵ Moreover, he stated, the proof of bad faith is facilitated, and the insurer's defense is impeded since this evidence may be introduced without a showing of the insurer's immoral intent or malice.¹¹⁶ The standard for proof of bad faith is one of subjective unreasonableness as evidenced by Justice Lucas's statement that "[t]he jury found only unreasonableness, and not malice or bad intent . . ."¹¹⁷ when it determined Western Title's liability for breach of the implied covenant of good faith and fair dealing. Unreasonableness is a much lower and much more easily proved standard than malice or immoral intent.

In illuminating this argument, Justice Lucas compared this situation to the facts of *In re Marriage of Flaherty*.¹¹⁸ There, the supreme court

114. *Id.* (Lucas, J., concurring and dissenting).

115. *Id.* (Lucas, J., concurring and dissenting).

116. *Id.* at 897, 710 P.2d at 325, 221 Cal. Rptr. at 525 (Lucas, J., concurring and dissenting). In *Neal v. Farmers Ins. Exch.*, 21 Cal. 3d 910, 582 P.2d 980, 148 Cal. Rptr. 389 (1978), the supreme court stated:

The terms "good faith" and "bad faith" . . . are not meant to connote the absence or presence of positive misconduct of a malicious or immoral nature—considerations which . . . are more properly concerned in the determination of liability for *punitive* damages. Here we deal only with the question of breach of the implied covenant and the resultant liability for *compensatory* damages. As stated by the draftsmen of the Restatement of Contracts, "[t]he phrase 'good faith' is used in a variety of contexts, and its meaning varies somewhat in the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes [from consideration] a variety of types of conduct characterized [in other contexts] as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness."

Id. at 921-22 n.5, 582 P.2d at 986 n.5, 148 Cal. Rptr. at 395 n.5 (quoting RESTATEMENT (SECOND) OF CONTRACTS § 231 comment a (Tent. Draft Nos. 1-7, 1974)) (citations omitted) (emphasis in original).

117. *White*, 40 Cal. 3d at 899, 710 P.2d at 327, 221 Cal. Rptr. at 527 (Lucas, J., concurring and dissenting).

118. 31 Cal. 3d 637, 646 P.2d 179, 183 Cal. Rptr. 508 (1982). In *Flaherty*, Jaquelyn and James Flaherty were involved in divorce proceedings and a custody battle over their daughter, Missy. *Id.* at 640, 646 P.2d at 181, 183 Cal. Rptr. at 510. James had filed a petition requesting custody of Missy and child support from Jaquelyn. *Id.* The court awarded temporary custody to James and visitation rights to Jaquelyn. After the custody award, James moved to Kentucky with Missy. Approximately one year later, while the divorce proceedings were still pending, Jaquelyn asked the court to modify its temporary order and award joint custody to each of the parents. *Id.* Although the court denied the request for joint custody, it modified the visitation order to provide that Missy could visit Jaquelyn for four months each year. *Id.* at 640-41, 646 P.2d at 181, 183 Cal. Rptr. at 510. According to the order, Jaquelyn was to pay

considered guidelines for determining when an appeal is frivolous and warrants sanctions.¹¹⁹ It balanced the interest of avoiding improper conduct against the interest of allowing attorneys to freely promote their clients' interests.¹²⁰ The *Flaherty* court held that counsel must have the freedom to file appeals on their clients' behalf without fear that an appellate court will second guess their reasons.¹²¹ Justice Lucas felt that the majority's holding prevented insurers from asserting valid claims without fear of suffering a greater penalty "than that typically imposed on de-

the transportation costs of Missy's trips to California, and James was to pay for her return trips. *Id.* at 641, 646 P.2d at 181, 183 Cal. Rptr. at 510.

The court later entered an interlocutory decree dissolving the Flahertys' marriage. *Id.* at 641, 646 P.2d at 182, 183 Cal. Rptr. at 511. The decree incorporated the prior orders regarding custody, visitation rights and costs of transportation. The court, however, denied James' request for child support. *Id.*

James appealed the issues of denial of child support and divided payment of transportation costs. In affirming the trial court's judgment, the court of appeal imposed a \$500 sanction against James' attorney for filing a frivolous appeal. *Id.* The California Supreme Court affirmed the trial court's judgment, but concluded that James' appeal was not frivolous. *Id.* at 645, 651, 654, 646 P.2d at 185, 188, 190, 183 Cal. Rptr. at 513, 517, 519.

In determining whether James' appeal was frivolous, the supreme court stated:

An appeal taken for an improper motive represents a time-consuming and disruptive use of the judicial process. Similarly, an appeal taken despite the fact that no reasonable attorney could have thought it meritorious ties up judicial resources and diverts attention from the already burdensome volume of work at the appellate courts. Thus, an appeal should be held to be frivolous only when it is prosecuted for an improper motive—to harrass the respondent or delay the effect of a judgment—or when it indisputably has no merit—when any reasonable attorney would agree that the appeal is totally and completely without merit.

However, any definition must be read so as to avoid a serious chilling effect on the assertion of litigants' rights on appeal. Counsel and their clients have a right to present issues that are arguably correct, even if it is extremely unlikely that they will win on appeal. An appeal that is simply without merit is *not* by definition frivolous and should not incur sanctions. Counsel should not be deterred from filing such appeals out of a fear of reprisals. . . .

. . . .

. . . Viewed under this standard, James' appeal in this case cannot be deemed frivolous. There is no evidence of subjective bad faith. In contrast to most of the cases where sanctions have been imposed, James had nothing to gain from delay. . . .

Id. at 650-51, 646 P.2d at 187-88, 183 Cal. Rptr. at 516-17 (emphasis in original) (citations omitted).

119. *Id.* at 650, 646 P.2d at 187-88, 183 Cal. Rptr. at 516-17.

120. *Id.* at 650-51, 646 P.2d at 187-88, 183 Cal. Rptr. at 516-17.

121. *Id.* at 650, 646 P.2d at 187, 183 Cal. Rptr. at 516. Justice Lucas quoted the *Flaherty* court:

"Free access to the courts is an important and valuable aspect of an effective system of jurisprudence, and a party possessing a colorable claim must be allowed to assert it without fear of suffering a penalty more severe than that typically imposed on defeated parties."

White, 40 Cal. 3d at 896, 710 P.2d at 324, 221 Cal. Rptr. at 524 (Lucas, J., concurring and dissenting) (quoting *In re Marriage of Flaherty*, 31 Cal. 3d 637, 648, 646 P.2d 179, 186, 183 Cal. Rptr. 508, 515 (1982) (quoting *Young v. Redman*, 55 Cal. App. 3d 827, 838, 128 Cal. Rptr. 86, 93 (1976))).

feated parties.'¹²² Accordingly, he concluded that the position of the *White* court destroyed the balance achieved in *Flaherty* between avoiding improper conduct and assuring that lawyers are free to actively assert their clients' interests.¹²³

Justice Lucas also discussed the defendant's right to conduct a vigorous defense when involuntarily haled into court. To support this position, he cited *Bertero v. National General Corp.*¹²⁴ In *Bertero*, the

122. *Id.* (Lucas, J., concurring and dissenting) (quoting *In re Marriage of Flaherty*, 31 Cal. 3d 637, 648, 646 P.2d 179, 186, 183 Cal. Rptr. 508, 515 (1982) (quoting *Young v. Redman*, 55 Cal. App. 3d 827, 838, 128 Cal. Rptr. 86, 93 (1976))).

123. *Id.* at 897, 710 P.2d at 325, 221 Cal. Rptr. at 525 (Lucas, J., concurring and dissenting).

124. 13 Cal. 3d 43, 529 P.2d 608, 118 Cal. Rptr. 184 (1974). In 1958, Mr. Bertero was elected president of National General Corporation (National). A power struggle ensued within National one year after his election, and Bertero resigned as president, but retained his seat on its board of directors. Upon resigning, Bertero entered into a 10-year employment contract with National under which he was to serve as a part-time executive for five years and as a consultant to the company for five years. *Id.* at 48, 529 P.2d at 612, 118 Cal. Rptr. at 188. The board of directors unanimously ratified the agreement. *Id.* Eugene Klein, one of the members of the board when Bertero's agreement was ratified, became National's president in 1961. *Id.* at 48-49, 529 P.2d at 612-13, 118 Cal. Rptr. at 188-89. Bertero and Klein frequently disagreed with each other and their relationship dissolved into one of animosity. *Id.* at 49, 529 P.2d at 613, 118 Cal. Rptr. at 189. Consequently, Bertero resigned from his directorship, but refused to rescind his 10-year employment contract or surrender his stock options obtained before and while he was president. *Id.* After Klein secured control of National's board of directors, Bertero surrendered some of his stock options. *Id.* Klein, however, continually attempted to persuade Bertero to rescind his contract and surrender the remaining portion of his stock options. *Id.* Bertero refused. *Id.* Klein then declared Bertero's contract invalid and unenforceable, and he terminated Bertero's stock options and all of his employment benefits under the contract. *Id.*

In June 1962, Bertero filed a declaratory relief action against National and Klein as to his employment agreement and stock options. The defendants filed a cross-complaint seeking the recovery of salary in the amount of \$104,000 already paid pursuant to Bertero's employment contract. The judgment was rendered in favor of Bertero and affirmed on appeal. Bertero then brought an action seeking damages for malicious prosecution of the cross-complaint. *Id.* The California Supreme Court concluded that defendants' cross-complaint constituted malicious prosecution. It reasoned:

Viewing the facts in a light most favorable to the judgment, we find that defendants' conduct consisted of filing fabricated claims in order to coerce Bertero to settle or abandon a legitimate claim. This flagrant abuse of the judicial process is precisely the type of tortious conduct that an award of exemplary damages is designed to deter.

Id. at 65, 529 P.2d at 624, 118 Cal. Rptr. at 200. The court also discussed the necessary element of malice:

[M]alice in fact may be proved by the inference from the want of probable cause. The jury in the instant case was so charged and evidence of want of probable cause was sufficient proof of malice to justify an award of punitive damages. The jury was also properly instructed that in order to establish malice for both liability and punitive damages personal hostility or ill will need not be shown; that the absence of an honest and sincere belief in the validity of the cross-action was sufficient.

Id. at 66, 529 P.2d at 625, 118 Cal. Rptr. at 201 (citations and footnote omitted).

supreme court found that a claim asserted by the defendant in a cross-pleading could give rise to an action for malicious prosecution. The *Bertero* court, however, refused to recognize a tort of malicious defense.¹²⁵ In so doing, the court stressed the importance of a defendant's right to assert a defense. The *White* majority failed to recognize the principle established in *Bertero*.¹²⁶ In addition, the *White* court overlooked the impact of the California Supreme Court holding in *Neal v. Farmers Insurance Exchange*:¹²⁷ A breach of the covenant of good faith and fair dealing requires no showing of malice or immoral intent. Justice Lucas

125. *Id.* at 52, 529 P.2d at 613, 118 Cal. Rptr. at 191. The elements of the proposed tort, "malicious defense," are "[a]ssertion of a defense, which the defendant knows or should know is without credible basis, for the purpose of delay" and the fundamental requirement of malice. Van Patten & Willard, *The Limits of Advocacy: A Proposal for the Tort of Malicious Defense in Civil Litigation*, 35 HASTINGS L.J. 891, 936, 931 (1984).

126. Justice Lucas stated:

Since the elements of a cause of action for a breach of the duty of good faith and fair dealing do *not* echo those required by an action alleging malicious prosecution (or defense), it is clear that the majority has taken a giant leap forward beyond that contemplated even by those advocating recognition of a general new tort based on improper defensive conduct.

White, 40 Cal. 3d at 896-97 n.6, 710 P.2d at 325 n.6, 221 Cal. Rptr. at 525 n.6 (Lucas, J., concurring and dissenting).

127. 21 Cal. 3d 910, 582 P.2d 980, 148 Cal. Rptr. 389 (1978). In July 1970, Mrs. Neal was seriously injured while riding as a passenger in a car operated by her husband. The car was struck broadside by an automobile driven by an uninsured motorist. *Id.* at 918, 582 P.2d at 983, 148 Cal. Rptr. at 392. Mrs. Neal spent the succeeding two months in the hospital. Initially she suffered total paralysis from the neck down, but that condition gradually changed to total disability involving serious sensory and motor defects. *Id.* She remained totally disabled until her death from cancer in 1974, about one year before trial. *Id.*

At the time of the accident, Mr. and Mrs. Neal were covered under an automobile insurance policy issued by Farmers Insurance Exchange (Farmers). The policy included a medical payment provision with \$5000 limits and an uninsured motorist provision with \$15,000 limits. *Id.* A few days after the accident, Mr. Neal contacted attorney Paul Gergen, who then attempted to communicate with Farmers in order to expedite payment of Mrs. Neal's claim. Approximately three months after it was first contacted, Farmers paid \$5000 pursuant to the medical payment coverage. *Id.* It refused, however, to pay the \$15,000 policy limit under the uninsured motorist coverage. *Id.* Farmers contended:

(1) that it was entitled, under an express policy provision to offset the amount paid under the medical payment coverage against any amount due under the uninsured motorist coverage; (2) that the accident resulted *solely* from the negligence of Mr. Neal, thus precluding liability on the part of the uninsured motorist; and (3) that contributory negligence on the part of Mr. Neal might be legally imputed to Mrs. Neal.

Id. (emphasis in original).

In January 1971, Gergen wrote to Farmers requesting a prompt settlement. *Id.* Because of the Neals' dire financial condition, Gergen asked that \$10,000 be paid immediately, reserving the question of the \$5000 offset for future determination. *Id.* at 918-19, 582 P.2d at 984, 148 Cal. Rptr. at 393. On April 21, 1971, after consulting its attorney, Farmers responded that it would settle the case for \$5000. Farmers' attorney had concluded "(1) that the law was unclear on the matter of offset, (2) that any negligence on the part of Mr. Neal could not be

was concerned over "the potential chilling effect on the right of a defendant to present its case"¹²⁸ since *any* conduct could almost unqualifiedly be used to prove the defendant's bad faith.

In conclusion to this segment of his argument, Justice Lucas stated:

On the one side is the importance of affording defendants an opportunity to defend (especially where there is not even a preliminary showing of any malicious intent on the defendant's part) and the potential for prejudice to them if their trial "conduct" may be second-guessed in a subsequent action. On the other is the necessity to admit the information here at issue into evidence. I conclude that without more showing the former interests must prevail.¹²⁹

Justice Lucas also disagreed with the majority's failure to apply sec-

imputed to Mrs. Neal, and (3) that 'at best' the case was '50-50' on liability." *Id.* at 919, 582 P.2d at 984, 148 Cal. Rptr. at 393.

Gergen rejected Farmers' offer on May 1, 1971 and repeated the Neals' previous settlement offer. *Id.* Farmers did not respond. Accordingly, Gergen again wrote Farmers, this time threatening it with arbitration proceedings. Once again, Farmers did not respond within 10 days. *Id.*

Gergen turned the case over to Mr. Aitken, another attorney, who made a demand for arbitration. *Id.* The proceedings commenced on February 16, 1973, and in April 1973, the arbitrator found in favor of Mrs. Neal on the issue of liability. *Id.* at 919-20, 582 P.2d at 984, 148 Cal. Rptr. at 393. Farmers then paid her the full \$15,000.

Mrs. Neal subsequently initiated an action seeking compensatory and punitive damages for Farmers' bad faith refusal to settle promptly. *Id.* at 920, 582 P.2d at 984-95, 148 Cal. Rptr. at 393-94. The jury returned a verdict of \$1,528,211.35 in favor of Mrs. Neal. *Id.* That amount was reduced to \$749,011.49 by remittitur. *Id.* Affirming the judgment, the supreme court stated:

We can deal briefly with Farmers' first contention that there was no substantial evidence that it breached [the duty of good faith and fair dealing]. Suffice it to say that the substantial record herein . . . contains abundant evidence, a good deal of it conflicting, on the subject of defendant's conduct and motives. While some of the evidence was to the effect that Farmers did no more than assert its legal position reasonably and in good faith, the jury herein concluded to the contrary.

It did so on the basis of evidence of undeniable substantiality to the effect that Farmers knew at an early date—certainly no later than its receipt of Mr. Gergen's letter dated May 1, 1971—that it had no colorable defense to plaintiff's claim under the uninsured motorist provisions of its policy and that the only genuine issue was that of the availability of an offset for the \$5000 paid by it under the medical payment provisions; that Mr. Gergen's offer to settle for an additional \$10,000, reserving the offset question for later decision by an appropriate tribunal, was wholly reasonable and should in good faith have been promptly accepted; and that Farmers' subsequent refusal to accept the offer constituted a breach of its obligation to deal fairly and in good faith with its insured by "refusing, without proper cause, to compensate its insured for a loss covered by the policy."

Id. at 921, 582 P.2d at 985-86, 148 Cal. Rptr. at 394-95 (quoting *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 574, 510 P.2d 1032, 1037, 108 Cal. Rptr. 480, 485 (1973)) (footnotes omitted). For a discussion of *Gruenberg*, see *infra* text accompanying notes 173-79.

128. *White*, 40 Cal. 3d at 897, 710 P.2d at 325, 221 Cal. Rptr. at 525.

129. *Id.* (Lucas, J., concurring and dissenting) (footnote omitted).

tion 1152 of the California Evidence Code to bar evidence of the settlement offers.¹³⁰ Section 1152, he stated, was “based upon the public policy in favor of settlement of disputes without litigation.”¹³¹ The majority, Lucas felt, ignored this underlying policy as well as the statute itself which he interpreted as having broad application.¹³²

Moreover, Justice Lucas distinguished the facts of *Fletcher v. Western National Life Insurance Co.*¹³³ from those of *White*. In *Fletcher*, he reasoned, the admissible settlement offers were made *prior* to the filing of the lawsuit, and evidence of those settlement offers was used to prove the elements of the tort of intentional infliction of emotional distress. In *White*, the settlement offers were made *after* the lawsuit was filed, and they were used to prove the elements of the tort of bad faith breach of contract. Justice Lucas called the application of *Fletcher* to *White* a “wholesale acceptance”¹³⁴ since the *Fletcher* court did not have the opportunity “to consider whether the making of settlement offers or other conduct following commencement of trial should be admitted despite section 1152’s bar.”¹³⁵ According to Justice Lucas, the court extended *Fletcher* with only an “empty nod”¹³⁶ at the policy behind section 1152.

Justice Lucas also argued that since the two prejudgment offers had been admitted, the third settlement offer of \$15,000 should have been introduced into evidence.¹³⁷ He reasoned that in excluding the 1982 offer, it appeared to the jury that the insurer’s last offer to settle was made twenty months before and that there was no attempt to settle after liability had been determined. Justice Lucas concluded that the court’s failure to admit this evidence was highly prejudicial to the insurer since the jury may very well have considered the lack of a subsequent settlement offer as a further indication of bad faith in light of the earlier lower offers.¹³⁸

130. *Id.* at 894, 710 P.2d at 323, 221 Cal. Rptr. at 523 (Lucas, J., concurring and dissenting).

131. *Id.* (Lucas, J., concurring and dissenting) (quoting 7 CALIFORNIA L. REVISION COMM’N, REPORTS, RECOMMENDATIONS & STUDIES 29, 218 (1965)).

132. *See infra* note 241.

133. 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970). *See supra* text accompanying notes 71-74 for a discussion of *Fletcher*.

134. 40 Cal. 3d at 894, 710 P.2d at 323, 221 Cal. Rptr. at 523 (Lucas, J., concurring and dissenting).

135. *Id.* (Lucas, J., concurring and dissenting).

136. *Id.* (Lucas, J., concurring and dissenting).

137. *Id.* at 898-99, 710 P.2d at 326, 221 Cal. Rptr. at 526 (Lucas, J., concurring and dissenting).

138. *Id.* at 899, 710 P.2d at 326-27, 221 Cal. Rptr. at 526-27 (Lucas, J., concurring and dissenting).

D. Concurring and Dissenting Opinion of Justice Kaus

Justice Kaus stated initially that he generally concurred in Justice Lucas' concurring and dissenting opinion.¹³⁹ However, Justice Kaus further expressed the fear that the rules laid down by the *White* majority would spill over into non-insurance contractual relationships.¹⁴⁰ He argued that since *Seaman's Direct Buying Service, Inc. v. Standard Oil Co.*,¹⁴¹ there has been great pressure on California courts to extend the

139. *White v. Western Title Ins. Co.*, 40 Cal. 3d 870, 900, 710 P.2d 309, 327, 221 Cal. Rptr. 509, 527 (1985) (Kaus, J., concurring and dissenting).

140. *Id.* (Kaus, J., concurring and dissenting).

141. 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984). *Seaman's Direct Buying Service, Inc.* (Seaman's) was a closely held corporation consisting of three shareholders. *Id.* at 759, 686 P.2d at 1160, 206 Cal. Rptr. at 356. One of Seaman's activities was the management of a small marine fueling station. *Id.* In 1970, after the City of Eureka decided to modernize the marina in which Seaman's station was located, Seaman's negotiated a dealership agreement with Standard Oil of California (Standard). *Id.* In October 1972, Standard wrote Seaman's a letter setting forth the terms of their agreement. One of the terms was that Standard would sign a Chevron Marine Dealer agreement with Seaman's for an initial period of 10 years. *Id.* at 760, 686 P.2d at 1160-61, 206 Cal. Rptr. at 356-57. The letter was accepted and agreed to by Seaman's, and Seaman's discontinued similar negotiations with Mobil Oil Company. *Id.*

In 1973, as a result of the changed conditions in the oil industry, Standard adopted a "no new business" policy." *Id.* at 760-61, 686 P.2d at 1161, 206 Cal. Rptr. at 357. During 1973, Standard and Seaman's signed a temporary dealership agreement for the supply of fuel while the marina was under construction. *Id.* The proposed marine dealership agreement contemplated in October 1972, however, was never signed. *Id.* In November 1973, a federal program was promulgated requiring "suppliers [of petroleum products] to supply [only] those purchasers to whom they sold during [the base period of 1972]." *Id.* at 761, 686 P.2d at 1161, 206 Cal. Rptr. at 357. Since Standard had not supplied products to Seaman's in 1972, Standard stated that "we will not be able to go forward with the financing we [have] been discussing." *Id.* Standard, however, said it would be willing to perform under the contract if Seaman's could obtain a supply authorization from the appropriate federal agency. Standard supplied Seaman's with the necessary forms and helped complete them. *Id.*

In 1974, the federal agency issued a supply order, but Standard responded by changing its position. *Id.* It contended that it did not have a binding contract with Seaman's and appealed the issuance of the supply order. Standard was successful on appeal, and internal memoranda demonstrated Standard's reaction: "[g]reat!! 'We are recommending to other div[isions] that they follow your example.'" *Id.*

Seaman's appealed, and the federal agency's decision was reversed. *Id.* "The new decision provided that an order 'direct[ing] [Standard] to fulfill supply obligations to Seaman's' would be issued upon the filing of a copy of a court decree that a valid contract existed between the parties under state law." *Id.* When Seaman's requested Standard to stipulate to the existence of a valid contract, Standard's representative replied, "'See you in court.'" *Id.* at 761-62, 686 P.2d at 1162, 206 Cal. Rptr. at 358.

Seaman's then filed suit against Standard for breach of the covenant of good faith and fair dealing, among other counts. The jury returned a verdict which awarded Seaman's \$397,050 in compensatory damages and \$11,058,810 in punitive damages for tortious breach of the covenant of good faith and fair dealing. *Id.* at 762, 686 P.2d at 1162, 206 Cal. Rptr. at 358. Standard appealed.

The California Supreme Court reversed the judgment for breach of the duty of good faith and fair dealing with directions to conduct further proceedings consistent with its opinion. *Id.*

tort of breach of the covenant of good faith and fair dealing to other contractual relationships. From his viewpoint, "it would be disastrous if every contract were to be subjected to the same set of rules [the court has] applied in the context of the insurer-insured relationship."¹⁴² Every person has the right to wilfully breach a contract, and Justice Kaus stated that he could not envision that everyone in that position should be subject to unlimited liability for punitive damages.¹⁴³ After *White*, he feared, that outcome is a grave possibility.

Recognizing that traditional contract damages are not always adequate to fully compensate a plaintiff for his or her loss,¹⁴⁴ Justice Kaus enumerated various alternative contract remedies in lieu of damages for bad faith breach of contract.¹⁴⁵ For example, he first discussed the *Had-*

at 774, 686 P.2d at 1170, 206 Cal. Rptr. at 366. The reason for reversal was the trial court's failure to instruct the jury that Standard's denial of the existence of the contract would not have been tortious if made in good faith. *Id.* at 770, 686 P.2d at 1167, 206 Cal. Rptr. at 363. The court, however, found that tortious bad faith may have properly been found under *Seaman's* facts, and it discussed the extension of tortious bad faith breach of contract into relationships outside that of insurer-insured:

While the proposition that the law implies a covenant of good faith and fair dealing in all contracts is well established, the proposition advanced by *Seaman's*—that breach of the covenant always gives rise to an action in tort—is not so clear. In holding that a tort action is available for breach of the covenant in an insurance contract, we have emphasized the "special relationship" between insurer and insured, characterized by elements of public interest, adhesion, and fiduciary responsibility. No doubt there are other relationships with similar characteristics and deserving of similar legal treatment.

When we move from such special relationships to consideration of the tort remedy in the context of the ordinary commercial contract, we move into largely uncharted and potentially dangerous waters. Here, parties of roughly equal bargaining power are free to shape the contours of their agreement and to include provisions for attorney fees and liquidated damages in the event of a breach. They may not be permitted to disclaim the covenant of good faith but they are free, within reasonable limits at least, to agree upon the standards by which application of the covenant is to be measured. In such contracts, it may be difficult to distinguish between breach of the covenant and breach of contract, and there is the risk that interjecting tort remedies will intrude upon the expectations of the parties. This is not to say that tort remedies have no place in such a commercial context, but that it is wise to proceed with caution in determining their scope and application.

For the purposes of this case, it is unnecessary to decide the broad question which *Seaman's* poses. Indeed, it is not even necessary to predicate liability on a breach of the implied covenant. It is sufficient to recognize that a party to a contract may incur tort remedies when, in addition to breaching the contract, it seeks to shield itself from liability by denying, in bad faith and without probable cause, that the contract exists.

Id. at 768-69, 686 P.2d at 1166-67, 206 Cal. Rptr. at 362-63 (citations and footnotes omitted).

142. *White*, 40 Cal. 3d at 900, 710 P.2d at 327-28, 221 Cal. Rptr. at 527-28 (Kaus, J., concurring and dissenting) (footnote omitted).

143. *Id.* at 901, 710 P.2d at 328, 221 Cal. Rptr. at 528 (Kaus, J., concurring and dissenting).

144. *Id.* (Kaus, J., concurring and dissenting).

145. *Id.* at n.4, 710 P.2d at 328 n.4, 221 Cal. Rptr. at 528 n.4 (Kaus, J., concurring and

ley v. Baxendale¹⁴⁶ rule that consequential damages are limited to those in the contemplation of the parties at the time of contract formation.¹⁴⁷ Second, he referred to the denial of agreed remedies where their enforcement would produce an unconscionable result.¹⁴⁸ Third, he advocated the use of prejudgment interest to compensate for loss of opportunity even where damages are unliquidated.¹⁴⁹ Fourth, juries and courts could be instructed to award higher compensatory awards to take into account the uncertainty inherent in the law of contract damages.¹⁵⁰ Finally, he suggested that courts could employ principles of restitution and unjust enrichment.¹⁵¹ Since the bad faith/punitive damages solution was unsatisfactory to Justice Kaus, he did not list it among the possibilities. He said, however, that the problem of an adequate remedy was one for the legislature to resolve and suggested that it do something to effect a change.¹⁵²

IV. ANALYSIS

A. Implied Covenant of Good Faith and Fair Dealing

1. Background

The common-law duty of good faith and fair dealing is implied in all contracts to protect the expectations of the parties to the contract.¹⁵³

dissenting) (quoting Traynor, *Bad Faith Breach of a Commercial Contract: A Comment on the Seaman's Case*, 8 BUS. L. NEWS 1, 12-13 (1984)).

146. 9 Ex. 341, 156 Eng. Rep. 145 (1854).

147. 40 Cal. 3d at 901 n.4, 710 P.2d at 328 n.4, 221 Cal. Rptr. at 528 n.4 (Kaus, J., concurring and dissenting) (quoting Traynor, *Bad Faith Breach of a Commercial Contract: A Comment on the Seaman's Case*, 8 BUS. L. NEWS 1, 12 (1984)).

148. *Id.* at 901-02 n.4, 710 P.2d at 328 n.4, 221 Cal. Rptr. at 528 n.4 (Kaus, J., concurring and dissenting) (quoting Traynor, *Bad Faith Breach of a Commercial Contract: A Comment on the Seaman's Case*, 8 BUS. L. NEWS 1, 12-13 (1984)).

149. *Id.* at 902 n.4, 710 P.2d at 328 n.4, 221 Cal. Rptr. at 528 n.4 (Kaus, J., concurring and dissenting) (quoting Traynor, *Bad Faith Breach of a Commercial Contract: A Comment on the Seaman's Case*, 8 BUS. L. NEWS 1, 13 (1984)).

150. *Id.* (Kaus, J., concurring and dissenting).

151. *Id.* at 902 n.4, 710 P.2d at 328 n.4, 221 Cal. Rptr. at 528 n.4 (Kaus, J., concurring and dissenting) (quoting Traynor, *Bad Faith Breach of a Commercial Contract: A Comment on the Seaman's Case*, 8 BUS. L. NEWS 1, 13 (1984)).

152. *Id.* at 901, 710 P.2d at 328, 221 Cal. Rptr. at 528 (Kaus, J., concurring and dissenting).

153. See 3 A. CORBIN, CORBIN ON CONTRACTS § 570 (Kaufman Supp. 1984).

If the purpose of contract law is to enforce the reasonable expectations of parties induced by promises, then at some point it becomes necessary for courts to look to the substance rather than to the form of the agreement, and to hold that substance controls over form. What courts are doing here, whether calling the process "implication" of promises, or interpreting the requirements of "good faith," as the current fashion may be, is but a recognition that the parties occasionally have understandings or expectations that were so fundamental that they did not need to negotiate about those expectations. When the court "implies a promise" or holds that "good faith"

This implied covenant requires the performance of any condition that is necessary to another's performance of the agreement.¹⁵⁴ One commentator has stated that "[i]f the cooperation of the other party is necessary for successful performance of an obligation, a promise to *give that cooperation and not to do anything which prevents* realization of the fruits of performance, will often be implied."¹⁵⁵ One case, *Harm v. Frasher*,¹⁵⁶

requires a party not to violate those expectations, it is recognizing that sometimes silence says more than words, and it is understanding its duty to the spirit of the bargain is higher than its duty to the technicalities of the language.

Id.

154. *Id.*

155. 1 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW § 576 (1973) (emphasis in original).

156. 181 Cal. App. 2d 405, 5 Cal. Rptr. 367 (1960). Hattie Harm and the Estate of Harold B. Frasher (Frasher Estate), acting through executors, were copartners engaged in an integrated trucking business. *Id.* at 410, 5 Cal. Rptr. at 370. Hattie Harm, individually and as trustee of the George Robert Harm Trust (Harm Interests), owned capital stock in two corporations. *Id.* The Frasher Estate also owned stock in those corporations. In July 1951, representatives of the Harm Interests and the Frasher Estate met with representatives of Consolidated Copperstate Lines (Copperstate) to negotiate the terms of an agreement whereby the Harm Interests and the Frasher Estate would sell their partnership and respective corporate shares to Copperstate. The parties simultaneously executed three instruments. One agreement was between Copperstate and the Harm Interests; another was between Copperstate and the Frasher Estate. Both were for the sale of the corporate stock. The third agreement was between Copperstate, Hattie Harm and the Frasher Estate for the sale of the partnership business. Each agreement referred to the others, and each was contingent on the others' concurrent closing. *Id.* After all the agreed conditions precedent occurred, Copperstate tendered performance. The Frasher Estate, however, refused to perform. Although the Harm Interests indicated their willingness and intention to perform, Copperstate required performance by all parties and refused to perform. Copperstate subsequently brought an action and was awarded specific performance of the contracts. Accordingly, the sales were consummated on August 7, 1956.

The Harm Interests claimed damage due to the Frasher Estate's delay in performance from the time that Copperstate initially tendered performance on September 1, 1954, to the consummation of the sale in 1956. After a trial on breach of the agreement between the Harm Interests and the Frasher Estate, the court concluded "that the agreement to sell was one transaction which was expressed in three written contracts, mutually integrated and interdependent." *Id.* at 412, 5 Cal. Rptr. at 371. The trial court found for the Harm Interests.

The appellate court affirmed the trial court's judgment. *Id.* at 424, 5 Cal. Rptr. at 379. In doing so, it discussed the duty of good faith and fair dealing. The court stated:

In refusing to complete the sale on September 1, 1954, the executors of the "Frasher Estate" breached the foregoing duty which they owed the "Harm Interests" under the contract of sale evidenced by the three agreements heretofore considered.

Defendants contend that the complaint does not allege any promise by the "Frasher Estate" to the "Harm Interests." Such an allegation was unnecessary to the statement of a cause of action. The complaint alleged the execution of the three agreements as part of one transaction, incorporated the provisions thereof by reference, and attached them thereto as exhibits. From such allegations the existence of the implied covenants heretofore considered is established as a matter of law. The record plainly indicates that all parties to the action were fully aware of their respective contentions. The defendant's objection to the pleading is without merit.

Id. at 417, 5 Cal. Rptr. at 374-75.

expanded on this concept and stated:

This covenant not only imposes upon each contracting party the duty to refrain from doing anything which would render performance of the contract impossible by any act of his own, but also the duty to do everything that the contract presupposes that he will do to accomplish its purpose.¹⁵⁷

In California, this bilateral obligation is implied in all contracts, including insurance contracts.¹⁵⁸

Implicit in the holdings of cases imposing upon insurers a duty of good faith and fair dealing is the rationale that insurance companies should act fairly and promptly on the claims of their insureds.¹⁵⁹ Two sub-duties have evolved from case law regarding the broader duty of good faith and fair dealing.

The first is the duty to conduct good faith settlement negotiations.¹⁶⁰ For example, in *Crisci v. Security Insurance Co.*,¹⁶¹ the supreme court held that "recovery may be based on unwarranted rejection of a reasonable settlement offer"¹⁶² regardless of the absence of dishonesty or fraud.¹⁶³ In *Crisci*, one of Mrs. Crisci's tenants fell down a wooden staircase in her apartment building when a tread gave way.¹⁶⁴ Mrs. Crisci's insurer suspected that a \$100,000 verdict might be returned if the jury believed the tenant's claim that the fall triggered her psychosis.¹⁶⁵ Nevertheless, the insurer refused the tenant's offer to settle for \$10,000, Mrs. Crisci's policy limit.¹⁶⁶ As expected, the tenant was awarded \$101,000 at trial.¹⁶⁷ Consequently, Mrs. Crisci was forced to settle with the victim for the excess over her policy limit.¹⁶⁸ As a result, Mrs. Crisci became indigent, suffered mental distress and attempted suicide.¹⁶⁹ She subsequently brought an action against her insurance company for breach of

157. *Id.* at 417, 5 Cal. Rptr. at 374.

158. *Brown v. Superior Court*, 34 Cal. 2d 559, 564, 212 P.2d 878, 881 (1949).

159. *See, e.g.*, *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973); *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958); *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

160. *See* Comment, *Extending the Insurer's Duty of Good Faith and Fair Dealing to Third Parties under Liability Insurance Policies*, 25 UCLA L. REV. 1413, 1413 (1978).

161. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

162. *Id.* at 430, 426 P.2d at 177, 58 Cal. Rptr. at 17.

163. *Id.*

164. *Id.* at 427, 426 P.2d at 175, 58 Cal. Rptr. at 15.

165. *Id.* at 428, 426 P.2d at 175, 58 Cal. Rptr. at 15.

166. *Id.*

167. *Id.* The jury awarded \$100,000 to Mrs. Crisci and \$1000 to her husband.

168. *Id.* at 429, 426 P.2d at 176, 58 Cal. Rptr. at 16.

169. *Id.*

the implied covenant of good faith and fair dealing.¹⁷⁰ Mrs. Crisci was awarded \$91,000 for compensatory damages and \$25,000 for emotional distress.¹⁷¹ By its decision, the California Supreme Court seemed to notify all insurers that they should conduct settlement negotiations in good faith. Without good faith negotiations, Mrs. Crisci was denied the "cooperation of the other party [to the insurance contract] . . . necessary for successful performance of an obligation."¹⁷²

The second sub-duty evolving from case law is the duty to promptly deliver the insurance policy benefits to the insured.¹⁷³ *Gruenberg v. Aetna Insurance Co.*¹⁷⁴ illustrates this point. Gruenberg, the owner of a business, the premises of which were damaged by fire, alleged that the insurer schemed to deprive him of the benefits due under a fire insurance policy.¹⁷⁵ He claimed that the insurer encouraged criminal charges against him by falsely implying that he had a motive to commit arson.¹⁷⁶ The insurers knew that while criminal charges were pending against Gruenberg, he could not appear for an examination concerning the loss as required by his policy, and the insurer used this failure to appear as a pretense for denying liability under the policy.¹⁷⁷ The trial court sustained a general demurrer.¹⁷⁸ Finding that Gruenberg had stated a cause of action for breach of the implied covenant of good faith and fair dealing, the supreme court reversed.¹⁷⁹ In this instance, the court sought to protect vulnerable insureds from insurers' bad faith tactics.

The two sub-duties mentioned above are significant since both are relevant to the issues in *White v. Western Title Insurance Co.*¹⁸⁰ The duty to effectuate good faith settlement negotiations is patently obvious in *White*. The Whites attempted to and were successful at admitting settlement negotiations into evidence to prove Western Title's bad faith. The duty to promptly deliver insurance policy benefits, however, is less obvious in the context of *White*. Nonetheless, it is present since the Whites alleged that Western Title attempted to delay delivery of policy benefits through its conduct in litigation. Accordingly, the Whites suc-

170. *Id.*

171. *Id.* at 427, 426 P.2d at 175, 58 Cal. Rptr. at 15.

172. *See supra* text accompanying note 155. *See also* 1 B.E. WITKIN, *supra* note 155, at § 576.

173. *See Comment, supra* note 160, at 1413.

174. 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

175. *Id.* at 570, 571, 510 P.2d at 1034, 1035, 108 Cal. Rptr. at 482, 483.

176. *Id.* at 571, 510 P.2d at 1035, 108 Cal. Rptr. at 483.

177. *Id.* at 571-72, 510 P.2d at 1035, 108 Cal. Rptr. at 483.

178. *Id.* at 569, 510 P.2d at 1034, 108 Cal. Rptr. at 482.

179. *Id.* at 581, 510 P.2d at 1042, 108 Cal. Rptr. at 490.

180. 40 Cal. 3d 870, 710 P.2d 309, 221 Cal. Rptr. 509 (1985).

cessfully admitted into evidence Western Title's trial conduct to prove undue delay in the provision of policy benefits.

The duty of good faith and fair dealing, it would appear, includes the insurer's duty to conduct an adequate and timely investigation of the insured's claim¹⁸¹ and the ubiquitous duty to defend the insured.¹⁸² The *White* court correctly assumed that all of these obligations were imposed by the nature of contractual relationship between Western Title and the Whites. However, the court was faced with the question of whether an insurer owes an insured a duty of good faith and fair dealing after the insured has commenced litigation against the insurer. The *White* court answered that question in the affirmative.

2. Continuation of the duty of good faith and fair dealing

The *White v. Western Title Insurance Co.*¹⁸³ court's holding that the duty of good faith and fair dealing¹⁸⁴ extends until after the commencement of litigation is subject to criticism and debate. Once an action for breach of contract is filed,¹⁸⁵ both performance of the contract and cooperation between the parties have been frustrated. This consequence is

181. Cf. *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

182. California courts have broadly interpreted an insurer's duty to defend. In *St. Paul Fire & Marine Ins. Co. v. Sears Roebuck & Co.*, the United States Court of Appeals, applying California law, held that the duty to defend under a policy of liability insurance is broader than the duty to indemnify. 603 F.2d 780, 786 (9th Cir. 1979). See also *Eichler Homes, Inc. v. Underwriters at Lloyd's, London*, 238 Cal. App. 2d 532, 47 Cal. Rptr. 843 (1965) and *Karpe v. Great Am. Indem. Co.*, 190 Cal. App. 2d 226, 11 Cal. Rptr. 908 (1961). Thus, although an insurer may not be obligated to indemnify an insured for damage or loss, it may owe the insured a defense.

Once a plaintiff raises allegations which potentially fall within the coverage provided the insured, the insurer is obligated to defend its insured fully. See *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966). The insurer must defend an entire action even if fewer than all the claims against the insured are covered by the policy. See *Hogan v. Midland Nat'l Ins. Co.*, 3 Cal. 3d 553, 476 P.2d 825, 91 Cal. Rptr. 153 (1970). Consequently, if even one of the causes of action against the insured is potentially covered by the insurance policy, then the insurer must defend the entire lawsuit.

Furthermore, California law requires that "[w]here there is doubt as to whether the duty to defend exists, doubt should be resolved in favor of the insured and against the insurer." *Eichler Homes*, 238 Cal. App. 2d at 538, 47 Cal. Rptr. at 847. If an insurer wrongfully refuses to defend an insured and a judgment is rendered against the insured, the insurer loses its right to assert any defenses to the insured's claim and must pay the entire amount of the judgment or settlement even if it exceeds the insured's policy limits. See *Betts v. Allstate Ins. Co.*, 154 Cal. App. 3d 688, 201 Cal. Rptr. 528 (1984).

183. 40 Cal. 3d 870, 710 P.2d 309, 221 Cal. Rptr. 509 (1985).

184. See *supra* text accompanying notes 153-57 & note 153.

185. No action for breach of the duty of good faith and fair dealing exists without a breach of contract. Of course, however, it is possible to allege breach of contract without alleging a count for breach of the duty of good faith.

true with respect to all breaches—whether total or partial. In the case of a total breach, performance of the contract has prematurely terminated or has been materially defective in some manner.¹⁸⁶ In other words, one or both parties to the contract are non-cooperative. In the case of a partial breach, performance continues despite some immaterial defect¹⁸⁷ and despite a lack of cooperation between the parties with respect to the particular defective performance.¹⁸⁸ In both situations, one of the parties to the contract has breached the implied promise to cooperate.¹⁸⁹ Since the parties are aligned in this position of non-cooperation, it would be illogical to impose the duty to cooperate or “the duty to do everything that the contract presupposes that [the party] will do to accomplish its purpose”¹⁹⁰ after a party has instituted an action for breach of contract.

This concept is equally applicable in the insurance contract context. In *Frommoethelydo v. Fire Insurance Exchange*,¹⁹¹ the California Supreme Court defined the covenant of good faith and fair dealing as

186. 4 A. CORBIN, CORBIN ON CONTRACTS § 946 (1951).

187. *Id.*

188. In finding that the duty of good faith and fair dealing continues after the commencement of litigation, the majority in *White* reasoned that the underlying contractual relationship did not terminate when a lawsuit was filed. Demonstrating this principle, the court analogized to an automobile liability policy where an insurer would have a continuing duty of good faith and fair dealing to an insured in the event that the insured was involved in a subsequent car accident. *White*, 40 Cal. 3d at 885, 710 P.2d at 317, 221 Cal. Rptr. at 517. The insurer would have to provide policy benefits to the insured necessary to protect him or her against a related suit.

As Justice Lucas related in his dissent, the majority focused on the wrong issue. Rather, it should have focused on the “nature of the relationship between the parties *as to the particular claim at issue*.” *Id.* at 892, 710 P.2d at 322, 221 Cal. Rptr. at 522 (Lucas, J., concurring and dissenting) (emphasis in original). In the insurance contract context where the payments of benefits are made upon the occurrence of a contingency, each covered event gives rise to a separate transaction. Although a continuing contractual relationship exists between the insurer and the insured, they are in an adversarial situation with respect to the particular claim being litigated. Once the contingency has occurred, a fundamental shift in the parties’ relationship results. No longer do the insured and insurer work toward a common goal—the mutually satisfactory fruition of bargained-for benefits—rather, they seek to protect their own interests at the expense of the other.

189. *See supra* text accompanying note 186.

190. *See supra* text accompanying note 188.

191. 42 Cal. 3d 208, 721 P.2d 41, 228 Cal. Rptr. 160 (1986). In *Frommoethelydo*, Clydelho Frommoethelydo was insured by defendant Fire Insurance Exchange under a homeowner’s policy. In August 1978, Frommoethelydo’s house was burglarized. After submitting a claim to the insurer, his claim was settled for \$10,784. *Id.* at 212, 721 P.2d at 42, 228 Cal. Rptr. at 161. Frommoethelydo’s house was burglarized again in June 1979, and he filed a claim with Fire Insurance Exchange for an aggregate loss of \$8871, including \$3000 for stereo and video equipment. *Id.* To his sworn statement, he attached a copy of a bill of sale which had been altered so that the date of equipment purchase appeared to be before the date of the second theft. The date on the receipt had been stenciled over to read “1/03/79.” When the insurer investigated the possibility of fraud, it discovered that the purported store of sale had no record

implied in insurance contracts. It stated that "[t]o fulfill its implied obligation, an insurer must give at least as much consideration to the interests of the insured as it gives to its own interests."¹⁹² This statement surely applies to situations where the insurer must decide whether to settle or litigate a third party claim against the insured, or whether to reasonably withhold payment of the claim of its insured. Once an insured has set in motion the wheels of litigation against its insurer, it would be an unreasonable, if not impossible, requirement for an insurer to both defend itself and protect the interests of its adversary, the insured. Imposing the duty of good faith and fair dealing after the commencement of an action would be to obligate the insurer to provide protection to the insured during trial. Under this perspective, the insurer would have to disclose to the insured all evidence detrimental to the insurer's case.¹⁹³

of Frommoethelydo's purchase in January 1979. The store did, however, have receipts dated before the first burglary and after the second. *Id.*

Although Frommoethelydo insisted he had purchased equipment at that store on three different occasions, Fire Insurance Exchange reported him to the Bureau of Fraudulent Claims for insurance fraud. Accordingly, the Bureau instituted criminal proceedings against Frommoethelydo. *Id.* at 212-13, 721 P.2d at 43, 228 Cal. Rptr. at 162. Frommoethelydo's attorney was able to convince the district attorney "that the latter could not prove beyond a reasonable doubt that the claim, as opposed to the receipt, was false." *Id.* at 213, 721 P.2d at 43, 228 Cal. Rptr. at 162. On the morning of trial, the district attorney dismissed the criminal charges. *Id.* The basis for dismissal was that Frommoethelydo had witnesses who would testify to seeing large quantities of stereo and video equipment in his house prior to the second theft and that false documentation of a valid claim was not a violation of section 556 of the California Insurance Code. *Id.* See CAL. INS. CODE § 556(a)(1) (West Supp. 1987) ("It is unlawful to: (1) Knowingly present or cause to be presented any false or fraudulent claim for the payment of a loss . . . under a contract of insurance.").

After dismissal, Frommoethelydo's attorney offered to compromise the insurance claim by waiving the disputed \$3000. 42 Cal. 3d at 214, 721 P.2d at 44, 228 Cal. Rptr. at 163. Without further investigating the claim, the insurer rejected the compromise "on the ground that a material misrepresentation in a claim justifies rescission of the entire policy." *Id.* The insurer so concluded in light of its newly acquired knowledge of Frommoethelydo's witnesses.

Frommoethelydo filed a lawsuit for, among other things, breach of the duty of good faith and fair dealing. The jury awarded him \$8871, the amount of his original claim, plus \$250,000 for emotional distress and \$1,250,000 for punitive damages. *Id.* The California Supreme Court reversed the awards for emotional distress and punitive damages, but upheld the award for economic loss. *Id.* at 220, 721 P.2d at 48, 228 Cal. Rptr. at 167. The court stated that "[b]y awarding damages for economic loss, the jury obviously determined that plaintiff had suffered the loss." *Id.* Additionally, the court found that the insurer had breached its duty to investigate after it was apprised of the existence of Frommoethelydo's witnesses and decided that he should be permitted to seek a further trial to recover those damages. *Id.*

192. *Frommoethelydo*, 42 Cal. 3d at 214, 721 P.2d at 44, 228 Cal. Rptr. at 163.

193. *White*, 40 Cal. 3d at 886, 710 P.2d at 317, 221 Cal. Rptr. at 517 (1985). In *San Diego Navy Federal Credit Union v. Cumis Insurance Society, Inc.*, 162 Cal. App. 3d 358, 208 Cal. Rptr. 494 (1984), the California Court of Appeal attempted to resolve these types of conflicts within the declaratory relief setting. The typical scenario is: the insured files a claim for loss, the insurer denies coverage subject to a reservation of rights, the insured files a lawsuit against the insurer, and the insurer cross-complains for a declaratory judgment that coverage does not

Additionally, any typical trial conduct might be paraded in front of a jury to evidence an attempt to unduly delay payment of the insured's claim. An insurer, consequently, might be adjudged acting in bad faith merely because it seeks to take a deposition. *White* effectively denies the insurer the right to defend itself vigorously.¹⁹⁴ Moreover, this reasoning certainly places the insurer's defense attorney in a precarious position.¹⁹⁵

a. *denial of the insurer's "fundamental right"*¹⁹⁶ to defend itself

Since the insurer's routine trial conduct may be viewed as acts of bad faith by an uninformed jury, an insurer may well be prejudiced when the jury interprets that conduct. In *White v. Western Title Insurance Co.*,¹⁹⁷ the court permitted the jury to hear evidence of Western Title's unsuccessful motion for summary judgment as well as evidence regarding

exist under the insured's policy. In that setting, *Cumis* mandates that an insurer pay for independent counsel for the insured, *id.* at 361, 208 Cal. Rptr. at 496, and surrender control of the insured's defense to that independent counsel. *Id.* at 375, 208 Cal. Rptr. at 506. Of course, this situation might occur during the pendency of a third party action against the insured. The insurer, consequently, would be defending the third party action while providing independent counsel for the insured in the declaratory relief action.

However, in actual practice, *Cumis* has created, rather than alleviated, many conflicts and problems between the various attorneys, the parties to the actions, and any combination of those categories. A discussion of those conflicts could be the topic of numerous law review articles.

194. In *White*, the court stated:

[I]t is not unusual for an insurance company to provide policy benefits, such as the defense of litigation, while itself instituting suit to determine whether and to what extent it must provide those benefits. It could not reasonably be argued under such circumstances either that the insurer no longer owes any contractual duties to the insured, or that it need not perform those duties fairly and in good faith.

White, 40 Cal. 3d at 885-86, 710 P.2d at 317, 221 Cal. Rptr. at 517.

Undisputably, the insurer owes the insured the duty "not to do anything which prevents realization of the fruits of [their agreement]" regarding defense of the third party claim against the insured. Some may wish, however, to extend the court's reasoning to reach an absurd result. At one point in its discussion, the court stated, "obviously the insurer could not be permitted to terminate its own obligations by initiating litigation . . ." *Id.* at 886, 710 P.2d at 317, 221 Cal. Rptr. at 517; see also *supra* note 155 and accompanying text. This dicta seems to indicate that the insurer owes the insured the duty of good faith and fair dealing in both the third party suit and the suit for declaratory relief. The very institution of the declaratory relief action, consequently, could be said to prevent or delay realization of contract benefits, and the insurer's attempt to determine those benefits would itself be an act of bad faith.

195. See *infra* notes 210-19 and accompanying text.

196. Without giving any support, Justice Lucas stated that "[t]he majority here does not give any reasoned consideration to this *fundamental* and recognized *right to defend*." *White*, 40 Cal. 3d at 896, 710 P.2d at 324, 221 Cal. Rptr. at 524 (Lucas, J., concurring and dissenting) (emphasis added). He also discussed this "fundamental right" in various other places in his argument. See, e.g., *id.* at 896 n.5, 710 P.2d at 324 n.5, 221 Cal. Rptr. at 524 n.5 (Lucas, J., concurring and dissenting).

197. 40 Cal. 3d 870, 710 P.2d 309, 221 Cal. Rptr. 509 (1985).

the negotiations and conduct of its attorneys.¹⁹⁸ Additionally, the insured's attorney presented this evidence without any suggestion "that the particular tactics used were in and of themselves improper; rather the implicit claim was that the normal delays of litigation themselves amounted to evidence of a lack of good faith."¹⁹⁹ The jury nevertheless decided that Western Title was liable for tortious bad faith breach of contract.

The problems associated with allowing juries to hear this type of evidence are twofold. First, juries largely comprise lay people who are not familiar with litigation strategies and tactics. Second, since no showing of malice is required to prove bad faith,²⁰⁰ this evidence is often sufficient in and of itself to prove the elements of the tort.

A jury comprising people without legal backgrounds is unlikely to discern the difference between bad faith conduct and trial strategy. In a lay jury's eyes, a normal delay may evince an insurer's lack of good faith. The *White* court, however, "trust[ed] that the jurors [would] be aware that parties to a lawsuit are adversaries, and [would] evaluate the insurer's conduct in relation to that setting."²⁰¹ But the *White* jury obviously did not live up to the court's expectations since it interpreted evidence of depositions, numerous files and briefs,²⁰² and a motion for summary judgment²⁰³ as bad faith conduct.

Paradoxically, the *White* court determined that the law provides adequate procedural safeguards to prevent this type of prejudicial effect. In referring to section 352 of the California Evidence Code,²⁰⁴ it declared

198. In his closing argument, White's attorney informed the jury that:

The other aspect of this case is that you have a situation where they have delayed the case, you've seen the files that we've been dragging around [O]nce a suit is filed then every movement from one side produces an equal and opposite movement in the other direction, and you end up with these numerous briefs. Briefs on that, briefs on this, research depositions, there were eight or nine depositions taken in this case. Most of which were unnecessary but once somebody takes some information you've got to do the same thing to prepare for trial.

Id. at 895 n.4, 710 P.2d at 323 n.4, 221 Cal. Rptr. at 523 n.4 (Lucas, J., concurring and dissenting). It is interesting to note that if an insurer is found liable for breach of the covenant of good faith and fair dealing as a result of its "bad faith" conduct during litigation, the insurer could then sue its attorney for malpractice since counsel usually determines trial strategy.

199. *Id.* (Lucas, J., concurring and dissenting).

200. *See supra* note 116.

201. *White*, 40 Cal. 3d at 886, 710 P.2d at 317, 221 Cal. Rptr. at 517.

202. *See supra* note 198.

203. *See supra* text accompanying note 198.

204. Section 352 provides in pertinent part: "The court in its discretion may exclude evidence if its probative value is substantially outweighed by the probability that its admission will . . . create substantial danger of undue prejudice, of confusing the issues, or of misleading the jury." CAL. EVID. CODE § 352 (West 1966).

that "[t]he trial court . . . would retain the authority to exclude evidence of settlement offers or other conduct of the insurer if it concluded that . . . the prejudicial effect of such evidence would outweigh its probative value."²⁰⁵ However, the court gave no guidelines to lower courts as to how they should determine whether prejudice outweighs probative value in this type of situation.²⁰⁶ This lack of guidelines destroys the defendant's procedural safeguards because the court's rule is difficult to apply. Moreover, since proof of bad faith conduct does not require the existence of malice,²⁰⁷ it is difficult to perceive *any* factual setting where this type of evidence would be more probative than prejudicial. For example, a lay jury could interpret an insurer's refusal to settle subsequent to the denial of a motion for summary judgment as conduct which contravenes the duty of good faith and fair dealing.²⁰⁸ Further, by the *White* court's rule, a trial court need not even consider whether the insurer proceeded with malicious or immoral intent. The conduct alone provides the basis of liability. In contrast, if proof of malice *were* a requirement, it would be infinitely more difficult to prove that a party's unsuccessful motion for summary judgment, or its taking of depositions, was evidence of bad faith conduct. Rather, the jury would be in a better position to understand that these actions are commonplace in litigation. Since the jury does not have this background, the admission of evidence of ordinary trial conduct is more prejudicial than probative.²⁰⁹

205. *White*, 40 Cal. 3d at 887 n.9, 710 P.2d at 317 n.9, 221 Cal. Rptr. at 517 n.9.

206. See *infra* note 209.

207. See *supra* note 116.

208. In *White*, "no flagrant misconduct was alleged and plaintiff's argument regarding defendant's litigation conduct [could] be characterized as asserting only that litigation generally caused delay." 40 Cal. 3d at 898 n.7, 710 P.2d at 325 n.7, 221 Cal. Rptr. at 525 n.7 (Lucas, J., concurring and dissenting).

209. Even if evidence of trial conduct is found to be more probative than prejudicial, a trial court's exercise of discretion still does not cure the insurer's basic problems. Justice Lucas stated that:

Insurers are still left uncertain as to whether any action they take with regard to litigation on an underlying breach of contract claim may be used against them. There is no lessening of the basic constraints on a defendant's right to defend by virtue of a rule which says the trial court has discretion to decide what may be introduced.

Id. at 897 n.7, 710 P.2d at 325 n.7, 221 Cal. Rptr. at 525 n.7 (Lucas, J., concurring and dissenting).

Although the *White* court summarily discussed this balancing of interests in connection with admission of evidence of litigation conduct, it admitted evidence of Western Title's settlement offers made during trial without attempting to apply section 352 of the California Evidence Code. *Id.* (Lucas, J., concurring and dissenting). Justice Lucas concluded that "[a]s a result, it is difficult to see when a trial court will ever exclude such evidence following this decision." *Id.* at 898 n.7, 710 P.2d at 325 n.7, 221 Cal. Rptr. at 525 n.7 (Lucas, J., concurring and dissenting).

After *White*, not only may an insurer's defensive conduct be prejudicially misunderstood by juries, but insurers may also be effectively denied the right to defend themselves because of their lawyers' ethical considerations.

b. the continuation of good faith and fair dealing and lawyers' ethics

The majority in *White v. Western Title Insurance Co.*²¹⁰ gave little attention to the insurer's argument that its defense would be impeded by the court's rule—that the duty of good faith and fair dealing continues during litigation. One of Western Title's contentions was that it would be subject to hardship since "the attorney who prepare[d] the case for trial could not conduct the trial because he would be a critical witness to the insurer's good faith during the pretrial period."²¹¹ In response, the court answered:

The issue of contractual liability can be tried separately, and prior to the trial on the good faith claim, as was done in the present case. In any event, what constitutes good faith and fair dealing depends on the circumstances of each case, including the stage of the proceedings and the posture of the parties.²¹²

In making this statement, the majority failed to analyze the significant prohibitions of the California Rules of Professional Conduct²¹³ (California Rules). Under the California Rules, an attorney must withdraw from employment if his or her testimony *may be* prejudicial to the client.²¹⁴ Consequently, if the insurer's attorney who prepared the case for

210. 40 Cal. 3d 870, 710 P.2d 309, 221 Cal. Rptr. 509 (1985).

211. *Id.* at 886, 710 P.2d at 317, 221 Cal. Rptr. at 517. For a discussion of the attorney-witness dilemma, see Ashley, *The Problem of Attorney-Witness in Bad Faith Cases*, BAD FAITH L. REP. 51 (1987).

212. *White*, 40 Cal. 3d at 886, 710 P.2d at 317, 221 Cal. Rptr. at 517.

213. Interestingly, the California Rules of Professional Conduct are approved and enforced by the California Supreme Court. See CALIFORNIA RULES OF PROFESSIONAL CONDUCT Rule 1-100 (1983).

214. See *id.* Rules 2-111(A)(5) & 2-111(B)(2). Those rules state:

If, after undertaking employment in contemplated or pending litigation, a member of the State Bar learns or it is obvious that *he or a lawyer in his firm* may be called as a witness other than on behalf of his client, he may continue the representation until it is apparent that his testimony is or may be prejudicial to his client.

Id. Rule 2-111(A)(5) (emphasis added).

A member of the State Bar representing a client before a tribunal . . . shall withdraw from employment, and a member of the State Bar representing a client in other matters shall withdraw from employment, if:

. . . .

He knows or should know that his continued employment will result in violation of these Rules of Professional Conduct or of the State Bar Act

Id. Rule 2-111(B)(2) (emphasis added).

trial is required to testify against the insurer as to bad faith in trial preparation or procedure, then the attorney must withdraw from employment.²¹⁵ The strict mandate of the California Rules renders the majority's distinction valueless.

Furthermore, the attorney's possible mandatory withdrawal from employment works a hardship on both the insurer and its attorney. The insurer may be harmed because its attorney may be reluctant to advise his or her client on issues of settlement or litigation strategy. The attorney may act in such a manner out of fear of being called to testify about those issues. Since that testimony might be prejudicial to the client, the attorney might be forced to withdraw from employment.²¹⁶ The insurer, consequently, would be compelled to seek new counsel who would be unfamiliar with the case. Moreover, if called to testify, the attorney would be forced, in many instances, to assert the attorney-client privilege.²¹⁷ The invocation of this privilege might lead a lay jury to believe that the insurer's attorney is hiding something—the insurer's bad faith

215. In a bifurcated trial situation such as *White*—where the issues of liability and bad faith are tried separately—the result would be the same. The insurer's attorney, however, would be able to try the issue of liability. On the other hand, the attorney would be precluded under the California Rules from trying the subsequent bad faith trial if called as a material witness.

An informal opinion of the Los Angeles County Bar Association Legal Ethics Committee stated:

The question whether the attorney should withdraw and serve only as a witness, depends on the facts in each case. Unless there are specific facts which patently indicate that . . . withdrawal by the attorney would work a substantial hardship on the client, resulting in the personal or financial sacrifice of the client, [previous] opinions indicate that the attorney . . . should withdraw.

L.A. County Bar Ass'n Comm. on Legal Ethics, Informal Op. 1970-13 (1970).

The Committee based its opinion on the following facts: The attorney for an estate had prepared the testator's will and was also one of the attesting witnesses. One of the decedent's relatives contested the will "on the grounds of undue influence, improper execution, etc." *Id.* Since the attorney's testimony was critical as to circumstances surrounding the making of the will, the question was whether he could ethically testify *and* represent the estate. The Committee concluded that the attorney should withdraw and testify.

The Committee did not define "substantial hardship." It did, however, adopt a portion of the Model Code of Professional Responsibility (Model Code). That portion provides that mandatory withdrawal may be disregarded "if [withdrawal] would work a substantial hardship on the client because of the distinctive value of the lawyer or his firm as counsel in the particular case." MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 5-101(B)(4) (1981). That general rule also provides that an attorney need not withdraw if the testimony relates to an uncontested or immaterial matter. *Id.* DR 5-101(B)(1)-(3). Furthermore, "[w]here the question arises, doubts should be resolved in favor of the lawyer testifying and against his . . . continuing as an advocate." *Id.* EC 5-10. In all other circumstances when testimony is required as to a material fact, withdrawal is mandatory. *Id.* DR 5-102. When these standards are applied to the insurance context, it seems, mandatory withdrawal will trump almost any consideration.

216. See *supra* note 214.

217. Pursuant to the attorney-client privilege, an attorney may not divulge to any tribunal

conduct—when in fact there may have been no bad faith whatsoever. For these reasons, attorneys might refrain from advocating the insurer's position as zealously as they otherwise might, thus undermining the adversarial system.

The attorney might also be harmed because withdrawal may mean the loss of necessary financial support. A sole practitioner, a small law firm, or even a large firm may lose a substantial portion of their income simply because that sole practitioner or member of the firm is called to testify regarding a material fact. If a member of a firm must testify, then under the California Rules the entire firm must withdraw from employment.²¹⁸

any confidential information communicated between the attorney and the client unless authorized to do so by the holder of the privilege, usually the client or the client's representative.

Section 952 of the California Evidence Code states:

"[C]onfidential communication between client and lawyer" means information transmitted between a client and his lawyer in the course of that relationship and in confidence by a means which, so far as the client is aware, discloses the information to no third persons other than those who are present to further the interest of the client in consultation or those to whom disclosure is reasonably necessary for the transmission of the information or the accomplishment of the purpose for which the lawyer is consulted, and includes a legal opinion formed and the advice given by the lawyer in the course of that relationship.

CAL. EVID. CODE § 952 (West Supp. 1987) (emphasis added). Accordingly, advice given by the attorney to the insurer regarding trial strategy or settlement procedures is included in the definition of "confidential communication between client and lawyer." The attorney may, however, disclose such information if the client waives the privilege and permits the attorney to reveal the confidential information: "Subject to [waiver of the privilege] . . . the client, whether or not a party, has a privilege to refuse to disclose, and to prevent another from disclosing, a confidential communication between client and lawyer . . ." CAL. EVID. CODE § 954 (West Supp. 1987). Generally, clients do not want any of their confidences disclosed because once some information is volunteered, then the privilege may be deemed waived. Consequently, other confidential information which may be prejudicial to the client may also be subject to waiver and placed in issue. Section 912(a) of the California Evidence Code states:

[T]he right of any person to claim a privilege provided by Section 954 (lawyer-client privilege) . . . is waived with respect to a communication protected by such privilege if any holder of the privilege, without coercion, has disclosed a significant part of the communication or has consented to such disclosure made by anyone. Consent to disclosure is manifested by any statement or other conduct of the holder of the privilege indicating consent to the disclosure, including failure to claim the privilege in any proceeding in which the holder has the legal standing and opportunity to claim the privilege.

CAL. EVID. CODE § 912(a) (West Supp. 1987).

218. See L.A. County Bar Ass'n Comm. on Legal Ethics, Informal Op. 1970-13 (1970). There, the Committee adopted the viewpoint of the American Bar Association which "expressed the view that if the testimony of a partner would be material in sustaining the will, the firm could not represent the proponent in the will contest." *Id.* (citing ABA Comm. on Professional Ethics and Grievances, Formal Op. 50 (1931)). See also MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 5-105(D) (1986) which states that "[i]f a lawyer is required to decline employment or to withdraw from employment under a Disciplinary Rule, no partner

c. defense of the continuing duty of good faith and fair dealing

There are several strategies which insurers can utilize to defend against alleged breaches of the continuing duty of good faith and fair dealing. An insurance company may choose to cancel or decline to re-

or associate, or any other lawyer affiliated with him or his firm may accept or continue such employment."

The California Rules do not speak to this proposition. However, since California adopted the Model Code, it follows that one must analogize to the Model Code in order to determine California law. *Cf.* L.A. County Bar Ass'n Comm. on Legal Ethics, Informal Op. 1970-13 (1970) (Committee analogized to Model Code because of absence of parallel provisions in California Rules). One California Supreme Court case, *Comden v. Superior Court*, 20 Cal. 3d 906, 576 P.2d 971, 145 Cal. Rptr. 9 (1978), analogized to the Model Code under similar circumstances and disqualified an entire law firm. In *Comden*, plaintiffs had retained a senior partner of a law firm to represent them in their continuing business activities. A contract dispute subsequently arose between plaintiffs and defendant. After unsuccessful negotiations, plaintiffs filed a complaint for injunctive relief through another attorney in the firm. In support of plaintiffs' application for preliminary injunction, the nonlitigating attorney filed a declaration detailing his negotiations with representatives of defendant and declaring that he had heard statements which established a breach of contract by defendant. *Id.* at 912, 576 P.2d at 973, 145 Cal. Rptr. at 11.

At the hearing for preliminary injunction, defendant moved to disqualify plaintiffs' law firm since members of the firm who had made declarations were likely to testify at trial. The trial court granted the motion and the supreme court affirmed. *Id.* at 910-11, 576 P.2d at 972, 145 Cal. Rptr. at 10.

In affirming withdrawal, the court reasoned:

An examination of the purposes underlying rule 2-111(A)(4) supports the court's ruling. An attorney who attempts to be both advocate and witness impairs his credibility as witness and diminishes his effectiveness as advocate. While the harm recedes when the attorney-witness is not himself trial counsel but only a member of trial counsel's firm, the opportunity still exists for opposing counsel to argue the attorney-witness' stake in the litigation through his law firm influences his objectivity. (See ABA Code of Prof. Responsibility, EC 5-9.)

Comden, 20 Cal. 3d at 912, 576 P.2d at 973, 145 Cal. Rptr. at 11. The court concluded that although plaintiffs might be inconvenienced by withdrawal of the law firm, inconvenience falls short of the California Rule's substantial hardship exception. *Id.* at 914, 576 P.2d at 974, 145 Cal. Rptr. at 12. To the contrary, the court stated that the firm's withdrawal would enhance plaintiffs' attorney's usefulness as a witness since the attorney would not be vulnerable to impeachment for interest. *Id.* The court then ruled:

When trial counsel foresees the possibility his continued representation of a client may fall within the prohibition of rule 2-111(A)(4) because he or a member of his firm ought to testify on behalf of such client at trial, he should resolve any doubt in favor of preserving the integrity of his testimony and against his continued participation as trial counsel. (See ABA Code of Prof. Responsibility, EC 5-10.)

Comden, 20 Cal. 3d at 915, 576 P.2d at 975, 145 Cal. Rptr. at 13. Therefore, it seems, a California law firm must withdraw from employment whenever a partner or associate is called to give any type of substantive testimony about one of its clients whether or not the testimony is prejudicial.

For other cases which have relied on the Model Code to impute disqualification, see *William H. Raley Co. v. Superior Court*, 149 Cal. App. 3d 1042, 197 Cal. Rptr. 232 (1983) and *Chambers v. Superior Court*, 121 Cal. App. 3d 893, 175 Cal. Rptr. 575 (1981).

new an insured's policy, allege comparative bad faith or, if available, assert a statute of limitations defense.

First, an insurance company either may decline to renew an insured's policy or it may cancel an insured who indicates substantial risk.²¹⁹ If the insurance policy were cancelled or not renewed before trial, then the *White* court's reasoning, arguably, would not apply. The court held that because an insurer would be obligated to provide an insured with contract benefits if the insured were involved in a second automobile accident, the insurer was equally obligated to provide those

219. Title insurers, however, would not be able to benefit under this proposition since a one-time premium insures the property for the duration of the insured's ownership. Other types of insurance carriers would be able to benefit as long as their contracts contained provisions for non renewal or cancellation. For example, one directors' and officers' liability insurance policy states:

A. Cancellation or Non-Renewal [sic]

- (1) This Policy may be cancelled by the [insured] at any time by written notice to the Insurer or by surrender of this Policy to the Insurer.

This Policy may also be cancelled by or on behalf of the Insurer by delivering to the [insured] or by mailing to [the insured] by certified mail or other first class mail, at the address stated [herein], written notice stating when, not less than thirty (30) days thereafter, the cancellation shall be effective. The mailing of such notice as aforesaid shall be sufficient proof of notice and this Policy shall terminate at the date and hour specified in such notice.

- (2) If this Policy shall be cancelled by the [insured], the Insurer shall retain the customary short rate portion of the premium.

If this Policy shall be cancelled by or on behalf of the Insurer, the Insurer shall retain the pro-rata portion of the premium. Payment or tender of any unearned premium by the Insurer shall not be a condition precedent to the effectiveness of cancellations, but such payment shall be made as soon as practicable.

- (3) If the Insurer elects not to renew this Policy, the Insurer shall provide the [insured] with no less than thirty (30) days advance notice thereof.

Zeavin & Drexler, *Recent Developments in Insurance Law*, in *DIRECTORS' AND OFFICERS' LIABILITY INSURANCE* 1987 81, 124-25 (D. Goldwasser ed. 1987).

An automobile liability insurance policy also contains similar provisions:

Cancellation

Allstate may cancel part or all of this policy by mailing notice to *you* . . . If *we* cancel because *you* didn't pay the premium, the date of cancellation will be at least 10 days after the date of mailing. If *we* cancel for any other reason during the first 60 days the original policy is in effect, *we* will give *you* 10 days notice of cancellation. After the first 60 days *we* will give *you* 20 days notice.

Proof of mailing the notice will be proof of notice. A refund, if due, will be in proportion to the time *your* policy has been in effect. Cancellation will be effective even if the refund is not made immediately.

Allstate Automobile Policy, California (emphasis in original) [copy on file at office of Loyola of Los Angeles Law Review]. Of course, if a claim for policy benefits were made during the time the policy was in effect, the insurer could not cancel without providing coverage for that claim. Upon cancellation, however, the insurer would have to repay unearned premiums to the insured.

benefits at the trial regarding the first accident.²²⁰ However, if no contract exists between the parties at the time of the second accident, then clearly the insurer owes no obligation to the insured with respect to that accident. Similarly, if there is no contract between the parties when they commence litigation, the insurer does not owe the insured a duty of good faith and fair dealing during the pendency of the action.²²¹

Second, an insurer can raise the affirmative defense of comparative bad faith. A breach of the insurance contract by the insured does not provide a defense in an action for bad faith unless the noncompliance with the policy is so grave as to permit the insurer to cancel the policy.²²² Bad faith by the insured, however, does constitute a defense to a bad faith action. In *California Casualty General Insurance Co. v. Superior Court*,²²³ the court of appeal stated explicitly that comparative bad faith by the insured is a valid defense.²²⁴ There, the insured alleged that the insurer unreasonably delayed in investigating her claim and failed to offer a sufficient settlement prior to arbitration.²²⁵ The insurer pleaded an affirmative defense of comparative bad faith, asserting that the insured and her counsel "were guilty of bad faith conduct in the prosecuting, handling and management of plaintiff's claim."²²⁶ The court analogized to the doctrine of comparative fault as applied in negligence and strict liability contexts and determined that the doctrine also applied in bad faith

220. See *supra* text accompanying notes 53-56.

221. See *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 578, 510 P.2d 1032, 1040, 108 Cal. Rptr. 480, 488 (1973) ("[T]he nonperformance by one party of its contractual duties cannot excuse a breach of the duty of good faith and fair dealing by the other party while the contract between them is in effect and not rescinded.").

222. See *id.* at 577-78, 510 P.2d at 1039-40, 108 Cal. Rptr. at 478-79.

223. 173 Cal. App. 3d 274, 218 Cal. Rptr. 817 (1985).

224. *Id.* at 282-83, 218 Cal. Rptr. at 822.

225. *Id.* at 276-77, 218 Cal. Rptr. at 818.

226. *Id.* at 277, 218 Cal. Rptr. at 818-19. The insurer's answer read in pertinent part:

The injuries and damages alleged by plaintiff, if any, were proximately caused by the negligence and liability of other parties and defendants request that an allocation of such negligence and liability be made among such other parties, and that if any liability is found on the part of defendants, that judgment against defendants be only in the amount which is proportionate to the extent and percentage by which defendants' acts or omissions contributed to plaintiff's injuries or damages.

... The plaintiff and her former attorney are guilty of bad faith conduct in the prosecuting, handling and management of the uninsured motorist claim referred to in plaintiff's First Amended Complaint and as a proximate cause of their bad faith acts, omissions and failure to provide full and complete information to the defendants and their insurer [sic], these defendants request that any damages awarded against them for bad faith be reduced by the amount of the bad faith conduct of plaintiff and her former attorney.

Id.

cases.²²⁷

Third, an insurer can raise a statute of limitations defense. The implied covenant of good faith and fair dealing arises from a written contract. The breach, however, sounds in tort and contract; therefore, which statute of limitations governs such a breach is uncertain.

The two-year limitations period has been held to apply to an action alleging breach of the covenant of good faith and fair dealing regardless of the nature of the damages prayed for. In *Richardson v. Allstate Insurance Co.*,²²⁸ Richardson sued his insurer alleging bad faith and emotional distress. The insurer argued that an action alleging emotional distress suggests infringement of a personal right. Therefore, it contended, section 340(3) of the California Code of Civil Procedure²²⁹ applied and the action was subject to the one-year statute of limitations.²³⁰ Disagreeing with the insurer, the court of appeal found that the two-year period of limitations of section 339(1) of the California Code of Civil Procedure²³¹ governed the action since an action for bad faith is analogous to an action for interference with contractual relations.²³² The court stated that

227. The court stated that the " 'duty of good faith and fair dealing in an insurance policy is a two-way street, running from the insured to his insurer as well as vice-versa.' " *Id.* at 283, 218 Cal. Rptr. at 822 (quoting *Commercial Union Assurance Cos. v. Safeway Stores, Inc.*, 26 Cal. 3d 912, 918, 610 P.2d 1038, 1041, 164 Cal. Rptr. 709, 712 (1980)). The court continued:

There can be little question but that an insurer which provides uninsured motorist coverage has a reasonable expectation that if the insured suffers a loss claimed to be covered under the uninsured motorist provisions of the policy, the insured will promptly and accurately furnish it with all the information and evidence pertinent to the claim that is known to the insured. If a failure of the insured to do so results in delaying or impeding the investigation of the claim by the insurer or delays or makes improvident the insurer's payment of the claim, any economic loss and emotional distress caused the insured by virtue of any such nonpayment or delay in investigation or payment will have been caused either wholly or in part by the conduct of the insured. We perceive no sound reason, nor is any suggested, why the doctrine of comparative fault enunciated and applied to negligent conduct by the California Supreme Court in *Li v. Yellow Cab Co.*, and later applied as between a strictly liable defendant and a negligent plaintiff and as between two tortfeasors one of whose liability was based on strict products liability and the other on negligence should not be applicable to bad faith cases.

California Casualty Gen. Ins. Co., 173 Cal. App. 3d at 283, 218 Cal. Rptr. at 822-23 (citations omitted).

228. 117 Cal. App. 3d 8, 172 Cal. Rptr. 423 (1981).

229. Section 340(3) of the California Code of Civil Procedure provides that within one year, one may bring "[a]n action for libel, slander, assault, battery, false imprisonment, seduction of a person below the age of legal consent, or for injury to or for the death of one caused by the wrongful act or neglect of another" CAL. CIV. PROC. CODE § 340(3) (West Supp. 1987).

230. *Richardson*, 117 Cal. App. 3d at 12, 172 Cal. Rptr. at 426.

231. Section 339(1) of the California Code of Civil Procedure states that within two years, one may bring "[a]n action upon a contract, obligation or liability not founded upon an instrument of writing" CAL. CIV. PROC. CODE § 339(1) (West Supp. 1987).

232. *Richardson*, 117 Cal. App. 3d at 12-13, 172 Cal. Rptr. at 426. The court stated:

“the nature of the right sued upon, not the form of action or the relief demanded, determines the applicability of the statute of limitations.”²³³

However, in *Frazier v. Metropolitan Life Insurance Co.*,²³⁴ another court of appeal held that because the action was based on a written contract, the four-year limitation period of section 337(1) of the California Code of Civil Procedure applied.²³⁵ In *Frazier*, plaintiff brought an action seeking emotional distress damages from an insurer for breach of the implied covenant of good faith and fair dealing. The court decided that since the action sounded in both contract and tort, the plaintiff could make an election to proceed on either theory.²³⁶ Concluding that plaintiff had not made an irrevocable election to proceed on a tort theory, the court rejected the insurer's section 340(3) argument and permitted plaintiff to proceed under the four-year period.²³⁷ Furthermore, the court

An action against an insurer for bad faith is conceptually similar to an action for interference with contractual relations, for in both actions the primary interest of the plaintiff which is invaded by the defendant's wrongful conduct is the plaintiff's right to receive performance under an existing contract. A cause of action for interference with contractual relations is governed by the two-year limitations period of section 339, subdivision 1, which applies to an “obligation or liability not founded upon an instrument of writing.”

Id. at 11-12, 172 Cal. Rptr. at 426 (citations omitted). The court concluded that:

The error in Allstate's reasoning is the assumption that a tort action against an insurer for bad faith is based upon an alleged interference with a personal right merely because mental distress is alleged. Breach of the implied covenant of good faith is actionable because such conduct causes financial loss to the insured, and it is the financial loss or risk of financial loss which defines the cause of action. Mental distress is compensable as an aggravation of the financial damages, not as a separate cause of action. We are satisfied, accordingly, that a tort action against the insurer for bad faith is subject to the two-year limitations period of section 339, subdivision 1.

Id. at 13, 172 Cal. Rptr. at 426 (citation and footnote omitted). For a case which relied on *Richardson* and decided similarly, see *Purdy v. Pacific Automobile Ins. Co.*, 157 Cal. App. 3d 59, 203 Cal. Rptr. 524 (1984).

233. *Richardson*, 117 Cal. App. 3d at 12, 172 Cal. Rptr. at 426 (quoting *Jefferson v. J.E. French Co.*, 54 Cal. 2d 717, 718, 355 P.2d 643, 644, 7 Cal. Rptr. 899, 900 (1960)).

234. 169 Cal. App. 3d 90, 214 Cal. Rptr. 883 (1985).

235. *Id.* at 101, 214 Cal. Rptr. at 889. Section 337(1) of the California Code of Civil Procedure provides that “an action upon any contract, obligation or liability founded upon an instrument in writing” must be brought within four years. CAL. CIV. PROC. CODE § 337(1) (West 1982).

236. *Frazier*, 169 Cal. App. 3d at 101, 214 Cal. Rptr. at 889.

237. *Id.* at 102, 214 Cal. Rptr. at 889-90. The court stated:

[S]ince plaintiff has the election to sue either on a contract or tort theory, if she chooses to proceed on a contract theory she is entitled to the four-year statute of limitations permitted by Code of Civil Procedure section 337, subdivision 1, when suing upon breach of the covenant of good faith and fair dealing and for damages for emotional distress based upon such breach.

...“Since the bad faith cause of action sounds in both contract and tort, and since insurance contract damages can appropriately be imposed in compensation for mental distress, this court cannot say that the tort character of the action predomi-

ruled that if plaintiff proceeded on the contract theory, she would be barred from receiving punitive damages.²³⁸ The court did not discuss section 339(1).²³⁹

nates. The defendants' § 340(3) argument is rejected. Plaintiffs can properly found their bad faith contract claim on § 337(1) and its four year statute of limitations provision."

Since Metropolitan has failed to show that Mrs. Frazier irrevocably elected to proceed on a tort theory, she is entitled to proceed upon a contract theory entitling her to a four-year statute of limitations.

Id. at 102-03, 214 Cal. Rptr. at 889-90 (quoting *McDowell v. Union Mut. Life Ins. Co.*, 404 F. Supp. 136, 145 (C.D. Cal. 1975)).

238. *Id.* at 105, 214 Cal. Rptr. at 891-92.

239. *See supra* notes 231-33 and accompanying text. Some additional guidelines have been discussed regarding the avoidance of the first-party bad faith case. What follows may be helpful in advising insurers:

1. Never deny a first-party claim without having fully and completely investigated the claim to determine if it is meritorious. All too often we fail to recognize how courts and juries may evaluate our conduct in the handling of claims. While economic conditions have reduced staffs and have necessitated the reduction of outside expenses, the failure to investigate a claim properly because we could not "afford" to do a thorough job can lead to a successfully prosecuted bad faith, punitive damages claim.

2. An insured should never be told that he or she is covered or that the claim will be paid promptly, if the investigation has not been completed. Such a misrepresentation made before completion of the investigation can be the basis for a bad faith claim.

3. Never insert in a claim file any comment, statement, or observation which you would not want a jury to hear. Although this seems to be elementary, claims files continue to describe the insured by race, creed, color, or nationality. Comments about the insured's dress, personal appearance, or marital status should likewise not find their way into the claim file. In fact, no personal comments about the insured should be inserted in the claim file unless pertinent to the issue of coverage or to the issue of damages.

4. Never threaten the insured with litigation as an attempt to secure a reduced settlement.

5. Do not require the insured to take steps not reasonably required in the policy as a precondition to payment.

6. Promptly communicate the company's position after your investigation is completed.

7. When it appears likely that a denied claim of any consequence will result in litigation, as is almost always the case, consult with counsel before denying the claim. While this will not materially increase your expense, reliance upon the advice of counsel may provide a defense to a punitive damages claim.

8. Honor all time deadlines found in the policy or required by statute. Failure to honor these time deadlines may constitute a waiver of the company's rights under certain policy provisions.

9. In situations where only a portion of a claim is in dispute, tender to the insured the amount not in dispute.

10. When denying a claim, cite the provisions of the policy upon which you rely.

11. Maintain a well-documented file which demonstrates your efforts to be fair and cooperative and which will avoid embarrassment if the claim file ever is produced to the insured, a court, or a jury.

12. Compose all letters you write to the insured as if you expect that a jury will hear them.

13. If a denial letter written to the insured or the insured's counsel contains accusa-

B. Section 1152 of the California Evidence Code

Section 1152 of the California Evidence Code precludes admission of settlement offers and conduct or statements made in settlement negotiations if offered to prove liability for the damages to which the negotiations relate.²⁴⁰ However, the majority in *White v. Western Title Insurance Co.*²⁴¹ affirmed the admission of Western Title's settlement offers to prove its tortious breach of the covenant of good faith and fair dealing.²⁴² In so doing, the *White* court misapplied relevant case law and ignored the policy considerations underlying section 1152.

1. Case law

The *White* majority exclusively relied on one case, *Fletcher v. Western National Life Insurance Co.*,²⁴³ to support the proposition that the settlement offers were admissible to prove the instrumentality of the tort of bad faith breach of contract, but not to prove liability for breach of contract damages. In *Fletcher*, the insurer, in two letters, falsely accused the insured of concealing a congenital back defect.²⁴⁴ In the second let-

tion of wrong-doing, i.e., arson or overvaluation of the claim, do not send copies to others. Distribution could set the stage for a defamation action.

14. Before drafts are issued to an insured, consult the declarations page of the policy to determine the identities of additional insureds, mortgagees, or loss payees. Failure to include these individuals on a draft could result in creating duplicate exposure under a single policy.

15. When unsure about facts, couch internal memoranda with words such as "it appears that" or "the evidence suggests that."

16. List all policy defenses in denial letters to avoid claims that the company may have waived certain defenses or certain policy exclusions.

Hilliker & Marick, *The Bad Faith Case: Litigation Techniques and Strategies, From the Defense Perspective*, in *BAD FAITH LITIGATION AND INSURER VS. INSURER DISPUTES 99*, 135-37 (R. Williams ed. 1986) (quoting Cozen & Danielski, *Bad Faith and Extra-Contractual Damages: The Defense Perspective*, in *LIABILITY BEYOND THE INSURANCE CONTRACT* (CPCU Monograph Winter 1985)).

240. CAL. EVID. CODE § 1152 (West Supp. 1987). Section 1152 states in pertinent part:

Evidence that a person has, in compromise or from humanitarian motives, furnished or offered or promised to furnish money or any other thing, act, or service to another who has sustained or will sustain or claims that he has sustained or will sustain loss or damage, as well as any conduct or statements made in negotiation thereof, is inadmissible to prove his liability for the loss or damage or any part of it.

Id.

241. 40 Cal. 3d 870, 710 P.2d 309, 221 Cal. Rptr. 509 (1985).

242. *Id.* at 888-89, 710 P.2d at 318-19, 221 Cal. Rptr. 518-19.

243. 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

244. Fletcher, the insured, had made a claim under a disability policy for an injury which he sustained while at work. Western National Life Insurance Co. had paid Fletcher \$2250 when it determined that Fletcher suffered from a preexisting back illness. *Id.* at 390, 89 Cal. Rptr. at 85-86. There were no facts which suggested that Fletcher knew about this condition. In fact, he "denied any previous back trouble and any knowledge of any such preexisting condition." *Id.* at 389, 89 Cal. Rptr. at 85. The insurer's accusatory letters to Fletcher were

ter, the insurer also offered to compromise Fletcher's claim under his disability policy by allowing him to retain the payments he had already received.²⁴⁵ Fletcher decided not to accept the compromise settlement and subsequently instituted a lawsuit against the insurer. At trial, Fletcher offered both letters into evidence and the court admitted them.²⁴⁶ The insurer argued that section 1152 barred the second letter containing an offer of settlement from being introduced into evidence.²⁴⁷ The court responded to the insurer's contention by stating:

If the second letter . . . were considered an offer to compromise, it would be an offer to compromise the claim of liability under the policy. Plaintiff, however, did not offer the letter to prove liability under the policy but, rather, as a part of his proof of the instrumentality of the tort. Section 1152, therefore, did not preclude its admission.²⁴⁸

Although the court did not expressly define the term "instrumentality of the tort," it is clear from the court's analysis that the term denotes the elements of the tort.²⁴⁹ In its discussion, it is apparent that the *Fletcher* court admitted the second letter as evidence of the insurer's conduct which caused Fletcher's emotional distress.²⁵⁰

The *Fletcher* court's distinction between proof of the instrumentality of the tort and proof of liability under the claim, when applied to *White*, seems artificial. In *Fletcher*, the settlement offer was made with respect to Fletcher's claim against the insurer for breach of his insurance contract. Applying section 1152, evidence of the settlement offer would not be admissible to prove liability for the breach of contract claim. Fletcher, however, did not attempt to introduce the settlement offer as evidence of the breach of contract claim, but offered it as evidence of a

apparently based upon a statement in a report by one of Fletcher's examining physicians. *Id.* Although several physicians were involved in Fletcher's treatment, *id.* at 387, 89 Cal. Rptr. at 83, the insurer failed to make any further investigation of Fletcher's possible congenital back defect. *Id.* at 389, 89 Cal. Rptr. at 85. Accordingly, the insurer terminated all payments and demanded that Fletcher repay the insurer \$2250, less the amount of premiums actually paid. *Id.* at 390, 89 Cal. Rptr. at 85. In a later letter, the insurer proposed to allow Fletcher to keep the \$2250 in consideration for the cancellation of the policy and a full release of liability. *Id.* Fletcher could not work because of his disability and the payments under the disability policy were a major source of his income. *Id.* at 389, 89 Cal. Rptr. at 85. As a result of the accusatory letters and the discontinuance of payments under the policy, Fletcher claimed that he suffered emotional distress. *Id.* at 394, 89 Cal. Rptr. at 88.

245. *Id.* at 390, 89 Cal. Rptr. at 85-86.

246. *Id.* at 396, 89 Cal. Rptr. at 90.

247. *Id.*

248. *Id.*

249. *See id.* at 398-401, 89 Cal. Rptr. at 91-93.

250. *Id.*

wholly unrelated claim²⁵¹—intentional infliction of emotional distress. Accordingly, the court admitted the settlement offers as evidence of outrageous conduct, an element of the tort.

In *White*, the settlement offers were made with respect to White's claim against Western Title for breach of contract. However, the settlement offers were not introduced as evidence of a wholly unrelated tort, but were admitted to prove the related tort of bad faith breach of contract.²⁵² Since there can be no claim for bad faith breach without a claim for breach of contract, the two are inextricably intertwined.²⁵³ A breach of contract claim alleges that one party has not rendered performance after an agreed condition has occurred.²⁵⁴ A claim for breach of the duty

251. Other cases have held that settlement offers are admissible to show the validity or invalidity of a *different* claim. For example, in *Fieldson Assocs., Inc. v. Whitecliff Labs., Inc.*, 276 Cal. App. 2d 770, 81 Cal. Rptr. 332 (1969), plaintiff sued defendant for breach of contract and defendant cross-complained for lost profits. Plaintiff offered into evidence a number of letters which had passed between the parties after transmittal of a purchase order. Defendant objected on the ground that some of its letters to plaintiff contained settlement offers and were therefore barred by section 1152. The court disagreed and held that the letters were not admitted for the purpose of proving liability for the breach of contract claim, but were instead admitted for the limited purpose of determining the intent of the parties at the time the purchase order was transmitted. The court stated:

Here the letters were not used to prove either liability for, or invalidity of, the claim concerning which the offer of compromise was made. Rather, they were received to show the invalidity of a different claim: [defendant's cross-] claim for lost profits under the purchase order, which was never mentioned in the negotiations . . .

Id. at 772, 81 Cal. Rptr. at 334.

Another example is *Warner Constr. Corp. v. City of Los Angeles*, 2 Cal. 3d 285, 466 P.2d 996, 85 Cal. Rptr. 444 (1970). In *Warner*, plaintiff sued for breach of warranty and fraud. Plaintiff contractor sought to introduce its correspondence with defendant municipality about the need for additional expense to construct a retaining wall. Despite the city's objection that it was part of settlement negotiations, the trial judge admitted the correspondence. On appeal, the California Supreme Court held that the trial court "could properly have admitted the evidence for the limited purpose of proving plaintiff's bona fide and good faith efforts to reach an agreement so that work could be resumed." *Id.* at 296, 466 P.2d at 1003, 85 Cal. Rptr. at 451.

252. The only difference between tortious breach of the covenant of good faith and fair dealing and the garden variety bad faith breach of contract is the existence of certain factors regarding the relationship of the contracting parties. For a discussion of those factors, see *infra* note 283 and accompanying text. The contract claim is elevated to a tort, but the principles underlying the basic claim remain the same.

253. Turning the tables, however, the two claims are not necessarily inextricably intertwined, for it is possible to have a breach of contract claim without a bad faith breach of contract claim.

254. The Restatement (Second) of Contracts states that "[a] condition is an event, not certain to occur, which must occur, unless its non-occurrence is excused before performance under a contract becomes due." RESTATEMENT (SECOND) OF CONTRACTS § 224 (1981). A "condition" is "an event which qualifies a duty under a contract." *Id.* § 224 comment a. For example, a condition would be the occurrence of loss or damage covered under an insurance policy. Upon the happening of the event, the insurer would have a duty to provide policy

of good faith and fair dealing describes the manner in which that performance was or was not rendered.²⁵⁵ Courts have merely fictitiously separated the two claims.²⁵⁶ Consequently, the *White* court allowed into evidence settlement offers to prove liability for the *very* claims which the offers were meant to settle.

Furthermore, breach of the duty of good faith is elevated to a tort only when a special relationship exists between the contracting parties.²⁵⁷ California courts, thus far, have found this relationship to exist in a limited number of contractual situations,²⁵⁸ including the insurer-insured relationship.²⁵⁹ In *White*, evidence of settlement offers was made admissible because of the tortious nature of the breach. If, however, the breach of good faith and fair dealing had occurred within a non insurance contractual relationship, there would have been no tort, and the settlement offers would have been inadmissible. *White*, therefore, has written a new rule: evidence of settlement offers is admissible when there is a special relationship and is inadmissible when there is not. Surely, this result is not what the legislature intended when it enacted section 1152.²⁶⁰ It intended that evidence of settlement offers be excluded to promote candor between the parties and thereby to encourage prompt and equitable settlements.²⁶¹

In his dissent to the majority opinion in *White*, Justice Lucas drew another distinction between *Fletcher* and *White*. Lucas argued that "the

benefits. "Performance under a contract becomes due when all necessary events, including conditions . . . , have occurred so that a failure of performance will be a breach." *Id.* § 224 comment b.

255. There are a number of ways in which the duty can be breached. For instance: [B]ad faith breach may be overt or consist of inaction A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of power to specify terms, and interference with or failure to cooperate in the other party's performance.

Id. § 205 comment d.

256. *Cf. Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984). In *Seaman's*, the California Supreme Court stated:

[P]arties of roughly equal bargaining power are free to shape the contours of their agreement and to include provisions for attorney fees and liquidated damages in the event of a breach. They may not be permitted to disclaim the covenant of good faith but they are free, within reasonable limits at least, to agree upon the standards by which application of the covenant is to be measured. In such contracts, *it may be difficult to distinguish between breach of the covenant and breach of contract*

Id. at 769, 686 P.2d at 1167, 206 Cal. Rptr. at 363 (emphasis added) (footnote omitted).

257. *See infra* note 283.

258. *See infra* note 283.

259. *See supra* note 4.

260. *See infra* note 277.

261. *See infra* note 277.

offers of settlement which the court found admissible were made *prior* to the filing of an action against the insurer . . .”²⁶² in *Fletcher*. By contrast, the Whites offered into evidence settlement offers which were made *after* the filing of the lawsuit. Justice Lucas’ attempt to distinguish the facts of *Fletcher* and *White* on this point might have been relevant if there had been no dispute in *Fletcher* prior to the filing of the action. But had there been no dispute, then there would have been no need for the insurer to attempt to settle or negotiate Fletcher’s claim.

*In re Marriage of Schoettgen*²⁶³ nullifies this temporal distinction. In *Schoettgen*, Mr. Schoettgen prepared a list, prior to litigation, setting forth those properties which he believed at the time to be community property. On the list he included property which, he claimed, he mistakenly believed was made community property by operation of law.²⁶⁴ At trial, Mrs. Schoettgen offered the list into evidence. Mr. Schoettgen objected on the ground that the document was part of a settlement offer, and, therefore, barred from evidence under section 1152.²⁶⁵ The trial court overruled the objection holding that “it was not an offer to settle litigation because the point of settlement of litigation had not been reached at the time the document was written.”²⁶⁶ The appellate court did not reverse the trial court’s ruling because it found that Mr. Schoettgen was not unfairly prejudiced by the admission of this evidence.²⁶⁷ However, the court of appeal reversed stating, “[m]ore realistically, Husband was preparing for a possible argument over the division of property, and thus may well have started a process of ‘negotiation’ which brought his list within [section 1152].”²⁶⁸ Similarly, the letter from the insurer to Fletcher was written in preparation for possible litigation. A negotiable controversy existed. Under the reasoning of the *Schoettgen* court, admissibility does not turn on whether the settlement offer was made before or after the initiation of litigation as long as a dispute exists between the parties.

Schoettgen had not yet been decided when *Fletcher* and *White* were handed down. Consequently, neither court could have used *Schoettgen* as authority. But in reaching its decision, the *Schoettgen* court relied on

262. *White*, 40 Cal. 3d at 894, 710 P.2d at 323, 221 Cal. Rptr. at 523 (Lucas, J., dissenting) (emphasis in original).

263. 183 Cal. App. 3d 1, 227 Cal. Rptr. 758 (1986).

264. *Id.* at 5, 227 Cal. Rptr. at 760.

265. *Id.* at 6, 227 Cal. Rptr. at 760.

266. *Id.*

267. *Id.* at 8, 227 Cal. Rptr. at 762.

268. *Id.*

Georgia-Pacific Corp. v. California Coastal Commission,²⁶⁹ a case which was decided before *White*.

In *Georgia-Pacific*, a section 1152 question was raised by the California Coastal Commission. The trial court excluded evidence that, during administrative hearings, Georgia-Pacific had offered to dedicate certain easements if its permit applications were granted.²⁷⁰ In ruling that the evidence was inadmissible pursuant to section 1152, the trial court stated that "Georgia-Pacific had offered 'nothing more than a compromise, attempted compromise of litigation.'" ²⁷¹ The Commission objected on the grounds that there was no lawsuit in existence at the time Georgia-Pacific made the offers.²⁷²

On appeal, the court stated:

The trial court's finding that the offers were made in "attempted compromise of litigation" is supported by the evidence of them in the administrative record. The relevance of an offer of compromise, as an "admission by conduct," is overridden by the "public policy in favor of settlement of disputes" which underlies Evidence Code section 1152. The policy applied here even if the precise language of the statute did not, and its application was not affected by the fact that litigation was not pending when the offers were made by Georgia-Pacific.²⁷³

Hence, even though no litigation was pending at the time the settlement offers were made, the court kept the offers out of evidence because they were made in an attempt to settle future litigation. *Georgia-Pacific* nullifies Justice Lucas' pre-, post-litigation distinction.²⁷⁴ It instructs that courts should not be concerned with whether the settlement offers were made prior to or after the filing of litigation; they should be con-

269. 132 Cal. App. 3d 678, 183 Cal. Rptr. 395 (1982). *Georgia-Pacific Corp.* (Georgia-Pacific) operated a lumber processing facility on its own land located on the northern California coastline. *Id.* at 683, 183 Cal. Rptr. at 397. Georgia-Pacific sought to construct four additional facilities on its property, and applied to the California Coastal Commission (Commission) for building permits. *Id.* at 683, 183 Cal. Rptr. at 398. The Commission granted the permits on the condition that Georgia-Pacific dedicate certain public access easements to the shoreline. *Id.* Georgia-Pacific then brought an action against the Commission by petitioning the superior court for a writ of administrative mandamus compelling the Commission to issue the building permits without the access conditions. *Id.* at 684, 183 Cal. Rptr. at 398.

270. *Id.* at 693, 183 Cal. Rptr. at 403-04.

271. *Id.* (quoting court below).

272. *Id.* at 693, 183 Cal. Rptr. at 404.

273. *Id.* (citations omitted).

274. It is important to note that although *Georgia-Pacific* might have been persuasive authority, it would not have been binding authority since the case was decided by the court of appeal.

cerned with the purpose of the offer. If made to compromise possible future litigation, or present litigation, then the offers should not be admitted into evidence. To allow these types of offers into evidence would be to undermine the policy behind section 1152.²⁷⁵

2. Policy

Rules of evidence, generally, are promulgated with underlying policy considerations.²⁷⁶ The policy behind section 1152 of the California Evidence Code is to promote candor and fairness between the parties during the settlement process.²⁷⁷ One case, *Fieldson Associates, Inc. v. Whitecliff Laboratories, Inc.*,²⁷⁸ stated very lucidly the legislature's intent

275. See *infra* note 277.

276. See generally FED. R. EVID. advisory committee's notes.

277. The Law Revision Commission's comment to section 1152 states in part:

The rule excluding offers is based upon the public policy in favor of the settlement of disputes without litigation. The same public policy requires that admissions made during settlement negotiations also be excluded. The rule of the Forster case that permits such statements to be admitted places a premium on the form of the statement. [Section 1152 overruled *People v. Forster*, 58 Cal.2d 257, 373 P.2d 630, 23 Cal. Rptr. 582 (1962) (certain statements made during settlement negotiations were admissible into evidence as admissions)] The rule of the Forster case is changed by Section 1152 because that rule prevents the complete candor between the parties that is most conducive to settlement.

7 CALIFORNIA L. REVISION COMM'N, REPORTS, RECOMMENDATIONS & STUDIES 29, 218 (1965).

278. 276 Cal. App. 2d 770, 81 Cal. Rptr. 332 (1969). In *Fieldson*, Fieldson Associates, Inc. (Fieldson), a packaging firm, entered into a contract with Whitecliff Laboratories, Inc. (Whitecliff) whereby Fieldson was to supply display cartons to Whitecliff. *Id.* at 771, 81 Cal. Rptr. at 333. Fieldson had also allegedly contracted with Whitecliff to purchase 100,000 units of one of Whitecliff's products, a one-cup coffee maker called "Brew-A-Cup." *Id.*

Fieldson initiated a lawsuit against Whitecliff to recover the display carton contract price of \$3011.14. *Id.* The court did not state why. Whitecliff cross-complained for loss of profits allegedly resulting from Fieldson's completed purchase of only 35,136 of the 100,000 Brew-A-Cup units. *Id.* The principal issue in the case was whether the written purchase order referring to the 100,000 units was intended to be binding on Fieldson. *Id.*

Fieldson offered in evidence a collection of letters which passed between the presidents of the two companies after transmittal of the purchase order. *Id.* Whitecliff objected since several of the letters written by its president contained compromise offers which were inadmissible under section 1152. *Id.* The court, however, ruled that the letters were admissible because they helped determine the intent of the parties at the time the purchase order was transmitted. *Id.* at 772, 81 Cal. Rptr. at 334. The court stated:

The letters were received for the sole purpose of showing the nonbinding nature of the "purchase order" in order to defeat [Whitecliff's] cross-complaint. When considered for that limited purpose, the letters had no bearing upon the primary validity of the claim asserted by [Fieldson] against [Whitecliff] for the unused cartons. Evidence Code section 1152 provides that evidence that a party has offered to compromise a claim is inadmissible to prove liability for *that claim*. . . . Here the letters were not used to prove either liability for, or invalidity of, the claim concerning which the offer of compromise was made. Rather, they were received to show the invalidity of a different claim: [Whitecliff's] claim for lost profits under the purchase order, which was never mentioned in the negotiations concerning the cartons.

behind passing the statute. The *Fieldson* court stated:

[T]he obvious policy of the statute is to avoid deterring parties from making offers of settlement and to facilitate candid discussion which may lead to settlement of disputes. Negotiation might well be discouraged if a party knew that statements made by him (or his failure to make certain statements) might later be used to prove the invalidity of some other claim which he wished to assert.²⁷⁹

Moreover, negotiation might be discouraged if a party knew that his statements or offers might later be used to prove his liability on a related claim. If the admissibility of such evidence tends to "inhibit candid discussion or deter either party from attempting to effect a compromise,"²⁸⁰ then the evidence should be barred by section 1152.

After *White v. Western Title Insurance Co.*,²⁸¹ any settlement offers made before or during the course of litigation will be admissible to prove the instrumentality of the tort of bad faith breach of contract. This decision undermines the clear intent of the legislature. Insurance companies and other defendants who fall into the tortious bad faith category will be very wary about attempting to settle potential or pending litigation for fear that their offers will or may be used as harmful evidence against them. There will no longer be candid discussion which may lead to settlement of disputes. Litigation will be the only means of resolving disputes between the parties unless plaintiffs would be willing to waive their right to offer evidence of settlement negotiations.

The rule in *White* is a double-edged sword. Under this rule, even if defendants make a reasonable, good faith offer, they may still be subject to additional liability for bad faith breach of contract. For example, in *White*, Western Title's final offer to White was \$5000. This offer was made in light of White's claim of loss of approximately \$63,000. The jury ultimately determined that White suffered a loss of only \$8400. Western Title, however, was still held liable to White for tortious bad faith breach of contract in the amount of \$20,000, because of its failure to settle in good faith even though the jury's verdict was only \$3000 greater

Id. at 772, 81 Cal. Rptr. at 333-34 (emphasis in original). The court concluded:

[T]he fact that there were negotiations at all was significant only as showing that the parties were in communication without [Whitecliff] having asserted a claim which it would have been natural to mention. The admissibility of such evidence for the limited purpose described above could have had no tendency to inhibit candid discussion or deter either party from attempting to effect a compromise.

Id. at 773, 81 Cal. Rptr. at 334 (citations omitted).

279. *Id.* at 773, 81 Cal. Rptr. at 334.

280. *Id.*

281. 40 Cal. 3d 870, 710 P.2d 309, 221 Cal. Rptr. 509 (1985).

than the offer which was allegedly in bad faith. Accordingly, defendants will not want to negotiate even if they could negotiate in a reasonable manner. But if they do not attempt to settle, they will be held liable for tortious bad faith breach of contract because of their failure to settle in good faith.

V. CONCLUSION

In light of the considerations enumerated above, *White v. Western Title Insurance Co.*²⁸² represents an unwarranted and unfair extension in the area of bad faith litigation. This decision threatens unjustly to thrust insurers into the precarious position of being subject to astronomical awards while being denied the ability to defend themselves effectively. The California Supreme Court has declared open season on insurance companies and has stripped them of their ability to retaliate. Insurers, consequently, will become easy prey to litigious insureds.

Furthermore, the California Supreme Court did not specifically limit its opinion to insurance contract litigation. The failure to limit *White* to its facts is significant because California courts have liberally expanded the contractual relationships where tortious bad faith breach of contract may attach.²⁸³ Consequently, the *White* decision may well have

282. 40 Cal. 3d 870, 710 P.2d 309, 221 Cal. Rptr. 509 (1985).

283. See *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984). See also *supra* note 141. In *Seaman's*, the court specifically allowed a tort remedy in the situation where a party "seeks to shield itself from liability by denying, in bad faith and without probable cause, that the contract exists." *Id.* at 769, 686 P.2d at 1167, 206 Cal. Rptr. at 363. Most importantly, the court also stated that the tort cause of action should be extended to commercial contracts involving relationships between the parties with "similar characteristics" to those found in the insurer-insured context. *Id.* at 768-69, 686 P.2d at 1166, 206 Cal. Rptr. at 362.

In the same year, a California Court of Appeal handed down its decision in *Wallis v. Superior Court*, 160 Cal. App. 3d 1109, 207 Cal. Rptr. 123 (1984). In *Wallis*, the court listed the following factors that could make a noninsurance contract subject to the bad faith doctrine:

- (1) the parties must have inherently unequal bargaining positions;
- (2) the contract must have been entered into for a non-profit motivation, i.e., to secure peace of mind, security or future protection;
- (3) ordinary contract damages would be inadequate because (a) they do not require the breaching party to account for its actions, and (b) they do not make the inferior party whole;
- (4) the non-breaching party has no alternative source of protection, having trusted the other party to perform; and
- (5) the breaching party is aware of the vulnerability and trust of the other.

Id. at 1118, 207 Cal. Rptr. at 129.

Combining both *Seaman's* and *Wallis*, California courts have expanded tortious bad faith breach of contract to apply to various noninsurance contract relationships. The areas in which this phenomenon has occurred are:

- (1) *Employer-employee*: See, e.g., *Khanna v. Microdata Corp.*, 170 Cal. App. 3d

opened the door for enterprising plaintiffs' attorneys to argue for the extension of *White's* analysis into noninsurance contract suits since *White* grants plaintiffs an enormous advantage in proving a defendant's tortious bad faith breach of contract.

*Henry Weinstein**

250, 215 Cal. Rptr. 860 (1985); *Wayte v. Rollins Int'l, Inc.*, 169 Cal. App. 3d 1, 215 Cal. Rptr. 59 (1985); *Rulon-Miller v. International Business Mach. Corp.*, 162 Cal. App. 3d 241, 208 Cal. Rptr. 524 (1984); *Shapiro v. Wells Fargo Realty Advisors*, 152 Cal. App. 3d 467, 199 Cal. Rptr. 613 (1984); *Crosier v. United Parcel Serv., Inc.*, 150 Cal. App. 3d 1132, 198 Cal. Rptr. 361 (1983); *Rosenfeld, Meyer & Susman v. Cohen*, 146 Cal. App. 3d 200, 194 Cal. Rptr. 180 (1983); *Pugh v. See's Candies, Inc.*, 116 Cal. App. 3d 311, 171 Cal. Rptr. 917 (1981); *Cleary v. American Airlines, Inc.*, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980).

(2) *Bank-depositor*: See, e.g., *Commercial Cotton Co. v. United Cal. Bank*, 163 Cal. App. 3d 511, 209 Cal. Rptr. 551 (1985).

(3) *Manufacturer-consumer*: See, e.g., *Gomez v. Volkswagen of Am., Inc.*, 169 Cal. App. 3d 921, 215 Cal. Rptr. 507 (1985); *Quigley v. Pet, Inc.*, 162 Cal. App. 3d 877, 208 Cal. Rptr. 394 (1984).

In *Gomez*, the court implied that it would have found tortious bad faith breach of contract. The court, however, held that the plaintiff was adequately protected by the Beverly-Song Act which allowed the plaintiff to recover treble damages under the circumstances of the case. Consequently, a finding of tortious bad faith breach of contract was unnecessary.

(4) *Franchisor-distributor*: In *Prestin v. Mobil Oil Corp.*, 741 F.2d 268 (9th Cir. 1984), the Ninth Circuit, interpreting California law, stated that a franchisor may not in bad faith terminate a franchise agreement despite language in the agreement that gave the franchisor a specific right to terminate for any reason. See also *Gianelli Dist. Co. v. Beck & Co.*, 172 Cal. App. 3d 1020, 219 Cal. Rptr. 203 (1985) (special relationship due to unequal bargaining power or special element of reliance did not exist, and, therefore, no bad faith breach of contract).

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