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Contracting for Punitive Damages: Fletcher v. Western National Life Insurance Company

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CONTRACTING FOR PUNITIVE DAMAGES:

FLETCHER v. WESTERN NATIONAL LIFE INSURANCE COMPANY[1]

On August 7, 1970, the California Court of Appeal for the Fourth District, in an opinion by Justice Kaufman, handed down a decision which has, to date, caused a certain amount of consternation in the insurance business. Not only will the holding of the court have widespread consequences upon the insurance industry and the insurance buying public, but it may affect contracting parties in all forms of business and private transactions. In *Fletcher v. Western National Life Insurance Company*, the Appeals Court affirmed a Superior Court judgment awarding $60,000 compensatory and $180,000 punitive damages against a disability insurer and $10,000 punitive damages against its claims supervisor personally, for intentional infliction of emotional distress. The Appellate Court held that, independent of the tort of intentional infliction, a bad faith and malicious refusal to make payments under an insurance policy by a disability insurer, who was bound by an implied-in-law duty of good faith with respect to its insured, constituted a tortious interference with a protected property interest of the policy holder. The insured was compensated for economic loss as well as emotional distress resulting from this conduct.[2]

In view of the large volume of business done by insurance companies, judicial interpretations of the relationship between insurer and insured have and will continue to have a great effect on a substantial portion of the populace. In light of these interpretations, an examination of *Fletcher* is appropriate.

U.L. Fletcher was a forty-one year old scrap operator with a wife and eight children. He worked seventy to eighty hours a week at a job that required heavy manual labor. His monthly income was $1358.70, based on his $289.00 per week wage and a $116.00 per month income received from the rental of Santa Ana property.[3] In order to protect himself and his family in the event he were disabled, Fletcher purchased a disability insurance policy from defendant Western National. The policy provided for payments of $150.00 per month to Fletcher should he be-

[1] 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

[2] *Id.* at 402, 89 Cal. Rptr. at 94.

[3] These figures are calculated by multiplying $289.00 per week, *Id.* at 386, 89 Cal. Rptr. at 83, by 4.3 to reach a monthly figure of $1242.70 and adding thereto $116.00 per month rental income. *Id.* at 389, 89 Cal. Rptr. at 85. Appellant's Petition for Rehearing at 28 n.13, Fletcher v. Western Nat'l Life Ins. Co., 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

come totally disabled because of sickness or injury. In the event of sickness, such payments were limited to a maximum of two years. In the event of injury, the maximum period in which the insured would remain eligible to receive payments was thirty years.

After regular payment of the premiums for two years, Fletcher sustained injuries while lifting a 361 pound bale of rubber. He was unable to work as a result of a hernia condition, for which he was surgically treated. Pursuant to the policy, disability due to hernia was payable as a sickness. Upon returning to work after the hernia surgery, Fletcher continued to have trouble with his back and was eventually placed on disability by his employer. Upon submitting a second proof of loss to the insurance company, monthly payments were resumed to Fletcher, although it was not made clear to him under which provision of the policy payments were being continued.[4]

Upon a thorough investigation of Mr. Fletcher's situation, Amason, Western National's new claims supervisor, immediately set out to find a way of minimizing or avoiding Fletcher's claim.[5] He sent Fletcher four letters around which the litigation centered. The content of these letters included the following: (a) rationalizations that Fletcher's condition originated from a congenital ailment and should therefore be paid under the Sickness Provision of the policy, which limited payments to a maximum of two years; (b) accusations of a material misrepresentation on the part of Fletcher in filling out this application for insurance coverage;[6] (c) a denial of any liability by Western National under the policy and a *demand* for the return of payments made to Fletcher. Western later modified its request by proposing that Fletcher keep the payments already made to him, $2250, in consideration of the cancellation of the policy and the execution by Fletcher of a full release; and (d) a statement that Western National would be willing to take any action necessary to have the policy cancelled in the event that Fletcher failed to accede to its so called "compromise" proposal.

At this point Fletcher brought an action against Western National based

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[4] Western National was informed by Fletcher's attending physician that he was disabled because of his back condition resulting from his initial injury. 10 Cal. App. 3d at 387, 89 Cal. Rptr. at 183-84.

[5] The opinion notes that the investigator received a letter from one of the physicians responding to an inquiry by the investigator in which it was stated: "I am sure that you are well aware of the fact that Mr. Fletcher has a large family and if such surgery [recommended for correction of Fletcher's injured back] were performed subsequently his employment outlook would be very poor to say the least." *Id.*

[6] This was done notwithstanding the complete absence of any investigation concerning the possible congenital defect, the complete absence of any proof that Fletcher knew about his condition, and in the face of information that Fletcher denied any previous back trouble and any knowledge of such a pre-existing condition. *See Id.* at 393-94, 89 Cal. Rptr. at 87-88.

primarily upon intentional infliction of emotional harm.[7] The court found that Western National, without probable cause for believing that Fletcher made an intentional and material misrepresentation, embarked upon a concerted course of conduct to induce Fletcher to surrender his insurance policy or enter into a disadvantageous "settlement" of a nonexistent dispute by means of false and threatening letters. It was also found that by employing economic pressure at a time when Fletcher was unable to meet his family's needs, the insurer acted maliciously and in bad faith by refusing to pay Fletcher's legitimate claim.

Defendants conceded that their conduct was "deplorable and outrageous".[8] The jury awarded Fletcher $60,000 compensatory damages, $640,000 punitive damages against Western National and $10,000 punitive damages against the claims' supervisor. Fletcher accepted a remission of the punitive damage award against Western National down to the sum of $180,000. The case reached the Court of Appeal based upon the denial of Western's motion for judgment notwithstanding the verdict on the intentional infliction finding.

On appeal, counsel for appellant's arguments were most ingenious.[9] He contended that: (1) If the action for intentional infliction were based upon the sending of the letters, as the pleadings suggested, causation could not be shown; and (2) If the action was based upon appellant's bad faith refusal to pay, that action must sound only in contract. Neither compensatory damages for emotional distress nor punitive damages would be recoverable.[10]

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[7] Note that this is the only cause of action which proceeded to verdict and judgment, and which was involved on appeal. The first cause, wherein Fletcher sought a declaration that he was entitled to monthly payments of $150.00 under the "Injury" provision of the policy so long as he should be totally disabled up to a maximum of thirty years, was stipulated to judgment by Western National. The second cause sought compensatory and punitive damages against both Western National and Amason, the claims' supervisor, for their alleged fraud in inducing Fletcher to buy the policy. At the conclusion of Fletcher's case, the court granted the insurer's motion for non-suit on this second cause of action.

[8] 10 Cal. App. 3d at 392, 89 Cal. Rptr. at 87.

[9] Appellant Western National made two other contentions which should be noted yet will not be discussed herein: (1) That prejudicial error was to be found in the jury instructions; and (2) that the damage awards, both compensatory and punitive, were excessive. 10 Cal. App. 3d at 386, 89 Cal. Rptr. at 82.

[10] *See* CAL. CIV. CODE §§ 3300, 3302 (West 1970) and CAL. INS. CODE ANN. § 10111 (West 1955).

An argument against the allowance of recovery for Fletcher on *any* tort theory was put forth. Brief for Appellant at 42-44, Fletcher v. Western Nat'l Life Ins. Co., 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970). The essence of it was that the rule of Erlich v. Etner, 224 Cal. App. 2d 69, 36 Cal. Rptr. 256 (1964), governed, and prohibited the recovery of punitive damages. Compensatory damages are not recoverable where there is no evidence of actual loss or damage to the plaintiff. "Since no actual damages were proven, an award of punitive damages was, of course, improper." *Id.*

Although the Court of Appeal affirmed, it did not directly confront these two contentions. In the long run, it abandoned the intentional infliction ground and relied instead on an alternative holding: Tortious interference by a disability insurer with a protected property interest of its insured. Because there is an element of recognition by omission in the court's reasoning, appellant's arguments merit more elaborate discussion.

I

Fletcher's action for intentional infliction was based upon two forms of conduct: (1) the bad faith, malicious conduct of Western National in writing the threatening and accusatory letters, thereby causing adverse effects on his emotional tranquility, and (2) the breach of the insurer's obligation to pay benefits due under a contract of disability insurance.[11] Though the latter contention is normally one of contract breach, recovery in tort was endeavored. A discussion of this contention will temporarily pre-empt comment upon the insurer's malicious conduct.

The court concluded that as a proximate result of Western's failure to perform its obligations under the contract, Fletcher suffered both emotional distress and economic losses.[12] Conceding that "[i]n every case of a contract breach, there is bound to be vexation and annoyance to one or both of the contracting parties,"[13] it does not necessarily follow that a causal connection between the breach and compensable distress is automatic. The court noted that were it not for Western National's bad faith refusal to pay the monies due, Mr. Fletcher would not have suffered the same degree of emotional distress and mental anxiety. Counsel for the appellant suggested that the actual cause of Fletcher's economic loss and mental distress was the disability itself, which was accompanied by a resulting loss of income, and that the loss of the (disability) payments was insignificant by comparison. He argued that it must necessarily follow that there is no causal connection between the appellant's refusal to pay and the respondent's emotional harm.[14] He maintained that prior to in-

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at 75, 36 Cal. Rptr. at 260.

Punitive damages are not recoverable where compensatory damages are not. Contractor's Safety Ass'n. v. Cal. Comp. Ins., Co., 48 Cal. 2d 71, 77, 307 P.2d 626, 629 (1957).

[11] Another cause of action was pleaded on the theory of a conspiracy between appellants Western National and Amason. "In a discussion in chambers prior to the taking of testimony it was apparently concluded that there could be no conspiracy between the corporate defendant and its employee acting within the scope of his employment [*see* Wise v. Southern Pac. Co., 223 Cal. App. 2d 50, 35 Cal. Rptr. 652 (1963)], and the case proceeded as if the [respondent] had pleaded tortious conduct by both [appellants on the intentional infliction count]." 10 Cal. App. 3d at 384-85 n.1, 89 Cal. Rptr. at 81-82 n.1.

[12] *Id.* at 402, 89 Cal. Rptr. at 94.

[13] Jankowski v. Mazzotta, 7 Mich. App. 483, 489, 152 N.W.2d 49, 51 (1967).

[14] The court realized that emotional distress was to some extent caused by Fletcher's

jury, Fletcher had a monthly income of $1358.70, which included income derived from his Santa Ana property. In the event of total disability, the payments due from Western were $150.00 per month for a maximum of thirty years. If Western National had done everything required of it under the contract and paid the $150.00 promptly, thereby making it innocent of both tort and breach of contract, Fletcher's income would still have been reduced by some $974.00 per month.[15]

The problem of the causal connection between the refusal to pay and the compensated emotional harm, raised by this argument, is not particularly troublesome. The jury awarded $60,000 compensatory damages, $54,000 of which was the accelerated lump sum payment under the disa-

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impecunious economic situation yet did not consider the situation to be the primary cause of the distress. Interestingly enough, his specific economic losses, i.e. loss of an Arizona property and late charges based on delinquency in making house payments, were not considered compensable.

[15] Appellant's Petition for Rehearing at 28-29, Fletcher v. Western Nat'l Life Ins. Co., 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

A proximate cause analysis of the situation, focusing on appellant's argument above, would yield that the insurer could not reasonably be expected to foresee any emotional distress resulting from its performance.

A three pronged attack upon the tort of intentional infliction was attempted, based on the threshold ground that the tort itself was not established. Western first tried to demonstrate that their purported conduct was privileged (privilege to pursue their own economic interests) and therefore excusable. This privilege would allow them to assert their legal rights and to communicate its position in good faith to its insured even though it is substantially certain that in doing so, emotional distress will be caused. RESTATEMENT (SECOND) OF TORTS § 46, comment g and illus. 14 (1965); *cf.* RESTATEMENT OF TORTS § 773 (1939); and *see generally* W. PROSSER, LAW OF TORTS 99-100 (3d ed. 1964). By pursuing its own economic interests, the appellant alluded to settlement negotiations. The word settlement presupposes that there is a dispute. Where there is no bona fide dispute between an insurer and its insured, it is difficult to conceive of how a settlement can take place. At the outset of the trial, Western National conceded that its conduct was outrageous and stipulated that the payments were due. That conduct amounts to a tacit admission that no dispute existed. It seems that the so called "settlement" negotiations (letters to Fletcher) were in essence efforts by Western to take advantage of the tremendous difference in bargaining positions with reference to the economic positions of the parties.

Though there are strong public policy considerations favoring amicable settlement of disputes, the facts of *Fletcher* reveal that there was no good faith dispute; there is no public policy in favor of an attempt to coerce settlement of a non-existent dispute by outrageous means. 10 Cal. App. 3d at 396, 89 Cal. Rptr. at 89-90. Therefore, the insurer's privilege was unequivocally defeated by its outward manifestations of bad faith and malice.

Next the appellant urged that the testimony of respondent established that he was but mildly upset by appellant's conduct and therefore not a victim of "severe" emotional distress. *Id.* at 397, 89 Cal. Rptr. at 90. The court disposed of this contention by concluding that there was sufficient evidence from which emotional distress of the requisite severity could be found. *Id.* at 397, 89 Cal. Rptr. at 90.

bility contract.[16] The jury, in effect, awarded $6,000 for Fletcher's emotional harm. The question before the Court of Appeal, therefore, was whether there existed substantial evidence to support the jury's verdict.[17]

Evidence was introduced to show that prior to the cessation of payments by Western National but after Fletcher's disability, the insurer obtained an investigation report with respect to Fletcher's situation at the time:

> [A]ll of his income is going out to upkeep on his two homes, food for family and expenses and medical bills. He is *barely* making ends meet and has no idea of how many expenses he has exactly but stated generally that they were normal household and family expense which seem to be more than he can manage without slighting one or the other. (emphasis added)[18]

As to the effects of Western National's nonpayment, Fletcher testified that:

> [H]e reduced his budget and kept trying to provide for his family; that he and his family were required to eat macaroni, beans and potatoes; that he gained 47 pounds; that during the summer of 1967 his utilities were turned off for nonpayment of charges and that he was required to "gather" money from friends and neighbors to have them turned back on; . . . that his wife was required to go to work two days a week; and that, as a result, he had to take one of his daughters out of school to tend to him and one small child for approximately two months on those two days a week that his wife worked.[19]

The court found the above evidence sufficient to establish a causal link between the insurer's failure to pay its contractual obligation and the insured's resulting emotional distress.[20]

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[16] *See* note 7 *supra.*

[17] *See* 10 Cal. App. 3d at 397, 89 Cal. Rptr. at 90.

[18] *Id.* at 389, 89 Cal. Rptr. at 85.

[19] *Id.* at 394, 89 Cal. Rptr. at 88.

[20] Since this finding rests upon the tort of intentional infliction, a brief background sketch of this cause of action and its requirements as applied to *Fletcher* is appropriate here.

California has been a forerunner in allowing recovery for the intentional infliction of emotional distress. Alcorn v. Anbro Eng'r, Inc., 2 Cal. 3d 493, 468 P.2d 216, 86 Cal. Rptr. 88 (1970); State Rubbish Collector's Ass'n v. Silznoff, 38 Cal. 2d 330, 240 P.2d 282 (1952). This recovery has been extended to situations wherein the plaintiff has suffered an emotional disturbance without a connected physical injury. Leavy v. Cooney, 214 Cal. App. 2d 496, 502, 29 Cal. Rptr. 580, 584 (1963).

The qualifications in an intentional infliction case, as recognized and cited by the *Fletcher* court, 10 Cal. App. 3d at 394, 89 Cal. Rptr. at 88, include: (1) outrageous conduct on the part of the defendant, conceded by appellant, *Id.* at 392, 89 Cal. Rptr. at 87; (2) defendant's intention of causing or reckless disregard of the probability of causing emotional distress. Appellant conceded that the evidence was sufficient to support the jury's implied finding of the requisite intent or recklessness. *Id.* at 394, 89 Cal. Rptr. at 88; (3) plaintiff's suffering severe emotional distress. Severe emotional distress means substantial or enduring as distinguished from trivial or transitory. RESTATEMENT (SECOND) OF TORTS § 46 (1965). "It is for the court to determine whether on the evidence severe emotional distress can be found; it is for the jury to determine whether, on the evidence, it has in fact existed. It is our conclusion that there is sufficient evidence from which emotional distress of the requisite severity can be found and that there is substantial evidence to support the jury's determination that it

This finding of causation is not inconsistent with appellant's argument that the action sounds solely in contract, breach of which was stipulated.[21] He did contend, however, that no causal link between the sending of the *letters* and the emotional distress existed. It may be consistent with sound logic and established legal principles to construe Fletcher's emotional distress as arising *independent* of his economic losses. Fletcher testified that he was frightened, worried and upset by Western National's letters, particularly those charging him with (a) the intentional misrepresentation of facts on his application in order to procure the insurance coverage, and (b) demanding repayment of a substantial sum of money and threatening legal action against him if he failed or refused to cooperate. After being notified that the $150.00 monthly payments were being discontinued and as a result of all these communications by Western, Fletcher became frightened and anxious about losing his home and his family lacking food and clothing. The court, in finding that Fletcher's worry and anxiety were substantial enough in quality, *assumed* the existence of causation, especially in view of the insurer's knowledge of Fletcher's disabled condition. Susceptibility of the plaintiff to emotional distress and a defendant's awareness thereof, have often been mentioned as significant in determining liability.[22]

In actuality, the court avoided the issue of whether a causal link could be shown between the letters alone and the emotional harm:

> Even if it were to be said that the theory of the pleadings was that the instrumentality of the tort consisted of the two letters, the case was fully tried, and, if the evidence established plaintiff's right to relief, the motions for judgment notwithstanding the verdict were properly denied. . . . *The doctrine limiting a plaintiff to recovery on the theory of his pleadings has long since been repudiated.* (emphasis added)[23]

Though the *Fletcher* court had an opportunity to discuss the issue of causation extensively, they failed to do so. Their language in fact, demonstrated a lack of confidence in holding upon the intentional infliction theory:

> We hold, therefore, that defendant's threatened and actual bad faith refusals to make payments under the policy . . . is conduct that *may* legally be the basis

in fact existed." 10 Cal. App. 3d at 397, 89 Cal. Rptr. at 90 *quoting* RESTATEMENT (SECOND) OF TORTS § 46 comment j (1965); and (4) actual and proximate causation of emotional distress by the defendant's outrageous conduct. Here, the court construed the instrumentality of the tort to be the entire course of conduct of Western National "from the moment they cut [Fletcher] off until they reinstated him." 10 Cal. App. 3d at 399 n.9, 89 Cal. Rptr. at 92, n.9.

[21] Appellant reasoned that even if causation between the refusal to pay and the emotional harm existed, compensation for emotional harm was not recoverable in an action on a contract. *See* section III, *infra.*

[22] *See* Alcorn v. Anbro Eng'r, Inc., 2 Cal. 3d 493, 498 n.3, 468 P.2d 216, 218 n.3, 86 Cal. Rptr. 88, 90 n.3 (1970) and authorities therein cited.

[23] 10 Cal. App. 3d at 399, 89 Cal. Rptr. at 92 (citations omitted).

for an action for damages for intentional infliction of emotional distress. (emphasis added)[24]

By equivocating and not affirmatively stating that the tort of intentional infliction *is* a definite basis for a holding under the given facts, the court is qualifying itself and is inexorably looking for another hinge upon which to base its holding:

Although it *might* be possible to rest our decision solely upon the first holding [intentional infliction], we *make* the latter holding . . . [recovery based upon the insurer's bad faith refusal to perform its contract obligation constituting a tortious interference with a protected property interest of its insured.] (emphasis added)[25]

This demonstrated lack of confidence is based primarily upon the insufficiency of the court's causation analysis. Implicit also in the court's choice of an alternative holding is the realization of merit in the appellant's argument that an action upon a bad faith refusal to pay is an action upon a contract.

II

The fundamental difference between tort and contract lies in the nature of the interest protected. Tort actions are created to protect the interest in freedom from various kinds of harm. The duties of conduct which give rise to them are imposed by the law, and are based primarily upon social policy, and not necessarily upon the will or intention of the parties. . . . Contract actions are created to protect the interest in having promises performed.[26]

Contract obligations arise because of conduct of the parties manifesting assent, and are owed only to the specific individuals named in the contract. Even as to these individuals, the damages recoverable for a breach of a contractual duty are limited to those reasonably within the contemplation of the parties when the contract was made,[27] while in a tort action, a much broader measure of damages is afforded.[28] Generally speaking, the tort remedy is likely to be more advantageous to the injured party in the greater number of cases, if only because it will often permit the recovery of greater damages. Where a case sounds both in contract and in tort, the plaintiff will ordinarily have the freedom of election between

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[24] *Id.* at 401, 89 Cal. Rptr. at 93.

[25] *Id.* at 402, 89 Cal. Rptr. at 94.

[26] W. PROSSER, LAW OF TORTS 634 (3d ed. 1964).

[27] McCormick, *The Contemplation Rule as a Limitation Upon Damages for Breach of Contract*, 19 MINN. L. REV. 497 (1935), reprinted in C. MCCORMICK, DAMAGES, ch. 22 (1935).

[28] CAL. CIV. CODE § 3333 (West 1970), affords recovery in tort for all detriment proximately caused the injured party, whether it could have been anticipated or not. Under CAL. CIV. CODE § 3300 (West 1970), the general rule in California is that damages may be recovered for breach of contract only if they may reasonably be supposed to have been within the contemplation of the contracting parties at the time the contract was made.

them.[29]

Traditionally, where an insurer wrongfully cancelled, repudiated, or terminated the contract of life or disability insurance, the action lay in contract and only actual damages were recoverable.[30] The insured had the option of pursuing one of three courses: "(1) he may elect to consider the policy at an end and recover its just value or such measure of damages as a court in the particular jurisdiction approves; (2) he may institute proceedings to have the policy adjudged to be in force; or (3) he may tender the premiums, and if acceptance is refused, wait until the policy by its terms becomes payable and then test the forfeiture in a proper action on the policy."[31] Being that the insurer's action was held to be a breach of a contractual obligation, if the insured elected to pursue option (3) above, his maximum recovery was the sum(s) payable in the manner and at the times as provided in the policy.[32] The rationale for this limitation was initially espoused in the old English case of *Hadley v. Baxendale*[33] and incorporated into California Civil Code section 3300.[34] The general rule, therefore, is that under section 3300, damages may be recovered for breach of contract only if they may reasonably be supposed to have been within the contemplation of the contracting parties, at the time the contract was made, as a probable result of a breach.[35]

In life and disability insurance contracts, California Insurance Code section 10111 provides that liability under the policy shall be limited to the proceeds payable. By comparing Civil Code section 3300 with Insurance Code section 10111, one discovers a statutory declaration that in disability insurance policies, the amount of damages reasonably contemplated by the parties is the amount payable under the policy.

This was precisely the argument urged by appellant insurer's counsel at the appellate level. He contended that since Fletcher achieved a declaration of his entitlement to the contractual benefit by stipulation, any recovery exceeding that amount, such as that awarded by the trial court, was precluded by statute (Insurance Code section 10111).[36]

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29 Eads v. Marks, 39 Cal. 2d 807, 811, 249 P.2d 257, 260 (1952).

30 *See generally*, Annot., 107 A.L.R. 1233 (1937) and cases cited therein for a comprehensive discussion of the traditional options of the insured.

31 *Id.*

32 CAL. INS. CODE ANN. § 10111 (West 1955); *cf.* Wetherbee v. United Ins. Co. of America, 265 Cal. App. 2d 921, 71 Cal. Rptr. 764 (1968).

33 156 Eng. Rep. 145 (EX. 1854). *See also* C. MCCORMICK, DAMAGES ch. 22 (1935); Bauer, *Consequential Damages in Contract*, 80 U. PA. L. REV. 687 (1932).

34 West Coast Winery v. Golden W. Wineries, 69 Cal. App. 2d 166, 158 P.2d 623 (1945); Westervelt v. McCullough, 68 Cal. App. 198, 228 P. 734 (1924).

35 Hunt Bros. Co. v. San Lorenzo Water Co., 150 Cal. 51, 87 P. 1093 (1906).

36 *See* Brief for Appellant at 42, Fletcher v. Western Nat'l Life Ins. Co., 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

In addition, it can be argued that by accepting Western National's stipulation to

It should be noted that the "contemplation of the parties" rule is not static. Traditionally, damages for mental and physical suffering were held not to follow from a breach of a contractual obligation, especially one wherein the loss to the injured party was pecuniary.[37] Thus, in contracts entered into for the accomplishment of commercial purposes, pecuniary interests are paramount and although a breach of contract may cause anxiety and worry, it can be argued that recovery for this anxiety and worry was not contemplated by the parties as a natural and probable result of the breach. As recently as 1966, a federal district court in *Dawkins v. National Liberty Life Insurance Company*[38] held that:

> [D]amages for mental suffering are too remote and consequential to be reasonably supposed within the contemplation of the parties to the contract of *insurance*. . . . The claim for actual damages [is] limited to the payment of the amounts due and owing within the coverage of the policy.[39]

There are a long line of California cases which hold that a plaintiff may not recover damages for mental suffering experienced as a result of a breach of contract. Such recovery has generally been denied on the theory that such damages were too uncertain, speculative, remote, and would open the door to a flood of litigation.[40]

Physical suffering or illness sustained as a proximate result of a breach of contract was the first extension of the rule which limited recovery in contract to damages for pecuniary loss only. *Westervelt v. McCullough*[41] enunciated that whenever the terms of a contract relate to matters which directly concern the comfort or personal welfare of a party thereto, that party may, in the event of a breach of the agreement, recover damages for this physical suffering.[42]

The impetus for extension in *Westervelt* was generated by an Alabama decision, *Browning v. Fies*,[43] which first alluded to the likelihood of recovery for mental anguish in a contract situation; but *Browning* was a

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judgment, Fletcher made an election of remedies (contract) and was thereby precluded from further relief in tort.

37 *See* Farmer's Ins. Exch. v. Henderson, 82 Ariz. 335, 343, 313 P.2d 404, 409 (1957):

> To recover for mental suffering and anguish in an action for breach of contract, the contract must be of such a nature that its breach would cause suffering for reasons other than pecuniary loss. [*citing* RESTATEMENT OF CONTRACTS § 341 (1932)].

38 252 F. Supp. 800 (D.S.C. 1966).

39 *Id.* at 802-03. "[These damages] do not flow naturally and directly from the breach of the contract." *Id.* at 802.

40 *E.g.*, Westwater v. Grace Church, 140 Cal. 339, 73 P. 1055 (1903); Walpole v. Prefab Mfg. Co., 103 Cal. App. 2d 472, 230 P.2d 36 (1951); *See* W. PROSSER, LAW OF TORTS 43 (3d ed. 1964) for argument contra.

41 68 Cal. App. 198, 228 P. 734 (1924).

42 *Id.* at 208-09, 228 P. at 738.

43 4 Ala. App. 580, 58 So. 931 (1912).

qualified extension, for it required "special circumstances" known to both parties at the time of entering into the contract and a contemplation that damages may result from a breach under these circumstances.[44]

The element of "bad faith" also served to expand the "contemplation of the parties" doctrine. The California Supreme Court, in *Overstreet v. Merritt*,[45] held the defendant liable for *all* damages traceable to his breach, including those which could not be foreseen at the time of the making of the contract. Finally in 1958, *Comunale v. Traders & General Insurance Company*[46] applied the *Overstreet* holding to an insurance contract situation wherein the insurer wrongfully denied coverage. The company was held to be liable for the *full* amount which would compensate the insured for *all* the detriment caused by the insurer's breach of the express and implied obligations of the liability contract. The court stated that the policy consideration behind its holding was not to permit the insurer to profit by its own wrong.[47] The impact of *Comunale* was to, for the first time, permit recovery in excess of the policy limits.

Comunale opened the door for the court in *Crisci v. Security Insurance Company*[48] to discuss the recoverability of damages for mental suffering when an insurer is held to commit a "bad faith" breach of its contractual duty owed to the insured.[49] *Crisci* took *Comunale* a step further by espousing that:

> an insurer should not be permitted to further its own interests by rejecting opportunities to settle within the policy limits unless it is also willing to absorb losses which may result from its failure to settle.[50]

What *Crisci* failed to delineate was whether damages for mental suffering were recoverable *solely* on the ground of breach of contract. On the surface it would appear that *Crisci*, in addition to employing the *Comunale* "bad faith" rule, extended *Westervelt* by stating that a contract which directly concerns the comfort, happiness, or personal esteem of one of the parties, should, because of those special circumstances, be a contract the

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[44] It is important to note that the relationship of the parties involved in *Browning* differs from that of insurer-insured, for in *Browning*, the contract was between private citizens, neither of whom were considered to have a superior bargaining position with respect to the other.

[45] 186 Cal. 494, 200 P. 11 (1921).

[46] 50 Cal. 2d 654, 328 P.2d 198 (1958).

[47] *Id.* at 660, 328 P.2d at 202.

[48] 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

[49] Although the *Crisci* court indicated a judicial willingness to impose quasi-strict liability on an insurer when it, in bad faith, refused or failed to perform its contractual obligations to its insured, this theory was not needed because the facts supported the traditional tort recovery. This strict liability theory was offered to the *Crisci* court by one of the amicus curiae briefs. *See* Brief of Mr. Edward L. Lascher as Amicus Curiae, Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

[50] *Id.* at 431, 426 P.2d at 177, 58 Cal. Rptr. at 17.

breach of which results in damages for mental suffering. A closer reading of *Crisci*, however, will reveal that the recovery of damages for mental suffering might not have been allowed had the breach of contract not also constituted a tort.[51]

The prevailing view with respect to recovery of damages for mental suffering in breach of contract situations reveals a reluctance by the courts to recognize mental suffering as an element of compensible damages. This attitude has stemmed in part from a fear of being then called upon to redress mere annoyance and hurt feelings.[52] The question remains whether an action based upon the refusal to pay proceeds due under a *disability* contract sounds solely in contract.

The past history of the unwillingness of the courts to extend damages for mental suffering to breach of contract situations is calling out for an extension. Though the tools necessary to make this extension were at their fingertips, the *Fletcher* court declined to use them. Instead of holding that Mr. Fletcher's emotional harm was recoverable in an action on the contract, which under the facts would have been supportable, the court chose to base their holding on a tort theory, which affords a wider measure of recovery.[53] It may be argued, and quite reasonably so, that the court did this to, (a) avoid a determination on whether damages for mental suffering were recoverable in an action based solely on a contract;[54] or (b) provide a new theory of recovery for the mass of insureds who are placed in an inferior bargaining position in relation to the insurance companies.

The duty of one party to conduct himself in a particular manner toward another is a fundamental concept of tort theory. The *Fletcher* court undertakes a discussion of a "special duty" imposed on a *disability* insurer to conduct himself in a particular manner towards its insured, i.e. in "good faith."[55] The duty concept in this factual situation is the backbone for

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[51] Recovery of damages for mental suffering in the instant case does not mean that in every case of breach of contract the injured party may recover such damages. Here the breach also constitutes a tort. *Id.* at 434, 426 P.2d at 179, 58 Cal. Rptr. at 19.

[52] The *Crisci* court notes merit to this objection by warning of the danger of fictitious claims and vexatious suits opening a "wide door" to litigation in the field of trivialities and mere bad manners. *Id.*

[53] 10 Cal. App. 3d at 401, 89 Cal. Rptr. at 93.

[54] Under CAL. CIV. CODE § 3300 (West 1970), it is required that all damages for breach of contract be within the reasonable contemplation of the parties at the time of making the contract. It could be argued that damage to the health of Fletcher was such an outcome as may have been reasonably within the contemplation of the parties at the time of making the contract and a reasonably foreseeable result of a breach; for did not Western National's agent contemplate the consequences of his threats and refusals to pay a man in as impecunious a situation as was Mr. Fletcher? A strong affirmative argument can be made along this line. On this point, *see* Kline v. Guaranty Oil Co., 167 Cal. 476, 483, 140 P. 1, 4 (1914).

[55] 10 Cal. App. 3d at 401, 89 Cal. Rptr. at 93.

the court's declaration of a new cause of action sounding in tort. In order to apply the duty element properly to the *Fletcher* facts, an examination of the nature of the insurer's duty with respect to its insured and an explanation of what constitutes "good or bad faith" is in order.

Most individuals seeking insurance coverage, after deciding upon the variety of insurance required by them, are unable to negotiate the contents of the policy with the insurer, since all companies issue policies with substantially identical terms.[56] Life in our complex and economically oriented society make certain types of insurance coverage indispensable to a reasonably prudent man. This situation thereby places the insurance companies in a superior bargaining position with respect to potential insureds. It has, in fact, been held to be a form of adhesion contract.[57]

Thus, the individual is confronted with the choice of either accepting the standard insurance policy drafted by the insurer, or risking financial disaster by not obtaining insurance at all. These realities necessitate the imposition of a "special duty" on the part of the insurance company toward its insureds. As early as 1934, the California court had occasion to comment upon this insurer-insured relationship. It stated a rule in *Stark v. Pioneer Casualty Company*[58] which imposed a broader legal responsibility upon the insurance carrier than would be imposed upon parties to a purely private contract.[59] A major North Dakota decision held that a "special duty" arose in the insurer, due to the unequal bargaining positions of the parties.[60] The nature of this so called "special duty" places the responsibility upon the insurer to give as much consideration to the interests of the insured as it gives to its own,[61] and requires the insurer to

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[56] Schultz, *The Special Nature of the Insurance Contract: A Few Suggestions for Further Study*, 15 LAW & CONTEMP. PROB. 376-77 (1950) (describes the nature of the insurance contract).

[57] It is well settled that insurance policies are characteristic of contracts of adhesion. Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 269-70, 419 P.2d 168, 171-72, 54 Cal. Rptr. 104, 107-08 (1966); *see generally*, Meyer, *Contracts of Adhesion and the Doctrine of Fundamental Breach*, 50 VA. L. REV. 1178 (1964); Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943).

[58] 139 Cal. App. 577, 34 P.2d 731 (1934).

[59] This is based upon the fact that those companies act under franchises from the state, and the policy of the state in granting such franchises proceeds upon the theory that it is in the interest of the public to the end that indemnity upon specific contingencies should be provided those who are eligible and desire it, and for their protection the state regulates, inspects and supervises their business. *Id.* at 580, 34 P.2d at 732.

Stark was a contract formation case, wherein the insurer was held to a duty to act promptly upon the insured's application for insurance. This "special duty" was imposed by virtue of the nature of the transaction and the relationship of the parties.

[60] Bekken v. Equitable Life Assurance Soc'y, 70 N.D. 122, 293 N.W. 200 (1940). *See also* Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); Steven v. Fidelity & Cas. Co., 58 Cal. 2d 862, 377 P.2d 284, 27 Cal. Rptr. 172 (1962).

[61] Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

exercise "good faith" in dealing with the insured.

A careful examination of the California cases which have broadened the insurer's duty to the insured, will yield the finding that this extension has only been applied to *liability* insurers.[62] The general policy reasons are well espoused in *Barrera v. State Farm Mutual Automobile Insurance Company*:[63]

> Because of the "quasi-public" nature of the insurance business and the relationship between the insurer and the insured, . . . , the rights and obligations of the insurer cannot be determined solely on the basis of rules pertaining to private contracts negotiated by individual parties of relatively equal bargaining strength.[64]

The policy basis of encouraging fair treatment of the public whom these enterprises serve would therefore, bring about implied-in-law duties toward the insured. Thus, the court in *Barrera* recognized the insurance company's role as one of a quasi-public entity.[65]

More specifically, the courts have broadened the liability insurer's duty by a full recognition of the status of the insurer and its relationship to innocent third parties. California courts have consistently subordinated the contract provision of liability insurance policies to compensate innocent third party victims.[66] Beginning with *Continental Casualty Company v. Phoenix Construction Company*,[67] the language of automobile liability insurance policies has been viewed in light of the public policy of California's Financial Responsibility Law.[68] The court stated that the objective of this law is to provide protection to those injured on the highways through no fault of their own.[69] It would therefore follow that because of the quasi-public nature of the insurance business and the public policy underlying the Financial Responsibility Law, the "special duty" was owed to the public.[70]

Fletcher seeks to bring an insured under a *disability* policy within the "special duty" umbrella. The duty has never before been so extended, presumably because the two party nature of the *disability* insurance con-

62 Barrera v. State Farm Mut. Auto. Ins. Co., 71 Cal. 2d 659, 456 P.2d 674, 79 Cal. Rptr. 106 (1969); 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); Stark v. Pioneer Cas. Co., 139 Cal. App. 577, 34 P.2d 731 (1934).

63 71 Cal. 2d 659, 456 P.2d 674, 79 Cal. Rptr. 106 (1969).

64 *Id.* at 669, 456 P.2d at 681-82, 79 Cal. Rptr. at 113.

65 *Id.* For a comprehensive discussion of the *Barrera* decision and related matters, including the "special duty" of a *liability* insurers, *see* Note, *Reasonable Investigations and the Financial Responsibility Law—Protecting The Innocent Third Party*, 3 LOY. L.A. L. REV. 169 (1970).

66 Note, *supra* note 65, at 174.

67 46 Cal. 2d 423, 296 P.2d 801 (1956).

68 Note, *supra* note 65, at 174 n.33.

69 46 Cal. 2d at 434, 296 P.2d at 808.

70 Barrera v. State Farm Mut. Auto. Ins. Co., 71 Cal. 2d 659, 668, 456 P.2d 674, 680-81, 79 Cal. Rptr. 106, 112-13 (1969).

tract distinguishes it from *liability* insurance contracts. There are, however, strong reasons for making the extension.

One might begin with the concept that all contracts require the parties to deal with one another in good faith. In addition, insurance contracts, whether disability or otherwise, are adhesion contracts;[71] a basis of the "special duty" is the superior bargaining position of the insurer. Correlatively, all insureds have an equal right to rely on the peace of mind and security that insurance provides for them.[72]

The *Fletcher* court's analogy to *Crisci* is well taken.[73] *Crisci,* to be sure, was a liability insurance case. But the "special duty" found therein was one owed not to third parties but to the insured. The quasi-public nature of liability insurance did not in any real sense effect the court's conclusion.

Further, it is arguable that a disability policy affects third parties in much the same way that a liability policy affects them. Note that the "special duty" is not limited to liability policies solely. It has been held in other jurisdictions to apply to life insurance as well, on the grounds that the purpose of such insurance is to benefit third persons, presumably the family of the insured.[74] Effectively, the reasons which have led courts to hold liability insurers "quasi-public" also apply to life insurance. The real purpose of the insurance, as understood by both the insurer and the insured, is the protection of innocent third parties.

Just as life insurance takes on a quasi-public tint, so does disability insurance. The real purpose behind acquisition of the policy is protection of the family. In *Fletcher*, for example, the persons injured by Western's failure to pay are, excepting Fletcher, third parties: his wife and eight children.

In liability or life insurance, the proceeds are paid directly to a third party. The protection of third parties which disability insurance affords is no less demonstrable because the mechanics of tendering payment directly are absent. In an enlightening statement made with regard to the insurer-insured relationship and which made *no* distinction between liability and disability insurers, Roscoe Pound in 1921 took the position that:

> The law of insurance [has been taken] out of the category of contact, and we have established that the duties of public service companies are not contractual, as the 19th century sought to make them, but are instead *relational*; they do not flow from agreements which the public servant may make as he chooses, the calling in which he is engaged and his consequent relation to the public. (emphasis added)[75]

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71 *See* note 57 *supra.*

72 Crisci v. Security Ins. Co., 66 Cal. 2d 425, 434, 426 P.2d 173, 179, 58 Cal. Rptr. 13, 19 (1967).

73 10 Cal. App. 3d at 401, 89 Cal. Rptr. at 93.

74 Bekken v. Equitable Life Assurance Soc'y, 70 N.D. 122, 293 N.W. 200 (1940).

75 R. POUND, THE SPIRIT OF THE COMMON LAW 29 (1921).

Neither *Crisci* nor the quasi-public rationale of liability insurance preclude extension of the "special duty" to disability insurers. The *Fletcher* court rested on solid ground in holding that a "special duty" of "good-faith and fair dealing", which requires an insurer to give equal consideration to the interests of its insured as it does to its own, applies to disability as well as liability insurers.

The *Fletcher* court never adequately discusses the concept of "bad faith" in an insurer's dealings with an insured. A discussion of it here will help clarify the court's use of this terminology and shed the proper illumination on the nature of the insurer's duty toward its insured.

Initially "bad faith" was defined quite narrowly. In *City of Wakefield v. Globe Indemnity Company*,[76] the court stated that "[g]ood or bad faith is a state of mind".[77] This line of reasoning was perhaps carried to its extreme in a Vermont case, *Johnson v. Hardware Mutual Casualty Company*.[78] The holding denoted that liability for "bad faith" could be imposed only for actions done "with actual intent to mislead or deceive another. It refers to a real and actual state of mind . . . It will not be imputed unless there is something in the particular transaction which is equivalent to fraud, actual or constructive."[79] The Vermont court realized the extremity of its holding. Upon rehearing, it relaxed its definition: "[T]he intentional disregard of the financial interests of the [insured] in the hope of escaping the full responsibility imposed on it by its policy."[80] In light of the *Johnson* court's new definition of bad faith, it may well be argued that the *Fletcher* court meant to construe the insurer's breach of faith consistent with the new *Johnson* definition, *i.e.*, that Western National, by its actions in writing the letters, attempted to escape their full responsibility to Fletcher under the policy and this very action constituted bad faith with respect to the interests of the insured.

Traditionally, the determination of whether the insurance company was acting in good faith toward its policy holders was once again limited to liability policies. The most widely litigated area wherein breach of "good faith" by the insurer was an issue was in claim settlement disputes. Beginning with the landmark case of *Hilker v. Western Auto Insurance Company*,[81] and extending down through *Comunale v. Traders & General Insur-*

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76 246 Mich. 645, 225 N.W. 643 (1929).

77 *Id.* at 653, 225 N.W. at 645.

78 108 Vt. 269, 187 A. 788 (1936).

79 *Id.* at 286, 187 A. at 796.

80 Johnson v. Hardware Mut. Cas. Co., 109 Vt. 481, 491, 1 A.2d 817, 820 (1938). For another definition of "bad faith" as dishonesty or fraud, *see* Harrod v. Meridian Mut. Ins. Co., 389 S.W.2d 74 (Ky. 1964).

81 204 Wis. 1, 231 N.W. 257 (1930), *aff'd on rehearing*, 204 Wis. 12, 235 N.W. 413 (1931).

ance Company[82] and *Crisci v. Security Insurance Company,*[83] the courts have broadened the requirement of good faith by holding the insurer to (1) give at least as much consideration to the interests of the insured as it gives to its own, and (2) exercise reasonable judgment, taking into account all of the circumstances known or that reasonably should be known, in paying off or settling a claim by its insured.[84]

A true fiduciary must refrain from a consideration of *all* self interests which would place those interests over that of his principal.[85] By requiring the insurance company to act reasonably and in good faith to settle claims against the insured by a third person, the court in *Crisci* is in fact treating the insurer as a *quasi-fiduciary* of the insured. The standard of conduct to which Security Insurance was held with respect to Mrs. Crisci was sufficiently high so as not to permit injury to her interests.

At the time of *Crisci,* bad faith was determined by the state of mind of the insurer in its dealings with the insured. If it were found that the insurer attempted to avoid its contractual obligation, it was not then acting in a *quasi-fiduciary* capacity and giving equal consideration to the interests of the insured. The insurer thereby breached its implied-in-law duty, imposed as a result of the nature of the relationship. It was this duty that the court in *Fletcher* extended to disability insurers.

III

Appellant argued, in respect to its bad faith refusal to pay, that an action based thereon must sound only in contract. That argument loses significance once the *Crisci* duty of good faith and fair dealing is extended to disability insurers. The *Fletcher* court correctly made that extension. That court, however, was not content to rest its holding upon an intentional infliction of emotional distress ground. Consistent with its definition of the extra-contractual duty owed, it proceeded to an alternative holding. It sought to achieve its objectives by creating a new right of action in tort.

The duty of Western National to act in good faith and deal fairly with Mr. Fletcher being established, the court made an application of it to the insurer's conduct and found that this duty was breached:

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82 50 Cal. 2d 654, 328 P.2d 198 (1958).

83 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

84 For a full discussion of the "reasonableness" requirements, *see* Davy v. Public Nat'l Ins. Co., 181 Cal. App. 2d 387, 5 Cal. Rptr. 488 (1960).

This standard of due care is gradually moving in the direction of tort law. *See* Radcliffe v. Franklin Nat'l Ins. Co., 208 Ore. 1, 298 P.2d 1002 (1956). The court also indicated that agency law could control if the insurer were regarded as either an agent or a fiduciary of the insured.

85 RESTATEMENT (SECOND) OF AGENCY §§ 387 and 393, and comments b & d (1958).

> [S]uch conduct[86] on the part of a disability insurer constitutes a *tortious* interference with a protected property interest[87] of its insured for which damages may be recovered . . . for all detriment proximately resulting therefrom, including economic loss as well as emotional distress resulting from the conduct or from the economic losses caused by the conduct . . . . (emphasis added)[88]

By holding that the insurer's conduct was in essence a tortious interference which "resulted, and could be expected to result in both economic loss and emotional distress",[89] the court, under the guise of a "new tort", a bad faith refusal to perform one's own contractual obligation, can be said to have extended the traditional measures of contract recovery.

Unfortunately, the *Fletcher* court has omitted a cause in fact application of this new tort to the given facts, although as has been demonstrated, causation could have been established. In lieu of an adequate discussion of the causal connection between Fletcher's harm and Western's conduct, the court has redefined the nature of the duty owed by a disability insurer to its insured for the following reasons: (1) From a policy standpoint, there are at least two advantages. First, others in a quasi-public enterprise in the public interest should be deterred from refusing to perform their contractual obligations in bad faith. It would be unconscionable to allow insurance companies to get by with merely paying the benefits due under the original policy of insurance while they engaged in this malicious and "bad faith" conduct.[90] Second, the new tort would engender public respect and confidence in the judicial process by permitting recovery of all proximately caused damages in a single cause of action;[91] (2) The court was reluctant to extend the holding in *Crisci*[92] (wherein the breach by the insurance company was considered both in contract and in tort) so as to find damages for mental suffering based solely on contract recoverable. By holding in tort, this extension of *Crisci* is tautly avoided; (3) Exemplary damages, which seek to deter bad faith and malicious conduct, are not recoverable in an action based on a contractual obligation, even if the

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86 "Such conduct" refers to the insurer's actions in embarking on a concerted course of activities to induce Fletcher to surrender his policy or enter into a disadvantageous "settlement" of a non-existent dispute by means of false and threatening letters and the employment of economic pressure based around Fletcher's disabled condition. This was brought about by Western National's malicious and bad faith refusal to pay Fletcher's legitimate claim, 10 Cal. App. 3d at 392, 89 Cal. Rptr. at 87.

87 "Contract rights are property, and as such are entitled to the protection of the law. . . ." Second Nat'l Bank v. Samuel & Sons, 12 F.2d 963, 967 (2d Cir. 1926).

88 10 Cal. App. 3d at 401-02, 89 Cal. Rptr. at 93-94.

89 *Id.* at 402, 89 Cal. Rptr. at 94.

90 An insurer who acts maliciously in refusing to perform his contract with its insured would run no risk of liability to this insured beyond that of paying what it was already obligated to pay, that is, its contractual obligation. Therefore, punitive damages are proper here as a deterrent. Restitution would have little or no deterrent effect.

91 *Id.*

92 Crisci v. Security Ins. Co., 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

breach is wilful and malicious.[93] They are recoverable when an action sounds in tort. These exemplary damages may be recoverable on a proper showing of malice, fraud, or oppression, even though the tort incidentally involves a breach of contract.[94] By recognizing these limitations of damage recovery in contract, the *Fletcher* court sought to apply a broader measure of damages to the given facts; (4) When a case sounds in tort, California Insurance Code section 10111 does not restrict recovery to the amounts due under the policy;[95] and (5) The court exhibited a compassionate feeling for the plight of Mr. Fletcher while, at the same time, expressing vehement outrage at the despicable conduct of insurer Western National.

The new tort enunciated in *Fletcher* protects dual interests: Freedom from emotional distress and freedom from economic losses as a consequence of a breach of contract.[96] The rationale behind this consolidation is that this new tort will square with the economic, social, and legal realities of the problem presented.

An acceptance of this extension may be said to, in fact, accede to a merger of tort and contract. Thus, the holding in *Fletcher* would then square with the attitude of Justice Finley of the Washington Supreme Court, who, in a recent dissenting opinion, stated:

> The actual damage to [a plaintiff] . . . is the same whether the cause of action be characterized as one sounding in tort or contract. To make the amount of . . . recovery differ, depending on the characterization of her action as tort or contract, is simply to pay homage to the ghost of the common law forms of action and thereby allow them to "rule us from their graves".[97]

There can be no doubt that the Court of Appeal's decision in *Fletcher* extended the law in tort. The effect of its decision was to merge a cause of action in contract into a tort action where one party in bad faith refuses to perform its contractual obligations. Can it be said that the court intended this merger to apply to non-insurance contracts in which one party, in bad faith, refuses to perform? If so, it appears that any bad faith breach of contract would be a tort, with damages recoverable for all detriment suffered by the injured party, whether anticipated or not. This would then comprehend mental suffering which included: nervousness, grief, anxiety, worry, shock, humiliation, indignity, and physical in-

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93 CAL. CIV. CODE § 3294 (West 1970).

94 CAL. CIV. CODE § 3294 (West 1970); Wetherbee v. United Ins. Co. of America, 265 Cal. App. 2d 921, 71 Cal. Rptr. 764 (1968).

95 Wetherbee v. United Ins. Co. of America, 265 Cal. App. 2d 921, 927-29, 71 Cal. Rptr. 764, 767-69 (1968).

96 Note that this recovery for economic losses differs from the recovery for same in tort. In tort, the economic losses must flow from a wrong to the individual or his property whereas in contract, the losses may result solely from a breach of an enforcible agreement.

97 Carpenter v. Moore, 51 Wash. 2d 795, 809, 322 P.2d 125, 133 (1958) (dissenting opinion).

juries and pains, provided that they naturally ensue and are proximately caused by the wrongful act.[98] Factual situations such as *Browning v. Fies*,[99] *Westervelt v. McCullough*,[100] and *Chelini v. Nieri*[101] involve purely personal and non-commercial contracts, where the parties are not multi-million dollar conglomerates such as insurance companies, but rather individual members of the community. Parties in situations such as these would be subjected to potential liability in tort which neither of them contemplated when entering into the contract nor would ever be likely to pay in the event of a breach. If *Fletcher* were so extended, ordinary citizens would be discouraged from entering into contractual arrangements with each other. The sanctity and stability of contract would be gone forever.

Unfortunate dicta in *Fletcher* aside,[102] a further extension to non-insurance contracts is highly unlikely. As has been shown, the basis of the *Fletcher* holding is the "special" extra-contractual duty which is unique to insurance contracts. That "special duty" being absent in non-insurance contracts, an extension of *Fletcher* to them is unwarranted.

The holding in *Fletcher* also has widespread consequences to the insurance industry as well as to the insurance buying public. By extending the *Comunale v. Traders & General Insurance Company*[103] and *Crisci v. Security*

98 *See* CAL. CIV. CODE § 3333 (West 1970).

99 4 Ala. App. 580, 58 So. 931 (1912).

100 68 Cal. App. 198, 228 P. 734 (1924).

101 32 Cal. 2d 480, 196 P.2d 915 (1948).

102 Brief mention should be made of the court's analogy to the tort of intentional interference with contractual relations. The court reasons that if a third party would have acted toward Fletcher as did Western National, that person would be equally as guilty of tortious conduct as was Western and would thereby be held responsible to Fletcher for all damages proximately caused thereby, and in the proper case, punitive damages. 10 Cal. App. 3d at 403, 89 Cal. Rptr. at 94. Though it may be more important to protect contracting parties against invasions from the outside, an argument may be made for extending this protection to the parties to the contract, especially where the contract calls for a "special duty" from one party toward the other.

An attack on this argument can be made with regard to the *Fletcher* facts. It is recognized in most jurisdictions today that an action in tort for damages will be allowed against a defendant who has unjustly induced a third person to breach a contract with a plaintiff (the cases are collected in Annot., 84 A.L.R. 43 (1933) and in Annot., 26 A.L.R.2d 1227 (1952)) or who has otherwise interfered with the contractual relationships of others. *See generally* Carpenter, *Interference with Contract Relations*, 41 HARV. L. REV. 728, 731-32 (1928); Note, *Tortious Interference with Contractual Relations*, 31 HARV. L. REV. 1017 (1918) and cases cited therein. An action for interference has never been extended to a party to the contract, *see e.g.*, Hein v. Chrysler Corp., 45 Wash. 2d 586, 277 P.2d 708 (1954). If the *Fletcher* court's reasoning were logically extended, then every party who would breach his contract with another would be liable, not only for his breach (in an action on the contract) but would also be held for intentionally interfering with a contractual relation and be subject to exorbitant liability in damages. This is surely not what the court was driving at by making their analogy.

103 50 Cal. 2d 654, 328 P.2d 198 (1958).

Insurance Company[104] decisions, all insurers now have an implied-in-law duty of "good faith and fair dealing" with respect to their insureds. There is now no distinction whether their dealings with the insured regard payments to him or to an outside third party. This good faith requirement imposes upon all insurers a duty to give their policy holder's interests at least as much consideration as it gives to its own. And, of course, a "new tort" is only as expansive as the duty which underlies it.

Spencer Daniel Proffer

104 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).