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# Silberg v. California Life Insurance Company: A New Dimension in the Tort of Insurer Bad Faith?

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# Silberg v. California Life Insurance Company: A New Dimension In The Tort Of Insurer Bad Faith?

The past eight years have seen the birth and development of an explosive new tort in California law involving insurance companies that fail to deal fairly and in good faith with their insureds. Since this "bad faith tort" was first announced in *Crisci v. Security Insurance Co.*[1] it has been applied to two types of insurance claims situations: *Crisci* applied it to liability insurers that fail to settle third-party claims against their policyholders; in 1973 the California Supreme Court, in *Gruenberg v. Aetna Insurance Co.*,[2] extended bad faith tort liability to insurers that refuse to pay the direct claims of their insureds. The expansive character of this tort was underscored in the more recent case of *Silberg v. California Life Insurance Co.*,[3] which held a health care insurer liable largely for its bad faith failure to honor a promise contained in the policy application. This aspect of the *Silberg* decision seems to foreshadow an entirely new dimension of the bad faith tort. In addition, the decision raised several new issues concerning insurer liability, but provided few practical criteria to define what appears to be a more expansive concept of liability. In light of these developments, this comment sets forth possible rationales supporting *Silberg's* expanded concept of insurer bad faith and pursues an analysis of statutory and judicial criteria which the courts may apply in clarifying and qualifying insurer liability in the context of direct claims of insureds.

## The Origins and Evolution of Insurer Bad Faith Tort Liability

### *A. Bad Faith in the Context of Third-Party Claims*

The *Crisci* case, which first established insurer *tort* liability for bad faith, was preceded by a wealth of decisions which grappled with the *contractual* liability of insurers for bad faith failure to settle claims

1. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).
2. 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).
3. 11 Cal. 3d 452, 521 P.2d 1103, 113 Cal. Rptr. 711 (1974).

against their insureds.[4] Many of the principles which evolved in these earlier cases were borrowed by *Crisci* when tort liability was first imposed.[5] To understand *Crisci*, and to gain some perspective on its counterpart in the area of direct claims of insureds ("first-party claims"), a brief overview of the decisions dealing with contractual liability for third-party claims is necessary.

Beginning with *Hilker v. Western Auto Insurance Co.*,[6] courts held that liability insurers faced with claims against their insureds must act in accordance with an obligation of good faith and fair dealing, implied in every contract, when deciding whether to settle within the policy limits. Insurers who breached this convenant by their bad faith refusal to accept such settlements were held liable in contract for the full amount of judgments against their insureds in excess of the policy limits.[7] To ascertain whether the insurer had acted in bad faith, which, quipped one writer, was "somewhat like asking what constitutes sin,"[8] the California courts established the following guidelines: (1) In considering a settlement offer, the insurer must act as though there were no policy limits;[9] (2) the insurer must give at least as much consideration to the interests of the insured as it does to its own interests;[10] (3) the insurer should keep the insured informed as to settlement negotiations;[11] (4) the insurer should investigate the claim or seek legal advice, and avoid seeking a settlement contribution from the insured;[12] and (5) the insurer should consider the strength of the claimant's case against the insured.[13]

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4. *E.g.*, Palmer v. Financial Indem. Co., 215 Cal. App. 2d 419, 30 Cal. Rptr. 204 (1963); Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 319 P.2d 69 (1957). *See also* Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136 (1954).

5. 66 Cal. 2d 425, 429-30, 426 P.2d 173, 176-77, 58 Cal. Rptr. 13, 16-17 (1967).

6. 204 Wis. 1, 231 N.W. 257 (1930).

7. *E.g.*, Communale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 659, 328 P.2d 198, 200 (1958); Critz v. Farmers Ins. Group, 230 Cal. App. 2d 788, 793-94, 41 Cal. Rptr. 401, 403-04 (1964); Martin v. Hartford Acc. & Indem. Co., 228 Cal. App. 2d 178, 182, 39 Cal. Rptr. 342, 345 (1964); Hilker v. Western Auto. Ins. Co., 204 Wis. 1, 8, 231 N.W. 257, 260 (1930).

8. Wymore, *Safeguarding Against Claims in Excess of Policy Limits*, 28 INS. COUNSEL J. 44, 44 (1961).

9. Kinder v. Western Pioneer Ins. Co., 231 Cal. App. 2d 894, 900, 42 Cal. Rptr. 394, 398 (1965); Ivy v. Pacific Auto. Ins. Co., 156 Cal. App. 2d 652, 659, 320 P.2d 140, 146 (1958).

10. Communale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 659, 328 P.2d 198, 201 (1958); Lysick v. Walcom, 258 Cal. App. 2d 136, 148, 65 Cal. Rptr. 406, 414-15 (1968); Ivy v. Pacific Auto. Ins. Co., 156 Cal. App. 2d 652, 660, 320 P.2d 140, 146 (1958).

11. Kinder v. Western Pioneer Ins. Co., 231 Cal. App. 2d 894, 901, 42 Cal. Rptr. 394, 398 (1965); *cf.* Palmer v. Financial Indem. Co., 215 Cal. App. 2d 419, 30 Cal. Rptr. 204 (1963).

12. Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 689, 319 P.2d 69, 75 (1957).

13. *See id.*

Perhaps the overriding factor behind this development of bad faith liability is the special character courts attribute to the insurance contract, under which insurers are held to broader legal responsibilities than are parties to purely private contracts.[14] In this respect, the California Supreme Court went so far as to emphasize in *Communale v. Traders & General Insurance Co.*[15] that even if the express terms of the policy do not require settlement, the implied obligation of good faith and fair dealing imposes a duty on the insurer to settle in appropriate cases. While the *Communale* court ostensibly permitted the insured to recover judgment against the insurer in contract, the court suggested that bad faith failure to settle might be treated as a breach of contract or as a *tort*.[16]

In the landmark case of *Crisci v. Security Insurance Co.*,[17] the California Supreme Court adopted the reasoning of *Communale* and for the first time imposed *tort* liability on an insurer for its bad faith refusal to settle a third-party claim against its insured. The court declared that liability was imposed "not for a bad faith breach of the contract but for failure to meet the *duty* to accept reasonable settlements, a duty included within the implied covenant of good faith and fair dealing."[18] In determining the existence of insurer bad faith the court considered whether "a prudent insurer without policy limits would have accepted the settlement offer."[19] The significance of the independent remedy in tort was that it allowed recovery by the insured of punitive damages and damages for emotional distress which otherwise would have been barred in contract.[20] The court emphasized that the newly conceived bad faith tort was designed to protect the insured's interest in peace of mind and security under a policy of liability insurance.[21]

### *B. Bad Faith in the Handling of Direct Claims of the Insured*

Soon after *Crisci* was decided, the California Supreme Court, in *Reichert v. General Insurance Co.*,[22] refused to extend an insurer's liability for bad faith to a case in which a *direct* claim of the insured was arbitrarily denied. The *Reichert* decision, together with the special agency relationship said to exist between a liability insurer and its

14. Stark v. Pioneer Cas. Co., 139 Cal. App. 577, 580, 34 P.2d 731, 732 (1934).
15. 50 Cal. 2d 654, 659, 328 P.2d 198, 201 (1958).
16. *Id.* at 663, 328 P.2d at 203.
17. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).
18. *Id.* at 430, 426 P.2d at 177, 58 Cal. Rptr. at 17 (emphasis added).
19. *Id.* at 429, 426 P.2d at 176, 58 Cal. Rptr. at 16.
20. *See id.* at 434, 426 P.2d at 179, 58 Cal. Rptr. at 19.
21. *Id.*
22. 68 Cal. 2d 822, 442 P.2d 377, 69 Cal. Rptr. 321 (1968).

insured when the insurer deals with third-party claimants,[23] may have fostered an assumption that *Crisci's* tort principles would be limited to the context of third-party claims. Nevertheless, three years after *Crisci* was decided, a California court of appeal announced in *Fletcher v. Western National Life Insurance Co.*[24] that the principles applied in *Crisci* should be extended to insurers handling the direct claims of their insureds. While the court in *Fletcher* held that the defendant was liable on grounds of intentional infliction of emotional distress, it also proceeded to an "alternate holding."[25] The court explained that a new tort action, allowing recovery of economic losses for breach of contract *and* damages for emotional distress, could be maintained against the insurer for its bad faith withholding of disability benefits.[26] This new tort action, the court explained, "square[d] with the economic, social and legal realities of the problem presented," in that it allowed recovery for all proximately caused detriment in a single cause of action, comported with the quasi-public nature of the insurance industry, and guarded the peculiarly vulnerable insured against the oppressive tactics of the economically powerful insurance industry.[27] The standard for this bad faith tort liability was framed in terms of the vexatious tactics which gave rise to the emotional distress action. Thus, an insurer would be held liable when payments were withheld "*maliciously* and *without probable cause, for the purpose of injuring* its insured by depriving him of the benefits of the policy."[28]

A second California appellate court decision, *Richardson v. Employers Liability Assurance Corp.*,[29] purported to adopt the principles embodied in *Crisci* and *Fletcher* in imposing tort liability on an automobile insurer who handled an uninsured motorist claim in the following manner:

> [1] Employers [the insurer] *deliberately, willfully and in bad faith* withheld payment of the Richardson claim months after it knew the claim to be completely valid; [2] it forced an arbitration hearing on a claim against which it already knew that it had no defense; [3] even after the award was made it instructed its local office to attempt "to make the best possible settlement," and [4] forced plaintiffs to resort to litigation to have the award judicially confirmed.[30]

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23. Comment, *Contracting for Punitive Damages: Fletcher v. Western National Life Insurance Company*, 4 LOY. L.A.L. REV. 208, 224 (1971).
24. 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).
25. *Id.* at 401-02, 89 Cal. Rptr. at 93-94.
26. *Id.*
27. *Id.* at 403-04, 89 Cal. Rptr. at 95.
28. *Id.* at 401, 89 Cal. Rptr. at 93 (emphasis added).
29. 25 Cal. App. 3d 232, 102 Cal. Rptr. 547 (1972).
30. *Id.* at 239, 102 Cal. Rptr. at 552 (emphasis added).

The court characterized this conduct as a "tortious breach of contract" insofar as the insurer had breached its implied-in-law duty of good faith and fair dealing in handling the insured's claim.[31] *Richardson* thus became the first California case to base tort recovery by a first-party claimant solely on the bad faith rationale.

Finally, in *Gruenberg v. Aetna Insurance Co.*,[32] the California Supreme Court voiced its approval of the theory of tortious liability espoused in *Fletcher* and *Richardson* and attempted to clarify the principles upon which it was based. The court emphasized that tort liability for failure to settle third-party claims or pay first-party claims follows from the breach of the implied duty of good faith and fair dealing common to both types of insurance claims.[33] In the context of the first-party claim, this implied duty imposes on an insurer the obligation not to withhold policy payments *without proper cause*[34] or *unreasonably and in bad faith.*[35] Pursuant to these standards, the plaintiff's allegations in *Gruenberg* that the insurer had "wilfully and maliciously entered into a scheme to deprive him [the insured] of the benefits of the fire policies," though not a model pleading, stated a cause of action for bad faith.[36] Under these same standards, damages for proximately caused mental distress were held to be recoverable regardless of whether the distress was "severe."[37] *Gruenberg* thus affirmed the fact that insurer bad faith presents a cause of action in tort distinct from an action for intentional infliction of emotional distress.[38]

Even after the decisions in *Fletcher*, *Richardson*, and *Gruenberg*, some uncertainty remained as to the type of conduct by an insurer which would give rise to bad faith tort liability in the first-party context.[39] The rather vague test enunciated in *Gruenberg* provided little guidance. Two commentators, after synthesizing the language and theory of the three decisions, suggested that a form of willful misconduct was required in order to state a cause of action based upon bad

31. *Id.*
32. 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).
33. *Id.* at 573, 510 P.2d at 1037, 108 Cal. Rptr. at 485.
34. *Id.* at 574, 510 P.2d at 1037, 108 Cal. Rptr. at 485.
35. *Id.* at 575, 510 P.2d at 1038, 108 Cal. Rptr. at 486.
36. *Id.*
37. *Id.* at 580, 510 P.2d at 1042, 108 Cal. Rptr. at 490. Two commentators have suggested that the allegation of "severe" emotional distress should be retained as an element in the bad faith action since actions for both negligent and intentional infliction of emotional distress retain such a requirement. Parks & Heil, *Insurers Beware: "Bad Faith" is in Full Bloom*, 9 FORUM 63, 71 (1973). *Gruenberg* disapproved *Richardson* insofar as it expressed a different view on this point. 9 Cal. 3d at 580 n.10, 510 P.2d at 1042 n.10, 108 Cal. Rptr. at 490 n.10.
38. 9 Cal. 3d at 580, 510 P.2d at 1041-42, 108 Cal. Rptr. at 489-90.
39. *See* Comment, *An Independent Duty of Good Faith and Fair Dealing in Insurance Contracts—Gruenberg v. Aetna Insurance Co.*, 11 SAN DIEGO L. REV. 492, 503 (1974).

faith.[40] Indeed, the facts proven in both *Fletcher*[41] and *Richardson*,[42] and those alleged in the *Gruenberg*[43] complaint, depict insurers who actively engaged in maneuvers to avoid making payment on policies under which liability was clear. In this respect, the factual setting in *Silberg v. California Life Insurance Co.*[44] presents a striking contrast.

### Silberg v. California Life Insurance Co.

The facts in *Silberg* constitute a classic illustration of the disastrous consequences which may befall an insured following a disability insurer's decision to withhold payments under the policy. The plaintiff, Silberg, had taken out a hospital care policy with the defendant, California Life, which provided for the payment of hospital costs of up to $5,000 in the event of injury or sickness, but excluded any loss caused by an injury covered by workers' compensation. On July 17, 1966, Silberg seriously injured his right foot while performing incidental services in his landlord's laundromat. He was hospitalized the same day and underwent surgery. Although notice of the injury and claim forms were immediately forwarded to the insurer, it failed to respond until the following November, at which time Silberg was informed that all payments would be withheld pending resolution of his workers' compensation claim.[45] As this claim was not settled until April 1968, Silberg was without any compensation for his medical expenses for almost two years.[46] Meanwhile, in order to secure necessary treatment without the insurance benefits, Silberg visited two other hospitals. In one case he was denied admission until he paid $500 of his prior bill, and in another case he had to resort to deception to obtain surgery. As Silberg's hospital costs mounted, so did his personal misfortunes. His unpaid medical bills established him as a credit risk, barring him from securing any business loans. As a result, he lost his dry cleaning business and suffered five evictions for failure to meet his monthly rent. His wheelchair was repossessed, and he was often un-

40. Parks & Heil, *Insurers Beware: "Bad Faith" is in Full Bloom*, 9 Forum 63, 67 (1973). These authors suggested that the elements of a cause of action based on bad faith exist when (1) the insurer had no reasonable basis for denying the claim of the insured and (2) with knowledge or in reckless disregard of this fact, the insurer denied the insured his policy benefits. *Id.* at 67-68.

41. 10 Cal. App. 3d at 386-94, 89 Cal. Rptr. at 83-88.

42. 25 Cal. App. 3d at 237-39, 102 Cal. Rptr. at 550-52.

43. 9 Cal. 3d at 569-72, 510 P.2d at 1034-35, 108 Cal. Rptr. at 482-83.

44. 11 Cal. 3d 452, 521 P.2d 1103, 113 Cal. Rptr. 711 (1974).

45. This decision followed defendant's discovery that the workers' compensation carrier had denied coverage and that the matter would not be heard on appeal for several months. *Id.* at 458, 521 P.2d at 1107, 113 Cal. Rptr. at 715.

46. Silberg's medical expenses were $6,900, and the workers' compensation carrier settled for $3,700. *Id.* at 456, 521 P.2d at 1105, 113 Cal. Rptr. at 713.

able to afford medication to ease his constant pain. Silberg utlimately suffered two nervous breakdowns provoked by his concern over the unpaid medical bills.[47]

In April 1968, the Workmen's Compensation Appeals Board resolved Silberg's claim through compromise and release. This action was taken due to conflicting evidence as to whether the injury occurred in the course of employment.[48] Consequently, no formal findings of coverage were ever made. The insurer interpreted this compromise as constituting payment under workers' compensation law and for this reason denied all liability under the policy.[49]

Following the insurer's denial of liability, Silberg initiated suit on the policy. His first cause of action, seeking a declaratory judgment as to coverage under the policy, resulted in a jury finding that the policy was ambiguous[50] and hence obligated the insurer to pay the full amount provided in the insurance contract. Plaintiff's second cause of action sought recovery for economic losses and physical and mental suffering, and alleged that the defendant was guilty of fraud, bad faith, and malicious and oppressive conduct.[51] On this count the jury awarded Silberg $75,000 compensatory and $500,000 punitive damages. Following judgment on the verdict, however, the trial judge, on defendant's motion, ordered a new trial on the basis that the evidence was insufficient to support a finding of bad faith.[52]

The plaintiff appealed the award of a new trial to the California Supreme Court. When faced with this unique set of facts, the court ruled that *as a matter of law* the insurer had breached its duty of good faith and fair dealing and was liable in tort for the physical and mental suf-

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47. *Id.* at 456-59, 521 P.2d at 1106-08, 113 Cal. Rptr. at 714-16.
48. *Id.* at 458, 521 P.2d at 1107, 113 Cal. Rptr. at 715.
49. *Id.*
50. A conflict between the insuring clause and the exclusionary clause in the policy gave rise to two reasonable interpretations of the policy: (1) that the insurer was not liable at all if the insured received any benefits, or (2) that the insurer was still liable for any hospital expenses not covered by workers' compensation. Applying the time-honored rule of construction which favors the insured in cases in which the interpretation of an insurance policy is in doubt, the court chose the latter alternative. *Id.* at 463-64, 521 P.2d at 110-11, 113 Cal. Rptr. at 718-19.
51. *Id.* at 456, 521 P.2d at 1106, 113 Cal. Rptr. at 714.
52. The evidence was insufficient to support the verdict. . . .

> There was no evidence that at the time the policy was issued the defendant knew or should have known how a court would rule on this set of facts or that they made any misrepresentation to him on which he relied. In researching the case neither counsel nor the Court found any case specifically on point that they would have been on notice of at the time of the issuance of the policy.
>
> Similarly there was insufficient evidence of any custom or usage in the industry at that time to justify any such finding or to impose any duty on the defendant to pay the proceeds of its policy and then assert a lien claim.

*Id.* at 460 n.3, 521 P.2d at 1108 n.3, 113 Cal. Rptr. at 716 n.3 (citing the order of the trial judge in granting a new trial).

fering occasioned the insured.[53] In spite of the fact that neither customary insurance practice nor the policy imposed a clear duty on the insurer to make payment while the workers' compensation award was unresolved,[54] the court found that delaying payment in these circumstances was "unreasonable and in bad faith" under *Gruenberg*.[55] The court's finding of bad faith was based largely on its determination that the insurer, in delaying payment of the claim, had failed to vindicate an *express promise* contained in the policy application.[56] That "promise" read, "Protect Yourself Against the Medical Bills That Can Ruin You." In the court's view, the insurer had warranted against the very ruination which its delay wreaked upon the insured.[57] As a "reasonable" alternative to delaying payment and facing potential liability, the court suggested that the insurer could have promptly paid the medical charges and later recouped the excess payments by asserting a lien on any forthcoming workers' compensation award.[58]

## Possible Rationales for a New Dimension in Tort Liability

If, as has been suggested, the existence of insurer bad faith is to be ascertained by analyzing the "totality of the circumstances" when a claim is made on the policy,[59] then it might be said that an insurer's failure to vindicate a precontractual promise or pledge is simply another element to consider in evaluating the insurer's conduct. Language in the *Silberg* opinion suggests, however, that the court eschewed such an approach and instead characterized the insurer's

53. *Id.* at 460, 521 P.2d at 1108, 113 Cal. Rptr. at 716. The case was remanded for retrial on the issue of punitive damages since the supreme court refused to equate bad faith conduct, as a matter of law, with the intent to injure requisite to an award of punitive damages. *Id.* at 463, 521 P.2d at 1110, 113 Cal. Rptr. at 718. One commentator views the *Silberg* decision as the forerunner to a more restrictive approach to punitive damages. Levit, *California Supreme Court Holds Insurer Guilty of Bad Faith But Denies Punitive Damages*, 1974 Ins. L.J. 321, 326.

54. 11 Cal. 3d at 460 n.3, 521 P.2d at 1108 n.3, 113 Cal. Rptr. at 716 n.3. The court refused to allow the insurer to defend on the basis that his conduct in withholding payment on the policy was not contrary to established practice in the industry. *Id.* at 462, 521 P.2d at 1109, 113 Cal. Rptr. at 717.

55. *Id.* at 461, 521 P.2d at 1109, 113 Cal. Rptr. at 717.

56. *Id.*

57. *Id.*

58. *Id.* An insurer might understandably be reluctant to make immediate payment under a policy similar to Silberg's where there is more certainty as to the insured's entitlement to workers' compensation, since in such cases entitlement to a lien claim on the workers' compensation award would be doubtful. *See* Foremost Dairies v. Industrial Acc. Comm'n, 237 Cal. App. 2d 560, 579, 47 Cal. Rptr. 173, 186 (1965).

59. Comment, *Good Faith and Fair Dealing in Insurance Contracts: Gruenberg v. v. Aetna Insurance Co.*, 25 Hast. L.J. 699, 712 (1974). A recent third-party bad faith case declares it to be axiomatic that the issue of an insurer's bad faith is a jury question. Johansen v. California State Auto. Ass'n, etc., Bureau, 41 Cal. App. 3d 974, 983, 116 Cal. Rptr. 546, 551 (1974).

failure to vindicate its precontractual promise as *patent* bad faith.[60] In any case, the *Silberg* court's emphasis on the promissory aspect of the insurer's conduct raises the possibility of a drastic expansion of insurer tort liability beyond the immediate contractual boundaries of the insurer-insured relationship. The extent of such an expansion, and the precise effect which precontractual promises may have on the insurer's standard of conduct, may depend upon the theoretical justification the courts articulate as the basis for this new dimension of bad faith liability (herein denominated "promissory bad faith"). Two potential justifications are examined below.

### *A. Wetherbee Fraud*

An insurer's breach of its precontractual promise, determined in *Silberg* to be actionable, could be characterized as a form of fraud. An instructive parallel to *Silberg* in this respect is *Wetherbee v. United Insurance Co. of America*,[61] decided by a California court of appeal soon after *Crisci* but before *Fletcher*. *Wetherbee* arose as a fraud action brought by an insured against her insurer. Assurances by the insurer that its policy awarded lifetime benefits for sickness or injury and could not be terminated in cases of disability induced plaintiff to renew her policy with the defendant. Subsequently, the plaintiff suffered a stroke, and monthly payments were made under the disability provision of the policy, though the checks were often late. Over a year later, however, following carefully worded inquiries made to the insured's doctor, the insurer stopped all payments on the ground that because plaintiff went regularly to the doctor's office for treatment, her disability was not "confining" within the general coverage of the policy. This action was taken in spite of a provision in the policy which expressly permitted recovery in cases where, as here, the insured visited a doctor for treatment which could not be administered in the home.[62]

In affirming a verdict of fraud the *Wetherbee* court declared that the character of the fraud was not so much a misrepresentation of the

60. 11 Cal. 3d at 462, 521 P.2d at 1106-07, 113 Cal. Rptr. at 717. The following facts in *Silberg* might have been used by the court to support its finding of bad faith: (1) The insurer failed to contact Silberg for several months after the claim was first made, and after several hospital bills had accrued; (2) the insurer made a collateral investigation to determine if the insured had made any misrepresentations as to his health on the policy application (to support a rescission of the contract); and (3) an offer to settle Silberg's claim for $200 was made by the insurer once the workers' compensation claim was settled by compromise and release. *Id.* at 457-58, 521 P.2d at 706-07, 113 Cal. Rptr. at 714-15.

61. 265 Cal. App. 2d 921, 71 Cal. Rptr. 764 (1968).

62. *Id.* at 925-27, 71 Cal. Rptr. at 766-67.

terms of the policy as it was a misrepresentation of the willingness of the insurer to live up to those terms.[63] The insurer's conduct following the insured's submission of her claim was viewed as indicative of an earlier intent to defraud:

> [I]t is obvious that the defendant's eagerness to seize upon the admission by plaintiff's doctor as a ground for cancellation of plaintiff's benefits furnishes ample support for a finding that it never intended to fulfill either . . . [its prior] representations . . . or the terms of the [policy].[64]

By inferring precontractual intent to defraud from post-contractual conduct, the *Wetherbee* court greatly reduced the difficulty which the insured would otherwise have confronted in attempting to prove fraud. With the development of the first-party bad faith action, the necessity for employing such a rationale may be questioned, but the reasoning still appears to be sound. In fact, the opinion was reaffirmed following the *Fletcher* decision, when the case came up on appeal from a retrial on the issue of punitive damages.[65] The second *Wetherbee* opinion provided further support for the earlier decision by declaring that a fraud recovery of this sort serves to protect the unwary consumer from unscrupulous insurance salesmen where the bargaining power of the parties is considerably disparate.[66]

It may be argued that *Wetherbee* fraud and promissory bad faith are but opposite sides of the same coin. In both instances the propriety of the later claims-handling conduct of the insurer is viewed with reference to the policy and precontractual representations. Since fraud has been found to be indicative of bad faith,[67] conduct by an insurer which would support a *Wetherbee* fraud action might also give rise to an action for promissory bad faith.

Examining the facts in *Silberg* in this light, it could be said that the insurer misrepresented its "willingness" to fulfill its precontractual promise and was thus guilty of a form of fraud under the *Wetherbee* rationale. The insurer promised to pay medical benefits to Silberg to protect him from "ruination."[68] However, the insurer later took the position that it was entitled to delay payment on the policy until work-

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63. *Id.* at 932, 71 Cal. Rptr. at 770.
64. *Id.* at 932, 71 Cal. Rptr. at 770-71.
65. Wetherbee v. United Ins. Co. of America, 18 Cal. App. 3d 266, 95 Cal. Rptr. 678 (1971).
66. *Id.* at 271, 95 Cal. Rptr. at 681.
67. "Bad faith implies dishonesty, fraud and concealment." Davy v. Public Nat'l Ins. Co., 181 Cal. App. 2d 387, 396, 5 Cal. Rptr. 488, 492-93 (1960); *accord,* Palmer v. Financial Indem. Co., 215 Cal. App. 2d 419, 429, 30 Cal. Rptr. 204, 208 (1963).
68. 11 Cal. 3d at 461, 521 P.2d at 1109, 113 Cal. Rptr. at 717.

ers' compensation proceedings were concluded.[69] This stance was maintained in spite of the fact that the medical bills incurred by the insured were in fact causing his ultimate ruination.[70] By *Wetherbee* standards this course of conduct might indicate that the insurer never intended to fulfill its promise contained in the policy application and thus a *Wetherbee* fraud action would lie.

Arguably, had the *Silberg* court's finding of bad faith been equivalent to a finding of fraud as a matter of law, then punitive damages should have been allowed.[71] The court, however, refused to hold that punitive damages were available as a matter of law.[72] One explanation for this result is that the court viewed the conduct of the insurer as fraudulent for the purposes of proving a case of bad faith, but insufficiently aggravated in character to establish the right to punitive damages. Another explanation is that the court effected a trade-off: in allowing the insured an inference of precontractual intent to defraud from such a showing of post-contractual conduct under *Wetherbee*, the court concomitantly denied the insured the right to punitive damages. Admittedly these explanations, if correct, would constitute a new approach to fraud and punitive damages.[73]

### *B. Fulfilling the Reasonable Expectations of the Insured*

As an alternative to its characterization as a form of fraud, promissory bad faith might be explained as an expansion of the judicial doctrine which holds an insurer accountable for the reasonable expectations of its insured.[74] Courts have long viewed the insurance industry as quasi-public in character[75] and have treated the insurance contract as one of adhesion.[76] In actions sounding in contract, courts have

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69. *Id.* at 458, 521 P.2d at 1107, 113 Cal. Rptr. at 715.

70. Silberg had no other hospital insurance, earned only a modest income, and was incurring large medical bills without the immediate benefit of workers' compensation. *Id.* at 461, 521 P.2d at 1109, 113 Cal. Rptr. at 717.

71. *See* Horn v. Guaranty Chevrolet Motors, 270 Cal. App. 2d 477, 484, 75 Cal. Rptr. 871, 875-76 (1969).

72. 11 Cal. 3d at 462, 521 P.2d at 1110, 113 Cal. Rptr. at 718. See note 53 *supra*.

73. Fraud alone is a sufficient basis for punitive damages. *E.g.*, Horn v. Guaranty Chevrolet Motors, 270 Cal. App. 2d 477, 484, 75 Cal. Rptr. 871, 875-76 (1969); *cf.* Levitt, *California Supreme Court Holds Insurer Guilty of Bad Faith But Denies Punitive Damages*, 1974 INS. L.J. 321, 326.

74. *See, e.g.*, Barrera v. State Farm Mut. Auto. Ins. Co., 71 Cal. 2d 659, 669, 456 P.2d 674, 682, 79 Cal. Rptr. 106, 114 (1969).

75. *E.g.*, Barrera v. State Farm Mut. Auto. Ins. Co., 71 Cal. 2d 659, 668 n.5, 456 P.2d 674, 680 n.5, 79 Cal. Rptr. 106, 112 n.5 (1969); Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 270, 419 P.2d 168, 172, 54 Cal. Rptr. 104, 107 (1966); Bekin v. Equitable Life Assur. Soc., 70 N.D. 122, 138, 293 N.W. 200, 210 (1940).

76. Barrera v. State Farm Mut. Auto. Ins. Co., 71 Cal. 2d 659, 669, 456 P.2d 674, 682, 79 Cal. Rptr. 106, 114 (1969); Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 269-70, 419 P.2d 168, 171-72, 54 Cal. Rptr. 104, 107-08 (1966); Terzian v. California Cas. Indem. Exch., 42 Cal. App. 3d 942, 950, 117 Cal. Rptr. 284, 290 (1974). It seems

therefore looked beyond the form of the contract, even to precontractual dealings, in determining the reasonable expectations of the insured.[77] The adhesion-contract, public-trust rationale is emphasized in *Fletcher*[78] and *Richardson*[79] and in a lengthy dissent in *Gruenberg*.[80] Furthermore, this rationale was utilized in the second *Wetherbee* opinion in support of the court's apparent expansion of the traditional fraud action.[81]

If the precontractual representation of the insurer in *Silberg* could be said to have raised the reasonable expectation of the insured that he would be paid in these particular circumstances, then the insurer would be bound to take this expectation into account in acting on a policy claim,[82] since the insurer's duty to deal fairly and in good faith would concomitantly rise with the reasonable expectations of the insured. Under this approach, the insurer could be held liable for promissory bad faith, even in cases in which liability was doubtful within the four corners of the policy,[83] unless strong justification could be shown by the insurer.[84]

It seems that the reasonable expectations theory would be more encompassing than *Wetherbee* fraud; the reasonable expectations theory

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unlikely that the bad faith tort will be extended to other contracts outside the quasi-public field of insurance. *See* Fletcher v. Western Nat'l Life Ins. Co., 10 Cal. App. 3d 376, 403-04, 89 Cal. Rptr. 78, 95 (1970); Comment, *An Independent Duty of Good Faith and Fair Dealing in Insurance Contracts—Gruenberg v. Aetna Insurance Co.*, 11 SAN DIEGO L. REV. 492, 502 (1974).

77. *See, e.g.*, Barrera v. State Farm Mut. Auto. Ins. Co., 71 Cal. 2d 659, 669, 456 P.2d 674, 682, 79 Cal. Rptr. 106, 114 (1969); *accord*, Terzian v. California Cas. Indem. Exch., 42 Cal. App. 3d 942, 950, 117 Cal. Rptr. 284, 290 (1974). "In short, the insurance company may not ignore its insured and then seek refuge in the fine print of its policy." *Id.*

78. 10 Cal. App. 3d 376, 403-04, 89 Cal. Rptr. 78, 95 (1970); *accord*, Eckenrode v. Life of America Ins. Co., 470 F.2d 1, 5 (7th Cir. 1972).

79. An insurance policy is a contract of adhesion; and, therefore, the reasonable expectations of the weaker party, the insured, must be taken into account. . . . A reasonable expectation of the insured under such protection is that his claim will be handled by the insurer promptly, fairly, and in good faith.

25 Cal. App. 3d 232, 244, 102 Cal. Rptr. 547, 555-56 (1972).

80. 9 Cal. 3d 566, 582-83, 510 P.2d 1032, 1043, 108 Cal. Rptr. 480, 491 (1973) (Roth, J., dissenting).

81. 18 Cal. App. 3d 266, 271, 95 Cal. Rptr. 678, 681 (1971). See text accompanying note 66 *supra*.

82. *See* Silberg v. California Life Ins. Co., 11 Cal. 3d at 461, 521 P.2d at 1109, 113 Cal. Rptr. at 717. *Silberg* failed to consider that there might be problems involved in introducing extrinsic evidence of precontractual representations if the insurance policy were considered to be an integrated contract. A. CORBIN, CONTRACTS §573 (1962). In the context of a *tort* action for insurer bad faith, however, even though a contractual relation must first exist, it seems particularly inappropriate to consider the parol evidence rule as a bar to the introduction of evidence of precontractual representations.

83. This would also seem to be true if promissory bad faith were to be rationalized in terms of *Wetherbee* fraud. Both rationales expand the judicial scrutiny of an insurer's conduct beyond the four corners of the policy.

84. *Silberg* intimates that in some cases justification might exist for an insurer's failure to vindicate a precontractual promise. 11 Cal. 3d at 461, 521 P.2d at 1109, 113 Cal. Rptr. at 717.

could take into account representations made beyond the immediate realm of negotiations with a potential insured, since many representations made outside this context could be said to foster reasonable expectations on the part of a prospective insured as to the performance of a particular insurer under particular types of policies.

## UNRESOLVED ISSUES IN THE WAKE OF SILBERG

### *A. Parameters for Promissory Bad Faith*

Whether promissory bad faith is characterized as a form of fraud or as a failure of the insurer to account for the reasonable expectations of the insured, this new dimension to the bad faith tort requires clarification in two broad aspects. First, *Silberg* lends scant guidance as to the kinds of promises or representations that will expose an insurer to liability on a promissory bad faith basis. Secondly, there is uncertainty as to the context in which a precontractual promise must be made and the relation it must bear to the underlying insurance policy in order for promissory bad faith liability to arise. This uncertainty is troublesome for the insurer who has advertised its services with a slogan such as "You Can Count On Us." Such a slogan may be sufficiently removed from the *Silberg* situation to insulate the insurer from liability, but *Silberg's* lack of useful criteria for distinguishing between liability and non-liability-producing precontractual promises makes this determination difficult and potentially hazardous for the insurer.

The court in *Silberg* treated the exhortation to "Protect Yourself Against Medical Bills That Can Ruin You" as equivalent to a promise to pay the insured if he were threatened with financial ruin.[85] The translation of those words into a specific obligation seems to require something of a quantum leap, and a more general representation, such as "You Can Count On Us," might not be translatable into an additional obligation of the insurer. In addition, it would appear that the relationship which the above advertising slogan would bear to later issuance of a policy would be more tenuous than that involved in *Silberg*, in which the precontractual representation appeared in the insurance application itself. Such distinctions might insulate an insurer who had made only generally-worded representations to an insurance applicant.

Finally, if a precontractual representation is of such a nature and is made in such a context as to charge the insurer with a specific obligation, it becomes important to ask if this obligation effectively changes

85. *Id.*

the coverage under the policy. If policy coverage is unclear, *Silberg* seems to imply that the precontractual representation does in fact override the policy and mandate coverage.[86] If, however, the policy's provisions clearly exclude coverage, it is doubtful that a precontractual representation would override the policy. This follows from the fact that it would be questionable whether reasonable expectations of coverage could be maintained in the face of express policy provisions which clearly excluded coverage in a particular situation. Until criteria for resolving these problems are forthcoming, however, insurers may find it necessary to re-examine the tenor of their advertising representations and consider the need for including disclaimers in policy applications.

### B. *The Effect of Industry Custom*

Independent of any consideration of promissory bad faith, another aspect of *Silberg* which needs further clarification is the effect of industry custom on the standard of conduct to which insurers are held. The weight which a court could assign to industry custom in determining liability was left open when the *Silberg* court indicated only that an insurer's duty could not be prescribed *entirely* by customs in the industry.[87] By implication, an insurer's adherence to industry custom might be considered as some evidence of good faith and fair dealing.[88] While courts would be reluctant to allow the insurance industry to dictate the standards for determining insurer good faith, it would appear that evidence of industry-wide, standardized claims-handling procedures should nevertheless carry some weight in determining liability.[89] Conversely, the failure of an insurer to follow recommended company claims-handling procedures may not in itself be conclusive of liability, but could be some evidence of bad faith.[90]

## PROPOSED LEGISLATIVE AND JUDICIAL LIMITATIONS ON THE BAD FAITH TORT

### A. *Legislative Criteria*

Practical legislative criteria which might be employed by the courts

86. *Id.*
87. *Id.* at 462, 521 P.2d at 1109, 113 Cal. Rptr. at 717.
88. One article points out the practical difficulty an insurer would have in trying to convince a jury of the reasonableness of its decision as to the insured's claim when no standardized industry-wide procedures exist against which the reasonableness of the insurer's conduct can be measured. Parks & Heil, *Insurers Beware: "Bad Faith" is in Full Bloom*, 9 FORUM 63, 68 (1973).
89. *See id.*
90. *Cf.* W. PROSSER, HANDBOOK OF THE LAW OF TORTS 168 (4th ed. 1971) (the effect of custom on the standard of care in negligence).

in first-party bad faith actions are embodied in "unfair claims settlement" provisions recently enacted in California[91] and a handful of other states.[92] These statutes enumerate claims-handling procedures, delineated in the margin,[93] which, if regularly employed, will subject the insurer to the suspension or loss of its license to do business in the state.[94] To the extent that the California statute imposes a duty on insurers to avoid such unfair practices, violation of the statute may be taken as bad faith per se.[95] While the list of unfair practices is by no means comprehensive,[96] and perhaps no list could conceive of all im-

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91. CAL. INS. CODE §790.03(h), *as enacted*, CAL. STATS. 1972, c. 725, §1, at 1314.

92. KAN. STAT. ANN. §40-2404(9) (1973); ORE. REV. STAT. §746.230 (1974); TEX. INS. CODE art. 21.21-2 (Supp. 1974).

93. The California staute proscribes the following procedures:

(1) Misrepresenting to claimants pertinent facts or insurance policy provisions relating to any coverages at issue.

(2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies.

(3) Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies.

(4) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss requirements have been completed and submitted by the insured.

(5) Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become *reasonably clear.*

(6) Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds, when such insureds have made claims for amounts reasonably similar to the amounts ultimately recovered.

(7) Attempting to settle a claim by an insured for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application.

(8) Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of, the insured, his representative, agent, or broker.

(9) Failing, after payment of a claim, to inform insureds or beneficiaries, upon request by them, of the coverage under which payment has been made.

(10) Making known to insureds or claimants a practice of the insurer of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration.

(11) Delaying the investigation or payment of claims by requiring an insured, claimant, or the physician of either, to submit a preliminary claim report, and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information.

(12) Failing to settle claims promptly, where liability has become apparent, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage.

(13) Failing to provide promptly a reasonable explanation of the basis relied on in the insurance policy, in relation to the facts or applicable law, for the denial of a claim or for the offer of a compromise settlement.

CAL. INS. CODE § 790.03(h) (emphasis added); *accord*, KAN. STAT. ANN. § 40-2404(9) (1973); ORE. REV. STAT. § 746.230 (1974); TEX. INS. CODE art. 21.21-2 (Supp. 1974).

94. CAL. INS. CODE § 790.07.

95. *See* Greenberg v. Equitable Life Assur. Soc'y, 34 Cal. App. 3d 994, 1001, 110 Cal. Rptr. 470, 475 (1973); *accord*, Shernoff v. Superior Court, 44 Cal. App. 3d 406, 410, 118 Cal. Rptr. 680, 682 (1975); *cf.* W. PROSSER, HANDBOOK OF THE LAW OF TORTS 196 (4th ed. 1971) (violation of statute in negligence cases).

96. A proposed amendment to California's "unfair claims settlement" statute would add the following two unfair practices: (1) directly advising the insured not to retain

proper claims-settlement practices, the California statute could nevertheless serve as a practical yardstick in many bad faith cases arising in the first-party context.

Just as the unfair claims-handling provisions of the Insurance Code may provide partial criteria for determining what types of conduct by an insurer will constitute a breach of its implied duty of good faith and fair dealing, specific regulations of the California Insurance Commission[97] governing disability insurance advertising could furnish guidelines as to the kinds of precontractual representations that may affect an insurer's post-contractual obligations. The purpose of these regulations is to establish minimum standards governing insurance advertising in order to ensure accurate and truthful descriptions of insurance policies.[98] While these regulations are expressly limited to disability insurers[99] and are designed to give the state the power to police infractions,[100] they appear broad enough to be of general application and could be construed to vest a private right of action in insurance consumers injured by the deceptive practices.[101] These regulations proscribe the use in disability insurance advertising of words and phrases which may mislead prospective purchasers as to policy benefits payable or types of losses covered, or which may exaggerate any benefits beyond the terms of the policy.[102] The fact that the insurer allows the purchaser to inspect the policy before the ultimate sale does not excuse the use of these misleading statements.[103] Moreover, the regulations require a disability insurer to affirmatively disclose policy limitations and coverage exceptions when describing any policy benefits.[104] These regulations could serve as viable criteria for insurer liability in the area of promissory bad faith in that they specify precontractual representations that fall below minimum standards of acceptability.

Specific legislation aimed at the problems raised in a *Silberg* factual setting would clarify the duties of the insurer and perhaps reduce future litigation in the area of insurer bad faith. A measure of this type,

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an attorney and (2) misleading the insured as to the applicable statute of limitations. A.B. 92, 1975-76 Regular Session, *as amended*, January 21, 1975.

97. 10 CAL. ADMIN. CODE art. 12 (commencing with §2535).

98. 10 CAL. ADMIN. CODE §2535.1.

99. 10 CAL. ADMIN. CODE §2535.2.

100. 10 CAL. ADMIN. CODE §2537. Violation of these regulations may ultimately result in the suspension or loss of the insurer's license to do business in the state. CAL. INS. CODE §790.07.

101. *See* Greenberg v. Equitable Life Assur. Soc'y, 34 Cal. App.3d 994, 1001, 110 Cal. Rptr. 470, 475 (1973).

102. 10 CAL. ADMIN. CODE §2536.2(a).

103. *Id.*

104. 10 CAL. ADMIN. CODE §2536.2(b).

Senate Bill 1357,[105] was introduced in the 1973-74 session of the California Legislature and failed passage in the assembly,[106] but similar legislation could be considered. Basically, Senate Bill 1357 would have imposed a duty upon companies insuring employees under disability or health care policies to furnish benefits in cases in which workers' compensation is pending, regardless of any language to the contrary in the insurance policy.[107] In addition, Senate Bill 1357 would have eliminated any bar to a disability insurer's assertion of lien rights in the proceeds of an insured's workers' compensation award.[108] By imposing an absolute obligation on an insurer to pay claims of its insureds in these cases, regardless of whether a precontractual promise such as in *Silberg* was involved, such legislation would render moot in some situations the question of the extent to which the existense of a precontractual promise creates a higher standard of conduct for an insurer.

If the paucity of guidelines for determining bad faith liability in the first-party context is due to the relatively recent recognition of the tort, then it may be helpful to examine judicial construction of "bad faith" statutes which have been in effect in other states for many years.[109] A typical example of such statutes is one enacted in Missouri in 1865,[110] which provides in effect that an insurer who "vexatiously" refuses to pay losses on certain policies is liable for a penalty of up to ten percent of the insured's actual losses and reasonable attorney's fees. The purpose of such a statute is twofold: (1) to shift to a recalcitrant insurer the expense of securing payment of loss[111] and (2) to correct the evil of arbitrary refusals to pay claims.[112] The statutory penalty has been imposed in cases where an insurer has withheld payment without reasonable cause or excuse, or in bad faith.[113]

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105. 1973-74 Regular Session, *as amended*, April 22, 1974.
106. WEEKLY HISTORY OF THE CALIFORNIA SENATE 220 (Oct. 4, 1974).
107. S.B. 1357, 1973-74 Regular Session, *as amended*, April 22, 1974, §§1-3.
108. *Id.* §4. In furnishing immediate benefits to an injured employee, an insurer runs the risk of losing its right to compensation from an employer who successfully asserts the defense of lack of notice of need for medical treatment. Gerson v. Industrial Acc. Comm'n, 188 Cal. App. 2d 735, 738, 11 Cal. Rptr. 1, 3 (1961).
109. ARK. STAT. ANN. §66-3238 (1966); LA. REV. STAT. §22:657 (Supp. 1975); MO. ANN. STAT. §375.420 (1968); NEB. REV. STAT. §44-359 (1974); TENN. CODE ANN. §56-1105 (1968). *See generally* R. KEETON, BASIC TEXT ON INSURANCE LAW 457-58 (1971) (statutory penalties for nonpayment or late payment of insurance claims); 44 AM. JUR. 2d, *Insurance* §§1798, 1799 (1969) (statutory damages for insurer's refusal to pay claim, or for delay in payment of claim).
110. MO. ANN. STAT. §375.420 (1968).
111. Willis v. American Nat'l Life Ins. Co., 287 S.W.2d 98, 108 (Mo. Ct. App. 1956).
112. Bouligny v. Metropolitan Life Ins. Co., 179 S.W.2d 109, 112 (Mo. Ct. App. 1944).
113. *E.g.*, Dixon v. Business Men's Assur. Co. of America, 365 Mo. 580, 285 S.W.2d 619 (1955).

The major limitation on insurer liability developed by judicial construction of such statutes is that an insurer is justified in withholding payment on a doubtful claim by an insured, provided that the insurer is not being recalcitrant or employing delaying tactics.[114] A "doubtful claim" is one in which there is an open question of law or fact as to liability,[115] or in which a prudent man in good faith would believe there is no liability.[116] To warrant refusal of a claim, the insurer must *at the time of the refusal* have facts which would justify such an action.[117] In addition, the insurer must prove that refusal of the insured's claim was based on such facts and was not the arbitrary decision of a claims representative unqualified to appraise the significance of these facts.[118] As a clarification of "statutory bad faith," the foregoing principles embodied in the case law of other jurisdictions may prove useful in qualifying the developing common law of insurer bad faith in California.

### B. *Judicial Criteria*

#### 1. *Criteria for the Handling of Doubtful Claims*

The preceding "statutory bad faith" cases suggest that insurer liability for bad faith should be limited in cases in which payment is withheld because a claim is doubtful. A recent California case, *Johansen v. California State Automobile Association, etc., Bureau*,[119] supports such a limitation and provides several qualifying factors. While *Johansen* involved bad faith tort liability in the context of a third-party claim, its applicability to first-party claims is indicated by the court's reliance on *Silberg*.[120] In *Johansen*, the liability insurer rejected a policy-limits settlement offer, honestly believing that the policy did not provide coverage under the circumstances. Subsequently, the claimant recovered judgment against the insured in excess of the policy limits. The court rejected the insured's contention that the insurer should be held strictly liable for the excess judgment and affirmed bad faith as the only standard of liability.[121] The court stated that

114. *See* Wiener v. Mutual Life Ins. Co., 61 F. Supp. 430, 432 (E.D. Mo. 1945).
115. *See, e.g.*, Kissel v. Aetna Cas. & Sur. Co., 380 S.W.2d 497, 509 (Mo. Ct. App. 1964).
116. *See* Union Indem. Co. v. Home Trust Co., 64 F.2d 906, 910 (8th Cir. 1933).
117. Cohen v. Metropolitan Life Ins. Co., 444 S.W.2d 498, 506 (Mo. Ct. App. 1969).
118. *See* Seguin v. Continental Serv. Life & Health Ins. Co., 230 La. 533, 89 So. 2d 113 (1956) (interpreting LA. REV. STAT. §22:657 (1959) which requires all claims under health and accident policies to be paid within thirty days from the filing of a claim unless there are "just and reasonable grounds" placing a "reasonable and prudent businessman on his guard").
119. 41 Cal. App. 3d 974, 116 Cal. Rptr. 546 (1974).
120. *See id.* at 985, 116 Cal. Rptr. at 552.
121. *Id.* at 979-82, 116 Cal. Rptr. at 549-51.

"[n]o rules of law or equity have ever prescribed that the insurer must pay under a policy which *does not provide coverage* for the incident in question."[122] The court proceeded to note two facts which distinguished the case at bar from *Silberg*: first, there was no assurance that the insurer would ever be able to recoup payment through a lien if noncoverage was later confirmed; secondly, proceedings to determine the existence of coverage were brought by the insurer.[123] *Johansen*, in denying recovery to the insureds,[124] thus suggested that liability for bad faith will not be imposed on insurers withholding payment of third-party *or* first-party claims if (1) liability under the policy is doubtful, (2) payment of the disputed claim cannot be recouped through a lien, and (3) declaratory relief is sought by the insurer.[125] It is questionable, however, whether the *Johansen* criteria would apply with equal force if the insurer, in withholding payment on a doubtful claim, thereby fails to fulfill a precontractual promise, a factor which *Silberg* treated as significant in determining insurer liability.[126] While *Johansen's* analysis of *Silberg* failed to include a consideration of how precontractual promises should affect the handling of doubtful claims, several assumptions can be made in this regard. If the reasonable expectations of the insured, as fostered through an insurer's precontractual representations, effectively change the coverage of the policy,[127] then to the extent that these representations may reasonably be construed to obligate the insurer to make payment under the policy, the insured's claim would no longer be classified as "doubtful," irrespective of express provisions within the four corners of the policy. If a doubtful claim loses its doubtful character in the presence of precontractual representations, then it would appear that the presence of the other *Johansen* factors would not operate to excuse the insurer's failure to pay. However, cases may arise in which claims are doubtful because or in spite of precontractual representations. In these situations, the presence of the other *Johansen* factors may bar a finding of bad faith.

122. *Id.* at 985, 116 Cal. Rptr. at 552 (emphasis added).
123. *Id.* In *Silberg* it was the insured who brought the dispute to court. 11 Cal. 3d at 456, 521 P.2d at 1106, 113 Cal. Rptr. at 714.
124. 41 Cal. App. 3d at 984, 116 Cal. Rptr. at 551-52.
125. *See id.* at 986, 116 Cal. Rptr. at 553. Even if the *Johansen* criteria are met it appears that if the insurer fails to keep the insured informed of the action being taken on his claim, that the insurer may still be held liable for bad faith. Kinder v. Western Pioneer Ins. Co., 231 Cal. App. 2d 894, 901, 42 Cal. Rptr. 394, 398 (1965); *cf.* Palmer v. Financial Indem. Co., 215 Cal. App. 2d 419, 30 Cal. Rptr. 204 (1963); *accord*, Bowler v. Fidelity & Cas. Co. of New York, 53 N.J. 313, 328, 250 A.2d 580, 588 (1969) (when a disability insurer discontinues payments under the policy, its duty of good faith requires it to inform the insured of the reasons for discontinuance and to explain to the insured how he may enforce the claim).
126. *See* 11 Cal. 3d at 461, 521 P.2d at 1109, 113 Cal. Rptr. at 717.
127. See text accompanying note 86 *supra.*

### 2. Privilege

*Johansen* suggests that an insurer may be justified in certain cases in withholding payment of a doubtful claim. A complementary consideration which may also narrow the scope of insurer bad faith in the first-party context is the concept of privilege. *Fletcher v. Western National Life Insurance Co.*[128] recognized that an insurer conducting settlement negotiations with its insured is privileged to assert its rights in a "permissible way and with a good faith belief in the existence of the rights asserted." The privilege was articulated by the court as a limitation on liability for intentional infliction of emotional distress.[129] However, such a broadly articulated privilege, rooted in the strong public policy favoring the settlement of disputed claims,[130] may extend to the bad faith tort. In fact, in *Mustachio v. Ohio Farmers Insurance Co.*,[131] a California appellate court expressly recognized such a privilege in the context of a first-party bad faith tort action. *Mustachio* indicated that an insurer who recognizes a claim but honestly disagrees with the insured as to the amount to be paid in settlement may be shielded from liability for bad faith if it *bargains* with the insured to reach some accord.[132] However, the scope of this privilege is exceeded if the insurer coerces acceptance of its first offer by threatening to otherwise disregard the claim.[133] As a limitation on liability for bad faith, the concept of privilege overlaps with the considerations in *Johansen* regarding the handling of doubtful claims. *Fletcher* and *Mustachio* thus suggest alternative courses of action for an insurer which will shield it from liability for bad faith: (1) the insurer may bargain in good faith for settlement of a doubtful claim, or (2) the insurer may withhold payment of a doubtful claim entirely and seek declaratory relief.[134]

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128. 10 Cal. App. 3d 376, 395, 89 Cal. Rptr. 78, 89 (1970); *accord*, Eckenrode v. Life of America Ins. Co., 470 F.2d 1, 5 (7th Cir. 1972).

129. 10 Cal. App. 3d at 395, 89 Cal. Rptr. at 89.

130. Potter v. Pacific Coast Lumber Co., 37 Cal. 2d 592, 602, 234 P.2d 16, 22 (1951); Fletcher v. Western Nat'l Life Ins. Co., 10 Cal. App. 3d 376, 396, 89 Cal. Rptr. 78, 89 (1970); Critz v. Farmers Ins. Group, 230 Cal. App. 2d 788, 800, 41 Cal. Rptr. 401, 408 (1964); Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 696, 319 P.2d 69, 79 (1957).

131. 44 Cal. App. 3d 358, 363-64, 118 Cal. Rptr. 581, 584 (1975).

132. *Id.* at 364, 118 Cal. Rptr. at 584.

133. *Id.* at 363, 118 Cal. Rptr. at 584.

134. The *Crisci* decision and the dissent to *Gruenberg* suggest a final limitation on an insurer's liability for bad faith when they indicate that the contract for insurance imposes *mutual* obligations of good faith and fair dealing. Crisci v. Security Ins. Co., 66 Cal. 2d 425, 429, 426 P.2d 173, 176, 58 Cal. Rptr. 13, 16 (1967); Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 583, 510 P.2d 1032, 1043, 108 Cal. Rptr. 480, 491 (1973) (Roth, J., dissenting). The existence of this mutual obligation suggests that an insurer who has reason to believe that an insured is prosecuting a claim fraudulently or in bad faith would be warranted in withholding payment of the claim.

### 3. *A Possible Synthesis of First-Party and Third-Party Criteria for Bad Faith*

The *Johansen* and *Fletcher* criteria for the handling of doubtful claims and the privileged settlement of claims delineate general circumstances in which insurer bad faith will not lie, or in which payment can be withheld with "proper cause" under *Gruenberg*.[135] When these standards are combined with those articulated in the area of third-party claims,[136] there evolves an outline of criteria for an insurer's handling of an insured's claim: (1) when an insured first files a claim, the insurer should conduct a bona fide investigation into the facts surrounding the claim and seek legal advice as to any questionable issues of liability;[137] (2) given strong indications of fraud on the part of the insured[138] or of noncoverage under the law or facts,[139] and absent an available lien right as in *Silberg*, the insurer may withhold payment of the claim; (3) the insured should be kept fully apprised of the handling of his claim and the reasons for any action on the claim;[140] (4) the insurer should seek declaratory relief as to its liability under the policy when, under the law or the facts, coverage is in question;[141] (5) alternatively, if the claim is weak on its merits or the amount of recovery is in question, then the insurer may bargain with the insured to reach a settlement.[142] The viability of these criteria in shielding an insurer from liability for bad faith is questionable, however, when the insurer has made precontractual representations which may reasonably be construed to mandate immediate payment of a claim. Any action short of immediate payment may be a breach of such a representation.[143] Under another interpretation, however, if the insured's claim is still doubtful in light of precontractual representations, the foregoing criteria are still valid considerations for an insurer seeking to shield itself from liability for bad faith. Whether the precontractual representation may be contrued to create an obligation overriding the express terms of the policy and exposing an insurer to bad faith for its nonfulfullment could ultimately depend upon the theory posited for holding insurers accountable for precontractual representations.[144]

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135. See text accompanying note 34 *supra*.
136. See text accompanying notes 6-13 *supra*.
137. *See* Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 689, 319 P.2d 69, 75 (1957); see text accompanying notes 114-18 *supra*.
138. See note 134 *supra*.
139. See text accompanying note 122 *supra*.
140. See note 125 *supra*.
141. See text accompanying note 125 *supra*.
142. See text accompanying notes 128-133 *supra*.
143. See text accompanying notes 53-58 *supra*.
144. See text accompanying notes 59-84 *supra*.

## Conclusion

In *Silberg v. California Life Insurance Co.*, the California Supreme Court appears to have added a new and as yet unqualified dimension to the insurer bad faith tort in the form of "promissory bad faith," calling into question the nature and scope of the insurer's implied-in-law duty of good faith and fair dealing. While it seems clear that a precontractual representation by an insurer will in some manner affect the insurer's standard of conduct in handling an insured's claim, the introduction of this new liability-producing factor requires both justification and a more careful delineation of the boundaries of the insurer bad faith tort. The boundaries of an insurer's obligations in handling the claims of its policyholders could be delineated in two ways: first, through the application of statutory criteria which suggest concrete guidelines for bad faith or unfair dealing and examples of precontractual representations which might subject the insurer to bad faith liability; secondly, by the application of judicial standards regarding privilege and the handling of doubtful claims which delineate instances in which withholding payment of an insured's claim may be justified. However the courts go about providing this clarification, the effort should soon be initiated in order to remove the shrouds of uncertainty surrounding the infant tort of insurer bad faith.

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