The Important Potential Implications of *Zhang v. California Capital Insurance Co.* For Insurance Litigation in California

After much anticipation, last week the Supreme Court of California heard oral arguments in the pivotal case of *Yanting Zhang v. California Insurance Co.*, S178542 on May 8, 2013. This case looks to have a substantial impact on insurance litigation in California and could open up another significant avenue for insureds to pursue claims against their insurance companies. The key issue in *Zhang* is under what circumstances may an insured bring a cause of action against an insurer under the "Unfair Competition Law" (Bus. & Prof. Code, section 17200 or "UCL"). Specifically, the issues on review by the Supreme Court are: (1) Can an insured bring a cause of action against its insurer under the unfair competition law (Bus. & Prof. Code section 17200) based on allegations that the insurer misrepresents and falsely advertises that it will promptly and properly pay covered claims when it has no intention of doing so? (2) Does *Moradi-Shalal v. Fireman's Fund Ins. Companies* 46 Cal.3d 287 (1988) bar such an action? Based on the Court's questions during the oral arguments, as they were reported in the Los Angeles Daily Journal, it appears that the Supreme Court may be on the verge of ruling in favor of the Plaintiff in *Zhang* and thereby substantially broadening the scope of potential claims available to insured.

A crucial question for the Supreme Court in *Zhang*, and a focal point of the oral arguments, is the reach of the Supreme Court's landmark decision in *Moradi-Shalal*, which barred private actions seeking to enforce California's Unfair Insurance Practices Act ("UIPA"), namely, Insurance Code Section 790.03, *et seq*. ("Section 790.03").

The Supreme Court's decision in *Moradi-Shalal* left open the issue of whether claims for violation of the UCL may still allege conduct that violates Section 790.03. Initially, courts in California heavily favored a broad reading of *Moradi-Shalal* and found that allegations of fraudulent misrepresentation and false advertising in violation of Section 790.03 cannot be brought under the UCL. Specifically, courts reasoned that allowing such claims would circumvent the Supreme Court's holding in *Moradi-Shalal. See, e.g., Textron Financial Corp. v. National Union Fire Insurance Company,* 118 Cal.App.4th 1061, 1070 (2004)*; Safeco Insurance Company v. Superior Court*, 216 Cal.App.3d 1491, 1494 (1990) (finding that the UCL "provides no toehold for scaling the barriers of *Moradi-Shalal"*). In *Textron*, a case that arose from an insurer's refusal to honor a claim for insurance benefits concerning property damage, the court found that "merely alleging these purported acts constitute unfair business practices under the unfair competition law is insufficient to overcome *Moradi-Shalal*." *Textron Financial Corp., supra* at 1070-71.

Now, the *Zhang* case has the potential to significantly limit the broad reading of *Moradi-Shalal* applied by courts in California in the past and, if the Court of Appeals decision is affirmed, open the door for a slew of new claims against insurers that they have engaged in unfair business practices in violation of Section 790.03. The *Zhang* case involves an insured, Zhang, who owned an apartment building which was damaged in a fire in 2005. Zhang attempted to collect benefits under the policy issued by her insurer California Capital Insurance Company ("California Capital"). However, Zhang alleged that there was a litany of problems with California Capital's handling of her claim and that they refused to approve adequate payment for the repair of the

premises. Zhang brought a claim against California Capital for breach of contract, breach of the implied covenant of good faith and fair dealing, and also several alleged violations of the UCL. The claims for breach of contract and bad faith were settled and dismissed, leaving her UCL claim. Included under her UCL claim were allegations that California Capital had acted unfairly by engaging in false and deceptive advertising, suggesting it would provide coverage in the event of a loss, when it had no intent to do so. Most importantly, she also alleged that California Capital engaged in unlawful conduct which violates Section 790.03 as part of UCL claim.

California Capital filed a demurrer to Zhang's cause of action under the UCL arguing, unsurprisingly, that Zhang could not state a cause of action under Section 790.03 based on the decision in *Moradi-Shalal*. The trial court sustained California Capital's demurrer relying largely on the *Textron* case. Then, in a stunning break from prior decisions, the Court of Appeal reversed the trial court's holding and found that because Zhang is alleging unlawful and misleading conduct prohibited by the UCL in violation of Section 790.03, the suit may proceed on that claim. The court in *Zhang* specifically addressed the clearly contradictory holding in the *Textron* decision. Specifically, the court in *Zhang* held that, contrary to the finding in *Textron*, *Moradi-Shalal* does not bar a claim under the UCL where the plaintiff specifically alleged conduct expressly prohibited by Section 790.03. The court pointed to the Supreme Court's decision in *Manufacturers Life Insurance Co. v. Superior Court*, 10 Cal.4th 257 (1995), in which the high court rejected the idea that Section 790.03 was intended to "displace existing rights and remedies for unlawful business practices" in the insurance industry, among them the UCL. As such, the court believed that there is no reason to treat insurers differently from other businesses when it comes to actions under the UCL. The court held that although the UIPA did not provide a private cause of action, in the UCL the legislature had provided such a remedy for conduct that fell within its purview and, as such, Zhang's allegations that the insurer solicited her business through false advertising and false promises clearly justified a claim under the UCL and is not barred by *Moradi-Shalal*.

Following the Court of Appeals' decision in *Zhang*, both plaintiff's attorneys and insurance companies anticipated a possibly ground-breaking decision by the Supreme Court after it held oral argument in the case three years after it took up the case. As was reported in the Daily Journal on Thursday May 9, 2013, the Supreme Court heard oral arguments the previous day on May 8. According to the Daily Journal, only three justices asked multiple questions and the arguments were both relatively short. However, "the questions posed by the justices suggested the court is inclined to rule in favor of Zhang." Specifically, Justice Joyce L. Kennard repeatedly asked Zhang's attorney "hypothetical questions based on the assumption the court were to side with his client." Although the attorney for California Capital argued that under *Moradi-Shalal,* Zhang's claim must be handled by the insurance commissioner, Justice Carol Corrigan questioned why Zhang cannot sue for false advertising where her contract was fraudulently induced. Justice Carol Corrigan also added that who wins the false advertising argument is currently irrelevant, and the only question is whether Zhang has a right to bring her claim. When asked by the Court whether it would have to overturn *Moradi-Shalal* if it ruled for Zhang, Zhang's attorney definitively answered "no" and explained that none of Zhang's actions are related to *Moradi-Shalal* and pleading false advertising is enough.

Based on the oral arguments, it seems that the Justices of the California Supreme Court are inclined to limit the scope of *Moradi-Shalal* and allow Zhang to proceed with her case. Such an outcome would have very important consequences for insurance litigation in California. Allowing insured plaintiffs to maintain claims under the UCL based on an insurer's advertising or representation regarding timely payment for covered

losses could open the floodgates for a huge number of new claims for such false advertising and fraud in connection with their advertising. Moreover, given the broad scope of the UCL, such claims will also likely to become common in complaints against insurance companies. Although damages per se are not recoverable under the UCL, restitution may be available under the theory that the insured purchased the policy in reliance on misrepresentations by the insurer. Recovery of insurance premiums paid may be a remedy, along with policy benefits that are owed under an insurance policy. In any case, the threat of injunction for violation of the UCL requiring changes to the insurer's practice would still be a powerful weapon for plaintiffs. On the other hand, if the Supreme Court decides in favor of California Capital, it would reaffirm *Textron* Court's broad reading of *Moradi-Shalal* and continue to limit insured plaintiffs to breach of contract and breach of the implied covenant of good faith and fair dealing claims. The decision by the Supreme Court in the *Zhang* case is expected within 90 days of the oral argument on May 8. Both insureds and their attorneys should keep careful watch for this potentially momentous decision in the field of insurance litigation.