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The Unfair Claims Settlement Practies Act: A Private Cause of Action for Third Party Claimants Seeking Punitive Damages

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THE UNFAIR CLAIMS SETTLEMENT PRACTICES ACT: A PRIVATE CAUSE OF ACTION FOR THIRD PARTY CLAIMANTS SEEKING PUNITIVE DAMAGES

I. INTRODUCTION

In 1971 the National Association of Insurance Commissioners proposed: "An Act Relating to Unfair Methods of Competition and Unfair and Deceptive Acts and Practices in the Business of Insurance."[1] This model legislation prohibits various unfair practices by insurance companies in dealing with applications, claims, and settlements of insurance with individuals.[2] In an effort to control unfair trade practices

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1. National Association of Insurance Commissioner's proceedings 1972 Vol. 493-518; Houser, *Unfair Claims Settlement Practices Act—How the Courts have Interpreted the Act*, 15 THE FORUM 336 (1979).

2. UNFAIR CLAIMS SETTLEMENT PRACTICES ACT § 4 (9) prohibits:

> Committing or performing with such frequency as to indicate a general business practice any of the following:
>
> (a) misrepresenting pertinent facts or insurance policy provisions relating to coverages at issue;
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> (b) failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies;
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> (c) failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;
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> (d) refusing to pay claims without conducting a reasonable investigation based upon all available information;
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> (e) failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed;
>
> (f) not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear;
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> (g) 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;
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> (h) attempting to settle a claim 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;
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> (i) attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of the insured;
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> (j) making claims payments to insureds or beneficiaries not accompanied by statement setting forth the coverage under which the payments are being made;
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> (k) making known to insureds or claimants a policy 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;
>
> (l) delaying the investigation or payment of claims by requiring an insured,

in the business of insurance, many states have enacted some form of the Act or its regulations.[3] In each of these states the enforcement of the provisions of the unfair practices legislation is the statutory duty of the state superintendent or commissioner of insurance. Courts have reached divergent results, however, regarding the utility of this legislation, particularly as to whether private individuals may invoke and enforce the Act in actions against insurers for punitive damages.[4]

When a private cause of action for punitive damages is allowed under the Act, an additional problem is presented. Courts have long upheld the fundamental principle of insurance law that an insurer's duty to settle claims fairly and in good faith is limited to the insured.[5] Whether the Act abrogates this principle and extends this obligation to a third party claimant has prompted inconsistent results among various state courts.[6] The purpose of this comment is first, to determine the basis upon which a private cause of action may be allowed under the Model Act; second, to examine the appropriateness of allowing third party claimants damages from insurers through a private action; and third, to evaluate the policy impact of the Act regardless of whether a private action is allowed.

II. ALLOWING A PRIVATE CAUSE OF ACTION

The Act specifically vests the commissioner of insurance with authority to investigate unfair insurance practices, conduct hearings, and issue cease and desist orders in the event an insurer is found to have engaged in unfair insurance practices. Section 13 of the Model Act stipulates: "The powers vested in the (Commissioner) by this Act, shall be additional to any other powers to enforce any penalties, fines or forfeitures authorized by law with respect to the methods, acts and

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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;
(m) failing to promptly settle claims, where liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage;
(n) failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement.

3. Best, *Statutes and Regulations Controlling Life and Health Insurance Claim Practices*, 29 DEF. L.J. 115 (1980). Thirty-two states have enacted some form of the Model Act. *Id.* at 117-18. Some of these states along with seven others have adopted some form of the Model Act's regulations. *Id.* at 121-22.

4. See *Id.* at 128.

5. See text accompanying notes 64 through 68 *infra*.

6. See text accompanying notes 69 through 107 *infra*.

practices hereby declared to be unfair or deceptive.'"[7] The issue whether these "other powers" include a private cause of action by individual claimants to enforce the provisions of the Act, in their attempt to collect damages from insurers, is unclear from the language of the Act.

In resolving this issue, state court decisions have focused primarily upon three related areas: 1) the impact of the Act upon the insurance contract; 2) the doctrines of exhaustion of administrative remedies and primary jurisdiction; and 3) the extent of the commissioner's jurisdiction over insurance disputes.

A. The Impact of the Model Act upon the Insurance Contract

Generally, a breach of the provisions of an insurance policy constitutes a breach of contract.[8] If an insurance company breaches the insurance contract, the insured is entitled to a cause of action to recover the value of the policy at the date of the breach.[9] Punitive damages are generally not recoverable unless the insured proves that the breach was accomplished through fraud,[10] or that a duty was violated which the insurer owed to the insured regardless of the contract.[11] The importance of the Model Act, then, is that it may impose upon the insurer statutory duties which the insurer must honor regardless of the insurance contract.[12] These statutory duties, being obligations in addition to those specified in the insurance contract, may consequently

7. UNFAIR CLAIMS SETTLEMENT PRACTICES ACT, § 13.

8. *See* 20 J. APPLEMAN, INSURANCE LAW AND PRACTICE § 11251 (Bendal ed. 1979).

9. *Id.* at § 11255.

10. *Id.*

11. Battista v. Lebanon Trotting Ass'n, 538 F.2d 111 (6th Cir. 1976). The *Battista* court held:

> The character of an action as one in tort or as an ex contractu is determined by whether it arises from the breach of some agreement of the parties, or from a violation of some duty imposed upon a party by law, independent of the contract or will of either . . . . It is no tort to carry a feeling of malice toward a person; it is no tort to breach a contract regardless of motive. A tort exists only if a party breaches a duty he owes to another independently of the contract, that is, a duty which would exist even if no contract existed. However, when the promisee's injury consists merely of the loss of his bargain, no tort claim arises because the duty of the promiser to fulfill the term of the bargain arises only from the contract. The tort liability to a contract arises from the breach of some legal duty imposed by law because of the relationship of the parties rather than from mere omission to perform a contract obligation. *Id.* at 117.

12. See Larson v. District Court, 149 Mont. 131, 423 P.2d 598 (1967), in which the Supreme Court of Montana held that, under the unfair claims legislation of Montana, a breach of an insurance contract may be both a breach of contract and a violation of the laws of Montana.

create a basis for punitive damages in addition to damages awarded on the basis of enforcement of the contract itself.[13]

This unique impact is well illustrated by the Supreme Court of Montana in *First Security Bank v. Goddard*,[14] in which the court allowed compensatory damages for breach of contract and punitive damages for breach of a statutory duty under legislation substantially similar to the Model Act.[15] Factually, the court found that Goddard borrowed money from the First Security Bank to purchase an automobile. In order to secure repayment of its loan, the bank, acting as agent for Banker's Union Life Insurance Company (BULIC), issued a credit life and disability insurance policy to Goddard who subsequently became disabled and unable to repay the loan. BULIC refused to pay the total amount of benefits that Goddard had forthcoming from the insurance contract. In the bank's action against Goddard, BULIC was joined as a third party defendant and held liable for refusing to settle fairly with Goddard.[16]

The insurance company in *Goddard* argued that only the commissioner of insurance could enforce the state's unfair claims practices legislation. The Montana court rejected this argument on the basis of the unique impact of the unfair claims settlement provisions upon the insurance contract. The *Goddard* court reasoned that settling claims fairly and promptly is a statutory obligation of an insurance company.[17] This statutory obligation imposes upon the insurer a duty which is independent of its obligations under the contract. This independent statutory duty, therefore, changes the essential nature of the insurance contract making the insurer potentially liable in contract and in tort.[18] The court stated:

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13. *Id.* at ____, 423 P.2d at 600. The *Larson* court concluded that a violation of the state's insurance laws amounts to a tort which warrants an award of punitive damages.

14. ____ Mont. ____, 593 P.2d 1040 (1979).

15. MONT. REV. CODES ANN. § 33-18-201 (1979). The defendant argued principles of administrative law—the doctrine of exhaustion of remedies and primary jurisdiction. For other judicial dispositions of these arguments *see* text accompanying notes 29-45 *infra*.

16. The *Goddard* court followed Larson v. District Court, 149 Mont. 131, 423 P.2d 598 (1967). *See* notes 12 and 13 *supra*.

17. MONT. REV. CODES ANN. § 33-21-105(1) (1979) provides:

"All claims shall be promptly reported to the insurer or its designated claim representative, and the insurer shall maintain adequate claim files. All claims shall be settled as soon as possible and in accordance with the terms of the insurance contract."

18. The duty of good faith which is independent of the insurance contract may also arise from a duty implied in-law which, in turn, gives rise to a tort claim for punitive damages. *See, e.g.*, Battista v. Lebanon Trotting Ass'n, 538 F.2d 111 (6th Cir. 1976).

> A cause of action may sound in tort although it arises out of a breach of contract, if the defaulting party, by breaching the contract, also breaches a duty which he owes to the other party independently of the contract. . .
>
> In Montana, insurance companies issuing credit disability risks have a statutory duty that exists beyond the insurance contract.[19]

On this basis the court awarded Goddard disability benefits under the insurance contract itself and punitive damages for the insurance company's breach of its statutory obligation.

The Montana approach necessarily allows the insured to allege in his complaint a violation of statute. The propriety of alleging violations of a regulatory statute in an action for private damages has been a source of division among courts construing unfair practices legislation. In *Greenberg v. Equitable Life Assurance Society*,[20] the court considered whether a complaint could be amended by alleging violations of the unfair claim practices legislation so as to avoid dismissal for failure to state a cause of action. The court held that under the ultra-liberal amendment of pleadings rule in California, the complaint could state a legally adequate cause of action for insurance practices prohibited by the section 790.03 of the California Insurance Code.[21]

Because unfair claims practices legislation is essentially regulatory, however, a complaint alleging violation of statute may be summarily dismissed.[22] In *Stack v. Nationwide Insurance Co.*,[23] the plaintiffs alleged that Nationwide breached the insurance contract by failing to pay proceeds under a fire insurance policy. The plaintiffs petitioned to amend their complaint by adding a claim for punitive damages on the basis that Pennsylvania's Unfair Insurance Practices Act[24] allowed an independent cause of action when an insurance company exercised bad faith in settling a claim. The *Stack* court denied the petition to amend, holding that neither the case law nor the unfair practices legislation in that state allows a private cause of action for punitive damages. The court reasoned that because the statute allegedly violated provides for administrative enforcement, the plaintiffs were limited to those administrative remedies.

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19. ____ Mont. at ____ , 593 P.2d at 1047.

20. 34 Cal. App. 3d 994, 110 Cal. Rptr. 470 (1973).

21. In California, "the denial of permission [to amend] is usually found to be an abuse of discretion, except where the impossibility of amendment to state a cause of action is clear." Greenberg v. Equitable Life Assurance Soc'y, 34 Cal. App. 3d at 998, 110 Cal. Rptr. at 473 (quoting 743 Cal. App. 2d 584, 586, 52 Cal. Rptr. 637, 639).

22. Courts have held that complaints of violations of the legislation comparable to the Model Act must be presented to the commissioner of insurance. *See* Cohen v. Prudential Ins. Co., 58 N.J. Super. 37, 155 A.2d 304 (1959).

23. 7 Pa.D. & C. 3d 113 (1978).

24. PA. STAT. ANN. tit. 40, § 1171.5 (Purdon 1971).

Similarily, in *Retail Clerk's Welfare Fund v. Continental Casualty Co.*,[25] the Superior Court of New Jersey held that an insured's complaint alleging violation of the New Jersey unfair claims practices legislation,[26] failed to state a cause of action upon which relief could be granted. The plaintiff was foreclosed from including in his complaint a violation of the state insurance law.[27] The reasoning of the *Retail Clerk's Welfare Fund* court was directly opposite the reasoning of the Montana court in *Goddard*. While the *Goddard* court reasoned that the unfair claims practices legislation imposed duties upon the insurer in addition to contract obligations, the New Jersey Superior Court in *Retail Clerk's Welfare Fund* reasoned that "[w]e do not construe N.J.S.A. 17:29B as being incorporated into contracts of insurance written in this State and thereby, creating a cause of action for breach of contract for the individual policyholder."[28] The *Retail Clerk's Retail Fund* court also reasoned that under the New Jersey insurance law, the insurance commissioner issues cease and desist orders for unfair insurance practices and violations of these cease and desist orders subjects the offender to monetary penalties. The court concluded that, absent express legislative authorization, a private cause of action will not be allowed under the insurance law.

The courts in *Retail Clerk's Welfare Fund* and *Stack* stress that unfair claims practices legislation is available to an insured only to initiate administrative enforcement of the legislation through the insurance commissioner. Whether the Model Act is limited in the same way, or whether it imposes obligations which the insured may enforce in addition to the insurance contract obligations requires an examination of whether one is required to exhaust these administrative remedies under section 13 before seeking judicial relief.

B. The Doctrine of Exhaustion of Administrative Remedies and Primary Jurisdiction

The Model Act provides that if, after a hearing, the commissioner determines that the Act has been violated, he must issue a cease and

25. 71 N.J. Super. 221, 176 A.2d 524 (1961).

26. N.J. REV. STAT. § 17:29 (1963).

27. The plaintiff was an unincorporated trust fund established as an adjunct labor union to provide benefits to employees. The defendant insurance company issued an insurance contract to plaintiff for accident and health group coverage for its employees. The plaintiff charged that the defendant unfairly calculated a certain refund which was due to plaintiff because plaintiff and holders of similar policies were given such refund. Plaintiff conceded that the policy made no provision for such refunds nor that discrimination by insurer in making such refunds is illegal. 71 N.J. Super. at 222-24, 176 A.2d at 525.

28. 71 N.J. Super. at 225, 176 A.2d at 526.

desist order and may impose a penalty at his discretion.[29] The Act also provides for judicial review of the commissioner's administrative orders.[30] Insurance companies, as defendants, frequently argue that a person aggrieved by a violation of the Act is required to exhaust his administrative remedies with the commissioner before seeking judicial relief.[31] They argue that primary jurisdiction is vested in the commis-

29. UNFAIR CLAIMS SETTLEMENT PRACTICES ACT, § 8 provides:

(a) If, after such hearing, the (Commissioner) shall determine that the person charged has engaged in an unfair method of competition, or an unfair or deceptive act or practice he shall reduce his findings to writing and shall issue and cause to be served upon the person charged with the violation a copy of such findings and an order requiring such person to cease and desist from engaging in such method of competition, act or practice and if the act or practice is a violation of Sections 4 or 5, the (Commissioner) may at his discretion order any one or more of the following:

(A) payment of a monetary penalty of not more than $1000 for each and every act or violation but not to exceed an aggregate penalty of $10,000 unless the person knew or reasonably should have known he was in violation of this Act, in which case the penalty shall be not more than $5000 for each and every act or violation but not to exceed an aggregate penalty of $50,000 in any six month period.

30. *Id.* at § 9(a) & (b) which provides:

(a) Any peron subject to an order of the (Commissioner) under section 8 or section 11 may obtain a review of such order by filing in the _____ court of _____ county, within ____ days from the date of the service of such order, a written petition praying that the order of the (Commissioner) be set aside. A copy of such petition shall be forthwith served upon the (Commissioner), and thereupon the (Commissioner) forthwith shall certify and file in such court a transcript of the entire record in the proceeding, including all the evidence taken and the report and order of the (Commissioner). Upon such filing of the petition and transcript such court shall have jurisdiction of the proceeding and of the question determined therein, shall determine whether the filing of such petition shall operate as a stay of such order of the (Commissioner), and shall have power to make and enter upon the pleadings, evidence, and proceedings set forth in such transcript a decree modifying, affirming or reversing the order of the (Commissoner), in whole or in part. The findings of the (Commissioner) as to the facts, if supported by _____ evidence, shall be conclusive.

[Drafting Note omitted]

(b) To the extent that the order of the (Commissioner) is affirmed, the court shall thereupon issue its own order commanding obedience to the terms of such order of the (Commissioner). If either party shall apply to the court for leave to adduce additional evidence and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for the failure to adduce such evidence in the proceeding before the (Commissioner), the court may order such additional evidence to be taken before the (Commissioner) and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The (Commissioner), may modify his findings of fact, or make new findings by reason of the additional evidence so taken, and he shall file such modified or new findings which if supported by _____ evidence shall be conclusive, and his recommendation if any, for the modification or setting aside of his original order, with the return of such additional evidence.

31. *E.g.*, Cohen v. New York Property Ins. Underwriting Ass'n, 65 A.D.2d 71, 410 N.Y.S.2d 597 (1978).

sioner who determines violations of the Act and judicial action is limited to review of the commissioner's determination.[32] For example, in *First Security Bank v. Goddard*,[33] BULIC argued that judicial review, in an unfair claims practices case, was available only after the commissioner assessed and imposed a penalty. BULIC argued further that a violation of the Montana Insurance Code was subject to a general penalty,[34] in addition to the administrative penalty; therefore, punitive damages to a private litigant would be inappropriate. The court summarily disposed of this argument by stating that no criminal penalty applied to violations of this duty.[35] Thus, the court could properly award punitive damages to plaintiff.

In California, courts have rejected the doctrine of exhaustion argument on the basis of statutory provisions substantially similar to section 13 of the Model Act.[36] In California, section 790.09 of the Insurance Code provides that an insurance company shall not be absolved from any criminal or civil liability under the laws of California even though the commissioner has issued a cease and desist order.[37] The California courts have held that this section makes the doctrines of exhaustion of remedies and primary jurisdiction irrelevant to an action for damages resulting from unfair insurance practices.

The court in *Greenberg v. Equitable Life Assurance Society*,[38] held that section 790.09 "contemplates a private suit to impose civil liability irrespective of governmental action against the insurer for violation of

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32. *Id.*

33. ____ Mont. ____ , 593 P.2d 1040 (1979).

34. MONT. REV. CODES ANN. § 33-1-104 (1979) provides:
Each violation of any provisions of this code with respect to which violation a greater penalty is not provided by other applicable laws of this state shall, in addition to any administrative penalty otherwise applicable thereto, upon conviction in a court of competent jurisdiction of this state be punishable by a fine of not less than $50 or more than $1,000 or by imprisonment in the county jail for not less than 30 days or more than 90 days or by both such fine and imprisonment.

35. ____ Mont. ____ , 593 P.2d 1048.

36. Greenberg v. Equitable Life Assurance Soc'y, 34 Cal. App. 3d 994, 110 Cal. Rptr. 470 (1973); Shernoff v. Superior Court, 44 Cal. App. 3d 406, 118 Cal. Rptr. 680, (1975); Royal Globe Ins. Co. v. Superior Court, 23 Cal. 3d 880, 592 P.2d 329, 153 Cal. Rptr. 842 (1979).

37. CAL. INS. CODE § 790.09 (West 1972) provides:
No order to cease and desist issued under this article directed to any person or subsequent administrative or judicial proceeding to enforce the same shall in any way relieve or absolve such person from any administrative action against the license or certificate of such person, civil liability or criminal penalty under the laws of this state arising out of the methods acts or practices found unfair or deceptive.

38. 34 Cal. App. 3d 994, 110 Cal. Rptr. 470 (1973).

a provision of the Insurance Code."[39] The insurance company argued, however, that no private cause of action exists under the California Insurance Code because 1) the insurance commissioner's administrative authority is exclusive and 2) the appellant did not exhaust the administrative remedies before the insurance commissioner. The court stated:

> Appellant's complaint seeks damages, and Insurance Code § 790.09 provides specifically that the commissioner's action cannot relieve or absolve the insurer from such a claim. No rule of exhaustion of administrative remedies precludes prosecution of the civil claim without resort to an administrative procedure which is irrelevant to the claim.[40]

The irrelevance of the doctrine of exhaustion to an action resulting from unfair insurance practices prohibited by the California Insurance Code was reiterated by the court in *Shernoff v. Superior Court*.[41] The *Shernoff* court held that "[t]he commissioner's disciplinary authority is limited to restraint of future illegal conduct by the real parties in interest, and he possesses no authority to enter money judgments for past injuries. This latter authority remains in the courts."[42] The court concluded that the right to seek damages for past injuries is expressly reserved under section 790.09.

In *Shernoff*, the defendant argued that the doctrine of primary jurisdiction provided a basis for disallowing a private action. The trial court issued a stay in the proceedings against the insurance company because the insurance commissioner was given first opportunity to act on the allegations. The insurance company argued that the stay should be continued because the commissioner held primary jurisdiction over investigating complaints alleging unfair claims practices under the California Insurance Code. The *Shernoff* court was not persuaded and explained that "[t]he doctrine of primary jurisdiction does not permanently foreclose judicial action but rather it provides the appropriate administrative agency with an opportunity to act if it so chooses. At most the commissioner's jurisdiction is 'primary,' not 'exclusive' and in this instance he has chosen not to exercise it."[43]

Because section 13 of the Model Act and Section 790.09 of the California Insurance Code are substantially similar, the rationale sustaining a private cause of action under section 790.09 and rejecting the

39. *Id.* at 1001, 110 Cal. Rptr. at 475.
40. *Id.*
41. 44 Cal. App. 3d 406, 118 Cal. Rptr. 680 (1975).
42. *Id.* at 409, 118 Cal. Rptr. at 682.
43. *Id.*

doctrines of exhaustion and primary jurisdiction, arguably, would apply to section 13. In *Royal Globe Insurance Co. v. Superior Court*,[44] the California Supreme Court, however, noted a distinction between the two sections. Based upon the holdings of *Greenberg* and *Shernoff*, the *Royal Globe* court held that section 790.09 "appears to afford a private litigant a cause of action against insurers which commit the unfair acts or practices defined in subdivision (h)."[45] The defendant insurance company contended that section 790.09 did not provide affirmative authority for allowing a private cause of action but merely allows a civil proceeding based upon other provisions of the law. In response to this argument and in an effort to make an additional argument for a private cause of action under section 790.09, the *Royal Globe* court drew a tenuous distinction between section 790.09 and section 13 of the Model Act. The court suggested that the Model Act does not allow a private action because section 13 states that the insurance commissioner's authority is additional to other powers authorized by law to enforce any penalties for unfair practices. Section 790.09, on the other hand, states that the commissioner's authority is additional to any laws which imposed civil liability for unfair practices. Such laws include the California Insurance Code itself.

> It should be noted in this connection that, while the Model Act states that a person shall not be absolved of liability under "other" state laws, the California act in section 790.09 eliminates the word "other" and provides that an insurer shall not be absolved from "civil liability . . . under the laws of this State" arising out of the insurer's unfair acts.[46]

C. *Extent of the Commissioner's Jurisdiction in Insurance Disputes*

Courts have applied the doctrines of exhaustion of administrative remedies and primary jurisdiction to their version of the Model Act.[47] Other courts conclude that imposing punishment upon insurance companies is exclusively within the jurisdiction of the commissioner.[48]

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44. 23 Cal. 3d 880, 592 P.2d 329, 153 Cal. Rptr. 842 (1979).

45. *Id.* at 885, 592 P.2d at 332, 153 Cal. Rptr. at 845.

46. *Id.* at 386, 592 P.2d at 333, 153 Cal. Rptr. at 846. The Royal Globe court's argument is logically circular. The court is raising an argument for a private cause of action by drawing a tenuous distinction between section 790.09 of the California Insurance Code and section 13 of the model act. The court reasoned that a private cause of action is allowed under California's unfair claims practices legislation because those provisions state that civil liability may be imposed under the law of the state. The unfair claims practices provisions are part of the California Insurance Code and the laws of the state; therefore, one may use them to impose liability upon an insurance company.

47. *E.g.*, Cohen v. New York Property Ins. Underwriting Ass'n, 65 A.D.2d 71, 410 N.Y.S.2d 597 (1978).

48. *See* Cosmopolitan Mut. Ins. Co. v. Nassau Ins. Co., 99 Misc. 2d 1018, 417

Consequently, a court may not award punitive damages to an insured on the basis of the insurer's violation of unfair claims practices legislation.[49] These courts, however, are in disagreement as to whether a private litigant may invoke such legislation in an action to enforce the insurance contract only.[50]

In *Grabowski v. Allstate Insurance Co.*,[51] the court strongly implied that a private cause of action should be allowed under New York's Unfair Claim Settlement Practices Act[52] to the extent that the insured sought compensatory damages and enforcement of the insurance contract itself. The court held that this act imposes upon insurance companies the obligation to make fair and prompt settlement of claims and that "the effectiveness of the statute itself is diluted to the extent that it is all but impossible for anyone 'wronged' by the tactics of a carrier to take any effective steps to seek redress."[53] The recovery of the plaintiff in *Grabowski*, however, was limited to the

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N.Y.S.2d 835 (App. Div. 1979); Russell v. Hartford Casualty Ins. Co., 548 S.W.2d 737 (Tex. 1977).

49. *See Id.*

50. *See* Houser *supra* note 1 at 338 (citing National Association of Insurance Commissioner's Proceedings 1972 Vols. 493-518).

51. 85 Misc. 2d 845, 380 N.Y.S.2d 587 (App. Div. 1976).

52. N.Y. INS. LAW § 40-d (McKinney Supp. 1979-80) provides:

1. No insurer doing business in this state shall engage in unfair claim settlement practices. Any of the following acts by an insurer, if committed without just cause and performed with such frequency as to indicate a general business practice, shall constitute unfair claim settlement practices:

a. knowingly misrepresenting to claimants pertinent facts or provisions relating to coverages at issue;

b. failing to acknowledge with reasonable promptness pertinent communications with respect to claims arising under its policies;

c. failing to adopt and implement reasonable standards for the prompt investigation of claims arising under its policies;

d. not attempting in good faith to effectuate prompt, fair and equitable settlements of claims submitted in which liability has become reasonably clear; or

e. compelling policyholders to institute suits to recover amounts due under its policies by offering substantially less than the amounts ultimately recovered in suits brought by them.

2. Evidence as to numbers and types of complaints to the insurance department against an insurer, and said department's complaint experience with other insurers writing similar lines of insurance, shall be admissible in evidence in an administrative or judicial proceeding brought under this section or articles nine-d or sixteen; provided no insurer shall be deemed in violation of this section solely by reason of the numbers and types of such complaints.

3. If it is found, after notice and an opportunity to be heard, that an insurer has violated this section, each instance of noncompliance with subdivision one may be treated as a separate violation of this section for the purposes of section five. A violation of this section shall not be a misdeameanor.

53. 85 Misc. 2d at 846, 380 N.Y.S.2d at 588 (App. Div. 1976).

amount to which he was entitled under the policy together with interest and costs of the court proceedings.

Subsequently, in *Frizzy Hairstylists, Inc. v. Eagle Star Insurance Co.*,[54] the civil court of New York City in Queens County held that, because the insurance commissioner had exclusive jurisdiction in imposing punishment for violations of the New York act, the court could not properly award punitive damages to the plaintiff. The court stated:

> The complaint herein merely alleges that defendant refused to pay under the terms of a policy issued to the plaintiff after due demand therefore was made. It is the opinion of this court that there can be no recovery for punitive damages herein. . . . While the conduct of the carrier herein is not to be condoned, its punishment is more properly within the province and jurisdiction of the state superintendent of insurance.[55]

Contrary to the implications in *Grabowski* and *Frizzy*, other courts have suggested that in an action for breach of the insurance contract, the insured is limited to the common law basis of recovery.[56] Punitive damages may be awarded in a contract action if the breach resulted from malicious, willful, intentional, or reckless tortious conduct.[57] Without allegations and evidence of such conduct, a court may not award such damages.[58] Violations of the Model Act or similar legislation serves as no basis for punitive damages to the insured.[59] Rather, punishment for such violations are within the exclusive province of the insurance commissioner.[60]

The Supreme Court of Oregon, in *Farris v. U.S. Fidelity and Guaranty Co.*,[61] held that the commissioner has exclusive penal

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54. 93 Misc. 2d 59, 403 N.Y.S.2d 389 (App. Div. 1977).

55. *Id.* at 60, 403 N.Y.S.2d at 390. Although the *Frizzy* court did not consider whether a private cause of action was allowed under the New York Insurance Code, the case has been cited for the proposition that no such action is allowed. Stack v. Nationwide Mut. Fire Ins. Co., 7 Pa. D. & C. 3d 113, 114 (C.P. 1978).

56. *See* Cohen v. New York Property Ins. Underwriting Ass'n, 65 A.D.2d 71, 410 N.Y.S.2d 597 (1978) in which the court, in construing the New York Unfair Claims Practices Legislation, held:

> The Legislature has enacted legislation 40-d of the Insurance Law, which applies to unfair claims practices by insurers. The statute performs the very same disciplinary function, which the plaintiff would have us apply here, and obviates the necessity for the maintenance of causes of action for punitive damages in insurance cases.

Id. at 79, 410 N.Y.S.2d at 602.

57. *See* Gordon v. Nationwide Mut. Ins. Co., 30 N.Y.2d 427, 285 N.E.2d 849 334 N.Y.S.2d 601 (1972), *cert. denied*, 410 U.S. 931 (1973).

58. *Id.*

59. Cohen v. New York Property Ins. Underwriting Ass'n, 65 A.D.2d 71, 410 N.Y.S.2d 597 (1978).

60. *Id.*

61. 284 Or. 453, 587 P.2d 1015 (1978).

authority for violations of Oregon's unfair insurance practices legislation. In *Farris*, the defendant insurer refused to defend the insured in an action brought by another party against the insured for unfair business practices. The insureds defended the action on their own, and then sought costs of the defense and settlement from the insurance company along with punitive damage for emotional distress. The *Farris* court disallowed punitive damages. The court said that emotional distress which resulted from pecuniary loss from a breach of the insurance contract was not recoverable. The court admitted, however, that punitive damages may be awarded if the facts show an action in tort.[62] The plaintiffs argued that because the defendant violated a state statute, an action in tort was justified. The court held, however, that although the insurance company violated the provisions of the insurance code which prohibited unfair settlement practices, "[t]here is nothing to indicate that the legislature intended, when it prohibited certain claims settlement practices in ORS 746.230, that actions for breach of insurance contracts would be transformed, in all the covered instances, into tort actions with a resulting change in the measure of damages."[63] The court concluded that the exclusive remedy for civil penalties is within the province of the insurance commissioner.

A persuasive dissent in *Farris* reasoned that the Oregon Insurance Code not only provided for civil penalties to be imposed by the commissioner but also provided that these "penalties are in addition to and not in lieu of other enforcement provisions."[64] One of these notable methods of enforcement includes a private cause of action.

III. EXTENDING THE INSURER'S OBLIGATIONS UNDER THE ACT TO THIRD PARTIES

Ordinarily, insurance policies leave the insurer with the decision whether to settle a claim of the insured.[65] Consequently, a duty of good faith and fair dealing is imposed upon the insurer so that the insured's interests are given consideration at least equal to that of the insurer.[66] The general rule, therefore, is that this duty of good faith and

62. *Id.* at 458, 587 P.2d at 1018.

63. *Id.*

64. *Id.* at 465, 587 P.2d at 1029 (Lent J., dissenting).

65. J. Appelman, INSURANCE LAW AND PRACTICE, § 4711 (Berdal ed. 1979). "Liability insurance contracts have been held to give the insurer absolute authority to settle claims within the policy limits, and the insured has no right to compel the insurer to make such settlements, or to prevent it from doing so." *Id.*

66. *See* Ballad v. Citizens Cas. Co., 196 F.2d 96 (7th Cir. 1952); Annot. 40 A.L.R.2d 168 (1955). There is a division of authority as to whether the insurer's duty is to act in good faith to the insured or whether the insurer's duty is to exercise due care.

fair dealing by the insurer, though implied in law, arises from the insurance contract and is owed only to the insured.[67] A majority of jurisdictions have held that absent a statute or contractual language granting a direct action against the insurer by a third party, an injured third party has no right of action against the insurer for breach of the duty to exercise good faith on behalf of the insured.[68] A general duty of good faith has been codified in the Model Act.[69] Thus, if a private action is allowed under the Model Act, the question immediately posed is whether third party claimants are entitled to enforce this provision through a private cause of action which, in effect, abrogates that principle of insurance law limiting good faith duty to the insured. This issue may be resolved by examining various state analyses of 1) whether the legislation preserves existing remedies or creates new remedies and 2) whether third party claimants are intended beneficiaries of such legislation.

A. Preservation of Existing Remedies or Creation of New Remedies for Third Party Claimants

No court would, of course, hold that the Model Act vests exclusive jurisdiction in the insurance commissioner beyond the imposition of penalties to insurance companies.[70] Section 13 clearly preserves a litigant's rights at common law and equity in enforcing an insurance contract.[71] On this basis, the weight of authority supports the position that this section preserves existing remedies and does not create new rights and liabilities.

In construing a provision which in substance is identical to section 13 of the Model Act, the court in *Collins v. Northwestern National Insurance Group*[72] noted that "[t]here is a substantial difference between the preservation of previously existing causes of action and the creation of new rights and liabilities."[73] The court held that the Penn-

67. Royal Globe Ins. Co. v. Superior Court, 23 Cal. 3d 880, 892-93, 592 P.2d 329, 337, 153 Cal. Rptr. 842, 850 (1979); Scroggins v. Allstate Ins. Co., 74 Ill. App. 3d 1027, 1030, 393 N.E.2d 718, 721 (1979).

68. Scroggins v. Allstate Ins. Co., 74 Ill. App. 3d 1027, 393 N.E.2d 718, 721 (1979).

69. See UNFAIR CLAIMS SETTLEMENTS PRACTICES ACT, § 3(9)(f) note 2 *supra*.

70. Plaintiffs may always enforce their common law rights in court.

71. Section 13 specifically states that the commissioners powers "shall be additional to any other powers to enforce any penalties, fines or forfeitures authorized by law with respect to the methods, acts and practices hereby declared to be unfair or deceptive." UNFAIR CLAIMS SETTLEMENT PRACTICES ACT, § 13.

72. 2 Pa. D. & C. 3d 568 (C.P. 1977).

73. *Id.* at 573.

sylvania Unfair Practices Act[74] clearly did not create a new cause of action for third party claimants when no such right exists in equity. The court refused to extend an insurance company's statutory duty of good faith to a third party.

Justice Richardson's concurring and dissenting opinion in *Royal Globe Insurance Co. v. Superior Court*[75] presents strong arguments against the creation of new remedies for third party claimants. In relying upon a previous California Supreme court decision, Justice Richardson said that the insurer's duty of good faith extends to the insured but not to the injured party.[76] The Justice also said that in the absence of a formal assignment of the insured's cause of action, an injured third party may not recover from the insurer for the breach of this duty. The Justice reasoned that "[t]he duty to settle is implied in law *to protect the insured* from exposure to liability in excess of coverage as a result of the insurer's gamble—on which only the insured might lose."[77] He reasoned further that "*[t]he insurer's duty to settle does not directly benefit the injured claimant. In fact, he usually benefits from the duty's breach.*"[78] The Justice then considered the section of the California Insurance Code patterned after the Model Act and concluded that the section "was intended to *preserve* any civil or criminal liability already provided for under state law, rather than to *create* new liability thereby changing pre-existing state law."[79]

The argument for allowing a third party a private cause of action to enforce the statutory duty of good faith, is premised on the fundamental principle that, if the insurer owes a duty of good faith to the third party, then an appropriate remedy must exist.[80] This principle applies, however, only if the statutory duties, under the unfair practices

74. PA. STAT. ANN. tit. 26, § 2716(a).

75. 23 Cal. 3d 880, 592 P.2d 337, 153 Cal. Rptr. 880.

76. In relying upon Murphy v. Allstate Ins. Co., 17 Cal. 3d 937, 553 P.2d 584, 132 Cal. Rptr. 424 (1976), Justice Richardson stated:

> Only three years ago we *unanimously* held . . . that the insurer's duty to settle *runs to the insured* and *not to the injured party*, and that, accordingly, the latter may *not* recover from the insurer for breach of that duty in the absence of a proper formal assignment of the insured's cause of action.

Royal Globe Ins. Co. v. Superior Court, 23 Cal. 3d at 892-93, 592 P.2d at 337, 153 Cal. Rptr. at 850.

77. *Id.*

78. *Id.*

79. *Id.* at 896, 592 P.2d at 339, 153 Cal. Rptr. at 852.

80. Greenberg v. Equitable Life Assurance Soc'y, 34 Cal. App. 3d 994, 110 Cal. Rptr. 470 (1973). The *Greenberg* court held, in interpreting the unfair claims settlement practices provisions of the California Insurance Code, that "[t]he fair construction is that the person to whom the civil liability runs may enforce it by an appropriate action." *Id.* at 1001, 110 Cal. Rptr. at 475.

acts, vest statutory rights in third parties. In resolving the issue whether third parties are vested with such rights, the courts have scrutinized the language of the unfair insurance practices acts to determine the intended beneficiaries.

B. The Intended Beneficiaries of the Act

California has initiated a trend toward including third party claimants as beneficiaries of the unfair claim practices legislation. In *Cancino v. Farmers Insurance Group*,[81] the plaintiff, a third party claimant under an uninsured motorist insurance policy, sought recovery for injuries in an amount equal to the policy limits. Plaintiff also sought punitive damages for the insurer's refusal to settle plaintiff's claim in a timely manner in accordance with good faith and fair dealing. The defendant insurer demurrered to the complaint on the basis that the plaintiff was not a party to the insurance contract and, therefore, could not sue for bad faith. The court disagreed by holding that

> [t]he duty of an insurer to deal in good faith is an aspect "of the relationship between the defendant insurer and its insured" . . . . Though an insurance contract is indispensable to the existence of such relationship and the insurer must by definition be a party, insureds often are not. This circumstance, however . . . does not exempt the insurer . . . from "unfair practices in the business of insurance." We, therefore, conclude that the complaint stated a cause of action.[82]

A more thorough analysis of this issue was presented in *Royal Globe Insurance Co. v. Superior Court*.[83] The plaintiff sustained injuries when she slipped and fell on the floor of a supermarket which carried liability insurance. The plaintiff joined Royal Globe Insurance Company as defendant. The complaint alleged that the defendant insurance company violated the Unfair Practices Act of California by refusing to settle a claim in good faith and advising plaintiff not to seek an attorney. As a basis for a motion for judgment on the pleadings, the defendant argued that a third party claimant has no standing to assert that the insurer violated a duty of good faith under the insurance contract. The *Royal Globe* court noted, however, that some of the protections under the California Unfair Claims Act[84] specifically

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81. 80 Cal. App. 3d 335, 145 Cal. Rptr. 503 (1978).
82. *Id.* at 338-39, 145 Cal. Rptr. at 504.
83. 23 Cal. 3d 880, 592 P.2d 329, 153 Cal. Rptr. 842, (1979).
84. CAL. INS. CODE § 790.03 (West Supp. 1980).

extended to the insured,[85] some to claimants[86] and others to both insureds and claimants.[87] Under the California Act, both provisions asserted by the plaintiff extended to third party claimants.

The *Royal Globe* court was confronted with compelling authority in *Murphy v. Allstate Insurance Co.*[88] which held that a third party claimant could not recover an amount in excess of the policy limits unless he was assigned the insured's cause of action. In distinguishing the *Murphy* holding, the *Royal Globe* court held that its decision in this case was not based upon insurance contract principles. The court reasoned that

> [i]n the present case, plaintiff does not seek to rely upon the violation of the insurer's duty to its insured to settle plaintiff's claim. Rather, she relies upon the insurer's duty owed to her as a claimant under subdivision (h)(5) and (h)(14) of section 790.03, a duty created by those statutory provisions and owed directly to plaintiff as a claimant.[89]

The prohibition of § 790.03(h)(5) is substantially identical to section 3(9)(8) of the Model Act. Therefore, under the holding of *Royal Globe*, a persuasive argument could be made that the prohibition applies to third party claimants who may assert its violation in a private cause for punitive damages.

Like the California Act, the Model Act states that unfair claims settlement practices acts are those which are committed with such frequency as to indicate a general business practice.[90] The defendant in *Royal Globe* convincingly argued that a violation of the statutory good

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85. The California Insurance Code prohibits insurers from "[a]ttempting 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." *Id.* § 790.03(h)(7).

86. The California Insurance Code prohibits insurance companies from "[d]irectly advising a claimant not to obtain the services of an attorney." *Id.* § 790.03(h)(14).

87. The California Insurance Code prohibits "[m]aking 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 compromise less than the amount awarded in arbitration." *Id.* § 790.03(h)(10).

88. 17 Cal. 3d 937, 553 P.2d 584, 132 Cal. Rptr. 424 (1976). The Royal Globe court distinguished Murphy on the basis that the plaintiff in Murphy unlike the plaintiff in Royal Globe, did not allege violations of the California Insurance Code.

89. 153 Cal. Rptr. at 845, 592 P.2d at 335.

90. CAL. INS. CODE § 790.03(h)(5) states that insurance companies are prohibited from "[k]nowingly committing or performing with such frequency as to indicate a general business practice" unfair and deceptive claims settlement practices. Section 4(9) of the Model Act prohibits insurance companies from "[c]ommitting or performing with such frequency as to indicate a general business practices" unfair claims settlement practices.

faith requirement is actionable only if committed with such frequency as to constitute an insurance practice. Under the Model Act a most flagrant violation could remain unpunished by either the commissioner or the court because "a single act does not constitute such frequency as to indicate a general business practice."[91] Insurance companies, by isolating their violations of the Act, could then shield themselves from punishment to their own pecuniary advantage.[92]

The *Royal Globe* court was sensitive to this problem.[93] In an apparent effort at judicial legislation,[94] the court held that frequency of an insurer's misconduct is relevant only to the insurance commissioner's duties in issuing cease and desist orders. On the other hand, the *Royal Globe* court ruled "[t]here would be no rational reason why an insured or a third party claimant injured by an insurer's unfair conduct, knowingly performed, should be required to demonstrate that the insurer had frequently been guilty of the same type of misconduct involving other victims in the past."[95] The court concluded that a private cause of action for punitive damages may arise from a single unfair insurance practice.[96]

Justice Richardson, concurring and dissenting in *Royal Globe*, reasoned that the legislative intent behind the California Insurance Code illustrated that no private action exists to enforce its provisions. The legislative intent, he stated, could be gleened from the express language of Section 790.03(h)(5) which prefaces the various practices deemed unfair. Because that section prohibits "[k]nowingly committing or performing with such frequency as to indicate a general business practice any of the following unfair claims settlement practices," Justice Richardson reasoned that a private cause of action could not be allowed to any party seeking damages for a single unfair practice. "Rather such acts were to be considered unfair practices . . . only if committed with the requisite frequency."[97]

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91. See Unfair Claims Settlement Practices Act § 3(9) note 2 *supra*.

92. Cohen v. New York Prop. Ins. Underwriting Ass'n, 65 A.D.2d 71, 410 N.Y.S.2d 597 (1978) (Lupiano, J., dissenting).

93. 23 Cal. 3d at 888, 592 P.2d at 335, 153 Cal. Rptr. at 847.

94. *Id.*

95. 23 Cal. 3d at 891, 592 P.2d at 336, 153 Cal. Rptr. at 849.

96. The Royal Globe court also held, however, that the plaintiff may not sue both the insured and his insurer in the same action because evidence of insurance in such action is prohibited. To prevent the obvious prejudicial effect of such evidence, the action against the insurer is postponed until liability of the insured to the plaintiff is established. *Id.*

97. 23 Cal. 3d at 895, 592 P.2d at 338-39, 153 Cal. Rptr. at 852 (Richardson J., concurring and dissenting).

In Illinois, insurance companies are prohibited from improper claims practices if "(a) it is committed knowingly in violation of this Act or any rules promulgated hereunder; or (b) it has been committed with such frequency to indicate a persistent tendency to engage in that type of conduct."[98] The Illinois Insurance Code defines a specific unfair claims practice as "[n]ot attempting in good faith to effectuate, prompt, fair and equitable settlement of claims submitted in which liability has reasonably become clear."[99] In *Scroggins v. Allstate Insurance Co.*,[100] the plaintiffs sought recovery for injuries allegedly sustained when struck by an automobile driven by the insured. The issue before the court was whether the plaintiffs had a cause of action against Allstate who allegedly violated the Illinois Insurance Code through failure to satisfy their claims in good faith. The plaintiffs argued that the Illinois Insurance Code[101] imposed a statutory duty on insurers to negotiate claims in good faith when liability is reasonably clear. Because Allstate violated this statutory duty, the plaintiffs claimed to have a private right of action. Furthermore, the Illinois insurance law requires only one act knowingly committed to constitute an unfair insurance practice.

The *Scroggins* court, however, held that the plaintiffs failed to state a cause of action. The court reasoned that the insurance company's duty to exercise good faith under the Illinois statutes was intended to benefit the insured and provided an administrative enforcement mechanism to benefit the public generally.[102] The court also reasoned that, assuming arguendo that the plaintiffs adequately alleged a breach of the statutory duty of good faith, they failed to establish that the statutory duty is one which runs to them or that they are members of the class which the statute was designed to protect.[103]

The Model Act, like both the Illinois and California Insurance Codes, requires insurance companies to act "in good faith to effectuate prompt, fair and equitable settlements of claims in which liability is reasonably clear."[104] Under the California approach, this provision protects third party claimants as well as insureds. Consequently, both groups are entitled to a private cause of action. Notwithstanding the California rule, Illinois third party claimants are denied a private cause

98. ILL. REV. STAT., ch. 73, § 154.6 (1975).
99. *Id.* at § 153.3(d).
100. 74 Ill. App. 3d 1027, 393 N.E.2d 718 (1979).
101. ILL. REV. STAT., ch. 73, § 154.6 (1975).
102. 74 Ill. App. 3d 1027, 393 N.E.2d 718.
103. *Id.*
104. See UNFAIR CLAIMS SETTLEMENT PRACTICES ACT § 3(9)(f).

of action, in part, because they are not among the intended beneficiaries for whom the legislation was enacted.

Although the Model Act is not accompanied by legislative history, a valid argument may be made for disallowing a private action on the basis of a federal court's interpretation of comparable federal legislation. In *Holloway v. Bristol-Meyers Corp.*,[105] the United States Court of Appeals of the District of Columbia Circuit held that the Federal Trade Commission Act[106] is not enforceable through a private cause of action because such an action would be inconsistent with the legislative scheme of the act and would endanger the specificity and certainty of enforcement by the Federal Trade Commissioner (FTC).

In *Holloway*, the court's argument necessarily assumes that the Federal Trade Commissioner exercises his enforcement authority and that the commissioner's measures are effective. The assumption has been found to be erroneous in that both the FTC and state consumer protection agencies are to a large extent ineffective in combating unfair trade practices.[107] Indeed, a private cause of action, under these circumstances, may assist in enforcement efforts and serve as a complementary device.[108]

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105. 485 F.2d 986 (D.C. Cir. 1973).

106. 15 U.S.C. § 41 et. seq. (1976).

107. A 1969 study of the FTC conducted by the ABA revealed that the FTC's enforcement mechanism was no match for the consumer fraud problem. State administrative efforts were similarily ineffective. Comment, *Private Remedies Under the Consumer Fraud Acts: The Judicial Approaches of Statutory Interpretation and Implication* 67 NW. U.L. REV. 413, 415 (1972).

108. One critic of the administrative system of enforcement has urged:

> What we need now in the deceptive trade practices area is a comparable development of private remedies to match the recent growth of government investigation and prosecution efforts. Without effective private remedies the widespread economic losses that result from these trade practices remain uncompensated, and furthermore, private remedies are highly desirable for additional consumer bargaining power and more complete discipline against fraud in the marketplace. However, it must be realized that the precise mixture of threatened injury, investigation costs, litigating risk and expenses, standards for illegality and properly recoverable damages will vary considerably as between antitrust violations, frauds involving corporate stocks or bonds, and deceptive trade practice situations. Therefore, the proper balance between consumer rights and remedies, the defenses of businessmen, and the appropriate allocation of attorney's fees and other legal costs, must be adjusted to the special circumstances of deceptive trade practice litigation.

Lovett, *Private Actions for Deceptive Trade Practices*, 23 AD. L. REV. 271, 272 (1970-71). The writer concluded that "the best solution to the problem of private remedies for deceptive trade practices would seem to be widespread enactment of treble damages plus attorney fees as the normal consumer remedy." *Id.* at 289.

C. Policy Considerations and the Act

In *Cancino v. Farmers Insurance Co.*,[109] a private cause of action was allowed on the basis of the policy of the unfair claims practices legislation. The *Cancino* court held that the duty of good faith under the California Insurance Code should extend to the named insured as well as to third party claimants to promote the policy of the insurance code. The court noted that a general policy of the insurance code was to "provide compensation for those injured through no fault of their own."[110] This general policy is accompanied by a specific policy which prohibits unfair insurance practices including failure to settle claims in good faith. The court concluded that "to deny the plaintiff in this case the benefit of the duty to negotiate in good faith *would* frustrate the policy of the Insurance Code."[111] *Cancino* clearly illustrates the importance of unfair claims practices legislation in promoting state policies through a private cause of action to third party claimants.

The interplay of public policy and the unfair insurance practices legislation is well illustrated by dissenting Justice Lupiano in *Cohen v. New York Property Insurance Underwriting Assoc.*[112] In *Cohen*, an owner of apartment houses in a depressed area of the Bronx in New York City sought to recover insurance proceeds after his buildings were severely damaged by fire. The insurance company delayed settlement resulting in further damage to the building. The *Cohen* majority held that the New York insurance law requiring good faith settlement did not create a private cause of action. Justice Lupiano, in the dissent, elaborated upon the problem of urban decay and noted that the

> moral and ethical imperative in stemming the tide of urban blight and in reclaiming these "lost" areas may not always coincide with business acumen and the profit motive. It may well be that the actions of the insurer herein can be viewed against the ambivalent and interlocking factors inherent in the war against urban decay. At the least, the policy factors inherent in the relationship of insured and insurer and in the case of distressed areas impel a liberal tendency by the court in its analysis of the legal issue presented in this appeal.[113]

Under Justice Lupiano's analysis, the relationship of the insured and insurer in this case affects not only the parties involved but also a major public policy concern involving urban decay. Whether a private cause of action is allowed or denied the insured, the court should not

109. 80 Cal. App. 3d 335, 145 Cal. Rptr. 503 (1978).
110. *Id.* at 345, 145 Cal. Rptr. at 509.
111. *Id.*
112. 65 A.D.2d 71, 410 N.Y.S.2d 597 (1978).
113. *Id.* at 90, 410 N.Y.S.2d at 609 (Lupiano J., dissenting).

ignore the interests of the general public. Justice Lupiano suggests that if the plaintiffs are able to prove bad faith by the insurance company and violation of the unfair claims settlement practices standards, then an award of punitive damages may provide the necessary sting to deter similar conduct and to reemphasize the policies of that jurisdiction.

An argument similar to that of Justice Lupiano was represented in *Farris v. U.S. Fidelity and Guaranty Co.*[114] The insured argued that, because the breach of an insurance contract is tinged with a public interest, public policy dictates an award of punitive damages.

The *Farris* court conceded that punitive damages may be awarded under circumstances in which a public service enterprise deliberately breaches its obligation to the public. The court established that under section 746.230 and 731.988 of the Oregon Revised Statutes, the legislature recognized the public service nature of the insurance business and prohibited certain unfair insurance practices. In construing these provisions, however, the court concluded that "the legislature did not intend that punitive damages result because of the public service character"[115] of the insurance company. The court concluded that in a situation in which an insurer breaches a contract, punitive damages may be allowed only on the basis of common law civil remedies.

IV. CONCLUSION

In states which have enacted legislation based on the Model Act, courts must consider several factors in determining whether a third party claimant may allege violation of this legislation in a direct action against an insurance company for compensatory and punitive damages. A court may hold that, despite its regulatory nature, the Act may be incorporated into the insurance contract so that breach of the insurance contract involves a violation of statute resulting in a tort and a basis for punitive damages. This result necessarily requires a determination of the inapplicability of the doctrine of exhaustion of administrative remedies and primary jurisdiction. In addition, allowing a third party a private right of action requires a finding that such person is an intended beneficiary of the statute and, therefore, is bestowed an enforceable right. This legal analysis becomes appropriate in circumstances in which a jurisdiction finds its administrative enforcement mechanism incapable of preventing insurance practices which offend the particular public policies of that jurisdiction.

James C. Klein

114. 284 Or. 453, 587 P.2d 1015 (1978).
115. *Id.* at 467, 587 P.2d at 1023.