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## Juries as Regulators of Last Resort

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## JURIES AS REGULATORS OF LAST RESORT

STEPHAN LANDSMAN\*

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## INTRODUCTION AND A BIT OF HISTORY

Juries were once the primary government regulators in America.<sup>1</sup> Throughout the eighteenth century and well into the nineteenth, at a time when legislation was rare and the executive branch weak, juries not only adjudicated legal disputes but, through court cases, enforced taxes, determined welfare rolls, mandated highway repairs, and generally oversaw public business.<sup>2</sup> In the early days of the Republic, the decisions of juries were also viewed as determining the law of the land, hence defining the legal standards for proper conduct.<sup>3</sup> With the growth of the other branches of government—and the judiciary’s assertion in the nineteenth century of control over law fixing—the jury lost its role as the chief regulator of societal conduct.<sup>4</sup> Yet, the regulatory function of juries never entirely ended. The jury’s determination of reasonableness in negligence cases provides an example of its continuing participation in the establishment of the parameters of proper social conduct.

Today, legislatures and executive bodies generate huge volumes of legal regulations and are the central instruments of governance.<sup>5</sup> Yet these bodies have, in a number of areas, faced substantial impediments to regulation. Some of these impediments are built into the American way of doing things. Samuel Issacharoff has explored the American inclination to allow free entry into markets and the legal consequences of that approach.<sup>6</sup> Such a policy has fostered dramatic business growth but has also meant that there may be few fixed regulations or standards to address harmful

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1. See WILLIAM E. NELSON, *AMERICANIZATION OF THE COMMON LAW: THE IMPACT OF LEGAL CHANGE ON MASSACHUSETTS SOCIETY, 1760-1830*, at 13-23 (1975).

2. See Stephan Landsman, *The Civil Jury in America: Scenes from an Unappreciated History*, 44 *HASTINGS L.J.* 579, 592-94 (1993) (noting the broad power of colonial American juries in legal, social, and economic matters).

3. See NELSON, *supra* note 1, at 3.

4. See MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW, 1780-1860*, at 140-41 (1977) (detailing the rise of legal practitioners to “position[s] of political and intellectual domination” in postrevolutionary American society).

5. See Marc Galanter, *Law Abounding: Legalization Around the North Atlantic*, 55 *MOD. L. REV.* 1, 6-7 (1992).

6. See Samuel Issacharoff, *Regulating After the Fact*, 56 *DEPAUL L. REV.* 375, 377 (2007).

activities.<sup>7</sup> This has necessitated frequent resort to courts and juries.<sup>8</sup> Where regulation has been undertaken, the well-heeled and well-connected have often been able to powerfully influence the regulatory process.<sup>9</sup> Sometimes this has amounted to the “capture” of the regulatory machinery by the regulated.<sup>10</sup> The substantial likelihood of such capture is suggested by the economist George Stigler’s observation that, when regulatory machinery is set up, it is often “acquired by the industry and is designed and operated primarily for its benefit.”<sup>11</sup>

In addition to outright capture, members of various regulated industries secure sympathetic treatment from regulators in a variety of other ways.<sup>12</sup> The desire among some regulators for future employment has led them to refrain from zealous enforcement.<sup>13</sup> When enforcement is undertaken, it is often based on information prepared and provided by the regulated. Such material is likely to favor industry claims<sup>14</sup> or simply overwhelm regulators because of its volume and complexity.<sup>15</sup> To add to the normal challenges regulators face, they are often hampered by inadequate budgets,<sup>16</sup> as well as the possibility of funding cuts engineered by politically powerful members of a regulated industry.<sup>17</sup> In a number of circumstances, those potentially subject to oversight have also been able to use their economic power and communications skills (honed

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7. *See id.* at 384-87.

8. *Id.* at 377 n.13.

9. *See* Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, FLA. ST. U. L. REV. 625, 667 (1999).

10. *See id.* at 639 & n.87.

11. George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3, 3 (1971), *quoted in* Barak Orbach, *What is Regulation?*, 30 YALE J. ON REG. ONLINE 1, 52 n.18 (2012).

12. *See* Randall, *supra* note 9, at 639 (explaining how the National Association of Insurance Commissioners is controlled by the insurance industry to an extent greater than just “capture”).

13. *See id.* at 662 n.232.

14. *Id.* at 681.

15. *See* Wendy E. Wagner, *Administrative Law, Filter Failure, and Information Capture*, 59 DUKE L.J. 1321 (2010).

16. *See* Richard B. Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1669, 1686 (1975).

17. *See* Randall, *supra* note 9, at 682-83 (showing how, in the insurance context, the National Association of Insurance Commissioners’ reliance on the industry for funding hobbles its regulatory function).

through advertising and public relations campaigns) to skew the regulatory debate in their favor—as exemplified by the often cited McDonald’s coffee spill episode.<sup>18</sup> The result of these checks on the efficiency and integrity of regulators is the creation of a less than perfect regulatory mechanism containing gaps, many of them perpetuated by those who might otherwise have been subject to scrutiny.

It will be this Article’s contention that the civil jury has been pressed into service by the judiciary on a number of occasions to address situations where a regulatory gap is perceived, administrative intervention—either grounded in a pre-existing statutory duty or prompted by court directive—seems hopeless, and the need for a rule to restrain the powerful from gross overreaching appears essential. What the jury has become in these circumstances is a regulator of last resort—albeit one without the focus or expertise of an executive agency or legislative committee, but one charged to respond nevertheless. Part I of this Article will examine the judge’s and jury’s roles in considering otherwise under or unregulated situations and the reasons why courts have been inclined, at least sometimes, to turn such matters over to juries. Part II will use the development of the tort of bad faith in insurance transactions as a case study of the growth of the use of the jury as a last resort regulator. This Part, while briefly considering the early history of the bad faith tort, will concentrate most of its attention on a series of California cases decided between 1958 and 1979. California’s decisions steadily expanded the bad faith tort from its narrow beginnings in so-called third-party situations, where an insurance carrier failed to honor an obligation to defend the interests of its insured against claims by others, to the much more common first party settings where an insurer, for one reason or another, denied a compensation claim by its own insured. Part II will analyze the California courts’ expressed reasons for acting, including the insured’s and company’s circumstances, as well as broader policy concerns. Part III will explore possible unarticulated motivations,

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18. See generally WILLIAM HALTOM & MICHAEL MCCANN, *DISTORTING THE LAW: POLITICS, MEDIA AND THE LITIGATION CRISIS* (2004); Stephen Daniels & Joanne Martin, “*The Impact that It Has Had Is Between People’s Ears: Tort Reform, Mass Culture, and Plaintiffs’ Lawyers*,” 50 *DEPAUL L. REV.* 453, 466-70 (2000).

like the absence of effective regulation and the capture by the insurance industry of the regulatory apparatus. Part IV will consider another area where the courts may be warranted in turning to the jury as a regulator of last resort: bad faith manipulation of adhesion—contract-imposed arbitration proceedings.

### I. JUDICIAL TORT-BASED REGULATION

America's courts have retained a significant role in law making, most particularly in the tort area.<sup>19</sup> They have continued the common law tradition of addressing perceived wrongs by recognizing a right of action accruing to those harmed.<sup>20</sup> In Blackstone's words: "[I]t is a general and indisputable rule, that where there is a legal right, there is also a legal remedy, by suit or action at law, whenever that right is invaded."<sup>21</sup> While creation of truly new torts has been rare since the middle of the twentieth century, there are at least four instances where a substantial number of courts have created new causes of action.<sup>22</sup> Two of these, the intentional infliction of emotional distress (IIED) tort and the expanded protection of privacy,<sup>23</sup> might be characterized as responding to heightened social sensitivity to the mental harms that tortfeasors can do their victims. The parameters of the IIED tort are flexible, as befits a cause of action about the myriad ways people and institutions can cause substantial psychological harm.<sup>24</sup> That said, courts have concentrated on limiting actionable IIED claims to particularly outrageous conduct that caused verifiable mental suffering.<sup>25</sup> The privacy tort concerns itself with a handful of ways defendants may

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19. See George L. Priest, *The Modern Transformation of Civil Law*, 54 *BUFF. L. REV.* 957, 957-68 (2006).

20. See *id.* at 964.

21. 3 WILLIAM BLACKSTONE, *COMMENTARIES* \*23.

22. See Roger C. Henderson, *The Tort of Bad Faith in First-Party Insurance Transactions: Refining the Standard of Culpability and Reformulating the Remedies by Statute*, 26 *U. MICH. J.L. REFORM* 1, 1 (1992).

23. See *id.*

24. See Daniel Givelber, *The Right to Minimum Social Decency and the Limits of Evenhandedness: Intentional Infliction of Emotional Distress by Outrageous Conduct*, 82 *COLUM. L. REV.* 42, 42 (1982).

25. *Id.* at 57.

intrude upon and undermine the privacy of others.<sup>26</sup> While the privacy tort has its roots in the classic work of Warren and Brandeis in 1890,<sup>27</sup> it truly flowered in the latter part of the twentieth century as the doctrines of intrusion, false light, misappropriation, and publication of private facts were all fleshed out.<sup>28</sup> Although both of these torts are arguably regulatory in thrust because they seek to curtail injurious behavior,<sup>29</sup> the serious restrictions placed on their scope by free speech concerns have narrowed their reach. This point was illustrated when the Supreme Court recently decided in *Snyder v. Phelps* that extraordinarily provocative behavior during the funeral of a soldier killed in the war in Iraq was protected from an IIED claim despite the great likelihood it would cause severe emotional pain.<sup>30</sup> *Snyder* relied on the limiting approach adopted by the Supreme Court in earlier privacy law rulings, like that in *Hustler Magazine v. Falwell* regarding Hustler Magazine's brutal parody about incest in an outhouse directed at the minister Jerry Falwell.<sup>31</sup> Moreover, it appears neither tort has been used to regulate the conduct of a specific industry or relationship.

The remaining two "new" torts have been far more clearly regulatory in thrust. The first of these torts is strict products liability.<sup>32</sup> Beginning in 1963 with *Greenman v. Yuba Power Products, Inc.*,<sup>33</sup> the courts developed a series of legal doctrines designed to regulate the distribution of defective products dangerous to the consuming public.<sup>34</sup> The judiciary stepped into a setting in which American industry was not extensively regulated and insisted on more regulation to ensure the manufacture of safe products.<sup>35</sup>

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26. Courts have extended the concept of IIED into the realm of negligently inflicted emotional distress (NIED), but with substantial additional limits, beginning with the California Supreme Court decision in *Dillon v. Legg*, 441 P.2d 912 (Cal. 1968). For analysis of the development of the NIED tort, see PROSSER AND KEETON ON THE LAW OF TORTS 359-66 (W. Page Keeton et al. eds., 5th ed. 1984).

27. See generally Samuel Warren & Louis Brandeis, *The Right to Privacy*, 4 HARV. L. REV. 193 (1890).

28. See PROSSER AND KEETON, *supra* note 26.

29. See Priest, *supra* note 19, at 957.

30. 131 S. Ct. 1207, 1219 (2011).

31. 485 U.S. 46 (1988).

32. See Priest, *supra* note 19, at 964-68.

33. 377 P.2d 897 (Cal. 1963).

34. See Priest, *supra* note 19, at 964-68.

35. See *id.*

The courts thus became the guardians of a broad swath of consumer interests.<sup>36</sup> Since the 1980s this regulatory activity appears to have slowed, but the courts continue to consider consumer products safety questions.<sup>37</sup>

The other new tort created in this period was the insurance bad faith tort.<sup>38</sup> This one also had an intensely regulatory thrust, focusing on the perceived misconduct of one particular industry, the providers of insurance coverage. Unlike products liability doctrine, the bad faith tort has continued to expand and has played an ongoing part in regulating the conduct of insurance companies.<sup>39</sup>

In these tort-based contexts, the key mechanism by which authority has been exercised is the verdicts of juries in civil cases. Juries have been asked to say when conduct is so outrageous as to be an intentional infliction of emotional distress, so intrusive as to violate our notions of privacy, so risky as to make a product defective, and so outside the expectations of good faith and fair dealing as to deny the reasonable expectations of insurance purchasers. In each of these settings the jury's focus is not some narrowly defined legal requirement but a far broader question of appropriate conduct in the circumstances. One might object that none of this is "real" regulation. To address that point, it is necessary, first, to clarify what the act of regulation entails and, second, to ask if jury decisions truly regulate. Perhaps surprisingly, there is no widely agreed upon definition of regulation.<sup>40</sup> In the wake of *National Federation of Independent Business v. Sebelius*,<sup>41</sup> Barak Orbach turned to this question, one central to the debate within the Supreme Court about President Obama's healthcare initiative.<sup>42</sup> Orbach agrees with those who argue that we do not have a fixed and

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36. *Id.* at 973-77 (explaining how increased attachment of legal liability forces manufacturers to internalize costs and risk of harm).

37. See generally James A. Henderson, Jr. & Theodore Eisenberg, *The Quiet Revolution in Products Liability: An Empirical Study of Legal Change*, 37 UCLA L. REV. 479 (1989).

38. See Henderson, *supra* note 22, at 1.

39. See *id.* at 3 (detailing the rise of bad faith breach of insurance contract claims).

40. See Orbach, *supra* note 11, at 2 n.5 (detailing the views of a number of scholars who have concluded that there is no settled definition of regulation).

41. 132 S. Ct. 2566 (2012).

42. See generally Orbach, *supra* note 11, at 1-6 (describing how the definition of the word "regulation" would impact judicial interpretations of legislative and executive actions due to its frequent reference by administrative agencies).

settled definition.<sup>43</sup> That said, he advances several proposals, perhaps the most useful of which for present purposes is “government intervention in the private domain or a legal rule that implements such intervention. The implementing rule is a binding legal norm created by a state organ that intends to shape the conduct of individuals and firms.”<sup>44</sup> This definition suggests the breadth of regulatory activity and recognizes that “our regulatory landscape does not originate in administrative agencies.”<sup>45</sup> Court and jury action in the settings described above are certainly interventions in the private domain. Such interventions may result in a sizeable award of damages by the jury if it concludes that inappropriate conduct has been demonstrated by the evidence produced.

The second question is whether jury verdicts create binding legal norms of the sort that courts and affected parties will recognize as shaping conduct. Jury decisions may create norms in a number of ways. Most directly, verdicts suggest that similar cases are likely to produce similar results. This, at a minimum, informs attentive lawyers of the potential strength of certain legal and factual combinations for the purposes of claims and settlement.<sup>46</sup> Most significantly, such verdicts and the facts that undergird them may have a powerful influence on the judiciary—signaling societal attitudes about the direction in which legal requirements should move. Perhaps the best illustration of this point is to be found in the development and eventual rejection of the doctrine of contributory negligence, which occurred over the course of the nineteenth and twentieth centuries.<sup>47</sup> During this process, a rule of reasonable conduct administered by juries came to be seen as a better way of addressing the relative degrees of fault of contending parties rather than a series of rigid, fixed precepts established and enforced by judicial decree.<sup>48</sup>

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43. *Id.* at 6.

44. *Id.* (italics omitted).

45. *Id.* at 5.

46. See Robert I. Rubin, *Remove Guesswork from Calculating Damages in Personal Injury Cases*, 58 DEF. COUNSEL J. 16, 16-17 (1991).

47. See Landsman, *supra* note 2, at 606-10.

48. See *id.*

When first created in England in 1809, the doctrine of contributory negligence did not seem to be intended as a tool to promote judicial, rather than jury, control of legal regulation.<sup>49</sup> By the middle of the nineteenth century, however, American judges were vigorously applying the doctrine to curb perceived jury generosity regarding negligence claims.<sup>50</sup> This was part of a more general move toward judicial control over negligence liability and the establishment of more particularized legal requirements regarding conduct.<sup>51</sup> Professor Wex Malone, one of the leading analysts of contributory negligence, concluded: “Courts wanted to control juries during the last century [the nineteenth], they want to control them today, and they will probably want to control them in the future. If we take away contributory negligence from the judges they will find some other way.”<sup>52</sup> If the proposition is correct that judges will always find a way to control juries, then juries are little more than puppets manipulated by judges and have only the smallest part to play in regulating conduct.

If Malone’s conclusion were the end of the contributory negligence story, one would have to conclude that judges, not juries, really control common law regulation, even with regard to such expansive terms as reasonableness.<sup>53</sup> But Malone’s vision was not the end of the story. Juries resisted judicial efforts to deny plaintiffs all recovery when they were no more than marginally at fault by making awards that challenged judicial dictates.<sup>54</sup> This resistance eventually called into question the soundness of the harsh and unrealistic tenets of contributory negligence.<sup>55</sup> In the guise of respecting jury decisions regarding questions of fact and jury determinations of reasonableness, the courts retreated to ever less determinative rules leaving more and more in the hands of jurors to be decided on a case-by-case basis.<sup>56</sup> In 1938, Fleming James, one of

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49. *See id.* at 606.

50. *See id.* at 606-08.

51. *Id.* at 606-07.

52. Wex S. Malone, *The Formative Era of Contributory Negligence*, 41 U. ILL. L. REV. 151, 182 (1946).

53. *See generally id.*

54. *See* Landsman, *supra* note 2, at 608-09 (arguing that judges relied on proactive juries to soften “harsh tort doctrines”).

55. *See id.* at 610 (referencing the judiciary’s “ill-conceived” contribution rule).

56. *See id.* at 606-12.

the leading tort scholars of his day, described the developing judicial solution to contributory negligence as “simpler and vaguer formulas in instructions to the jury.”<sup>57</sup> The law of contributory negligence gave way to comparative negligence.<sup>58</sup> It was not that regulation through the law of negligence had been abandoned, but that flexible principles demanding a jury’s weighing of evidence and equities were being utilized.

The shift involved in the contributory negligence context is neatly illustrated by a pair of cases decided by the United States Supreme Court. In the first, Justice Oliver Wendell Holmes, Jr., wielding the full power of judges as seemingly exclusive lawmakers in tort, ruled in *Baltimore & Ohio Railroad v. Goodman* that jury awards were to be rejected in railroad intersection collision cases if the motorists crossing the railroad tracks did not stop their cars, alight, look and listen.<sup>59</sup> Not only was such driver behavior impractical, especially in urban settings where there was substantial vehicular traffic, but it also conflicted with the custom then developing among operators of automobiles across the nation. Judge Holmes sought to definitively regulate automobile operation at railroad crossings. His approach held sway for a brief seven years and was then overridden by Justice Benjamin Cardozo in *Pokora v. Wabash Railway Co.*<sup>60</sup> There the Supreme Court returned intersection regulation back to the jury.<sup>61</sup>

The Court’s motivation for empowering juries in the *Pokora* line of cases was to allow them to closely scrutinize the facts of each case and, in light of those facts, decide the question of reasonable conduct. Judges were ceding control of regulation to juries. Hard and fast judicial mandates were rejected in favor of sensible, rough and ready standards bottomed on daily experience and a community sense of appropriateness. Justice Cardozo emphasized that in this setting, it was up to the jury to frame “standards of behavior” and not for judges to impose “rules of law.”<sup>62</sup>

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57. Fleming James, Jr., *Last Clear Chance: A Transitional Doctrine*, 47 YALE L.J. 704, 723 (1938).

58. See Landsman, *supra* note 2, at 609-10.

59. 275 U.S. 66, 70 (1927).

60. 292 U.S. 98 (1934).

61. *Id.* at 101.

62. See *id.* at 105.

It might be protested that verdicts are not regulatory. After all, they articulate no rules for the future. But courts have seen it differently. In cases like *Silkwood v. Kerr-McGee Corp.*, regarding regulation in the handling of nuclear materials,<sup>63</sup> and *Cipollone v. Liggett Group, Inc.*, addressing the impact of regulations regarding warnings on cigarette packages,<sup>64</sup> the Supreme Court made clear that a state law damages remedy has an inherently regulatory effect. It is important to note that these cases arose in legal settings where the standard governing conduct was established by federal regulatory action preempting a field.<sup>65</sup> Yet, state safety concerns, as expressed through jury judgments fixing damages, were recognized not only as legitimate but as serving valid regulatory ends, most particularly insisting on safer conduct in highly regulated industries.<sup>66</sup>

It is a fair question to ask why the courts have turned to juries to do what amounts to regulation in these settings. First, of course, cases at law are required by the federal<sup>67</sup>—and virtually every state's<sup>68</sup>—Constitution to be tried by a jury. These constitutional requirements mean that courts will use juries when they fashion new torts. That answer, however, elides the deeper appeal of the jury as a regulator when no other regulatory mechanism appears to be available and no other governmental body seems willing or able to act.

The jury has a number of characteristics that mark it as an attractive choice for the regulation of actors who have proven impervious to the more usual forms of oversight. As frequently noted, the jury is the voice of the community.<sup>69</sup> It brings to bear the

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63. 464 U.S. 238, 240-41 (1984).

64. 505 U.S. 504, 508-09 (1992).

65. See Landsman, *supra* note 2, at 617-19.

66. See, e.g., David E. Izhakoff, *Federal Preemption: State Regulation of Federally Owned Nuclear Production Plants*, 1989 ANN. SURV. AM. L. 665, 674-77.

67. U.S. CONST. amend. VII (“In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.”).

68. See, e.g., CAL. CONST. art. I, § 16 (“[T]rial by jury is an inviolate right and shall be secured to all.”); *Selection of Jurors*, 50 STATE STATUTORY SURVEYS: CIVIL LAWS: CIVIL PROCEDURE, Apr. 2013, available on Westlaw at 0020 SURVEYS 13.

69. See Landsman, *supra* note 2, at 616-19.

views of a cross section of the public. This is particularly valuable in situations where other regulatory efforts are absent and the parameters of public concern have not otherwise been defined. Moreover, this cross section is uniquely representative.<sup>70</sup> It does not suffer from the professional and political winnowing processes that make legislators, executive officials, and judges unrepresentative of the wide variety of educational, social, and ethnic backgrounds of the polity. Its representativeness makes it far less vulnerable to special appeals, bias, or prejudice in favor of any industry, political orientation, or ideology. Representativeness lends legitimacy to jury decisions, which usually are not associated with special interests. Legitimacy is reinforced by the public visibility of jury proceedings in which the evidence warranting action is laid out for all to see rather than buried in the bowels of the bureaucratic process.<sup>71</sup> By the same token, the jury may draw on a wellspring of practical experience and common sense. These resources may be particularly valuable in a regulatory context in which the question to be answered is whether conduct is reasonable or appropriate in settings where jurors have first-hand experience as clients or consumers.

There are a number of other considerations that argue in favor of juries. Juries offer the courts decision makers who are uniquely anonymous. There is little prospect of locating jurors in advance of litigation in hopes of manipulating them. As Blackstone remarked:

A competent number of sensible and upright jurymen, chosen by lot from among those of the middle rank, will be found the best investigators of truth and the surest guardians of public justice. For the most powerful individual in the state will be cautious of committing any flagrant invasion of another's right, when he knows that the fact of his oppression must be examined and decided by twelve indifferent men, not appointed till the hour of trial; and that, when once the fact is ascertained, the law must of course redress it. This therefore preserves in the hands of the

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70. See Stephan Landsman, *The Civil Jury in America*, 62 LAW & CONTEMP. PROBS. 285, 288 (1999) (remarking that juries are made up of distinct individuals who are not predisposed in any one direction).

71. See Richard H. Pildes & Cass R. Sunstein, *Reinventing the Regulatory State*, 62 U. CHI. L. REV. 1, 8 (1995).

people that share which they ought to have in the administration of public justice, and prevents the encroachments of the more powerful and wealthy citizens.<sup>72</sup>

This insulation makes juries an ideal mechanism for addressing questions affecting those predisposed to attempt to influence decision makers, something certain industries have been quite adept at with regard to legislatures and executive agencies. Further, the fact that juries are perceived as less predictable than other sorts of regulators may heighten their regulatory efficacy. It is difficult to feel comfortable taking an extreme position when a jury judgment looms that is likely to punish tactics that appear outside the mainstream. Additionally, the use of the jury process to regulate is quite cheap. No bureaucratic apparatus needs to be maintained. Private parties will take on the effort of investigating and prosecuting claims so long as there is a decent prospect of substantial monetary recovery.

Juries offer a number of further social and political benefits to the judges who call them into action. If a verdict turns out to be provocative, the jury can be blamed rather than the courts.<sup>73</sup> In this way, juries deflect political heat from the judicial branch. Connected to this point is Judge Guido Calabresi's argument that jurors are the decision makers best suited to make extremely difficult or "tragic" choices,<sup>74</sup> like those involving life or death,<sup>75</sup> or the most challenging applications of moral principles.<sup>76</sup> Part of the strength of jury decision making in this context is the jury's ability to apply social standards without ever precisely defining those standards.<sup>77</sup> This produces not only decisions but guidelines to the exercise of moral judgment without the need for a precise articulation that is vulnerable to attack or distortion.

What juries are asked to do is distinct from the sort of regulation judges engage in when they redraft regulations in the guise of

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72. BLACKSTONE, *supra* note 21, at \*380.

73. See Oliver Wendell Holmes, *Law in Science and Science in Law*, 12 HARV. L. REV. 443, 459-60 (1899).

74. GUIDO CALABRESI & PHILIP BOBBITT, TRAGIC CHOICES 63-64 (1978).

75. See *id.* at 57-58.

76. See *id.* at 64.

77. See *id.* at 57.

reviewing them<sup>78</sup> or discipline regulators who fail to do their job.<sup>79</sup> Rather, it is the judiciary turning to the jury, asking jurors to scrutinize the facts regarding each defendant's conduct and to reach verdicts assessing that conduct in a setting where no specific standards exist. It is a means of insisting on appropriate behavior by punishing practices that fall outside what the community, upon reflection, finds acceptable. The dissemination of such determinations both in the press and among those facing potentially similar claims establishes a rough but discernible regulatory framework. In turning to juries this way, judges harness the particular power of jurors to determine facts, to apply principles of fair dealing, and to bring to bear widely shared but hard to articulate expectations about the way people and organizations ought to behave. Commentators have frequently noted the widespread judicial respect for juries and the decisions they render.<sup>80</sup> It should come as no surprise that judges might turn to juries for the regulation of conduct for which no other mechanism is available.

## II. THE BAD FAITH TORT: A CASE STUDY IN LAST RESORT REGULATION BY JURIES

### A. Pre-1950 Developments

The bad faith tort in insurance transactions, like other new torts, has roots in legal activity stretching back well beyond its formalization in the era after 1950. At the end of the nineteenth century, some legislatures and courts began to grapple with a cluster of seemingly unfair insurance company claims practices.<sup>81</sup> One particularly troubling practice was insurer use of contract terms that obliged payment of a claim only if the customer had both suffered an adverse judgment and, out of his or her own pocket, paid

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78. This strategy was considered and perhaps constrained in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 866 (1984). *But see* Thomas W. Merrill, *Judicial Deference to Executive Precedent*, 101 YALE L.J. 969, 982 (1992).

79. Susan N. Herman & Lawrence M. Solan, *Jury in the Twenty-First Century*, 66 BROOK. L. REV. 971, 982 (2001).

80. *See id.* at 982.

81. *See* Henderson, *supra* note 22, at 16-19 (highlighting indemnity insurance contracts as an example of these unfair practices).

that judgment.<sup>82</sup> This “indemnity” provision often undercut the reason why the insured had purchased the insurance. The provision paid those clients who needed financial protection the least and denied protection to those who needed it the most because of their limited ability to pay an adverse judgment on their own.<sup>83</sup> Eventually, court pressure led insurers to abandon this approach.<sup>84</sup> But insurers persisted in their use of other practices that delayed or denied payments to those claiming insurance coverage.<sup>85</sup> Despite the widespread nature of the problem and the obvious economic incentives for withholding payment, few state legislatures reacted in a serious way to this challenge. Those that did took only the modest step of authorizing the award of interest on funds improperly withheld and, in a few instances, the imposition of attorneys’ fees to offset the expense to which insureds were put to recover contractually required payments.<sup>86</sup> As late as 1950, no more than one-quarter of the states had adopted these modest regulatory requirements.<sup>87</sup> In virtually all cases, the ceiling for recovery (apart from interest and fees) was defined by the contract and was limited to nothing more than the contractually stipulated amount.<sup>88</sup> Self-interested negotiating tactics, incentives for insurer refusal to pay, and delay were virtually unaffected by these remedies because few insureds had the wherewithal to contest company action in court proceedings.

Into this legal setting in 1930, the Wisconsin Supreme Court introduced a new concept and approach to insurance company claims practices when it decided *Hilker v. Western Automobile Insurance Co.*<sup>89</sup> Western Automobile Insurance, which had a contractual duty to defend its insured and concomitant control of litigation involving third-party claims, refused a reasonable settlement offer within policy limits.<sup>90</sup> The company instead decided to take the auto accident case to trial motivated, no doubt, by the hope

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82. *See id.* at 16.

83. *See id.*

84. *See id.* at 18-19.

85. *See id.* at 11-12.

86. *See id.* at 12.

87. *See id.* at 13 n.43.

88. *See id.* at 12.

89. 231 N.W. 257 (Wisc. 1930).

90. *See id.* at 260.

of reducing its outlay.<sup>91</sup> At trial, the jury returned a verdict for twice the policy limits.<sup>92</sup> The court noted the company's contractual right to control the litigation, the possibility of a serious conflict of interest between insurer and insured, and Western's exclusive pursuit of its own financial objectives.<sup>93</sup> This combination led the court to conclude that the insurer had breached its duty of good faith to and fair dealing with its insured, warranting the court to order the insurer to pay the entire judgment, including the amount above the policy limit.<sup>94</sup> The court's holding created a new remedy, but the scope of that remedy was narrowly circumscribed by the size of the award in the underlying litigation. There was, as yet, little latitude for jury appraisal of insurer misconduct.

*B. The California Cases: 1958-1979*

*Hilker* provided the basis for the California Supreme Court's analysis when it turned to the issue of insurer claims-related misconduct in *Comunale v. Traders General Insurance Company* in 1958.<sup>95</sup> The insurance company refused to defend its insured, Percy Sloan, or participate in settlement negotiations after he was sued by two pedestrians, Mr. and Mrs. Comunale, whom he had struck while driving another party's truck.<sup>96</sup> The court decided that in cases like *Comunale* in which the insured was sued by strangers to the insurance contract, so-called third-party claims cases, the company had an obligation to "take into account the interest of the insured and give it at least as much consideration as it does its own interest."<sup>97</sup> Here the company pursued its own interests exclusively, denying that it had a duty to defend, a claim eventually rejected by the courts,<sup>98</sup> and absenting itself from settlement negotiations. Cutting the insured off from assistance in the settlement process, which in this case included an offer to settle within policy limits,<sup>99</sup>

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91. *See id.* (finding the insurance company acted in bad faith by not settling).

92. *See id.* at 258.

93. *See id.* at 259-60.

94. *See id.* at 261.

95. 328 P.2d 198 (Cal. 1958).

96. *See id.* at 200.

97. *Id.* at 201.

98. *See id.* at 202.

99. *See id.* at 200.

was deemed a breach of the duty of “good faith and fair dealing”<sup>100</sup> as previously identified in *Hilker*.<sup>101</sup> This was not simply a breach of contract for which damages limited to the sum specified in the contract would be appropriate but an independent wrong arising out of the claims-handling process. It was a wrong that could be described as “sounding in tort or in contract,”<sup>102</sup> warranting damages up to and including the full sum of the jury’s award in the underlying case, which was approximately twice the coverage amount.<sup>103</sup> The court determined that the insurer’s duty stretched well beyond the specific terms of the contract into the settlement context which was viewed as a fundamental part of the insurance relationship.<sup>104</sup> When the company refused to participate in the claims resolution process without complete legal justification, it became obliged to pay the entirety of the judgment rendered. The wrongs that led the court to act appeared to be a set of business practices that maximized the prospect of protecting company assets while exposing clients to substantial financial risk. The insurer was not accused of dishonesty or malice; indeed, the conduct of neither party was extensively examined by the Court. The narrow focus of the decision was the insurer’s clear and single-minded pursuit of company interests which, if proven to the jury, would warrant protection of the policy holder from any award above policy limits.

Nine years later the California Supreme Court returned to the claims-practice question in *Crisci v. The Insurance Co. of New Haven, Connecticut*.<sup>105</sup> Again, the court scrutinized a jury decision about an insurer’s behavior in a matter in which the insured was being sued by a third party.<sup>106</sup> This time the company had defended its insured but declined an offer to settle for \$10,000 (the policy limit) in a case in which its claims manager and attorney both thought there was significant likelihood of a much larger

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100. *Id.* at 201.

101. *See* 231 N.W. 257, 261 (Wis. 1930).

102. *Id.* at 202.

103. *See id.* at 200.

104. *See id.* at 201 (“It is common knowledge that a large percentage of the claims covered by insurance are settled without litigation and that this is one of the usual methods by which the insured receives protection.”).

105. 426 P.2d 173 (Cal. 1967).

106. *See id.* at 175.

judgment.<sup>107</sup> The company appeared to decide that it might as well attempt to convince a jury that a smaller verdict (or none at all) was warranted because it had solid evidence and its own risk was capped at \$10,000. The case was tried and the jury awarded \$100,000.<sup>108</sup> This award ruined the insured, a seventy-year-old immigrant widow named Rosina Crisci.<sup>109</sup> In the ensuing settlement Mrs. Crisci lost the rental property that was her sole source of income as well as everything else of value that she owned.<sup>110</sup> According to the court, her health declined, she suffered bouts of hysteria, and attempted suicide.<sup>111</sup> She filed a bad faith action against her insurer claiming not only monetary damages of the sort sought in *Comunale*, but also mental distress for which the jury awarded her \$25,000.<sup>112</sup> Citing its earlier decision, the Supreme Court once again condemned one-sided, self-interested insurance company claims handling practices.<sup>113</sup> It declared that proof of “dishonesty, fraud, or concealment” was not needed for there to be liability.<sup>114</sup> The key was a failure on the part of the insurer to act in “the most reasonable manner” in the claims-handling process.<sup>115</sup> The insured had a right to rely on the company not to “gamble with the insured’s money to further its own interests.”<sup>116</sup> Turning to the question of damages, the court picked up on *Comunale*’s observation that bad faith cases sound in both tort and contract.<sup>117</sup> The import of this observation was that mental suffering, as well as monetary loss, could be compensated and that the insured’s mental state could be considered as a basis for damages in a jury award. Although not expanding the group of claimants who could recover, *Crisci* dramatically expanded the sums recoverable in such matters and the scope of the jury’s scrutiny of the consequences of insurer misconduct. *Crisci* heightened focus on the well-being of the insured and

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107. *See id.* (“[B]oth men believed that if the jury felt that the fall triggered the psychosis, a verdict of not less than \$100,000 would be returned.”).

108. *See id.* at 176.

109. *See id.*

110. *See id.*

111. *See id.*

112. *See id.* at 178.

113. *See id.* at 176-77.

114. *Id.* at 177.

115. *Id.* at 176-77.

116. *Id.* at 177.

117. *See id.* at 178.

imposed on insurance providers the necessity of considering the unintended but injurious mental consequences of their self-interested business practices in third party initiated litigation. All of this was to be triggered if a jury found that the insurer had acted in an unreasonable manner in handling the claim. The jury was no longer simply protecting insureds from excessive judgments; it was scrutinizing insurer conduct affecting a designated subset of customers and awarding damages if it found improper business practices.

The next holding in the history of the development of judge and jury regulation of the California insurance industry was not a bad faith claims-handling case, but rather one focusing on the distinct duty of “an automobile liability insurer [to] undertake a reasonable investigation of the insured’s insurability within a reasonable period of time from the acceptance of the application and the issuance of a policy.”<sup>118</sup> Anthony Alves sought auto insurance from State Farm Mutual.<sup>119</sup> Without checking Mr. Alves’s driving record, State Farm issued a policy.<sup>120</sup> Seven months later, Alves struck and severely injured a pedestrian, Eva Barrera.<sup>121</sup> State Farm then initiated an investigation of its insured and found a material misrepresentation in Alves’s application for insurance—that despite his written denial, his license had been suspended once and placed under probation orders twice in the five years before he sought coverage from State Farm.<sup>122</sup> On the strength of this information, the company rescinded its policy and refused to consider Ms. Barrera’s claim.<sup>123</sup> Justice Tobriner, writing for six of the seven members of the Supreme Court, concluded that the jury was correct in finding that such conduct breached a company’s duty to undertake a reasonable and timely investigation of eligibility, in the absence of which someone injured by the insured could, as a third party beneficiary, claim coverage under the insurance contract.<sup>124</sup>

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118. *Barrera v. State Farm Mut. Auto. Ins. Co.*, 456 P.2d 674, 677 (Cal. 1969).

119. *See id.* at 678.

120. *See id.* at 679-80.

121. *See id.* at 678.

122. *See id.* at 679. There was a significant dispute about whether Alves or a State Farm agent had actually filled out the application. *See id.*

123. *See id.* at 680.

124. *See id.* at 685-86.

According to evidence heard by the jury, State Farm failed to heed the custom and practice of the insurance industry by not, at the outset, seeking a Department of Motor Vehicles (DMV) report of the insured's driving record.<sup>125</sup> This was part of a cost reduction strategy that allowed State Farm to avoid investigative expenses of \$3.35 per customer (of which 25 cents was for the purchase of the DMV report).<sup>126</sup> This "policy of saving minor costs on its part at the expense and sacrifice of the interests of its insured and those of the general public"<sup>127</sup> deeply troubled the court and served as a basis for its willingness to allow a jury to consider whether the company was investigating in a reasonable manner.

The court grounded its approval of jury intervention on a number of legislative enactments and social considerations. First, the court pointed out that, pursuant to California's Financial Responsibility Law, insurance companies were involved in a "quasi-public" activity when they provided drivers with insurance coverage.<sup>128</sup> State Farm's failure to investigate applicants in a timely manner meant that the public might be denied protection from dangerous drivers, a serious threat to the public at large. This undermining of the legislature's protective scheme was particularly troublesome because it was engineered by an "economically powerful entity"<sup>129</sup> utilizing an adhesion contract that allowed it to rescind agreements to avoid "any risk whatsoever"<sup>130</sup> while innocent victims would go uncompensated. The strategy of pursuing the company's self-regarding advantage without considering the public interest, all to save a few dollars, was, in the court's view, a sound basis for the jury's action.<sup>131</sup> Relying on a duty much like that recognized in *Comunale* and *Crisci*, "sounding either in tort or quasi-contract,"<sup>132</sup> the court held that the third party injured pedestrian could recover.<sup>133</sup> In essence, the court was asking the jury to determine whether there had been appropriately prompt action on auto insurance applica-

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125. *See id.* at 680.

126. *See id.*

127. *Id.*

128. *See id.* at 680-81.

129. *Id.* at 682.

130. *Id.*

131. *See id.* at 680-81.

132. *Id.* at 681.

133. *See id.* at 687-88.

tions and the expenditure of appropriate sums on investigators. The justices made room for the jury's scrutiny by putting to the side legislative enactments that appeared to grant insurers latitude in making the rescission decision.<sup>134</sup> Through the jury trial mechanism, regulatory scrutiny of the insurance business was being steadily expanded. This expansion occurred in the face of rules that, arguably, insulated insurers from oversight.

The courtroom-based regulation of insurance claims-handling procedures underwent further significant expansion when California's Court of Appeal decided *Fletcher v. Western National Life Insurance Co.* in 1970.<sup>135</sup> This decision extended jury scrutiny of the reasonableness of claims practice from its original setting in third party claims cases to first party situations. In first party situations, the insured was suing his or her own insurer for failing to fairly evaluate or handle a claim made for injuries suffered by the insured and potentially covered by the insurance agreement. In the third party context, there had been particular legal grounds to allow a finding of liability because the company involved had agreed to assume responsibility for defending the insured, thereby triggering something like a fiduciary duty to protect client interests.<sup>136</sup> No such fiduciary obligation could be found in the far more numerous first party cases. In first party cases, the company and the insured were always potential antagonists regarding coverage and the insurer did not appear to have any particular obligation to represent its clients' interests in any proceedings.

What led the appellate court to take the leap into the first party setting becomes clear upon reading the *Fletcher* opinion. In *Fletcher*, three factors combined to force the court's hand: the scandalous behavior of the insurer, the suffering of the insured, and the previously recognized expansive tort remedy in third party cases.<sup>137</sup> The defendant insurer in *Fletcher* conceded that its conduct had been "deplorable and outrageous."<sup>138</sup> The insurer tried every trick it

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134. See *id.* at 683 n.10 ("Thus, not only contractual provisions in, but also statutory provisions governing, automobile insurance policies must be construed in light of the basic public policy underlying the Financial Responsibility Law.").

135. 89 Cal. Rptr. 78 (1970).

136. See Henderson, *supra* note 22, at 19-22.

137. See *Fletcher*, 89 Cal. Rptr. at 86-90.

138. *Id.* at 87 (internal quotations omitted).

could think of to deprive Fletcher, an impecunious, hard-working father of eight with a fourth grade education,<sup>139</sup> of the \$150 per month his disability policy called for after he was injured “while lifting a 361 pound bale of rubber” at work.<sup>140</sup> The company’s claims supervisor, Tom Amason—whose behavior was so egregious as to warrant his being named individually as a defendant—with the express approval of Western’s President, propounded bogus claims about preexisting conditions, distorted medical opinions, and sought to take advantage of Fletcher’s impoverished circumstances to coerce his agreement to a benefits-denying settlement.<sup>141</sup> Eventually, the insured obtained the assistance of skilled counsel.<sup>142</sup> Suit was brought seeking not only payment of the contractual amount, but compensatory and punitive damages because of the company’s fraudulent conduct and its IIED.<sup>143</sup> The Court of Appeal suggested that Western’s conduct warranted the jury’s finding of a “malicious and bad faith refusal to pay plaintiff’s legitimate claim.”<sup>144</sup>

While considering the IIED claim the appeals court made it clear that the plaintiff might recover by reliance on the bad faith tort embraced in *Crisci*, which in essence coupled the bad faith and IIED concepts.<sup>145</sup> The court buttressed its ruling by providing a strikingly detailed narrative of the evidence the jury had heard about the hardships suffered by Mr. Fletcher because of his insurer’s conduct. The opinion noted that the plaintiff’s family had been reduced to eating nothing but “macaroni, beans and potatoes”<sup>146</sup> and that the plaintiff had gained forty-seven pounds on this diet.<sup>147</sup> The court informed readers that the plaintiff’s wife had to get a job, despite the eight children at home, and one of the children was pulled from school to manage the household and care for her severely disabled father.<sup>148</sup> The family was hounded by creditors, lost what few possessions they owned, and suffered repeated suspensions of their

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139. *See id.* at 83.

140. *See id.*

141. *See id.* at 83-88.

142. *See id.*

143. *See id.* at 81.

144. *Id.* at 87.

145. *See id.* at 90-91.

146. *Id.* at 91.

147. *See id.*

148. *See id.* at 88.

utility services.<sup>149</sup> After this recitation, the Court of Appeal concluded: “It would not appear unreasonable that a person with a prior history of industry and concern for his family would suffer substantial emotional distress in the nature of grief, humiliation, embarrassment, chagrin, disappointment and worry.”<sup>150</sup> Despite Western’s protests about causation, all this was laid at its doorstep because of the “special relationship”<sup>151</sup> the company had with Fletcher. The court found obligations arising in such relationships due to the insured’s reliance on the company and “the great disparity in the economic situations and bargaining abilities” of the two.<sup>152</sup> In the end, the Court of Appeal concluded that based on all of these facts and the previously established precedent and bad faith protection, concomitant tort damages ought to be extended to first party insureds.<sup>153</sup> The panel upheld not only the jury’s compensatory award but punitive damages in the sum of \$180,000 (reduced from the \$640,000 the jury had awarded).<sup>154</sup> The punitive component of the award in particular underscored the jury’s distinctive role in evaluating and regulating insurance company conduct.

The issue of first party bad faith claims came before the California Supreme Court in the 1973 case, *Gruenberg v. Aetna Insurance Company*.<sup>155</sup> The decision, reviewing a dismissal after Aetna’s demurrer, addressed a dispute regarding a fire insurance policy; a different and far more legislatively structured part of the insurance business than had been before the court in previous cases. Yet, the themes and analysis of the majority were remarkably similar to those set forth by the Court of Appeal in *Fletcher*. The decision featured an extremely detailed recitation of the insurer’s aggressive practices after Gruenberg’s cocktail lounge was destroyed by a fire of “incendiary” origin.<sup>156</sup> The company and its agents, suspecting that Gruenberg had committed arson, claimed that he had “excessive fire insurance coverage”<sup>157</sup> and went on to provide testimony at

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149. *See id.* at 91.

150. *Id.*

151. *Id.* at 95.

152. *Id.*

153. *See id.* at 99.

154. *See id.*

155. 510 P.2d 1032 (Cal. 1973).

156. *Id.* at 1044 (Roth, J., dissenting).

157. *Id.* at 1035.

a preliminary hearing convened to consider arson and fraud charges against him.<sup>158</sup> Apparently mindful of the pendency of the criminal case and the pressure it might exert on Gruenberg, Aetna insisted on an almost immediate deposition, on the basis of a policy provision requiring the insured's cooperation.<sup>159</sup> On the advice of counsel representing him in the criminal matter, Gruenberg declined to appear at the deposition and Aetna cancelled the policy citing his failure to cooperate.<sup>160</sup> Shortly thereafter, the charges against Gruenberg were dismissed, and he offered to appear for his deposition.<sup>161</sup> The company refused and reiterated its rejection of his fire insurance claim.<sup>162</sup> This rejection led Gruenberg to file the bad faith claim that was then dismissed by the trial court.<sup>163</sup>

Echoing *Fletcher*, the Supreme Court, on the basis of the pleadings rather than proven facts, detailed the plaintiff's alleged injuries including his loss of income due to the demise of the cocktail lounge (rendered inoperable because of a lack of insurance funds for repairs), aggressive efforts by Gruenberg's creditors to obtain payment of outstanding debts, and the ruin of Gruenberg's credit rating.<sup>164</sup> Similar to the Court of Appeal in *Fletcher*, the Supreme Court emphasized the breadth of the bad faith principle established in *Comunale* and *Crisci*, seeing it as expansive enough to warrant jury scrutiny of Gruenberg's situation.<sup>165</sup> The court announced what amounted to a general mandate that judges and juries examine insurance company claims-handling processes and reject those amounting to one-sided advantage seeking at the insured's expense.<sup>166</sup> The *Fletcher* decision was embraced, but its partial reliance on IIED was rejected in favor of the broad compass of damages allowed in prior Supreme Court bad faith cases. The upshot of the decision was that in the widest range of insurance relationships—from third party motorist situations to first party disability and fire cases—the courts empowered jurors to review

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158. *See id.*

159. *See id.* at 1034-35.

160. *See id.*

161. *See id.* at 1035.

162. *See id.*

163. *See id.*

164. *See id.* at 1041.

165. *See id.* at 1037.

166. *See id.* at 1049.

insurers' handling of their customers' claims. Insurer disregard of customer interests, not to mention malice and misrepresentation, would warrant liability under the rubric of bad faith including an award of punitive damages.<sup>167</sup>

The lone dissenter, Justice Roth, detailed the implications of the court's decision. Roth noted that *Comunale* and *Crisci* were third party cases and, as such, involved companies in a clearly recognized quasi-fiduciary relationship arising out of the insurer's assumption of exclusive control over the defense.<sup>168</sup> There was no such relationship in first party cases like *Gruenberg*. If liability were to be recognized in *Gruenberg*, it would have to be on the basis of a new, judicially-manufactured duty. The dissent pointed out that the case before the court, unlike *Fletcher*, did not involve an adhesion contract because legislation specified virtually all fire insurance policy terms used in California.<sup>169</sup> Justice Roth argued that *Gruenberg* posed a serious question of claimant fraud, in light of the incendiary nature of the fire, and the company did its duty by seeking to detect and punish dishonesty.<sup>170</sup> He challenged the court's invocation of the image of the innocent customer set upon by an unscrupulous, self-interested, and unrestrained insurance company.<sup>171</sup>

Within a year, the Supreme Court confirmed the *Gruenberg* holding in *Silberg v. California Life Insurance Company*.<sup>172</sup> Again, the court emphasized the plight of a poor insured who suffered incredible hardship because of the one-sided claims practices of his insurer. California Life denied coverage because of the possibility that workers' compensation might apply and the insurance contract made an exception from coverage in such circumstances.<sup>173</sup> The insurance company delayed its payment decision for two years.<sup>174</sup> In that time, Enrique Silberg suffered numerous medical complications and financial hardships.<sup>175</sup> Eventually, the hospital that had been

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167. *See id.* at 1037.

168. *Id.* at 1042-43 (Roth, J., dissenting).

169. *Id.* at 1043.

170. *See id.* at 1044, 1046.

171. *See id.* at 1045, 1047.

172. 521 P.2d 1103 (Cal. 1974).

173. *Id.* at 1105, 1111.

174. *Id.* at 1105.

175. *See id.* at 1106-08.

providing care denied him treatment because of his failure to pay his bill.<sup>176</sup> He lost his small dry cleaning business, had his credit destroyed, had to change residences repeatedly with his wife and two young children, suffered two nervous breakdowns, and even had his wheelchair repossessed.<sup>177</sup> California Life did nothing demonstrably underhanded in the case, but its stubborn refusal to pay set in motion all of Mr. Silberg's troubles. The court pointed out that the company had taken its harsh stand despite the fact that its economic interests were protected because any erroneous payment could be recouped if there were a workers' compensation award.<sup>178</sup> The court went on to underscore the insured's reliance on the company's promises, most particularly a slogan in California Life's policy application: "Protect Yourself Against the Medical Bills That Can Ruin You."<sup>179</sup> The company's callous refusal to consider Silberg's plight and its simple-minded pursuit of its selfish interest cried out for correction—a step the court was willing to allow a jury to consider.<sup>180</sup> In only one regard did the California Supreme Court show restraint. It upheld the trial judge's rejection of a \$500,000 punitive damages award.<sup>181</sup> It did, however, approve a compensatory award of almost \$80,000.<sup>182</sup>

The punitive damages barrier was definitively surmounted by the California Supreme Court in a first party case in 1978, *Neal v. Farmers Insurance Exchange*.<sup>183</sup> Again, the court took particular pains to describe the facts the jury had heard detailing the sad plight of the plaintiff and the brutal callousness of the insurer. An uninsured motorist gravely injured the plaintiff, Neal, who then sought payment from her insurer, Farmers Exchange.<sup>184</sup> The company sought to dodge its clear obligation.<sup>185</sup> This forced the plaintiff to pursue arbitration, which seriously delayed resolution.<sup>186</sup>

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176. *Id.* at 1106-07.

177. *Id.* at 1107-08.

178. *Id.* at 1109.

179. *Id.*

180. *See id.* at 1108.

181. *Id.* at 1106.

182. *Id.* at 1112.

183. 582 P.2d 980 (Cal. 1978).

184. *Id.* at 983-84.

185. *Id.* at 984.

186. *See id.*

The insurer not only knew that it had no defense but that Neal's family was facing a separate crisis, a son with cancer.<sup>187</sup> The son eventually died. Farmers, with what the court described as malice, adopted a "conscious course of [obstructive] conduct, firmly grounded in established company policy" designed to force a low-ball settlement.<sup>188</sup> The California Supreme Court, agreeing with the trial judge, ratified a nearly \$750,000 jury judgment that mixed compensatory and punitive damages.<sup>189</sup> Two justices dissented. The first justice noted that the uninsured motorist in the case was not cited for improper operation of his car and that Neal's attorney had heavily relied on manipulative appeals for sympathy.<sup>190</sup> The second justice decried the court's interference both with the state's uninsured motorist scheme and the arbitration mechanism put in place to deal with disputes—both competing approaches to regulation.<sup>191</sup> He further argued that premiums would rise for all drivers because of windfalls awarded to a few motorists, like that given to Neal.<sup>192</sup> That the Supreme Court brushed these concerns aside signaled its willingness to allow jury regulation of the full range of insurance company behavior through the employment of compensatory and punitive damage awards.

Any lingering doubts about the reach of juror appraisal of insurer reasonableness were dispelled in 1979 in *Egan v. Mutual of Omaha Insurance Co.*, in which the California Supreme Court upheld a finding of bad faith in a first party disability insurance case.<sup>193</sup> Mutual of Omaha, following in the footsteps of so many insurer defendants before it, attempted to take advantage of its insured to force an unfair settlement. The insurer dragged its feet in the claims process and was forced to admit in litigation that the file had "fallen ... into a crack."<sup>194</sup> In passing, the California Supreme Court noted that the plaintiff asked the Department of Insurance to get the insurer to review the matter, the first time the Department was

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187. *See id.*

188. *Id.* at 983.

189. *Id.* at 985, 994.

190. *Id.* at 994, 996 (Richardson, J., dissenting).

191. *Id.* at 999 (Clark, J., dissenting).

192. *Id.*

193. 620 P.2d 141 (Cal. 1979).

194. *Id.* at 144.

mentioned in the bad faith series of cases.<sup>195</sup> The court reported no steps on the Department's part.<sup>196</sup> The only effective regulation seemed to depend on a jury judgment pursuant to the doctrine of tortious bad faith. The California Supreme Court reiterated its prior justifications for intervention: client reliance on the insurer, the quasi-public nature of the service promised, and a requirement of company fair play arising because of its adhesive power and "superior bargaining position."<sup>197</sup> Finally, the court presented punitive damages as a means to "restore balance" to the relationship.<sup>198</sup> The California Supreme Court had developed a quasi-legislative principle regarding good faith and fair dealing. The principle empowered juries to function like regulators by making individualized assessments of insurance company conduct.

*C. The California Courts' Articulated Justification for Last Resort Jury Regulation*

As California's courts developed the tort of bad faith insurance company conduct, they revealed some of the fundamental reasons why judges may call upon juries to serve as regulators of last resort. Two points come across most clearly: first, a deep concern for impecunious and vulnerable insureds who suffer serious harm at the hands of underregulated insurance companies and, second, the self-interested and, in many cases, grossly exploitative behavior of insurers who seem to hold virtually unlimited economic and legal power in their relationships with customers. From the very beginning, in 1958, the California Supreme Court displayed sensitivity to the inability of many insureds to protect themselves either financially or otherwise. In *Comunale*, the initial case in the development of the doctrine, the court appeared to emphasize the economic vulnerability of Percy Sloan, who apparently did not have the resources to take advantage of a reasonable settlement offer in the wake of his insurer's wrongful denial of coverage.<sup>199</sup> Sloan was financially helpless without the assistance of the company. The

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195. *Id.*

196. *Id.*

197. *Id.* at 146.

198. *Id.*

199. *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 205 (Cal. 1958).

theme of financial vulnerability was more specifically highlighted in *Crisci* in which the company decided to “gamble with the insured’s money” and in the process ruined her.<sup>200</sup> Here, the court expanded the reach of the tort to allow the jury to consider compensatory damages for the hurt caused by the company’s conduct.<sup>201</sup> In these cases and the ones that followed, the weak, financially and otherwise, are overborne; lose virtually everything; and find protection only through the jury’s consideration of the bad faith tort.

Over time, the physical and psychological costs of financial vulnerability came, more and more, to figure in the jury’s appraisal of bad faith claims. Concern about such harm was already apparent in 1967, when the California Supreme Court in *Crisci* observed that not only had the widowed seventy-year-old Mrs. Crisci lost all her worldly possessions because of the insurer’s “gamble,” she had suffered a precipitous decline in health, been seized by repeated bouts of hysteria, and had attempted suicide.<sup>202</sup> Although it may be hard to imagine much more serious distress, the *Fletcher* and *Silberg* cases provided stories of the starkest suffering. In these two matters, in which the decades-old barrier between third and first party liability was pushed aside, the mental and physical harm done to the insureds was atrocious. The *Fletcher* court narrated a tale of the destruction of a proud and hard-working father of eight and his family.<sup>203</sup> Their health was undermined, their childrens’ education disrupted, creditors hounded them, and they fell into abject poverty.<sup>204</sup> The Court of Appeal listed some of the mental consequences: “grief, shame, humiliation, embarrassment, anger, chagrin, disappointment, [and] worry.”<sup>205</sup> The *Silberg* facts are sadly similar featuring loss of income, interruption of medical treatment, constant family displacement and, in an almost Dickensian touch, repossession of the insured’s wheelchair—all while the insurance company withheld the assistance the court found it was legally obligated to provide.<sup>206</sup> The financial hardships to which the insurers knowingly

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200. *Crisci v. Sec. Ins. Co. of New Haven, Conn.*, 426 P.2d 173, 176-77 (Cal. 1967).

201. *Id.* at 178-79.

202. *Id.* at 176-77.

203. *Fletcher v. W. Nat’l Life Ins.*, 89 Cal. Rptr. 78, 83 (1970).

204. *See id.* at 87.

205. *Id.* at 91.

206. *Silberg v. Cal. Life Ins. Co.*, 521 P.2d 1103, 1107-08 (Cal. 1974).

exposed their insureds clearly had consequences of the most traumatic sort. And so the stories piled up. What the cases suggested was the profound vulnerability of those seeking protection and the damaging consequences of insurance company conduct.

The courts' concern for the welfare of the insureds was heightened by the fact that all had tried, through the purchase of insurance, to protect themselves from disaster.<sup>207</sup> The insureds had paid their premiums and relied on company promises to provide help if they ran into trouble. This was not a point remarked upon in *Comunale*, but even there Sloan repeatedly asked his insurer for help and was rebuffed.<sup>208</sup> The *Crisci* decision tied the tort to the notion of customer reliance, declaring: "Among the considerations in purchasing liability insurance, as insurers are well aware, is the peace of mind and security it will provide in the event of an accidental loss."<sup>209</sup> This language was picked up in *Fletcher*<sup>210</sup> and was amplified in *Silberg* in which the California Supreme Court stressed the reliance rationale and quoted the defendant's policy application inducement: "Protect Yourself Against the Medical Bills That Can Ruin You."<sup>211</sup> Thwarting customer reliance and thereby destroying their promised peace of mind were matters of great concern to the California courts.

Turning from the insured to the insurers, the story the California courts chose to tell was one of self-regard, greed, and exploitation. From the outset, the Supreme Court seemed deeply concerned by the self-interested behavior of insurers. In *Comunale*, the court depicted an insurer preoccupied with its own advantage and unwilling to consider the interests of its insured despite its quasi-fiduciary obligation to customers facing third party claims.<sup>212</sup> This selfish approach was condemned and, on the basis of the reasoning in *Hilker*, the insurer was required to show equal regard for its

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207. See, e.g., *Crisci v. Sec. Ins. Co. of New Haven, Conn.*, 426 P.2d 173, 179 (Cal. 1967) (noting that the insured did not purchase insurance to obtain a commercial gain, but to protect against accidental losses).

208. *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 200 (Cal. 1958) (noting that Sloan notified Traders of the accident, notified them a second time when the suit was filed, and yet a third time on the second day of trial when the plaintiffs offered to settle well within policy limits).

209. *Crisci*, 426 P.2d at 179.

210. *Fletcher v. W. Nat'l Life Ins. Co.*, 89 Cal. Rptr. 78, 95 (1970).

211. *Silberg v. Cal. Life Ins. Co.*, 521 P.2d 1103, 1109 (Cal. 1974).

212. *Comunale*, 328 P.2d at 201.

client's position or face the possibility of paying the full amount of an adverse judgment despite policy limits.<sup>213</sup> *Crisci* was a case in which the company's pursuit of its own interest was even more readily apparent. Despite warnings from its staff, the Security Insurance Company decided to "gamble with its client's money" in hopes of obtaining a verdict below the \$10,000 policy limits.<sup>214</sup> Instead, the jury awarded a sum of \$100,000 that ruined the policy holder.<sup>215</sup> All this led the court to authorize jury consideration of a far broader range of damages.<sup>216</sup> The same theme runs through the *Barrera* decision in which State Farm declined to spend \$3.35 to conduct a proper investigation and thereby exposed the public to vehicular risks that the insurer would seek to disavow.<sup>217</sup> *Fletcher*, *Silberg*, *Neal*, and *Egan* all presented a pattern of deplorable insurer misconduct always grounded in a desire to save the company a bit of money by denying or delaying compensation payments. In several cases, the conduct was far worse, involving fraud and malicious cruelty, all in pursuit of a few more dollars.<sup>218</sup>

The pattern of insurer greed and self-interest signaled a profound moral obtuseness on the part of those running operations in the insurance industry. Insurers' disregard for any interest other than their own and exploitation of their clients' weaknesses was already plain in *Comunale* and *Crisci*. The risk the insurer created in *Barrera* was even greater, exposing the whole public to a dangerous driver whose harms it would deny insuring. All of this pales when compared with the shameful conduct detailed in the later cases. How could any decent human being conclude that it was morally defensible to try to deprive the honest, hard-working father of eight, Mr. Fletcher, of the \$150 a month pittance the company had contracted to pay him? How could the company's employees, all the way up to the president, go farther, trying to swindle and intimidate? Cases like *Fletcher* depict an unregulated environment in which the greedy have neither shame nor fear. To that picture,

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213. *Id.* at 200-01.

214. *See Crisci*, 426 P.2d at 175, 177.

215. *Id.* at 176.

216. *See id.* at 179.

217. *Barrera v. State Farm Mut. Auto Ins. Co.*, 456 P.2d 674, 680 (Cal. 1969).

218. *See, e.g., Neal v. Farmer's Ins. Exch.*, 582 P.2d 980, 987 (Cal. 1978).

*Gruenberg* added a self-interested, self-righteous, and, ultimately, unjustified vigilantism.

Neither the market nor any existing regulatory mechanism seemed capable of curbing these excesses. As the decisions multiplied, courts talked more bluntly about the unchecked power of the insurance industry. This power was seen as springing from substantial economic resources. Economic strength allowed insurers to dictate adhesion contract terms in most settings as well as get their way in most claims disputes. Financial might was augmented by the public's inescapable and, sometimes, legally mandated need for insurance to drive a car, to purchase a home, or to run a business. In light of the insured's vulnerability, the insurers' self-aggrandizing economic power, and the necessity for insurance, the California courts came to view the interchange between client and company as a matter of public interest.<sup>219</sup> Taking note of the requirements of California's Financial Responsibility Law, the *Barrera* court deemed insurance a "quasi-public" activity.<sup>220</sup> Viewed in this light, insurance company failure to perform fairly called for correction in the public interest. Although *Egan* arose in a far less regulated setting than *Barrera*, the California Supreme Court adopted the same analysis. The court found that the public interest could not be left exclusively in the hands of an industry that had shown itself, in case after case, to be preoccupied with its own advantage to the exclusion of all else.<sup>221</sup>

### III. THE UNARTICULATED GROUNDS FOR JUDICIAL ACTION: THE REGULATORY VACUUM

The vulnerability of clients and the exploitativeness of insurers were not the only bases for California's adoption of a mechanism that called upon juries to become last resort regulators of insurance practices in the state. When the courts examined the insurance business, what they found was an industry without an effective regulatory structure.<sup>222</sup> Despite substantial legislation regarding

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219. *Barrera*, 456 P.2d at 682, 684.

220. *Id.* at 680-81.

221. *Egan v. Mut. of Omaha Ins. Co.*, 620 P.2d 141, 146 (Cal. 1979).

222. *See id.* at 144 (noting that it was unclear whether the Department of Insurance followed up with an insurer about its poor claims review process).

uninsured motorists, insurers, as demonstrated in *Barrera*, were regularly skipping background investigations and rescinding coverage so as to deprive Californians of protection.<sup>223</sup> Similarly, in *Gruenberg*, the court found that legislatively stipulated fire insurance policy terms failed to promote the proper balance between the customer and the company.<sup>224</sup> In the seminal cases that developed the bad faith doctrine between 1958 and 1978, the California Department of Insurance was not mentioned once. It was as if that agency had nothing to contribute to the regulation of company claims practice. In *Egan*, in 1979, the Department was mentioned in passing but nothing ever came of the insured's plea for help.<sup>225</sup> In light of the ineffective legislative and administrative actions, an observer would be justified in concluding that there was no place to turn for relief except the courts.

This should not come as a surprise. The insurance industry has been remarkably successful at blocking regulation of its conduct in handling customer claims.<sup>226</sup> In large measure, its success is owed to the exclusion of federal government regulators from the area, the enactment—at industry urging—of state legislation designed to exclude company claims practices in individual cases from administrative review, and the dogged resistance of state insurance departments to scrutiny of consumer complaints.<sup>227</sup>

The story of federal exclusion begins with the Supreme Court decision in *United States v. South-Eastern Underwriters Ass'n* in 1944.<sup>228</sup> There the Court reversed more than seventy years of precedent and held that the insurance business was subject to Congress's power to regulate interstate commerce.<sup>229</sup> This decision alarmed the industry, which over decades had developed comfortable relationships with most state regulators and wanted nothing to do with federal oversight by New Dealers.<sup>230</sup> To block regulation at the federal level, the industry and a group of state regulators called the National Association of Insurance Commissioners

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223. *Barrera*, 456 P.2d at 680, 684.

224. *See Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032, 1036-38 (Cal. 1973).

225. *Egan*, 620 P.2d at 144.

226. Randall, *supra* note 9, at 632.

227. *Id.* at 631, 642-43.

228. 322 U.S. 533 (1944).

229. *Id.* at 553.

230. *See* Randall, *supra* note 9, at 632-33.

(NAIC)<sup>231</sup> drafted what became known, when adopted, as the McCarran-Ferguson Act.<sup>232</sup> It declared that “[no] Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance.”<sup>233</sup> The Act bars any federal regulation of improper insurance claims handling.<sup>234</sup>

Although federal involvement was anathema, the insurance industry did have a desire for uniform laws across the states that could shield the industry from excessive or onerous regulation and simplify the administration of the insurance business nationally.<sup>235</sup> To pursue these goals, NAIC drafted a string of model laws.<sup>236</sup> NAIC’s efforts on behalf of the industry should come as no surprise because the Association receives half of its funding from insurance companies,<sup>237</sup> works closely with them on the gathering of data about the industry’s operations<sup>238</sup> and generally has been—at least in the industry’s view—“part of the industry and answerable to the industry.”<sup>239</sup> Indeed, in 1995, NAIC defined itself as “a private trade organization.”<sup>240</sup>

As pressure began to mount in the late 1960s on the bad faith question, NAIC set about drafting a model act to address the issue, called the Unfair Trade Practices Act.<sup>241</sup> Its provisions have been of virtually no assistance to individual consumers seeking help from

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231. *Id.* at 633-34; Steven Plitt & Christie L. Kriegsfeld, *The Punitive Damages Lottery Chase Is Over: Is There a Regulatory Alternative to the Tort of Common Law Bad Faith and Does It Provide an Alternative Deterrent?*, 37 ARIZ. ST. L.J. 1221, 1245-46 (2005).

232. The McCarran-Ferguson Act, Ch. 20, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011-1015 (2012)); see Randall, *supra* note 9, at 633; see also Plitt & Kriegsfeld, *supra* note 231, at 1245.

233. 15 U.S.C. § 1012(b).

234. Randall, *supra* note 9, at 634.

235. See Randall, *supra* note 9, at 630 (“The history of the NAIC, from its beginning in 1871 to the present, illuminates the tension between state-level regulation and an acknowledged need for uniformity. The NAIC’s central role in the United States system of insurance regulation demonstrates that, for the most part, the states’ regulatory apparatus has been unable to function appropriately as individual units because of the complex national and international nature of the insurance industry.”).

236. *Id.* at 634; Plitt & Kriegsfeld, *supra* note 231, at 1245.

237. See Randall, *supra* note 9, at 639.

238. *Id.*

239. *Id.* at 640 n.90.

240. *Id.* at 638.

241. See Plitt & Kriegsfeld, *supra* note 231, at 1246-47.

state insurance regulators.<sup>242</sup> The Act's declared concerns include a desire to bar misrepresentation, to promote promptness, to encourage investigation, and to foster settlement.<sup>243</sup> Yet, the Act does virtually nothing to effectuate enforcement of those high-minded principles. From the outset, NAIC has stressed that the Act is not intended or designed to create a private cause of action.<sup>244</sup> Hence, if there is to be any enforcement of the Act, state insurance department officials must initiate it.<sup>245</sup> The Act, by its terms, limits enforcement to situations when regulators find that the insurer committed a violation "flagrantly and in conscious disregard of [the] Act"<sup>246</sup> or "with such frequency [as] to indicate a general business practice."<sup>247</sup> These requirements demand such extensive proof as to make a finding of an improper claim practice highly unlikely in all but the most extreme circumstances.<sup>248</sup> Complainants must document repeated misconduct or prove an intention so clear as to be beyond any doubt.<sup>249</sup> Moreover, the main tool of enforcement is monetary penalties generally so trivial as to amount to a gentle slap on the wrist.<sup>250</sup> Even so, many states have rejected the penalty schedule and adopted even lower fines.<sup>251</sup> Together, the NAIC Model Act and state legislative tweaking of it have produced a set of rules so toothless that Roger Henderson, who has written perhaps the best analysis of the bad faith tort, concluded that the regulation has "not materially aided the individual claimant."<sup>252</sup> It seems as if NAIC and the state legislatures have been involved in a race to the bottom to see who can offer insureds less protection, while seeming to be responsive. Although championing a legislative solution, Henderson, after painstaking analysis, rejected reliance on NAIC and urged that the National Conference of Commissioners on

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242. *Id.* at 1248.

243. *Id.* at 1247-48.

244. Henderson, *supra* note 22, at 14-15; Plitt & Kriegsfeld, *supra* note 231, at 1268.

245. Plitt & Kriegsfeld, *supra* note 231, at 1248.

246. *Id.*

247. *Id.*

248. *See id.* at 1249-50.

249. *See id.* at 1249.

250. *See id.* at 1260.

251. *Id.* at 1260-61.

252. Henderson, *supra* note 22, at 14.

Uniform Laws undertake an effort to fashion effective remedial legislation.<sup>253</sup>

State insurance departments have an abysmal record in dealing with insurance companies' claims-related misconduct. The California Supreme Court seemed to suggest the ineffectiveness of the State Department of Insurance in its passing reference to that agency in the *Egan* case.<sup>254</sup> The lack of agency responsiveness suggested in *Egan* is in no way unusual. In a 1988 dissent in *Moradi-Shalal v. Fireman's Fund Insurance Co.*, Justice Stanley Mosk of the California Supreme Court noted that since 1959, when California adopted its own unfair claims practice statute, there had not been "a single case reported in which the Insurance Commissioner has taken disciplinary action against a carrier for 'unfair and deceptive acts or practices in the business of insurance' involving a claimant."<sup>255</sup> Moreover, a 1997 audit found that the California Department of Insurance had a backlog of 5000 consumer complaints while the Department was cutting staff beyond already inadequate levels.<sup>256</sup>

In the nation as a whole, Henderson has found that individual insureds "seldom [can] obtain timely relief by complaining to the state ... regulator."<sup>257</sup> NAIC compiled national statistics from 2007 that confirm this conclusion and almost certainly understate the problem.<sup>258</sup> In that year consumers lodged 222,000 complaints with state insurance departments.<sup>259</sup> Of these complaints, 126,000 were described as "confirmed."<sup>260</sup> Of this number, 0.4 percent were sent to market conduct divisions for follow-up and enforcement.<sup>261</sup> There are a number of reasons for nonenforcement, and they have proven crippling. Most insurance departments are woefully understaffed and simply do not have the personnel for investigation and enforce-

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253. *Id.* at 64-65.

254. *Egan v. Mut. of Omaha Ins. Co.*, 620 P.2d 141, 144 (Cal. 1979).

255. 758 P.2d 58, 77 (Cal. 1988) (Mosk, J., dissenting).

256. See Randall, *supra* note 9, at 662.

257. Henderson, *supra* note 22, at 15.

258. See Daniel Schwarcz, *Redesigning Consumer Dispute Resolution: A Case Study of the British and American Approaches to Insurance Claims Conflict*, 83 TUL. L. REV. 735, 750-51 (2009).

259. *Id.*

260. *Id.* at 751.

261. See *id.* at 753.

ment.<sup>262</sup> It has been estimated that almost half of all insurance departments are incapable of processing all of the complaints they receive.<sup>263</sup> For example, between 1993 and 1997, the Indiana Insurance Department received 21,000 complaints.<sup>264</sup> In response, the Department issued 211 warnings and initiated one disciplinary action.<sup>265</sup> Colorado's agency received 7000 complaints in 1996 and levied seven fines.<sup>266</sup> Most departments have no serious wish to get involved in consumer protection.<sup>267</sup> They are, in many cases, captives of the industry they regulate and are strongly disposed to take the industry's side.<sup>268</sup> Most agencies take the position that they have no authority to require insurance companies to settle claims.<sup>269</sup> Agencies generally strive to avoid any action that might be construed as a regulatory decision that could either create enforceable precedent or be subject to judicial review.<sup>270</sup> Insurance companies understand the toothless nature of the enforcement mechanism and, in the majority of cases, refuse to compromise on complaints.<sup>271</sup> Only seventeen states require insurance companies even to keep records of complaints regarding improper claims handling.<sup>272</sup> The other thirty-three states deprive those who might provide oversight with any real record of problematic behavior.<sup>273</sup> The consequence of this regulatory vacuum is the deployment of judges and juries to review insurance company claims practices.<sup>274</sup> As Henderson put it: "[T]he recognition of the tort of bad faith in insurance cases represents a judicial response to the perceived failure of the other branches of government to regulate adequately the claims processes of the insurance industry."<sup>275</sup>

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262. *See id.* at 756-57.

263. *Id.* at 757.

264. *See* Randall, *supra* note 9, at 661.

265. *Id.*

266. *Id.* at 662.

267. *See* Schwarcz, *supra* note 258, at 757.

268. *Id.*

269. *Id.* at 753.

270. *Id.* at 755.

271. *Id.* at 755-56.

272. *See* Plitt & Kriegsfeld, *supra* note 231, at 1267.

273. *Id.*

274. Henderson, *supra* note 22, at 11.

275. *Id.*

What California started with *Comunale*, *Gruenberg*, and the cases following them swept the nation's courts. By the early 1990s, half of the country's state supreme courts had embraced some version of the bad faith tort,<sup>276</sup> underscoring the judiciary's widespread concern about the lack of regulatory protection for insurance customers. Reports from a variety of sources have remarked on the durable nature of the tort in terms of filings and awards.<sup>277</sup> Although this has been a cause for alarm to both those in the industry and those who represent it,<sup>278</sup> it has not been a spur to action for any agency or branch of government besides the judiciary. Courts continue to be presented with case after case of insurer oppression and misconduct.<sup>279</sup>

The regulatory intervention undertaken by juries, under the supervision of judges, attracts serious criticism. Critics argue that the balance between consumer and company is tipped too far in favor of the insured, creating the possibility, most particularly with large punitive damages awards, of undermining the "financial vitality" of the industry and raising the cost of insurance.<sup>280</sup> With the United States Supreme Court's decision in *State Farm Mutual Automobile Insurance Co. v. Campbell*, eliminating as a matter of constitutional principle the possibility of extremely large punitive awards,<sup>281</sup> the power of this criticism is substantially blunted. In passing, it might be noted that the conduct at issue in *Campbell* was, despite the Supreme Court's avoidance of a close examination, bad faith of the most troubling sort, tied to a major insurance corporation's scheme to boost profits by oppressing customers.<sup>282</sup> The

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276. *Id.* at 26-28.

277. *See, e.g.*, Alan O. Sykes, "Bad Faith" Breach of Contract By First-Party Insurers, 25 J. LEGAL STUD. 405, 406 (1996).

278. *See, e.g.*, Douglas R. Richmond, *Bad Insurance Bad Faith Law*, 39 TORT TRIAL & INS. PRAC. L.J. 1, 1 (2003); James A. Varner, Sr., Tiffany R. Drust & Debra T. Herron, *Institutional Bad Faith: The Darth Vader of Extra-Contractual Litigation*, 57 FED'N DEF. & CORP. COUNS. Q. 163, 163 (2007) ("Institutional bad faith is the 'Ebola' virus of extra contractual litigation. Darth Vader manages the field hospital and it is completely run by plaintiffs."). Although the metaphors are mixed, and the grammar dubious, the import is fairly clear.

279. *See, e.g.*, *Campbell v. State Farm Mut. Auto. Ins. Co.*, 65 P.3d 1134, 1150 (Utah 2001).

280. Henderson, *supra* note 22, at 32.

281. 538 U.S. 408, 409 (2003).

282. *Campbell*, 65 P.3d at 1148 (detailing State Farm's "pattern of 'trickery and deceit,' 'false statements,' and other 'acts of affirmative misconduct' targeted at 'financially vulnerable' persons") (quoting *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 575, 576 (1996)).

Utah Supreme Court, a generally conservative body, concluded that State Farm's behavior warranted the most severe punishment.<sup>283</sup>

The recent history of the insurance industry does not bear out the claim that tort liability—or anything else for that matter—leads to industry timidity or even appropriate caution.<sup>284</sup> In the 1980s, there was a rash of insurance company insolvencies.<sup>285</sup> Congressional investigation of the failures uncovered a wide range of improper practices, among them “false reports, reckless management, gross incompetence, fraudulent activity, greed, and self-dealing.”<sup>286</sup> These are precisely the sorts of behaviors found in the bad faith cases, although it should be noted that the congressional materials were not specifically focused on the treatment of claimants.<sup>287</sup> In the mid-1990s, a stunning example of the bad faith problem came to light in the UNUM/Provident scandal, in which “the largest American insurer specializing in disability insurance[] was engaged in a deliberate program of bad faith denial of meritorious benefit claims.”<sup>288</sup> This reprehensible scheme was, for the most part, shielded from judicial detection and correction by ERISA rules that cut off access to punitive damages and other remedies available in bad faith actions.<sup>289</sup> And so the story continued into the new century as the reprehensible bad faith of the State Farm Insurance Company was uncovered in the *Campbell* case.

The bad faith tort engenders particularly sharp criticism from legal scholars with a law and economics orientation. Some argue that the tort is likely to increase insurance premiums, stifle efforts to prevent fraud, and introduce inefficiencies into the claims adjusting process.<sup>290</sup> It is of course true that calling insurance companies to account for misconduct may make their operations more expensive or less profitable. Unfortunately, the industry has

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283. *Id.* at 1148-49.

284. *See* Randall, *supra* note 9, at 642.

285. *Id.*

286. *Id.* (quoting STAFF OF THE H.R. SUBCOMM. ON OVERSIGHT AND INVESTIGATIONS OF THE COMM. ON ENERGY AND COMMERCE, 101ST CONG., FAILED PROMISES: INSURANCE COMPANY INSOLVENCIES (Comm. Print 1990)).

287. *See, e.g., Campbell*, 65 P.3d at 1148.

288. John H. Langbein, Essay, *Trust Law as Regulatory Law: The UNUM/Provident Scandal and Judicial Review of Benefit Denials Under ERISA*, 101 NW. U. L. REV. 1315, 1315 (2007).

289. *Id.* at 1319.

290. Sykes, *supra* note 277, at 426-27.

not shown itself capable of operating reliably or fairly without such interventions. The California cases, *Campbell*, and the UNUM scandal amply testify to the need for oversight. In the vacuum created by insurance department inactivity and legislative timidity, the courts are the only institution seemingly up to the regulatory challenge. Given recent history, the burden of proof should be borne by those seeking what is, in essence, deregulation.

The fraud claim is open to serious doubt too. Evidence suggests that there is a great deal of claimant insurance fraud.<sup>291</sup> In the face of that fraud, which has been going on for decades, the insurance industry has undertaken few vigorous curative steps.<sup>292</sup> The issue appears to provide companies with a convenient excuse for delaying payments to honest customers and low-balling claimants.<sup>293</sup> At least several insurers, including State Farm in *Campbell* and UNUM, seem to have given in to the temptation to commit fraud. It is hard to accredit a claim that such companies, if left to their own devices, will be efficient and dedicated fraud fighters. They show the opposite propensity—to pursue easy profits at the expense of their most vulnerable customers, using fraud claims as a convenient excuse. Moreover, the structure of the insurance industry appears to make it easier to raise insurance rates than to vigorously pursue fraud.<sup>294</sup>

Some scholars worry that the bad faith tort undermines insurance industry efficiency in claims processing by rendering each step in the process a potential basis for liability.<sup>295</sup> This argument is grounded on an unsupported assumption that insurance companies are ready, willing, and able to design and implement fair and efficient claims processing schemes. They do not appear to have seized the opportunity to do so. If efficiency requires unfairness, delay, and cruelty—all of which have been repeatedly reported in the bad faith cases<sup>296</sup>—one can legitimately ask: “What is such efficiency worth and to whom?”

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291. *Id.* at 434.

292. See Richmond, *supra* note 278, at 1-3.

293. See Plitt & Kriegsfeld, *supra* note 231, at 1222.

294. Henderson, *supra* note 22, at 32.

295. Sykes, *supra* note 277, at 438-39.

296. See, e.g., *Campbell v. State Farm Mut. Auto. Ins. Co.*, 65 P.3d 1134, 1150 (Utah 2001).

## IV. ANOTHER RELATIONSHIP WARRANTING JURY REGULATION?

The reasons for developing the bad faith tort become fairly clear when the circumstances of the California cases and the absence of effective regulation are considered. The tort's durability suggests that things have not changed very much and that last resort jury regulation is still needed in the interaction between insurers and insured. A question that arises is whether there might be other relationships where such a remedy is necessary. The factors that trigger concern include a vulnerable population that must avail itself of the services of financially powerful partners, the use of adhesion contracts by those partners, the absence of effective regulation, and interactions requiring that the *bona fides* of claims be determined. This describes the conditions that exist between customers and employees on the one side and large business corporations on the other, where compulsory arbitration has been imposed by adhesion contract.

Since the middle of the 1980s, the United States Supreme Court has been expanding the reach of compulsory arbitration through its interpretation of the Federal Arbitration Act (FAA).<sup>297</sup> The precedents so far indicate that adhesion contracts with imposed arbitration clauses will be enforced in the widest array of cases, compelling arbitration not only of disputes about contract terms but most statutory claims as well.<sup>298</sup> According to the Supreme Court, the FAA established a "federal policy favoring arbitration"<sup>299</sup> that requires courts to "rigorously enforce agreements to arbitrate."<sup>300</sup> Generally, the agreement to arbitrate terminates access to the courts and compels the use of private arbitration proceedings that are secret and unreviewable (at least as a general matter).<sup>301</sup> The agreement that requires this shift to arbitration may be imposed by

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297. Federal Arbitration Act, Pub. L. No. 68-401, 43 Stat. 883 (1925) (codified as amended at 9 U.S.C. §§ 1-14 (1982)); see Stephan Landsman, *ADR and the Cost of Compulsion*, 57 STAN. L. REV. 1593, 1603 (2005).

298. See, e.g., *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987) (holding that disputants with claims under the Securities Exchange Act of 1934 and the Racketeer Influenced and Corrupt Organizations (RICO) Act may be compelled to arbitrate).

299. *Id.* at 226 (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

300. *Id.* (quoting *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985)).

301. See Landsman, *supra* note 297, at 1594.

means of lengthy boilerplate contracts, may be incorporated by reference to documents outside the original contract, or plastered on shrink wrap packaging.<sup>302</sup> Compulsory arbitration agreements have become ubiquitous, governing consumer transactions involving the services of telecommunications providers,<sup>303</sup> the use of credit cards, and a wide range of other activities.<sup>304</sup>

A number of states are deeply concerned about the unfairness of compulsory arbitration clauses, especially in circumstances of unequal bargaining power. Through legislation some have sought to regulate the use of such mechanisms.<sup>305</sup> For the most part, such regulation has been invalidated as violative of the FAA.<sup>306</sup> Not only are the states barred from regulating the imposition of arbitration agreements, it would appear that they are not even free to require that compulsory arbitration agreements be set forth in contract formats that are either clear or prominent.<sup>307</sup> Arbitration is further insulated from regulation because there are no government agencies that have authority over these private adjudicatory proceedings.<sup>308</sup> What rules there are come from private entities like the American Arbitration Association (AAA), the members of which provide arbitration services.<sup>309</sup>

The arbitration setting is characterized by conditions quite similar to those previously noted in the insurance claims process. The parties upon whom arbitration is imposed are, like insureds, the financially less powerful who have little choice about the terms

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302. See *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 682 (1996); Jean R. Sternlight, *Mandatory Binding Arbitration and the Demise of the Seventh Amendment Right to a Jury Trial*, 16 OHIO ST. J. ON DISP. RESOL. 669, 698-703 (2001).

303. See Judith Resnik, Comment, *Fairness in Numbers: A Comment on AT&T v. Conception, Wal-Mart v. Dukes, and Turner v. Rogers*, 125 HARV. L. REV. 78, 122 (2011).

304. See, e.g., Richard C. Reuben, *Constitutional Gravity: A Unitary Theory of Alternative Dispute Resolution and Public Civil Justice*, 47 UCLA L. REV. 949, 1031 (2000); David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33, 36.

305. See, e.g., *Southland Corp. v. Keating*, 465 U.S. 1, 2-3 (1984) (invalidating California legislation restricting compulsory arbitration in franchisor/franchisee relationships).

306. *Id.*

307. See *Doctor's Assocs., Inc.*, 517 U.S. at 683 (invalidating a Montana statute requiring boldface type to warn adhering parties about arbitration requirement).

308. Schwartz, *supra* note 304, at 80-81.

309. See Myriam Gilles & Gary Friedman, *After Class: Aggregate Litigation in the Wake of AT&T Mobility v. Conception*, 79 U. CHI. L. REV. 623, 624-27 (2012); Resnik, *supra* note 303, at 109.

imposed upon them.<sup>310</sup> They, like their insurance customer counterparts, are vulnerable to the economic and legal strength of their contractual partners.<sup>311</sup> Although job tenure, statutory rights, or substantial monetary claims may be involved, adhering parties have few, if any, options outside of arbitration.<sup>312</sup> Like those who are dependent on insurance company claims processes, adhering parties must proceed in the way their contract and their potential adversary demands. As the stakes grow, so does the likelihood that the proceedings will have an emotional, or perhaps even physical, impact on the adhering party (as was the case in the insurance context).<sup>313</sup> The adherents have no alternatives so, by necessity, they must pursue arbitration if they hope to secure vindication.

Those who impose arbitration requirements are, for the most part, free to craft procedures that further their own objectives.<sup>314</sup> Through such agreements many contract drafters have insulated themselves from class actions<sup>315</sup> and jury trials.<sup>316</sup> The corporate creators of arbitration procedures are free to design and put in place the mechanisms that will be employed.<sup>317</sup> This places them in a position strikingly like that occupied by insurance companies, which may specify and put in place the claims procedures that will be used.<sup>318</sup> In the arbitration world, the private providers usually employed to carry out the adjudicatory function often have a history of congeniality towards business.<sup>319</sup> Finally, as with insurance claims, the costs associated with adjudication may be so high as to discourage most adhering parties from seeking relief.<sup>320</sup>

It should come as no surprise that the adhesion power fostered by the FAA is abused by some contract drafters or that the arbitration mechanisms established by some cause significant financial, physical, and emotional harm to those required to adhere. Two

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310. Landsman, *supra* note 297, at 1601-02, 1604.

311. *See id.*

312. *See id.*

313. *See id.* at 1623-25.

314. *See id.* at 1594-99.

315. *See* AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1752 (2011); Gilles & Friedman, *supra* note 309, at 627.

316. *See* Landsman, *supra* note 297, at 1611.

317. *Id.* at 1601-02.

318. *See id.* at 1608-11.

319. *See id.* at 1614-18.

320. *Id.* at 1617-18.

examples may suffice. The first involves the Hooters restaurant chain. It used its dominant position to impose an arbitration requirement upon its employees with respect to all sorts of claims, whether contractual or statutory.<sup>321</sup> It went on to insist that all arbitrators be selected from a list compiled exclusively by Hooters, that only Hooters could seek summary disposition, that only the company was allowed to make a record of the arbitration proceedings, and that only the corporation could seek a court determination that an arbitrator exceeded his authority.<sup>322</sup> The Fourth Circuit Court of Appeals found this so-called arbitration mechanism “a sham”<sup>323</sup> and allowed the adhering employee to move her discrimination claim against Hooters to court. What the appellate court did not do was in any way sanction the company for its attempt to oppress its employee or punish it for its effort to stifle claims.<sup>324</sup> Hooters seemed to set out to thwart all claims. This was a winning economic strategy because even when the company’s process was invalidated, the legal challenge took years and came to a successful conclusion only after large numbers of employees had been deterred from making a claim or had their claims rejected in a “sham” process.<sup>325</sup> The company faced no financial or legal deterrent save a judgment on the merits of an already valid legal claim.<sup>326</sup>

If the sort of abuse Hooters engaged in is to be deterred and punished, there is need for a tort action capable of identifying and responding to the bad faith manipulation of the arbitration mechanism as a distinct wrong that courts may address. Otherwise, there is no reason for a company ever to resist the temptation to deter its employees from seeking legal relief against it by means of a stacked arbitration process. The damages awarded for such a wrong need to be sufficient not only to compensate for the breach of the covenant of good faith and fair dealing implicit in every contract,<sup>327</sup> but the

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321. *See* Hooters of Am., Inc. v. Phillips, 173 F.3d 933, 935-36 (4th Cir. 1999).

322. *Id.* at 936-39.

323. *Id.* at 940.

324. *See id.* at 941.

325. *Id.* at 940.

326. *See id.* at 941.

327. *See* Henderson, *supra* note 22, at 22; *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 200 (Cal. 1958) (“There is an implied covenant of good faith and fair dealing in every contract that neither party will do anything which will injure the right of the other to receive the benefits of the agreement.”).

physical suffering and mental harm an employee can prove she experienced in dealing with a mechanism designed to oppress her. The basis for such a tort is the same as that relied upon by the California courts in the first party bad faith insurance cases. In both settings, protection is warranted because of the economic and legal advantages of the contract drafter, the reliance of the vulnerable adhering party, and the company's demonstrated exploitative or oppressive designs.<sup>328</sup> Moreover, in both settings the company breached a significant public policy or obligation, in the former case fixed by a host of socially-generated insurance demands, in the latter by depriving the adhering party of access to justice and a jury trial—rights of the highest value.<sup>329</sup> This should not be construed as an argument for a generalized bad faith tort in the employment or consumer claims area. Courts have properly found these to be too amorphous or regulated to warrant such an intrusion.<sup>330</sup> Rather, it targets a specific sort of abusive conduct in which an employer or distributor of goods and services manipulates the design of an arbitration mechanism to deprive adherents of access to legal protection.

There is a second situation in which the bad faith mechanism should be imported into the compulsory arbitration context. This is illustrated by *Engalla v. Permanente Medical Group, Inc.*<sup>331</sup> Permanente created a proprietary arbitration process between itself and the patients it served under a healthcare contract.<sup>332</sup> Engalla was compelled by contract to seek arbitration after a medical malpractice claim arose regarding Permanente's provision of care.<sup>333</sup> Permanente designed and operated its arbitration system in a manner that purposely delayed consideration of Engalla's claim

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328. See Landsman, *supra* note 297, at 1623-25.

329. See, e.g., *Hooters*, 173 F.3d at 941; *Campbell v. State Farm Mut. Auto. Ins. Co.*, 65 P.3d 1134, 1150 (Utah 2001).

330. For more discussion, see Matthew J. Barrett, "Contort": *Tortious Breach of the Implied Covenant of Good Faith and Fair Dealing in Noninsurance, Commercial Contracts-Its Existence and Desirability*, 60 NOTRE DAME L. REV. 510, 525-26 (1985); see also *Foley v. Interactive Data Corp.*, 765 P.2d 373, 418 (Cal. 1988) (holding there is no tort cause of action for breach of the implied covenant of good faith and fair dealing in an employment contract to employees who allege they were discharged in violation of the covenant); *Egan v. Mut. of Omaha Ins. Co.*, 620 P.2d 141, 145-46 (Cal. 1979).

331. 938 P.2d 903 (Cal. 1997).

332. *Id.* at 909-10.

333. *Id.*

until he had died.<sup>334</sup> Once disclosed, Permanente's money-saving gambit so outraged Californians that legislation was proposed and adopted limiting waiting time for arbitration hearings and creating an arbitration bypass if the statutory period was exceeded.<sup>335</sup> Although helpful, this regulation came too late for Engalla, and, one may speculate, for hundreds of other patients victimized by Permanente. Again, the facts of vulnerability, oppression, and absence of regulation cry out for the bad faith tort solution. The patients involved were clearly vulnerable, in this case physically and emotionally as well as monetarily.<sup>336</sup> It is not hard to imagine how Engalla felt as the last few months of his life slipped away without a hearing to consider his claim. He, like so many in the insurance cases, had no opportunity to go elsewhere. He was completely dependent on Permanente, and they exploited his vulnerability to dodge their responsibility.<sup>337</sup> To recognize a bad faith claim here would be to impose some regulation, although modest, on an otherwise unregulated party and create incentives for rejecting oppressive but financially tempting schemes.

There is already California precedent considering the abuse of arbitration proceedings, albeit as part of a bad faith insurance case. In *Richardson v. Employers Liability Assurance Corporation*, the insurer refused payment of a first party claim involving injuries caused by an uninsured motorist.<sup>338</sup> Knowing that the claim was valid, the company nevertheless "forced an arbitration hearing" and, thereafter, sought to evade paying the arbitration award.<sup>339</sup> This course of conduct was considered bad faith by the California Court of Appeal.<sup>340</sup> The connection between the insurance and arbitration realms here is made clear and the appropriateness of sanctions endorsed. *Richardson* does not focus on arbitration alone but does

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334. *Id.* at 912-13; see Thomas J. Stipanowich, *Contract and Conflict Management*, 2001 WIS. L. REV. 831, 898.

335. See CAL. HEALTH & SAFETY CODE § 1373.20 (West 2000); Marc A. Rodwin, *Backlash as Prelude to Managing Managed Care*, 24 J. HEALTH POL. POL'Y & L. 1115, 1118 (1999) (citing Landsman, *supra* note 297, at 1614 n.164).

336. See *Engalla v. Permanente Med. Grp. Inc.*, 938 P.2d 903, 931-32 (Cal. 1997).

337. See *id.* at 909-10.

338. 102 Cal. Rptr. 547, 550 (1972).

339. *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032, 1037 (Cal. 1973) (describing insurer's behavior in *Richardson v. Emp'rs Liab. Assurance Corp.*, 510 P.2d 1032 (Cal. 1973)).

340. *Id.* at 1032.

recognize its potential to become oppressive.<sup>341</sup> It, along with *Hooters* and *Permanente*, all bring into focus the harm that can be done to vulnerable adhering parties in the virtually unregulated compulsory arbitration context and the appeal of extending the bad faith tort into an area where no other effective regulation exists.

### CONCLUSION

Since the late 1950's courts, particularly in California, have called upon juries to scrutinize the claims-paying behavior of insurance companies. When juries found bad faith or an absence of fair dealing, they were empowered to award a range of damages, covering not only the monetary losses of the insured but the emotional and physical trauma they suffered because of the wrongful denial of claims.<sup>342</sup> In egregious cases punitive damages were permitted as well.<sup>343</sup>

Juries are called on to regulate these interactions for a number of reasons. The first is a concern for impecunious insureds, who are vulnerable to serious harm when the insurer they have relied upon turns on them. The second is the greed and exploitative behavior of insurers who, all too often, adopt strategies designed to enhance the bottom line while disregarding fairness and, in many cases, decency. The courts turn to juries to regulate insurance company conduct because no other governmental body is willing and able to handle the task. State insurance departments sedulously avoid consumer protection and legislatures show little sympathy for the plight of the insured.<sup>344</sup> Courts put in place a vague and expansive tort remedy that empowers juries to function like a regulatory agency to closely examine insurer behavior.<sup>345</sup> Their case-by-case review establishes a regulatory framework to curtail insurance company overreaching.

The insurance company context is not the only one where vulnerable consumers face extremely powerful counterparts with adhesion power and financial incentives to oppress. Customers and employees required, under the Supreme Court's interpretation of

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341. *Id.* at 1037.

342. *See, e.g.*, *Campbell v. State Farm Mut. Auto. Ins. Co.*, 65 P.3d 1134, 1172 (Utah 2001).

343. *See, e.g., id.*

344. *See Plitt & Kriegsfeld, supra* note 231, at 1267.

345. *See Henderson, supra* note 22, at 11.

the Federal Arbitration Act, to arbitrate an extremely wide array of claims are in virtually the same situation. They too need the protection of the jury as a last resort regulator.