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Certifying the insurance class-action case

Only 14 percent of insurance cases filed get class certified, but 90 percent of those will settle

A 2007 study by the Rand Institute for Civil Justice on insurance class actions surveyed 62 insurers that had been named as defendants in class actions during a ten-year period. The survey included 743 cases, some of which were pending. The data revealed that only 25 percent of insurance cases made it to a certification hearing and, of those that did, 56 percent were certified (representing 14 percent of the cases filed as insurance class actions). Significantly, 90 percent of all certified insurance class actions resulted in a settlement. Although this statistic did not take into account the differences between classes certified for settlement purposes and stand-alone certifications, there can be little doubt about the importance of certifying an insurance class action.

Issues arising out of insurance practices typically involve a pattern of conduct in the sale or administration of a genre of policies which go to the very heart of a company's operations. A certified insurance class action provides an ideal platform for seeking redress for, and reforming, unfair practices by insurers. This article examines some of the typical hurdles that arise when moving for class certification in an insurance case.

Class certification standards

To obtain class certification under Code of Civil Procedure section 382, it must be shown that there is an ascertainable class and a well-defined community of interest. (*Sav-On Drug Stores, Inc. v. Superior Court* (2004) 34 Cal.4th 319, 326; *Linder v. Thrifty Oil Co.* (2000) 23 Cal.4th 429, 435.) A "class is ascertainable if it identifies a group of unnamed plaintiffs by describing a set of common characteristics sufficient to allow a member of that group to identify himself or herself as having a right to recover based on the description." (*Bartold v. Glendale Federal Bank* (2000) 81 Cal.App.4th 816, 828.) The "community of interest" requirement embodies the following elements: (1) predominant common questions of law or fact; (2) class representatives with claims or defenses typical of the class; and (3) class representatives who can adequately represent the class. (*Linder v. Thrifty Oil Co.*, *supra*, 23 Cal.4th at 435.) Moreover, the issue presented on certification is not whether the action has merit but whether the merits can be determined on a common basis. (*Sav-On Drug Stores*, *supra*, 34 Cal.4th at 32.) The elements required for class certification under Rule 23 of the Federal Rules of Civil Procedure are similar.

While the facts specific to a given class representative may create a basis for denying certification (e.g., claims not typical, representative not adequate due to conflict), those problems can usually be solved by replacing the class representative or redefining the class. (*La Sala v. American Savings & Loan Assoc.* (1971) 5 Cal.3d 864, 872.) And given the nature of insurance, an insurance class is almost always ascertainable and numerous. Insurance companies typically have sophisticated information technology systems that will allow them to easily identify a list of policyholders within a given set of identifying factors.

This leaves the issue of commonality as the central battlefield on certification. The cases addressing the commonality issue in insurance class actions generally involve one or more of the following categories: sales practices, contract construction, and statutory violations.

Sales practices

Class actions based upon an insurer's sales practices raise issues as to whether the alleged representations and the putative class members' reliance thereon can be established on a class-wide basis. It is well established that evidence of a standardized sales pitch or standardized marketing materials can be used to establish common representations or omissions in a sales fraud case. (*Vasquez v. Superior Court* (1971) 4 Cal.3d 800 [recitations by salesmen of a standard sales monologue contained in a training book and sales manual]; *Occidental Land, Inc. v. Superior Court* (1976) 18 Cal.3d 355 ["Unlike the circumstances in *Vasquez*, the present record reveals no standardized, rehearsed sales presentation made to prospective buyers . . . . But the trial court also had before it the written representations contained in the Final Subdivision Public Report provided to each purchaser of a home."])

As for the element of reliance, class-wide proof can be based upon the presumption of reliance that arises when the misrepresented or omitted fact is material. "[I]f the trial court finds material misrepresentations were made to the class members, at least an inference of reliance would arise as to the entire class." (*Vasquez*, *supra*, 4 Cal.3d at 805.) And "[a] misrepresentation is judged to be 'material' if 'a reasonable man would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question' [citations]." (*Engalla v. Permanente Medical Group, Inc.* (1977) 15 Cal.4th 951, 977.)

These rules are well suited to insurance sales practices. For instance, in *Wilner v. Sunset Life Ins. Co.* (2000) 78 Cal.App.4th 952, the plaintiff alleged the insurer and its agents engaged in a scheme to induce policyholders to cash in their existing policies for purposes of selling replacement policies while failing to disclose the adverse financial consequences of those actions. The court determined that these sales representations

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were sufficient to survive a demurrer to the class allegations because they alleged a common course of conduct based upon a misrepresentation of material facts.

In *Massachusetts Mutual Life Ins. Co. v. Superior Court* (2002) 97 Cal.App.4th 1282, the court reviewed an order granting class certification of a class of persons who purchased "vanishing premium" life insurance policies – policies that paid dividends which were to eliminate the need to pay premiums after a certain period of time. The plaintiffs alleged that the insurer violated the Business & Professions Code section 17200 (Unfair Competition Law or "UCL") and the Consumers Legal Remedies Act because it failed to disclose its plan to "ratchet down" the dividend which, in turn, would cause premium obligations to continue. The court determined that the element of reliance (causation) could be satisfied on a class basis based upon the nondisclosure of a material act, the anticipated dividend decrease.

> Like the circumstances discussed in *Vasquez* and *Occidental*, here the record permits an inference of common reliance. Plaintiffs contend Mass Mutual failed to disclose its own concerns about the premiums it was paying and that those concerns would have been material to any reasonable person contemplating the purchase of an N-Pay premium payment plan. If plaintiffs are successful in proving these facts, the purchases common to each class member would in turn be sufficient to give rise to the inference of common reliance on representations which were materially deficient.

(*Id.* at 1293.)

The common sales pitch basis for proving common misrepresentations must be substantiated by facts showing that sales agents were required to make sales in a given manner. This can be accomplished by proving the mandatory use of sales scripts, uniform training, and the like. The insurer will inevitably submit declarations from a variety of agents attesting that they did not follow any type of standardized sales presentations and that every sale was different. For example, in *Kaldenbach v. Mutual of Omaha Life Ins. Co.* (2009) 178 Cal.App.4th 830, 844, 846, the plaintiff alleged that he bought a vanishing premium life insurance policy which purportedly would pay for itself after four years. He alleged that through standardized sales presentations and illustrations he and a class of purchasers were misled. The court concluded individualized issues predominated after finding that the defendant's training materials and methods were not uniform, agents were not required to use written materials or illustrations in presentations, and not all agents used them. Indeed, of the 13 declarations that the plaintiff submitted from other purchasers, the vast majority did not mention having ever been shown an illustration. Moreover, the defendant's independent sales agents were not required to take the offered training and were not required to use any particular sales method in their presentations.

Even when there is evidence of individualized sales pitches, courts routinely find common misrepresentations and grant class certification if the alleged representations or nondisclosures are contained in uniform written materials. (See, e.g., *Yokoyama v. Midland National Life Ins. Co.* (9th Cir. 2010) 594 F.3d 1087 [reversing denial of class certification based upon insurer's use of form documents with common misrepresentations and nondisclosures]; *Cooper v. Pacific Life Ins. Co.* (S.D. Ga. 2005) 229 F.R.D. 245, 262-264 [mandatory distribution of a uniform written prospectus misrepresenting benefits of annuity product satisfied predominance, despite thousands of declarations attesting to full oral disclosure]; *In re Home-Stake Production Company Securities Litigation* (N.D. Okla. 1977) 76 F.R.D. 351, 369, fn. 11 [certification granted despite stipulated non-uniform oral sales presentations, because alleged misrepresentations or omissions "were contained in a common core of documents"]; *Smith v. MCI Telecommunications Corp.* (D. Kan. 1989) 124 F.R.D. 665, 678-79 [where basic allegation was misrepresentations in written material shown all class members, common issues outweighed possible individual issues from alleged oral misstatements]; *In re Great Southern Life Ins. C., Sales Practices Litigation* (N.D. Tex. 2000) 192 F.R.D. 212, 214, 216 [certifying vanishing premium life insurance sales fraud action, noting insurer-developed written materials were a primary marketing tool.])

Contract claims

In the insurance context, claims for breach of contract, declaratory relief, and contractual bad faith all lend themselves to a finding of commonality. The standardized nature of insurance contracts coupled with an insurer's practice of denying claims on specific bases under the standardized language typically give rise to common issues. (*La Sala v. Amer. Savings & Loan Assn., supra*, 5 Cal.3d 876 ["Controversies involving widely used contracts of adhesion present ideal cases for class adjudication"]; *Steinberg v. Nationwide Mut. Ins. Co.* (E.D.N.Y. 2004) 224 F.R.D. 67, 74 ["When viewed in light of Rule 23, claims arising from interpretations of a form contract appear to present the classic case for treatment as a class action, and breach of contract cases are routinely certified as such"].)

In *Lebrilla v. Farmers Group, Inc.* (2004) 119 Cal.App.4th 1070, the plaintiffs sought certification of a class of California insureds for, *inter alia*, declaratory relief based upon the insurer's use of aftermarket crash parts in repair of their vehicles in breach of policy provisions requiring "like kind and quality" parts. In reversing the denial of certification on the declaratory relief claim, the court determined that the coverage issue arising out of standardized language was susceptible to common proof.

When the claims practice attacked is one which necessarily entails individualized factual inquiries that will vary from claimant to claimant, certification will be denied. Accordingly, in *Basurco v. 21st Century Insurance Co.* (2003) 108 Cal.App.4th 110, the court concluded that individualized issues predominated in two class actions brought on behalf of homeowners who were denied coverage for property damage sustained in the 1994 Northridge earthquake. The court said the inquiry into the merits of policyholders' claims would vary greatly, given

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that, for example, the claims of one named plaintiff involved asbestos damage, while another named plaintiff made a claim for damage to a retaining wall. And in *Newell v. State Farm General Ins. Co.* (2004) 118 Cal.App.4th 1094, another Northridge earthquake case, the court followed *Basurco* in determining that plaintiffs could not satisfy the commonality and superiority requirements. The court said, "Even if [defendants had] adopted improper claims practices to adjust Northridge earthquake claims, each putative class member still could recover for breach of contract and bad faith only by proving his or her individual claim was wrongfully denied . . . . In such cases, class treatment is unwarranted." (*Id.* at 1103.)

Even so, depending on the nature of the coverage issue, declaratory and/or injunctive relief may be appropriate to address a widespread company practice. While certification of a class action seeking money damages must include a finding that common issues predominate (*Sav-On Drug Stores, Inc. v. Superior Court*, *supra*, 34 Cal.4th at 238), a class that only seeks declaratory or injunctive relief merely requires a single common issue per Rule 23(b)(2) of the Federal Rules of Civil Procedure. California courts look to the federal rules in those circumstances. (*Capitol People First v. State Dept. of Developmental Services* (2007) 155 Cal.App.4th 676, 691-92, fn. 12; *Bell v. American Title Insurance Co., et al.* (1991) 226 Cal.App.3d 1589, 1604-1606.) Under Rule 23(b)(2), class certification is appropriate where the defendant has acted or refused to act on grounds generally applicable to the class. This test is satisfied when there is a pattern of activity which violates the rights of individuals. (*Capitol People First*, *supra*, 155 Cal.App.4th at 690-93 [finding common issues where named plaintiffs sought to remedy defendants' systemic failure to provide proper oversight and enforce constitutional, statutory, and regulatory mandates]; *Reyes v. Bd. of Supervisors of San Diego County* (1987) 196 Cal.App.3d 1263, 1277 [finding that commonality requirement was satisfied where putative class had common goal of invalidating defendants' process of issuing sanctions].)

Thus, if an insurer's practice is such that it evidences a systematic denial of claims, a class can be certified to address the practice regardless of the individualized facts that may apply to a given claimant. In *Ticconi v. Blue Shield Life & Health Insurance Company* (2008) 160 Cal.App.4th 528, the plaintiff sought certification of claims for declaratory and injunctive relief for a class of insureds whose health insurance policies had been rescinded (and claims denied) on the basis they had made material misstatements of fact about their health histories in their applications for insurance. The plaintiff alleged that the insurer had systematically violated statutes that precluded rescission unless the applications were attached to the policies, something the insurer admittedly had not done. The court reversed the denial of class certification on the basis that the individual issues raised by the defendant would not affect the liability decision to be made under the relevant statutes. (*Id.* at 544-543.)

Likewise, in *Williams v. Nat'l Sec. Ins. Co.* (M.D. Ala. 2006) 237 F.R.D. 685 the plaintiffs brought a civil rights class action on behalf of a class of African-American policyholders, alleging that the insurer had employed a racially discriminatory pricing structure from 1947 through 1980. As a result of an investigation by the Alabama Department of Insurance over these same practices, the defendant decided to settle the class action. The court found Rule 23(b)(2) certification to be appropriate. "Whether policies sold to African-Americans were objectively more costly and inferior than comparable policies sold to Caucasians is an objective, common question provable on a class-wide basis. The class is cohesive because all members have been affected in the same way by NSIC's practices."

An insurer's contractual duty of good faith may also provide a basis for common proof. Under certain policies, insurers retain discretion to make certain determinations, such as the decision to credit annual returns under annuities or to set rates under health insurance policies, which triggers the contractual duty of good faith and fair dealing. "The covenant of good faith finds particular application in situations where one party is invested with a discretionary power affecting the rights of another. Such power must be exercised in good faith. [Citations omitted.]" (*Carma Developers (Cal.) Inc. v. Marathon Development California, Inc.* (1992) 2 Cal.4th 342, 372; *Cal. Lettuce Growers v. Union Sugar Co.* (1955) 45 Cal.2d 474, 484.)

The duty of good faith in this context is determined under an objective standard, one that inquires into the insured's objectively reasonable expectations given the purpose of the policy and its express provisions. This objective standard provides the basis for common issues under standardized contracts like insurance contracts. (*Acree v. General Motors Acceptance Corp.* (2001) 92 Cal.App.4th 385, 393-396 [upholding judgment in class action based upon finance company's unreasonable exercise of discretion in determining how premium refunds would be calculated]; *Lazar v. Hertz Corp.* (1983) 143 Cal.App.3d 128, 141 [acknowledging that rental car company's right to set price for gasoline was limited by covenant of good faith in class action].)

Statutory violations

Insurance is a highly regulated industry. State laws and regulations impose duties on insurers in addition to those arising out of the companies' policies. "An insurance policy is governed by the relevant statutory law in force at the time the policy is issued; such provisions are read into the policy and become part of the insurance contract." (*Modglin v. State Farm Mutual Automobile Ins. Co.* (1969) 273 Cal.App.2d 693, 698; *Kotlar v. Hartford Fire Insurance Company* (2000) 83 Cal.App.4th 1116, 1120-1123 [insurer could not enforce the contract's termination provision because it failed to provide the required statutory notice of termination].) Because the statutory duties are

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superimposed on the insurer's contractual duties, violations of statutes create common issues.

These violations can also serve as a basis for establishing liability against an insurer on behalf of a class under the UCL's unlawful prong. For example, in *Krumme v. Mercury Ins. Co.* (2004) 123 Cal.App.4th 924, the court concluded that the insurer had committed an unlawful business practice by using "broker" agents who had not been appointed under the requirements of Insurance Code section 1704. The courts in *Donabedian v. Mercury Ins. Co.* (2004) 116 Cal.App.4th 968 and *Chabner v. United Omaha Life Ins. Co.* (9th Cir. 2000) 225 F.3d 1042 reached similar conclusions. (*Donabedian* at 983-87 [concluding that violation of Proposition 103 gave rise to UCL liability under unlawful prong]; *Chabner* at 1048-49 [finding that plaintiff could maintain a UCL claim under the unlawful prong based on defendant's violation of Ins.Code, § 10144].)

An important distinction here is that, for class standing under the UCL, only the class representative must show that he or she lost money or property as a result of the unlawful act. (*In re Tobacco II Cases* (2009) 46 Cal.4th 298, 324.) The question under the unlawful prong relative to insurance law violations becomes what "causation," if any, is required. *Tobacco II* made clear that its holding regarding the requirement of a reliance element for class standing under the UCL was limited to the fraud prong. (*Id.* at 326, fn. 17.) Subsequently, in *Kwikset Corp. v. Superior Court* (2011) 51 Cal.4th 310, 326-327, the court determined that class standing for a claim under the unlawful prong of the UCL requires a showing of reliance when the predicate law prohibits some type of misrepresentation or deceit. Thus, when moving for certification under the UCL based upon an insurance statute that outlaws misrepresentations (e.g., Ins.Code, § 332), there must be a showing that the class representative relied on some misrepresentation or nondisclosure.

Class-wide arbitration

In the recent case of *AT&T v. Concepcion* (2011) _ U.S. _ [131 S. Ct. 1740, 179L.Ed.2d 742] the United States Supreme Court determined that arbitration clauses in consumer contracts subject to the Federal Arbitration Act (FAA) preempt California's *Discover Bank* rule (finding class waivers in arbitration agreements unconscionable). In doing so, the Court determined that class arbitration, absent an agreement between the parties, is inconsistent with the FAA. The upshot is that unless there is a contractual defense to the agreement to arbitrate which is not unique to arbitration (e.g., arbitration is unconscionable or against public policy because it does not allow judicially monitored discovery), arbitration is required in consumer contracts subject to the FAA and class claims cannot proceed.

Contractual arbitration provisions in mass-marketed insurance products are not typical with the exception of health care contracts. Following the *AT&T* decision, it remains to be seen whether insurers will rush to insert such provisions in their policies in the hope of immunizing themselves from class actions contesting their practices. There are drawbacks to arbitration for insurers. Arbitration does not provide for an appeal and does not produce guiding stare decisis. Nor does it provide a basis for claim preclusion. This means that an insurer's practice could be attacked over and over again regardless of a given outcome. Insurers like predictability and arbitration provides none.

While it was once clear that California allowed class-wide arbitrations (*Blue Cross v. Superior Court* (1998) 67 Cal.App.4th 42), the rules underpinning that allowance are now in question. Needless to say, the interplay between state rules and the FAA will be the subject of much further litigation following *AT&T*.

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