NOTES

The Need for Revisiting the Imposition of Bad Faith Liability: *Industrial Indemnity Co. v. Kallevig*

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I. INTRODUCTION

Numerous values are promoted under the American legal system. While business growth is encouraged by various state and federal laws,[1] the legal system also recognizes and promotes an individual's freedom from negligent and intentional harms.[2] At times, however, these two separate values can

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1. Most state codes authorize the corporate form of business organization, which bestows certain distinct advantages. For example, one of the most recognized advantages of corporate formation is the availability of limited liability for investors, which encourages investment in business enterprise. *See* WASH. REV. CODE § 23B.06.220 (1989) (limiting the liability of shareholders to consideration paid for the shares purchased or as otherwise specified in the subscription agreement).

In addition, specific legislative declarations recognize the benefits to a state's economic base from the promotion of business development. *See* WASH. REV. CODE § 43.170.010 (1989) (recognizing the benefits of small businesses created by innovators and inventors); WASH. REV. CODE § 43.210.010 (1989) (recognizing and promoting export businesses).

2. In the late nineteenth and early twentieth centuries, various state courts either did not recognize or only recognized a limited contractual remedy available for insureds seeking to redress certain insurance claim settlement procedures common at that time. STEPHEN S. ASHLEY, BAD FAITH ACTIONS § 2.02 (1984 & Supp. 1990). These practices included situations where the insurer would assume the insured's defense pursuant to the policy and, in exercising this control, would refuse to accept a settlement offer within the policy limits unless the insured contributed to the settlement. *Id.* While rejecting contract claims in this area, the courts recognized the potential for tort remedies in situations involving abusive claim settlement procedures. *Id.* at § 2.03.

The availability of tort remedies is based on various theories of negligence and fraud. *Id.* The recognition of tort remedies in insured/insurer disputes is generally attributable to two factors. First, the insurance industry's activity is strongly related to and affected by the public interest. *See* WASH. REV. CODE § 48.01.030 (1989) (stating the business of insurance is one affected by the public interest); Salois v. Mutual of clash in cases such as bad faith litigation between insureds and their insurance companies. Bad faith litigation arises when an insurance company denies payment of a claim submitted by an insured, and the insured pursues judicial relief on grounds that the insurer's denial is not appropriately based.[3] In Washington, the relationship between an insurance company and its insured is governed by common, statutory, and administrative law.[4] The Washington Supreme Court recently considered these laws as they apply to bad faith litigation in *Industrial Indemnity Co. v. Kallevig.*[5]

Before the *Kallevig* decision can be placed into context and analyzed, one must consider the development of bad faith litigation in Washington. The body of law governing bad faith litigation in Washington developed primarily over the past twenty-five years. While previously requiring the business of insurance be actuated in good faith,[6] the Washington State Legislature repealed the insurance exemption from the Con-

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Omaha Ins. Co., 90 Wash. 2d 355, 581 P.2d 1349 (1978) (citing WASH. REV. CODE § 48.01.030 and declaring a public interest in the business of insurance). Second, insurance contracts are usually considered to be contracts of adhesion because of the normal disparity in bargaining power between the insured and the insurance company. WILLIAM M. SHERNOFF ET AL., INSURANCE BAD FAITH LITIGATION § 1.03 (1986).

3. The underlying insurance company activity that is recognized as constituting bad faith conduct can be the insurer's inadequate investigation, delay, deception, wrongful cancellation, nondisclosure, and liability arising from the misconduct of the insurer's agents. JOHN C. MCCARTHY, RECOVERY OF DAMAGES FOR BAD FAITH §§ 1.10-1.19 (5th ed. 1990).

4. *See* Pierce County v. Highlands Ins. Co., 59 Wash. App. 782, 801 P.2d 284 (1990) (stating that a bad faith insurance analysis under the Consumer Protection Act "requires a generalized excursion through the statute and the case law"). *See also* Tyler v. Grange Ins. Ass'n, 3 Wash. App. 167, 473 P.2d 193 (1970); WASH. ADMIN. CODE ch. 284-30 (1990).

Although insurance transactions are governed by statutory, administrative, and common law, one may better appreciate the duties and restrictions imposed by legislatures, regulators, and courts by considering the underlying relationship of the insured and insurer. The underlying motivation of all insurance purchasers is the acknowledgement and management of perceived risk. ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW § 1.3 (1988) (recognizing two principal characteristics of insurance as the transfer and distribution of risk). By choosing to manage a perceived risk through the acquisition of insurance, purchasers acknowledge, at least implicitly, that the value derived from the insurance (i.e. the risk avoided) outweighs the cost of the insurance. In effect, the insured is purchasing "peace of mind." SHERNOFF ET AL., *supra* note 2, at § 1.02. This expectation of the insured, coupled with the inherent characteristics of an insurance contract and public interest considerations, creates the basis for various statutory and common law provisions concerning the insured/insurer relationship. *Id.*

5. 114 Wash. 2d 907, 792 P.2d 520 (1990).

6. 1911 Wash. Laws ch. 49, § 1 (codified as amended at WASH. REV. CODE § 48.01.030 (1989)).

sumer Protection Act (CPA) to ensure sufficient reimbursement to the insured and to deter unjustified claim denials.[7] In 1970, Washington courts followed this trend by explicitly recognizing that a fiduciary relationship exists between an insurer and its insured.[8] At the same time, while recognizing and promoting an insured's ability to recover when an unjustified claim denial occurs,[9] the courts have attempted to develop a bad faith standard that allows insurers some flexibility in protecting their own interests.[10] Under this standard, Washington

7. 1967 Wash. Laws ch. 147, § 1 (codified as amended at WASH. REV. CODE § 19.86.170 (1989)). Under the Washington Consumer Protection Act (CPA), an individual may bring a civil action to recover actual damages to his or her business or property arising from certain violations. WASH. REV. CODE § 19.86.090 (1989). Such violations occur in certain enumerated situations including those involving an unfair or deceptive act or practice, WASH. REV. CODE § 19.86.020 (1989), or a monopoly, WASH. REV. CODE § 19.86.040 (1989). In addition to recovering actual damages and costs of the suit, the action may enjoin further violations, and the court may increase the damages up to three times the actual damages. However, in situations involving an unfair or deceptive act or practice, the increased damages may be no more than ten thousand dollars. WASH. REV. CODE § 19.86.090 (1989). The imposition of liability for costs of the suit, including reasonable attorneys' fees, and increased damages can be considered extracontractual damages because they are imposed in addition to actual damages from breach of the insurance contract.

8. Tyler v. Grange Ins. Ass'n, 3 Wash. App. 167, 473 P.2d 193 (1970). The case involved an insurance company's failure to settle a claim within automobile liability insurance policy limits. The court stated that the insurer's duty to refrain from acting in bad faith was founded on the fiduciary relationship between the insurer and its insured and that this duty implied a broad obligation of fair dealing. *Id.* at 173, 473 P.2d at 197. Consequently, when an insurer acts pursuant to its right to defend and settle a claim, the insurer must act in good faith and with ordinary care. *Id.* at 176, 473 P.2d at 199. To satisfy this duty, the insurer must consider the insured's interests equal to those of its own. *Id.* at 177, 473 P.2d at 199. In addition, the court cited an insurer's responsibility under its duty of good faith to investigate properly the prospective amount of damages when the insurer defends an action brought against its insured. *Id.* at 179, 473 P.2d at 200.

9. *See* Industrial Indemnity Co. v. Kallevig, 114 Wash. 2d 907, 792 P.2d 520 (1990); Saunders v. Lloyd's of London, 113 Wash. 2d 330, 729 P.2d 249 (1989); Transcontinental Ins. v. Utility System, 111 Wash. 2d 452, 760 P.2d 337 (1988); Schroeder v. Royal Globe Ins., 99 Wash. 2d 65, 659 P.2d 509 (1983); Salois v. Mutual of Omaha, 90 Wash. 2d 355, 581 P.2d 1349 (1978); Evergreen Int'l v. American Casualty Co., 52 Wash. App. 548, 761 P.2d 964 (1988); Escalante v. Sentry Ins., 49 Wash. App. 375, 743 P.2d 832 (1987), *review denied*, 109 Wash. 2d 1025 (1988); Castle & Cooke v. Great Am. Ins., 42 Wash. App. 508, 711 P.2d 1108, *review denied*, 105 Wash. 2d 1021 (1986); Whistman v. West American, 38 Wash. App. 580, 686 P.2d 1086 (1984); Smith v. Ohio Casualty Ins. Co., 37 Wash. App. 71, 678 P.2d 829 (1984); Safeco Ins. Co. v. JMG Restaurant, 37 Wash. App. 1, 680 P.2d 409 (1984); Miller v. Indiana Ins. Co., 31 Wash. App. 475, 642 P.2d 769 (1982).

10. *See* Schroeder v. Royal Globe Ins. Co., 99 Wash. 2d 65, 659 P.2d 509 (1983) (holding an insurer's denial of coverage does not breach the insurer's good faith fiduciary duty); Pierce County v. Highlands Ins. Co., 59 Wash. App. 782, 801 P.2d 284 (1990) (stating that an insurer's clumsy conduct is not unreasonable in a situation involving a complicated insurance claim); Smith v. Ohio Casualty Ins., 37 Wash. App. 71, 678 P.2d 829 (1984) (holding a mere denial of coverage because of a debatable

courts review an insurance company's actions and surrounding circumstances to determine whether the insurer was reasonably justified in denying a claim.[11]

The Washington Supreme Court in *Kallevig* employed this reasonable justification standard for determining whether an insurer acted in bad faith by denying a claim. While this standard is consistent with prior case law,[12] a subsequent appellate court decision applied an arguably less onerous bad faith standard in *Gingrich v. Unigard Security Insurance Co.*[13] The standard applied by the *Gingrich* court required consideration of whether an insurer's actions were unreasonable, frivolous, or untenable.[14] Because this standard is less onerous than the reasonable justification standard of *Kallevig*, insurers may attempt to avoid the *Kallevig* standard and its underlying public interest considerations by recharacterizing claim denials in a manner more closely analogous to the denial in *Gingrich*.

In addition to applying a reasonable justification standard, the *Kallevig* court held that a single violation of the insurance commissioner's regulations delineating unfair business practices was sufficient to impose CPA liability upon the insurer. This holding, however, disregards the frequency provision within the regulations. In order to constitute unfair claims settlement practices, the frequency provision requires violation of the regulations with such frequency as to indicate a general business practice.[15]

Because of the potential uncertainty created by two inconsistent bad faith standards articulated in *Kallevig* and *Gingrich*, and the failure to recognize a regulatory frequency provision, this Note posits two recommendations. First, in order to harmonize the bad faith standards applied in *Kallevig* and *Gingrich*, the *Kallevig* reasonable justification standard should be applied in situations involving questions similar to those confronted by the *Gingrich* court. Second, this Note con-

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coverage question does not give rise to a CPA violation); Miller v. Indiana Ins. Co., 31 Wash. App. 475, 642 P.2d 769 (1982) (holding an insurer's denial of benefits because of a debatable question is insufficient to show bad faith).

11. *Whistman*, 38 Wash. App. at 584-585, 686 P.2d at 1089; *Safeco Ins. Co.*, 37 Wash. App. at 15, 680 P.2d at 418 (holding an insurer's refusal to pay a claim on the basis of suspicions and conjectures may violate a fiduciary duty of good faith because such a refusal must be reasonably based).

12. *See supra* note 11.

13. 57 Wash. App. 424, 788 P.2d 1096 (1990).

14. *Id.* at 434, 788 P.2d at 1102.

15. WASH. ADMIN. CODE § 284-30-300 (1990).

tends that the *Kallevig* court's analysis imposing liability under the CPA was defective because it failed to take proper account of the frequency requirement within the unfair trade practices regulations. By ignoring the frequency provision, the *Kallevig* decision allows inconsistent treatment of similar factual situations depending on whether the decision is being made by an agency or judicial body. As such, the legislature should review the appropriateness of a frequency requirement for determining unfair business practices. If its review establishes the appropriateness of this requirement, the legislature should amend the unfair business practices statute to prevent a single violation of the unfair trade practices regulations from serving as the basis for CPA liability.

To provide a basis for analyzing the *Kallevig* decision, this Note will first review the development of the bad faith standard employed in Washington. The Note will then discuss the facts in *Kallevig* and consider the imposition of the bad faith standards employed by the *Kallevig* and *Gingrich* courts. Lastly, the court's analysis for the imposition of CPA liability will be reviewed and critiqued.

II. The Development of Bad Faith Liability of Insurers

Bad faith liability is a general categorization for liability imposed upon an insurer when the insurer has acted in bad faith. These actions include inadequate investigation, unfounded settlement delay, or wrongful cancellation.[16] The consideration of bad faith liability can be separated into two distinct areas: (1) the formulation of the standard used to measure an insurance company's conduct and (2) the mechanism employed to enforce compliance with this standard.

In Washington, the first recognition of an insurer's bad faith liability to an insured was in *Tyler v. Grange Insurance Association*.[17] In considering the refusal to settle a claim within an insurance policy's limits, the *Tyler* court recognized an insurer's contractual right to defend and settle a claim. The court noted, however, that an insurer owed a duty of good faith arising from a fiduciary relationship between an insurer and insured.[18] Since the recognition of this fiduciary duty in *Tyler*, several decisions have expanded and clarified the duty owed to

16. *See supra* note 3.
17. 3 Wash. App. 167, 473 P.2d 193 (1970).
18. *Id.* at 173, 473 P.2d at 197.

an insured by an insurance company.[19] For example, while *Tyler* addressed an insurer's duty to settle a claim within policy limits,[20] the Washington Supreme Court later considered the insurer's duty to pay an insured's claim.[21] In this context, the court held that insurers had a broad obligation of fair dealing; therefore, a specific showing of dishonesty, misrepresentation, deceit, or fraud was not required to impose penalties under the CPA.[22]

On the other hand, rather than describe an insurer's duty as a broad obligation of fair dealing, some Washington courts have formulated this duty differently. For example, bad faith action can be shown by a frivolous and unfounded denial of policy benefits, while the denial of benefits due to a debatable question of coverage is insufficient for a bad faith claim.[23]

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19. *See* Schroeder v. Royal Globe Ins., 99 Wash. 2d 65, 659 P.2d 509 (1983); Safeco Ins. Co. v. JMG Restaurant, 37 Wash. App. 1, 680 P.2d 409 (1984); Miller v. Indiana Ins. Co., 31 Wash. App. 475, 642 P.2d 769 (1982).

20. *Tyler*, 3 Wash. App. at 172-76, 473 P.2d at 197-99.

21. *Schroeder*, 99 Wash. 2d at 74, 659 P.2d at 514. In *Schroeder*, the insured was a carpet cleaning business that sought recovery under a property liability policy for the cost of replacing a carpet destroyed by a malfunctioning carpet cleaning machine operated by an employee of the insured. *Id.* at 66, 659 P.2d at 510. The insurer denied coverage based upon a policy exclusion and reliance on prior case law regarding the interpretation of policy exclusions. *Id.* at 68, 72, 659 P.2d at 511, 513. Although the court found the exclusionary provision did not apply in this situation, the court held that the insurer did not breach its good faith fiduciary duty in refusing to extend coverage in the absence of litigation. *Id.* at 74, 659 P.2d at 514; *but see* 16 GEORGE J. COUCH, INSURANCE § 58:173 (2d ed. 1966) (stating that an insurer's claim refusal based upon an erroneous construction of its policy and applicable law may be sufficient to impose statutory penalties and attorneys' fees).

22. *Schroeder*, 99 Wash. 2d at 74, 659 P.2d at 514.

23. In Miller v. Indiana Ins. Co., 31 Wash. App. 475, 642 P.2d 769 (1982), the insurer denied the insured's claim for the theft of a customer's goods that were in the insured's vehicle during the course of his business. The court first considered the applicable insurance policy provisions and determined that the policy exclusion used as the basis for denial by the insurer did not apply to this situation. The court next considered whether the insurer's actions constituted bad faith, thus invoking the CPA. In deciding this question, the court held that the insurer denied coverage based upon a "reasonable interpretation of the policy" and that such an action did not constitute bad faith as a matter of law. *Id.* at 479, 642 P.2d at 771.

The Washington Supreme Court also reached a similar result in considering whether an insurance company acted improperly by seeking a declaratory judgment on the issue of coverage provided under two policies. Transcontinental Ins. v. Utility System, 111 Wash. 2d 452, 760 P.2d 337 (1988). Both policies were special excess liability policies that provided coverage for losses exceeding a certain limit covered by the insured's self-insurance agreement. *Id.* at 454-55, 760 P.2d at 339. Similar to the court in *Miller*, the *Transcontinental* court examined the policies' language and determined that both policies provided coverage for the insured's officers, directors, and employees acting within their duties for liabilities arising out of litigation over a $2.25 billion bond default. *Id.* at 464, 760 P.2d at 344. The court also held that the

Another court stated that the insured must prove the insurance company did not act fairly, honestly, and objectively, or the insurer acted without reasonable justification in refusing the claim.[24] Most recently, the *Kallevig* court considered whether the insurer was reasonably justified in denying a claim.

Along with developing a standard for measuring an insurance company's conduct, courts have considered which mechanism should be used to enforce compliance with this standard. The appellate court in *Tyler* recognized a duty sounding in tort in order to encourage the insurer to consider the insured's interests when settling a claim.[25] The Washington Supreme Court, however, has not expressly recognized an insurer's duty to an insured in bad faith actions as giving rise to a tort.[26] Instead, Washington and a minority of other states have enacted a statutory framework through which an insured can recover under the CPA.[27] By using a statutory framework to

insurer's actions were not sufficient to constitute bad faith because they were not unreasonable, frivolous, or untenable. *Id.* at 470-71, 760 P.2d at 347.

24. Safeco Ins. Co. v. JMG Restaurant, 37 Wash. App. 1, 14-15, 680 P.2d 409, 418 (1984). The *Safeco* court considered a factually analogous situation to that in *Kallevig*. In *Safeco*, the insurer sought a declaratory judgment that the insurer was not liable under a fire policy for fire damage caused to a restaurant owned by the insureds. *Id.* at 3, 680 P.2d at 412. Evidence was presented that the fire department arson squad suspected the insured of arson, that the insured was in financial trouble, and that the insured was seen leaving the restaurant shortly before the fire. *Id.* at 14-15, 680 P.2d at 418. However, the court stated that the arson suspicions were not sufficient to implicate the insured, that the evidence indicating that the insured was in financial trouble was disputed, and that another person may have left the restaurant without being seen. *Id.* Lastly, the insurer's reliance on the fact that an insured was a suspect for arson was considered unreasonable because the prosecutor later dropped arson charges. *Id.* at 15, 680 P.2d at 418. Consequently, the court held that the evidence was sufficient to support the jury's verdict in favor of the insured on a CPA claim. *Id.*

25. Tyler v. Grange Ins. Ass'n, 3 Wash. App. 167, 172, 473 P.2d 193, 197 (1970).

26. *See* Patricia G. Stegmaier, *An Insurer's Bad Faith Refusal to Pay a Valid First Party Claim: A Tort Whose Time Has Come in Iowa*, 32 DRAKE L. REV. 987 (1983). A majority of jurisdictions have recognized a tort action in situations where the insured acted in bad faith against the first party insured. *Id.* at 990. Support for recognizing such a tort has primarily been found in three areas. First, the quasi-public nature of the insurance business is seen as justifying the imposition of a tort to protect and benefit first-party insureds. *Id.* at 989. Second, an insured is viewed as purchasing an insurance policy for financial protection against a calamity and to promote financial peace of mind, not to gain a personal commercial advantage. As such, denying the insured his or her benefit of a bargain with the insurer would be unfair. *Id.* at 990. Third, a bad faith tort remedy is considered an "equalizing power" to enable the insured to recoup consequential and potentially punitive damages. *Id.* *See also infra* note 79 and accompanying text.

27. *See* ROWLAND H. LONG, THE LAW OF LIABILITY INSURANCE § 5B.11 (1986). *See also* Stegmaier, *supra* note 26, at 996 (indicating that a minority of states have adopted

impose liability in bad faith actions, the Washington State Legislature created a system that attempts to balance compensating an injured insured with enabling the insurer to protect its interests.[28] The Washington Supreme Court recently applied this statutory framework for bad faith actions in *Kallevig*.

legislation delineating unfair and deceptive acts or practices that, if violated, provide sufficient remedy for an insurer's bad faith actions).

Another reason cited for imposing a statutory penalty rather than providing an action in tort in bad faith actions is the potential for excessive punitive damage awards that could impair the financial status of an insurer, overcompensate the insured, and increase premiums to the general public. *See* Bradley J. Fisher, Egan v. Mutual of Omaha Ins. Co.: *The Expanding Use of Punitive Damages in Breach of Insurance Contract Actions*, 15 SAN DIEGO L. REV. 287, 304-05 (1978) (stating that insurance companies are particularly vulnerable to punitive damage awards because they are not favored by juries).

28. *See supra* notes 26 and 27. The public nature of the insurance business is recognized in Washington through WASH. REV. CODE § 48.01.030 (1989). The imposition of CPA liability through WASH. REV. CODE § 19.86.170 (1989) enables the injured insured to recover the benefit of his or her bargain with the insurer. The first two policy reasons usually given for recognizing a bad faith tort (the protection of first-party insureds and the promotion of the insured's financial protection) are achieved under this statutory framework. The third policy reason cited for a bad faith tort is the recovery of consequential and punitive damages. While consequential damages are available under Washington's statutory scheme, unbounded punitive damages are not permissible. Instead, the CPA sets forth various limitations on extracontractual damages. *See supra* notes 6-7. Thus, the primary difference between the bad faith tort and Washington's statutory framework is the limitation on punitive damages.

The Washington approach is preferable because it more efficiently balances the interests of the insurer with those of the insured. In considering the merits of imposing punitive damages in bad faith actions, one should note that the underlying relationship between the insured and insurer is based upon an insurance contract. As such, appropriate deference should be given to the contracting parties. In addition, although insurers are subject to considerable state regulation, insurers are entitled to a reasonable underwriting profit. WASH. REV. CODE § 48.19.030(c) (1989) (indicating that consideration is to be given to a reasonable margin for underwriting profit in the insurance rate-making process). Furthermore, the premiums and policy forms used for many types of insurance coverage must be approved by the insurance commissioner prior to their use. WASH. REV. CODE ch. 48.19 (1989). It is important to recognize the statutorily authorized profit-making nature of the insurance industry and the industry's ability to receive the benefits of the bargain entered into with the insured. As such, the law in bad faith actions must enable the insurer to protect these statutorily recognized benefits. By imposing the potential of unlimited punitive damages awards, the insurer's ability to receive the benefit derived from its insurance contracts would be substantially impaired. *See* Miller v. Indiana Ins. Co., 31 Wash. App. 475, 642 P.2d 769 (1982) (recognizing the insurer's right to deny benefits due to a debatable question of coverage). Thus, by limiting the extracontractual damages that are awardable under the CPA, the insured receives sufficient compensation, and the insurer is deterred from inappropriate behavior without the potential for excessive liability.

III. THE DECISION IN *KALLEVIG*

A. *The Facts of the Case*

On January 27, 1986, the Peach Tree Restaurant was destroyed by fire.[29] The restaurant, owned by David and Judith Kallevig, was insured by Industrial Indemnity Company of the Northwest, Inc.[30] Following a claim under the restaurant's policy, Industrial Indemnity brought an action for declaratory judgment alleging that David Kallevig intentionally caused the fire. The Kallevigs, in turn, counterclaimed for damages under contract and CPA theories.

On the evening of the fire, two employees closed the restaurant and turned off the electrical switches in the food preparation area. Shortly thereafter, David Kallevig arrived at the restaurant, counted the money, and placed the money into a floor safe. The fire was reported to the Yakima Fire Department approximately one-half hour after Kallevig left.[31]

At trial, Industrial Indemnity and Kallevig offered conflicting evidence as to the cause of the fire. Industrial Indemnity produced evidence that the source of the fire was in the food preparation area, although no evidence typically associated with arson was found.[32] In fact, a local fire department investigator pinpointed the origin as being immediately below the food preparation table. The investigator consulted an electrical expert who concluded that the hot plate was turned on during the fire and that no malfunction was found in the electrical outlet or hotplate.[33] The investigator also learned that the restaurant may have been in financial difficulty. A creditor's late notice was found in a restaurant garbage can, and the investigator discovered that the Department of Labor and Industries had filed a lien against Kallevig on the day of the fire.[34] Based upon these findings, the fire department investi-

29. Industrial Indemnity Co. v. Kallevig, 114 Wash. 2d 907, 910, 792 P.2d 520, 523 (1990).

30. The policy provided coverage for the restaurant building up to $100,000, the restaurant contents up to $25,000, and lost income after an insurable loss up to $18,000. *Id.* at 910 n.1, 792 P.2d at 523 n.1.

31. *Id.* at 910-11, 792 P.2d at 523.

32. *Id.* at 911, 792 P.2d at 523. The fire department investigator testified at trial that no evidence of incendiary devices, accelerants, trailers, multiple ignition points, or other evidence associated with arson was found. *Id.*

33. *Id.* at 911, 792 P.2d at 523 (indicating that the electrical expert reached his conclusions even though he was not allowed to completely dismantle the outlet box).

34. *Id.*

gator opined that David Kallevig intentionally caused the fire.[35]

In addition to the fire department investigator's opinion, Industrial Indemnity's claims representative relied upon its own independent fire investigator.[36] Industrial Indemnity's investigator concluded that the fire was intentionally set and notified the claims representative of this conclusion. The claims representative also obtained an internal underwriter's report that stated the cause of the fire may have been the result of faulty workmanship by an electrical contractor. Industrial Indemnity, however, did not retain an electrical expert to investigate this possibility.[37] Based upon the fire department investigation and the conclusions of the independent investigator, Industrial Indemnity denied the Kallevigs' claim.[38]

The Kallevigs pursued their own investigation and conducted tests that demonstrated the hot plate could not have started the fire.[39] The Kallevigs hired a fire protection consultant who, along with an electrical engineer, concluded that the origin of the fire was a faulty outlet box and that the fire department's investigation was inadequate because it failed to find a breaker that was tripped.[40]

B. The Trial Court and Appellate Court Decisions

At the trial court level, the jury found that Industrial Indemnity acted in bad faith in denying the Kallevigs' claim and awarded damages to the Kallevigs.[41] The trial court denied Industrial Indemnity's motion for a directed verdict on the bad faith and CPA counterclaim. A unanimous jury then found that David Kallevig did not start the fire and that Industrial Indemnity's decision to deny coverage was unreasonable. The jury awarded $128,104.69 for the breach of contract and $20,000 for the CPA violation. The trial judge, pursuant to

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35. *Id.* at 911-12, 792 P.2d at 523 (stating that the fire department investigator believed that the insured had the opportunity and motive to cause the fire).

36. *Id.* at 912, 792 P.2d at 524.

37. *Id.* at 912-13, 792 P.2d at 524.

38. *Id.* at 913, 792 P.2d at 524.

39. *Id.* The hot plate tests also indicated that the wall would not ignite even when combustibles were placed on the hot plate. *Id.*

40. *Id.* at 913, 792 P.2d at 524.

41. During the proceedings, the trial court entered an order *in limine* preventing Industrial Indemnity from presenting evidence that a factor in the company's decision to deny the claim was David Kallevig's refusal to take a polygraph test. *Id.*

Revised Code of Washington (RCW) § 19.86.090, increased damages by $10,000 and awarded $64,422 for attorney's fees.[42]

The appellate court rejected Industrial Indemnity's contention that the trial court erred by denying the motions for directed verdict and for judgment notwithstanding the verdict on the Kallevig's CPA claim.[43] The standard of review applied by the appellate court was whether, as a matter of law, the evidence or reasonable inferences therefrom, when viewed in the light most favorable to the nonmoving party, could not support a verdict for the nonmoving party.[44] In its analysis, the court focused on (1) the lack of evidence of any accelerant used to start the fire, (2) the insurer's reliance on an electrical expert who did not visit the scene or completely dismantle the outlet box, and (3) Mr. Kallevig's contrary assertion and evidence that he did not cause the fire. Relying on these facts, the court held that the evidence was sufficient for a jury to find that a reasonable insurer would have conducted a more extensive investigation.[45]

C. *The Washington Supreme Court's Decision*

The Washington Supreme Court applied the same standard of review employed by the appellate court to review the trial court's denial of a motion for directed verdict and judgment notwithstanding the verdict.[46] Applying this standard, the court considered two questions. First, the court addressed what constitutes a bad faith denial of coverage. Second, the court considered whether the evidence was sufficient for the jury to find that Industrial Indemnity denied coverage in bad faith.

In determining what constitutes a bad faith denial of an insurance claim in Washington, the court looked to both statutory and common law. Citing RCW § 48.01.030,[47] the court rec-

42. *Id.* at 914-15, 792 P.2d at 525.

43. Industrial Indemnity Co. v. Kallevig, 54 Wash. App. 558, 774 P.2d 1230 (1989).

44. *Id.* at 562, 774 P.2d at 1233 (quoting Cowsert v. Crowley Maritime Corp., 101 Wash. 2d 402, 405, 680 P.2d 46, 49 (1984)); *see infra* note 46.

45. *Id.* at 563, 774 P.2d at 1233.

46. *Kallevig*, 114 Wash. 2d at 915-16, 792 P.2d at 525 (citing Boeing Co. v. Sierracin Corp., 108 Wash. 2d 38, 67, 738 P.2d 665, 683 (1987)) ("A directed verdict or judgment n.o.v. is appropriate if, when viewing the material evidence most favorable to the nonmoving party, the court can say, as a matter of law, that there is no substantial evidence of reasonable inferences to sustain a verdict for the nonmoving party.").

47. WASH. REV. CODE § 48.01.030 (1989) provides, in part, that "[t]he business of insurance is one affected by the public interest, requiring that all persons be actuated

ognized that insurers must act in good faith in dealing with their insureds.[48] The court further clarified this fiduciary duty by examining several prior decisions.[49] These decisions recognized that the duty to act in good faith is "fairly broad and may be breached by conduct short of intentional bad faith or fraud."[50] Based on this analysis, the court summarized an insurer's duty in denying a claim as follows:

> [a]n insurer does not have a reasonable basis for denying coverage and, therefore, acts without reasonable justification when it denies coverage based upon suspicion and conjecture. . . . [A]n insurer must make a good faith investigation of the facts before denying coverage and may not deny coverage based on a supposed defense which a reasonable investigation would have proved to be without merit.[51]

Applying this rule to the facts in the case, the court held that the evidence was sufficient to support the jury's verdict.[52] The court then rejected Industrial Indemnity's argument that the company did not act in bad faith as a matter of policy because the company relied upon a local fire authority's determination that the fire was caused by arson.[53]

In rejecting Industrial Indemnity's proposition, the court promoted, at least implicitly, a thorough investigation by the insurance company. Had the court accepted this proposition, Washington insurers would have little incentive to fully investigate claims when independent investigator's reports support

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by good faith, abstain from deception, and practice honesty and equity in all insurance matters."

48. *Kallevig*, 114 Wash. 2d at 916, 792 P.2d at 526 (citing Pruitt v. Alaska Pac. Assur. Co., 28 Wash. App. 802, 804, 626 P.2d 528, 529 (1981)).

49. *Id.* at 917, 792 P.2d at 526 (citing Phil Schroeder, Inc. v. Royal Globe Ins. Co., 99 Wash. 2d 65, 73, 659 P.2d 509, 514 (1983); Whistman v. West Am., 38 Wash. App. 580, 584-85, 686 P.2d 1086, 1089 (1984); Safeco Ins. Co. v. JMG Restaurant Inc., 37 Wash. App. 1, 11-12, 680 P.2d 409, 416 (1984)).

50. *Id.*

51. *Id.* For this proposition, the court cites *Safeco*, 37 Wash. App. at 15, 680 P.2d at 15, and *Schroeder*, 99 Wash. 2d at 15, 659 P.2d at 74 (quoting 16 GEORGE J. COUCH, INSURANCE § 58:168 (2d ed. 1966)).

52. In reaching this conclusion, the supreme court assessed the factors considered by Industrial Indemnity in denying the claim and contrary evidence offered by the Kallevigs. In addition, the court considered a factually similar case, Safeco Ins. Co. v. JMG Restaurant, 37 Wash. App. 1, 680 P.2d 409 (1984). *See supra* note 24 (discussing *Safeco*).

53. *Kallevig*, 114 Wash. 2d at 920, 792 P.2d at 528. The court noted the lack of authority for this proposition and declared the determinative factor to be the reasonableness of the insurer's action in light of all the surrounding circumstances, not the stature of any one investigator.

the interests of the insurer. Conversely, in situations where an investigator's finding is at odds with the interests of the insurer, the insurer may initiate or continue an investigation to rebut the independent investigator's findings. As a result, the focus and extent of the insurer's efforts would become dependent upon an investigator's findings. Consequently, to encourage an appropriate amount of investigation by the insurer without undue reliance on an independent investigator's conclusions, the court rejected the proposition in order to promote reasonable conduct by the insurer.

Having determined that Industrial Indemnity was not reasonably justified in denying the Kallevigs' claim, the court turned to the question of whether a single violation of the Washington Administrative Code (WAC) § 284-30-330[54] constituted an unfair or deceptive trade practice under RCW § 48.30.010.[55] Pursuant to authority granted in RCW § 48.30.010(2), the insurance commissioner adopted unfair claims settlement regulations to establish minimum standards for claims settlement practices.[56] Failure of an insurer to comply with these standards is considered an unfair act or practice under the insurance code.[57] This characterization is important

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54. In 1978, the insurance commissioner adopted WASH. ADMIN. CODE § 284-30-330, which defines 19 types of unfair methods of competition and unfair or deceptive acts or practices in the business of insurance. Wash. St. Reg. 78-08-082.

A National Association of Insurance Commissioners' questionnaire dated March 7, 1983 and completed by a public defender, who acted as the deputy commissioner for Washington State's insurance commissioner, provides an indication of the intent behind the adoption of the regulation. A response to a question concerning whether a private right of action is allowed under the unfair claims settlement practices regulation indicates that the sole intent behind the regulation was to implement an administrative enforcement mechanism for the benefit of the public at large and not to afford a private cause of action (questionnaire on file with the *University of Puget Sound Law Review*).

55. WASH. REV. CODE § 48.30.010 (1989) provides, in part, that

> (1) [n]o person engaged in the business of insurance shall engage in unfair methods of competition or in unfair or deceptive acts or practices in the conduct of such business as such methods, acts, or practices are defined pursuant to subsection (2) of this section.
>
> (2) In addition to such unfair methods and unfair or deceptive acts or practices as are expressly defined and prohibited by this code, the commissioner may from time to time by regulation . . . define other methods of competition and other acts and practices in the conduct of this business reasonably found by the commissioner to be unfair or deceptive.

Thus, the regulations adopted by the commissioner pursuant to subsection (2) of this statute are not an exclusive list of unfair or deceptive acts or practices but rather a guide to practices the commissioner finds to be unfair or deceptive.

56. WASH. ADMIN. CODE § 284-30-300 (1990).

57. WASH. REV. CODE § 48.30.010(2) (1989).

from the standpoint of CPA liability. Under the CPA, "[u]nfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce" are unlawful,[58] and a private citizen may enforce a violation of this CPA provision through a civil action.[59]

In order for a private citizen to bring a successful CPA action, the private party must satisfy a five-part test set forth in *Hangman Ridge Training Stables, Inc. v. Safeco Title Ins. Co.*[60] To satisfy this test, the private plaintiff must prove that the defendant's act or practice (1) is unfair or deceptive, (2) occurs in the conduct of any trade or commerce, (3) affects the public interest, (4) injures the plaintiff in his business or property, and (5) creates a causal link between the injury and the unfair or deceptive act.[61]

A plaintiff's burden of satisfying this test is eased if the defendant's action or practice violates a Washington State statute declaring that action or practice to be unfair or deceptive, such as RCW § 48.30.010.[62] When a defendant's action violates a statute declaring that action to be unfair or deceptive, the action is considered to be a per se unfair business practice.[63] As such, the per se unfair business practice satisfies the first and second elements of the CPA private action test. Consequently, the issue becomes especially important whether an insurer's single violation of WAC § 284-30-330 is an unfair business practice under RCW § 48.30.010. If a single violation of the WAC regulation constitutes an unfair or deceptive action under RCW § 48.30.010, the action is a per se unfair business

58. WASH. REV. CODE § 19.86.020 (1989).

59. WASH. REV. CODE § 19.86.090 (1989).

60. Industrial Indemnity Co. v. Kallevig, 114 Wash. 2d 907, 920-21, 792 P.2d 520, 528 (1990) (citing Hangman Ridge Training Stable, Inc. v. Safeco Title Ins. Co., 105 Wash. 2d 778, 719 P.2d 531 (1986)).

61. *Hangman Ridge*, 105 Wash. 2d at 784-85, 719 P.2d at 535.

62. In addition to WASH. REV. CODE § 48.30.010 in the insurance code, numerous statutes governing various industries provide that their violation constitutes an unfair business practice for purposes of the CPA. *See, e.g.*, WASH. REV. CODE § 19.102.020 (1989) (pyramid selling); WASH. REV. CODE § 19.105.500 (1989) (camping resorts); WASH. REV. CODE § 19.134.070 (1989) (credit service organizations); WASH. REV. CODE § 19.138.080 (1989) (travel charter and tour operators); WASH. REV. CODE § 19.142.100 (1989) (health studios); WASH. REV. CODE § 19.146.100 (1989) (mortgage brokers); WASH. REV. CODE § 46.70.180 (1989) (motor vehicle dealers); WASH. REV. CODE § 58.19.270 (1989) (land development); WASH. REV. CODE § 64.36.170 (1989) (timeshares); WASH. REV. CODE § 68.05.330 (1989) (funeral homes).

63. *Hangman Ridge*, 105 Wash. 2d at 786, 719 P.2d at 535 (stating that a violation of a statute declared by the legislature to constitute an unfair or deceptive act in trade or commerce is a per se unfair trade practice for purposes of the CPA).

practice, and the plaintiff must only prove the final three elements of the CPA private action test. Otherwise, the plaintiff possesses the burden of proving all five elements to bring a successful CPA action.

In considering this issue, the Washington Supreme Court indicated that the court had previously considered on two occasions whether a single instance of conduct violating WAC § 284-30-330 constitutes a violation of RCW § 48.30.010(1).[64] In both instances, the court declared that the issue was unclear because WAC § 284-30-300 contains a frequency provision.[65] Prior to the supreme court's consideration of this issue, the court of appeals held that a single violation of WAC § 284-30-300 constituted an unfair business practice under RCW § 48.30.010 and, thus, was a per se unfair trade practice under the CPA.[66] However, the supreme court in *Kallevig* rejected the appellate court's reasoning[67] because it gave ipso facto liability under the CPA for a violation of WAC § 284-30-330.[68] Instead, the supreme court substituted the following reasoning:

64. *Kallevig*, 114 Wash. 2d at 923 n.9, 792 P.2d at 530 n.9 (citing Villella v. Public Employees Mut. Ins. Co., 106 Wash. 2d 806, 725 P.2d 957 (1986); Federated Am. Ins. Co. v. Strong, 102 Wash. 2d 665, 689 P.2d 68 (1984)).

65. *Id.*

66. *Id.* at 923, 792 P.2d at 529-30 (citing Evergreen Int'l, Inc. v. American Casualty Co., 52 Wash. App. 548, 761 P.2d 964 (1988); Escalante v. Sentry Ins. Co., 49 Wash. App. 375, 743 P.2d 832 (1987), *review denied*, 109 Wash. 2d 1025 (1988)).

67. In *Escalante*, the insurer for the driver of an automobile involved in an accident denied underinsured motorist (UIM) coverage to the family and estate of a passenger killed in the accident. During the settlement negotiations, the insurer continually asserted that the family and estate must collect the UIM coverage from the deceased passenger's insurer. *Escalante*, 49 Wash. App. at 379-81, 743 P.2d at 834-36. In determining whether a private right of action was created under certain insurance commissioner regulations, the court considered the language in WASH. REV. CODE § 48.30.010 and WASH. ADMIN. CODE § 284-30-300 and concluded that there was "no clearly expressed intent . . . to provide private causes of action for isolated violations of the regulations." *Id.* at 389, 743 P.2d at 840. However, the court held that the CPA created a private right of action for violations of regulations set forth in WASH. ADMIN. CODE ch. 284-30. *Escalante*, 49 Wash. App. at 390, 743 P.2d at 840 (citing WASH. REV. CODE § 19.86.170 providing, in part, that "actions and transactions prohibited or regulated under the laws administered by the insurance commissioner" are subject to certain CPA provisions).

The Court of Appeals in *Evergreen* accepted the analysis in *Escalante*, distinguishing the goals served by the insurance commissioner's enforcement of the regulations from the purposes set forth in the CPA. *Evergreen*, 52 Wash. App. at 558, 761 P.2d at 969. As such, the frequency of violation provision contained in WASH. ADMIN. CODE § 284-30-300 is consistent with the insurance commissioner's purpose but is inconsistent with the liberally construed CPA. *Id.* As a result, the court concluded that an isolated violation of WASH. ADMIN. CODE § 284-30-330 constitutes a per se unfair trade practice for purposes of the analysis under *Hangman Ridge*. *Id.*

68. *Kallevig*, 114 Wash. 2d at 924, 792 P.2d at 530.

> [A]ny violation that would constitute an unfair trade practice under WAC § 284-30-330 is an unfair trade practice under RCW § 48.30.010 regardless of whether it would take more than a single violation of WAC § 284-30-330 for the insurance commissioner to exercise any administrative powers to seek corrective action or penalties against the insurer.[69]

Thus, the court found that the frequency requirement in WAC § 284-30-300[70] did not have to be satisfied because no such requirement is set forth within RCW § 48.30.010.[71] As a result, the court held that a violation of RCW § 48.30.010, based upon a single violation of WAC § 284-30-330, was a per se unfair trade practice under the CPA.[72]

Finally, the supreme court rejected Industrial Indemnity's argument that a violation of RCW § 48.30.010 did not afford CPA liability because this section was enacted prior to the CPA.[73] Instead, the court cited the legislature's express provision that violations of the insurance code and regulations are subject to the CPA.[74] The court also noted that RCW § 48.30.010 had been amended three times since the enactment of the CPA.[75] Because the legislature had the opportunity, its failure to amend this section was perceived by the court as an indication of legislative intent not to afford the insurance industry immunity from CPA liability.[76]

IV. CRITIQUE OF *KALLEVIG*

A. *The Bad Faith Analysis*

The *Kallevig* court's imposition of the reasonable justification standard to determine whether Industrial Indemnity acted

69. *Id.*

70. WASH. ADMIN. CODE § 284-30-300 (1990) provides:

> RCW § 48.30.010 authorizes the commissioner to define methods of competition and acts and practices in the conduct of the business of insurance which are unfair or deceptive. The purpose of this regulation, WAC §§ 284-30-300 through 284-30-410, is to define certain minimum standards which, *if violated with such frequency as to indicate a general business practice*, will be deemed to constitute unfair claims settlement practices (emphasis added).

71. *Kallevig*, 114 Wash. 2d at 924, 792 P.2d at 530.

72. *Id.*

73. *Id.* at 924-25, 792 P.2d at 530.

74. *Id.* at 924, 792 P.2d at 530 (citing the legislature's adoption of WASH. REV. CODE § 19.86.170, which provides that "actions and transactions prohibited or regulated under the laws administered by the insurance commissioner" are subject to the CPA).

75. *Id.* at 925, 792 P.2d at 530.

76. *Id.*

in bad faith in denying the Kallevigs' claim was consistent with prior case law in Washington.[77] Two observations can be made about the imposition of this standard in *Kallevig*. First, although the reasonable justification standard may adversely impact an insurer's planning ability because the insurer may have difficulty predicting what will be considered reasonable conduct during a future review, this standard of review accommodates public interests more thoroughly than proposed substitutes. Second, while the reasonable justification standard in *Kallevig* may be more onerous than a standard employed in the subsequent appellate court case of *Gingrich*, adoption of the *Kallevig* standard will avoid potential confusion and more efficiently accommodate fair settlement practices.

1. Impact Upon Insurance Company Practices

The *Kallevig* court reviewed the insurer's conduct to determine whether the insurer was reasonably justified in denying the Kallevigs' claim. The imposition of this reasonable justification standard can create a difficult position for the insurer from the planning perspective. Unless analogous situations were previously decided to give an insurer an indication of the type of activity that is considered reasonable, the insurer may have a difficult time establishing policies and procedures to assure that its conduct complies with what a reviewing court, with the benefit of hindsight, would consider reasonable. This uncertainty also impacts the insurer's rate-making ability because of the uncertainty surrounding the estimation of prospective loss experience.[78]

This uncertainty could undermine one of the values underlying the legislature's adoption of the unfair settlement practices regulations: predictability.[79] By actually identifying those

77. *See supra* notes 9 and 10 and accompanying text.

78. Pursuant to WASH. REV. CODE § 48.19.030, insurers must give due consideration to several factors in making insurance rates. These factors include past and prospective loss experience, operating expenses, investment income, and reasonable underwriting profit. WASH. REV. CODE § 48.19.030(3) (1989).

79. In 1977, the National Association of Insurance Commissioners developed a model act to address the concerns raised by the insurance industry about the lack of standardization and accepted procedures to be followed in processing claims. LONG, *supra* note 27, at § 5B.10. The lack of such standardization caused difficulty for counsel representing insurance companies to argue that their client acted reasonably. *Id.* WASH. ADMIN. CODE § 284-30-300 (1990) follows the model act in adopting a frequency requirement. MODEL INSURANCE LAWS, REGULATIONS & GUIDELINES, ACT RELATING TO UNFAIR METHODS OF COMPETITION AND UNFAIR AND DECEPTIVE ACTS AND PRACTICES IN THE BUSINESS OF INSURANCE § 4(9) (Nat'l Ass'n Ins. Comm'rs 1977).

actions that were considered unfair, the legislature established specific guides to compare an insurer's actions. These guides served as notice to the insurance industry of those practices that would subject an insurer to extra-contractual liability under the CPA. However, the predictability provided by these guides may be impaired by the use of a reasonable justification standard in reviewing actions of insurers.

Although concerns can be raised about the lack of predictability under the reasonable justification standard, alternative standards appear to provide no appreciable gain in predictability. And of the proposed standards, the reasonable justification standard more effectively promotes the public's interest in fair insurance settlements.[80] In fact, the *Kallevig* court rejected an alternative standard suggested in an amicus brief filed with the court that would have placed a higher burden on the insured bringing a bad faith action.[81] Although not expressly stated in the *Kallevig* opinion, the court's rejection of this proposed test and imposition of the reasonable justification standard are likely based upon the court's strong interest in promoting the public interest.[82] Thus, concerns about the lack of predictabil-

According to a letter dated March 23, 1983, written to Ronald Gene Meyers by Scott Jarvis, a deputy commissioner with the Washington State Insurance Commissioner's office, this model act was used as a pattern by Washington's insurance commissioner in preparing the state regulations in this area. Letter from Scott Jarvis to Ronald Gene Meyers (Mar. 23, 1983) (on file with the *University of Puget Sound Law Review*). However, the insurance commissioner's unfair settlement practices regulations were not specifically intended to provide a private right of action. *See supra* note 54.

80. Some courts have considered the imposition of liability using negligence terminology. *See* ASHLEY, *supra* note 2, at § 2:04-2:05 (stating that a majority of courts have expressed an insurer's duty in considering settlement offers in terms of good faith, not due care). In addition, approximately 20 jurisdictions have recognized a common law tort for bad faith conduct by an insurer. MCCARTHY, *supra* note 3, at § 1.33. Lastly, some courts have considered a strict liability standard in situations where the insurer rejects a settlement within policy limits. Although the predictability of such a standard would be high, this standard has not gained widespread approval. ASHLEY, *supra* note 2, at § 2:13.

81. Brief of amicus curiae at 4-6 (Pemco Insurance Co., Safeco Insurance Co., State Farm Fire & Casualty Co., Mutual of Enumclaw, The Grange Insurance Association, The Unigard Group), Industrial Indemnity Co. v. Kallevig, 114 Wash. 2d 907, 792 P.2d 520 (1990) (No. 56389-6). For a bad faith claim, the brief cited a test that required the plaintiff to show a lack of reasonable basis for denying a claim *and* the defendant's knowledge or reckless disregard for the lack of a reasonable basis for denial. *Id.* at 4 (citing a test imposed by the Wisconsin Supreme Court in Anderson v. Continental Ins. Co., 85 Wis. 2d 675, 691, 271 N.W.2d 368, 376 (1978)).

82. *See* McRae v. Bolstad, 101 Wash. 2d 161, 676 P.2d 496 (1984); Anhold v. Daniels, 94 Wash. 2d 40, 614 P.2d 184 (1980). In *Anhold*, the plaintiff, an unemployed woman, brought a CPA claim against the promoters of a restaurant in which she was an investor. The woman asserted that the promoters made false representations about

ity caused by use of a reasonable justification standard are diminished when alternative standards and the court's strong preference in protecting the public interest are considered.

2. Discrepancy Between the *Kallevig* and *Gingrich* Decisions

A more troubling result of the *Kallevig* court's use of the reasonable justification standard is the potential discrepancy that may have been created in disputes involving a question of fact or a question of law. The dispute in *Kallevig* concerning whether the insurer was reasonably justified in concluding the insured committed arson was characterized as a question of fact.[83] In *Gingrich v. Unigard Security Insurance Co.*, however, a Washington appellate court addressed the interpretation of the language within an insurance policy and approached the dispute as one posing a question of law; the court then applied a standard different from *Kallevig*.[84] After reviewing

her opportunity to become a partner in the venture. *Anhold*, 94 Wash. 2d at 41-42, 614 P.2d at 186. The *Anhold* court stated that a private individual must show that an act is unfair or deceptive within the sphere of trade or commerce and that the act must impact the public interest. *Id.* at 45, 614 P.2d at 188. In deciding whether the public interest element is present, courts may take note of specific legislative declaration that recognizes a public interest. *Id.* at 43, 614 P.2d at 186-87 (citing Salois v. Mutual of Omaha Ins. Co., 90 Wash. 2d 355, 581 P.2d 1349 (1978), in which the presence of public interest in the insurance business was held to exist). In addition to specific legislative declaration, the court stated that the public interest element could be satisfied as follows:

> [T]he presence of public interest is demonstrated when the proof establishes that (1) the defendant by unfair or deceptive acts or practices in the conduct of trade or commerce has induced the plaintiff to act or refrain from acting; (2) the plaintiff suffers damage brought about by such action or failure to act; and (3) the defendant's deceptive acts or practices have the potential for repetition.

Anhold, 94 Wash. 2d at 46, 614 P.2d at 188. Applying this test, the *Anhold* court reversed the lower court's dismissal of the CPA claim and remanded the case for further consideration. *Id.* at 47, 614 P.2d at 189.

This test for determining the presence of public interest in a CPA claim was applied and satisfied in *McRae*, which involved a real estate agent's failure to disclose problems with a residence being purchased. *McRae*, 101 Wash. 2d at 161, 676 P.2d at 496 (holding the likelihood additional plaintiffs have been or will be injured satisfies the potential for repetition requirement).

83. Gingrich v. Unigard Security Ins. Co., 57 Wash. App. 424, 433, 788 P.2d 1096, 1102 (1990).

84. *Id.* at 434, 788 P.2d at 1102. The appellant, Gingrich, challenged the trial court's decision granting a summary judgment motion for dismissal of a CPA claim. Gingrich was injured in an accident involving a pickup truck. Title to the pickup had been transferred two days earlier to Gingrich from his father. *Id.* at 425, 788 P.2d at 1098. Gingrich did not pay for the truck and understood he would transfer the title back to his parents after they returned from an emergency trip. *Id.* at 427, 788 P.2d at 1098-99. Finding that the transfer was a bailment, the court held that the ownership of

the determination of this legal dispute, the *Gingrich* court held that the trial court's dismissal of the cause of action on summary judgment, based on the CPA, was justified because the insurer's position was "not unreasonable, frivolous, or untenable."[85]

By comparing the standards of review employed in *Gingrich* and *Kallevig*, the discrepancy arises. The reasonable justification standard applied in *Kallevig* arguably establishes a more onerous standard upon the insurer by requiring it to show reasonable justification for denying an insured's claim. In comparison, the *Gingrich* standard merely requires the insurer to show that its position is not unreasonable. One could conclude that *Kallevig* and *Gingrich* both impose a "reasonableness" test. However, a plaintiff's attorney may be able to formulate a successful argument that the *Kallevig* reasonable justification standard imposes a more affirmative obligation on the insurer to show justification for a claim denial. In comparison, the *Gingrich* standard arguably requires a lesser showing of justification; the insurer's act cannot be frivolous, untenable, *or* unreasonable.

The existence of these two similar, yet potentially distinct standards of review for situations involving denial of coverage based upon a question of fact or law is troublesome. A justification for this discrepancy can be found in the desire to give insurers more leniency when they are faced with a situation involving a question of law, such as an insurance policy interpretation question. Any benefit derived from applying this more lenient standard, however, is substantially outweighed by the impact upon policy holders. The *Gingrich* standard encourages insurers to phrase claim denials in terms of a policy interpretation rather than upon the evidence supporting the claim. By doing so, insurers may invoke a more lenient standard of review should judicial review occur. As a result, the strong public interest implicated in the analysis of CPA claims is frustrated.[86] While the reasonable justification standard employed in *Kallevig* imposes CPA liability to promote, in

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the truck remained with the parents. *Id.* at 432, 788 P.2d at 1101. As such, the court upheld the trial court's determination that Gingrich was entitled to personal injury protection under the parents' insurance policy because ownership was not transferred. *Id.*

85. *Id.* at 434, 788 P.2d at 1102.

86. *See supra* note 82.

part, the protection of the public interest, this standard is arguably circumvented by the *Gingrich* standard.

Because of the potential inconsistency of the "reasonable justification" and "unreasonable, frivolous, or untenable" standards, the courts should reconsider this issue and apply one standard in insurance bad faith litigation to ensure that a consistent standard of review is applied. Resolving this inconsistency will, in turn, promote predictability[87] and prevent the intentional circumvention of one standard for the other. Upon reconsideration of this issue, the *Kallevig* reasonableness standard should be employed in situations like *Gingrich* that involve questions of law. The *Kallevig* standard is more suitable because it substantially supports the public interest by imposing a higher standard of conduct to measure an insurer's actions.[88] By allowing circumvention of the *Kallevig* standard by use of the *Gingrich* standard, the legislature's apparent intent in applying the CPA to insurance bad faith litigation is similarly circumvented. Thus, the replacement of the *Gingrich* standard with the *Kallevig* reasonable justification standard, for coverage actions involving questions of law will further the public interest by promoting fair settlement practices.

Presuming the standard for measuring an insurer's conduct is clarified, a second issue raised in bad faith litigation is whether CPA liability should be imposed if the insurer's conduct fails to satisfy the reasonable justification standard. In *Kallevig*, after finding a breach of the insurer's duty of good faith based on a violation of the insurance commissioner's unfair settlement practice regulations, the court considered the imposition of CPA liability.[89]

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87. *See supra* note 79 and accompanying text.

88. *See supra* note 82. In addition to the judicial recognition of the public interest in *McRae* and *Anhold*, the Washington State Legislature has specifically declared that the CPA is to be liberally construed. WASH. REV. CODE § 19.86.920 (1989). In describing the purposes behind the CPA, this section provides, in part, that

> the intent of the legislature [is] that this act shall not be construed to prohibit acts or practices which are reasonable in relation to the development and preservation of business or *which are not injurious to the public interest*, nor be construed to authorize those acts or practices which unreasonably restrain trade or are unreasonable per se. *Id.* (emphasis added).

89. Industrial Indemnity Co. v. Kallevig, 114 Wash. 2d 907, 920, 792 P.2d 520, 528 (1990).

B. *The Imposition of CPA Liability*

The imposition of CPA liability by the *Kallevig* court results in three noteworthy consequences. First, liability under the CPA includes several noncontractual remedies.[90] Second, the imposition of CPA liability based upon a single violation of the commissioner's unfair settlement regulations disregards a frequency requirement that applies to those regulations. Third, imposing CPA liability upon insurers may substantially alter their behavior in handling claims. For example, the prospect of CPA liability may create an incentive for insurers to pay out claims when the claim payout is less than the anticipated costs of a more thorough investigation. This incentive is particularly acute when the claim is small in comparison to the necessary investigation costs. Thus, even if paying claims may be economically efficient in this situation, a public policy question is raised regarding whether encouraging payment of potentially undeserving claims is appropriate. Conversely, insurers may respond to this noncontractual liability by expending an economically inefficient amount of resources on investigations in fear of CPA liability. If either of these responses occur, the insurance purchasing public would undoubtedly bear the costs of these questionable pay-outs and increased investigations through increased premiums.[91] Therefore, CPA liability should only be imposed in situations where promotion of the purposes behind the CPA[92] outweighs these potential costs.

In *Kallevig*, the court found CPA liability by reasoning that a single violation of WAC § 284-30-330 constitutes an unfair trade practice under RCW § 48.30.010.[93] As such, a per se unfair business practice is created for purposes of determining CPA liability in a private action. The *Kallevig* court's analysis, however, misreads the explicit authorization granted to the insurance commissioner in RCW § 48.30.010(2). Under RCW § 48.30.010(2), the commissioner is authorized to define other unfair business acts and practices by regulation. One of the regulations adopted pursuant to this authorization is WAC § 284-30-330, which the court relied upon as supporting the RCW § 48.30.010 violation. Although relying on the commis-

90. *See supra* notes 6-7 and accompanying text.
91. *See supra* note 78.
92. *See supra* notes 27 and 28.
93. *Kallevig*, 114 Wash. 2d at 924, 792 P.2d at 530.

sioner's regulation to support the statutory violation, the court dismissed the frequency requirement that is applicable to WAC § 284-30-330. The court stated that "[t]he language of RCW § 48.30.010 is plain and unambiguous. RCW § 48.30.010 does not contain the frequency requirement set forth in WAC § 284-30-300."[94]

The *Kallevig* court's analysis unjustifiably disregards the frequency requirement adopted by the insurance commissioner in conjunction with WAC § 284-30-330.[95] WAC § 284-30-330 was adopted by the commissioner to define specific unfair acts or practices that fall within RCW § 48.30.010. As such, the regulation incorporates the frequency requirement[96] of WAC § 284-30-300. The United States District Court for the Western District of Washington implicitly adopted this view, dismissing a CPA claim against an insurer because the evidence failed to suggest the insurer violated the insurance commissioner's regulations with such frequency as to satisfy WAC § 284-30-300.[97] Similarly, in analyzing whether RCW § 48.30.010 was violated in *Kallevig*, the Washington Supreme Court should have considered whether the frequency requirement in WAC § 284-30-300 was satisfied prior to finding a violation of the statute.

Recognized administrative law doctrine also supports this conclusion. The Ninth Circuit Court of Appeals held that administrative regulations have the force and effect of law when they are reasonably adapted to the administration of a legislative act.[98] However, an administrative agency's authority to adopt regulations is clearly not unlimited; an agency may not adopt regulations that modify or amend a statute.[99] In this situation, WAC § 284-30-300 does not modify or amend what constitutes an unfair practice under RCW § 48.30.010. Rather,

94. *Id.*

95. According to Washington State Register 78-08-082, the statutory authority for WASH. ADMIN. CODE § 284-30-300 and WASH. ADMIN. CODE § 284-30-330 is found in two statutes: WASH. REV. CODE § 48.02.060 (1989) (creating the insurance commissioner's general regulation making authority) and WASH. REV. CODE § 48.30.010 (establishing the general unfair practices statute).

96. *See supra* note 70.

97. *See* Underwriters at Lloyds v. Denali Seafoods, Inc., 729 F. Supp. 721, 727 (W.D. Wash. 1989).

98. General Services Admin. v. Benson, 415 F.2d 878, 880 (9th Cir. 1969) (affirming a lower court's decision that the agency be enjoined from withholding certain records regarding a property transaction).

99. State *ex rel.* Living Servs., Inc. v. Thompson, 95 Wash. 2d 753, 759, 630 P.2d 925, 929 (1981) (citing Kitsap-Mason Dairymen's Ass'n v. State Tax Comm'n, 77 Wash. 2d 812, 467 P.2d 312 (1970)).

this requirement merely acts as part of the definition of other methods of competition that the commissioner found to be unfair or deceptive. Moreover, the frequency requirement does not modify or amend the CPA because the requirement only defines what constitutes other unfair practices under the insurance code. As such, the unfair settlement practices regulations, and particularly the frequency requirement, adopted by the commissioner pursuant to RCW § 48.30.010 do not modify or amend the statute. Therefore, the frequency requirement in WAC § 284-30-300 should be employed to determine whether an act violates RCW § 48.30.010.

The court dismisses the application of the frequency requirement by distinguishing the court's use of WAC § 284-30-330 from the insurance commissioner's enforcement authority under the regulation.[100] This distinction, however, is questionable because the court is using the regulation for the purpose for which it was adopted: to define unfair acts or practices in the insurance industry for purposes of RCW § 48.30.010. As the court suggests, the frequency requirement may serve as a benchmark for bringing administrative enforcement actions. This use, however, does not support the court's conclusion that the requirement is solely applicable in administrative situations. Rather, acting pursuant to specific authorization in RCW § 48.30.010, the commissioner defined other unfair acts or practices under Washington State's insurance code when the commissioner adopted WAC § 284-30.[101] Included in that definition of unfair acts or practices *is* the frequency requirement of WAC § 284-30-300. Thus, the court's decision finding a violation of RCW § 48.30.010 through a single violation of WAC § 284-30-330 fails to account for a necessary frequency requirement contained within WAC § 284-30-300.

In addition to failing to recognize the commissioner's authority to define other unfair acts or practices, the court's analysis is flawed from a policy standpoint. By finding a violation of RCW § 48.30.010 from a single violation of the unfair settlement practices regulations, the court gives a private party more enforcement authority through private litigation than the insurance commissioner through administrative actions.[102]

100. Industrial Indemnity Co. v. Kallevig, 114 Wash. 2d 907, 924, 792 P.2d 520, 530 (1990).

101. *See supra* note 55.

102. *See* William R. Hickman, *Court Gives Juries More Power Than the Insurance Commissioner*, INSURANCEWEEK, July 6, 1990, at 23. One could argue that the

While the commissioner is bound to find a violation with such frequency as to indicate a general business practice,[103] a single violation is sufficient in a private lawsuit alleging a CPA violation.[104] This result appears contrary to the legislature's intent in authorizing the insurance commissioner to define other unfair practices or acts.[105]

As a result, the Washington State Legislature should review the statutory and regulatory methodology for bad faith insurance actions created by the *Kallevig* decision. This review should result in the adoption of legislation amending the unfair practices statute to include a frequency requirement. By amending the statute in this manner, Washington would move one step closer to codifying the model unfair trade practices statutory language adopted in other states.[106] Such an amendment would also respect the apparent legislative intent underlying RCW § 48.30.010 by further enabling the commissioner to define other unfair practices. The amendment would similarly reflect the commissioner's intent to preclude private rights of action under the unfair claim settlement practices regulations and would alleviate the disparate enforcement power that currently exists between the general public and the insurance commissioner. Specific statutory recognition of a frequency requirement also would diminish concerns about the lack of predictability for insurers currently arising from this disparate enforcement power and would reduce inefficient investigations by insurers. Thus, whether at the request of a legislative standing committee on insurance or from an executive request by the insurance commissioner's office, the Washington State Legislature should adopt legislation recognizing this frequency requirement.

V. CONCLUSION

The development of bad faith insurance litigation in Washington during the past twenty-five years illustrates the recogni-

insurance commissioner is not bound by the frequency requirement within WASH. ADMIN. CODE § 284-30-300 because the commissioner has the authority to amend the regulation. *See* WASH. REV. CODE § 48.02.060 (1989). While the frequency requirement may be arbitrary and subject to revision, the requirement is currently in place and applicable to an enforcement action by the commissioner under this regulation.

103. WASH. ADMIN. CODE § 284-30-300 (1990).

104. Industrial Indemnity Co. v. Kallevig, 114 Wash. 2d 907, 792 P.2d 520 (1990).

105. WASH. REV. CODE § 48.30.010(2) (1989).

106. *See* Stegmaier, *supra* note 26, at 996.

tion by the Washington State Legislature and judiciary of the special relationship between an insurer and insured.[107] This relationship is marked by a lack of bargaining power on the part of the insured and by the public interest nature of the insurance business.[108] In light of this relationship, bad faith insurance litigation developed to require an insurer to act in good faith and to possess a reasonable justification for denying an insured's claim.[109]

In Washington, however, a discrepancy has developed between two standards for reviewing the denial of an insured's claim depending upon whether the denial is based on a question of law or a question of fact.[110] This discrepancy results in an arguably more lenient standard in situations involving a question of law. The presence of this more lenient standard may create a means to circumvent the reasonable justification standard employed by the *Kallevig* court and dilute the purposes underlying the reasonable justification standard. Consequently, the Washington Supreme Court should revisit this issue at the first opportunity and adopt the reasonable justification standard employed in *Kallevig* in both question of fact and question of law situations.

The court should also reconsider its analysis for imposing CPA liability in *Kallevig*. In holding that a single violation of the insurance commissioner's regulation defining unfair settlement practices constitutes a violation of RCW § 48.30.010, the court's analysis dismisses the regulations' frequency requirement without sufficient justification. Thus, the legislature should redirect the court to abandon that portion of its reasoning in *Kallevig* and give proper deference to the regulations' frequency requirement. The legislature can accomplish this direction by amending RCW § 48.30.010 to expressly incorporate this frequency requirement.

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107. *See supra* note 4.

108. *See* WASH. REV. CODE § 48.01.030; SHERNOFF, *supra*, note 2.

109. *See* Industrial Indemnity Co. v. Kallevig, 114 Wash. 2d 907, 792 P.2d 520 (1990).

110. *Compare* Industrial Indemnity Co. v. Kallevig, 114 Wash. 2d 907, 792 P.2d 520 (1990) (employing a reasonable justification standard to review a CPA claim) *with* Gingrich v. Unigard Security Ins. Co., 57 Wash. App. 424, 788 P.2d 1102 (1990) (stating an insurer will be exposed to CPA liability if the insurer's actions are unreasonable, frivolous, or untenable).