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Unraveling the Tangled Web: Choosing the Proper Statute of Limitation for Breach of the Implied Covenant of Good Faith and Fair Dealing

Tyler T. Ochoa
Santa Clara University School of Law, ttochoa@scu.edu

Andrew Wistrich
Magistrate Judge, U.S. District Court, Central District of California

UNRAVELING THE TANGLED WEB: CHOOSING THE PROPER STATUTE OF LIMITATION FOR BREACH OF THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING†

Tyler T. Ochoa** and Andrew J. Wistrich***

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At the authors' request, parallel citations to the official reporters are included for the benefit of practitioners.

** Assistant Professor of Law, Whittier Law School. A.B. 1983, J.D. 1987, Stanford University.

*** Magistrate Judge, United States District Court, Central District of California. A.B. 1972, 1973, University of California, Berkeley; J.D. 1976, University of Chicago.

I. INTRODUCTION

The cause of action for tortious breach of the implied covenant of good faith and fair dealing has traced a spectacular trajectory across the sky of California law, from its lift-off in *Comunale v. Traders & General Insurance Co.*[1] in 1959, to its zenith in *Seaman's Direct Buying Service v. Standard Oil Co.*[2] in 1984, to the curtailment of tort remedies in *Foley v. Interactive Data Corp.*[3] in 1988, and culminating in the reversal of *Seaman's* in *Freeman & Mills, Inc. v. Belcher Oil Co.*[4] in 1995. Throughout this period, the potential for recovering punitive damages in contract cases fueled an epic struggle in the California courts to define the nature and substance of the cause of action.

1. 50 Cal. 2d 654, 328 P.2d 198 (Cal. 1958).

2. 36 Cal. 3d 752, 206 Cal. Rptr. 354, 686 P.2d 1158 (Cal. 1984).

3. 47 Cal. 3d 654, 254 Cal. Rptr. 211, 765 P.2d 373 (Cal. 1988).

4. 11 Cal. 4th 85, 44 Cal. Rptr. 2d 420, 900 P.2d 669 (Cal. 1995). *Freeman & Mills, Inc.* announced "a general rule precluding tort recovery for noninsurance contract breach . . . ." *Id.* at 102, 44 Cal. Rptr. 2d at 430-31, 900 P.2d at 679-80. However, "nothing in this opinion should be read as affecting the existing precedent governing enforcement of the implied covenant in insurance cases." *Id.* at 103, 44 Cal. Rptr. 2d at 431, 900 P.2d at 680.

From the beginning, statutes of limitation have played an important role in defining the parameters of a claim for breach of the implied covenant of good faith and fair dealing.[5] As a result of this interaction between substance and procedure, however, the case law regarding the statute of limitation for breach of the implied covenant lies in considerable confusion. Several different statutes of limitation have been considered by California courts in an attempt to find the most appropriate limitation period for the cause of action.[6] In addition, the task of choosing the proper statute of limitation has been complicated by the efforts of insurance companies and others to shorten the limitation period by contractual modification.[7]

In this article, we first will review the general principles applicable to classification of claims for limitation purposes and the various statutes which could be applied to breach of the implied covenant of good faith and fair dealing. We then will examine cases in which the statute of limitation for breach of the implied covenant of good faith and fair dealing was at issue and analyze what limitation period, rules of accrual and tolling doctrines are appropriate in the absence of contractual modification. Finally, we will analyze the extent to which contractual modification of the limitation period, rules of accrual and tolling doctrines has been permitted, and analyze what limits, if any, should be placed on such modifications.

5. *See, e.g.*, Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 662-63, 328 P.2d 198, 203 (Cal. 1958) (discussing election between tort and contract theories of liability and effect on the statute of limitation).

6. *See infra* notes 29-82 and accompanying text.

7. *See infra* notes 141-230 and accompanying text.

II. Classification, Accrual and Tolling in the Absence of Contractual Modification

A. *Classification*

1. General Principles

The first step in answering any limitation question is to determine which statute applies to the particular claim at issue.[8] In many cases, proper classification of the action is obvious, and the selection of the appropriate statute can be made without difficulty. In other cases, courts may resort to the principle of statutory construction that the more specific statute should be applied when there is a conflict with a statute of general application.[9] However, when a claim does not clearly fall within a particular statute, or when it appears to fall within more than one statute, neither of which is more specific than the other, potential plaintiffs can be misled, and a tremendous amount of time, money and judicial resources can be spent fighting over the proper classification of the cause of action for limitation purposes.

8. The statutes of limitation which apply to civil actions generally are contained in Title II of the California Code of Civil Procedure. These statutes are divided into two major categories: Actions for the Recovery of Real Property (Chapter II) and Actions Other Than for the Recovery of Real Property (Chapter III). *See* Cal. Civ. Proc. Code § 335 (West 1982). These limitation periods apply except "where, in special cases, a different limitation is prescribed by statute." Cal. Civ. Proc. Code § 312 (West 1982). Statutes prescribing special limitation periods applicable to specific causes of action are scattered throughout the California codes. *See generally* California Statutes of Limitation, 25 Sw. U. L. Rev. 745 (1995).

9. "In the construction of a statute . . . when a general and particular provision are inconsistent, the latter is paramount to the former." Cal. Civ. Proc. Code § 1859 (West 1982). "This rule applies to statutes of limitations and consequently a specific statute must take precedence over general statutes of limitation." Comm. for a Progressive Gilroy v. State Water Resources Control Bd., 192 Cal. App. 3d 847, 859, 237 Cal. Rptr. 723, 730 (Ct. App. 1987); *accord*, Loken v. Century 21-Award Properties, 36 Cal. App. 4th 263, 272-73, 42 Cal. Rptr. 2d 683, 689 (Ct. App. 1995); Krieger v. Nick Alexander Imports, Inc., 234 Cal. App. 3d 205, 214, 285 Cal. Rptr. 717, 722 (Ct. App. 1991); Estate of Mason, 224 Cal. App. 3d 634, 638, 274 Cal. Rptr. 61, 64 (Ct. App. 1990).

Unfortunately for practitioners, the Legislature has left little or no evidence of its rationale in enacting the original classification scheme, and courts have not been able to discern any underlying policy or set of policies by which such classification problems can be solved. Indeed, the statutes purport to classify actions on at least four different bases: the nature of the remedy sought,[10] the nature of the injury alleged,[11] the identity or occupation of the defendant,[12] and the grounds or legal theory upon which the action is based.[13]

Given the apparent absence of a coherent rationale or set of policies underlying the classification scheme, it is perhaps unsurprising that the California courts have failed to develop a meaningful test to apply in deciding classification problems. In its most recent pronouncement on the subject, the California Supreme Court said:

> To determine the statute of limitations which applies to a cause of action it is necessary to identify the nature of the cause of action, i.e., the "gravamen" of the cause of action. "[T]he nature of the right sued upon and not the form of action nor the relief

10. *Compare* CAL. CIV. PROC. CODE § 318 (West 1982) (action for the recovery of real property) *and* CAL. CIV. PROC. CODE § 338(a) (West Supp. 1996) (action upon a liability created by statute, other than a penalty or forfeiture) *with* CAL. CIV. PROC. CODE § 335 (West 1982) (actions other than for the recovery of real property) *and* CAL. CIV. PROC. CODE § 340(1) (West Supp. 1996) (action upon a statute for a penalty or forfeiture).

11. *Compare* CAL. CIV. PROC. CODE § 340(3) (West Supp. 1996) (actions for, *inter alia*, injury or death caused by wrongful act or neglect of another) *with* CAL. CIV. PROC. CODE § 339(1) (West Supp. 1996) (action upon any obligation or liability not founded upon an instrument in writing).

12. *See, e.g.*, CAL. CIV. PROC. CODE § 340.5 (West 1982) (action for injury or death against a health care provider based upon professional negligence); CAL. CIV. PROC. CODE § 340.6 (West 1982) (action against an attorney for a wrongful act or omission in the performance of professional services).

13. *See, e.g.*, CAL. CIV. PROC. CODE § 338(d) (West Supp. 1996) (action for relief on the ground of fraud or mistake).

> demanded determines the applicability of the statute of limitations under our code."[14]

One problem with this statement is that it is contradicted in part by a legislative scheme that explicitly classifies some actions on the basis of the relief sought.[15] Thus, when read in context, the quote appears to be nothing more than a restatement of the familiar proposition that the label attached to the cause of action in the pleading is not dispositive.[16]

More fundamentally, however, a test based upon "the nature of the right sued upon" or the "gravamen" of the cause of action provides virtually no guidance beyond the specific case in

14. Hensler v. City of Glendale, 8 Cal. 4th 1, 22-23, 32 Cal. Rptr. 2d 244, 258, 876 P.2d 1043, 1057 (Cal. 1994) (citations omitted), (quoting Maguire v. Hibernia Sav. & Loan Soc'y, 23 Cal. 2d 719, 733, 146 P.2d 673, 680 (Cal. 1944)). *Accord*, Jefferson v. J.E. French Co., 54 Cal. 2d 717, 718, 7 Cal. Rptr. 899, 900, 355 P.2d 643, 644 (Cal. 1960); *see also* Leeper v. Beltrami, 53 Cal. 2d 195, 214, 1 Cal. Rptr. 12, 25, 347 P.2d 12, 25 (Cal. 1959) ("the modern tendency is to look beyond the relief sought, and to view the matter from the basic cause of action giving rise to the plaintiff's right to relief . . . .").

"Gravamen" is defined as "[t]he material part of a grievance, charge, etc." Williamson v. Pac. Greyhound Lines, 67 Cal. App. 2d 250, 252, 153 P.2d 990, 991 (Ct. App. 1944); *see also id.* at 253, 153 P.2d at 992 ("gravamen, or essential facts or grievance as alleged"); BLACK'S LAW DICTIONARY 701 (6th ed. 1990) ("[t]he material part of a grievance, complaint, indictment, charge, cause of action, etc. The burden or gist of a charge; the grievance or injury specially complained of.") (citation omitted).

15. *See supra* note 13 and accompanying text.

16. *See, e.g., Hensler*, 8 Cal. 4th at 26, 32 Cal. Rptr. 2d at 260-61, 876 P.2d at 1059-60 ("The gravamen of plaintiff's cause of action is therefore a claim that the Glendale ordinance is invalid on its face or as applied. . . . regardless of the title attached to the cause of action or the remedy sought."); Hatch v. Collins, 225 Cal. App. 3d 1104, 1110, 275 Cal. Rptr. 476, 479 (Ct. App. 1990) ("Although the Hatches label their complaint 'Breach of Fiduciary Duty. . . .' we must disregard those characterizations for purposes of determining which limitations period applies."); *Williamson*, 67 Cal. App. 2d at 253, 153 P.2d at 991 ("the character of the action is to be determined by the nature of the grievance rather than by the form of the pleadings.") (italics omitted) (citations omitted); Fed. Deposit Ins. Corp. v. McSweeney, 976 F.2d 532, 534 (9th Cir. 1992) ("To determine which statutory period applies, California courts look to the substance or gravamen of the complaint and the nature of the right sued upon rather than the caption of the complaint or the relief sought."), *cert. denied*, 508 U.S. 950 (1993).

which it is applied. In the absence of an underlying policy, how is a court to determine "the nature of the right sued upon" except by assertion? In practice, California courts tend to determine "the nature of the right sued upon" by analogy.[17] This method breaks down, however, when an analogy can plausibly be drawn to more than one of the causes of action for which a limitation period has expressly been provided.

One of the difficulties in selecting a statute of limitation for breach of the implied covenant of good faith and fair dealing is that a number of plausible analogies to other causes of action can be drawn. First, because the covenant is *implied* into a contractual relationship (which may or may not be in writing), it can be argued that the cause of action is "[a]n action upon a contract, obligation or liability not founded upon an instrument of writing," to which a two-year period applies.[18] Second, the availability of punitive damages for certain breaches of the implied covenant[19] supports the application of this statute on a different theory, since the statute applies to most commercial torts as well as breaches of oral and implied contracts.[20] Third, because the

17. *See, e.g.*, Augusta v. United Serv. Auto. Ass'n, 13 Cal. App. 4th 4, 10, 16 Cal. Rptr. 2d 400, 404 (Ct. App. 1993) (action for spoliation of evidence; holding "the situation in the case at bar presents a direct analogy to the two-year rule applicable to actions for interference with prospective economic advantage.").

18. CAL. CIV. PROC. CODE § 339(1) (West 1982). *Cf.* Foley v. Interactive Data Corp., 47 Cal. 3d 654, 690, 254 Cal. Rptr. 211, 232, 765 P.2d 373, 394 (Cal. 1988) ("An allegation of breach of the implied covenant of good faith and fair dealing is an allegation of breach of an 'ex contractu' obligation, namely one arising out of the contract itself.").

19. *See, e.g.*, Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 819-24, 169 Cal. Rptr. 691 696-99, 620 P.2d 141, 146-49 (Cal. 1979) (upholding jury's decision to award punitive damages but reversing amount of punitive damages as excessive).

20. *See, e.g.*, Eisenberg v. Insurance Co. of N. Am., 815 F.2d 1285, 1292 (9th Cir. 1987) (Section 339(1) "was enacted as 'a catch-all for unusual tort actions not otherwise provided for.'") (citation omitted); *cf.* CAL. CIV. CODE § 3294 (West Supp. 1996) (punitive damages authorized "[i]n an action for the breach of an obligation not arising from contract . . . .").

covenant is implied into written contracts as well as oral ones, it can be argued that where the underlying contract is in writing, an action for breach of the implied covenant is "[a]n action upon any contract, obligation or liability founded upon an instrument in writing," to which a four-year period applies.[21] Fourth, because damages for emotional distress are available for certain breaches of the covenant,[22] it can be argued that such breaches are actions "for injury to . . . one caused by the wrongful act or neglect of another," to which a one-year limitation period applies.[23] Fifth, because "bad faith" implies an element of dishonesty, it can be argued that an action for breach of the covenant is "[a]n action for relief on the ground of fraud or mistake, to which a three-year limitation period applies."[24] Sixth, because the cause of action most frequently arises in the insurance context, it can be argued that the one-year limitation period in the California standard form fire-insurance policy[25] should be applied if such a provision is contained in the written contract,

21. CAL. CIV. PROC. CODE § 337, subd. 1 (West 1982). *See, e.g.*, Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 662, 328 P.2d 198, 203 (Cal. 1958) ("The promise which the law implies as an element of the contract is as much a part of the [written] instrument as if it were written out.").

22. *See* Crisci v. Security Ins. Co. of New Haven, 66 Cal. 2d 425, 432-34, 58 Cal. Rptr. 13, 18-19, 426 P.2d 173, 178-79 (Cal. 1967) (affirming award of damages for mental suffering for breach of implied covenant of good faith and fair dealing).

23. CAL. CIV. PROC. CODE § 340(3) (West Supp. 1996). *Cf.* Cantu v. Resolution Trust Corp., 4 Cal. App. 4th 857, 889, 6 Cal. Rptr. 2d 151, 170 (Ct. App. 1992) ("Because intentional infliction of emotional distress is an injury to the person, the applicable statute of limitations is one year.").

24. CAL. CIV. PROC. CODE § 338(d) (West Supp. 1996); *cf. Crisci*, 66 Cal. 2d at 430, 58 Cal. Rptr. at 16, 426 P.2d at 176 ("Several cases, in considering the liability of the insurer, contain language to the effect that bad faith is the equivalent of dishonesty, fraud, and concealment.").

25. CAL. INS. CODE § 2071 (West 1993) ("No suit or action on this policy for the recovery of any claim shall be sustainable in any court of law or equity unless . . . commenced within 12 months next after inception of the loss.").

either by statutory mandate (for fire-insurance policies)[26] or by agreement of the contracting parties.[27] Seventh, it can be argued that the cause of action for breach of the implied covenant is simply "[a]n action for relief not hereinbefore provided for," to which a four-year period applies.[28] Faced with so many plausbile choices, it is not surprising that courts sometimes reached inconsistent results.

2. Case Law Prior to 1986: Election of Remedies

In the seminal case of *Comunale v. Traders & General Insurance Co.*,[29] the California Supreme Court held that an action could be maintained against an insurer "who refuses to accept a reasonable settlement within the policy limits in violation of its duty to consider in good faith the interest of the insured in the settlement."[30] The court then went on to consider whether the newly-recognized cause of action was barred by the statute of limitation. The court noted that the complaint had been filed "less than four years but more than two years after the cause of action arose."[31] Accordingly, the insurer argued that "an action on an implied obligation arising out of contract is not on the

26. CAL. INS. CODE § 2070 (West 1993) ("All fire policies on subject matter in California shall be on the standard form . . . ."); *see* Prieto v. State Farm Fire & Cas. Co., 225 Cal. App. 3d 1188, 1195, 275 Cal. Rptr. 362, 365-66 (Ct. App. 1990) ("[W]e find neither reason nor authority to signify that a plaintiff's election to seek redress under the implied covenant . . . should nullify the legislatively prescribed limitation . . . .").

27. *See, e.g.*, Frazier v. Metropolitan Life Ins. Co., 169 Cal. App. 3d 90, 103, 214 Cal. Rptr. 883, 890 (Ct. App. 1985) ("Metropolitan urges that if Mrs. Frazier is permitted to proceed upon a contractual theory, she is then bound by the time limitations contained in the insurance policy itself . . . .").

28. CAL. CIV. PROC. CODE § 344 (West 1982).

29. 50 Cal. 2d 654, 328 P.2d 198 (Cal. 1958).

30. *Id.* at 661, 328 P.2d at 202. *See also id.* at 659, 328 P.2d at 201 (the insurer's "unwarranted refusal [to settle] . . . constitutes a breach of the implied covenant of good faith and fair dealing.").

31. *Id.* at 662, 328 P.2d at 203.

written instrument,"[32] and therefore that the two-year limitation period of section 339(1) applied, rather than the four-year limitation period of section 337(1). The court rejected this argument, stating:

> The promise which the law implies as an element of the contract is as much a part of the instrument as if it were written out. [Citations omitted]. Traders relies on a statement in *Scrivner v. Woodward*, 139 Cal. 314, 316, 73 P. 863 [(Cal. 1903)], that 'Promises merely implied by law, and not supported by any express promise or stipulation in the written instrument, do not fall within the provision of section 337, relating to contracts in writing.' This statement is too broad, and it was limited in *O'Brien v. King*, 174 Cal. 769, 774, 164 P. 631 [(Cal. 1917)], as applying only to a quasi contractual liability.[33]

The court's holding on this point is supported by the language of section 337(1), which reads (in relevant part): "[a]n action upon any contract, obligation or liability founded upon an instrument in writing."[34] This language appears to encompass an *implied* "obligation or liability" so long as it is "*founded upon* an instrument in writing."

Had the court ended the opinion there, it would have been clear that a cause of action for breach of the implied covenant of good faith and fair dealing was a contractual action, and that the limitation period to be applied depended only on whether the underlying contract was or was not in writing. However, the court went on to state: "Although a wrongful refusal to settle has generally been treated as a tort, it is the rule that where a case sounds both in contract and tort the plaintiff will ordinarily

32. *Id.*
33. *Id.*
34. CAL. CIV. PROC. CODE § 337(1) (West 1982).

have freedom of election between an action of tort and one of contract."[35]

This comment sowed the seeds of confusion over the nature of the cause of action for decades to come.[36] Certainly it provided a hook on which the California Supreme Court could hang its subsequent decisions recognizing the availability of tort remedies, including punitive damages, for breach of the implied covenant of good faith and fair dealing.[37] And it was the availability of tort remedies that led to proliferation in the number of claims and to efforts to extend the doctrine to contracts outside the insurance context.[38] The availability of tort remedies also lent added urgency to the efforts of defendants to try to defeat such claims by means of the statute of limitation.

The implications of the dual nature of the cause of action for the statute of limitation was first confronted by a federal

35. *Id.* at 663, 328 P.2d at 203 (citations omitted). *See also id.* at 661, 328 P.2d at 202 (action is assignable "whether the action is considered as sounding in tort or in contract.").

36. *See, e.g.,* Frazier v. Metropolitan Life Ins. Co., 169 Cal. App. 3d 90, 100, 214 Cal. Rptr. 883, 888 (Ct. App. 1985) ("The question whether an action . . . for breach of [the] implied covenant of good faith and fair dealing . . . sounds in tort or in contract is difficult to analyze in clear logical terms. In the words of the trial court 'it seems to me that the Courts have created a hybrid. . . .'").

37. *See, e.g.,* Crisci v. Security Ins. Co. of New Haven, 66 Cal. 2d 425, 432, 58 Cal. Rptr. 13, 18, 426 P.2d 173, 178 (Cal. 1967) (holding that "an action of the type involved here sounds in both contract and tort" and approving recovery of damages for mental suffering); Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 578-80, 108 Cal. Rptr. 480, 488-90, 510 P.2d 1032, 1040-42 (Cal. 1973) (approving recovery of damages for emotional distress); Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 819-24, 169 Cal. Rptr. 691, 696-99, 620 P.2d 141, 146-49 (Cal. 1979) (upholding jury's decision to award punitive damages but reversing amount of punitive damages as excessive).

38. *See, e.g.,* Seaman's Direct Buying Serv., Inc. v. Standard Oil Co., 36 Cal. 3d 752, 206 Cal. Rptr. 354, 686 P.2d 1158 (Cal. 1984) (recognizing tort action for bad faith denial of the existence of a contract and suggesting that breach of the covenant of good faith and fair dealing in employment or commercial contracts might also give rise to an action in tort), *overruled by,* Freeman & Mills, Inc. v. Belcher Oil Co., 11 Cal. 4th 85, 44 Cal. Rptr. 2d 420, 900 P.2d 669 (Cal. 1995).

court. In *McDowell v. Union Mutual Life Insurance Co.*,[39] the insureds sued two insurance companies for, *inter alia*, bad faith refusal to pay benefits due under group medical insurance policies, and sought to recover damages for emotional distress and punitive damages.[40] The insurer argued that Code of Civil Procedure section 340(3), the one-year statute of limitation for personal injury, "embraces any wrongful act resulting in personal injury whether that act be a contractual breach or the violation of a tort duty" and should be applied to the bad-faith claims.[41] The district court rejected this argument for two reasons. First, it relied on dicta in *Comunale* which indicated that the bad-faith cause of action was one "which relate[s] to financial damage . . . [rather than one] for personal injury caused by negligence, where the tort character of the action is considered to prevail . . . ."[42] Second, it noted that the California Supreme Court had permitted recovery of damages for emotional distress while reemphasizing the dual nature of the cause of action.[43] The court concluded:

> Since the bad faith cause of action sounds in both contract and tort . . . this court cannot say that the tort character of the action predominates. The defendants' § 340(3) argument is rejected. Plaintiffs can properly found their bad faith contract claim on § 337(1) and its four year statute of limitation provision.[44]

39. 404 F. Supp. 136 (C.D. Cal. 1975).

40. *Id.* at 138-39.

41. *Id.* at 143.

42. *Id.* at 144-45 (quoting Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 663, 328 P.2d 198, 202 (Cal. 1958)).

43. *Id.* at 145 (citing Crisci v. Security Ins. Co., 66 Cal. 2d 425, 432, 58 Cal. Rptr. 13, 18, 426 P.2d 173, 178 (Cal. 1967) (bad faith cause of action "sounds in both contract and tort")); Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 573, 108 Cal. Rptr. 480, 484, 510 P.2d 1032, 1036 (Cal. 1973); *see also* State Farm Mut. Auto. Ins. Co. v. Allstate Ins. Co., 9 Cal. App. 3d 508, 527, 88 Cal. Rptr. 246, 258 (Ct. App. 1970) (award for pain and distress "was proper even under a breach of contract theory.").

44. McDowell v. Union Mut. Life Ins. Co., 404 F. Supp. 136, 145 (C.D. Cal. 1975). However, the court did apply the one-year limitation period to the insured's separately

The court went on to hold, however, that if the insureds elected to sue in contract, they could not maintain a claim for punitive damages, noting that "the courts in California do not uphold awards for punitive damages in contract actions."[45] On the other hand, if the insureds elected to bring their bad faith cause of action in tort rather than in contract, in order to preserve their punitive damage claim, then a different statute of limitation would apply.[46] The court explained, "[t]he gravamen of the bad faith cause of action in tort is the tortious interference with an intangible property interest,"[47] and such a claim "is to be controlled by the two year statute of limitations covering actions upon 'a contract, obligation or liability not founded upon an instrument in writing.'"[48] The court acknowledged that *Comunale* had held that the four-year statute of limitation applied, and that there was a "respectable argument" that the four-year period should apply even when punitive damages were sought:

> [I]t would seem natural to conclude that the tortious bad faith cause of action is based upon an obligation founded upon a written instrument and that a section dealing with obligations not founded upon a written instrument has no bearing. Moreover such a reconciliation of the sections would seem to comport with their underlying philosophy which appears to be that if there is a writing in permanent form evidencing the existence of an agree-

pleaded claims for intentional infliction of emotional distress. *Id.* at 147-48; *accord,* Murphy v. Allstate Ins. Co., 83 Cal. App. 3d 38, 50, 147 Cal. Rptr. 565, 575 (Ct. App. 1978).

45. *McDowell*, 404 F. Supp. at 145 (citing for support Crogan v. Metz, 47 Cal. 2d 398, 405, 303 P.2d 1029, 1033 (Cal. 1956)).

46. *Id.* at 145-46 & n.7.

47. *Id.* at 146 (citing for support Mustachio v. Ohio Farmers Ins. Co., 44 Cal. App. 3d 358, 363, 118 Cal. Rptr. 581, 584 (Ct. App. 1975)).

48. *Id.* at 146 (quoting CAL. CIV. PROC. CODE § 339(1) (West 1982)); *see e.g.,* TU-VU Drive-In Corp. v. Davies, 66 Cal. 2d 435, 437, 58 Cal. Rptr. 105, 106, 426 P.2d 505, 506 (Cal. 1967).

> ment and the terms and obligations thereof, it is appropriate that a longer statute of limitations apply.[49]

On the other hand, the court also noted that *Comunale* had distinguished cases "where the tort character of the action is considered to prevail,"[50] and that other cases had applied the two-year period to tort actions, even though the duty was founded upon a written contract.[51] Consequently, since the action in *McDowell* was filed more than two years, but less than four years, after the alleged wrongful refusal to pay, the court granted the insurer's motion to dismiss or strike the claim for punitive damages.[52]

Subsequent California cases have confirmed both aspects of the *McDowell* opinion. In *Richardson v. Allstate Insurance Co.*,[53] the California Court of Appeal rejected the argument that the one-year personal-injury statute of limitation applied to a bad-faith action alleging damages for emotional distress:

> The error in Allstate's reasoning is the assumption that a tort action against an insurer for bad faith is based upon an alleged interference with a personal right merely because mental distress is alleged. Breach of the implied covenant of good faith is actionable because such conduct causes financial loss to the insured, and it is the financial loss or risk of financial loss which defines the cause of action. Mental distress is compensable as an aggravation of the financial damages, not as a separate cause of action.[54]

49. *Id.* at 147.

50. *See* Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 663, 328 P.2d 203 (Cal. 1958).

51. *McDowell*, 404 F. Supp. at 147 (citing L.B. Lab., Inc. v. Mitchell, 39 Cal. 2d 56, 63, 244 P.2d 385, 389 (Cal. 1952) (accountant malpractice); Benard v. Walkup, 272 Cal. App. 2d 595, 600, 77 Cal. Rptr. 544, 547 (Ct. App. 1969) (legal malpractice)). The Legislature has since enacted a specific statute of limitation for legal malpractice actions. *See* CAL. CIV. PROC. CODE § 340.6 (West 1982).

52. 404 F. Supp. at 147.

53. 117 Cal. App. 3d 8, 172 Cal. Rptr. 423 (Ct. App. 1981).

54. *Id.* at 13, 172 Cal. Rptr. at 426. The same conclusion was also reached in Eisenberg v. Insurance Co. of N. Am. 815 F.2d 1285, 1291-92 (9th Cir. 1987), a case involving

Having decided that the action was timely filed as a tort action under the two-year statute, *Richardson* declined to decide whether it could also be brought under the four-year statute.[55] In *Frazier v. Metropolitan Life Insurance Co.*,[56] however, the court of appeal confirmed that the plaintiff "is at liberty to make an election" between an action in contract and an action in tort.[57]

an alleged tortious breach of the covenant of good faith and fair dealing in an employment contract. In *Eisenberg*, the employer cited Newfield v. Ins. Co. of the West, 156 Cal. App. 3d 440, 203 Cal. Rptr. 9 (Ct. App. 1984), for the proposition that the one-year statute of limitation should apply. In *Newfield*, the court held that plaintiff had not stated a cause of action for wrongful discharge founded upon violation of public policy or a statute, 156 Cal. App. 3d at 443-44, 203 Cal. Rptr. at 11, and further held that "any tort action would be barred by the one-year statute of limitations." *Id.* at 443, 203 Cal. Rptr. at 10. The *Newfield* court cited no authority, and *Eisenberg* correctly noted that "[t]his proposition is not embraced by the majority of California courts." 815 F.2d at 1291 n.7. The *Eisenberg* court also noted that *Newfield* was followed on this point in Miller v. Indasco, Inc., 223 Cal. Rptr. 551 (Ct. App. 1986), *review granted*, 227 Cal. Rptr. 390, 719 P.2d 986 (Cal. 1986); *transferred with directions to vacate and reconsider*, 264 Cal. Rptr. 353, 782 P.2d 594 (Cal. 1989). *See Eisenberg*, 815 F.2d at 1291. In so doing, the *Eisenberg* court apparently overlooked the fact that when review was granted, *Miller* was deprived of its precedential effect under California law. *See* CAL. R. CT. 976(d) (West Supp. 1996) ("Unless otherwise ordered by the Supreme Court, no opinion superseded by grant of review, rehearing or other action shall be published.") *See also* CAL. R. CT. 977(a) (West Supp. 1996) ("An opinion that is not ordered published shall not be cited or relied on by a court or a party in any other action or proceeding except as [otherwise] provided . . . .").

Having rejected the one-year statute, *Eisenberg* held that the two-year period of CAL. CIV. PROC. CODE § 339(1) applied to a tort action for breach of the covenant of good faith and fair dealing. *Eisenberg*, 815 F.2d at 1292. *Eisenberg* was subsequently overruled on this point by Harrell v. 20th Century Ins. Co., 934 F.2d 203 (9th Cir. 1991). *See infra* notes 71-75 and accompanying text.

55. *Richardson*, 117 Cal. App. 3d at 14, 172 Cal. Rptr. at 427.

56. 169 Cal. App. 3d 90, 214 Cal. Rptr. 883 (Ct. App. 1985).

57. *Id.* at 101, 214 Cal. Rptr. at 889. The court of appeal also held that plaintiff had not made an irrevocable election to sue in tort by checking the "tort" box in the certificate of assignment. Instead, it held "[a] person should be entitled to change his alternative remedies until one of his inconsistent rights is vindicated by satisfaction of judgment or by application of the doctrines of res judicata or estoppel." *Id.*

> [I]f [the plaintiff] chooses to proceed on a contract theory she is entitled to the four-year statute of limitations permitted by Code of Civil Procedure section 337, subdivision (1), when suing upon breach of the covenant of good faith and fair dealing and for damages for emotional distress based upon such breach.[58]

The court also adopted *McDowell*'s holding that the two-year limitation period applied if the plaintiff elected to proceed on a tort theory,[59] emphasizing that "if the tort cause of action is time-barred . . . plaintiff must proceed solely on her contract theory; and she may not also proceed on the time-barred tort theory to obtain punitive damages."[60] Although the court recognized the inconsistency of permitting damages for emotional distress but barring punitive damages, it explained that "[w]e fail to find any California case allowing punitive damages when the complaint is based only on a contract theory of action,"[61] and concluded that "pure logic must give way to the strict statutory prohibition of [Civil Code] section 3294 and case authority interpreting the statute . . . ."[62]

Thus, by 1986 it was relatively clear that plaintiff could make an election between contract and tort when suing for breach of the implied covenant of good faith and fair dealing, and that if a contract theory was chosen, the four-year statute would apply if the underlying contract was in writing; but if a tort theory was chosen (in order to provide the basis for punitive

58. *Id.* at 102, 214 Cal. Rptr. at 889.

59. *Id.* at 105-06, 214 Cal. Rptr. at 892.

60. *Id.* at 107, 214 Cal. Rptr. at 892. The court also held that the action was not barred by the two-years-and-ninety-days limitation contained in the insurance policy itself. *Id.* at 103-04, 214 Cal. Rptr. at 890-91. This aspect of the decision is discussed in Part II below. *See infra* notes 99-100 and accompanying text.

61. *Id.* at 106, 214 Cal. Rptr. at 892 (italics in original).

62. *Id.* at 107, 214 Cal. Rptr. at 893. That section provides that punitive damages may be awarded "[i]n an action for the breach of an obligation not arising from contract." CAL. CIV. CODE § 3294(a) (West Supp. 1996).

damages), the two-year statute would apply. Unfortunately, this apparent stability turned out to be transitory.

3. Case Law After 1986: Changing the Nature of the Implied Covenant

On November 4, 1986, three justices of the California Supreme Court were defeated in a recall election,[63] and they were soon replaced by three justices appointed by then-Governor George A. Deukmejian.[64] Overnight, the ideological composition of the court shifted from dominance by a liberal majority, which had consistently expanded the cause of action for breach of the implied covenant of good faith and fair dealing, to dominance by a conservative majority, which was widely perceived to be more pro-business and less pro-consumer.[65] Within its first full term, the new majority immediately set about limiting the scope of the cause of action for breach of the implied covenant of good faith and fair dealing.

In *Foley v. Interactive Data Corp.*,[66] the California Supreme Court held that "tort remedies are not available for breach of the implied covenant [of good faith and fair dealing] in an employment contract to employees who allege they have been discharged in violation of the covenant."[67] Although the court

63. *See* Frank Clifford, *Voters Repudiate Three of Court's Liberal Justices*, L.A. TIMES, Nov. 5, 1986, at F8. The defeated justices were Chief Justice Rose Elizabeth Bird, and Associate Justices Joseph R. Grodin and Cruz Reynoso. *Id.*

64. *See* Philip Hagar, *Three New Justices of State High Court Sworn In*, L.A. TIMES, Mar. 19, 1987, at 1. The three new Associate Justices were John A. Arguelles, David N. Eagleson and Marcus M. Kaufman. *Id.* Former Associate Justice Malcom M. Lucas had previously been elevated to Chief Justice by Governor Deukmejian. *Id.* at 30.

65. *See, e.g.*, Philip Hagar, *Dropped Cases Indicate Shift to Right by Court*, L.A. TIMES, May 26, 1987, at F3.

66. 47 Cal. 3d 654, 254 Cal. Rptr. 211, 765 P.2d 373 (Cal. 1988).

67. *Id.* at 700, 254 Cal. Rptr. at 239-40, 765 P.2d at 401; *see also id.* at 696, 254 Cal. Rptr. at 236-37, 765 P.2d at 398 ("[T]he employment relationship is fundamentally contractual, and several factors combine to persuade us that in the absence of legislative

purported only to decide the question with respect to employment contracts, its broad language left little doubt that it intended its holding to apply to all contracts except insurance policies, where the tort cause of action was already well-established:

> An allegation of breach of the implied covenant of good faith and fair dealing is an allegation of breach of an "ex contractu" obligation, namely one arising out of the contract itself. The covenant of good faith is read into contracts in order to protect the express covenants or promises of the contract, not to protect some general public policy interest not directly tied to the contract's purposes. The insurance cases thus were a major departure from traditional principles of contract law. We must, therefore, consider with great care claims that extension of the exceptional approach taken in those cases is automatically appropriate if certain hallmarks and similarities can be adduced in another contract setting.[68]

In the wake of *Foley*, two opinions have recognized that the California Supreme Court's renewed emphasis on the contractual nature of the cause of action has implications for the selection of the proper statute of limitation to be applied. In *Krieger v. Nick Alexander Imports, Inc.*,[69] the California Court of Appeal cited *Foley* and *Frazier* in holding that the plaintiff could elect to proceed on a contract theory in pursuing its third cause of action, labeled "Tortious Bad Faith Breach of the Covenant of Good Faith," and that therefore the proper limitation period was the

direction to the contrary[,] contractual remedies should remain the sole available relief for breaches of the implied covenant of good faith and fair dealing in the employment context.").

68. *Id.* at 690, 254 Cal. Rptr. at 232, 765 P.2d at 394; *see also id.* at 683, 254 Cal. Rptr. at 227, 765 P.2d at 389 ("The covenant of good faith and fair dealing was developed in the contract arena and is aimed at making effective the agreement's promises."); *id.* at 684, 254 Cal. Rptr. at 227, 765 P.2d at 389 ("Because the covenant is a contract term, however, compensation for its breach has almost always been limited to contract rather than tort remedies.").

69. 234 Cal. App. 3d 205, 285 Cal. Rptr. 717 (Ct. App. 1991).

four-year period of section 337(1).[70] Likewise, in *Harrell v. 20th Century Insurance Co.*,[71] the Ninth Circuit held that *Foley* had the effect of superseding the Ninth Circuit's previous holding in *Eisenberg v. Insurance Co. of North America*[72] that "the California Supreme Court would most likely adopt section 339(1)'s two-year limitations period to a claim for breach of the covenant of good faith and fair dealing."[73] Since *Harrell* involved "a dispute arising from an alleged breach of a standard commercial contract for the sale of a business,"[74] the court held that "the Harrell's claim for breach of the implied covenant of good faith and fair dealing presents a contract claim subject to the four-year statute of limitation applicable to written contracts set forth in California Code of Civil Procedure § 337(1)."[75]

More recently, in *Freeman & Mills, Inc. v. Belcher Oil Co.*,[76] the California Supreme Court overruled *Seaman's Direct Buying Service v. Standard Oil Co.*,[77] a 1984 California Supreme Court decision which had recognized a cause of action in tort for bad faith denial of the existence of a contract.[78] *Seaman's* had suggested that tort remedies might be available for breach of the implied covenant of good faith and fair dealing in contexts other than insurance, including employment and commercial con-

70. *Id.* at 220-21, 285 Cal. Rptr. at 726-27.

71. 934 F.2d 203 (9th Cir. 1991).

72. 815 F.2d 1285 (9th Cir. 1987).

73. *Harrell*, 934 F.2d at 207 (citing *Eisenberg*, 815 F.2d at 1291-92).

74. *Harrell*, 934 F.2d at 208.

75. *Id.* In light of its reliance on more recent California authority, *Harrell* should also be deemed to overrule other federal cases in which the two-year limitation period was applied to actions for breach of the implied covenant of good faith and fair dealing in a non-insurance context. *See, e.g.*, Eichman v. Fotomat Corp., 871 F.2d 784, 793 (9th Cir. 1989); Crossen v. Foremost-McKesson, Inc., 537 F. Supp. 1076, 1079 (N.D. Cal. 1982).

76. 11 Cal. 4th 85, 44 Cal. Rptr. 2d 420, 900 P.2d 669 (Cal. 1995).

77. 36 Cal. 3d 752, 206 Cal. Rptr. 354, 686 P.2d 1158 (Cal. 1984).

78. *Id.* at 769, 206 Cal. Rptr. at 363, 686 P.2d at 1167.

tracts.[79] Moreover, lest its message remain unclear, the *Freeman* court announced "a general rule precluding tort recovery for noninsurance contract breach, at least in the absence of violation of 'an independent duty arising from principles of tort law' other than the bad faith denial of the existence of, or liability under, the breached contract."[80]

Thus, in light of the California Supreme Court's return to the contractual principles underlying the implied covenant of good faith and fair dealing, it is now clear that the case law permitting an "election of remedies" for breach of the implied covenant, and the consequent election of the statute of limitation to be applied, no longer has any application outside the insurance context.[81] Instead, the limitation period to be applied is either the four-year period, if the underlying contract is in writing, or the two-year period, if the underlying contract is oral or implied.[82]

79. *Id.* at 768-69 & n.6, 206 Cal. Rptr. at 362-63 & n.6, 686 P.2d at 1166-67 & n.6.

80. *Freeman*, 11 Cal. 4th at 102, 44 Cal. Rptr. 2d at 430-31, 900 P.2d at 679-80 (citations omitted). The holding in *Freeman* obviously also has the effect of eliminating the need to determine which statute of limitation applies to the cause of action for bad faith denial of the existence of a contract. *Cf.* Smyth v. USAA Property & Cas. Ins. Co., 5 Cal. App. 4th 1470, 1476-77, 7 Cal. Rptr. 2d 694, 697-98 (Ct. App. 1992) (applying two-year statute).

81. *Cf.* Love v. Fire Ins. Exch., 221 Cal. App. 3d 1136, 1144 n.4, 271 Cal. Rptr. 246, 249 n.4 (Ct. App. 1990) (four-year statute of limitation applies to plaintiffs' "claim for breach of the covenant of good faith and fair dealing insofar as it rests on the implied contractual promise," but two-year statute applies "[t]o the extent the Loves seek tort remedies on their claim for breach of the covenant of good faith and fair dealing."). Moreover, in the insurance context, the issue of whether the plaintiff may choose the statute of limitation by means of an election of remedies has been almost entirely superseded by the insurers' attempts to modify the applicable limitation period by contract. This issue is discussed *infra* Part III.

82. Of course, in accordance with CAL. CIV. PROC. CODE § 312, this general rule will not apply in contractual contexts where "a different limitation period is prescribed by statute." CAL. CIV. PROC. CODE § 312 (West 1982). *See, e.g.*, Loehr v. Ventura Community College Dist., 147 Cal. App. 3d 1071, 1079, 195 Cal. Rptr. 576, 581 (Ct. App. 1983) (one-year period of California Tort Claims Act applies to claims seeking

B. Accrual and Tolling

1. General Principles

Section 312 of the California Code of Civil Procedure provides: "[c]ivil actions . . . can only be commenced within the periods prescribed in this title, *after the cause of action shall have accrued* . . . ."[83] Once the proper period has been selected, the next step is to determine when the cause of action accrues.[84]

It has been stated that "[i]n ordinary tort and contract actions, the statute of limitations . . . begins to run upon the occurrence of the last essential element to the cause of action."[85] This statement, however, is a circular truism: it merely states that a person is not required to sue (and cannot be precluded from doing so) until he or she is able to do so. In the absence of legislative guidance,[86] the courts have created three major rules of

damages against governmental entities "whether [the underlying action] sound[s] in tort or contract."); Ficalora v. Lockheed Corp., 193 Cal. App. 3d 489, 238 Cal. Rptr. 360 (Ct. App. 1987) (action for violation of Fair Employment and Housing Act subject to one-year limitation period provided in Act; common law causes of action preempted).

83. CAL. CIV. PROC. CODE § 312 (West 1982) (emphasis added).

84. Section 312 "does not define that point at which the cause of action accrues." Neel v. Magana, Olney, Levy, Cathcart & Gelfand, 6 Cal. 3d 176, 191 n.30, 98 Cal. Rptr. 837, 846 n.30, 491 P.2d 421, 430 n.30 (Cal. 1971). Moreover, "[t]he Legislature has enacted no statute which describes for each class of civil action, the date of accrual." *Id.* at 191, 98 Cal. Rptr. at 846, 491 P.2d at 430. Thus, when the statute does not specify when the cause of action accrues, "the Legislature has chosen to defer to judicial experience and to repose with the judiciary the rendition of rules for the accrual of causes of action." *Id.* at 192, 98 Cal. Rptr. at 847, 491 P.2d at 431.

85. *Neel*, 6 Cal. 3d at 187, 98 Cal. Rptr. at 844, 491 P.2d at 428.

86. California's first statute of limitation, enacted in 1850, specified the time of accrual for only one type of civil action: "[a]n action for relief on the ground of fraud," was "not to be deemed to have accrued until the discovery, by the aggrieved party, of the facts constituting the fraud." Act of April 22, 1850, ch. 127, § 17(4), 1850 Cal. Stat. 343, 345 (commencement of civil action); *cf.* CAL. CIV. PROC. CODE § 338(d) (West Supp. 1996) (action for relief on the grounds of fraud or mistake). Since 1970, however, most newly-enacted statutes of limitation specify the time of accrual in addition to the period of limitation. *See, e.g.*, CAL. CIV. PROC. CODE § 340.5 (West 1982) (medical

accrual, whose applicability depends in part on the substantive law applicable to the cause of action: the "wrongful act" rule, the "damage" rule, and the "discovery" rule.

Under the "wrongful act" rule, "a cause of action arises when the wrongful act was committed and not at the time of the discovery; the statute commences to run even though a plaintiff is ignorant that he has a cause of action."[87] This rule is most frequently applied in contract cases, where it is held that a cause of action for breach of contract accrues, and the statute of limitation begins to run, at the time the breach occurs.[88]

The "wrongful act" rule is consistent with the notion that a cause of action for breach of contract may be maintained even though the plaintiff suffered only nominal damages.[89] Sometimes, however, the "wrongful act" rule of accrual can result in a cause of action being barred before the injured party suffered any appreciable damage. For example, if a plaintiff is exposed to a toxic substance, such as asbestos, that exposure may not result in cancer or other injury for many years. Thus, in tort cases, courts came to hold that "damage" is an essential element of the

malpractice); CAL. CIV. PROC. CODE § 340.6 (West 1982) (legal malpractice); CAL. CIV. PROC. CODE § 340.2 (West 1982) (exposure to asbestos).

87. Myers v. Eastwood Care Ctr., Inc., 31 Cal. 3d 628, 634, 183 Cal. Rptr. 386, 389-90, 645 P.2d 1218, 1221 (Cal. 1982).

88. *See* Spear v. Cal. State Auto. Ass'n, 2 Cal. 4th 1035, 1042, 9 Cal. Rptr. 2d 381, 385, 831 P.2d 821, 825 (Cal. 1992) ("A contract cause of action does not accrue until the contract has been breached."); Krieger v. Nick Alexander Imports, Inc., 234 Cal. App. 3d 205, 221, 285 Cal. Rptr. 717, 727 (Ct. App. 1991) ("In contract actions, the cause of action generally accrues at the time of the breach."); *cf.* CAL. COM. CODE § 2725(2) (West Supp. 1996) ("A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.").

89. *See, e.g.*, Xebec Dev. Partners, Ltd. v. National Union Fire Ins. Co., 12 Cal. App. 4th 501, 576, 15 Cal. Rptr. 2d 726, 769 (Ct. App. 1993) ("if no injury were proved XDP . . . would in any event be entitled to nominal damages for breach of the insurance contract.").

cause of action, without which the plaintiff cannot sue.[90] The practical consequence of this view is that "the statute of limitation does not begin to run against a negligence action until some damage has occurred."[91]

Even under the "damage" rule of accrual, however, a cause of action may become barred by the statute of limitations before the plaintiff discovers, or should have discovered, a causal connection between the alleged wrongful act and the injury. This can occur, for example, in toxic tort cases, where the plaintiff may suffer a disease or disability, but may not be aware that it was caused by exposure to a toxic substance until a much later date. Thus, courts developed a third rule of accrual, the "discovery" rule, under which "the accrual date of a cause of action is

90. "Unlike a contract action where the plaintiff is entitled to a judgment and nominal damages without proof of actual damages, a negligence action may not be maintained in the absence of proof of actual, proximately caused damages." Garton v. Title Ins. & Trust Co., 106 Cal. App. 3d 365, 381, 165 Cal. Rptr. 449, 458 (Ct. App. 1980); *see also* Budd v. Nixen, 6 Cal. 3d 195, 200, 98 Cal. Rptr. 849, 852, 491 P.2d 433, 436 (Cal. 1971) ("If the allegedly negligent conduct does not cause damage, it generates no cause of action in tort.").

91. *Budd*, 6 Cal. 3d at 200, 98 Cal. Rptr. at 852, 491 P.2d at 436; *see also* Davies v. Krasna, 14 Cal. 3d 502, 513, 121 Cal. Rptr. 705, 712, 535 P.2d 1161, 1168 (Cal. 1975) (tort action for breach of confidence) (citations omitted):

> [W]e have drifted away from the view held by some that the limitations period necessarily begins when an act or omission of defendant constitutes a legal wrong as a matter of substantive law. Rather, we subscribe to the view that the period cannot run before plaintiff possesses a true cause of action, by which we mean that events have developed to a point where the plaintiff is entitled to a legal remedy, not merely a symbolic judgment such as an award of nominal damages.

Accord, Miller v. Bean, 87 Cal. App. 2d 186, 189, 196 P.2d 596, 598 (Ct. App. 1948) (action for breach of written covenant to protect title to property subject to deed of trust).

The same result is achieved regardless of whether the "damage" rule is considered to be a rule of accrual or a tolling doctrine. *Compare* Jolly v. Eli Lilly & Co., 44 Cal. 3d 1103, 1109, 245 Cal. Rptr. 658, 661, 751 P.2d 923, 926 (Cal. 1988) (describing "the common law rule, that an action accrues on the date of injury") *with* CAL. CIV. PROC. CODE § 340.6(a)(1) (West 1982) (action for legal malpractice is "tolled during the time that . . . [t]he plaintiff has not sustained actual injury.").

delayed until the plaintiff is aware of her injury and its negligent cause."[92] The standard is one of inquiry notice: "Under the discovery rule, the statute of limitations begins to run when the plaintiff suspects or should suspect that her injury was caused by wrongdoing, that someone has done something wrong to her."[93]

2. Insurance Contracts

Given the California Supreme Court's renewed emphasis on the contractual nature of the cause of action for breach of the implied covenant of good faith and fair dealing,[94] one might assume that the "wrongful act" rule should be applied, and that the cause of action should be deemed to accrue at the time the breach occurs. In most cases involving breach of contract, however, application of the "wrongful act" rule is consistent with the discovery rule, because the plaintiff "is easily aware that the contract has been breached."[95] On the other hand, where the plaintiff is justifiably unaware of the breach, courts have applied the discovery rule, even in a contract cases.[96] Thus, although case law continues to maintain that the discovery rule is an exception

92. *Jolly*, 44 Cal. 3d at 1109, 245 Cal. Rptr. at 661, 751 P.2d at 926-27.

93. *Id.* at 1110, 245 Cal. Rptr. at 662, 751 P.2d at 927.

94. *See infra* notes 69-75 and accompanying text.

95. April Enter., Inc. v. KTTV, 147 Cal. App. 3d 805, 831, 195 Cal. Rptr. 421, 436 (Ct. App. 1983).

96. *See, e.g., id.* at 832, 195 Cal. Rptr. at 437 ("we hold the discovery rule may be applied to breaches [of contract] which can be, and are, committed in secret and, moreover, where the harm flowing from those breaches will not be reasonably discoverable by plaintiffs until a future time."); *accord*, Lee v. Escrow Consultants, Inc., 210 Cal. App. 3d 915, 923 n.5, 259 Cal. Rptr. 117, 122 n.5 (Ct. App. 1989); Evans v. Eckelman, 216 Cal. App. 3d 1609, 1614, 265 Cal. Rptr. 605, 607 (Ct. App. 1990) (dictum); *cf.* CAL. COM. CODE § 2725(2) (West Supp. 1995) ("where a warranty explicitly extends to future performance . . . and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.").

to the traditional rules of accrual in contract and tort cases,[97] a realistic assessment of the law of accrual as it is currently applied leads to the conclusion that the discovery rule is now the general rule of accrual for civil actions in California.[98]

In insurance cases, breach of the implied covenant of good faith and fair dealing usually occurs in one of three ways: wrongful refusal to pay benefits due under the policy; wrongful refusal to defend the insured against claims made against him or her under a liability insurance policy; or wrongful refusal to settle a claim against the insured under a liability insurance policy. Each of these will be discussed in turn.

In a case of wrongful refusal to pay benefits, the breach could be deemed to occur when the contingent event giving rise to the contractual liability occurs.[99] Thus, for example, for failure to pay benefits due under a life insurance policy, the breach could be deemed to occur when the insured dies. The insured's right to receive payment, however, does not necessarily mature upon occurrence of the conditional event; typically, the insured

97. *See, e.g.,* Neel v. Magana, Olney, Levy, Cathcart & Gelfand, 6 Cal. 3d 176, 187, 98 Cal. Rptr. 837, 844, 491 P.2d 421, 428 (Cal. 1971) (contrasting "ordinary tort and contract actions" with "cases of professional malpractice").

98. *See* Stephen V. O'Neal, Comment, *Accrual of Statutes of Limitations: California's Discovery Exceptions Swallow the Rule*, 68 CAL. L. REV. 106, 120 (1980) ("Adoption of the discovery principle across the board would align judicial statements of accrual law with its actual application"); *April Enter.*, 147 Cal. App. 3d at 828-29, 195 Cal. Rptr. at 434 ("We agree that as a result of judicial pronouncements, the discovery rule can be regarded as the general rule of accrual in many classes of cases in California.").

99. This is the effect of the limitation provision in the California Standard Form Fire Insurance Policy, which provides that "[n]o suit or action on this policy for the recovery of any claim shall be sustainable in any court of law or equity . . . unless commenced within 12 months next after inception of the loss." CAL. INS. CODE § 2071 (West 1993). Although this statute applies only to fire insurance policies, most insurance contracts contain a similar provision. The effect of these clauses will be considered *infra* Part III; the question posed here is what rule of accrual would be appropriate in the absence of a contractual or statutory provision.

(or the beneficiary) must submit a claim to the insurance company in a timely manner,[100] and the insurer must make a determination that no policy exclusions apply. Thus, most policies provide that the insured (or the beneficiary) is not entitled to receive payment until a fixed time after the claim is submitted.[101] When the occurrence of a condition precedent is not within the control of the party claiming a breach, then the cause of action is not deemed to have accrued until the condition precedent is satisfied.[102] Accordingly, a cause of action for wrongful refusal to pay benefits under the policy should not be deemed to accrue until the insurer actually denies the insured's claim by refusing to pay benefits due under the policy.[103] If, however, the insurer

100. For example, the California Standard Form Fire Insurance Policy provides that "[t]he insured shall give written notice to this company of any loss without unnecessary delay. . . . and within 60 days after the loss, unless such time is extended in writing by this company, the insured shall render to this company a proof of loss . . . ." CAL. INS. CODE § 2071 (West 1993).

101. For example, the California Standard Form Fire Insurance Policy provides:

> The amount of loss for which this company may be liable shall be payable 60 days after proof of loss, as herein provided, is received by this company and ascertainment of the loss is made either by agreement between the insured and this company expressed in writing or by the filing with this company of an award as herein provided.

CAL. INS. CODE § 2071 (West 1993).

102. *See, e.g.*, Williams v. Pacific Mut. Life Ins. Co., 186 Cal. App. 3d 941, 949-51, 231 Cal. Rptr. 234, 238-40 (Ct. App. 1986) (private right of action under Fair Employment and Housing Act does not accrue until Department of Fair Employment and Housing notifies claimant that it will not take action); *see also* 3 B.E. WITKIN, CALIFORNIA PROCEDURE, ACTIONS § 380 (3d ed. 1985) ("If the obligation of the defendant is conditional upon the happening of an event or the act of a third person, the cause of action does not accrue until that time.").

103. *See* Frazier v. Metropolitan Life Ins. Co., 169 Cal. App. 3d 90, 103, 214 Cal. Rptr. 883, 890 (Ct. App. 1985):

> Mrs. Frazier's action does not commence until Metropolitan denies her claim on the ground of suicide. Prior to such time Mrs. Frazier has a right . . . to sit back and wait until denial of claim before urging bad faith. Because it is not until Metropolitan actually denies the claim on the ground of suicide that Mrs. Frazier can actually ascertain whether or not Metropolitan has acted in bad faith.

Cf. Neff v. New York Life Ins. Co., 30 Cal. 2d 165, 170, 180 P.2d 900, 904 (Cal. 1947) ("it is apparent that defendant's above-quoted letter was an unconditional denial of liability

simply fails to act on the claim, then the cause of action should be deemed to accrue on the date that benefits are due under the policy.[104] If no deadline for payment is specified in the policy, then the claim should be deemed to accrue when a "reasonable time" has passed after the claim has been submitted to the insurer.[105]

When liability insurance is involved, however, different considerations come into play. The claim by the third party against the insured often will be the subject of litigation. Thus, if the insurer wrongfully refuses to defend the insured, there is the possibility that the limitation period for the insured's cause of action against the insurer could expire before the underlying litigation is concluded.[106] The insured would then be compelled either to forego his or her bad faith claim, or to sue the insurer while the underlying action is still pending. Litigating two lawsuits simultaneously, however, can raise a number of practical

to the insured and gave rise to an immediate cause of action in favor of the insured."); McDowell v. Union Mut. Life Ins. Co., 404 F. Supp. 136, 147 (C.D. Cal. 1975) (measuring limitation period from "the refusal to pay, which was alleged to be in bad faith").

104. This assumes, of course, that the time for the insurer's response, and therefore the date on which benefits are due, has not been extended by agreement of the parties. "[I]f the insurer expressly extends the one-year suit provision during its claim investigation, the insurer waives its right to raise a timeliness defense to the insured's action." Prudential-LMI Commercial Ins. Co. v. Superior Court, 51 Cal. 3d 674, 690, 274 Cal. Rptr. 387, 397, 798 P.2d 1230, 1240 (Cal. 1990) (In such a case, the statute of limitation should begin to run when the extended deadline has passed). Similarly, if the insurer causes the plaintiff to delay filing suit by means of improper conduct, the statute of limitation could be tolled under the doctrines of fraudulent concealment or estoppel. *Id.* at 689-90, 274 Cal. Rptr. at 397, 798 P.2d at 1240.

105. What constitutes a "reasonable" time would inevitably be the subject of litigation; however, in the absence of legislative guidance, the courts could hold that sixty days after proof of loss is presumptively reasonable by analogy to the statutory provision in the California Standard Form Fire Insurance Policy. *See supra* note 100 and accompanying text.

106. *See* Lambert v. Commonwealth Land Title Ins. Co., 53 Cal. 3d 1072, 1077, 282 Cal. Rptr. 445, 447-48, 811 P.2d 737, 739-40 (Cal. 1991).

and legal problems.[107] For example, the suit against the insurer could alert the third-party claimant to information that might compromise the insured's defense in the underlying action. Second, the insured might be forced to take inconsistent positions in the two lawsuits.[108] Third, if the insured is an individual or a small business, it is likely to be financially and emotionally impracticable for the insured to engage in simultaneous litigation to protect his or her rights.[109]

In *Lambert v. Commonwealth Land Insurance Co.*,[110] these considerations led the California Supreme Court to hold that although a cause of action against an insurer for wrongful refusal to defend "accrues upon discovery of loss or harm, i.e., when the insurer refuses to defend, . . . it is equitably tolled until the underlying action is terminated by final judgment."[111] The court reasoned that the duty to defend was a continuing duty, and that failing to equitably toll the claim "would allow expiration of the statute of limitation on a lawsuit to vindicate the duty to defend

107. These problems are analogous to the problems faced by a client who discovers an attorney's malpractice while the underlying action is still pending. *See generally* Tyler T. Ochoa & Andrew J. Wistrich, *Limitation of Legal Malpractice Actions: Defining Actual Injury and the Problem of Simultaneous Litigation*, 24 Sw. U. L. REV. 1, 19-23 (1994) (hereinafter *Simultaneous Litigation*).

108. For example, in the underlying litigation the insured will necessarily take the position that the claim is without merit; however, in the bad-faith litigation against the insurer, the insured will want to take the position that the claim had sufficient merit to trigger the duty to defend or the duty to settle.

109. *See Lambert*, 53 Cal. 3d at 1078, 282 Cal. Rptr. at 448, 811 P.2d at 740 (citations omitted) (emphasis in original):

> It is harsh to require an insured — often a private homeowner — to defend the underlying action, at the homeowner's own expense, and *simultaneously* to prosecute — again at the homeowner's own expense — a separate action against the title company for failure to defend. "[T]he unexpected burden of defending an action may itself make it impractical to immediately bear the additional cost and hardship of prosecuting a collateral action against an insurer."

110. 53 Cal. 3d 1072, 282 Cal. Rptr. 445, 811 P.2d 737 (Cal. 1991).

111. *Id.* at 1077, 282 Cal. Rptr. at 447, 811 P.2d at 739.

even before the duty itself expires."[112] The court also emphasized that "the contract of insurance is unique in that the purchaser seeks not commercial advantage, but rather peace of mind and security in the event of unforeseen calamity,"[113] and concluded that it would be inequitable to require the insured "to simultaneously enforce rights under the policy and defend a costly and potentially devastating claim"[114] at the insured's own expense.[115]

The same considerations apply to a cause of action for wrongful refusal to settle a claim brought against the insured by a third party. In *Comunale v. Traders and General Insurance Co.*,[116] the case in which the cause of action for wrongful refusal to settle was first recognized, the California Supreme Court stated that "[the] cause of action against the insurer arose on August 13, 1950, when the judgment in the [underlying] bodily injury action became final."[117] This result can be justified on the ground that the insured is not injured by the wrongful refusal to settle until a final judgment or settlement is reached under which the insured is liable for an amount greater than the settlement offer which was rejected.[118] Such a holding would also be consis-

112. *Id.*

113. *Id.* at 1081, 282 Cal. Rptr. at 450, 811 P.2d at 742 (citations omitted).

114. *Id.*

115. *Id.* at 1078, 282 Cal. Rptr. at 448, 811 P.2d at 740.

116. 50 Cal. 2d 654, 328 P.2d 198 (Cal. 1958).

117. *Id.* at 662, 328 P.2d at 203.

118. *See* Purcell v. Colonial Ins. Co., 20 Cal. App. 3d 807, 814-15, 97 Cal. Rptr. 874, 878 (Ct. App. 1971) (dictum) (stating that although "the wrong occurred when the defendant refused to settle . . . the statute would of course commence to run only when the total damages were determinable, i.e., when the amount of the pecuniary loss was finally fixed."); Critz v. Farmers Ins. Group, 230 Cal. App. 2d 788, 799, 41 Cal. Rptr. 401, 407 (Ct. App. 1964) ("The fact of damage would become fixed and the policyholder's cause of action arise when he incurred a binding judgment in excess of the policy limits."); Brown v. Guarantee Ins. Co., 155 Cal. App. 2d 679, 690, 319 P.2d 69, 75 (Ct. App. 1957) ("the insured's cause of action arises when he incurs a binding judgment in excess of the policy limit."); Larraburu Bros., Inc. v. Royal Indem. Co., 604

tent with those California cases which have held that a cause of action for wrongful refusal to settle may not be maintained in the absence of a judgment in excess of the policy limits against the insured.[119] Other California cases, however, have held or suggested that a judgment in excess of the policy limits is *not* a

F.2d 1208, 1215 (9th Cir. 1979) ("the statute of limitations on [bad faith] claims . . . begins to run from the date of the final judgment.") (construing California law); *accord*, 2 CALIFORNIA LIABILITY INSURANCE PRACTICE: CLAIMS AND LITIGATION § 26.12 (Cal. CEB rev. 1994) ("Although the insurer's breach of duty occurs when it unreasonably refuses the settlement offer, the cause of action for failure to settle does not accrue until the insured suffers a binding judgment in excess of policy limits and damages can be ascertained.") *Cf.* ITT Small Bus. Fin. Corp. v. Niles, 9 Cal. 4th 245, 257-58, 36 Cal. Rptr. 2d 552, 559, 885 P.2d 965, 972 (Cal. 1994) ("an action for attorney malpractice accrues on entry of adverse judgment, settlement, or dismissal of the underlying action" because "ITT did not suffer 'actual injury' resulting from Niles's alleged malpractice until it settled the adversary proceeding on unfavorable terms."). This argument is even stronger in the insurance context, because the insured does not incur additional attorneys' fees as a result of the wrongful refusal to settle unless there is also a breach of the duty to defend.

119. *See* Finkelstein v. 20th Century Ins. Co., 11 Cal. App. 4th 926, 930, 14 Cal. Rptr. 2d 305, 307 (Ct. App. 1992) ("Since there was no judgment in excess of the policy limits, appellant's cause of action never matured."); Doser v. Middlesex Mut. Ins. Co., 101 Cal. App. 3d 883, 891-92, 162 Cal. Rptr. 115, 119-20 (Ct. App. 1980) (judgment in excess of policy limits is "a condition precedent to [an insured's] cause of action against the insurer"). This argument is also supported by the similar holding in Moradi-Shalal v. Fireman's Fund Ins. Cos., 46 Cal. 3d 287, 250 Cal. Rptr. 116, 758 P.2d 58 (Cal. 1988), that a cause of action by a third-party claimant against an insurer for a violation of INS. CODE § 790.03 may not be maintained absent "a final judgment determining the insured's liability . . . ." *Id.* at 311, 250 Cal. Rptr. at 131, 758 P.2d at 73. In *Moradi-Shalal*, the Court overruled its prior holding in Royal Globe Ins. Co. v. Superior Court, 23 Cal. 3d 880, 153 Cal. Rptr. 842, 592 P.2d 329 (Cal. 1979) and held that no implied private right of action arises under the statute. *Moradi-Shalal,* 46 Cal. 3d at 292, 250 Cal. Rptr. at 118, 758 P.2d at 60. However, the court also held that its ruling would apply prospectively only, and it therefore went on to clarify the holding in *Royal Globe* that such a claim "may not be brought until the action between the injured party and the insured is concluded." *Id.* at 305, 250 Cal. Rptr. at 127, 758 P.2d at 69 (quoting *Royal Globe*). One of the policy reasons cited in favor of its holding was that "damages suffered by the injured party as a result of the insurer's violation . . . may best be determined after the conclusion of the action by the third party claimant against the insured." *Id.* at 306, 250 Cal. Rptr. at 128, 758 P.2d at 70. As noted below, however, subsequent cases have cast

prerequisite to maintaining an action for wrongful refusal to settle.[120] In light of the California Supreme Court's subsequent decision in *Lambert*,[121] the better rationale is that the cause of

doubt over whether *Moradi-Shalal's* holding applies to common-law bad-faith claims. *See infra* note 120.

120. *See* Camelot by the Bay Condominium Owners' Ass'n v. Scottsdale Ins. Co., 27 Cal. App. 4th 33, 48, 32 Cal. Rptr. 2d 354, 362 (Ct. App. 1994) ("there is no explicit requirement for bad faith liability that an excess judgment is actually suffered by the insured, since the reasonableness analysis of settlement decisions is performed in terms of the probability or risk that such a judgment may be forthcoming in the future"); *id.* at 47 n.6, 32 Cal. Rptr. 2d at 361 n.6 ("the breach of the insurer's obligation occurs at the time when it indulges in the unwarranted rejection of a reasonable compromise offer within the policy limits.") (quoting *Critz*, *supra* note 118, 230 Cal. App. 2d at 797, 41 Cal. Rptr. at 401); Bodenhamer v. Superior Court, 192 Cal. App. 3d 1472, 1476-79, 238 Cal. Rptr. 177, 179-81 (Ct. App. 1987) (rejecting insurer's argument that a settlement or judgment against the insured is a prerequisite to insured's bad faith action against insurer); *accord*, 3 HON. H. WALTER CROSKEY ET AL., CALIFORNIA PRACTICE GUIDE: INSURANCE LITIGATION ¶ 12:340 (The Rutter Group 1995) ("The dictum in *Camelot*, supra, seems correct. An excess judgment should *not* be essential to a bad faith action based on unreasonable refusal to settle.") (emphasis in original). *See also* Isaacson v. Cal. Ins. Guarantee Ass'n, 44 Cal. 3d 775, 793, 244 Cal. Rptr. 655, 667, 750 P.2d 297, 309 (Cal. 1988) (holding that CIGA is immune from common-law bad-faith claims, but holding that under CIGA's statutory duty to settle, "[t]he insured need not prove his actual liability on the underlying claim, and establishing a breach does not require a trial of the underlying action."). This argument is also supported by cases which have refused to extend to bad-faith claims *by an insured* the holding of *Moradi-Shalal* that a final judgment is a condition precedent to the now-disapproved cause of action for violation of INS. CODE § 790.03. These cases reason that "the duty of an insurer to its insured is more extensive than is its duty to a third party claimant." *Bodenhamer*, 192 Cal. App. 3d at 1480, 238 Cal. Rptr. at 182; *accord*, Tricor Calif., Inc. v. Superior Court, 220 Cal. App. 2d 880, 883-84, 269 Cal. Rptr. 642, 643-44 (Ct. App. 1990) (dictum); Continental Cas. Co. v. Royal Ins. Co., 219 Cal. App. 3d 111, 126, 268 Cal. Rptr. 193, 201 (Ct. App. 1990); Carter v. Superior Court, 194 Cal. App. 3d 424, 427-28, 239 Cal. Rptr. 723, 724-25 (Ct. App. 1987); Cal. State Auto. Ass'n, Inter-Insurance Bureau v. Superior Court, 184 Cal. App. 3d 1428, 1432-33, 229 Cal. Rptr. 409, 412 (Ct. App. 1986); *contra*, Interinsurance Exch. v. Superior Court, 213 Cal. App. 3d 1439, 1443, 262 Cal. Rptr. 392, 394 (Ct. App. 1989).

121. *See* Lambert v. Commonwealth Land Title Ins. Co., 53 Cal. 3d 1072, 1080, 282 Cal. Rptr. 445, 449-50, 811 P.2d 737, 741-42 (Ct. App. 1991) (action for wrongful refusal to defend "accrues when the insurer refuses the insured's tender of defense, but is tolled until the underlying action is terminated by final judgment.").

action for wrongful refusal to settle accrues on the date the insurer refuses to settle, but that the limitation period is equitably tolled until an adverse judgment or settlement is entered in the underlying action.[122]

3. Employment Contracts

Only a handful of cases address the issue of when a claim for wrongful termination based on a breach of the implied covenant of good faith and fair dealing accrues under California law. Although at first glance they seem to point in opposite directions, they are easily reconciled with each other and with precedent regarding other types of wrongful termination claims.

In *Eisenberg v. Insurance Co. of North America*,[123] the Ninth Circuit held, in accordance with the discovery rule and federal statutory precedent, that "[a]n employer's liability for wrongful discharge commences upon notice of the employee's termination even though the employee continues to serve the employer after receipt of such notice."[124] *Eisenberg* is in accord

122. However, because the policies underlying simultaneous litigation must be balanced against the policies advanced by the statute of limitation (guaranteeing repose and avoiding deterioration of evidence), a cause of action for wrongful refusal to defend or settle a claim against the insured should not continue to be tolled after entry of judgment while the underlying action is appealed. *Cf. Simultaneous Litigation*, *supra* note 107, at 14-19, 23-26; Laird v. Blacker, 2 Cal. 4th 606, 615, 7 Cal. Rptr. 2d 550, 551, 828 P.2d 691, 692 (Cal. 1992) (cause of action for legal malpractice accrues upon entry of adverse judgment or order of dismissal in the underlying action and is not tolled during appeal); ITT Small Bus. Fin. Corp. v. Niles, 9 Cal. 4th 245, 258, 36 Cal. Rptr. 552, 559-60, 885 P.2d 965, 972-73 (Cal. 1994) (reaffirming *Laird*).

123. 815 F.2d 1285 (9th Cir. 1987).

124. *Id.* (applying California law). *See also* Daniels v. FESCO Div. of Cities Serv. Co., 733 F.2d 622, 623 (9th Cir. 1984) (applying California law) (wrongful discharge claim; no discussion of covenant of good faith); Crossen v. Foremost-McKesson, Inc., 537 F. Supp. 1076, 1079 (N.D. Cal. 1982) (construing California law) ("Here, the cause of action accrued *no earlier than* November 29, 1978, the date of plaintiff's termination letter") (emphasis added); *cf.* Delaware State College v. Ricks, 449 U.S. 250, 257-58, 101 S. Ct. 498, 503-04 (1980) (federal Title VII claim).

with a recent California case holding that a claim for wrongful termination under the Fair Employment and Housing Act and in violation of public policy accrues "at the time the adverse employment decision was communicated to her, not when it took effect."[125]

In *Loehr v. Ventura Community College District*,[126] the plaintiff filed a complaint alleging six counts of wrongful termination, including "tortious breach of an implied covenant of good faith and fair dealing."[127] The court stated that "[a]s a general rule, the date of accrual is the date the plaintiff incurred injury as a result of the defendant's alleged wrongful act or omission."[128] In a footnote, the court added: "We note here that plaintiff's first five causes of action accrued on May 5, 1980, the date on which his employment contract was allegedly terminated."[129] No authority was cited, but May 5 was the day the Board *voted* to discharge the plaintiff,[130] and there was no indication that plaintiff continued to work after that date, although he did request on May 12, 1980, that the Board reconsider its action and reinstate him. *Loehr* is therefore not inconsistent with the rule stated in *Eisenberg*.

Similarly, in *Shoemaker v. Myers*,[131] the court held, in a case involving wrongful discharge in violation of public policy under the Government Claims Act, that "[u]ntil plaintiff was terminated, he did not suffer appreciable harm sufficient to justify legal action."[132] However, the opinion states that "[p]laintiff was

125. Regents of the Univ. of Cal. v. Superior Court, 33 Cal. App. 4th 1710, 39 Cal. Rptr. 2d 919 (Ct. App. 1995).

126. 147 Cal. App. 3d 1071, 195 Cal. Rptr. 576 (Ct. App. 1983).

127. *Id.* at 1077, 195 Cal. Rptr. at 579.

128. *Id.* at 1078, 195 Cal. Rptr. at 580.

129. *Id.* at 1082 n.7, 195 Cal. Rptr. at 583 n.7.

130. *Id.* at 1077, 195 Cal. Rptr. at 579.

131. 2 Cal. App. 4th 1407, 4 Cal. Rptr. 2d 203 (Ct. App. 1992).

132. *Id.* at 1427, 4 Cal. Rptr. 2d at 215.

terminated on December 23, 1981, and this was upheld on departmental review on January 11, 1982. Plaintiff submitted a claim to the Department on March 25, 1982, within 100 days of termination."[133] Earlier in the opinion, the court also stated that the plaintiff "was fired for insubordination by Shuttleworth and, on an intradepartmental appeal, senior Department officials upheld the termination, ***which became effective January 11, 1982.***"[134] Although the matter is not free from doubt (because both possible dates were within 100 days of the filing of the claim), it appears from the language used by the court that the plaintiff continued to work while the termination was being appealed, but that the cause of action was deemed to accrue on the date when the original "termination" occurred, rather than upon the date it became effective. Since this is analogous to receiving a termination notice that takes effect on a later date, *Shoemaker* is also consistent with the rule stated in *Eisenberg.*[135]

4. Other Contracts

As for claims of breach of the implied covenant of good faith and fair dealing in other types of contracts, general principles of accrual should apply. Thus, in *Krieger v. Nick Alexander Imports*,[136] the court held that a claim for breach of the implied covenant was brought under a contract theory, and noted that "[i]n contract actions the cause of action generally accrues at the time of the breach."[137] The court also noted that the discovery rule was an exception to this principle; however, it held that the

133. *Id.* (citations omitted).

134. *Id.* at 1415, 4 Cal. Rptr. 2d at 206-07 (emphasis added).

135. A definitive resolution of this issue may be forthcoming. The California Supreme Court recently granted review in a case which distinguished the *Eisenberg* rule. *See* Romano v. Rockwell Int'l, Inc., 46 Cal. Rptr. 2d 77 (Ct. App. 1995), *review granted*, 49 Cal. Rptr. 2d 205, 909 P.2d 327 (Cal. 1996).

136. 234 Cal. App. 3d 205, 285 Cal. Rptr. 717 (Ct. App. 1991).

137. *Id.* at 221, 285 Cal. Rptr. at 727.

discovery rule did not apply in the absence of a fiduciary relationship or similar duty.[138] The court therefore granted summary judgment on this claim.[139]

Although *Krieger* correctly recognizes that general principles of accrual should apply to claims for breach of the implied covenant, it is incorrect in limiting the discovery rule to cases in which a fiduciary relationship or similar duty exists. The discovery rule is a general rule of accrual that should be applied in all cases in which a plaintiff could not reasonably be expected to discover the facts concerning his or her cause of action until a future time.[140] Thus, for example, the court in *Krieger* correctly held that the discovery rule applies to an action for breach of warranty of future performance under the Uniform Commercial Code.[141] *Krieger* should also have held the same with regard to the related claim for breach of the implied covenant of good faith and fair dealing.

III. CONTRACTUAL MODIFICATION OF THE LIMITATION PERIOD

A. *Validity of Contractual Modification*

1. General Principles

As noted above,[142] most insurance policies contain a clause that limits the time within which an action may be commenced against the insurer. For example, California's Standard Form

138. *Id.* at 221-22, 285 Cal. Rptr. at 727.

139. *Id.*, 285 Cal. Rptr. at 727-28.

140. *See supra* notes 92-98 and accompanying text.

141. *Krieger*, 34 Cal. App. 3d at 218, 285 Cal. Rptr. at 725. *See* CAL. COM. CODE § 2725(2) (West Supp. 1996) (emphasis added):

> A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, *except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.*

142. *See supra* note 99.

Fire Insurance Policy[143] contains the following clause: "No suit or action on this policy for the recovery of any claim shall be sustainable in any court of law or equity . . . unless commenced within 12 months next after inception of the loss."[144] Such a clause, if enforced, has two effects. First, it shortens the limitation *period* from four years for an action upon a written instrument[145] to one year. Second, it changes the date of *accrual* of the limitation period from the date the contract was breached (i.e., the date the claim is denied) to the earlier date of the inception of the loss.

The California Supreme Court first considered the validity of a contractual limitation clause in 1909. In *Tebbets v. Fidelity & Casualty Co. of New York*,[146] the life insurance policy provided that "legal proceedings for recovery hereunder may not be brought before the expiry of three months from the date of filing proofs at the company's home office, nor brought at all unless begun within six months from the time of death."[147] The court held that "a condition in a policy of insurance, providing that no recovery shall be had thereon unless suit be brought within a given time, is valid, if the time limited be in itself not unreasonable."[148] The court reasoned that since a defendant may waive

143. CAL. INS. CODE § 2071 (West 1993).

144. *Id.* The origin and purpose of this provision was described by former Chief Justice Traynor as follows:

> The short statutory limitation in the present case is the result of long insistence by insurance companies that they have additional protection against fraudulent proofs, which they could not meet if claims could be sued upon within four years as in the case of actions on other written instruments. Originally the shortened limitation periods were inserted into policies by insurers. Some courts declared such provisions void as against public policy while other courts enforced them to protect freedom of contract.

Bollinger v. National Fire Ins. of Hartford, 25 Cal. 2d 399, 407, 154 P.2d 399, 403-04 (Cal. 1944) (citations omitted).

145. CAL. CIV. PROC. CODE § 337(1) (West 1982).

146. 155 Cal. 137, 99 P. 501 (Cal. 1909).

147. *Id.* at 138, 99 P. at 502.

148. *Id.*

the statute of limitation as a defense to an action, a plaintiff should have "[the] right to waive a portion of the time granted by the statute for the commencement of an action."[149] Since "[t]he six months' period was not in itself unreasonable,"[150] the court affirmed the dismissal of the action.

The rule announced in *Tebbets* that a contractual limitation clause will be upheld if not unreasonable has consistently been reaffirmed.[151] Thus, in *Prudential-LMI Commercial Insurance Co. v. Superior Court*,[152] the California Supreme Court expressly upheld the validity of the limitation-of-suit provision in California Insurance Code section 2071: "Such a covenant shortening the period of limitations is a valid provision of an insurance contract and cannot be ignored with impunity as long as the limitation is not so unreasonable as to show imposition or undue advantage. One year was not an unfair period of limitation."[153]

149. *Id.* at 139, 99 P. at 502.

150. *Id.*

151. *See, e.g.*, Prudential-LMI Commercial Ins. Co. v. Superior Court, 51 Cal. 3d 674, 683, 274 Cal. Rptr. 387, 393, 798 P.2d 1230, 1236 (Cal. 1990); Fageol Truck & Coach Co. v. Pacific Indem. Co., 18 Cal. 2d 748, 753, 117 P.2d 669, 672 (Cal. 1941); Beeson v. Schloss, 183 Cal. 618, 622, 192 P. 292, 294 (Cal. 1920); State Farm Fire & Cas. Co. v. Superior Court, 210 Cal. App. 3d 604, 608-09, 258 Cal. Rptr. 413, 415-16 (Ct. App. 1989); Lawrence v. W. Mutual Ins. Co., 204 Cal. App. 3d 565, 571, 251 Cal. Rptr. 319, 322 (Ct. App. 1988); C & H Foods Co. v. Hartford Ins. Co., 163 Cal. App. 3d 1055, 1064, 211 Cal. Rptr. 765, 769-70 (Ct. App. 1984).

152. 51 Cal. 3d 674, 274 Cal. Rptr. 387, 798 P.2d 1230 (Cal. 1990).

153. *Id.* at 683, 274 Cal. Rptr. at 393, 798 P.2d at 1236, *quoting C & H Foods*, 163 Cal. App. 3d at 1064, 211 Cal. Rptr. at 769-70, *quoting Fageol*, 18 Cal. 2d at 753, 117 P.2d at 672. *Prudential* added that "[w]hen a clause in an insurance policy is authorized by statute, it is deemed consistent with public policy as established by the Legislature." *Prudential,* 51 Cal. 3d at 684, 274 Cal. Rptr. at 393, 798 P.2d at 1236 (citation omitted). Conversely, where the Legislature has fixed a minimum limitation period by statute, a shorter contractual limitation period will be deemed invalid. *Cf.* Hayman v. Sitmar Cruises, Inc., 14 Cal. App. 4th 1499, 1505, 18 Cal. Rptr. 2d 412, 415 (Ct. App. 1993) (maritime contract; "the challenged limitations clause is not reasonable because it effectively shortens the time to institute suit, in violation of [46 U.S.C. Appx.] section

The principle that a contractual limitation clause will be upheld unless there is "imposition or undue advantage" suggests a congruence with the doctrine of unconscionability. California Civil Code section 1670.5,[154] enacted in 1979, "codified the established doctrine that a court can refuse to enforce an unconscionable provision in a contract."[155] Unconscionability has been defined as "an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party."[156] The leading California case elaborated on this definition as follows:

> [U]nconscionability has both a "procedural" and a "substantive" element. The procedural element focuses on two factors: "oppression" and "surprise." "Oppression" arises from an inequality of bargaining power which results in no real negotiation and "an absence of meaningful choice." "Surprise" involves the extent to which the supposedly agreed-upon terms of the bargain are hidden in a prolix printed form drafted by the party seeking to enforce the disputed terms.... No precise definition of substantive unconscionability can be proffered. Cases have talked in terms of "overly harsh" or "one-sided" results.... [But] "unconsciona-

183b."); CAL. COM. CODE § 2725(1) (West 1996) ("By the original agreement the parties may reduce the period of limitation to not less than one year . . . .").

154. If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

CAL. CIV. CODE § 1670.5(a) (West 1985).

155. Perdue v. Crocker Nat'l Bank, 38 Cal. 3d 913, 925, 216 Cal. Rptr. 345, 353, 702 P.2d 503, 511 (Cal. 1985). The *Perdue* court noted that "[s]ection 1670.5 is based upon Uniform Commercial Code section 2-302, but expands coverage to include noncommercial contracts." *Id.* at 913 n.10, 216 Cal. Rptr. at 353 n.10, 702 P.2d at 511 n.10.

156. A & M Produce Co. v. FMC Corp., 135 Cal. App. 3d 473, 486, 186 Cal. Rptr. 114, 121 (Ct. App. 1983), (quoting Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965)).

bility turns not only on a "one-sided" result, but also on an absence of "justification" for it."[157]

The case law concerning the enforceability of contractual limitation provisions is remarkably similar to this definition of unconscionability. In practice, courts have enforced contractual limitation periods because of an absence of unfair surprise[158] and because of the presumed substantive reasonableness of the one-year period.[159] Consequently, the only California court to address the issue has held that "[t]he enactment of [Civil Code] section 1670.5 expands our scrutiny of limitation of actions pro-

157. *A & M Produce*, 135 Cal. App. 3d at 486-87, 186 Cal. Rptr. at 121-22 (citations omitted). In *Perdue*, the California Supreme Court approved this analysis "an alternative analytical framework" to its opinion in Graham v. Scissor-Tail, Inc., 28 Cal. 3d 807, 171 Cal. Rptr. 604, 623 P.2d 165 (Cal. 1981), and noted that "[b]oth pathways should lead to the same result." *See Perdue*, 38 Cal. 3d at 925 n.9, 216 Cal. Rptr. at 353 n.9, 702 P.2d at 511 n.9. In practice, however, California courts have followed the *A & M Produce* analysis. *See, e.g.*, Samura v. Kaiser Found. Health Plan, 17 Cal. App. 4th 1284, 1296-97, 22 Cal. Rptr. 2d 20, 27-28 (Ct. App. 1993); U.S. Roofing, Inc. v. Credit Alliance Corp., 228 Cal. App. 3d 1431, 1448, 279 Cal. Rptr. 533, 543 (Ct. App. 1991); Dean Witter Reynolds, Inc. v. Superior Court, 211 Cal. App. 3d 758, 767-78, 259 Cal. Rptr. 789, 794-95 (Ct. App. 1989).

158. *See, e.g.*, C & H Foods Co. v. Hartford Ins. Co., 163 Cal. App. 3d 1055, 1064, 211 Cal. Rptr. 765, 770 (Ct. App. 1984) ("As the policies clearly so provided, and in view of the fact that plaintiffs do not deny that C & H was furnished the policies, we reject plaintiffs' claim that they were unaware of that provision."); West v. Henderson, 227 Cal. App. 3d 1578, 1586-87, 278 Cal. Rptr. 570, 574-75 (Ct. App. 1991) (limitation provision in lease was not oppressive as to plaintiff because "[k]nowing her own inexperience, she signed the lease without consulting an attorney (despite a prominent admonition in the lease to do so)").

159. *See, e.g.*, Prudential-LMI Commercial Ins. Co. v. Superior Court, 51 Cal. 3d 674, 684, 274 Cal. Rptr. 387, 393, 798 P.2d 1230, 1236 (Cal. 1990) ("When a clause in an insurance policy is authorized by statute, it is deemed consistent with public policy as established by the Legislature."); State Farm Fire & Cas. Co. v. Superior Court, 210 Cal. App. 3d 604, 609, 258 Cal. Rptr. 413, 416 (Ct. App. 1989) ("[i]t makes no difference whether the limitations provision in question is statutory or contractual. Not only . . . is there no fundamental difference between the two, but also, the one-year policy period of limitations in insurance contracts is specifically authorized by statute.").

visions from an analysis of the reasonableness of the provision to the broader analysis of the conscionability of the provision."[160]

Although the California courts have upheld the validity of contractual limitation clauses in general, and the limitation-of-suit provision of Insurance Code section 2071 in particular, two important questions remain. First, to what extent does a contractual limitation provision apply to causes of action for breach of the covenant of good faith and fair dealing? Second, to what extent may the contractual limitation provision change the otherwise applicable rule of accrual?

2. Applicability to Bad Faith Actions

There is a split of authority regarding the extent to which a contractual limitation clause applies to a claim for breach of the covenant of good faith and fair dealing. Although the majority of California cases hold that an action for breach of the implied covenant is barred whenever suit on the contract would be barred, two California cases have held that a bad-faith suit may be maintained notwithstanding a contractual limitation-of-suit provision.

In *Murphy v. Allstate Insurance Co.*,[161] the plaintiff homeowners alleged that Allstate conspired with Golden West Construction Company and others to defraud plaintiffs after their house was substantially damaged by fire. Specifically, they al-

160. *West*, 227 Cal. App. 3d at 1585-86, 278 Cal. Rptr. at 574. Although the statutory language indicates that a clause must be unconscionable "at the time it was made," in practice courts analyze the effect of the provision as applied. *See, e.g., West*, 227 Cal. App. 3d at 1588, 278 Cal. Rptr. at 576 (although contractual provision limiting defenses as well as claims might be "unjustifiably inequitable" in a hypothetical situation, it is "irrelevant to this case because it is not being asserted against West"). This is consistent with the statutory language providing that the court "may so limit the *application* of any unconscionable clause as to avoid any unconscionable *result*." CAL. CIV. CODE § 1670.5 (West 1985) (emphasis added).

161. 83 Cal. App. 3d 38, 47, 147 Cal. Rptr. 565, 572 (Ct. App. 1978).

leged that Allstate arranged with the other defendants to preserve and repair the damaged home, and represented that they were qualified to do the work.[162] In fact, Golden West was not a licensed contractor, and plaintiffs alleged that "neither it nor the other persons and firms were competent or qualified to do the work for which they were engaged,"[163] and that the work was done so poorly "that both the home and the furniture and the furnishings were further damaged."[164] Plaintiffs further alleged that after the amount of the loss was fixed by an appraiser selected by the parties, Allstate filed an interpleader action to resolve the claims of the contractors to the proceeds which delayed payment for nearly two years.[165] Plaintiffs pleaded causes of action for fraud, conspiracy to defraud, two counts of bad faith breach of the implied covenant, and intentional infliction of emotional distress.[166]

Construing the statutory phrase "[n]o suit or action on this policy for the recovery of any claim," the court held that the statute only applied to "a claim for a loss covered by the policy,"[167] and that "[n]one of plaintiff's alleged causes of action are actions 'on the policy' of insurance."[168] The court noted that the

162. *Id.* at 41-42, 147 Cal. Rptr. at 569.

163. *Id.* at 42, 147 Cal. Rptr. at 569.

164. *Id.*, 147 Cal. Rptr. at 569.

165. *Id.* at 43, 147 Cal. Rptr. at 570.

166. *Id.* at 43-44, 47-48, 147 Cal. Rptr. at 572, 573.

167. *Id.* at 44, 147 Cal. Rptr. at 571. *Murphy* cited Stockton Combined Harvester and Agric. Works v. Glen Falls Ins. Co., 98 Cal. 557, 33 P. 633 (Cal. 1893), a California Supreme Court case in which the insurer and insured had submitted a claim to binding arbitration. Stockton sued to collect the award, and the defendant tried to set up the limitation of action clause in the policy as a defense. The *Stockton* court held: "The distinction between . . . an action upon an award fixing the liability of an insurer [under an insurance contract, and a cause of action upon a policy of insurance] . . . is marked and important. . . . *In such a case, the action is not upon the policy, but upon the agreement to pay.*" *Stockton,* 98 Cal. at 569, 33 P. at 634.

168. *Murphy*, 83 Cal. App. 3d at 46, 147 Cal. Rptr. at 572.

third and fourth counts "purport to state one or more causes of action for bad faith, that is, unjustified refusal to pay or prolonged delay in paying legitimate claims under the policy."[169] Allstate argued that "plaintiffs' bad faith claim is based upon alleged breaches of the implied duty of good faith and fair dealing which arises only because of the contract of insurance."[170] The court rejected this argument:

> [T]here is a significant difference between "arising out of the contractual relationship" and "on the policy. . . ." Much of the conduct complained of in the third and fourth causes of action occurred long after the fire loss and related to the repair and restoration of plaintiffs' home and personal property and the employment of persons and firms to do that work, [and] the institution and prosecution of the interpleader action. Here again, the damages claimed were not caused by any risk insured against under the policy and were not recoverable under the policy.[171]

Murphy was followed by *Frazier v. Metropolitan Life Insurance Co.*,[172] in which the insurer denied the plaintiff's claim under a life insurance policy on the grounds that she had not proved that the decedent had not committed suicide. The *Frazier* court held that "the policy time limitation, even if reasonable, does not bar this action based on the hybrid contractual nature of the implied covenant of good faith and fair dealing."[173] The court relied in part on *Murphy*, and in part on the ground that the bad-faith cause of action could not be deemed to accrue until the insurer denied the claim:

> The trial judge held that plaintiff's breach of contract claim was barred by the time limitations of the contract, but that since her cause of action for breach of the covenant of good faith and fair

169. *Id.* at 47, 147 Cal. Rptr. at 573.
170. *Id.* at 48, 147 Cal. Rptr. at 573.
171. *Id.* at 49, 147 Cal. Rptr. at 574.
172. 169 Cal. App. 3d 90, 98, 214 Cal. Rptr. 883, 886 (Ct. App. 1985).
173. *Id.* at 104, 214 Cal. Rptr. at 891.

> dealing did not accrue until the claim on the double indemnity portion of the contract was denied, . . . the action was timely filed under the policy for breach of that covenant. . . . [A]s found by the trial judge, Mrs. Frazier's action does not commence until Metropolitan denies her claim on the ground of suicide. Prior to such time Mrs. Frazier has a right (so far as the policy limitation is concerned) to sit back and wait until denial of a claim before urging bad faith. Because it is not until Metropolitan actually denies the claim on the ground of suicide that Mrs. Frazier can actually ascertain whether or not Metropolitan has acted in bad faith.[174]

In contrast to *Murphy* and *Frazier*, *Lawrence v. Western Mutual Insurance Co.*[175] held that "the one-year commencement of suit provision also precludes Lawrence from recovery on the cause of action for alleged tortious bad faith in handling his claim because of purported misrepresentations in the policy concerning coverage."[176] In *Lawrence*, the plaintiff suffered extensive damage to his house due to inadequate compaction of the fill beneath the foundation.[177] In late 1983 and early 1984, the plaintiff incurred expenses of $250,000 for geological reports and correction of the problem.[178] However, Lawrence did not present a claim to his insurer at that time, because the policy contained an exclusion for earth movement.[179] In July 1985, Lawrence consulted an attorney, who advised him that since the settlement was caused by the negligence of a third party, the loss might be covered despite the exclusion.[180] Lawrence submitted

174. *Id.* at 103, 214 Cal. Rptr. at 890.
175. 204 Cal. App. 3d 565, 251 Cal. Rptr. 319 (Ct. App. 1988).
176. *Id.* at 574-75, 251 Cal. Rptr. at 324.
177. *Id.* at 569, 251 Cal. Rptr. at 320.
178. *Id.*
179. *Id.* at 569-70, 251 Cal. Rptr. at 320-21.
180. *Id.* at 570, 251 Cal. Rptr. at 321.

a claim on July 15, 1985, which was denied on January 7, 1986, and Lawrence filed suit on January 28, 1986.[181]

Lawrence argued that "inception of the loss" incorporated a discovery rule of accrual, and that therefore the contractual limitation period did not begin to run until "the insured knew or should have known that a loss has occurred which is covered by his insurance policy."[182] The court disagreed, holding that under the discovery rule, "[i]t is the occurrence of some . . . cognizable event rather than knowledge of its legal significance that starts the running of the statute of limitations."[183] Therefore, since Lawrence had obtained reports in December 1983 concerning the cause of the damage, he was placed on inquiry notice "from which he could have surmised that his loss was due to the negligence of a third party."[184]

In holding that Lawrence's bad-faith claim was subject to the contractual limitation period, the court attempted to distinguish the prior cases:

> Lawrence's allegation of tortious bad faith relates to the complete denial of the claim on the underlying policy. In both *Murphy* and *Frazier*, a subsequent event occurred after the initial policy coverage was triggered which was the basis for the cause of action. The subsequent event related to the policy, but either was not a claim directly on the policy (*Murphy*) or was a claim which arose after the insurer paid on the policy but did so not to the satisfaction of the beneficiary of the policy (*Frazier*). Here, Lawrence's cause of action for bad faith in purportedly misrepre-

181. *Id.*

182. *Id.* at 571-72, 251 Cal. Rptr. at 322.

183. *Id.* at 573, 251 Cal. Rptr. at 323, (quoting McGee v. Weinberg, 97 Cal. App. 3d 798, 804, 159 Cal. Rptr. 86, 90 (Ct. App. 1979)). *See also* Gutierrez v. Mofid, 39 Cal. 3d 892, 898, 218 Cal. Rptr. 313, 316, 705 P.2d 886, 889 (Cal. 1985) (cause of action for medical malpractice accrues even though "plaintiff is ignorant of his legal remedy or the legal theories underlying his cause of action.").

184. *Lawrence*, 204 Cal. App. 3d at 572, 251 Cal. Rptr. at 322-23.

> senting the scope of coverage in the policy is fundamentally a claim on the policy and is thus time barred.[185]

Shortly after *Lawrence* was decided, the same conclusion was reached in *Abari v. State Farm Fire and Casualty Co.*[186] In *Abari*, the plaintiff alleged that he first noticed cracks in his home in 1979, and that after renting the property for several years, he observed more severe cracks and damage when he returned in September 1984.[187] Abari consulted an attorney and submitted a claim to State Farm on January 21, 1985, then filed suit on January 23, 1985.[188] The court refused to credit Abari's argument that he was not put on inquiry notice in 1979, because Abari had failed to plead that he "was not alerted to the gravity of the damage" at that time, despite having been given two opportunities to amend his pleading to include such an allegation.[189] The court in *Abari* also attempted to distinguish *Murphy*:

> In *Murphy*, the plaintiffs complained of wrongful conduct by the insurer subsequent to their fire loss, and alleged unjustified refusal to pay or prolonged delay in paying legitimate claims under the policy. As such, the bad faith "damages claimed were not caused by any risk insured against under the policy and were not recoverable under the policy." Contrarily, Abari alleged in both the bad faith and unfair practices counts that "[b]y reason of defendants STATE FARM . . . breach of the covenant of good faith and fair dealing, plaintiff has been and continues to be damaged in an amount equal to the benefits payable under the policies, plus interest thereon." Abari's pleading thus reveals his bad faith and unfair practices claims are a transparent attempt to recover

185. *Id.* at 575, 251 Cal. Rptr. at 324-25.

186. 205 Cal. App. 3d 530, 252 Cal. Rptr. 565 (Ct. App. 1988).

187. *Id.* at 533, 252 Cal. Rptr. at 566.

188. *Id.* at 532-33, 252 Cal. Rptr. at 565.

189. *Id.* at 535, 252 Cal. Rptr. at 567.

> *on the policy*, notwithstanding his failure to commence suit within one year of accrual.[190]

Subsequent cases have followed *Lawrence* and *Abari* in holding that a bad faith claim is barred by the expiration of the contractual limitation period "where the gravamen of the bad faith action pertained to the insurer's handling of the initial claim for loss."[191] This view is also supported by the California Supreme Court's opinion in *Prudential-LMI Commercial Insurance v. Superior Court*,[192] in which the court, in dicta, quoted *Abari*'s holding on this point with apparent approval.[193]

But the issue will not go away, because *Lawrence*'s and *Abari*'s attempts to distinguish *Murphy* and *Frazier* are extremely unpersuasive. *Lawrence* gives no reason why the *partial* denial of the plaintiff's claim in bad faith in *Frazier* should take the cause of action outside the contractual limitation period, while the *complete* denial of the claim in *Lawrence* should not.[194] Similarly, although *Murphy*, unlike *Frazier*, at least involved

190. *Id.* at 536, 252 Cal. Rptr. at 567-68 (citations omitted).

191. Velasquez v. Truck Ins. Exch., 1 Cal. App. 4th 712, 720, 5 Cal. Rptr. 2d 1, 5 (Ct. App. 1991); *see also* Magnolia Square Homeowners Ass'n v. Safeco Ins. Co., 221 Cal. App. 3d 1049, 1063, 271 Cal. Rptr. 1, 9 (Ct. App. 1990).

192. 51 Cal. 3d 674, 274 Cal. Rptr. 387, 798 P.2d 1230 (Cal. 1990).

193. *Id.* at 686, 274 Cal. Rptr. at 394-95, 798 P.2d at 1237. However, despite its apparent approval of *Abari*, the *Prudential* opinion largely eliminates the problem which *Murphy* and *Frazier* attempted to address by changing the rules of accrual and tolling with respect to contract and bad faith claims. *See infra* notes 206-30 and accompanying text.

194. *See* Prieto v. State Farm Fire & Cas. Co., 225 Cal. App. 3d 1188, 1194-95, 275 Cal. Rptr. 362, 365 (Ct. App. 1990) ("in both *Frazier* and the instant case the insurer's alleged misconduct involved breach of a primary obligation to pay policy benefits."). Because *Prieto* recognized that the claim in *Frazier* was essentially identical, it chose instead to repudiate *Frazier*:

> [W]e find neither reason nor authority to signify that a plaintiff's election to seek redress under the implied covenant rather than the express contract should nullify the legislatively prescribed limitation for actions that are "on the policy" because grounded in a failure to pay benefits that are due under the policy and indeed constitute its very reason for being.

Id. at 1195, 275 Cal. Rptr. at 365-66.

conduct in addition to the denial of benefits, both *Lawrence* and *Abari* fail to explain why the breach of a "duty not to withhold unreasonably payments due under a policy"[195] in *Murphy* should be taken outside the contractual limitation period simply because the insurer allegedly conspired with third parties to avoid its contractual obligation, rather than denying the claim outright, as in *Lawrence* and *Abari*.[196]

The key to understanding this dilemma is recognizing that the contractual limitation provision modifies the date of accrual as well as the applicable limitation period. Thus, the possibility foreseen in *Frazier* that the limitation period might expire before the cause of action accrues under otherwise-applicable law[197] is not limited to bad faith claims, but would also apply to ordinary claims to collect the benefits due "on the policy." This anomaly could occur for one of two reasons. First, the insurer could delay responding to the plaintiff's claim until after the contractual limitation period had expired.[198] This would not happen under general accrual principles, because a "breach" would not occur until the insurer denied the claim or the deadline for responding had

195. *Murphy*, 83 Cal. App. 3d at 49, 147 Cal. Rptr. at 574.

196. It should be noted that this argument applies only to the bad-faith claim in *Murphy*, which necessarily rested on the implied covenant of good faith and fair dealing, and therefore arguably should be considered a claim "on the policy." The other causes of action in *Murphy* were tort claims for fraud and intentional infliction of emotional distress, neither of which required or depended on the existence of a contractual duty. *See Murphy*, 83 Cal. App. 3d at 46-47, 147 Cal. Rptr. at 572-73 (fraud claim); *id.* at 49-50, 147 Cal. Rptr. at 574-75 (emotional distress claim).

197. *See Frazier*, 169 Cal. App. 3d at 103, 214 Cal. Rptr. at 890.

198. *See* Prudential-LMI Commercial Ins. Co. v. Superior Court, 51 Cal. 3d 674, 692-93, 274 Cal. Rptr. at 399, 798 P.2d at 1242 (Cal. 1990) ("It was not until September 1987 that plaintiff's claim was denied unequivocally. Thus, if the one-year suit provision were literally applied, plaintiff's suit would have been untimely before the insurer denied coverage."); *see also Frazier*, 169 Cal. App. 3d at 103, 214 Cal. Rptr. at 890. Similarly, in *Murphy* the insurer caused the payment of the claim to be delayed nearly two years while it pursued an interpleader action, allegedly in bad faith. *Murphy*, 83 Cal. App. 3d at 42-43, 147 Cal. Rptr. at 570.

passed.[199] Contractual limitation provisions, however, seem to measure the period from the happening of the contingent event ("inception of the loss"). Second, if the contractual limitation period begins running upon the happening of the contingent event, rather than upon the discovery of the cause of action, bad-faith conduct by the insurer subsequent to denial of the insured's claim might not occur, or reasonably might not be discovered, until after the contractual limitation period has expired. Barring suit in circumstances such as these would be absurd.

This anomaly could be resolved in one of three ways. First, courts could hold that the limitation provision in the policy is unconscionable as applied unless it permits the plaintiff a reasonable time within which to sue. If the provision is unconscionable, the court could refuse to enforce it and instead apply the default limitation periods discussed in Part II, above. While this would be consistent with the general test for the validity of contractual limitation provisions, it is difficult, to say the least, to find a legal basis for holding that a provision authorized by statute is void for unconscionability.

Second, in order to provide a legal basis for holding the statutory provision invalid, courts could hold that the statute, as applied in certain cases, is an unconstitutional deprivation of due process. For example, the New Mexico Supreme Court has held that "[d]ue process requires a limitations statute to provide a reasonable period within which an accrued right may be exercised."[200] The court analogized the situation to that in which the Legislature passes a statute that retroactively shortens the appli-

199. *See supra* notes 99-105 and accompanying text.

200. Garcia v. La Farge, 893 P.2d 428, 437 (N.M. 1995); *see also* 5 RONALD ANDERSON, ANDERSON ON THE UNIFORM COMMERCIAL CODE § 2-725:11 (3d ed. 1985 & Rev. 1994) ("Questions of constitutionality may also be engendered by a disparity in fixing the beginning date for the running of the statute of limitations period.").

cable limitation period.[201] In the latter situation, California courts have consistently held that the new statute must be interpreted to allow a "reasonable time to sue" for claims that were not yet expired at the time the act was passed, in order to avoid constitutional problems.[202] However, unlike New Mexico, the majority of jurisdictions have resisted extending such an argument to all statutes of limitation.[203]

The third solution is to attack the causes of the potential problem: unreasonable delay by the insurer in responding to the plaintiff's claim, and the accrual of the contractual limitation period before discovery of the cause of action. The legal basis for this solution will be discussed in the following section.

B. Accrual on Discovery and Equitable Tolling of Limitation Period

As noted above, the California Standard Form Fire Insurance Policy provides for a one-year limitation period commenc-

201. *Garcia*, 893 P.2d at 437. ("It is no less arbitrary when an existing statute of repose is applied to bar a claim accruing near the end of the limitations period than when a newly enacted limitations period is applied to a cause of action existing at the time of the enactment.").

202. *See, e.g.*, Brown v. Bleiberg, 32 Cal. 3d 426, 437, 186 Cal. Rptr. 228, 233-34, 651 P.2d 815, 820-21 (Cal. 1982) (citations and footnotes omitted):

> The 1970 enactment and the 1975 amendment [of CAL. CIV. PROC. CODE § 340.5] . . . could not be given retroactive effect so as to wipe out plaintiff's claim, but the Legislature may restrict the period of limitations on a pending claim so long as the plaintiff is given "a reasonable time in which to sue." A statute shortening the statute of limitations may be interpreted prospectively to avoid constitutional problems which would attend retroactivity.

203. *See, e.g.*, Brubaker v. Cavanaugh, 741 F.2d 318, 321 (10th Cir. 1984) ("[Statutes of limitation] sometimes expire before a claimant has sustained any injury, . . . or before he knows he has sustained an injury . . . . If the limitation period is otherwise reasonable, a claimant is not thereby deprived of his right to due process.") (quoting Jewson v. Mayo Clinic, 691 F.2d 405, 411 (8th Cir. 1982)); *accord*, Admire Bank & Trust v. City of Emporia, 829 P.2d 578, 586 (Kan. 1992); 5 RONALD ANDERSON, ANDERSON ON THE UNIFORM COMMERCIAL CODE § 2-275:11 (3d ed. 1985 & Rev. 1994) ("The courts have not been troubled by the theoretical considerations discussed above and have found statute of limitations provisions constitutional.").

ing upon "inception of the loss."[204] Many contractual limitation clauses are similar.[205] This provision was derived from the New York Standard Fire Insurance Policy, which originally provided that suit must be brought "within twelve months next after the fire," but was amended to the present language "as insurance coverage was expanded to cover more than fire (e.g., theft, lightning and other property damage) . . . ."[206]

If interpreted literally, this language would commence the contractual limitation period upon the happening of the contingent event for which coverage is provided. In many cases, such a provision would cause little difficulty; for example, the date of "inception of the loss" is easily determined in the case of a fire or life insurance policy. When other types of property damages are at issue, however, the date of "inception of the loss" may not be so clear. For example, in the case of progressive property damage caused by construction defects, the wrongful act may occur long before any damage occurs, and the damage may not then be discovered for a long time. Thus, unless "inception of the loss" is defined in accordance with the discovery rule of accrual, the shortened one-year period may well expire before the insured is aware of his or her cause of action.

204. CAL. INS. CODE § 2071 (West 1993).

205. *See, e.g.*, Prudential-LMI Commercial Ins. Co. v. Superior Court, 51 Cal. 3d 674, 680 n.2, 274 Cal. Rptr. 387, 390 n.2, 798 P.2d 1230, 1233 n.2 (Cal. 1991) (policy provision barring suit "unless commenced within twelve months next after the ***happening*** of the loss" (emphasis added); but holding that "[w]e perceive no legal difference between 'inception' and 'happening' for purposes of resolving the questions presented."); State Farm Fire & Cas. Co. v. Superior Court, 210 Cal. App. 3d 604, 610, 258 Cal. Rptr. 413, 416 (Ct. App. 1989) ("the differences between 'occurrence' and 'inception of the loss' are trivial; if anything . . . the policy provision is an improvement in the direction of plain English."); Magnolia Square Homeowners Ass'n v. Safeco Ins. Co., 221 Cal. App. 3d 1049, 1059 n.3, 271 Cal. Rptr. 1, 6 n.3 (Ct. App. 1990) ("No less trivial is the difference between 'inception of the loss' and 'loss occurs.'").

206. *Prudential*, 51 Cal. 3d at 682-83, 274 Cal. Rptr. at 392, 798 P.2d at 1235.

This problem has been partially alleviated by the California Supreme Court's holding in *Prudential-LMI Commercial Insurance v. Superior Court*[207] that for first-party insurance claims concerning progressive property damage, "the one-year suit provision begins to run on the date of inception of the loss, defined as that point in time when appreciable damage occurs and is or should be known to the insured, such that a reasonable insured would be aware that his notification duty under the policy has been triggered."[208] The court thus approved of the holdings in *Lawrence* and *Abari* that "'inception of the loss' means that point in time at which appreciable damage occurs so that a reasonable insured would be on notice of a potentially insured loss."[209] Under *Prudential*, contingent events which have a definite date of occurrence (such as a fire) will be presumed to place the insured on inquiry notice and will commence the running of the contractual limitation period;[210] but contingent events which by their nature are difficult to discover will not trigger the contractual limitation period until the insured is on inquiry notice concerning the event.

Using the discovery rule, however, only solves part of the problem. Even if the shortened limitation period commences upon the discovery of the contingent event, another problem may arise. Under the default rules of accrual, the cause of action for breach of the implied covenant of good faith and fair dealing

207. 51 Cal. 3d 674, 274 Cal. Rptr. 387, 798 P.2d 1230 (Cal. 1990).

208. *Id.* at 678, 274 Cal. Rptr. at 389, 798 P.2d at 1232; *see also id.* at 686, 274 Cal. Rptr. at 395, 798 P.2d at 1238 ("We agree that 'inception of the loss' should be determined by reference to reasonable discovery of the loss and not necessarily turn on the occurrence of the physical event causing the loss.").

209. *Id.* at 685, 274 Cal. Rptr. at 394, 798 P.2d at 1237.

210. *See, e.g.*, Prieto v. State Farm Fire & Cas. Co., 225 Cal. App. 3d 1188, 1196, 275 Cal. Rptr. 362, 366 (Ct. App. 1990) ("The statute still must be deemed to have begun running on the date of the fire, because the complaint alleges a sufficiently disastrous loss, at which plaintiffs were personally present, to alert them immediately.").

would not accrue until the insurer denied the claim, or at least until the deadline for paying benefits under the policy had passed.[211] If the limitation period starts running earlier, however, it is possible that the one-year period will expire before the insurer denies the claim, thereby terminating the insured's rights even before they would have accrued under the discovery rule.[212] Indeed, the insurer could even delay processing the claim on purpose, in the hope that the insured will neglect to file suit while waiting for a response.

A situation somewhat similar to the latter was presented in *Bollinger v. National Fire Insurance Co.*[213] There, the plaintiff sued the insurer to recover for a covered fire loss. The defendant insurer "requested and obtained numerous continuances and extensions of time, thereby delaying the time of trial" for one year; then it moved for a nonsuit on the ground that the action was prematurely filed.[214] The trial court erroneously granted the motion and dismissed the action; but instead of appealing the trial court's ruling, the plaintiff refiled the action in another county after the shortened limitation period had passed.[215] Plaintiff alleged that the action would have been filed on time but for the defendant's intentional delay in raising the issue that the previous action was premature.[216]

Faced with an egregious example of alleged intentional conduct in bad faith,[217] but unable to change the date of accrual

211. *See supra* notes 99-105 and accompanying text.

212. *See, e.g., Prudential*, 51 Cal. 3d at 692-93, 274 Cal. Rptr. at 399, 798 P.2d at 1242 ("Thus, if the one-year suit provision were literally applied, plaintiff's suit would have been untimely before the insurer denied coverage.").

213. 25 Cal. 2d 399, 154 P.2d 399 (Cal. 1944).

214. *Id.* at 402, 154 P.2d at 401.

215. *Id.* at 402-03, 154 P.2d at 401. At that time, INS. CODE § 2071 contained a fifteen-month limitation provision. *Id.* at 402, 154 P.2d at 401.

216. *Id.* at 403, 154 P.2d at 401.

217. *See id.* at 407-08, 154 P.2d at 404 (citations omitted):

contained in the statutory insurance policy, the court created a novel solution: the doctrine of equitable tolling. First, it noted that virtually all jurisdictions have held that statutory tolling provisions which were "designed to prevent technical forfeitures under statutes of limitation also apply to the limitation period incorporated by statute into every insurance policy."[218] Next, it held that Code of Civil Procedure section 355[219] should be "supplemented by judicial construction and applied beyond its literal language to accomplish its purpose."[220] Finally, the court boldly asserted that "[i]n any event this court is not powerless to formulate rules of procedure where justice demands it."[221]

Although the doctrine of equitable tolling rests upon a questionable legal basis,[222] its flexible dimensions make it attractive to courts seeking practical solutions to limitation problems. Thus, equitable tolling was used in the insurance context as the basis for the holding in *Lambert v. Commonwealth Land Title Insurance Co.*[223] that although the duty to defend accrues when the insurer refuses the insured's tender of defense, the limitation period is tolled until the underlying action is terminated by a final judgment.[224] Similarly, when faced with the issue of accrual

> [I]t is clear to us that defendant's conduct furnished the occasion for the delay and that it cannot take advantage of a situation which was of its own creation. Under the circumstances of the present case it would be manifestly unjust for this court to prevent a trial on the merits . . . by enforcing the fifteen-month limitation period when the prior action was filed promptly and long before the period expired.

218. *Id.* at 408, 154 P.2d at 404.

219. In 1955, that section provided: "If an action is commenced within the time prescribed therefor, and a judgment therein for the plaintiff be *reversed on appeal*, the plaintiff . . . may commence a new action within one year after the *reversal*." *Id.* at 409, 154 P.2d at 404 (emphasis added).

220. *Id.*, 154 P.2d at 405.

221. *Id.* at 410, 154 P.2d at 405.

222. *See generally, Simultaneous Litigation*, *supra* note 107 (describing objections to applying equitable tolling to legal malpractice actions and responses to these objections).

223. 53 Cal. 3d 1072, 282 Cal. Rptr. 445, 811 P.2d 737 (Cal. 1991).

224. *Id.* at 1080, 282 Cal. Rptr. at 449-50, 811 P.2d at 741-42.

for progressive property damage claims in *Prudential*, the California Supreme Court used the doctrine of equitable tolling to hold that "this limitation period should be equitably tolled from the time the insured files a timely notice, pursuant to policy notice provisions, to the time the insurer formally denies the claim in writing."[225] In so holding, the court emphasized the policy considerations in favor of the doctrine:

> [T]he principle of equitable tolling presents several advantages in eliminating the unfair results that often occur in progressive property damage cases. First, it allows the claims process to function effectively, instead of requiring the insured to file suit *before* the claim has been investigated and determined by the insurer. Next, it protects the reasonable expectations of the insured by requiring the insurer to investigate the claim without later invoking a technical rule that often results in an unfair forfeiture of policy benefits. . . . Third, a doctrine of equitable tolling will further our policy of encouraging settlement between insurers and insureds, and will discourage unnecessary bad faith suits that are often the only recourse for indemnity if the insurer denies coverage after the limitation period has expired. . . . Equitable tolling is also consistent with the policies underlying the claim and limitation periods — e.g., the insurer is entitled to receive prompt notice of a claim and the insured is penalized for waiting too long after discovery to make a claim. For example, if an insured waits 11 months after discovering the loss to make his claim, he will have only 1 month to file his action after the claim is denied before it is time-barred under section 2071.[226]

Thus, in one opinion, the California Supreme Court resolved four major problems concerning the applicability of the statute of limitation for breach of the implied covenant of good faith and fair dealing. First, the court reaffirmed the principle that contractual limitation provisions were valid and enforceable "'as long as the limitation is not so unreasonable as to show im-

225. *Prudential*, 51 Cal. 3d at 678, 274 Cal. Rptr. at 389, 798 P.2d at 1232.

226. *Id.* at 692, 274 Cal. Rptr. at 398-99, 798 P.2d at 1241-42 (citations omitted).

position or undue advantage.'"[227] Second, it endorsed the holding of *Abari* that the "rule that [the] one-year suit provision does not apply to bad faith suits [is] inapplicable when the insured's bad faith action is [a] 'transparent attempt to recovery *on the policy*, notwithstanding his failure to commence suit within one year of accrual.'"[228] Third, it held that "inception of the loss" should be interpreted in accordance with the discovery rule of accrual.[229] Fourth, it held that the doctrine of equitable tolling should be applied to toll the limitation period from the time the insured files the claim until it is denied by the insurer.[230] As one subsequent court stated:

> Significantly, *Prudential*'s rules of flexible accrual and equitable tolling will provide for policyholders under section 2071 much the same disposition as did *Frazier*. Thus, an insured who makes a timely claim will thereafter "ha[ve] a right (so far as the policy limitation is concerned) to sit back and wait until denial of claim" before the statute begins running again. But the statute still will have commenced running, as its terms require, upon inception of the loss (as defined in *Prudential*).[231]

IV. CONCLUSION

The so-called "hybrid" nature of the cause of action for breach of the implied covenant of good faith and fair dealing was

227. *Id.* at 683, 274 Cal. Rptr. at 393, 798 P.2d at 1236 (quoting C & H Foods Co. v. Hartford Ins. Co., 163 Cal. App. 3d 1055, 1064, 211 Cal. Rptr. 765, 769 (Ct. App. 1984)).

228. *Id.* at 692, 274 Cal. Rptr. at 398-99, 798 P.2d at 1241-42.

229. *Id.* at 678, 274 Cal. Rptr. at 389, 798 P.2d at 1232.

230. *Id.* at 678, 274 Cal. Rptr. at 389, 798 P.2d at 1232. In so holding, the court observed that "[o]ne commentator has called it 'unconscionable' to permit the limitation period to run while the insured is pursuing its rights in the claims process," *id.* at 690, 274 Cal. Rptr. at 397, 798 P.2d at 1240 (citing 18A GEORGE J. COUCH, COUCH ON INSURANCE § 75:88 (2d ed. 1983)), thus connecting the tolling rationale to the modern standard for assessing the validity of contractual limitation of suit provisions. *See supra* notes 153-59 and accompanying text.

231. Prieto v. State Farm Fire & Cas. Co., 225 Cal. App. 3d 1188, 1196, 275 Cal. Rptr. 362, 366 (Ct. App. 1990) (alteration in original) (citation omitted).

the product not only of overlapping legal theories of recovery but also of attempts to extend or shorten the limitation period within which claims for emotional distress and punitive damages could be brought. Now that the California Supreme Court has firmly re-established the contractual nature of the implied covenant in non-insurance cases, the applicable limitation principles are more clear. The limitation periods and rules of accrual that apply to contract claims generally should govern the cause of action for breach of the implied covenant outside the insurance context. For actions for breach of the implied covenant in insurance contracts, the doctrine of election of remedies applies only in the absence or invalidity of contractual modification. The vast majority of such actions are subject to contractual limitation-of-suit provisions, which are now governed by a new set of rules incorporating the principles of discovery accrual and equitable tolling. These principles should bring a measure of stability to what has been a contentious and complicated question of statutory interpretation.