COMMENTS

With Insurance Like This Who Needs Enemies?: Reforming California's Industrial Life Insurance Industry

This comment examines an area of widespread consumer abuse which is exempted from many of California's insurance regulations: industrial life insurance. The comment explores these exemptions as well as New York's more stringent regulatory scheme in proposing a comprehensive package of reforms for the California industrial life insurance industry.

INTRODUCTION

Mrs. D. is a single black woman who lives in Los Angeles. Fifty-seven years old and disabled, she survives on county welfare checks totalling $150 per month. Despite her meager income, Mrs. D. spends $52 per month on life and disability insurance. Her seventeen insurance policies afford her far less coverage than would one or two ordinary policies for a lower premium. However, with only a third grade education, Mrs. D. never understood the coverage her policies provided or failed to provide.[1]

Mrs. D. purchased "industrial" insurance, which is sold primarily to the poor and uneducated. Unfortunately, her predicament is not unusual in California. The high cost and low value of industrial insurance coupled with many marketing abuses make it one of the worst buys in the insurance business. Nevertheless, the California Legislature has established a protective niche in the Insurance Code for industrial insurance. After describing the consumer abuses associated with industrial insurance and its treatment under the California Insurance Code, this comment will suggest measures for reform.

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[1] The author interviewed Mrs. D. while investigating industrial insurance for the California State Legislature's Joint Legislative Audit Committee (Aug. 22, 1979) (transcript on file at the offices of the U.C. DAVIS LAW REVIEW) [hereinafter cited as Interview of Mrs. D.].

I. Brief History of Industrial Insurance

The label "industrial insurance" is misleading since it includes life, health and accident, and fire protection as well as industrial accident insurance.[2] This comment will concentrate on industrial life insurance since it is the most prevalent form of industrial insurance[3] and receives statutory treatment apart from that of ordinary insurance.[4]

Industrial life insurance was introduced to the United States in 1875 because existing life insurers did not provide coverage in small amounts for the working class.[5] From its introduction to the present time, industrial insurance has been widely criticized.[6]

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[2] Originally, "industrial insurance" referred to insurance sold to factory workers in England.

[3] Federal Trade Commission Policy Planning Issues Paper, Life Insurance Sold To The Poor: Industrial And Other Debit Insurance 1 (1979) [hereinafter cited as FTC Issues Paper].

Although this comment focuses on industrial life insurance, nearly all of the consumer abuses described below occur with other forms of industrial insurance. For a discussion of these marketing and claims abuses, *see* Section II(B), "Marketing and Claims Practices," *infra*.

Recently, a form of quasi-industrial insurance, known as monthly debit ordinary, has emerged. Monthly debit ordinary consists of small insurance policies with monthly premiums collected at the insured's home. In different respects, monthly debit ordinary resembles both ordinary and industrial insurance. However, since industrial life insurance statistics are separated from ordinary life insurance while monthly debit ordinary statistics are grouped with ordinary life insurance, this comment concentrates exclusively on industrial life insurance.

[4] Unlike industrial life insurance, other forms of industrial insurance (health and accident, and fire insurance) are governed by the same code provisions in California as ordinary insurance. For the special treatment of industrial life insurance, *see* notes 35-38, 44-45 and accompanying text *infra*.

[5] R. Marshall & E. Zubay, The Debit System of Marketing Life and Health Insurance 18 (1971). Industrial insurance expanded rapidly, elevating Prudential, Metropolitan Life and John Hancock Insurance companies to the top of the life insurance business. By 1891, these companies held over 95 percent of the $481 million of industrial insurance in force in the United States. *Id.* at 19.

[6] In 1914, for example, Louis Brandeis advocated the abolition of industrial insurance because of its excessive expense. L. Brandeis, Business As A Profession 109-53 (1914). A recent Federal Trade Commission study details modern abuses of industrial insurance. FTC Issues Paper, *supra* note 3. Both Congress and the California State Legislature are currently investigating the industry. *See, e.g., Debit Life Insurance Industry: Hearings Before the Subcomm. On Antitrust, Monopoly and Business Rights of the Senate Comm. on the Judiciary, 96th Cong., 1st Sess.* (1979) [hereinafter cited as *Senate Antitrust Subcomm. Hearings*]. The author has conducted investigatory interviews on behalf of California's Joint Legislative Audit Committee. *See, e.g.*, summary of interview of Mrs. D. at note 1 *supra*.

Despite such criticism, industrial insurance policy terms and sales practices are relatively unregulated by state insurance codes.[7]

Perhaps the most significant change in the industrial insurance industry was initiated by the companies themselves. In 1965, the major industrial insurance companies began phasing out their marketing of industrial insurance policies. By 1978, Prudential, Metropolitan Life and John Hancock had discontinued selling industrial life insurance policies in the United States.[8]

Over the past fifteen years, the number of new industrial life insurance policies sold has decreased, while the face value of the industrial life insurance policies in force has remained stable.[9] Since the number of policies outstanding is declining, industrial insurance arguably should not be subject to additional regulation. However, consumer advocates contend that the amount of industrial life insurance in force continues to represent a very significant portion of the entire life insurance market.[10]

Several features distinguish industrial from other forms of insurance. Generally, industrial insurance agents provide home premium collection either weekly, bi-weekly or monthly.[11] The face values of the policies are very small compared to ordinary policies.[12] Industrial insurance is sold almost exclusively in pov-

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[7] The McCarran-Ferguson Act of 1945 grants states the exclusive authority to regulate insurance. 15 U.S.C. §§ 1011-15 (1945).

The only state which strictly regulates industrial insurance is New York, which has done so since the 1940's. (New York's regulatory approach is discussed in detail in Section IV(A), "The New York Approach," *infra.*)

In constrast, California has done very little to regulate industrial insurance. (California's treatment of industrial life insurance is discussed in detail in Section III, "The Inadequacy of Existing Remedies in California," *infra.*)

[8] *See 1979 Annual Statement to the California Insurance Commissioner* by Prudential, Metropolitan Life, and John Hancock Insurance Companies, on file at the California Department of Insurance.

[9] The number of industrial life insurance policies in force nationwide decreased from 92 million policies in 1964 to 66 million in 1977. AMERICAN COUNCIL OF LIFE INSURANCE, LIFE INSURANCE FACT BOOK 31 (1978) [hereinafter cited as LIFE INSURANCE FACT BOOK].

The face value amount in force in the United States decreased from $39.83 billion in 1964 to $39.05 billion in 1977. *Id.*

[10] The $39.05 billion of industrial life insurance in force in 1977 constituted two percent of the total life insurance in force in the United States. *Id.* The number of industrial life insurance policies in force in 1977, however, represented *32%* of the 205 million total life insurance policies in force. *Id.* at 27, 31.

[11] FTC ISSUES PAPER, *supra* note 3, at 8.

[12] Industrial life insurance policies generally have a face value of less than

erty areas, usually to women and non-whites.[13]

II. Consumer Abuses

Consumers of industrial insurance encounter two major types of problems. First, extremely high costs and low values are characteristic of industrial insurance policies. Second, abusive insurer marketing and claims practices are widespread.

A. High Cost and Low Value

The high cost and low value of industrial insurance has been criticized by reformers since the early twentieth century.[14] Today, for example, industrial life insurance policies charge the highest premiums per $1,000 of face value but offer the lowest benefits of any type of life insurance.[15]

The high premiums are partly the result of high operating expenses. The Federal Trade Commission discovered that the average administrative cost per $1,000 of life insurance was 2.3 times greater for industrial insurance than for ordinary insurance sold by the same company.[16]

$1,000 compared to the $18,000 average size ordinary life insurance policy. Life Insurance Fact Book, *supra* note 9, at 13, 31. *See also* FTC Issues Paper, *supra* note 3, at 4.

[13] FTC Issues Paper, *supra* note 3, at 12. As one industry-funded study explains: "Stressing the sale of policies with lower face values and convenient collections of premiums, Home Service (industrial and monthly debit ordinary) agents have dominated the sale of life insurance protection to women." J. Blicksilver, Market Prospects and Potential For Home Service Insurance 35 (1975) (parentheses added).

[14] *See, e.g.*, L. Brandeis, *supra* note 6, at 123-24.

[15] FTC Issues Paper, *supra* note 3, at 26.

The low value of industrial life insurance was described by former industrial insurance agent Robert Lee in testimony before the Senate Antitrust Subcommittee:

> Policy owners were always stunned and angered on the cash value of their policy. Because they had paid in premiums . . . many times more than what the cash value was. The policy had been misrepresented at the time of the sale, people . . . could not read and interpret a policy. Example, industrial whole life ($1000): a policy is sold to a 65-year-old person, premium is $4 per week or $208 per year. At the end of the 10 years the person would have paid in premiums $2,800, cash value $49.80. Net loss to the policy owner $1,930.20 (if the policy was cashed in).

Senate Antitrust Subcomm. Hearings, supra note 6, at 25.

[16] FTC Issues Paper, *supra* note 3, at 27-28.

Another reason for the high prices charged for industrial insurance is that industrial insurers base their rates on outdated mortality statistics.[17] Since Medicaid and Medicare have considerably improved industrial insureds' life expectancy, the continued use of prior "mortality experience" is not justified.[18]

Additionally, industrial insureds must pay higher premiums for extra benefits in the event of highly unusual accidental death or dismemberment. These extra benefit provisions are automatically included although they are virtually worthless.[19] For example, one common feature of industrial insurance is triple indemnity benefits for death while riding a school bus or public transport.[20] In contrast, accidental death or dismemberment provisions are not included in ordinary life insurance policies unless the purchaser requests them. This omission contributes to the lower cost of ordinary insurance policies relative to industrial insurance policies.

The comparative value of industrial insurance is further diminished by statutory provisions in California. Industrial life insurance policies may not pay cash surrender or nonforfeiture benefits until policy premiums are paid for five years.[21] In contrast, ordinary insurance pays these benefits after three years.[22]

B. Marketing and Claims Practices

The most flagrant consumer abuses in the industrial insurance

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[17] *Id.* at 27.

[18] *Id.* at 17-18. ("Mortality experience" refers to the death rate a company assumes, from its experience, in setting its rates.) Insurance companies use their own "mortality experience" to compute insurance rates.

In California, *cash surrender* and *nonforfeiture benefits*, however, must be calculated from the 1961 Standard Industrial Mortality Table. CAL. INS. CODE § 10163.5(b) (West Cum. Supp. 1979). The use of outdated mortality statistics in this table similarly lowers the value of industrial life insurance by reducing these benefits. *See* notes 36-37 and accompanying text *infra*.

[19] Such provisions are virtually worthless because the accidents covered are so unlikely to occur. Nevertheless, the extra cost of providing these features is reflected in higher premiums. FTC ISSUES PAPER, *supra* note 3, at 143 n. 105.

[20] *Id.* at 36.

[21] CAL. INS. CODE § 10160(b) (West 1972). "Nonforfeiture benefits" are those options available to a policyholder when premium payments are discontinued on a life insurance policy which has accumulated a cash value. The cash value may be taken (i) in cash (the "cash surrender value"), (ii) as extended term insurance, or (iii) as reduced paid-up insurance. LIFE INSURANCE FACT BOOK, *supra* note 9, at 123.

[22] CAL. INS. CODE § 10160(b) (West 1972).

business arise from marketing and claims practices. Since agents, not the insurance companies, keep the records of individual industrial policy accounts,[23] agents may manipulate the records and hide marketing abuses from the company. This system has led to many unethical practices, several of which are so common that they are referred to generically as "overloading," "roll over" and "blind advances."

The most widespread industrial insurance abuse is "overloading" which occurs when an agent sells an excessive number of policies to an individual in relation either to that individual's need or ability to pay.[24] For example, Mrs. D., described at the beginning of this comment, was "overloaded." She held seventeen individual policies when she could have received more extensive coverage from one or two ordinary policies for a lower premium. Mrs. D. and others like her illustrate the fact that overloading decimates a household's monthly income through excessive insurance payments.

A second industrial insurance abuse, "roll over," occurs when agents induce policyholders to lapse (discontinue) old policies and replace them with similar new ones.[25] Lapses tend to be particularly costly to industrial life insureds because their cash surrender and nonforfeiture benefits take longer to accrue than similar ordinary insurance benefits.[26] Agents often induce policyhold-

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[23] The industrial insurance system of recordkeeping is unusual. First, agents' accounting to a company is handled on a mass basis as opposed to a transaction-by-transaction basis. Second, the companies utilize a cash system of accounting. R. MARSHALL & E. ZUBAY, *supra* note 5, at 78, 80.

[24] FTC ISSUES PAPER, *supra* note 3, at 38. In recent years, industrial insurance companies have mounted intensive sales campaigns in which additional insurance applications are prepared for every present policyholder. The necessary information about the policyholder is pre-typed onto the application. Agents then encourage insureds to buy the policies regardless of need. For a discussion of pre-typed ("pre-issue") company practices, *see Senate Antitrust Subcomm. Hearings*, *supra* note 6, at 27. *See also* interview by the author of Robert Rosen, a former industrial insurance office manager (July 24, 1979) (transcript on file at the offices of the U.C. DAVIS LAW REVIEW) [hereinafter cited as Interview of Robert Rosen].

[25] A policy "lapses" whenever the policyholder withholds premium payment past the grace period. For a variety of reasons (lapse inducement, poverty, etc.), industrial insurance has a very high lapse rate. A major industry-sponsored study indicates that first year lapse rates on industrial insurance may reach 50% and higher. R. MARSHALL & E. ZUBAY, *supra* note 5, at 68 n.20. In comparison, first-year lapses on ordinary insurance range from 7 to 25%. FTC ISSUES PAPER, *supra* note 3, at 33.

[26] If an industrial life policy lapses before it is five years old, the insured will

ers to lapse existing life insurance policies by suggesting that they keep part of their cash surrender value and use the rest to purchase a new policy.[27] Of course, agents do not disclose to insureds that they will lose all or most of their investment in the old policy.

The third widespread abuse is the "blind advance." This practice occurs when the insured has made extra payments (advances) which should be credited toward future premiums. "Blind" refers to the fact that an insured generally makes these payments unwittingly. Although agents tell newlysigned insureds that their coverage will start immediately upon payment of the first premium, agents frequently process the policy application several weeks after the first payment and retain the first few weeks of premiums without giving credit for the payment.[28] Since agents keep the only records of individual accounts, it is not difficult for them to misappropriate this advance payment by manipulating the books.[29]

Bad faith claims practices are also widespread in the industrial insurance industry.[30] The industrial insurance companies' policy of paying their managers a yearly bonus based on the number of

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receive no cash value or nonforfeiture benefits from the policy. *See* note 21 and accompanying text *supra*. Even if eligible for these benefits under the old policy, an insured must earn these benefits again under the new policy. In addition, the insured will pay higher premiums on the new policy since the insured begins the policy at an older age.

Frequently, agents do not inform insureds that they will pay higher premiums. Testifying before the Senate Antitrust Subcommittee, former industrial agent Robert Lee explained the practice:

> [I]f a person was paying $10 a month and you wanted to increase your sales, you would say, 'Well, this policy is 10 or 12 years old. Why don't you get the cash value of this and take out another one?' And you would not tell the person that the premiums would be at the attained age and not 10 years ago.

Senate Antitrust Subcomm. Hearings, supra note 6, at 29.

[27] FTC ISSUES PAPER, *supra* note 3, at 42. *See also Senate Antitrust Subcomm. Hearings, supra* note 6, at 29, *set forth in* note 26 *supra*. Occasionally, agents "roll over" policies without informing the insured that the old policy was terminated and a new one written to replace it. *See, e.g., id.* at 26 (statement of Robert Lee).

[28] For an account of this practice, *see Senate Antitrust Subcomm. Hearings, supra* note 6, at 32-33 (statement of William Moulton, Jr.). *See also* Interview of Robert Rosen, *supra* note 24.

[29] For a brief description of the industrial insurance accounting system, *see* note 23 *supra*.

[30] These practices occur when an insurer withholds, in bad faith, claims payments which are due the insured.

claims they pay is responsible for many of the claims abuses in the industry.[31]

One common company practice is to refuse to pay a disability claim because a fine print clause in the policy requires the insured's "total and continuous confinement indoors." Industrial insurance companies preclude payment of disability claims by interpreting such a clause very strictly.[32]

Mrs. D. was a victim of one such bad faith claims practice.[33] Her industrial insurance company refused to pay her disability claims resulting from an operation to remove a growth on her left hip. The company reasoned that since the disability emanated from an area near the lower back, a clause in her policy which excluded all disability resulting from "lower lumbar strains" exempted the company from liability. Although Mrs. D.'s doctor notified the insurance company that the operation did not involve a lumbar strain, the company never paid her claims.

III. The Inadequacy of Existing Remedies in California

A. Statutory Regulation of Consumer Abuses

Most of the above-discussed consumer abuses are not regulated by the California Insurance Code. For example, the California Insurance Commissioner lacks authority to disapprove life insurance rates or provisions[34] and has little control over the high cost

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[31] Generally, the fewer policyholder claims the manager pays during the year, the greater the manager's bonus. For descriptions of companies' claims-based bonus policies, *see Senate Antitrust Subcomm. Hearings*, *supra* note 6, at 25 (statement of Robert Lee), and Interview of Robert Rosen, *supra* note 24.

[32] For example, in one case an industrial insurance company discontinued payments on its health and accident insurance policy because the policyholder left the confines of her home to visit her doctor and attend several meetings. Although the policyholder required the assistance of others to leave her home and only left it on a few occasions during several years of disability, the insurer claimed that the disability was not "totally and continuously confining within doors." The policyholder sued the insurer for misrepresentation and breach of contract and was awarded over $200,000. Wetherbee v. United Ins. Co. of America, 265 Cal. App. 2d 921, 71 Cal. Rptr. 764 (1st Dist. 1968), *aff'd on remand*, 18 Cal. App. 3d 266, 95 Cal. Rptr. 678 (1st Dist. 1971).

[33] *See* Interview of Mrs. D., *supra* note 1.

[34] Life insurance is exempt from the rate restrictions of other insurance. Cal. Ins. Code § 1851(b) (West 1972). The Commissioner also lacks the authority to disapprove life insurance policies and thereby prohibit their sale.

In contrast, all disability insurance rates and policies are subject to the approval of the Insurance Commissioner. Cal. Ins. Code §§ 10291.5(b)(7), 10191 (West 1972).

and low value of industrial life insurance. The Commissioner may neither prohibit unfair exclusionary clauses and automatic accidental death or dismemberment provisions nor proscribe unreasonably expensive policies. Without these powers, the Commissioner cannot regulate the high cost and low value of industrial life insurance.

Three California regulatory provisions aggravate the high cost/low value problem. First, the Insurance Code permits insurers to withhold cash surrender and nonforfeiture benefits for industrial life insurance longer than for ordinary life insurance.[35] Second, the Code requires that cash surrender and nonforfeiture benefit computations be based on the 1961 Standard Industrial Mortality Table.[36] Since this table grossly underestimates the average lifespan of industrial insureds,[37] it lowers cash surrender and nonforfeiture benefit amounts available to industrial insureds. Third, the California Administrative Code exempts industrial insurance from California's requirement that life insurers provide customers with cost disclosure policy information.[38] Without this information, industrial insureds cannot possibly understand the complicated benefit structure of their life insurance policies.[39]

The California Insurance Code also offers little protection against industrial insurers' marketing practices. With the exception of "roll over" (lapse inducement), none of the marketing abuses described above are specifically prohibited by the Code.[40]

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[35] CAL. INS. CODE § 10160(b) (West 1972). *See* notes 21-22 and accompanying text *supra*.

[36] CAL. INS. CODE § 10163.5 (West Cum. Supp. 1979).

[37] *See* note 18 and accompanying text *supra*.

[38] CAL. ADMIN. CODE, tit. 10, § 2545.5(9) exempts all "[l]ife insurance policies wherein the face amount of insurance is $5000 or less" from the disclosure requirements of CAL. ADMIN. CODE, tit. 10, § 2545. Since nearly all industrial life insurance policies have a face value under $1,000 (*see* note 12 *supra*), they are exempt from cost disclosure requirements.

[39] Although many industrial insureds might not be able to understand the cost disclosure information (*see* note 76 and accompanying text *infra*), it should be provided for the benefit of those who would understand and use the information to compare costs of various industrial life insurance policies.

[40] CAL. INS. CODE § 790.03 (West Cum. Supp. 1979) prohibits the following "unfair methods of competition and unfair and deceptive acts or practices in the business of insurance": (a) lapse inducement; (b) misleading advertising; (c) acts of boycott resulting in restraint of trade; (d) filing false statements of financial condition; (e) falsifying any information entered by the insured in the insurer's records; (f) discrimination between individuals of the same class in

The industrial system of accounting, which permits many consumer abuses to remain undetected, is also unregulated by the California Insurance Code.

Bad faith claims practices are only prohibited by the Code insofar as they are "committed with such frequency as to indicate a general business practice" by an insurer.[41] Since such "frequency" is very difficult to prove, this provision offers little or no protection to the consumer.

The state arguably could regulate "overloading," "roll over," "blind advances" and bad faith claims practices under a general provision of the "unfair practices" section of the California Insurance Code. This provision grants the Insurance Commissioner broad authority to hold investigative hearings on suspected unfair practices not otherwise prohibited by the Code.[42] The Commissioner, however, interprets "unfair practices" under the statute to mean only "discriminatory" treatment of insureds.[43] Thus, no

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rate-setting; (g) advertising that insurers are members of the California Guarantee Association; and (h) unfair claims practices committed with such frequency as to indicate a general business practice.

"Blind advances," of course, are prohibited by the Penal Code insofar as they constitute theft. *See* CAL. PENAL CODE § 484 (West 1970).

[41] CAL. INS. CODE § 790.03(h) (West Cum. Supp. 1979).

[42] CAL. INS. CODE § 790.06(a) (West 1972) provides:

> Whenever the commissioner shall have reason to believe that any person engaged in the business of insurance is engaging in this State in any method of competition or in any act or practice in the conduct of such business which is not defined in Section 790.03 and . . . that such act or practice is unfair or deceptive . . . he may issue and serve upon such person an order to show cause . . . and a notice of hearing . . .

If the hearing discloses unfair practices the Commissioner may seek an injunction restraining the practice. *Id.* § 790.06(b).

[43] Interview of Angele Khachadour, General Counsel to the California Department of Insurance, by author (July 12, 1979) (transcript on file at the offices of the U.C. DAVIS LAW REVIEW).

"Discriminatory" treatment occurs when an insurer treats one class of insureds differently than another *(e.g.,* in ratesetting) without statistical justification.

The Commissioner's interpretation of section 790.06 raises the question of whether industrial insurers' rates are "discriminatory." Insurers claim that there is statistical justification for differences between ordinary and industrial life insurance rates, including higher costs. *See generally* note 16 and accompanying text *supra.* However, if insurers base industrial life insurance rates on outdated mortality statistics which are unjustifiably high (*see* note 18 and accompanying text *supra*), these rates "discriminate" against low income people since this is the group that purchases most industrial insurance. The Insurance

investigative hearings have been held on "overloading," "roll over," "blind advances" and bad faith claims practices.

The recent amendment of California Insurance Code sections 1692.1 and 1685 underscores the continuing exemption of industrial insurance from the general regulation of insurance.[44] The new statute phases out the use of temporarily licensed agents who have not yet passed their licensing examination, but exempts industrial insurance agents from such regulation.[45] Thus, California prohibits the least knowledgeable and experienced agents from selling all types of insurance *except industrial insurance.*

B. Judicial Remedies for Consumer Abuses

California's common law has expanded in recent years to provide insureds with greater protection against insurer bad faith. The tort of misrepresentation is a long-recognized but largely ineffective avenue to insurer liability.[46] In contrast, the judicial recognition of an implied covenant of good faith and fair dealing[47]

Commissioner could arguably prohibit such insurer practices under CAL. INS. CODE § 790.06 (West 1972).

[44] CAL. INS. CODE §§ 1692.1, 1685 (West Cum. Supp. 1979) (1977 Cal. Stats. 3570, c. 1111, §§ 1, 8).

[45] These sections permit the continued issuance of "certificates of convenience" (temporary licenses) to industrial life and disability insurance agents. *See* CAL. INS. CODE §§ 1692.1(h), 1685(c) (West Cum. Supp. 1979).

[46] The tort of misrepresentation is largely ineffective because plaintiffs face the almost impossible task of proving the insurer's intent to misrepresent. For a discription of the elements of misrepresentation, *see* W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 105, at 685 (4th ed. 1971).

In some cases, however, the burden of proving intent is mitigated and the tort of misrepresentation becomes very effective. For example, in Wetherbee v. United Ins. Co. of America, 265 Cal. App. 2d 921, 71 Cal. Rptr. 764 (1st Dist. 1968), *aff'd on remand,* 18 Cal. App. 3d 266, 95 Cal. Rptr. 678 (1st Dist. 1971), the court inferred an insurer's precontractual intent to defraud from its postcontractual claims practices. Such an inference reduces the difficulty in proving an insurer's fraudulent intent. For a discussion of the facts in *Wetherbee, see* note 32 *supra.*

[47] In California, an action for breach of an insurer's implied covenant of good faith and fair dealing was first recognized in Communale v. Traders and General Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958), where an insurer failed to sufficiently consider the plaintiff-insured's interest when the insurer refused to settle a third-party claim. For more recent examples, *see* Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 598 P.2d 452, 157 Cal. Rptr. 482 (1979) (disability insurer's failure to properly investigate policyholder's claims held breach of covenant of good faith and fair dealing as a matter of law); and Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973) (policy-

is very significant and potentially beneficial to industrial insurance consumers.

A tort action for breach of the implied covenant of good faith and fair dealing protects an insured against bad faith precontractual promises made by an insurer.[48] In *Silberg v. California Life Insurance Company*, the California Supreme Court held that the defendant insurance company's refusal to make medical payments under its policy until the plaintiff's claim for worker's compensation benefits had been decided was a breach of the implied covenant of good faith and fair dealing.[49] In particular, the court ruled that the company acted in bad faith by refusing to

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holder's allegation that insurer maliciously refused to pay policyholder's fire insurance claims held to state a cause of action for breach of implied covenant of good faith and fair dealing). *See also* discussion of Silberg v. California Life Ins. Co., 11 Cal. 3d 452, 521 P.2d 1103, 113 Cal. Rptr. 711 (1974), at notes 49-50 and accompanying text *infra*.

The scope of the implied covenant of good faith and fair dealing is unsettled. Recently, the California Supreme Court indicated that insurers owe fiduciary duties to insureds: "The obligations of good faith and fair dealing encompass qualities of decency and humanity inherent in the responsibilities of a fiduciary. Insurers hold themselves out as fiduciaries, and with the public's trust must go private responsibility consonant with that trust." Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d at 820, 598 P.2d at 457, 157 Cal. Rptr. at 487 (1979), quoting from Goodman & Seaton, *Foreword: Ripe For Decision, Internal Workings and Current Concerns of the California Supreme Court*, 62 CALIF. L. REV. 309, 346-47 (1974).

Egan is not the only California Supreme Court case recognizing an elevated public duty for insurers. *See* Barrera v. State Farm Mut. Auto. Ins. Co., 71 Cal. 2d 659, 668 n.5, 456 P.2d 674, 680 n.5, 79 Cal. Rptr. 106, 112 n.5 (1969) (liability insurer must investigate policyholder's "insurability" within reasonable period after issuing policy if it is to later avoid liability to a third party by claiming that the policyholder was "uninsurable": "It has long been recognized that 'the business of insurance is *quasi-public* in nature'"). *See also* Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 270 n.6, 419 P.2d 168, 172 n.6, 54 Cal. Rptr. 104, 108 n.6 (1966) (liability insurer's failure to defend an action against insured held to breach the insurance contract notwithstanding exclusionary clause because insured reasonably expected such coverage: "[W]e have taken the law of insurance practically out of the category of contract, and we have established that the duties of public service companies . . . flow from the calling in which [the company] has engaged and [its] consequent relation to the public").

[48] Silberg v. California Life Ins. Co., 11 Cal. 3d 452, 461, 521 P.2d 1103, 1109, 113 Cal. Rptr. 711, 717 (1974). For a discussion of the tort of good faith and fair dealing's application to precontractual promises, *see* Comment, *Silberg v. California Life Insurance Company: A New Dimension In The Tort Of Insurer Bad Faith?*, 6 PAC. L.J. 590 (1975).

[49] Silberg v. California Life Insurance Company, 11 Cal. 3d 452, 460, 521 P.2d 1103, 1108, 113 Cal. Rptr. 711, 716 (1974).

honor an express promise in its policy application to protect the insured against ruinous medical bills.[50]

Although both tort actions — misrepresentation and breach of the covenant of good faith and fair dealing — are designed to compensate an insured against bad faith precontractual promises made by an insurer, they frequently fail to do so. This failure is partly due to the fact that marketing abuses such as "overloading" and "roll over" often occur through nondisclosure rather than active misrepresentation.[51]

The California Insurance Code gives both the insured and insurer a remedy of rescission in the event of nondisclosure by the other party; however, no *tort* remedy exists for such nondisclosure.[52] Rescission is not an effective deterrent to insurer marketing practices.[53] Punitive damages for tort nondisclosure, however,

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[50] *Id.* at 461, 521 P.2d at 1109, 113 Cal. Rptr. at 717.

[51] Generally, the agent's failure to disclose material facts about the acquisition and lapsing of policies leads to detrimental insurance purchases and lapses by consumers. *See* notes 24-29 and accompanying text *supra*. For example, the insurance agent who sold Mrs. D. her seventeen industrial policies failed to inform her that she was becoming overinsured and that she could purchase one larger policy at a much lower overall price. The agent also failed to point out the many fine print exclusionary clauses in Mrs. D.'s policies. Interview of Mrs. D., *supra* note 1.

[52] CAL. INS. CODE § 331 (West 1972) provides: "Concealment, whether intentional or unintentional, entitles the injured party to rescind insurance." CAL. INS. CODE § 332 (West 1972) extends this rescission remedy to "Each party to a contract of insurance . . . ."

Furthermore, industrial insurance policies often contain a special clause under which the policy is voidable on specific conditions—*e.g.*, where the insured has received previous hospital care on a condition that is material to the risk covered by the insurance, and conceals such fact from the insurer. R. KEETON, BASIC TEXT ON INSURANCE LAW 16 (1971).

In California, insurers also owe a "duty" to insureds to make policy terms "conspicuous, unambiguous and unequivocal . . . [such that] an ordinary layman can understand" in order to uphold a company's otherwise unexpected construction of the policy against the insured. Thompson v. Occidental Life Ins. Co., 9 Cal. 3d 904, 912, 513 P.2d 353, 357, 109 Cal. Rptr. 473, 477 (1973). Since this "duty" arises under contract law, the insured's remedy is limited to the terms of the contract.

[53] Rescission is little deterrent to insurers because it fails to penalize them adequately for concealment. In the case where an insured has a large claim pending on a policy, for example, concealment by the insured allows the insurer to avoid payment and save a substantial amount of money. Where the insurer conceals material facts, however, the insured can only retain the unsatisfactory policy or rescind it and lose whatever equity it has accumulated. Neither of these options compensates the insured or penalizes the insurer.

would provide insurers with a true incentive to limit marketing abuses.[54]

Judicial remedies alone cannot adequately reform the industrial insurance industry. Most industrial insureds are poor and rarely have either the resources or the experience to obtain counsel and sue their insurance company. In addition, although punitive awards would tend to deter abusive practices, tort remedies are largely compensatory, rather than preventive, in nature. These considertions dictate that greater statutory regulation of the industry is necessary. Nevertheless, broad judicial remedies are important in order to compensate the infrequent industrial insured who does sue the insurer for marketing abuses.

IV. Suggestions for Reform

California's statutory regulations and judicial remedies fail to adequately protect industrial insureds from the high cost/low value problem and the marketing/claims abuses of industrial insurance companies.[55] A variety of potential reforms are analyzed below and a comprehensive package of reforms for California is suggested.

A. The New York Approach

New York regulates industrial insurance more extensively than any other state. It regulates the high cost of industrial life insurance by limiting each company's total expenses.[56] Under this pro-

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One commentator argues that the inadequacy of contract remedies for insurer nondisclosure requires that more compensatory awards such as treble damages be given. Slawson, *Mass Contracts: Lawful Fraud In California,* 48 S. Cal. L. Rev. 1, 23-47 (1975).

In addition, Slawson argues that application of a warranty concept to standardized contracts such as insurance policies would be beneficial: "Terms in a form which would materially interfere with the purposes for which the form is sold should not be enforced unless their full implications are brought clearly and conspicously to the buyer's attention before he buys." *Id.* at 19.

[54] For a further discussion of this point, *see* Section IV(C), "Expanding Tort Remedies," *infra.*

[55] *See* Section III, "The Inadequacy of Existing Remedies in California," *supra.*

[56] *See* N.Y. Ins. Law § 213-a (McKinney Cum. Supp. 1979). The impact of this expense limitation is magnified by the fact that it is extraterritorial. Therefore, an industrial insurance company licensed in New York must comply with the statute's limitations for its operations throughout the United States. *Senate Antitrust Subcomm. Hearings, supra* note 6, at 177 (statement of Hon. Albert Lewis, Superintendent of Insurance, State of N.Y.).

vision, a company's expenses may not exceed a sum of percentages of its yearly premiums and total insurance in force.[57] Other cost controls[58] prohibit greater first-year commissions to agents for industrial insurance sales than for ordinary insurance sales,[59] and prohibit bonuses and prizes for industrial agents based upon the volume of new business or aggregate number of policies they sell.[60] New York further requires each industrial life insurance policy issued to be "self-supporting on reasonable assumptions as to interest, mortality, and expense."[61]

The New York Superintendent of Insurance lacks direct control over life insurance rates but may indirectly regulate rates by disapproving a policy as inequitable or prejudicial to the policyholder.[62] According to Albert Lewis, present New York Superintendent of Insurance, the power to disapprove inequitable policies is used to prohibit the sale of excessively expensive industrial insurance.[63]

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[57] The formula used to compute this limit is complicated. The more significant provisions include the computation of the sum of: 1) nine percent of all monthly premiums; 2) sixteen and one-half percent of all premiums payable more often than monthly; 3) forty-five percent of all first-year monthly premiums except industrial endowment insurance; 4) forty percent of the first year premiums payable more often than monthly except industrial endowment insurance; 5) miniscule percentages of the aggregate insurance in force at the beginning of the year; and 6) seventy-five cents for each premium-paying policy which was in force at the beginning of the year. N.Y. INS. LAW §§ 213-a(3)(a), (b), (c), (e), (g), (i) (McKinney Cum. Supp. 1979), respectively.

Small companies with less than $20 million of industrial life insurance in force throughout the United States at the end of the preceding year receive a 100% increase in their limits under the law. *Id.* § 213-a(4).

[58] As well as reducing the cost of industrial insurance, these latter two restrictions greatly diminish an industrial insurance agent's incentive to "roll over." *See* note 73 and accompanying text *infra.*

[59] N.Y. INS. LAW § 213-a(7) (McKinney 1966).

[60] N.Y. INS. LAW § 213-a(6) (McKinney 1966).

[61] N.Y. INS. LAW § 213-a(8) (McKinney 1966). This type of provision should be interpreted to prevent insurers from using outdated mortality statistics which increase rates. For an account of the use of such statistics, *see* note 18 and accompanying text *supra.*

[62] The Superintendent may disapprove any industrial life policy which would be "prejudiced to the interests of its policyholders or members" or which "contains provisions which are unjust, unfair, or inequitable." N.Y. INS. LAW § 154(1) (McKinney Cum. Supp. 1979). The Superintendent may also disapprove any health or accident insurance policy for similar reasons. *Id.* Furthermore, the Superintendent may withdraw prior approval of a policy whenever the policy is later discovered to violate these requirements. N.Y. INS. LAW § 141 (McKinney 1966).

[63] *See Senate Antitrust Subcomm. Hearings, supra* note 6, at 175.

New York requires that the insurer include a number of protective provisions in every industrial life insurance policy.[64] These provisions protect the industrial insured against forfeiture of a policy in the event of late payment,[65] and require disclosure of cost information on cash surrender[66] and nonforfeiture[67] benefits. Unlike California, New York also requires identical cash surrender and nonforfeiture benefits for ordinary and industrial life insurance.[68] Other required provisions protect against forfeiture for misstatement of age,[69] treat policies as incontestable after they are one year old[70] and require discounts for policyholders who pay premiums directly to the insurance office.[71] These provisions significantly increase the value of industrial life insurance.[72]

New York's regulation of marketing and claims abuses is less extensive than its regulation of high cost and low value in the industrial insurance area. Two statutes, however, tend to reduce "overloading" and "roll over." Restrictions on first-year commissions decrease the agents' incentive to "roll over" industrial policies.[73] To prevent overloading, New York prohibits the sale of any industrial life insurance policy which, if added to existing policies, would provide an insured with more than $1,000 of industrial life insurance coverage.[74]

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[64] N.Y. INS. LAW § 163 (McKinney 1966).

[65] N.Y. INS. LAW §§ 163(1)(a), (h) (McKinney 1966). Subsection (a) provides for a four week "grace period" within which an industrial insured may pay an overdue premium without lapsing the policy. Subsection (h) mandates that any lapsed policy may be reinstated by the insured within two years of the due date of the premium in default.

[66] N.Y. INS. LAW § 163(1)(g) (McKinney 1966).

[67] N.Y. INS. LAW § 163(1)(f) (McKinney 1966).

[68] In New York, cash surrender and nonforfeiture benefits become available to both industrial and ordinary insureds after three years of premiums on a whole life insurance policy. N.Y. INS. LAW §§ 163(1)(f), (g) (McKinney 1966). *Compare* California's provisions discussed in notes 21-22 and accompanying text *supra*.

[69] N.Y. INS. LAW § 163(1)(d) (McKinney 1966).

[70] N.Y. INS. LAW § 163(1)(b) (McKinney 1966).

[71] N.Y. INS. LAW § 163(1)(k) (McKinney 1966). Direct payments obviate the need for home collection, saving the company the cost of such collection.

[72] The significant digressions from the California Insurance Code are N.Y. INS. LAW §§ 163(f), (g) (three-year maximum withholding of, and cost disclosure on, cash surrender and nonforfeiture benefits), and N.Y. INS. LAW § 163(h) (two-year reinstatement period for lapsed policyholders).

[73] N.Y. INS. LAW § 213-a(6), (7) (McKinney 1966). These provisions also act to reduce costs and increase value. *See* note 58 and accompanying text *supra*.

[74] N.Y. INS. LAW § 201(1) (McKinney 1966).

While the New York approach offers very strong regulation of industrial insurance, it does have weaknesses. For example, "blind advances" and bad faith claims practices are not specifically restricted by the New York Insurance Law. Moreover, the expense limitation statute is extremely complicated and only indirectly limits insurance rates.

Due to market structure, the expense limitation probably does little more than act as a ceiling on rate increases. Insurance rates are low only when there is a competitive market forcing insurance companies to lower rates as costs decrease. The industrial insurance market, however, is not price or benefit competitive.[75] Most of its consumers lack the ability or opportunity to meaningfully compare the costs and benefits of policies offered by different companies.[76] Therefore, insurers need not reduce premiums as expenses decrease.

Other cost control provisions in the New York Insurance Law are more effective. The limitations on first-year commissions for agents[77] and the requirement that policies be self-supporting[78] do not require a competitive market to be effective. In addition, the Superintendent's broad control over industrial insurance rates[79] may compensate for shortcomings in the expense limitation approach.

B. Other Possible Statutory Reforms

The New York approach by no means exhausts the possible avenues of statutory reform. An effective measure to rectify the high cost and low value of industrial insurance would be to prohibit industrial life insurance policies with face values under $3,000. The justification for such a proposal is that policies worth less than $3,000 are not economically beneficial to the policyholder in light of fixed company expenses.[80]

Industrial insurance companies would likely argue that a

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[75] FTC ISSUES PAPER, *supra* note 3, at 20.

[76] *Id.*

[77] N.Y. INS. LAW §§ 213-a(6), (7) (McKinney 1966). *See* note 58 and accompanying text *supra.*

[78] N.Y. INS. LAW § 213-a(8) (McKinney 1966). *See* note 61 and accompanying text *supra.*

[79] *See* note 62 and accompanying text *supra.*

[80] Fixed expenses are those expenses (such as recordkeeping, mailing, and personnel costs) which remain constant regardless of the size of an individual policy. In small policies such as industrial insurance, fixed expenses consume a large portion of the premium, leaving little for the cash surrender value.

$3,000 minimum would prevent many people from owning life insurance. However, since low face value industrial life insurance has a very high cost and low relative value,[81] these consumers would lose little if they were uninsured. In addition, many insureds are "overloaded" with multiple low face value industrial life insurance policies and would obtain far greater value with one larger policy.

Another useful reform, aimed at reducing the high cost and low value problem, would be to eliminate weekly and bi-weekly premium industrial insurance policies entirely and permit only monthly premium policies. Since much of the high expense of industrial insurance is caused by frequent home collections, this reform would lower the cost of industrial insurance.[82]

Industrial insurers criticize this proposal, arguing that their customers lack the discipline to pay monthly premiums.[83] Many insureds such as Mrs. D., however, subsist on monthly welfare checks. For these insureds, monthly premiums near the time welfare checks arrive are more appropriate than weekly premiums. Moreover, the fact that many monthly debit ordinary (monthly premium) policies are sold to the same low income group that purchases industrial insurance[84] indicates the industrial insureds' ability to pay monthly premiums.

In addition, the failure of industrial insurance companies to use updated mortality statistics results in excessive premium rates.[85] A provision mandating the use of updated mortality statistics in setting rates would alleviate this problem.

A badly needed reform is regulation of the industrial insurance system of accounting.[86] The failure of industrial insurance companies to keep records of individual policyholder accounts permits agents to obtain and misappropriate "blind advances."[87] Such abuses will continue until the companies and Insurance Commis-

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[81] *See* Section II(A), "High Cost and Low Value," *supra*.

[82] This proposal suffers from the same weakness as New York's expense limitation approach in that it also depends in part upon a competitive market for industrial insurance companies to lower rates. Unfortunately, such a market does not exist. *See* note 75 and accompanying text *supra*.

[83] FTC ISSUES PAPER, *supra* note 3, at 47.

[84] *Id.* at 14.

[85] *See* note 18 and accompanying text *supra*.

[86] New York does not specifically regulate the industrial insurance accounting system. For a brief description of this system, *see* note 23 and accompanying text *supra*.

[87] *See* note 28 and accompanying text *supra*.

sioner more closely police the agents' collection and sales activities through company records of individual accounts.

C. Expanding Tort Remedies

A new tort remedy to compensate insureds for an insurer's concealment of material facts regarding an insurance purchase should be recognized in California for reasons of policy and fairness. The present rescission remedy affords insureds entirely inadequate relief in the event of insurer concealment.[88] In addition, due to the unequal bargaining power between the parties, punitive damages are necessary to restore balance in the insured-insurer relationship.[89] A new tort would deter future bad faith insurer concealment by permitting the award of punitive damages.[90]

An insured's duty to disclose material facts arguably stems from an implied convenant of good faith and fair dealing. The California Supreme Court recognized a trust-like relationship between insured and insurer when it first adopted the tort of good faith and fair dealing.[91] Given this relationship, the insurer's failure to disclose material facts about insurance purchases arguably breaches the trust which the insured has placed in the insurer. Moreover, a recent opinion indicates that the California Supreme Court may be willing to expand insurers' duties to their insureds through the tort of good faith and fair dealing.[92]

Since an insurer's simple disclosure of policy terms in the contract is insufficient to protect industrial insureds from marketing abuses,[93] an insurer's duty should encompass the disclosure of

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[88] *See* note 53 and accompanying text *supra*.

[89] The California Supreme Court recently recognized such a need for punitive damages in a bad faith claims practice case: "[T]he relationship of insurer and insured is inherently unbalanced; the adhesive nature of insurance contracts places the insurer in a superior bargaining position. The availability of punitive damages is thus compatible with recognition of insurers' underlying public obligations and reflects an attempt to restore balance in the contractual relationship." Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 820, 598 P.2d 452, 457, 157 Cal. Rptr. 482, 487 (1979).

[90] *See* text accompanying note 54 *supra*.

[91] *See* Communale v. Traders and Gen. Ins. Co., 50 Cal. 2d 654, 658-59, 328 P.2d 198, 200-01 (1958).

[92] *See* Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 820, 598 P.2d 452, 457, 157 Cal. Rptr. 482, 487 (1979), *set forth in* note 47 *supra*.

[93] Insurance provisions appearing in the policy are often typed in small print, are written in "legalese" and are not effectively communicated to the insured.

additional information. The agent should disclose to the insured both the insured's reasonable need for insurance and the optimum coverage available for a total premium payment in order to protect the insured from unfair sales practices. A tort action for an insurer's concealment of such material facts would provide an adequate remedy for these abuses.

Imposing a duty to disclose material facts upon insurers would place a substantial burden upon the companies. Insurers will likely argue that any breach of a duty of disclosure should not bring greater consequences to insurers than insureds. It is arguably inequitable to allow insureds to receive punitive damages while restricting companies to the remedy of rescission. However, given (i) the inadequacy of the rescission remedy for insureds,[94] (ii) the unequal bargaining power between the parties[95] and (iii) the elevated public duty of insurers,[96] such "inequitable" treatment is justified. It clearly is necessary to protect industrial insureds from insurers' marketing and claims abuses. In fairness, however, insurers should only be liable in tort for their *bad faith* concealment of material facts of which they have *actual knowledge.*[97]

D. A Package of Reforms for Industrial Insurance in California

In order to improve value, reduce costs, and discourage marketing and claims abuses, California must adopt comprehensive regulations of industrial insurance. California should adopt the following cost control and value increasing provisions which are similar to New York statutes:[98] limitations upon agent commissions and bonuses,[99] mandatory self-supporting policies,[100] policy and

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This problem is compounded by the fact that insureds do not receive their policies until several weeks after entering into the contract.

[94] *See* note 53 and accompanying text *supra.*

[95] *See* note 89 and accompanying text *supra.*

[96] *See* note 47 *supra.*

[97] A *bad faith* standard is also fair because the disclosure requirement emanates from the tort of *good faith* and fair dealing.

[98] New York's total expense limitation provision is not an appropriate method of reducing industrial insurance rates and should not be adopted by California. For an explanation of this provision and its problems, *see* notes 57, 75 and accompanying text *supra.*

[99] *See, e.g.*, "Appendix" § 6 *infra* at page 297. For the rationale underlying such a provision, *see* notes 59-60, 73 and accompanying text *supra.*

[100] *See, e.g.*, "Appendix" § 4 *infra* at page 296. For the rationale underlying such a provision, *see* note 61 and accompanying text *supra.*

rate review authority vested in the Insurance Commissioner,[101] earlier cash surrender and nonforfeiture benefits[102] and cost disclosure.[103] Additional regulations which should be adopted to increase the value of industrial life insurance include prohibitions upon the sale of policies with a face value of less than $3,000[104] and prohibitions upon home premium collection more frequently than once each month.[105]

Several of these provisions will serve dual purposes. The first-year agent commission and bonus limitations will limit the companies' expenses and decrease the agents' incentive to undertake practices such as "roll over." The cost disclosure requirement will both decrease inappropriate consumer insurance purchases and promote competition in the industrial insurance market by informing consumers about the product so that they can make price and benefit comparisons between policies.

The use of mortality tables which more accurately reflect the life expectancy of today's industrial insureds should also be required by statute. A more standard mortality guide than the 1961 Standard Industrial Mortality Table should be used in calculating cash surrender and nonforfeiture benefits for industrial life insurance policies.[106] Moreover, a provision requiring that policies

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[101] *See, e.g.*, "Appendix" § 3 *infra* at page 296. For the rationale underlying such a provision, *see* notes 34, 62-63 and accompanying text *supra*.

[102] *See, e.g.*, "Appendix" § 5(b) *infra* at page 297. For the rationale underlying such a provision, *see* notes 21-22, 68 and accompanying text *supra*.

[103] *See, e.g.*, "Appendix" § 5(b) *infra* at page 297. For the rationale underlying such a provision, *see* notes 38-39, 72 and accompanying text *supra*.

[104] *See, e.g.*, "Appendix" § 2(a) *infra* at page 296. For the rationale underlying such a provision, *see* note 80 and accompanying text *supra*.

[105] *See, e.g.*, "Appendix" § 2(b) *infra* at page 296. For the rationale underlying such a provision, *see* note 82 and accompanying text *supra*.

[106] *See, e.g.*, "Appendix" § 5(b)(1) *infra* at page 297.

The American Society of Actuaries is currently investigating whether the life expectancy of industrial insureds has increased sufficiently (*see* note 18 and accompanying text *supra*) to warrant the use of the Standard *Ordinary* Mortality Table in calculating industrial life insurance cash surrender and nonforfeiture benefits. If industrial insureds' life expectancy is now roughly equal to that of ordinary insureds, then the Standard *Ordinary* Mortality Table should be used to calculate these benefits. If industrial insureds' life expectancy is significantly different from that of ordinary insureds, however, then a separate (updated) Standard *Industrial* Mortality Table should be used. Interview of John Montgomery, Chief Actuary of the California Department of Insurance, by author (August 14, 1979) (transcript on file at the offices of the U.C. DAVIS LAW REVIEW).

For further rationale underlying such a provision, *see* notes 36-37 and accompanying text *supra*.

be "self-supporting" should include a mandate that recent mortality statistics be used by the companies in setting rates.[107]

The legislature should enact additional provisions to prevent marketing abuses by industrial insurance companies. Regulations should require industrial insurance companies to keep records of individual policyholder payments in their home offices for inspection by the Insurance Commissioner.[108] Additionally, New York's provisions which restrict "overloading"[109] and "roll over"[110] should be adopted. Similarly, a statute preventing "blind advances"[111] by requiring any payment accepted in advance to be credited, with interest, to the policyholder's account is necessary to prevent marketing abuses. Finally, the Insurance Commissioner should be prohibited from issuing certificates of convenience to industrial insurance agents.[112]

Specific provisions are necessary to prevent industrial life insurers' bad faith claims practices. Prohibitions upon an insurance company's bad faith withholding of or refusal to settle claims[113] should also provide that a violation of the section renders the company liable for actual and exemplary damages.[114] Moreover, provisions should prevent industrial insurance companies from paying (or withholding) any bonus, prize, or other compensation to (or from) its managers or other employees based on the number of policyholder claims paid.[115]

The California Legislature should also enact a statute prohibit-

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[107] *See, e.g.*, "Appendix" § 4 *infra* at page 296. For the rationale underlying such a provision, *see* notes 18, 85 and accompanying text *supra*.

[108] *See, e.g.*, "Appendix" § 9 *infra* at page 298. For the rationale underlying such a provision, *see* notes 86-87 and accompanying text *supra*.

[109] *See, e.g.*, "Appendix" § 8 *infra* at page 298. For the rationale underlying such a provision, *see* note 74 and accompanying text *supra*.

[110] *See, e.g.*, "Appendix" § 7 *infra* at page 298. For the rationale underlying such a provision, *see* notes 58, 73 and accompanying text *supra*.

[111] *See, e.g.*, "Appendix" § 10 *infra* at page 298. For the rationale underlying such a provision, *see* notes 28-29 and accompanying text *supra*.

[112] *See, e.g.*, "Appendix" § 13 *infra* at page 299. For the rationale underlying such a provision, *see* notes 44-45 and accompanying text *supra*.

[113] *See, e.g.*, "Appendix" § 11 *infra* at page 298. For the rationale underlying such a provision, *see* notes 30-33, 41 and accompanying text *supra*.

[114] *See, e.g.*, "Appendix" § 14 *infra* at page 299. For the rationale underlying such a provision, *see* notes 30-33 and accompanying text *supra*. This provision is merely a codification of the common law tort remedies available in California for victims of insurers' bad faith claims practices.

[115] *See, e.g.*, "Appendix" § 6(c) *infra* at page 298. For the rationale underlying such a provision, *see* note 31 and accompanying text *supra*.

ing insurer concealment of material facts.[116] Such a provision should permit an insured to both rescind the policy-contract *and* sue the insurer for actual and exemplary damages resulting from the insurer's failure to disclose material facts.

CONCLUSION

There is a great need to increase regulation of industrial life insurance sales in California to prevent abuses against industrial insureds such as Mrs. D. Excessive costs, low value and numerous marketing and claims abuses characterize industrial life insurance. Nevertheless, existing California law exempts industrial life insurance from many insurance regulations.

New York's regulatory scheme offers the most comprehensive existing protection against the problems of industrial insurance. Even broader regulation is necessary, however, to improve the value and lower the costs of industrial life insurance more effectively, and to avoid the numerous marketing and claims abuses.

In California, judicial recognition of a new tort, breach of an insurer's duty to disclose material facts, would significantly contribute to effective regulation. The pervasive problems of industrial life insurance, however, require comprehensive legislation. This comment suggests a package of reforms for the industrial life insurance industry which would increase value, prevent abuses and provide remedies for insurer misconduct.

William T. Eliopoulos

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[116] *See, e.g.*, "Appendix" § 12 *infra* at page 299. For the rationale underlying such a provision, *see* notes 88-97 and accompanying text *supra*.

APPENDIX

Proposed Insurance Code Statute

§ 1 *Definition of Industrial Life Insurance.*

The term "industrial life insurance," as used in this chapter, shall refer to that form of life insurance under which the premiums are collected at the policyholder's home and where the face amount of insurance provided is greater than $3,000 but less than $5,000.

§ 2 *Minimum Face Value and Frequency of Collection.*

No industrial life insurance policy shall be sold:

(a) which has a face value of less than $3,000; or

(b) which provides for home premium collection more frequently than monthly.

§ 3 *Policy Review By Insurance Commissioner.*

All industrial life insurance policies and their rate schedules must be filed with and approved by the Insurance Commissioner before sale of the policies to the public. The Commissioner shall disapprove any such policy which contains provisions or rates which are unfair or of inadequate economic benefit to policyholders.

Under this section, the Commissioner shall have authority to disapprove new policies as well as policies previously approved which have, since approval, failed to comply with the requirements of this section.

§ 4 *Self-Supporting Policies.*[117]

Each policy of industrial life insurance shall be self-supporting on reasonable assumptions as to interest, mortality and expense. This requirement mandates the use of updated mortality statistics by insurers when calculating policy rates.

§ 5 *Standard Policy Provisions.*[118]

No policy of industrial life insurance shall be delivered or issued

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[117] This section is modeled after N.Y. INS. LAW § 213-a(8) (McKinney 1966).

[118] Subsection (a) is modeled after N.Y. INS. LAW § 163(1)(d) (McKinney 1966). Subsection (b) is modeled after N.Y. INS. LAW § 208-a(b) (McKinney 1966), and N.Y. INS. LAW §§ 163(1)(f), (g) (McKinney 1966). Subsection (d) is modeled after N.Y. INS. LAW § 163(1)(h) (McKinney 1966).

for delivery in this state unless it contains in substance the following provisions (in addition to any other applicable provisions required under this Code), or provisions which in the opinion of the Commissioner are more favorable to policyholders:

(a) A provision that if the age of the person insured has been misstated, any amount payable or benefit accruing under the policy shall be that which the premium would have purchased at the correct age.

(b) A provision specifying that in the event of default in the payment of any premium after premiums shall have been paid for no longer than three years, the insured shall be entitled to cash surrender or nonforfeiture benefits as specified for ordinary life insurance under sections 10160 and 10151 of this Code. Such provision shall also contain a table showing in figures any cash surrender value and nonforfeiture benefits available during each of the first twenty years after issuance of the policy.

(1) All cash surrender and nonforfeiture benefits under this section shall be calculated according to the most recent Standard Ordinary Mortality Table.[119]

(c) A provision that the policy may be reinstated at any time within two years from the due date of the premium in default unless the cash value has been paid, upon the production of evidence of insurability and good health satisfactory to the insurer and the payment of all overdue premiums.

§ 6 *First-Year Agent Commissions*[120] *and Bonuses;*[121] *Manager Bonuses.*

(a) On first-year premiums of industrial life insurance policies, no company shall pay any agent or field representative a rate of commission, exclusive of collection and conservation commissions, in excess of first-year commissions which would be payable on a comparable ordinary life insurance policy.

(b) No company selling industrial life insurance shall pay any bonus, prize or reward of any kind or any increased or additional commissions or compensation of any kind, based upon the volume of new business or aggregate number of policies written.

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[119] If the study by the American Society of Actuaries concludes that use of a separate Standard *Industrial* Mortality Table is justified, the provision should substitute this table for "Standard Ordinary Mortality Table." For further explanation, *see* note 106 *supra.*

[120] This section is modeled after N.Y. INS. LAW § 213-a(7) (McKinney 1966).

[121] This section is modeled after N.Y. INS. LAW § 213-a(6) (McKinney 1966).

(c) No company selling industrial life insurance shall pay (or withhold) any bonus, prize or other compensation to (or from) its managers or other employees based on the number of policyholder claims which have been paid.

§ 7 *Roll Over.*

No insurance company or agent shall induce a policyholder to lapse an industrial life insurance policy and purchase another to replace it unless such inducement is made for the benefit of the policyholder and all material negative consequences of the lapse are communicated to the policyholder.

§ 8 *Overloading.*[122]

Any industrial life insurance policy is prohibited if sold with knowledge that the face value of the policy, together with the face values of all other industrial life insurance policies on the insured, exceed $5,000.

§ 9 *Debit Accounting Requirements.*

Any company selling industrial life insurance must keep records of each individual payment and transaction of insurance by its policyholders in its home office, and such records shall be open for immediate inspection by the Insurance Commissioner.

§ 10 *Blind Advances.*

No agent or company selling industrial life insurance shall accept advance premium payments of the policyholder without crediting such payments to the policyholder's account. Such credit will include the amount of interest accruing on the payment from the date it is received by the insurance company to the due date of the premium to which the payment is actually applied. Those who accept such payment without crediting the policyholder's account shall be punishable for "theft" under Penal Code Section 484.

§ 11 *Bad Faith Claims Practices.*

Any payment or withholding of claims in bad faith, or settlement of claims in bad faith, by an insurance company is prohibited.

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[122] This section is modeled after N.Y. INS. LAW § 201(1) (McKinney 1966).

§ 12 *Insurer Concealment.*

The bad faith failure of an insurance company or its agent to disclose material facts of which it has knowledge about the insurance purchase to the policyholder shall allow the policyholder to rescind the policy, recover all premiums paid and sue the insurer for actual and exemplary damages. Such material facts shall include those listed in the policy, as well as those relating to the circumstances of the insured which a reasonably prudent insurer or agent would believe to be material to the customer's decision to purchase the insurance.

§ 13 *Certificates of Convenience: Industrial Insurance Agents.*

No certificates of convenience shall be issued to any industrial insurance agent after January 1, 1981.

§ 14 *Consumer Remedies.*

Practices in violation of sections 7, 8, 10, 11 and 12 of this article may render the company liable for actual and exemplary damages.

§ 15 *Penalties.*

Violations of sections 4, 5, 6 and 9 of this article shall, within the discretion of the Insurance Commissioner, result in the suspension of the violating company's license, or a $5,000 fine, or both.