attitude of our society to alcoholism, it is not surprising that the court felt obligated to decide this issue. By emphasizing the claimant's "voluntary control of the use of alcohol," the court has successfully adopted contemporary theories on alcoholism.[80] The *Adams* holding illustrates that the concept of a compensable disability can change to meet the evolving needs of society.

Fredd Joseph Haas

INSURANCE—THE DOCTRINE OF IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING APPLIES TO CANCELLATION CLAUSE OF MEDICAL MALPRACTICE INSURANCE POLICY.—*Spindle v. Travelers Insurance Cos.* (Cal. Ct. App. 1977).

Plaintiff Spindle, a physician, was issued a malpractice insurance policy from defendant Phoenix Insurance Co., a subsidiary corporation of codefendant Travelers Insurance Co., pursuant to a master insurance contract with the Southern California Physicians Council of which plaintiff was a member. The policy contained a standard cancellation clause which gave the insured and the insurer an absolute right to cancel.[1] Defendant Phoenix Insurance Co. exercised this right of cancellation and Spindle brought suit against both insurers to recover compensatory, punitive and special damages for the alleged bad faith cancellation of his malpractice insurance policy. Spindle based his cause of action on the ground that Phoenix's purpose in cancelling the policy was to coerce the Southern California Physicians Council into accepting higher insurance premiums.[2] The trial court sustained defendant's demurrer to plaintiff's amended complaint and dismissed, ruling that plaintiff had failed to state a

80. *See* Driver v. Hinnant, 356 F.2d 761 (4th Cir. 1966) (chronic alcoholism cannot be the basis for judgment of criminal conviction).

1. The cancellation clause, which is standard in all malpractice insurance policies, read:

> This policy may be cancelled by the named insured, by surrender thereof to the company, or any of its authorized agents, or by mailing to the company written notice stating when thereafter the cancellation shall be effective. This policy may be cancelled by the company by mailing to the named insured, at the address shown on this policy, written notice stating when, not less than thirty days thereafter, such cancellation shall be effective. The mailing of notice as aforesaid shall be sufficient proof of notice. The time of surrender of the effective date and hour of cancellation stated in the notice shall become the end of the policy. Delivery of such written notice, either by the named insured, or by the company, shall be equivalent to mailing.

Brief for Appellant at 6, Spindle v. Travelers Ins. Cos., 66 Cal. App. 3d 951, 956, 136 Cal. Rptr. 404, 406-07 (1977).

2. More specifically, plaintiff alleged defendant Phoenix "breached 'its implied obligation to plaintiff [to act in good faith] . . . did not act in good faith and did not deal fairly with plaintiff,' but cancelled his policy 'willfully, with malice, and with the intent and purpose to hurt, harm and injure the plaintiff in the practice of his profession.' " Spindle v. Travelers Ins. Cos., 66 Cal. App. 3d 951, 954-55, 136 Cal. Rptr. 404, 406 (1977).

cause of action. The plaintiff appealed from the judgment dismissing his complaint contending that the defendant did not have an absolute right to cancel the policy. *Held*, reversed. The doctrine of implied covenant of good faith and fair dealing is applicable to the cancellation provisions of a malpractice policy. *Spindle v. Travelers Insurance Cos.*, 66 Cal. App. 3d 951, 136 Cal. Rptr. 404 (1977).

The *Spindle* court was presented with the question of whether an insurer's absolute right of cancellation contained in a malpractice insurance policy is limited to good faith cancellations. Prior to the *Spindle* decision, the California courts had not had occasion to consider limitations on an insurer's motives in cancelling malpractice insurance policies. However, Justice Jefferson, for a unanimous court in *Spindle*, found that the doctrine of implied covenant of good faith and fair dealing which had in the past been held applicable to an insurance company's failure to settle[3] and failure to pay claims to the insured,[4] also extended to the cancellation provisions of a malpractice insurance policy.[5]

Cancellation provisions in insurance agreements are either reserved in the policy itself, provided for by statute or effectuated by concurrent agreement of the parties.[6] The insurance policy will normally contain a provision which gives both parties an absolute right to cancel, a right more often exercised by the insurer than the insured.[7] The clauses usually provide for the giving of proper notice[8] and the return of the unearned premium.[9] The cancellation clause benefits both parties to the insurance policy. The insured is able to obtain insurance without delay;[10] and an agent may deliver the policy before investigation of the insured is completed, subject to the insurer's reserved right to cancel the policy.[11] The insurer profits by the inclusion of the cancellation clause because if the insured becomes a greater risk than initially anticipated, the policy may be cancelled.[12]

The standard cancellation clause in most insurance policies gives both par-

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3. Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958) (insurer failed to agree to a settlement proposed by a plaintiff suing its insured when there was a good probability of a judgment in excess of the policy's liability limits).

4. Silberg v. California Life Ins. Co., 11 Cal. 3d 452, 113 Cal. Rptr. 711, 521 P.2d 1103 (1974).

5. Spindle v. Travelers Ins. Cos., 66 Cal. App. 3d 951, 958-59, 136 Cal. Rptr. 404, 408 (1977).

6. Prudential Ins. Co. of Am. v. Ferguson, 51 Ga. App. 341, 346, 180 S.E. 503, 506 (1935).

7. Smoot, *The Cancellation Clause*, 295 INS. L. J. 675, 676 (1947) [hereinafter cited as Smoot].

8. *See generally* Davidson v. German Ins. Co., 74 N.J.L. 487, 65 A. 996 (1907). *See* IOWA CODE § 514A.3(2)h (1977).

9. *See generally* German Union Fire Ins. Co. v. Fred G. Clarke Co., 116 Md. 622, —, 82 A. 974, 975-76 (1911).

10. *See* Smoot, *supra* note 7, at 675.

11. *Id.*

12. *Id.* Comment, *Insurance—Cancellation Clause—Improper Motive Invalidates Insurer's Cancellation*, 54 IOWA L. REV. 649, 650 (1969) [hereinafter cited as IOWA Comment].

ties an absolute right to cancel; consequently, in the past the motives for cancellation have been considered immaterial.[13] For example, in *Camp v. Aetna Insurance Co.*,[14] a judge delivered his charge to the jury in which he denounced the insurance industry and its practices. Shortly thereafter, the fire insurance policy he held with an insurance company was cancelled. The judge brought suit against the insurance company alleging the motive for cancellation was to chastise and intimidate him and therefore the cancellation should be enjoined as against public policy.[15] A Georgia Supreme Court Justice, in a concurring opinion, found that since there was no fraud on the part of the insurance company, the judge was bound by the contract terms.[16]

The rule of "motive immaterial" is rooted in the doctrine of freedom of contract.[17] The doctrine is grounded on the belief that the individuals are free to bargain for themselves as to the terms of the contract they enter into and to choose the person they wish to have as a party to the agreement.[18] The doctrine of freedom of contract presupposes that there is equality of bargaining power between the parties and that the terms of the contract are not predetermined before the parties negotiate the agreement.[19]

Although some courts have been willing to protect insured persons who have not truly "bargained" for a particular clause in an insurance contract by reconstructing an "ambiguous" clause,[20] other courts have held that a contract term permitting an insurer to terminate "for any other cause the company shall so elect" prohibits judicial interference.[21] Therefore, a court need not inquire into the motive for cancellation of the policy.[22]

In determining whether or not an implied covenant of good faith is applicable to a cancellation clause in a malpractice insurance policy, the *Spindle* court first acknowledged that at least one court has stated that improper motives

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13. International Life Ins. & Trust Co. v. Franklin Fire Ins. & Trust Co., 66 N.Y. 119, 35 N.Y.S. Appendix 40 (1876).

14. 170 Ga. 46, 152 S.E. 41 (1930).

15. Camp v. Aetna Ins. Co., 170 Ga. 46, 47, 152 S.E. 41, 42 (1930).

16. *Id.* at 48, 152 S.E. at 43 (Atkinson, J., concurring); IOWA comment, *supra* note 12, at 651.

17. The freedom of contract doctrine was defended in Paramount Pictures Theatres Corp. v. Partmar Corp., 97 F. Supp. 552, 557-58 (S.D. Cal. 1951):

> One of our fundamental legal rights is that of making contracts. Contracts freely made should be upheld. It is not the duty of courts to look for some reason to set aside contracts freely entered into by and between individuals of their own volition; for individuals should have the right to make contracts as they see fit. The courts should seek reasons to sustain existing contracts legally entered into. Hence, as we see it, the duty of this court is to uphold the contract entered into between Paramount and Partmar, unless it was entered into because of misrepresentation, fraud, undue influence, et cetera, or unless the contract is illegal and void because it violates statutory provisions.

18. *See generally* Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 630 (1943) [hereinafter cited as Kessler].

19. *Id.*

20. *Id.*

21. International Life Ins. & Trust Co. v. Franklin Fire Ins. & Trust Co., 66 N.Y. 119, 35 N.Y.S. Appendix 40 (1876).

22. *See* Jablonski v. Washington Co. Mut. Fire Ins. Co., 15 Ill. App. 2d 499, 142 N.E.2d 170 (1957).

in cancelling a malpractice insurance policy constitutes a breach of contract.[23] In *L'Orange v. Medical Protective Co.*,[24] an insurance company cancelled a dentist's malpractice insurance policy after he testified in a malpractice case in which a judgment was rendered against another dentist insured by the same company. The dentist in *L'Orange* alleged that the insurance company had cancelled his policy to prevent him from testifying as a witness in a court of law. The court held the cancellation was to effectuate an illegal purpose—to intimidate and threaten a witness—and therefore constituted a breach of contract.[25] However, the applicability of *L'Orange* to the situation in *Spindle* would appear to be restricted due to the fact that the *L'Orange* holding limits improper motives for cancellation to illegal acts which are violative of public policy.[26] Nevertheless, the holding in *L'Orange* may be viewed as the beginning of a trend towards examination by the courts of the motives of the insurer in cancelling a policy.

The trend is also apparent in contractual agreements other than insurance policies where courts have limited cancellation provisions by the public policy considerations. For example, although an employment contract may be terminable at will,[27] one court has held that an employer could not terminate the contract in order to punish an employee who would not perjure himself.[28] A landlord's power of eviction over a tenant at will has also been limited by considerations of public policy.[29]

The California Supreme Court in *Spindle* found that there had been no express public policy basis announced by the California courts by which to limit the bad faith cancellation of malpractice insurance.[30] However, several statutes had been enacted by the California legislature which severely restrict an insur-

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23. Spindle v. Travelers Ins. Cos., 66 Cal. App. 3d 951, —, 136 Cal. Rptr. 404, 407 (1977).

24. 394 F.2d 57 (6th Cir. 1968).

25. L'Orange v. Medical Protective Co., 394 F.2d 57, 62-63 (6th Cir. 1968).

26. *Id.* The *Spindle* court stated that there was an "absence of an expressed 'public policy' basis pursuant to existing California decisional law" upon which to find a legal remedy when such a cancellation occurs. Spindle v. Travelers Ins. Co., 66 Cal. App. 3d 951, 954, 136 Cal. Rptr. 404, 407 (1977).

27. *See* Lim v. Motor Supply, Ltd., 45 Hawaii 111, —, 364 P.2d 38, 45 (1961).

28. Petermann v. International Brotherhood of Teamsters Local 396, 174 Cal. App. 2d 184, 344 P.2d 25 (1959).

29. Edwards v. Habib, 397 F.2d 687, 699-701 (D.C. Cir. 1968) (court held that a landlord could not use eviction as retaliation against a tenant who had reported housing code violations; the court's decision was based on considerations of statutory construction and public policy).

> In trying to effect the will of Congress and as a court of equity we have the responsibility to consider the social context in which our decisions will have operational effect. In light of the appalling condition and shortage of housing in Washington, the expense of moving, the inequality of bargaining power between tenant and landlord, and the social and economic importance of assuring at least minimum standards in housing conditions, we do not hesitate to declare that retaliatory eviction cannot be tolerated.

Id. at 701.

30. Spindle v. Travelers Ins. Cos., 66 Cal. App. 3d 951, 956, 136 Cal. Rptr. 404, 407 (1977).

er's right to cancel automobile liability and property loss insurance policies.[31] The court concluded on the basis of these statutes that the right to cancel insurance policies in California was therefore not absolute.[32] The statutes were, according to the court, an expression of legislative policy to limit the scope of cancellation clauses. By analogy, this legislative policy can be applied to the type of cancellation clause in the instant case[33] to thus limit an insurer's right to cancel malpractice insurance policies.

The California court also noted that an area of case law had developed which pertained to the matter of bad faith in carrying out the terms of insurance contracts.[34] In earlier decisions, an implied covenant of good faith and fair dealing had been applied to the settlement of third party claims[35] and to the claims of the insured.[36] In *Comunale v. Traders & General Insurance Co.*,[37] the California Supreme Court defined the implied covenant of good faith and fair dealing as being a promise "that neither party will do anything which will injure the right of the other to receive the benefits of the agreement,"[38] and applied the doctrine to the settlement of third party claims against the insured.[39] The California Supreme Court in *Spindle* extended the *Comunale* rule to the cancellation clause of an insurance policy. The court could find no logical reason for distinguishing between bad faith conduct by the insurer in settling claims and bad faith conduct in the cancelling of policies.[40] The situations are very similar in that both types of action by the insurer results in the insured being deprived of the benefit of his bargain.[41] The court noted that depriving the insured of the benefit of his bargain in the cancellation of his malpractice insurance is greater than in other types of insurance policies "due to the lack of competition in the field of malpractice insurance."[42] Therefore, the court concluded that public policy required that the cancellation provisions in malpractice policies be limited by the implied covenant of good faith and fair dealing.[43]

The approach of the *Spindle* court in limiting the bad faith cancellation of malpractice insurance policies marks a significant departure from past judicial decisions concerned with cancellation clauses in insurance policies in general. The *Spindle* court is so far the only court to apply an implied covenant

31. *Id., citing* CAL. INS. CODE §§ 661, 676 (West 1972) and 674.71 (West Supp. 1977).
32. Spindle v. Travelers Ins. Cos., 66 Cal. App. 3d 951, 956, 136 Cal. Rptr. 404, 407 (1977).
33. *Id.*
34. *Id.*
35. Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, 328 P.2d 198 (1958).
36. Silberg v. California Life Ins. Co., 11 Cal. 3d 452, 521 P.2d 1103, 113 Cal. Rptr. 711 (1974).
37. 50 Cal. 2d 654, 328 P.2d 198 (1958).
38. Comunale v. Traders & Gen. Ins. Co., 50 Cal. 2d 654, —, 328 P.2d 198, 200 (1958).
39. *Id.*
40. Spindle v. Travelers Ins. Cos., 66 Cal. App. 3d 951, 958, 136 Cal. Rptr. 404, 408 (1977).
41. *Id.*
42. *Id.*
43. *Id.*

of good faith and fair dealing to the bad faith cancellation of a malpractice insurance policy. However, many courts have employed various other approaches to the problem of arbitrary or bad faith cancellation of insurance policies in general. Another well recognized approach is the adoption of legislative standards which delineate the permissible reasons for cancellation.[44] The enactment of such legislative standards alleviates the infirmities present in judicial control over the cancellation power. The most serious limitation on judicial regulation of the insurer's use of the cancellation clause is the problem of defining the criteria for determining improper motives for cancellation.[45] The courts necessarily are left to develop the criteria on a case by case basis, thus achieving the undesirable result of leaving both the insured and insurer uncertain as to what motives are reasonable in cancelling the policy.[46]

Legislative enactments delineating permissible motives for the cancellation of automobile liability insurance have been recently enacted in several states.[47] Such legislative enactments designate as justifiable, for example, cancellation of an automobile liability insurance policy where there is a failure by the insured to comply with the conditions of the contract,[48] or where there is some action on the part of the insured which prevents the insurer from gaining full knowledge of the nature of the risk.[49] Both types of justifications for cancelling give the insurer reasonable latitude in his control over the cancellation of the policy while at the same time protecting the insured with certain limitations which reduce the possibility of arbitrary or bad faith cancellation by the insurer.[50]

The allowable reasons for the cancellation of automobile liability policies would appear applicable to the cancellation of malpractice insurance policies.[51]

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44. This approach was noted by the *Spindle* court with reference to particular kinds of insurance policies. *Id.* at 957, 136 Cal. Rptr. at 407.

45. *See* Iowa Comment, *supra* note 12, at 656.

46. *Id.*

47. *Id., citing* Cal. Ins. Code § 2371 (West 1972); Ga. Code Ann. § 56-2430 (1977); Iowa Code § 515D.4 (1977); Me. Rev. Stat. tit. 24-A., § 2914 (1964); Mo. Ann. Stat. § 379.114 (Vernon Supp. 1977).

48. Iowa Code § 515D.4 (1977). The permissible reasons for failure to comply with the conditions of the contract include nonpayment of the premium and violation of terms or conditions of the policy.

49. *Id.* These acts include fraud or material misrepresentation of some factor which affects the insurer's risk. *Id.* at § 515D.4(3).

50. *See generally* Ghiardi & Wienke, *Recent Developments in the Cancellation, Renewal and Rescission of Automobile Insurance Policies*, 51 Marq. L. Rev. 219 (1967) [hereinafter cited as Ghiardi & Wienke].

51. A typical example of this type of statute is Iowa Code § 515D.4 (1977) which provides:

> No policy may be cancelled except by notice to the insured as provided in this chapter. No notice of cancellation of a policy shall be effective unless it is based on one or more of the following reasons:
> (1) Nonpayment of premium.
> (2) Nonpayment of dues to an association or organization other than an insurance association or organization, where payment of dues is a prerequisite to obtaining or continuing insurance in force and the dues payment requirement was in effect prior to January 1, 1969.
> (3) Fraud or material misrepresentation affecting the policy or the presentation of a claim.
> (4) Violation of terms or conditions of the policy.
> (5) The named insured or any operator who either resides in the same household

The permissible reasons for the cancellation of the malpractice insurance policy would therefore usually be limited to failure to comply with conditions of the contract and failure to disclose the full extent of the nature of the risk involved. The necessity for the application of such limitations to malpractice insurance policies becomes especially strong in light of the physician's role in society. The physician depends as heavily, if not more so, on malpractice insurance as does the automobile driver on automobile insurance.[52] The physician is an essential component of society and deserves as much protection from arbitrary or bad faith cancellation of his liability policy as the driver of an automobile. With the limited competition in the field of malpractice insurance,[53] the physican faces a serious situation if his policy is cancelled; not only is he labelled a "bad risk," thus making future coverage difficult,[54] he is also precluded from pursuing his livelihood until adequate coverage is obtained. Therefore, the adoption of legislative standards limiting the reasons for the cancellation of malpractice insurance is urgently needed for the protection of the physician, with such enactments patterned after the types of statutes applicable to automobile liability insurance.[55]

Another alternative to judicial control over the cancellation of malpractice insurance policies through the use of the implied covenant of good faith is the application of the "reasonable expectations" doctrine to the cancellation clause in malpractice insurance policies.[56] This doctrine states that the expectations of the insured as to the coverage allowed under the policy is not to be frustrated by ambiguous exclusionary clauses[57] or false representations by the insurer. Several states have applied the reasonable expectations doctrine[58] to insurance

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> or customarily operates an automobile insured under the policy has his driver's license suspended or revoked during the policy term or, if the policy is a renewal, during its term or the one hundred eighty days immediately preceding its effective date.
>
> This section shall not apply to any policy or coverage which has been in effect less than sixty days at the time notice of cancellation is mailed or delivered by the insurer unless it is renewal policy. This section shall not apply to the nonrenewal of a policy.
>
> During the policy period no modification of automobile physical damage coverage, except coverage for loss caused by collision, whereby provision is made for the application of a deductible amount not exceeding one hundred dollars shall be deemed a cancellation of the coverage or of the policy.

52. *See* IOWA Comment, *supra* note 12, at 656-57.

53. *Id.*; Spindle v. Travelers Ins. Cos., 66 Cal. App. 3d 951, 958, 136 Cal. Rptr. 404, 408 (1977).

54. *See* Ghiardi & Wienke, *supra* note 50, at 250.

55. *E.g.*, IOWA CODE § 515D.4 (1977).

56. The doctrine of reasonable expectations is based on the premise that insurance agreements are adhesion contracts in which the insured has no bargaining power to determine the terms of the policy. The doctrine states that as to the terms of the policy, the insured's reasonable expectations will control when ambiguity exists or when the insurer has made misrepresentations as to the coverage of the policy. For a good explanation of the reasonable expectations doctrine *see* Note, *Reasonable Expectations: The Insurer's Dilemma*, 24 DRAKE L. REV. 853 (1975).

57. C & J Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 169, 176 (Iowa 1975); Gray v. Zurich Ins. Co., 65 Cal. 2d 263, —, 419 P.2d 168, 171, 54 Cal. Rptr. 104, 107 (1966).

58. *See generally* Kessler, *supra* note 18.

agreements because of the "adhesion" character of such agreements.[59] In such cases, the application of the reasonable expectations doctrine protects the insured because he does not always fully understand the terms of the contract[60] and must rely on the representations of the insurer as to the contents of the agreement.[61]

In the *Spindle* case, the plaintiff alleged that the insurer represented to him that if all the conditions precedent were complied with and there were not excessive claims against him, the policy would not be cancelled.[62] As plaintiff did comply with all of the insurer's requirements the application of the "reasonable expectations" doctrine would seem to have prevented the insurer from cancelling. However, California limits the doctrine of reasonable expectations to ambiguous exclusionary liability clauses in insurance agreements and therefore such an argument in the principal case would probably have failed had it been argued.[63]

Other jurisdictions have applied the reasonable expectations doctrine in varying degrees to insurance policies. The Iowa Supreme Court, for example, has extended the doctrine of reasonable expectations to situations where the policy is unambiguous and the insurer made no misrepresentations as to the extent of policy coverage on which the insured relied.[64]

The logical extension of the doctrine of reasonable expectations is to the cancellation provisions in insurance agreements of the type in the principal case,[65] thus limiting the reasons for cancelling the policy by the insurer to those that are reasonably expected by the insured.

The growing necessity for medical malpractice insurance and the limits on its availability dictated the result in *Spindle*. The limitation on the absolute right of cancellation[66] announced by the California Supreme Court marks a departure from past decisions[67] which have analyzed cancellation clauses of insurance agreements. The absolute right of the insurer to cancel malpractice insurance policies is a power which must be limited by either the legislature or the judiciary. The application of an implied covenant of good faith and fair dealing

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59. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 966 (1970).

60. *See* Jones v. Continental Cas. Co., 123 N.J. Super. 353, —, 303 A.2d 91, 94-95 (Ch. Div. 1973).

61. Gray v. Zurich Ins. Co., 65 Cal. 2d 263, —, 419 P.2d 168, 171, 54 Cal. Rptr. 104, 107 (1966).

62. Spindle v. Travelers Ins. Cos., 66 Cal. App. 3d 951, 954, 136 Cal. Rptr. 404, 405 (1977).

63. Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966).

64. *See* C & J Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 169, 176-77 (Iowa 1975) (court held that even though the clause, which required physical signs of force and violence to the exterior of the insured's premises was unambiguous, the insured's reasonable expectations controlled).

65. Spindle v. Travelers Ins. Cos., 66 Cal. App. 3d 951, 958, 136 Cal. Rptr. 404, 408 (1977).

66. *Id.*

67. *E.g.*, Camp v. Aetna Ins. Co., 170 Ga. 46, 152 S.E. 41 (1930); Jablonski v. Washington Co. Mut. Fire Ins. Co., 15 Ill. App. 2d 499, 142 N.E.2d 170 (1957).

to the cancellation of malpractice insurance policies espoused by the California court in the principal case represents a much needed limitation. However, the most appropriate limitation is provided by legislative enactments declaring the circumstances justifying cancellation of the insurance policy. This alternative to the doctrine of implied covenant of good faith and fair dealing would enable both parties to the agreement to know with a degree of certainty the acts which would give rise to cancellation by the insurer, and would thus disallow cancellation for improper motives. At a minimum, other jurisdictions should follow the wisdom of *Spindle* and limit by judicial control an insurer's right to cancel for arbitrary or bad faith reasons.

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