UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	CV 08-956 DSF (RZx)	Date	4/21/08
Title	California Joint Powers Insurance Authority v. Munich Reinsurance America, Inc.		

Present: The Honorable	DALE S. FISCHER, United States District Judge

Paul D. Pierson	Not Present
Deputy Clerk	Court Reporter
Attorneys Present for Plaintiffs:	Attorneys Present for Defendants:
Not Present	Not Present

Proceedings: (In Chambers) Order GRANTING Defendant's Motion To Dismiss

This matter is before the Court on Defendant's Motion To Dismiss Plaintiff's Complaint Pursuant to Federal Rule 12(b)(6) and Alternative Motion To Strike Pursuant to Federal Rule 12(f). Defendant contends that Plaintiff's Second Cause of Action for breach of the implied covenant of good faith and fair dealing should be dismissed, as reinsureds may not recover tort damages for the breach of the implied covenant of good faith and fair dealing. In the alternative, Defendant argues that Plaintiff's prayer for punitive damages should be stricken.

The Court deems this matter appropriate for decision without oral argument. See Fed. R. Civ. P. 78; Local Rule 7-15. For the following reasons, the Court GRANTS Defendant's Motion.

I. FACTS[1]

Plaintiff California Joint Powers Insurance Authority is a joint powers self-insured retention pool consisting of numerous California public agencies. (Compl. ¶ 1.) Plaintiff provides general liability and special liability coverage to its members for amounts in excess of $1 million per occurrence, with a maximum of $50 million in protection. (Id. ¶ 3.) The City of Rancho Palos Verdes is a member. (Id. ¶ 5.) Defendant Munich

[1] The allegations of the Complaint are taken as true for purposes of this motion only.

Reinsurance America, Inc. reinsured Plaintiff pursuant to two agreements. (Id. ¶ 4.)

In 1978, Rancho Palos Verdes enacted a moratorium on development in part of the city due to concern about landslides. (Id. ¶ 7.) Certain developers objected to a 2002 extension of the moratorium that they felt improperly shifted the burden to them to demonstrate geological stability before being excepted from the moratorium. (Id. ¶ 8.) Litigation ensued, and the city tendered a claim to Plaintiff for indemnity and defense. (Id. ¶¶ 9, 13.) Plaintiff provided a defense under a reservation of rights, and later tendered a claim to Defendant. (Id. ¶¶ 14-15.)

The developers' claims were mediated, resulting in a settlement of $4.25 million paid by the city. (Id. ¶ 28.) However, Defendant declined to provide reinsurance coverage to Plaintiff on several bases, including apparent disagreement with Plaintiff regarding whether the city's claims were covered under the policy between Plaintiff and the city. (Id. ¶ 29.)

Plaintiff filed its Complaint on February 12, 2008, asserting causes of action for (1) breach of contract, (2) breach of the implied covenant of good faith and fair dealing, and (3) declaratory relief. Plaintiff's second cause of action alleges that Defendant "tortiously breached the implied covenant of good faith and fair dealing" (id. ¶ 41) and seeks punitive damages (id. ¶ 48).

II. LEGAL STANDARD

A motion pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure tests the legal sufficiency of the pleadings. "When a federal court reviews the sufficiency of a complaint, before the reception of any evidence by affidavit or admissions, its task is necessarily a limited one. The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." Scheuer v. Rhodes, 416 U.S. 232, 236 (1974), overruled on other grounds by Harlow v. Fitzgerald, 457 U.S. 800 (1982).

The plaintiff bears the burden of pleading sufficient facts to state a claim. Courts will not supply essential elements of a claim that are not initially pled. Richards v. Harper, 864 F.2d 85, 88 (9th Cir. 1988). "[W]hen ruling on a defendant's motion to dismiss, a judge must accept as true all of the factual allegations contained in the complaint." Erickson, 127 S. Ct. at 2200. "Dismissal can be based on the lack of a cognizable legal theory or the absence of sufficient facts alleged under a cognizable legal theory." Balistreri v. Pacifica Police Dept., 901 F.2d 696, 699 (9th Cir. 1990).

"If a complaint is dismissed for failure to state a claim, leave to amend should be granted unless the court determines that the allegation of other facts consistent with the challenged pleading could not possibly cure the deficiency." Schreiber Distrib. Co. v. Serv-Well Furniture Co., 806 F.2d 1393, 1401 (9th Cir. 1986). Leave to amend should

be granted even if the plaintiff did not request leave, unless it is clear that the complaint cannot be cured by the allegation of different facts. Doe v. United States, 58 F.3d 494, 497 (9th Cir. 1995).

III. DISCUSSION

Defendant contends that Plaintiff's second cause of action should be dismissed, as reinsureds may not recover in tort for the breach of the implied covenant of good faith and fair dealing. Research by the parties and the Court reveals no California authority addressing this question.[2] In the absence of California Supreme Court precedent, this Court must apply the rule it believes the court would adopt under the circumstances. Wyler Summit P'ship v. Turner Broad. Sys., Inc., 135 F.3d 658, 663 n.10 (9th Cir. 1998). Based on the California Supreme Court's consistent limitation of tort recovery for breach of the covenant of good faith and fair dealing, the Court concludes that the California Supreme Court would not impose tort liability in the reinsurance context.

"Because the covenant of good faith and fair dealing essentially is a contract term that aims to effectuate the contractual intentions of the parties, compensation for its breach has almost always been limited to contract rather than tort remedies." Cates Constr., Inc. v. Talbot Partners, 21 Cal. 4th 28, 43 (1999) (internal quotation omitted). The exception is "when the actions that constitute the breach violate a social policy that merits the imposition of tort remedies." Erlich v. Menezes, 21 Cal. 4th 543, 552 (1999). California courts have found that an insurer's breach of the covenant of good faith and fair dealing violates social policy, justifying tort damages. Cates, 21 Cal. 4th at 43.

Reinsurance is a type of insurance. See Cal. Ins. Code § 620. However, the California Supreme Court has made clear that the availability of tort remedies depends not on the label attached to a contract but whether social policy supports the imposition of tort remedies for any class of contracts.[3] See Cates, 21 Cal. 4th at 47, 52. In Cates, the California Supreme Court held that there could be no tort recovery for breach of the

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[2] One California court of appeal concluded that a reinsured has no tort cause of action against a reinsurer for breach of the implied covenant. See Cent. Nat'l Ins. Co. v. Prudential Reinsurance Co., 241 Cal. Rptr. 773 (1987). However, the case was ordered de-published by the California Supreme Court, and cannot be relied on as precedent. See Cal. Rules of Ct. 8.1105, 8.1115. "A Supreme Court order to depublish is not an expression of the court's opinion of the correctness of the result of the decision or of any law stated in the opinion." Cal. Rule of Ct. 8.1125(d).

[3] Thus, Plaintiff's extensive reliance on authority stating the general rule of liability in insurance cases is misplaced.

implied covenant in a surety bond, despite the inclusion of surety bonds as a type of insurance in the California Insurance Code. 21 Cal. 4th at 47. Rejecting the argument that inclusion of surety bonds in the California Insurance Code automatically made tort damages applicable, the Court carefully considered the relationship between the parties to a surety bond in order to "evaluate whether the policy considerations recognized in the common law support the availability of tort remedies in the context of a performance bond." Id. at 52. This Court takes the same approach with regard to reinsurance contracts.

It does so, keeping in mind that "the insurance policy cases represent a major departure from traditional principles of contract law." Id. at 46. Consequently, California courts have been loathe to "extend the exceptional approach taken in those cases to another contract setting." Id. (denying tort recovery for breach of a surety bond); see also Erlich, 21 Cal. 4th at 548 (denying tort recovery for negligent breach of a contract to build a residence); Foley v. Interactive Data Corp., 47 Cal. 3d 654, 682-700 (1988) (denying tort recovery for breach of an employment agreement). Only where policy "justif[ies] the same extraordinary remedies that are available in insurance policy cases," will the California Supreme Court accord such relief. Cates, 21 Cal. 4th at 47.

"[T]ort remedies for breach of the implied covenant are permitted in the insurance policy setting for policy reasons pertaining to the distinctive nature of such contracts and the relationship between the contracting parties." Id. at 50. They are "considered appropriate . . . because such contracts are characterized by elements of adhesion and unequal bargaining power, public interest and fiduciary responsibility." Id. at 52. The relationship between reinsurer and reinsured does not implicate the same policy concerns.

"As defined by statute, [i]nsurance is a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event. The purpose of liability insurance is to protect the insured against losses from contingent or unknown risks of harm." Catholic Mut. Relief Soc. v. Super. Ct., 42 Cal. 4th 358, 367 (2007) (internal quotations and citations omitted). In contrast to liability insurance, "[a] contract of reinsurance is one by which an insurer procures a third person to insure him against loss or liability by reason of such original insurance." Cal. Ins. Code § 620. It is "obtained by insurance companies to help spread the burden of indemnification. A reinsurance company typically contracts with an insurance company to cover a specified portion of the insurance company's obligation to indemnify a policyholder. . . . This excess insurance . . . enables the insurance companies to write more policies than their reserves would otherwise sustain since [it] guarantees the ability to pay a part of all claims." Catholic Mut. Relief Soc., 42 Cal. 4th at 368. "Because a contract of reinsurance is defined by statute as a contract of indemnity made for the benefit of the liability insurer, as a general matter it has no relevance in an underlying tort

action brought against an insured under the policy of liability insurance. Indeed, the insurance code expressly provides that '[t]he original insured has no interest in a contract of reinsurance.' Id. at 367 (quoting Cal. Ins.Code § 623).[4]

Because reinsurance contracts are negotiated between sophisticated business entities, elements of adhesion and unequal bargaining power are generally absent. See Stonewall Ins. Co. v. Argonaut Ins. Co., 75 F. Supp. 2d 893, 909-10 (N.D. Ill. 1999) (describing the ability of reinsureds to defend themselves in contract negotiations and determining that tort damages are not recoverable by reinsureds under California law). Cates noted that tort recovery is justified in insurance cases, because "the vast majority of insureds . . . must accept insurance on a 'take-it-or-leave-it' basis." 21 Cal. 4th at 52. It found that where sophisticated entities engage in negotiations, the policies supporting tort recovery for over-matched original insureds are not implicated. Id. The Court thus finds that tort damages cannot be justified on the basis of an unequal bargaining position between the parties.

The public policy concerns supporting tort recovery for original insureds also are not implicated where an insurer obtains reinsurance. The California Supreme Court has identified two major public policy considerations supporting tort recovery in insurance cases. First, "insureds generally do not seek to obtain commercial advantages by purchasing policies; rather, they seek protection against calamity." Id. at 53. Thus, "[t]he insurers' obligations are . . . rooted in their status as purveyors of a vital service labeled quasi-public in nature." Foley, 47 Cal. 3d at 684-85 (quoting Egan v. Mut. of Omaha Ins. Co., 24 Cal. 3d 809, 820 (1979)). Second, "an insured faces a unique 'economic dilemma' when its insurer breaches the implied covenant of good faith and fair dealing. Unlike other parties in contract who typically may seek recourse in the marketplace in the event of a breach, an insured will not be able to find another insurance company willing to pay for a loss already incurred." Cates, 21 Cal. 4th at 43.

Reinsureds are not seeking "peace of mind and security in the event of an accident or other catastrophe." Id. Rather, insurers seek reinsurance in order "to write more policies than their reserves would otherwise sustain since [it] guarantees the ability to pay a part of all claims." Catholic Mut. Relief Soc., 42 Cal. 4th at 368. This provides a mere commercial advantage, and does not justify the imposition of tort liability. See Cates, 21 Cal. 4th at 53.

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[4] For this reason, Plaintiff's reliance on authority addressing excess liability insurance is misplaced. See Schwartz v. St. Farm Fire and Cas. Co., 88 Cal. App. 4th 1329 (2001). Excess liability insurance provides coverage for an original insured where liabilities exceed a primary insurance policy. See id. at 1333. Reinsurance provides indemnity for the insurer. The policy concerns that justify the imposition of tort damages where individual insureds are involved do not apply where the parties are both sophisticated business entities.

Reinsureds do face the economic dilemma recognized by the California Supreme Court. In the event of non-payment by the reinsurer, they are not able "to find another insurance company willing to pay for a loss already incurred." Id. at 43. However, given the "extraordinary" nature of tort relief for breach of an insurance agreement, id. at 47, and the California Supreme Court's consistent limitation of the grounds for that relief, the Court concludes that this concern alone is not sufficient to impose tort liability on reinsurers. This is particularly true as a reinsured facing this dilemma is a sophisticated business entity capable of incorporating risk of non-payment into its reinsurance agreement.

Finally, the California Supreme Court has found that the fiduciary relationship between insurer and insured justifies the imposition of tort remedies. The Court has "observed that the tort duty of a liability insurer ordinarily is based on its assumption of the insured's defense and of settlement negotiations of third party claims. The assumption of those responsibilities obligates the insurer to give at least as much consideration to the welfare of its insured as it gives to its own interests so as not to deprive the insured of the benefits of the insurance policy." Id. at 43 (citations omitted). "[R]einsurers have no comparable duties to investigate or defend claims between third parties and the underlying liability insurers or their insureds . . . ." Catholic Mut. Relief Soc., 42 Cal. 4th at 369. Moreover, other jurisdictions have found that reinsurers owe no fiduciary duty to reinsureds. See Stonewall, 75 F. Supp. 2d at 910-11 (gathering cases). "Because the relevant policy reasons inherent in a finding of a fiduciary relationship, e.g., one party's dominance, do not extend to the reinsurance context," this Court, like that in Stonewall, "predicts that the California Supreme Court would adopt the reasoning of these cases and find that a reinsurer does not have a fiduciary responsibility while dealing with its reinsured." See id. at 911.

Because most of the policy considerations that support tort liability in the insurance context do not apply in the reinsurance context, the Court concludes that the California Supreme Court would not find the imposition of tort damages to be appropriate. More is needed to justify such a "major departure from traditional principles of contract law." See Cates, 21 Cal. 4th at 46.

Plaintiff suggests that its second cause of action should not be dismissed, nonetheless, because it may recover contract damages for breach of the implied covenant of good faith and fair dealing. However, the second cause of action is framed entirely in terms of tortious action, describing Defendant as having "tortiously breached the implied covenant of good faith and fair dealing" (Compl. ¶ 41) and Defendant's refusal to pay as a "continuing tort" (id. ¶ 42). The Court declines to construe this cause of action as a breach of contract action. See Fed. R. Civ. P. 8 (requiring that complaints include "a short and plain statement of the claim showing that the pleader is entitled to relief." (emphasis added).)

IV. CONCLUSION

For the foregoing reasons, Defendant's Motion To Dismiss Plaintiff's Complaint Pursuant to Federal Rule 12(b)(6) and Alternative Motion To Strike Pursuant to Federal Rule 12(f) is GRANTED. Plaintiff's second cause of action is DISMISSED without prejudice. Plaintiff's prayer for punitive damages is STRICKEN.

IT IS SO ORDERED.

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Initials of Deputy Clerk: *PdP*