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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

CALIFORNIA JOINT POWERS INSURANCE AUTHORITY, a California public entity,

Plaintiff,

vs.

MUNICH REINSURANCE AMERICA, INC., a Delaware Corporation,

Defendant.

Case No. CV08-00956 DSF (RZx)

[Assigned to The Honorable Dale S. Fischer]

Complaint Filed: February 12, 2008

NOTICE OF MOTION AND MOTION TO DISMISS PLAINTIFF'S COMPLAINT PURSUANT TO FEDERAL RULE 12(b)(6) AND ALTERNATIVE MOTION TO STRIKE PURSUANT TO FEDERAL RULE 12(f); MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

DATE: April 14, 2008
TIME: 1:30 p.m.
DEPT:

Discovery Cutoff: None
Motion Cutoff: None
Trial Date: None

TO ALL PARTIES AND THEIR COUNSEL OF RECORD:

PLEASE TAKE NOTICE that on April 14, 2008 at 1:30 p.m., or as

soon thereafter as counsel may be heard in the courtroom of Hon. Dale S. Fischer, United States District Judge for the Central District of California, located at 312 North Spring Street, Los Angeles, California, Defendant MUNICH REINSURANCE AMERICA, INC. ("MRAm") will, and hereby does, move this Court for an order dismissing Plaintiff's Second Count for Breach of the Covenant of Good Faith and Fair dealing pursuant to *Federal Rule of Civil Procedure* 12(b)(6) on the ground that the Complaint fails to state a claim upon which relief may be granted. Alternatively, MRAm requests this Court strike Plaintiffs' request for punitive damages pursuant to Federal Rule of Civil Procedure 12(f) as such claim is immaterial.

The Motion is based on this Notice of Motion and Motion, the attached Memorandum of Points and Authorities in support thereof, all pleadings, papers and records on file in this action, and such matters which this Court may take judicial notice, and upon such further oral argument and documentary evidence as may be presented at the time of hearing.

This motion is made following the conference of counsel pursuant to L.R. 7-3 which took place on March 11, 2007.

DATED: March 17, 2008

MUSICK, PEELER & GARRETT LLP

By: _____
Susan J. Field
Attorneys for Defendant MUNICH REINSURANCE AMERICA, INC.

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I. SUMMARY OF ARGUMENT

California Joint Powers Insurance Authority ("CJPIA") alleges that Munich Reinsurance America, Inc. ("MRAm") issued reinsurance to CJPIA under certain Casualty Excess of Loss Treaties. In this action, CJPIA alleges three Counts: Breach of Contract, Breach of the Implied Covenant of Good Faith and Fair Dealing and Declaratory Relief. In the Second Count, CJPIA seeks tort damages, including punitive damages, from MRAm. However, California law prohibits tort recovery in breach of contract actions except in very limited circumstances, the most notable being in the third-party liability context, and this case does fall within the limited exception. Indeed, the court in *Stonewall Ins. Co. v. Argonaut Ins. Co.*, 75 F. Supp. 2d 893, 908 (N.D. Ill. 1999), examined relevant California cases and expressly found that the public policy underpinnings justifying the "insurance policy exception" do not apply to reinsurance agreements. Recent California cases recognize the distinction between reinsurance and direct insurance. Moreover, in other settings, the California Courts, like the *Stonewall* court, have refused to convert breach of contract disputes in commercial contract settings into tort cases.

This case involves a reinsurance dispute with no special circumstances justifying an exception to the general rule under California law prohibiting tort recovery in breach of contract actions. Thus, the Second Count fails to state a claim and should be dismissed.

In addition, CJPIA's Second Count is insufficient to support a claim for punitive damages. California law requires that a claim for punitive damages be plead with specificity. This Complaint falls far short of the mark.

Thus, MRAm requests this Court grant this Motion to Dismiss the Second Count of CJPIA's Complaint. Alternatively, should the Court not dismiss the Second Count, the Court should strike Plaintiff's request and prayer for punitive damages.

II. STATEMENT OF FACTS

A. The CJPIA Memorandum

CJPIA is a self-insured retention pool consisting of numerous California public agencies organized under the California Government Code. (CJPIA Complaint, ¶1.) Pursuant to a written "Memorandum Stating the Protection Provided" ("Memorandum"), CJPIA provides general liability and special liability coverage to its Member agencies. *Id.* at Par. 3. CJPIA advises its Members, however, that the Memorandum is "not an insurance policy." The Cover Page to the Memorandum states:

> "This Memorandum is a description of the terms and conditions of the Program through which certain specified and limited self-insured risks of liability are administered by the Authority [CJPIA] and shared by its Members. *This Memorandum is not an insurance policy.* As provided in ...California Government Code ...the pooling of self-insured claims or losses among the Members of the Authority shall not be considered insurance nor be subject to regulation under the Insurance Code."

(Memorandum, Complaint, Exhibit "B [It appears that while the Complaint identifies the Memorandum as Exhibit A, it is actually Exhibit B.][1]) CJPIA further advises that the pooling of losses under the program is *not insurance. Id.*, Complaint, ¶25; *see* Exhibit B. While the CJPIA can indemnify Member agencies for "claims or losses" subject to the terms of the Memorandum, "there is no transfer of risk from the Member" to CJPIA "nor assumption of risk" by CJPIA. Exhibit B. CJPIA admits in its Complaint that it is "not an insurance carrier" and as a result "insurance case law does not apply to it." (Complaint, ¶25.)

B. The MRAm Reinsurance Agreement

The Complaint alleges that CJPIA entered into two "Casualty Excess of Loss Reinsurance Agreements" ("Reinsurance Agreement") with American Re-

[1] Further complicating this citation, Plaintiff has not met the requirements for numbering Exhibit pages (L.R. 11-5.2).

Insurance Company n/k/a MRAm, whereby MRAm agrees to reimburse CJPIA, on an excess of loss basis, for certain amounts of ultimate net loss CJPIA may pay under the Memorandum. (Complaint, ¶¶4, 26, 33, Exhibit "A" [It appears that while the Complaint identifies the Reinsurance Agreement as Exhibit B, it is actually Exhibit A.].)

C. CJPIA's Claims

CJPIA alleges that the City of Palos Verdes Estates , a member of CJPIA, was sued in state and federal court (each suit entitled *Monks, et al. v. City of Rancho Palos Verdes*) by certain plaintiffs (the "*Monks* Plaintiffs") alleging various claims arising from and related to the City's enactment of several moratorium on development. (Complaint, ¶¶6 – 10.) CJPIA alleges that on or about January 24, 2007, CJPIA settled certain claims alleged by the *Monks* Plaintiffs (Complaint, ¶28) and that MRAm has refused to indemnify it for sums expended in defense and settlement of the *Monks* actions. (Complaint, ¶¶28, 32, 38.)

III. ARGUMENT

A. Dismissal of the Second Count Is Proper Under FRCP 12(b)(6)

Federal Rule of Civil Procedure 12 (b)(6) provides that a complaint must be dismissed for failure to state a claim when the plaintiff is unable to plead facts that would entitle the plaintiff to relief. *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). In this case, Plaintiff's Second Count is fatally defective as it seeks tort damages in a claim for breach of a commercial contract and because it fails to allege facts with specificity which would permit recovery of punitive damages. Thus, MRAm requests this Motion be granted.

B. Striking the Punitive Damage Claim is Proper.

"A motion to strike is appropriate to address requested relief, such as punitive damages, which is not recoverable as a matter of law. 2 Schwarzer, Tashima & Wagstaffe, Cal. Practice Guide: Fed. Civil Procedure Before Trial (2005) Attacking the Pleadings, para. 9-389 and 9-390, p. 9-97." *Wilkerson v.*

Butler, 229 F.R.D. 166, 172 (E.D. Cal. 2005). In this case punitive damages are not properly recoverable as tort damages are not recoverable as a matter of law. Moreover, because the Complaint does not properly plead the facts which would support a claim for punitive damages, all such claims should be dismissed.

C. Reinsureds May Not Assert Tort Claims Against Reinsurers

CJPIA's Second Count alleges that MRAm "tortiously breached the implied covenant of good faith and fair dealing arising from" the Reinsurance Agreement by "unreasonably withholding benefits" owed CJPIA. (Complaint, ¶41.) CJPIA lists various acts and omissions by MRAm (which MRAm denies) that allegedly constitute a breach of the implied covenant of good faith and fair dealing, including "[u]nreasonably withholding full benefit payments;" "not attempting in good faith to effectuate a prompt ...settlement" of the underlying plaintiff's claim; and "[i]nterpreting the Memorandum in an unduly restrictive manner." (Complaint, ¶43 (a)-(b), (g).)[2] CJPIA seeks punitive damages from MRAm based on these allegations of tortious conduct. (Complaint, ¶48.)

California law, however, does not permit tortious bad faith claims in a commercial context. Because the relationship of a reinsurer and a reinsured is a commercial one, not akin to the insured/insurer relationship, the rules of commercial, not insurance, contracts apply. Thus, tort damages are not available to a reinsured for breach of the reinsurance contract and this Court should dismiss the Second Count of the Complaint.

1. Tort Damages Are Not Available In the Commercial Context

California law is clear that, except in the case of an insured which is

[2] Notably these claims mirror California's *Insurance Code* §790.03(h) which identifies "unfair claims settlement practices" and is applicable to identified entities. That list of identified entities does not include reinsurers. No private right of action arises under this Insurance Code section. See *Moradi-Shalal v. Fireman's Fund Insurance Companies*, 46 Cal.3d 287, 250 Cal. Rptr. 116 (1988).

wrongfully denied benefits by its insurer, a party injured by a breach of contract is limited to recovery of contract damages, and may not seek tort damages for breach of contract — or breach of any implied obligation. *See*, *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 682-84, 694, 254 Cal. Rptr. 211, 226-28, 235 (1988); *Freeman & Mills, Inc. v. Beicher Oil Co.*, 11 Cal. 4th 85, 93-98, 44 Cal. Rptr. 2d 420, 24-428 (1995). Both cases were cited with approval more recently by the California Supreme Court in *Robinson Helicopter Co., Inc. v. Dana Corp.*, 34 Cal. 4th 979, 996, 22 Cal. Rptr. 3d 352, 364 (2004). The Court there further explained that "[r]estricting parties to contract damages in the wide run of cases 'promote[s] contract formation by limiting liability to the value of the promise.'" *Robinson Helicopter Co.*, 34 Cal. 4th at 996, 22 Cal. Rptr. 3d at 364, citing *Harris v. Atlantic Richfield Co.*, 14 Cal. App. 4th 70, 77, 17 Cal. Rptr. 2d 649, 653-54 (1993).)

Efforts made by parties to contracts to expand the scope of tort liability have found little success. In *Cates Construction, Inc. v. Talbot Partners*, 21 Cal. 4th 28, 45, 86 Cal. Rptr. 2d 855, 866 (1999), the California Supreme Court refused to extend the "insurance policy exception" for tort recovery in breach of contract actions to a claim for breach of a surety bond. The Court there explained, quoting *Foley*, "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.'" *Id.* at 43, 86 Cal. Rptr. 2d at 865. The Court further noted that:

> Subsequent to Foley, the Courts of Appeal have considered this issue in a variety of settings and have unanimously refused to sanction tort remedies outside the context of an insurance policy. (E.g., Copesky v. Superior Court (1991) 229 Cal.App.3d 678, 280 Cal.Rptr. 338 [bank/depositor], overruling its prior holding in Commercial Cotton Co. v. United California Bank (1985) 163 Cal.App.3d 511, 209 Cal.Rptr. 551 (Commercial Cotton); Careau & Co. v. Security Pacific Business Credit, Inc. (1990) 222 Cal.App.3d 1371, 272 Cal.Rptr. 387 [bank/commercial borrower]; Trustees of Capital Wholesale Electric etc. Fund v. Shearson Lehman Brothers, Inc. (1990) 221 Cal.App.3d 617, 270 Cal.Rptr.

> 566 [stockbroker/investor]; Price v. Wells Fargo Bank (1989) 213 Cal.App.3d 465, 261 Cal.Rptr. 735 [bank/loan customers], criticizing Commercial Cotton, supra, 163 Cal.App.3d 511, 209 Cal.Rptr. 551, and Barrett v. Bank of America (1986) 183 Cal.App.3d 1362, 229 Cal.Rptr. 16; Martin v. U-Haul Co. of Fresno (1988) 204 Cal.App.3d 396, 251 Cal.Rptr. 17 [involving dealership contract]; see generally, Careau & Co. v. Security Pacific Business Credit, Inc., supra, 222 Cal.App.3d at p. 1399, fn. 25, 272 Cal.Rptr. 387 [listing additional decisions where tort remedies were denied].)

Cates, 21 Cal. 4th. at 46, 86 Cal. Rptr. 2d at 867 fn. 9.

Since then, other Courts have cited *Cates* in declining to expand the limited exception to the rule against tort damages in contract cases. *See e.g.*, *Archdale v. American Intern. Specialty Lines Ins. Co.*, 154 Cal. App. 4th 449, 46, 64 Cal. Rptr. 3d 632, 643 fn. 13 (2007) ("[N]ot only does the applicable statute of limitations bar such a recovery, but also plaintiffs' (including Godinez) singular reliance on a contract theory of recovery constitutes an abandonment of any tort claim."); *Stoops v. Abbassi*, 100 Cal. App. 4th 644, 657, 122 Cal. Rptr. 2d 747, 757 fn 10 (2002) ("Stoops's causes of action are based upon the simple premise that the other members have failed to comply with their contractual obligations. Stoops may not convert his contract cause of action into a tort."); *20th Century Ins. Co. v. Superior Court*, 90 Cal. App. 4th 1247, 1266, 109 Cal. Rptr. 2d 611, 626 (2001) ("The significant public interest in the special relationship between the insured and insurer justifies the availability of tort remedies, and distinguishes insurance contracts from other types of contracts. Tort remedies remain unavailable in non-insurance contract cases."); *Fairchild v. Park*, 90 Cal. App. 4th 919, 927, 109 Cal. Rptr. 442, 447 (2001) ("Yet, with the exception of bad faith insurance cases, a breach of the covenant of good faith and fair dealing permits a recovery solely in contract.")

In *Jonathan Neil & Associates, Inc. v. Jones*, 33 Cal. 4th 917, 938 , 16 Cal. Rptr. 3d 849, 866 (2004), the California Supreme Court faced "[t]he question [ ] whether tort remedies should be extended to the breach of the covenant of good

faith and fair dealing when the insurer has in bad faith retroactively billed an insured for an excessive premium" and answered "no". Thus, even in cases between an insured and its insurer, the right to tort damages is limited.

Recently, a California Court of Appeal in *Stop Loss Ins. Brokers, Inc., v. Brown & Toland Medical Group,* 143 Cal. App. 4th 1036, 49 Cal. Rptr. 3d 609 (2006), refused to allow an insurance broker to assert a tortious bad faith claim against a medical group.

> A person may not ordinarily recover in tort for the breach of duties that merely restate contractual obligation. Instead, [c]ourts will generally enforce the breach of a contractual promise through contract law, except when the actions that constitute the breach violate a social policy that merits the imposition of tort remedies.

(Internal citation omitted). *Id.* at 1041, 40 Cal. Rptr. 3d at 612-13. The court held that the broker was improperly attempting to "recast a breach of contract cause of action as a tort claim," which California law prohibits. *Id.*, 49 Cal. Rptr. 3d at 613.

In deciding whether to allow the broker to proceed in tort, the *Stop Loss* court examined the following factors: "'(1) the extent to which the transaction was intended to affect the plaintiff, (2) the foreseeability of harm to the plaintiff, (3) the degree of certainty that the plaintiff suffered injury, (4) the closeness of the connection between the defendant's conduct and the injury suffered, (5) the moral blame attached to the defendant's conduct and (6) the policy of preventing future harm.'" *Id.* at 1042, 49 Cal. Rptr. 3d at 613. Finding the factors lacking as to the broker's claim, the court stated: "Contrary to Stop Loss's [broker] assumption, courts have not applied [these] factors to create broad tort duties in arms-length business dealings whenever it is convenient to resort to the law of negligence." *Id.*, 49 Cal. Rptr. 3d at 613. The court reasoned that, even if a contract existed between the broker and the medical group, no third party was injured. Rather, the broker simply alleged that Regents [Hospital] was injured by negligent claims handling which caused it to lose insurance coverage. "As noted, the Regents may not recover

in tort for BTMG's [medical group] breach of a contractual obligation." *Id.* at 1042-43, 49 Cal. Rptr. 3d at 614. To allow the broker to pursue a tort claim in the absence of an injury to a third party, in the court's view, would "circumvent this rule and blur the law's distinction between contract and tort remedies." *Id.* at 1043, 49 Cal. Rptr. 3d at 614. *Stop Loss* cited "no case holding a business entity owes a tort duty of care to prevent another business from suffering purely financial losses, and we decline to announce such a duty here." *Id.* at 1043, 49 Cal. Rptr. 3d at 614. The court quoted the California Supreme Court in *Erlich v. Menezes,* 21 Cal. 4th 543, 87 Cal. Rptr. 2d 886 (1999): "If every negligent breach of a contract gives rise to tort damages the limitation would be meaningless, as would the statutory distinction between tort and contract remedies." *Id.* at 1044, 87 Cal. Rptr. 2d at 893.

Thus, California law is clear. Tort remedies and damages are not available for a breach of contract claim outside of the limited area of inured-insurer disputes involving denial of insurance policy benefits.

2. <u>There Is No Basis For Tort Liability In The Reinsurance Context</u>

The relationship between an reinsurer and the ceding company is a commercial one. It does not have the attributes of the "typical" insurance relationship. *See* Hon. H. Walter Croskey, et al., *Cal. Practice Guide Ins. Lit.* Ch. 8-D para. 8:385 (2008), citing *American Re–Insurance Co. v. Insurance Comm'n of State of Calif.*, 527 F. Supp. 444, 453–454 (C.D. Cal. 1981) (applying California law). The distinction between insurance contracts and ordinary commercial contracts was highlighted by the Court in *Foley.* Quoting *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 819-20, 169 Cal. Rptr. 691, 696 (1979), the Supreme Court noted that: "[T]he relationship of insurer and insured is inherently unbalanced: the adhesive nature of insurance contracts places the insurer in a superior bargaining position." *Foley*, 47 Cal. 3d at 685, 254 Cal. Rptr. 211, 228.

Here, CJPIA bases its suit on conduct pertaining to a reinsurance

contract. There is a material difference between a reinsurance contract and an insurance contract. A reinsurance contract is a commercial risk sharing arrangement between two sophisticated parties. It is, in virtually all material respects, no different from any other commercial contract arrangement. No adhesive relationship exists between insurance companies and reinsurance companies. *See Westlye v. Look Sports, Inc.*, 17 Cal. App. 4th 1715, 1735-36, 22 Cal. Rptr. 2d 781, 791-92 (1993) (defining adhesion contracts); Lee R. Russ & Thomas F. Segalla, *1A Couch on Insurance* §9:2 (3d ed. 2005); *Stonewall Ins. Co. v. Argonaut Ins. Co.*, 75 F. Supp. 2d 893 (N.D. Ill. 1999). There is simply no reason to treat the commercial contract dispute presently before the Court as if it concerned a denied claim for benefits.

Although no reported California case has directly addressed the issue presented here, one Illinois federal court examined California law and expressly rejected the effort to impose tort liability in the reinsurance arena. In *Stonewall Ins. Co. v. Argonaut Ins. Co.*, 75 F. Supp. 2d 893 (N.D. Ill. 1999), after a trial on breach of contract and bad faith claims against a reinsurer, the jury returned a verdict for the reinsured awarding it $13 million in punitive damages on the bad faith claims. *Id.* at 898 fn. 8. However, the District Court struck the punitive damages award, holding that under "California law tort damages are not recoverable for breach of the covenant of good faith in the reinsurance context." *Id.* at 913.

The District Court reached this conclusion after engaging in a careful, detailed examination of California law, beginning with the general rule that tort damages are not recoverable in breach of contract cases. *Id.* at 906 (citations omitted). The District Court identified some of the reasons the California Supreme Court refused to allow plaintiffs to assert tortious bad faith claims in breach of contract cases: "(1) the different objectives underlying tort and contract breach; (2) the importance of predictability in assuring commercial stability in contractual dealings; (3) the potential for converting every contract breach into a tort, with

accompanying punitive damage recovery; (4) and the preference for legislation in affording appropriate remedies." *Id.* at 907.

As the *Stonewall* court recognized, this prohibition is not without exceptions: in the third-party liability insurance context, tort damages are available to a direct insured where its insurer breaches the implied covenant of good faith and fair dealing in an insurance contract. *Id.* at 907 (citations omitted). The *Stonewall* court reviewed the public policy underpinnings for the exception allowing an insured's tort recovery in breach of insurance contract cases, and quoted the California Supreme Court in *Cates Construction, Inc. v. Talbot Partners*:

> Unlike most other contracts for goods and services, an insurance policy is characterized by elements of adhesion, public interest and fiduciary responsibility. In general, insurance policies are not purchased for profit or advantage; rather they are obtained for peace of mind and security in the event of an accident or other catastrophe. Moreover, 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. In addition ...the tort duty of a liability insurer ordinarily is based on the assumption of the insured's defense and of settlement negotiations of third party claims.

Stonewall, 75 F. Supp. 2d at 908; s*ee also Erlich v. Menezes*, 21 Cal. 4th 543, 551, 87 Cal. Rptr. 2d 886, 892 (1999) ("Moreover...the insurance cases represented 'a major departure from traditional principles of contract law,' any claim for automatic extension of that exceptional approach whenever 'certain hallmarks and similarities can be adduced in another contract setting' should be carefully considered." (Citation omitted.)) The District Court noted especially that the California Supreme Court was persuaded by the "unequal bargaining power" between an insured and its insurer in creating an exception to the general prohibition against tort damages in a contract action. *Stonewall*, 75 F. Supp. 2d at 908.

The *Stonewall* court then determined whether these same policy

considerations apply as well in the reinsurance context and concluded that they do not:

> In other words, the policy reasons that allow an original insured to recover tort damages for its insurer's breach of the duty of good faith under California law do not extend to the reinsurance context to allow a reinsured to recover tort damages against a reinsurer. Indeed, as one commentator has noted, 'The primary mistake of most courts considering reinsurance issues is blindly applying principles of original insurance.'

Stonewall, 75 F. Supp. 2d at 908, citing *Unigard Sec. Ins. Co., Inc. v. North River Ins. Co.*, 4 F.3d 1049, 1065 (2d Cir. 1993).

The court explained that reinsurance is "separate and distinct" from direct insurance, involving "contracts of indemnity, not liability." *Stonewall*, 75 F. Supp. 2d at 909 (citation omitted). Additionally,

> Reinsurance "allows an original insurer to diversify its risk of loss over a larger number of policies and to reduce its capital reserves that state law requires to protect the original insured. By purchasing reinsurance, therefore, the original insurer can increase its profitability.

Id. at 908-09 (citations omitted). The court explained further that a reinsurance contract involves "'two sophisticated business entities familiar with the business of insurance who bargain at arms-length for the terms in their contract." *Id.* at 909 (citations omitted). Because a reinsurance contract involves two sophisticated insurers "[i]t follows that a reinsured may employ bargaining tactics that it has already mastered in its own, original insurance business." *Id.* A reinsurer "can include penalty provisions in their reinsurance contract, such as a clause for the payment of attorney's fees." *Id.* The court noted further that "'repeat transactions are the norm'" in the reinsurance business and, as a result, "reputation is...important to commercial success and the loss of repeat business is a penalty that usually outweighs the short-term gains of misrepresentations or stonewalling contractual obligations." *Id.* at 909-10 (citations omitted).

Having identified the foregoing characteristics of reinsurance, the

district court concluded that the public policy underpinnings that allow a direct insured to obtain punitive damages and assert tort claims against its insurer are *lacking* in the reinsurance context:

> California allows an insured to recover tort damages for breach of the covenant of good faith in an insurance contract because an insurance policy is characterized by elements of adhesion, unequal bargaining power, public interest, and fiduciary responsibility. Because these elements are either entirely lacking or are present to a much lesser degree in a reinsurance policy, a reinsured cannot recover tort damages for a reinsurer's breach of the covenant of good faith.

Id. at 909; *see also, Gaffer Ins. Co., Ltd. v. Discover Reinsurance Co.*, 2007 WL 2972580, *10 (M.D. Pa. Oct. 10, 2007) (dismissing bad faith claim against reinsurer: "The two parties in this case were sophisticated companies whose business was reinsurance law. ...A business transaction alone 'is not enough to establish a fiduciary relationship; otherwise, every breach of contract would support such a claim.'") (citation omitted).

The legal principles and the California cases upon which the District Court relied in *Stonewall* apply with equal force today. More recent California cases recognize the distinction between reinsurance and direct insurance, and decide cases accordingly.[3] These California decisions, consistent with *Stonewall,* reflect the courts' acknowledgement that reinsurance is very different than direct insurance and, as a result, the public policy underpinnings differ as well. Reinsurance agreements are the result of arms-length negotiations by knowledgeable, sophisticated business entities, with equal bargaining power who are free to negotiate terms as they see fit. *See, Unigard Sec. Ins. Co., Inc. v. North River Ins.*

[3] *See, e.g., Catholic Mut. Relief Society v. Superior Court,* 42 Cal. 4th 358, 368, 64 Cal. Rptr. 3d 434, 440 (2007) ("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.' (Ins.Code, § 620 added.) 'A reinsurance is presumed to be a contract of indemnity against liability, and not merely against damage.' (Ins.Code, § 621.)"); *Zenith Ins. Co. v. Cozen O'Connor,* 148 Cal. App. 4th 998, 55 Cal. Rptr. 3d 911 (2007).

Co., 4 F. 3d 1049, 1054 (2d Cir. 1993). Reinsurance agreements are not "insurance" but indemnity contracts. *Id.* Unlike direct insurance contracts, they are not purchased for "peace of mind and security in the event of an accident or other catastrophe," but for profit - - to enable direct insurers to write more policies than their reserves would otherwise allow. *Stonewall*, 75 F. Supp. 2d at 980; *Catholic Mutual. Relief Society v. Superior Court,* 42 Cal. 4th 358, 368, 64 Cal. Rptr. 3d 434, 440 (2007). There is a built-in safeguard because, in the special world of reinsurance, "repeat transactions are the norm" and, as a result, "reputation is thus important to commercial success and the loss of repeat business is a penalty that usually outweighs the short-term gains of misrepresentations or stonewalling contractual obligations." *Stonewall,* 75 F. Supp. 2d at 990 (citations omitted).

The public policy concerns regarding direct insurance are particularly inappropriate here where the underlying contract is not a policy of insurance but a "Memorandum" that expressly does not transfer risk to CJPIA and is not subject to insurance regulations. CJPIA admits in its complaint in this case, that it is "not an insurance carrier" and as a result "insurance case law does not apply to it."

There are no compelling reasons for this Court to find an exception here to the general rule under California law prohibiting tort recovery in breach of contract actions. Thus, this Court should dismiss the Second Count of the Complaint.

IV. DISMISSAL OF COUNT II FOR PUNITIVE DAMAGES IS PROPER

In order to seek punitive damages, a complaint must allege **specific facts** that, if proven, would establish "by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or malice . . . ." *Civil Code* §3294; *see also, Smith v. Superior Court*, 10 Cal. App. 4th 1033, 1041-42, 13 Cal. Rptr. 2d 133, 138-39 (1992) (stating that Plaintiff must allege specific facts supporting its claim for punitive damages). It is not sufficient to allege merely that a defendant "acted with oppression, fraud or malice". *See Smith*, 10 Cal. App. 4th at 1041-42,

13 Cal. Rptr. 2d at 138-39. "Not only must there be circumstances of oppression, fraud or malice, but **facts** must be alleged in the pleading to support such a claim." *Grieves v. Superior Court*, 157 Cal. App. 3d 159, 164, 203 Cal. Rptr. 556, 560 (1984), citing *G. D. Searle & Co. v. Superior Court*, 49 Cal. App. 3d 22, 29, 122 Cal. Rptr. 218 (1975); *see also Cohen v. Groman Mortuary, Inc.*, 231 Cal. App. 2d 1, 8, 41 Cal. Rptr. 481, 486 (1964); *Brousseau v. Jarrett*, 73 Cal. App. 3d 864, 872, 141 Cal. Rptr. 200, 205 (1977).

The Complaint here merely sets forth a conclusory claim that action was taken with "conscious disregard" (Complaint, ¶47) , with "intent to injure" and was "willful, oppressive and malicious" (Complaint, ¶48). Such vague allegations are not sufficient.

Although as stated above, rules applicable to insurers do not apply to reinsurers, even in the more strict context of the insurer/insured relationship, far more is required to state a claim for punitive damages than has been set forth in this Complaint. For example, malice is not shown merely by an insurer's unexplained delays in investigating claims. *Stewart v. Truck Ins. Exchange*, 17 Cal. App. 4th 468, 482-84, 21 Cal. Rptr. 2d 338, 347-49 (1993). Nor may it be shown by evidence that the insurer simply unreasonably refused to provide coverage. *Weisman v. Blue Shield of California*, 163 Cal. App. 3d 61, 67, 209 Cal. Rptr. 169, 174 (1984). There must be evidence that the insurer's conduct is "despicable" and the insurer is aware of the probable consequences of its conduct to the insured before punitive damages may be awarded. *Id.*, 209 Cal. Rptr. at 174. Further, an insurer's conduct is oppressive if the insurer engages in "despicable conduct" that subjects a person to cruel and unjust hardship in conscious disregard for the person's rights. *Civil Code* §3294. Oppression may be found where the insurer refuses to defend without conducting any investigation into the matter, failing to compare the allegations to the terms of the policy and choosing to disregard advice of counsel. *Tibbs v. Great American Ins. Co.*, 755 F.2d 1370, 1375 (9th Cir. 1985) (applying California law).

Finally, the facts pled to support a punitive damage claim must be clearly pled. As the California Supreme Court stated:

> In California, fraud must be pled specifically; general and conclusory allegations do not suffice. Thus the policy of liberal construction of the pleadings ... will not ordinarily be invoked to sustain a pleading defective in any material respect. [¶] This particularity requirement necessitates pleading facts which show how, when, where, to whom, and by what means the representations were tendered.

(Internal citations omitted.) *Lazar v. Superior Court*, 12 Cal. 4th 631, 645, 49 Cal. Rptr. 2d 377 (1996); *Robinson Helicopter Co., Inc. v. Dana Corp.*, 34 Cal. 4th 979, 993, 22 Cal. Rptr. 3d 352 (2004).

Here, any claim for punitive damages is improper as California law does not permit tort damages in a commercial contract dispute. Further, the instant claim for punitive damages fails as a matter of law to meet the stringent pleading requirements for such a claim and, thus, should be stricken.

V. CONCLUSION

There is no basis for tort recovery against a reinsurer and CJPIA's Complaint does not allege any set of facts which would suggest that this Court should establish a new rule expanding California's limited exception to the prohibition against tort recovery in the commercial context. Further, the Complaint does not allege with any specificity facts entitling CJPIA to punitive damages. Thus, this Court should dismiss the Second Count of CJPIA's complaint for failure to state a cause of action against MRAm or at a minimum, this Court must strike CJPIA's claims for tort damages, specifically including its prayer for punitive damages.

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