Supreme Court Case No. S107855
5th Civil No. F029400 consolidated with F030300

IN THE SUPREME COURT

OF THE STATE OF CALIFORNIA

JONATHAN NEIL & ASSOCIATES, INC.,

Plaintiff, Appellant and Respondent,

v.

FRED JONES,

Defendant, Respondent and Petitioner.

Appeal from the Superior Court for the County of Fresno
The Honorable Franklin P. Jones, Judge
Fresno County Superior Court Case No. 512318-7

ANSWER BRIEF ON THE MERITS

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INTRODUCTION

A $51,294 assigned risk premium billing dispute.

A $13.5 million dollar bad faith tort verdict.

No administrative determination that the bill was improper.

No claim or evidence that coverage was impaired.

Result: A nightmare.

Why a nightmare? Because the billing dispute could have been resolved administratively in a matter of months — without anyone suffering a whit of damage.

Instead, the litigants and the court system endured massive and totally avoidable burdens: An almost-nine year court battle; a six week jury and court trial; a 150-volume appellate record; many hundreds of pages of briefs; a mountain of exhibits; years of appellate litigation — all stemming from disposition of complex, arcane assigned risk rating issues by a trial court and jury, bodies least equipped to resolve them.

Had the dispute been handled administratively as the Legislature commanded, it would have been expeditiously resolved, without harm and with minimal (if any) court involvement. Regrettably, that didn't happen. Our judicial system has suffered the consequences.

The core dispute in this case is whether the unpaid $51,294 premium bill was founded on an untenable reading of complex rating rules. Without benefit of any determination by the administrative agencies the Legislature designated to resolve such issues, a trial court and jury struggled — without success — to make sense of rating rules they were never supposed to interpret or apply. Laboring under incomprehensible instructions, the jury found that sending the bill constituted a tortious breach of the implied covenant of good faith and fair dealing and fraud. It awarded $2 million compensatory and $11.5 million punitive damages. The award, even after reduction by remittitur, totaled about $6.5 million.

The Court of Appeal reversed, reaching just two of many issues. It held: no bad faith tort cause of action arises for receiving unpaid premium bills for an expired insurance policy; and when a dispute's central issue involves matters falling within the exclusive purview of an administrative agency, a superior court has no jurisdiction to address the issue until legislatively-mandated administrative remedies have been exhausted.

The Court of Appeal got it right. Under this Court's rulings (*Cates Construction, Inc. v. Talbot Partners* (1999) 21 Cal.4th 28; *Foley v. Interactive Data Corp.* (1988) 47 Cal.3d 654; *Farmers Ins. Exchange v. Superior Court* (1992) 2 Cal.4th 377), no other answer is possible.

In *Foley* and *Cates*, this Court held that tort actions for breach of the implied covenant of good faith and fair dealing are not permissible, except in certain insurance cases. However, to warrant bad faith tort remedies in an insurance setting, there must be more than just an ordinary breach. Rather, there must be an unreasonable denial of the coverage benefits promised by the policy — defense, indemnity, settlement.

A loss of coverage benefits is the *sine qua non* of bad faith tort liability because such benefits are what differentiate insurance contracts from other commercial agreements, for which tort liability is unavailable. Coverage benefits are the reason why persons purchase insurance. They are the insurance product and their benefits are irreplaceable, as an insured cannot look elsewhere to protect against a risk that has already occurred. Thus, when a covered risk occurs and coverage benefits are unreasonably denied, the insured is placed in a particularly vulnerable position. He is forced to endure the catastrophe without the protection he paid premiums to receive; and he cannot extricate himself from the dilemma by purchasing new insurance.

Under *Cates* and *Foley,* it is these elements that must be satisfied if bad faith tort liability is to be available. None is satisfied here.

Here, no coverage benefit was ever denied or impaired. None. This is nothing more than a billing dispute, common in every type of contractual setting. Far from being unempowered or vulnerable, the insureds here had multiple options, all within their control. They could refuse to pay — which is exactly what they did — with consequences no different from that in any contract dispute over price. The insureds also had the option of pursuing available administrative remedies, but they chose not to do so.

If tort liability for breach of the implied covenant were to arise from legitimate billing disagreements such as the dispute in this case, the boundaries between tort and contract liability carefully set by *Foley* and *Cates* would be undone. No assigned risk servicing carrier could afford to run the serious tort risk of sending premium bills.

If what occurred at the trial level is approved here, all California citizens will be the losers. Agencies having specific expertise, authority and statewide responsibility for the uniform administration of the assigned risk system will be bypassed in favor of a tort gamble to be decided by those having the least experience — trial courts and juries. Remedies designed to prevent harm will be circumvented. Disputes will take years to resolve, rather than months. Efforts to collect premiums essential to the viability of the assigned risk system will be impaired.

And perhaps worst of all, any hope that the system can be managed on a uniform statewide basis for the benefit of all California citizens will be lost. It will succumb to chaos, where courts and juries will decide individual rating cases, without knowledge, expertise or responsibility for managing the system as a whole.

Where, as here, the dispute involves nothing more unique than the propriety of an unpaid premium bill for an expired assigned risk policy, with absolutely no impact on coverage entitlements, this Court should set the law straight: Rating and premium disputes in the assigned risk system should not give rise to tort liability for insurance bad faith; and when such disputes occur, administrative remedies must be exhausted before court remedies may be invoked.

What happened at trial should never happen again.

STATEMENT OF FACTS

A. The Parties.

1. Cal Eagle Insurance Company, a commercial assigned risk servicing carrier.

In early 1991, Cal Eagle Insurance Company ("Cal Eagle") contracted with the California Automobile Assigned Risk Plan ("CAARP") to become a "servicing carrier" for the one of its subdivisions, Commercial Automobile Insurance Procedure ("CAIP"). CAIP deals with commercial assigned risk insureds such as truckers, taxis, and couriers. (RT 2527-2528, 8721-8723.)

California's assigned risk system, administered by the Department of Insurance ("DOI"), is charged with statutory responsibility to protect victims against losses caused by uninsured drivers. It does this by pooling California's automobile insurers to provide coverage for marginal risks that are otherwise unable to secure coverage. (Ins. Code, §§ 11620 et seq., 12900, 12906, 12921; *Nipper v. California Auto. Assigned Risk Plan* (1977) 19 Cal.3d 35; *County of Los Angeles v. Farmers Ins. Exchange* (1982) 132 Cal.App.3d 77, 83, 87 [Commissioner of Insurance acts in DOI's name]; RT 8721-8722, 9161.)

Under the commercial system, servicing carriers such as Cal Eagle are required by contract and regulation to perform according to DOI's and CAARP's comprehensive operating rules. They issue and administer commercial assigned risk insurance policies whose terms, rates, and premiums are dictated by CAARP and DOI. (Exh. 14, SCT 236; Exh. 33, SCT 285-346.)

Under CAIP, servicing carriers such as Cal Eagle bear no insurance risk. All commercial assigned risk exposures are undertaken by CAARP itself. (RT 8724, 9199-9200; see OB 2.)[1] Premiums collected by the servicing carriers are remitted to CAARP, which uses them to fund the system, including reimbursing servicing carriers for coverage claims they have paid. (Exh. 14, SCT 255; Cal. Code Regs., tit. 10, § 2432; RT 4175-4179, 8722-8724.)

2. The Joneses and Fred Jones Trucking Company.

In 1991, Fred and Mildred Jones owned a small trucking company known as Fred Jones Trucking. It operated with two tractors and six trailers, and also hired other truckers — "subhaulers"—to haul its customers' goods. (RT 2547, 6761, 6766.)

The California Public Utilities Commission ("PUC") regulated intrastate trucking. It required that both the Joneses and their subhaulers provide minimum liability insurance coverage. (PUC Gen. Order No. 102-h, ¶ 4.d, Exh. P, SCT 2986-2987.)[2]

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[1] "OB" designates the Joneses' Opening Brief on the Merits. Court of Appeal briefs are cited "AOB," "RB," and "ARB." The Supplemental Clerk's Transcript (containing trial exhibits) is cited "SCT."

[2] PUC regulatory authority over highway carriers ended in 1996. (Former Pub. Util. Code, §§ 1061 et seq., repealed Stats. 1996, ch. 1042, § 23.) Citations are to PUC regulations as they applied before 1996.

On September 1, 1992, Fred and Mildred Jones assigned their interests in their trucking company to a corporation, Fred Jones Trucking, Inc. In that transaction, the corporation assumed all the business' assets and liabilities, including the then-expired Cal Eagle policy giving rise to this litigation. (CT 16; Exh. 283, SCT 2018; RT 8109-8111.)[3]

B. The Joneses' Coverages.

In March 1991, Fred Jones purchased a one-year commercial assigned risk liability insurance policy from Cal Eagle to cover the company's trucking operations. The policy was in a form required by CAARP. (Exh. 3A, SCT 56; RT 8728-8729, 8969.)

The Joneses paid an initial "estimated" premium of about $15,000 based on vehicles and employees identified in their application. Because the application requested hired auto coverage but estimated "-0-" cost of hire (Exh. 2B, SCT 46), the estimated premium was based largely on owned auto coverage for the identified vehicles; only a nominal $299 minimum premium was charged for the policy's hired auto coverage. During the policy term the Joneses paid premiums totaling about $20,000, including the initial estimated premium and amounts attributable to changes in drivers and listed vehicles. (RT 2563-2564, 4974-4977.)

The policy included three basic categories of liability coverage: "owned auto," for vehicles listed in the policy; "non-owned auto," for

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[3] This brief identifies "the Joneses" collectively as the insureds in order to minimize confusion.

unlisted passenger vehicles (such as employees' vehicles); and "hired auto," for vehicles "hired" to haul goods. (Exh. 3A, SCT 57-58, 61, 64; RT 4943-4948.) The rates for each of these coverage categories are set by the Commissioner of Insurance, published in a CAARP Commercial Automobile Manual of Rules And Rates ("CAARP rules"). (Cal. Code Regs., tit. 10, §§ 2432(e)(3)(A), 2460, 2498.5; RT 2536, 4942.)[4] Owned auto coverage is rated by size and type of the insured's specified vehicles. Non-owned auto coverage is rated according to the number of employees. Hired auto coverage is rated primarily according to "cost of hire" — the insured's gross expenditures for "hired autos," including their drivers and overhead. (Exh. 33, SCT 303; Exh. 3A, SCT 57-58; RT 2559-2575, 4092-4096.)

Because actual hired auto usage cannot be ascertained in advance, a trucker's initially "estimated" premium is not final until its total cost of hire is determined during an audit conducted after the policy expires. (RT 2536-2537; see Appl. Stmt. No. 6, Exh. 1-O, SCT 34; Exh. 3A, SCT 71, 73 [right to audit for 3 years after policy expires].)

By law, prime haulers such as the Joneses are liable to victims of accidents caused by any vehicle — including subhaulers' trucks — used in their trucking operations. (*Eli v. Murphy* (1952) 39 Cal.2d 598, 601; *Gamboa v. Conti Trucking, Inc.* (1993) 19 Cal.App.4th 663, 668; RT 2533.) To cover that risk, every trucker must obtain from its insurer, in addition to liability coverage for its own operations, a "PUC endorsement"

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[4] The CAARP rules as they were during the Joneses' policy term are in Exhibit 33, SCT 285-346.

providing liability coverage for any vehicle used in its trucking operations, whether specified in the policy or not. The PUC endorsement (Exh. 3A, SCT 80) is designed to ensure that *some* source of compensation is available in all commercial vehicle accidents. (RT 4953-4954, 10324-10325, 10657; *Klein v. Leatherman* (1969) 270 Cal.App.2d 792, 794-796.)

It is undisputed that Cal Eagle defended and settled, without any cost to the Joneses, all liability claims that arose during the term of their coverage. (RT 7718-7720. See discussion, § II.F, below.)

C. CAARP Rule 23.

1. Old Rule 23.

During the term of the Joneses' policy, CAARP Rule 23 — the "truckers' rule" — governed the rating of "liability because of a contract involving the hire of trucks, tractors and trailers." (Rule 23 ¶ C.2, Exh. 33, SCT 303; RT 2759.)

When Cal Eagle became a servicing carrier in early 1991, there was one other CAIP servicing carrier, NCI (a CAIP servicing carrier since 1988). NCI had rated subhaulers' exposures under hired auto coverage, applying Rule 23's "cost of hire" basis. (Rule 23 ¶ C.2, Exh. 33, SCT 303.) Cal Eagle followed suit. (RT 9161-9163.)

2. DOI's review of Rule 23 arising from complaints about its fairness.

By Fall 1990 (before Cal Eagle became a servicing carrier), DOI was receiving complaints that hired auto ratings and premiums were unfair under Rule 23 because subhaulers' policies provide primary coverage for their accidents. Prime haulers argued that they ordinarily bore only excess exposure when their subhaulers were properly insured, but because Rule 23 did not distinguish between primary and excess exposures, they were being charged too much for hired auto coverage. (E.g., Exhs. 447-448, SCT 2931-2935; RT 5646, 9162-9163, 9216, 9227.)

These complaints prompted DOI to undertake a review of Rule 23 in late 1990. (RT 9216-9219.) During that review process, the servicing carriers continued to rate subhauler's exposures using the then-effective version of Rule 23. Although it continued to receive complaints about the rule (RT 9168-9171), DOI did not direct the servicing carriers to change the way they rated subhauling exposures. Instead, it directed them to temporarily suspend collections (but not audits or billings) of disputed hired auto premiums on a case-by-case basis (as complaints were received) until the review was completed. (RT 9168-9169, 9184-9185.)

3. Revised Rule 23.

Rule 23 was revised by DOI on July 28, 1992, about four months after the Joneses' policy expired. (RT 9181.) The revision replaced a portion of "old" Rule 23 (Exh. 33, SCT 303) with "revised" Rule 23 (Exh. 12, SCT 233-235), making explicit that subhaulers were classified as hired autos. It specified that a "cost of hire basis" shall be used to rate "liability because of a lease, rental contract *or subhaul agreement* involving the hauling of goods on behalf of an insured trucker by a hired carrier." (Rev. Rule 23 ¶ C.2, Exh. 12, SCT 233, italics added.)

In addition to confirming that subhaulers are rated as hired autos, revised Rule 23 changed the calculation of hired auto premiums in three ways: First, it replaced old Rule 23's single rate for hired auto coverage with a primary rate one-third that of the old rate. (Rev. Rule 23 ¶ C.2.b.(2), Exh. 12, SCT 234-235; RT 4197-4198.) Second, it created an optional secondary rate, which reduced hired auto premiums for eligible truckers another 95 to 96 percent. The new secondary rate was available to those truckers who maintained a subhaul register showing their daily, per-haul use in accordance with PUC regulations, and had specified documentation designed to ensure that their subhaulers in fact had primary insurance coverage during the entire job. (Rev. Rule 23 ¶¶ C.2.a.(2), (3), Exh. 12, SCT 233-34; RT 2648, 4126, 4221-4222, 4987-4990, 5641-5642.) Third, the revised rule imposed a minimum cost of hire of $60,000 per subhauler, per year, designed to preclude "sweetheart" contracts where haulers set artificially low costs of hire in order to obtain low premiums. (Rev. Rule 23 ¶ C.2.b.(1), Exh. 12, SCT 234; RT 4979, 9178-9179.)

4. Revised Rule 23's implementation.

The Joneses and their broker received notice of Rule 23's revision and a CAARP Bulletin explaining how to qualify for the revised rule's lower rates. (RT 4119, 4983-4984, 8667-8668; Exh. 6, SCT 213.)

DOI declared the revision for "immediate implementation," retroactive to October 1990. (Exh. 12, SCT 233; RT 9180-9181.) CAARP specified (arguably inconsistently) that truckers must affirmatively request re-rating under the revised rule. (Exh. 6, SCT 213-214.) This generated uncertainty in a number of respects, including uncertainty about which version of the rule should apply when a trucker had not yet requested re-rating for a yet-to-be-billed premium; whether and how to apply the revised rule to truckers that did not request re-rating (particularly when audits and billings had been done under the old rule's requirements); and how to prorate the revised rule's $60,000 minimum annual cost of hire when subhaulers were used only briefly during the policy year. Cal Eagle asked for instructions from CAARP about one such uncertainty, but was unable to get any response. (Exh. 418, SCT 2883; RT 4116-4118, 4985-4986, 9175-9181, 9189-9196.) DOI's later assessment of the revision's impact led to further revisions, clarifications, and interpretations, extending at least until 1995. (RT 5642, 9195.)

D. Premium Audits and Billings.

1. First premium audit and bills.

On July 21, 1992, shortly before DOI announced its revision of Rule 23, Cal Eagle audited the Joneses' records under the old rule. The audit disclosed $369,482 subhauler cost of hire for the year. (RT 4151, 5793; Exh. 1A, SCT 16.) Based on this audit, Cal Eagle calculated an additional premium of $111,523 and sent its bill on September 16, 1992, two weeks after the revised rule was announced but before CAARP's December deadline for the Joneses to request re-rating. Because this audit was performed before Rule 23 was revised, when there was no reason to gather the information that would be necessary to rate subhauler exposures under the revised rule, the premium bill reflected old Rule 23's rate. (Exh. 65, SCT 374; RT 2589-2594, 4986.)

On December 11, 1992, Cal Eagle sent a second bill (also calculated under old Rule 23) for $115,869, reflecting further adjustments to the billed hired auto premium as well as premiums for additional vehicles observed in the Joneses' yard during the audit. (Exh. 66, SCT 376; RT 6445.) After the Joneses provided evidence that some of the added vehicles had not been used in their business and that another was sold during the policy year, Cal Eagle eliminated the additional premiums arising from all but one of those vehicles. (RT 4962-4966.)

2. Second premium audit and bills.

The Joneses requested re-rating under revised Rule 23 in late November 1992, and Cal Eagle conducted a second audit in early January 1993. (Exh. 2A, SCT 39; RT 4986-4987.) At the second audit the Joneses provided a subhaul register they had prepared in order to comply with the revised rule's new documentation requirements. However, contrary to CAARP and PUC requirements, the register did not show the use of their 44 subhaulers on a daily or per-haul basis, but only by month. (Exh. 1B, SCT 24-25; RT 4151, 4552.) This omission made it impossible to prorate the annual $60,000 minimum cost of hire on a daily basis. (RT 4427, 4561, 4706-4715, 4777-4801, 5361, 7583-7584.)[5]

When the $60,000 minimum annual cost of hire was applied to the $369,482 actual cost of hire, the result (even prorated on a monthly basis) was $726,689. Applying revised Rule 23's primary rate to that figure reduced the previously-billed premium to $51,294, about $50,900 of which was attributable to hired auto coverage. (RT 4558-4561, 4979; Exh. 146, SCT 650.)

Cal Eagle sent Fred Jones a $51,294 premium bill in February 1993, and again in March and April 1993. (Exhs. 67-70, SCT 377-380.) He never paid.

After sending the initial $51,294 bill, Cal Eagle sent two admittedly incorrect bills, each for $96,972, as a result of clerical errors. (Exhs. 51, 73, SCT 362, 381; RT 2603.) However, when the Joneses' insurance broker inquired about the $96,972 bill, Cal Eagle confirmed that it was incorrect and that the amount actually due was $51,294. (RT 8128-8129 [Mildred Jones admits knowing amount of bill was $51,000 when business closed], 10388 [broker was told premium sought was $51,000, not $96,000 or $115,000]; see also Exh. 73, SCT 381 [broker's note confirms "claim has been reduced to $51,000"]; Exh. 445, SCT 2929 [Joneses' attorney's letter confirms knowledge that $51,294 bill supplanted other bills].)

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[5] Both CAARP Bulletin 21-92 and PUC regulations explicitly required that subhauler use be shown on a daily, per-haul basis. (Exh. 6, SCT 214; PUC Gen. Order No. 102-H, ¶ 4.d, Exh. P, SCT 2986-2987.) Despite the impossibility of daily prorating based on the monthly data they furnished, the Joneses characterize Cal Eagle's failure to prorate as a fraudulently-invented reason "to deny the Joneses an excess rating." (OB 16.)

E. The Joneses' Complaints To DOI and CAARP And Their Responses.

In January 1993, after the second audit but before Cal Eagle sent the reduced $51,294 bill, the Joneses complained to DOI that the premium was excessive in light of their subhaulers' primary coverage, that Cal Eagle's addition of covered vehicles was unjustified, and that Cal Eagle was being unfair. (Exh. 435, SCT 2914-2916; RT 8117-8118.) The Joneses' broker also complained, writing to CAARP that it was unfair for revised Rule 23 to retroactively require the documentation needed to qualify for its secondary rating. (Exh. 468, SCT 2960-2961.) CAARP responded by confirming to the Joneses' broker that the requested documentation was essential to establish eligibility for the secondary rating and that the Joneses should address any dissatisfaction with the rule's requirements to DOI. (Exh. 469, SCT 2962-2963.)

DOI responded to the Joneses' complaint by seeking information from Cal Eagle. (Exh. 139, SCT 641-642.) In mid-February 1993, Cal Eagle advised the Joneses (and DOI) that it had used revised Rule 23's primary rate because the Joneses' documents did not show their eligibility for the secondary rate; it also advised that it had removed the premium charges for a number of the added vehicles. (Exh. 146, SCT 647-650; RT 4992-4997, 9595-9596.)

In late February 1993, DOI apprised the Joneses that (1) Cal Eagle was entitled to audit; (2) the additional documentation Cal Eagle requested is required to show eligibility for revised Rule 23's secondary rating; and

(3) if Cal Eagle continued to withhold that rating after the Joneses provided the required documentation, DOI would "intercede on your behalf" to obtain the rating. (Exh. 141, SCT 644.)[6]

F. The Joneses' Responses To DOI's And CAARP's Rulings.

After receiving DOI's promise to intercede if documents showing their eligibility were produced, the Joneses did not supply any additional documents. (RT 4989, 7576, 8122.) On April 27, 1993, their attorney notified Cal Eagle that they would not pay the $51,294 premium, and they would contest any legal action. (Exh. 445, SCT 2929.)

In a November 1993 letter transmitted to the Joneses' attorney (RT 5365), Cal Eagle again sought the required documentation, offered to conduct another audit, and suggested that if they had further disputes about Rule 23, they should "address this with the DOI directly." (Exh. 444, SCT 2927-2928.) The Joneses' attorney responded to the letter in February 1994, denying any duty to produce documents showing eligibility but offering to make records accessible on request. (Exh. 10, SCT 229-232.)

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[6] DOI's express promise to "intercede on your behalf" if the requested documents were provided dispels the claim that the Joneses reasonably believed DOI could and would do nothing to change Cal Eagle's position on the secondary rating. (See OB 17.)

STATEMENT OF THE CASE

A. Cal Eagle's Premium Collection Suit And The Tort Cross-Action.

Jonathan Neil & Associates sued Fred Jones for the $51,294 premium on Cal Eagle's behalf. (CT 1-3.)[7] Fred Jones, Mildred Jones, and Fred Jones Trucking, Inc. cross-complained, alleging that by seeking an additional premium Cal Eagle was guilty of tortious insurance bad faith and fraud. (CT 15, 10284.)[8]

B. Cal Eagle's Pretrial Motions To Require Exhaustion Of Administrative Remedies Are Denied.

The action against Fred Jones was a straightforward collection suit for "money due" for the billed and unpaid $51,294 premium. (CT 1.) The

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[7] The collection suit named only Fred Jones, because the policy made only him responsible for premiums. (Exh. 3A, SCT 71, 81.) Cal Eagle's appeal contended that Mildred Jones lacks standing under any theory because she was neither billed nor sued. Cal Eagle also challenged the standing of both Fred and Mildred Jones because they had transferred the trucking company's assets and liabilities of the trucking business before any cause of action arose. (AOB 48-53; ARB 59-68.) The Court of Appeal's decision declined to reach these points. (Opn., p. 15.)

[8] The Joneses also sued their insurance broker, Johnsey Insurance Agency, for luring them into the assigned risk market without warning them of "the controversy in commercial trucking insurance . . . with regard to Rule 23 and cost of hire." (3d Am. Cross-compl. ¶ 13(g), CT 10294.) The claims against Johnsey were settled during trial. (CT 11548.)

Joneses' cross-complaint, however, contested Cal Eagles' interpretation and application of CAARP's rules, the propriety of Cal Eagle's rating of exposures under Rule 23, and the good faith of its conduct as a servicing carrier. (CT 15-20, 10284-10300.)

In view of the issues raised by the cross-complaint, Cal Eagle challenged the Joneses' failure to exhaust DOI's and CAARP's administrative procedures for the resolution of disputes about rates, premiums, and administration of the assigned risk system. (CT 45, 51-54, 1673, 1690-1694.) The trial court denied relief (CT 342-343, 6680), and the Court of Appeal and this Court summarily denied writ relief (CT 7703; *Cal Eagle Ins. Co. v. Fresno Superior Court*, 5 Civ. No. F027006).

C. The Three-Phase Trial.

1. Phase 1.

The court heard evidence and ruled on key legal issues involving interpretation of the assigned risk policy and CAARP's rating rules and whether and how they apply to rating the Joneses' exposures and calculating their premiums. (RT 3261-3264.) The court ruled that subhaulers are not rated as hired autos under Rule 23, precluding use of subhauler cost of hire to determine the Joneses' hired auto premium. (See RT 3262:5-7, 3262:17-18, 3466.)

2. Phase 2.

A jury was empaneled, instructed on the court's phase 1 rulings (RT 3712-3715, 4090), and heard evidence about the meaning of the CAARP policy, Rule 23 and its revision, the PUC regulations, the Insurance Code, and the propriety of Cal Eagle's assessment of the hired auto exposures.[9] The jury was instructed, inconsistently, that under Rule 23 subhauler exposures both are, and are not, rated as hired autos.[10]

The jury heard evidence of the Joneses' compensatory damages, consisting of emotional distress, attorneys fees, and lost profits. According to the Joneses, uncertainty about Cal Eagle's bills and collection lawsuit left them upset, sleepless, and depressed; Mildred was upset also by Cal Eagle's rude auditor. (RT 7674-7679, 7838-7844.)

The evidence showed that after the premium collection suit was filed, the Joneses entered into a contingent attorney fee agreement that discharged their existing fee obligation, replacing it with a $25,000 cap plus a contingent share of any damages collected by their tort cross-action. (Exhs. 471, 472, SCT 2965, 2974.) Although the jury was not permitted to

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[9] On appeal, Cal Eagle claimed prejudicial error in the admission of lay and expert opinion evidence with respect to both insurance bad faith and fraud. (AOB 77-85, ARB 99-111.) The Court of Appeal's decision did not reach these issues.

[10] RT 11496:22-23, CT 12869 ¶ 9 [rev. Rule 23 applies to subhauler risks]; RT 11496:17-21 [rev. Rule 23 controls change in Joneses' premium]; RT 4090:16-18 [subhaulers are not hired autos]; RT 11496:14-15, CT 12868 ¶ 7 [subhaulers are not hired autos]; RT 11515:20-24 [cost of hire does not included charges for subhaulers with PUC authority and insurance]. Cal Eagle's appeal attacked as prejudicially erroneous these and many other instructions. (See AOB 57-76, ARB 75-98.) The Court of Appeal decision did not reach these issues.

know about the discharge of the existing fee obligation or the contingent fee agreement (RT 7914-7921, 8058, 8621-8622), it was allowed to hear the Joneses claim for attorneys fees under *Brandt v. Superior Court* (1985) 37 Cal.3d 813, based on their attorneys' allegations they spent time valued at more than $1 million to defeat the $51,294 premium claim. (CT 12948; RT 9552-9553, 9891-9912.)[11]

The Joneses testified that, due to the unresolved premium dispute, they decided in December 1993 not to invest in equipment that the business needed to continue. Fred Jones Trucking, Inc. closed its doors and sold its trucks, allegedly losing profits. (RT 7679-7681, 8134, 8421-8434.)

3. Phase 3.

This phase of the trial involved punitive damages.

D. The Verdict, Judgment, And Post-Trial Motions.

The jury found no premium was due and imposed liability against Cal Eagle for tortious bad faith and fraud. (CT 12612-12615.) It awarded the Joneses $409,783 for loss of profits and $1,067,384 for attorneys fees and costs under *Brandt.* Fred and Mildred were each awarded $275,000 for

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[11] Cal Eagle's appeal asserted prejudicial errors in sheltering the jury from the actual fee agreement and in the *Brandt* fee award (AOB 85-94, ARB 112-120), however the Court of Appeal declined to reach these issues. (Opn., p. 15.)

emotional distress. (CT 12614.) The jury awarded punitive damage of $11,445,714.23. (CT 12713-12714.)[12]

Cal Eagle's post-judgment motions resulted in a new trial unless the Joneses would accept a reduction of punitive damages to $4,350,887; the Joneses accepted the reduction. (CT 15249, 15261.)[13] Motions to vacate, for judgment notwithstanding the verdict, and to amend the judgment to reflect the remitted punitive award were denied. (CT 13389, 13395, 13422, 13507, 13743, 13935.)[14]

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[12] Neither the fraud verdict nor any conduct other than the premium billing can support the judgment. Although the Joneses frequently charge Cal Eagle with fraudulent auditing, unreasonable claim settlement, and other undefined fraud, the only economic damages they claimed arose from lost profits allegedly caused by closure of the business due to uncertainty about the $51,294 premium bill. (RT 7681:23-26 [Joneses had no reason except disputed premium bills to close business], 7683-7684 [Joneses would have stayed in business "if it weren't for the Cal Eagle bills"], 8611 [Joneses' *Brandt* attorney fee claim is based on premium suit].)

[13] The court awarded post-verdict interest on each element of damages, including the remitted portion of the punitive award. (CT 15617 ¶ 6B, 15616-15618.) It also awarded costs separately against Jonathan Neil & Associates, Inc. and Cal Eagle (in addition to costs within the jury's verdict), reserving a right to increase its award if an appeal results in reduction of the jury's cost award. (CT 15722-15723.)

[14] Because the trial court refused to enter a modified judgment to reflect the reduced punitive award (CT 15428, 15705-15706), no judgment or other document reflects the judgment as remitted. The Court of Appeal declined to reach Cal Eagle's appeal from the trial court's refusal to enter a modified judgment. (CT 15707; Opn., p. 15; see AOB 97, ARB 122-123.)

E. The Appeal.

Cal Eagle and Jonathan Neil & Associates, Inc. appealed from the judgment and the post-judgment orders. (CT 15266, 15299, 15707, 15725.) The Joneses cross-appealed from the judgment and the new trial order. (CT 15327.)

The Court of Appeal reversed, holding that Cal Eagle's conduct did not give rise to a tort cause of action for breach of the implied covenant of good faith and fair dealing and that administrative remedies must be exhausted before judicial relief can be available.

The Court of Appeal did not reach reaching multiple remaining issues raised by the appeal. It remanded the matter with directions, requiring a stay of trial court proceedings pending the outcome of administrative proceedings. (Opn., p. 45.)

This Court granted review.

ARGUMENT

I.

INSURANCE BAD FAITH TORT LIABILITY IS PRECLUDED AS A MATTER OF LAW BECAUSE THERE ARE GENUINE ISSUES WHETHER CAL EAGLE'S BILLINGS WERE APPROPRIATE.

The Joneses insist that tort liability is appropriate because Cal Eagle's post-expiration premium bills were wrongful and wrongfully motivated. But Cal Eagle's premium claim, whether ultimately right or wrong, was supported both by the language of Rule 23 and by the undisputed fact that the Joneses did extensively use subhaulers for which no premiums had been assessed. Its application of that rating rule was objectively tenable, and not actionable in tort.

Imposing tort liability for Cal Eagle's assertion of a tenable and legitimately-disputed legal position would violate established law and would impair its constitutionally protected right of access to the courts for the determination of its rights.

A. Billing And Suing For A Legitimately-Disputed Premium Is Constitutionally Protected And Cannot Be Tortious.

Where a legal position is supported by objectively tenable arguments — where it is the subject of legitimate dispute — its assertion by any citizen (an insurer or anyone else) cannot give rise to tort liability. "It is now settled law in California that an insurer denying or delaying the payment of policy benefits due to the existence of a genuine dispute with its insured . . . is not liable in bad faith even though it might be liable for breach of contract." (*Chateau Chamberay Homeowners Assn. v. Associated Internat. Ins. Co.* (2001) 90 Cal.App.4th 335, 347.)

This is so both as a matter of constitutional principle and the law of torts. "[T]he . . . considerations underlying the bad faith tort must yield to 'the policy of encouraging free access to the courts . . . .'" (*Old Republic Ins. Co. v. FSR Brokerage, Inc.* (2000) 80 Cal.App.4th 666, 688.) If the law were otherwise, litigants would be subjected to tort liability and punishment merely for asserting their tenable legal positions. Then, "tort law would inhibit free access to the courts and impair our society's commitment to the peaceful, judicial resolution of differences." (*California Teachers Assn. v. State of California* (1999) 20 Cal.4th 327, 335, 338-339.)

Numerous additional cases squarely so hold.[15] Even the Joneses

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[15] E.g., *Pacific Gas & Electric Co. v. Bear Sterns & Co.* (1990) 50 Cal.3d 1118, 1131-1132, 1134, 1137 [tort liability cannot constitutionally be imposed unless the "defendant's pursuit of judicial and administrative relief was so clearly baseless as to amount to an abuse of process"]; *Gruenberg v. Aetna Ins. Co.* (1973) 9 Cal.3d 566, 574 [no tort liability for bad faith unless insurer acted "without proper cause"]; *Fraley v. Allstate Ins. Co.* (2000) 81 Cal.App.4th 1282, 1292 [same]; *Dalrymple v. United States Auto. Assn,* (1995) 40 Cal.App.4th 497, 516-517 [absence of proper cause is affirmative element of bad faith cause of action]; *Opsal v. United Services Auto. Assn.* (1991) 2 Cal.App.4th 1197, 1205-1206 [bad faith liability cannot be imposed where there is "genuine issue" as to insurer's contract liability]; *State Farm Mut. Auto. Ins. Co. v. Superior Court* (1991) 228 Cal.App.3d 721, 726-727 [no bad faith liability unless insurer acted
(continued...)

concede that the existence of a genuine dispute precludes bad faith tort liability. (OB 35.)[16]

Because Cal Eagle's premium claim is supported by objectively tenable grounds that were the subject of genuine dispute, there can be no bad faith tort liability.[17] This alone should end the case.

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[15] (...continued)
without proper cause]; see also *Sheldon Appel Co. v. Albert & Oliker* (1989) 47 Cal.3d 863, 871, 875 [absence of probable cause is required to prove malicious prosecution to "avoid improperly deterring individuals from resorting to the courts for the resolution of disputes"]; *California Motor Transport Co. v. Trucking Unlimited* (1972) 404 U.S. 508, 510-511 [30 L.Ed.2d 642, 646, 92 S.Ct. 609, 611-612] [no antitrust liability for petitioning government with probable cause]; *Sierra Club v. Butz* (N.D. Cal. 1972) 349 F.Supp. 934, 938-939 [no interference cause of action when claim is based on probable cause].

[16] The Joneses' brief cites two cases for the opposite proposition, *Rich & Whillock, Inc. v. Ashton Development, Inc.* (1984) 157 Cal.App.3d 1154, 1159, and *Louisville Title Ins. Co. v. Surety Title & Guar. Co.* (1976) 60 Cal.App.3d 781, 800-801. (OB 29.) Both are inapposite, because they involve only *contract enforcement*, not tort liability.

[17] Cal Eagle unsuccessfully requested rulings and, failing that, jury instructions on this issue. (CT 12588, 13236, 13238, 13240, 13244, 13245, 13246; RT 11081, 11462-11463, 13582-13583.) The jury was instructed, at the Joneses' request, that it could impose tort liability for "incorrect billing statements" alone. (CT 12928.) Although the jury was permitted to "consider" (if it chose) whether Cal Eagle's bills arose from a reasonable, honest, or mistaken belief that they were correct (CT 12935; see ARB 90-91), it was not told that those circumstances would preclude tort liability.

B. Cal Eagle's Premium Claim Was Objectively Tenable And The Subject Of Legitimate Dispute.

Objectively reasonable grounds for Cal Eagle's application of Rule 23 permeate the record. For example:

- In revising Rule 23, DOI clarified — explicitly — that a trucker's use of subhaulers is included in the cost of hire calculation for hired auto premiums. (Rev. R. 23 ¶ C.2, Exh. 12, SCT 233.) According to DOI's senior attorney in charge of revising Rule 23, DOI essentially "adopted [NCI's] reading of [old] Rule 23." (RT 9366.)
- Old Rule 23's rating formula — explicitly applicable to "liability because of a contract involving the hire of trucks, tractors and trailers" — furnished an objectively-tenable basis for believing "the hire of trucks" included subhaulers (as both NCI and Cal Eagle concluded). (Rule 23 ¶ C.2, Exh. 33, SCT 303; RT 9364-9365.)
- Under the policy's definitions, a "trucker" transports property "by 'auto' for hire" (Exh. 3A § VI.L., SCT 72); "hired auto" coverage applies to vehicles that truckers "lease, hire, rent or borrow [with certain inapplicable exceptions]." (Exh. 3A § I.A., SCT 64.) The Joneses and their trucks are "hired" by customers to haul goods; the Joneses in turn "hire" subhaulers to do the job. Under this straightforward reading, subhaulers

are "hired autos" and, therefore, are tenably subject to rating under Rule 23's cost of hire formula.

- DOI was fully aware that NCI was applying Rule 23 to rate subhauling exposures even before Cal Eagle became a CAARP servicing carrier. (RT 9162-1963.) When Cal Eagle was appointed, it did the same. (RT 9163.) Nevertheless, DOI did not direct the servicing carriers to change the way they rated those exposures; it merely instructed them to suspend collection (but not auditing or billing) of any disputed hired auto premiums until DOI finished reviewing and revising Rule 23. (RT 9164, 9168-9169; see Exh. 148, SCT 695.)
- When DOI investigated the Joneses' consumer complaint, it concluded that Cal Eagle was justified in seeking an additional premium under revised Rule 23's primary rate unless the Joneses were able to furnish the documentation required to establish their eligibility for the lower secondary rate. (Exh. 141, SCT 644.)
- Key witnesses involved with commercial assigned risk rating (including some who testified for the Joneses) interpreted both old and revised Rule 23 to encompass subhauler risks. (E.g., RT 2148, 9366 [senior DOI attorney in charge of Rule 23]; 5551, 6165 [DOI clerk testifying for Joneses]; RT 10408, 10416 [Joneses' agent]; RT 2646, 2651 [Cal Eagle expert]; 10122-10123 [Joneses' expert].)

- In March 1991, the Commercial Automobile Committee of AIPSO (the organization with whom CAARP had contracted for management services) approved rating subhauling exposures under Rule 23. (RT 4096-4097; Exh. 18A, SCT 265-266.)
- The Joneses have not denied, and have even affirmatively proclaimed, the existence of "diametrically opposite written legal opinions" on the subject. (OB 5-6; RT 9343-9348; see Exh. 89, SCT 404.)
- Unless subhaulers are rated as hired autos under Rule 23, they would fall outside CAARP's rating classifications altogether. That would leave the commercial assigned risk system responsible for subhauler exposures without any mechanism for calculating or collecting premiums for the risk — whatever its magnitude. (RT 2787-2788, 10108-10111, 10410-10411; Exh. 89, SCT 402.)
- Even if Cal Eagle's application of CAARP's rating rules had been improper, *some* additional premium was inevitable. *Some* additional exposure (whether primary or excess) necessarily arose from the Joneses' previously undisclosed use of 44 subhaulers with $369,482 actual cost of hire. (RT 6896-6897, 9173-9174.)

Each of these facts — just the tip of the iceberg — confirms the existence of a genuine dispute about how the Joneses' subhauler exposures should be rated and billed and objectively tenable grounds for Cal Eagle's application of Rule 23. During the entire period there was an ongoing, industry-wide controversy about whether and how subhauling exposures should be rated under Rule 23 — a dispute that led DOI to undertake its extensive review and revision of the rule beginning in 1990. (RT 4195-4196, 5457-5460, 9162, 10122-10123.) As their own agent put it, even when the Joneses applied for coverage DOI was actively reviewing "the considerable confusion and difference of opinion as to what constituted hired auto exposure." (RT 10615; Exh. 2A, SCT 39.)

The existence of objectively tenable grounds for a party's legal position is an issue of law. (*Sangster v. Paetkau* (1998) 68 Cal.App.4th 151, 167; *Hufstedler, Kaus & Ettinger v. Superior Court* (1996) 42 Cal.App.4th 55, 62-66 [if claim is legally tenable, factual disputes are irrelevant to existence of probable cause].) Because Cal Eagle's premium claims — right or wrong — were supported by objectively tenable legal arguments, their assertion cannot give rise to tort liability.

C. The Policy Did Not Guarantee the Joneses Any Right to Be Unbothered by A Genuine Premium Dispute.

Insurers impliedly covenant not to impair the benefits of the coverage that their insureds have purchased. (*Foley v. Interactive Data Corp., supra,* 47 Cal.3d at p. 683; *Waller v. Truck Ins. Exchange, Inc.* (1995) 11 Cal.4th 1, 36.) But those "benefits" do not encompass a right to be free from a legitimate dispute. (*Western Polymer Technology, Inc. v.*

Reliance Ins. Co. (1995) 32 Cal.App.4th 14, 27 [policy's purpose is to provide insured with defense and indemnification within scope of coverage purchased, "not to insure the entire range of the insured's well-being"].)

The Joneses maintain that an insurer's "threat of a collection action" constitutes "an act which the law recognizes as wrongful." (OB 29.) Under that paradigm, insurers must forfeit a disputed premium (or any other tenable claim) lest they risk tort liability if their legal position proves to be wrong. This is not the law, nor should it be.

Under long settled principles, insurers are allowed to assert their legitimate claims — even those that threaten the very heart of the insurance relationship — without being saddled with tort liability. (See authorities cited in footnote 15, above.) For example, insurers are permitted to reserve their rights, and to sue to contest and resolve their contractual obligations, without risking tort liability. (*John Hancock Mutual Life Ins. Co. v. Greer* (1998) 60 Cal.App.4th 877 [lawsuit is appropriate to resolve legitimate disputes over insurance contract]; *Atlas Assurance Co. v. McCombs Corp.* (1983) 146 Cal.App.3d 135, 150 [lawsuit to determine rights under insurance policy "cannot form the basis of breach of the duty of good faith and fair dealing"]; *Dalrymple v. United States Auto. Assn., supra,* 40 Cal.App.4th at pp. 516-517 [same]; *Prichard v. Liberty Mutual Ins. Co.* (2000) 84 Cal.App.4th 890, 894-895 [insurer breaches no duty by reserving rights to assert tenable reimbursement claim]; see *Sheldon Appel Co. v. Albert & Oliker, supra,* 47 Cal.3d at pp. 871, 875 [no tort liability for prosecuting tenable claim].)

These acts directly threaten coverage entitlements; yet they are the approved means by which an insurer may lawfully protect its legal interests. If these acts cannot be the basis for tort liability, how could tort liability be triggered by the far less intrusive and less threatening act of billing for a disputed post-expiration premium?

The answer is that they cannot. By seeking to impose tort liability on Cal Eagle for sending premium bills supported by objectively tenable bases, the Joneses would undermine years of established precedent protecting Cal Eagle's constitutional right to assert and resolve genuine rating and billing disputes without risk of punishment.

II.

BAD FAITH TORT LIABILITY IS NOT, AND SHOULD NOT BE, AVAILABLE IN A PREMIUM BILLING DISPUTE.

Contract remedies enforce the parties' intentions; tort law is designed primarily to vindicate public policy. (Prosser & Keeton, The Law of Torts (5th ed. 1984) § 1, p. 4; *Carma Developers (Cal.), Inc. v. Marathon Development California, Inc.* (1992) 2 Cal.4th 342, 373 & fn. 13.)

A covenant is implied in all contracts, including insurance policies, that neither party will impair the other's receipt of the contract's express benefits. (*Foley, supra*, 47 Cal.3d at pp. 683-684, citing Rest.2d Contracts § 205.) Because the implied covenant is a contract term, compensation for its breach is "almost always" limited to contract remedies. (*Cates Constr., Inc. v. Talbot Partners, supra,* 21 Cal.4th at p. 43; *Foley, supra*, 47 Cal.3d at p. 684.)

There is one recognized exception: the "insurance exception." (*Cates, supra,* 21 Cal.4th at p. 43; *Foley, supra,* 47 Cal.3d at p. 684.) However, this exception does not apply to every insurance dispute. As this Court has held, it is the actual nature of the benefit withheld that dictates whether tort remedies are available. This is true even where the dispute involves a statutorily-defined insurer's withholding of payments. As *Cates* held, "contractual relationships may give rise to tort liability only in *exceptional* circumstances." (*Cates, supra,* 21 Cal.4th at p. 50 & fn. 14, original emphasis; see also pp. 49, 52.)

We demonstrate below that this premium dispute manifests none of the characteristics that this Court has identified as the sort of "exceptional" circumstances that are essential before tort liability may be imposed. Their absence is fatal to the Joneses' bad faith tort claims.

A. The "Insurance Exception" Cannot Apply Because Cal Eagle Undertook No Insurance Risk.

At a basic level, bad faith tort liability is precluded because Cal Eagle was not an insurer with respect to the Joneses' exposures. Cal Eagle was merely a *servicing carrier*, shouldering no insurance risk under the CAARP policy.

Under CAIP, it is California's automobile insurers collectively, through CAARP, that underwrite commercial assigned risk policies. (Cal. Code Regs., tit. 10, § 2432.) As a CAARP servicing carrier, Cal Eagle did not undertake any duty to indemnify — the *sine qua non* of insurance. (Ins. Code, § 22; Exh. 14, SCT 236, 246-248; RT 8724.) As the Joneses concede, servicing carriers such as Cal Eagle carry "'no insurance risk at all.'" (OB 2.)[18]

Where, as here, no insurance risk has been assumed, there can be no tort liability for breach of the implied covenant — not even against an entity classified by statute and label as an "insurer." This is the holding in *Cates, supra,* 21 Cal.4th at pp. 52-61 [bad faith tort remedies not available because surety, although defined as an insurer, bears no insurance risk].)

B. A Dispute About the Price of Insurance Does Not Trigger Application of the "Insurance Exception."

An insurance policy is a contract. Like most contracts, it involves a product and a price. The product is a promise of protection when covered

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[18] The absence of insurance risk distinguishes commercial assigned risk servicing carriers such as Cal Eagle from insurers in the non-commercial assigned risk system. In the non-commercial system, unlike under CAIP, each issuing insurer undertakes the insurance risk for each assigned risk insured. (See *California State Auto. Assn. Inter-Ins. Bureau v. Garamendi* (1992) 6 Cal.App.4th 1409.) This distinction explains the decision in *Hightower v. Farmers Ins. Exchange* (1995) 38 Cal.App.4th 853, that a non-commercial assigned risk insurer may incur tort liability for bad faith claims handling.

risks occur. The price is the premium. (*Buss v. Superior Court* (1997) 16 Cal.4th 35, 45.)

Foley and *Cates* establish the general rule that tort liability is not available for breach of contractual covenants, including the implied covenant of good faith and fair dealing. However, these cases declare the general rule is subject to an insurance exception, one that is to be applied with "great care." (*Cates, supra,* 21 Cal.App.4th at p. 46.)

What are the special features of insurance contracts that warrant departure from the general rule? *Cates* reveals the answer.

- The answer does not lie in the "insurance" label, nor in the fact that covered benefits have been withheld, nor in the fact that the breach causes economic detriment. Each of these elements was present in *Cates*, yet tort liability was refused.
- The key to whether bad faith tort liability can be imposed on an insurer lies in two unique elements: the promise that the insured will be protected against calamity if a covered risk occurs, and the "unique economic dilemma" that the insured faces if the insurer unreasonably fails to furnish the promised protection. (*Cates, supra,* at p. 56; *Foley, supra,* at pp. 684-692.)

Ordinary commercial contracts, and even many aspects of insurance contracts, do not present these unique characteristics.[19] The unique

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[19] Commercial contracts are typically executed for commercial advantage rather than protection against calamity. Breach of an ordinary contract might trigger financial consequences, but the victim suffers no unique

(continued...)

economic dilemma confronting an insured after a covered risk occurs and coverage is unreasonably denied stems from the particular vulnerability he faces from both the catastrophe and his complete dependence on the insurer for performance of the promised protection. In such situations, the insurer has complete control over whether it will afford coverage in the manner promised, and the insured can look only to the insurer for such protection because replacement coverage is impossible to obtain after a covered risk has occurred. The only way the insured's dilemma can be successfully resolved is if the insurer promptly honors its promises. (*Cates, supra,* at pp. 54-55.)

It is the confluence of *both* these special circumstances — an unreasonable denial of promised protection and a unique economic dilemma — that warrants the "exceptional approach" and "extraordinary remedies" of bad faith tort liability. (*Cates, supra,* at pp. 51-52.) As *Cates* held, a denial of coverage without the special economic dilemma does not suffice.

There is only one aspect of the insurance relationship that is sufficiently unique and powerful to place the insured in a unique economic dilemma from which there is no extrication. That aspect involves coverage benefits — defense, indemnity and settlement — and the unreasonable denial of those benefits. These are the promises that are irreplaceable after a calamity occurs.

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[19] (...continued)
economic dilemma since he ordinarily possesses a number of viable options to protect his interests. (*Cates, supra,* at pp. 54-56.)

Cates establishes that an unreasonable breach of these coverage promises permits tort liability because this type of breach differs from the "ordinary sort of situation," where breach has "merely adverse financial significance to the nonbreaching party" or where the breach results merely in additional or increased financial harm (such as attorney's fees) that "typically occur[s]" whenever a contract is breached. (*Cates, supra,* at p. 54.) As *Cates* holds, an insured's claim "that the breach detrimentally affected their business" cannot transmute a breach of contract into tort liability. (*Ibid.*)

Cates refused to permit tort liability under its facts, even though an insurer's promise of protection was breached. It did so because the other core element, unique to applying the tort exception, was missing. The insured simply was not confronted with a unique economic dilemma from which extrication was possible solely through performance of the insurance promise.

Our case is one step even further removed than *Cates,* for it reflects *neither* of the components essential to the imposition of tort liability. Unlike our case, *Cates* at least involved a denial of promised protection. Here, no covered protection was denied. The Joneses received full coverage benefits.

Nor is the second *Cates* component satisfied. The dispute in our case concerns only *price.* There is nothing unique about price; it is a component of virtually every contract. At most, a breach as to price presents only the "ordinary sort of situation" that typically occurs in the event of any contract breach — a situation that deals only with commercial advantage and results in "merely adverse financial significance" to the non-breaching party. (*Cates, supra,* at pp. 53-54, 56 fn. 20.) Price relates exclusively to commercial advantage, a consideration that *Cates* holds does not suffice to trigger tort remedies. (*Id*. at p. 53.)

Because tort liability safeguards only the promise of coverage protection against possible calamity there is no reason to make such liability available for a contract price dispute. When coverage benefits are not unreasonably threatened or denied, the insured faces no unique economic dilemma that distinguishes him from other victims of contractual breach. Absent unreasonable coverage denial, the implied covenant cannot transform an ordinary contract breach into a tort. (*Waller, supra*, 11 Cal.4th at pp. 35-36 [no bad faith tort liability where no coverage duty owed]; *Old Republic Ins. Co. v. FSR Brokerage, Inc., supra,* 80 Cal.App.4th at p. 688 [no bad faith tort liability unless insurer's conduct threatens "the security against losses and third party liability" that the insured purchased]; *Western Polymer Technology, Inc. v. Reliance Ins. Co., supra,* 32 Cal.App.4th at p. 27 [policy's purpose is to provide insured with defense and indemnification within scope of coverage purchased, "not to insure the entire range of the insured's well-being"].)

For these reasons alone, bad faith tort liability is impermissible in this case.

C. The Specific Factors That Justify the "Insurance Exception" for Bad Faith Tort Liability Are Absent from this Case.

In implementing the core considerations essential to imposition of bad faith tort liability, this Court identified a number of distinct elements that must be satisfied. These elements, each tied to the core promise of coverage benefits, are the following: (1) the insurer's superior bargaining position and the adhesive nature of the relationship (*Foley, supra*, 47 Cal.3d at pp. 684-685; *Cates, supra,* 21 Cal.4th at pp. 52-53); (2) the "unique 'economic dilemma'" facing the insured when insurance benefits are withheld (*Cates, supra,* at pp. 53-55); *Kransco v. American Surplus Lines Co*. (2000) 23 Cal.4th 390, 400); and (3) the quasi-fiduciary position of confidence and discretionary control over policy benefits that insurers typically enjoy (*Foley, supra,* at pp. 684, 691-692; *Cates, supra,* at pp. 53-56).

None of those factors is satisfied here.

1. The premium dispute had nothing to do with any adhesive bargaining position.

Insureds typically are bound in an adhesive relationship where the insurer unilaterally imposes the policy's terms and exercises total control over whether and when coverage benefits will be provided. This imbalance is absent here.

Here, the parties' relative economic power had nothing at all to do with their premium dispute. In response to the disputed bill, the Joneses confronted no lack of power to address it. Quite to the contrary, the Joneses possessed full power. They could — and did — just say "no." Moreover, they could have obtained the dispute's prompt resolution by pursuing DOI's or CAARP's grievance procedures. (See discussion, Section III, below.) Faced with the Joneses' refusal to pay, it was Cal Eagle that was required to respond if it wanted to collect the disputed premium. It was Cal Eagle that was required to take legal action.

The price dispute here was unaffected by any legally cognizable disparity in the parties' relative bargaining positions. Nothing here involves the type of relative imbalance in economic or bargaining power that the cases have considered important.

2. The Joneses faced no "unique economic dilemma," but only the "merely adverse financial" consequences that attend any commercial dispute.

When they received Cal Eagle's premium bills, the Joneses did not confront the "unique 'economic dilemma'" that faces an insured "when an insurer in bad faith refuses to pay a claim or accept a settlement offer within policy limits." Far from it. The Joneses faced nothing more than the "ordinary sort of situation in which breach of a commercial contract may have merely adverse financial significance." (*Foley, supra*, at p. 692; *Cates, supra*, at p. 54.) The premium dispute related only to commercial advantage — the contract price. Nor could anything more possibly have been involved, as the policy had already expired and all coverage claims had been paid.

Cates holds that financial impact alone does not pose the type of unique economic dilemma that permits imposing tort liability for breach of the implied covenant. That is because ordinary financial impact does not pose the unique economic dilemma that an insured faces where irreplaceable coverage protections are unreasonably denied. "[A] breach of contract . . . cannot be transmuted into tort liability by claiming that the breach detrimentally affected [the insured's] business." (*Cates, supra,* at p. 54.)

But this is exactly what the Joneses claim here. It is not enough.

Of course, no one likes to receive bills they believe are unjustified. But billing disputes occur commonly — even in relationships infused with the very highest of fiduciary responsibilities, such as attorney-client, doctor-patient, and trustee-beneficiary. Notwithstanding the tenderness and "financial significance" of billing disputes that arise during these relationships, none is "exceptional" and none justifies tort liability for breach of any covenant, express or implied.

There is nothing in Cal Eagle's policy, in the relationship of the parties, or in the law of insurance bad faith that immunizes the Joneses from the "merely adverse financial" consequences of their premium dispute with Cal Eagle.

3. The premium dispute had nothing to do with any quasi-fiduciary position of trust and confidence.

The premium dispute in this case had nothing to do with the position of trust, confidence, and quasi-fiduciary control that insurers exercise when dispensing coverage benefits. (*Cates, supra,* at pp. 44, 60.)

Cal Eagle's post-expiration premium bills, right or wrong, did nothing to jeopardize the "certainty and security in a risky enterprise" that coverage promises, nor did the bills "negate[ ] the very purpose" of the insurance contract. (*Cates, supra,* at p. 66 (conc. and dissenting opn.).) Just as any client, patient, beneficiary or other contracting party can decline to pay its bills, the Joneses opted not to pay theirs — without "negat[ing] the very purpose" of their expired coverage benefits. Nor would their coverage benefits have been threatened or impaired it they had resorted to the available administrative remedies that were precisely designed to address their grievances. (Cal. Code Regs., tit. 10, § 2495.)

Because none of the public policy factors that this Court has found to be essential to justify imposing tort liability for insurance bad faith is present here, the Joneses' request for relief should be rejected.

D. Creation Of A Bad Faith Billing Tort Is Unnecessary Because Existing Remedies Fully Protect Insureds' Legitimate Rights.

This Court's cautionary warning should be heeded: "great care" should be exercised before the "exceptional approach" of bad faith tort liability is extended. (*Cates*, *supra*, 21 Cal.4th at p. 46.) No expansion is needed here because existing remedies fully protect persons who are wrongfully damaged by improper billings.

Under existing law, insureds (or other contracting parties) can recover *contractual* relief for breach of the implied covenant of good faith and fair dealing. (E.g., *MacGregor Yacht Corp. v. State Comp. Ins. Fund* (1998) 63 Cal.App.4th 448, 453, 456-458 [contract remedies for insurer's improper reserve overestimates that result in insureds' payment of excessive premiums]; *Mission Ins. Group, Inc. v. Merco Construction Engineers, Inc.* (1983) 147 Cal.App.3d 1059 [equitable accounting as to how insurer "determined the amount" of dividend].)

Under existing law, fraud tort liability is available when an insurer (or anyone else) actually obtains undeserved premiums (or other benefits) from an insured through misrepresentations or false promises. (E.g., *Lance Camper Manufacturing Corp. v. Republic Indemnity Co.* (2001) 90 Cal.App.4th 1151, 1155, 1160; *Notrica v. State Comp. Ins. Fund* (1999) 70 Cal.App.4th 911, 919.)[20]

Under existing law, one who prosecutes a lawsuit without probable cause is subject to tort liability for malicious prosecution. (*Sheldon Appel*

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[20] The Court of Appeal declined to reach the multiple arguments that impeach the fraud verdict in this case, a verdict that resulted from the same prejudicial jury instructions and erroneously received evidence that underlies the bad faith verdict. (Opn., p. 15; see AOB 57-85, ARB 75-111.) Proof of fraud was missing in any event: the Joneses did not rely on any misrepresentation or false promise in closing their business — the only economic damage they claimed to have incurred. (AOB 95-96, ARB 120-121.)

Co. v. Albert & Oliker, *supra*, 47 Cal.3d at p. 871; *Old Republic Ins. Co. v. FSR Brokerage, Inc.*, *supra,* 80 Cal.App.4th at p. 688.)

Under existing law, one who intentionally inflicts serious emotional distress on another (insured or not) without justification can be held liable. (*Manufacturers Life Ins. Co. v. Superior Court* (1995) 10 Cal.4th 257, 280.)

The availability of alternative remedies "militates against judicial creation of a tort cause of action for damages." (*Katzberg v. Regents of the University of California* (2002) 29 Cal.4th 300, 327.) The fabric of the law of contracts, and the carefully drawn distinctions between tort and contract remedies, should not be distorted to create a new tort cause of action where none is needed.

E. Imposing Bad Faith Tort Liability For Unpaid Premium Bills Is Unsupported And Contrary To Existing Authority.

1. No existing authorities authorize imposition of tort remedies for sending bills that are never paid.

No authority holds that an insurer's premium bill gives rise to bad faith tort liability under circumstances anything like this case.

Only a very few bad faith cases involve premiums at all. Those cases, however, arise from conduct that threatens the policy's unique promise of protection in the event of a covered calamity. For example, in *Spindle v. Travelers Ins. Companies* (1977) 66 Cal.App.3d 951, 954-955, bad faith liability was triggered because the insurer *cancelled coverage* in order to coerce insureds to pay higher premiums. There was no such coverage threat here.

Only a small handful of cases, all from the workers' compensation insurance arena, even superficially support tort liability arising from premium disputes. Each of those cases rests upon circumstances and regulatory schemes wholly unlike those involved here. None addresses whether bad faith tort liability should encompass disputes about unpaid premiums, and none supports bad faith tort liability arising from a premium dispute involving genuinely disputed issues. If they did, they would be inconsistent not only with the principles discussed in Section I above, but also with the principles enunciated in *Foley* and *Cates*.

In the workers' compensation cases, institutional employers alleged their workers' compensation insurer had misreported claims data to the rating agency responsible for setting their experience-rated premiums. As a result of those improper manipulations, the employers had been induced *to pay* excessive premiums. (See *State Compensation Ins. Fund v. Superior Court* (2001) 24 Cal.4th 930, 934-935 [administrative proceedings determined that insurer wrongfully manipulated claims data resulting in payment of excessive premiums].) Here, unlike the workers' compensation cases, the Joneses were not tricked. They paid not a penny of the disputed premiums.

The workers' compensation cases imply (for the most part in dicta) that tort remedies might be available to address the insurer's fraudulent conduct.[21] We don't disagree. However, the appropriate label for such a tort is fraud, not tortious breach of the implied covenant of good faith and fair dealing. Without a loss of promised coverage benefits that subjects the insured to particular vulnerability and a "unique economic dilemma," there is no "exceptional circumstance" to justify application of the insurance exception. And that is especially true where any alleged wrongs can be fully redressed by existing tort and contract causes of action. (*Cates*, *supra*, 21 Cal.App.4th at pp. 54, 56.)[22]

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[21] E.g., *Lance Camper Manufacturing. Corp. v. Republic Indemnity Co.*, *supra*, 90 Cal.App.4th at pp. 1155, 1160 [tort liability for improper claims administration that results in *payment* of increased premiums]; *Notrica v. State Comp. Ins. Fund*, *supra*, 70 Cal.App.4th at pp. 918-919 [tort damages for insurer's "case reserve and claims handling policies and practices" that caused insured *to pay* excessive premiums]; *Tricor California, Inc. v. State Compensation Ins. Fund* (1994) 30 Cal.App.4th 230, 239-240 [tort liability for insurer's claims practices that improperly increase employer's reported losses and result in *payment* of excessive past and future premiums]. See also *Security Officers Service, Inc. v. State Compensation Ins. Fund* (1993) 17 Cal.App.4th 887, 889-890 [workers' compensation insurer must defend and resolve claims with due regard to impact on insureds' past and future experience-rated premiums and dividends]; *MacGregor Yacht Corp. v. State Comp. Ins. Fund*, *supra*, 63 Cal.App.4th at pp. 453, 456-458 [contract remedies for insurer's bad faith of implied covenant by ineffectively investigating claims and improperly overestimating reserves, resulting in *payment* of excessive premiums]; *Mission Ins. Group, Inc. v. Merco Construction Engineers, Inc.*, *supra*, 147 Cal.App.3d at p. 1062 [equitable accounting for how insurer "determined the amount" of dividend].

[22] *State Compensation Ins. Fund v. Superior Court*, *supra*, 24 Cal.4th 930, the only one of the workers' compensation cases to reach this Court, neither authorized nor endorsed an extension of bad faith tort liability to the circumstances in the cited workers' compensation cases. Rather, it expressly left the issue undecided. (*Id*. at pp. 932, 943.)

2. Other jurisdictions that have considered the issue abjure bad faith tort remedies for an insurer's retroactive premium bills.

The other jurisdictions that have addressed the issue have declined to expand the bad faith tort. Although many jurisdictions recognize tort or quasi-tort remedies for various sorts of insurance bad faith, none come close to imposing those remedies for an insurer's billed but unpaid premiums. Four states — Arizona, Idaho, New York, and Texas — have held expressly that bad faith tort remedies are unavailable for retrospective premium disputes that threaten no coverage benefit. These cases comport with *Cates*' rationale.

Arizona recently so held, even when an insurer's determinations resulted in excessive premium payments. (*Beaudry v. Insurance Co. of the West* (Ariz.App. 2002) 50 P.3d 836, 842-843 ["We decline to expand the tort of bad faith to cover a situation such as this, where contract damages . . . are adequate to protect the insured's interests"].) Because the dispute involved only "'commercial advantage'" and did not impair the coverage security and protection for which insurance was purchased, the Arizona court expressly rejected the results of California's workers' compensation cases.

Idaho limits insurance bad faith tort remedies to circumstances where an insurer unreasonably denies or delays resolution of coverage claims; bad faith tort remedies are unavailable even where the insurer increases premiums in bad faith. (*Selkirk Seed Co. v. State Ins. Fund* (Idaho 2000) 22 P.3d 1028, 1031-1032; *Simper v. Farm Bureau Mut. Ins.*

Co. (Idaho 1999) 974 P.2d 1100, 1103-1104 [no tort cause of action for insurer's unjustified premium increase].)

In ***New York***, bad faith tort remedies are not available for retrospective premium disputes, even where the excessive premiums result from bad faith claims handling. (*Insurance Co. of Greater New York v. Glen Haven Residential Health Care Fac., Inc.* (N.Y.App.Div. 1998) 676 N.Y.S.2d 176, 177 ["New York has never recognized a cause of action or defense" for insurance bad faith "where, as here, it is alleged that an insurer's failure to reasonably investigate claims made against the insured results in an increased retrospective premium . . . and we decline to do so here"].)

Texas, too, rejects the Joneses' position. In *Garrison Contractors, Inc. v. Liberty Mut. Ins. Co.* (Tex.App. 1996) 927 S.W.2d 296, 302, the Texas Court of Appeals refused to extend the bad faith tort to encompass the calculation and payment of retrospective insurance premiums: "The concern the good faith and fair dealing cause of action addresses, that unscrupulous insurers might take advantage of an insured's unequal bargaining power in negotiating and settling a claim, does not reach the purchase transaction or the calculation and payment of premiums." The Texas Supreme Court affirmed this decision in the course of reviewing an unrelated issue. (*Liberty Mutual Ins. Co. v. Garrison Contractors, Inc.* (Tex. 1998) 966 S.W.2d 482, 487.)

Other states, while not dealing expressly with improper premium bills, limit bad faith tort (and analogous) remedies to situations involving claims handling and conduct lacking probable cause. *None* permits tort remedies for a premium claim that was not paid, that does not threaten or impair any coverage security or protection, and that arises from a genuine and legitimate dispute.[23]

[23] E.g., *Waldon v. Cotton States Mut. Ins. Co.* (Ala. 1985) 481 So.2d 340, 341-342 [bad faith tort restricted to insurer's failure to process claim or pay policy benefits without "debatable excuse"]; *Best Place, Inc. v. Penn. America Ins. Co.* (Haw. 1996) 920 P.2d 334, 346 [insurance bad faith tort liability recognized where insurer "damages the very protection or security which the insured sought to gain by buying insurance"]; *Dolan v. AID Ins. Co.* (Iowa. 1988) 431 N.W.2d 790, 794 [no liability possible where insured failed to show absence of objectively reasonable basis for insurer's action]; *Glickman, Inc. v. Home Ins. Co.* (D.Kan. 1995) 887 F.Supp. 259 [insured cannot recover attorney fees where insurer's position arguably valid, though wrong]; *Wallace v. State Farm Mutual Auto. Ins. Co.* (La.App. 2002) 821 So.2d 704, 710 [statutorily-defined bad faith penalties not assessed unless insurer's conduct lacks probable cause]; *Braesch v. Union Ins. Co.* (Neb. 1991) 464 N.W.2d 769, 777 [plaintiff "must show the absence of a reasonable basis for denying benefits of the policy and the defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim"] disapproved on other grounds in *Wortman v. Unger* (Neb. 1998) 578 N.W.2d 413, 417; *Michael v. Metropolitan Life Ins. Co.* (W.D.N.C. 1986) 631 F.Supp. 451, 455 [bad faith tort confined to claim settlement practices]; *Hanson v. Cincinnati Life Ins. Co.* (N.D. 1997) 571 N.W.2d 363 [bad faith defined in terms of claims handling]; *Price v. Mid-Continent Cas. Co.* (Okla.App. 2001) 41 P.3d 1019 [no bad faith cause of action where insurer's nonpayment resulted from legitimate dispute]; *Crossley v. State Farm Mut. Auto. Ins. Co.* (S.C. 1992) 415 S.E.2d 393 [insurer not liable for bad faith in contesting claim upon reasonable grounds]; *Emmert v. Progressive County Mut. Ins. Co.* (Tex.App. 1994) 882 S.W.2d 32 [insurer has right to deny questionable claim with reasonable basis]; *Bushey v. Allstate Ins. Co.* (Vt. 1995) 670 A.2d 807 [no bad faith where liability under policy is fairly debatable]; *McCullough v. Golden Rule Ins. Co.* (Wyo. 1990) 789 P.2d 855, 860-861 [bad faith tort available only with respect to claims handling, and only where validity of claim is "not fairly debatable"]; cf. *Allsup's Convenience Stores, Inc. v. North River Ins. Co.* (N.M. 1998) 976 P.2d 1, 15, 20 [tort damages affirmed for nondisclosure of insurer's mishandling of claims that results in insured's payment of excessive premium].

The Joneses' tort cause of action for insurance bad faith is without support from any jurisdiction in the country. It should not be adopted here.

F. This Case Is Not About Claims Handling.

Facing overwhelming authority against permitting bad faith tort liability for premium disputes, the Joneses try to characterize this case as though it also involves Cal Eagle's bad faith "handling [of] a claim against the Joneses." (OB 26-27.) The record supports no issue of bad faith claims handling, as a matter of law.

This is apparent from the critical facts that the Joneses' account (OB 26-27 & fn. 9) omits:

- Cal Eagle resolved the third-party claim reasonably promptly, far below policy limits, and without cost to the Joneses. (SCT 2411, 2433-2435.) There was *no* judgment or settlement in excess of policy limits, and *nothing* in the evidence suggests that Cal Eagle acted unreasonably by initially declining a lower offer before it conducted discovery. (See ARB 89, fn. 77.)

- The only economic damages the Joneses claimed were lost profits from closing their business. But they ruled out any possibility that those damages resulted from Cal Eagle's claims handling, by positively insisting they would have remained in business if it were not for the premium dispute. (RT 7681, 7683-7685.)

- The claims handling could not possibly have caused them to close their business or lose profits anyway. Their own attorney knew that the claim had been settled well before they closed the business; indeed, it was he who advised Cal Eagle about the claim's dismissal. (SCT 2410-2411; see ARB 85-90.)

Without evidence that Cal Eagle acted unreasonably in handling the claim, that the Joneses reasonably relied on any such conduct, or that they were harmed by it, there is no possible liability. (*J.B. Aguerre, Inc. v. American Guarantee & Liability Ins. Co.* (1997) 59 Cal.App.4th 6, 13-19 [no liability unless insurer unreasonably refused settlement]; *Western Polymer Technology, Inc. v. Reliance Ins. Co., supra,* 32 Cal.App.4th at p. 24 [no liability from settlement within policy limits, even if insured suffers detriment]; *Waters v. United Services Auto. Assn.* (1996) 41 Cal.App.4th 1063, 1069 [mere fear of financial loss cannot support bad faith tort liability]; *New Plumbing Contractors, Inc. v. Edwards, Sooy & Byron* (2002) 99 Cal.App.4th 799 [insurer's right to settle within policy limits preludes claim for failure to inform insured of settlement].)[24]

This case involves a premium dispute, pure and simple. No possible bad faith claims handling issue is involved as a matter of law.[25]

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[24] Notwithstanding the absence of evidence, an erroneous instruction permitted the jury to consider Cal Eagle's settlement of the third-party claim in determining bad faith. This constituted prejudicial error that the Court of Appeal declined to reach. (Opn., p. 15; see AOB 66-68, ARB 85-90.)

[25] The Court of Appeal declined to reach Cal Eagle's appeal from erroneous instructions that permitted the jury to consider whether Cal Eagle acted in bad faith by its initial denial of initial settlement offer. (Opn., p. 15; see AOB 66-68, ARB 85-90.)

III.

MANDATORY STATUTORY PROCEDURES REQUIRE THAT DISPUTES ABOUT INSURANCE RATING AND ASSIGNED RISK PREMIUMS BE RESOLVED BY THE RESPONSIBLE ADMINISTRATIVE AGENCIES BEFORE ANY DAMAGE CLAIMS CAN BE HEARD IN A JUDICIAL FORUM.

The Legislature requires DOI to establish and regulate liability insurance rates and premiums and to administer the commercial assigned risk system with CAARP's assistance. It requires that DOI and CAARP provide procedures for the resolution of grievances about rates and premiums, as well as about all other aspects of the system's operation.

The Joneses' grievances fall squarely within DOI's and CAARP's exclusive jurisdiction. They expressly concern rates, premiums, and the claims of misconduct by a CAARP servicing carrier — key elements of the assigned risk plan.[26]

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[26] Just a few examples: CT 10565:14-10566:17 [pleadings that "old Rule 23 did not require rating at all when subhaulers had their own insurance"; that Cal Eagle "failed to implement revised Rule 23 immediately"; that Cal Eagle violated CAARP directives by refusing recognize eligibility for Rule 23's secondary rating; that in applying Rule 23 Cal Eagle refused its secondary rating]; 10673-10677 [contention that issue is whether premium should be based on Rule 23 rather than "'Actual Exposure'"], 10677-10680 [contention that issue is whether premium is based on proper CAARP rules], 10680-10685 [contention that issue is "Whether CAARP Rule 23 And Revised Rule 23 Govern The Premium Rate Calculation For Hired
(continued...)

The Legislature decided that these types of dispute are better handled in the first instance by an administrative body with specialized expertise and statewide responsibility for managing the entire assigned risk system, rather than by courts and juries whose only task is resolution of a specific dispute.

This decision must be honored. The grievances were required to have been addressed to DOI and CAARP. Until those agencies have had an opportunity to interpret their own rules and apply their own remedies, there is nothing to be heard in a judicial forum. End of story.

A. By Statutory Mandate, DOI Exercises Administrative Jurisdiction Over Liability Insurance Rating And Premiums And Over the Assigned Risk System.

DOI exercises plenary regulatory authority over liability insurance rating and premiums,[27] and (through CAARP) over California's assigned

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[26] (...continued)
Carrier Coverage"], 10686-10687 [contention that issue is whether there is conflict between CAARP rating rules and CAARP policy], 10687-10689 [contention that issue is whether DOI's communications to Cal Eagle constitute DOI "directives"]. See also RB 72, 74 [contention that issue "whether sub-hauler's trucks are 'hired autos'" arose in part "under Rule 23," and involves "interpretation of a (CAARP) regulation"]; RB 129 [contention that jury was required to make determinations about ratings, premiums, and "actual exposure"].

[27] Ins. Code, §§ 1850.4, 1858-1858.7, 1861-1861.16; see § 1861.01, subd. (c) ["insurance rates ... must be approved by the commissioner prior to their use"], § 1861.05, subd. (a) ["No rate shall . . . remain in effect which is excessive, inadequate, unfairly discriminatory or otherwise in violation of
(continued...)

risk system.[28] It must hear and resolve grievances about liability insurance rates and premiums[29] and about the manner in which the assigned risk

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[27] (...continued)
(specified law)"]; *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 242-246 [DOI has express and implied power to grant relief from invalid rates]; *Farmers Ins. Exchange v. Superior Court*, *supra*, 2 Cal.4th at pp. 384-385 [comprehensive administrative system for investigation and resolution of complaints about rates and premiums]; *Walker v. Allstate Indemnity Co.* (2000) 77 Cal.App.4th 750, 752-753 ["Once the commissioner's decision is final, an insurer must charge only the approved rate"]; *Karlin v. Zalta* (1984) 154 Cal.App.3d 953, 971 [commissioner has power to take "necessary and proper" action to correct insurer's improper rating].

[28] Ins. Code, § 11620 [commissioner shall issue assigned risk plan]; *California State Auto. Assn. Inter-Ins. Bureau v. Garamendi, supra,* 6 Cal.App.4th at p. 1414 [Ins. Code, § 11620 mandates that commissioner "design and implement" assigned risk plan].

[29] Ins. Code, § 1858, subd. (a) [remedies provided in §§ 1851-1861.16 for "any person aggrieved by any rate charged, rating plan, rating system, or underwriting rule followed or adopted by an insurer or rating organization"]; *Smith v. State Farm Mutual Automobile Ins. Co.* (2001) 93 Cal.App.4th 700, 726-727 [under § 1858, challenge to insurers' application of underwriting rule must be heard by commissioner]; *County of Los Angeles v. Farmers Ins. Exchange, supra,* 132 Cal.App.3d at p. 87.

system is administered.[30] It possesses powerful sanctions to enforce its orders and to redress insurers' violations.[31]

If these comprehensive statutory mandates were somehow not enough, the contract under which Cal Eagle acted as a servicing carrier provides DOI with additional authority to control any misconduct.[32] And there is still more: DOI exercises "such additional powers as are necessary for the due and efficient administration of powers expressly granted by statute, or as may fairly be implied from the statute granting the powers." (*Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 824.)

The rating dispute presented by the Joneses' tort suit fits precisely within the legislature's administrative dispute resolution mandate:

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[30] Ins. Code, § 11624, subd. (b) [assigned risk plan must include procedures "for appeal to the commissioner by persons who believe themselves aggrieved by the operation of the plan"]; *Hightower v. Farmers Ins. Exchange, supra,* 38 Cal.App.4th at p. 860 [CAARP has jurisdiction over setting of rates for assigned risk policies]. See Cal. Code Regs., tit. 10, § 2495 [after obtaining advice of CAARP committee, commissioner's decision is "binding upon all parties" with respect to grievances of any assigned risk insured "who is affected by any act, ruling, decision or order of an insurer" believed to be "in conflict with or not authorized by the provisions of the plan or by the law . . . ." as well as any "persons who believe themselves aggrieved" (Ins. Code, § 11624, subd. (b)) by operation of plan].

[31] Ins. Code, §§ 1858.07, 1858.1 [penalties up to $10,000 for willful use of rate, rating plan, or rating system in violation of specified law, and up to additional $100,000 for violation of DOI consent order], 1859.1 [penalties up to $250,000 for willful failure to comply with DOI rating determination], 1858.3, subd. (a) [power to prohibit use of rate or rating system], 1858.3, subd. (b) [power to require compliance by insurer acting in violation of DOI rating rules], 1858.3, subd. (c) [penalties up to $100,000 for failure to comply with DOI orders].

[32] CAIP Servicing Carrier Agt., Exh. 14, SCT 236-257.

- The Joneses claim to be "aggrieved by [a] rate charged . . . or [an] underwriting rule" (Ins. Code, § 1858, subd. (a)).

- The Joneses "believe themselves aggrieved by the operation of the [assigned risk] plan" (Ins. Code, § 11624, subd. (b)).

- The Joneses contend that Cal Eagle's conduct was "in conflict with [and] not authorized by the provisions of the [assigned risk] plan or by the law" (Cal. Code Regs., tit. 10, § 2495).

These are exactly the grievances that legislative mandate requires DOI and CAARP to hear and resolve. Far from lacking adequate remedies to address the Joneses' grievances, the regulatory scheme is designed to *prevent* any damages from occurring. That's the best possible remedy.[33]

Had the available administrative procedures been employed here, the Joneses would have enjoyed a quick, expert, authoritative and relatively inexpensive determination of their premium dispute, judicially reviewable by administrative writ if necessary. (Code Civ. Proc., § 1085, 1094.5; *Leone v. Medical Board* (2000) 22 Cal.4th 660, 673-674 (conc. opn. of George, C.J.).) Had the administrative remedies been employed, they

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[33] The Joneses' are doubly wrong when they argue that administrative remedies that do not include tort damages need not be exhausted. (OB 38.) Not only are the administrative procedures designed to *prevent* the damages before they are incurred, but "[e]ven where the administrative remedy may not resolve all issues or provide the precise relief requested by a plaintiff, the exhaustion doctrine is still viewed with favor 'because it facilitates the development of a complete record that draws on administrative expertise and promotes judicial efficiency.'" (*Sierra Club v. San Joaquin Local Agency Formation Com*. (1999) 21 Cal.4th 489, 501; *Westlake Community Hosp. v. Superior Court* (1976) 17 Cal.3d 465, 476 [same].)

would have rendered moot any question whether tort damages might be available. If the Joneses were right, they would have suffered no damages.

Whether Cal Eagle correctly interpreted and applied DOI's and CAARP's rating rules in billing an additional premium — the heart of the Joneses' case — necessarily must be determined in the first instance by DOI and CAARP. This has never happened.

B. DOI's and CAARP's Jurisdiction Over Grievances About Liability Insurance Rates, Premiums, and the Assigned Risk System Is Exclusive.

The Joneses assert that administrative jurisdiction, even if available, is not exclusive. Say the Joneses, courts and juries are better equipped than administrative agencies to determine whether servicing carriers have properly evaluated exposures and interpreted rating rules. (See OB 43.) Legislation precludes their argument.

1. Statutorily-mandated administrative remedies are exclusive until they are exhausted.

DOI's and CAARP's jurisdiction over disputes about rating, premiums, and the assigned risk system is compulsory and exclusive. "[T]he fundamental rule of procedure" is that "where an administrative remedy is provided by statute, relief must be sought from the administrative body and this remedy exhausted before the courts will act." (*Abelleira v. District Court of Appeal* (1941) 17 Cal.2d 280, 292.) Where an insured's claim implicates a matter within the jurisdiction of an administrative agency, the claim must be submitted first for agency determination. (*Plaza Hollister Ltd. Partnership v. County of San Benito* (1999) 72 Cal.App.4th 1, 26-31.) "That is so even where the administrative remedy is couched in permissive language." (*County of Los Angeles v. Farmers Ins. Exchange, supra,* 132 Cal.App.3d at pp. 85-86.)

Because rates, premiums and grievances about servicing carrier misconduct are the issues here, administrative remedies must be exhausted before judicial relief can be sought. Multiple authorities compel this result:

- The Legislature so directs. (Ins. Code, § 1860.2 ["administration and enforcement of (chapter on Rates and Rating) shall be governed solely by the provisions of this chapter" notwithstanding any other law]; § 1860.1 [no act or agreement under authority of chapter on Rates and Rating shall constitute grounds for civil proceeding under any law which does not specifically refer to insurance].)

- This Court so directs. (E.g., *Farmers Ins. Exchange v. Superior Court, supra,* 2 Cal.4th at p. 382, fn. 1 [disputes involving rating and underwriting rules are "exclusively the province" of DOI]; *State Comp. Ins. Fund v. Superior Court* (2001) 24 Cal.4th 930, 943 ["the calculation of insurance premiums and interpretation of (insurer's) reporting requirements . . . is best suited to the administrative process. Here . . . the administrative process has run its course, and we enjoy the benefit of that expertise"].)

- The courts of appeal so direct. (E.g., *Walker v. Allstate Indemnity Co., supra,* 77 Cal.App.4th at p. 756 [statute bars claims "based upon an insurer's charging a rate that has been approved by the commissioner"]; *Wilson v. Fair Employment & Housing Com.* (1996) 46 Cal.App.4th 1213, 1223-1224 [claims involving rating issues must be decided first by DOI]; *Hightower v. Farmers Ins. Exchange, supra,* 38 Cal.App.4th at p. 856 [CAARP regulatory scheme provides forum for rating disputes]; *Barnes v. State Farm Mut. Ins. Co.* (1993) 16 Cal.App.4th 365, 380-381 [exhaustion required if action seeks "reduction in premiums" or "appropriate rates of insurance," even if agency may not resolve all issues or provide all requested relief]; *Karlin v. Zalta*, *supra*, 154 Cal.App.3d at pp. 980-986 [failure to exhaust agency's remedies forecloses plaintiff's resort to judicial process even though administrative remedy does not award damages]; *County of Los Angeles v. Farmers Ins. Exchange, supra,* 132 Cal.App.3d at pp. 80-82 [no civil action until administrative remedies are exhausted where unlawful rating practice is alleged].

- CAARP so directs. (CAARP letter-brief filed Nov. 4, 1996, *Cal Eagle Ins. Co. v. Fresno Superior Court*, 5 Civ. No. F027006, at pp. 8-9 [premium determinations must be subject to its administrative process because "the issue is one in which the regulatory body has peculiar expertise and which warrants close administrative control to ensure that a coherent, consistent regulatory system for assigned risk policies is maintained . . . ."].)[34]

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[34] The CAARP letter-brief, filed November 4, 1996 in support of Cal Eagle's unsuccessful writ petition in 5 Civil No. F027006, was the subject of a motion for judicial notice filed September 19, 2000 in the Court of Appeal in this case, 5 Civil No. F029400. The Court of Appeal deferred its ruling on the motion pending its decision (Order, Oct. 11, 2000), and apparently did not rule. A Request For Judicial Notice of the CAARP amicus letter-brief is filed with this brief.

Where, as here, matters are delegated exclusively to administrative agencies, courts have no power to act until the administrative process has been completed. (3 Witkin, Cal. Procedure (3d ed. 1985) Actions, § 234, 265; *Rojo v. Kliger* (1990) 52 Cal.3d 65, 85.) That rule applies here.

2. The authorities relied upon by the Joneses do not undermine — and in fact support — the exclusivity and exhaustion doctrines.

The authorities cited by the Joneses (OB 43) do not support them. If anything, they demonstrate both the applicability of the exclusivity rule and its importance. For example, this Court squarely confirmed that statutory remedial procedures are exclusive when it held in *California Correctional Peace Officers Assn. v. State Personnel Bd.* (1995) 10 Cal.4th 1133,1151 (OB 42), that "[i]ntervention by the court . . . would constitute an interference with the jurisdiction of another tribunal."

Other cases cited by the Joneses do not require exclusivity, but *only* where exclusivity is neither intended by the Legislature nor necessary for the regulatory scheme. None deals with anything close to our case, where exclusivity is mandated by the Legislature and essential if uniform statewide regulation of ratings, premiums, and the assigned risk system is to be achieved.

For example, *National Audubon Society v. Superior Court* (1983) 33 Cal.3d 419, 449-451 (OB 43) declines to change the rule that the Water Board's original jurisdiction is only concurrent and not exclusive, at least where the doctrine of primary jurisdiction would already provide the court with the Board's specialized expertise. Similarly, in *Miller v. Superior Court* (1996) 50 Cal.App.4th 1665, 1676 (OB 43), administrative exhaustion was found not to be required in every auto dealer dispute, due to "insufficient indicia from the Legislature that it intended the Board to occupy the field exclusively" — again, at least where the board's primary jurisdiction would be enforced.

Far from supporting the Joneses, *Hightower v. Farmers Ins. Exchange*, *supra*, 38 Cal.App.4th 853 (OB 37), illuminates the importance of the exclusivity rule and demonstrates why it applies here. In *Hightower*, two reasons excused exhaustion of CAARP's remedies: First, the grievance involved *claims handling*, not rates; CAARP's administrative remedies extend "solely to matters regulated by the CAARP" — and claims handling is *not* one of those. Second, claims handling disputes require no specialized administrative expertise. (*Id.* at p. 860.) Neither reason applies here.

The same reasons that excused the exhaustion of administrative remedies in *Hightower* illustrate why those remedies are exclusive here. Unlike claims handling, ratings and premiums *are* "matters regulated" exclusively by DOI and CAARP; thus under *Hightower*, the DOI and CAARP administrative remedies *do* apply to the Joneses' grievances. Unlike disputes about claims handling, specialized technical expertise *is* required to interpret and apply the complex framework of truckers' rating rules, to balance the relevant actuarial and public policy factors necessary to assure that rates and premiums are adequate to ensure financial viability for the commercial assigned risk system, and to administer the entire system fairly on a uniform statewide basis.

This case — with its massive record detailing the intricacies of a complex and comprehensive administrative scheme — is a monument to the wisdom of the exclusivity and exhaustion doctrines. As even the Joneses argue, this case is "a hundred times more complex than any claims case"; it is "a two (2) month training course on Assigned Risk underwriting, auditing and premium calculation." (RT 11366:11-15; RB 3.)

Addressing assigned risk underwriting, auditing, and premium calculation issues is exactly what DOI and CAARP are supposed to do in order to govern the assigned risk system. Trial courts and juries, whose jobs are limited to the very different task of resolving specific disputes, are equipped with neither the expertise nor the prerogative to handle rating and premium issues with statewide public policy in mind.

This Court's decision in *Rojo v. Kliger, supra,* 52 Cal.3d 65 (also relied upon by the Joneses, OB 43), embodies this reasoning as well. In *Rojo,* FEHA's jurisdiction over discrimination claims was found not to be exclusive because FEHA's remedies encompass only certain kinds of discrimination by certain classes of employers and landlords. Unlike the Insurance Code, FEHA's procedure is not "pervasive and self-contained," and no intention was demonstrated to displace common law remedies. (*Id.* at pp. 80-83, 87.)

The opposite is true when rating, premiums, and operation of the assigned risk system is at stake. Indeed, *Rojo* approves *Karlin v. Zalta, supra,* and other cases holding that under the Insurance Code's "pervasive and self-contained system of administrative procedure," issues of excessive rates are "*singularly* within the technical competence of the Insurance

Commissioner through the enlistment of [DOI] resources." (*Rojo v. Kliger, supra,* 52 Cal.3d at p. 87, italics added.) In such cases, "[i]t is indispensable that the expertise of the insurance commissioner and [DOI] staff be initially engaged to make such review." (*Ibid.*, see pp. 85-87.)

Rojo goes even further. It establishes that where a remedy is provided by the agency whose rule is being challenged, the challenge must be made under the agency's procedures. (*Rojo v. Kliger, supra,* 52 Cal.3d at p. 85.) *Rojo* explains why: (1) the administrative agency "may be able to minimize, and sometimes eliminate, any monetary injury to the plaintiff"; (2) the administrative procedure recognizes the agency's specialized expertise and at the same time lays the foundation for any later trial in the judicial forum; (3) even if ultimate resort to the courts is inevitable, "the prior administrative proceeding will still promote judicial efficiency by unearthing the relevant evidence and by providing a record which the court may review." (*Ibid.*)

Each of these factors was absent from *Rojo*. All are present here: (1) the "'pervasive and self-contained system'" for monitoring claims of excessive rates puts the Joneses' grievances "'singularly within the technical competence'" of DOI; (2) the Joneses' claims involve interpretation and application of complex, interrelated rating rules, all essential to the assigned risk system; (3) prompt administrative determination would have corrected any improper rating, eliminating uncertainty and avoiding or vastly reducing any damages (RT 7681, 7683-7685 [Joneses would have stayed in business but for uncertainty about premium]); and (4) the benefits of DOI's and CAARP's expertise would have been available to the parties and the court as the foundation for any later trial.

The Joneses' challenges to ratings, premiums, and administration of the assigned risk system are unquestionably within DOI's and CAARP's exclusive jurisdiction. Sidestepping that jurisdiction was impermissible.

3. The Joneses did not exhaust available administrative remedies.

The Joneses argue that filing a DOI consumer complaint satisfied the exhaustion requirement. (OB 41-42.) Nonsense. They did not *exhaust* their remedies; they *abandoned* them midstream.

Their DOI consumer complaint was the first step. Exhaustion requires not just initiating administrative procedures, but "pursuing them to their appropriate conclusion and awaiting their final outcome before seeking judicial intervention." (*County of Los Angeles v. Farmers Ins. Exchange*, *supra*, 132 Cal.App.3d at p. 87.)

Far from exhausting, the Joneses chose to ignore DOI's preliminary ruling. (Exh. 141, SCT 644.) But if they did not like that ruling, the available administrative avenue was to seek a CAARP or DOI hearing, then a judicial writ. (Ins. Code, § 1858.6; Code Civ. Proc., §§ 1085, 1094.5; see *California Coastal Com. v. Superior Court* (1989) 210 Cal.App.3d 1488, 1496-1497, fn. 5 [administrative decision from which no writ is taken is binding].) Even the Joneses' own authority (OB 41) says exactly that. (See *McPherson v. City of Manhattan Beach* (2000) 78 Cal.App.4th 1252.)

The Joneses did not pursue — let alone exhaust — any administrative challenge to the propriety of Cal Eagle's conduct in assessing and billing for an additional premium.

C. Effective Uniform Administration Of The Assigned Risk System Would Be Impossible Without DOI's and CAARP's Exclusive Administrative Jurisdiction.

Neither juries nor trial courts are responsible for administration of uniform insurances ratings and premiums, nor for statewide administration of the assigned risk system. They have no notion of the impact that various rating rule interpretations might have on public safety, nor are they responsible for implementation of an actuarially sound, financially viable statewide assigned risk plan. These are only some of the most obvious reasons that the Legislature delegated solely to DOI and CAARP the task of resolving grievances about misapplication of rating rules, miscalculation of premiums, and other misconduct in operating the assigned risk plan. (See *P.W. Stephens, Inc. v. State Compensation Ins. Fund* (1994) 21 Cal.App.4th 1833, 1839-1842.)

DOI and CAARP could not possibly fulfill the statutory requirement that there be fair and "actuarially sound" premiums if their rating rules were subject to diverse and likely conflicting interpretations of their meaning and application by disparate courts and juries, without regard to actuarial soundness, regulatory consistency, commercial impact, or statewide uniformity. DOI and CAARP cannot administer the assigned risk plan effectively unless they can oversee the way their rules are interpreted and applied by insurers generally and by their own assigned risk servicing carriers in particular. CAARP expressed this point in its 1996 amicus letter-brief in this case, stating that regulation of the system "warrants close administrative control to ensure that a coherent, consistent regulatory system for assigned risk policies is maintained . . . ." (CAARP letter-brief filed Nov. 4, 1996, *Cal Eagle Ins. Co. v. Fresno Superior Court*, 5 Civ. No. F027006, at pp. 8-9. See fn. 34, above.)

The concern is not idle. The alternative would yield chaos. Not only might jury determinations vary from locale to locale, they would likely also conflict with administrative rulings on the same issue. One jury might determine, for example, that a premium is justified under a particular rule, while another jury might reach the opposite result with respect to a different trucker. These rulings might, in turn, conflict with DOI's and CAARP's own interpretations and intentions. The confusion would have no end.

The Joneses' approach vividly illustrates the soundness of a uniform statewide program. Eschewing an administrative challenge to Cal Eagle's rating and premium determinations, the Joneses ignored DOI's express offer to intercede on their behalf (Exh. 141, SCT 644), declined to seek further administrative relief, and waited for damages to occur and a tort remedy to mature. They sought a tort jackpot, not dispute resolution. If they had exhausted the available administrative remedies, they would have had no prolonged uncertainty and no damages to redress.

If the facts, the law, and the applicable regulations conformed to their claims, this dispute could have been promptly concluded. The Joneses would have prevailed at the administrative level. The premium bills would have been eliminated by a DOI or CAARP ruling; Cal Eagle could not have pursued collection. If dispute resolution were the real goal, the Joneses had so much to gain from administrative exhaustion, and nothing to lose.[35]

Nothing to lose, that is, if their grievances were well founded. But if their grievances were found to lack merit by the responsible agencies and by the courts on mandate review, then the victory would have been of a different sort: years of needless litigation would have been avoided.[36]

The Joneses would exclude DOI and CAARP from any role in the matters that the Legislature has delegated to their exclusive oversight and regulation. That is anything but what the Legislature intended.

CONCLUSION

This insurance bad faith case presents no issue about the extent of coverage or any unpaid coverage claim. The issue concerns only the *price* of coverage previously afforded and the manner in which that price should be determined in California's assigned risk system.

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[35] In *Katzberg v. Regents of the University of California, supra,* 29 Cal.4th at p. 326, this Court recently addressed a circumstance much like the Joneses' claim here: "If [the plaintiff seeking tort damages] had promptly filed for a writ of mandate, rather than waiting 14 months to file a civil complaint seeking compensatory damages, it could have achieved [its objective]." (*Ibid.,* quoting *Carlsbad Aquafarm, Inc. v. State Dept. of Health Services* (2000) 83 Cal.App.4th 809, 821, fn. omitted.)

[36] The fact that an adverse administrative determination could preclude the Joneses' tort claims is exactly what concerned the Joneses' counsel. (RT 9570-9571.)

The price issue has been subsumed in a protracted court battle that should never have happened. What remains after a decade of litigation is a stale dispute about the price of long-expired insurance coverage, determined according to rules long ago rendered irrelevant by regulatory evolution.

A decade ago, when the dispute was ripe and the issue had industry-wide significance and scrutiny, the procedures for its speedy and fair resolution by DOI and CAARP were readily available. Had they been used, we wouldn't be here today.

The larger issue has little to do with insurance pricing, but much to do with issues of far greater significance to our citizens: whether oversight of the commercial assigned risk system, as well as its implementation and day-to-day operations, will be in the hands of the Insurance Commissioner (as the Legislature explicitly intended) or will be in the hands of juries hearing exotic rating issues as a prelude to tort liability. Even if there were some logical reason to favor the second option over the first (we believe there are none), nothing in our law could justify subverting the Legislature's contrary determination.

The existing law of administrative remedies, as well as the law of contracts and torts, are fully able to address every claim of wrongdoing that the Joneses have alleged against Cal Eagle. The Joneses' seek to scrap the administrative system and to distort and expand the narrow insurance bad faith tort beyond its recognizable borders solely because they refused to pursue their administrative remedies. Their invitations should be rejected.

Dated: March 12, 2003

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CERTIFICATION

Pursuant to California Rules of Court, Rule 14(c), I certify that this Answer Brief On The Merits contains 15,990 words, not including tables, caption page, signature blocks, or this Certification.

Dated: March 12, 2003

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Peter O. Israel