

**CLAIM FOR ANY TORT REMEDY, WHETHER BASED ON
EMOTIONAL DISTRESS, CROSS-COMPLAINT FOR
EQUITABLE INDEMNITY, OR OTHER TORT CLAIM MUST
BE BASED ON A TRUE TORT AND NOT MERELY ON A
NEGLIGENT BREACH OF CONTRACT**

Do you have a case that really boils down to a breach of contract, but where plaintiff is trying to sue for emotional distress or other tort damages? Wesierski & Zurek has had great success getting judges to cut these cases down to breach of contract only, where no claims for "distress" or "pain and suffering" are allowed. A recent appellate opinion highlights the rule of law that allows us to cut these cases down to size. Under the Ramifications section of this article, we show how to use this rule to defeat hybrid tort/contract claims that seek tort damages where the matters really are based on contract.

U.C. San Francisco Medical Center treats patients under "capitated" health care plans. "Capitated" plans are basically a "fixed rate" system where an insurer pays the hospital a fixed annual amount no matter how much or how little any individual member actually uses the hospital's services. Obviously that involves significant risk for the hospital as any given patient can become very ill and require hundreds of thousands, even millions, of dollars of care. So the hospital obtained an insurance policy to pay for

patient stays that rose above a certain deductible. They bought the insurance from a broker. The policy required the hospital to timely disclose large bills.

At the beginning of the policy period, the hospital's billing administrator vendor, BTMG, submitted a written disclosure of all such claims. Unbeknownst to the hospital, however, the disclosure failed to identify a particular claim for a patient who had been repeatedly hospitalized. Accordingly, when the patient's claim was submitted to the insurer for payment, it was denied. The hospital then suffered a loss of \$1,000,000 in unreimbursed expenses for the claim.

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Based on the foregoing, the hospital sued the broker for breach of contract and negligence (not its billing administrator) for failing to timely disclose the bill to the insurance company.

The broker, however, said that it never got the information from BTMG.

The broker filed a cross-complaint against BTMG for equitable indemnity, a tort remedy. The cross-complaint admitted that there was no contract between the broker and BTMG. Instead, the cross-complaint alleged BTMG owed a duty to the hospital to properly analyze claims and provide timely information to the broker. The broker said that the billing administrator acted negligently when it breached its contract with the hospital, and that said negligence damaged the broker.

The problem here is that there is no duty owed by the administrator to the broker, either in tort or in contract. As to contract, there was no contract between BTMG and the broker - only between BTMG and the hospital. Further, an equitable indemnity cross-complaint can only be based on a breach of tort duty, *i.e.*, it must be based on ordinary negligence, not breach of contract. California does not recognize causes of action for "negligent breach of contract." The cause of action is either for breach of contract, or for negligence, not both. The broker's challenge was to somehow base its cross-complaint on a negligence (tort) theory where the actual situation revolved around whether BTMG lived up to its contract (with the hospital) to relay information to the broker.

The trial court sustained BTMG's demurrer to the cross-complaint on the grounds that it failed to state

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facts sufficient to demonstrate a duty owed by BTMG to the hospital. The appellate court reaffirmed the trial court's ruling.

To make out the tort of negligence, the broker's cross-complaint alleged that BTMG owed a contractual duty to the hospital to properly administer the hospital's claims, and that BTMG negligently breached that duty. No good. Generally speaking, there is no such tort as a "negligent" breach of contract. (Insurance bad faith is one of the few exceptions.)

The dissent argued that California law was archaic and should be

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Insurance Reserves Subject To Discovery In Bad Faith Cases

The United States District Court for the Northern District of California recently decided *Berstein v. Travelers Insurance Company* allowing the scope of discovery to include insurance reserves. Plaintiffs were first party insureds who filed a bad faith action regarding policies for property damages issued by Traveler's Ins. Co., the defendant insurer. The issue in the discovery motion before the Court was whether plaintiffs could obtain information and documents regarding defendant's reserve setting during the claims process. Interestingly, defendant only objected to the targeted discovery on the grounds of relevance and failed to raise the objection of privilege.

Plaintiffs sought discovery as to the following issues: (1) the reserve amounts Travelers had at each adjustment juncture; (2) defendant's employees' thoughts and communications regarding reserve setting; and (3) the criteria defendant used when fixing reserves. Plaintiffs argued that reserve evidence was relevant based on theories that: (a) defendant delayed payments it knew plaintiffs were entitled to; and (b) that defendant adopted a strategy of unjustifiably demanding proof of loss and delaying payments so that plaintiffs would accept a low settlement offer. Plaintiffs contended that discovery of internal documents, comments, and communications regarding reserves would reveal an inexplicable difference between what defendant told plaintiffs and what defendant really understood about the coverage and valuation issues.

The Court confirmed the Federal Rule that setting a reserve is not an admission of liability and that the use of reserve evidence to directly establish an element of the plaintiff's claim is prohibited. While a defendant may argue that: (1) a reserve is only an educated guess as to the amount the insurer might be required to pay; (2) the insurer's information is incomplete and not entirely reliable early in the claims process; or (3) it is common to frequently adjust reserves during the processing period, the Court determined that those probative arguments are not barred from discovery. The Court declared that reserve evidence may be relevant where there is a question as to whether the

insurer conducted a proper investigation or reasonably considered all the factors which might expose its insured to an excess verdict. Although reserve evidence is not admissible, that does not automatically mean that is not discoverable.

The Court acknowledged that reserve setting is regulated by statute and the Department of Insurance. Under the applicable regulations, insurers consider broad actuarial data and their own loss and/or payout experience. The Court found that these general considerations do not harbor a heavy influence when the adjuster decides the reserve amount for a particular claim, the timing of adjusting reserves, or the criteria for modifying reserve amounts.

The Court limited the assertion of the genuine dispute doctrine which makes an insurer's motives and its adjusters' understandings irrelevant. Under the genuine dispute doctrine, there is no bad faith when an insurer mistakenly withholds benefits, if the mistake is reasonable or based on a legitimate dispute. The Court opined that where allegations point to several claim decisions or focus on courses of conduct, the genuine dispute doctrine does not apply. In determining whether Defendant acted unreasonably in making a settlement offer, evidence as to what defendant actually knew at the time the offer was made and what defendant actually thought about the value of plaintiff's claims is relevant. The Court concluded that, absent any invocation of the genuine dispute doctrine, plaintiffs could conduct discovery as to defendants' actual thoughts as to the merits and values of the subject claims.

Ultimately, the Court held that under Federal Discovery Rules and the applicable substantive California law, the reserve evidence sought was relevant. The Court granted plaintiff's discovery motion subject to a protective order prohibiting plaintiffs from using defendants' information, internal criteria and communications about the reserves for any other purpose beyond the subject litigation. With the foregoing limitations, reserve evidence is subject to discovery.

- Edye A. Hill

New at Wesierski & Zurek

Mark Velasquez: Mark Velasquez received his Bachelor Degree in Environmental Science from Rutgers University in 1995. He graduated from Pacific McGeorge School of Law in 2006, and was admitted to the California State Bar that same year. Mr Velasquez was on the Client Competition and Counseling Team, and received honors in Trial Advocacy while in law school.

After attending college, Mr. Velasquez pursued his dream to become a commercial pilot. He taught others to fly as a flight instructor in San Diego, flew cargo across the country for AirNet Express, and flew people across oceans for American Eagle. Mr. Velasquez interned for the Sacramento Public Defenders Office while studying law, and afterwards, worked as an associate practicing civil litigation including business litigation and aviation law.

Mark Velasquez is a Member of The Board of Directors for the Young New Lawyers Division of the San Diego County Bar Association. He also co-chairs the CLE Committee and chairs the Sports Committee for the YNLD.

Steven Ibarra: Steven Ibarra attended University of California at Berkeley and earned his Bachelor of Arts degree in Legal Studies in 2003. Steven then went on to attend law school at the University of West Los Angeles where he graduated *cum laude* in 2007. In May of the same year, Steven was admitted to the California State Bar and the United States District Court for the Central District of California.

During his final year of law school, Steven was invited to participate in the 2006 University of San Diego National Criminal Moot Court Competition. The issue was whether *Miranda* and its progeny require an accused be specifically apprised of his right to have counsel present during police interrogation in order to adequately inform the accused of his Fifth and Sixth Amendment rights to counsel. Steven wrote a brief set in the United States Supreme Court which earned him second place in the Top-10 Briefs category out of over 40 law schools across the country including William and Mary and UC Hastings.

Steven is a member of the Mexican-American Bar Association (MABA) and the Los Angeles County Bar Association. His experience includes a clerkship for a civil rights litigation firm and also offering free legal advice to low-income individuals on behalf of a Mexican consulate sponsored program.

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modernized. The dissent suggested that if an injured party seeks recovery only from one source, defendant should be allowed to seek equitable indemnity against another party.

Ramifications

It is a very rare situation where the plaintiff will not bring in the real wrongdoer himself, and where the defendant ends up being unable to cross-complain. So the moral of this case is not how to avoid that situation, but rather how to use the rule to defeat hybrid tort/contract cases, which are common. California continues to distinguish tort duties from contract duties, so if you get sued on something that really relates mostly to a contract, you can often block causes of action for emotional distress or other tort damages. If the situation really revolves around a contract, plaintiff is generally not allowed to claim emotional distress, etc., and is limited to the contract damages. You can also often bar the plaintiff from claiming any torts or tort damages, like pain and suffering, or emotional distress. Wesierski & Zurek has been very successful in these kinds of cases. Examples:

- A landlord breaches a commercial lease and delays repairs leaving the premises under construction for months, which floods the tenant's travel agency and closes his business for months. Damages are at most in contract only, **Editor** not for emotional distress, for supposedly "ruining" his business, as a result of the "negligence."

- A man contracts to tow an owner's expensive collection of sports cars from a showroom and gets in an accident. The owner gets only contract damages, not damages for "negligently" fulfilling the contract. The negligence in driving is simply a form of breaching the contract to deliver the car.