Nos. 07-15326, 07-15356, 07-15541

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

AMERICAN COLOR GRAPHICS, INC.,

Plaintiff-Appellee-Cross-Appellant,

vs.

TRAVELERS PROPERTY CASUALTY INSURANCE COMPANY,

Defendant-Appellant-Cross-Appellee.

On Appeal from the United States District Court
for the Northern District of California, Oakland Division
Case No. CV-04-03518-SBA
Hon. Saundra Brown Armstrong, Presiding

OPENING BRIEF OF APPELLANT TRAVELERS PROPERTY CASUALTY COMPANY OF AMERICA

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CORPORATE DISCLOSURE STATEMENT
(FED. R. APP. P. 26.1)

Travelers Property Casualty Company of America is a wholly owned subsidiary of The Phoenix Insurance Company, which in turn is a wholly owned subsidiary of The Travelers Indemnity Company. The Travelers Indemnity Company is a wholly owned subsidiary of Travelers Insurance Group Holdings, Inc., which in turn is a wholly owned subsidiary of Travelers Property Casualty Corp. Travelers Property Casualty Corp. is a wholly owned subsidiary of The Travelers Companies, Inc.

No individual or corporation owns 10% or more of the stock of The Travelers Companies, Inc.

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I. JURISDICTIONAL STATEMENT

The amount in controversy is more than $75,000 and there is diversity of citizenship between the parties. 28 U.S.C. § 1332. Appellee American Color Graphics, Inc. ("ACG") is incorporated in New York and has its principal place of business in Tennessee. Appellant Travelers Property Casualty Company of America ("Travelers") is incorporated and has its principal place of business in Connecticut.

This appeal is timely. 28 U.S.C. § 2107(a); Fed. R. App. Proc. 4(a)(1)(A). Judgment was entered on October 24, 2006. The order on post-trial motions was filed on January 22, 2007. Travelers' notice of appeal was filed on February 21, 2007.

II. ISSUES PRESENTED

1) Was ACG improperly allowed to claim tort damages for breach of the implied covenant of good faith and fair dealing where Travelers paid for and defended ACG against the claim and the only harm is ACG's deductible payment?

2) Did the district court err in finding ACG's deductible payment was caused by Travelers' breach of the implied duty to investigate where there is no evidence that, had Travelers conducted a more thorough investigation, ACG would have paid less?

3) Did the district court err in finding the evidence supports a compensatory damages award of $140,000 where the evidence of monies paid by Travelers is $42,506.12 and there is no evidence ACG reimbursed Travelers?

4) Did the district court improperly submit punitive damages to the jury because a deductible payment only constitutes contract damages and ACG did not prove tort damages?

5) Is there sufficient evidence for the jury to find malice, oppression or fraud where Travelers' relevant conduct is negligent failure to investigate, that conduct falls well short of "despicable," and there is no evidence Travelers intended to harm ACG?

6) Is a 10:1 ratio of punitive damages to compensatory damages unconstitutional where there is a "low level of reprehensibility," the case "only involves economic damage to a single plaintiff," the plaintiff was awarded "substantial compensatory damages," there is no company-wide policy, and the high ratio is justified by the defendant's financial condition?

7) Did the district court improperly order the parties to arbitrate ACG's fees pursuant to California Civil Code section 1717 and a 2005-2006 finance agreement because ACG has never introduced a finance agreement applicable to ACG's 2002-2003 workers' compensation policy, this action is "on" that policy, ACG's fees were "incurred to enforce that" policy, and the agreement has mandatory Connecticut forum-selection and choice-of-law provisions?

III. STATEMENT OF THE CASE

This is a dispute over one deductible payment incurred by ACG for one of hundreds of workers' compensation claims handled by Travelers. ACG alleged Travelers is liable in tort for breach of the implied covenant of good faith and fair dealing "by failing to act reasonably in the investigation and defense" of Aiza Custodio's ("Custodio") workers' compensation claim. There is no dispute Travelers paid to fully defend and settle the Custodio claim.

Under California law, tort damages for breach of the implied covenant are unavailable where the insurer has paid to defend and resolve a claim. A commercial dispute about a deductible does not involve the failure to defend or resolve a claim.

The jury found Travelers liable for breach of contract, bad faith, and punitive damages. The jury awarded ACG nominal damages of $.07 for breach of contract, $140,000 for tortious bad faith, and $4 million in punitive damages. This unprecedented award was the result of judicial error. No case holds an insurer liable in tort for *paying* a single claim. ACG's claims sound only in contract, not tort. Regardless of the verdict form, one deductible payment incurred due to breach of the duty to investigate constitutes at most contract, not tort, damages. ACG cannot recover punitive damages because it proved no tortious conduct.

ACG claimed it would not have paid any deductible had Travelers conducted a more thorough investigation. However, there is no evidence that, had Travelers denied the claim, Custodio would have withdrawn her claim or ACG's deductible would have been less.

The district court also refused to remit the compensatory damages to comport with the evidence. There is no evidence ACG paid or reimbursed Travelers for any monies. The record shows Travelers paid, at most, $42,506.12 for the Custodio claim. Thus, the record does not support the compensatory damages, much less tort or punitive damages.

The court remitted the punitive damages to $1.4 million. The court found a "low level of reprehensibility," but applied a 10:1 ratio based on Travelers' "financial condition." ER 00048 (40:17-19).[1] This was patent error. If punitive damages are upheld, the maximum permissible ratio is 1:1.

After judgment was entered, ACG moved for its fees and costs based on California Civil Code section 1717 and a 2005-2006 finance agreement. The district court held the finance agreement, which did not exist when this action was

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[1] Travelers' Excerpts of Record are cited herein as "ER." The Reporter's Transcript is cited herein as "RT."

filed, and the 2002-2003 workers' compensation policy are the same contract. Thus, this is somehow an action "on" that finance agreement, and ACG's fees were incurred to enforce that agreement. However, the finance agreement incorporates ACG's 2005-2006 policy, not the applicable 2002-2003 policy. No fee provision before this Court was in effect during the relevant policy period. The agreement also has a Connecticut choice-of-law provision and a mandatory forum-selection clause. Simply stated, ACG is not entitled to recover its fees.

Travelers seeks reversal of the orders and the verdict based on the errors addressed herein.

IV. STATEMENT OF FACTS

A. ACG's Workers' Compensation Policy

Travelers has been ACG's workers' compensation carrier since 1990. RT 1251:25-1252:4/ER 01765-66. The policy at issue, # TC2JUB-395J873-6-02 (the "Policy"), was effective November 1, 2002 through November 1, 2003. ER 01268. ACG purchased the Policy with a $250,000 deductible. ACG also contracted to have Travelers manage, investigate, and settle claims within the deductible in exchange for a fifteen percent payment. ER 01493-97.[2] There is no evidence any Travelers claims handler was aware of this financial arrangement. *See, e.g.,* RT 388:3-9, 1170:10-12/ER 01661, 1739.

The Policy's insuring agreement expressly grants Travelers the "right to investigate and settle" claims, proceedings, or suits against ACG. ER 01300. ACG agreed expenses incurred to adjust claims would be credited against the deductible limit. The deductible states ACG receives a "reduced premium" in

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[2] ACG's Vice President and Assistant Treasurer testified "[ACG] understands that when it enters into this deal," "Travelers is going to charge this amount" for the loss conversion factor. RT 1366:15-20, 1372:11-19/ER 01778, 1780.

return for the higher deductible. ER 01493.

The Policy does not expressly state a duty to investigate. Thus, this duty is an implied duty.

B. Statement of Factual Background

ACG submitted 838 workers' compensation claims to Travelers from January 2001 to June 2005. RT 1539:19-1540:20/ER 01793-94. According to ACG's Corporate Director of Human Resources, "[T]he amount of incurred losses in workers' compensation claims that [ACG] has had between 2000 and 2005" is "approximately $4 million." RT 1179:15-23, 1180:16-19/ER 01744-45.

This case concerns only one workers' compensation claim. RT 1347:3-19/ER 01776. An insurer's obligations to defend and indemnify workers' compensation claims are governed by liberal workers' compensation laws.

Workers' compensation benefits are due when the California Workers' Compensation Act requires Travelers to pay them. ER 01300. An employee injured in the workplace is entitled to benefits after resolving "all reasonable doubts" in favor of compensation. *See* Cal. Labor Code § 3600(a); *McLune v. Workers' Compensation Appeals Board*, 63 Cal. Comp. Cas. 261, 264-65 (1998) ("the established legislative policy is that [the Act] must be liberally construed in the employee's favor and all reasonable doubts as to whether an injury arose out of employment are to be resolved in favor of the employee"), citing *Garza v. Workmen's Comp. App. Bd.*, 3 Cal. 3d 312, 317 (1970). A preexisting injury is not grounds to deny a claim. Cal. Labor Code § 4600; *Buhlert Trucking v. Workers' Comp. Appeals Bd.*, 199 Cal. App. 3d 1530, 1632 (1988).

Travelers could not deny the Custodio claim unless it could satisfy its burden to prove a genuine doubt as to ACG's liability. *Kerley v. Workers' Comp. Appeals Bd.*, 4 Cal. 3d 223, 227, 230 (1971). *See also* RT 1387:13-1389:14/ER

01783-85.

At trial, expert George Williams testified he has represented hundreds of claimants before the Workers' Compensation Appeals Board ("WCAB") and only *once* has there been a finding of no industrial injury. RT 1382:13-22, 1394:2-23/ER 01782, 1786. Expert Steve Bobus testified workers' compensation fraud is prosecuted by the district attorney under the strictest standard of proof, and "[i]n [his] experience in analyzing and packaging a cases [sic] for workers' compensation fraud prosecution," "hard evidence, not he-said-she-said kinds of stuff" is "required for [him] to actually submit the referral to the D.A.'s office." RT 1547:3-22, 1551:20-25, 1569:20-24/ER 01795, 1797, 1801. Examples of "hard evidence" include a "statement under penalty of perjury that is proven false by video evidence" or "a change of a doctor's opinion after review of the video." RT 1547:25-1548:20/ER 01795-96. Bobus testified "change of date of injury and delay of reporting" are common, changes in the injury description happen "all the time," and 60% of his cases involve an unwitnessed injury. RT 1566:13-18, 1567:3-1568:15/ER 01798-1800. Williams also testified the majority of injuries are unwitnessed. RT 1396:10-1398:23/ER 01787-89.

1. Travelers Paid to Defend and Settle Custodio's Claim

a. Custodio Claimed She Was Injured at Work

Custodio began working in bindery at ACG on April 16, 2003. RT 524:6-17/ER 01674. While cleaning up at shift's end on June 24-25, 2003, Custodio felt pain in her right groin while lifting a wood pallet. RT 531:14-532:10/ER 01675-76. Miguel Larios, Custodio's immediate supervisor, called her and asked her to come to work on June 25, 2003. RT 543:4-12/ER 01679. Custodio told him she was unable to work because she was in "very intense pain" in her "groin." RT 539:11-540:24/ER 01677-78.

Her pain persisting, Custodio – who had "never gone to a doctor other than for the birth of [her] children" (RT 547:12-17/ER 01680) – went to Tijuana to see a doctor. Custodio saw Dr. Velazquez on June 27, 2003 and told him she hurt her groin after picking up a pallet at work. RT 552:6-14/ER 01681. The following day Custodio had an x-ray, which Dr. Velazquez reviewed. He told her she was "injured" and "that the injury could have been related to the injury that [she] told him happened at work." RT 568:4-21/ER 01682.

After returning from Mexico, Custodio went to see Dr. Sorenson, ACG's company doctor. RT 571:21-575:9/ER 01683-87. Custodio told a nurse there that she "had been hurt at work lifting a pallet." RT 576:2-8/ER 01688. The nurse told her that she "needed to report the injury to [ACG]," which she did that day. RT 576:9-17/ER 01688.

b. ACG Reported the Claim to Travelers and Travelers Investigated

On August 6, 2003, Martha Madrigal, Larios' supervisor, reported Custodio's claim to Travelers and stated she questioned its validity. ER 01569-70. Travelers assigned Jeanie Urban to handle the claim. *Id.*

The very next day, Urban interviewed Custodio who stated she was "hurt at work lifting the pallet." RT 590:8-22, 591:13-16/ER 01690-91; ER 01568. Urban also called Melanie Wallace, ACG's Human Resources Director, to ask why ACG was questioning the claim. RT 646:22-24, 649:20-25/ER 01695-96; ER 01567. Wallace told Urban that "per Miguel Larios, [Custodio] did not lift pallets in her job." RT 656:6-8/ER 01698; ER 01571-72.

Urban's investigation included scheduling an AOE/COE examination, meaning "arising out of employment/course of employment," to determine whether Custodio's injury arose in the course of employment. ER 01567, 1573-74, 1578-80. Urban subpoenaed Custodio's medical records the day she received the

completed medical release.[3] ER 01566, 1576-77.

Dr. Leonard performed the examination on October 28, 2003. ER 01584-92. For Urban, who did not have medical training, Dr. Leonard's conclusion was critical to her evaluation. RT 401:22-24, 405:11-13/ER 01665, 1667. Her uncontroverted testimony is that if Dr. Leonard had determined the claim was not job-related, she would have denied the claim. RT 405:2-9/ER 01667.

Dr. Leonard found "Custodio presents with a history that is disturbing" and "appears to represent secondary gain issues," pointing to the reporting delay and her employer saying she did not lift pallets. ER 01585-90. Urban advised Dr. Leonard that ACG was "questioning the claim." ER 01578. But Dr. Leonard circled both "YES" and "NO" and stated, "Trier of fact," in response to the question, "Is injury/condition industrially related to the incident or activities in question?" ER 01584. Based on Dr. Leonard's conclusion that a question of fact existed, Urban accepted the claim on November 7, 2003. ER 01565.

On November 25, 2003, Dr. Leonard confirmed that the "three volumes of records [subsequently] provided by [Travelers]" contained nothing to "cause [him] to alter any of the opinions that [he] expressed in [his previous] report." ER 01591-92.

In October 2003, Custodio retained "attorney, Jonathan Brand, to represent [her] . . . [in] [her] workers' compensation claim." RT 591:17-20/ER 01691. On November 25, 2003, Custodio filed an "Application for Adjudication of Claim" through her attorney (the "WCAB claim"). ER 01593.

In early December 2003, Custodio returned to work at ACG, per ACG's

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[3] While Urban took many steps to investigate the Custodio claim, ACG emphasized at trial what Urban did not do. While ACG may emphasize this on appeal, no evidence indicates the medical evaluation resulting in the claim being accepted was affected by anything Urban failed to do.

request, for approximately one week. ER 01565.

On December 9, 2003, Patricia Landree, the second Travelers adjustor, called Custodio, who said her pain persisted. ER 01564. Landree also spoke to Wallace who told her Custodio was represented by counsel. ER 01562-63. In response, Travelers retained Kathryn Zalewski, the attorney on the "majority" of ACG's claims. RT 954:19-955:2, 959:20-24, 1230:19-25, 1342:16-20/ER 01726-27, 1731, 1758, 1775.

Dr. Bernhoft at Muir Orthopedic examined Custodio on December 11, 2003, and diagnosed her with "degenerative arthritis, right hip." ER 01560-61.

Because of a number of "red flags," Landree sent a letter to Zalewski explaining the claim was "being referred to . . . set employee's deposition." ER 01595-96. Custodio's deposition was taken on May 24, 2004. ER 01545.

The claim was referred to a new adjuster, Diane Nashban, in January 2004. ER 01556. Nashban entered the following note: "Surgery scheduled for 2/3/04, received pre certification, authorized hip." *Id.* Nashban testified she did not ask Dr. Bernhoft "how lifting a pallet could cause the need for hip replacement" or contact Custodio before authorizing the hip replacement. RT 832:17-24, 875:24-876:2/ER 01717, 1720-21. However, Nashban had known Dr. Bernhoft for years "in the capacity of a qualified medical evaluator as well as a treater" and that "he considers every patient as they are presented to him." RT 955:3-956:16/ER 01727-28. On February 3, 2004, Dr. Bernhoft replaced Custodio's right hip. ER 01552-53.

c. Travelers Continued to Investigate

Following Dr. Leonard's and Dr. Bernhoft's reports, Travelers' claim reserve increased from $5,000 to $300,000. RT 883:2-9/ER 01723. Floyd Childress, ACG's Vice President and Assistant Treasurer, testified at trial he "was

preparing the year-end reserve analysis to make sure [ACG] had all of [its] claims properly reserved for and ... noticed a large claim outstanding that [he] was unfamiliar with," so he "contacted Mike Spragge and [he] asked him if he was aware of this claim." RT 1366:15-16, 1370:11-22/ER 01778-79. Spragge, ACG's Corporate Director of Human Resources, testified that in January 2004, Pat Kellick, ACG's Chief Financial Officer, called "pretty upset because he wanted to understand why the dollar value for the incurred claims in California had gone up as much as they had." RT 1183:13-21/ER 01746. Kellick said he was concerned because ACG is a leveraged company. RT 1184:5-10/ER 01747.

On January 29, 2004, Jerry Anderson, a claims consultant at ACG's broker, Marsh, sent Spragge an email regarding his discussion with Karen Anderson, ACG's account representative at Travelers:

> Travelers accepted the claim as medically compensable which alone is probably correct. I explained to Karen that I believe the claim should have been denied from the beginning as we believe the alleged incident never happened. This would be the only grounds for denial. It appears the claimant may require surgery and it could turn into a major claim.

ER 01597.

Travelers took ACG's concerns regarding the claim seriously and continued to investigate. Camp Investigations retained by Travelers interviewed eight employees, including Larios, Madrigal, and Garcia. ER 01598. Its March 5, 2004 report, which summarized the interviews, highlighted ACG's understanding of the facts was inconsistent or simply wrong. ER 01599-1612. For example, Wallace, ACG's Human Resources Director, said Custodio did not work on June 25, 2003, forgetting the night shift began on June 24, 2003. ER 01611. Larios confirmed Custodio worked with pallets and "assisted him at times with the cleanup." ER 01603-04. Another co-worker "admitted that there was some handling of empty pallets." ER 01605.

On March 22, 2004, Chris Nelson, a Director of Field Services and Quality Management at Travelers, received a copy of a January 28, 2004 letter from Zalewski, ACG's attorney for the Custodio claim. Nelson testified Zalewski's letter said "Dr. Bernhoft determined it was work related," he had no reason to disbelieve Zalewski, and the letter formed the basis for his March 23, 2004, letter to Jerry Anderson re-affirming Travelers properly accepted the Custodio claim based on available facts. RT 1172:13-1174:10/ER 01741-43; ER 01613-14. Nelson testified he "intend[ed] to accurately state the facts," and "if there was an inaccurate statement in the claim notes upon which [he] relied, [he] would have been merely repeating it." RT 1171:23-1172:8/ER 01740-41.

Richard Busch, ACG's counsel in this action, sent Nelson an April 12, 2005 letter asserting Travelers mishandled the claim. ER 01615-17. Nelson responded to Busch's letter, explaining "the presence of red flags prompted the investigation," but "those red flags were not substantial enough to refute the medical evidence that an injury was present and consistent with the mechanics of the accident and the job functions." ER 01618-19. Still, Travelers continued to investigate the claim.

In addition to taking Custodio's deposition in May 2004, Travelers sent an investigator to Tijuana to investigate ACG's concerns in August and September 2004. ER 01540-42, 1545. The investigator did not discover any information contrary to Custodio's claims. ER 01540-42.

In November 2004, Dr. Bernhoft addressed "apportionment," stating, "You do point out that x-rays of her right hip taken three days after her injury showed arthritic changes and I would agree that there is certainly an issue of apportionment. In my opinion I would apportion 50% of her permanent partial disability to her industrial injury of 6/11/03 and 50% to the pre-existing degenerative arthritic changes that prior to her incident of 6/11/03 had not

produced any apparent pain for her." ER 01621-22.

In September 2005, Dr. Cremata, Custodio's doctor, issued a report finding Custodio's injury is "industrially related" and denying an offset for apportionment, explaining: "Prior to this industrial injury this patient had no related symptoms, impairments, or disabilities. Although it is likely that she had preexisting degenerative joint disease of the right hip, this degenerative joint disease was never symptomatic and never contributed to any pain, impairment or disability." RT 1049:12-1050:20/ER 01735-36; ER 01623-38.

Around December 1, 2005, Custodio settled for $35,000, less than the authority extended by ACG. RT 1236:23-1237:21/ER 01762-63; ER 01510-16. Kellick, ACG's CFO, testified ACG paid "approximately $140,000" but no witness testified as to the "[s]pecific payees for each element of the $140,000." RT 1250:14-18, 1335:4-10, 1347:24-1348:8/ER 01764, 1772, 1776-77. All monies paid "in connection with the Custodio claim" were within ACG's deductible. ER 01493-97.

C. ACG Expressed Its Satisfaction with Travelers' Handling and Resolution of the Custodio Claim

ACG expressed its overall satisfaction with the resolution of the Custodio claim. On July 8, 2004, ACG's insurance broker wrote he was pleased both with how Travelers handles ACG's workers' compensation claims and with adjuster Diane Nashban: "Overall I think Travelers is doing a good job handling your workers compensation claims...Having Diane Nashban handle more of your claims is obviously a good thing. She is aggressive, knows her claims and knows how to get the best results." ER 01639.

On November 3, 2005, ACG's Human Resources Director wrote to Nashban and commended her for her work in resolving the WCAB claim: "Good job yesterday, the AON rep. commented that he wished all the other adjusters were as

prepared/knowledgeable as you were." RT 1179:15-23, 1201:25-1202:23/ER 01744, 1748-49; ER 01512.

D. Statement of Procedural History and Damage Award

1. The District Court Denied Travelers' Motion for Summary Judgment

On January 27, 2006, the district court denied Travelers' motion for summary judgment. For purposes of the motion only, Travelers did not dispute its investigation was inadequate. Fed. R. Civ. Pro., rule 56(c). Travelers highlighted its contractual right to control and settle claims. *Id. New Hampshire Ins. Co. v. Ridout Roofing Co.*, 68 Cal. App. 4th 495, 505-07 (1998). The district court rejected Travelers' argument, finding issues of material fact, including whether Travelers' investigation was reasonable, Travelers acted in bad faith, and ACG was entitled to tort damages. ER 00146. The district court relied in part on *Security Officers Service, Inc. v. State Compensation Ins. Fund*, 17 Cal. App. 4th 887 (1993). ER 00145.

2. The District Court Permitted ACG to Seek Nominal Damages for Breach of Contract and Submitted Bad Faith to the Jury

ACG initially sought three types of damages at trial: (1) "monies [ACG] paid to . . . Travelers or Aiza Custodio in connection with the Custodio claim" (ER 01031); (2) "any premium adjustments related to the Custodio claim or this litigation" (ER 01033); and (3) "the amount of attorney fees and costs [ACG] incurred to recover the insurance policy benefits" (*Id.*).

At trial, the court found ACG failed to introduce evidence of attorneys' fees or a "premium adjustment." RT 1332:18-23, 1589:24-1590:18/ER 00096, 99-100. Thus, ACG had one item of damages for two causes of action. ACG considered dismissing its breach of contract claim or seeking no damages for it, but instead sought nominal damages for breach of contract and its deductible payment for bad

faith in order to maintain its punitive damages claim. RT 1595:1-10/ER 00105. Over objection, the court instructed the jury: (1) "[ACG] is seeking nominal damages for the breach of contract"; and (2) for bad faith, ACG claims "[a]ll monies paid by [ACG] either to Travelers or to Aiza Custodio in connection with the Aiza Custodio claim." RT 1663:25-1665:23, 1686:5-1692:15/ER 00122-24, 130-36; ER 00075, 80. ACG agreed to instruct the jury nominal damages means "plaintiff has failed to prove damages" for breach of contract. ER 00076.

The court's decisions to instruct the jury it could enter an award for "nominal damages" and to treat ACG's bad faith claim as necessarily affording tort damages were fundamental errors. They enabled the jury to award punitive damages based on contract damages.

3. The Jury Awarded Tort, Contract and Punitive Damages

The jury found breach of contract, *i.e.*, Travelers "fail[ed] to do something that the [insurance] contract required it to do," awarding $.07 in nominal damages. ER 00090-91. The jury also found Travelers breached "its implied obligation of good faith and fair dealing" "during the course of administering the workers' compensation claim or thereafter," and awarded $140,000 for the "monies [ACG] paid to Travelers or Aiza Custodio in connection with the Custodio claim." ER 00092-93. Finally, the jury awarded $4,000,000 in punitive damages. ER 00094.

Travelers moved for judgment as a matter of law on several grounds, including failure to prove damages. The motion was denied despite the court's conclusion that "American's evidence of damages is skimpy." RT 1596:3-16/ER 00106.[4] After ACG was awarded $140,000, Travelers renewed its motion and moved for a new trial. ER 01007-14. Both motions were denied. RT 1596:13-

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[4] In Section VI.B.2, *infra,* at page 33, Travelers explains why the evidence was insufficient to support the verdict.

16/ER 00106.

The court remitted the punitive damages from $4 million to $1.4 million despite finding "this case appears to present a fairly low degree of reprehensibility." ER 00048 (40:17-19). The court also used Travelers' financial condition against Travelers in deciding the remittitur, noting Travelers' "*financial condition is such that if the punitive damage award were reduced to a 1:1 ratio with the compensatory damage award, little or no deterrence or punishment would be achieved.*" ER 00052 (44:7-9) (emphasis added).

4. ACG Moved for Its Attorneys' Fees Post-Trial Pursuant to *Brandt* and California Civil Code Section 1717

After judgment, ACG moved for its attorneys' fees pursuant to: (1) *Brandt v. Superior Court,* 37 Cal. 3d 813 (1985); and (2) California Civil Code section 1717, which makes a contractual attorneys' fees provision reciprocal to all parties to the contract under certain circumstances. ER 00932-58. ACG asserted the attorney-client privilege at trial when the court questioned why ACG did not produce evidence of its fees prior to trial, but then waived the privilege in its post-trial motion. ER 01016-17.

The court rejected ACG's post-trial attempt to recover its fees via *Brandt.* ER 00022-23 (14:13-15:22). The court agreed with *Brandt* that determination of "the recoverable fees *must be made by the trier of fact unless the parties stipulate otherwise.*" ER 00022 (14:18-23) (emphasis in original). "Because the Court excluded evidence of attorney's fees, no determination of the recoverable fees was made by the jury, and the parties have not stipulated for the Court to make that determination." ER 00022 (14:24-25).

ACG then argued it "is contractually entitled to recover attorneys' fees and other costs under the *insurance contract* . . . pursuant to [section 1717]." ER 00939-40. Yet, importantly, the Policy does not contain a fees provision, and ACG

has never submitted a copy of any agreement in effect during the Policy Period. ER 01267-1497; ER 00383-859. Instead, ACG relied on an inapplicable and irrelevant 2005-2006 finance agreement, which states certain obligations regarding the deductible in ACG's *2005-2006* policy. Of course, the 2002-2003 (not the 2005-2006) Policy is at issue. Thus, the evidence submitted by ACG is wholly irrelevant. In addition, the agreement submitted by ACG has a Connecticut choice-of-law provision and a mandatory forum-selection clause. ER 00411-413. The trial court, however, agreed with ACG and ordered the parties to arbitrate ACG's fees pursuant to the 2005-2006 agreement's arbitration provision. ER 00023 (15:23), 412.

V. TRAVELERS SEEKS REVERSAL

Travelers appeals the following errors of the district court:

1) A breach of the duty to investigate sounds in tort where the insurer paid to defend and settle the claim (RT 1588:7-1591:22, 1648:24-1668:4, 1669:6-1670:1/ER 00098-101, 107-29; ER 00035-41 (27:11-33:2), 55, 78, 80, 92-93, 142-47, 1092-96, 1143-52);

2) Choosing to proceed only in tort transforms contract damages into tort damages sufficient to impose punitive damages (RT 1588:7-1596:16, 1648:24-1668:4, 1669:6-1670:1/ER 00098-106, 107-29; ER 00041 (33:4-8), 55, 78, 80, 90-93, 142-47, 1092-96, 1143-52);

3) The evidence admitted at trial supports a compensatory damages award of $140,000 (ER 00034-35 (26:19-27:9), 39 (31:1-22), 45-47 (37:12-39:14), 81-83);

4) There is sufficient evidence for a jury to infer malice, oppression or fraud as required by section 3294 (ER 00042-44 (34:24-36:7));

5) A 10:1 ratio of punitive damages to compensatory damages is not unconstitutional, even though there is "low reprehensibility," because of Travelers' net worth (ER 00048 (40:18-19), 51-52 (43:27-44:17));

6) ACG can recover its attorneys' fees pursuant to California Civil Code section 1717 because:

a. The 2005-2006 finance agreement between Travelers and ACG contains a fees provision applicable to a dispute over a claim accepted under the 2002-2003 policy, which the finance agreement does not refer to or incorporate (ER 00015-22 (7:16-14:11));

b. This is an action "on" the 2005-2006 finance agreement and that agreement and the 2002-2003 policy are the same contract (ER 00014 (6:11-17), 15 (7:16-10:20));

c. ACG's fees were incurred to enforce that contract (ER 00018 (10:14-20));

d. The 2005-2006 finance agreement did not have to be introduced at trial (ER 00014 (6:11-17), 15-16 (7:16-8:16));

e. The Connecticut choice-of-law provision in the 2005-2006 finance agreement does not apply (ER 00019-21 (11:23-13:5));

f. The Connecticut forum-selection provision in the 2005-2006 finance agreement does not apply (ER 00019 (11:3-22)); and

g. The 2005-2006 finance agreement's arbitration provision applies to ACG's fees and costs claim (ER 00021-22 (13:6-22, 13:25-14:11)).

VI. ARGUMENT

A. The Trial Court Erred in Treating ACG's Damages as Tort Damages Instead of Contract Damages

The promised payment of defense and indemnity upon a loss is unique to the insurance relationship. Because of the specific economic dilemma created by an insurer's wrongful failure to defend or indemnify, courts have crafted a narrow exception to the general rule that only contract remedies are available for a breach of the implied covenant. This exception helps to prevent a breach of these core promises to pay. Thus, it is unsurprising that no legal support exists for imposing tort liability against Travelers due to *payment* of a workers' compensation claim asserted against ACG.

At trial, Judge Armstrong instructed the jury over objection that "nominal" contract damages could be awarded, permitted recovery of contract damages under

a bad faith cause of action, and then treated those contract damages as tort damages. This interchange of tort for contract was a critical error.

If Travelers breached its good faith duty to investigate, then more than nominal damages may be appropriate if proven. The jury should have been instructed on how to calculate damages for breach of contract – not merely told to award "nominal" damages. But it was error to instruct the jury that an award of contract damages is an award of tort damages simply because it was based on an implied covenant theory. Tort damages are legally unavailable as a remedy where the policyholder has been fully defended and indemnified.

The trial court's ruling treating any compensatory damages awarded as tort damages, and, in particular, its application of California bad faith principles, must be reviewed de novo. *See* Ninth Circuit Court of Appeals, Standards of Review, September 2006, p. 254 ("A district court's interpretation of state law is reviewed de novo.").

1. A Covenant of Good Faith and Fair Dealing Is Implied in Every Contract

"In addition to the duties imposed on contracting parties by the express terms of their agreement, the law implies in every contract a covenant of good faith and fair dealing." *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 818 (1979). *See also Cates Construction, Inc. v. Talbot Partners,* 21 Cal. 4th 28, 43 (1999). This implied promise requires each contracting party to refrain from doing "anything which will injure the right of the other to receive the benefits of the agreement." *Comunale v. General Ins. Co.*, 50 Cal. 2d 654, 658 (1958). "This duty has been recognized in the majority of American jurisdictions, the Restatement and the Uniform Commercial Code." *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 683 (1988).

Compensation for any breach of the implied covenant is, outside the

insurance context, strictly limited to contract remedies. "As a contract concept, breach of the duty led to imposition of contract damages determined by the nature of the breach and standard contract principles." *Foley*, 47 Cal. 3d at 684. The nature and extent of the duty imposed by the implied promise hinges on the contractual purpose. *Egan*, 24 Cal. 3d at 818.

While a narrow "insurance exception" to the general prohibition against imposing tort remedies for contractual breaches has evolved, it remains the exception – not the rule – *even for contractual breaches of an insurance policy*. *Egan*, 24 Cal. 3d at 818. As explained in *Jonathan Neil & Associates v. Jones*, 33 Cal. 4th 917, 923 (2004), the narrow insurance exception only allows an insured to seek tort damages for the breach of specific duties:

> The remedy for breach of [the implied covenant of good faith and fair dealing] is generally limited to contract damages, but we have recognized an exception to this rule when the breach occurs in the context of an insurance company's failure to properly settle a claim against an insured or to resolve a claim asserted by the insured.

2. Tort Liability for Breach of the Implied Covenant in Insurance Departs from the Traditional Distinction Between Contract and Tort Remedies

a. The Law Distinguishes Between the Remedies Available in Tort and Contract Based on Their Fundamentally Divergent Objectives

A clear distinction exists between tort and contract remedies in California. That distinction is well grounded in common law, and "divergent objectives underlie the remedies created in the two areas." *Foley*, 47 Cal. 3d at 683. "Whereas contract actions are created to enforce the intentions of the parties to the agreement; tort law is primarily designed to vindicate 'social policy.'" *Id.* (*citing* William L. Prosser, The Law of Torts 613 (4th ed. 1971)).

Business transactions, including those involving payment for an insurance policy, are entered into when the parties "agree upon the rules and regulations

which will govern their relationship; the risks inherent in the agreement and the likelihood of its breach." *Applied Equip. Corp. v. Litton Saudi Arabia Ltd.*, 7 Cal. 4th 503, 517 (1994). Because the relationship is voluntary and the obligations, risks, and rewards are defined by the parties, "it is appropriate to enforce only such obligations as each party voluntarily assumed, and to give him only such benefits as he expected to receive." *Id.*

Allowing only contract damages for a contract breach is central to the efficient operation of our free market economy. "[P]redictability about the costs of contractual relationships plays an important role in our commercial system." *Foley*, 47 Cal. 3d at 654 (citation omitted). Damages for contractual breaches is intended to compensate the party who has lost the benefit of the bargain rather than to punish the breaching party. *Id.* at 683. Limiting damages for breach to those damages encompassed by the contract and anticipated by the parties "serves to encourage contractual relations and commercial activity *by enabling parties to estimate in advance the financial risks of the enterprise*." *Erlich v. Menezes*, 21 Cal. 4th 543, 550 (1999) (emphasis added).

b. The Law Limits the Tort of Bad Faith to Protecting Against Wrongful Denial of Defense or Indemnity

Mere contract disputes, *even those involving insurance contracts*, fall outside the "insurance exception" and do not require the special protection provided by tort remedies. Bad faith tort liability exists to ensure the insurer's promise to defend or indemnify the policyholder is kept. *Benavides v. State Farm*, 136 Cal. App. 4th 1241, 1250-51 (2006) (no liability for improper investigation because "to establish an implied covenant tortious breach, an insured must first show that benefits were due under the policy, and second that the benefits were withheld without proper cause"); *Neil,* 33 Cal. 4th at 923.

The "insurance exception" developed because an insured does not buy

insurance seeking profit. Insurance is purchased for "[t]he bargained-for peace of mind [which] comes from the assurance that the insured will receive prompt payment of money in times of need." *Love v. Fire Ins. Exch.*, 221 Cal. App. 3d 1136, 1153 (1990). Because this is unique to insurance contracts, courts impose special duties on insurers "consonant with these special purposes, *seeking to encourage insurers promptly to process and pay claims*." *Id.* (emphasis added). As explained in *Love* at 1148, tort liability is imposed to assure insurers' promises of defense and indemnity are kept:

> If an insurer were free of such special duties and could deny or delay payment of clearly owed debts with impunity, the insured would be deprived of the precise benefit the contract was designed to secure (i.e., peace of mind) and would suffer the precise harm (i.e., lack of funds in times of crises) the contract was designed to prevent.

Thus, courts have created special rules allowing tort damages to protect policyholders from the *exceptional* losses that can result from denying a defense or indemnity.

3. The California Supreme Court Has Consistently Refused to Extend the Exception to Allow Tort Liability for a Breach of the Implied Covenant

Since 1995, the California Supreme Court has rejected a number of attempts to expand bad faith tort liability and apply it outside the context of a failure to defend or indemnify. For example, in *Waller v. Truck Ins. Exchange,* 11 Cal. 4th 1 (1995), the Court held that only wrongful denial of a defense or indemnity allows an insured to maintain a bad faith tort cause of action. *Id.* at 36.

Likewise, *Cates* refused to extend the insurance exception to a surety bond because the bond obligee is not confronted with the same "economic dilemma" created by an insurer not paying covered defense or indemnity costs. "Although a construction surety's breach of the implied covenant might very well have

financial significance for a performance bond obligee, the obligee does not face the same *economic dilemma* as an insured." *Cates*, 21 Cal. 4th at 54 (emphasis added). The Court reasoned: "[I]t should not be common for an owner to confront the sort of *economic dilemma* that an insured faces *after a catastrophic loss or accident*, or for an owner to be particularly vulnerable to a surety's inaction." *Id.* at 56 (emphasis added). *See also id.* at 44.

The Court again refused to expand the scope of the insurance exception in *Neil*, even where the insurer "retroactively overcharges" its insured "a premium it knows is not owed." *Neil*, 33 Cal. 4th at 923. The Court rejected the insured's attempt to turn the intentional overbilling into an "economic dilemma" based on "several critical factors that counsel against the availability of tort remedies for breach of the covenant" in a mere business dispute:

> First, the billing dispute does not, by itself, deny the insured the benefits of the insurance policy—the *security against losses and third party liability*. Second, the dispute does not require the insured to prosecute the insurer in order to enforce its rights, as in the case of bad faith claims and settlement practices.
>
> Third, traditional tort remedies may be available to the insured who is wrongfully billed a retroactive premium.

Id. at 939 (citations omitted; emphasis added).

Applying these factors, the Court concluded tort remedies for breach of the implied covenant "are unnecessary to protect the insured's interests" because the insureds were "not in the same vulnerable position as those who suffer from the insurer's bad faith claims and settlement practices," "were not denied the benefits of the insurance policy, were not required to prosecute the insurer to vindicate their contractual rights, and had available various administrative, contractual, and tort remedies." *Id.* at 941.

The first two factors apply similarly here. Travelers paid for and defended ACG against the Custodio claim, providing ACG with "security against losses and

third party liability." Like the insured in *Neil*, ACG did not have to sue Travelers in order to force Travelers to pay the Custodio claim as Travelers had paid it. This case, too, is a mere billing dispute.

The third factor does not directly apply here because this is not a "retroactive premium" case raising potential tort remedies such as malicious prosecution, defamation, and intentional interference with prospective economic advantage. *Id.* at 939. However, ACG is not without remedies. One of the reasons *Neil* refused to extend tort remedies to a billing dispute was the available marketplace remedies. *Id.* at 939 ("[G]enerally speaking, the insurer's ability to charge excessive premiums will be disciplined by competition among insurers."). The cost of insurance "implicates the marketplace aspect of [an insured's] relationship with [the insurer]." *Emerald Bay Community Assn. v. Golden Eagle Ins. Corp.,* 130 Cal. App. 4th 1078, 1095 (2005).

ACG's executives testified at trial about the marketplace remedies ACG could have sought. ACG's service instructions require Travelers to notify ACG "prior to denying, opposing or contesting a workers' compensation claim," but do not "require[] that Travelers inform [ACG] before accepting a claim which [ACG] has raised questions about." ER 01501; RT 1203:25-1206:11/ER 01750-53. ACG "considered adding or requesting that [a requirement] be added to the instructions" that Travelers inform ACG before accepting a claim which ACG questioned, but did not do so. RT 1206:13-15/ER 01753.

ACG's CFO testified ACG considered becoming self-insured and switching carriers. RT 1223:14-22, 1254:16-1255:1/ER 01755, 1767-68. ACG received a quote from Hartford. RT 1254:16-1255:1, 1292:6-18, 1340:5-18, 1341:3-13/ER 01767-68, 1771, 1773-74. ACG's marketplace remedies also included negotiating a lower deductible or a policy requiring Travelers to obtain ACG's approval before

accepting a claim. *See, e.g., Hurvitz v. St. Paul Fire & Marine Ins. Co.*, 109 Cal. App. 4th 918, 931 (2003) ("The alternative [for the insured] is to negotiate—and pay for a policy with a consent provision.").

Thus, applying the *Neil* factors mandates the same conclusion as in *Neil*: no tort liability. Any breach by Travelers did not "occur[] in the context of an insurance company's *failure to properly settle a claim* against an insured, *or to resolve a claim* asserted by the insured." *Neil*, 33 Cal. 4th at 923 (emphasis added). Thus, under *Neil,* the bad faith insurance exception allowing tort remedies does not apply here.

In short, the California Supreme Court has made it clear that a policyholder may recover in tort for breach of the implied covenant only if the insured faces the "economic dilemma" of an insurer failing to defend or resolve a covered claim. ACG's deductible payment resulting from Travelers paying all costs of defense and indemnity does not create that "economic dilemma."

4. Absent that "Economic Dilemma," the Insurance Exception Has Only Been Applied Where the Insured's Premiums Inexorably Increased Due to State Regulations No Longer in Effect

Between 1993 and 1999, the California Court of Appeal applied the insurance exception to allow bad faith tort recovery where the insurer's claims handling and reserving practices necessarily resulted in increased premiums and a loss of dividends for the insured under a unique statutory "insurance regime" then in place. None of these facts are in evidence here, including the "insurance regime." ACG offered no evidence of a premium increase, and there are no "increased premium" cases after 1999 because the "insurance regime" is no longer in effect. Consequently, these cases do not permit ACG to recover in tort for a breach of the implied covenant.

In *Security Officers, supra*, the insured sued its workers' compensation

carrier for bad faith, alleging harm caused by the insurer's "systematic failure to process claims diligently, and its unreasonable inflation of the reserves assigned to them." *Security Officers*, 17 Cal. App. 4th at 890. The trial court sustained the insurer's demurrer, dismissing the suit. On appeal, the court "[held] that *under an insurance regime* in which the insured's annual claims experience *inexorably influences* its premiums, the insurer may be liable if it processes claims and sets reserves without good faith regard for their impact on the insured's premiums and potential dividends." *Id.* (emphasis added).

Essential to the court's ruling is the statutory "insurance regime" then in effect:

> Plaintiff's policy premiums are determined by the rating bureau, as a function of the "manual rate" for the industry in question (prescribed by Cal. Code Regs., tit. 10, § 2350), the employer's annual payroll, and its loss "experience rating," as modified with regard to the number of claims outstanding at the end of the year, and the amount of reserves SCIF has established for those unresolved claims. (See Cal. Code Regs., tit. 10, § 2353 [rating bureau experience rating plan].)

Id. at 891. The *Security Officers* court limited its decision to this statutory "insurance regime":

> When an insurance policy contains a retrospective premium feature, an insurer's failure to act reasonably when adjusting claims *automatically* subjects the insured to greater financial obligations in the form of increased premium rates.

Id. at 897 (emphasis added).

Security Officers does not apply here for two basic reasons. First, there is no evidence ACG's premium increased as the result of Travelers' breach of the duty to investigate. RT 1591:10-11/ER 00101. The trial court specifically held that ACG did not have a claim for "an increased premium adjustment." RT 1589:24-1590:18/ER 00099-100. Second, the "insurance regime" ended in 1993 when the legislature amended Insurance Code section 11732 and related regulations. *See*

1993 Cal. ALS 228; 1993 Cal. SB 30; Stats 1993 ch. 228 (repealing former California Insurance Code section 11732). Consequently, premiums are no longer regulated by the legislature, but set by insurers in the marketplace.

A series of cases developed after *Security Officers* allowing recovery in tort where the insurer's claims handling and reserving practices directly affected the insured's premiums and dividends. *See, e.g., MacGregor Yacht Corp. v. State Comp. Ins. Fund*, 63 Cal. App. 4th 448 (1998); *Lance Camper Mfg. Corp. v. Republic Indem. Corp.*, 44 Cal. App. 4th 194 (1996); *Tricor Calif., Inc. v. State Comp. Ins. Fund*, 30 Cal. App. 4th 230 (1994); *Notrica v. State Comp. Ins. Fun*, 70 Cal. App. 4th 911 (1999). All of these cases involve the same statutory "insurance regime" and are therefore similarly distinguishable and inapplicable. There is no "increased premium" case decided after 1999 as enough time had passed for litigation on pre-1993 policies to conclude.

A decade after *Security Officers*, insureds "[sought] to rely on [*Notrica, supra*] for the proposition that the insurer must at least consider the potential impact on the insured's future premiums when it settles a third party lawsuit." *Hurvitz*, 109 Cal. App. 4th at 933. The court disagreed, finding "[t]he situation here is not at all analogous to that in *Notrica* and *Security Officers*." *Id.*

Similarly, as discussed above, *Neil* in 2004 refused to extend the insurance exception to an insurer "retroactively bill[ing] an insured for an excessive premium." *Neil*, 33 Cal. 4th at 938. The Court rejected the insured's attempt to rely on *Security Officers*:

> *Security Officers Service* is clearly distinguishable from the present case. There, *the overcharging of premiums was inextricably linked to the mishandling of claims*—precisely the kind of bad faith behavior that goes to the heart of the special insurance relationship and gives rise to tort remedies. [Footnote omitted.]

Id. at 940-41 (emphasis added).

In sum, ACG's single deductible payment with no evidence of increased premiums is not analogous to the systematic mishandling and over-reserving of claims which inexorably increased premiums due to insurance regulations and does not involve the statutory insurance regime at issue in *Security Officers*.[5] Whereas the insured's premium in *Security Officers* was automatically determined *by* the insurer's handling of the claim, ACG, unlike the insured in *Security Officers*, negotiated the deductible before purchasing the policy and prior to Travelers' handling of the claim. ACG could have negotiated a different arrangement. Neither statute nor regulation required this arrangement. Premiums are now "disciplined by competition among insurers." *Neil*, 33 Cal. 4th at 939.

5. ACG Is Only Entitled to and Was Only Awarded Contract Damages for Travelers' Breach of the Implied Covenant

Under the decisions discussed above, absent the specific "economic dilemma" that would have been created by Travelers' failure to pay or defend a claim, ACG is only entitled to contract damages. Even the district court recognized the jury's award of the "monies paid ... in connection with the Aiza Custodio claim" is contract damages. ER 00093. Indeed, after determining ACG only proved one item of damages - its deductible payment - the district court concluded "[ACG] has shown that it did suffer damages as a *proximate result* of

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[5] Indeed, California recognizes insurers have discretion in settling claims, even with a deductible. *See, e.g., Western Polymer Tech., Inc. v. Reliance Ins. Co.*, 32 Cal. App. 4th 14, 24-25, 26 n. 7 (1994) ("an insurer normally cannot be liable to the insured if the insurer does no more than settle a claim or suit within the policy's limit"). This is particularly true where the insurance policy, as is true here, grants the insurer the "right," not the duty, to settle. *See, e.g., id.* at 24-25; *Ridout*, 68 Cal. App. 4th at 502. Indeed, *Western Polymer* and *Ridout* hold an insurer is *not* liable for how it resolves a claim even if it causes the insured financial harm. More is required. For workers' compensation cases, "more" was the statutory regime no longer in effect.

Travelers' alleged *breach of contract*." RT 1590:19-23/ER 00100 (emphasis added).

At the close of evidence, ACG recognized it was on the horns of a dilemma: it needed to recover tort damages to seek punitive damages, but had at best introduced evidence of contractual payments for the Custodio claim. Clever lawyering found a ruse. ACG requested, and the district court erroneously allowed, the following shuffle: first, use a breach of contract jury instruction that ACG is only seeking nominal damages for breach of contract, instructing the jury nominal damages means "plaintiff has failed to prove damages" for breach of contract; and, second, use a bad faith jury instruction seeking, verbatim, what ACG was originally going to seek for breach of contract. RT 1591:23-1596:5, 1663:25-1665:23, 1686:5-1692:15/ER 00101-06, 122-24, 130-36.

This error allowing ACG to seek its necessarily contractual damages under an instruction specifically used for awards sounding in tort provided the springboard for ACG to seek punitive damages. The "monies paid . . . in connection with the Aiza Custodio claim," if supported by the evidence which Travelers disputes, are precisely the kind of damages contemplated by Civil Code section 3300 as contract damages. That is, the "monies paid" had to be based on a breach of a contractual obligation, implied in this instance.

Furthermore, an erroneous instruction allowing the "monies paid" to be awarded under the label of bad faith does not transform a contractual deductible payment into tort damages. *Archdale v. American Internat. Specialty Lines Ins. Co.*, 154 Cal. App. 4th 449, 466 (2007) ("Whether the insured's remedy will be in contract or tort will depend on the nature of the relief or recovery sought by the insured."). A deductible payment is inescapably contractual in nature, and the district court erred in treating it as tort damages.

This error was also of fundamental importance. There is "a significant difference" in "the available remedies" between tort and contract recovery. *Id.* at 467, n. 19. Only tort recovery entitles a plaintiff to seek "extra-contractual damages such as those for emotional distress, punitive damages and attorney fees." *Id.*

It was error for the district court to give the tort instruction and to treat the "monies paid" as tort damages. Both errors can be remedied at once by limiting ACG to contract damages and treating the "monies paid" as contract damages, regardless of the instruction under which the damages were requested.

B. The Evidence Does Not Support an Award of $140,000

ACG was awarded $140,000 for the "monies [ACG] paid to Travelers or Aiza Custodio in connection with the Custodio claim." ER 00093. The court denied Travelers' motion for judgment as a matter of law on the speculative nature of the damages and Travelers' post-trial motion to remit the award, finding "although the evidence was ... skimpy, the Court cannot say that the verdict was based *only* on speculation or guesswork." ER 00047 (39:9-12) (emphasis in original).

The Ninth Circuit reviews compensatory damages for substantial evidence. *Three Boys Music Corp. v. Bolton*, 212 F.3d 477, 482 (9th Cir. 2000). It may reverse an award if "the amount is grossly excessive or monstrous, clearly not supported by the evidence, or based only on speculation or guesswork." *Del Monte Dunes v. City of Monterey*, 95 F.3d 1422, 1435 (9th Cir. 1996).

1. The Evidence Shows the "Monies Paid" Were Not *Caused* by Travelers' Breach of the Duty to Investigate

ACG had the burden of proving its damages for breach of contract, i.e., "the amount which will compensate the party aggrieved for all the detriment *proximately caused* thereby, or which, in the ordinary course of things, would be

likely to result therefrom." Cal. Civil Code § 3300 (emphasis added). Specifically,

> "[c]ontract damages are generally limited to those within the contemplation of the parties when the contract was entered into or at least *reasonably foreseeable* by them at that time; consequential damages beyond the expectation of the parties are not recoverable. [Citations.] This limitation on available damages serves to encourage contractual relations and commercial activity by enabling parties to estimate in advance the financial risks of their enterprise."

Erlich, 21 Cal. 4th at 550 (emphasis added), quoting *Applied,* 7 Cal. 4th at 515.

ACG argued, and the district court agreed, "Any 'evidence' that [ACG] could have attempted to submit showing that Custodio would have abandoned her claim if Travelers had conducted an appropriate investigation would have been subject to a valid objection on the ground that it called for speculation." ER 00039 (31:12-14). The court agreed with ACG that what would have happened had Travelers conducted a more thorough investigation was "highly speculative." ER 00035 (27:3).

The court thus allowed ACG to offer no evidence to prove Travelers' inadequate investigation "proximately caused" Custodio to maintain her WCAB claim and ACG to pay part of its deductible. ACG was allowed to excuse this failure to satisfy its burden by impermissibly raising the shield of "speculation." *See Warner Constr. Corp. v. L.A.*, 2 Cal. 3d 285, 301 (1970) (reversing damages award because plaintiff did not prove impairment of capital caused its lost profits and award therefore required speculation).

Given the number of workers' compensation claims previously submitted, the parties could foresee ACG paying a large portion of its deductible, just as it had for many years. RT 1539:19-1540:20/ER 01793-94. It was also foreseeable Travelers would accept most of the claims. *Id.* ACG's service instructions do not even require Travelers to inform ACG before accepting a claim that ACG

questioned. ER 01501; RT 1203:25-1206:11/ER 01750-53. Thus, ACG's deductible payment was neither proximately caused by Travelers' breach of the duty to investigate nor "in the ordinary course of things, likely to result therefrom."

Moreover, Custodio hired an attorney before Travelers accepted the claim, and the AOE/COE examination resulted in a "Yes"/"No" "Trier of fact" finding. RT 591:17-20/ER 01691; ER 01584, 1593. ACG did not challenge Urban's testimony about accepting a claim based on this AOE/COE conclusion.

An award of the "monies paid" wrongly assumes ACG would have had no deductible payment if Travelers had denied the claim (regardless of any investigation expenses such as the cost of the AOE/COE examination). There is no evidence from which a juror could infer Custodio's claim would have proceeded differently had Travelers investigated any differently.

a. Travelers Had an Obligation to Pay "When Due the Benefits Required of [It] by the [California Workers' Compensation Act]," Which Is Liberally Construed

Benefits are due under the Policy when the California Workers' Compensation Act requires Travelers to pay them. ER 01300. "[T]he established legislative policy is that [the Act] must be liberally construed in the employee's favor and all reasonable doubts as to whether an injury arose out of employment are to be resolved in favor of the employee." *McLune,* 63 Cal. Comp. Cas. at 264-65; Cal. Labor Code § 3600(a). Travelers could not deny Custodio's claim unless it could satisfy its burden to prove with substantial evidence a genuine doubt as to its liability for the withheld benefits. *Kerley*, 4 Cal. 3d at 230.

Experts testified at trial that "change of date of injury and delay of reporting" are common, changes in the description of the injury happen "all the time," and the majority of injuries are unwitnessed. RT 1382:13-22, 1396:10-1398:23, 1547:3-22, 1566:13-18, 1567:3-1568:15/ER 01782, 1787-89, 1795, 1798-

1800. The existence of any or all of these factors common to workers' compensation claims is not "substantial evidence" sufficient to deny a claim. *See Kerley*, 4 Cal. 3d at 230; RT 1387:13-1389:14/ER 01783-85.

The facts obtained by Travelers as of November 6, 2003, were sufficient to require Travelers to accept the claim. Custodio said she was injured at work while lifting a pallet. No one witnessed the accident. The AOE/COE doctor's diagnosis included "possible groin strain." ER 01584. The doctor also concluded the injury was consistent with the type of activity reported by Custodio. ER 00089. The claims adjustor testified she accepted the claim because the doctor circled both "Yes" and "No" and wrote "Trier of Fact" in response to the question whether the injury was work-related. RT 401:22-24, 405:2-13/ER 01665, 1667; ER 01565, 1584. She testified she had worked with the doctor before and when he reported "No," she denied the claim. RT 404:15-16, 405:2-9/ER 01666-67. The adjustor is not a doctor and appropriately relied on the doctor's conclusion. RT 281:4-9, 401:22-24, 405:11-13/ER 01651, 1665, 1667. There is no proof Custodio was not injured on the job. Any reasonable doubt about whether the injury was work-related had to be resolved in favor of Custodio. No evidence suggests that, with a more thorough investigation, Travelers would have uncovered a sufficient basis to deny the claim.

b. <u>There Is No Evidence Custodio Would Have Dismissed the Workers' Compensation Proceeding</u>

Custodio retained a workers' compensation lawyer *before* Travelers accepted the claim. RT 591:17-20/ER 01691. Custodio filed a Notice of Adjudication of Claim *after* learning Travelers had accepted her claim. ER 01593. The workers' compensation proceeding was resolved for $35,000, "less than the amount of the authority extended" by ACG. RT 1236:23-1237:21; ER 01762-63. The settlement was approved by the judge assigned to Custodio's case. *See* Cal.

Labor Code § 3715(e) (requiring judicial approval of settlement). These facts are uncontroverted.

No evidence exists that had Travelers done everything ACG argued Travelers could or should have done, Custodio would have abandoned her claim or settled for less than $35,000. Thus, linking Travelers' breach of its duty to investigate with Custodio maintaining and settling her claim requires pure, unsubstantiated speculation unsupported by the evidence. ER 00035 (27:3), 39 (31:12-14).

2. $140,000 Is "Clearly Not Supported by the Evidence"

Only one witness and four exhibits address monies incurred "in connection with the Custodio claim," and no evidence exists that ACG paid or reimbursed Travelers for any amount:

> 1) Testimony from ACG's CFO that the amount is "approximately $140,000," but he does not know what amounts were paid to whom (RT 1250:14-18, 1335:4-10, 1347:24-1348:8/ER 01764, 1772, 1776-77);
>
> 2) The electronic claim notes for the Custodio claim showing reserves, "resubmissions" for medical expenses totaling $450, and the amount of the settlement (ER 01509);
>
> 3) A letter from claims handler Patricia Landree to attorney Kathy Zalewski dated January 5, 2004, stating "Total paid to date: [¶] TT = $1,248.02 ... MED = $1,729.57" (ER 01595-96);
>
> 4) An email from account executive Karen Anderson to ACG's insurance broker regarding a "$18,735.29 Cost Containment Charge" and explaining Travelers has "not yet issued the payment for the implants ($15,745.00)" with no evidence ACG paid a cost containment charge or Travelers ever paid and was later reimbursed by ACG for any implants. (ER 01620); and
>
> 5) Records from Custodio's chiropractor showing "Total Insurance Pymts: $4058.03" incurred before Custodio learned Travelers had accepted the claim (ER 01558-64).

There was no evidence introduced of payments "to" Travelers or Custodio. ACG's CFO testified he did not know what amounts were paid to whom. No other

testimony or exhibits address possible "monies [ACG] paid to Travelers or Aiza Custodio in connection with the Custodio claim." This fundamental failure of proof alone is a basis for overturning the verdict.

California Civil Code section 3301 states: "No damages can be recovered for a breach of contract which are not *clearly ascertainable in both their nature and origin.*" (Emphasis added). The record does not "clearly ascertain" both the "nature and origin" of the $140,000. Thus, the evidence fails to prove ACG's claimed harm.

The electronic claim notes do not prove the "$140,000" as ACG's counsel asserted during closing argument. RT 1761:18-1762:6/ER 01803-04. The "PROJECTED INCURRED VALUES" and reserves amounts are *estimates* of the total cost of Custodio's claim and therefore irrelevant. As ACG's CFO testified, "[T]he amount of the liability" is "the amount of the actual payment on the claim." RT 1341:22-1342:14/ER 01774-75. While the claim notes show the WCAB claim settled for $35,000, the notes also show ACG authorized the settlement. RT 1236:23-1237:21/ER 01762-63; ER 01509. The "MED" expense of $1,729.57 was for Custodio's AOE/COE and was part of Travelers' investigation, not a breach of that duty. ER 01595-96.

The jury's award of $140,000 is "clearly not supported by the evidence" and is "based only on speculation or guesswork." *Del Monte Dunes*, 95 F.3d at 1435. Thus, the district court erred in not remitting it to comport with the evidence.

3. The Nominal Damages Award Should Be Affirmed

ACG chose to seek nominal damages for breach of contract and to instruct the jury nominal damages means "plaintiff has failed to prove damages" caused by Travelers' breach of the implied covenant. ER 00076. This is consistent with ACG's failure to prove Travelers' breach of the duty to investigate caused ACG

any harm. There is no evidence ACG paid any monies to Travelers or Custodio.

California Civil Code section 3360 states: "When a breach of duty has caused no appreciable detriment to the party affected, he may yet recover nominal damages." *See also* CACI No. 360 (Contracts - Nominal Damages). With no evidence of harm to ACG due to Travelers' breach of its implied duty to investigate, there is "no appreciable detriment" here. Consequently, the nominal damages award was proper, and ACG's relief should be limited to $0.07.

C. ACG Cannot Recover Punitive Damages Because It Did Not Prove Tort Damages

Punitive damages can only be awarded for "breach of an obligation *not* arising from contract." Cal. Civ. Code § 3294(a) (emphasis added). "In the absence of an independent tort, punitive damages may not be awarded for breach of contract even where the defendant's conduct in breaching the contract was willful, fraudulent, or malicious." *Cates,* 21 Cal. 4th at 61 (citing Cal. Civ. Code § 3294(a)) (internal quotes omitted); *accord Applied,* 7 Cal. 4th at 516. The availability of punitive damages is reviewed de novo. *See* Ninth Circuit Court of Appeals, Standards of Review, September 2006, p. 339.

Based on this settled rule, ACG had to recover tort damages to seek punitive damages. ACG failed to prove a breach of the implied covenant sounding in tort because, as discussed above, a breach of the implied covenant absent the failure to pay a claim does not sound in tort. ACG sought "monies paid" by ACG for the Custodio claim, at first under a contract theory and then under a bad faith theory, but the deductible payment is, plain and simple, contract damages regardless of the theory of recovery. ACG recovered for an obligation arising out of contract. *See Foley,* 47 Cal. 3d at 690 ("An allegation of breach of the implied covenant of good faith and fair dealing is an allegation of breach of an 'ex contractu' obligation,

namely one arising out of the contract itself."). Therefore, ACG is not entitled to punitive damages.

D. Even Assuming Travelers' Failure to Investigate Was Tortious, It Does Not Support Punitive Damages

Punitive damages are disfavored and "should be granted with the greatest caution." *Dyna-Med, Inc. v. Fair Employment & Housing Comm'n*, 43 Cal. 3d 1379, 1392 (1987). To recover punitive damages, ACG had to prove Travelers' failure to investigate was tortious *and* "by clear and convincing evidence that [Travelers] has been guilty of oppression, fraud, or malice." Cal. Civ. Code § 3294(a). No such showing was made here. The sufficiency of the evidence to support an award of punitive damages is reviewed for substantial evidence. *See* Ninth Circuit Court of Appeals, Standards of Review, September 2006, p. 339.

"Malice" and "oppression" require "despicable conduct" "intended" or with "conscious disregard" of the injured party's rights. Cal. Civ. Code § 3294(c)(1)-(2). "[T]he adjective 'despicable' is a powerful term that refers to circumstances that are 'base,' 'vile,' or 'contemptible.'" *College Hosp. Inc. v. Sup. Ct. (Crowell),* 8 Cal. 4th 704, 725 (1994). "Despicable conduct" is described as "having the character of outrage frequently associated with crime." *Tomaselli v. Transamerica Ins. Co.*, 25 Cal. App. 4th 1269, 1287 (1994) "Fraud" requires "an intentional misrepresentation, deceit, or concealment of a material fact known to the defendant with the intention . . . [to] deprive[e] a person of property or legal rights or otherwise causing injury." Cal. Civ. Code § 3294(c)(3).

Not just any evidence of "oppression, fraud, or malice" will suffice. In *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 418, 155 L. Ed. 2d 585 (2003), the United States Supreme Court held that a jury's decision to impose punitive damages must remain tightly focused on the underlying tort, and may not be based on "acts . . . independent from the acts upon which liability was

premised." *Id.* at 422-23. In other words, "the conduct that harmed [the plaintiffs] *is the only conduct relevant*" to a punitive damages determination. *Id.* at 424 (emphasis added). *See also Hilliard v. A. H. Robins Co.*, 148 Cal. App. 3d 374, 391 (1983) ("There is no cause of action for punitive damages. . . . 'The concurrence of both an actionable wrong and damages are necessary elements for a cause of action. Exemplary damages, where recoverable, are deemed to be ". . . mere incidents to the cause of action and . . . [not] the basis thereof.'").

Here, the underlying conduct is Travelers' breach of its implied duty to investigate, and the "specific harm" suffered by ACG is, at most, its deductible payment. Therefore, the *only* conduct relevant to the punitive damages award is Travelers' *failure to investigate*, e.g., failure to contact witnesses. There is no evidence the adjustor who accepted the claim or any Travelers' employee who subsequently handled the claim, intended to harm ACG, had an incentive to do so, or knew her conduct would harm ACG and disregarded that harm.[6]

Any other conduct is irrelevant, including the subsequent adjustor's purported misrepresentations of a doctor's report relying on a letter from ACG's counsel or a field services director's reiteration of those statements. RT 880:13-22, 1171:23-1172:8, 1173:12-1174:10/ER 01722, 1740-43. This conduct did not cause ACG the harm proven at trial and therefore is not the basis for Travelers' liability.

In *Tomaselli,* the court held retaining counsel with a "reputation for digging up reasons to deny coverage," taking an "examination under oath" for undisclosed reasons, and failing to follow up on representations "evidences only negligence or slipshod investigation." *Tomaselli*, 25 Cal. App. 4th at 1288. The court

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[6] For example, there is no evidence any claims handler was aware of or sought to take advantage of the fact that ACG's policy had a deductible. *See, e.g.,* RT 388:3-9 and 1170:10-12/ER 01661, 1739.

concluded:

> In summation, the actions of appellant may be found to be negligent (failing to follow up information provided by the insured), overzealous (taking an unnecessary deposition under oath of the insured), legally erroneous (relying on an endorsement which was not shown to have been delivered), and callous (failing to communicate). There was nothing done, however, which could be described as evil, criminal, recklessly indifferent to the rights of the insured, or with a vexatious intention to injure.

Id. See Stewart v. Truck Ins. Exch., 17 Cal. App. 4th 468, 482-84 (1993) ("malice'" was not shown merely by insurer's unexplained delays in investigating a claim); *Patrick v. Maryland Casualty Co.*, 217 Cal. App. 3d 1566, 1576 (1990) (reversing jury's award of punitive damages where claims handling was "witless and infected with symptoms of bureaucratic inertia and inefficiency" which does not add up to malice or oppression).

In *Shade Foods v. Innovative Prods. Sales & Mktg.*, 78 Cal. App. 4th 847 (2000), "despicable" conduct was *not* shown by an insurer's careless evaluation of a claim and persistent refusal to reconsider its coverage denial although factual errors were called to its attention. Such conduct fell "within the common experience of human affairs"; it was "*well short* of establishing by clear and convincing evidence the sort of contemptible conduct that could be described as 'despicable.'" *Id.* at 892.

Here, there is no evidence from which the jury could infer Travelers intended to harm ACG, nor is there any evidence Travelers' conduct was "despicable." At worst, Travelers mistakenly paid a claim which it should have more thoroughly investigated. This falls 'well short of...the sort of contemptible conduct" required by section 3294. The punitive damages award must be reversed.

E. The Court Erred in Remitting the Punitive Damages to 10:1 Instead of 1:1

Even if this Court somehow affirms Travelers breached its covenant of good faith and fair dealing, that breach gave rise to tort liability, and that breach caused ACG's damages, the district court's failure to reduce the punitive damages to a 1:1 ratio, i.e., an amount that does not violate Travelers' constitutional due process right, must still be corrected.

The court partially granted Travelers' motion to remit the punitive damages, finding: (1) 29:1 is unconstitutionally excessive because there "is a fairly low degree of reprehensibility" here; (2) the relevant ratio of punitive damages to tort damages is 29:1, not 4.5:1, because any fees and costs awarded to ACG are not included in the calculation; (3) the relevant civil penalty is $10,000; and (4) application of the three factors in *BMW of No. America, Inc. v. Gore*, 517 U.S. 559, 575, 116 S. Ct. 1589, 1599 (1996), mandates reducing the ratio to 10:1. ER 01786-91. This reduction is plainly insufficient in light of the three "guideposts" analysis mandated in *State Farm*, 538 U.S. at 418, 123 S. Ct. at 1520.

Whether a punitive damages award violates due process is a question of law reviewed de novo. *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424, 436, 440, 121 S. Ct. 1678, 1688, n.14 (2001).

1. Here, 10:1 Is Constitutionally Excessive

In *State Farm*, the Supreme Court recognized three "guideposts" to evaluate the constitutionality of a punitive damages award: "(1) the degree of reprehensibility of the defendant's misconduct; (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases." *State Farm*, 538 U.S. at 418, 123 S. Ct. at 1520.

The most important factor is the "degree of reprehensibility" of the defendant's conduct. *Gore*, 517 U.S. at 575, 116 S. Ct. at 1599. Here, the court emphasized that "this case appears to present a fairly low degree of reprehensibility." ER 00048 (40:17-19). Thus, the first and most important guidepost strongly favors Travelers.

The court's low reprehensibility finding is also significant to the second guidepost, the ratio between the actual harm and the punitive damages. In *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 23-24, 111 S. Ct. 1032 (1991), and again in *BMW*, 517 U.S. at 581, the Supreme Court concluded that punitive damages greater than four times the compensatory damages might be close to the line of constitutional impropriety. *See State Farm*, 538 U.S. at 425. A higher ratio is possible, but only in cases where truly egregious behavior caused only minimal economic damages. *Id. See, e.g., Swinton v. Potomac Corp.*, 270 F.3d 794, 818 (9th Cir. 2001) (racial taunting and discrimination); *Zhang v. American Gem Seafoods*, 339 F.3d 1020, 1043 (9th Cir. 2003) (intentional racial discrimination).

The record here shows both low reprehensibility and substantial economic damages. In fact, notwithstanding the court's comments to the contrary, the $140,000 economic damages awarded are substantial as a matter of law. An award almost a third that amount was recently held to be *substantial*. *Bains LLC v. ARCO Prods. Co.*, 405 F.3d 764, 776 (9th Cir. 2005) ("[t]his is not a 'small amount' case because the economic damages were substantial – $50,000"). A 10:1 ratio is only appropriate when the compensatory damages are *nominal* or insubstantial. Such a ratio is plainly inappropriate where, as here, substantial damages are awarded.

In *State Farm*, the Court endorsed a ratio of no more than 1:1 even though the evidence showed "State Farm's employees altered the company's records to

make Campbell appear less culpable, . . . disregarded the overwhelming likelihood of liability and the near-certain probability that, by taking the case to trial, a judgment in excess of the policy limits would be awarded . . . , [and] amplified the harm by at first assuring the Campbells their assets would be safe from any verdict and by later telling them, postjudgment, to put a for-sale sign on their house." *Id.* at 419. The Court went on to state that "when compensatory damages are *substantial*, then a lesser ratio, perhaps *only equal to compensatory damages*, can reach the outermost limit of the due process guarantee." *Id.* at 425 (emphasis added). Travelers' conduct is far less egregious than that in *State Farm* where the Court endorsed a 1:1 ratio.

Earlier this year *Walker v. Farmers Ins. Exch.*, 153 Cal. App. 4th 965 (2007), applied these "guideposts" to uphold a 1:1 ratio. The jury awarded $45,431.80 for the cost of defending the underlying case, $6,500 in settlement costs, $1,500,000 for emotional distress, and $8,338,255.73 in punitive damages. *Id.* at 972. The court found "the United States Supreme Court has determined that the due process clause of the Fourteenth Amendment ... places limits on state courts' awards." *Id.* at 972-973. Applying the "guideposts," the court affirmed the trial court's decision to reduce the award, finding 5.5:1 inappropriately high. *Id.* at 973-974. The court concluded a 1:1 ratio was appropriate and neither the amount of compensatory damages nor Farmers' conduct justified a higher award. *Id.*

Likewise, recently in *Jet Source Charter, Inc. v. Doherty*, 148 Cal. App. 4th 1, 4 (2007), the court again held the appropriate ratio is 1:1. The court addressed a series of purchases by an agent for a principal in which the agent was later caught secretly siphoning off a portion of the purchase to a shadow entity which was, in fact, the agent. The agent then reported to the principal the purchase price was the actual cost plus the amount paid to the agent by way of the shadow entity. There

were a number of these fraudulent transactions. *Id.* at 5-8. Yet, the court only approved a 1:1 ratio:

> Where, as here, substantial compensatory damages have been awarded, and the conduct in question only involves economic damage to a single plaintiff who is not particularly vulnerable, *an award which exceeds compensatory damages is not consistent with due process.*

Id. at 4 (emphasis added).

Like *Jet Source,* this case "only involves economic damage to a single plaintiff" awarded "substantial compensatory damages." While *Jet Source* involved multiple transactions, ACG complained of just *one* claim. Here, as was significant in *Jet Source*, the punitive damages exceed the compensatory damages by $1,260,000. *Accord, Planned Parenthood of the Columbia/Willamette, Inc. v. Am. Coalition of Life Activists,* 422 F.3d 949, 962 (9th Cir. 2005) (acts of bad faith "warrant something closer to a 1:1 ratio").

Given the "low level of reprehensibility" found by the district court, the economic nature of the harm suffered, the absence of an improper corporate policy, and substantial compensatory damages, the district court erred in only remitting the punitive damages to $1.4 million for a 10:1 ratio. The punitive damages award patently violates Travelers' due process rights. Case law establishes the maximum ratio is 1:1.

2. The District Court Impermissibly Determined Travelers' Wealth Justifies a 10:1 Ratio

The "guideposts" indicate a 1:1 ratio is appropriate here. Disregard for constitutional limits directing a 1:1 ratio and imposition of a higher ratio based solely on the defendant's wealth is improper, but that is what the court did here:

> The Court may also take into consideration Travelers' financial condition in deciding how much to reduce the award. * * * Travelers stipulated to a jury instruction that it would not be materially affected by any amount of punitive damages awarded. Jury Instructions at 30. *Clearly, its financial*

> *condition is such that if the punitive damage award were reduced to a 1:1 ratio with the compensatory damage award, little or no deterrence or punishment would be achieved.*

ER 00052 (44:4-9) (emphasis added).

In *State Farm,* the Court held: "*The wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award.*" *State Farm,* 538 U.S. at 427-28 (emphasis added), citing *Gore*, 517 U.S. at 585 ("The fact that BMW is a large corporation rather than an impecunious individual does not diminish its entitlement to fair notice of the demands that the several States impose on the conduct of its business").

A court's reliance on a defendant's wealth to justify a higher ratio is legally improper. For example, in *Textron Financial Corp. v. National Union Fire Ins. Co.*, 118 Cal. App. 4th 1061 (2004), a policyholder sued National Union for fraud and tortious bad faith arising from National Union's refusal to pay a claim for property damage to a commercial bus. The jury awarded the policyholder $165,414.40 in compensatory damages and $10 million in punitive damages, which the trial court remitted to $1.7 million. The appellate court at 1084, citing *State Farm,* 538 U.S. at 427, rejected the policyholder's argument that National Union's wealth justifies a 10:1 ratio and further reduced the award to $360,000[7]:

> Plaintiff cites defendant's purported wealth and complains an award smaller than the trial court's 10-to-1 ratio would "render the award laughable." But our review of the punitive damages award must ensure the recovery comports with due process. The Supreme Court has recognized that "[t]he wealth of a defendant cannot justify an otherwise unconstitutional punitive damages award. [Citations.]"

A defendant's wealth will *not* justify a verdict in excess of the maximum due process ratio. The district court erred in making Travelers' wealth its justification

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[7] *Textron* was decided before the case cited in Section VI.E.1, *supra,* directing a 1:1 ratio here.

for the 10:1 ratio.

F. ACG Is Not Entitled to Its Attorneys' Fees Pursuant to Section 1717 and the 2005-2006 Finance Agreement

1. The District Court's Decision to Permit ACG to Seek Its Attorneys' Fees Post-Trial is Subject to De Novo Review

Having been denied its attorneys' fees at trial, ACG sought them by post-trial motion based on a finance agreement between Travelers and ACG never introduced at trial. The finance agreement proffered post-trial has no bearing on this dispute and would be inapplicable even if it did. Nonetheless, the district court allowed ACG to seek its attorneys' fees through arbitration pursuant to a unilateral attorneys' fees provision in that agreement and California Civil Code section 1717(a).

The district court found, over objection, this is an action "on" the 2005-2006 finance agreement. Whether the district court's application of section 1717 is correct should be reviewed de novo. *Jorgensen v. Cassiday*, 320 F.3d 906, 918 (9th Cir. 2003) A de novo review shows both that the finance agreement proferred post-trial is unrelated to the Custodio claim and that section 1717(a) is inapplicable here.

2. No Applicable Attorneys' Fees Provision Is Before This Court

This is a dispute over the investigation of a claim accepted under the 2002-2003 Policy. Yet, ACG supported its motion based on inapplicable post-policy period documents: (1) the 2005-2006 finance agreement; (2) the 2005-2006 workers' compensation policy; and (3) three pages from each of the 2003-2004 and 2004-2005 finance agreements. ER 00383-859. None of these documents pertain to this dispute involving the 2002-2003 Policy, and all were in effect *after* the 2002-2003 Policy expired.

To determine whether section 1717 applies, the court must first find there is

an enforceable, applicable contract in evidence. *Santisas v. Goodin*, 17 Cal. 4th 599, 608, 615 (1998). Here, this threshold issue cannot be satisfied. In short, the attorneys' fees provision in the 2005-2006 finance agreement is irrelevant to a dispute over a claim accepted under the 2002-2003 Policy.[8]

3. To Recover Under Section 1717, ACG Was Required to Introduce the Finance Agreement at Trial

The district court incorrectly found ACG did not have to introduce the finance agreement at trial. The court relied on *Nielsen v. Stumbos*, 226 Cal. App. 3d 301, 304 (1990) and *Sears v. Baccaglio,* 60 Cal. App. 4th 1136 (1998). There, unlike here, the plaintiffs sued on the actual contract containing the attorneys' fees provision. *Nielsen*, 226 Cal. App. 3d at 303; *Sears*, 60 Cal. App. 4th at 1141. These cases concerned whether the plaintiffs had to both plead and prove the actual *fees* incurred at trial. The court erroneously interpreted *Nielsen* and *Sears* to mean ACG did not have to plead and prove the *contract* with the attorneys' fees clause at trial. The court's application of state law should be reviewed de novo. *Jorgensen*, 320 F.3d at 918.

"[S]ection 1717 applies only to actions that contain at least one contract claim." *Santisas*, 17 Cal. 4th at 615 (citations omitted). Section 1717 only applies to attorneys' fees "as they relate to the contract action" and not as they relate to any tort action. *Id. See also Topanga & Victory Partners v. Toghia*, 103 Cal. App. 4th 775, 783-84 (2002).

In order to succeed on a "contract claim," plaintiff must prove the contract at

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[8] ACG's CFO's post-trial declaration that the fees provision in the 2005-2006 finance agreement was in the "insurance contract," i.e., the 2002-2003 Policy, he testified about at trial is not only false but does *not* excuse ACG's failure to submit a fees provision effective in 2002-2003. ER 00930-31. *See* Fed. R. Evid. 1004.

trial. *First Commercial Mortgage Co. v. Reece*, 89 Cal. App. 4th 731, 745 (2001) (elements of breach of contract prima facie case include "the existence of the contract"). A written contract must be proved by the original or an otherwise admissible copy of the original. *See* Cal. Evid. Code §§ 1520 and 1523(a). *See also* Fed. R. Evid. 1004. In *Brittalia Ventures v. Stuke Nursery Co., Inc.*, 153 Cal. App. 4th 17, 29 (2007), the court refused to apply section 1717 because the plaintiff failed to establish at trial the applicable contract contained a fees provision.

Hsu v. Semiconductor Systems, Inc., 126 Cal. App. 4th 1330 (2005), further supports having to prove the contract in an action "on" that contract. *Hsu* addressed whether section 1717 limits the recovery of costs pursuant to contract to those identified in California Code of Civil Procedure section 1033.5. The plaintiff argued the contract provided a definition of "costs" broader than the statutory definition. The court found "even if [it was] to do as plaintiff urges," the costs award was insupportable because "[r]ecovery of costs provided by contract must be specially pleaded and proven at trial, and not awarded posttrial as was done here." *Id.* at 1341, citing *Arntz Contracting Co. v. St. Paul Fire & Marine Ins. Co.*, 47 Cal. App. 4th 464, 491 (1996).

As in *Hsu*, ACG failed to prove the finance agreement at trial and Travelers was denied the opportunity to present evidence that the parties did not intend for the finance agreement to apply to a claims handling dispute. The court erred in finding ACG did not have to either prove the finance agreement at trial or maintain an action on that agreement. This court should apply the same result as in *Hsu* and find ACG's fees claim fails for failing to plead and prove the finance agreement at trial.

4. This Is Not an Action "On" the 2005-2006 Finance Agreement for Fees "Incurred to Enforce That Contract" as Required by Section 1717

Section 1717 only applies to an action "on a contract, where the contract specifically provides that attorney's fees and costs" are recoverable and to fees "which are incurred to enforce that contract." This is not an action "on" the 2005-2006 finance agreement, and ACG's fees were not incurred to enforce that agreement. Rather, this is solely an action "on" the 2002-2003 Policy, and ACG's fees were incurred with regard to that policy. *Pilcher v. Wheeler*, 2 Cal. App. 4th 352, 356 (1992) (section 1717 only applies when the contract sued on and breached contains an attorneys' fee provision). *See also Sawyer v. Bank of America*, 83 Cal. App. 3d 135, 140 (1978).

ACG did not sue Travelers on any finance agreements. The First Amended Complaint alleges Travelers breached the Policy; it does not mention any finance agreement. ER 01257-66. ACG recovered for breach of the Policy at trial, not for breach of any other agreement. ER 00089-94. No witness was even shown a finance agreement at trial. Clearly, the reasoning in *Pilcher* applies equally here. 2 Cal. App. 4th at 356. *See also Brittalia Ventures*, 153 Cal. App. 4th at 29 (the court concluded that because the contract sued on did not contain a fees provision, section 1717 did not apply and "It is that simple.").

Like the plaintiff in *Brittalia*, ACG sued on a contract, the Policy, that does not contain a fees provision. As both ACG's president and treasurer recognized, the finance agreement is a different contract applicable to different facts.[9] ER

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[9] ACG's president stated in a letter to Travelers that ACG considers Travelers' failure to pay its fees "a potential *separate* breach of the contract between [the] respective companies." ER 00293 (emphasis added). ACG's assistant treasurer testified at deposition the 2005-2006 agreement "constitute[s] the agreement

00290, 293.

Moreover, section 1717 only applies to "ensure mutuality of remedy." *Id.* at 29. Had Travelers prevailed at trial, it would not have been entitled to its fees because the finance agreement only applies to fees "incurred by [Travelers] in connection with the collection or enforcement of any of [ACG's] Obligations to [Travelers]." ER 00405. This case is not a dispute about ACG's financial "Obligations" to Travelers. Just as Travelers would not have been entitled to its fees, ACG is not entitled to its fees. *Id. See also Hsu v. Abbara*, 9 Cal. 4th 863, 870-71 (1995) ("To achieve its goal, the statute generally must apply in favor of the party prevailing on a contract claim whenever that party would have been liable under the contract for attorney fees had the other party prevailed.").

ACG's section 1717 claim also fails because the fees and costs ACG seeks were not incurred to enforce Travelers' obligations under any finance agreement. *Pilcher*, 2 Cal. App. 4th at 356. *See also Super 7 Motel Associates v. Wang*, 16 Cal. App. 4th 541, 544-45 (1993). ACG sued Travelers for breaching its duty to investigate the Custodio claim inherent in Travelers' defense and indemnity obligations under the Policy. ACG incurred fees to prove Travelers breached the Policy, not the finance agreement.

In sum, this is clearly an action "on" the Policy. The First Amended Complaint alleges Travelers breached the Policy; it does not mention any finance agreement. ACG recovered for breach of the Policy at trial, not for breach of any finance agreement. ACG introduced the Policy at trial, not the finance agreement. The district court erred in applying section 1717 to the 2005-2006 finance

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between [ACG] and Travelers for the specified period with respect to the cost of the insurance program." ER 00290.

agreement to award ACG its attorneys' fees.

5. *If* the 2002-2003 Policy and the 2005-2006 Agreement Somehow Constitute One Contract, ACG Cannot Prove Its Fees Because It Cannot Waive the Attorney-Client Privilege After Trial for the First Time

ACG withheld evidence of its attorneys' fees before and during trial based on the attorney-client privilege. When asked by the district court at trial why it had not produced evidence of its fees in response to Travelers' discovery requests, ACG asserted the attorney-client privilege. ER 01016-17. If a party refuses to provide discovery responses based on a privilege, it cannot later waive the privilege to its advantage and introduce the previously withheld information. *Steiny & Co. v. California Electric Supply Co.*, 79 Cal. App. 4th 285, 291-93 (2000). *See also A & M Records, Inc. v. Heilman*, 75 Cal. App. 3d 554, 566 (1977) ("The enactment of the Discovery Act of 1957 "was intended to take the 'game element' out of trial preparation and do away with surprise at trial" and "[A] litigant cannot be permitted to blow hot and cold in this manner.").

ACG asserted the attorney-client privilege before and during trial to avoid producing evidence of its fees. ER 01016-17, 998-1002. ACG cannot, after failing to recover its fees pursuant to *Brandt* at trial, waive that privilege in an attempt to recover those same fees post-trial under section 1717. Therefore, ACG cannot prove its fees, and it is not entitled to any.

6. *If* Allowed to Waive the Privilege to Recover Its Fees, ACG Must Prove Which of Its Fees Were "Incurred to Enforce" the 2005-2006 Finance Agreement

ACG is only entitled to those fees, if any, incurred to prove Travelers breached its implied duty to investigate. "If an action asserts both contract and tort or other noncontract claims, section 1717 applies only to attorney fees incurred to litigate the contract claims." *Santisas,* 17 Cal. 4th at 615. *See also Diamond v. The John Martin Co.,* 753 F.2d 1465, 1467 (9th Cir. 1985) (section 1717 applied to

dispute between contractors, *but* "the prevailing party may recover fees under section 1717 only as they relate to the contract action"). This action involves both contract and tort claims. ACG has not satisfied its burden, or even attempted, to prove its fees were incurred to prove its breach of contract claim and not its bad faith and punitive damages claims. *Santisas,* 17 Cal. 4th at 615; Cal. Code Civ. Proc. § 1033.5(c)(5).

Relying on *Santisas,* ACG argued post-trial it does not have to allocate its fees because the fees provision in the 2005-2006 finance agreement is broad enough to encompass fees related to its tort and punitive damages claims. ER 00176-78. *Santisas* authorizes the recovery of fees to prove a tort where expressly permitted by contract, but explicitly held those fees are not recoverable by operation of section 1717. *Id.* at 617-18. The subject fees provision applies to ACG, if at all, pursuant *only* to section 1717's mutuality provision. Section 1717 does not apply to tort claims or fees incurred to prove them. *Id.*

In *Santisas*, the plaintiff voluntarily dismissed its contract and tort claims before trial. *Id.* at 602. In *Santisas*, unlike here, the contract sued "on" contained the following fees provision: "In the event legal action is instituted by the Broker(s), or any party to this agreement, or arising out of the execution of this agreement or the sale, or to collect commissions, the prevailing party shall be entitled to receive from the other party a reasonable attorney fee to be determined by the court in which such action is brought." *Id.* at 603. The court found this provision, on its face, applies to contract and tort claims. Thus, the issue was whether section 1717 precludes recovery of fees incurred to prove a tort regardless of the contract provision because of the voluntary dismissal.

Santisas held the plaintiffs could recover their fees to prove their noncontract claims, but only pursuant to the contract, *not* the mutuality provisions

of section 1717. *Id.* at 617. Here, ACG does not have "a contractual right, not affected by Section 1717, to recover attorneys fees incurred in litigating [its tort] causes of action." *Id.* ACG's only contractual right, if any, is pursuant to section 1717, which does not apply to tort claims. *Exxess Electronixx v. Heger Realty Corp.*, 64 Cal. App. 4th 698, 708 (1998), again distinguished between fees to prove a breach of contract and fees to prove a tort:

> Civil Code section 1717 does not apply to tort claims; it determines which party, if any, is entitled to attorneys' fees on a *contract claim only*...This distinction between contract and tort claims flows from the fact that a tort claim is not "on a contract" and is therefore outside the ambit of section 1717. [Citations omitted.]

The court concluded that "Exxess's claims for constructive fraud and breach of fiduciary duty were not brought to "enforce the terms." *Id. at 709.* Because section 1717 does not encompass tort claims, it follows that tort claims do not "enforce" a contract. *Id.*

ACG also argued post-trial it does not have to prove which of its fees were incurred to prove a breach of contract "since the issues required to prevail on the contract action were the same as those required to prevail on the bad faith action." ER 00942, citing *Diamond,* 753 F.2d at 1467 and two unpublished district court holdings.

All of these cases are consistent with the holding in *Santisas*, 17 Cal. 4th at 615: "If an action asserts both contract and tort or other noncontract claims, section 1717 applies only to attorney fees incurred to litigate the contract claims." *See, e.g., Diamond,* 753 F.2d at 1467 (section 1717 applied to dispute between contractors, *but* "the prevailing party may recover fees under section 1717 only as they relate to the contract action"). While it is true that "[a]ttorney's fees need not be apportioned when incurred for representation on an issue common to both a cause of action in which fees are proper and one in which they are not allowed,"

fees incurred for the sole purpose of litigating tort claims are not recoverable. *Reynolds Metals Co. v. Alperson,* 25 Cal. 3d 124, 129-30 (1979). Accordingly, *Reynolds* held "fees incurred solely for defending causes of action based on [a different] agreement and defending against the tort causes of action are not recoverable." *Id.* at 129.

While some of ACG's fees may have been incurred to litigate its contract and tort claims, certainly not all of ACG's fees were incurred to litigate its contract claim. For example, ACG incurred fees: (1) to research bad faith, the recovery of attorneys' fees, premium increases, and punitive damages; (2) to obtain Travelers' financial statements and SEC filings; (3) to depose Travelers' and ACG's executives who had nothing to do with any breach of the Policy; and (4) to research and prepare jury instructions on and verdict forms for bad faith and punitive damages. ER 00271-78. *See also* ER 00860-929.

ACG also moved for its costs pursuant to section 1717, but section 1717 does not authorize the award of costs in addition to the costs authorized by California Civil Code section 1033.5. *See Fairchild v. Park,* 90 Cal. App. 4th 919, 929-30 (2001) ("litigants cannot expand the definition of "costs" in section 1717 to include items not permitted under section 1033.5"); *Hsu,* 126 Cal. App. 4th at 1341 ("Recovery of costs provided by contract [versus section 1717] must be specially pleaded and proven at trial, and not awarded posttrial as was done here"). ACG filed a Bill of Costs for $94,980.41 in costs authorized by statute. ER 00001. The district court reduced those costs to $54,943.19. ER 00001-8. Section 1717, even if applicable, does not allow ACG an award of costs in addition to those already determined by the court.

If ACG is somehow awarded its fees pursuant to section 1717 in combination with the 2005-2006 finance agreement, ACG is only entitled to those

fees it shows were incurred to prove Travelers' breach of the duty to investigate. And it is not entitled to any additional costs.

7. ACG Failed to Satisfy a Condition Precedent to Travelers' Performance by Violating the Agreement's Mandatory Forum-Selection Clause

The district court rejected Travelers' argument that, if the 2005-2006 finance agreement applies at all, this matter is subject to the jurisdiction of the State of Connecticut. The district court reasoned the entire dispute was subject to the forum-selection clause, and, because Travelers never moved to dismiss for improper venue, Travelers waived the clause. "The district court's interpretation and meaning of contract provisions are questions of law reviewed de novo." *Kukje Hwajae Ins. Co., Ltd. v. M/V Hyundai Liberty*, 294 F.3d 1171, 1174 (9th Cir. 2002) (enforcing clause); Ninth Circuit Court of Appeals, Standards of Review, September 2006, p. 272.

a. Travelers Did Not Waive the Forum-Selection Clause

Waiver is the intentional relinquishment of a known right. It requires knowledge of the facts. The burden is on the party claiming a waiver of a right to prove it by clear and convincing evidence that does not leave the matter to speculation, and doubtful cases will be decided against a waiver. *Stewart v. Seward*, 148 Cal. App. 4th 1513, 1524 (2007); *Kacha v. Allstate Ins. Co.*, 140 Cal. App. 4th 1023, 1033-34 (2006).

A finding of waiver requires either an actual intention to relinquish the known right or conduct so inconsistent with any intent to enforce the right as to induce a reasonable belief that it has been relinquished. *Rheem Mfg. Co. v. United States*, 57 Cal. 2d 621, 626 (1962); *Utility Audit Co. v. City of Los Angeles*, 112 Cal. App. 4th 950, 959 (2003). "[T]he valid waiver of a right presupposes an actual and demonstrable knowledge of the very right being waived." *Hittle v.*

Santa Barbara County Employees Retirement Assn., 39 Cal. 3d 374, 389 (1985) (*citing Jones v. Brown*, 13 Cal. App. 3d 513, 519 (1970)). "[F]airness is at the heart of a waiver claim." *JRS Products, Inc. v. Matsushita Electric Corp.*, 115 Cal. App. 4th 168, 178 (2004).

Travelers was not put on notice that ACG would seek to rely on the 2005-2006 finance agreement to recover its attorneys' fees until post-trial motions. The agreement did not exist when the case was filed and was not an issue prior to or during trial, not marked for identification, and not responsive to the Custodio claim charges. ACG sought its attorneys' fees via *Brandt* from the time it filed suit through trial.

No evidence exists that Travelers intended to waive the forum-selection clause contained in the 2005-2006 agreement because the application of the agreement was raised for the first time post-trial. When ACG raised the issue post-trial, Travelers immediately raised the forum-selection clause. The district court acknowledged ACG did not "clearly explain when Travelers should have raised the forum selection clause." ER 00019 (11:12-13).

Here, Travelers lacked the requisite knowledge and intent to waive the forum-selection clause. Thus, the court erred in finding Travelers waived it.

b. ACG's Compliance with the Forum-Selection Clause is Mandatory

In the 2005-2006 agreement, ACG "agree[d] and consent[ed] that venue for [this action] shall lie . . . in Connecticut." ER 00412-13. ACG's compliance with this clause is mandatory, and ACG's failure to comply precludes its ability to enforce the other provisions of the contract.

In *Docksider, Ltd. v. Sea Technology, Ltd.*, 875 F.2d 762 (9th Cir. 1989), the Ninth Circuit addressed a virtually identical clause and held "that where venue is specified with mandatory language the clause will be enforced." *Id.* at 764. The

venue clause in the 2005-2006 finance agreement is mandatory, stating venue "shall lie in" Connecticut.

The agreement's forum-selection clause is mandatory and satisfying it is a condition precedent to Travelers' performance under the agreement. A condition precedent is an act or event that *must* be performed or a certain event that *must* happen before the promisor's duty of performance under the contract arises. Cal. Civ. Code § 1436; *NGV Gaming, Ltd. v. Upstream Point Molate, LLC,* 355 F. Supp. 2d 1061, 1064 (N.D. Cal. 2005). If a condition precedent is unsatisfied, the contract is unenforceable. *See, e.g., Platt Pacific v. Andelson*, 6 Cal. 4th 307, 313-14 (1993).

ACG "failed to fulfill a [mandatory] condition that was within its power to perform." *Id.* , at 314; *Docksider,* 875 F.2d at 764. It "is not an excuse that [ACG] did not thereby intend to surrender any rights under the agreement." *See Platt Pacific,* 6 Cal. 4th at 314. To enforce the 2005-2006 agreement, ACG *had* to file suit in Connecticut.

8. The District Court Erred in Failing to Apply the 2005-2006 Finance Agreement's Choice-of-Law Provision

The court found the 2005-2006 finance agreement's choice-of-law provision inapplicable because of California's "materially greater interest" than Connecticut's in "having its law concerning attorneys' fees applied." ER 00020 (12:23-25).[10] A court's choice of law is reviewed de novo. *Torre v. Brickey*, 278 F.3d 917, 919 (9th Cir. 2002) (state versus federal law).

The applicable choice-of-law analysis is stated in *Nedlloyd Lines B.V. v.*

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[10] The district court found Travelers did not waive the choice of law provision because it does not apply to "coverage disputes" and, therefore, "now really is the first time Travelers could or should have raised the choice of law argument, as all previous litigation was properly characterized as a coverage dispute." ER 00020-21 (12:28-13:3).

Superior Court, 3 Cal. 4th 459, 466 (1992). "[S]trong policy favor[s] enforcement of such provisions." *Id.* at 465. Under *Nedlloyd*, an initial determination is made (1) whether the chosen state has a substantial relationship to the parties or their transaction, or (2) whether there is any other reasonable basis for the parties' choice of law. *Id.* at 466. If either test is met the court must next determine whether the chosen state's law is contrary to a fundamental policy of California. If no such conflict exists, the court shall enforce the parties' choice of law. If there is a fundamental conflict with California law, the court has discretion to disregard the parties' express agreement where California has a "materially greater interest than the chosen state in the determination of the particular issue." *Id.*

The district court did not dispute that Connecticut has a relationship to the parties because Travelers is incorporated in and has its principal place of business in Connecticut. ER 00020 (12:4-6); *ABF Capital Corp. v. Berglass,* 130 Cal. App. 4th 825, 834-35 (2005). Further, ACG is located in Tennessee and incorporated in New York. ER 01258. The court also correctly found Connecticut law was contrary to the law of California. Specifically, the court concluded the reciprocity of attorneys' fees under section 1717(a) is a fundamental policy of California, and because there is no statutory counterpart in Connecticut, Connecticut law is contrary to California law. ER 00020 (12:19-21). *See Ribbens Intern., S.A. de C.V. v. Transport Intern. Pool, Inc.,* 47 F. Supp. 2d 1117, 1123 (C.D. Cal. 1999).

Next, the district court incorrectly concluded California has a "materially greater interest" than Connecticut in "having its law concerning attorneys' fees applied," because the events underlying the lawsuit occurred in California and the action was litigated in California. ER 00020 (12:18-25). This ruling is contrary to the case law, including that relied on by the district court.

The district court misapplied the holding in *ABF Capital Corp. v. Grove*

Properties, 126 Cal. App. 4th 204 (2005). In *Grove Properties*, the contract was negotiated in California and New York and made in California. The court refused to apply the contract's choice of law provision "[b]ecause resort is made to the California courts, and implicates the equitable treatment of California **citizens."** *Id.* at 220 (emphasis added).

This reasoning fails to apply here, because there is no California resident to protect. ACG is a Tennessee resident and no longer has a plant in California. RT 1287:6-8/ER 01258. Resort was not made to California's courts, but to a federal court in California. Moreover, while the Custodio claim may have occurred in California, the actual subject matter of this lawsuit is ACG's claimed deductible payment. Correctly applied, *Grove Properties* would enforce the Connecticut choice-of-law provision in favor of Travelers.

Moreover, six months after *Grove Properties, ABF Capital Corp. v. Berglass,* 130 Cal. App. 4th 825, 838 (2005), enforced a choice-of-law provision. There, the court found the contract's choice-of-law provision in the disputed contract applied notwithstanding the conflict between California and New York on attorneys' fees. While the court did not know where the defendant executed the contract or where the parties negotiated the contract, the court found the place of performance of the agreement was New York, at least one party to the contract resided in and had its place of business in New York, and that most of the contacts favored application of New York law. *Id.* at 838-39.

The *Berglass* court concluded, "Having determined that New York law would apply in any event, [its] analysis is complete" and it is "immaterial whether the application of New York law to the attorney's fees issue would contravene a fundamental public policy of California." *Id.* at 839. According to *Berglass*, it is "immaterial" here that Connecticut does not have a section 1717 counterpart.

The only similar statute is Connecticut General Statute section 42-150bb, which provides for attorneys' fees in an action based on a "consumer contract" or lease. A "consumer contract" is entered into by "an individual who borrows, leases, buys or obtains money, property or services under a written agreement...primarily for personal, family or household purposes." Conn. Gen. Stat. § 42-151 (2006). Section 42-150bb does not apply to insurance policies. *See Rizzo Pool Company v. Daniel Del Grosse et al.*, 240 Conn. 58, 71 n. 15 (Conn. 1997). Connecticut has made a policy decision to impose reciprocal attorneys' fees provision only in circumstances inapplicable here.

The *Berglass* opinion is consistent with *Nedlloyd*: "In some such cases, enforcement of the law of the chosen state may be appropriate despite California's policy to the contrary. [Citations omitted.] Careful consideration, however, of California's policy and the other state's interest would be required." *Nedlloyd*, 3 Cal. 4th at 466, n.6. The California Supreme Court also recognized the contractual nature of such provisions and that their intent is to provide certainty, a goal undermined by setting aside the parties' agreement. *Id.* at 469-70. *See also Olinick v. BMG Entertainment*, 138 Cal. App. 4th 1286, 1298 (2006); *Consul, Ltd. v. Solide Enterprises, Inc.*, 802 F.2d 1143, 1146-47 (9th Cir. 1986).

If the 2005-2006 agreement applies to the 2002-2003 Policy, the district court erred in its failure to enforce the parties' agreement to apply Connecticut law. The reason to apply California law in *Grove Properties* is inapplicable here because there are no California residents in this suit. Connecticut law applies. Finally, because Connecticut does not have a section 1717 counterpart, ACG is not entitled to its attorneys' fees pursuant to the agreement.

9. The District Court Erred in Ordering the Parties to Arbitration

In addition to the issues discussed above regarding attorneys' fees, the Ninth Circuit must also determine whether the district court properly ordered the parties to arbitration pursuant to the 2005-2006 finance agreement's arbitration provision and 9 U.S.C. § 3 (The Federal Arbitration Act).

A district court's decision regarding the validity and scope of an arbitration clause is reviewed de novo. *Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257, 1267 (9th Cir. 2006) (en banc); *Moore v. Local 569 of Int'l Broth. of Elec. Workers*, 53 F.3d 1054, 1055-56 (9th Cir. 1995). A decision regarding the arbitrability of a dispute is reviewed de novo. *United Computer Systems, Inc. v. AT & T Corp.*, 298 F.3d 756, 760 (9th Cir. 2002).

The district court erred in finding ACG's fees claim is arbitrable. Pursuant to the finance agreement, any dispute pertaining to the agreement must be resolved in Connecticut under Connecticut law. ER 00411-12. As discussed above, ACG does not have a fees claim under Connecticut law because Connecticut does not have a mutuality provision making the unilateral fees provision in the finance agreement applicable to ACG's fees. Consequently, there is no dispute, and ACG's fees claim is not arbitrable.

The district court's order to arbitrate also violates clear procedural rules. The Federal Arbitration Act requires a party seek to "stay the trial of the action until such arbitration has been had." Neither party did. Of course, the "trial of the action" cannot now be stayed, because the trial has concluded. Moreover, it is established that a judgment or order is appealable if it represents the district court's final disposition of all issues as to all parties in the proceedings below. *See* 28 U.S.C. § 1291; *Cunningham v. Gates*, 229 F.3d 1271 (9th Cir. 2000). Given the court's order on post-trial motions, there is nothing left for the court to decide.

Consequently, the court lacks the authority to stay Travelers' statutory right to appeal the judgment, and the court erred in ordering the parties to arbitration.

VII. CONCLUSION

For the foregoing reasons, correctly applying the governing authorities to the facts of this case should yield the following conclusion: the verdict of nominal damages in the amount of $.07 for breach of contract may be sustained, but all other results in favor of ACG should be reversed for the reasons explained by Travelers.

Respectfully submitted,

Dated: January 25, 2008

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By: _____
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Dated: January 25, 2008

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CERTIFICATE OF COMPLIANCE
(FED. R. APP. P. 32(a)(7)(C) and Ninth Circuit Rule 32-1)

I certify that pursuant to Fed. R. App. P. 32(a)(7)(C) and Ninth Circuit Rule 32-1, the attached opening brief is proportionately spaced, has a typeface of 14 points, and contains 17,994 words.

The attached brief is not subject to the type-volume limitations of Fed. R. App. P. 32(a)(7)(B) because the brief complies with a page or size-volume limitation established by separate court order dated December 13, 2007.

Dated: January 25, 2008 GORDON & REES LLP

By: _____
DAVID C. CAPELL

Attorneys for Defendant
TRAVELERS PROPERTY CASUALTY
COMPANY OF AMERICA

STATEMENT OF RELATED CASES
(Ninth Circuit Rule 28-2.6)

Appellant is aware of no related pending cases before this court.

Dated: January 25, 2008 GORDON & REES LLP

By: _____
DAVID C. CAPELL

Attorneys for Defendant
TRAVELERS PROPERTY CASUALTY
COMPANY OF AMERICA

PROOF OF SERVICE

I am a citizen of the United States, a resident of the State of California, over the age of eighteen and not a party to the within action. My business address is Gordon & Rees, LLP, 275 Battery Street, Suite 2000, San Francisco, California. On January 25, 2008, I served the following documents entitled:

- **OPENING BRIEF OF APPELLANT TRAVELERS PROPERTY CASUALTY COMPANY OF AMERICA**
- **EXCERPTS OF RECORD OF APPELLANT TRAVELERS PROPERTY CASUALTY COMPANY OF AMERICA (VOLUMES 1 - 7)**

by placing the document listed above in a sealed envelope with postage thereon fully prepaid, in the United States **mail** at San Francisco, California addressed as set forth below. I am readily familiar with the firm's practice of collection and processing correspondence for mailing. Under that practice it would be deposited with the U.S. Postal Service on that same day with postage thereon fully prepaid in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after date of deposit for mailing in affidavit.

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I declare that I am employed in the office of a member of the bar of this court at whose direction the service was made. I declare under penalty of perjury that the foregoing is true and correct, and this certificate was executed in San Francisco, California on January 25, 2008.

Diane Moreno