

01-55467

**UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

JEANETTE C. HOWER,

Plaintiff and Appellant,

vs.

PACIFICARE OF CALIFORNIA and
PACIFICARE HEALTH SYSTEMS, INC.,

Defendants and Appellees.

APPELLANT'S OPENING BRIEF

**[Concurrently filed with Petition for Hearing En Banc
and Request for Judicial Notice]**

Appeal from a Final Judgment of the
U.S. District Court for the Central District of California
Hon. Gary L. Taylor, Presiding
(USDC Case No. SACV00987GLT)

William M. Shernoff
Michael J. Bidart
Jeffrey Isaac Ehrlich
SHERNOFF, BIDART & DARRAS
600 S. Indian Hill Blvd.
Claremont, California 91711
(909) 621-4935

Attorneys for Plaintiff and Appellant
Jeanette C. Hower

TABLE OF CONTENTS

PRELIMINARY STATEMENT	1
STATEMENT OF JURISDICTION	2
STATEMENT OF THE CASE.....	3
STATEMENT OF FACTS	5
SUMMARY OF ARGUMENT	6
ARGUMENT	8
A. California’s common-law tort of “insurance bad faith” is a state law that regulates insurance and therefore falls within ERISA’s saving clause.	8
1. California’s bad-faith tort regulates insurer conduct and therefore regulates insurance as a matter of common sense.	9
2. The common-sense conclusion is consistent with the McCarran-Ferguson Act test for state laws that regulate insurance.....	14
B. <i>Kanne</i> has been undermined by developments in the law of ERISA preemption over the last 12 years, and should be reexamined.....	17
1. <i>Kanne</i> reads <i>Pilot Life</i> to require the preemption of bad-faith claims based on state law, even if they are saved.....	17
2. <i>Kanne</i> ’s reading of <i>Pilot Life</i> has been undercut by the changes in the view of the Supreme Court and the Solicitor General.....	19
3. <i>Kanne</i> is based on a view of ERISA preemption the Supreme Court has since abandoned.....	22
4. <i>Kanne</i> has prompted a split in the circuits.	25
5. <i>Kanne</i> is inconsistent with ERISA’s text and legislative history.	27

6. Reexamination of <i>Kanne</i> would avoid the injustice that occurs when ERISA preempts state-law claims without providing a remedy	32
CONCLUSION.....	33
Certificate of Compliance and Statement of Related Cases	35

TABLE OF AUTHORITIES

Cases

<i>Associated General Contractors of America v. Metropolitan Water Dist. of Southern California</i> , (9 th Cir. 1998) 159 F.3d 1178	4
<i>Bast v. Prudential Ins. Co. of America</i> , (9 th Cir. 1998) 150 F.3d 1003, cert. denied (1999) 528 U.S. 870, 120 S. Ct. 170.....	32, 33
<i>Carpenters Local Union No. 26 v. U.S. Fidelity & Guar. Co.</i> , (1 st cir. 2000) 215 F.3d 136	22
<i>Carpenters s. Cal. Admin Corp. v. D & L Camp Constr. Co.</i> , (9 th Cir. 1984) 738 F.2d 999	24
<i>Cates Construction Co. v. Talbot Partners</i> , (1999) 21 Cal.4 th 28, 86 Cal.Rptr.2d 855	11, 12
<i>Cipollone v. Liggett Group, Inc.</i> (1992) 505 U.S. 504, 112 S. Ct. 2608	13
<i>Comunale v. Traders & General Ins. Co.</i> , (1958) 50 Cal.2d 654, 328 P.2d 198.....	10
<i>Copesky v. Superior Court</i> , (1991) 229 Cal.App.3d 678, 280 Cal.Rptr.338	10
<i>Egan v. Mutual of Omaha Insurance Co.</i> , (1979) 24 Cal.3d 809, 157 Cal.Rptr. 482	10
<i>Egelhoff v. Egelhoff</i> , __ U.S.__, 121 S. Ct. 1322 (2001)	31
<i>Electrical Workers Health & Welfare Trust v. Marjo Corp.</i> , (9 th Cir. 1993) 988 F.2d 865	24
<i>Epstein v. Washington Energy Co.</i> , (9 th Cir.1996) 83 F.3d 1136	5

<i>Foley v. Interactive Data Corp.</i> , (1988) 47 Cal.3d 654, 254 Cal.Rptr. 211	10, 11
<i>Freeman & Mills, Inc. v. Belcher Oil Co.</i> , (1995) 11 Cal.4 th 85, 44 Cal.Rptr.2d 420	10, 11
<i>Gilbert v. Alta Health & Life Ins. Co.</i> , (N.D. Ala. 2000) 122 F.Supp. 1267.....	16
<i>Gonzalez v. Metropolitan Transp. Auth.</i> , (9 th Cir.1999) 174 F.3d 1016	4
<i>Gruenberg v. Aetna Ins. Co.</i> , (1973) 9 Cal.3d 566, 108 Cal.Rptr. 480	10
<i>Hoffman v. Empire Blue Cross and Blue Shield</i> , (S.D.N.Y. 1999)1999 WL 782518, n.5	26
<i>Humana Inc. v. Forsythe</i> , (1999) 525 U.S. 299, 119 S. Ct. 710	6, 15
<i>Kanne v. Connecticut General Life Ins. Co.</i> , (9 th Cir. 1989) 867 F.2d 489, cert. denied (1989) 492 U.S. 906.....	passim
<i>Kransco v. American Empire Surplus Lines Ins. Co.</i> , (2000) 23 Cal.4 th 390, 97 Cal.Rptr.2d 151	12
<i>Lange v. Penn Mut. Life Ins. Co.</i> (9 th Cir. 1988) 843 F.2d 1175	11
<i>Lewis v. U.S. Healthcare</i> , (N.D. Okl. 1999) 78 F.Supp.2d 1202	16
<i>Metropolitan Life Ins. Co. v. Massachusetts</i> , (1985) 471 U.S. 724, 105 S. Ct. 238	26, 28, 31
<i>Moradi-Shalal v. Fireman’s Fund Ins. Co.</i> , (1988) 46 Cal.3d 287, 250 Cal.Rptr. 116	17
<i>New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.</i> , (1995) 514 U.S. 645, 115 S. Ct. 1671	23

<i>Noble v. National American Life Ins. Co.</i> , (1981) 128 Ariz. 188, 624 P.2d 866	11
<i>Norman v. Paul Revere Life Ins. Co.</i> , (2000 W.D. Wash.) 2000 WL 33116829	16
<i>Pilot Life Ins. Co. v. Dedeaux</i> , (1987) 481 U.S. 41, 107 S. Ct. 1549	18
<i>San Diego Building Trades Council v. Garmon</i> , (1959) 359 U.S. 236, 79 S. Ct. 773	13
<i>Seaman’s Direct Buying Service v. Standard Oil Co.</i> , (1984) 36 Cal.3d 752	11
<i>Selby v. Principal Mutual Life Ins. Co.</i> , (S.D.N.Y 2000) 2000 WL 1781191	26
<i>Shaw v. Delta Airlines, Inc.</i> , (1981) 463 U.S. 85, 103 S. Ct. 2890	22
<i>Southern Cal. IBEW-NECA Trust Funds v. Standard Industrial Electric Co.</i> , (9 th Cir. 2001)247 F.3d 920	23, 24
<i>Toumajian v. Frailey</i> , (9 th Cir. 1998) 135 F.3d 648	23
<i>United States Fidelity & Guaranty Assoc. v. Peterson</i> , (1975) 91 Nev. 617, 540 P.2d 1070.....	15
<i>UNUM Life Ins. Co. v. Ward</i> , (1999) 526 U.S. 358, 119 S. Ct. 1380	passim
<i>Williams Ins. Trust v. Travelers Ins. Co.</i> , (2d Cir. 1995) 50 F.3d 144	25, 26
Statutes	
15 U.S.C. § 1011.....	14
28 U.S.C. § 1291.....	3

28 U.S.C. § 1331	2
29 U.S.C. § 1132(a)	<i>passim</i>
29 U.S.C. § 1132(e)(1).....	2
29 U.S.C. § 1144(a)	8
29 U.S.C. § 1144(b)(2)(A).....	<i>passim</i>
29 U.S.C. § 1144(b)(4)	29

Other Authorities

Donald T. Bogan, <i>Protecting Patients' Rights Despite ERISA: Will the Supreme Court Allow States to Regulate Managed Care?</i> 74 Tulane L. Rev. 951(2000).....	30
--	----

PRELIMINARY STATEMENT

This appeal requires the court to resolve two issues:

- Is California’s common-law tort of “insurance bad faith” — which exists solely to regulate insurer conduct and to protect policyholders — a state law that regulates insurance within the meaning of ERISA’s insurance saving clause?
- If so, has the time come for this court to reexamine its 1989 decision in *Kanne v. Connecticut General Ins. Co.*, which held that ERISA preempts all claims for insurance bad faith, even if they regulate insurance within the meaning of the saving clause?

Kanne was decided at the high-water mark of ERISA preemption. In the ensuing 12 years the Supreme Court has constricted ERISA’s preemptive sweep with decisions narrowing the preemption clause and broadening the saving clause. These changes have already required this court to reevaluate its own ERISA precedents. *Kanne* is overdue for similar reconsideration.

The lynchpin of *Kanne*’s holding is the court’s finding that it would be “impossible” to read the Supreme Court’s decision in *Pilot Life* to allow state-law-based claims or remedies for insurance bad faith, even if they regulate insurance and therefore come within the saving clause. This reading of *Pilot Life* has been eroded by two developments.

First, the Supreme Court has indicated that *Pilot Life* did not resolve the issue of whether ERISA’s remedies clause can preempt state-law claims that are saved. Rather, both the Court and the Solicitor General view this as an open question. The circuits are currently split on this issue, with *Kanne* finding preemption and the Second Circuit finding it “quixotic” to hold that ERISA could both save and preempt the same state law. At least seven district courts in the last two years have held that state-law bad-faith claims are not preempted.

Second, the Solicitor General has argued that *Kanne's* view of *Pilot Life* is wrong. Specifically, the Solicitor General has argued that *Pilot Life* did not compel the rule this court adopted in *Kanne*, and that ERISA's text and legislative history support the contrary view — that Congress meant what it said when it said that state laws that regulated insurance were saved from ERISA preemption.

The Solicitor General's view is of particular relevance here, since it was the Solicitor General who authored the preemption argument discussed in *Pilot Life* and adopted in *Kanne*. The National Association of Insurance Commissioners and the Attorneys General for 25 states support the view that ERISA does not preempt state insurance laws that are saved.

This court has lamented that it is often unfair and sometimes tragic that ERISA can preempt state-law claims without supplying a corresponding remedy. The receding tide of ERISA preemption now reveals that neither Supreme Court precedent nor the text of the statute requires this result. The time has come to rethink *Kanne*.

STATEMENT OF JURISDICTION

Jeanette Hower filed this action in the Superior Court of Riverside County. PacifiCare removed it to the U.S. District Court for the Central District of California, claiming Hower's claims arose under ERISA. If so, the district court would have had jurisdiction under 29 U.S.C. § 1132(e)(1) (ERISA), as well as under 28 U.S.C. § 1331 (federal question jurisdiction).

Hower contends that this action does not arise under ERISA, and that the district court was without jurisdiction. This court has jurisdiction because this is an appeal from a final decision of the district court, dismissing Hower's

action with prejudice on February 8, 2001.¹ 28 U.S.C. § 1291. Hower filed a timely notice of appeal on March 1, 2001.²

STATEMENT OF THE CASE

This is an appeal from a judgment dismissing Hower's case with prejudice for failing to state a claim on which relief could be granted.³ Hower filed suit against her health insurer, PacifiCare, for what she contends was its bad-faith refusal to provide her with referrals to specialists who could have diagnosed and treated her Lyme disease before it progressed so far that it caused permanent damage to her heart.⁴

PacifiCare removed this action, contending that Hower's claims arose under, and were preempted by, ERISA, because she obtained her health insurance through her employer.⁵ Hower then amended her complaint as-of-right to clarify that the only relief she was seeking was damages against PacifiCare for tortious breach of the implied covenant of good faith and fair dealing.⁶

Hower then moved to remand her lawsuit, arguing that her claim was based on a California common-law rule that regulated insurance and was therefore saved from preemption under ERISA's saving clause.⁷ PacifiCare opposed remand, and moved to dismiss because ERISA does not provide any remedy for the injuries Hower sustained.⁸ Hower did not oppose the motion

¹ Excerpt of Record ("ER") tab 21. The excerpts of record are tabbed to correspond to the Clerks Record ("R."). (The docket entry for this order reflects a dismissal "w/o" prejudice, but the minute order specifies the dismissal was with prejudice.)

² ER 22.

³ ER 21.

⁴ ER 7.

⁵ R. 1.

⁶ ER 7.

⁷ R. 9.

⁸ R. 5 and 15.

to dismiss, but urged the district court to determine the remand motion first, since if the action was remanded the motion to dismiss would be moot.⁹ Hower requested that the court dismiss the action with prejudice in the event it denied the remand motion, so that Hower could obtain immediate appellate review of the two issues described above.¹⁰

The district court denied the motion to remand and granted the motion to dismiss, finding that California's law of insurance bad faith did not regulate insurance and was not saved.¹¹ The court gave Hower leave to amend to attempt to state a cause of action under ERISA. Hower elected not to amend, since ERISA does not provide a remedy for her injuries, and filed a notice informing the court and PacifiCare of her election.¹² The district court then issued an order dismissing the case with prejudice for failure to state a claim on which relief could be granted, finding that Hower's claim arose under, and was preempted by ERISA.¹³

A district court's dismissal of a complaint under Rule 12(b)(6) is reviewed de novo on appeal.¹⁴ Likewise, a district court's determination regarding ERISA preemption is a legal conclusion subject to de novo review.¹⁵

⁹ R. 16.

¹⁰ R. 16.

¹¹ ER 19.

¹² R. 20.

¹³ ER. 21.

¹⁴ *Gonzalez v. Metropolitan Transp. Auth.*, 174 F.3d 1016, 1018 (9th Cir.1999) (district court's dismissal under Rule 12(b)(6) subject to de novo review).

¹⁵ *Associated General Contractors of America v. Metropolitan Water Dist. of Southern California*, 159 F.3d 1178, 1180 (9th Cir. 1998)(district court's determination regarding ERISA preemption is reviewed de novo).

STATEMENT OF FACTS

Since this matter was dismissed on a Rule 12(b)(6) motion, the only facts in the record are those stated in the first amended complaint, which are deemed true.¹⁶ The relevant facts are these. In October 1999 Hower sought medical treatment through her PacifiCare medical group for symptoms including extreme fatigue, dizziness, shaking, and irregular heart palpitations.¹⁷ She was seen only by a nurse and was diagnosed with an ear infection.¹⁸

Her symptoms became worse in December 1999, so she returned for treatment.¹⁹ At the time, she was demonstrating stroke-like symptoms.²⁰ The medical group authorized blood work and an EKG, but refused to refer her to a specialist or to perform any additional tests.²¹

Because she was unable to obtain access to a specialist, Hower was forced to go out-of-plan to UCLA and the Eisenhower Medical Center to obtain a diagnosis of Lyme disease.²² By the time she was diagnosed in March 2000, the illness had permanently damaged her heart.²³ She now suffers from life-long residual effects from the Lyme disease.²⁴

¹⁶ *Epstein v. Washington Energy Co.*, 83 F.3d 1136, 1140 (9th Cir.1996)(on review of dismissal under Rule 12(b)(6) all factual allegations set forth in the complaint are taken as true and construed in the light most favorable to plaintiff).

¹⁷ First Amended Complaint, ER 7, para 9.

¹⁸ *Id.* at para. 10.

¹⁹ *Id.* at para. 11.

²⁰ *Id.* at para. 11.

²¹ *Id.* at para. 11.

²² *Id.* at para. 13.

²³ *Id.* at para. 14.

²⁴ *Id.* at para. 14.

SUMMARY OF ARGUMENT

A.

California's common-law tort claim for "insurance bad faith," is a state law that regulates insurance within the meaning of ERISA's saving clause. The tort is grounded on policy concerns specific to the insurance industry, and may be stated only by a policyholder against an insurer. It therefore is targeted directly at the insurance industry, and regulates insurance as a matter of common sense.

The tort also regulates insurance when measured against the criteria developed under the McCarran-Ferguson Act, because it is integral to the policy relationship between the policyholder and the insurer, and is limited solely to the insurance industry. It therefore satisfies the two-part test articulated in *UNUM Life Ins. Co. v. Ward*.²⁵

The Supreme Court has already determined that state common-law tort remedies for insurance bad faith qualify under the McCarran-Ferguson Act as state laws that regulate insurance, in *Humana Inc. v. Forsythe*.²⁶ This determination is dispositive here.

B.

This court should reexamine its decision in *Kanne*,²⁷ which held that even if California's tort of insurance bad faith was a state law that regulated insurance, it would nevertheless be preempted by ERISA because it created a remedy that was not available under ERISA's civil-remedies clause.

Kanne based this holding on its reading of the Supreme Court's decision in *Pilot Life*, which it viewed as requiring preemption. In the 12 years since *Kanne* was decided, the Supreme Court has markedly shrunk

²⁵ *UNUM Life Ins. Co. v. Ward*, 526 U.S. 358, 119 S.Ct. 1380 (1999)

²⁶ *Humana Inc. v. Forsythe*, 525 U.S. 299, 119 S.Ct. 710 (1999).

²⁷ *Kanne v. Connecticut General Life Ins. Co.*, 867 F.2d 489 (9th Cir. 1989), cert. denied 492 U.S. 906. (1989).

ERISA's preemptive scope. The Court has abandoned its expansive literal construction of ERISA's preemption clause and has broadened the scope of the saving clause, sweeping away restrictions that the lower courts had read into it and noting that it is phrased with the same breadth as the preemption clause it qualifies.²⁸

Kanne is grounded on the view that the Supreme Court's decision in *Pilot Life* requires that ERISA's civil-remedies clause trumps the saving clause. But the Supreme Court has never held that ERISA can preempt a state law that regulates insurance. Both it and the Solicitor General have indicated that this issue remains unresolved. The Second Circuit has held that ERISA's remedies clause cannot preempt a law that is saved. *Kanne's* reading of *Pilot Life* as foreclosing the issue and mandating preemption is therefore suspect.

The Solicitor General, who originally articulated the preemption argument this court adopted in *Kanne*, has since qualified it — arguing that Congress intended in the saving clause to shield state laws that regulate insurance from preemption, even if they provide an alternate remedy.

The Supreme Court's current approach to ERISA preemption includes a reluctance to preempt state law in areas that states have traditionally regulated and a consideration of the types of state laws that Congress intended would survive preemption. Congress plainly intended to protect state insurance laws when it enacted ERISA because it included those laws in the saving clause.

The High Court has explained that the central purpose of ERISA preemption is to achieve uniformity of regulation of ERISA plans. But the Court has also repeatedly acknowledged that by saving the insurance laws of 50 states, the saving clause inherently produces disuniformity. Since Congress understood that state insurance laws were not uniform, it makes

²⁸ *Ward*, 526 U.S. at 362, 373-374; 119 S.Ct. at 1384, 1389.

scant sense to sacrifice on the altar of uniformity insurance laws that ERISA expressly saves.

ARGUMENT

A. California’s common-law tort of “insurance bad faith” is a state law that regulates insurance and therefore falls within ERISA’s saving clause.

ERISA’s preemption clause applies to “any and all State laws insofar as they . . . relate to any employee benefit plan.”²⁹ The scope of preemption is limited, however, by ERISA’s saving clause, which makes the preemption clause inapplicable to “any law of any State which regulates insurance, banking, or securities.”³⁰ The preliminary question in this appeal is whether California’s common-law claim against an insurer for tortious breach of the implied covenant of good faith and fair dealing, often called “insurance bad faith,” is a state law that regulates insurance and is therefore saved from preemption by the saving clause.

The answer to this question is clear. California’s tort of insurance bad faith exists to regulate insurer conduct and is available only to policyholders. It therefore is an instrument of state regulation of insurance and satisfies all aspects of the Supreme Court’s two-part test to discern which state laws fit within the saving clause.

The test was explained in *UNUM Life Ins. Co. v. Ward*,³¹ which affirmed this court’s determination that California’s common-law “notice-prejudice rule” regulated insurance and was therefore saved from ERISA

²⁹ Section 514(a) of ERISA, 29 U.S.C. § 1144(a).

³⁰ Section 514(b)(2)(A) of ERISA, 29 U.S.C. § 1144(b)(2)(A).

³¹ *UNUM Life Ins. Co. v. Ward*, 526 U.S. 358, 119 S.Ct. 1380 (1999)

preemption. The first inquiry is whether, from a common-sense view of the matter, the law at issue regulates insurance.³² This answer is then checked against the criteria used to determine whether a state law regulates the business of insurance within the meaning of the McCarran-Ferguson Act.³³

1. California’s bad-faith tort regulates insurer conduct and therefore regulates insurance as a matter of common sense.

Ward affirmed this court’s conclusion that California’s notice-prejudice rule regulates insurance as a matter of common sense. That rule prevents an insurer from denying a claim as untimely unless it can show that the delay caused substantial prejudice.³⁴ Because the rule is, by its very terms, directed specifically at the insurance industry and applicable only to insurance contracts, the Court concluded that it regulates insurance as a matter of common sense.³⁵

Ward contrasted the California notice-prejudice rule with the Mississippi common-law claim for “bad-faith,” which it held in *Pilot Life* did not regulate insurance.³⁶ The crucial distinction was that the Mississippi law allowed a bad-faith claim to be brought for *any* breach of contract, and was therefore not limited to the insurance industry.³⁷ By contrast, the California rule “homes in on the insurance industry.”³⁸

Like the notice-prejudice rule at issue in *Ward*, California’s tort of insurance bad faith is “grounded on policy concerns specific to the insurance industry”³⁹ and is “a rule of law governing the insurance relationship

³² *Ward*, 526 U.S. at 367, 119 S.Ct. at 1386.

³³ *Ward*, 526 U.S. at 373, 119 S.Ct. at 1389.

³⁴ *Ward*, 526 U.S. at 366-377, 119 S.Ct. at 1386.

³⁵ *Ward*, 526 U.S. at 368, 119 S.Ct. at 1386.

³⁶ *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 46, 107 S.Ct. 1549 (1987)

³⁷ *Ward*, 526 U.S. at 369, 119 S.Ct. at 1387.

³⁸ *Ward*, 526 U.S. at 368, 119 S.Ct. at 1387.

³⁹ *Ward*, 526 U.S. at 372, 119 S.Ct. at 1388.

distinctively.”⁴⁰ California permits tort recovery for breach of the implied covenant of good faith and fair dealing in only one situation — in an action brought by a policyholder against an insurer.⁴¹

The insurance bad faith tort was created by the California Supreme Court in 1958 in *Comunale v. Traders & General Ins. Co.*,⁴² which allowed a policyholder to recover in tort for his insurer’s wrongful refusal to settle a third-party claim. The concept was expanded to “first-party” claims by a policyholder against the carrier in 1973.⁴³

In the early 1980s, California’s intermediate appellate courts allowed terminated employees to sue their employers in tort for breach of the implied covenant, but the California Supreme Court overruled these decisions in 1988, in *Foley v. Interactive Data Corp.*⁴⁴ *Foley* explained that, because the implied covenant is a contract term, recovery for its breach is generally limited to contract damages — but insurance contracts formed an exception to this rule.⁴⁵

The court further explained that this exception for insurance contracts developed “for a variety of policy reasons” that arise from the unique relationship between an insurer and policyholder.⁴⁶ The court detailed these

⁴⁰ *Ward*, 526 U.S. at 373, 119 S.Ct. at 1389.

⁴¹ *Freeman & Mills, Inc. v. Belcher Oil Co.*, 11 Cal.4th 85, 95, 102, 44 Cal.Rptr.2d 420, 425, 431 (1995).

⁴² *Comunale v. Traders & General Ins. Co.*, 50 Cal.2d 654, 328 P.2d 198 (1958); see *Copesky v. Superior Court*, 229 Cal.App.3d 678, 685, 280 Cal.Rptr. 338 (1991)(explaining history of the tort).

⁴³ *Gruenberg v. Aetna Ins. Co.*, 9 Cal.3d 566, 575, 108 Cal.Rptr. 480 (1973).

⁴⁴ *Foley v. Interactive Data Corp.*, 47 Cal.3d 654, 684, 254 Cal.Rptr. 211 (1988).

⁴⁵ *Foley*, 47 Cal.3d at 684, 254 Cal.Rptr. at 228.

⁴⁶ *Foley*, 47 Cal.3d at 684, 685, 254 Cal.Rptr. at 228, 229.

reasons in *Egan v. Mutual of Omaha Insurance Co.*⁴⁷ and in *Foley*.⁴⁸ They include four salient points:

- An insurance policy is purchased as protection against calamity, not for commercial advantage;
- Policyholders seldom occupy an equal bargaining position with the insurer, either when purchasing coverage or when making a claim;
- The economic interests between policyholders and their insurers are in conflict, making policyholders particularly vulnerable after a loss occurs; and
- The relationship between policyholders and insurers includes elements of public interest and fiduciary responsibility.⁴⁹

This court summed up the principal reason that courts have created the tort of insurance bad faith this way: “The whole purpose of insurance is defeated if an insurance company can refuse or fail, without justification, to pay a valid claim.”⁵⁰

Recent decisions of the California Supreme Court confirm that the bad-faith tort is limited to the insurance context. In 1995, the court overruled one of its own earlier cases, which had suggested that breach of a contract could be tortious in some circumstances beyond the insurance context.⁵¹ In 1999,

⁴⁷ *Egan v. Mutual of Omaha Insurance Co.*, 24 Cal.3d 809, 820, 157 Cal.Rptr. 482, 487 (1979).

⁴⁸ *Foley*, 47 Cal.3d at 684, 693, 254 Cal.Rptr. at 228, 234

⁴⁹ *Ibid.*

⁵⁰ *Lange v. Penn Mut. Life Ins. Co.* 843 F.2d 1175, 1181 (9th Cir. 1988), citing *Noble v. National American Life Ins. Co.*, 128 Ariz. 188, 189, 624 P.2d 866 (1981)(adopting the California Supreme Court’s justification for creating the tort of insurance bad faith).

⁵¹ *Freeman & Mills, Inc.* 11 Cal.4th at 103, 44 Cal.Rptr. 2d at 441(overruling *Seaman’s Direct Buying Service v. Standard Oil Co.*, 36 Cal.3d 752 (1984))

the court held in *Cates Construction Co. v. Talbot Partners*,⁵² that breach of a surety contract did not subject the surety to liability in tort because a surety contract was not an insurance contract. *Cates* explained, “At present, this Court recognizes only one exception to that general rule: tort remedies are available for a breach of the covenant in cases involving insurance policies.”⁵³

Last year, the court clarified that the bad-faith tort is designed specifically to regulate the conduct of insurers. In *Kransco v. American Empire Surplus Lines Ins. Co.*,⁵⁴ the court held that although the implied covenant is a “two-way street,” only an insurer’s breach of the covenant is governed by tort principles.⁵⁵ This is because the policy justifications for imposing tort liability on the carrier do not extend to the policyholder. Therefore the policyholder’s breach of the covenant is not a tort, nor can it be raised by the carrier as an affirmative defense to the policyholder’s tort claim.⁵⁶

Here, the district court advanced two reasons to support its conclusion that California’s common-law claim for tortious breach of the implied covenant did not regulate insurance from a common-sense perspective: (1) that tort damages affect only the remedy, not the parties’ underlying obligations, and (2) that the California Supreme Court has left open the possibility that in the future, it might determine that some other contractual relationship was analogous to the insurer-insured relationship, and

⁵² *Cates Construction Co. v. Talbot Partners*, 21 Cal.4th 28, 86 Cal.Rptr.2d 855 (1999).

⁵³ *Cates Construction Co.*, 21 Cal.4th at 45, 86 Cal.Rptr.2d 866.

⁵⁴ *Kransco v. American Empire Surplus Lines Ins. Co.*, 23 Cal.4th 390, 402, 97 Cal.Rptr.2d 151 160 (2000).

⁵⁵ *Kransco*, 24 Cal.4th at 402, 97 Cal.Rptr. 2d at 160.

⁵⁶ *Ibid.*

accordingly allow a tort recovery to protect that relationship.⁵⁷ Neither reason will withstand scrutiny.

First, creating remedies that punish certain conduct with enhanced liability is the essence of using common-law rules to regulate conduct. The U. S. Supreme Court explained this in *Cipollone v. Liggett Group, Inc.*⁵⁸:

The obligation to pay compensation can be, indeed is designed to be, a potent method of governing conduct and controlling policy. As we noted in another context, “[state] regulation can be as effectively exerted through an award of damages as through some form of preventive relief.”

The district court’s first reason therefore misconceives the nature of the common law as a regulatory tool. The bad-faith tort regulates insurance precisely because it provides a tort remedy for conduct that is otherwise not punishable in tort.

The second reason is equally problematic. A statement by the California Supreme Court that it *might someday* approve tort remedies for breach of a non-insurance contract in another context does not mean that California is not using the bad-faith tort to regulate insurance. Given the way common-law doctrines develop, it is always possible that a court may borrow rules from one area to address an issue raised in a different area. This does not mean that the particular rule in question does not serve a regulatory function.

In *Ward*, the Supreme Court rejected a variant of the same argument, finding that the notice-prejudice rule regulated insurance even though it was

⁵⁷ ER. 19.

⁵⁸ *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 521, 112 S.Ct. 2608, 2620 (1992), quoting, *San Diego Building Trades Council v. Garmon*, 359 U.S. 236, 247, 79 S.Ct. 773, 780 (1959).

derived from the broadly applicable maxim that “equity abhors a forfeiture.”⁵⁹ The Court held that the notice-prejudice rule involved an application of that maxim “of a special order.”⁶⁰ The major difference between the general rule and the insurance-specific rule amounted to who bore the burden of departing from the contract’s written terms. The notice-prejudice rule was insurance-specific because it automatically applied absent a showing by the insurer of substantial prejudice; whereas the general rule placed the burden on the party invoking the rule.⁶¹

This mirrors the difference between the general claim for breach of the implied covenant, which is available in any case involving a contract, and a tort claim for insurance bad faith, which is available only to insureds. The latter is insurance specific, and hence regulates insurance as a matter of common sense.

2. The common-sense conclusion is consistent with the McCarran-Ferguson Act test for state laws that regulate insurance.

The second part of the test to determine whether a state law regulates insurance under ERISA requires the court to test its common-sense conclusion against criteria used to determine whether a state law regulates “the business of insurance” under the McCarran-Ferguson Act.⁶² There are three factors in the McCarran-Ferguson Act inquiry:

- Whether the rule at issue has the effect of transferring or spreading a policyholder’s risk;

⁵⁹ *Ward*, 526 U.S. at 369, 119 S.Ct. at 1387.

⁶⁰ *Ibid.*

⁶¹ *Ibid.*

⁶² The McCarran-Ferguson Act is codified at 15 U.S.C. § 1011, et seq.

- Whether the rule serves as an integral part of the policy relationship between the insurer and the policyholder; and
- Whether the rule is limited to entities within the insurance industry.⁶³

Ward made it clear that these factors are to be applied flexibly, and that they are “relevant” to the inquiry, but not determinative.⁶⁴ The notice-prejudice rule considered in *Ward* satisfied the test, even though it did not spread risk.⁶⁵

The Supreme Court has already determined that a common-law claim for insurance bad faith qualifies under the McCarran-Ferguson Act as a state law that regulates insurance. In *Humana Inc. v. Forsythe*⁶⁶ the Supreme Court applied the McCarran-Ferguson Act (“Act”) to Nevada’s common-law tort for insurance bad faith. (Nevada’s bad-faith claim is based on the California bad-faith decisions.⁶⁷) Since the inquiry under ERISA and the Act is the same, *Forsythe* is dispositive here.

Forsythe involved an insurer’s attempt use the Act as a defensive shield against a civil RICO claim. The Act forbids the application of generally applicable federal laws in a way that would “invalidate, impair, or supersede” state laws that regulate insurance. The insurer claimed that RICO’s treble-damage remedy was so draconian that its application effectively “impaired” Nevada’s regulatory regime, which consisted of administrative and statutory penalties, plus common-law claims. The Court rejected this contention,

⁶³ *Ward*, 526 U.S. at 374-375, 119 S.Ct. at 1389.

⁶⁴ *Ward*, 526 U.S. at 373, 119 S.Ct. at 1389.

⁶⁵ *Ward*, 526 U.S. at 374, 119 S.Ct. at 1389.

⁶⁶ *Humana Inc. v. Forsythe*, 525 U.S. 299, 119 S.Ct. 710 (1999)

⁶⁷ *United States Fidelity & Guaranty Assoc. v. Peterson*, 91 Nev. 617, 620, 540 P.2d 1070, 1071 (1975)(adopting California rule concerning tort remedy for insurer’s breach of implied covenant).

holding that RICO could be applied in harmony with Nevada’s regulatory system.⁶⁸

Forsythe’s significance here is that no issue would have been presented under the McCarran-Ferguson Act unless the Nevada law in question regulated insurance. The Court unmistakably included Nevada’s common-law tort of insurance bad faith in its analysis of the law potentially impacted by the RICO claim. The Court discussed the insurer’s potential tort liability in detail and referred to the common-law remedies for bad-faith — compensatory and punitive damages — as part of the state’s “remedial regime.”⁶⁹ The Court concluded, “RICO’s private right of action and treble damages provision appears to compliment Nevada’s statutory and common-law claims for relief.”⁷⁰ Accordingly, the Court held that the McCarran-Ferguson Act did not bar the RICO action.

Even if *Forsythe* did not resolve the issue, there is ample precedent based on *Ward* that common-law and statutory bad-faith claims meet the McCarran-Ferguson Act test. District courts have held that bad-faith claims available under Colorado law, Oklahoma law, Washington law, and Alabama law all regulate insurance within the meaning of the saving clause.⁷¹

⁶⁸ *Forsythe*, 525 U.S. at 303, 119 S.Ct. at 714.

⁶⁹ *Forsythe*, 525 U.S. at 303, 312, 313, 119 S.Ct. at 714, 718, 719.

⁷⁰ *Forsythe*, 525 U.S. 299 at 313, 119 S.Ct. at 719.

⁷¹ *Gilbert v. Alta Health & Life Ins. Co.*, 122 F.Supp. 1267, 1271-1273 (N.D. Ala. 2000)(Alabama statutory bad-faith claim meets common sense and McCarran-Ferguson Act test); *Lewis v. U.S. Healthcare*, 78 F.Supp.2d 1202, 1214 (N.D. Okl. 1999)(Oklahoma common-law bad-faith tort meets both tests under *Ward* and regulates insurance); *Colligan v. UNUM Life Ins. Co. of America*, 2001 WL 533742 (D.Colo. 2001)(Colorado common-law bad-faith claim regulates insurance); *Norman v. Paul Revere Life Ins. Co.*, 2000 WL 33116829 (2000 W.D. Wash.)(Washington’s statutory and common-law claims regulate insurance); see also *Selby v. Principal Mutual Life Ins. Co.*, 2000 WL 1781191 (S.D.N.Y 2000)(New York statutory claim saved; court

In each case, the court has found that, as in California, the bad-faith tort remedy is available only against an insurer (satisfying the third element) and that it arises out of the policy relationship between the policyholder and insurer (satisfying the second element).

Ultimately, this case cannot be distinguished from *Ward* in any meaningful way. *Ward* made clear that common-law rules qualify under the saving clause as “state law.”⁷² Both the California notice-prejudice rule and its tort claim for insurance bad faith are limited to the insurance industry, and exist to regulate insurer behavior and protect insureds.

The first time this court considered whether the notice-prejudice rule regulated insurance, it asked rhetorically, “If California's rule does not regulate insurance, what does it regulate?”⁷³ This question applies with equal force here, and commands the same answer.

B. *Kanne* has been undermined by developments in the law of ERISA preemption over the last 12 years, and should be reexamined.

1. *Kanne* reads *Pilot Life* to require the preemption of bad-faith claims based on state law, even if they are saved.

*Kanne*⁷⁴ held that ERISA preempted California’s statutory and common-law tort claims for insurance bad faith. (California no longer allows

assumes without deciding that law regulates insurance in light of defendants concession that it does).

⁷² *Ward*, 526 U.S. at 367 n. 1, 119 S.Ct. at 1386 n.1.

⁷³ *Cisneros v. UNUM Life Ins. Co.*, 134 F.3d 939, 946 (9th Cir. 1998), cert. denied 526 U.S. 1086, 119 S.Ct. 1495 (1999).

⁷⁴ *Kanne v. Connecticut General Life Ins. Co.*, 867 F.2d 489 (9th Cir. 1989), cert. denied 492 U.S. 906. (1989).

a statutory bad-faith claim.)⁷⁵ *Kanne*'s holding is based entirely on its reading of the Supreme Court's decision in *Pilot Life Ins. Co. v. Dedeaux*.⁷⁶ *Kanne* was briefed, argued, and submitted before *Pilot Life* was decided; then withdrawn from submission and re-argued in light of *Pilot Life*.

In *Pilot Life*, the Court held that common-law tort claims for "bad-faith" brought under Mississippi law were preempted by ERISA because they fell within the scope of ERISA's preemption clause, § 514(a), and were not rescued by the saving clause because they did not regulate insurance.⁷⁷

The Court's analysis went further, however. After concluding that the Mississippi law was not saved, the Court explained in the second part of its decision that the Solicitor General had argued that "Congress clearly expressed an intent that the civil enforcement provisions of ERISA § 502(a) be the exclusive vehicle for actions by ERISA plan participants asserting improper processing of a claim for benefits."⁷⁸

The Court found this contention persuasive.⁷⁹ It reviewed the language and structure of ERISA and its legislative history, and concluded that it would undermine the policy choices reflected in Congress's decision to include certain remedies in ERISA and exclude others, if claimants could obtain remedies under state law that were not included in § 502(a).

This discussion was plainly dictum, since the Court's conclusion that the Mississippi law did not regulate insurance disposed of the case, and the Court ultimately concluded that the law was preempted by ERISA's preemption clause, not by the civil remedies clause. But the exclusive nature

⁷⁵ *Moradi-Shalal v. Fireman's Fund Ins. Co.*, 46 Cal.3d 287, 250 Cal.Rptr. 116 (1988).

⁷⁶ *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 107 S.Ct. 1549 (1987).

⁷⁷ *Pilot Life*, 481 U.S. at 57 and n.4, 107 S.Ct. at 1558 and n. 4.

⁷⁸ *Pilot Life*, 481 U.S. at 52, 107 S.Ct. at 1555.

⁷⁹ *Pilot Life*, 481 U.S. at 52, 107 S.Ct. at 1555.

of ERISA’s civil remedies provision was undeniably an important part of the Court’s decision; in fact, it called it the “most important” consideration of those it had weighed.⁸⁰

In *Kanne*, this court read *Pilot Life* to foreclose any state-law claim for insurance bad faith, but treated common-law and statutory claims differently. The court dispatched the common-law claim in two terse sentences: “In the *Pilot Life*, the Supreme Court held that state common law causes of action arising from improper processing of a claim are preempted by federal law. The *Kanne*’s claims arising out of delay in payment are claims for improper processing and are therefore preempted.”⁸¹ (To the extent that this discussion suggests that common-law claims cannot be saved, it is inconsistent with *Ward*.)

Kanne’s analysis of the statutory claim turned on *Pilot Life*’s discussion of § 502(a) as an exclusive remedy. The court assumed without deciding that the statutory claim regulated insurance, but held that it did not matter. In the court’s view, it was impossible to read the second part of the decision in *Pilot Life* to allow a state statute, whether saved or not, to supplement ERISA’s civil-enforcement mechanism.⁸² In other words, *Kanne* read *Pilot Life* as having conclusively resolved that all bad-faith claims based on state law were preempted, regardless of whether they regulated insurance.

2. *Kanne*’s reading of *Pilot Life* has been undercut by recent changes in the view of the Supreme Court and the Solicitor General.

Ward calls into question *Kanne*’s fundamental premise — that *Pilot Life* conclusively determined that a state insurance law that regulated

⁸⁰ *Pilot Life*, 481 U.S. at 57, 107 S.Ct. at 1558.

⁸¹ *Kanne*, 867 F.2d at 493.

⁸² *Kanne*, 867 F.2d at 494.

insurance would nevertheless be preempted if it permitted the insured to pursue a remedy beyond those allowed by § 502(a).

In rejecting the insurer's argument that the notice-prejudice rule was preempted by *Pilot Life* because it supposedly created an alternative remedy to recover benefits, the Court observed, “[w]hatever the merits of UNUM’s view of § 502’s preemptive force, [FN 7] the issue is not implicated here. . . . The case therefore does not raise the question whether § 502(a) provides the sole launching ground for an ERISA enforcement action.”⁸³

The Court’s footnote 7, which is discussed in greater detail below, explains that *Pilot Life* discussed the issue of § 502’s preemptive force, but did so in a case that concerned a law that was not specifically directed to the insurance industry and was therefore not saved from ERISA preemption. The Court noted that, “in that context,” the Solicitor General had argued that § 502(a) provided an exclusive remedy, and that the Court had accepted that submission.⁸⁴

The Court’s language in *Ward* is at odds with the view of *Pilot Life* adopted in *Kanne*, because it suggests that *Pilot Life* did not conclusively resolve the issue of § 502(a)’s preemptive force in all cases. If *Pilot Life* was the final word, it would make no sense for the Court to refer to “the question whether § 502(a) provides the sole launching ground for an ERISA enforcement action.” No question would exist.

Likewise, the Court was plainly limiting the scope of *Pilot Life* when it distinguished it as a case dealing with a state law that was not saved, and noted that the Solicitor General’s argument concerning § 502(a) arose “in that context.”

⁸³ *Ward*, 526 U.S. at 377, 119 S.Ct. at 1390-91.

⁸⁴ *Ward*, 526 U.S. at 377 n. 7, 119 S.Ct. at 1390-91 n. 7.

The Solicitor General does not view *Pilot Life* as reaching the issue raised in *Kanne*. In an amicus brief filed on behalf of the United States in *Ward* in 1999, the Solicitor General argued, “[T]he general background of Section 502(a) discussed *Pilot Life* does not in itself require that a state law that ‘regulates insurance’ and so comes within the terms of the savings clause, is nevertheless preempted if it provides a state-law cause of action or remedy.”⁸⁵

The Solicitor General confirmed this view of *Pilot Life* in a recent opposition to a petition for certiorari filed by the State of Texas in *Montemayor v. Corporate Health Care*.⁸⁶ There, the Solicitor General for the new Bush administration urged the Court not to accept review because the issue raised in the petition — whether ERISA preempted statutes creating a system of independent review of HMO decisions — was being addressed by Congress. In a footnote to the opposition, however, the Solicitor General wrote:

If review were granted, the Court might also find it necessary to address questions concerning the relationship between the ERISA insurance saving clause . . . and the scope of preemption required by ERISA's exclusive remedy provision See *Pilot Life* [cite]; *Ward* [cite] n.7. That issue may have far-reaching consequences, since it may affect the enforceability of many state insurance regulations (including perhaps even those that provide for liability for insurers) insofar as they apply to insured ERISA plans. These far-reaching implications suggest that this

⁸⁵ *Ward*, 526 U.S. at 377 n. 7, 119 S.Ct. at 1390-91 n. 7, citing Solicitor General’s brief. A copy of the brief is attached to the concurrently filed request for judicial notice.

⁸⁶ *Montemayor v. Corporate Health Care*, No. 00-665.

Court ought not address that issue in a case in which the crucial issue -- the availability of independent review to those covered by HMOs -- maybe resolved on wholly different grounds by Congress.⁸⁷

The Court's discussion of *Pilot Life*, as confirmed by the Solicitor General's reading of that discussion, undercuts *Kanne's* conclusion that *Pilot Life* foreclosed the issue of whether state-law claims for insurance bad faith could survive ERISA preemption if they regulated insurance. Since the question remains open for decision by the High Court, this court is free to reconsider *Kanne*.

3. *Kanne* is based on a view of ERISA preemption the Supreme Court has since abandoned.

This court recently admitted that it tread into the field of ERISA preemption with great trepidation because the Supreme Court's 17 prior decisions devoted to developing a clear statement of ERISA's preemptive scope have failed to bring clarity to the law.⁸⁸ Nor have the Court's decisions followed a straight trajectory. The Justices have been called "at least mildly schizophrenic" in mapping the contours of ERISA preemption.⁸⁹

The Supreme Court's initial preemption decisions adopted a literal construction of the key phrase "relate to" in the preemption clause, stressing that the clause was drafted to be "deliberately expansive."⁹⁰ *Pilot Life* quoted

⁸⁷ Solicitor General's opposition brief at n. 4, available at

www.usdoj.gov/osg/briefs/2000/2pet/6invt/2000-0665.pet.ami.inv.html.

⁸⁸ *Dishman v. UNUM Life Ins. Co. of America*, 250 F.3d 1272, 2001 WL 476914, *3, (9th Cir. 2001).

⁸⁹ *Carpenters Local Union No. 26 v. U.S. Fidelity & Guar. Co.*, 215 F.3d 136, 139 (1st cir. 2000).

⁹⁰ See, e.g., *Shaw v. Delta Airlines, Inc.*, 463 U.S. 85, 97, 103 S.Ct. 2890, 2900 (1981).

this formulation with approval, noting the “expansive sweep of the preemption clause.”⁹¹ This then, was the prevailing view of ERISA’s preemptive scope when *Kanne* was decided.

Times have changed. This court recently observed that, “Twelve years of experience with that standard, however, convinced the Court that it created as many problems as it solved.”⁹² Hence, in 1995, in *New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*,⁹³ the Supreme Court markedly narrowed the scope of “relate to” preemption.⁹⁴

First, the Court emphasized for the first time the “starting presumption that Congress does not intend to supplant state law” and warned that unless congressional intent to preempt clearly appears, ERISA will not be deemed to supplant state law in areas traditionally regulated by the states (like the regulation of insurance.)

Second, and even more significantly, *Travelers* abandoned the earlier literal construction of the term “relate to,” noting that, “[i]f ‘relate to’ were taken to extend to the furthest stretch of its indeterminacy, then for all practical purposes pre-emption would never run its course. . . .”⁹⁵

This court described the arc of the Supreme Court’s preemption rulings, and the resulting need for this court to recalibrate its own precedents, in *Southern Cal. IBEW-NECA Trust Funds v. Standard Industrial Electric Co.*⁹⁶ First, in 1984, this court held that ERISA did not preempt a state’s payment

⁹¹ *Pilot Life*, 481 U.S. at 47, 107 S.Ct. at 1553.

⁹² *Dishman*, 250 F.3d at ___, 2001 WL 476914 at *3.

⁹³ *New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 654, 655, 115 S.Ct. 1671 (1995).

⁹⁴ *Toumajian v. Frailey*, 135 F.3d 648, 653 (9th Cir. 1998).

⁹⁵ *Travelers*, 514 U.S. at 655, 115 S.Ct. 1671.

⁹⁶ *Southern Cal. IBEW-NECA Trust Funds v. Standard Industrial Electric Co.* 247 F.3d 920, 924 (9th Cir. 2001).

bond remedy.⁹⁷ In 1993, the court abrogated that decision, based on the Supreme Court precedents prescribing a broad literal meaning of “relate to.”⁹⁸ Then, in 2001, the pendulum swung back to its starting point based on the Supreme Court’s narrowing of ERISA’s preemptive scope. In abrogating the 1993 decision that abrogated its 1984 decision, this court “proceed[ed] to resolve an issue once resolved, guided by principles once held, to make it crystal clear that California’s payment bond and stop notice remedies are not preempted by ERISA.”⁹⁹

The constriction of ERISA’s preemptive sweep has not resulted solely from the narrowing of the preemption clause. In *Ward*, the Supreme Court also broadened the reach of the saving clause in several respects. *Ward* acknowledged that the saving clause “is framed with similar breadth” as the preemption clause and confirmed that it includes common-law rules as well as statutes.¹⁰⁰

Ward also held that a variant of a generally applicable principle could regulate insurance if grounded on policy concerns specific to insurance; rejected the mechanical application of the McCarran-Ferguson Act factors; and recognized that state laws that pertain to policy administration, which do not affect substantive terms of insurance policies, could be saved.¹⁰¹

Measured against the developments in ERISA preemption over the last 12 years, *Kanne’s* approach has been rendered obsolete. This court should

⁹⁷ *Carpenters s. Cal. Admin Corp. v. D & L Camp Constr. Co.*, 738 F.2d 999, 1000 (9th Cir. 1984).

⁹⁸ *Electrical Workers Health & Welfare Trust v. Marjo Corp.*, 988 F.2d 865, 867-68 (9th Cir. 1993.)

⁹⁹ *Southern Cal. IBEW-NECA Trust Funds*, 247 F.3d at 924-25.

¹⁰⁰ *Ward*, 526 U.S. at 363, 367 n.1, 119 S.Ct. at 1384, 1386 n.1

¹⁰¹ *Ward*, 526 U.S. at 372, 373, 375 n. 5, 119 S.Ct. 1388, 1389, 1390 n.5.

therefore update the law of the Circuit to reflect the Supreme Court's current thinking.

4. *Kanne* has prompted a split in the circuits.

In 1995, the Second Circuit disagreed with *Kanne*, in *Williams Ins. Trust v. Travelers Ins. Co.*¹⁰² The primary issue in *Williams Ins. Trust* was whether removal of the case had been proper. The lawsuit was a class action against an insurer based on its failure to comply with a New York statute requiring that interest on life insurance claims be paid from the date of death. The insurer had instead paid interest from the date a claim was filed.

The insurer removed the action based on ERISA, arguing that it was a suit to recover plan benefits. The district court held that ERISA applied and that removal was therefore proper; that the New York law was saved because it regulated insurance; that the law was nevertheless preempted by § 502(a); and that plaintiffs had failed to exhaust their administrative remedies under ERISA, necessitating dismissal. The Second Circuit reversed.

The Second Circuit analyzed the New York statute under the Supreme Court's saving clause precedents and held that it regulated insurance and was therefore saved. But the court also held that preemption was a necessary predicate for removal, and since the statute was saved by preemption, it could not be removed. The court explained:

It also follows [from the conclusion that the law was saved] that the district court erred in holding that ERISA's civil enforcement provision . . . preempts enforcement of the New York law . . . because such a result would be plausible only if the state law itself were also preempted. It would be quixotic to rule that a claim under a state statute that is saved from ERISA preemption,

¹⁰² *Williams Ins. Trust v. Travelers Ins. Co.*, 50 F.3d 144 (2d Cir. 1995).

with the result that the claim may not be removed to federal court, may nonetheless be enforced only via ERISA provisions and remedies.¹⁰³

The *Williams Trust* court then noted that in *Metropolitan Life*, after finding that the state law was saved, the Supreme Court affirmed a state court injunction mandating compliance with the state law.¹⁰⁴ The court followed its citation to *Metropolitan Life* with a “but see” citation to *Kanne*.

Following *Williams Ins. Trust*, the district court for the Southern District of New York in *Selby v. Principal Mutual Life Ins. Co.*,¹⁰⁵ held that ERISA did not preempt plaintiff’s state-law claim for punitive damages under New York law against an ERISA insurer for wrongful denial of disability benefits. The court rejected the argument that under *Pilot Life*, the punitive damage claim was barred by § 502(a), stating:

[D]efendant’s reliance on *Pilot Life* is misplaced since that case did not address the distinct question presented here: whether ERISA § 502(a) preempts a claim based on a state law which regulates insurance within the meaning of ERISA’s saving clause. The United States Supreme Court recently declined to address this question in [*Ward*, citing fn. 7] and indicated the question remained unresolved, see *Hoffman v. Empire Blue Cross and Blue Shield*.¹⁰⁶

¹⁰³ *Williams Ins. Trust*, 50 F.3d at 151.

¹⁰⁴ *Williams Ins. Trust*, 50 F.3d at 151, citing *Metropolitan Life*, 471 U.S. at 735, 758, 105 S.Ct. at 2386, 2399.

¹⁰⁵ *Selby v. Principal Mutual Life Ins. Co.*, 2000 WL 178191 (S.D.N.Y. 2000).

¹⁰⁶ *Hoffman v. Empire Blue Cross and Blue Shield*, 1999 WL 782518, n.5 (S.D.N.Y. 1999).

The *Hoffman* case, also from the Southern District of New York, found that whether ERISA preempts state laws that are saved remains an “open question” after *Ward*.¹⁰⁷ Relying on *Ward*, district courts have held that ERISA does not preempt claims for insurance bad faith arising under the laws of Colorado, Washington, Oklahoma, and Alabama.¹⁰⁸

5. *Kanne* is inconsistent with ERISA’s text and legislative history.

Perhaps the strongest case against *Kanne* was made by the Solicitor General in the United States’ amicus brief in *Ward*. The brief supported *Ward*’s view that the notice-prejudice rule was saved. The part that is relevant here responded to UNUM’s argument that the notice-prejudice rule somehow created an alternative enforcement mechanism that was barred by *Pilot Life*.

The Solicitor General argued, like *Ward*, that the case did not present any issue under § 502(a), since *Ward* was merely seeking payment of plan benefits. But the Solicitor General also made an alternate argument — that *if* the Court was inclined to reach the issue, *Pilot Life* overstated the preemptive force of § 502(a).

The Court ultimately concluded that *Ward*’s case did not require it to address this issue, since *Ward* was suing to recover his plan benefits under ERISA. But before deciding that it need not reach the issue, the Court summarized the Solicitor General’s argument at length — as if planting a seed for consideration of the issue in future cases.

The Court viewed the Solicitor General’s new argument as qualifying the position it took in *Pilot Life*.¹⁰⁹ The Solicitor General was almost coy on

¹⁰⁷ *Id.*

¹⁰⁸ Please see fn. 71, *supra*.

¹⁰⁹ *Ward*, 526 U.S. at 377 n. 7, 119 S.Ct. at 1390-91 n. 7.

this point, noting only that if the views expressed in the *Ward* brief differed from those expressed in the briefing in *Pilot Life*, it resulted from refinements suggested by 12 years of experience with ERISA preemption, and the changes in the Court’s preemption analysis.¹¹⁰

The Solicitor General’s brief directly addresses this court’s statement in *Kanne* that it was not possible to read *Pilot Life* in a way that allows the enforcement of a state-law bad-faith remedy. Citing *Kanne*, the brief acknowledges that some courts have read *Pilot Life* this way, but then demonstrates that this view is mistaken.¹¹¹ The brief makes three primary points.

First, the second part of *Pilot Life* placed primary reliance on expressions of legislative intent, but failed to examine the actual text of the statute. Specifically, the saving clause states that “nothing in this subchapter shall be construed to exempt or relieve any person from any law of any State which regulates insurance.” The brief points out that § 502 is within the same subchapter as the saving clause. Accordingly, the saving clause itself says that nothing in § 502, which concerns causes of actions and remedies under ERISA, shall be “construed” to relieve or exempt any person from “any law” of a State that regulates insurance.¹¹² In short, ERISA is structured so that the saving clause trumps the remedies clause; not vice-versa.

The brief notes that in *Metropolitan Life*¹¹³ the Court gave effect to the facially unrestricted scope of the saving clause when it declined to impose any limitation on the saving clause beyond those that had Congress imposed

¹¹⁰ Brief at 25-26, n. 14.

¹¹¹ Brief at 20, n.10.

¹¹² Brief at 23.

¹¹³ *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 105 S.Ct. 238 (1985).

in the clause itself and in the “deemer clause” that modifies it.¹¹⁴ The brief argues that the power of the express terms in the saving clause is reinforced by the Court’s recent recognition that ERISA’s preemption provisions must be read against the presumption that Congress did not intend ERISA to supplant state law in areas that states have traditionally regulated. The brief notes that this presumption is “particularly strong” in the area of insurance regulation, given its inclusion in the saving clause.¹¹⁵

Second, the brief questions how Congress could have intended to preempt state laws that regulated insurance when it elected to save the same body of law. It argues that in the situation where Congress has saved state substantive law, “it is not clear why Congress would have wanted to foreclose all access to state-created remedies or sanctions to enforce that substantive law . . . especially where the causes of action provided under § 502 itself are not suited to that purpose.”¹¹⁶

By way of example, the brief points out that ERISA also saves “any generally applicable criminal law of a State,”¹¹⁷ and argues that this provision surely allows the State to bring a criminal prosecution, not merely to have its substantive law applied in a suit brought under ERISA.¹¹⁸

The Solicitor General acknowledges that the discussion in *Pilot Life* concerning the Congressional intent that ERISA’s civil enforcement remedies be exclusive was accurate with respect to rights guaranteed under ERISA. The brief suggests that, in light of the saving clause, the preemption inquiry should differ when the state-law cause of action or remedy regulates insurance.

¹¹⁴ Brief at 24, citing *Metropolitan Life*, 471 U.S. at 746, 105 S.Ct. at 2393

¹¹⁵ Brief at 24, 26 n. 14.

¹¹⁶ Brief at 23.

¹¹⁷ 29 U.S.C. § 1144(b)(4).

¹¹⁸ Brief at 23.

Third, the brief addresses the discussion of ERISA’s legislative history, which provides the primary support for the discussion in the second part of *Pilot Life*. The brief notes that the references in the legislative history of an intent to pattern suits under § 502(a) on suits brought under § 301 of the LMRA ignores a fundamental difference between the two statutes — the LMRA has no saving clause. Hence, it argues that, while § 301 “is no doubt highly instructive” in cases involving the scope of ERISA’s “relates to” preemption, Congress’s enactment of the saving clause “suggests that it did not intend the parallel between § 301 of the LMRA and § 502 of ERISA to be controlling where state law fell within the scope of the saving clause.”¹¹⁹

The Solicitor General’s view of ERISA’s legislative history is confirmed by an exhaustive study and analysis of that legislative history by Professor Donald T. Bogan, published in the *Tulane Law Review*.¹²⁰ Bogan demonstrates that when Congress enacted ERISA, its intent was to comprehensively reform the pension industry, which Congress had studied extensively for a decade before ERISA was passed. By contrast, there is no indication that Congress has studied or investigated non-pension benefit plans, or that it had any concern with the management of non-pension assets.¹²¹

Bogan concludes that Congress was simply not dealing with non-pension benefit plans when it enacted ERISA, and there is nothing in ERISA’s legislative history that suggests any Congressional intent to dominate the field of non-pension employee benefits.¹²² This view is

¹¹⁹ Brief at 25.

¹²⁰ Donald T. Bogan, *Protecting Patients’ Rights Despite ERISA: Will the Supreme Court Allow States to Regulate Managed Care?*, 74 *Tulane L. Rev.* 951 (2000).

¹²¹ Bogan, 74 *Tul. L. Rev.* at 976-977.

¹²² Bogan, 74 *Tul. L. Rev.* at 964-965.

confirmed by that lack of any substantive regulations of non-pension benefits within ERISA; rather, its comprehensive regulations all deal with pension benefits.¹²³

The National Association of Insurance Commissioners and the attorneys general for 25 states have recently filed briefs in the Supreme Court urging it to grant review in *Montemayor* and arguing the view of the saving clause advanced by the Solicitor General's amicus brief in *Ward*.¹²⁴

There are two additional reasons why ERISA does not preempt California's bad-faith remedy. First, the Supreme Court explained in *Travelers* that the basic thrust of ERISA's preemption clause was to "avoid a multiplicity of regulation in order to permit the nationally uniform administration of employee benefit plans."¹²⁵ But the Court has also repeatedly recognized that an "inevitable result" of Congress's decision to save state laws that regulate insurance is the creation of "disuniformities" for national plans that enter local markets to purchase insurance.¹²⁶ It therefore makes scant sense to subordinate the saving clause—which inherently creates disuniformity—to the remedies clause in the pursuit of a uniformity that Congress never intended.

Second, the Supreme Court has explained that ERISA's preemption clause must be viewed in light of the objectives of the ERISA statute as a guide to the scope of the state law that Congress understood would survive.¹²⁷ While much about ERISA is murky, Congress's intent that state insurance

¹²³ Bogan, 74 Tul. L. Rev. at 974-975.

¹²⁴ The amicus briefs filed by the NAIC and the attorneys general for 24 states, supporting the petition for certiorari filed by the State of Texas in *Montemayor* are attached to the concurrently filed request for judicial notice.

¹²⁵ *Travelers*, 514 U.S. at 656-657, 115 S.Ct. at 1677.

¹²⁶ *Ward*, 526 U.S. at 376 n.6, 119 S.Ct. at 1390 n.6, citing *Metropolitan Life*, 471 U.S. at 747, 105 S.Ct. at 2380.

¹²⁷ *Egelhoff v. Egelhoff*, ___ U.S. ___, 121 S.Ct. 1322, 1327 (2001).

law would survive is not — Congress expressly provided that state laws that regulated insurance were saved. The relevant rule of construction is therefore the most basic rule: “Congress says in a statute what it means and means in a statute what it says there.”¹²⁸

6. Reexamination of *Kanne* would avoid the injustice that occurs when ERISA preempts state-law claims without providing a remedy

One of the least satisfactory aspects of *Kanne*'s construction of ERISA is that it can result in injustice. This court's 1998 decision in *Bast v. Prudential Ins. Co. of America*¹²⁹ is illustrative:

We echo the words of Judge Porfilio of the Tenth Circuit:

‘Although moved by the tragic circumstances of this case and the seemingly needless loss of life that resulted, we conclude that the law gives us no choice but to affirm.’ . . . The Bast's state law claims are preempted by ERISA, and ERISA provides no remedy. Unfortunately, without action by Congress, there is nothing we can do to help the Basts and others who find themselves in this same unfortunate situation.”

The tragic circumstance in *Bast* was that Mrs. Bast's health insurer had refused to authorize treatment that she needed to fight her cancer. By the time the insurer reconsidered its denial her window of opportunity had closed; her cancer had metastasized; and she was no longer eligible for the treatment. Her health declined steadily, and she died.¹³⁰

¹²⁸ *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.* 530 U.S. 1, 6, 120 S.Ct. 1942, 1947 (2000)

¹²⁹ *Bast v. Prudential Ins. Co. of America*, 150 F.3d 1003, 1011 (9th Cir. 1998), cert. denied, 528 U.S. 870, 120 S.Ct. 170 (1999).

¹³⁰ *Bast*, 150 F.3d at 1006.

The unfortunate situation the court described was that under ERISA as construed by *Kanne*, all of the Basts' state-law claims against the insurer for bad-faith were held preempted, and ERISA itself provided no remedy. *Bast* noted that the Fifth, Sixth, and Tenth Circuits had "reached the same conclusion under equally tragic circumstances."¹³¹

While *Kanne's* reading of *Pilot Life* was not unreasonable, particularly given the Supreme Court's expansive view of ERISA preemption at the time, the Solicitor General's brief in *Ward* shows that it is no longer the only possible reading, or even the most reasonable one. This court is therefore free to, and should, reconsider *Kanne* in light of the new course the High Court has charted since *Kanne* was decided. ERISA need not be an instrument of injustice.

CONCLUSION

This court's lament in *Bast* that until Congress amends ERISA there is nothing it can do for ERISA's victims is unfounded. ERISA's structure is clear: the civil-remedies clause is subordinate to the saving clause, and Congress clearly provided that state laws that regulate insurance are saved. Nothing in ERISA's legislative history suggests that Congress ever intended bizarre result that a law could simultaneously be "saved" and preempted. The time has come to re-think *Kanne*. California's common-law tort of insurance

¹³¹ *Bast*, 150 F.3d at 1009.

bad faith regulates insurance, and is saved. The district court therefore erred in dismissing this case, and in denying Hower's motion to remand.

Dated: June 22, 2001.

Respectfully submitted,

SHERNOFF BIDART & DARRAS

William M. Shernoff

Michael J. Bidart

Jeffrey Isaac Ehrlich

By _____

Jeffrey Isaac Ehrlich

Attorneys for Appellant

Jeanette C. Hower

STATEMENT OF RELATED CASES

Appellant is unaware of any related cases within the meaning of Ninth Circuit Rule 28-2.6.

CERTIFICATE OF COMPLIANCE

I certify under Ninth Circuit Rule 32-1 that this brief complies with the type-volume limitation in Fed. R. App. P., Rule 32(a)(7), in that the brief uses a proportionally spaced 14-point Times New Roman font, and contains 10,348 words.

Jeffrey Isaac Ehrlich
Counsel for Appellant