Sheldon Eisenberg (SBN 100626)
Adam Thurston (SBN 162636)
Erin E. McCracken (SBN 244523)
Drinker Biddle & Reath LLP
1800 Century Park East, Suite 1400
Los Angeles, CA 90067-5717
Telephone: (310) 203-4000
Facsimile: (310) 229-1285
sheldon.eisenberg@dbr.com
adam.thurston@dbr.com
erin.mccracken@dbr.com

Attorneys for Defendant
CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF LOS ANGELES

ELMA SANCHEZ and HOLLY WEDDING, individually and on behalf of all others similarly situated,

Plaintiffs,

v.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM, and DOES 1 through 100, inclusive,

Defendants.

Case No. BC517444

NOTICE OF DEMURRER AND DEMURRER; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

Dept.: 308
Judge: Hon. Jane L. Johnson

Hearing Date: TBD
Hearing Time: TBD
Trial Date: Not Yet Set

Complaint Filed: August 6, 2013

TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD HEREIN:

PLEASE TAKE NOTICE that at a time and date to be determined by the Court, in Department 308 of this Court, located at 600 S. Commonwealth Avenue, Los Angeles, California 90005, before the Honorable Jane L. Johnson, Defendant California Public Employees' Retirement System ("CalPERS") will and hereby does demur to the first, second, third and fourth causes of action in the Complaint filed by Plaintiffs.

Dated: October 9, 2013

DRINKER BIDDLE & REATH LLP

By: _____
Sheldon Eisenberg
Adam Thurston
Erin McCracken

Attorneys for Defendant
California Public Employees' Retirement System

DEMURRER

CalPERS demurs to the Complaint on the following grounds:

DEMURRER TO FIRST CAUSE OF ACTION

The first cause of action for breach of contract fails to state a cause of action against CalPERS under California Code of Civil Procedure section 430.10(e) because the contract at issue explicitly allowed CalPERS to take the complained of actions that are the basis of Plaintiffs' claim.

DEMURRER TO SECOND CAUSE OF ACTION

The second cause of action for breach of the implied covenant of good faith and fair dealing fails to state a cause of action against CalPERS pursuant to California Code of Civil Procedure section 430.10(e) because a party cannot breach the implied covenant by taking action expressly permitted by the contract, and the Complaint shows that CalPERS took action expressly permitted by the contract at issue.

DEMURRER TO THIRD CAUSE OF ACTION

The third cause of action for rescission fails to state a cause of action against CalPERS pursuant to California Code of Civil Procedure section 430.10(e) because rescission is a remedy, not a cause of action, and even if it was a cause of action, CalPERS is absolutely immune from suit on Plaintiffs' fraud-based claim under California Government Code section 818.8.

DEMURRER TO FOURTH CAUSE OF ACTION

The fourth cause of action for declaratory and injunctive relief fails to state a valid cause of action against CalPERS pursuant to California Code of Civil Procedure section 430.10(e) because Plaintiffs have not (and cannot) state an underlying claim for relief against CalPERS.

This Demurrer is based upon the Notice, this Demurrer, the attached memorandum of points and authorities, the concurrently filed Appendix of Non-California Authorities, all pleadings currently on file in this matter, and upon such other documentary and oral evidence as may be presented at this time of this hearing.

Dated: October 9, 2013

DRINKER BIDDLE & REATH LLP

By: _____
Sheldon Eisenberg
Adam Thurston
Erin McCracken

Attorneys for Defendant
California Public Employees' Retirement System

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I.

SUMMARY OF ARGUMENT

Plaintiffs' putative class action against the California Public Employees' Retirement System ("CalPERS") challenges the propriety of announced rate increases on their long-term care ("LTC") coverage[1] ("LTC coverage") even though the rate increases are expressly permitted by the plain language of the coverage on which Plaintiffs' Complaint is based. Indeed, no breach of any specific provision of Plaintiffs' LTC coverage is even alleged in the Complaint.

Given CalPERS' clear contractual right to impose the complained of rate increases, Plaintiffs attempt to create claims where none exist based on implausible allegations that CalPERS intentionally underpriced its LTC coverage, underfunded the LTC program, willingly lost money on its investments for over a decade, and then wrongfully increased its premiums, all as it had supposedly planned to do from the start of the program. *Complaint*, ¶¶ 3-4. Even if these allegations were true (and they assuredly are not), and as unfortunate as the LTC rate increases may be, they are simply not legally actionable, nor limited to CalPERS. The fact is that LTC rate increases have occurred throughout the industry because LTC coverage is a relatively new product, the pricing for which has been "subject to considerable uncertainty."[2] In anticipation of the effects of such novelty and uncertainty, and as early as 1997, Consumer Reports had recommended that consumers be financially able to pay for premium increases of at least 50 percent on LTC coverage.[3]

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[1] Long-term care is a type of coverage developed to cover the costs of long-term care services, including services in an individual's home such as assistance with activities of daily living as well as care in a variety of facility and community settings.

[2] In *Rakes v. Life Investors Insurance Company of America*, 582 F.3d 886, 888 (8th Cir. 2009), the Eighth Circuit explained that LTC coverage "is a relatively new product. It has been available since the mid-1970s and experienced substantial growth in the 1990s. In 2003, the Kaiser Foundation published the report, 'Regulation of Private Long-Term Care Insurance: Implementation Experience and Key Issues.' The report described the pricing of LTC policies as 'subject to considerable uncertainty,' and it listed a number of variables—including lapse rates—that affect the reliability of premium calculations."

[3] *See* A. Kimberly Dayton, Julie Ann Graber, Robert A. Mead and Molly M. Wood, 3 Advising the Elderly Client § 24:8 50, Ability to Pay Premiums (June 2013) (citing the 1997 Consumer Reports study and stating: "Bottom line: A consumer should generally not buy long-term care insurance unless easily able to pay premiums out of available income.").

But regardless of the industry and broader economic reasons that exacerbated this situation after the Great Recession in 2008, Plaintiffs' allegations do not give rise to actionable claims, and CalPERS' demurrer to all of the causes of action in Plaintiffs' Complaint should be sustained. Plaintiffs' first cause of action for breach of contract fails as a matter of law because the LTC coverage explicitly allows CalPERS to increase premiums on an issue-age basis, which is what happened here. Plaintiffs' claim for breach of the implied covenant of good faith and fair dealing claim is also irremediably flawed because a party cannot breach the implied covenant by taking action expressly permitted by the contract. Plaintiffs' rescission claim, which is based on alleged misrepresentations, fails because, among other reasons, rescission is a remedy, not a cause of action, and even if it were, CalPERS has absolute immunity from misrepresentation claims under California Government Code section 818.8. Finally, Plaintiffs' claim for declaratory and injunctive relief necessarily fails because Plaintiffs have not (and cannot) state an underlying claim for relief against CalPERS.

II.

STATEMENT OF FACTS

A. The Parties

CalPERS, a unit of the California Government Operations Agency, was created by statute and provides retirement and health benefits to over a million members, including current California public employees, retirees and certain relatives. Cal. Gov. Code §§ 20000 *et seq.* In 1995, the California Legislature enacted the Public Employees' Long Term Care Act. *Id.* at §§ 21660 *et seq.* ("Long Term Care Act"). Under the Long Term Care Act, CalPERS provides a self-funded LTC program. *Id.* at § 21661. The CalPERS LTC program is the nation's only voluntary, self-funded, not-for-profit LTC program. Through 2007[4], CalPERS issued LTC coverage pursuant to eligibility and underwriting criteria established by the CalPERS Board. *Id.* CalPERS is not an insurance company, and its long-term care program is not subject to the California Insurance Code or California Department of Insurance regulations.

[4] The CalPERS LTC program will begin accepting applications again in December 2013. http://www.calpers.ca.gov/index.jsp?bc=/member/ltc/home.xml&pst=ACT&pca=ST

Plaintiffs Elma Sanchez ("Sanchez") and Holly Wedding ("Wedding") are two individuals who purchased LTC coverage from CalPERS.

B. The Long Term Care Coverage Offered By CalPERS Expressly Authorized Premium Increases

In 1995, CalPERS began offering and promoting the sale of LTC coverage to public employees and retired employees of the State of California, and certain of their relatives. *Complaint*, ¶ 1. CalPERS promised to provide LTC coverage in accordance with the terms of its agreements with Plaintiffs, which are explicitly set forth in the Evidence of Coverage ("EOC") attached to Plaintiffs' Complaint. *Complaint*, ¶ 63; Exhibit 1 (the "EOC").

The EOC provides, ***in three separate places***, that CalPERS may change premium rates on an issue-age basis. Page 2 of the EOC states: "Your premiums will never increase due solely to a change in Your age or health. ***CalPERS can, however, change Your premiums, but only if We change the premium schedule on an issue-age basis for all similar coverage issued in Your state on the same form as this coverage.***" (EOC, at 2) (emphasis added). Elsewhere, the EOC states: "***The premium rates shown in the Schedule of Benefits may be changed*** on the anniversary of Your Coverage Effective Date and on any premium due date thereafter. Any changes made will be on an issue age basis for all similar coverage issued in Your state on the same form as this coverage..." (*Id.* at 39) (emphasis added). And, again, the EOC states: "We will notify You of the right to reduce coverage if Your coverage is about to lapse ***and in the event that premiums are increased.***" (*Id.* at 52) (emphasis added).

C. Plaintiffs' Claims Are Based On CalPERS' Announced Increase In Premiums

Plaintiffs' claims are all grounded on their allegation that in February 2013, CalPERS advised Plaintiffs that its Board had voted to increase premiums by 5% immediately, 5% in 2014, and 85% in 2015. *Complaint*, ¶ 28. As Plaintiffs admit, the premium increases were done on an issue-age[5] basis and applied to all policyholders who purchased "LTC1" and "LTC2" coverage

[5] "Issue age" means that a covered individual's premiums are based on the individual's age at the time the covered individual purchases coverage.

issued from 1995-2004 with lifetime coverage and built-in inflation protection, lifetime coverage without inflation protection, and 3-year and 6-year coverage with inflation protection. *Id.* Plaintiffs do not identify any provision of the EOC that CalPERS has breached by raising premiums on an issue-age basis.

III.

ARGUMENT

A. A Demurrer Must Be Sustained Where A Complaint Fails To State Facts Sufficient To Constitute A Cause Of Action.

A demurrer tests the legal sufficiency of the entire complaint or a cause of action alleged therein at an early stage in the proceedings. *Johnson v. County of Los Angeles*, 143 Cal. App. 3d 298, 306 (1983); Cal. Civ. Proc. Code § 430.30(a). A demurrer must be sustained where a complaint fails to state facts sufficient to constitute a cause of action. Cal. Civ. Proc. Code § 430.10(e); *Johnson v. Superior Court*, 25 Cal. App. 4th 1564, 1567 (1994). In ruling on a demurrer, the court can consider the facts in the complaint and also facts contained in any exhibits attached to the complaint.[6] *Picton v. Anderson Union High Sch. Dist.*, 50 Cal. App. 4th 726, 730 (1996).

When a contract "is not reasonably susceptible to the meaning alleged in the complaint, it is proper to sustain a demurrer without leave to amend." *George v. Auto Club of S. Cal.*, 201 Cal. App. 4th 1112, 1128 (2011). *See also Hoffman v. Smithwoods RV Park, LLC*, 179 Cal. App. 4th 390, 401 (2009) ("[W]here the nature of the plaintiff's claim is clear, and under substantive law no liability exists, a court should deny leave to amend because no amendment could change the result.").

B. Plaintiffs' Breach Of Contract Claim Fails Because The EOC Explicitly Authorizes CalPERS To Increase Premiums On An Issue-Age Basis.

In Count I, Plaintiffs allege that CalPERS breached its contracts by "increasing premiums

[6] Plaintiffs have attached the CalPERS Long-Term Care Program Evidence of Coverage to their Complaint, and have alleged that it sets forth the terms of the parties' agreement. *Complaint*, ¶ 63.

in violation of the agreement." *Complaint*, ¶ 66. Yet, the EOC explicitly authorizes CalPERS to raise premiums on an issue-age basis, which is exactly what was done here. *Complaint*, ¶ 28; EOC at 2, 39, 52. Plaintiffs do not (and cannot) allege otherwise. Consequently, Plaintiffs' claim fails as a matter of law and should be dismissed without leave to amend.

It is well established that there is no breach of contract where the complained of act is explicitly permitted by the contract's terms. *See Carma Developers (Cal.), Inc. v. Marathon Development California, Inc.*, 2 Cal. 4th 342, 375 (1992) ("If defendants were given the right to do what they did by the express provisions of the contract there can be no breach."); *PMC, Inc. v. Porthole Yachts, Ltd.*, 65 Cal. App. 4th 882, 891 (1998) (same); Cal. Civ. Code § 1638 ("The language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity.").

Every court that has applied this well established principle to premium increases for long-term care coverage has held that an LTC provider does not breach a contract with the covered individual by raising premiums in accordance with the contract's terms. In *Flint v. Metlife Insurance Company of Connecticut,* Case 3:11-cv-00054-JGH, 2011 WL 1575364, at *2 (W.D. Ky. April 26, 2011), the district court dismissed plaintiff's breach of contract claim against a long-term care provider because "no breach of contract claim can be stated based on the premium rate increase. The Policy explicitly authorizes MetLife to raise premium rates on a class-wide basis. MetLife has not breached any contractual duty by raising premium rates on a class basis in accordance with DOI regulations." *See also Compton v. Aetna Life Insurance and Annuity Company*, 956 F.2d 256, 258 (11th Cir. 1992) (affirming dismissal of breach of contract claim where the insurance policy permitted the insurer to make premium rate changes effective on any premium due date); *Flint v. Metlife Ins. Co. Connecticut*, 460 Fed. Appx. 483 (6th Cir. Dec. 12, 2011) ("Flint cannot state a claim that MetLife breached its contract with him by seeking the rate increase, because the policy explicitly provided for premium rate increases."); *Thompson v. Community Insurance Co.*, 213 F.R.D. 284, 300 (S.D. Ohio 2002) (granting summary judgment for Anthem on a breach of contract claim because "Anthem could, pursuant to the terms of the Ohio Certificate, institute new premiums. It clearly could do so, as long as the requisite notice

was given.").

Here, Plaintiffs claim that CalPERS breached the EOC by "increasing premiums in violation of the agreement." *Complaint*, ¶ 66. But this allegation is directly contradicted by the express and unambiguous language of the EOC, which expressly authorizes—***in three different places***—CalPERS to change premium rates if it does so on an issue-age basis. As the EOC provides: "Your premiums will never increase due solely to a change in Your age or health. ***CalPERS can, however, change Your premiums, but only if We change the premium schedule on an issue-age basis for all similar coverage issued in Your state on the same form as this coverage***. We must give You at least 60 days written notice before We change Your premiums. The premium for any increases in coverage which You voluntarily elect will be based on Your age at the time You elect the increase." (EOC, at 2; *see also* EOC, at 39, providing, "***The premium rates shown in the Schedule of Benefits may be changed*** on the anniversary of Your Coverage Effective Date and on any premium due date thereafter. Any changes made will be on an issue age basis for all similar coverage issued in Your state on the same form as this coverage, and made by action of the CalPERS Board of Administration, according to the criteria they establish." (emphasis added); EOC, at 52, providing, "We will notify You of the right to reduce coverage if Your coverage is about to lapse ***and in the event that premiums are increased***." (emphasis added)).

The Complaint does not allege that CalPERS implemented premium increases on anything other than an issue-age basis, or that CalPERS failed to provide Plaintiffs with the requisite notice under the EOC before changing their premiums. Plaintiffs simply allege that CalPERS promised that rates "would never rise based on the consumer's age or health." *Complaint*, ¶ 1. Yet, Plaintiffs admit that the premium increases were not based on Plaintiffs' age or health but rather were done on an issue-age basis: "Commencing in approximately February 2013, Class members began receiving letters from CalPERS advising them that it had voted to increase premiums by another 5% immediately, 5% in 2014, and 85% in 2015. These increases ***applied to all policyholders who purchased LTC1 and LTC2 policies issued from 1995-2004*** with lifetime coverage and built-in inflation protection, as well as lifetime policies without inflation protection,

and 3-year and 6-year policies with inflation protection." *Complaint*, ¶ 28 (emphasis added). Accordingly, Plaintiffs' claim fails because the explicit terms of the EOC permit CalPERS to raise Plaintiffs' premiums on an issue-age basis.

Plaintiffs alternatively allege that CalPERS breached the EOC by increasing the premium rate for those Class members who elected to purchase the Inflation Protection Benefit. *Complaint*, ¶ 64("The EOC provided that CalPERS could not increase the premium rate ***as a result of*** the annual benefit increases afforded to those who elected to purchase the Inflation Protection Benefit.") (emphasis added). Plaintiffs do not allege, nor could they allege, that the premiums were increased ***as a result of*** "the annual benefit increases afforded to those who elected to purchase the Inflation Protection Benefit." Instead, Plaintiffs simply allege that the premiums increased as a result of CalPERS' desire to stabilize the $3.6 billion fund. *Complaint*, ¶ 30. Moreover, Plaintiffs' claim fails for the additional reason that Plaintiffs Sanchez and Wedding do not even allege that they purchased the Inflation Protection Benefit.

Because Plaintiffs have not alleged and cannot allege a breach of contract given the undisputed terms of the EOC, the First Cause of Action not only should be dismissed, but should be done so without leave to amend. *See Ratcliff Architects v. Vanit Constr. Mgmt., Inc.*, 88 Cal. App. 4th 595, 604 (2001) (leave to amend a breach of contract claim is properly denied where any amendment to the complaint would be futile because the terms of the contract, which are not subject to change, preclude plaintiff's claim).

C. Plaintiffs' Claim For Breach Of The Duty Of Good Faith And Fair Dealing Fails As A Matter Of Law.

1. Plaintiffs' Claim Fails Because The Alleged Breach Is Based On Conduct Explicitly Authorized By The EOC.

Plaintiffs' claim for breach of the duty of good faith and fair dealing (Count II) should also be dismissed because California law is clear that a breach of the implied covenant of good faith and fair dealing is not cognizable where the alleged breach is based on conduct that is explicitly permitted by the contract. *See Carma Developers*, 2 Cal. 4th at 374 (recognizing that the covenant does not "prohibit a party from doing that which is expressly permitted by an agreement. On the contrary, as a general matter, implied terms should never be read to vary

express terms."). *See also McClain v. Octagon Plaza, LLC*, 159 Cal. App. 4th 784, 805 (2008) (holding that because "the implied covenant operates to protect the express covenants or promises of [a] contract ... [it] cannot impose substantive duties or limits on the contracting parties beyond those incorporated in the specific terms of [the parties'] agreement."); *New Hampshire Ins. Co. v. Ridout Roofing Co.*, 68 Cal. App. 4th 495 (1998) (an express contractual term cannot be limited by the duty of good faith and fair dealing); *Everett v. State Farm General Ins. Co.*, 162 Cal. App. 4th 649, 663-64 (2008) (granting summary adjudication of a claim for breach of the covenant of good faith and fair dealing and stating, "[b]ecause there was no breach of contract, there was no breach of the implied covenant.").

In a case directly on point, *Alvarez v. Ins. Co. of N. Am.*, Case No. 2:06-cv-04326-SD (E.D. Pa. Nov. 21, 2006), the Pennsylvania district court dismissed a breach of the covenant of good faith and fair dealing claim that was nearly identical to the one Plaintiffs assert here. In that case, plaintiff Alvarez filed a putative class action on behalf of himself and other purchasers of long-term care coverage underwritten by the Insurance Company of North America ("INA"). Alvarez claimed that because his LTC coverage was guaranteed to be renewable, INA's subsequent increases of his premiums constituted a breach of the implied covenant of good faith and fair dealing. In rejecting that claim, the court began "by noting that INA's contractual right to raise the premium is clear" where the contract provided that premiums "will not increase unless the Company changes premiums on a class basis." Thus, "the unavoidable implication of that clause is that the Company can change premiums, so long as it does so for everyone in the class." Consequently, the court held: "It is obvious that INA cannot violate the implied covenant by exercising rights that are explicitly reserved to it by contract."

Here, the EOC states, in three places, that CalPERS ***can change premiums*** if it does so on an issue age basis for all similar coverage issued in a state. Consequently, Plaintiffs' claim for breach of the covenant of good faith and fair dealing must be dismissed without leave to amend. *See Carma Developers*, 2 Cal. 4th at 374 ("As to acts and conduct authorized by the express provisions of the contract, no covenant of good faith and fair dealing can be implied which forbids such acts and conduct. And if defendants were given the right to do what they did by the

express provisions of the contract there can be no breach."). *See also Storek & Storek, Inc. v. Citicorp Real Estate, Inc.*, 100 Cal. App. 4th 44, 56 (2002) ("Similarly, it has been held that the implied covenant of good faith and fair dealing does not impose an affirmative duty on a party to forbear from enforcing rights expressly given under the contract.").

2. Plaintiffs' Claim Fails For The Additional Reason That Plaintiffs Cannot Impose Extra-Contractual Duties On CalPERS.

Plaintiffs also allege that CalPERS breached the covenant of good faith and fair dealing by "fail[ing] to properly and adequately underwrite the policies," "fail[ing] to invest the premiums wisely and safely," "fail[ing] to conduct the necessary actuarial analysis that would have revealed the true costs for future benefits," "clos[ing] the program to new enrollments in 2009 . . . knowing full well that closing enrollment . . . would adversely affect the fund and benefits it had guaranteed Plaintiffs and the Class," and "ma[king] false promises of fixed premium rates." *Complaint*, ¶ 69(a)-(e). None of these purported duties arise from the plain terms of the EOC, and Plaintiffs do not allege otherwise. Rather, Plaintiffs specifically claim that these duties are imposed on CalPERS because of the "relationship contained in all insurance contracts." *Complaint,* ¶ 69. But because CalPERS is not an insurance company, their argument fails from the outset. *Cf. Kotlar v. Hartford Fire Ins. Co.*, 83 Cal. App. 4th 1116, 1119 (2000) (rejecting plaintiff's attempt to impose duties on defendant by analogy; since defendant was not an attorney, it was axiomatic that it did not owe plaintiff those duties imposed on attorneys).

Moreover, the law is clear that even insurance companies do not owe their insureds the alleged duties that form the basis of Plaintiffs' claim. Indeed, under California law, the duties an insurer owes to an insured ***consist only*** of the following: "an insurer must investigate claims thoroughly; it may not deny coverage based on either unduly restrictive policy interpretations or standards known to be improper; [and] it may not unreasonably delay in processing or paying claims." *Love v. Fire Ins. Exchange*, 221 Cal. App. 3d 1136, 1148 (1990).

For example, in *Tilbury Constructors, Inc. v. State Compensation Insurance Fund*, 137 Cal. App. 4th 466, 474 (2006), the California Court of Appeals held that the covenant of good faith and fair dealing does not "prevent the insurer from taking unreasonable actions that will

increase future premiums" if the increase is not "inextricably linked to the mishandling of claims." In that case, the court explained that an increase in insurance premiums, standing alone, does not "give[] rise to the tortious breach of the covenant of good faith and fair dealing." *Id.* at 480. Rather, it is only the underlying conduct that arises out of an insurance company's duty to defend, investigate and settle claims that gives rise to a breach of the covenant of good faith and fair dealing. *Id.*

Other courts agree. "The law does not allow the implied covenant of good faith and fair dealing to be an everflowing cornucopia of wished-for legal duties . . . ." *Comprehensive Care Corp. v. Rehabcare Corp.*, 98 F.3d 1063, 1066 (8th Cir. 1996). Thus, in *Alvarez v. Ins. Co. of N. Am.*, 313 Fed. Appx. 465, 468 (3d Cir. 2008), the Third Circuit held that a provider of LTC coverage "did not have any duty to disclose the possibility of future premium increases or the underlying actuarial assumptions for that possibility." Likewise, in *Rakes v. Life Investors Ins. Co. of Am.*, 582 F.3d 886, 895 (8th Cir. 2009), the Eighth Circuit explained: "Plaintiffs contend that Life Investors had a duty to disclose that its lapse rate assumptions were wrong and that rate increases were thus inevitable, but they have cited no law that requires an insurance company to disclose its actuarial assumptions to its policyholders . . . ."

Thus, CalPERS does not owe Plaintiffs the duties they allege not only because CalPERS is not an insurance company, but also because the extra-contractual duties alleged in the Complaint are not actionable where, as here, there is no alleged breach of a duty to investigate, process or pay claims on LTC coverage.[7] *See Love*, 221 Cal. App. 3d at 1148.

[7] Moreover, to the extent that Plaintiffs purport to base their breach of the implied covenant of good faith and fair dealing claim on pre-contractual actions (*e.g.*, CalPERS' alleged failure to adequately underwrite the LTC coverage or conduct the necessary actuarial analyses), their claim necessarily fails. *See Hess v. Transamerica Occidental Life Ins. Co.*, 190 Cal. App. 3d 941, 945 (1987) (dismissing plaintiffs' claim that defendant insurance company breached its duty of good faith and fair dealing by failing to adequately evaluate the health of applicants for insurance policies because an insured cannot base a claim for breach of the implied covenant on acts that occurred in pre-contract dealings.).

3. Plaintiffs' Bad Faith Claim Also Fails Because Plaintiffs Do Not Allege That CalPERS Has Denied Their Claims.

California courts have never held a bad faith claim to be cognizable based on the sale, renewal or pricing of LTC coverage, as Plaintiffs' Complaint purports to allege. Rather, it is well established that "the essence of the tort of the implied covenant of good faith and fair dealing is focused on the ***prompt payment of benefits due*** under the insurance policy; there is no cause of action for breach of the implied covenant of good faith and fair dealing when no benefits are due." *Progressive West Ins. Co. v. Yolo Cnty. Superior Court*, 135 Cal. App. 4th 263, 279 (2005) (emphasis added); *see also Brizuela v. Calfarm Ins. Co.*, 116 Cal. App. 4th 578, 592 (2004) ("The gravamen of a claim for the breach of the covenant of good faith and fair dealing, which sounds in both contract and tort, is the insurer's refusal, without proper cause, to compensate the insured for a loss covered by the policy."); *Rakes*, 582 F.3d at 895-96 ("We affirm the district court's dismissal of the plaintiffs' claim for tortious breach of the implied covenant of good faith and fair dealing (bad faith)" because "Plaintiffs have not made a claim for benefits under their policies, and we decline the invitation to extend Iowa law to fit their allegations.").

There is no suggestion in the Complaint that CalPERS failed to pay benefits. Plaintiffs' claim for breach of the implied covenant thus fails as a matter of law for the additional reason that it is not premised on the denial of any contractual rights due under the LTC coverage. Plaintiffs' claim should be dismissed without leave to amend.

D. Plaintiffs' Claim For Rescission Fails As A Matter Of Law.

1. There Is No Cognizable Claim For Rescission Under California Law.

Under California law, rescission is a remedy rather than a cause of action. *See Nakash v. Superior Court*, 196 Cal. App. 3d 59, 70 (1987) ("Rescission is not a cause of action; it is a remedy"); *Taguinod v. World Sav. Bank, FSB*, 755 F. Supp. 2d 1064, 1072 (C.D. Cal. 2010) (dismissing claim for rescission because "Plaintiffs' fourth cause of action seeks state law rescission upon the theory that Plaintiffs' agreement to the loan was 'induced by fraud and misrepresentation.' . . . Rescission is a remedy, not a cause of action."); *Shapouri v. CitiMortgage, Inc.*, 3:12-CV-1133, 2012 WL 5285910 at *5 (S.D. Cal. Oct. 22, 2012)

("rescission and injunctive relief are remedies, not causes of action."); *Ozuna v. Home Capital Funding*, No. 08–CV–2367–IEG (AJB), 2009 WL 4544131, at *11 (S.D.Cal. Dec.1, 2009) (holding that "rescission is not a cause of action, but a remedy" and dismissing rescission claim when no underlying cause of action was stated against the defendant); *Marcelos v. Dominguez*, No. C 08–00056 WHA, 2008 WL 1820683, at *11 (N.D. Cal. April 21, 2008) (dismissing claim for rescission and restitution on the ground that "it is not a claim for relief, but rather a remedy"). For this reason, Plaintiffs' purported claim for rescission (Count III) should be dismissed.

2. Even If Rescission Was A Separate Cause Of Action, CalPERS Is Absolutely Immune From Suit On A Fraud-Based Rescission Claim.

The gravamen of Plaintiffs' request for the remedy of rescission is that CalPERS "made material misrepresentations and concealed material facts from Plaintiffs and members of the Class which induced them to purchase" the LTC coverage. *Complaint*, ¶ 80. Thus, Plaintiffs' rescission claim is based on alleged misrepresentations and sounds in tort. As a result, it is barred by section 818.8 of the California Government Code, which provides public entities such as CalPERS absolute immunity from liability for negligent or intentional misrepresentation.

Section 818.8 of the Government Code provides: "A public entity is not liable for an injury caused by misrepresentation by an employee of the public entity, whether or not such misrepresentation be negligent or intentional." Cal. Gov't Code § 818.8. Under section 818.8, public entities have "***absolute immunity*** from liability for negligent or intentional misrepresentation." Cal. Law Revision Com., Comment, Deerings Ann. Gov. Code (1982 ed.) § 818.8, p. 174 (emphasis added); *Masters v. San Bernardino County Employees Retirement Assn.*, 32 Cal. App. 4th 30, 43 (1995) ("[T]he immunity of a public entity for misrepresentation by its employee, whether intentional or negligent, is absolute."); *Grenell v. City of Hermosa Beach*, 103 Cal. App. 3d 864, 873-74 (1980) ("The language of section 818.8 is . . . absolute . . .").

CalPERS is, by statute, a unit of the California Government Operations Agency, *see* Cal. Gov. Code §§ 20000 *et seq.*, and is thus a governmental entity that is absolutely immune from liability for alleged misrepresentations to Plaintiffs. *See Jopson v. Feather River Air Quality*

Mgmt. Dist., 108 Cal. App. 4th 496-97 (2003) (finding that the air quality management district was immune for its alleged misrepresentation regarding the miscalculation of emission reduction credits); *Grenell*, 103 Cal. App. 3d at 873-74 (holding that public entities are provided with "absolute immunity from liability for negligent or intentional misrepresentation" even where the misrepresentation "interferes with financial and commercial interest."); *Nuveen Mun. High Income Opportunity Fund v. City of Alameda, Cal.*, 11-17391, 2013 WL 5273097, --- F.3d ---, (9th Cir. Sept. 19, 2013) (affirming the district court's dismissal of investors' claims against the City of Alameda for misrepresentations about a telecom system's anticipated performance and the concomitant value of municipal bonds offered to finance the development of the system).

Although section 814 of the Government Code provides that the absolute immunity provided for in section 818.8 does not "affect[] liability based on contract," this rule does not apply here because the claimed basis for "rescission" is tortious. "Whether an action is based on contract or tort depends upon the nature of the right sued upon, not the form of the pleading or relief demanded. If based on breach of promise it is contractual; if based on breach of noncontractual duty, it is tortious." *Kangarlou v. Progressive Title Co., Inc.*, 128 Cal. App. 4th 1174, 1178–79 (2005).

In *Janis v. California State Lottery Commission*, 68 Cal. App. 4th 824, 831 (1998), the court found that Government Code section 818.8 barred a class action claim styled as a claim for rescission of contract against the State Lottery Commission because the claim was "based on tort rather than contract." In that case, plaintiffs alleged that the State Lottery Commission misrepresented the legality of Keno and sought the return of all funds they had wagered on the game. Plaintiffs' claim thus centered on the allegation that the State Lottery Commission "misled" Keno players and players relied on such misrepresentations in playing the game. The court dismissed the claim, holding that "[i]rrespective of how packaged in the complaint, this is a fraud claim, not a breach of contract claim." *Id.* at 830. *See also Kucharczyk v. Regents of the University of California*, 946 F. Supp. 1419, 1445 (N.D. Cal. 1996) (applying California law) (holding that where plaintiff sought rescission of contract and damages, his negligent misrepresentation claim was barred by Government Code section 818.8).

Here, Plaintiffs' so-called "rescission" claim is nothing more than a claim for fraudulent inducement seeking the remedy of rescission. Plaintiffs allege that CalPERS made misrepresentations that induced Plaintiffs to obtain the LTC coverage and if the "true facts had been disclosed to Plaintiffs," they would not have obtained the coverage. *Complaint*, ¶ 80. This is a tort claim. "An action premised on fraud in the inducement seeks to avoid the contract rather than to enforce it; the essential claim is 'I would not have entered into this contract had I known the truth.' The duty not to commit such fraud is precontractual; it is not an obligation undertaken by the entry into the contractual relationship." *Electronixs v. Heger Realty Corporation*, 64 Cal. App. 4th 698, 709-11 (1998).

As a result, the gravamen of Plaintiffs' claim sounds in tort and is barred by Government Code section 818.8. *See Janis*, 68 Cal. App. 4th at 831; *Kucharczyk*, 946 F. Supp. at 1445. *Cf. Lundeen Coatings Corp. v. Department of Water & Power*, 232 Cal. App. 3d 816, 832-33 (1991) (finding that a claim for misrepresentations allegedly causing a party to breach a contract was barred by Government Code section 818.8); *Burden v. County of Santa Clara*, 81 Cal. App. 4th 244, 251-52 (2000) (finding that plaintiff's claim that he was fraudulently induced to relocate his residence by false statements concerning an employment contract was barred by Government Code section 818.8 because even though the alleged misrepresentations concerned the terms of a contract, plaintiff's claim sounded in tort).

3. The California Insurance Code Does Not Apply To CalPERS.

Plaintiffs' purported claim for rescission fails to the extent that it is predicated on the California Insurance Code. Because CalPERS is not an insurance company, these provisions are inapplicable.

CalPERS is not an insurance company and is not subject to California Insurance Commission regulations. CalPERS is a governmental entity that manages pension and health benefits. CalPERS is also a qualified state plan that is regulated under federal law. *See* 26 U.S.C. 7702(B)(f)(2) (defining state long-term care plan). Because CalPERS is not an insurance company regulated under California state insurance law, the sections of the California Insurance Code on which Plaintiffs predicate their claim (California Insurance Code sections 331 *et seq.*) do

not apply here. *Cf. Hailey v. California Physicians' Service*, 158 Cal. App. 4th 452, 469-470 (2007) (finding that an Insurance Code section 332 claim against Blue Shield was not cognizable because Blue Shield is not an insurance company).

4. In Any Event, Plaintiffs Cannot Rescind The EOC Because They Cannot Return CalPERS To The Status Quo.

Plaintiffs' so-called rescission claim is also barred by Plaintiffs' failure to allege tender of the benefits they have received under their LTC coverage. Under California law, in addition to giving notice of rescission, a plaintiff seeking rescission must restore or tender restoration of everything of value that has been received under the contract. Cal. Civ. Code § 1691; *Kreisa v. Stoddard*, 127 Cal. App. 2d 627, 633 (1954) ("Since he neither restored to plaintiffs everything of value which he received from them under the contract, nor did he offer to do the same upon condition that plaintiffs do likewise, he could not bring himself within" section 1691). Indeed, rescission requires that both parties be restored to the status quo ante. *See Farina v. Bevilacqua*, 192 Cal. App. 2d 681, 684-85 (1961) ("[T]he general rule is that rescission cannot be had unless the party demanding it can and does restore the other party to status quo."); *Medina v. Safe-Guard Products*, 164 Cal. App. 4th 105, 112 n.8 (2008) ("Rescission requires an offer to *restore* benefits already received under the contract") (emphasis in original).

Although no California court has directly decided this issue, in *Medina*, the court explained that a class seeking rescission of insurance coverage "presents a number of thorny issues," and that a class member "could only fully restore [the insurance company] by paying the value of the coverage already received." *Medina*, 164 Cal. App. 4th at 112 n.8.

Here, Plaintiffs have not alleged that they have offered to restore CalPERS to the position it was in prior to contracting. Rather, they simply "demand that CalPERS restore to Plaintiffs and the other members of the class all of the money paid by Plaintiffs and the members of the Class plus interest at the maximum rate allowed by law." *Complaint,* ¶ 87. This, in and of itself, precludes their request for rescission.

In any event, Plaintiffs have received years of LTC coverage. If they were to restore CalPERS to the position it was in prior to contracting, Plaintiffs would be required to pay the

value of the coverage they already have received. *See* 1 Dan B. Dobbs, *Law of Remedies* § 4.8 (2d ed. 1993) ("Suppose the plaintiff has purchased insurance and paid premiums, then seeks restitution of the premiums because of a substantial breach by the insurer. If it is felt that the plaintiff was insured until the insurer's breach, the plaintiff has received something which he must restore if he is to get restitution of his premiums.). Because Plaintiffs have made no such offer, this is an additional reason why rescission is not an available remedy, much less a cause of action, in this case.

5. Plaintiffs' Alternative Mistake Of Fact Theory Also Fails.

Plaintiffs alternatively allege that their LTC contracts should be rescinded because they entered into the contracts as a result of an alleged unilateral mistake of fact "in that they thought that they were buying viable insurance which could legally ***deliver its promised benefits***." *Complaint*, ¶ 85 (emphasis added). But Plaintiffs have not alleged that they have made any claims under their LTC coverage for benefits and were denied such promised benefits. Consequently, Plaintiffs have not established through their allegations that their LTC coverage cannot legally deliver its promised benefits. Plaintiffs thus have not properly alleged an actionable unilateral mistake of fact.

In addition, even if Plaintiffs' allegation sufficiently stated a unilateral mistake of fact (which it does not), their claim would still fail as a matter of law. The only mistakes of fact that can justify rescission are those as to "a fact past or present," or "the present existence of a thing material to the contract, which does not exist, or in the past existence of such a thing, which has not existed." Cal. Civ. Code §§ 1689, 1577. A mistaken belief about a future occurrence will not suffice. *See Mosher v. Mayacamas Corp.*, 215 Cal. App. 3d 1, 5 (1989) (finding that a purchaser of real property could not rescind a sales contract on the basis of a unilateral mistake as to the valuation of the property and failure of consideration because the purchaser's predicament was the result of a changed economic situation, and noting that the "[a]doption of appellant's argument would expose virtually any unprofitable contract to legal attack upon the later occurrence of unforeseen adverse events."); *see also YTY Indus. SDN. BDH. v. Dow Chemical Co.*, No. 05-8881, 2009 WL 3633871, at *23 (C.D. Cal. Oct. 28, 2009) ("[T]he mistake that YTY

really complains of is that the business did not succeed . . . . [t]his, however, does not justify rescission").

Moreover, to warrant rescission, the mistake must concern an "objective, existing fact" rather than a subjective fact or opinion. *Hedging Concepts, Inc. v. First Alliance Mortgage Co.*, 41 Cal. App. 4th 1410, 1421 (1996). Indeed, "[t]he doctrine of mistake customarily involves such errors as the nature of the transaction, the identity of the parties, the identity of the things to which the contract relates, or the occurrence of collateral happenings." *Odorizzi v. Bloomfield Sch. Dist.*, 246 Cal. App. 2d 123, 130 (1966).

Here, Plaintiffs did not obtain the LTC coverage under any mistake of fact as to what was being provided by CalPERS. They, like the purchaser in *Mosher*, are only complaining about events that transpired long after the contracts' formation, and are thus unrelated to the issue of whether a valid contract was freely entered into between Plaintiffs and CalPERS. In addition, Plaintiffs' alleged mistake of fact—that "they thought that they were buying viable insurance which could legally deliver its promised benefits"—refers only to subjective opinions as to the quality of the LTC coverage that are not actionable as objective mistakes of fact. Consequently, Plaintiffs' request for rescission based on an alleged unilateral mistake of fact must be rejected.

E. Plaintiffs' Claim For Declaratory And Injunctive Relief Fails As A Matter of Law.

Plaintiffs' last purported cause of action for declaratory and injunctive relief (Count IV) fails because, as explained above, Plaintiffs have not (and cannot) state an underlying claim for relief against CalPERS.

Plaintiffs' declaratory judgment claim cannot survive demurrer for the same reasons that Plaintiffs' other claims must fail. *See Ratcliff Architects*, 88 Cal. App. 4th at 607 (where plaintiff had failed to state a claim sufficient to recover on any of its causes of action, its "claim for declaratory relief action must also fail as a matter of law.").

In addition, "[a]n action in declaratory relief will not lie to determine an issue which can be determined in the underlying . . . action." *Cal. Ins. Guarantee Ass'n v. Superior Court*, 231 Cal. App. 3d 1617, 1623 (1991). Thus, "[t]he declaratory relief statute should not be used for the purpose of anticipating and determining an issue which can be determined in the main action.

The object of the statute is to afford a new form of relief where needed and not to furnish a litigant with a second cause of action for determination of identical issues." *Id.* at 1624.

The issues presented by Plaintiffs' declaratory relief cause of action and the first, second and third causes of action in the Complaint are the same. All of these causes of action are based on CalPERS' allegedly wrongful act of increasing Plaintiffs' premiums and require "the determination of identical issues." *Cal Ins. Guarantee Ass'n*, 231 Cal. App. 3d at 1623. Accordingly, for this reason, too, Plaintiffs' cause of action for declaratory relief must be dismissed without leave to amend.

IV.

CONCLUSION

Regardless of Plaintiffs' erroneous speculation on the reason for the increases in LTC coverage premiums, the undeniable and indisputable fact is that CalPERS has the clear legal right to impose the complained of increases pursuant to the clear and prominent language of the contract on which Plaintiffs' claims are based.

For all of the foregoing reasons, CalPERS respectfully requests that the Court sustain the Demurrer as to the first, second, third and fourth causes of action asserted against CalPERS in Plaintiffs' Complaint without leave to amend.

Dated: October 9, 2013

DRINKER BIDDLE & REATH LLP

By: _____

Sheldon Eisenberg
Adam Thurston
Erin McCracken

Attorneys for Defendants
CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

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PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action. My business address is Drinker Biddle & Reath LLP, 1800 Century Park East, Suite 1400, Los Angeles, California 90067.

On **October 9, 2013**, I served the foregoing document described as: **NOTICE OF DEMURRER AND DEMURRER; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF** on the interested parties in this action by personally delivering the documents to the persons listed below:

[SEE ATTACHED SERVICE LIST]

____ **By PERSONAL SERVICE**

____ by personally delivering such envelope to the addressee.

____ by causing such envelope to be delivered by messenger to the office of the addressee.

__X__ **By UNITED STATES MAIL** (I am readily familiar with the firm's practice of collection and processing correspondence for mailing. Under that practice it would be deposited with U.S. Postal Service on that same day with postage thereon fully prepaid at Los Angeles, California 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.)

__X__ (State) I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Executed on **October 9, 2013**, at Los Angeles, California.

MARY T. AVILA
Name

Signature

SERVICE LIST

Attorneys for Plaintiffs and the Class

Michael J. Bidart
Gregory L. Bentley
Clare H. Lucich
SHERNOFF BIDART ECHEVERRIA BENTLEY LLP
600 South Indian Hill Boulevard
Claremont, California 91711
Telephone: (909) 621-4935
Facsimile: (909) 625-6915
Email: mbidart@shernoff.com; gbentley@shernoff.com; clucich@shernoff.com

Gretchen M. Nelson
Stuart R. Fraenkel
KREINDLER & KREINDLER LLP
707 Wilshire Boulevard, Suite 3600
Los Angeles, CA 90017
Telephone: (213) 622-6469
Facsimile: (213) 622-6019