Tab 3

The Securitization of Surplus Notes by Property and Casualty Insurers: Empirical Evidence

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Abstract

Surplus notes have been utilized by insurers for decades, although large insurers dominated in this market long ago. Lately popular securitization deals revive surplus notes as an efficient financing device for small and mid-sized insurers to tap capital markets at a reasonable cost. This paper intends to fill in the gap never touched by the prior studies by investigating what factors determine the insurers' decisions to securitize their surplus notes and what are the underlying rationales of surplus notes securitization. After implementing several models on censoring data, our results show that insurers' size, organization form, and risk-based capital position significantly affect the participation decision made by insurers to securitize surplus notes, while the size and organization form impact the volume decision in a different way from they do the participation decision. In addition, the rating agency's ratings significantly affect both participation and volume decisions. Overall, our results suggest that deductions of financial distress costs and agency costs are important incentives for insurers to securitize their assets/liabilities.

Keywords: surplus notes, hybrid capital, insurance company, securitization

JEL Classification: G22, G32

1. Introduction

One important trend occurred recently in insurance industry is the convergence of insurance markets and financial markets by securitization. Several studies (Doherty, 1997; Doherty and Schlesinger, 2002; Cummins, Lalonde, and Philips, 2004; Cowley and Cummins, 2005; Iacobucci and Winter, 2005) have intended to analyze the economics of innovations regarding catastrophic risk (CAT) securitization, assets-backed securitization (ABS), and XXX reserve securitization by life insurers.

Since the year of 2002, securitization of surplus notes has sparked resurgence in the issuance of these hybrid notes by insurers. As unsecured indenture deeply subordinated to policyholder claims and other indebtedness, surplus notes have been widely used by insurers for several decades. However, based on a study by A.M. Best in 2003 (A.M. Best, 2003), issuers of surplus notes with large face amount and long maturity in 1990's were usually biggest insurers that had more access to capital markets, while small or mid-size insurers could only issue surplus notes in relatively small denomination and short maturity. At the same time, surplus notes are not regarded as an effective financing device to raise capital for small or mid-sized insurers, who traditionally lack channels to capital markets. With the inception of the first insurance collateralized debt obligation (CDO), the securitized interest in the pool of collaterals such as bonds and loans in 2002, the securitization of surplus notes receives warm welcome in small and mid-sized insurers as they obtain a sesame door to capital markets at reasonable costs. According to Fitch Ratings' survey (Fitch Ratings, 2005), thirteen insurance CDO offerings with $3.76 billion assets had been completed from December

2002 to December 2004, of which surplus notes and trust preferred securities account for 30% and 70%, respectively.

Dumm and Hoyt (1999) provide the first empirical study about surplus notes issuance by life insurers during 1992 to 1995, but this unique hybrid security receives little attention in the academia under the background of securitization. Therefore, the reasons for insurers' renewed interest in issuing surplus notes are unclear based upon both scholarly research and industry reports. Under the assumptions of perfectly efficient capital markets, securitization of surplus notes would not add insurers' value and therefore insurers should have no incentives to securitize. Nevertheless, if any assumption underlying perfect markets is violated in the reality, insurers are willing to securitize driven by friction reduction and utility maximization. Several hypotheses have been proposed by researchers (Doherty, 1997; Doherty and Schlesinger, 2002; Cummins, Lalonde, and Philips, 2004; Cowley and Cummins, 2005; Iacobucci and Winter, 2005) about incentives of securitization by insurers and other financial institutes. They argue that in the presence of bankruptcy costs, information asymmetry, agency costs, and regulation costs, securitization may help insurers mitigate these costs and add some value to firms. Empirical studies on hybrid securities in the banking industry deliver supports to these hypotheses to some extents, and they find that banks use securitization generally to mitigate tax burdens (Engel, Erickson, and Maydew, 1999), financial distress costs (Benston, Irvine, Rosenfeld and Sinkey, 2003; Harvey, Collins, and Wansley, 2003; Sironi, 2003), and regulatory scrutiny (LaCour-Little, and Sander, 2004).

The increasing popularity of surplus notes securitization over last four years prompt us to explore the logic behind the phenomenon and examine the above hypotheses for the insurer universe. Hence, the significant relation between surplus notes securitization and firm characteristics related to financial distress costs, information asymmetry, agency costs, and regulatory costs, will illustrate how the surplus notes securitization is motivated. However, little work has been done on how surplus notes securitization is driven by firm characteristics, especially for property-casualty (P-C) insurers, although P-C insurers issued 75% total assets of insurance CDOs from December 2002 to June 2004 (Fitch Ratings, 2005). Therefore, P-C insurers provide a good arena to study factors driving securitization of surplus notes.

In this paper, we examine the characteristics of insurers that lead to activity in the issuance of securitized surplus notes issues. The purpose of this study is to investigate what factors determine insurers' decision to participate in securitization of surplus notes, and furthermore, how these factors affect issuers' decision - how much surplus notes they should issue in the pool. Following Cummins, Philips, and Smith's (2001) study on derivative usage by insurers, we distinguish the participation and volume decision in the securitization of surplus notes issuance. Moreover, our study will shed some lights on the economic rationale of surplus notes securitization by insurers. Using a sample of 1686 P-C insurers consisting of 45 surplus notes issuers and 1641 non-issuers in insurance CDO deals during year 2003, we empirically test the effects of firm characteristics, including size, financial strength rating, organization form, leverage, and risk-based capitalization, on the insurers' decisions to engage in surplus notes securitization.

Our results indicate that insurers with larger size, weaker risk-based capital position, and mutual insurers are more likely to issue surplus notes. On the other hand, we find that smaller insurers, stock insurers, group affiliated insurers, and insures with marginal A.M. Best's ratings issue more surplus notes after deciding to issue. Overall, our results provide strong support to the financial distress hypothesis, and marginal support to the agency costs and asymmetric information hypotheses. Our analysis has important implication for how regulators should regulate the issuance of surplus notes and how rating agencies control credit risk of issuers by insurer's characteristics such as size and organization form.

The rest of paper is organized as follows. In part 2, we introduce the background about securitization of surplus notes and review the previous research on the surplus notes issuance. We disclose the potential determinants of securitized surplus notes issuance in part 3. We then describe our data and methodology in part 4. Empirical results are presented in the part 5, and we conclude in part 6.

2. Background and Literature Review

2.1. Standalone Surplus Notes Issues

Surplus notes are unsecured debt obligation issued directly by insurance operating companies and thereby provide double advantages to issuers: the interest payments are tax deductible as surplus notes are reported as debt on a GAAP basis, and at the same time, they are treated as statutory surplus by state regulator and included in the calculation of total adjusted capital (TAC) of RBC ratio by NAIC. Regulators usually treat surplus notes as statutory capital on the basis of not only its deep subordination and unsecured, but also regulator's control on payments to surplus notes. Under the most restrictive condition, some state regulators (e.g. New York and California) require approval for any interest payment and principal repayment of surplus notes before insurers want to do so[1]. As a less rigid form, some state regulators (e.g. New Jersey) permit pre-approval for interest and principal payments on case that insurers have met some explicit requirements[2]. Because of the equity-like nature of surplus notes, the disapproval of interest or principal payments on both two types of surplus notes by regulators is not regarded as default, and interest is cumulative and payable once obtaining approval.

Despite some dividing opinions regarding pre-approval surplus notes between regulators[3], major rating agencies view both types as equity as long as they meet certain criterion on maturity, subordination, and payment restriction. For instance, A.M. Best requires equity-like surplus notes: (1) have a stated maturity of 10 to 30 years; (2) subordinate to policyholders, claimants, beneficiary claims and other classes of creditors; (3) any interest and principal payment is subject to approval of state regulators. Similarly, S&P's considers long maturity (at least 10 years) and structure (subordination and no ongoing payments leading to bankruptcy) to be two basic requisites of equity treatment for surplus notes. On the other hand, to address the hybrid nature of surplus notes, rating agencies only taking account certain percentage of surplus notes in calculating financial ratios. Based on the A.M. Best's continuum, surplus notes usually receive 25% to 50% equity credit of their face amounts. The major three rating agencies (S&P's, Moody's, and Fitch) do not explicitly indicate the amount of equity credit

[1] Despite no specific guideline or interpretation regarding how state regulators determine the payment approval, it is widely held that the insurers' own financial conditions are the underlying bottom line for decision.
[2] Most common requirements include: (1) insurers has not defaulted any claim or indebtedness; (2) no federal or state agency has filed any action (e.g. rehabilitation, liquidation, conservation, or dissolution) on insurers; (3) insurers' RBC ratio must exceed the minimum level after principal repayments.
[3] In December 2003, a NAIC subcommittee tentatively voted that the second form of surplus notes should be accounted for as liability as a result of its pre-approval feature and nominal requirements. However, this decision is never finalized since then.

surplus notes will receive, but they publicly provide their own debt-equity continuum or equity credit list as a reference.

Historically, surplus notes were mainly issued by troubled insurers to policyholders for additional surplus since they usually had no other access to capital. Crippled by their limited access to capital markets, mutual insurers also used surplus notes to relieve the sole dependence on retained earnings to grow their statutory equity. In addition, insurers directed their proceeds from surplus notes towards mitigating operating leverage pressures, retaining additional profitable business in lieu of quota share participations from their reinsurers, funding acquisitions, and refinancing more expensive debt that may not receive equity-like treatment from the rating agencies.

In 1990's, large insurers such as Prudential, MetLife, and New York Life dominated the surplus notes issuance market (Dumm and Hoyt, 1999), as scale of economy made them more efficient to finance externally. Unfortunately, the trickle down effect originating from this large company syndrome became tenuous for small and mid-sized insurers because the hurdles of traditional financing still plagued with the rise of surplus notes. From the issuer's view, fees paid to investment bankers and rating agencies[4] made the costs of standalone debt issuance in small size unaffordable. Vicissitudes of debt markets also made pricing of individual issuance very difficult. From the investor's perspective, surplus notes tend to be rather illiquid instruments due to the absence of an exchange listing and private placement to institutional investors. Therefore, investments on surplus notes issued by small and mid-sized insurers without proven track records were confined to the most sophisticated investors.

[4] A large proportion of small and mid-sized insurers do not obtain public ratings from major rating agencies, so investors usually require rating before the issuance. Furthermore, unfavorable rating change may deteriorate the insurers' financing burden.

Tab 4

STATE OF MICHIGAN

COURT OF APPEALS

In the Matter of CADILLAC INSURANCE COMPANY In Liquidation.

JENNIFER GRANHOLM, Attorney General of the State of Michigan, ex rel FRANK M. FITZGERALD, Commissioner of Insurance of the State of Michigan,

Petitioner-Appellee,

and

CALIFORNIA INSURANCE GUARANTEE ASSOCIATION; and MICHIGAN PROPERTY & CASUALTY GUARANTEE ASSOCIATION,

Appellees,

v

CADILLAC INSURANCE COMPANY, a Michigan Corporation,

Respondent,

and

EMS ENTERPRISES, INC; ERNEST SOLOMON; PRICE BROTHERS COMPANY; GRIFFIN PIPE PRODUCTS COMPANY; and J. WEBB, INC.,

Respondents-Appellants.

UNPUBLISHED
April 29, 2003

No. 234945
Ingham Circuit Court
LC No. 89-064126-CK

In re CADILLAC INSURANCE COMPANY In Liquidation.

JENNIFER GRANHOLM, Attorney General of the State of Michigan, ex rel FRANK M. FITZGERALD, Commissioner of Insurance of the State of Michigan,

Petitioner-Appellee,

v

No. 237336
Ingham Circuit Court
LC No. 89-064126-CK

CADILLAC INSURANCE COMPANY, a Michigan Corporation,

Respondent,

and

EMS ENTERPRISES, INC; and ERNEST SOLOMON,

Respondents-Appellants.

Before: Donofrio, P.J., and Markey and Murray, JJ.

PER CURIAM.

In Docket No. 234945, respondents, EMS Enterprises, Inc., Ernest Solomon, Price Brothers Company, Griffin Pipe Products Company, and J. Webb, Inc., appeal as of right an opinion and order granting a petition authorizing the processing of insurance claims. In Docket No. 237336, respondents,[1] EMS Enterprises, Inc., and Ernest Solomon, appeal as of right an order approving the associated proposed claims adjudication procedures.

This case arises out of the insolvency of the former Cadillac Insurance Company (Cadillac). Ernest M. Solomon solely owned EMS Enterprises, Inc., which in turn entirely owned Cadillac. Cadillac conducted business in several states including Michigan, Arizona, California, and Mississippi at the time of the insolvency. Conservatorship proceedings

[1] We will use the word "respondents" throughout this opinion to refer to both sets of respondents simply for ease and clarity, despite the fact that the parties constituting respondents in each of the cases are not identical.

commenced in 1989, and the receivership was required to marshal Cadillac's assets, continue operations, and pay appropriate claims pursuant to the then in effect Chapter 78.[2] After a liquidation order was entered, the receiver sent notice of Cadillac's liquidation and proof of claim forms to "all insureds and other persons known or reasonably expected to have or be interested in claims against the Cadillac estate."

The receiver "maintained regular and consistent contact" with guaranty associations including, the California Insurance Guarantee Association (CIGA), the Mississippi Insurance Guaranty Association (MIGA), and the Arizona Property and Casualty Insurance Guaranty Association (APCIGA) (collectively the "CAM Associations") beginning in early 1990 at the inception of the insolvency proceedings. The contacts included conversations concerning the status and amount of ongoing claims paid by the guaranty funds on behalf of the Cadillac estate. Years later, on June 17, 1998, the receiver filed a petition for an order authorizing the receiver to accept for processing the claims of CIGA, MIGA, and APCIGF. The receiver further sought an order declaring that the claims of CIGA, MIGA, and APCIGF were not barred as untimely. The circuit court held that the CAM Associations need not have filed any proof of claim in order to be reimbursed by the receiver. The appeal in docket no. 234945 followed. Subsequently, the circuit court approved the claims adjudication procedures. The appeal in docket no. 237336 followed. As it relates to the CAM Associations and covered claims, the issues in both appeals are the same or equally resolved in the opinion of this Court. With respect to late filed non-covered claims, the issue of timely proof of loss is dealt with separately.

On appeal, respondents argue that the CAM Associations did not file timely claims to Cadillac's assets during the liquidation proceedings, and therefore, dispute the distribution of Cadillac's assets. Respondents further argue that the circuit court erred when it approved the associated proposed adjudication procedures claiming Chapter 78's language bars untimely claims, the deadline was binding, and that assignees and subrogees are subject to the same filing requirements.

Questions of law are reviewed de novo on appeal. *Universal Underwriters Ins Co v Kneeland*, 464 Mich 491, 496; 528 NW2d 491 (2001). This Court reviews de novo the trial court's interpretation of a statute, which constitutes a question of law. *Rickwalt v Richfield Lakes Corp*, 246 Mich App 450, 468; 633 NW2d 418 (2001); *Saginaw Co v John Sexton Corp of Michigan*, 232 Mich App 202, 214; 591 NW2d 52 (1998). Furthermore, the circuit court's decisions on the motions below effectively constituted a decision on cross-motions for summary disposition in the case. Thus, this Court reviews a trial court's grant or denial of a motion for summary disposition de novo. *Spiek v Dep't of Transportation*, 456 Mich 331, 337; 572 NW2d 201 (1998).

The distribution of assets of an insolvent insurance company is controlled by statute. When Cadillac began the liquidation process in 1989, the statute in effect was Chapter 78 of the Insurance Code, MCL 500.7800 through MCL 500.7868. As noted above, Chapter 78 was

[2] Chapter 78 was repealed by 1989 PA 302 and required receiverships initiated after January 1, 1990 to commence under the newly enacted Chapter 81. MCL 500.8101. We note that MCL 500.8101(4) specifically directs that proceedings commenced prior to January 1, 1990 "shall be conducted pursuant to former Chapter 78." MCL 500.8101(4).

repealed by PA 1989, No. 302, § 2, effective immediately on January 3, 1990, and was replaced with Chapter 81 of the Insurance Code, MCL 500.8101 *et seq.*[3] Accordingly, the circuit court has applied, and we will review the issue under the former Chapter 78 of the Insurance Code. MCL 500.8101(4).

The primary goal of judicial interpretation of statutes is to ascertain and give effect to the intent of the Legislature. *Frankenmuth Mut Ins Co v Marlette Homes, Inc*, 456 Mich 511, 515; 573 NW2d 611 (1998). The first criterion in determining intent is the specific language of the statute. *In re MCI Telecommunications Complaint*, 460 Mich 396, 411; 596 NW2d 164 (1999). The fair and natural import of the terms employed, in view of the subject matter of the law, should govern. *In re Wirsing*, 456 Mich 467, 474; 573 NW2d 51 (1998). The Legislature is presumed to have intended the meaning it plainly expressed. *Nation v WDE Electric Co*, 454 Mich 489, 494; 563 NW2d 233 (1997). Courts may not speculate as to the probable intent of the Legislature beyond the language expressed in the statute. *Cherry Growers, Inc v Michigan Processing Apple Growers, Inc*, 240 Mich App 153, 173; 610 NW2d 613 (2000). If the plain and ordinary meaning of the language is clear, judicial construction is normally neither necessary nor permitted. *Sun Valley Foods Co v Ward*, 460 Mich 230, 236; 596 NW2d 119 (1999); *Toth v AutoAlliance International (On Remand)*, 246 Mich App 732, 737; 635 NW2d 62 (2001).

Specifically regarding insurance laws in Michigan, "[t]he Michigan Insurance Code was enacted for the benefit of the public and the insurance laws should be liberally construed in favor of policy holders, creditors and the public." *Murphy v Seed-Roberts Agency, Inc*, 79 Mich App 1, 9; 261 NW2d 198 (1977) citing *Dearborn National Ins Co v Comm'r of Ins*, 329 Mich 107, 118, 44 NW2d 892 (1950); *Comm'r of Ins v American Life Ins Co*, 290 Mich 33, 43-44, 287 NW 368 (1939). As recently as 1998, this Court has followed this longstanding principle when construing insurance laws and policies. *Depyper v Safeco Ins Co of America*, 232 Mich App 433, 441; 591 NW2d 344 (1998).

In order to transact business in the state of Michigan at the time of this case, insurers were statutorily required to be members of the Michigan Property and Casualty Guaranty Association (the association). MCL 500.7911; *Satellite Bowl v MPCGA*, 165 Mich App 768, 771; 419 NW2d 460 (1988).

At the heart of both cases on appeal is respondents argument that the CAM Associations were required, under Chapter 78 of the Insurance Code, specifically MCL 500.7842(1), to file a proof of claim form in addition to those claim forms filed by assigned claimants in order to be reimbursed for amounts they spent on covered claims on behalf of the receiver. We find that the plain language of Chapter 78 is contrary to this assertion.

The applicable statutes demonstrate no requirement of guaranty associations to file any proof of claim to protect their reimbursement rights. It is true that MCL 500.7842(1) does require claimants to file claims "on or before the last date fixed for the filing of claims in the domiciliary proceedings" and it is undisputed that the CAM Associations did not file separate or

[3] P.A. 1989, No. 302, § 3, provides in regard to the replacement provisions, "[t]his amendatory act shall take immediate effect, and was approved January 2, 1990 and filed January 3, 1990."

"blanket" proof of claim forms. However, respondents ignore the interplay of the language of MCL 500.7842(1) with other relevant statutes.

The interaction of the relevant statutes reveals that guaranty associations are statutorily assigned the rights of the timely-filed claimants whose claims it thereafter adjusted. In other words, guaranty associations actually stand in the shoes of those individual covered claimants pursuant to MCL 500.7935(2). It clearly states, that:

> *An insured or claimant* entitled to the benefits of this chapter *shall be considered to have assigned to the association*, to the extent of any payment received from the association, *his or her rights against the estate of the insolvent insurer, rights under the policy under which his or her claim arose, and any other rights the insured or claimant may have against another person for payment of the covered claim paid by the association.* MCL 500.7935(2). [Emphasis added.]

By definition, a "covered claim" is a claim that is filed in a timely manner pursuant to MCL 500.7925. Therefore, by operation of MCL 500.7842(1), MCL 500.7925, MCL 500.7935(2), each individual claimant whose claims the CAM Associations paid had filed a timely proof of claim form, and thus the associations succeed to the rights of the underlying individual covered claimant, including the right to recover from the receivership estate. Hence, the CAM Associations need not re-file individual proof of claims forms or "blanket" proof of claim forms.

Moreover, respondents argument that MCL 500.7935 does not support the court's result because it does not provide for the assignment of any rights to out-of-state guaranty associations is error. Clearly, respondent has ignored the plain language of MCL 500.7832 and MCL 500.7837 that together specifically describe and provide for the approval and payment of covered claims, and related expenses incurred by the receiver or ancillary receiver in this state or another.

Respondent also argues that the circuit court erred when it retroactively applied Chapter 81 to this case when Chapter 78 governs the case at bar. As stated above, by operation of MCL 500.8101(4), Chapter 81 does not apply to this case. However, our reading of the circuit court's opinion and order does not support respondents' contention. We find that although the trial court did make a reference to Chapter 81 in the order, the reference was cursory and the trial court in its analysis actually applied Chapter 78. Due to the marginal extent the lower court applied Chapter 81, it is insignificant and does not change the result of this case.

By application of the interaction of the relevant statutes in this case, the circuit court erred in part when it approved the proposed claims adjudication procedures. The circuit court correctly applied Chapter 78 of the Insurance Code and did not deviate from the statutory guidelines concerning covered claims through the CAM Associations. However, respondents correctly point out the limitation of MCL 500.7842(1) as that statute is applied to late filed non-covered claims. Covered claims as defined in MCL 500.7925 do not include claims presented to the receiver after the last date fixed for the filing of claims. MCL 500.7925(1)(c). Therefore, the specific portion of the trial court's order that approves the claims adjudication procedures regarding late non-covered claims violates MCL 500.7342(1) and is vacated. The remaining portion of the order approving the procedures for covered claims is affirmed.

Affirmed in part, vacated in part. We do not retain jurisdiction.

/s/ Pat M. Donofrio
/s/ Jane E. Markey
/s/ Christopher M. Murray

Tab 5

C
Only the Westlaw citation is currently available.

United States District Court,
E.D. Michigan,
Southern Division.
GROEB FARMS, INC., a Michigan corporation,
Plaintiff,
v.
ALFRED L. WOLFF, INC., a Delaware corporation,
Defendant.

No. 08-CV-14624.
Feb. 27, 2009.

West KeySummary**Sales 343 ⚷411**

343 Sales
343VIII Remedies of Buyer
343VIII(C) Actions for Breach of Contract
343k410 Pleading
343k411 k. Declaration, Complaint, or Petition. Most Cited Cases

The buyer pled sufficient facts in order to survive a motion to dismiss its breach of contract claim. The parties entered into a contract whereby the seller would ship honey from a specific country to the buyer. The contract stated that the seller was not responsible for shipments that were prevented from entering the country. One such order was not allowed into the country because it originated from a country different from the one that was specified in the contract.

Martin G. Lozier, Aymond, Lozier, Jackson, MI, for Plaintiff.

Barry B. Sutton, Harvey Kruse, Troy, MI, Tracy A. Hannan, Wildman, Harrold, Chicago, IL, for Defendant.

OPINION AND ORDER GRANTING IN PART AND DENYING IN PART DEFENDANT'S MOTION TO DISMISS PLAINTIFF'S COMPLAINT PURSUANT TO FED. R. CIV. P. 12(b)(6)

PAUL D. BORMAN, District Judge.

*1 Now before the Court is defendant Alfred L. Wolf, Inc.'s ("Defendant") November 14, 2008 Motion to Dismiss plaintiff Groeb Farms, Inc.'s ("Plaintiff") Complaint pursuant to Federal Rule of Civil Procedure 12(b)(6). (Dkt. No. 4). A hearing on this matter was held on February 5, 2009. For the following reasons, the Court GRANTS IN PART and DENIES IN PART Defendant's Motion to Dismiss Plaintiff's Complaint pursuant to Rule 12(b)(6).

I. BACKGROUND

This action arises from Plaintiff's allegations that Defendant breached contracts for the sale and delivery of honey.

Plaintiff is a Michigan corporation with its principal place of business in Onsted, Michigan. (Compl.¶ 1). Defendant is a Delaware corporation with its principal place of business in Chicago, Illinois. (*Id.* ¶ 2).

On or about, September 19, 2005, Defendant entered into a sales contract ("Sales Order 770-1") with Plaintiff, whereby Defendant agreed to ship 2,045,980 pounds of honey originating from Korea to Onsted, Michigan-17 FCL February delivery, 17 FCL March delivery, and 16 FCL April 2006 delivery. (*Id.*, Ex. A). Under the heading Delivery Terms, Sales Order 770-1 provides: "free delivered Onsted, duty paid, customs cleared, FDA released." (*Id.*) In addition, the bottom of the contract contains the following language:

> IN EVENT OF FDA/USDA/CUSTOMS REJECTION OR NON-SHIPMENT BY ORIGINAL VENDOR OF ALL OR PART OF GOODS REPRESENTED IN THIS SALE, SELLER DOES NOT GUARANTEE REPLACEMENT. DUE TO UNPREDICTABILITY OF USA IMPORT REGULATIONS AND COUNTRY OF ORIGIN EXPORT REGULATIONS, AND REMOTENESS OF SOURCE, SELLER DOES NOT GUARANTEE TOTAL FULFILMENT OF THIS ORDER-DELIVERIES ARE GUARANTEED FOR PRICE & QUANTITY BUT PRECISE WEEKS OR MONTHS OF DELIVERY CANNOT BE GUARANTEED. WE INTEND TO DELIVER ACCORDING TO THE PROJECTED DELIVERY PERIODS INDICATED IN THIS CONTRACT BUT WE WILL EXTEND DELIVERY IF CIRCUMSTANCES BEYOND OUR CONTROL

OCCUR WITHOUT LIABILITY ON PART OF ALFRED L. WOLFF INC. FOR ANY REASONABLE DELAYS.

(*Id.*)

On March 14, 2008, Defendant entered into another contract ("Sales Contract 1205") with Plaintiff, whereby Defendant agreed to ship 1,466,074 pounds of honey originating from India to Jacksonville-35 FCL in May 2008 plus or minus 1 month. (*Id.*, Ex. A). The delivery terms are: "ex Rail Jacksonville/FL: Customs cleared and FDA released." Like Sales Order 770-1, Sales Contract 1205 contains, which provides:

IN EVENT OF FDA/USDA REJECTION OR NON-SHIPMENT BY ORIGINAL VENDOR OF ALL OR PART OF GOODS REPRESENTED IN THIS SALES, SELLER'S DUTY TO FULFILL THIS ORDER IS VOIDED. DUE TO UNPREDICTABILITY OF USA/IMPORT REGULATIONS AND COUNTRY OF ORIGIN EXPORT REGULATION AND REMOTENESS OF SOURCE. SELLER HAS NO OBLIGATION TO FULFILL THIS ORDER. DELIVERIES ARE GUARANTEED FOR PRICE & QUANTITY BUT PRECISE WEEKS OR MONTHS OF DELIVERY CANNOT BE GUARANTEED. WE INTEND TO DELIVER ACCORDING TO THE PROJECTED DELIVERY PERIODS INDICATED IN THIS CONTRACT BUT WE WILL EXTEND OR SHORTEN DELIVERY DATES IF CIRCUMSTANCES BEYOND OUR CONTROL OCCUR WITHOUT LIABILITY ON PART OF ALFRED L. WOLFF, INC FOR ANY REASONABLE DELAYS. ILLINOIS STATE LAW APPLIES.

***2** (*Id.*)

Plaintiff contends that Defendant did not deliver the types of honey listed in Sales Order 770-1 or Sales Contract 1205 (collectively the "Contracts") or even make substitute performance or a partial delivery. (*Id.* ¶ 10). Plaintiff alleges, upon information and belief, the Department of Homeland Security refused to allow the type of honey which Defendant was importing into the United States to be delivered to Plaintiff because it was Chinese honey and therefore was subject to anti-dumping duties/tariffs. (*Id.* ¶ 50). The total value of the non-delivered shipments was $2,857,609.88. (*Id.* ¶ 63).

On September 5, 2008, Plaintiff filed an action in the Lenawee County Circuit Court alleging breach of contract, fraud and misrepresentation, innocent misrepresentation, breach of express and implied warranties, promissory estoppel, specific performance, breach of contract-UCC, breach of contract-right to set off, breach of duty of good faith, and action for accounting. Defendant removed the case to this Court on October 31, 2008.

Defendant now moves this Court to dismiss Plaintiff's claims by asserting that Plaintiff has failed to state a claim upon which relief can be granted.

II. ANALYSIS

A. Standard of Review

Federal Rule of Civil Procedure 12(b)(6) provides for the dismissal of a case where the complaint fails to state a claim upon which relief can be granted. When reviewing a motion to dismiss under Rule 12(b)(6), a court must "construe the complaint in the light most favorable to the plaintiff, accept its allegations as true, and draw all reasonable inferences in favor of the plaintiff." *DirectTV, Inc. v. Treesh,* 487 F.3d 471, 476 (6th Cir.2007). But the court "need not accept as true legal conclusions or unwarranted factual inferences." *Id.* (quoting *Gregory v. Shelby County,* 220 F.3d 433, 446 (6th Cir.2000)). "[L]egal conclusions masquerading as factual allegations will not suffice." *Eidson v. State of Term. Dep't of Children's Servs.,* 510 F.3d 631, 634 (6th Cir.2007).

To survive a motion to dismiss, the "[f]actual allegations contained in [the] complaint must 'raise a right to relief above the speculative level.' " *Bassett v. Nat'l Collegiate Athletic Ass'n,* 528 F.3d 426, 430 (6th Cir.2008) (quoting *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 127 S.Ct. 1955, 1965, 167 L.Ed.2d 929 (2007)). This "does not 'require heightened fact pleading of specifics, but only enough facts to state a claim to relief that is plausible on its face.' " *Id.* (quoting *Twombly,* 127 S.Ct. at 1974). A plaintiff's factual allegations, while "assumed to be true, must do more than create speculation or suspicion of a legally cognizable cause of action; they must show *entitlement* to relief." *LULAC v. Bredesen,* 500 F.3d 523, 527 (6th Cir.2007) (citing *Twombly,* 127 S.Ct. at 1965). Thus, "[t]o state a valid claim, a complaint must contain either direct or inferential allegations respecting all the material elements to sustain recovery under some viable legal theory." Bredesen, 500 F.3d at 527 (citing *Twombly*, 127 S.Ct. at 1969).

B. Choice of Law

*3 Sales Contract 1205 expressly provides that Illinois law applies. Sales Contract 770-1 has no such choice of law provision. The parties agree that to the extent that any other state law applies, Michigan law would govern because laintiff's principal place of business is in Michigan and the place of delivery for Sales Contract 770-1 was in Michigan. Because the laws of Michigan and Illinois do not greatly diverge as to the issues presented in this case, the Court examines Defendant's Motion under the common legal framework from both states.

C. Breach of Contract (Counts I, VII, and VIII)

Plaintiff alleges three separate breach of contract causes of action: "Breach of Contract" as Count II; "Breach of Contract-UCC" as Count VII and "Breach of Contract-Right to Set Off" as Count VIII. It is undisputed by both parties that the Contracts involve the sale of goods and that the applicable provisions of the Michigan and Illinois Uniform Commercial Code ("UCC") apply. Because all three counts allege breach of contract and are based on the same underlying set of facts, i.e., the sale of goods, the Court construes the counts together as one breach of contract claim under the UCC.

To state a breach of contract claim against Defendant, Plaintiff must allege: (1) the existence of a contract between the parties, (2) the terms of the contract require performance of certain actions, (3) Defendant breached the contract, and (4) the breach caused the Plaintiff an injury. *See, e.g., Servpro Indus. v. Schmidt*, 905 F.Supp. 475, 479 (N.D.Ill.1994) (interpreting Illinois law); *Webster v. Edward D. Jones & Co., L.P.*, 197 F.3d 815, 819 (6th Cir.1999) (interpreting Michigan law). Thus, in order to survive a Rule 12(b)(6) motion to dismiss for failure to state a claim, a plaintiff must allege facts sufficient to establish the elements listed above.

Defendant argues that Plaintiff cannot satisfy the elements of a breach of contract claim because its allegations demonstrate that Defendant did not breach the Contracts. That is, defendant contends that under the Contracts, Defendant is not responsible for non-delivery, when, as alleged here, the goods are rejected by U.S. Customers, USDA, or FDA. Plaintiff, on the other hand, argues that its allegation regarding the denial by U.S. Customs does not defeat its breach of contract claim because: (1) the allegation is an inconsistent and alternative pleading permitted by Federal Rule of Civil Procedure 8; and (2) its Complaint nevertheless sufficiently points to a breach under the Contracts.

A party may allege *factually* inconsistent theories of recovery. *Henry v. Daytop Village*, 42 F.3d 89 (2d Cir.1994) ("[A] party may properly submit a case on alternative theories. The inconsistency may lie either in the statement of the facts or in the legal theories adopted ....") (internal quotations omitted) (citations omitted). This rule is subject to one caveat-the pleading must abide by Federal Rule of Civil Procedure 11's mandate that "the factual contentions [contained within the pleading] ... will likely have evidentiary support after a reasonable opportunity for further investigation or discovery." Thus, "a pleader may assert contradictory statements of fact only when legitimately in doubt about the facts in question." *Am. Int'l Adjustment Co. v. Galvin*, 86 F.3d 1455, 1461 (7th Cir.1996). Still, a party may plead itself out of court if the party pleads facts which show that it has no claim. *See, e.g., Wilson v. O'Brien*, No. 07 C 3994, 2007 U.S. Dist. LEXIS 91555, at *5 (N.D.Ill.Dec.13, 2007) ("[I]f a plaintiff alleges facts within a complaint that defeat an essential element of a claim, the complaint can be dismissed under Rule 12(b)(6).").

*4 In the present action, under Count I Breach of Contract, Plaintiff alleges that Defendant "breached the Contract[s] by failing to deliver the types of honey as promised." (Compl.¶ 10). Then, under Count VII Breach of Contract, Plaintiff alleges that the "the Department of Homeland Security refused to allow the type of honey which [Defendant] was importing into the United States to be delivered to [Plaintiff] because it was Chinese honey and therefore was subject to the anti-dumping duties/tariffs." (Compl.¶ 50).

Plaintiff's Complaint could be read as pleading factually inconsistent theories of recovery in Counts I and VII. It also could be read as simply providing detail in Count VII as as to why Defendant failed to deliver the types of honey as promised as it generally alleged in Count I. This distinction is immaterial, though, as Plaintiff's breach of contract claim survives under either interpretation.

First, the Contracts provide that "IN THE EVENT OF FDA/USDA/CUSTOMS REJECTION ... OF ALL OR PART OF THE GOODS *REPRESENTED IN THIS SALE,"* Defendant does not guarantee replacement (Sales Contract 770-1) or Defendant's duty to fulfill the order is voided (Sales Contract 1205). (Compl.Ex. A). Since Plaintiff alleges that the Department of Homeland Security rejected the honey because it was from China-not from Korea or India as represented in the Contracts-Plaintiff has adequately alleged a breach of contract action against Defendant. That is, Plaintiff alleges that Defendant breached the Contracts by shipping Chinese honey, which ultimately resulted in the shipments being refused by the Department of Homeland Security and not being received by Plaintiff.

Second, as Plaintiff highlights in its Response, both Contracts provide that "DUE TO UNPREDICTABILITY OF USA IMPORT REGULATIONS ... [DEFENDANT] DOES NOT GUARANTEE TOTAL FULFILLMENT OF THIS ORDER-DELIVERIES ARE GUARANTEED FOR PRICE & QUANTITY BUT PRECISE WEEKS OR MONTHS OF DELIVERY CANNOT BE GUARANTEED." (Compl.Ex. A). The Contracts appear to state that even when a shipment is seized, delivery is still guaranteed but a precise date of delivery is not. At the very least, the Contracts are ambiguous on their face and should be construed against the drafter-Defendant. *See* Ladd v. Teichman, 359 Mich. 587, 103 N.W.2d 338 (1960). Contrary to Defendant's assertion, Plaintiff's only alleged basis for breach of the Contracts is not Defendant's failure to *timely* delivery the honey or to provide replacement. Plaintiff clearly alleges that Defendant "breached the Contract[s] by failing to deliver the types of honey as promised and likewise failed to cure its default." (Compl.¶ 10).

Accordingly, construing the Complaint in the light most favorable to Plaintiff and accepting its allegations as true, the Court denies Defendant's Motion to Dismiss Plaintiff's breach of contract claim (Count I, VII, and VIII).

D. Misrepresentation: Counts II and III

Under Counts II and III of its Complaint, Plaintiff asserts claims of fraud and misrepresentation and negligent misrepresentation.

1. Legal Bar to Claims

***5** Defendant asserts that the economic loss doctrine bars Plaintiff from asserting tort causes of action arising from Plaintiff's Contracts with Defendants. Thus, the Court looks to Michigan and Illinois common law to determine whether the economic loss doctrine is a bar to Plaintiff's fraud claims.

The economic loss doctrine arose as a means to separate actions arising in tort from those arising in contract. Simply stated, the economic loss doctrine provides that where a plaintiff's damages are purely economic in nature, the plaintiff cannot maintain a tort claim based on breach of contract facts. *Neibarger v. Universal Coops., Inc.,* 439 Mich. 512, 520, 486 N.W.2d 612 (1992) (" 'Where a purchaser's expectations in a sale are frustrated because the product he bought is not working properly, his remedy is said to be in contract alone, for he has suffered only 'economic' losses.' "); *Moorman Mfg. Co. v. Nat'l Tank Co.,* 91 Ill.2d 69, 81, 435, 61 Ill.Dec. 746, 435 N.E.2d 443 (Ill.1982). Both Michigan and Illinois courts, however, recognize an exception to the economic loss doctrine for fraud in the inducement. *See, e.g., Huron Tool & Eng'g Co. v. Precision Consulting Servs., Inc.,* 209 Mich.App. 365, 368, 532 N.W.2d 541 (1995); *BP Amoco Chem. v. Flint Hills Res., LLC,* 489 F.Supp. 853 (N.D.Ill.2007) (interpreting Illinois law).

As to Plaintiff's negligent misrepresentation claim, Michigan does not recognize such an exception to the economic loss doctrine, but Illinois does. *BP Amoco,* 489 F.Supp. at 858. "With regard to that exception, the Illinois Supreme Court ... held that the alleged misrepresentation must involve a duty that arose outside of the terms of the contract, such as the duty between a lawyer and a client." *Id.* In this case, Plaintiff has not alleged any misrepresentation that was extraneous to the contract. Therefore, the distinction between Michigan law and Illinois law as to this issue is of no consequence. Accordingly, Plaintiff's negligent misrepresentation claim is barred by the economic loss doctrine.

In an attempt to save its fraudulent misrepresentation claim from the economic loss doctrine, Plaintiff asserts that his Complaint sets forth an action for fraud in the inducement. "Fraud in the inducement presents a special situation where parties to a contract appear to negotiate freely-which normally would constitute grounds for invoking the economic loss doctrine-but where in fact the ability of one party to negotiate fair terms and make an informed decision is undermined by the other party's fraudulent behavior." *Id.* at 858 (quoting Huron Tool, 209 Mich.App. at 372-73, 532 N.W.2d 541).

The allegations in support of Plaintiff's fraud claim may fairly be read as supporting a claim of fraud in the inducement. On the one hand, defendant's alleged representation that it would deliver a certain quality and country of origin is merely a promise of future action and therefore cannot support a fraud claim. *See BP Amoco,* 489 F.Supp.2d at 858 (citing *Cont'l* Bank, N.A. v. Meyer, 10 F.3d 1293, 1298-99). But, on the other hand, Defendant's alleged representation that it could deliver honey of a certain country of origin is not a promise of future action and instead can be construed as a representation of present or past facts-i.e., that Defendant is then capable of obtaining Indian and Korean honey for delivery. Hence, Defendant's alleged misrepresentations do not merely "concern the quality and characteristics of" the honey to be supplied by it, *Huron Tool & Eng'g,* 532 N.W.2d at 546, but rather have the independent harm of potentially inducing Plaintiff to enter into a contract with a party that knowingly and intentionally made a promise it could not keep.

2. Sufficiency of the Pleadings

***6** Even though Plaintiff's fraudulent misrepresentation claim is not legally barred under the economic loss doctrine, the Court nevertheless finds that it was not pled with requisite particularity under the Federal Rules of Civil Procedure.

The special pleading rules contained in Federal Rule of Civil Procedure 9(b) require that to survive a motion to dismiss, the plaintiff state "with particularity the circumstances constituting fraud or mistake." Under Rule 9(b), a plaintiff "at a minimum, must 'allege the time, place, and content of the alleged misrepresentation on which [the plaintiff] relied; the fraudulent scheme; the fraudulent intent of the defendants; and the injury resulting from the fraud.' " *United States ex rel. Marlar v. BWXT Y-12, L.L.C.,* 525 F.3d 439, 444 (6th Cir.2008).

Here, Plaintiff merely alleges that "[*i*]*n connection with* the sales of honey and in order to induce Plaintiff to enter into the Contracts ... [Defendant] made representations regarding facts which were material to the Contract[s], including but not limited to, a representation that [Defendant] could and would deliver honey of a certain quality and country of origin." (Compl.¶ 13) (emphasis added). While the Complaint alleges sufficient facts as to Plaintiff's alleged representation regarding whether Defendant would deliver the honey of certain quality and country of origin,[FN1] as set forth above, a promise of future action cannot support a fraud claim. As to Defendant's alleged representation that he could deliver honey of certain country of origin, Plaintiff has not pled sufficient facts outside of the contract to overcome the heightened pleading standards in Rule 9(b). Plaintiff has not alleged any specific facts regarding when that representation was made; by whom it was made; or where it was made. While paragraphs forty-nine through fifty-one [FN2] provide further detail on Defendant's failure to deliver the honey contemplated in the Contracts, those paragraphs do not elaborate on Defendant's alleged representation that it had the capability to delivery Korean and Indian honey. Those paragraphs only state that Defendant attempted to deliver Chinese honey in satisfaction of its obligations under the Contracts.

FN1. Plaintiff attached the Contracts to its Complaint, which were incorporated into its breach of contract claim, which was incorporated by reference into its fraud claim. (Compl.¶¶ 9, 12). The Contracts clearly set forth the particular origin and quantity of the honey to be delivered by Defendant and provide detail as to the time and place of the representations.

FN2. Paragraphs fifty and fifty-one begin with "[u]pon information and belief." (Compl.¶¶ 50, 51). Generally, "allegations based on information and belief fail to satisfy the particularity requirement of Rule 9(b). However, an exception to this rule exists for matters that are peculiarly within the knowledge of the opposing party." *In re Consumers Power Co. Sec. Litig.,* 105 F.R.D. 583, 591 (E.D.Mich.1985). In addition, paragraphs forty-nine through fifty-one are not specifically incorporated into Plaintiff's fraud claim because the claim only incorporates those paragraphs preceding the claim and

> those paragraphs come after the claim. Nonetheless, the Court construes the Complaint in the light most favorable to Plaintiff and, therefore, incorporates those later factual allegations into its fraud claim.

Accordingly, even construing the Complaint in the light most favorable to Plaintiff and accepting its allegations as true, the Court grants Defendant's Motion to Dismiss Plaintiff's misrepresentation claims (Counts II and III).

E. Breach of Express and Implied Warranties: Count IV

Plaintiff also asserts a claim for breach of express and implied warranties based on Defendant's failure to deliver the honey under the Contracts. Even construing the Complaint in the light most favorable to the Plaintiff, the Court finds that Plaintiff has failed to state a claim for breach of express and implied warranties under Count IV.

Pursuant to section 2-725 of the UCC (as codified in MCL § 440.2725 and 810 ILCS 5/2-725(2)), "[a] breach of warranty occurs when tender of delivery is made ...." "Tender of delivery requires that the seller put and hold conforming goods at the buyer's disposition and give the buyer any notification reasonably necessary to enable him to take delivery." MCL § 440.2503(1); 810 ILCS 5/2-503(1).

*7 Plaintiff has not alleged that Defendant tendered delivery or even alleged facts that the Court could construe as a tender of delivery. In fact, Plaintiff seems to allege the exact opposite under Count IV-Defendant attempted to deliver non-conforming goods. (Compl.¶ 29). Accordingly, the Court dismisses Plaintiff's breach of express and implied warranties under Count IV.

F. Promissory Estoppel: Count V

Defendant asks this Court to dismiss Plaintiff's promissory estoppel claim because Plaintiff's Complaint acknowledges the existence of a valid contract. Plaintiff contends that its promissory estoppel claim is an alternative theory of liability allowed under Federal Rule of Civil Procedure 8.

Michigan and Illinois courts do not allow the equitable action of promissory estoppel where the plaintiff includes allegations of the existence of an express contract in its prayer for relief. *See, e .g.,* *Advanced Plastics Corp. v. White Consol. Indus.,* 828 F.Supp. 484, 491 (E.D.Mich.1993) (citing *Campbell v. Troy,* 42 Mich.App. 534, 537, 202 N.W.2d 547, (1972)); *Sharrow Group v. Zausa Dev. Corp.,* 2004 U.S. Dist. LEXIS 24997, at *9 (N.D.Ill.Dec. 3, 2004). "This is because promissory estoppel is an alternative theory of recovery where no contract exists; and, thus, it is a substitute for consideration." *Advanced Plastics,* 828 F.Supp. at 491 (citations omitted).

Here, neither party disputes that there was a valid, binding contract between the parties. Plaintiff, however, argues that it was merely pleading an inconsistent claim in the alternative, as allowed under the federal rules. *See* Fed.R.Civ.P. 8(e)(2) ("A party may set forth two or more statements of a claim or defense alternately or hypothetically, either in one count or defense or in separate counts or defenses."). While it is true that Plaintiff may plead breach of contract in one count and promissory estoppel in another, it may not allege the existence of an express contract in its claim for promissory estoppel. Under paragraph thirty-four of Plaintiff's Complaint, Plaintiff specifically incorporates it prior allegations of express and valid contracts into its promissory estoppel claim. (Compl.¶¶ 34, 8). In addition, dismissal of Plaintiff's promissory estoppel on "this basis is especially appropriate where [, as here,] the plaintiff has attached the relevant contracts to the complaint." *Sharrow Group,* 2004 U.S. Dist. LEXIS 24997, at *10.

G. Specific Performance: Count VI

Plaintiff seeks specific performance based upon Defendant's alleged breaches of the Contracts. Plaintiff alleges that it has no adequate remedy at law because it cannot purchase the subject honey at such prices and in such quantities given the nature of the market.

Specific performance is an equitable remedy that may be awarded where the legal remedy of damages is impracticable. *See* *John O. Schofield, Inc. v. Nikkel,* 314 Ill.App.3d 771, 784, 247 Ill.Dec. 142, 731 N.E.2d 915, 925 (2000); *Ruegsegger v. Bangor Twp. Relief Drain,* 127 Mich.App. 28, 31, 338 N.W.2d 410 (1983). Under section 2-716 of the UCC (as codified in M.C.L. § 440.2716(1) and 810 I.L.C. S. 5/2-716(1)), specific performance is granted where the goods are unique or in other proper circumstances. The commentary to MCL § 440.2716(1) and 810

ILCS 5/2-716(1) explains that uniqueness may arise from market conditions:

> *8 Specific performance is no longer limited to goods which are already specific or ascertained at the time of contracting. The test of uniqueness under this section must be made in terms of the total situation which characterizes the contract. Output and requirements contracts involving a particular or peculiarly available source or market present today the typical commercial specific performance situation, as contrasted with contracts for the sale of heirlooms or priceless works of art which were usually involved in the older cases. However, uniqueness is not the sole basis of the remedy under this section for the relief may also be granted "in other proper circumstances" and inability to cover is strong evidence of "other proper circumstances"

Plaintiff has stated a claim for specific performance. Defendant contends that it cannot purchase this type of honey at the prices and quantities demanded under the Contracts. Essentially, Defendant alleges that it is unable to cover. As set forth above, a claimant's inability to cover may justify a decree of specific performance.

While courts do not grant specific performance where the defendant simply cannot perform, *Soloman v. W. Hills Dev. Co.,* 110 Mich.App. 257, 261, 312 N.W.2d 428 (1981) (rejecting claim for specific performance for delivery of land where subject land had been sold to a third party); *Geist v. Lehman,* 19 Ill.App.3d 557, 563-64, 312 N.E.2d 42 (1974) (explaining rule that specific performance is not available where the subject property has been destroyed), this does appear to be case in the present action. As alleged, Plaintiff ordered Korean and Indian honey. Instead of attempting to import Korean or Indian honey into the United States, Defendant allegedly imported Chinese honey. As a result, the U.S. Department of Homeland Security refused to allow the honey into the United States because it was subject to anti-dumping duties. Therefore, Defendant perhaps could have performed the Contracts by attempting to import Korean and Indian honey rather than Chinese honey.

H. Breach of Duty of Good Faith: Count IX

Plaintiff submits that Defendant breached its duty of good faith [FN3] imposed by UCC 1-203. *See* M.C.L. § 440.1203; 810 I.L.C. S. 5/1-203. That section provides: "Every contract or duty within this act imposes an obligation of good faith in its performance or enforcement." M.C.L. § 440.1203.

> FN3. " 'Good faith' means honesty in fact in the conduct or transaction concerned. MCL § 440.1201(19).

As set forth by Defendant, both Michigan and Illinois law do not recognize an independent cause of action for breach of the duty of good faith. *See Burton v. William Beaumont Hospital,* 373 F.Supp.2d 707, 718 (E.D.Mich.2005) ("Michigan does not ... recognize a claim for breach of an implied covenant of good faith and fair dealing separate from an action on the underlying contract.") (citing *Belle Isle Grill Corp. v. City of Detroit,* 256 Mich.App. 463, 666 N.W.2d 271 (2003)); *Voyles v. Sandia Mortgage Corp.,* 196 Ill.2d 288, 295, 256 Ill.Dec. 289, 751 N.E.2d 1126, 1131 (Ill.2001) (explaining that the breach of the covenant of good faith and fair dealing is not an independent cause of action under Illinois law, except in the narrow context of an insurer's failure to settle a claim).

*9 Defendant argues that a cause of action for the breach of the duty of good faith exists where, as here, a party to a contract makes its performance a matter of its own discretion. Plaintiff cites *Gernhardt v. Winnebago Indus.,* No. 03-73917, 2003 U.S. Dist. LEXIS 25747 (E.D.Mich. Dec. 30, 2003) (interpreting Michigan law) and *Greer Props., Inc. v. LaSalle Nat. Bank,* 874 F.2d 457 (7th Cir.1989) (interpreting Illinois law).

In *Gernhardt,* this Court first held that M.C.L. § 440.1203 "does not serve to create an independent cause of action for failure to perform or enforce in good faith." 2003 U.S. Dist. LEXIS 25747, at *16 (citing UCC Comment to § 1-203). This Court, quoting the Michigan Court of Appeals, then went on to hold that "[a] cause of action for breach of the duty of good faith does exist, however, 'where a party to a contract makes the manner of its performance a matter of its own discretion.' " *Id.* (quoting *Ferrell v. Tanny Int'l, Inc.,* 137 Mich.App. 238, 243, 357 N.W.2d 669 (1984)).[FN4] *Ferrell,* though, dealt with whether the plaintiff adequately pled a violation of the duty of good faith as a breach of contract, not as an independent claim for relief as Plaintiff would like the Court to believe. Thus, as set forth above, a breach of the duty of good faith is not an independent claim for relief under Michigan law.

FN4. Ultimately, this Court went on to find that the situation described in *Ferrell* did not apply to the facts of that case. *Gernhardt,* 2003 U.S. Dist. LEXIS 25747, at *16

In *Greer Properties,* the Seventh Circuit found that under Illinois law, where a contract provides discretion on behalf of one of the parties to the contract, an abuse of that discretion-i.e., a breach of the duty of good faith-can only give rise to a breach of contract claim. *Greer Props.,* Inc. 874 F.2d at 460-61 ("If discretion is exercised in bad faith, a breach of contract occurs and the court must grant relief to the aggrieved party."). Therefore, similar to Michigan, under Illinois law, a breach of the duty of good faith is not an independent claim for relief.

Thus, because Plaintiff asserts a separate cause of action for a breach of the duty of good faith instead of as an element of its breach of contract claim, the Court dismisses Count IX of the Complaint.

I. Action for Accounting: Count X

Lastly, Plaintiff seeks an accounting of the transactions at issue to determine what honey, if any, was purchased by Defendant, where the honey currently is being stored, and the amount of honey Defendant has in its possession.

"An equitable accounting is an adjustment of the accounts of the parties and a rendering of a judgment for the balance ascertained to be due." *Triple Canopy, Inc. v. Moore,* 2005 U.S. Dist. LEXIS 14219, Case No. 04 C 3265, 2005 WL 169768 at *5 (N.D.Ill. July 1, 2005). Equitable accounting is appropriate where the plaintiff shows there is no adequate remedy at law and the existence of special circumstances, such as the need to determine complicated damages. *Thorpe v. Levenfeld,* 2005 U.S. Dist. LEXIS 22050, at * 16-17 (N.D.Ill. Sept. 29, 2005) ("Under Illinois law, the elements of equitable accounting are: a) the absence of an adequate remedy at law; and b) one or more of the following: 1) breach of fiduciary duty; 2) fraud; 3) need for discovery, or 4) complex mutual accounts); *Eyde v. Empire of Am. Fed. Sav. Bank,* 701 F.Supp. 126, 130 (E.D.Mich.1988) ("An action for accounting is an equitable remedy and ... [p]laintiffs have no right to proceed in equity if they have an adequate remedy at law or where discovery is sufficient to determine the damages owed.").

***10** Plaintiff has adequately pled the elements of equitable accounting and facts sufficient to demonstrate that an accounting is appropriate. Specifically, Plaintiff has alleged that Defendant recently has been the subject of a criminal investigation by the Department of Homeland Security. Such an investigation, and the potential likelihood of further investigations could not only make discovery difficult but also could result in evidence of fraudulent acts perpetrated by Defendant against Plaintiff.

III. CONCLUSION

For the reasons stated, the Court:

(1) DENIES Defendants' Motion to Dismiss Plaintiff's breach of contract claim (Counts I, VII, and VIII);

(2) DISMISSES Plaintiff's misrepresentation claims (Counts II and III);

(3) DISMISSES Plaintiff's breach of express and implied warranties claim (Count IV);

(4) DISMISSES Plaintiff's promissory estoppel claim (Count V);

(5) DENIES Defendant's motion to dismiss Plaintiff's claim for specific performance (Count VI);

(6) DISMISSES Plaintiff's breach of the duty of good faith claim (Count IX); and

(7) DENIES Defendant's motion to dismiss Plaintiff's claim for an equitable accounting (Count X).

SO ORDERED.

E.D.Mich.,2009.
Groeb Farms, Inc. v. Alfred L. Wolff, Inc.
Not Reported in F.Supp.2d, 2009 WL 500816 (E.D.Mich.), 68 UCC Rep.Serv.2d 539

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Tab 6

INSURERS REHABILITATION AND LIQUIDATION MODEL ACT

The date in parentheses is the effective date of the legislation or regulation, with latest amendments. Related legislation marked with a # is based on or contains provisions of the Uniform Insurers Liquidation Act (UILA) from the National Conference of Commissioners on Uniform State Laws. This uniform law is similar to Article III of the NAIC model. Also see KEY at end of list.

NAIC MEMBER	MODEL/SIMILAR LEGIS.	RELATED LEGIS./REGS.
Alabama		ALA. CODE §§ 27-32-1 to 7-32-41 (1971/1975) #
Alaska	ALASKA STAT. §§ 21.78.010 to 1.78.330 (1966/1990).	
Arizona		ARIZ. REV. STAT. ANN. §§ 20-611 to 20-650 (1954/1997) #
Arkansas		ARK. CODE ANN. §§ 23-68-101 to 23-68-132 (1959/1997) #
California		CAL. INS. CODE §§ 1010 to 1043 (1935/2000); § 1063.6 (1999); §§ 1064.1 to 1064.12 (1988) #
Colorado	COLO. REV. STAT. §§ 10-3-501 to 10-3-559 (1992/2001).	COLO. REV. STAT. §§ 10-3-401 to 10-3-512 (1963) #
Connecticut	CONN. GEN. STAT. §§ 38a-903 to 38a-961 (1979/1998) **[1]**	
Delaware		DEL. CODE ANN. tit. 18 §§ 5901 to 5944 (1953/1995) #
District of Columbia	D.C. CODE ANN. §§ 35-2801 to 35-2857 (1993/2000) **[2]**	
Florida		FLA. STAT. §§ 631.001 to 631.399 (1982/1995) #
Georgia	GA. CODE §§ 33-37-1 to 33-37-50 (1991/1997) **[1]**	
Guam		GUAM GOV'T CODE §§ 43225 to 43238 (1981) #
Hawaii	HAWAII REV. STAT. §§ 431:15-101 to 431:15-411 (1988/1996).	
Idaho	IDAHO CODE §§ 41-3301 to 41-3360 (1981/1999).	
Illinois		215 ILL. COMP. STAT. 5/187 to 5/221.13 (1937/2001) #
Indiana	IND. CODE §§ 27-9-1-1 to 27-9-4-10 (1979/1996).	
Iowa	IOWA CODE §§ 507C.1 to 507C.59 (1984/1997).	
Kansas	*KAN. STAT. ANN. §§ 40-3605* to 40-3658 (1991).	
Kentucky	KY. REV. STAT. §§ 304.33-010 to 304.33-600 (1970/1996).	
Louisiana		LA. REV. STAT. ANN. §§ 22:731 to 22:764 (1958/2001) #

INSURERS REHABILITATION AND LIQUIDATION MODEL ACT

NAIC MEMBER	MODEL/SIMILAR LEGIS.	RELATED LEGIS./REGS.
Maine	ME. REV. STAT. ANN. tit. 24-A § 4351 to 4407 (1970/1993) (Much of model).	
Maryland		MD. ANN. CODE Ins. §§ 9-201 to 9-232 (1933/2001) #
Massachusetts		MASS. GEN. LAWS. ANN. ch. 175 §§ 180A to 180L (1939/2000) #
Michigan	MICH. COMP. LAWS §§ 500.8101 to 500.8159 (1990/1996).	
Minnesota	MINN. STAT. §§ 60B.01 to 60B.61 (1969/1999).	
Mississippi	MISS. CODE ANN. §§ 83-24-1 to 83-24-117 (1991/2000).	MISS. CODE. ANN. §§ 83-23-1 to 83-23-9 (1942).
Missouri	MO. REV. STAT. §§ 375.1150 to 375.1246 (1991/2001).	MO. REV. STAT. §§ 375.535 to 375.780 (1939/1996); §§ 375.950 to 375.990 (1976/1986) #
Montana	MONT. CODE ANN. §§ 33-2-1301 to 33-2-1388 (1979/2001) **[1]**	
Nebraska	NEB. REV. STAT. §§ 44-4801 to 44-4861 (1989/1995).	NEB. REV. STAT. §§ 44-120 to 44-133 (1913/1989).
Nevada	NEV. REV. STAT. §§ 696B.010 to 696B.570 (1971/1979) #	
New Hampshire	N.H. REV. STAT. ANN. §§ 402-C:1 to 402-C:61 (1969/1998).	
New Jersey	N.J. STAT. ANN. §§ 17B:32-31 to 17B:32-91 (1992) (Life Insurers).	N.J. STAT. ANN. §§ 17:30C-1 to 17:30C-31 (1975) (P/C Insurers) #
New Mexico		N.M. STAT. ANN. §§ 59A-41-1 to 59A-41-57 (1985/1993) #
New York		N.Y. INS. LAW §§ 7401 to 7435 (1984/1999) #
North Carolina	N.C. GEN. STAT. §§ 58-30-1 to 58-30-305 (1989/2001) **[1]**	
North Dakota	N.D. CENT. CODE §§ 26.1-06.1-01 to 26.1-06.1-59 (1991/1997).	
Ohio	OHIO REV. CODE ANN. §§ 3903.01 to 3903.99 (1982/1995).	
Oklahoma		OKLA. STAT. tit. 36 §§ 1801 to 1812 (1975/2000)(Supervision and Conservatorship); §§ 1901 to 1937 (1957/2001) **[1]** (Rehabilitation and Liquidation) #
Oregon		OR. REV. STAT. §§ 734.010 to 734.440 (1967/1995) **[1]**
Pennsylvania	PA. UNCONS. STAT §§ 40-11-101 to 40-11-511 (1979/1996).	

INSURERS REHABILITATION AND LIQUIDATION MODEL ACT

NAIC MEMBER	MODEL/SIMILAR LEGIS.	RELATED LEGIS./REGS.
Puerto Rico		P.R. LAWS ANN. tit. 26 §§ 4001 to 4024 (1978) #
Rhode Island	R.I. GEN. LAWS §§ 27-14.3-1 to 27-14.3-65 (1993/2001) [1]	R.I. GEN. LAWS §§ 27-14.4-1 to 27-14.4-23 (1994/1999) #
South Carolina	S.C. CODE ANN. §§ 38-27-10 to 38-27-1000 (1988/2000).	
South Dakota	S.D. CODIFIED LAWS §§ 58-29B-1 to 58-29B-161 (1989/2001).	
Tennessee	TENN. CODE ANN. §§ 56-9-101 to 56-9-510 (1991/1999).	
Texas		TEX. INS. CODE art. 21.28 (1951/1995); art. 21.28-A (1967/1993); art. 21.28-B (1967).
Utah	UTAH CODE ANN. §§ 31A-27-101 to 31A-27-411 (1986/1999) [1]	
Vermont	VT. STAT. ANN. tit. 8 §§ 7031 to 7100 (1991).	
Virgin Islands		V.I. CODE ANN. tit. 22 §§ 1253 to 1285 (1968/1985) #
Virginia		VA. CODE §§ 38.2-1500 to 38.2-1521 (1986).
Washington	WASH. REV. CODE ANN §§ 48.31.030 to 48.31.360 (1947/2001) (Parts of model) [1]	WASH. REV. CODE §§ 48.99.010 to 48.99.080 (1947) #
West Virginia		W. VA CODE §§ 33-10-1 to 33-10-39 (1957/1996) #
Wisconsin	WIS. STAT. §§ 645.01 to 645.90 (1967/1989).	
Wyoming		WYO. STAT. §§ 26-28-101 to 26-28-131 (1967/1983) #

KEY:

[1] Contains Section 9 adopted in 1992 to indemnify receivers.

[2] Includes confidentiality provisions adopted by the NAIC in Jan. 2000.