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No. S232322

IN THE SUPREME COURT OF CALIFORNIA

SAMUEL HECKART,
individually and on behalf of a class of those similarly situated,

Plaintiff and Appellant,

v.

A-1 SELF STORAGE INC., et al.

Defendants and Respondents.

AFTER A DECISION BY THE COURT OF APPEAL,
FOURTH APPELLATE DISTRICT, DIVISION ONE
CASE NO. D066831
(after appeal from the Superior Court of the State of California for the County of San Diego, Case No. 37-2013-00042315-CU-BT-CTL, Hon. John S. Meyer. Judge)

ANSWER TO AMICUS CURIAE BRIEF OF THE INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA

John T. Brooks, Cal. St. Bar No. 167793
SHEPPARD MULLIN RICHTER & HAMPTON LLP
501 West Broadway, 19th Floor
San Diego, California 92101
619.338.6500

Attorneys for Defendants and Respondents A-1 Self Storage Inc., Caster Group LP, Caster Properties, Inc., and Caster Family Enterprises, Inc.

Service on the Office of the Attorney General and the District Attorney of the County of San Diego pursuant to Bus. & Prof. Code § 17209

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I.

INTRODUCTION

In his amicus curiae brief, the Insurance Commissioner ("Commissioner") disavows the opinions previously issued by his department and advocates for reversal of the Court of Appeal's opinion.

The Commissioner's views in the amicus curiae brief are not entitled to deference because no position or argument in the brief is grounded in the Commissioner's expertise, technical knowledge or experience. Nor does the Commissioner offer any facts that might assist the Court in evaluating the dispute from a public policy perspective. Rather, the Commissioner offers solely legal argument, largely repeating the legal arguments petitioner has already made. As such, it is entitled to no deference. (*Interinsurance Exch. of the Auto. Club v. Superior Court* (2007) 148 Cal.App.4th 1218, 1235-37 [declining to defer to Commissioner's opinion that was not based on a longstanding interpretation of the statute in question or on special expertise].) The Court is the ultimate arbiter of the law, not the Commissioner.

Further, if anything, the points made by the Commissioner – and the points he fails to make – bolster the Court of Appeal's conclusion for several reasons. First, the Commissioner's discussion of Article 16.3 of the Insurance Code further demonstrates that Article 16.3 does not reflect a Legislative intent to subject leases provisions, like the one at issue here, to regulation as insurance.

Second, the Commissioner fails to cite any case or other authority holding or suggesting that any test, other than the principal object test, is the appropriate test by which to determine whether a contract that contains elements of indemnity is subject to regulation as insurance.

Third, the Commissioner provides no reason in law or fact to overturn the Court of Appeal's conclusion that the principal object of Heckart's contract with A-1 was a lease, and that the parties' risk allocation agreement was secondary to and supportive of that non-insurance principal object.

For all these reasons, A-1 respectfully urges that the Court should not defer to or adopt the Commissioner's views. Rather, it should reaffirm that the principal object test applies and hold that, on the facts alleged here, the lease is not subject to regulation as insurance because the parties' principal object is a lease and the risk allocation provisions in the lease are secondary to and supportive of that object.

II.

THE COMMISSIONER'S VIEWS, NOT GROUNDED IN PRACTICE OR ITS EXPERTISE, ARE NOT ENTITLED TO DEFERENCE

Noticeably missing from the Commissioner's amicus brief is any discussion of any matter that is uniquely within the knowledge and expertise of the Department of Insurance ("DOI"). Instead, the Commissioner merely parrots Heckart's interpretation of the statute and other arguments, as if the Commissioner were an advocate and also the decision maker. But in circumstances like those here, where the Commissioner's role is not quasi-legislative but rather interpretive, the Commissioner's *legal opinion* "commands a commensurably lesser degree of judicial deference." (*Yamaha Corp. of America v. State Bd. of*

Equalization (1998) 19 Cal.4th 1, 11.) That is because the Court is the ultimate arbiter of the law. (*Id.* at p. 12.)

A court will give greater weight to an agency's interpretation where the agency shows its "expertise and technical knowledge." (*Id.*; *see also Farmers Ins. Exch. v. Superior Court* (2006) 137 Cal.App.4th 842, 859 [in determining the level of deference to give to administrative opinions, courts will consider whether the agency has an "interpretive advantage over the courts" due to its "expertise and technical knowledge."].) The Commissioner did not rely on expertise and technical knowledge here, though, and so the Commissioner's amicus brief is not entitled to greater weight for that reason.

The Court also should not give deference to the Commissioner's interpretation of the law as discussed in his amicus brief, because the Commissioner's current opinion is not based on any long-standing construction of Article 16.3 of the Insurance Code. (*See Interinsurance Exch. of Automobile Club*, 148 Cal.App.4th at p. 1235-1236 ["when, as here, the agency does not have a long-standing interpretation of the statute and has not adopted a formal regulation interpreting the statute, courts may simply disregard the opinion offered by the agency"].) "[A] vacillating position . . . is entitled to no deference." (*Yamaha Corp., supra*, 19 Cal.4th at p. 13.) As discussed at pages 30-33 of A-1's Answer Brief on the Merits, the DOI issued opinion letters in 2003 and 2008 that reached the opposite conclusion to that which the Commissioner is espousing now. [1] The DOI's long-standing construction of Article 16.3 would require that the Court of Appeal opinion be affirmed.

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[1] The separate answer to the Commissioner's amicus brief filed by respondent Deans & Homer addresses the DOI's previous long-standing interpretation of Article 16.3 in more detail. A-1 joins in, and incorporates by reference, the arguments made by Deans & Homer in its brief.

Another consideration is whether the interpretation was adopted "contemporaneously with the legislative enactment of the statute in question." (*Farmers Ins. Exch.*, *supra*, 137 Cal.App.4th at p. 859.) The DOI's earlier interpretations were contemporaneous with the enactment of Article 16.3 and in some instances, were directly responsive to it. The Commissioner's recent amicus brief, on the other hand, was filed nine years later. For this reason, the DOI's earlier interpretation, not its recent one, is entitled to deference.

At bottom, the Court is "in as good a position as the DOI" to determine the meaning and scope of Article 16.3. (*Interinsurance Exch. of Automobile Club*, *supra*, 148 Cal.App.4th at p. 1237.) Like in *Interinsurance Exch. of Automobile Club*, the Court should "give little, if any, deference to the DOI's opinion on the instant question." (*Id.* [Court of Appeal held the trial court erred in giving deference to the DOI's opinion about the interpretation of a provision of the Insurance Code]; cf. *Morris v. Williams* (1967) 67 Cal.2d 733, 748 ["Administrative regulations that alter or amend the statute or enlarge or impair its scope are void and courts not only may, but it is their obligation to strike down such regulations."].)

III.

THE COMMISSIONER'S LEGAL ARGUMENTS LACK MERIT

The Commissioner's legal arguments, which rehash and largely copy arguments by Heckart's counsel, lack merit.

A. The Legislature Has Not Acted to Regulate Self-Storage Lease Provisions as Insurance

Echoing Heckart, the Commissioner's lead argument is that the principal object test is inapplicable because Article 16.3 of the Insurance Code demonstrates a "clear legislative intent" to subject the lease to

regulation as insurance. (Amicus Brief, pp. 6-7.) But after announcing this lead argument in the introduction, the Commissioner thereafter provides no supporting argument. For the reasons at pages 37-41 of A-1's Answering Brief on the Merits, the Court of Appeal correctly concluded that Heckart's argument under Article 16.3 "puts the cart before the horse" (slip op., p. 11) and provides no evidence that the Legislature intended to subject agreements like Heckart's lease to regulation as insurance.

To the contrary, the Commissioner's discussion of Article 16.3 at pages 7-9 of the brief underscores the correctness of the Court of Appeal's conclusion. The Commissioner concedes that the only purpose of Article 16.3 was "[t]o create a limited *agent* license for self-service storage facilities to sell hazard insurance to renters of storage units." (Amicus Brief, p. 8, italics supplied.) The Commissioner also concedes that, in enacting Article 16.3, the Legislature did not intend to subject a new category of contract to regulation as insurance, but adopted new rules for the sale of insurance policies that "already exist and are written and sold by standard insurance companies." Article 16.3 thus did not change *what* contracts are insurance, but merely who was entitled to act as an agent to sell such contracts. (*Id.*)

When the Legislature wants to subject a particular type of contract to regulation as insurance, it knows how to do so. For example, the Legislature has declared certain contracts to be subject to regulation under the Insurance Code, even though the contract on its face appears to offer warranty, maintenance, or service rather than indemnity. (*See* Ins. Code, §§ 116, 116.6, 12800 *et seq.*) Where the Legislature has thus specifically spoken, the statutory language controls. But Article 16.3 does not express a legislative intent to regulate self-storage leases as insurance. Because the Legislature has not spoken, the principal object test should be applied.

B. The Commissioner Does Not Argue that the Principal Object Test Is the Wrong Test

1. *The Commissioner concedes that the principal object test effectuates legislative intent*

The Commissioner does not dispute that the principal object test appropriately effectuates legislative intent where, as here, there is a dispute whether a contract should be regulated as insurance. Indeed, the Commissioner concedes that a literal application of the elements of "insurance" would defeat legislative intent by subjecting too many contracts to regulation as insurance:

> Many common business ventures, however, entail some element of risk distribution or assumption. To prevent an overbroad reading inconsistent with the Legislature's intent, this Court has clarified that the shifting and distribution of the risk of loss "does not necessarily mean that an agreement constitutes an insurance contract *for purposes of statutory regulation.*"

(Amicus Brief, p. 13, quoting *Sweatman v. Department of Veterans Affairs* (2001) 25 Cal.4th 715, 726, italics in *Sweatman*). The Commissioner further concedes that the principal object test is appropriately applied to decide whether a contract that contains some elements of indemnity – elements that in isolation resemble insurance – is subject to regulation as insurance. (Amicus Brief, p. 14.)

2. *The Commissioner's discussion of case law further demonstrates the propriety of the Court of Appeal's analysis*

The Commissioner's lengthy discussion of 70 years of principal object cases (Brief, pp. 13-23) drives home the same point. While the Commissioner strives to find factual distinctions between prior published cases and the facts alleged here, he does not and cannot dispute that the

courts have for decades relied on the principal object test to effectuate legislative intent by limiting insurance regulation to contracts the principal goal of which is indemnity.

Further, the Commissioner's attempted factual distinctions and his characterizations of prior cases echo the arguments already made by Heckart and addressed by A-1 in its Answering Brief on the Merits at pages 48-53. To avoid redundancy, A-1 refers the Court to this prior discussion.

C. The Commissioner Fails to Show that the Court of Appeal Should Have Reached a Different Result Under the Principal Object Test

The Commissioner also argues that the Court of Appeal should have reached a different result under the principal object test (Amicus Brief, p. 23), but his arguments in that regard are misplaced.

First, the Commissioner argues that form should not prevail over substance. (Amicus Brief, p. 24.) But manifestly, a risk allocation agreement that addresses risks inherent in an ongoing business relationship is substantively, not just formally, different from an insurance contract. Indemnity is the insurer's sole offering, actuarial profit is an insurer's sole goal, and there is no possibility that the insurer can be blamed for the occurrence of the loss that it insures. None of this is true of the agreement between A-1 and Heckart, or of other agreements to allocate risk in connection with a non-insurance principal object. Absent express direction of the Legislature, courts should not interfere with parties' freedom to allocate such risks as they see fit by subjecting such agreements to regulation as insurance. The Court of Appeal's opinion properly recognizes this substantive distinction.

Second, and relatedly, the Commissioner argues that it does not matter "who" the contracting parties are. (Amicus Brief, p. 24.) This

argument is wrong for the same reason. The identity of the parties is directly related to whether the parties' principal object is indemnity or something else. A-1 stands in a substantively different relationship to its tenants than does an insurer who is a stranger to the lease.

Third, the Commissioner argues that the risk allocation agreement here is "not in furtherance of, or incidental to" the lease. (Amicus Brief, p. 24.) The Commissioner's arguments do not support this conclusion. The risk allocation provisions in the lease would not exist but for the lease. They relate solely to a risk – the possibility of damage to goods stored on A-1's premises – that would not exist without the lease. They further the (presumably mutual) goal of avoiding disputes about liability for the loss, which is important to A-1 because of the possibility that it could be held responsible for damage to property on its premises. All these attributes make the risk allocation secondary to and supportive of the parties' principal object: a problem-free lease.

The Commissioner's conclusory assertion (Amicus Brief, p. 25) that disputes would be better avoided by an absolute exculpatory clause is unsupported by evidence, allegations, or reasoned argument. It is contrary to public policy disfavoring exculpation. (*See, e.g., Philippine Airlines, Inc. v. McDonnell Douglas Corp.* (1987) 189 Cal.App.3d 234, 237 ["The law generally looks with disfavor on attempts to avoid liability or secure exemption for one's own negligence."].) It is also contrary to case law demonstrating that exculpatory clauses do not necessarily prevent lawsuits. (*Id.*; *see also Pelletier v. Alameda Yacht Harbor* (1986) 188 Cal.App.3d 1551, 1554 [holding exculpatory clause in lease void]; *c.f.*., Ex. A to Amicus Curiae Brief of Baker, Burton & Lundy at page 1 [article asserting that small claims judges sometimes ignore exculpatory clauses in self-storage leases].) Further, and in any event, it is not the Commissioner's

province to tell private parties the best way for them to allocate risk between themselves.

Fourth, the Commissioner suggests that the need for adequate reserves supports regulating the lease as insurance (Amicus Brief, p. 26), but the argument is contrary to this Court's precedent. In *People ex rel. Roddis v. Community Mutual Association* (1968) 68 Cal.2d 677, this Court considered a health plan that combined elements of direct medical service with elements of indemnity. The Court held that the need for loss reserves supported regulating the health plan as insurance only if "indemnity is a significant financial proportion of the business." (*Id.*, p. 683.) Here, however, Heckart admits that A-1's obligations under the lease addendum are insignificant in proportion to its overall business. (CT 203, 213 [¶¶ 17, 49-51].) Under *Roddis*, therefore, any alleged need for reserves is insufficient to justify regulating A-1 as an insurer. More broadly, many companies assume future obligations the performance of which depends on continued solvency. Plainly, the Legislature did not intend to regulate all contracts involving future obligations as insurance. (*C.f.*, Answering Brief on the Merits, pp. 44-47.) If a non-insurance business raises solvency issues implicating the public interest, the answer is not to subject those businesses to regulation as insurers. Rather, the Legislature can enact reserve regulation tailored to the need. (*See*, *e.g.*, Fin. Code, § 6476 [savings and loan reserves]; Educ. Code, § 22311.5 [loss reserves for pensions]; Bus. & Prof. Code, § 11240 [time-share plan reserves for maintenance and capital expenditures]; Fin. Code, § 32332 [loan loss reserves].)

Finally, the Commissioner refers to the potential that A-1 might charge "excessive consideration." (Amicus Brief, p. 26.) But the desire to regulate prices is no justification for subjecting a contract whose principal object is not insurance to regulation as insurance. If there is a dysfunctional

market for a non-insurance product or service that suggests a need for price regulation, it is for the Legislature to ascertain that need and devise the solution. Further, nothing in the record supports an inference of above-market pricing in any event. To the contrary, Heckart admits that A-1's $10 per month charge for the lease addendum is not materially different from the $9.66 per month cost of an allegedly comparable insurance policy, and the minimal difference in cost is offset by the fact that A-1's obligations are not reduced by any deductible. (CT 201, ¶ 40 [alleging that Deans & Homer sells an insurance policy with $3,000 coverage limits but subject to a $100 deductible, which thus provides a lower payment than the lease addendum for all losses below $2,600].)[2]

D. The Commissioner's Vacillating Position Reinforces A-1's Alternative Argument Under the Rule of Lenity

The unlicensed sale of insurance is a criminal offense. (Ins. Code, §§ 700, 1633.) Where there is doubt about the correct interpretation of a criminal statute, this Court has held that due process and ex post facto considerations compel interpreting the statute as favorably to the defendant as circumstances reasonably permit – even in a civil action such as this one. (*Walsh v. Department of Alcoholic Beverage Control* (1963) 59 Cal.2d 757, 764-65; *People v. Davis* (1994) 7 Cal.4th 797, 811; *c.f.*, Answer Brief of the Merits, pp. 36-37.)

Here, A-1 submits that the principal object test establishes beyond doubt that its lease is not subject to regulation as insurance.

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[2] The Commissioner also unfairly compares the price A-1's tenants pay for the lease addendum to the price A-1 pays to Deans & Homer. (Amicus Brief, p. 26.) Under the lease addendum, A-1 pays for damage without a deductible. Deans & Homer, in contrast, only pays A-1 if A-1's payments to tenants exceed $250,000 in a year. (CT 206.)

But to the extent there is any doubt, the Commissioner's vacillating position, along with the weakness of his argument in support of his new position, supports A-1's alternative argument under the rule of lenity. A-1 has relied for years on the DOI's 2003 and 2008 opinions. Now the Commissioner changes position, but fails to articulate (i) any basis for his lead argument that the principal object test is made irrelevant by Article 16.3, or (ii) any plausible argument that a lease, rather than indemnity, was the principal object of Heckart's contract with A-1. The circumstances thus raise the very due process and ex post facto concerns justifying application of the rule of lenity.

IV.

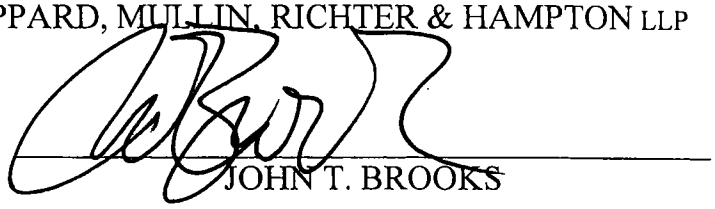
CONCLUSION

The Commissioner's brief offers no perspective requiring judicial deference, and the legal arguments the Commissioner offers not only fail to show error, but reinforce that the Court of Appeal correctly applied the principal object test to determine that A-1's lease is not subject to regulation as insurance.

Dated: October 2, 2017

Respectfully submitted,

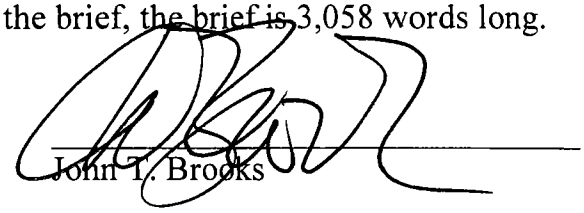
SHEPPARD, MULLIN, RICHTER & HAMPTON LLP

By 
JOHN T. BROOKS

Attorneys for A-1 Self Storage, Inc., Caster Properties, Inc., Caster Family Enterprises, Inc., and Caster Group LP

CERTIFICATE OF COMPLIANCE

I, John T. Brooks, appellate counsel to A-1 Self Storage, Inc., Caster Properties, Inc., Caster Family Enterprises, Inc., and Caster Group LP, certify that the foregoing brief is prepared in proportionally spaced Times New Roman 13 point type and, based on the word count of the word processing system used to prepare the brief, the brief is 3,058 words long.



John T. Brooks

PROOF OF SERVICE

Samuel Heckart v.A-1 Self Storage Inc., et al.
Supreme Court of California, Case No. S232322
Court of Appeal, Fourth Appellate District, Division One, Case No. D066831
San Diego Superior Court, Case No. 37-2013-00042315-CU-BT-CTL

I, Tamara Siemers, declare as follows: I am employed with the law firm of Sheppard Mullin Richter & Hampton LLP, whose address is 501 West Broadway, 19th Floor, San Diego, California 92101. I am over the age of eighteen years, and am not a party to this action. On **October 2, 2017**, I served the foregoing document described as:

ANSWER TO AMICUS CURIAE BRIEF OF THE INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA

[X] **U. S. MAIL:** I placed a copy in a separate envelope, with postage fully prepaid, for each addressee named below for collection and mailing on the below indicated day following the ordinary business practices at Sheppard Mullin Richter & Hampton LLP. I certify I am familiar with the ordinary business practices of my place of employment with regard to collection for mailing with the United States Postal Service. 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 or mailing affidavit.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed at San Diego, California on **October 2, 2017**.

Tamara Siemers

SERVICE LIST

Xavier Becerra, Esq.
Diane S. Shaw, Esq.
Moly K. Mosley, Esq.
Attorney General of California
1300 I Street, Suite 125
P.O. Box 944255
Sacramento, CA 94244-2550
Tel. (916) 210-7358
Attorneys for Amicus Curiae, Dave Jones, Insurance Commissioner of the State of California

Court of Appeals
Fourth District, Division One
750 B Street, Suite 300
San Diego, CA 92101

William R. Restis, Esq.
David J. Harris, Esq.
Trent Kashima, Esq.
FINKLESTEIN & KRINKS LLP
550 West C Street, Suite 1760
San Diego, CA 92101
Tel. (619) 238-1333
Attorneys for Samuel Heckart

San Diego Superior Court
Attn: Hon. John S. Meyer
330 West Broadway, Dept. 61
San Diego, CA 92101

John R. Clifford, Esq.
David Aveni
WILSON ELSER MOSKOWITZ EDELMAN & DICKER LLP
655 West Broadway, Suite 900
San Diego, CA 92101
Tel. (619) 321-6200
Attorneys for Deans & Homer

Superior Court of California
Appeal Court Division
3rd Floor, Room 3005
220 West Broadway
San Diego, CA 92101

Brian N. Baker, Esq.
Albro L. Lundy, III, Esq.
BAKER BURTON and LUNDY PC
515 Pier Avenue
Hermosa Beach, CA 90254
Tel. (310) 376-9893
Attorneys for Baker Burton and Lundy PC, Amicus Curiae

Office of the District Attorney
Appellate Division
P.O. Box X-1011
San Diego, CA 92112
Attorneys for The People of the State of California – Notification as per Bus. & Prof. Code Sec. 17209

Dale E. Washington, Esq.
5942 Edinger Avenue 113/1325
Huntington Beach, CA 92649
Tel. (714) 242-3868
Attorney for Dale E. Washington, Esq., Amicus Curiae

Office of the Attorney General
P.O. Box 85266
San Diego, CA 92186-5266
Attorneys for The People of the State of California – Notification as per Bus. & Prof. Code Sec. 17209

Raymond Zakari, Esq.
ZAKARI LAW
301 E. Colorado Blvd., Suite 407
Pasadena, CA 91101
Tel. (626) 793-7328
Attorneys for Zakari Law, Amicus Curiae

A-1 Self Storage Inc., Caster Group LP, Caster Properties, Inc. and Caster Family Enterprises, Inc.
Address Confidential

Chalres A. Bird
Dentons US LLP
4655 Executive Drive, Suite 700
San Diego, CA 92121
Attorneys for California Self Storage Association, Amicus Curiae

Deans & Homer
Address Confidential

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