S232322

IN THE
SUPREME COURT
OF THE STATE OF CALIFORNIA

SAMUEL HECKART,

Plaintiff & Appellant,

vs.

A-1 SELF STORAGE, *INC. et al.*

Defendants & Respondents.

AFTER A DECISION BY COURT OF APPEAL, FOURTH APPELLATE DISTRICT, DIV. ONE, APPEAL NO. D066831, APPEAL FROM JUDGMENT OF THE SAN DIEGO COUNTY SUPERIOR COURT; CASE NO. 37-2013-00042315 CU-BT-CTL, HON. JOHN S. MEYER

ANSWER BRIEF ON THE MERITS BY DEANS & HOMER

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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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CERTIFICATE OF INTERESTED PARTIES

The identity of interested persons or entities who have an ownership interest of 10% or more in Deans & Homer has not been publicly disclosed in this action and these individuals and entities wish to keep their identities undisclosed. The identities of these individuals and entities are not relevant to any material issues in this dispute and would impair their right of privacy. Public disclosure of private ownership information is inapplicable to the purpose and intent of Cal. Rule of Court 8.208. Hence, Deans & Homer has previously filed an application to file a certificate of interested parties under seal.

There are no other interested entities or persons to be disclosed. (Cal. Rule of Court 8.208, subd. (e).)

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INTRODUCTION

At the heart of this case is a complex policy choice by the Legislature about how to define and regulate insurance. The choice is naturally one that is subject to competing policy interests. But it is the Legislature, not the judiciary, that is in the best position to balance and resolve these competing interests. The Legislature has done so by imposing specific limits on what storage companies can and cannot do. It devised a statutory scheme that fits the purposes of the licensing requirement and the economic realities of storage rental transactions. Heckart's brief refuses to give weight to the Legislature's judgment and substitutes his own, missing the mark in the process. In light of the negative consequences that will follow by adopting Heckart's position, this Court should uphold the lower courts' judgment.

The lower courts and the Department of Insurance each analyzed the contract at issue here under the bright line test for insurance that governs when, as here, the parties to a contract include a provision allocating risks between them. Applying that simple "principal object" test, the Superior Court, the Court of Appeal, and the Department of Insurance each came to the same conclusion – that the contract at issue is not insurance.

Seeking to implement a sea change in the law in adjudicating what constitutes insurance, Heckart asks this Court to abrogate the principal object test, one that has been applied by California courts for literally 70 years. The academic approach to statutory interpretation employed by Heckart and the public policy grounds invoked by him under the guise of consumer protection do not justify revolutionizing the law on this point.

In any event, in contrast to Heckart's utter failure to articulate a single, bright line test in lieu of the principal object test, this brief proposes

two alternatives. In the unlikely event that this Court decides to modify or replace this well-established test, it should consider those alternatives for resolving such disputes in other cases.

Finally, even if this Court ultimately decides that the lease agreement challenged by Heckart constitutes insurance, this Court should limit its decision in this case prospectively. Any other ruling would raise serious due process questions, given that the lease agreement challenged by Heckart was expressly approved by the Department of Insurance.

In sum, Heckart is not entitled to a reversal in this case. To the extent he is unhappy with the rulings below, his fight is with the Legislature and the Department of Insurance.

STATEMENT OF THE CASE

A. Factual Background

1. The Underlying Transaction Between Heckart and A-1

a. The two components of storage rental

In June 2012, plaintiff Samuel Heckart signed an agreement with A-1 Self-Storage to rent a storage unit from an A-1 self-storage facility in San Diego, California. (1 CT 202, ¶ 12.)[1] The lease agreement had two components: A-1's standard storage unit lease agreement (1 CT 49-51), and a lease addendum (1 CT 52-53) (the standard lease agreement and the lease addendum are collectively referred to herein as the "Lease Agreement"). The latter modified the standard agreement's risk-of-loss

[1] The clerks' transcripts reflect two sets of pagination. Pages identified in this brief refer to the pagination on the top right corner of the clerks' transcripts.

provisions so that A-1 accepted certain of the risks that otherwise would have been borne by Heckart. (1 CT 52-53; 229-230.)

b. The key contractual terms

The standard lease agreement was titled "A-1 Self Storage Rental Agreement." (2 CT 258.) The lease agreement covered the various issues that typically would be found in a contract for the lease of storage space, including the rent Heckart would pay each month; each party's right of access to the storage unit; maintenance of security for the unit; and a provision prohibiting Heckart from storing hazardous materials on the premises. (2 CT 258-260.) Throughout the agreement, Heckart is referred to as the "tenant" and A-1 is called the "landlord." (*Id.*)

The lease agreement also contains a provision releasing A-1 from any liability for damage to the tenant's property stored at the facility (2 CT 259, ¶ 13), and a requirement that the tenant maintain at his or her own expense an insurance policy covering the property the tenant stores in the rented unit. (*Id.*, ¶ 12.)

For an additional $10 per month, Heckart had the option of adding the lease addendum (also called the Customer Goods Protection Plan) to the contract, which modified the standard lease agreement. (2 CT 261-262.) Under the lease addendum, rather than waiving the storage facility's liability for property damage, A-1 retained such liability for damage to Heckart's stored property, up to $2,500 in losses. (2 CT 262, ¶ 6.) The lease addendum also stated that if selected, it satisfied the requirement that the tenant maintain an insurance policy covering property stored at the facility. (2 CT 261.)

The lease addendum was not a free-standing, separate contract. The lease addendum expressly stated that if selected, it modified the terms of the standard lease agreement and became a part of the contract. (2 CT 261, ¶ 2 ["This limited acceptance of liability is a modification to the waiver of liability in paragraph eleven (11) of the rental agreement that it forms a part of"].) The lease addendum also stated on each page that it is not a contract of insurance, and that A-1 is not an insurance company. (2 CT 261-262.)

c. Heckart fails to provide proof of insurance despite his written promise to do so.

Heckart initially declined to accept the lease addendum as part of his lease agreement. (1 CT 202, ¶ 12.) Instead, Heckart agreed to provide to A-1 within 30 days proof that he had separate insurance coverage for his property stored at the facility. (2 CT 261.) Heckart also acknowledged that if he failed to provide such proof, he would be enrolled automatically in A-1's protection plan, and the lease addendum thereby would be added to his lease agreement. (*Id.*) Heckart agreed to these terms by checking a box of the lease agreement that stated as follows:

> No, I decline participation in the Customer Goods Protection Plan. I am currently covered by an insurance plan that covers my belongings in the storage facility. I understand that I need to provide the policy information in writing to the facility Owner within 30 days or I will automatically be enrolled in the Customer Goods Protection Plan until I do provide such information to the Owner.

(*Id.*) Contrary to the agreement he signed, Heckart failed to provide proof of insurance within 30 days. As a result, he was automatically enrolled in A-1's protection plan based on the terms of the parties' contract. (1 CT 202, ¶ 12.)

2. The Separate Transaction Between A-1 and Its Insurer

Although storage facilities such as A-1 are not legally required to enter into any risk-shifting agreements with third parties (e.g., an insurer) to eliminate their own risks, they have the option to do so by purchasing a traditional form of insurance from a licensed insurer. This is precisely what A-1 did by purchasing a Storage Liability Policy. (1 CT 206, ¶ 28; 1 CT 106-113 [copy of Storage Operator's Contract Liability Policy, abbreviated here as "Storage Liability Policy"].)

Having purchased this policy, A-1 eliminated its own contractual risks under its protection plans beyond the $250,000 threshold. (1 CT 206, ¶ 28.) In other words, while A-1 remains contractually obligated to pay tenants' losses below this threshold, A-1 and its insurer have transferred the risk beyond this point to A-1's insurer. As a result, whether a single tenant or hundreds of tenants have suffered losses, the Storage Liability Policy will cover A-1's risk once this threshold has been met.

Heckart concedes that Deans & Homer, the entity selling this insurance policy to A-1, is "an insurance underwriter, agent, and broker licensed to sell insurance by the California Department of Insurance under license number 0300517." (1 CT 204, ¶ 19.) Heckart also alleges Deans & Homer "underwrites" this policy. (*Id.*)

3. The Differences Between the Two Risk-Shifting Contracts

Based on the discussion above, there are two distinct risk-sharing contracts at issue in this lawsuit. The two transactions at issue here (the underlying transaction between the tenant and A-1 and the other transaction between A-1 and its insurer) are analytically different. On the one hand, the protection plan offered by A-1 and Heckart's rental agreement are inextricably intertwined. On the other hand, the protection plan and the

Storage Liability Policy are not inextricably intertwined because storage operators can have one without the other. There is no legal requirement to have both – i.e., the protection plan *and* the Storage Liability Policy.

B. Procedural Background

1. The Initial Round of Pleadings

Heckart filed his initial complaint against A-1 Self Storage, *Inc.* and Caster Group LP as a proposed class action. Heckart alleged violations of California's Unfair Competition Law ("UCL"), Bus. & Prof. Code § 17200 *et seq.*, and Consumer Legal Remedies Act, Civ. Code § 1750 *et seq.* (1 CT 2-23.)

In response to defendants' demurrer to the original complaint (1 CT 26-43 [points & authorities]; 44-66 [judicial notice request]), Heckart filed his opposition papers (1 CT 73-92), challenging defendants' request for judicial notice (1 CT 93-126). Heckart also submitted his own request for judicial notice of a DOI bulletin and legislative intent materials. (1 CT 127-138.) In addition, Heckart submitted four federal district court decisions, mostly unpublished. (1 CT 139-178.)

After defendants filed their reply papers (1 CT 181-191), the trial court held a hearing. (1 CT 192-195 [minute order].) Having sustained the demurrers to both causes of action, the court granted Heckart leave to amend his complaint to address the identified deficiencies. (1 CT 197.)

2. The Second Round of Pleadings

a. The allegations of the operative complaint

On April 18, 2014, Heckart filed his First Amended Complaint ("FAC"). The FAC defined the proposed class as "all California residents

who, from April 3, 2009 to the present, were charged fees by an A-1 Self Storage facility in California for the Consumer Goods Protection Plan." (1 CT 216.)

The FAC added several new defendants. First, Heckart added Caster Properties, *Inc.* and Caster Family Enterprises, *Inc.* as alleged affiliates of Caster Group, LP, an original defendant. (1 CT 203, ¶¶ 14-15.) The FAC alleges the new defendants, together with defendant Caster Group LP, operate and manage defendant A-1.[2]

The FAC also added respondent Deans & Homer as a new defendant. (1 CT 204, ¶ 19.) The FAC does not allege any contractual or other relationship between Heckart and Deans & Homer. The FAC does not allege Heckart purchased any insurance from Deans & Homer, nor does it allege Deans & Homer ever came into contact with Heckart in any manner.

Instead, the FAC claims Deans & Homer is liable because it allegedly "promoted" the concept of the lease addendum to A-1 as a means of avoiding the requirements of the California Insurance Code. (1 CT 199, ¶ 3.) The FAC alleges Deans & Homer provides support to A-1 on how to structure the lease agreement and lease addendum, and on the policies and procedures A-1 needs to operate the indemnity element of the lease transaction. (1 CT 205-206, ¶¶ 25-27.)

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[2] A-1 Self Storage, *Inc.*, Caster Properties, *Inc.*, Caster Family Enterprises, *Inc.* and Caster Group LP are referred to collectively as "A-1" in this brief.

The FAC further states that Deans & Homer sold insurance policies to A-1 to provide coverage for the risks A-1 has assumed for damage to tenants' property stored at A-1's facility. (1 CT 206, ¶ 28.)[3]

The FAC again included claims under the UCL and CLRA, and it also added claims for negligent misrepresentation and civil conspiracy. (1 CT 219-226.)

b. The demurrers to the operative complaint

Deans & Homer and A-1 each demurred to the FAC.[4] After holding a hearing on September 4, 2014, the court sustained the demurrers without leave to amend. The court also ruled on the parties' requests for judicial notice. (2 CT 475.)[5]

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[3] The FAC also refers to a third form of risk-shifting agreement, a traditional insurance policy offered by Deans & Homer to *tenants* at other storage facilities, the "Customer Storage Insurance Policy." (1 CT 209-211, ¶ 40.) Heckart implicitly challenges the fact that this policy was not offered to him and other A-1 tenants.

[4] Various documents were filed by both sides. (1 CT 232-252 [A-1's demurrer]; 2 CT 253-284 [A-1's request for judicial notice]; 2 CT 285-287 [A-1's supporting declaration]; 2 CT 290-305 [Deans & Homer's demurrer]; 2 CT 306-343 [Deans & Homer's judicial notice request]; 2 CT 344-347 [joinder]; 2 CT 348-368 [Heckart's consolidated opposition to demurrers]; 2 CT 369-370 [Heckart's lodgment of non-California authorities]; 2 CT 371-413 [Heckart's request for judicial notice]; 2 CT 414-434 [Heckart's opposition to defendants' judicial notice request]; 2 CT 435-445 [A-1's reply]; 2 CT 448-450 [A-1's objections to Heckart's judicial notice request]; 2 CT 453-463 [Deans & Homer's reply]; 2 CT 464-467 [Deans & Homer's objections to Heckart's judicial notice request].)

[5] The court granted defendants' requests for judicial notice while denying Heckart's request for judicial notice with one exception as to a bulletin issued by the DOI. (2 CT 468-470 [tentative ruling]; 2 CT 471-474 [first minute order]; 2 CT 475-477 [second minute order]; 2 CT 412-413 [DOI bulletin].)

Rejecting Heckart's arguments, the court held that the principal object of the contract between A-1 and Heckart was the rental of a storage unit, not insurance. (2 CT 477.) As a result, the court held each of Heckart's claims must be dismissed because they are dependant on the allegation that the lease agreement and the protection plan qualify as an insurance transaction. (*See id.*) The court also held that the CLRA claim must be dismissed for the separate reason that the CLRA does not apply to insurance. (*See id.*) Consequently, the court held even if Heckart is able to prove the transaction involves an insurance contract, that precludes the application of the CLRA.[6] (*See id.*)

3. The Appeal

a. Heckart's arguments on appeal

Heckart filed a timely appeal to challenge the dismissal of his lawsuit. (2 CT 478-479 [judgment]; 2 CT 480-482 [notice of appeal].)

On appeal, Heckart limited his argument to whether the Lease Agreement constitutes an insurance contract, and whether the FAC properly stated a claim under the UCL and CLRA. (AOB 8-9; 24-50.) Heckart did not present any separate arguments related to the negligent misrepresentation and civil conspiracy claims, other than the insurance-licensing issue that applies equally to all of his causes of action. (ARB 4, fn. 2 [explaining Heckart's rationale].)

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[6] Because this case arises from the trial court's order sustaining Defendants' demurrers, the version of the facts relevant to this appeal is the set of facts Heckart alleged in his FAC. Consequently, Defendants necessarily have not had the opportunity to dispute those facts or to present different facts relevant to the issues, including facts relevant to whether the Lease Agreement constitutes insurance.

b. The Court of Appeal's decision

Affirming the trial court's decision, the Court of Appeal rejected Heckart's argument that the Lease Agreement constituted an insurance policy. The Court of Appeal reached this conclusion based on *Truta v. Avis Rent A Car System, Inc.* (1987) 193 Cal.App.3d 802 and the principal object test discussed therein. Based on the principal object test, the Court of Appeal held that "[w]ithout the Rental Agreement, the Protection Plan would not exist and would have no purpose. . . . Looking at the entire transaction between the parties, the principal object or 'distinctive character' was the rental of storage space." (Opn. 10.)

Having examined the lease agreement and the protection plan as a whole (Opn. 10), the Court of Appeal noted the Lease Agreement allocated the risk of property damage and loss to the tenant, but that tenants had the option of paying an additional monthly fee and allocating the risk instead to A-1. The Court of Appeal held:

> Just as the parties were free to contract to allocate risk to the tenant, they were also free to allocate risk to A-1. Allowing parties to shift the risk of property damage does not turn an agreement, whose primary objective is storage rental into insurance. (*Id.*)

The Court of Appeal also rejected Heckart's attempt to transmute the storage rental transaction into an insurance transaction based on the separate Storage Liability Policy A-1 purchased from Deans & Homer:

> [C]ontrary to Heckart's argument, the Storage Liability Policy between A-1 and Deans & Homer does not suggest the Protection Plan is insurance. . . . A-1 was not required to purchase the Storage Liability Policy from Deans & Homer as a condition of offering tenants the Protection Plan option to the Rental Agreement. . . . The Storage Liability Policy

simply provided a way for A-1 to limit its exposure. (Opn. 11.)

Upholding an administrative opinion issued by the Department of Insurance ("DOI") approving the sale of such protections plans without an insurance license (2 CT 326, 328), the Court of Appeal also rejected Heckart's argument that the DOI's opinion is not entitled to deference. (Opn. 12-13.) As summarized by the Court of Appeal, "the DOI opined [in 2003] that such programs were not insurance for purposes of statutory regulation because the primary purpose of the contract was real property rental. In 2008, which was after the enactment of article 16.3 of the Insurance Code, the DOI confirmed its 2003 opinion." (*Id.* at p. 12 [brackets added].)

Having rejected Heckart's assertion that "Deans & Homer did not accurately describe the Protection Plan program to the DOI" (*id.*), the Court of Appeal "recognized that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer, and the principle of deference to administrative interpretations." (*Id.* at p. 13 [internal citation, quotation marks and ellipses omitted].) The Court of Appeal concluded that there is "no reason to depart from the DOI's opinion" in this case. (*Ibid.*)

Finally, the Court of Appeal held that all of the causes of action presented by Heckart fail because they "were all premised on his allegation that the Protection Plan is insurance." (Opn. 13.)

c. Heckart challenges the Court of Appeal's decision.

Rather than filing a rehearing petition to challenge the factual analysis in the Court of Appeal's opinion (as articulated in the opening

brief on the merits), Heckart directly sought review in this Court. This Court granted review on March 16, 2016.

LEGAL DISCUSSION

I. The Lease Agreement Offered by A-1 Does Not Constitute Insurance.

A. The Court of Appeal Properly Considered the Department of Insurance's Approval of the Lease Agreement and Rejected Heckart's Attempt to Transform it into an Insurance Contract.

The Court of Appeal held the Lease Agreement offered by A-1 was not insurance based on the Court's own analysis under the principal object test, rejecting Heckart's argument that Insurance Code Article 16.3 governed this case.[7] (Opn. 10-11.) However, as additional support for its ruling, the Court of Appeal also noted the Department of Insurance ("DOI") had reached precisely the same conclusion as the Court. (Opn. 12-13.) As much as Heckart wishes the DOI's view carries no weight, the fact the DOI reached the same conclusion as the trial court and the Court of Appeal is significant and is properly considered. (2 CT 320-324.)

1. Deans & Homer Voluntarily Sought the DOI's Approval on Multiple Occasions

In 2003, Deans & Homer voluntarily requested the DOI's review and approval of its proposed program to provide coverage to self-storage facilities – the program in which A-1 later participated. As the record

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[7] In 2004, the California Legislature enacted Division 1, Part 2, Chapter 5, Article 16.3 of the Insurance Code, sections 1758.7, *et seq.* (referred to herein as "Article 16.3"). Article 16.3 prohibits self-storage facilities from serving as agents for insurers by selling insurance to their customers on the insurer's behalf, without an insurance license. (*See* Cal. Ins. Code §1758.7(a).) Article 16.3 creates a limited license for self-storage companies that act as such agents, obviating the need for them to comply with the more extensive requirements for a full insurance license. (*See* Cal. Ins. Code §1758.7(b).)

reveals, Deans & Homer had multiple communications with the DOI about the program in 2003, (2 CT 320), and ultimately sent the DOI a detailed letter describing the program. (2 CT 320-24.)

The DOI responded in August 2003. (2 CT 326.) Relying on *Truta v. Avis Rent A Car Systems, Inc.*, 193 Cal.App.3d 802 (1987), the DOI stated that a contract between a landlord and tenant that allocates risk between them does not constitute insurance for regulatory purposes. The DOI reasoned,

> The primary purpose of the contract is rental of the premises. The parties appear to be allocating the risk by contractual agreement. For an additional amount of rent, the risk of damage for a particular risk shifts from the lessee to the lessor. (2 CT 326.)

After Article 16.3 was enacted, Deans & Homer sought confirmation that the self-storage lease agreement program would not be considered insurance, and that it remained in compliance with its legal obligations. Thus, Deans & Homer – again voluntarily – contacted the DOI to seek approval for its program, and to obtain the DOI's analysis as to any impact Article 16.3 could have. (2 CT 331, ¶ 5.) The DOI responded with a request for further materials on the Deans & Homer's program, so that it could properly analyze the program in light of the Insurance Code. The record reveals Deans & Homer sent materials to the DOI on its program, as requested. (2 CT 328.) After analyzing those materials, the DOI again confirmed Deans & Homer's program would not be considered insurance, despite the passage of Article 16.3, the statute on which Heckart's entire argument depends.[8] (*See id.*)

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[8] The fact that the DOI conducted multiple reviews of the Deans & Homer program, and the fact that the DOI both requested and reviewed

2. The Court of Appeal Properly Considered the DOI's Analysis

Given the DOI's expertise in this area and thus the significance of the DOI's repeated approval of the Deans & Homer program, it is not surprising Heckart has tried to thwart consideration of the DOI's analysis. In the Court of Appeal, Heckart argued the DOI's conclusions should be ignored because he claimed Deans & Homer misrepresented various aspects of the program to the DOI. (Heckart Court of Appeal Reply Brief, at 32.) Heckart thus argued the DOI was misled, and that it opined on a different theoretical program. (*See id.*)

The Court of Appeal thoroughly rejected that stance, finding Deans & Homer fairly and accurately described its program to the DOI. (Opn. 12-13.) As a result, although the Court independently analyzed A-1's Lease Agreement and the relevant provisions of the Insurance Code and concluded the Lease Agreement was not insurance, (Opn. 10-11, 13), the Court gave weight to the fact that the DOI reached the same conclusion. (Opn. 13.)

In light of the Court of Appeal's rejection of his argument that Deans & Homer somehow misled the DOI, Heckart abandons that position here. Instead, he attempts to downplay the DOI's approvals, almost entirely ignoring them until the end of his brief, and then dismissing them as "casual agency musing." (Heckart Opening Brief on the Merits ("OBOM") at 45.)

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additional materials related to the program before approving it, demonstrates Heckart's attack on the adequacy of the DOI's administrative review is flawed. (OBOM 44-47.)

However, both sound legal doctrine and common sense compel consideration of the DOI's analysis. As the Court of Appeal noted, (Opn. 13.), the DOI is the agency tasked with enforcing the Insurance Code, including Article 16.3. (*See* Cal. Ins. Code § 1758.74.) It has considerable knowledge and experience in this area. In fact, as discussed below, Article 16.3 was crafted specifically to conform to the DOI's view as to what activities related to the self-storage industry should be regulated as insurance. (*See* Section I.E.2. below.) While Heckart criticizes the Court of Appeal for giving any weight to the DOI's analysis, it is the DOI that is responsible for enforcing the very statute that Heckart claims governs this case. *See* Cal. Ins. Code § 1758.74. As such, it is not only proper to consider the DOI's view of what is covered by the statute, it defies common sense to ignore the DOI's analysis.[9] (*See, e.g., Communities For A Better Environment v. State Water Resources Control Bd.* (2005) 132 Cal.App.4th 1313, 1334 [discussing the considerable deference given to an administrative agency's interpretation of the regulatory scheme the agency implements or enforces].)

Moreover, Heckart is wrong in arguing that the Court of Appeal deferred improperly to the DOI's opinion. The Court of Appeal did not replace its own analysis for that of the DOI. Instead, the Court conducted its own analysis under the principal object test and the language of Article 16.3 and concluded the Lease Agreement was not insurance. (Opn. 10-11,

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[9] The DOI's analysis also is relevant here because Heckart somewhat smugly asserts the Lease Agreement is so obviously insurance, and that it so clearly is covered by Article 16.3, that "only a lawyer could find [it] to be anything else." (OBOM 12.) But the record reveals the opposite is true – everyone who has analyzed the Lease Agreement and Article 16.3 – including the trial court, three justices on the California Court of Appeal, and the DOI on multiple occasions – has reached precisely the opposite conclusion from Heckart, and has found the Lease Agreement was not insurance.

13.) The Court then found further support for its *own* conclusion in the fact the DOI reached the same result. (Opn. 12 [stating, "Based on *our* analysis of the Protection Plan and statutory scheme upon which Heckart relies, we see no reason to depart from the DOI's opinion in that regard"] [emphasis added].) It was perfectly appropriate for the Court of Appeal to acknowledge that the DOI's position confirmed the Court's own conclusion.

In fact, in *Truta v. Avis Rent A Car System, Inc.* (1987) 193 Cal.App.3d 802 – a case on which everyone involved in this matter has relied, including most importantly Heckart himself – the court gave similar consideration to the DOI's opinion. In that case, the court reached its own conclusion that under the principal object test, the contract at issue was not insurance. (*See id.* at 814.) The court then expressly acknowledged it found further support for its conclusion in the fact the DOI came to the same result. The court stated, "We also give deference to the Department of Insurance's interpretation of the Insurance Code. . . . It is obvious from the above that the Department of Insurance does not consider the California Insurance Code as designed to regulate the type of practice contained in the [] transaction before us." (*Id.* at 814-15.) The court gave consideration to the DOI's opinion even though the DOI did so through an opinion letter, similar to the present case. (*See id.* at 809-10.) Given Heckart's (mistaken) belief *Truta* supports his argument, and given the weight Heckart gives to the *Truta* opinion, it is ironic he so strongly opposes consideration of the DOI's analysis, when the *Truta* court did the exact same thing.[10]

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[10] In addition, while Heckart attempts to dismiss the DOI's analysis in response to Deans & Homer's voluntary requests in 2003 and 2008, (OBOM 44-47), Heckart ignores the fact that the DOI by necessity approved Deans & Homer's program on a *third* occasion. Specifically, in

In light of the DOI's expertise in this area, and its responsibility for enforcing the statutory scheme at issue in this case, the DOI's multiple approvals should be given weight, and they were properly considered by the Court of Appeal.

B. Applying the Principal Object Test, the Court of Appeal Properly Concluded the Lease Agreement is not Insurance.

The Court of Appeal, the trial court, and the DOI each analyzed the Lease Agreement under the governing principal object test and came, not only to the same conclusion, but to the right result – that the principal object of the transaction between A-1 and Heckart was the rental of a storage unit, not the purchase of insurance. Under seventy years of consistent and controlling precedent, the Lease Agreement thus is not an insurance contract.

The Legislature has defined insurance as "a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event." (Cal. Ins. Code, § 22.) Thus,

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addition to the DOI's response to Deans & Homer's requests for approval of its program, Deans & Homer also was required to obtain the DOI's authorization for issuance of the Storage Liability Policy Deans & Homer's sold to A-1. (*See* Cal. Ins. Code §1861.05.) Heckart acknowledges Deans & Homer sold this separate insurance policy to A-1 to cover some of the risks it assumed under the lease agreements with its tenants such as Heckart. (1 CT 206 [Heckart FAC, ¶ 28].) Before Deans & Homer could sell such a policy, it was required by law to submit the policy to the DOI for review and rate approval. (*See* Cal. Ins. Code §1861.05.) The thorough vetting of insurance policies by the DOI before they can be sold necessarily entails a review of the specific risk to be covered and the context for the coverage, and here, that must have included Deans & Homer's program for self-storage companies. Heckart never suggests the Storage Liability Policy sold to A-1 was improperly vetted by the DOI before Deans & Homer sold it, nor does he even address this separate approval of Deans & Homer's program by the DOI.

insurance necessarily involves at least "two elements: (1) a risk of loss to which one party is subject and a shifting of that risk to another party; and (2) distribution of risk among similarly situated persons." (*Metropolitan Life Ins. Co. v. State Bd. of Equalization* (1982) 32 Cal.3d 649, 654.) However, evaluating these two elements is the *beginning* of the analysis in deciding whether a particular contract constitutes insurance, not the end.

In other words, the "[a]bsence or presence of assumption of risk or peril is not the sole test to be applied in determining its status. The question, more broadly, is whether, looking at the plan of operation as a whole, 'service' rather than 'indemnity' is its principal object and purpose." (*California Physicians' Service v. Garrison* (1946) 28 Cal.2d 790, 809.) If the principal object of the transaction is to provide a service (e.g., leasing a storage facility to a tenant) and certain risks are incidentally transferred as part of the transaction, the contract does not involve the sale of insurance.

Applying this distinction, this Court has refused to extend insurance regulations to non-insurance agreements merely because they contain an element of risk distribution. (*See, e.g., Transp. Guar. Co., Ltd. v. Jellins* (1946) 29 Cal.2d 242, 244, 247-252 ("*Jellins*") [an agreement to maintain, garage and fuel certain trucks, to obtain insurance and to repair any collision damage they sustained, was not insurance; the primary objective of the contract was vehicle service]; *Title Ins. Co. v. State Bd. of Equalization* (1992) 4 Cal.4th 715, 725-726 [underwriting agreements between title insurers and underwritten title companies, under which portion of certain title insurance claims were allocated to title companies, were not illegal insurance contracts, even if agreements served risk-shifting function].)

Applying this test to this case, A-1's Lease Agreement does not qualify as insurance because, as even Heckart readily admits, the principal object of the tenants' contract is to rent storage space. (2 CT 365 [Heckart trial court brief admitting that "as defendants point out, [Heckart's] purchase of the Protection Plan was *incidental* to his primary purpose of obtaining a storage unit."] [emphasis in original]; OBOM 21 [calling the protection plan "incidental" to the lease agreement between A-1 and Heckart].) The risk-shifting associated with the Lease Agreement is – as everyone in this case acknowledges – an incidental part of that transaction. The only reason for the protection plan addendum to the Lease Agreement to exist, and for A-1 and Heckart to have allocated risk between them, was because Heckart leased storage space from A-1. Thus, the Lease Agreement is exempt from insurance licensing laws.

C. Heckart is Wrong that Applying the Principal Object Test Exalts Form Over Substance.

Heckart argues application of the principal object test here would promote form over substance. (OBOM 13-14.) In Heckart's view, if A-1's name was taken off the protection plan, and Deans & Homer's name was placed on it instead, so that it became a contract directly between Deans & Homer and Heckart, rather than as part of the Lease Agreement between A-1 and Heckart, then it would be treated as insurance. Heckart complains this makes no sense. (*See id.*) Heckart's argument fails for several reasons.

First, the principal object test recognizes there is an important difference between a contract that allocates risk between the parties to the contract, on the one hand, and a separate policy of insurance with an insurer that is not a party to the contract, on the other hand. The principal object test acknowledges it is beneficial for parties to a contract to allocate the risks inherent in the contract between them by agreement, in advance of any

dispute – and that such allocation by itself should not render the contract as "insurance" for purposes of regulation under the Insurance Code.

That same policy choice is not present, however, when an insurance carrier, not a party to the contract, reaches a separate agreement the purpose of which is indemnity. The critical difference is that in such instance, the insurance carrier is agreeing to accept risk where it otherwise would bear none. Unlike the situation in which parties to a contract are allocating risk, the insurance carrier is not resolving questions regarding the allocation of risks in a transaction before a dispute arises. Instead, an insurer is being paid to accept a risk of loss when it otherwise could have no such risk. This distinction is the entire reason for the principal object test, and the past seventy years of consistent precedent making this distinction.

That also is why it is not particularly relevant that the risk allocation portion of the Lease Agreement might in another context look similar to insurance. In fact, the principal object test only applies when that is the case – the principal object test *assumes* as its starting point the fact that the contract at issue looks similar to insurance, and then determines whether the contract actually should be treated as such under the Insurance Code.

In fact, in *Jellins*, one of the very first cases in which this Court discussed the principal object test, the Court expressly described a set of facts very similar to the present case as the type of situation to which the insurance regulations should *not* be applied. In its opinion, the *Jellins* court discussed the fact that nearly every contract involves some assumption of risk, and that the basic premise of the principal object test is that the insurance laws should not be extended to cover all such agreements. One of the specific fact scenarios the Court described was a landlord-tenant agreement in which risk of property damage is allocated between them –

precisely the scenario involved in the present case. (*See Jellins* (1946) 29 Cal.2d 242, 248 [describing "[t]he lessee who agrees to hold his lessor harmless for damage to property of, or injury to third persons occurring on the leased premises [and] the lessor who agrees to keep the premises in repair" and suggesting the extension of insurance regulations to cover such situations would be improper].)

Just as the *Jellins* court stated, the fact that the landlord-tenant Lease Agreement in the present case involves the allocation of risk between them does not mean the contract should be treated as insurance. Instead, because the principal object of such a transaction is the leasing of space, the insurance laws do not apply. (S*ee id.* at 248-249.) To summarize, the notion that applying the principal object test here would exalt form over substance is flawed.

D. Heckart's Argument that the Principal Object Test is not Dispositive Ignores Seventy Years of Precedent.

Because Heckart admits, as he must, that the principal object of the transaction here was the rental of storage space, rather than indemnity, (2 CT 365; OBOM 21), Heckart's only chance of prevailing is to avoid application of that test. To that end, Heckart argues the principal object test is not dispositive, but rather is only one factor among many to be considered. (OBOM 3, 27.) Heckart's argument boldly ignores the past seventy years of precedent, in which the test was dispositive in every case in which it was applied.

1. The Principal Object Test is a Dispositive Test; it is Not Part of a More Extensive, Multi-Factor Test.

Neither this Court nor the Courts of Appeal have ever treated the principal object test as anything but dispositive. Although Heckart's entire

case rests on the hope that the principal object test is a non-dispositive "factor," Heckart fails to identify even a single case in which the test was applied, and the principal object of the transaction was found to be something *other* than indemnity, but the court decided to treat the contract as insurance despite the principal object test. In other words, there would need to be some case in which the court found the principal object test leaned against a finding of insurance, but the court ultimately dismissed the principal object "factor" and ruled the contract was insurance anyway. If Heckart's argument were to have any merit, he would need to be able to point to such cases – but he cannot find even one.[11]

On the contrary, the principal object test has always been applied in a dispositive manner. For example, in *Jellins*, this Court considered whether several truck maintenance contracts that also required the provision of insurance for the trucks, were insurance contracts. The Court treated the principal object test as dispositive in answering that question. The Court stated, "*[t]he question turns*, not on whether risk is involved or assumed, but on whether that or something else to which it is related in the particular plan is its principal object and purpose." (*Transportation Guarantee Co. v. Jellins* (1946) 29 Cal.2d 242, 249 [emphasis added] [internal citation omitted].) The Court then determined the contracts at issue were not insurance by applying the principal object test. The Court stated, "The

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[11] Heckart might attempt to argue *Wayne v. Staples* is such a case. Actually, as discussed below, the court in *Wayne v. Staples* decided the principal object test did not apply at all to the facts before it, because the contract at issue was admitted to be insurance, and because the customer in that case was actually becoming an "additional insured" on an insurance policy with an insurer. (*See Wayne*, 135 Cal.App.4th at 471-72, 475 n.3.) Under those facts, the principal object test simply was not needed. (*See id.* at 476-77.) Because the purpose of the principal object test is to determine whether a contract containing an allocation of risk is insurance, the court in *Wayne v. Staples* did not apply the test to the facts presented.

above quoted provisions of the contract, on careful consideration, seem amply to support the conclusion that, as stated in the contract itself, 'the major part of the Contractor's service is the supplying of labor.'" (*Id.* at 252.)

Similarly, in *Title Insurance Company v. State Board of Equalization*, (1992) 4 Cal.4th 715, this Court's determination of whether the contracts at issue were insurance relied solely on an application of the principal object test, which it treated as dispositive. The Court stated, "[W]e conclude that the underwriting agreements are not illegal contracts of insurance. . . . The indemnity provisions are secondary to the main object and purpose of the underwriting agreements." (*Id.* at 726-27; *see also Truta*, *supra*, 193 Cal.App.3d at 814 [treating the principal object test as dispositive].) The Court did not take any other "factors" into account before reaching its conclusion.

Heckart argues that in some instances, courts applying the principal object test also have noted other considerations relevant to whether the contract at issue was insurance. (*See, e.g.,* OBOM 28, 33.) But in each instance, any other considerations simply confirmed what the court already found to be true under the principal object test. In other words, at times courts simply noted there were other relevant facts that showed the court's decision under the principal object test was correct. But critically, there is not a single instance in which a court looked at some other relevant facts and found they "overruled" the principal object test, which is precisely what Heckart asks the Court to do here.

Contrary to Heckart's view, the principal object test is not a factor to be applied, but a dispositive test for determining whether a contract that contains risk allocation provisions constitutes insurance.

2. There is no So-Called "Evils" Prong Considered in Conjunction with the Principal Object Test.

In support of his argument that the principal object test is not dispositive, Heckart argues there is a two-part test for determining whether a contract is insurance. Heckart contends the first prong of this test is the principal object "factor." The second prong, Heckart argues, is what he calls the "evils" test – whether the contract at issue involves evils at which the insurance regulations were aimed. (OBOM 32-36.) Heckart bases his argument on the fact that the Court of Appeal in *Truta v. Avis Rent A Car System, Inc.* (1987) 193 Cal.App.3d 802, quoted language from a treatise that discussed this "evils" analysis in conjunction with the principal object test. (*See Truta, supra*, 193 Cal.App.3d at 812-13 [quoting Keeton, *Insurance Law* (1971) § 8.2(c), p. 552].)

There is no so-called "evils" prong to be applied in conjunction with the principal object test. The test this Court set out and applied in *Jellins* was a straightforward determination of whether it was indemnity, or some other purpose, that was the principal object of the transaction at issue in the case. (*Jellins*, 29 Cal.2d at 249.) The *Jellins* court did not discuss or apply any so-called "evils" prong to the test. Further, while the Court of Appeal in *Truta* did quote language from a treatise regarding whether the contract involves the evils at which the regulatory statutes were aimed, the *Truta* court never actually engaged in any such analysis. The *Truta* court simply applied the principal object test as set out by this Court in *Jellins*. The *Truta* court concluded that the principal object of the contract at issue was the rental of a car, not indemnity, and on that basis, ruled that the contract was not insurance. (*See Truta, supra*, 193 Cal.App.3d at 814.)

Following *Truta*, this Court continued to apply the principal object test, without consideration of any so-called evils at which the regulatory

statutes were aimed. For example, in *Title Insurance Company v. State Board of Equalization* (1992) 4 Cal.4th 715, decided several years after *Truta*, this Court once again determined the contract at issue was not insurance based solely on the principal object test. (*See id.* at 726-27.) The Court did not even mention any so-called "evils" prong of the test, never mind apply such an analysis in reaching its conclusion. (*See id.*)

Heckart disregards the manner in which this Court actually has applied the principal object test, and instead describes a set of so-called "evils" he believes would be present here if the Insurance Code is not applied. (OBOM 24-26.) For example, Heckart argues because A-1 has not been regulated under the Insurance Code, it has not been subject to the Code's capital and reserve requirements that help ensure there are sufficient funds to pay insurance claims. (OBOM 25.)

But as the Court of Appeal found, Heckart's argument is utterly circular. Heckart's argument is that A-1 violated the Insurance Code by failing to comply with the rules governing insurance agents, *and therefore*, A-1 should be treated as an insurance agent. As the Court of Appeal described it, Heckart "puts the cart before the horse." (Opn. 11-12.) The regulations contained in Article 16.3 could only apply if the Lease Agreement is found to be insurance. Heckart cannot use those same requirements to reach the conclusion the Lease Agreement is insurance and thus that those regulations should apply.

In any event, even if Heckart somehow could use the requirements of Article 16.3 as part of the test to show the requirements of Article 16.3 apply, Heckart could not demonstrate he is the victim of any "evils" here. For one thing, although A-1 is not subject to the Insurance Code's capital and reserve requirements, there is no dispute Deans & Homer is a

managing general agent licensed under the insurance code. (1 CT 204, ¶ 19.) Heckart also has not argued that Deans & Homer (or A-1's storage liability insurer) has violated the Insurance Code's requirements, including capital and reserve requirements.[12] Thus, if Heckart were to suffer a loss compensable under his contract with A-1, there is no legitimate risk A-1 would lack the funds to reimburse his loss.

In addition, even if there was a risk A-1 did not have the financial resources to pay for any obligations to Heckart under the Lease Agreement, that does not mean A-1 should be regulated as an insurance agent. It is obviously quite normal for parties to enter into contracts that could obligate them financially. But in the normal course, that does not mean such parties must be regulated by the DOI to make sure they have sufficient capital and reserves so they can meet their contractual obligations. It certainly does not mean every such contracting party is an insurance agent.

E. Neither Article 16.3 Nor *Wayne v. Staples* Apply Because they Only Address the Situation in which a Party is an Agent for an Insurer.

Heckart's entire argument in this case essentially is that when a transaction looks like insurance, the principal object test should not block it from being treated as insurance merely because it is "incidental" to another transaction. Heckart relies heavily on Article 16.3 of the Insurance Code and *Wayne v. Staples*, 135 Cal.App.4th 466 (2006), arguing each shows the

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[12] Given Heckart's calculation that the Storage Liability Policy "assumes approximately 99.994% of the liability" subsumed in the protection plans (AOB 17), Heckart cannot legitimately argue there is a real risk of default by A-1. Furthermore, Heckart's assertion that A-1 owns 3.4 million square feet of California real estate (1 CT 180, ¶ 17) precludes any suggestion A-1 is judgment proof.

principal object test is not dispositive of whether the lease addendum at issue here is deemed insurance. (OBOM 10-17, 40-42.)

But what Heckart fails to grasp is that *Wayne v. Staples* and Article 16.3 both address a situation very different than that present in this case. Both *Wayne v. Staples* and Article 16.3 address the situation in which one of the parties to the transaction is serving as an agent for an insurance carrier and is selling an insurance policy on the carrier's behalf to the other party in the transaction. In such instance, there is, and can be, no dispute that the policy constitutes insurance under existing law, and the principal object test simply is not relevant or applicable.

This case, on the other hand, involves a quite different scenario. In this case, A-1 is not acting as an agent for Deans & Homer and A-1 is not selling a Deans & Homer insurance policy to its customers. Instead, A-1 has reached an agreement with its tenant as to how to allocate between them certain risks that arise from their larger contractual relationship. It is in this context that the principal object test applies to determine whether the contract at issue is insurance.

1. *Wayne v. Staples* Involved One Party Serving as an Agent to Sell an Insurance Carrier's Policy to the Other Party.

Wayne v. Staples addressed the situation in which the defendant, a nationwide retailer of office supplies, was selling an insurance policy on behalf of an insurer. Staples was offering package shipping services for customers through United Parcel Service (UPS). As a means of allowing customers to protect themselves for any loss or damage to their packages in shipping, Staples sold excess value insurance offered by an insurance company, National Union Fire Insurance Company. Customers who purchased the coverage became additional insureds under the policy, which

was a separate document expressly labeled as an insurance policy. (*See Wayne*, 135 Cal.App.4th at 471-72.)

In *Wayne*, there was no real dispute the document at issue was an insurance policy. In fact, the defendant in *Wayne* had already admitted the contract at issue was insurance, as the *Wayne* court pointed out. (*See id.* at 475 n.3.) Based on these facts, the *Wayne* court simply held it was inappropriate to use the principal object test to *exempt* from regulation the sale of what otherwise was admitted to be an insurance policy, merely because the policy was sold incidental to another transaction. The court held the principal object test, which is used to determine whether a contract is insurance, does not apply when the contract at issue already is acknowledged to be an insurance policy sold for an insurance carrier. In other words, an admitted insurance policy does not become something other than insurance merely because it is sold in connection with another non-insurance transaction. In such instance, the principal object test is not needed to confirm the contract is insurance, and the test thus does not apply. (*See id.* at 476-77.)

2. Similar to *Wayne v. Staples*, Article 16.3 only Addresses the Sale of Insurance Policies by Self-Storage Companies as Agents for Insurance Carriers.

Article 16.3 of the Insurance Code was designed to address the same basic scenario as *Wayne v. Staples*, except in the context of self-storage companies. Article 16.3 formed a new Article in the Insurance Code titled "Self-Storage *Agents*" (emphasis added). As the name suggests, its purpose is simply to require self-storage companies that are selling insurance policies on behalf of, and as agents for, licensed insurers to be licensed.

The language of Article 16.3 demonstrates it is only triggered when the storage facility is selling an insurance policy on behalf of, and expressly as the agent for, a licensed insurance carrier. For example, Section 1758.7 states that the Insurance Commissioner is authorized to issue to a storage facility a license to sell insurance "*on behalf of any insurer* authorized to write those types of insurance policies in this state." (Cal. Ins. Code § 1758.7(b) (emphasis added).) Similarly Section 1758.71 states that any storage facility applying for a license under the statute must file a "certificate by the insurer that is to be named in the self-service storage agent license stating that the insurer has satisfied itself that the named applicant is trustworthy and competent to act as its agent . . . ." (Cal. Ins. Code § 1758.71.)

These provisions reveal that what the statute governs is the situation in which a self-storage facility acts as an agent for an insurance carrier, selling an insurance policy that is separate from its rental contract, and that is issued on behalf of, and in the name of, the insurance carrier (similar to *Wayne v. Staples*). Under such an insurance policy, the individual renting the storage unit would have a contractual relationship directly with the insurance carrier, and any claim made under the policy would be made directly to, and paid by, the insurer. That is not the case here.

The legislative history of Article 16.3 also confirms its purpose was to create a limited agent license to allow self-storage facilities to sell insurance on behalf of insurance carriers.

The report on the bill for the Senate Committee on Insurance, in describing the bill, confirms the bill that became Article 16.3 was designed to cover storage companies expressly acting as agents on behalf of an insurer. The report states that "The Department of Insurance has taken the

position that the self-storage facilities making [insurance] coverage available *and collecting the premium for licensed agents and/or insurers should be also licensed.*" (Senate Committee on Insurance Report on AB 2520, hearing date June 16, 2004 at 3 [http//www.leginfo.ca.gov/pub/03-04/bill/asm/ab_2501-2505/ab_2520_cfa_20040616_081436_sen_comm.html].)

This same report also notes (as it is noted throughout the bill's legislative history) the bill is in response to efforts by the Department of Insurance to stop self-storage facilities from selling insurance policies as agents for insurance carriers. The legislative history notes that the Department of Insurance has issued "cease and desist orders against several self-service storage facilities" acting in this manner, and that the bill was in response to the DOI's position. (*Id.* at 3.)

This is significant because it reveals the DOI was acutely aware of a situation it viewed as a violation of the Insurance Code – self-storage companies acting as agents for insurers – and Article 16.3 was designed to address the specific problem the DOI had identified. And yet in the exact same time frame, the DOI expressly *approved* Deans & Homer's program and concluded the Lease Agreement was not insurance. (2 CT 326, 328). One of the DOI's approvals came after Article 16.3 was enacted, and the DOI thus confirmed Article 16.3 did not apply to Deans & Homer's program. The DOI's approval of Deans & Homer's program, and concurrent issuance of cease and desist letters against other storage companies that were acting as agents for insurers further confirms Article 16.3 was designed to regulate the latter and not the former.

Rather than limiting Article 16.3 to the scenario it was designed to address, Heckart attempts to use Article 16.3 as a replacement for the

principal object test. Because Article 16.3 regulates the sale of insurance in the context of self-storage facilities, Heckart argues Article 16.3 essentially defines all contracts that allocate risk in the context of self-storage to be insurance.

Nothing in Article 16.3 is intended to replace the principal object test or to define when a transaction constitutes insurance. Article 16.3 was not intended to be used to set out a new definition for when a transaction constitutes insurance, but rather to confirm the DOI's view that a self-storage facility selling insurance on behalf of an insurer needs an insurance license to do so, and sets out the regulations that apply in that limited scenario. In other words, the Article does not define "insurance" in the context of self-storage transactions. Instead, Article 16.3 takes as its starting point that the underlying transaction already has been determined to be insurance because it is being sold as such for a licensed insurance carrier, and thus is insurance under existing law.

The Court of Appeal reached the same conclusion. The Court of Appeal held Article 16.3 does not define what constitutes insurance, but rather only applies if the contract at issue is determined under other existing law to be insurance. The Court of Appeal pointed out several provisions in Article 16.3 that demonstrate this fact. For example, section 1758.7 states that a self-storage facility shall not "'*offer or sell insurance* unless it has complied with the requirements of [Article 16.3].'" (Opn. 11 [quoting Cal. Ins. Code § 1758.7(a)] [emphasis added by Court of Appeal].) Further, the Court of Appeal pointed to Section 1758.76, which states a self-storage facility "'*shall not sell insurance* pursuant to [Article 16.3]' unless it provides required written materials and disclosures." (*Id.* [quoting Cal. Ins. Code § 1758.76] [emphasis added by Court of Appeal].] As the Court of Appeal concluded, Article 16.3 does not create a new definition of

insurance in the context of self-storage facilities, but rather only applies if the self-storage facility is selling insurance under existing law, such as when the self-storage company is serving as the agent for an insurer.

F. Heckart's Concern about a Parade of Horribles is Misplaced.

Heckart complains that if the Court of Appeal's decision is affirmed, it will cause a horde of unlicensed "insurance" schemes to be unleashed on consumers across the State. Heckart contends that all sorts of vendors could include protection plans at the back of their contracts with customers that shift contractual risks among the parties and would not be regulated as insurance. (OBOM 26-27.)

Heckart's concern about a parade of horribles is misplaced. As discussed above, the Court of Appeal applied the principal object test in the same manner in which it consistently has been applied for the past seventy years. During this entire time, it has been true that parties could include provisions in their contract that allocates risks between them, without the contract being regulated as insurance, so long as indemnity is not the principal object of the transaction. This is nothing new. Heckart's concerns notwithstanding, the past seventy years of the principal object test have not caused it to be "open season" on Californians with predatory insurance schemes. (OBOM 27.) Nor does Heckart provide any evidence to the contrary.

In fact, if Heckart's alleged parade of horribles was a true concern, then one would have expected the DOI to have opposed Deans & Homer's program rather than approving it multiple times. Similarly, one would have expected the DOI to have issued a cease and desist letter to A-1 if the DOI believed A-1 was violating Article 16.3. (*See* Cal. Ins. Code § 1758.74(b).)

But none of that has occurred, and again, Heckart has not alleged anything different. There is simply no reason why affirming the Court of Appeals' decision would cause California businesses to operate any differently than they have for the past seventy years.

II. The Various Remaining Arguments Raised by Heckart Are Factually and Legally Flawed. In Addition, His Approach Entails Significant, Adverse Consequences.

A. Other Cases Have Similarly Rejected Heckart's View That A-1's Lease Agreement Constitutes Insurance.

The Lease Agreement sold by A-1 "differed from a traditional insurance contract in several key respects that supports our conclusion that this program is not insurance. First, it is difficult to consider the [monthly] fee a 'premium' for insurance because [A-1] charged all [tenants] a fixed fee. [1 CT 200, ¶ 4]. Therefore, there was no underwriting of risk unique to individual" renters. (*Allen v. Burnet Realty, LLC* (Minn. 2011) 801 N.W.2d 153, 159 [brackets added].) Furthermore, "in an insurance contract, the insurer will have no connection with or control over the losses sustained on the part of the insured." (*Id.* [indemnification arrangement between real estate broker and sales agent covering professional liability claims did not constitute E&O insurance under statutory definition, thus eliminating the need to adopt the principal object test].) Here, by contrast, the risks covered by the Lease Agreement can be controlled by the storage operator; e.g., the risk of fire, roof leak, water damage, etc. (1 AA 206, ¶ 2(a)-(e).) Therefore, Heckart's view that A-1's Lease Agreement constitutes insurance should be rejected.

B. Heckart's Arguments, If Adopted, Will Have Negative Repercussions for Both Consumers and Businesses.

Adopting Heckart's arguments could lead storage facilities to eliminate the availability of protection plans such as the lease addendum to A-1's Lease Agreement, leaving consumers unprotected in the event of a loss. Alternatively, storage facilities would have to raise their rates to offer consumers the same benefits (e.g., loss protection). Either result inevitably would harm consumers.

In addition, the adoption of Heckart's arguments will have implications outside the licensing context presented here. "The purposes of examining whether a specific arrangement amounts to insurance can vary widely and include determinations of which statute of limitations applies to a claim, whether a specific state regulation applies . . . , whether attorney's fees are available in a dispute over the agreement, and whether an arrangement amounts to 'other insurance' rendering an existing insurance policy only secondarily applicable to a claim." (1 Couch on Insurance (3d ed. 1997) § 1:19.) In advancing his proposed sea change in the law, Heckart has conveniently ignored these practical ramifications of adopting his view.

Finally, numerous professionals, vendors, service providers and sellers of goods routinely engage in functionally equivalent transactions every single day. For example, a tax preparer may offer to pay the difference between the tax computed for a customer and the amount deemed by the IRS to be due by offering to cover the difference. A furniture store may sell a protection plan covering rips if the furniture is accidentally damaged. An exterminator may sell a termite damage guarantee to pay for any property damage caused by a defective inspection or an inadequate extermination. While the number of such transactions is admittedly unknown, there is no reason to believe that the sky is falling

under the current system as suggested by Heckart. (*See Boyle v. Orkin Exterminating Co., Inc.* (Fla.Dist.Ct.App. 1991) 578 So.2d 786, 787-788 [lifetime termite damage guarantee sold in connection with an exterminator's treatment of termites was not insurance where exterminator assumed responsibility for retreatment if termites reappeared and promised to pay for replacement of damaged property]; *see also* Bus. & Prof. Code, § 8516, subd. (h) & (h)(6) [authorizing registered/licensed exterminators to sell "control service agreements", including "extended warranties"].)

Adopting Heckart's view, however, would mean that all such professionals and vendors are suddenly subject to the DOI's jurisdiction. That would engender a turf war between the DOI and other licensing agencies regulating such entities. This provides another ground for rejecting Heckart's paternalistic position.

C. It is Up to the Legislature to Decide Whether the Scope of Contracts Regulated as "Insurance" Should be Expanded.

While licensing questions inherently present complex policy issues best left to the Legislature, Heckart blames the lower courts for declining to develop or apply an *ad hoc* test when neither the trial judge nor the appellate panel was in a position to know, weigh, or balance the potential consequences of such a decision. This provides another basis to reject Heckart's attacks on the lower courts' decisions.

Heckart's response is that this Court should deem A-1's Lease Agreement as insurance to maximize consumer protection. "Whether more consumer protections are needed, or whether [new types of transactions] should also be regulated by the Department, are matters for the Legislature, not for us." (*Automotive Funding Group, Inc. v. Garamendi* (2003) 114 Cal.App.4th 846, 857 [car finance lender's loss damage waiver, canceling

debt when car was deemed as a total loss, was not "insurance"; the program was intended to protect the lender's lien rather than being the principal object of lender's transaction].) Accordingly, to the extent Heckart is asking this Court to usurp the traditional policymaking function of the Legislature – by classifying all lease arrangements offered by storage facilities as insurance – his arguments should be rejected on this alternative ground.

D. Heckart's Attacks on the Court of Appeal's Decision Are Equally Futile.

While Heckart criticizes the Court of Appeal's decision by assuming that the opinion applies a mechanical approach in deciding whether a particular contract qualifies as insurance, Heckart is the one seeking to apply a formulaic, mechanical approach by effectively deeming all risk-transfer agreements as insurance. The Court of Appeal properly rejected such a one-size-fits-all approach by examining the substance and the commercial realities of the parties' transaction. (Opn. 9-11.)

Attempting to distort the Court of Appeal's opinion, Heckart claims that "according to the Opinion below, replacing Deans & Homer's name with A-1's name as the 'insurer' in a standard form insurance policy—and changing nothing else—somehow renders the policy noninsurance under the Code." (OBOM 13.) This hypothetical scenario, however, ignores the dispositive distinction articulated in this brief. If a vendor stands behind its own service or product (e.g., by transferring the risk of non-conformance of its own service or product *to itself* (whether in the form of a protection plan, guarantee, warranty, etc.), such a risk-transfer is not considered insurance. The hypothetical advanced by Heckart, however, completely ignores this distinction. Contrary to Heckart's view, there is absolutely nothing wrong with examining the identity (and, thus, the relationship) of the parties to the

contract in evaluating whether a particular form of risk-transfer qualifies as insurance.

E. The Remaining Factual and Legal Arguments Raised by Heckart should be Summarily Rejected.

Heckart implies that because A-1 offered its Lease Agreement in lieu of the tenant obtaining a separate insurance policy from an insurer, the Lease Agreement must itself be considered insurance. In other words, in Heckart's view, if a contract is offered as an alternative to insurance, it should be treated as such, suggesting that any other result would encourage vendors to avoid insurance laws by labeling their contracts differently. Heckart is dead wrong. "Offering an alternative to insurance does not mean that the alternative *is* insurance." (*Automotive Funding Group, supra,* 114 Cal.App.4th at 854 [italics in original; footnote omitted].)

In addition, contrary to Heckart's assertion, (OBOM 6), even if Deans & Homer provides services to process the tenants' applications for reimbursement for property damage under A-1's Lease Agreement, that does not render the protection plan an insurance contract. (*See, e.g., Truck Ins. Exch. v. Amoco Corp.* (1995) 35 Cal.App.4th 814, 823-824 [provision of insurance-related services (*e.g.*, administrative support to help process claims) does not make the provider an insurer].)

To summarize, the remaining factual and legal arguments raised by Heckart lack merit.

III. Alternatively, If the Court Were to Modify or Replace the Principal Object Test, the Dismissal of Heckart's Lawsuit Should Still Be Affirmed Under the Different Alternative Tests Proposed Here.

Given that the principal object test has been applied by California courts for 70 years, the Court should reject Heckart's attempt to replace such an easy-to-administer test. While Heckart has expressed reservations about the validity of the principal object test, he does not present any cogent arguments to articulate an alternative test that adequately addresses the competing policies at issue here. Deans & Homer, in contrast, suggests the following alternative tests, providing this Court with additional grounds for rejecting the myopic view advanced by Heckart under the guise of consumer protection.

A. The First Alternative Test, the Self-Provider Test, Focuses on Whose Service or Product Is Being "Insured."

Assuming for the sake of argument that the Court is inclined to modify or replace the principal object test, a protection plan should be deemed as insurance when sold by a vendor principally to insure risks other than the integrity of the vendor's own service or product. Conversely, if the protection plan sold by the vendor principally assures the consumer of the integrity of the vendor's own product or service (in this case, providing a safe and secure storage unit), the protection plan would not qualify as insurance under our proposed bright line test. In the latter example, as a self-provider, the provider of the underlying transaction also sells what Heckart has labeled as insurance.

This proposed test fills the contractual gap created by disclaimers in the tenant's contracts with the storage facility, confirming the parties'

understanding that the tenant will not hold the facility liable for such damage. This logical test also eliminates any coverage gap that may be present under the storage facility's own commercial general liability policy for property damage claims by tenants. (*See, e.g., Pacific Indem. Co. v. Bellefonte Ins. Co.* (2000) 80 Cal.App.4th 1226, 1233 [confirming applicability of CGL exclusion for property "entrusted to the insured for storage or safekeeping" to personal property subject to a bailment or similar arrangement].) Instead of leaving the tenant unprotected (whether based on contractual disclaimers or CGL exclusions), allowing the storage facility to offer protection without deeming such a transaction to be an illegal sale of insurance fosters consumer protection by allowing the tenant to have this crucial recourse – recovery for damage to goods – in the event of a loss.

In addition to its bright line feature and common sense root, this test is fully consistent with the Insurance Code. Adopting a virtually identical approach, the legislature has exempted risk-allocating contracts that would otherwise qualify as insurance from the definition of insurance when the contract is sold by the same party whose own product or service is being "insured." For example, although the sale of a vehicle service contract generally requires a license (*See* Cal. Ins. Code, § 12815), such a contract does "not constitute insurance" as long as it is sold by the manufacturer/distributor that manufactured/distributed the subject vehicle. (*Id.*, § 12805, subd. (a)(1).) Likewise, the sale of an "agreement that promises the repair or replacement of a tire or wheel . . . caused by a road hazard" is subject to insurance regulations. (*Id.*, § 12800, subd. (c)(4)(A).) However, the same agreement is exempt from the licensing requirement (§ 12815) if the obligor – "the entity legally obligated under the terms of a service contract" – is the tire manufacturer itself. (*Id.*, § 12800, subds. (c)(4)(A) & (g).) Similarly, while the sale of a contract promising to repair

or replace components of a home qualifies as a "home protection contract" (*id.*, § 12740, subd. (a)) – requiring a license under section 12744 – such contracts are exempt from the licensing requirement when offered by "the builder of a home or the manufacturer or seller of an appliance." (*Id.*, § 12741, subd. (a).)

Applying our proposed test here, the Lease Agreement offered by A-1 does not constitute insurance because it is offered by A-1 to "insure" the integrity of *its own* service. In essence, A-1 assures its tenants that any loss associated with the self-storage service provided by A-1, the vendor under the Lease Agreement, will be reimbursed by entering into the Lease Agreement (i.e by signing the Lease Agreement with the protection plan addendum as part of the contract). Because A-1 is merely assuring the integrity of its own service (providing tenants with a safe storage space), the Lease Agreement does not constitute insurance under this test.

B. Under the Second Proposed Test, the Proportionality Test, No License Is Required If the Sale of the Protection Plan Represents a Small Portion of the Defendant's Total Revenues.

Second, if the Court is inclined to modify the principal object test, it could apply the following test, one that was originally applied by this Court in another context. A company selling a protection plan in connection with the sale of its own product or service is required to have an insurance license as long as "indemnifying against future contingent [] expenses represents a significant financial proportion" of its total revenues. (*Myers v. Board of Equalization* (2015) 240 Cal.App.4th 722, 727 [citing *People ex rel. Roddis v. California Mut. Assn.* (1968) 68 Cal.2d 677].) In *Roddis*, this Court held that a health care service plan is not subject to insurance laws as long as it meets this test. (*Roddis,* at p. 683.) The Court balanced two

competing policies in formulating this test: the need to ensure adequate financial reserves for payment of claims and a "strong social policy to encourage the services" offered to the public. (*Id.* at p. 682.)

Likewise here, the competing policies at issue in this case can be balanced by applying the *Roddis* test while tweaking it. Rather than encouraging litigation over what constitutes a "significant financial proportion" of the defendant's total revenues, the Court should adopt a bright line rule to mathematically define this phrase. If the revenues generated by the sale of the defendant's protection plans constitute 50% or more of the total revenues obtained from all of the defendant's operations, those revenues should be deemed as "significant," thus triggering the need for an insurance license in such cases. (*Cf. Myers, supra,* 240 Cal.App.4th at 740-741 [applying *Roddis* as "the appropriate standard for determining whether an entity should be regarded as an 'insurer' for purposes of assessing the gross premium tax"].)

Applying this test here, Heckart states that A-1's annual revenues from the protection plan total $1,641,000 (excluding the claims paid); the record, however, does not reflect A-1's total revenues from all of its operations. The Lease Agreement reflects that while the protection plan cost Heckart $10/month (2 CT 314, ¶ 2), the storage rental fee was $55 per month (2 CT 311, ¶ 3), yielding an 18% ratio. Because this figure is below the 50% threshold, it cannot constitute a "significant financial proportion" of A-1's total revenues. Therefore, the protection plan does not constitute insurance under this proposed test.

* * * *

To summarize, even if this Court were to modify the parameters of the principal object test as requested by Heckart, there would still be no

basis to deem A-1's License Agreement as insurance under either of these proposed tests. While Heckart has not articulated a single practical test in order to replace or abrogate the principal object test, the alternatives suggested here impose easy-to-administer, bright line tests. (*Cf. Cel–Tech Comms. Inc. v. L.A. Cellular Tel. Co.* (1999) 20 Cal.4th 163, 185 [rejecting proposed test that was "too amorphous" in defining UCL violations].) [13]

Therefore, even if the Court were inclined to modify the principal object test, Heckart's licensing arguments would still fail.

IV. Alternatively, If the Court Were to Deem the License Agreement Challenged Here as Insurance, Its Decision Should Be Limited Prospectively.

While court decisions are ordinarily applied to pending cases retroactively, "[c]onsiderations of fairness and public policy may require that a decision be given only prospective application." (*Claxton v. Waters* (2004) 34 Cal.4th 367, 378.) "Particular considerations relevant to the retroactivity determination include the reasonableness of the parties' reliance on the former rule, the nature of the change as substantive or procedural, retroactivity's effect on the administration of justice, and the purposes to be served by the new rule." (*Id.* at pp. 378-379.) [14]

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[13] Our proposed alternatives can also be used *in conjunction* with the principal object test, or by evaluating whether "the gravamen or principal thrust" of a transaction involves a service or indemnity. (*In re Episcopal Church Cases* (2009) 45 Cal.4th 467, 477 [applying this test to evaluate if a lawsuit qualifies as a SLAPP].)

[14] Consistent with our position, this Court has limited the application of its own decisions prospectively in various cases. (*See e.g., Moradi-Shalal v. Fireman's Fund Ins. Cos.* (1988) 46 Cal.3d 287, 305 [decision abolishing the "*Royal Globe* bad faith" cause of action against insurers]; *Woods v. Young* (1991) 53 Cal.3d 315, 329-331 [decision interpreting the

In this case, it would be particularly unfair to impose liability on Deans & Homer retroactively. The record makes it clear that Deans & Homer made every reasonable effort to ensure its program and sale of insurance to self-storage facilities that shift the risk of loss onto themselves was in full compliance with the Insurance Code. Before starting its program, Deans & Homer voluntarily sought guidance from the DOI. As the Court of Appeal concluded, Deans & Homer fully and fairly disclosed the details of its program, and obtained the DOI's approval to proceed. (Opn. 12-13.) After Article 16.3 was enacted, Deans & Homer again voluntarily sought confirmation from the DOI that the protection plan was not insurance. Deans & Homer thus undertook considerable effort to ensure what it was doing was proper and in accordance with its legal obligations.

Given the DOI's repeated express approval of the program challenged by Heckart (2 CT 326, 328) and the parties' reliance on such administrative approval, retroactive imposition of liability is unjustified. The availability of criminal penalties for selling insurance without a license (Ins. Code, § 1633) and the availability of significant civil penalties in UCL cases initiated by public prosecutors (Bus. & Prof. Code, § 17206) further underscore the need for prospective application of any ruling that changes the status quo. Otherwise, the retroactive imposition of punishment for previously unproscribed conduct violates the cardinal constitutional

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tolling of the medical malpractice statute of limitations by statutory notice of intent to sue]; *Camper v. Workers' Comp. Appeals Bd.* (1992) 3 Cal.4th 679, 688-690 [decision holding that the statutory extension of time after service by mail does not apply to the deadline for filing a petition challenging WCAB decisions]; *Moss v. Superior Court* (1998) 17 Cal.4th 396, 428-430 [decision that a willfully unemployed parent is subject to contempt sanctions for nonpayment of court-ordered child support].)

principle of fair notice. (*See, e.g., Bouie v. City of Columbia* (1964) 378 U.S. 347, 350 [new judicial interpretation of the law, deeming the offense of trespass to cover the act of remaining on the premises of another after being asked to leave, could not be constitutionally applied, where prior judicial decisions had not adopted such an interpretation as of the time the offense was committed].)

Unless the decision is limited prospectively, it would impose strict liability with regard to the complex scheme of "insurance" regulation in California. At the very least, a retroactive decision casts a cloud of ambiguity over the business decisions of all storage operators across California, who had no reason to know that their conduct, though initially viewed reasonably as lawful, may now be condemned as illegal under the theory advanced by Heckart.

Furthermore, given that the Department of Insurance "has expressly declared to be lawful"[15] the identical program challenged by Heckart, defendants' participation in that program cannot trigger retroactive liability under the UCL. Retroactive invalidation of a program that has already been scrutinized and approved by the Insurance Commissioner would necessarily undermine California's system of insurance regulation. Otherwise, an administrative agency's express approval would be meaningless if the permittee remained subject to retroactive civil liability for engaging in the identical conduct approved by the agency. Businesses would have to act under administrative authority at their own peril, the peril being that a court in an isolated lawsuit might later decide that the agency-approved conduct qualified as unfair competition, exposing them to massive liability under the UCL.

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[15] (*Hobby Industry Assn. of America, Inc. v. Younger* (1980) 101 Cal.App.3d 358, 370.)

Finally, prospective application of this Court's decision is particularly appropriate here because consumers would not be adversely affected. If the Court deems the protection plan to be insurance, such plans "will be enforceable, despite [A-1's] unlicensed status." (*Medina v. Safe-Guard Products, International Inc.* (2008) 164 Cal.App.4th 105, 112.) Given that A-1 is already subject to other statutory requirements governing its transactions with the public (see Bus. & Prof. Code, §§ 21700-21716 [addressing liens, late fees, etc.]), the failure to obtain a license is, in essence, a technical violation of the Insurance Code under the interpretation advanced by Heckart. (*Cf. Peterson v. Cellco Partnership* (2008) 164 Cal.App.4th 1583, 1591 [upholding dismissal of UCL case predicated on the unlicensed sale of cell phone insurance in violation of Insurance Code section 1758.6 based partially on the enforceability of such insurance contracts irrespective of licensing violation]; *see also Automotive Funding Group, Inc., supra,* 114 Cal.App.4th at 857 [declining to impose insurance licensing requirement where defendant lender was "subject to various consumer protection provisions," including bond and licensing requirement under separate statutory scheme].)

In other words, while Heckart may think the protection plan should have been subject to oversight by the Department of Insurance, the protection plan remains a fully enforceable contract, and Heckart will still receive the full benefit of the bargain he reached with A-1. As a result, prospective application of this Court's decision is particularly appropriate under the circumstances of this case.

CONCLUSION

The decisions of the trial court and the appellate court should be affirmed.[16]

Respectfully submitted,

DATED: July 25, 2016

WILSON, ELSER, MOSKOWITZ, EDELMAN & DICKER LLP

By _____

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[16] In addition to the Court of Appeal's conclusion the protection plan did not qualify as insurance, the Court of Appeal also affirmed the trial court's dismissal of Heckart's Consumer Legal Remedies Act ("CLRA") claim on an adequate and independent ground: namely, that the Rental Agreement between Heckart and A-1 was neither a good nor a service, and thus does not fall within the ambit of the CLRA. (Opn. 15.) Heckart has not included this issue in his petition to this Court, and the Court of Appeal's ruling on this issue thus is not subject to review. The Court of Appeal's ruling on this issue should stand.

CERTIFICATE OF WORD COUNT

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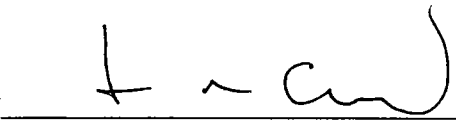
By 

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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, Div. One, Case No. D066831
San Diego Superior Court Case No. 37-2013-00042315-CU-BT-CTL

I, the undersigned, declare as follows: I am employed with the law firm of Wilson, Elser, Moskowitz, Edelman & Dicker LLP, whose address is 655 West Broadway, Suite 900, San Diego, California 92101. I am over the age of eighteen years, and am not a party to this action. On **July 25, 2016**, I served the foregoing documents described as:

ANSWER BRIEF ON THE MERITS BY DEANS & HOMER

[X] OVERNIGHT MAIL - As follows: I am "readily familiar" with the firm's practice of processing documents for mailing overnight via Federal Express. Under that practice it would be deposited in a Federal Express drop box, indicating overnight delivery, with delivery fees provided for, on that same day, at San Diego, California.

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

Angela Balistreri

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