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

ANSWER TO PETITION FOR REVIEW

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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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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

Statutes

INTRODUCTION

For 70 years, this Court and the California Courts of Appeal have consistently applied the "principal object" test to decide whether a contract that includes elements of assumption and distribution of risk is subject to regulation as insurance. The Court of Appeal's opinion was a straightforward application of that longstanding test to the facts alleged in the complaint, and no other case has ever reached a contrary result on similar facts. The California Department of Insurance likewise concluded that the contractual arrangement at issue here is not insurance for the purposes of statutory regulation. Accordingly, this case does not raise any unsettled question of law or create any disuniformity of decision. The petition for review should be denied.

ARGUMENT

A. The Risk Allocation Provisions in the Self-Storage Lease Differ Fundamentally from Insurance

For 70 years, California has applied the principal object test to decide whether a contract is subject to regulation as insurance. (Section B, *post.*) Under that test, a contract is not subject to regulation as insurance – even if it contains elements of indemnity – unless risk shifting and risk distribution is the parties' principal object.

Here, both the trial court and Court of Appeal found that the risk allocation provisions in the parties' self-storage lease did

not transform the lease into insurance subject to regulation as such because parties had a non-insurance principal object: namely, the lease of storage space. (Slip Op., pp. 5, 13.) The risk allocation provisions in the lease (i) would not exist but for the parties' landlord-tenant relationship, and (ii) served the parties' principal object – a problem-free storage lease – by avoiding liability disputes that could otherwise disrupt that relationship.

Specifically, when personal property in self-storage is damaged, the self-storage tenant may blame the landlord. The tenant may, for example, contend that (i) a leaky roof caused water damage, (ii) inadequate security led to theft, or (iii) inoperative fire sprinklers permitted a fire loss. Published cases involving such claims by tenants against landlords demonstrate that the threat of such disputes is real. (*See, e.g. Cregg v. Ministor Ventures* (1983) 148 Cal. App. 3d 1107, 1110 [theft; landlord failed to provide adequate security]; *Pelletier v. Alameda Yacht Harbor* (1986) 188 Cal. App. 3d 1551, 1554 [vandalism; landlord failed to provide adequate security]; *George v. Bekins Van & Storage Co.* (1949) 33 Cal. 2d 834 [fire; landlord negligently allowed smoking]; *Evans v. Thomason* (1977) 72 Cal. App. 3d 978 [fire; landlord failed to repair defective electric outlet]; *Ewing v. Balan* (1959) 168 Cal. App. 2d 619 [fire; landlord supplied defective water heater]; *Stoiber v. Honeychuck* (1980) 101 Cal. App. 3d 903 [water damage; landlord failed to maintain roof]; *Poulsen v. Charlton* (1964) 224 Cal. App. 2d 262 [same].)

Such disputes are costly and time-consuming, even if the tenant's attempt to blame the landlord (or the landlord's attempt to escape blame) is meritless. Both landlord and tenant accordingly have an interest in structuring their contract to avoid the expense and uncertainty of disputes over responsibility for damage to stored property. The A-1 Self Storage lease allows the parties to avoid potential liability disputes – in advance, smoothly, and without litigation – in one of two ways. Either:

> (i) the tenant agrees, via an exculpatory clause, to forego any argument that A-1 Self Storage is legally responsible for damage to stored property, or
>
> (ii) for $10 more per month, A-1 Self Storage agrees to forego any argument that it is not legally responsible up to $2,500 if tenant property is damaged while stored in an A-1 Self Storage facility.

(Slip Op., pp. 2-4; CT 200 [¶ 4], 207 [¶ 33], 229-30.) Through one option or the other – the choice belongs to the tenant – the parties resolve in advance a serious potential dispute inherent in their landlord-tenant relationship.

Petitioner Samuel Heckart contended below that a tenant's choice of the latter option transforms what would otherwise just be a lease into a contract of insurance – thus rendering the lease subject to prior approval by the Department of Insurance as to form and price, and subjecting A-1 Self Storage itself to all the many other requirements imposed on insurers. That simply is not the law. Under the principal object test, the lease remains a lease and does not become subject to regulation by the

Department of Insurance, regardless of which risk allocation option the tenant chooses.

Because the risk allocation options in the parties' contract support a non-insurance principal object, they are fundamentally different from the indemnity obligations taken on by insurers. Unlike insurers – whose *sole* relationship with their customers is one of financial guaranty – A-1 Self Storage and its customers have a landlord-tenant relationship. Unlike insurers – who cannot possibly be blamed when a risk they insure comes to pass – landlords can be blamed (meritoriously or otherwise) if tenant property is stolen or damaged. Landlords and tenants, as well as parties to contracts more generally, have a legitimate need to anticipate and address such potential liability disputes incidental to their business relationship.

Agreeing to allocate those risks in advance and without litigation is both prudent business and good public policy. For 70 years, the principal object test has promoted this sound public policy by permitting parties in non-insurance transactions to make these prudent agreements without thereby subjecting themselves to the extensive regulation imposed upon insurers.

B. There is No Unsettled Question of Law

1. The Rule of Decision – the "Principal Object" Test – Is Settled Law

The principal object test, which the Court of Appeal applied to decide that the parties' storage lease agreement is not subject to regulation as insurance (Slip Op., pp. 9-10), was adopted by this Court in 1946 and has been consistently applied since then. This case therefore raises no unsettled question of law.

In *Transportation Guar. Co. v. Jellins* (1946) 29 Cal. 2d 242, 249 ("*Jellins*"), this Court recognized that "it was not the purpose of the insurance statutes to regulate all arrangements for assumption or distribution of risk. That view would cause them to engulf practically all contracts." (*Id.* at p. 249.) *Jellins* accordingly articulated the principal object test to distinguish contracts subject to regulation as insurance from contracts which, despite involving some assumption or distribution of risk, are not subject to regulation as insurance:

> The 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.

(*Id.*)

The principal object test remains well-established law. Since *Jellins*, this Court and the Court of Appeal have reaffirmed the principal object test and applied it to different fact patterns many times.

In *California Physicians' Service v. Garrison* (1946) 28 Cal. 2d 790, 809, for example, this Court held that "[a]bsence or presence of assumption of risk or peril is not the sole test to be applied in determining [whether a health care arrangement was subject to regulation as insurance]. 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."

This Court applied the same test in *Title Ins. Co. v. State Bd. of Equalization* (1992) 4 Cal. 4th 715, 726, holding that underwriting agreements were not illegal contracts of insurance because "[t]he indemnification provisions are secondary to the main object and purpose of the underwriting agreements."

The Court of Appeal likewise has consistently applied the principal object test to decide whether a contract is subject to regulation as insurance. In *Truta v. Avis Rent A Car System, Inc.* (1987) 193 Cal. App. 3d 802, 812, for example, the Court of Appeal held that a collision damage waiver offered by car rental company was not insurance because "[t]he principal object and purpose of the transaction before us, the element which gives the transaction its distinctive character, is the rental of an automobile."

Similarly, in *Automotive Funding Group, Inc. v. Garamendi* (2003) 114 Cal. App. 4th 846, 855, the Court of Appeal held that a debt cancellation program offered by car finance lender – under which lender waived debt in the event of certain damage to the

car – was not insurance because "the primary objective of [the defendant's] transactions is to finance a used car purchase."

Because the principal object test is both well-established and has proven effective in addressing many diverse fact patterns, the petition does not raise any important unsettled issue of law.

2. *There Is No Conflict Between the Principal Object Test and the Insurance Code*

Petitioner's contention that the principal object test has been superseded by and "now conflicts with" Insurance Code section 1758.7 *et seq.* is incorrect. (Petition, pp. 12-17.) The Court of Appeal correctly found that petitioner's argument "fails because it puts the cart before the horse." (Slip Op., p. 11.)

In support of his misplaced argument, petitioner purports to give section 1758.7 *et seq.* a name – the "Storage Insurance Act" – that exists nowhere in the Insurance Code. (Petition, p. 12.) This misnomer appears designed to support the argument that section 1758.7 *et seq.* was enacted to create a new class of insurance contract – "storage insurance" – and to subject such contracts to regulation as insurance. (*Id.* at p. 13.) But in fact, section 1757.8 *et seq.* is not entitled the "Storage Insurance Act." Rather, it is codified as Article 16.3 of the Insurance Code, which is entitled "Self-Service Storage *Agents*" (italics supplied).

As the correct title of Article 16.3 suggests, the purpose of section 1758.7 *et seq.* was to create a new a limited class of

insurance *agents*, not to create or define a new class of insurance. Indeed, the type of insurance to which section 1757.8 *et seq.* applies had been offered in the market for at least 20 years before the statute was enacted. (CT 264 [judicially-noticed legislative history reciting that "[s]elf-storage facilities have been offering optional personal property insurance coverage to their tenants for more than 20 years"]; CT 475 [grant of judicial notice].)

More specifically, Article 16.3 established a category of insurance agents with limited rights – called "self-service storage agents" – who are licensed *only* to sell (i) hazard insurance covering property in storage, (ii) issued by an authorized insurer, and (iii) sold "in connection with, and incidental to" a self-service storage lease. (Ins. Code, § 1758.7, subd. (b) and § 1758.75.) The requirements imposed on self-storage operators that obtain such a limited license are modest and are contained completely in a single article (Article 16.3) comprising only twelve sections. (Ins. Code, §§ 1758.7-1758.792.) In contrast, the requirements imposed on persons who obtain a broad license to sell all classes of property insurance (i) span fourteen articles of the Insurance Code comprising 153 sections, and (ii) include detailed licensing and bonding obligations, educational requirements, and disciplinary provisions, all of which do not apply to self-service storage agents licensed under Article 16.3. (Ins. Code, §§ 1621-1751.7.) By creating a class of agents with limited rights and correspondingly limited regulatory burdens, the Legislature made it easier for self-storage operators to help tenants who want

to insure their stored property to find and purchase an suitable insurance policy.

But nothing in section 1758.7 *et seq.* purports to define what contracts qualify as insurance requiring a license to sell. Nothing in those sections suggests a rejection of the principal object test. Nothing in those sections even mentions private risk allocation provisions in self-storage leases, much less evinces a legislative intent to subject leases with provisions like those at issue in this case to regulation as insurance.

Accordingly, there is no conflict between the longstanding principal object test and section 1758.7 *et seq.* The former governs whether a contract is or is not subject to regulation as insurance. The latter imposes certain obligations if, and only if, a self-storage operator acts as an agent to offer a contract that is subject to regulation as insurance. As the Court of Appeal correctly found, Petitioner's argument to the contrary puts the cart before the horse.

C. There is No Disuniformity of Decision

The Court of Appeal's opinion also creates no disuniformity of decision. It applies the same rule of decision – namely, the principal object test – that other courts have applied for 70 years:

> The Protection Plan in this case was an addendum to and dependent on the Rental Agreement. Without the Rental Agreement, the Protection Plan would not exist and would have no purpose. Thus, we must

> look at the Rental Agreement and Protection Plan as a whole. Looking at the entire transaction between the parties, the principal object or "distinctive character" was the rental of storage space.

(Slip Op., p. 10.) Nor does the opinion create any conflict with respect to application of that rule of decision to a particular fact pattern. Indeed, such a conflict is not possible because no other California appellate decision has applied the principal object test in the context of agreements between a landlord and tenant to allocate the risk of loss to a tenant's stored property.

In particular, there is no conflict with *Truta v. Avis Rent A Car System, Inc.*, *supra*, 193 Cal.App.3d 802. In *Truta*, the Court of Appeal applied the principal object test to hold that risk allocation provisions in a car rental contract did not subject the lessor to regulation as an insurer:

> The principal object and purpose of the transaction before us, the element which gives the transaction its distinctive character, is the rental of an automobile. . . . [The] tangential risk allocation provision should not have the effect of converting the defendants as contracting lessors into insurers subject to statutory regulation.

(*Id.*, p. 812.) The same is true here. The principal object of the transaction between petitioner and A-1 Self Storage – the element which gives the transaction its "distinctive character" – was leasing the storage unit. But for their relationship as landlord and tenant, there would be no reason for A-1 Self Storage to offer to Heckart (and no reason for Heckart to seek from A-1 Self Storage) any sort of agreement allocating financial

responsibility in the event of damage to stored property. Thus, there is no disuniformity because *Truta* and this case apply the same fundamental rule to the particular facts presented.

Further, petitioner mischaracterizes *Truta* in part. *Truta* did not, as petitioner claims, hold that the result there would be different if the car lessor had agreed "to pay money to third parties." (Petition, p. 20.) The quoted language was in fact contained in an analysis by the Department of Insurance and is not part of *Truta's* holding. (*Truta v. Avis Rent A Car System, Inc.*,, *supra*, 193 Cal. App. 3d at p. 815.) In any event, nothing in the parties' lease agreement here requires payment to any third party. Rather, the parties agreed only to resolve in advance the liability disputes that might arise among themselves as a direct consequence of their landlord-tenant relationship. For the reasons in Part A, *ante*, that is fundamentally different from an insurer who has no other relationship with its policyholder agreeing to discharge liabilities that the policyholder might owe to third parties.

The Court of Appeal's opinion also does not conflict with *Wayne v. Staples, Inc.* (2006) 135 Cal. App. 4th 466. *Wayne* did not reject the principal object test. To the contrary, it reaffirmed it:

> The test in *Truta*, *supra*, 193 Cal.App.3d 802, 238 Cal.Rptr. 806, and *AFG*, *supra*, 114 Cal.App.4th 846, 7 Cal.Rptr.3d 912, is whether the principal purpose of the transaction is risk allocation and indemnification or something else. An incidental contract provision that, for a fee, shifts risk of loss from the consumer to

> the provider of the goods or services does not make the agreement an insurance contract subject to regulation under the Insurance Code.

(*Id.* at p. 551.) Rather, *Wayne* simply found there was no need to apply the principal object test because there was no question that what the defendant retailer was selling – a insurance policy issued by National Union Fire Insurance company, under which National Union agreed to pay for damage that could not possibly be attributed to its negligence – was insurance. (*Id.*, pp. 471-72, 476-77.) *Wayne* was not called upon to determine when or whether risk allocation provisions like those here – in which to parties agree to allocate risks inherent in their non-insurance relationship – should be subject to regulation as insurance. Thus, there is no conflict between the Court of Appeal's opinion and *Wayne*.

Finally, petitioner's "parade of horribles" argument – that the Court of Appeal's opinion will invite evasion of the insurance regulatory statutes – is also misplaced. (Petition, pp. 28-31.) The principal object test inherently prevents such evasion by distinguishing between agreements that have indemnity as their principal object and those in which indemnity arrangements support a non-insurance principal object. Only agreements in which the parties' risk allocation agreements legitimately serve a primary, non-insurance object will not be subject to regulation as insurance.

CONCLUSION

Permitting agreements like the one here – without burdening landlords with regulation as insurers, or burdening the Department of Insurance with the obligation to police landlords – is both socially valuable and administratively prudent. There is no unsettled issue of law because the rule of decision (the principal object test) has been California law for 70 years. There is no conflict among cases because no court applying that rule of decision has reached a contrary result on similar facts. The petition for review should be denied.

Dated: February 26, 2016

Respectfully submitted,

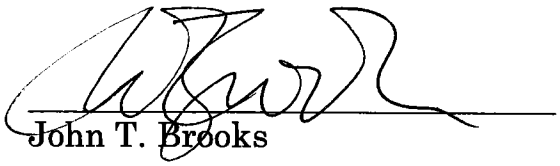
SHEPPARD, MULLIN, RICHTER & HAMPTON LLP

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 Century Schoolbook 13 point type (for the text) and proportionally spaced Arial 13 point type (for the headings) and, based on the word count of the word processing system used to prepare the brief, the brief is 2,893 words long.



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APP-009, Item 3a

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