S130717

IN THE SUPREME COURT OF CALIFORNIA

PHILADELPHIA INDEMNITY INSURANCE COMPANY, Plaintiff and Respondent,

v.

BLANCA MONTES-HARRIS et al., Defendants and Appellants; and Companion case.

On Request of the United States Court of Appeals
for the Ninth Circuit, Case Nos. 03-56651/03-56652
United States District Court, Central District Case No. 02-3616 RSWL (RCx)
The Honorable Judge, Ronald W. Lew

OPENING BRIEF OF APPELLANTS BLANCA MONTES-HARRIS, MONICA ARREDONDO, AND CAMILLA TONI HARRIS

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I. CERTIFIED QUESTION OF LAW

Does the duty of an insurer to investigate the insurability of an insured, as recognized by the California Supreme Court in *Barrera v. State Farm Mut. Auto. Ins. Co.* (1969) 71 Cal. 2d 659, 79 Cal.Rptr. 106, 456 p. 2d 674, apply to an automobile liability insurer that issues an excess liability insurance policy in the context of a rental car transaction?

II. PROPOSED ANSWER

Yes. *Barrera* held that an automobile liability insurer has a duty to undertake a reasonable investigation of the insured's insurability within a reasonable time from the acceptance of the application and the issuance of the automobile insurance policy. If the automobile liability insurer breaches that duty and the risk insured against occurs, the insurer may not rescind the policy even if the policy was procured by fraud. *United Servs. Auto. Ass'n v. Pegos* (2003) 107 Cal. App. 4th 392, 131 Cal.Rptr. 2d 866 confirmed the *Barrera* rule and held the duty to investigate applies to the addition of a new car to the policy, Id. at p. 401. This rule should be extended to apply to an excess liability insurer in the rental car context.

Exempting an excess liability insurer from the duty to investigate, yet allowing it to retain the right to rescind, would be inimical to the well established duty of all insurers to investigate the insurability of the insured, *Barrera*, supra, 71 Cal.2d. at pp. 669-671. It would also frustrate the public's expectation that insurance companies will perform their duty to provide insurance coverage if a loss occurs. And the most compelling reason not to exempt an excess liability insurers from the duty to investigate is not doing so would undermine the long expressed judicial and legislative desire to provide compensation for death and injuries caused by the negligent operation of an automobile.

All of the public policy reasons articulated in *Barrera* that preclude a primary liability insurer from rescinding after the risk occurs when the insurer breached its duty to investigate, apply with equal force to an excess liability insurance carrier in the rental car context. There are no sound policy reasons that would justify insulating an excess liability carrier from the very liability it intentionally and voluntarily undertook. A contrary rule excusing an excess liability insurer from investigating, but authorizing it to rescind after a loss occurred would result in serious harm to the public and only benefit the financial interests of the excess liability insurer.

A liability insurer that issues an excess liability insurance policy in the rental car context is a public service entity just as a primary liability issuer is; therefore, an excess liability insurer in the car rental context should not be exempted from the duty to investigate the insured's insurability imposed on all other insurance companies. There should be no special rule or protection for excess automobile liability insurers in the rental car context. Whether the contemplated use of an automobile is for a year or for a day, the public should be protected from automobile drivers unable to respond to damages. The toll and tragedy of the innocent injured in automobile accidents is the same whether the injury is caused by the negligence of one who rents an automobile or one who owns one. California's financial responsibility laws are designed to provide monetary compensation for death and injury caused by the negligent operation of an automobile. This policy is advanced by imposing a duty to investigate on an excess liability insurer in the rental car context.

Once an excess automobile liability insurer voluntarily undertakes to provide liability insurance to a car renter, it should be subject to the same duties and recission restrictions as a primary liability insurer. If that were the case, then if the excess liability insurer breached its duty to investigate, it, like a primary liability insurer, would forfeit the right to rescind even if the policy was procured by fraud. Imposing this duty to investigate on a liability insurer who issues an excess liability policy in the rental car context would be in the public's best interest and would increase the likelihood of compensation for death and injury caused by automobile accidents.

III. STATEMENT OF THE CASE

A. Factual Background

This case arises out of an automobile accident that caused serious injuries to a number of the appellants, most notably to Camilla Toni Harris, an infant, who suffered brain damage. On June 6, 2001, Alric Burke, his sister, and friends flew from Arizona to California for a vacation. Burke rented a car from Budget Rent-A-Car [Budget]. During the rental application process, Burke was asked for and presented his Arizona license. Additionally, Budget's rental agent offered Burke excess liability insurance over the primary minimum statutory coverage up to $1,000,000.00. Burke accepted and paid for the excess liability insurance.

Philadelphia Indemnity Insurance Company [Philadelphia] issued the excess liability policy. It was Philadelphia's policy to offer excess liability coverage to every renter, but investigate the insured's insurability only if there was a loss.

Prior to the rental date, Burke's license had been suspended. Accordingly, when Burke rented the car, he either knew or he should have known his license had been suspended. In reliance upon the presentation of his license, Philadelphia issued the excess liability policy.

On June 10, 2001, Burke caused a multi-car accident resulting in injuries to all the appellants. The police were summoned to the scene of the accident, investigated, and wrote a traffic collision report which included the information that Burke's license had been suspended. Various lawsuits followed.

B. Procedural Background

Appellants Montes-Harris, Arredondo, and Camilla Toni Harris filed a lawsuit in state court against Burke and Budget. Appellant Cortez filed a separate action which was consolidated with the Montes-Harris case. Thereafter Budget filed for bankruptcy; however, the consolidated state action against Burke is still pending.

Respondent Philadelphia filed a declaratory relief action in the federal district court for the Central District of California. Philadelphia sought to have the court declare that Philadelphia could rescind the excess liability insurance policy Burke misrepresented his driver's license status when he rented the car and was offered excess liability insurance. Appellants answered. The trial court granted judgment in favor of Philadelphia and made findings of fact and conclusions of law including that Burke had misrepresented the status of his driver's license which constituted fraud; therefore, Philadelphia had a right to rescind the policy.

C. Appeal

Appellants appealed to the Ninth Circuit Court of Appeals contending that the trial court had erred because Philadelphia had forfeited its right to rescind by not having undertaken a reasonable investigation of the insured's insurability within a reasonable time. Philadelphia argued that its agent, Budget, had conducted an investigation when it requested Burke to present his driver's license in accordance with Vehicle Code sections 1604 and 16408. Philadelphia also argued that it had no duty to investigate beyond that done by the rental car company.

All interested parties briefed and argued the case before the Ninth

Circuit Court of Appeals. The Ninth Circuit Court of Appeals came to the conclusion that there is no California precedent regarding whether or not the duty to investigate recognized and expressed by *Barrera* applies to an excess liability insurer in the rental car context. Consequently, it stayed the appeal and certified a question of law to this court.

D. Certification of Question of Law

Although the *Barrera* holding was expressed in broad terms, it did not specifically address excess liability insurers which, along with the absence of any appellate decision addressing whether or not an excess liability insurer had the duty to investigate, led the Ninth Circuit Court of Appeals to conclude there was no controlling precedent concerning the certified question, *Philadelphia Indemnity Insurance v. Findley et al* (2005) 395 F.3d 1046, 1049. On March 2, 2005, this court granted the Ninth Circuit Court of Appeals' request that this court decide the question of California law presented.

IV. LEGAL DISCUSSION

A. It should be the declared public policy of California that an

excess automobile liability insurer in the rental car context has a duty to undertake a timely reasonable investigation of the insured's insurability

Imposing the duty to investigate on an excess liability insurer in the rental car context is necessary to meet the reasonable expectation of the public and the insured that the insurer will duly perform its basic commitment of providing insurance. The main objective of the automobile financial responsibility law to provide monetary compensation for death and injuries caused by negligence in automobile accidents is advanced by requiring an excess liability insurer in the rental car context to undertake a reasonable and timely investigation of the insured's insurability.

The public policy to provide compensation for death and injuries caused by the negligence of another automobile driver is best served by treating automobile excess liability insurers the same as primary liability insurers. A primary automobile liability insurer that fails to undertake a reasonable investigation within a reasonable time, may not rescind the insurance policy after an innocent person is harmed, even if the insured procured the policy through fraud. This rule should apply to excess liability insurers with equal force

The obligation to investigate the insured's insurability inures to the benefit of the public. An insurer's breach of that duty results in the forfeiture of the right to rescind, *Barrera*, supra, 71 Cal.2d. at p 667. *Barrera* involved a primary insurer; however, there is no logical reason to exempt excess insurers from the obligation to investigate.

It doesn't matter whether the focus is a primary or excess liability insurer because the automobile insurance business is a quasi-public service. Therefore, once the excess liability insurer voluntarily assumes the contractual responsibility to indemnify the insured for amounts in excess of the primary coverage, public policy demands that the duty to investigate be imposed on the excess liability insurer just as it is with a primary liability insurer. .

A contrary rule would benefit the excess liability insurer and harm the innocent injured party. The public is entitled to the same protection in the rental car context as a result of the quasi-public nature of the automobile insurance business as it enjoys in other contexts. To deny this protection in the rental car context would frustrate the firmly established policy insuring compensation for death and injury caused by automobile accidents.

It is not onerous or unfair that public policy impose this duty to investigate the insured's insurability and bar rescission for breach of that duty. Indeed, "California has developed a line of decisions imposing a duty upon all insurers to act promptly upon an application for insurance. The rationale underlying the extra-contractual imposition of this duty parallels the philosophy underlying the Financial Responsibility Law and related statutory and judicial rules governing automobile liability insurance." *Barrera*, supra, 71 Cal.2d. at p. 673.

Both primary and excess liability insurers run risks for pay. Both serve the same public interest and expectations. The public's expectation of the primary and the excess liability insurers is the same. The public's expectation of both primary and excess liability insurers is that the insurer will duly perform its basic commitment to provide insurance.

Attempting to draw a distinction between a primary insurer and an excess liability insurer is misguided. Such an effort is misguided because once the excess liability insurer has voluntarily assumed its role as an automobile liability insurer, the public policies designed to protect the public and provide compensation for death and injury are just as important and logically just as applicable as they are when a primary liability insurer is involved.

There is no indication that undertaking a reasonable investigation within a reasonable time is costly, complicated, or time consuming. Furthermore, there is no indication that such an undertaking is impossible in the rental car context. The police were able to determine that Burke's license was suspended while at the scene of the accident. Insurers can access public records with the aid of computers and the use of the internet so that a reasonable investigation can be done almost instantaneously.. An excess liability insurer should not be able to avoid its duty to investigate just to save a little money.

There is no viable distinction in the rental automobile context between a primary liability insurer and an excess liability insurer that would justify insulating excess liability insurers from the consequences of their own negligence or failure to investigate. If an excess liability insurer is permitted to solicit and obtain an application for insurance, collect the premium, and issue a policy but retain the right to rescind until after the risk insured against occurs, it would be permitted to pocket premiums without running any risks. *Barrera* has, for obvious and common sense reasons, already rejected this proposition, Id. at pp. 673-674.

Once the excess liability insurer has issued insurance, it should act promptly and investigate the insured's insurability or forfeit its right to rescind. "Any other rule would place it in the power of an insurance company to take the chances of a loss, and, if none occurred, retain the premium; but if one does occur, repudiate the contract and compel the assured to bear the loss." *Barrera*, supra, 71 Cal.2d. at p. 674 quoting from *Security Ins. Co. v. Cameron* (1922) 85 Okla. 171 [205 P. 151, 159-160, 27 A.L.R. 444. Although there may be less time to investigate in the rental car context than in other contexts, there is enough time. Much has changed in the 36 years since *Barrera* was decided. Computers and the internet are commonplace and make it possible to rapidly obtain information. A reasonable investigation can be made almost instantaneously.

Here, Philadelphia did not complain it would take a long time to obtain the DMV record nor did it contend it would be too costly. Rather, it relied upon the right to rescind even though it had not conducted any investigation. The law should not encourage Philadelphia's policy of soliciting and accepting an application for insurance, receiving and retaining the premium payment and then issuing a policy but reserving the right to rescind because of a misrepresentation, *Barrera*, supra, 71 Cal.2d. at p.

673.

“The rule is well established that the means of knowledge is equivalent to knowledge, and that a party who has the opportunity of knowing the facts constituting the fraud of which he complains cannot be supine and inactive, and afterwards allege a want of knowledge that arose by reason of his own laches or negligence, *Barrera*, supra, 71 Cal.2d. at p. 669 quoting from *Shain v. Sresovich* (1984) 104 Cal. 402, 405 [38 P. 51].

It is the public that needs to be protected, not the excess liability insurer. The holding of *Barrera* makes no distinction between a primary and excess liability insurer, rather it refers to automobile liability insurers.

By statutory mandate a car rental company must verify that the proposed renter has a driver’s license by inspecting the driver’s license but does not have to inquire with the DMV to determine if the licence is valid, Vehicle Code sections 14604 and 14608. Philadelphia argues that its duty to investigate in the rental car context is the same as the statutory duty to investigate imposed upon a car rental company; and, it, therefore satisfied the duty to investigate, if it even had one, when its agent Budget asked Burke for a copy of his driver’s license. This conclusion is invalid because the premise is faulty. Sections 14604 and 14608 deal explicitly with owners and car rental companies, not liability insurers.

Both *Barrera* and *Pegos* indicate that the duty to investigate is more than simply inspecting the driver's license. A reasonable investigation entails checking on the insured's driving record with the DMV as well as possibly obtaining other pertinent information,*Barrera*, supra, 71 Cal.2d. at p. 682 and *Pegos,* supra 107 Cal. App. 4th at p. 1050. A car rental company business is not quasi-public; therefore, a car rental company is not a public service entity. It is simply a private business for profit. The legislature has specifically addressed the duty of the car rental company to verify that the proposed renter has a valid driver's license. If the legislature had intended that an insurer could satisfy its investigational duty in the same way, it could have said so. It did not. Sections 14604 and 14608 apply to a car rental company not to an automobile liability insurer. The statutory low investigative threshold for a rental car company does not obviate the excess insurer's duty to undertake a reasonable investigation.

B. The public would be better protected if the duty to investigate as expressed in Barrera is extended to an excess liability insurer in the rental car context.

Imposing the duty to investigate and the penalty for breach of that duty on an excess liability insurer in the rental car context would help to accomplish the public policy of providing compensation for death and injury caused by automobile accidents. The rental car business is an integral part of our mobile society and it is necessary for the public welfare that those who rent cars are able to respond to damages. Furthermore, excess liability insurance is an insurance product designed to meet the actual damages caused by death or other serious injuries. That protection inures to the benefit of the motoring public; therefore, it is proper to impose upon a excess liability insurer who voluntarily runs that risk for pay, to be bound by the same duties as a primary liability insurer. This policy would give vitality to the public expectation that insurers will perform their primary obligation of providing insurance.

If the duty to investigate the insured's insurability is not extended to an excess insurer in the rental car context, the inevitable consequence will be that some excess liability policies will be rescinded leaving innocently injured people to suffer the frustration and hardships of inadequate compensation or no compensation at all. It would be wrong to carve out an exception for a liability insurer who issues an excess liability insurance policy in the rental car context. Extending the duty to investigate the insured's insurability to an excess liability insurer in the rental car context would improve the likelihood of achieving the important established goal of providing compensation for death and injury caused by automobile accidents.

V. CONCLUSION

The duty of an insurer to investigate the insurability of an insured, as recognized in *Barrera v. State Farm Mut. Auto. Ins. Co.* (1969) 71 Cal. 2d 659 should be extended to an automobile liability insurer that issues an excess liability insurance policy in the context of a rental car transaction. This is the logical, natural, and needed extension of the duty to investigate. Extending the duty to investigate to an excess liability insurer in a rental car transaction would advance the critical public policy to provide compensation for death and injured caused by automobile accidents. furthermore, it would be inherently inequitable to allow an excess insurer the right of recission without imposing the burden of a reasonable investigation.

Therefore, appellants respectfully request that this court answer the certified question in the affirmative and hold that the duty of an insurer to investigate the insurability of an insured, as recognized by the California Supreme Court in *Barrera* applies to an automobile liability insurer that issues an excess liability insurance policy in the context of a rental car transaction.

Dated: March 31, 2005 Respectfully submitted,

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CERTIFICATION OF WORD COUNT

I certify that, pursuant to California Rules of Court, Rule 29.1(c)(1), that the attached **OPENING BRIEF OF APPELLANTS BLANCA MONTES-HARRIS, MONICA ARREDONDO, AND CAMILLA TONI HARRIS**, excluding the cover and components of the brief excluded from the word count computation under Rule 29.1(c)(3), contains 3,287 words.

Dated: April 1, 2005

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PHILADELPHIA INDEMNITY vs. MONTES-HARRIS
Supreme Court Case No.: S130717

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action. My business address is 11601 Wilshire Boulevard, Suite 2490, Los Angeles, CA 90025.

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APPELLANT'S OPENING BRIEF

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Clarissa B. Sison

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Supreme Court Case No.: S130717

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