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

REPLY BRIEF
OF DEFENDANTS and APPELLANTS BLANCA MONTES-HARRIS, MONICA ARREDONDO, and CAMILLA TONI HARRIS

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TABLE OF CONTENTS

TABLE OF CONTENTS i

TABLE OF AUTHORITIES ii

MEMORANDUM OF POINTS AND AUTHORITIES 1-15

I. CERTIFIED QUESTION OF LAW 1

II. AS A MATTER OF PRINCIPLE, AN AUTOMOBILE INSURER'S DUTY TO INVESTIGATE THE INSURABILITY OF AN INSURED SHOULD BE EXTENDED TO AN AUTOMOBILE INSURER WHO ISSUES AN EXCESS LIABILITY POLICY IN THE RENTAL CAR CONTEXT 1

III. CONCLUSION. 14

TABLE OF AUTHORITIES

CALIFORNIA CASES **PAGE**

Barrera v. State Farm Mutual Auto Ins. Co (1969)
71 Cal. 2d 659, 79 Cal. Rptr.106, 156 p.2d 674. 1-14

Continental Cas. Co v. Phoenix Constr. Co. (1956)
46 Cal. 2d 423, 296 P. 2d 801, 57 A.L.R. 2d 914 13

Interinsurance Exchange v. Ohio Cas. Ins. Co. (1962)
58 Cal. 2d 142, 23 Cal. Rptr. 592, 373 P. 2d 640 13

CALIFORNIA STATUTES

Insurance Code §
331 10

338 10

359 10

Vehicle Code §

14608 3

MEMORANDUM OF POINTS AND AUTHORITIES

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. AS A MATTER OF PRINCIPLE, AN AUTOMOBILE INSURER'S DUTY TO INVESTIGATE THE INSURABILITY OF AN INSURED SHOULD BE EXTENDED TO AN AUTOMOBILE INSURER WHO ISSUES AN EXCESS LIABILITY POLICY IN THE RENTAL CAR CONTEXT

Barrera analyzed the function and role of an automobile insurer and concluded that it is a quasi-public entity with duties imposed as a matter of public policy, *Barrera* at pages 670-675. One duty is to, within a reasonable time, investigate the insurability of an insured. If the insurer fails to fulfill its responsibility to investigate and a loss occurs, it may not rescind the policy even if the policy

was procured by fraud. Id. at p. 663. The essential facts of *Barrera* and this case match for purposes of public policy, the quasi-public function of an automobile insurer, and the protection of the motoring public.

In *Barrera,* when the insured applied for automobile insurance, he made a material misrepresentation. The policy was issued and the insured paid the premiums. The insurer did not conduct an investigation of the insurability until after a substantial accident occurred. It then rescinded the policy based upon fraudulent misrepresentation. This court repudiated that conduct. *Barrera* involved only primary insurance, but the operative language of the case and the underlying principles should apply to any automobile insurance in any context, particularly in the rental car context.

In our case, Burke was offered and accepted excess insurance when renting a car from Budget. At the time of renting the car in California and accepting the offer of excess liability insurance, Burke made a material misrepresentation regarding the status of his Arizona driver's license. Burke paid the premiums and Philadelphia issued the policy. Neither Budget, as Philadelphia's agent, nor

Philadelphia conducted a reasonable investigation of the insurability of Burke. Before renting a car, a rental car company is mandated by statute to view a prospective renter's driver's license. But that statute, Ca. Veh. Code § 14608, specifically applies to a rental car company, not to an automobile insurer. And, as respondent correctly notes, the statute was amended in 1993; however, the legislature did not include any language that an automobile insurer who issues an excess liability policy is excused from the duty imposed by *Barrera.* Surely, the legislature could have carved out an exception for an excess automobile liability insurer, but it did not. Indeed, the focus of the statute targets the responsibility of a rental car company. It has nothing to do with the responsibility of an automobile insurer.

Furthermore, there is no California case that limits an automobile insurer's duty to investigate to a primary automobile insurer. For that matter, neither does *Barrera.* No California case declares that an automobile insurer that issues an excess liability policy is not a quasi-public entity. Nor is there any California case that even suggests that an automobile insurer that issues an excess liability policy is exempt from the publicly imposed duty to investigate the insurability of the insured.

Modern day commerce demands that people who come to California and rent an automobile be able to respond to damages. The Financial Responsibility Law (FRL) is the minimum requirement, but is not designed to offer protection, or some exemption to an insurer who offers excess liability insurance that is not afforded a primary insurer. Philadelphia voluntarily undertook to offer excess liability coverage to every prospective renter. And, it did so without any protocol to ever investigate the insurability of the insured before a risk occurred. Philadelphia's established protocol was to offer excess liability to every prospective renter, collect the premium, and issue the policy. An investigation of the insurability is done only after an accident.

Here, Philadelphia wants to be able to pursue its lucrative business of excess liability insurance in the rental car context, collect the premium, but eliminate or reduce its risk. This is inimical to the principle articulated in *Barrera* and contrary to California's public policy that an automobile insurer's duties are not only based on the contract, but on the role of an automobile insurer in our society. Imposing the duty to investigate the insurability of a prospective insured is not an infringement on the freedom of contract nor is it

unreasonable.

In many cases, such as this one, the prospective renter makes a reservation days in advance. While some investigations of some driver such as drivers from other countries may involve unusual difficulties, that problem does not, nor should it, supersede, the public policy of providing protection for the motoring public. Philadelphia chooses to offer excess liability to every prospective renter, regardless of where that prospective renter is from. Philadelphia wants that business, presumably because it is profitable. Insurance companies make a profit assuming risks. Id. at p. 669. If there is an inherent risk in offering excess liability to every prospective renter, then that is a risk the insurer is voluntarily assuming. The burden should not fall on the innocent injured accident victims injured by one that rents a car and obtains an excess policy.

Contrary to Philadelphia's assertion, Petitioners did try to introduce the testimony of Fani Dilmani, a case administrator with Hindin & Abel, LLP on the ease and availability of information on the status of drivers' licenses; but, the court, over objection, excluded that evidence stating that it was not relevant. Philadelphia

made no effort to establish that it could not obtain relevant information. Moreover, the advent of the computer age has made information almost instantly available. Philadelphia's argument that conducting an investigation of the insurability of a prospective insured involves privacy issues is totally without merit. If the prospective renter wants excess liability coverage and the insurer needs to obtain otherwise privileged or confidential information, the problem is easily solved by having the prospective renter sign a waiver.

An excess liability insurer should not be exempt from the duty to investigate. It is an automobile insurer serving the same essential role as a primary automobile insurer. The public's expectation is that insurance companies will perform their duty to provide insurance coverage if a loss occurs, not that the insurer's liability will be limited by the FRL. Id. at p. 669. There is no evidence or basis to assert that the public's expectation is that an insurer's responsibility will be limited by the minium coverage required by statute. Rather, *Barrera* unmistakably affirmed the common sense conclusion that the public expects an insurer to provide the promised coverage. Id. at p. 669. If an insurer promises to provide one

million dollars of excess liability coverage, then it is most reasonable that an innocent injured accident victim would, upon learning of such coverage, expect the insurer to honor that commitment. This is logical and harmonious with the long expressed judicial and legislative desire to provide compensation for death and injuries caused by the negligent operation of an automobile.

Respondent's argument that this is not a rescission case, but rather enforcement of a contractual exclusion clause misses the point. Philadelphia is an automobile insurer upon which should be imposed the same duties that are imposed upon a primary automobile insurer. Whether a car was rented or privately owned, is of no consequence to the innocent injured accident victim. The need to provide compensation to the innocent injured accident victim is the same in the rental car context as in any other context. Only the insurer would benefit from limiting *Barrera* to the primary insurer and excluding an excess liability insurer in the rental car context. As a practical matter, if Philadelphia's position is adopted, the public would, inevitably, be harmed and the public's expectation that insurance companies will provide the coverage promised would be defeated.

An insurance contract is not like an ordinary commercial contract. This case is not dealing with an ordinary commercial contract, rather it is dealing with an automobile insurance contract. Id. at p. 669. And because of that, if the insurer, which is a public service entity, breaches its duty to promptly and reasonably investigate the insurability of an insured, it will be liable to an innocent accident victim of the insured, despite the insured's intentional misrepresentation to obtain the insurance. Id. at p. 663.

Here, Philadelphia is focused on Burke and the contractual provision requiring a valid driver's license to qualify for the insurance. That focus runs contrary to the analysis of *Barrera* and is simply wrong. *Barrera* focused on the relational aspects created by an automobile insurance contract. As a quasi-public entity functioning as a public service, the insurer, upon issuance of the insurance policy, has a relationship to the public and the motoring public in particular. That Burke intentionally misrepresented a material fact was discussed, but the guiding principles of the analysis and holding flow from the automobile insurer as a public service entity and the underlying purpose of the FRL which is to provide compensation to innocent injured accident victims. Id. at pp. 669-

671.

It is the underlying principle to compensate innocent injured accident victims that should be enlarged and extended to reach the rental car context. Limiting coverage to the minimum set by the FRL is not in the public's best interest and runs counter to the reasonable expectation of the motoring public that an insurance company will provide the promised insurance. To say that one may have an expectation that the driver of a rental car will have the minimum protection required by the FRL does not exclude nor prevent that same person from expecting that if there is coverage beyond that minimum, the insurer will provide such coverage as promised. In fact, the ready availability of excess liability insurance in the rental car context would support the expectation and hope that drivers of rental cars will be able to respond to the actual damages. There can be no real dispute that the minimum set by the FRL is woefully inadequate in the cases of death or other serious injury.

In this case, Petitioners were seriously injured. The minor infant suffered brain damage which caused seizures. Such an injury cannot be compensated by the minimum coverage. And it would be wrong for the law to limit the insurer's exposure to the innocent

injured accident victim because of the wrong of the insured. The innocent injured accident victim does not stand in the shoes of the insured. While, because of a material misrepresentation of the insured, the insurer may not be obligated to the insured for injuries or property damage, its liability to the innocent injured accident victim is mandated by *Barrera* and public policy.

Philadelphia's position, if adopted, would decrease the likelihood of recovery by the innocent injured party, which contradicts the *Barrera* policy. *Barrera* recognized and re-affirmed California's policy that every insurance company has an obligation to investigate the insurability of the insured. Id. at p. 673. No insurance company is excluded.

There is no sound reason to exempt an automobile insurer that issues an excess liability policy from the same requirements of every other insurance company. Indeed, to exempt Philadelphia in this circumstance would create an exception, for it would undermine the long established legislative and judicially expressed policy of providing coverage for innocent injured accident victims.

Language of exclusion in the excess liability insurance policy is not stronger than the statutory right of rescission (Ins. Code §§

331, 338, and 359) given to an insurer in the case of fraud. *Barrera* held that the statutory right of rescission is waived if the insurer breaches its duty to conduct a prompt and reasonable investigation of the insurability of the insured. If the statutory right to rescission can be waived by the insurer's breach of its duty, so can any provision of the excess liability policy.

If the insurer can solicit the insurance business, collect the premium, and wait until the risk occurs, and then either claim there is no insurance because of the exclusionary language or that the policy is rescinded because of the material misrepresentation, it receives an unjust windfall. This is exactly what Philadelphia does and wants to be able to continue to do without interference. Even in this case, which has been in litigation for years, Philadelphia has never returned the premium paid by Burke. The insurer should not be able to solicit excess liability insurance, collect the premium, issue the policy, and take no action whatsoever to investigate the insurability until after the risk occurs, and then avoid coverage by any means or theory. Id. at pp. 671-672.

In *Barrera*, State Farm pursued a policy of saving minor costs at the expense of the insured and the potential victim. *Barrera*

repudiated and criticized this policy. Philadelphia has the very same policy, which should be repudiated and deemed unacceptable as contrary to the public welfare. An automobile insurer that issues an excess liability insurance policy in the rental car context is functioning as a public service entity. California should encourage a policy that adequately and realistically compensates accident victims. California should not turns its eye from the mangled lives of the innocent injured accident victims to afford relief to an insurance company that breached its publically imposed duty to investigate.

It is both the underlying policy of the Financial Responsibility Law and the quasi-public nature of the insurance business that imposes on the insurer the duty to investigate. "*As we explain hereinafter in more detail, the 'quasi-public' nature of the insurance business [FN5] and the public policy underlying the Financial Responsibility Law ... impose upon the automobile liability insurer a duty both to the insured and to the public to conduct a reasonable investigation of insurability within a reasonable time after issuance of an automobile liability policy.*" Id. at pp. 667-678. The underlying policy of the FRL is to provide compensation to the innocent injured accident victim. This underlying policy is not a

limiting factor, but one which supports extension into the rental car context.

According to *Barrera,* California has practically taken the law of insurance out of the category of contract. Id. at p. 669. An insurance company runs risks for pay. Id. at p. 669. It should not be able to avoid liability because the insurance is short term or because it is offered, paid for, and issued in the rental car context. Id. at pp. 669 and 670.

The policy of the FRL is to provide "monetary protection to that ever changing and tragically large group of persons who while lawfully using the highways themselves suffer grave injury through the negligent use of those highways by others." (Interinsurance Exchange v. Ohio Cas. Ins. Co. (1962) 58 Cal. 2d 142, 153, 23 Cal. Rptr. 592, 598, 373 P. 2d 640, 646, quoting from Continental Cas. Co. v. Phoenix Constr. Co. (1956) 46 Cal. 2d 423, 434, 296 P. 2d 801, 57 A.L.R. 2d 914.) Id. at p. 671.

Here, an automobile insurer who issues excess liability insurance in the rental car context must either indemnify or decline to do so within a reasonable time and before the risk occurs. Id. at p. 673. The innocent injured party's right should not be defeated

because the insured is not entitled to recover. Id at pp. 679-680.

III. CONCLUSION

The duty of an insurer to investigate the insurability of an insured should be extended to an automobile liability insurer that issues an excess liability insurance policy in the context of a rental car transaction. This would advance the public policy to provide compensation for death and injuries caused by automobile accidents.

Therefore, this court should 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: June 20, 2005 Respectfully submitted,

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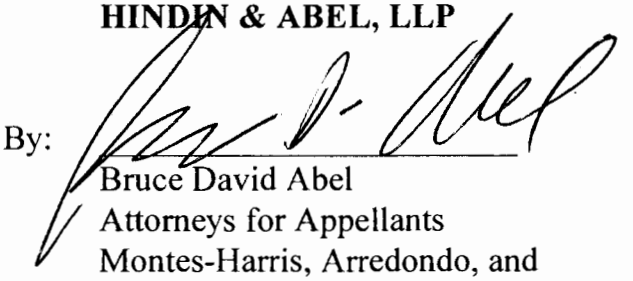
By: 
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CERTIFICATION OF WORD COUNT

I certify that, pursuant to California Rules of Court, Rule 29.1(c)(1), the attached **REPLY 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 2,695 words.

Dated: June 20, 2005

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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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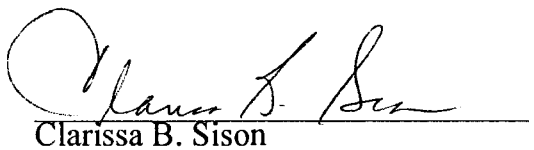

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PHILADELPHIA INDEMNITY vs. MONTES-HARRIS

Supreme Court Case No.: S130717

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