NO. S161008

IN THE

SUPREME COURT OF CALIFORNIA

VILLAGE NORTHRIDGE HOMEOWNERS ASSOCIATION,

Plaintiff and Appellant,

vs.

STATE FARM FIRE AND CASUALTY COMPANY,

Defendant and Respondent.

After a Decision of the Court of Appeal
Second Appellate District, Division Eight, No. B188718
Los Angeles County Superior Court, No. BC265328
Honorable Wendell Mortimer, Jr., Judge

APPLICATION OF PERSONAL INSURANCE FEDERATION OF CALIFORNIA AND NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES TO FILE AMICI CURIAE BRIEF; PROPOSED AMICI CURIAE BRIEF IN SUPPORT OF STATE FARM FIRE AND CASUALTY COMPANY

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APPLICATION TO FILE AMICI CURIAE BRIEF IN SUPPORT OF STATE FARM FIRE AND CASUALTY COMPANY

Pursuant to California Rule of Court 8.200(c)(1), Personal Insurance Federation of California (PIFC) and National Association of Mutual Insurance Companies (NAMIC) (collectively "Amici") respectfully request leave to file an amici curiae brief supporting the position of State Farm Fire and Casualty Company in this appeal.

PIFC is a trade organization dedicated to representing its member companies' interests before governmental bodies, including the California Legislature, the California Insurance Commissioner, and the California courts. PIFC's members are insurers specializing in personal lines of insurance, primarily homeowners and private passenger automobile insurance. These member companies account for more than 50 percent of all personal lines insurance premiums sold in California.

Founded in 1895, NAMIC is a full service national insurance trade association with more than 1,400 member companies that underwrite more than 40 percent of the property/casualty insurance premiums in the United States. NAMIC benefits its member companies through advocacy, public policy and member services.

Most claims presented to Amici's members are resolved without litigation. Of those that do end up in litigation, the vast majority are resolved

by settlement. Any rule that threatens the stability and predictability of the settlement process therefore directly, and negatively, affects Amici's members. Amici believe that the opinion of the Second District Court of Appeal in this action poses such a threat.

Counsel for Amici has reviewed the briefing in this matter and believes Amici can provide additional analysis regarding the issues pending before the Court. Amici therefore respectfully request that they be granted leave to file the accompanying Amici Curiae Brief in Support of State Farm Fire and Casualty Company.

Dated: August 22, 2008

Respectfully submitted,

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AMICI CURIAE BRIEF OF PERSONAL INSURANCE FEDERATION OF CALIFORNIA AND NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES IN SUPPORT OF STATE FARM FIRE AND CASUALTY COMPANY

TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. ARGUMENT 4

A. There Is No Justification for a Special "Affirm and Sue" Rule Applicable Only to First Party Insurers 4

B. The "Affirm and Sue" Rule Proposed by Village Northridge Would Cause Uncertainty as to the Finality of Settlements and Would Thus Deter Defendants from Entering Into Settlement Agreements 8

III. CONCLUSION 15

TABLE OF AUTHORITIES

California Cases **Page**

American Motorcycle Ass'n v. Superior Court,
20 Cal. 3d 578 (1978) 12

City of Orange v. San Diego County Employees Retirement Ass'n,
103 Cal. App. 4th 45 (2002) 12

Foley v. Interactive Data Corp.,
47 Cal. 3d 654 (1988) 4

Garcia v. California Truck Co.,
183 Cal. 767 (1920) .... *passim*

McClure v. McClure,
100 Cal. 339 (1893) 3

Moradi-Shalal v. Fireman's Fund Insurance Co.,
46 Cal. 3d 287 (1988) 5

Myerchin v. Family Benefits, Inc.,
162 Cal. App. 4th 1526 (2008) 9

Neary v. Regents of University of California,
3 Cal. 4th 273 (1992) 3, 12

Persson v. Smart Inventions, Inc.,
125 Cal. App. 4th 1141 (2005) 2, 13

Sears, Roebuck & Co. v. International Harvester Co.,
82 Cal. App. 3d 492 (1978) 11-12

Sime v. Malouf,
95 Cal. App. 2d 82 (1949) 2,10,13

Taylor v. Hopper,
207 Cal. 102 (1929) .... *passim*

Tower Acton Holdings v. Los Angeles County Waterworks Dist. No. 37,
105 Cal. App. 4th 590 12

Villa v. Cole,
4 Cal. App. 4th 1327 (1992) 11, 12

Wilson v. Wal-Mart Stores, Inc.,
72 Cal. App. 4th 382 (1999) 12-13

Non-California Cases

Daly v. Mueller,
630 S.E.2d 799 (Ga. App. 2006) 14

Dunaway v. United Ins. Co.,
124 S.E.2d 353 (S.C. 1962) 6-7

Fleming v. U.S. Postal Service AMF,
27 F.3d 259 (7th Cir. 1994) 11

Pizzoni v. Lightning Rod Mut. Ins. Co.,
638 N.E.2d 146 (1994) 6

Statutes and Regulations

Civil Code § 1542 8

Civil Code § 1691 .... 2, 8-9

10 California Code of Regulations § 2695.2(c) 5

10 California Code of Regulations § 2695.2(f) 5

10 California Code of Regulations § 2695.2(x) 5-6

Other Authorities

Jonathan D. Glater, *Study Finds Settling Is Better Than Going to Trial*,
N.Y. Times, Aug. 7, 2008, available at
http://www.nytimes.com/2008/08/08/business/08law.html 10

I.

INTRODUCTION

When is a settlement agreement *not* a settlement agreement? According to Village Northridge, when the parties to the agreement are an insurer and its insured. In that circumstance, Village Northridge argues, the insured is free to accept millions of dollars of the insurer's money in settlement of a disputed claim, including a release of all present and future claims against the insurer, then turn around and, while keeping the money, sue the insurer for yet more money on the ground the settlement was procured by fraud.

Unfortunately for Village Northridge, the law in California is to the contrary. Nearly 90 years ago, this Court held that a litigant seeking to challenge a settlement agreement on the basis of alleged fraud cannot do so without first rescinding the agreement and returning the settlement proceeds. *Garcia v. California Truck Co.*, 183 Cal. 767, 769-70 (1920). This longstanding principle, grounded in equity and common sense, was affirmed and expanded nine years later, when the Court rejected an attempted end-run around *Garcia* by a plaintiff who claimed a right to "affirm" the fraudulently induced settlement, retain the money received under the settlement agreement, and sue for damages. *Taylor v. Hopper*, 207 Cal. 102, 103 (1929). But for the

decision below, no court in this state has departed from the *Garcia-Taylor* rule in the intervening eight decades.[1]

Applying an analysis even Village Northridge rejects (*see* Answer Brief at 4-5), the Court of Appeal held that the *Garcia-Taylor* rule applies only in the context of personal injury cases. Accordingly, because this case stems from a dispute over insurance benefits, Village Northridge was free to sue State Farm without returning the million and a half dollars State Farm paid it for the specific purpose of avoiding just such a suit. Now before this Court, Village Northridge seeks to justify this holding by proposing a newfound "exception" to the *Garcia-Taylor* rule for one limited class of settlement agreements: those between insurers and their insureds. Absent from Village Northridge's purported analysis, however, is any principled reason why first party insurers should be treated differently from all other litigants, or why insureds who choose to settle their claims should not be bound by the mandates of California law to the same extent as any other settling party. In fact, insofar as it relates to the mandates of Civil Code section 1691, the distinction between first party cases and all others that Village Northridge

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[1] As discussed by State Farm in its Opening Brief, cases such as *Persson v. Smart Inventions, Inc.*, 125 Cal. App. 4th 1141 (2005), in which the settlement involved the sale of a res and not the release of a disputed claim (*see* Opening Brief at 28-29 & n.15; Reply Brief at 13-15), or *Sime v. Malouf*, 95 Cal. App. 2d 82 (1949), where the plaintiff's entitlement to the full consideration paid is undisputed (Opening Brief at 22 n.9; Reply Brief at 10), are distinguishable

proposes is as arbitrary and artificial as the distinction between personal injury cases and all others that Village Northridge specifically eschews. To use Village Northridge's words, "there is nothing inherently distinctive about [a first party insurance] claim which warrants disparate treatment in the eyes of the law." (Answer Brief at 4)

Not only is the singling out of first party insurance claims for "disparate treatment" unfair on its face, but the lack of a meaningful distinction between first party insurers and other defendants in this context means that the Village Northridge exception would quickly swallow the *Garcia-Taylor* rule. By the simple expedient of crying "fraud," a settling plaintiff could reap the entire benefit of its settlement bargain without any of its attendant burdens. Even were this result not conclusively foreclosed by *Garcia* and *Taylor*, it is manifestly unfair.

Moreover, the proposed exception is clearly contrary to the public policy of this state, which favors settlements. *See Neary v. Regents of University of Calif.*, 3 Cal. 4th 273, 277 (1992) (noting that settlement agreements "'are highly favored as productive of peace and good will in the community,'" as well as "'reducing the expense and persistency of litigation'" (quoting *McClure v. McClure*, 100 Cal. 339, 343 (1893)). Defendants who would otherwise be willing to resolve claims by accepting a release of claims

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and inapposite.

in exchange for the payment of money will understandably be reluctant to do so if, as the court below has held, the settling plaintiff can keep the settlement proceeds and sue anyway. For all these reasons, this Court should reverse the court below and unequivocally hold that the *Garcia-Taylor* rule remains the law of this State.

II.

ARGUMENT

A. There Is No Justification for a Special "Affirm and Sue" Rule Applicable Only to First Party Insurers.

Unable to justify the Court of Appeal's holding based on the court's own analysis, Village Northridge instead proposes an exception to the *Garcia-Taylor* rule for settlements in first party insurance cases – that is, between insurers and their insureds. (*See* Answer Brief at 5) Village Northridge purports to justify this proposal on the "special relationship" between the parties to an insurance contract, as defined in California case law and controlling administrative regulations.

Amici acknowledge that insurance carriers hold a unique place in California jurisprudence. Only they, for example, are subject to liability in tort for breach of the covenant of good faith and fair dealing, despite the fact that the covenant is implied in every contract. *See Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 693 (1988). But the existence of insurance "bad faith"

doctrine has no place in the analysis here, and the fact that insurers may have special duties to their insureds does not justify creating an exception to California rescission law applicable only to them. In fact, the existence of an established body of bad faith law compels the opposite conclusion, since an insured who claims it was fraudulently induced to enter into a settlement agreement already has remedies available to it that the average litigant does not. In other words, in the first party context, existing remedies fully protect the insured, since an aggrieved insured not only can seek to rescind the settlement agreement but, if successful, can assert bad faith claims against the insurer along with its original causes of action.

Moreover, to the extent Village Northridge purports to rely on them, the administrative regulations governing insurance companies do not support disparate treatment of first party insurance cases.[2] (*See* Answer Brief at 46, 51-52) In fact, the bulk of the regulations apply equally to third party claimants and insureds. 10 Cal. Code Regs. § 2695.2(c) ("Claimant" means a *first or third party claimant* as defined in these regulations . . . .").[3] And even

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[2] Amici question such reliance, given that the regulations are subject to enforcement by the Department of Insurance alone and do not create a private right of action. *See Moradi-Shalal v. Fireman's Fund Ins. Co.*, 46 Cal. 3d 287 (1988).

[3] Under the regulations, "first party claimant" means "any person asserting a right under an insurance policy as a named insured, other insured or beneficiary under the terms of that insurance policy, and including any person

were that not the case, because a liability insurer's duties to its insured are the cornerstone of its obligation to settle third party claims, the very arguments Village Northridge advances to support its "first party" exception apply equally in the third party context.

More to the point, however, there is simply nothing in the insurer-insured relationship that compels an exception to the *Garcia-Taylor* rule in the first place.4 The reality is that, having been forced to disavow the Court of Appeal's flawed analysis, Village Northridge had to come up with some justification for refusing to return the $1.5 million State Farm paid it in settlement. Since *Garcia* and *Taylor* foreclosed adoption of the "affirm and sue" rule on a broad scale, Village Northridge sought to articulate a limited version of the rule that would both skirt well-established California law and provide it with an excuse to retain the settlement proceeds.

The problem with Village Northridge's analysis is that it necessarily runs afoul of the *Garcia-Taylor* rule, on the one hand, and, on the other, provides no basis for confining its application to the limited class of first party

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seeking recovery of uninsured motorist benefit"; "third party claimant" means "any person asserting a claim against any person or the interests insured under an insurance policy." 10 Cal. Code Regs. §§ 2695.2(f), (x).

[4] In fact, other states that have adopted the mandatory tender rule have applied the rule in the context of first party insurance cases. *See, e.g.*, *Pizzoni v. Lightning Rod Mut. Ins. Co.*, 638 N.E.2d 146, 150 (Ohio 1994) (uninsured motorist coverage); *Dunaway v. United Ins. Co.*, 124 S.E.2d 353, 354-55 (S.C.

insurance cases. In addition to the obvious comparison with third party insurance cases, it is a short leap to applying the same rule to other types of "special" relationships, such as employer-employee or attorney-client. Indeed, if the rule applies to insurers because of their "*quasi*-fiduciary" relationship with their insureds (*see* Answer Brief at 18), surely the same argument can be made with respect to *true* fiduciaries. It is worth noting that none of the "affirm and sue" cases from other jurisdictions limits application of the rule to cases in which there is a special relationship between the parties, and there is no reason to believe the California courts would impose any such limitation here.

Likewise, if the misrepresentation of policy limits by an insurer is sufficient to justify an exception, why would the same not be true of any misrepresentation by a settling party of an allegedly material fact within the party's special knowledge?[5] A defendant could misrepresent his total assets to a plaintiff in order to convince the plaintiff to accept a lower settlement figure than the facts warrant. Or he could assert he was going to declare bankruptcy unless the plaintiff accepted an outstanding settlement offer. There are any number of fraudulent representations a defendant might make to induce a

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1962) (life insurance).

[5] In this case, the alleged misrepresentation appears not to answer to this description. (*See* Opening Brief at 57-58)

plaintiff to settle, and Village Northridge's argument provides no basis for distinguishing one from another, much less for singling out alleged misrepresentations by insurers concerning available policy limits.

The rule proposed by Village Northridge, even if purportedly limited on its face to a small collection of cases, is the proverbial tip of the iceberg. The fact is that if the Court were to adopt such a rule, *Garcia* and *Taylor* would soon be the anomaly, with the exception having engulfed the rule.

B. The "Affirm and Sue" Rule Proposed by Village Northridge Would Cause Uncertainty as to Finality of Settlements and Would Thus Deter Defendants from Entering Into Settlement Agreements.

Despite Village Northridge's contrary argument, there can be no serious question that the direct and immediate effect of the rule it now proposes would be to destabilize the settlement landscape. Under current California law, a defendant knows there is a way to buy its litigation peace: pay a sum sufficient to obtain the plaintiff's agreement to resolve any pending claims and to release all future claims, whether known or unknown, pursuant to a written waiver of Civil Code section 1542. Should the plaintiff then have second thoughts, believe it was taken advantage of, or otherwise want out of the deal, its remedy is to seek to rescind the settlement agreement – but only after returning to the defendant the money it received under that agreement, as required by Civil

Code section 1691.[6] This legislatively-mandated process treats both parties equally, as both "get back" what they otherwise gave up via the settlement: a right of action, in the case of the plaintiff, and the settlement funds, in the case of the defendant.

In addition to treating the parties fairly by ensuring they are restored to their pre-settlement positions, the tender requirement serves to discourage marginal rescission claims, since the rescinding plaintiff's prospect of succeeding is counterbalanced by the risk that it might ultimately recover nothing, or some amount less than it would have received under the settlement agreement. In this way, the tender requirement brings certainty and predictability to the settlement process, since it effectively limits the number of settlements subject to challenge.

The "affirm and sue" rule, by contrast, promises just the opposite result. As the Fourth District recently observed, to allow a plaintiff to "retain the benefits of the release" and nonetheless sue would not only "violate the terms of his bargain," it "would *frustrate the very purpose of the release and destroy its effectiveness as a favored device for eliminating litigation*." *Myerchin v. Family Benefits, Inc.*, 162 Cal. App. 4th 1526, 1535-36 (2008) (emphasis

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[6] Any exception to the rule requiring restoration of consideration is not implicated in this action, since Village Northridge has made clear that it does *not* seek to rescind the settlement agreement.

added) (quoting *Sime v. Malouf*, 95 Cal. App. 2d 82, 111 (1949)). The reason is simple: Whether out of fear of an adverse judgment, the high cost of litigation, the desire to avoid adverse publicity, or some other reason, a defendant seeking to settle a claim or lawsuit does so to fully and finally resolve that pending matter and buy its peace. To accomplish that objective, the defendant is willing to pay money – in many cases, substantial sums – to obtain a release of present and future claims.[7] What the defendant gains is certainty: certainty that the pending claim will be resolved or the litigation dismissed; and certainty that the plaintiff will not sue it again in the future.

Insurance companies are among the largest consumers of legal services, whether defending themselves in claim litigation or, as is more typical, providing a defense to their insureds. In either case, in recognition of both their common law duties and business realities, insurance companies settle the vast majority of lawsuits. In many cases, an insurer will pay more than it believes a claim is intrinsically worth simply to avoid (or minimize) attorney fees and related defense expenses. It takes little imagination to realize that the

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[7] A recent analysis of settlements bears this out. According to a study to be published in the September issue of the *Journal of Empirical Legal Studies*, "in the vast majority of cases," defendants offer more in settlement than plaintiffs ultimately recover at trial. Jonathan D. Glater, *Study Finds Settling Is Better Than Going to Trial*, N.Y. Times, Aug. 7, 2008, available at http://www.nytimes.com/2008/08/08/business/08law.html. These findings strongly suggest that defendants are willing to pay a premium to avoid the expense and uncertainty of a litigated outcome.

greater the likelihood that settlement agreements are subject to challenge, the less willing defendants will be to enter into such agreements, and the less they will be willing to pay for them. Because the "affirm and sue" rule affords plaintiffs a risk-free means to avoid a release, the rule will necessarily serve to deter settlements. As Judge Richard Posner explained in a related context:

> Not even plaintiffs are helped in the long run by a rule allowing them to have their cake and eat it, for a defendant will not pay as much for a release that the plaintiff can challenge without having to repay the money as the price of maintaining the challenge.

Fleming v. U.S. Postal Service AMF, 27 F.3d 259, 261 (7th Cir. 1994) (affirming denial of former postal service employee's Rule 60(b) motion seeking reinstatement of her action because she failed to tender settlement funds, as required).

Quite apart from the settling defendants' concerns addressed above, this Court should be wary of a rule that not only gives a settling plaintiff the option to challenge a settlement agreement without the formalities and protections of rescission, as mandated by the Legislature, but gives it an incentive to do so in the form of a windfall settlement fund. It is beyond axiomatic that, as a matter of public policy, "settlements of litigation are favored and should be encouraged." *Villa v. Cole*, 4 Cal. App. 4th 1327, 1338 (1992). This overarching policy has been recognized in a variety of contexts and has informed a number of judicial decisions. *See, e.g.*, *Sears, Roebuck & Co. v.*

International Harvester Co., 82 Cal. App. 3d 492, 496 (1978) (identifying "encouragement of settlement of the injured party's claim" as second in the "hierarchy of interests" in the resolution of personal injury actions (citing *American Motorcycle Ass'n v. Superior Court*, 20 Cal. 3d 578, 603-04 (1978)); *Tower Acton Holdings v. Los Angeles County Waterworks Dist. No. 37*, 105 Cal. App. 4th 590, 602 (finding error in admission of evidence of settlement negotiations; "[s]ettlement is encouraged by allowing the parties to communicate freely, without fear that their communications may be used against them if settlement negotiations are not successful"); *City of Orange v. San Diego County Employees Retirement Ass'n*, 103 Cal. App. 4th 45, 55 (2002) (enforcing oral option contract to settle). "[S]ettlement agreements "'are highly favored as productive of peace and good will in the community,'" as well as "'reducing the expense and persistency of litigation.'" *City of Orange v. San Diego County Employees Retirement Ass'n*, 103 Cal. App. 4th at 55 (quoting *Villa v. Cole*, 4 Cal. App. 4th at 1338). It is no overstatement to say that, without settlements, "our system of civil adjudication would quickly break down.'" *Neary v. Regents of University of Calif.*, 3 Cal. 4th 273, 277 (1992), superseded by statute on other grounds as stated in *In re Rashad H.*, 78 Cal. App. 4th 376, 379 (2000); *see Wilson v. Wal-Mart Stores, Inc.*, 72 Cal. App. 4th 382, 390 (1999) (noting that "public policy in favor of settlement primarily is intended to reduce the burden on the limited resources of the trial

courts"). Accordingly, any rule that discourages settlements, as does Village Northridge's proposed rule, is a recipe for disaster. Given that California law provides ample remedies for fraudulently induced settlements, the Court need not, and should not, stray from the core principles addressed in *Garcia* and *Taylor*.

By way of justification, Village Northridge seeks to bring itself within an exception to the mandatory tender rule for cases in which the settling plaintiff is allowed to keep the settlement proceeds because it has an *independent right* to them. *See Persson v. Smart Inventions, Inc.*, 125 Cal. App. 4th 1141, 1155 (2005); *Sime v. Malouf*, 95 Cal. App. 2d at 111. Although Village Northridge repeatedly states that it has such an independent right, it never identifies or explains what the basis of that right is – and, more to the point, the facts belie its claim to such a right, since the amount State Farm owed Village Northridge prior to the settlement, if anything, was plainly in dispute. (Answer Brief at 4) In such a circumstance, the settling plaintiff "cannot retain the benefits of the release and sue, for to sue would violate the terms of his bargain." As noted above, "[t]o hold otherwise would frustrate the very purpose of the release and destroy its effectiveness as a favored device for eliminating litigation." *Sime v. Malouf*, 95 Cal. App. 2d at 111 (citing *Garcia* as a case addressing "fraudulently procured releases of claims which, both before and after the execution of the release, were disputed as to right and

as to amount"). As aptly stated by the Georgia Court of Appeals when faced with a similar contention:

> Such an argument misperceives the principle behind this exception to the tender requirement. The concept is that no tender is required where it is *undisputed* that the plaintiff in any and all events – even if rescission were granted – would be entitled to at least the tender amount. *Where, on the other hand, the questions to be decided are whether the plaintiff is entitled to recover anything at all, and if so, how much, this principle does not apply and tender is required.* The fact that a defendant at one point decided to pay an amount in settlement "does not fix such an amount as a minimum recoverable," but simply represents the defendant's willingness to pay a certain sum to avoid further litigation and risk. Otherwise, the exception would swallow the rule, as every plaintiff who seeks rescission believes that she may recover more through rescission; why else seek rescission? The plaintiff's fervent belief that she may recover more is hardly grounds for carving out an exception and allowing her to keep the benefits of the release while she at the same time seeks to undo the release.

Daly v. Mueller, 630 S.E.2d 799, 802 (Ga. App. 2006) (citations omitted; emphasis added).

Neither the policy justifications offered by Village Northridge nor the facts of its claim justify relieving Village Northridge of its duty to tender the settlement proceeds to State Farm if it wishes to sue State Farm for fraud. The very same principles that guided this Court's analysis and holdings in *Garcia* and *Taylor* apply to Village Northridge's claim, and the same rule should apply.

III.

CONCLUSION

For the foregoing reasons, PIFC and NAMIC respectfully request that this Court reverse the decision below; reject Village Northridge's invitation to adopt the "affirm and sue" rule in California; and reaffirm that *Garcia* and *Taylor* accurately state the law in California.

Dated: August 22, 2008

Respectfully submitted,

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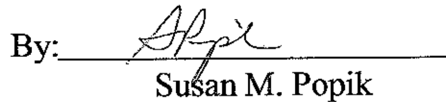
CERTIFICATE OF WORD COUNT
(Cal. Rules Ct. 8.204(c))

The text of this brief, including footnotes, consists of 3,588 words as calculated by the Microsoft Word word processing program used to generate the brief.

Dated: August 22, 2008

CHAPMAN, POPIK & WHITE LLP

By: 
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PROOF OF SERVICE

I, the undersigned, declare:

I am employed in the City and County of San Francisco, California. I am over the age of eighteen years and not a party to the within entitled action. My business address is Chapman, Popik & White, 650 California Street, 19th Floor, San Francisco, CA 94108.

On August 22, 2008, I served the following document(s):

APPLICATION OF PERSONAL INSURANCE FEDERATION OF CALIFORNIA AND NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANYIES TO FILE AMICI CURIAE BRIEF IN SUPPORT OF STATE FARM FIRE AND CASUALTY COMPANY

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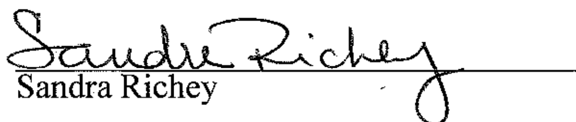
X **BY MAIL**: By placing a true copy thereof enclosed in a sealed envelope with postage fully prepaid, in the United States mail, at San Francisco, California

____ **BY FACSIMILE**: I caused each envelope, affixed with a prepaid overnight delivery airbill, to be deposited in a box regularly maintained by an overnight delivery service, such as Federal Express or California Overnight.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed on August 22, 2008, at San Francisco, California.



Sandra Richey