THE FOUNDATION FOR TAXPAYER AND CONSUMER RIGHTS

1750 OCEAN PARK BOULEVARD, #200, SANTA MONICA, CA 90405-4938
TEL: 310-392-0522 • FAX: 310-392-8874 • NET: CONSUMERWATCHDOG.ORG

May 4, 2001

By Facsimile Transmission and U.S. Mail
The Honorable Harry Low
Insurance Commissioner
California Department of Insurance
300 Capitol Mall, Suite 1700
Sacramento, CA 95814

Re: Request for Rulemaking Proceeding to Establish Uniform Public Policy on Uninsured Motorist Surcharge Issues as Raised in Pending Administrative and Court Proceedings; *In the Matter of the Complaint of Mitchell et al. v. Allstate Insurance Company*, IH-00-0097-91 and *Mitchell v. Allstate*, Los Angeles Superior Court Case No. BC 212492.

Dear Commissioner Low:

As you know, Ins. Code §1861.02(c), enacted by Proposition 103, prohibits insurers from discriminating against previously uninsured motorists. The above-referenced proceedings were instituted to rectify one carrier's violation of the law. We are now informed that Department of Insurance staff have reviewed and informally approved of a proposed rule through a settlement of the above-referenced proceedings, which would permit the continued violation of §1861.02(c) and would establish a bad precedent to be utilized by other carriers. Because we believe other carriers are also improperly penalizing consumers who have no prior insurance, we request that you reject any proposed settlement and immediately institute a rule-making proceeding to prohibit the continued, widespread violation of §1861.02(c).

Proposition 103 specifies that any surcharge or discount that is not an approved rating factor adopted by the Commissioner through regulation may not be used by any company in the determination of rates and premiums. *See* Ins. Code §1861.02(a)(4). For the Commissioner to allow companies to evade this requirement would violate a superior court writ issued against former Commissioner Quackenbush in 1997. *See Proposition 103 Enforcement Project v. Quackenbush*, Case No. 982646 and *Consumers Union and Southern Christian Leadership Conference v. Quackenbush*, Case No. 982181 (discussed further below).

Further, no such approved rating factor may be allowed to trump the specific provision of Proposition 103, Ins. Code §1861.02(c), which requires that:

> the absence of prior automobile insurance coverage, in and of itself, shall not be a criterion for determiningeligibility for a Good Driver Discount policy, or generally for automobile rates, premiums or insurability.

The public policy behind §1861.02(c) is that consumers entering the insurance market should not be penalized for being previously uninsured, especially in light of industry practices such as red-lining and territorial rating, which render insurance unaffordable and unavailable for many Californians. Proposition 103's "no prior" rule is sound public policy because it eliminates, rather than erects, unfair barriers to consumers purchasing insurance and because it recognizes that consumers may have not had prior insurance for a number of reasons unrelated to risk.

FTCR has challenged attempts by insurance companies to circumvent §1861.02(c) both before the Department and in the courts.

Consumer Groups Challenge Allstate's Rule 39 "Non-Verifiable Accident Record Surcharge"

In 1997, FTCR's Proposition 103 Enforcement Project and other groups initiated administrative proceedings on the Class Plan Applications of State Farm, Farmers, and Allstate. (File Nos. PA-97-0077-00, PA-97-0079-00, and PA-97-0078-00.) Those proceedings were bifurcated into two phases. Phase I sought to determine whether the companies were in compliance with Ins. Code § 1861.02(a)'s requirement that premiums be based primarily on factors related to driving history as implemented through Quackenbush's factor weighting regulations. After the Department upheld insurers' interpretation of the law and regulations, consumer groups petitioned for a writ of mandate in Alameda County Superior Court challenging Quackenbush's regulations. As you know, that issue has recently completed its course through the courts, ending in a denial of review by the California Supreme Court in *Spanish Speaking Citizens Foundation, et al. v. Quackenbush*, leaving in place the Court of Appeal's decision upholding the Quackenbush regulations, which permit insurers to continue to utilize territory as the principal determinant of premiums, rather than the mandatory factors specified by the statute.

Phase II of those proceedings was to determine, among other issues, the validity of Allstate's Rule 39, a "non-verifiable accident driving record surcharge." In raising this issue in its petition for hearing on the class plans, FTCR argued that Rule 39 violated §1861.02(c) by using the absence of prior insurance as a basis to charge previously uninsured motorists higher premiums. A hearing on Phase II has yet to be noticed by the Department.

The Mitchell Proceedings

In the interim, private litigation, to which consumer groups are not parties, was instituted to challenge Allstate's Rule 39. *Mitchell v. Allstate*, Los Angeles Superior Court Case No. BC 212492, is a class action filed on June 24, 1999, alleging that the defendant's Rule 39 violated §1861.02(c); plaintiffs sought damages and injunctive relief.

By mutual agreement of the parties, the litigation was stayed pending a hearing and decision by the CDI on the concurrently filed administrative complaint (*In the Matter of the Complaint of Mitchell et al. v. Allstate*, IH-00-0097-91), under the putative authority of the primary jurisdiction doctrine set forth in *Farmers v. Superior Court* (1992) 2 Cal.4th 477, on the question of whether Rule 39 violated the statute. The CDI held an informal hearing on March 14, 2000, although the Department and Allstate failed to notify the parties in Phase II of the prior Class Plan challenges of that fact. The parties in *Mitchell v. Allstate* filed post-hearing briefs and comments with the Department in April and May 2000.

For reasons which we cannot discern and which cause us concern about the administrative process, we understand that the Department has agreed to withhold issuance of its decision on Allstate's Rule 39 in order to permit the parties in the litigation to settle the matter.

FTCR has since learned through plaintiffs' counsel in the *Mitchell* proceedings that the parties have entered into a settlement agreement which:

1. Requires Allstate to discontinue the use of its Rule 39 surcharge – an action which is superfluous, as noted below, given the Department's emergency regulation.
2. Permits Allstate to utilize a new, so-called "Persistency Discount" rule. Allstate's proposed "Persistency Discount" would require motorists applying for an insurance policy with Allstate to provide proof of insurance with a single carrier for the previous 12 months in order to receive an approximately 11% discount. Acceptable proof of prior "persistency" for purposes of receiving Allstate's discounted premium include:
   - A letter of experience;
   - Automobile insurance identification cards;
   - Automobile insurance declarations pages; or
   - Automobile insurance renewal offers.
3. In lieu of damages, requires Allstate to issue "coupons" to those drivers who were improperly surcharged under Rule 39; the coupons provide discounts for future purchases of Allstate insurance products.

The proposed "Persistency Discount," has the same effect as its discredited predecessor, Rule 39: to impose a surcharge on previously uninsured motorists. The proposed persistency discount violates §1861.02(c) because it results in higher rates for consumers solely because of no prior insurance. Two consumers – otherwise identical – would be charged different rates solely because one had prior insurance and one did not.

We understand that Department of Insurance staff have met with counsel for parties in the Mitchell case and have given their initial approval of the proposed rule. (The settlement agreement states that final approval by the court is contingent upon the Department's approval of the proposed rule in the context of a new rating plan to be submitted by Allstate).

We are deeply troubled by the proposed settlement because it does not stop the illegal action and thus provides no meaningful relief to injured parties. If our understanding is correct that the Department has tentatively signed off on the proposed settlement, that action, taken in a manner which eschews the regulatory process with proper public notice and opportunity for public comment, is of equal concern to us.

The Department's approval of the proposed settlement will establish a precedent that will allow all other carriers to formulate similar discounts in violation of §1861.02(c). Our review of other insurers' practices has revealed the use of a wide variety of similar rules that have the same effect. A rulemaking proceeding in advance, where the Commissioner considers the needs of all drivers and all insurers, not just a few, is far more likely to establish sound, and long-term public policy on an issue effecting 20-25% of the drivers in California who are uninsured.

Meanwhile, on April 9, 2001, the Department issued a notice of a proposed emergency regulation (File No. ER-41) that would prohibit insurance companies from requiring proof of insurance to verify driving history, effectively nullifying Allstate's Rule 39. Whether this would moot out the administrative proceedings in Phase II of the 1997 class plan challenges referenced above and in *In the Matter of the Complaint of Mitchell et al. v. Allstate*, IH-00-0097-91, is unclear. The question of relief to policyholders who were surcharged under Rule 39 remains outstanding. In any case, this new rule may not prevent insurers from using persistency or some other subterfuge as a way to continue to discriminate against uninsured drivers in violation of §1861.02(c), and as an emergency regulation, would have to proceed to a noticed rulemaking proceeding under the APA anyway.

Allstate is Not an Isolated Example

Since the passage of Proposition 103, insurance companies have formulated auto insurance rating rules that, under the guise of a variety of labels, have the same result: to impose higher premiums on previously uninsured motorists, in violation of Ins. Code §1861.02(c). Furthermore, there appears to be a lack of consistency in the Department's approval of the various surcharges (or so-called "discounts") used by companies in the determination of premiums.

Previously, FTCR and other groups have challenged violations of §1861.02(c) in *Proposition 103 Enforcement Project v. Quackenbush*, Case No. 982646 and *Consumers Union and Southern Christian Leadership Conference v. Quackenbush*, Case No. 982181. Those actions evolved from the Department's denials of requests for hearings by the Project to challenge Safeco's Class Plan (PA-96-0070-00) and by Consumers Union and Southern Christian Leadership Conference to challenge the Class Plan of the Interinsurance Exchange of the Automobile Club. Both insurers were implementing a surcharge on drivers who could not verify compliance with the state's financial responsibility law. The San Francisco Superior Court issued writs in both cases which prohibit the Commissioner from approving the use of any rating factor requiring proof of compliance with the mandatory insurance laws (prior insurance coverage). In our view, the subsequent approval of Allstate's Rule 39 surcharge, or any other companies' rating plans and rating factors that violate §1861.02(c), would be in direct violation of the writs of mandate issued by the superior court.

A Rulemaking Proceeding is Required

By styling Allstate's proposal as a "Persistency Discount," the parties seek to bury a highly controversial matter within the routine process of approving a rating plan, using a rating factor listed only as "persistency" but nowhere defined in the regulations adopted by former Insurance Commissioner Quackenbush. We believe that that approach is inappropriate, and under the APA, any standards of general application that the Department uses to define "persistency" in the class plan approval process are themselves required to be adopted by regulation.

The serious issues raised here are industry-wide in scope, as they are relevant to the rating plans of every auto insurance carrier operating in California. Thus, the Department must necessarily establish the parameters and validity of "persistency" as rating factor in light of §1861.02(c)'s prohibition against the use of absence of prior insurance as a rating factor. Only then will the Department be able to resolve the issues as raised by Phase II and the Allstate proceedings. Indeed, Allstate's proposed "Persistency Discount" reveals the apparent fungibility of the "persistency" rating factor, allowing it to mean different things to different companies and subjecting the Department's approval process to an appearance of arbitrariness and capriciousness. A rulemaking proceeding is therefore the best way to proceed, rather than on a case by case basis, as the Department recognized in noticing its April 9, 2001 emergency regulation.

Such issues should certainly not be determined by the settlement of private litigation that hinges on the approval by the Department of an insurer's class plan. That consumer groups would have the opportunity to intervene before the Department once Allstate's class plan is filed, does not negate the fact that such a process is an economically inefficient way to address an industry-wide practice. Neither the taxpayers of California nor motorists would be well served by repeated and duplicative proceedings.

In light of the foregoing, we urge you to promptly undertake the following actions:

1) Initiate a rulemaking proceeding to determine the appropriateness of any surcharges/discounts for persistency in light of §1861.02(c)'s prohibition against using the absence of prior insurance as a rating factor;
2) In the interim, stay any action on the *Mitchell v. Allstate* proceeding, IH-00-0097-91, and reject any settlement proposal, reversing any prior decision of your staff to the contrary;
3) Notice the parties in Phase II of the administrative proceedings initiated by consumer groups in 1997 (File Nos. PA-97-0077-00, PA-97-0079-00, and PA-97-0078-00) that a final ruling on Allstate's Rule 39 surcharge to determine the appropriate relief owed to policyholders forced to pay the illegal surcharge will be stayed pending the rulemaking proceeding; and
4) Determine what relief policyholders of other carriers are entitled to for the violation of the statute, and issue the appropriate orders; and
5) Notify the Superior Court of these actions so that the Allstate class action litigation is stayed pending the Department's completion of these actions.

We would be happy to meet with Department staff to further discuss this matter and to answer any questions raised herein.

Sincerely,

Pamela Pressley
Staff Attorney

Harvey Rosenfield
President

Cc: Natasha Ray
Maureen Mason
Elizabeth Mohr
Patricia Staggs
Mark Savage
Thomas McDonald
Dean Hansell
Drew Pomerance
Mark Goshgarian