Case No. B159982

IN THE COURT OF APPEAL
FOR THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION ONE

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SAM DONABEDIAN,
Individually and on behalf of the general public
*Plaintiff and Appellant*;
v.
MERCURY INSURANCE COMPANY,
A Corporation, and DOES 1 through 100, inclusive
*Defendants and Respondents*.

Appeal from the Superior Court of the State of California in and for the
County of Los Angeles, Case No. BC249019
(The Honorable Ann Carolyn Kuhl, Judge)

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# THE FOUNDATION FOR TAXPAYER AND CONSUMER RIGHTS' REVISED [PROPOSED] AMICUS CURIAE BRIEF*

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* As directed by the Court's Nov. 5, 2003 order, this revised brief supersedes The Foundation's previously-served oversized amicus curiae brief dated Nov. 4, 2003.

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## INTRODUCTION AND SUMMARY

This is a straightforward case concerning the statutory construction of four provisions of the Insurance Code. But this Court's ruling will have profound consequences for the balance of power between insurance companies and consumers that has prevailed for the preceding fourteen years. Mercury asserts, and the court below agreed, that two statutes enacted in 1947 to preclude challenges to the rates, premiums and practices of property-casualty insurance companies – §§ 1860.1 and 1860.2 – must be held to supersede and override two provisions of the 1988 voter-approved Proposition 103 that explicitly authorize private citizens to bring suit against insurers under the Unfair Competition Law. Thus, Mercury argues that, as a matter of law, the Insurance Commissioner's alleged approval of an insurance company's illegal conduct – an approval that in fact Mercury never secured – immunizes the insurance from challenge under the Unfair Competition Law. Such an interpretation flies in the face of the plain language of the statutory provisions at issue, especially when read in light of the context of the entire Proposition 103 insurance regulatory scheme, and therefore the court's decision below must be reversed.

If not reversed, insurers will be emboldened to conceal or disguise violations of any California law, such as discrimination based on race or religion, within the voluminous filings they submit to the Insurance Commissioner, in the reasonable expectation that his staff will fail to uncover the deception and that the insurer will be immunized from liability when consumers seek restitution.

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Proposition 103 made "numerous fundamental changes in the regulation of automobile and other forms of insurance in California." (*Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 812; *20th Century*

*Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 240.) To address widely-recognized abuses in the automobile insurance marketplace, Insurance Code § 1861.02(a)[1] requires insurers, when determining the premium a motorist must pay, to utilize three mandatory factors[2] and only "such other factors" as adopted by the Insurance Commissioner by regulation. There are presently sixteen such rating factors.[3] Section 1861.02(c) specifically prohibits the use of one rating factor that is routinely permitted in other states: "the absence of prior insurance."

Mercury has long violated – indeed, continues to violate – both subdivisions. It offers a premium discount to anyone who has had prior insurance with any company. The only individuals who do not qualify for this discount are those who have been previously uninsured.[4] This is a straightforward violation of § 1861.02(a) and § 1861.02(c) and of regulations promulgated by the Insurance Commissioner for the express purpose of interdicting Mercury's misconduct.

Who is affected by Mercury's misconduct? Those who did not previously own or operate a car; military reservists serving overseas who

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[1] All citations are to the Insurance Code unless otherwise indicated.

[2] The three mandatory rating factors are "(1) The insured's driving safety record. (2) The number of miles he or she drives annually. (3) The number of years of driving experience the insured has had." (§ 1861.02(a)(1)-(3).)

[3] The approved optional rating factors are: (1) Type of vehicle; (2) Vehicle performance capabilities; (3) Type of use of vehicle; (4) Percentage use of the vehicle; (5) Multi-vehicle households; (6) Academic standing of the rated driver; (7) Driver training; (8) Vehicle characteristics; (9) Gender; (10) Marital status; (11) Persistency: (credit applied "at policy renewal"; (12) Non-smoker; (13) Secondary Driver Characteristics. (14) Multi-policies with the same, or an affiliated, company; (15) Relative claims frequency; (16) Relative claims severity. (Cal. Code Regs., tit. 10, § 2632.5.)

[4] Mercury defines the class of persons ineligible for this discount to include those who have let their policy lapse for a period of more than thirty days.

chose to cancel or let their policy lapse; people who let their coverage lapse because they were hospitalized or worked outside the United States; and those who simply cannot afford insurance. Those who are denied the discount have three choices: buy the policy at the inflated price; try to locate another carrier that is complying with the law; or choose not to buy insurance at all. Thus, the purpose of § 1861.02(c) – to reduce the number of uninsured motorists by making insurance more affordable to buyers – is thwarted by Mercury's practice.

Recognizing that the California Department of Insurance (CDI) has insufficient resources to ensure compliance by each of the estimated eight hundred insurers doing business in California, Proposition 103 gave the public the unqualified private right to enforce both the provisions of the measure and the state's civil rights and consumer protection statutes (§ 1861.10), which it made applicable to insurers for the first time (§ 1861.03). Appellant Donabedian in this case filed suit under one of those statutes – the Unfair Competition Law (Business and Professions Code §§ 17200, *et seq*.) (UCL).

Mercury has never denied that it offers a discount to applicants who have been previously insured by any company.

Rather, Mercury insists that its violation of § 1861.02(c)[5] is "insulated from civil action" by two vestigial provisions of the pre-Proposition 103 regulatory regime, §§ 1860.1 and 1860.2 of the Insurance Code. (Respondent's Brief (RB) at 2). By their own terms, neither provision applies.

In a related argument, Mercury claims that it is immunized because the Insurance Commissioner approved Mercury's class plan, which

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[5] Inexplicably, Donabedian did not allege, nor did Mercury discuss, the violation of § 1861.02(a).

contained the rating factors Mercury intended to use. Mercury contends that under the First District Court of Appeal's decision in *Walker v. Allstate* (2000) 77 Cal.App.4th 750)(*Walker*), there can be no liability for a violation of § 1861.02(c) as long as the Insurance Commissioner gave his approval to the filing. Finding that the Commissioner approved Mercury's class plan, the trial court sustained Mercury's demurrer without leave to amend, citing *Walker*.

This was error. By its own terms, *Walker* is inapposite to this case.

First, the record demonstrates that Mercury did not disclose, and the Commissioner did not approve, the rating factor that Mercury is actually using, which is the length of prior coverage with any carrier. *This is known in other states as a "prior insurance" rating factor.*[6] Mercury insists that "prior insurance," or "length of prior coverage with any carrier," is identical to "persistency," an *approved* rating factor that allows an insurance company to provide a discount to customers who have remained with that company for an extended period of time. But, as a matter of law, "length of prior coverage with any carrier" is not "persistency," and the Insurance Commissioner has rejected Mercury's equation of the two. "Length of prior coverage with any carrier" is not an approved rating factor under § 1861.02(a) because it is illegal under § 1861.02(c). *Walker* does not apply to *unapproved* conduct. The trial court erred in so applying it.

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[6] As an example, attached as Exhibit A to the accompanying Request for Judicial Notice is a filing submitted to Michigan regulators by Progressive Michigan Insurance Company. The filing refers to "Prior [] Insurance" (Progressive Michigan Insurance Company, Michigan Private Passenger Automobile Insurance Program, May 29, 2001, Attachment 8, p. 8.1.) It clearly applies to applicants coming from other insurers "Major Discounts (New Business)". (Hereafter, "Exh. __" refers to exhibits attached to the accompanying Request for Judicial Notice.)

Second, it is a basic tenet of administrative law that an administrative agency has no authority to approve the violation of a statute. (*See Assoc. for Retarded Citizens v. Dept. of Development Svcs.* (1985) 38 Cal.3d 384, 391.) Even if the Commissioner purported to approve Mercury's use of an unapproved and illegal rating factor, such approval would be *ultra vires*. The trial court erred in according legitimacy to such an approval.

Third, the question that the trial court was asked to resolve in this case is whether Mercury's use of a "length of prior coverage with any carrier" rating factor is on the list of rating factors insurers may use to categorize policyholders for purposes of determining the *premium each* motorist must pay.[7] *Walker*, by contrast, prohibited a lawsuit seeking damages for excessive *rates* previously approved by the Insurance Commissioner. A rate is the total amount of revenue to be collected from all of an insurer's customers. Whether a rate is "reasonable" is a technical matter for which the regulator has special expertise; whether an insurer has set individual premiums by using a rating factor that is not on the approved list requires zero technical expertise, but only a legal determination of the kind that courts undertake every day. Mercury's "length of prior coverage with any carrier" is a rating factor that determines premiums, not a <u>rate</u>; the superior court failed to make this crucial distinction.

In any case, *Walker* is bad law and should not be followed by this court. Ignoring basic rules of statutory construction, the *Walker* court held that the regulatory scheme in place prior to the passage of Proposition 103 survived its substantive repeal by that measure. It incorrectly treated two vestigial sections of the old law (§§ 1860.1 and 1860.2), which were not repealed by Proposition 103, as inconsistent with the later-enacted

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[7] Section 1861.02(a); Cal. Code Regs., tit. 10, § 2632.5.

provisions of Proposition 103. As already noted, they do not apply here by their own terms. To the extent such a conflict existed, the court should have ruled that the two sections were partially or completely repealed by implication. (*Burlington Northern and Santa Fe Railway Co v. Public Utilities Commission* (2003) __Cal.Rptr.3d __, 2003 WL 22390021; *accord People v. Bustamante* (1997) 57 Cal.App.4th 693, 700-701.) Instead, the *Walker* court incorrectly held that the old law superseded the new law.

Because *Walker* does not and cannot apply to this case, Mercury was properly sued and the superior court has jurisdiction to hear the matter. To overcome that result, Mercury asks this court to reach far beyond it or any court's jurisdiction to declare that violations of Proposition 103 can no longer be challenged in court, whether the violation was approved by the CDI or not. Mercury seeks nothing less than a judicial repeal of explicit provisions of Proposition 103 that provide recourse to the courts for violations of state law. The California Supreme Court expressly rejected this contention in *Farmers Insurance Exchange v. Superior Court* (1992) 2 Cal.4th 377 (*Farmers*). Undaunted, Mercury advocates that this court overrule *Farmers*.

Perhaps anticipating that its outlandish invitation to judicial excess would not be well received by this Court, Mercury has hedged its position. After a two year lobbying effort, Respondent has obtained Governor Davis's signature on legislation that purports to legalize Mercury's use of the "length of prior coverage with any carrier" rating factor. The company offers the result of its efforts, S.B. 841, as "evidence" that what it was doing was legal all along. (RB at 20.)

The fact that Mercury had to get the legislature to override the explicit mandates of §§ 1861.02(a) and 1861.02(c) and impose a new rating factor is eloquent proof of exactly the opposite. In any case, S.B. 841 does not "further the purposes" of Proposition 103, infringes upon the powers

accorded the Insurance Commissioner under Proposition 103, and therefore is void as an unconstitutional act. (*See Amwest Surety Ins. Co. v. Wilson* (1995)11 Cal.4th 1243; *Proposition 103 Enforcement Project v. Quackenbush* (1998) 64 Cal. App. 4th 1473.)

The issue of the constitutionality of that amendment to Proposition 103 has been squarely raised, and is presently pending for decision, before the Los Angeles Superior Court. (*The Foundation for Taxpayer and Consumer Rights, et al. v. Garamendi*, et al., Los Angeles Super. Court case no. BS086235.) It is not at issue in this case, which challenges Mercury's conduct prior to the purported adoption of S.B. 841 on August 2, 2003.

## BACKGROUND

The changes wrought by Proposition 103, and the interplay between its provisions and the provisions of prior law that Proposition 103 did not repeal, are at the heart of the trial court's error in this matter. The Foundation therefore begins with an extensive history of the relevant insurance statutes and their enforcement.

### A. The Pre-Proposition 103 McBride-Grunsky Insurance Regulatory Act of 1947 Afforded Consumers No Right to Challenge Insurer Misconduct in the Courts.

The pre-Proposition 103 insurance code – known as The McBride-Grunsky Insurance Regulatory Act of 1947 ("McBride-Grunsky") – was the product of the insurance industry's determination to limit the application of governmental authority to its conduct.

Antitrust was the initial concern. In 1944, the U.S. Supreme Court overturned an 1868 ruling and held that the business of insurance was a matter of interstate commerce and that therefore insurers were subject to the federal antitrust laws. (*U.S. v. South-Eastern Underwriters Assn.* (1944) 322 U.S. 533.) Two years later, the California Supreme Court ruled that the

Cartwright Act, the state's antitrust law, applied to insurers. (*Speegle v. Board of Fire Underwriters* (1946) 29 Cal.2d 34.)

The insurance industry asked Congress to overturn *South-Eastern Underwriters*, and in 1947 Congress complied by enacting the McCarran-Ferguson Act, which exempted insurers from federal antitrust law *to the extent that state laws "regulated" insurance*. (McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015.) (McCarran). At the behest of the insurance lobby, every state legislature then quickly enacted laws to meet McCarran's "regulation" standard.[8]

California's enactment, McBride-Grunsky,[9] explicitly authorized insurance companies to share pricing and loss data among themselves as part of the process of setting their rates – conduct which would otherwise have been a violation of antitrust laws.[10] McBride-Grunsky expressly

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[8] *See* Sidney L. Weinstock and John R. Maloney, *History and Development of Insurance Law in California*, WEST'S INSURANCE CODE ANNOTATED LXVI (1971). *See also Smith v. Pacificare Behavioral Health of California* (2001) 93 Cal.App.4th 139, 149-154 (discussing McCarran provisions).

[9] Exh. B (The text of the 1947 McBride-Grunsky Act as enacted and amended through the passage of Proposition 103 on November 8, 1988.)

[10] Its purpose was to "authorize cooperation between insurers in rate making and other related matters." (Cal. Ins. Code § 1853, added by Stats. 1947, c. 805, § 1, p. 1896*, repealed by* Proposition 103, as approved by voters, Gen. Elec. (Nov. 8, 1988).) As the Insurance Commissioner explained to then Governor Earl Warren in urging his signature on the McBride-Grunsky legislation:

> [T]o prevent the application of the Federal Anti-Trust Laws to this necessary activity in the insurance field of interstate commerce it is essential that state legislation be enacted to affirmatively authorize such concert of action in the making of insurance rates.

(Exh. D [Letter from J.R. Maloney, Deputy Insurance Commissioner, on behalf of Wallace K. Downey, Insurance Commissioner, to Gov. Earl Warren, June 10, 1947, pp. 1-2.])

authorized "[c]oncerted action of insurers" (§ 1853);[11] "[a]greements to adhere to rates" (§ 1853.6);[12] and the "[e]xchange of information and experience data" (§ 1853.7).[13]

While antitrust was the immediate concern, McBride-Grunsky reached beyond antitrust issues to erect a statutory framework under which the property-casualty insurance industry would be subject to highly limited government or judicial oversight.

McBride-Grunsky prohibited affirmative regulation of insurers' rates and practices.[14] As the California Supreme Court has noted in comparing it to Proposition 103, McBride-Grunsky "established the 'open competition' system of regulation," (*20th Century Ins. Co. v. Garamendi*, *supra*, 8 Cal.4th 216, 273), under which "'rates [were] set by insurers without prior

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Insurers traditionally set their rates by relying on an insurer-controlled "rating" organization that would collect historical loss data, project that data into the future, and then disseminate the proposed rates to insurers. The latter activity would violate the antitrust laws if such activity were not expressly authorized under state insurance law and exempted from federal antitrust prosecution by the McCarran-Ferguson Act. (*See, e.g.,* Angoff, "Insurance Against Competition: How the McCarran-Ferguson Act Raises Prices and Profits in the Property/Casualty Insurance Industry," 5 Yale Journal on Regulation 397 (1988).)

[11] Cal. Ins. Code § 1853, added by Stats. 1947, c. 805, § 1, p. 1896, *repealed by* Proposition 103, as approved by voters, Gen. Elec. (Nov. 8, 1988).

[12] Cal. Ins. Code § 1853.6, added by Stats. 1947, c. 805, § 1, p. 1896, *repealed by* Proposition 103, as approved by voters, Gen. Elec. (Nov. 8, 1988).

[13] Cal. Ins. Code § 1853.7, added by Stats. 1947, c. 805, § 1, p. 1896, *repealed by* Proposition 103, as approved by voters, Gen. Elec. (Nov. 8, 1988).

[14] "[N]othing in this chapter is intended to give the Commissioner power to fix and determine a rate level by classification or otherwise." (Cal. Ins. Code §1850, added by Stats. 1947, c. 805, § 1, p. 1896, *repealed by* Proposition 103, as approved by voters, Gen. Elec. (Nov. 8, 1988).)

or subsequent approval by the Insurance Commissioner . . . .' (*Id*. at 240, *quoting King v. Meese* (1987) 43 Cal.3d 1217, 1221.) Such control of rates as may be said to have existed under the 'open competition' system was essentially through market forces alone . . . ." (*Id*. at 300.) Insurance companies were not required to file their rates or underwriting plans with the Insurance Commissioner. Even if a rate was excessive, the Commissioner was prohibited from taking any action so long as there was "competition" in the marketplace.[15] As the Supreme Court described it: "[u]nder [McBride-Grunsky], 'California ha[d] less regulation of insurance than any other state, and in California automobile liability insurance [was] less regulated than most other forms of insurance.'" (*20th Century Ins. Co. v. Garamendi*, *supra*, 8 Cal.4th 216, 240, *quoting King v. Meese*, *supra*, 43 Cal.3d 1217, 1221.)

McBride-Grunsky also provided a tightly circumscribed and largely illusory process for resolution of individual grievances against an insurer's rates, premiums or practices. It established, in §§ 1858 *et seq*., an administrative complaint process under which an aggrieved consumer's sole initial recourse against an abusive insurer was the filing of a complaint *with the insurance company* itself. If the complaint was rejected, the consumer could appeal to the Insurance Commissioner, and request a hearing, which could be summarily denied within the Commissioner's discretion. Should a hearing substantiate misconduct, the Insurance Commissioner could provide prospective relief only. The Commissioner had no authority to order refunds, restitution or disgorgement.[16] Not

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[15] Cal. Ins. Code § 1852, added by Stats. 1947, c. 805, § 1, p. 1897, repealed by Prop. 103, as approved by voters, Gen. Elec. (Nov. 8, 1988).

[16] Cal. Ins. Code §§1858 – 1859.1 (amended 1977, 1979, 1984, 1987 and 1989). As the Attorney General remarked at the time:

surprisingly, this convoluted and inherently futile process was rarely invoked and, according to state records, never resulted in a successful challenge to an insurer's rates.[17]

To enforce its tight limits on government oversight or public accountability of insurers, McBride-Grunsky contained two jurisdictional shields, §§ 1860.1 and 1860.2. In language that closely parallels the federal McCarran-Ferguson Act,[18] section 1860.1 reads:

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> It should also be noted that no express provision is made whereby the Commissioner upon notifying the insurers, and possibly calling a hearing upon a violation, may, at least from that time forward, require the insurers to refund excess premium collected by reason of an excessive or discriminatory rate, or to hold the excess, subject to refund at time of final determination . . . . [t]he absence of proper provision for requirement of impound by the Commissioner puts a premium upon stalling and delay in the Commissioner's proceedings.

(Exh. E [Letter from Harold B. Haas, Deputy Attorney General, California Dept. of Justice, to Gov. Earl Warren, June 11, 1947, at p. 5-6.])

This section was amended in 1987 to enable a consumer to file a complaint directly with the Commissioner.

[17] An investigation by the California "Little Hoover Commission" "was unable to find a single formal determination made by the Department in the past 25 years that a rate is excessive." It further found that "[s]ince the enactment of [McBride-Grunsky] in 1948 [sic] the Insurance Commissioner has never fined an insurance company for excessive rates." (Commission on California State Government Organization and Economy, *A Report on the Liability Insurance Crisis in the State of California*, July 1986, p. 29.)

[18] McCarran provides that no federal law shall "invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance unless such Act *specifically relates to the business of insurance*." (15 U.S.C. §1012(b), emphasis added.) Similarly, §1860.1 provides that no act done "pursuant to the authority conferred by this chapter" shall constitute a violation under any other state law "which does not *specifically refer to insurance*." (Emphasis added). Thus McBride-Grunsky and McCarran-Ferguson collectively conferred complete immunity upon the insurers' conduct under both federal and state antitrust laws.

> No act done, action taken or agreement made pursuant to the authority conferred by this chapter shall constitute a violation of or grounds for prosecution or civil proceedings under any other law of this State heretofore or hereafter enacted which does not specifically refer to insurance.
>
> (§ 1860.1.)

The "authority conferred by this chapter" in § 1860.1 referred specifically to the statutory authority conferred *on insurance companies and affiliated entities* to engage in concerted activity that might otherwise violate the antitrust laws – the activity expressly authorized under §§ 1853, 1853.6 and 1853.7. In a contemporary analysis of the legislation, the California Attorney General noted the breadth of § 1860.1's impact in immunizing insurance company actions:

> This, in effect, exempts *acts of insurers and other persons* done under the provisions of the bill from the Cartwright Act and any other restraint of trade or similar provisions of California law. (Emphasis added.)[19]
>
> …
>
> The point is that all such acts in concert authorized by the bill are expressly exempted from prosecution or civil proceedings under any law of this State which does not expressly refer to insurance. This, obviously, includes the Cartwright Act concerning combinations in restraint of trade. *If other business regulations such as the Fair Trade Act are applicable to insurance, the exemption applies to them also*. (Emphasis added.)[20]

Section 1860.1's companion provision was § 1860.2, which was sometimes referred to as establishing the Commissioner's "exclusive jurisdiction":

> The administration and enforcement of this chapter [Chapter 9] shall be governed solely by the provisions of this chapter. Except as provided in this chapter, no other law relating to insurance and no other provisions in this code heretofore or hereafter enacted shall apply to or be construed as supplementing or modifying the

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[19] Exh. E (Letter from Haas, *supra* note 16, at 13, citation omitted.)

[20] *Id.* at 3, citation omitted.

provisions of this chapter unless such other law or other provision expressly so provides and specifically refers to the sections of this chapter which it intends to supplement or modify.

(§1860.2.)

The combination of §§ 1860.1 and 1860.2 operated to isolate insurers from the application of any authority external to Chapter 9. Section 1860.1 ensured their immunity from antitrust and other state police power statutes that, at the time, did not "refer to insurance." And § 1860.2 provided significant additional protection, based on the fact that Chapter 9 of the Insurance Code, as enacted in 1947, contained no regulation, no disclosure, no public accountability and no judicial remedies. There was no legal basis upon which a consumer could successfully object to or challenge the rates, premiums or practices of insurance companies. This was precisely the goal. The concept underlying both McCarran and McBride-Grunsky was that the insurance business was to be regulated only under the insurance codes and not under laws of general application.

Under McBride-Grunsky, therefore, insurers faced no public accountability or liability. As a result, the courts consistently applied McBride-Grunsky's provisions to dismiss suits brought against insurers alleging improper rates or practices.[21]

During the liability insurance "crisis"[22] of the 1980's, the failure of the McBride-Grunsky regime became a matter of great public interest.

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[21] *See, e.g., Karlin v. Zalta* (1984)154 Cal.App.3d 953, discussed in detail *infra* at 46-47. *See also County of L.A. v. Farmers Ins. Exchange* (1982)132 Cal. App. 3d 77 (affirming dismissal of the case because the CDI had "exclusive jurisdiction" over the challenge to use of residence in setting auto insurance premiums and petitioners had failed to exhaust that sole remedy).

[22] For a detailed description of the national crisis, *see The Manufactured Crisis*, CONSUMER REP. 51, Aug. 1986, at 544; *Premium Increases and Refusals to Deal in the Property/Casualty Insurance Industry: Hearing*

Numerous reports pointed out in highly critical terms that state law accorded the CDI too little authority to effectively address the insurance "crisis."[23] A legislative report published at the time concluded:

> The McBride-Grunsky Act must be judged a failure. There is simply no reason to believe, based on thirty years of evidence that consumers have any hope of protection from moderate overcharging to blatant rate gouging under the present Act. [24] (Emphasis in original.)

Other inquiries faulted the Insurance Commissioner – an appointed post – for failing to utilize even the limited authority he had.[25]

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*Before the Judiciary Comm.,* 99th Cong. 5 (1986) (statement of Jay Angoff, Counsel, National Insurance Consumer Organization).

[23] *See, e.g.,* Commission on California State Government Organization and Economy, *A Report on the Liability Insurance Crisis in the State of California*, July, 1986, p. 24-30. (Noting the Insurance Commissioner's powers more limited than other states, particularly over rates); National Insurance Consumer Organization, *Insurance in California: A 1986 Status Report for the Assembly*, October, 1986.

[24] Exh. F (Sen. Claims and Corporations Com., Analysis of Assem. Bill 1687 (1987-1988 Reg. Sess.) July 15, 1987, p. 4 [analyzing legislation amending the McBride-Grunsky complaint process].)

[25] *See, e.g.,* Consumers Union, *"Sorry We Could Not Be of More Help": How the California Department of Insurance Regulates a Trillion Dollar Industry*, May, 1986 (chronicling ongoing failure to use regulatory authority to address excessive or inadequate rates, consumer complaints, improper policy cancellations); Auditor General of California, *The Department of Insurance Needs to Further Improve and Increase Its Regulatory Efforts*, June, 1987 (CDI failing to "adequately oversee[] the underwriting and rate setting practices of insurance companies," at S-1; inadequate resources partly responsible); Consumers Union, *Bark But No Bite: Toothless Regulation by the Department of Insurance Has Left California Consumers Unprotected*, July, 1987 (criticizing the CDI for use of informal and secret "jawboning" instead of statutory enforcement actions to address insurer misconduct).

**B. Proposition 103 Replaced McBride-Grunsky with a Regulatory Framework to Hold Insurance Companies and the Insurance Commissioner Accountable in the Courts.**

In 1988, Proposition 103 replaced the discredited McBride-Grunsky system with an entirely different regime involving strict controls on rates and practices of the industry: "The measure made numerous fundamental changes in the regulation of automobile and other forms of insurance in California." (*20th Century Ins. Co. v. Garamendi*, *supra*, 8 Cal.4th 216, 240.)

Referring to the McBride-Grunsky regime, Proposition 103's findings clause stated that "the existing laws inadequately protect consumers and allow insurance companies to charge excessive, unjustified and arbitrary rates." (Exh. C [The text of Proposition 103 as enacted by the voters on November 8, 1988]; *see Calfarm*, *supra*, 48 Cal.3d at 812-813.) The measure imposed five major reforms: (1) immediate rate reductions (§ 1861.01); (2) stringent regulation of insurance rates (§ 1861.05, *et. seq*.); (3) stringent regulation of insurance company premium setting practices (§ 1861.02); (4) the elimination of barriers to competition in the marketplace (§ 1861.03); and (5) creation of a private right of action for consumers to enforce any provision of Proposition 103 and other state consumer protection statutes (§§ 1861.10 and 1861.03).

The application of two of these categories is at issue in this case: regulation of premium setting practices and the private enforcement rights.

1. Proposition 103's Mandated Rating Factors, Used to Set Premiums, Are Distinct from its Rate-Setting Process.

Proposition 103 distinguished between "rates" and "premiums," mandating separate procedures for the regulation of insurance rates and the premium setting practices employed by insurers. The distinction is of major importance in this case, in light of trial court's extension of *Walker v. Allstate* (2000) 77 Cal.App.4th 750, which proscribed suits challenging previously approved rates, to rating factors.

A "rate" is the amount of revenue an insurance company may collect from *all* its policyholders for a given line of insurance (automobile, homeowner, etc). Under §§ 1861.05 *et. seq.,* Proposition 103 established a stringent process by which rates for *all lines* of property-casualty insurance are determined and approved by the Commissioner prior to their use. (§ 1861.13). In submitting applications for rate changes, insurers must comply with a technical formula developed by the Commissioner to ensure that the proposed rates are neither "excessive" nor "inadequate." (Cal. Code Regs., tit. 10, §§ 2644.1, *et seq*.) Only then may the Commissioner approve the rates.[26]

This case is not about rates.

Under a separate procedure specified by Proposition 103, and *applicable only to automobile insurance*, a company selling such insurance to individuals must also obtain approval for the method by which it allocates its total revenue requirement (rate) among its policyholders, i.e., how much in *premium* it can collect from each insured motorist. The

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[26] The formulae applied by the Commissioner to determine whether a rate is reasonable are set forth in Cal. Code Regs., tit. 10, §§ 2644.1 *et. seq*. As explained in the regulations, to determine an appropriate rate an insurer must*, inter alia,* estimate its current losses through the "loss development" process (Cal. Code Regs., tit. 10, § 2644.6); project future losses through the "loss trend" process (Cal. Code Regs., tit. 10, § 2644.7); project investment income (Cal. Code Regs., tit. 10, §§ 2644.19, 2644.20, 2644.21 and 2644.22); and determine a reasonable rate of return (Cal. Code Regs., tit. 10, § 2644.16). The Commissioner reviews the insurer's estimates and calculations, and if, based on his technical and actuarial expertise and judgment, he agrees that those estimates and calculations are reasonable and comply with the applicable formula, then the proposed rate meets the statutory "excessive/inadequate" standard, and he will approve the rate. This process has been discussed in *Calfarm*, *supra*, 48 Cal.3d 805; *20th Century Ins. Co. v. Garamendi*, *supra*, 8 Cal.4th 216; *Proposition 103 Enforcement Project v. Quackenbush* (1998) 64 Cal.App.4th 1473; and *Spanish Speaking Citizens' Foundation, et al. v. Low* (2000) 85 Cal.App.4th 1179.

criteria that an insurer uses to establish a person's premium are known as "rating factors."[27]

Section 1861.02 sets forth the special rules governing the use of automobile rating factors. Section 1861.02(a) requires that "[r]ates and premiums for an automobile insurance policy . . . shall be determined" principally by three specified rating factors (known as "mandatory" factors) (*see supra* footnote 2) and by other rating factors (known as "optional" factors) that "the commissioner may adopt by regulation and that have a substantial relationship to the risk of loss" (§ 1861.02(a)(4), *see supra* footnote 3.) Regulations adopted by the Commissioner set forth the optional rating factors an insurer may use, the process by which the factors a company intends to use are submitted for approval, and how much each rating factor is to be "weighted" for purposes of determining a person's premium. (Cal. Code Regs., tit. 10, § 2632.5.) In contrast to the determination of a rate, which requires the exercise of the Commissioner's discretion and judgment, the determination of whether an insurance company is using an approved rating factor requires neither. Once the Commissioner establishes which rating factors may be used, and approves their "weight," whether the insurers are legally using a particular rating factor as authorized by statute or regulation is a simple matter of law. That analysis involves no technical expertise.

Proposition 103 specifically forbids the use of only one rating factor, the application of which was a major abuse prior to the measure's passage. In that era, many automobile insurers offered policies "only [to] those who

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[27] *See Spanish Speaking Citizens' Foundation, et al. v. Low* (2000) 85 Cal.App.4th 1179, 1186, in which the court explained the difference between rates and the determination of premiums.

already had insurance" (*King v. Meese*, *supra*, 43 Cal. 3d 1217, 1225).[28] To ensure that insurance would be "available and affordable to all," one of Proposition 103's stated purposes, (Exh. C (Prop. 103), § 2 [Purpose]), the voters expressly prohibited this unfair exclusionary practice:

> The absence of prior automobile insurance coverage, in and of itself, *shall not be a criterion* for determining . . . automobile rates, premiums, or insurability.
>
> (§ 1861.02(c), emphasis added.)

Under subdivision (c), drivers previously excluded from the insurance marketplace would henceforth have access to coverage (and to reduced-cost "good driver" policies) on an equal footing with other drivers.[29]

2. Proposition 103 Creates A Private Right Of Action, And Permits Consumers to Challenge Insurers and the Insurance Commissioner in Alternative Fora.

To ensure that its provisions were properly implemented, enforced and obeyed, Proposition 103 mandated a regulatory regime suffused with public accountability and the opportunity for public participation. (*See* §§1861.05 *et seq*.) It also made the Insurance Commissioner an elective position, accountable directly to the voters. (§ 12900.)

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[28] The combination of soaring rates and insurers' refusal to sell to those not previously insured left a significant proportion of drivers unable to obtain the insurance they needed to comply with California's "financial responsibility" law (Veh. Code §§ 16020 *et seq*.). The Court in *King v. Meese* noted that insurers in some parts of the State "often impose[d] so many restrictions (e.g., no prior insurance precludes application) that . . . insurance… [was] inaccessible." (*Id.* at 1239.) The Court also noted that the Insurance Commissioner "routinely dismissed complaint[s] . . . alleging a refusal by an insurer to provide coverage to an applicant." (*Id.* at 1222.)

[29] Subdivision (b) (1) requires an insurer to sell a reduced-cost policy on demand to a qualified "good driver."

While under Proposition 103, "much is necessarily left to the Insurance Commissioner[,]"[30] the voters wisely chose not to leave *everything* to the Commissioner. Thus they established, in § 1861.10(a), an additional, independent check upon the conduct of the insurance companies: the *unqualified* right to enforce the insurance code themselves in the judicial branch as well as before the Department of Insurance (CDI). Section 1861.10(a) provides:

> Any person may initiate or intervene in any proceeding permitted or established pursuant to this chapter, challenge any action of the commissioner under this article, and enforce any provision of this article.

No court has methodically reviewed subdivision (a)'s three clauses, which manifest a very carefully drafted private right of action.[31]

**Clause 1** specifies that "any person" may "initiate or intervene in any proceeding permitted or established pursuant to this *chapter* [Chapter 9]." (Emphasis added.) Chapter 9 includes both Proposition 103 and the remains of the McBride-Grunsky Act; therefore, "proceeding" includes any legal action brought under state laws pursuant to §1861.03 (discussed below).

**Clause 2** allows "any person" to "challenge any action of the commissioner under this *article* [Article 10, i.e., Proposition 103]." (Emphasis added.) "Challenge" means initiating a lawsuit in California courts.[32] Thus there is no requirement under Proposition 103 that a person first exhaust any available administrative remedies.

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[30] *Calfarm*, *supra*, 48 Cal.3d 805, 824; *20th Century Ins. Co. v. Garamendi, supra*, 8 Cal.4th 216, 245.

[31] As will be discussed *infra*, the *Walker* court, bereft of the assistance of competent counsel, tried but failed.

[32] Note that "challenge" cannot be limited to the filing of an administrative complaint, since that was already an available option under §1858 of McBride-Grunsky (which has its own provision for judicial review). Nor

**Clause 3** of § 1861.10(a) specifies that "any person" may "enforce any provision of this article." Clause 3 creates a private right to go directly to court to enforce the provisions of the insurance code added by Proposition 103.

To expand the rights and remedies that can be enforced under §1861.10(a), the voters granted themselves the protection of all California's laws, from which insurance companies were previously exempt by virtue of §§ 1860.1 and 1860.2 of McBride-Grunsky. Section 1861.03(a) provides that all state laws apply to the insurance industry, without exception. It expressly references several key consumer remedies, including the UCL, which it incorporates in the insurance consumer's arsenal:

> The business of insurance shall be subject to the laws of California applicable to any other business, including, but not limited to, the Unruh Civil Rights Act (Civil Code Sections 51 through 53), and the antitrust and unfair business practices laws (Parts 2 and 3, commencing with section 16600 of Division 7, of the Business and Professions Code).
>
> (§ 1861.03(a).)

Thus, as the Supreme Court has unequivocally concluded, Proposition 103 offers consumers the alternative to seek recourse from either the regulatory agency or the judicial branch, without any requirement that administrative remedies be exhausted. (*Farmers Ins. Exchange v. Superior Court* (1992) 2 Cal.4th 377, 390-391.)

Sections 1861.03 and 1861.10 reflect sensible public policy decisions by the voters based on practical considerations and the historical experience under McBride-Grunsky:

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can "challenge" be limited to participation in the administrative rate setting process established by Proposition 103, since that process contains its own provision for judicial review and is governed by Clause 1. (*See, e.g.,* §§ 1861.05 and 1861.09).

• Practical limits on the budget and expertise of the CDI meant that it would be impossible for the Insurance Commissioner to effectively police the entire marketplace.[33] Encouraging private enforcement, a well-understood concept,[34] provides regulators with needed enforcement resources and thus a deterrent to misconduct.

• The voters were cognizant that they were establishing an elected office in which a powerful industry would be vitally interested. They understood that insurers might successfully influence the election of the Insurance Commissioner. Section 1861.10's private right of action provides an independent check on the conduct of the industry, in the event the Commissioner exercised his discretion in a manner adverse to his statutory responsibilities.

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[33] The CDI oversees roughly 800 property-casualty insurance companies with $38 billion in premium volume in 2001 (National Association of Insurance Commissioners, 2000 Insurance Department Resources Report (2001) at pp. 33, 40-41). To regulate this vast market, CDI in 2000 had only four actuaries on staff, (*id*. at 5), and 27 market conduct examiners (*id*. at 6). CDI's 140 complaint analysts contended with over 30,000 complaints and 422,000 inquiries in 2000 (*id*. at 57). CDI initiated 424 market conduct and 62 financial examinations that year (*id*. at 43-44.) Enforcement actions are the best measure of the CDI's ability to police the marketplace when addressing the value of the private right of action authorized by Proposition 103. Between 1991 and 2001, the CDI brought a total of 159 enforcement actions. (*See* www.insurance.ca.gov/Consumer-Alert/Insurer.htm, visited May 27, 2002.) Although Proposition 103 provides that insurers pay fees to cover the cost of regulating them (§ 12979 [added by Prop. 103, § 5]), the CDI has contended with budget deficiencies. (Michael Liedtke, *Need to Cut Insurance Agency Challenged*, CONTRA COSTA TIMES, August 14, 1996, p. 1C.)

[34] Mank, *Is There a Private Right of Action under EPA's Title VI Regulations? The Need to Empower Environmental Justice Plaintiffs* (1999) 24 Columbia Journal of Environmental Law 1, 48-49 (private rights of action have been highly instrumental in "protecting individual rights because of the limitations…of administrative enforcement mechanisms").

**C. Proposition 103 Repealed All Substantive Provisions of McBride-Grunsky.**

As the California Supreme Court has said, "[i]f nothing else is clear, this is: Proposition 103 was intended to do away with the 'open competition system'" of McBride-Grunsky. (*20th Century Ins. Co. v. Garamendi, supra*, 8 Cal.4th 216, 300.)

Because McBride-Grunsky was incompatible with the purposes and specific provisions of Proposition 103's pervasive reach and goals, Proposition 103 explicitly repealed every provision of McBride-Grunsky that was inconsistent with the initiative statute.[35]

What remains is largely a matter of definitions, reporting requirements, administrative procedures and penalty provisions. Proposition 103 retained only those portions of the McBride-Grunsky Act that the voters viewed as compatible with the purposes and specific provisions of the initiative.

Three of the retained provisions relevant to this action have already been discussed in the context of McBride-Grunsky. Their roles in the system of insurance regulation, however, shifted dramatically once Proposition 103 became a part of Chapter 9, as will be discussed in detail *infra*:

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[35] Proposition 103 repealed the following sections of McBride-Grunsky: §§ 1850, 1850.1, 1850.2, 1850.3, 1852, 1853, 1853.6, 1853.7, 1857.5, 1854.1, 1854.2, 1854.25, 1854.3, 1854.4, 1854.5 (Exh. C, Prop. 103, § 7 ["Repeal of Existing Law"]). Exhibit B displays these repealed provisions as redlined.

• § 1858. The administrative complaint process for aggrieved consumers is now a *voluntary* alternative to the more powerful direct access to the courts afforded by § 1861.10(a).[36]

• § 1860.1. As already noted, this provision immunized insurers from liability for engaging in collective activities that would otherwise violate the antitrust laws. However, Proposition 103, a part of Chapter 9, repealed all three McBride-Grunsky provisions that had provided that immunity. Instead, Proposition 103 includes a very narrow "safe haven" provision that authorizes only certain joint conduct (§ 1861.03(b)).[37] As a result, §1860.1 now has extremely limited scope, as confirmed by a definitive analysis published by the California Attorney General in 1990:

> Proposition 103 did not repeal Insurance code section 1860.1. . . . This section has been interpreted to exempt business conducted under the McBride-Grunsky rating law from general-purpose statutes, including the Cartwright Act. *Karlin v. Zalta* [citation omitted]. While the initiative did not repeal this section, it provided specifically, in section 1861.03, subdivision (a), for the application of certain general-purpose laws. This specific provision in Proposition 103 prevails over the earlier provision of Section 1860.1, the continued existence of which is thus no impediment to the application of the Cartwright Act to the business of insurance formerly governed by this provision of the McBride-Grunsky Act."
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> (State of California, Department of Justice, *Antitrust Guidelines for the Insurance Industry*, March 1990, at p. 23.)

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[36] Under 1987 amendments to § 1858, retained by Proposition 103, the CDI now offers a free dispute mediation program, an advantageous and efficient alternative to the time and expense of a lawsuit.

[37] Section 1861.03(b) provides: "Nothing in this section shall be construed to prohibit (1) any agreement to collect, compile and disseminate historical data on paid claims or reserves for reported claims, provided such data is contemporaneously transmitted to the commissioner, or (2) participation in any joint arrangement established by statute or the commissioner to assure availability of insurance." Section 1860.1's immunity for insurers' actions is limited to these activities.

• § 1860.2. By its own terms, § 1860.2 is now governed by Proposition 103: § 1861.10(a) of Proposition 103 eliminated the Insurance Commissioner's "exclusive jurisdiction" over insurance matters, and § 1861.03(a) makes the antitrust, unfair business practices, and other state laws applicable to insurance companies. Like § 1860.1, § 1860.2 was not repealed by Proposition 103 because it is consistent with the new regime imposed by Proposition 103.

**D. History of Enforcement of 103's "No Prior Insurance" Rule.**

The absolute prohibition against using "[t]he absence of prior automobile insurance coverage" (§ 1861.02 (c)) as a criterion for setting premiums has been the subject of numerous enforcement actions, both private and public.

1. The Persistency Optional Rating Factor.

As already noted, insurers are required to set automobile insurance premiums by application of authorized rating factors. As originally adopted in 1996, section 2632.5(d)(11) of the Commissioner's regulations included "persistency" as one of sixteen optional rating factors. The regulations did not define persistency, because it is a well-known, long established term of art within the industry. It means the *length of time the insured has been insured by the company writing the coverage.*[38] Indeed, State Farm,

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[38] *See, e.g.*, http://www.insweb.com/learningcenter/glossary/general-p.htm (Persistency. The tendency or likelihood of insurance business not lapsing or being replaced by another insurer's product; an important underwriting factor.); http://insource.nils.com/gloss/GlossaryTerm.asp?tid=4466 (persistency Insurer Operations – The percentage of insurance policies remaining in force or that have not been canceled for nonpayment of premium during their term.); http://www.uwm.edu/People/memitch/glossary.htm (Persistency: A measurement of an insurer's retention of in-force business. It refers both to insurance that is not surrendered and has not lapsed for non-payment.);

California's largest auto insurer, defines persistency in the traditional way: "number of years the policy has been in force with the State Farm Insurance Companies."[39] The court in *Spanish Speaking Citizens' Foundation*, *supra*, confirmed the traditional definition of persistency: it stated it as "years insured by the company." (*Spanish Speaking Citizens' Foundation*, *supra*, 85 Cal. App. 4th 1179,1187.) In effect, persistency is used by automobile and other insurers to reward a customer's loyalty to the company.

2. The Proof of Financial Responsibility Rating Factor.

In 1996, Commissioner Quackenbush approved, as a part of some insurers' class plans,[40] a "financial responsibility rating factor" which

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http://www.buyhealthplan.com/BHP/glossary_p.asp (Persistency - the staying quality of insurance policies (renewals).); http://www.jmwsons.com/life2.html#GlossP (Persistency. The staying quality of insurance policies, i.e., the renewal quality. High persistency means that a high percentage of policies stay in force to the end of the period coverage, while low persistency means that a high percentage of policies lapse for nonpayment of premiums.); http://216.239.57.104/search?q=cache:_PCFax4FA_UJ:www.actuary.org/briefings/pdf/risk101_handout.pdf+persistency+%26+insurance&hl=en&ie=UTF-8 (Persistency: how long the customer keeps the policy.); http://insurance.cch.com/rupps/persistency.htm (persistency: The percentage of insurance policies remaining in force or that have not been canceled for nonpayment of premium during their term.); http://www.imsaethics.org/c_ibg_gloss_m_q.html#p (persistency: The retention of business that occurs when a policy remains in force as a result of the continued payment of the policy's renewal premiums.); http://www.insurancebeacon.com/Online_Insurance_Quote_Glossary/glossary_p.htm (Persistency: A term used to refer to the length of time insurance remains continuously in force with a company.)

[39] Exh. G (Decl. of Curtis Stewart Re State Farm's Definition of Persistency, Feb. 12, 2002, *Poirer v. State Farm Mutual Automobile Ins. Co.* (Super. Ct. L.A. County, No. BC 249205).)

[40] "Class plans" are the filings submitted by insurers to the Commissioner which, among other things, disclose which of the authorized rating factors the insurer proposes to use. (Cal. Code Regs., tit.10, § 2632.3.)

insurers were using to transgress § 1861.02(c). Specifically, the Interinsurance Exchange of the Automobile Club and Safeco were surcharging applicants who could not demonstrate previous compliance with the Financial Responsibility Law. (Veh. Code §§ 16020, *et. seq*.) Requiring proof of previous insurance – the principal way to comply with the financial responsibility law – as a predicate to offering a policy, or using its absence to surcharge motorists applying for coverage, was an obvious violation of § 1861.02(c). The Foundation and two other citizen groups filed separate suits against Quackenbush, and the San Francisco Superior Court directed Quackenbush to not approve any insurer's class plan that contained a "financial responsibility" rating factor. (Exh. H [Writ of Mandate, *Proposition 103 Enforcement Project v. Quackenbush* (Super. Ct. S.F. County, Feb. 10, 1997, No. 982181) and Writ of Mandate, *Consumers Union and Southern Christian Leadership Conference v. Quackenbush* (Super. Ct. S.F. County, Feb. 10, 1997, No. 982181)].)

3. Mercury's Clandestine Redefinition of "Persistency" to Evade § 1861.02(c).

In 1994, Mercury filed its list of automobile rating factors for approval by the Commissioner. (CT *passim*.) All that appeared on the face of Mercury's filing was that it planned to use a "persistency" rating factor as that term had been understood in the industry for many years. Mercury's filing described its rating factor as follows:

> PERSISTENCY. The Persistency discount is based on loss experience and the number of years the Named Insured has been continuously insured and no lapse of coverage in excess of 30 days. (CT 2060.)

Nothing on the face of Mercury's submitted definition suggests that it refers to anything other than a discount reflecting the number of years an insured was continuously insured *by Mercury*.

In practice, however, Mercury's so-called "persistency" rating factor turned out to be quite different from what it had disclosed to the CDI. As alleged (CT 2233-4 [FAC ¶7]) and argued by Appellants (CT 2214-2215, Appellant's Opening Brief (AOB) 10), Mercury adopted its own, unique definition of persistency: it defined "persistency" in practice to mean "length of prior insurance coverage with *any* carrier."[41] The Appellant alleged – and Mercury has not denied – that under Mercury's definition, a driver who has been insured by *any* company gets a discount, while a person who had no prior insurance for a period of more than thirty days is surcharged. This is a clear violation of § 1861.02(c), for which appellant Donabedian sued.

There is *no evidence* in the record that Mercury's unique definition of "persistency" – a definition inherently in conflict with the traditional, acknowledged term of art – was *disclosed to, understood or knowingly approved* by the Commissioner. In other states, Mercury's rating factor, as it is actually applied by Mercury, is known as "prior insurance."[42] Mercury understandably does not denominate it as such in California, because "prior insurance" is not only not an approved rating factor, but, as Commissioners Low and Garamendi have both acknowledged, it is expressly prohibited by § 1861.02(c).

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[41] Mercury has recently relabeled its rating factor "portable persistency," an oxymoron that purports to legitimize Mercury's conduct. In fact, it reveals the absurdity of Mercury's redefinition of persistency, as it suggests that you can take your discount for *staying with one company* and get credit for it with another.

[42] Unlike California, in other states insurers utilize a "length of prior coverage with any carrier" rating factor. (*See*, *e.g.*, Exh. A.) The Foundation has found no state in which such a rating factor is defined as "persistency," however. There is nothing in the record to suggest otherwise.

Mercury claims that the Commissioner not only authorized, but "dictated" that Mercury apply its redefinition of persistency. (RB 1.) In support of this allegation, Mercury refers to two pages from a document (CT 2255-2256), the first page of which is dated September 30, 1994, that Mercury characterizes as a final order by CDI issued after a "Market Conduct Exam." (CT 1902-1903.) Mercury has misrepresented these pages to the court, and there is no basis for Mercury's claim.[43]

4. The CDI Rulemaking on the Misuse of "Persistency".

In response to Mercury's conduct and efforts by other carriers to adopt Mercury's improper redefinition of persistency, the Foundation, on May 4, 2001, petitioned the Insurance Commissioner for a hearing on the abuse and for the promulgation of a regulation specifically forbidding it.

In issuing a hearing notice, then-Commissioner Harry Low stated:

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[43] According to the Insurance Commissioner, the document Mercury relies on "is not from the final Official Report of Examination dated September 30, 1994, as asserted by Mercury." (CDI letter of February 14, 2002, denying Mercury's request for reconsideration of CDI's refusal to accept primary jurisdiction in this matter.) (CT 2229.) A June 11, 2003 letter from the Department of Insurance to state Sen. Don Perata again explicitly rejects Mercury's contentions, stating that the two pages (which Mercury had circulated to legislators) consisted of work papers of the CDI staff who conducted the initial market conduct examination in 1994: "Only a final signed report can be relied on to accurately reflect the position of the Commissioner." (Exh. I [Beverly Hunter, Department of Insurance Legislative Director, letter to Sen. Don Perata re Sen. Bill 841 (2002-2003 Reg. Sess.) June, 11, 2003, p. 1.]) The final Market Conduct Exam is not in the record. In any case, a careful reading of the two pages shows that the CDI examiners were concerned that Mercury was giving a discount to Mercury insureds who had previously purchased insurance through a Mercury agent, but not to Mercury insureds who had bought insurance from an agent *who did not represent Mercury.* The examiners reasoned that this discrimination *based on the agent's affiliation* was improper. The papers proffered by Mercury do not support its contention that it was ordered to misuse the persistency rating factor.

> insurers have adopted differing interpretations of the meaning of persistency as an optional rating factor. Some insurers have interpreted persistency to mean the length of time a consumer has continuously maintained automobile insurance exclusively with that insurer. Other insurers have defined persistency more broadly to include coverage by different insurers, so long as there was not a lapse in coverage."
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> (Cal. Dep't of Ins., Statement of Initial Reasons, RH-402 (Dec. 21, 2001).) (CT 1851.)

By disregarding the established definition of persistency, Commissioner Low stated that, "[s]ome of these insurers may have impermissibly required consumers to provide evidence of prior insurance to show that the consumer was 'persistently' covered by one insurer or another over time," in violation of § 1861.02 (c), which "provides that the absence of prior insurance cannot be used, in and of itself, to determine automobile rates, premiums, or insurability generally."(*Id*.) The Commissioner also noted, without mentioning any names, that "a small percentage of insurers with rating guidelines that currently violate Insurance Code, section 1861.02, subdivision (c) will have to file modifications to their existing class plans." (*Id.*)

Commissioner Low commenced a rulemaking proceeding (RH-402) to expressly clarify that insurers could not define "persistency" to violate the prohibition of Subdivision (c). As required by Proposition 103, the Commissioner's proceeding was accompanied by a full public process; it included a workshop, a formal public hearing, written comments and testimony from a variety of interested parties. Respondent Mercury Insurance Company participated in this proceeding, as did other insurers and the Foundation.

In the proceeding, the Commissioner made several key factual findings in RH-402 regarding the undesirable effects of Mercury's unprecedented definition of "persistency." He found that "[t]he costs of a

discount to a person previously insured is borne by those who do not have prior insurance," creating, "in effect[,] a surcharge to those without prior insurance." (Exh. J at 10 [Cal. Dep't of Ins., Final Statement of Reasons, RH-402 (July 26, 2002)].) Further, he found that the language affirming the proper application of "persistency" would "encourage[ ] the uninsured to join the pool of insured drivers," and that "[i]ncreasing the pool of insured drivers will ultimately benefit all insured persons, by lowering the cost of uninsured/under insured motorist coverage." (*Id.* at 9.) No insurer sought judicial review of, or otherwise challenged, these findings.

On September 26, 2002, Commissioner Low, pursuant to his power to "adopt [optional rating factors] by regulation" (§ 1861.02(a )(4)), strictly limited the application of the persistency rating factor to its well-established scope in order to ensure that insurers would not violate the prohibition of § 1861.02(c). (Cal. Code of Regs., tit. 10, § 2632.5 (d)(11).)[44] The regulation comports with long-standing industry practice by requiring that the factor only be applied to an existing insured upon policy renewal; and it prohibits consideration of a new applicant's prior insurance coverage with another insurance company.

Like Commissioner Low, the present Insurance Commissioner, John Garamendi, has consistently interpreted Subdivision (c) as barring any premium surcharge based on a driver's prior uninsured status. As he has noted, a surcharge that "penalize[s] consumers for the absence of prior insurance" is inconsistent both with the voters' intent and with the established public policy of "encourag[ing] [these drivers] to obtain and retain insurance." (Exh. L at 2 [John Garamendi, Insurance Commissioner,

[44] A copy of Cal. Code Regs., tit. 10, §2632.5 is provided for the Court's convenience at Exh. K.

letter to Gray Davis, Governor re Sen. Bill 841 (2002-2003 Reg. Sess.) July 18, 2003].)

**E. This Lawsuit.**

Both the parties and the court below failed to correctly follow the process by which this dispute should have been adjudicated.

Section 1861.10(a) of Proposition 103 leaves no doubt that a private plaintiff may challenge insurer conduct in superior court, and is not required to file an administrative complaint under § 1858. However, if a consumer decides to file a § 1858 challenge, he must follow that process. Specifically, a complainant dissatisfied with the Commissioner's decision may seek judicial review by taking a writ under § 1858.6.

Here, the plaintiffs and the superior court conflated the two procedures, an error which has placed this matter before this court in an awkward posture. Donabedian first filed its claim as a class action in superior court on April 4, 2001. (CT 7.) Mercury demurred on August 7, 2001 (CT 848), but before the court ruled thereon, Donabedian sought relief from the Commissioner by filing a complaint under § 1858 on September 17, 2001. (CT 2225.) Donabedian characterized its § 1858 complaint as a request for the Department to exercise its primary jurisdiction pursuant to the *Farmers* case (AOB 13), although such referrals are more properly based upon §1861.10(a), the authority for plaintiff to be in court in the first place. On November 20, 2001, two months *after* Donabedian filed the § 1858 complaint, the superior court stayed its proceedings, citing *Farmers'* primary jurisdiction doctrine. It also sustained the demurrer with leave to amend. (CT 1807.)

Both Donabedian and the superior court erred. Under a *Farmers* primary jurisdiction referral, a *court orders* the referral; once the Commissioner acts, the case returns to that superior court, where it proceeds to dispose of the case one way or the other. (*See Farmers v.*

*Superior Court*, *supra*, 2 Cal. 4th 377, 398 [primary jurisdiction "*applies where a claim is originally cognizable in the courts*…; in such a case, the judicial process is suspended pending referral of such issues to the administrative body for its views"].)

By letter dated January 29, 2002, the Commissioner declined jurisdiction under the primary jurisdiction doctrine, stating that he intended to address the issue by way of the rulemaking proceeding requested by the Foundation. The declination letter implies that Donabedian's allegations were meritorious although it expressly states that it is not "addressing the merits" of the complaint.[45] (CT 2225-2226.)

Nevertheless, the trial court erroneously interpreted the denial of primary jurisdiction by the CDI as a substantive rejection of the merits of Appellant's § 1858 complaint and concluded that Mercury's "persistency discount was approved." (Reporter's Transcript (RT) 12, line 9 [May 1, 2002 hearing].) Citing *Walker*, the trial court sustained Mercury's demurrer. (RT 14-15.)

Had the Superior Court properly invoked the primary jurisdiction process here in the first instance, it could have requested that the Commissioner address the principle factual issue that remains unanswered: whether the Commissioner approved of Mercury's "length of prior coverage with any carrier" rating factor, or whether the Commissioner simply approved what it believed was "persistency."

[45] The Commissioner also treated the § 1858 complaint as a referral under § 1861.10.

## ARGUMENT

## I.

## SECTIONS 1860.1 AND 1860.2 DO NOT PRECLUDE UCL SUITS, WHICH ARE EXPRESSLY AUTHORIZED BY PROPOSITION 103.

Respondent Mercury argues that members of the public should no longer have the right to bring suits under the Unfair Competition Law (Business and Professions Code §§ 17200, *et. seq*. ["UCL"]) for violations of Chapter 9 [of Part 2 of Division 1] of the insurance code, despite Proposition 103's express authorization of such suits (§§ 1861.10(a) and 1861.03). (RB at 23.) Mercury nevertheless takes the position that such suits are precluded by the vestigial provisions of the McBride-Grunsky Act, Sections 1860.1 and 1860.2 of the Insurance Code. (RB 26, 32, 38-39.) *The trial court below made no such ruling, and Mercury offers not one citation for its proposal – because it is utterly insupportable*.

This court must, of course, construe all sections of the Insurance Code so as to give effect to each section of the Code to the extent possible. (*Spanish Speaking Citizens' Foundation, et al. v. Low* (2000) 85 Cal.App.4th 1179, 1214 ["We do not construe statutes in isolation, but rather read every statute with reference to the entire scheme of law of which it is part so that the whole may be harmonized and retain effectiveness. [] We must consider the consequences that might flow from a particular construction and should construe the statute so as to promote rather than defeat the statute's purpose and policy," citations omitted]; *Manufacturers Life Ins. Co. v. Superior Court* (1995) 10 Cal.4th 257, 274 ["Well-established canons of statutory construction preclude a construction which renders a part of a statute meaningless or inoperative…. [W]here there are several provisions or particulars, such a construction is, if possible, to be adopted as will give effect to all. Pursuant to this mandate we must give

significance to every part of a statute to achieve the legislative purpose," citations omitted].)

The statutory construction process begins by "examining the statute and giving the words their ordinary meanings." (*Torres v. Automobile Club of So. California* (1997) 15 Cal. 4th 771, 777, quoting *People v. Cruz* (1996) 13 Cal.4th 764, 774-775.) As the California Supreme Court has stated, "if there is no ambiguity, then we presume the lawmakers meant what they said, and the plain meaning of the language governs." (*Allen v. Sully-Miller Contracting Co.* (2002) 28 Cal.4th 222, 227, quoting *Day v. City of Fontana* (2001) 25 Cal.4th 268, 272.)

Particular deference is accorded to statutes enacted by the voters as an exercise of their "precious" initiative powers. (*Rossi v. Brown* (1995) 9 Cal 4th 688, 695 ["it has long been our judicial policy to apply a liberal construction to this power wherever it is challenged in order that the right not be improperly annulled. If doubts can reasonably be resolved in favor of the use of this reserve power, courts will preserve it," citations omitted].) Reading the vestigial provisions of McBride-Grunsky, §§ 1860.1 and 1860.2 and the later-enacted provisions of Proposition 103, §§ 1861.03(a) and 1861.10(a) together, it is indisputable that private plaintiffs can challenge insurer conduct that violates Proposition 103 as violations of the UCL and other state statutes.

**A. By Its Own Terms, § 1860.1 Does Not Apply To Immunize Mercury's Conduct.**

Section 1860.1 immunized joint activity of insurers from challenge under antitrust laws. It did not, and does not, immunize a single insurer from a challenge to its unilateral conduct. Section 1860.1 reads, in its entirety:

> No act done, action taken or agreement made pursuant to the authority conferred by this chapter shall constitute a violation of or grounds for prosecution or civil proceedings under any other law of

> this State heretofore or hereafter enacted which does not specifically refer to insurance.

Like the parallel provision in the federal McCarran-Ferguson Act, this provision was adopted to grant insurers immunity from civil or criminal liability for joint activity. To avail itself of this immunity, an insurer must meet two conditions.

1. Its "act," "action" or "agreement" must be "taken or . . . made pursuant to the authority conferred by this chapter."
2. The "law[s] of this State" from which the insurer seeks immunity from liability are only those "which do[] not specifically refer to insurance."

Required to overcome both hurdles, Mercury can surmount neither.

1. Chapter 9 does not confer authority on Mercury to use a rating factor that Proposition 103 expressly prohibits.

Even though it relies heavily on § 1860.1 for its contention that its conduct is immunized from court challenge, (RB 26, 32, 38-39), Mercury does not offer a careful reading of § 1860.1, but simply cites to *Walker*, *supra*, 77 Cal.App.4th 750 (RB at 26), a distinguishable First District decision that misread that section. (In Part III, below, we explain why *Walker* is wrongly decided, and give several additional reasons why it is distinguishable.)

The *Walker* court failed to properly interpret § 1860.1. Its misinterpretation began with a misreading of the language of § 1860.1, the court stating that:

> [t]hat statute refers to an 'action taken . . . pursuant to the authority conferred by this chapter. . . .' Whatever else the amended McBride Act does, it definitely confers authority upon the *commissioner* to approve rates.
>
> (*Id.* at 756.)

The court immediately went astray at this point. As already noted, the history and purpose of § 1860.1, like that of the parallel provision in McCarran, makes it clear that it was focused on the conduct of insurers, not insurance commissioners. Thus, the "authority conferred by this chapter" refers *not* to any authority of the *Commissioner*, but to the authority conferred on *insurers* to engage in conduct that would otherwise have violated the anti-trust laws.

The California Supreme Court confirmed this reading of the McBride-Grunsky provision in *Manufacturers Life Ins. Co. v. Superior Court* (1995) 10 Cal.4th 257, 282. And it made the same construction of identical language in another part of the Insurance Code in *State Compensation Insurance Fund v. Superior Court* (*"SCIF"*) (2001) 24 Cal. 4th 930. There, the Court construed § 1860.1's counterpart provision in the workers' compensation insurance law,[46] stating that "the authority conferred by this chapter" is not authority conferred on the Insurance Commissioner to approve rates, but rather, authority conferred on insurance companies to engage in concerted activity that would otherwise be barred by the antitrust laws. (*SCIF*, *supra*, 24 Cal. 4th 930, 938.)[47] Even though the workers compensation statutes contain no counterpart to Proposition 103's provisions, the Supreme Court permitted the case to go forward.

It is clear that the act for which Mercury seeks immunity from liability is not any form of joint activity. Rather, Mercury seeks immunity

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[46] Section 11758 adopted verbatim the language of § 1860.1, which was enacted four years earlier as part of McBride-Grunsky.

[47] Mercury attempts to distinguish *SCIF* (RB 30-32), but its discussion (which erroneously cites to § 1860.2 instead of § 1860.1 as the analogous statute to § 11758) but fails to recognize that the "chapter" to which § 1860.1 refers includes § 1861.03, which refers to insurance and specifically renders the business of insurance subject to liability under the UCL (*see* discussion A2 immediately below).

for its own failure to offer a discount to drivers who are not already insured – a practice not within the scope of § 1860.1.

Nothing in Chapter 9 – neither in the remnants of McBride-Grunsky nor in Proposition 103 – confers on an insurer the authority to withhold a discount solely on the basis of the prior-insurance status of a driver. To the contrary, Proposition 103, in § 1861.02(c), expressly *prohibits* an insurer from using "[t]he absence of prior automobile insurance coverage . . . [as] a criterion for determining . . . automobile rates, premiums, or insurability."

The *Walker* court was apparently unaware that § 1860.1 has meaning under the Proposition 103 regime solely by reference to § 1861.03(b), which immunizes very limited collective activities. It could therefore find no other explanation for the retention of § 1860.1 by Proposition 103, and concluded:

> If section 1860.1 has any meaning whatsoever (which under the accepted rules of statutory construction it must), the section must bar claims based upon an insurer's charging a rate that has been approved by the commissioner pursuant to the amended McBride Act.
>
> (*Id.* at 756.)

Unfortunately, the First District was never presented with an analysis of the proper interpretation of § 1860.1 in the context of later-enacted § 1861.03. Indeed, the *Walker* court itself noted that the plaintiffs' lawyers had failed to address, much less harmonize, the vestigial McBride-Grunsky provisions with those added by Proposition 103:

> In analyzing the interplay between section 1861.03 and sections 1860.1 and 1860.2, appellants simply write: "Clearly the 1989 adoption of the above section modified the 1948 strictures of section 1860.1 and 1860.2.
>
> (*Walker*, *supra*, 77 Cal.App.4th 750, 755-756.)

Bereft of adequate briefing on the issue, the *Walker* court misread these statutes to reach the result it did; this Court should not fall prey to the same error.

2. Section 1861.03 (a), which references the UCL, specifically refers to insurance.

Mercury also fails to meet the second requirement of § 1860.1. If the law "specifically refer[s] to insurance," § 1860.1 is no bar to prosecution and civil proceedings.

The law that imposes the liability Mercury seeks to escape here is Proposition 103, a law that specifically refers to nothing but insurance. "All of the provisions of Proposition 103 relate generally to the cost of insurance or the regulation thereof . . . ." (*Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal. 3d 805, 842 [rejecting single-subject challenge to Proposition 103].) One of those provisions in particular, § 1861.03(a), expressly incorporates by reference the provisions of, *inter alia*, the UCL. It provides that "[t]he business of *insurance* shall be subject to the laws of California applicable to any other business, including…unfair business practices laws…." (Emphasis added.) Section 1861.03(a) therefore specifically refers to insurance within the meaning of § 1860.1, and therefore by the terms of § 1860.1, UCL cases can be brought against insurers.

While admitting that "Section 1861.03(a) does refer to the unfair competition laws," Mercury argues that "Section 17200 is not a law relating to insurance." (RB 36.) Mercury implies that a suit under the UCL is barred, notwithstanding the express reference to that, and other, statutory provisions in § 1861.03(a). But Mercury's reading would deprive § 1861.03(a) of all meaning. It would also render useless § 1861.10(a), which authorizes a "person [to] initiate or intervene in any proceeding permitted or established pursuant to this chapter."

Section 1860.1 was not repealed by Proposition 103 because it can be read in a manner consistent with the measure. As discussed *supra* at 22-24, Proposition 103 repealed the McBride-Grunsky statutes authorizing insurers to engage in collective activities, and the broad immunity originally conferred by § 1860.1 has been vastly narrowed by § 1861.03(b) of Proposition 103.

**B. By Its Own Terms, § 1860.2 Does Not Apply To Immunize Mercury's Conduct.**

The inapplicability of § 1860.2 to Donabedian's claim against Mercury is even simpler than that of § 1860.1. Section 1860.2 specifies which laws apply in the "enforcement" of the provisions of Chapter 9. The section reads, in its first sentence:

> The administration and enforcement of this chapter [Chapter 9] shall be governed solely by the provisions of this chapter.

If the provision which provides the authority for Donabedian's enforcement action is found in Chapter 9, then the first sentence of this section is by itself dispositive. That is, in fact, the case. Donabedian's suit against Mercury is based on the express authority of Chapter 9, which includes Proposition 103. Specifically, Donabedian's suit is expressly authorized by §§ 1861.03(a) and 1861.10(a) of Proposition 103. Section 1861.03(a) permits enforcement pursuant to the UCL, which it expressly references. It is also a proceeding "permitted or established pursuant to this chapter" within the meaning of § 1861.10(a). Further, § 1861.10(a) authorizes "any person" to "enforce any provision of this article [Proposition 103]." Therefore "any person" has a right to initiate a UCL proceeding in court to enforce the provisions of Proposition 103.[48]

[48] The combination of §§ 1860.2 and 1861.10(a) clearly authorizes plaintiffs to challenge conduct violating the substantive provisions of Proposition 103 directly, without reference to the UCL.

Mercury simply ignores the first sentence of § 1860.2. It focuses entirely on the second sentence of § 1860.2 (which it paraphrases incorrectly (RB 36)). Even then, Mercury's argument fails.

The second sentence addresses the applicability of provisions that are not included in Chapter 9:

> Except as provided in this chapter, no other law relating to insurance and no other provisions in this code heretofore or hereafter enacted shall apply to or be construed as supplementing or modifying the provisions of this chapter unless such other law or other provision expressly so provides and specifically refers to the sections of this chapter which it intends to supplement or modify.

The second sentence forbids the application of other laws, with the critical exception: "[e]xcept as provided in this chapter." Again, Proposition 103's provisions are within the chapter.

In short, by their own terms, neither § 1860.1 nor § 1860.2 operate to bar the application of Proposition 103's private right of action, since Proposition 103 is within Chapter 9. As noted previously, like McCarran, McBride-Grunsky permitted the legislature to make insurers subject to laws of general application, but both statutory schemes make clear that in order to do so the legislature would have to specifically provide that a law of general application applies to the insurance industry. This is precisely what Proposition 103 did.

**C. To the Extent §§ 1860.1 and 1860.2 Are Construed to Conflict With the Later Enacted Provisions of Proposition 103, They Must be Considered Repealed by Implication.**

A careful analysis of the provisions enacted by Proposition 103 demonstrates that the measure expressly authorizes private plaintiffs to bring suit under the UCL to challenge violations of Proposition 103. And the interplay between the Proposition 103 enactments and those few provisions of McBride-Grunsky that the voters chose not to repeal reveals a

carefully erected statutory framework that is internally consistent and harmonious.

Mercury does not attempt to harmonize the vestigial McBride-Grunsky provisions with the Proposition 103 provisions that superseded them. To the contrary, Mercury does not even attempt to explain how its position that § 1860.2 precludes UCL suits can be sustained in light of the language of § 1861.10(a). In fact, *nowhere in its brief does Mercury mention § 1861.10(a) at all*.

Mercury asserts that §§ 1860.1 and 2 were "intentionally left intact," (RB at 1), by "Proposition 103's drafters," (RB 32), and this is true. But contrary to Mercury's assertion, the drafter's purpose was not "to incorporate their broad preemptive language into" Proposition 103 in order to maintain the McBride-Grunsky era immunities (RB at 33). Rather, as explained above, the vestigial provisions were allowed to remain only because they were consistent with Proposition 103's express provisions and specific purposes.

Mercury's construction would erect an irreconcilable conflict between the provisions. It defies logic (and all the rules of statutory construction) to suggest that the voters would legislate immunities and a prohibition on private actions at the same time they repealed the immunities (Exh. C [Prop. 103], § 7), applied state laws (§ 1861.03(a)), and authorized private actions thereunder (§ 1861.10(a)). (*See Halbert's Lumber v. Lucky Stores* (1988) 6 Cal.App.4th 1233, 1239 [courts must "apply reason, practicality, and common sense to the language at hand" and interpret the words of a statute "in accord with common sense and justice, and avoid an absurd result"].)

If, however, the court were to find that the McBride-Grunsky provisions conflicted with the plain meaning of §§ 1861.10(a) and 1861.03(a), as Mercury contends, then the proper result under California

law would be to hold the McBride-Grunsky provisions repealed by implication. As reiterated recently, the rule is:

> When a later statute supersedes or substantially modifies an earlier law but without expressly referring to it, the earlier law is repealed or partially repealed by implication. The courts assume that in enacting a statute the Legislature was aware of existing, related laws and intended to maintain a consistent body of statutes. [Citations omitted]
>
> (*Burlington Northern and Santa Fe Railway Co v. Public Utilities Commission* (2003) __Cal.Rptr.3d __, 2003 WL 22390021; *accord People v. Bustamante* (1997) 57 Cal.App.4th 693, 700-701 [statute passed by initiative conflicted with a parallel provision which the initiative did not repeal; finding that "[t]his inconsistency makes concurrent operation of these two statutes impossible," the court held that the earlier statute was repealed by implication].)

Mercury suggests that the fact that Proposition 103 did not repeal §§ 1860.1 and 1860.2 while it repealed other provisions of McBride-Grunsky means that it intended those provisions to override the newly-enacted provisions of Proposition 103. (RB at 32-33.) But the law is to the contrary. (*See Burlington*, *supra*, 2003 WL 22390021, p. 7["our conclusion that [the conflicting older statute] has been repealed by implication is not precluded by the fact that the electorate did not expressly repeal [it] as part of Proposition 17"].)

## II.

## THE CASE LAW DOES NOT SUPPORT MERCURY'S ARGUMENT THAT CONSUMERS LACK A PRIVATE RIGHT OF ACTION AGAINST IT UNDER THE UCL.

### A. Mercury's Argument Flies in the Face of The California Supreme Court's Decision in *Farmers*, Which Affirms the Right to Bring UCL Challenges for Violations of Proposition 103.

Respondents' creative definition of "persistency" is matched only by the novelty of its argument that the Supreme Court's decision in *Farmers*

*Ins. Exchange v. Superior Court* (1992) 2 Cal.4th 377 (*Farmers*), is no longer good law. (RB 23). Mercury is forced to make this far-fetched argument because *Farmers* is directly on point.

In *Farmers*, the Attorney General, acting under the authority of § 1861.10(a) and § 1861.03(a), filed a civil suit against Farmers Insurance Exchange on behalf of The People for numerous violations of Proposition 103, including violations of § 1861.02(c), the statutory proscription Mercury violated here. (*Farmers*, *supra*, 2 Cal.4th 377, 381-382.)[49] Farmers sought exactly the same result Mercury seeks here: a ruling that, despite the clear language of the initiative statute, there was no right to bring a UCL suit against an insurance company for violation of the insurance code. Farmers, like Mercury here, argued that the McBride-Grunsky era immunities and jurisdictional bars applied.

The California Supreme Court was unequivocal in rejecting the insurer's argument:

> We agree that section 1861.03 does not condition a suit under Business and Professions Code section 17200 on prior resort to the administrative process under the Insurance Code. Indeed, it does not speak to that issue at all. It merely modifies preexisting law, to provide, in essence, that insurers are subject to the unfair business practices laws in addition to preexisting regulations under the McBride Act, as amended.
>
> (*Farmers*, *supra*, 2 Cal.4th 377, 394.)

The Court proceeded to apply the judicial doctrine of "primary jurisdiction," under which the courts have it within their discretion to *temporarily abstain* from deciding a matter in order to avail themselves of the technical "expertise presumably possessed by the Insurance Commissioner." (*Id*. at 398.) In distinguishing "primary jurisdiction" under

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[49] The People also alleged that Farmers' *rates* were "unfairly discriminatory" under § 1861.05. (*See* further discussion at footnote 60 *infra*.)

Proposition 103 from the "exhaustion of administrative remedies" doctrine, the Court again made clear that under Proposition 103, "'alternative' or 'cumulative' administrative and civil remedies are made available to a plaintiff." (*Id*. at 393-394.) Primary jurisdiction, it said,

> *applies where a claim is originally cognizable in the courts*, and comes into play whenever enforcement of the claim requires the resolution of issues which, under a regulatory scheme, have been placed within the special competence of an administrative body; in such a case the judicial process is suspended pending referral of such issues to the administrative body for its views."
>
> (*Id*. at 390, italics in original, emphasis added.)

The status of a UCL claim against an insurer for violations of provisions of Proposition 103 is the same today as it was in *Farmers:* such claims are originally cognizable in the courts and not subject to the McBride-Grunsky era "exclusive jurisdiction" of the Commissioner.

Confronted with the inescapable holding of *Farmers*, Mercury now asserts that it is no longer "viable":

> Farmers arose in the unique and temporary context of a public mandate for a prior approval rate-setting regime without any mechanical implementation of that regime. The court understandably felt the need for administrative guidance when confronted with this vacuum. That condition no longer pertains.
>
> (RB 23.)

In other words, in Mercury's view, there is no longer any need for private civil litigation against insurers. (RB 4, 23 and 37.) Mercury's premise is demonstrably false.[50]

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[50] Contrary to Mercury's assertions, regulations *were* in place at the time of the *Farmers* decision, (Cal. Code Regs., tit. 10, §2632.1, *et seq*.), as cited to by the Court, (*Farmers*, *supra*, 2 Cal.4th 377, 399), which reasoned that referral under the primary jurisdiction doctrine to the Insurance Commissioner was appropriate to determine whether insurers had violated § 1861.02(c) and "*to determine whether his or her own regulations pertaining to compliance have been faithfully adhered to by an insurer*."

First, one will search in vain for anything in Proposition 103 that says, "the provisions of § 1861.03(a) and 1861.10(a) shall sunset once the Insurance Commissioner has promulgated regulations implementing Proposition 103."

Nor is there support in *Farmers* for Mercury's argument. There, the Supreme Court clearly envisioned litigation before the courts pursuant to §§ 1861.03(a) and 1861.10(a) in future years. Its ruling was designed to ensure that the courts would be able to take advantage of the agency's technical expertise in such litigation. Indeed, the very premise of Mercury's factually fallacious argument dictates a contrary result: primary jurisdiction is *most useful* to the courts when the CDI has fully implemented necessary regulations and can therefore provide the court with a consistent body of administrative decisions.

Experience since the passage of Proposition 103 has demonstrated both the wisdom of Proposition 103's private right of action and the need for civil litigation. This case is "Exhibit A." The Insurance Commissioner and staff lack the resources to catch every possible violation of the law that might be among the thousands of filings made each year, much less violations, like Mercury's, that are *not disclosed in any filing*. Private enforcement remains a powerful adjunct to the agency's activities, as the CDI itself wrote to the Supreme Court in the *Farmers* case.[51] Which is, of

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(*Ibid*., emphasis added.) If these were issues that, as Mercury contends, were within the exclusive jurisdiction of the Commissioner (both pre- and post-Proposition 103), then the *Farmers* Court would have simply dismissed the case and told the People that their sole remedy was before the Commissioner. It did not do so.

[51] "[T]he Commissioner welcomes the assistance of law enforcement officials and individuals acting as private attorneys general in seeking compliance with various provisions of the Insurance Code. Indeed, it is the Commissioner's view that Proposition 103 amended the Insurance Code precisely to encourage such actions by law enforcement officers and

course, precisely the motive for Mercury's strenuous efforts to slip the bonds of §§ 1861.03 and 1861.10. Mercury's attack on *Farmers* reflects its recognition that the only way it can prevail here is to convince this Court to judicially repeal provisions of Proposition 103 that have remained in force for nearly fifteen years, and overrule a seminal decision of the California Supreme Court construing those provisions.

**B. No Other Case Law Support's Mercury's Position**

*Farmers* is vital and controlling. Unable to circumvent it persuasively, Mercury falls back on a smattering of case law, both published and unpublished, that both pre-dates and post-dates Proposition 103. None of it avails to demonstrate that Proposition 103 does not mean what it says when it grants consumers an unqualified right of private action.

1. Pre-Proposition 103 Case Law is Irrelevant to this Case.

In support of its argument against the application of Proposition 103's statutory provisions, Mercury relies heavily, and inappropriately, upon a case that was decided during the McBride-Grunsky era, before the passage of Proposition 103, *Karlin v. Zalta* (1984) 154 Cal.App.3d 953. (RB 32-34.)

In *Karlin*, a consumer alleged a conspiracy among insurers and others to set rates for medical malpractice insurance at excessive levels

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consumers. (See Ins. Code § 1861.03, subd. (a).)… In the Commissioner's view, the drafters of Proposition 103 understood that the Department, even under an elected Insurance Commissioner, could not reasonably be expected to respond to all allegations of violations of its newly-enacted reforms…. [T]hose organizations or individuals who have sufficient resources to pursue an unfair business practices lawsuit involving insurance rating practices or other claims would be able to do so, without having to rely solely upon the Department to investigate and prosecute their claims." (Exh. M, Janice E. Kerr, General Counsel, California Department of Insurance to the California Supreme Court re *Farmers Insurance Exchange v. Superior Court of Los Angeles County*, Cal. Sup. Ct. No. S017854, December 18, 1991, pp. 1-2.)

during the "malpractice crisis" of the 1970s, in violation of § 1852 of McBride-Grunsky (the rate "regulation" provision) and the Unfair Insurance Practices Act (UIPA) Insurance Code §§ 790, *et seq*., which was enacted in 1959 to prohibit "unfair methods of competition" by insurance companies. The Court of Appeal ruled – correctly – that § 1853 of McBride-Grunsky expressly sanctioned rate-setting collusion. (*Karlin v. Zalta*, *supra*, 154 Cal.App.3d 953, 970.) It also held – correctly – that to the extent that insurance rates were challenged, the UIPA was completely preempted by §§1860.1 and 1860.2 of McBride-Grunsky. (*Id*. at 969–975.) Finally, the court found – correctly – that McBride-Grunsky dictated that objections to insurance rates could only be raised in the form of an administrative complaint under § 1858, and that the plaintiff had failed to exhaust that "exclusive" administrative remedy. Having instructed the petitioner to exhaust, the court in a footnote predicted the ultimate futility of the process: "A finding that the activities complained of were authorized under the McBride Act might call into play the immunities of sections 1860.1 and 1860.2 against any civil claim." (*Id.* at 986, fn. 23.)

*Karlin* was properly decided under McBride-Grunsky. However, it is self-evidently not valid law under Proposition 103. Indeed, *Karlin* was substantially overruled by the Supreme Court in *Manufacturers Life Ins. Co. v. Superior Court* (1995) 10 Cal.4th 257, discussed more fully below.

Cases construing McBride-Grunsky's provisions can have no precedential value in construing the provisions added by Proposition 103 described above. (*People v. Hinds* (2003) 108 Cal.App.4th 897, 901 ["[l]anguage used in any opinion is of course to be understood in the light of the facts and the issue then before the court, and an opinion is not authority for a proposition not therein considered"].)

2. Cases Decided After Proposition 103's Passage Provide No Support for Mercury.

Nor do cases cited by Mercury (two of which it admits are non-citable) that were decided after the enactment of Proposition 103 support its argument that the Commissioner has "exclusive jurisdiction" over challenges to conduct in violation of Proposition 103.

Mercury cites *Wilson v. Fair Employment and Housing Commission* (*FEHC*) (1996) 46 Cal.App.4th 1213, in support of its argument that the only proper process for objection to an insurer's violation of 103 is through the administrative complaint process set forth in § 1858, the McBride-Grunsky era complaint procedure retained by Proposition 103. (RB at 34-35.) Mercury completely misstates *FEHC*. In *FEHC,* the issue before the court was whether the Fair Employment Housing Commission *or* the Department of Insurance had jurisdiction over an *administrative claim* brought by a pilot charging that an aviation insurer's refusal to insure pilots over 60 violated the Unruh Act, applicable pursuant to § 1861.03(a). The plaintiff had not filed a claim in superior court, and the court emphasized that it was *not* addressing the question whether he could file such a claim in court. (*Wilson*, *supra*, 46 Cal.App.4th 1213,1224, fn. 7.) Rather, after comparing the expertise of the two agencies, the court held only that "given Wilson's decision to bring this matter before an administrative agency, we conclude that the proper administrative procedure is to file a written complaint with the Insurance Commissioner pursuant to section 1858 of the Insurance Code." (*Ibid*.)

Nothing in the court's decision can remotely be read as limiting a plaintiff's right to proceed in court.

Mercury points out that after the decision in *FEHC*, the plaintiff filed an age discrimination case in federal district court. (*Wilson v Avemco,* 2002 WL 243633 (N.D.Cal.).) Mercury notes that the case is unpublished

and uncitable, but proceeds to argue that District Court's decision supports Mercury's view. (RB at 37-40). Once again, the decision contradicts Mercury's argument. Like Mercury here, the defendant in *Avemco* argued to the District Court that CDI had exclusive jurisdiction and that in *FEHC*, the California Court of Appeal had ruled that the court could not hear the case on that basis. The District Court rejected this characterization of the *FEHC* decision, rejected the exclusive jurisdiction argument, and permitted the claim to proceed. (*Wilson v. Avemco*, *supra*, at 2-3.) Of particular relevance here, the District Court noted that when the case went to the CDI after *FEHC*, *the CDI itself* rejected the insurance company's claim that the Department had "exclusive jurisdiction." CDI wrote the plaintiff that "any determination of damages would be a civil matter and should be addressed by a court of law….*While this department may have primary jurisdiction we do not have sole jurisdiction*, therefore, you may wish to consult with an attorney or to seek other judicial remedies." (*Id*. at 3, emphasis added.)

The *Wilson* cases do not provide any support for Mercury.

*Manufacturers Life Ins. Co. v. Superior Court* (1995) 10 Cal.4th 257 is no more helpful to Mercury's position. Mercury asserts that *Manufacturers Life* holds that there can be no UCL actions "with regard to ratemaking (i.e. the [§§ 1860.1 and 1860.2] immunity provisions." (RB at 25.) Again, Mercury misstates the decision, which actually negates Mercury's argument.

*Manufacturers Life* concerned an antitrust suit brought against a life insurance company and related entities. The insurer argued that the Cartwright Act, California's antitrust law (Bus. & Prof. Code §§ 16720-16770, *et seq*.), was preempted by the UIPA "*except to the extent Proposition 103 applies.*" (*Manufacturers Life Ins. Co. v. Superior Court* (1995) 10 Cal.4th 257, 268, emphasis added.) The Supreme Court noted that life insurance companies are not subject to Proposition 103 (§ 1861.13),

and thus concluded that Proposition 103 did not apply to life insurers. (*Id.* at 282, fns. 14 and 15.)

While the decision therefore did not construe the private right of action established by Proposition 103, it disposes of a contention identical to that made by Mercury here.

Manufacturers Life contended that the UIPA preempted the application of the Cartwright Act and that "[t]herefore, insurers are subject only to the regulatory authority of the Insurance Commissioner and there is no private right of action to redress [antitrust] injuries…" (*Id*. at 268.) It argued that § 790.09, which provides that no remedy under the UIPA shall "relieve or absolve" an insurer from "civil liability," meant only that a cease and desist order issued by the Commissioner did not preclude him from imposing another *administrative* remedy. (*Id*. at 273.) The Supreme Court disagreed, holding that the UIPA does not supersede claims under the Cartwright Act or the UCL:

> The Legislature intended that rights and remedies available under [the antitrust and unfair business practices statutes] were to be cumulative to the powers the Legislature granted to the Insurance Commissioner.
>
> (*Id*. at 263.)

To hold otherwise, the Court reasoned, would render the reference to "civil liability" meaningless. Thus, even in a statutory scheme *without the express authority for a private right of action accorded by Proposition 103* under § 1861.10(a), the Court rejected the argument that the Commissioner had "exclusive jurisdiction."

In sum, neither *Farmers*, which remains the law, nor any other case law, supports Mercury's contention that Proposition 103 excludes consumers from a judicial forum to challenge insurer misconduct.

## III.

## *WALKER*, WHICH IMMUNIZED INSURERS FROM SUITS CHALLENGING APPROVED RATES AS EXCESSIVE, WAS BASED ON AN ERRONEOUS APPLICATION OF §§ 1860.1 and 1860.2, AND SHOULD NOT BE FOLLOWED, MUCH LESS EXTENDED, BY THIS COURT.

The trial court below cited the First District Court of Appeal's holding in *Walker v. Allstate Indemnity Co*. (2000) 77 Cal.App.4th 750 (*Walker*), as authority for its conclusion that it had no jurisdiction over Appellant's suit against Mercury. (RT 22.) *Walker* was wrongly decided by a court that did not have the benefit of competent briefing by plaintiffs' counsel, and this Court should not accept its faulty reasoning. Like the court below, the *Walker* court misapplied the vestigial provisions of McBride-Grunsky (§§ 1860.1 and 1860.2), while failing to properly apply §§ 1861.10 and 1861.03, added by Proposition 103. The *Walker* court apparently sought to establish a "filed rate doctrine." However, California law does not authorize it, as the *Walker* court acknowledged, and the court erred in finding a statutory substitute for it. This court need not – and should not – follow *Walker*. (*In re Hadley* (1943) 57 Cal.App. 2d 700, 703; *Estate of Toy* (1977) 72 Cal.App. 3d 392, 396 [Court of Appeal decision incorrectly distinguished binding opinion of Supreme Court].)

(Part IV will explain why even if this court finds that the holding in *Walker* was correct, it must decline to extend that decision, as Mercury urges, to the circumstances here).

### A. The *Walker* Court Erroneously Permitted the Vestigial McBride-Grunsky Statutes to Supersede Proposition 103's Provisions.

In December of 1997, the plaintiffs in *Walker* filed a class action lawsuit against seventy-eight insurance companies, as well as then-Commissioner Chuck Quackenbush, challenging as "excessive" auto insurance rates that had been approved by the Commissioner over the preceding three years pursuant to § 1861.05, the rate-setting process

established by Proposition 103.[52] The plaintiffs demanded at least $1 billion in disgorgement, plus punitive damages and attorneys fees.

The insurers demurred, arguing that §§ 1860.1 and 1860.2 provide that an insurer may not be sued under the general laws of California for using approved rates. The superior court granted the demurrers without leave to amend, stating that: "it's antithetical, I think, to suggest that when you've gone through that kind of [administrative] process, that rates can be considered illegal under any circumstances." (*Walker*, *supra*, 77 Cal.App.4th 750, 754.) Evincing a similar discomfort with the plaintiffs' blunderbuss assault – "the time has long since lapsed to challenge the actions on which the complaint was based", (*id*. at 760), the First District affirmed, citing the vestigial McBride-Grunsky Act provisions: "[E]xplicit statutory authority [– §§1860.1 and 1860.2 –] bar[s] the suit." (*Id*. at 754.)

The *Walker* court's decision is demonstrably erroneous for four reasons:

1. The *Walker* Court Failed to Construe §§ 1860.1 and 1860.2 Consistently with § 1861.03.

The *Walker* court read § 1860.1 incorrectly, as already discussed in Part I, A, above.

2. The *Walker* Court Failed to Properly Construe § 1861.10.

The court in *Walker* also failed to reconcile §§ 1860.1 and 1860.2 with the later enacted § 1861.10(a), which authorizes any person not only to initiate any proceeding permitted by Chapter 9, but to "enforce any provision of this article [10]," which consists of the provisions added to the

[52] The amended complaint stated five causes of action against the insurers: (1) violation of Proposition 103's provisions; (2) violation of the Unfair Competition Law (Business and Professions Code §§ 17200, *et seq*.); (3) unjust enrichment; (4) fraud by concealment, and (5) declaratory relief that the Commissioner be required to enforce the laws.

Insurance Code by Proposition 103. Under 1861.10(a), therefore, if conduct violates a provision of Proposition 103, a person may challenge that conduct by seeking to enforce that provision of Proposition 103 in the courts.

Indeed, the *Walker* court erroneously appeared to believe that § 1861.10(a) allows consumers to participate only in *administrative challenges* to rates under § 1861.05, *et seq*.:

> Appellants' argument seems an obvious attempt to avoid consumer participation provisions of Proposition 103 that appellants deem burdensome or impractical and thus frustrate the power granted to the commissioner by the voters to set insurance rates after soliciting both insurer and consumer input into his decision.
>
> (*Id.* at 757.)

Based on a fundamental failure to properly construe the McBride-Grunsky statutes in the light of the later-enacted provisions of Proposition 103, the court discerned a conflict between them. It then, incredibly, resolved that conflict by permitting the older statutes to supersede the newer ones:

> To read sections 1861.03 and 1861.10 as appellants urge would result in an unnecessary conflict between these statutes and section 1860.1, which embodies the finality of the commissioner's rate-making decision.
>
> (*Id*. at 758.)

This too was error. As noted *supra* at 40-42, it is hornbook law that where there is a conflict between statutes, the later-enacted law must prevail.

Here, again, the *Walker* plaintiffs failed to provide a cogent argument that the McBride-Grunsky provisions are not in conflict with § 1861.10(a), but can and must be read together, as the court itself pointed out:

> Tellingly, appellants simply ignore these sections in their opening brief. In their reply brief, they string together pages of statutory

> quotations with hardly any analysis demonstrating how the quoted statutes aid their cause. Appellants' inability to craft a cohesive argument taking cognizance of these immunity statutes [§§ 1860.1 and 1860.2] demonstrates, we believe, that their claims are inimical to the statutory scheme that they purport to enforce and, thus, were properly dismissed.
>
> (*Walker*, *supra*, 77 Cal.App.4th 750, 755.)

3. The *Walker* Court Ignored the California Supreme Court's Decision in *Farmers.*

The *Walker* court also refused to follow *Farmers.* (*Id.* at 759.) Precluding a court challenge to rates would impose precisely the kind of bar that *Farmers* itself expressly rejected. In *Farmers*, the Supreme Court noted that the "primary jurisdiction" doctrine

> . . . does not operate to remove these issues completely from the sphere of judicial action; its operation is, rather, to determine whether the initial consideration of the matter should be by a court or by an agency.
>
> (*Farmers*, *supra*, 2 Cal.4th 377, 387, fn.7.)

However, the *Walker* court distinguished *Farmers*, stating:

> [T]he *Farmers* court did not consider whether an Unfair Business Practices Act claim arising in an exclusively rate- making context could be brought in the superior court in light of the immunity provided in Insurance Code sections 1860.1 and 1860.2.
>
> (*Walker*, *supra*, 77 Cal.App.4th 750, 759.)

The *Walker* court misread the *Farmers* case. As noted *supra* in Part IIA, the very question before the Supreme Court in *Farmers* was whether the UCL would apply or whether the vestigial McBride-Grunsky statutes would be allowed to supersede Proposition 103. Moreover, the Supreme Court in *Farmers* stated that the question of whether an insurer's *rate* was "unfairly discriminatory" under § 1861.05 was one that could benefit from referral to the Commissioner *under the primary jurisdiction* doctrine. (*Farmers Ins. Exchange v. Superior Court* (1992) 2 Cal. 4th 377, 399.) Thus the holding in *Farmers* directly undermines *Walker* as well as Mercury's

contentions, (RB 27, 42), that a *rate* that violates § 1861.05 falls "within the original and exclusive jurisdiction of the Insurance Commissioner" and can never form the basis for civil liability.

Finally, the *Walker* court was mistaken about the procedural posture of *Farmers*, stating that, "this is not a case, like *Farmers,* where the administrative process has yet to be invoked. In this case, the regulatory process had been followed to its conclusion." (*Walker*, *supra*, 77 Cal.App. 4th 750, 759.) Like the dozens of insurers in *Walker*, Farmers had, indeed, filed its rating factors with the Commissioner, and they were approved.

4. The *Walker* Court Further Misapplied Other California Supreme Court Precedents.

The *Walker* court cited *Chicago Title Ins. Co. v. Great Western Financial Corp.* (1968) 69 Cal.2d 305 and *Karlin v. Zalta* (1984) 154 Cal.App.3d 953, for the proposition that the Insurance Commissioner has "exclusive jurisdiction" over ratemaking. (*Walker*, *supra*, 77 Cal.App.4th 750, 755.) But these are pre-Proposition 103 cases construing the McBride-Grunsky Act and are irrelevant here, as was discussed *supra* at 46-47.

*Walker* also mischaracterized two post-103 cases it relied upon, *Quelimane Co. v. Stewart Title Guaranty Co*. (1998) 19 Cal.4th 26, and *Manufacturers Life Ins. Co. v. Superior Court* (1995) 10 Cal.4th 257, as continuing to recognize the existence of statutory exceptions to the viability of unfair business practices cases against insurers after Prop 103 "for rate-making decisions." (*Id.* at 759.)

*Quelimane* says nothing about the viability of unfair business practices cases against insurers after Proposition 103, because *Quelimane* concerned title insurance, to which Proposition 103 does not apply (§ 1861.13).

*Manufacturers Life* makes clear that the § 1860.1 immunity which Mercury is urging this court to apply to a challenge to its unilateral conduct

under the UCL was intended to apply only to a challenge to joint ratemaking activity under the antitrust laws. Thus the Supreme Court in *Manufacturers Life* refutes *Walker's* analysis of § 1860.1 and "exclusive jurisdiction." (*See* discussion *supra* at 49-50).

**B. *Walker* Improperly Attempted to Establish A "Filed Rate Doctrine" With Respect to California Insurance Rates.**

It is clear that the First District was highly offended by the notion that insurance companies could face liability for damages for charging rates that had been approved by the CDI years before. As discussed in detail *supra* at 15-16, there is no one "correct" rate, but rather, revenue needs are estimated within a range, the determination of which is heavily dependant upon the Commissioner's discretion. Because the reasonableness of a rate is a mixed question of law and fact,[53] requiring expertise and judgment, courts are inherently reluctant to substitute their judgment for those of administrative agencies. Some courts have therefore imposed the so-called "filed rate doctrine" to immunize from private challenge rates previously approved as not excessive by an administrative agency. (*See, e.g., Wegoland Ltd. v. Nynex Corp* (2003) 27 F.3d 17, 19.)

However, there is no statutory authority in Proposition 103 for imposing a "filed rate doctrine," and the doctrine is inconsistent with the statutory scheme approved by the voters. This is because the voters understood that the CDI's limited resources could not possibly provide on a routine basis the depth and breadth of regulation assumed by the court in *Walker*, *supra*, 77 Cal.App.4th 750 at 752. When each of the hundreds of property-casualty insurers doing business in California wish to change their rates, they must submit an application to the CDI for its approval pursuant to § 1861.05 *for each line of insurance*. Most of these filings receive only a

[53] *See, e.g.*, *Interstate Commerce Commission v. Union Pacific Railroad Co.* (1912) 222 U.S. 541, 547.

cursory check at best, and the vast majority of applications are automatically "deemed approved" after sixty days.[54] (*See, e.g.,* Exh. N, [a typical weekly public notice, published by the CDI, of various applications made by insurers pursuant to Proposition 103.])

Proposition 103 gave the Commissioner and the public powerful new *authority* to challenge insurers' rates and practices, but whether the Commissioner utilizes that authority is a voluntary decision. No statute can guarantee that the Commissioner or consumers will review every application and catch every mistake, omission or other violation of the law. For that reason, Proposition 103 placed insurers under a continuing obligation to charge rates that are not "excessive": § 1861.05 says that "[n]o rate shall be approved or *remain in effect* which is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter." (Emphasis added). Thus Prop. 103 placed the obligation to keep rates at proper levels not only upon the Commissioner, but *also upon the insurers themselves*. The insurers were on notice that they could be subject to later challenges by consumers to their rates, even after approved by the Commissioner, should their rates be proven excessive.[55] A rule that immunizes any rate that can get past the necessarily cursory review provided by the CDI is guaranteed to lead to exactly the abuses Prop. 103 was intended to prevent.

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[54] Ins. Code §1861.05(c), as added by Stats. 1992, c. 1257, 1; Stats. 1993, c. 646, §1. This legislation, sponsored by the insurance industry after the enactment of Proposition 103, set additional time limits for CDI action in the event a hearing is noticed on an application for a rate change.

[55] *See, e.g., 20th Century Ins. Co. v. Garamendi*, *supra*, 8 Cal.4th 216, at 282, *cert. denied*, 513 U.S. 1153 (given insurers were on prior notice, application of rate rollbacks was not impermissibly retroactive, and interest was allowed on amounts).

After a careful analysis of the statute, the Attorney General of California has opined that "the filed rate doctrine does not apply to insurance rates in California," citing § 1861.03(a).[56] Further, the California Supreme Court, in establishing the "primary jurisdiction doctrine" in *Farmers*, relied in significant part on a U.S. Supreme Court case that rejected a challenge to rates precisely because they had been filed with the administrative agency.[57] This suggests that the California Supreme Court recognized that a bar to challenges to previously approved rates would not be compatible with Proposition 103.[58]

Perhaps for these reasons the Court of Appeal in *Walker* rejected the contention that it was invoking a filed rate doctrine – but considered it "consistent with our interpretation of the statutory provisions at issue in this case." (*Walker*, *supra*, 77 Cal.App.4th 750, 757, fn. 4.)

In any case, there is no need to impose a "filed rate doctrine" into California insurance law. Existing law – especially as modified by the primary jurisdiction doctrine articulated by *Farmers* – adequately protects insurers against the kind of broadside that the plaintiffs employed in *Walker*.

## IV.

## *WALKER* DOES NOT APPLY TO THIS CASE, AND THE TRIAL COURT ERRED IN EXPANDING IT TO IMMUNIZE MERCURY'S CONDUCT FROM COURT CHALLENGE.

Although *Walker* is erroneous, this Court need not disavow it in order to hold that the trial court erred in applying it here. By its own terms,

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[56] Antitrust Guidelines, *supra* p. 23, at 22.

[57] *Texas & Pac. Ry. v. Abilene Cotton Oil Co*. (1907) 204 U.S. 426, cited by *Farmers*, *supra*, 2 Cal.4th 377, 386-387.

[58] Whether Proposition 103's rejection of a "filed rate doctrine" is to be changed is a matter reserved to the legislative process. As the California Supreme Court has said to other petitioners concerning the perceived unfairness of the Insurance Code, such objections must be brought to the legislative branch. (*King v. Meese* (1987) 43 Cal.3d 1217, 1235.)

the *Walker* decision is inapposite to this case. There is no legitimate basis for expanding *Walker*, which precludes only those private suits that challenge approved rates, to also preclude private suits challenging violations of explicit state statutes, unapproved conduct of any kind, or rating factors whether approved or unapproved.

**A. *Walker* Does Not Apply Because Appellant Alleges That Mercury's Rating Factor Violates a State Statutory Proscription and *Cannot be Approved.***

*Walker*, by its own terms, applies only to *rates*, and only to *approved* rates at that. (*Walker*, *supra*, 77 Cal.App.4th 750, 753 ["The causes of action were each bottomed on the insurers' charging approved *rates* alleged nevertheless to be 'excessive'"]; *id*. at 756 [1860.1 "must bar claims based upon an insurer's charging a *rate* that has been approved"; "under the statutory scheme enacted by the voters, the charging of an approved *rate* cannot be deemed 'illegal' or 'unfair' for purposes of the Unfair Business Practices Act or, indeed, tortious"]; *id*. at 757 ["an insurer's action of collecting premiums consistent with an approved *rate* is certainly done pursuant to the authority conferred on the Commissioner by the amended McBride Act"]; *id*. at 759 ("as appellants alleged in their complaint, the insurers then charged the *rates* approved by the commissioner.") (Emphasis added).)

Here, by contrast, Appellant's complaint charges Mercury with violating an explicit statutory proscription, § 1861.02(c), which forbids insurers from using the "absence of prior insurance" to set premiums.

Neither *Walker*, nor the reasoning behind it, nor the application of the "filed rate doctrine" in other states, has ever been applied to immunize violations of a state statute. This is because an administrative agency simply does not have the authority to approve an action that violates a state law; such approval would be *ultra vires*. (*See, e.g., Assoc. for Retarded*

*Citizens v. Dept. of Development Svcs.*, *supra*, 38 Cal.3d 384, 391; *see also AICCO v. Insurance Company of North America* (2001) 90 Cal.App.4th 579; *Reichard v. Life Ins. Co. of North America* (1979) (N.D. Cal.) 485 F.Supp. 56 ; *Peachtree Casualty Insurance Co. v. Sharpton* (Ala. 2000) 768 So.2d 368, 372, 373 ["This case is not a rate case; the filed-rate doctrine is inapplicable."]; *Insurance Company Of North America v. Hippert* (1986) 354 Pa.Super. 333, 1367; *Walton v. State Farm Mutual Automobile Insurance Company* (1974) 55 Haw. 326, 327-330; *Deane v McGee* (1972) 261 La. 686, 698); *Wegoland Ltd. v. Nynex Corp* (2003) 27 F.3d 17.

As noted *supra* at 56-58, both *Walker* and the "filed rate doctrine" reflect judicial unease with post hoc second-guessing of the complex determinations of reasonableness made by regulators. However, none of the concerns in support of the "filed rate doctrine" apply to violations of explicit statutory proscriptions.

According to *Walker*, as long as the Commissioner follows the correct process in determining that a rate is not excessive, a challenge to the Commissioner's determination that a proposed *rate* is not "excessive" cannot be heard by a court in a subsequent de novo challenge seeking damages. By contrast, all the administrative process in the world will not transform a *rating factor* that is not on the list of nineteen authorized rating factors pursuant to § 1861.02(a) and § 2632.5 of the Commissioner's regulations into a rating factor that is on that list. And no conceivable administrative process could transform the one rating factor the voters thought was so unjustifiable that they specifically prohibited it – the absence of prior coverage – into a rating factor that Proposition 103 permits.

Thus, even if Mercury is correct that the Commissioner "approved" its "length of prior coverage with any carrier" under the rubric of

"persistency," that approval could not insulate Mercury's violation of the statutory proscription from private challenge, just as the Commissioner's approval could not immunize an insurer from liability for basing premiums on race or religion, a clear violation of California law. As the cases above reflect, no administrative agency has such authority.

Moreover, expanding *Walker* to cover *any* violation of the insurance code would encourage insurers to engage in misrepresentations in their filings, knowing that they would be insulated from liability. This would defeat the general purposes of Proposition 103 and the specific purpose of §§ 1861.10(a) and 1861.03(a), which is to authorize private enforcement to deter violations of the insurance code.

(Mercury contends that it has not violated § 1861.02(c) because of the meaning of the phrase "in and of itself" therein. However, the sole issue before this court is whether the trial court erred in sustaining the demurrer on the ground that it had no jurisdiction to hear the lawsuit. Mercury's arguments are demonstrably incorrect but are not properly raised here. The Foundation would be pleased to provide further briefing on that question if the court desires).

**B. *Walker* Does Not Apply If Mercury's Rating Factor Was *Not Approved*.**

Even accepting the *Walker* court's erroneous interpretation of §§ 1860.1 and 1860.2 as immunizing conduct approved by the Commissioner, these sections could not possibly immunize *unapproved* conduct. Throughout its opinion, the *Walker* court emphasizes that it its holding is based on the fact that the rates being challenged as excessive were *approved*. (*Walker*, *supra*, 77 Cal.App.4th 750, 753, 756 and 759.) Neither *Walker*, nor any other California statute or case, provides support for immunizing challenges to unapproved conduct, and such a rule would

require an impermissible repeal of Proposition 103's provisions, as well as the overruling of the Supreme Court's decision in *Farmers*.

While the complaint is not a model of clarity on this point, Appellant alleged that Mercury was in violation of the rating plan approved by the Commissioner when it redefined "persistency" to mean "length of prior coverage with any carrier." The new definition was in contradiction to what it had submitted to the CDI. (First Amended Complaint, ¶ 7, CT 1883-1884); AOB 2, 3 and 11.)

The trial court appears to have assumed that so long as Mercury's entire rating plan was approved, Mercury's subsequent, undisclosed re-definition of the rating factor had to be considered approved as well, and sustained the demurrer to the FAC. This is error.

Here, as noted *supra* at 26-28, Mercury submitted to, and won CDI approval for, a definition of persistency that comported exactly with the traditional definition of persistency. Only later did consumers – including Donabedian – and regulators realize that Mercury had unilaterally chosen to apply a "length of prior coverage with any carrier" rating factor while calling it "persistency."

Accepting the well-pleaded allegations in the complaint as true, as the court must, Mercury's redefinition was in conflict with the objective definition of "persistency" as it was then and is now understood by the Commissioner as well as the industry.

Mercury's use of the "length of prior coverage with any carrier" rating factor not only violates § 1861.02(c), it would also violate § 1861.02(a), discussed *supra* at 17. Subdivision (a) requires that the Commissioner approve all rating factors used by insurers.[59] Plaintiffs did

[59] Even if § 1861.02(c) did not exist as a blanket prohibition on the use of no prior insurance, Mercury would still have violated § 1861.02(a) for

not directly allege a violation of § 1861.02(a), only of § 1861.02(c). But that was sufficient to challenge whether the Commissioner approved of Mercury's conduct.

Unfortunately, the question of whether the CDI approved Mercury's conduct was not squarely put to the Commissioner when the primary jurisdiction process was invoked. *See supra* at 31-32. But as Appellant points out, the Commissioner's response indicates it was not approved. (AOB 14-16.) And because the trial court incorrectly believed that approval of the rating plan equated to approval of Mercury's conduct, it sustained the demurrer before any factual investigation of the issue.

There is no support in the record for Mercury's contention that the Commissioner approved its "length of prior coverage with any carrier" rating factor. However, even if there were to be a dispute over whether Mercury's definition of persistency was "approved" by the CDI, the administrative agency actions must either be susceptible of an interpretation so as to comply with the law, or else be voided. (*See*, *e.g.*, *Assoc. for Retarded Citizens v. Dept. of Development Svcs.*, *supra*, 38 Cal.3d 384, 391.) If the rating factor definition Mercury submitted to the Department is susceptible of two interpretations – one that complies with all statutory provisions, and one that does not – as a matter of law the Commissioner could not have approved the interpretation that violated the law, and should have been considered by the trial court as having approved only the interpretation that complies with the law. Thus, the court below should have accepted the allegations and concluded that the rating factor actually used by Mercury – the absence of prior coverage – was not approved, and denied the demurrer.

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failing to obtain the Commissioner's approval for a "length of prior coverage" rating factor.

Alternatively, the superior court could have referred this case to the Commissioner pursuant to the doctrine of primary jurisdiction – not necessarily to determine whether the rating factor Mercury is using violates 1861.02(a) or 1861.02(c), since the Commissioner had commenced a rulemaking on that point, but rather to ask the Commissioner for his views on what he approved when he approved the language Mercury filed.

The trial court's decision would reward Mercury for practicing a fraud upon the CDI. It does not take much to imagine how such an immunity would affect insurers' behavior if granted here.

**C. *Walker* Does Not Apply Because Mercury's Rating Factor Is Not A "Rate" Regardless of *Whether Or Not It Was Approved*.**

As noted *supra* at Subpart A, *Walker* involved a challenge to the base *rates* of insurers as "excessive" under § 1861.05. It did not involve a challenge, as here, *to the use of rating factors*, since they are neither part of the § 1861.05 process nor subject to the same standard that governs rates thereunder.[60] Thus, even if Mercury can show – which it cannot – that the Department was aware of and approved its use of "length of prior coverage with any carrier" in the guise of the "persistency" rating factor, there is no basis for immunizing Mercury.

As discussed in detail *supra* at 15-18, determining the propriety of rates is completely different from determining the legality of a rating factor. Whether an insurer is complying with the law is a simple matter requiring

[60] As noted *supra* in Part III, A3., even *Walker's* determination that challenges to *rates* could not be subject to a later UCL action is belied by the Supreme Court's decision in *Farmers*, which held that a UCL cause of action alleging "unfairly discriminatory" rates under § 1861.05 was "originally cognizable" in the courts, even if referable to the Commissioner under the doctrine of primary jurisdiction. (*Farmers*, *supra*, 2 Cal.4th 377, 399.)

the court to look at the list of rating factors approved by the Commissioner, a task that requires no technical expertise.[61]

Thus, none of the reasons to decline jurisdiction explicated by "filed rate doctrine" cases apply to the challenge here. As is the case with a violation of § 1861.02(c), the Commissioner simply has no authority to authorize an insurer to use a rating factor that is not on the list of nineteen factors allowed by statute or regulation.

Even if one accepts the *Walker* court's erroneous conclusion that "the authority conferred by this chapter" in § 1860.1 means the authority of the Insurance Commissioner to approve insurer rates, the Commissioner can have no authority to authorize an insurer to use a rating factor that is not on the list of approved rating factors. Holding otherwise would be to sanction the Commissioner's authority to ignore § 1861.02 and his own regulations.

Permitting suits against such violations complies with *Farmers*, § 1860.1 – whether interpreted consistently with Proposition 103's provisions or as the *Walker* court interpreted it – and §§ 1861.03(a) and 1861.10(a). Precluding challenges to rating factors that violate a specific statutory prohibition, by contrast, expands *Walker* to overrule *Farmers*, disregards §§ 1861.03(a) and 1861.10(a), and is not justified by § 1860.1 – even as wrongly interpreted by *Walker*.

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[61] In *Spanish Speaking Citizens' Foundation*, *supra*, 85 Cal.App.4th 1179, the court confronted a challenge to the weight accorded one rating factor: territory. The court stated: "Both sides invoke the "excessive/inadequate" standards of section 1865.01 [sic], subdivision (a) to some extent, but those standards appear to be aimed more at the base rates insurers can charge than at the distribution of premiums among policyholders. As we stated at the outset, base rates for auto insurance are not at issue in this case."
(*Id*. at 1224-25, citations omitted.)

## V. Mercury's Conduct Has Not Been Retroactively Immunized by SB 841, Which Is Irrelevant to the Issue on Appeal, and This Court Should Abstain From Dicta Addressing The Constitutionality of That Statute, A Matter Which Is Pending In Another Court.

Mercury grandiosely contends that "all three branches of government" have blessed its challenged "portable persistency discount." (ROB at 14-15.) Far from it.

As noted earlier, there is no evidence in the record that the Insurance Commissioner approved Mercury's violation of § 1861.02(c). To the contrary, the language the Commissioner approved complied on its face with the traditional industry meaning of "persistency," which is an adopted rating factor. Commissioner Low not only did not approve of Mercury's clandestine application of its "persistency" rating factor as a "no prior insurance" rule, he actually expressly *disapproved* of that practice in a rulemaking proceeding to prevent certain insurance companies, including Mercury, from abusing the persistency rating factor in a manner that violates section 1861.02(c). (*See* AOB at 14-16; CT 2225.) The outcome of that rulemaking provides very clearly that Mercury's clandestine redefinition of persistency is improper. Mercury has failed, to this day, to file a rating plan to comply with this regulation.

The mere fact that the Commissioner declined to take jurisdiction of the instant case, leaving it instead to the court to adjudicate Mercury's specific violation of the law, does not indicate that he now approves of conduct that violates his regulation. Rather, as discussed above, Proposition 103 expressly gave individuals the right to challenge insurers' illegal practices directly in court and under the primary jurisdiction doctrine, the court has jurisdiction to adjudicate the matter once the agency has referred it back.

Secondly, no court has approved of Mercury's use of "length of prior coverage with any carrier" rating factor. The decision below was

based, albeit erroneously, solely on jurisdictional grounds. By contrast, two court decisions have ruled invalid the use by other insurers of rating factors that considered the absence of prior insurance, as noted previously at page 26.

Finally, SB 841, the legislation that Mercury cites as condoning its conduct, has no bearing on this case, as it does not purport to clarify existing law, has no retroactive application and did not take effect until this case was already on appeal. Most importantly, the bill is currently the subject of a constitutional challenge in Los Angeles Superior Court on the grounds that it does not "further the purposes" of Proposition 103, infringes upon the powers accorded the Insurance Commissioner under Proposition 103, and therefore is void as an unconstitutional act.[62] (*See Amwest Surety Ins. Co. v. Wilson* (1995)11 Cal.4th 1243; *Proposition 103 Enforcement Project v. Quackenbush* (1998) 64 Cal. App. 4th 1473.)

None of the parties to this action have briefed the issue of SB 841, and this Court should studiously avoid any dicta that might prejudge the issues raised in that challenge.

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[62] *The Foundation for Taxpayer and Consumer Rights, et al. v. Garamendi, et al.* (Super. Court L.A. County, No. BS086235).

## CONCLUSION

For all the foregoing reasons, amicus respectfully urges that the trial court decision sustaining Mercury's demurrer without leave to amend must be reversed.

Dated: November 4, 2003

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