D075529

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
FOURTH APPELLATE DISTRICT, DIVISION ONE

STATE FARM GENERAL INSURANCE COMPANY

Plaintiff and Appellant,

v.

RICARDO LARA, IN HIS OFFICIAL CAPACITY AS INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA,

Defendant and Appellant,

CONSUMER WATCHDOG,

Intervenor and Appellant.

San Diego County Superior Court
Case No. 37-2016-00041469-CU-MC-CTL
The Honorable Katherine Bacal, Judge, Dept. C-69

CONSUMER WATCHDOG'S COMBINED APPELLANT'S REPLY BRIEF AND CROSS-RESPONDENT'S BRIEF

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APPELLANT/ PETITIONER: State Farm General Insurance Company RESPONDENT/ REAL PARTY IN INTEREST: Ricardo Lara, in his official capacity as the Insurance Commissioner of the State of California, et al.	
CERTIFICATE OF INTERESTED ENTITIES OR PERSONS *(Check one):* [x] INITIAL CERTIFICATE [ ] SUPPLEMENTAL CERTIFICATE	

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(2)		
(3)		
(4)		
(5)		

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Date: November 2, 2020

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INTRODUCTION

State Farm General Insurance Company's (SFG) Combined Brief persists in a reading of Proposition 103 that would severely restrict the Commissioner's discretion in regulating insurance rates and prevent him from protecting consumers when insurance companies knowingly overcharge consumers. That is contrary to the plain language and the explicit purposes of the landmark insurance-reform measure, which not only established a new system for rate regulation in California to prohibit excessive and arbitrary rates, but expressly placed the Commissioner in charge of enforcing the law and granted him broad powers to do so.

In this appeal, SFG challenges the Commissioner's exercise of those broad powers, arguing that the Commissioner's application of a single element of the Proposition 103 regulatory formula is invalid. By regulation, the Commissioner has determined that rates shall be calculated based on group investment data when, as here, the insurance company is part of a wholly owned and controlled group of insurers. SFG disagrees with this rule, asserting that it has structured itself in a way that requires the use of SFG's individual data only.

Not only is SFG's challenge here an improper "piecemeal examination" of the regulatory formula, it is contrary to the entire concept of formulaic ratemaking, which the California Supreme Court explicitly approved of and recognized may include "using data reflecting the condition and performance of a *group* of regulated firms." (*20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 293, citations omitted, italics added (*20th Century*).) In other words, SFG cannot selectively pick and choose which parts of the regulatory formula the Commissioner can and cannot use, and it certainly cannot do so with respect to the Commissioner's use of group data, which the Supreme Court has already found permissible.

SFG's opinions that the Commissioner's regulation would "*reduce* competition" (SFG Brief, p. 47, original italics), would "disincentivize" prudent investment strategy (*ibid*.), and is "not good California policy" (*id*., p. 92) are precisely the policy judgments exclusively within the discretion of the Commissioner. The Commissioner considered these and other relevant factors and determined that his regulation was necessary for the due and efficient administration of Proposition 103.

SFG also objects to the Commissioner's order requiring the company to pay refunds to policyholders whom SFG substantially overcharged—by at least $100 million. SFG argues that Proposition 103 affirmatively precludes such a refund order, but it ignores that the California Supreme Court held exactly the opposite: that the plain text of the law authorizes the Commissioner to grant interim relief and order that an "insurer must refund excess premiums collected with interest." (*Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 825 (*Calfarm*).) If Proposition 103's prohibition against excessive rates means anything, the Commissioner must have this authority to protect consumers when they are unlawfully overcharged.

SFG's putative constitutional arguments also fail. They are based on inapplicable case law, ignoring that insurance regulation is a matter specifically reserved to the states, and rely on long-discarded standards, seeking to create a constitutional right that would guarantee regulated insurance companies an expected profit.

SFG's attempts to limit Proposition 103 and the Commissioner's powers should be rejected. The Commissioner's Decision should be upheld in all respects.

CONSUMER WATCHDOG'S APPELLANT'S REPLY BRIEF

I. THE COMMISSIONER'S CONSIDERATION OF AN INSURER GROUP'S INVESTMENT DATA IS CONSISTENT, AND DOES NOT CONFLICT, WITH SECTION 1861.05(A)

SFG's Brief has substantially narrowed the statutory-construction dispute. SFG now admits that the purpose of Insurance Code[1] section 1861.05(a)'s requirement that "the commissioner shall consider whether the rate mathematically reflects the insurance company's investment income" is to "adopt[] the 'total return' approach to ratemaking," which requires the Commissioner to offset insurance rates with investment income. (SFG Brief, p. 18; see also *id*., p. 26, quoting *20th Century*, *supra*, 8 Cal.4th at p. 290.) That is precisely Consumer Watchdog's position: The Commissioner must consider—and cannot ignore—investment income when determining rates.

The only remaining point of disagreement is *how* the Commissioner may consider this factor. SFG reads into this language an explicit and absolute requirement that the Commissioner must use SFG's individual investment data and cannot rely on any other data in "consider[ing]" investment income. As shown below, neither section 1861.05(a) nor its legislative purpose supports such an arbitrary restriction on the Commissioner's discretion. On the contrary, Proposition 103 "does not establish a detailed method of processing and deciding rate applications," and "[m]uch is necessarily left to the Commissioner, who has broad discretion to adopt rules and regulations as necessary to promote the public welfare." (*Calfarm*, *supra*, 48 Cal.3d at p. 824.)

[1] Unless otherwise specified, all statutory citations are to the Insurance Code and all citations to the regulations are to Title 10 of the California Code of Regulations. Subdivision (a) of section 1861.05, the focus of this appeal, is cited as "section 1861.05(a)."

A. There Is No Dispute That the Commissioner Considered SFG's Investment Income in Determining Its Rates

SFG devotes much of its brief to a straw man argument: that SFG, and not the State Farm Group,[2] is "the insurance company" in section 1861.05(a). (SFG Brief, pp. 49-55.) This argument proves nothing because, as Consumer Watchdog demonstrated (CW Opening Brief, pp. 27-31), the record is unequivocal: The Commissioner *did* consider SFG's investment income in determining the rate, devoting eight pages of the Decision to explaining how he applied the regulatory formula to calculate this factor (Decision, AR 5119-5126).

Just as the Commissioner, following the regulations, calculated the indemnity payments, adjustment expenses, overhead costs, and profit allowance for SFG, he also considered how much investment income should be recognized in SFG's rates. That the Commissioner did so on a group basis—considering the investment data of *both* SFG and the other wholly owned and controlled affiliates that are part of the State Farm Group—does not negate the fact that SFG's investment income was considered.

Such reliance on group data was expressly approved of in *20th Century*, which ruled that the method of calculating rates "may implicate formulaic ratemaking … using data reflecting the condition and performance of a *group* of regulated firms" and that "[i]t is permissible for an agency to use *average costs* rather than the costs of individual regulated firms." (8 Cal.4th at p. 293, italics added.)

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[2] As more fully discussed in Consumer Watchdog's Opening Brief, SFG is part of a group of nine insurance companies known as the State Farm Group; this insurer group is wholly owned and controlled by State Farm Mutual Automobile Insurance Company (State Farm Mutual). (CW Opening Brief, p. 9.)

Consistent with *20th Century*'s authorization of formulaic ratemaking, the Commissioner's regulatory formula comprises a combination of company-specific numbers, averages across insurance companies, and normative regulatory standards. For example, the ratemaking formula takes the insurance company's own numbers for losses (indemnity payments on policies), which are then developed, trended, and otherwise actuarially adjusted using both company and industry data. (See Cal. Code Regs., tit. 10, §§ (Reg.) 2644.4-2644.7, 2644.23.) Most non-indemnity expenses, on the other hand, are imputed to the insurer (i.e., they are not company-specific data) using an "efficiency standard," which calculates the industry-average expense ratio by line; the company's own expenses are not considered (except as they are part of the industry-wide data), and certain expenses are excluded. (Regs. 2644.10, 2644.12; see also Reg. 2644.14 [commissions and premium taxes treated separately].) And profits and investment income are calculated based on an imputed rate of return, imputed measures of surplus and reserves, statutory tax rates, and an imputed investment yield. (Regs. 2644.15-2644.22.)

B. Nothing in the Text of Section 1861.05(a) Prohibits the Commissioner from Considering Group Investment Data

SFG insists that section 1861.05(a)'s use of the term "insurance company" in the singular requires a specific calculation of SFG's investment income based entirely on SFG's investment portfolio and nothing else. That is a lot of weight to place on the singular use of "insurance company." (SFG Brief, p. 39.)

First, SFG misses the point when it attempts to distinguish the numerous other sections of the Insurance Code that define that term to include insurer affiliates and insurer groups. (SFG Brief, pp. 49-55.) Those statutory definitions demonstrate that there exists no universal definition of the term "insurance company" that would allow, much less require, a court to reject the Commissioner's consideration of an insurer group's investment data. In fact, the purpose of section 13, which provides that "the singular number means the plural, and the plural the singular," is precisely to preclude the types of inferences SFG attempts to draw from the singular use of a statutory term.

More to the point, SFG refuses to acknowledge the distinction between the investment income of "the insurance company" that must be considered under section 1861.05(a) and the information the Commissioner may take into account when considering whether the final rate mathematically reflects "the insurance company's investment income." The former is the output, which the Commissioner calculated specifically for SFG, not for the State Farm Group or anyone else. The latter is the set of inputs he used to mathematically reflect SFG's investment income. SFG can point to nothing in the statute that limits these inputs to only the data from SFG's books.

Indeed, SFG's position before the Court doesn't even comply with its own made-up rule that investment income must be calculated based only on SFG data. There are lines on SFG's individual annual statement for "Net investment income earned" and "Net investment gain," which reflect the insurance company's investment income for the prior year. (AR 7078.) SFG does not call for either of those figures to be used, and is instead perfectly content with the Commissioner's use of other inputs in the calculation of investment income—most of which are not based on company-specific data. For example, the inputs for yields used in the formula are not the yields SFG actually earned on its investments. They are imputed yields, not SFG-specific yields, that the Commissioner determined generally represent the expected yields for each asset class. (Reg. 2644.20(c).) Not only will each insurer's returns fluctuate from year to year, some will systematically vary from the result of the regulation's calculation—whether by under- or overperformance of investment managers, more conservative investment policy, or other idiosyncratic reasons. All of which is to say that SFG cannot pick and choose which aspects of the ratemaking formula it likes. The Commissioner's methodology for calculating rates is "not subject to piecemeal examination: The economic judgments required in rate proceedings are often hopelessly complex and do not admit of a single correct result." (*20th Century*, *supra*, 8 Cal.4th at p. 293.)

SFG's interpretation would also read out of the statute the "consider whether" language, transforming section 1861.05(a) into a requirement that, as SFG reads it, "the rate *must* mathematically reflect [SFG's] investment income." (SFG Brief, p. 44, italics added.) But as Consumer Watchdog demonstrated (CW Opening Brief, pp. 27-28), the "consider whether" language makes clear that the statute simply requires the Commissioner to take into account investment income and not ignore it. Other than that, section 1861.05(a) leaves to the Commissioner's discretion how to specifically take that factor into account.

This is entirely consistent with SFG's cited case, *Plantier v. Ramona Municipal Water District* (2019) 7 Cal.5th 372, which ruled that a requirement to "consider all protests" before increasing a proposed fee meant that the agency must "take all protests into account when deciding whether to approve the proposed fee." (*Id*. at pp. 385-386.) The Court in *Plantier* did not then go on to find, as SFG asks this Court to do, that such a general requirement to "consider" something also mandates exactly *how* the agency must take that factor into account.

SFG also misreads the phrase "mathematically reflects" to require that the rate must mathematically *equal* the insurance company's investment income. (SFG Brief, pp. 57-59.) Again, that is not what the statute says. Instead, in proper context, this phrase simply confirms that the purpose of section 1861.05(a)'s second sentence is to mandate total return ratemaking. Effective consideration of the insurer's investment income necessarily requires a mathematical exercise. A commissioner ought not to be allowed simply to say without evidence, "Yeah, I considered the company's investment income, and I'm satisfied that this rate takes investment income into account." The regulator must show his or her work in a mathematical exercise, such as a regulatory formula, as the Commissioner adopted and applied here. But the Commissioner's discretion to promulgate a regulation specifying the mathematical calculations is no more bounded by section 1861.05(a) than the Commissioner's discretion in selecting any of the other variables in the ratemaking formula.

Nothing in the phrase "mathematically reflects" supports SFG's claim that exact precision is required (SFG Brief, pp. 57-58).[3] As Consumer Watchdog demonstrated (CW Opening Brief, p. 29), *20th Century* recognized that section 1861.05(a) did not require an exact matching with an insurer's actual investment income, finding it within the Commissioner's discretion to determine what to include and what not to include in calculating the investment income variable. (8 Cal.4th at pp. 290-291 [recognizing that the regulations excluded from an insurer's investment income and profit calculations capital "not used and useful" to support insurance].) SFG has no response. Nor does SFG explain how it can square a purported requirement that rates "'exactly' or 'precisely' 'mirror' its 'investment income'" (SFG Brief, p. 58) with its acceptance of the

[3] SFG relies on a dictionary definition of "mathematical" as "rigorously exact; precise, certain" (SFG Brief, pp. 57-58, quoting Webster's 3d New Internat. Dict. (11th ed. 2019), but Webster's also defines that term to mean "of, relating to, or according with mathematics." (*Mathematical*, Merriam-Webster Online Dict.)

Commissioner's use of other data for investment income that do not come from SFG's books.

SFG's failure to acknowledge the Commissioner's discretion under *20th Century* is made more glaring by its claim that combining two passages from that case appearing 47 pages apart somehow shows that the Court has "confirmed" SFG's preferred construction of section 1861.05(a). (SFG Brief, pp. 43-44, quoting *20th Century, supra*, 8 Cal.4th at pp. 243, 290.) *20th Century*'s simple acknowledgment that section 1861.05(a) requires the Commissioner to "consider[] the 'investment income' of the individual insurer" (8 Cal.4th at p. 243) can hardly be read as confirmation of SFG's construction. Nowhere in *20th Century* does the Court opine on the question of whether the Commissioner must use individual or group data in considering investment income.

C. SFG Concedes That the Purpose of the Disputed Language Was to Resolve an Ongoing National Policy Debate by Requiring that Proposition 103 Implement Total Return Ratemaking

The wider historical circumstances of Proposition 103's adoption further support reading the disputed language of section 1861.05(a) as simply requiring the Commissioner to *take into account* investment income in determining whether rates are excessive. As Consumer Watchdog explained (CW Opening Brief, pp. 35-36), two contemporaneous official reports issued by the National Association of Insurance Commissioners (NAIC) and the National Insurance Consumer Organization (NICO) recounted the national debate at the time over whether investment income should be taken into account *at all* when states regulate insurance rates. (See CW Motion for Judicial Notice (MJN), Exhs. A & B.)

For instance, the NAIC report studied the question of *whether* "investment income can be given *explicit consideration* in property/casualty ratemaking" (Exh. A, p. 4, italics added), ultimately answering the question in the affirmative, using language plainly foreshadowing the words of section 1861.05(a): that "today's insurance environment requires *consideration* of investment income," and that "any methodology for *reflecting* investment income in the ratemaking/review process should be flexible in its application" (*id.*, p. 2, italics added). But the NAIC report acknowledges that there were many ways to implement this recommendation, offering several examples of such methodologies, and proffering as its "Model A" a "*mathematical formula* which can be used to determine the needed margin from underwriting," in which "total return of the insurance enterprise is *considered*." (*Id.*, p. 38, italics added.)

SFG objects to the Court taking judicial notice of these documents,[4] but then quickly pivots to a quest for language in the reports that might help

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[4] State Farm's sole objection to Consumer Watchdog's Request for Judicial Notice is that the two official documents "are not relevant to the interpretation of the initiative" because they were not in the voter pamphlet. (State Farm General Insurance Company's Opposition to Consumer Watchdog's Motion For Judicial Notice (SFG Opp. to CW MJN), pp. 3-4.) That is simply not the law. "'The legislative history of a statute, *as well as the wider historical circumstances of its enactment*, may be considered in ascertaining legislative intent.'" (*Spanish Speaking Citizens' Foundation, Inc. v. Low* (2000) 85 Cal.App.4th 1179, 1214 [construing Proposition 103], quoting *Watts v. Crawford* (1995) 10 Cal.4th 743, 753, italics added.) In *Spanish Speaking*, the court took judicial notice of a wide range of materials to construe section 1861.02 of Proposition 103, none of which were contained in the ballot pamphlet. (See 85 Cal.App.4th at p. 1217.)

SFG's argument to the contrary is premised on an obvious logical error. Its putative authority is *20th Century*, citing 8 Cal.4th at pp 269-270, fn. 8, where the Supreme Court denied judicial notice of "'flyers' purportedly distributed to voters during the Proposition 103 campaign." That scarcely amounts to a holding that *nothing* other than the contents of the voter pamphlet—such as government documents and other historical materials—is relevant to construction of an initiative. Nor is SFG's claimed rule supported by its string-citation of cases holding that materials in the voter pamphlet *are* judicially noticeable. (See SFG Opp. to CW MJN, p. 3.)

its case. (SFG Brief, pp. 61-63.) In the course of addressing the reports, however, SFG concedes the central issue: that the purpose of the statutory language at issue in this case is precisely what Consumer Watchdog has said, to commit California law to the recognition of investment income as an offset to premiums. SFG specifically recognizes that the reports counsel a "'total return' method of calculating rates" and "repeatedly explain how rates charged by an insurer must take into account that insurer's investment income." (See SFG Brief, p. 62.) As SFG explains it, the principal argument in the NAIC and NICO reports is that investment income should be taken into account because it "is a significant part of insurance operations" and is "an 'important consideration in the offering and pricing of insurance.'" (*Ibid*., quoting CW MJN, Exh. A.)

Indeed, throughout its Brief, SFG consistently argues that the disputed language in section 1861.05(a) "adopts the 'total return' approach to ratemaking, which assesses the total premium that the applicant needs to run the business, and offsets that amount by the applicant's investment income to arrive at the amount of premium the applicant may charge in its policies." (SFG Brief, p. 18.) And, further, "[t]his provision adopts the 'total return' approach to ratemaking: The Commissioner assesses the premium the insurer needs to run its business and offsets that amount by the insurer's investment income." (*Id*., p. 26.)

That is the purpose of the disputed language of section 1861.05(a): to require that, as Consumer Watchdog has explained, the Commissioner

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Cases finding one source of legislative intent judicially noticeable logically do not stand for the proposition that no other source is noticeable. Initiatives, like other legislation, often use technical or scientific terms that have known meaning to those who work in the field but may not be familiar to voters. The absence of a glossary in the voter pamphlet does not prevent a court construing the initiative from consulting those established definitions.

take into account investment income. But the voters stopped there and chose not to prescribe exactly how investment income should be taken into account—that was left to the Commissioner. (See CW Opening Brief, pp. 26, 34-37.) Both reports emphasize that there are multiple ways to recognize investment income in rates and eschew any intent to prescribe how the mathematical exercise should be performed.[5]

SFG goes on to misread the reports, arguing that because they offer examples of how one might calculate the investment income of a standalone company, they must be read to preclude an investment income calculation taking into account the returns of an affiliated group of insurance companies' pooled investments. (SFG Brief, p. 63.) Neither report says or implies anything of the sort. They present *examples* of ways an insurance commissioner might go about calculating investment income. The reports do not address or discuss the issue of corporate structure. For sound pedagogical reasons, the examples they set forth are simple and avoid the myriad complexities that might be presented, say, by the pooled investments of the largest property-casualty insurance group in the United States. Just as a judicial decision "does not stand for a proposition not

[5] Illustrative of the point is one of the examples offered in the NAIC report, "Model A," which it describes as "a mathematical formula which can be used to determine the needed margin from underwriting for any line of insurance. The total return of the insurance enterprise is considered. [¶] The rate of investment return used in the model can be the actual rate expected to be earned on the total portfolio of the industry or it can be the currently available rate, either risk-free or otherwise. Once a rate of return from investments has been determined, it is applied both to equity and the anticipated cash flow from underwriting." (CW MJN, Exh. A, p. 38.)

The language makes clear that this is but one way investment income may be considered in ratemaking and, in fact, offers alternatives within the example itself. Plainly, the NAIC report was not prescribing how investment income should be recognized in a company's rates but rather was emphasizing the broad range of permissible approaches.

considered by the court" (e.g., *Wishnev v. The Northwestern Mutual Life Ins. Co.* (2019) 8 Cal.5th 199, 217), a technical report does not stand for a principle the report does not address.

D. The Commissioner's Construction of Section 1861.05(a) Is Consistent with, and in Furtherance of, the Purposes of Proposition 103

SFG argues that its interpretation is the only one that furthers the purposes of Proposition 103. (SFG Brief, pp. 45-48.) To hear SFG tell it, the whole point of Proposition 103 was to protect the "'insurer's legitimate interest in financial integrity'" (SFG Brief, p. 45, quoting *20th Century*), which SFG argues is undermined here because the Commissioner's consideration of group investment data would result in lower rates for some insurance companies (namely, SFG), discourage insurers from entering the market, and reduce the availability of insurance in California (*id.* at pp. 45-47).

SFG has it exactly backwards. The voters adopted Proposition 103—titled the "Insurance Rate Reduction and Reform Act" (*Amwest Surety Ins. Co. v. Wilson* (1995) 11 Cal.4th 1243, 1247)—not for the benefit of insurance companies, but to protect consumers from "[e]normous increases in the cost of insurance [that] have made it both unaffordable and unavailable to millions of Californians." (JA 2906, Prop. 103, § 1 [Findings and Declaration].) The voter-sponsored initiative was intended to replace the "existing laws [that] inadequately protect[ed] consumers and allow[ed] insurance companies to charge excessive, unjustified and arbitrary rates." (*Ibid.*)

For more than a decade, the Commissioner has determined that these purposes are best furthered by the use of groupwide asset allocations when calculating investment income for insurance companies that are part of an insurance group subject to common ownership and control. In amending

Regulation 2644.20 in 2007 to require the use of group data for such insurer groups, the Commissioner made explicit findings that this "more modern and comprehensive approach" was "necessary and required" in order to "insure accuracy and consistency in ratemaking." (SFG Motion for Judicial Notice, Exh. G, p. 327 [Final Statement of Reasons, Rulemaking File for Reg. 2644.20, File No. RH05042749].)

The Commissioner's Decision explains that the use of group investment data is consistent with "a statutory scheme regulating rates within an industry composed in large part of national, group insurers" (Decision, AR 5124), which are required to manage their investment risk at the group level, not individually by each member of the group (*id.*, AR 5130-5131).

There is no larger an insurance group in the nation than the State Farm Group (*id*., AR 5093), and it manages the investments of each member company, including SFG, on a groupwide basis applying a groupwide investment strategy (*id*., AR 5095-5096, 5130-5131). As the Decision explicitly found, this arrangement provides the State Farm companies significant financial advantages, including higher returns and greater financial strength. (*Id*., AR 5095-5096.) The regulation's requirement to use group data, faithfully applied in the Decision, therefore reflects this economic and financial reality in furtherance of the purpose of Proposition 103.

Consumer Watchdog also demonstrated that the Commissioner's use of group data for insurer groups was necessary to avoid rate manipulation. (CW Opening Brief, pp. 38-39.) This case and the arguments raised by SFG here illustrate the danger well. The company is attempting to use its current corporate structure to justify higher insurance rates. The thrust of SFG's argument, repeated throughout its Brief in various ways, is that its individual investment data must be used, which results in higher insurance rates, because it purportedly does not have direct and immediate access to the assets of its parent company and the other affiliates. (E.g., SFG Brief, pp. 14 [“no access to investment income”], 23 [“no right to access”], 32, 42, 44, 46, 80, 88.) But this supposed lack of access is an artifice. SFG does not dispute that it, and the other affiliates in the insurer group, are wholly owned and controlled by their parent company, State Farm Mutual, which can, with a little paperwork, always change the corporate structures of SFG and the affiliates, or require them to enter into agreements, to provide such access. (Decision, AR 5124).

Significantly, while SFG vigorously asserts its absolute right to use individual data in this case, which would allow substantially higher rates, SFG raises no similar concerns as to State Farm Mutual, which sells automobile insurance in California, because in State Farm Mutual’s case, the Commissioner’s use of group data results in higher automobile insurance rates. As the Decision found, applying group data to all companies within a group avoids such manipulation because it “treats members of a group the same in the aggregate” (Decision, AR 5125):

> SFG’s projected yield may be higher due to the inclusion of State Farm Mutual’s stock holdings in the calculation of its projected yield. But the same consolidated statement would lower the yield for State Farm Mutual’s automobile insurance line by including the lower yielding bonds of SFG in rates for State Farm Mutual’s auto insurance in California. (*Ibid*.)

What’s SFG’s response? To argue that there’s “nothing in the text or history of Proposition 103 even hinting that the purpose of section 1861.05(a) was to prevent ‘rate manipulation’ by insurance groups.” (SFG Brief, p. 60.) That is an absurd statement. As discussed, Proposition 103 was a consumer-protection statute that sought to establish an effective rate regulation program to protect consumers from “arbitrary insurance rates and practices.” (JA 2906, Prop. 103, §§ 1-2 [Findings &

Declaration, Purpose].) This express purpose, and the statute itself, naturally embody a legislative policy to preclude rate manipulation by insurance groups that would allow them to avoid effective regulation. SFG's statutory interpretation of Proposition 103 would open a hole in the strict regulatory system; far from abiding by the will of the People, SFG's construction would undermine it.

Equally absurd is SFG's assertion that the Commissioner's interpretation would undermine Proposition 103 by "disincentiv[ing] a prudent strategy tailored to current market volatility and California's catastrophic risk," i.e., an all bond portfolio (SFG Brief, p. 47). First, that is not what the Commissioner's use of group data does. It has no effect on how an insurance company decides to invest its assets and, to the contrary, treats all companies in an insurer group the same regardless of how they do so.

And second, SFG's underlying argument is premised on a myth: that because homeowners insurance is so risky, SFG must insulate itself from that risk with a super-conservative, low-yield investment portfolio, and is therefore entitled to a rate offset by a more modest calculation of its "investment income." In fact, other variables in the ratemaking formula already adequately ensure that SFG's rate fully reflects the insurance risk of the homeowners policies it writes. The leverage factor (the ratio of premiums to surplus) represents the measure of insurance risk in a particular line of insurance—the measure of how much surplus (capital) is necessary to support the insurance business and therefore entitled to a return. Under the regulations, different leverage factors are promulgated for each line of insurance, reflecting the differing insurance risk of each line. (Reg. 2644.17(a)&(b).) Higher-risk lines have a lower leverage factor—they should be less leveraged, with more surplus required to back up each dollar of premium.[6] An insurer claiming that its book of business in a given line is more risky than the industry average may moreover request a variance and a different leverage factor. (Reg. 2644.27(f)(2)(C)(3).) Furthermore, in lines of insurance prone to catastrophic losses, such as homeowners, the regulations have a built-in catastrophe adjustment, based on historical averages for such losses. (Regs. 2644.4, 2644.5.) And they provide for adjustment to reserves for lines of business subject to catastrophes. (Reg. 2644.21(c).)

At bottom, SFG's investment stratagem is not about any uncompensated risks of writing California homeowners insurance. It is simply a way for SFG to try to evade the Proposition 103 rate regulations by sheltering its proportionate share of the returns of the State Farm Group and thereby to charge excessive premiums.

II. REGULATION 2644.20'S REQUIREMENT THAT THE COMMISSIONER USE GROUP DATA IS ENTITLED TO SUBSTANTIAL DEFERENCE

As discussed, section 1861.05(a) does not decree *how* the Commissioner is supposed to "consider whether the rate mathematically reflects the insurance company's investment income," only that the Commissioner must do so. In carrying out that obligation, the Commissioner adopted Regulation 2644.20(a) to "fill up the details of the statutory scheme" (*Ford Dealers Assn. v. Dept. of Motor Vehicles* (1982) 32 Cal.3d 347, quotation marks omitted), reflecting the Commissioner's considered policy choices and reasoned judgment about how best to carry out his duties to enforce Proposition 103. Such determinations promulgated

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[6] None of this is merely the subjective opinion of the Commissioner. The leverage factors are set by calculating the average capitalization that insurers themselves maintain for each line of insurance. (Reg. 2644.17(b).) They literally represent the industry's consensus assessment of how risky each line of insurance is.

in an official regulation are entitled to substantial deference (*Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 13) and will not be disturbed by the courts unless "the agency has clearly overstepped its statutory authority" (*Ford Dealers Assn. v. Department of Motor Vehicles* (1982) 32 Cal.3d 347, 356).

In an attempt to avoid the strong deference owed this regulation, SFG argues that the regulation's requirements are unclear and internally inconsistent (SFG Brief, pp. 68-71), that it was neither contemporaneously adopted nor consistently maintained (*id*., pp. 71-75), and, alternatively, that even though the regulation "may make sense" in "some cases," SFG should be granted a special exemption from it (*id*. p. 80). These arguments are contrary to the law, the evidence in the record, and even SFG's own prior statements.

A. Regulation 2644.20 Unambiguously Requires the Commissioner to Calculate Projected Yield Based on Group Data in the Combined Statement

As the Commissioner's Decision found, Regulation 2644.20 is "not ambiguous" in requiring that the insurer group data contained in the consolidated statement be used to calculate the projected yield. (Decision, AR 5121.) SFG tries to undermine the regulation's requirements by reading into it "serious internal inconsistencies" that SFG asserts require the Court to disregard the regulation altogether and adopt SFG's contrary interpretation. (SFG Brief, pp. 68-71.) According to SFG (*id*., p. 68), the regulation's reference to "the insurer's actual portfolio" is irreconcilably in conflict with its requirement to use the group data in "the insurer's most recent consolidated statutory annual statement" (Reg. 2644.20(a)).

SFG's effort to create a conflict in the regulation violates the most basic principles of regulatory interpretation. As when a court interprets a statute, its primary task is "to ascertain the intent of the agency issuing the regulation." (*De La Torre v. California Horse Racing Bd.* (2017) 7 Cal.App.5th 1058, 1066.) This requires courts to "interpret the words of a regulation in context, harmonizing to the extent possible all provisions relating to the same subject matter" (*Environmental Charter High School v. Centinela Valley Union High School District* (2004) 122 Cal.App.4th 139, 149), and avoid "an interpretation which renders any language mere surplusage" (*De La Torre*, at p. 1066).

Unlike SFG's strained analysis, the Commissioner's interpretation of the regulation gives effect to all the provisions in the regulation and carries out its manifest intent. The regulation's requirement to use the group data in the insurer's consolidated statement is purposeful and unmistakable. The regulation twice references the consolidated statement by name, and then specifies—by page and line number—the exact data in the consolidated statement that are to be used in the calculation. (Reg. 2644.20(a).)

As the Decision explained, the term "insurer's actual portfolio" does not conflict with this requirement to use group data because the data in the consolidated statement represent SFG's "actual portfolio on a group basis." (Decision, AR 5122.) Indeed, SFG ignores the Commissioner's finding in the Decision that the "actual portfolio" language was simply intended to distinguish the current regulation from the prior version, which had defined the projected yield as an "imbedded yield" and did not attempt to calculate the insurer's portfolio at all. (*Id*., AR 5122, fn. 181; see also *id*., AR 5119, fn. 173 [quoting the prior version of the regulation, which provided that "'Projected yield' means the insurer's imbedded yield…."].) Thus, by referencing the "insurer's actual portfolio," and, in the very next sentence, providing a formula based on the data in the consolidated statement, Regulation 2644.20 was *defining* the insurer's actual portfolio as the group data in the consolidated statement.

Separately, SFG feigns confusion about the meaning of the regulation's reference to "the insurer's consolidated statutory annual statement." SFG asserts that the company "does not have a 'consolidated' annual statement for this purpose" and therefore "the word 'consolidated'" in the regulation cannot refer to SFG's "combined annual statement" that the Commissioner used in this case to calculate SFG's projected yield. (SFG Brief, pp. 68-70.) But the combined annual statement's instructions explicitly provide that the terms "consolidated" and "combined" are to be used interchangeably: "Whenever the word 'combined' appears in the blank [i.e., the NAIC form], it should be construed to mean consolidated or combined" (AR 7395). In fact, SFG previously acknowledged that the "'consolidated statutory annual statement' refers to the NAIC *combined* annual statement" (AR 3503, italics added), that Regulation "2644.20(a) uses a yield derived from the *combined* annual statement" (JA 2790, italics added), and that the "use of the '*combined* statutory annual statement' to calculate an applicant's projected yield might not be problematic" and "may make sense" in some instances (JA 2491-2492, italics added). And in prior rate applications, SFG understood full well what statement it was required to use when seeking a rate change, reporting on its applications that, even though SFG maintained that individual data is appropriate, the investment data SFG was using are "from State Farm's combined statutory annual statement." (CW Supplemental Motion for Judicial Notice, Exh. 1, pp. 29-31 [see footer].)[7]

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[7] Nor is there any merit to SFG's argument that its combined statement is not required by law. (SFG Brief, p. 68.) As SFG acknowledges, section 923 requires that insurers file their annual statements in compliance with NAIC instructions. (*Id*., p. 69.) Those NAIC instructions, in turn, require that an insurer "shall complete a combined annual statement and file it with the NAIC" if it meets the specified ownership and control conditions. (AR 7395.) Given that there is no dispute

B. Regulation 2644.20 Was Amended to Address Changes in the Insurance Industry and Has Been Consistently Maintained by the Commissioner

SFG next contends that Regulation 2644.20 is entitled to no deference because it "was not promulgated contemporaneously with Proposition 103" and differs from the prior version of the projected-yield regulation. (SFG Brief, pp. 71-73.) But whether a regulation was contemporaneous with the statute is just one of several considerations in determining the level of deference to apply; no case holds it is a prerequisite to deferring to the expert agency's construction.

While SFG itself prefers the old regulation (SFG Brief, pp. 71-72), the Commissioner—the official charged with regulating insurance companies and enforcing Proposition 103—made the determination over a decade ago in 2007 that amendment was necessary "in light of changed circumstances and to conform to decisions of the Commissioner in reviewing company-specific rate applications." (AR 1396 [Initial Statement of Reasons, Rulemaking File for Reg. 2644.20, File No. RH05042749].) As the Commissioner explained at the time, the prior version of the regulation relied only on "a specific yield without the benefit of a weighted average," which he found "is apt to produce anomalous results." (SFG Motion for Judicial Notice, Exh. G, p. 327 [Final Statement of Reasons, Rulemaking File for Reg. 2644.20, File No. RH05042749].) The Commissioner thus amended Regulation 2644.20 to provide for such a weighted average in order to "provide[] a much more detailed measure of projected yield" (AR 1391) and "a more accurate forecast of future investment earnings" (AR 1397).

SFG satisfies those conditions (AR 5252, ¶ 28), it is required by law to file a combined annual statement (§§ 900, 923, 931).

As the Decision explained, with the consolidation of insurance companies and the prevalence of nationwide group insurers—including the State Farm Group, the largest homeowners insurance company in the U.S. (Decision, AR 5093)—the trend in insurance regulation "has been to regulate insurers operating in a group on a group basis" (*id*., AR 5094). Regulation 2644.20's consideration of group investment data is thus "part of a statutory scheme regulating rates within an industry composed in large part of national, group insurers" (*id.*, AR 5124) and is "consistent with how other parts of the Regulation use group data," such as applying aggregated industry-wide data "to determine the leverage factor and other factors used to determine investment income" (*id.*, AR 5122).

Deference is further warranted because, as Consumer Watchdog demonstrated, the Commissioner has consistently maintained this interpretation for the last 13 years since the regulation's amendment in 2007. (CW Opening Brief, p. 44.) SFG does not dispute that it previously admitted that the Commissioner has interpreted section 1861.05(a) and Regulation 2644.20 in this manner for "many years," leading to what SFG described as a "perennial disagreement" between the Commissioner and SFG. (JA 3294.) Instead, SFG asserts that the interpretation is not "consistently maintained" because the Commissioner does not use the data in a combined statement for *individual* insurance companies that are not part of any insurer group, which SFG vaguely alleges "raises serious fairness and equal protection concerns." (SFG Brief, pp. 74-75.) But, as SFG itself acknowledges, these truly standalone insurance companies "are not carried on any combined statement" (SFG Brief, p. 74, fn. 29), and therefore, there exists no combined statement to be used for them. These are not "similarly situated entities" that SFG claims them to be (*id*., p. 75, fn. 30), and SFG's observation that the Commissioner doesn't use a non-existent combined statement for them has no bearing on whether the regulation requires the Commissioner to use SFG's combined statement here.

C. Regulation 2644.20 Validly Applies to All Insurer Groups, and There Are No Grounds to Exempt SFG

After leveling these substantive and procedural attacks on the regulation, SFG then reverses course and argues that the regulation's use of group data is actually perfectly fine and, indeed, "may make sense" in "some cases"—just not for SFG. (SFG Brief, p. 80.) In SFG's judgment, relying on group data in the consolidated statement is permissible where insurer groups have decided to enter into "pooling arrangements" allowing assets to be shared with one another, but illegal without such pooling agreements. (SFG Brief, pp. 80-81.) Thus, SFG admits that using group data doesn't conflict with section 1861.05(a). It just wants this Court to rewrite the regulation to draw the line for using group data at whether an insurer group has a pooling agreement—a new rule that would conveniently allow SFG to be exempted from the regulation's requirement.

But the Commissioner has already drawn that line: Regulation 2644.20 requires the use of group data whenever an insurer group satisfies the ownership and control thresholds set forth by the NAIC (Decision, AR 5096). As the Decision recognized, the ownership-and-control dividing line properly reflects the financial realities that such insurer groups have, at all times, the ability to "transfer assets between affiliates," which State Farm Group did when it reconfigured SFG in 1998 and can do still do today as a wholly owned and controlled insurer group. (*Id.*, AR 5124.) On the other hand, the pooling-agreement test offered by SFG would be arbitrary and formalistic because, as the Decision notes, a wholly owned and controlled insurer group, like the State Farm Group, could, at any time, choose to enter into such agreements. (*Id.*, AR 5124.) That it has, for the moment, not done so does not preclude it from doing so in the future, does not impair its ability to transfer assets between affiliates because of its ownership and control, and does not invalidate or require modification of Regulation 2644.20's requirements.

This is not a matter of the Court choosing between alternative interpretations of a law offered by two private parties in a civil dispute. It is the Commissioner—not SFG—who is charged with enforcing Proposition 103 and who has "an intimate knowledge of the problems dealt with in the statute and the various administrative consequences arising from particular interpretations." (*Spanish Speaking Citizens' Found., Inc. v. Low* (2000) 85 Cal.App.4th 1179, 1215.) The Commissioner's construction, embodied in Regulation 2644.20, consistently maintained, and applied to all insurer groups, is entitled to strong deference and should be affirmed.

III. THE COMMISSIONER'S CONSIDERATION OF GROUP DATA IN RATEMAKING DOES NOT RAISE ANY CONSTITUTIONAL ISSUES

A. There Is No Commerce Clause Violation, Because the Commissioner Is Regulating Insurance Rates in California and Not Requiring or Prohibiting Any Out-of-State Conduct

SFG devotes pages and pages to arguing that the Commissioner's use of group data to calculate the insurer's rate violates the Commerce Clause, but it cites not a single case that ever invalidated an insurance law or regulation on that ground. (SFG Brief, pp. 83-102.) SFG's failure is not surprising given that "Congress explicitly removed all Commerce Clause limitations on the Authority of the States to *regulate and tax the business of insurance* when it passed the McCarran-Ferguson Act" in 1945. (*Western & Southern Life Ins. Co v. State Bd. of Equalization of California* (1981) 451 U.S. 648, 653, italics added; see 15 U.S.C. §§ 1011-1015.) That Act declared that the "business of insurance,… shall be subject" to state laws relating to the "regulation … of such business" (15 U.S.C. § 1012(a)), thereby "free[ing] state insurance regulation from the negative force of the dormant commerce clause, which normally invalidates state laws that materially burden interstate commerce" (*Lac D'Amiante du Quebec, Ltee v. American Home Assur. Co.* (3d Cir. 1988) 864 F.2d 1033, 1039).

Ignoring this broad exclusion for insurance regulation, SFG nevertheless persists by relying on non-insurance case law that has no applicability here. But even those cases show how far afield SFG's argument is. They establish that the foundation of any Commerce Clause violation is a law, regulation, or other state action that impermissibly *requires* or *prohibits* some sort of activity in another state, which is not present here.

In *Healy v. Beer Institute, Inc.* (1989) 491 U.S. 324, for instance, the U.S. Supreme Court struck down a Connecticut beer-pricing statute that *required* out-of-state brewers to affirm that their Connecticut prices for the next month would be no higher than the lowest price charged in any bordering state. This requirement, the Court held, effectively *prohibited* brewers from being able to offer competitive pricing and discounts in neighboring states, resulting in an unconstitutional extraterritorial effect of controlling pricing outside of the state. (*Id*. at pp. 337-339; see also *Brown-Forman Distribution Corp. v. N.Y. State Liquor Authority* (1986) 476 U.S. 573, 583 [statue that prohibited distillers from lowering liquor prices in other states without regulatory approval from New York directly regulated interstate commerce and violated Commerce Cause].)

Same thing in *Edgar v. Mite* (1982) 457 U.S. 624, where an Illinois law affirmatively *prohibited* any interstate tender offer on an Illinois company unless the offeror notified the Illinois Secretary of State and the target company 20 business days before the effective date of the offer. During this waiting period, the target company could communicate with its shareholders, but the offeror was prohibited from doing so, regardless of whether the shareholders resided in Illinois. This prohibition was struck down as a "direct restraint on interstate commerce," because it regulated interstate transactions not only with Illinois shareholders, but those taking place with shareholders "wholly outside of the State's borders." (*Id.* at pp. 642-643.)

Even were these non-insurance cases to apply to California's regulation of the insurance industry, Regulation 2644.20 and the Commissioner's consideration of group data to calculate an insurer's rate do not require, prohibit, or otherwise regulate any wholly out-of-state conduct. SFG repeatedly asserts that it is being forced to change its corporate structure and being required to enter into pooling agreements that allow assets to be shared among affiliates. (E.g., SFG Brief, pp. 91-92, 98.) That's false. Under the regulation, the Commissioner considers group data whenever an insurance company is part of an owned and controlled insurer group. This treats such insurers the *same* regardless of their corporate structure. In other words, group data will be considered for such insurance companies whether or not the insurer group has pooling agreements. And to put it yet another way, SFG can enter into pooling agreements or not. The Commissioner's regulation does not care. The Commissioner's Decision could not have been more clear: "Whether Applicant has a pooling agreement, reinsurance contracts, or shared service agreements between its affiliates is *Applicant's choice*." (Decision, AR 5124, italics added.)

SFG's complaint appears to be that it is not getting a benefit it *thinks it deserves* under its current corporate structure. Because the State Farm Group has opted not to enter into such pooling agreements, SFG contends that it and the other affiliates should be entitled to have their projected yield calculated based on individual company data only. SFG's inability to escape a lawfully adopted and consistently applied regulation, however, does not impose a requirement or prohibition on any out-of-state conduct.

The possibility that SFG may decide to enter into pooling agreements if its challenge to the regulation fails does not mean the Commissioner is requiring or prohibiting any conduct. SFG's own cases explain that any such incidental impact on SFG's out-of-state behavior is constitutionally permissible, and even expected. (*Edgar*, *supra*, 457 U.S. at p. 640 [no Commerce Clause violation "'unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits'"]; *Minn. Rate Cases* (1913) 230 U.S. 352, 410 ["In the intimacy of commercial relations, much that is done in the superintendence of local matters may have an indirect bearing upon interstate commerce."].)[8]

The fact of the matter is that the only actual requirement of the regulation, and the Commissioner's application of it, is that the insurance company's group data must be used to calculate SFG's rates applicable in California, which regulates no aspect of anyone's out-of-state activity.

B. There Is No Due Process Violation, Because the Commissioner's Use of Group Data Is Reasonable and Does Not Penalize Any Out-of-State Conduct

SFG next claims that the Commissioner's consideration of out-of-state affiliates' investment data violates the Due Process Clause by "effectively penaliz[ing] SFG" for income "beyond the state's regulatory jurisdiction." (SFG Brief, pp. 92, 96.)

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[8] Nor does the Commissioner's use of group data to calculate SFG's rate interfere with the company's "internal affairs" or its "corporate existence." (SFG Brief, pp. 84-91.) As SFG recognizes, those doctrines are designed to prevent two states from imposing conflicting requirements on an insurer's internal operations and corporate structure, such as if a "'consolidation or reorganization were to be held valid in one state and invalid in another.'" (*Id*., p. 86, quoting *SF Mutual*, *supra*, 114 Cal.App.4th at p. 443.) As discussed, the Commissioner's use of group data to calculate SFG's California rates imposes no such requirements. SFG remains free to maintain its existing structure or, if it so chooses, to reconfigure itself or to enter into pooling or other agreements with its affiliates.

First, that is not the proper test for a due process violation. The "standard for determining whether a state price-control regulation is constitutional under the Due Process Clause is well established: Price control is unconstitutional … if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt." (*20th Century*, *supra*, 8 Cal.4th at p. 291, quotation marks omitted; see also *id*. at p. 318 ["The same analysis is called for when a rate order itself is challenged as violative of the due process clause."].) As discussed (*ante*, pp. 21-25; CW Opening Brief, pp. 37-41), the regulation and the Commissioner's consideration of group data are reasonable and rationally related to Proposition 103's prohibition against excessive, inadequate, or discriminatory insurance rates. (See also Decision, AR 5122-5125.) SFG does not even attempt to make a contrary showing. (*20th Century*, at p. 292 ["The burden of proving otherwise rests on the party asserting the violation…. It is not easily met."], quotation marks and citation omitted.)

Second, SFG's cited cases again have nothing to do with insurance rate regulation. *BMW of North America v. Gore* (1996) 517 U.S. 558 was a punitive damages case against an automobile company. *Smyth v. Ames* (1898) 169 U.S. 466, *disapproved by FPC v. Hope Natural Gas Co.* (1944) 320 U.S. 591 was a case from the 1800s about railroad rates. And *El Paso Electric Co. v. FERC* (5th Cir. 1982) 667 F.2d 462 was a case about the rates of an electric company, and it did not involve any analysis of due process. In fact, that case explained that the principle set forth in *Smyth* placed no constitutional limitation on a state's consideration of out-of-jurisdiction conduct when regulating electric rates. Rather, *Smyth* sought to prevent "one class of customers from paying the costs attributable to another class," and did not require a regulator "to close its eyes to other aspects of a utility's operations" occurring in another jurisdiction. (*Id*. at pp. 468-469.) Nothing about these cases supports SFG's claim that due process prohibits the Commissioner from considering group investment data in regulating California insurance rates.

And even if SFG's unsupported formulation of due process were to be applied, SFG again cannot show that the Commissioner's use of group data would penalize SFG in any way, much less that it would penalize wholly out-of-state conduct. The Commissioner's methodology for calculating rates for a California affiliate of an insurer group that satisfies the ownership and control thresholds is the *same* regardless of whether or not the group has pooling or other agreements to share assets. No one is penalized for having such agreements. No one is penalized for not having them.[9]

IV. THE RATE ORDERED BY COMMISSIONER IS NOT CONFISCATORY

SFG argues that the Commissioner erred in denying SFG's request for the confiscation variance, also referred to as Variance 9. (SFG Brief, pp. 105-108.) The Commissioner's Decision found that SFG failed not only to apply the correct standard for the variance, but also to establish as a factual matter that the rate ordered by the Commissioner was unconstitutionally confiscatory. (Decision, AR 5139-5147.) The trial court declined to rule on this issue, but should the Court decide to reach it,

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[9] SFG also incorrectly argues that the Commissioner's use of group data would lead to "double-counting" of the insurer group's investment income if other states adopted a similar methodology. (SFG Brief, pp. 101.) SFG is confused. The Commissioner is neither using "the same investment income of the same affiliate" nor "offset[ing] rates with investment income earned by affiliates in other states." (*Ibid*.) The group data being used by the Commissioner are to calculate the "weights," i.e., the asset allocation of the insurer group, which is multiplied by the imputed yields to arrive at the projected yield. (Reg. 2644.20.) That projected yield is then applied to the imputed investable assets *of SFG only* (Reg. 2644.19, 2644.21-2644.22); the Commissioner does not use the total investable assets of the entire insurer group to calculate SFG's investment income. (See CW Opening Brief, pp. 14, 45.)

Consumer Watchdog joins in the Commissioner's arguments in defense of his Decision. To avoid duplication, Consumer Watchdog's response will focus on SFG's mischaracterizations of the applicable standard for confiscation.

By regulation, the confiscation variance requires the insurance company to establish:

> That the maximum permitted earned premium would be confiscatory as applied. This is the constitutionally mandated variance articulated in *20th Century v. Garamendi* (1994) 8 Cal.4th 216 which is an end result test applied to the enterprise as a whole. (Reg. 2644.27(f)(9).)

20th Century, in turn, held that confiscation "require[s] 'deep financial hardship' within the meaning of *Jersey Central*, i.e., the inability of the regulated firm to operate successfully." (8 Cal.4th at p. 297.) The Court repeatedly made clear that an insurance company "*may* complain of confiscation only if the rate in question does not allow it to operate successfully" and that "absent the sort of deep financial hardship described in [*Power Comm'n v. Hope Gas Co.* (1944) 320 U.S. 591] … there is no taking" and no confiscation. (8 Cal.4th at pp. 295-296, original italics.)

The scope and application of the confiscation variance is intended to be—and is—limited. As *20th Century* recognized in upholding the Commissioner's ratemaking regulations, "the rate making formula itself … is designed to yield a nonconfiscatory rate for the individual insurer even before any variance might come into play." (*Id.* at p. 313.) The confiscation variance is thus an additional safety valve that only comes into play in the unlikely event that the end result of the Commissioner's application of the comprehensive and carefully crafted regulatory formula would leave an insurance company unable to operate successfully such that the approved rate could be considered unconstitutionally confiscatory. "Judicial inquiry as to whether or not a rate is just and reasonable [and hence confiscatory] is necessarily difficult" and "is also limited." (*Id*. at p. 318.) It is a "standard that only the most egregiously confiscatory rate structure would have difficulty meeting." (*Id*. at p. 296, quoting Tribe, American Constitutional Law (2d ed. 1988).)

SFG nevertheless asks this Court to ignore the Supreme Court's holding in *20th Century* and to apply SFG's discredited "fair rate of return" standard, under which SFG asserts a rate would be confiscatory whenever it denies "a property owner a fair and reasonable return on its property." (SFG Brief, p. 105, quoting *California Building Industry Assn. v. City of San Jose* (2015) 61 Cal.4th 435, 464.) That is, SFG believes that insurance companies have a constitutional right that guarantees them a return "commensurate with returns on investment in other enterprises having corresponding risks." (SFG Brief, p. 106, quoting *Hope*, *supra*, 320 U.S. at p. 603.)

SFG's formulation of confiscation was expressly rejected in *20th Century*. The California Supreme Court could not have been clearer that confiscation "does *not* arise … whenever a rate simply does not 'produce[] a profit which an investor could reasonably expect to earn in other businesses within comparable investment risks and which is sufficient to attract capital.' Profit of that magnitude is, of course, an interest that the producer may pursue. But it is not a right that it can demand." (8 Cal.4th at pp. 297-298, original italics.) The Court went even further, explaining that a "regulated [firm] has no constitutional right to a profit…. [Citations.] Indeed, such a firm has no constitutional right even against a loss. [Citation.]" (*Id*. at p. 294, quotation marks and citations omitted.)

Recently, the court of appeal in *Mercury Casualty Co. v. Jones* (2017) 8 Cal.App.5th 561 applied these constitutional principles in rejecting a nearly identical argument made by Mercury Casualty and State Farm's trade association: "The Supreme Court explained in no uncertain terms in *20th Century* that the inability to operate successfully is a necessary … condition of confiscation, and the court soundly rejected the contrary assertion that a regulated business is constitutionally guarantee[d] a fair and reasonable return." (*Id*. at pp. 587-588, quotation marks and citation omitted.) Thus, *Mercury* held there was "no error in the application by the commissioner and the superior court of the 'deep financial hardship' standard to determine whether a price control is constitutionally confiscatory." (*Id*. at p. 589.) Neither the California nor the U.S. Supreme Court found it necessary to review the *Mercury* decision. (*Mercury*, 8 Cal.App.4th 561, review den. May 10, 2017, No. S240772, cert. den. Feb. 20, 2018, ___ U.S. ___ [138 S.Ct. 977].)

Hope and the rent-control cases SFG relies upon are not to the contrary. SFG selectively excerpts passages from those cases that refer to a fair rate of return or commensurate returns of other enterprises, but those are references to "the investor interest" and the "company point of view," which must be balanced against the consumer interests when determining whether a rate is confiscatory; they do not represent the standard for determining confiscation. (*Hope*, *supra*, 320 U.S. at p. 603.) *Kavanau v. Santa Monica Rent Control Board* (1999) 19 Cal.4th 952 applied this same constitutional balancing test between "the investor and the consumer interests" in the context of a rent-control ordinance, recognizing that "[o]ne of these investor interests is a 'return … commensurate with returns on investments in other enterprises having corresponding risks." (*Id*. at pp. 771-772.) *Kavanau* did not deviate from, and instead explicitly relied upon, the "operating successfully" standard of *20th Century*. (*Id*. at p. 778, quoting *20th Century*; see also *California Building*, *supra*, 24 Cal.4th at pp. 464-465 [relying on *Kavanau*'s constitutional analysis of rent-control price controls].) *Galland v. City of Clovis* (2001) 24 Cal.4th 1003 also made clear that the investors' interest in, and expectation of, a "fair rate of return" is part of the balancing test, but is not a constitutional guarantee:

> For those price-regulated investments that fall above the constitutional minimum, but are nonetheless disappointing to investor expectations, the solution is not constitutional litigation but, as with nonregulated investments, the liquidation of the investments and the transfer of capital to more lucrative enterprises. (*Id*. at p. 1026.)

SFG also relies on *Guaranty National Insurance Co. v. Gates* (9th Cir. 1990) 916 F.2d 508 as its sole case in the insurance context that purportedly applied a "fair rate of return" standard. (SFG Brief, p. 105.) But SFG's reading of that case was also expressly rejected in *20th Century*:

> In *Guaranty Nat. Ins. Co. v. Gates* (9th Cir. 1990) 916 F.2d 508, 515, there is language that may be read to erroneously state that the producer is constitutionally 'guarantee[d]' a '"fair and reasonable return[,]"' and that such a return must necessarily be above the 'break even' level. We will not indulge in such a reading. (8 Cal.4th at p. 294, fn. 18.)

SFG also complains that the Commissioner applied the confiscation standard to the enterprise as a whole, and not to SFG by itself. (SFG Brief, pp. 107-108.) But that is exactly what the confiscation variance requires— "an end result test applied to the enterprise as a whole." (Reg. 2644.27(f)(9); see also *Mercury*, *supra*, 8 Cal.App.5th at p. 583.)

Even accepting SFG's asserted 2.65 percent return—which it incorrectly calculates based on the SFG-only return "[i]gnoring the standard of *20th Century*" (Decision, AR 5145)—the company's projected after-tax profit would be about $27 million.[10] As the Decision found, such a

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[10] Calculated by multiplying a premium base of about $1.1 billion (AR 6601) and the "Total Profit after Tax % Premium" of 2.42% (AR 7490, Line (33)).

return does not establish the "inability to operate successfully" showing that is necessary to obtain the confiscation variance:

> While perhaps not generating the profit margin Applicant desires, Applicant fails to demonstrate that the rates ordered by the Commissioner will impair the enterprise as a whole's financial integrity, profitability, or overall ability to operate successfully. (Decision, AR 5146.)

Under *20th Century*, a profit of this magnitude cannot be considered confiscatory. (8 Cal.4th at p. 294 ["A regulated [firm] has no constitutional right to a profit" and "no constitutional right even against a loss."], citations omitted.)

V. THE COMMISSIONER CORRECTLY DETERMINED THAT PROPOSITION 103 AUTHORIZES HIM TO ORDER SFG TO PAY REFUNDS OF EXCESSIVE RATES

Key to Proposition 103's promise to "protect consumers from arbitrary insurance rates and practices" and "to ensure that insurance is fair, available, and affordable for all Californians" (JA 2906, Prop. 103, § 2 [Purpose]) is its prohibition against excessive, inadequate, or unfairly discriminatory rates remaining in effect. The "remain in effect" language in section 1861.05—unique in the nation—makes clear that the law's requirements apply not only to rates to be charged in the future, but also to the rates that are currently "in effect," thus creating a continuing obligation to maintain rates in effect that are neither excessive nor inadequate.

In his June 22, 2015 order calling for the hearing to determine SFG's homeowners rates, the Commissioner made an interim determination that put SFG on notice that SFG's rates then in effect "will be excessive by 6.6% commencing July 15, 2015," declaring that the insurer must reduce its rates or pay refunds "retroactive to July 15, 2015" to overcharged policyholders. (AR 106.)

SFG did not reduce its rates, and instead continued to overcharge its policyholders for nearly one-and-a-half years past July 15, 2015, until

December 8, 2016. Thus, in accordance with his order, the Commissioner required SFG not only to reduce its rates going forward, but also to refund over $100 million in overcharges that it had collected from its policyholders during that interval. (Decision, AR 5152; JA 2500 [SFG acknowledging that "the Commissioner ordered SFG to refund more than $100 million to policyholders"].) The California Supreme Court has confirmed the Commissioner's authority to do so, holding that Proposition 103 authorizes the Commissioner to order insurance companies to "refund excess premiums collected with interest." (*Calfarm*, *supra*, 48 Cal.3d at p. 825; see also *20th Century*, *supra*, 8 Cal.4th at p. 281.) SFG's legal challenges to the refund order should be rejected.

A. Section 1861.05(a)'s Prohibition That Excessive Rates Not "Remain in Effect" Authorizes the Commissioner to Order SFG to Pay Refunds

The plain language of Proposition 103 prohibits insurance companies from continuing to charge excessive rates. Section 1861.05(a) provides in relevant part:

> No rate shall be approved or *remain in effect* which is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter. (Italics added.)

The ongoing prohibition against excessive rates was part of the dramatic change in insurance rate regulation brought about by Proposition 103, which replaced wholesale the "existing laws [that] inadequately protect[ed] consumers and allow[ed] insurance companies to charge excessive, unjustified and arbitrary rates." (JA 2906, Prop. 103, § 1 Findings & Declaration].) By its terms, the "remain in effect" requirement is *in addition* to the approval requirement. In other words, it is not enough that a rate was approved at some time in the past. If that previously approved rate becomes excessive, inadequate, or unfairly discriminatory, Proposition 103 prohibits it from remaining in effect.

Calfarm addressed this very issue, finding that the "remain in effect" language of section 1861.05(a) authorized the Commissioner to order an insurer to pay refunds when the insurer had charged excessive premiums. (48 Cal.3d at p. 825.) In that case, insurance companies brought a facial challenge against Proposition 103, arguing that the law posed a threat to their solvency. In a unanimous decision upholding the law, the Supreme Court found that to protect an insurance company from a potentially confiscatory rate, the Commissioner had broad power under Proposition 103 to grant "interim relief" that would allow the insurance company to charge an "interim rate" pending final determination of the approved rate. (*Ibid*.) But, as part of this power, if that interim rate turned out to be higher than the rate ultimately approved by the Commissioner, "the insurer must refund excess premiums collected with interest." (*Ibid*.) The Court found that the Commissioner's power to grant such interim relief and later require refunds of excessive premiums "is necessary for the due and efficient administration of Proposition 103 and may fairly be implied from its command that '[n]o rate shall … *remain in effect* which is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter.'" (*Ibid*., quoting § 1861.05(a), original ellipses and italics.)

Five years later, *20th Century* reaffirmed the Commissioner's authority to order refunds of excess premiums charged by insurance companies. In unanimously upholding the Commissioner's rollback regulations, the Supreme Court held that the "ordering a refund of rates is 'akin to a reduction of rates,' when, as here, the rates in question were charged 'pending a determination of [their] legality.'" (8 Cal.4th at p. 281, citation omitted.)

The Commissioner exercised this same power here, ordering SFG to pay refunds of the excessive premiums it charged pending the ultimate determination of SFG's rates. The legality of SFG's then-in-effect rates was put at issue when SFG filed an application for a rate increase. Consumer Watchdog and another intervenor, Consumer Federation of California (CFC), filed petitions for hearing, arguing that under the regulatory formula, SFG's then-existing rates were excessive. (AR 127-138, 112-124.) After a preliminary, six-month investigation, the Commissioner issued an order on June 22, 2015, granting a hearing on SFG's requested rate increase. (AR 104-107.) In that order, the Commissioner notified SFG that "commencing July 15, 2015"—the effective date SFG itself selected in its rate application (AR 5148, 5150)—"Applicant's current homeowners rates will be excessive by 6.6%," in violation of section 1861.05(a). (AR 106.) The Commissioner further determined that pending the result of the hearing, "Applicant must reduce its rates by 6.6% or any other amount by which they are determined through this proceeding to be excessive," or else it "will owe refunds retroactive to July 15, 2015 to its homeowners policyholders who pay the excessive rates." (*Ibid*.)

SFG did not seek to reduce its rates on July 15, 2015. After an exhaustive year-long proceeding, the Commissioner's Decision determined that State Farm's existing rates were, in fact, excessive, mandated an overall rate decrease of 7.0% (Decision, AR 5126), and ordered refunds of the premium amounts charged in excess of that amount, plus interest, back to the July 15, 2015 effective date originally selected by SFG. This is the procedure contemplated by section 1861.05(a) and affirmed by *Calfarm* and *20th Century*.

Just as the "remain in effect" requirement was found by the Supreme Court to authorize the Commissioner to grant interim relief in furtherance of protecting insurance companies from inadequate rates, the same language authorizes refunds when consumers pay excessive rates. This is precisely the symmetry the voters applied, weighing, as the Supreme Court described it, "the insurer's legitimate interest in financial integrity and the insured's legitimate interest in freedom from exploitation." (*20th Century*, *supra*, 8 Cal.4th at p. 245.)

SFG itself admits that "the statute allowed [the Commissioner] to order refunds," but proposes that this refund authority only temporarily existed during the one-year transition period after the passage of Proposition 103, known as the rollback period, when rates were to be reduced by 20% of the insurance company's prior rates. (§ 1861.01, subd. (a).) According to State Farm, this refund authority automatically terminated once the prior-approval regime took effect after the one-year rollback period. (RB, p. 118.) That is incorrect. The Supreme Court found that Proposition 103 had granted the Commissioner authority to order refunds in section 1861.05(a), specifically relying on the "remain in effect" language at issue here. (*Calfarm*, *supra*, 48 Cal.3d at p. 825.) By their terms, section 1861.05(a) and its "remain in effect" requirement apply to *both* the rollback period and the permanent prior-approval regime. (*Id.* at pp. 822-823 ["the general standard for rate adjustment [is] set out in section 1861.05, subdivision (a)" and "the standards set by section 1861.05, subdivision (a), govern rate regulation during the first year of the initiative's operation"]; *20th Century*, *supra*, 8 Cal.4th at p. 244 [section 1861.05(a) is the "general standard applicable in all cases"].)

Thus, *Calfarm* recognized that the Commissioner could order insurance companies to pay refunds during both the rollback period and the prior-approval period, describing precisely how the Commissioner's power to grant such "interim relief" would work under both scenarios. First, the Court explained that during the rollback period (before the prior-approval requirement took effect), an insurance company that filed an application for a rate higher than the rollback rate "may immediately begin charging that higher rate pending approval from the commissioner." (48 Cal.3d at p. 825.) After the prior-approval requirement became effective, "the commissioner can approve an interim rate pending her final decision." (*Ibid*.) But the Court made clear that *in both cases*—under the one-year rollback period and during the permanent prior-approval regime that followed—if the rate actually charged by the insurer was higher than the rate ultimately approved by the Commissioner, "the insurer must refund excess premiums collected with interest." (*Ibid*.)

There is no basis to limit the Commissioner's refund authority to the rollback period only. The statute does not do so. The Supreme Court did not do so. And logic and common sense do not allow it. SFG fails to explain why the voters would prohibit excessive rates from remaining in effect, empower the Commissioner to make findings that the rates that have been in effect are excessive and illegal, but then leave the Commissioner powerless to do anything about them and the public to suffer unlawful charges with no recourse. That would make no sense and would be contrary to the plain text and explicit purpose of Proposition 103 to prohibit excessive rates from remaining in effect and to protect consumers from arbitrary insurance rates and practices.

B. Section 1861.05(a)'s Separate Prior-Approval Requirement Does Not Preclude Ordering Refunds When an Insurance Company Charges Excessive Rates

But, SFG protests, it was just charging the rate that was previously approved by the Commissioner. As SFG sees it, the Commissioner's approval of a rate—no matter how long ago and no matter how different the circumstances were—gives an insurance company free rein to continue to charge that rate indefinitely, even after the rate becomes excessive and even when the insurance company knows that the rate is excessive. Not correct. Section 1861.05(a) prohibits excessive rates both from being approved *and* from remaining in effect. Compliance with the first requirement does not establish compliance with the second.

Under SFG's interpretation, section 1861.05(a)'s requirements would be the same if the "remain in effect" language were entirely struck from the statute. This violates a cardinal rule of statutory construction and must be rejected. (*State Farm Mutual Auto. Ins. Co. v. Garamendi* (2004) 32 Cal.4th 1029, 1045 ["An interpretation that renders statutory language a nullity is obviously to be avoided."], quoting *Williams v. Superior Court* (1993) 5 Cal.4th 337, 357.)

SFG selectively cites passages from *20th Century* to support its argument negating the "remain in effect" language. (SFG Brief, pp. 109-110.) But those passages describe only the "prior approval" requirement of section 1861.05(a), and do not address the separate "remain in effect" requirement. Nothing in *20th Century* suggests that the Commissioner's approval of a rate somehow supersedes the prohibition against excessive rates remaining in effect. *20th Century* did not purport to invalidate the Commissioner's authority to grant interim relief to enforce the "remain in effect" requirement. And it certainly did not overrule *Calfarm*'s authorization of the Commissioner to allow interim rates but order refunds, if necessary. On the contrary, *20th Century* goes on to reaffirm *Calfarm*'s determination of how the "prior approval" requirement and the "remain in effect" requirement work together:

> After [November 8, 1989] insurance rates subject to Proposition 103 must be approved by the commissioner prior to their use, but … the commissioner can approve an interim rate pending [his or] her final decision. If the commissioner finds the initiative's rate, or some other rate less than the insurer charged, is fair and reasonable, the insurer must refund excess premiums with interest. (8 Cal.4th at p. 246, quoting *Calfarm*, *supra*, 48 Cal.3d at p. 825, quotation marks omitted, brackets added in *20th Century*.)

Walker v. Allstate Indemnity Co. (2000) 77 Cal.App.4th 750 and *MacKay v. Superior Court* (2010) 188 Cal.App.4th 1427, on which SFG relies, are inapposite. First, the two cases have nothing to do with the "remain in effect" prohibition. They rejected attempts by a class of insureds to bring a civil action in superior court challenging insurance rates and rating factors that had been approved by the Commissioner. As the Commissioner's Decision explained, those decisions concluded that "the Insurance Commissioner, not the courts, has exclusive jurisdiction over challenges to rates, i.e., that such challenges must first be brought before the agency." (AR 5151; *Walker*, at pp. 759-760; *MacKay*, at pp. 1448-1449.)

The out-of-context passages from those cases selectively quoted by SFG (SFG Brief, p. 111) relate to *Walker*'s and *MacKay*'s holdings that *a court* cannot entertain a civil suit under Business and Professions Code section 17200 for charging a rate that is in compliance with the law. (*Walker*, at p. 759 [when an insurance company charges an approved rate, "there is simply no violation of the law to support a Business and Profession Code section 17200 claim for disgorgement of premiums"]; *MacKay*, at pp. 1448-1449 ["the charging of an approved rate cannot be deemed 'illegal' or 'unfair' for purposes of the Unfair Business Practices Act or, indeed, tortious"], quoting *Walker*.)[11]

[11] *Walker* and *MacKay* are not only irrelevant to the case at hand, but substantively of questionable precedent. (See *Farmers Ins. Exchange v. Superior Court* (1992) 2 Cal.4th 377, 390-399 [rejecting the claim that the Commissioner has exclusive jurisdiction over UCL challenges to insurance rates after passage of Proposition 103]; *Donabedian v. Mercury Ins. Co.* (2004) 116 Cal.App.4th 968, 991 ["It would make little sense if Proposition 103—which subjects insurers to the UCL—were interpreted to preclude a civil action alleging a violation of that very Proposition."]; *Fogel v. Farmers Group, Inc*. (2008) 160 Cal.App.4th 1403, 1418 [rejecting the application of the "filed rate doctrine" as a bar to civil actions challenging approved insurance rates].)

These cases do not affect *the Commissioner's* authority to determine, as he did here, that a previously approved rate was now excessive and direct the insurer to either reduce its rate pending determination of its legality or pay refunds after the fact. By their own terms, the two cases focus on lawful rates; the footnote in *MacKay* explaining the requirement that an insurance company charge a rate approved by the Commissioner is premised on that approved rate having "the imprimatur of the" Department of Insurance and being "compliant with the law to the best of the [Department's] determination." (*MacKay*, at p. 1436, fn. 6.) The rate SFG continued to charge its policyholders in this case did not have any such imprimatur. On the contrary, the Commissioner made an initial determination that SFG's rate in effect was not compliant with the law: It was to be "excessive by 6.6% commencing July 15, 2015," in violation of section 1861.05(a)'s requirement that "excessive rates shall not remain in effect." (AR 105.)

SFG asks the Court to extend *Walker* and *MacKay* so that neither a court nor the Commissioner can hold an insurance company accountable when it overcharges consumers by hundreds of millions of dollars. The Court should decline that invitation.

The Commissioner's separate authority to hold noncompliance proceedings under section 1858 et seq. does not restrict his refund powers, either. SFG contends that these provisions permit prospective relief only, seizing on the language of section 1858.3, subdivision (a) that authorizes the Commissioner to order that, "within a reasonable period of time, the further use of that rate … in contracts of insurance made thereafter shall be prohibited" (SFG Brief, pp. 111-112, quoting excerpt of § 1858.3, subd. (a)). But the *very next sentence* of that subdivision provides that "[t]he commissioner may, in addition to that order, direct the insurer or rating organization to take such other corrective action as he or she may deem necessary and proper." (§ 1858.3, subdivision (a).) That provision, omitted by SFG, would authorize the Commissioner to order insurers to take any necessary and proper corrective action to redress past wrongs, such as ordering an insurer to pay refunds to overcharged policyholders.

The provisions for noncompliance proceedings (§ 1858 et seq.) are beside the point, in any event. They were enacted by the Legislature in 1977 (Stats.1977, c. 994, § 5, p. 2984) before Proposition 103 was adopted, and—contrary to SFG's representations (SFG Brief, pp. 111, 124)—were not part of the voter-adopted Proposition 103 law. Thus, even if the Court were to find an irreconcilable conflict between the two laws, it would be Proposition 103 that would control, not the pre-existing noncompliance provisions. (*Burlington N. & Santa Fe Ry. Co. v. P.U.C.* (2003) 112 Cal.App.4th 881, 890 ["When a later statute enacted by initiative is inconsistent and cannot operate concurrently with an earlier statute enacted by the Legislature, the later statute prevails."].)

C. Ordering Refunds of Excessive Rates Is Not Retroactive Ratemaking

SFG argues that the Commissioner's refund order violates the rule against retroactive ratemaking (SFG Brief, pp. 113-117), ignoring controlling Supreme Court precedent. As the Commissioner's Decision explicitly noted (Decision, AR 5148), *20th Century* directly addressed this question, rejecting the analysis SFG proposes here. *20th Century* holds that the "ordering of a refund of rates" that "were charged pending determination of their legality" is prospective, not retroactive:

> The fixing of a rate and the reducing of that rate are prospective in application. The ordering of a refund of rates is akin to the reduction in rates, when, as here, the rates in question were charged pending a determination of their legality. It follows that the ordering of a refund of rates is itself prospective. (8 Cal.4th at p. 281, quotation marks, ellipses, and citations omitted.)

20th Century further explained that even if such refunds could be considered “retroactive,” they would not be impermissibly so. (*Ibid.*) The rule against retroactivity applies only to “primary retroactivity,” which alters the *past* legal consequences of past actions. (*Ibid*., original italics.) That is not what happened here. Instead, as authorized by *20th Century*, the Commissioner ordered refunds of excessively charged premiums back to the date when the legality of SFG’s then-current rates had been put at issue—in fact, the date SFG itself selected for its new rates to become effective. At most, the Commissioner’s refund order would implicate “secondary retroactivity,” which affects the *future* legal consequences of past transactions. (*Ibid.*, original italics.) Secondary retroactivity “is an entirely lawful consequence of much agency rulemaking and does not by itself render a rule invalid.” (*Id*. at pp. 281-282, quotation marks and citation omitted.)

Instead of addressing the jurisprudence on refunds under Proposition 103, SFG relies on cases interpreting the ratemaking provisions of the Public Utilities Code. But, as the Commissioner’s Decision recognized, those provisions contain “entirely different statutory language” (Decision, AR 5151), imposing restrictions on the Public Utilities Commission’s (PUC) rate-setting authority that do not apply to the Insurance Commissioner under Proposition 103.

Specifically, Public Utilities Code section 728 provides that when the PUC, “*after* a hearing,” finds that the rates being charged by the utility are unreasonable, it “shall determine and fix, by order, the just, reasonable, or sufficient rates … to be *thereafter* observed and in force.” (Italics added.) As the court in SFG’s key case, *Pacific Telephone & Telephone Co. v. Cal.P.U.C.* (1965) 62 Cal.2d 634 (*Pacific Telephone*), held, this “plain and unambiguous” statutory language instructs that the PUC is permitted “after a hearing” to make an “order fixing rates to be in force *thereafter*." (*Id*. at p. 650, original italics.) Based on this language, the court held "[t]here is no basis in the statute for concluding that the Commission's orders can be retroactive to the date when the Commission's inquiry into the rates was begun." (*Ibid*.) Proposition 103 contains no such restrictive language.

Even more to the point, Public Utilities Code section 734 expressly prohibits the PUC from issuing an "order for the payment of reparation," which the court in *Pacific Telephone* ruled was the equivalent of a refund order. (*Id*. at pp. 654-655; see also *City of Los Angeles v. Cal.P.U.C.* (1972) 7 Cal.3d 331, 335-336 [discussing the prohibition on refunds based on Public Utilities Code sections 728 and 734].)

Proposition 103 contains no such restrictions on reparations or refunds. On the contrary, it broadly prohibits excessive rates not only from being approved but also from remaining in effect, which the courts have found authorizes the Commissioner to allow interim rates pending final determination of their legality and order refunds if necessary. (*Calfarm*, *supra*, 48 Cal.3d at p. 825; *20th Century*, 8 Cal.4th at p. 281.)[12]

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[12] Even more far afield is SFG's argument that the refund order "raises serious constitutional issues." (SFG Brief, pp. 121-124.) To make this generalized claim, SFG now reaches beyond ratemaking cases to decisions about, for example, the imposition of special assessments on companies decades after the offending conduct, and the application of Title VII to events that occurred before the law's enactment. (*Id*., pp. 122-123, citing, e.g., *Eastern Enterprises v. Apfel* (1998) 214 U.S. 498 and *Landgraf v. USI Film Products* (1994) 511 U.S. 244.) Those cases rejected retroactive application based on the specific statutes and circumstances at issue. They do not interpret the "remain in effect" requirement or anything like it, do not overrule *Calfarm* and *20th Century*, and do not apply here.

CONSUMER WATCHDOG'S CROSS-RESPONDENT'S BRIEF

After ruling that the Commissioner erred in calculating SFG's projected yield, the trial court ordered the matter remanded to the Commissioner to recalculate the proper rate consistent with the court's ruling. (JA 3618.) SFG's cross-appeal asks the Court to deny such remand.

If the Court reverses the trial court's judgment and upholds the Commissioner's Decision, then SFG's appeal on the issue of remand will be moot. But, if the trial court's order on the projected-yield issue is affirmed by this Court, the matter must be remanded for the Commissioner to determine the appropriate rates for the period from July 15, 2015, to December 8, 2016—as well as the amount of refunds, if any, and any other remaining issues. (See Code Civ. Proc., § 1094.5, subd. (f) [authorizing trial court to order reconsideration in light of the court's judgment setting aside agency decision].)

SFG argues that remand is unnecessary and should be denied because "any different rate" for that period "would be unlawfully retroactive." (SFG Brief, p. 125.) This argument assumes that SFG is correct that Proposition 103 does not authorize the Commissioner to set the effective date of his rate order as July 15, 2015. Unless this Court rules in SFG's favor on that issue (see *ante*, pp. 42-53), remand would be necessary under the trial court's order.

SFG's challenge to the trial court's denial of the insurer's motion for reconsideration (SFG Brief, pp. 126-128) is irrelevant. As SFG acknowledges, remand may be denied only "[i]f the Commissioner lacks the authority to impose a retroactive rate before December 8, 2016." (SFG Brief, p. 129.) Whether the trial court properly denied SFG's motion for reconsideration does not affect this determination or the need for remand proceedings.

In any event, SFG mischaracterizes the trial court's denial order, portraying it as though the court simply read the wrong subdivision. SFG does not dispute that its motion was late under Code of Civil Procedure section 1008, subdivision (a). It instead claims that the trial court should have granted reconsideration under subdivision (b). But subdivision (b) is limited to when a "party who originally made an application for an order" renews that "application for the *same order* upon new or different facts, circumstances, or law." (Italics added; see also *California Correctional Peace Officers Ass'n v. Virga* (2010) 181 Cal.App.4th 30, 43 [an "application for the same order" as used in subdivision (b) means a motion seeking the *same relief* as an earlier motion].)

SFG's reconsideration motion asked the trial court to deny remand to the Commissioner and to grant declaratory relief (JA 3294, 3298)— two new requests for relief that SFG never raised in moving on the writ or at trial. Indeed, SFG's merits briefs asked the trial court to "issue a writ commanding the Commissioner to set aside the Decision and directing him to enter a new decision that is consistent with the Court's ruling." (JA 2804.) SFG thus affirmatively *asked for* remand. The trial court was therefore correct that "section 1008(b) simply does not apply to a reconsideration, such as this." (JA 3534.)

Separately, the trial court ruled that even if SFG's reconsideration motion were timely, there was no "new or different fact or circumstance" that "warrants reconsideration of the March 23 order." (JA 3534.) This deficiency precluded reconsideration under either subdivision (a) or (b), and SFG has failed to provide any basis for reversing that determination.

CONCLUSION

SFG's arguments here are an affront to insurance regulation and ratemaking under California law, a framework under which consumers have been protected—and insurance companies have prospered—for 32 years. Proposition 103 replaced the prior open-competition regime with a rigorous system of rate regulation to be administered by the Commissioner. In so administering, "[m]uch is necessarily left to the Insurance Commissioner"—not to insurance companies—"who has broad discretion to adopt rules and regulations as necessary to promote the public welfare." (*Calfarm*, *supra*, 48 Cal.3d at p. 824.) The Commissioner exercised this broad discretion in applying the statutory and regulatory requirements to determine the maximum rates SFG was allowed to charge policyholders. That determination was reasonable, consistent with the law, and should be upheld.

Dated: November 2, 2020

Respectfully submitted,

STRUMWASSER & WOOCHER LLP
MICHAEL J. STRUMWASSER
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CONSUMER WATCHDOG
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Attorneys for Intervenor and Appellant Consumer Watchdog

CERTIFICATE OF COMPLIANCE WITH RULE 8.204(C)(1)

I certify that, pursuant to California Rules of Court, rule 8.204(c)(1), the attached Consumer Watchdog's Combined Appellant's Reply Brief and Cross-Respondent's Brief is proportionally spaced, has a typeface of 13 points or more, and contains 14,387 words, as determined by a computer word count.

Dated: November 2, 2020

Respectfully submitted,

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PROOF OF SERVICE

STATE OF CALIFORNIA

Re: *State Farm General Insurance Company v. Lara, et al.,*
4DCA No. D075529, SDSC No. 37-2016-00041469-CU-MC-CTL

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action. My business address is 10940 Wilshire Boulevard, Suite 2000, Los Angeles, California 90024. Me electronic email address is loliver@strumwooch.com.

On **November 2, 2020**, I served the foregoing document(s) described as **CONSUMER WATCHDOG'S COMBINED APPELLANT'S REPLY BRIEF AND CROSS-RESPONDENT'S BRIEF** on all appropriate parties in this action, as listed on the attached Service List, by the method stated:

☒ If Electronic Filing Service (EFS) is indicated, I electronically filed the document(s) with the Clerk of the Court by using the EFS/TrueFiling system as required by California Rules of Court, rule 8.70. Participants in the case who are registered EFS/TrueFiling users will be served by the EFS/TrueFiling system. Participants in the case who are not registered EFS/TrueFiling users will be served by mail or by other means permitted by the court rules.

☒ If U.S. Mail service is indicated, by placing this date for collection for mailing true copies in sealed envelopes, first-class postage prepaid, addressed to each person as indicated, pursuant to Code of Civil Procedure section 1013a(3). I am readily familiar with the firm's practice of collection and processing correspondence for mailing. Under that practice, it would be deposited with the U.S. Postal Service on that same day with postage thereon fully prepaid at Los Angeles, California, in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after date of deposit for mailing contained in the affidavit.

I declare under penalty of perjury under the laws of the State of California that the above is true and correct and that this is executed on **November 2, 2020**, at Los Angeles, California.

LaKeitha Oliver

LaKeitha Oliver

SERVICE LIST

State Farm General Insurance Company v. Lara, et al.,
4DCA No. D075529, SDSC No. 37-2016-00041469-CU-MC-CTL

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Via U. S. Mail Honorable Katherine Bacal, Judge San Diego County Superior Court 330 W. Broadway San Diego, CA 92101	