ISSUE PRESENTED

Whether the Superior Court erred in failing to implement the protections afforded consumers by Proposition 103, when it sustained Respondent's demurrer without leave to amend and granted Respondent's motion to dismiss, thereby failing to allow a private right of action under the Unfair Business Practices Act of the Business and Professions Code?

INTRODUCTION

The California Department of Insurance (the "Department") urges this Court to affirm three principles. First, that Proposition 103, through California Insurance Code sections 1861.03(a) and 1861.10(a), establishes an original private right of action in Superior Court. Second, in those cases involving an alleged violation of the Insurance Code, that the Commissioner may be asked by the parties or the Superior Court to exercise his primary jurisdiction, but in those cases, the Commissioner does not have exclusive jurisdiction and the Commissioner's decision not to exercise that jurisdiction does not deprive the Court of jurisdiction to hear the matter. Third, that an original private right of action

exists for violations of the Insurance Code, whether or not the alleged violation concerns an insurer's rate or class plan approved by the Department. Based upon the principles stated above, the trial court incorrectly applied Insurance Code section 1860.2 to the facts of this case for the legal and public policy reasons that follow.

OVERVIEW

A. The Department 's Involvement in This Lawsuit.

On April 24, 2001, Appellant Steven Poirer (hereinafter "Appellant") filed a complaint against Respondent, alleging that Respondent was engaged in an unfair business practice, within the meaning of California Business and Professions Code, section 17200. (See Joint Appendix ("JA") at 1-36.) Appellant's complaint alleged that Respondent was engaging in a course of conduct that was depriving policyholders of Proposition 103 protections by surcharging policyholders who lacked a prior history of automobile insurance. (*Id.* at 4, para. 12.) Further, Appellant alleged that such a practice was in violation of California Insurance Code section 1861.02(c), prohibiting insurers from considering the absence of prior insurance, in and of itself, in the calculation of insurance rates

or the determination of eligibility. (*Ibid.*)

On August 6, 2001, Respondent filed a demurrer to the complaint on the grounds that Appellant's claims were subject to the exclusive jurisdiction of the Insurance Commissioner. (JA at 37-39.) The Superior Court sustained Respondent's demurrer with leave to amend, citing the authority of *Farmers Insurance Exchange v. Superior Court* (1992) 2 Cal.4th 377, 401. (JA at 212-214.) Relying upon the reasoning of the California Supreme Court's decision in *Farmers*, the Superior Court stayed Appellant's lawsuit, pending the Commissioner's resolution of Appellant's claim. (JA at 213.)

The Commissioner subsequently issued an order declining to accept jurisdiction of the matter without ruling on the merits, on the ground that the Commissioner was engaged in a rulemaking proceeding that was designed to prevent the kind of practices that were alleged in Appellant's complaint. (JA at 250-251.)

The case returned to Superior Court on Respondent's demurrer and alternative motion to dismiss on the first amended complaint, and on January 31, 2003, the Superior Court ordered

Respondent's demurrer sustained without leave to amend and granted Respondent's motion to dismiss. (JA at 886.) In support of his decision, the Superior Court Judge, the Honorable Wendell Mortimer, Jr., concluded that Division 1, Part 2, Chapter 9 ("Chapter 9"), of the Insurance Code "does not include a right to bring an original civil action such as this." (JA at 887.)

B. Insurance Ratemaking under the McBride-Grunsky Act and Proposition 103.

Prior to Proposition 103, the principal insurance regulatory law for property and casualty insurance rates was the McBride-Grunsky Regulatory Act of 1947 (hereinafter "McBride Act"). The McBride Act, which covered most forms of insurance, including automobile liability insurance, did not require that insurers file rates with the Commissioner, nor that insurers receive the Commissioner's approval prior to use. (*King v. Meese* (1987) 43 Cal. 3d 1217, 1241.) In fact, under the McBride Act, the Commissioner was forbidden to set or fix rates. (*Ibid.*) The McBride Act represented nothing more than "the minimal regulation required to exempt California insurance from federal antitrust law."

(*King*, *supra*, at p. 1240.)

The McBride Act included Insurance Code section 1860.1, which states that:

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

This provision was codified, in order to confer authority on insurers so that they would be exempt from the Cartwright Act and any other restraint of trade or similar provisions of California law for the concert of pricing activity or other conduct performed under the provisions of the McBride Act. (*Karlin v. Zalta* (1984) 154 Cal.App.3d 953, 968-971). Additionally, the McBride Act included Insurance Code section 1860.2, a provision which stated that the "administration and enforcement" of Chapter 9 of the Insurance Code would be governed solely by the provisions of Chapter 9. Thus, the McBride Act represented a system that sought to "balance" the concert of action among insurers, while allowing an open competition system in the setting of insurance rates. (*Karlin*, *supra*, at pp. 971-972.) In lieu of the antitrust strictures, the

McBride Act bestowed enforcement powers upon the Commissioner to prevent any insurer abuses of the open competition system. (*Ibid*.) As part of the McBride Act, the Commissioner was given the option to investigate rates. *(King v. Meese, supra*, 43 Cal.3d 1217, 1222.) While consumers with a rate or classification grievance were entitled to file a complaint with the Commissioner, the McBride Act gave the Commissioner the option to dismiss the complaint without investigation. (*Ibid.*)

Understandably, consumers found that the Commissioner's role under the McBride Act inadequately protected consumers from arbitrary rating practices. Indeed, some consumers complained that their insurance complaints were routinely dismissed without a hearing by the Commissioner. (See, e.g., *King v. Meese, supra*, 43 Cal. 3d 1217, 1242.)

In 1987, the Legislature passed, and the Governor signed, A.B. 1687. The Legislative Counsel's Digest stated, in relevant part:

> **"This bill would recast [the McBride Act] by requiring rather than permitting the commissioner to hold public hearings in certain circumstances, requiring the commissioner to review and investigate requests for a review of rates, rating plans or**

systems, or underwriting rules…and to require rather than permit the commissioner to suspend or revoke the license of … any insurer which fails to comply with the commissioner's orders…".
(Legis. Counsel's Dig., Assem. Bill No. 1687 (1987).)

The Legislature reacted to the growing dissatisfaction of consumers by attempting to strengthen the procedural enforcement powers of the Commissioner. Consumers, however, were not satisfied with the regulatory framework proposed by the Legislature.

In 1988, Proposition 103 declared that:

"Enormous increases in the cost of insurance have made it both unaffordable and unavailable to millions of Californians. The existing laws inadequately protect consumers and allow insurance companies to charge excessive, unjustified and arbitrary rates."
(Ballot Pamp., Gen. Elec. (Nov. 8, 1988), Text of Prop. 103, p. 99.)

One of Proposition 103's major purposes was to replace the McBride Act with a system in which the Commissioner must approve of rates prior to their use. (*Amwest Surety Ins. Co. v. Wilson* (1995) 11 Cal.4th 1243, 1258-59.) The voters declared that "any

person" could initiate "any proceeding" established pursuant to Chapter 9 of the Insurance Code, and enforce any provision of Chapter 9, Article 10 of the Insurance Code. (Ins. Code § 1861.10, subd. (a).) Additionally, Proposition 103 repealed various sections that previously exempted the business of insurance from the State's antitrust laws, and instead, declared that "[t]he business of insurance shall be subject to the laws of California that are applicable to any other business", including the antitrust laws and the Unfair Business Practices Act. (Ins. Code § 1861.03, subd. (a); *Farmers Insurance Exchange v. Superior Court* (1992) 2 Cal.4th 377, 385-386.)

Some argued that Proposition 103's measures would create a "huge government bureaucracy." (Ballot Pamp., Gen. Elec. (Nov. 8, 1988) argument against Prop. 103, p. 101.) The voters, however, chose to offset the enforcement burden Proposition 103 imposed upon the agency by providing consumers with the option to pursue an original private right of action in Superior Court, as an alternative to the administrative hearing procedures enforced by the Commissioner under Insurance Code section 1858 et seq.

California's highest court agrees that there is an

original private right of action in Superior Court. The interplay between Proposition 103 and the Unfair Business Practices Act was described in detail by the California Supreme Court in *Farmers*, *supra*, 2 Cal. 4th 377.

C. Historical Background of the *Farmers* and *Walker* Decisions.

***Farmers* involved a lawsuit filed in Superior Court by the Attorney General's office against certain insurers on behalf of consumers. The complaint alleged two causes of action. The first cause of action alleged various violations of Insurance Code sections 1861.02 and 1861.05, including that the defendants had used the absence of insurance as a criterion for setting automobile insurance rates and premiums. (*Farmers*, *supra*, at pp. 381-382.) The second cause of action incorporated the allegations of the first cause of action and asserted violations of Business and Professions Code section 17200. (*Farmers*, at p. 382.) The defendants demurred to both causes of action on the ground that the Attorney General's lawsuit was precluded by the exhaustion of remedies doctrine. (*Ibid.*) The trial court sustained the demurrer to the first cause of**

action pursuant to Insurance Code section 1860.2, finding that the exhaustion doctrine applied to allegations under the Insurance Code. (*Farmers*, at p. 382.) As to the second cause of action under the Business and Professions Code, the court overruled the insurer's demurrer. (*Farmers*, at p. 383.)

Ultimately, the California Supreme Court reviewed the denial of the insurer's demurrer to the second cause of action, addressing the question of whether violations of the Insurance Code could constitute unfair business practices under the Business and Professions Code. The Court rejected the insurer's argument that the Attorney General had failed to exhaust its administrative remedies and held that the primary jurisdiction doctrine applied. (*Farmers*, *supra*, at p. 383.)[1]

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[1]In dicta in a footnote, the Supreme Court agreed with the trial court's ruling regarding the first cause of action. The Court, citing section 1860.2, stated that claims brought under the Insurance Code "are exclusively the province of the Insurance Commissioner," and therefore fell within the commissioner's exclusive jurisdiction, subject to judicial review. (*Farmers*, 2 Cal.4th 377, 382, fn. 1.) However, the Attorney General did not contest the trial court's ruling, and the question of whether a private suit could be brought to enforce provisions of the Insurance Code directly was neither raised nor briefed before the Supreme Court. Thus no party called the Supreme Court's attention to the fact that section 1861.10(a), enacted by Proposition 103, provides an unqualified private right of action to enforce Insurance Code violations, and that it "governed" enforcement of the Insurance Code under the terms of section 1860.2.

The Court explained that,

> **"'Exhaustion' applies where a claim is cognizable in the first instance by an administrative agency alone: judicial interference is withheld until the administrative process has run its course. 'Primary jurisdiction,' on the other hand, applies where a claim is originally cognizable in the courts, and comes into play whenever enforcement of the claim requires the resolution of issues which, under a regulatory scheme, have been placed within the special competence of an administrative body; in such a case the judicial process is suspended pending referral of such issues to the administrative body for its views."**
> **(*Farmers*, *supra*, at p. 390, quoting *United States v. Western Pac. R. Co.* (1956) 352 U.S. 59, 63-64.)**

In *Farmers,* the Supreme Court noted that the policy reasons behind the exhaustion and primary jurisdiction doctrines were "similar and overlapping." (*Farmers*, *supra*, at p. 391.) "The exhaustion doctrine is principally grounded on concerns favoring administrative autonomy…[T]he primary jurisdiction doctrine enhances court decision making and efficiency by allowing courts to take advantage of administrative expertise, and it helps assure uniform application of regulatory laws." (*Ibid*.)

Applying those principles to the facts, the Court noted that issues of insurance ratemaking concern complex factual issues, and that the Department of Insurance has specialized technical

expertise in this field. (*Farmers*, *supra*, at p. 397.) Furthermore, the Court stated that judicial economy and the desire to maintain uniformity in the application of insurance regulations strongly support application of the primary jurisdiction doctrine, not the exhaustion of remedies doctrine, over claims alleging violations of the Insurance Code. (*Id*. at p. 396.) Notably, the Court specifically stated "the determination of whether petitioners have used the absence of prior insurance 'in and of itself' as 'a criterion for determining eligibility for a Good Driver Discount policy, or generally for automobile rates, premiums or insurability,' also calls for exercise of administrative expertise preliminary to judicial review." (*Farmers*, *supra*, at p. 399, fn. 18.) The Court held therefore, that the "Business and Professions Code claim … is 'originally cognizable in the courts' and thus it triggers application of the primary jurisdiction doctrine." (*Farmers*, at p. 391.)

***Walker v. Allstate Indemnity Company* (2000) 77 Cal. App.4th 750 concerned a lawsuit which alleged that Insurance Commissioner Quackenbush had failed to promulgate regulations governing the approval of rate change applications, and had**

approved, and the insurer defendants had charged, excessive rates in violation of Insurance Code section 1861.05 and Business and Professions Code section 17200 et seq. (*Walker*, *supra*, at p. 753.) The insurer defendants demurred to the complaint on the ground that the case was a rate case, which fell solely within the exclusive jurisdiction of the Commissioner. (*Walker*, at pp. 753-54.) The trial court granted the demurrers without leave to amend, reasoning that challenges to rate applications must be timely raised during the administrative process, not by a class action long after the time for challenging individual rate applications has passed. The plaintiffs dismissed defendant Commissioner Quackenbush from their suit and appealed. (*Id*. at p. 754.) The Court of Appeal affirmed the judgment, reasoning that Insurance Code section 1860.1 completely proscribes civil claims under the Unfair Business Practices Act, when based upon an insurer's imposition of a rate that has been approved by the Commissioner. (*Id.* at p. 756.)

In its effort to reconcile its conclusion with *Farmers*, the Court reasoned that:

> **"the Farmers court did not consider whether an Unfair Business**

> **Practices Act claim arising in an exclusively ratemaking context**
> **could be brought in the superior court in light of the immunity provided in Insurance Code sections 1860.1 and 1860.2 … Moreover, this is not a case, like *Farmers*, where the administrative process has yet to be invoked and followed to its conclusion. No challenges to the commissioner's decisions were brought in the superior court as specifically permitted by the governing statutes."**
> **(*Walker, supra*, at p. 759.)**

Since the decision in *Walker*, as this Court is no doubt aware, Division One of the Second District Court of Appeal rendered its decision in *Donabedian v. Mercury Insurance Company* (March 11, 2004, B159982) __Cal.App.4th__ [2004 DJDAR 3180]. Interpreting the plain language of Proposition 103 and its legislative history, the Court rejected the statutory construction advanced by Respondent Mercury Insurance Company, by State Farm as amicus curiae, and by the court in *Walker*, that Insurance Code sections 1860.1 and 1860.2 give the Commissioner exclusive jurisdiction over alleged violations of Insurance Code section 1861.02 (c). (*Donabedian*, 2004 DJDAR 3180, at p. 3187.) Instead, the Court construed the provisions of Proposition 103 and concluded that the plaintiff in *Donabedian* could maintain his civil action under the Unfair Business Practices Act. (*Donabedian*, 2004 DJDAR 3180 at p. 3180.) The

Department firmly believes that a review of the plain text of Proposition 103 as well as its legislative history, when applied to the circumstances of this case, requires the same result here.

DISCUSSION

A. Proposition 103 Establishes a Private Right of Action.

With the adoption of Proposition 103 in 1988, there can be no doubt but that the voters were dissatisfied with the Commissioner's limited authority and resources for enforcement of the ratemaking provisions of the Insurance Code. Not only did the ballot pamphlet reflect the voters' dissatisfaction with the effect of the enforcement provisions of the McBride Act, but the plain text of Proposition 103 went one step farther, and expressly provided for an alternate enforcement method. (See Ballot Pamp., Gen. Elec., (Nov. 8, 1988), text of Prop. 103, pp. 99 & 140.)

In enacting Proposition 103, the voters vested the power to enforce the Insurance Code in the public as well as in the Commissioner. As the plain text of Insurance Code sections 1861.03 and 1861.10 make clear, Proposition 103 established a private right

of action for the enforcement of Chapter 9 of the Insurance Code.

In addition to imposing greatly expanded regulatory responsibilities upon the Department to combat excessive rates and other perceived abuses, the voters sought to create an entirely new enforcement avenue. Thus, in adopting Insurance Code sections 1861.03 and 1861.10, the voters envisioned that the Commissioner's ability to enforce the provisions of the Insurance Code would be supplemented by the use of private attorneys general.[2]

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[2]The Argument in Favor of Proposition 103 also reveals that voters anticipated "a permanent, independent consumer watchdog system [that] will champion the interests of insurance consumers." (Ballot Pamp., Gen. Elec, *supra*., Argument in Favor of Prop. 103, at p.100.) The goals of Proposition 103, in this regard, could not be enforced to the full extent envisioned by the voters. The California Supreme Court struck down the "nonprofit public benefit corporation" provision of Proposition 103 on the grounds that it impermissibly identified a private corporation to perform a governmental function, in violation of Article II, section 12, of the California Constitution. (*CalFarm Ins. Co. v. Deukmejian* (1989) 48 Cal. 3d 805, 831-836.)

Insurance Code section 1861.03(a), expressly provides:

> **"The business of insurance shall be subject to the laws of California applicable to any other business, <u>including, but not limited to</u> ... the antitrust and <u>unfair business practices laws</u>.... (Emphasis added.)**

Moreover, Insurance Code section 1861.10(a) states that "Any person" is empowered to initiate "any proceeding" established pursuant to Chapter 9 of the Insurance Code, and enforce any provision of Chapter 9, Article 10 of the Insurance Code.

Since the California Supreme Court has recognized that claims alleging violations of Chapter 9 of the Insurance Code, when brought under the Unfair Business Practices Act, are originally cognizable in the courts (*Farmers*, *supra*, at p. 391), it follows that Appellant's complaint should not have been dismissed for lack of jurisdiction.

B. Walker Is Inapplicable Here.

The *Walker* court opines that the *Farmers* court never considered whether an Unfair Business Practices Act claim arising in a ratemaking context is a matter of exclusive jurisdiction. On the

contrary, in concluding that the primary jurisdiction doctrine applies to Unfair Business Practices Act claims, the *Farmers* court specifically acknowledged that "questions involving insurance ratemaking pose issues for which specialized agency fact-finding and expertise is needed in order to both resolve complex factual questions and provide a record for subsequent judicial review." (*Farmers,* supra, at p. 397.)

As acknowledged in our briefing before the *Donabedian* Court,[3] the Department now agrees that the *Walker* Court misinterpreted Insurance Code sections 1860.1 and 1860.2.[4]

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[3] (See, The Foundation for Taxpayer and Consumer Rights' Mtn. for Judicial Notice in Support of *Amicus Curiae* Brief, Exhibit G, p. 14, fn.3.)

[4] The Department understands that Respondent State Farm has requested judicial notice of the Commissioner's brief in *Jonathan Neil & Associates, Inc. v. Fred Jones*, No. S107855. The Department's briefing in that case concerned the application of the

exhaustion of remedies doctrine to the statutory provisions of the California Automobile Assigned Risk Plan (CAARP). The Department's arguments interpreting the specific and comprehensive regulatory provisions of CAARP have no application within the context of the unique regulatory framework of Proposition 103. (See, e.g., *CAARP v. Garamendi* (1991) 234 Cal.App.3d 1486, 1494-95 [Prop. 103 hearing procedures do not apply to CAARP regulatory framework]; *CAARP v. Garamendi* (1991) 232 Cal.App.3d 904, 913 [Ins. Code 1861.05 does not apply to CAARP].)

Section 1860.1, enacted as a provision of the McBride Act in 1947, merely concerns the authority bestowed upon insurers to engage in data sharing and not the authority of the Commissioner to approve rates. (See *Karlin v. Zalta*, *supra,* 154 Cal.App.3d 953, 968-971.) It was not until decades after the McBride Act when Proposition 103 was enacted, that the Commissioner's authority extended to include the prior approval of property and casualty insurance rates.

Section 1860.2, another provision from the McBride Act, provides that the "administration and enforcement" of Chapter 9 "shall be governed solely by the provisions of [Chapter 9]." Of course, the voters' provisions that created an original private right of action, Insurance Code sections 1861.03 and 1861.10, are found within this same chapter.

Insurance Code sections 1860.1, 1860.2, 1861.03, and 1861.10 must be read in context, keeping in mind the nature and purpose of voter approved Proposition 103.

Whatever limited force that Insurance Code sections 1860.1 and 1860.2 can be said to have today, those sections, read in

context, cannot and should not immunize insurers from civil liability for unlawful conduct that is based upon statements found in their voluminous regulatory filings. In this regard, the drafters of the McBride Act could not have envisioned that decades later under Proposition 103, insurers would assert the defense of immunity from suit, whenever the allegedly illegal conduct fell within the broad confines of an approved rate or practice, as Respondents did here.

As Division One of this District Court of Appeal recently noted, Insurance Code sections 1860.1 and 1860.2 do still serve a purpose within the Proposition 103 regulatory scheme, by allowing insurers to still engage in some limited concert of action. (*Donabedian v. Mercury Ins. Co.* (March 11, 2004, B159982) __Cal.App.4th__ [2004 DJDAR 3180, 3187.) Indeed, Insurance Code section 1853.5 permits related insurers to act in concert, and Insurance Code sections 1855 through 1855.5 allow advisory organizations to share insurance forms and manuals. (*Ibid.*) But, as the *Donabedian* Court makes clear, Insurance Code sections 1860.1 and 1860.2 do not preclude a civil action alleging a violation of Proposition 103. (*Id.* at pp. 3182 & 3187.)

To the extent that the *Walker* opinion interprets Insurance Code sections 1860.1 and 1860.2 to preclude a private right of action in Superior Court, it thwarts a crucial public protection guaranteed by Proposition 103. At a minimum, it contravenes the *Farmers* opinion which indicates that such matters should not be dismissed on exhaustion grounds, but rather, when a superior court deems it useful, should be stayed under the primary jurisdiction doctrine, until the Commissioner has an opportunity to review the specific problem raised in the judicial forum. (*Farmers*, *supra*, at p. 401.)

C. The Primary Jurisdiction Doctrine and the Private Right of Action for Unfair Business Practices Act Claims Must Exist, Even if an Insurer's Application is Approved.

Even if this Court should find that the reasoning in *Walker* is sound insofar as *Walker* applies the exhaustion of remedies doctrine to a dispute over whether a previously-approved rate is excessive in violation of section 1861.05(a), the facts of this case do not fall within the *Walker* exception to the application of the primary jurisdiction doctrine. *Walker*, by its own terms, provides that the exhaustion of remedies doctrine deprives a court of jurisdiction over

Unfair Business Practices Act claims when such claims arise exclusively within the context of a challenge to rates as excessive. (*Walker*, *supra*, at p. 759.) But, as the *Farmers* court makes clear, there are many Insurance Code violations that do fall under the Unfair Business Practices Act where a court does have jurisdiction.

In fact, the *Farmers* Court concluded that the Superior Court has jurisdiction over precisely the same kind of allegation that was raised by Appellant's complaint in this case. As the California Supreme Court has recognized, an Unfair Business Practices Act claim that alleges a violation of Insurance Code section 1861.02 (c) is a claim that is subject to the primary (not exclusive) jurisdiction doctrine. (*Farmers*, *supra*, at p. 399, fn. 18.) It is the interplay between section 1861.02 (c) and Respondent's application of its accident verification guideline that is at the heart of this lawsuit.

Not only does the reasoning in the *Farmers* opinion demand the application of primary jurisdiction over Appellant's claim here, but the reasoning of the *Walker* opinion also supports the application of the primary jurisdiction doctrine here because the issue before the trial court was not a question of "ratemaking."

When the distinction between rates and other insurance practices is recognized, the conduct challenged in the present case cannot reasonably be considered a "pure ratemaking challenge."

California automobile insurance premiums are generally calculated in a two step process.

First, an insurer must calculate a "base rate," a figure which is the same for each policyholder and represents the total annual premium that the insurer must charge in order to cover expenses and obtain a reasonable rate of return. The calculation of a base rate pursuant to section 1861.05, requires that an insurer provide a highly technical, formulaic presentation of its loss, expense and claims data so that the Department can determine whether the base rate is excessive, inadequate or unfairly discriminatory, as required by Insurance Code section 1861.05 (a). Moreover, section 1861.05 (a) accords the Commissioner broad discretion: to approve the rate, the Commissioner must find that it falls inside the statutory boundaries of "excessive" and "inadequate," a determination

uniquely within his technical expertise.[5]

[5]Note that the same rate review standards govern all property-casualty insurers subject to Proposition 103. (Ins.Code, § 1861.13.)

The second step in this process, applicable only to automobile insurers, concerns the evaluation of the automobile rating factors under section 1861.02. Rating factors have a different effect on different policyholders, depending upon each policyholder's unique characteristics. (*Spanish Speaking Citizens' Foundation, Inc. v. Low* (2000) 85 Cal.App.4th 1179, 1186.) Insurers may only use those rating factors set forth in the statute or that have been expressly approved by the Commissioner. (Ins. Code § 1861.02, subd. (a).) The list of approved rating factors is set forth in Title 10, California Code of Regulations, section 2632.5. The regulations provide the formula for how the weight of each rating factor is calculated.[6] The formula also involves a highly technical, formulaic evaluation of the individual optional rating factors.

Each insurer must file a "class plan" with the Department that contains the rating factors an insurer proposes to utilize and the weight accorded to each rating factor.[7] The class plan must be approved prior to use, so that the Department may ensure that it

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[6]California Code of Regulations, title 10, §§ 2632.7 & 2632.8.

[7]California Code of Regulations, title 10, §§ 2632.3 & 2632.10.

complies with applicable requirements and that the influence of each rating factor applied to an insured's premium is weighted as specified by the Department's regulations.

Approving rates, promulgating the list of authorized rating factors by regulation, and establishing a regulatory formula by which the weight of each rating factor is calculated, exemplify the technical function of the Department's review process. Each requires the Commissioner to exercise his technical expertise. The summation of these steps operates to ensure not only that the ultimate rate filed with the Department is not excessive, inadequate or unfairly discriminatory, but also to ensure that the rating factors are calculated as prescribed by Proposition 103. Here Appellant's claim does not involve any of these technical steps; it does not challenge the Commissioner's "ratemaking" authority, nor does it require the court to engage in ratemaking functions. The issue here is whether the insurer is utilizing optional rating factors that comply with the Insurance Code and the applicable regulations, particularly as they have been applied by the insurer.[8] This is a critical

[8]California Code of Regulations, title 10, § 2632.10(b).

distinction, and it is the issue that was before the trial court in the present case.

It is possible for an insurance carrier to file a rate filing and class plan with the Department that satisfies all of the components of the regulations, yet result in a violation of the Insurance Code as applied. Such a predicament does not involve a question of rates, but rather the separate, factual question of how the components of the class plan are applied towards members of the public.

Here, Appellant's central argument is not that the filed and approved rates of Respondent are excessive or inadequate. Rather, Appellant's challenge concerns the manner in which Respondent applies its "accident verification" underwriting guideline in practice.[9] This lawsuit asks whether Respondent has applied its guideline in a manner that considers the absence of prior insurance, in violation of Insurance Code section 1861.02(c).

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[9]While insurers are required to submit underwriting guidelines, including guidelines such as Respondent's "accident verification" guideline, along with their class plan applications, the Department does not formally approve or disapprove such guidelines. (See Cal.Code Regs., tit. 10, §§ 2632.3, 2632.11(b), and 2648.4.)

This case does <u>not</u> present a question of the technical formulaic components of ratemaking; rather, this dispute involves the factual question of the application of an underwriting guideline in practice. For these reasons, *Walker* does <u>not</u> apply to the facts of this case.

Moreover, if *Walker* were read to require dismissal of Appellant's complaint, such a construction would potentially immunize insurers from civil liability whenever a rating factor or an underwriting guideline is at the heart of an Unfair Business Practices Act claim. Such a construction would lead to potentially disastrous results, if an insurer were to file a rating factor that seemed innocuous in its definition, but proved invidious in practice.[10]

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[10]Consider, for example, the following hypothetical. Among the factors that an insurer may use to assign automobile insurance rates is the optional factor of "Marital status of the rated driver." (Cal.Code Regs., tit.10 § 2632.5(d)(10).) Suppose an insurer filed a class plan which described the marital status rating factor as follows: "Whenever a rated driver is married, the driver shall receive a 10% discount." Assume that the insurer's underwriting manual contains a guideline that was not formally filed with the Department, but was submitted along with the rate application, and that this guideline says "proof of marriage, for purposes of this rating factor, is limited to a marriage certificate signed by a representative of a religious institution founded upon principles of Christianity." Suppose, further, that the Department fails to notice this language, and approves the class plan. If a plaintiff were to proceed directly to superior court, alleging a violation of the Unruh Act, in accordance with Insurance Code section 1861.03, would the court dismiss the lawsuit, on the grounds that the matter involves a "pure ratemaking question"?

The example described in footnote ten, while hypothetical, is a very realistic possibility.

The Department goes to great lengths to review the class plan applications that it receives. However, this is no small feat. From January of 2003 to December of 2003, the Department reviewed 260 class plans, some of which may contain hundreds of pages. During this same time period, the Department received and reviewed a total of 6,885 rate increase/decrease filings, generally. In order to conduct the class plan review, the Department employs a total of 29 rate analysts and actuaries. The Department employs a total of 46 analysts to review the other prior approval filings

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To ask the question is to answer it. Such questions do not involve questions of ratemaking. Rather, such questions concern whether the *application* of an optional rating factor to an individual policyholder violates state law. Appellant's claim in the present case, likewise, does not involve questions of formulaic rate calculations. It is exactly the kind of factual question that Superior Courts commonly decide. And, to the extent that a Superior Court believes that such questions involve complicated questions of ratemaking, they should be referred to the Department under the primary jurisdiction doctrine rather than be dismissed outright under the exhaustion of remedies doctrine.

received, literally, on a daily basis. While each of these analysts and actuaries are familiar with the Insurance Code, they typically do not have the benefit of legal training.

Like all administrative agencies, the Department must balance its statutory responsibilities with the available resources when exercising its discretion to deploy its prosecutorial authority. Private attorneys general often have access to resources not available to the Department. The voters concluded that a second enforcement avenue would serve as a valuable complement to the Commissioner's enforcement powers. If such private litigation is dismissed by courts under the exhaustion of remedies doctrine, on the grounds that the issue concerns a pure question of "rates," much insurer conduct which violates the law will unnecessarily persevere.

Many insurers' historical application of the accident verification requirement illustrates the risks which would attend such an application of the exhaustion of remedies doctrine.

In order to qualify for a Good Driver discount in California, a policyholder must have no more than one at-fault

accident within the last three years. (Ins. Code § 1861.025, Cal.Code Regs., tit.10, § 2632.13.) Insurance Code section 1861.02, subdivision (a) requires insurers to consider an individual's driving safety record when calculating private passenger automobile insurance rates. Many insurers filed class plans which contained underwriting guidelines that required policyholders to verify the number of accidents they had been involved in over a given period of time, as part of that policyholder's application for automobile insurance. Ultimately, the Department determined that some insurers were using the "accident verification" requirement to compel policyholders to show their prior insurance history, under the pretense that such insurance history would disclose any accidents the policyholder may have had. And, it appeared that some carriers used the "prior insurance" information to impose premium surcharges and discounts, in violation of Insurance Code section 1861.02, subdivision (c). Despite the Department's best efforts to prevent such an application of the "accident verification" rule, the Department ultimately chose to adopt a regulation to stop such violations. The Department's regulation operated to ensure that

insurers would not improperly ask for "prior insurance" information. (Cal.Code Regs., tit. 10, § 2632.13(i) [Insurer must generally accept policyholder's declaration of accident history as definitive].)

The Department strives to prevent companies from using "the absence of prior insurance" to affect rates, in the same way it strives to prevent other violations of laws in the State of California. However, some class plans, which are inherently technical in nature, will be approved because the violations of law occur on an "as applied" basis and may be undiscovered in the review process. Indeed, in many cases, the adverse effects of an insurer's class plan when applied to particular policyholders in the "real world" may not be apparent from a sterile reading of the class plan itself. The absence of a finding on an issue that was not before the Department cannot be construed as an approval of that conduct or an interpretation of any statute the Department is charged with enforcing. (*Stevens v. API Ins. Services, Inc.* (1999) 75 Cal.App.4th 594, 608.)

Still other violations may be found directly in the

language of the class plan, but it may take time for the Department to fully appreciate the implications of the language and the manner in which such language violates State law.

Finally, the Department may determine that a violation does not warrant the expenditure of its limited enforcement resources, or that the Department prefers to address the matter through a different means, such as rulemaking.

It is no surprise, then, that the voters saw fit to adopt Insurance Code sections 1861.03 and 1861.10, and allow private attorneys general to apply their resources and technical skill to ferret out and challenge violations of law.

Some insurers, both before this Court and in other forums, have argued that as a matter of policy the voters could not have intended to subject insurers to dual accountability in both the administrative and judicial forums. In essence, they argue that it would be unfair for an insurer to file a class plan with the Commissioner, obtain his approval, and still be subject to civil liability. Thus, some have urged for a construction of Chapter 9, which would inflate the scope of Insurance Code sections 1860.1 and

1860.2 from its narrow rate sharing function during the McBride Act era to a post-Proposition 103 rule which would insulate insurers from liability for any rates approved by the Commissioner. This argument not only fails to comport with the plain meaning of the provisions of Chapter 9, as amended by Proposition 103, but also fails to take into account the equitable principles which are the foundation of any Unfair Business Practices claim.

At the outset, it is important to remember that Chapter 9 has never given the Commissioner the authority to make legal that which would otherwise be illegal. Indeed, as Insurance Code sections 12921(a) and 12926 make clear, the Commissioner is duty bound to require that all carriers comply with all of the provisions of the Insurance Code. Insurance Code section 1860.3 expressly states that this duty applies to the Commissioner's acts under Chapter 9. Thus, any act by the Commissioner to "approve" of a violation of law by approving an illegal class plan would necessarily be an act outside the bounds of his authority.

Moreover, an insurers' good faith submission of, and reliance upon, the provisions of a class plan approved by the Commissioner

would still protect the insurer against any remedies that a civil court may deem inequitable. Section 17203 of the Unfair Business Practices Act contains a grant of broad equitable power. (*Cortez. v. Purolator Air Filtration Products Co.* (2000) 23 Cal.4th 163, 179-180.) Neither restitution nor injunctive relief is mandatory under the Unfair Business Practices laws. (*Id.*) Instead, a court must consider the equities on both sides of a dispute in deciding whether to grant remedies to a private attorney general, and an insurer is always entitled to assert any equitable defenses it may have. In light of that protection, any suggestion that public policy and principles of fairness dictate that insurers should not be subject to an original cause of action for conduct based upon an approved class plan simply ignores the equitable nature of an Unfair Practices lawsuit. More importantly, it totally disregards the voters' established views on the balance of equity in insurance regulation.

CONCLUSION

The Department urges this Court to affirm the private right of action created by Proposition 103. Furthermore, the Department asks that this Court disapprove of the application of the

exhaustion of remedies doctrine to Unfair Business Practices Act claims on the grounds that it is inconsistent with *Farmers*, Proposition 103, and the plain meaning as well as legislative intent behind Insurance Code sections 1860.1 and 1860.2. Finally, even if this Court declines to reject the holding of the *Walker* opinion, the Department respectfully submits that the facts of this case do not concern a "pure ratemaking question" and therefore the reasoning of *Walker* does not apply here.

Therefore, the Department urges that this Court reverse the trial court's ruling.

Respectfully Submitted,

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CERTIFICATE OF COMPLIANCE
WITH CALIFORNIA RULES OF COURT, RULE 14(c)

I certify that, pursuant to California Rules of Court, rule 14(c),

and relying on the word count of our word-processing program, the number of words in the attached brief, including footnotes, is 7,163.

Dated: March 18, 2004.

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Bryant Henley