Case No. B182156

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

BENJAMIN J. FOGEL, ET AL.,
Plaintiff and Appellant;

v.

FARMERS GROUP, INC., D/B/A FARMERS UNDERWRITERS ASSOCIATION,
FIRE UNDERWRITERS ASSOCIATION, TRUCK UNDERWRITERS ASSOCIATION,
Defendants, Respondents, and Cross Appellants.

Appeal from the Superior Court of the State of California in and for the
County of Los Angeles, Case No. BC300142
(The Honorable Peter D. Lichtman, Judge)

[PROPOSED] AMICUS CURIAE BRIEF OF THE FOUNDATION FOR TAXPAYER AND CONSUMER RIGHTS

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INTRODUCTION & SUMMARY OF DISCUSSION

Though the Plaintiff did not allege any violation of Proposition 103, and no insurance company regulated by Proposition 103 is presently a defendant, the superior court treated Farmers Group, Inc. and its subsidiary attorneys-in-fact (collectively "FGI") as an insurance company, the attorney-in-fact fee (AIF Fee) as an insurance rate governed by Proposition 103, and ruled that *Walker v. Allstate Indemnity Co.* (2000) 77 Cal.App.4th 750 (*Walker*) immunizes FGI from accountability in the courts. Moreover, the trial court reasoned that the "filed rate doctrine" was consistent with *Walker* and applied it to this case – the first time that doctrine has ever been applied to the California Insurance Code. The court's application of *Walker* and the "filed rate doctrine" was a serious mistake of law that compels the attention of amicus curiae the Foundation for Taxpayer and Consumer Rights (FTCR).

The principal issue presented by this appeal is whether the trial court erred in holding that Insurance Code sections 1860.1 and 1860.2,[1] enacted by the Legislature in 1947, accord the Insurance Commissioner "exclusive jurisdiction," or establish a "filed rate doctrine," so as to *bar* a lawsuit that does not challenge the filed rates of an insurer but rather the propriety of a *fee imposed by contract* on customers by their *attorney-in-fact and fiduciary* FGI.

The court below erred. The question of whether an Unfair Competition Law (UCL) suit may be brought to challenge violations of Proposition 103 by *insurance companies* has been intensely litigated by the insurance industry in recent years. This Court's extensive analysis in *Donabedian v. Mercury Insurance Co.* (2004) 116 Cal.App.4th 968

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[1] All further references are to the Insurance Code unless otherwise specified.

(*Donabedian*) largely settled the issue. *Donabedian* confirms that the voters expressly authorized such suits when they passed Proposition 103, and that sections 1860.1 and 1860.2 do not bar suit or liability.[2] The court below eschewed the *Donabedian* analysis, however. It relied instead upon the erroneous reading of the statutes set forth in the First District's decision in *Walker*, which concluded that the sections 1860.1 and 1860.2 barred a lawsuit against insurance companies challenging insurance rates approved pursuant to the regulatory process established by Proposition 103.

FTCR believes the court below erred by treating FGI as an insurance company and the AIF Fee as a "rate" subject to Proposition 103. By its own terms, *Walker*, which was a Proposition 103 rate case, is wholly inapplicable to this case for three reasons.

First, the present Defendants are not insurance companies. (See Discussion, Section I-A.) *Walker* was a suit against *insurance companies* challenging the *rates* they charged. The Defendants here are not insurance companies. FGI and its subsidiaries are attorneys-in-fact. The laws governing the organization of reciprocal insurers like Farmers *require* that the AIF be a separate entity from the insurance company.

Moreover, AIFs are not regulated as insurance companies by Proposition 103 because the subscription agreement they enter into with a subscriber is not a "contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event." (Section 22.) Proposition 103, which may be found in Chapter 9

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[2] *Farmers Insurance Exchange v. Superior Court* and *Proposition 103 Enforcement Project v. Safeco Insurance Co. of America* (2006) 137 Cal.App.4th 842 ("*Farmers/Safeco*") is in accord. It held that Proposition 103 established a right of action to enforce Proposition 103 under the UCL, but held that there was no right to enforce the statutes directly. (*Id.* at 853, fn. 8 and 854.)

of Part 2 of Division 1 (hereafter, Chapter 9) of the Insurance Code, does not regulate attorneys-in-fact, which are authorized by Chapter 3 of that part of the Insurance Code.

Neither *Walker* nor the "filed rate doctrine" can apply to immunize the actions of a company that does not file rates.

Second, plaintiff's lawsuit does not challenge an insurance rate. (See Discussion, Section I-B.) *Walker* barred a challenge to insurance *rates* regulated by the Insurance Commissioner pursuant to Proposition 103. Fogel does not challenge as excessive any insurance rate or allege any violation of Proposition 103. Rather, Fogel challenges the AIF Fee imposed pursuant to a written contract – the Subscription Agreement – between the subscriber and FGI.

The AIF Fee is *not a rate*. FGI's authority to levy the AIF Fee comes neither from the Department of Insurance, nor from the provisions of the Insurance Code that govern the regulation of rates (sections 1861.05 - 1861.09, enacted by Proposition 103), but from a *contract* between FGI and subscribers. The obligations that govern the subscriber and the attorney-in-fact are regulated by the terms of that agreement, not Proposition 103.

Nor does Proposition 103 authorize the Commissioner to regulate the specific expenditures of an insurance company. The regulations implementing section 1861.05 only specify what portion of an insurer's overall expenses may be passed through to policyholders. (Cal. Code Regs., tit. 10, § 2644.1 et seq.)

If the ruling of the court below was correct, and approval of an insurer's *rates* immunized an insurer from any challenge to its *expenditures*, then even a slip-and-fall case would be barred, since the damages would arguably be recognized as costs in the insurer's rates.

Third, even if the AIFs were considered insurance companies, and the AIF Fee considered a "rate," *Walker* does not apply because the AIF

Fee was *not disclosed to or approved by the Commissioner*. (See Discussion, Section I-C.) The Commissioner's approval was the predicate for the immunity *Walker* discerned (incorrectly) in the statutes. The record here affirmatively establishes that the Exchanges did not disclose, and the Commissioner did not approve, the AIF Fee.

Nor is there anything in the record that suggests that the Commissioner received, much less reviewed, the management services agreement between FGI and the Exchanges that presumably specifies what services are provided to the Exchanges by FGI. In fact, amendments to section 1215.5(b)(4), sponsored by Farmers Insurance Group after the passage of Proposition 103, purport to relieve the Exchanges of their obligation to submit certain of their management agreements to the Commissioner. The applicability of that statute to FGI's current management agreements, and its interaction with the overriding disclosure and regulatory requirements of Proposition 103, cannot be determined here, because neither party raised this statute in this proceeding. But the amendments suggest that the company believes the Commissioner cannot regulate some of agreements between FGI and the Exchanges.

While FTCR believes that this is a fiduciary duty case, not an insurance rate case, the absence of the Exchanges deprived the lower court of the information needed to ascertain that distinction. Indeed, if the court below believed this to be an insurance rate case, the proper procedure, as dictated by the California Supreme Court in *Farmers Insurance Exchange v. Superior Court* (1992) 2 Cal.4th 377 (*Farmers*), would have been to stay the trial court proceedings and request that the Commissioner weigh in – not dismiss the case as barred.

In the event that the Court concludes that this is an insurance rate case and proceeds to address the statutory issue of whether insurance companies are immune from this suit by virtue of sections 1860.1 and

1860.2, as *Walker* held, this brief also demonstrates that the trial court erred on that ground.

The argument made by FGI and accepted by the court below – that suits under the Unfair Competition Law (UCL) challenging violations of Proposition 103 are prohibited by those statutes – has been repeatedly presented by insurers to California courts in recent years. Each time, beginning with this Court's decision in *Donabedian*, *supra*, 116 Cal.App. 4th 968, the courts have rejected the argument, with one exception: *Walker.* *Walker* was decided incorrectly, and its statutory analysis cannot be squared with the Supreme Court's subsequent decision in *State Compensation Insurance Fund v. Superior Court* (2001) 24 Cal.4th 930 (*SCIF*) and the far better reasoned authority of *Donabedian*, which correctly construed the statutes.

As explained in the Background section, Proposition 103, enacted by the voters in 1988, eliminated the "exclusive jurisdiction" of the Insurance Commissioner over insurance rates, premiums and practices; consumers are explicitly authorized by Proposition 103 to bring an Unfair Competition Law action against insurance companies in court for violations of Chapter 9 (of Part 2 of Division 1 of the Insurance Code) by section 1861.10(a). (*Farmers*, *supra*, 2 Cal.4th 377; *Donabedian, supra,* 116 Cal.App.4th 968; see also *Farmers/Safeco*, *supra*, 137 Cal.App.4th 842, 853, fn. 8.) Thus, in the context of Proposition 103, the vestigial provisions of the 1947 law no longer operate to confer immunity from a UCL suit upon insurance companies. (*Donabedian*, *supra*, 116 Cal.App.4th 968 at 990-991; *SCIF, supra*, 24 Cal.4th at 938-940.) (See Discussion, Section III.)

Further, the private right of action authorized by section 1861.10(a) of Proposition 103 is unconditional. There is no statutory basis upon which to impose a "filed rate doctrine" upon Proposition 103. Such a doctrine is inconsistent with the language and purposes of Proposition 103, the

Supreme Court's decision in *Farmers*, and *Donabedian*. (See Discussion, Section IV.) This case does not allege a violation of any provision of Proposition 103, but if Proposition 103's provisions were implicated, Proposition 103 explicitly authorizes this UCL suit.

Walker's construction of the relevant statutes and its reasoning are manifestly incorrect, have been discredited by the California Supreme Court and *Donabedian*, and this Court should reject its analysis.

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Three times in the last three years, insurance company defendants and insurance companies appearing as amici have asked the Second District Court of Appeal to judicially restore the era of "exclusive jurisdiction" and immunity from suit that the voters swept away when they enacted Proposition 103.[3] Each time, the insurance companies have been rebuffed. Consumer advocacy groups like FTCR and the Insurance Commissioner have demonstrated to the courts that the plain language, legislative history and judicial construction of the relevant statutes establish the right to bring a UCL lawsuit against an insurer for violations of Proposition 103.[4]

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[3] In addition to *Donabedian*, *supra*, 116 Cal.App.4th 968, the issue was litigated in *Poirer v. State Farm Mutual Automobile Insurance Co.* (B165389) 2004 WL 2325837, and most recently in *Farmers/Safeco*, *supra*, 137 Cal.App.4th 842.

[4] FTCR filed extensive amicus briefs in *Donabedian* and *Poirer* (which may be found at 2003 WL 23209749 and 2004 WL 1284440 respectively) and was a party in *Farmers/Safeco* (the Plaintiff in the *Safeco* case, the Proposition 103 Enforcement Project, is a project of FTCR). The Insurance Commissioner filed amicus briefs in all three proceedings; his amicus brief in *Donabedian* is attached as Exh. A to FTCR's Motion for Judicial Notice (MJN) (available at 2003 WL 23280980); his *Poirer* brief may be found at 2004 WL 1284440.

In this, the fourth time the argument has been presented to this Court, the insurer seeks to extend the *Walker* bar to a company that is not a regulated insurance company, and to a fee that is not a rate. Regardless of FGI's status, should the argument prevail here, the consequences will be disastrous for consumers and the regulatory process, as the Insurance Commissioner himself has repeatedly emphasized in briefs addressing this very issue.

A ruling accepting and applying *Walker's* reasoning would conflict with this Court's decision in *Donabedian* and jeopardize the right that the voters reserved to themselves to prevent violations of the Insurance Code, to remedy such violations through civil actions, and to obtain refunds of money improperly collected by insurers. Finally, such a ruling would place FGI beyond the rule of law, neither regulated by the Commissioner nor accountable in the courts for breach of contract and fiduciary duties.

The court below erred, and this Court should reverse the trial court's ruling.

BACKGROUND

This section will briefly review the unique relationships created by a reciprocal insurance arrangement. It will then proceed to discuss the background needed to assess the statutory immunity issue, should the Court reach it.

A. Structure of the Relationships Between Policyholders, Subscribers, and FGI and the Exchanges; the AIF Fee.

The entities that to the public appear as "Farmers Insurance" are separate and distinct entities. The Exchanges – Farmers Insurance Exchange, Fire Insurance Exchange, and Truck Insurance Exchange – are insurance companies, and serve as the vehicle through which insureds co-insure each other in a "reciprocal" arrangement. (Section 1303.) The Exchanges perform the principal function of insurance as it is defined by

section 22: "shifting one party's risk of loss to another party and distributing that risk among similarly situated persons." (*Wayne v. Staples* (2006) 135 Cal.App.4th 466, 475-476.)

Plaintiff Fogel initially sued the Exchanges. However, the Exchanges were dropped in the First Amended Complaint to avoid the implications of *Walker* (rather than challenge its application and flawed reasoning). (Appellant Benjamin Fogel's Op. Brf. (AOB) at 9.)

The AIFs – Farmers Group, Inc. (dba Farmers Underwriting Association), Fire Underwriters Association and Truck Underwriters Association – execute the insurance contracts on behalf of the policyholder pursuant to a power of attorney, and are separate entities. (Section 1305.) The AIFs here are subsidiaries of FGI. (7 JA 1917.)

Consumers have differing legal relationships with these separate entities, reflecting the unique nature of reciprocal insurance.

Policyholders pay premiums to the Exchanges, and submit claims (7 JA 1878) to the Exchanges. State law regulates the relationship between insurance policyholders and insurance companies in manifold ways. As discussed in greater detail below, the provisions of the Insurance Code that regulate the rates, premiums and certain practices of property-casualty insurers, including automobile insurers, are contained principally in Article 10 of Chapter 9 of Part 2 of Division 1 of the Insurance Code. Chapter 9 was enacted by the Legislature in 1947 as the McBride-Grunsky Regulatory Act of 1947, and Article 10 was enacted in 1988 by the electorate as Proposition 103. Common law doctrines also regulate the relationship between policyholders and the Exchanges. (See, e.g., *Moradi-Shalal v. Fireman's Fund Insurance Cos.* (1988) 46 Cal.3d 287 [liability in tort for bad faith].)

The consumer's relationship with the AIFs, such as FGI, is distinct from the policyholder relationship with the insurers. The policyholder is

considered a "subscriber." (Sections 1300-1301.) The subscriber executes a "subscription agreement" appointing the attorney in fact. (Section 1305.) The AIF then becomes a fiduciary to the subscriber. (*Tran v. Farmers Group, Inc*. (2002) 104 Cal.App.4th 1202.) Pursuant to that agreement, the subscriber agrees to pay a fee to the AIF for its services.

The nature of the AIF Fee is a key issue for this case. The AIF Fee is therefore ostensibly necessary to cover FGI's cost of providing "management services" to the Exchanges on behalf of subscribers. (7 JA 1877-1878.) The AIF Fee is not intended to cover an insured's "risk of loss," but rather to compensate FGI for services rendered on behalf of subscribers.

The authority of FGI to levy the AIF Fee does not arise from the Department, or from the provisions of the Insurance Code that govern the regulation of rates. Rather, the authority comes from an entirely different section of the Insurance Code.

Moreover, FGI collects the AIF Fee from the Exchanges regardless of the Exchange's losses on any insured. (7 JA 1888.)

Finally, the amount of the AIF Fee is not determined by the risk of the policyholder, but rather is based, according to the subscription agreement, on a flat percentage of the premium each policyholder pays. (4 JA 1077.)

Failure to grasp the unique aspects of the arrangement is clearly the basis of the confusion below, specifically the court's decision equating the AIF Fee to a rate. The confusion is exacerbated by the way in which the AIF Fee is collected: the subscriber does not pay the AIF Fee directly to FGI. Instead, the Exchanges collect the AIF Fee on behalf of FGI, through the billing statements issued by the Exchanges. (Responding and Opening Brief of Respondents/Cross-Appellants (RB) at 28-29.) Moreover, the fee is not billed by the Exchanges as a separate item – even though it is a

separate item – but rather the AIF Fee is rolled into the amount of the premium on the bill. (*Id*.) This is a billing arrangement that may make practical sense, avoiding the need to issue separate bills. But it has led to the conflation of the fee, which is a matter of private contract, with the rate, which is regulated by the Commissioner.

Having delineated the distinct differences in the relevant relationships, this brief will now turn to the background of insurance regulation necessary to discuss the *Walker* and "filed rate doctrine" arguments at issue here.

B. The Pre-Proposition 103 Insurance Code Denied Consumers the Right to Challenge Insurer Misconduct in the Courts.

Though FGI is not an insurance company, it seeks to avail itself of a statutory immunity from suit and liability that was a hallmark of pre-Proposition 103 insurance statutes. FGI contends this immunity not only survived, but expanded, as a result of the passage of Proposition 103.

To evaluate the changes in insurance law wrought by Proposition 103, and the meaning of the vestigial provisions of prior law that Proposition 103 did not repeal, it is important to compare the two relevant statutory regimes, the McBride-Grunsky Insurance Regulatory Act of 1947 (McBride) and Proposition 103, which replaced it in 1988.

As *Donabedian* explains, McBride was the product of a U.S. Supreme Court decision applying the federal antitrust laws to the insurance industry. Congress enacted the McCarran-Ferguson Act (McCarran), exempting insurers from federal antitrust law to the extent that state laws regulated insurance. (See 15 U.S.C. §§ 1011-1015.) Every state legislature then enacted laws to meet the federal standard for exemption. (*Donabedian, supra,* 116 Cal.App.4th at 978-979.)

California followed suit. "One primary purpose of the McBride Act was 'to authorize cooperation between insurers in rate making and other related matters.' (Former section 1850, enacted by Stats.1947, ch. 805, § 1, p. 1896, repealed by Proposition 103, section 7.)" (*Donabedian*, *supra*, 116 Cal.App.4th at 979.)[5] This included authority for "[c]oncerted action" (former section 1853), "[a]greements to adhere to rates" (former section 1853.6), and the "[e]xchange of information and experience data" (former section 1853.7).[6] Under McCarran, such activity could escape federal antitrust liability only if expressly authorized by state insurance law. (See, e.g., Angoff, *Insurance Against Competition: How the McCarran-Ferguson Act Raises Prices and Profits in the Property/Casualty Insurance Industry* (1988) 5 Yale J. on Reg. 397.)

However, McBride-Grunsky reached beyond the antitrust exemption to erect a statutory framework under which the property-casualty insurance industry was virtually exempt from oversight by the executive or judicial branches. As *Donabedian* notes, insurers were not required to file their rates or underwriting plans with the Insurance Commissioner; even if a rate was excessive, the Commissioner was prohibited from taking any action so long as there was "competition" in the marketplace.[7] (*Donabedian*, *supra*, 116 Cal.App.4th at 980-981.) Insurers similarly were accorded carte-

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[5] See MJN Exh. B [Letter from J.R. Maloney, Deputy Insurance Commissioner, on behalf of Wallace K. Downey, Insurance Commissioner, to Gov. Earl Warren, June 10, 1947, pp. 1-2], quoted by *Donabedian*, *supra*, 116 Cal.App.4th at 980.

[6] All three former sections were added by Stats. 1947, c. 805, section 1, p. 1898-1899, and repealed by Proposition 103.

[7] Former section 1852, added by Stats. 1947, c. 805, § 1, p. 1897, repealed by Proposition 103.

blanche in the setting of premiums.[8] (*Ibid.*) "Under [McBride-Grunsky], 'California ha[d] less regulation of insurance than any other state, and in California automobile liability insurance [was] less regulated than most other forms of insurance.'" (*Donabedian*, *supra*, 116 Cal.App.4th at 980, quoting *King v. Meese* (1987) 43 Cal.3d 1217, 1240-1241.)

McBride-Grunsky also insulated insurers from judicial accountability. This was accomplished through two provisions whose residual scope after Proposition 103 was severely misconstrued by *Walker*: sections 1860.1 and 1860.2.

Section 1860.1 authorized insurers to engage in certain forms of concerted activity that might otherwise violate the antitrust laws. In language that closely parallels the federal antitrust immunity conferred by the 1947 McCarran-Ferguson Act,[9] section 1860.1 reads:

> No act done, action taken or agreement made pursuant to the authority conferred by this chapter [Chapter 9] 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.

(Section 1860.1.)

As this Court explained in *Donabedian*, the phrase "authority conferred by this chapter" had a very specific meaning when it was enacted: it referred to the statutory authority conferred on *insurance companies* to engage in concerted activities that, were they not expressly

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[8] *See* former section 1850, 1852(d), added by Stats. 1947, c. 805, § 1, p. 1897, repealed by Proposition 103.

[9] McCarran provides that no federal law shall "invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance unless such Act *specifically relates to the business of insurance.*" (15 U.S.C. § 1012(b), emphasis added.)

authorized by McBride-Grunsky, might violate the antitrust laws. (*Donabedian*, *supra*, 116 Cal.App.4th at 987-990.)

Section 1860.2 established what came to be known as the Insurance Commissioner's "exclusive jurisdiction." It specified that "[t]he administration and enforcement of this chapter shall be governed solely by the provisions of this chapter." (Section 1860.2) At that time, Chapter 9 provided that objections to an insurer's rates, premiums, or practices could be raised only ("exclusively") through an administrative complaint process established by McBride-Grunsky. Under that process, an aggrieved consumer's *sole* recourse was to file a complaint *with the insurance company* itself. If the complaint was rejected, the consumer could appeal to the Insurance Commissioner, who could summarily deny a hearing in his or her sole discretion. Hearings could be held in secret. Should a hearing substantiate misconduct, the Commissioner could provide prospective relief only. *The Commissioner had no authority to order refunds*, *restitution or disgorgement.* (See §§ former 1858-1859.1 [amended 1977, 1979, 1984, 1987 and 1989].) Judicial review was available only by way of administrative mandamus under Code of Civil Procedure section 1094.5.[10] (See section 1858.6.) This miserly administrative process was rarely invoked and never resulted in a successful challenge to an insurer's rates.[11]

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[10] It was noted at the time that the absence of such authority "puts a premium upon stalling and delay in the Commissioner's proceedings." (See MJN Exh. C [Letter from Harold B. Haas, Deputy Attorney General, California Dept. of Justice, to Gov. Earl Warren, June 11, 1947], p. 6.) These sections were amended, effective 1988, to enable a consumer to file a complaint directly with the Commissioner. **(***Donabedian*, *supra*, 116 Cal.App.4th at 980, fn.3.)

[11] An investigation by the Little Hoover Commission "was unable to find a single formal determination made by the Department in the past 25 years that a rate is excessive." (Commission on California State Government

Thus, section 1860.2 foreclosed any judicial remedy except judicial review by means of administrative mandamus (section 1858.6).

Collectively, the two McBride-Grunsky provisions constituted a regime in which insurers won and consumers lost. As *Donabedian* summarized: "In short, under the McBride Act, the commissioner had exclusive jurisdiction to adjudicate complaints about insurance rates but had practically no authority to regulate them effectively." (*Donabedian*, *supra*, 116 Cal.App.4th at 981.)

Indeed, the courts consistently applied McBride to dismiss suits against insurers alleging improper rates or practices, on the dual grounds that the plaintiffs had failed to exhaust their exclusive administrative remedy under section 1858, and because the challenged conduct was immunized. The decision in *Karlin v. Zalta* (1984) 154 Cal.App.3d 953 (*Karlin*) is illustrative. There, a consumer brought suit, alleging a conspiracy among insurers and others to fix prices for medical malpractice insurance at excessive levels during the "malpractice crisis" of the 1970s, in violation of section 1852 of McBride-Grunsky and the Unfair Insurance Practices Act (UIPA) (section 790 et seq.). The Court of Appeal ruled that section 1853 of McBride-Grunsky expressly sanctioned rate-setting collusion. (*Karlin*, *supra*, 154 Cal.App.3d at 970.) It also held that, to the extent that insurance rates were challenged, relief under the UIPA was foreclosed by sections 1860.1 and 1860.2. (*Id*. at 968-979.) Finally, the court held that objections to insurance rates could be raised only in the form of an administrative complaint under section 1858, and that the plaintiff had failed to exhaust that exclusive remedy. (*Id*. at 974.) Having instructed the petitioner to exhaust, however, the court predicted the ultimate futility of

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Organization and Economy, *A Report on the Liability Insurance Crisis in the State of California*, July 1986, p. 29.)

the process: "A finding that the activities complained of were authorized under the McBride Act might call into play the immunities of sections 1860.1 and 1860.2 against any civil claim." (*Id*. at 986, fn. 23.)

C. Proposition 103 Replaced McBride-Grunsky with a Regulatory Framework that Holds Insurance Companies Accountable in the Courts.

During the liability insurance "crisis" of the 1980's, the McBride-Grunsky regime drew enormous criticism. A legislative analysis published at the time concluded that, "[t]he McBride-Grunsky Act must be judged a failure."[12]

In 1988, the voters replaced the discredited McBride-Grunsky system with a new statutory regime, Proposition 103, imposing substantive regulation upon insurers, and retaining for themselves the authority to enforce those requirements in the courts.

Proposition 103's findings clause stated that "the existing laws [McBride-Grunsky] inadequately protect consumers and allow insurance companies to charge excessive, unjustified and arbitrary rates."[13] To address that inadequacy, Proposition 103 explicitly repealed every provision of McBride-Grunsky that was inconsistent with the initiative statute.[14] A few sections of McBride-Grunsky were not expressly repealed

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[12] MJN Exh. D (Sen. Claims and Corporations Comm., Analysis of Assem. Bill 1687 (1987-1988 Reg. Sess.) July 15, 1987, p. 4 [analyzing legislation amending the McBride-Grunsky complaint process].) See also, e.g., Auditor General of California, *The Department of Insurance Needs to Further Improve and Increase Its Regulatory Efforts* (June, 1987)

[13] MJN Exh. E sets forth the text of Proposition 103 as enacted by the voters on November 8, 1988.

[14] MJN Exh. E, Proposition 103, Section 7 ["Repeal of Existing Law"]. MJN Exhibit F displays the repealed provisions in strike-through.

because, as explained below, these vestiges were consistent with the Insurance Code as modified by Proposition 103.

The voters imposed reforms in five broad categories: (1) immediate rate reductions (§ 1861.01); (2) application of the antitrust laws and reforms to encourage competition in the marketplace (§ 1861.03, subd. (a); see also §§ 1861.04, 1861.12); (3) regulation of automobile premium and underwriting practices (section 1861.02; see also § 1861.03, subd. (c)); (4) regulation of the rates of property-casualty companies (§§ 1861.05-1861.09); and (5) public participation and insurer accountability (§§ 1861.03, subd. (a) and 1861.10, subd. (a)). The last three reforms are at issue here. Their provisions are summarized below.

1. How Proposition 103 Regulates Rates, Premium and Underwriting Practices.

Because the AIF Fee is rolled into the premium collected by the Exchanges, FGI argues that the AIF Fee is part of the Proposition 103 ratemaking process; that it was "approved" by the Commissioner as part of that process; and thus is subject to the *Walker*/filed rate doctrine defenses. To assess that argument, it is important to understand how Proposition 103 regulates various aspects of insurance pricing.

a. Rates.

As the *Donabedian* decision explains, a "rate" "represents the total amount of annual premium that the insurer must charge in order to cover expenses and obtain a reasonable rate of return." (*Donabedian*, *supra*, 116 Cal.App.4th at 992.) Under section 1861.05 et seq., Proposition 103 requires insurers to submit a proposed rate for each line of property-casualty insurance (see section 1861.13), e.g., automobile, homeowner, etc., to the Commissioner for review and approval prior to their use. This is known as the "prior approval" process. The process is prospective; insurers collect rates based on their projection of future revenue requirements. (*20th*

Century Ins. Co. v. Garamendi (1994) 8 Cal.4th 216, 252, 282 (*20th Century*).)

The Commissioner has promulgated regulations that govern the prior approval process. An insurer must 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. [(See generally Cal. Code Regs., tit. 10, §§ 2644.1-2644.23.)]." (*Donabedian*, *supra*, 116 Cal.App.4th at 992, quoting from the amicus curiae brief of the Insurance Commissioner; see also *Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805 (*Calfarm*); *20th Century*, *supra*, 8 Cal.4th 216; *Proposition 103 Enforcement Project v. Quackenbush* (1998) 64 Cal.App.4th 1473.) The regulatory formula is designed to ensure that the proposed rates are within a *range of reasonableness* bounded by the statutory requirement (§ 1861.05(a)) that rates be neither "excessive" nor "inadequate."

It is undisputed that the AIF Fee itself is not a "rate."

b. Expenses.

The prior approval ratemaking formula regulates several specific components of insurers' rates. The formula establishes a methodology by which the amount an insurer estimates it will pay out in claims – "losses" – is projected and reserves are set aside in anticipation of those losses. (Cal. Code Regs., tit. 10, §§ 2644.4-.14.)

The formula also establishes the amount of "fixed expenses" that an insurance company may pass through to policyholders. Fixed expenses include: (1) acquisition, field supervision, and collection expenses (2) general expenses (3) state and local taxes, licenses, and fees minus premium taxes and (4) unallocated loss adjustment expenses. (Cal. Code Regs., tit. 10, § 2644.9; *Calfarm*, *supra*, 48 Cal.3d at 828.)

The precise amount of fixed expenses that may be included in any insurer's rate is limited by the "efficiency standard" set forth in section 2644.12 of title 10 of the California Code of Regulations. The efficiency standard is established by computing an industry-wide average. An insurer may not pass through to policyholders an amount of fixed expenses that exceeds the amount allowed by the efficiency standard. (See *Calfarm*, *supra*, 48 Cal.3d at 853.)

Finally, the formula excludes certain expenses from being passed through to policyholders: bad faith judgments, fines and an insurer's contributions to political candidates, for example, must be borne by the stockholders. (Cal. Code Regs., tit. 10, § 2644.10.) Among the expenses that an insurer is "not [] allowed" to include "for ratemaking purposes" are "payments to affiliates" that "exceed the fair market rate or value of the goods or services in the open market." (Cal. Code Regs., tit. 10, § 2644.10(g).) The application of this provision to the Exchanges, and their compliance with this provision, will be discussed *infra*.

It should be clear that the formula does not regulate the individual expenditures of an insurance company. It does not regulate the rent an insurer pays, for example. The prior approval formula only requires that if an insurer's overall expenses exceed the allowable amount, the insurance company must bear the excessive expenses.

No provision of Proposition 103, nor any provision of the prior approval regulations, provides for the regulation of the contracts between reciprocal insurers such as the Exchanges and AIFs. Like rent, management services are considered part of the fixed expenses of an insurance company.

c. Premiums.

As explained by *Donabedian*, Proposition 103 sets forth an independent set of regulatory requirements *applicable only to automobile*

insurance, under which an insurer must also obtain approval for the method by which it allocates its total revenue requirement (its rate) among its policyholders, i.e., how much *premium* it can collect from each insured motorist. Those criteria that an insurer uses to establish a motorist's premium are known as "rating factors." (Section 1861.02; *Donabedian*, *supra*, 116 Cal.App.4th at 973.) An insurer may only use rating factors authorized by the Commissioner, and must disclose, on a checklist, which rating factors it intends to use. (See Cal. Code Regs., tit. 10, § 2632.5; *Donabedian*, *supra*, 116 Cal.App.4th at 993.)

The AIF Fee is not a rating factor.

2. Proposition 103 Repealed the Insurance Industry's Immunity from the Antitrust Laws, Replacing it with Narrow Exceptions.

To effectuate its goal of increasing competition, Proposition 103 repealed the McBride-Grunsky era provisions that explicitly authorized joint conduct that would otherwise violate the antitrust laws: former section 1853, 1853.6, 1853.7, and 1854 through 1854.5. (See MJN Exh. E [Prop. 103], § 7.) It expressly made California's antitrust, civil rights, consumer protection and other laws applicable to the industry through section 1861.03(a).

After Proposition 103, Chapter 9 authorizes very little anti-competitive conduct. Section 1861.03(b), however, created a narrow "safe harbor" provision for certain activities between two or more insurers.

Additionally, Proposition 103 did not repeal several provisions of McBride-Grunsky that permit other joint activities, such as section 1853.5 (concerted action among insurers with common ownership or management); section 1853.8 (agreements to apportion risks); section 1855 (operation of advisory organizations); and section 1856 (joint underwriting and reinsurance).

Thus, as *Donabedian* noted, section 1860.1, which immunizes acts taken by insurers "pursuant to the authority conferred by [Chapter 9]," *still serves its traditional purpose* by providing *some* immunity for certain joint conduct. (*Donabedian*, *supra*, 116 Cal.App.4th at 990-991.) The basic *meaning* of that section remains unchanged; however, the *scope* of the immunity it confers has contracted.

3. Proposition 103 Created a Broad Private Right of Action and Eliminated the Commissioner's Exclusive Jurisdiction.

As a comprehensive scheme for *controlling insurance rates and premiums*, Proposition 103 places paramount emphasis on the accountability of both insurers and the Insurance Commissioner to the public. Throughout Proposition 103, the voters manifested in plain terms their intent to retain an active role in ensuring the proper enforcement of the provisions of Proposition 103. The measure requires notice, disclosure, and the opportunity for public participation in the matters governed by the measure. (See, e.g., section 1861.05 et seq.) It also made the Insurance Commissioner an elected official, accountable directly to the voters. (Section 12900.)

While under Proposition 103 "much is necessarily left to the Commissioner" (*Calfarm*, *supra*, 48 Cal.3d at 824), the voters chose not to leave *everything* to the Commissioner. Thus, as this Court discussed in *Donabedian*, the electorate established in section 1861.10(a) an independent check upon the conduct of insurance companies (as well as the Commissioner):

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

(Section 1861.10(a).)

Section 1861.10(a) confers on members of the public an *unqualified* right to seek administrative *or* judicial redress against any insurer as well as against the Commissioner. In particular, anyone may "initiate . . . any proceeding" that Chapter 9 "permit[s] or establishe[s]"; and anyone may "enforce any provision of" Proposition 103. (*Donabedian*, *supra*, 116 Cal.App.4th at 987.)

Under McBride-Grunsky, before Proposition 103, Chapter 9 did not "permit[] or establish[]" any proceeding other than the often-futile grievance proceeding allowed by section 1858 et seq. But a key section of Proposition 103 changed that decisively. Section 1861.03(a) states:

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

Sections 1861.10(a) and 1861.03(a) of Proposition 103 changed the landscape of Chapter 9, directly affecting the scope (but *not the meaning*) of the two vestigial provisions. The concerted activities immunized by section 1860.1 are now sharply limited by Chapter 9. And no longer does section 1860.2 have the effect of prohibiting private enforcement actions in the courts. While it remains the case that "[t]he administration and enforcement of this chapter [are] governed solely by the provisions of this chapter," the provisions of this chapter – Chapter 9 – now include section 1861.03(a), which subjects the insurance industry to the UCL's remedies, and section 1861.10(a), which allows any person to enforce those remedies.

The Commissioner's formerly "exclusive jurisdiction" under section 1858 now gives way to the alternative or parallel remedies provided by section 1861.03(a) and 1861.10(a). Consumers now can elect to employ the less costly, less complicated administrative process for the resolution of

minor individual grievances, or they can choose the more powerful judicial forum when desirable – the latter without any requirement of exhausting administrative remedies. (*Farmers*, *supra*, 2 Cal.4th at 394.)

DISCUSSION

I. *Walker* and the "Filed Rate Doctrine" Do Not Apply to This Case.

In Section III below, FTCR explains that *Walker* incorrectly construed the McBride-Grunsky provisions and that the "filed rate doctrine" conflicts with the parallel private enforcement scheme established by Proposition 103. It is FTCR's view that *Walker* is bad law and that there is no "filed rate doctrine" under Proposition 103.

However, this Court need not reach that conclusion, for even if *Walker's* analysis of the McBride provisions was correct, *Walker*, by its own terms, is inapposite to this case. Similar considerations distinguish this case from those in which the "filed rate doctrine" has been applied.

A. FGI Is Not An Insurance Company Regulated by Proposition 103 and Has Not Filed Any Rates.

Walker was a suit against *insurance companies* challenging the rates they charged. The Defendants here are not insurance companies. FGI and its subsidiaries are attorneys-in-fact. An exchange is the entity that is "deemed an insurer" by the statutory framework that governs the organization of reciprocal insurers – chapter 3 of Part 2 of Division 1 of the Insurance Code. (Section 1303.) The Farmers' Exchanges are not present here.

Proposition 103, which may be found in Chapter 9 of Part 2 of Division 1 of the Insurance Code, does not regulate attorneys-in-fact. (See section 1861.13.) Proposition 103 regulates only insurance companies – in the case of reciprocals, the Exchanges.

An essential attribute of a company availing itself of the "filed rate doctrine" is that the company be a regulated entity required to file "rates." (*Texas & Pac. Ry. v. Abilene Cotton Oil Co*. (1907) 204 U.S. 426, 437-448.) Even if the "filed rate doctrine" were to be applied to insurance companies in California, the defendants here are attorneys-in-fact and would not be entitled to avail themselves of the doctrine.

B. The AIF Fee is not a "rate."

In assessing the challenge to insurance rates that were filed with the California Department of Insurance (CDI) and previously approved by the Commissioner, *Walker* characterized the matter before it as an "*exclusively rate-making*" case. (*Walker*, *supra*, 77 Cal.App.4th at 759, emphasis added.)

FGI's defense does not focus on the AIF Fee or its function, but on how it is collected. FGI insists that the AIF Fee constitutes a rate, and is therefore subject to a *Walker/*filed rate doctrine defense, because (1) it is collected by the Exchanges on behalf of FGI; (2) it is rolled into the amount of the premium charged, rather than itemized separately; and (3) it is calculated as a percentage of premium. (See, e.g., RB at 8 [equating AIF Fee to "premium"].) In essence, FGI argues that *anything that is paid for from the proceeds of the rates charged by the exchanges is equivalent to a rate*. The court below agreed. (16 JA 4475-4478.)

This was error. Though FGI has tried mightily to muddy the difference, this case is not about insurance rates.

The AIF Fee is expressly described in the subscription agreement as a fee charged by the AIF "for becoming and acting as attorney-in-fact." (4 JA 1077.) In that sense, the AIF Fee is uniquely a creature of the subscription agreement that reciprocals utilize.

Moreover, the authority of FGI to levy the AIF Fee comes not from the Department of Insurance, nor from the provisions of the insurance code

that govern the regulation of rates (sections 1861.05 through 1861.09), but from a private contract – the subscription agreement – between FGI and subscribers as required by an entirely different section of the Insurance Code*:* section 1305. The operative complaint here does not allege any violation of Proposition 103.

If FGI had billed the subscriber directly, there would be no question that the AIF Fee is not a "rate." The court below seemed to acknowledge such a distinction, stating "defendants never collected AIF fees directly from any insured. Rather, such fees were collected from premiums paid to the 'Exchanges.'" (16 JA 4474.) The result here should not turn on how the AIF Fee is collected. The fact that FGI arranged to utilize the Exchanges as the bill collector, and the premium notice as the mechanism to collect the AIF Fee, should not be permitted to transform the AIF Fee into an insurance rate.

As discussed in the Background section at pp. 16-17, "rates" refer to the revenue needs of insurance companies. Proposition 103 regulates the rates of property-casualty insurance companies operating in California. It does so by requiring that rates remain within a range bounded by the "excessive/inadequate" standards. (Section 1861.05.) Insurance companies must apply to change their rates in a process that requires public notice, disclosure and the opportunity for public scrutiny and judicial review of the Commissioner's ultimate action. (Sections 1861.05 – 1861.09.)

Because the process is prospective, it is necessarily inexact. Moreover, because section 1861.05(a) permits rates that are within a "range" of reasonableness (neither "excessive" nor "inadequate"), there is no uniquely "correct" rate. The reasonableness of a rate is a mixed question of law and fact, requiring specialized expertise and judgment. (See, e.g., *Interstate Commerce Commission v. Union Pacific Railroad Co.* (1912) 222 U.S. 541, 547.) As a result, courts are sometimes reluctant to

substitute their judgment for those of the regulators that have approved the rates. Decisions applying the "filed-rate doctrine" reflect those specific concerns. (See, e.g., *Wegoland Ltd. v. Nynex Corp* (2003) 27 F.3d 17, 19.)

The attorney-in-fact subscription fee is not an insurance rate because the subscription agreement does not provide insurance as that term is defined by section 22: it does not "shift[] one party's risk of loss to another party," nor does it "distribute that risk among similarly situated persons." (*Wayne v. Staples*, *supra*, 135 Cal.App.4th at 475-476.)

Furthermore, as discussed previously at pp. 17-18, the ratemaking formula (Cal. Code Regs. § 2644.1 et seq.) does not regulate an insurer's expenditures or contracts with third persons. It simply determines how much of an insurer's overall expenses may be passed through to ratepayers. Fees paid by an insurer to third parties are considered an expense. Absent comprehensive discovery, there is no way to examine a specific expenditure or expense of an insurer and determine whether or not the expense was passed through, in whole or part, to the policyholder, or borne solely by the company.

Equating "expenditures" to rates for purposes of *Walker* or the "filed rate doctrine" not only makes no sense, it would lead to absurd consequences. For example, if any *expenditure* that an insurer makes is deemed to be "approved" by the Commissioner as a "*rate*" and therefore not subject to challenge, then policyholders would be barred from challenging a claims payment made in bad faith, or filing a derivative suit charging waste of corporate assets. In fact, any tort lawsuit would be barred, since the judgment would be paid out of rates.

This analysis brings us back to the core point. *Walker* and/or the "filed rate doctrine" are not the proper legal framework by which Fogel's allegations should be adjudicated. Other legal frameworks and theories of liability have been developed that are applicable here. (See, e.g., *Tran v.*

Farmers Group, *Inc.* (2002) 104 Cal.App.4th 1202 [applying agency and fiduciary principles]; *Lee v. Interinsurance Exchange of the Automobile Club of Southern California* (1996) 50 Cal.App.4th 694 [applying "business judgment rule"].)

Determining whether a revenue request (i.e., a rate) is *reasonable* may require the expertise and judgment of the Commissioner, as noted. By contrast, whether a company has breached a contract, or its fiduciary duty, or overcharged a customer or violated a law, is the kind of issue that courts adjudicate every day.

Even if FGI was an insurance company, the AIF Fee is not a "rate," and neither *Walker* nor the "filed rate doctrine" apply.

C. Neither the AIF Fee Nor the Management Services Agreement Was Filed Or Approved.

Walker repeatedly emphasizes that its holding is based on the fact that the challenged rates were *approved*. The Commissioner's approval was expressly the predicate for the immunity *Walker* discerned (incorrectly) in the statutes. (*Walker*, *supra*, 77 Cal.App.4th at 753, 756, 757, 759.) Thus, even if sections 1860.1 and 1860.2, or the "filed rate doctrine," immunized approved rates, no such immunity would apply to that which is *unapproved*.

1. The AIF Fee Was Neither Filed Nor Approved.

The record here affirmatively establishes that the Exchanges did not disclose, and the Commissioner did not approve, the AIF Fee, contrary to FGI's repeated assertions and the court below. (16 JA 4474 ["[T]he AIF fees are a disclosed expense as part of the "Exchanges" rate applications to the Insurance Commissioner"].)

First, neither the existence of the AIF Fee, nor the dollar amount of the AIF Fee, has ever been filed with or disclosed to the Commissioner pursuant to the public disclosure and regulatory review requirements of

Proposition 103, contrary to the defendants' repeated assertions (see, e.g., RB at 8). A cursory review of the exhibits FGI provided before the trial court confirms this. FGI acknowledges (2 JA 473), that the management services for which subscribers pay the AIF Fee are treated as an expense and contained within the overall expense figures listed simply as "other acquisitions, field supervision, and collection expenses incurred" in FGI's Expense Exhibits. (For an example, see 3 JA 790.) If so, it is similar to any other expense, such as rent, advertising, etc. It is neither itemized nor disclosed.

As previously noted at pp. 17-18, under the present regulations, the Commissioner must disallow an overall fixed expense level that exceeds that specified by the regulatory formula. However, this means only that amounts in excess may not be recouped from policyholders. Nothing in the Commissioner's regulations authorize him to prohibit an insurer from making any allowable fixed expenditures that fall within the expense cap, as calculated by applying the efficiency standard. Moreover, insurers are not prohibited from making expenditures above the cap – they simply may not pass such expenditures through to policyholders.

Section 2644.10 does provide that certain expenses be excluded from the rate calculation altogether, including "payments to affiliates" that "exceed the fair market rate or value of the goods or services in the open market." (Cal. Code Regs., tit. 10, § 2644.10(g).) However, nothing in the record suggests that the Commissioner reviewed or approved of the AIF Fee pursuant to this requirement. To the contrary, the record indicates that when the Exchanges provided expense allocation information as part of their rate filings, they simply stated in a conclusory fashion that "all expenses referenced by CCR 2644.10 are excluded" from their filing. (See, e.g., 3 JA 666.) Thus, at least with respect to that filing by the Exchanges,

nothing was presented to the Commissioner to indicate whether or not the AIF Fee, or any portion of it, was included in the reported expenses.

FTCR also calls the Court's attention to, and requests judicial notice of, a Market Conduct Examination by the California Department of Insurance of Farmers Insurance Exchange dated December 31, 1992. It states: "While underwriting (management) fees are reportable and subject to aggregation under CIC Section 1215.4, the Department of Insurance is not asserting that prior approval of management fee payments is required under that section." (MJN Exh. G [Market Conduct Examination] at 5.)

2. The Management Services Contract was Neither Filed Nor Approved.

Nor is there anything in the record that suggests that the Commissioner received, much less reviewed, the actual contract between FGI and the Exchanges that presumably specifies what management services are provided to the Exchanges by FGI as consideration for the fees. In fact, a statute that requires reciprocals like Farmers Insurance Group to submit such contracts to the Commissioner for review was amended at the behest of "Farmers Insurance Group" in an apparent attempt to relieve Farmers from that obligation.

The Insurance Holding Company System Regulatory Act, section 1215 et seq., enacted in 1969, requires that the Commissioner be notified of certain specified transactions between insurance affiliates; the Commissioner may disapprove them. (Section 1215.5(b).) These include "all management agreements, service contracts, and cost-sharing arrangements." (Section 1215.5(b)(4).) The terms and charges or fees performed for services provided must be "fair and reasonable." (Section 1215.5(a)(1)-(2).) This was the law when Proposition 103 was approved.

In 1996, amendments to section 1215.5, sponsored by "Farmers Insurance Group," were enacted into law purportedly to clarify that insurers

would not be required to "report[]" such agreements "if the form of the agreement was in use before 1940 and was not amended in any way to modify payments, fees, or waivers of fees or otherwise substantially amended after 1940." (Stats. 1996, ch. 820, § 5.) As the legislative analyst explained:

> As passed by the Assembly, this bill required covered insurers to disclose all management agreements, service contracts, and cost-sharing agreements in their registration statement, without regard to their age.
>
> The Senate amendments are intended to remedy the concern of Farmers Insurance Group, that the bill would have allowed the Department [of Insurance] to review all subscription agreements and cost allocation agreements between a reciprocal insurer and its attorney-in-fact, including those made over 50 years ago.

(MJN Exh. H [Assembly Floor Analysis, August 30, 1996, analysis of Assembly Bill 2538 (1995-1996 Reg. Sess.) as amended August 19, 1996], p. 3.)

The bill became law.

However, Farmers Insurance Group had erred in drafting the 1996 amendments to exempt only those contracts dated prior to 1940. In 1998, at the behest of Farmers, the date was changed to 1943. (Stats. 1998, ch. 368, § 2.) As a legislative committee analysis explained:

> The author introduced AB 2689 at the request of Farmers Insurance Company (Farmers) in order to correct an inaccurate date that was added to the Insurance Code in 1996 by AB 2538 (Miller, Chapter 820). Farmers is organized as an insurance exchange in which the policyholders are the owners. The policyholders hire a management company to operate the business. Initially, AB 2538 would have affected management agreements that have been in place over 50 years. As it was not the Legislature's intent to force changes on long-standing agreements, these management agreements were grandfathered in. Unfortunately, the date that was used was wrong, as Farmers discovered when it determined that one of the exchanges was not subject to the agreement until 1942. Changing the date from 1940 to 1943 will rectify this error.

(MJN Exh. I [Sen. Comm. on Insurance, analysis of AB 2689 (1997-1998 Reg. Sess.), as introduced].)

Neither Fogel nor FGI has referenced this statute. The record does not permit a determination of whether the subscription agreements have been amended and no longer qualify for the relief from disclosure that section 1215.5(b)(4) purports to accord.[15] Thus, it is unknown whether the Exchanges would in fact accede to the Commissioner's authority to review the management services agreement, or resist such regulation by citing section 1215.5(b)(4) as grounds to refuse the Commissioner's authority.

In any case, FGI would presumably have placed evidence in the record if the Exchanges had disclosed and obtained approval for the management services contract. There is no such evidence in the record.

3. There Can Be No Approval of That Which Is Not Specifically Disclosed.

FGI's argument reduces to this: the Commissioner's approval of the Exchange's rate filings automatically immunizes, under *Walker*, the AIF Fee, which was neither disclosed nor approved. The Commissioner has noted the "potentially disastrous" impact of a rule immunizing items buried in a class plan. (MJN Exh. A [Commissioner's Brief], p. 18.) Here, the AIF Fee was nowhere to be found in the Exchange's filings. As the CDI approval letters state, "Only the changes specifically requested in the application set forth above are approved." (See, e.g., 3 JA 603.)

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[15] Nor, in any case, could section 1215.5(b)(4), as amended, shield the management agreements from the Commissioner's authority under Proposition 103 to review the agreements as they affect rates and premiums under section 1861.05(a); if applied as a shield, such an amendment would violate the proscription against legislative amendments to Proposition 103, as this Court has recently held. (See *The Foundation for Taxpayer and Consumer Rights v. Garamendi* (2005) 132 Cal.App.4th 1354 [invalidating legislation which sought to alter the regulatory authority the voters accorded the Commissioner].)

Failure to specifically disclose and obtain approval for the AIF Fee implicates a larger statutory concern. The Proposition 103 voters established a new regulatory regime under which insurance companies are required to submit applications for rate changes and for automobile insurance rating factors to the Commissioner for review and approval. Disclosure is a critical element of the process. Insurers must "open their books" and submit not only to the Commissioner's investigation, but to public scrutiny. (See § 1861.07; *State Farm Mutual Automobile Insurance Co. v. Garamendi* (2004) 32 Cal.4th 1029.) As FGI's filings do not disclose the AIF Fee, much less the management services contract, the statutory public review process would be short-circuited by a ruling that determined that the Fee has been approved merely because the Exchanges' overall expense levels were reviewed for purposes of approving its rates.

II. This is Not An Insurance Rate Case, But if it Were, the Court Should Have Followed *Farmers* and Referred it to the Commissioner.

The fundamental error of the Court below was to treat this as an insurance rate case. The present defendants are not insurance companies. They are not subject to the provisions of the Insurance Code that govern rates and premium setting practices.

This is a pivotal point for purposes of this appeal. As a matter of litigation strategy, both Fogel and FGI sought at the trial level to avoid the implications connected with a lawsuit against insurers – though for opposite reasons.

Fogel amended his complaint in an attempt to avoid the holding of *Walker*, which misconstrued provisions of the Insurance Code in order to bar a challenge to approved insurance rates. (See AOB at 9; 2 JA 337-339.)

By eliminating the insurance companies as parties to the suit, Fogel attempted to zero in on his core challenge: FGI's alleged breach of its fiduciary duty to its subscribers to charge a reasonable fee for its management services. Because his case concerned FGI's fiduciary obligations, and because the Exchanges were no longer before the court below, Fogel argued, correctly, that a primary jurisdiction referral was unnecessary. (AOB at 52; 2 JA 338.) Put another way, plaintiff here has not proceeded on a theory of liability based on an attack on approved insurance rates. Rather, he proceeds on an entirely independent theory, one based on FGI's liability as a fiduciary.

While Fogel's amended complaint does not address unlawful insurance rates, premiums or practices, or insurance companies, FGI's defense, by contrast, does so directly. FGI contends that the AIF Fee was approved by the Commissioner as part of the regulatory process established by Proposition 103, and that such approval bars any challenge to the AIF Fee. FGI never specifically addresses the question of its fiduciary duty as an attorney-in-fact, nor does FGI address the question of whether it breached that duty. FGI's position is that the Commissioner's approval of the *Exchange's rates* in effect immunized *FGI* from a lawsuit claiming FGI breached its *fiduciary duties*.

Yet, despite the fact that FGI's defense rested entirely upon its contentions regarding the insurance regulatory process, FGI joined Fogel in eschewing a referral to the Insurance Commissioner under the primary jurisdiction doctrine articulated in *Farmers*. (10 JA 2792, 2801-2802.) The result was that FGI obtained the benefits of characterizing this as an insurance case, while evading a referral to CDI that would have vastly aided the trial court in assessing the merits of FGI's contentions, including its *Walker* defense.

The court below rejected Fogel's attempt to hold FGI accountable under a breach of fiduciary duty theory. Instead, the court agreed with FGI that this was a Proposition 103 rate case.

The trial court's decision to treat this as an insurance rate case placed the case in exactly the same posture as the one our Supreme Court encountered when it first articulated the primary jurisdiction doctrine in *Farmers*. There, the Supreme Court unequivocally *rejected* the contention of Farmers Insurance Group that a UCL action against insurers was barred despite the passage of Proposition 103. (*Farmers*, *supra*, 2 Cal.4th 377, 390, 394.) However, the Court imposed the primary jurisdiction doctrine, under which a superior court may solicit the expertise and views of the agency most familiar with the regulation of insurance companies to obtain its "technical expertise." (*Id*. at 398.)

FTCR does not contend that a primary jurisdiction referral was necessary here to resolve this case. FTCR believes that the issue of FGI's fiduciary duties to its subscribers can and should be addressed on its own. When the "Farmers Insurance Group" availed itself of the unique statutory authority to organize itself as a reciprocal pursuant to Insurance Code section 1280 et seq., and FGI became an attorney-in-fact, it assumed a fiduciary duty to its subscribers that is *independent of any liability that the Exchanges might have incurred to their policyholders*. There is no statute or case law that suggests that the Commissioner has any authority to adjudicate, much less alter, the fiduciary duties undertaken by an attorney-in-fact to a subscriber.

However, if the trial court was going to treat the case as an insurance rate case under Proposition 103, it should have asked the Commissioner to advise it on the insurance questions by way of the primary jurisdiction doctrine established by the Supreme Court in *Farmers*. Indeed, the Supreme Court made it quite clear that, in a Proposition 103 rate case, the

proper procedure is to stay the trial court proceedings and request that the Commissioner weigh in – not dismiss the case as barred. (*Farmers*, *supra*, 2 Cal.4th at 390.)

III. Even If This an Insurance Rate Case, Sections 1860.1 and 1860.2 Do Not Bar a UCL Action Against Insurance Companies.

Assuming arguendo that this is an insurance rate case, the principal issue for this appeal is whether Fogel's UCL suit is barred. FGI's argument here – that UCL lawsuits challenging a violation of Proposition 103's provisions are prohibited – has been repeatedly presented by insurers to California courts. Each time, the courts have rejected the argument, with one exception: the First District Court of Appeal's 2000 decision in *Walker*.

The basic issue was first decided by our Supreme Court in *Farmers.* (See *Donabedian*, *supra*, 116 Cal.App.4th at 984-986.) There, Farmers Insurance Exchange and its amici invoked pre-Proposition 103 cases such as *Karlin* to argue that the McBride regime barred a suit by the Attorney General under the UCL charging a violation of provisions of Proposition 103. The Court rejected Farmers' contentions, holding that Proposition 103 provides "'alternative' or 'cumulative' administrative *and civil* remedies." (*Farmers*, *supra*, 2 Cal.4th at 393-394, emphasis added.)

There the matter rested, seemingly resolved, until *Walker*. In that case, the plaintiffs filed a class action lawsuit against 78 insurance companies, as well as then-Commissioner Chuck Quackenbush, challenging as "excessive" auto insurance *rates* that had been *approved* by the Commissioner over the preceding three years. The plaintiffs demanded disgorgement and punitive damages. The insurers demurred, arguing that the challenged rates had been approved by the Commissioner and thus

immunized from civil challenge by the two vestigial McBride provisions, sections 1860.1 and 1860.2. The Court of Appeal agreed.

By its terms, *Walker*'s application of the vestigial statutes applied to *rates* filed and *approved* by the Commissioner. But insurance companies subsequently argued that the same construction of sections 1860.1 and 1860.2 barred *any form of UCL suit* against insurers for violation of *any* provision of Proposition 103. The insurers' argument carried the day when it was presented to the trial court in *Donabedian*.

The *Walker* panel itself noted that the plaintiffs before it had failed to provide a detailed explanation of the interplay between the various statutes. (*Walker*, *supra*, 77 Cal.App.4th at 755.) It was not until this Court's opinion in *Donabedian* that a careful analysis of the McBride and Proposition 103 statutes was conducted.

Yet the court below relied on *Walker* to the exclusion of the far better reasoned authority in *Donabedian*.

A. Proposition 103 Did Not Alter the Meaning or Expand the Scope of Sections 1860.1 and 1860.2.

As is clear from the *Donabedian* analysis, *Walker* misconstrued and misapplied sections 1860.1 and 1860.2. By their very text, these statutes do not bar private consumer enforcement of Proposition 103 under section 1861.10, subdivision (a). Section 1860.1 provides:

> No act done, action taken or agreement made pursuant to the authority conferred by this chapter [Chapter 9] 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.

Section 1860.2 provides:

> The administration and enforcement of this chapter shall be governed solely by the provisions of this chapter. Except as provided in this chapter, no other law relating to insurance

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

The First District gave the two vestigial McBride provisions a much broader substantive sweep than they have in the Proposition 103 era. Today, these statutes immunize only certain types of concerted activity between two or more insurers. They do not apply to cases like this one involving the conduct of only one insurance company.

Walker did not involve, in any way, joint conduct or actions taken in concert by the insurers. Yet that court held that section 1860.1 barred the suit, because that section purportedly "[e]mbodies the finality of the commissioner's ratemaking decisions." (*Walker*, *supra*, 77 Cal.App.4th at 758.)

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

(*Id*. at 756.)

This conclusion disregards section 1860.1's limited scope of immunity, particularly after Proposition 103. Contrary to what the *Walker* court assumed, section 1860.1 is not shorthand for the "finality of the Commissioner's ratemaking decisions." *Walker*'s interpretive gloss transformed this provision from one immunizing only certain types of joint conduct by insurers into one also immunizing an insurer's unilateral conduct.

Walker made this quantum leap by failing to examine the origins of sections 1860.1 and 1860.2. Their limited immunity has always extended

only to concerted activity. As one appellate decision observes: "The preamble to the McBride Act describes it as an act 'granting certain immunities under other laws which do not specifically refer to insurance.'" (*Karlin v. Zalta*, *supra*, 154 Cal.App.3d at 968.) Sections 1860.1 and 1860.2 worked together to immunize insurers against Cartwright Act or other antitrust liability to allow concerted action by insurers with regard to ratemaking. (*Id*. at 969.)

Under the analysis adopted by *Walker*, and the court below, section 1860.1 is no longer limited to the concerted conduct of *multiple* insurers, but extends as well to an *individual* insurer's unlawful practices. (*Ibid*.) According to that reasoning, the passage of Proposition 103 mandated a radical change in the meaning of the two provisions: an antitrust immunity that formerly attached to the concerted conduct of multiple insurers now attaches to an individual insurer's violation of the Proposition's consumer protections.

Nowhere in Proposition 103 is there any evidence that the voters intended to expand two statutes passed by legislators in 1947, much less impose immunity from suit that would negate their own enactment of section 1861.03(a) and 1861.10(a) – quite the contrary. No principle of statutory construction sanctions such a sweeping transformation of the plain meaning of forty-year old statutory language.

This fatal analytical flaw in *Walker's* construction of the McBride provisions was addressed and corrected *sub silentio* a year later by the Supreme Court in *State Compensation Insurance Fund v. Superior Court* (2001) 24 Cal.4th 930 (*SCIF*). The Supreme Court in *SCIF* construed section 11758, which governs workers' compensation insurers and is textually identical to section 1860.1. The similarity led the high court to draw on the legislative history and purposes of McBride-Grunsky to flesh out the meaning of section 11758. (*SCIF*, 24 Cal.4th at 938-940.)

Summing up, the Court concluded: "Interpreting section 11758 to only apply to concerted activity otherwise barred by the antitrust laws, and not to the individual misconduct of an insurer regarding its insured, is also supported by section 11758's legislative history." (*Id*. at 938.) The Court quoted a letter from then-Commissioner Quackenbush distinguishing between joint and unilateral conduct: "'The purpose of Insurance Code section 11758 is to immunize insurers and rating organizations from anti-trust laws so that they can act in concert to make rates. . . . The plain language of Insurance Code Section 11758 does not immunize an insurer from misconduct in reporting data to the rating organization.'" (*Id*. at 940, brackets deleted.)

Donabedian confirms the limited role for sections 1860.1 and 1860.2 in the regulatory scheme after Proposition 103. Drawing on *SCIF*, this Court observed that these statutes "were enacted to permit concerted action among insurers in setting rates. Like the statutory scheme in [*SCIF*], these two provisions of the McBride Act were adopted to immunize insurers from antitrust laws. [Citations.]" (*Donabedian*, *supra*, 116 Cal.App.4th at 990.) *Donabedian* notes that the two provisions retain their traditional meaning under Proposition 103, but their scope is greatly limited. (See discussion at pp. 19-20, supra.) The decision states: "Of course, this is not to say that sections 1860.1 and 1860.2 no longer serve any purpose. For example, insurers are still permitted to engage in some concerted and joint activity under provisions of McBride-Grunsky that Proposition 103 did not repeal. [Citations to statutes omitted]." (*Id*. at 990-991.)

Fogel's suit, we repeat, is not a Proposition 103 rate case. But, if it were – assuming arguendo that FGI is an insurance company – this case, like *Donabedian*, concerns the actions of one company, FGI. The following passage from *Donabedian* fits the circumstances here: "Like the claim in [*SCIF*], plaintiff's claim challenges the unilateral conduct of a

single insurer, does not involve concerted action, and has no antitrust implications." (*Donabedian*, *supra*, 116 Cal.App.4th at 990.) Contrary to *Walker* and FGI, sections 1860.1 and 1860.2 do not impact a case like this one involving an insurer's unilateral conduct.

B. The *Walker* Construction of Sections 1860.1 and 1860.2 Violates Grammar and Logic.

Walker not only misapprehended the role of the two vestigial statutes, it literally misread them.

Construing 1860.1, the *Walker* court suggested that the phrase "act done or action taken" referred to the Commissioner's *approval* of the challenged rates:

> Whatever else the amended McBride Act does, it definitely confers authority *upon the commissioner to approve rates*.

(*Walker*, *supra*, 77 Cal.App.4th at 756, emphasis added.)

FGI, citing this sentence in *Walker*, adopts precisely the same reasoning: "The Commissioner's authority to approve rates… is conferred by chapter 9. Accordingly, there is no right to pursue a civil proceeding based on an approved rate…." (RB at 7.)

Upon careful inspection, this reading hopelessly violates the grammar and logic of the statute, as well as the history. Section 1860.1 confers *immunity upon insurers* for *actions* which they take jointly "pursuant to the authority conferred by this chapter." Any logical reading must conclude that the immunity flows to *the same parties* who engage in the acts – the insurers.

If, as *Walker* and FGI contend, the "act done" refers to the Commissioner's approval of insurance rates, then the immunity would flow to the Commissioner – not to the insurer – an absurd result never intended by the 1947 Legislature.

This reading is absurd not only because section 1860.1 confers immunity on insurers, not on the Commissioner, but also because it confers immunity on insurers who act *jointly*, not on an insurer's unilateral wrongdoing, as explained in Section A above. Not surprisingly, the *Walker* analysis is unable to account for the phrase "agreement made" in section 1860.1. Neither the Commissioner, nor an insurer, can make an agreement with itself.

Not content with that manifestly incorrect construction, FGI insists that the phrase "act done" has yet another meaning, simultaneously. It asserts that the "act done" is the insurer's "***authority to charge premiums based on those rates***." (RB 7, emphasis added.) However, this too is a grammatical impossibility. The authorization for a specific company to implement rates and charge individuals a premium comes *from the Commissioner* when he approves a rate application; that authority is not "conferred by" the statutory provisions in chapter 9.

To support FGI (or *Walker's*) interpretation of section 1860.1, it would have to read: **"**No act done, action taken or agreement made pursuant to the authority conferred by the chapter ***upon the commissioner and by the commissioner upon an insurer***…."

But section 1860.1 doesn't say that.

Finally, *Walker* ignored the limitation on the immunity conferred by 1860.1 that is contained in the phrase "under any other law of this State heretofore or hereafter enacted which does not specifically refer to insurance." As this Court explained in *Donabedian*, the code sections that "authorize this action are not 'other law' – they are part of the same chapter as section 1860.1." (*Donabedian*, *supra*, 116 Cal.App.4th at 977.) And, of course, all of Proposition 103 specifically refers to insurance, including the provision that authorizes private suits (section 1861.10(a)), as well as the provision that makes the insurance industry subject to the Unfair

Competition Law and all other laws of general applicability. (Section 1861.03(a).)

The same distinction applies to similar phrasing in the second vestigial statute, section 1860.2. It states that Chapter 9's various strictures may generally be enforced only through the proceedings specified in the chapter, not through "other law." To the extent that the present case is considered an insurance rate case brought subject to Proposition 103's provisions, section 1860.2 is no bar. As *Donabedian* stated: "Once again, the statutory sections that permit this suit are part of the same chapter as section 1860.2 and are not 'other law.'" [Citation.] (116 Cal.App.4th at p. 978.)

Walker interpreted and applied the vestigial McBride provisions incorrectly. They cannot be read as to bar a UCL brought against an insurance company, much less as a bar to a suit brought against a non-insurance defendant such as FGI for breach of its fiduciary duties.[16]

While this Court distinguished *Walker* in *Donabedian*, *Walker's* erroneous statutory analysis cannot be squared with this Court's far more thorough statutory analysis in *Donabedian* – an analysis that, as this Court noted in its opinion, also comports with the legislative history and case law.

The trial court erred in applying *Walker*. To discourage further confusion, this Court should affirmatively reject *Walker's* statutory analysis.

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[16] Indeed, the two McBride provisions apply, by their own terms, only to Chapter 9. If, as FTCR and Fogel contend, this is not an insurance rate case, the two provisions are irrelevant.

IV. There Is No Filed Rate Doctrine for Insurance Rates in California.

In the nearly eighteen years since the passage of Proposition 103, no court in California has imposed a "filed rate doctrine" upon the Insurance Code. Even the Court of Appeal in *Walker* declined to invoke the "filed rate doctrine," though it considered the doctrine "consistent with our interpretation of the statutory provisions at issue in this case." (*Walker*, *supra*, 77 Cal.App.4th 750, 757, fn. 4.) The court below went beyond *Walker*, however, to strongly imply that the "filed rate doctrine" was an *independent* basis for its ruling. (16 JA 4475-4476.) That is clearly FGI's contention on appeal. (RB at 25-28.)

They are wrong, because there is no statutory basis for the doctrine's application here. The plain language governs. (*Donabedian*, *supra*, 116 Cal.App.4th at 976.) In fact, such an application would directly conflict with Proposition 103's plain language and purposes.

A. There is No Statutory Tether in Proposition 103.

From its inception, the essential prerequisite to application of the "filed rate doctrine" has been a statute that provides an agency with "exclusive jurisdiction" over a regulated industry. (*Texas & Pac. Ry. v. Abilene Cotton Oil Co*. (1907) 204 U.S. 426, 448.)

In *Walker*, the court held that the vestigial McBride provisions – sections 1860.1 and 1860.2 – provided the statutory support for its holding that the Commissioner's jurisdiction was exclusive, even after Proposition 103's passage. As discussed in section III *supra*, however, *Walker's* interpretation of the McBride provisions was manifestly incorrect; comparison to *Donabedian* confirms the error of construction in the *Walker* decision.

Referring to Proposition 103, the court below suggested that "[t]he prior approval of rate sections in the Insurance Code are analogous to the filed rate doctrine." (16 JA 4476.) But neither the decision nor FGI cite any provision of Proposition 103 as authority. There is no such authority. (RB at 26-27.) There is no statutory basis to which a "filed rate doctrine" for insurance rates might be tethered.[17] After exhaustively analyzing section 1861.10(a), which establishes private enforcement authority, and section 1861.03(a), which applies the UCL to the insurance industry, *Donabedian* stated: "We conclude that the commissioner does not have exclusive jurisdiction…" (*Donabedian*, *supra*, 116 Cal.App.4th at 983.)

Indeed, when they enacted Proposition 103 and its prior approval regulatory requirements, the voters expressly created a "parallel private enforcement" system with no conditions or restrictions on the ability of consumers to seek relief from overcharges in the judicial branch, as the Supreme Court recognized when it first addressed the private right of action in *Farmers*, *supra*. A bar on lawsuits imposed by the "filed rate doctrine" would directly conflict with the unconditional statutory right set forth in section 1861.10(a). As the *Donabedian* decision noted in addressing the argument that UCL suits were barred: "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." (*Donabedian*, *supra*, 116 Cal.App.4th at 991.)

B. The Filed Rate Doctrine Is Inconsistent With Proposition 103 Case Law and Other Authorities.

The Supreme Court declined to impose a "filed rate doctrine" upon the Insurance Code in *Farmers*, where insurers argued that UCL suits

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[17] Thus FGI is left to citing two cases involving telecommunications regulated by the Federal Communications Commission. (RB at 26-28.) They are inapposite to Proposition 103.

challenging an insurer's rates and practices were barred. The Supreme Court examined numerous cases for guidance, specifically citing and relying upon the U.S. Supreme Court case that first enunciated the "filed rate doctrine": *Texas & Pac. Ry. v. Abilene Cotton Oil Co*., *supra*, 204 U.S. 426 (cited by *Farmers*, *supra*, 2 Cal.4th at 386-387). So the California Supreme Court was well aware of the "filed rate doctrine." But it did not adopt it. Instead, it adopted an alternative compatible with Proposition 103: the "primary jurisdiction doctrine," which authorizes courts to stay a case and refer issues to the Insurance Commissioner for its review.

Donabedian, like *Farmers*, began its analysis by looking at the plain language of the measure. After exhaustively analyzing section 1861.10(a), which establishes private enforcement authority, and section 1861.03(a), which applies the UCL to the insurance industry, *Donabedian* stated: "We conclude that the commissioner does not have exclusive jurisdiction…" (*Donabedian*, *supra*, 116 Cal.App.4th at 983.)

The California Attorney General considered and rejected the application of the "filed rate doctrine" in a lengthy and careful statutory analysis of Proposition 103's impact on antitrust law published in 1990. It began:

> A line of federal antitrust cases has established a rule limiting antitrust treble damages recovery for conspiracies involving rates fixed and regulated under certain Congressional enactments. The Doctrine is based upon elaborate review of Congressional intent under the applicable regulatory statute and depends upon a Congressional intent to regulate rate competition under a statutory scheme other than the Sherman Act. The doctrine … has no application under regulatory statutes that are not intended to supplant antitrust remedies.

(State of California, Department of Justice, *Antitrust Guidelines for the Insurance Industry*, March 1990, published in DiMugno & Glad, *California Insurance Laws Annotated* (Thomson-West 2006) at 1707, 1716 [footnotes omitted].)

The Attorney General then stated:

> [T]he Insurance Code cannot be said to reflect a legislative intent to supplant antitrust law or its remedies. To the contrary, Insurance Code section 1861.03 subdivision (a) expressly negates any such implication, applying the same antitrust rules to the insurance industry as apply "to any other business." Not only does Proposition 103 expressly apply antitrust law to insurance, but it goes further by divesting the commissioner of earlier authority over the competitiveness of rates.

(*Ibid*.)

The Attorney General concluded that the "filed rate doctrine does not apply to insurance rates in California." (*Ibid*.)

C. The Filed Rate Doctrine Would Conflict with the Purposes Set Forth by the Voters in Proposition 103.

Aside from the plain language of the measure, the "filed rate doctrine" would frustrate the manifest policy purposes behind Proposition 103. One of Proposition 103's principal goals is to reduce the cost of insurance: the voters found that "[t]he existing laws [McBride] inadequately protect consumers and allow insurance companies to charge excessive, unjustified and arbitrary rates." (Exh. E [Proposition 103], Section 1, Findings; *Donabedian*, *supra*, 116 Cal.App.4th 968 at 981.)

The language of the initiative makes clear that the voters were well aware of the practical realities that might frustrate the regulatory safeguards they were enacting to achieve their goals.

They understood, for example, that budgetary and staffing considerations would necessarily limit the ability of the Commissioner to ensure that every insurance company's filings comply with applicable laws and regulations, and to police the marketplace. When each of the hundreds of property-casualty insurers doing business in California wishes to change its rates, it must submit an application to the CDI for the Commissioner's approval pursuant to section 1861.05 *for each line of insurance*. Most of

these filings do not receive an exhaustive review and virtually none are called to a public hearing; the vast majority of applications are automatically "deemed approved" after sixty days.[18] Such mechanical processing cannot be equated to formal agency rulemaking proceedings, or adjudicatory proceedings on rate applications (which have occurred less than a handful of times in the last five years), for which courts would accord greater deference. (See *Yamaha Corp. of Am. v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 13; see also *Stevens v. Superior Court* (1999) 75 Cal.App.4th 594, 607-609.) Indeed, contrary to the apparent assumption of the *Walker* court, 77 Cal.App.4th at 756, none of the challenged rates in that case had ever been subject to a public hearing by the Commissioner.

The Insurance Commissioner – who would be expected to be most protective of his regulatory jurisdiction – has disputed *Walker* on both statutory and public policy grounds, referring to precisely these policy considerations. In its amicus brief in *Donabedian* (and in amicus briefs in two subsequent cases), the Commissioner has embraced parallel enforcement by private attorneys general, explaining it was an essential supplement to the necessarily limited resources of the agency in reviewing filings by insurance companies. (MJN Exh. A [Commissioner's Brief], pp. 19-20.)

The Commissioner explained that it is impossible for the CDI to catch every mistake, omission or violation of the law. (*Id*. at 19-22.) Rejecting the argument that the Commissioner retains exclusive jurisdiction, he concluded:

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

> It is for these reasons 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 those violations of law that pass through the Department's administrative review without either detection or action."

(*Id*. at 22.)

The Commissioner's views are entitled to substantial deference. (*Southern California Edison Co. v. Peevey* (2003) 31 Cal.4th 781, 796; see also *Bell v. Blue Cross of California* (2005) 131 Cal.App.4th 211, 218, fn. 8 [court accorded "substantial deference" to state agency's view that private citizens could enforce the provisions of the statute the agency administered.]) His opinion is entitled to even greater weight when he urges an interpretation of the Insurance Code supposedly contrary to his own self-interest in protecting his agency's jurisdiction. (*Krumme v. Mercury Ins. Co*. (2004) 123 Cal.App.4th 924, 937.)

The Insurance Commissioner's analysis confirms the voters' purposes. Private enforcement acts as a deterrent to violation of Proposition 103's provisions. It ensures that illegal charges are repaid to policyholders. And it provides an independent safeguard in the event that the Commissioner failed or declined to protect consumers' rights.

A rule that immunizes anything that may get past the necessarily limited review provided by the CDI would lead to exactly the abuses Proposition 103 intended to prevent.

The interests of insurers are amply protected under the framework adopted by the electorate. Courts can apply equitable principles – such as the doctrine of equitable estoppel – to bar or limit restitution if necessary to prevent an unjust result. (See, e.g., *Cortez v. Purolator Air Filtration Products Co.* (2000) 23 Cal.4th 163, 179-180.) Moreover, the primary jurisdiction doctrine articulated by *Farmers* enables superior courts to

obtain the agency's views on challenges to previously approved rates. It is highly unlikely that an insurance commissioner would overturn a previous finding of "reasonableness" absent circumstances strongly militating in favor of relief – and even then, under *Farmers*, the superior court would have the last say.

In any case, the objections of the insurers are beside the point. The wisdom of the voters in incorporating a private right of action as part of the regulatory framework it was adopting is entitled to the respect of the judicial branch. As the California Supreme Court has said to other petitioners concerning the perceived unfairness of the Insurance Code, such objections must be brought to the legislative branch – or, in this case, to the voters. (See *King v. Meese* (1987) 43 Cal.3d 1217, 1235.)

CONCLUSION

FGI denies any fiduciary responsibility to subscribers, relying on the argument that any breach would be immunized by the Commissioner's alleged approval of the exchange's rate applications. FGI further insists there can be no liability in courts because of that approval. Finally, FGI admits that the Commissioner "does not have power to order refunds." (RB at 3.) In short, according to FGI, there is no remedy for its wrong, and it is completely immune from accountability to any subscriber or policyholder for overcharging. Fortunately, that is not the law in California.

As we have demonstrated, this case does not implicate rates, but even if it did, a UCL suit is not barred. It was precisely to be able to protect themselves against insurance overcharges that the voters passed Proposition 103, ordered rollbacks, mandated an open process of rate and premium regulation, repealed barriers to competition, created the office of elected commissioner and – if all those safeguards somehow failed – authorized themselves to take matters into their own hands by acting as private

attorneys general in order to employ judicial remedies that would stop unlawful conduct and return illicit gains. FGI asks the judicial branch to restore what insurance companies lost at the ballot box on November 8, 1988.

The decision below should be reversed.

Dated: July 12, 2006

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