EXHIBIT
IRH-SFG-151

SFG-VW-8

D075529

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT, DIVISION ONE

STATE FARM GENERAL INSURANCE COMPANY

Plaintiff and Appellant,

v.

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

Defendant and Appellant,

CONSUMER WATCHDOG,

Intervenor and Appellant.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The Commissioner exercised this same power here, ordering SFG to pay refunds of the excessive premiums it charged pending the ultimate determination of SFG's rates. The legality of SFG's then-in-effect rates was

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

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

Just as the "remain in effect" requirement was found by the Supreme Court to authorize the Commissioner to grant interim relief in furtherance of protecting insurance companies from inadequate rates, the same language authorizes refunds when consumers pay excessive rates. This is precisely the symmetry the voters applied, weighing, as the Supreme Court described it, "the insurer's legitimate interest in financial integrity and the

insured's legitimate interest in freedom from exploitation." (*20th Century*, *supra*, 8 Cal.4th at p. 245.)

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

Thus, *Calfarm* recognized that the Commissioner could order insurance companies to pay refunds during both the rollback period and the prior-approval period, describing precisely how the Commissioner's power to grant such "interim relief" would work under both scenarios. First, the Court explained that during the rollback period (before the prior-approval requirement took effect), an insurance company that filed an application for a rate higher than the rollback rate "may immediately begin charging that higher rate pending approval from the commissioner." (48 Cal.3d at p. 825.) After the prior-approval requirement became effective, "the

commissioner can approve an interim rate pending her final decision." (*Ibid*.) But the Court made clear that *in both cases*—under the one-year rollback period and during the permanent prior-approval regime that followed—if the rate actually charged by the insurer was higher than the rate ultimately approved by the Commissioner, "the insurer must refund excess premiums collected with interest." (*Ibid*.)

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

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

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