

BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF CALIFORNIA

In the Matter of the)	
Rate Application of:)	
)	File Nos. PA-2024-00011
STATE FARM GENERAL INSURANCE)	PA-2024-00012
COMPANY,)	PA-2024-00013
)	
Applicant.)	Volume I
_____)	

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REPORTER'S TRANSCRIPT OF PROCEEDINGS
TUESDAY, APRIL 8, 2025

Reported by:

Aaron Ellington
CSR No. 13449

Job No.:
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TRANSCRIPT OF PROCEEDINGS, taken at
1901 Harrison Street, 3rd Floor, Oakland,
California, commencing at 10:05 a.m. on
on Tuesday, April 8, 2025, reported by
Aaron Ellington, CSR No. 13449, a Certified
Shorthand Reporter in and for the State of
California.

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1 TUESDAY, APRIL 8, 2025

2 MORNING SESSION

3
4
5 THE COURT: Good morning.

6 MS. MCKENNEDY: Morning, your Honor.

7 THE COURT: Please be seated. Morning.

8 THE REPORTER: Morning, your Honor.

9 THE COURT: On the record. Good morning, everyone.

10 I am Karl Fredric Seligman, the administrative law judge
11 assigned to this case. Today is Tuesday, April 8th, 2025 and
12 it's 10:00 o'clock in the morning or just thereafter. We have
13 convened in the Administrative Hearings Bureau hearing room in
14 Oakland located at 1901 Harrison Street on the third floor for
15 the first day in the evidentiary hearing in this matter.

16 This is the matter of the rate applications of State Farm
17 General Insurance Company identified as File Numbers
18 PA-2024-00011, PA-2024-00012, PA-2024-00013. This hearing is
19 being conducted pursuant to the applicable provisions of the
20 Insurance Code and Administrative Procedures Act, including
21 Government Code beginning at 11500.

22 This courtroom and -- This is a courtroom, and these are
23 formal proceedings. Please silence all mobile devices, remain
24 quiet to allow the attorneys and their clients the opportunity
25 to do their important work. Please be aware that electronic

1 equipment is being used that captures and transmits audio and
2 visual images.

3 With that I'm gonna start with appearances. I'll start
4 with State Farm General Insurance, please. If you will make
5 your appearances?

6 MR. TETI: Jordan Teti with Hogan Lovells for State
7 Farm General, the Applicant.

8 MS. WELLINGTON: Katherine Wellington for the
9 Applicant.

10 MR. MADDIGAN: Michael Maddigan for the Applicant.

11 THE COURT: All right. Thank you very much. And for
12 the Department of Insurance, please?

13 MS. MCKENNEDY: Good morning, your Honor.

14 THE COURT: There's a slight delay when you push
15 those buttons. Is the light illuminated?

16 MS. MCKENNEDY: Your Honor, it does not seem to be
17 working, but my name is Nikki McKennedy for the California
18 Department of Insurance.

19 THE COURT: If it's green, you just leave it green.

20 MR. MONTGOMERY: Good morning, your Honor. My name
21 is Duncan Montgomery, with the Department of Insurance.

22 THE COURT: Thank you.

23 MR. PLETCHER: Good morning, your Honor. William
24 Pletcher for Intervenor Consumer Watchdog.

25 THE COURT: Thank you.

1 MS. PRESSLEY: Good morning, your Honor. Pamela
2 Pressley for Intervenor Consumer Watchdog.

3 THE COURT: Thank you.

4 MR. MELLINO: Good morning your Honor, Ryan Mellino
5 on behalf of the Intervenor Consumer Watchdog.

6 THE COURT: Thank you.

7 MR. ARMSTRONG: Good morning, your Honor. Ben
8 Armstrong.

9 THE COURT: Just a second.

10 (Brief pause in the proceedings.)

11 THE COURT: All right. This proceeding is being held
12 concerning the stipulation concerning the Applicant's
13 emergency interim rate request between the California
14 Department of Insurance and the Applicant State Farm General
15 Insurance Company in the above referenced proceeding I earlier
16 mentioned, and the objections raised by Intervenor Consumer
17 Watchdog in order to determine whether the stipulation should
18 be approved, recommendations modified, or rejected.

19 The hearing is being recorded by a court reporter who
20 will prepare a verbatim transcript of the proceedings. The
21 transcript is the official record. If you wish to receive a
22 copy of the transcript, please make arrangements with the
23 reporter directly. As a courtesy to the reporter, please
24 remember to assist in creating an accurate record by speaking
25 clearly, and not interrupting one another or a witness.

1 Okay. So that gets us down to where we are with regards
2 to proceeding. Thank you for filing the proposed schedule and
3 working on that. A number of things came in, and/or were
4 pending.

5 For those of you who are observing today, you will find
6 that at the outset today we're going to be handling some
7 administrative matters associated with getting underway with
8 evidence being presented, so it might be a little bit boring,
9 but, you know, you are free to observe notwithstanding that.

10 If there's anything that -- that the parties want to
11 advance right now as priority to address before I make some
12 suggestions, can I hear that? I'll start with -- with the
13 carrier, please? Anything you think we need to address right
14 at the outset?

15 MR TETI: Not from Applicant, your Honor. Thank you.

16 THE COURT: All right. And the Department?

17 MS. MCKENNEDY: No, your Honor. Thank you.

18 MR. PLETCHER: And no, your Honor. Thank you.

19 THE COURT: Okay. So I noticed that we have, in
20 addition to a series of requests that we need to tackle, we
21 also have the matter of all of the exhibits. Have the parties
22 discussed how they -- where that is with regard to them yet,
23 in the sense of their acceptability in being received? Since
24 some of them have just been lodged, I'm gonna kind of look to
25 you, Consumer Watchdog, about that?

1 MR. PLETCHER: I can say at this -- not having a
2 chance to fully catch up to everything that's come in, so, you
3 know, but we are definitely amenable to quickly review things,
4 identify any documents that we think might be problematic, but
5 other than that, we're happy with the documents, I think, we
6 would stip to come into evidence, but we don't expect to have
7 any sort of foundation or those types of objections.

8 THE COURT: Okay. So is there a suggestion as to how
9 to approach that? Should we go through each of them in a
10 rapid succession in order to capture it for the reporter's
11 record, and you want to be looking at them then, or do you
12 have another idea?

13 MR. PLETCHER: We had talked to counsel over the
14 weekend, about possibly coming to some sort of stipulation.
15 There hasn't been time for that, but I think, you know, we
16 would be open to at a break, or as folks are able to put
17 together e-mails and things like that to make sure there are
18 no objections to handling it that way, and then report back to
19 you as soon as we can if there will be particular exhibits
20 that we'd like to further address.

21 THE COURT: All right. And so when would you be
22 suggesting that that happen?

23 MR. PLETCHER: After the lunch break, or something
24 like that to just -- I know there are people who are frantically
25 reading and reviewing right now, so I don't want to commit to

1 an exact time, but I think that would be the target.

2 THE COURT: All right. Anything from the Department
3 to supplement those comments?

4 MS. MCKENNEDY: Well, your Honor, you're looking at
5 the trial team here, so we're not currently frantically
6 reviewing exhibits. We might need a little more time.
7 Perhaps by tomorrow morning?

8 THE COURT: Okay. I'm not saying I agree with that.
9 I'm just saying I understand.

10 From the Applicant? What's your sense, since a large
11 number of them are yours?

12 MR. MADDIGAN: Thank you, your Honor. The parties
13 did discuss, as counsel for Consumer Watchdog indicated,
14 entering into a stipulation with respect to most or all of the
15 exhibits. Certainly, many of the documents are
16 publicly-filed documents, publicly-available documents
17 that we don't anticipate there being any issue about. We have
18 a motion to strike pending with respect to one of the
19 exhibits, so there's a dispute about that, but we would be
20 fine meeting and conferring at a break later today, or going
21 through it now, whatever your Honor prefers?

22 THE COURT: Okay. So I'll let the parties confer on
23 that, at least initially, but I will suggest that, a couple of
24 things. You don't have to do it in writing if that slows you
25 down. You can make the stipulation on the record orally, so,

1 you know, you already have a lot of work in front of you, and
2 you're wrestling with, so you might contemplate doing that in
3 lieu of. If it's easier to write them up, I'm not telling you
4 now, I'm just saying that that's one approach.

5 If we have to deal with them in the interim in connection
6 with taking one or more witness, then we're gonna have to sort
7 of just deal with it in real time, because what you're
8 suggesting, which is fine, but it may also slow that process
9 down just a bit.

10 Okay. So that sounds like we're gonna -- we'll come back
11 to that in part. I will make a footnote to it, because
12 there's, the number was, you know, significantly added to in
13 the last few hours, if there's things that are not maybe
14 captured in the record, this is on my points from the
15 conferences, you might want to look to that to make sure that
16 you captured everything. I, you know, I want to make sure
17 that -- that we have a comprehensive record, so the cleanest
18 way is to have it specific. You don't have to make it your
19 own exhibit. It can be an ALJ exhibit. If there's something
20 hanging out there, I noticed a couple of them, and we'll make
21 sure we have them drafted in the record, okay?

22 So from the things that I see on the list of matters
23 that, just either to clarify where we stand with that, or
24 whether or not they -- whether or not we're going to deal with
25 them this morning, at which time I'm going to give the parties

1 an opportunity to speak to them, we have the March 25th, 2025
2 Consumer Watchdog's Objections to CDI's and State Farm's
3 two-way stipulation to an interim rate dated March 24th, 2025.

4 Consumer Watchdog also wrote a letter to me dated March
5 28th, 2025, State Farm General Insurance Company's brief in
6 support of the interim request and response to Consumer
7 Watchdog's pre-hearing objections, which was dated April 2nd,
8 2025.

9 State Farm General's motion to strike portions of
10 Consumer Watchdog's objections to Consumer -- Sorry.
11 Objections to the California Department of Insurance's and
12 State Farm's two-way stipulation to interim rate, and for an
13 order excluding evidence, dated April 2nd, 2025.

14 Consumer Watchdog's opposition to State Farm General's
15 motion to strike portions of Consumer Watchdog's objection to
16 the California Department of Insurance's and State Farm's
17 two-way stipulation to an interim rate and court order
18 excluding evidence dated April 4th, 2025.

19 The California Department of Insurance's motion to limit
20 the testimony of, or in the alternative exclude State Farm
21 General's retained expert witness Nancy Watkins based on her
22 current consulting agreement with the Department dated April
23 7th, 2025, and the declaration of Nikki McKennedy in support
24 of the California Department of Insurance's motion to limit
25 testimony of, or in the alternative exclude State Farm

1 General's retained expert witness Nancy Watkins based on her
2 current consulting agreement with the Department dated April
3 7th, 2025.

4 Consumer Watchdog's notice of and motion in limine Number
5 1 to exclude evidence regarding State Farm General's financial
6 condition dated April 7th, 2025.

7 Consumer Watchdog's notice of motion in limine Number 2
8 to exclude evidence regarding the supplement to the February
9 7th, 2025 stipulation dated April 7th, 2025.

10 Consumer Watchdog's notice of motion in limine Number 3
11 to exclude evidence regarding RBC calculations dated April
12 7th, 2025.

13 Consumer Watchdog's objections to strike, and a notice of
14 motion for sanctions regarding State Farm and the Department's
15 untimely submissions dated April 7th, 2025.

16 Consumer Watchdog's reply brief, and supplemental
17 objection in opposition to California Department of Insurance
18 and State Farm General's two-way stipulation to interim rate
19 increase dated April 7th, 2025.

20 And if nothing has been added to the docket since I
21 walked away from it, a supplemental declaration of Benjamin
22 Armstrong's Consumer Watchdog's reply brief in opposition to
23 State Farm General's request for rate increase dated April
24 7th, 2025.

25 Now I understand some of these are attributable to one

1 another not in the order that I read them, except I read them
2 from the docket, but I wanted to make sure that they were
3 reflected in the record. Does anyone immediately notice
4 something that's is missing from that list?

5 MS. MCKENNEDY: Your Honor, did you include the
6 supplemental stipulation filed and served on April 4th?

7 THE COURT: I do have it here, and it's obviously a
8 concern in connection with the other ones that I listed, but I
9 did not read it aloud, and that is the April 4th California
10 Department of Insurance's supplement to the February 7th, 2025
11 stipulation to interim rate, subject to refunds with interest,
12 pending a final determination of the legality of the rate
13 dated April 4th, 2025.

14 MS. MCKENNEDY: Thank you, your Honor.

15 THE COURT: Thank you. So let's start to pick them
16 apart. Maybe in an order that is not necessarily the
17 chronological one. How about starting with the motion by the
18 Department from yesterday as to the testimony evidence --
19 testimonial evidence, and/or -- Sorry. I was receiving a
20 note.

21 The testimonial evidence and/or other proffered evidence
22 from Nancy Watkins, the Department's motion. Shall we start
23 with that?

24 MR. MONTGOMERY: Sure.

25 THE COURT: So what I was thinking I would do before

1 I take your arguments on this, I'll -- I'll hear from all of
2 you as to each of these pieces, and then we might take a quick
3 break. I originally thought you might need to talk about the
4 exhibits. Maybe you can take this is an early opportunity to
5 do so, and then we'll go from there, so does the Department
6 have anything to add to what it included in the moving papers?

7 MR. MONTGOMERY: Sure. I'd like to just briefly go
8 through it.

9 THE COURT: Please.

10 MR. MONTGOMERY: Your Honor, would you like us to
11 stand when we argue?

12 THE COURT: You do not have to. You can stay right
13 where you are. If you want to, you can. We have nifty new
14 equipment, so if you want to take the mike we can hand you a
15 mike if you prefer standing?

16 MR. MONTGOMERY: No, that's fine. Thank you. So,
17 yes. We brought this motion to exclude or limit the testimony
18 of Nancy Watkins, and there's three main reasons why we've
19 done this.

20 First, she has a contract with the Department. It's a
21 consulting agreement that she signed as a principal of
22 Milliman. It's a big company that she's worked at with, and
23 it's a very important contract, and in that contract it says
24 specifically that there will be no conflict of interest with
25 her work, and that she'll keep all the information she has

1 confidential. That's the first point.

2 Second point is, she is, as through her work with the
3 Department, she has received significant amount of
4 confidential information, including a lot of data calls where
5 confidential information is shared, and number three, we've
6 asked State Farm to withdraw her as an expert witness, because
7 we believe it's not appropriate, and they have not -- they
8 said they would not do that.

9 We also checked with Consumer Watchdog to see if they
10 would accommodate -- make accommodations with us with respect
11 to her testimony, and we have not heard back from them, or
12 we have not been able to finalize that, so just in general
13 those are the three main points why we seek to limit her
14 testimony.

15 THE COURT: Thank you.

16 MR. MONTGOMERY: And just for the record -- And just
17 for the record, if I can add, we have not waived her conflict
18 of interest, so, and they had asked us last August if we would
19 waive it, and we said we would not.

20 THE COURT: Can you add a little bit to the nature of
21 the retention of this expert by the Department?

22 MR. MONTGOMERY: I'm sorry?

23 THE COURT: How was she retained?

24 MR. MONTGOMERY: It's through a contract, and that
25 contract has been produced. It's in the thousands of

1 documents I'm sure before you, your Honor.

2 THE COURT: Okay.

3 MR. MONTGOMERY: And she was the one that signed the
4 contract.

5 THE COURT: Okay. And can you give us some
6 representations as to whether she's been involved in this
7 matter or?

8 MR. MONTGOMERY: Well, she is -- she is provided a
9 declaration, and we've reviewed the declaration, and we're
10 fine with the contents of the declaration. We would propose,
11 your Honor, that as long as she sticks to the four corners of
12 the declaration, we would be okay, but we just don't know
13 what's gonna happen. We don't know if something comes up on
14 cross-examination, or in some other manner. We're just afraid
15 of what's going to happen, so as long as she'll still stick to
16 the four corners of the declaration, we're fine.

17 THE COURT: But she -- But this proposed expert
18 hasn't consulted with the Department on this case? Has Ms.
19 Watkins done that?

20 MR. MONTGOMERY: She has not. As far as I know, she
21 has not.

22 MS. MCKENNEDY: Your Honor, if I may?

23 I have direct personal knowledge on this. The issue is
24 that we read the Commissioner's order as requiring State Farm
25 to update its data through the first quarter of 2025. Ms.

1 Watkins' declaration, as currently set forth, is analyzing the
2 applications as they were submitted in June and July of 2024,
3 but if and when State Farm updates its rate applications, new
4 regulations that Ms. Watkins did directly consult with us on
5 may come into play, so that is our overall concern.

6 We have directly asked Consumer Watchdog if they would
7 agree to limit their cross-examination of Ms. Watkins to her
8 declaration and its contents, and we've never received a
9 response.

10 THE COURT: Okay. Thank you. All right. From State
11 Farm General, please?

12 MR. TETI: Yes, your Honor. Thank you. Ms. Watkins
13 is an expert declarant and actuary that's been presented by
14 State Farm General to respond to Consumer Watchdog's actuary
15 Ben Armstrong's technical, actuarial objections to State Farm
16 General's interim rate submissions.

17 In its motions CDI has identified some concerns about two
18 specific topics that they believe might be raised by questions
19 that Consumer Watchdog might, but has not even indicated that
20 it will ask Ms. Watkins. Namely, she has been consulting with
21 respect to drafting, going forward regulatory tax materials
22 connected to, number one, net cost of insurance, number two,
23 catastrophe models, neither of which is at issue here, and
24 certainly has not been discussed in Ms. Watkins' declaration,
25 as CDI acknowledged today, and as CDI acknowledged in its

1 motion.

2 Nonetheless, CDI, as we've heard, in an abundance of
3 caution, fearful of what Consumer Watchdog will ask, seeks to
4 limit Nancy Watkins' testimony in these two areas, and we do
5 not oppose that request to limit the testimony of -- with
6 respect to those three areas if Consumer Watchdog raises such
7 questions, or in the alternative, to exclude Ms. Watkins
8 entirely, which would be extremely prejudicial to State Farm
9 General, and that request should be denied for three reasons.

10 Number one, it's premature. There's no live conflict as
11 they have acknowledged in their motion and today.

12 Number two, it's unnecessary. There is no conflict. As
13 CDI acknowledged just a minute ago, the analysis that Ms.
14 Watkins provides is with respect to the rate applications that
15 have been filed in the past, and not going forward, and as CDI
16 acknowledged in footnote two of its motion, the applications
17 at issue here are subject to the rate regulations in effect at
18 the time the applications were submitted, June, July 2024,
19 consistent with what CDI said today.

20 And number three, it's concerning as a legal matter that
21 an industry expert, an independent third party like Ms.
22 Watkins, would be disqualified based on her work for separate
23 parties involving separate issues in separate matters. For
24 those reasons we believe this motion should be denied. Thank
25 you.

1 THE COURT: Thank you. Consumer Watchdog?

2 MR. PLETCHER: Yes. Yes, your Honor. Thank you. We
3 definitely appreciate the position of both the Department and
4 State Farm in respect to Ms. Watkins, and our sort of one area
5 of concern, obviously, is it seems that there's intent to omit
6 her testimony to essentially her declaration. We don't know
7 exactly what kind of direct testimony might be elicited from
8 her, and if that door is opened to these areas, then we want
9 to be able to explore that.

10 Just in a very general sense, reinsurance is at issue, or
11 has been discussed by other witnesses to this case. CAT
12 models have been discussed by other issues in this case, so
13 it's not like those issues are so far afield that it's
14 inconceivable that it would ever come up, but if you just look
15 at her declaration, those aren't the issues. We're prepared
16 to cross her on her declaration. We just want to make sure
17 that if the door is opened, we have the ability to be able to
18 explore that.

19 THE COURT: So that seems to be an interesting point
20 for both the Department and the Carrier. I would like to
21 speak to that. Anything else you have to add in response.

22 MS. MCKENNEDY: Thank you, your Honor. That's why --
23 Sorry.

24 THE COURT: Yeah. You don't have to have it real
25 close.

1 MS. MCKENNEDY: That's why the Department has moved
2 to, in the alternative, exclude Ms. Watkins from testifying,
3 because we understand the quandary that Consumer Watchdog is
4 in. We appreciate it, and I would like to say for the record
5 there is a direct current conflict. Ms. Watkins is under a
6 pre-existing contractual duty to the Department of Insurance
7 that extends through December 31st, 2025. It's ongoing, and
8 that is a pre-existing contractual relationship. State Farm's
9 counsel asked me in August 2024 if we would waive the
10 conflict, and I said, "No."

11 We didn't find out that they had hired her anyway until
12 April 1st of this year. It's a problem.

13 THE COURT: Okay.

14 MR. MONTGOMERY: And as well, your Honor, if I can
15 just add? In the contract it says, this is not just a
16 conflict, but it's the appearance of a conflict, so this is
17 clearly an appearance of conflict, if not a conflict itself.

18 THE COURT: Sure. Go ahead.

19 MR. TETI: The way I understood Mr. Pletcher's
20 comments from Consumer Watchdog is that there's not
21 necessarily a quandary for Consumer Watchdog, and that if the
22 door's opened, they want to reserve the right to pursue
23 questions. We don't plan to open that door, your Honor. The
24 declaration is what it is, and it sounds like they don't plan
25 to cross-examine her on topics outside of her declaration as

1 they stand, and again, the original motion was primarily to
2 limit the testimony to not address these other topics which
3 involve, you know, going forward regulatory texts that is not
4 at issue in the declaration.

5 She's an actuary. She's responding to objections that
6 Consumer Watchdog has raised with respect to the actuarial
7 analysis done by State Farm General. That's why we're
8 offering her, to respond to those technical objections with
9 respect to loss development factor, AIY trend, the choices
10 that State Farm General has made, and the objections that
11 Consumer Watchdog has levied to those choices. That's why
12 we're proffering her, and it's relevant testimony that we
13 really believe should be heard, and that is not a conflict
14 with respect to that testimony.

15 THE COURT: If I limit the testimony, as was the, at
16 least it was the initial request from the Department was in
17 the alternative to exclude in the entirety, and nevertheless,
18 this -- as counsel for Consumer Watchdog put it, the door is
19 opened, somehow are you prepared to take that risk? I then
20 say that you have to -- they have to go down that road.

21 MR. TETI: We will not be the ones to open the door,
22 your Honor. That I can say.

23 MS. MCKENNEDY: Your Honor, they would also be the
24 ones not to take the risk. The ones at risk are the
25 California Department of Insurance who have provided

1 confidential information to Ms. Watkins.

2 THE COURT: Sure. So how comfortable are you with a
3 limiting order? Let's turn to you next.

4 MS. MCKENNEDY: Not very comfortable, since Consumer
5 Watchdog has not agreed to limit their cross-examination
6 testimony, your Honor.

7 THE COURT: May I ask why that you made that -- made
8 the alternative exclusion, and not the primary request?

9 MS. MCKENNEDY: Because I met and conferred with
10 Consumer Watchdog's counsel on Saturday, and he said he would
11 take the question under advisement, but I have not heard back.

12 THE COURT: Okay. And I don't think you have
13 anything further to say?

14 MR. PLETCHER: None. Nothing further.

15 THE COURT: Seems to me it could open up numerous
16 things, and while the counsel's confident from the Carrier
17 that it doesn't put them in sort of the target of,
18 nevertheless, you don't know where that goes, so sometimes
19 people find things, there are surprises. Okay. Anything
20 further on that?

21 MS. MCKENNEDY: Your Honor, if I may add? Consumer
22 Watchdog has previously voiced concerns over the Department's
23 retention of Nancy Watkins in, I believe it was September of
24 2024 when she was working with the Department at a rule-making
25 hearing, and so we know that Consumer Watchdog has concerns

1 over the conflict, and I believe that they -- if they don't
2 agree to limit their cross-examination testimony, and I
3 understand why they would not, but that is why the Department
4 is very concerned.

5 THE COURT: I understand.

6 MS. MCKENNEDY: Thank you.

7 THE COURT: And I can see as a preliminary matter, I
8 want to make sure that we have a comprehensive record, and I'm
9 having representations from counsel which I accept on the face
10 of them that it is prejudicial for them not to have the
11 evidence received, so it puts us in a difficult spot.

12 MS. MCKENNEDY: It was all in my declaration, your
13 Honor.

14 MR. TETI: Your Honor, may I be heard just briefly?
15 Your Honor, I actually think the parties are aligned here.
16 CDI and State Farm General are aligned with respect to not
17 opening this door, and should that door be opened, your Honor
18 could choose to strike that testimony, or limit that testimony
19 to avoid this issue.

20 THE COURT: Okay. Anything?

21 MS. PRESSLEY: Your Honor?

22 THE COURT: Yes.

23 MS. MCKENNEDY: I would say this is a very public
24 hearing, your Honor, and so if the Department's confidential
25 information is stated in open court, I believe that even if

1 you move to strike it from the transcript, it will still be
2 made public.

3 THE COURT: Can't un-ring the bell.

4 MS. MCKENNEDY: Thank you, your Honor.

5 THE COURT: Yes.

6 MS. PRESSLEY: Your Honor, I just wanted to add that
7 I think beyond just the, limiting the testimony, our, as Ms.
8 McKennedy said, our broader concern was the fact that Ms.
9 Watkins is -- has an ongoing contractual relationship
10 consulting with the Department, so to the extent she's
11 consulting with both the Department and State Farm, the
12 concern is that it could be unfairly prejudicial if she's
13 using information that she's gaining from State Farm to convey
14 to the Department through the course of the proceeding, and
15 also directly, possibly communicating to the Commissioner, and
16 that's our broader concern of having that ongoing conflict
17 during the proceeding.

18 THE COURT: I appreciate those concerns, but they're
19 somewhat, you know, they're speculative. I think you don't
20 have them.

21 MR. MONTGOMERY: And, your Honor, if I can just add?
22 What Ms. Pressley just stated was exactly the conflict that
23 we're concerned about.

24 THE COURT: Okay. We've exhausted our position on
25 that. All right.

1 Let me ask this before we tackle the objections matter,
2 the preliminary ones, are more objections being -- What's
3 happening with that? Are there gonna be more objections
4 today?

5 MR. PLETCHER: Consumer Watchdog does not anticipate
6 any additional objections or motions in limine.

7 THE COURT: All right.

8 MR. PLETCHER: With the, if I can just reserve, you
9 know, sort of late things that are coming in.

10 THE COURT: I mean, to some extent these build on
11 each other, just, you know, and so I'm trying to look to you
12 as to an efficient way to sort of manage it. As I've
13 indicated to the parties, both in writing, and on the record
14 conference, I understand that certain things are gonna be
15 contested and dealt with in the decision with respect to some
16 procedural issues, and the applicable law to apply and
17 evaluate the evidence under, but I want to certainly give you
18 the opportunity to speak to the -- to the in limine motions
19 not withstanding, and have us address those, and so would you
20 like to start with that, and then -- and then if there's, you
21 know, we'll take those in the order that you put them, one,
22 two, three, or is better to do it another way in your mind?

23 MR. PLETCHER: We might even be able to sort of do
24 that collectively, because I think they are linked a bit, but
25 I'll turn to my colleague, Mr. Mellino.

1 THE COURT: What do you want to do, Mr. Mellino?
2 What do you want to present?

3 MR. MELLINO: I think we can take them one, two,
4 three, if that works for your Honor?

5 THE COURT: That's the way you put it, so --

6 MR. MELLINO: I just want to make sure, I'm not
7 positive we mentioned earlier that you saw State Farm's
8 responses to motion in limines?

9 THE COURT: I know that we got the filings, but I --
10 but I -- I wasn't finished studying them.

11 MR. MELLINO: Okay. I'll just briefly address those,
12 I guess, in my comments. So the first motion in limine
13 focuses on State Farm's financial condition, which we believe
14 to be excluded from this hearing. Our position is that
15 California law authorizes the --

16 THE REPORTER: -- Counsel, I -- Counsel? Counsel?

17 THE COURT: We can't hear you.

18 THE REPORTER: I can't hear.

19 THE COURT: You may have to move the mike a little
20 bit? Just move it to the side.

21 MR. MELLINO: Got me now?

22 THE COURT: That's better.

23 THE REPORTER: Thank you.

24 MR. MELLINO: So our position is California law
25 authorizes the Commissioner to approve interim rates only when

1 current rates are plainly invalid, and State Farm originally
2 had pled or argued that it was entitled to Variance 6 through
3 its initial applications, but it expressly explains reliance
4 on that variance in applying for the interim rates, and it is
5 also never relied on Variance 10, which would apply to the
6 claim that its current rates are -- so in the absence of
7 reliance on either of those variances, we believe that
8 financial conditions should be excluded.

9 In addition to not relying on the variances, State Farm
10 had not, if they wanted to rely on variances, have not
11 produced sufficient information as required by the variance,
12 which requires, among other things, the plan to restore
13 solvency, and a plan to return excessive charges to
14 policyholders, which in this case would be any amounts above
15 the maximum earned premium that were left.

16 We further don't think there's been admissible evidence
17 to support State Farm's financial claims. The appellate
18 declaration is generally seeking to shift blame to the
19 Department for State Farm's current affairs, but --

20 THE REPORTER: Your Honor? Your Honor? I can't hear
21 him.

22 THE COURT: Adjust that mike a little bit.

23 MR. MELLINO: Sorry.

24 THE COURT: It doesn't have to be super close to you,
25 but it does have to point towards you.

1 MR. MELLINO: So we believe the appellate declaration
2 does not provide any financial analysis, but rather a
3 narrative of an economic viewpoint. The Ehrhart declaration
4 discusses reinsurance issues, but doesn't really go to any
5 claims of State Farm's financial distress, and Ms. Watkins'
6 declaration is focused mainly on Consumer Watchdog's actuarial
7 analysis, but like the other declarations, is not intending --
8 or analysis of State Farm's financial condition. Those are
9 the only declarations in this matter.

10 So to sum up, we believe this evidence should be
11 excluded, for State Farm did not produce this evidence when it
12 was relying on Variance 6, and so to allow it to be, or any
13 such evidence to be produced at this proceeding, we believe
14 would be both prejudicial and possible to litigation by
15 surprise, so for those reasons we would ask for an order
16 excluding all evidence, testimony, or argument concerning
17 State Farm's financial condition.

18 THE COURT: So let's stick with that first. Let me
19 ask a couple questions. So accepting your premise that it was
20 late, and you expected it and/or it was required, can you
21 point to how you've been prejudiced in your own case in chief?

22 MR. MELLINO: Well, we would be prejudiced by arguing
23 about an issue that we don't believe is actually at stake in
24 this proceeding, which is State Farm's financial condition,
25 and we'd be prejudiced by lacking the evidence that was not

1 provided over the months of the underlying rate proceedings
2 when they were relying on that variance in which we requested
3 many documents concerning its financial condition that State
4 Farm refused to produce, and we still don't have those
5 documents.

6 THE COURT: But as to your first point that is during
7 the entire that the applications have been under
8 consideration, you did indicate that; is that accurate?

9 MR. MELLINO: Yes.

10 THE COURT: Okay. So it's an ongoing concern, slash,
11 objection that you have?

12 MR. MELLINO: Yes. But of course, in the underlying
13 rate applications, they were explicitly relying on Variance 6.
14 Now they're not, but they're still claiming that that same
15 evidence that goes to Variance 6 is relevant here, so.

16 THE COURT: Understood. And that was raised right at
17 the onset with the pleadings taken and directed to my
18 attention. Okay.

19 So that's as to Tier 1. You want to continue to 2 and 3,
20 and then handle them in that consolidated manner, or should we
21 stay just at the 1?

22 MR. MELLINO: I'm happy to continue, or if your Honor
23 --

24 THE COURT: -- Find out what's easier for those who
25 have to respond? Would you like to just respond to Point --

1 Yeah. Let's stick with Point -- Okay. State Farm General,
2 please?

3 MS. WELLINGTON: Thank you, your Honor. So in the
4 orders setting interim rate proceeding, the Commissioner asked
5 this Court to address the issues in the stipulation, and one
6 of the key issues addressed and described in the stipulation
7 is State Farm's financial condition, in particular as it
8 relates to the risk of an imminent financial strength ratings
9 downgrade. We think that's very much at issue here. I think
10 that's -- that is precisely what the Commissioner is asking
11 this Court to address, so that's why we've addressed that
12 issue throughout our briefing, and that's why we submitted and
13 asked for declarations, in particular by Mr. Appel and Mr.
14 Ehrhart explaining their position on that financial strength
15 rating downgrade issue, so we think to exclude that evidence,
16 would really be to ignore what the Commissioner is asking this
17 Court to address, and what the Commissioner wants to hear
18 evidence about.

19 And I think it's very important, your Honor, to keep in
20 mind that Proposition 103 is about keeping insurance available
21 in California, and Consumer Watchdog has made a lot of
22 arguments, and we can debate what the proper legal standard is
23 here, but I don't think there's any dispute that Proposition
24 103 is at the center of this case, and the point here is to
25 keep insurance available in California, and the reason why

1 we're concerned here, the primary reason we're concerned that
2 insurance won't remain available to State Farm General's
3 policyholders is the risk of an imminent financial strength
4 ratings downgrade, and this is really important for the
5 hundreds of thousands of State Farm General policyholders with
6 a mortgage, because it's people with a mortgage that have to
7 get insurance from a company with a specific financial
8 strength rating, and if, you know, State Farm General slips
9 below that level, all of these hundreds of thousands of people
10 might have to go out and get other insurance, and that may not
11 be available.

12 They might have to go with the FAIR plan, which as you
13 know, has less insurance and is more expensive, so this is
14 very much at the center of this proceeding. I think however
15 you look at the legal standard, it's relevant, even under this
16 plainly invalid standard, Proposition 103 is relevant. If
17 something violates Proposition 103, it violates even their
18 standard.

19 Now, we've explained we think that's not the standard.
20 We think it's the fundamentally fair, adequate, reasonable,
21 and in the interest of justice, and we think all of that
22 certainly takes into account particularly the interest of
23 justice standard. What matters to California consumers and
24 policyholders in this financial strength rating issue is
25 particularly important, and you've seen it addressed both in

1 the original stipulation, and in the supplemental stipulation.
2 We certainly don't think you should exclude this evidence
3 which we think will be incredibly helpful to the Commissioner
4 as he ultimately makes the decision here in the stipulations.

5 THE COURT: Okay. Thank you. And the Department?

6 MS. MCKENNEDY: Thank you, your Honor. The
7 Department would just add that State Farm has not actually
8 abandoned its variances assertion. It's still in the rate
9 applications, which are still pending, and even if State Farm
10 did withdraw the Variance 6, I think it's still incumbent upon
11 the Commissioner to consider the financial strength and
12 solvency of all insurers when reviewing rate applications.

13 THE COURT: Okay. Thank you.

14 MR. MELLINO: May I briefly respond to a couple of
15 points?

16 THE COURT: Mm-hmm.

17 MR. MELLINO: Thank you. So we certainly agree that
18 when a financial strength rating drops significantly it is
19 important to the insurer that insurance is available, but that
20 objective is fulfilled within the statutory texts, not just a
21 generalized command that the Commissioner can feel how we
22 wants to.

23 Obviously, interim rates are a big exception for, kind of
24 outside the bounds of what prior approval would normally
25 require, and so there are ways that State Farm could introduce

1 that evidence of its financial condition at these proceedings,
2 you know, in order to argue that, and that would be through
3 the variances. I understand that it does not explain the
4 variances in the underlying rate application, but we are here
5 discussing these interim rate applications, and the rate
6 templates that we're submitting in support of that are
7 expressly not from this variance, so we would argue that
8 they're not at issue here.

9 We also argue that it's speculation about the
10 availability of insurance if State Farm's financial strength
11 rating was downgraded is just that, speculation. There's no
12 evidence that other insurers would not be available to cover
13 those people who lost their insurance through State Farm, or
14 that it would be more expensive, and so that's pure
15 speculation, and finally the standard for approval, we agree
16 that the standard for approval of the stipulation is whether
17 it's fundamentally fair and in the interest of justice, but
18 whether an interim rate should be approved is the standard of
19 whether the current rates are plainly invalid, so those
20 standards work in tandem. They're not separate standards.
21 The stipulation would be fundamentally fair, adequate,
22 reasonable, and justified if the current rates are plainly
23 invalid. They're not, and I'll rest that.

24 THE COURT: Thank you. Move to Number 2?

25 MR. MELLINO: Yeah. Motion in limine Number 2

1 concerns the supplemental stipulation. Pretty straight
2 forward. Our objections are, first, that it was filed
3 untimely. Your Honor, ordered that it be filed no later than
4 April 2nd. It was not filed April 2nd. It was filed April
5 4th, therefore it is late. We believe it should be excluded
6 for that reason, especially given the very tight timelines in
7 which this hearing is held, a one or two-day delay is very
8 significant. It does not allow us to address the differences
9 in the supplemental stipulation.

10 I understand from State Farm's response that Ms. Vanessa
11 Wells was involved in negotiating the terms of the
12 stipulation, and that she had a family tragedy and was unable,
13 and that contributed to the delay.

14 We're obviously sympathetic with Ms. Wells, but we would
15 say State Farm has many lawyers that work on these matters,
16 and in particular there is no reason that Ms. Wells's absence
17 precluded State Farm or the Department from providing notice
18 that they were continuing to work on the stipulation, or that
19 there were still planning to file. We didn't get one on
20 February, or on April 2nd, and the parties submitted
21 declarations that appeared to be supporting differing ideas of
22 what the stipulation or the final decision should be. The
23 reason we assumed, "Well, they haven't agreed to a
24 stipulation, so that's not gonna happen," and suddenly Friday
25 morning without notice we get the stipulation, so we think

1 that's prejudicial.

2 We still don't know whether it's -- We've had to prepare
3 to argue both stipulations, because it's not clear whether the
4 stipulation should be allowed, and then furthermore, there
5 were no declarations submitted in support of the supplemental
6 stipulation. I know that State Farm has argue in its response
7 that declaration's already submitted were sufficient because
8 they generally go to the same issues, but they were not
9 submitted in support of that declaration. They were submitted
10 in support of the original stipulation, which has different
11 terms than the supplemental stipulation.

12 The Department's declaration is also not under those same
13 terms, because the Department's declaration did not
14 incorporate any non-renewals while the supplemental
15 declaration did, so we have all these competing declarations
16 that are arguing about different stipulations, and that
17 stipulation came without notice, all together. I think this
18 is prejudicial, and especially given the short timeline, we
19 would ask that any evidence about the supplemental stipulation
20 be excluded, and that this hearing concern the February 7th
21 stipulation that was on the -- Thank you.

22 THE COURT: All right. So similar to your recitation
23 earlier, I'm gonna ask you, are you -- is there something that
24 you're not prepared to do given that outline?

25 MR. MELLINO: I mean, I would say that we prepared

1 the best we can in the very short time we've had, but
2 certainly feel that we would be more prepared if we knew
3 exactly which stipulation we were working on. We were all
4 working all weekend, day and night, and, you know, I think
5 it's not fair to a party to have to prepare two different
6 types of arguments because another party submitted something
7 late and now we don't know whether that's what we're arguing
8 about or not, so we're prepared to do our best if we have to
9 argue on this, but we don't feel that it would be a fair
10 result to require that.

11 THE COURT: Because I can appreciate your concern
12 about the timeline and not receiving it when you anticipated,
13 you know, working on it, but I'm trying to pinpoint what you
14 were not able to accomplish in preparation? If there's
15 something you can literally say that didn't happen, and what
16 would that be? Is there something that you couldn't do? That
17 you couldn't prepare for?

18 MR. MELLINO: Well, I mean, we had no chance to ask
19 any questions about the supplemental stipulation, and again,
20 there were no declarations submitted in support of it, no
21 analysis submitted in support of it, so we prepared the best
22 we can, but we don't feel like that means that we're
23 sufficiently prepared and not prejudiced in any way by this.

24 THE COURT: Seems like you're doing pretty good.
25 Sounds like you're ready to attack them in real time at trial.

1 Is that not true?

2 MR. MELLINO: I mean, I'm ready to attack the
3 timeliness of the stipulation. We're ready to attack the
4 original stipulation. I mean, obviously, from a legal
5 perspective we don't believe this stipulation is justified,
6 but, you know, this is a hearing under the EPA. You know, at
7 the very least, one of the parties could have given us a heads
8 up that this was still in the works, because we did
9 immediately start working on this under the assumption that it
10 was done.

11 THE COURT: Thank you. All right. State Farm
12 General?

13 MS. WELLINGTON: Thank you, your Honor. So returning
14 to the Commissioner's order setting the interim rate hearing,
15 it did instruct CBI and State Farm General to continue
16 discussing the issues that the Commissioner is concerned,
17 about in particular our capital infusion from State Farm
18 Mutual in the nonrenewal issue, and so CBI and State Farm
19 General have continued to discuss those issues in good faith.
20 We were able to reach a second supplemental stipulation on
21 Friday.

22 We regret we couldn't get that done earlier, but there
23 were really exigent circumstances here. This is a
24 complicated. There's lot of parties involved. The key lawyer
25 who'd been working on this for weeks was very unexpectedly

1 unable to continue, and so we regret the delay here, but we
2 think this is in incredibly important issue, again, that the
3 Commissioner wants to hear about. The Commissioner cares
4 about the issues described in the supplemental stipulation, in
5 particular the agreement between CBI and State Farm General
6 that if and when the Commissioner enters an order approving
7 the interim rates in the supplemental stipulation, State Farm
8 General shall obtain a surplus note of 4 million -- 400
9 million dollars from State Farm Mutual, and again, this is
10 something that, as I understand, Consumer Watchdog was asking
11 for itself, some kind of capital infusion.

12 We were able to reach that agreement. As CBI's actuary
13 explained is directly relevant to State Farm General's
14 continued financial health. It interacts with the rate
15 increase, so we think it is an incredibly important issue that
16 this Court should take evidence on, and should provide a
17 recommendation to the Commissioner on this issue, and again,
18 we don't think there's prejudice here, because CBI's actuary
19 submitted a declaration on April 2nd talking directly about
20 this 400 million dollar issue, so Consumer Watchdog has had
21 all the evidence, that declaration is in support of this
22 supplemental stipulation. They've had that since April 2nd.

23 We are not planning to submit any additional
24 declarations. We believe the declarations our declarations
25 that we've submitted both support the original stipulation and

1 the supplemental stipulation, so there's no additional
2 evidence we're filing. The only thing that was filed on
3 Friday is just the text of that supplemental stipulation.

4 The supplemental stipulation also addressed the
5 nonrenewal issue. Again, this is an issue the Commissioner
6 raised in the discussions between the parties, asked the
7 parties to address. This was the agreement that we were able
8 to reach, which was to stipulate to a lower interim rate of 17
9 percent for the homeowner's line to take into account the
10 CBI's actuary's view of how the nonrenewals impact Start Farm
11 General's risk profile, so this is part of really the core
12 issues that are of concern here, and we think they're very
13 important for this Court to address.

14 We do apologize about the timing. We really were trying
15 to get it done on Wednesday, but there were really exigent
16 circumstances here, and all of us are hardworking in this
17 situation.

18 I did want to just point out here, they do have an
19 opportunity to address the second supplemental stipulation.
20 They supported -- supported their arguments on that with an
21 actuary declaration that they filed yesterday. They will have
22 an opportunity, of course, to present evidence, and conduct a
23 cross-examination, so there is plenty of an opportunity to be
24 heard under the Barkley case that we cited in our briefing.
25 Thank you.

1 THE COURT: All right. Can I ask, why nobody asked
2 for an extension? Either the -- I mean, I won't ask you to
3 speak for the Department. I'm going to ask them too, or said
4 anything?

5 MS. WELLINGTON: I apologize about that, your Honor.
6 I think the problem was we thought we were gonna be able to
7 get it done on Wednesday, and then we thought we were gonna be
8 able to get it done, so it just, we thought we were gonna be
9 able to get it done before Friday morning. We should have
10 said something.

11 To be frank, your Honor, we thought that the CBI's
12 actuary declaration, which expressly discussed the terms that
13 were agreed to, indicated that the parties were trying to
14 reach another agreement, and we apologize if that was
15 misconstrued, and frankly, we simply had a ton going on on
16 Wednesday with everything that we had to file, and we were
17 really working as quickly as possible to get it done.

18 THE COURT: Okay. I mean, I appreciate you
19 responding to it, but I do find it troublesome, especially
20 since it's administrative law, there's not even a required
21 pleading format. You can literally print an e-mail, and file
22 it, so just -- just a little learning lesson. Don't do that.
23 Anything from the Department?

24 MS. MCKENNEDY: We appreciate that, your Honor, and
25 we apologize as well. I think one of the issues here is that

1 we view this as an ongoing discussion trying to reach
2 resolution of the interim rate issue, and I would say that
3 under the Regulation 2656.1, Consumer Watchdog still has the
4 opportunity to submit written objections if it wants to, to
5 the supplemental stipulation. They would be due tomorrow.

6 If they want to request a separate hearing on the
7 supplemental stipulation, they could, although I would prefer
8 that we get it done in this one shot, but it's unclear to me
9 what prejudice they will have suffered, because under the
10 regulation it's still -- it's still timely. I mean, the
11 Department and State Farm could then turn in a new stipulation
12 next week on yet another new issue. It's an ongoing
13 litigation process.

14 And I will say, your Honor, last week all the parties
15 were working extremely hard under an extremely set of tight
16 deadlines. No one was lazing about, or, I mean, I'm proud of
17 all the parties here. The fact that we're here, and we have
18 shoes on is, you know, a good sign, your Honor.

19 I would also point out that I'm not clear that the
20 regulation actually requires declarations in support of this
21 particular stipulation. This is a stipulation to resolve an
22 issue, not to resolve the entire rate application proceeding,
23 and under 2656.1, Subdivision C, declarations are only
24 required if a stipulation dispositive of the case or a
25 settlement is proposed prior to the taking of any testimony.

1 If you also look at Subdivision C, there's no timing.
2 There's no set deadline for when declarations in support of
3 the stipulation have to be submitted. Here I would argue that
4 the declaration of Tina Shaw is in support of the supplemental
5 stipulation as it amends the overall prior stipulation, and it
6 was submitted early, because in all honesty we thought that
7 was giving CW the heads up as to the additional terms we were
8 still trying to work out, so I don't understand CW's focus on
9 maintaining that declarations in support of a stipulation have
10 to be simultaneously filed with the stipulation itself.
11 There's no regulatory requirement for that, your Honor.

12 THE COURT: Thank you. You might recall in the
13 conference I cited to those very same provisions without
14 finding a -- making a determination, nevertheless hearing
15 whether -- Okay. Something in response to those comments?

16 MR. MELLINO: Yeah. Yeah. So I'd first like to say
17 State Farm, you know, raised the issue of the Commissioner's
18 order, and the Department generally did too, that it's some
19 kind of ongoing negotiation, and they can just amend a
20 stipulation at any time, and we specifically discussed those
21 at the conference -- an order requiring a stipulation to file
22 at a certain time. They could have asked for a extension.
23 They could have put us on notice that they were still working
24 on it. They did not.

25 The Department's declaration that was filed by Tina Shaw

1 absolutely did not give a heads up that they were still in the
2 process of working on and signing a stipulation, giving that
3 the time set by the Court's order had passed, and State Farm's
4 declarations did not discuss those same terms, and to be clear
5 the Tina Shaw declaration is not about the terms in the
6 supplemental stipulation. That declaration did not
7 incorporate any agreement to stop nonrenewals by State Farm,
8 which are in the supplemental stipulation.

9 On the issue of 2656.1, Subdivision C, we would argue
10 that this is an interim rate hearing, and an interim rate
11 proceeding, you might call it, and the issue of whether State
12 Farm should get a interim rate will be fully disposed of in
13 this hearing, and so the requirement to file declarations
14 should clearly apply, and while we acknowledge that there's no
15 express timeline stated in that regulation, it's simply not
16 logical to interpret that as somehow, "Oh, we can file the
17 declarations whenever. We don't have to file them with the
18 stipulation," particularly when there's a regulatory timeline
19 of five days for a party to object to a stipulation. If --
20 If -- When would the parties who stipulated ever have to file
21 it? Do they file it the same day that the party had to
22 object? What would the party be objecting on?

23 And to the suggestion that we could file objections to
24 the supplemental stipulation, and then that would trigger
25 another hearing, I mean, I think we all realize that would be

1 ridiculous. Either this is a hearing about the original
2 stipulation, or it's about the supplemental stipulation,
3 depending on how your Honor interprets this, but we can't --
4 We've been working to prepare for this hearing not knowing
5 which stipulation it would be on, and it would be unreasonable
6 to have us also be filing objections, and then preparing for
7 another hearing on possibly the exact same subject. I don't
8 think that was a realistic suggestion.

9 THE COURT: You knew the first -- You knew the basis
10 of the issues, did you not?

11 MR. MELLINO: Yes. There are --

12 THE COURT: So it's not -- You just didn't know in
13 addition to the supplemental --

14 MR. MELLINO: No. We did not, and I mean, we would
15 argue that, you know, arguably supplemental stipulations are
16 not envisioned under the stipulation. There is no
17 envisionment of a continued negotiation or something like that
18 regards of what the Commissioner's order may have applied, but
19 --

20 THE COURT: But, again, consistent with the question
21 I asked you earlier, that's consistent with many of the
22 concerns you've raised by objection or otherwise; is that not
23 correct? Process? The law?

24 MR. MELLINO: Yes. We have many concerns about the
25 process.

1 THE COURT: Okay. I'm not beating you up about it.
2 I just want to understand. Okay. Anything further?

3 MS. MCKENNEDY: Your Honor, if I may? I would just
4 add that the terms of the supplemental stipulation are further
5 protected for California consumers, and so if there is any
6 intent to exclude the stipulation, then your Honor should
7 expressly ask State Farm to agree to those terms on the record
8 when making a final determination in this matter.

9 THE COURT: Why don't you -- Why don't you offer
10 that?

11 MS. MCKENNEDY: I would prefer the supplemental
12 stipulation be in place, your Honor, because it contains all
13 the bells and whistles that we could come up to put in
14 writing, and have State Farm sign that.

15 THE COURT: Sure. You can confirm it on the record
16 too. You could do both, right?

17 MS. MCKENNEDY: We could read it into the record,
18 your Honor. Thank you.

19 MS. WELLINGTON: And, your Honor, we would be fine to
20 read the supplemental stipulation into the record. In our
21 view, it's closer. It's not what Consumer Watchdog wants, but
22 it is closer to what Consumer Watchdog wants, so we really
23 don't see any prejudice in the parties moving closer to each
24 other.

25 THE COURT: All right. Thank you. All right.

1 Moving on.

2 MR. MELLINO: Yeah. Motion in limine Number 3. So
3 hopefully this will be more straight forward than the last
4 two. This goes to the declaration submitted by Tina Shaw on
5 behalf of the Department. Specifically, the parts of the
6 declaration that are limited to discussion of the RBC, Risk
7 Based Capital, instructions. Under statute, Insurance Code
8 Section 739.8, Subdivision C, "It is the judgment of the
9 legislature that RBC instructions shall not be used by the
10 commissioner for ratemaking nor considered or introduced as
11 evidence in any rate proceeding, nor used by the commissioner
12 to calculate or derive any elements of an appropriate premium
13 level or rate of return."

14 In Ms. Shaw's declaration, she expressly notes that she
15 is relying on the RBC instructions independently to calculate
16 State Farm's RBC ratios. That independent instruction does
17 not make it acceptable under the regulation, which
18 specifically cites the RBC instructions as something that
19 shall not be considered or introduced as evidence by the
20 commissioner in a rate proceeding, and so for those reasons we
21 would argue that the portions of her testimony about, or that
22 were based on the RBC instructions in some way should be
23 struck, and any further evidence should be excluded from this
24 hearing. Thank you.

25 THE COURT: All right. Department want to start on

1 this one?

2 MS. MCKENNEDY: Yes, your Honor. Thank you. I
3 believe there might be some confusion regarding what the term
4 "RBC instructions" means statutorily. If you look at
5 Insurance Code Section 739, Subdivision I, it says, "RBC
6 instructions means the RBC report, including risk-based
7 capital instructions adopted by the NAIC."

8 My understanding is that the RBC report itself tells
9 insurers how to calculate their RBC ratios, and that as part
10 of that RBC report, that overall document is what Ms. Shaw did
11 not review, did not rely upon in independently calculating the
12 RBC ratios. Ms. Shaw did use the same formula that is set
13 forth in the NAIC instructions. It's set forth in other
14 places as well. It is the only way to calculate the RBC
15 ratios.

16 Ms. Shaw was merely identifying that that is where the
17 formula is identified, but the RBC ratios are the best way to
18 measure an insurance solvency. If we don't use the RBC
19 ratios, there is no way for the Commissioner to assess State
20 Farm's solvency concerns, and Variance 6, your Honor, which I
21 believe is still in play in this rate proceeding, expressly
22 allows the Commissioner exception to the rate-setting formula
23 if an insurance -- an insurer's solvency is at stake. If the
24 Commissioner has no way to measure the insurer's solvency,
25 then Variance 6 would become just meaningless. I mean, how

1 else is the Commissioner supposed to do this?

2 Ms. Shaw was very careful not to review any confidential
3 RBC reports submitted by State Farm, or any other insurer, to
4 my knowledge. I also believe if you look at Insurance Code
5 Section 739.8, Subdivision A, this is State Farm's objection
6 to make, not Consumer Watchdog's. There is a concern with
7 confidentiality that State Farm may choose to raise, however,
8 they already put their solvency issues at issue in this
9 proceeding, and they've already raised the RBC ratio issue
10 themselves in their initial interim rate request, and so I
11 believe Ms. Shaw's declaration is exactly on point to
12 addressing the Commissioner's orders request that we consider
13 further information.

14 And finally, I would note that your case management order
15 requested that the parties should endeavor to meet and confer
16 on the issue of excluding witnesses on the hearing, and
17 counsel for CW failed to do that.

18 THE COURT: Okay. State Farm?

19 MS. WELLINGTON: Our understanding here is that the
20 RBC information that is used in this declaration is from State
21 Farm General's annual report. That's publicly available
22 information. We don't view there to be any legal prohibition.
23 If you read the text of what Consumer Watchdog is objecting
24 about, it says, you know, you can't disclose RBC information
25 that is legally protected. This is not legally protected

1 information. It is literally in State Farm's annual
2 statement. That's our understanding at least of where this
3 information came from.

4 We don't think there's any legal reason why it can't be
5 used to calculate these RBC ratios, so we don't actually
6 really understand what the objection here is. We do agree
7 that there is confidential information related to the RBC
8 calculations, but again, that's not in this report, so we
9 don't have any objection to using public information here, and
10 to be fair, we think that that's what all of the party's
11 witnesses are relying on is this publicly available RBC
12 information, including what Mr. Appel used in his declaration?

13 MS. MCKENNEDY: Your Honor, may I add one thing that
14 I forgot to mention? I apologize for that.

15 THE COURT: Yes.

16 MS. MCKENNEDY: The RBC ratios were not used by Ms.
17 Shaw to set the rate itself that -- in her declaration. She
18 is recommending adoption of the interim rates, but she's not
19 using the RBC ratios as a rate-making tool, if that makes
20 sense? She's just using the RBC ratios to address the
21 solvency concerns.

22 THE COURT: All right.

23 MR. MELLINO: Yes. Yes. So we note that RBC ratios
24 are not directly relevant to rate-making, in so far as this is
25 a proceeding about interim rates, and whether they're

1 acceptable, and State Farm's current rates.

2 Again, I recognize that Ms. McKennedy is raising that
3 Variance 6 is still at issue in the underlying proceedings.
4 We still believe it's not at issue in this proceeding. State
5 Farm could have submitted some rate term requests pursuant to
6 Variance 6, and things would look differently now. They did
7 not. That was a purposeful choice, and they should be held to
8 that, and --

9 THE COURT: What do you have to say that applies to
10 Ms. McKennedy's point that the declarant -- the declarant was
11 speaking to the solvency as a general proposition?

12 MR. MELLINO: Well, again, we would say that's a
13 Variance 6 issue. That's not a issue here, and furthermore to
14 the extent that policy -- in the extent this was a Variance 6
15 proceeding, the regulation would not override the statute. It
16 would be the other way.

17 Now, we also recognize that there seems to be some kind
18 of conflict if the Commissioner is required to investigate
19 solvency but there's a statute prohibiting that, but that's
20 the determination of the legislature, and that's what we have
21 to go with, so the code section plainly states judgment of the
22 legislature that RBC instructions shall not be used or
23 considered as evidence, so even if this was a variance
24 proceeding, that statute would still supercede any
25 alternative.

1 THE COURT: Okay. Anything further?

2 MS. MCKENNEDY: No.

3 THE COURT: All right. Thank you.

4 As to your March 25th objections, and Consumer Watchdog's
5 objections, together with your subsequent motion of April 7th
6 objections, do you want those -- How do you envision those
7 being addressed? Did you, I mean, you have objections in the
8 case in chief itself, so, but are you -- are you looking, you
9 know, with most of the motions from yesterday, to strike, and
10 a motion for sanctions, that's succinct as to what you're
11 trying to accomplish procedurally. You want to start -- You
12 want to address that now?

13 MR. MELLINO: I will defer to Mr. Pletcher.

14 MR. PLETCHER: Yes. With respect to the objections?

15 THE COURT: Your initial ones?

16 MR. PLETCHER: The initial objection. Yeah. I
17 believe those will be taken up. To the extent there's still
18 apply as new files come in, I think they'll be taken up over
19 the course of this hearing.

20 THE COURT: Yeah. What I was saying is what I said
21 earlier, you know, there's some overlap in some things, so I'm
22 just trying to see what you want to address with your actual
23 motion for relief?

24 MR. PLETCHER: Right. As to our motion to strike,
25 you know, that goes to the late filings, and the procedural

1 problems. That's certainly something we intend to argue, and
2 you know, we would certainly invite a strike now.

3 We understand that this is an administrative proceeding
4 where you may want to hear the record before you decide to do
5 that, but that could also be a way to go. I don't think that
6 needs to be resolved at this moment, but we're prepared to
7 argue it either way.

8 As to the sanctions, that's something we would like some
9 additional time to prepare. We just wanted to give notice
10 that we thought this was a significant violation that involved
11 significant prejudice, and that we had a moment to return to
12 that issue to further address that.

13 THE COURT: Okay. So if you want -- If there's
14 anything you want to add to those pieces, you're more to
15 welcome to do so now, and you can -- you're not prejudiced
16 from supplementing that later, so what do you want to do?

17 MR. PLETCHER: Nothing to add at this moment, because
18 so much of the dispute or the issues surrounding late filings
19 was addressed by Mr. Mellino, but I believe it's something we
20 will be addressing throughout.

21 THE COURT: All right. And so I will sort of
22 consolidate that also with the letter of March 28th as being
23 -- encompassing those pieces.

24 MR. PLETCHER: I think that makes sense, your Honor.

25 THE COURT: Is there anything that the parties want

1 to speak to those particular matters raised by Consumer
2 Watchdog at this time? You can make some preliminary comments
3 in response and/or the only ones you are gonna make in
4 response if that's what you want to do. It's up to you.

5 MR. MADDIGAN: We'd like to speak to it briefly, your
6 Honor?

7 THE COURT: Yeah. Please, go ahead.

8 MR. MADDIGAN: This is in connection with the motion
9 to strike that was filed yesterday. We filed our opposition
10 this morning.

11 There are really two components to that, your Honor. The
12 first is with respect to these allegedly late filings. The
13 basis of that is submitting something electronically after the
14 4:30 deadline for submitting things in paper filings, and as
15 we laid out in our papers, all the parties have been doing
16 that, including Consumer Watchdog, so there's no basis for
17 finding those filings to be -- to be late as has been the
18 practice of the parties that everyone has followed.

19 And the second point that's the basis of the motion, your
20 Honor, is the stipulation, which has already been addressed,
21 so I won't belabor that, but in brief, there's really no basis
22 for granting the motion to strike, and certainly no basis for
23 sanctions, which we're happy to address if and when that is
24 formally made, which hopefully it will not be.

25 THE COURT: Anything from the Department?

1 MS. MCKENNEDY: Your Honor, I actually do have a
2 request for clarification from the Court. One of the
3 complaints that Consumer Watchdog makes in its motion for
4 sanctions is that the Department and State Farm have been
5 including the Commissioner on our proofs of service in this
6 matter, but your Honor, I can't speak for State Farm, but the
7 Department is doing that, because the Administrative Hearing
8 Bureau is doing that on your proofs of service, so we thought
9 that that is what the Court would like us to do.

10 There is no ex parte violation by including the
11 Commissioner on any publicly-filed pleading that is also being
12 simultaneously served on all parties and filed with the Court,
13 however, Consumer Watchdog raised the issue, and so I would
14 like to request clarification. Is this something that the
15 Court would like the parties to stop doing?

16 THE COURT: I will answer that, but I'm gonna see if
17 there's any further comments.

18 MS. MCKENNEDY: Thank you, your Honor.

19 MR. PLETCHER: Just very briefly with respect to the
20 motion to strike, we realize that we're talking about hours
21 here, not days or weeks, and that's certainly not, you know, a
22 position that we would normally take, but because of
23 compressed schedule, this is a time where hours mattered, and
24 mattered greatly.

25 With respect to the service issue, this was something

1 that we wanted to raise, perhaps just to get clarification
2 about Consumer Watchdog has not been serving the Commissioner.
3 If that's gonna be the practice, we're happy to do so, but we
4 understood from one of the early notices from AHB that we were
5 not supposed to do that. We might have misunderstood it, but
6 we want to make sure all three parties are on the same footing
7 with respect to whether or not the Commissioner should be
8 served.

9 THE COURT: I believe you're correct in the sense
10 that I confirmed the application regulation in the notice of
11 hearing, if I'm not mistaken, but go ahead. Anything further
12 on that?

13 MR. PLETCHER: No. That's it on that issue.

14 THE COURT: Just a moment. Something more?

15 MS. MCKENNEDY: No, your Honor. Thank you.

16 THE COURT: Okay. So I -- I appreciate being alerted
17 to that. I don't have an exact answer, because I didn't know
18 until I read it on your paperwork, and I did put in motion
19 requiring how that came to be, so I would speculate to tell
20 you why there are additional noticing included in the service,
21 but I can share with you as a general proposition that the
22 support staff have typically been liberal in courtesy copying
23 when requested.

24 I don't know about the Commissioner's Office, because
25 that's -- that has not been something that I've seen. For

1 example, when we're having workers compensation cases, the
2 Workers Compensation Insurance Rating Bureau sometimes will
3 not choose to be a party. They have the option to do that,
4 but they nevertheless want to be courtesy copied, and so I can
5 only indicate to you that that -- they would not necessarily
6 think if something was irregular, absent an instruction, but I
7 appreciate that the optics are not good with that.

8 I will also share that once we issue something, it's in
9 the public record anyway, and anybody can see it, and as to
10 their adherence as to what their obligations are, that's up to
11 them to make that determination, it's not before to render a
12 decision, but I will instruct that correction me made, and so
13 that the -- to the extent that somehow that is, that those
14 documents are sought by others, they have other means to do
15 so, because we want to make sure it's absolutely clear.

16 I will also include in my comments so it is absolutely
17 clear in the record, I have had no contact as far as substance
18 with either the Department or any party in any manner other
19 than on the record or through notice, order, I haven't had a
20 decision yet, and the only contact I have is -- is with
21 respect to the Department providing support, infrastructure
22 support, or what we're sitting here today doing, and arranging
23 for those kind of things, and that's not -- That's done
24 through our process of liaison to notice the parties what
25 happens, so is there any question whatsoever about that?

1 MR. PLETCHER: I guess our remaining question would
2 be as a potential remedy as you consider this issue, would you
3 consider giving us leave to file what has been, you know,
4 previously filed on the other parties on the service list,
5 just so everything on the same -- the footing?

6 THE COURT: Is there any comment about that?

7 MS. MCKENNEDY: I was just going to say it's not a
8 filing. It's just a service.

9 THE COURT: It's a service.

10 MS. MCKENNEDY: And the Department would not object,
11 so --

12 THE COURT: I don't know that you even need to -- I
13 mean, it doesn't have to be a formal service if you're
14 providing a courtesy copy to another party, but you can think
15 about what you're comfortable with in that regard. I don't
16 want to instruct you, cause I am in agreement with you with
17 respect to being very cautious with regard to the separation
18 of functions, especially in the context of an actual matter
19 being litigated in front of me, so I don't -- I don't want to
20 make that worse than -- than -- than your concern has been
21 raised. I don't think -- I'm not aware of anything
22 substantively that effects my role, but if I did, I will tell
23 you.

24 MR. PLETCHER: Thank you. I appreciate that. And
25 we're not seeking instructions, just to the extent that that

1 might violate the prior order, would just seek leave so that
2 we could consider whether we --

3 THE COURT: -- I see what you mean. Let me think
4 about that, cause I don't wanna -- I don't want to -- It has
5 some implications for you of others adhering to their own
6 obligations, so to the extent there was a mistake that was --
7 that occurred, given my understanding of what I said, I don't
8 want to -- I don't wanna -- I don't wanna -- I don't wanna
9 further it, but I understand why you're saying what you're
10 saying.

11 MR. PLETCHER: Thank you, your Honor. And we
12 appreciate it. It's a bit tricky.

13 THE COURT: Yeah? Yes?

14 MS. PRESSLEY: I just wanted to add, I think the
15 reason the confusion came up is this was highly unusual where
16 the Commissioner stepped in and had the conferences, so we
17 were serving -- we were serving communications at that time.
18 I think our position has been that once everything was noticed
19 and gone to Stage B, typically the Commissioner as the
20 decision-maker would not be copied on ongoing, you know,
21 discovery disputes.

22 There are procedures in the regulations that deal with if
23 they're not satisfied -- if a party's not satisfied with your
24 Honor's rulings on evidentiary issues or motions to compel to
25 seek interim from the Commissioner but generally, the record

1 is developed fully, and then you issue a proposed decision,
2 and the whole package would then go to the Commissioner, so
3 our concern has been there is no filings at this point, the
4 Commissioner doesn't have -- doesn't even know that we've made
5 filings, but so, I think our preference would be going forward
6 to follow the procedure as it's contemplated under the
7 Government Code, and the regulations that the Commissioner
8 acting as the decision-maker would get the final record, not
9 ongoing, you know, updates on --

10 THE COURT: -- The general outline is correct.

11 MS. PRESSLEY: Yes.

12 THE COURT: And that is what I was indicating when I
13 made the statements that I did. My only pause was the
14 catching them up with things, and I'm not comfortable with
15 that. I think that we should just leave it the way it is.
16 Stop doing that practice. It should not have happened.

17 There's a lot of reason to speculate as to why it is, and
18 I'm also consistent with what you were indicating because the
19 way it positioned itself procedurally was not one that they
20 normally would see, you know, people copy and paste, so I
21 don't really have any other actions than that, but I would
22 rather the optics be absolutely untarnished, so I think that
23 we should -- The Commissioner's office, to the extent there's,
24 you know, it will go up, they will -- they have, as the
25 regulations contemplate, the decision by the Commissioner it

1 will be based on the record that the Commissioner's Office
2 receives, so that's the entirety of the record at that time,
3 and I'm confident that's what they'll be looking at, rather
4 than some sort of mishmash of stuff that they received in the
5 interim, whether intentionally or otherwise, and I can't speak
6 to what they've done with those or anything.

7 All I can tell you is what I did, and that is that I
8 found out because you mentioned it, so something more from
9 anybody?

10 MR. MONTGOMERY: We're just wondering, your Honor, if
11 this might be a good time to take a break?

12 THE COURT: Getting tired. Sure. Why don't we --
13 We've blown through a lot of time. It's slow going, but we're
14 getting there.

15 What do we have left here on -- We have the -- We've just
16 addressed your -- Is there any other moving matter that -- any
17 moving papers, request for relief, that we haven't talked
18 about?

19 MR. PLETCHER: Your Honor, in the nature of
20 preliminary evidentiary objections or motions in limine,
21 Consumer Watchdog has a response to State Farm's motion.

22 THE COURT: All right. Do you want to start with any
23 comments from State Farm first, or -- furtherance of that
24 request?

25 MR. TETI: This is regarding State Farm's motion to

1 strike what was filed on April 2nd; is that right?

2 MS. PRESSLEY: Yes, the motion to strike portions of
3 Consumer Watchdog's objections to extent concern --

4 THE COURT: -- Yes. It was lodged on April 2nd. It
5 was actually filed on April 3rd, because of the timing of
6 everything, so, yes.

7 MS. PRESSLEY: Correct.

8 MR. TETI: Yes. We can address the -- We can address
9 this motion now, or after the break, your Honor, would be
10 preferable for State Farm?

11 THE COURT: If you need it for prep time. I'm just
12 thinking because of 11:30, we have the option of taking an
13 early lunch, and then breaking completely, so we don't have to
14 take it up now. We can take it up when we get back, but if we
15 take it up now, it might save us a little time when we get
16 back?

17 MR. TETI: We would like to save time, but if your
18 Honor is amenable to the earlier lunch, that would be great?

19 THE COURT: You want to take time. That is fine.
20 We'll do that. I'm not gonna jam you up.

21 MR. TETI: Thank you, your Honor.

22 THE COURT: Okay. So how about an early lunch. We
23 usually take a long lunch, because people have things to do,
24 and I've also asked you to talk about the exhibits.

25 Did you all get a sheet as to places you can go to lunch?

1 MR. TETI: I don't believe so, your Honor.

2 THE COURT: All right. Then we'll bring it out if
3 you just wait here, like, after I step off? The secretary
4 will bring out the cheat sheet for you, but how about if we
5 come back at 1:00 o'clock? Is there any concerns about that?

6 MS. MCKENNEDY: That's fine, your Honor. Thank you.

7 THE COURT: Okay. So we are recessed until 1:00
8 o'clock.

9 (Pause in the proceedings from 11:36 a.m.
10 until 1:04 p.m.)

11
12 TUESDAY, APRIL 8, 2025

13 AFTERNOON SESSION
14

15 THE COURT: Please be seated. All right. Back on
16 record after a recess for lunch. Parties did not take a
17 morning break, and consistent with traditional practice we
18 took a longer lunch resuming at approximately 1:00 o'clock or
19 just thereafter in the matters of State Farm General Insurance
20 Company, the Applicant, for Case Numbers PA-2024-00011, and
21 PA-2024-00012, and PA-2024-00013.

22 Prior to taking the recess we had heard oral argument on
23 a series of outstanding motions, and we had agreed to resume
24 that process in order to get through those that were pending
25 upon coming back from the break. So with that, we had planned

1 to take up State Farm's -- State Farm's motion, and are you
2 ready now, Counsel, to speak to that?

3 MR. TETI: Yes, your Honor. Thank you.

4 Your Honor, State Farm General withdraws it's motion to
5 strike. Hopefully this helps move things along. We noted
6 that in Consumer Watchdog's opposition brief acknowledged that
7 it was not presenting this material for the truth of the
8 matter. As with any other piece of evidence offered in the
9 course of this proceeding, we reserve our rights to object as
10 appropriate, but we do withdraw this motion.

11 THE COURT: All right. The withdrawal, is there
12 anything to be mentioned by the other parties as to their
13 withdrawal?

14 MS. PRESSLEY: No, your Honor.

15 MR. MONTGOMERY: Sounds good to us.

16 THE COURT: All right. The withdrawal is accepted.

17 I got an updated docket report, and I just wanted to
18 clarify with respect to the Department's motion that we
19 discussed earlier, prior to the break, was there any written
20 response filed by State Farm in that, or was it -- did you --
21 did you respond solely orally?

22 Cause I have a -- I have your response to the motions in
23 limine generally, which was just -- was filed today, and is
24 that incorporated in that, or does that speak only to the --

25 MR. TETI: -- Yes, your Honor. It is incorporated in

1 that. It's in the first section of that document.

2 THE COURT: Okay. So I'm gonna have to look at that
3 in a few minutes in more depth since it came in today.

4 All right. Reviewing other business, you have your
5 outstanding, meaning State Farm General has outstanding
6 requests also for personal notice of certain exhibits?

7 MR. TETI: Yes, your Honor. We believe that can be
8 addressed in connection with the meet and confer process
9 that's underway. We connected with Consumer Watchdog about
10 that during the lunch, and we have a plan for identifying the
11 documents which we'd stipulate to being admitted in evidence,
12 and trust that that process will work its course today
13 efficiently, and that we can reach agreement on a lot of that.

14 THE COURT: All right. Very good. So would you
15 anticipate having that ready later this afternoon, or is that
16 something that's gonna spill into tomorrow?

17 MR. TETI: I think we're striving to do that, your
18 Honor. That's where we hope to get that done today.

19 THE COURT: Okay.

20 MR. TETI: And just to clarify, the material that's
21 part of that request for official notice, that's included in
22 the exhibits, and so that -- that would be -- that would help
23 to resolve that -- that request essentially.

24 THE COURT: Okay. So that we're clear just on the
25 procedure, when you get to the point when you're ready to do

1 that, we can state orally in the record. It's very helpful
2 for us to be able to identify the specific ones that are
3 coming in so that the reporter has something to look at in
4 connection with doing that, and so it just doesn't become a
5 mess on the -- on the record.

6 MR. TETI: The current -- Yes, your Honor. To
7 address that, the current plan is to have a list of the
8 documents that will come in, so hopefully that will result in
9 --

10 THE COURT: -- Perfect. Thank you for cooperating
11 and working on that today.

12 Okay. Is there something else that we need to
13 address with respect to the moving papers that we haven't
14 talked about? Going? Going? Okay. Very well.

15 So what I'm gonna do is we're gonna take another recess,
16 but hopefully brief. I just want to make sure that I have
17 looked at State Farm General's written material in connection
18 with those things that we talked about earlier that the filing
19 was only earlier today, and then I'll come back on.

20 In the interim while we're on that, maybe you could work
21 further on your exhibit work, and try to get that in order.
22 If you need to move to a room in order to do that, as a
23 reminder, you don't know what's being captured by audio and
24 visual in this room, you know? Simply indicate to someone
25 here on the staff that -- that you're doing that, so that I

1 know, okay?

2 Right now we are going off the record, and let's come
3 back at -- It says ten after on that clock, and I don't have
4 another one, is that about right? 10 after the hour?

5 MS. MCKENNEDY: Yes.

6 THE COURT: Let's come back at 1:30? Is 1:30 too
7 fast? Okay. Hopefully. Off the record.

8 (Pause in the proceedings from 1:10 p.m.
9 until 1:36 p.m.)

10 THE COURT: Please be seated. Oh, please be seated.
11 I'm sorry.

12 On the record. Back on the record after a brief break.
13 Allow the parties to confer further, and for additional study
14 on some filings that came in today. We are on -- here on the
15 matter of the applications from State Farm General Insurance
16 Company, Cases PA-2024-00011, PA-2024-00012, and
17 PA-2024-00013.

18 Before I revisit the various motions that we talked about
19 earlier on the calendar today, is there anything I need to be
20 updated on? Okay.

21 So starting with the motion to disqualify Watkins, I
22 considered this matter carefully. In the context of this
23 motion, presumptions arising under Evidence Code 605 and 606,
24 as well as case law, imposed on the party against whom it
25 operates the burden of proof as to the non-existence of a

1 presumed fact. Because I find the confidential information
2 was provided by Nancy Watkins as an expert, the presumption
3 applies to also find the confidential information was shared
4 by Watkins under the facts so presumed and established.

5 Applicant did not rebut the presumption that Watkins'
6 testimony should not be excluded. The purpose of the law,
7 indeed the presumptions themselves, is to implement public
8 policy protecting confidential communications in its broader
9 concept can simply lead evidence to be offered.

10 Therefore I am granting the motion as to the
11 disqualification, exclusion if you will, to track the language
12 of the motion itself, and I am doing so with the note to
13 remind everybody this is an in limine ruling, which can be
14 revisited at any time during the hearing, and I also will
15 solicit for an offer of proof from State Farm, which I would
16 expect is consistent with the declaration, but I wanted to see
17 if that's true?

18 MR. TETI: An offer of proof with regard to?

19 THE COURT: So I'm -- want to make an offer of proof
20 since I'm excluding?

21 MR. TETI: Yes, your Honor. Well, your Honor, first,
22 if your Honor has considered the potential to manage the --
23 Ms. Watkins' testimony in the context of this hearing with the
24 potential of a sealed proceeding, in which if any questions
25 should arise that would potentially implicate this -- this

1 potential conflict, that she can so testify in a sealed
2 manner. She can advise the Court that this question would
3 solicit that material, and the Court can manage the
4 proceedings accordingly, should that even arise, which again,
5 we believe would be speculation.

6 Second, the material that CBI submitted in connection
7 with this motion does not provide any evidence that any
8 confidential information was in fact shared at all, and I
9 think they acknowledge that they don't believe it has been. I
10 understand the presumption your Honor mentioned, but I want to
11 underscore that that is what the record is.

12 And then third, we would -- we would ask that the
13 declaration that has been provided by Ms. Watkins and has not
14 been objected to by the Department would come in, because,
15 again, this is testimony that addressed Consumer Watchdog's
16 actuary issues with the actuarial model that is before your
17 Honor, and it is extremely prejudicial to exclude this
18 evidence, and we believe that it's important that that
19 discussion come in.

20 It has been responded to in the form of argument by
21 Consumer Watchdog, and an additional declaration that
22 Mr. Armstrong strong for Consumer Watchdog submitted last
23 night, so it has been responded to. They've had an
24 opportunity to respond to all these actuarial matters that,
25 again, are not being objected to by CBI, so we would hope that

1 your Honor consider those three -- those three considerations
2 here in ruling on this.

3 THE COURT: I did consider those things, but if you
4 look to the papers, contrary to what I understood your
5 representations to just be, the Department specifically
6 indicates that, "During the course of her consulting work with
7 the Department, Ms. Watkins has received, and is continuing to
8 receive confidential information relating to the Department's
9 internal processes, as well as confidential information
10 received from industry and considered on pursuant to Insurance
11 Code Sections 735.5 and 129.19," which was reiterated in the
12 representations which I accepted as true from counsel earlier
13 today.

14 That doesn't prevent the parties from trying to work on
15 this. Like I said, in limine motions, broadly as to all of
16 them, can be revisited during trial, so you guys can work on
17 something to see if you can present something that would be
18 okay, and I'll deal with it at that time. You can also
19 attempt to change my mind if you think that something has been
20 left out.

21 I think that part of what, you know, I tried to explain
22 here in making the ruling itself is that while you've included
23 a number of things in order to indicate that -- that it
24 shouldn't be considered because of the nature of the -- of
25 what this witness may speak to, that isn't necessarily the

1 entire analysis because of the burden shifting with respect to
2 the presumption, so you can look at that again. You can raise
3 it again in due course if -- I prompted you to indicate if
4 you're gonna make an offer of proof now, you don't have to.
5 You can do it then, like, when you were gonna present that
6 testimony, that's fine, but you may want to do that so that's
7 -- that's in the record, and the parties in talking may want
8 to talk about that, because of course the down side to having
9 an offer of proof in the record is that if my ruling
10 ultimately is not maintained, then you didn't have an
11 opportunity necessarily to really deal with that or wrestle
12 with that, and that's just a reality, so you might want to
13 think about it.

14 I will note for the parties, and for the Department's
15 purposes, although I did not bear on my decision-making, you
16 might want to look at the Code of Professional Conduct of the
17 American Academy of Actuaries. Again, it didn't -- wasn't
18 considered in connection with making the decision. I have
19 already told you what I based that on, but it seems to confirm
20 the results.

21 Moving on, anything more anyone wants to say on that, or
22 on that topic?

23 MS. MCKENNEDY: Thank you, your Honor.

24 THE COURT: Uh-huh. Like I said, you guys are good
25 at it, so you can work on it. Let me know.

1 And just to be clear, to just follow-up to make sense to
2 ensure that we understand the disqualification is broad, so it
3 excludes the testimony which reaches down to the declaration,
4 so essentially, and in fact, I'll just make it instruct --

5 MS. MCKENNEDY: -- Thank you, your Honor.

6 THE COURT: So financial condition motion in limine,
7 that's at least what I kind of titled it to deal with it, and
8 the relevancy of the supplemental stipulation which has been
9 addressed together, I, from Consumer Watchdog, I, as I've kind
10 of indicated in asking questions about this, do respect many
11 of the points that are raised, but I am also very aware, and I
12 want to respect that we're not getting too far ahead in --
13 from deciding specific evidentiary issues, because this form
14 of law and motion is not meant to replace dispositive motions,
15 so your ultimate outcome would be the weight of the case
16 essentially, by virtue of the fact papers have been filed in
17 connection with the series of the things you have raised that
18 actually said that, which you are fully reminded repeatedly,
19 you can continue to argue and are not prejudiced, but I'm not
20 prepared to grant those two pieces, and then curtail our
21 evidentiary presentation such that we don't have a complete
22 record upon which to wrestle with them.

23 And in fact, if you are faced with points in the
24 evidentiary presentation where you specifically feel that
25 those arguments are applicable to some prejudice that you

1 would not have otherwise faced, certainly, as with the earlier
2 motion, you are free to raise those, and I will otherwise,
3 however, also include these issues with the general ones that
4 there's some overlay and overlap, as I've also mentioned, and
5 your objections and other concerns when I wrestled with the
6 decision itself, so whether that's characterized as some sort
7 of dispositive motion, it's then taken under submission,
8 really probably is another mechanics thing that is less
9 important to the fact that I will address it in the decision
10 in a more in depth manner, but when it comes to those first
11 two, the financial condition in one, and relevancy of the
12 supplemental stipulation in two, I don't want to curtail at
13 the outset our ability to consider the evidence when it's
14 being proffered, so those are denied.

15 The third is more troubling, the RBC, so I'm not going to
16 rule on this now. Instead I'm going to take a slightly
17 different route with it, which is in keeping with the idea
18 that with in limine motions you want to try to look for
19 alternatives that are reasonable to certainly dispositive
20 outcomes, and I think that I'm going to entertain a form of
21 voir dire when that -- when that is brought up for -- in
22 evidence, by the Plaintiffs, slash, witnesses, and we'll
23 wrestle with it then.

24 Any comments as to that?

25 MS. MCKENNEDY: No, your Honor. Thank you.

1 THE COURT: Consumer Watchdog?

2 MR. PLETCHER: No, your Honor. Thank you.

3 THE COURT: And from State Farm General? Anything?

4 MR. TETI: No, your Honor. Thank you.

5 THE COURT: All right. So that moves us into, I
6 think, back to the parties and where they're at with their
7 exhibit admissions and managing the exhibits?

8 MR. TETI: Your Honor, I can -- I can weigh in on
9 that. In the break we were able to have productive meet and
10 confer discussions so that the witnesses that we, perhaps
11 witness or witnesses that we expect to testify today, the
12 parties have stipulated that the exhibits associated with
13 those witnesses would be admissible, so we've addressed
14 today's exhibits and witnesses.

15 As for the balance of the items on the exhibit list, we
16 are anticipating being able to stipulate to the vast majority
17 of them. Many of them were SIR filings, for example, or other
18 administrative records, so we've created a list, and we've
19 sent it to the other side, and we're working to catalogue that
20 list.

21 We expect the results of that list probably to be
22 completed by tomorrow morning, but for the purposes today,
23 your Honor, we're able to stipulate to admission --
24 admissibility of the exhibits that we expect to be used for
25 the witnesses today.

1 THE COURT: All right. Anything to add to those
2 comments from counsel for the Department or Consumer Watchdog?

3 MS. PRESSLEY: Yes, your Honor. I just wanted to
4 clarify that was for the exhibits that have already been
5 proffered on behalf of the witnesses that are appearing today,
6 but if there's additional exhibits they're planning to
7 introduce on additional direct, we have -- we haven't reached
8 any stipulations. These are just the ones that were on their
9 exhibit list as of now for the two witnesses that might be
10 testifying today.

11 THE COURT: Okay. Is that consistent with your
12 expectations, Ms. McKennedy?

13 MS. MCKENNEDY: Yes, your Honor.

14 MR. TETI: Yes, your Honor.

15 THE COURT: All right. Very good. So have you -- Do
16 you have that list ready to read into the record now?

17 MR. TETI: We do.

18 MR. MADDIGAN: Your Honor, I was just going to do
19 that at the beginning of each witness, but I could do it now,
20 if you prefer?

21 THE COURT: We can do it either way. Usually we do
22 them kind of wholesale, but that's not a rule, that's just so
23 many people have fallen into the practice of doing.

24 MR. MADDIGAN: No problem. I can do it now.

25 THE COURT: That way we can -- Go ahead.

1 MR. MADDIGAN: So the exhibits that are being
2 discussed for the witnesses today are Exhibit 103, the
3 declaration of David Appel.

4 Exhibit 104, which is his CV.

5 Exhibit 105, which is CW's letter to Commissioner Lara
6 dated February 26th, 2025.

7 Exhibit 106, which is State Farm's financial strength
8 rating from AM Best dated March 28th, 2025.

9 Exhibit 107, which is an S&P credit watch announcement
10 dated February 25, 2025.

11 And Exhibit 108, which is CW's objections to the two-way
12 stipulation to interim rate.

13 Those are the -- Mr. Appel, Dr. Appel's declaration, and
14 exhibits to the declaration.

15 I don't know if we'll get to Mr. Ehrhart today, but if we
16 do, the exhibits that have been stipulated to in connection
17 with Mr. Ehrhart are Exhibit 109, which is his declaration,
18 and Exhibit 101, which is the stipulation to the interim rate.

19 THE COURT: All right. Let me check with the
20 reporter. Is there any clarifications you need in connection
21 with the review by counsel?

22 THE REPORTER: One second, your Honor.

23 (Brief pause in the proceedings.)

24 THE REPORTER: No thank you, your Honor.

25 THE COURT: All right. Very good.

1 So as to the stipulation to -- for admission of the
2 exhibits that were referenced by counsel, from the Department,
3 so stipulated?

4 MS. MCKENNEDY: Yes, your Honor.

5 THE COURT: And from Consumer Watchdog?

6 MS. PRESSLEY: Yes, your Honor. So stipulated.

7 THE COURT: Is that a yes?

8 MS. PRESSLEY: Yes.

9 THE COURT: Okay. Thank you very much, so those
10 exhibits are received.

11 MS. MADDIGAN: Thank you.

12 THE COURT: So now we're going to get into the
13 presentation of evidence. We're finally at that exciting
14 point. Maybe some folks can wake up a little bit. Things
15 that aren't just referred to on paper and in theory.

16 With respect to media coverage in the room, has -- has --
17 Let me ask this. Have they seen a copy of the media order?

18 JUDGE LATIMER: The order on court room management
19 has been published in AHB's website, but the media
20 representatives here have not received a copy.

21 THE COURT: Okay. So for the media's purposes in
22 coverage of today 's proceedings, and ongoing until we have
23 completed, now that we're getting into the evidentiary phase
24 of this, and the presentation by the parties of their live
25 witnesses, there may be issues that come up, but as a standing

1 matter, when -- when you're taking your videography, I guess
2 they still call it that, or any audio, if the attorneys are
3 conferring between themselves privately, please do not include
4 that in your coverage, and if I give instructions otherwise as
5 to some sort of limitation, please honor that, or indicate to
6 me that you have to -- you want to express some position about
7 it so that we can deal with it, and we will.

8 Is there anything from counsel on that that they want
9 reinforced? No?

10 Okay. Who's going to be calling the first witness? Who
11 will it be?

12 MR. MADDIGAN: Were we going to do opening
13 statements, your Honor?

14 THE COURT: Oh, yeah. Thanks for reminding me.

15 MR. PLETCHER: And, your Honor, one brief
16 housekeeping point, if I may? We discussed this over this
17 weekend. I understand it has been the practice at prior rate
18 hearings that actuaries -- party's actuaries are not excluded
19 from the proceedings, and I also note your order regarding
20 exclusion of witnesses. We would certainly appreciate the
21 ability to to have that resource available to us, and would,
22 you know, certainly not object to any other party having their
23 actuary present for the testimony of other witnesses.

24 THE COURT: So I asked the parties to talk about it.
25 Is there any difference in that? There's been no interest

1 raised in doing so?

2 MR. PLETCHER: Not that I'm clear. I just wanted to
3 make that clear.

4 MS. MCKENNEDY: Agreed, your Honor.

5 THE COURT: Yeah. There's no -- There's no --

6 MR. MADDIGAN: -- We have no objection to the
7 witnesses being present.

8 THE COURT: All right. So consistent with California
9 law anyway, so, and with opening remarks, as I indicated
10 previously, you can make them now, or if you want to defer to
11 when you're calling your own witness, you may do so, or if you
12 simply don't want to make them, that's fine too. We'll start
13 with the Applicant?

14 MS. WELLINGTON: Thank you, your Honor, and I was
15 planning to make opening remarks regarding the whole case if
16 that's all right with you?

17 THE COURT: Sure.

18 MS. WELLINGTON: So we're here before you, your
19 Honor, to address an emergency situation. State Farm General
20 has proudly provided homeowner and other property insurance in
21 the State of California for more than 60 years, but no insurer
22 can stay in business if it pays more in claims than it
23 collects in premiums year after year.

24 That's been the case for State Farm General in California
25 for a decade. During that period State Farm General's

1 financial position has steadily declined. For every \$1 dollar
2 it has received in premiums, it has paid out \$1.26 in claims
3 and expenses. State Farm General's surplus, which is the
4 money that's available to pay claims has fallen from about 4
5 billion in 2015 to about 1 billion in 2024.

6 This is a serious situation. It has only been
7 exacerbated by the wild fires in Los Angeles. State Farm
8 General is committed to supporting the Los Angeles homeowners
9 who have tragically lost their homes, and it is estimated it
10 will pay about 7 billion dollars in claims.

11 Fortunately, the critical reinsurance that State Farm
12 General has purchased will cover a significant portion, but
13 the fire losses will further reduce State Farm General's
14 surplus. Following the fires in Los Angeles, State Farm
15 General has estimated that its surplus will decline to about
16 600 million dollars. That's down from 4 billion.

17 State Farm General filed applications in mid-2024 seeking
18 rate increases for its homeowners, non-tenant, HO-3, renter
19 condo tenant, and renter dwelling line. These rate increases
20 would help State Farm stabilize and rebuild its surplus to
21 continue to be there for its policyholders, but the 2024 rate
22 applications remain pending until a full rate hearing, and
23 State Farm General doesn't know when its rate applications
24 will be resolved. Its 2024 rate application, for example, was
25 not resolved until 2022. That's eight years later.

1 In light of these circumstances, State Farm General has
2 asked the Commissioner to approve an interim rate which would
3 remain in place until State Farm General's rate applications
4 were decided. Rate increases were needed before the Los
5 Angeles wildfires, and a rate increase is certainly needed
6 now.

7 The rate-- More wildfires like the ones in Los Angeles
8 could happen at any time. An interim rate poses no risk to
9 policyholders, because if the final rate ends up being lower
10 than the interim rate, policyholders will be entitled to a
11 refund of the difference with interest.

12 Denying the interim rate in contrast will hurt the
13 California insurance market as a whole, and deeply impact
14 State Farm General's policyholders. State Farm General's
15 surplus is now at a point where it gravely threatens the
16 company's financial strength. This matters to all of State
17 Farm General's policyholders, because it means the company has
18 fewer resources to pay claims in the event of another
19 catastrophe like the recent Los Angeles wildfires.

20 But it matters in particular to the hundreds of thousands
21 of State Farm General policyholders who have a mortgage. When
22 homeowners take out a mortgage, they are generally required to
23 purchase homeowner's insurance from a company that has a
24 significant financial strength rating. That makes sense,
25 because the bank wants to ensure if there's a fire or some

1 other loss, the insurance company can pay.

2 The two main rating agencies that banks rely on are AM
3 Best and S&P. If an insurance company doesn't meet a specific
4 rating from one of these two agencies, then homeowners with a
5 mortgage cannot use that insurance.

6 AM Best has already downgraded State Farm General's
7 rating from an 'A' to a 'B', and S&P just issued a credit
8 watch with negative implications which S&P says could lead to
9 a ratings downgrade by multiple notches. If that happens, it
10 would mean the hundreds of thousands of State Farm General
11 policyholders may have to find new insurance.

12 That would send a shockwave through the California
13 market, and it simply wouldn't be possible for many of these
14 homeowners to find new insurance, and they'd be forced onto
15 the FAIR plan which provides less robust coverage at a higher
16 price. State Farm General seeks to avoid this result and to
17 again be self-sufficient in the California market, and the
18 interim rate serves that goal.

19 As your Honor is aware, State Farm General and CDI
20 entered into a supplemental stipulation on Friday. Under the
21 terms of the supplemental stipulation the parties agree that
22 if and when the Commissioner enters an order approving the
23 interim rates agreed to in that stipulation, State Farm
24 General will obtain capital from its parent company, State
25 Farm Mutual Automobile Insurance Company, in the form of a 400

1 million dollar surplus note.

2 CDI's actuary concludes the combination of a 4 million
3 dollar surplus note, and a 17 percent interim rate increase
4 will help address State Farm General's financial condition.
5 In the supplemental stipulation CDI acknowledges State Farm
6 General's position that it cannot pause its nonrenewal program
7 initiated in March 2024 and nearing completion, because State
8 Farm General must reduce its risk exposure in the California
9 market given its declining surplus, and the increasing risk of
10 catastrophic loss in California.

11 CDI has proposed a 17 percent interim rate increase for
12 homeowners instead of the originally requested 22 percent,
13 which CDI believes will account for these nonrenewals. State
14 Farm General has stipulated to the 17 percent interim rate
15 increase for homeowners, because State Farm General's goal is
16 to get an interim rate and to help prevent an imminent ratings
17 downgrade. We thus ask your Honor to recommend that the
18 Commissioner approve the supplemental stipulation.

19 Contrary to Consumer Watchdog's position, CDI filed a
20 declaration on April 2nd that expressly supports its position
21 in the supplemental stipulation, and all three or two of State
22 Farm General's witnesses similarly filed declarations
23 supporting State Farm General's position that an interim rate
24 increase is warranted.

25 Consumer Watchdog claims that the supplemental

1 stipulation is not properly before your Honor, but that is
2 wrong. The Commissioner is looking for your Honor's
3 considered views on whether to grant an interim rate, and he
4 expressly instructed State Farm General and CDI to continue to
5 work together to reach an agreement to address the
6 Commissioner's concerns about nonrenewals and a surplus note
7 from State Farm Mutual, which is exactly what State Farm
8 General and CDI did.

9 I want to address next the legal standard that applies
10 to his hearing. The Commissioner may approve a stipulation as
11 long as it's fundamentally fair, adequate, reasonable in the
12 interest of justice. Consumer Watchdog claims that State Farm
13 General must make a much higher showing and demonstrate that
14 its rates are plainly invalid, but that's the standard that
15 applies at a full rate hearing.

16 As the California Supreme Court has made clear, an
17 interim rate may be approved, even if it is later determined
18 to be incorrect, and the insurer is required in that situation
19 to pay refunds. That means to obtain an interim rate an
20 insurer is not required to undertake the same burden of proof
21 as a full rate hearing. All that's required here is to show
22 that the stipulation, which has been agreed to by both State
23 Farm General and CDI, is fundamentally fair, adequate,
24 reasonable, and in the interest of justice.

25 That standard is met here in spades. There can be no

1 real dispute State Farm General's current financial situation,
2 including its declining surplus, and the fact that it has paid
3 more in claims than it has received in premiums for many
4 years, nor can there be any real dispute that California's
5 insurance market is in distress and in need of solutions.

6 Even before the Los Angeles wildfires, the Governor issued
7 an emergency order instructing the Commissioner to take prompt
8 regulatory action to strengthen and stabilize California's
9 marketplace for homeowner's insurance, taking into account the
10 requisite sudden deterioration of the private insurance
11 market. After the Los Angeles wildfires, the need for prompt
12 action is even clearer.

13 Even if the plainly invalid standard applies however, it
14 is met here. Consumer Watchdog agrees that a rate is invalid
15 if it violates Proposition 103, but Consumer Watchdog ignores
16 that the objective of Proposition 103 is not just to keep
17 insurance rates fair to consumers, but to keep insurance
18 available, which requires that rates be fair to insurers as
19 well. That's straight from the State Farm General against
20 Lara decision in the California Court of Appeal, and that's
21 what's at stake here. Whether insurance will be less
22 available in California as State Farm General's financial
23 strength rating is downgraded, and hundreds of thousands of
24 consumers lose their insurance.

25 Of course the Commissioner can approve an interim rate

1 that helps keep insurance available in California. That's
2 fully consistent with Proposition 103, which the people of
3 California adopted in part to keep insurance available in
4 California. We ask that your Honor recommend the Commission
5 -- recommend that the Commissioner approve the supplemental
6 stipulation.

7 The State Farm General's expert David Appel explains
8 that, "In light of State Farm General's current financial
9 condition, the benefits to the market and the absence of risk
10 to policyholders, it seems obvious the interim rate increase
11 should be approved and implemented as soon as possible."

12 Consumer Watchdog is the only party opposing the
13 stipulation. According to Consumer Watchdog, State Farm
14 General should not be permitted to charge an interim rate
15 despite the Los Angeles wildfires, despite State Farm
16 General's declining surplus, and despite the negative credit
17 watch from S&P. Instead Consumer Watchdog argues that State
18 Farm General's rate for homeowner's insurance should be
19 decreased.

20 Your Honor, Consumer Watchdog's position simply isn't
21 credible. The Los Angeles wildfires were a truly catastrophic
22 event, combined with the 2017 and 2018 wildfires reflect that
23 the risk of wildfire loss in California is increasing. The
24 stipulated interim rate reflects this fact. It seeks to
25 return State Farm General to a sustainable financial position.

1 Consumer Watchdog has two main complaints with the
2 stipulation. First it claims that State Farm General's
3 declining financial condition isn't due to the unsustainable
4 difference between its premiums and its losses, but is instead
5 because State Farm General is purportedly overpaying for
6 reinsurance from its parent company State Farm Mutual.

7 Second, Consumer Watchdog claims the stipulated interim
8 rate is plainly invalid, citing the testimony of its actuary
9 Mr. Armstrong. State Farm General intends to present
10 testimony from Mr. Appel and from Mr. Ehrhart to refute
11 Consumer Watchdog's position and support its request for an
12 interim rate.

13 These experts have submitted declarations describing
14 their opinions, and they're available for direct, and
15 cross-examination, as well as to answer your Honor's
16 questions. Mr. Appel is an experienced consulting economist,
17 and a retired professor with more than four decades of
18 experience, and he's here to testify about State Farm
19 General's declining financial health, the reasons for that
20 decline, and how it impacts its financial strength, and --
21 financial strength rating and policyholders. His analysis
22 demonstrates that under these circumstances an interim rate is
23 reasonable, justified, and essentially to State Farm General's
24 continued operations in the State.

25 I'd like to highlight two parts of Mr. Appel's testimony,

1 and I believe he'll be the first witness. First, Mr. Appel
2 describes State Farm General's current financial condition and
3 how we got there. The math is simple. For many years, State
4 Farm General has been paying out more in claims than it
5 collects in premiums. That is not sustainable.

6 Mr. Appel examined State Farm General's public financial
7 statements, and its financial strength across several metrics.
8 His conclusion is that State Farm General's financial
9 condition is significantly weakened with sustained
10 underwriting losses that average over 520 million dollars per
11 year, and that takes into account years where there was no
12 catastrophe, like the 2017 and 2018 wildfires, or the recent
13 Los Angeles strategy.

14 Consumer Watchdog attributes these losses to State Farm
15 General supposedly overpaying for reinsurance, but Mr. Appel
16 shows this isn't true. Even if State Farm General had
17 incurred half the net cost for reinsurance, it would still
18 have sustained significant underwriting losses. Mr. Appel
19 will also explain that State Farm General's financial
20 condition urgently needs to improve.

21 Its surplus is expected to be about 600 million dollars
22 after the Los Angeles wildfires, down from 4 billion a decade
23 ago. This decline in surplus is a serious problem, because it
24 impacts State Farm General's financial strength rating. As
25 Mr. Appel will explain, the downgrade by S&P would mean that

1 as a practical matter State Farm General policyholders with a
2 mortgage may no longer be able to use State Farm General to
3 insure their properties, impacting hundreds of thousands of
4 people in California.

5 Mr. Appel will explain that an interim rate is
6 reasonable, because it is critical to the health of State Farm
7 General, and the California homeowner's insurance market.
8 Indeed, in Mr. Appel's words, "An interim rate is an obvious
9 choice because it will immediately ameliorate State Farm
10 General's decline while posing no risk to the policyholders."

11 I believe the second witness will be Mr. Ehrhart, who is
12 the Global Head of Growth and Strategic Development for AON,
13 the largest reinsurance brokerage in the world. He has nearly
14 four decades of experience in the insurance and reinsurance
15 industry, and he will explain how reinsurance work, and
16 confirm that State Farm General's reinsurance practices are
17 prudent and deeply beneficial for its policyholders.

18 As Mr. Ehrhart will testify, reinsurance is essential.
19 It permits insurance companies to transfer some of the
20 company's risk to a reinsurer. In exchange, the reinsurer
21 receives some portion of the insurer's premium. This is
22 really crucial in situations like the Los Angeles wildfires
23 where reinsurance ensures that State Farm General has
24 resources available to pay the policyholders even after a
25 large scale catastrophe.

1 Mr. Ehrhart will explain that most reinsurance companies
2 are not willing to sell the amount of reinsurance that State
3 Farm General needs to account for the increasing frequency and
4 cost of California wildfires. As he puts it, "The reinsurance
5 market does not have the capacity or the appetite to assume
6 California property risk at the level State Farm General
7 requires." Mr. Ehrhart estimates that if State Farm General
8 were to try to purchase reinsurance from unaffiliated
9 companies, it would cost four times more, if State Farm could
10 even buy it.

11 By relying on affiliated reinsurers, like its parent
12 company State Farm Mutual, State Farm can buy reinsurance that
13 is otherwise unavailable at the price. Mr. Ehrhart details
14 the many ways this benefits policyholders, including by
15 providing reliable coverage despite surging exposure.

16 Indeed, State Farm General's reinsurers are estimated to
17 pay 5 billion dollars in claims as a result of the Los Angeles
18 wildfires. Consumer Watchdog's position that State Farm
19 General should have purchased less reinsurance simply isn't
20 tenable given how significantly State Farm General's
21 policyholders have benefited from State Farm General's prudent
22 purchase of reinsurance.

23 Hold on one second, your Honor.

24 So with respect to Ms. Watkins, I'm not going to address
25 her testimony here, but I think the key thing that we want to

1 emphasize, which we've made in our briefs from the very
2 beginning, is we don't think this action comes down to some
3 kind of actuarial dispute. The standard under, that this
4 Court is looking at is whether the stipulation is
5 fundamentally fair, adequate, reasonable, and in the interest
6 of justice.

7 As we explained, that is the Proposition 103 standard
8 that looks at maintaining the availability of insurance, so
9 the question isn't, you know, should it have been this number
10 or that number? In this situation, where State Farm General
11 and CDI have reached a stipulation, and you have an actuarial
12 report from CDI's expert explaining why they reached the 17
13 percent number, and, you know, in light of the really serious
14 financial circumstances, we think that's really the question
15 here, not the numbers that Mr. Armstrong is putting forth.

16 I do want to point out though, your Honor, that in his
17 latest declaration Mr. Armstrong abandoned his defense of a
18 selected AIY trend, and he admits that his non-catastrophe
19 loss development factor was wrong. These two changes result
20 in a 17 percent higher maximum rate indication according to
21 Consumer Watchdog's own numbers, and can -- Sorry.

22 These two changes result in a 7 percent higher maximum
23 rate indication according to Consumer Watchdog's own numbers.
24 Consumer Watchdog's initial number was negative 0.1 percent
25 for the homeowners line, and now it's positive 7 percent as a

1 result of these two key changes in Mr. Armstrong's analysis.

2 Again, we really don't think this is the key focus,
3 should be the key focus for the Court. We do think that this
4 is an important thing that we wanted to flag with respect to
5 the change in State Farm General's, or excuse me, with respect
6 to the change in Consumer Watchdog's actuary's numbers.

7 I want to briefly touch on Consumer Watchdog's litany of
8 complaints about this interim rate proceeding. All of the
9 parties have been working under short timelines to respond to
10 the Commissioner's order setting an interim rate hearing.
11 Consumer Watchdog thinks prejudice, but has had ample
12 opportunity to respond to the stipulations, including filing
13 multiple briefs, and expert analysis, and it's also had
14 opportunity to present evidence in argument to this Court.

15 State Farm General and CDI both agree that there is a
16 pressing need for an interim rate. State Farm Generally has
17 amply supported the stipulations with testimonies from
18 experienced insurance industry experts, and publicly available
19 information demonstrates State Farm General's weakened
20 financial state, as two rating agencies have recognized.

21 An interim rate is fundamentally fair, adequate, and
22 reasonable as a response to one of the largest wildfire
23 catastrophes in California history, and it is in the interest
24 of justice because it will help prevent the ratings downgrade
25 that would negatively impact hundreds of thousands of

1 California homeowners. Thank you.

2 THE COURT: Thank you very much. Ms. McKennedy for
3 the Department?

4 MS. MCKENNEDY: Thank you, your Honor.

5 The Department agrees with State Farm that this is an
6 emergency situation. Approximately 3.2 million Californians
7 rely on State Farm General for their property insurance, but
8 the company is in a currently precarious financial condition.
9 That is why Department staff is recommending that you propose,
10 and the Commissioner approve, State Farm General's emergency
11 request for an interim rate increase.

12 This is not based upon a rigid application of the Prop
13 103 rate-making formula, but rather based upon the holistic
14 assessment of State Farm's exigent circumstances, as will be
15 described by Ms. Shaw. The interim rate increase is a
16 stopgap, temporary measure. It will not solve all of State
17 Farm General's problems, nor is it intended to, but by
18 granting the interim rate increase, the Commissioner will open
19 the door to an infusion of 400 million dollars in capital from
20 State Farm General's parent company.

21 Based upon the Department's analysis, the combination of
22 the interim rate increase, plus the 400 million dollars in
23 surplus note from the parent will immediately improve State
24 Farm General's financial condition. This in turn will protect
25 the over 3 million State Farm General policyholders in

1 California by ensuring they continue to have insurance
2 protection. It will also provide much needed stability for
3 the California insurance marketplace.

4 At the same time, Department staff and State Farm General
5 have agreed that the interim rate increase will be subject to
6 full investigation and proof as part of the complete rate
7 hearing process. If the interim rate increase turns out to be
8 excessive, State Farm General has already agreed and
9 stipulated that it will pay refunds plus interest to its
10 California policyholders.

11 Consumer Watchdog intends that the Commissioner does not
12 have authority to do anything but rigidly apply his own
13 rate-making formula, and that the Commissioner must deny State
14 Farm's request for emergency relief because they have not
15 demonstrated the company is entitled to a rate increase under
16 the formula, but this approach is un -- is without merit for
17 two main reasons.

18 First, the Commissioner's rate-making formula contains an
19 express exception where a company's solvency is at stake, as
20 it is here. State Farm General has already requested
21 application of Variance 6 in order to allow it relief from a
22 too rigid application of the Prop 103 regulations.

23 Second, and perhaps more importantly, your Honor, these
24 are the Commissioner's own regulations. The California
25 Supreme Court has already previously recognized the

1 Commissioner has plenary authority to take whatever steps are
2 necessary to implement Prop 103. Approving State Farm
3 General's emergency request for an interim rate increase is a
4 very necessary step.

5 It is not in California consumer's best interest to allow
6 State Farm General, the largest property insurance in
7 California by far with 20 percent market share, to go
8 bankrupt, or to otherwise withdraw from the California market.
9 This is why the Commissioner has already provisionally
10 approved the interim rate increase request, and following that
11 provisional approval, Department staff have worked hard to
12 secure an additional agreement from State Farm General. To
13 confirm the 400 million dollars in capital infusion from the
14 parent company, and to reduce the interim rate increase in the
15 homeowners line from 21.8 percent to 17.0 percent.

16 Nothing in this situation is normal. The normal rules
17 don't apply. We're on the Titanic, and we see the iceberg.
18 Now is not the time to argue about where to put the deck
19 chairs. There is still time, your Honor, to turn this ship
20 around. If we don't, over 3 million Californians are going in
21 the water, and there are not enough lifeboats.

22 THE COURT: Thank you. Consumer Watchdog, would you
23 like to make remarks now?

24 MR. PLETCHER: Yes, please.

25 Good afternoon, your Honor. William Pletcher on behalf

1 of Consumer Watchdog. We acknowledge this is a difficult time
2 in the California insurance market. People are worried about
3 availability. They're worried about affordability. There are
4 concerns about inflation, climate change, global instability,
5 and these are all real concerns.

6 There's also a lot of attention on these proceedings.
7 From the media, from the legislature, from regulators, and
8 from the over 2 million State Farm policyholders who are going
9 to be effected by the outcome at an average of \$600 per
10 homeowner's policy. That comes to about 900 million dollars
11 on the original proposal, to about 470 million for homeowner.
12 That's 750 million total on the supplemental proposal.

13 And we're not here to dispute State Farm's importance in
14 California. It is the largest insurer, and we all know that,
15 but with that said, all of those concerns, while, very, very
16 real, are outside this hearing room today. There's a limited
17 question before the Court. Has State Farm met its burden to
18 justify an emergency interim rate increase? The answer, based
19 on the facts and the law, must be no.

20 Let's start with the legal standards, with the rules. We
21 just heard that the normal rules don't apply, but some rules
22 have to apply, or else we're not only abandoning Prop 103,
23 we're moving into a world where Prop 103 is completely
24 inverted. Where rates will be -- can be approved or put in
25 place before there's any opportunity to review them, and

1 that's just not the law.

2 Now, there is a standard for interim rates, and that's
3 the plainly invalid standard. That's the phrase from the
4 California Supreme Court in CalFAR, and plainly invalid means
5 what it means. It's not arguably wrong, it's not maybe too
6 low, it has nothing to do with the insurer's belief it's the
7 wrong rate.

8 So how following the rules and not abandoning them, how
9 do you figure out if a rate is plainly invalid? You have to
10 turn to Prop 103 and its regulations. You have to apply the
11 formula actuarially that is there starting in Section 2644.1
12 in the regs, and that formula does some different things. It
13 accounts for expected losses, it accounts for expenses, and
14 it's designed to leave a fair rate of return for the insurer.
15 Fundamentally it's designed to match price to risk. It's not
16 designed to solve business problems, to manage market
17 volatility, or to store capital, and there's a very, very good
18 reason for this, and we would argue as a matter of policy,
19 that State Farm cannot rely on its financial condition to
20 justify a rate increase.

21 There are multiple reasons for this. First of all,
22 they've abandoned Variance 6. We just heard from the
23 Department that Variance 6 is the Commissioner's ability to
24 look at financial condition. It's not part of this
25 proceeding, even if it's still part of the main proceeding on

1 the final rate. They aren't arguing Variance 6, and they're
2 also not arguing the rates are plainly invalid.

3 Secondly, there's a second safeguard to keep financial
4 condition out of rate calculations, and that's Insurance Code
5 Section 739.8(c). That statute says you can't use risk-based
6 capital in a rate hearing.

7 Well, stop, the Commissioner can use it for different
8 reasons, such as monitoring insolvency, to take corrective
9 actions, but you can't use it in a rate hearing, and we're
10 here on interim rate. This isn't a rate hearing. I don't
11 know what to call it as a matter of common sense, and when we
12 look at the declarations, it's this RBC level, it's financial
13 condition, that's what they're focused on. They're not
14 focused on the actuary analysis, and they may argue it, and we
15 appreciate your, the Court's considering the motion in limines
16 on these topics, but we don't think that this Court should
17 consider it.

18 And there's -- Fundamentally, taking a step back, there's
19 a very good reason why the legislature has to clearly exclude
20 financial condition from rate considerations that really goes
21 to the heart of this hearing. It's because policyholders are
22 not insurance company investors. They don't pay premiums to
23 boost a company's surplus, or to protect a parent company's
24 140 billion dollar surplus, and they're not here to bail out
25 the insurance company.

1 The relationship between policyholders and insurance
2 companies runs the other direction. Consumers pay to have
3 their risks covered, to get help when they need it, not the
4 other way around, and that's why you need -- why financial
5 condition information needs to be excluded so the calculations
6 are just focused on -- so the rate is developed to cover
7 expected losses, pay some, allow for expenses, and allow some
8 profit, and we're not here about people in Los Angeles not
9 having the ability to have their claims paid.

10 In this room in February, State Farm's executives said
11 that they will be able to cover losses from that disaster, and
12 we haven't seen any declaration or evidence to the contrary in
13 this hearing, but rate is not to recapitalize a company's
14 balance sheet, at least certainly not in the short term, and
15 not to make up for market volatility, and not to respond to
16 internal business decisions, and I'll turn to those in a
17 minute here.

18 But I want to turn first to the evidence, because when
19 you push past the rhetoric that we're hearing, the evidence
20 coming from State Farm and the Department falls short. None
21 of them provide what's required under the regs, that would be
22 10 CCR, Section 2656.1(c).

23 First of all, we believe that the sworn declarations that
24 regulation requires to come with the stipulations need to
25 support that the proposed rate is fundamentally fair,

1 adequate, reasonable, and in the interest of justice, but
2 these declarations, and now we're talking about Mr. Appel, and
3 Mr. Ehrhart for State Farm, none of them run a rate indication
4 using the regulatory formula to determine if the rates are
5 invalid, so what do we get instead?

6 Mr. Appel, we expect, will offer a policy and economic
7 defense, State Farm's financial position, but he doesn't
8 submit any actuarial analysis. He generally say the interim
9 rate is justified based on the company's surplus decline, and
10 its weakening credit position, but that's an argument that's
11 relying heavily on the RBC and financial condition, and we
12 don't think that that should be considered here, but he
13 clearly doesn't apply the regulatory formula, he doesn't
14 calculate a rate, and he doesn't test the maximum minimum rate
15 change permitted under the law.

16 What he presents is largely a critique of California's
17 regulatory system, and he's entitled to that viewpoint, but
18 his personal disagreements with Proposition 103 doesn't help
19 resolve the positions we have here today.

20 Now, Mr. Ehrhart, he's a reinsurance executive, and he's
21 gonna discuss State Farm's reinsurance program, but he doesn't
22 dispute that State Farm has paid around 3 billion dollars for
23 reinsurance from its parent over the last decade. He just
24 disagrees with Consumer Watchdog's position that State Farm
25 overpaid for that insurance, and he's free to disagree, and we

1 don't need a definitive answer on that question here today or
2 in this hearing, but again, he doesn't offer a rate analysis.
3 He doesn't look at whether a 17 percent rate is reasonable, or
4 a 22 percent is reasonable, or fair, or adequate. His
5 testimony is fundamentally about corporate risk strategy, and
6 it doesn't address whether this Court should allow emergency
7 relief.

8 Tina Shaw is the Department's chief actuary who supports
9 granting an interim rate with certain conditions, which to
10 some extent are now in the supplemental declaration, but of
11 course it's not directed at a supplemental situation --
12 supplemental stipulation, because that's just a pure timing
13 issue. Her analysis is, she calls it a holistic assessment of
14 State Farm's financial condition, and its systemic role in the
15 market. Neither of those are part of the rate formula, and
16 again, she's relying heavily on RBC data. She acknowledges
17 that RBC data is inadmissible under the Evidence -- Insurance
18 Code, but she still relies on it extensively to justify
19 interim relief.

20 Probably most critically though, she also admits that her
21 review is very early stage, and she hasn't ideated the impact
22 of nonrenewals. When an actuary is telling you that things
23 are very early stage and they need more information, we
24 believe that's what they should get, and that will be part of
25 a final rate hearing.

1 We appreciate her candor on the limitations of her
2 analysis, but she's just not presenting what's required here,
3 and by contrast, we would say the only complete, data-driven
4 rate analysis comes from Consumer Watchdog, and that testimony
5 will come from Benjamin Armstrong, our staff actuary, and a
6 fellow of the Casualty Actuarial Society.

7 He's reviewed State Farm's files, and identified multiple
8 violations of actuarial standards and regulatory requirements.
9 He identified that State Farm used inconsistent time periods
10 for catastrophe and non-catastrophe data. He saw that State
11 Farm applied a biased catastrophe weighting to emphasize the
12 January 2025 fires, and obviously, of course, any weighting
13 towards that event of other events would have a rate impact,
14 but that's not actuarially sound, and he analyzed the
15 inconsistent trend data, mismatching catastrophe load and
16 other trends. That leads to further bias in State Farm's
17 favor.

18 But he didn't stop in identifying flaws in the numbers.
19 He also ran multiple rate indication scenarios using State
20 Farm's own data, and most cases his preferred assumptions, and
21 every scenario resulting indicated rate change for homeowners
22 remained within the lawful range that is not plainly invalid,
23 and even under the most favorable assumptions for State Farm,
24 the minimal indicated rate was still negative, which shows
25 that State Farm's current rates are not inadequate based on

1 the formula.

2 So this can't support the claim that State Farm's current
3 homeowners rate is plainly invalid if everything shows the
4 opposite. Even in the high-endest scenario, based on State
5 Farm's assumptions, the result is still negative.

6 Now, Mr. Appel also looked at the reinsurance issue,
7 again, looking at State Farm's own data. From 2015 to 2024,
8 State Farm's general -- State Farm's reinsurance program
9 resulted in a net 3 billion dollar outflow, primarily to its
10 parent company. I'm sure we'll hear a lot in these
11 proceedings about the 2025 Los Angeles fires, but, and again,
12 that's what reinsurance is for, and it will help pay for those
13 losses, but from an actuarial standpoint, you can't ignore or
14 downplay the previous decade of capital outlooks from
15 reinsurance. That's not a structure that benefits consumers,
16 and it just doesn't justify the elevated reinsurance charges
17 built into this rate request.

18 Mr. Appel will also look at some of the market data. We
19 saw that if State Farm had simply requested a 6.9 percent rate
20 increase in each of the years when it claimed it needed a
21 relief, including 2017 and 2019, we would be sitting at a
22 cumulative rate level about 14 percent higher today. That's
23 really similar to what's being proposed in the proposed
24 stipulation.

25 You can also see in the data that after a brief dip, this

1 pricing strategy coincided with a growing market share for
2 State Farm, so instead of steadily building their rate, State
3 Farm held back, chose not to file, and now wants an emergency
4 relief to make up the difference. That's not Proposition 103
5 or insurance regulation failing the company. That's a company
6 that's not availing itself of the process it has available to
7 it, and we'll also hear that State Farm didn't ask for more
8 than 6.9 percent, because they didn't think they could get it.

9 But we saw even last year, they were approved for 20
10 percent without a hearing, so the idea here that this is
11 somehow Proposition 103's fault, or the regulations fault, it
12 just doesn't hold up, so we urge the Court to not let this
13 hearing become a bailout for bad business decisions, rather
14 than problems that are driven by the rate calculations.

15 Now I want to briefly talk about the refund argument.
16 State Farm says, "If we're wrong, we'll give the money back."
17 I understand that as a alternative, because the data and
18 calculations are there, but this -- this panacea, this
19 cure-all for process defects, or the chance that they've got
20 the wrong rate, the idea that they'll just give money back is
21 not how Proposition 103 works.

22 A collect now, maybe pay later scheme is the exact
23 opposite of prior rate approval required by California voters.
24 Refunds are not a substitute for legality. They're not a
25 permission slip to charge unlawful rates today, to maybe

1 correct them later, and they don't insulate the company or the
2 Department from the legal requirement to set rates
3 perspective based on a full evidentiary hearing.

4 Refunds also don't fix damage done now. They don't help
5 a homeowner who is being forced to choose between paying a new
6 premium, a \$600 increase, or a \$470 dollar increase, and
7 paying their mortgage. They don't help a family that gets
8 non-renewed or priced out that can't find replacement
9 coverage. These harms are immediate, and in many cases they
10 can be irreversible.

11 Every dollar charged under an unjustified rate is a
12 dollar wrongfully taken. It's taken from a family trying to
13 keep their home, to put food on the table. Many of these
14 families are still recovering from the January fires. There
15 are neighbors who are literally sifting through the ash and
16 rubble of their homes, and to ask them to pay more now, based
17 on incomplete, inadequate filings, is not just unfair, it's
18 unconscionable, and there's certainly no guarantee of a refund
19 here. There's no certainty. There's no protection.

20 Let's be honest about what a refund means in practice.
21 It means policyholders pay more now for coverage that hasn't
22 changed, only maybe to get some of that money back in 60
23 years, a year, 2 years after these legal fights, and going
24 through other regulatory hurdles.

25 And let's be clear, State Farm has resisted refunds

1 before. It has fought them in court. It has denied
2 liability, and delayed repayment, so when the company stands
3 before this Court and says, "Don't worry, we'll make it
4 right," the public and this tribunal have every reason to be
5 very skeptical. This isn't a question of trust. It's a
6 question of regulatory compliance and following the rules.
7 Compliance with Proposition 103 doesn't mean you collect first
8 and prove it up later. You prove first, or you don't collect
9 at all.

10 So where does that leave us? We're in the middle of an
11 insurance market that is absolutely under pressure. Financial
12 markets are in turmoil. There's public fear, political
13 urgency, and intense scrutiny here, and we acknowledge all of
14 that, but we also cannot let those things override the law
15 that governs this proceeding, because if we open the door to
16 emergency relief without justification, then the rules stop
17 meaning what they say. The proposition's prior approval
18 process is finished, and once we abandon that, we abandon the
19 consumer protections of Proposition 103.

20 So what happens in this hearing room cannot be about
21 market pressures. It can't be about Wall Street, or politics.
22 It needs to be about the law, the facts, and the record before
23 this Court, and the record is clear, State Farm hasn't shown
24 its current rates are plainly invalid. Multiple procedural
25 safeguards have been bypassed here or broken down. Even if

1 the Department nominally supports an interim rate in concept,
2 it cannot do so in violation of its own regulations. This is
3 a process the Department itself designed, and the parties
4 haven't followed it.

5 The only comprehensive actuarial evidence presented by
6 Consumer Watchdog here is that there is no justification for
7 the emergency rates. When the largest insurer in the state
8 fails to follow the rules, it should not be rewarded with rate
9 increases. It should be held to the same legal standards of
10 every other party, so with that we'll respectfully ask the
11 Court to deny their request for relief and proceed to a full
12 evidentiary hearing as soon as June 1st.

13 Thank you, your Honor.

14 THE COURT: Thank you. Thank you very much.

15 MS. MCKENNEDY: Your Honor, if I may? I'm wondering
16 if the court reporter would like a break? We've been very
17 talky.

18 THE COURT: Sounds good. Why don't we recess until
19 3:00 o'clock. Off the record.

20 MS. MCKENNEDY: Thank you, your Honor.

21 (Pause in the proceedings from 2:40 p.m.
22 until 3:05 p.m.)

23 THE COURT: All right. If you're ready, back on the
24 record after a recess, afternoon recess. We are back on the
25 record in the matter of State Farm General Insurance Company,

1 and Case Numbers PA-2024-00011, PA-2024-00012, and
2 PA-2024-00013.

3 The parties having earlier completed their opening
4 remarks, we're proceeding to the stage of the proceeding where
5 we have testimony from live witnesses. I had asked the
6 parties just before going on the record again whether this
7 raises the RBC matter that had been the point of motion in
8 limine Number 3, I believe, from Consumer Watchdog, and we --
9 I deferred until we got back on the record for them to speak
10 further to that, because it was an answer that had conditions,
11 so going back to that, I'll start with State Farm. Maybe you
12 can restate what you started to indicate before we got back on
13 the record, Counsel?

14 MR. MADDIGAN: Yes, thank you, your Honor. In
15 response to your question of whether Dr. Appel's testimony
16 implicates the RBC issues that were subject of the motion, the
17 answer to the question was no. The motion was directed only
18 toward the actuary of the Department, and the basis for the
19 motion was whether the actuary had used confidential
20 information that is statutorily protected.

21 The analysis by Dr. Appel is -- talks about a concept of
22 risk-based capital, RBC, but is completely different. It
23 relies only on public sources, which in the statute was
24 excepted from the information that is treated as confidential,
25 and as Dr. Appel will explain, is different than what is

1 discussed in the statute, and wasn't the subject of any
2 motion. In fact, the declaration was already agreed to be
3 admitted.

4 THE COURT: Okay. Thank you. Consumer Watchdog, do
5 you have a comment to make?

6 MR. PLETCHER: Yes, no. We have no objection to the
7 admission of the declaration. Where we still want to intend
8 to argue that this really goes to the financial condition
9 motion in limine. Argue about, as we've described, that
10 financial condition shouldn't play a role here in this
11 decision, and things like that.

12 We also would disagree with the limited definition of RBC
13 information in that particular statute, because we think the
14 policy certainly extends further than that, but, you know --

15 THE COURT: -- Well, any part of --

16 MR. PLETCHER: -- We think this is something you
17 could, you know, could further argue a motion in limine or
18 these issues. You know, it could be -- Dr. Appel could be
19 examined on this at this point, and then you're certainly
20 capable of deciding whether this information comes in or not.

21 THE COURT: Sure. You can tackle it in different
22 ways. I really just reached out because I had indicated if it
23 came up in connection with the concerns raised by your motion
24 in limine directly, I was going to entertain voir dire, so
25 then you could sort of see where it is going, but you could

1 address it through, whether it's objections, or other motions
2 and such.

3 MR. PLETCHER: Okay.

4 THE COURT: So you want to call your first witness?

5 MR. MADDIGAN: Yes. Thank you, your Honor. We would
6 like to call Dr. David Appel.

7 DR. APPEL: Morning.

8 THE COURT: Good afternoon.

9 DR. APPEL: Good afternoon, sorry. Water is okay?

10 THE COURT: Yes.

11 DR. APPEL: Thank you.

12 THE COURT: So just a couple of things. I'm going to
13 ask for the court reporter to place you under oath in a
14 moment. If there's an objection during your testimony, please
15 pause so that we can address it before you respond, and I'll
16 let you know whether to answer it or not, okay?

17 DR. APPEL: Okay. Thank you.

18 THE COURT: So if the reporter would place the
19 witness under oath?

20 THE REPORTER: Yes, your Honor. Thank you, Doctor.

21 Do you solemnly swear or affirm the testimony you shall
22 give in this matter will be the truth, the whole truth, and
23 nothing but the truth?

24 THE WITNESS: I do.

25 THE REPORTER: Thank you.

1 DIRECT EXAMINATION

2 BY MR. MADDIGAN:

3 Q. Good afternoon, Dr. Appel.

4 A. Good afternoon.

5 Q. You provided a declaration in this matter; is that
6 correct?

7 A. Yes.

8 Q. If you would please, look at Exhibit 103 in front of
9 you? Which is a document entitled, "Declaration of David
10 Appel".

11 A. Okay.

12 Q. Do you have that?

13 A. I'm there. Yeah.

14 Q. Is that the declaration you provided?

15 A. Yes.

16 Q. And this declaration contains a summary of your
17 opinions in this matter, right?

18 A. It does.

19 Q. You intended it as your direct testimony?

20 A. Yes.

21 Q. Okay. I'm not going to ask you to repeat the whole
22 declaration, but I will ask you to briefly focus on a few
23 points within the declaration, but before we do that, let's
24 just take care of some housekeeping matters. Your declaration
25 has a number of exhibits as well, right?

1 A. Correct.

2 Q. And those are attached to the declaration; is that
3 correct?

4 A. Yes.

5 Q. And they're numbered as Exhibits 104 through 108, is
6 that correct, on the version before you?

7 A. Yes.

8 Q. Okay. Thank you. You wanted to, at the beginning of
9 your testimony, identify a couple of minor errata in your
10 declaration for the record, so I'd like to ask you to do that?

11 A. Correct.

12 Q. Beginning at Page 4, Line 19?

13 A. Your Honor, do you want me to make the changes to the
14 record copy? I will just strike out and insert a number.

15 THE COURT: The parties have a view about how they
16 want that to be memorialized?

17 MR. MADDIGAN: I think it's fine for him just to say
18 it. It would be okay, I think.

19 THE COURT: Fine with an oral convey?

20 MS. MCKENNEDY: That's fine with the Department, your
21 Honor.

22 MR. PLETCHER: That's fine.

23 THE COURT: You can orally convey.

24 THE WITNESS: Okay. There's only three. At Page 4,
25 at Line 14, there's a sentence that ends, "at total operating

1 losses of almost 2.8 billion." That number should be 2.7
2 billion.

3 At the same page at Lines 22, there's a sentence that
4 reads, "Aside from the risk from that risk, SFG's previous
5 surplus ratio in excess of 3.0 causes it to fail the first
6 IRIS ratio test." That should be, "the second IRIS ratio
7 test."

8 And then at Page 8 at Line 26, it says, "Results are
9 shown in Column 3." That should be, "Column 4," so those are
10 obviously all incidental. Those are the only ones I've found
11 to date.

12 BY MR. MADDIGAN:

13 Q. Okay. Thank you for correcting those typographical
14 errors.

15 All right. So to begin discussing your declaration, the
16 first exhibit to your declaration is your CV; is that correct?

17 A. Yes.

18 Q. And without asking you to go over every line of that
19 document, can you highlight, please, some of your relevant
20 professional experience?

21 A. Sure. I have a Doctoral degree in Economics from
22 Rutgers University. I've worked -- I worked for about 40
23 years in the insurance industry. Initially at a organization
24 called the National Counsel on Compensation Insurance where I
25 worked for the first nine years of my career after finishing

1 my education, and then I moved to Milliman where I founded and
2 managed for the next 30 years the Economics Consulting
3 practice for the firm. I was the principal at Milliman, and
4 as I said, I was in charge of the Economics Consulting
5 practice for 30 years between 1989 and 2019.

6 Q. And in the course of your work at Milliman did you
7 have experience working with insurance in California?

8 A. Yeah. I was -- I testified in, I think, what was the
9 first or possibly the second Prop 103 hearing in 1989.
10 Represented Safeco in that matter. I testified a number of
11 times in the generic hearings that took place shortly
12 thereafter. I participated in, I would guess, 40 or 50
13 individual rate cases, of which at least 25 went to public
14 hearing for which I provided public testimony.

15 Most importantly probably was the fact that I assisted
16 State Farm in a hearing that began and was pursuant to a
17 filing that was made in December of 2014. The hearing began
18 in 2015, and continued on until beginning of the next year.
19 The case, as I mentioned in my testimony, was not ultimately
20 resolved until 2022 when the California Supreme Court
21 overruled in favor of State Farm on issues that had been the
22 subject of my testimony.

23 MS. MCKENNEDY: Your Honor, I'm going to object as to
24 the extent it mischaracterizes the court holding. It was a
25 denial of cert.

1 THE WITNESS: I apologize.

2 THE COURT: Are you withdrawing that representation
3 then or, are you unsure?

4 THE WITNESS: Yeah. I'm not certain of the legal
5 status. What I know is that there was -- the Court of
6 Appeals, I believe, ruled in favor of State Farm. That case
7 was finally appealed to the Supreme Court. If it was the fact
8 that they did not deny certification, then that's what it was,
9 but then the final --

10 THE COURT: Is that adequate?

11 MS. MCKENNEDY: Thank you, your Honor.

12 THE COURT: I think we're good.

13 BY MR. MADDIGAN:

14 Q. Okay. So I'd like to ask you to focus and to talk
15 about with the Court here today some portions of your
16 declaration, beginning with Paragraph 17. If you could turn
17 to that, please, on Page 8 of Exhibit 103?

18 A. Yeah. Okay.

19 MR. PLETCHER: Your Honor, I'd like to object based
20 on the financial condition, and RBC issues we're discussing.
21 I don't want to interrupt the flow of the exam with --

22 THE REPORTER: Counsel? Counsel?

23 MR. PLETCHER: I -- I wanted to -- Your Honor, I
24 wanted to object based on the financial condition, and the RBC
25 issues. I don't want to interrupt the flow -- interrupting to

1 object to a series of question on financial condition, so we'd
2 like to have sort of a standing objection on that, and we'll
3 deal with that at a later date, if that's all right?

4 THE COURT: Any opposition to a -- Any opposition --
5 And is there any opposition to a standing objection on
6 financial condition, generally expressed both in the papers by
7 Consumer Watchdog and by --

8 MR. MADDIGAN: If by "standing objection" is meant as
9 I understand it, that rather than asserting the objection to
10 every question that it relates to financial -- the financial
11 condition of State Farm, that will just be an assumed
12 objection to the questions of Dr. Appel, then I have no
13 objection.

14 THE COURT: Is that part adequate?

15 MR. PLETCHER: That's adequate, thank you.

16 THE COURT: It'll be settled. The record will
17 reflect that the objection as to that piece. The RBC, I want
18 you to be more particular about, given the nature of it, so if
19 -- I'm not telling you how to proceed or strategize, but I
20 don't want that to be left sort of ambiguous or somehow
21 subject to a catchall when the issue as you presented it, and
22 has been examined is one that's subject to the statutory
23 restriction on entertaining that type of evidence in the right
24 context or the wrong context depending how you deal with it,
25 so do you want to address that as the testimony is solicited?

1 MR. PLETCHER: I would rather if we could deal with
2 that in the same way as to the RBC. If that could be a
3 separate objection, more specific to RBC-related data when
4 that comes up, but --

5 THE COURT: -- What I'm telling you is I want you to
6 point out when we're in territory that you're indicating is a
7 problem.

8 MR. PLETCHER: Will do, thank you.

9 THE COURT: Go ahead.

10 MR. MADDIGAN: Thank you, your Honor.

11 BY MR. MADDIGAN:

12 Q. Dr. Appel, do you have Paragraph 15 in front of you?

13 A. Yes.

14 Q. And there is a chart that you prepared that is
15 contained within Paragraph 17; is that right?

16 A. Correct.

17 Q. All right. I'd like to ask, if you could, for you
18 just to walk through this chart, explaining what each column
19 is. We can move from left to right beginning with the
20 left-hand column, Column Number 1, which might be the most
21 straight forward because it is entitled "Year". So what does
22 that column represent?

23 A. That column represents the year, surprisingly, and
24 it's from -- the exhibit runs from 2015 to 2024. It is a
25 10-year period.

1 Q. Just as a preliminary question, where did you get the
2 information that is contained within the chart in Paragraph
3 17?

4 A. It's from a page of the State Farm General statutory
5 annual statement. It's actually from two --

6 THE REPORTER: -- Doctor? Doctor? Doctor? I can't
7 hear him.

8 THE WITNESS: You can't hear me?

9 THE REPORTER: It's from a page of the State Farm
10 General Statutory?

11 THE WITNESS: Statutory annual statements. It's
12 actually from two statutory annual statements, 2019 and 2024.
13 The specific page is called the 5-year historical page, and it
14 reproduces a variety of information that's drawn from other
15 portions of the annual statements, so every lineup on that
16 page comes from a different place in the annual statement, or
17 is a calculation based on the data from the annual statement.

18 BY MR. MADDIGAN:

19 Q. And the annual statement is a public document; is
20 that correct?

21 A. Yes. It's the -- It's the required financial
22 statement that has to be filed by insurers in their state
23 domicile, and also in any other state in which they do
24 business, I believe. It's promulgated by the NAIC, the
25 National Association of Insurance Commissioners. It has a

1 standard format. Every insurance company reports its data
2 under that format. One, I suppose, nuance, might be that it's
3 -- the statutory annual statement is developed using statutory
4 accounting principles, as opposed to generally accepted
5 accounting principles, and so statutory accounting principles
6 pertain to the accounting for property for insurers generally.

7 Q. Okay. If you could please look at Exhibit 174?

8 A. Mm-hmm. Yes.

9 Q. What is Exhibit 174?

10 A. That is the pages -- Sorry. That's pages from the
11 statutory annual statement, the 5-year historical pages, and
12 this is from the December -- from the 2024 annual statement,
13 and then several pages further back are -- are the pages that
14 are from the 2019 statement, and every column that appears on
15 the table that we've just been talking about in my testimony,
16 every data element in that exhibit comes from one or another
17 of the lines of this annual statement.

18 I guess I would also -- Well, I was going to point out
19 that risk-based capital analysis is contained on those pages,
20 but we can talk about that when we get there --

21 Q. Yes, thank you. Okay. So now that we understand the
22 source of the chart in Paragraph 17, let's continue walking
23 across the column. So Column Number 2 is entitled, "Net
24 Written Premium," so what is net written premium?

25 A. Net written premium is the dollar value of the

1 premium for all the policies that were sold by the company
2 during each given year, and it is the net written premium, I
3 want to distinguish that from direct written premium, because
4 the difference from those two is important for the issues in
5 this case.

6 Direct written premium reflects the actual premium that
7 is going to be received when a policy -- when a policy is
8 sold, and that premium was ultimately paid, so if there was a
9 homeowners policy of \$1,000, the direct written premium on
10 that policy would be 1,000, but let's say that the insurer
11 ceded some of their risk to a reinsurer. Let's say they ceded
12 5 percent of the risk, or they ceded 5 percent of the premium,
13 meaning that they paid a reinsurer 5 percent of 1,000 or \$50
14 to purchase some reinsurance coverage.

15 In that case, the direct premium on that policy would be
16 500, but the net -- I'm sorry. The direct premium would be
17 \$1,000, but the net premium would be 950. The 1,000 minus the
18 \$50 ceded.

19 Q. Because the \$50 represents the 5 percent?

20 A. Exactly. 5 percent of \$1,000 is 50, and so that
21 premium would be part of direct premium, but not part of net
22 premium. I mentioned that specifically because I know
23 reinsurance is a subject of, you know, some dispute here, and
24 so just to be clear about what this exhibit reflects.

25 Q. Okay. Thank you. Column Number 3 on the chart in

1 Paragraph 17 is entitled, "Net Underwriting Gain,"
2 parentheses, "Loss". What does Column 3 represent?

3 A. Column 3 is, represents the direct results of the
4 insurance operation for State Farm General over the last 10
5 years. It is computed by taking net earned premium, and then
6 subtracting from it net incurred losses, and loss adjustment
7 expenses, and all the other operating expenses that insurers
8 face, which include commission and brokerage taxes, licenses
9 and fees, other acquisition expense, and general expense, so
10 those are the four broad categories of expenses, and net
11 underwriting gain is the total premium earned during the year
12 from all the business written by State Farm General, and then
13 subtracted from that, the incurred loss, and loss adjustment
14 expenses, and other underwriting expenses, and what that
15 shows, obviously, is that the lost over the 10-year period was
16 almost 5.3 billion dollars.

17 Q. And what you're referencing there is the total for
18 Column 3 is \$5,278,040,708; is that correct?

19 A. Precisely.

20 Q. And I think you just said this, but what does that
21 number represent?

22 A. That represents the 10-year underwriting loss
23 sustained by State Farm General from its insurance operations.

24 Q. And if you wanted to look at the total for any
25 individual year, you would just go across the column for that

1 year, so for example, looking at the year 2023, what would the
2 -- what were the net underwriting results for that year?

3 A. 1 billion -- Sorry. 1,066,061,350.

4 Q. As a loss?

5 A. Yes. All the numbers in red or in brackets are
6 losses.

7 Q. And for 2024?

8 A. I should say they are -- For 2024, the loss was
9 589,384,079.

10 Q. Okay. Column 4 in your chart is entitled, "Net
11 Income After Tax". Do you see that?

12 A. Yes.

13 Q. What does that represent?

14 A. The underwriting gain or loss, your Honor, is just
15 the results of the insurance operation without consideration
16 of investment income or tax credits to other important
17 considerations in determining the final income available to
18 the insurer, so net income after tax takes the underwriting
19 gain or loss, and adds to it all the investment income earned
20 by the insurer during the period, and also takes account of
21 tax credits or tax liabilities to the extent that they were
22 available to the insurer, so that column reflects, really, the
23 after tax results of State Farm General having sold insurance
24 in California over the last 10 years.

25 After consideration of the underwriting operation, all

1 the investment income from both the underwriting operation, as
2 well as from the company's own surplus, and in consideration
3 of all the tax benefits they may have achieved as a result of
4 the losses they sustained. After all of that is taken into
5 account, the loss over the 10-year period was 2 billion, 663
6 million without reading any of the fine print.

7 Q. And so just to understand how that comparison works,
8 from the perspective of a single year, let's look at 2023
9 again. As we saw, there was a net underwriting loss during
10 that year of 1.066 billion dollars, right?

11 A. Correct.

12 Q. And in Column 4, the results for that year show a
13 negative net income of 880 million dollars, approximately,
14 correct?

15 A. Mm-hmm.

16 Q. And so the different -- What does the difference
17 between those two numbers represent?

18 A. The difference is the sum of all the investment
19 income that was available to the company, plus the impact of
20 the tax position that they were in during that year, so in
21 this case, it would have likely been a tax credit given the
22 size of the underwriting loss, so that value, the difference
23 between the 1 billion, 66 million, and the 880 million, so
24 that's about a 186 million dollars, that would have been the
25 net benefit of the investment income and the tax credits.

1 Q. All right. Thank you. Column 5 in your chart is
2 entitled, "Policyholder Surplus". What is policyholder
3 surplus?

4 A. If this were reported under normal accounting rules,
5 generally accepted accounting principals, this would be
6 shareholder equity. It's the difference between the assets
7 and the liabilities of the company, and so it is in effect the
8 equity investment that's been made in State Farm Mutual, or
9 I'm sorry, State Farm General. The cumulative impact of all
10 the investment or retained earnings that have occurred over
11 the entire history.

12 Q. Okay.

13 A. Also, I guess I should add that surplus is kind of
14 the earnest money that stands behind the promise to pay that's
15 inherit in the insurance policy. To the extent that the
16 revenue collected from premiums and all investment earnings
17 are insufficient to pay losses and expenses, which has been
18 the case for the last 10 years, in that event, surplus is
19 available to meet those needs.

20 As you can see, and has been amply discussed already in
21 this hearing, the surplus has declined by about 75 percent
22 from near 4 billion dollars to around 1 billion, and actually
23 if you take into account further reduction from the fires, the
24 LA fires, then that surplus level would be at about 600 or 620
25 mullion, so a truly dramatic decline over the last decade.

1 Q. And when you talk about that decline over the last
2 decade, just to identify the numbers on the chart, you're
3 comparing the surplus in the year 2015 of 3.99 million --
4 billion, with the surplus in the year 2024 of about 1 billion;
5 is that correct?

6 A. Yes.

7 Q. And again, just to make sure I understand, when you
8 reference the fact that it would be -- the surplus would be
9 lower now as a result of the LA fires, is that because those
10 fires took place in 2025 so those results aren't reflected
11 here?

12 A. Oh, yes. Yes.

13 Q. Okay. Please explain what is meant by Column 6:
14 "Change In Surplus"?

15 A. Column 6 is just the year-to-year change in Column 5.
16 Let's start at 2024, because it's right at the top of the
17 column, so the policyholder surplus at the end of 2024 was 1
18 billion, 38 million. At the end of 2023 it was 1 billion, 342
19 million. The difference between those is 304 million dollars,
20 so the loss in surplus or the change in surplus in 2025 -- I'm
21 sorry. The change in surplus in 2024 is the difference
22 between year-end surplus in 2024, and the year-end surplus in
23 2023. That surplus declined by 300 million, which is, you
24 know, virtually the same as the net income after tax, meaning
25 this demonstrated, and I point this out in the testimony, that

1 State Farm General's surplus is strictly the result of its
2 insurance operations in California.

3 If you compare the column Net Income After Tax in Column
4 4 and Change In Surplus, first of all the totals are identical
5 virtually, off by 100 million dollars or something, but 2.7
6 versus 2.8 billion, but furthermore, each and every year those
7 changes are -- they're not identical, but if you calculate the
8 correlation between net income after tax and surplus, that
9 correlation is 99.99 percent. That's the correlation between
10 the net income after tax and the change in policy orders,
11 meaning that it's virtually identical those two values, and
12 what that demonstrates, as I said, is that State Farm's
13 surplus is strictly the result of the California insurance
14 operations, and by the way, I point that out in my testimony
15 that, because I've been involved in the State Farm matter a
16 decade ago, I had looked at the same kind of analysis for the
17 proceeding 15 years. I think I --

18 Q. -- Is that in Paragraph 21 that you describe that?

19 A. Yes. This pattern that the company surplus is solely
20 a function of California insurance operations has been the
21 case from 2000 on, so for the last quarter century State Farm
22 General's general surplus has risen and fallen solely as the
23 result of its California operations.

24 Q. Thank you. What about Column 7 in your chart
25 entitled, "Return Of Surplus," what does that mean?

1 A. Yeah. That's just a calculation of the net income
2 after tax divided by the average policyholder surplus during
3 the year, so you take the value in Column 4, Net Income After
4 Tax, and divide that by the average of the year-end and
5 proceeding year-end's surplus, so that tells you, you know,
6 what the income was over the average amount of surplus that is
7 covering, and in six of the years, the returns were negative,
8 significantly, in four of the years, there are very, very
9 small positive returns.

10 I think it's the case that not in any single year did
11 State Farm General ever earn a return on surplus that was even
12 equal to the allowable rate of return, or the maximum
13 allowable rate of return under the regulations.

14 Q. What about Column Number 8, the "Premium To Surplus
15 Ratio"? First of all, what is the premium to surplus ratio?

16 A. It's a ratio which is the net written premium, the
17 numerator, divided by statutory surplus, the denominator, and
18 as I mentioned, it's the second IRIS test, IRIS is for
19 Insurance Regulatory Information System test, and it's
20 probably the most widely used metric for an insurer's level of
21 capitalization.

22 Normally you would want to see insurers with capital at
23 least equal to their premium. I think that the industry
24 average today is probably, the ratio is probably around .8 or
25 something like that. I'm not sure, and I haven't checked the

1 numbers recently, but the IRIS test specified, what unusual
2 values for any of the ratios, and by unusual values, they mean
3 the value is sufficient to generate some regulatory intention,
4 and the unusual value for the net surplus ratio is 3 to 1.

5 As you can see, State Farm's value in the most recent
6 year exceeds that. The value in 2015 was .48, or roughly a
7 1/2 to 1. That's a level of capitalization that is pretty
8 solid and secure, particularly for an insurer that writes a
9 catastrophe book of business. When the ratio is as high as 3
10 to 1 for an insurer with State Farm's profile, that's just
11 really outside the bounds of what would be considered prudent
12 financial condition.

13 Q. And so just to again make clear where that ratio
14 comes from, it's indicated in the column, but it's the figure
15 in Column 2, so for 2024, 3.1 billion in net written premium
16 divided by the figure in Column 5, which is the policyholder
17 surplus, or about 1 million for 2024, correct?

18 A. Correct.

19 Q. And can you just explain, maybe, listened to what you
20 said, and obvious to you, but just to make sure we have a good
21 record, and it's clear, why is it bad to have a higher ratio,
22 and good to have a lower ratio?

23 A. Well, the premium reflects the amount of exposure the
24 insurer is taking. The more premium they've written, the more
25 they are exposed to the loss, and surplus is the buffer

1 against losses exceeding your revenues, your premium plus
2 investment income, so when that --

3 THE REPORTER: -- Hold on. One second, one second.
4 If I could ask you to slow down, please?

5 Surplus is the buffer against losses exceeding?

6 THE WITNESS: The revenues available to pay those
7 losses.

8 THE REPORTER: Thank you.

9 MR. MADDIGAN: Okay? Is it okay to proceed?

10 THE REPORTER: Yes. Thank you, Counsel. Sorry.

11 THE WITNESS: Let me just add one thing. The number
12 of 600 or 620 million was already articulated here as State
13 Farm's surplus today after the impact of the LA fires, so if
14 you just took 2024 net written premium of 3 billion, roughly,
15 and divide by 600 million, you have a premium to surplus ratio
16 of 5 to 1.

17 That is really outside the bounds, and I can understand
18 why the Insurance Department is concerned about financial
19 condition of State Farm General with a ratio like that.

20 BY MR. MADDIGAN:

21 Q. Now, you mentioned in your testimony that the ratio,
22 having a high ratio can be -- lead to an insurer being subject
23 to regulatory scrutiny, and I think you talked about this in
24 Paragraph 31 of your declaration, is that right?

25 A. Yeah.

1 Q. Oh, sorry.

2 A. 31 I'm talking about the RBC calculations.

3 Q. Sorry. 29. I apologize.

4 A. Okay. Yes. That says that -- It discusses the fact
5 that the ratio above 3.0 is deemed to be an unusual value, and
6 as I said a moment ago, it's particularly an unusual value for
7 an insurer whose exposure is so catastrophe prone, and
8 catastrophe dependent.

9 Q. Okay. Column 9 in your chart on Paragraph 17 is
10 entitled, "Risk-Based Capital or RBC Ratio," is that correct?

11 A. Yes.

12 MR. PLETCHER: Objection. Your Honor, respect to the
13 RBC information.

14 THE COURT: Okay. You want to elaborate rate on
15 that, because we have the statute, which you raised earlier?

16 MR. PLETCHER: I don't want to fully reargue things.
17 We offered to brief it this evening. But generally, you know,
18 we think there's a clear distinction in the statute between
19 what the Commissioner can look at, which is one question, or
20 look at, at least with respect to rate, and a separate
21 question about which pieces of RBC information are publicly
22 available through other sources or in confidential reports.

23 We think the fundamental purpose is to prevent this kind
24 of financial condition information from coming into rate
25 proceedings. We think it's a subset of financial condition

1 information, along with a specific prohibition that goes to
2 the general policy, but --

3 THE COURT: So stated another way, are you saying
4 Subsection C of 739.8 is a absolute prohibition?

5 MR. PLETCHER: It looks pretty clear to us that it's
6 an absolute prohibition, your Honor.

7 THE COURT: And that Subsection A, which I understand
8 counsel or State Farm General to be contending it's not, some
9 might say, conditioning it to public versus non-public source
10 -- sources? Am I understanding that right?

11 MR. PLETCHER: We think that's the distinction, and
12 you know, we'd love an opportunity with everything that's been
13 occurring to take a look at it, and try to get you a brief on
14 it this evening, or first thing tomorrow morning.

15 THE COURT: Okay. Let's take it up before we end the
16 day, but as to the objection, I want to handle it in the
17 appropriate manner, that's why I asked you to sort of give me
18 more detail when they begin to emphasize these points.

19 MR. PLETCHER: That's our understanding of it at the
20 moment, and you know, we just wanted to flag this, and again,
21 don't want to, um --

22 THE COURT: -- Well, it depends on how you -- I don't
23 mean to put you on the spot. Do you plan to move to strike
24 after the testimony is proffered because of that, and then
25 take it up in connection with that, or are you going to

1 preclude it from being even entered?

2 MR. PLETCHER: We would, I think at this point,
3 handle it through a motion to strike process after we get a
4 chance to look at it carefully, because we want to take the
5 arguments raised by opposing counsel seriously, and make sure
6 we're addressing them appropriately. Just in the pace of
7 these proceedings I wants to make sure we have the best
8 possible answer for the Court on that.

9 THE COURT: All right. So we'll proceed subject to
10 that.

11 MR. MADDIGAN: Thank you, your Honor.

12 BY MR. MADDIGAN:

13 Q. So let's take this in steps to make sure we have a
14 good record about what you mean, and where you got this
15 information, so first of all, if you could please define
16 risk-based capital?

17 A. Well, risk-based capital in a broad sense is a
18 program that was instituted or implemented by the NAIC years
19 ago to better monitor and evaluate the solvency of insurers,
20 as opposed to the IRIS test, which we talked about a minute
21 ago, and they are also a solvency-monitoring tool, but as
22 opposed to the IRIS test which calculate 13 ratios based on
23 annual statement information data, risk-based capital takes a
24 much more detailed and comprehensive approach to evaluating or
25 assessing the risks insurers face.

1 They consider risks associated with the assets of the
2 company, with the underwriting, with the liabilities. They
3 consider credit risk, investment risk, etc., also importantly
4 catastrophe risk, and all of those risks are identified and
5 quantified in the risk-based capital report that has to be
6 filed by insurers.

7 There are instructions to that report. The instructions
8 contain the formulae, and data requirements, and show the
9 manner of calculation of each component of this risk-based
10 capital value, and a lot of that information is likely to be
11 confidential and proprietary, and I can understand that that
12 information might not be admissible in any kind of proceeding,
13 simply because it's privileged and confidential. I don't know
14 about any of the other arguments, but at least in respect to
15 that, that makes sense to me.

16 However, the final value of the risk-based capital
17 calculation is reported publicly, so what risk-based capital
18 does is it says for a company with, let's say, take State Farm
19 General as an example, so for State Farm General, in
20 consideration of all of its potential risks we're going to
21 calculate a number that we called the authorized control level
22 risk-based capital number. That's a dollar value, and it
23 turns out that when you calculate that number with all of the
24 confidential and privileged information that goes into the
25 calculation, it turns out that in 2024, the risk-based capital

1 calculation authorized control level of risk-based capital was
2 \$691,001,813.

3 That's the value that appears on the table -- I'm sorry.
4 It doesn't appear on the table. The RBC ratio appears on the
5 table, but if you turn to Exhibit 174, that's the exhibit I
6 was directed to a moment ago, which is the 5-year history
7 page.

8 Q. Mm-hmm.

9 A. And the annual statement, if you go to the second
10 page, the upper side of this page, you'll see in Rows Number
11 28 and 29, the heading of those two rows is, "Risk-Based
12 Capital Analysis." It shows total adjusted capital, which in
13 the case of State Farm General is exactly equal to its
14 surplus. There are no adjustments that were made based on
15 State Farm's peculiarities, and the authorized control level
16 risk-based capital is 691 million, and if you take the ratio
17 of those two numbers, that is the RBC ratio that appears in my
18 exhibit.

19 So the first two -- The first year or the first column to
20 the right of the words on this page are the values for 2024,
21 and that ratio, 1 billion, 38 -- 1 billion, 38 million divided
22 by 691 million, that ratio is 1.50 or 150 percent, which is
23 exactly the value that's shown on my table.

24 Q. So --

25 A. -- Just to demonstrate the calculation one other

1 time, if you take the ratio of 1 billion, 342 million, which
2 is the next column to the right, that's total adjusted capital
3 for 2023, and divide that by the authorized control level of
4 588 million dollars, the ratio of those two is 228 percent, so
5 those are the values that I believe were referenced in the
6 insurance declaration, I think, but those are the values.

7 They are computed from publicly available information.
8 They provide probably the most comprehensive single measure of
9 a company's financial condition, and as I discuss at some
10 length in the testimony, and also was discussed in Ms. Shaw's
11 testimony, State Farm's level at the end of 2024 was 150
12 percent, which is just at the edge of the regulatory action
13 level, and if you calculate, or based on Ms. Shaw's
14 declaration, she shows that given the surplus decline
15 associated with the LA fires, and the -- the impact on surplus
16 to reduce surplus to roughly 600 or 620 million, that would
17 not change the authorized control level of risk-based capital,
18 but it would change the total adjusted capital, and the ratio
19 would fall below 100 percent, and a ratio of below 100 percent
20 is what is called the reg --

21 Q. -- Yeah. Let me -- Let me just stop there, because I
22 want to go through those different categories that you explain
23 in Paragraph 31, but just to close out the last topic, you --
24 the information that you included in your chart in Column 8
25 about RBC, I think you said this, but just want to make sure,

1 you derived that from publicly reported information that you
2 identified as being on Exhibit 174; is that right?

3 A. Yes, exactly.

4 Q. You didn't use -- Thank you. Okay. So let's look at
5 Paragraph 31 and talk about the significance of the RBC just
6 for the purposes of the opinions and findings that you are
7 making in this case, and in Paragraph 31 you describe the
8 different levels of the risk-based capital that may the
9 involve regulatory concern; is that right?

10 A. Yes.

11 Q. Okay. So let's walk through those. The first one is
12 something called, "CAL," or "Company Action Level," is that
13 correct?

14 A. Yes.

15 Q. What is that?

16 A. That's when the RBC ratio, or the ratio of risk-based
17 capital, total adjusted capital to risk-based capital is
18 between 150 to 200 percent. It falls below 200 percent.

19 Q. And in that instance, a regulator may require a
20 company to do something to take action to address that
21 situation? Reduce risk, or increase capital; is that correct?

22 A. Yes. They are intending to file a plan, and the
23 regulators should review the plan and determine it is
24 reasonable to address the concerns.

25 Q. The next level is called "RAO", or "Regulatory Action

1 Level." What is that?

2 A. It's when the RBC ratio is between 100 and 150
3 percent, so the capital surplus in the numerator is smaller
4 relative to the minimum requirement, and in that situation,
5 the regulator may be empowered to intervene more directly in
6 the company's calculations. They certainly have to continue
7 to file their action plan, and so on, and those plans would
8 continue to be reviewed, but the regulator has more authority
9 to intervene.

10 Q. The next level is called "ACL", or "Authorized
11 Control Level"?

12 A. Yes.

13 Q. What is that?

14 A. That means that the regulator is authorized to take
15 control of the company. It could mean an aggressive plan to
16 manage risk and exposure, or to try to restore the financial
17 condition. It could potentially mean receivership of the
18 company or the organization depending on how severe the
19 condition was.

20 Q. And for ACL, Authorize Control Level, what is the
21 threshold for that?

22 A. Oh, that -- The total capital falls below the
23 authorized control level, so it's when the ratio, RBC ratio is
24 below 100 percent, but greater than 70 percent.

25 Q. And the last level that you identify in Paragraph 31

1 is called "MCL", or "Mandatory Control Level", correct?

2 A. Yes.

3 Q. And what is that?

4 A. It's when the RBC ratio falls below 70 percent, and I
5 say the regulator has the authority to take control. I think
6 in, you know, the actual RBC statute, it may be stronger than
7 that. It may be that the regulator is required to take
8 control of a company, but suffice it to say that that is an
9 extremely severe financial condition for a company, and it's
10 one that State Farm General today, in the absence of rate
11 increase and capital infusion, is getting perilously close to.

12 Q. So if you look at the risk-based capital ratio in
13 Column 9 of your chart for the year 2024 that you calculated
14 based on the publicly available NAIC information, it's 150
15 percent; is that right?

16 A. Yes.

17 Q. So right on the dividing line between a company
18 action level and regulatory action level; is that right?

19 A. Yes.

20 Q. A few minutes ago in talking about the premium to
21 surplus ratio you made some general -- you provided some
22 general testimony about the significance of that, so looking
23 at the data that you pulled together in your chart about
24 risk-based capital, what general observations do you make as a
25 result of looking at that data?

1 A. As I noted in the testimony, the fact that the
2 largest insurer in the largest state in the country has an RBC
3 ratio that is virtually at the regulatory action level is
4 extraordinary, and I think I demonstrate that it's
5 extraordinary by looking at the RBC ratios for every property
6 casualty insurer in the United States for the last 7 years.
7 That's in the chart that appears on Page 13 of my testimony.
8 That shows the actual distribution of RBC ratios.

9 By the way, the vast majority of this chart, 2018 through
10 2023 comes from the NAIC directly. It's a report that the
11 NAIC files, so they do the computation, and then they put
12 together this report. I replicate that for 2024, because the
13 NAIC report doesn't come out until June, or at least that's
14 when it's traditionally been published, so I, in order to
15 update this to 2024, I did that using my own data sources, but
16 the most important take away from this is really the bottom
17 two lines of this exhibit, bottom two rows.

18 Q. In Paragraph 35?

19 A. Yes. Yes. So that shows the number of companies
20 with RBC ratios less than 200 percent, and the number of --
21 and the proportion of total companies with RBC ratios that
22 low, and as you can see, it's a scant number of companies, and
23 the percentage of companies with RBC ratios that low is
24 generally in the range of 1.5 to 2 percent of companies, and I
25 haven't done any study of these individual companies, but

1 typically, companies that fall into that condition are
2 relatively small, and they are certainly not characterized by
3 being the largest insurer, in the largest state in the
4 country, in the most catastrophe-prone line in one of the most
5 catastrophe-prone jurisdictions.

6 Q. Thank you. Now that we've gone through the chart
7 that you set forth in Paragraph 17, I'd like to ask you to go
8 back a few pages in your declaration to Paragraph 10? On Page
9 4. You there?

10 A. I'm there.

11 Q. Okay. Paragraph 10 summarizes your findings as you
12 describe them as a result of your work in this matter, right?

13 A. Yes.

14 Q. Okay. So I'd like to just walk -- have you walk
15 through now these with the benefit of the context that's
16 provided in the chart, and not repeating anything if we've
17 covered it already, but I just want to make sure that your
18 conclusions from the chart are clear, so in Paragraph 10-A,
19 what is your opinion regarding State Farm General's current
20 financial condition in light of what you described in the
21 chart about its surplus?

22 A. It's exactly what I say at Lines 10 and 11 of Page 4.
23 "Condition is characterized by a dangerously low level of
24 surplus as a result of a decade of sustained underwriting
25 losses in California," and I could add underwriting and

1 operating costs, and then the remainder simply identifies the
2 basis for that statement, and the basis is that the operating
3 underwriting losses were over 5 billion, the operating losses
4 were 2.7 billion, and evidence of financial distress is in the
5 IRIS test, surplus ratio, as well as the RBC ratio, so those
6 are the demonstration. That plus the reduction in the ratings
7 by AM Best, and the potential reduction by S&P, but those are
8 all the sources of information that I relied upon to come to
9 the conclusion that State Farm is in severe financial
10 condition, and needs some measure of relief.

11 Q. So you mentioned a minute ago, I think you made a
12 reference to some rating agencies, so let me ask you about
13 Paragraph 10-B, and the conclusion that you said -- set forth
14 there. In particular, with respect to a ratings downgrade, so
15 talk about what you mean when you describe a ratings
16 downgrade? First, tell us what it is, then I'm going to ask
17 you what the significance of it is, but first just what is it?

18 A. Well, insurance company, financial strength is rated
19 by various agencies, and I think it was already noted here
20 that the two most prominent ones rating insurance companies
21 are AM Best, and Standard and Poor. There are other rating
22 agencies, but Best and S&P are really the dominant ones.

23 Insurance -- When insurance company ratings fall below a
24 certain level, their homeowners insurance policies are no
25 longer, or may no longer be adequate to insure the collateral

1 underlying mortgages. It's been mentioned in a bunch of the
2 papers here that Fannie Mae and Freddie Mac, the two entities
3 that do the majority of purchasing and securitization of
4 mortgages, have minimum financial strength rating requirements
5 for the insurers that write homeowners insurance that support
6 the collateral for the mortgage, and those minimum ratings are
7 a B-plus rating from Best, and a Triple-B rating, BBB rating,
8 from S&P, and as I've noted, State Farm's Best rating has
9 already declined below that, and their S&P rating is in some
10 danger.

11 The real import of the matter is that if the insurance
12 can no longer serve as support for the underlying collateral
13 of the mortgage, then all those policies will no longer be
14 suitable to support mortgages, and I don't know whether it's 1
15 million or 1.2 million homeowners policies that are currently
16 enforced for State Farm, but I looked at some census data. I
17 found that 68 percent of homeowners in California have
18 mortgages, and so if I assume 68 percent of State Farm's
19 policyholders have mortgages, and there are, say, even a
20 million policyholders, then 680,000 policies could be on the
21 market tomorrow if the ratings go down, and I don't think that
22 that's a condition that the California market can sustain at
23 this point.

24 The market has already deteriorated dramatically, it's
25 continued. The FAIR plan has grown astronomically. There's

1 no capacity for another half a million or million policies to
2 go on the market in California, so I think from the
3 perspective of maintaining the company's ratings, both Best
4 and S&P mentioned specifically the adverse environment in
5 California. I think State Farm getting a rate increase, and
6 with a commitment to infuse capital in the form of a surplus
7 note, that's going to go a long way to maintaining the rating
8 at a level that will allow it to support the collateral for
9 mortgages.

10 Q. I just want to go over a couple of things that you
11 said in that answer, and identified some exhibits that relate
12 to them to make sure the record is clear. First thing I think
13 you mentioned that AM Best had downgraded the credit rating of
14 State Farm General; is that right?

15 A. Yes.

16 Q. Okay. So if you look, please, at Exhibit 4 to your
17 declaration, which is Exhibit 106?

18 A. Yeah, that's -- 106. I'm sorry. That is actually
19 identified as SFG-DA-3 in my book.

20 Q. Yes. That's correct. Exhibit 3 to your declaration?

21 A. Okay.

22 Q. And so what is this?

23 A. This is the notice Best released in March of 2024
24 notifying about the downgrade of State Farm General.

25 Q. And it was downgraded it says to B, Fair from A,

1 Excellent; is that right?

2 A. Yes.

3 Q. Okay.

4 A. And they're mentioning on here, in the first
5 paragraph to the summary investment downgrade financial
6 strength rating from B to A, in the long term issue of credit
7 rating to B-plus from A, it's the financial strength rating
8 that matters for the mortgage collateral. Fannie Mae and
9 Freddie Mac require that the financial strength ratings of the
10 companies be at the levels I mentioned, not at the issuer
11 credit ratings.

12 Q. Okay. Thank you. If you look at the next exhibit to
13 your declaration, which has the numbering in your declaration,
14 SFG-DA-4, but it also Exhibit 107?

15 A. Yes.

16 Q. That is a document entitled, "State Farm General
17 Insurance Company's AA Ratings Placed on Credit Watch,
18 Negative Of Weakening Capital Position," right?

19 A. Yes.

20 Q. Okay. So what is this document?

21 A. This is the Standard and Poor's press release of
22 February 25th of this year, 2025, which speaks to the
23 maintenance of the current rating, but explains why it's on
24 negative credit watch, and what the potential implications of
25 that would be.

1 Q. Okay. And you also mentioned that you had reviewed
2 some Census Bureau data to attempt to ascertain approximately
3 what percentage of Californians have mortgages; is that
4 correct?

5 A. Yes.

6 Q. If you look at Exhibit 173, is that the data that you
7 looked at from the Census Bureau?

8 A. Exactly. Exactly.

9 Q. Okay. And you also mentioned about the FAIR plan.
10 Let me ask you about that. First of all, just to define it,
11 what is the California FAIR plan?

12 A. It's the, what's called the market of last resort
13 for, you know, property insurance in California, so if an
14 insured policyholder has -- cannot find coverage elsewhere,
15 they can buy coverage through the FAIR plain, and FAIR plain
16 is like an association of insurers that writes coverage to the
17 -- those otherwise uninsurable risks or insured or
18 policyholders who are unable to find insurance, and the
19 financial deficits that may be -- may arise from the FAIR plan
20 are then spread back to the companies that participate in the
21 voluntary insurance market, and there's, I don't know if in
22 100 percent of states there are FAIR plans, but FAIR plans are
23 common things around the country, and there are FAIR flans for
24 residual markets of that type, for homeowners insurance, for
25 auto insurance in some states, for workers compensation, etc.

1 Q. And you made a comment, if I heard you correctly,
2 that the FAIR plan has -- has grown; is that correct?

3 A. Mm-hmm. Yeah. The policy accounts has tripled, and
4 the exposure has doubled, I think. The policy count now
5 anyway is 500, about a half a million policies, and the
6 exposure is 500 billion dollars. I was actually interested to
7 know that the average exposure is a million dollars per
8 policy.

9 I mean, that's, in my experience that's just astonishing
10 that homes of that value are being insured in the FAIR plan.
11 I think that tells you something about the appetite in the
12 market for the risk of homeowners insurance in California.

13 Q. If you look at Exhibit 172, please?

14 A. Yes. That's the document that -- from which I drew
15 my conclusions in my declaration.

16 Q. About the status of the FAIR plan?

17 A. Yes. So you can see that from 2022 to 2024, policy
18 counts almost doubled, and exposure went two and a half times.
19 I guess, 2021 through 2024 the exposure more than tripled, and
20 the policy counts more than doubled.

21 Q. All right. Thank you. Back to Paragraph 10 of your
22 declaration, in Paragraph 10-C you address a contention by
23 Consumer Watchdog that SFG's distressed financial condition is
24 self-inflicted, right?

25 A. Yes.

1 Q. Can you explain what your finding is in Paragraph
2 10-C?

3 A. You know, several of the letters that Consumer
4 Watchdog sent to the Commissioner, they mentioned, I have a
5 quote, "self-inflicted". That's me as telling it's taken
6 directly from the letter, and those letters, I'm sure, are in
7 evidence here, so you'll find the statements, but it seemed to
8 me the allegations in those letters were basically that State
9 Farm's financial condition is the result of two things.

10 One is that if paid too much for reinsurance, and the
11 other is it didn't take the rate increases it could have
12 taken, or it didn't file for the rate increases it might have
13 filed for, and I believe neither of those explanations can
14 possibly explain State Farm's current financial condition.

15 Q. Let's take them one at a time. How about the
16 reinsurance contention that you referred to? Why is it your
17 view that that cannot possibly explain State Farm General's
18 financial condition?

19 A. Well, I mean, for one thing, there's no, no
20 discussion at all about the price of reinsurance in comparison
21 to what could have been purchased elsewhere. It seems like
22 Consumer Watchdog is contending that because State Farm Mutual
23 or State Farm General purchases much of its insurance from its
24 parent State Farm Mutual, that for some reason the price is
25 unreasonably high, but there's no evidence provided to support

1 that assertion. The evidence of whether the price of
2 something is reasonable is by comparing that price to the
3 price of equivalent goods and services in the market, and
4 Consumer Watchdog doesn't do anything like that. That's what
5 Bryon Ehrhart's testimony is about, is about how State Farm's
6 costs compare to what would be available in the market.

7 MR. PLETCHER: Objection --

8 THE REPORTER: -- Counsel?

9 THE COURT: Your mike?

10 MR. PLETCHER: Just object that Mr. Ehrhart's
11 testimony can speak for itself.

12 THE COURT: Sustained.

13 MR. MADDIGAN: I'm sorry. I couldn't hear the
14 objection, your Honor?

15 MR. PLETCHER: The objection is that Mr. Ehrhart's
16 testimony can speak for itself. The description of it from
17 Dr. Appel --

18 THE COURT: -- He doesn't have to testify on behalf
19 of somebody else, so let's move along.

20 BY MR. MADDIGAN:

21 Q. You were referencing his declaration; is that
22 correct?

23 A. Yes. In any event, I've seen no data or evidence
24 from Consumer Watchdog as to whether State Farm's reinsurance
25 program was reasonable. What evidence they provided was a

1 10-year history of the, what I would call the ceded-loss
2 ratios of several of the large California homeowners insurers.

3 What I mean by ceded-loss ratios is, when you buy
4 reinsurance, you give some premium to the reinsurer because
5 they're taking on the risk of certain exposure. It might be,
6 for example, "Oh, if I incur losses in excess of a quarter
7 billion dollars from a catastrophe event, then the reinsurer
8 will pay those losses," so you give some premium to the
9 reinsurer in order to -- in order for that reinsurer to absorb
10 that risk. That's called the ceded-premium. It is the
11 premium ceded to the reinsurer.

12 But if a loss event occurs, and that is large enough to
13 get into the reinsurer there, then the primary insurer will
14 cede some losses to the reinsurer, and if you look at the
15 ratio of the ceded-losses to the ceded-premium, that's the
16 ratio of the losses the reinsurer absorbed compared to the
17 premium it got to absorb those losses, and so what Consumer
18 Watchdog did was provide a table or several tables showing the
19 reinsurance experience for State Farm General, and -- I guess
20 I can find the other companies. Fire Insurance Exchange was
21 one of them. I'm just not recalling the individual companies,
22 but the analysis they did compared the ceded-loss ratios for
23 those companies to State Farm for two particular years, the
24 two wildfire years of 2017 and '18, and several of those
25 companies had significant recoveries relative to their

1 premium. One of the companies seemed to have recovered about
2 \$4 in losses for every dollar of premium they paid. That is,
3 they had a ceded-loss ratio of 400 percent in one of the
4 years.

5 What I said in my testimony is that it is impossible to
6 compare the experience of different companies, their
7 ceded-loss experience, unless you know a fair bit about the
8 details of their reinsurance program. If one company attaches
9 at a relatively low level, meaning their reinsurance kicks in
10 when their losses are relatively low, they may get a fair bit
11 of recovery from a given event. Another company that attaches
12 at a much higher lever, might not get any recoveries.

13 That doesn't mean that the second company's program is
14 overpriced. It just means that the event wasn't big enough to
15 hit their attachment point, so I don't think you can say
16 anything meaningful about the value of the reinsurance program
17 by looking strictly at the ceded-loss ratios.

18 The other piece that they talk about in terms of
19 reinsurance is the fact that over the 10-year period the cost
20 of the reinsurance, the ceded-premium, exceeded, was greater
21 than the ceded-losses by about 3 billion dollars, and that's
22 true, and as I discuss at some length in my testimony, the
23 economics of reinsurances demand that that's true, so the fact
24 that in a 10-year period, the reinsurance didn't pay off
25 significantly is not evidence that it was overpriced, and in

1 fact, if they had added in the last -- the next quarter of
2 data, so if they had included just January and March of 2025,
3 then even by Consumer Watchdog's own admission, there was a 5
4 billion dollar net benefit to State Farm from its reinsurance
5 program, so that's compared to the 3 billion dollar, sorry,
6 net loss over the prior 10 years.

7 You add them both together. So over 10 and a quarter
8 years there's a 2 billion dollar net benefit to State Farm
9 General from its reinsurance. A 5 billion dollar benefit in
10 the last three months, and a 3 billion dollar cost in the
11 proceeding 10 years. That is not at all surprising for
12 reinsurance property, and in fact when you are reinsuring
13 events that might occur once every 20, or 50 or 100, or 500
14 years, it's not surprising that you don't see those events in
15 a given 10-year period.

16 So the two pieces of proof I think that Consumer Watchdog
17 tries to provide about the cost of reinsurance are the
18 ceded-loss ratio comparisons, which I think is bankrupt,
19 because you can't compare them without knowing about the
20 insurance programs, and also the 10-year history of State
21 Farm's program, and the net cost it incurred, because just
22 including another three months changes whole picture entirely.

23 Q. Because by cutting -- choosing to cut off the
24 analysis at December 31, 2024, it excluded the January 2025
25 fires in Los Angeles?

1 A. Yes. And I understand that formal financial data as
2 normally reported on annual statements or quarterly statements
3 is not available including those events, but to come into a
4 hearing where State Farm is asking for emergency interim
5 relief, and to exclude from the analysis entirely that event,
6 and considering the implications it has for all of the
7 allegations that are being made by Consumer Watchdog, it just
8 surprises me that it wouldn't have been considered, but it
9 does change the picture.

10 Q. One of the things you address in Paragraph 10-D is
11 the allegation by Consumer Watchdog that State Farm General
12 intentionally elected to file inadequate rates in order to
13 capture market share; is that right?

14 A. Yes.

15 Q. And in your analysis, did you look to see if State
16 Farm General actually had increased its market share over
17 the --

18 (Lights went out in courtroom.)

19 Got to liven it up here.

20 A. Getting kind of intimate here.

21 Q. Should we keep going? Did you look to see if State
22 Farm General actually had increased its market share over the
23 years 2015 to 2024?

24 A. I did. I noted that at least at the two endpoints
25 from 2015, the market share was 19.7 percent, I think, and

1 2024 it was 19.5 percent, so I noted those facts. I did not
2 include the entire 10-year history, and it is true that during
3 that period, State Farm's market share declined for a period
4 of time, and then starting around 2017 or so, it increased,
5 but at the end of the 10-year period the market share was
6 virtually identical to what it was at the beginning of the
7 period.

8 Q. And what if we look at it differently, not in terms
9 of market share, but in terms of number of policies? Did you
10 -- Did you examine that?

11 A. Yeah. I think that -- Can you point me to what
12 Consumer Watchdog letter? I don't actually --

13 Q. Yes.

14 A. I'm sorry. This might be more in Mr. Armstrong's
15 declaration that was filed last night.

16 Q. Yeah.

17 A. Where is that?

18 Q. If you want to see that, we can put it in front of
19 you?

20 A. He has State Farm premium numbers over that period of
21 time, and just from memory the premium volume for State Farm
22 increased, I want to say, about 80 percent between maybe 2017,
23 and 2024. That's not an increase in market share, that's just
24 an increase in premium volume, in the dollars collected.

25 That comes from -- One thing Mr. Armstrong noted, you

1 know, rate increases contribute to that premium change. New
2 business could contribute to that premium change, but perhaps
3 the most important factor is the underlying inflation in
4 homeowner's insurance costs which get, most policies get built
5 in automatically through inflation adjustment costs, so that
6 the exposure, the amount of insurance increases by the change
7 in building costs, or the change in the cost to repair or
8 replace damage, and the combination of all those factors
9 certainly contributed to a significant increase in premium
10 volume for State Farm over that period from 2017 to 2023 or
11 '24.

12 But I wanted look at policy counts, because if the
13 allegation is that State Farm deliberately underpriced its
14 insurance in order to gain new business and dominate the
15 market or something like that, if that's the allegation, then
16 one way to measure that is whatever happened to their policy
17 counts? Did they actually write more listings, or did they --
18 did those other factors like inflation, and, you know, other
19 consideration, rate changes and so forth, did that explain the
20 difference.

21 And the number of policies in force is an exhibit in the
22 rate filing, and so I found that exhibit, it is Exhibit B, and
23 I couldn't tell you what page it is in the file, but it shows
24 the policies in force over the 10-year period from 2014 to
25 2023, 9 years. I'm sorry. 10 years. And between 2017 and

1 2023, that's the time at which in Mr. Armstrong's exhibit the
2 significant majority of the premium increases occur. The
3 policy counts increased in total over that time only 8.5
4 percent, which is an average annual increase of about 1.4
5 percent a year in policies.

6 So that to me does not suggest the company is trying to
7 write every new piece of business and dominate the market.
8 That seems like a rather modest annual increase, and I
9 understand that at least some of that has to do with the fact
10 that State Farm chose not to non-renew some of its business,
11 where as other companies were trying to, at least limit their
12 exposure, if not exit the market, so I don't think there's any
13 support for the fact that State Farm was responsible for its
14 own financial condition, because of an attempt to charge lower
15 than reasonable rates in order to capture market share, I
16 don't think there's any evidence to support that at all.

17 Q. In Paragraph 10-E of your declaration you state, "It
18 is my opinion that the interim rate increase is not only
19 reasonable and justified, but in fact is critical to the
20 health of State Farm General and the California homeowners
21 insurance market." Can you elaborate on the reasons that you
22 think that?

23 A. Well, for, I guess, the very same reasons that Ms.
24 Shaw wrote about it, and anyone else with eyes wide open would
25 be concerned as well. If the company became financially

1 impaired in such a way that it could no longer serve its
2 California policyholders, either because it's taken over, or
3 under some degree of regulatory control, or because it's
4 financial strength ratings declined to the point where it's
5 insurance is no longer acceptable as collateral mortgage, then
6 you're going to see hundreds of thousands, possibly up to a
7 million policies on the market, and that is just an
8 unsustainable situation at this point in California.

9 So the interim rate increase provides some immediate
10 benefit. There will be some immediate infusion of revenue
11 just due to the rate increase, but with the agreement and the
12 stipulation that if the rate increase is approved in its
13 entirety, then State Farm Mutual will purchase surplus note
14 from State Farm General. That just enhances the value of this
15 stipulation or interim rate agreement.

16 It likely means, I would guess, I mean, I don't talk to
17 the credit agencies on a regular basis, but I would guess that
18 that would be a very strong signal that State Farm General is
19 going to continue to be supported by its parent, and that
20 therefore the credit ratings would likely be maintained, and
21 as long as --

22 MR. PLETCHER: -- Objection, your Honor, due to the
23 speculations describing --

24 THE COURT: I'll Sustain that.

25 MS. MCKENNEDY: Your Honor, I don't want to

1 interrupt, but I think it might be time for a break?

2 THE COURT: I'm willing to do that. We're getting
3 towards the end of the time anyway, so I'll make an inquiry
4 first as to the further duration of this witness's direct?

5 MR. MADDIGAN: I think the direct is very close to
6 complete, your Honor.

7 THE COURT: Couple more question on direct? What
8 does it look like?

9 MR. MADDIGAN: I mean, five minutes, something like
10 that.

11 THE COURT: You want to wait five minutes, or do
12 people want to take a break?

13 MS. MCKENNEDY: I'd like to ask the court reporter,
14 your Honor?

15 THE REPORTER: That's fine, your Honor. Thank you.
16 Thank you, Counsel.

17 THE COURT: Five minutes?

18 MS. MCKENNEDY: I'm good, your Honor.

19 THE COURT: I appreciate the check-in, because it's
20 one of the things I get criticized about is not taking any
21 breaks, and you're welcome to raise at any point if it's
22 necessary. Okay. So let's see if we can complete the direct,
23 and then we'll talk about where we're at, okay?

24 BY MR. MADDIGAN:

25 Q. One of the things you mentioned in a few places in

1 your declaration, including Paragraph 10, is a reason you
2 believe that the stipulation is reasonable is because it has,
3 I think you used the phrase, "no risk to policyholders". What
4 do you mean by that?

5 A. I mean that at some later date when the full rate
6 application is reviewed, and the rate change is finally
7 determined, if allowed rate increase is less than what was
8 permitted under the stipulation, that there would be refunds
9 to policyholders with interest. I don't deny that
10 policyholders will pay a higher premium in the near term.

11 That higher premium, in my view, is warranted, because
12 the exposure and risk in California is so evidently
13 significant that an increase in premium is warranted, and so I
14 appreciate the -- the needs of consumers, and the burdens that
15 this may place on consumers, and I'm mindful of that, but I'm
16 also mindful of the financial condition of the largest insurer
17 in the state, and the fact that insurance rates have to be
18 adequate to cover underlying insurance costs, and that has not
19 been the case for State Farm General, at least for the last
20 decade.

21 Now, I'm not saying that that is something they can put
22 into a rate template, and determine and rate change based on
23 it, but it's something the Commissioner has to consider,
24 because the Commissioner's primary responsibility -- In my
25 view, Commissioner's primary responsibility is ensuring the

1 financial solvency of the insurers under its control, or
2 authority, and taking into account the distressed financial
3 condition of a company is entirely appropriate in the case of
4 an interim rate increase that has dramatic level of protection
5 for policyholders.

6 Absent drafting the rate increase, and absent the capital
7 infusion, I think it's like rolling the dice. You don't know
8 what's gonna happen to State Farm General, and if you want to
9 take a risk, proposing a rate reduction, for example, you want
10 to take the risk that State Farm General is going to remain
11 viable, and remain in the market, I think that's a big risk to
12 take, and the other side of that is to grant the interim rate
13 increase schedule, 400 million dollar surplus, and it will
14 restore to some extent the financial condition of the company,
15 and then go to a rate hearing and determine if it's reasonable
16 or not, so that's my opinion.

17 Q. Thank you, Dr. Appel. Just two more housekeeping
18 questions before we conclude. You testified -- You referred
19 throughout your testimony to -- to some exhibits, I'm sorry,
20 to the stipulations. You made reference to them.

21 I would just like to ask you to identify them, and to
22 make sure that the record is clear about what you've been
23 talking about, so first of all if you look at Exhibit 101?

24 A. Yes.

25 Q. What is that?

1 A. Stipulations with a whole bunch of words. I'm
2 looking for the date.

3 Q. Okay. Yeah. And what -- what is the date?

4 A. February 7th, 2025.

5 Q. And Exhibit -- That's what you were -- one of the
6 stipulations you were referring to in your testimony?

7 A. Yeah. I was really thinking more of the revised one.

8 Q. Okay. That's why I wanted to do this, and that's
9 Exhibit 102?

10 A. Yes. And that's the one that has the 17 percent
11 interim rate, subject to refunds, with interest, etc., and it
12 also states that, but somewhere it states that State Farm
13 Mutual will purchase the rest of them.

14 MR. MADDIGAN: Okay. Thank you, you Honor. May I
15 have 30 seconds to talk to my colleagues, or maybe this would
16 be a good time for a break? I believe I'm done.

17 THE COURT: Sure. If you need to confer a little
18 bit, let's just take a 5-minute break before we resume and
19 conclude for the day. The witness remains under oath. If you
20 want to step aside for the moment to use the facilities or get
21 water. Please do. We're in recess for 5 minutes until 4:45.
22 I'm going to stay on the bench unless you ask me to step off,
23 okay?

24 MR. MADDIGAN: Thank you.

25 (Pause in the proceedings from 4:40 p.m.)

1 until 4:48 p.m.)

2 THE COURT: Okay. We're back on the record after a
3 brief break in the State Farm General Insurance Company, Cases
4 PA-2024-00011. I'm going to stop saying the whole thing. 12
5 and 13.

6 We were just finishing up with the testimony on direct
7 from the witness called by State Farm General Insurance
8 Company, and we agreed that we would talk about where we stood
9 with respect to continuing testimony, and what to expect for
10 tomorrow, so I'm gonna just confirm, are you sure your
11 finished with your direct, Counsel?

12 MR. MADDIGAN: I have just one more question. I have
13 a housekeeping matter, your Honor?

14 THE COURT: All right. You want to squeeze that in?

15 MR. MADDIGAN: Yes. First of all, the --

16 THE COURT: You're still under -- Sorry. You're
17 still under oath.

18 MR. MADDIGAN: The housekeeping matter, I asked the
19 witness about Exhibit 102, the amended stipulation. I was
20 told I did not say Exhibit 102 at the beginning of the exam
21 when I listed the exhibits that I was going to ask about. It
22 was just inadvertence, so I want to make sure it's part of the
23 record.

24 THE COURT: Okay. The record will so reflect.

25 MR. MADDIGAN: Thank you.

1 BY MR. MADDIGAN:

2 Q. And then the question that I had for the witness is,
3 if you could look at Exhibit 102, Paragraphs 1 and 2, you made
4 a reference to a surplus note in your testimony. If you look
5 at Paragraph 2 it says, "Accordingly the parties supplement
6 the terms of the prior stipulation by stipulating and agreeing
7 as an additional term that should the Commissioner approve the
8 interim rates as set forth herein, Applicant shall obtain a
9 surplus note of 400 million from State Farm Mutual." You see
10 that?

11 A. Yes.

12 Q. Is that what you were referencing in your testimony
13 when you described the surplus note?

14 A. Exactly.

15 MR. MADDIGAN: Thank you.

16 THE COURT: All right. Thank you very much. I'm
17 gonna turn to the Department, because although this witness
18 was called by State Farm General Insurance, the Department is
19 aligned in a sense of wanting to seek approval of the
20 stipulations, and the stipulation that is consolidated, and I
21 wanted to know if you were going to have questions for this
22 witness? Anticipated questions?

23 MS. MCKENNEDY: Your Honor, the Department has two
24 very brief questions.

25 THE COURT: You want to get those in now?

1 MS. MCKENNEDY: I would love to. Thank you, your
2 Honor.

3 THE COURT: Sure. Let's do it.
4

5 CROSS-EXAMINATION

6 BY MS. MCKENNEDY:

7 Q. Dr. Appel, hello.

8 A. Hi. Nice to see you again.

9 Q. Nice to see you again too. I am wondering, did you
10 look at State Farm General's data through the first quarter of
11 2025 informing any of your opinions you've expressed here
12 today, or in your declaration?

13 A. I didn't look at any specific data that were reported
14 by State Farm -- but I did pay attention, obviously, to
15 information about the fires, and the impact, and what
16 happened.

17 Q. And can I just ask why you didn't look at the first
18 quarter of 2025 data?

19 A. I didn't have access to it.

20 MS. MCKENNEDY: That's all. Thank you. Thank you,
21 sir.

22 THE COURT: Anything further from State Farm given
23 those questions?

24 MR. MADDIGAN: No.

25 THE COURT: All right. And now turning to Consumer

1 Watchdog in connection with a further exam on cross, be ready
2 for that tomorrow, or do you have just a, you know, where are
3 you at?

4 It's less of a tap, but more of a hold. We're talking
5 about our mikes, and just a push.

6 MR. PLETCHER: Yes. We anticipate a cross of the
7 witness tomorrow.

8 THE COURT: Okay. And can I, without holding you to
9 it, are you going to be including in your examination, you
10 know, some specifics or a teasing-in of the RBC part that is
11 in contention? That is, what -- what -- what -- where --
12 where the conclusions that are reached by this witness depend
13 on those are independently justified?

14 MR. PLETCHER: Right. At this point, we might want
15 to address some of those at a high level, and also wanted to
16 address the matter legally through a motion as well.

17 THE COURT: Okay. Okay. So we'll put that, what I
18 said, aside for a minute, but I put it out for discussion with
19 both parties, and whether or not you want to, you know,
20 rehabilitate depending on how the cross-examination goes with
21 that, and be thinking about. Let's just -- Let's --

22 We have anything further for this witness right now? I
23 don't think so, so we're not excusing him, since you'll be
24 subject to recall, but you can step down.

25 THE WITNESS: Thank you.

1 THE COURT: Thank you for your testimony. So do you
2 have a suggestion for me, Counsel, with respect to what you
3 wanted to accomplish? I hate to see you having to draft
4 through the night, but it seems that you will be engaged in
5 things. You were suggesting some sort of written submission?

6 MR. PLETCHER: We hope to get in a brief written
7 submission on the RBC issue to further clarify some of the
8 questions that have been raised about its applicability.

9 THE COURT: Okay. Do you anticipate that in the
10 morning? Some time tonight? Not holding you to it. I'm
11 trying to help the other parties, because they are gonna see
12 something, and then it's gonna thrust everybody to have to
13 respond.

14 MR. PLETCHER: Sure. We'll work to get it done as
15 soon as possible, and we'll do it tonight if we can. We
16 absolutely want, you know, enough time for you to have a
17 chance to review, and for the other parties to have a chance
18 to at least review it before we begin again tomorrow morning.

19 THE COURT: All right. So any comments about that
20 before I make comments about it?

21 MR. MADDIGAN: No.

22 THE COURT: Okay. So what I would anticipate -- Go
23 ahead, Ms. McKennedy?

24 MS. MCKENNEDY: Your Honor, we haven't seen it yet,
25 but the Department might want the opportunity to respond in

1 writing. I just raise that as a possibility.

2 THE COURT: Absolutely, and that's where I was going,
3 so it just depends on, you know, what you want to do once you
4 see what comes from there. I would like to nip it in the bud
5 sooner than later, because I think that it changes the
6 characterization of examinations.

7 This was fine. Some of the suggestions that we just
8 heard as to how to operate with it, but if once you see it,
9 you only have oral remarks, that's fine. If you still need
10 time to produce something more than, let me know, and we'll
11 navigate somehow to have you able to do that if at all
12 possible, okay?

13 MS. MCKENNEDY: Thank you, your Honor.

14 THE COURT: So to give you a sense of what I
15 anticipate in the morning when we resume is we obviously have
16 this witness coming back for cross-examination. Prior to him
17 resuming the stand, I will do a very mini-recap, cause we went
18 through a lot of stuff this morning, and I like to make sure
19 we've done sort of a little housekeeping step that just says,
20 "This is what we did," in case there's, you know,
21 clarifications that people sit up in the middle of the night
22 and say, "Oh, my God. What did he really say?" And if you
23 need to ask me for something in that regard, then you can at
24 that point too, so that we're all at the same page going
25 forward, and you can -- you can plan your -- plan your

1 strategy and your approach before you --

2 We open the room early. About, at least an hour
3 early. I don't know that anybody really wants to leave
4 anything here. I wouldn't recommend it, because if it's,
5 like, something confidential, sensitive, or you can't lose,
6 but you could leave things that are not of that
7 characterization at your table, and kind of shift it.

8 What else? Is there any questions?

9 MR. MADDIGAN: I have two questions, your Honor?

10 THE COURT: Sure.

11 MR. MADDIGAN: First, in terms of leaving things, is
12 it okay to leave the binders of exhibits?

13 THE COURT: Those are the kind of things that
14 typically do get left, yes, but I would put them on the table.
15 I mean, they come in and clean, but if you put it on counsel
16 table, and make clear it's yours, I would suggest that.

17 And like I said, don't leave anything that you wouldn't
18 -- couldn't replace, if you had to. Nothing personal, or
19 computers, or anything like that.

20 MR. MADDIGAN: Thank you. The second question was
21 just to confirm the time you would like to start?

22 THE COURT: I was planning to start at 10:00 o'clock.
23 It's our standard time, and I'm getting nods from the room,
24 because it looks like people need that allocation. As we get
25 closer to the end of the week, if we need to expand our hours,

1 I'm willing to do that, but I will ask the parties to talk
2 about that and tell me, rather than expecting me to raise it,
3 okay? So sort of collaborate and see whether or not you can
4 stay awake that long and do it, but we do want do -- we do
5 want to finish.

6 So is there anything further that should be addressed
7 today? I do want to thank you for your advocacy, and for your
8 work today. I know that these are very important issues for
9 those of you that are participating, as well as observing, and
10 with that, we will adjourn until 10:00 a.m. tomorrow, April
11 9th, at the Administrative Hearings Bureau courtroom in
12 Oakland. All right? Good night. Everybody stay safe.

13 MS. MCKENNEDY: Thank you, your Honor.

14 (Whereupon the proceedings were continued.)
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1 REPORTER'S CERTIFICATION

2
3 I, the undersigned, a Certified Shorthand
4 Reporter of the State of California, do hereby certify:

5 That the foregoing proceedings were taken before
6 me at the time and place herein set forth; that any
7 witnesses in the foregoing proceedings, prior to
8 testifying, were duly sworn; that a record of the
9 proceedings was made by me using machine shorthand, which
10 was thereafter transcribed under my direction; that the
11 foregoing transcript is a true record of the testimony
12 given.

13 Further, that if the foregoing pertains to the
14 original transcript of a deposition in a federal case,
15 before completion of the proceedings, review of the
16 transcript was not requested.

17 I further certify I am neither financially
18 interested in the action nor a relative or employee of any
19 attorney or party to this action.

20 IN WITNESS WHEREOF, I have this date subscribed
21 my name.

22 Dated: APRIL 15, 2025

23 

24 Certified Shorthand Reporter

25 For The State of California

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