



Formerly The Foundation for Taxpayer & Consumer Rights

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June 10, 2008

Senator Machado, Chair
Senate Banking, Finance & Insurance Committee
State Capitol, Room 407
Sacramento, CA 95814

Re: AB 1051 (Calderon) – OPPOSE

Dear Senator Machado:

AB 1051 (Calderon) would lead to higher insurance rates for California consumers and businesses by changing the terms under which the Insurance Commissioner can review rates governed by Proposition 103. The legislation would also prevent refunds when insurers illegally overcharge customers.

An April 2008 report by the Consumer Federation of America found that California drivers saved \$62 billion on their auto insurance premiums since 1989 thanks to Proposition 103's strong rate regulation (see http://www.consumerfed.org/pdfs/state_auto_insurance_release.pdf) AB 1051 would strip away key aspects of rate regulation that delivered those savings to California consumers. Consumer Watchdog urges the committee's opposition to AB 1051's attack on Proposition 103's central reforms.

Section 1 Removes Accountability for Insurance Companies That Break the Law

Proposed section 1861.05 (e) seeks to eliminate insurer accountability for any illegal act they may commit if they claim to be doing it under the cover of a rate approval. The proposal is a direct attack on 1861.05 (a), which makes clear that nothing allows an insurance company to maintain a rate that violates Prop 103:

No rate shall be approved **or remain in effect** which is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter. [Insurance Code §1861.05(a), emphasis added]

This bill seeks to override the "remain in effect" provision by allowing insurers to illegally overcharge customers even after they have been caught and ordered to end the overcharges.

When an insurer violates a consumer's legal right to a fair premium or refuses to change a rate that is in violation of the law, that company must be required to refund any ill-gotten gains, whether or not they claim their lawbreaking was at some point approved by the Commissioner. If insurers were not required to refund illegal overcharges, then insurers would do everything possible to maintain excessive, unfair or otherwise illegal rates as well as attempt to surreptitiously include illegal practices in the rate application process and then never change their rates. Prop 103's prohibition on illegal rates, whether approved or not, is the protection against that. As such, no company is immune when they break the law, and no customer is prevented from getting their money back if it can be demonstrated that a charged rate, premium or rating practice is illegal under Prop 103's provisions.

For example, in *Donabedian v. Mercury*, Mercury was sued for surcharging drivers who had been previously uninsured, even though such surcharges are illegal under Proposition 103 (section 1861.02 (c)). Mercury's defense was that it was immune from the suit because it had obliquely "disclosed" the surcharge to the Commissioner in its rate application and that when the Commissioner approved the application, the Commissioner authorized the illegal surcharge. Other insurance companies have unsuccessfully made the same argument to escape liability for violations of Prop 103. Several insurers, including Mercury, have settled class action suits exactly on point and are refunding (a form of "retrospective adjustment") tens of millions of dollars to consumers who were improperly overcharged.

Through Insurance Code Section 1861.03, the voters made the insurance industry subject to California's unfair business practices law, which provides for restitution. In upholding the right of policyholders to sue an insurer for restitution for a violation of Proposition 103, the Court of Appeal writes:

Proposition 103 prohibits insurers from using the absence of prior insurance as a rating criterion (§ 1861.02, subd. (c)) and subjects insurers to the UCL (§ 1861.03, subd. (a)). The Proposition further provides: "Any person may initiate or intervene in any proceeding permitted or established pursuant to ... chapter [9]." (§ 1861.10, subd. (a).) The formal administrative process is found in chapter 9. "Any person may [also] ... enforce any provision of ... article [10 of chapter 9]." (§ 1861.10, subd. (a).) The prohibition against using the lack of prior insurance as a rating criterion is found in article 10. Giving effect to all of these provisions, "[a]ny person" may initiate or intervene in the formal administrative process (established in chapter 9) and may enforce the ban on using the lack of prior insurance as a rating criterion (contained in article 10, chapter 9) by bringing a civil action under the UCL. [*Donabedian v. Mercury Ins. Co.* (2004) 116 Cal.App.4th 968, 987]

AB 1051 purports to strip consumers of their legal rights to obtain refunds in court under the unfair competition law, in direct contravention of Prop 103's protection of that right.

Section 1 Will Remove Insurance Commissioner's Power to Order Refunds From Intransigent Insurers That Maintain Excessive Rates

This proposed provision also seeks to prohibit the Commissioner or a court from ordering rate refunds if it is determined that customers are being overcharged and an insurer has

refused to reduce rates appropriately, in direct violation of Insurance Code Section 1861.05 (a).

In a matter still before the Department of Insurance, Allstate, among other insurers, was put on notice in June 2006 pursuant to Insurance Code section 1861.05(a) that its current homeowner rates were excessive and needed to be reduced immediately. While all the other insurers lowered their rates in response to the Commissioner's notice, Allstate refused to comply and insisted on continuing to charge excessive rates, filing an application to increase its rates even more. The Commissioner, after almost a year of trying to get the company to agree to lower their rates, put the company on notice again in May 2007 that its current rates were excessive and that the Commissioner would take all corrective action, including ordering refunds to policyholders of excessive premiums paid, if it were determined that in fact Allstate's rates were too high. AB 1051 would take away the Commissioner's power to hold companies like Allstate accountable for charging excessive rates.

AB 1051 says that once a rate is approved, refunds cannot be ordered, no matter how out of date the rate might be and no matter how long the insurer has frozen an unfair, excessive or illegal rate in place by fighting attempts to make its rates appropriate and compliant with the law. This directly contradicts the aforementioned requirement in Proposition 103 that "no rate shall ... *remain in effect* which is excessive, inadequate, unfairly discriminatory or otherwise in violation of [Prop 103]..." [section 1861.05 (a), emphasis added].

Section 2 Proposes a Workers Comp Nightmare For Auto, Homeowners and Commercial Insurance

Proposed section 11580.06 (h) deregulates insurance oversight in California by importing (from Ins Code Section 11732.5) the rules that failed the workers compensation system and devastated California businesses.

AB 1051 would amend section 11580.06 (h) to re-define the term "unfairly discriminatory," which is a key component of Prop 103's consumer protections. The Supreme Court has laid out a clear analysis of Insurance Code Section 1861.05 (a), in which "unfairly discriminatory" appears and the Court defines the terms broadly. This bill would instead apply a narrow, actuarial definition to the term that would, in practice, deregulate insurance rates, in spite of the Court's definitive ruling that the voter-enacted language is "unique" and therefore immune to such mechanical equations.

Just because a rate has an insurance company actuary's approval that it is high enough to cover whatever expenses the insurer wants to incur, or successfully implements insurance executives' marketing decisions, does not automatically mean that these expenses are in the best interests of consumers or even reasonable or fair as non-actuaries (in other words, the voters who enacted Proposition 103) use these words. Equating "excessive, inadequate or unfairly discriminatory" solely with actuarial science would reduce rate regulation in California to an empty gesture.

Under this definition, insurers would claim that any law or regulation requiring rates or premiums to be set in a manner that didn't fit the loss and expense costs that any insurer selected would be unfairly discriminatory. Within moments of this law taking effect, insurers would assert that current rules prohibiting insurance companies from prioritizing a driver's ZIP Code or marital status in premium-setting are unfairly discriminatory. Insurers will argue that their actuarial calculations indicate that married drivers have lower costs and expenses than unmarried customers and drivers living in one ZIP Code have higher costs than another and in each case the insurer must be allowed to charge those customers as they see fit, despite other laws and rules prohibiting the emphasis of those factors.

The California Supreme Court has clearly and squarely rejected any "actuarial" interpretation of Proposition 103's ban on "excessive, inadequate or unfairly discriminatory" rates in section 1861.05(a). Insurers have often argued in the courts and elsewhere that section 1861.05(a)'s prohibition against unfair discrimination evinces a voter intent to prevent any distribution of premium that does not hew to the preferences expressed by actuaries in the employ (and under the control) of the insurance companies. The California Supreme Court has summarily dispensed with this argument:

The insurers argue in substance that the [section 1861.05(a) standard] as defined in the initiative should be interpreted in accordance with the insurance industry's **or the actuarial profession's** understanding of its operative terms. We believe that subdivision (a) of Insurance Code §1861.05, as quoted above, stands in the way. *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal. 4th 216, 289. (Emphasis added.)

The reason the Supreme Court held that section 1861.05(a) cannot be interpreted according either to an actuarial definition or in light of "similar statutes" from other jurisdictions (*id.* at 289) is because:

We must observe that the "excessive/inadequate" standard as defined in Proposition 103 is itself apparently "unique" and without "precedent" among similar statutes." *Ibid.*

The California Supreme Court's decision in *Calfarm* also interpreted the "inadequacy" standard in section 1861.05(a) to embrace constitutional, not just actuarial, precepts. *Calfarm v. Deukmejian* (1989) 48 Cal.3d 805, 823, fn.15. These two California Supreme Court rulings conclusively "stand in the way" of the actuarial interpretation that is proposed in this bill.

This is why it is improper to read Section 1861.05(a)'s language in light of other California statutes invoking so-called "actuarial science." AB 1051 invokes section 11732.5 governing worker's compensation insurance to say that insurance presently subject to Prop 103 ratemaking standards would instead be regulated according to the standards established when workers compensation insurance was deregulated. (A decade of insurer insolvencies and rate spikes illustrated the devastating effect of deregulating workers' compensation insurance.)

Under AB 1051, insurers would argue that anything other than rates determined by their actuaries to be “cost-based” would be unfairly discriminatory. Adoption of this definition would prevent the Insurance Commissioner, in reviewing rate increases, from doing anything more than checking to see if insurer-employed actuaries got their own numbers right; i.e., whether the actuary’s arithmetic was correct. This means that the Commissioner would be powerless to review rates for reasonableness or fairness or establish standards prohibiting patently unfair practices.

This definition would be used to toss out everything from the current "excessive and inadequate" regulatory standard of Proposition 103 to the requirement that driving record and miles driven be more important in premium setting than ZIP Code and marital status.

Finally, for the record, most of the bill findings are alternately wrong or incomprehensible.

We believe that both parts of this proposal, if enacted, illegally violate Proposition 103 and would be rejected by the Courts. As such, this bill is not only anti-consumer, it is a waste of the precious taxpayer resources that will spent defending a doomed proposal sponsored by an insurer seeking to remove accountability for its habit of breaking consumer protection laws. We urge you to stop this attempt to raise consumer rates and immunize law-breaking by insurers and oppose this bill.

Sincerely,

Douglas Heller

Carmen Balber