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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF LOS ANGELES

SAM DONABEDIAN, individually, and on Behalf of Those Similarly Situated,

Plaintiff,

v.

MERCURY INSURANCE COMPANY, a Corporation; MERCURY CASUALTY COMPANY; CALIFORNIA AUTOMOBILE INSURANCE COMPANY; AMERICAN MERCURY INSURANCE COMPANY; MERCURY INSURANCE GROUP, an unknown entity, and DOES 5 through 100, inclusive,

Defendants.

THE FOUNDATION FOR TAXPAYER AND CONSUMER RIGHTS, on Behalf of the General Public,

Intervenor.

Case No. BC 249019

Honorable Victoria Chaney, Los Angeles County Superior Court Judge

THE FOUNDATION FOR TAXPAYER AND CONSUMER RIGHTS' OPPOSITION TO JOINT MOTION FOR PRELIMINARY APPROVAL OF PROPOSED SETTLEMENT

Date: October 30, 2006
Time: 11:30 a.m.
Dept.: 324
Judge: Hon. Victoria Chaney

Complaint Filed: April 20, 2001

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INTRODUCTION AND SUMMARY

Defendants (hereafter "Mercury") have never contested the core factual charges of this lawsuit: that Mercury employed an "absence of prior insurance" rating factor to surcharge certain motorists despite the explicit prohibition of Insurance Code section 1861.02(c). Rather, for more than five years, Mercury has bitterly fought to evade accountability for its actions, in an effort that has traversed the judicial, legislative and executive branches of California and consumed enormous time and judicial resources.

All of Mercury's efforts ultimately failed, and it appeared as if this case would finally proceed to discovery, when Donabedian and Mercury entered into settlement negotiations from which intervenor Foundation for Taxpayer and Consumer Rights (FTCR) was excluded. The result is a proposed settlement that snatches defeat from the jaws of victory. The (estimated) one million consumers victimized by Mercury's practices are to be offered *coupons* that may only be used to buy a new Mercury insurance product and, worse, cannot be used by existing automobile insureds – the people who were overcharged – to pay for their insurance renewal. (Indeed, it is unclear whether existing insureds would be authorized to use the coupons at all.) Moreover, the proposed settlement does not assure that Mercury will not employ other underwriting practices to recoup the value of the coupon in the form of a higher premium, or even refuse to honor the coupon.

Thus what is described as a $65 million settlement is little more than a marketing scheme for Mercury that could result in as little as a few million dollars back to the class, with Mercury permitted to keep the balance – clearly an *inadequate* result for class members. In exchange, Mercury would be released from liability not only for the actions complained of in this lawsuit, but for virtually any other unlawful underwriting activity it has engaged in. This is *unfair* to the class, as well as to present and former Mercury insureds who are not members of the class but who may have been the victims of other unlawful Mercury practices.

What is the rationale for failing to provide meaningful relief – i.e. cash refunds – to the class? According to Mercury and Donabedian, it's the "risk" that Mercury might somehow prevail on its "the Commissioner made me do it" defense. Never mind that the parties proffer this argument in the

absence of any discovery on the issue. Mercury has made this argument before and it has been shown to be devoid of factual basis or legal force. It is *unreasonable* to base a settlement on Mercury's defenses in the absence of any facts or law supporting them.

In their strikingly unsubstantiated motion, Mercury and Donabedian have failed to demonstrate that the proposed settlement is "fair, reasonable and adequate." Coupon settlements undermine public confidence in the judicial system and are now disfavored in the federal courts. Concealing its conduct from the public and the Commissioner, Mercury overcharged its insureds, and they are entitled to their money back. A settlement on their behalf should not result in a financial or marketing windfall for the defendant. Nor, as a matter of public policy, should injured consumers be forced to do business with the wrongdoer in order to be made whole. FTCR respectfully urges this court to reject the settlement in its present form.

BACKGROUND

A. The Foundation for Taxpayer and Consumer Rights (FTCR)

Established in 1985, FTCR is a nationally recognized non-profit public benefit corporation. FTCR's core mission is to defend, enforce and monitor the implementation of Proposition 103. FTCR and its attorneys have participated in virtually every lawsuit concerning Proposition 103's constitutionality and scope, including the presentation of an exhaustive amicus and oral argument before the Court of Appeal in this case, as well as in dozens of proceedings initiated pursuant to the measure's provisions. FTCR has brought four suits against insurers for violations of Proposition 103 similar to those alleged here, and has recently settled one of them – for cash refunds. (See Exhibit 1 [FTCR Press Release, April 3, 2006].) FTCR was granted intervention in this case on April 24, 2005.

B. Proposition 103

Insurance Code section 1861.02(a)[1] states that "[r]ates and premiums for an automobile insurance policy . . . shall be determined" principally by three specified rating factors (known as the

[1] All statutory references are to the Insurance Code unless otherwise designated.

"mandatory" factors) (section1861.02(a)(1)-(3)) and by other rating factors (known as "optional" factors) that "the commissioner may adopt by regulation and that have a substantial relationship to the risk of loss." (section 1861.02(a)(4).) The statute commands that, "Notwithstanding any other provision of law, the use of any criterion without such approval shall constitute unfair discrimination." (*Ibid.*) Proposition 103 bars the use of only one rating factor. Section 1861.02(c) provides: "The absence of prior automobile insurance coverage, in and of itself, shall not be a criterion for determining . . . automobile rates, premiums, or insurability."

C. Regulations Governing Section 1861.02(c)

As originally adopted in 1996, regulations promulgated by the Commissioner included "persistency" as one of sixteen optional rating factors.[2] The 1996 regulations did not define persistency, because it was, and remains, a long-established term of art within the industry. It means the length of time a person has been insured *by the company writing the coverage*. In effect, persistency is used to reward a customer's loyalty.

It subsequently became apparent that some insurance companies had adopted practices that violated section 1861.02(c) and the regulations. In May 2001, FTCR petitioned the Insurance Commissioner to amend the regulations to specifically forbid insurers from applying the approved "persistency" rating factor in a manner that violated Proposition 103. Agreeing, the Commissioner observed that "some" unnamed insurers "may have impermissibly required consumers to provide evidence of prior insurance" under the rubric of "persistency," in violation of section 1861.02 (c). (See Exhibit 2 [Cal. Dept. of Ins., Statement of Initial Reasons, RH-402 (Dec. 21, 2001)], pp. 1-2.)

Mercury was one such insurer. As is alleged in both Donabedian's complaint and FTCR's complaint-in-intervention, Mercury had secretly and improperly applied the persistency rating factor so as to grant a "persistency" discount not only to its own loyal insureds, but to any applicant previously insured *by any other company*. The net effect of this unannounced revision of the common meaning of "persistency" was to grant discounts to all previously insured motorists. Because insurance rates are a

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[2] See Cal. Code Regs., tit. 10, § 2632.5, subd. (d)(11).

"zero sum game," providing discounts to previously insureds results in overcharges for those previously *uninsured*. (For an explication of the reasoning and math, see *The Foundation for Taxpayer and Consumer Rights v. Garamendi* (2005) 132 Cal.App.4th 1354, 1367-1368.) In written comments, Mercury's counsel insisted that its practice comported with section 1861.02(c). However, the Commissioner explicitly rejected Mercury's argument, finding that "[t]he costs of a discount to a person previously insured is borne by those who do not have prior insurance," creating, "in effect[,] a surcharge to those without prior insurance." (See Exhibit 3 [Cal. Dep't of Ins., Final Statement of Reasons, RH-402 (July 26, 2002)], p. 10.) On September 26, 2002, Commissioner Low amended the regulations to define "persistency" as it had traditionally been understood, expressly rejecting the redefinition Mercury utilized, in order to ensure that insurers would not violate the prohibition of section 1861.02(c). (Cal. Code Regs., tit. 10, § 2632.5(d)(11).)

D. The *Donabedian* Case

Though the new regulation clearly barred Mercury's misuse of the persistency rating factor, Mercury continued its illegal practice. In this litigation, Mercury commenced a challenge to Donabedian's right to sue for violations of Proposition 103's provisions. Mercury insisted that its practices had been approved by the Department and that therefore lawsuits such as this one were barred by statutes. FTCR as well as the California Department of Insurance submitted extensive amicus briefs before the Court of Appeal in this and a nearly identical case, *Poirer v. State Farm Mutual Auto. Ins. Co.* (B165389) 2004 WL 2325837, in 2003. The Court of Appeal's decision adopted many of the arguments made by FTCR and CDI to uphold the private right of action provided by Proposition 103. The Court of Appeal expressly declined to resolve the issue of whether CDI had approved of Mercury's practice, and if so, the legal import of such approval. (*Donabedian v. Mercury Insurance Co*. (2004) 116 Cal.App.4th 968, 994-995 ["*Donabedian*"].)

E. SB 841 Litigation

In addition to its unsuccessful challenge to the right of Donabedian to bring this suit, Mercury sought legislative relief. In 2003, it sponsored passage of an amendment to section 1861.02(c), Senate Bill 841 (SB 841), that purported to *legalize* Mercury's misuse of the persistency rating factor, which

Mercury had by then renamed, employing the oxymoronic term "portable persistency." Before this court, Mercury offered SB 841 as "evidence" that the practice challenged here was legal all along.

FTCR and other consumer organizations challenged the validity of SB 841 on the grounds that it did not "further [the] purposes" of Proposition 103 and therefore was void as an unconstitutional act. Mercury intervened in the proceeding. The Court of Appeal invalidated the legislation.[3] (*The Foundation for Taxpayer and Consumer Rights v. Garamendi* (2005) 132 Cal.App.4th 1354.)

The Court of Appeal in *FTCR v. Garamendi* made several determinations regarding Mercury's "portable persistency discount" that are determinative in this case. After carefully construing section 1861.02(c) and the Commissioner's regulation, the Court held that Mercury's view of "persistency," enshrined in SB 841, did not comport with section 1861.02(c):

> By allowing insurers to grant a discount on the basis of whether an applicant was previously insured by any insurer, Sen. Bill 841 in effect excludes only the previously uninsured from the benefit of the discount. Based on the showing below, Sen. Bill 841 would permit insurers to surcharge previously uninsured drivers to fund discounts for drivers with prior or persistent insurance. Whereas the voters had *prohibited* insurers from using the absence of prior insurance coverage as a premium criterion to promote fairness for previously uninsured drivers now required to purchase insurance under California law, Sen. Bill 841 *authorizes* insurers to use that criterion to determine whether a policyholder's premium will be discounted or surcharged.

(*Id.* at 1366.)

F. The Settlement Process

Despite, or perhaps because of, FTCR's extensive experience with insurance regulation and insurance practices, Mercury has vehemently resisted FTCR's participation in the proceeding, and in the mandatory settlement conference in particular. At Mercury's insistence, FTCR was excluded from participation in the negotiations before Judge West that led to the proposed settlement. While FTCR submitted two statements during that process that were served upon the other parties, Mercury did not provide its statements to FTCR.

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[3] By separate decision, the Court of Appeal affirmed an order by the Superior Court that held that the anti-SLAPP motion filed by Mercury as an intervenor in FTCR's case was frivolous. (*The Foundation for Taxpayer and Consumer Rights v. Garamendi* (2005) 132 Cal.App.4th 1375.)

STANDARD OF REVIEW OF PROPOSED SETTLEMENT

Class action settlements, unlike typical settlements, require court approval for "the protection of those class members . . . whose rights may not have been given due regard by the negotiating parties." (*Dunk v. Ford Motor Co*. (1996) 48 Cal.App.4th 1794, 1801.) In order to protect the due process rights of absent class members, the Court cannot approve the settlement unless it independently evaluates the evidence and determines that the settlement is "fair, reasonable and adequate to all concerned." (*Wershba v. Apple Computer, Inc.* (2001) 91 Cal.App.4th 224, 245.) To make this determination, "the court must examine *whether the interests of the class are better served by the settlement than by further litigation*." (Herr, *Annotated Manual for Complex Litigation* (Fourth Edition, 2006) § 21.61, p. 413.)

Heightened scrutiny is required here because the parties reached a settlement prior to class certification and are no longer in an adversarial posture. (See *id*., § 21.612, p. 416; see also *Amchem Prods., Inc. v. Windsor* (1997) 521 U.S. 591, 620-21 [holding that the rights of absent class members "demand undiluted, even heightened, attention in the settlement context"].)

Courts and commentators have also noted several "red flags" in proposed settlements requiring particular vigilence: (1) settlements "granting class members illusory nonmonetary benefits, such as discount coupons for more of defendants' product" (Herr, *supra*, § 21.61, p. 414); (2) settlements reached before discovery, where "it may be more difficult to assess the strengths and weaknesses of the parties' claims and defenses…and to consider how class members will actually benefit from the proposed settlement" (Herr, *supra*, § 21.612, p. 416); (3) settlements where "defendants have incentives to restrict payment of claims because they may reclaim residual funds" (*Id*., § 21.62, p. 420). These red flags are present here.

The parties seeking approval bear the burden of showing that the settlement is fair, reasonable and adequate. (*Oldham v. Cal. Capital Fund, Inc.* (2003) 109 Cal.App.4th 421, 434.)

ARGUMENT

I. THE COURT SHOULD NOT APPROVE THE SETTLEMENT BECAUSE THE PARTIES HAVE FAILED TO SHOW THAT IT IS FAIR, ADEQUATE AND REASONABLE.

A. The Parties Have Failed to Document the Basis for their Estimates of the Size of the Class and the Amount of the Overcharges.

As a preliminary matter, FTCR notes that the parties' papers fail to substantiate in any way their estimate of the size of the class ("over one million" policyholders between April 20,1997 and December 5, 2005 [Plaintiff's Memorandum of Points and Authorities in Support of Joint Motion (Plaintiff's Mem.), p. 10]) or the amount of the overcharges experienced by the class ("in excess of $65 million" [Plaintiff's Mem., p. 6]). There has been no discovery on this (or any other) question – a red flag that calls for judicial intervention. There is no indication that an actuary or others with the necessary expertise have independently confirmed these data points. Indeed, based upon a regulatory filing made by Mercury on November 16, 2005 at the order of the Commissioner, FTCR has calculated that the unlawful surcharge to Mercury policyholders for the first nine months of 2005 *alone* was more than $35 million. (See Exhibit 4 [Filing Memorandum and Persistency Removal Dislocation Exhibit, filed November 16, 2005].) Mercury's filing calls into question the undocumented estimate of $65 million. The fairness, adequacy, and reasonableness of the proposed settlement cannot be properly assessed by the court (and members of the class) until the necessary information is provided – for the public record – and has been reviewed by a qualified expert.

B. The Coupons Would Provide Inadequate Relief.[4]

The most compelling reason to reject the proposed settlement is its use of "Premiums Rebate Certificates" - coupons - for financial relief.

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[4] Mercury and Donabedian highlight Mercury's agreement to injunctive relief as a benefit of the settlement (see, e.g., Plaintiff's Mem., p. 10), but after a regulation, two appellate rulings and an order of the Commissioner, Mercury has little choice but to comply with the law. Memorializing Mercury's responsibility to obey the law is important but not such a benefit to the class as to outweigh the inadequacy of the coupon relief proposed here.

There is growing concern among courts, policy makers, and the public that class action settlements involving coupons are improper, and they are now disfavored under federal law (see 28 U.S.C.A. § 1712). Two key factors which this Court should consider in determining the adequacy of the coupon portion of the settlement agreement here, and on which the parties have provided *no information*, are: (1) the likelihood the coupons will be redeemed (see, e.g. *Buchet v. ITT Financial Corp.* (D.Minn. 1994) 845 F.Supp. 684, 684-86, *amended* 858 F.Supp. 944 (D.Minn. 1994) (*Buchet*) [rejecting coupon settlement after reviewing redemption rate in a previous case involving the same defendant]) (for convenience, copy attached as Exhibit 5),[5] and (2) their actual value if redeemed (*id*. at 693 [rejecting the argument of proponents that the Court need only look to face value of scrip certificates stating that "the true value of the certificates to the class depends on when the certificates will be used, how they will be used, and who will be using them"].)[6] Courts have criticized and rejected coupon settlements as inadequate and unfair, citing to the low redemption rates and value to defendants as inducements to purchase their own products, among other reasons. (See *Dunk v. Ford Motor Co.*, *supra*, 48 Cal.App.4th 1794, 1805 [stating that "questions arise as to the value of a settlement where" … "the coupon relates to a 'big ticket item,' is not transferable, represents only a tiny

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[5] Because of this potential for low redemption rates in coupon settlements, The National Association of Consumer Advocates (NACA), a well-respected national non-profit organization, has recommended in its guidelines for the settlement of consumer class actions that

> [a] settlement involving certificates should require a minimum level of redemption by the class members within a reasonable period of time.
>
> . . .
>
> [c]lass counsel and defendants should submit to the court and all counsel of record detailed information about redemption rates and coupon transfers during the entire life of the coupon. By doing so, a public record will be made of what works and what does not work in non-cash settlement cases.

(National Ass'n of Consumer Advocates, Standards and Guidelines for Litigating and Settling Consumer Class Actions ["NACA Guidelines"], § 2C, 176 F.R.D. 383 (1998) [a copy of the NACA Guidelines is attached hereto for the Court's convenience as Exhibit 6]).

[6] As the NACA guidelines point out, "for most of the class, redemption may not be an option, because they are unwilling or unable to make a future purchase. Thus, the class members are not equally compensated—some get more, others get less." (NACA Guidelines, § 2B, *supra*, 176 F.R.D. 383.)

percentage of the purchase price, and is valuable to the defendant as an inducement to promptly purchase the defendant's product"].)

Limitations of Coupons.[7] Assuming that $65 is a reasonable measure of the damages incurred by each class member, the actual value of the coupons here is likely to be significantly less, for several reasons. First, unlike cash, which is fungible, the coupons can only be used to purchase a Mercury product. Courts have properly rejected settlements where the coupons were "little more than a sales promotion" for the defendant. (*In Re Gen. Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig.* (3rd Cir. 1995) 545 F.3d 768, 818-19, attached for convenience as Exhibit 7.) Requiring that members of the class do business with the defendant that has wronged them is inherently unfair.

Worse, the coupons can only be used to purchase a *new* insurance policy from Mercury. *They cannot be used to pay for renewal of an existing auto insurance policy.* Thus, current auto insureds who were victimized by Mercury's conduct are barred from applying their "relief" to reduce the cost of the insurance for which they were previously overcharged. Indeed, several of the documents submitted to the court appear to exclude any member of the class that has an in-force Mercury auto policy from receiving the coupons; these class members would be entitled to *no relief*.[8]

Redemption rates. Coupon redemption rates generally average in the single digits. (See, e.g., Tharin, J. and Blockovich, B., *Coupons and the Class Action Fairness Act,* 18 Geo. Journal of Legal Ethics 1443, 1445 (Fall 2005) [redemption rates of one to three percent]; Judge Thomas A. Dickerson,

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[7] It should also be noted that class members receive only one coupon, no matter how many or few Mercury policies they paid for. (Agreement, p. 6, Section III B.) Some class members will therefore receive far less relief for their overcharges than others.

[8] The settlement agreement provides that "each member of the Class who does not opt out" shall receive the coupons (Agreement, pp. 5-6). However, the Stipulation Regarding Settlement of Class Claims provides that coupons will only be provided to "each Class Member who, as of the Effective Date does not have an in-force California private passenger automobile insurance policy issued by a Defendant." (P. 3, ¶7b [sic-there is no ¶8].) And Plaintiff's Mem. states that "Premium rebates will be made available to all Class Members who no longer own a Mercury private passenger automobile policy with Defendants…" (P. 6, line 23.) The latter formulations would exclude existing auto insurance policyholders from the coupon relief.

Consumer Class Actions and Coupon Settlements: Are Consumers Being Shortchanged? ADVANCING THE CONSUMER INTEREST (Sept. 2000), p. 6 [redemption rates of two to six percent]). Here, because the coupons are subject to highly restrictive conditions, the rate could be quite low. Thus, what the parties herald as a $65 million settlement could be worth as little as $1.3 million (at 2%) to $3.9 million (at 6%). Mercury and Donabedian proffer no substantive information in their motion and accompanying papers regarding redemption rates; they simply "assume that the redemption rate … will be high" because Mercury is a big company "with very competitive rates." (Plaintiff's Mem., p. 10.) Thus there is no basis to believe that redemption rates here will deviate from the low levels predicted by historical experience.

Another aspect of the settlement suggests that the parties themselves expect a poor redemption rate. In a true $65 million settlement, the plaintiff's attorneys could properly expect a contingency fee of 20% or more. Here, Donabedian's counsel have agreed to a fee cap of $1,575,000, only 2.4% of $65 million. (Agreement, pp. 8-9.) That suggests recognition that the actual redemption rate will be minimal. At a 2% redemption rate – $1.3 million in redemptions – the agreed upon fee award would represent a 121% contingency fee. To reach a more appropriate 25% contingency level, redemptions would equal only $6,300,000 – about ten percent of the total estimated relief to which the class is entitled.

Protections re underwriting. Another severe flaw in the coupon-based relief proposed here is that there is no guarantee that Mercury will accept the coupons and sell a policy to any member of the class who desires to purchase one. Mercury might claim that some recipients may no longer qualify for automobile coverage, or Mercury might simply attempt to charge higher premiums to coupon users to offset the coupon value. Similar considerations led the court to reject the settlement in *Buchet*, *supra*.[9]

Transferability. Though transferability of the coupons is considered a plus in coupon settlements, no evidence has been adduced to support the implication that class members here will be

[9] A related omission in the proposal is an agreement by Mercury not to raise rates in the future in order to recoup the value of redeemed coupons from policyholders.

able to engage in the complex process of marketing the coupons to other applicants (who might find the coupon worthless if Mercury will not underwrite them) or insureds. In reality, the time and expense involved in selling the coupons – at, by necessity, a substantial discount – will eradicate 100% of the coupon's value to class members. In any case, injured class members should not have to participate in such a process in order to attempt to make themselves whole.

In light of these considerations, the settlement likely will provide only minimal relief for the class. Mercury and Donabedian cite *Dunk*, *supra*, in support of their proposal. However, the Court in *Dunk* emphasized the importance of several elements that are missing here: first, there had been "extensive discovery" through which counsel could gauge the strength of their case (*id*. at 1802), a fundamental issue here, as discussed below in greater detail. Second, class certification had been adversarial (*id*. at 1803). Moreover, *Dunk* was a mass tort (product liability) case, and the court opined that "due regard should be given to what is otherwise a private consensual agreement between the parties." (*Id*. at 1801.) This, by contrast, is a case brought under the Unfair Competition Law, which protects both consumers and competition – including other insurance companies that have the right to expect a level playing field – and is therefore imbued with concern for the broader public interest. (See *Kasky v. Nike, Inc.* (2002) 27 Cal.4th 939, 949.)

Mercury and Donabedian have not met their burden of demonstrating the fairness, adequacy and reasonableness of the coupon relief.

C. The Proposal Does Not Guarantee any Minimum Payment to the Class.

Under the terms of the proposal, Mercury will retain the value of any unclaimed class benefits. There is no provision requiring Mercury to continue to issue coupons until a minimum number are redeemed, or to specify a *cy pres* award to a charitable organization if the total amount of redeemed vouchers falls short of a specified minimum. Given the combination of a likely low redemption rate and no requirement for the next best use of the funds, it is clear that the principle beneficiary of this settlement would be Mercury. Courts have rejected such settlements. (See, e.g., *Sylvester v. Cigna Corp.* (D. Me. 2005) 369 F.Supp.2d 34, 53 [finding that a claims rate of less than 20% combined with a clause permitting the unclaimed funds to revert to defendant "work[ed] in concert to produce a

settlement that is unfair, inadequate and unreasonable and that in practice yields comparably little for the Class"]; *Buchet*, *supra*, 845 F.Supp. at 696, as amended 858 F. Supp. 944 [finding settlement unreasonable due to low claims rate and "the lack of any form of guaranteed minimum value"].

D. The Proposal Requires a Manifestly Unfair Release by the Class.

In exchange for the paltry benefits discussed above, the proposal grants Mercury a full release not only from violations of section 1861.02(c) – the target violation of this lawsuit – but from any other claims that class members may have against Mercury for any "purported violation of Insurance Code section 1861.02" (the section of Proposition 103 that governs the general underwriting practices of automobile insurers) "now or in the future." (Agreement, p. 5, "K. Settled Claims.") Donabedian has no right to agree to the forfeiture of the rights of Mercury policyholders to prosecute the company for violations that are not the subject of this suit.

E. The Class Is Likely to Do Better if this Case Goes to Trial Than Under the Proposed Settlement.

There are many serious flaws in the proposed settlement, as FTCR has demonstrated. *They all proceed, however, from a fundamentally incorrect premise: that Mercury secured regulatory approval for its practice, and that its conduct, though illegal, is thereby immunized from liability.*

Mercury has been asserting this defense for years. In amicus briefs before the Court of Appeal, both FTCR and the Department of Insurance disputed Mercury's factual and legal arguments on this point. Donabedian himself solidly rebutted Mercury's arguments in his February 2005 Motion for Judgment on the Pleadings, which remains pending. But Donabedian has undergone an inexplicable conversion. He now tells this court: "The primary reason why this settlement is fair and reasonable is the huge uncertainty of whether Plaintiff could achieve a better result if this matter proceeded to trial.... there is a great deal of doubt as to whether Plaintiff would be able to recover anything on behalf of the class for that violation" based on Mercury's "safe harbor" and "estoppel" defenses. (Plaintiff's Mem. p. 10-11.)

Discovery that would have answered this preeminent issue was, unfortunately, delayed pending settlement discussions, a fact that by itself militates in favor of rejection of the proposal. (*Dunk, supra*,

at 1802; *Herr, supra,* at 419; *Wershba v. Apple Computer, Inc.* (2001) 91 Cal.App.4th 224, 234-235.) The result is a lopsided settlement that assumes Mercury's defenses are credible. They are not, as FTCR will summarize here.

First, Mercury's practice was not approved. Pursuant to section 2632.1, et seq. of title 10 of the California Code of Regulations, Mercury is required to submit a "class plan," which contains the list of automobile rating factors Mercury proposed to utilize. As FTCR pointed out in its amicus brief, and the *Donabedian* court confirmed, the official "checklist" filed by Mercury did not disclose to either the Commissioner or the public that Mercury had unilaterally redefined persistency so as to penalize the previously uninsured. (See Brief Amicus Curiae of the Foundation for Taxpayer and Consumer Rights, December 5, 2003, pp. 21-24 ["FTCR Amicus"], Exhibit A to Declaration of Harvey Rosenfield in Support of FTCR's Ex Parte Application for Leave to Intervene, April 26, 2005; *Donabedian, supra*, at 993-994.) For the Court's convenience, several Mercury checklists are attached as Exhibit 8.

Mercury has claimed that members of the Commissioner's staff "suggested" and "encouraged" Mercury to apply its redefinition of persistency. (Defendants' Memorandum of Points and Authorities in Support of Joint Motion, pp. 2-3.) Before the Court of Appeal, Mercury provided documents it characterized as orders from CDI. However, FTCR closely examined these documents, and submitted information, including additional CDI documents, which demonstrate that these documents were drafts, as the Court of Appeal noted. (See FTCR Amicus, p. 23, fn. 35; *Donabedian* at 993-994.)

Second, there is no "safe harbor" in either the statutes or case law for violation of an express statutory prohibition of Proposition 103. To find a "safe harbor," *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Company* (1999) 20 Cal.App.4th 163 requires that a statute specifically provide one. *Donabedian* confirmed that provisions of the Insurance Code do not address, much less immunize, the conduct challenged here. In *Krumme v. Mercury Ins. Co*. (2004) 123 Cal.App.4th 924, the Court of Appeal eviscerates Mercury's argument that actions by Department personnel could constitute a "safe harbor"; *Krumme* states that even "administrative regulations are insufficient to create a safe harbor from UCL liability." (*Id.* at 940, fn. 5, and 946.) An administrative agency simply does not have the authority to *approve* an action that violates a state law; such an approval would be *ultra*

vires. (See, e.g., *Assoc. for Retarded Citizens v. Dept. of Development Svcs.* (1985) 38 Cal.3d 384, 391; *AICCO v. Insurance Company of North America* (2001) 90 Cal.App.4th 579.)

As for the administrative estoppel argument put forward on behalf of Mercury (Plaintiff's Mem. at 5, 11), that doctrine only bars an agency from contradicting itself. (See 11 Witkin, Summary of California Law (9th Edition, 1990) Equity, § 182, p. 864; § 177, pp. 858-859.) *It does not apply to bar the claims of innocent third parties, such as the class.* (*Id*. at § 177, p. 859.) Even if the court were to apply it to the class, Mercury bears the burden of showing that the CDI had actual knowledge of Mercury's unlawful practice, issued its approval of Mercury's practice with the intent to induce Mercury to commit the unlawful practice, and that Mercury had no knowledge that the practice was unlawful. (*Ibid*.) Mercury has offered no evidence to meet its burden, and the appellate record here strongly suggests it cannot. But even if Mercury did, "there can be no estoppel where it would defeat operation of a policy protecting the public" (*id*. at §183, p. 864) or where the action was beyond the agency's power (*id*. at §184, p. 866). Both conditions apply here.

CONCLUSION

The defects in the proposed settlement agreement are numerous and profound. The use of coupons is neither good for the class nor for public policy, and the parties have not met the high burden of justifying their use. The actual value of this proposed settlement to the class is likely to be, at best, one-tenth of the parties' own unsubstantiated estimate of the overcharges. It is not even clear who will be allowed to use the coupons. To the extent the coupons are redeemed, the conditions of their use transform the class relief here into a marketing bonanza for Mercury. And any relief not utilized remains in the coffers of the company, a further windfall. On top of that extraordinary largesse, Mercury would receive a release of claims far broader than the narrow issue adjudicated here. In its present form, this settlement is not fair, adequate and reasonable, and should be rejected.

FTCR understands litigation risk and would not object to a reasonable settlement involving compromise by the class in order to resolve this case. But real harm has been done here. A statute has been flouted. The victims of Mercury's practice are out of pocket real money. After six years of

continuous litigation, Mercury has failed in its efforts to defeat this suit. Yet this settlement would give Mercury the victory that has eluded it in the courts.

Judging from the settlement terms, it would appear that the parties believe, after all this time, that Donabedian's chance of prevailing is poor. But nothing in the joint motion and accompanying documentation provided by the parties in support of the request for preliminary approval justifies such a conclusion.

FTCR believes that rather than submit to the limited relief, it would be in the best interests of the class and the public at large to conduct discovery and adjudicate what is obviously the central issue: whether Mercury's nearly ten year violation of the law and subsequent regulations were based upon "an innocently mistaken view of what the Department of Insurance had instructed Mercury to do" (Plaintiff's Mem., p. 11) and whether the defendants are therefore immunized from liability. FTCR does not share Donabedian's concern that a "trial court sitting in equity" will decide Mercury owes its policyholders nothing. Neither the facts, nor, especially, the law, sanction such a result. If Mercury has something more persuasive to offer in support of its defense, it ought to be required to put it forth now. In its absence, FTCR believes that the opportunity for refunds with interest greatly outweighs the risk. Although the interests of the class are paramount, other broader interests are implicated here, too. Insurance companies and the public need to know what the consequences will be when the law is broken.

Dated: October 24, 2006

Respectfully Submitted,

THE FOUNDATION FOR TAXPAYER AND CONSUMER RIGHTS
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BY:_____

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