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BEFORE THE INSURANCE COMMISSIONER

OF THE STATE OF CALIFORNIA

In the Matter of the Rate Application of Allstate Insurance Company, Allstate Indemnity Company, Northbrook Indemnity Company, Applicants.	FILE NO.: PA-2013-00003 **CONSUMER WATCHDOG'S OBJECTION TO CDI AND ALLSTATE OCTOBER 21, 2013 STIPULATION AND REQUEST FOR PROPOSED DECISION AND ORDER** **REQUEST FOR HEARING PURSUANT TO CAL. CODE REGS., TIT. 10, § 2656.1(g)**

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I. INTRODUCTION

Consumer Watchdog ("CWD") hereby objects to the October 21, 2013, Joint Stipulation and Request for Proposed Decision and Order ("October 21 Stipulation") filed by the California Department of Insurance ("CDI" or "Department") and Applicants Allstate Insurance Company, Allstate Indemnity Company, and Northbrook Indemnity Company ("Allstate"), and requests a hearing on the proposed stipulation pursuant to California Code of Regulations, title 10 ("10 CCR"), 2656.1(g). Specifically, Consumer Watchdog objects to Allstate's proposed "affinity groups," which are based on, among other things, occupational and educational status. The use of such rating classifications violates Insurance Code section 1861.02[1] and is unfairly discriminatory in violation of Insurance Code section 1861.05.[2] Under the rates proposed, Allstate seeks to implement new discounts for its wealthier, more educated customers, which, by law, must be offset by surcharging its blue-collar, less educated customers.

Instead of providing any analysis to support their contention that the proposed "affinity groups" fall under Insurance Code section 1861.12, the CDI and Allstate merely point to the CDI's previous approval of applications by other insurance companies containing similar types of groups. The fact that the agency permitted some of those applications to take effect (none of which were ever subject to a formal public hearing) says nothing about the legality of Allstate's proposed "affinity groups."

Indeed, the argument proffered by the CDI and Allstate – that the agency's approval of "affinity groups" has been a rule of general application implementing the statute – is fatally flawed. Such a rule of general application is a "regulation," as defined under the Administrative Procedures Act ("APA"), and the Department is prohibited from applying such a rule unless it was adopted pursuant to the rulemaking provisions of the APA, Government Code section 11340

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[1] All Code citations are to the Insurance Code, unless otherwise stated.

[2] While this brief identifies Consumer Watchdog's objections to Allstate's proposed "affinity groups" in connection with the proposed October 21 Stipulation, this brief is neither intended to be nor should it be construed as Consumer Watchdog's full statement of the factual and legal issues in dispute in this matter or pertaining to "affinity groups" in particular.

et seq. The CDI has never adopted such a regulation, and therefore the agency's application of the rule is an underground regulation, which is forbidden by law.

In sum, because the classifications violate Proposition 103, result in unfairly discriminatory rates, and are based, according to the CDI itself, on an illegal underground regulation, the October 21 Stipulation is fundamentally unfair and not in the public interest, and therefore must be rejected.

II. THE ADMINSTRATIVE LAW JUDGE MUST EVALUATE THE PROPRIETY OF THE PROPOSED AFFINITY GROUPS, AND MUST REJECT THE OCTOBER 21 STIPULATION AFTER FINDING THAT THEY ARE NOT APPROVED RATING FACTORS.

10 CCR § 2656.2 provides:

> The administrative law judge shall reject a proposed stipulation or settlement whenever, in his or her judgment, the stipulation or settlement is not in the public interest and is not, taken as a whole, fundamentally fair, adequate, and reasonable.

Because the proposed stipulation would allow Allstate to charge rates that violate the Insurance Code and the prior approval regulations, it would categorically not be in the public interest and would be fundamentally unfair, inadequate and unreasonable.

During a Scheduling Conference on October 14, 2013, and in the Order Following Scheduling Conference on October 14, 2013, the Administrative Law Judge stated that he "would not rule on the legitimacy or legality of the proposed affinity group programs." In a prior ruling, however, the Administrative Law Judge correctly ruled that the affinity groups are "not fair, just, or equitable," and "[n]one of the Optional Factors fit the Allstate affinity program." (Decision Rejecting Proposed Settlement, Sept. 24, 2013, pp. 2, 3.) While the Administrative Law Judge subsequently withdrew his September 24, 2013, Decision Rejecting Proposed Settlement, the fact that the "affinity groups" were specifically identified as requiring a rejection of the parties' original proposed stipulation necessitates that the Administrative Law Judge evaluate the legality and fairness of said "groups" in determining whether the October 21 Stipulation is "in the public interest" or "fundamentally fair, adequate, and reasonable."

Such evaluation will necessarily lead to rejection because the proposed "affinity groups" both violate the Insurance Code and are premised on an illegal underground regulation.

III. THE OCTOBER 21 STIPULATION MUST BE REJECTED BECAUSE THE AFFINITY GROUPS VIOLATE INSURANCE CODE SECTIONS 1861.02 AND 1861.05.

Insurance Code section 1861.02(a) mandates:

> Rates and premiums for an automobile insurance policy, as described in subdivision (a) of Section 660, shall be determined by application of the following factors in decreasing order of importance:
>
> (1) The insured's driving safety record.
>
> (2) The number of miles he or she drives annually.
>
> (3) The number of years of driving experience the insured has had.
>
> (4) Those other factors that the commissioner may adopt by regulation and that have a ***substantial relationship to the risk of loss***. . . . . Notwithstanding any other provision of law, the use of any criterion without approval shall constitute unfair discrimination. (Emphasis added.)

As explained by the Court of Appeal in *Foundation for Taxpayer and Consumer Rights v. Garamendi* (2005) 132 Cal.App.4th 1354, 1372:

> the voters limited the Insurance Commissioner's authority both substantively and procedurally. Substantively, the Insurance Commissioner may adopt only those optional rating factors having a "substantial relationship to the risk of loss." (§ 1861.02, subd. (a)(4).) Procedurally, the Insurance Commissioner may do so only in the context of a formal rulemaking proceeding with established rights of public participation and judicial review. (*Ibid.*)

10 CCR § 2632.5(d), among other things, lists the "optional rating factors" that have been adopted by the Commissioner by regulation, pursuant to section 1861.02(a)(4).

Additionally, both the statute and the regulations require determining the "weight" of rating factors – that is "the average effect on the premiums of all policyholders" – to be calculated and adjustments made so that, among other things, none of the optional rating factors outweighs the three mandatory factors. (See 1861.02, subd. (a)(4); 10 CCR § 2632.8; *Spanish Speaking Citizens' Foundation, Inc. v. Low* (2000) 85 Cal.App.4th 1179, 1189.)

Allstate's proposed "affinity group" discounts based on occupation, education, and homeownership, among other classifications, are clearly "rating factors" as that term is defined

under the Commissioner's regulations,[3] but they are not among the sixteen optional rating factors, which have been specifically *authorized* by the Commissioner and set forth in the regulation as required by section 1861.02(a)(4). (See 10 CCR § 2632.5(d).) Nor have they been adopted after a public hearing. Indeed, neither Allstate nor the Department has provided *any* evidence that the selected discounts are in any way related to the risk of loss, much less meet the "substantial relationship" requirement in the statute.

Moreover, there is no evidence that shows whether Allstate's proposed use of these unauthorized rating factors complies with the factor weighting requirements in 10 CCR § 2632.8. It is entirely possible that, as proposed by Allstate, these classifications have a greater weight and impact on premiums than the three mandatory factors – a result that also violates Insurance Code section 1861.02(a). It was precisely to prevent such irrational, arbitrary and unjust discrimination that the voters enacted the process for regulating rating factors contained within Proposition 103.[4]

Indeed, these "affinity groups" are simply an end run around section 1861.02(a): they would allow Allstate to surcharge the majority of its policyholders based solely on the fact that they do not have a preferred characteristic such as a professional occupation, four-year college degree, or own a home. Because the auto rating factor process established by Proposition 103 is a revenue-neutral, "zero-sum" system (see generally *The Foundation for Taxpayer and Consumer Rights v. Garamendi* (2005) 132 Cal. App. 4th 1352, 1367-1368), those who do not "qualify" for the "affinity groups" – for example, drivers who aren't members of an elite profession, who have lost jobs, are students, or rent instead of own their residence – are required to pay higher premiums to subsidize those who do qualify.

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[3] "Rating factor" is defined as "any factor, including discounts, used by an insurer which establishes or affects the rates, premiums, or charges assessed for a policy of automobile insurance." (10 CCR § 2632.2(a).)

[4] Declaring that "the existing laws inadequately protect consumers and allow insurers to charge excessive, unjustified and arbitrary rates," (Prop. 103, uncodified § 1 [Findings and Declaration]), the voters adopted the initiative to "protect consumers from arbitrary insurance rates and practices" and "ensure that insurance is fair, available, and affordable for all Californians." (Prop. 103 uncodified § 2 [Purpose].)

Here, the "Standard" program (i.e., people who do not have the elite characteristics preferred by Allstate) will pay an average surcharge of 1.24% in order for "Specialized Professionals" and "Professionals" to get a discount of 2.47%, and homeowners to get a 2% discount, among others. (See October 21 Stipulation, ¶ 2.) On its face, these are unfairly discriminatory rates in violation of Insurance Code section 1861.05(a). Additionally, Insurance Code section 1861.02(a)(4) expressly states that unapproved rating factors are unfairly discriminatory and unlawful. As such, the proposed rates violated both sections 1861.02(a) and 1861.05(a).

IV. CDI AND ALLSTATE IMPROPERLY SEEK TO APPLY AN ILLEGAL UNDERGROUND REGULATION.

A. The "Affinity Group" Rule Advanced by CDI and Allstate Is a Matter Subject to the Rulemaking Provisions of the APA.

An unwritten, generally applicable interpretation of a statute "amount[s] to a regulation" subject to the APA. (*Morning Star Co. v. State Bd. of Equalization* (2006) 38 Cal.4th 324, 334; see also Gov. Code § 11342.600 [defining "regulation" to include every "standard of general application . . . adopted by any state agency to implement, interpret, or make specific the law enforced or administered by it"].) "Any regulation not properly adopted under the APA is labeled an 'underground regulation,'" which by statute the agency is *prohibited from applying*. (*Davenport v. Superior Court* (2012) 202 Cal.App.4th 665, 669, disapproved of on other grounds by *Reilly v. Superior Court* (2013) 57 Cal.4th 641; Gov. Code, § 11340.5 ["No state agency shall issue, utilize, enforce, or attempt to enforce any guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule, which is a regulation as defined in Section 11342.600, unless the guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule has been adopted as a regulation and filed with the Secretary of State pursuant to this chapter."].)

Here, the CDI has *not* formally adopted a regulation to interpret section 1861.12 or determine the legality of "affinity groups" generally. Instead, the CDI relies exclusively on its previous approval of other rate applications containing "affinity groups" to support its blithe claim that the affinity groups are permitted pursuant to section 1861.12. For example, Deputy

Commissioner Joel Laucher states "the six rating groups approved for Allstate under this agreement are consistent with rating groups CDI has approved for other insurers under CIC section 1861.12." (Declaration of Joel Laucher in Support of October 21, 2013 Joint Stipulation and Request for Proposed Decision and Order, Oct. 21, 2013, ¶ 6.) Similarly, CDI Senior Staff Counsel Daniel Goodell declares, "The CDI has approved affinity groups for other automobile insurers under the language of CIC 1861.12," and "The Allstate groups are consistent with affinity groups that CDI has approved for other insurers under CIC 1861.12." (Declaration of Daniel M. Goodell in Support of October 21, 2013 Joint Stipulation and Request for Proposed Decision and Order, Oct. 21, 2013, ¶¶ 14, 15.) And CDI actuary Lynne Wehmueller provides specific examples of "similar programs" that the CDI has approved in the past. (Declaration of Lynne Wehmueller in Support of October 21, 2013 Joint Stipulation and Request for Proposed Decision and Order, Oct. 21, 2013, ¶ 8.)

Allstate also points to the similarity between Allstate's proposed "groups" and those previously approved by the CDI. (See, e.g., October 21, 2013 Declaration of Robert W. Hoffman in Support of Joint Settlement Stipulation, Oct. 13, 2013, ¶¶ 6, 7 ["The proposed new affinity programs are similar, if not identical, to programs that have been approved by the California Department of Insurance ("CDI") for other companies," and "the reduced rates for those programs agreed to by the parties in the Stipulation are very similar to the reduced rates approved by the CDI for those same programs for other companies."].)

Notably absent from the October 21 Stipulation, and the supporting declarations, is any analysis explaining *how* such groups (whether previously approved or not) fall within section 1861.12. As discussed below, the plain language of section 1861.12 does not support a finding that Allstate's proposed "affinity groups" are allowed thereunder. Instead, CDI and Allstate ask the Administrative Law Judge to simply rubber stamp the CDI's unwritten rule of general application that groups like those proposed by Allstate fall within the purview of section

1861.12. That unwritten rule constitutes an unlawful underground regulation that cannot be the basis for approving the October 21 Stipulation.[5]

B. The Plain Language of Section 1861.12 Does Not Support a Conclusion That Allstate's Proposed "Affinity Groups" Are Permitted.

The parties repeatedly assert that "affinity groups" have been approved in the past pursuant to section 1861.12 and that therefore the proposed "affinity groups" are lawful. This cursory and circular argument cannot substitute for the careful statutory analysis required here.

Section 1861.12 states, in full:

> Any insurer may issue any insurance coverage on a group plan, without restriction as to the purpose of the group, occupation or type of group. Group insurance rates shall not be considered to be unfairly discriminatory, if they are averaged broadly among persons insured under the group plan.

There is no evidence to suggest that Allstate's "affinity group" discounts for some of its preferred customers constitute a "group plan" under section 1861.12. To the contrary, Allstate itself explained that its proposed "affinity group" discounts are a marketing scheme to generate business from its preferred customers. Allstate's stated purpose for introducing its proposed "affinity groups" is "to create an outlet to market and better retain *specific groups of customers* . . . ." (October 21, 2013 Declaration of Laura Hoffman in Support of Joint Settlement Stipulation, Oct. 13, 2013, Exh. A, p. 1 [Allstate Amended Rate Filing, Exh. 17], emphasis added.)

A claim that such marketing classifications providing discounts to preferred customers constitute a "group plan" authorized by section 1861.12 cannot be squared with the statutory framework established by sections 1861.02 and 1861.05, which explicitly set forth how automobile rating factors are regulated. Obviously the voters would not have enacted stringent

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[5] The CDI's attempt to rely on a rule that was never adopted as a regulation is particularly troubling given that the voters expressly mandated that the rating factor system be implemented by the promulgation of regulations. (See Ins. Code § 1861.02(e).) As the Court of Appeal confirmed in *Foundation for Taxpayer and Consumer Rights v. Garamendi* (2005) 132 Cal.App.4th 1354, 1372: "Substantively, the Insurance Commissioner may adopt only those optional rating factors having a 'substantial relationship to the risk of loss.' (§ 1861.02, subd. (a)(4).) Procedurally, *the Insurance Commissioner may do so only in the context of a formal rulemaking proceeding with established rights of public participation and judicial review*. (*Ibid.*)" (Emphasis added.)

regulation of automobile rating factors only to allow insurance companies to completely ignore section 1861.02(a) by creating a patchwork of "affinity group" discounts that fit an insurer's preferences, however irrational and discriminatory.

The argument that the proposed "affinity groups" are the equivalent of "coverage on a group plan" pits section 1861.12 against section 1861.02(a) in a manner that threatens the integrity of the voter-approved statute. There is an express exception to the underground regulation prohibition, which permits the agency to employ an underground regulation if the statute "'can reasonably be read only one way' [Citation], such that the agency's actions or decisions in applying the law are essentially rote, ministerial, or otherwise patently compelled by, or repetitive of, the statute's plain language." (*Morning Star*, *supra*, 38 Cal.4th at pp. 336–337.) That exception is manifestly not applicable here. The CDI and Allstate's construction of section 1861.12 is far from "compelled by, or repetitive of, the statute's plain language" and should not be permitted to short circuit the inquiry required here.

Allstate also points to an instruction contained in the Department's Private Passenger Auto Class Plan Filing Instructions. (See October 21, 2013 Declaration of Laura Hoffman in Support of Joint Settlement Stipulation, Oct. 13, 2013, ¶ 15.) Allstate Actuary Laura Hoffman states: "As part of my job duties, I refer to the Department's Private Passenger Auto Class Plan Filing Instructions ('Instructions'), which specifically refer to use of programs in rate filings. The Instructions state that 'CIC §1861.12 allows for the submission of group programs without restriction as to the purpose of the group, occupation or type of group.'" This "instruction," which has not been adopted in a regulation by the Commissioner, neither elucidates meaning and proper implementation of the statute nor provides any support for a claim that Allstate's proposed "groups" fall within the purview of the statute. The instruction replaces the language "group plan" in section 1861.12 with "group program," but provides no definition of "group program." To the extent that the "instruction," which does not have the force of law, conflicts with the statutes and regulations implementing Proposition 103, it is void.

In sum, the October 21 Stipulation proposed by CDI and Allstate relies solely on the parties' argument that "what we're doing now is legal because we've done it before." Reliance on such a standard of general application that has not been adopted in a rulemaking proceeding

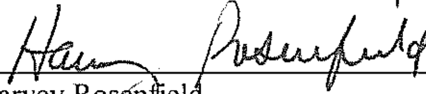
pursuant to the APA constitutes reliance on an unlawful underground regulation, and the Administrative Law Judge must therefore ignore such evidence of the Department's past practices and reject the October 21 Stipulation in favor of an inquiry into the merits of Allstate's application.

V. CONCLUSION

Since Allstate's proposed "affinity groups" violate the Insurance Code and applicable regulations, result in higher premiums for Allstate's "regular" customers than otherwise indicated, and the CDI and Allstate are seeking to apply an illegal underground regulation, the Administrative Law Judge should reject the October 21 Stipulation as fundamentally unfair and not in the public interest.

DATED: October 25, 2013

Respectfully submitted,



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I am employed in the City of Santa Monica and County of Los Angeles, State of California. I am over the age of 18 years and not a party to the within action. My business address is 2701 Ocean Park Blvd., Suite #112, Santa Monica, California 90405, and I am employed in the city and county where this service is occurring.

On October 25, 2013 I caused service of true and correct copies of the document entitled

CONSUMER WATCHDOG'S OBJECTION TO CDI AND ALLSTATE OCTOBER 21, 2013 STIPULATION AND REQUEST FOR PROPOSED DECISION AND ORDER

upon the persons named in the attached service list, in the following manner:

1. If marked FAX SERVICE, by facsimile transmission this date to the FAX number stated to the person(s) named.

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3. If marked U.S. MAIL or OVERNIGHT or HAND DELIVERED, by placing this date for collection for regular or overnight mailing true copies of the within document in sealed envelopes, addressed to each of the persons so listed. I am readily familiar with the regular practice of collection and processing of correspondence for mailing of U.S. Mail and for sending of Overnight mail. If mailed by U.S. Mail, these envelopes would be deposited this day in the ordinary course of business with the U.S. Postal Service. If mailed Overnight, these envelopes would be deposited this day in a box or other facility regularly maintained by the express service carrier, or delivered this day to an authorized courier or driver authorized by the express service carrier to receive documents, in the ordinary course of business, fully prepaid.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on October 25, 2013, at Santa Monica, California.

Jason Roberts

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