Insurance Discrimination and the Story Behind the Mercury Initiatives

Mandatory Insurance Law - 1984

In 1984, the California Legislature imposed severe penalties on drivers who did not carry automobile insurance. At that time, the premiums and practices of insurance companies were unregulated, and, at the same time that the "mandatory insurance law" took effect, premiums began to soar.

The Legislature's goal was to get uninsured motorists off the road. Unfortunately, uninsured motorists who tried to buy insurance to comply with the law were faced with a "Catch-22": insurance companies often charged motorists much higher premiums just because they did not *already* have insurance. In fact, many insurance companies would refuse to sell insurance at any price to people who did not already have it.

California Department of Insurance Bulletin (Bunner Bulletin) - 1985

In 1985, responding to widespread public complaints, the California Insurance Commissioner Bruce Bunner issued a bulletin warning insurance companies not to utilize this practice known as "no prior insurance." It said:

> …The intent of this bulletin is to inform recipients that such rating practice could result in a charge of unfair rate discrimination. It has been the position of this Department that lack of evidence of prior insurance in itself is not a proper rating standard. There are many reasons why an applicant may not have had prior insurance, many of which have no bearing on the applicant's future loss potential. The carrier should review the specific conditions that led to an applicant's failure to carry insurance rather than apply a blanket surcharge simply because the applicant has had no prior insurance.

King v Meese - 1987

The mandatory insurance law was challenged in court by citizens who argued it wasn't fair for government to require consumers to buy auto insurance if there were no protections against unfair rates and abusive actions by insurance companies like the "no prior" practices.

This and other unfair practices led to a constitutional challenge to the mandatory insurance law by civil rights and low-income organizations. The case ended up before the California Supreme Court.

The Court noted that many automobile insurers offered policies **"only [to] those who already had insurance**" (*King v. Meese* (1987) 43 Cal. 3d 1217, 1225, emphasis added).

Justice Broussard, in his concurring opinion, elaborated on the dilemma:

> When it comes to automobile liability insurance, the poor pay more or do without. Private companies have been increasingly unwilling to insure residents of certain low-income urban neighborhoods, particularly South Central Los Angeles. Residents are forced to turn to the assigned risk program, paying rates much higher than available through private insurance to persons living in other areas. Those who cannot afford such rates drive without insurance.
>
> This serious social problem has, with enactment of Vehicle Code section 16028, become a legal problem. That statute was intended to compel previously uninsured drivers to purchase insurance by threatening the violator with fines and suspension of his driving privileges, yet it did nothing to ensure that insurance was

> available. Thus the poor no longer have the option of driving without insurance; to comply with the law, they must stop driving, whatever the consequences.
>
> 43 Cal. 3d at 1245-46.
>
> This case arises from the attempt of the California Legislature to solve a serious social problem - the uninsured driver - without taking into account an equally serious problem - **insurance pricing practices which make automobile liability insurance prohibitively expensive** for many of the urban poor.
>
> 43 Cal. 3d at 1237 [emphasis added].

Broussard focused on the impact of the pricing practices:

> [A]s insurance became essential, for many people it was also becoming more difficult to obtain. Private insurance companies were increasingly unwilling to sell liability coverage, at least at affordable rates, to residents of South Central Los Angeles and portions of Oakland. [FN6] Often a resident of those areas with a perfect driving record could obtain private coverage, if at all, only by paying more than a resident of some other areas with a history of accidents and violations.
>
> 43 Cal. 3d at 1237-8.

Broussard zeroed in on the Catch-22 practice of surcharging people without prior insurance, or refusing them altogether:

> [Insurance companies] often impose so many restrictions (e.g., **no prior insurance** precludes application), that the insurance quoted at those rates is inaccessible.
>
> 43 Cal. 3d at 1239 [emphasis added].
>
> [Plaintiffs] speak also of the **reluctance of insurance companies to insure persons who were previously uninsured**, a problem of particular concern since the purpose of the 1984 legislation was to compel such persons to obtain insurance. They speak also of the difficulty persons with assigned risk insurance experience in later obtaining private insurance.
>
> 43 Cal. 3d at 1240 [emphasis added].

Broussard noted this specific example:

> Willie Henry, age 73, has had no tickets or accidents for the past 10 years. His income is under $500 per month. **Most companies would not insure him because he had been driving without insurance** until the present law went into effect.
>
> 43 Cal. 3d at 1238.

Notwithstanding the arbitrary and unfair nature of the insurance industry's conduct, the Court held that the mandatory insurance law was constitutional, and that the industry practices at issue would have to be addressed by the legislative branch. (43 Cal. 3d at 1235.)

When the Legislature failed to act, the voters did – by passing Proposition 103.
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In a major ruling in 1987, the California Supreme Court acknowledged "the lack of procedural safeguards in the area of private insurance," and that there was no "guaranty that such insurance [was] offered at fair and equitable rates."

The Court singled out the "no prior" rules, noting that many insurance companies would sell policies "only [to] those who already had insurance." As a result, many drivers were "unable to afford or obtain private insurance." The case is *King v. Meese*, 43 Cal.3d 1217.

A later Court of Appeal ruling summarized:

> In his concurring opinion in *King v. Meese,* Justice Broussard noted two practices were widespread in the insurance industry prior to Proposition 103's passage: **prohibitively high insurance rates for the previously uninsured driver, and the exclusion of uninsured drivers from the insurance market altogether simply because they were not previously insured…Such practices arbitrarily penalized uninsured motorists, leaving many unable to comply with California's mandatory insurance laws.** *The Foundation for Taxpayer and Consumer Rights v. Garamendi* (2005) 132 Cal. App. 4th at 1369 [emphasis added].

But the Court said the judicial branch had no power to fix the problem, saying that the "case should be made to the Legislature." (*Id.* at 1235.) Consumer groups took the Court's advice, and went to Sacramento to demand reform of the insurance industry's rates and practices. But the Legislature was deeply influenced by the insurance industry, whose free-spending lobbyists repeatedly blocked the proposals. The only alternative left was the ballot box.

Proposition 103 -1988

Proposition 103, now part of the state insurance code, specifically bars insurance companies from refusing to insure, or surcharging, people who were not previously insured. It states:

> The absence of prior automobile insurance coverage, in and of itself, shall not be a criterion for determining . . . automobile rates, premiums, or insurability.
> (Insurance Code § 1861.02(c).)

Proposition 103 was enacted in 1988 despite an $80 million campaign against it by Mercury and the rest of the insurance industry.

Mercury Begins Surcharging People Without Prior Insurance

As already noted, insurers are required to set automobile insurance premiums by application of authorized "rating factors" approved by the Insurance Commissioner. As originally adopted in 1996, the commissioner's regulations included "persistency" as one of sixteen optional rating factors. Persistency means the length of time the insured has been insured *by the company writing the coverage.*

When Mercury filed its list of automobile rating factors for approval by the Commissioner in 1996, it included a "persistency" rating factor. In practice, however, Mercury's so-called "persistency" rating factor turned out to be quite different from what it had disclosed to the Insurance Department. Mercury uniquely defined "persistency" in practice to mean "length of prior insurance coverage with *any* carrier." A driver who has been insured by *any* company gets a discount, while a person who had no prior insurance for a period of more than thirty days is surcharged. This was then a clear violation of the Proposition 103 law § 1861.02(c).

It is also almost exactly what Mercury has proposed in his new ballot measure.

Mercury Is Sued - 2001

A group of plaintiffs filed a class action lawsuit against Mercury in April 2001 for violating Proposition 103's "no prior rule."

Before the Court of Appeal, Mercury had contended that under Proposition 103, a discount for continuous coverage with any company did not violate the statute. The Court of Appeal rejected Mercury's argument, citing with approval the Insurance Commissioner's determination that "continuous coverage" is the same thing as "prior insurance":

> The Department is aware that that some insurance companies have interpreted "persistency" broadly; to authorize a credit to persons who have switched insurance carriers, but have been **continuously insured**. **Such a definition necessarily requires [an insurance] company to consider a consumer's prior insurance, or lack thereof**. In the Commissioner's opinion, this type of stretched interpretation of 'persistency' would violate Insurance Code section 1861.02, subdivision (c)." *Donabedian v. Mercury Insurance Company* (2004) 116 Cal.App.4th 968, 974-975.

Mercury settled the case.

Insurance Commissioner Issues Regulations - 2002

In response to Mercury's conduct and efforts by other carriers to adopt Mercury's improper redefinition of persistency, Consumer Watchdog petitioned the Insurance Commissioner in May, 2001, for a hearing on the abuse and for development of a regulation specifically forbidding it.

In ordering Mercury and other insurers to cease their violation of the law in September 2002, the Insurance Commissioner made several key factual findings regarding the undesirable effects of Mercury's unprecedented definition of "persistency." He found 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*." Further, he found that the language affirming the proper application of "persistency" would **"***encourage[ ] the uninsured to join the pool of insured drivers," and that "[i]ncreasing the pool of insured drivers will ultimately benefit all insured persons, by lowering the cost of uninsured/under insured motorist coverage.***"**

Mercury Seeks Legislative Repeal of Prop 103's No Prior Rule - 2003

Hedging its bet that the courts would toss the *Donabedian* lawsuit, Mercury went to Sacramento seeking legislation to override the Prop 103 provision. Mercury donated a total of over $895,000 to more than two-thirds of the legislature. (Proposition 103 says that it can only be amended to "further its purposes" and then only by a two-thirds vote.)

Championed by then-Senate Majority Leader Don Perata, the 2002 bill authorized insurance companies to penalize motorists who did not previously carry insurance. The legislature passed the measure. Mercury's campaign ignited widespread outrage and Gov. Gray Davis ultimately vetoed the bill, correctly concluding it did not "further the purposes" of Proposition 103.

In his veto message, Davis asked the Insurance Commissioner to prepare a study of the impact that Mercury's proposal would have had upon motorists. According to the report that the Insurance Commissioner prepared:

> Since insurance is a mechanism, which provides for the sharing of total losses among all insureds within an insurance company, the discounts given to one group of insureds are not simply money saved. The total losses of the insurance company will not change. The sharing mechanism works by making the remaining group who do not qualify for the discounts *pay more*.
>
> *People who do not have prior insurance are surcharged under portable persistency.* Many of these people are those that can least afford to pay for insurance or who already have high premiums caused by other rating factors. This discourages them from buying insurance, which may add to the number of uninsured motorists and ultimately drives up the cost of the uninsured motorist coverage for every insured. (Exhibit G, page 6 of the study; italics added.)

Undaunted, Mercury came back the following year. Despite the opposition of citizen groups and Insurance Commissioners Low and Garamendi, the new bill, SB 841, once again got to Davis's desk. Davis, facing recall that year, received over $100,000 from Mercury prior to the bill arriving on his desk. This time, Davis signed the bill. After it was signed, Mercury donated a total of $175,000 to Davis's anti-recall campaign.

Like Proposition 17, SB 841 left intact subdivision (c) of section 1861.02 as enacted by Proposition 103, but added additional language that created a "continuous coverage" rating factor "**notwithstanding**" Proposition 103's protections.

California Courts Invalidate SB 841 – 2005

Led by Consumer Watchdog, a coalition of consumer, taxpayer and civil rights organizations -- Consumers Union, Public Advocates, Southern Christian Leadership Conference, and National Council of La Raza -- filed suit in Los Angeles Superior Court on October 15, 2003, asking that the legislation be invalidated as an unconstitutional amendment to Proposition 103 because SB 841 did not further 103's purposes.

The Superior Court ruled that SB 841 was invalid, as did the Court of Appeal.

As the Court of Appeal explained, providing a discount always requires imposing a corresponding surcharge. The Court of Appeal stated:

> The premiums for policyholders who, because of their characteristics, do not qualify for a particular discount must be *surcharged* in an amount *equal to the total of the discounts* given to the policyholders that qualified for the discount…[If 20% of motorists seeking insurance coverage are uninsured,] This would result in a surcharge equal to a 40 percent increase in premium for…policyholders who do not qualify for the 'continuous insurance' discount. *Foundation for Taxpayer and Consumer Rights v. Garamendi* (2005) 132 Cal.App.4th 1354, 1367-1369

The Court cited both the Bunner Bulletin of 1985 and the Broussard opinion in King V. Meese of 1987 in its decision. In its essence, the Court ruled SB 841 would have allowed insurers to impose an impermissible surcharge on motorists based solely on their lack of prior auto insurance coverage.

Proposition 17 – 2010

Proposition 17 was Mercury's first attempt to repeal Proposition 103's prohibition on the use of pre-existing insurance coverage. The measure was rejected by California voters.