April 17, 2009

Assemblyman Joe Coto, Chair
Assembly Insurance Committee
State Capitol, Room 2013
Sacramento, CA 95814

Re: AB 1054 (Coto) – OPPOSE

Dear Chairman Coto:

On behalf of Consumer Watchdog, I write in opposition to your bill AB 1054. Sponsored by Mercury Insurance, AB 1054 would lead to higher insurance rates, more discrimination, and less accountability in California's insurance marketplace. The legislation, which would prevent refunds being ordered by the Insurance Commissioner or a court when insurers are found to have illegally overcharged customers, violates the mandates of voter-approved Proposition 103. A second provision related to premium payment by credit card would allow companies to circumvent the regulatory ratemaking structure adopted by the Commissioner to ensure that rates are not excessive.

Allowing companies to break California laws with impunity has no public or consumer benefit and creates moral hazard not unlike the devastating effect of unaccountability on Wall Street in recent years. The statutory immunity AB 1054 proposes to confer on insurers would remove a basic deterrent to lawbreaking: a requirement to give back what was stolen.

If someone sneaks dynamite through airport security, they are still breaking the law, even if the TSA staff authorized their passage to the terminal because they didn't notice the weapon. If AB 1054 were enacted, insurers would be incentivized to do the regulatory equivalent of sneaking dynamite through security,because they would get to keep all illegal overcharges received before (and even after) their misconduct was discovered.

Under this proposal, an insurer who illegally surcharges customers in direct violation of a state law would be entitled to keep the illegal surcharges. This is not a theoretical example. In recent years, several insurers agreed to refund tens of millions of dollars to customers in order to settle lawsuits brought after it was revealed that the companies illegally surcharged customers in violation of California law. Under AB 1054, the companies would never have settled the lawsuits. Instead, the companies would have extended the litigation as long as possible, knowing that they would get to keep every penny in illegal surcharges, even though the Court found them guilty as charged.

The effect of this law would be akin to allowing Bernie Madoff to keep his ill-gotten earnings, since he did file paperwork with the SEC. The only difference is that at least with Madoff, there's jail time.

Proposed Section 1861.05(f) Removes Accountability for Insurance Companies That Break the Law

Proposed section 1861.05(f) seeks to eliminate insurer accountability for any illegal act they commit if they claim to be doing it under the cover of a rate approval. The proposal is a direct attack on Proposition 103's section 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.)

The initiative's purpose is clear here: any rate that is "excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter" (referring to Insurance Code §§ 1850.4 – 1861.16) cannot remain in effect, even if it was previously approved. Any rate so charged by an insurer is a violation of section 1861.05(a).

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.

Proposition 103's clear prohibition on illegal rates and rating practices, whether proposed or in effect, is the protection against that kind of gaming. 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 Proposition 103's provisions. Confirming this analysis, the Attorney General of California has opined that "the filed rate doctrine does not apply to insurance rates in California," citing § 1861.03(a).[1]

For example, in *Donabedian v. Mercury*, Mercury was sued for surcharging previously uninsured drivers, even though such surcharges are illegal under Proposition 103 (section 1861.02(c)). Mercury claimed it was immune from the suit, because it had received approval for the filing in which these surcharges were added. Mercury's argument was that, since the Commissioner approved the application, the Commissioner effectively authorized the illegal surcharge. Other insurance companies made the same argument in similar cases challenging the same practice. These arguments were unsuccessful, and many of these insurers, including Mercury, have agreed to refund tens of millions of

[1] State of California, Department of Justice, *Antitrust Guidelines for the Insurance Industry*, March 1990, at 22.

dollars to policyholders in order to settle class action lawsuits seeking restitution (a form of "retrospective adjustment" that would be prohibited under this bill) of the surcharges.

Through Insurance Code section 1861.03, the voters made the insurance industry subject to California's unfair business practices law, which provides for restitution.[2] In upholding the right of policyholders to sue an insurer for restitution for a violation of Proposition 103, the Court of Appeal in the *Donabedian* case held that:

> Proposition 103 prohibits insurers from using the absence of prior insurance as a rating criterion and subjects insurers to the UCL. The Proposition further provides: "Any person may initiate or intervene in any proceeding permitted or established pursuant to ... chapter [9]." The formal administrative process is found in chapter 9. "Any person may [also] ... enforce any provision of ... article [10 of chapter 9]." 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, internal citations omitted.)

AB 1054 seeks to strip insurance policyholders of their legal rights to obtain refunds in court under the unfair competition law, in direct contravention of Prop 103's establishment of that right.

Consider this scenario that could happen under AB 1054:

In an otherwise *pro forma* filing, an insurer obliquely references a demographic component to its homeowners premium structure. Five years later, it is determined that the insurer has been adding a 10% annual surcharge on Latino policyholders. Despite Proposition 103's prohibition on unfair discrimination and its application of the Unruh Civil Rights Act to insurance rates, a court would be prohibited, as a result of AB 1054, from requiring the insurer to issue refunds for the five years of illegal 10% surcharges.

AB 1054 would allow an insurer to keep its illegal surcharges no matter how reprehensible its conduct.

AB 1054 Will Remove the 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).

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[2] Section 1861.03 makes insurers subject "to the laws of California applicable to any other business, including but not limited to, the Unruh Civil Rights Act [], and the antitrust and unfair business practices laws []."

In June 2006, the Insurance Commissioner put several insurers on notice that their then-current homeowner rates were excessive and needed to be reduced immediately. Soon thereafter, all the insurers, except Allstate, agreed to lower their rates in response to the Commissioner's notice. Allstate refused to comply, instead filing an application to increase its rates even more. In May 2007, after almost a year of trying to get Allstate to lower its rates, the Commissioner again put Allstate on notice that its current rates were excessive and stated that he intended to take all necessary corrective action, including possibly ordering refunds to policyholders. Allstate, in Spring 2008, was ordered to lower its rates by about $250 million through a Commissioner decision that was immediately upheld in Superior Court. Under the threat of another $250 million in refunds, Allstate gave up its appeal and implemented the rate cut.

If the power to order refunds were not available to the Commissioner, Allstate customers would likely still be overpaying for homeowners insurance as the company appealed every aspect of the Commissioner's decision. AB 1054 would, thus, take away a crucial regulatory tool empowering the Commissioner to hold companies like Allstate accountable for charging excessive rates.

AB 1054 says that once a rate, premium or rating factor 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 failing to disclose new data to the Department or fighting attempts to bring its rates into compliance 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]…" (Ins. Code § 1861.05 (a), emphasis added.) It also directly conflicts with section 1861.03, which subjects insurers to liability under the Unruh Act and state antitrust and unfair business practices laws.

Proposed Section 1861.05 (e) Would Allow Insurers To Charge Policyholders Extra Fees For Paying Premiums With Credit Despite The Fact That Credit Card Costs Are Already Incorporated Into Company Expense Ratios

This provision allows insurers to increase the overall costs of insurance unnecessarily.

Currently, credit card expenses are already included in a company's individual expense ratio and the industry-wide efficiency standard set forth in the Insurance Commissioner's ratemaking regulations, which operates to limit the amount of insurers expense that can be passed through in the rates charged to policyholders. While unclear from the proposed language, this amendment appears to require the Insurance Commissioner to remove costs associated with credit card payment from the expense efficiency standard and presumably allow insurers to charge policyholders for those costs by some other mechanism. It is, however, entirely unclear how this provision would function.

As a threshold matter, the amendment fails to take into account the fact that there should be no net increase in costs to insurance companies for using credit cards to collect premiums. For example, credit card use reduces a whole host of insurance company costs such as printing (for printing bills), postage (for mailing bills), salaries (for employees that were needed to handle billing), and the like, which are also built into the

expense efficiency standard set by the Commissioner. Credit card billing also should reduce costs associated with the non-payment of premiums. Consequently, any increased use of credit cards to collect premiums may even reduce overall insurance company expenses. This is probably why so many insurance companies already allow credit card payments for premiums. There is no reason to amend Proposition 103 to alter the ratemaking formula adopted by the Commissioner by regulation that establishes the excessive/inadequate standards in determining the rates insurers are allowed to charge pursuant to section 1861.05.

Tinkering With Complex Actuarial Ratemaking Formulae Is Not The Job Of The Legislature

Insurance rate regulations adopted by the Insurance Commissioner to enforce section 1861.05(a) incorporate highly complex mathematical formulae in order to ensure fair and adequate pricing in the industry. The Legislature, which does not have staff actuaries able to assess the impact of changes to the efficiency standard, is not equipped to sift through the finer points of ratemaking. And it need not be, as questions requiring specific technical expertise are generally left to the regulator.

Indeed, in *FTCR v. Garamendi*, regarding SB 841, the Court of Appeal made this very point:

> By subjecting insurance premium-setting practices to an open, evidence-driven regulatory process, the voters both replaced the former laissez-faire competition framework with one calculated to prevent arbitrary practices and ensured their right of access and participation in the regulatory process. As our Supreme Court has observed, "questions involving insurance rate making pose issues for which specialized agency fact-finding and expertise is needed in order to both resolve complex factual questions and provide a record for subsequent judicial review." (*Farmers Ins. Exchange v. Superior Court* (1992) 2 Cal.4th 377, 397, 6 Cal.Rptr.2d 487, 826 P.2d 730.)

(*FTCR v. Garamendi* (2005) 132 Cal.App.4th 1354, 1372.)

If the sponsor of this legislation wishes to amend the mathematical formula for calculating rates, such requests are properly directed to the Department of Insurance.

AB 1054 is a Waste Of Precious Taxpayer Resources Because It Will Be Struck Down By a California Court if Enacted.

Anticipating a lawsuit – consumer groups will undoubtedly sue should AB 1054 be signed into law – this year's industry attack on Proposition 103 contains this language:

> The Legislature finds and declares that this act furthers the purposes of Proposition 103 of the November 8, 1988, statewide general election. . . . This act furthers the purpose of Proposition 103 by providing certainty to insurers and consumers following the commissioner's rate approval and by ensuring that the insurance commissioner is held accountable.

Notwithstanding similar declarations of furthering the purpose of Proposition 103, consumer advocates have successfully challenged three insurance industry-sponsored amendments to Proposition 103 as invalid. In the landmark decision, *Amwest v. Wilson*, the California Supreme Court, by unanimous vote, invalidated legislation that attempted to exempt one type of insurance from the initiative's rollback and rate regulation provisions. Although the Court in *Amwest* was faced with a similar, self-serving statement of "furthering the purpose" of Proposition 103, the Court saw through this tactic, concluding that "the Legislature's stated purpose in enacting 1861.135—to clarify the scope of Proposition 103—does not withstand scrutiny." (*Amwest v. Wilson* (1995) 11 Cal.4th 1243.)

In *Proposition 103 Enforcement Project v. Quackenbush*, in which the Court invalidated SB 905 (Insurance Code section 769.2), the Court reiterated:

> [S]ection 769.2 suffers from a defect which is apparent without regard to the results of its actual application. . . . Because it does not further the purposes of Proposition 103 it is an act in excess of the amendatory powers granted to the Legislature by the voters, and hence, it is invalid regardless of how it might be applied in any given case."

(*Proposition 103 Enforcement Project v. Quackenbush* (1998) 64 Cal. App 4th 1473, 1495.)

In *FTCR v. Garamendi*, challenging SB 841, which also contained similarly spurious findings, the court wrote:

> The Legislature cannot simply in the guise of amending Proposition 103 undercut and undermine a fundamental purpose of Proposition 103, even while professing that the amendment "furthers" Proposition 103. The power of the Legislature may be "practically absolute," but that power must yield when the limitation of the Legislature's authority clearly inhibits its action. (*Amwest, supra,* 11 Cal.4th at p. 1255, 48 Cal.Rptr.2d 12, 906 P.2d 1112.) Since Sen. Bill 841 flies in the face of the initiative's purposes, it exceeds the Legislature's authority.

(*FTCR v. Garamendi*, *supra*, 132 Cal.App.4th at 1371.)

What all these cases make clear is that legislative findings cannot overcome this bill's fatal defect; it specifically violates Proposition 103. The legislative findings alleging that the bill furthers the purpose of Proposition 103 are little more than legislative sugar-coating that dissolves immediately. Therefore, if this bill were enacted, every taxpayer dollar spent until it is unsuccessfully defended in court will be money wasted.

Proposition 103 has saved California consumers more than $62 billion on auto insurance alone, according to a 2008 study by the Consumer Federation of America, in part because the prospect of refunds makes it economically unsound to overcharge customers. When companies surreptitiously violate the law, either with or without some purported regulatory approval, Proposition 103 provides the courts and the Commissioner the authority to require companies to return the money they stole from consumers. AB 1054

would provide insurers a license to steal and remove the right to refunds that deters bad behavior and remedies illegalities when they do occur.

As a final note, AB 1054 is just the latest in a series of attempts by Mercury Insurance to remove liability for its illegal surcharges. It unsuccessfully attempted to change the surcharge rules at the Department of Insurance. It lost an appellate ruling validating consumers' rights to sue for refunds. It unsuccessfully sponsored legislation in 2002 to authorize the surcharges and then shepherded that legislation through in 2003 only to see it invalidated by California courts. It also unsuccessfully sponsored legislation similar to AB 1054 last year.

Mercury certainly has a right to spend its own money in these efforts to exempt itself from the standards of California law, but the public should not be asked to continue to subsidize their selfish quest for immunity. We urge you to withdraw this bill in order to protect policyholders and taxpayers from Mercury Insurance's proposed attack on longstanding protections adopted by the voters of California.

Sincerely,

Douglas Heller

Cc: Members of the Assembly Insurance Committee