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SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF SAN DIEGO

STATE FARM GENERAL
INSURANCE COMPANY,

Petitioner and Plaintiff,

v.

DAVE JONES, in his official capacity as
the Insurance Commissioner of the State
of California; and Does 1-50,

Respondent and
Defendant.

CONSUMER WATCHDOG and
CONSUMER FEDERATION OF
CALIFORNIA,

Intervenors.

Case No. 37-2016-00041469-CU-MC-CTL

Consolidated Non-Lead Case Nos.
37-2016-00041750-CU-MC-CTL
37-2017-00025569-CU-WM-CTL
37-2017-00027239-CU-WM-CTL

**CONSUMER WATCHDOG'S
OPPOSITION TO STATE FARM
GENERAL INSURANCE COMPANY'S
PHASE 1 OPENING BRIEF**

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1 **I. INTRODUCTION**

2 On December 4, 2014, Petitioner State Farm General Insurance Company (SFG) applied for a
3 6.9% rate increase to its homeowners insurance policies. Consumer Watchdog’s experts reviewed the
4 request and, invoking the consumer protection rights enacted by Proposition 103, petitioned for a public
5 hearing, as did the Consumer Federation of California (CFC). The Commissioner granted those requests,
6 and after a thorough evidentiary hearing, concluded that SFG’s rates had been excessive at least since
7 July 15, 2015. The Commissioner denied the requested increase, ordered SFG to decrease its rates by
8 7% and to refund over \$100 million in overcharges to its policyholders.

9 SFG’s Petition challenges the hearing procedures, the 83-page Decision adopted by the
10 Insurance Commissioner, the decades-old Proposition 103 regulations that govern rate applications, and
11 the multiple unanimous decisions of the California Supreme Court and other courts that collectively
12 constitute well-established Proposition 103 jurisprudence. SFG’s Opening Brief (OB) slashes broadly
13 but superficially; with few citations to the record and no apposite legal authority, it provides no support
14 for SFG’s request that this Court overturn the Commissioner’s Decision. Indeed, SFG’s true challenge is
15 to the voters’ decision to regulate insurance rates in California. It lost that case at the ballot box nearly
16 30 years ago.

17 This brief will provide historical background on Proposition 103, which Consumer Watchdog
18 and its attorneys have enforced and successfully defended against many such industry attacks since
19 1988. (In the latest, decided last February, the Third District Court of Appeal rejected a very similar
20 challenge by Mercury and State Farm’s trade association. (*Mercury Casualty Company v. Jones* (2017)
21 8 Cal.App.5th 561 (*Mercury*)).) The brief will then address three of SFG’s arguments: (1) that the
22 regulation that governs the yield on invested assets used in the calculation of an insurance company’s
23 investment income is invalid (see Cal. Code Regs., tit. 10,¹ § 2644.20(a)); (2) that if the regulation is
24 applied to SFG, the company—a subsidiary wholly-owned and entirely controlled by the \$168 billion
25 State Farm Mutual Automobile Insurance Company (SFMA) and with no employees of its own—will
26 suffer confiscation; and (3) that SFG cannot be required to repay the money it unlawfully took from its
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¹ These regulations are cited below as “Regulations” or “Regs.” followed by their section number.

1 policyholders.² Consumer Watchdog maintains that SFG’s arguments are without merit.

2 II. BACKGROUND OF PROPOSITION 103

3 Finding that “the existing laws inadequately protect consumers and allow insurers to charge
4 excessive, unjustified and arbitrary rates,” California voters passed Proposition 103 in November 1988.
5 (*Donabedian v. Mercury Ins. Co.* (2004) 116 Cal.App.4th 968, 981, quoting Prop. 103, § 1 [Findings
6 and Declaration].) Proposition 103 sought to achieve three main purposes: “[P]rotect consumers from
7 arbitrary insurance rates and practices,” “provide for an accountable Insurance Commissioner,” and
8 “ensure that insurance is fair, available, and affordable for all Californians.” (*Id.* at 977, quoting Prop.
9 103, § 2 [Purpose].) The measure contains a panoply of insurance reforms (see Ins. Code³ §§ 1861.01–
10 1861.14), one of which is a core reform that SFG has targeted in this matter.

11 A. The Prior Approval Statute Prohibits Excessive Rates from Being Approved or 12 Remaining in Effect.

13 Proposition 103 “replace[d] the former system for regulating insurance rates (which relied
14 primarily upon competition between insurance companies) with a system in which the commissioner
15 must approve such rates prior to their use.” (*Amwest Surety Ins. Co. v. Wilson* (1995) 11 Cal.4th 1243,
16 1259; §§ 1861.01(c), 1861.05.) Proposition 103 requires all property-casualty insurers to submit rate
17 applications to the Insurance Commissioner for public review and regulatory approval prior to the
18 proposed rates taking effect. (§§ 1861.01(c), 1861.05(b).) Section 1861.05 requires, in relevant part:

19 No rate shall be *approved or remain in effect which is excessive*, inadequate, unfairly
20 discriminatory or otherwise in violation of this chapter.... and the commissioner shall
21 consider whether the rate mathematically reflects the insurance company's investment
22 income.

23 (Emphasis added.) In other words, excessive rates are *unlawful*. Insurers “have the *burden of proving*
24 that the requested rate change is justified and meets the requirements of this article.” (§ 1861.05(b),
25 emphasis added; see also Regs., § 2646.5.)

26 The California Supreme Court unanimously upheld Proposition 103 against constitutional attack
27 by the insurance industry in 1989. (*Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805 (*Calfarm*).)

28 ² Consumer Watchdog joins in the arguments of Respondent Insurance Commissioner and CFC to the extent they are consistent with its positions; Consumer Watchdog expressly does not waive any right to subsequently address any issue raised by SFG not discussed in this brief.

³ All subsequent statutory cites without attribution are to the Insurance Code.

1 **B. The Prior Approval Regulations Are Designed to Yield a Reasonable, Nonconfiscatory**
2 **Rate.**

3 In 1991, after an exhaustive rulemaking proceeding, the Commissioner adopted a detailed set of
4 regulations to be used in determining whether an insurer’s proposed rates are excessive or inadequate.
5 (See Regs., §§ 2641.1–2644.27.) Following another series of challenges from the industry, these prior
6 approval regulations were unanimously upheld by the California Supreme Court in 1994 and have
7 governed the insurance industry for more than two decades since. (*20th Century Ins. Co. v. Garamendi*
8 (1994) 8 Cal.4th 216 (*20th Century*)). The regulations contain regulatory formulas that represent the
9 Commissioner’s determination of the boundaries of “excessive” and “inadequate” rates set forth in
10 section 1861.05(a).⁴ (*Id.* at 254.) The formula combines the insurer’s expected “losses” (payouts on
11 policies) (see Regs., §§ 2642.2, 2644.15–2644.18) with various expenses and other costs (see Regs., §§
12 2644.8–2644.12) to derive the reasonable cost of providing the insurance. Insurers must maintain funds
13 necessary to ensure they can pay future claims. It is this capital on which the insurer is entitled to an
14 opportunity to earn a profit, and the regulatory formula specifies how the permitted profit is to be
15 calculated. (See Regs., §§ 2644.2, 2644.15–2644.19.) The insurer’s capital does not, however, sit idle
16 waiting to pay claims. Insurers invest it, yielding investment income, and that investment income
17 reduces the amount consumers may be charged in rates. Proposition 103 expressly requires the
18 Commissioner to ensure that “the rate mathematically reflects the insurance company’s investment
19 income.” (§ 1861.05(a); Regs., § 2644.2.) This calculation is prescribed in Regulations 2644.17–
20 2644.22, and it is these sections and their application that SFG challenges here. The regulations establish
21 a consistent methodology over time and across companies.

22 **C. The Prior Approval Regulations Provide for Variances from the Regulatory Formula.**

23 “[T]he ratemaking formula itself . . . is designed to yield a nonconfiscatory rate for the individual
24 insurer even before any variance might come into play.” (*20th Century, supra*, 8 Cal.4th at 313.)
25 Therefore, the vast majority of approved rates fall within the regulatory range of maximum and
26 minimum permitted earned premiums. But as an extra layer of regulatory protection for insurance
27 companies, the regulations permit insurers to seek 22 separate “variances” from either individual
28 components or the final output of the regulatory formula if certain conditions are met. (Regs., §

⁴ Given that the formula used to calculate the boundary of *excessive* rates is mainly at issue here, subsequent references to the formula will be in the singular tense.

1 2644.27(f)(1)-(9).)

2 The California Supreme Court has upheld each of these provisions of the Commissioner’s
3 regulations against constitutional challenges by the insurance industry, both facially and as applied.
4 (*20th Century, supra*, 8 Cal.4th at 243, 291, 297, 312, 328, cert. den. sub nom. *State Farm Mutual*
5 *Automobile Ins. Co. v. Quackenbush* (1995) 513 U.S. 1153.)

6 **III. THE PROJECTED YIELD ESTABLISHED BY THE DECISION IS LAWFUL.**

7 SFG disputes the Commissioner’s calculation of the projected yield, arguing that the
8 Commissioner has violated the “separate corporate existence” and “internal affairs” doctrines, that his
9 calculation is inconsistent with the statute, that it raises serious constitutional concerns, and that the
10 resulting rate is confiscatory. (OB, pp. 8-22.) But at bottom, SFG’s arguments are all premised on the
11 insurer’s disagreement with the substance of the Commissioner’s projected yield regulation, which
12 contains explicit directions for calculating the projected yield. SFG is thus asking this Court to invalidate
13 that duly adopted regulation, upending the Commissioner’s regulatory authority under Proposition
14 103, disregarding bedrock constitutional principles concerning confiscation and ignoring longstanding
15 principles of actuarial science.

16 It is no surprise that SFG tries to present its argument as anything but a direct attack on the
17 regulation. As the California Supreme Court reaffirmed eleven months ago, the burden SFG faces to
18 invalidate a duly adopted regulation is high. First, a challenged regulation “comes to the court with a
19 presumption of validity.” (*Assn. of California Ins. Cos. v. Jones* (2017) 2 Cal.5th 376, 389 (*ACIC*.) And
20 particularly with respect to a quasi-legislative regulation—such as the projected yield regulation, which
21 was adopted to implement and make specific the language of Proposition 103—the courts are
22 exceedingly deferential to the administrative agency. Review of such enactments is very narrow: “If
23 satisfied that the rule in question lay within the lawmaking authority delegated by the Legislature, and
24 that it is reasonably necessary to implement the purpose of the statute, judicial review is at an end.” (*Id.*
25 at 397.) Where, as in this case, “the Legislature has delegated to an administrative agency the
26 responsibility to implement a statutory scheme through rules and regulations, the courts will interfere
27 only where the agency has clearly overstepped its statutory authority or violated a constitutional
28 mandate.” (*Ford Dealers Assn. v. Department of Motor Vehicles* (1982) 32 Cal.3d 347, 356.)

Deference to the agency is particularly strong where, as here, the challenged interpretation is

1 longstanding, having been operative for over a decade; has been consistently maintained; is embodied in
2 a formally adopted regulation in accordance with the rulemaking procedures of the Administrative
3 Procedure Act, and after careful consideration by the senior most agency officials; and reflects the
4 agency’s expertise and knowledge in interpreting legal text that is “technical, obscure, complex, open-
5 ended, or entwined with issues of fact, policy, and discretion.” (*Yamaha Corp. of America v. State Bd. of*
6 *Equalization* (1998) 19 Cal.4th 1, 12–13 (*Yamaha*).

7 **A. The Commissioner’s Interpretation and Application of the Projected Yield Regulation Is**
8 **Consistent with Section 1861.05 and Its Underlying Purpose.**

9 The regulation targeted by SFG addresses the calculation of the projected yield figure to be used
10 in the regulatory formula. It provides in relevant part:

11 “Projected yield” means the weighted average yield computed using the insurer’s actual
12 portfolio and yields currently available on securities in US capital markets. The weights
13 shall be determined using the insurer’s most recent *consolidated statutory annual*
14 *statement*, and shall be computed by dividing the insurer’s assets in each separate asset
15 class shown on page 2, lines 1 through 9 of the insurer’s *consolidated statutory annual*
16 *statement*, by the total of lines 1 through 9.

17 (Regs., § 2644.20(a), emphasis added.) As the Commissioner concluded, this provision of the regulation
18 “is not ambiguous.” (Decision, Administrative Record (AR) 5121.) It requires using the figures in the
19 insurer’s most recent “consolidated statutory annual statement” to calculate the projected yield—a
20 straightforward requirement that there is no dispute the Commissioner followed.

21 SFG makes two arguments to challenge the Decision’s projected yield calculation. First, SFG
22 argues that the Commissioner should have ignored the specific text of the regulation, which has been
23 applied to tens of thousands of rate applications over the last 10 years, and instead create a special rule
24 applicable only to SFG and the State Farm Group that calculates projected yield based on SFG’s
25 *individual* annual statement, which reflects the asset distribution of the *California subsidiary only*. (OB,
26 pp. 5, 11-15.)

27 But SFG does not dispute that the projected yield regulation it challenges “lay within the
28 lawmaking authority delegated by the Legislature, and that it is reasonably necessary to implement the
purpose of the statute” (*ACIC, supra*, 2 Cal.5th at 397.) Nor could it. The California Supreme Court
long ago recognized that “Proposition 103 effectively requires the Commissioner to establish rules. It
implicitly empowers him to proceed by regulation.” (*20th Century, supra*, 8 Cal.4th at 280.) And

1 because Proposition 103 “does not establish a detailed method of processing and deciding rate
2 applications [m]uch is necessarily left to the Insurance Commissioner, who has broad discretion to
3 adopt rules and regulations as necessary to promote the public welfare.” (*Calfarm, supra*, 48 Cal.3d at
4 824.) In other words, the regulations setting forth the formula for determining rates, including the
5 projected yield regulation challenged here, are “reasonably necessary to implement the purpose of”
6 Proposition 103, and accordingly, “judicial review is at an end.” (*ACIC, supra*, 2 Cal.5th at 397.)

7 Second, SFG maintains that the formula in the regulation that requires using the *consolidated*
8 statutory annual statement of State Farm Group as an enterprise conflicts with Proposition 103’s general
9 requirement that “the commissioner shall consider whether the rate mathematically reflects the insurance
10 company’s investment income,” because the statute uses the term “insurance company” in the singular.
11 (OB, pp. 11-15, quoting § 1861.05(a).)

12 The Commissioner’s Decision correctly rejected SFG’s argument, finding no conflict between
13 the regulation and the statute:

14 [Section 1861.05, subd. (a)] only requires that the calculation of an insurer’s investment
15 income be mathematically accurate. Section 1861.05, subdivision (a) does not determine
16 which statement shall be used when an insurance company is a group. Such details are
17 resolved by Regulation section 2644.20, subdivision (a) [i.e., the projected yield
18 regulation.]

19 (Decision, AR5123.) There is nothing in section 1861.05(a) that requires that the “insurance company”
20 be an individual affiliate instead of a group of affiliated insurers with integrated operations. The
21 Insurance Code makes clear that the use of a term in the singular does not restrict its meaning to the
22 singular: “The singular number includes the plural, and the plural the singular.” (§ 13.) As the Decision
23 further noted, there is “extensive authority for the term ‘insurer’ encompassing insurers operating within
24 a group for the purpose of ratemaking.” (Decision, AR5123.)

25 Nor does the phrase “mathematically reflects” in the statute mean that the rate must reflect *only*
26 the investment income reported on the books of the individual insurer. As the Decision recognizes, the
27 regulatory formula *does* project (and therefore “mathematically reflects”) the insurance company’s
28 investment income using group data. (Decision, AR5082-5083, 5119, 5123.) In fact, even SFG’s own
witness conceded in written testimony that the regulatory formula “tak[es] investment income into
account.” (AR5275, ¶ 7.) This meets the statutory directive that the Commissioner “consider” the

1 insurance company’s investment income. *20th Century* does not stand for the proposition that “it is the
2 ‘individual insurer’ whose investment income must be ‘offset’ against the rate sought,” as SFG argues
3 based on selectively excerpting two passages from that case that are 47 pages apart. (OB, p. 12:3-5,
4 12:14-23, quoting *20th Century, supra*, 8 Cal.4th at 243, 290.) In context, *20th Century* merely notes the
5 statutory command that the Commissioner “consider[] the ‘investment income’ of the individual
6 insurer.” (*20th Century, supra*, 8 Cal.4th at 243, 290.) Nowhere does *20th Century* opine on the question
7 of whether the Commissioner can calculate the projected yield using the insurer’s actual portfolio on a
8 groupwide basis.

9 *California Auto. Assigned Risk Plan v. Garamendi* (1991) 232 Cal.App.3d 904 does not support
10 SFG’s argument, either. That case considered whether section 1861.05 applied to CAARP, a program in
11 which all auto insurers are required to participate, that insures drivers who are unable find insurance on
12 the regular market. (*Id.* at 910–911.) Rates under the CAARP program “are set by the commissioner,
13 and all insurers issuing assigned-risk policies must charge these uniform rates.” (*Ibid.*) In finding that
14 CAARP is *not* subject to Proposition 103’s rate-setting provisions, the court explained that section
15 1861.05’s requirement that the Commissioner consider “the investment company’s investment income”
16 was on its face inapplicable to CAARP because “[n]o single, uniform rate could be expected to
17 ‘mathematically reflect[] the . . . investment income’ of each individual insurance company participating
18 in CAARP.” (*Id.* at 912.) Thus, “the statutory reference to ‘*the* insurance company’s investment income’
19 *has no clear meaning in this context.*” (*Ibid.*, second emphasis added.) In no way was the *CAARP* court
20 holding that section 1861.05 prohibited the Commissioner from considering the projected yield of a
21 group of affiliated insurers in determining rates.

22 SFG assails the projected yield regulation’s use of consolidated or group data as “based on the
23 unsustainable fiction that SFG has access to the investment assets and income of its parent and affiliate.”
24 (OB, pp. 10, 15.) But the only unsustainable fiction here is SFG’s portrayal of itself as an independent
25 company. SFG is a wholly owned subsidiary of SFMA, which has over \$168 billion in assets and also
26 owns and controls the eight other affiliates referenced in its consolidated statement. (Decision, AR5092,
27 5096; AR7400-7401.) SFMA exercises total control over SFG. As the Decision found, “SFG is managed
28 by State Farm Mutual employees, SFG’s board of directors and board committees consist entirely of
employees of State Farm Mutual, some of whom are also members of State Farm Mutual’s board of

1 directors.” (*Id.*, AR5097.) And “State Farm Mutual employees provide legal, risk management, and
2 other services SFG needs to serve SFG’s policyholders. As a result, SFG has no employees of its own.”
3 (*Ibid.*) SFMA also “provides SFG with the majority of its catastrophe reinsurance protection” and “a
4 liquidity pool and a half a billion dollar line of credit.” (*Id.*, AR5099.) Such identity of control,
5 management, and financial integration belies SFG’s purported isolation from the investment income or
6 assets of its parent and other controlled affiliates. At any time, *SFMA*, the parent company and 100%
7 owner of SFG, “may transfer assets between affiliates in compliance with regulations as State Farm
8 Mutual undoubtedly did when it reconfigured SFG in 1998.” (*Id.*, AR5124.) The fact that the State
9 Farm Group operates without a “‘pooling agreement’ or similar arrangement by which they could
10 ‘transfer assets between affiliates’” (OB, p. 11) is entirely a matter of SFMA’s choice. (Decision,
11 AR5124.) Thus, the Decision’s use of consolidated statements to calculate the projected yield, as
12 required by the regulation, is not an effort to “coerce an insurer to enter into revenue sharing
13 agreements,” as SFG contends (OB, pp. 11, 13); it is simply a recognition of the corporate structure
14 SFMA has selected. The weight of the evidence more than supports the Decision’s findings in this
15 regard, and SFG does not argue otherwise.

16 Contrary to SFG’s assertion that the projected yield regulation “would lead to impermissible
17 double counting” (OB, p. 19), it actually would ensure that all members of an insurance group, such as
18 the State Farm Group, are treated the same in the aggregate: “SFG’s projected yield may be higher due
19 to the inclusion of State Farm Mutual’s stock holdings in the calculation of its projected yield. But the
20 same consolidated statement would lower the yield for State Farm Mutual’s automobile insurance line
21 by including the lower yielding bonds of SFG in the rates for State Farm Mutual’s auto insurance in
22 California.” (Decision, AR5125.)

23 Ironically, SFG argues that allowing a wholly owned subsidiary such as itself to be treated as a
24 separate, standalone insurer for purposes of ratemaking “is supported by the purpose of section
25 1861.05(a), as well as its history and structure.” (OB, p. 12.) But SFG’s argument would eviscerate
26 Proposition 103’s provisions and destabilize California’s insurance market. SFG freely admits that its
27 preferred yield calculation results in a “drastically” higher rate than would be calculated pursuant to the
28 regulatory formula. (OB, p. 2:2-4.) Thus, if SFG’s argument were accepted, every national insurer doing
business in California could follow SFG’s example, “wall off” their California affiliates on paper, hold

1 low-yield investments in those companies, and concentrate their higher-yield investments in other
2 controlled affiliates doing business in states where there is no rate regulation or where the projected
3 yield does not affect the rate that can be charged.

4 Finally, SFG’s request that it be granted a special exemption from the projected yield regulation
5 so that its individual data can be considered is a thinly disguised attack on insurance ratemaking
6 generally. (OB, pp. 14-15.) It is an undisputed and fundamental principle of actuarial science that
7 ratemaking involves *projections*, i.e., an estimate of rate needs that is based on historical data. (E.g.,
8 Decision, AR5149.)⁵ Thus, all of the components of the regulatory formula, including the investment
9 income, are estimates. And as a corollary, it is axiomatic that ratemaking may use aggregate data as
10 opposed to an individual insurer’s data. Many components of the formula do not use a company’s own
11 costs. For example, the efficiency standard, surplus, and reserve ratios are all based on industry-wide
12 averages. (See Regs., §§ 2644.12, 2644.17, 2644.21.) In fact, many of the values used in the investment
13 income calculation are based on aggregates. (See Regs., §§ 2644.17–2644.22.) They impute an
14 estimated volume of financial assets into the investment income calculation, based on an industry
15 average. (See Regs., §§ 2644.17, 2644.21, 2644.22.) SFG does *not* object to any of the industry-wide
16 ratios used in the investment income calculation and which the California Supreme Court has
17 specifically authorized. (*20th Century, supra*, 8 Cal.4th at 309–314 [“It is permissible for an agency to
18 use average costs rather than the costs of individual regulated firms.” (*Id.* at 293, internal quotes
19 omitted].) As the Decision thus observed, the projected yield regulation “is part of a statutory scheme
20 regulating rates within an industry composed in large part of national, group insurers.” (AR5124.)

21 **B. The Projected Yield Regulation Does Not Raise Any Constitutional Issues.**

22 Relying on out-of-context snippets from various cases, SFG also tries to piece together a
23 constitutional argument against the projected yield regulation. (OB, pp. 15-20.) But SFG’s cases simply
24 confirm that the foundation of any Due Process or Commerce Clause violation is a law, regulation, or
25 other state action that *requires* or *prohibits* certain activity that occurs *outside the state*—which the
26 regulation at issue here plainly does not do.

27 *Healy v. Beer Institute* (1989) 491 U.S. 324, for example, struck down a Connecticut law that
28

⁵ See also, AR5274-5275, ¶ 6; 5290:20-21 (SFG witness mentioning “the appropriate basis for the *projection of investment income*,” emphasis added).

1 *required* out-of-state beer distributors to affirm that their prices for Connecticut wholesalers were no
2 higher than the prices charged in bordering states. The statute had the “practical effect of controlling”
3 the prices that could be charged outside Connecticut and limiting discounts that could be offered in other
4 states, in violation of the Commerce Clause. (*Id.* at 338–339.) Similarly, *Edgar v. Mite Corp.* (1982) 457
5 U.S. 624 involved an Illinois law that *prohibited* any tender offer on an Illinois company unless the
6 offeror first notified the Illinois Secretary of State and the target company 20 business days before the
7 offer became effective, during which time the target company could communicate with its shareholders
8 but the offeror could not. (*Id.* at 626.) The Supreme Court found this law in violation of the Commerce
9 Clause because it “directly regulates and prevents, unless its terms are satisfied, interstate tender offers
10 which in turn would generate interstate transactions.” (*Id.* at 640.) And *BMW v. Gore* (1996) 517 U.S.
11 559 held that an Alabama court could not impose a punitive damage award against BMW based on its
12 conduct outside of Alabama. Doing so, the Supreme Court found, would “*infring[e]* on the policy
13 choices of other States” where BMW’s conduct at issue was, in fact, lawful. (*Id.* at 572, emphasis
14 added.)

15 In no way does the projected yield regulation challenged by SFG require, prohibit, or otherwise
16 regulate any out-of-state conduct. The regulation simply provides a methodology for ensuring that the
17 insurer’s projected yield accurately reflects all the entities under the same control: If the State Farm
18 Group is going to structure its operations in a way that the parent company exercises complete control
19 over and directly owns 100% of its affiliates, then the regulation will account for that by considering
20 projected yield (as well as costs) on an enterprise-wide basis. The regulation does not require that SFG
21 or SFMA structure its operations in any particular way. In short, it does not implicate the Due Process or
22 Commerce Clauses.

23 **C. The Commissioner Properly Denied the Confiscation Variance Because SFG Failed to**
24 **Demonstrate That the Ordered Rate Is Confiscatory.**

25 SFG next claims that the ordered rate is “confiscatory” because the Decision applied the
26 projected yield regulation. (OB, pp. 20:6-22:19.) In support of its claim, SFG substitutes its own
27 purported “actual yield” for the value calculated by the ratemaking formula and then complains that this
28 generates a “mere” total return of approximately 2.65% on its California homeowners business. (OB, pp.
2:23, 20:13-15.) Using SFG’s preferred yield calculation in place of the one required by the regulatory

1 formula is not a valid way to establish confiscation. The Commissioner properly applied California and
2 U.S. Supreme Court precedent to reject SFG’s request for a confiscation variance and concluded that
3 SFG “fail[ed] to demonstrate the rate decrease indicated by the formula results in deep financial
4 hardship to Applicant’s enterprise as a whole such that it cannot operate successfully.” (AR5143.)

5 1. Under the Controlling 20th Century and U.S. Supreme Court Confiscation Standards,
6 an Insurer Must Show That the Ordered Rate Prevents It from Operating
7 Successfully.

8 SFG ignores or misstates the well-established and controlling constitutional jurisprudence.

9 *Calfarm* held that the original standard for setting rates during the first year after the passage of
10 Proposition 103—a flat 20% reduction of rates—could not stand without allowing a company to show
11 that this standard was confiscatory as applied to it. (48 Cal.3d 805, 823–826.) Accordingly, the
12 Commissioner adopted regulations setting the general ratemaking standard, comprised of formulas
13 accounting for the reasonable costs of providing insurance and adding a component to the formulas for a
14 reasonable profit. (See Regs., § 2642.1–2642.2, 2644.1–2644.26.) In *20th Century*, the Supreme Court,
15 citing *Calfarm*, upheld the Commissioner’s regulations, including his authority to regulate rates by
16 formula. (8 Cal.4th at 293 [the ratemaking method “may implicate formulaic ratemaking (see *Permian*
17 *Basin Area Rate Cases* (1968) 390 U.S. 747, 768-770 (*Permian Basin*)) using data reflecting the
18 condition and performance of a group of regulated firms (see *id.* at pp. 766-790.”)] “[T]he ratemaking
19 formula itself . . . is designed to yield a nonconfiscatory rate for the individual insurer even before any
20 variance might come into play.” (*20th Century, supra*, 8 Cal.4th at 313.)

21 As a further safety valve, the confiscation variance invoked by SFG allows an insurer to
22 demonstrate that: “the maximum permitted earned premium would be confiscatory as applied. This is
23 the constitutionally mandated variance articulated in *20th Century v. Garamendi* (1994) 8 Cal.4th 216
24 which is an *end result test* applied to the enterprise as a whole.” (10 CCR § 2644.27(f)(9), emphasis
25 added.) When a regulation or ordered rate is challenged as being confiscatory as applied, as SFG does
26 here, “the question is whether, in the particular case, its terms set a rate that is unjust and unreasonable
27 and hence confiscatory.” (*20th Century, supra*, 8 Cal.4th at 318.) The *20th Century* Court went on to
28 state, “[j]udicial inquiry as to whether or not a rate is just and reasonable is also limited.” (*Ibid.*) Indeed,
such an inquiry by the court is “at an end” “[i]f the total effect of the rate order cannot be said to be
unjust and unreasonable. . . . The fact that the method employed to reach that result may contain infirmities

1 is not then important.” (*Ibid.*, quoting *Power Comm’n v. Hope Gas. Co.* (1944) 302 U.S. 320, 602
2 (*Hope*); *Calfarm, supra*, 8 Cal.4th at 816; see also *20th Century, supra*, 8 Cal.4th at 292–293.)

3 The determination of whether a rate “is unjust and unreasonable in its consequences and
4 therefore confiscatory depends on a *balancing of the interests of [the insurer] and its insureds.*” (*Id.* at
5 325, emphasis added; see also *id.* at 293–295; *Hope, supra*, 320 U.S. at 603 [“[T]he fixing of ‘just and
6 reasonable’ rates, involves a balancing of the investor and the consumer interests”].) “But striking a
7 balance to the producer’s detriment does not necessarily work confiscation. Indeed, it can *threaten*
8 confiscation only when it prevents the producer from ‘operating successfully ... *during the period of the*
9 *rate and subject to then-existing market conditions.*” (*20th Century, supra*, 8 Cal.4th at 295, emphasis
10 in original.)

11 Accordingly, an insurer “may complain of confiscation only if *the rate in question does not*
12 *allow it to operate successfully.*” (*Ibid.*, emphasis added; *Hope, supra*, 320 U.S. at 605.) “In a word, the
13 inability to operate successfully is a necessary-*but not a sufficient*-condition of confiscation.” (*20th*
14 *Century, supra*, 8 Cal.4th at 296, emphasis added.)

15 The *20th Century* Court further explained that:

16 absent the sort of deep financial hardship described in *Hope*, . . . there is no taking. . . .
17 This follows from the fact that, under *Hope*, a regulated firm may claim that a rate is
18 confiscatory only if the rate does not allow it to operate successfully. In such
19 circumstances, the firm is not inaptly characterized as experiencing ‘deep financial
20 hardship’ as a result of the rate.

21 (*Ibid.*, quoting *Jersey Cent. Power & Light Co. v. F.E.R.C.* (D.C. Cir. 1987) 810 F.2d 1168, 1181, fn. 3.)

22 As the passage makes clear, *20th Century* was equating “deep financial hardship” with the “inability to
23 operate successfully” confiscation standard articulated in *Hope*. (See *Hope, supra*, 320 U.S. at 605.)

24 Last February, this constitutional principle was again applied to a nearly identical challenge to
25 the regulations brought by Mercury Casualty and State Farm’s trade association: “[W]e find no error in
26 the application by the commissioner and the superior court of the ‘deep financial hardship’ standard to
27 determine whether a price control is constitutionally confiscatory.” (*Mercury, supra*, 8 Cal.App.5th 561,
28 589.)

While acknowledging that *20th Century* delineates the appropriate test for determining whether
insurance rates are confiscatory (OB, p. 21:11-18), SFG quotes from *Hope* to claim that insurers are

1 constitutionally entitled to a “return to the equity owner...commensurate with returns on investments in
2 other enterprises having corresponding risks.” (OB, p. 20:18-20, citing *Hope, supra*, 320 U.S. at 603.)
3 However, the portion of the sentence SFG quotes is but one element of the “investor’s interest in the
4 financial integrity of the enterprise” side of the constitutional balancing equation set forth in *Hope* as
5 applied in *20th Century*. (*Hope, supra*, 320 U.S. at 603; see also *20th Century, supra*, at 325–326;
6 *Permian Basin, supra*, 390 U.S. 747, 769 [“Regulation may, consistently with the Constitution, limit
7 stringently the return recovered on investment, for investors’ interests provide only one of the variables
8 in the constitutional calculus of reasonableness”].) Altogether missing from SFG’s analysis is the other
9 side of the test: consumers’ interest in reasonable rates. (*Hope, supra*, 320 U.S. at 603.)

10 In any case, the rate ordered in this case does not deny SFG the opportunity to earn a fair return.
11 Even accepting SFG’s own calculations (using the yield it projected for SFG instead of the yield
12 projected under the regulatory formula using its consolidated annual statement), SFG will earn an after-
13 tax return of 2.65%. (OB, p. 20:13-14; see also AR07490; AR10955:25-10956:13, 10958:22-25, 16504
14 ¶ 60.) This results in projected after-tax profit of about \$27 million.⁶ Case law mandates that a profit of
15 this magnitude cannot be considered confiscatory. (See, e.g., *20th Century, supra*, 8 Cal.4th at 294 [“A
16 regulated [firm] has no constitutional right to a profit” [Citations,] Indeed, such a firm has no
17 constitutional right even against a loss.”].)

18 2. The Commissioner Correctly Evaluated the Rate Order’s Impact on SFG As an
19 Enterprise.

20 Next, SFG complains that the Decision analyzed “confiscation by reference to ‘the insurer as a
21 group.’” (OB, p. 21:26-27.) As noted above, however, SFG is not an operationally independent
22 company. Indeed, as the Decision points out, A.M. Best gave SFMA an A++ rating—indicating the
23 company is financially sound—in part because of its “well diversified” financial position. (AR5095.)
24 That diversification comes not from the separate holdings of SFMA and SFG, but from the
25 diversification of the group as a whole taking the separate portfolios together. (*Id.*, AR5095-5096.) At
26 the same time that SFG, which has no employees (see *Id.*, AR5097), is happy to have its parent’s
27 personnel *costs* recognized in its rates, it insists to this Court that allocating to it a portion of the
28

⁶ Calculated by multiplying a premium base of about \$1.1 billion (AR6601) and the “Total Profit after Tax % Premium” of 2.42% (AR7490, Line (33)).

1 investment *income* of the group of which it is a member is an injustice of constitutional dimension.

2 Moreover, SFG proffers calculations that ignore the unbroken line of cases prescribing that
3 confiscation is to be evaluated on an enterprise-wide basis. As the Third District recently reiterated, an
4 evaluation of confiscation is not limited to an “examination of the regulated investment.” (*Mercury*,
5 *supra*, 8 Cal.App.5th at 590.) Rather, relying on *20th Century*, the Third District noted that “confiscation
6 is judged with an eye toward *the regulated firm as an enterprise*.” (*Id.* at 585, quoting *20th Century*,
7 *supra*, 8 Cal.4th at 293, emphasis added; see also *20th Century*, *supra*, 8 Cal.4th at 308–309 and 322
8 [same].)⁷ Applying the bottom-line, enterprise-wide analysis prescribed by the case law, the
9 Commissioner found that SFG could not meet the evidentiary burden required by Variance 9. (AR5139-
10 5143.) He concluded that “[w]hile perhaps not generating the profit margin Applicant desires, Applicant
11 fails to demonstrate that the rates ordered by the Commissioner will impair the enterprise as a whole’s
12 financial integrity, profitability, or overall ability to operate successfully.” (AR5146.) For example:
13 “Looking at the enterprise as a whole – i.e., the State Farm group – during the [five year period from
14 2010 through 2014], [the] State Farm [Group] reported net income after taxes of \$12.22 billion – an
15 average of \$2.4 billion per year – and profited \$4.6 billion in 2014, alone.” (*Id.*, AR5143.) Moreover,
16 SFG itself has earned “average profits of nearly \$300 million per year” over the last 10 years. (*Id.*,
17 AR5147.) The Commissioner also noted that “the insurance industry’s national rating organization, AM
18 Best, rated State Farm’s financial strength as A++” and the individual affiliate’s financial strength as
19 A+. (*Id.*, AR5146.)

20 Contrary to SFG’s contentions (OB, p. 22:11-19), courts have consistently considered this type
21 of historical data demonstrating past performance under the same regulatory scheme to determine
22 whether an ordered rate will result in confiscation. (See, e.g., *Mercury*, *supra*, 8 Cal.App.5th 561, 591;
23 *Hope*, *supra*, 320 U.S. 591, 603–604 [discussing historical financial data under the regulatory regime];
24 *Duquesne Light Co. v. Barasch* (1989) 488 U.S. 299, 311–312 [same].)

25 _____
26 ⁷ The unanimous *20th Century* decision makes it clear that there is no conflict on this point with the
27 same Court’s unanimous decision in *Calfarm*: “In *Calfarm*, we recognized that a court might
28 subsequently be presented with a claim that Proposition 103’s maximum rate for the rollback year ‘is
confiscatory as to a particular insurer and line of insurance. ([48 Cal.3d at 825, fn. 18].) Our recognition
was factual: it concerns the nature of the complaint that an insurer might make. It was not normative: it
does not mean that confiscation is judged other than with an eye toward the insurer as a whole.” (*20th
Century*, *supra*, 8 Cal.4th at 309, fn. 23)

1 **IV. THE REFUNDS ORDERED BY THE DECISION ARE LAWFUL.**

2 Challenging the Commissioner’s authority under Proposition 103 to order the insurer to refund
3 policyholders for rates found to be excessive, SFG argues that “[n]othing in the statute authorizes” the
4 Commissioner’s action and cites various in-state and out-of-state case authority. (OB, pp. 24-28.) But
5 noticeably absent is any reference or citation to, much less discussion of, the controlling statute itself,
6 section 1861.05(a), which was the foundation for the Commissioner’s Decision on this issue (Decision,
7 AR5147). Under Proposition 103, it is *unlawful* to allow excessive rates to “remain in effect.” The
8 Commissioner found that SFG’s *in-effect rates* were excessive, resulting in SFG overcharging its
9 approximately 1.7 million policyholders by over \$100 million between July 15, 2015, the effective date
10 (chosen by SFG itself), and November 7, 2016, the date the Commissioner issued his final Order. This is
11 precisely what California voters sought to prohibit when they enacted the “*remain in effect*” language.
12 SFG would completely read the voters’ explicit and unambiguous command right out of the statute, and
13 dismiss controlling California Supreme Court precedent in favor of importing out-of-state regulatory
14 doctrines that conflict with California law.

15 **A. The Decision Correctly Determined That Proposition 103’s Explicit Prohibition Against**
16 **“Excessive” Rates “Remain[ing] in Effect” Authorizes Ordering Refunds.**

17 1. Proposition 103’s Plain Language and Purpose Establish Refund Authority.

18 The inquiry here begins, as it must, with the plain text of the law: “[A] court must look first to
19 the words of the statute themselves, giving to the language its usual, ordinary import and according
20 significance, if possible, to every word, phrase and sentence in pursuance of the legislative purpose.”
21 (*State Farm Mutual Auto. Ins. Co. v. Garamendi* (2004) 32 Cal. 4th 1029, 1043, citations omitted.)
22 When examining a law enacted by initiative, particular care must be exercised to protect the voters’
23 exercise of their “precious” initiative power. (*Rossi v. Brown* (1995) 9 Cal.4th 688, 695.)

24 The unambiguous language of section 1861.05—unique in the nation—that no excessive,
25 inadequate, or unfairly discriminatory rate “shall be approved or remain in effect” directs that the legal
26 standard applies not only to applications for rates to be charged in the future, but also to the rates that are
27 currently “in effect.” The law places insurers doing business in California on notice that they have a
28 *continuing obligation* to maintain rates in effect that are neither excessive nor inadequate.⁸

⁸ In furtherance of their Finding that “the existing laws inadequately protect consumers and allow insurers to charge excessive, unjustified and arbitrary rates” (Prop. 103, § 1 [Findings and Declaration]),

1 SFG has no response whatsoever to this clear statutory requirement; it literally does not even
2 attempt to address the “remain in effect” language—a violation of a cardinal rule of statutory
3 construction. (*Ladd v. County of San Mateo* (1996) 12 Cal.4th 913, 927–928 [“[W]e avoid statutory
4 constructions that render particular provisions superfluous or unnecessary.”].) Nor does SFG try to
5 explain why the voters would empower the Commissioner to make findings that rates that have been in
6 effect are excessive and illegal, but then not allow him to do anything about them. That would make no
7 sense. When rates that are “in effect” are excessive, the insurance is not “fair” or “affordable,” but rather
8 in violation of the plain text and *explicit purpose* of Proposition 103 to prohibit excessive rates from
9 “remain[ing] in effect.”⁹

10 The Commissioner’s Decision correctly found that Proposition 103 authorized him to order
11 refunds based on SFG’s excessive rates that had illegally remained in effect. This determination made
12 by the official charged with implementing Proposition 103, who possesses extensive experience with,
13 and technical expertise in, this area of rate regulation is entitled to “great weight and respect.” (*Yamaha*,
14 *supra*, 19 Cal.4th 1, 12.) SFG’s refusal to even acknowledge the “remain in effect” language fatally
15 undermines its argument.

16 2. California Case Law Unequivocally Supports the Commissioner’s Decision to Order 17 Refunds.

18 Two unanimous decisions of the California Supreme Court confirm the Commissioner’s
19 authority to order refunds under Proposition 103. *Calfarm* interpreted section 1861.05(a) and found that
20 the very same language at issue here—“remain in effect”—provided the Commissioner the “power to
21 grant interim relief” to allow insurers to charge a higher rate on an interim basis if the insurer believed
22 the statutorily required rate would be confiscatory:

23 The power to grant interim relief is necessary for the due and efficient administration of
24 Proposition 103, and may fairly be implied from its command that “[n]o rate shall ...
25 *remain in effect* which is excessive, inadequate, unfairly discriminatory or otherwise in
violation of this chapter.” (§ 1861.05, subd. (a).)

26 the voters *repealed* the antecedent provision governing insurance rates in California, which contained *no*
27 *reference to “in effect”* rates. (§ 1852, added by Stats. 1947, c. 805, § 1, p. 1896, *repealed by*
28 Proposition 103, as approved by voters, Gen. Elec. (Nov. 8, 1988).) SFG asks this Court to judicially
revert California insurance law to its pre-Proposition 103 state.

⁹ Proposition 103 requires that it “shall be liberally construed and applied in order to fully promote its
underlying purposes.” (*Foundation for Taxpayer and Consumer Rights v. Garamendi* (2005) 132
Cal.App.4th 1354, 1354, as modified (Oct. 27, 2005), quoting Prop. 103, uncodified § 8(a).)

1 (48 Cal.3d at 825, quoting § 1861.05(a), ellipses and emphasis in original.) *But*, as part of this power to
2 grant interim relief, “[i]f the commissioner finds the initiative’s rate, or some other rate less than the
3 insurer charged, is fair and reasonable, the *insurer must refund excess premiums* collected with interest.”
4 (*Ibid.*, emphasis added.)

5 Five years later, *20th Century* again reaffirmed the Commissioner’s broad authority to order
6 refunds of excess premiums charged by insurers. (8 Cal.4th at 245–246, 267, 281.) In upholding the
7 Commissioner’s rollback regulations, the Supreme Court held that the “ordering of a refund of rates is
8 ‘akin to a reduction of rates,’ when, as here, the rates in question were charged ‘pending a determination
9 of [their] legality.” (*Id.* at 281; Decision, AR5148.) The Court continued: “It follows that the ordering of
10 a refund of rates is itself prospective. Since the regulations in question serve such a refund, they may
11 soundly be viewed to share its character.” (*Ibid.*)

12 Just as the “remain in effect” language was found by the Supreme Court to authorize refunds in
13 the furtherance of protecting insurers from confiscatory rates, the same language authorizes refunds
14 when consumers pay excessive rates. This is precisely the symmetry that the voters applied, weighing,
15 as the Supreme Court described it, “the insurer’s legitimate interest in financial integrity and the
16 insured’s legitimate interest in freedom from exploitation.” (*20th Century, supra*, 8 Cal.4th at 245.)

17 SFG attempts to limit the reasoning in *Calfarm* and *20th Century* to the initial rate rollbacks
18 only. (OB, pp. 26:23-28:6.) But those cases interpreted section 1861.05(a)—and indeed the exact
19 “remain in effect” language at issue here—a fact that SFG does not dispute (failing even to reference the
20 controlling statutory language). Those cases further make clear that section 1861.05(a) not only applies
21 to rate regulation during the one-year rollback period *but also* reflects the general standard for rate
22 adjustment applicable in all cases. (*Calfarm, supra*, 48 Cal.3d at 822–823 [“the general standard for rate
23 adjustment [is] set out in section 1861.05, subdivision (a)” and “the standards set by section 1861.05,
24 subdivision (a), govern rate regulation during the first year of the initiative’s operation”]; *20th Century,*
25 *supra*, 8 Cal.4th at 244 [section 1861.05(a) is the “general standard applicable in all cases”].)

26 SFG’s argument boils down to this: Proposition 103’s provisions protect *insurance companies*
27 from being required to charge *too little*, but do *not* protect consumers when insurance companies
28 charged them *too much*. SFG’s “heads we win, tails you lose” argument founders on the shoals of
Calfarm and *20th Century*.

1 Instead of relying on the statutory language or controlling Supreme Court precedent, SFG
2 contends that two cases holding that consumers could not challenge approved rates in superior court
3 somehow bar the Commissioner from ordering refunds in an administrative proceeding. (OB, p. 25.) As
4 the Decision found, in both *Mackay v. Superior Court* (2010) 188 Cal.App.4th 1427 and *Walker v.*
5 *Allstate* (2000) 77 Cal.App.4th 750, the “insurance companies argued, and those courts agreed, [that] the
6 Insurance Commissioner, not the courts, has exclusive jurisdiction over challenges to rates, i.e., that
7 such challenges must first be brought before the agency.” (AR5151.) Those cases have nothing to do
8 with the Commissioner’s authority to order refunds under section 1861.05(a). SFG nevertheless asks this
9 court to *expand* the purported immunity from a *civil suit* challenging an insurer’s rates to an immunity
10 from administrative oversight. In short, according to SFG, *no* tribunal, civil or administrative, has
11 jurisdiction over overcharges.

12 The Commissioner correctly rejected SFG’s argument: “The holding in *McKay* that the
13 Commissioner has exclusive jurisdiction over rates does not operate to now limit the Commissioner’s
14 authority to establish rates and to order rates to be refunded.” (AR5151.)

15 **B. SFG’s Various Challenges to the Effective Date That SFG Itself Set Are Unfounded.**

16 Despite the fact that SFG itself initially selected July 15, 2015, as the effective date for its new
17 rates, it now argues that using that date would be unfair to the insurer and would violate due process and
18 ratemaking doctrines. (OB, pp. 25-29.) Because the Commissioner determined that a rate decrease, not
19 SFG’s requested increase, was required, SFG’s new position is that effective date for those rates should
20 remain open until the last possible date. None of SFG’s arguments are meritorious.

21 1. The Decision Correctly Found That Setting a Fixed Effective Date Was Within the
22 Commissioner’s Broad Authority and Was Necessary to the Enforcement of
23 Proposition 103.

24 As the Decision found, setting an effective date is critical to the implementation and enforcement
25 of Proposition 103. The regulatory formula is heavily dependent on the use of historical data to project
26 future losses, expenses, investment income, and other ratemaking components: “The effective date of a
27 rate application impacts the rates indicated by the regulatory formula because rates are determined, in
28 Thus, “[c]hanging the effective date of a rate application causes further delays in an already lengthy rate
hearing process because doing so may impact the data cut-off period, trend analysis, and other factors

1 that can require the resubmission, re-analysis, and recalculation of data and rates.” (*Id.*, AR5150.)

2 The Notice of Hearing in this case fixed the effective date based on the date set by SFG in its
3 application, and based on that date, the parties agreed to use data only through the end of 2014 and
4 proceeded to a hearing without resubmitting data beyond 2014. (*Id.*, AR5148, 5150-5151.) Moving the
5 effective date for SFG’s rates, as SFG demands, would likely require reopening the rate hearing to
6 reassess the data cut-off period, trend analysis, and other factors and to recalculate new rates based on a
7 different effective date—resulting in precisely the “moving target of fluctuating data to analyze” that the
8 Decision sought to avoid. (*Id.*, AR5151.)

9 On the other hand, setting an effective date and allowing for an interim rate “minimizes delays
10 and helps to reduce rate hearings to a ‘manageable size’” (*Id.*, AR5150)—well within the
11 Commissioner’s broad authority recognized in *Calfarm* and *20th Century* to “tak[e] whatever steps are
12 necessary to reduce the job to manageable size.” (*20th Century, supra*, 8 Cal.4th at 280, quoting
13 *Calfarm, supra*, 48 Cal.3d at 824.) In fact, the regulations specifically direct ALJs to “eliminate
14 unnecessary delay in the progress and ultimate resolution of the proceeding.” (Regs., § 2654.1(b).)

15 SFG notes that in the past the Department has allowed, on a case-by-case basis, effective dates to
16 change, but the example it cites concerned an informal review and settlement of a rate application, not a
17 challenge that was resolved through a public hearing, as here. The Decision correctly found that the past
18 practice “is not controlling, is not manageable, and contributes to unnecessary delay in the rate hearing
19 process, which the ALJ is mandated to eliminate.” (AR5152.)

20 Allowing SFG’s contrary rule would only encourage an insurer to prolong and delay an order for
21 a rate reduction, potentially for months or years, knowing that every day it did so it could continue to
22 collect and keep excessive and illegal premiums from policyholders. It would also invite manipulation
23 of the regulatory process where data differences over time may be used to influence the rate. Such
24 results would undermine, not further, the purposes of Proposition 103 to protect consumers from
25 excessive rates.

26 2. SFG Has No Due Process Right to Keep Excessive and Illegal Premiums.

27 Citing inapposite cases about criminal trespass statutes and special assessments imposed on
28 companies decades after the offending conduct, SFG argues the Commissioner’s Decision to require the
insurer to refund overcharged policyholders “violates basic notions of due process.” (OB, p. 28.) But it

1 is well established that due process requires only that “laws give the person of ordinary intelligence a
2 reasonable opportunity to know what is prohibited, so that he may act accordingly.” (*Cranston v. City of*
3 *Richmond* (1985) 40 Cal.3d 755, 763.) As SFG’s cases state, the criminal standard is similar, requiring
4 that “a criminal statute must give fair warning of the conduct that it makes a crime.” (*Bowie v. City of*
5 *Columbia* (1964) 378 U.S. 347, 350–351; *U.S. v. Lanier* (1997) 520 U.S. 259, 265.)

6 As discussed, the plain text of section 1861.05(a) makes absolutely clear to insurers that rates
7 that are excessive shall not “be approved or remain in effect.” The California Supreme Court has further
8 held that Proposition 103 generally, and section 1861.05(a) and its implementing regulations
9 specifically, unmistakably place insurance companies doing business in California on notice that their
10 rates must be fair, and not excessive, *at all times*, and that the Commissioner has the authority under
11 section 1861.05(a) to order insurers that have charged excessive rates to “refund excess premiums.”¹⁰
12 (*Calfarm, supra*, 48 Cal.3d at 825; *20th Century, supra*, 8 Cal.4th at 281.)

13 Moreover, the Notice of Hearing explicitly notified SFG that its “current homeowners rate will
14 be excessive by 6.6% commencing July 15, 2015”; that it “must reduce its rates by 6.6% or any other
15 amount by which they are determined through this proceeding to be excessive”; and that if SFG
16 “charges excessive rates after July 15, 2015,” it “will owe refunds retroactively to July 15, 2015 to its
17 homeowners policyholders who pay excessive rates.” (AR42; see also Decision, AR5152.) As the
18 Decision explains, “[s]ince the legality of Applicant’s current rate was not known, Applicant’s current
19 rates served as an interim rate after July 15, 2015.” (AR5152.) Any assertion that SFG did not know or
20 was not given fair warning that charging excessive rates was prohibited is counterfactual.¹¹

21 _____
22 ¹⁰ Contrary to SFG’s assertion that “the Commissioner has *never before* attempted to impose” refunds
23 (OB, p. 24, emphasis in original), refunds have been at issue in at least two other rate hearings. (See
24 Consumer Watchdog’s Request for Judicial Notice, p. 1, Exh. A, Exh. B.)

25 ¹¹ The cases SFG relies upon only demonstrate how far afield its due process claim is. *Eastern*
26 *Enterprises v. Apfel* (1998) 524 U.S. 498 involved a constitutional challenge to a law enacted *nearly 30*
27 *years after* a coal mining company ceased mining operations that required the company to pay
28 substantial fees to cover lifetime health care benefits for former employees. It was the magnitude of the
law’s retroactivity—“reach[ing] back 30 to 50 years to impose liability” (*id.* at 532)—and the disruption
of the company’s settled expectations—facing assessments decades after having left the coal business
(*id.* at 534–536)—that led a plurality of the Court find the law unconstitutional as to the company. (*Id.* at
537.) In *Maine Yankee Atomic Power Co. v. U.S.* (1999) 44 Fed.Cl. 372, the Federal Circuit *rejected* a
due process challenge to a law that retroactively imposed clean-up fees on electric companies that had
purchased enriched uranium from the government. Even though the plaintiff companies’ last purchase
from the government occurred over 20 years before the law’s passage, the court found that they had

1 SFG has no constitutional right to escape accountability for the more than \$100 million in
2 excessive premiums it overcharged its policyholders while its application was pending.

3 3. The “Rule Against Retroactive Ratemaking” Is Inapposite Because the
4 Commissioner’s Refund Order Is Not Retroactive.

5 Citing the “rule against retroactive ratemaking,” SFG insists that being required to refund
6 excessive rates would be unlawful. As a statutory proposition, SFG’s claim is refuted by the words of
7 the statute—section 1861.05 and its prohibition against excessive rates “remain[ing] in effect.” And as a
8 constitutional claim, SFG’s claim is flatly implausible.

9 As discussed, *Calfarm* confirms the Commissioner’s authority to order refunds. The Supreme
10 Court explained how the insurers’ then-current rates were interim rates while the lawfulness of the rates
11 was adjudicated, with the insurer required to refund any excess subsequently determined. (48 Cal.3d at
12 825.) Here, SFG filed the operative application to change rates effective July 15, 2015, which was
13 confirmed by the Commissioner’s Notice of Hearing. (Decision, AR5150-5151.) From that date
14 forward, SFG’s then-current rates were interim rates, with the company on notice that the hearing would
15 determine whether those rates were lawful. (*Id.*, AR5150.)

16 As the Court explained in *20th Century*, the “fixing of a rate and the reducing of that rate are
17 prospective in application.... [Citation.] It follows that the ordering of a refund of rates is itself
18 prospective. Since the regulations in question serve such a refund, they may soundly be viewed to share
19 its character.” (*20th Century, supra*, 8 Cal.4th at 281, internal quotation marks omitted.)

20 SFG cites various cases addressing other agencies or applying other statutes to other industries,
21 to claim that the Commissioner’s Order is impermissible. It suffices to say that neither the Public
22 Utilities Code nor any other statute governing SFG’s cases contains “remain in effect” language. For
23 example, SFG cites *Pacific Telephone & Telegraph Co. v. Public Utilities Commission* (1965) 62 Cal.2d
24 634, for the proposition that under “circumstances indistinguishable from those here” the Court struck

25
26 “continued to participate in the uranium enrichment field” and therefore, unlike the *Eastern Enterprises*
27 plaintiff, could not have reasonably “concluded that its dealings in the . . . industry were complete.” (*Id.*
28 at 379.) The court further noted that “plaintiffs’ participation in so highly regulated a field and their
receipt of benefit from that field should each have served as notice of a possible future obligation.” (*Id.*
at 381.) Not only has SFG utterly failed to show any sort unfair disruption of settled expectations on the
level of the cases SFG cites, as discussed below, it cannot even demonstrate that the Commissioner’s
refund order is retroactive in the first place.

1 down an order for rate reductions and refunds. (OB, p. 26.) Wrong. Looking at the “plain and
2 unambiguous” text of the statute, the Supreme Court in that case concluded that the agency lacked
3 refund authority. (62 Cal.2d at 652.) “The Legislature has instructed the [Public Utilities Commission]
4 that after a hearing it is to make its order fixing rates to be in force *thereafter*.” (*Id.* at 650.) This
5 statutory language is obviously different than the language of Proposition 103, which prohibits excessive
6 rates from “be[ing] approved” *and* from “remain[ing] in effect” and contains no reference to
7 “thereafter.” (Decision, AR5151.) *Bowen v. Georgetown Univ. Hosp.* (1988) 488 U.S. 204, which SFG
8 also cites, makes clear that the availability of refunds is a statutory question: “a statutory grant of
9 legislative rulemaking authority will not, as a general matter, be understood to encompass the power to
10 promulgate retroactive rules *unless that power is conveyed by Congress in express terms.*” (*Id.* at 208,
11 emphasis added.)

12 SFG can be assumed to have known that its rates had become excessive, based on the
13 Commissioner’s consistent previous interpretation of the law, yet failed to take the required immediate
14 regulatory action—to submit an application for a rate decrease—that would have prevented the
15 overcharges. Therefore, SFG has nobody to blame but itself for having to repay overcharges.

16 V. CONCLUSION

17 SFG is entitled to its day in court. But it’s not entitled to re-litigate controlling Supreme Court
18 decisions and try to undo the results of the 1988 election. The Commissioner has applied the
19 Proposition 103 regulations, adopted pursuant to his broad authority to implement the initiative, to find
20 that the rates SFG was charging were excessive and impermissible under section 1861.05, and that SFG
21 must pay refunds with interest for the overcharges its customers have paid since July 15, 2015. The
22 regulations, including the one challenged here, are rational, and the Commissioner’s findings are
23 supported by the evidence. Petitioner is not entitled to a writ.

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1 Dated: December 22, 2017

Respectfully Submitted,

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8
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