2nd Civil Nos. B220469/223772
LASC Case Nos. BC297438/Related Case BC266219
Hon. John S. Wiley, Jr.
Hon. Anthony J. Mohr

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION THREE

AMBER MACKAY and JACQUELINE LEACY, Individuals, on Behalf of Themselves and All Others Similarly Situated,

Petitioners & Real Parties in Interest,

vs.

THE SUPERIOR COURT OF THE STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

Respondent.

21ST CENTURY INSURANCE COMPANY

Petitioner & Real Party in Interest.

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# APPLICATION FOR LEAVE TO FILE *AMICI CURIAE* BRIEF OF PERSONAL INSURANCE FEDERATION OF CALIFORNIA AND ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES ON BEHALF OF 21ST CENTURY INSURANCE COMPANY

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TO THE HONORABLE PRESIDING JUSTICE AND ASSOCIATE JUSTICES OF THE COURT OF APPEAL IN AND FOR THE STATE OF CALIFORNIA:

Personal Insurance Federation of California ("PIFC") and Association of California Insurance Companies ("ACIC") (collectively "PIFC/ACIC"), by their attorneys Sedgwick, Detert, Moran & Arnold LLP, request permission pursuant to Rule of Court 8.520(f) to file a brief as Amici Curiae in this matter in support of the position of 21st Century Insurance Company.

add AIA

## Interest of *Amici Curiae* PIFC/ACIC

PIFC is a California-based trade association that represents insurers writing over ~~40%~~ 60% of the personal lines insurance in California. PIFC represents the interests of its members on issues affecting automobile, homeowners, and earthquake insurance before government bodies, including the California Department of Insurance, the California Legislature, and the California courts. PIFC's membership includes mutual and stock insurance companies.

ACIC is an affiliate of the Property Casualty Insurers Association of America ("PCIAA") and represents more than 300 property/casualty insurance companies doing business in California. ACIC members write approximately 40% of the property/casualty insurance in California. ACIC members include all sizes and forms of insurers including stocks, mutuals, reciprocals, Lloyds-plan affiliates, as well as excess and surplus lines insurers.

The interests of PIFC/ACIC members are likely to be substantially impacted by the Court's decision in this matter. The Court's opinion is likely to address the global question of whether and in what circumstances

private plaintiffs may bring collateral civil actions seeking relief based on an insurer defendant's charging of approved rates, under approved rating plans, and according to specific elements of approved rating plans. Thus, the Court's opinion is likely to profoundly affect all insurers writing lines of insurance subject to Chapter 9 of Division 1, Part 2 of the California Insurance Code, the majority of which are members of PIFC/ACIC.

## How the *Amicus Curiae* Brief Will Assist The Court

Counsel for PIFC/ACIC has reviewed the briefs submitted to this Court in this matter. The *Amicus Curiae* Brief prepared by PIFC/ACIC will aid the Court's consideration of this matter by providing the Court with a broad perspective concerning insurance rate regulation and the relationship between rate regulation and civil litigation. The perspective provided by the PIFC/ACIC Brief includes the manner in which similar issues have been addressed in jurisdictions across the country, as well as the nature of rate regulation in this State as established by California's highest court, and practiced by the regulator.

As California's trade associations representing most of the industry, PIFC and ACIC are uniquely situated to present to this Court an explanation of technical insurance rate issues that should be considered in ruling on the questions presented. Further, as both PIFC and ACIC are accustomed to representing members before the Insurance Commissioner, Legislature and courts, PIFC and ACIC have the appropriate expertise to present to this Court an explanation of the interplay among the various branches of government in the context of insurance rate regulation. An understanding of these matters is critical to an informed decision in this case.

## Tender and Service of *Amicus Curiae* Brief

PIFC/ACIC tender herewith their *Amicus Curiae* Brief and request the Court to accept the brief for filing at the time it grants this Application. Copies of this brief have been served on the parties to this matter concurrently with the making of this Application.

## Representation of Non-Participation by Parties and Their Counsel

Pursuant to Rule of Court 8.520(f)(4), *Amici Curiae* state that no party or counsel for any party has authored the proposed *Amicus Curiae* Brief in whole or in part, nor has any party or counsel for any party made a monetary contribution intended to fund the preparation or submission of the brief. No person or entity participated in the writing of this brief or made a monetary contribution intended to fund the preparation or submission of the brief other than *amici curiae* and their counsel.

Dated: July 1, 2010

**SEDGWICK, DETERT, MORAN & ARNOLD LLP**

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# [PROPOSED] BRIEF OF *AMICI CURIAE* PERSONAL INSURANCE FEDERATION OF CALIFORNIA AND ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES ON BEHALF OF 21ST CENTURY INSURANCE COMPANY

---

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## I. STATEMENT OF THE CASE

This case presents this Court with questions which are among the most significant and complex facing the insurance industry. At issue is the system for regulating insurance rates in this state. In its briefing, 21st Century Insurance Company ("21st Century") asks this Court to align California with the rest of the nation by confirming that the elected regulator has exclusive original jurisdiction over the highly technical and quasi-legislative subject matter involved. Plaintiffs[1] argue for a dual system of rate regulation whereby rates may be regulated through ordinary civil actions as well as through the comprehensive system specifically constructed for the purpose. Plaintiffs further argue that key components of a California private passenger auto insurance rating plan are actually not "the rate", but "application of the rate", such that they may be the subject of an ordinary civil action even if such an action may not be brought to challenge "the rate" itself. *Amici curiae* Personal Insurance Federation of California ("PIFC") and Association of California Insurance Companies ("ACIC") (collectively "PIFC/ACIC") join 21st Century in urging this Court to reject Plaintiffs' unworkable positions, to enforce the clear and straightforward command of the statutes at issue, and thereby support a rational system of rate regulation in this state.

These questions – and this entire genre of litigation – are unique to the insurance industry. Generally, in this country and this state a seller may charge what the market will bear for what it has to sell. Not so with insurance. Insurance prices are carefully regulated in order to balance

[1] The putative class plaintiffs Amber MacKay and Jacqueline Leacy are both petitioners and respondents in this proceeding. For simplicity, they are identified herein as "Plaintiffs".

potentially competing interests. At its essence, rate regulation balances the consumer interest in the cheapest rates with the consumer interest in the insurer remaining solvent, also considering the right of a private company to earn a reasonable profit. Solvency concerns dominate the job of the regulator: consumers suffer great harm when insurers become insolvent, and insolvencies can lead to availability crises. Because the regulation of insurance rates involves complex and technical questions of economic policy, virtually every court across the country that has considered the question has concluded that the regulator has exclusive original jurisdiction over insurance rates.

The California Supreme Court has expressly held that rate regulation under the California system is "quasi-legislative" in nature. *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216, 277 (1994). It follows from that holding that rate issues – for example, the determination of the allowable components of the rate – cannot be fixed by a court in a civil action. Indeed, the California Insurance Code includes specific statutes that expressly prescribe the mechanism for enforcing the rate laws and resolving disputes about rates, and expressly preclude the use of ordinary civil actions for this purpose. But with or without those specific statutes, it is well-established that courts will not usurp the legislative function and decide such matters of economic policy presented in the guise of an ordinary civil action.

Integral to the rate issues that fall within the regulator's quasi-legislative jurisdiction are the components of the rate that actually determine the rates charged. That is what is at issue here. Conceptually, the total, overall amount an insurer is permitted to earn from the entire state is converted to rates to be charged to specific policyholders through a

"sequential analysis" (10 C.C.R. § 2632.7) of the experience data organized by "rating factors" (10 C.C.R. § 2632.2) in "decreasing order of importance" (Ins. Code § 1861.02(a), 10 C.C.R. § 2632.5) to establish the "rate relativities" for each rating factor "category",[2] which are then used (after any adjustment necessary to meet "weight" requirements – 10 C.C.R. § 2632.8) to calculate the risk-based rates appropriately charged to different policyholders. The result of this entire process is the "rates", and there are no "rates" until this process is complete. An insurer does not charge an overall premium amount, an insurer charges the specific rates produced by the approved rating plan. Plaintiffs' assertion that the overall premium approved for the state is the "rate" mistakes the raw material for the finished product.

The regulator – in California, the Insurance Commissioner – could be wrong, and can be challenged. The rates and rating plans approved by the Commissioner can be challenged, both before and after they are implemented by the insurer. The Commissioner's determinations are expressly subject to independent judicial review. But, any challenge is restricted to the administrative mechanisms prescribed by statute. These preclude a civil action. Despite Plaintiffs' protestations, there is no unfairness in limiting their remedies to the generous and elaborate processes described in Chapter 9.[3] If it were not for the existence of specific statutes within the insurance rate regulatory system setting forth the

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[2] *Spanish Speaking Citizens' Foundation, Inc. v. Low*, 85 Cal. App. 4th 1179, 1187-88 (2000).

[3] Throughout this brief, "Chapter 9" refers to Chapter 9 of Division 1 Part 2 of the Insurance Code. Chapter 9 is the portion of the Insurance Code devoted to property/casualty insurance rate regulation. The specific lines regulated by Chapter 9 are identified in Insurance Code § 1851 (*see also* § 1861.13).

unique pricing restrictions upon which Plaintiffs rely, Plaintiffs would have no claim. The accompanying restrictions on remedies are part of the same system and are necessary for that system to function. There is no unfairness in enforcing them.

## II. QUESTIONS ADDRESSED BY AMICI CURIAE PIFC/ACIC.

This is a rate case. Plaintiffs challenge the private passenger automobile rates charged by 21st Century during the period 1997 – 2005. 21st Century's rates were approved, including specifically the components of the rating formula challenged here. Specifically, Plaintiffs challenge the portable persistency and accident record verification rating factors included in 21st Century's rating formula during the time period at issue. Plaintiffs contend that these approved components of 21st Century's rates violate Insurance Code § 1861.02(c), which precludes the use of the "absence of prior insurance, in and of itself" in determining "automobile rates, premiums, or insurability."

The first question the Court must address is whether individuals may regulate rates through civil actions brought in a Court. 21st Century has provided this Court with briefing that details the only logical interpretation of the California regulatory statutes at issue. There is no need for PIFC/ACIC to duplicate that presentation, although this brief will address some of the flaws in the statutory construction proffered by Plaintiffs. The primary purpose of this brief is to provide the Court with a broader perspective concerning insurance rates and rate regulation, as the backdrop against which this case plays. Viewed from that perspective, it is obvious that 21st Century cannot be held liable in a civil action for charging rates in accordance with a rating plan approved by the Insurance Commissioner. Any such liability could only be based upon a retroactive judicial re-

assessment of quasi-legislative determinations in conflict with the determinations made by the Commissioner at the time of the approval. With or without codifying statutes, this action requires a court to step outside the judicial purview, and cannot be maintained for that reason.

The second question the Court must address is whether this action involves the rate setting matters falling within the Insurance Commissioner's quasi-legislative jurisdiction, or whether it presents merely the application of the rate. The insurance industry has never maintained that misapplication of a rate – such as an agent's miscalculation of and charging the wrong rate to an individual – would fall within the Commissioner's exclusive jurisdiction. But that is not what is at issue here. Plaintiffs here challenge specific components constituting inter-related parts of an entire rate plan, which functions as a whole to produce not only the actual rates charged to policyholders, but also the overall premium the Commissioner has approved as not "excessive" or "inadequate". Changing those components changes the entire plan, the rates charged, and the overall premium. Further, approval of those components requires exercise of quasi-legislative authority. The rating components challenged here are at the heart of the rate setting function, and cannot be regulated through a civil action.

## III. RATE REGULATION IS A "QUASI-LEGISLATIVE" EXERCISE OUTSIDE THE JUDICIAL PURVIEW

### A. Virtually Every Jurisdiction To Consider The Issue Has Held That Rate Setting Issues Are Outside The Scope Of The Judicial Function.

Most businesses throughout the country may independently set prices without government interference. That is not the case with insurance. Every state and the District of Columbia exercises some form of

regulation over insurance rates. Most commonly, regulatory models include, in increasing order of stringency, "use and file", "file and use", and "prior approval".[4] Both "use and file" and "file and use" systems require that rates be filed. NAIC Compendium p. II-PA-10-21. The regulator *may* review the filed rates and *may* disapprove them, but the insurer is not required to obtain prior approval from the regulator before charging the rate. Under "prior approval", obviously, the insurer must both file the proposed rates and obtain approval before charging the applied-for rates. *Id.* Most prior approval systems include a "deemer" provision pursuant to which the applied-for rates are "deemed" approved after passage of a set period of time. *Id.* The typical standard for "use and file", "file and use", and "prior approval" systems is that rates may not be "excessive", "inadequate", or "unfairly discriminatory".

In all cases, the regulation of insurance rates falls within the state's police power, and is legislative in nature. As one court explained:

> [W]hen government assumed the burden of determining through its administrative agencies or bodies what were reasonable rates, it did so . . . in its legislative capacity and only in a prospective manner. Thus, when the agency or body sets the rates, these are the only lawful rates that can be charged and remain such until overturned and set aside by a court.

*Anzinger v. Illinois State Medical Inter-Insurance Exchange*, 494 N.E. 2d 655, 657 (Ill. App. 1986) (disallowing collateral action to recover damages for excessive premiums under "use and file" system). Indeed, the

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[4] *See* National Association of Insurance Commissioners' ("NAIC's") "Compendium of State Laws on Insurance Topics: Rate Filing Methods for Property/Casualty Insurance, Worker's Compensation, Title" dated 2005, PIFC/ACIC's Request for Judicial Notice ("RJN") Exhibit A ("NAIC Compendium"). The NAIC Compendium also describes "Modified Prior Approval", "Flex Rating", and "No File" as methodologies.

judgments made in regulating rates inherently involve complex questions of economic policy. The Minnesota Supreme Court elaborated:

> In performing [rate] review, the [regulator] is directed to protect the interests of ratepayers against excessive rates, but also to balance the interests of ratepayers against the right of the regulated entity to charge adequate rates. [citations omitted] Thus, when a regulatory agency approves rates, it seeks to achieve a balance by assuring that rates are not excessive for ratepayers but yet are adequate to satisfy the regulated entity's due process right to earn a reasonable return. [citations omitted] And, for insurance rates specifically, '[r]ate regulation is designed to generate premium charges that are equitable for each policyholder-insured as well as yield insurers a fair return for the risks undertaken." [citation omitted]

*Schermer v. State Farm Fire and Casualty Co.*, 721 N.W. 2d 307, 314-15 (Minn. 2006) (holding that civil action challenging insurer's utility rating plan could not be brought). As the Court noted, the legislative decision-making involved in rate regulation goes beyond a determination as to the appropriateness of the overall amount, and includes *allocation* of that overall amount through the rating plan:

> "[R]atemaking is a legislative and not a judicial function." [citation omitted] We have also recognized that certain aspects of the ratemaking function, such as the allocation of rates among classes of customers, are peculiarly legislative in nature. [citation omitted] . . . . Thus, if a court were to entertain a private claim that a regulated rate was unreasonable or unlawful, it would necessarily have to second-guess the decisions of the agency to whom the legislature has delegated the responsibility to approve rates, and a court generally would not have the technical expertise to do so nor the capacity to consider the entire rate structure or to balance all competing interests.

*Id.* at 313-314. Moreover, perhaps of particular importance in today's economy, the most critical underlying purpose of insurance rate regulation has always been ensuring solvency:

> Indeed, one of the reasons that states began to regulate insurance rates was to assure the solvency of insurers so that they could be relied upon to pay policyholder claims.

*Id.*

Because regulation of rates is inherently legislative, courts have, with virtual uniformity, adopted the rule that regulated rates cannot be challenged through a civil action. This rule is described as the "filed rate" doctrine. *See Commonwealth ex rel. Chandler v. Anthem Insurance Companies, Inc.*, 8 S.W. 3d 48, 53 (Ky. App. 1999) ("[T]he filed rate doctrine is but a special instance of the more general principle . . . that legislative functions are outside the scope of judicial power. . . . Such legislative functions include . . . the rate setting at issue here."). As summarized by one state's highest court:

> Permitting [a court] to impose liability in such circumstances [i.e., based on insurer's having charged an approved rate] would result in a judicial infringement upon the duties and responsibilities which are expressly delegated by the Legislature to the Department of Insurance.

*American Bankers' Ins. Co. of Florida v. Wells*, 819 So. 2d 1196, 1204 (Miss. 2001). But, courts "are required to give judicial deference to the jurisdiction and authority granted to a governmental agency by the Legislature." *Id.* at 1205. For this reason, "[a]lthough some jurisdictions have recognized exceptions to the filed rate doctrine, the acceptance of the doctrine's basic applicability is near-universal." *Id. See also Allen v. State Farm Fire and Casualty Co.*, 59 F. Supp. 2d 1217, 1227 (S.D. Ala 1999) ("The filed-rate doctrine prohibits collateral challenges to rates set by a regulatory agency thereby preserving the authority of such agency over determinations of the reasonableness of rates and insuring that entities charge only those rates that the agency has approved . . . . Two companion

principles lie at the core of the filed rate doctrine: first, that legislative bodies design agencies for the specific purpose of setting rates; and second, that courts are not institutionally well-suited to engage in retroactive rate setting."); *Anzinger*, *id.*; *City of New York v. Aetna Casualty & Surety Co.*, 264 A.D. 2d 304, 305; 693 N.Y.S. 2d 139, 140 (N.Y. App. 1999) ("The legal and equitable remedies sought by the complaint are both barred because granting either kind of relief would enmesh the court in the rate-making process, which the Legislature has committed to the Superintendent . . . ."); *Edge v. State Farm Mutual Automobile Ins. Co.*, 623 S.E. 2d 387, 391 (South Carolina 2005) ("'The filed rate doctrine stands for the proposition that because an administrative agency is vested with the authority to determine what rate is just and reasonable, courts should not adjudicate what a reasonable rate should be in a collateral lawsuit.'"); *N.C. Steel, Inc. v. National Council on Compensation Insurance*, 496 S.E. 2d 369, 372 (North Carolina 1998) ("The General Assembly has given the Insurance Commissioner the duty of setting rates. The Commissioner, aided by his staff, has the expertise to determine proper rates. We do not believe that, by the enactment of [another law], the General Assembly intended that duly set rates be challenged in another forum. When the Commissioner approved the rates, they became the proper rates. . . . The filed rate doctrine provides that rates may not be collaterally attacked after they have been set by a regulator."); *Richardson v. Standard Guaranty Ins. Co.*, 853 A. 2d 955, 963 (N.J. Super. 2004) ("[W]e also reject the plaintiff's mistaken contention that the filed rate doctrine does not apply to the insurance industry not only because courts are not institutionally suited to regulate insurance premium and benefit rates, but also because of the extensive regulation of the industry. We, thus, align our decision with the

considerable weight of authority from other jurisdictions that have applied the filed rate doctrine to ratemaking in the insurance industry.") (citing cases); *Rios v. State Farm Fire and Casualty Ins. Co.*, 469 F. Supp. 2d 727, 735-36 (S.D. Iowa 2007) (Iowa Supreme Court would likely adopt filed rate doctrine "given that Iowa legislatures have established a scheme for ratemaking in the insurance industry."); *Schermer*, *id.* at 314-315 ("When a court is asked to determine whether one part of the rate structure is unlawful, as applied to a subset of ratepayers, it must necessarily interfere with the function delegated by the legislature to the [regulator], and it has neither the expertise nor the mechanisms to deal with the entire rate structure or the adequacy of the return to the regulated entity.").

That is, it is the general rule throughout the country that filed and/or approved insurance rates are not subject to collateral attack through a civil action. The case law cited by PIFC/ACIC herein establishing this rule is all specific to the insurance context. The principles mandating the rule are that rate setting is inherently legislative in character, and that allowing collateral challenge through civil actions would violate the separation of powers doctrine by requiring courts to interfere with the legislative function. These principles are established tenets of California law. The rule should apply in California.

### B. Under California Statutes And Separation Of Powers Principles, Plaintiffs Cannot Interfere With The Quasi-Legislative, Rate Setting Function Through The Mechanism Of A Civil Action.

The California system of rate regulation is one of the most rigorous, active, and thorough in the country. The current system has existed for over two decades and was adopted by the 1988 voter initiative known as "Proposition 103". Proposition 103 completely replaced the substance of

the prior law (the "McBride/Grunsky Act"), introducing "prior approval" rate regulation. As with other prior approval systems, an insurer must obtain approval from the regulator before charging an approved rate. Ins. Code § 1861.01(c). Once a rate is approved, that is the rate the insurer must charge. *Walker v. Allstate Indem. Co.*, 77 Cal. App. 4th 750, 753, 756 (2000). The standard for approval is that the applied-for rate must not be "excessive, inadequate, unfairly discriminatory or otherwise in violation of [Chapter 9]." Ins. Code § 1861.05(a). The system includes a mandatory "Good Driver Discount" (§ 1861.02(b)), rigid regulation of private passenger auto rating factors (§ 1861.02(a)), and certain restrictions on rating and underwriting based on the absence of prior insurance so as to avoid pricing disincentives for the uninsured to purchase auto insurance (§ 1861.02(c)). Each of these elements is implemented through extraordinarily complex regulations, which require specific submissions necessary for the insurer to obtain approval of its rate applications and auto class plan. *See* 10 C.C.R. §§ 2641.1 – 2644.50 (rate regulations governing whether applied-for rate meets "not excessive or inadequate" standard); 10 C.C.R. §§ 2632.1 – 2632.11 (rate regulations governing auto class plan); 10 C.C.R. §§ 2632.12 – 2632.13 (regulations governing implementation of "Good Driver Discount"); 10 C.C.R. § 2632.5(d)(11) (regulation adopted in 2002 governing "persistency" rating factor); 10 C.C.R. § 2632.13(i) (regulation adopted in 2002 governing accident verification procedure).

The system includes numerous provisions intended to encourage consumer participation in the rate setting process. All rate filings are publicly-noticed and publicly available. Ins. Code §§ 1861.06 – 1861.07. Consumers may request a hearing as to any rate filing, may participate in a hearing noticed by the Commissioner, and may trigger a hearing as to

existing rates by filing a complaint. Ins. Code §§ 1861.05(b), 1861.10(a), 1858. In any such proceeding, the consumer may recover advocacy and witness fees. Ins. Code § 1861.10(b). If the Commissioner denies a consumer request for a hearing on a rate application, that determination is subject to judicial review (§ 1861.09) under an independent judgment standard (§ 1858.6).

The system also includes ample provision for enforcement and penalties. In addition to the exacting review process an insurer must undergo before obtaining an approval in the first place, the Commissioner performs regular and targeted Field Rating and Underwriting exams which, among other things, allow the Commissioner to ensure that the rates in effect continue to meet the § 1861.05(a) standard. *See* Ins. Code §§ 1857.1, 1857.2, *see also* 1860.3, incorporating examination procedures of Article 4 of Chapter 1, Part 2, Div. 1 of the Insurance Code. The Commissioner may hold a hearing concerning any suspected non-compliance following an examination (§§ 1858.1-1858.2), in which consumers may participate (§ 1861.10(a)). As with hearings on rate applications and consumer complaint hearings, consumers may recover advocacy and witness fees incurred for their participation. Ins. Code § 1861.10(b). If an insurer is found to have violated Chapter 9, it is subject to substantial financial penalties. Ins. Code §§ 1858.07, 1858.3, 1859.1, 1861.14 (providing for penalties of $5000 *for each act* or $10000 *for each act* if willful, and additional penalties of $100,000 and $250,000 for non-compliance with orders). In addition, the Commissioner has the ability to suspend or revoke an insurer's right to do business in California if the insurer fails to comply with an order of the Commissioner. Ins. Code § 1858.4.

While this process includes some quasi-adjudicatory procedures, it is legislative in character. The California Supreme Court unequivocally so held in *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216 (1994). In *20th Century*, the Court considered the very rate regulatory system – Proposition 103 – at issue here. The Court held that "[w]hen performed by an administrative agency, ratemaking has uniformly been considered a quasi-legislative action. [citation omitted] That is because 'ratemaking is an essentially legislative act . . . .' [citation omitted]." *Id.* at 277. Rate setting is legislative, the Court held, not just as to the fixing of the process for determining rates, but also "so far as the application of such rules in individual cases is involved." *Id.* citing *Prentis v. Atlantic Coast Line*, 211 U.S. 210, 226 (1908) as "stating that the 'establishment of a rate . . . is an act legislative not judicial in kind'". *20th Century, id.* The Court went on to emphasize: "it is established beyond peradventure that ratemaking is not a judicial function." *Id.* at 278. While rate determinations are subject to direct judicial review, that review is limited by the standards applicable to review of legislative acts, or set by statute. *Id. see also* pp. 271-73 (standards of review).

Because under California law – in common with the general rule – rate setting is legislative in character, an insurer's rates should not be subject to collateral attack in a civil action. These principles should (1) guide interpretation of the Chapter 9 statutes limiting remedies as to rate matters; and (2) preclude civil actions challenging an insurer's rates even without resort to those statutes.

### 1. Insurance Code §§ 1860.1 and 1860.2 should be read by their terms and in accordance with separation of powers principles to limit remedies to those set forth in Chapter 9, and preclude challenges to rates by way of civil actions.

Insurance Code § 1860.1 provides:

> No act done, action taken or agreement made pursuant to the authority conferred by [Chapter 9] shall constitute a violation of or grounds for prosecution or civil proceedings under any other law of this State heretofore or hereafter enacted which does not specifically refer to insurance.

The companion statute, § 1860.2, provides:

> **The administration and enforcement of [Chapter 9] shall be governed solely by the provisions of [Chapter 9].** Except as provided in [Chapter 9], no other law relating to insurance and no other provisions in this code heretofore or hereafter enacted shall apply to or be construed as supplementing or modifying the provisions of [Chapter 9] unless such other law or other provision expressly so provides and specifically refers to the sections of [Chapter 9] which it intends to supplement or modify. (emphasis added)[5]

These statutes use incredibly restrictive language. Presumably, that is because they are intended to be restrictive. On their face, they limit the remedies and mechanism for administration and enforcement of the Chapter 9 substantive statutes to the remedies and mechanism provided by the Chapter 9 enforcement statutes. This mechanism is comprehensive and consumer-friendly. But it does not include civil actions. Moreover, reading these statutes according to their plain terms as precluding civil

[5] Insurance Code § 1860.3 then elaborates upon the other sections of the Insurance Code that supplement the Chapter 9 statutes for purposes of administering and enforcing Chapter 9.

actions is consistent with California Supreme Court law establishing the legislative character of rate setting.[6]

The Court's opinion in *Walker v. Allstate Indem. Co.*, 77 Cal. App. 4th 750 reflects the quasi-legislative character of the rate setting function, and the corresponding restriction to the administrative remedies provided by the Insurance Code. As the Court explained:

> If section 1860.1 has any meaning whatsoever (which under the rules of statutory construction it must), the section must bar claims based upon an insurer's charging a rate that has been approved by the commissioner under the amended McBride Act. The statutory scheme enacted by the voters in Proposition 103 compels this result. Under this scheme, the *commissioner* is charged with settings rates after an extensive hearing process in which consumers and interested parties are encouraged to participate. [The Court then describes the process – *see* Part III. B. *supra*] When this process has run its course, the insurers must charge the approved rate and cannot be held civilly liable for so doing. (§§ 1861.01, subd. (c), 1858.07, 1859.1, 1861.05, 1861.09).

77 Cal. App. 4th at 756 (emphasis in original).

Notably, what "compels [the] result" that civil actions are barred is that, under Proposition 103, "the *commissioner*" is charged with the rate regulatory function. That is, this is a quasi-legislative function. Thus, the *Walker* opinion reads § 1860.1 to simply codify the constitutional rule that courts do not interfere in quasi-legislative, policy matters consigned to a different government body. *See Coachella Valley Unified School Dist. v. State of California*, 176 Cal. App. 4th 93, 117 (2009) (independent judicial consideration of school testing policy, with "battle of the experts and the like", and "at the end of the day" independent decision by court as to

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[6] PIFC/ACIC address Plaintiffs' assertions that other provisions of Chapter 9 incorporate civil actions as a remedy for alleged violations of Chapter 9 in Part IV, below.

whether testing regime met standards, would make the court the "official second-guesser" on quasi-legislative question, "impermissibly injecting the judiciary into the quasi-legislative functions lodged with the State Board"); *San Francisco Fire Fighters Local 798 v. City And County Of San Francisco*, 38 Cal. 4th 653, 667 (2006) ("The deferential standard of review generally accorded legislative and quasi-legislative actions, at issue here, has both a constitutional and an institutional basis. 'The courts exercise limited review of legislative acts by administrative bodies out of deference to the separation of powers between the legislature and the judiciary, to the legislative delegation of administrative authority to the agency, and to the presumed expertise of the agency within its scope of authority.' [Citation omitted.] These principles of separation of powers and deference to administrative expertise apply not only to actions of the state but also to local legislation and to quasi-legislative administrative rules issued by local agencies."). *See also Wolfe v. State Farm Fire and Casualty Co.*, 46 Cal. App. 4th 554, 565 (1996) (even if complaint states Unfair Competition Law claim, that does not warrant "judicial interference in an area of complex economic policy."); *Harris v. Capital Growth Investors XIV*, 52 Cal. 3d 1142, 1168, n. 15 (1991) ("We have frequently noted the inappropriateness of judicial intervention in complex areas of economic policy..."); [7] *Max Factor & Co. v. Kunsman*, 5 Cal. 2d 446, 454-455 (1936) ("[T]his court has neither the power nor the duty to determine the wisdom of any economic policy; that function rests solely with the legislature.").

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[7] *Harris* was superceded on a different aspect by a statute adopted in 1992, as explained in *Wilson v. PFS, LLC dba McDonald's # 23315*, 493 F. Supp.2d 1122, 1125 (S.D. Cal. 2006). That event did not in any way affect the propositions for which *Harris* is cited herein, and the opinion continues to be cited as valid authority.

The *Walker* Court's interpretation of Insurance Code §§ 1860.1 and 1860.2 as barring civil actions challenging approved rates is consistent with the plain, restrictive language of those statutes, with the rate regulatory system adopted by Proposition 103 which delegates the rate setting function to the commissioner and is inherently legislative in character, and with the rule throughout the United States that courts will not entertain civil actions that require them to second-guess the regulator as to rate matters. This Court should adopt the *Walker* interpretation here.

**2. Separation of powers principles likewise compel the conclusion that rates cannot be challenged through civil actions.**

California Supreme Court law establishes that California is aligned with the rest of the country in considering insurance rate setting a quasi-legislative action. *See discussion of 20th Century*, 8 Cal. 4th 216, *supra* Part III. B. It is likewise a firmly established tenet of California law that courts do not interfere in legislative matters. *See Board of Supervisors v. Superior Court*, 33 Cal. App. 4th 1724, 1741 (1995). Courts always have the power to *review* legislative acts – including specifically the Commissioner's rate setting determinations – according to the applicable standard. *See 20th Century*, 8 Cal. 4th 216 (reviewing Insurance Commissioner's rate regulations adopted to implement rollback provision of Proposition 103 and rollback order issued against 20th Century Insurance Company); *San Francisco Fire Fighters Local 798*, 38 Cal. 4th 653, *supra*, (reviewing City's rule changing method by which applicants selected for fire department promotion). But courts do not entertain such matters in the first instance, and they cannot be the subject of an ordinary civil action. *Walker*, *supra*, 77 Cal. App. 4th at 754-756.

As a specific application of these established principles, courts should not entertain civil actions involving challenges to approved rates. As discussed in Part III. A., the "filed rate" doctrine as it has been adopted in the context of insurance rates is simply a specific application of the general rule that courts will not interfere in legislative functions. Because rate setting is a legislative function, the general rule requires the bar to collateral civil actions challenging rates.

Courts are, of course, always the final arbiter of what the law is, including the meaning of a particular statute. *San Francisco Fire Fighters Local* 798, *supra*, 38 Cal. 4th at 668. Consequently, it is within the judicial prerogative to interpret a statute that governs rating plans. If that interpretation is inconsistent with approved rating plans, the judicial interpretation will control, but any resulting invalidation of an approved plan can only operate prospectively. *See Anzinger, supra*, 494 N.E.2d at 657 ("Rate making by government, historically, has been considered to be prospective only because government is viewed as acting in its legislative capacity when it sets rates, and it is a long standing principle that the legislature acts prospectively and not retroactively."); *Walker*, *supra*, 77 Cal. App. 4th at 756 (explaining that a consumer or interested party may "petition the commissioner to review the continued use of any approved rate, *i.e. obtain prospective, not retrospective relief*") (emphasis added).

Citing *Brown v. Ticor Title Ins. Co.*, 982 F.2d 386 (9th Cir. 1992), Plaintiffs argue that the "filed rate" doctrine does not apply whenever there is a "deemer" provision in the rate regulatory system (i.e., the rates may be "deemed" approved after lapse of a set period of time). *[Plaintiffs' 5/20 Reply Brief at p. 39.]* Plaintiffs misconstrue the holding in *Brown*, which, in any event, has been rejected by every other court to consider the issue.

*Brown* considered the Arizona "use and file" system of rate regulation, pursuant to which an insurer is not required to obtain any form of pre-approval in order to charge a rate, although rates must be filed (within 30 days after first use) and can be examined by the regulator. In *Brown*, the Court held that the "filed rate" doctrine could not be applicable where the regulatory system did not include "meaningful review" of the filed rates. *Id.* at 393-94.

California's extraordinarily stringent prior approval system cannot in any way be equated to a "use and file" system. California insurers cannot "file any rate they want." *Id.* at 394. California insurers must comply with a complex regulatory system and submit proposed rates and supporting calculations and data on prescribed forms. *See* 10 C.C.R. § 2648.4. If the insurer does not comply with these requirements, the rate application is not even accepted for filing. 10 C.C.R. § 2648.2(b). The statutory system does not allow the Commissioner to approve a rate that does not meet the statutory standards: "No rate shall be approved or remain in effect which is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter." Ins. Code § 1861.05(a). In accordance with the presumption that an administrative agency is performing its function,[8] it must be presumed that if the Commissioner were to allow a rate application to be "deemed" approved under § 1861.05(c) that the applied-for rates meet the standard.

A "deemer" provision is a common feature in prior approval rate regulatory systems. *See* NAIC Compendium, RJN Exh. A at p. II-PA-10-1

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[8] *Calfarm Ins. Co. v. Deukmejian*, 48 Cal. 3d 805, 824 (1989) (stating that it is presumed that an agency will properly exercise its function, discussing the Insurance Commissioner's anticipated implementation of Proposition 103).

("In a state with prior approval, a filing may be deemed to have been approved after a certain number of days."). No case suggests that existence of a "deemer" provision precludes application of the filed rate doctrine, or impacts "meaningful review". Some of the cases cited in Part III.A, *supra* actually considered *Brown*, and rejected its application on the grounds that the system before the Court did afford "meaningful review". In *Schermer*, for example, the Minnesota Supreme Court held that, although Minnesota utilizes the less stringent "file and use" system where review by the regulator is discretionary, review was nonetheless "meaningful", as well as the system prescribed by the Legislature. 721 N.W.2d 307 at 317-18. In *Rios*, the court acknowledged that "if a regulatory agency is so powerless that it only rubber-stamps the rates filed, then it may be inappropriate to apply the filed rate doctrine", but held that Iowa's "use and file" system – which includes a waiting period provision – does afford "meaningful review". 469 F. Supp. 2d at 736. That is, Plaintiffs' unsupported assertion that inclusion of a "deemer" provision means that the "filed rate" doctrine cannot be applied is expressly contradicted by existing case law.

Plaintiffs also cite *Fogel v. Farmers Group, Inc.*, 160 Cal. App. 4th 1403 (2008), contending that *Fogel* holds that the "filed rate" doctrine does not apply in California. *[Plaintiffs' 5/20 Reply Brief at pp. 48-49.]* There is *dicta* in *Fogel* stating that the federal filed rate cases do not apply. As 21st Century points out, since the Court had already held that the Attorney In Fact fees at issue in that case were not rates, the discussion is necessarily *dicta*. *[21st Century's Reply Brief at p. 33]* Further, the Court considered only the "federal filed rate doctrine" (160 Cal. App. 4th at 1418), based its discussion on a comparison with the Federal Communications Act of 1934, and does not appear to have been presented with any cases applying the

"filed rate" (or legislative function) doctrine to insurance rates. *Id.* Moreover, the Court was mistaken in suggesting that insurers can elect to retroactively change rates by paying rate rebates: they cannot. The statutes cited by the Court relate to payment of dividends.[9] The point of Insurance Code § 1860 – cited by the Court – is that dividends *are not* included in the rate regulatory system. In fact, the Commissioner has expressly so found, in holding that Proposition 103 does not authorize him to compel an "up front dividend" in the form of reduced rates. *See* Request for Judicial Notice, Exh. B. Payment of dividends does not change the rate.

The separation of powers doctrine does apply in California, as does the rule that rate regulation is quasi-legislative. The "filed rate" doctrine, as it has applied in the insurance rate context, is but an application of separation of powers doctrine. It does apply in California, and does bar civil actions brought to challenge approved rates.

## IV. PLAINTIFFS' TORTURED CONSTRUCTION OF THE CHAPTER 9 STATUTES IS INTERNALLY INCONSISTENT AND DISTORTS THE PLAIN MEANING OF THOSE STATUTES

In an effort to avoid the plain meaning of Insurance Code §§ 1860.1 and 1860.2, Plaintiffs suggest a confused admixture of competing interpretations of the Chapter 9 statutes. Plaintiffs contend:

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[9] The jurisdictions involved in every case cited in Part III. A. applying the filed rate doctrine in the insurance context have dividend statutes similar to California's. *See, e.g.*, 215 ILCS 5/54 (Illinois), M.S.A. §§ 66A.14, 65A.18 (Minnesota), KRS § 304.24-330 (Kentucky), Miss. Code Ann. § 83-2-27 (Mississippi), Ala. Code §§ 27-27-37, 27-27-38 (Alabama), NY Ins. §§ 2324, 4106, 4207, 4231 (New York), § SC ST § 38-19-270 (South Carolina), N.C.G.S.A. § 58-8-25 (North Carolina), N.J.S.A. § 17:25-3 (New Jersey), §§ 515.4, 515A.16 (Iowa).

1. Proposition 103 deliberately introduced a "dual system" of rate regulation whereby rates are regulated by ordinary civil actions as well as the prescribed administrative system. This theory is based on the notion that Insurance Code § 1861.03(a) incorporates all laws of the State of California applicable to business within the enforcement mechanism to which rate regulation is restricted by §§ 1860.1 and 1860.2 (the "dual system" theory).
2. The impact of §§ 1860.1 and 1860.2 is confined to conferring immunity over concerted activity conducted under one of the few remaining statutes preserved from the original McBride/Grunsky Act (the "vestigal statute" theory).

These theories are inconsistent. Under the "dual system" theory, Plaintiffs purportedly can bring their Unfair Competition Law ("UCL") action because, under this theory, the UCL – along with all other California laws applicable to business – is actually made a part of the Chapter 9 enforcement mechanism. *[Plaintiffs' 5/20 Reply Brief at pp. 17-18.]* Under this theory, §§ 1860.1 and 1860.2 assertedly do apply to this case, and it is because they apply that a UCL action is affirmatively authorized. *[Plaintiff's 5/20 Reply Brief at p. 19.]*

Under the "vestigal statute" theory, §§ 1860.1 and 1860.2 are considered anachronisms, to be construed in accordance with the legislative history of the 1947 McBride/Grunsky Act with no consideration given to the legislative purpose in retaining these statutes in the 1988 overhaul of that Act by Proposition 103. *[Plaintiffs' 5/20 Reply Brief at pp. 13-14.]* Under this theory, §§ 1860.1 and 1860.2 are limited to conferring immunity

for concerted activity under the few original McBride Act statutes not repealed by Proposition 103 although, as Plaintiffs point out, these statutes are completely superfluous as Insurance Code § 1861.03(b) serves the same purpose. *[Plaintiffs' 5/20 Reply Brief at p. 15.]* In a complete reversal from the "dual system" theory, Plaintiffs' civil action is permitted under this theory because §§ 1860.1 and 1860.2 do not apply to it.

Notably, the specific conduct immunized under the vestigal statute theory is, under the dual system theory, subject to a UCL, antitrust and any other civil action brought under California law. Under the dual system theory, UCL, antitrust, and other actions brought under California laws applicable to businesses are incorporated into the Chapter 9 mechanism and apply *through* §§ 1860.1 and 1860.2. That means that they apply to the conduct "immunized" by the vestigal statute theory.

That is to say, the two theories are irreconcilable, reflecting the absence of a cohesive construction of the Chapter 9 statutes and an intent to simply throw up any argument that would allow this case to stay in court. As observed by the court in *Walker*, the absence of a cohesive construction suggests that Plaintiffs' "claims are inimical to the statutory scheme they purport to enforce". 77 Cal. App. 4th at 755. In any event, neither theory bears close examination.

### A. Insurance Code § 1861.03(a) Does Not Create A Dual System Of Rate Regulation.

Insurance Code § 1861.03(a) provides:

> The business of insurance shall be subject to the laws of California applicable to any other business, including, but not limited to, the Unruh Civil Rights Act (Sections 51 to 53, inclusive, of the Civil Code), and the antitrust and unfair business practices laws (Parts 2 (commencing with Section

16600) and 3 (commencing with Section 17500) of Division 7 of the Business and Professions Code).

This statute ended a perceived "unfair exemption" from California's antitrust and other substantive laws applicable to other businesses. 1988 Ballot Pamphlet, RJN at Exh. C, pp. 100 and 101.[10] It makes the business of insurance subject to numerous *substantive* laws. But it does not purport to incorporate *procedures* for enforcement of the rate laws.

On its face, the import of this statute is to treat the business of insurance like any other business, and make the business of insurance subject to California laws to the same extent as other businesses. But other businesses are not subject to price setting, and civil actions are never permitted as a means of intruding into areas within the legislative – not judicial – prerogative. In *Harris v. Capital Growth Investors XIV*, 52 Cal. 3d 1142 (1991), for example, the California Supreme Court held that plaintiff could not utilize the Unruh Civil Rights Act to preclude landlords from using minimum income formulae to assess prospective tenants' ability to pay rents. The Court held that "[s]tepping into the fray would 'involve the courts in a multitude of microeconomic decisions we are ill-equipped to make. . . .'" *Harris*, 52 Cal. 3d at 1166. In *California Grocers Ass'n v. Bank of America*, 22 Cal. App. 4th 205 (1994), plaintiff alleged that service charges imposed by the bank were unconscionable and unfair under the

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[10] As it turned out, there never was an actual exemption for the insurance industry from these laws, just a perception. That, however, did not emerge until seven years after Proposition 103 was adopted, when the California Supreme Court decided the case *Manufacturers Life Ins. Co. v. Superior Court*, 10 Cal. 4th 257 (1995). *See* Wells, "Ships Passing In The Night: How California's Statutory Framework Directs Traffic Through The Maze Of Jurisdictional Doctrines Concerning Insurance Rates", 44 S.F. L. Rev. 853, 869-870, 885-886 (forthcoming Spring 2010) (hereinafter "S.F. L. Rev. Article").

UCL. "[T]he *Grocers* court held that the case implicated a question of economic policy – whether service fees charged by banks are too high and should be regulated – which was best left to the Legislature." *See Wolfe*, 46 Cal. App. 4th 554 at 563 (summarizing *California Grocers*, 22 Cal. App. 4th at 218). Thus, making the business of insurance equally subject to the laws of California does not incorporate those laws as part of the quasi-legislative rate setting mechanism, because those laws do not provide for a civil action addressing matters outside the judicial purview.

Plaintiffs follow an elaborate scavenger hunt through §§ 1860.1, 1860.2, 1861.03(a) and 1861.10(a) to piece together the construction for which they advocate. 21st Century has explained the infirmities of that construction. *[21st Century's Reply Brief at pp. 6-10.]* More broadly, the voters could never have followed this tortured path, and could never have discerned in the text of Proposition 103 or the Ballot Pamphlet materials an intent to take the enormously significant step of making rates subject to regulation through civil actions, contrary to the rest of the country. *See Farmers Insurance Exchange v. Superior Court*, 137 Cal. App. 4th 842, 857-58 (2006) (We cannot presume that . . . the voters intended the initiative to effect a change in law that was not expressed or strongly implied in either the text of the initiative or the analyses and arguments in the official ballot pamphlet."). Proposition 103 made other significant changes, but these are apparent on the face of the initiative, and were announced in the Ballot materials. A change of this magnitude would be underscored, not hidden.

In this regard, it should be noted that there do exist California statutes that incorporate the UCL as an enforcement mechanism. They do

so plainly and on their face.[11] If Proposition 103 had intended to do likewise, it would have used similar, direct language. The notion that a broad extension of remedies to all civil actions brought under any of the California laws applicable to business was instead accomplished by *retaining* statutes – §§ 1860.1 and 1860.2 – which on their face *restrict* remedies is too incredible to countenance.

### B. The "Vestigal Statute" Argument Fails To Take Into Account The Complete Overhaul Of Chapter 9 Accomplished By Proposition 103.

Insurance Code §§ 1860.1 and 1860.2 were part of the original, 1947 McBride/Grunsky Act, and were among the few Chapter 9 statutes retained by Proposition 103. These statutes are framed to restrict the remedies and enforcement mechanism for the substantive statutes of "this chapter" – Chapter 9. As these statutes are drafted, they apply to whatever is the subject matter of Chapter 9. It is therefore necessary to analyze the whole of Chapter 9 to determine what falls within the ambit of the restrictions mandated by §§ 1860.1 and 1860.2.

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[11] *See, e.g.*, Cal. Ins. Code § 12693.81 (West 2005) ("It shall constitute unfair competition for purposes of Chapter 5 (commencing with Section 17200) of Part 2 of Division 7 of the Business and Professions Code for an insurer, an insurance agent or broker, or an administrator" to make statements or take action to induce an individual employee to separate from the employer's group health coverage in reliance on the Healthy Families Program); Cal. Ins. Code § 12725.5 (West 2005) (same as § 12693.81, but concerning the California Major Risk Medical Insurance Program); Cal. Civ. Code § 1797.86 (West 2009) ("any violation of this chapter constitutes unfair competition under Section 17200 of the Business and Professions Code, grounds for rescission under Section 1689 of this Code, and an unfair method of competition or deceptive practice under Section 1770 of this Code."); Cal. Bus. & Prof. Code § 17364 (West 2008) ("Every failure to comply with any provision of this chapter constitutes unfair competition and shall be enforced under Chapter 5 (commencing with Section 17200).").

This is the approach followed by the California Supreme Court in both *State Compensation Insurance Fund v. Superior Court (Schaefer Ambulance)*, 24 Cal. 4th 930 (2001) and *Quelimane Company, Inc. v. Stewart Title Guaranty Company*, 19 Cal. 4th 26 (1998). Both cases involved statutes modeled after §§ 1860.1 and 1860.2. In both cases, the California Supreme Court acknowledged that the impact of these statutes is to preclude civil actions for subject matter falling within their ambit. In *Quelimane*, the Court held that the statutes did not bar a civil action alleging a concerted refusal to deal, because the statutes were limited in effect "to title insurance company activities related to rate setting." 19 Cal. 4th at 33.

In *Schaefer Ambulance*, the Court considered whether the alleged misleading and inflated reporting of medical expenses by a workers' compensation insurer to the Workers' Compensation Insurance Rating Bureau fell within the scope of the statute at issue there – Insurance Code § 11758, which was modeled after §§ 1860.1 and 1860.2 – thus barring a civil action. The substance of the Article defining the restrictive scope of the statutes in *Schaefer Ambulance* allowed concerted activity in order to share ratemaking information. The Court defined the scope of the "immunity" conferred by the statutes according to the substance of that Article, and held that it did not encompass the alleged misreporting at issue. *Id.* at 936-38.

The Court bolstered its conclusion by referring to the legislative history of § 11758, which, in turn, referred to the legislative history of the McBride/Grunsky Act, since § 11758 was modeled from §§ 1860.1-1860.2. In 1947, the McBride/Grunsky Act did not include the prior approval regulation predominately characterizing Chapter 9 today, but, like the

present-day workers' compensation rating system, allowed sharing of rate information to facilitate ratemaking. Consequently, that legislative history confirmed that, in 1947, the activities undertaken pursuant to Chapter 9 and covered by the restrictions of §§ 1860.1 and 1860.2 concerned concerted activity. *Id.* at 938-39.

Plaintiffs here leap from the *Schaefer Ambulance* Court's use of the 1947 legislative history to the conclusion that, today, §§ 1860.1 and 1860.2 have no application other than to restrict remedies and enforcement as to concerted activity under the few remaining statutes adopted in the original McBride/Grunsky Act. *[Plaintiffs' 5/20 Reply Brief at p. 13 n.4.]* This argument ignores the structure of the Court's analysis, and the substance of Chapter 9 as it exists today. The legislative history of the McBride/Grunsky Act, and the Court's citation to it for a different purpose in *Schaefer Ambulance*, does not freeze in time the impact of §§ 1860.1 and 1860.2, when today they appear in a different statutory context.

In *Schaefer Ambulance*, the Court analyzed the "article" referenced in § 11758, which established the parameters of the so-called "immunity" from civil actions conferred by that statute. That article did not set up a system of prior approval rate regulation with elaborate controls by the Commissioner on every aspect of the rates and rating plan, and the specific requirement that the insurer must charge only the approved rate. *Compare with* Chapter 9. That is, the content of Chapter 9 – setting the scope for the "immunity" conferred by the applicable statutes – is wholly different than the article referenced in § 11758. The Court so acknowledged in distinguishing (not disapproving) *Walker*. *Id.* at 941-42. The Court quoted *Walker* as holding: "'If section 1860.1 has any meaning whatsoever . . . the

section must bar claims based on an insurer's charging a rate that has been approved by the commissioner'". *Id.* at 942.

*Quelimane* and *Schaefer Ambulance* both establish that the impact of statutes structured like §§ 1860.1 and 1860.2 is to bar civil actions as to matters falling within their scope, whatever those matters may be. At least as to the property/casualty insurance rate matters addressed by Chapter 9, this is not "immunity". The term "immunity" is simply a shorthand for stating that the available remedies and enforcement procedures exclude ordinary civil actions. As described above in Part III. B., Chapter 9 sets forth a stringent system of rate regulation with numerous sections providing for examinations, investigations and hearings and severe penalties, as well as generous provision for consumer participation complete with recovery of advocacy and witness fees. Neither the Commissioner's decisions nor the insurer's actions in accordance with the Commissioner's decisions are "immune" from judicial review, which may be had by writ petition. But, civil actions are barred, and they are barred as to the approved rates at issue here.

## V. THE FEATURES OF THE RATING PLAN AT ISSUE HERE ARE INTEGRAL COMPONENTS OF THE RATES, AND RESULT FROM QUASI-LEGISLATIVE DETERMINATIONS MADE BY THE INSURANCE COMMISSIONER. THEY ARE NOT PROPER SUBJECTS OF A CIVIL ACTION.

Having established that rate setting is a quasi-legislative function and that civil actions that call upon the courts to engage in rate setting are barred, there is still the question of whether this action involves the rate setting function or, as Plaintiffs argue, presents simply the "application" of the rate. This can be a difficult determination. The Court must examine

whether the challenged aspects of the rate plan were approved, and whether the issue raised involves the quasi-legislative function.

*Donabedian v. Mercury Insurance Company*, 116 Cal. App. 4th 968 (2004) provides an example of an action where the challenged conduct could have been – so far as appeared from the limited record on demurrer – "application" of the rate. In *Donabedian* the insurer used a "portable persistency" rating factor. "Persistency" is an allowed rating factor (10 C.C.R. § 2632.5(d)(11)), which traditionally meant the period for which a policyholder remained insured with the same insurer, sometimes referred to as "loyalty" persistency. *See Spanish Speaking*, 85 Cal. App 4th 1179 at 1187 (defining "persistency" as "years insured by the company"). Some insurers defined persistency to mean the period for which the applicant/policyholder was insured by any insurer. *Donabedian*, *id.* at 974. This is sometimes referred to as "portable persistency". *Id.* at 993. In *Donabedian*, the Court quoted the insurer's stated definition of "persistency" as "'based on loss experience and the number of years the Named Insured has been continuously insured and no lapse of coverage in excess of 30 days . . . .'". *Id.* This could be interpreted to mean "continuously insured" with that insurer – indicating "loyalty" persistency – or continuously insured by any insurer – "portable" persistency. If in fact the Department approved a loyalty persistency rating factor and the insurer actually applied a portable persistency rating factor, then the challenge would be to the "application" of the rating plan rather than to the rating plan as approved. *See also id.* at 994 (discussing additional factual disputes precluding a determination of what was actually approved). This determination could not be made on demurrer, which was the procedural posture in which *Donabedian* was presented.

More common "application" of the rate cases involve "tortious conduct in the *performance*, rather than the rates and terms, of the contract in question." *American Bankers' Insurance Company v. Wells*, 819 So. 2d 1196 at 1205 (emphasis in original). In *American Bankers*, for example, the court held that certain of the plaintiffs' claims – which challenged force place insurance rates – were barred,[12] but that claims that the defendants backdated policies so as to collect extra premium payments for periods preceding the true start date of the policy were not. Compelling consumers – in a force place situation – to buy insurance for a period preceding the execution date of the contract, where the consumer had no claims for that period, forced the consumer to buy nothing for something. This situation did not involve the rate: it did not matter what the rate was for the superfluous period.[13] A court could hold that the insurer could not charge

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[12] Significantly, in *American Bankers* the Court noted that it had previously ruled in a similar case that the civil claims could go forward. The Court explained that the prior case came up on interlocutory appeal, and the Court did not have the same evidentiary record establishing that the claims *did* challenge the approved rates. *Id.* at 1205 n. 2. That is the same distinction marking the difference between *Donabedian* and this case.

[13] Some situations might require primary jurisdiction review by the Commissioner in the first instance to determine whether or not the claim challenges the rate itself or application of the rate. In *Jonathan Neil & Associates, Inc. v. Jones*, 33 Cal. 4th 917 (2004), for example, the insurer sued the plaintiff to collect premiums allegedly owed under the contract and the plaintiff cross-claimed for breach of contract for allegedly overcharging. The question of whether the insurer had charged the correct rate depended upon whether the insurer had correctly applied the rating rules in calculating the premium, in that individual case. The California Supreme Court held that the correct application of the rating rules fell within the Commissioner's primary jurisdiction, and could not be decided by the Court. If it turned out that the insurer had applied the rules correctly, that would end the matter. If it turned out that the insurer had misapplied the rules and incorrectly calculated the rate, the case could proceed. *Id.* at 936-37.

for a period of time predating the actual start of the coverage without disturbing the approved rate structure.

This case is different. It involves a challenge to integral elements of an approved rating plan that cannot simply be removed without impacting the entire rate structure. What is more, the determinations that went into the approval of the specific elements challenged here are of the type that belong to the quasi-legislative function, that cannot be second-guessed by a court.

### A. 21st Century's Use Of A Portable Persistency Rating Factor Was One Piece Of An Entire, Cohesive And Approved Rate Structure.

#### 1. The rating plan is an integral part of the rate.

California's rate approval process can be conceptualized as composed of two steps. *Spanish Speaking Citizens' Foundation*, 85 Cal. App. 4th 1179 at 1186. The first conceptual step involves approval of the total amount of premium the insurer will be permitted to charge for that line for the entire state, based on the total amount the insurer is projected to need to cover projected losses and expenses for the entire line, plus a reasonable profit. *Id.* The regulations set forth at 10 C.C.R. §§ 2641.1-2644.50 govern approval as to whether that total meets the "not excessive" or "inadequate" standard. *See* 10 C.C.R. § 2641.3.

For private passenger auto insurance, approval of the rates as "not . . . unfairly discriminatory" requires submission, review and approval of the "class plan." This step involves the determination of the manner in which the total amount the insurer is permitted to earn will be distributed as the rates actually charged to policyholders. This step is accomplished by calculations involving "rating factors": risk-based parameters used to

calculate risk-based rates. For private passenger auto, these rating factors are set by statute and regulation, and include three mandatory rating factors (driver safety record, miles driven, and years driving experience) as well as 16 optional rating factors. Ins. Code § 1861.02(a); 10 C.C.R. § 2632.5.

Each rating factor is divided into two or more categories representing risk level. For example, annual mileage might be divided into high and low mileage, with high mileage drivers representing higher than average risk and low mileage drivers representing lower than average risk. *See Spanish Speaking*, *id.* at 1187. A *relativity* is assigned to each category, reflecting the risk of loss for that category *relative* to average. For example, if average risk is represented by 1, then high miles drivers might be assigned a relativity of 1.3, with low miles drivers assigned a relativity of .7. *See id.*[14] These relativities are part of the calculation of the rates ultimately paid by policyholders. The rate is determined by multiplying the base rate – the average rate that would be charged if all policyholders paid the same rate regardless of risk – by the appropriate relativities. For example, if the base rate were $1000, then drivers in the high mileage category would pay $1300 and drivers in the low mileage category would pay $700. *Id.* at 1187-88. A high risk rate is referred to as a "surcharge" while a low risk rate is referred to as a "discount" (i.e., the rate is "surcharged" or "discounted" from the average). *Id.*

It must be understood that no one pays the base rate. Every policyholder is charged a rate determined by distributing premium

[14] Relativities can be "multiplicative" or "additive". *See, e.g.*, 10 C.C.R. § 2632.7(c). If relativities are multiplicative the average is represented by 1. If the relativities are additive the average is represented by 0. *Spanish Speaking* assumes multiplicative relativities based on the State Farm examples in the evidence before the Court. For ease of reference, this discussion will also assume multiplicative relativities, with average = 1.

according to the relativities calculated for each category for each rating factor in the class plan. There are no "rates" before this step.

The relativities are determined as directed by regulation (10 C.C.R. §§ 2632.7-2632.8). Regulation § 2632.7 calls for a "sequential analysis", by which overlapping influences of the various rating factors are isolated and allowed to impact rates only through the first factor analyzed. For example, as explained in *Spanish Speaking*, there may be an overlap in driver safety record and miles driven ("e.g., the more one drives, the greater the likelihood of an accident"). *Id.* at 1188. The sequential analysis directed by the regulations assigns any overlap to the first factor analyzed, and also directs the order of analysis. *Id.* In some circumstances the regulations may require a "weighting" adjustment, under regulation § 2632.8. Importantly, at the end of the day, the rate relativities must balance, so that when premium is distributed according to the approved relativities for all policyholders the total premium equals the total premium approved: the relativities must balance to 1. §§ 2632.7(c), 2632.8; *Cf. Spanish Speaking*, *id.* at 1225 ("To the extent our ruling raises anyone's premiums, it will lower those of others. The overall cost, as we have stated, will remain the same."); California Department of Insurance Report: "Continuous Coverage Discount Initiative Impact On Rates" ("CDI Proposition 17 Report"), RJN Exh. E.

Each rating factor – including 21st Century's portable persistency rating factor – and the relativities assigned to each category for the rating factor constitute integral components in determining rates for each policyholder, and the rates overall. There is no "rate" until all relativities for the particular risk involved are included in the calculation. Moreover, any change to one rating factor is not isolated: it impacts the entire

calculation, because the relativities for each category of each rating factor are calculated using the inter-related sequential analysis, and the whole must balance to 1.

### 2. 21st Century's portable persistency rating factor constituted part of the approved rate.

That the portable persistency rating factor in particular constitutes an integral component of the rate is perhaps best illustrated by official materials concerning an initiative measure that was before the voters on June 8, 2010: Proposition 17. In essence, Proposition 17 would have changed Proposition 103 to affirmatively authorize portable persistency rating factors. *See* Proposition 17 text, RJN Exh. D pp. 76-78. Proposition 17 did not win, but that is immaterial to the point here, which is that both the Ballot Pamphlet and the CDI Proposition 17 Report unambiguously affirm that this rating factor is part of the rate. The "Argument Against Proposition 17" – which succeeded – states:

> Prop 17 allows insurance companies to raise rates on customers with perfect driving records, just because they canceled insurance for as little as ninety-one days over the past five years. . . .
>
> . . . .
>
> This initiative raises rates on Californians who stop their insurance, including military serving stateside.

RJN Exh. D p. 35. That, of course, constitutes a representation about the impact of portable persistency rating factors. It may not be true that the net impact is to *raise* rates,[15] but it certainly acknowledges that this is a rate issue.

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[15] The "Argument Against Proposition 17" misrepresents the CDI Report on Proposition 17, misleading voters into the belief that Report concludes that Proposition 17 increases rates generally. The "Argument" states: "The insurance backers of Prop 17 won't tell you the whole story, but the

The CDI Report On Proposition 17 – issued at the request of the Legislative Analyst (RJN Exh. E p. 1) – describes the impact on rates of using a portable persistency rating factor more accurately and completely:

> California automobile rating is unique in many ways. However, the nature of applying discounts and surcharges is not unique and reflects a basic principle of insurance ratemaking. This basic ratemaking principle is "zero sum" in the following sense: Every automobile insurer must have an approved "rate plan" that establishes its average premium. Within that rate plan, every "discount" requires a corresponding "surcharge" so that every factor influencing a rate will balance evenly over an insurer's book of business. [citation to 2632.7(c)] . . . .
>
> [Proposition 17] is subject to this principle. That is, if an insurer offers a [portable persistency] discount for some drivers it will result in a surcharge for other drivers. This is because automobile insurance discounts and surcharges must offset one another so that each rating factor applied by an insurer is evenly balanced within an insurer's rating plan. . . .
>
> Automobile rating is extremely complicated, and there is no way of predicting the precise impact a specific factor (in this case, continuous prior insurance) will have on each of the insurer's customers until the insurer submits specific data to the Department of Insurance. . . .

As the Department's Report explains, auto insurance rating is "extremely complicated", and the rating factors within the rating plan work together to yield the ultimate rates. As the Department's Report also explains, the "discounts" and "surcharges" must balance so that the influence of the rating factor on the overall premium is neutral. If a court were to order restitution of premium surcharges resulting from application

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California Department of Insurance does. It says Prop 17 *"will result in a surcharge"* for California drivers." (emphasis in original). The CDI Report actually says: "[I]f an insurer offers a continuous coverage discount for some drivers it will result in a surcharge for other drivers." RJN Exh. E.

of a rating factor, this would throw the rates out of balance. Such an order would retroactively alter the total amount of premiums the Commissioner approved for the state, as well as the specific risk-based rates, because the surcharges – which were balanced with discounts in the approved plan – are refunded while the discounts remain. This would mean that the total amount of premium collected is not the approved amount, and may not be adequate.

Further, when the rating plan utilizing the portable persistency rating factor was approved, inclusion of that rating factor impacted the calculation of the rates throughout, as every factor affects every other by reason of the § 2632.7 sequential analysis and § 2632.8 "weighting". "[T]here is no way" for a court to determine "the precise impact a specific factor (in this case, continuous prior insurance) [had] on each of the insurer's customers . . . ." *See id.*

Undeniably, there have been developments in the law affecting use of this rating factor. But at the time 21st Century's rating plan was approved, the portable persistency rating factor with its reverberating influence on the entire plan was approved with it. *[21st Century's Reply Brief at p. 27.]* That was a quasi-legislative decision of the Commissioner. The system allows consumers ample remedies if they disagree. The Commissioner's approval could have been challenged directly, before the rates were even implemented, or at any time subsequently. And the Commissioner's quasi-legislative act can be invalidated *prospectively* by a Court's decision ruling on the governing law. *See* Part III. B. 2., *supra*. But this approved rating plan cannot be collaterally challenged through an ordinary civil action, which calls upon the court to unwittingly unravel the

insurer's entire rating scheme, with the potential for retroactively rendering the rates inadequate.

### B. The Commissioner's Approval Of 21st Century's Accident Record Verification Requirements As Part Of The First Mandatory "Driver Safety Record" Rating Factor Constitutes A Quasi-Legislative Decision Not Subject To Collateral Challenge Through An Ordinary Civil Action.

Also at issue is 21st Century's use of an "accident record verification" rating factor as a driver safety record rating factor. *See* Ins. Code § 1861.02(a)(1) (number one rating factor that must be given the greatest importance is "driver safety record"). Under the trial court's order, everything depends upon whether "accident record verification" constitutes a "rating factor" or an "underwriting rule". As 21st Century explains in its June 7, 2010 Brief, this characterization of the question puts too much emphasis on labels. *[21st Century's Reply Brief at p. 34.]* The question is really whether 21st Century's use of "accident record verification" was part of what the Commissioner approved in approving the rating plan, and whether that approval fell within the Commissioner's quasi-legislative authority.

Whether labeled a rating factor or underwriting rule, "accident record verification" is used to rate drivers correctly as to the first mandatory rating factor, driver safety record. As described to the voters, Proposition 103 "'forces insurance companies to base your [automobile insurance] rates on your driving record first, rather than on where you live. This means good drivers throughout the state will pay less than they do now, while bad drivers will pay more.'" *Spanish Speaking*, 85 Cal. App. 4th at 1184 (quoting Ballot Pamphlet). In the context of Proposition 103, generally speaking, a "good" driver is a driver with a clean record and a "bad" driver

is a driver with a record of accidents or traffic citations. Ins. Code § 1861.025; 10 C.C.R. § 2632.13. In order to implement the command to "base . . . rates on . . . driving record first", insurers have to be able to determine what that record is. Insurers must be able to determine who is a "good driver" and who is a "bad driver", in order to base "good driver" rates on "good driver" experience and "bad driver" rates on "bad driver" experience.

Importantly, this consideration impacts all drivers, not just what rate will be assigned to an individual applicant. Rates for drivers within the "good driver" categories are based on the experience for all drivers in that category. If true accident record is masked so that riskier drivers are included within the "good driver" categories, then actual good drivers will pay higher rates, because the rate calculation will include the experience of higher risk drivers within the "good driver" categories. Thus, if classification is not accurate, insurers cannot deliver on the promise of Proposition 103.

That is, to rate for the driver safety record rating factor, insurers must be able to determine accident record. The question, historically, has been whether an insurer can require independent verification of accident record, or must just take an applicant's word for it that he or she has not had any accidents for the last three years, or six years, or whatever period the insurer uses for the various rating categories. There is little argument that it would be better to have independent verification. The controversy arises because sources for independent verification for applicants who were not previously insured are slight and sometimes not available. Some – including Plaintiffs here – argue that the lack of available sources for independent verification equates to the use of the "absence of prior

automobile insurance coverage, in and of itself" to determine "automobile rates, premiums, or insurability" in violation of Insurance Code § 1861.02(c).

PIFC/ACIC submit that when an insurer requires independent verification of accident record in order to rate for a driver safety record rating factor – whether or not that use is labeled a "factor" or an "underwriting rule" – the insurer is not using the absence of prior insurance "in and of itself" to rate the policy, as a matter of law. The insurer is complying with the letter and spirit of the law requiring that driver safety record be the most "important" rating factor, and the connection to "absence of prior insurance" is incidental, simply resulting from unavailability of sources other than prior insurance (in most cases) to provide reliable independent verification. This incidental connection is not use of absence of insurance "in and of itself".

Be that as it may, at the least the question calls for a quasi-legislative balancing of competing requirements within Proposition 103. Driver safety record cannot really be the most important rating factor unless the insurer can determine what the driver's safety record is. The interest in a reliable source for accident record – necessary to fulfill the purpose of Proposition 103 that rates be determined based first on driver safety record – is considered by some to be in tension with the possibility that requiring independent verification might indirectly lead to rating based on the absence of prior insurance. Prior to the adoption of current regulation 10 C.C.R. § 2632.13(i),[16] the Commissioner resolved these competing interests

[16] Section 2632.13(i) was adopted October 31, 2002, with an effective date of November 30, 2002, and compliance required (by the terms of the regulation) in 2003. Through a somewhat complicated history, 21st

on an *ad hoc* basis through approval (or not) of submitted rating plans. The Commissioner then adopted the regulation to balance these interests, which itself requires inclusion of certain elements in a class plan filing. *Id.* The Commissioner may make such quasi-legislative determinations through either process. *20th Century*, 8 Cal. 4th at 280 (Commissioner may determine rate setting rules through *ad hoc* determinations or through regulation), *see also* 285-86 (Commissioner may proceed either case-by-case or through regulatory formula). In all cases, the determination is quasi-legislative in nature, as it balances competing goals of the initiative. *See Spanish Speaking*, 85 Cal. App. 4th 1179 at 1237-38 (finding that competing goals of Proposition 103 could not be reconciled, and that "[t]he current regulations constitute a lawful choice among imperfect options.").

The Commissioner's approval of 21st Century's accident record verification requirement was a quasi-legislative act, whether that requirement is labeled a "rating factor" or "underwriting rule". The record demonstrates that the Department specifically considered the accident record verification rating factor and approved it, combined with 21st Century's other driver safety record rating factor for "weight" purposes. Because the approval is by definition quasi-legislative, it is within the scope of the rate matters outside the purview of the courts, and not merely the "application" of the rate. That approval can be challenged through the comprehensive system created for the purpose, but not through a collateral civil action.

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Century's accident record verification rating factor remained in effect through 2005, due to the Legislature's amendment of Insurance Code § 1861.02(c) by SB 841, which was held invalid in 2005.

## VI. CONCLUSION

Plaintiffs' action herein challenges 21st Century's approved rating plan. An order by the Court requiring restitution of surcharges paid under that plan would retroactively alter the rates, countermand quasi-legislative decisions of the regulator, and potentially render the rates for the period in question inadequate, all based on approved action as to which 21st Century received no extra profit. *See* CDI Report on Proposition 17, noting that insofar as rating factors are concerned rating is a "zero sum game". In accordance with longstanding California legal principles and interpreting the statutes at issue in accordance with those principles, Plaintiffs' collateral civil action is barred.

Dated: July 1, 2010

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## CERTIFICATE OF WORD COUNT

(Cal. Rules of Court, Rule _____)

The text of this brief consists of 11,685 words as counted by the word processing program used to generate the brief.

Dated: June 24, 2010 SEDGWICK, DETERT, MORAN & ARNOLD LLP

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