HOGAN LOVELLS US LLP
Vanessa O. Wells (Bar No. 121279)
525 University Avenue, 4th Floor
Palo Alto, California 94301
Telephone: (650) 463-4000
Facsimile: (650) 463-4199
vanessa.wells@hoganlovells.com

Attorneys for Intervenors
Personal Insurance Federation of California, American Insurance Association, Association of California Insurance Companies, Property Casualty Insurers Association of America dba Association of California Insurance Companies, National Association of Mutual Insurance Companies, and Pacific Association of Domestic Insurance Companies

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SACRAMENTO

MERCURY CASUALTY COMPANY, Petitioner and Plaintiff, v. DAVE JONES, IN HIS OFFICIAL CAPACITY AS THE INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA, Respondent and Defendant.	Case No. 34-2013-80001426 Hon. Eugene L. Balonon, Dept. 14 VERIFIED COMPLAINT IN INTERVENTION
CONSUMER WATCHDOG, Intervenor.	
PERSONAL INSURANCE FEDERATION OF CALIFORNIA, AMERICAN INSURANCE ASSOCIATION, PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA DBA ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES, NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES, AND PACIFIC ASSOCIATION OF DOMESTIC INSURANCE COMPANIES, Intervenors.	

Personal Insurance Federation of California ("PIFC"), American Insurance Association ("AIA"), Property Casualty Insurers Association of America ("PCI") doing business as Association of California Insurance Companies ("ACIC"), National Association of Mutual Insurance Companies ("NAMIC"), and Pacific Association of Domestic Insurance Companies ("PADIC") (collectively the "Trades") allege as follows:

NATURE OF THIS ACTION

1. Through this Complaint, the Trades seek to intervene in this action brought by Mercury Casualty Company ("Mercury") to obtain review of the Insurance Commissioner's Order dated February 11, 2013 issued by Defendant, Dave Jones, in his capacity as Insurance Commissioner of the state of California ("Commissioner") in *In the Matter of the Rate Application of Mercury Casualty Company*, File No. PA-2009-00009 (the "Order"). The Trades seek to intervene in order to represent the interests of their members in the correct resolution of the important questions of law before the Court in this matter. The Court's resolution of those questions of law will significantly impact every insurer doing business in this state subject to "Proposition 103" rate regulation.

2. The Trades collectively represent the majority of the insurers in California subject to Proposition 103. Some members of the Trades are among the largest writers of personal lines insurance in the country and in California. Other members are relatively small and localized. Most of the Trades' members who write insurance in California are subject to the prior approval rate regulatory system put in place by Proposition 103 (Ins. Code §§ 1861.01 *et seq.*). These members – large, small, local and national – are all entitled to a fair and constitutional system of rate regulation.

3. The Trades ask the Court to correct the Insurance Commissioner's unprecedented interpretation of the constitutional standard for confiscation. In Mercury's rate proceeding the Insurance Commissioner applied an erroneous standard to Mercury's request for a constitutional variance from the maximum permitted rate identified by the Proposition 103 ratemaking formula. Such variances are explicitly authorized by the regulations implementing Proposition 103. Cal. Code Regs., title 10 ("10 C.C.R"), § 2644.27(f)(9). This confiscation variance serves

as the bottom line "safety valve", as the Commissioner put it in adopting the current regulations, preserving the constitutionality of the entire regulatory scheme by providing sufficient accommodation for an individualized case where the limitations and assumptions of the regulatory formula would otherwise result in confiscation.

4. The Order abandoned controlling federal and California law, which provides that price regulation must afford a regulated entity an opportunity to earn a "fair rate of return". The Order substitutes a financial distress standard. The Commissioner's novel financial distress standard significantly circumscribes the rates that would qualify as confiscatory by requiring that a rate order – which is issued as to a single line of insurance in California – must cause the insurer financial distress across the entire company before the rate order would be considered confiscatory.

5. The substantive standard applied by the Commissioner is inconsistent with constitutional jurisprudence and insufficient to provide the constitutionally mandated protection against confiscation.

6. Compounding the impact of the Commissioner's opinion as to the substantive standard for confiscation, the Commissioner also interpreted the "relitigation bar" of 10 C.C.R. § 2646.4(c) as precluding Mercury's legal argument as to the correct constitutional standard, as well as the evidence proffered by Mercury to prove up its claim to the confiscation variance.

7. Moreover, the substitution of the financial distress test for the fair return standard affects the entire regulatory system. As described by the Commissioner in adopting the regulations, the system is intended to produce a fair result *ab initio* through the selection of reasonable, "most actuarially sound" rating components, controlled by the regulations. In the event the regulatory selections prove insufficient to allow for a fair rate, the regulations allow for several "variances". The ultimate variance is the confiscation variance. The standard governing the selection as to each component – and determining whether the Commissioner will allow a variance – strongly impacts the end result of the formula. By imposing a financial distress standard in place of a fair return standard, that lowered standard impacts every selection of every component, as it inherently bears on what is reasonable or "most actuarially sound". Similarly,

whether the rate is judged by a financial distress or fair return standard influences the decision as to whether a variance can be granted, and at what level.

8. The consequence of these substantive and procedural rulings is to eliminate the ultimate "safety valve" previously recognized by the Commissioner as necessary to render the rate regulations constitutional. As interpreted by the Commissioner in the Order, the system no longer contains the necessary safeguards against unconstitutional confiscation, and the system itself fails to meet constitutional standards.

9. The Order contains an additional error of law addressed by the Trades in this complaint in intervention. The Order misreads regulation 10 C.C.R. § 2644.10(f), which requires exclusion from the expense component of the rate formula of "institutional advertising expenses". The regulation is awkwardly drafted, but obviously intended to exclude expenses relating to certain advertising promoting corporate image, while allowing inclusion of expenses relating to product advertising. The Order interprets the regulation in such a manner as to effectively sweep all advertising into the category of "institutional advertising," thereby excluding all advertising expense from consideration in the rate. The Order's interpretation contradicts the plain language of the regulation.

10. What is more, the exclusion of "institutional advertising" expense chills and burdens commercial speech protected under the First Amendment to the United States Constitution and Article I § 2(a) of the California Constitution. The regulation chills and burdens this protected commercial speech solely on the basis of content, by significantly reducing the rate the insurer is permitted to charge if the content of the commercial speech is not of the type favored by the regulation. This burden on commercial speech is not supported by a legitimate governmental objective. Consequently, the regulation excluding advertising expense is not constitutional.

PARTIES

11. Intervenor PIFC is a California trade association representing six personal lines insurers who collectively write the majority of the personal lines auto and home insurance in California.

12. Intervenor AIA is a national trade organization representing the interests of more than 300 property and casualty insurance providers.

13. Intervenor PCI is a national property casualty trade organization representing the interests of more than 1,000 member companies. PCI does business in California as Association of California Insurance Companies.

14. Intervenor PADIC is a trade organization representing small and mid-sized property and casualty insurance companies operating in California.

15. Intervenor NAMIC is a national trade organization representing the interests of more than 1,400 mutual insurance companies providing property and casualty insurance.

16. Defendant Dave Jones currently occupies the office of Insurance Commissioner of the state of California and is sued herein solely in his capacity as Commissioner and not otherwise. The Commissioner regulates the business of insurance in California and is governed by the California Insurance Code, as well as by other applicable constitutional and statutory law. Pursuant to Insurance Code section 12906, the California Department of Insurance ("CDI") is under the control of the Commissioner. The Commissioner issued the February 11, 2013 Order which is the subject of this action.

17. Petitioner Mercury filed the homeowner's insurance rate application that is the subject of the Commissioner's Order. In this action, Mercury challenges the Commissioner's Order through a California Code of Civil Procedure ("CCP") 1094.5 "administrative" writ petition, and a complaint for declaratory relief.

18. There is an existing intervenor – Consumer Watchdog. Consumer Watchdog was founded by Harvey Rosenfield, the author of Proposition 103. Consumer Watchdog and its predecessors have been frequent intervenors opposing insurers in rate applications and other actions touching upon rate regulation in California. The original parties did not oppose Consumer Watchdog's petition for leave to intervene, and this Court granted the petition on March 22, 2013.

JURISDICTION AND VENUE

19. This is a Complaint in Intervention, filed in connection with a Petition for Writ of

Mandate and Complaint for Declaratory Relief over which this Court has jurisdiction, and which is properly venued in this Court. Consequently, this Court has jurisdiction over this Complaint in Intervention, which is properly venued in the Court in which the original action was filed.

RIGHT TO INTERVENE AND STANDING

20. Insurance Code § 1861.10(a) provides that "[a]ny person may initiate or intervene in any proceeding permitted or established pursuant to this chapter, challenge any action of the commissioner under this article, and enforce any provision of this article." "[T]his chapter" is Chapter 9 of Division 1 Part 2 of the Insurance Code. [T]his article" is Article 10 of Chapter 9, Division 1 Part 2 of the Insurance Code. Mercury's Petition is brought pursuant to Insurance Code §§ 1861.08, 1861.09, and 1858.6, among other statutes. Mercury Petition, ¶ 11. All of these Insurance Code statutes appear in Chapter 9. Sections 1861.08 and 1861.09 are in Article 10, and § 1861.09 directs that review of a rate order issued under § 1861.08 may be had as described in § 1858.6. The action commenced by Mercury with the filing of its petition is a "proceeding" to which § 1861.10(a) applies. Consequently, the Trades, as persons, have a right to intervene.

21. Section 1861.10(a) likewise confers standing upon the Trades to bring this action, challenging the Commissioner's legal interpretations and imposition of unconstitutional standards through the Order, through the devices established by California law to challenge action by an agency. These devices include a petition for writ of ordinary mandamus and a complaint for declaratory relief. The causes of action stated herein are so framed, in the interests of consistency with Insurance Code § 1861.10(a) and California law generally regarding the appropriate form of action for challenging determinations of law made by an administrative agency.

THE CONFISCATION ISSUE: GENERAL ALLEGATIONS

Proposition 103 and the Confiscation Standard

22. California voters approved Proposition 103 on November 8, 1988, replacing California's "open competition" system of insurance regulation with a prior approval system to regulate rates and premiums for most insurance in California. In addition to the prior approval

system, Proposition 103 also required insurers to "rollback" rates for the first year following passage of Proposition 103, to 80% of 1987 rates. *See* Ins. Code § 1861.01(a). Insurers could avoid the "rolled back" rate only upon a showing that the statutory rate would cause the insurer to be "threatened with insolvency". Ins. Code § 1861.01(b).

23. Upon its passage, seven insurance companies and a trade association challenged aspects of the initiative measure. Pertinent here, the insurers and trade association challenged the "threatened with insolvency" standard as insufficient to protect against the risk that the Proposition 103 "rollback" would be confiscatory as applied to individual insurers.

24. In *Calfarm Insurance Co. v. Deukmejian*, 48 Cal. 3d 805 (1989), the California Supreme Court agreed, concluding that the "threatened with insolvency" standard was unconstitutional because it provided no protection from confiscation for an insurer who might be in no danger whatsoever of insolvency, but for which the "rollback" rate would not provide an opportunity to earn a fair return. The opportunity to earn a fair rate of return is the constitutional standard protecting entities subject to price regulation from confiscation. The Court held, however, that the general rate standard set forth in Insurance Code § 1861.05(a) – allowing rates that are not excessive or inadequate – would apply once the unconstitutional "threatened with insolvency" standard was stricken. The Court held that the § 1861.05(a) standard was sufficient to allow insurers to apply for relief from confiscation, in the event the rollback rate would be confiscatory.

25. Because the rollback year was almost concluded by the time the *Calfarm* opinion issued, the Court reshaped the "rollback" from a prospective rate to a rebate of premiums. Insurers could apply for and charge the rates they considered appropriate during the rollback year, subject to refunding premium if it were ultimately determined that the rate actually charged during the rollback year was higher than the minimum non-confiscatory rate.

26. The Commissioner adopted a regulatory formula to set the minimum non-confiscatory rate. The regulations substituted industry averages and certain assumptions for the insurer's own experience, as to certain parts of the rate formula. Because the formula was applied retrospectively to determine a rebate rather than prospectively to calculate a rate for a

future period, the formula used actual, past historical data whenever the insurer's own data was implicated. Additionally, in the rollback context there were two formulas used to determine the rollback refund: the formula for determining the by-line "maximum permitted earned premium" ("MPEP") – which in the rollback context constituted an intermediate step in calculating the rollback – and the rollback formula set forth in 10. C.C.R. § 2645.9.

27. 20th Century Insurance Company – the first insurer to which the regulations were applied – challenged the regulations, supported by numerous other insurers which were also subject to the regulations. *See 20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216 (1994). In *20th Century*, the Court held the regulations and formula constitutional "as to rollbacks". The Court held that flaws in the individual components of the formula were unimportant unless such flaws led to a confiscatory result. Moreover, the Court held that in the event such flaws produced a confiscatory result in the first instance, that intermediate result could be rectified by the allowance of "variances" sufficient to accommodate the potential for confiscation in an individual case. Implicitly recognizing that the variances actually written into the regulations were not sufficient, the Court implied a "separate and independent constitutionally mandated 'variance,' which . . . would be available to the individual insurer on proof of confiscation, that is to say, on proof that the regulations in question would otherwise be confiscatory as applied." 8 Cal. 4th at 313. The Court went on to examine the rate of return to 20th Century post-rollback, found that 20th Century would receive an 11% rate of return, and held that "[w]ith a profit and rate of return of this magnitude, confiscation does not appear." *Id.* at 328.

The Current Regulations

28. In 2006, the Commissioner proposed regulations modeled after the structure approved in *20th Century* "as to rollbacks". That is, they utilized industrywide averages as to some components and gross assumptions as to others in the interests of "'reduc[ing]" the job of review and approval of a large annual volume of rate applications "'to a manageable size.'" *20th Century*, 8 Cal. 4th 216, 280, *quoting Calfarm*, 48 Cal. 3d at 824. Consideration of the constitutional concern with confiscation pervaded the entire regulatory structure as each regulation was designed to account for the "fair return principle." Ensuring the opportunity for a

fair rate of return was woven into the fabric of the scheme, and expressly included as the bottom line "variance" protecting against confiscation (10 C.C.R. § 2644.27(f)(9)).

29. The Commissioner reaffirmed his commitment to the "fair return principle" and its importance to every step of the ratemaking process when he stated, in the course of adopting the current regulations:

> The *20th Century* Court emphasized the importance of variances and stated time and time again that the variances expressly provided for in the regulations are the final mechanism for rate adjustments necessary to avoid confiscation before the final rate determination is made. The Commissioner recognizes the importance of variances and is fully cognizant that the Court in *20th Century* relied on variances as an extremely important protection against confiscation. Both the *Calfarm* and *20th Century* Courts made it clear that the Commissioner has the legal authority to take those steps reasonably necessary to make the job of rate regulation manageable. (*20th Century*, (quoting *Calfarm*), 8 Cal. 4th 216, 245; 32 Cal. Rptr. 807, 824.) ***The Commissioner is also aware that insurers must be allowed an opportunity to earn a fair and reasonable rate of return.*** Variances are important as the constitutional safety valves. However, a variance cannot be created for every possible contingency. The Commissioner has determined that variances must be carefully considered, otherwise the exceptions will swallow the rule making meaningful rate regulation impossible. *And the opposite is also true.* ***The regulations must contain enough of these safety valves to ensure insurers may avoid confiscation.***

Summary of And Response To Public Comment Received Prior To September 13, 2006 Public Comment Deadline, at p. 128 (emphasis added).

30. The "fair return principle" traces a lineage from the U.S. Supreme Court to the California Supreme Court and into the Proposition 103 regulatory scheme and the Commissioner's own statements. It has been a cornerstone of the Proposition 103 regulations, helping to ensure that the process results in rates that are both fair to consumers and constitutional as to insurers. The Commissioner's Order, abandoning the "fair return principle" in favor of his novel financial distress standard, strips the regulations of the safety valves the Commissioner once underscored as essential, leaving insurers with no protection from confiscatory rates.

The Commissioner's Order

31. On February 11, 2013, the Commissioner issued his order requiring Mercury to reduce homeowner's rates by 5%. The Commissioner's February 11, 2013 Order adopted the law, analysis, and conclusions of the ALJ with no changes.

32. In considering Mercury's request for the constitutional variance under 10 C.C.R. § 2644.27(f)(9), the Commissioner renounced the "fair return principle", which had served as the foundation underlying the entire regulatory structure when the current regulations were adopted in 2007. The Commissioner substituted a financial distress test, requiring that a rate order (which is issued as to a single line of insurance for the California market) must cause financial distress companywide in order to be considered confiscatory. This standard appears indistinguishable from the "threatened with insolvency" standard held unconstitutional in *Calfarm*.

33. Additionally, the Order upholds the use of the "relitigation bar" set forth in 10 C.C.R. § 2646.4(c) to preclude Mercury from arguing the question of the constitutional standard, and to preclude Mercury from presenting the evidence Mercury believed would meet the standard if Mercury correctly interpreted the law. Mercury was entitled to present its valid interpretation of the constitutional variance, and entitled to present evidence corresponding with its valid interpretation. By interpreting the relitigation bar to prevent Mercury from even arguing its case, the Order eliminates the accommodation necessary to allow for the possibility that a formulaic approach may yield a confiscatory result in an individual case.

THE CONFISCATION ISSUE: CAUSES OF ACTION

FIRST CAUSE OF ACTION

Petition for Writ Of Mandate Directed To Interpretation of 10 C.C.R. § 2644.27(f)(9)

(CCP §§ 1085, 1088.5: By the Trades Against Insurance Commissioner)

34. The Trades hereby incorporate by reference the allegations of paragraphs 1-33.

35. Regulation 10 C.C.R. § 2644.27(f)(9) purports to incorporate the "implied constitutional variance" articulated in *20th Century*.

36. The Commissioner's interpretation of that standard set forth in the Order is contrary to established constitutional law and contrary to the legislative history of the regulations.

37. The Commissioner's interpretation of 10 C.C.R. § 2644.27(f)(9) therefore constitutes an abuse of discretion, subject to a writ of mandate issued by this Court compelling

the Commissioner to correct that abuse of discretion.

SECOND CAUSE OF ACTION

Request for A Declaration As To The Correct Interpretation of 10 C.C.R. § 2644.27(f)(9)

(CCP § 1060 and Gov't Code § 11350: By the Trades Against Insurance Commissioner)

38. The Trades hereby incorporate by reference the allegations of paragraphs 1 - 37.

39. A controversy has arisen between the Insurance Commissioner on the one hand and the Trades and their members on the other regarding the correct interpretation of 10 C.C.R. § 2644.27(f)(9).

40. The Commissioner asserts that 10 C.C.R. § 2644.27(f)(9) requires that a rate order cause financial distress to the affected company as a whole in order to be considered confiscatory, and that § 2644.27(f)(9) does not entitle regulated insurers to the opportunity to earn a fair rate of return.

41. The Trades and their members assert that the Due Process (Fourteenth Amendment) and Takings (Fifth and Fourteenth Amendments) Clauses of the US Constitution create a protection against confiscatory price controls, which requires that regulated rates allow the regulated entity an opportunity to earn a fair rate of return on the regulated property or investment. The Trades and their members assert that 10 C.C.R. § 2644.27(f)(9) requires this protection.

42. The Trades' members are subject to rate regulation by the Commissioner in accordance with the Commissioner's interpretations of the regulations. Without relief from this Court, the Trades' members will be subjected to an incorrect interpretation, which allows unconstitutional rate orders.

43. Thus, the Trades pray for a declaration of the correct interpretation of 10 C.C.R. § 2644.27(f)(9).

THIRD CAUSE OF ACTION

Petition for Writ Of Mandate Directed To Interpretation of 10 C.C.R. § 2646.4(c)

(CCP §§ 1085, 1088.5: By the Trades Against Insurance Commissioner)

44. The Trades hereby incorporate by reference the allegations of paragraphs 1 - 43.

45. As alleged, the Commissioner interpreted 10 C.C.R. § 2646.4(c) to preclude Mercury from arguing an interpretation of law, and to preclude Mercury from presenting any evidence of its individual circumstances intended to show that the rate order would not allow Mercury the opportunity to earn a fair rate of return on its California homeowner's insurance business.

46. The Commissioner's interpretation of § 2646.4(c) is incorrect as a matter of law and deprives an applicant insurer of its right to a fair hearing, guaranteed by the Fourteenth Amendment to the US Constitution.

47. The Commissioner's interpretation of § 2646.4(c) therefore constitutes an abuse of discretion, subject to a writ of mandate issued by this Court compelling the Commissioner to correct that abuse of discretion.

FOURTH CAUSE OF ACTION

Request for A Declaration As To The Correct Interpretation of 10 C.C.R. § 2646.4(c)

(CCP § 1060 and Gov't Code § 11350: By the Trades Against Insurance Commissioner)

48. The Trades hereby incorporate by reference the allegations of paragraphs 1 - 47.

49. A controversy has arisen between the Insurance Commissioner on the one hand and the Trades and their members on the other regarding the correct interpretation of 10 C.C.R. § 2646.4(c).

50. The Commissioner asserts that 10 C.C.R. § 2646.4(c) precludes an insurer applicant from taking the position that the applicant is entitled to an opportunity to earn a fair rate of return on the insurance subject to the rate order, and precludes an insurer applicant from presenting evidence of its individual circumstances establishing that the insurer will not have the opportunity to earn a fair rate of return on the insurance subject to the rate order, as a result of the rate order.

51. The Trades and their members assert that the Due Process Clause (Fourteenth Amendment) of the US Constitution create a right to a fair hearing, which includes the right to present the insurer applicant's case that a contemplated rate order will not allow the insurer the opportunity to earn a fair return due to the individual insurer's circumstances differing from the

assumptions built into the regulations.

52. The Trades' members are subject to rate regulation by the Commissioner in accordance with the Commissioner's interpretations of the regulations. Without relief from this Court, the Trades' members will be subjected to an incorrect interpretation, which allows unconstitutional rate orders.

53. Wherefore, the Trades pray for a declaration of the correct interpretation of 10 C.C.R. § 2646.4(c).

FIFTH CAUSE OF ACTION

Petition for Writ Of Mandate Directed To Unconstitutional Regulatory Scheme

(CCP §§ 1085, 1088.5: By the Trades Against Insurance Commissioner)

54. The Trades hereby incorporate by reference the allegations of paragraphs 1 - 53.

55. As the Commissioner has interpreted 10 C.C.R. §§ 2644.27(f)(9) and 2446.4(c), the rate regulatory scheme is unconstitutional.

56. Price control regulation that proceeds by way of formulaic assumptions can be constitutional, but only if the regulatory mechanism is capable of accommodating adjustments that may be necessary in an individual case to avoid confiscation. As the Commissioner interprets the regulations in the Order, the current regulations contain no accommodation where, in an individual case, the regulatory formula may generate a rate order that will not permit the affected insurer the opportunity to earn a fair rate of return on the insurance business that is subject to the rate order. Since the system contains no mechanism to accommodate an adjustment that may be necessary to avoid confiscation, it is unconstitutional.

57. Further, as the Commissioner interprets the regulations in the Order, the regulatory system does not allow an affected insurer to present its evidence that a proposed rate order will not permit the insurer the opportunity to earn a fair rate of return on the insurance business subject to the rate order.

58. The current rate regulations are therefore unconstitutional, as a whole, as interpreted by the Commissioner, and subject to a writ of mandate issued by this Court compelling the Commissioner to cease applying an unconstitutional regulatory system.

SIXTH CAUSE OF ACTION

Request for A Declaration That the Rate Regulations As A Whole Are Unconstitutional As Interpreted By The Insurance Commissioner

(CCP § 1060 and Gov't Code § 11350: By the Trades Against Insurance Commissioner)

59. The Trades hereby incorporate by reference the allegations of paragraphs 1 -58.

60. An actual controversy has arisen between the Insurance Commissioner on the one hand and the Trades and their members on the other regarding the constitutionality of the Insurance Commissioner's rate regulations as interpreted by the Commissioner.

61. The Insurance Commissioner contends that the rate regulations are lawful and constitutional.

62. The Trades and their members contend that, as interpreted by the Commissioner, the regulations do not provide for a variance sufficient to provide the final mechanism for rate adjustments necessary to avoid confiscation, both because the Commissioner's interpretations do not permit an insurer a rate allowing the insurer the opportunity to earn a fair rate of return on the insurance that is the subject of the rate order, and because the Commissioner's interpretations do not permit an insurer the opportunity to present evidence to demonstrate that a particular rate is, as to it, a confiscatory rate.

63. The Trades' members are subject to this unconstitutional rate regulatory system.

64. Wherefore, the Trades and their members request that this Court declare the Commissioner's rate regulations, as interpreted by the Commissioner, to be unconstitutional.

<u>THE INSTITUTIONAL ADVERTISING ISSUE: GENERAL ALLEGATIONS</u>

65. Regulation 10 C.C.R. § 2644.10 provides:

The following expense items shall not be allowed for ratemaking purposes:

(a) Political contribution and lobbying.

(b) Executive compensation that exceeds the reasonable amount for such compensation. [formula omitted]

(c) Bad faith judgments and associated defense and cost containment expenses.

(d) All costs attendant to the unsuccessful defense of discrimination claims.

(e) Fines and penalties.

(f) Institutional advertising expenses. "Institutional advertising" means advertising not aimed at obtaining business for a specific insurer and not providing consumers with information pertinent to the decision whether to buy the insurer's product.

(g) All payments to affiliates, to the extent that such payments exceed the fair market rate or value of the goods and services in the open market.

. . . .

66. Excluded expenses are considered at Page 13 of the rate application. On Page 13b, the insurer applicant lists, by line, the excluded expense amount for each of the three most recent years. There is one line for each of the lettered items in § 2644.10. It is commonly the case that various lines will show zeroes, when the insurer does not have expenses for that excluded expense item.

67. Page 13b also calculates the "excluded expense factor". The "excluded expense factor" is an expense ratio of excluded expenses to direct earned premium. The expense component within the formula – known as the "efficiency standard" – is an expense to premium ratio. In the formula, the "efficiency standard" – the expense ratio – is reduced by the excluded expense factor. Reducing the efficiency standard by a percentage point or two, based on the excluded expense factor, makes a dramatic difference in the rate produced by the formula.

68. Regulation § 2644.10, subpart (f) is directed at excluding advertising expense for institutional advertising. There is a general understanding that "institutional advertising" promotes image, rather than promoting products to consumers. There is, however, no general understanding as to the boundary between institutional advertising and product advertising.

69. The regulation is awkwardly worded in the negative, identifying two categories of advertising that ***are not*** institutional advertising. For convenience in discussing the regulation, the two categories are referred to herein as "Category A" and "Category B". Category A is advertising aimed at obtaining business for a specific insurer. Category B is advertising providing consumers with information pertinent to the decision whether to buy the insurer's product. If advertising is ***not*** A and ***not*** B, then it is institutional advertising. The converse also

being true, if the advertising ***is*** A, it is not institutional advertising, and if the advertising ***is*** B, it is not institutional advertising.

70. The Order misreads the regulation, as if it defined advertising ***as to which expense is includable*** as "A and B". Order pp. 102-103. But the regulation is not so framed. The regulation defines advertising ***as to which expense is excluded*** as ***not*** A and ***not*** B.

71. Additionally, the Order reads Category A – advertising aimed at obtaining business for a specific insurer – as requiring that the "specific insurer" be named in the advertising. That requirement is not included in the regulation, nor is it consistent with common practice or consumer understanding. For example, advertising in a Northern California market urging consumers to buy homeowner's insurance from AAA due to a recent price reduction is "advertising aimed at obtaining business for" AAA of Northern California, Nevada, and Utah Insurance Exchange. It is not necessary to state the formal name of the specific insurer in the advertising, which would serve no useful purpose and only be confusing. If a consumer wishes to contact "AAA" and follows the instructions in the advertising, the consumer will contact, and, if he or she ultimately makes that decision, purchase insurance from the "specific insurer" that writes homeowner's insurance in Northern California as AAA: AAA of Northern California, Nevada and Utah Insurance Exchange. That is, it is not necessary that the "specific insurer" be formally named in the advertising, rather than identified by the name by which the insurer is popularly known. All that is required is that the business generated will accrue to a specific insurer.

72. The Order incorrectly describes regulation § 2644.10 as identifying expenses that cannot be "passed on" to consumers. Order p. 101. Similarly, the Order contrasts "excludable shareholder cost[s]" with "includable ratepayer expenditure[s]". Order p. 103. The Order relies heavily on public utility cases for this analysis. But insurance companies are not public utilities. They are competitors in a voluntary market. Advertising expenses, like other reasonable, legitimate, and accepted costs of doing business, are not "passed on" to "ratepayers". They are ***the insurer's*** costs of doing business. Neither the controlling statutes nor the implementing regulations ascribe certain expenses to "ratepayers" and others to "shareholders". The

regulations simply use the insurer's costs of doing business – including losses and expenses – as the basic building blocks to determine the range between a rate that is "excessive" and a rate that is "inadequate". The public utility model, and public utility cases applying public utility standards, does not apply.

73. There is another reason the public utility model – assigning certain costs to shareholders and certain costs to ratepayers – does not belong in the insurance market. A substantial portion of the insurance written in California is written by insurers who have no shareholders. The "mutual insurer" form of corporate organization is unique to the insurance industry. Mutual insurers are owned for the benefit of their policyholders, and have no shareholders. *See e.g.* Ins. Code § 4010. The California market includes both large and small mutual insurers writing a significant portion of the insurance in this state.

74. Regulation § 2644.10(f), particularly as interpreted in the Order, substantially burdens affected insurers' constitutionally protected commercial speech. The Order asserts that "[t]he Regulation does not regulate the content and form of advertising . . . ." Order p. 101. The regulation is expressly content-based, chilling and burdening some speech by requiring an insurer to reduce the expense component in the rate based solely on the content of the advertising. Unquestionably, applying an excluded expense factor, based on excluded advertising costs, which results in reducing the permitted rate by tens of millions of dollars has a chilling effect on a regulated insurer's commercial speech.

THE INSTITUTIONAL ADVERTISING ISSUE: CAUSES OF ACTION

SEVENTH CAUSE OF ACTION

Petition for Writ Of Mandate Directed To Interpretation of 10 C.C.R. § 2644.10(f)

(CCP §§ 1085, 1088.5: By the Trades Against Insurance Commissioner)

75. The Trades hereby incorporate by reference the allegations of paragraphs 1-74.

76. The Commissioner's interpretation of 10 C.C.R. § 2644.10(f) set forth in the Order is contrary to the plain meaning of the regulation, defines terms contained in the regulation in a manner not set forth in the regulation itself and that are inconsistent with common practice and consumer understanding, and ignores advertising expenses that are a legitimate and reasonable

part of the cost of doing business.

77. The Commissioner's interpretation of 10 C.C.R. § 2644.10(f) therefore constitutes an abuse of discretion, subject to a writ of mandate issued by this Court compelling the Commissioner to correct that abuse of discretion.

EIGHTH CAUSE OF ACTION

Request for A Declaration As To The Correct Interpretation of 10 C.C.R. § 2644.10(f)

(CCP § 1060 and Gov't Code § 11350: By the Trades Against Insurance Commissioner)

78. The Trades hereby incorporate by reference the allegations of paragraphs 1-77.

79. A controversy has arisen between the Insurance Commissioner on the one hand and the Trades and their members on the other regarding the correct interpretation of 10 C.C.R. § 2644.10(f).

80. The Commissioner asserts that 10 C.C.R. § 2644.10(f) defines advertising for which the expense is includable as advertising that is both aimed at obtaining business for a specific insurer and providing consumers with information pertinent to the decision whether to buy the insurer's product. The Commissioner further interprets § 2644.10(f) as requiring that a specific insurance company be formally identified in the advertising for the expense of that advertising to be includable.

81. The Trades and their members assert that 10 C.C.R. § 2644.10(f) defines institutional advertising – as to which expenses are excluded – by identifying two categories of advertising not constituting institutional advertising. Each of the two categories, then, defines advertising as to which advertising expense is not excluded. The Trades and their members further assert that the phrase "aimed at obtaining business for a specific insurer" does not require that a specific insurance company be formally named in the advertising. All that is required is that the business generated by the advertising (assuming success) will accrue to a specific insurer.

82. The Trades' members are subject to rate regulation by the Commissioner in accordance with the Commissioner's interpretations of the regulations. Without relief from this Court, the Trades' members will be subjected to an incorrect interpretation, with the potential to

drastically and unfairly reduce the rate level permitted by the formula.

83. Wherefore, the Trades pray that this Court declare the proper meaning of 10 C.C.R. § 2644.10(f).

NINTH CAUSE OF ACTION

Petition for Writ Of Mandate Directed To Unconstitutional Regulation

(CCP §§ 1085, 1088.5: By the Trades Against Insurance Commissioner)

84. The Trades hereby incorporate by reference the allegations of paragraphs 1-83.

85. Regulation § 2644.10(f), as written and as interpreted by the Commissioner, is a content-based regulation that substantially chills and burdens affected insurers' constitutionally protected commercial speech by altering their permitted rates based on whether their speech is an excludable expense.

86. The current regulations are therefore unconstitutional, as written and as interpreted by the Commissioner, and subject to a writ of mandate issued by this Court compelling the Commissioner to cease applying an unconstitutional regulation.

TENTH CAUSE OF ACTION

Request for A Declaration That 10 C.C.R. § 2644.10(f) Is Unconstitutional

(CCP § 1060 and Gov't Code § 11350: By the Trades Against Insurance Commissioner)

87. The Trades hereby incorporate by reference the allegations of paragraphs 1-86.

88. An actual controversy has arisen between the Commissioner on the one hand and the Trades and their members on the other regarding the constitutionality of regulation § 2644.10(f) as written and as interpreted by the Commissioner.

89. The Commissioner contends that the regulation § 2644.10(f) is lawful and constitutional.

90. The Trades and their members contend that, as written and as interpreted by the Commissioner, regulation § 2644.10(f) is a content-based regulation that substantially chills and burdens affected insurers' constitutionally protected commercial speech by altering their permitted rates based on whether their speech is an excludable expense.

91. The Trades' members are subject to this unconstitutional regulation.

92. Wherefore, the Trades and their members request that this Court declare regulation § 2644.10(f), as written and as interpreted by the Commissioner, to be unconstitutional.

PRAYER FOR RELIEF

WHEREFORE, the Trades pray for the following relief:

1. That this Court issue a Declaratory Judgment as requested in the Second, Fourth, Sixth, Eighth, and Tenth Causes of Action;
2. That this Court issue its writ of mandate compelling the Commissioner to interpret the regulations in a lawful and constitutional manner, as requested in the First, Third, Fifth, Seventh and Ninth Causes of Action;
3. For attorney's fees and costs incurred herein; and
4. For such other and further relief as the Trades may request or this Court may determine is appropriate.

Dated: June 21, 2013

Respectfully submitted,

HOGAN LOVELLS US LLP

By: _____
Vanessa O. Wells

Attorneys for Intervenors
Personal Insurance Federation of California, American Insurance Association, Property Casualty Insurers Association of America dba Association of California Insurance Companies, National Association of Mutual Insurance Companies, and Pacific Association of Domestic Insurance Companies

VERIFICATION

I, Kara S. Cross, declare as follows:

I am General Counsel for the Personal Insurance Federation of California ("PIFC") and I am authorized to make this verification on its behalf.

In that capacity, I have reviewed and am familiar with the COMPLAINT IN INTERVENTION on behalf of Personal Insurance Federation of California, American Insurance Association, Property Casualty Insurers Association of America dba Association of California Insurance Companies, National Association of Mutual Insurance Companies, and Pacific Association of Domestic Insurance Companies in the action titled *Mercury Casualty Company v. Dave Jones, in his Official Capacity as the Insurance Commissioner of the State of California*, Superior Court of the State of California, County of Sacramento, Case No. 34-2013-80001426.

The facts and matters set forth in that document as they relate to PIFC are true, correct and complete to the best of my current knowledge and belief.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this Verification was executed on June 19, 2013 at Sacramento, California.

Kara S. Cross

Kara Cross

HOGAN LOVELLS US LLP
ATTORNEYS AT LAW
PALO ALTO

VERIFICATION

I, Marjorie M. Berte, declare as follows:

I am Vice President, Western Region for the American Insurance Association ("AIA") and am authorized to make this verification on its behalf.

In that capacity, I have reviewed and am familiar with the COMPLAINT IN INTERVENTION on behalf of Personal Insurance Federation of California, American Insurance Association, Property Casualty Insurers Association of America dba Association of California Insurance Companies, National Association of Mutual Insurance Companies, and Pacific Association of Domestic Insurance Companies in the action titled *Mercury Casualty Company v. Dave Jones, in his Official Capacity as the Insurance Commissioner of the State of California*, Superior Court of the State of California, County of Sacramento, Case No. 34-2013-80001426.

The facts and matters set forth in that document as they relate to AIA are true, correct and complete to the best of my current knowledge and belief.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this Verification was executed on June 20, 2013 at Sacramento, California.

Marjorie M. Berte

VERIFICATION

I, Colleen Reppen Shiel, declare as follows:

I am Legal Counsel for Property Casualty Insurers Association of America doing business as Association of California Insurance Companies ("PCI") and am authorized to make this verification on behalf of PCI.

In that capacity, I have reviewed and am familiar with the COMPLAINT IN INTERVENTION on behalf of Personal Insurance Federation of California, American Insurance Association, Property Casualty Insurers Association of America dba Association of California Insurance Companies, National Association of Mutual Insurance Companies, and Pacific Association of Domestic Insurance Companies in the action titled *Mercury Casualty Company v. Dave Jones, in his Official Capacity as the Insurance Commissioner of the State of California*, Superior Court of the State of California, County of Sacramento, Case No. 34-2013-80001426.

The facts and matters set forth in that document as they relate to PCI are true, correct and complete to the best of my current knowledge and belief.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this Verification was executed on June 20, 2013 at Chicago, Illinois.

Colleen Reppen Shiel

VERIFICATION

I, Christian J. Rataj, declare as follows:

I am the Western State Affairs Manager for the National Association of Mutual Insurance Companies ("NAMIC") and am authorized to make this verification on its behalf.

In that capacity, I have reviewed and am familiar with the COMPLAINT IN INTERVENTION on behalf of Personal Insurance Federation of California, American Insurance Association, Property Casualty Insurers Association of America dba Association of California Insurance Companies, National Association of Mutual Insurance Companies, and Pacific Association of Domestic Insurance Companies in the action titled *Mercury Casualty Company v. Dave Jones, in his Official Capacity as the Insurance Commissioner of the State of California*, Superior Court of the State of California, County of Sacramento, Case No. 34-2013-80001426.

The facts and matters set forth in that document as they relate to NAMIC are true, correct and complete to the best of my current knowledge and belief.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this Verification was executed on June 19 2013 at Fort Collins, Colorado.

Christian J. Rataj

VERIFICATION

I, Milo Pearson, declare as follows:

I am Executive Director for the Pacific Association of Domestic Insurance Companies ("PADIC") and am authorized to make this verification on its behalf.

In that capacity, I have reviewed and am familiar with the COMPLAINT IN INTERVENTION on behalf of Personal Insurance Federation of California, American Insurance Association, Property Casualty Insurers Association of America dba Association of California Insurance Companies, National Association of Mutual Insurance Companies, and Pacific Association of Domestic Insurance Companies in the action titled *Mercury Casualty Company v. Dave Jones, in his Official Capacity as the Insurance Commissioner of the State of California*, Superior Court of the State of California, County of Sacramento, Case No. 34-2013-80001426.

The facts and matters set forth in that document as they relate to PADIC are true, correct and complete to the best of my current knowledge and belief.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this Verification was executed on June __, 2013 at Auburn, California.

Milo Pearson