October 12, 2012

SENT VIA EMAIL TRANSMISSION

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Re: Second Notice of Workshop Regarding Proposed Regulations: Scope of Prior Approval, OV-2011-00076 (September 14, 2012)

Dear Mr. Henley:

We write on behalf of Consumer Watchdog regarding amendments to Proposition 103 regulations proposed by the Department in its Second Workshop Notice (Second Notice) dated September 14, 2012.

Consumer Watchdog strongly supports the Department's effort to clarify its process and procedures in connection with the review and approval of rating factors and practices pursuant to Insurance Code section 1861.02[1] and of property-casualty rates pursuant to section 1861.05, enacted by the voters as part of Proposition 103. We believe new rules are urgently needed to correct ambiguities and uncertainties in the current process that have exposed consumers to unlawful rates and practices and led to inconsistent judicial decisions.

Portions of the draft regulations presented for discussion purposes in the Second Notice would help resolve these problems. However, other suggestions represent a step back for consumers, do not comport with Proposition 103, and would lead to inefficiency and greater confusion. Consumer Watchdog's analysis follows.

I. Background: What's At Stake

The Insurance Industry Claims "Approval" Means Immunity

To summarize the situation, many insurance companies seek to transform the Department's regulatory prior approval process from one designed to protect consumers into one that can be wielded as a shield by insurance companies to immunize themselves from accountability in the courts – or even in proceedings before the Commissioner – for unlawful

[1] All statutory references are to the Insurance Code except as specifically noted otherwise.

rates and practices. The insurers argue that *anything* that the Department can be said to have "approved" in connection with an application – whether disclosed, undisclosed, or not even filed with the Department, including conversations with agency staff – cannot be subsequently challenged by a lawsuit seeking damages or restitution, or subject to a later enforcement action by the Commissioner. According to the industry, the result of such a broadly defined interpretation of "approval" is immunity for any practice, even if that practice is unmistakably illegal under California law, and for any rate, no matter how excessive. However, when it suits them, insurers take a contradictory position, arguing that the Commissioner does not have the authority to regulate certain practices such as the public disclosure of underwriting guidelines or homeowners insurance rating practices.

Here are four brief examples of how the industry seeks to characterize "approval" as grounds for immunity from civil or administrative accountability:

(1) *Donabedian v. Mercury Insurance* (2004) 116 Cal.App.4th 968 ("*Donabedian*") – In this civil case brought by an individual consumer represented by private law firms as a class action under the Unfair Competition Law ("UCL") to enforce section 1861.02, it was revealed that the insurer unilaterally, and without disclosing its action to the Commissioner, redefined the lawfully-approved "persistency" rating factor so that the company surcharged insurance applicants who did not have prior insurance coverage, a practice specifically forbidden by Proposition 103. The insurer contended that by approving its class plan, the Commissioner approved the insurer's unlawful practice. (*Id.* at 990-991.) The insurer further contended that the Department, after a market conduct examination, ordered the company to violate the law, although it appears that this contention is incorrect. (The final documents have not been released to the public.) The Court of Appeal, significantly relying on the views of the Department submitted in an amicus brief, rejected Mercury's contention of a statutory bar to immunity. (*Id.* at 991-993.) The case later settled.

(2) *Landers v. Interinsurance Exchange of the Automobile Club* (Super. Ct. Los Angeles County, 2007, No. BC281759) – This was a civil proceeding, brought by an Auto Club policyholder represented by Consumer Watchdog and a private law firm as a UCL action to enforce section 1861.02, which was referred by the superior court to the Department under the primary jurisdiction doctrine to determine whether the Department had "approved" the rating practice at issue. In the proceeding held to address this question, the Administrative Law Judge concluded that the insurer had unlawfully surcharged a policyholder for the absence of prior insurance coverage through the use of an "underwriting rule" as part of underwriting guidelines that were not made available to the public, "[were] not part of its class plan and [] were not approved by the Department[.]" (Findings of Fact and Determination of Issues, *In the Matter of the Superior Court Referral of: Tracy Landers v. Interinsurance Exchange of the Automobile Club et al.* (Department of Insurance Administrative Hearing Bureau, Mar. 21, 2005, No. LI03033530), p. 4.) The Administrative Law Judge confirmed that "[s]ince the inception of Proposition 103, the Department has not recognized underwriting guidelines as part of a class plan application or filing, and has not approved them." (*Ibid.*) The case later settled.

(3) *MacKay, et al. v. Superior Court* (*21st Century Insurance Co.*) (2010) 188 Cal.App.4th 1427 ("*MacKay*") – In this civil case brought by policyholders who were surcharged based on their prior insurance coverage, the insurer contended that it was immune from civil challenge for an underwriting guideline, which, in effect, illegally used the absence of prior insurance in violation of Proposition 103, contained in an approved class plan filing. The Court of Appeal conflated the meaning of underwriting guidelines with rating factors, which were not at issue in the case, and held that the Department's approval "of a rating factor by the [Department] precludes a civil action against the insurer challenging the use of that rating factor" and immunized the carrier from suit. (*Id.* at 1435.) In comments submitted by the Personal Insurance Federation of California ("PIFC") on December 12, 2011, in response to the first workshop notice in this proceeding, PIFC stated that they "believe the *MacKay* case to be settled case law[,]" and that "[t]he department's description of a filing as a 'package' is fitting and, in practice, it is that package that is approved."

(4) *Farmers Insurance Exchange v. Superior Court* (*Dave Jones*) ("*FIE*") (Court of Appeal, Second Appellate District, Division Three, May 16, 2012, B233948) – In a writ action before the same appellate panel that issued the *MacKay* opinion, the insurer attempted to expand the decree in *MacKay* that "the filed rate doctrine" applies to bar *civil actions* on insurance rates in California to a ruling that would bar any *agency action* – even an investigation – of unlawful practices, when, according to the insurer, the Department had previously considered but declined to act on a similar complaint and had allegedly "approved" the illegal conduct at issue because the Department had approved its class plan. (Verified Petition for Writ of Mandate filed in the *FIE* action cited above, Jun. 24, 2011, pp. 23-41.) The case was later dismissed by the parties.

The Department's and the Public's Role in Proposition 103 Enforcement

As a comprehensive scheme for controlling insurance rates, premiums and practices, Proposition 103 places paramount emphasis on the accountability of both insurers and the Insurance Commissioner to the public. Proposition 103 granted the Commissioner the responsibility to review and approve insurance rates and practices subject to notice, public disclosure, and the opportunity for public participation in the matters governed by the measure. While under Proposition 103, "much is necessarily left to the Insurance Commissioner" (*Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 824), the voters chose not to leave *everything* to the Commissioner. The voters understood the practical limitations of the agency's resources and authority. As the Department pointed out in its September 21, 2011, Notice of Workshop:

> Over the course of a given year, the Department approves hundreds, and sometimes, thousands of rate and class plan filings. Each filing can contain hundreds of documents and records, including attachments and exhibits, some of which may not have been disclosed to the public. Despite the Department's best efforts to review the file to ensure that it complies with California law, a filing

> that contains practices that do not comport with California law may nevertheless be approved.

A similar but more detailed analysis was contained in an amicus brief that the Department submitted to the Court of Appeal in 2004 in connection with *Donabedian*, *supra*, 116 Cal.App.4th 968, discussed above. In its amicus brief, the Department stated:

> The Department goes to great lengths to review the class plan applications that it receives. However, this is no small feat. From January of 2002 to December of 2002, the Department reviewed 217 class plans, some of which may contain hundreds of pages. During this same time period, the Department received and reviewed a total of 6,739 rate increase/decrease filings, generally. In order to conduct the class plan review, the Department employs a total of 29 rate analysts and actuaries. The Department employs a total of 46 analysts to review the other prior approval filings received, literally, on a daily basis. While each of these analysts and actuaries are familiar with the Insurance Code, they typically do not have the benefit of legal training. Moreover, private attorneys general often have access to resources that the Department does not. Like all administrative agencies, the Department must balance its statutory responsibilities with the available resources when exercising its discretion to deploy its prosecutorial authority.
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> The Department does conduct some enforcement actions against carriers, upon discovery of an optional rating factor that violates the law on an "as applied" basis. In all candor, however, the Department simply lacks sufficient resources to pursue every allegation where an approved rate or rating factor appears reasonable on its face when approved by the Department, but through the independent investigation and resources expended by a private attorney general, a violation of the Insurance Code is revealed.
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> (Amicus Curiae Brief of the California Department of Insurance, *Donabedian*, *supra*, 116 Cal.App.4th 968, p.19 (brief at 2003 WL 23280980).)

Recognizing these limitations, the voters reserved to themselves both the right to monitor and participate in the Department proceedings established by Proposition 103, and the concurrent right to enforce Proposition 103 in the courts – a right that every elected Insurance Commissioner has endorsed and that was affirmed by the California Supreme Court in *Farmers Insurance Exchange v. Superior Court* (1992) 2 Cal.4th 377 ("*Farmers*"). At the core of this system of accountability – and essential to the achievement of its objectives – is the requirement of transparency.

Proposition 103 regulates both rates and the practices by which insurers allocate rates among customers to determine a policyholder's premium. The Commissioner cannot approve

rates that are excessive, inadequate, or unfairly discriminatory. (Ins. Code § 1861.05.) The system mandated by section 1861.05 requires the Insurance Commissioner to obtain extensive supporting information from each insurance company seeking approval for a rate change. (See *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216 [upholding challenge to prior approval regulations promulgated pursuant to section 1861.05].) Section 1861.05(b) mandates that insurance companies provide the Commissioner with "***such … information as the [C]ommissioner may require***" in order to exercise his responsibility to ensure that the rates approved are not "excessive, inadequate, unfairly discriminatory, or otherwise in violation of [chapter 9]." (Emphasis added.)

Proposition 103 places additional specific limitations on automobile insurance rates, premiums, and practices. Insurers must also file and obtain the Commissioner's approval before utilizing automobile rating factors. Section 1861.02(a) requires insurance companies to primarily utilize three mandatory rating factors, but allows the Commissioner to authorize the use of other optional rating factors. (Ins. Code § 1861.02.) The Commissioner must adopt optional rating factors, which must be substantially related to risk of loss, by regulation, and "the use of any criterion without such approval shall constitute unfair discrimination" under section 1861.05(a). (Ins. Code § 1861.02(a)(4).)

To make meaningful the opportunity for public participation they established through section 1861.10, the voters enacted an unqualified mandate for public disclosure, codified at 1861.07. It requires the disclosure of *all* information provided to the Commissioner pursuant to sections 1861.01 through 1861.16:

> All information provided to the commissioner pursuant to [article 10] shall be available for public inspection, and the provisions of Section 6254(d) of the Government Code and Section 1857.9 of the Insurance Code shall not apply thereto.

The two statutory provisions specifically cited in the second clause as inapplicable to section 1861.07, Government Code section 6254(d) and Insurance Code section 1857.9, were the principal statutory provisions that insurers employed prior to Proposition 103 to prevent disclosure of information. Both statutes "specifically exempt from disclosure records relating to regulatory information provided by insurers to state agencies." (*State Farm Mutual Automobile Insurance Company v. Garamendi* (2004) 32 Cal.4th 1029, 1044.) Government Code section 6254(d) exempts from public disclosure "[a]pplications filed with any state agency responsible for the regulation or supervision of ... insurance companies." Insurance Code section 1857.9 requires insurers to report, and deems confidential, certain information specified by the Commissioner "that is collected by a licensed advisory organization on an annual basis for each class of insurance designated in the prior calendar year by the [C]ommissioner[.]"

In *State Farm Mutual Automobile Insurance Company v. Garamendi, supra,* 32 Cal.4th 1029, the Supreme Court of California interpreted section 1861.07 in the context of State Farm's

challenge to a regulation requiring disclosure of community service statements that are filed with the Department as part of a rate application. The Court concluded that the second clause in section 1861.07 specifically cited Government Code section 6254(d) and Insurance Code section 1857.9 as inapplicable to section 1861.07 "[b]ecause the application of these exemptions would nullify the broad disclosure mandate of [section 1861.07] ..." (*Id.* at 1044.) The reference to the two provisions "make[s] clear that these exemptions do not apply." (*Ibid.*)

The Court rejected State Farm's argument that all other subdivisions of Government Code section 6254, except subdivision (d), applied to section 1861.07. Specifically, the Court rejected State Farm's argument that subdivision (k), which exempts from disclosure "[r]ecords, the disclosure of which is exempted or prohibited pursuant to federal or state law, including, but not limited to, provisions of the Evidence Code relating to privilege [such as trade secret information privileged under Evidence Code section 1060]," applies to section 1861.07. (*State Farm Mutual Automobile Insurance Company v. Garamendi, supra,* 32 Cal.4th 1029, 1044; Gov. Code § 6254(k).) According to the Court:

> [T]his clause does not establish that the other statutory exemptions from disclosure found in Government Code section 6254—such as section 6254, subdivision (k)—do apply. Indeed, the drafters' use of the inclusive term "all" to describe the information subject to public disclosure bolsters this construction of Insurance Code section 1861.07.
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> (*Ibid.*)

The Supreme Court of California thus confirmed that section 1861.07 provides no trade secret protection to insurance companies. *All* information submitted to the Department pursuant to Proposition 103 is subject to public disclosure. "All" means "All."

Neither the agency, nor the public, can properly fulfill their roles as mandated by the voters without full public disclosure of insurance information. The public obviously cannot "enforce any provision of" Proposition 103 (Ins. Code § 1861.10(a)) if it lacks access to information submitted with a class plan or rate application; the existence of the broad right contained in section 1861.07 is thus necessary to effectuate the statute's public enforcement mechanisms. And a right to access the information relied upon by the Commissioner in all of his determinations is similarly required if the public is to intelligently decide whether and how to exercise its right under section 1861.10(a) to "challenge any action of the [C]ommissioner."

This is the statutory context in which the issues raised in this workshop should be viewed.

II. 10 CCR § 2632.2 – Proposed Amendment To Regulation Defining Authorized and Unauthorized Rating Factors

Consumer Watchdog supports the proposed amendment to define "rating factor" and specify that the requirements of Proposition 103 must be followed before an insurer may use a proposed rating factor. However, we believe more specificity in the text of the proposed regulation text is necessary in order to prevent confusion about the difference between an authorized and unauthorized rating factor. The regulation should state that the only *permissible* rating factors are the three mandatory factors set forth in section 1861.02(a)(1)-(3) and those optional factors expressly adopted by the Commissioner by regulation as set forth in California Code of Regulations, title 10 ("10 CCR"), section 2632.5(c) and (d). Consumer Watchdog proposes the following language (Department's proposed amendment to current regulation text in underline; Consumer Watchdog's additions to Department's proposed text in double underline; deletions to Department's proposed text in strikethrough):

§ 2632.2 Rating Factors

(a) The term "rating factor" is defined as any factor, including discounts, used by an insurer which establishes or affects the rates, premiums, or charges assessed for a policy of automobile insurance. No insurer may use a rating factor unless it has been ~~filed with the Commissioner and~~ fully described in a class plan application approved by the Commissioner and is one of the three Mandatory Factors set forth in Insurance Code section 1861.02(a)(1)-(3) or one of the Optional Factors adopted by the Commissioner by regulation as set forth in section 2632.5, subdivisions (c) and (d). ~~and is in compliance with the requirements set forth in Insurance Code section 1861.02. Except as provided in section 2632.6, a~~ Any use of a rating factor not ~~authorized by Insurance Code section 1861.02(a)~~set forth in Insurance Code section 1861.02(a)(1)-(3) or section 2632.5(c) and (d) shall constitute the use of an illegal rate in violation of Insurance Code sections 1861.01 and 1861.05.

III. 10 CCR §§ 2632.20 and 2648.5 –Proposed Regulation Regarding Materials with Rate Impact

Consumer Watchdog believes that the proposed regulations regarding "Materials with a Rate Impact" are potentially confusing because they introduce new terms into the lexicon of the governing Insurance Code and regulatory provisions. Consumer Watchdog proposes that for the proposed text relating to class plans, the Department make the following changes:

§ 2632.20. Materials with Rate Impact.

(a) Any rating rule, rating factor, underwriting rule, eligibility guideline, coverage form with an impact on losses, or any other proposed criteria that has an

impact on rates or losses must be fully described in a rate application submitted to the Commissioner.~~Before an insurer may implement a rating method, an insurer must receive approval from the Commissioner for a class plan that fully describes the rating method~~.

(b) Notwithstanding any other provision of law, an insurer's use of any ~~unfiled~~ rating ~~method~~rule, rating factor, underwriting rule, eligibility guideline, coverage form with an impact on losses, or any other proposed criteria that may have an impact on rates or losses that has not been submitted and fully described as required by (a) shall constitute a violation of Insurance Code sections 1861.01 and 1861.05.

(c) All rating rules, rating factors, underwriting rules, eligibility guidelines, coverage forms with an impact on losses, or any other proposed criteria that has an impact on rates or losses, and any documents which contain a description of such criteria submitted to the Commissioner shall be made available to the public in accordance with Insurance Code section 1861.07.~~For purposes of this section "rating method" shall mean any rating rule, rating factor, underwriting rule, eligibility guideline, coverage form with an impact on losses, or any other change that has an impact on rates or losses.~~

With respect to rating factors utilized in lines other than automobile insurance and any rating rules, underwriting rules, eligibility guidelines, or coverage forms used in all property-casualty lines subject to section 1861.05, Consumer Watchdog proposes the following amendment to the Department's proposed text:

§ 2648.5. Materials with Rate Impact.

(a) Any rating rule, rating factor, underwriting rule, eligibility guideline, coverage form with an impact on losses, or any other proposed criteria that has an impact on rates or losses must be fully described in a rate application submitted to the Commissioner. ~~Before an insurer may implement a rating method, an insurer must receive approval from the Commissioner for a rate application that fully describes the rating method.~~

(b) Notwithstanding any other provision of law, an insurer's use of any ~~unfiled~~ rating ~~method~~rule, rating factor, underwriting rule, eligibility guideline, coverage form with an impact on losses, or any other proposed criteria that may have an impact on rates or losses that has not been submitted and fully described as required by (a) shall constitute a violation of Insurance Code sections 1861.01 and 1861.05.

(c) All rating rules, rating factors, underwriting rules, eligibility guidelines, coverage forms with an impact on losses, or any other proposed criteria that has an impact on rates or losses, and any documents which contain a description of such criteria submitted to the Commissioner shall be made available to the public in accordance with Insurance Code section 1861.07. ~~For purposes of this section "rating method" shall mean any rating rule, rating factor, underwriting rule, eligibility guideline, coverage form with an impact on losses, or any other change that has an impact on rates or losses.~~

IV. 10 CCR §§ 2632.11 & 2648.4 – Proposed Amendments to Categorize Portions of Filings as "Approved" or "Unapproved"

These proposed amendments seek to establish a bright line between which materials contained within or submitted with class plans and rate applications are subject to "approval" and which items must be submitted for review but are not considered subject to "approval."

Consumer Watchdog believes implicit in these proposed regulations is the Department's recognition that it cannot possibly review all of the materials and documentation that would be needed to determine, with one hundred percent certainty, that the insurer's rates and rating practices as proposed in rate and class plan applications comport with California law. Moreover, the Department is concerned that while some items submitted in support of a class plan or rate application may be necessary for the Commissioner to review to determine the appropriate rate or rating relativities, the Department should not be held to have "approved" every item contained within the supporting data and documentation. Thus the Department wants to draw a clear distinction between those items that will be subject to "approval," and those supporting data and documents that the Department will review but "not approve."

It is Consumer Watchdog's view that the bright line distinction as drafted in the Department's currently proposed regulation text is unnecessary and ill-advised. First, the focus on approved versus unapproved items as drafted will no doubt be misapplied by the industry to suggest that the Department agrees with or adheres to the industry's view that approval constitutes immunity from subsequent legal challenges in the courts or before the Department. The Department has expressly rejected the industry's argument in court documents on numerous occasions, however. And while the *MacKay* court sought to impose the "filed rate doctrine" by judicial fiat in that case, the better reasoned analysis by the *Donabedian* court – which correctly focused on the statutory framework – as well as the court in *Fogel v. Farmers Group Inc.* (2008) 160 Cal.App.4th 1403, leads to the conclusion that the Department's "approval" does *not* immunize an insurer from suit.

In *Donabedian, supra,* 116 Cal.App.4th 968, the Court of Appeal held that civil actions alleging violations of Proposition 103 are not precluded under the McBride-Grunsky Insurance Regulatory Act of 1947, codified at sections 1860.1 and 1860.2, stating: "It would make little sense if Proposition 103 – which subjects insurers to [California's Unfair Competition Law, Bus.

& Prof. Code § 17200 et seq.] – were interpreted to preclude a civil action alleging a violation of that very Proposition." (*Id.* at 991.)

In *Fogel v. Farmers Group Inc.* (2008) 160 Cal.App.4th 1403, insurance policyholders brought a class action against an insurance company and its subsidiaries for breach of fiduciary duty, fraud, and unlawful and/or unfair business practices in allegedly charging excessive fees. Among other things, the insurer argued that the action was barred under the "filed rate doctrine" because it sought refunds of premiums that were part of a rate approved by the Insurance Commissioner. (*Id.* at 1418.) The *Fogel* court held that the "filed rate doctrine" did not apply in California and stated that "even if the filed rate doctrine [did] apply[,] … it nevertheless would have no application here." (*Ibid.*)

In short, notwithstanding the industry's drumbeat that everything it submitted to the Department or discussed with the Commissioner or his staff is "approved" and therefore "immunized" from later challenge, there are two appellate court opinions expressly rejecting that position, and there is no reason why the Department should consider embracing the industry's paradigm.

Indeed, Consumer Watchdog believes that guidance provided by the Commissioner with respect to these issues *in the form of a regulation* will be of immense value to the judicial branch in clarifying the regulatory review process and the Commissioner's considered view of the extensive statutory framework he is charged with enforcing – a view to which courts are required to grant "substantial deference." (See, e.g., *Bell v. Blue Cross of California* (2005) 131 Cal.App.4th 211, 218, fn. 8 [finding the construction of a statute by the executive department charged with its administration is entitled to great weight and "substantial deference"]; *SCE Co. v. Pub. Util. Comm.* (2004) 117 Cal.App.4th 1039, 1050 [upholding PUC's interpretation of intervenor compensation statute finding agency's construction entitled to "considerable deference" and "should not be disturbed unless it fails to bear a reasonable relation to statutory purposes and language"], quoting *SCE Co. v. Peevey* (2003) 31 Cal.4th 781, 796.)

For many years, the Department has included in its approval letters to insurance companies the following statement:

> If any portion of the application or related documentation conflicts with California law, that portion is specifically not approved. Policy forms and underwriting guidelines included in this filing were reviewed only insofar as they relate to rates contained in this filing or currently on file with the California Department of Insurance. This approval does not constitute an approval of underwriting guidelines nor the specific language, coverages, terms, covenants and conditions contained in any forms, or the forms themselves. The Commissioner may at any time take any action allowed by law if he determines that any underwriting guidelines, forms or procedures for application of rates, or

> any other portions of the application conflict with any applicable laws or regulations.

This language correctly reflects the statutory framework, under which insurance companies are at risk of civil or administrative prosecution if they are found to violate the law. While the industry or others may perceive that this is "unfair to insurance companies" or that "insurance companies deserve to have certainty," those are policy arguments, and they were expressly rejected by the voters. As between consumers who are at risk of an endless array of potentially unfair rates, premiums or practices, and the possibility that an insurance company could be challenged for such a practice (which it may have only cryptically described in a rate or class plan filing, or hidden from public view altogether) post "approval," it is not even a close question. The statute requires that consumers should be protected and the law enforced against the insurance company.

Consumer Watchdog believes that the proposed amendments should be revised to strike the suggested text and replace it with language stating that the Commissioner has the right to require the submission of any material deemed necessary to fulfill his statutory responsibilities, and to specify that certain materials will be required to be submitted in conjunction with a rate or class plan application, while other materials may be requested.

Further, we propose that the Commissioner include in the regulation language similar to the notice contained in its approval letters, as follows:

> If any portion of an application or related documentation conflicts with California law, that portion is specifically not approved. Policy forms, underwriting guidelines or rules, or eligibility guidelines that were submitted in connection with the filing may have been reviewed only insofar as they relate to rates contained in the filing or currently on file with the California Department of Insurance. Approval of an application pursuant to Article 10 of Chapter 9 of Part 2 of Division 1 of the Insurance Code does not constitute approval of such materials. The Commissioner or any person may at any time take any action allowed by law if it is determined that any underwriting guidelines or rules, policy forms or procedures for application of rates, eligibility guidelines or any other portions of the application conflict with any applicable laws or regulations.

V. 10 CCR § 2632.11 - Proposed Amendment Creating New Process for Establishing Trade Secrets

This proposed amendment would establish a new series of complex procedures through which documents submitted by insurers to the Commissioner under the "approved/unapproved" proposed amendment discussed above would be withheld from the scrutiny of the public. Consumer Watchdog believes this proposal would create an unwieldy and impractical process

that conflicts with the Insurance Code. **Consumer Watchdog believes that the Department should strike these proposed amendments.**

First, as discussed at length above, section 1861.07 requires that all information submitted to the Commissioner must be made available to the public. The Supreme Court has made clear that "all" means "all." The voters specifically barred the application of "trade secret" protection for documents submitted by insurance companies to the Commissioner. The proposed amendment would countermand the statutory mandate and the California Supreme Court's interpretation of it, and thus would be unlawful.

Consumer Watchdog is aware that many insurance companies, and perhaps others, are offended by this provision of the law. They claim that their underwriting practices must be hidden from the public so as to prevent competitors from accessing the information. However, the voters made a different policy choice: they determined that public scrutiny of the industry's practices was a policy goal of greater importance than the insurers' desire for secrecy. The expression of the voter's policy decision is in plain language in the statute, and must be respected.

As shown above, consumers have been harmed when the Department has permitted insurers to conceal material from the public, or to engage in conversations or negotiations with Department employees that are not part of the public record. Insurers have taken advantage by instituting practices that are directly prohibited by statute, and yet, they argue, have received the blessing of the Commissioner and are therefore shielded from accountability when policyholders later discover they have been illegally surcharged. This situation cannot be tolerated.

Indeed, Consumer Watchdog notes that the amendments discussed above, proposing to establish a bright line list of what is "approved" versus "reviewed but not approved," combined with the proposed new secrecy amendment, would **permit insurers to do precisely what we thought this workshop was originally intended to prevent:** allow insurers to claim "approval" of documents that are submitted to the agency but hidden from public scrutiny.

As proposed, an insurance company that desires to conceal documents submitted with a rate or class plan filing would be required to show that the information is a "trade secret" by "clear and convincing evidence." (Proposed Regulation Text, §§ 2632.11, subd. (k)(1), 2648.4, subd. (f).) These terms are nowhere defined, leaving it to the discretion of the insurer and, apparently, a person acting in the name of the Commissioner, who would make the determination of whether something is a "trade secret" and whether the "clear and convincing" showing has been met. Since the proposal does not specify who in the Department would make that decision, it is quite possible that an employee without legal training would be authorized to grant the "trade secret" protection that the statute denies.

Should the person acting on behalf of the Commissioner reject the insurer's designation, the proposed amendment grants *the insurance company* the right to invoke a complex discovery

sub-proceeding before an Administrative Law Judge, and the proposal appears to contemplate the right of other members of the public to intervene in this new sub-proceeding.

Consumer Watchdog further notes that the process envisioned by the proposed text conflicts with the hearing process required by Proposition 103. Section 1861.05 mandates that the Commissioner hold a hearing upon a public request for rate changes greater than 7% and 15% for personal and commercial lines, respectively. Hearings on applications for rate changes below those levels are discretionary. Proposition 103 hearings are required to be conducted under the formal hearing procedures and protections of the Administrative Procedures Act, Government Code section 11500 et seq. The proposed amendment can be read to contemplate a "hearing within a hearing," but more likely, it reflects the Department's increasing reliance on informal proceedings to adjudicate rate challenges. Under this proposal, the only way a matter can get to an Administrative Law Judge is when *the insure*r requests it. To the extent that the informal proceedings employed by the Department are intended to expedite review of rate change challenges, permitting an insurer to obtain a hearing before an Administrative Law Judge on the trade secret issue, while denying the consumer's request for such a hearing on the rates as required by the statute, does not comport with the statute.

In sum, Consumer Watchdog believes this proposed amendment should be withdrawn. The statute mandates insurers *must* submit information requested by the Commissioner, and that the public be afforded the opportunity to review that information. Insurers do not have a choice on these matters. The proposed regulation appears to offer insurers a compromise that the statutes do not permit.

VI. Additional Proposal - Regulation Establishing Procedures Governing Primary Jurisdiction Referrals and Insurance Code Section 1858 Complaints

Consumer Watchdog once again urges the Commissioner to promulgate a regulation clarifying "Section 1858 Complaints and Primary Jurisdiction Referrals ["PJRs"]," a topic raised in the September 21, 2011 workshop notice and discussed at the November 11, 2011 workshop. The issue has arisen in each of the four legal proceedings mentioned above, and established procedures for processing such referrals would be of immense benefit to the courts, the Department, litigants and the industry.

As stated in Consumer Watchdog's December 1, 2011 comments, we propose a regulation that:

- Expressly differentiates between a primary jurisdiction referral made by a court pursuant to *Farmers, supra,* 2 Cal.4th 377, and a section 1858 complaint.
- Specifies procedure for when a court orders PJR:
    - Within thirty days after a court orders a PJR referral, the parties shall transmit to the Commissioner a copy of the court order and the civil complaint.

- At that time, the parties may each submit a letter of no more than ten pages explaining why the Department should or should not accept the referral.
- The parties shall provide any additional pleadings or information upon the request of the Commissioner.
- Within thirty days of receipt of the court order and complaint, the Commissioner shall notify the parties and the court whether the referral will be accepted or rejected.

Thank you for the opportunity to provide our preliminary comments on the topics identified by the Department's workshop notice and the proposed regulations.

Should you have any questions concerning these comments, please do not hesitate to contact us.

Sincerely,

Harvey Rosenfield

Pamela Pressley

Harvey Rosenfield Pamela Pressley