No. 17-537

IN THE

Supreme Court of the United States

MERCURY CASUALTY COMPANY, ET AL.,
Petitioners,
v.
DAVE JONES, INSURANCE COMMISSIONER, ET AL.,
Respondents.

On Petition for a Writ of Certiorari to the California Court of Appeal, Third Appellate District

BRIEF FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, CALIFORNIA CHAMBER OF COMMERCE, CALIFORNIA BUSINESS ROUNDTABLE, WASHINGTON LEGAL FOUNDATION, AND AMERICAN CONSUMER INSTITUTE AS *AMICI CURIAE* SUPPORTING PETITIONER

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Other Authorities

INTERESTS OF *AMICI CURIAE*[1]

The Chamber of Commerce of the United States of America (the "Chamber") is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, in every economic sector, from every region of the country. One important function of the Chamber is to represent the interests of its members in matters before Congress, the executive branch, and the courts. To that end, the Chamber regularly files *amicus* briefs in cases that raise issues of concern to the nation's business community.

The California Chamber of Commerce ("CalChamber") is a non-profit business association with over 13,000 members, both individual and corporate, representing virtually every economic interest in the state of California. For more than 100 years, CalChamber has been the voice of California business. While CalChamber represents several of the largest corporations in California, 75% of its members have 100 or fewer employees. CalChamber acts to improve the state's economic and jobs climate by representing the business community on a broad range of

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[1] Pursuant to Rule 37.6, *amici* affirm that no counsel for a party authored this brief in whole or in part, and that no party, counsel for a party, or any person other than *amici*, their members, or their counsel made a monetary contribution intended to fund the preparation or submission of the brief. *Amici* provided all parties with timely notice of their intent to file this brief under Rule 37.2(a), and all parties have consented to the filing.

legislative, regulatory and legal issues. CalChamber often advocates before the state and federal courts by filing *amicus curiae* briefs in cases, like this one, involving issues of paramount concern to the business community.

The California Business Roundtable is a nonpartisan organization comprised of the senior executive leadership of the major employers throughout the state, with a combined workforce of over half a million Californians. The Roundtable identifies issues critical to a healthy business climate, such as the one presented in this case, and provides the leadership needed to strengthen California's economy and create jobs.

Washington Legal Foundation ("WLF") is a nonprofit, public-interest law firm and policy center with supporters in all 50 states, including California. WLF devotes a substantial portion of its resources to promoting free enterprise, individual rights, limited government, and the rule of law. To that end, WLF has frequently appeared as *amicus curiae* before this Court in a variety of cases that impact WLF's free-market mission. WLF is concerned that the decision below, by holding that regulated firms have no constitutional right to earn a "fair rate of return," sets a dangerous precedent that—if allowed to stand—will drive many vital businesses to the brink of failure.

American Consumer Institute ("ACI") Center for Citizen Research is a nonprofit educational and research institute with a mission to identify, analyze, and project the interests of consumers in technology and related matters. Recognizing that consumers' interests can be variously defined and measured, and that numerous parties purport to speak on behalf of consumers, the goal of ACI is to bring to bear the tools of economic and consumer welfare analyses as rigorous as available data will allow, while taking care to assure that the analyses reflect relevant and significant costs and benefits of alternative courses of governmental action. ACI's policy topics include extensive analysis and research on state and federal insurance regulation. ACI is interested in this matter because state regulations that set low rates of return create high risks of insolvency among insurance carriers, which jeopardizes the ability of consumers to receive reimbursement for insurance claims.

SUMMARY OF ARGUMENT

Amici take a particular interest in this case because (as the petition demonstrates) the question presented has vital importance to a wide range of industries regulated by state and federal governments. Insurers, utilities, telecommunications providers, and other industries subject to governmental price controls all rely on the ratemaking process to provide income sufficient to cover their costs, including the cost of attracting the capital necessary to successfully operate a business. Absent a fair rate of return, a regulated firm and its equity holders are deprived of the value of their investments in violation of the Fifth and Fourteenth Amendments. Rational, profit-seeking businesses cannot be expected to continue doing business under such circumstances.

Yet the California Court of Appeal's new "deep financial hardship" standard upsets businesses' settled expectations, as grounded in longstanding principles and precedents. That standard is manifestly contrary both to the rules adopted in other jurisdictions and to the standard set forth by this Court: The decision below expressly *repudiates* the long-settled principle that a firm is constitutionally entitled to a fair and reasonable rate sufficient to attract and retain capital investments.

This conflict between the rule adopted below and this Court's precedents (as well as those of other courts around the Nation) warrants this Court's review particularly because California's imposition of unfairly low insurance rates threatens serious adverse consequences. As just one example, a recent explosion in costs and the persistent low-interest environment have left providers of long-term care insurance ("LTCI") especially dependent on the ability to recover actuarially justified rates. Yet States have blocked attempts to charge such rates and thus to recover a fair rate of return—thereby impairing insurers' financial stability and leaving them with little choice but to exit the market. The result is to deprive investors of their property, as well as to deprive consumers of a fully functioning insurance system. Similar harms will follow in other industries if firms are unable to recover returns sufficient to attract capital investments. This Court should grant review in order to head off that result.

ARGUMENT

I. THE CALIFORNIA COURT OF APPEAL'S DECISION CONFLICTS WITH THE CONSTITUTION AND THIS COURT'S PRECEDENTS

As the petition explains (at 9-16), the court of appeal's decision in this case deepens a conflict among the lower courts regarding the standard for identifying ratemaking that is confiscatory and therefore unconstitutional. The petition should be granted to resolve this split of authority.

In addition to this conflict, certiorari is also warranted because the standard adopted by the decision below conflicts with this Court's jurisprudence. While state and federal governments are undoubtedly free to impose restrictions on the prices at which goods and services may be sold, this Court has long recognized that the Constitution prohibits restrictions set so low as to effect confiscation of the seller's property. *See, e.g.*, *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307-08 (1989) (collecting authorities). And since this Court has also made clear that the "just and reasonable" standard imposed by the Natural Gas Act "'coincides' with the applicable constitutional standards," *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 770 (1968) (quoting *Fed. Power Comm'n v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585-86 (1942)), that standard "defines the point at which a rate becomes unconstitutionally confiscatory as well," *Jersey Cent. Power & Light Co. v. F.E.R.C.*, 810 F.2d 1168, 1175 (D.C. Cir. 1987) (en banc).

This Court has likewise made clear that this constitutional minimum requires that any fixed rate be sufficient to cover not only a business's operating expenses, but also its capital costs—which include both "service on the debt and dividends on the stock." *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 603 (1944). The returns must be "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital," and thus must be "commensurate with returns on investments in other enterprises having corresponding risks." *Id.* If a government-set rate is so low as to preclude payment of dividends sufficient to attract and retain capital investment, the rate goes beyond mere regulation and deprives the firm and its investors of constitutionally protected property interests. *See id.*; *Permian Basin*, 390 U.S. at 792 (reviewing court "must determine" whether a rate is sufficient to "maintain financial integrity" and "attract necessary capital").

The decision below—which is binding throughout California, *see Hale v. Superior Court*, 539 P.2d 817, 822 n.3 (Cal. 1975)—stands in sharp conflict with these long-settled rules of constitutional law. The California Court of Appeal held that state and federal governments are free to dictate prices just so long as the rates are not confiscatory in the sense that they impose "deep financial hardship" on the seller's "enterprise as a whole." Pet. App. 30a, 38a (internal quotation marks omitted). The court rejected any "fair rate of return" standard, holding that a regulated entity has *no* constitutional right to any such fair return. Pet. App. 38a. Indeed, in articulating what it meant by "deep financial hardship," the court expressly relied on the California Supreme Court's earlier repudiation of the notion that a regulated firm has a constitutional right to "'a profit which an investor could reasonably expect to earn in other businesses with comparable investment risks and which is sufficient to attract capital.'" Pet. App. 37a (quoting *20th Century Ins. Co. v. Garamendi*, 878 P.2d 566, 618 (Cal. 1994)).[2]

The conflict between this Court's standard for identifying confiscation and the Court of Appeal's rule could hardly be starker: This Court *requires* that any fixed rate be sufficient to cover capital costs, while the California court *denies* any right to a rate that will cover such costs. Certiorari is warranted to correct California's rejection of this Court's constitutional standard, and to reestablish a uniform nationwide rule protecting businesses and their investors from unconstitutionally confiscatory rate-making.

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[2] For its "deep financial hardship" standard, the Court of Appeal relied (Pet. App. 35a-37a) on a footnote in the D.C. Circuit's opinion in *Jersey Central*, 810 F.2d at 1181 n.3. But the court in that case defined "deep financial hardship" (*see id.*) in terms of what this Court had described in *Hope*, which in turn made clear that the constitutional minimum rate is one sufficient to cover capital costs including by paying dividends that are sufficient to attract investment. *See* 320 U.S. at 603; *supra*, at 5-6. The court below actually acknowledged this requirement in the course of describing the history of the doctrine (Pet. App. 35a-36a) before rejecting it immediately thereafter (Pet. App. 37a-38a).

II. THE QUESTION PRESENTED HAS EXCEPTIONAL NATIONAL IMPORTANCE FOR THE BUSINESS COMMUNITY AND CONSUMERS

Unless corrected, California's cramped "deep financial hardship" standard will have significant and injurious effects across the Nation—affecting a broad array of industries and consumers and even reaching into jurisdictions that have adhered to this Court's fair-return standard.

a. Any number of industries are subject to government-imposed ratemaking and price fixing. The California ratemaking statute that underlies the petition, for example, Cal. Ins. Code § 1861.01(c), applies to "all insurance on risks or on operations" in California, with a few limited exceptions. *Id.* § 1851. It thus pertains to homeowner's insurance, automobile insurance, mortgage insurance, earthquake insurance, health insurance, and most forms of business insurance. Other states have similar statutes. *See, e.g.*, Angelo Borselli, *Insurance Rates: Regulation in Comparison with Open Competition*, 18 Conn. Ins. L.J. 109, 112 (2011) (noting that, while rate-setting methods vary, "it must be emphasized that none of these methods fully rely on competition since the insurance commissioner basically still retains the right to direct the insurers' setting of rates"); *id.* at 161-67 (summarizing state filing and approval methods).

As one specific example of the adverse effects of California's approach to ratemaking, consider LTCI. Americans buy LTCI policies in their 40s and 50s, and begin to claim benefits in their 80s to pay for inhome nursing care, assisted-living facilities, and the like.[3] The costs of these services are unpredictable (they vary based on an insured's lifespan and medical needs), and are often quite high.[4] Insurance to cover such expenses is thus critical to many seniors' financial stability.[5] The very fact that so many seniors depend on LTCI coverage, however, poses a serious challenge to insurers: Due to improvements in medical knowledge and increased longevity, insurers face more claims and greater costs than they may have anticipated when many LTCI policies were written three decades ago.[6] Moreover, persistently low interest rates have hindered returns on insurers' investment of their reserves in recent years, leaving

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[3] *See* America's Health Insurance Plans, *Issue Brief: Addressing Long-Term Care Rates by Regulators Is Essential for Market Stability and Financial Security for Seniors* (AHIP Issue Brief) 1-2 (June 2017), *available at* https://tinyurl.com/y8th28v8.

[4] *See id.* at 1.

[5] *Id.*

[6] *See id.*; National Association of Insurance Commissioners & Center for Insurance Policy and Research, *The State of Long-Term Care Insurance: The Market, Challenges and Future Innovations* (State of LTCI) 7 (May 2016), *available at* https://tinyurl.com/y987f4cg; *id.* at 3 ("Most insurers' LTCI policies issued before the mid-2000s have seen adverse experience when compared to their original pricing assumptions."); *id.* at 19 ("more recent changes [in requested premiums] are related to the truing up of pricing assumptions" vis-à-vis past expectations); *id.* at 140 (noting "faulty assumptions" underpinning low rates on policies issued in the 1990s).

them with less financial stability than was contemplated as sound.[7]

Particularly in this environment, it is critical for insurers to maintain actuarially justified rates for LTCI. Without such rates, an LTCI carrier seeking to fund its obligations on existing policies will be forced either to draw down its reserves (leaving the company in a financially weak position), or else to subsidize its LTCI expenses by charging higher rates on other lines of business (which may not even be possible due to applicable rate-setting regimes). Yet despite these documented concerns, "state regulators have rejected actuarially sound premium requests that reflect increases in underlying costs,"[8] and "[s]tate approvals of rate requests [in this area] have been unpredictable and sometimes politicized."[9]

In this context, the necessity of constitutional protections for insurers is all the more evident. Absent an opportunity to earn a fair return, LTCI insurers will be (and indeed have been) forced to exit the market or else to face insolvency.[10] The prospect of rates being set in California (and elsewhere) un-

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7 AHIP Issue Brief, *supra*, at 1; State of LTCI, *supra*, at 19.

8 AHIP Issue Brief, *supra*, at 2.

9 *Id.*

10 *See id.* (noting insolvency of Penn Treaty); State of LTCI, *supra*, at 25 ("more than half of insurers in the sample have exited the market (or specific market segments) in the past eight years," with "concern about the ability to obtain needed rate increases" as the second most cited cause for exit).

der a restrictive "severe financial distress" standard will ultimately cause further contraction of the market—leaving aging Americans seeking coverage with fewer choices among financially weaker companies. Moreover, because reserve drawdowns affect other lines of insurance in addition to LTCI, these impacts will be felt even by consumers and policyholders who do not participate in the LTCI market.

b. While LTCI and the insurance industry more generally provide a particularly vivid example, myriad other industries are also subject to potentially confiscatory ratemaking regimes under the California standard. As the cases discussed in the petition (at 10-20) make clear, power generators, gas companies, sewer operators, telecommunications providers, and suppliers of other important services are all subject to governmental price controls or oversight. And firms in these sectors face pressures that are similar or even more substantial than those facing the insurance industry.

For instance, telecommunications providers and utility operators may be unable to respond to excessively depressed rates by exiting the market: Infrastructure is already in place, and it cannot readily be sold if the buyer lacks reasonable opportunity to turn a profit. Thus, absent an opportunity to collect rates sufficient to maintain a fair rate of return, firms may be compelled to cut costs in areas such as customer service—ultimately leaving consumers and the public worse off. Alternatively, a multistate firm may try to compensate for unfairly low rates in California (the Nation's largest economy) by charging higher rates elsewhere—causing ripple effects that will reach and impose burdens upon the States that acknowledge the constitutional right to a fair rate of return. The petition thus presents a question of great significance to numerous important sectors of the local, state, and national economies, and *amici* respectfully urge the Court to grant review.

CONCLUSION

The Court should grant the petition and reverse the decision below.

Respectfully submitted,

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