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IN THE SUPREME COURT OF CALIFORNIA

MERCURY CASUALTY COMPANY,
Plaintiff and Appellant,

v.

DAVE JONES, as Insurance Commissioner, etc.,
Defendant and Respondent.

PERSONAL INSURANCE FEDERATION OF CALIFORNIA, PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA DBA ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES, and NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES,
Intervenors, Appellants, and Petitioners.

CONSUMER WATCHDOG,
Intervenor and Respondent.

AFTER A DECISION BY THE COURT OF APPEAL THIRD APPELLATE DISTRICT
CASE NOS. C077116, C078667

PETITION FOR REVIEW

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PERSONAL INSURANCE FEDERATION OF CALIFORNIA, PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA DBA ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES AND NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

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I. QUESTIONS PRESENTED

1. Whether the State may, consistent with the Fifth and Fourteenth Amendments to the United States Constitution,[1] impose on insurers rates insufficient to allow an insurer the opportunity to earn a fair return on the capital devoted to the regulated business, so long as the rate order does not create "deep financial hardship" to "the enterprise as a whole".

2. Whether the State may, consistent with First Amendment[2] "strict scrutiny," adopt a regulation imposing a financial burden on advertising messages the regulator decides do not benefit consumers.

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[1] The action challenged herein is action by the California Insurance Commissioner, thus implicating Cal. Const. art 1, §§ 7, 15, and 19, which parallel the cited provisions of the U.S. Constitution. Throughout, we will refer only to the federal constitutional provisions, as there are no relevant distinctions.

[2] "First Amendment" refers to the First Amendment of the United States Constitution. Similar to the confiscation issue presented by Question 1, the regulation is a California regulation, and Cal. Const. art. 1, § 2 applies in addition to the federal provision. While art. 1 § 2 has been held to have a broader reach than the First Amendment, we do not perceive those differences to be implicated in this case.

II. WHY REVIEW SHOULD BE GRANTED

A. Question 1: Confiscation

Petitioners Personal Insurance Federation of California, Property Casualty Insurers Association of America (dba "Association of California Insurance Companies" in California), and National Association of Mutual Insurance Companies (the "Trades") raise two distinct issues before this Court. The first concerns confiscation, through price regulation of insurers. The Court of Appeal placed its imprimatur on a unique standard for insurance rate regulation derived from the 1994 case *20th Century Ins. Co. v. Garamendi,* 8 Cal. 4th 216 (1994). In stark contrast to prevailing federal and state constitutional law[3] – including opinions issued by this Court – the

[3] **California Cases**: *California Bldg. Indus. Ass'n v. City of San Jose*, 61 Cal. 4th 435, 464 (2015) (price controls confiscatory "if they deny a property owner a fair and reasonable return on its property", citing *Calfarm Ins. Co. v. Deukmejian*, 48 Cal 3d 805, 816-17 (1989)); *Kavanau v. Santa Monica Rent Control Bd*., 16 Cal. 4th 761, 771 (1997) ("In the context of price control … courts generally find that a regulation bears 'a reasonable relation to a proper legislative purpose' so long as the law does not deprive investors of a 'fair return' and therefore become 'confiscatory.'"); *Gerken v. Fair Political Practices Comm'n*, 6 Cal. 4th 707, 716 (1993) ("[I]n *Calfarm* …we held unconstitutional a key provision of Proposition 103, a measure designed to institute insurance reform. The challenged provision illegally precluded rate adjustments necessary to allow the insurer a fair rate of return."); *Calfarm*, 48 Cal. 3d at 816-17, 819-21 n.9 ("Having determined that section 1861.01, subdivision (b), precludes adjustments necessary to achieve the constitutional standard of fair and reasonable rates … we hold it invalid under the due process clauses of the state and federal Constitutions.").

20th Century standard permits the regulator to impose rates that do not allow for a fair return, so long as the rate order does not create "deep financial hardship" to "the enterprise as a whole".

The Court of Appeal's opinion is not clear as to what is encompassed within "the enterprise as a whole." Slip op. 31-33. This appears, however, to mean the entire national insurance organization. *See*

<u>Federal Cases</u>: *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310, 314 (1989) ("[W]hether a particular rate is 'unjust' or 'unreasonable' will depend to some extent on what is a fair rate of return given the risks under a particular rate-setting system, and on the amount of capital upon which the investors are entitled to earn that return. At the margins, these questions have constitutional overtones …. One of the elements always relevant to setting the rate under *Hope* is the return investors expect given the risk of the enterprise."); *Pennell v. City of San Jose*, 485 U.S. 1, 13-14 (1988) (city rent control ordinance ensuring that landlords were guaranteed a fair return on their investment satisfied due process); *Louisiana Pub. Serv. Comm'n v. F.C.C.*, 476 U.S. 355, 364-65 (1986) ("[A] regulated carrier is entitled to recover its reasonable expenses and a fair return on its investment through the rates it charges its customers …."); *Swift & Co. v. Wickham*, 382 U.S. 111, 117 (1965) ("In *Chicago, M. & St. P.R. Co. v. State of Minnesota*, 134 U.S. 418 … this Court held that the setting of rates not permitting a fair return violated the Due Process Clause of the Fourteenth Amendment."); *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603-04 (1944) ("[T]he fixing of 'just and reasonable' rates, involves a balancing of the investor and consumer interests …. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business …. By that standard, the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks …. Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the so-called 'fair value' rate base."); *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679, 690 (1923) ("Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory").

In the Matter of the Rate Application of State Farm General Insurance Company, CDI File No. PA-2015-00004, https://www-insurance.ca.gov/0250-insurers/0500-legal-info/0600-decision-ruling/0100-precedential/upload/StateFarmGeneralCompany.pdf (hereinafter "Precedent Decision"), pp. 65-66 ("Looking at the enterprise as a whole – ***i.e., the State Farm Group*** ….") (emphasis added) and pp. 11-12 ("Collectively, the State Farm Group operates in all states …. The State Farm Group includes eight affiliated property and casualty carriers …") Thus, the Court of Appeal opinion precludes insurers from obtaining relief from confiscatory rates unless the impact of the rate order is "deep financial hardship" to the entire, national insurance organization, including affiliates operating in other states outside California's regulatory jurisdiction.

As noted, the Court of Appeal derived its standard from *20th Century*. The case before this Court is the first insurance case ever to reach appellate review of the confiscation standard since *20th Century* was decided. It presents a question the insurance industry has been waiting over two decades to ask this Court:

> How can *20th Century*'s "deep financial hardship" test be reconciled with the overwhelming authority – including opinions of this Court prior and subsequent to *20th Century* – that confiscation through price regulation occurs when the rate order does not permit the regulated firm to earn a fair rate of return?

This question is of grave consequence to the industry. Insurers expect – and believe they are entitled to – the opportunity to earn a fair return on the business they write in California, regardless of financial condition. That is certainly the express message of *Calfarm Ins. Co. v. Deukmejian*, 48 Cal. 3d 805 (1989). *Calfarm* rejected a statutory standard for rate relief requiring that the insurer be "substantially threatened with insolvency" as violating constitutional protections against confiscation:

> "Insolvency" has various meanings, but none will allow us to construe [the "threatened with insolvency" standard] to conform to the constitutional standard of a fair and reasonable return . . . . The insolvency standard . . . refers to the financial position of the company as a whole, not merely to the regulated lines of insurance. Many insurers do substantial business outside of California, or in lines of insurance within this state which are not regulated by Proposition 103. If an insurer had substantial net worth, or significant income from sources unregulated by Proposition 103, it might be able to sustain substantial and continuing losses on regulated insurance without danger of insolvency. In such a case the continued solvency of the insurer could not suffice to demonstrate that the regulated rate constitutes a fair return.

> The effect of [the insolvency standard] is thus to bar safely solvent insurers from obtaining relief from "inadequate" rates . . . .

48 Cal. 3d at 818-19 (footnotes omitted).[4]

In the past, despite *20th Century*, the Commissioner appeared to subscribe to the same belief. In the course of adopting the current rate regulations in 2006, the Commissioner declared:

> The Commissioner is also aware that insurers must be allowed to earn a fair and reasonable return.

(App. 6, 1443)[5].

Now, however, the Commissioner has argued, and the Court of Appeal has accepted, that insurers have no right to a rate allowing the opportunity to earn a fair and reasonable return. Indeed, the selected standard of "deep financial hardship" to "the enterprise as a whole" seems to enshrine precisely what the *Calfarm* Court identified as the defects in the unconstitutional "threatened with insolvency" standard. *See* passage cited pp. 5-6 *ante*.

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4 As we explain below, California's system of rate regulation was adopted by voter initiative – Proposition 103 – and is frequently referred to by the originating initiative's number.

5 References to the Appellants' Joint Appendix will be "App.", followed by the Appendix Volume Number and page number (e.g., App., 1, 33).

20th Century addressed a unique problem: at the time of the opinion, there had been no final orders and no "rollback" refunds paid for the "rollback" year, 1989, five years after adoption of the law.[6] The "rollback" was a one-time rate reduction intended to be imposed for 1989 – a past period. At the time the California Supreme Court got the case, not only was there complete gridlock on rollback refunds, the rules of the game were still in flux. Sometimes the role of the state's highest court is to cut through a Gordian knot, and that is what the Court did in *20th Century*. The opinion itself firmly places itself in the unique context of the rollback, attaching the words "as to rollbacks" like a suffix to every holding in the opinion, repeated over thirty times.[7] This unusual usage virtually forecasts a sequel to address the permanent prior approval system effective following the rollback year – a sequel that has yet to be released.

The Trades intervened in this case because it presents issues of statewide importance, implicating the interests of every insurer writing property/casualty insurance in California. It has been 23 years since this Court issued the *20th Century* opinion, which by its terms is specific to the retroactive rollback. After almost a quarter century, there is a profound

[6] As we develop below, the "rollback" was the first phase of Proposition 103 insurance rate regulation.

[7] *See* 8 Cal. 4th at 241, 275-282, 284, 288-91, 306-17, 319-25, 328.

need for a new look at insurance rate regulation – this time focused on the permanent prior approval system now governing insurance rates.

B. Question 2: First Amendment

The Trades also raised a wholly separate issue concerning the validity of a specific regulation – 10 C.C.R. § 2644.10(f) – under the First Amendment. That regulation controls price by regulating the content of advertising messages: it ***disallows*** advertising expenses for "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." The described advertising is labeled "institutional advertising". Examples of so-called institutional advertising include event sponsorship of a "worthy cause", "promotion of a company's environmental efforts", and "campaigns against cell phone use while driving." (App. 1, 170.) The Trades challenged the regulation as an impermissible restraint on free speech, imposed through a financial burden. This is a question of first impression in the context of insurance price regulation.

The Court of Appeal agreed with the Trades that (1) the First Amendment applies to restraints imposed through a financial burden just as it applies to an outright ban, (2) the regulation at issue does impose a financial burden on speech, (3) the regulation impacts non-commercial as well as commercial speech, and (4) because the regulation sweeps noncommercial speech within its scope, the strict scrutiny test applies. Slip op. 20-22. But, having so held, the Court went on to hold that the regulation met the requirements of the strict scrutiny test because it imposed a financial burden, which is more narrowly-tailored than an outright ban, and that financial burden is necessary to achieve a content-based purpose of limiting insurers' advertising spend to advertising that "directly benefits" consumers. Slip op. 23.

But the point of the First Amendment is that, when it comes to speech, government does not decide what benefits consumers. Consumers get to make the decision, and insurers have the right to engage in the messaging they think will appeal to consumers. Further, if the First Amendment protects speakers from burdens on speech just as it protects against an outright ban – and it does – that government proceeds through a financial burden instead of an outright ban cannot meet strict – or any other – scrutiny: such a rule would eliminate First Amendment protection against financial burdens on speech.

This Court's review is necessary to protect insurers from wholesale eradication of First Amendment rights in the California market.

III. BACKGROUND

On November 8, 1988, California voters adopted an initiative measure to regulate insurance prices in California. That measure was "Proposition 103." The history of Proposition 103 is the history of this case, and critical to understanding the confiscation question before this Court.

A. Proposition 103

Proposition 103 employed a two phase approach to introduce insurance rate regulation to California. The first, "rollback", phase applied for the first year (1989), and required insurers to "roll back" rates on all property/casualty lines to 20% below rates charged in 1987. CIC § 1861.01(a). Relief from the rollback was permitted only if an insurer were "substantially threatened with insolvency." CIC § 1861.01(b). The second, "prior approval", phase went into effect on a permanent basis at the close of the rollback year, and required that insurers obtain "prior approval" of any proposed rates before charging them. CIC § 1861.01(c); *see also* CIC § 1861.05(a) (stating the standard applicable to prior approval of rates). *See generally 20th Century*, 8 Cal. 4th at 288-89 (discussion of Proposition 103's two phases).

B. *Calfarm:* Fair Rate Of Return

On the first day following Proposition 103's adoption, seven insurers and a trade group filed a challenge to the Proposition directly in this Court. This Court assumed original jurisdiction and issued an alternative writ. *Calfarm*, 48 Cal. 3d at 812.

Relevant here, petitioners challenged the "rollback", on the grounds that CIC Section 1861.01(b)'s "substantially threatened with insolvency" standard did not allow for relief from potentially confiscatory rate orders. The Court's analysis of the constitutionality of the rollback provision focused on the power of the state in the area of price regulation. The Court followed a line of cases considering the validity of state price controls under the Due Process Clause of the U.S. Constitution starting with *Nebbia v. People of N.Y.*, 291 U.S. 502 (1934). The Court described the specific articulation of the Due Process analysis to the price control context as, effectively, a moderator to the state's police power:

> We followed [the *Nebbia* test] in *Birkenfeld v. City of Berkeley* (1976) 17 Cal. 3d 129 …, a rent control case, and went on to explain that "[t]he provisions are within the police power if they are reasonably calculated to eliminate excessive rents and ***at the same time provide landlords with a just and reasonable return on their property***." (P. 165)

Calfarm, 48 Cal. 3d at 816 (emphasis added). *See also id*. at 818, referring to "the constitutional standard of a fair and reasonable return" (quoted in full, *ante*, pp. 5-6). The Court held the "threatened with insolvency" standard unconstitutional, because it precluded the constitutionally-required fair and reasonable return as to insurers "in no danger whatever of insolvency." 48 Cal. 3d at 818-19 and n. 11, *see also* extensive quote at pp. 5-6 *ante*.

The Court, however, rescued the rollback provision in Section 1861.01(a), by holding that in the absence of the "threatened with insolvency" standard, the "general standard" of Section 1861.05(a) applied. *See* CIC § 1861.05(a) (rates must not be "excessive, ***inadequate***, [or] unfairly discriminatory . . . .") (emphasis added) The Court held that "a confiscatory rate is necessarily an 'inadequate' rate", such that the 1861.05(a) standard barred confiscatory rates. *Calfarm*, 48 Cal. 3d at 822-23.

By the time of the *Calfarm* decision, the rollback year was half over, and it was not possible to apply the *Calfarm*-modified rollback on a prospective rating basis. The Court, consequently, effectively revised the rollback so that it could apply after the rating period, in the form of rate refunds. As the Court held, insurers could file applications with the Commissioner for rate levels either at the "rollback" level, or whatever the insurer considered the minimally non-confiscatory rate, if the insurer believed the rollback rate would be confiscatory. *Id*. at 825-26. The Commissioner could then hold hearings to determine whether the rates charged by insurers were minimally non-confiscatory or higher than minimally non-confiscatory, and, in the latter case, could order refunds to balance to the minimally non-confiscatory rate. *Id*.

C. *20th Century*: A "Rollback" Perspective

Subsequent to the *Calfarm* decision, industry participants generally filed what might be termed "*Calfarm*" rate applications, claiming exemption from the statutory rollback rate. Upon his 1991 election to office, Commissioner Garamendi chose to adopt a regulatory formula to set the minimum non-confiscatory rate for the year 1989, against which the *Calfarm* rate applications would be judged. *20th Century*, 8 Cal. 4th at 247-48.

Commissioner Garamendi's regulations specifically directed how each rating component would be established for purposes of rate review. The regulations were drafted to work with "generic determinations" that would complete the rate review template. *Id.* at 250. The "generic determinations" substituted broad assumptions regarding rating components for an insurer's actual data. For example, the regulations created an "efficiency standard" cap on expenses, and the "generic determinations" set the numerical caps, by line of insurance. *Id*. The generic determinations applicable to the rollback year were based, as was the entire rollback scheme, on data for a concluded period. *See* 10 C.C.R. §§ 2645.5-2645.6.

The *20th Century* case was the first, "test" case to be tried. It became the platform on which the Commissioner's rollback regulations were considered for constitutional validity. The Commissioner elected to consider whether the rollback rate was confiscatory, and, if so, what constituted the minimum non-confiscatory rate, by an examination of the concluded, audited, experience for the past period of the rate. In *20th Century*, the California Supreme Court upheld that election, noting that, in contrast to prior approval, "because the rate rollback concerns rates for a period that has passed, its orientation is retrospective. Hence, for review of rates thereunder, the ratemaking formula relies much on actual historical data." 8 Cal. 4th at 252.

20th Century and various industry participants challenged the Commissioner's regulations as insufficient to permit an insurer to achieve a non-confiscatory rate when the assumptions codified within the regulations did not fit the circumstances of a particular insurer. The Court upheld the regulatory system as constitutionally adequate, because the regulatory system allowed "variances" from the result produced by the formula sufficient to flexibly take into account situations in which the regulatory system might produce a confiscatory result. *Id.* at 298, 309, 311-13 (repeatedly holding that any tendency of the regulations to produce a confiscatory rate could be avoided by application of "variances").

In this connection, the Court undertook the novel course of creating an ***implied*** "separate and independent constitutionally mandated 'variance'" that would allow insurers the opportunity to present evidence that the formula would create a confiscatory result as it operated in a specific case. *Id.* at 313. Following a more traditional approach, the Court could well have simply held that such a variance would be necessary to the constitutional validity of the rollback regulations, the regulations contained no such variance, and the Court could not imply into the regulatory scheme that which is not there. *See, e.g.*, *Vasquez v. State of Cal.*, 45 Cal. 4th 243, 253 (2008) ("In construing this, or any, statute, our office is simply to ascertain and declare what the statute contains, not to change its scope by reading into it language it does not contain . . . . We may not rewrite the statute to conform to an assumed intention that does not appear in its language.") But, that would have meant another round of regulations, hearings, and judicial review, projecting out another five years.

The ***standard*** identified by the Court to establish confiscation is not clear. The Court used the words "deep financial hardship" to label the standard. The words were taken from a footnote in Justice Bork's opinion in *Jersey Central Power & Light Company v. Federal Energy Regulatory Commission*, 810 F.2d 1168, 1181 n.3 (D.C. Cir. 1987), describing the necessary showing to obtain compensation under the Takings Clause. But what the Court meant by "deep financial hardship" is obscured by references to financial propositions not illustrative of what would normally be understood by "deep financial hardship". The Court said:

> The firm may experience such hardship when it does not earn enough revenue for both "operating expenses" and "the capital costs of the business," including "service on the debt and

> dividends on the stock," of a magnitude that would allow a "return to the equity owner" that is "commensurate with returns on the investments in other enterprises having corresponding risks" and "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital."

20th Century, 8 Cal. 4th at 296. All of the quoted terms are from a passage in *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 603 (1944). It has generally been understood that "*Hope* itself required that the investor's return be commensurate with returns on equally risky investments in other enterprises[]"[8] – a standard equated with the "classic definition" of the economic concept of "cost of capital."[9] Thus, the Court's description does not seem to follow the common understanding of "deep financial hardship".

Be that as it may, the Court used rate of return to measure whether the rollback rate order was confiscatory as to 20th Century. It ultimately concluded that, based on a retrospective analysis of the impact of the rate order, taking into account retrospective adjustments available to 20th

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[8] A. L. Kolbe and William B. Tye, *"The Duquesne Opinion: How Much "Hope" is There for Investors in Regulated Firms?"*, 8 Yale J. on Reg. 117 (1991).

[9] Stephen F. Williams (Judge, United States Court of Appeals for the District of Columbia Circuit), *"Fixing the Rate of Return After Duquesne"*, 8 Yale J. on Reg. 160 (1991).

Century, the actual impact of the rate order was to leave 20th Century with an 11% return on the capital devoted to the business, which could not be considered confiscatory. *Id*. at 328.

D. The Prior Approval Rate Regulations

Effective April, 2007, the Commissioner adopted rate regulations applicable to prior approval. The regulations utilized the model approved in *20th Century* consisting of default assumptions subject to variances. As the Commissioner described the regulatory model:

> 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.***

(*See* App. 6, 1443 (emphasis added).)

The ultimate protection included by the Commissioner in the "variances" was the implied "constitutionally mandated variance articulated in *20th Century v. Garamendi* (1994) 8 Cal. 4th 216 which is an end result test applied to the enterprise as a whole." 10 C.C.R. § 2644.27(f)(9). This is known as "Variance 9".

E. The Case Before This Court

1. *Mercury* And The Financial Distress Test

On February 11, 2013, the Insurance Commissioner issued his decision in *In the Matter of the Rate Application of Mercury Casualty Company*, CDI File No. PA-2009-00009. (App. 1, 68-206.) In that opinion, the Commissioner discarded the working hypothesis that *20th Century* may have affected the fair rate of return test in some degree, but that it remained true that the ultimate determination of the constitutionality of a rate order depends upon the rate of return afforded by the rate order, taking into account the incidences in which an individual insurer's actual circumstances vary from the gross assumptions in the components of the regulatory formula. *See Kavanau*, 16 Cal. 4th at 778 (in an individual case, "flexibility in one part of a regulatory scheme may [or may not] offset restrictiveness in another.")

Instead, the Commissioner held that "deep financial hardship" in *20th Century* means structural financial distress to "Mercury Casualty as a whole" (App. 1, 194), giving examples of what could constitute "deep financial hardship," including lowered financial soundness ratings by rating agencies, slippage in stock prices, contraction in business, and "investor flight". (App. 1, 196-197.)

The Commissioner struck the evidence Mercury presented to show what its actual rate of return would be under the rate order, if Mercury's individualized circumstances were substituted for the gross assumptions in the formula. While the opinion includes a "rate of return" calculation, it is simply an algebraic rearrangement of the original formula components so that the rate of return specified in the regulations is stated as the result – there is no change to any of the components as they are fixed by regulation. (App. 1, 190, 198.)[10]

That is, in contrast to the weight of confiscation jurisprudence, state and federal, the Commissioner rejected consideration of the rate of return to the individual insurer as a measure of the constitutional fairness of the rate order.

The stated justification for this was that the *20th Century* "deep financial hardship" standard is not a rate of return standard. The Commissioner held that *20th Century* "modified" *Calfarm*, by "abandon[ing] the notion of a 'fair rate of return' . . . ." (App. 1, 200.) The Commissioner also held that rent control cases such as *Kavanau* – which, he acknowledged, ***do*** require a fair rate of return – do not apply because,

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[10] To explain further, 10 C.C.R. § 2644.16 specifies a maximum rate of return of the risk free rate plus 6%. In the Mercury case, that regulatory return was 7.3%. App., 1, 190 and footnote 374. The regulatory 7.3% was used in the regulatory equation to produce the maximum permitted earned premium. As with any equation, if the components are rearranged to an algebraically equivalent equation, the values don't change. The "rate of return" calculation in the Commissioner's decision simply rearranged the pieces so that the maximum permitted earned premium became a component and 7.3% became the result: no different than changing 3+4=7 to 7-4=3.

although they are price control cases, they "evolved from eminent domain cases", and, further, while "the due process standard in rent control cases measures for a fair rate of return", *20th Century* set a "different confiscation standard" for insurance price control. (App. 1, 201-202.) *But see California Bldg.*, 61 Cal. 4th at 463-64 (rejecting petitioner's eminent domain-based arguments on the grounds that the city controls at issue were price controls, subject instead to the rate of return test, citing both *Kavanau* and *Calfarm*).

2. The Trial Court Opinion

The Trades intervened in Mercury's petition for review given the potentially devastating impact of the Commissioner's decision on the insurance market in California and every competitor in that market.

The trial court accepted the Commissioner's construction of *20th Century* as requiring structural financial distress to "the enterprise as a whole" as necessary to obtain relief from a potentially confiscatory rate order. The court acknowledged that this is not the standard applied in *Calfarm*, or the other California Supreme Court cases considering confiscation through price controls, but evidently felt bound to follow *20th Century* to the exclusion of all other case law. (App. Vol. 11, 2836) ("[Petitioners] cite *Calfarm's* rejection of the 'insolvency standard,' and other federal cases to argue that the standard for confiscation is not 'deep financial hardship' but 'fair rate of return.' However, *20th Century* represents the California Supreme Court's most recent, comprehensive articulation of the standard for confiscation . . . .")

3. The Court of Appeal Validates The Financial Distress Test.

The Court of Appeal, similarly, relied solely on *20th Century* as its source for confiscation jurisprudence, concluding therefrom that *20th Century* had set a "deep financial hardship" test in the sense of structural financial distress. Slip op. 25-31. The Court rejected the fair rate of return test. Slip op. 29.

The Court's analysis differed from that of the Commissioner's Decision and the trial court's opinion in that it completely ignored all other confiscation jurisprudence, with the exception of *Calfarm*. With respect to *Calfarm*, the opinion states that *Calfarm* and *20th Century* are "harmonious" on the basis of the following sentence from *20th Century*:

> At this point, we would do well to rehearse, and elaborate on, the principles set forth in *Calfarm*.

20th Century, 8 Cal. 4th at 291, quoted at slip op. 31. For decades, the industry clung to the hope that this and other passages in *20th Century* suggested that the *20th Century* Court did not intend to depart from *Calfarm*. The Court of Appeal, however, dashed that hope, labeling the Trades' theory "hocus pocus." Slip op. 31.

The Court of Appeal does not itself offer an analysis reconciling the "fair rate of return" test clearly articulated and applied in *Calfarm* to the structural financial distress test it derives from *20*th *Century*. *See also* Precedent Decision (cited in full, *ante*, p. 4) p. 63, echoing the Mercury Decision's conclusion with the statement that "While *Calfarm* required rates to be 'fair and reasonable,' the same Supreme Court abandoned the notion of a 'fair rate of return' in favor of the 'operating successfully' standard of *20th Century*."

F. "Institutional Advertising" and the First Amendment

The Commissioner's *Mercury* Decision also considered whether Mercury's advertising expenses should be labeled "institutional advertising" and excluded under 10 C.C.R. § 2644.10(f), which provides:

> The following expenses shall not be allowed for ratemaking purposes:
>
> ***
>
> (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.

In the *Mercury* Decision, the Commissioner interpreted this regulation to encompass within "institutional advertising" such speech as sponsorship of "a worthy cause", "promotion of a company's environmental efforts", and "campaigns against cell phone use while driving." (App. Vol. 1, 170.) Under the regulation, then, an insurer is penalized through a component in the rate formula excluding expenses – reducing the permitted rate – for all advertising disfavored by the Commissioner based on its content.

In its Petition In Intervention, the Trades challenged Section 2644.10(f) as a regulation controlling speech in violation of the First Amendment. While not an outright ban, the State can equally effectively control speech by controlling the purse. Under the rate formula's "institutional advertising" expense exclusion, the rate permitted to an insurer whose advertising contains content disfavored by the Commissioner is lower than the rate permitted when advertising content is favored.

The Court of Appeal acknowledged the cases settling that the First Amendment applies to state action chilling speech through financial burdens as well as through an outright ban. Slip op. 20. The Court therefore found that the regulation must meet First Amendment standards protecting free speech. *Id*. The Court further found that the regulation impacted non-commercial as well as commercial speech, such that the "strict scrutiny" standard applies. *Id*. at 21-22. The Court then, however, contradicted itself, finding that the regulation met strict scrutiny because it operated through a financial burden rather than an outright ban, and therefore constituted the "least restrictive means available to promote the specific interest at issue." *Id.* at 23.

IV. LEGAL ANALYSIS

A. The Conflict Between the "Deep Financial Hardship" Test Derived By the Court of Appeal From *20th Century* And the Fair Rate of Return Test Articulated By *Calfarm* – As Well As The Overwhelming Weight of Confiscation Jurisprudence – Compels Review By This Court.

Unquestionably, *20th Century*'s analysis and articulation of confiscation principles significantly departs from that in *Calfarm* – a departure not repeated in subsequent California Supreme Court cases. Over the decades following *20th Century*, the insurance industry has had a vested interest in understanding that opinion, and in attempting reconciliation with *Calfarm* and other confiscation jurisprudence. The industry has theorized as follows:

1. *20th Century* is *sui generis* because it addressed a unique problem that will never be duplicated.

It is abundantly clear from the text of the opinion that this Court perceived *20th Century* to present an urgent problem that could only be resolved by the Court. As the opinion recites, the Court transferred review from the Court of Appeal to itself, "because it 'presents issues of imperative public importance requiring prompt resolution' . . . 'justifying a departure from normal appellate processes.'" 8 Cal. 4th at 240. The Court elaborated:

> "Proposition 103 [has] proven to be a problem child from its inception. It is doubtful whether any other initiative or

> legislative enactment has, in the span of just [a few] years, engendered more extensive administrative proceedings and as much litigation as Proposition 103."

Id. at 247. The Court described a backdrop consisting of "'over fifty lawsuits in California state courts'", an LA County Superior Court coordination proceeding initially including 22 cases and mounting from there, and a federal challenge. *Id*. at 246-47 and n.3. As the Court also described, 20th Century was the "test case", with a remaining 4,000 "'rollback exemption'" applications filed by 460 insurers to go. *Id*. at 263.

The opinion emphasizes throughout the distinction between the "rollback" and prior approval. *See e.g.. id.,* at 252, 283, 286, 288-89, 321. Throughout the opinion, the Court takes the unusual step of repeatedly limiting its holdings to the rollback context. *See* footnote 7, *ante*. It is common for a Court to include a footnote making clear that its holdings are limited to the case before it, but it is unusual for a Court to confine every observation, remark and holding with such a confining phrase.

Most importantly, *20th Century* addressed an inherently one-time phenomenon. The rollback period had concluded. The regulations relied primarily on "actual historical data" to determine whether a one-time refund for a past and concluded period would constitute a taking. *Id*. at 252, 305, 321. This "retrospective" "orientation" (at 252) dominates the analysis.

First, it accounts, perhaps entirely, for 20th Century's rollback liability. The rollback calculation used 20th Century's actual losses for the earthquake line – none – to determine the refund. But insurance is the transfer of risk, and the price for insurance is the price for the ***risk*** – here, the price associated with the ***risk*** of losses from earthquake. 20th Century wrote in Southern California. There were no earthquakes in Southern California in 1989. There was a major earthquake in Northern California in 1989 (Loma Prieta), and an even bigger earthquake in Southern California a mere five years later (Northridge). Loma Prieta and Northridge underscore that 20th Century's actual experience in Southern California in 1989 did not equal the ***risk*** of loss: either to 20th Century or its policyholders.

Second, and relatedly, it accounts for *20th Century*'s rejection of cost of capital (the accepted measure of fair rate of return; see footnotes 8 and 9 and related text, *ante*) to measure the minimum non-confiscatory return:

> Another assumption seems to be that cost of capital is dispositive as to the issue here, which concerns rate rollback liability. Although cost of capital . . . may be "pertinent for prospective rate-making" under the "prior approval" system, "implementation of the rollback does not require prospective ratemaking but rather ***the determination of a minimum nonconfiscatory return for a period now past.***"

Id. at 321 (emphasis added).

2. Attempts to reconcile the "deep financial hardship" test with the "fair rate of return" test have failed.

Following *20th Century*, the industry sought some way to reconcile "deep financial hardship" with the prevailing "fair return" standard, focusing on *20th Century*'s equation of "deep financial hardship" with the absence of a return allowing the firm to recover its cost of capital. *See* discussion *ante* at footnotes 8, 9. The Trades acknowledge that *20th Century* contains numerous potentially conflicting statements, not all of which are consistent with this working theory. But, the theory allowed a way to harmonize *20th Century* and *Calfarm*. No other theory appears, or has been proposed. Insurers operate under a regime dominated by *Calfarm* and *20th Century*, and the need to function demanded some hypothesis that could accommodate both, imperfect as it might be. In 2006, the Commissioner appeared to subscribe to this working theory, declaring that "[t]he Commissioner is [] aware that insurers must be allowed to earn a fair and reasonable return." (App. 6, 1443).

The Court of Appeal opinion extinguishes that possibility. The Court of Appeal shares the Commissioner's newly-stated vision of "deep financial hardship" as entirely eliminating the relevance of the insurer's actual rate of return. Slip op. 33-34. The further expression of "deep financial hardship" as measured with regard to the "enterprise as a whole" by definition eliminates a rate of return quantification, as the Court of Appeal held. *Id*. at 31-33. This is precisely why *Calfarm* rejected the "threatened with insolvency" standard (48 Cal. 3d at 818-19), driving a further wedge between *20th Century* and *Calfarm*.

The "deep financial hardship" to the "enterprise as a whole" standard generates further, serious fallout in the form of an overreach of regulatory authority beyond California's borders. Not only does the use of "enterprise as a whole" mask and therefore allow confiscation – the concern in *Calfarm* – it compels *support* of California rates with revenues from business outside California. So long as other business within the "enterprise" independently supports the "enterprise's" financial strength, California can force rates deeply beneath a break-even point, in violation of constitutional principles fundamental to our nation's charter. *C.f. e.g. Hans Rees' Sons v. State of N.C. ex rel. Maxwell*, 283 U.S. 123, 134 (1931) (where state uses method that "operates so as to reach profits which are in no just sense attributable to transactions within its jurisdiction" the state violates the Commerce Clause and other provisions of the U.S. Constitution.)[11]

[11] The Court of Appeal misunderstood the Trades' concern to be that the Commissioner affected other states' rate determinations. Slip op. 32.

3. *Lingle v. Chevron* discloses that the "deep financial hardship" test is actually a "takings" test.

In *Lingle v. Chevron USA, Inc.*, 544 U.S. 548 (2005), the U.S. Supreme Court "correct[ed] course" with respect to the historical intertwining of Due Process and Takings concepts in the constitutional review of price control. *Id*. at 548. That case was a challenge to a Hawaii law limiting rents Chevron could charge for gas stations. Chevron did not contend that the rents imposed upon it were confiscatory, but argued that the statute did not "substantially advance" a legitimate state purpose and that the price control thus constituted a taking. *Id*. at 543.

The *Lingle* Court clarified the roles of the Due Process and Takings Clauses in review of price regulation. The Court held that the "substantially advances" test is a Due Process formula, which addresses the validity of regulations, not whether there has been a compensable taking. The Due Process inquiry, the Court held, is "logically prior to and distinct from the question of whether a regulation effects a taking." *Id*. In contrast, the Takings analysis presupposes validity and is designed "to secure *compensation* in the event of otherwise proper interference amounting to a taking." *Id*. at 537, 543. If a regulation is invalid in violation of Due Process, the Court explained, "that is the end of the inquiry" and "[n]o amount of compensation can authorize such action." *Id*. at 543.

The *Lingle* clarification can explain *20th Century* vis a vis *Calfarm*. *20th Century* considered whether a refund applied against premium revenues for a past and concluded period would constitute a taking. *Calfarm* decided that a statutory standard requiring the "company as a whole" to be "threatened with insolvency" could not be reconciled with the Due Process mandate requiring the opportunity to earn a fair return. As a Takings case applied to a past period, under *Lingle*, *20th Century* would not control the validity of a prospective rate order that does not allow an individual insurer the opportunity to earn a fair rate of return.

The Trades presented each of these theories to the Court of Appeal. The Court described the first as "smoke and mirrors – nothing more." Slip op. 31. The Court dismissed the second as "hocus pocus." *Id.* As to the third, the Court stated that "*Lingle* was not a price control case at all, and the court [sic] therein never considered or addressed the 'deep financial hardship' standard for determining whether a price control is constitutionally confiscatory." Slip op. 30.[12] That is, the Court did not consider the broader implications of a United States Supreme Court opinion addressing price regulation.

It may be that any attempt to harmonize *20th Century* with the rest of confiscation jurisprudence – particularly *Calfarm* – requires "hocus

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[12] Nor could the Court have done so, as it would have had to have been aware of the existence of this singular standard.

pocus" and "smoke and mirrors". Previously, the industry had no choice, in the absence of a path to this Court. Now, this Court has the opportunity to address and resolve the *20th Century* conundrum. Without review, the insurance industry will be condemned to a singular standard, allowing what would be confiscation applied to any other business, with no explanation. No California court can address this task other than this Court. As the Court of Appeal put it:

> To the extent either Mercury or the Trades can be understood to offer other reasons why the standard the commissioner applied is "[i]llogical" or "[u]nworkable," we simply say that it is not for us to question the logic or workability of our Supreme Court's opinions in *Calfarm*[13] and *20th Century*. We can only follow them.

Slip op. 33. The Trades believe that this Court intends its opinions to be logical and workable, as well as consistent. The Trades pray that this Court take review of this case, to achieve that end.

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[13] As we have shown, a significant issue is the inconsistency between *Calfarm* and *20th Century*.

B. This Court's Review Is Essential To Preserve Two Fundamental First Amendment Principles Of Statewide Importance: 1) The State May Not Assume a Paternalistic Dictation of What Speech is "Beneficial"; And 2) Scrutiny Of Financial Burdens On Speech Must Be Meaningful.

1. Dictation of what speech benefits consumers is not a permissible, let alone a "compelling", governmental purpose.

The Court of Appeal held that the expense exclusion for "institutional advertising" met the First Amendment strict scrutiny test. The fulcrum of this holding is the invention of a governmental purpose not raised by any party: the purpose to ensure that only expenses for advertising that "directly benefits" consumers are "pass[ed] on" in rates. Slip op. 23. This is not an acceptable purpose under the First Amendment.

At the threshold, the Court of Appeal is mistaken in the underlying assumption that insurance rates are a conduit through which an insurer's expenses are "passed on" to consumers. The California insurance rate system controls price by considering all of an insurer's revenues and costs, and, supposedly, a reasonable rate of return. *See 20th Century*, 8 Cal. 4th at 283. Expenses are not "passed on" by consideration of costs, any more than an insurer's investment income – which, by statute, must be considered in determining the appropriate rate[14] – is "passed on" to consumers.

More significantly, designating control over what messages benefit consumers as a "compelling" state interest is fundamentally at odds with First Amendment principles. The state makes many decisions to protect consumers, but the state does not get to determine what messages benefit consumers in deciding what companies they wish to patronize, or what products they want to buy.

As the United States Supreme Court explained in *Central Hudson Gas & Elec. Corp. v. Public Service Commission of New York*, 447 U.S. 557, 561-62 (1980):

> Commercial expression not only serves the economic interest of the speaker, but also assists consumers and furthers the societal interest in the fullest possible dissemination of information. In applying the First Amendment to this area, we have rejected the "highly paternalistic" view that government has complete power to suppress or regulate commercial speech. "[P]eople will perceive their own best interests if only they are well enough informed, and … the best means to that end is to open the channels of communication rather than to close them…."

This principle protects both the insurer's right to deliver speech and consumers' right to receive it. *See U.S. v. Playboy Entm't Grp., Inc.*, 529 U.S. 803, 817-18 (2000) ("The citizen is entitled to seek out or reject certain ideas or influences without Government interference or control ….

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14 CIC § 1861.05(a) (rate must mathematically reflect investment income); *20th Century*, at 290 (rates must be offset by insurance company's investment income).

What the Constitution says is that these judgments are for the individual to make, not for the Government to decree, even with the mandate or approval of a majority."); *Consol. Edison Co. of N.Y., Inc. v. Pub. Serv. Comm'n of N.Y.*, 447 U.S. 530, 537-38 (1980) ("As a general matter, 'the First Amendment means that government has no power to restrict expression because of its message, its ideas, its subject matter, or its content.'… If the marketplace of ideas is to remain free and open, governments must not be allowed to choose 'which issues are worth discussing or debating.'").

That is, the First Amendment precludes the Commissioner from deciding what messages are appropriate for consumers to hear and insurers to air – what messages are "beneficial" to consumers in choosing their insurance. The First Amendment protects consumers' right to pick their insurance because an insurer sponsors a home team, or contributes to the community, or just because they find the insurer's advertisements entertaining—and insurers have a corresponding right to deliver those messages. It is not the Commissioner's prerogative to find certain messages not worthy.

This is precisely what is wrong with the regulation, and the regulation's fault cannot masquerade as a compelling state purpose.

2. Application of the First Amendment to financial burdens as well as outright bans cannot be cancelled out in the course of applying the strict scrutiny test.

The Court of Appeal correctly recognized that government cannot stifle speech through financial burdens any more than it can through an outright ban. Slip op. 20. *See Playboy Entm't Grp.*, 529 U.S. at 812 ("The distinction between laws burdening and laws banning speech is but a matter of degree. The Government's content-based burdens must satisfy the same rigorous scrutiny as its content-based bans") *see also* 818 ("It is rare that a regulation restricting speech because of its content will ever be permissible.") *Accord Sorrell v. IMS Health Inc.*, 564 U.S. 552, 566 (2011) ("Lawmakers may no more silence unwanted speech by burdening its utterance than by censoring its content.").

But, in applying the strict scrutiny test, the Court of Appeal held that the "institutional advertising" exclusion represented that "rare" situation "that a regulation restricting speech because of its content will ever be permissible" (*Playboy*, *id*. at 818) precisely because it is a financial burden rather than an outright ban. Slip op. 23.

Until the Court of Appeal's opinion, never, under U.S. or California law, has the actual burden on speech itself—creating the need for First Amendment review in the first place—been employed to establish that a law is narrowly tailored to overcome strict scrutiny. Instead, to survive strict scrutiny, "[t]he State must specifically identify an 'actual problem' in need of solving, and the curtailment of free speech must be actually necessary to the solution." *Brown v. Entm't Merchants Ass'n*, 564 U.S. 786, 799 (2011).

The opinion did not engage in that analysis. If it had, it necessarily would have concluded that financially burdening speech based on content is not necessary to support the *legitimate* governmental purpose of ensuring reasonable insurance rates. The "curtailment of free speech" is not "actually necessary" to the goal of reasonable insurance rates. It is only "necessary" to the constitutionally-infirm goal of deciding for consumers and insurers what messaging they should hear and present in relative to the insurance purchase.

The Court of Appeal opinion leaves in place a regulation blatantly violating the First Amendment rights of all participants in the California insurance market. That is a serious, statewide concern, calling for review by this Court.

V. CONCLUSION

The Trades intervened in this case at the outset to press constitutional issues of industrywide concern in this state. Four years of litigation have confirmed that this is the only California court capable of resolving the conflict between *20th Century* and *Calfarm* (and all other confiscation jurisprudence), thereby restoring a fair and rational system of price regulation.

The Commissioner's regulation of rates through paternalistic judgments regarding what advertising content benefits consumers is a newer, but equally disturbing, constitutional question, likewise requiring this Court's review.

The Trades pray that this Court certify review of this action.

Dated: March 21, 2017

HOGAN LOVELLS US LLP

By: ______________________
Vanessa O. Wells
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CERTIFICATE OF WORD COUNT

The undersigned counsel certifies that pursuant to rule 8.504(d) of the California Rules of Court, the text of this brief, not including the caption, tables, or this certificate, consists of 8,336 words as counted by the Microsoft Word 2010 computer program used to generate the brief.

DATED: March 21, 2017

Vanessa O. Wells

ATTACHMENT

Filed 2/10/17

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

THIRD APPELLATE DISTRICT

(Sacramento)

MERCURY CASUALTY COMPANY, Plaintiff and Appellant, v. DAVE JONES, as Insurance Commissioner, etc., Defendant and Respondent; PERSONAL INSURANCE FEDERATION OF CALIFORNIA et al., Interveners and Appellants; CONSUMER WATCHDOG, Intervener and Respondent.	C077116, C078667 (Super. Ct. No. 34201380001426CUWMGDS)

APPEAL from a judgment of the Superior Court of Sacramento County, Shelleyanne W.L. Chang, Judge. Affirmed.

Hinshaw & Culbertson, Richard G. De La Mora and Spencer Y. Kook, for Plaintiff and Appellant.

Kamala D. Harris, Attorney General, Diane S. Shaw, Senior Assistant Attorney, Stephen Lew, Supervising Deputy Attorney General, for Defendant and Respondent.

Hogan Lovells, Vanessa O. Wells, Victoria C. Brown, Jenny Q. Shen, Lisa K. Swartzfager, for Interveners and Appellants.

Harvey Rosenfield, Pamela M. Pressley, Jonathan Phenix; Zohar Law Firm, Daniel Y. Zohar and Todd M. Foreman, for Intervener and Respondent.

This appeal arises out of an application Mercury Casualty Co. (Mercury) filed in 2009 to increase its homeowners' insurance rates. In denying the increase Mercury requested, the California Insurance Commissioner (the commissioner) made two decisions that are at issue on appeal. First, the commissioner determined that under subdivision (f) of section 2644.10 of title 10 of the California Code of Regulations, which disallows, for ratemaking purposes, all "[i]nstitutional advertising expenses," Mercury's entire advertising budget had to be excluded from the calculation of the maximum permitted earned premium because "Mercury[] aims its entire advertising budget at promoting the Mercury Group as whole" rather than "seek[ing] to obtain business for a specific insurer and also provid[ing] customers with pertinent information" about that specific insurer.[1] Second, the commissioner determined that Mercury did not qualify for

1 Section 2644.10 provides that certain expenses "shall not be allowed for ratemaking purposes." Subdivision (f) of that section identifies "[i]nstitutional advertising expenses" as one category of disallowed expenses and defines "[i]nstitutional advertising" as "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."

We will refer to this regulation as section 2644.10(f); other undesignated section references are also to title 10 of the California Code of Regulations.

a variance from the maximum permitted earned premium under subdivision (f)(9) of section 2644.27 because "Mercury failed to demonstrate the rate decrease [that resulted from application of the regulatory formula] results in deep financial hardship."[2]

Mercury and certain insurance trade organizations referred to collectively as the Trades[3] unsuccessfully sought to challenge the commissioner's decision in the superior court. On appeal from the superior court's judgment against them, Mercury and the Trades raise three main issues. First, Mercury and the Trades contend the commissioner and the superior court erred in interpreting and applying section 2644.10(f) with regard to what constitutes institutional advertising expenses. Second, the Trades contend section 2644.10(f) violates the First Amendment to the United States Constitution because the regulation imposes a content-based financial penalty on speech. Third, Mercury and the Trades contend the commissioner and the superior court erred in determining that Mercury did not qualify for the constitutional variance because the commissioner and the court wrongfully applied a "deep financial hardship" standard instead of a "fair return" standard.

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2 Subdivision (f)(9) of section 2644.27 provides that one valid basis for requesting a variance is "[t]hat the maximum permitted earned premium would be confiscatory as applied. This is the constitutionally mandated variance articulated in 20th Century v. Garamendi (1994) 8 Cal.4th 216 which is an end result test applied to the enterprise as a whole."

We will refer to this regulation as section 2644.27(f)(9) and to the variance described therein as the constitutional variance or the confiscation variance.

3 The Trades consist of the following organizations: 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.

Finding no merit in these arguments, or any of the other arguments offered to overturn the judgment, we affirm.

FACTUAL AND PROCEDURAL BACKGROUND

We begin with some brief background on the area of the law involved here. "At the November 8, 1988, General Election, the voters approved an initiative statute that was designated on the ballot as Proposition 103. The measure made numerous fundamental changes in the regulation of automobile and other forms of insurance in California. Formerly, the so-called 'open competition' system of regulation had obtained, under which 'rates [were] set by insurers without prior or subsequent approval by the Insurance Commissioner . . . .' [Citation.] Under that system, 'California ha[d] less regulation of insurance than any other state, and in California automobile liability insurance [was] less regulated than most other forms of insurance.' [Citation.] The initiative contained, among others, provisions relating to the rollback of rates for insurance within its coverage for the period extending from November 8, 1988, through November 7, 1989. (For purposes here, a rate is the price or premium that an insurer charges its insureds for insurance.)" (*20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 239-240 (*20th Century*).) "For the period extending from November 8, 1988, through November 7, 1989 (hereafter sometimes the rollback year or simply 1989), as a temporary regulatory regime of rate reduction and freeze evidently designed to allow the setting up of a permanent regulatory regime to follow, Proposition 103 itself sets a maximum rate for covered insurance at 80 percent of the rate for the same insurance in effect on November 8, 1987 (hereafter sometimes the 1987 rate). [¶] For the period extending from November 8, 1989, into the future, Proposition 103 institutes a permanent regulatory regime comprising the 'prior approval' system, under which, in the words of Insurance Code section 1861.05, subdivision (a), the Insurance Commissioner must approve a rate applied for by an insurer before its use, looking to whether the rate in question is 'excessive, inadequate, unfairly discriminatory or otherwise in violation of' specified law -- considering the 'investment income' of the individual insurer and *not considering* the 'degree of competition' in the insurance industry generally." (*20th Century*, at p. 243.)

"In *Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805 [258 Cal.Rptr. 161, 771 P.2d 1247] (hereafter sometimes *Calfarm*), [the Supreme Court] upheld, inter alia, Proposition 103's provision requiring rate rollbacks." (*20th Century*, *supra*, 8 Cal.4th at p. 240.) The court "reviewed Proposition 103 against challenges under the United States and California Constitutions, including a claim that the rate rollback requirement provision was on its face invalid as confiscatory and arbitrary, discriminatory, or demonstrably irrelevant to legitimate policy in violation of the takings clause of the Fifth Amendment and article I, section 19 and the due process clause of the Fourteenth Amendment and article I, sections 7 and 15. In the course of [the court's] analysis, [the court] rejected the point." (*20th Century*, at pp. 243-244, fn. omitted.)

Five years after *Calfarm*, in *20th Century*, the Supreme Court "review[ed] the implementation of Proposition 103's rate rollback requirement provision by the Insurance Commissioner." (*20th Century*, *supra*, 8 Cal.4th at p. 240.) The court ultimately upheld the commissioner's actions. (*Id.* at p. 329.)

With that background in mind, we turn to the facts of the present case. In May 2009, Mercury filed an application with the Department of Insurance to increase its rates on its homeowner's multi-peril line of insurance, which consists of policy form HO-3 (residential homeowners' insurance), policy form HO-4 (renters and tenants insurance), and policy form HO-6 (insurance for condominium owners). Originally, Mercury sought an overall rate increase of 3.9 percent. As the administrative proceeding regarding Mercury's application continued, however, Mercury filed updated applications, so that Mercury ultimately sought an overall rate increase of either 8.8 percent or 6.9 percent. (The reason for the difference is not material here.)

In June 2009, Consumer Watchdog submitted a petition to intervene in the proceeding, combined with a petition for a hearing on Mercury's application. The commissioner granted the petition to intervene in July 2009 but deferred ruling on the petition for a hearing until two years later, when, in May 2011, the commissioner issued a notice of hearing on his own motion and on Consumer Watchdog's petition.

In October 2011, Mercury submitted the prefiled direct testimony of various witnesses, including Robert S. Hamada and David Appel. As a financial economist, Hamada was asked "to provide an economic application of th[e] variance . . . in [section 2644.27(f)(9)], and to determine whether the maximum permitted return is quantitatively 'confiscatory' to the providers of Mercury's capital." Hamada asserted that "[t]o do this, it is necessary to lay out an economic interpretation of 'fair' return to use as a benchmark to quantify whether a statutorily-determined return is 'confiscatory.' " For his part, Dr. Appel was also asked to opine (among other things) whether it was appropriate for Mercury to seek a variance under section 2644.27(f)(9).

The commissioner and Consumer Watchdog filed motions to strike some of Mercury's prefiled direct testimony, including the testimony of Hamada and some of the testimony of Appel. In ruling on those motions, the administrative law judge (ALJ) explained that to qualify for the variance under section 2644.27(f)(9), Mercury had to "demonstrate [that] the maximum earned premium under the ratemaking formula results in an inability to operate successfully. Put differently Mercury is permitted to show the maximum rate will cause deep financial hardship to Mercury's enterprise as whole." Finding that neither Hamada nor Appel "provide[d] evidence that the regulatory rate, as applied to Mercury, prevents Mercury from operating successfully," the ALJ struck Hamada's "statements pertaining to confiscation" and those portions of Appel's testimony contending that the "regulatory rate of return is confiscatory." The ALJ later made similar rulings as Mercury tried several more times to offer testimony from Hamada and Appel concerning "fair return."

In its posthearing brief, Consumer Watchdog argued that all of Mercury's advertising expenses should be excluded from the rate calculation as institutional advertising expenses because the evidence showed that none of Mercury's advertising in California was aimed at obtaining business for a particular insurer; instead, "Mercury's ads and campaigns promote a fictional entity called 'Mercury Insurance Group.' "

For its part, Mercury argued that under the language of section 2644.10(f), "advertising is not 'institutional advertising' if it is aimed at obtaining business for an insurer <u>or</u> it provides consumers with information pertinent to the decision whether to buy the insurer's product." Mercury further argued that "Mercury's advertisements are all aimed at obtaining business for Mercury or its affiliate insurance companies and providing information to consumers on why they should buy a Mercury product."

In its posthearing brief, the Department of Insurance argued that under *20th Century*, "[c]onfiscation occurs when proposed regulatory action would impose deep financial hardship on the regulated entity." The department further argued that its "rate proposal, far from convincingly demonstrating deep financial hardship and an inability to operate successfully, would allow Mercury to successfully operate in California" because "[a]ccording to Mercury's own calculations, the [department's] proposal would result in $3,670,645 of expected operating profit" -- a " 'total return of less than 5%' " -- and such a return "would not constitute deep financial hardship."

For its part, Mercury argued that under *20th Century*, "in deciding whether rates produced by the formula are 'confiscatory,' courts are required to determine if they would deny an insurer the opportunity to earn a 'just, reasonable and fair return.' "

In January 2013, the ALJ submitted her proposed decision, which the commissioner adopted in full in February 2013. As relevant here, the commissioner found that "Mercury General Corporation is the parent company for Mercury Casualty and 21 other entities. Mercury General provides no services to customers and receives all its operating resources directly from its insurance affiliates, most notably Mercury

Casualty." "In 2008, 2009 and 2010 Mercury General Corporation's advertising expenses totaled $26 million, $27 million, and $30 million respectively." "Mercury General and all its affiliates advertise under the name 'Mercury Insurance Group,' " and "Mercury does not allocate advertising expenditures to specific insurance affiliates nor does the advertising department distinguish between insurance entities when generating advertising campaigns." Based on these findings, the commissioner determined that under section 2644.10(f), "Mercury's entire advertising budget must be excluded from the rate application" because "Mercury[] aims its entire advertising budget at promoting the Mercury Group as whole" rather than "seek[ing] to obtain business for a specific insurer and also provid[ing] customers with pertinent information" about that specific insurer. The commissioner also determined that Mercury did not qualify for the constitutional variance under section 2644.27(f)(9) because "Mercury failed to demonstrate the rate decrease results in deep financial hardship." Based on these (and other) determinations, the commissioner denied Mercury's application for an overall rate increase of 8.8 percent and instead approved an 8.18 percent rate decrease for policy form HO-3, a 4.32 percent rate increase for policy form HO-4, and a 29.44 percent rate increase for policy form HO-6.

In March 2013, Mercury filed a petition for writ of mandate and complaint for declaratory relief in the superior court seeking review of the commissioner's decision. Consumer Watchdog and the Trades successfully petitioned for leave to intervene.

In June 2014, the superior court issued its ruling denying Mercury's writ petition. As relevant here, the court rejected Mercury's argument that the commissioner "applied the wrong standard to assess whether Mercury could show confiscation to entitle Mercury to a variance." Disagreeing with Mercury that the commissioner "should have assessed whether Mercury could earn a 'fair rate of return' under the rate order," the court instead agreed with the commissioner "that the test for confiscation is 'deep financial hardship' " and "Mercury did not demonstrate 'deep financial hardship' to support its request for a confiscation variance." The court also rejected Mercury's argument that the commissioner "misinterpreted the regulation defining 'institutional advertising.' "

In August 2014, Mercury appealed from the superior court's June ruling denying its writ petition, even though judgment had not yet been entered. In January 2015, the court issued a formal order denying Mercury's writ petition and dismissing Mercury's complaint for declaratory relief. The court also denied or dismissed all of the causes of action in the Trades' complaint in intervention. In doing so, the court addressed and rejected the Trades' argument that section 2644.10(f) violates the First Amendment.

In February 2015, the court entered judgment against Mercury and the Trades. Mercury and the Trades timely appealed from that judgment.

DISCUSSION

I

Section 2644.10(f) -- *Institutional Advertising*

Section 2644.10(f) provides that "[i]nstitutional advertising expenses" "shall not be allowed for ratemaking purposes" and that " '[i]nstitutional 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."

In disallowing all of Mercury's advertising expenses as institutional advertising expenses, the commissioner explained that "institutional advertising is image advertising which strives to enhance a company's reputation or improve corporate name recognition. Such advertising does not promote a specific product or service but instead attempts to obtain favorable attention to the company as whole." (Fns. omitted.) The commissioner then made the following findings regarding Mercury's advertising: "Mercury General and all its affiliates advertise under the name 'Mercury Insurance Group.' The Mercury Insurance Group is not a legal entity in any state and not a licensed insurer in California. Mercury General's advertising department supports all of Mercury's affiliates and

Mercury guides all its prospective customers to one telephone number. Mercury does not allocate advertising expenditures to specific insurance affiliates nor does the advertising department distinguish between insurance entities when generating advertising campaigns. All Mercury companies share a common website which identifies the company as Mercury Insurance Group." (Fns. omitted.)

The commissioner concluded that section 2644.10(f) "permits [in the context of ratemaking] only [expenses for] advertising that seeks to obtain business for a specific insurer and also provides customers with pertinent information. As Mercury[] aims its entire advertising budget at promoting the Mercury Group as a whole, . . . Mercury's entire advertising expenditures must be removed from the ratemaking formula."

The superior court concluded that the commissioner's interpretation of section 2644.10(f) was "reasonable and consistent with Proposition 103's goals of consumer protection." "Thus, if Mercury wished to include its advertising expenses in the ratemaking calculation, it was required to show that (1) its advertising was aimed at obtaining business for a specific insurer *and* (2) provided consumers with information pertinent to the decision whether to buy the insurer's product." The court further concluded that the commissioner "properly concluded that Mercury's advertising was not directed at a 'specific insurer' " and for that reason the commissioner correctly excluded all of Mercury's advertising expenses from the rate calculation.

A

Mercury's Arguments On Appeal

On appeal, Mercury contends the commissioner erred in disallowing all of Mercury's advertising expenses because the commissioner erroneously held that advertising qualifies as institutional advertising if *either* of the two criteria in section 2644.10(f) is met, when the regulation requires that *both* criteria be met. According to Mercury, "[t]he [c]ommissioner . . . improperly substituted the word 'or' for the word 'and' in the regulation."

We find no merit in this argument because section 2644.10(f) does not set forth two criteria that are to be separately analyzed and applied. Instead, the regulation sets forth a singular, unified definition of what constitutes "[i]nstitutional advertising." Specifically, advertising is institutional if it is not aimed at obtaining business for a specific insurer and does not provide consumers with information pertinent to the decision whether to buy that insurer's product.

Here, the commissioner concluded that all of Mercury's advertising qualified as institutional advertising within the meaning of section 2644.10(f) because Mercury aims its entire advertising budget at promoting the Mercury Insurance Group as a whole and the Mercury Insurance Group is not a specific insurer. If the commissioner was correct in his characterization of Mercury Insurance Group (which we address below), then the commissioner was also correct in his conclusion that all of Mercury's advertising qualifies as institutional advertising within the meaning of section 2644.10(f) because advertising that is aimed entirely at promoting an entity that is *not* a specific insurer is advertising that is not aimed at obtaining business for a specific insurer and does not provide consumers with information pertinent to the decision whether to buy that insurer's product.

That brings us to Mercury's argument that the commissioner erred in concluding that Mercury's advertising was not aimed at obtaining business for a specific insurer because "all of Mercury's advertising was conducted under the name trade name 'Mercury' rather than the technical corporate name 'Mercury Casualty Company.' " Mercury contends the commissioner was wrong in this regard "for several reasons." Before addressing those reasons, however, we pause to more fully set forth the commissioner's exact ruling on this subject.

Contrary to Mercury's argument, the commissioner did not conclude that Mercury's advertising was not aimed at obtaining business for a specific insurer because all of that advertising was conducted under the trade name "Mercury" rather than the technical corporate name "Mercury Casualty Company." Instead, the commissioner's ruling was far more comprehensive and nuanced than Mercury's argument acknowledges. First, the commissioner found, by a preponderance of the evidence, "the following facts with regard to Mercury's advertising expenditures and methods":

"Mercury General and all its affiliates advertise under the name 'Mercury Insurance Group.'[4] The Mercury Insurance Group is not a legal entity in any state and not a licensed insurer in California. Mercury General's advertising department supports all of Mercury's affiliates and Mercury guides all its prospective customers to one telephone number. Mercury does not allocate advertising expenditures to specific insurance affiliates nor does the advertising department distinguish between insurance entities when generating advertising campaigns. All Mercury companies share a common website which identifies the company as Mercury Insurance Group.

"In 2008, 2009 and 2010, Mercury General Corporation's advertising expenses totaled $26 million, $27 million and $30 million respectively. Mercury allocates its advertising budget among a variety of media, including television, radio, direct mail and sports sponsorship. Mercury's Annual Report states the company 'believes that its advertising program is important to create brand awareness and to remain competitive in the current insurance climate.' " (Fns. omitted.)

Based on these findings, the commissioner reached the following conclusions:

"Mercury defines institutional advertising as advertising that is not designed to generate business or provide customers with information. This definition of institutional advertising is both narrow and impracticable, and would render all advertising expenses chargeable to the ratepayer; a fact Mercury concedes. Instead, the Regulation permits only advertising that seeks to obtain business for a specific insurer and also provides

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4 Elsewhere, the commissioner found that "Mercury General Corporation is the parent company for Mercury Casualty and 21 other entities."

customers with pertinent information. As Mercury[] aims its entire advertising budget at promoting the Mercury Group as a whole, the [commissioner] concludes that Mercury's entire advertising expenditures must be removed from the ratemaking formula.

"[¶] . . . [¶]

"Mercury admits its advertising does not seek to obtain business for a specific insurer. In fact, Mr. Thompson acknowledges that all of Mercury's advertising is designed for the insurance group and <u>not</u> for a specific affiliate or company within Mercury. This fact is further confirmed when analyzing Mercury's advertisements. Both print and radio advertisements urge consumers to contact the 'Mercury Insurance Group' through a common website and telephone number. Consumers do not contact the specific insurance affiliates directly, nor do any of Mercury's specific insurers engage in their own advertising. While Mr. Thompson argues the advertising is 'insurance' specific, the Regulation requires the promotion be aimed at generating business for a specific insurer, not a specific industry

"[¶] . . . [¶]

"Nor can Mercury argue that the 'Mercury Insurance Group' is a specific insurer. The Mercury Insurance Group is not a legal entity, nor is there any consensus as to the makeup of the Mercury Insurance Group. Mr. Thompson testified the Mercury Insurance Group is comprised of Mercury Casualty, Mercury Insurance Company, and California Automobile. But Mr. Yeager testified the Mercury Insurance Group includes all 22 legal entities that make up the consolidated Mercury General Corporation. What is certain is that Mercury General does not advertise for its specific insurers and instead engages in advertising on behalf of the organization as a whole.

"[¶] . . . [¶]

"Mercury urges the Commissioner to interpret 'specific insurer' to mean 'a specific group of affiliated insurers.' Yet such an interpretation is contrary to the clear regulatory intent and inconsistent with the purpose of [the] provision.

"The rules governing statutory interpretation also apply to the Commissioner's Regulations. The first rule in statutory construction requires the interpreter to examine the regulation's language. If the regulation's words, given their usual and ordinary meaning and read in context, are clear and unambiguous, the conclusion must be that the adopting authority meant what it said, and the plain meaning of the regulation applies.

"Regulation 2644.10, subdivision (f) contains clear and unambiguous language. The Regulation defines institutional advertising as advertising not aimed at obtaining business for a <u>specific</u> insurer. Had the Commissioner intended to charge consumers for affiliate or group advertising, he could have eliminated the reference to 'a specific' insurer. But the Commissioner['s] decision to include the 'specific insurer' requirement renders the Regulation's meaning unmistakable. Advertising which generates business for a group of insurance companies, regardless of affiliation, is not advertising for a specific insurer.

"Mercury also argues the Regulation is arbitrary. Mercury contends there is no logical reason to penalize an insurer for advertising under a group insurance name. But such an argument is defeated when one considers the Regulation's intent. Consumers are obligated to pay only expenses necessary in the offering of an insurance product or that in some way provide them benefit. Mercury may not charge consumers for advertising that promotes corporate identity, enhances public opinion, or increases name and brand awareness. Mercury chose to direct its advertising budget towards its entire group of affiliates. In so doing, Mercury does not distinguish between those expenses chargeable to Mercury Casualty customers and those chargeable to affiliated ratepayers. As such, Mercury cannot require its Mercury Casualty policyholders to fund its advertising for other Mercury companies. In addition, Mercury does not explain why Mercury Casualty policyholders, as opposed to shareholders, should shoulder the expense of advertising for Mercury General since that does not benefit them in any fairly discernible and direct way.

This failure means Mercury's entire advertising budget must be excluded from the rate application." (Fns. omitted.)

With this more complete understanding of the commissioner's ruling, we turn back to Mercury's arguments. Eschewing even any pretense of arguing about the meaning of the term "specific insurer" in light of the various well-known rules of statutory construction, Mercury offers four ad hoc reasons why the commissioner's determination that the term "specific insurer" does not embrace " 'a specific group of affiliated insurers' " should be deemed "wrong." First, Mercury contends the commissioner's ruling "unreasonably forces insurers to advertise under their technical corporate names" because it "would generate confusion as consumers shop for coverage among insurers known to them by trade names such as Farmers, State Farm, and Allstate and not by obscure technical corporate names." Second, Mercury contends "the Commissioner's interpretation does not allow an insurance company, such as Mercury, to take into account its allocated share of expenses incurred for advertising that solicits business for affiliated insurers operating as part of a single insurance holding company system," and "[s]uch a result would be absurd and contrary to the Regulations, which in numerous places -- including the consideration of 'excluded expenses' such as 'institutional advertising' -- require the assessment of data at the group level." Third, Mercury contends "the 'technical corporate name only' interpretation will lead to results that are contrary to one of the primary goals of the prior approval laws -- to ensure that rates are not excessive. [Citation.] To achieve this goal the prior approval laws should be construed to encourage, not penalize, cost-effective business practices such as trade name advertising." Fourth, Mercury contends that "recognizing the cost of 'trade name advertising' in the formula would be consistent with those provisions of Proposition 103 that require the consideration of insurer groups as a single insurer for marketing, underwriting, and rating purposes."

In our view, none of Mercury's arguments on this point is cognizable with respect to how the term "specific insurer" should be interpreted under the various well-known canons of statutory interpretation. Instead, Mercury's arguments are really directed at why the regulation never should have included the term "specific insurer" in the first place. In other words, these are *policy* arguments that should have been (and, indeed, may have been) directed at the commissioner when he promulgated section 2644.10(f) in the first place. But we are not a legislative or quasi-legislative body, and it is not within our power to decide what terms the regulation *should* have included. We can only interpret what is already there, and inasmuch as Mercury's arguments on this point are not addressed to any interpretation that reasonably could be affixed to the existing term, "specific insurer," we have no cause to consider those arguments further.

Finally, Mercury contends that "[b]ecause the [c]ommissioner . . . erroneously construed section 2644.10(f) in the disjunctive and then found that Mercury's trade name advertising did not meet the 'specific insurer' requirement," the commissioner did not consider or weigh "the evidence to determine if Mercury's ads met the 'pertinent information' requirement" of the second criterion in the regulation. This argument need not detain us long. We have concluded already that section 2644.10(f) does not set forth two criteria that are to be separately analyzed and applied. Instead, the regulation sets forth a singular, unified definition of what qualifies as "[i]nstitutional advertising." Having found that Mercury aims its entire advertising budget at promoting the Mercury Insurance Group as a whole and having concluded that the Mercury Insurance Group is not a specific insurer within the meaning of section 2644.10(f), the commissioner properly excluded all of Mercury's advertising expenses from the rate calculation pursuant to the regulation because Mercury's advertising was not aimed at obtaining business for a specific insurer and did not provide consumers with information pertinent to the decision whether to buy that insurer's product. Accordingly, all of Mercury's challenges to the commissioner's rulings with respect to Mercury's advertising expenses are without merit.

B

The Trades' Arguments On Appeal

For their part, the Trades contend the commissioner's interpretation of section 2644.10(f), "endorsed by the trial court -- is inconsistent with the language of the regulation, and is incorrect." The Trades also contend that the exclusion of institutional advertising expenses from the rate formula violates the First Amendment by imposing a content-based penalty on speech. We address these arguments in turn.

1. *Interpretation Of Section 2644.10(f)*

To fully understand the Trades' argument that the commissioner and the superior court erred in interpreting section 2644.10(f) , further explanation of the regulatory scheme, and the superior court's decision, is required.

Expenses that are excluded from the rate calculation, including institutional advertising expenses, are entered on pages 13a and 13b of the rate application. These pages provide for calculation of a three-year average "[e]xcluded [e]xpense [f]actor," which is a percentage determined by dividing total excluded expenses by direct earned premiums. For example, Mercury's updated application showed a 0.20 percent excluded expense factor for 2008, which resulted from dividing total excluded expenses of $5,703,498 by direct earned premiums of $2,808,839,000.

Section 2644.10 -- the regulation governing excluded expenses -- provides that the excluded expense factor is "the ratio of the insurer's *national* excluded expenses to its *national* direct earned premium." (§ 2644.10, italics added.) Consistent with this, the application calls for the use of "[c]ountrywide direct earned premium" and "[c]ountrywide" institutional advertising expenses in calculating the excluded expense factor.

In framing the issue regarding the commissioner's interpretation of section 2644.10(f), the superior court stated that "[t]he dispute is whether the term 'specific insurer' means only the rate applicant (in this case, Mercury Casualty Company) or whether it encompasses advertising on behalf of a group of affiliated entities, which are not rate applicants." The court then concluded as follows: "The Commissioner's interpretation of the regulation's term 'specific insurer' was reasonable. The advertising did not relate specifically to Mercury Casualty Company, the rate applicant. Rather it related a large group of affiliates, that were not applying for a rate reduction, and that may or may not do business in the state. Accordingly, the Commissioner's interpretation protects consumers from underwriting advertising expenses of other entities that may not operate in California, and were not applying for the rate adjustment."

Construing the superior court's conclusion to be that the term "specific insurer" in section 2644.10(f) "means the applicant," the Trades argue that "[t]his construction [of the regulation] is not acceptable" because it "does not match what is calculated as the excluded expense factor." Noting that the regulation calls for *nationwide,* or "groupwide," data to calculate the excluded expense factor, the Trades argue that "[i]f all advertising for other group affiliates is counted as an excluded expense in the numerator, the numerator and denominator do not contain like data." In other words, the Trades posit that under the superior court's construction of the regulation, the denominator will consist of the national direct earned premium from all insurers within the group but the numerator will consist of all advertising expenses except those relating to the applicant, including advertising expenses related to "specific insurers" other than the applicant. The Trades contend that "the result of such a mismatch is not a proper allocation to a California line of insurance of its proper share of countrywide group expense."

The commissioner responds that "advertising for specific affiliates [other than the applicant] is *not* excluded under [section] 2644.10[(f)]." "Advertising for a specific affiliate -- any affiliate -- is not considered institutional and therefore any such expenses are not excluded. So long as the advertising is targeted to a specific insurer, it does not matter what affiliate it is for." Moreover, the commissioner points out that "there [wa]s no evidence that any advertising expenses for any specific insurer were excluded" here.

This last point is dispositive of the Trades' argument. The commissioner specifically found that "Mercury[] aims its entire advertising budget at promoting the Mercury Group as a whole" and that "Mercury General does not advertise for its specific insurers and instead engages in advertising on behalf of the organization as a whole." The Trades point to no evidence to the contrary. Accordingly, it is apparent that here the numerator in the calculation of the excluded expense factor contained *no* expenses for advertising that related to *any* "specific insurer," whether the applicant (Mercury Casualty Company) or any other affiliate within the insurance group. Thus, the Trades' argument that the numerator and denominator did "not contain like data" is without merit.

The Trades next argue that the commissioner's interpretation of section 2644.10(f) "is inconsistent with the reality of consumer perception" because "[i]f an advertisement makes a point about homeowner's insurance, and says 'Mercury', it is an advertisement 'aimed at obtaining business for [the] specific insurer' writing Mercury homeowner's insurance." Even if this were true, however, the Trades point to no evidence that Mercury's excluded advertising expenses included expenses for any such advertisement. Accordingly, the Trades have failed to fully develop this argument, and we need not consider it further.

The Trades also argue that "an advertisement may be 'aimed at obtaining business' for more than one affiliated 'specific insurer[]'." This argument goes nowhere because the commissioner found that Mercury's advertising was not aimed at obtaining business for *any* specific insurer, and the Trades point to no evidence to the contrary.

In summary, none of the Trades' attacks on the commissioner's interpretation and application of section 2644.10(f) has any merit.

2. *First Amendment Challenge To Section 2644.10(f)*

The Trades contend that because expenses for advertising that is deemed "institutional" are excluded from the rate formula, thereby reducing the "permitted earned premium," and because the determination of whether advertising qualifies as "institutional" is based on the content of the advertisements, the institutional advertising regulation amounts to a constitutionally impermissible content-based penalty on speech. We are not persuaded.

At the outset, we reject the argument by the commissioner and Consumer Watchdog that section 2644.10(f) does not implicate the First Amendment. For his part, the commissioner asserts that the regulation "does not in any way ban speech or compel specific content." This may be so, but that does not mean the regulation is immune from scrutiny under the First Amendment. The United States Supreme Court "has recognized . . . that the 'Government's content-based burdens [on speech] must satisfy the same rigorous scrutiny as its content-based bans.' " (*Sorrell v. IMS Health Inc.* (2011) 564 U.S. 552, 565-566 [180 L.Ed.2d 544, 556].) "Imposing a financial burden on a speaker based on the content of the speaker's expression is a content-based restriction of expression and must be analyzed as such." (*Pitt News v. Pappert* (3d Cir. 2004) 379 F.3d 96, 106.) Thus, if section 2644.10(f) imposes a content-based burden on Mercury's speech, it does not matter that the regulation does not ban speech or compel specific content; it is nonetheless subject to First Amendment scrutiny.

For its part, Consumer Watchdog contends section 2644.10(f) does not place any financial burden on speech, but we disagree. Here, the regulation burdened Mercury financially because its effect was to exclude all of Mercury's advertising expenses from the rate formula, which necessarily resulted in a lesser maximum premium rate than Mercury would have been allowed if its advertising expenses had been included in the formula. As Mercury points out, "[i]f advertising expense is excluded from the dollars permitted in the rate, there is no revenue source from which it can be paid. The insurer can either pay for such advertising out of profit, or stop the advertising." Thus, assuming two otherwise identically situated insurers, one of which engaged solely in institutional advertising and the other of which engaged solely in noninstitutional advertising, the advertiser that engaged only in noninstitutional advertising would reap a greater profit because of section 2644.10(f) than the advertiser that engaged only in institutional advertising. For this reason, as the Trades contend, "the regulation burdens . . . speech" based on the content of that speech and thus implicates the First Amendment.

The next question is whether section 2644.10(f) encompasses only commercial speech or whether, as the Trades argue, it encompasses both commercial and noncommercial speech. This matters because different levels of scrutiny are implicated depending on whether commercial or noncommercial speech is involved. " '[T]he [federal] Constitution accords less protection to commercial speech than to other constitutionally safeguarded forms of expression.' [Citation.] [¶] For noncommercial speech entitled to full First Amendment protection, a content-based regulation is valid under the First Amendment only if it can withstand strict scrutiny, which requires that the regulation be narrowly tailored (that is, the least restrictive means) to promote a compelling government interest. . . . [¶] 'By contrast, regulation of commercial speech based on content is less problematic.' [Citation.] To determine the validity of a content-based regulation of commercial speech, the United States Supreme Court has articulated an intermediate-scrutiny test." (*Kasky v. Nike, Inc.* (2002) 27 Cal.4th 939, 952.)

We reject the argument by the commissioner and Consumer Watchdog that the speech to which section 2644.10(f) applies qualifies as commercial speech simply because the regulation pertains to "advertising." In *Bolger v. Youngs Drug Products Corp.* (1983) 463 U.S. 60 [77 L.Ed.2d 469], the United States Supreme Court held that even though certain pamphlets "were conceded to be advertisements, that fact alone did not make them commercial speech because paid advertisements are sometimes used to convey political or other messages unconnected to a product or service or commercial transaction." (*Kasky v. Nike, Inc.*, *supra*, 27 Cal.4th at p. 956, citing *Bolger*, at p. 66 [77 L.Ed.2d at p. 477].) The *Bolger* court "identified three factors -- advertising format, product references, and commercial motivation -- that in combination supported a characterization of commercial speech in that case," but the court also "rejected the notion that any of these factors is *sufficient* by itself" to support such a characterization and "also declined to hold that all of these factors in combination, or any one of them individually, is *necessary* to support a commercial speech characterization." (*Kasky*, at p. 957.)

Here, as the Trades argue, section 2644.10(f) primarily singles out advertising that may qualify as *noncommercial* speech for the excluded expense penalty. As we have explained, under the regulation an insurer cannot pass on to the consumer the cost of advertising that is *not* aimed at obtaining business for a specific insurer and/or that does *not* provide consumers with information pertinent to the decision whether to buy that specific insurer's product. Thus, the less commercial the speech is, the more likely it is to fall within the exclusion of section 2644.10(f). It is at least possible that an insurer might engage in advertising that would, at least in some part, be deemed noncommercial speech for First Amendment purposes. Thus, as the Trades contend, section 2644.10(f) may sweep within its ambit both commercial and noncommercial speech. For this reason, the regulation is subject to strict scrutiny. (See *Dex Media West, Inc. v. City of Seattle* (9th Cir. 2012) 696 F.3d 952, 953, 954 [holding that an ordinance that imposed "substantial conditions and costs on the distribution of yellow pages phone directories" was subject to strict scrutiny because, "[a]lthough portions of the directories are obviously commercial in nature, the books contain more than that"].)

We conclude that section 2644.10(f) survives that scrutiny. Under strict scrutiny, " the regulation [must] be narrowly tailored (that is, the least restrictive means) to promote a compelling government interest." (*Kasky v. Nike, Inc.*, *supra*, 27 Cal.4th at p. 952.) In arguing that the regulation would not survive even the intermediate scrutiny that applies to commercial speech, the Trades admit that the regulation serves a "legitimate governmental purpose." We have no problem going further and concluding that the regulation promotes a compelling governmental interest. As Consumer Watchdog characterizes it, it is the "interest in prohibiting excessive [insurance] rates . . . by making sure 'that only "the reasonable costs of providing insurance" [are] included in the rates.' " More precisely, the regulation promotes the compelling government interest in ensuring that insurers like Mercury pass on to consumers through their insurance premiums only expenses for advertising that directly benefits consumers by providing them with information pertinent to the consumers' decision whether to buy a specific insurer's product. We further conclude that section 2644.10(f) is narrowly tailored to serve that purpose. The regulation does not *ban* insurers like Mercury from engaging in advertising that does not directly benefit consumers: that is, advertising that is not aimed at obtaining business for a specific insurer and does not provide consumers with information pertinent to the decision whether to buy the specific insurer's product. Instead, the regulation simply prohibits the insurer from passing the cost of such advertisements on to the consumer. That is, in fact, the least restrictive means available to promote the specific interest at issue. Thus, the regulation is narrowly tailored to promote the compelling government interest the regulation serves.

For the foregoing reasons, the Trades' constitutional challenge to section 2644.10(f) is without merit.

II

Section 2644.27(f)(9) -- The Constitutional Variance

Section 2644.27(f)(9) provides that one valid basis for requesting a variance from the maximum rate obtained by applying the regulatory formula is "[t]hat the maximum permitted earned premium would be confiscatory as applied. This is the constitutionally mandated variance articulated in 20th Century v. Garamendi (1994) 8 Cal.4th 216 which is an end result test applied to the enterprise as a whole." The commissioner determined that Mercury did not qualify for the constitutional variance under section 2644.27(f)(9) because "Mercury failed to demonstrate the rate decrease results in deep financial hardship." The superior court agreed with the commissioner "that the test for confiscation is 'deep financial hardship' " and "Mercury did not demonstrate 'deep financial hardship' to support its request for a confiscation variance."

On appeal, Mercury and the Trades assert various errors in this aspect of the commissioner's and superior court's rulings. First, Mercury asserts that the commissioner and superior court erred in holding that rates are constitutionally confiscatory only if they result in financial distress, rather than simply in the inability to earn a fair return. The Trades make a similar argument. Second, Mercury asserts that the commissioner and the superior court erred in determining that "the relevant enterprise" "in assessing confiscation" "was not Mercury's homeowners' insurance line, but Mercury as a whole." Again, the Trades make a similar argument. Mercury and the Trades also make some other arguments we will identify more fully below. And the Trades argue that the superior court applied the wrong standard of review in addressing the constitutional variance.

The last argument by the Trades can be disposed of briefly. Inasmuch as section 2644.27(f)(9) expressly incorporates principles of constitutional law, and because "where the action of an administrative agency infringes constitutionally granted rights, independent judicial review must be invoked" (*Kerrigan v. Fair Employment Practice Com.* (1979) 91 Cal.App.3d 43, 51), it does not matter for our purposes whether, as the Trades argue, the superior court improperly deferred to the commissioner in construing and applying section 2644.27(f)(9). Engaging in our own independent judicial review, as we must, we will not defer to either the commissioner or the superior court. Thus, any error the superior court might have made in this regard was necessarily harmless.

With that out of the way, we turn to the remaining arguments presented on the constitutional variance in section 2644.27(f)(9).

A

Deep Financial Hardship Versus Fair Return

Because section 2644.27(f)(9) expressly refers to *20th Century*, it is appropriate to begin there. As we have noted, in *20th Century* the California Supreme Court "review[ed] the implementation of Proposition 103's rate rollback requirement provisions by the Insurance Commissioner." (*20th Century, supra*, 8 Cal.4th at p. 240.) As relevant here, the superior court had "determined that the rate regulations as to rollbacks [we]re invalid on their face with respect to the ratemaking formula" (*id.* at p. 282) because, among other things, the ratemaking formula the commissioner adopted "preclude[d] a return covering the insurer's cost of service plus 10 percent of its capital base," and "through such preclusion, the formula [wa]s . . . confiscatory" (*id.* at p. 288). In support of this latter conclusion, the superior court also determined that "confiscation does not require 'deep financial hardship' within the meaning of *Jersey Central [Power & Light Co. v. F.E.R.C.* (D.C. Cir. 1987) 810 F.2d 1168]." (*20th Century*, at p. 288)

The Supreme Court concluded that "[i]n this regard . . . , the superior court's conclusion is substantially erroneous." (*20th Century, supra*, 8 Cal.4th at p. 288.) In determining "the ratemaking formula . . . [wa]s . . . not confiscatory," the high court began by noting that it "would do well to rehearse, and elaborate on, the principles set out in *Calfarm*." (*20th Century Ins. Co.*, at p. 291.) The court then explained as follows:[5]

"The crucial question under the takings clause is whether the rate set is just and reasonable. [Citation.] If it is not just and reasonable, it is confiscatory. [Citation.] If it is confiscatory, it is invalid. [Citation.] '[I]t is the result reached not the method

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5 We set forth the Supreme Court's discussion from *20th Century* at length because, as will become apparent hereafter, that discussion directly answers the arguments by Mercury and the Trades on what standard applies in determining whether a rate is constitutionally confiscatory.

employed which is controlling.' [Citations.] The method may of course be traditional, and may involve case-by-case ratemaking using data reflecting the condition and performance of the regulated firm as an individual entity. But it may also be novel [citation.], and may implicate formulaic ratemaking [citation] using data reflecting the condition and performance of a group of regulated firms [citations]. It is not subject to piecemeal examination: 'The economic judgments required in rate proceedings are often hopelessly complex and do not admit of a single correct result. The Constitution is not designed to arbitrate these economic niceties.' [Citation.] And, of course, courts are not equipped to carry out such a task. [Citations.] '[S]o long as rates as a whole afford [the regulated firm] just compensation for [its] over-all services to the public,' they are not confiscatory. [Citation.] That a particular rate may not cover the cost of a particular good or service does not work confiscation in and of itself. [Citation.] In other words, confiscation is judged with an eye toward the regulated firm as an enterprise.

"The answer to the question whether the rate set is just and reasonable depends on a balancing of the interests of the producers of the goods or services under regulation and the interests of the consumers of such goods or services.

"[¶] . . . [¶]

"[T]he consumer has a legitimate interest in freedom from exploitation.

"[F]or its part, the producer 'has a legitimate concern with [its own] financial integrity. . . . From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. [Citation.] By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.' [Citation.]

"It must be emphasized that the foregoing describes an interest that the producer may pursue and not a right that it can demand. That interest is 'only one of the variables in the constitutional calculus of reasonableness.' [Citation.] 'A regulated [firm] has no constitutional right to a profit . . . .' [Citations.] Indeed, such a firm has no constitutional right even against a loss. [Citation.]

"In balancing the relevant producer and consumer interests for a just and reasonable rate, one is concerned with a 'broad zone of reasonableness' and not with any particular point therein. [Citation.] So long as the rate set is within that zone, 'there can be no constitutional objection . . . .' [Citation.]

"In attempting to balance producer and consumer interests, one may of course arrive at a rate that disappoints one or even both parties. But a striking of the balance to the producer's detriment does not necessarily work confiscation. Indeed, it can *threaten* confiscation only when it prevents the producer from 'operating successfully' -- as that phrase is impliedly defined in prior opinions and is expressly used in this, viz., operating successfully *during the period of the rate and subject to then-existing market conditions*.

"[¶] . . . [¶]

"Thus, a producer *may* complain of confiscation only if the rate in question does not allow it to operate successfully. . . . In a word, the inability to operate successfully is a necessary -- but not a sufficient -- condition of confiscation.

"In *Jersey Central*, the United States Court of Appeals for the District of Columbia Circuit, sitting in bank, and speaking through Judge Bork, explained: '. . . [T]he only circumstances under which there is a possibility of a taking of investors' property by virtue of rate regulation is when a [regulated firm] is in the sort of financial difficulty described [as] 'deep financial hardship.' [Citation.] The firm may experience such hardship when it does not earn enough revenue for both 'operating expenses' and 'the capital costs of the business,' including 'service on the debt and dividends on the stock,' of a magnitude that would allow a 'return to the equity owner' that is ‘commensurate with returns on investments in other enterprises having corresponding risks’ and ‘sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.’ [Citation.] ‘But absent [that] sort of deep financial hardship . . . there is no taking . . . .’ [Citation.] This follows from the fact that . . . a regulated firm may claim that a rate is confiscatory only if the rate does not allow it to operate successfully. In such circumstances, the firm is not inaptly characterized as experiencing ‘deep financial hardship’ as a result of the rate.

“[¶] . . . [¶]

“[T]he law under the due process clause of article I, sections 7 and 15 of the California Constitution and the takings clause of article I, section 19 of that same instrument is in accord with the foregoing principles.” (*20th Century*, *supra*, 8 Cal.4th at pp. 292-297, fns. omitted.)

In the course of the foregoing discussion, our Supreme Court also included the following footnote: “In *Guaranty Nat. Ins. Co. v. Gates* (9th Cir. 1990) 916 F.2d 508, 515, there is language that may be read to erroneously state that the producer is constitutionally ‘guarantee[d]’ a ‘ “fair and reasonable return [,]” ’ and that such a return must necessarily be above the ‘break even’ level. We will not indulge in such a reading.” (*20th Century, supra*, 8 Cal.4th at p. 294, fn. 18.)

Turning back to the superior court’s ruling, the California Supreme Court explained that the ratemaking formula could not be “deemed confiscatory” because the terms of the formula “do not themselves impose a rate . . . that inflicts on insurers ‘. . . deep financial hardship . . . .’ ” (*20th Century, supra*, 8 Cal.4th at p. 297.) The court then continued as follows:

“This point is crucial. It deserves special emphasis. The superior court committed fundamental error. At least in the general case, such as this, confiscation does indeed require ‘deep financial hardship’ within the meaning of *Jersey Central*, i.e., the inability of the regulated firm to operate successfully -- meaning, again, the inability of the regulated firm to operate successfully *during the period of the rate and subject to then-existing market conditions*. [Citation.] Hence, it does *not* arise, as the superior court erroneously believed, whenever a rate simply does not 'produce[] a profit which an investor could reasonably expect to earn in other businesses with comparable investment risks and which is sufficient to attract capital.' Profit of that magnitude is, of course, an interest that the producer may pursue. But it is not a right that it can demand. It is 'only one of the variables in the constitutional calculus of reasonableness.' [Citation.] . . . [T]he 'notion that [a regulator] is required to maintain, or even allowed to maintain to the exclusion of other considerations, the profit margin of any particular [regulated firm] is incompatible . . . with a basic precept of rate regulation. "The fixing of prices, like other applications of the police power, may reduce the value of the property which is being regulated. But the fact that the value is reduced does not mean that the regulation is invalid." ' " (*20th Century*, *supra*, 8 Cal.4th at pp. 297-298.)

With the foregoing understanding of the constitutional concept of confiscation, we turn back to the arguments presented by Mercury and the Trades, and we find no merit in them. Mercury contends the commissioner and the superior court erred in rejecting the "fair rate of return" standard of confiscation in favor of the "deep financial hardship" standard, but we find no such error. The Supreme Court explained in no uncertain terms in *20th Century* that "the inability to operate successfully is a necessary . . . condition of confiscation" (*20th Century*, *supra*, 8 Cal.4th at p. 296), and the court soundly rejected the contrary assertion that a regulated business is "constitutionally 'guarantee[d]' a ' "fair and reasonable return" ' " (*id.* at p. 294, fn. 18). The "fair rate of return" standard espoused by Mercury contravenes both of these principles.

The Trades' arguments fare no better. The Trades first argue that in *Lingle v. Chevron* (2005) 544 U.S. 528 [161 L.Ed.2d 876], the United States Supreme Court reached the conclusion that "a Takings analysis is not a vehicle for invalidating a price control statute or regulation, or agency order. It is a basis for compensation by government when government has legitimately exercised its power to 'take', subject to the duty to compensate. It is the Due Process analysis -- which is 'logically prior to and distinct' from the Takings analysis -- that determines whether a specific price regulation may be invalid as transgressing constitutional limits on the state's power to regulate price." However, if by this argument the Trades mean to suggest that the "deep financial hardship" test for confiscation under takings clause that was articulated and explained in *20th Century* is no longer valid, we cannot agree. The question in *Lingle* was whether language originating in *Agins v. City of Tiburon* (1980) 447 U.S. 255 [65 L.Ed.2d 106], declaring that "government regulation of private property 'effects a taking if [such regulation] does not substantially advance legitimate state interests,' " was "an appropriate test for determining whether a regulation effects a Fifth Amendment taking." (*Lingle*, at pp. 531, 532 [161 L.Ed.2d at pp. 883, 884].) The Supreme Court concluded it was not. (*Id.* at p. 532 [161 L.Ed.2d at p. 884].) *Lingle* was not a price control case at all, and the court therein never considered or addressed the "deep financial hardship" standard for determining whether a price control is constitutionally confiscatory. Accordingly, *Lingle* is of no assistance to the Trades here.

The Trades next argue that the superior court "placed undue reliance on *20th Century*" because that case: "(1) did not involve a separate due process analysis; (2) can and should be read consistently with *Calfarm*; and (3) is based on unique facts conclusively distinguishing the current context." None of these arguments is persuasive. The first argument depends on the Trades' assertion that *Lingle* foreclosed any continuing analysis of a price control under the takings clause and instead substituted a separate due process analysis. We have rejected that argument already; *Lingle* had nothing to do with price controls.

The Trades' second argument -- that "*20th Century* can be harmonized with *Calfarm*" -- is one with which we agree, but not in the way the Trades would like. We have already shown how our Supreme Court expressly stated that the extended discussion from *20th Century* set forth above regarding the "deep financial hardship" standard was a "rehears[al of], and elaborat[ion] on, the principles set out in *Calfarm*." (*20th Century*, *supra*, 8 Cal.4th at p. 291.) In *that* manner, *20th Century* and *Calfarm* are harmonious. The Trades' attempt to explain how the *Calfarm* court, "ruling on the state and federal due process clauses, conducted an analysis in line with *Lingle's* pronouncement of the Due Process standard," and how the *20th Century* court can be understood to have "equated 'deep financial hardship,' as used in the opinion, with more traditional notions of confiscation centered on the absence of a fair rate of return," amounts to little more than hocus pocus.

The Trades' third argument -- that "*20th Century's* 'deep financial hardship' test is inextricably tied to its retrospective context," e.g., examination of the regulations applying to the rollback period rather than those applying to the prior approval system that followed the rollback -- does not carry the day either. Nothing in the Supreme Court's extended discussion of the "deep financial hardship" standard suggests that it would apply only to a retrospective price control rather than a prospective price control. Again, the Trades' argument is smoke and mirrors -- nothing more.

For the foregoing reasons, we find no error in the application by the commissioner and the superior court of the "deep financial hardship" standard to determine whether a price control is constitutionally confiscatory.

B

The Relevant Enterprise

Mercury next contends that "[h]aving adopted a constitutionally deficient 'financial distress' test, the Commissioner and Superior Court compounded that error by applying that test to . . . Mercury as a whole, including unregulated enterprises and activities." In Mercury's view, "the 'enterprise' subject to the regulated rate" should have been "Mercury's homeowners' line." The problem with this argument is that it is inextricably intertwined with the argument we have rejected already -- that the commissioner should have used a "fair rate of return" standard for determining confiscation. Mercury itself admits that the standard the commissioner used "dictated the use of data related to Mercury as a whole rather than to Mercury's homeowners' line," while use of a "fair rate of return" standard would have easily allowed the commissioner "to calculate the rate of return yielded by the homeowners' premium as determined under the formula." Because we have determined that the commissioner used the correct, "deep financial hardship" standard, and correctly eschewed the "fair rate of return" standard proffered by Mercury, it follows that there is no basis for us to further consider Mercury's argument that the commissioner did not consider the correct "enterprise."

The Trades offer a similar argument, contending that "[t]he 'enterprise as a whole' concept is inextricably linked to" the standard the commissioner used, while "the fair rate of return standard inherently belongs to examination of *the regulated investment*." But given that we have determined already that the commissioner used the correct standard, it follows that he used the correct "enterprise" as well, and the Trades' claim to the contrary is without merit.

The Trades also contend that allowing the commissioner to apply the standard of constitutional confiscation to Mercury as a whole necessarily allows him to consider "insurers' revenue generated outside his jurisdiction," which "unconstitutionally extends the powers of a single state." We do not agree. By considering whether the rate formula in California allows an insurer that operates nationwide to avoid "deep financial hardship," the commissioner is not exercising his power outside the bounds of the state, as his determination of the permissible range of rates in California has no bearing on what the insurer is permitted to charge in any other state.

The Trades also contend that allowing the commissioner to apply the standard of constitutional confiscation to Mercury as a whole wrongfully applies the standard "to all lines of insurance even though the prior-approval structure provides for rate regulation by line of insurance." In making this argument, however, the Trades merely returns to its own “fair rate of return” standard, by arguing that “[t]he insurer . . . will be deprived of the property devoted to the regulated line of business if not allowed the opportunity to earn a fair return” and thus, “the only sensible test is one that looks to the regulated property.” As we have rejected the Trades’ proffered standard already, we have no basis for accepting the “lines of insurance” argument based on that rejected standard.

To the extent either Mercury or the Trades can be understood to offer other reasons why the standard the commissioner applied is “[i]llogical” or “[u]nworkable,” we simply say that it is not for us to question the logic or workability of our Supreme Court’s decisions in *Calfarm* and *20th Century*. We can only follow them. (See *Auto Equity Sales, Inc. v. Superior Court* (1962) 57 Cal.2d 450, 455.)

C

Remaining Arguments

Mercury contends the commissioner and the superior court erred by applying the standard for constitutional confiscation to “historical financial data that related to a period when the rates were not in effect.” Mercury makes no effort to show, however, what data they *should* have applied the standard to, nor any effort to show that application of the standard to such other data would have resulted in a more favorable result for Mercury. Accordingly, we need not consider this argument further.

Mercury and the Trades also both contend that the commissioner and/or the superior court erred in holding that the “re-litigation ban” in section 2646.4, subdivision (c) precluded Mercury from offering evidence showing that application of the rate formula would deny Mercury a fair return.[6] But again, this argument fails at the

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6 The regulation in question provides as follows: “Relitigation in a hearing on an individual insurer’s rates of a matter already determined either by these regulations or by a generic determination is out of order and shall not be permitted. However, the administrative law judge shall admit evidence he or she finds relevant to the determination of whether the rate is excessive or inadequate (or, in the case of a outset because it depends on their advocacy of a "fair rate of return" standard. As we understand it, the ALJ precluded the evidence Mercury offered on the constitutional variance because Mercury's evidence did not have any tendency to show "deep financial hardship" that would arise from application of the rate formula, but instead went only toward showing that the rate formula would deny Mercury a "fair return." We have already concluded the commissioner (and the ALJ whose proposed decision the commissioner adopted) applied the correct standard. Thus, we perceive no error in the ALJ's use of that standard in justifying the exclusion of the evidence Mercury proffered.

Finally, Mercury asserts that "[b]ased on its erroneous legal rulings, the Superior Court refused to exercise its independent judgment on the evidence establishing that [application of the rate formula] failed to yield a " 'fair return.' " We have already concluded, however, that the superior court's rulings with respect to the applicable standard of constitutional confiscation were not erroneous. Consequently, the further assertion of error Mercury offers is necessarily without merit as well.[7]

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proceeding under Article 5, relevant to the determination of the minimum nonconfiscatory rate), whether or not such evidence is expressly contemplated by these regulations, provided the evidence is not offered for the purpose of relitigating a matter already determined by these regulations or by a generic determination." (§ 2646.4, subd. (c).)

[7] Mercury has filed a request that we take judicial notice of certain materials, and the Trades have filed three such requests. In addition, the commissioner has requested that we strike certain portions of the Trades' reply brief. Because we find the materials that are the subject of the various requests for judicial notice are not relevant to our decision, we deny those requests. And because we are affirming the trial court's decision and thereby disposing of this appeal favorably to the commissioner, we deny his request to strike as moot.

DISPOSITION

The judgment is affirmed. The commissioner and Consumer Watchdog shall recover their costs on appeal. (Cal. Rules of Court, rule 8.278(a)(1).)

/s/
Robie, J.

We concur:

/s/
Raye, P. J.

/s/
Mauro, J.