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SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SACRAMENTO

MERCURY CASUALTY COMPANY, Petitioner and Plaintiff. vs. DAVE JONES, IN HIS OFFICIAL CAPACITY AS THE INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA, Respondent and Defendant,	CASE NO.: 34-2013-80001426 **VERIFIED PETITION FOR A PEREMPTORY WRIT OF MANDATE UNDER CCP § 1094.5, GOV'T CODE § 11523, AND INSURANCE CODE § 1858.6; AND COMPLAINT FOR DECLARATORY RELIEF AND INJUNCTIVE RELIEF** **[STAY REQUESTED]**

Petitioner and Plaintiff Mercury Casualty Company ("Mercury Casualty") alleges as follows:

INTRODUCTION

1. Mercury Casualty petitions this Court for a peremptory writ of mandate under Code of Civil Procedure section 1094.5 directed to Respondent and Defendant Dave Jones, in his capacity as California Insurance Commissioner ("Commissioner"), seeking judicial review and an order vacating the Commissioner's February 11, 2013 Order Adopting Proposed Decision

("Commissioner's Order") in *In the Matter of the Rate Application of Mercury Casualty Company,* File No. PA-2009-00009 (hereinafter "Rate Proceeding"). A true and correct copy of the February 11, 2013 Order is attached hereto as Exhibit "A" (hereinafter "Commissioner's Order or Order").

2. Even though Mercury Casualty's homeowners premiums are among the lowest in the state, the Commissioner, based on outdated data, adopted the ALJ's decision that Mercury Casualty's rates for its homeowners' lines of insurance overall must be decreased even further by approximately 5%.

3. The Order separates the rates to be implemented by coverage forms. The Rate Proceeding involved three homeowners insurance coverage forms, the HO-3, HO-4 and HO-6 forms. HO-3 is the more standard homeowners insurance coverage form. HO-4 provides renters and tenants coverage. HO-6 provides condominium owners coverage. For HO-3, which is the largest portion of Mercury Casualty's homeowners line of business, the Order states the rates should be decreased by 8.18%. For HO-4, which is a much smaller segment of the homeowners line, the Order imposes a 4.32% increase. For HO-6, which is also a smaller segment of the homeowners line, the Order imposes a 29.44% increase. When the overall premium volume is taken into account for these different coverage forms, the overall rate decrease is approximately 5%.

4. The Commissioner reached his erroneous conclusions and rate decrease notwithstanding the fact that his own agency, the California Department of Insurance ("CDI"), advocated in the Rate Proceeding that the rate should be decreased overall by 2.33%. By coverages, the CDI argued for -2.21% for HO, -13.81% for HO-4, and 1.88% for HO-6. Mercury maintained that it was entitled to an 8.8% increase overall if allowed the 90% concentration variance under 10 Cal. Code Regs. ("C.C.R.) § 2644.27(f)(3) and, alternatively, a 6.9% increase without the concentration variance.[1] The Commissioner's Order rejected both the CDI's and Mercury's recommended rate changes. Instead, the Commissioner's Order adopted the ALJ's own actuarial calculations which she performed independently from the parties.

5. Pursuant to Insurance Code section 1858.6, "the court is authorized and directed to

[1] Mercury's breakdown by coverage form is as follows if the concentration variance is granted: 7.3 for HO-3; 5.5% for HO-4; and 31.2% for HO-6. If the concentration variance is not applied, the rate changes are 5.5% for HO-4; 4.2% for HO-4; and 29.0% for HO-6.

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exercise its independent judgment on the evidence and unless the weight of the evidence supports the findings, determination, rule, ruling or order of the commissioner, the same shall be annulled."

6. This Order should be "annulled" as it is in violation of law, not supported by the findings, and the findings are not supported by the weight of the evidence, in that:

- The Order is not based upon the most updated data that was available during the course of the administrative hearing though the use of such data is expressly required under the Regulations and such updated data shows a worsening loss experience that supports Mercury Casualty's need for a rate *increase*, not a decrease.
- The Order is based upon a number of incorrect legal and factual conclusions concerning the meaning, applicability, and calculation of the "institutional advertising" excluded expense component of the rate regulations.
- The Order is based upon an incorrect conclusion concerning the applicability of the "political contributions and lobbying expenses" for purposes of determining excluded expenses under the rate regulations because it incorrectly treated, as excluded expenses, the political and lobbying expenses of companies *other than Mercury Casualty Company*.
- The Order is based upon a number of incorrect legal and factual conclusions concerning the meaning and applicability of the "constitutional" (i.e., confiscation) variance under the rate regulations, including the erroneous determination that Mercury is not entitled the opportunity to earn a fair rate of return on the rates it charges its policyholders;
- The Order is based on the improper exclusion of evidence and the consideration of information not introduced into evidence during the Rate Proceeding;
- The Order is based upon an incorrect determination that Mercury Casualty did not qualify for a leverage variance under 10 C.C.R. § 2644.27(f)(3), though more than 90% of its homeowners' line of business is located in California.

7. Mercury Casualty also seeks a declaration regarding the interpretation and application of: (1) 10 California Code of Regulations ("C.C.R.") § 2644.10(f), which governs which

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expenses are considered "institutional advertising" expenses for ratemaking purposes; (2) 10 C.C.R. § 2644.10(a), which requires the exclusion of "political contributions and lobbying" expenses; (3) 10 C.C.R. § 2644.27(f)(9), which permits a "variance" from the regulations when the rate is confiscatory as applied; (4) 10 C.C.R. § 2642.8 and the meaning of "most actuarially sound" as used in this section and throughout the Regulations; and (5) 10 C.C.R. § 2644.27(f)(3), which permits a "variance" from the Regulations when the insurer writes at least 90% of its direct earned premium in one line in California.[2] These regulations are impermissibly vague and arbitrary, have imposed arbitrary rates, have been applied inconsistently and in an arbitrary fashion, have been applied in a manner that constitutes an underground regulation in violation of California law, and have been applied in manner that violates the California and federal constitutions.

8. Accordingly, the Commissioner's Order must be vacated and the Court should issue a declaration as to the proper meaning of the above-referenced sections of the Regulations.

PARTIES

9. Petitioner and plaintiff herein, Mercury Casualty, is a multi-state insurer authorized and licensed to engage in the business of selling property/casualty insurance in California. According to the CDI survey as contained on its website, premiums for Mercury Casualty homeowners policies are among the lowest in the state.

10. Respondent and defendant herein, Dave Jones, is named in his official capacity as Insurance Commissioner of the State of California ("Commissioner"). The Commissioner is required to follow and apply the California Insurance Code and the implementing regulations in a consistent and reasonable manner, and to abide by the California Government Code, and to otherwise discharge his duties according to the law, including the California and United States Constitution. At all times mentioned in this Petition, the Commissioner has been and is now the agency charged with administering Insurance Code sections 1861.05 *et seq.* (Chapter 9, Article 10 ("Reduction and Control of Insurance Rates")).

[2] 10 C.C.R. § 2644.27(a) defines a "variance" request as "[a] request that the maximum permitted earned premium or minimum permitted earned premium should be adjusted."

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JURISDICTION AND VENUE

11. Mercury Casualty has a right to judicial review of the Commissioner's February 11, 2013 Order pursuant to California Insurance Code sections 1861.08, 1861.09, 1858.6 and Government Code section 11523. Mercury Casualty has exhausted all administrative remedies. The Court has jurisdiction over this action seeking a Writ of Administrative Mandamus pursuant to California Code of Civil Procedure section 1094.5. This Court also has jurisdiction over Mercury Casualty's complaint for declaratory relief under Code of Civil Procedure section 1060 and Government Code section 11350 ("Any interested person may obtain a judicial declaration as to the validity of any regulation . . . .").

12. Venue is proper in the County of Sacramento pursuant to Code of Civil Procedure section 393(b), as the Commissioner's February 11, 2013 Order was issued out of his executive office in Sacramento and the State Attorney General maintain official offices in Sacramento.

FACTUAL ALLEGATIONS

Proposition 103

13. On November 8, 1988, the California voters passed Proposition 103. Insurance Code section 1861.05(a), part of Proposition 103, provides: "No rate shall be approved or remain in effect which is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter. In considering whether a rate is excessive, inadequate or unfairly discriminatory, no consideration shall be given to the degree of competition and the commissioner shall consider whether the rate mathematically reflects the insurance company's investment income."

14. As relevant here, Insurance Code section 1861.05(b) requires "[e]very insurer which desires to change any rate shall file a complete rate application with the commissioner." Under the prior approval regulations ("Regulations"), 10 C.C.R. §§ 2641.1 *et seq.*, an insurer files a rate application containing its request for a rate change with the CDI. The rate application contains, among other things, data reflecting the insurers historical losses and expenses and estimates of future losses and expenses. Through the rate application, an insurer provides information to the Commissioner showing its rate need to enable it to charge a rate that will allow it to cover its losses

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and expenses and be afforded the opportunity to earn a fair rate of return on its investment. The Commissioner reviews the rate application to determine whether the requested rate change seeks a rate that is excessive or inadequate or otherwise complies with Insurance Code section 1861.05(a). He does so by applying the Regulations and the formula contained therein.

The Mercury Casualty Rate Application and Rate Proceeding

15. On or about May 15, 2009, Mercury Casualty filed its rate application with the California Department of Insurance ("CDI") for its Homeowners Multi-Peril line of insurance, RFB App. No. 09-3851 (hereinafter "Application"). In its rate application, Mercury Casualty requested a 3.9% rate increase.

16. On or about June 29, 2009, Consumer Watchdog ("CWD") filed a Petition for Hearing, Petition to Intervene and Notice of Intent to Seek Compensation regarding the Application.

17. On or about July 6, 2009, Mercury Casualty filed its Answer to the Petition.

18. On or about July 10, 2009, Mercury Casualty agreed to toll the statutory 60-day "deemer" period set forth in California Insurance Code § 1861.05(c).

19. On or about July 22, 2009, the CDI approved CWD's Petition for Intervention.

20. On or about May 13, 2011, pursuant to California Insurance Code § 1861.05(c)(2) and 10 C.C.R. section 2648.3, the Commissioner issued a Notice of Hearing wherein he ordered a hearing on the Application. The Commissioner's Notice of Hearing specified the hearing on the Application would be subject to California Insurance Code § 1861.08 and would be held before the Administrative Hearing Bureau of the CDI.

21. On or about June 3, 2011, Administrative Law Judge Kristin L. Rosi ("ALJ") of the CDI's Administrative Hearing Bureau issued a Notice of Scheduling Conference and Order for a scheduling conference to take place on June 29, 2011. The parties agreed to an evidentiary hearing date of December 12, 2011.

22. On October 13, 2011, Mercury Casualty lodged its written direct testimony of several witnesses, including Professor Robert S. Hamada, the Edward Eagle Brown Distinguished Service Professor Emeritus of Finance and former Dean at The University of Chicago Graduate

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School of Business. Professor Hamada's testimony was filed in support of the independent constitutional or confiscation variance contained in 10 C.C.R § 2644.27 (f)(9). The testimony showed that the rates suggested by the CDI and CWD would not provide Mercury Casualty the opportunity to earn a fair rate of return. CWD and the CDI filed motions to strike portions of Mercury Casualty's written direct testimony, including testimony of Professor Hamada.

23. The ALJ granted the motion to strike and erroneously struck the entire testimony of Professor Hamada on the ground that the confiscation related economic testimony constituted impermissible relitigation of the formula contained in the Regulations. The ALJ held that Mercury Casualty could not introduce evidence that the rates suggested by the CDI and CWD denied Mercury Casualty the opportunity to earn a fair rate of return that is commensurate with the returns afforded businesses of comparable risk.

24. On December 8, 2011, Mercury Casualty lodged supplemental testimony of its witnesses, including Dr. David Appel, and included updated loss and trend calculations based on 3rd quarter 2011 data.

25. On December 9, 2011, the ALJ permitted admission of Mercury Casualty's 3rd quarter data, but ordered that no further or updated data may be submitted past the 3rd quarter 2011 regardless of the length of the hearing when a decision would be issued, or when the rate would actually go into effect. The ALJ continued the evidentiary hearing date to December 30, 2011.

26. On December 27, 2011, CWD and the CDI filed motions to strike Dr. Appel's supplemental testimony.

27. On December 30, 2011, the first day of the evidentiary hearing, the ALJ granted the motions to strike Dr. Appel's testimony. The evidentiary hearing was continued to January 3, 2012.

28. On January 3, 2012, Mercury Casualty's counsel requested a continuance of the evidentiary hearing due to a family medical emergency. As a result, the parties agreed to reconvene the evidentiary hearing on January 18, 2012.

29. On January 18, 2012, Mercury Casualty made an Offer of Proof regarding the supplemental direct testimony of Dr. Appel, that Dr. Appel would present testimony that the maximum indicated rate of return presented by the CDI and CWD, based on 3rd quarter 2011 data,

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would be confiscatory as applied. On January 19, 2012, the ALJ granted Mercury Casualty leave to file additional testimony from Dr. Appel. On February 8, 2012, Mercury Casualty lodged additional direct testimony from Dr. Appel.

30. On February 15, 2012, the CWD and CDI filed motions to strike Dr. Appel's confiscation testimony and its accompanying exhibits. On February 21, 2012, the ALJ admitted a portion of Dr. Appel's testimony regarding his understanding of the confiscation variance, but struck Dr. Appel's calculations regarding confiscation and any reference to fair rate of return which she found were based on an economic theory not contained in regulatory formula.

31. The evidentiary hearing reconvened on February 27, 2012 and continued through March 2, 2012.

32. On March 29, 2012, Mercury Casualty lodged its rebuttal testimony from Dr. Appel and Professor Hamada regarding the confiscation variance. On March 30, 2012, CWD and the CDI moved to strike the rebuttal testimony of Dr. Appel and Professor Hamada.

33. On April 2, 2012, the ALJ granted the motion to strike Professor Hamada's rebuttal testimony. Again, the ALJ refused to allow Mercury Casualty's testimony and evidence on the issue of what was a fair rate of return for Mercury Casualty.

34. The ALJ heard rebuttal testimony from April 2 through April 4, 2012.

35. On August 27, 2012, the ALJ issued an order closing the record in the hearing on the Rate Application.

36. On September 26, 2012, the ALJ issued her Proposed Decision on the Rate Application.

The Commissioner's Order Rejecting the ALJ's First Proposed Decision and Certification of Questions for Consideration

37. On October 26, 2012, the Commissioner issued an order rejecting the Proposed Decision, and referring the matter back to the ALJ to take additional evidence on: "The appropriate Loss Trend Selection" and Mercury Casualty's "investment income and its impact on the Company's rate of return."

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38. On November 26, 2012, the ALJ issued an Order Granting the Parties' Joint Motion to Certify Question to the Commissioner ("Certification Order"), and submitted the following certified question to the Commissioner regarding the October 26, 2012 Order: "What issue does the Commissioner wish to see addressed by ordering the parties to provide additional evidence on 'Mercury Casualty Company's investment income and its impact on the Company's rate of return?'" In addition to the certified question, the Certification Order stated that "the parties agree the Commissioner's regulations mandate both the investment income yield and the maximum rate of return," and that "the parties may not stray from the investment and rate factors provided in the regulatory formula."

39. On November 27, 2012, Mercury Casualty requested the ALJ modify the Certification Order to, among other items, correct misstatements concerning Mercury Casualty's position. Specifically, Mercury Casualty stated it did not agree that the regulation mandates the use of the formula's derived investment income yield and the maximum rate of return. "To the contrary, Mercury Casualty has argued in this case, the regulatory formula expressly permits a 'variance' from the use of the regulatory formula insofar as it results in a rate that is confiscatory."

40. On or about January 7, 2013, Mercury Casualty submitted a new Homeowners rate application (CDI File No. 13-716), in which Mercury Casualty is seeking a 6.9% rate increase based upon data through the third quarter of 2012. This rate application is currently pending before the CDI and the CDI has indicated that it must act on the rate application (the 60 day deemer date will run under Insurance Code section 1861.05(c)) by March 26, 2013.

41. On January 14, 2013, the Commissioner issued his Response to the Certified Question, wherein he stated the "Proposed Decision, beginning on page 107, contains a discussion regarding a constitutional variance pursuant to California Code of Regulations, title 10, section 2644.16, subdivision (f)(9). In this section, the ALJ, makes findings of fact regarding Mercury Casualty's after-tax rate of return and profit. In so doing, the ALJ identifies and/or calculates the following terms (among others): underwriting profit; ancillary income; underwriting and other income before tax; before tax profit; after tax profit; before tax annual profit; after tax annual profit; average net income; investment income on reserves and surplus; after-tax return on surplus; and

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profit. Because of the inconsistent reference to these terms in the Proposed Decision, it was unclear whether investment income was properly considered in determining Mercury Casualty's after tax rate of return and profit...¶ Based on the lack of clarity in the Proposed Decision, it appeared that the ALJ lacked the requisite evidence regarding Mercury Casualty's investment income and its impact on the rate of return. Accordingly, the Commissioner's Order Rejecting the Proposed Decision and Order of Referral included an order that the ALJ take additional evidence on the following: 'Mercury Casualty Company's investment income and its impact on the Company's rate of return.'" However, the Commissioner, based on the ALJ's Certification Order which misstated the parties' stipulation to the use of the regulatory formula's income investment factors, determined that his October 26, 2012 Order to "take additional evidence on 'Mercury Casualty Company's investment income and its impact on the Company's rate of return,' may be disregarded."

42. On January 18, 2013, Mercury Casualty filed its Petition for Reconsideration of the Commissioner's January 14, 2013 Response to the Certified Question on the ground it was based upon the incorrect understanding that the parties had agreed to the use of the regulatory formula's investment factors in connection with an analysis of its eligibility to a confiscation variance.

43. On January 28, 2013, the ALJ issued an order closing the record and issued a Proposed Decision on the Rate Application. The Proposed Decision was substantively identical to the September 26, 2012 Proposed Decision.

44. On February 8, 2013, Mercury Casualty submitted a brief to the Commissioner regarding errors made by the ALJ in the Proposed Decision, and requested modification and/or rejection of the Proposed Decision.

The Commissioner's Order Adopting the ALJ's Second Proposed Decision

45. On February 11, 2013, the Commissioner issued an Order Adopting Proposed Decision without modification. [Exh. A] The Conclusions of Law in the Proposed Decision provide, in relevant part:

- "All of Mercury's advertising expenses constitute 'institutional advertising' and shall be included in the calculation of Mercury's excluded expense factor." [Exh. A, p.

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128.]

- "Mercury's political expenditures of $183,326 for 2008, $210,656 in 2009, and $528,015 for 2010 shall be included in the calculation of Mercury's excluded expense factor." [Exh. A, p. 128.]
- "Mercury failed to support its request for a variance under California Code of Regulations, title 10, section 2644.27, subdivision (f)(9). Mercury did not satisfy its burden of proof that application of the maximum permitted earned premium results in deep financial hardship to Mercury Casualty as a whole." [Exh. A, p. 129.]
- Mercury Casualty is not entitled the opportunity to earn a fair rate of return on the rates it charges its policyholders [Exh. A, p. 123-126];
- "Mercury failed to support its request for a variance under California Code of Regulations, title 10, section 2644.27, subdivision (f)(3). Mercury did not satisfy its burden of proof that it writes at least 90% of its direct premium in California. In addition, Mercury did not satisfy its burden of proof that its mix of business presents investment risks different from the risks typical of the line as a whole." [Exh. A, p. 128-129.]
- "Mercury shall remove no less than $7,529,928 in catastrophic losses from its policy form HO-3 projected losses as a result of the December 2010 catastrophic rain event." [Exh. A, p. 127.]
- "The regulatory ratemaking formula, without a variance, indicates a rate decrease of 8.18% for Mercury's HO-3 line." [Exh. A, p. 128.]

46. Subsequently, Mercury Casualty filed a petition for reconsideration with the Commissioner, which has not been granted.

47. Mercury Casualty has requested that the administrative record be prepared and delivered.

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FIRST CAUSE OF ACTION

(Writ of Mandamus: CCP Section 1094.5 and Insurance Code Section 1858.6)

48. Mercury Casualty realleges paragraphs 1 through 47 above and incorporates them herein by reference.

49. Pursuant to California Code of Civil Procedure ("CCP") section 1094.5(b), in mandamus proceedings seeking review of administrative orders the Court's inquiry is to extend to the following questions:

- Whether the respondent agency has proceeded without, or in excess of jurisdiction;
- Whether there was a fair trial;
- Whether there was any prejudicial abuse of discretion.

Under section 1094.5(b), "abuse of discretion is established if the respondent [agency] has not proceeded in the manner required by law, the order or decision is not supported by the findings, or the findings are not supported by the evidence."

50. In mandamus proceedings reviewing administrative orders issued by the Insurance Commissioner under the terms of Proposition 103, pursuant to Insurance Code section 1858.6 "the court is authorized and directed to exercise its independent judgment on the evidence and unless the weight of the evidence supports the findings, determination, rule, ruling or order of the commissioner, the same shall be annulled."

51. Through his Order, dated February 11, 2013, the Commissioner has prejudicially abused his discretion in not proceeding in the manner required by law, by issuing an order that is not supported by the findings, and by making findings that are not supported by the weight of the evidence, all as more particularly alleged herein.

1. The Commissioner's Order Must be Set Aside Because the Commissioner Did Not Proceed in the Manner Required by Law in that the Decision was Not Based on the Most Updated Data as Required by Law

52. The Rate Regulations provide, "[i]f updated data underlying the application becomes available during the course of the hearing, the applicant ***shall*** provide the updated data as

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additional direct testimony as soon as practical after the updated data becomes available." 10 C.C.R. § 2655.8(b) (emphasis added).

53. The hearing in this matter was closed on May 21, 2012. Pursuant to the ALJ's December 9, 2011 Order, however, Mercury Casualty was precluded from submitting updated data beyond the 3rd quarter of 2011. There was at least one, if not two, additional quarters (the 4th quarter of 2011 and 1st quarter of 2012) of available updated data that Mercury Casualty was entitled (and required) to present in this hearing but was denied from doing so.

54. The preclusion of post-3rd quarter 2011 data also violated 10.C.C.R. section 2642.6, which provides that the "recorded period" – i.e., the historical period from which data are taken to provide the basis for the proposed rate – must be the "the most recent three years for which reliable data are available ..." Though the recorded period must be the most recent three years of data, here, the Commissioner only considered data up to the 3rd quarter of 2011 and thereby ignored nearly a year's worth of data that should have been used to develop rates. In other words, the Order is not based upon data that must be used to develop rates for use in 2013.

55. The preclusion of post-3rd quarter 2011 data also violates the "most actuarially sound" requirements set forth in the Regulations, which requires that the "most actuarially sound" choices be made in connection with various data selections and/or methodologies. *See, e.g.*, 10 C.C.R. §§ 2642.8, 2644.6, 2644.7, & 2644.8. Only through the use of the most current and available data can the "most actuarially sound" selections be made.

56. The failure to consider the post-3rd quarter 2011 data was not only inconsistent with what is required by law, it also prejudiced Mercury Casualty's rights. If Mercury Casualty's 4th quarter 2011 data was considered, the loss ratio for the year ending in the 4th quarter 2011 would be 56.8%, while the loss ratio for the year ending in the 3rd quarter 2011 was determined by the Commissioner to be 48.7%. Such a worsening of Mercury Casualty's loss experience strongly suggests that the determination that a negative, not a positive, loss trend is simply wrong.

57. The infirmity of the Commissioner's Order is further confirmed by Mercury Casualty's recent rate filing, File No. 13-716, which shows that Mercury Casualty has updated data through the 3rd quarter of 2012. Significantly, the recent rate filing uses the values and/or

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methodologies proposed by the ALJ in her September 26, 2012 Proposed Decision and indicates Mercury Casualty is in need of a rate increase of at least 8.2%, not the rate decrease in the Order.

58. Accordingly, the Order should be vacated and remanded so that the Commissioner is ordered to consider Mercury Casualty's post 3rd quarter 2011 data.

2. The Commissioner's Interpretation and Application of "Institutional Advertising" Expenses Set Forth in 10 C.C.R. § 2644.10(f) is Arbitrary, Contrary to the Law and the Evidence and Reflects a Prejudicial Abuse of Discretion

59. California regulations prohibit an insurer from passing on the costs of certain expense items to policyholders, which includes "institutional advertising." 10 C.C.R. § 2644.10, subdivision (f).

60. Based on an erroneous interpretation of the regulation, and contrary to the weight of the evidence, the Commissioner determined that ***all*** of Mercury Casualty's advertising expenses constituted "institutional advertising" and should be included in Mercury Casualty's excluded expense factor. [Exh. A., p. 128.] This erroneous finding lead the Commissioner to conclude that $83 million that Mercury General Corporation spent in advertising from 2008-2010, should be attributed to Mercury Casualty, and thus increasing Mercury Casualty's excluded expense factor.

A. The Commissioner's Decision Incorrectly Holds that Non-Institutional Advertising Requires Mercury Casualty's Advertising to Contain Both (1) Specific Insurer Information and (2) Pertinent Insurance Information, Where the Regulation Only Requires One of these Characteristics to Constitute Non-Institutional Advertising

61. Section 2644.10 provides, in relevant part: "The following expense items 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." (Emphasis added.)

62. The Commissioner erroneously interpreted and applied the "Institutional advertising expenses" to Mercury Casualty's rate application. Specifically, while the regulation requires a showing of two prerequisites to qualify as "Institutional advertising," the Commissioner determined

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that only one prerequisite need be demonstrated for the expenses of such advertising to constitute "Institutional advertising" and therefore be excluded for ratemaking purposes. This interpretation of the regulation is erroneous and contrary to its plain meaning and prejudiced Mercury Casualty by improperly increasing its expense factor.

B. <u>The Commissioner's Application and Interpretation of "Specific Insurer" in 10 C.C.R. § 2644.10(f) is Arbitrary, Contrary to the Law, and Not Supported by the Evidence</u>

63. The Commissioner's determination that advertisements directed at Mercury Insurance Group, not Mercury Casualty Company, were not aimed at obtaining business for a "specific insurer" is erroneous, contrary to the law, and not supported by the weight of the evidence. Indeed, under the Commissioner's Order affiliated insurers would now have to incur the separate expense of advertising its own company, though the advertising of the group can be done more cost-effectively. There is no logical, actuarial or regulatory reason to prohibit affiliated insurers to advertise on a group-wide basis and take into account, as a legitimate business expense that should be considered for ratemaking, their fairly allocated share of expenses for those advertisements. Instead, a more sensible view of "specific insurer" and consistent with 10 C.C.R., section 2641.17 must contemplate the fact that insurers engage in group advertising and that each specific insurer should be allowed to consider, in developing rates, its share of such expenses.

64. The Commissioner committed further error by relying upon rate applications of other insurers such as State Farm, Travelers, Zurich, Hartford and Liberty Mutual. The Commissioner noted that these companies "exclude substantial institutional advertising expenditures" and that "[g]iven the evidence that Mercury's competitors successfully obey the law the intent and language of the Regulation, the [Commissioner] rejects Mercury's claim that strict adherence would eliminate insurance groups." However, the rate applications relied upon by the Commissioner and which were not introduced into evidence or otherwise addressed in the hearing, provide no information as to what were the advertisements these companies considered "institutional advertisement." In any event, there is reason to believe that these other applications may have had advertising that is not directed at driving insurance business or were listed by the insurers for other unknown reasons. For instance, as the Commissioner noted, State Farm is a group

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of affiliated insurance *and financial service companies*. If State Farm marketed its name to promote both its regulated insurance and non-regulated financial service companies, that may be the basis for State Farm considering at least a portion of those expenses as "institutional" advertisement. In contrast, Mercury Insurance Group only sells insurance and any advertisements have been directed at promoting business and sales through its insurance companies. There is no evidence of what makes up these entries in the other insurer rate filings, which again, were not admitted or tested in the Rate Proceeding. The conclusions reached are at best guesses and there is no support in the record.

65. The weight of the evidence establishes that Mercury Insurance Group's advertisements were directed towards a "specific insurer" to increase its insurance business, and that the advertising expenses for Mercury Insurance Group is accumulated by state in which the advertising takes place and reasonably allocated to each company, including Mercury Casualty, based upon premiums written in that state.

C. The Commissioner's Determination that Mercury Insurance Group's Advertisements Did Not Provide Pertinent Insurance Information is Contrary To and Not Supported by the Evidence

66. The Commissioner's determination that "Mercury fail[ed] to demonstrate significant portions of its advertising provided consumers with pertinent insurance information" is erroneous and not supported by the evidence.

67. Rather than focusing on substantial evidence proffered by Mercury Casualty demonstrating the pertinent insurance information provided by Mercury Insurance Group's advertisements, the Commissioner narrowly focused in on one aspect of Mercury Insurance Group's sports advertising, in particularly, the display of Mercury Insurance Group's logo on the sides of the Los Angeles King's hockey rinks and baseball stadiums or the sponsorship of a tennis tournament as evidence of instances of pure "branding" advertising. This focus, however, ignores the testimony by Mercury Insurance Group's marketing director explaining that these sport sponsorships are part and parcel of a larger, more comprehensive, advertising campaign that is directly geared to providing pertinent insurance information to customers to drive the sale of insurance business.

68. The weight of the evidence shows that Mercury Insurance Group's advertisements

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provide such pertinent information to consumers reasonably calculated to promote insurance sales, and thus they do not constitute "institutional advertising":

(a) The hundreds of pages and print advertisement and DVDs of television advertisements for the years 2008, 2009 and 2010 clearly demonstrate that Mercury Insurance Group's advertisements provide pertinent insurance information to consumers on why they should buy Mercury insurance (e.g., superior rates, coverage and/or customer service) and/or how to obtain a quote (e.g., through Mercury's website or through a Mercury producer).

(b) Mercury Insurance Group's sports advertisement campaigns are a multi-faceted campaign that involve not only the display of Mercury's logo in certain venues, but also the passing out of handouts, the use of radio and TV spots, the inclusion of ads in the program and other banners emphasizing the benefits of Mercury insurance and directing consumers to Mercury's website and/or a designated telephone number.

D. The Commissioner Incorrectly Removed Purported Institutional Advertising Expenses from the Expense Component of the Rate and Reduced the Efficiency Standard Where Only the Efficiency Standard Should Have been Affected

69. The Commissioner's Order removes all of Mercury's advertising of whatever nature from the expense component of the rate. In other words, Mercury Casualty was not allowed to include any advertising expenses as part of the rate. In addition to removing the advertising expense dollars from the rate, the Commissioner also reduced the "efficiency standard," which serve to cap an insurer's expenses, such that additional allowable expenses were arbitrarily and wrongfully reduced.

70. The Commissioner abused his discretion when he arbitrarily removed what he wrongfully characterized as "institutional expenses" from the expense component of the rate and then further reduced expenses by reducing the efficiency standard. This had the effect of arbitrarily and unreasonably double counting the so-called "institutional advertising" expense thereby eliminating allowable expense dollars from the rate.

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3. The Commissioner's Interpretation and Application of "Political Contributions and Lobbying" Expenses Set Forth in 10 C.C.R. § 2644.10(a) to Mercury Casualty's Rate Application is Arbitrary, Contrary to the Law and Evidence and Reflects a Prejudicial Abuse of Discretion

71. California regulations prohibit an insurer from passing on the costs of certain expense items to ratepayers, which includes "political contributions and lobbying." 10 C.C.R. § 2644.10, subdivision (a). As a general matter, increasing the insurer's excluded expense factor usually results in a lower overall indicated rate, and a lower efficiency standard.

72. California Code of Regulations, title 10, section 2644.10 provides, in relevant part: "The following expense items shall not be allowed for ratemaking purposes: ¶ (a) Political contributions and lobbying."

73. The Commissioner's Order excluded from Mercury Casualty's rate application the following total amounts designated by Mercury Insurance Group as expenses for political contributions and lobbying - $183,326 for 2008, $210,656 for 2009 and $528,015 for 2010. However, the allocation of the entirety of these expenses to Mercury Casualty is arbitrary and contrary to law as only those expenses allocated to Mercury Casualty should have been excluded.

74. The weight of the evidence also shows that:

(a) The Order improperly includes as Mercury Casualty's excluded expenses for "political contributions and lobbying", expenses of Mercury Insurance Company and Mercury Insurance Group, which should not have been attributed to Mercury Casualty as there is no evidence and no reason to believe that those expenses were allocated to Mercury Casualty.

4. The Commissioner's Interpretation and Application of the Confiscation ("Constitutional") Variance Set Forth in 10 C.C.R. § 2644.27(f)(9) is Arbitrary, Contrary to the Law and Evidence and Reflects a Prejudicial Abuse of Discretion

75. The Commissioner's Order constitutes an abuse of discretion, is in violation of law and is not supported by the weight of the evidence to the extent it determines that Mercury Casualty is not entitled to a Constitutional Variance, and is not entitled to a "fair rate of return."

76. Under the regulations, a confiscation variance is allowed if:

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> "the maximum permitted earned premium would be confiscatory as applied. This is the constitutional 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).

77. In the Commissioner's comments filed in October 2006 in support of the regulations, the Commissioner stated:

> "Under Proposition 103, as modified by *Calfarm Insurance Co. v. Deukmejian,* (1989) 48 Cal. 3d 805, insurers are entitled to the opportunity to earn a fair and reasonable rate of return. Court decisions interpreting the "fair rate of return" standard make it clear that the opportunity to achieve a fair return must be provided only to those who conduct their operations in a reasonably efficient manner."

78. Notwithstanding his comments in support of the regulations, in the Commissioner's Order he ignored California Supreme Court precedent and rejected application of the "fair rate of return test" established by *20th Century Ins. Co. v. Garamendi* ("*20th Century*"), 8 Cal. 4th 216, 292-296 (1994) ("*20th Century*"). *See Santa Monica Beach, Ltd v. Sup. Court*, 19 Cal. 4th 952, 967 (1999); *Kavanau v. Santa Monica Rent Control Bd.*, 16 Cal. 4th 761, 771 (1997). The Commissioner erred in rejecting the "fair rate of return test," and he should have considered whether the rates proposed by CWD, which the Commissioner adopted, fails to provide a "fair rate of return" and, therefore, is confiscatory. The Commissioner erroneously ruled that "Confiscation is Not Judged Under a "Fair Rate of Return" Standard." [Exh. A, 123.] This is clearly contrary to the most recent California Supreme Court decisions that require a regulated entity must be afforded the opportunity to earn a fair return under any price control scheme.

> "A price control regulation is generally constitutionally challenged with the contention that a particular price or rate regulation is confiscatory, i.e., does not allow a just and reasonable rate to investors. (*See, e.g., 20th Century Ins. Co., supra*, 8 Cal. 4th at p. 293; *Duquesne Light Co. v. Barasch* (1989) 488 U.S. 299 []) ... **As we also noted in *Kavanau* and *20th Century Ins. Co.*, courts have employed this fair return analysis in price regulation cases whether the contested regulation is denominated as a taking or a deprivation of property without due process.**"
>
> *Santa Monica Beach, Ltd v. Sup. Court*, 19 Cal. 4th 952, 967 (1999) (bold emph. added).

79. Further, the Commissioner erred in adopting and applying CWD's "confiscation"

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test to determine if the proposed rates were confiscatory. CWD's "confiscation" test is flawed. Under its "confiscation" test, CWD determined that its indicated rate change will result in a fair rate of return of 7.33% and, therefore, cannot be "confiscatory." In reaching this conclusion, however, CWD uses the same values embedded in the regulatory formula (which includes the 7.33% rate of return) that it used to develop its indicated rate change in the first place to conduct a "reverse" calculation that arrives at the presumed 7.33% rate of return value. In other words, this "test" will always yield a 7.33% rate of return and would never show confiscation. It fails to consider Mercury Casualty's actual cost of capital, which is higher than 7.33%. *This* tautological "confiscation" test nullifies and makes superfluous the "confiscation" variance permitted under the regulation and the *20th Century* decision which holds there must be a constitutional variance based on confiscation that is separate and independent from the formula.

80. Under California law, the constitutional variance is to be assessed on an "end result" basis without regard to the formula stated in the regulations. As a result, the constitutional variance must take into account the many expenses the regulations would not recognize. In this regard, the Commissioner erred as a matter of law in excluding testimony from Mercury Casualty's expert regarding the "fair rate of return" standard and by simply adopting the CWD's tautological test.

81. Further, the Commissioner erred in concluding the regulation's "relitigation" provision barred consideration of Mercury Casualty's *actual* projected losses, expense and returns to test the "confiscatory" impact of the proposed rate change. In *20th Century*, the California Supreme Court expressly rejected the proposition that the "relitigation" bar prevents a company from introducing evidence to demonstrate confiscation:

> "The 'relitigation bar,' as noted above, is this: '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 proceeding [concerning a rate for the rollback year], 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.' (Cal. Code Regs., tit. 10, § 2646.4, subd. (e).)"

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20th Century, supra at 311.

82. An insurer must be allowed to test the confiscatory impact of the rate indication developed by any party by considering an insurer's *actual* expected costs, expenses and returns, not the values as limited and projected under the regulatory formula. Companies must logically be able to test the "end-result" of the regulatory formula by going outside of the formula's constraints (such as those on expenses and costs); otherwise, no company could ever demonstrate confiscation if it were simply required to test the results of the formula with the formula itself.

83. The Commissioner erred in concluding that Mercury Casualty agreed the values in the regulatory formula could be properly used to test "confiscation" and no further data or evidence was needed. The weight of the evidence shows that at all relevant times, Mercury Casualty did not agree or stipulate that the regulatory values, including the investment income factors, could be used to determine Mercury Casualty's **actual** investment income and its **actual** impact upon its rate of return. As the Order is based upon the erroneous premise that Mercury Casualty stipulated to the use of the regulatory values to test confiscation and only considers the values of the regulatory formula (i.e., CWD's "tautological" "confiscation" test discussed above), the Order is wrong and must be vacated.

84. The Commissioner also erred in determining that the proposed rate decrease will not impair Mercury Casualty's financial integrity by relying on Mercury Casualty's historical profitability and financial condition. The consideration of Mercury Casualty's *past* profitability and financial condition under prior rates to assess the impact of the yet-to-be approved rate decrease on Mercury Casualty's *future* profitability and condition is wrong as a matter of law. As the California Supreme Court expressly held:

> "But the concept that rates may be set at less than a fair rate of return in order to compel the return of past surpluses is not one supported by precedent. 'The just compensation safeguarded to the utility by the Fourteenth Amendment is a reasonable return on the value of the property used at the time that it is being used for the public service. . . . [The] law does not require the company to give up for the benefit of future subscribers any part of its accumulations from past operations. **Profits of the past cannot be used to sustain confiscatory rates for the future**.' []"

Calfarm Ins. Co. v. Deukmejian, 48 Cal. 3d 805, 819 (1989) (emph. added).

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Thus, the Commissioner's conclusion that Mercury Casualty's past credit ratings and historic profitability can be maintained under the future, proposed rate decrease is incorrect as a matter of law and without any evidentiary basis.

85. The weight of the evidence shows that the proposed rate decrease, which Mercury Casualty offered through the testimony of its experts, would result in confiscation and not allow for a "fair rate of return."

86. At the hearing, evidence submitted by Mercury Casualty was improperly excluded on the issue of confiscation. The evidence that was stricken by the ALJ included Mercury Casualty evidence on the "fair rate of return" standard for determining whether a proposed rate is confiscatory. This improperly excluded evidence includes, but is not limited to, testimony of Professor Robert S. Hamada submitted on behalf of Mercury Casualty on October 12, 2011 and March 28, 2012, and the testimony of Dr. Appel submitted on December 8, 2011. Other testimony and documents regarding Mercury Casualty's claim of confiscation were excluded as well. The exclusion of this evidence was improper and unlawful and the reviewing court should admit and consider this evidence in exercising its independent judgment and evaluating Mercury Casualty's claims.

87. Finally, the Commissioner erred as a matter of law in concluding that "enterprise as a whole" in the "confiscation" regulation, 10 C.C.R. § 2644.27(f)(9), must refer to the entire insurance company's nationwide operations, and not merely the line of insurance in question in the rate application. Contrary to the Commissioner's interpretation, a line-by-line analysis is consistent with all aspects of ratemaking in California. Insurance Code section 1861.05(a) provides the means of determining whether a rate is inadequate or excessive. That analysis has always been done on a line-by line basis. *See* 10 C.C.R. § 2643(b) ("[r]ate applications … shall be filed on a line-by line basis … Thus, a rate must stand on its own for the line of insurance for which it is being charged."). What an insurer profits from a different line, in another state, is not a factor. How profitable an insurer may be nationally is not considered in determining whether a rate is inadequate or excessive.

88. Accordingly, the for the reasons set forth above, the Order must be vacated as the Commissioner's findings that Mercury Casualty is not entitled to the confiscation variance is in

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violation of law and is not supported by the weight of the evidence, and therefore is an abuse of discretion.

5. The Commissioner's Interpretation and Application of the "Leverage Factor" Under 10 C.C.R. § 2644.27(f)(3) to Mercury's Rate Application is Arbitrary, Contrary to the Law and Evidence and Reflects a Prejudicial Abuse of Discretion

89. California Code of Regulations, title 10, section 2644.27, subdivision (f) provides, in relevant part: "The following are valid bases for requesting a variance: ¶ (3) That the insurer should be authorized leverage factor…on the basis that the insurer either writes at least 90% of its direct earned premium in one line or writes at least 90% of its direct earned premium in California and its mix of business presents investment risks different from the risks that are typical of the line as a whole."

90. The Commissioner, contrary to the regulation, determined that Mercury Casualty does not qualify for this variance even though 95% of its direct earned homeowners premium is in the state of California. The Commissioner erroneously interpreted section 2644.27, subdivision (f)(3) to require Mercury Casualty to demonstrate it writes 90% of its entire direct earned premium on all lines of business in California or 90% of its direct earned premium in just one line of insurance in order to qualify for this variance.

91. Under section 2644.27, subdivision (f)(3), the line of business, not the overall premium of the insurer, is the relevant measuring point.

92. Further, the Commissioner erroneously rejected Mercury Casualty's evidence that its homeowners' insurance concentration in California (95%) presents a risk different from the line as a whole. Mercury Casualty presented undisputed evidence that it is subject to higher capital requirements by A.M. Best because of its high concentration of written premium in California that otherwise would not be required to achieve the same rating as a more diversified insurer.

93. The weight of the evidence shows that:

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(a) Mercury Casualty's 95% direct earned homeowners' premium in the state of California satisfies the variance under section 2644.27, subdivision (f)(3).

(b) Mercury Casualty's 95% homeowners' insurance concentration in California presents risk different from the line as a whole and thus satisfies the variance under section 2644.27, subdivision (f)(3).

(c) Mercury Casualty's 95% direct earned homeowners' premium in the state of California and the different risks this concentration in California presents meets all applicable regulatory requirements in section 2644.27, subdivision (f)(3) and is supported by the weight of the evidence.

94. For each of the reasons stated in paragraphs 1 through 93 above, the Commissioner's Order adopting the ALJ's Proposed Decision constitutes a prejudicial abuse of discretion as the rulings stated therein are in violation of law, not supported by the findings, and not supported by the weight of evidence.

95. Mercury Casualty has exhausted all administrative remedies. Mercury Casualty lacks a "plain, speedy, adequate remedy, in the ordinary course of law" within the meaning of Code of Civil Procedure section 1086.

96. Mercury Casualty is therefore entitled to a writ of mandamus under Code of Civil Procedure section 1094.5 and Insurance Code section 1858.6 that directs the Commissioner to set aside his Order Adopting Proposed Decision, dated February 11, 2013, for each of the reasons set forth above.

SECOND CAUSE OF ACTION

(Declaratory Relief: CCP Section 1060)

97. Mercury Casualty realleges paragraphs 1 through 96 above and incorporates them herein by reference.

98. An actual controversy has arisen and now exists between the parties concerning the Commissioner's interpretation and application of the Regulations to Mercury Casualty's rate application in his Order, specifically: (1) 10 C.C.R. § 2644.10(f), which governs which expenses are considered "institutional advertising" expenses for ratemaking purposes; (2) 10 C.C.R.

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§ 2644.10(a), which requires the exclusion of "political contributions and lobbying" expenses; (3) 10 C.C.R. § 2644.27(f)(9), which permits a "variance" from the regulations when the rate is confiscatory as applied; (4) 10 C.C.R. § 2642.8 and the meaning of "most actuarially sound" as used in this section and throughout the Regulations; and (5) 10 C.C.R. § 2644.27(f)(3), which permits a "variance" from the Regulations when the insurer writes at least 90% of its direct earned premium in one line in California.

99. Mercury Casualty contends the Commissioner misinterpreted and misapplied the above-referenced ratemaking regulations with respect to Mercury Casualty's rate application. As such, Mercury Casualty contends the Commissioner did not proceed in the manner required by law and thus, the Order must be vacated. These regulations are impermissibly vague and arbitrary, have imposed arbitrary rates, have been applied inconsistently and in an arbitrary fashion, have been applied in a manner that constitutes an underground regulation in violation of California law, and have been applied in manner that violates the California and federal constitutions.

10 C.C.R § 2644.10(f) and "Institutional Advertising"

100. Under this subdivision, expenses incurred for "institutional advertising" are not allowed for ratemaking purposes. The Commissioner contends that all advertising is "institutional advertising" unless the advertising seeks to obtain business for an individual insurer and also provides customers with pertinent information.

101. The Commissioner contends that this "institutional advertising" regulatory exclusion means that insurers can only account for advertising expenses in their rates when the advertising seeks to obtain business for an individual insurer and provide customers with pertinent information.

102. The Commissioner's interpretation of "institutional advertising" as set forth in the Regulation is wrong, arbitrary and violative of the California and federal constitutions.

103. "Institutional advertising" is defined in this subdivision 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." 10 Cal. Code Regs. § 2644.10(f) (emph. added).

104. Advertising must satisfy both of the characteristics above to constitute "institutional

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advertising." In other words, an insurer may consider, in developing its rates, expenses for advertising so long as that advertising is either aimed at obtaining business for a specific insurer or it provides consumers with pertinent information. 10 C.C.R. § 2644.10(f). The advertising need only do one of the items above so as to constitute non-institutional advertising such that the expenses for such advertising can be considered for ratemaking.

105. By reason of the Commissioner's interpretation and application of this subdivision, advertisements on behalf of a group of insurance companies, such as "Mercury Insurance Group," are not allowable expenses for ratemaking purposes because such advertisements are not aimed at obtaining business for a "specific insurer" but rather more than one insurer – the group of insurers. In Mercury Casualty's case, that would be three property-casualty insurers in California.

106. Under the Commissioner's interpretation and application of this subdivision, affiliated insurers would now have to incur the separate expense of advertising for its own company, though the advertising of the group can be done more cost-effectively. There is no logical, actuarial or legal reason to prohibit affiliated insurers to advertise on a group-wide basis and take into account, as a legitimate business expense that should be considered for ratemaking, their fairly allocated share of expenses for those advertisements.

107. The Commissioner's interpretation will lead to an absurd result. Under his view, an advertisement for a "specific insurer" is not "institutional advertising" if it only identifies one company, but the same exact advertisement is "institutional advertising" if it happens to name a second company or identifies a group of affiliated insurers. Presuming the advertisement is of a character such that its expense should be properly accounted for in ratemaking, this character should not change simply because the advertisement drives the sale of insurance business for more than one insurance company. Under this view, then effectively **all** insurers would have to exclude **all** of their advertising expenses since all insurance advertising is geared toward the insurance group.

108. A more sensible view of "specific insurer," which is contended by Mercury Casualty, must contemplate the fact that insurers engage in group advertising and that each specific insurer should be allowed to consider, in developing rates, its share of such expenses. *See, e.g.*, *People v. Zambia*, 51 Cal. 4th 965, 972 (2011) ("a statute 'must be given a reasonable and common

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sense interpretation consistent with the apparent purpose and intention of the lawmakers, practical rather than technical in nature, which upon application will result in wise policy rather than mischief or absurdity.'"). .

109. The Commissioner also contends that in accounting for the so-called excluded expense for "institutional advertising," the institutional advertising dollars are to be removed from the expense totals in the rate filing and efficiency standard that is used to cap an insurer's expenses for ratemaking purposes is to be reduced by "the ratio of the insurer's national excluded expenses to its national direct earned premium. This will have the effect of arbitrarily and unreasonably double counting the so-called "institutional advertising" expense and eliminate allowable expense dollars from the rate.

10 C.C.R § 2644.10(a) and "Political Contributions and Lobbying"

110. Under this subdivision, expenses incurred for "political contributions and lobbying" are not allowed for ratemaking purposes.

111. In the Order, the Commissioner determined that Mercury Casualty must treat as its own excluded political contributions and lobbying expenses those expenses that were actually incurred and/or allocated to companies other that Mercury Casualty. This determination is based upon an incorrect interpretation and/or application of this regulation as only those expenses actually incurred and/or allocated to Mercury Casualty should have been treated as an excluded expense.

10 C.C.R. § 2644.27 (f)(9) and the Constitutional Variance

112. A separate and independent constitutionally mandated variance is available to an insurer when the maximum permitted earned premium resulting from the application of the Regulations is confiscatory. This "end result constitutional variance" must allow an insurer the opportunity for a return to the equity owner commensurate with the returns on investments and other enterprises having corresponding risks (a "fair rate of return"). Despite this, the Commissioner has adopted a test for determining whether an insurer is entitled to an end result constitutional variance that does not afford an insurer an opportunity for a return on equity that is

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commensurate with the returns on investments and other enterprises having similar risks.

113. The Commissioner has applied this regulation by only considering the components of the regulatory formula and not the end result separate and independent of the formula.

114. In determining confiscation, the Commissioner has also concluded that "enterprise as a whole" depends on the operations of Mercury Casualty and its affiliates all lines of insurance combined. In other words, business operations of Mercury Casualty and its affiliates that are unrelated to the homeowners line of insurance (the subject of the rate application) can subsidize the homeowners rates and allow the Commissioner to impose a confiscatory rate because Mercury Casualty is not precluded from earning a return on other business activities.

115. Contrary to the Commissioner's Order and contention, an insurance line-by-line analysis is consistent with all other aspects of ratemaking in California. Insurance Code section 1861.05(a) provides the means of determining whether a rate is inadequate or excessive. That analysis has always been done on a line-by line basis. What an insurer profits from a different line, in another state, is not a factor. How profitable an insurer may be nationally or as a result of business activities of affiliated companies are not considered in determining whether a rate for a particular insurance line of business is inadequate or excessive. This is confirmed by 10 C.C.R. § 2643.4(b), which provides that "[r]ate applications … shall be filed on a line-by line basis." Thus, a rate must stand on its own for the line of insurance for which it is being charged.

116. In deciding to write homeowners insurance, the key economic decision for Mercury is whether to commit capital to the homeowners line of insurance in California. That decision will depend on the return on capital an investor could earn on the California homeowners insurance business as compared to other investments of similar risk. Thus, the only relevant inquiry in determining confiscation is the impact of the rate on the line of business under review.

117. Under the regulations, surplus is to be allocated to state and line of insurance and not to all lines or all affiliated companies. Thus, even the regulations require a determination of the reasonableness of the rate by considering the individual line of coverage in the rate application.

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10 C.C.R. § 2642.8 and the Meaning of "Most Actuarially Sound"

118. Section 2642.8 provides:

> The "most actuarially sound" choice is the most appropriate choice within the range of permissible actuarially sound choices, considering both the relative likelihood of all choices within the range and the context in which the choice will be employed.

119. This regulation is impermissibly vague and provides no guidance or direction to allow consistent application to all insurers. There is no one "most actuarially sound" method. In accordance with actuarial principles, an insurer must show that it is using sound and reasonable actuarial methods. To the extent this regulation seeks the "most actuarially sound" choice, it provides no definition or standard by which to determine on a consistent basis or otherwise what is the most actuarially sound choice. It is unclear, vague and ambiguous as to how the Commissioner will determine whether one choice is more actuarially sound than another actuarially sound choice. The vagueness of this subdivision and lack of standards precludes insurers from knowing what criteria will be used for determining what is most actuarially sound.

120. The vagueness of this regulation is compounded by the use of terms "most actuarially sound" throughout the Regulations. For example, under 10 C.C.R. § 2644.7, insurers are to file rate applications "using the single data period that it determines to be "most actuarially sound." Under section 2644.8, an insurer is required to demonstrate that the defense and cost containment expenses it selects is the "most actuarially sound." There are numerous other instances throughout the Regulations of the use the terminology "most actuarially sound" as referred to section 2642.8 and these are just two examples. In the Mercury Rate Proceeding, Mercury's most actuarially sound choices were rejected without any standard or uniform criteria to the detriment of Mercury.

10 C.C.R. § 2644.27 (f)(3) and the 90% Concentration Variance

121. The Commissioner determined that section 2644.27 (f)(3) requires an insurer to write 90% of its direct earned premium in one line or in California and that its mix of business presents investment risks different from the risks that are typical of the line as a whole.

122. This interpretation is arbitrary and capricious. In determining whether a variance is

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warranted, the line of business, not the overall premium of the insurer, should be the relevant yardstick as is reflected by remedy under this variance.

123. Under section 2644.27(f)(3), when an insurer qualifies for this variance, the leverage factor for the line of business under review (e.g. homeowners) is adjusted by multiply it by 0.85. Given that the variance is directed to providing relief in the form of allowing more surplus to support the line of business, it only makes sense that the relevant inquiry is the line of business.

124. The Commissioner has also determined that the meaning of "mix of business" refers to an insurer's mix of investments. This too makes no sense. Rather, concentration of an insurer's line of business in California should be the relevant inquiry. For Mercury, its mix of business of its heavily concentrated homeowners line of business presents risks that are different from the line as a whole. For instance, it is subject to higher capital requirements by A.M. Best due to the high concentration of written premium in California required to achieve the same rating as a more diversified insurer.

125. This variance recognizes the greater risk associated with highly concentrated insurance operations. Under such circumstances it is economically prudent to allocate additional surplus to the activity, in order to stabilize overall returns and reduce the probability of default. For Mercury, based on the distribution of Mercury's homeowners' business, and this understanding of how the leverage factors in the formula were developed, Mercury should be granted the requested variance in this matter had the regulation been properly applied.

126. The Commissioner contends in all respects to the contrary of Mercury's contentions regarding the interpretation, meaning and application of the above-referenced Regulations. The Commissioner disputes that he did not proceed in the manner required by law in interpreting and applying the above-referenced regulations generally or to Mercury Casualty's rate application. The Commissioner contends his interpretation and application of the above-referenced Regulations is consistent with all applicable laws.

127. Mercury Casualty is entitled to a determination of the validity of the Commissioner's Order and the interpretation and application of (1) 10 C.C.R. § 2644.10 (f); (2) 10 C.C.R. § 2644.10(a); (3) 10 C.C.R. § 2644.27 (f)(9); (4) 10 C.C.R. § 2642.8; and (5) 10 C.C.R. §

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2644.27, (f)(3).

128. Mercury Casualty has exhausted all administrative remedies and a declaration is necessary and proper at this time under all circumstances.

THIRD CAUSE OF ACTION

(For Injunctive Relief Enjoining or Staying Enforcement of the Commissioner's Order)

129. Mercury Casualty realleges paragraphs 1 through 128 above and incorporates them herein by reference.

130. If Mercury Casualty is compelled to implement the reduction of its homeowners rates pursuant to the Commissioner's Order, Mercury will be reducing rates for policyholders and receiving premium at the reduced rate notwithstanding the unlawfulness of the Commissioner's Order as alleged herein. Once the rates are wrongfully reduced and coverage afforded to the policyholders, upon the Court's determination in response to this Writ and Complaint that the Commissioner's Order should be vacated and the rate reduction declared a nullity, Mercury Casualty will not be able to recover the additional premium (the amount of the wrongful reduction plus the increase Mercury Casualty is otherwise entitled to) from its policyholders. There is no remedy available to Mercury to recover amounts it will lose by reason of the implementation of the rate reduction before judicial review and the coverage it afforded at an unlawful rate.

131. In contrast to the loss Mercury Casualty will suffer by reason of the premature implementation of the Commissioner's Order, Mercury Casualty can track those policyholders who would be entitled to a rate decrease if the Court determines after judicial review not to vacate the Commissioner's Order. Mercury Casualty can refund amounts to those policyholders and the policyholders will suffer no harm.

132. In addition, on or about January 7, 2013, Mercury Casualty submitted a new Homeowners rate application (CDI File No. 13-716), in which Mercury Casualty is seeking a 6.9% rate increase based upon data through the third quarter of 2012. This is the data Mercury Casualty requested the ALJ and the Commissioner to consider because it shows that the rate decrease set forth in the Commissioner's Order is not supported by the data. What this rate application clearly

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shows is that Mercury Casualty rates should not be decreased. Indeed, Mercury Casualty adopted the ratemaking components set forth in the Commissioner's Order (without waiver of its disagreement with those components) and then added the data through the third quarter 2012. Thus, even under the approach laid out in the Commissioner's Order as applied to the more current data, Mercury is entitled to an increase and not a decrease. This rate application is currently pending before the CDI and the CDI has indicated that it must act on the rate application (the 60 day deemer date will run under Insurance Code section 1861.05(c)) by March 26, 2013.

133. Given the likelihood that the ordered rate decrease will be declared invalid for the reasons set forth in this Writ and Complaint, and Mercury Casualty's ability to take steps to ensure its policyholders will be made whole in the unlikely event Mercury Casualty does not prevail, Mercury Casualty is seeking to preserve the status quo pending judicial review because of the irreparable and substantial harm and injury that will occur to Mercury Casualty as a result of the enforcement of the Commissioner's Order imposing an arbitrary and unlawful rate.

134. Mercury Casualty has no adequate remedy at law.

135. Mercury Casualty seeks a permanent injunction enjoining the Commissioner from enforcing Commissioner's Order.

PRAYER

WHEREFORE, Mercury Casualty prays for judgment as follows:

1. That this Court issue a peremptory writ of mandamus directing and compelling the Commissioner to vacate his February 11, 2013 Order,

2. That this Court issue a peremptory writ of mandamus directing and compelling the Commissioner to grant the rate increase requested by Mercury Casualty,

3. For a declaration regarding the scope and meaning of: (1) 10 C.C.R. § 2644.10(f); (2) 10 C.C.R. § 2644.10(a); (3) 10 C.C.R. § 2644.27(f)(9); (4) 10 C.C.R. § 2642.8; and (5) 10 C.C.R. § 2644.27(f)(3).

4. That this Court enjoin or otherwise stay enforcement of the February 11, 2013 Order until this action is resolved,

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5. Plaintiffs request the recovery of attorneys' fees pursuant to Code of Civil Procedure Insurance Code section 12926.1(d)(2).

6. For such other or further relief as the Court may deem just and proper.

Dated: March 1, 2013

BARGER & WOLEN LLP

By: _____
STEVEN H. WEINSTEIN
MARINA M. KARVELAS
SPENCER Y. KOOK
PETER SINDHUPHAK
Attorneys for Petitioner/Plaintiff Mercury Casualty Company

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VERIFICATION

Steven H. Weinstein declares as follows:

I am an attorney with the law firm of Barger & Wolen licensed to practice in California. I am one of the attorneys at my firm with the primary responsibility for the handling of this action. I have been representing Mercury Casualty Company in connection with the matters alleged in this Petition for Peremptory Writ of Mandate ("Petition"). I have personal knowledge of the matters alleged in the Petition. All Exhibits accompanying and filed in support of this Petition are true and correct copies of documents on file with the Commissioner. If called to testify as a witness, I could and would be able to testify competently as to such matters alleged in the Petition. I am authorized to make this verification on behalf of Mercury Casualty Company.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on March 1, 2013 at Los Angeles, California.

By: _____
Steven H. Weinstein

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