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SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SACRAMENTO

MERCURY CASUALTY COMPANY,

Petitioner and Plaintiff,

v.

DAVE JONES, IN HIS OFFICIAL CAPACITY AS THE INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA,

Respondent and Defendant.

CONSUMER WATCHDOG,

Intervenor.

PERSONAL INSURANCE FEDERATION OF CALIFORNIA, et al.,

Intervenors.

Case No. 34-2013-80001426
Hon. Shellyanne W.L. Chang, Dept. 24

TRADES' REPLY TO CONSUMER WATCHDOG'S OPPOSITION TO PETITION FOR WRIT OF MANDAMUS

Date: May 2, 2014
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I. INTRODUCTION

The Trades respond to Consumer Watchdog's ("CW's") opposition separately, addressing issues therein raised which are different than those raised by the Commissioner. To the extent there is overlap, the Trades will not repeat the response they have made to the Commissioner's opposition.

At the threshold, the Trades underscore that the causes of action sounding in mandate included within the Trades' complaint in intervention *are* before the Court for hearing. The Trades separately noticed a hearing on those causes of action. *See* Notice of Hearing On Petition for Writ of Mandate, filed February 11, 2014. The hearing before the Court is not limited to Mercury's petition for writ of mandate.

Further to the point, the Trades clarify what is put at issue by their causes of action sounding in mandate. The Trades contend that the Commissioner has adopted an incorrect constitutional standard in the Mercury Opinion. Well-settled case law establishes that the power to regulate price is limited by the "fair return principle": the state has a legitimate interest in controlling price so long as the regulated entity is permitted a fair rate of return. The Opinion rejects that standard, and in so doing denies insurers subject to the Proposition 103 rate system the constitutionally-required redress in the event that a proposed rate order would deny the applicant a fair rate of return. The Opinion further adopts other, procedural interpretations that make it impossible for an applicant to prove up a case of confiscation.

The Trades do not seek to overturn *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216 (1994), or to "gut" the current rate regulations, or to preclude the Commissioner from applying a regulatory formula in reviewing rates. To be sure, the Trades do present the case that *20th Century*, in major respects, is confined to rollbacks, providing limited guidance in the prior approval context. What is more, the *20th Century* opinion predates a new distinction between due process limits on government as opposed to "takings" provisions for recompense to entities suffering a taking. The Trades certainly advocate judicial clarification of the principles considered in *20th Century* to the prior approval process, keeping in mind additional

developments in the law. The Trades consider that this would be a welcome development in a rational system of rate regulation, not an overthrow of an existing system.

In short, the Trades seek to have this Court issue its mandate compelling the Commissioner to conform to the constitutional fair return principle in reviewing rates, to allow an adequate mechanism for an applicant to raise constitutional concerns when they are implicated, and, as a part of that mechanism, to allow an applicant to present evidence of the return that would be afforded by the proposed rate order, so that it is possible to evaluate whether the applicant is being permitted the opportunity to earn a fair return on its investment in the regulated business.

The issues CW raises that are different than those identified by the Commissioner, to which the Trades will respond herein, are:

CW argues that the "fair return principle" does not control price regulation. CW is wrong. The "balancing test" identified by CW is part of determining what is a fair rate of return. The case law identifies only a few, limited circumstances in which a facially "fair rate of return" is ultimately not fair, due to the "exploitative" effect on consumers. Those circumstances do not pertain, here.

CW opposes the Trades' position that Variance 9 cannot be singled out for greater procedural obstacles, such as the mandate that an applicant must go to hearing in order to raise Variance 9. CW argues that application of Variance 9 cannot be treated like any other part of rate review, to be considered and resolved in the prehearing review phase of rate review made part of the system by the Commissioner's 2006 intervenor regulations. *See Ass'n of Cal. Ins. Cos. v. Poizner*, 180 Cal. App. 4th 1029, 1040 (2010) (lauding new prehearing review phase as "encourag[ing] consumer representatives and applicants to resolve rate challenges informally so as to avoid engaging in lengthy formal hearings that benefit no one.") (*quoting* Cal. Dept. of Ins., File No. RH06092874, Initial Statement of Reasons (Sept. 22, 2006)). The argument falls flat. There is no greater "behind doors" aspect to resolving a rate application based on Variance 9, than on any other basis. If the streamlined procedure for which CW fought in *Poizner* truly

presents the benefits lauded in that case, that procedure should be open to cases presenting Variance 9 issues.

CW appears to argue that the Trades are limited to petitioning the Commissioner to amend the Variance 9 regulation. That is not an accurate articulation of the law. Affected parties always have access to the courts for relief from agency interpretations on questions of law.

CW also makes an attempt at distinguishing the Trades' cases supporting the long held notion that a financial penalty imposed on speech based on content is a violation of the First Amendment. However, CW disregards the structure compelled by the statute governing insurance rate regulation – Insurance Code § 1861.05(a) – requiring a "total" rather than a "two account" approach, which negates the concept that the excluded expense penalty merely allocates certain expenses to a "shareholder" account. CW, moreover, ignores that as the expense provisions in the formula have evolved, the applicant's expenses are not included in the formula, and the excluded expense penalty cannot act to prevent a "pass through" to consumers of expenses that are not there in the first place.

II. THE "FAIR RETURN PRINCIPLE" GOVERNS THE LIMITS ON THE STATE'S POWER TO REGULATE PRICE. "BALANCING" OCCURS IN THE ANALYSIS OF WHAT CONSTITUTES A FAIR RATE OF RETURN.

CW asserts that the "fair return principle" does not govern the confiscation analysis, without any authority refuting the substantial constitutional jurisprudence to the contrary. CW's error appears to result from a misreading of certain significant case law. Indeed it is the case, as argued by CW, that a "balancing test" figures into the equation. The "balancing test" is used to evaluate what constitutes a "fair rate of return" in a particular case. *See Galland v. City of Clovis*, 24 Cal. 4th 1003, 1021, 1026 (2001) (price regulation must permit a fair rate of return, which is a term of art requiring a return commensurate with returns on investments in other enterprises having corresponding risks subject to balancing against consumers' right to be free from exploitation).

Generally, the investor's or owner's right or interest is represented by a calculation of "cost of capital", an economic concept embodying the elements of financial integrity articulated

in *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). *See 20th Century*, 8 Cal. 4th at 321 ("cost of capital" pertinent to prospective ratemaking under prior approval system, because it measures elements described as representing a "fair return" in *Hope*). The investor's or owner's right or interest in receiving a return at that level must be balanced against the consumer's interest in avoiding "exploitation." *See 20th Century*, 8 Cal. 4th at 293.

The case law identifies two circumstances in which a return to the regulated entity which is fair on its face is actually not fair, as exploitative of consumers. The first occurs where the regulated entity or entities attempt to use price regulation as price support, where it would not be possible for the regulated entity or entities to achieve the proposed profit (or perhaps any profit) were prices not dictated by regulation. This is the situation described in *Market St. Ry. Co. v. R.R. Comm'n of Cal.*, 324 U.S. 548 (1945), discussed in the Trades' Opening Brief at 9-10. It would be "exploitative" of consumers to use price regulation to support a supra-competitive price. In such a case, regulation is not depriving the regulated entity of a calculated "fair rate of return", the entity is not able to achieve a return at that level on its own. In that situation, it would exploit consumers to set a rate fixing a profit at a level not achievable without regulatory intervention.

It is in this context, primarily, that the case law collected in *20th Century* asserts that a regulated entity has no right to a profit at any particular level, and no right as against a loss. *20th Century*, 8 Cal. 4th at 294. The fact of regulation is not protection against economic forces. The constitutional protection is against the deprivation that would occur by an act of the regulator.

The second circumstance identified by case law is where the capital base upon which the rate of return is calculated is the "market" or "fair value" rate base, a "circular" standard comprehending the profits that could be achieved in the absence of regulation. *Fisher v. City of Berkeley*, 37 Cal. 3d 644, 680 n.33 (1984). As the Court in *Fisher* observed, it was this second circumstance that was at issue in *Hope*. *Id.* The actual holding in *Hope* – not discernible from any of the Opinion, the Commissioner's brief, or CW's brief – was that there is no constitutional mandate to calculate the fair rate of return based upon a "fair value" capital base. Thus, *Hope* held that, so long as the returns to the investors/owners of the company met the standards typical

of a fair rate of return and embodied in the "cost of capital" concept, the rate of return met constitutional standards "even though they might produce only a meager return on the so-called 'fair value' rate base." *Hope*, 320 U.S. at 605.[1]

In discussing this second circumstance, CW inserts ellipses after the words "meager return," suggesting that a "meager return" is constitutionally acceptable. It is not. *Hope* held that a *fair* return is constitutionally acceptable even though it might prove "meager" when judged against a "fair value" or "market" capital base.

Neither of these situations involving concerns about exploiting consumers pertain here. Insurers could obtain on the open market the rates for which they apply; they do not seek to use regulation to support rates. Further, the capital base upon which the rate of return is applied is regulated by the Commissioner, and is not a "fair value" rate base.

In this context, there is nothing against which a calculated fair rate of return need be balanced. An insurer would be entitled to a rate of return based on "cost of capital", which incorporates the elements of a fair rate of return.

That is, an insurer-applicant is entitled to a price that permits the opportunity to earn a fair rate of return. As a question of constitutional law, this entitlement must be balanced against factors that would render a return at that level exploitative to consumers. No such factors appear, and CW suggests none.

III. THE FAIR RATE OF RETURN IS EARNED ON THE APPLICANT'S INVESTMENT IN THE REGULATED ENTERPRISE. IN THE PRIOR APPROVAL CONTEXT, THAT IS THE INVESTMENT IN THE LINE OF INSURANCE THAT IS THE SUBJECT OF THE RATE APPLICATION.

CW argues in support of the Opinion's holding that confiscation requires financial distress to the entire, nationwide organization of which the prior approval applicant is a part, by citing and quoting the same passages from *20th Century* cited in the Opinion. These passages are those addressed in the Trades' Opening Brief at 24-25. As explained in the Trades' Opening Brief, in

[1] The U.S. Supreme Court subsequently recognized, in *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989), that the selection of capital base does impact whether the permitted rate allows a fair rate of return and is or is not confiscatory.

20th Century the Court considered an all-lines "rollback", which was calculated and uniformly paid as a percentage to the insurer's entire California business invested in lines of insurance subject to Proposition 103. The Court expressly confined its holding regarding the "enterprise" at issue to "this context". *See* Opening Brief pp. 24-25.

The excerpts from the RH-291 Rulemaking Record submitted by CW support the correct notion that the "enterprise" means the investment upon which the regulated entity is entitled to earn a fair rate of return; that is to say, the investment in the regulated line of insurance. As explained in one of the Commissioner's Responses to Comments contained in "Volume 6" (page 4_000003 of Exhibit 4 to CW's Request for Judicial Notice):

> "Total-rate-of-return methodology" focuses directly on the relationship between pricing and profit and regulates rates on the basis of the ultimate profitability of rates to the insurer, ***where profitability is calculated on the basis of the return on the investment***. As set forth in *Calfarm*, each insurer must be given an opportunity to earn a fair profit. The investment, or equity, must be measured because ***what is or is not deemed to be a "fair profit"*** (i.e., what level of profit the insurer will be entitled to earn), ***will be gauged by the amount of the insurer's equity or investment in the business enterprise***. (emphasis added)

That is to say, the "fair profit" or "fair return" mandated by *Calfarm* (and other constitutional law) is determined by a rate of return ***on the investment in the business enterprise being regulated***. In the case of prior approval insurance rate regulation, that is the investment in the line of insurance that is the subject of the rate application. Indeed, this concept is comprehended in the fair return principle itself. *See, e.g., Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) ("[T]he return to the equity owner should be commensurate with ***returns on investments in other enterprises*** having corresponding risks.") (emphasis added). *See also Kavanau v. Santa Monica Rent Control Bd.*, 16 Cal. 4th 761, 773 (1997) (increases in the capital devoted to the business, in the form of improvements, must be considered because "'fair rate of return' depends on 'the amount of capital upon which the investors are entitled to earn that return.'") *quoting Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989).

IV. THE STATUTORY FRAMEWORK APPLICABLE HERE PROVIDES A GLOSS TO THE CONSTITUTIONAL RULE: HERE, THE APPLICANT MAY CHARGE A RATE WITHIN THE RANGE BOUNDED BY THE "INADEQUATE", AND THE "EXCESSIVE", LIMITING THE REGULATOR'S POWER TO FIX A CEILING LOWER THAN THAT SET BY STATUTE

CW emphasizes a passage from *Galland* describing a "fair rate of return" as "refer[ing] to a constitutional *minimum* within a broad zone of reasonableness." *Galland*, 24 Cal. 4th at 1026. That is the constitutional standard, and that minimum is determined by examining the "cost of capital" that embodies the listing of the *Hope* factors, and the existence if any of factors that would suggest that a return at that level would be "exploitative" of consumers. *See* discussion immediately above. As a matter of constitutional law, it would be difficult to challenge a particular number falling within the range described as "a broad zone of reasonableness".

As a statutory matter, however, *the applicant* is permitted a rate anywhere within the "broad zone of reasonableness" denoted by what it "inadequate" as the floor and what is "excessive" as the ceiling. *See* Ins. Code § 1861.05(a). Within section 1861.05(a), "a confiscatory rate is necessarily an 'inadequate' rate under the statutory language, section 1861.05 requires rates within that range which can be described as fair and reasonable and prohibits approval or maintenance of confiscatory rates." *Calfarm Ins. Co. v. Deukmejian*, 48 Cal. 3d 805, 822-23 (1989) (*see also* n.15); *Compare 20th Century*, 8 Cal. 4th at 286-87 (distinguishing the rollback year from the prior approval system: for the *rollback year*, the Commissioner does not apply the prior approval "excessive"/"inadequate" standard, rather, for the rollback year an "inadequate" rate is a confiscatory rate and an "excessive" rate is a rate above the statutory standard *or* the minimally non-confiscatory rate.)

As an "inadequate" rate is defined by *Calfarm*, The Commissioner cannot compel a confiscatory rate, and any rate below the minimally non-confiscatory rate would be confiscatory. The minimally non-confiscatory rate, then, becomes the floor of adequacy – the Commissioner cannot compel a rate below that floor. The Commissioner, likewise, must allow rates falling anywhere within the "broad zone of reasonableness", because the prior approval system does not limit applicants to the minimally non-confiscatory rate. The Constitution's protection only

extends to the minimally non-confiscatory rate, but the statute allows applicants to charge rates anywhere between that floor, up to the ceiling of the "broad zone of reasonableness".

V. RESOLUTION OF RATE APPLICATIONS INVOLVING VARIANCE 9 IN ACCORDANCE WITH THE ESTABLISHED PRE-HEARING REVIEW PROCESS DOES NOT EQUATE TO A "SECRET DEAL"

At the behest of consumer groups, against the opposition of the industry, the Commissioner established a mechanism for reviewing rate applications – with the participation of consumer groups – without any noticed hearing. *See, e.g.*, *Poizner*, 180 Cal. App. 4th at 1040. The regulations, however, create one single exception to this streamlined process – where Variance 9 is claimed (versus, for example, variances 1 through 8), there MUST be a hearing.

There appears to be no basis for requiring this exception from the much-extolled streamlined rate review process. The basis that appears is to burden applicants wishing to claim Variance 9 by requiring that they undergo a process clearly outside of practicality for all but the most well-financed insurers.

The governing statute requires a hearing only where the applicant seeks a rate change exceeding certain thresholds – 7% for personal lines and 15% for commercial lines – and an intervenor has petitioned for a hearing. Ins. Code § 1861.05(c)(3). There is no statutory authority to write in a new requirement for a hearing, in addition to those created by statute. The Commissioner's decision to do so undermines the constitutionality of the process. *See Calfarm*, 48 Cal. 3d at 824 (holding that the Proposition 103 statutory system avoided the infirmities of the invalid system struck down in *Birkenfeld v. City of Berkeley*, 17 Cal. 3d 129, 169-73 (1976) largely because hearings were not required – and rate applications could be deemed approved – except in very limited circumstances).

CW argues that resolution of rate applications under Variance 9 cannot occur under the accepted process, because that would allow "secret" resolutions. Actually, all resolutions of rate applications appear on the CDI's online viewing room ("Web Access to Rate and Form Filings" or "WARFF"). More to the point, CW's objection simply dodges the issue here: if resolution under the pre-hearing review process is acceptable – and CW advocated for that process – why is

anything different where resolution involves Variance 9? Answer: It isn't. Compelling a hearing is simply a regulatory obstacle to asserting a right.

Pursuant to the statutory scheme, a "hearing" is required only when a rate application seeks a rate change in excess of 7% (personal lines) or 15% (commercial lines). Ins. Code § 1861.05(c). The hearing requirement imposed by Variance 9 is at odds with this statutory mandate. There is no argument – and neither CW nor the Commissioner propose one – for imposing a hearing requirement upon applicants who seek relief under Variance 9. Imposing the hearing requirement upon rate applicants who must resort to Variance 9 does not fulfill any legitimate regulatory objective. The only purpose served is to attempt to discourage resort to Variance 9.

Given the evidence of Mercury's ordeal, and the absence of justification – practical or statutory – for requiring a hearing in every case in which an applicant must resort to Variance 9, that requirement cannot be upheld, under *Birkenfeld v. City of Berkeley.*

VI. THE TRADES ARE ENTITLED TO A JUDICIAL REMEDY

CW argues that the Trades' remedy – in praying that Variance 9 be interpreted according to the constitutional fair return principle – "is to petition for a rulemaking to amend the regulation, not to this court to change the standard articulated therein". CW's Opposition at p. 15, lines 11-13. CW is wrong. While petitioning for a rulemaking to amend the regulation might be an available remedy, the Trades also have the independent right to seek judicial review, because "the standard articulated therein" is controlled by constitutional law. There is always redress to the courts for review of agency interpretations of law.[2]

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[2] *See Bodinson Mfg. Co. v. Cal. Emp't Comm'n*, 17 Cal. 2d 321, 326 (1941) ("[I]t is the duty of this court, when a question of law [i.e. the proper interpretation of a statute] is properly presented [in that case, via a petition for writ of mandate], to state the true meaning of the statute finally and conclusively, even though this requires the overthrow of an earlier erroneous administrative construction."). *See also Cal. School Boards Ass'n v. State Bd. of Educ.,* 186 Cal. App. 4th 1298, 1327 (2010) ("Mandamus may issue . . . to compel an official both to exercise his discretion (if he is required by law to do so) and to exercise it under a proper interpretation of the applicable law.") (citation omitted); *Hayward Area Planning Ass'n, Inc. v. Alameda Cnty. Transp. Auth.*, 72 Cal. App. 4th 95, 103-04 (1999) (pure legal question regarding agency's statutory authority to expend Measure B funds in a certain manner proper for judicial review via petition for

The Opinion presents two views offering judicial review on questions of law. First, the Trades understand Variance 9 to represent the implied "constitutional variance" from *20th Century*, and to therefore incorporate principles of constitutional law. The Trades' complaint under this view is that the Opinion (and, now, the Commissioner's Opposition) fails to correctly interpret constitutional principles, and thus fails to properly interpret and apply Variance 9. Under this view, the correct interpretation of Variance 9 depends upon a correct elucidation of constitutional principles, and the question of law presented for review is the meaning to be given to Variance 9.

Alternatively, CW's statements (quoted above) seem to suggest that Variance 9 must be interpreted independently of constitutional jurisprudence, and the words in Variance 9 mean what the Commissioner says they mean, regardless of constitutional precedent and constitutional requirements. In that event, the Trades contend that the Commissioner's regulatory scheme lacks the key element necessary to make a price control system consistent with constitutional requirements: an adequate means of seeking redress in the eventuality that the price control system precludes a constitutionally valid rate in an individual case. *See Geeslin v. State Farm Lloyds*, 255 S.W.3d 786, 795 (Tex.App. 2008) ("proof provision" in Texas rate regulation scheme unconstitutional on its face because, by its inclusion the rating scheme, that scheme "fail[ed] to provide regulated companies with constitutionally adequate review of government-set rates."); *Guaranty Nat'l Ins. Co. v. Gates*, 916 F.2d 508, 512 (9th Cir. 1990) (rate regulatory statute unconstitutional on its face because it did not provide a mechanism for relief in the event the regulatory scheme did not allow a regulated insurer the required fair rate of return). The questions of law presented for review under this alternative view are whether constitutional principles do indeed set a requirement that a regulated entity be permitted a rate allowing for the opportunity to earn a fair return, and whether an applicant must be allowed the opportunity to

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peremptory writ of mandate and complaint for injunctive relief as "[a]bsent judicial action, respondents have given every indication that they will, in effect, continue to exercise the very power that appellants claim they do not have . . . and [f]ailure to resolve the tendered issue now will only create 'lingering uncertainty.'").

show, by examining a rate of return produced by the proposed rate order, that this standard is not met in a particular case.

In either case, these are questions of law falling within the Court's special competence, and the Trades are entitled to a judicial remedy.

The Trades stress that their petition is not about a specific result for Mercury. The rate order issued to Mercury may or may not have been within the scope of the Commissioner's power to regulate rates. But Mercury thought the rate order confiscatory, and had a right to present its evidence, and to have a correct standard applied on a developed record. The process denied Mercury its rights, by failing to apply the correct fair return standard, and by blocking Mercury's ability to present evidence addressed to that standard.

The Trades seek relief in the form of this Court's mandate, issued to the Commissioner and requiring the Commissioner to apply the correct constitutional standard, and an adequate opportunity to present the evidence relevant to that standard.[3]

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[3] Although not material to determination of the Trades' petition, from an intellectual standpoint, the nature of the Trades' challenge appears to fall in somewhat of a gray area, comprising aspects of both an as-applied challenge and a facial challenge to the regulatory scheme. In certain respects—notably the proper interpretation of Variance 9 to comply with constitutional requirements, the Trades' challenge arguably fits more within in the as-applied rubric. *See, e.g.*, *Cal. Ass'n of Sanitation Agencies v. State Water Resources Control Bd.*, 208 Cal. App. 4th 1438, 1463 n 22 (2010) ("[A]n as-applied challenge lies where the particular application of a regulation . . . is not a reasonable interpretation of the underlying statute . . . ."); *Sturgeon v. Bratton*, 174 Cal. App. 4th 1407, 1418-19 (2009) ("An as-applied challenge may seek (1) relief from a specific application of a facially valid statute or ordinance to an individual or class of individuals who are under allegedly impermissible present restraint or disability as a result of the manner or circumstances in which the statute or ordinance has been applied, or (2) an injunction against future application of the statute or ordinance in the allegedly impermissible manner it is shown to have been applied."); *In re Marriage of Siller*, 187 Cal. App. 3d 36, 50-51 (1986) ("Where *application* of a statute is successfully challenged on constitutional grounds, the usual remedy is an order to officials charged with enforcement of the statute to refrain from its unlawful application; the statute itself remains intact and may be applied in other situations where the constitution is not offended.") (emphasis in original). In contrast, the Trades' challenge to the mandatory hearing requirement for Variance 9 and the First Amendment defect in the institutional advertising regulation are more akin to a facial challenge, in which the law is challenged as unconstitutional on its face as "inevitably pos[ing] a *present* total and fatal conflict with applicable constitutional prohibitions" necessitating invalidation of the statute. *Id.* at 48 (emphasis in original).

VII. THE COMMISSIONER'S REGULATORY PENALTY ON DISFAVORED SPEECH CANNOT BE JUSTIFIED BY RESORT TO THE UTILITY MODEL.

CW asserts that the Commissioner, in crafting 10 C.C.R. section 2644.10:

> "[R]elied on the principles familiar to utility ratemakers, who permit the company to pass through to consumers only those costs that are reasonably incurred for the benefit of consumers. Costs incurred for the benefit of insurer's shareholders and costs imprudently incurred are excluded for ratemaking purpose . . . These statements in the RH-291 Rulemaking record refute the Trades' argument that the treatment of excluded advertising expenses in the public utility setting has no bearing on their treatment under the Prior Approval Regulations.

CW Opp'n at 35-36:18-5 (internal citations omitted). It may well be that the Commissioner intended to follow the utility model, but that model requires two accounts – a "shareholder" account out of which expenses assigned to shareholders would be paid, as well as a "consumer" or "ratepayer" account. The governing statute here eliminates the shareholder account. The investment income typically understood as the income belonging to the owners of the business MUST be considered in the rate. *See* Ins Code § 1861.05(a). Consequently, it is not a neutral act to purport to assign expenses to a "shareholder account" when the revenues for that "account" are included in the rate calculation. Secondarily, the notion of a "shareholder" account in the insurance market context is a true fiction, as the insurance market tends to feature differently structured organizations that do not have "shareholders".

Many insurers – such as mutual insurers – have no shareholders at all. In fact, any company with "mutual" in its name (and even some that do not) have no shareholders because mutual insurers do not have shareholders.[4] Mutual insurers are owned for the benefit of policyholders. *See, e.g.*, Ins. Code § 4010. Therefore, unlike in the public utility market, these insurers that have no shareholders cannot be said to be expending funds on advertising for the benefit of non-existent shareholders.[5]

CW's characterization of the Trades' cases as inapposite depends upon the portrayal of

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[4] E.g. State Farm Mutual Automobile Insurance Company, Nationwide Mutual Insurance Company, Northwestern Mutual, Penn Mutual, Western Mutual Insurance Group, etc.

[5] *See* Trades' Opening Brief at Section V. B.

§ 2644.10(f) as simply a neutral assignment of expenses to a "shareholder" or a "consumer" account. Such an assignment is not "neutral", and does create a penalty, when the expenses for engaging in protected speech are assigned to a fictional secondary account containing no revenues. This financial burden on speech creates a detriment and chills the disfavored speech just as surely as confiscation of income from designated speech.[6] CW argues that "[i]nsurers remain free to spend their money on any type of advertising they wish." CW Opp'n at 40:4-5. This is plainly untrue. Insurers are doubly penalized as all of their money is already included in the rate calculation and then a financial penalty is imposed on them if they choose to speak in a manner that the Commissioner disfavors.

In the case upon which CW relies, *El Paso Elec. Co. v. N.M. Pub. Serv. Comm'n*, 103 N.M. 300 (1985), there were in fact two accounts – a shareholder account and a ratepayer account – so the act of assigning expenses to one versus the other was a neutral act. *See id.* at 304.

Further, in the context of speech, the Commissioner's act of deciding what speech is good for consumers and so should not be penalized versus that which "does not benefit" consumers and is therefore deserving of penalty – is an act in violation of the First Amendment. It may be that in most cases a regulator makes policy decisions unfettered by the courts. But in the context of regulations impacting speech, the wisdom or otherwise of the regulator's policy determinations is beside the point: "At the heart of the First Amendment lies the principle that each person should decide for himself or herself the ideas and beliefs deserving of expression, consideration, and adherence." *Turner Broadcasting Sys., Inc. v. Fed. Commnc's Comm'n*, 512 U.S. 622, 641 (1994). If it is unwise or not beneficial for consumers to prefer advertising that highlights event sponsorship for "worthy" causes, environmental protection efforts, campaigns against cell phone use while driving, sports sponsorship, or simply advertising that entertains, consumers remain entitled to that choice, as are insurers. The Commissioner cannot penalize that choice, even if he has deemed it "not beneficial".

The First Amendment prohibits the Commissioner from distinguishing among advertising

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[6] *See* Trades' Reply to the Commissioner's Opposition at Section VIII. A. and B.

messages – as he does in 10 C.C.R. § 2644.10(f) – and imposing a financial penalty upon advertising whose messages the Commissioner unilaterally decides do not benefit consumers. For this reason, the regulation is facially invalid.

VIII. CONCLUSION

By their petition, the Trades pray that this Court issue its mandate to compel the Commissioner to comply with constitutional and statutory law in interpreting and administering California law governing insurance rate review. Nothing in CW's Opposition prevents such a mandate because the Trades are entitled to a judicial remedy that will check the regulatory power of the Commissioner by imposing judicial oversight over questions of law and requiring that the Commissioner remain within constitutional bounds in wielding the power of the State. For all of the above reasons, this petition should be granted.

Dated: April 17, 2014

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