IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

THIRD APPELLATE DISTRICT

MERCURY CASUALTY COMPANY, Plaintiff and Appellant **v.** **DAVE JONES, as Insurance Commissioner of the State of California,** Defendant and Respondent; **CONSUMER WATCHDOG,** Intervener and Respondent; **PERSONAL INSURANCE FEDERATION OF CALIFORNIA et al.,** Interveners and Appellants.	Case Nos. C077116 & C078667

Appeal from Judgment of Sacramento County Superior Court,
Case No. 34201380001426CUWMGDS (Hon. Shellyanne W.L. Chang, Judge)

RESPONDENT'S BRIEF OF INSURANCE COMMISSIONER DAVE JONES

KAMALA D. HARRIS
Attorney General of California
DIANE S. SHAW
Senior Assistant Attorney General
STEPHEN LEW, State Bar No. 81205
Supervising Deputy Attorney General
300 South Spring Street, Suite 1702
Los Angeles, CA 90013
Telephone: (213) 897-8526
Fax: (213) 897-5775
E-mail: Stephen.Lew@doj.ca.gov

Attorneys for Defendant and Respondent Dave Jones, in his Official Capacity as the Insurance Commissioner of the State of California

TO BE FILED IN THE COURT OF APPEAL

APP-008

COURT OF APPEAL, THIRD APPELLATE DISTRICT, DIVISION	Court of Appeal Case Number: C077116 & C078667
ATTORNEY OR PARTY WITHOUT ATTORNEY *(Name, State Bar number, and address):* KAMALA D. HARRIS, Attorney General of California — STEPHEN LEW, Supervising Deputy Attorney General, State Bar No. 81205 300 S. Spring Street, Suite 1702 Los Angeles, CA 90013 TELEPHONE NO.: (213) 897-8526 FAX NO. *(Optional):* (213) 897-5775 E-MAIL ADDRESS *(Optional):* stephen.lew@doj.ca.gov ATTORNEY FOR *(Name):* Respondent Daves Joens, Insurance Commissioner	Superior Court Case Number: 34201300001426CUWMGGDS
APPELLANT/PETITIONER: MERCURY CASUALTY COMPANY RESPONDENT/REAL PARTY IN INTEREST: DAVE JONES, Ins. Commissioner	*FOR COURT USE ONLY*
CERTIFICATE OF INTERESTED ENTITIES OR PERSONS *(Check one):* ☑ INITIAL CERTIFICATE ☐ SUPPLEMENTAL CERTIFICATE	

Notice: Please read rules 8.208 and 8.488 before completing this form. You may use this form for the initial certificate in an appeal when you file your brief or a prebriefing motion, application, or opposition to such a motion or application in the Court of Appeal, and when you file a petition for an extraordinary writ. You may also use this form as a supplemental certificate when you learn of changed or additional information that must be disclosed.

1. This form is being submitted on behalf of the following party (*name*): Respondent Dave Jones, Insurance Commissioner

2. a. ☑ There are no interested entities or persons that must be listed in this certificate under rule 8.208.
   b. ☐ Interested entities or persons required to be listed under rule 8.208 are as follows:

	Full name of interested entity or person	Nature of interest *(Explain):*
(1)		
(2)		
(3)		
(4)		
(5)		

☐ Continued on attachment 2.

The undersigned certifies that the above-listed persons or entities (corporations, partnerships, firms, or any other association, but not including government entities or their agencies) have either (1) an ownership interest of 10 percent or more in the party if it is an entity; or (2) a financial or other interest in the outcome of the proceeding that the justices should consider in determining whether to disqualify themselves, as defined in rule 8.208(e)(2).

Date: April 4, 2016

STEPHEN LEW
(TYPE OR PRINT NAME)

▶ Stephen Lew
(SIGNATURE OF PARTY OR ATTORNEY)

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

INTRODUCTION

In 2009, appellant Mercury Casualty Company ("Mercury") filed a 180-page application seeking a rate increase for its homeowners' line of business (the "Application"). The Department of Insurance (the "Department") reviewed the Application and ascertained that Mercury's rates were already too high and that California law required a rate decrease.

Over the next two years, Mercury submitted updated data – the equivalent of a new rate application – at least twice. Each time, the Department determined a rate decrease was required. In February 2013, after the administrative hearing, respondent Insurance Commissioner Dave Jones (the "Commissioner") issued a final decision ordering Mercury to reduce its homeowners' rates by 5.4% (the "Rate Order"). Mercury implemented the rate decrease in May 2013.

In November 2013, based on a January, 2013 rate application and new data, the Commissioner approved an 8.7% rate increase for Mercury's homeowners line, more than erasing the 5.4% rate decrease in this case. In short, Mercury overcharged its policyholders for more than three years, [1] and now appeals the 5.4% rate decrease that was in effect for less than one year before Mercury stipulated to, and the Commissioner ordered, an 8.7% rate increase.

[1] Mercury overcharged its homeowners insureds from 2009, when Mercury filed its rate application, until 2013 when the 5.4% rate decrease went into effect.

Mercury and the intervener trade organizations (the "Trades") have challenged the Rate Order on two grounds. First, Mercury and the Trades contend the Commissioner erred by following the deep financial hardship test set forth in *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216 ("*20th Century*") to determine if the rate generated by the regulatory formula was "confiscatory" as applied. *20th Century*, however, is controlling precedent. While there is no dispute that an insurer is entitled to a rate that, over time, allows the insurer the opportunity to earn a fair return, Mercury and the Trades fail to acknowledge that the opportunity to earn a fair rate of return is built into the Commissioner's ratemaking regulations. (See *20th Century*, *supra*, 8 Cal.4th at pp. 250-251.)

Under relevant United States and California Supreme Court precedents, the first step to obtaining relief from a formula-generated rate requires the insurer to demonstrate that the end result of the rate order is confiscatory. As discussed below, this step requires a showing that the rate order causes or will cause deep financial hardship to the enterprise as a whole. In other words, the insurer must show that under the rate order the it would be unable to operate successfully. This burden can be met neither by relitigating the regulatory formula nor by substituting one or more components of the regulations with insurer-specific components such as a different "rate of return." Instead, deep financial hardship requires a showing, for example, of indicators of financial condition or financial hardship such as inability to pay dividends, to maintain financial integrity, to attract capital, and to compensate its investors for risks assumed. Since Mercury has not even attempted to make such a showing in this case, Mercury failed to carry its burden to show confiscation, and the trial court therefore correctly affirmed the Commissioner's Rate Order.

Second, Mercury and the Trades argue that the Rate Order was invalid because the Commissioner misinterpreted his own regulation relating to institutional advertising, and should have included Mercury's advertising expenses in the determination of Mercury's rates unless that advertising *both* was not aimed at obtaining business for a specific insurer, *and* did not provide consumers information pertinent to the decision of whether to purchase the insurer's product. That argument was properly rejected. It ignores Proposition 103's ratemaking goals that require that insurance rates charged in California should be based on "risks or on operations in this state" and that California consumers should not be required to fund nationwide advertising campaigns by their insurers.

In any event, the Department found that Mercury's advertising in fact satisfied both institutional advertising criteria, and thus even under appellants' construction, the advertising expenses were properly excluded.

The Trades, but not Mercury, further argue that the institutional advertising regulation implicates First Amendment free speech. The regulation, however, is content-neutral and neither controls nor compels specific content. The trial court thus correctly determined this argument was groundless.

The judgment should be affirmed.

PROPOSITION 103 BACKGROUND

On November 8, 1988, California voters enacted Proposition 103, fundamentally altering how property-casualty premium rates are regulated in California. Before Proposition 103, insurers were free to set their rates in a competitive market. Among other things, Proposition 103 instituted a one-year rate "rollback" and a permanent "prior approval" system of rate regulation. (See *20th Century*, *supra*, 8 Cal.4th at pp. 239-240.)

Rollbacks. Proposition 103 required insurers to immediately roll back their rates 20% below their 1987 levels for one year. (§ 1861.01, subd. (d).)[2] Insurers could only obtain relief from the rollback if they could show they were "substantially threatened with insolvency." (§ 1861.01, subd. (b) [the "insolvency standard"].)

Prior Approval. Proposition 103 also implemented a permanent rate-review system requiring insurers to file applications and obtain the Commissioner's approval before changing any rate. (§ 1861.05.) The Commissioner must approve any request for a rate change that falls within the range of "excessive" and "inadequate" (the "prior approval" or

[2] Statutory references are to the Insurance Code unless otherwise indicated.

"excessive-inadequate" standard):

> No rate shall be approved or remain in effect which is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter. …

(§ 1861.05, subd. (a); see *20th Century*, *supra*, 8 Cal.4th at p. 254.)

Calfarm. The insurance industry immediately challenged Proposition 103 facially on constitutional grounds. (*Calfarm Ins. Co. v. Garamendi* 4(1989) 48 Cal.3d 805, 812 ["*Calfarm*"].) *Calfarm* struck the insolvency standard because it did not provide sufficient protection for insurers from confiscatory rates, and could not "conform to the constitutional standard of a fair and reasonable return." (*Id.* at p. 818.) But except for the insolvency standard, *Calfarm* largely upheld the initiative – including the 20% rollback and the excessive-inadequate standard for prior approval.

Calfarm observed that the prior approval excessive-inadequate standard would fill the void left by the stricken insolvency standard and protect insurers in case the 20% rollback would otherwise result in confiscation.

> As stated above, we have concluded that the [prior approval] standards set by 1861.05, subdivision (a) govern rate regulation during the first year of the initiative's operation.

(*Id*. at p. 815.) The Court later stated:

> Since a confiscatory rate is necessarily an

> "inadequate" rate under the statutory language, section 1861.05 requires rates within that [excessive-inadequate] range which can be described as fair and reasonable and prohibits approval or maintenance of confiscatory rates.

(*Id.* at pp. 822-823.)

In other words, *Calfarm* held the prior approval excessive-inadequate standard provided the required protection against confiscation in both the rollback and prior approval contexts. This holding should lay to rest the concerns Mercury and the Trades have expressed here about whether *20th Century*'s discussion regarding confiscation in the context of Proposition 103 rate regulation applies in this case. In fact, *20th Century* subsequently referred to the "inadequate" end of the excessive-inadequate range as the "minim[um] nonconfiscatory" rate for determining the "constitutional percentage" for rollbacks. (8 Cal.4th at p. 254.)

The Rate Regulations. After *Calfarm* upheld most of Proposition 103, including the prior approval standard, the Commissioner adopted regulations to implement the initiative, including the prior approval standard. (Regs. 2641.1 to 2647.1.)[3] The regulations set forth comprehensive formulas for the range of reasonable rates for prior approval purposes. The range is bounded by "excessive" rates at the top of the range and "inadequate" rates at the bottom. (Regs. 2642.1 to 2642.3.) A few of

[3] References to Regulations are to sections of title 10 of the California Code of Regulations. (See also, *20th Century* at 248-249.)

the regulations were limited to rollbacks. (Regs. 2645.1 to 2645.9).

Both appellants argue that *20th Century* is irrelevant, or at least not controlling in this prior approval case. Apparently trying to bolster this argument, the Trades (but not Mercury) imply, incorrectly, that the prior approval regulations were adopted in 2007 – 13 years after *20th Century*. (Trades Br. pp. 23-24; see also Mercury Br. p. 18.)[4] In fact, the prior approval regulations were in place before *2th Century.* As explained in greater detail in Section III. D., below, *20th Century* discussed the prior approval regulations extensively in 1994 and found they provided insurers with adequate constitutional protection. (8 Cal.4th at pp. 248-255.)

20th Century. In his first rollback order after a hearing under the regulations, then Commissioner John Garamendi ordered 20th Century Insurance Company to refund 12.2% instead of the statutory 20% rollback. As intended by *Calfarm*, the 12.2% rollback was calculated under the prior approval standard. This “constitutional percentage” was the bottom or “inadequate” end of the prior approval range of reasonable rates for 20th Century’s rollback year.

20th Century filed a writ of mandate challenging the 12.2% rollback order. The vast majority of the California property and casualty insurance industry joined, raising the same or similar issues as they raise in this case.

[4] The regulations were amended in 2007 but fundamentally the model for regulating insurance rates was unchanged.

The trial court ruled almost across the board in favor of the industry. A unanimous California Supreme Court reversed, holding, among other things, that:

● The trial court erred in overturning the administrative law judge's holding that confiscation requires deep financial hardship. "It is rather the superior court that erred. . . . Confiscation does indeed so require, at least in the general case, such as this." (8 Cal.4th at p. 324; see also *id*. at pp. 288 & 325.)

● The trial court erred in failing to balance investor and consumer interests and "in mistaking what is an interest that [the insurer] may pursue for a right that it can demand." (*Id*. at p. 326.)

● An "individualized" hearing outside of the regulations was not required to determine the firm's rollback liability. (*Id*. at p. 324.)

● The rate of return allowed for in the regulations was valid. (*Id*. at p. 320.)

● The trial court erred in determining that the so-called relitigation bar regulation prevented proof of confiscation. (*Id*. at p. 311.)

● Although a firm has an interest in its cost of capital, "it has no right." (*Id*. at p. 320; compare Mercury Br. at pp. 44-46 [alleging that confiscation analysis must include the insurer's actual cost of capital].)

Mercury's and the Trades' goals here are the same as they were in *20th Century*: to eliminate meaningful formulaic insurance-rate regulation in California. The industry argues for opening up the regulatory process to give every insurer an individualized hearing on its rate of return on request -- in addition to the hearing that is currently available to insurers under the regulations. If the industry were to succeed, the Commissioner would have to provide a hearing to every insurer that *claimed* confiscation to determine a unique rate of return under whatever formula the insurer wishes to use. Such a result would threaten to create an unmanageable and ad hoc regulation process. This is precisely what *20th Century* sought to avoid. (8 Cal.4th at p. 286.)

PROCEDURAL HISTORY

On March 1, 2013, Mercury filed its writ petition and complaint for declaratory and injunctive relief seeking to overturn the Rate Order. (1:JA000033-000217.)[5] Consumer Watchdog was granted leave to intervene. (2:JA000617-000625.) On May 7, 2013, the trial court denied Mercury's ex parte application for a stay of the Rate Order, holding that it would not be in the public interest to do so. (See 11:JA002827.)

---

[5] References to "JA" are to appellants' Joint Appendix preceded by the volume number.

Subsequently, the Trades were granted leave to intervene (5:JA000973-000980) and filed their petition and complaint in intervention (5:JA000985-001005).

On May 2, 2014, the trial court heard Mercury's and the Trades' writ claims on the confiscation and institutional advertising issues. On June 11, 2014, the trial court, in a 20-page Ruling, denied the writ claims and dismissed all of Mercury's declaratory relief claims. (11:JA002825-002845.) The trial court held, among other things, the Commissioner properly determined that Mercury must first demonstrate evidence of confiscation before entertaining whether to grant Mercury a confiscation variance (11:JA002834-002835); that the Commissioner applied the correct standard for confiscation (11:JA002835-002838); and that the Commissioner properly excluded Mercury's advertising expenses from the ratemaking calculation (11:JA002840-002843). Mercury filed its Notice of Appeal on August 7, 2014, from the June 11, 2014 Ruling (Case No. CO77116). (11:JA002881-002908.)

On January 9, 2015, the trial court, among other things, heard the Trades' claim that the institutional advertising regulation was unconstitutional on First Amendment free speech grounds. On January 16, 2015, the trial court, in an 8-page ruling, denied the free speech claim and denied the Trades' declaratory relief claims. (12:JA003224-003233.)

On February 5, 2015, the trial entered its Order denying the appellants’ writ claims and dismissing their declaratory and/or injunctive relief claims (12:JA003255-003294) and its judgment in favor of the Commissioner and Consumer Watchdog on Mercury’s and the Trades’ writ petitions and declaratory relief complaints (12:JA003295-003334).

On February 24, 2015, Mercury filed its Notice of Appeal from the judgment (Case No. C078667). (12:JA003255-003294.) On March 24, 2015, the Trades filed their Notice of Appeal from the judgment. (12:JA003427-003432.) On May 19, 2015, the Court, upon stipulation of the parties, entered its Order consolidating case numbers C077116 and C078667 for all further appellate procedures.

STANDARD OF REVIEW

The Commissioner agrees with appellants that questions of law are reviewed *de novo*. Further, however, inasmuch as Mercury sought review of the Commissioner’s Rate Order pursuant to Code of Civil Procedure section 1094.5, Mercury was required to show that the Commissioner abused his discretion. As the trial court noted, ‘“Abuse of discretion is established if the respondent 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.’” (11:JA002831, citing Code Civ. Proc., § 1094.5, subd. (b).)

And, as the trial court (11:JA002831) as well as Mercury (Mercury Br. p. 30) recognized, section 1858.6. requires a court to apply its independent judgment in reviewing the Rate Order and provides, in part:

> Any finding, determination, rule, ruling or order made by the commissioner ... shall be subject to review by the courts of the State and proceedings on review shall be in accordance with the provisions of the Code of Civil Procedure .... [T]he 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.

(§ 1858.6.) However, '"[t]he independent judgment standard requires the trial court to accord a strong presumption of correctness to the Commissioner's findings, and the burden of proof rests on the party challenging those findings, but ultimately the trial court is free to reweigh the evidence and substitute its own findings.'" (11:JA002831, quoting *from State Farm Mut. Auto. Ins. Co. v. Quackenbush* (1999) 77 Cal.App.4th 65, 71.)

As the California Supreme Court recently stated, "we give great weight to interpretations like these, rendered in an official adjudicatory proceeding by an administrative body with considerable expertise interpreting and implementing a particular statutory scheme." (*Larkin v. Workers' Comp. Appeals Bd*. (2015) 62 Cal.4th 152, 158; see also *Calderon v. Anderson* (1996) 45 Cal.App.4th 607, 613, citing *Ralphs Grocery Co. v. Reimel* (1968) 69 Cal.2d 172, 176, 179-180 [Commissioner's interpretation of his own regulation is entitled to great weight and deference]; *State Farm Mut. Ins. Co. v. Quackenbush*, *supra*, 77 Cal App 4th at p. 71 [Department's interpretation of its own regulation "deserves substantial weight"].) "[A] court may not substitute its independent judgment for that of the administrative agency on the facts or on the policy considerations involved." (*Credit Ins. Gen. Agents Assn. v. Payne* (1976) 16 Cal.3d 651, 657.) Thus, an agency interpretation that is "not plainly at odds with the statutory scheme" deserves "great weight." (*Larkin v. Workers' Comp. Appeals Bd.*, *supra*, 62 Cal.4th at p. 158.)

ARGUMENT

I. MERCURY HAS THE BURDEN OF PROOF.

In a rate proceeding, the applicant (here, Mercury) has the burden of demonstrating by a preponderance of the evidence that the rate applied for is not excessive, inadequate, or unfairly discriminatory, or otherwise in violation of Chapter 9 of Part 2 of Division 1 of the Insurance Code (dealing with rates and rating organizations). (Reg. 2646.5.)

Rate orders are presumed valid, and to upset a rate order requires a convincing showing that it is unjust and unreasonable in its consequences.

> A presumption of validity therefore attaches to each exercise of the Commission's expertise, and those who would overturn the Commission's judgment undertake "the **heavy burden** of making a **convincing showing** that it is invalid because it is unjust and unreasonable in its consequences."

(*In re Permian Basin Area Rate Cases* (1968) 390 U.S. 747, 767 ["*Permian*

Basin"], bold added.)

II. THE REGULATIONS PRODUCE CONSTITUTIONALLY SOUND RATES.

A. The Regulations Provide Constitutional Protections for Insurers, Including A Fair Rate of Return.

Both appellants argue repeatedly they are entitled to the opportunity to earn a fair rate of return on each individual line of insurance and the Commissioner must provide it to them in response to each of the hundreds of rate applications he reviews annually. As explained below, the regulations are designed to give the insurer a fair rate of return in response to every rate application. The Trades also incorrectly claim that under the Constitution they are entitled on every rate order to a return that is commensurate with returns the insurer would earn in an industry with comparable risks. (See Trades Br. p 45; see also Mercury Br. pp 44-45.)

While *20th Century* does state that "[t]he firm *may* experience such hardship when it does not earn enough revenue" (8 Cal.4th at p. 296, italics added), it did not go on to indicate that under the Constitution every rate order "must" provide returns commensurate with returns achievable in comparably risky enterprises. Rather the U.S. and California Supreme Courts state that to determine fair and reasonable rates requires a balancing of business and consumer interests.

> The answer to the question whether the rate set is just and reasonable depends on a balancing of the interests of the producers of the goods or services

> under regulation and the interests of the consumers of such goods or services.

(*Id*. at p. 294; see also *Federal Power Commn. v. Hope Natural Gas Co.* (1944) 320 U.S. 591, 603 [“*Hope*”].)

Further, *Calfarm* states that insurers are entitled to the opportunity to earn a fair return *over the long term*. (48 Cal.3d at p. 821.) This proposition is not in dispute.

The Commissioner’s regulations are designed to give insurers a “fair return” in a manner that both Mercury and the Trades advocate. The regulations define “fair return” as follows:

> A fair return is the profit an investor can reasonably expect to earn from an investment in a business other than insurance subject to regulation under this subchapter presenting investment risks comparable to the risks presented by insurance subject to this subchapter.

(Reg. 2642.2.)

The regulations also define the range of reasonable rates that give an insurer a fair return. “Excessive” rates are rates expected to yield more than a fair return. (Reg. 2642.1.) “Inadequate” rates are expected to yield less than a fair return. (Reg. 2642.2.) Insurers can charge any rate between excessive and inadequate under the regulations. (Reg. 2644.1.)

In other words, the regulations are designed to give every insurer a “fair return” exactly as appellants define it in response to every rate application. Insurers that still believe the maximum rate under the regulations is unconstitutional in the particulars of the insurer's situation may challenge that rate.

As explained in Section III, below, the test for whether a particular rate order is confiscatory is whether the rate order will cause deep financial hardship to the enterprise as a whole, demonstrated by inability to operate successfully.

Accordingly, the test for whether a particular rate order is confiscatory is not whether the rate order achieves a "fair rate of return" or "fair and reasonable rates." But even if the test for confiscation were fair rate of return, it would require a balancing test between the interests of the insurer and of consumers (*20th Century*, *supra*, 8 Cal.4th at p. 253) which neither Mercury nor the Trades acknowledge as being required to determine fair and reasonable rates.

The regulations also provide nine variances to the rate formula determination to accommodate the unique circumstances of individual insurers. *20th Century* found the regulations constitutionally sound when only three of the current nine variances were available.

> [T]he three applicable variances should not be considered, as it were, each in isolation, but rather together within their full context. … Because [the ratemaking formula] has "safety" built-in, it does not appear to need "safety valves" different from those provided by the variances. ...

> In view of the foregoing, the variances must be deemed sufficient for rate adjustments necessary to avoid confiscation.

(8 Cal.4th at pp. 255, 313.)[6]

The following summarizes the constitutional protections that the regulations provide to insurers. The regulations:

- use a definition of fair return that is what Mercury and the Trades have argued for.

- allow insurers to charge rates at the top of the range of reasonable rates. In *20th Century*, the "minimum non-confiscatory rate" for rollbacks was defined as the bottom of the range of reasonable rates under the prior approval regulations, and the 20% rollback was not determined to be confiscatory unless it was below the bottom of the range. Mercury is arguing here that the top of the range of reasonable rates is confiscatory as to it.

- allow insurers to file rate applications as frequently as they want. No rate is necessarily in effect for any particular period. In this case, Mercury's rate was in effect for approximately six months when the Commissioner ordered a subsequent rate increase for Mercury that Mercury stipulated to.

---

[6] The three variances were described by *20th Century* as the "one-line" variance, the "entering-the-market" variance, and the "insurer insolvency" variance. (8 Cal.4th at p. 255.) These variances, as has been modified, are currently codified as Regulation 2644.27, subdivisions (f)(3), (4) & (6).

- provide nine variances. *20th Century* found that only three variances were sufficient to protect against confiscation. (8 Cal.4th at p. 313.)

20th Century upheld the regulations against a due process attack, and held that the regulations are "demonstrably relevant to the policy of protection of consumer welfare." (8 Cal.4th at p. 297.) But at the same time, "[**n]either can the ratemaking formula be deemed confiscatory**. Its terms do not themselves preclude the setting of a rate that is just and reasonable." (*Ibid.*, bold added.)

B. The Rate Regulations Are Permissibly Formulaic in Order to Make the Task of Managing Prior Approval Rate Applications Manageable.

Proposition 103 requires the Commissioner to review every property and casualty rate application every insurer files in California. To make the task manageable, the courts have acknowledged that formulaic ratemaking is necessary even though it may not achieve a perfect individually tailored result in every case.

> [The method of rate setting] may implicate formulaic ratemaking . . . using data reflecting the condition and performance of a group of regulated firms . . . . It is not subject to piecemeal examination: "The economic judgments required in rate proceedings are often hopelessly complex and do not admit of a single correct result. The Constitution is not designed to arbitrate these economic niceties." . . . And, of course, courts are not equipped to carry out such a task. . . . "[S]o long as rates as a whole afford [the regulated firm]

> just compensation for [its] over-all services to the public," they are not confiscatory. . . . That a particular rate may not cover the cost of a particular good or service does not work confiscation in and of itself. . . . .

(*20th Century, supra*, 8 Cal.4th at p. 293, citations omitted.)

Formulaic ratemaking is the preferred mechanism for determining insurance company rates. "One of the purposes of Proposition 103 is 'to protect consumers from arbitrary insurance rates.' Formulaic ratemaking furthers that goal. Case-by-case ratemaking does the opposite." (*Id.* at pp. 285-286, citations omitted.)

III. THE COMMISSIONER APPLIED THE CORRECT STANDARD FOR CONFISCATION IN THE RATE ORDER.

Mercury claimed the Rate Order was confiscatory under the U.S and California Constitutions and sought a variance from the maximum rate under the ratemaking formula pursuant to Regulation 2644.27, subdivision (f)(9) ("Variance 9"). The Commissioner concluded that Mercury failed to demonstrate confiscation and denied the variance. (Proposed Decision at pp. 109-126 [1:JA000185-000202].) The trial court agreed with the Commissioner. (11:JA002835-002857.)

Variance 9, also known as the "confiscation" or "constitutional" variance, provides:

> That the maximum permitted earned premium would be confiscatory as applied. This is the constitutionally mandated variance articulated in *20th Century v. Garamendi* (1994) 8 Cal.4th 216 which is an end result

> test applied to the enterprise as a whole. Use of this variance requires a hearing pursuant to 2646.4.

(Reg. 2644.27, subd. (f)(9); see *Permian Basin, supra*, 390 U.S. at p. 767 ["if the 'total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.'"].)

A. *20th Centu*ry Sets Forth the Applicable Standard for Confiscation Which Requires Mercury to Show Deep Financial Hardship.

To show the Rate Order -- which was designed to give Mercury a fair return on its homeowners line of business (Reg. 2642.2) -- was confiscatory, Mercury must show the "end result" of the Rate Order was "deep financial hardship" to the "enterprise" as a whole and "not on a line-by-line basis." (*20th Century*, *supra*, 8 Cal.4th at pp. 258, 298.) While Mercury and the Trades both acknowledge that *20th Century* repeatedly used the words "deep financial hardship," they reject the deep financial hardship standard and urge a "fair rate of return" standard for confiscation. Under appellants' "fair rate of return" standard, any rate order could be challenged on the ground that the order does not produce a fair rate of return and, if the insurer is able to prove as much, the rate order would be deemed unconstitutional. The appellants' view is not supported by either U.S. or California Supreme Court precedents.

A rate order is confiscatory if, viewed in its *entirety*, its terms are *unjust and unreasonable*. (*20th Century*, *supra*, 8 Cal.4th at pp. 292, 317-

318, citing *Hope*, *supra*, 320 U.S. at p. 601, and *Duquesne Light Co. v. Barasch* (1989) 488 U.S. 299, 307-308 ["*Duquesne*"].)

20th Century upheld the ratemaking formula under both a due process and a takings analysis:

> Neither can the ratemaking formula be deemed confiscatory. Its terms do not themselves preclude the setting of a rate that is just and reasonable. Put differently, they do not themselves impose a rate, to quote *Jersey Central* [*Power & Light Co. v. Federal Energy Regulatory Commn.* (D.C. Cir. 1987) 810 F.2d 1168 ("*Jersey Central*")], that inflicts on insurers "the sort of deep financial hardship described in *Hope* ...."

(8 Cal.4th at p. 297, citation omitted.) The Supreme Court elaborated on the deep financial hardship concept:

> **This point is crucial. It deserves special emphasis.** The superior court committed fundamental error. At least in the general case, such as this, confiscation does indeed require "deep financial hardship" within the meaning of *Jersey Central*, i.e., the inability of the regulated firm to operate successfully - meaning, again, the inability of the regulated firm to operate successfully *during the period of the rate and subject to then-existing market conditions*.

(*Ibid*., italics by the Court; bold added.) To find the Rate Order was confiscatory absent deep financial hardship or inability to operate successfully would also be "fundamental error."

As *20th Century* explained:

> "Rates which enable the company to operate successfully, to maintain its financial integrity, to

> attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return ....” [citations omitted] More simply, “a company [cannot] complain if the return which was allowed made it possible for the company to operate successfully.” [citation omitted].

(8 Cal.4th at p. 319, citing *Hope*, *supra*, 320 U.S. at p. 605 and *Duquesne*, *supra*, 488 U.S. at p. 310.)

The concept that confiscation can be judged based only on rate of return is not as simple and straightforward as it might seem. As *20th Century* observed, “any given rate of return can operate to generate a rate that is much too high or much too low.” (8 Cal.4th at p. 291.) “It is really rather obvious from the record herein that all models can be manipulated/applied to produce a great range of rates of return.” (*Id*. at p. 304.) Accordingly, in determining confiscation, what matters is the “total effect” and the “consequences” of the rate order:

> “It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry ... is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.” [citation omitted.]
>
> And in determining whether the 20th Century rate rollback order is unjust and unreasonable in its consequences and therefore confiscatory, the superior court should of course have focused *on its consequences*.

(8 Cal.4th at p. 326, citing *Hope*, *supra*, 320 U.S. at p. 602; italics by the Court.)

Thus, to determine whether the Rate Order is confiscatory, the Court must look to the consequences of the Rate Order. Since Mercury failed to produce any evidence regarding the end-result consequences of the Rate Order, the Court must reject Mercury's confiscation claim.

B. The Deep Financial Hardship Test Is to Be Applied to the Enterprise as a Whole.

Having chosen to ignore the deep financial hardship standard for confiscation set forth in *20th Century,* Mercury and the Trades compound their error by arguing that "enterprise as whole" should mean only Mercury's homeowners line in isolation from the rest of Mercury's business. (See Mercury Br. pp. 11, 42, 52, 53-57; Trades Br. pp. 48-50) But *20th Century* squarely rejected this argument:

> [C]onfiscation is judged with an eye toward the regulated firm as an enterprise. In this context, it depends on the condition of the insurer as a whole -- and not on the fortunes of any one or more of its lines.

(8 Cal.4th at pp. 308-309 & 322; see also *id* at pp. 258 ["it 'is an enterprise-wide issue, not one to be parsed on a line-by-line basis'"], 293 [discussing cases and concluding that "confiscation is judged with an eye toward the regulated firm as an enterprise"], 309, fn. 23 ["it does not mean that confiscation is judged other than with an eye toward the insurer as a

whole”].)

Appellants argue that the standard of deep financial hardship to the enterprise as a whole would lead to a number of alarming results, ranging from resurrection of the insolvency standard” struck down by *Calfarm* (Mercury Br. pp. 49-51, Trades Br. p 52) to the specter of “structural financial distress”. (Trades Br. pp. 30, 34.) For example, the Trades allege:

> This standard [deep financial hardship to the enterprise as a whole] allows the Commissioner authority to make rate orders deeply submerged beneath the break-even point for the insurance under examination, for “safely solvent” multistate insurers with significant revenues from other states and other lines.

(Trades Br. p 49.)

None of these things has occurred in this case or during the many years the regulations have been in force. Here, the Commissioner did not make a rate order “deeply submerged beneath the break-even point.” To the contrary, the Rate Order contemplated Mercury would earn a profit. The Trades’ concerns about “authority” the Commissioner did not exercise in this case are irrelevant speculation. Such speculation cannot be the basis for an as-applied challenge to the Rate Order or the regulations.

Mercury and the Trades also argue that confiscation should not be judged on a line-by-line basis because rates are regulated by line. (Mercury Br. pp. 55-56, Trades Br pp. 50-51.) Again, *20th Century* disposes of this argument. (See, e.g., 8 Cal.4th at p. 322 [confiscation "depends on the condition of the enterprise as a whole – and not on the fortunes of any one or more of its lines"]; see also *id*. at p. 297 [deep financial hardship means "the inability of the regulated firm to operate successfully"].)[7]

In support of its argument that confiscation should be judged on its homeowners line in isolation, Mercury contends that *Permian Basin* "determined that constitutional concerns are properly assessed by examining the profitability of each regulated well" and "did not require an examination of the impact of the rate order on of the totality of the natural gas company's operations." (Mercury Br. pp. 56-57.) But Mercury mischaracterizes that case. *Permian Basin*, like *20th Century*, analyzed whether the rate order would maintain the *producer's* – not an individual well's -- financial integrity. (*Permian Basin*, *supra*, 390 U.S. at pp. 792,

---

[7] *20th Century* also clarified its statements in *Calfarm* on the enterprise as a whole question:

> In *Calfarm*, we recognized that a court might subsequently be presented with a claim that Proposition 103's maximum rate for the rollback year "is confiscatory as to a particular insurer *and line of insurance*." [citation omitted] Our recognition was factual: it concerns the nature of the complaint that an insurer might make. It was not normative: it does not mean that confiscation is judged other than with an eye toward the insurer as a whole.

(8 Cal.4th at p. 309 fn. 23, italics by the Court.)

808.)

C. Mercury Failed to Demonstrate Deep Financial Hardship.

Mercury maintains that Variance 9 allows an insurer to "go outside of the formula." (See Mercury Br. at p. 22.) This is not in dispute. But, as has been discussed, Mercury may not use the formula in the rate regulations or an alternative formula that produces a different rate of return to demonstrate confiscation. Mercury must first demonstrate confiscation by showing the Rate Order will cause deep financial hardship to the enterprise as a whole. (*20th Century*, *supra*, 8 Cal.4th at p. 297 ["i.e., the inability of the regulated firm to operate successfully"].) Then, and only then, an alternative rate would have to be determined outside the formula, ad hoc.

As discussed further in Section III.G, below, the U.S. Supreme Court has struggled to articulate a standard for when a regulation constitutes confiscation. (See *Kavanau v. Santa Monica Rent Control Bd.* (1997) 16 Cal.4th 761, 773-774 ["*Kavanau*"] [listing thirteen factors identified by the U.S. Supreme Court].)

Some of the ways and insurer could show deep financial hardship, would be to produce evidence showing deterioration or projected deterioration of its financial condition, inability to pay dividends to shareholders, a decline in its AM Best ratings, an inability to attract capital, or other indicators of financial condition. (See, e.g., *20th Century*, *supra*, 8 Cal.4th at pp. 294, 296.)

Mercury and the Trades argue the only standard by which to measure confiscation is fair rate of return. Mercury more specifically argues the Commissioner incorrectly disregarded fair rate of return evidence that supposedly showed confiscation. (Mercury Br. pp. 11, 22-23, 24-26, 42-43, 64-66). However, since the regulations provide a fair rate of return, such evidence is simply an attempt to calculate the appropriate rate in a way different from the rate regulations. Therefore, it is not useful to showing the end result of the rate under the regulations is confiscation or deep financial hardship, and it is barred by the relitigation bar regulation (see Section III.H, below.)

Accordingly, fair rate of return evidence is not relevant and proper in this case prior to showing deep financial hardship. But even if it was relevant and proper, the Commissioner, in fact, did not exclude such evidence. For example, Mercury states:

> These economists testified that under established economic methodologies, Mercury's "fair return" on its homeowners' business was between 8.15% and 9.23% on the market value of its homeowners' business.[94] This evidence was deemed irrelevant and stricken.

(Mercury Br. p. 65, citing AR2982 in fn. 94.)[8] However, the administrative record at the page cited by Mercury shows the above-described economists'

[8] "AR" references are to the administrative record of the rate-making proceedings that resulted in the Rate Order.

testimony was *not* stricken.

Also, Mercury incorrectly claims that the testimony of its economic expert, Dr. Appel, was uncontradicted. (Mercury Br. p. 68.) In fact, expert economic witness Dr. Atarri pointed out that Dr. Appel's conclusions were "speculative" and based on "unproven assumptions." (AR2890-2891.)

Further, the evidence shows Mercury was operating successfully under the regulations, and its financial condition appeared to be very healthy.[9] For example:

- Over the previous five years Mercury had issued nearly $1 billion in dividends. (Proposed Decision at p. 120 [1:JA000196].)

- Over the previous five years Mercury maintained an A+ financial strength rating from AM Best. (*Ibid*.)

- Mercury's 2010 California operations show a robust policyholder surplus of $975 million. (*Ibid*.)

- Mercury realized millions of dollars of profits every year. (*Ibid*.)

- Mercury failed to demonstrate any previous rate approval under the regulations weakened its financial integrity. (*Ibid*.)

- Mercury did not show that it had any plans or need to raise capital during the period in which the rates would be in effect.

[9] Mercury's counsel represented below, "I submit, your Honor, that this [Mercury] is a highly solvent company that's monitored by the Department of Insurance." (Transcript of May 3, 2013 hearing on Mercury's motion for a stay, at p. 9.)

- Mercury made no effort to show that the Rate Order would prevent the company from operating successfully. (*Market Street Railway Co. v. Railroad Comm'n* (1945) 324 U.S. 548, 566.)

- Mercury made no effort to show why Mercury's rate-of-return needs were different from the rate-of-return needs of other California insurers.[10]

Mercury argues the Commissioner improperly considered Mercury's past successful experience under the regulations in evaluating its confiscation claim. (Mercury Br. pp. 52-53, citing *Calfarm*, *supra*, 48 Cal.3d at p. 819.) Mercury is mistaken both on the facts here and in its citation to *Calfarm*. *Calfarm* was discussing *setting* rates at unreasonably low levels *to offset past excessive rates*, as opposed to looking at the insurer's past performance to assess its financial condition. (See *ibid*.) In any event, the Commissioner only considered Mercury's financial condition and past performance to assess the *consequences* of the Rate Order and Mercury's confiscation claim. (Proposed Decision at p. 120 [1:JA000196]; see also *20th Century*, *supra*, 8 Cal.4th at p. 325 ["The analysis set out above establishes that the question whether the 20th Century rate rollback order is unjust and unreasonable in its consequences and therefore confiscatory depends on a balancing of the interests of 20th

---

[10] Mercury's proposed rate-of-return testimony did not go to showing Mercury's own financial condition and was irrelevant and improper relitigation. (See, e.g., *20th Century*, *supra*, 8 Cal.4th at p. 294 [a rate of return comparable to returns in other industries with comparable risk is an interest but not a right].)

Century and its insureds."].) Like the Commissioner, the court below also determined that Mercury would not suffer deep-financial hardship. (11:JA002837-38.)

D. *20th Century* Discussed and Upheld Both the Rollback and Prior Approval Regulations.

Mercury and the Trades argue that *20th Century* is inapplicable because it involved review of a Proposition 103 rate rollback as opposed to review of a prior-approval rate case. Rollbacks, they contend, are retrospective in effect, not prospective. (Trades Br. at pp. 42, 46-48; see Mercury Br. at p. 55.) First, *20th Century* expressly states that rollbacks *were* prospective in nature because the rates were charged "pending a determination of their legality":

> **The rate regulations as to rollbacks may properly be considered prospective**. The "fixing of a rate and the reducing of that rate are prospective in application ...." [citations omitted] The ordering of a refund of rates is "akin to a reduction in rates," when, as here, the rates in question were charged "pending a determination of [their] legality ...." [citations omitted] It follows that the ordering of a refund of rates is itself prospective.

(8 Cal.4th at p. 281, bold added.)

Second, *20th Century*'s analysis is not restricted to rollbacks. The 90-page opinion addresses rate regulation under Proposition 103, both as to prior-approval cases and rollbacks. *20th Century* never states that its holdings, analysis or observations do not also apply to prior-approval rate orders. The opposite is the case.

20th Century explains in detail how the regulations apply to both rollbacks and prior approval cases. (8 Cal.4th at pp. 248-256.) The Court stated:

> To cover both the rate rollback and "prior approval" system, the ratemaking formula may be used to yield both a *maximum* permitted earned premium (when the profit factor variable takes as its value a maximum profit factor based on the maximum permitted after-tax rate of return [citing Regs. 2644.2 & 2644.15]) and *minimum* permitted earned premium (when the profit factor variable takes as its value a *minimum* profit factor based on a minimum permitted after-tax rate of return [citing Regs. 2644.3, & 2644.15]).

(*Id*. at pp. 253-254, italics by the Court.)

Even when *20th Century* uses the phrase "as to rollbacks," it is often discussing the rate calculation set forth in the prior approval regulations, not in the rollback regulations. Therefore, the discussion frequently applies with even greater force in the prior approval context. (See, e.g., *id*. at pp. 289-290, in which the discussion of limiting expenses to "reasonable" expenses is a reference to Regulation 2644.10, the "excluded expenses" provision in the prior approval regulations; there is no "excluded expenses" or other comparable regulation among the rollback regulations.)

E. *Calfarm* and *20th Century* Are Not Inapposite and Do Not Need to Be "Harmonized".

Calfarm invalidated the insolvency standard statutory provision because, on its face, it "preclude[d] adjustments necessary to achieve the constitutional standard of fair and reasonable rates." (48 Cal.3d at p. 821.) *20th Century* determined that the standard for determining the constitutionality of a rate order issued under constitutionally sound regulations is deep financial hardship. The two cases invoked different standards because the issue and circumstances posited in each case was different. There is no need to harmonize *Calfarm* and *20th Century* because they are not in conflict.

Calfarm specified that "over the long term the state must permit insurers a fair return." (48 Cal.3d at p. 821.) *Calfarm* did not say a rate order issued under constitutionally sound regulations could be challenged on the same basis upon which it struck the insolvency standard.

As stated, *Calfarm* invalidated the insolvency standard because it did not provide sufficient protection for insurers from confiscation. *20th Century* upheld the Commissioner's formulaic rate regulations (which had not been promulgated when *Calfarm* was written) and explicitly stated they provide the constitutional protection required. (8 Cal.4th at p. 313 ["the variances must be deemed sufficient for rate adjustments necessary to avoid confiscation"].)

The hearing on Mercury's rates was conducted in conformance with the regulations that *20th Century* discussed in great depth and upheld. (See, e.g., 8 Cal.4th at pp. 251 [describing what premium the prior approval ratemaking formula is designed to yield], 253 [stating the rate regulations' definition of a "fair return" for prior approval], 320 [addressing confiscation in the context of the regulations].)

Mercury claims *Calfarm* "specifically held" that "assessing the legality of a rate order by reference to an insurer's financial condition would not satisfy the constitutional standard of a 'fair and reasonable return.'" (Mercury Br. p. 50, citing 48 Cal.3d at p. 820.) Again, Mercury errs. *Calfarm* actually stated the exact opposite – financial condition is considered in determining fair rate of return. (*Id*. at p. 818 fn. 9, quoting *Hope*, *supra*, 320 U.S. at p. 603 ["in determining a fair rate of return, one must consider 'the financial integrity of the company whose rates are being regulated'"].)

F. *Lingle* Did Not Change the Standard for Confiscation In Proposition 103 Rate Cases and is Irrelevant.

In their effort to discredit the deep financial hardship standard set forth in *20th Century*, the Trades, but not Mercury, rely on *Lingle v. Chevron U.S.A. Inc.* (2005) 544 U.S. 528 ("*Lingle*"). (Trades Br. pp. 11, 36-38, 42-43.) But *Lingle*'s narrow holding is irrelevant to this case.

In *Lingle*, the lower court struck down a Hawaii statute as an unconstitutional taking solely on the grounds that the statute did not substantially advance a legitimate state interest (the "substantially advances" test). (*Id*. at p. 532.) The U.S. Supreme Court addressed only one question in *Lingle*: whether the "substantially advances" test was "an appropriate test for determining whether a regulation effects a Fifth Amendment taking." (*Ibid.*)

Lingle held that the "substantially advances" test was not relevant to takings:

> We hold that the "substantially advances" formula is not a valid takings test, and indeed conclude that it has no proper place in our takings jurisprudence.

(*Id.* at p. 548.)

The U.S. Supreme Court went out of its way to clarify that its holding was narrow and did change any of its precedents, stating that "our holding today -- that the 'substantially advances' formula is not a valid takings test -- does not require us to disturb any of our prior holdings." (*Id.* at p. 545.)

Nonetheless, the Trades claim, incorrectly, that *Lingle* overturned the unanimous holding in *20th Century* that the correct test for confiscation for Proposition 103 rate cases is deep financial hardship. (See Trades Br. p 43.) While the Trades' argument is difficult to understand, they appear to argue that under *Lingle* a due process analysis, instead of a takings analysis, should apply in this case. (See *id*. pp. 37-38.) The Trades make this argument even though they admit that *Lingle* did not involve a due process challenge. (See *id.* p. 37, fn. 11.)

To the extent the Trades are challenging the regulations under the due process clause, *20th Century* has already held the rate formula did not violate due process:

> It is demonstrably relevant to the policy of protection of consumer welfare -- a policy that the voters were free to adopt, and did in fact adopt, in approving Proposition 103. Further, it is not arbitrary, taking an approach to rates that is a reasonable one, although not the only such approach. Lastly, it is not discriminatory. To the extent that it may be said to disfavor insurers and favor their insureds, it does so well within the limits marked out by due process jurisprudence since at least the late 1930's.

(8 Cal.4th at p. 297).

Ignoring *20th Century*'s due process holding, the Trades argue that under a due process analysis supposedly derived from *Lingle* and *Kavanau*, the government does not have a legitimate interest in a regulation if the regulation deprives investors of a fair return:

> Under the Due Process analysis, the price regulation is valid only if California has a "legitimate interest" in that regulation, and it has a legitimate interest *only* "so long as the law does not deprive investors [in the regulated company of] a 'fair return' and therefore become 'confiscatory'." (citing) (emphasis on word "only" added.)

(Trades Br. p. 38, citing *Kavanau*, *supra*, 16 Cal.4th at pp. 771-772; italics added.)

The above passage the Trades purport to quote from or paraphrase *Kavanau* uses the word “generally” and does not contain or imply the word “only.” The exact quote from *Kavanau* states:

> In the context of price control, which includes rent control, courts generally find that a regulation bears “a reasonable relation to a proper legislative purpose” so long as the law does not deprive investors a “fair return” and thereby become “confiscatory.”

(16 Cal.4th at p 771.)

The Trades also omit *Kavanau*’s conclusion from the referenced discussion, which points out that determining whether a price regulation violates due process requires a balancing of investor and consumer interests:

> In sum, when considering whether a price regulation violates due process, a “court must determine whether the [regulation] may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection for the relevant public interests, both existing and foreseeable.”

(*Id.* at p 772.)

20th Century is not only a takings case as the Trades claim. *20th Century* articulates distinct constitutional tests to assess whether a rate order: (1) violates due process, and (2) constitutes a taking under the Fifth Amendment (which technically for a state is a violation of the 14th

Amendment's Due Process Clause).[11] A rate order (or a regulation) violates due process if it is arbitrary, discriminatory, or "demonstrably irrelevant to legitimate policy." [12] (8 Cal.4th at p. 291.)

20th Century also discussed what constitutes a taking in the ratemaking context:

> Consistently with *Hope*, [*Duquesne*] effectively defined a "confiscatory" rate thus: "A rate is too low if it is 'so unjust as to destroy the value of [the] property for all the purposes for which it was acquired,' and in so doing 'practically deprive[s] the owner of property without due process of law[.]"

(8 Cal.4th at p. 295.)

A rate order is confiscatory under the Fifth Amendment, constituting a taking, if, viewed in its entirety, its terms are unjust and unreasonable. (*20th Century*, *supra*, 8 Cal.4th at pp. 292, 317-318 [citing *Hope*, *supra*,

---

[11] The Fifth Amendment only applies to the states by incorporation through the Due Process Clause of the 14th Amendment. (*20th Century, supra*, 8 Cal.4th at p. 292.) Thus, for a state, a violation of the Fifth Amendment's Takings Clause constitutes a violation of the 14th Amendment's Due Process Clause. Further, a rate order that is considered confiscatory also violates the Due Process Clause. *(Ibid.)*

[12] *20th Century* states:

> [I]n *Calfarm*, we used such phrases as the "due process clause" and "due process" to refer, of course, to the due process clause and its protection but also, more broadly, to the takings clause and its protection.

(8 Cal.4th at p. 244 fn. 2.)

320 U.S. at p. 601, and *Duquesne*, *supra*, 488 U.S. at pp. 307-308 ("If it is not just and reasonable, it is confiscatory.")].)

G. The Rent Control Cases Appellants Rely on Do Not Support Appellants' Argument That the Commissioner Applied the Wrong Confiscation Standard.

Mercury and the Trades cite to rent control cases in support of their fair-return argument, but those cases do not support their position. At the outset, it should be noted that, as in the rate-making context here, the constitutional proscription against confiscatory takings does not "guarantee" landlords a "fair return"; rather, it simply requires that local ordinances provide a mechanism sufficient to avoid confiscatory results, i.e., rent adjustment procedures for allowing "excess" increases by landlords who otherwise would not be able to realize a fair return. (*Fisher v. City of Berkeley* (1984) 37 Cal.3d 644, 679-680, *aff'd on other grounds* (1986) 475 U.S. 260.)

Mercury and the Trades cite *Kavanau* in support of their argument, but their reliance is misplaced. *Kavanau* held that Santa Monica's 12 percent rent-increase limit as applied to the landlord in that case *did not* constitute a taking. (16 Cal.4th at p. 782.) The Court stated that the landlord's "continuing right to an adjustment of future rents can provide an adequate remedy" for any alleged due process violation in Santa Monica's rent control process. (*Id*. at p. 783.) "Put another way, the *ongoing process* of setting rent ceilings *dispels* the due process violation" (*id*. at p. 786, italics added), and "obviates a finding of a taking" (*id*. at p. 782).

Similarly, under Proposition 103, insurers can apply for rate adjustments as often as they wish. Mercury took full advantage of this ability and in November, 2013, based on a subsequent rate application, the Commissioner approved an 8.7% rate increase – more than erasing the 5.4% rate reduction that is the subject of this case. Mercury stipulated to the rate increase.

Further, Mercury's and the Trades' suggestion that *Kavanau* repudiated a deep financial hardship test and overruled *20th Century* is erroneous. In fact, the rent control board in *Kavanau* invoked the deep financial hardship test. Although offered an opportunity to reject it, the Supreme Court did not do so. (16 Cal.4th at p. 782.)

Both appellants twice quote the same incomplete passage from *Kavanau:*

> In the context of price control, which includes rent control, courts generally find that a regulation bears "a reasonable relation to a proper legislative purpose" so long as the law does not deprive investors a "fair return" and thereby become "confiscatory."

(16 Cal.4th at p. 771; see Mercury Br. pp. 43, 47; Trades Br. pp. 38, 44, fn. 14.) Neither appellant included the continuation of the Court's discussion, which repeats the same principles as the Court had stated before in *20th Century*:

Determining prices that will provide a fair return

> “involves a balancing of the investor and the consumer interests.” (*Hope Gas*, *supra*, 320 U.S. at p. 603 [64 S.Ct. at p. 288].) “It is the product of expert judgment which carries a presumption of validity.” (*Id.* at p. 602 [64 S.Ct. at p. 288].) A reviewing court focuses on whether the regulatory agency took relevant investor interests into account. (*Permian Basin Area Rate Cases* (1968) 390 U.S. 747, 770 [88 S.Ct. 1344, 1361-1362, 20 L.Ed.2d 312] (*Permian Basin*); [*Power Commn. v. Pipeline Co.* (1942) 315 U.S. 575], 586 [62 S.Ct. at p. 743].) One of these investor interests is a “return ... commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to ... attract capital.” (*Hope Gas*, *supra*, 320 U.S. at p. 603 [64 S.Ct. at p. 288].) Though due process protections generally focus on method, not result, in the context of price regulation “it is the result reached not the method employed which is controlling. [Citations.] It is not theory but the impact of the [price regulation] which counts.” (*Id.* at p. 602 [64 S.Ct. at pp. 287-288].) In sum, when considering whether a price regulation violates due process, a “court must determine whether the [regulation] may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection for the relevant public interests, both existing and foreseeable.” (*Permian Basin*, *supra*, 390 U.S. at p. 792 [88 S.Ct. at p. 1373].)

(*Ibid*.)

Accordingly, while both appellants rely heavily on the short passage they cite, the full passage does not support their position.

Kavanau stated that the U.S. Supreme Court “has struggled to articulate a standard for when a regulation ‘goes too far’ and effects a taking,” and that the U.S. Supreme Court has thus “concluded that the constitutional inquiry in any particular case is 'essentially ad hoc.'" (16 Cal.4th at pp. 773-774.)

Kavanau went on to list thirteen factors the U.S. Supreme Court has considered to find a taking absent physical invasion. A "reasonable return" to investors is only one of the factors, and the first listed factor is an end-result test -- the "economic impact of the regulation on the claimant." (*Id*. at p. 775.) *Kavanau* concluded:

> This list is not a comprehensive enumeration of all the factors that might be relevant to a takings claim, and we do not propose a single analytical method for these claims. Rather, we simply note factors the high court has found relevant in particular cases. Thus, instead of applying these factors mechanically, checking them off as it proceeds, a court should apply them as appropriate to the facts of the case it is considering.

(*Id*. at p. 776.) Accordingly, *Kavanau* does not support the proposition that a simple fair rate of return analysis is a proper test for determining confiscation.

Kavanau's discussion of the meaning of "just and reasonable return" is also instructive:

> Though we have used the phrase "just and reasonable return", we have never held that either the state or federal Constitution requires application of the fair return on investment formula or any other specific formula.

(16 Cal.4th at p. 777 [citations omitted].) The Supreme Court then rejected the court of appeal's analysis, emphasizing that the rent-increase cap was

but one aspect of a comprehensive regulatory scheme. The Court also observed "[t]he Court of Appeal did not expressly find that the 12 percent limit prevented Kavanau from 'operating successfully.'" (*Id*. at pp. 778-779.)

Further explaining its repudiation of the court of appeal's reasoning, the Supreme Court stated:

> Regulated prices must fall within a "broad zone of reasonableness" to be constitutional and due process requires fundamentally a balancing of interests (*Hope Gas*, *supra*, 320 U.S. at p. 603 []). The 12 percent limit achieved this balance. It balanced landlords' interests in recouping their increased costs against tenants' interests in avoiding sudden, large rent increases.

(16 Cal.4th at pp. 778-779 [other citations omitted].) As with the rent control scheme in *Kavanau*, one of the aims of the rate regulations is to achieve appropriate fair balance between the insurer's and its insureds' interests.

H. The Commissioner Properly Invoked the Relitigation Bar.

The relitigation bar protects the Commissioner's rate review process by preventing insurers from challenging the regulations in individual hearings. The relitigation bar regulation provides.

> Relitigation in hearing on individual insurer's rates of the 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, ... 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.

(Reg. 2646.4, subd. (c).)

Mercury and the Trades argue that the ALJ wrongfully invoked the relitigation bar regulation to strike Mercury's purported evidence to show deep-financial hardship. (Mercury Br. pp. 24-26, 58-63; Trades Br. pp. 53-56.) That evidence was comprised of substituting Mercury's own data into an alternative formula to the regulatory formula. (*Ibid*.) Such evidence is not relevant to a determination whether there is confiscation based on a showing of deep-financial hardship. As has been discussed, to show a particular rate order fails to provide a fair rate of return, i.e., is confiscatory, the regulated entity must show that the rate derived from the regulatory formula – not some alternative formula using individualized data – would result in deep financial hardship.

As *20th Century* stated, quoting the ALJ with approval:

> "The regulations," explained the administrative law judge, "avoid the administrative gridlock that would result from readjudicating over and over hundreds of issues that affect multiple insurers in lengthy hearings that would yield inconsistent results -- *if* they ever yielded any result at all." (Italics added in place of underscoring in original.) "The regulations employ generic determinations and a detailed formula designed to ensure manageability and consistent treatment of insurers

> and insureds." "At the same time, the regulations incorporate multiple company-specific factors into the rollback formula, and then are applied in individual adjudicatory hearings. The company-specific hearings allow further tailoring to a company's situation ... ."

(8 Cal.4th at p. 257 [italics by the Court].)

In this case, the ALJ's comments on relitigation are consistent with *20th Century's* comments set out above.

> Mercury argues any analysis of confiscation must permit an insurer to apply cost and expense amounts different from those provided by the regulatory formula. . . . This argument amounts to little more than impermissible relitigation of the regulatory formula and must again be rejected.

(1JA:000197 [footnote omitted].)

Deep financial hardship is shown by the *impact* of the *end result* of a rate. The relitigation bar does not preclude an insurer from making that showing. The relitigation bar does prevent an insurer from challenging the regulatory formula, and components and inputs of the formula set out in the ratemaking regulations.

Mercury argues that to test confiscation, it should be permitted to "step aside from the formula" and introduce an alternative rate calculation. (Mercury Br. pp. 60-61.) Mercury relies heavily on a rent control case, *TG Oceanside L.P. v. City of Oceanside* (2007) 156 Cal.App.4th 1355, to support this argument. As with the other rent control cases appellants cite, *TG Oceanside* actually supports the Commissioner.

In *TG Oceanside*, a mobile home park owner applying for a rent increase sought a variance from the city's rent adjustment formula on the grounds that the formula would not have permitted the park to earn a fair rate of return. (*Id*. at p. 1362.) In an effort to prove that the formula-generated rate was confiscatory, the mobile home park owners attempted to put on evidence that an alternative rate, calculated using the park owners' own formula not provided for in the regulations, would have generated a fair rate of return. (*Id*. at pp. 1362-1363.)

The court in *TG Oceanside* did not permit this:

> In view of the presumption established by the Ordinance, it is not sufficient for Owner to attack City's showing or argue that a different formula will provide a fair return. As stated, **it must first make its own threshold evidentiary showing that the formulas provided for by City's Ordinance are unjust and unreasonable in their consequences**.

(*Id*. at pp. 1381-1382, bold added.) Just as the regulations in this case were upheld in *20th Century*, the regulations in *TG Oceanside* had also been previously upheld against a facial challenge. (*Id*. at p. 1378.)

To demonstrate the necessary unjust and unreasonable consequences, the court in *TG Oceanside* required a showing that the formula generated rate would have result in the park being unable to operate successfully. (*Id*. at p. 1373, citing *20th Century*, *supra*, 8 Cal.4th at p. 295 ["'Regulations that enable the company to operate successfully cannot be condemned as invalid, even though they might produce only a meager return.'"].)

Far from supporting Mercury's position that it should be permitted to submit alternative rate calculations to show confiscation, *TG Oceanside* supports the Commissioner's position that such calculations are not permitted until Mercury makes a threshold showing of deep financial hardship (i.e., inability to operate successfully). Until such a showing is made, such reworking of the formula is "little more than impermissible relitigation," as the ALJ properly found. (1JA:000197.)

IV. THE COMMISSIONER CORRECTLY CONSTRUED AND APPLIED THE INSTITUTIONAL ADVERTISING REGULATION.

A. The Commissioner Correctly Interpreted Regulation 2644.10 As It Relates to "Institutional Advertising."

Implementing the voter's mandate from Proposition 103, the Commissioner has determined that "institutional advertising" provides no benefit to California consumers and instead only benefits the company and its shareholders. Accordingly, institutional advertising expenses are excluded from the ratemaking formula under Regulation 2644.10, subdivision (f), which provides:

> (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 to buy the insurer's product.

(Emphasis added.)

In other words, "institutional advertising" is "'image advertising' which strives to enhance a company's reputation or improve corporate name recognition." (Proposed Decision at p. 93 [1:JA000169].) It is not advertising aimed at obtaining business for a specific insurer. Nor does it provide consumers with information helpful in deciding whether to purchase the insurer's product. Instead, the ALJ, the Commissioner, and the trial court have all concluded that Regulation 2644.10, subdivision (f) only allows Mercury to expense advertising costs under the ratemaking formula if the advertising *both*: (1) is directed at obtaining business for a specific insurer *and* (2) provides consumers with information relevant to the decision whether to buy the specific product. (AR4117:6-14 [testimony of Mercury's Erik Thompson]; 1:JA000173; 11:JA002841.)

Thus, expenses meeting *either* prong of Regulation 2644.10, subdivision (f) will result in excluding those advertising expenses. But Mercury and the Trades make the opposite argument -- that *both* prongs of the regulation must be satisfied for an advertising expense to be excluded. (Mercury Br. pp. 8-9, 31, 32-35; Trades Br. pp. 57, 61.) This argument is erroneous. The Commissioner's construction of the regulation is consistent with, and well supported by, the Proposition 103 ratemaking goals. California insurance ratemaking is premised on the concept that insurance rates charged in California should be based on "risks or on operations in this state" and that California consumers should not be required to fund nationwide advertising campaigns by their insurers. (Reg. 2641.2.) Thus, Regulation 2644.10, subdivision (f) simply ensures that California consumers pay premiums that reflect costs or expenses related to a specific insurer's advertising in this state for its line(s) of insurance.

Appellants' argument is also irrelevant. Mercury's advertising did not meet *either* of the regulation's prongs. Under the first prong, the regulation's reference to "specific insurer" means a specific affiliate of the Mercury Insurance Group, such as the insurer making the rate application, in this case Mercury Casualty Company. As an admitted insurer in this state, Mercury is charged with knowing that it was required to advertise in its own name.[13] Despite this requirement, virtually none of Mercury's advertisements admitted into evidence in the rate proceeding (see, e.g., Exs. 68-70 [AR7043-7629]) contain the name Mercury Casualty Company, or any other specific affiliate's name.

Notably, the Trades' argument – that the trial court erroneously interpreted "specific insurer" to refer only to the applicant, Mercury Casualty Company (Trades Br. pp. 59-62) – is a red herring. Specifically,

---

[13] Every insurer in California is required to transact the business of insurance in its own name. (§ 880.) Advertising is a form of solicitation. (See § 35.) Further, the Insurance Code's statutory scheme expressly contemplates that insurers advertising on the internet include the legal name under which they are admitted to transact insurance business. (See § 702 [providing that an insurer admitted in California that wishes to advertise on the internet must include on the advertisement its official name, state of domicile and certificate of authority number].)

the Trades argue that "[i]f all advertising for other group affiliates is counted as an excluded expense in the numerator, the numerator and denominator do not contain like data." But advertising for specific affiliates is *not* excluded under Regulation 2644.10, subdivision (f). Instead, institutional advertising, i.e., advertising which is not aimed at obtaining business for a specific insurer but rather simply promotes the group brand, is excluded. Thus, when calculating the excluded expense ratio, the numerator (expenses that are excluded from the efficiency standard) and denominator (direct earned premium) comprises an "apples-to-apples" comparison because they are both based on insurer group data. Advertising for a specific affiliate – any affiliate – is not considered institutional and therefore any such expenses are not excluded. So long as the advertising is targeted at a specific insurer, it does not matter what affiliate it is for. But there is no evidence that any advertising expenses for any specific insurer were excluded.

Rather, the undisputed evidence shows that most of the advertising submitted in the administrative hearing referenced the "Mercury Insurance Group," which is not an admitted insurer in California. (See 1:JA000170-000173; AR4436:10-24 [testimony of Mercury Insurance Group Controller David Yeager].) In fact, a Mercury witness admitted that *all* of Mercury's advertising is aimed at supporting the "Mercury Insurance Group" as a whole, and not any specific insurer within the Mercury affiliated companies. (AR4126:7-10 [Thompson testimony]; 1:JA000173.) Accordingly, since Mercury's advertising did not refer to a specific insurer, Mercury failed to meet the first prong of Regulation 2644.10, subdivision (f).

Mercury's advertising also failed to meet the second prong that the advertising itself must provide consumers with information pertinent to the decision whether to purchase the insurer's product. Again, Mercury's advertising was directed at obtaining business for the entirety of the Mercury Insurance Group, which consists of 22 separate legal entities comprising Mercury General Corporation. (See 1:JA000174; AR4436:10-24 [Yeager testimony].) Its advertising did not provide specific information regarding any particular product line of Mercury Casualty Company or any other specific affiliate. (See, e.g., Exs. 69-096 [AR7310], 70-176 [AR7564].)[14] Moreover, Mercury never broke down its advertising costs in such a way that the Commissioner would have been able to discern which advertising costs would accrue to the ratemaking process and which were attributable to other operations of other entities under the Mercury Insurance Group umbrella. Thus, by failing to reference a specific insurer, Mercury's advertising was inherently unable to refer to any of its specific

[14] Mercury's contention that neither the Commissioner nor the trial court considered whether its advertising provided "pertinent information" (Mercury Br. pp. 31-32, 39-40) is not true. (See AR7310, 7564; 1:JA000173; 11:JA002483.)

insurance *products*.

Since Mercury failed to meet *both* prongs of Regulation 2644.10, subdivision (f), its institutional advertising expenses were properly excluded from the ratemaking formula.

B. The First Amendment is Not Implicated by Regulation 2644.10(f).

The Trades' argument that Regulation 2644.10, subdivision (f) violates the First Amendment free speech of insurers is without merit. The U.S. Supreme Court has explained that "[s]peech regulation is content based if a law applies to particular speech because of the topic discussed or the idea or message expressed." (*Reed v. Town of Gilbert, Ariz.* (2015) 135 S.Ct. 2218, 2227, citations omitted.) Rather than restricting an insurer's advertising for "the idea or message expressed," Regulation 2644.10 merely limits insurers from unreasonably passing on the cost of certain advertising to insurance ratepayers. (See *20th Century*, *supra*, 8 Cal.4th at p. 289.) Regulation 2644.10 does not in any way ban speech or compel specific content; insurers retain the freedom to pay for any type of advertising, including institutional advertising. Regulation 2644.10 does, however, prevent consumers from having to pay higher premiums resulting from costs not associated with a specific insurer or product information.

Unlike Regulation 2644.10, other First Amendment cases concern statutes that expressly ban or prohibit certain advertising content (e.g., prescription drug prices). (See *Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc.* (1976) 425 U.S. 748.) Regulation 2644.10 allows insurers to advertise as they desire, but at their expense and not at their ratepayers' expense.

In a similar context, courts have upheld the validity of public-utility regulations that exclude institutional advertising costs. (See, e.g., *El Paso Electric Co. v. New Mexico Public Service Commn.* (N.M. 1985) 706 P.2d 511, 304 [concluding that a regulation excluding institutional advertising expenses is constitutional because it "does not ban any speech; it only reasonably requires that the cost of certain advertising not be passed on to a utility's 'captive' customers, the ratepayers"]; see also, e.g., *Pacific Tel. & Tel. Co. v. Public Utilities Commn.* (1965) 62 Cal. 2d 634, 669; *Public Service Commn. v. Federal Energy Regulatory Commn.* (D.C. Cir. 1987) 813 F.2d 448, 456.) While the public utility framework is not identical to the insurance framework, the principle of limiting regulated entities from passing on to consumers costs that are only reasonably incurred for the benefit of the consumers logically applies to both.

To the extent that Regulation 2644.10 arguably implicates speech at all, it is only to distinguish certain types of disfavored expenses that for public policy purposes are not properly included in the ratemaking process to inappropriately influence the rate in favor of an insurer and against the consumer. These include political contributions and lobbying (Reg.

2644.10, subd. (a)), unreasonable executive compensation (*id*., subd.(b)), bad faith judgments and associated costs (*id*., subd. (c)), costs related to the defense of unsuccessful discrimination claims (*id*., subd. (d)), fines and penalties (*id*., subd. (e)), and payments to affiliates exceeding fair market value of goods and services (*id*., subd. (g)). In fact, Regulation 2644.10 recognizes advertising costs related to a specific insurer and including information pertinent to the insurance product.

Even if the regulation is deemed to regulate speech in some manner, the trial court correctly determined that it passed constitutional muster. (12:JA003328-003329.) Historically, courts have recognized several types of speech, some more deserving of a higher level of judicial protection than others. Advertising has long been recognized as a type of commercial speech. "Commercial speech," at its core, is speech that does "no more than propose a commercial transaction" and, more broadly, is speech that goes beyond proposing such a transaction but yet "relate[s] solely to the economic interests of the speaker and its audience." (*Cincinnati v. Discovery Network, Inc.* (1993) 507 U.S. 410, 420-423, citations omitted.)

The trial court thus correctly held that "institutional advertising" as described in Regulation 2644.10 is commercial speech, given that it is '"expression related solely to the economic interests of the speaker and its audience.'" (12:JA003327, citing *Central Hudson Gas & Elec. Corp. v. Public Service Commission of New York* (1980) 447 U.S. 557, 561

[“*Central Hudson*”]; see also *Kasky v. Nike, Inc.* (2002) 27 Cal.4th 939, 956.) Speech is commercial if it is likely to influence consumers in their commercial decisions. (*Id.* at p. 969.)

The trial court also discussed *Bolger v. Youngs Drug Products Corp.* (1983) 463 U S 60, 66-67:

> In *Bolger*, the United States Supreme Court articulated that the combination of three characteristics provides “strong support” that the information in question is commercial speech: speech proposing a commercial transaction, speech that references a particular product, and speech with an economic motivation. The Court applied this test to hold that informational pamphlets about contraceptives were commercial speech, notwithstanding the fact that they discussed important public issues, such as preventing the spread of venereal disease and family planning. (*Id.* at p. 67-68.)

(12:JA003330.) Based on *Bolger*, the trial court correctly deemed the advertisements described by the Trades, “such as an insurer sponsoring an event, or an insurer engaging in informal advertising about ‘worthy causes,’” to be commercial speech.

It has long been established that there is a “‘commonsense’ distinction between speech proposing a commercial transaction, which occurs in an area traditionally subject to government regulation, and other varieties of speech.” (*Central Hudson, supra*, 447 U.S. at p. 562, quoting *Ohralik v. Ohio State Bar Assn.* (1978) 436 U.S. 447, 455-456.) The First Amendment “therefore applies lesser protection to commercial speech than to other constitutionally guaranteed expression.” (*Id.* at pp. 562-563.)

The United States Supreme Court has regularly adopted the test announced in *Central Hudson* to resolve commercial speech First Amendment challenges. (*Greater New Orleans Broad. Assn. v. United States* (1999) 527 U.S. 173, 183.) Hence, the trial court was correct in applying this test to analyze the validity of Regulation 2644.10:

> To determine whether commercial speech is protected by the First Amendment, the Court must apply a four-part test: (1) The commercial speech must concern lawful activity and not be misleading; (2) The asserted governmental interest must be substantial; (3) The regulation must directly advance the governmental interest asserted; and (4) [T]he regulation must not be more extensive than is necessary to serve that interest.

(12:JA003328, citing *Central Hudson*, *supra*, 447 U.S. at p. 566, footnote omitted.)

There is no dispute regarding the first and second prongs and there does not appear to be any dispute regarding the third prong. As the trial court noted:

> First, no party disputes that the claimed advertising is unlawful or misleading.
>
> Second, the governmental interest m the regulation excluding certain advertising expenses is compelling -- the regulation's purpose is part of the process "to establish the process and policies the Commissioner shall employ to determine whether the proposed [insurance] rates are excessive or inadequate" (10 CCR § 2641.3.) . . . .
>
> Third, Regulation 10 C C R § 2644.10(f) advances the government's interest in determining whether

the rates are excessive or inadequate.

(12:JA003328; see Trades Br. p. 68.)

As stated above, Regulation 2644.10 does not ban or compel any speech. Insurers retain the freedom to pay for any type of advertising. But, insurers cannot pass on to consumers costs for advertising that does not meet the conditions set forth in Regulation 2644.10.

CONCLUSION

For the foregoing reasons, the judgment should be affirmed in all respects.

Dated: April 4, 2016

Respectfully Submitted,

KAMALA D. HARRIS
Attorney General of California
DIANE S. SHAW
Senior Assistant Attorney General

s/STEPHEN LEW

STEPHEN LEW
Supervising Deputy Attorney General

Attorneys for Defendant and Respondent Dave Jones, Insurance Commissioner of the State of California

CERTIFICATE OF COMPLIANCE

I, counsel for respondent Dave Jones, in his official capacity as the Insurance Commissioner of the State of California, hereby certify that this Respondent's Brief of Insurance Commissioner Dave Jones uses 13 point Times New Roman font and contains 12,112 words, not including the tables, based on the word count of the Word 2010 word processing program used to prepare this document.

Dated: April 4, 2016

KAMALA D. HARRIS
Attorney General of California

s/ STEPHEN LEW

STEPHEN LEW
Supervising Deputy Attorney General

Attorneys for Defendant and Respondent Dave Jones, in his Official Capacity as the Insurance Commissioner of the State of California

<u>DECLARATION OF SUPPLEMENTAL SERVICE BY U.S. MAIL</u>

Case Name: *Mercury Casualty Company v. Dave Jones, Insurance Commissioner*
Ct. App. Case Nos.: **C077116 & C078667**

I declare:

I am employed in the Office of the Attorney General, which is the office of a member of the California State Bar, at which member's direction this service is made. I am 18 years of age or older and not a party to this matter; my business address is: 300 South Spring Street, Suite 1702, Los Angeles, CA 90013.

On April 4, 2016, in addition to the parties served electronically via TruFiling, I also served the attached **RESPONDENT'S BRIEF OF INSURANCE COMMISSIONER DAVE JONES** by placing a true copy thereof enclosed in a sealed envelope with postage thereon fully prepaid, in the United States mail at Los Angeles, California, addressed as follows:

Honorable Shelleyanne W.L. Chang
Judge of the Superior Court
Gordon D. Schaber Sacramento County Courthouse
Fourth Floor, Department 24
720 9th Street
Sacramento, California 95814

I declare under penalty of perjury under the laws of the State of California the foregoing is true and correct and that this declaration was executed on April 4, 2016, at Los Angeles, California.

KATHI PALACIOS	Kathi Palacios
Declarant	Signature