No. 17-

IN THE
Supreme Court of the United States

MERCURY CASUALTY CO., ET AL.,
Petitioners,
v.

DAVE JONES, INSURANCE COMMISSIONER, ET AL.,
Respondents.

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

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

The Constitution forbids States from imposing price controls that are "confiscatory." *Duquesne Light Co.* v. *Barasch*, 488 U.S. 299, 307 (1989). If a State imposes a price or rate that fails to "afford sufficient compensation" to a regulated firm, "the State has taken the use" of the firm's property "without paying just compensation and so violated the Fifth and Fourteenth Amendments." *Id.* at 308.

California is one of many States that regulate the rates that businesses may charge for certain products and services. In this case, the California Court of Appeal concluded that the Federal Constitution does not prohibit States from imposing rates that are so low as to preclude regulated businesses from earning a fair rate of return—meaning a return that is both sufficient "to attract capital" and "commensurate with returns on investments in other enterprises having corresponding risks." *Fed. Power Comm'n* v. *Hope Nat. Gas Co.*, 320 U.S. 591, 603 (1944). The decision below is in agreement with the holdings of a handful of state supreme courts. But it splits sharply with the decisions of three federal courts of appeals and many more state high courts, which have concluded that government rate regulations are unconstitutionally confiscatory if they preclude regulated entities from recovering a fair rate of return on their capital.

The question presented is:

Whether the Fifth and Fourteenth Amendments permit a State to fix the rates charged by a regulated entity at a level that precludes a fair rate of return on the regulated entity's capital.

PARTIES TO THE PROCEEDING

Petitioner Mercury Casualty Company was the plaintiff-appellant below.

Petitioners National Association of Mutual Insurance Companies, Property Casualty Insurers Association of America, and Personal Insurance Federation of California were intervenor-appellants below.

Respondent Dave Jones, Insurance Commissioner of the State of California, was the defendant-appellee below.

Respondent Consumer Watchdog was an intervenor-appellee below.

RULE 29.6 DISCLOSURE STATEMENT

Mercury Casualty Company is a wholly owned subsidiary of Mercury General Corporation, which is a publicly traded corporation. BlackRock, Inc., a publicly traded corporation, owns 10% or more of Mercury General Corporation's stock.

The National Association of Mutual Insurance Companies is an Indiana nonprofit corporation. It has no parent corporation, and no publicly held company owns 10% or more of its stock.

The Property Casualty Insurers Association of America, doing business in California as the Association of California Insurance Companies, is an Illinois non-profit corporation. It has no parent corporation, and no publicly held company owns 10% or more of its stock.

The Personal Insurance Federation of California is a California non-profit corporation. It has no parent corporation, and no publicly held company owns 10% or more of its stock.

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Petitioners Mercury Casualty Company ("Mercury") and the National Association of Mutual Insurance Companies, the Property Casualty Insurers Association of America, and the Personal Insurance Federation of California (collectively, the "Trades") respectfully petition for a writ of certiorari to review the judgment of the California Court of Appeal in this case.

OPINIONS BELOW

The opinion of the California Court of Appeal (Pet. App. 1a-45a) is reported at 214 Cal. Rptr. 3d 313 (2017). The opinions of the state trial court (Pet. App. 46a-59a, 60a-97a) are not reported. The California Supreme Court's order denying further review (Pet. App. 98a) is also unreported.

JURISDICTION

The California Court of Appeal, Third Appellate District, entered judgment on February 10, 2017. The California Supreme Court denied timely petitions for review on May 10, 2017. On July 21, 2017, Justice Kennedy extended the time for filing a petition for a writ of certiorari, up to and including October 9, 2017.[1] *See* No. 17A82. This Court's jurisdiction is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISIONS INVOLVED

The Fifth Amendment, U.S. Const. amend. V, provides in pertinent part:

> No person shall * * * be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

The Due Process Clause of the Fourteenth Amendment, U.S. Const. amend. XIV, § 1, provides:

> No State shall * * * deprive any person of life, liberty, or property, without due process of law.

INTRODUCTION

This case squarely presents a question that has divided the States and lower federal courts: Whether the Fifth and Fourteenth Amendments prohibit

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[1] Petitioners sought an extension of 60 days, which would have run on Saturday, October 7, 2017. Justice Kennedy granted an extension up to and including the following Monday, which is October 9, 2017. *See* S. Ct. R. 30.1. Petitioners' counsel contacted the Clerk's office and was advised that this petition should be filed on October 10, 2017 because October 9, 2017 is a federal legal holiday. *See id.*; 5 U.S.C. § 6103(a).

States from setting rates at levels that preclude a regulated entity from obtaining a fair rate of return on its capital.

For over seventy years, this Court has held that the Constitution guarantees a regulated business the opportunity to earn "enough revenue not only for operating expenses but also for the capital costs of the business." *Fed. Power Comm'n* v. *Hope Nat. Gas Co.*, 320 U.S. 591, 603 (1944). In case after case, this Court has emphasized that government-imposed rates must allow affected firms to "maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed." *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968); *cf. Duquesne Light Co.* v. *Barasch*, 488 U.S. 299, 312 (1989).

The decision below departs dramatically from those precedents. The California Court of Appeal held that rate regulations violate the Constitution only if they inflict "deep financial hardship" to "the enterprise as a whole." Pet. App. 30a, 38a (internal quotation marks omitted). In announcing that standard, the court held that a "'fair rate of return' standard" is fundamentally incompatible with the court's "understanding of the constitutional concept of confiscation." *Id*. at 38a. It flatly rejected the idea that firms are entitled to returns that are sufficient "to attract capital" and "commensurate with" those "in other enterprises having corresponding risks." *Id.* at 36a. That holding deepens a sharp split between the handful of state supreme courts that share California's view and a larger contingent of state supreme courts and federal courts of appeals that have concluded that the Fifth and Fourteenth Amendments

bar rate regulations that deprive firms of the opportunity to earn a fair rate of return on their capital.

The conflict could not be clearer or more cleanly presented. The Court of Appeal rendered a pure legal ruling that was unencumbered by any of the complex factual questions or methodological disputes that often attend challenges to government ratemaking. And because California is the Nation's largest economy, the court's unequivocal repudiation of the "fair rate of return" standard threatens to have enormous consequences for regulated industries both in California and across the country. This Court's intervention is urgently needed.

STATEMENT

A. California's Regulation Of Insurance Premiums

In 1988, voters in California approved a ballot initiative known as Proposition 103. Proposition 103 requires insurers to obtain approval from the California Insurance Commissioner for any change in the rates they charge for most lines of insurance. Cal. Ins. Code § 1861.01(c).

The Commissioner ordinarily does not approve a premium increase unless the proposed premium falls below a rate ceiling set by the Commissioner. To calculate the maximum premium the insurer may charge, the Commissioner applies a formula that considers, among other things, the insurer's projected losses and a fixed maximum rate of return. *See* Cal. Code Regs. tit. 10, §§ 2644.2, 2644.15.

The Commissioner's authority to impose this rate ceiling is constrained, however, by the Federal Constitution. The Fifth and Fourteenth Amend-

ments to the Constitution prohibit States from imposing price controls that are "confiscatory." *Duquesne*, 488 U.S. at 307.

In *20th Century Insurance Co.* v. *Garamendi*, 878 P.2d 566 (Cal. 1994), *cert. denied*, 513 U.S. 1140 (1995), the California Supreme Court applied that prohibition to Proposition 103. The court held that firms were entitled to seek a "constitutionally mandated 'variance'" from any rate order that "would otherwise be confiscatory as applied." *Id.* at 628. In other words, firms may charge a premium higher than the rate ceiling set by the Commissioner if the otherwise maximum permitted rate would effect an unconstitutional confiscation. That holding was later incorporated into a regulation, which requires the Commissioner to grant a variance if "the maximum permitted earned premium would be confiscatory as applied." Cal. Code Regs. tit. 10, § 2644.27(f)(9). In 2006, the Commissioner recognized in official responses to public comments on amendments to the insurance regulations that "the Court in *20th Century* relied on variances as an extremely important protection against confiscation," and that "insurers must be allowed an opportunity to earn a fair and reasonable rate of return." C.A. App. 1443.

B. Factual And Procedural Background

Mercury is one of California's leading insurers. In 2009, Mercury filed an application with the California Insurance Commissioner to increase its homeowners' insurance rates. Pet. App. 6a. Although that increase would have brought Mercury's premiums above the rate ceiling set by the Commissioner, Mercury asserted that it was entitled to a rate in-

crease based on the "constitutional variance" in Section 2644.27(f)(9) of the state regulations.

1. In 2011, the Commissioner convened a hearing before an administrative law judge (ALJ) to consider Mercury's application. Pet. App. 6a-7a. Mercury argued that the maximum permitted rate within the Commissioner's rate ceiling is "confiscatory," and that an insurer is therefore entitled to a variance, when that rate "would deny an insurer the opportunity to earn a just, reasonable and fair return." *Id.* at 9a (internal quotation marks omitted). In support of its application, Mercury submitted expert testimony from a financial economist who opined on whether the State's regulations permitted Mercury to earn a "'fair' return," which he viewed as the appropriate "benchmark" to determine whether the return was "quantitatively 'confiscatory.'" *Id.* at 7a (internal quotation marks omitted).

The ALJ refused to allow that testimony—and portions of another expert's testimony—on the ground that Mercury was not constitutionally entitled to a "fair return." The ALJ explained that, in order to qualify for a variance, "Mercury had to demonstrate that the maximum earned premium under the ratemaking formula results in an inability to operate successfully." *Id.* (internal quotation marks and brackets omitted). As a result, Mercury was permitted to show only that "the maximum rate will cause deep financial hardship to Mercury's enterprise as [a] whole." *Id.* (internal quotation marks omitted).

In 2013, the Commissioner adopted the ALJ's proposed ruling wholesale. *Id.* at 9a. The Commissioner denied Mercury's requested rate increase, and

instead approved a *decrease* of approximately 5%. The Commissioner determined that Mercury was not entitled to a constitutional variance because it had "failed to demonstrate" that the rate decrease would result in "deep financial hardship." *Id.* at 9a-10a (internal quotation marks omitted). That was a remarkable about-face given the Commissioner's prior interpretation of *20th Century*. *See* C.A. App. 1443.[2]

2. Mercury sought judicial review of the Commissioner's decision in the state trial court. The Trades intervened in support of Mercury. Among other things, Mercury and the Trades alleged that the Commissioner "applied the wrong standard to assess whether Mercury could show confiscation." Pet. App. 10a (internal quotation marks omitted).

The trial court rejected those arguments and affirmed the Commissioner's decision in full. The court agreed with the Commissioner that "the test for confiscation is 'deep financial hardship.'" *Id.* at 85a. And it concluded that "Mercury did not demonstrate 'deep financial hardship' to support its request for a confiscation variance." *Id*.

3. Mercury and the Trades appealed to the California Court of Appeal. As relevant here, they maintained that the "deep financial hardship" standard did not offer constitutionally adequate protection from confiscatory rates. *Id.* at 31a. Relying on this

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[2] The Commissioner also excluded certain portions of Mercury's advertising budget from the calculation of the maximum permitted return. Pet. App. 2a. Petitioners challenged that aspect of the Commissioner's decision in the courts below, but they do not raise that issue in this petition.

Court's decisions, Mercury and the Trades argued that a regulated firm is constitutionally entitled to returns sufficient "to attract capital, and to compensate its investors for the risks assumed." Trades' C.A. Br. 36 (quoting *Hope Nat. Gas*, 320 U.S. at 605); *see also* Mercury's C.A. Br. 43-44.

The California Court of Appeal rejected that argument. The court began by summarizing the federal constitutional standards announced by the California Supreme Court more than two decades earlier in *20th Century*. It explained that *20th Century* had established that rate regulations are unconstitutionally confiscatory only when they inflict "deep financial hardship" to "the enterprise as a whole." Pet. App. 30a, 38a. The court also noted that *20th Century* had made "the inability to operate successfully" a "necessary condition of confiscation." *Id.* at 38a (internal quotation marks and alterations omitted). Accordingly, the court found "no error" in the Commissioner's and the trial court's application of the "'deep financial hardship' standard" in determining whether the rate at issue was unconstitutionally confiscatory. *Id.* at 41a.

But the California Court of Appeal then went one step further than the California Supreme Court had in *20th Century*: The court explicitly denied that a "fair rate of return" had any place in the constitutional analysis. *Id.* at 38a. It held that the "fair rate of return" standard espoused by Mercury and the Trades "*contravenes*" the "deep financial hardship" standard. *Id.* (emphasis added).

The California Supreme Court denied timely petitions for review of the Court of Appeal's decision without comment. This petition followed.

REASONS FOR GRANTING THE PETITION

I. THERE IS A SQUARE SPLIT ON THE QUESTION PRESENTED

The California Court of Appeal held that the Federal Constitution does not guarantee a "fair rate of return" to regulated firms. Pet. App. 38a. In doing so, the court rejected the idea that a firm must be allowed returns "sufficient to attract capital" or commensurate with what "investor[s] could reasonably expect to earn in other businesses with comparable investment risks." *Id.* at 37a (internal quotation marks and brackets omitted). Instead, the court concluded that firms are entitled to relief only from rates that inflict the kind of "deep financial hardship" that leaves them unable "to operate successfully." *Id*. at 38a (internal quotation marks omitted).

That decision sharpens a longstanding split among both federal and state courts. California, the Nation's largest economy, now stands squarely among a handful of States that have concluded that the Constitution permits price controls that deny regulated firms access to needed capital and drive them to the brink of failure. The decisions in those States conflict with the decisions of three federal courts of appeals and a number of state supreme courts—all of which have concluded that the Fifth and Fourteenth Amendments bar rate regulations that deprive firms of the opportunity to earn a fair rate of return on their capital.

1. Unlike California, three federal courts of appeals—the Sixth, Ninth, and D.C. Circuits—and six state supreme courts—Nebraska, New Jersey, New Mexico, Maine, Massachusetts, and Utah—have concluded that price controls must allow for returns

that are sufficient to attract capital and that are commensurate with what investors reasonably could expect to earn in other enterprises with comparable risks.

a. Several federal courts of appeals have embraced the fair rate of return standard. In *Guaranty National Insurance Co.* v. *Gates*, 916 F.2d 508 (9th Cir. 1990), the Ninth Circuit considered a facial challenge to a Nevada statute that required automobile insurers to reduce their rates unless they were "substantially threatened with insolvency" by the rate reduction. *Id.* at 510 (quoting 1989 Nev. Stat. 784.1.2). The plaintiff insurers argued that the statute violated the Constitution because it denied them "the opportunity to earn, at a very minimum, a fair and reasonable rate of return." *Id.* at 512 (internal quotation marks omitted). The Ninth Circuit agreed. It held that rate regulations must "guarantee the constitutionally required 'fair and reasonable return,'" including "'enough revenue not only for operating expenses but also for the capital costs of the business.'" *Id.* at 515 (quoting *Hope Nat. Gas*, 320 U.S. at 603). Forcing a firm to show that it was "threatened with insolvency" before granting a variance would not adequately vindicate that guarantee. *Id.* at 514. Nor did the general standard that Nevada law applied to insurance rates offer an adequate safeguard; it "guarantee[d] only that an insurer will *break even*"—a standard that the court held was "constitutionally unacceptable." *Id.* at 515 (emphasis added). The Ninth Circuit thus struck down the rate reduction statute as unconstitutional. *Id.* at 516.

The Sixth Circuit followed a similar approach in *Michigan Bell Telephone Co.* v. *Engler*, 257 F.3d 587 (6th Cir. 2001). That case addressed a challenge to a Michigan statute that froze certain telephone rates. *Id.* at 591. The statute allowed limited exceptions for small firms and "competitive" services. *Id.* at 594. But the Sixth Circuit found that these exceptions could not "adequately safeguard against imposition of confiscatory rates." *Id.* Adopting the Ninth Circuit's reasoning in *Guaranty National*, the Sixth Circuit also held that Michigan's general rate-setting standard "clearly d[id] not guarantee a constitutionally adequate rate of return for regulated telephone service providers" because it "merely" allowed firms "to cover *costs*," and did not "ensure a fair and reasonable rate of return on investment." *Id.* Accordingly, the Sixth Circuit concluded that the plaintiffs had "demonstrated a substantial likelihood" of success on their constitutional challenge and preliminarily enjoined the statute. *Id.* at 596.

Finally, in *Jersey Central Power & Light Co.* v. *FERC*, 810 F.2d 1168 (D.C. Cir. 1987) (en banc), the D.C. Circuit reviewed a challenge to a Federal Energy Regulatory Commission (FERC) order that effectively reduced the amount of money the utility was authorized to recover from ratepayers. Writing for the court, Judge Bork explained that a government-imposed rate must "reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed." *Id.* at 1177 (quoting *Permian Basin*, 390 U.S. at 792); *see id.* at 1175 (noting that this standard "defines the point at which a rate becomes unconstitutionally confiscatory"). Like the Ninth Circuit in *Guaranty National*, the D.C. Circuit thus

flatly rejected the argument that a regulated entity may seek relief only if a rate order would plunge the entity "into bankruptcy." *Id*. To the contrary, the court observed that the order before it was "almost certainly" unconstitutional because it had allegedly "shut off" the petitioner "from long-term capital." *Id.* at 1181.

The D.C. Circuit also indicated in a footnote that a rate regulation may violate the Constitution when it inflicts "the sort of deep financial hardship described in *Hope*." *Id.* at 1181 n.3. As the court's extensive discussion made plain, the "deep financial hardship described in *Hope*," *id.*, was simply the *absence* of a fair and reasonable return—in other words, a rate of return that did not allow a business to cover "the capital costs of the business" or to "assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." *Id.* at 1176, 1178 (quoting *Hope Nat. Gas*, 320 U.S. at 603). By pegging "deep financial hardship" to the harms "described in *Hope*," the D.C. Circuit underscored the primacy of the fair rate of return in its analysis.

b. Many state high courts have likewise held that the Federal Constitution forbids price controls that do not allow returns sufficient to compensate and attract investors. For example, the New Jersey Supreme Court has expressly recognized a " 'fair rate of return' " standard—namely, a "constitutional requirement that a business be permitted a return sufficient to assure its financial health," including revenues "adequate to attract and retain invested capital." *State Farm Mut. Auto. Ins. Co.* v. *New Jersey*, 590 A.2d 191, 199 (N.J. 1991) (quoting *Duquesne*, 488 U.S. at 310); *see also Hutton Park Gardens* v. *Town Council*, 350 A.2d 1, 15 (N.J. 1975)

(holding that returns "should be *** generally commensurate with returns on investments in other enterprises having comparable risks").

New Jersey is not alone. States across the country have applied the same standard. The Supreme Judicial Court of Massachusetts has held that regulated firms "are entitled to the opportunity to realize a fair and reasonable return on their investment" sufficient to "maintain investor confidence." *Fitchburg Gas & Elec. Light Co.* v. *Dep't of Pub. Util.*, 7 N.E.3d 1045, 1053 (Mass. 2014) (internal quotation marks and brackets omitted). Maine's high court has likewise indicated that a rate is unconstitutionally confiscatory "where the approved rate denies a regulated entity the opportunity to realize a reasonable return on its investment." *Anthem Health Plans of Me., Inc.* v. *Superintendent of Ins.*, 40 A.3d 380, 389 (Me. 2012) (internal quotation marks and brackets omitted). And it has indicated that a regulated entity "cannot be forced to operate its business at a loss or at such legislatively imposed, diminished margins that the risk of a confiscatory taking would be manifest." *Id.*

Further to the west, similar decisions abound. The Nebraska Supreme Court has recognized that "[a] government-established rate for a public utility is confiscatory when the rate fails to produce a return on investment equal to the return realized on investments which have risks corresponding to those of the utility." *Peoples Nat. Gas. Co.* v. *City of Bellevue*, 579 N.W.2d 510, 512 (Neb. 1998). The Utah Supreme Court has explained that rates are confiscatory unless they "produce enough revenue to pay a utility's operating expenses plus a reasonable return on capital invested *** includ[ing] the cost of debt

service and a return on equity capital sufficient to attract investors, given the nature of the risk of the investment." *Stewart* v. *Utah Pub. Serv. Comm'n*, 885 P.2d 759, 767 (Utah 1994). And the New Mexico Supreme Court has observed that rates "constitute a taking of property" when they prevent a regulated firm "from earning a reasonable rate of return on its investment"—i.e., "one that provides a fair opportunity for the utility to receive just compensation for its investments." *In re Petition of PNM Gas Servs.*, 1 P.3d 383, 391 (N.M. 2000).

2. California unambiguously rejects the view shared by these courts. Far from embracing the "'fair rate of return' standard," the Court of Appeal held that it "contravenes" California's interpretation of the Federal Constitution. Pet. App. 38a. Under that interpretation, the constitutional prohibition on confiscatory rates is not even implicated by government-imposed rates until they inflict such "deep financial hardship" that a regulated firm is left unable "to operate successfully." *Id.* (internal quotation marks omitted).[3]

Although no federal court has adopted California's extreme position, the supreme courts of New Hampshire, Pennsylvania, Kansas, and Ohio have agreed that regulated firms are not guaranteed a fair rate of

[3] Although the Court of Appeal's reference to "deep financial hardship" originates in a footnote to the D.C. Circuit's decision in *Jersey Central*, *supra* pp. 11-12, the court broke sharply with the D.C. Circuit's decision by holding that "deep financial hardship" displaces the fair rate of return standard. As the D.C. Circuit used the phrase, "deep financial hardship" simply described the absence of the constitutionally mandated fair rate of return.

return under the Federal Constitution. The New Hampshire Supreme Court has held that rates need not provide "[a] margin of profit sufficient to enable the company to attract capital." *Appeal of Eastman Sewer Co.*, 636 A.2d 1030, 1033 (N.H. 1994) (internal quotation marks omitted). Instead, rates need only be "sufficient to pay" the "expenses of operating" the business. *Id.* (internal quotation marks omitted). Meanwhile, Kansas and Ohio have followed Pennsylvania in concluding that the "investor interests" in obtaining a fair rate of return are not of a "constitutionally guaranteed dimension." *Pa. Elec. Co.* v. *Pa. Pub. Util. Comm'n*, 502 A.2d 130, 131 (Pa. 1985); *accord Kan. Gas & Elec. Co.* v. *State Corp. Comm'n*, 720 P.2d 1063, 1071 (Kan. 1986) (similar); *Ohio Edison Co.* v. *Pub. Util. Comm'n*, 589 N.E.2d 1292, 1300 (Ohio 1992) (per curiam) (observing that "the rates' effect on the company's financial integrity * * * is but another of the risks which a utility, as any other unregulated enterprise, must bear"). These courts have explained that the Constitution does not prohibit State rate regulations that interfere with "the continued financial integrity" of a regulated firm. *Pa. Elec. Co.*, 502 A.2d at 133. None of these decisions can be reconciled with the majority view that the Federal Constitution prohibits States from setting price controls that deny businesses a fair rate of return.

In sum, federal and state courts are sharply divided over an important question of Federal constitutional law. Such an acute divide would be reason enough to grant review in the ordinary case. But the lack of uniformity is particularly untenable here because, as the California Court of Appeal itself suggested, the decision below is in direct conflict

with the Ninth Circuit's decision in *Guaranty National*. Pet. App. 36a. As a result, in California, regulated firms are entitled to a fair rate of return in the federal courthouse but will be denied the same right in the state courthouse down the street. This Court should correct that perverse state of affairs.

II. THE DECISION BELOW IS CONTRARY TO THIS COURT'S PRECEDENTS

Review is warranted for another reason: The decision below is wrong. The "deep financial hardship" standard articulated by the California Court of Appeal runs counter to this Court's consistent teaching that the Constitution guarantees a fair rate of return to regulated businesses.

1. The Constitution protects businesses from confiscatory rates. "If [a] rate does not afford sufficient compensation, the State has taken the use" of property "without paying just compensation and so violated the Fifth and Fourteenth Amendments." *Duquesne*, 488 U.S. at 308.

In *Hope*, this Court made clear that "sufficient compensation" means "enough revenue not only for operating expenses but also for the capital costs of the business." 320 U.S. at 603. The reason is simple. As Justice Brandeis explained in an opinion that this Court has recognized as the foundation for the *Hope* decision, "there is no difference" as a constitutional matter between a company's "capital charge"—the cost of attracting and retaining capital—and its "operating expenses." *Sw. Bell Tel. Co.* v. *Pub. Serv. Comm'n*, 262 U.S. 276, 306 (1923) (Brandeis, J., concurring in the judgment); *see Duquesne*, 488 U.S. at 309. "Each is part of the current cost of supplying the service." *Sw. Bell*, 262 U.S. at

306 (Brandeis, J., concurring in the judgment). Because "the Constitution guarantees an opportunity to earn" the "reasonable cost of conducting the business," it necessarily "guarantees [a regulated firm] the opportunity to earn a fair return" on its invested capital. *Id.* at 290-291.

Citing Justice Brandeis, *Hope* defined this constitutionally guaranteed "fair" rate of return as a return "commensurate with returns on investments in other enterprises having corresponding risks," and "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." 320 U.S. at 603.

That standard has governed this Court's cases ever since. In *Permian Basin*, the Court held that a court reviewing a government rate regulation "must determine" whether affected businesses will be able to "maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed." 390 U.S. at 792. Likewise, in *Duquesne*, the Court concluded that the challenged rates were not "constitutionally objectionable" because the rates did not "jeopardize the financial integrity of the companies, either by leaving them insufficient operating capital or by impeding their ability to raise future capital" and because the rates were not "inadequate to compensate current equity holders for the risk associated with their investments." 488 U.S. at 312.

2. In spite of these clear teachings, the California Court of Appeal held that the "fair rate of return" standard "contravenes" the court's "understanding of the constitutional concept of confiscation." Pet. App. 38a. Quoting the California Supreme Court's deci-

sion in *20th Century Insurance Co.* v. *Garamendi*, the court below suggested that *Hope* merely described "an interest that the producer may pursue and not a right that it can demand." *Id.* at 34a. Having sidelined this Court's decision in *Hope*, the court below concluded that a rate is confiscatory only when it inflicts "deep financial hardship" that renders a regulated firm unable "to operate successfully." *Id.* at 38a.[4]

The Court of Appeal's repudiation of the fair rate of return standard cannot be squared with this Court's cases. To be sure, under *Hope* and its progeny, the government must not only ensure that price controls allow a regulated firm to "maintain financial integrity, attract necessary capital, and fairly compensate investors," but also must "provide appropriate protection to the relevant public interests." *Permian Basin*, 390 U.S. at 792. The passages from *20th Century* quoted by the Court of Appeal make much of the truism—articulated in *Permian Basin*—that the investor's interest is "only one of the variables in the constitutional calculus." Pet. App. 35a, 38a (quoting *Permian Basin*, 390 U.S. at 769).

But the Court of Appeal ignored the very next line from this Court's opinion, which explains that rates must be set "in conformity with the *pertinent constitutional limitations*." *Permian Basin*, 390 U.S. at

[4] Although the court below quoted extensively from *20th Century*, the Court of Appeal's express rejection of the fair rate of return standard went far beyond the Commissioner's own reading of that case as requiring that insurers "be allowed an opportunity to earn a fair and reasonable rate of return." C.A. App. 1443.

769 (emphasis added). And *Permian Basin* itself makes clear that the requirement of a fair rate of return is just such a constitutional limitation. *See id.* at 792; *see also Hope*, 320 U.S. at 603; *Duquesne*, 488 U.S. at 312; *id.* at 317 (Scalia, J., concurring) ("whether the government's action is confiscatory" depends on "whether the payments a utility has been allowed to collect constitute a fair return on investment"). Only by airbrushing those important details out of the picture could the court below claim that nothing short of "deep financial hardship" violates the Fifth and Fourteenth Amendments.

The Court of Appeal also relied on *20th Century*'s invocation of this Court's statement that regulators are not "required to maintain, or even allowed to maintain to the exclusion of other considerations, the profit margin" of any firm. Pet. App. 37a (quoting *FERC* v. *Pennzoil Producing Co.*, 439 U.S. 508, 518 (1979)). Of course that is true. But that says nothing about the *extent* to which regulators may *reduce* a firm's earnings. The quoted phrase does not imply that regulators may reduce a business's rates below a fair rate of return.

With no foothold in this Court's precedents, the court below relied for its "deep financial hardship" rule on *20th Century*'s earlier invocation of a footnote in Judge Bork's opinion for the D.C. Circuit in *Jersey Central*. Pet. App. 35a-38a (quoting *Jersey Cent.*, 810 F.2d at 1181 n.3). As noted in Part I, *supra*, the D.C. Circuit's fleeting reference to "the sort of deep financial hardship described in *Hope*" did not mean what *20th Century* thought it meant. That phrase confirms, rather than contravenes, the fair rate of return principle reaffirmed time and again in this Court's precedents.

The California Court of Appeal's "understanding of the constitutional concept of confiscation," Pet. App. 38a, cannot be reconciled with this Court's precedents. Had the court faithfully applied those precedents, it would have concluded that petitioners are entitled to a fair rate of return.

III. THIS CASE IS AN IDEAL VEHICLE TO ADDRESS THE QUESTION PRESENTED

This case presents a singular opportunity for the Court to resolve an entrenched split on an important constitutional question. The decision below resolved a pure question of law with unusual clarity, making this the ideal vehicle to address a question that is too often obscured by voluminous records and complex factual disputes.

To begin, the California Court of Appeal's decision squarely tees up the question presented. The principal issue below was whether the Commissioner and the trial court had "erred in holding that rates are constitutionally confiscatory only if they result in financial distress, rather than simply in the inability to earn a fair return." Pet. App. 31a. The court answered that question unequivocally: It found "no error in the application by the commissioner and the superior court of the 'deep financial hardship' standard to determine whether a price control is constitutionally confiscatory." *Id.* at 41a. The court clarified that this standard could not be reconciled with the "fair rate of return standard espoused by" the petitioners. *Id.* at 38a (internal quotation marks omitted). Thus, unlike prior decisions in California and elsewhere, the Court of Appeal made crystal clear that regulated firms are not constitutionally entitled to a fair rate of return.

Moreover, the Court of Appeal's conclusion was unencumbered by the factual or technical issues that ordinarily muddy the waters in cases involving challenges to confiscatory rates. The decision below is not bound up with thorny methodological questions regarding "what is a fair rate of return given the risks under a particular rate-setting system" or "the amount of capital upon which the investors are entitled to earn that return." *Duquesne*, 488 U.S. at 310. Instead, the court reached a purely legal conclusion, one that hardly was a ticket for this train only. That makes this case a particularly suitable vehicle for this Court's review.

That the decision here was issued by an intermediate appellate court, as opposed to a state supreme court, does not make it any less suitable for review. This Court has not hesitated to review decisions of intermediate state appellate courts in cases where the state supreme court has denied discretionary review. *See, e.g.*, *Cyan* v. *Beaver Cty. Emps. Retirement Fund*, 137 S. Ct. 2325 (2017); *Murr* v. *Wisconsin*, 137 S. Ct. 1933 (2017). With good reason: The "trend in state supreme courts towards discretionary review has resulted in the intermediate state appellate courts taking on a large and significant role in the development and application" of federal constitutional law. *Arizona* v. *Kempton*, 501 U.S. 1212, 1212-13 (1991) (White, J., dissenting from denial of certiorari). In any event, a State's high court should not be able to shield the decisions of intermediate state appellate courts from scrutiny just by declining discretionary review. The fact that the decision below was rendered by an intermediate appellate court and was not reviewed by the state supreme

court therefore "should make no difference." *Id.* at 1212.

Moreover, the Court of Appeal's decision is likely to have practical consequences on par with a decision of the California Supreme Court. Under California law, a decision of the Court of Appeal is binding on *all* trial courts in California, not just the trial courts within its jurisdiction. *See Hale* v. *Superior Ct.*, 539 P.2d 817, 822 n.3 (Cal. 1975). Like a California Supreme Court decision, the decision below will thus be binding on litigants in every trial court in the Nation's most populous State.

In sum, this case offers an unusually clean vehicle to resolve an important issue of federal constitutional law that has divided the state and federal courts. This Court should take the opportunity to resolve that issue now.

IV. THE QUESTION PRESENTED IS IMPORTANT AND RECURRING

Certiorari should be granted for yet another reason: The question whether insurers are entitled to a fair rate of return has sweeping implications for regulated businesses and for the national economy as a whole.

California is home to the Nation's largest economy. The State accounts for nearly one-seventh of the Nation's gross domestic product.[5] The decision below will therefore have an outsized economic impact. Indeed, in California alone, insurers subject to rate regulation by the State wrote over $50 *billion* in

[5] Bureau of Econ. Analysis, *Gross Domestic Product by State: First Quarter of 2017* (July 26, 2017), http://goo.gl/Ajtsa1.

premiums in 2016.[6] Thus, whether insurers are constitutionally guaranteed a fair rate of return—or are instead guaranteed only a rate that staves off "deep financial hardship"—is likely to be of enormous consequence for insurers. It is also likely to matter a great deal for consumers who purchase insurance and for the economy as a whole.

Of course, the significance of the issue is not limited to California. For one thing, under the constitutional standard announced by the Court of Appeal, regulators in California can limit national insurers to rates that come just shy of inflicting "deep financial hardship" on the "enterprise *as a whole*"—not just the insurer's California business. Pet. App. 30a, 38a (emphasis added and internal quotation marks omitted). Given the size of the California market, such low rates could force national insurers to use money earned in *other* States to support policies sold in California, effectively compelling ratepayers in other States to subsidize the California insurance market. The "deep financial hardship" standard thus affects the interests of insurers and consumers far beyond the State's borders.

More than that, the question whether businesses are constitutionally entitled to a fair rate of return affects the way many other States regulate *their* insurance markets. Although States vary widely in how they regulate insurers, almost every State imposes price controls or otherwise requires state approval for at least some types of insurance prod-

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[6] Cal. Dep't of Ins., *1991-2016 California P&C Historical Premium and Loss Total: Prop 103 Lines Only* (Apr. 30, 2017), http://goo.gl/JvB85J.

ucts. *See* Angelo Borselli, *Insurance Rates Regulation in Comparison With Open Competition*, 18 Conn. Ins. L.J. 109, 126-127, 161-167 (2011). The constitutional constraints on those regulations will affect the rates insurers are allowed to charge across the country. And that in turn affects a large swath of the national economy: Nationwide, property and casualty insurance was a $600 *billion* industry in 2016.[7]

The significance of the question presented is not limited to insurance, either. Indeed, insurers are just the tip of the iceberg. As the cases discussed above illustrate, the same constitutional principles govern everything from electricity and telephone service to municipal sewers and rental housing. Because the standard for unconstitutionally confiscatory rates does not vary from industry to industry, the question presented affects the many thousands of businesses that are subject to rate regulation by the States. That makes immediate review by this Court all the more necessary.

[7] Nat'l Assoc. of Ins. Comm'rs, *Property and Casualty Insurance Industry: 2016 Top 25 Groups and Companies by Countrywide Premium* (Mar. 27, 2017), http://goo.gl/2eCFhj.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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OCTOBER 2017

APPENDIX

APPENDIX A

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA, THIRD APPELLATE DISTRICT

Nos. C077116, C078667

MERCURY CASUALTY COMPANY,
Plaintiff and Appellant,
v.
DAVE JONES, as Insurance Commissioner, etc.,
Defendant and Respondent.
PERSONAL INSURANCE FEDERATION OF CALIFORNIA et al.,
Interveners and Appellants,
CONSUMER WATCHDOG,
Intervener and Respondent.

Filed: February 10, 2017

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

OPINION

ROBIE, J.

This appeal arises out of an application Mercury Casualty Co. (Mercury) filed in 2009 to increase its homeowners' insurance rates. In denying the increase Mercury requested, the California Insurance

Commissioner (the commissioner) made two decisions that are at issue on appeal. First, the commissioner determined that under subdivision (f) of section 2644.10 of title 10 of the California Code of Regulations, which disallows, for ratemaking purposes, all "[i]nstitutional advertising expenses," Mercury's entire advertising budget had to be excluded from the calculation of the maximum permitted earned premium because "Mercury[ ] aims its entire advertising budget at promoting the Mercury Group as whole" rather than "seek[ing] to obtain business for a specific insurer and also provid[ing] customers with pertinent information" about that specific insurer.[1] Second, the commissioner determined that Mercury did not qualify for a variance from the maximum permitted earned premium under subdivision (f)(9) of section 2644.27 because "Mercury failed to demonstrate the rate decrease [that resulted from application of the regulatory formula] results in deep financial hardship."[2]

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[1] Section 2644.10 provides that certain expenses "shall not be allowed for ratemaking purposes." Subdivision (f) of that section identifies "[i]nstitutional advertising expenses" as one category of disallowed expenses and defines "[i]nstitutional advertising" as "advertising not aimed at obtaining business for a specific insurer and not providing consumers with information pertinent to the decision whether to buy the insurer's product."

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

[2] Subdivision (f)(9) of section 2644.27 provides that one valid basis for requesting a variance is "[t]hat the maximum permitted earned premium would be confiscatory as applied. This is the constitutionally mandated variance articulated in *20th Century v. Garamendi* (1994) 8 Cal.4th 216, 32 Cal.Rptr.2d 807,

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

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

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878 P.2d 566 which is an end result test applied to the enterprise as a whole."

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

[3] The Trades consist of the following organizations: Personal Insurance Federation of California, American Insurance Association, Property Casualty Insurers Association of America dba Association of California Insurance Companies, National Association of Mutual Insurance Companies, and Pacific Association of Domestic Insurance Companies.

FACTUAL AND PROCEDURAL BACKGROUND

We begin with some brief background on the area of the law involved here. "At the November 8, 1988, General Election, the voters approved an initiative statute that was designated on the ballot as Proposition 103. The measure made numerous fundamental changes in the regulation of automobile and other forms of insurance in California. Formerly, the so-called 'open competition' system of regulation had obtained, under which 'rates [were] set by insurers without prior or subsequent approval by the Insurance Commissioner * * * .' [Citation.] Under that system, 'California ha[d] less regulation of insurance than any other state, and in California automobile liability insurance [was] less regulated than most other forms of insurance.' [Citation.] The initiative contained, among others, provisions relating to the rollback of rates for insurance within its coverage for the period extending from November 8, 1988, through November 7, 1989. (For purposes here, a rate is the price or premium that an insurer charges its insureds for insurance.)" (*20th Century Ins. Co.* v. *Garamendi* (1994) 8 Cal.4th 216, 239-240, 32 Cal.Rptr.2d 807, 878 P.2d 566 (*20th Century*).) "For the period extending from November 8, 1988, through November 7, 1989 (hereafter sometimes the rollback year or simply 1989), as a temporary regulatory regime of rate reduction and freeze evidently designed to allow the setting up of a permanent regulatory regime to follow, Proposition 103 itself sets a maximum rate for covered insurance at 80 percent of the rate for the same insurance in effect on November 8, 1987 (hereafter sometimes the 1987 rate). [¶]

For the period extending from November 8, 1989, into the future, Proposition 103 institutes a permanent regulatory regime comprising the 'prior approval' system, under which, in the words of Insurance Code section 1861.05, subdivision (a), the Insurance Commissioner must approve a rate applied for by an insurer before its use, looking to whether the rate in question is 'excessive, inadequate, unfairly discriminatory or otherwise in violation of' specified law—considering the 'investment income' of the individual insurer and *not considering* the 'degree of competition' in the insurance industry generally." (*20th Century*, at p. 243, 32 Cal.Rptr.2d 807, 878 P.2d 566.)

"In *Calfarm Ins. Co.* v. *Deukmejian* (1989) 48 Cal.3d 805 [258 Cal.Rptr. 161, 771 P.2d 1247] (hereafter sometimes *Calfarm*), [the Supreme Court] upheld, inter alia, Proposition 103's provision requiring rate rollbacks." (*20th Century, supra*, 8 Cal.4th at p. 240, 32 Cal.Rptr.2d 807, 878 P.2d 566.) The court "reviewed Proposition 103 against challenges under the United States and California Constitutions, including a claim that the rate rollback requirement provision was on its face invalid as confiscatory and arbitrary, discriminatory, or demonstrably irrelevant to legitimate policy in violation of the takings clause of the Fifth Amendment and article I, section 19 and the due process clause of the Fourteenth Amendment and article I, sections 7 and 15. In the course of [the court's] analysis, [the court] rejected the point." (*20th Century*, at pp. 243-244, 32 Cal.Rptr.2d 807, 878 P.2d 566, fn.,omitted.)

Five years after *Calfarm*, in *20th Century*, the Supreme Court "review[ed] the implementation of Proposition 103's rate rollback requirement provision

by the Insurance Commissioner." (*20th Century*, *supra*, 8 Cal.4th at p. 240, 32 Cal.Rptr.2d 807, 878 P.2d 566.) The court ultimately upheld the commissioner's actions. (*Id.* at p. 329, 32 Cal.Rptr.2d 807, 878 P.2d 566.)

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

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

In October 2011, Mercury submitted the prefiled direct testimony of various witnesses, including Robert S. Hamada and David Appel. As a financial economist, Hamada was asked "to provide an economic application of th[e] variance *** in [section

2644.27(f)(9)], and to determine whether the maximum permitted return is quantitatively 'confiscatory' to the providers of Mercury's capital." Hamada asserted that "[t]o do this, it is necessary to lay out an economic interpretation of 'fair' return to use as a benchmark to quantify whether a statutorily-determined return is 'confiscatory.' " For his part, Dr. Appel was also asked to opine (among other things) whether it was appropriate for Mercury to seek a variance under section 2644.27(f)(9).

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

In its posthearing brief, Consumer Watchdog argued that all of Mercury's advertising expenses should be excluded from the rate calculation as insti-

tutional advertising expenses because the evidence showed that none of Mercury's advertising in California was aimed at obtaining business for a particular insurer; instead, "Mercury's ads and campaigns promote a fictional entity called 'Mercury Insurance Group.' "

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

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

For its part, Mercury argued that under *20th Century*, "in deciding whether rates produced by the formula are 'confiscatory,' courts are required to de-

termine if they would deny an insurer the opportunity to earn a 'just, reasonable and fair return.' "

In January 2013, the ALJ submitted her proposed decision, which the commissioner adopted in full in February 2013. As relevant here, the commissioner found that "Mercury General Corporation is the parent company for Mercury Casualty and 21 other entities. Mercury General provides no services to customers and receives all its operating resources directly from its insurance affiliates, most notably Mercury Casualty." "In 2008, 2009 and 2010 Mercury General Corporation's advertising expenses totaled $26 million, $27 million, and $30 million respectively." "Mercury General and all its affiliates advertise under the name 'Mercury Insurance Group,' " and "Mercury does not allocate advertising expenditures to specific insurance affiliates nor does the advertising department distinguish between insurance entities when generating advertising campaigns." Based on these findings, the commissioner determined that under section 2644.10(f), "Mercury's entire advertising budget must be excluded from the rate application" because "Mercury[ ] aims its entire advertising budget at promoting the Mercury Group as whole" rather than "seek[ing] to obtain business for a specific insurer and also provid[ing] customers with pertinent information" about that specific insurer. The commissioner also determined that Mercury did not qualify for the constitutional variance under section 2644.27(f)(9) because "Mercury failed to demonstrate the rate decrease results in deep financial hardship." Based on these (and other) determinations, the commissioner denied Mercury's application for an overall rate increase of 8.8 percent

and instead approved an 8.18 percent rate decrease for policy form HO-3, a 4.32 percent rate increase for policy form HO-4, and a 29.44 percent rate increase for policy form HO-6.

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

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

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

court addressed and rejected the Trades' argument that section 2644.10(f) violates the First Amendment.

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

DISCUSSION

I

Section 2644.10(f)—Institutional Advertising

Section 2644.10(f) provides that "[i]nstitutional advertising expenses" "shall not be allowed for ratemaking purposes" and that " '[i]nstitutional advertising' means advertising not aimed at obtaining business for a specific insurer and not providing consumers with information pertinent to the decision whether to buy the insurer's product."

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

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

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

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

A

Mercury's Arguments On Appeal

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

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

Here, the commissioner concluded that all of Mercury's advertising qualified as institutional advertising within the meaning of section 2644.10(f) because Mercury aims its entire advertising budget at promoting the Mercury Insurance Group as a whole and the Mercury Insurance Group is not a specific insurer. If the commissioner was correct in his characterization of Mercury Insurance Group (which we address below), then the commissioner was also correct in his conclusion that all of Mercury's advertising qualifies as institutional advertising within the meaning of section 2644.10(f) because advertising

that is aimed entirely at promoting an entity that is *not* a specific insurer is advertising that is not aimed at obtaining business for a specific insurer and does not provide consumers with information pertinent to the decision whether to buy that insurer's product.

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

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

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

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

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

"Mercury defines institutional advertising as advertising that is not designed to generate business or provide customers with information. This definition of institutional advertising is both narrow and im-

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

practicable, and would render all advertising expenses chargeable to the ratepayer; a fact Mercury concedes. Instead, the Regulation permits only advertising that seeks to obtain business for a specific insurer and also provides customers with pertinent information. As Mercury[ ] aims its entire advertising budget at promoting the Mercury Group as a whole, the [commissioner] concludes that Mercury's entire advertising expenditures must be removed from the ratemaking formula.

"[¶] * * * [¶]

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

"[¶] * * * [¶]

"Nor can Mercury argue that the 'Mercury Insurance Group' is a specific insurer. The Mercury Insurance Group is not a legal entity, nor is there any consensus as to the makeup of the Mercury Insur-

ance Group. Mr. Thompson testified the Mercury Insurance Group is comprised of Mercury Casualty, Mercury Insurance Company, and California Automobile. But Mr. Yeager testified the Mercury Insurance Group includes all 22 legal entities that make up the consolidated Mercury General Corporation. What is certain is that Mercury General does not advertise for its specific insurers and instead engages in advertising on behalf of the organization as a whole.

"[¶] * * * [¶]

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

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

"Regulation 2644.10, subdivision (f) contains clear and unambiguous language. The Regulation defines institutional advertising as advertising not aimed at obtaining business for a <u>specific</u> insurer. Had the Commissioner intended to charge consumers for affiliate or group advertising, he could have eliminated the reference to 'a specific' insurer. But the Commis-

sioner['s] decision to include the 'specific insurer' requirement renders the Regulation's meaning unmistakable. Advertising which generates business for a group of insurance companies, regardless of affiliation, is not advertising for a specific insurer.

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

With this more complete understanding of the commissioner's ruling, we turn back to Mercury's arguments. Eschewing even any pretense of arguing about the meaning of the term "specific insurer" in

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

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

Finally, Mercury contends that "[b]ecause the [c]ommissioner *** erroneously construed section 2644.10(f) in the disjunctive and then found that Mercury's trade name advertising did not meet the 'specific insurer' requirement," the commissioner did not consider or weigh "the evidence to determine if Mercury's ads met the 'pertinent information' requirement" of the second criterion in the regulation. This argument need not detain us long. We have concluded already that section 2644.10(f) does not set forth two criteria that are to be separately analyzed and applied. Instead, the regulation sets forth a singular, unified definition of what qualifies as "[i]nstitutional advertising." Having found that Mercury aims its entire advertising budget at promoting

the Mercury Insurance Group as a whole and having concluded that the Mercury Insurance Group is not a specific insurer within the meaning of section 2644.10(f), the commissioner properly excluded all of Mercury's advertising expenses from the rate calculation pursuant to the regulation because Mercury's advertising was not aimed at obtaining business for a specific insurer and did not provide consumers with information pertinent to the decision whether to buy that insurer's product. Accordingly, all of Mercury's challenges to the commissioner's rulings with respect to Mercury's advertising expenses are without merit.

B

The Trades' Arguments On Appeal

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

1. *Interpretation Of Section 2644.10(f)*

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

Expenses that are excluded from the rate calculation, including institutional advertising expenses,

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

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

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

of other entities that may not operate in California, and were not applying for the rate adjustment."

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

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

ing expenses for any specific insurer were excluded" here.

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

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

The Trades also argue that "an advertisement may be 'aimed at obtaining business' for more than one affiliated 'specific insurer[ ]'." This argument goes

nowhere because the commissioner found that Mercury's advertising was not aimed at obtaining business for *any* specific insurer, and the Trades point to no evidence to the contrary.

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

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

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

At the outset, we reject the argument by the commissioner and Consumer Watchdog that section 2644.10(f) does not implicate the First Amendment. For his part, the commissioner asserts that the regulation "does not in any way ban speech or compel specific content." This may be so, but that does not mean the regulation is immune from scrutiny under the First Amendment. The United States Supreme Court "has recognized *** that the 'Government's content-based burdens [on speech] must satisfy the same rigorous scrutiny as its content-based bans.' " (*Sorrell* v. *IMS Health Inc.* (2011) 564 U.S. 552, 565-566, 131 S. Ct. 2653, 2664, 180 L.Ed.2d 544, 556.) "Imposing a financial burden on a speaker based on

the content of the speaker's expression is a content-based restriction of expression and must be analyzed as such." (*Pitt News* v. *Pappert* (3d Cir. 2004) 379 F.3d 96, 106.) Thus, if section 2644.10(f) imposes a content-based burden on Mercury's speech, it does not matter that the regulation does not ban speech or compel specific content; it is nonetheless subject to First Amendment scrutiny.

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

The next question is whether section 2644.10(f) encompasses only commercial speech or whether, as

the Trades argue, it encompasses both commercial and noncommercial speech. This matters because different levels of scrutiny are implicated depending on whether commercial or noncommercial speech is involved. " '[T]he [federal] Constitution accords less protection to commercial speech than to other constitutionally safeguarded forms of expression.' [Citation.] [¶] For noncommercial speech entitled to full First Amendment protection, a content-based regulation is valid under the First Amendment only if it can withstand strict scrutiny, which requires that the regulation be narrowly tailored (that is, the least restrictive means) to promote a compelling government interest. * * * [¶] 'By contrast, regulation of commercial speech based on content is less problematic.' [Citation.] To determine the validity of a content-based regulation of commercial speech, the United States Supreme Court has articulated an intermediate-scrutiny test." (*Kasky* v. *Nike, Inc.* (2002) 27 Cal.4th 939, 952, 119 Cal.Rptr.2d 296, 45 P.3d 243.)

We reject the argument by the commissioner and Consumer Watchdog that the speech to which section 2644.10(f) applies qualifies as commercial speech simply because the regulation pertains to "advertising." In *Bolger* v. *Youngs Drug Products Corp.* (1983) 463 U.S. 60, 103 S. Ct. 2875, 77 L.Ed.2d 469, the United States Supreme Court held that even though certain pamphlets "were conceded to be advertisements, that fact alone did not make them commercial speech because paid advertisements are sometimes used to convey political or other messages unconnected to a product or service or commercial transaction." (*Kasky* v. *Nike, Inc.*, *supra*, 27 Cal.4th at p.

956, 119 Cal.Rptr.2d 296, 45 P.3d 243, citing *Bolger*, at p. 66, 103 S. Ct. at p. 2880, 77 L.Ed.2d at p. 477.) The *Bolger* court "identified three factors—advertising format, product references, and commercial motivation—that in combination supported a characterization of commercial speech in that case," but the court also "rejected the notion that any of these factors is *sufficient* by itself" to support such a characterization and "also declined to hold that all of these factors in combination, or any one of them individually, is *necessary* to support a commercial speech characterization." (*Kasky*, at p. 957, 119 Cal.Rptr.2d 296, 45 P.3d 243.)

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

tribution of yellow pages phone directories" was subject to strict scrutiny because, "[a]lthough portions of the directories are obviously commercial in nature, the books contain more than that"].)

We conclude that section 2664.10(f) survives that scrutiny. Under strict scrutiny, "the regulation [must] be narrowly tailored (that is, the least restrictive means) to promote a compelling government interest." (*Kasky* v. *Nike, Inc.*, *supra*, 27 Cal.4th at p. 952, 119 Cal.Rptr.2d 296, 45 P.3d 243.) In arguing that the regulation would not survive even the intermediate scrutiny that applies to commercial speech, the Trades admit that the regulation serves a "legitimate governmental purpose." We have no problem going further and concluding that the regulation promotes a compelling governmental interest. As Consumer Watchdog characterizes it, it is the "interest in prohibiting excessive [insurance] rates * * * by making sure 'that only "the reasonable costs of providing insurance" [are] included in the rates.' " More precisely, the regulation promotes the compelling government interest in ensuring that insurers like Mercury pass on to consumers through their insurance premiums only expenses for advertising that directly benefits consumers by providing them with information pertinent to the consumers' decision whether to buy a specific insurer's product. We further conclude that section 2644.10(f) is narrowly tailored to serve that purpose. The regulation does not *ban* insurers like Mercury from engaging in advertising that does not directly benefit consumers: that is, advertising that is not aimed at obtaining business for a specific insurer and does not provide consumers with information pertinent to the decision whether to

buy the specific insurer's product. Instead, the regulation simply prohibits the insurer from passing the cost of such advertisements on to the consumer. That is, in fact, the least restrictive means available to promote the specific interest at issue. Thus, the regulation is narrowly tailored to promote the compelling government interest the regulation serves.

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

II

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

Section 2644.27(f)(9) provides that one valid basis for requesting a variance from the maximum rate obtained by applying the regulatory formula is "[t]hat the maximum permitted earned premium would be confiscatory as applied. This is the constitutionally mandated variance articulated in *20th Century* v. *Garamendi* (1994) 8 Cal.4th 216, 32 Cal.Rptr.2d 807, 878 P.2d 566 which is an end result test applied to the enterprise as a whole." The commissioner determined that Mercury did not qualify for the constitutional variance under section 2644.27(f)(9) because "Mercury failed to demonstrate the rate decrease results in deep financial hardship." The superior court agreed with the commissioner "that the test for confiscation is 'deep financial hardship' " and "Mercury did not demonstrate 'deep financial hardship' to support its request for a confiscation variance."

On appeal, Mercury and the Trades assert various errors in this aspect of the commissioner's and superior court's rulings. First, Mercury asserts that the

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

The last argument by the Trades can be disposed of briefly. Inasmuch as section 2644.27(f)(9) expressly incorporates principles of constitutional law, and because "where the action of an administrative agency infringes constitutionally granted rights, independent judicial review must be invoked" (*Kerrigan* v. *Fair Employment Practice Com.* (1979) 91 Cal.App.3d 43, 51, 154 Cal.Rptr. 29), it does not matter for our purposes whether, as the Trades argue, the superior court improperly deferred to the commissioner in construing and applying section 2644.27(f)(9). Engaging in our own independent judicial review, as we must, we will not defer to either the commissioner or the superior court. Thus, any error the superior court might have made in this regard was necessarily harmless.

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

A

Deep Financial Hardship Versus Fair Return

Because section 2644.27(f)(9) expressly refers to *20th Century*, it is appropriate to begin there. As we have noted, in *20th Century* the California Supreme Court "review[ed] the implementation of Proposition 103's rate rollback requirement provisions by the Insurance Commissioner." (*20th Century*, *supra*, 8 Cal.4th at p. 240, 32 Cal.Rptr.2d 807, 878 P.2d 566.) As relevant here, the superior court had "determined that the rate regulations as to rollbacks [we]re invalid on their face with respect to the ratemaking formula" (*id.* at p. 282, 32 Cal.Rptr.2d 807, 878 P.2d 566) because, among other things, the ratemaking formula the commissioner adopted "preclude[d] a return covering the insurer's cost of service plus 10 percent of its capital base," and "through such preclusion, the formula [wa]s *** confiscatory" (*id.* at p. 288, 32 Cal.Rptr.2d 807, 878 P.2d 566). In support of this latter conclusion, the superior court also determined that "confiscation does not require 'deep financial hardship' within the meaning of *Jersey Central [Power & Light Co.* v. *F.E.R.C.* (D.C. Cir. 1987) 810 F.2d 1168]." (*20th Century*, at p. 288, 32 Cal.Rptr.2d 807, 878 P.2d 566)

The Supreme Court concluded that "[i]n this regard *** , the superior court's conclusion is substantially erroneous." (*20th Century*, *supra*, 8 Cal.4th at p. 288, 32 Cal.Rptr.2d 807, 878 P.2d 566.) In determining "the ratemaking formula *** [wa]s *** not confiscatory," the high court began by noting that it "would do well to rehearse, and elaborate on, the principles set out in *Calfarm*." (*20th*

Century Ins. Co., at p. 291, 32 Cal.Rptr.2d 807, 878 P.2d 566.) The court then explained as follows:[5]

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

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

confiscation is judged with an eye toward the regulated firm as an enterprise.

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

"[¶] * * * [¶]

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

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

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

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

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

"[¶] * * * [¶]

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

"In *Jersey Central*, the United States Court of Appeals for the District of Columbia Circuit, sitting in bank, and speaking through Judge Bork, explained: ' * * * [T]he only circumstances under which there is a possibility of a taking of investors' property by virtue of rate regulation is when a [regulated firm] is in the sort of financial difficulty described [as] 'deep financial hardship.' [Citation.] The firm may experience such hardship when it does not earn enough

revenue for both 'operating expenses' and 'the capital costs of the business,' including 'service on the debt and dividends on the stock,' of a magnitude that would allow a 'return to the equity owner' that is 'commensurate with returns on investments in other enterprises having corresponding risks' and 'sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.' [Citation.] 'But absent [that] sort of deep financial hardship * * * there is no taking * * * .' [Citation.] This follows from the fact that * * * a regulated firm may claim that a rate is confiscatory only if the rate does not allow it to operate successfully. In such circumstances, the firm is not inaptly characterized as experiencing 'deep financial hardship' as a result of the rate.

"[¶] * * * [¶]

"[T]he law under the due process clause of article I, sections 7 and 15 of the California Constitution and the takings clause of article I, section 19 of that same instrument is in accord with the foregoing principles." (*20th Century*, *supra*, 8 Cal.4th at pp. 292-297, 32 Cal.Rptr.2d 807, 878 P.2d 566, fns. omitted.)

In the course of the foregoing discussion, our Supreme Court also included the following footnote: "In *Guaranty Nat. Ins. Co.* v. *Gates* (9th Cir. 1990) 916 F.2d 508, 515, there is language that may be read to erroneously state that the producer is constitutionally 'guarantee[d]' a ' "fair and reasonable return [,]" ' and that such a return must necessarily be above the 'break even' level. We will not indulge in such a reading." (*20th Century*, *supra*, 8 Cal.4th at p. 294, fn. 18, 32 Cal.Rptr.2d 807, 878 P.2d 566.)

Turning back to the superior court's ruling, the California Supreme Court explained that the rate-making formula could not be "deemed confiscatory" because the terms of the formula "do not themselves impose a rate * * * that inflicts on insurers ' * * * deep financial hardship * * * .' " (*20th Centur*y, *supra*, 8 Cal.4th at p. 297, 32 Cal.Rptr.2d 807, 878 P.2d 566.) The court then continued as follows:

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

value is reduced does not mean that the regulation is invalid.' " (*20th Century*, *supra*, 8 Cal.4th at pp. 297-298, 32 Cal.Rptr.2d 807, 878 P.2d 566.)

With the foregoing understanding of the constitutional concept of confiscation, we turn back to the arguments presented by Mercury and the Trades, and we find no merit in them. Mercury contends the commissioner and the superior court erred in rejecting the "fair rate of return" standard of confiscation in favor of the "deep financial hardship" standard, but we find no such error. The Supreme Court explained in no uncertain terms in *20th Century* that "the inability to operate successfully is a necessary * * * condition of confiscation" (*20th Century*, *supra*, 8 Cal.4th at p. 296, 32 Cal.Rptr.2d 807, 878 P.2d 566), and the court soundly rejected the contrary assertion that a regulated business is "constitutionally 'guarantee [d]' a ' "fair and reasonable return" ' " (*id.* at p. 294, fn. 18, 32 Cal.Rptr.2d 807, 878 P.2d 566). The "fair rate of return" standard espoused by Mercury contravenes both of these principles.

The Trades' arguments fare no better. The Trades first argue that in *Lingle* v. *Chevron* (2005) 544 U.S. 528, 125 S. Ct. 2074, 161 L.Ed.2d 876, the United States Supreme Court reached the conclusion that "a Takings analysis is not a vehicle for invalidating a price control statute or regulation, or agency order. It is a basis for compensation by government when government has legitimately exercised its power to 'take', subject to the duty to compensate. It is the Due Process analysis—which is 'logically prior to and distinct' from the Takings analysis—that determines whether a specific price regulation may be invalid as

transgressing constitutional limits on the state's power to regulate price." However, if by this argument the Trades mean to suggest that the "deep financial hardship" test for confiscation under takings clause that was articulated and explained in *20th Century* is no longer valid, we cannot agree. The question in *Lingle* was whether language originating in *Agins* v. *City of Tiburon* (1980) 447 U.S. 255, 100 S. Ct. 2138, 65 L.Ed.2d 106, declaring that "government regulation of private property 'effects a taking if [such regulation] does not substantially advance legitimate state interests,' " was "an appropriate test for determining whether a regulation effects a Fifth Amendment taking." (*Lingle*, at pp. 531, 532, 125 S. Ct. at pp. 2077, 2078, 161 L.Ed.2d at pp. 883, 884].) The Supreme Court concluded it was not. (*id.* at p. 532, 125 S. Ct. at p. 2078, 161 L.Ed.2d at p. 884].) *Lingle* was not a price control case at all, and the court therein never considered or addressed the "deep financial hardship" standard for determining whether a price control is constitutionally confiscatory. Accordingly, *Lingle* is of no assistance to the Trades here.

The Trades next argue that the superior court "placed undue reliance on *20th Century*" because that case: "(1) did not involve a separate due process analysis; (2) can and should be read consistently with *Calfarm*; and (3) is based on unique facts conclusively distinguishing the current context." None of these arguments is persuasive. The first argument depends on the Trades' assertion that *Lingle* foreclosed any continuing analysis of a price control under the takings clause and instead substituted a separate due process analysis. We have rejected that

argument already; *Lingle* had nothing to do with price controls.

The Trades' second argument—that "*20th Century* can be harmonized with *Calfarm*"—is one with which we agree, but not in the way the Trades would like. We have already shown how our Supreme Court expressly stated that the extended discussion from *20th Century* set forth above regarding the "deep financial hardship" standard was a "rehears[al of], and elaborat[ion] on, the principles set out in *Calfarm*." (*20th Century*, *supra*, 8 Cal.4th at p. 291, 32 Cal.Rptr.2d 807, 878 P.2d 566.) In that manner, *20th Century* and *Calfarm* are harmonious. The Trades' attempt to explain how the *Calfarm* court, "ruling on the state and federal due process clauses, conducted an analysis in line with *Lingle*'s pronouncement of the Due Process standard," and how the *20th Century* court can be understood to have "equated 'deep financial hardship,' as used in the opinion, with more traditional notions of confiscation centered on the absence of a fair rate of return," amounts to little more than hocus pocus.

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

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

B

The Relevant Enterprise

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

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

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

The Trades also contend that allowing the commissioner to apply the standard of constitutional confiscation to Mercury as a whole wrongfully applies the standard "to all lines of insurance even though the prior-approval structure provides for rate regulation by line of insurance." In making this argument, however, the Trades merely returns to its own "fair rate of return" standard, by arguing that "[t]he insurer *** will be deprived of the property devoted to the regulated line of business if not allowed the opportunity to earn a fair return" and thus, "the only sensible test is one that looks to the regulated prop-

erty." As we have rejected the Trades' proffered standard already, we have no basis for accepting the "lines of insurance" argument based on that rejected standard.

To the extent either Mercury or the Trades can be understood to offer other reasons why the standard the commissioner applied is "[i]llogical" or "[u]nworkable," we simply say that it is not for us to question the logic or workability of our Supreme Court's decisions in *Calfarm* and *20th Century*. We can only follow them. (See *Auto Equity Sales, Inc.* v. *Superior Court* (1962) 57 Cal.2d 450, 455, 20 Cal.Rptr. 321, 369 P.2d 937.)

C

Remaining Arguments

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

Mercury and the Trades also both contend that the commissioner and/or the superior court erred in holding that the "re-litigation ban" in section 2646.4, subdivision (c) precluded Mercury from offering evidence showing that application of the rate formula

would deny Mercury a fair return.[6] But again, this argument fails at the outset because it depends on their advocacy of a "fair rate of return" standard. As we understand it, the ALJ precluded the evidence Mercury offered on the constitutional variance because Mercury's evidence did not have any tendency to show "deep financial hardship" that would arise from application of the rate formula, but instead went only toward showing that the rate formula would deny Mercury a "fair return." We have already concluded the commissioner (and the ALJ whose proposed decision the commissioner adopted) applied the correct standard. Thus, we perceive no error in the ALJ's use of that standard in justifying the exclusion of the evidence Mercury proffered.

Finally, Mercury asserts that "[b]ased on its erroneous legal rulings, the Superior Court refused to exercise its independent judgment on the evidence establishing that [application of the rate formula] failed to yield a " 'fair return.' " We have already concluded, however, that the superior court's rulings with respect to the applicable standard of constitutional confiscation were not erroneous. Consequent-

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[6] The regulation in question provides as follows: "Relitigation in a hearing on an individual insurer's rates of a matter already determined either by these regulations or by a generic determination is out of order and shall not be permitted. However, the administrative law judge shall admit evidence he or she finds relevant to the determination of whether the rate is excessive or inadequate (or, in the case of a proceeding under Article 5, relevant to the determination of the minimum nonconfiscatory rate), whether or not such evidence is expressly contemplated by these regulations, provided the evidence is not offered for the purpose of relitigating a matter already determined by these regulations or by a generic determination." (§ 2646.4, subd. (c).)

ly, the further assertion of error Mercury offers is necessarily without merit as well.[7]

DISPOSITION

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

We concur:

Raye, P.J.

Mauro, J.

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

APPENDIX B

IN THE SUPERIOR COURT OF CALIFORNIA
SACRAMENTO COUNTY

No. 34-2013-80001426

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.

January 16, 2015

RULING ON SUBMITTED MATTER: TRADES' MOTION FOR LEAVE TO AMEND PETITION; RULING ON MERITS OF TRADES' REMAINING CLAIMS

SHELLEYANNE W. L. CHANG, Judge.

Nature of Proceedings

The following is the Court's tentative ruling to the above entitled matters, set for hearing in Department 24, on Friday, January 9, 2015, at 10:00 a.m. The tentative ruling shall become the final ruling of the Court, unless a party wishing to be heard so advises the clerk of this Department no later than 4:00 p.m. on the court day preceding the hearing, and further advises the clerk that such party has notified the other side of its intention to appear.

Oral argument, if requested, shall not exceed 25 minutes per side.

I. BACKGROUND

This proceeding originated when Mercury Casualty Company (Mercury) filed a petition for writ of mandate and complaint for declaratory and injunctive relief challenging a February 2013 order of Respondent State Insurance Commissioner (Respondent or Commissioner) following Mercury's 2009 application for a rate increase.

Thereafter, two parties moved to intervene: (1) Consumer Watchdog, whose interests are aligned with Respondent, and (2) Personal Insurance Federation of California, American Insurance Association, Property Casualty Insurers Association of America, doing business as Association of California Insurance Companies, National Association of Mutual Insurance Companies, and Pacific Association of Domestic Insurance Companies (collectively, Trades), whose interests are aligned with Mercury's. Notably, no

party opposed these motions to intervene, and in fact, the parties even filed statements indicating that they would *not* oppose the motions. Accordingly, the Court granted leave to intervene to Consumer Watchdog and the Trades. Pertinent here, the Trades filed a Petition and Complaint in Intervention (Petition), asserting claims that largely duplicated those raised by Petitioner.

After hearings on several motions and reviewing extensive briefing from all four parties, the Court considered the merits of both Petitions. The parties appeared for oral argument on May 2, 2014.

On June, 11, 2014, the Court issued a ruling after hearing (Ruling). The Ruling denied all writ claims Mercury's Petition and all but one writ claim raised in the Trades' Petition. The Ruling also dismissed all of Mercury's causes of action in Mercury's Petition and Complaint. The Ruling did not dispose of the Trades' ancillary claims for declaratory relief.

Thereafter, the parties requested a status conference. Specifically, the Trades requested that the Court's Ruling address two claims that it had raised in its briefing, one of which was not raised in its Petition.

At a status conference, held on July 18, 2014, the Court set the following matters for hearing on July 9, 2014: (1) the additional claims by the Trades that were not disposed of in the Court's Ruling, and (2) the Trades' motion to file a first amended Complaint.

The two additional claims that the Trades wishes the Court to consider on the merits are: (1) the

Trades' claim that 10 C.C.R. § 2644.10(f) violates the First Amendment by imposing a financial penalty on speech based on content ("First Amendment Claim")[1]; and (2) the claim that the regulatory scheme requiring an applicant for a variance to undergo a "fullblown" hearing denies insurers due process ("Due Process Claim").

The Court specifically declined to address these two claims in its Ruling.

The Court has reconsidered its Ruling, as stated at the status conference: the Court concludes that because Insurance Code section 1861.10 allows the Trades to intervene, the Trades may raise and the Court may consider claims not raised by Petitioner Mercury, provided that the Trades complies with other rules of Civil Procedure. However, the Court also concluded at the status conference that it was not proper to consider the Trades' "Due Process" claim, because it did not appear in the Trades' Petition. Accordingly, the Trades filed this motion seeking leave to amend the Petition so that the Court could consider this argument on the merits.

The Trades, the Insurance Commissioner, and Consumer Watchdog have stipulated that if the Court grants the Trades' motion for leave to amend, a further hearing on the merits of the "new issue" (Due Process Claim) in the amended pleading shall be on March 13, 2015, and the parties may "meet and

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[1] The Trades' constitutional challenges to 10 C.C.R. § 2644.10(f) are raised in the Petitions' Ninth and Tenth Causes of Action.

confer" about any further briefing. (See Stipulation filed November 21, 2014.)

II. DISCUSSION

a. The Trades' Motion for Leave to Amend Petition

The Trades seek leave to amend to add new Eleventh and Twelfth causes of action: a Code of Civil Procedure section 1085 "writ" cause of action directing the Commissioner to cease applying 10 C.C.R § 2644.27(f) (9) [requiring a hearing for the confiscation variance], "in tandem" with a cause of action requesting a declaration that 10 C.C.R. § 2644.27(f)(9) is unconstitutional. The Court collectively refers to these causes of action as the "Due Process" Cause of Action.

The Trades argue that the Court should allow it leave to amend because (1) the amendment would conform its Petition to the argument it already raised in its briefs on the merits, to which Consumer Watchdog (but not the Commissioner) responded, (2) and the standard for allowing leave to amend is liberal. Respondent and Consumer Watchdog oppose the Trades' motion. Respondent and Consumer Watchdog have the better argument. The Trades' motion for leave to amend is **DENIED**.

Code of Civil Procedure section 473(a)(1) provides that the court may "in furtherance of justice, and on any terms as may be proper, allow a party to amend any pleading or proceeding by adding or striking out the name of any party, or by correcting a mistake in the name of a party, or a mistake in any other respect * * * . The court may likewise, in its discretion,

after notice to the adverse party, allow, upon any terms as may be just, an amendment to any pleading or proceeding in other particulars * * * ."

However, "amendment may not be permitted where the effect of such amendment is to state 'another and distinct cause of action'... [that] give[s] rise to a wholly distinct and different legal obligation against the defendant." (*Klopstock* v. *Superior Court* (1941) 17 Cal.2d 13, 20.) The "Due Process" Claim would impose a new theory of liability on the Commissioner each time it required a variance applicant to undergo a hearing under 10 C.C.R. § 2644.27(f)(9).

The Trades reply that the "Due Process" Cause of Action is not a "wholly new claim" but rather an "extension" of their Fifth and Sixth Causes of Action challenging the entire "rate regulatory scheme" governing the Commissioner as unconstitutional. The Court disagrees. The Fifth and Sixth Causes of Action challenge the "rate regulatory scheme," but on the grounds that "the system contains no mechanism to accommodate an adjustment that may be necessary to avoid confiscation"—not on the ground that the "fullblown" hearing requirement deprives due process to an applicant seeking a confiscation variance.

Additionally "[t]he trial court has wide discretion where the amendment raises new issues after the pleadings have been settled and the trial has begun." (*Stockton* v. *Ortiz* (1975) 47 Cal.App.3d 183, 194.) "[T]ime and knowledge are important factors to be considered when granting or denying a motion to amend." (*Ibid*.) The Commissioner did not respond to the Trades' arguments and requested additional

briefing on the "Due Process" cause of action, which claim is scheduled to be heard in March 2015, To allow the Trades to amend their Petition to add the due process claims would put the Commissioner in a position of defending against a theory and cause of action not raised in the Petition, after the Court considered and disposed of the majority of Mercury's and the Trades' claims on the merits. (*See Ibid*)

Accordingly, the Trades' motion to amend is **DENIED**. The Court now will dispose of the Trades' remaining claims.

b. Disposition of Trades' Claims

a. First Amendment Claim

The Trades also claim that 10 C.C.R. § 2644.10(f) (Regulation 2644.10(f)) violates the First Amendment[2] by imposing a financial penalty on speech based on content. This claim is **DENIED**, and the Trades' "tandem" declaratory relief claim is **DISMISSED**.

Regulation 2644.10(f) provides that "'Institutional advertising' means advertising not aimed at obtaining business for a specific insurer and not providing consumers with information pertinent to the decision whether to buy the insurer's product." Accordingly, that type of advertising is an excluded "expense item[, which] shall not be allowed for ratemaking purposes." (10 C.C.R., § 2644.10.)

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[2] The Trades' Opening Brief references only the "First Amendment," and does not distinguish between the federal and state constitutions. Accordingly, the Court assumes that the Trades' claim applies to the United States Constitution only.

The Trades argue that Regulation 2644.10(f) impermissibly burdens speech by calling out disfavored content or "institutional advertising" by attaching a financial penalty in the form of reducing allowable insurance rates.

Regulation 2644.10(f) applies to "commercial speech, that is, expression related solely to the economic interests of the speaker and its audience." (*Central Hudson Gas & Elec. Co.* v. *New York Pub. Svcs Comm'n (Central Hudson)* (1980) 447 U.S. 557, 561.)[3] "The First Amendment, as applied to the States through the Fourteenth Amendment [of the U.S. Constitution], protects commercial speech from unwarranted governmental regulation." (*Ibid*.) However, "[t]he Constitution therefore accords a lesser protection to commercial speech than to other constitutionally guaranteed expression." (*Id.* at p. 563.)

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) the regulation must not be more extensive than is necessary

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[3] The Court rejects the Trades' argument articulated on reply that the regulation does *not* apply to "commercial speech." Regulation 2644.10(f) excludes certain advertising expenses; such advertising is speech "proposing a commercial transaction" a [*sic*].

to serve that interest.[4] (*Central Hudson, supra*, 447 U.S. at p. 566.)

First, no party disputes that the claimed advertising is unlawful or misleading.

Second, the governmental interest in 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 C.C.R. § 2641.3.) Additionally, the Court notes that the California Supreme Court in *20th Century Insurance* v. *Garamendi* (1994) 8 Cal.4th 216, 289, considered the regulations governing rollbacks and concluded that it was not "constitutionally improper" for "rate regulations as to rollbacks to recognize as the insurer's cost of service only the *reasonable* cost of providing insurance" to consumers. Similarly, the government has an interest in ensuring that regulations governing rate setting, such as 10 C.C.R. § 2644.10(f), recognize the "reasonable cost of providing insurance."

Third, Regulation 10 C.C.R. § 2644.10(f) advances the government's interest in determining whether the rates are excessive or inadequate.

Fourth, the Court does not find that Regulation 10 C.C.R. § 2644.10(f) is "more extensive than is nec-

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[4] Trades do not apply the test for commercial speech in their Opening Brief, likely because they claim that advertising is not commercial speech at all. However, the Court finds that the advertising is commercial speech, applies the test therfor, and rejects the Trades' claim.

essary to serve that [government] interest." Although the Trades do not apply this test, they appear to suggest that Regulation 10 C.C.R. § 2644.10(f) is more extensive than necessary, because it could exclude some advertising that highlights event sponsorship, or advertising for other "worthy causes." However, such advertising would not necessarily be excluded under Regulation 10 C.C.R. § 2644.10(f). Rather, that Regulation excludes advertising that is "not aimed at obtaining business for a specific insurer and not providing consumers with information pertinent to the decision whether to buy the insurer's product." Additionally, the Court finds that although some types of advertising could be excluded under the regulation (such as event sponsorship unrelated to a specific insurer), this potential exclusion does not render Regulation 10 C.C.R. § 2644.10(f) more extensive than necessary to serve the government's interest in ensuring that insurance rates are neither excessive nor inadequate.

Accordingly, the Trades have not shown that Regulation 10 C.C.R. § 2644.10(f) is an impermissible restriction on commercial speech in violation of the First Amendment.

The Trades liken Regulation 10 C.C.R. § 2644.10(f) to cases interpreting "Son of Sam" laws, which required that proceeds from an accused or convicted criminal's works describing the crime be deposited into an escrow account available to crime victims. (*Simon & Schuster, Inc.* v. *Members of New York State Crime Victims Bd.*, (1991) 502 U.S. 105; *see also Keenan* v. *Superior Court* (20020 27 Cal.4th 413 [holding similar California law to be unconstitutional violation of First Amendment].) These cases are dis-

tinguishable, as they do not involve "commercial speech," such as advertising.

The Trades also dispute Consumer Watchdog's argument that Regulation 10 C.C.R. § 2644.10(f) does not restrict the content of advertising, but only requires that the cost of certain advertising not be passed to the ratepayer. The Trades argue that Regulation 10 C.C.R. § 2644.10(f) *does* restrict the content of advertising by excluding certain types of advertising expenses. The Trades argue that although public utility cases may allow public utility companies to pass through to consumers only costs necessarily incurred for the consumers' benefit, the "public utility model" is inapplicable, because it requires both a "shareholder" and "consumer" account, and there is no "shareholder" account in the insurance regulatory context. The Court need not decide this issue, as it holds that the regulation affects advertising or commercial speech, and the Trades have demonstrated no First Amendment violation under the applicable test.

b. "Tandem" Declaratory Relief Claims

The Trades have also asserted "tandem" claims for declaratory relief that accompany each writ claim. Because these claims essentially duplicate the writ claims, and the Court denies each of the Trades' writ claims, the declaratory relief claims are **DISMISSED**.

III. DISPOSITION

The Trades' motion to amend the Petition is **DENIED**.

Each of the Trades' "writ" claims, and in particular, the Ninth Cause of Action, are **DENIED**. All of the Trades' "declaratory relief claims, and in particular, the Tenth Causes of Action for declaratory relief, are **DISMISSED**.

This ruling shall constitute the Court's final ruling on all of the claims raised by the Trades in the Petition.

In the event this tentative ruling becomes the final ruling of the Court, Counsel for the Commissioner is directed to prepare a formal order, incorporating this ruling and the June 11, 2014 Ruling as exhibits thereto, and a separate judgment incorporating both aforementioned rulings as exhibits thereto, submit them to the parties for approval as to form, and thereafter submit them to the Court for signature, in accordance with California Rules of Court, Rule 3.1312.

RULING AFTER HEARING

The matter was argued and submitted. The Court affirms the tentative ruling with the following modifications:

Motion for Leave To Amend

At the hearing, the Trades offered to submit on the tentative ruling as the motion to amend the Petition. Accordingly, the tentative ruling is affirmed as to the motion for leave to amend.

First Amendment Claim

At the hearing, the Trades first disputed that the potential "advertising" that would fall within Regu-

lation § 2644.10(f) is commercial speech, citing *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.)

Under the rationale announced in *Bolger*, the Court considers the hypothetical advertisements proposed by the Trades—such as an insurer sponsoring an event, or an insurer engaging in informational advertising about "worthy causes"—to be commercial speech.

Because such advertising is commercial speech, Regulation § 2644.10(f) is constitutional if it meets the test for commercial speech announced in *Central Hudson, supra*.

As noted earlier in the ruling, the Trades did not apply the *Central Hudson* test in their moving papers. At the hearing, the Trades argued that the third prong of this test—whether Regulation 10 C.C.R. § 2644.10(f) advances the government's interest in determining whether the rates are excessive or inadequate—is not met. The Court disagrees.

To show that this prong is met, there must be a nexus between the government's goal (ensuring that rates are neither excessive nor inadequate) and the regulation. The import of Regulation 10 C.C.R. § 2644.10(f) is to ensure that some insurers' costs—including, but not limited to, certain advertising costs—is not passed to consumers through higher rates, and that the insurers' costs are not "excessive." There is a reasonable nexus between this goal and the regulation.

Moreover, unlike *Bolger* and *Central Hudson*, the regulation is not a ban on advertising or a ban on advertising by certain means. The Trades argue that the regulation nonetheless chills insurers' speech because insurers cannot recoup those costs from the consumers, and this affects and can limit requests to increase insurance rate adjustments.

First, the Trades furnish no evidence of any financial or economic burden to the Trades, or that the regulation has chilled insurers' speech. Additionally, the Trades cite no authority for the proposition that any "economic" or "financial" burden, to the extent one exists at all, infringes upon the Trades' or insurers' free speech rights.

Accordingly, the Trades do not show that Regulation 10 C.C.R. § 2644.10(f) unconstitutionally infringes on the Trades' free speech rights.

APPENDIX C

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SACRAMENTO

Case No.
34-2013-80001426

MERCURY CASUALTY COMPANY,
Petitioner and Plaintiff,
vs.
DAVE JONES, in his Official Capacity as the Insurance Commissioner of the State of California,
Respondent and Defendant,
CONSUMER WATCHDOG,
Intervenor,
PERSONAL INSURANCE FEDERATION OF CALIFORNIA et al.,
Intervenors.

June 11, 2014

RULING ON SUBMITTED MATTER: PETITION FOR WRIT OF MANDATE AND COMPLAINT FOR DECLARATORY RELIEF AND INJUNCTIVE RELIEF

HON. SHELLEYANNE W. L. CHANG, Judge.

Nature of Proceedings:

On May 1, 2014, the Court issued a tentative ruling on Petitioners' Petition for Writ of Mandate and Complaint for Declaratory and Injunctive Relief, and pertinent claims in Intervenors' Petition for Writ of Mandate. The parties appeared for oral argument on May 2, 2014, and were represented by counsel as stated on the record. After oral argument, the Court took the matter under submission.

Having further considered the matter, the Petition is **DENIED**.

Petitioner, Mercury Casualty Company (Petitioner or Mercury) seeks a writ of mandate either setting aside the February 2013 order of Respondent State Insurance Commissioner (Commissioner or Respondent) or granting Mercury its requested rate increase and related declaratory and injunctive relief. Interventor trade associations[1] (the Trades) join Mercury in challenging the Commissioner's decision.

Mercury and the Trades[2] challenge the decision on two bases: (1) the Commissioner's order requiring

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[1] Intervenors are: Personal Insurance Federation of California, American Insurance Association, Property Casualty Insurers Association of America, doing business as Association of California Insurance Companies, National Association of Mutual Insurance Companies, and Pacific Association of Domestic Insurance Companies.

[2] As Mercury and the Trades advance similar arguments contesting the Commissioner's decision, this ruling shall refer to Mercury and the Trades as "Petitioners," when applicable.

Mercury to decrease its rates is invalid because it is confiscatory and does not allow Mercury a fair rate of return, and (2) the Commissioner improperly excluded all of Mercury's advertising expenses from the Commissioner's ratemaking calculation.

I. FACTUAL AND PROCEDURAL BACKGROUND

The pertinent facts are largely undisputed.

Pursuant to Proposition 103, the Commissioner must approve property and casualty insurance rates set by an insurer. The parties refer to this rate-setting as the "prior approval" process. (Ins. Code, § 1861.01(c).) On May 15, 2009, Mercury filed an application with the Department of Insurance (DOI) to increase rates for its Homeowners' Multi-Peril line of insurance, RFB App. No. 09-3851 (Rate Application). (AR, 20.) Specifically, Mercury sought to increase rates in three separate lines: HO-3 (residential homeowners' insurance), HO-4 (tenants' insurance), and HO-6 (condominium owners' insurance). (AR, 2048.) Mercury sought an overall rate increase of 6.9%, and alternatively, an increase of 8.8% if its request for a variance were granted. (AR, 2048.)

The administrative proceedings following Mercury's Rate Application lasted nearly four years. After extensive evidentiary hearings, the administrative law judge (ALJ) issued a proposed decision on September 27, 2012. (AR, 1880.) The Commissioner rejected the ALJ's proposed decision and ordered the ALJ to take additional evidence on Mercury's investment income and rate of return. (AR, 1880-84.) After an inquiry from the ALJ, the Commissioner re-

scinded this request and stated that its previous order could be "disregarded." (AR, 1939.) The ALJ issued another proposed decision on January 28, 2013, which was adopted by the Commissioner on February 11, 2013 (Order). (AR, 1973, 2037-2178.)

The Commissioner's Order concluded that Mercury's proposed overall rate increase of 8.8% was excessive. (AR, 2174.) It ordered Mercury to *decrease* its HO-3 rates by 8.18%, and allowed increases of 4.32% and 29.44% in its HO-4 and HO-6 lines, respectively.[3] (AR, 2174.) It is the 8.18% decrease that is the subject of the Petition.

As stated in the Order, the ALJ made particular findings that affected how the ordered rates were calculated. In particular, the ALJ found that all of Mercury's advertising expenses were "institutional advertising," such that these expenses could not be considered in setting the rate (AR, 2173.) The ALJ also found that Mercury was not entitled to certain "variances," from the ratemaking formula, including the "confiscation variance." (10 Cal. Code Regs., § 2644.27, subdivision (f)(9).) (AR, 2174.)

The Petition was filed on March 1, 2013. Later that month, the Court granted Intervenor Consumer Watchdog's (CW) unopposed motion for leave to intervene. On May 7, 2013, this Court denied Mercury's ex parte application for a stay of the Order. On

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[3] Because the premiums in HO-3 lines outnumber those in the HO-4 and HO-6 lines, Mercury contends that the effect of the Order requires it to decrease its overall rates by approximately 5%. (Petition, ¶¶ 2-3.)

June 18, 2013, the Court granted the unopposed motion to intervene of the Trades.

On March 28, 2014, Respondents, joined by CW, moved for judgment on the pleadings against Mercury, on the basis that the Petition was moot. The basis for this motion was that the rates set by the Commissioner's Order were no longer effective. This is because Mercury and the Commissioner settled another prior rate approval action and entered into a November 2013 stipulation approving an 8.26% rate increase for Mercury's 2013 Homeowner's Multi-Peril rate application. Respondents also moved to strike the Trade's complaint in intervention or portions thereof.

The Court denied both motions. The Court found that the Petition was not moot, because Petitioner decreased its rates under February 2013 Order for a period of about 6 months, until the stipulated rate increase took effect in November 2013. Thus, a court decision setting aside the February 2013 order on the basis that the rates were "confiscatory" could provide the basis for a future administrative adjustment of Mercury's rates. Additionally, the Court found that the matters raised by the Petition were not moot in that they involved issues of broad public interest that are likely to recur.

Mercury and the Trades have filed two separate petitions for writs of administrative mandamus or mandate, and complaints for declaratory relief (Petitions). Mercury and the Trades have purported to set for hearing the mandate/mandamus claims *only* for May 2, 2014, and no party has objected. Accordingly, in this proceeding, the Court will consider the

mandamus claims filed by Mercury, and where relevant, the mandate claims of Trades. The Court does *not* consider claims for declaratory relief filed by the Trades. As discussed later, the declaratory relief claims filed by Mercury are denied.

II. LEGAL BACKGROUND

a. Proposition 103 and Regulation of Insurance

In 1988, California voters enacted Proposition 103, which dramatically changed regulation of property-casualty insurance rates. Prior to Proposition 103 insurers could set rates in a competitive market.

Among other things, Proposition 103 required insurers to "rollback" insurance rates 20% below 1987 levels for one year, starting November 1988. (*20th Century Ins. Co.* v. *Garamendi* (*20th Century*) (1994) 8 Cal.4th 216, 239-240.) Insurers could only obtain relief from the 20% rollback if they could show that they were "substantially threatened with insolvency." (Ins. Code, § 1861.01, sub. (b).) This is known as the "insolvency standard."

Proposition 103 also implemented the "prior approval" system, which required the Commissioner to approve any insurance rate adjustment in a rate-making process. (*See* Ins. Code, § 1861.05.) The Commissioner may neither require insurers to charge "excessive" rates nor subject insurers to "inadequate" rates.[4] (*20th Century*, *supra*, 8 Cal.4th at

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[4] Insurance Code section 1861.05, subdivision (a) provides in pertinent part: "No rate shall be approved or remain in effect

p. 243; Ins. Code, § 1861.05, subd. (a).) Under the prior approval ratemaking process, the Commissioner determines the bounds of such "excessive" and "inadequate" rates: the maximum and minimum permitted earned premium. (*20th Century*, *supra*, 8 Cal.4th at p. 254.) Insurers may charge any rate between this range of "excessive" and "inadequate" rates. (*Ibid*.)

The parties cite heavily to two cases interpreting Proposition 103 and, in the case of *20th Century*, its implementing regulations: *Calfarm Insurance Company* v. *Deukmejian (Calfarm)* (1989) 48 Ca1.3d 805, and *20th Century*, *supra*, 8 Cal.4th at 263.

In *Calfarm*, the insurance industry challenged the constitutionality of Proposition 103 immediately after its passage. The California Supreme Court largely upheld Proposition 103 and the 20% rollback requirement. (*Id.* at p. 815.) However, it held that Proposition 103's "insolvency standard"—wherein an insurer could only receive a relief from the 20% rollback if "threatened with insolvency"—was unconstitutional. This is because the "insolvency standard" could not "conform to the constitutional standard of a fair and reasonable return." (8 Cal.4th at p. 818.) For example, companies that were not threatened with insolvency could nonetheless be subject to "confiscatory" rates in violation of the Constitution. (*Ibid*.)

Although the Court invalidated the "insolvency standard," it left untouched the "general standard for

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which is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter . . . ."

rate adjustment" set out in Insurance Code section 1861.05[5] and affirmed that this statute "provide[d] a constitutionally valid standard for rate adjustment." (*Id.* at p. 822-823.) Because an "inadequate" rate under Section 1861.05 was necessarily a "confiscatory" rate, the statute required rates to be "fair and reasonable" and prohibited confiscatory rates. (*Ibid*.)

After *Calfarm*, the Commissioner adopted "Prior Approval Regulations" to implement Proposition 103.

These regulations established procedures to calculate whether rates were "excessive" or "inadequate" under Section 1861.05. (*See* 10 Cal. Code Regs., §§ 2641.1-2644.67.) The regulations also included comprehensive formulas for the upper and lower boundaries of the "excessive-inadequate" range: the "maximum permitted earned premium" and "minimum permitted earned premium" (maximum PEP and minimum PEP). (10 Cal. Code Regs., § 2644.2, 2644.3.) The regulations also allowed insurers to seek "variances" from the maximum or minimum PEP derived from the rate-setting formula. (10 Cal. Code Regs., § 2644.27(f)(1)-(9).)

In his first "rollback exemption order" made after a hearing, the Commissioner ordered 20th Century Insurance to refund each insured 12% of the "rollback year" premium rather than 20%. (*20th Century*, *supra*, 8 Cal.4th at p. 263.) 20th Century Insurance petitioned for a writ of mandate, joined by the majority of the property-casualty insurance industry. The tri-

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[5] Unless otherwise indicated, all future statutory references shall be to the Insurance Code.

al court ruled largely 20th Century's favor. The California Supreme Court did not, and held that the application of the rollbacks to 20th Century were not invalid. Among other things, the Court found that:

- The regulations implementing the ratemaking formula were valid. The Commissioner could set rates by a formula rather than on a case-by-case basis, and the insurer was not entitled to an "individualized" hearing outside the regulations to determine its rollback liability. (*20th Century*, *supra*, 8 Cal.4th at p. 324.)

- The trial court erroneously found that "confiscation," *does not* require "deep financial hardship." (*Id.* at pp. 320, 324.)

- "Confiscation is judged with an eye toward the regulated firm as an enterprise. In this context, it depends upon the condition of the insurer as a whole, and not on the fortunes of any one or more of its [insurance] lines." (*Id.* at p. 322.)

- The regulations' "relitigation bar"[6] does not allow a regulated entity to introduce evidence to challenge the premises of the regulatory formula. The trial court erroneously determined that the relitigation bar operated to bar the insurer from presenting proof of confiscation. (*Id.* at pp. 257, 311-312, 324.)

- Whether the insurer's rollback order is unjust and unreasonable and therefore "confiscatory,"

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[6] The "relitigation bar" appears at 10 Cal. Code Regs., § 2646.4, subdivision (e).

depends upon balancing the interests of the insurer and insured consumers. (*Id.* at p. 325.)

- Although a regulated industry has an "interest" in its cost of capital, it has no right to it, and it has no constitutional right to a profit or right against a loss. (*Id.* at pp. 320-321, 326.)

b. Price Control Regulation

A brief discussion of background law governing price control measures is warranted. These principles apply to regulated entities such as Mercury that challenge the price control laws or a specific rate order. (*20th Century*, *supra*, 8 Cal.4th 319.)

"When a regulation is challenged as violative of the takings clause as applied, the question is whether, in the particular case, its terms set a rate that is unjust and unreasonable and hence confiscatory." (*20th Century*, *supra*, 8 Cal.4th at 318 (emphasis added).) When a rate order itself is challenged as violative of the takings clause, 'the question is whether that order 'viewed in its entirety' meets the [relevant] requirements .... Under the ... standard of 'just and reasonable' it is the result reached not the method employed which is controlling. [Citations.]" (*Ibid*. (citing *Federal Power Comm'n* v. *Hope Natural Gas Co.* (*Hope*) (1944) 320 U.S. 591, 602).)

"Judicial inquiry as to whether or not a rate is just and reasonable is necessarily difficult." (*20th Century*, *supra*, 8 Cal.4th a p. 318.) "[N]either law nor economics has yet devised generally accepted standards for the evaluation of rate-making orders

* * * ." (*Id.* (citing *Permian Basin Area Rate Cases* (1968) 380 U.S. 747, 790).)

Accordingly, "[j]udicial inquiry as to whether or not a rate is just and reasonable is also limited. Indeed, it 'is at an end' '[i]f the total effect of the rate order cannot be said to be unjust and unreasonable * * * . The fact that the method employed to reach that result may contain infirmities is not then important * * * . [H]e who would upset the rate order * * * carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." (*20th Century*, *supra* 8 Cal.4th at p. 318-319 (citing *Hope* 320 U.S. at p. 602).)

"The *Hope* court identified one situation in which 'he who would upset the rate order' could not bear that 'heavy burden.' 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 * * * ." (*20th Century*, *supra* 8 Cal.4th at p. 319 (citing *Hope* 320 U.S. at p. 605).) "More simply, 'a company [cannot] complain if the return which was allowed made it possible for the company to operate successfully." (*20th Century*, *supra* 8 Cal.4th at p. 318-319 [citation omitted].)

In setting rates for regulated entities, the regulator is *not* bound to use any single formula or combination of formulas. The regulator's rate-making function involves making "pragmatic adjustments." (*Hope*, *supra*, 320 U.S. at p. 602; *20th Century*, *supra*, 8 Cal.4th at 216.) Additionally, the regulator's fixing

of "just and reasonable rates" involves a balancing of investor and consumer interests. (*Hope*, *supra*, 320 U.S. at p. 602.)

III. ANALYSIS

a. Requests for Judicial Notice

The Court makes the following rulings on the requests for judicial notice filed in support of (1) Mercury's Opening Brief, (2) the Trades' Opening Brief, (3) CW's Opposition Brief, and (4) the Commissioner's Opposition Brief:

As to CW's Request for Judicial Notice, Exhibits 1, 2, and 3, are **DENIED** and Exhibits 4 and 5 are **GRANTED**. As to the Trades' Request for Judicial Notice, Exhibits 1, 2, and 3 are **GRANTED**. The Commissioner's Request for Judicial Notice, Exhibit 1, is **GRANTED**.

As to Mercury's Request for Judicial Notice, Exhibits 1, 5 and 6 are **GRANTED**. The parties dispute whether the Court may take notice of Exhibits 2, 3, and 4, prior non-precedential decisions of the Insurance Commissioner. The Commissioner objects on the basis that the exhibits are irrelevant and inconsistent with a position adopted by the Trades. However, Mercury attaches these exhibits not to show that the Commissioner's application of the law is binding, but to show how the Commissioner has applied regulations in previous instances. The Court of Appeal has held that this information is relevant in an administrative proceeding on an insurer's rollback liability. (*RLI Insurance Group* v. *Superior Court* (1996) 51 Cal.App.4th 415, 435.) Accordingly,

the Court **GRANTS** the request as to Exhibits 2, 3, and 4.

b. Standard of Review

Mercury seeks review of the Commissioner's Order pursuant to Code of Civil Procedure section 1094.5, which requires Mercury to show that the Commissioner abused his discretion. "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." (Code Civ. Proc, § 1094.5(b).) Section 1858.6. also requires the Court to apply its independent judgment in reviewing the Order. This statute 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." (Ins. Code, § 1858.6.)

"The 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." (*State*

Farm Mut. Auto. Ins. Co. v. *Quackenbush* (1999) 77 Cal.App.4th 65, 71.)

The parties dispute the degree of judicial deference owed to the Commissioner's interpretation of his regulations implementing Proposition 103. "The Commissioner's interpretations are to be respected, though they are not binding... An administrative agency's interpretation of its own regulation deserves substantial weight, even if it amounts to a 'litigating position.' On the other hand, it is well settled that the interpretation of a regulation, like the interpretation of a statute, is a question of law ultimately decided by the courts. [Citation.] The level of deference due to an agency's regulatory interpretation turns on a legally informed, commonsense assessment of its merit in the context presented." (*State Farm Mutual Auto. Ins. Co.* v. *Quackenbush* (1999) 77 Cal.App.4th 65, 75 (citing *Yamaha Corp. of America* v. *State Bd. of Equalization* (1998) 19 Cal.4th 1, 14).)

c. The Trades' Petition and Complaint in Intervention

The Trades filed a Petition for writ of mandate and complaint for declaratory relief in intervention. The Trades do not brief their claims for declaratory relief and the Court does not consider them.

The Trades do not seek review of the Commissioner's Order under Code of Civil Procedure section 1094.5, but rather seek a writ of mandate pursuant to Civil Procedure section 1085 to compel the Commissioner to interpret the regulations in a lawful and constitutional manner. Accordingly, the standards of review for the Trades' Petition and Mer-

cury's petition are materially different. Without addressing the differing standards of review, the Trades' memorandum of points and authorities (MPAs) merely advances arguments as to why the Commissioner's Order was invalid. Because the Court denies Mercury's Petition and concludes that the Order was valid, it also concludes that the Trades' arguments fail under the more deferential standard of review applicable to "traditional" mandate petitions.

Additionally, the Trades advance certain arguments in the MPAs attacking the Commissioner's decision in Mercury's rate application that were not raised by Mercury or in the administrative proceedings below. The Court stated in its tentative ruling that it would not consider these additional claims.

At oral argument, Counsel for the Trades opposed the Court's decision and requested that it be allowed to argue the merits of the points raised separately in its MPAs. The Trades reiterated this request in a May 14, 2014 letter to the Court, and requested the Court to set a further hearing to allow the Trades to address these arguments. Respondent urged the Court to disregard the Trades' letter. The Court denies the Trades' request. The Court will not rule on the Trades' separate claims raised in the MPAs, as detailed below, and will not consider further oral argument.

The Trades challenge the Commissioner's Order regarding "institutional advertising" expenses because he compared advertising for insurance expenses to advertising to public utility cases, and because he interpreted the regulations in a manner that vio-

lated the First Amendment. As Mercury did not raise these challenges in the administrative proceedings, Mercury could not raise them here.

At oral argument, the Trades averred that it was appropriate for the Court to consider the Trades' challenge the Commissioner's Order on this basis, notwithstanding Mercury's decision not to do so. The Trades cite *Bodinson Manufacturing Company* v. *California Employment Commission* (1941) 17 Ca1.2d 321 for the proposition that an affected entity aggrieved by an agency's action may challenge it. However, *Bodinson* did not address this in the context of an intervening party that wishes to raise new and additional challenges.

"As a general rule an intervener takes the suit as he finds it [Citation] and he cannot avail himself of irregularities the original parties have expressly or impliedly waived." (*Hospital Council of Northern California* v. *Superior Court* (1973) 30 Cal.App.3d 331, 336.) The intervener is "bound by the record of the action at that time." (*Ibid*.) The Court finds the reasoning in *Hospital Council* persuasive, and declines to consider arguments raised by Trades that were not, and could not be raised by Petitioners in this litigation.

Additionally, the Trades argue that the hearing requirement to obtain a variance violates an insurer's due process rights. An independent ground exists to disregard this claim: it appears nowhere in the Trade's Complaint in Intervention and the Court will not entertain it.

d. Whether the Rate Order is Confiscatory

In issuing the Order, which required Mercury to decrease rates in its HO-3 line by approximately 8%, the Commissioner determined that Mercury did not qualify for a "confiscation variance." Petitioners argue that (1) Mercury did qualify for the confiscation variance, but (2) the Commissioner applied the wrong standard in determining whether Mercury qualified and (3) the Commissioner prevented Mercury from showing that it could qualify. Thus, Petitioners argue, the Order is invalid.

i. Background—How the Commissioner Sets Rates

As discussed earlier, the Commissioner uses a formula to determine the maximum and minimum permitted earned premium, which define the bounds of "excessive" and "inadequate" (or confiscatory) rates. (10 Cal. Code Regs., §§ 2644.2, 2644.3.)

The rate regulations are purposefully formulaic, to allow the Commissioner to manageably determine insurance rates:

> [The ratemaking method] may implicate formulaic ratemaking (*see Permian Basin Area Rate Cases* (1968) 390 U.S. 747, 768-770) 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."

> [Citation.] And, of course, courts are not equipped to carry out such a task. [Citation.] "[S]o long as rates as a whole afford [the regulated firm] just compensation for [its] over-all services to the public," they are not confiscatory. [Citation.] That a particular rate may not cover the cost of a particular good or service does not work confiscation in and of itself. [Citation.] (*20th Century*, *supra*, 8 Cal.4th at p. 293.)

The ratemaking formula takes into consideration projected losses, projected expenses, projected income, and uses broad assumptions and "plug-in" data to represent variables in the formula. For example, the regulations define how variables, such as "losses," are calculated. (10 Cal. Code Regs., §§ 2644.4; 2644.7.) The regulations also use for the "expenses" variable the average of industry-wide expenses by line of insurance, rather than the insurer's actual expenses.[7] (10 Cal. Code Regs., § 2644.12.)

The regulations also allow "variances" from the rate set by the ratemaking formula: that the maximum or minimum permitted earned premium set by the formula be adjusted. (10 Cal. Code Regs., § 2644.27.) One such variance is the "confiscation variance."[8] The basis for a confiscation variance occurs when:

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[7] This "expense variable" is also called the "efficiency standard."

[8] The "confiscation variance" is also referred to as "Variance 9."

> [] 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 [Regulation] 2646.4. (10 Cal. Code Regs., § 2644.27(f)(9))

The applicant requesting the variance must identify the amount of the variance and the "applicable component" of the ratemaking formula, set forth the expected result that the variance would have if granted compared to the result if the variance were denied, and "identify the facts and their source justifying the variance request and provide the documentation supporting the amount of the change to the component of the ratemaking formula." (10 Cal. Code Regs., § 2644.27, subd. (b).)

ii. The Commissioner Properly Determined that Mercury Must First Demonstrate Evidence of Confiscation Before Entertaining Whether to Grant it the Confiscation Variance

The ALJ found that Mercury did not qualify for a confiscation variance from the rate set by the formula, because Mercury did not make a *prima facie* showing that the applying formula to yield the rate decrease would cause Mercury to suffer "deep financial hardship" to its "enterprise as a whole." (AR, 2164.) Rather, the Commissioner found that the rate set by the formula would permit Mercury to earn a

profit and maintain its financial integrity. (Id.) Thus, the rate set by the formula was not "confiscatory" and Mercury was not entitled to the "confiscation variance." (AR, 2163.)

The parties first take issue with the Commissioner's requirement that the applicant make a prima facie showing of confiscation before it entertains the question of whether a variance is necessary.

Mercury and the Trades make similar arguments against this requirement. The Trades contend that this threshold *prima facie* confiscation showing is unreasonable because sometimes applying the standard formula may not show that a rate order is confiscatory; in some cases an insurer can only show confiscation if it uses its own data. Mercury does not argue that it cannot show confiscation under the standard formula, but argues that the Commissioner prevented it from using data which Mercury claims would have shown confiscation.

However, *20th Century* supports the Commissioner's approach: a variance is "available to the individual insurer *on proof of confiscation*, that is to say, on proof that the regulations in question would otherwise be confiscatory as applied." (*20th Century*, *supra*, 8 Cal.4th at p. 312 (emphasis added); *see also* 10 Cal. Code Regs., § 2644.27, subd. (b) [requiring the applicant to submit evidence in support of its request].) Because the ratemaking formula derives from the regulations, it was reasonable for the Commissioner to require Mercury to first make a *prima facie* showing that applying the ratemaking formula would result in confiscation.

Further, given the complex and time-consuming nature of the ratemaking process, the applicant must do more than simply allege that it needs a variance to trigger the Commissioner's duty to entertain whether one is warranted.

Thus, the Commissioner properly determined that Mercury was required to make a *prima facie* showing of confiscation before the Commissioner considered whether Mercury was eligible for a confiscation variance.

iii. The Commissioner Applied the Correct Standard for Confiscation

Mercury claims that the Commissioner applied the wrong standard to assess whether Mercury could show confiscation to entitle Mercury to a variance. Mercury asserts that the Commissioner should have assessed whether Mercury could earn a "fair rate of return" under the rate order, and not whether the company would suffer "deep financial hardship to its enterprise as a whole." Similarly, the Trades assert that the Commissioner cannot deprive an applicant of a rate that affords the applicant the opportunity to earn a fair rate of return on the regulated investment.

Petitioners' dispute with the Commissioner's Order centers on how the Commissioner determines that a proposed rate order is confiscatory. Petitioners argue that the "fair rate of return" test is applicable to show confiscation, not "deep financial hardship." Mercury describes the "fair rate of return test" as whether the applicant's ability to earn a return is commensurate with the returns on investments in

other similar risky enterprises. (Mercury Opening Brief pp. 18-19 (citing *Hope*, supra, 329 U.S. at p. 603; *Permian Basin*, *supra*, 390 U.S. at 790-91.)

The parties devote a substantial amount of briefing as to which of these tests applies. The Commissioner and CW argue that *20th Century* establishes that confiscation requires a showing of "deep financial hardship." The Court agrees that *20th Century* sets forth the test for confiscation as "deep financial hardship."

20th Century held that an insurer can threaten confiscation only when it demonstrates that the maximum permitted rate prevents it from "operating successfully" during the period of the rate and subject to the then-existing market conditions; in such circumstances, the insurer experiences "deep financial hardship" from the total effect of the rate. (*20th Century*, *supra*, 8 Cal.4th at pp. 295-299.)

The California Supreme Court considered federal case law in defining the standard by which an insurer could show confiscation: "[r]ates 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 * * * ." (*20th Century*, *supra*, 8 Cal.4th at p. 295 (citing *Hope*, supra, 320 U.S. at p. 605).) "'[A] company [cannot] complain if the return which was allowed made it possible for the company to operate successfully.'" (*Ibid*. (citing *Market Street R. Co.* v. *Railroad Comm'n of California* (1945) 324 U.S. 548, 566).)

20th Century cited *Hope* and observed that the regulated entity may experience "deep financial hardship" "when it does not earn enough revenue for both 'operating expenses' and 'the capital costs of the business,' including 'service on the debt and dividends on the stock,' of a magnitude that would allow a 'return to the equity owner' that is `commensurate with returns on investments in other enterprises having corresponding risks" and "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.'" (*20th Century*, *supra*, 8 Cal.4th at p. 296 (citing *Hope*, *supra*, 320 U.S. at p. 603) (emphasis added).) Accordingly, absent this "deep financial hardship," an entity cannot complain that a rate is confiscatory. (*Ibid*.)

20th Century made clear that confiscation "does not arise...whenever a rate simply does not 'produce [] a profit which an investor could reasonably expect to earn in other businesses with comparable investment risks and which is sufficient to attract capital.'" (*20th Century*, *supra*, 8 Cal.4th at pp. 298-299.) An insurer has an interest in profit, but it is not a right that it can demand. "It is only one variable in the "constitutional calculus of reasonableness." (*Ibid*. (citing *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at p. 769).)

Thus, confiscation arises when a regulated entity cannot earn enough revenue for its operating expenses and business costs, not when a rate does not produce profit that the entity could reasonably expect to earn in similar business.

Mercury and the Trades cite *Calfarm*'s rejection of the "insolvency standard," and other federal cases to argue that the standard for confiscation is not "deep financial hardship" but "fair rate of return." However, *20th Century* represents the California Supreme Court's most recent, comprehensive articulation of the standard for confiscation in insurance rollback cases. The other cases cited by Petitioners do not persuade the Court that the Commissioner applied the wrong standard in this proceeding.

Petitioners seek to distinguish *20th Century* by arguing that confiscation standard set therein applies only to insurance "rollback" proceedings, and not rate-setting proceedings.

Petitioners note that variables in the "rollback" formula are derived from past, actual events. In contrast, because the ratemaking formula is forward-looking, some variables therein are represented by generic, industry-wide data.

Although *20th Century* considered "rollback" proceedings, it addressed Proposition 103 and its implementing regulations in a lengthy decision spanning over 100 pages. *20th Century* considered in detail how the Proposition 103 regulations work and how they apply to prior approval and rollback proceedings. Additionally, federal case law, considered and cited by *20th Century*, approves the regulator's use of "generic" industry-wide data in setting price control regulations.

The Court concludes that the California Supreme Court did not intend to set forth two different standards to show confiscation depending upon the specific

nature of the proceedings before the Commissioner. (*20th Century*, *supra*, 8 Cal.4th at p. 293 (citing *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at p.768-770).)

Mercury also cites prior non-precedential decisions of the Commissioner to argue that the Commissioner did not always apply the "deep financial hardship test" when considering confiscation. However, the fact that the Commissioner may have acted differently in other non-precedential decisions (many of which did not involve rate-setting) does not meet Mercury's "heavy burden" of showing that the Commissioner's rate order was unconstitutionally confiscatory.

Finally, the regulation defining the confiscation variance defines the variance as "the constitutionally mandated variance articulated in *20th Century*...which is an end result test applied to the enterprise as a whole." (10 Cal. Code Regs., § 2644.27(f)(9).) The test for confiscation set forth in *20th Century* is "deep financial hardship." The regulation does not reference any other test for confiscation.

Here, the Commissioner denied use of a confiscation variance because it found, after applying the ratemaking formula, that Mercury would not suffer financial hardship; it would profit even with a proposed 8.18% decrease to its HO-3 rates.

The Commissioner found that the regulatory "formula results in at least $1.8 million profit from Mercury's California homeowner's line [of insurance]" and that "Mercury fail[ed] to demonstrate that the total effect of such a profit is unjust." (AR, 2164.)

The Order noted that while "perhaps not generating the profit margin Mercury desires, Mercury failed to demonstrate the rate decrease will impair the company's financial integrity." (AR, 2164-2165.) The Commissioner noted that Mercury maintained an A+ financial strength rating with AM Best from 2006 through 2010, California operations showed a "robust policyholder surplus in 2010, and that Mercury issued dividends over the last 5 years totaling nearly $5 billion. While acknowledging that confiscation is determined prospectively, the Commissioner noted that Mercury had not exhibited any signs of financial distress, or indicated that past rates weakened the company's financial integrity. (AR, 2165.)

Having reviewed the Order, the Court agrees that (1) the Commissioner properly concluded that the test for confiscation is "deep financial hardship" required by *20th Century*, and (2) Mercury did not demonstrate "deep financial hardship" to support its request for a confiscation variance.

Rather, Mercury argues that the Commissioner should have applied a different standard. Mercury appears to fault the Commissioner because the rate ordered would not allow it to 'produce [] a profit which an investor could reasonably expect to earn in other businesses with comparable investment risks and which is sufficient to attract capital." (*20th Century*, *supra*, 8 Cal.4th at pp. 298-299.) However, this is not evidence of confiscation. Accordingly, Mercury has not shown that the Commissioner applied the incorrect standard, and thus erroneously denied its request for a variance.

iv. The Commissioner Correctly Ruled that Mercury's Attempt to Use its Own Expense Data to Show Confiscation, Amounted to "Relitigation"

Mercury attempted to introduce evidence of its own expenses to show that, if its expenses were substituted as a variable in the ratemaking formula, Mercury would suffer confiscation from the rate order. The Commissioner barred Mercury from presenting this evidence, under the "relitigation bar." Petitioners argue that the Commissioner improperly denied Mercury the ability to present evidence of confiscation.

The "relitigation bar" appears at 10 Cal. Code Regs., § 2646.4, which pertains to hearings on individual insurer's rates. It states:

> Relitigation in a hearing on an individual insurer's rates of a matter already determined either by these regulations or by a generic determination is out of order and shall not be permitted. However, the [ALJ] shall admit evidence he or she finds relevant to the determination of whether the rate is excessive or inadequate (or, in the case of a proceeding under Article 5, relevant to the determination of the minimum nonconfiscatory rate), whether or not such evidence is expressly contemplated by these regulations, provided the evidence is not offered for the purpose of relitigating a matter already determined by these regulations or by a generic determination. (10 Cal. Code Regs., § 2646.4, subd. (c).)

The California Supreme Court interpreted the "relitigation bar" in *20th Century* to mean that it is improper relitigation for an insurer to request that the ALJ "entertain the question of whether the underlying [regulations] are sound...Otherwise standardless, ad hoc decisionmaking would result." (*20th Century*, *supra*, 8 Cal.4th at p. 312.)

Petitioners respond that they are not inviting the ALJ to question whether the pertinent regulations are sound, rather, they argue that Mercury should be allowed to present its evidence that is relevant to confiscation—e.g., whether the rate is excessive or inadequate. However, the "relitigation bar" requires the All to admit evidence that he or she—not the insurer—finds to be relevant to confiscation. (10 Cal. Code Regs., § 2646.4, subd. (c)); *20th Century*, *supra*, 8 Cal.4th at p. 257 (noting that the ALJ "effectively lifted the 'relitigation bar' to allow [the insurer] to introduce evidence to challenge the premises of the rate regulations, 'accord [ing] it the opportunity to present evidence ... on every issue that it contended was material.'").)

Moreover, the ratemaking formula, and the variables used therein (such as expenses) are established by the regulations. Thus, Mercury's request to substitute its own expenses in the formula would effectively relitigate "a matter already determined either by [the] regulations or by a generic determination." (10 Cal. Code Regs., § 2646.4, subd. (c).)

Here, the Court finds that the All properly determined that the evidence Mercury proposed to submit was not relevant to confiscation, because Mercury did not make a prima facie showing of confiscation.

The All rejected Mercury's argument that "any analysis of confiscation must permit an insurer to apply cost and expense amounts different from those provided by the regulatory formula." (AR, 2166.) Accordingly, Mercury's attempt to admit that evidence amounted to challenging or "relitigating" the regulations used to set the ratemaking formula. Therefore, Mercury has not shown that the ALJ improperly applied the relitigation bar in these proceedings.

e. It is Irrelevant Whether the Ratemaking Formula is "Tautological"

Mercury challenges the Commissioner's refusal to consider in the ratemaking formula Mercury's actual expected losses, expenses and returns by attacking the formula itself. Petitioners argue that the Commissioner adopted a "tautological" test for confiscation, because the test is nothing more than a restatement of the formula and its components, and the components do not vary. In *20th Century*, the petitioners made a similar argument that the regulations for the ratemaking formula for rollbacks were "recursive." The California Supreme Court responded as follows:

> To be sure, the ratemaking formula is indeed "recursive." But contrary to the superior court's evident belief and the insurers' vigorously urged position, that is no vice. The adjective is not pejorative. It is merely descriptive. Simply put, it means in this context that the value solved for figures in the solution itself. For example, an insurer desires to determine the rate it must charge its insureds to net $100 after paying a 20 percent commission

> to its agents. It uses the following "recursive" formula, in which "*r*" REFERS TO THE RATE TO BE CHARGED: r = \$ 100 + 0.2 r; r 0.2 r = \$ 100; 0.8 r = \$ 100; r = \$ 125. In and of itself, "recursiveness" is not objectionable. (*20th Century*, *supra*, 8 Cal.4th at p. 288.)

Mercury argues that the test is infirm because Mercury can "never show" confiscation if it cannot use its own loss and return estimates in the formula. However, the relevant inquiry is whether the insurer can make a *prima facie* showing of "deep financial hardship" to its enterprise as a whole under the ratemaking formula. If it can, then the insurer can obtain a variance and use its actual data.

The ratemaking formula is not unconstitutionally tautological because Mercury cannot use its own data in the formula to show confiscation.

To conclude, Petitioners have not shown that the Commissioner abused his discretion in setting Mercury's rates under the Order or that the Order should be annulled under Section 1858.6. The Commissioner appropriately applied the "deep financial hardship" test for confiscation and determined that Mercury had not made a *prima facie* showing of confiscation under the proposed rate decrease. Accordingly, Mercury was not entitled to a variance to present its own data in the ratemaking formula. Moreover, the Commissioner did not abuse his discretion in applying an unconstitutionally "tautological" ratemaking formula, and appropriately disallowed Mercury from presenting data under the "relitigation bar."

f. Insurance Commissioner Properly Excluded Mercury's Advertising Expenses from the Ratemaking Calculation

The "prior approval" regulations disallow the Commissioner from considering certain "excluded expenses" in the ratemaking calculation. (10 Cal. Code Regs., § 2644.10.) "Excluded expenses" include excessive executive compensation, "institutional advertising expenses, political contributions and lobbying, bad faith judgments, costs of unsuccessful defense of discrimination claims, fines and penalties, and payments to affiliates in excess of fair market value. (*Ibid*.)

Accordingly, regulated insurers have an interest in insuring that their advertising expenses are *not* excluded from the ratemaking calculation. Here, the Commissioner determined that Mercury's entire advertising budget was excluded from its rate application. (AR, 2148.)

Petitioners contend that the decision is erroneous because the Commissioner misinterpreted the regulation defining "institutional advertising," and because Mercury's advertising met the definition under the regulation. The Court rejects these arguments.

i. The Commissioner Properly Interpreted the Regulation Governing Institutional Advertising

The regulations define "institutional advertising," as it pertains to "excluded expenses" as follows:

> "Institutional advertising" means advertising not aimed at obtaining business for a specific

> insurer and not providing consumers with information pertinent to the decision whether to buy the insurer's product. (10 Cal. Code Regs., § 2644.10, subd. (f).)

Petitioners contend that the Commissioner can consider advertising "institutional advertising," only if *both* criteria are met: (1) it is not aimed at obtaining business for a specific insurer, *and* (2) does not provide consumers with information pertinent to the decision to buy the insurance product. Thus, advertising that meets only "one prong" of this test, is not "institutional advertising," and the Commissioner must consider these advertising expenses in setting a rate. This argument is not well-taken.

First, the Commissioner's interpretation of the regulation is supported by the clear language thereof: "institutional advertising" is advertising meeting the criteria set forth in the regulation. The regulations do not require that only advertising meeting *both* criteria be considered "institutional advertising" and thus excluded from the ratemaking calculation.

Second, the Commissioner's interpretation is reasonable and consistent with Proposition 103's goals of consumer protection. Proposition 103 seeks to set insurance rates based on "risks or operations in [California]" (*See* Cal. Code Regs., § 2641.2), so that California consumers do not inadvertently fund nationwide "operations" or advertising campaigns by the insurers.

The Commissioner's order defined institutional advertising as "image advertising." This type of advertising enhances a company's reputation or improves

name recognition and may benefit the company's shareholders. However, it does not assist insurance consumers. Companies may use institutional advertising to promote a series of products or to promote a product on a nationwide basis. (See AR, 2138.)

The intent behind regulation 2644.10, subdivision (f) is to limit the types of advertising expenses that could be factored into the calculation of rates paid by consumers. Petitioners' interpretation would greatly expand the scope of advertising that must be factored into the ratemaking formula. It would include all advertising directed at garnering business for a "specific insurer," whether or not it benefitted the consumer (e.g., by providing consumers helpful information about the product). In contrast, the Commissioner's interpretation of the regulation limits insurers from including all manner of advertising. The Court finds that the Commissioner's interpretation of "institutional advertising" was reasonable and supported by Proposition 103 and its regulations.

Thus, if Mercury wished to include its advertising expenses in the ratemaking calculation, it was required to show that (1) its advertising was aimed at obtaining business for a specific insurer *and* (2) provided consumers with information pertinent to the decision whether to buy the insurer's product.

ii. The Commissioner Properly Concluded that the Mercury's Advertising did not Issue from a "Specific Insurer"

The Commissioner first concluded that Mercury's advertising expenses were excluded from the calcula-

tion, because Mercury did not show that the advertising was aimed at obtaining business for a "specific insurer." (10 Cal. Code Regs., § 2641.2.) Rather, the expenses Mercury submitted reflected advertising on behalf of the organization as a whole, and not for a specific affiliate or company within Mercury. (AR, 2142145.)

The dispute is whether the term "specific insurer" means only the rate applicant (in this case, Mercury Casualty Company) or whether it encompasses advertising on behalf of a group of affiliated entities, which are not rate applicants.

First, this regulation distinguishes between a "specific insurer" and an "insurance group." (*See* 10 Cal. Code Regs., § 2644.10, subd. (b) [excluding executive compensation in "insurer's five highest-paid policy-making positions in each 'insurance group'"], subd. (f) [referring to "specific insurer" in institutional advertising definition].) When different words are used in adjoining subdivisions of a statute that was enacted at the same time, this fact raises a compelling inference that a different meaning was intended. (*See People* v. *Childs* (2013) 220 Cal. App.4th 1079, 1102.) Accordingly, by using the terms "specific insurer" and "insurance group" within the same regulation, the Court infers that the Commissioner intended to give these terms different meanings. Had the Commissioner intended to include affiliate or group advertising in the ratemaking calculations (e.g., require consumers to bear these costs) he could have eliminated the reference to "specific insurer" and used the term "insurance group."

The Commissioner properly concluded that Mercury's advertising was not directed at a "specific insurer."

The advertising did not refer to Mercury Casualty Company, the rate applicant, but rather "Mercury Insurance Group," a name under which Mercury Casualty Company and its affiliates advertise. (AR, 2139, 2142-2143.) "Mercury Insurance Group" includes all 22 affiliates that make up "Mercury General Corporation." (AR, 2145.)

The Commissioner found that: Mercury Insurance Group is not a legal entity in any state and not a licensed insurer in California; Mercury General Corporation's advertising department supports all Mercury affiliates; Mercury guides all prospective customers to one telephone number; Mercury does not allocate advertising expenditures to specific insurance affiliates; Mercury's advertising department does not distinguish between insurance entities when generating advertising campaigns; and all Mercury companies shared a common website that identifies the company as "Mercury Insurance Group." (AR, 2139-2140.) The total advertising for Mercury General Corporation was $26, $27, and $30 million a year for 2008, 2009, and 2010, respectively. (AR, 2140.)

Mercury does not dispute these findings. Rather, it argues that the entire advertising expenses attributable to "Mercury Insurance Group" are advertising expenses of a "specific insurer" under the regulations.

Mercury has not demonstrated that the Commissioner's order was invalid on this basis.

The Commissioner's interpretation of the regulation's term "specific insurer" was reasonable. The advertising did not relate specifically to Mercury Casualty Company, the rate applicant. Rather it related a large group of affiliates, that were not applying for a rate reduction, and that may or may not do business in the state. Accordingly, the Commissioner's interpretation protects consumers from underwriting advertising expenses of other entities that may not operate in California, and were not applying for the rate adjustment.

Mercury argues that these concerns are not present, because it "only accounted for its fairly allocated share of advertising expenses that were spent on group advertising in California." (Reply Brief, p. 15:14-15.) Mercury argues that the Commissioner's interpretation penalizes insurers advertising under a group name, which it claims is a more efficient means of advertising that will lower rates for consumers. Mercury also points to Proposition 103's goals of protecting insurers from inadequate or confiscatory rates.

Mercury argues that a *more reasonable* interpretation of "specific insurer" includes companies that, *unlike Mercury*, engage in business unrelated to insurance. For example, advertising that only mentions the name of such company.

In sum, Mercury's arguments reduce to a dispute that its interpretation of the regulation is more reasonable than that of the Commissioner. However,

the fact that another interpretation of the regulation may exist is not enough to show that the Commissioner's interpretation is incorrect or unreasonable.

Mercury also argues that the Commissioner incorrectly excluded all of its advertising expenses, because at least some of Mercury's advertising provided consumers with information pertinent to the decision whether to buy the insurer's product. (10 Cal. Code Regs., § 2644.10, subd. (f).) However, even if this were the case, the Commissioner found that all of Mercury's advertising was not aimed at obtaining business for a "specific insurer." Accordingly, the advertising was excluded from the rate calculation. (*Id.*)

IV. DISPOSITION

Mercury has not briefed several of its mandamus claims in the Petition. The Court considers Mercury to have abandoned those claims and they are denied.

Additionally, Mercury's Petition brings declaratory relief claims that essentially duplicate the mandamus claims, and a claim for injunctive relief that is ancillary to the mandate claims. The resolution of the mandamus claims necessarily disposes of the declaratory and injunctive relief claims. Further, the declaratory relief claims challenge the Commissioner's "interpretation" and "application" of the regulations in the rate proceeding. Declaratory relief is not appropriate to review an administrative decision. (*Walter Leimert Co.* v. *Calif Coastal Commn.* (1983) 149 Cal.App.3d 222, 225, 230-231 (citing *State of California* v. *Superior Court (Veta)* (1974) 12 Cal.3d

237, 249).) Accordingly, Mercury's claims for declaratory and injunctive relief are dismissed.[9]

Mercury's Petition for Writ of Mandate is **DENIED**, and all claims in its Complaint for Declaratory Relief are **DISMISSED**. The Trades' claims in its Petition for Writ of Mandate are **DENIED**.

Counsel for the Commissioner is directed to prepare a formal order, incorporating the Court's ruling as an exhibit thereto, and a separate judgment, submit them to the parties for approval as to form, and thereafter submit it to the Court for signature, in accordance with California Rules of Court, Rule 3.1312.

Date: June 11, 2014

/s/ Shelleyanne W.L. Chang
Shelleyanne W.L. Chang
Judge of the Superior Court of California
County of Sacramento

[9] Because Mercury's claims for declaratory relief are dismissed, this moots Respondent's motion to for a protective order quashing discovery requests served by Mercury in furtherance of its declaratory relief claims. Accordingly, the Court vacates the hearing set for Respondent's motion, set for June 27, 2014 at 11:00 a.m.

APPENDIX D

IN THE SUPREME COURT
OF CALIFORNIA

Case No. S240772

Court of Appeal, Third Appellate District
Nos. C077116/C078667

En Banc

MERCURY CASUALTY COMPANY,
Plaintiff and Appellant,
v.
DAVE JONES, as Insurance Commissioner, etc.,
Defendant and Respondent;
PERSONAL INSURANCE FEDERATION
OF CALIFORNIA et al.,
Interveners and Appellants;
CONSUMER WATCHDOG,
Intervener and Respondent.
AND CONSOLIDATED CASE.

Filed: May 10, 2017

The petitions for review are denied.

/s/ Cantil-Sakauye
Chief Justice