BEFORE THE INSURANCE COMMISSIONER

OF THE STATE OF CALIFORNIA

In the Matter of the Rate Application of **AMERICAN HEALTHCARE INDEMNITY COMPANY and SCPIE INDEMNITY COMPANY,** Applicants.	)	FILE NO.: PA-02025379

CORRECTED ORDER ADOPTING PROPOSED DECISION AND DESIGNATING PORTION OF DECISION AS PRECEDENTIAL

The proposed decision of Administrative Law Judge Marjorie A. Rasmussen dated July 24, 2003, is adopted as the Insurance Commissioner's decision in the above-entitled matter. This order shall be effective September 22, 2003. Judicial review of this decision may be had pursuant to Insurance Code sections 1861.08, 1861.09 and 1858.6. (*See, Economic Empowerment Foundation v. Quackenbush et al.* (1998) 65 Cal.App.4th 1397.) Any party seeking judicial review of this decision shall lodge copies of the request for judicial review and the final judicial order on the request for judicial review with the Administrative Hearing Bureau of the California Department of Insurance.

Additionally, I hereby designate the standard of review and burden of proof discussions on pages 8 through 11, as precedential.

Dated: _____ , 2003

John Garamendi
Insurance Commissioner

By:_____
JANICE E. KERR
Special Counsel

The California Supreme Court in the *20th Century* decision also commented on the 'excessive/inadequate' provision of Insurance Code §1861.01 as follows:

> "we must observe that the 'excessive'/'inadequate' standard as defined in Proposition 103 is apparently 'unique' and without 'precedent' among 'similar statutes. . . .' . . . The insurers argue in substance that the 'excessive'/'inadequate' standard as defined in the initiative should be interpreted in accordance with the insurance industry's or actuarial professions' understanding of its operative terms. We believe that subdivision (a) of Insurance Code section 1861.05, as quoted above, stands in the way." (*20th Century Ins. Co. v. Garamendi, supra,* 8 Cal.4th at p. 289.)

The "excessive, inadequate" language of Insurance Code section 1861.05 contemplates a range of rates that are neither excessive nor inadequate, within which the insurer has discretion to choose. (See, *Calfarm Ins. Co. v. Deukmejian*, *supra* 48 Cal. 3d at pp. 822-823.)

C. The Regulatory Formula: California Code of Regulations, title 10, §§2641.1 *et seq.*

CCR §2641.1 states that "[t]his subchapter is adopted to implement the provisions of Proposition 103, governing approval of insurance rates." The regulations are clear that "[w]hile companies remain free to formulate their rates under any methodology, the commissioner's review of those rates must use a single, consistent methodology." (CCR §2643.1.) The methodology the commissioner is to apply is set forth in a formula described in CCR §§2642.1 *et seq*. Various elements of the regulatory formula contain provisions in which the commissioner is to select a numeric value to be applied to given lines of insurance. SCPIE contends that because the commissioner has failed to select these generic determinations, the formula is incomplete and cannot serve as the standard of review in this matter.

CCR §2646.4(e) bans the relitigation of the regulations implementing Proposition 103. The California Supreme Court in *20th Century*, *supra*, at p. 312 has clearly upheld this relitigation ban.

> ". . . [t]he effect of the 'relitigation ban' is unobjectionable. In adjudication, the judge applies declared law; he does not entertain the question whether its underlying premises are sound. That is as it should be. Otherwise, standardless, ad hoc decision making would result. Similarly, in quasi-adjudicatory proceedings, the administrative law judge applies adopted regulations; he does not entertain the question whether their underlying premises are sound. That is also as it should be, and for the same reason." *Id*.

SCPIE's challenge to the ALJ's use of the regulatory formula as the method of review in this hearing is impermissible relitigation. Arguably, the problems created by the lack of generic determinations for prior approval proceedings may be perceived as leading to the type of "standardless ad-hoc decision making" that was abjured in *20th Century, supra*, at p. 312, and as vitiating the formula's goal of reducing the rate review task to a manageable size. However, where the Commissioner has not promulgated a numerical value for a generic factor in a given line of insurance, values can be selected using generally accepted actuarial principles, expert judgment and standards of reasonableness. Barring explicit direction from the legislature or the commissioner, the ALJ must apply the regulatory formula when determining whether SCPIE's rate request is reasonable. SCPIE has not provided authority for ignoring the regulations in the face of their clear legal applicability.

By the same token, the Foundation has offered no legal authority to support its argument that an ALJ must confine her review to the data submitted in support of the original rate filing.[15] Nor does the Foundation offer facts that suggest it was prejudiced by any evidentiary ruling in this proceeding. Indeed, the parties stipulated that all testimony that was not stricken and all

[15] Foundation OB, p. 19.

exhibits identified in the Joint Exhibit List submitted on June 20, 2003, were admitted into evidence. The parties also have conceded that an insurer could use a method other than the regulatory formula to prove up the rate application submitted to the CDI rate filing bureau.

Since the question before the ALJ in a prior approval hearing is whether the evidence the applicant/insurer submits is reliable when used in the regulatory formula, it does not matter if the insurer initially used other methods or data to support the rate request on its rate application submitted to the CDI's rate filing bureau. Furthermore, the discovery provisions contained in the regulations ensure that all interested parties are allowed access to the data ultimately used to support the rate request at the prior approval hearing. The ALJ was not made aware of any discovery disputes prior to the close of discovery or the evidentiary hearing.

Accordingly, the arguments of SCPIE and the Foundation on these matters are rejected. The ALJ must use the regulatory formula to review SCPIE's rate increase request, based on the evidence that has been admitted in this proceeding.

D. Burden of Proof

SCPIE also contends that the Foundation bears the burden of proof in this matter because: (a) Insurance Code §1861.05(b) only places the burden of proof on the applicant during the rate review process and not during a rate hearing; and (b) the CDI already had approved SCPIE's rate increase prior to the evidentiary hearing. (SCPIE's OB, pp. 7-9.) SCPIE is incorrect.

Proposition 103 specifically places the burden of proof on the applicant. Insurance Code section 1861.05(b) states that "the applicant shall have the burden of proving that the requested rate change is justified and meets the requirements of this article." The regulations mandate that the burden of proof is on the insurer/applicant. In Article 6 of the regulations, entitled "Procedures for Determination of Rates," CCR §2646.5 states, in pertinent part: "[T]he insurer

has the burden of proving, by a preponderance of the evidence, every fact necessary to show that its rate is not excessive, inadequate, unfairly discriminatory. . . ." Thus, the applicant bears the burden of proof in a rate case prior to a rate becoming effective and after a rate is in effect. (*See*, CCR §2646.4(a).) Furthermore, while the commissioner must approve a rate when it is within the range of reasonableness, if the insurer fails to meet its burden, expert testimony need not be offered to support a rate disapproval.

III. ANALYSIS OF PROPOSED RATE USING THE REGULATORY FORMULA

Background

Pursuant to the regulations, the commissioner must use a single, consistent methodology to review rates. (CCR §22643.1.) Except as otherwise provided, rates are to be computed on the basis of premium charged per exposure. (CCR §2643.2.) The determination of whether rates are excessive or inadequate is made on the basis of the aggregate earned premiums that rates are expected to produce. (CCR §2643.3.) Statutory accounting principles rather than generally accepted accounting principles shall be used to measure equity. (CCR §2643.45)

The Foundation maintains that SCPIE's proposed rate increase of 15.6% will lead to an excessive rate under the regulatory formula set forth in CCR §2644.2 *et seq.* and should not be approved by the commissioner. SCPIE disagrees and offers three different methods to prove its case: (a) an "actuarial" method that does not use the regulatory formula; (b) a "SCPIE Generic" method using the regulatory formula with the generic determinations set forth in a CDI workshop notice; and (c) a "Model A Formula Approach" method using SCPIE data and applying them in